Japan and China in the World Political Economy

Edited by Saadia M. Pekkanen
and Kellee S. Tsai

Foreword by Ezra F. Vogel

Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First published 2005
by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN

Simultaneously published in the USA and Canada
by Routledge
270 Madison Ave, New York, NY 10016

Routledge is an imprint of the Taylor & Francis Group

© 2005 Editorial selection © Saadia M. Pekkanen and Kellee S. Tsai;
Individual chapters, © the contributor

Typeset in Times by Prepress Projects Ltd
Printed and bound in Great Britain by Biddles Ltd, King's Lynn

All rights reserved. No part of this book may be reprinted or reproduced or utilised in any form or by any electronic, mechanical, or other means, now known or hereafter invented, including photocopying and recording, or in any information storage or retrieval system, without permission in writing from the publishers.

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
Japan and China in the world political economy / edited by Saadia M. Pekkanen and Kellee S. Tsai.
p. cm. – (Politics in Asia series)
Includes bibliographical references and index.
1. Free trade – Japan. 2. Free enterprise – Japan. 3. Japan – Economic policy – 1945–1989. 4. Japan – Economic policy – 1989–. 5. Japan – Economic conditions – 1945–1989. 6. Japan – Economic conditions – 1989–. 7. Japan – Foreign economic relations. 8. Free trade – China. 9. Free enterprise – China. 10. China – Economic policy – 1976–2000. 11. China – Economic policy – 2000–. 12. China – Economic conditions – 1976–2000. 13. China – Economic conditions – 2000–. 14. China – Foreign economic relations. I. Pekkanen, Saadia M. II. Tsai, Kellee S. III. Series.

HF2366.J37 2005

330.952–dc22
2005007588

ISBN 0–415–36901–0

For Robert and Sophia; and for Davis and Felix

The institutional, political, and global foundations of China's trade liberalization

Margaret M. Pearson

No country has expanded its presence in the global economy as rapidly as China has over the past two and a half decades. Trade liberalization has been a crucial component of China's broader integration into the global economy that has also included inward and outward direct investment (analyzed in Yi-Feng Tao's contribution to this volume) and, more tentatively, participation in international capital markets. The liberalization of China's trade patterns over the past twenty-five years has been dramatic and time-compressed; indeed, the distance and speed traveled have been nothing short of extraordinary given China's starting point. Up until 1978, international trade was viewed by the Maoist leadership as, at best, a way to supplement what could not easily be produced at home, and was administratively dictated by the state.

By the time China was admitted to the World Trade Organization (WTO) in December of 2001, trade was a significant engine of growth in the economy of China's coastal regions, and China had become an important force in global trade – a force deemed worthy of nearly unprecedented international attention. China's economic future, if not primarily dependent upon its trade performance, was deeply intertwined with the global trade system in terms of both business transactions and membership in formal trade organizations. The ideological question of the Maoist era – whether price-based trade was tainted with the stain of capitalism – had become a non-issue. Trade increasingly was carried out without state supervision. To the extent that elements of trade continued to be administered by the state, the tools used looked increasingly like those of advanced industrial nations. Moreover, the domestic politics of trade increasingly resembled those found in advanced industrialized nations. In short, the ideology, instruments, and domestic politics of trade all had undergone extensive revision. The pressure for deep and quick liberalization that emanated from the WTO, the hegemonic dominance of the free trade ideal, and the deep involvement of the Chinese state in shaping liberalization led China to what this volume's editors term "late liberalization."[1] China has sped through and in some instances leapfrogged phases of trade liberalization that countries such as Japan had traversed earlier.

This chapter analyzes the domestic and international causes underlying the rapid and wide-ranging liberalization of China's international trade system. It is organized into four sections. The first section details the scope of trade liberalization, emphasizing changes made in the lead-up to and final agreement for China's WTO entry in late 2001. The institutional and political foundations for the transformation of the state's trade policy – in essence the domestic politics of trade liberalization – are discussed in the second section. The third section lays out the international pressures for liberalization, and explores how these interact with internal causes. Finally, the last section of the chapter speculates on the evolution of China's post-WTO trade pattern as it concerns three significant issues raised by the editors of this volume: constituents, compensation, and commitment.

Before moving on, several observations can be offered that help frame China's trade liberalization statistically, historically, and comparatively. Numerous aggregate statistics tell of the breathtaking change in China's trade system from an almost totally closed economy in the mid-1970s to, at the end of 2004, the third largest trading nation in the world behind the United States and Germany (J. Zhang 2005).[2] In dollar terms, China's total trade rose from approximately US$20 billion at the initiation of the "open" policy in 1978 to US$1.15 trillion in 2004, vastly outstripping the rate of growth in world trade (J. Zhang 2005).[3] During the 1990s, China's share of the world export market grew by roughly 10 percent per year, contrasting with Japan's decline of 4.6 percent per year (Lardy 2002: 55).[4] Whereas prior to 1979 official PRC estimates set China's trade volume as a percentage of GDP at not more than 10 percent, by 2003 exports alone (goods and services) had reached 44.4 percent of GDP.[5]

Looking beyond aggregate figures, it is instructive to draw some broad comparisons to Japan's more limited trade liberalization prior to 1989.[6] Whereas China failed to participate in the rapid growth of world trade after World War II, Japan entered the General Agreement on Tariffs and Trade (GATT) in 1955. Japan's accession occurred in a substantially different domestic and international environment than China faced in the 1990s. Japan's GATT integration occurred at a time of global post-war insecurity about the damaging national impact of liberal trade. Reflecting this context, GATT was a relatively weak institution and placed much less stringent restrictions on Japan. As a result, and protected by its strong political and security ties to the United States, Japan was able to maintain high tariff and non-tariff barriers. Ideological acceptance of a free trade philosophy was slow to emerge in Japan, moreover, despite the fact that the 1960s provided a highly favorable international environment for the expansion of Japanese trade growth (Komiya and Itoh 1988: 186).

In contrast, China undertook global economic integration at a time when the model of free trade was arguably more dominant than it had ever been. Moreover, the WTO, by its very nature, requires of China significantly deeper cuts than had been required of Japan, and addresses myriad forms of trade protectionism. The Asian financial crisis of 1997 more fully catapulted China into the global economy and strengthened integrationist ideology among China's reformers (in contrast to other Asian nations such as Malaysia).

In the composition of trade, China has had substantial success in moving up the value chain from being a labor-intensive processor of low-value added products (starting in the mid-1980s[7]) to being increasingly a producer of manufactured goods (such as televisions), and further to become a member of electronics production networks (such as notebook computers). In short, China began exporting according to its comparative advantage, and as its comparative advantage has begun to migrate to higher value-added goods, trade flows have followed. This has occurred in China thirty years after Japan engaged in the same process (Komiya and Itoh 1988: 187–8).

Timing and context have been important factors in China's "late trade liberalization." China's success has been greatly influenced by a favorable position in the international economy: there was strong demand (especially in the United States) for low-cost labor-intensive goods (notably, textiles and apparel) that have been the core of China's comparative advantage. China has been positioned to displace production of exports from other developing nations, particularly in Southeast Asia. Moreover, trade has benefited from the productivity that was unleashed through the radical reorganization of domestic production – especially reforms that released labor from the land – that was at the heart of China's domestic economic reforms.[8]

There have been clear disadvantages to late liberalization in trade, however. China was hemmed into a liberal strategy if it was to use trade as a significant tool for growth; there was no alternative to accepting the era's established international trade rules. This disadvantage played out concretely in China's WTO agreement, in which it formally conceded many potential "Chinese characteristics" to its trade system. Moreover, the fact that China was not a founding member of the WTO meant that the bar for China's entry was greatly raised, and requirements for its admission were much more stringent than for any country before.[9] Interestingly, the negative example that most pressed US trade negotiators to extract stringent conditions from China was Japan.

This broad characterization of China's trade liberalization as rapid and deep must be tempered in two senses. First, although in comparative terms China's trade liberalization was quick and top-down, this should not suggest that the Chinese state carried out a "big bang" trade liberalization or that it began with a master plan. In a manner quite consistent with China's overall economic reform, trade liberalization was carried out in piecemeal, incremental fashion (Naughton 1995). The traditional mode, originating with Mao, of experimenting with an idea or policy in a geographically or sectorally limited area was followed in trade. Observers witnessing the process of trade reform at first hand were often keenly aware of its incrementalism. It is only in hindsight that the rapidity of scope has become more apparent.

Second, there must be recognition of the limits to liberalization; as China began its membership in WTO, substantial trade barriers and distributive problems remained. Concern that implementation of China's WTO commitments would proceed more slowly than called for in the agreed-upon timetables is discussed below. It is also important to understand that the impact of trade liberalization thus far has been skewed toward certain sectors and regions. Liberalization of trade policy has been most pronounced in the export sector (as opposed to the import sector). Moreover, foreign-invested enterprises (FIEs) and export processing firms have conducted the bulk of trade. Indeed, by 2000, exports from China's FIEs accounted for about half of total exports, whereas these firms produced only one-eighth of all manufacturing output (Lardy 2002: 6–7). Domestic firms that produce exports often rely on duty-free imported materials, limiting the demand for inputs from domestic firms. Local value-added averages 35 percent, but often is as low as 25 percent.[10] Moreover, FIEs alone have been responsible for more than half of all Chinese imports since 1995. Thus, the impact of the growth in trade (and its presumed benefits) has not been spread evenly throughout the domestic economy. While it is not accurate to term China's trade pattern as "enclave trade," the uneven distribution cannot be ignored.[11]

The content of China's trade liberalization

What specifically have China's reformers done to liberalize trade? Changes fall into two broad categories, trade policy instruments (discussed in this section) and political and institutional bases of trade (discussed in the following section). In both categories, China's liberalizing patterns enhance its similarities to other advanced industrial countries, and are consistent with the markers of liberalization presented in Table 1.1 in the introductory chapter of this volume.

It is tempting to see WTO as the watershed for the reform of China's external economic activity, and in many ways this is accurate. However, the Chinese government carried out substantial reform to its trade system prior to WTO entry. Many reforms, especially those made after 1995, were part of a negotiating strategy to make China seem more attractive to WTO member nations. Equally important is the fact that much of the impetus for these changes was domestic, and an effort to strengthen the overall economy. As such, China's WTO commitments, particularly in the area of trade, can be interpreted as part of a longer evolution of trade-positive changes that began in earnest in 1995.[12] This section discusses the most significant trade-related policy changes and commitments leading up to and pursuant to China's very complex WTO accession.

In the Maoist era, international trade was carried out according to a system of direct material planning administered by bureaucratic authorities. Ten to sixteen foreign trade corporations (FTCs) dominated trade, each attached to a production ministry and each of which held effective monopolies in its specified sector. The State Planning Commission determined quantities of imports needed to fill the projected gap between domestic supply and demand for high-priority goods, such as equipment and industrial raw materials. Exports were set at the level needed to pay for planned imports, while the composition of exports was determined largely by any unexpected overproduction of goods.[13] In short, physical quantities set by planners, and not relative prices, determined the volume and composition of trade. This system was criticized in the West as squelching information about supply and demand and creating enormous inefficiencies (World Bank 1988).

The political decision in 1978 to "open to the outside world" led the PRC government to begin replacing materials-based planning with indirect price-based tools to manage trade flows. The first trade reforms of the early 1980s established

a system of tariffs, as well as quotas and licenses. While the new tools were also barriers to trade, their use was a sign of liberalization and convergence with the standard instruments of trade management. The scope of these instruments was gradually reined in over the second half of the 1980s and the 1990s, in part as a result of WTO accession. Tariff levels were reduced, as was the number of goods subject to licensing, quotas, and so forth.

Thus, in the import regime, the tariff level fell in a fairly regular series of reductions, with particularly sharp cuts occurring in 1994 (as China negotiated to enter GATT), 1997, and 1999–2001 (as China focused on WTO entry). As of 1982, soon after the tariff system was introduced, the average statutory tariff rate was high: 56 percent. By 2001 – and thus before China entered WTO – this rate was only 15 percent, reduced to one-quarter of the original level. From a comparative perspective, China's 2001 tariff level was about half that of India, and on a par with the rates of Mexico and Brazil (Lardy 2002: 33). By the beginning of 2004, overall average tariffs had declined from 11 percent to 10.6 percent and, with a few exceptions, all imported goods reached their final bound duty rate on January 1, 2004.[14] Moreover, as indicated previously, raw materials and intermediate goods used to assemble products that were subsequently exported, and capital goods used in FIEs, were often exempt from *any* statutory tariffs, privileging these internationally oriented sectors of the economy.

Non-tariff barriers to imports (NTBs) – particularly quotas, licenses, registration requirements, import substitution lists, restricted trading rights/state trading and tendering requirements – remained a bigger hindrance to trade. Less transparent than tariffs, these barriers are more difficult to track. Nevertheless, over the course of the 1990s, and in part a result of 1992 market access agreements with the US government, the number of tariff lines subject to quotas and licenses fell dramatically. By 2001, NTBs covered less than 10 percent of total tariff lines, and the share of imported goods for which trading rights restricted trade declined from 90 percent in 1980 to 11 percent in 1998 (Ianchovichina and Martin 2001: 5).

As with imports, China's export regime was substantially liberalized over the course of the 1980s and 1990s in conjunction with the end of physical planning and evolution to first an expansive and, later, much contracted system of export quotas and licenses. Also important was the passing from favor of the assumption that exports were important solely for earning foreign currency. The clearest measure of export regime liberalization was the reduction in the number of commodities subject to export licensing and quotas from a peak of 235 in 1991 to fifty products in 2000 (Lardy 2002: 46–55).[15] Several corollary policy reforms supported the liberalization of the export regime. Key among them were the decentralization of export authority (discussed below) and reform of the currency exchange system. Devaluation of the currency reduced the differential between domestic and international prices, thereby making exporting more attractive to domestic producers. Additional foreign currency reforms allowed exporting firms to retain a share of their foreign exchange revenues. Finally, tax policy was changed to rebate a portion of the value-added taxes paid by exporters, and to rebate import tariffs for goods used in export processing. These tax incentives have helped promote

China's integration into global production networks, notably for computers and computer components. As a result of China's WTO entry, government budgetary considerations, and pressure from foreign governments, these rebates were scaled back in 2003 (Mui and Lee 2004).

A major thrust of China's WTO commitments as they relate to trade has been to move China even further toward a tariff-based trade regime by phasing out licenses, quotas, and other non-tariff quantitative restrictions by 2005. As noted, tariffs on all products were reduced further from 2001 levels to rates well below those of India and Indonesia, for example.[16] Moreover, China agreed to bind *all* tariffs at the new low rates as they were phased in, something very few countries have done. Trading rights – the legal right granted to firms to make independent export and import decisions – were extended to all domestic firms by 2004, though some state trading was allowed to remain, particularly for agricultural and oil/petroleum products. A revised Foreign Trade Law passed in April 2004 extended trading rights for both imports and exports to individuals and small firms, further removing trade from government control (Zhao 2004). This dramatic expansion of trading rights greatly expanded domestic firms' access to international markets.

The commitments in agriculture and in textiles and apparel merit specific comment. Agricultural imports are extremely sensitive in China because of worries both about food security and about rural instability. The depth of China's WTO commitments on agriculture is quite surprising given this context. Some analysts argue that the baseline comparative advantage in agriculture is moving against China (Ianchovichina and Martin 2001: 7; see also Rosen *et al.* 2004). Therefore, increased trade in agricultural commodities – encouraged by lower tariffs on agricultural imports – makes sense economically if China is to avoid the highly protectionist, inefficient and high cost mode of agriculture as found in Japan. To this end, China has agreed to binding agricultural tariffs that are very low by East Asian standards. Even more important is China's adoption of a tariff rate quota (TRQ) system, under which a certain minimum volume of imports must be subject to low tariff rates. For many agricultural products (e.g., wheat, corn, rice, and cotton), the low tariff rate applies to the whole amount that historically has been imported (Lardy 2002: 76–9; see also Table 3.2).[17] In addition, while not agreeing to lower domestic agricultural supports to the level desired by the United States (5 percent), the PRC did limit aggregate support to agriculture to 8.5 percent of the value of agricultural output (plus, for any individual crop, a limit of 8.5 percent of the value of that crop).[18] Finally, China agreed to eliminate all of its substantial agricultural export subsidies upon accession – an extreme commitment, particularly compared with the failure of the United States or EU to eliminate such subsidies (Lardy 2002: 93–4). China has not implemented these commitments to the complete satisfaction of foreign grain exporters, yet has moved steadily in that direction.[19]

The keen sensitivity in the area of agriculture is a result of perceived threats to Chinese producers from foreign competition. In contrast, the issue of textiles and apparel is important because it concerns China's most important export market. Textiles and apparel exports from China have long been restricted by quotas set

by the multilateral Multifiber Arrangement (MFA) to prevent any one country's dominance. As perhaps the clearest example of a big bang effort at global liberalization, multilateral trade negotiations (concluded prior to China's WTO entry) agreed to end the MFA quota system as of January 1, 2005. This gave a huge boost to an already strong Chinese export industry, despite the option provided importers to erect special textile safeguards on China until the end of 2008. China's exports in textile and apparel were expected to surge in the near term as soon as the MFA was lifted; one model predicts that the results of WTO accession will be to raise China's share of exports in apparel by 151 percent, increasing China's share of world apparel exports to over 39 percent by 2005, up from 19.6 percent in 1995.[20] The textile and apparel example is touted as a clear example of how Chinese industry can gain from trade liberalization.

While China's commitment to tariff reductions and other liberalizing measures subsequent to WTO entry has been excellent, concerns about non-tariff barriers remain. Chinese industries have been quite adept at finding new ways to hinder foreign competition. NTBs remain in several forms, most notably the use of standards certification and product type testing. Tools such as requiring testing to meet Chinese standards for health and safety have been used in increasing numbers. These are barriers not just because they provide justification for barring entry of foreign goods, but because such tests must be conducted in China or by Chinese inspectors. China also has become more sophisticated in the use of anti-dumping actions to protect domestic industries from foreign imports. It promulgated the (relatively WTO-consistent) Anti-dumping Regulations in 1997 and, immediately after WTO admission, made effective a more thorough Anti-dumping Law.[21] Indeed, in 2003 it initiated six anti-dumping investigations, most of which were targeted against South Korean and Japanese companies in the chemicals industry. These methods, of course, are not unique to China, and are perhaps the prime weapon of other countries' antidumping actions (particularly the United States and EU countries (US–China Business Council 2005).[22] NTBs, particularly the use of dumping charges, are likely to be the focus of most trade-related disputes involving China in the near future.

This bare-bones rendition of China's trade liberalization indicates how much China has accomplished since the early 1990s. Undoubtedly there will continue to be difficulty implementing its WTO commitments, yet that should not diminish recognition of their depth. Equally noteworthy to the changes in trade policy are the institutional and political changes that accompanied them. These changes are the subject of the following section.

The landscape evolves: institutional and political foundations of liberalization

A central theme of this volume is the exploration of institutional and political bases for the liberalizing political economies of China and Japan. What we can conclude about institutional and political causes of Chinese trade liberalization is, from a comparative point of view, both surprising and unsurprising. What is surprising, as illustrated by the previous description of trade policy changes, is the pace and degree of institutional and political change, both in government and in the economy itself. What is unsurprising (but perhaps more interesting!) is that the domestic political economy of Chinese foreign trade has come to look increasingly like that of advanced industrialized countries. There has been a strong trend toward pluralization of domestic influences on trade policy. Pluralization appears in two forms. The first is the expansion of the number and character of *institutional* organs that engage in trade in China. Second is *political* pluralization, albeit within the state; actors who were originally quite marginal to trade policy-making have gained an influential and highly politicized role. Thus, although we cannot claim convergence, China's trade politics now look much more familiar to outside observers.

Institutional foundations of trade liberalization

The usual cast of institutional suspects has been deeply involved in China's trade policy liberalization. From the 1990s until 2003, the central governmental organ responsible for trade – the Ministry of Foreign Trade and Economic Cooperation (MOFTEC)[23] and, especially, its WTO division – took the lead on trade-related issues. In particular, it was responsible for the negotiations with the US government and the WTO Working Party on China's WTO accession agreement, and oversaw early implementation of China's WTO commitments. Yet, as is standard in Chinese policy-making, the ministry-level organ serves less as a policy-maker than as an implementer of decisions made from above. Located between the MOFTEC and the top leadership during the WTO accession negotiations was the WTO Leading Small Group, which played an important role in resolving internal disputes about WTO negotiating positions. At key decision points, the top leaders responsible for trade and, ultimately, the decision to sign a major treaty – the Politburo Standing Committee of the CCP – had to give assent.

Simultaneously, the institutional landscape for trade policy evolved significantly as China was negotiating entry to the WTO. One key change has been the drastically increased number of actors involved in trade. First came the break-up of the monopoly of China's FTCs. Recall that under the pre-reform trade system Chinese firms, or even government bureaus (except for FTCs), were not permitted to directly export or import. Progressively over the course of the 1980s and 1990s, the number of FTCs was expanded, including to the local level, becoming legally independent entities operating with the goal of commercial viability rather than political clout. These FTCs evolved into and subsequently have been made marginal by the further expansion of trading rights, as discussed above, first to large state-owned firms and Sino-foreign joint ventures as well as firms located in China's special economic zones, and then, as of 1998, to private trading companies. Increasingly, then, trade was to become a viable part of China's private sector. By 2001 the number of domestic entities authorized to conduct foreign trade had grown from twelve (all FTCs) to 35,000, mostly firms.[24] The capstone

of this process was the granting of trading rights to all domestic firms within three years of WTO accession. Thus, traded goods were increasingly removed from planning controls and effective government oversight, and the institutional basis for extensive trade by domestic firms had been laid.

Institutional change has also occurred in the form of legalization and codification of rules. China is in an earlier stage than Japan in its "judicialization at the behest of WTO"; despite much progress, China is in the initial stages of promulgation and revision of laws. A comprehensive discussion of the promulgation of laws is not possible in this chapter, as the topic is large and complex. However, it is important to note that, as part of its WTO accession package, China agreed to rewrite a long list of laws and regulations in order to make them WTO compliant, continuing a process that had been ongoing since the beginning of the economic reforms. In the run-up to WTO accession in late 2001, China's legislative, administrative, and legal systems moved ahead in a frenzy on regulatory changes that would make these systems WTO compliant. As if the scope of these legal changes alone were not daunting enough, these rules have to be transmitted downward to the provincial and local levels of government, including to the local judicial and administrative systems in charge of adjudicating disputes.[25]

The pressure from the United States and WTO for reform of China's legal system was aimed, first and foremost, at fostering transparency in China's trade system.[26] This international pressure found domestic support. Chinese economic reformers appeared to agree that clearer rules governing the economy would not only allow for WTO compliance, but also strengthen the market economy and reduce incentives for local protection and corruption. Reformers further became aware of the advantages of using law to protect China's industries against potentially unfair competition from foreign firms, as illustrated by the previously discussed move to strengthen its anti-dumping regime.

The importance of the legal, administrative, and judicial changes to which China has committed should not be underestimated. Rather than merely changing China's trade regime at the point of entry and exit, the rules insert themselves deeply into the way the Chinese conduct government and business affairs internally.

Domestic political foundations of trade liberalization

Any narrative on the domestic politics of China's trade liberalization must be punctuated by recognition of the key role played by top leaders. Thus, the decision in 1978 to "open China to the outside world" was not forced on China, either bilaterally or multilaterally, from outside; rather, it resulted from a leadership decision by Deng Xiaoping and a cohort of reformers. This decision reflected the initiation of what would evolve into a genuine paradigm shift about China's role in the global economy, including political acceptance that China could benefit from the "objective" (not capitalist) laws of comparative advantage and the international division of labor (Pearson 1991: 55–6). The decision in 1986 to seek GATT membership was strongly influenced by then-premier Zhao Ziyang. Moreover, the negotiating position at this time – that tariff reduction, rather than market access, should be the centerpiece of China's entrance protocol – was apparently influenced by Deng Xiaoping.[27] Later, in 1992 Deng Xiaoping's famous "southern tour" gave new life to the economic reform program as a whole, pulling the process out of the post-Tiananmen conservatism that had stalled reforms in many areas. While this injection of life into the reforms was broader than the trade arena, those negotiating China's entry to GATT felt that they were given a strong positive signal to proceed with negotiations.[28] The final push for WTO admission culminated in early 1999 with decisions by both President Jiang Zemin and Premier Zhu Rongji that it was time to close the bilateral negotiations with the United States that were the main stumbling block to accession, and which had dragged out for thirteen years (Pearson 2001: 363–4).[29] Thus, the liberalizing interventions of reformers have been crucial (Yong 2000).

The role of central actors and ideology do not tell the whole story of the politics trade policy, however. As with the institutions concerned, there has been pluralization of the political actors involved. Trade (and investment) liberalization began as a highly centralized process designed to limit the participants to the foreign policy bureaucracy, i.e., those least likely to object to liberalizing plans.[30] By the time of China's WTO accession, however, the number of participants involved in negotiations had expanded to almost unmanageable size and diversity. This pluralization in policy-making participants can be explained both by Chinese policy-making processes and by the nature of trade politics in most trade-oriented regimes. Chinese policy-making is often depicted as operating according to "fragmented authoritarianism," in which a complex matrix of relevant bureaucracies engages in extensive coordination and bargaining to produce relatively consensual policy (Lieberthal and Lampton 1992). This system of domestic bargaining bogged down China's WTO negotiations, and was a key condition for Jiang's and Zhu's intervention in early 1999. Whereas previously foreign trade was relatively isolated from the fragmented authoritarianism that pervaded domestic policy, as the broad domestic implications of GATT (and then WTO) accession became more widely understood in the 1990s more state actors asserted their views.

Concretely, cross-functional development groups – notably the State Development Planning Commission (SDPC) and, especially, the State Economic and [domestic] Trade Commission (SETC) – became involved, as did industrial bureaus and ministries with strong interests in particular areas.[31] Local industries and governments also became more active over time, providing some of the most detailed analyses of the potential impact of WTO accession on their local economies. Simply put, trade politics became more porous to bureaucratic actors, who previously had been largely excluded from the foreign trade policy process. An interesting parallel between politico-institutional roles of the United States and the PRC can be drawn: in both systems trade negotiators spend the lion's share of their time meeting with domestic constituents rather than with their foreign interlocutors.

These interests engaged in a Chinese version of intrastate "lobbying" in order to influence outcomes through the consultations dictated by fragmented authoritarianism, as well as through direct involvement in negotiations. Initially, MOFTEC negotiators felt that broad participation in foreign trade policy would help foster consensus and lessen the danger of non-compliance. As a result, however, meetings at home as well as those involving Chinese negotiating delegations sent to Geneva and Washington became increasingly unwieldy throughout the 1990s, such that trade negotiators began to wish (with futility) that they could limit participation.[32] Moreover, as would not surprise any trade scholar who studies industrialized nations, including Japan, protectionist interests worried about foreign competition became most vocal in China over the course of the 1990s.[33] In this sense, the growing pluralization of Chinese trade politics and the rise of protectionist voices suggest something of a Chinese evolution toward the norm of trade policy-making elsewhere.

Although trade politics has become more porous and pluralization of policy-making has made Chinese trade politics look much like that in other industrialized nations, there are limits to any claim of convergence. The institutional actors in the PRC are overwhelmingly from *within* the state – ministries, bureaus, and state owned enterprises – not the private businesses with whom United States Trade Representative (USTR) officials spend so much of their time. Moreover, despite the rise of plural voices which put negative pressure on negotiators, the deal that was signed with the United States and with the WTO member nations did not, broadly speaking, reflect their pressure. Chinese negotiators did not win special deals for an industry in the way that, for example, European insurers were given special treatment in the EU–China bilateral agreement. To the extent that the PRC argued late in the negotiations for special protections for Chinese agriculture, this was not so much a result of special interest pressure from the Ministry of Agriculture as a position developed at the central level and considered crucial for the state of the whole economy. In short, control over the final deal was asserted from the top at Beijing. While this circumnavigation of the bureaucratic actors may have facilitated the formulation of a final package by breaking the stalemate in negotiations, it also became a factor in bureaucratic intransigence in industry compliance with China's WTO commitments.

Debate over exactly how *much* China should integrate to the global economy was not resolved by the pronouncements of Deng and other reformers or by accession; indeed, arguments over the benefits of economic liberalism versus mercantilism continue today. As expected, moreover, protectionist voices have continued after WTO accession to be stronger than liberalizing ones, for the costs of liberalization are relatively concentrated whereas the benefits are more diffuse. Exporters, especially textiles and apparel manufacturers, and consumers who gained access to cheaper imported products, stand to be the winners in this process. As protectionist walls to imports continue to fall, losers include the manufacturing firms that are unable to weather inevitable layoffs and become more competitive.

The role of international pressure in China's trade liberalization

The greater openness to non-traditional Chinese voices in trade policy-making raises the possibility that international forces also have gained influence. Indeed, the question whether China's opening to the outside world is due primarily to domestic change or to international pressure is often raised. A decisive answer to this question is extremely difficult to ascertain; both internal and external pressures have been evident, and at different times each has appeared to dominate. The discussion in this section attempts to make some sense of the complex dynamic between internal and external pressure as it has interacted with China's trade liberalization.

As discussed above, China's reform leadership made many key decisions affecting trade liberalization internally, for domestic economic reasons, and without coercion from outside. Obviously, then, a great deal of the concrete impetus for change came from within. External pressure, moreover, has been mediated through domestic politics and institutions. Having acknowledged the key role of domestic forces, though, there were key moments at which foreign exigencies took center stage. As a general trend, moreover, international pressure over the specific commitments required for WTO accession grew over time. Once Chinese reformers decided in the late 1970s to make industrialization of the economy the country's first priority (in "The Four Modernizations"), the international context in which they found themselves became crucial.

Indeed, the situation for the post-Mao reformers was markedly different from Mao's effort to build China's economy in the Soviet image and from the time when he changed course (disastrously) in the Great Leap Forward effort to surpass the West. By the late 1970s, these two alternative models of Soviet-style industrialization and self-reliance had been discredited in Chinese eyes. The success of market-oriented Hong Kong was obvious. The "East Asian miracle" model of large industrial conglomerates with strong ties to and support from the state retained relevance for the most strategic sectors of the state-owned economy, but in the wake of the Asian financial crisis was not seen as a viable model for the economy as a whole. Thus, Deng Xiaoping and his cadre of reformers found themselves with no viable alternative model for industrialization but one that involved integration into the world trading system.

It was therefore the desire to gain the perceived benefits of the established global market system and international trade regime, over which they had little meaningful leverage at the time to shape, that gained a foothold in reformers' minds and ultimately pushed them to liberalize. As Chinese reformers came increasingly to believe that China could reap tremendous rewards from international trade, they committed more and more to the system. Nowhere was this clearer than with the textiles and apparel industry, and in the new-found wealth of China's "new" industrial cities in which export-oriented township and village enterprises (TVEs) thrived. The decline of export markets after the Asian financial crisis, and the slowing of the world economy in the late 1990s and early 2000s, suggested how much these sectors and regions had come to depend on overseas

markets. Another form of international pressure – China's desire to be rid of the annual cycle of most favored nation status renewal in the US Congress – was also a strong impetus for WTO membership.

More concretely, key negotiations with foreign governments and international organizations, particularly the US government, punctuated the liberalization process. Once China decided that WTO membership was crucial for its economic development, it had to meet the requirements imposed from outside. Because the requirements for any country's entry to WTO were substantially higher than those for admission to GATT, and because of the perception outside China that too lenient an accession package would be harmful to world trade, foreign pressure increased over the second half of the 1990s. Indeed, the requirements for China's entry were set higher than those for previous WTO entrants. The fact that China often made liberalizing reforms ahead of the deadlines imposed by foreign negotiators, such as the early 2001 tariff reductions that brought tariffs on many goods into WTO compliance even before China's formal accession, has made these changes appear non-coerced. Yet the Chinese government clearly made them with an eye toward meeting externally imposed requirements.

Chinese advocates of WTO membership argued in domestic negotiations (with state-owned firms, provinces, etc.) that domestic economic actors had to change their behavior to meet international requirements. WTO accession therefore came to be seen as a tool for promoting internal changes that China's reformers could not achieve on their own.[34] Ironically, since accession, the loss of Chinese flexibility due to the outside pressure for strict compliance with rules originating from outside China was interpreted by some as reflecting China's international weakness, and as hemming China into doing things in a particular way, and on a restricted timetable.[35] The role of outside pressure in China's trade liberalization fostered a backlash of economic nationalism among many citizens.

Although it is impossible to determine whether international or domestic factors have been more important in shaping China's trade liberalization, it is clear that international context and direct pressure from outside have been extremely influential. In contrast to the pattern of China's economic development in the Maoist era, the post-Mao reformers have subjected themselves to the exigencies of the international market and international economic institutions. Indeed, in the late twentieth century there appeared to them to be no alternative. At the same time, China's opening has the clear imprint of its statist legacy. In this sense, China's version of "late liberalization" fits well the core idea of this volume.

Looking ahead – the impact of Chinese WTO membership on PRC trade politics

China has made a clear and dramatic gambit for trade liberalization. Yet many important issues crucial to the character of China's trade system remain unsettled. This concluding section flags three key issues that will shape the future of China's participation in the international trade regime: the need for deeper institutionalization of China's more open trade regime; the growing domestic sensitivity of trade politics and the problem of compensation of losers; and international frictions.

The pressure for deeper institutionalization

The domestic institutional reforms that the PRC has undertaken as a member of the WTO are related to China's overall effort to build robust, capacious institutions to support the new direction.[36] A key issue in understanding China's formal commitments to WTO is the fact that, even if supported by top leaders, compliance cannot be achieved without such institutionalization. China's agreement to make numerous institutional changes on a short timetable, in many instances three to five years heightens the urgency of this issue. It is unlikely that the depth of institutionalization necessary to achieve compliance can occur at the pace dictated by the agreement.

PRC compliance with the WTO is being watched very closely from outside. However, even more important is the *domestic* need to develop these institutions. Saadia Pekkanen's contribution to this volume illustrates Japan's legal development vis-à-vis WTO membership. Japan in recent years has been keen to leverage WTO rules to its advantage in trade disputes – a process of "legalization." Yet though such leverage attempts undoubtedly will become important to PRC international strategy, China starts at a much more basic level. It is only now building a modern regulatory state with the capacity to manage a complex market-oriented economy. Moreover, at this juncture the pluralization of WTO politics has put pressures on the Chinese state that in many ways work *against* institution-building. Pressure from substate actors tends to be made on protectionist grounds in ways that contravene China's WTO commitments. At this point, the Chinese state must be relied upon as the driving force for liberalization.

Domestic political sensitivity of trade and the pressure for compensation

The economic nationalist debate and evidence of backlash to liberalization suggests the importance of examining the domestic sensitivities to trade integration. Concerns about loss of economic sovereignty are palpable, so much so that those around then-President Jiang Zemin rejected use of the Chinese equivalent of the term "integration" when referring to the process of WTO accession. (This term in Chinese (*ronghe*) implies absorption into the outside world and loss of identity and power. It is the term that has long been applied to China's policy toward domestic ethnic minorities.) Newly active, pluralized, and largely protectionist interests were squelched by the top levels of the Chinese government in order to obtain China's entry into the WTO; despite the remarkable public campaign designed to foster compliance with the WTO, these constituencies have not disappeared. Despite having been stymied in the negotiation phase, they have become ever stronger in the implementation phase. An important question therefore is how these interests become institutionalized, particularly as they move from the state's purview to the private realm. The answer to this question remains open.[37]

Efforts to manage domestic actors newly interested in trade policy – and to pay off or otherwise compensate losers – are made both difficult and politically necessary by the significant costs of WTO integration, particularly in the short to medium term. The major costs are expected to be increased levels of unemployment in some sectors resulting from displacement of domestic industries. Layoffs in SOEs sectors are worrisome. As one public security official from Anhui Province stated, "We need to pay close attention to those companies that may experience a huge [unemployment] impact from our joining the WTO," adding that "troops of domestic security" should prepare for "actual combat" over failing SOEs (Hamrin and Carnes 2002).[38] Unemployment, income gaps, and potential unrest in the agricultural sector and inland regions have been particularly worrisome, for they exacerbate the existing discrimination of the overall reforms. Issues of urban–rural equity topped the agenda of the Hu Jintao government, which came to power in 2003, and it is clear that the government must manage growing public awareness of competition from foreign imports.[39] As these examples make clear, issues of compensation associated with late liberalization therefore feed into extant underlying social problems linked to rapid urbanization and privatization. Whether or not WTO accession in fact makes these problems worse, such a perception may result in the leadership being blamed for harming the country at the behest of foreign interests.

International cooperation/international friction

The domestic tensions enumerated here do not occur in a vacuum, and the manner in which they may be affected by international events, particularly relations with China's trade partners, will be relevant to their outcome. Most salient for the purposes of this volume are China's relations with the United States and Japan, and the prospects for further regional trade integration.

It remains to be seen how circumspect the US government will be about difficulties China is likely to have in meeting its stringent timetables for compliance across a multitude of fronts. In trade, as discussed previously, compliance with many of the tariff and non-tariff commitments was well under way before accession, and most phased-in commitments have been met on time. Yet, inevitably, there have been and will continue to be disputes. By far the most difficult problem concerns the US trade deficit with China, which has grown steadily despite a decline in China's trade surplus with the world as a whole.[40] Rather than being reduced by China's entry to the WTO, China's increased ability to export textiles and apparel to the United States, its projected absorption of key export markets from other Asian regions, and its overall export strength in sectors of strong US consumption have resulted in an increase in the bilateral deficit over the past several years. Indeed, the deficit exceeded US$150 billion in 2004.[41] The deficit issue has been played out in two ways. As part of the bilateral agreement on WTO accession the US government negotiated strongly protectionist measures that permit trade actions against China under much more flexible criteria than is the norm in the WTO: product-specific safeguards and special textile safeguards

(Lardy 2001: 15–18).[42] Moreover, despite the granting of PNTR status to the PRC by the US government in 1999, the function of having a platform to monitor Chinese behavior that had been served by annual NTR renewal was simply shifted to other organizations.[43] Exactly how judicious US political actors choose to be in employing these tools remains to be seen. Evidence from the first four years after accession does not lead to optimism about a smooth relationship, as outsourcing to China and the overvalued Chinese currency were increasingly targeted by US politicians as the source of many economic problems in the United States.

China's trade relations with Japan are also poised to be tense, as worries are growing in Japan about competition from China, including a first-time trade deficit with China (including Hong Kong) (Brooke 2001).[44] As Japan's economic sluggishness drags on and Japanese manufacturers shift production to the mainland, many Japanese officials have worried that the high-wage Japanese economy will be suffocated by China's lower-wage dynamo. Moreover, Japan's highly protected farmers have blanched at low-cost imports from China in several areas. Given Japan's turn to legalization to resolve disputes, WTO dispute mechanisms are likely to be given wider berth to resolve bilateral disputes. At the same time, however, China has passed the United States as Japan's largest trading partner, suggesting a deepening interdependence and need for attention by both governments to its implications (Blustein 2005).

Conclusion

China's process of late liberalization clearly will continue to be affected by the international context of the early twenty-first century, not only by bilateral and regional interactions, but also by evolution of global norms of trade management and the niche it takes in the global economy. More than in Japan, however, the state will continue to dominate China's process of liberalization, and perhaps be the crucial driver of liberalization against more protectionist domestic interests. This interplay between the winners from liberalization, with elements of the reformist state as their champion, and the losers and their champions – many of whom are also located in the purview of the state – will be the crucial dynamic affecting China's ongoing commitment to liberalization of trade.

Notes

1 The reference point for "late development" is Gerschenkron (1962: 5–30).
2 Despite this trade growth, China still accounted for less than 5 percent of world trade in 2002 ("On a Roll," Economist Global Agenda, June 27, 2003; at http://www.economist.com/agenda/.cfm?Story_ID=1872018). China's share of world trade was projected to reach 10 percent by 2020 (World Bank 1997b: 31).
3 From 2003 to 2004 overall trade grew by 35.7 percent. However, over the period 2002–04, China's total trade grew by more than 200 percent, whereas global trade overall was up 40 percent (Blustein 2005).
4 China's post-accession share of world export markets is estimated by Ianchovichina and Martin (2001, Table 6) to rise from 3.7 percent in 1995 to 6.7 percent in 2005.

5 On the 1979 figure, see Suh and Seo (2000). The 2004 figure is from World Bank (2004).
6 On Japan's trade liberalization up to the mid-1980s, see Komiya and Itoh (1988). Japan was routinely discriminated against by other GATT signatories throughout the post-accession period, as Japan's major trade partners refused to offer Japan GATT privileges.
7 Although China's "opening to the outside world" began in the late 1970s, the composition of exports until the mid-1980s continued to reflect the mid-1970s policy of exporting capital-intensive crude oil and refined petroleum products to pay for imports, despite a growing domestic energy shortage.
8 Quasi-private township and village enterprises (TVEs), which were the institutional drivers of exports, depended upon cheap labor from rural families as well as state policy and entrepreneur officials that fostered them. On TVEs, see Oi (1999).
9 China unsuccessfully attempted to join the GATT before that institution segued into the WTO on January 1, 1995 (Pearson 1999). All countries entering the WTO face stricter standards in terms of tariff levels and their binding nature (Lardy 2002: Ch. 3).
10 The average is cited in Lardy (2002: 180, fn. 43).
11 One effect of China's WTO compliance should be to lower internal protectionist barriers, which create disincentives for *domestic* producers to engage in trade. On how domestic protectionism affects trade patterns, see Naughton (2000).
12 Ianchovichina and Martin (2001: 16) anticipated that benefits to China from WTO accession would "occur mainly as a result of its own liberalization over the course of 6 years starting in 1995. Tariff reform after 2001 will lead to relatively small gains . . . since the welfare effects of tariff cuts from a given tariff reduction starting from a high initial level [sic] is much larger than the benefits from subsequent cuts in already lowered tariffs."
13 This pre-reform trade system contained exchange rate distortions, i.e., the overvaluation of the renminbi, which suppressed the incentive to export and gave false incentives to import. Moreover, export manufacturers did not receive any foreign exchange income, while imports tended to be sold at the inflated domestic price, further dampening their incentive to produce for export. FTCs created an airlock between domestic producers and the foreign market, further distorting incentives (see Lardy 2002: 29–31).
14 On tariff rates and reductions up to 2001, see Ianchovichina and Martin (2001: 5). Figures for 2004 are from US–China Business Council (2005). Excluded from the 2004 rate are certain agricultural goods, natural resources, and products under quota or license management. The dispersion of tariffs around the average fell from 32.1 percent in 1992 to 10 percent in 2001, however, signifying an overall reduction in protection across multiple industries. Lardy (2002: 37) argues that in the first half of 2000, i.e., even prior to WTO accession, less than 40 percent of imports were in practice subject to any tariff.
15 The figure for products subject to export restrictions excludes textiles and apparel, for which export quotas were externally imposed via the Multifiber Arrangement (MFA) and therefore were not an instrument of domestic protectionism. For more on the MFA, see below.
16 For example, the average tariff on manufactures was reduced to 8.9 percent by 2005, well below the rates of 32 percent for India and nearly 37 percent for Indonesia.
17 Further enhancing the possibility that China will increase its imports (the TRQ system does not compel a country to import the full amount that is guaranteed a lower rate), China agreed to US demands that part of its import quota for each commodity be allocated to private traders, who arguably will be more responsive to lower import prices. This strategy was in large part a reaction to experience with Japan, which has directed state trading monopolies to raise domestic prices rather than importing.

18 This rate of 8.5 percent falls below the "developing country" rate of 10 percent (see Ianchovichina and Martin 2001: 9; Lardy 2002: 91–3).
19 On continued foreign dissatisfaction, particularly with the administration of the TRQ system, see US–China Business Council (2005).
20 Other models are less optimistic, predicting a rise of only 6–10 percent by 2005–06. See US International Trade Commission (1999: 8–24).
21 On the 1997 law, see Lardy (2002: 57–8). On the 2002 law (promulgated October 31, 2001), see "China Introduces Anti-Dumping Law," *Xinhua*, December 10, 2001; at www.cnd.org/Global/01/12/10/011210–91.html.
22 Various PRC government agencies have developed Chinese firms' capacity to defend against anti-dumping actions, reflecting the fact that, worldwide, China is the most frequent target of anti-dumping charges (see O'Neill 2001: Kennedy 2005).
23 A new Ministry of Commerce was established in March 2003 and immediately absorbed the functions of the now-defunct MOFTEC.
24 As of 2000, one thousand of these were private enterprises (Lardy 2002: 40–2 and Table 2-3).
25 On legal changes, see "China Submits Working Documents to WTO," *Xinhua*, October 31, 2000 (in FBIS-CHI-2000-0322); "WTO Entry to Challenge China's Administration System," *Xinhua* December 29, 2001 (at www.cnd.org/Global/01/12/30/011230–92.html); "China Adjusts Trade Laws for Final WTO Entry," *People's Daily* (English edition), November 29, 2001 (at http://english.peopledaily.com.cn/200111/29/eng20011129_85604.html); and Shao (2002).
26 This goal is reflected in the statements of US Trade Representative (Zoellick 2002).
27 On Zhao's role, see Feng (1992: 219–21). On the centrality of tariff reduction, see Jacobson and Oksenberg (1991: 100–1).
28 Interview with MOFTEC trade negotiator, February 15, 2002, Washington, DC.
29 Strong influence over WTO negotiations was also exercised by the top leaders in the foreign economic relations arena, Li Lanqing and Wu Yi.
30 On the narrow scope of political actors early in the reforms, see Shirk (1994).
31 In 2003, the SDPC was renamed the National Reform and Development Commission (NRDC), and the SETC was absorbed into three other ministries.
32 On intrabureaucratic involvement, see Pearson (2001: 351–2).
33 On domestic actors' strategies in the case of Japan, see Schoppa (1997) and, for the United States, Destler (1995).
34 For example, Chinese reformers favored tariff reductions for putting competitive pressure on domestic enterprises and reducing revenues lost to smuggling.
35 Interview with MOFTEC trade negotiator, February 15, 2002, College Park, MD, USA.
36 An optimistic view of these institutional developments is D. Yang (2004).
37 Scott Kennedy (2005) sees growing influence of these lobbying efforts.
38 Solinger (2001a) traces the areas where unemployment is likely to be exacerbated in potentially destabilizing ways.
39 State Council Document #1 of 2005 addresses the rural–urban equity gap as a top priority, and, in particular, discusses the need to help Chinese farmers adjust to pressures from foreign imports ("Closing Farm–Urban Income Gap 'Top' Goal," *China Daily*, February 1, 2005; at http://news.xinhuanet.com/english/2005–02/01/content_2533283.htm). See also Rosen *et al.* (2004).
40 China's trade surplus fell in 2003, as import growth exceeded export growth. (This was in part a result of the SARS crisis.)
41 The rise in the Sino-US bilateral deficit was forecasted to be offset to a degree by a decrease in US imports from other Asian countries, as production of labor-intensive goods shifts into China.
42 As an example of how closely these international and domestic issues are linked, it is growth in the Chinese textile and apparel industries that is likely to absorb the most workers in the near term, helping to offset increased unemployment in other sectors.

43 Funds to monitor China's compliance with WTO have gone to the US Congress (in the form of the US–China Security Review Commission) and the departments of Agriculture, Commerce, and State, and the Office of the US Trade Representative (Lardy 2002: 162–3).
44 Japan has long had a deficit with China *excluding* Hong Kong, but this was made up for by Japan's huge historical surplus with Hong Kong.