How China Changed the Global Economy and the Global Economy Changed China: Thirty Years of Investment and Trade

Shaun Breslin

As with virtually everything to do with contemporary China, things have changed so much and so quickly since 1978 that it is almost as if we are talking about two different places. And indeed, it is probably fair to say that we are dealing with two entirely different economies in that the 1978 version had little that we would recognize in the 2008 incarnation. Whilst change in the domestic arena has done much to generate this change, engaging the global economy has also played its part in changing China – and in the process also changing the global economy.

Despite the vast dissimilarities between 1978 and 2008, there is nevertheless an evolutionary logic that spans the three decades of change, and we can divide the period into four phases – all of which provide over stark delineations between the 'before' and the 'after', but roughly correspond to important sea changes in policy. Using Fung, Hitomi and Tong (2002 4), the first phase from 1978-86 where internationalization was "permitted" gave way to a second phase until 1992 characterized by facilitating investment and trade. The third phase from 1992 to World Trade Organization (WTO) entry in 2001 saw the start of the phenomenal growth that we have come to accept and even expect in international economic relations, with the focus in the fourth and final phase after 2001 on becoming WTO compliant.

The original strategy was designed to reap the perceived benefits of the global economy whilst not being subject to perceived detrimental challenges. In short, domestic producers were largely protected from market competition while investment to fund exports was encouraged and facilitated. The decision to join the WTO theoretically should have resulted in the abandonment of this "model" through ever greater liberalization. Nevertheless, the task of becoming WTO compliant remains far from complete, and with an ever growing trade surplus, economic issues remain a key cause of political friction between China and the West.

Whilst 30 years of global engagement has brought much to the Chinese economy, and changed it forever, the strategy has not always been successful in its own terms. For some analysts, not least many within China itself, global engagement has left China somewhat vulnerable to the vagaries of the global economy. Nor has it brought all of the benefits in terms of technological development and industrial upgrading that China's leaders wanted and expected when they embarked on the process of reform. As a result, recent policy changes suggest that China's leaders are searching for a new role in the global political economy. This new role is partly sought by "trading up" and changing the nature of China's global engagement, but also through the exhortation to "go global" in 2003 since when Chinese outward investment has become increasingly important. As such, the chapter concludes by considering whether we are witnessing the start of a new fifth phase in policy that is already resulting in a change from China as recipient to China as initiator of global financial and commodity flows.

From Isolation to Integration

There is a tendency to describe China in the Maoist period as a ‘closed economy’. This popular perception rather exaggerates the level of isolation, and is primarily a product of equating the capitalist world with the international economy (Harding 1987: 131). As Zhang Yongjin (1998: 26-31) has demonstrated, while China did look to self-reliance where possible in economic development, foreign trade also played a role ‘as a balancing sector’ of the Chinese economy. Nevertheless, despite the fact that trade increased after 1949, it is fair to say that China was not a significant player in the global economy during the Maoist era. After China's break from the Soviet Union and the gradual and moderate programme of re-engagement with the West in the 1970s, trade did increase, but volumes remained low (Howell 1993).

In terms of actual policy changes, the events of 30 years ago[1] were very minor compared with what was to follow and gave only a strictly limited role for international economic interactions. Initially at least, China's re-integration into the global economy was a slow and gradual affair, and in many respects didn’t take off until the early 1990s. Nevertheless, in moving the basis of party rule from politics to economics, the Third Plenum marked a fundamental ideological shift that was a pre-requisite for all that was to follow.

Phase One: Opening China 1978-86

The first phase, from 1978 to 1986 marked the gradual opening of parts of China to the global economy. Following the decision to place economic modernization above class struggle in the list of party objectives, interaction with the global economy was conceived as being beneficial to this modernization drive. But given that the party leadership had railed against the evils of the capitalist global economy for much of the preceding thirty years, insertion into the capitalist global economy had to be handled with care. Thus, following the Third Plenum, China opened just four SEZs with the (limited) freedom to conduct international economic relations.[2] In July 1979, the National People's Congress passed a supporting law which provided a legal basis for the existence of joint ventures and foreign investment. These SEZs were conceived as 'windows on the world' for China – allowing international economic contacts to grow, but limiting them to specific areas to allay fears from political conservatives that such contacts would lead to 'bourgeois spiritual pollution' (Bachman 1988).

The argument for moving away from limited integration came not on ideological grounds, but because of the success of the SEZs in attracting investment and facilitating rapid capital accumulation. Hamrin (1990: 83) argues that this resulted in lobbying from other local authorities to be allowed the same access to the global economy which persuaded the central leadership to "open" 14 cities in 1984, all of them along China's coast. As we shall see, whilst the rest of the country was gradually opened up, the uneven geographic distribution of international economic contacts remains a striking feature of China's re-engagement with the global economy today.

Phase Two: From Permitting to Facilitating, 1986-1992 (l2h)

For Fung, Hitomi and Tong (2002 4) a new policy of facilitating, rather than simply permitting, global engagement began with the passing of what have now come to be known as the 'twenty-two regulations' in 1986. In combination, these regulations created a more beneficial environment for foreign investors including lower fees for labor and rent, tax rebates for exporters, and made it possible for foreign companies to convert and repatriate some profits earned in China. It also extended the joint venture contracts beyond the original 50-year limit, and created a legal basis for wholly foreign owned enterprises, rather than the previous insistence on foreign companies working in joint venture with a Chinese partner. This move considerably increased the attraction of investing in China – not to produce in China, but to produce exports to be sold on other markets. While Foreign Invested Enterprises (FIEs) only accounted for two per cent of exports and six per cent of imports before 1986, the figure increased to 48 per cent and 52 per cent respectively by 2000 (Braunstein and Epstein 2002: 23). Since then, export based investment has not only dominated investment into China, but has also been a major motor of Chinese export growth.

Phase Three: Accelerating Opening, 1992-1999

As with domestic reform, the third key change came in the *nan xun* of 1992. And in many respects, it was only now that China began to emerge as a global trading power. From 1993, exports increased by 60 per cent in two years (53 per cent in real terms), and doubled in the space of five years.[3] In the process, a US$12.2 billion trade deficit was transformed into a US$5.4 billion surplus the following year, the start of a period of continual trade surpluses that have done so much to raise China's economic profile and also to politicize China's international economic relations – particularly, but not only, with the United States. This growth in exports was a side-effect of the emergence of China as a major recipient of investment in 1993 – a year that saw more Foreign Direct Investment (FDI) than the entire preceding fourteen years of reform put together.

A Dualistic Economy

In theory at least, the benefits of engagement – new investment, new export markets, tax income, technology transfer, new jobs - should have been offset by the impact of international competition on vulnerable and inefficient domestic sectors:

> if we pursue more open policies to encourage global competition, the less competitive national industry would be in competition with powerful international capital owners which could lead to problems in the future…..In this world, it is not possible to satisfy both sides (Jin Bei 1997)

To understand how the two sides were satisfied, we need to follow Naughton (2000) and divide the focus of analyses into two distinct and largely separate spheres.[4]

Where foreign actors did not compete with domestic actors, then they were encouraged to come to China. This almost always entailed encouraging FDI to produce exports for external markets. The extent of incentives offered to investors will be discussed in more detail below, but what is important here is the extent to which China constructed a liberal ***internationalized*** export regime. Investment was made simple, as was bringing in components to be used in export industries - as China joined the WTO entry, some 60 per cent of all imports came into China tariff free.

But this liberal export regime sat alongside a relatively closed and protected ***domestic*** trading regime.[5] This regime was partly designed to protect domestic producers from competition in order to main production, profitability and jobs. Thus, it protected inefficient loss making State Owned Enterprises (SOEs) from international competition, and also ensured relatively stable incomes for agricultural producers. But it was also partly designed to provide price advantage to domestic exporters. For example, Zweig (2001: 160) has shown how small scale Township and Village Enterprises (TVEs) swapped access to China's domestic markets in return for international capital and access to international markets'. Such TVEs accounted for around half of all Chinese exports in 1996 when the significance began to tail off, and alongside FIEs, were a key source of Chinese export growth in the first three phases.

External Pressure to Reform

Both central and local governments eased access to investment capital by providing loans through the creation of specialist banks, and provided a number of tax exemptions and other incentives for exporters. In addition, the government also used import plans, licenses and quotas and retained some of the highest import tariffs in the world to protect key domestic sectors (though notably these were steadily reduced even prior to WTO entry). Not surprisingly, these policies resulted in complaints from those who felt that China was acting unfairly, and in 1995 the Office of the US Trade Representative drew up the 'November Roadmap' outlining the areas in which the US government thought China was 'unfairly' protecting domestic producers. Although this list provides a snapshot of issues at a specific point in time, it nevertheless provides a rough overview of those issues that have been raised over the years. In addition to 'normal' trade issues such as tariffs, trading rights, and access to 'closed' sectors of the Chinese economy, the roadmap pointed to:

- incomplete currency convertibility
- lack of transparency in China's policy making (and in particular, the monopoly of the state news-agency, Xinhua, in the dissemination of economic information)
- intellectual and property right infringement was costing millions to copyright owners;

- the differential application of fiscal system where local companies typically negotiated tax free deals with the local government,
- the lack of full price reform in China also acted as a hidden state subsidy for favoured Chinese producers that paid cheap state set prices

Those who are familiar with more recent trade disputes will recognize that notwithstanding WTO entry, not all of these problems have gone away. Nor have complaints over exchange rate manipulation.

In the early 1990s, a market rate of sorts appeared for the Renminbi (RMB) as the government relaxed regulations on exchanges and allowed the emergence of 'swap shops' to ease access to foreign currency. Although the official exchange rate at the time was US$1 - RMB5.7, the swap shop rate was influenced by supply and demand, and was closer to RMB9 to the dollar. In 1994, the government 'unified' the two rate, which essentially entailed moving to the swap shop rate. The new official exchange rate of RMB8.7 to the dollar apparently representing a 50 per cent devaluation. But in reality, the headline figure misses the point that most companies were already using the swap shops and the market rate to get hold of the majority of their foreign currency. As such, the real effective devaluation was probably nearer 20-30 per cent for most exporters - and Fernald, Edison, and Prakash Loungani (1998: 2-3) put the figure at a mere seven per cent. But while we can argue over the real extent of this devaluation, there is a consensus that producing for export in China after 1994 became increasingly attractive.

In its own terms, this dualistic policy was a great success – domestic producers were protected from competition, domestic exporters were helped to gain a competitive foothold, and investment to produce exports increased year on year. As Lardy (2000) notes, protectionist measures had incrementally eased in the reform era.

For example, average tariff rates of 50 per cent in the early 1980s had been reduced to 17 per cent by 1998. Nevertheless, perhaps even more than the first generation of late developing states in East Asia, China's re-engagement with the global economy appeared to be a great example of how to reap the benefits of the global market-place whilst maintaining strong defences against the dangers of globalization. The relative lack of liberalization – particularly financial liberalization – also had the added if unplanned for benefit of ensuring that China escaped the Asian crises relatively unscathed (Yu Yongding 1999: 15). As such, it came as something of a surprise to many (not least many within China itself) when the government moved to end years of at times rather bitter negotiations by signing an agreement with the US government in November 1999 which led to China's entry into the WTO at Doha in 2001.

Phase Four: Becoming WTO Compliant 1999-2008

China had been in the process of attempting to join what was then the General Agreement on Tariffs and Trade (GATT) since July 1986. But up until the late 1990s, the Chinese position was that China would join on its own terms – essentially terms that allowed China greater and more stable access to external markets than it would reciprocally grant to others.[6] Initial claims that China was simply retaking the China seat vacated by the Republic of China in 1950, and therefore didn't need to do anything in terms of further liberalization were slowly but firmly rebuffed. Subsequently, Chinese negotiators emphasized entry as a 'developing country' as this would allow them to maintain some protection for key domestic sectors, to partially subsidize exporters, and to have a longer period of post-entry adjustment than that afforded to developed countries.

While previous ‘developing country’ new members had not been forced to fully liberalize immediately (Trebilcock and Howe 1999), but this preferential treatment for new developing countries declined significantly after GATT became the WTO in 1995. More important, special treatment for developing countries is not mandatory and the definition and legal basis of WTO membership is astonishingly vague (Jackson, 1989: 279). There are definitions for what a ‘Least Developed Country’ is and what this means, but no definition of what constitutes a developed or developing country in the WTO rules at all – let along any conception of differential treatment for them. In effect, a country can decide to classify itself as a developing country if it wants to, but its up to others to decide whether to give them preferential treatment through the Generalized System of Preferences or not. More important still, this only applies once a country has joined, and the definitions and legal basis of membership provide event greater levels of ambiguity. There are no set processes at all, with the specifics of each individual attempt to join the WTO worked out on a case by case basis. The WTO will establish a special working party to undertake negotiations in consultation with interested member country parties, but this working party does not act on behalf of the members with power to make an agreement. Any existing member can demand a bilateral negotiation with the prospective member and can block entry until or unless they are happy (or can agree to membership on the condition that it doesn’t treat the new member as a member at all).[7] As such, Chinese negotiators insistence on being treated as a developing country where pointless. The terms of Chinese entry were determined by the individual discussions with existing members; what they wanted from China and what they were prepared to offer through hard nosed negotiations irrespective of how China classified itself.[8]

Quite simply, China was considered to big and too potentially important to be allowed in on its own terms. And trying to negotiate entry conditions that allowed considerable residual protection was not likely to succeed while China was running massive trade surpluses with the EU and the USA, and while many in the US in particular were warning about the future rise of China to challenge the existing global order. As Charlene Barshefsky put it, China would only be allowed in on terms that were 'commercially meaningful' to the US and that debates over what 'developing' and 'developed' meant were in fact meaningless.[9]

Domestic Opposition to Membership

Debates over the wisdom of WTO membership was a source of political friction throughout the 15 and a half years of negotiations (Fewsmith 2001). From within the leadership itself, former Minister of Propaganda Deng Liqun[10] was the most vocal critic of liberalization in general and WTO membership in particular, which he argued was another step on the road towards the creation of a new capitalist ruling class in China (Masaharu Hishida 2002). Others were less concerned about class, and focussed instead on the relationship between the economic benefits of increased economic integration on one hand, and the concomitant potential political problems of being subject to the vagaries of global capitalist economy dominated by China's (potential) enemies on the other. Major actors (which almost always meant the US) could use economic levers to not only pressure China to undertake domestic economic reform, but also to threaten economic repercussions if China did not comply with US political and security interests. Thus, divisions emerged within the leadership between those emphasising the logic of economic transformation, and those who argued that traditionally conceived national security issues should take predominance.

The wisdom of WTO membership was also debated in the wider population. Han Deqiang (2000) captured a popular mood by claiming that not only would WTO membership endanger Chinese jobs and incomes, but would also subject China to the vagaries of a global economy dominated by US hegemony. Other ‘new left’ writers joined the criticism – but according to Wang Hui (2004) the vast majority of works that appeared at first sight to be an attack on neoliberalism and/or US hegemony and/or the WTO were in reality much more pragmatic and practical. What they were really opposing was the timing and/or specific conditions of membership, and the impact that this might have on societal groups and social stability. Further liberalization might be good in the long term, but what about the impact of rapid change on rural incomes, on employment in uncompetitive SOEs, and the fragile (to say the least) financial system?[11]

Given this domestic opposition, the inability to push China’s preferred position at the international level, and that that the Chinese economy was not exactly in crisis, it is not wholly easy to understand Chinese leadership pushed for WTO membership in 1999. But we can suggest three main explanations for not just the push for entry, but also the timing of the push for entry. The first explanation is in the desire to have a say in shaping future changes to the global trading system at a time when the WTO was debating its own future role. To influence the organization, you have to become a member, and to become a member, you have to accept its existing rules and norms (in the short run at least).

Domestic Considerations and the Limits of Reform

The second explanation lies in shifting conceptions of what was in China's long term economic interest. By 1994, key leaders, considered that the logic of protecting domestic producers from competition had to be reconsidered – not least because of the financial losses uncured by keeping SOEs afloat. The limits of reform (gaige) had been reached and a new economic structure now needed to be put in place (gaizhi) (Yang Yao 2004). Thus, the residual elements of the old system that were still largely protected from international competition were no longer perceived of as the sacred cows of the Chinese economy, but instead were seen as obstacles preventing the full transition to a new economic paradigm. Key amongst these leaders were Premier Zhu Rongji (who would clearly not have been able to push the agenda without the support of Jiang Zemin), and China's chief WTO negotiator, Long Yongtu.

Initially, the transition from gaige to gaizhi focussed on domestic change and was nothing to do with the WTO. But there was considerable resistance to further liberalization both within the central bureaucratic agencies and in particular, from local authorities in areas where agriculture and/or the residual state sector continued to dominate economic activity. According to Fewsmith (2001: 574), 'frustrated by bureaucratic obstruction to fundamental reform, Zhu Rongji was willing to avail himself of foreign competitive pressures to force restructuring'. In the first instance, this entailed apparently offering considerable concessions in a bid to gain US support for China's entry during an official visit to Washington in March 1999. If the Chinese participants at a conference taking place in Beijing at the time were anything to go by, this was not a popular move.

When these concessions were rejected in the US, Zhu's position as Premier and liberalizer in chief came under scrutiny. He was not helped by the fact that the anti-inflation strategy pursued after 1994 did not result in the expected soft landing, but instead turned into deflation. To say that Zhu was saved by his another turn to the US authorities in November 1999 is to go too far. But to some extent at least, the desire to bolster reformers and to encourage China's engagement with multilateral organizations appeared to inform US policy makers as well. Clearly, the deal would have to be on the 'commercially beneficial' terms that Barshefsky set as the bottom line, but if this helped lock China into a liberalization path and reduce the possibility of any future reversal, then all the better.

This understanding of debates over domestic politics doesn't just partly explain the reason for joining the WTO, but also partly explains how the entry negotiations were negotiated. Any researcher who interviews Chinese officials and academics will be told that Long Yongtu and other negotiators were isolated from other political elites within China. The negotiations were 'closed' (Lai Hongyi 2001) in that a small group of leaders led the process without discussion with other domestic interested parties. Furthermore, a senior official at the WTO confided on the basis of anonymity that Zhu and Long knew that they had to reach a deal to maintain credibility and even delaying too long might reignite opposition in China. The suggestion is that the process became a 'one-level game', with the need to come to an agreement with negotiating partners – the international game - overriding the need to ensure that the domestic Chinese constituents were happy with any concessions – the domestic game.

The Politics of Sino-US Trade Relations

The final explanation returns to the idea of commercially beneficial terms – but in this case, Chinese commercial interests. While exports were an important source of growth the period under review, they became ever more important when domestic growth was sluggish – as it was in the mid to late 1990s. Ensuring stable access to major markets – particularly Japan, the EU and the US – was thus an important component in China's overall growth strategy – something that WTO membership would make more predictable if not, as we shall see, wholly guaranteed.

Ensuring access to the US market was more unpredictable than most due to the annual vote in the US congress over whether to extend Most Favoured Nation (MFN) status to China. Hence, in the words of Long Yongtu after the negotiations had been completed:

> the question concerning MFN status had long been the crucial factor for difficulties in China-US negotiation, US Congress' involvement in it had made the negotiation more politicized…. I want to point out that entry into the WTO would make future trade disputes between us and other countries and regions not easily be politicized (People's Daily 2001)

In practice, the US President had consistently proposed granting China annual MFN rights despite a welter of complaints about China's human rights record, one child policy, treatment of Tibet, policy towards Taiwan, unfair trade practices, trade surplus, labor abuses, arms sales, military technology transfer, environmental degradation and so on. But the chance remained that politics in the US could change and the best way of removing uncertainty was through the certainty provided by WTO - a means of depoliticising market access issues, and of taking some of the bilateral out of trade relations with the US by providing access to multilateral dispute resolution mechanisms.

Has WTO Membership Achieved its Aims?

There is a wide acceptance that the terms of China's accession protocol entailed significant concessions far exceeding the obligations of previous 'developing country' members. For example, China agreed to subsidies for agricultural production at 8.5% of the value of farm output rather than the 'normal' 10 per cent enjoyed by developing countries (but more than the 5 per cent for developed countries). In addition, China agreed to adhere to Article 6.2 of the WTOs Agriculture Agreement, which, according to the US Department of Agriculture Foreign Agricultural Service, means, 'China agreed to forego the developing country exemption'.[12] Even observers from the World Bank office in Beijing who were highly supportive of China's entry argue that the concessions exceeded even developing countries obligations (Kawai and Bhattasali 2001: 2).

Though it is still too early to guess the long term implications, its fair to say that WTO membership has changed China. Trade and foreign investment have increased - of course both were rising before 2001 and we cannot know what the figures would have been if China had not joined. In urban China in particular, one of the most visible early impacts was the large increase in private car ownership as import tariffs were cut and obtaining loans to buy cars became simpler with the approval of car financing ventures by General Motors, Volkswagen and Toyota. The more apocalyptical forecasts of a collapse in rural incomes has failed to materialize, though grain prices did drop back and to below the 1996 level.

Becoming WTO compliant has also entailed a significant transformation of the Chinese administrative legal system. For example, MOFTEC has been merged with the SETC to create a new Ministry of Commerce reflecting the understanding that it is no longer possible to separate the international and the domestic when it comes to planning trade and regulation. The Chinese authorities have also put in place a number of legal changes to ensure WTO compliance relating to the ownership of foreign enterprises and customs regulations. Most clearly, the new Foreign Trade Law which came into effect in July 2004 was the result of two years of negotiations between interested parties across a range of different administrative units in national level bureaucracies. The new law had three major changes from the previous Trade Law adopted in 1994. First, individuals rather than just companies were permitted to engage in foreign trade. Second, legally registered foreign traders no longer needed to gain administrative approval for individual activities. And third, SOEs monopolies on trade in petroleum, grain, chemical fertilizers, cotton, sugar and edible oil were partially revoked.[13]

The 2004 Trade Law in itself generated the need for a range of other administrative reforms by different bureaucratic agencies to ensure that they themselves complied with the new law. It will take a long time for the legal administrative reforms to be completed, but in the process, we can hypothesize that there will be a shift in the balance of power within China. With the emphasis increasingly on a law based system – economically if not politically – then power should shift from the party as an institution to the state.

But in some respects, the WTO didn't change things and change China quite as much as it might have done. Originally, there was considerable obstruction from 'the regulatory agencies who often regard themselves as the protector of domestic companies rather than the regulator' (Kynge 2002). These agencies "interpreted" agreements in ways that allow more protection for domestic producers that was originally intended. This resulted in 'a dense web of Chinese regulations' (Dougherty 2002) which in some cases has undermined the liberalising logic of the WTO agreement and resulted in new "countermeasures" (*duice)* – "it is one page of opening up and fifteen pages of trying to reverse it' (China Biz 2002). According to Stratford (2002), this process entails 'legitimate (though unwelcome) exploitations of 'loopholes'', 'China's aggressive interpretations of ambiguous language', and 'blatant disregard for clear-cut obligations'.

For example, when "The Catalogue Guiding Foreign Investment in Industry" was revized in 2002 and again in 2004 to make the FDI regime WTO compliant, many of those sectors where investment was not officially 'encouraged' were only encouraged with qualifications which in reality made them "restricted". According to the annual Congressional-Executive Commission report in 2005:

> The Chinese government has also proposed and implemented new measures that appear to protect and promote domestic industry and disadvantage foreign business, sometimes in contravention of its WTO commitments. (CECC 2005, 99)

The list of unfair practices included denying foreign firms access to domestic marketing channels; imposing unreasonable requirements for technology transfer by foreign investors; discriminating against foreign companies in the allocation of major government projects; continuing to use the financial system as a means of channelling preferential loans from state banks; facilitating privileged access to listings on stock markets; providing tax relief to domestic producers; by giving domestic firms special access to land; and by funding the research and design (R&D) activities of Chinese firms through the official government budget. In preparing a submission to the US government calling for restrictions on Chinese steel imports, Price et al (2006: iv) added to this list the manipulation of raw material prices to provide cheap inputs, currency manipulation (more of this below); access to 'sophisticated facilities at low cost' in government funded development parks; and the conversion of debt to equity, debt forgiveness and lack of action to recover non-performing loans (thus freeing Chinese producers from historical debt burdens).

Intellectual Property Rights (IPR) abuses are not included on either of these two lists but are also frequent cause of criticism.[14] Here, there is recognition that WTO entry has made a difference, and that the Chinese authorities have placed an emphasis on preventing IPR abuses. For example, legal changes have made it easier for foreign companies to use the Chinese courts to protect their IPR, and the government has established 50 IPR reporting centres to increase surveillance. But the acceptance that something has been done is heavily tempered by the general understanding that much more remains to be done. For the US Coordinator for International Intellectual Property Enforcement, Chris Israel (2006: 3), poor IPR enforcement in China is a consequence of:

> lack of sufficient political will, corruption, local protectionism, misallocated resources and training, and a lack of effective public education regarding the economic and social impact of counterfeiting and piracy

with enforcement at the local level marked out as the single biggest problem. In a US congressional briefing paper, Morrison (2002) similarly argued that ‘Corruption and local protectionism are rampant in China, and gaining the cooperation of local officials and government bureaucrats that oversee various affected industries could prove difficult in the short run’. It might not be impossible for the central government to ensure compliance in the provinces, but it is a far from easy task.

Perhaps even more than IPR abuses, China’s exchange rate policy has continued to be the biggest source of external complaints and pressure for further to reform. From 1994 until July 2005 the RMB was pegged to the Dollar, and subsequently pegged to a basket which added the Yen and the Won to the Dollar. The new system allows the RMB to fluctuate by a maximum of 0.3 per cent of its value every day, and during the first year of new system, the RMB appreciated by 3.8 per cent against the Dollar (People's Daily 2006). There are widely fluctuating estimations of what the real exchange rate should be and how to calculate alternatives in the absence of a real market (Goldstein 2004). Before the introduction of the basket, the lowest estimate was 15 per cent, and the highest 100 per cent (China Currency Coalition, 2004: 19), with 40 per cent the most often cited level. Since the ending of the peg the RMB has also consistently appreciated against the dollar. But the statistical uncertainty over the new rate is in large respect less important than the political reality that 46 trade unions and producers associations have come together to form the China Currency Coalition to lobby the US government for punitive action against China, and that many in the US blame China's unfair currency manipulation for at last part of an ever growing trade deficit.

Initial external observations of China's compliance record were prepared to accept a degree of hesitance and remained relatively positive. To be sure, there were calls for China to do more, but while the glass was not full, most portrayed it as being half full rather than half empty (USCBC 2002, USGAO 2002, Chan 2004). But in January 2006, Deputy US trade representative Karan Bhatia (2006) suggested that China's track record of WTO compliance was 'remarkably mixed' and that:

> The United States will not hesitate, when appropriate, to use all tools at its disposal to ensure that China lives up to its commitments…. We will continue to hold China accountable. That is our responsibility to the workers, farmers, and businesses here in the United States

US Commerce Secretary Carlos Gutierrez (2006) similarly commented that 'The bottom line is that our companies do not have their rightful access under the terms of

China's WTO commitments' he went on to suggest that if things didn't improve 'it only strengthens those who want to build protectionist barriers around the U.S. market'.

Residual barriers to Chinese exports

But if WTO entry has not fully opened the Chinese economy, not has it resulted in the guarantees of market access that were hoped for on the Chinese side. In fact, the continued growth of Chinese exports after WTO entry resulted in more trade conflicts, not less including an increase in anti-dumping measures against Chinese exports. Moreover, the WTO itself has become an arena for criticising Chinese trade policy including a successful case against Chinese restrictions on auto-parts imports in February 2008.

In addition, there is a strong feeling in China itself that health, environment and safety standards are increasingly becoming used as a means of protecting western producers from competition from China. There have been a number of other trade disputes with the EU over the import of 'unsafe' foodstuffs and cigarette lighters, and with Japan over "infected" dumplings. High profile withdrawals of "unsafe" Chinese made toys from shops across the world in 2007 made particularly significant news in the US, where the idea that unfair Chinese trade practices had resulted in the loss of US jobs already meant that there was strong pressure from some quarters to limit trade with China. The annual theatre of the MFN vote may have gone, but China remains an important part of political discourses in the US, particularly but not only during election campaigns. For example, whilst fighting for the Democratic candidacy in 2007, both Barack Obama and Hillary Clinton signed as co-sponsors a bill calling for higher anti-dumping duties on Chinese imports (and any other country, but the target is clearly China) that has “misaligned currency”.

Has China Changed the Global Economy?

China as "Problem"

Discussing complaints about the impact of Chinese trade practices on US jobs highlights one of the major focuses on the impact of China on the global economy – a largely negative impact in terms of the diversion of investment and jobs from other parts of the world. This discourse might be loudest on the global scene when it is being espoused in the US, but is in many ways more significant in Southeast Asia, and ***most*** significant in those states that are competing with China to attract investment to produce the same goods for export to the same markets. Makin (1997) and Bergsten (1997) both argue that China's 1994 devaluation was the starting point for economic problems in Southeast Asia that ultimately resulted in the financial crises of 1997.

This might be taking things too far, but it is clear that jobs have been diverted not just from the US and Southeast Asia, but from all parts of the world to China. It is also clear that three decades of engaging the global economy has changed not only the nature of individual economies and economic strategies in the region, but the nature of the regional economy as a whole. For example, many regional states have adjusted their own domestic economic structures to become suppliers to China rather than just a competitor. While Thai exports to the EU, Japan and the US have effectively 'stagnated' and 'labor-intensive manufactured exports shrunk', exports to China have increased – perhaps most notably of 'technology-intensive products' used in Chinese export oriented industries (World Bank 2003). Malaysian exports to China are also increasingly dominated by electrical components, chemicals, machinery parts, and petroleum and Indonesia's by processed oil and rubber – all materials or components that are in high demand in China's export oriented industries.

Indeed, Chinese demand for materials has had a profound impact on the global economy as a whole and not just the region. Prices have risen sharply for virtually all raw materials and semi-finished industrial goods as a result of rising demand from China (and of course other big emerging economies such as India). Companies and individuals across the world who have no direct contact with (or even interest in) China now find themselves indirectly affected by what is happening in China and are unable to insulate themselves from the impact of domestic Chinese growth, let alone the impact of China's global engagement.

China as "Actor"

These changes are all very real, but is it really China that is the source of change – or perhaps more correctly, China alone. Three factors warrant attention here. First, as Felker (2003: 255) notes, the China challenge to the region is a consequence of those 'same historical forces' that helped generate growth in the first place. Or put another way, the late development growth strategies of other states are being undermined by the emergence of an even later developing state in China. On another level, whilst Chinese officials have done much to make China an attractive place for investors, those investors have not been forced to move production to China; they have done it because it makes commercial sense. Thus, what has changed the world has been a combination of Chinese state politics and the investment strategies of foreign companies.

This brings us to the second and very much related point. China's entry into the global economy has in part simply resulted in the re-routing of existing trade relationships through China. For example, there was a mass migration of South Korean productive capacity to China in 2003 which resulted in both an increase in

Chinese exports to the three key markets of the EU, US and Japan, and also an increase in Chinese imports (of components) from Korea (Brooke 2004). These Korean exports to China are largely disguised exports to Japan, the EU, and the US while conversely, the US trade deficit with China is largely a disguised deficit with the region as a whole, and not just with China (Ross 1997: 48). What we see instead is China in part acting as the manufacturing conduit through which the regional deficit is processed (Hale and Hale 2003). Similarly, Takashi, Hirofumi and Rüffer (2002: 3) argue that 'Japanese exports to East Asia 'cause' significant inter-regional trade and ultimately exports to the US by East Asia', while Hu Jintao has noted that 'at least 90 percent of US imports from China are goods that are no longer produced in the United States…. Even if not from China, the United States will still have to import these products from other suppliers' (CD 2006).

Third, we have to question the focus on states as the source of global financial and commodity flows. The focus on China as "problem" is understandable. In the world of real politics, stark black and whites are more understandable than complex shades of grey. It's also easy to build on existing fears and prejudices by identifying China as an emerging threat. And to be fair, the way in which the Chinese authorities promote the idea of China as a rising power feeds into this discourse; and somewhat ironically, while the concept of China's Peaceful Rise (heping jueqi) was intended to counteract the "China threat" school, by confirmed for some the inevitability of China's "rise", it has actually increased those same perceptions of threat in some areas. But the reality is that this is a joint effort.

So while we can't be certain of the exact figures, we do know that most of China's exports are produced by or for foreign companies and are at least partly based on the investment decisions of foreign executives and demand in the major markets of the US, Japan and the EU. To be sure, since 2005 the main growth area in Chinese exports has been non-processing exports, and the percentage of FIE exports in the national total is falling slowly. But looking back over the last three decades, we can see that foreign investors have been the major producers of Chinese exports – and indeed still were in 2007 accounting for around 50 per cent of the national total. We can add to this those domestic Chinese companies that are not FIEs, but nevertheless produce foreign branded goods under contract with foreign companies (often via intermediaries)[15] and suggest that the percentage of exports produced either by or ***for*** is probably still around 60 per cent of the national total.

Moreover, these exporting FIEs have sourced the majority of their components overseas over the same period. The value of imports was greater that the value of exports until as late as 1998, and are still at around 80 per cent of export value today. Imported components remain particularly important in hi-tech industries, which are the fastest growing export sectors with a particularly striking growth of FDI in computer related manufacturing for export. 17 of the top 20 FIE exporters are in electronic related manufacturing.

China as "opportunity"

What this suggests is that Chinese producers have not always benefited as much from global engagement as the headline investment and export growth figures suggest – an issue we will return to shortly. It also suggests that others outside China have also benefited considerably from their engagement of China as China engages the global economy. Over half of Chinese exports to the US have originated in one way or another from the decisions of US-based companies themselves - Wal-mart alone imports ten per cent of all Chinese imports to the US, equivalent in country terms to being China's fifth biggest export market.[16]

These companies and their consumers in the West have all made significant gains from the movement of production to China at the same time that workers have been losing their jobs through the very same process. For example, a People's Daily (2005) report suggested that for each dollar paid for Chinese made designer clothes in the US, on average the Chinese manufacturers receive 10 cents. Or put another way brand-owning producers, wholesalers, retailers, advertizers and so on keep 90 per cent of the retail cost of clothes made in China. Moreover, according to Morgan Stanley, buying US rather than Chinese made goods in 2005 would have increased prices by 0.5 per cent, and buying Chinese had saved US consumers US$600 billion in the preceding decade – more than China had received in FDI over the same period.[17]

Has the Global Economy Changed China?

There is a simple answer to question of whether the global economy has changed China; yes it has. Global engagement has generated new tax revenues, created new jobs and generated massive foreign currency reserves. It is also responsible for at least part of the reduction of rural poverty in China through the remission of incomes earned in export industries, and relative financial stability by facilitating the recapitalization of banks. It has also brought to China new management techniques, new technologies and new ways of thinking, and provided an impetus of domestic industrial change. In the process the physical geography of parts of China has changed beyond recognition, with the creation of new urban spaces increasingly linked by modern transportation facilities.

Of course for some this urban transformation is not necessarily a good thing, and critics argue that not all of this dramatic transformation has been for the better. Detailed investigations by Chinese labor watch reveal working conditions in FIEs that Anita Chan (1995) described as 'Dickensian' in 1995 had not noticeably improved over a decade later.[18] Whilst Chan and Zhu (2003: 561) are correct when they remind us that "management practices at workplaces in the PRC are no less authoritarian, disciplinary, and punitive than their counterparts in England in the period of the Industrial Revolution", Kynge (2006) calculates that Chinese workers earn less in real terms than British workers did at a comparable stage.

Whether viewed through rose coloured or sceptical perspectives, there is no argument that thirty years of investment and change has resulted in massive change. But if the headline figures perhaps hide the extent to which foreign actors have benefited from China's global engagement, the corollary should be that the headlines also overstate the impact on China. The crucial word here is "overstate" – there is no denying that the impact has been very real and very important; but perhaps not quite as much as might appear at first sight.

Referring back to the discussion about WTO entry, the impact has been partly deflected through the less than full liberalization of the Chinese economy and the less than even playing field for external economic actors. In a number of areas, there is much still to be done to ensure compliance (if indeed it is to be ensured) and so the impact has in this respect been delayed. The impact has also been far from evenly distributed and/or felt across China as a whole. Almost 90 per cent of cumulative FDI since 1978 has gone to China's coastal provinces. Guangdong Province has been the single biggest recipient, though its share of investment has declined as more FDI has moved to other coastal areas such as Shanghai and Liaoning. In combination, eight provincial level authorities on the coast account for 95 per cent of all Chinese exports produced by FIEs.[19]

Writing just after the first big wave of FDI to produce exports, Lardy (1995: 1080) referred to parts of coastal China as 'enclaves' that were linked to global production but increasingly isolated from the rest of the domestic economy. The idea that the technology base of the national economy is not advanced when economic growth occurs through the assembly of external productive forces I supported by (Hout and Lebreton (2003) who argue that:

> Unlike Japan a generation ago, which reinvented manufacturing through quality and continuous improvement, China is deinventing it by removing capital and reintroducing manual skill and handling on the plant floor.

This perhaps goes too far. The quantity and quality of technology transfer has increased, particularly since WTO entry as investors have increasingly exported machinery to China for use in export production, rather than simply exporting components. Cheung and Lin (2004) have shown clear spillover benefits in terms of innovation, research and development and technological upgrading in domestic Chinese companies. Domestic Chinese companies in the supply chain have also restructured their operations, reduced costs and increased quality in an attempt to develop a domestic source of components and other supplies for FIEs. In some sectors such as audio-visual consumer goods, the development of a domestic supply chain has occurred rather quickly.

Nevertheless, if we take the three decades of reform as a whole, we can suggest that linkages between export oriented areas and sectors with the rest of the domestic national economy as a whole have been relatively weak or 'shallow' (Steinfield 2004). At the very least, the level of technological and developmental spill-overs of export oriented growth are lower than the huge global FDI figures for China might suggest without investigation, and lower than China's leaders hoped for when embarking on the reform process (Rosen 2003, Lemoine and Unal-Kesenci 2004).

Towards a Fifth Phase of Global Engagement?

This understanding that global engagement, whilst clearly hugely important, has not been an unqualified success is not lost on Chinese analysts and policymakers. For example, the influential economist, Yu Yongding (2006), has argued that the dominance of the processing trade in Chinese FIEs means that the process of global integration to date has not proved to be an effective way of promoting domestic industrial upgrading. In addition, local officials have spent so much time, effort and money trying to attract investment that the real impact of many projects has been minimal, and perhaps in some cases actually negative. For Yu, the emphasis on attracting investment (or at least, investment for processing and assembly) should be overturned:

> Preferential policies for exports should be cancelled. Preventative measures should be introduced to stop local governments competing for Foreign Direct Investment. The local government should also be banned from using the introduction of FDI as part of the political performance criteria for local officials.

As Yeung (2008) has shown, there is also now a relatively large Chinese literature that points to the significant challenges to China's economic security that emerge from an over strong dependence on the global economy as a means of generating growth. Where many external observers point to the size of investment in China and the growth of Chinese exports as a source of Chinese strength, some in China instead see vulnerability and potential long term weakness.

These concerns have influenced the development of new policies that might represent the start of a new fifth phase in China's global economic strategy. On one level, there has been an attempt since 2004 to promote the domestic economy as a driver of growth and to rebalance the relative importance of endogenous and exogenous demand (Lardy 2006). On another level, the government has attempted to slow export growth by cutting export tax rebates in 2007, and by allowing the Renminbi to appreciate since 2006. Whilst this is partly intended simply to reduce the growth of the trade surplus (not to create a deficit, but to slow the rate of growth) it is also hoped that the nature of investment will change from predominantly low tech and labor intensive industries to higher tech and higher value added.

Initial evidence suggests that some shoe and textile producers have sought new production sites elsewhere (not least in Vietnam). But in terms of both the growth of domestic demand (as opposed to domestic investment driven growth) and also the changing structure of investment and trade, it is simply far too early to judge if this really does mark a new turning point. The task of evaluating the efficacy of this strategy will have to wait until later.

However, there is one area where we can say with confidence that we are in a new era. In terms of investment, the historical focus over the last three decades has been on foreign investment to China. While this will remain an important issue in the future, we now also have to consider the importance of China's outward investment. Since 2003, Chinese companies have been encouraged to "go global (走出去 *zou chu qu*) and the outward investment regime has been liberalized to make it easier to invest overseas. Such investment might be small in global scales (around 1.5 per cent of global flows) and dwarfed by inward investment (by more than a factor of five in 2006), but it is growing extremely quickly. From an admittedly low starting point in 2003, it nearly doubled in 2004 to reach US$5.5 billion, grew by 123 per cent the following year to reach US$12.26 billion, and then by another third to reach US$16.1 billion in 2006. By the end of 2006, China had become the 13^{th} biggest source of investment in the world, and all analysis suggests that it will increase for the foreseeable future.

To date, the focus has been on China's search for resources, and in particular, how this is resulted in China's engagement of Africa and to a lesser extent Latin America. It is not just that this engagement has an impact on the price and distribution of key resources, but also that this engagement provides a political alternative for those who are seeking such alternatives. As economic contacts with China come with no political strings attached, authoritarian state elites not only have a new economic partner, but a counterweight to liberalising pressure from the west. Thus, Chinese outward investment not only challenges the existing global economic order, but also challenges the promotion of a western liberal political order (Taylor 2008).

In addition a new sovereign wealth fund, The China Investment Corporation came on-stream in September 2007 with US$200 billion worth of funds at its disposal. Around two-thirds of the fund appears to be earmarked for domestic purposes – not least heading off the potential of economic woes by ensuring that banks and asset management companies (that have purchased large chunks of the bank's bad loans) do not go to the wall. But there is still a sizable chunk of money to be used to buy equity overseas. US$3 billion has already gone to Blackstone and a further US$5 billion stake acquired in Morgan Stanley, and it seems reasonable to expect that Chinese outward investment is going to be about much more than just acquiring resources in the decades to come.

Conclusion

It is hard to argue with the blunt statement that China's engagement of the global economy has had a profound impact on the global economy. Whether this is beneficial or not is another question, and largely depends on who you are, and partly on where you are. Those who are in competition with China have found such rivalry difficult to deal with – be that those wishing to compete with Chinese exports to third markets, or those who wish to compete with Chinese producers in China itself. To be sure, WTO has altered the terms of such competition, but the task of creating a truly level playing field is far from complete (if it ever will be). By contrast, those who supply or consume production in China have tended to fare much better.

In short, China has changed the global economy. The structure of both the East Asian regional economy and individual regional economies has been altered by the interplay between Chinese state policies and the investment decisions of foreign companies; the supply and price of most resources have altered and raised respectively; and Chinese outward investment is beginning to change the economic and political landscape of Africa and Latin America.

And of course the global economy has changed China. Perhaps not always in the way that policymakers would have liked; perhaps it has changed some parts of China more than others; and perhaps it not always generating as much change and brought as many benefits as the headline figures might suggest. But the physical, economic and to some extent political landscape of (parts) of China are now unrecognizable when compared to the status quo ante of 1978.

In the late 1980s (before June 1989 at least), observers marvelled at the speed and extent of change, only to later realize that in many respects it was only in 1992 that China began to engage the global economy in any meaningful way; important as prior changed might have been, they were dwarfed in scale and significance by what came after 1992. Looking back on three decades of reform, it is impossible to say that what has happened so far is meaningless. Nevertheless, it is hard to escape the feeling that we are at the beginning of something new. It seems likely that future analyses of four decades of China's interaction with the global economy will need to devote considerable space to the process and implications of ever greater outward investment.

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Notes

1 Not at the Third Plenum itself, but shortly afterwards. For details of the specifics see Ho and Huenemann (1984).

2 These were Xiamen in Fujian Province, and Zhuhai, Shantou, and Shenzhen in Guangdong. When Hainan Island was later separated from Guangdong to become a province in its own right, it was established as the fifth SEZ.

3 Unless indicated to the contrary, the trade data used in this paper all originates from sources that use figures from the PRC General Administration of Customs. These figures are lower than those estimates of non-Chinese agencies due to different accounting methods. While these figures might deflate the real value of exports by western standards, they are the only way of ensuring the use of common figures, and therefore making like-to-like comparisons.

4 See also Lardy (1998, 200o).

5 From 1995, this system became more transparent through 'The Catalogue Guiding Foreign Investment in Industry' which established on an industry by industry basis where foreigners were allowed (with restrictions invest), where they were encouraged and incentivised to invest, and where they were prohibited from investing. Later changes to the Catalogue in 2002, 2004, and 2007 reflected the need to become more WTO compliant. For more details, see Breslin (2006).

6 For details of the technicalities involved in negotiating WTO entry, see Yang Guohua and Cheng Jin (2001).

7 For example, sector specific reservations were negotiated by Argentina, the European Union, Hungary, Mexico, Poland, the Slovak Republic and Turkey. These reservations were largely related to exports of items of textiles, clothing, footwear, toys, ceramics and cigarette lighters. Mexico, which did not resolve its bilateral disputes with China, but agreed not to block accession, has 21 items on its reserved list. See WTO (2001).

8 It is notable that there is no mention of 'developing country' at all in the final accession document.

9 Reported by China News Digest, 10 December 1996.

10 Considered by some to be a candidate for Party leadership in 1982.

11 These issues and others were addressed in Yu, Zheng and Song, (2000), one of the earliest Chinese collections on the potential impact of WTO entry.

12 http://www.fas.usda.gov/itp/china/accession.html

13 A percentage of trade in each commodity remained reserved for SOEs.

14 The US Department of State has a web-page devoted to Chinese IPR issues. See http://usinfo.state.gov/ei/economic_issues/intellectual_property/ipr_china.html

15 Many companies invest in China via intermediaries – through tax havens in the Caribbean, through specialist contract manufacturers in East Asia and through established regional offices and/or partners in Hong Kong. As such it is difficult (perhaps impossible) to trace the real origins of investment – the statistics might show a Hong Kong investment in China, but they won't show the chain of relations and links that tie the Hong Kong investor to producers that are more often in the US, Japan and the EU than the headline figures suggest.

16 This information is taken from the American Federation of Labor and Congress of Industrial Organizations (AFLCIO) web pages devoted to the impact that Wal-mart has on jobs in the US and production processes overseas. It is fair to say that the AFLCIO is not Wal-mart's biggest fan, but very similar statistics can be found from a range of other less critical sources. See http://www.aflcio.org/corporatewatch/walmart/walmart_5.cfm

17 According to the official Chinese government webpage, http://english.gov.cn/2006-04/06/content_247295.htm accessed 23 August 2006. Morgan Stanley were also cited as Hu

Jintao's source when he claimed that Chinese exports had created four million jobs in the US in 2004 (CD 2006).

18 See also Chan (2001).

19 Guangdong alone has accounted for over 4o per cent of FIE exports. The other seven are Shanghai, Jiangsu, Fujian, Shandong, Tianjin, Liaoning and Zhejiang.