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ASIA PROGRAM

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China Enters the WTO: The Death Knell for State-Owned Enterprises?

ABSTRACT: This Special Report containing two essays explores the implications of China's WTO membership for that country's economic development and social stability. Dorothy J. Solinger of the University of California at Irvine highlights the negative impact of China's WTO membership on the country's rampant unemployment. Lawrence C. Reardon of the University of New Hampshire argues that reformist elites in China consciously use WTO accession as a catalyst to marketization. Mark A. Groombridge of the U.S. Department of State, who offered commentary on these two essays when they were first presented, asserted that China has no choice but to integrate itself into the world economy. This Special Report stresses both the huge opportunities and the dangerous repercussions that Chinese SOEs face in the wake of China's entry into the WTO.

Introduction

Gang Lin

Beijing perceives China's entry into the World Trade Organization (WTO) as both a great opportunity for accelerating economic reform and a threat to China's industrial structure and financial security. China's state-owned enterprises (SOEs) have continued to shrink, with several million workers being laid off each year. Meanwhile, the urban private sector has increased its number of employees dramatically. Swift economic growth has turned China into one of the world's largest economies and sharply raised the per capita income of the average Chinese. The benefits of growth, however, have not been evenly spread over the country, and there is an increasing economic gap between the eastern coastal areas and the western hinterlands.

Chinese reformers hope that, with China's entry into the WTO, intensive international competition will accelerate reforms of the country's money-losing SOEs and create new industries and jobs. Although China's service industries—from banking and insurance to the Internet—and capital-intensive sectors are gen-

erally ill-prepared to compete on the world stage, Beijing believes China will move substantially toward enlarging its comparative advantage by developing its labor-intensive sectors as well as new technology industries. It is unclear, however, to what degree the benefits for certain industries will offset bankruptcies and layoffs in other industries. Will China's WTO membership finally solve the problem of its inefficient SOEs, or strike the death knell for these terminally ill ventures? How does Beijing evaluate the benefits and costs of its membership in the WTO? How will Beijing tackle the issue of increasing urban unemployment in the wake of its admission to the WTO?

To answer these and related questions, the Woodrow Wilson Center's Asia Program convened a panel of experts to look at "State-Owned Enterprises under Siege." This panel constituted one part of a conference titled "China Joins the WTO: Domestic Challenges and International Pressures," which met at the Wilson Center on December 12, 2001, and was co-hosted by three of the Center's programs (the Asia Program, the Environmental Change and Security Project, and the Project on America and the Global Economy). This special

Gang Lin is program associate in the Woodrow Wilson Center's Asia Program.



report, containing two of the essays for the panel on state enterprises, focuses on the implications of China's WTO membership for that country's economic development and social stability.

In the first essay, **Dorothy J. Solinger** of the University of California at Irvine highlights the negative impact of China's WTO membership on the country's rampant unemployment. According to Solinger, the rosy picture drawn by WTO proponents of a "win-win" deal between Washington and Beijing turns bleak when one considers the plight of the 45-60 million former state-employed workers who have been left with few economic opportunities. Solinger challenges five optimistic assertions about China's entry into the WTO:

- More jobs will be gained than lost.
- The pain will be short term, and the problems will all be solved in the longer term.
- Chinese consumers will benefit from more choice and cheaper foreign goods.
- Export-oriented sectors of the economy, such as textiles, will benefit.
- The tertiary sector and private enterprises will provide places for the unemployed.

Solinger observes that Beijing's several efforts to help the unemployed have yet to bear much fruit. Started in 1995, the national government's Reemployment Project has targeted only a fraction of the unemployed. With entry into the WTO and heightened international competition, millions of better-placed citizens will rise to the challenges of a more open and exposed market economy. However,

millions of less fortunate workers will sink into obscurity.

Woodrow Wilson Center/George Washington University Fellow **Lawrence C. Reardon** of the University of New Hampshire agrees with Solinger that China's WTO accession will force the closure of many SOEs, thus ruining the livelihood of millions of workers. It is precisely these dangerous "transaction costs," however, that are most valued by Chinese elites promoting a long-term modernization agenda. Stymied over the past several years by conservative elites, state bureaucracies, and regional interest groups, reformist leaders hope to use the economic crisis created by international competition to merge, privatize, and close China's 75,000 inefficient SOEs. According to Reardon, China was not forced into the WTO by some unseen hand of globalization. Rather, reformist elites consciously decided to give up a degree of national sovereignty, hoping to exert global economic power and to double the country's economy to \$2 trillion within ten years. Still, reformist elites face obvious dangers in using WTO accession as a catalyst to marketization. It is unclear whether the non-coastal Chinese economy will be able to absorb the onslaught of foreign competition, especially after direct and non-direct aids to SOEs are phased out.

In commentary delivered during the panel, **Mark A. Groombridge** of the U.S. Department of State argued that China has no choice but to integrate itself into the world economy. According to Groombridge, both China's inefficient SOEs and the resulting unemployment problem are the legacy of the Mao era's command economy. Despite severe social disparity and dislocation, the Chinese population's living standard has improved in general, thanks to the economic reforms of the past two decades.

This special report stresses both the huge opportunities and the dangerous repercussions that Chinese SOEs face in the wake of China's entry into the WTO. As Reardon put it, Beijing is gambling on international competition as the death knell of the command economy, and that this outside challenge will change China for the better. China's future development hinges upon whether Beijing can appropriately reconcile the tension between economic efficiency and social stability, an old theme within the new context of China's economic transition.

THE ASIA PROGRAM

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Asia Program Staff:

Robert M. Hathaway, Director
Gang Lin, Program Associate
Amy McCreedy, Program Associate
Wilson Lee, Program Assistant
Timothy R. Hildebrandt, Program Assistant



WTO and China's Workers

DOROTHY J. SOLINGER

On December 11, 2001, China formally joined the World Trade Organization (WTO), a cause for rejoicing for the Chinese—and for us as well, we have been told. Indeed, ever since the United States and the People's Republic signed their bilateral agreement in November 1999, the public expectation in both nations has been almost nothing but positive, with much of the informed population in both places quite satisfied. It appears China is set to become much more modern and prosperous, American products will be able to enter China free of most of the barriers set up against them in the past, and American investors will no longer have to suffer discriminatory restrictions and requirements once they receive national treatment in sales, purchasing, distribution, and transportation. The news media—especially when quoting the negotiators on both sides—have told us repeatedly that the two sides achieved a “win-win” deal.

But this rosy picture turns bleak when one considers the plight of the former state-employed workforce. Beginning in the mid-1990s the Chinese government has enforced a policy of cutting back the workforce in a chase after efficiency. In addition, as an unemployed informant told me, “A lot of factories have gone bankrupt because people prefer foreign-made electronics.” So I would argue that the win-win scenario can be supported only if a large portion of the 45 to 60 million laborers who have already been “laid-off” in the past half decade or so, along with the millions more to follow, are simply discounted altogether.

With the dependents of those already unemployed, amounting to about 100 million or so, this could mean that somewhere between a sixth to a fourth of the urban workforce and over a third of the urban population are being ignored when making the positive assessments. These once formal workers are overwhelmingly over age 35, unskilled, and, because they came of age during the Cultural

Revolution and so were deprived of an education past junior high, have a low cultural level. Moreover, even of those still nominally at work, some 70 percent have been said to be owed wages, pensions, and compensation for medical expenses, as their firms sink deeply into debt. With WTO entry and the heightened international competition it brings, many firms will just disappear.

With new international competition, plus the structural adjustments, deindustrialization, and economic system transition, the numbers of adversely affected people are sure to mount. Morgan Stanley has predicted that as many as 40 millions are apt to be thrown out of work within the first five years of China's entry into the WTO (of whom 10 million could be former peasants). If, as some projections from within China hold, the WTO connection may bring about one half percentage point of gross domestic product growth per year, about 350,000 jobs could be created per annum—providing the economy can continue to churn out new positions at the same rate that it did in the early 1990s, when one percentage point of economic growth could produce 600,000 jobs. Alternatively, some have claimed that there could be a growth of 500,000 new jobs in labor-intensive exports per year, or five million in 10 years.

Thus, if these reckonings are right, while 40 million jobs are to be lost, only 1.75 to 2.5 million would be added in the first five years. Granted, projections do vary, ranging from estimates of gains of a mere 10,000 to as many as 12 million jobs per year, to an appraisal that there could instead be a net decrease amounting to a quarter of the present jobs. Some have also calculated that entry into the WTO could drive economic growth up an additional three percentage points a year, provided that China's exports remain high. But this estimate preceded September 11 and its impact; whereas exports grew 23 percent in 2000, a recent figure for 2001 is a growth of only 14 percent. Overall, entering the

WTO will definitely negatively affect China's agriculture and manufacturing, the sectors heretofore housing some 80 percent of the labor force.

In the remainder of this essay, I would like to address a number of exaggerations—or might I say myths?—that have informed the popular discourse on the US-China trade deal, explaining why they are unlikely to be borne out. I will also note the ways in which the Beijing government expects to cope with what it surely knows to be the realities behind these tales, and the obstacles confronting these solutions. And finally, I will suggest the potential fallout that could come with the failure of these initiatives.

FIVE MYTHS BEHIND THE WIN-WIN STORY

Number One: "More jobs will be gained than lost."

According to China's Ministry of Labor and Social Security, labor supply is, even at present, greater than demand in the cities by more than 30 percent. True, there will surely be many new jobs created after China enters the WTO. Trade growth, industrial adjustment, and upgrading will lead to new employment posts, as will new foreign investment.

As trade barriers fall and as foreign firms find it much more convenient to invest in China, however, they—as domestic firms in China already are—will be prone either to hire young, well educated workers, for their skills, good health, and general know-how and energy; or else to engage peasant migrants, for their willingness to serve as drudges for very low wages. So those getting new jobs—whether in banking, insurance, telecommunications, and hi-tech or else in assembly-line plants—will not be the workers who have lost their posts.

Number Two: "The pain will be short term, and the problems will all be solved in the longer term."

This statement can only be accurate from the macro and aggregate perspective of the economy as a whole. If we consider the fate of the laid-off workforce, the prognosis is certainly poor not just in the near future, but over the longterm too. As a trade union official told me, "It's very hard to get employers to hire people over age 35." Though Chinese journal articles have charged that the furloughed

refuse to find work and are waiting for posts in state firms to be restored, in fact a multitude of impediments face the hardy ones who do make the effort to find their own jobs. Despite governmental programs to retrain them, find them work, and supply them with living allowances while they wait, state preferential policies frequently fall flat when bureaucrats can benefit from ignoring them.

Recent investigations in China demonstrate that less than 20 percent of the discharged workers, for whatever reason, have not received any job training; that the reemployment rate for the laid-off has dropped from 50 percent a few years ago to just 16 percent in the past year; and that the average per capita income of the furloughed is now about half the national urban average. At the same time, only 21 million—certainly less than half of the officially designated furloughed, not to mention millions of others whose firms have crashed that the regime does not count—had been allowed to register for governmental reemployment programs as of the end of 2000. Meanwhile, a mere 23 percent of the 14 million urbanites across China who are living below the poverty line (mainly because of job loss) are getting the poverty relief designed for them. Those attempting to start a small business venture typically find themselves denied bank credit and harassed by petty officials.

Even as early as mid-1998 an academic survey done in China showed that half of those laid-off had been so for over a year, a sixth for more than three years. As an official magazine noted, these people are destined to compose a "longterm, unstable mass;" a researcher in the Chinese Academy of Social Sciences recently reported that, they will "just be excluded and drift downward."

Number Three: "Chinese consumers will benefit from more choice and cheaper foreign goods."

The rising middle class and of course the wealthy will obviously reap these benefits. But for the laid-off and the soon-to-be-laid off, this one can be quickly dispensed with in the savvy speech of two of my interviewees who had been thrown out of work. According to one of them, a woman forced to retire in her early forties, "If cars are cheap, so what. We can't afford it. As for color TV's, we already have one." Asked about her view of the WTO, she



replied: "It won't be good for us. We don't understand it too well. We can't see any good points for us ordinary people. The unemployed will be even more. We're pretty apathetic about this. We just don't care." The other, a man of 35 years, quipped, "The WTO is good for the rich. It's not all commodities that are going to get cheaper, just high-class stuff like cars. We can't afford those things." He went on to muse, "People like us doing bitter labor will just increase; for us ordinary folk, us poor people, the WTO doesn't have any good points. What it's all about, we don't much understand."

Number Four: "Export-oriented sectors, such as textiles, will benefit."

It is accurate to divide industrial sectors into winners and losers—up to a point. Yes, it is true that labor-intensive export industries, such as toys, clothing, shoes, and textiles, should find more open markets abroad with time. But this does not necessarily translate into opportunities for those who have been and will be dismissed from the outmoded plants—the hundreds of thousands of former steel, machinery, automobile, pharmaceutical and chemical industry workers. On top of layoffs that have already occurred and been noted by Chinese analysts are over 100 automobile factories that "can't go on" now that China has entered the trade organization.

Even among textile workers, supposedly members of a winning sector, millions of mill hands have already been let go with the intentional destruction of over nine million out-of-date spindles as of the end of 1999; in one major industrial inland city, Wuhan, of the more than 100 state-owned textile firms that existed in the 1980s, not one remains today. In their place are some joint ventures, whose owners, after investing, demanded the release of large numbers of former employees; others have simply collapsed, unable to bear up under competitive pressures. Except for a few major bases along the eastern coast, much of the textile technology in China is obsolete, the equipment decades old, the varieties too plain and unmarketable, and the mill workers too undereducated to suit the demands of modern industry. And, according to an essay by a top trade union researcher, export processing in general by now is limited by market saturation, the intensification of competition, and the entry of labor-saving technology.

Number Five: "The tertiary (service) sector and privately-owned enterprises will provide places for the unemployed."

Governmental accounts routinely underline that under a third of the positions in the labor market are currently ones in the service economy and, thus, that expansion potential here is vast. Unfortunately, official commentaries generally conflate two distinct components of the service sector, the large-scale and small-scale sectors. True enough, there is or soon will be demand for large service industries such as insurance and banking. But there is really no market left in small business to which unskilled labor can appeal. I graphically illustrate this point in my observation below:

Along the streets of Chinese inland cities these days, the service sector, starved nearly to death until the early 1980s, seems full of life, packed with business. You can get your shoes shined for two *yuan* (25 cents) by three different peddlers on just one block, buy the same pair of nylons for ten *yuan* five or six times or the same ballpoint pen for two or three *yuan* in the same lane. Or you can choose any one of ten pedicabs to deliver you as far as a couple of miles away, for as little as a piddling three to five *yuan*.

Indeed, this emerging market lacks true demand-driven economic activity, at least insofar as the work done by the furloughed is concerned. This is because, given the immense proportions of the official program of enforced dismissals, plus the unspecialized nature of the labor the affected workers have to offer, there simply cannot be demand sufficient to absorb the millions made redundant, now struggling to find takers for their wares and their services.

BEIJING'S STRATEGIES TO STANCH THE DRAIN

By now, over four years have passed since the Communist Party first announced explicitly at a major convocation in the fall of 1997 that firms would have to "reduce the workforce and increase efficiency." Unfortunately for the victims, the Party's several efforts to help the discarded have yet to bear much fruit.

These include a Reemployment Project begun in 1995 that targeted only a fraction of the dismissed, in its narrow designation of who deserved to be its beneficiaries: in practice, it only served the employ-



ees of the better off, state-owned firms, for the most part ones that are still in existence. For a variety of reasons, the main one being insufficient funding, workers from the more than half of state enterprises losing money; from the untold numbers of plants that have just disappeared, whether due to buyouts, mergers, or effective bankruptcy; and from factories that formally went bankrupt, are ineligible for the Reemployment Project.

The regime has also essayed to install a social security system, but its difficulties are legion. Unemployment insurance, only established some 15 years ago, has no accumulation to speak of. Pooling even at the city level is hindered as firms doing well eschew contributing while failing ones cannot afford to put in their share. Bureaucratic misappropriation and outright official corruption eat away at what monies are provided. An internal report disclosed that as of the end of 1999, 73 percent of households where the head was employed were not participating in the program, and only 18 percent said they were. In four major cities, just 11 percent were participating, while among the out-of-work, merely 2.9 percent were part of the program. Of those laboring in the private sector, a scant four percent of the employees had been entered into the system at that time.

Thirdly, a principal thrust in the past two years—urging the laid-off to perform community service—is also floundering. Of about two million temporary posts in this sector uncovered in a recent four-city sample survey, for instance, more than half remain unfilled. Among the reasons given in an official journal are lack of training, absence of intermediaries to connect potential job holders with employers, preferential policies not made good, and a disinclination among the furloughed to do such petty labor as minding the sick, chaperoning children home from school, or sweeping the streets.

PROJECTED POTENTIAL FALLOUT

What I have sketched above is really past history and current realities, not a story of the future, which is, of course, yet to unfold. But surveying the data, it is

most difficult not to conclude that dangers lie ahead, both for those already marginalized, and, most likely, for many more like them. How, as a mass, they will react, is anyone's guess. Whether from a spirit of throwing themselves into the glory of an imagined future of plenty once China has become fully modern and prosperous, or else just from the lack of any alternative to forging their livelihood through their own mettle, a number of my informants in 1999 displayed admirable pluck, as their words reveal:

- If you don't fear fatigue and bitterness, you can find something to do; if you've no income, you can't be choosy;
- (On being asked about a suicide case) It was his own character. A lot of people are laid off. They can't all commit suicide!
- Even though there's a lot of people laid off in Wuhan, you can still find something to do...if you still have two hands.

Also belying journalistic charges against their adaptability, in a 1997 survey of laid-off workers, 55 percent expressed a willingness to become just an ordinary worker, service or sales person, and another 35 percent professed that they were prepared to do any kind of work, no matter how dirty or tiring, if only it would enable them to meet their own basic expenses.

But there is also a much darker side to the years ahead. One account in an internal publication revealed that in the year 2000, some 30,000 protest demonstrations broke out, many about issues of job loss and unpaid wages and pensions. In another variant, as one of my informants so frankly expressed it, "People would rather be criminals than starve to death. They'll use all kinds of ways to survive."

Which one of these prospects will come to predominate as China turns more fully to the global economy is yet to be known. But we can expect for certain that while millions of better-placed citizens rise to the challenge, more people will sink into obscurity—their working lives cut short, their potential undeveloped, and their ability to purchase products offered up by the world market completely lost.



The Death Knell of China's Command Economy?: The WTO and China's State-Owned Enterprises

LAWRENCE C. REARDON

THE DOMESTIC IMPACT OF WTO ACCESSION

After 15 years of arduous negotiations, the People's Republic of China (PRC) has finally been admitted to the last bastion of global economic management—the World Trade Organization (WTO). While China undoubtedly will use its growing economic power to effect changes in the WTO, the WTO will also have profound effects upon its 143rd member. Willingly or unwillingly, PRC elites must adhere to international norms of foreign trade behavior, which will accelerate China's transformation into an outward oriented, market economy.

However, China was not forced into the WTO by some unseen hand of globalization. PRC elites have consciously decided to give up a degree of national sovereignty in order to exert global economic power and to double the country's economy to \$2 trillion within 10 years. WTO membership has its privileges. PRC elites hope to realize China's comparative advantages in labor and land, and thus continue along the Asian path of development. By eliminating many global protectionist barriers, such as the multilateral fiber arrangement, WTO membership will increase Chinese foreign trade. Freed from the annual U.S. congressional battle over normal trade relations, foreign investors will continue to flood the Chinese domestic market. Chinese elites hope this increase in foreign trade and foreign direct investment will act as engines of growth to accelerate domestic growth. Chinese elites also realize the costs of WTO membership. Bureaucratic fiat must give way to a transparent legal system, which is consistently applied and does not discriminate against foreigners. With the reduction or elimination of tariff and non-tariff barriers and other protectionist barriers, Chinese industrial, agricultural, financial and service sectors will be thrust into a very competitive global marketplace. The Darwinian effects will force the closure of many state-owned enter-

prises (SOEs), thus ruining the livelihood of millions of workers and intensifying social unrest.

Yet it is precisely these dangerous "transaction costs" that are perhaps most valued by reformers promoting a long-term modernization agenda. Stymied by conservative elites, bureaucracies and regional interest groups over the past several years, reformist leaders, such as Premier Zhu Rongji, hope to use the economic crisis created by international competition to merge, privatize or close China's 75,000 state-owned enterprises. While retaining control over enterprises that are related to national security and the state's ability to guide development, China's reformist elites hope to fully marketize the economy. In essence, international competition will enable changes that the current leadership is unable to realize.

However, there are risks.

EXOGENOUS CRISIS AS A CATALYST FOR MARKETIZATION

Over the past two decades, Chinese elites have used the international economy to transform the country's moribund, inwardly-oriented command economy by partially integrating certain geographical areas and economic sectors into the international economy. The "opening" strategy of the early 1980s confined international market influences to the experimental special economic zones. Within the zonal laboratories, the Communist Party experimented with private entrepreneurship, western management techniques and foreign direct investment. The qualified success of the initial experiment brought about the systematic opening of the coastal and central regions, which were partially incorporated into the global economy. The "Go West" strategy of the 1990s was designed to jump-start growth in the far Western interior, so it could compete with both the coastal/central areas and the international

economy. These controlled experiments to realize a modernized, market-style economy resulted in two decades of spectacular growth rates and improvements in the standard of living unprecedented in the PRC's economic history. According to Wu Yi, state councilor and former minister for Foreign Trade and Economic Cooperation (MOFTEC), China had initiated a limited, policy-guided opening in which Beijing controlled (or more appropriately stated, attempted to control) the domestic and international market influences.

Yet after two decades, the greatest obstacle to eliminating the last vestiges of China's command economy has been SOEs, which now produce less than 30 percent of China's total industrial output, yet employ more than 40 percent of its workforce. Zhu Rongji's recent reform initiatives have resulted in a limited rationalization of industries, such as Shanghai's textiles sector, resulting in 35 million layoffs and the transfer of US \$169 billion dollars of non-performing loans (NPLs) to four asset management corporations. In 2000, Shanghai, Shenzhen, Hong Kong and New York stock markets sold \$20 billion of SOE shares, which have been forced through the initial public offering (IPO) process to become better managed and more competitive. Reportedly, a new generation of entrepreneurial managers are also helping to transform SOEs into more efficient, profit-oriented enterprises.

Unfortunately, since April 2000 SOE profits have continued to decrease by five percent each month; the Chinese National Bureau of Statistics estimated that 43 percent of SOEs would operate in the red in 2001 with a loss of \$70 billion. Conservative elites, bureaucracies and regional interest groups have effectively blocked further attempts to close bankrupt SOEs, restructure industrial enterprises, and further separate government ministries from financial organs and production enterprises. As many of the major state-owned and commercial banks are considering offering equity shares, they can no longer afford to provide financial lifelines to SOEs. Officially, 30 percent of total state-owned bank assets are non-performing loans (non-official estimates range up to 50 percent), most of which come from SOEs. While the Party now welcomes the new capitalists as members, private firms continue to suffer discrimination from the government, state banks and enterprises. Hidden behind Potemkin—like

high growth rates of seven to eight percent, China's industrial, financial and service sectors are suffering from deep structural problems. To break through this policy impasse and effect profound structural change, Zhu Rongji and Jiang Zemin are relying on an exogenously-caused crisis—WTO accession.

Elites in the developed and developing worlds have used crisis to overcome domestic opposition to implement dramatic policy changes that could fundamentally transform the basic direction of the state. Leaders oftentimes must react to exogenously-caused crisis. The Bush administration rightly or wrongly has used the September 11 incident to justify military tribunals, interfere with lawyer-client privileges, and justify "fast-track" authority to negotiate the upcoming WTO trade round. In other instances, leaders can intentionally initiate exogenously-caused crisis or create a perception of it to bring about major policy changes. Countering Zhou Enlai's Four Modernizations development strategy that was based on import substitution, Mao Zedong in 1964 invoked the Soviet and American military threats to justify an inward oriented, wartime economy (i.e., the Third Front). Lin Biao allegedly instigated the Sino-Soviet clashes in March 1969 to consolidate his position as Mao's successor at the 9th Party Congress. While Beijing reformers in early 1986 discussed the appropriateness of Marxist-Leninism and a "socialist" market economy, Premier Zhao Ziyang approved China's application to rejoin the GATT (i.e., the WTO), possibly as an exogenous variable to accelerate domestic market-based reforms. Thus, there is precedence to argue that the Chinese leadership has used exogenously-caused crisis to realize domestic policy objectives.

MERGERS, PRIVATIZATION AND CLOSURES

During the summer 2001 Party meeting at Beidaihe, Zhu Rongji reportedly argued that SOEs would best compete in the new WTO environment if they focused productive forces into fewer, nationwide production conglomerates. SOEs should also accelerate privatization by offering more IPOs, thus further separating enterprises and state bureaucracies, and promoting dramatic managerial reforms. Because of its sensitive nature and continued legal problems, bankruptcy appears to be the least favored method.



Larger conglomerates potentially can greatly rationalize production in certain economic sectors. By 2006, the WTO will have obligated China to reduce automobile tariffs from 80-100 percent to 25 percent, while tariffs for automobile parts will be reduced to 10 percent. High tariff barriers have allowed China to develop its own automobile industry, which in the past twenty years has ballooned to over 136 state-owned automakers nationwide. High tariffs also have encouraged foreign investment such as VW's Santana and more recently the GM operations in Shanghai. However, just as like other maturing "infant industries" in the global economy, Chinese automobiles are produced inefficiently at a high cost to the consumer. According to the Ministry of Labor and Social Security, increased competition from foreign automakers after 2006 will reduce the number of domestic producers to 40, resulting in the unemployment of 500,000 workers. Although such dislocation will endanger social stability, reformers argue that an even greater concentration of production into four or five nationwide automobile conglomerates is necessary to counter foreign competition. If these conglomerates follow the Asian example of learning to satisfy domestic consumers' demand and to produce world-class automobiles at lower prices, Chinese producers eventually could expand into the global marketplace.

Consumer electronics is another sector in which China could compete internationally if it is to focus manufacturing in several larger conglomerates. Because of domestic demand and enthusiastic local governments willing to provide financial support, China currently has 20 major television brands, 60 manufacturers and hundreds of assembly lines. Because of a five-year price war, Chinese manufacturers produce televisions far below international prices, and even below actual production cost. In 2000, China produced 40 million televisions, of which 20 million were sold domestically and 10 million were exported. Manufacturers were left with 10 million unsold sets in their warehouses, for which they were still obligated to pay foreign proprietary knowledge fees. While foreign multinationals will not dominate the post-WTO television market, Chinese industry will continue to suffer from severe production overcapacity; the government estimates that total industrial losses between

1998-2001 was RMB 20 billion *yuan*. The solution will be to eliminate backdoor financial deals with locally controlled financial institutions, reducing cutthroat competition and concentrating production into fewer manufacturers. With less domestic competition, Chinese manufacturers can invest in research and development, reduce the content of foreign proprietary technology, and expand exports abroad. One potential model is the TCL Information Technology Group, which enjoys a 19 percent share of the domestic television market, 5 percent of the Vietnamese market, and 7 percent of the Indian market. A state-owned enterprise started in 1981 by the Guangdong's Huizhou city government, TCL is planning to reduce Huizhou's 79 percent share in the holding company to 50 percent. It was one of the few domestic television manufactures reporting a profit in 2001.

Zhu Rongji also plans to break-up monopolies and to merge new players in the telecom sector, which is considered important for national security but particularly prone to ministerial infighting. Nine existing telecom companies will be merged into four integrated service providers. The state-owned China Telecom, which traditionally enjoyed a monopoly on fixed line service, will be divided into northern and southern branches: the northern branch will cover 10 provinces and incorporate China Netcom, which is managed by Jiang Zemin's son; the southern arm will control 21 provinces. China Mobile and China Unicom will be the remaining two providers. To regulate the providers as well as prevent ministerial fighting, an information management commission will be established under the State Council.

Privatization has been an on-going but complicated process. The state controls 65 percent of SOE stocks, while the remainder is issued as IPOs or non-IPOs on domestic and international markets. IPOs are planned for the Aluminum Corporation of China (\$500 million), China Unicom (\$1.8 billion), the Bank of China (\$4-5 billion) and China Telecom (\$4-6 billion). However, these offerings have been delayed. In summer 2001, the Bank of China revealed the extent of its NPLs; perhaps to shore up potential investor confidence, it announced in fall 2001 a merger with its 10 smaller sister banks in Hong Kong. The delayed initial public offering of China Telecom no doubt was related to its division

into northern and southern units. However, another possible reason has been the Ministry of Finance's plan to finance the state's bankrupt social security fund by selling the state's shares of SOEs and channeling 10 percent of IPO sales to the fund. The government, not the market, has determined state share pricing. These artificially high prices and problems of irregular practices in Chinese brokerages and accounting firms have led to a 30 percent drop in Chinese stock prices since July 2001. While suspending plans to sell further shares, the state still must determine a better method of valuing state shares, and funding its social security fund.

Chinese and foreigners alike were stunned when the first bankruptcies were declared in the 1980s. Yet, the low number of bankruptcies can be attributed to the complicated relationship among the central government, local bureaucracies, and financial institutions, and to irregular accounting procedures, inadequate legal protections for creditors, and similar shortcomings. A recent Chinese Supreme Court decision mandated the Court's prior approval for all bankruptcies valued over \$six million. One possible reason for this delaying tactic could be the sale of NPLs to foreign investors. On 30 November 2001, Huarong Asset Management Company sold \$1.3 billion of NPLs at a deep discount of nine percent to a foreign consortium led by Morgan Stanley; in December 2001, Golman Sachs bought \$240 million of NPLs, but at 10 percent of face value. The successful sale of NPLs promises a greater degree of solvency to China's anemic banking system, and portends a larger number bankruptcies in the future.

DANGERS OF USING EXOGENOUS CRISIS

Elites face obvious dangers of using WTO accession as a catalyst to marketization. Zhu Rongji has publicly stated a longstanding rule to govern contemporary China successfully: reforms will be vigorously pursued as long as there is a stable social order. Yet, it is unclear that the non-coastal Chinese economy will be able to absorb the onslaught of foreign competition, especially after direct and non-direct support of SOEs is phased out. WTO members successfully negotiated a 12-year cushion of time during which members can invoke a transitional safeguard mechanism to protect themselves from an onslaught of Chinese goods. For 15 years, China will also be

designated a "non-market economy," allowing the United States and others various means to devise anti-dumping complaints. China will not enjoy such protectionist luxuries, and must face international competition within a much shorter period. This most probably will translate to a dramatic rise in Chinese unemployment, which will not be readily absorbed by the more productive sectors of the economy. The leadership most probably will deal with the resulting unrest by slowing the marketization process, much to the consternation of its well-protected WTO partners.

Should marketization reforms proceed, the central government is not assured of implementation. The leadership has financed two decades of phenomenal growth by yielding a significant degree of its governing capacity. Decentralization has empowered bureaucracies and localities, which implement policies based on self-interest. It has not been in their interest to close local inefficient SOEs, much less merge or diversify operations. Such rent-seeking behavior is commonplace today, the most notorious case occurring in China's northeast rustbelt where bureaucrats, the Party and organized crime had controlled Shenyang.

And then there is Chinese nationalism. In the mid-1980s, Peking University students openly protested against the onslaught of Japanese products. In the 1990s, Chinese boycotted U.S.-made goods following the NATO bombing of the Chinese Embassy. Conservatives strongly criticized Zhu Rongji following Bill Clinton's rejection of the April 1999 market opening offers. Just as in the United States, South Korea and Japan, there will be demonstrations against foreign companies perceived to have bankrupted Chinese SOEs and to have secretly stolen China wealth by purchasing NPLs. With foreigners penetrating industrial and technological sectors, Chinese nationalists will declare that China's national interest is threatened and denounce WTO proponents as traitors.

WTO accession creates credible dangers to the ruling elite, which is currently undergoing the sensitive process of choosing new leaders for the 21st century. However, the current leadership is gambling that this exogenous crisis will be the death knell of the command economy and change China for the better.



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