China’s Reforms and International Political Economy

Edited by
David Zweig and Chen Zhimin
China’s Reforms and International Political Economy

International forces shape a state’s domestic development, particularly under globalization. Yet most analysts have ignored the influence of China’s position in the global economy on its economic and political development. Given the deep economic ties between China and the world today, and the state’s increasingly limited capacity to control transnational flows, such a position is difficult to sustain.

No single model can explain the relative role of internal and external forces in China’s domestic reforms and international economic policy. Instead this book presents a variety of academic opinions from both mainlanders and Western-trained scholars on this issue. These China specialists debate a number of key areas including China’s entry to the WTO and whether state policy or international forces dictate China’s position within the global economy; the role of the local state versus the central state in determining China’s production networks within global manufacturing processes; the question of whether global forces and international organizations, such as the WTO, are leading China to adopt conciliatory policies towards both the US and ASEAN, or whether China’s elites still determine the final pattern of trade liberalization and domestic reform? A broad range of case studies supports these areas of investigation, including research on the internationalization of the Chinese state, the opening of the pharmaceutical sector, the Sino-South Korean “Garlic War” and returnees to China who seek greater economic and social remuneration.

Providing vital insights into China’s likely development and international influence in the next decade, China’s Reforms and International Political Economy will appeal to students and scholars of international political economy, China studies and international relations.

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Preface
Globalization and China’s reforms: a Canadian ambassador’s perspective

*Joseph Caron*

China’s accession to the WTO and its irreversible trend towards globalization will deepen China’s ambitious economic reforms. Aimed at making China more competitive at home and abroad, these reforms follow 20 years of unprecedented economic growth. Despite continued reform, changes in the international political economy suggest that maintaining high growth will become more difficult. While the 1990s offered an international environment favourable to China’s rapid expansion, the coming decade will be more difficult due to domestic bottlenecks and unforeseen (and unpredictable) international developments. To sustain growth in an increasingly competitive environment, China must deepen its reforms, increase transparency, open domestic markets, strengthen regulatory institutions and possibly, open its political system to competition.

The defeat of socialism in the Soviet Union and its Eastern European allies in the early 1990s by the capitalist development model placed economic diplomacy on an equal footing with traditional security diplomacy, making it a public good and key objective of international relations. International political economy, the construct of economic diplomacy played out by countries and international economic institutions, is now central to geopolitics. Today a variety of threats to the international order – not just military in nature – can seriously disrupt a state’s national security. These include long-term trade imbalances, trade deficits, industrial restructuring, currency crises, cyber-terrorism, uncontrolled population movements, or the transnational spread of infectious diseases.

However, positive developments in other countries and international economic institutions can benefit a country’s economic security: that, after all, is the promise of globalization. But will China’s economic rise benefit the world? And will deeper economic engagement with the world benefit China? At the heart of future debates will be the effects of China’s economic development – be it growth, stasis or a reversal of China’s expansion – on the world’s economy.

This volume and the conference which preceded it – funded in part by the Department of External Affairs and International Trade of Canada – seeks to assess the links between China’s continued economic reforms and growth
and the global political economy. As David Zweig and Chen Zhimin make clear in the Introduction, these two processes are highly interdependent. The supportive nature of the global political economy in the 1980s and 1990s facilitated China’s reforms and growth; at the same time, China’s economic growth has had a major impact on the world’s economy, particularly in the past five years.

The management of direct and collateral international dimensions of China’s economic growth will remain central to its policies for another decade or longer. To attain its new goal of per capita income of US$3,000 by 2020, China will need to engage the global economy further. The state of the world’s political economy, resource allocations and power distribution, will greatly affect whether it will achieve that goal.

As we look at the international political economy of the 1980s and 1990s, we see that China benefited from a veritable geopolitical free ride that allowed its leaders to focus on growth, particularly from 1992 to today. Despite its nonconformity with many global trading norms, China was welcomed by the world economy into the trading family. Chinese exports rose from US$20 billion in 1978 to US$84 billion in 1992, and reached US $762 billion in 2005. The U.S., China’s biggest market, imported US$610 billion, and sustained a total trade deficit of US$486 billion in the past 20 years. While less dramatic, Canada’s cumulative trade deficit with China for the 1990s was approximately CDN$25 billion. In essence, the United States, the EU and Canada opened their economies and allowed massive investment flows to what was then a largely closed economy. Among many reasons for this was the geopolitical benefit of drawing China further into the global community.

A similar openness occurred in science and technology and copyrighted knowledge, such as computer software. Imagine China today without Chinese-language Windows applications, however they were obtained – and we know that most were obtained without authorization or compensation. Much of China’s growth arose thanks to significant resource reallocation and important efficiency gains that were driven not only by domestic reform, but also by China’s foreign trade.

From the beginning of the 1990s, the United States insisted that China open its domestic market to foreign products. And by the late 1990s, the entire world was driving a very hard bargain, using China’s desired entry in to the World Trade Organization (WTO) to demand widespread domestic deregulation and domestic economic restructuring that is currently transforming China’s economic institutions. Consequently, the future could be a lot tougher for China, as many of its WTO commitments are back-ended, and will only come into effect in the middle of this decade. So, the serious challenges for China resulting from these concessions have yet to materialize.

For example, Chinese sectors such as agriculture, the automotive industry, banking, insurance, telecoms and others, will face serious challenges.
Response to international competition will require sophisticated re-engineering of Chinese industries at the nexus where corporate management, risk-sensitive financial institutions, regulatory authority, and government support all meet. It is not clear that this essential alignment of competencies will develop smoothly or rapidly.

The interrelationships among sections of the economy require coherent restructuring so that capital, labour, science and technology and other key resources can be allocated more efficiently. In addition, China needs significant mergers and acquisition legislation and regulations, in order to create stronger national champions who can compete with the global players. The financial sector is not yet up to the task of allocating resources, and not only because of the significant amount of non-performing loans problem. Financial intermediation is weak throughout the economy.

Regulatory agencies need not only the independence and freedom to do their jobs, but the sophistication to develop the capacities of self-regulation and discipline in the industries. China is too vast, its institutions too numerous, and the demands of growth economies too diverse, for Beijing to address all its problems.

In the next decade, China’s growth will depend on the following reforms: the CCP must quickly modernize market and governance institutions, allow greater government transparency, expand the rule of law, and create an independent judiciary. Government elites must substitute power and personal relationships with a commitment to the highly abstract notion of the public good. And while China need not copy Western democratic norms, China’s leaders will not master the flow of political signals essential to managing a modern economy unless they introduce competitive practices in political governance. The increasingly affluent, educated and globalized middle class will no longer accept institutions, such as the CCP, telling them what to think and do. This class of over 100 million people will be the real force of transformation. Nor will current governance practices provide the hundreds of millions of poor and low-income earners with a sense that they are building the new China, and make them confident that they, too, will benefit from its growth.

Therefore, any assessment of the strategic impact of China on the region cannot be understood without appreciating the challenges facing China’s domestic economy. These will help to determine the extent of China’s engagement with the international political economy. At the same time, China’s engagement is also affected by external forces, such as the U.S., which has made China’s growth a national security concern. This changed environment will require a Chinese response whose dimensions remain largely unknown, though as Chen Zhimin asserts in this volume, U.S. assertiveness currently leads China to engage in a limited form of balancing.

We must not respond passively to China’s growing impact on the world’s political economy. Western governments, businesses, and institutions, such as universities, must acknowledge China’s rising strategic importance and
decide how to respond to it, for both their corporate and national benefit. It is easy to let China’s domestic difficulties dominate our perspectives. But caution is not the only prism through which to divine the future. Governments and academics must lead. As a Canadian, whose country is being influenced by developments in China, I believe that it is incumbent on Western governments to prepare for a China whose influence will only increase, perhaps dramatically, rather than plan for its decline. It is easier to respond to the latter, but anticipating a rise in China’s political and economic influence is the wiser course.
Acknowledgements

Although the duration of my stay at Queen’s University was limited to one year, this volume represents the fruits of my efforts there. And while other programmes I established during my brief stay have faded in the wind, this book will always remind me of the willingness of colleagues, administrators and students at Queen’s to engage actively with China. In fact, the initial seed funding for the conference at Fudan University that spawned this collection of essays came from the office of the Dean of Arts and Sciences at Queen’s University. Stewart Beck, then Canadian Consul General in Shanghai, and himself a Queen’s graduate and a great booster of the university, introduced me to Mr Marc Sterling, the head of regional operations for Asia for the Canadian insurance firm, Manulife, who put me in touch with their Shanghai office. At Manulife-Sinochem, I received strong support from the office’s General Manager Raymond Chan, as well as the Deputy General Manager, Elaine Wong, who made a generous contribution to the funding of the conference. As one of the earliest foreign players in China’s evolving political economy, they were very supportive of this academic effort to better understand the growing link between China’s international political economy and domestic reforms. In return, they requested only public recognition of their public service. We publicized their support in Shanghai at the time of the conference, but this note of appreciation allows me to fulfill that responsibility to them.

The second key supporter of the conference and this volume was the Department of Foreign Affairs and International Trade (DFAIT) in Ottawa. DFAIT always stands ready to help Canadian academics who organize projects on the People’s Republic of China. The coordination at DFAIT, in terms of funding for and participating in this project was carried out through the Office of Chinese and Mongolian Affairs, then under John Morrison, who joined us in Shanghai at the conference. DFAIT asked for publication of our findings in return for financial support. This volume fulfills my contract with them. Thanks also to former Canadian Ambassador to China, Joseph Caron, who helped secure the funds, and gave the keynote address at the conference, which we have produced as the Preface to this book.
A key goal of this project was to pull together scholars from around the region, particularly from Canada and China, to assess how integration with the global economy has affected China’s economic development, its regulatory regime, its trade relations and its foreign policy. We also wanted very much to introduce ideas from International Political Economy into Chinese and Western analysis of China’s foreign relations, and to make those ideas available to a broader public in China. Fudan University, especially its then Associate Dean, Dr Chen Zhimin, helped us to do this, and throughout the life of the project he has remained a strong supporter and advocate. Dr Chen was also keen to enhance ties between Queen’s University’s Department of Political Studies and the Department of International Politics at Fudan, particularly after his visit to Queen’s in the fall of 2000, which was funded by Queen’s University. As for the conference, Fudan University was a gracious host, covering the local costs of the foreign visitors, and filling the seminar room with enthusiastic and bright graduate students. Faculty at Fudan and at other top schools in Shanghai formally commented on the papers at the conference. Based on this wonderful cooperation, Zhimin and I have produced this book, as well as a Chinese version, which makes the ideas raised here more available to graduate students and scholars in China who would prefer to read these papers in Chinese. This hopefully is a long-lasting footprint of the time I spent at Queen’s University.

A few more thanks and acknowledgments are necessary. A slightly different version of the chapter by Zweig, Chen and Rosen appeared in the China Quarterly, no. 179 (September 2004: 735–757). The transcript of the conference was compiled by our own rapporteur, Ms Cynthia Wu, whose summary helped us write the “Introduction”. Shirley Fraser at Queen’s University helped with editing, as did Tommy Lee. We also wish to thank several colleagues who presented papers at the conference, but due largely to reasons of space, their papers do not appear in this volume.

At Routledge, we have been extremely fortunate to work with Helen Baker and Stephanie Rogers who very patiently shepherded this volume through various stages, and the fact that I was able to complete the editorial work is testament to their fortitude. I also wish to recognize the financial support of the Research Grants Council of Hong Kong, which gave a grant to me and my colleague, Dr Fan Yongming of Fudan, to conduct a more detailed study of the domestic impact of entry to the WTO on China’s economic and political development. This funding helped us in writing our chapters. Thanks also to Dr Kim Nossal, the head of the Department of Political Studies at Queen’s University, who also attended the conference and supported the project.

David Zweig
Hong Kong
### Abbreviations

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<tr>
<th>Abbreviation</th>
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>AFTA</td>
<td>ASEAN Free Trade Area</td>
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<td>Asian Monetary Fund</td>
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<td>American International Group</td>
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<td>AD</td>
<td>Anti-dumping</td>
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<td>CASS</td>
<td>Chinese Academy of Social Sciences</td>
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<td>CCPIT</td>
<td>China Council for the Promotion of International Trade</td>
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<td>CITIC</td>
<td>China International Trust and Investment Corporation</td>
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<td>CVDs</td>
<td>Countervailing duties</td>
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<td>DPT</td>
<td>Democratic Peace Theory</td>
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<td>EAEC</td>
<td>East Asian Economic Caucus</td>
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<td>EAVG</td>
<td>East Asian Vision Group</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>Foreign Investment and Control Commission</td>
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<td>Gross National Income</td>
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<td>GSP</td>
<td>Generalized System of Preferences</td>
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<td>IGOs</td>
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<td>Ministry for Economic Relations with Foreign Countries</td>
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<td>MFA</td>
<td>Multi-Fibre Agreement [UK]</td>
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<td>MII</td>
<td>Ministry of Information Industry</td>
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<td>Acronym</td>
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<td>MMA</td>
<td>Minimal Market Access</td>
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<td>MNCs</td>
<td>Multinational Corporations</td>
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<td>MOFAT</td>
<td>Ministry of Foreign Affairs and Trade</td>
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<td>MOFERT</td>
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<td>NACF</td>
<td>National Agricultural Cooperative Federation</td>
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<td>NPE</td>
<td>New Political Economy</td>
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<td>NIEs</td>
<td>Newly Industrializing Economies</td>
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<td>ODA</td>
<td>Overseas Development Assistance</td>
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<td>PPP</td>
<td>Purchasing Power Parity</td>
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<td>RMB</td>
<td>Renminbi</td>
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<td>SARS</td>
<td>Severe Acute Respiratory Syndrome</td>
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<td>SETC</td>
<td>State Economic and Trade Commission</td>
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<td>SIEC</td>
<td>State Import and Export Commission</td>
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<td>SOEs</td>
<td>State Owned Enterprises</td>
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<td>State Planning Commission</td>
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<td>TNCs</td>
<td>Transnational Corporations</td>
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<td>UN Conference on Trade and Development</td>
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Introduction

International political economy and explanations of China’s globalization

David Zweig and Chen Zhimin

Introduction

Most academic explanations of China’s reforms, and even its foreign policy, have been based on domestic politics. Elite preferences or intra-elite conflicts, regional interests, or domestic political coalitions, have been highlighted by scholars as the driving forces behind policy shifts within the domestic polity and economy. This level of academic insularity was understandable, given China’s relative autarky and limited involvement in international markets. According to Shirk, China’s socialist economy and “at the border” institutions were simply too powerful, preventing changes in global prices or international economic forces from affecting domestic prices, domestic supply and demand, or preventing domestic actors from “knowing their interests” – i.e., recognizing that they could benefit from deeper global economic engagement. In fact, due to China’s fixed currency, even the East Asian Financial Crisis, which toppled leaders across Southeast and East Asia and triggered major structural economic reforms, had quite a limited impact on China’s domestic political and economic development.

To a certain extent, international politics has been seen to have some political ramifications for China, particularly on politics within the Chinese Communist Party and in the Party’s relationship with society. Crises within the Socialist camp, such as the repression of rebellions in Hungary in 1956 and Czechoslovakia in 1968, affected Chinese elite attitudes towards domestic politics and Sino-Soviet relations. The collapse of the USSR in 1991, which was explained in part by a faulty economic system, may have instigated Deng Xiaoping’s “southern trip” in January 1992, triggering the radical economic liberalization and market boom that followed it. In an adaptation of Gourevitch’s “second image reversed,” Naughton showed how the Gulf of Tonkin Affair in 1964, and the expanded American involvement in war in Vietnam, led the Chinese leadership to establish the “Third Front” and reallocate a massive share of its domestic budget away from coastal regions and into Sichuan and Guizhou provinces. Similarly, the 1969 border war with the USSR led to the emergence of a second “Third Front” in China’s northwest.

Since the introduction of China’s “open policy,” and its deeper engagement with the global economy, such an intellectual position has become
much harder to sustain. China’s search for oil in the mid- and late-1970s had a deep impact on Hua Guofeng’s “great leap outward,” and the national development strategy that he introduced in 1977. Solinger showed how the failure to find large amounts of oil in the South China Sea, which was to have driven China’s economic reform, led to another strategic shift, this time from heavy industry to light industry, particularly textiles, and significant budget reallocations. The late James Townsend, writing at the end of the 1980s, warned readers not to underestimate the impact that foreign forces – strategic, intellectual, cultural and economic – could have on China’s opening, arguing that “new social forces produced by the introduction of modern technology and organization” were driving China’s opening. Similarly, Tom Moore has shown that what he calls “moderate economic closure” – that is, limitations on economic expansion imposed on China by the global economy, such as the quotas under the Multi-Fibre Agreement – forced the textile sector to carry out significant reforms and move to higher value-added products in order to improve their competitiveness and expand their global market. Recently, Zweig has shown that once domestic actors actually were allowed to understand the enormous gap in the relative value of goods and services inside and outside China, the potential beneficiaries of internationalization acted as unorganized collective interests and drove down the barriers to deeper engagement with the international system. In fact, Zweig showed that internationalization and the decentralization of transnational linkages beyond the purview of Beijing greatly strengthened the local state in the coastal regions of China relative to the central regime and local society. Now that China has joined the WTO, it is anticipated that domestic reforms, begun in large part in anticipation of WTO accession, will increase under strong external pressure.

Nevertheless, a major debate ensues as to whether China’s authoritarian regime will be driven by external forces, or whether the Communist elite and China’s bureaucrats will rein in these outside forces. State-led development models, particularly in East Asia, suggest that enlightened bureaucrats can manage the external environment and maintain control over the direction of economic development. Critics of China see both its mercantilistic predilections, and also fears of domestic unrest triggered by WTO liberalization, dominating the decision-making processes. Thus, they assert, only continued external pressure can move China’s economy towards greater compliance with global economic norms.

With these questions in mind, a small group of political scientists in the Department of Political Studies at Queen’s University and the School of International Politics and Public Policy at Fudan University approached Manulife of Canada and the Department of Foreign Affairs and International Trade (DFAIT) in Ottawa and requested financial support for an international conference to address these issues. Under the leadership of Professor David Zweig and Associate Dean Chen Zhimin, the two schools
pulled together a team of scholars from Korea, Britain, the U.S., Canada and China who could address the relationship between the international political and economic system and China’s economic and political transition.

We chose to employ an international political economy approach for several reasons. First, given China’s “open policy,” and the declining barriers to translational exchanges over the past 20 years, it was our working hypothesis that outside forces should have increased their influence on China’s development. Second, while this conceptual framework has begun to bear explanatory fruit among Western Sinologists, it has been largely ignored within China. By employing this framework, we could both increase our ability to explain China’s opening and help Chinese social scientists find a new framework to illuminate their search for explanations. Third, much of the “globalization” literature assumes that the state’s role in managing global economic relations has declined dramatically. In fact, Wang asserts that globalization has dramatically weakened the welfare functions of the Chinese state, such as its ability to avoid unemployment. Similarly, Coxian frameworks, which focus on how capitalist production chains evade international boundaries and create global products, suggest that as more and more of China’s economy is controlled by multinational corporations and their international production networks, the outside world should have enormous impact on significant aspects of China’s economic development. And many of these changes will occur below the radar screen of the national economic planning system. Similarly, the work of both Redding and Hamilton suggest that any explanation of China’s economic transformation of the past 20 years cannot ignore the role of Overseas Chinese capital. The dramatic rise of Taiwanese capital and the boom in the information technology (IT) and semi-conductor sectors in Shanghai and its environs shows how Overseas Chinese “network capital” can transform the local political economy.

Therefore, the key questions we wish to address include:

1. Have external forces, particularly global markets, U.S. hegemonic pressure, the global structure of power, international regimes and organizations, the regional political economy, and Overseas Chinese, shaped China’s position within the global polity and economy and affected the way China deals with the world economy?
2. Have Chinese leaders and foreign policy makers internalized the norms and values of the global economic order so that these norms affect state behaviour and domestic economic activity? Or, is China merely engaged in “strategic adaptation,” whereby it appears to adopt global norms, while defending sovereignty at all costs?
3. Perhaps economic reform has been driven by elites who recognized the need for reform, greater market regulation, and deeper engagement with the global economy, as well as domestic market forces and/or local elite interests, rather than external forces. The role of global and domestic
forces could vary across sectors. But if reform is internally driven, compliance and what the World Bank calls “deepening,” should be central to China’s own strategy of development, rather than something that the external world, and specifically the US, has imposed on China. Should the latter be true, there is much less need to monitor China’s WTO compliance and intrude on Chinese sovereignty. China on its own will deepen the reform process as it sees that it is in its national interest to do so.

Finally, who are the key players in China in this process of globalization? What role do bureaucrats, elites, entrepreneurs, state-owned enterprises and multinational corporations play in this process? What are their interests and how do those interests shape China’s pattern of integration?

Theoretical issues: global structure, norms and multilateral institutions

In this section, we discuss the key points of each paper, how they address the above issues, and wherever possible, draw linkages among the core arguments.

The book begins with a broadly based paper by Shaun Breslin, who looks at Chinese studies of international relations and finds little appreciation for the impact of International Political Economic theory (IPE) on China’s development. He laments the statist approach of most Chinese scholars, as well as Western analyses of China’s foreign relations, and advocates instead greater sensitivity to regional and local influences – a more “bottom-up” approach to understanding China’s development. Breslin, an editor of Pacific Review, calls for a wedding between the creation of IPE theory and the reality of developing countries, particularly China. Employing a Coxian framework, which highlights transnational capitalist production networks which function outside government controls, he sees China’s globalization from two levels: first, the pattern of China’s engagement with the global economy occurs within a hegemonic system of global rules dominated by the “Washington Consensus” on free trade and unfettered capital markets. Globalization structures national-level debates between those leaders in China who see liberalization as key to China’s rapid development and those who resist the “embeddedness” of international guidelines. Their battle means that elite policy shapes the pattern of China’s global integration within a context that is defined by external forces.

For Breslin, however, a second level of analysis illustrates how China’s own development pattern contributes to the theoretical development of IPE. While the global and regional economies may delimit much about China’s mode of production, those capitalist forms are transmitted into China through localized relationships – what we might call an “outside-in, bottom-up” approach – where MNCs or Overseas Chinese network capital determine how China’s economy is integrated into the global economy.
Thus while the IPE literature takes the nation state or the global system as its given level of analysis, the China case forces us to focus at the sub-national or local level, where the global and the local intersect, and what many post-modernists refer to as the “glocal.” An analytical focus wedging the knowledge of both elite and local conditions in China with the global economy and IPE literature means that the best scholars must hone their “area studies” skills, even as they come to appreciate the role of the global political economy on China’s development.23

Dr Chen Zhimin sees a close link between the international distribution of power, wealth and values, and uses the three structures of the international system – political-military, political economy, and normative – to understand the global constraints on China’s foreign policy behaviour. As its rapid rise to power is challenged by U.S. hegemonic authority, China might have selected “hard balancing” – rapid military development and building strong ties with other major powers in an anti-U.S. coalition – as a means to promote its national interest.24

But as Dr Chen shows, international economic and normative structures greatly constrain China’s strategic options, forcing it to select “soft” rather than “hard” balancing – i.e., the search for informal, rather than formal, alliances, and a less aggressive international posture. Hard balancing would affect trade relations with the United States and China’s priority on economic development because the major industrial powers would eschew economic links with a belligerent China. Second, Chen believes that China’s leaders have internalized the global norms of the market economy – even seeing the international division of labour, the epitome of the capitalist economic order and a concept anathema to Marxists worldwide, as legitimate. These values give China a strong normative incentive to accommodate the United States and the global distribution of political power. Finally, the distribution of global power – with one hegemon and several major powers who, the Iraq War of 2003 aside, do not challenge US authority to any major extent – makes hard balancing an impossible strategy, as China cannot find any serious allies for such an external strategy. Taking Chen’s logic one step further, the global context which leads to soft balancing leaves China more open to the global economy, as it prohibits China from employing “hard balancing” in the strategic realm and a tough mercantilist strategy in the economic sphere. The result, therefore, is a moderate, engaged and open China.

Richard Stubbs also shows how changes in the global distribution of power – the “outside-in approach” – has affected China’s foreign policy, particularly its deepening participation in the “ASEAN Plus Three” (APT) multilateral institution. Both the end of the Cold War and the decline of Japan’s regional economic hegemony have encouraged China to engage in more cooperative behaviour at the regional level and adopt a larger leadership role in East Asia. During the Cold War, China saw ASEAN as a tool of America’s encirclement of China. But less American influence in the
region – despite the U.S.-led “War on Terror” – and exemplified by the closing of US bases in the Philippines, has changed China’s view of ASEAN and led China to become much more engaged with this organization. Also, the economic growth of ASEAN and China’s desire to diversify its economic interactions and to weaken its dependence on the US, encouraged China to propose a free-trade zone with ASEAN, which will come into effect in 2005.

The utility of Stubbs’ analysis to our effort is to supplement China’s strategic or global analysis with a regional focus and show how changes in the regional political economy help deepen China’s economic integration as well. Yet while Stubbs, a regional political economist, keeps his focus on state-to-state interactions, or even China’s links to a regional economic organization, his argument could easily be supplemented, à la Breslin, by looking at the remarkable role that Overseas Chinese capital has played in pressing the nations of Southeast Asia to open their own economies to China through the establishment of a remarkable network of manufacturing, trade, and familial relationships that virtually ignore national boundaries and the central government.

Finally, in a paper which weds IPE theory with the analysis of China’s internal structure, Su Changhe bolsters Chen Zhimin’s argument that norms dominant in the international system have been internalized in China and thereby will deeply affect both China’s external and internal politics. Borrowing from Gourevitch’s “second image reversed,”25 and the IPE literature that tries to explain how a state’s domestic structure affects its willingness to incorporate and abide by international norms,26 Su asserts that China’s domestic structure, i.e., its authoritarian nature, plays much less of a role than international institutions and norms in determining China’s foreign strategic and economic policy. In fact, argues Su, relatively strong states, such as China, as compared to weak states, are more able to inculcate global values into the political system once the state and its organizations accept global norms.

By participating in so many international organizations, China has begun to identify with those norms. In particular, “embedded liberalism” which has characterized so many international regimes,27 has been working its way through the Chinese foreign policy-making system to influence China’s behaviour in several key ways.28

Concerned about China’s image in these organizations, Chinese leaders behave better.29 The discourse of Chinese domestic politics and foreign relations has changed, with many articles calling on China to conform to international norms (yu guoji guize jiegui – “keep in line with the international track”).30 Similarly, references to “international rules of the game,” and the importance of “multilateralism,” are repeatedly found in the newspapers. Managers of bureaucratic organizations that link with these international organizations, and “get in line with the international track,” become “linkage agents” who identify with global values. Perhaps optimistically, Su
argues that as political participation increases, China’s parliament must introduce new laws and domestic regimes that mirror regimes in more open economic and political systems. Chinese intellectuals, too, will voice support for political liberalization and become part of a “liberal epistemic community” that can transfer international norms into the domestic politics and foreign policy-making system. As “constructivist” theory would predict, a national policy agenda based on international institutions could emerge to ultimately overcome the elite’s “cultural realism” and reconstitute China’s own national interest and national identity, allowing greater acceptance of interdependence. International pressure may directly affect domestic decision-making, as in the case of SARS in spring 2003; and in some cases, domestic actors may move issues from the domestic arena to the international one, where international values can directly influence these decisions in China.31

The results, argues Su, will be very significant. International values will gradually but consistently become incorporated into domestic politics and society, as a more vibrant civil society draws strength from its links with global institutions and organizations. No doubt, China’s strong state/weak society system means that the transition costs of accepting global norms will be great, possibly triggering a domestic political crisis. Still, this process will ultimately move China towards a more open and democratic society. Concomitantly, China’s foreign behaviour will become more transparent and predictable. In this way, international institutions and domestic politics will intertwine to bring China into the world and the world into China. While optimistic, Su’s view incorporates a rich understanding of the international system, solid theoretical understanding of the IPE literature, and an awareness of important trends under way within China’s public policy community.

**China and the WTO**

Unlike Dr Su, Dr Fan Yongming sees China’s leaders and the state in control of the country’s foreign trade behaviour. Contrary to assertions that China’s WTO concessions resulted from external pressure, Dr Fan argues that China was able to make key concessions in the negotiations over accession precisely because of significant progress in domestic reform, not vice versa. Only success in domestic reforms allowed for liberalization in its international reforms. This way, domestic politics and economics deepened China’s economic and political integration with the global system, not the reverse.

For example, the concept of the “socialist market economy,” introduced at the Third Plenum of the 14th Party Congress in 1993, broke the domestic deadlock over whether China would continue towards a market economy, a basic requirement for WTO accession. Until that point, China’s negotiations with the General Agreement on Tariffs and Trade (GATT) Working
Group had stalled over this philosophical issue. With that barrier removed, negotiations moved to specific issues.\textsuperscript{32} According to Fan, many liberalizing policies agreed to by China’s negotiators had already been tried out in various locations, part of a process Zweig calls “segmented deregulation.”\textsuperscript{33} Thus, Fan argues, domestic reforms preceded external pressures and demand, and then fitted with the overall reform programme of the leadership. And while entering the WTO has harmed some interests in China, accession was a common goal of many Chinese who used external pressure to weaken the bureaucracy’s hold on the economy and force the government to be more open. Fan, therefore, sees a close link between globalization or liberalization and domestic reforms, but sees the latter as a precondition of the former, rather than a result of the former.

No doubt, part of the disagreement between professors Fan and Su, who at the time were both professors at Fudan University, arises because the two authors look at different periods. While Fan focuses more on the 1980s and mid-1990s, Su looks at the contemporary period and tries to extrapolate to the future. Similarly, one could argue that while international forces strengthened the local state in the 1980s and 1990s, the remarkable opening following China’s WTO accession is undermining state power at all levels of the system.

Like Su, Paltiel, who looks at the build-up to WTO accession and post-WTO debates, feels strongly that China has changed its behaviour and sense of identity. While in the past China engaged in what he calls “exception mongering” – accepting general principles but insisting on exceptions for China based upon its particular characteristics – today he sees China willing to bargain hard on specific issues. Moreover, China’s ultimate concession on WTO accession, acceding to terms more demanding than any other developing country, signals that China accepts the universality of international norms and is willing to live by those norms. And, even if the adoption of these norms is primarily instrumental, he argues, a “cognitive breakthrough” leads officials and non-officials alike to see the values of the WTO as important to the reconstitution of domestic society.

Paltiel also believes that China is internalizing international norms of “embedded liberalism.” For example, while most observers emphasize China’s rigid insistence on sovereignty, Paltiel cites some Chinese observers who argue that there is no inherent contradiction between joining the WTO, abiding by international norms, and maintaining sovereignty. He also strongly supports Fan Yongming’s argument that domestic reforms have affected China’s relationship to the outside world. In particular, he cites China’s adoption of the socialist market economy at the 15\textsuperscript{th} Party Congress in September 1997 as a critical turning point in the entire reform process. For Paltiel, this action signified the willingness of central leaders to apply rule-of-law to China’s economic development. And, if they could do so domestically, they could also do so internationally, which, according to Paltiel, “engendered a new spirit of compromise over WTO accession.”
Again, like Su, Paltiel sees important changes in China, particularly the introduction of the rule-of-law and the rising importance of legislation by China’s various parliaments due to the need for making laws that mesh with China’s WTO commitments. He also sees central leaders using WTO pressures to control administrative discretion, which is at the root of much of the corruption in China today.

Margaret Pearson locates her analysis firmly within the IPE literature and shows how domestic politics affects a state’s international trade behaviour. Employing what she calls the “outside-looking-in” perspective, Pearson shows that there are “wide bands of acceptable rules” under the WTO, which means that a state’s internal structures, such as its ideology, institutions, and its chosen policy instruments for attaining liberalization, vary significantly across WTO members. Indeed, such wide bands are anticipated by the WTO itself. Thus, domestic institutions, not the WTO itself or external models, have the most important impact on the final form of trade liberalization.

Second, Pearson outlines two patterns of regulatory behaviour that are widely employed in the world: an Anglo-American model with high degrees of transparency and limited government involvement in the economy except to prevent market failures; and a Japanese-style, developmentalist state model which encourages industrial policy and promotes Chinese multinational firms that can manage the challenges brought on by globalization and the WTO. Both models are found among WTO members, and to date it remains unclear which model China will follow. Therefore, although China continues to regulate its foreign trade and limit the impact of the WTO on reform and trade liberalization, the fact that China’s WTO-induced liberalization does not match domestic reforms in other countries is not surprising and does not, ipso facto, imply non-compliance on the part of Beijing.

Nevertheless, Pearson’s position on China’s movement towards a regulatory state supports Fan Yongming: that much of the restructuring, as well as the shift from a planned economy to a regulatory economy, was driven by China’s own recognition of the need to deepen domestic reforms and introduce market facilitating regulations that could ensure that stable regulated markets will replace the antiquated planned economy.

**“Outside-in” and “bottom-up?” Case studies**

For authors who see significant change in elite norms, legal codes and regulations, as well as China’s external behaviour, Chin’s paper delineates one source of those shifts: revisions in the central organizations that manage China’s global deepening. Without weakening these central organizations’ economic levers and significant shifts in their leaders’ attitudes towards global economic deepening, the outside world could not attain the freedoms that Breslin says have driven China’s globalization.

Taking a “statist perspective,” Chin shows how globalization affects the role and status of Chinese bureaucratic agencies, particularly those whose
function is closely linked to changes in the external environment. China’s export-led growth strategy, within an international political economy where trade and FDI are keys to national development, increased the status of the Ministry of Foreign Economic Relations and Trade. Under these conditions, bureaucratic agencies that manage these affairs and the elites who run them become key administrative players in the bureaucratic politics in Beijing and in the provinces. And although decentralization of investment and foreign trade controls undermined central bureaucrats’ authority, their lower level counterparts benefited from this shift in China’s development strategy.

Moreover, the need to conform to international norms, as China’s economic integration with the global economy deepened, led to significant changes in the form of the state – what he calls its “internationalization.” These changes involved the growth of new bureaus to manage transnational linkages and organizational innovations which transform the norms of employees in those organizations, thereby further integrating China into the global economy. Unlike the dominant view of Jacobson and Oksenberg, who believed that Chinese working in the key international economic organizations did not adopt universalistic norms, Chin believes that significant changes in organizational structure internationalize the culture and values of Chinese officials.

However, Chin also shows that the status of bureaucratic agencies is not static. While the very top party leaders responsible for the foreign trade sector, particularly Li Lanqing and Wu Yi, with the support of Prime Minister Zhu Rongji, aggressively pushed China’s WTO accession, the pluralization of the decision-making process on foreign trade that was needed to build consensus among interested agencies actually undermined the Ministry of Foreign Economic Relations and Trade’s authority, as well as that of the elites who advocated deeper global integration. While industrial ministries became the target of WTO reform, they also played a significant role in the policy-making process, protecting their industry’s interests.

While many of our authors see a significant and rather smooth liberalization in China’s norms, organizations, and foreign trade behaviour, Minden and Dong, who address one of the most vulnerable industries in China, are much less sanguine about China’s post-WTO road. Employing a “business systems” approach, they show how the WTO could affect the structure of China’s pharmaceutical industry. This analysis is important because pharmaceuticals are the fifth largest industry in China and one of the most protected and therefore vulnerable economic sectors. Thus they first lay out the pre-WTO structure of the industry, showing the links between manufacturers, distributors, and consumers (including China’s hospitals), and highlight points where national and local governments interfere in this process. Then, they revise that schema to show how entry to the WTO could transform it.
Based on this framework, they argue that despite lower tariffs and easier access for foreign firms at the border, what they call “soft walls” will limit China’s ability to meet its WTO commitments. In particular, protectionism will thrive because in China the government reimburses selected companies that must sell medicinal products to hospitals at low, non-profitable rates. Without such subsidies, these firms would die. But these benefits, and the ability to sell to hospitals, are distributed through a network of particularistic ties among bureaucrats and company managers that basically excludes foreign firms. Since hospitals distribute approximately 70 per cent of all medicines in China, such non-tariff barriers close off much of the domestic market to foreign players. While external pressure and citizens’ demands for better medicines could liberalize this sector, it will also take significant central government intervention to undo this regulatory regime.

Jae Ho Chung’s paper assesses the relative role of external versus domestic forces in determining the way states respond to trade disputes. International organizations, such as the WTO, possess important mechanisms for resolving trade disputes. But under what conditions do states cooperate and adopt conciliatory policies in line with global norms favouring negotiations? And when do states react aggressively and defensively, resorting to conflict and a potentially destructive tit-for-tat, zero-sum game? And, what is the role of domestic politics, compared to the nature of bilateral relations, in determining the adopted strategy?

Approaching China’s foreign trade from a regional and bilateral perspective, Chung explores these issues by looking at the “garlic war” between China and South Korea in 2000. In this war, South Korea restricted the importation of Chinese garlic in order to protect its own farmers, seriously harming Chinese exporters. Because bilateral trade problems had already peaked when China retaliated, Dr Chung argues that China’s domestic politics, particularly anti-Korean public opinion following the suicide of Shandong farmers who suffered financial losses due to South Korean trade measures, forced then Premier Zhu Rongji to choose conflict over cooperation. Here again China’s foreign trade policy mirrors other trading nations; it is largely driven by domestic politics and the domestic constituencies who are deeply harmed by foreign trade problems, reflecting an “inside-out” and “bottom-up” perspective.

Chung proves his point by comparing the “garlic war” with a Sino-Japanese trade dispute over shitake mushrooms, tatami reeds and leeks in which China adopted a much more conciliatory posture. Why the different responses? Clearly, external factors were at work: with China dependent on Japanese aid, Beijing had few incentives to escalate a trade dispute with Japan into a diplomatic incident. Second, unlike Seoul, which resorted to stringent measures by imposing safeguards against Chinese imports, Japan merely raised tariffs. Therefore, bilateral relations can partly explain China’s more conciliatory posture. However, Japan’s trade sanctions harmed few Chinese domestic interests; instead, Japanese tariffs punished Japanese-
invested farms in China, which served as export processing zones for Japanese firms. Few individual Chinese farmers were directly harmed and domestic interests did not resort to drastic and politicized actions, such as suicide. In the absence of domestic politics, China smoothly resolved its trade dispute with Japan.

The final case study presented by Zweig, Rosen and Chen, sees external factors as critical to the development (or retardation) of China’s science and technology (S&T) sector. First, the relative value of goods, services and jobs overseas pulled many of China’s best and future scientists out of the country in search of greener pastures. Also, foreign universities and international agencies paid for much of the training of this generation of overseas scholars. Even today, a large share (as much as 25 per cent) of Chinese graduate students continues to go overseas. Finally, many scholars and entrepreneurs who have opted to remain overseas are still transferring large amounts of technology and information into China, strengthening the national economy.

On the other hand, domestic factors, such as central government policy, inter-city and inter-organizational competition, as well as China’s booming market, are all generating a “reverse brain drain” that is bringing people who possess “transnational human capital” back to China. Imbued with foreign knowledge or possessing foreign products unavailable in China, many of these people find that the knowledge and products acquired overseas have greater value within China’s domestic market than they did overseas. The result of both these processes – the reverse brain drain and the establishment of many companies in China by overseas scholar entrepreneurs – has triggered the enormous proliferation of economic networks that cross the Pacific and mesh into global IT markets. Such findings reinforce Breslin’s portrait of a porous local economy, heavily influenced by transnational networks which function largely outside of central government controls.

Evaluating the source of change in China’s globalization

In this concluding section, we will try to organize the disparate elements that are reflected in these papers. The papers can be situated along two dimensions: one reflects the relative impact of external/global versus internal/domestic forces, or the inside/outside dimension. This continuum reflects the extent to which China has chosen to integrate globally under its own volition, and the extent to which it remains in control of this process. To a certain extent, we are asking whether China succumbed to external pressure and, once it began to open up, whether it has maintained its sovereignty despite deeper economic ties to the global system. The second continuum juxtaposes two alternative forces that could drive further economic integration: markets, international firms, or domestic demands from social forces for engagement in transnational exchanges, versus foreign governments and/or international organizations and their institutional
norms. This continuum reflects the extent to which the forces managing a state’s economic integration remain under the control of governments or international organizations, or whether global market forces, such as changes in relative prices, comparative advantage in foreign trade, and domestic firms or multinational corporations, lead the process of integration largely beyond the purview of formal international organizations or pressure from other nation states.

While the four categories in this schema, as reflected in Table 1.1, may overlap to some degree, they reflect the different views of our authors and perspectives from the IPE literature, while also offering some insight about how China’s process of integration might have occurred. They also help us speculate about where that process is likely to lead. For example, in Breslin’s view, the globalization of China’s economy is well reflected in the lower right quadrant, where, based on the work of Robert Cox, the driving forces for China’s integration are multinational corporations and the production chains created by the global capitalist system that function largely beyond the purview of national governments. No doubt, these MNCs rely on their home governments and international organizations and regimes to pressure developing countries such as China to lower their barriers so that their penetration of domestic markets in developing countries can move forward more easily. This quadrant also reflects the role of Overseas Chinese or foreign businessmen who link with local governments or local firms, relatively free of higher-level government interference. Yet we must also note that while “network capital” moved in easily in the late-1980s and early-1990s, the larger MNCs found it either necessary or expedient to work with government agencies in China’s municipalities, or even with the central government, as the scale of their projects and the level of capital commitment from the Chinese side went beyond the administrative authority or financial means of local governments. Similarly, as Jae Ho Chung has shown, when trade disputes emerged, the central government could become actively involved, moving the process into the upper left quadrant.

Table 1.1  Explanations of China’s global economic integration

<table>
<thead>
<tr>
<th>Institutional force</th>
<th>Promoting/Managing Global Integration</th>
<th>Locus of Pressure for Global Integration</th>
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<tbody>
<tr>
<td></td>
<td>Government/Organization</td>
<td>Inside sovereignty or mercantilism B</td>
</tr>
<tr>
<td></td>
<td></td>
<td>C popular resistance</td>
</tr>
<tr>
<td></td>
<td>Market/Society</td>
<td>Outside global norms and regimes, US hegemony A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>D globalization</td>
</tr>
</tbody>
</table>
This upper left quadrant, with its “inside-out, top-down” perspective, most sharply challenges Breslin’s “outside-in, bottom-up,” Coxian perspective. Fan Yongming most clearly represents this “state sovereign” view, in that he sees China’s government in full control of the country’s global integration and believes that the state’s ability to move forward on domestic reforms drove the integration process forward. Interestingly, Minden and Dong also see this process as highly influenced by the central and regional governments. But while Fan believes that the centre favoured deeper integration, Minden and Dong highlight the protectionist mercantilist nature of this quadrant. This quadrant, therefore, reflects both the views within China that see interdependence as a major threat to national security and sovereignty, and those who believe that government-led deepening is the most likely strategy for successful integration, as uncontrolled integration of the type described by Breslin would not win popular support and could ultimately fail. Also, recognizing that “inside/outside” remains a relative concept, Pearson’s argument can fit into this quadrant, as she sees the Chinese government actively creating effective regulations that limit the degree of market liberalization, but which in the view of Steven Vogel, are “market facilitating,” not necessarily “market constraining” rules.

Even Su, who sees outside global forces influencing a state’s external behaviour, believes that strong governments are critical if external norms are to penetrate a society and transform its elites’ and citizens’ values. To this extent, the pure dichotomy between outside and inside presented by this 2 x 2 table is overstated, as domestic structure influences the ways that outside forces and international norms can change a society. This outside-in process depends greatly on the state’s willingness and ability to support and reform the foreign trade and FDI regime, and to create new regulations and facilitate domestic reforms in line with global rules. Similarly, Chin, who sees global forces reshaping state organizations, such as the Ministry of Foreign Economic Relations and Trade, and turning them into advocates of greater internationalism, also believes that these global forces are constrained and undermined by ministries that prefer the protectionism inherent in the upper left quadrant.

The third quadrant, the bottom left one, is where external forces dominate. For Chen and Stubbs, this globalist, systemic-level explanation reflects the focus of their papers. For Chen, an IR specialist, both American hegemony and China’s economic interdependence force China to adopt a moderate, “soft balancing” strategy, and prevent it from taking a more hostile, anti-American “hard balancing” posture. But like most realists, he does not look inside the black box of the nation state to see how external pressures constrain the specific debates or capabilities of the Chinese state. Similarly, Stubbs keeps his analysis at the regional level, and does not move into quadrant D, where he would be forced to recognize first, that Overseas Chinese money flowed into China relatively unconstrained, and second, the role that network capital from Southeast Asia played in driving forward
Chinese foreign trade liberalization and Chinese foreign trade policies, such as the ASEAN Free Trade Zone. Ironically, it really falls to Paltiel, who is deeply engrossed in the study of Chinese sovereignty, to assert that international norms, as espoused by international organizations, have become entrenched within the body politic and viewpoints of China's elites. This view makes him quite sanguine about the continued integration of China into the global economy and its willingness and ability to meet its commitments under the WTO.

Finally, quadrant C may be the least likely explanation of China's deepening integration, as one might envision few domestic market or social forces that would want trade liberalization or global integration in the absence of some foreign force. Most of the IPE literature that sees domestic forces pushing for trade liberalization argues that some external change occurred to mobilize a domestic constituency. In the case of China, large differences in the relative prices of goods and services inside and outside the country were critical for mobilizing domestic constituencies that favoured more transnational exchanges. On the other hand, domestic interests, such as laid-off workers, farmers who fear the liberalization of agricultural trade, bank employees or domestic insurance agents, all of whom would be fearful of a shift to quadrant D, would oppose, rather than support, China's further global integration. In this way, the upper right quadrant may play a role in China's global integration, albeit a negative one, representing popular forces that resist that process.

In summary, the view that emerges from this study remains somewhat mixed, suggesting that a synthetic, rather than uniform approach, is preferable. No doubt, a key finding of our study is that outside forces, such as international organizations and norms, as well as global markets, have been and will continue to deepen China's links with the world community. But these norms interact with domestic reforms and domestic political structures to influence the final form of China's global integration. Moreover, we would be deeply remiss if we missed the very significant role that China's government and bureaucracy have played, and will continue to play, in shaping future relations between China and the outside world.

Notes
4 Susan Shirk, “Opening China to the World Economy: Communist Institutions and Foreign Economic Policy Reforms,” in Robert Keohane and Helen Milner,


22 Agnes Ku and Pun Ngai (eds), *Making Citizenship in Hong Kong: (Post-)Colonial Subject, Community and Global City* (London and New York: Routledge, 2005).

23 Breslin does recognize that much recent work on China’s relationship with the global economy does precisely what he says has not been done. These works include Moore, *China in the World Market*, Lawrence C. Reardon, *The Reluctant Dragon: Crisis Cycles in Chinese Foreign Economic Policy* (Seattle, WA: University of Washington Press, 2002), and Zweig, *Internationalizing China*.


28 Some values of the “Washington Consensus,” including opening the economy through free trade and less government intervention and regulation, are also affecting policy debates in China. However, the desire to protect or expand social services and use fiscal stimulus to stabilize the society may still reflect “embedded liberalism.”


30 Cortell and Davis see changes in domestic discourse as one key indicator that global norms have become salient to a political system. See Andrew Cortell and James Davis, “Understanding the Domestic Impact of International Norms: A Research Agenda,” *International Studies Review*, vol. 2, no. 1 (Spring 2000): 65–87.


32 According to one legal official in Hebei Province interviewed in 2003 by Professor Chen Mingming of Fudan University, “15 years of negotiations to enter WTO were not wasted chatter (bai tan); it was talk on the one hand and reform on the other. The constant creation of new theoretical views also pushed forward government reform.”

33 Zweig, *Internationalizing China*.


37 It is difficult to use the term international institutions, since markets, in the lexicon of Douglass North, are an institution.

38 This perspective would fit with the views of Ohmae’s “borderless world” or Strange's global economic forces. However, one must recognize that these global
“market” players often employ governments or international organizations to press for liberalization and market access.


41 Zweig, Internationalizing China.
PART I

External structures

Power, norms, multilateralism and production
1 Beyond the disciplinary heartlands
Studying China’s international political economy

Shaun A. Breslin

Introduction

China’s (re)integration into the global economy challenges students of Chinese politics, economics, international relations and political economy. Old paradigms and epistemologies developed to understand China in an era of relative economic isolation, where international relations were dominated by the geo-strategic considerations of the Cold War, need, at the very least, to be modified to take into account the changing domestic and international environments.

Many studies of contemporary China have assessed these changing environments. Nevertheless, and at the risk of caricaturising a vast canon of literature, much of what is written on China – particularly from inside China – is constrained by a realist perspective that remains overly statist, and establishes the domestic and the international, and the economics and political, as separate spheres of enquiry. To be sure, there is now a considerable literature that deconstructs or disaggregates the Chinese state, focussing on how localities have interacted with the regional and global economy. Nevertheless, much of these writings remain constrained by bilateral and/or regional levels of analysis that miss the salience of extra-regional actors and wider global processes in the evolution of what Gereffi et al. refer to as commodity-driven production networks.

Building on Payne’s analysis of the political economy of area studies, this chapter proposes a Coxian framework of International Political Economy (IPE) – or what Payne and Gamble among others term the New Political Economy (NPE) – as an effective analytical framework for understanding both the dynamics of globalisation and the impact of globalisation on China. Such a framework respects the inherent power of states, but also considers the power of non-state actors in the global political economy, and the way in which the global becomes embedded within domestic policy making.

While Payne advances IPE as the most efficacious analytical framework, he accepts that much of that theory has been developed through examining the experiences of advanced industrialised economies. And although IPE
studies of the implication of globalisation and the state have become more “pluralistic” in case studies\(^5\) and more nuanced in approach, many approaches still do not transfer efficaciously to the study of developing states.

The objective of this paper, then, is both quite straightforward and rather grand at the same time. On one level, the study of China can be enhanced by deploying the analytical tools of NPE to consider China’s political economy under conditions of globalisation. On another level, the study of IPE needs to become more sensitive to case studies from the developing world, with recognition of the different characters of “the state” outside the advanced industrialised world. It also needs to consider not just national levels of the state, but also the role of local states – an area in which students of China have much to offer IPE theorists.

**International relations studies of China**

The dominant approaches to studying China’s international relations over-emphasise the nation state as the level of analysis, and build on statist and realist notions of international relations. This statist and realist ontology is also reflected in the way in which IPE is emerging as a field of enquiry within China itself. Song Xinning argues that “the divides which separate disciplines and institutions are still very deep in China.”\(^6\) For Song, this is a consequence of “the social setting in which the study of IR in China takes place”\(^7\) – namely, the dominance of policy related research, the residual ideology, and the simple fact that the state remains a very powerful force in contemporary China. In combination, these factors reinforce the separation of disciplines and have obstructed the emergence of an IPE which considers the importance of non-state actors (and economics in general) in considering what constitutes international relations.

I suggest a fourth explanation. While there clearly is an emerging sophisticated IPE field in China – as the contributions to this volume amply demonstrate – many Chinese scholars are heavily influenced by US academia and therefore sometimes overlook new theoretical innovations occurring outside of the US. For example, in a paper intended to explain IPE in China to an international audience, Zhu Wenli depicts an IPE which is heavily statist, and largely defined in response to American IPE theories as analytical tools, particularly hegemonic stability theory.\(^8\) In particular, she argues: “The emergence of global issues is portrayed as the expansion of the diplomatic arena.”\(^9\) Thus, while the issues governments face are increasingly transnational in character, the solution is still seen to be found in inter-governmental dialogue and processes. Under this approach, economic affairs are often ignored as being “economics,” or more often subsumed as a subject that can be dealt with by state-to-state relations.

On another level, Song and Chan argue that there is a strong concept in China that equates IPE with “the approaches used by Western scholars in IPE studies, such as rational choice, game theory, mathematical and statistical
methods.”10 Again, this view reflects the over-dependence on the US as a source of ideas (even if those ideas are being rejected) in the Chinese IR and IPE disciplines. At the very least, non-statist critical IPE in the Coxian or neo-Gramscian tradition has had little impact on Chinese international relations studies.

The above is not intended to “rubbish” Chinese academia – far from it. Very similar comments could be made about the majority of Western observations of IR in general, and of Chinese foreign policy in particular. Wæver has shown, for example, how publications in the mainstream IR journals are in general dominated by rational choice and realist approaches (and also by authors based in the US).11 Nor is China the only country where the link between academia and policy making can create methodological myopia. Indeed, at times it is difficult to know whether some scholars are writing about US policy towards China, or trying to write that policy itself. Finally, divisions between disciplines are also strong outside China.

Similarly, debates over the relationship between area studies and discipline (particularly in the US) are, like much of Chinese IR theory, overly dominated by conceptions of “discipline.” Broadly speaking, the complaints from the area studies scholars revolve around the notion that economics, and its bastard offspring, rational choice theory, have become hegemonic in academic discourses. According to Johnson, rational choice theorists are attempting to promote their agenda by discriminating against “unscientific” area studies.12

It is not my intention here to embark on a detailed account of the relationship between politics and economics in IPE. It suffices to say that within the international financial institutions, economic-oriented approaches dominate much research and also have a disproportionate influence on policy-making methodology. But while it is right to be sceptical of the efficacy of rational choice and economic theory as explanatory tools and methods, it is important not to fall back into a defence of area studies that denies the relevance and utility of all theoretical approaches.

The area studies discipline, particularly but not only related to the study of China, needs to come to terms with the changing geo-strategic environment within which it functions. The Cold War context that Cumings argued drew the lines of demarcation between area studies and international relations has gone.13 To borrow a Maoist concept, the primary analytical contradiction is no longer a geo-strategic one based on security, but a geo-economic one based on increased economic interdependence (albeit an asymmetric interdependence) through greater trade and investment flows. And this means that the boundaries between the domestic and the international become ever more blurred, requiring an analysis of how the two interact. As Gamble, et al. argue, “The separation between the global and the local no longer holds, as the new hierarchies of the global economy cut across regional and national boundaries.”14
This shift requires an understanding of the dynamics of the external environment, actors and processes.

In the case of “Chinese studies,” the end of the geo-strategic context of study has coincided with the end of a period of relative autarky. Until perhaps as late as Deng Xiaoping’s “southern tour” in 1992, Chinese politics could be studied almost entirely in terms of domestic dynamics. And while I would contend that such “domesticism” was no longer efficacious for much of the 1990s, China’s post-WTO political economy clearly cannot be considered without recognition of the role of external factors.

The debate over the validity and future of area studies versus discipline should not just be conducted within the narrow confines of US academia, and in the specific context of a revolt against hegemonic approaches in the shape of economics and rational choice theory. Area studies require revitalizing, but the aim should not be to replace old disciplinary barriers between “area studies” and “international relations” with new barriers.

If we move away from an internecine battle within U.S. academia, we can find ways in which area and discipline come together to enhance each other. This synthesis is done by recognising that there is a set of internationalised factors that most, if not all states, face that can fall under the broad heading of “globalisation.” But we must also recognise that these globalising factors will play out in different ways in different states because of the embedded domestic contexts of each individual state.15 We need the discipline to understand the former, and the area studies to understand the latter.

**Studying IPE in an era of globalization**

The dominant approaches to understanding contemporary Chinese IR have a number of pitfalls for researchers. However, IPE does not have all the answers. On the contrary, a starting point for this paper is that IPE itself can be enhanced by taking on a more comparative nature that is aware of the contexts of individual states – and in particular, states from non-core areas of the global political economy.

From Kenichi Ohmae at one extreme, to Hirst and Thompson at the other, there is a vast literature attempting to understand what globalisation really means (or in the case of Hirst and Thompson, to ask if it is even happening at all).16 As Hurrell notes:

> Although rarely tied to any very clearly articulated theory, it [globalization] has become a very powerful metaphor for the sense that a number of universal processes are at work generating increased interconnection and interdependence between states and between societies.17

[original emphasis]

There is simply not space here to trawl through all the different IPE interpretations of globalisation, and clearly any comment about the nature
of globalisation, and IPE studies of it, runs the risk of making gross generalisations. However, just as there are methodological pitfalls in using dominant approaches to understand China’s IR in an era of globalisation, so too there are potential methodological pitfalls in the IPE literature.

**Universalism**

The first pitfall is one that emerges from trying to make definitive statements that contain universal truths. Trying to find a once-and-for-all answer to, for example, the question of which has power, states or markets, is essentially misguided. The real quest should be twofold: the first goal is to discover differential levels of power in the international political economy – an approach that fits well with conceptions in the Chinese literature regarding the uneven nature of power in a unipolar globalised world. Quite simply, there is a clear divergence in each state’s ability to dictate, respond or react to globalising forces. This study, then, shares an understanding with those scholars who perceive globalisation as an uneven process.\(^{18}\) For proponents of this view, rather than globalisation leading to harmonisation and convergence, “existing inequalities make it more likely that globalization will lead to an increasingly sharp division between ‘core’ states, who share in the values and benefits of a global world economy and polity, and ‘marginalised’ states.”\(^{19}\)

The second goal is to embrace divergence and, deploying the insights of area studies, consider how the relationship between states and power is determined by the specific setting; to accept that the ability of humans to change history (agency) is constrained by the economic and social structures within which they exist; but also to accept that the balance between agency and structure may vary on a case-by-case basis. IPE should not only allow diversity, but indeed emphasise the fact that there is no single explanation and no single set of relationships. The researcher should consider, particularly through comparative approaches, how different sets of relationships emerge with different balances of power between actors in different and specific historical, geographical, social and political contexts. As Tim Shaw has argued:

> any local-to-global social relationship inevitably includes a trio of heterogeneous actors [states, non-state economic actors and civil societies] … To be sure, the balance among this trio varies between regions and issue-areas and over time but none of them can be excluded or overlooked in any ongoing relationship.\(^{20}\)

This approach does not lead to simplicity. Nor does it lend itself to snappy book titles or defining characteristics that ensure good results on citation indexes. But as Hettne and Söderbaum argue,\(^{21}\) the world is complex, and saying this is much better than truncating reality to fit methodological or ideological predilections.
IPE as a study of developed states

The search for universal truths is helped when the universe is contracted. Tony Payne has argued that theories of hegemony were largely constructed around observations of the US experience, moderated by some comparisons with Europe. What we end up with is a concept constructed from a narrow set of cases. More to the point, a concept that, because it is so case (or a few cases) specific, might not have relevance outside that setting. The same argument can be made for many of the approaches within IPE. Once we move outside the setting of the case studies (either explicit or more inferential) that have been used to construct theory, then the applicability of theory becomes more questionable.

One of the major research questions for IPE scholars is to consider the relationship between the state and the market. But much of this literature is based on understandings of the role of the state in advanced industrialised democracies. The separation of state and market that underpins much IPE analysis in the West does not always hold true outside the context of the West itself.

Van Wolferen, for example, has long argued that Western analysts fail to understand Japan because they start with false assumptions. The concept of a separation between public and private that lies at the heart of some investigations of political economy is, according to van Wolferen, absent in Japan. For Deans, this is a consequence of “both the traditional understanding of ‘economy’ in East Asia and the way in which market economies were established there.” For Whitley, capitalism in Japan developed in a different way from in the West due to “pre-industrial legacies, patterns of industrialization, and twentieth-century state structures and policies.”

There are effectively two problems here. The first is the aforementioned dominance of studies of advanced industrialised economies. Even in some of the best works on comparative capitalism, the emphasis remains on advanced industrialised economies. Similarly, with a brief exception for analyses of the Asian financial crises, discussions of developing states are in a minority in the major IPE journals. Here, though, we should note a difference between US journals and those in Europe – particularly the UK, and particularly in New Political Economy.

The second problem emerges from the potential of concept stretching. If Van Wolferen is right, and Western paradigms are used incorrectly to try and understand things that look similar in Japan, then the problem becomes magnified when we move on to look at states like China. When China was a state-planned economy, it was relatively easy to analyse. We knew that China’s political economy was different and treated it as such (though sometimes falsely putting it in a box with other “different” states – assuming that socialist economies were all the same, for example). As China has reformed and moved away from socialism, we have found it increasingly difficult to box. Dealing with the bits that are still different...
from most other societies remains relatively easy. The problem is that of the familiar.

For example, there is a widespread understanding of how stock markets work and why they exist in the West. Now that China has stock markets, it is tempting to assume that they serve the same functions in China and work in the same way as they do in London, Frankfurt or New York. But as China “area study” specialists know, not only do Chinese stock markets serve different purposes and interests, but the stock exchanges in Shanghai and Shenzhen each have different characteristics. The embedded power of the state in the emerging Chinese market economy means that we have to be very careful in deploying modes of analysis devised from case studies in very different parts of the world.

The nation-state as the unit of analysis

As with much of the economics and IR literature, there is still a tendency in IPE to consider the nation state as the unit of analysis. Even studies of globalisation normally consider how this impacts on states, rather than disaggregating the state as a unit of analysis. On a very simple level, we need to remember perhaps the first question of politics – who gets what? So we should not ask if, for example, China will benefit from joining the WTO, but instead ask who will benefit and who will not. As China specialists know, reform has had a highly differential impact on Chinese society. The gap between the urban and the rural is just one example, to which we could add the benefits accruing to the existing elites versus the benefits accruing to the workers,28 and many others.

The Chinese case also reveals massive regional differentials: while some parts of China have become embedded within internationalised networks of production and are highly integrated into the global economy, other parts of the country are at best only marginally participating. This is not to say that they are unaffected by globalisation, but to suggest that they are not internationally “integrated.” As new spatial patterns of economic activity emerge that are less national, and more transnational in character, these new transnational economic spaces become “denationalised” or dis-embedded from the national economy. In effect, there is a disjuncture between national political space and internationalised economic spaces where the local interacts with the global.

This recognition of the differential impact within nation states is manifest in only a few theoretical pieces considering the political economy of regional integration and the relatively small body of IR literature dealing with globalisation and integration.29 There are a number of good case studies discussing the significance of sub-national and cross-national regional integration in various parts of the world. Nevertheless, work on microregionalism, and the way that globalisation can lead to a disjuncture between the national political and emerging transnational economic space remains an understudied
phenomenon.30 In this respect, much of the work on the spatial impact of globalisation on China and the importance of the local state is ahead of the game, and provides important insights for IPE theorists.

Teleology and politics: what drives globalisation?

The final potential pitfall is the danger of falling into teleological explanations. To be fair, teleological explanations no longer have much salience in IPE discourses in the West. However, discussions of globalisation in China often come back to the assertion that it is an economic phenomenon, and not a political one. This view is based on a separation of economics and politics that is also evident in wider interpretations of globalisation. In its extreme form, such a separation of economics and politics can lead to understandings that take globalisation as a given factor, or something that is divorced from politics.

Critics will complain that this is a caricature of Chinese work on globalisation. They will point to the fact that Chinese scholarship on globalisation does consider how states can respond and live with globalisation, and also deals with the political implications of participating in a globalised economy. A good example comes from Wang Yizhou:

Globalisation also naturally represents a process of politics, which is used here in its widest sense. That is to say, in addition to the operation of government, the competition among upper-level leaders, and speeches given by various politicians, it includes decision-making, such as making development strategy, handling social conflict, assessing opportunity as well as challenge, working out the timetable for opening up and participation. Economic globalisation has become a growing tendency, causing social instability in many countries. It urges national states in the age of globalisation to adjust or change their set agenda.31

On one level, Wang’s piece is instructive in its recognition that globalisation impacts on state sovereignty and permeates into societal issues. It also recognises that globalisation does not just happen, but is dependent on government decisions and policies. But on another level it is problematic as it considers the political responses to globalisation, without accepting that economic globalisation in itself is inherently political.

In proposing an IPE framework for considering China’s IR in an era of globalisation, it is essential to start from an understanding that globalisation does not just happen. It is a phenomenon that is driven by the complex interaction of a number of factors – by technological advances, and changing patterns of production, which place a significant element of power in the decisions of non-state economic actors; by the policy preferences and dominant ideas within the major international financial institutions; by the result of the actions and policies of states, based on an acceptance that neo-liberal economic policies are the best way of generating growth. In this respect,
globalisation also entails an ideological dimension. In combination, as Bernard and Ravenhill argue in relation to the political economy of East Asia,

the emerging political economy of East Asia should be understood in terms of the relationship between changes in the global political economy, changes in the political economy of individual states, and changes in the organization of production.\(^{32}\)

**Technology and production**

One of the key driving forces for globalisation, then, has been technological changes which have facilitated changing modes of production. For Oman, a “principle macroeconomic force shaping those dynamics and driving ‘globalization’ ... is the ongoing development, formidable competitive strength, and spread ... of post-Taylorist ‘flexible’ approaches to the organization of production within and between firms.”\(^{33}\) While there has always been world trade, the structure of that trade has changed. Rather than raw materials flowing to production sites, and finished goods flowing to markets, the production of a single commodity can now take place at a number of different stages in a number of different states. “Capitalism today ... entails the detailed disaggregation of stages of production and consumption across national boundaries, under the organizational structure of densely networked firms or enterprises.”\(^{34}\) As such, the investment-trade nexus has become increasingly significant, as investments move to the most profitable location for specific parts of the production cycle.

Building on the work of Cox,\(^{35}\) the “new political economy” approach associated with Andrew Gamble, Tony Payne and others,\(^{36}\) argues that the international economy of the Bretton Woods era characterised by exchange relations between national economies has been replaced by a global economy grounded in production and finance:

The formative aspect of the new global political economy is seen to be the structural power of internationally mobile capital. States now have to recognise the power not only of other states and international organisations ... but also of international capital, the banks, and foreign exchange markets.\(^{37}\)

It is a system where non-state actors play a significant role in shaping financial and commodity flows, but one in which states and state actors remain key actors.

**The state as facilitator of globalisation**

While accepting that non-state actors have considerable power in the global political economy, we also need to think about the political dimensions and
political decisions that have facilitated their increased power. Technological changes may have created the potential for more globalised production, but turning potential into reality has depended on policy changes by governments. As the German Bundestag report on globalisation forcefully argued: “The growing worldwide integration of economies came not by any law of nature – it has been the result of active and deliberate policies.”

First, we need to consider how non-state actors came to have such power in the first place. While Susan Strange asserted that transnational corporations (TNCs) are key actors in the promotion of globalised production, she argued that this did not occur by accident, but through the deliberate and specific policy preferences of governments in the developed world: “It was not that the TNCs stole or purloined power from the government of states. It was handed to them on a plate – and, moreover, for ‘reasons of state’.” Strange goes on to argue that even the US government could not contain the forces that it unleashed, and that even the world’s most powerful government finds its actions constrained by the actions of TNCs. Nevertheless, this should not obscure the fact that the original liberalisation of the economic structure was based on political choice and decisions.

State policies and ideational change

This analysis effectively concentrates on what we might call the initiators of globalisation. But we also need to consider the political dynamic of globalisation in developing states. In the 1960s and 1970s, much of the literature on developing states concentrated on the attempts to ensure that developing states did not become locked in a system of dependency on the core states. There is also a considerable literature on the way in which international financial institutions forced neo-liberal agendas on developing countries through conditionality on aid packages. But in the current era, the dynamic is very different. As Bowles argues:

By 1991 the purpose … was no longer premised on the need to be more independent of the global economy but rather seen as a measure to ensure continued participation in it. The fear of developing countries was no longer one of dependence on the global economy but rather was seen as a measure to ensure continued participation in it.

In the wake of the financial crises of 1997, some of the enthusiasm for neo-liberal economic policies has been tempered, and now there is increased interest in how best to regulate global capitalism. Nevertheless, if globalisation is the new dependency theory, then it is in large part a domestically self-imposed dependency – dependency as the best way of achieving growth.

There are two key issues to consider here. The first is the “ideological” or “ideational” change. In short, key elites in much of the developing world
have altered their policy preferences and accepted the neo-liberal project as the best method of achieving growth. The second issue relates to specific policy changes designed to facilitate globalisation. On one level, while the internet and telecommunications facilities increase the speed of communication, goods still have to be transported around the world on ships, trucks and trains. In order to do this, you need the necessary “hard” infrastructure, almost always provided through state investment, rather than through private sector funding. “Transport and communications are massively state-subsidized, and the overhead costs of transport and communication (e.g. policing, rules and regulations) are met not by the users but by the general public.”

On another level, policies conducive to the international economy do not just occur on their own. The SEZs are not “natural economic territories,” as Scalapino has defined emerging cross-border micro-regions – they were established through political fiat, and supported by other state policies on taxation, distribution, etc. The Chinese government has invested billions of renminbi to provide an environment in which foreign investment and trade can flourish, as it is now doing in an attempt to develop the west of China. Local governments, too, have invested huge amounts of money to increase their attraction to foreign investors, often in competition with other local authorities. And perhaps most importantly of all for the future, the decision to join the WTO, and to accept all the disciplining elements of neo-liberalism that follow, was a political choice.

In summary, this internal process of change has been promoted by what Leslie Sklair terms “globalising state bureaucrats,” who might also be considered as constituting a party–state comprador class. This group epitomised by the policies of Zhu Rongji, is engaged in a process of making the investment regime within China more and more liberalised and attractive to international capital, and reforming the domestic economic structure to reduce domestic protectionism and institute a more neo-liberal economic paradigm. In combination, these processes can best be understood by using a framework of analysis established by Robert Cox:

There is something that could be called a nascent historic bloc consisting of the most powerful corporate economic forces, their allies in government, and the variety of networks that evolve policy guidelines and propagate the ideology of globalisation. States now by and large play the role of agencies of the global political economy, with the task of adjusting national economic policies and practices to the perceived exigencies of global economic liberalism. This structure of power is sustained from outside the state through a global policy consensus and the influence of global finance over state policy, and from inside the state from those social forces that benefit from globalisation (the segment of society that is integrated into the world economy). Neo-liberalism is hegemonic ideologically and in terms of policy.
Towards a framework of analysis

In his attack on Bates, Johnson suggested that all that the disciplinary community wanted from area studies specialists was raw information that could be used by the “scientists” in their own work. In promoting the efficacy of IPE approaches for the study of contemporary China, it is not my intention to make a similar mistake. Rather, I suggest that by considering the importance of globalisation, area studies specialists can enhance their own understandings, and also contribute to a more holistic and comparative IPE. Indeed, the substantial body of work that analyses the role of the local state in China – particularly in terms of the local–global nexus in China’s international economic relations – provides a rich source for IPE theorists.

Studying Chinese IR

In terms of the study of China’s international relations, this framework suggests moving away from bilateral and statist interpretations of IR. In particular, it suggests increased attention on the interaction among Chinese state elites at various levels and external non-state actors. There is a lot of good research being undertaken to study the way in which parts of China are integrating with the global economy, with a particular and entirely appropriate emphasis on China’s coastal provinces. This work, which emphasises the partial national nature of integration into the global economy, and points to issues related to the integration of the national economy as a whole, makes an important contribution to theoretical understandings regarding the impact of globalisation on nation states. However, there are two areas in which this work needs strengthening.

The first is in the way that these analyses fit into overall analyses of China’s IR. While some may reject this, on the grounds that the relationships under investigation are purely economic, this denies the linkages between politics and economics outlined above. Although there are clearly exceptions, the vast majority of work on Chinese IR both from within and outside China still concentrates on official government-to-government relationships. If we take the local–local nexus in Sino-Japanese relations as an example, it is clearly important to focus on the dialogue between local governments in China and Japan. Such relations are also facilitated or at least supported by national government agencies. But while intergovernmental activity remains crucial, governments are not the only actors. We also need to consider the role of individual companies, the relationship between different companies in the supply chain, providers of transportation, and even the role of Chinese students who have returned to China after being educated in Japan and who helped broker a sister city relationship between Dalian and Kita Kyushu. In this case, the role of the local state acting to further the interests of non-state economic actors (primarily on the Japanese side) is particularly notable.
Second, it is important not to focus too closely on specific localised manifestations of such relationships. There is, for example, now a considerable literature on the emergence of this thing called “Greater China.” Some of this literature has, at its heart, an understanding of the complexities of the relationship. Going beyond a simple bilateral level of analysis, they consider the wider regional and global processes involved. Others do not. They are instead over-concerned with, for example, showing how China is trying to ensnare Taiwan through economic relations. Even some of those analyses that recognise that the political borders of China are not the parameters of economic activity often replace a politically defined boundary of economic activity with another one – even if this new one is the conflation of a number of different political boundaries. An understanding of a “Greater China” economic space is constructed which does not give due significance to the role of Japanese and US interests and actors. Economic regionalisation is taking place within Greater China, but key extra-regional actors and processes shape this regionalisation. A concept designed to illuminate the transnational nature of economic relations can, without care, obscure more than it reveals.

We need to move beyond this national basis of analysis. We should also think of how the particular and the localised fit with wider regional/international modes of analysis. It is entirely correct to focus on the way in which localised relationships between local Chinese officials and Hong Kong and/or Taiwanese businessmen is helping shape China’s re-engagement with the global economy. But these local sets of relationships do not exist in isolation. Regional and global modes of production are primarily transmitted or linked into China through more localised relationships. Indeed, overseas Chinese networks often deliberately exploit cultural links in locating themselves at the local level in China. But these localised relationships are themselves predicated on the wider structure of a regional and global economy. If Taiwanese companies were not signing Original Equipment Manufacturing deals with Japanese and American companies to produce computers for Western markets, then these same Taiwanese companies would not be moving parts of their productive capacity to China. If Contract Manufacturing Enterprises in Hong Kong were not contracted to produce toys for Disney for resale in the West, then the level of economic integration between Hong Kong and China would be considerably diminished.” The overall structure may be a regional one, or indeed even a global one. But the mechanism through which China is integrated can be a local one, or indeed, through a number of different local processes. Thus, I follow Smart’s understanding that “many capitalist practices are embedded in local structures, and that certain contexts can generate new and vibrant variations upon the theme of capitalism. If nothing else, globalization produces a considerably diverse set of local outcomes.”

The structure of regional capitalism, then, goes much deeper than either bilateral or regional levels of analysis can hope to explain. A good example
is the case of the production of Barbie Dolls first reported in a *Los Angeles Times* report in 1996, and subsequently cited in the Chinese 1997 White Paper “On Sino-US Trade Balance.” “Barbie” is produced by the Mattel Company, which has its headquarters in El Segundo in California. Mattel sub-contracts to a company in Taiwan to produce the dolls. The Taiwanese company imports plastics from the Middle East and synthetic hair from Japan. The dolls are semi-finished in Taiwan, and then exported to China through Hong Kong for the final stages of production. From there, the dolls are re-exported through Hong Kong to markets in the developed world.

Anita Chan has investigated similar processes in the production of sports shoes in Guangdong Province. The world’s biggest shoe factory in Guangdong, a joint venture with the Yu Yuan Company in Taiwan, produces sports shoes carrying Reebok, Nike and Adidas labels. FDI and import statistics indicate the importance of relations with the rest of Asia, and export figures show Chinese exports to Japan and the West – yet the brand names on the goods are associated with major Western corporations. Similarly, Sasuga has shown that computers bearing the “made in China” stamp produced through Taiwanese investments in southern China (now primarily Dongguan) contain virtually no Chinese content other than occasional inputs to peripherals (i.e., plastic casing for keyboards, etc.). The high tech components are all produced in Taiwan, Japan or the US, with most of the Taiwanese companies operating under OEM licenses with original companies in Japan or the US.

If we simply focus on the local manifestation of these production networks, what we see are increasing linkages between southern China, Hong Kong and Taiwan. While such linkages are clearly increasing, we need to see the whole picture, which suggests that localised networks are themselves a result of wider globalised networks of production, many of which originate in the US.

**Studying Chinese politics**

One of the basic tenets of IPE is that the distinction between the domestic and the international needs to be broken down. As Gamble, *et al.*, argue: “the separation between the global and the local no longer holds, as the new hierarchies of the global economy cut across regional and national boundaries.” As such, deploying IPE approaches not only has efficacy for studying IR, but also for the study of domestic Chinese politics. Even before China’s entry into the WTO, this assertion held true. But in the coming years, for example, as China’s legal structure continues to become WTO compliant, the significance of the global for the domestic in China will become increasingly apparent. It will remain entirely correct to consider the actions of Chinese elites from an understanding of the specific social, economic, historical and cultural context of China. But any such analyses will also have to consider the context of globalisation, and the way that the market or neo-liberalism has a disciplining impact on domestic polities.
Following from this, we need to internationalise the study of factional formation and political alliances in China. I contend that the decision to join the WTO in 1999 cannot be considered without recognition of an alliance between reformers in Beijing, and those in the US and elsewhere that wanted to promote a type of reform in China that conforms to international norms and the interests of the “international community.” Here we return to the key issue of how leaders changing conceptions of “the national interest” have a crucial impact on policy. As Fewsmith convincingly argues:

Frustrated by bureaucratic obstruction to fundamental reform, Zhu was willing to avail himself of foreign competitive pressures to force restructuring. As Zhu put it in his report to the recent meeting of the NPC, “China”s economy has reached the point where it cannot further develop without being restructured’.54

Outside China this idea is perhaps best summed up by an official White House statement of March 2000 which could almost be a definition of liberal international relations theory:

China’s accession agreement will deepen and help to lock in market reforms – and empower those in China’s leadership who want their country to move further and faster toward economic freedom. In opening China’s telecommunications market, including to Internet and satellite services, the agreement will expose the Chinese people to information, ideas, and debate from around the world. And China’s accession to the WTO will help strengthen the rule of law in China and increase the likelihood that it will play by global rules.55

The boundaries between economics and politics as academic disciplines also need to be broken down. The chief constraint on economic restructuring – particularly within the financial system – is political will, and the biggest challenge to political stability lies in how the leadership handles economic restructuring.56 Add this to the national-international linkages noted above, and we arrive at a situation which is almost the basic defining characteristic of IPE as a field of enquiry. Returning again to the WTO issue, the delays in reaching a final agreement after the November 1999 agreement between China and the USTR office can largely be explained by considering how domestic political demands in each negotiating partner were played out in an international forum.

Therefore, while the state is still important, our understanding of the dynamics of power within China must accept that sovereignty, in the economic sphere at least, is “perforated,”57 and that external actors influence the functioning of the Chinese political economy. As suggested in the introduction, globalisation has increased the number of actors in policy making and the power of external actors.
In Sassen’s words, the global becomes embedded within the national. She argues that the effects of economic globalisation often “materialize in national territories,” and that “the strategic spaces where global processes are embedded are often national; the mechanisms through which new legal forms, necessary for globalization, are implemented are often part of national state institutions.” Following Sassen, we need to investigate the impact of globalisation on the institutional balance of power within China’s governmental structures – as suggested in the Introduction – to argue that globalisation leads to a renegotiation of relationships among state actors. Sassen’s main emphasis was on the shifting balance of power among different ministries and agencies within government – the financial agencies may gain power and influence while others may lose. In the specific case of China and the WTO, the state organs in charge of reforming the legal structure within the National People’s Congress will play an increasingly important role in shaping the bases of China’s domestic political economy. While separating the state from the Party is still an inherently difficult task in China, WTO membership should further strengthen the role of state organs, particularly legal institutions of the NPC, vis-à-vis those of the Party. In this respect, fundamental political reform in China is inspired, or perhaps more correctly, facilitated, by an international economic agreement.

The search for political change in China should not be constrained by views that equate political change with democratisation or that conceive that economic reform inevitably leads to democratisation. Ironically, while such approaches were designed to explain the link between economic and political change, equating political change with political liberalisation can actually contribute to the depoliticisation of analyses of economic change – no liberalisation is equated with no political reform. Rather, we should assess the reformulation of political alliances and strategies – alliances within China’s political elites, between political elites and new economic elites, between elites and societal groups, and between domestic and transnational actors. These changes were occurring long before China’s WTO entry – but entry could accelerate them.

While IPE as a discipline is largely concerned with the relationship between state and non-state actors, in the Chinese case, the emphasis should be on how these relationships are emerging. In particular, the way in which a new bourgeois class (or classes) emerge from within the existing party – state elites – and the way that they utilise their political position to enhance their economic position – warrants further attention.

Finally, we need to consider ideology and ideational change. If “neoliberalism is hegemonic ideologically and in terms of policy,” as Cox suggests, then we need to consider the mechanisms by which it becomes hegemonic. This is partly a result of the use of blunt instruments of power by the core states to enforce change on developing countries. For example, in developing his concept of “disciplinary neo-liberalism,” Stephen Gill argued that “the US government is using access to its vast market as a lever of
power, linked to a reshaping of the international business climate, by sub-
jecting other nations to the disciplines of the new constitutionalism, whilst 
largely refusing to submit to them itself.”

Although published almost seven years before China joined the WTO, this understanding could have all 
but been designed to understand the process.

But there are also many much less blunt ways in which ideas are trans-
ferred from one setting to another. Through educational exchanges, the 
 provision of training programmes to allow Chinese officials to become 
“WTO compliant,” the rise of the Internet, and increased access to the 
outside world, and so on, Chinese academics, government researchers and 
policy makers all learn from overseas. Business people, too, are developing new concepts and practices through processes of “social learning” and 
“industrial learning.” Chinese government policy is increasingly being 
shaped by the actions of pro-market “policy entrepreneurs,” and also by 
epistemic communities that are often transnational in nature.

Conclusion

In a special edition of *New Political Economy* in November 2000, Breslin 
and Higgott called for “regional-based groups/communities of scholars to 
talk more within a disciplinary framework in order to provide a basis for 
dialogue and comparison.” This desire to imbue area studies with more 
discipline, whilst accepting that more analyses of non-core states can 
enhance the discipline itself, was also at the core of Payne’s important paper 
on the political economy of area studies and IPE. The aim of this paper, 
then, is to contribute to an understanding of how area specialists and dis-
ciplinary specialists can together improve the study of each.

The way that China receives or responds to globalisation is very much 
embedded in the specific historical, political and cultural contexts that have 
influenced the emergence of the contemporary Chinese political economy. But 
it is no longer possible to consider this Chinese political economy by only 
considering the internal dynamics of change. Through conscious political 
decision, elements of the Chinese leadership have chosen to integrate China – 
or at least, parts of China – into the global political economy. In the process, 
they have allowed Chinese sovereignty, in the economic sphere at least, to 
become “perforated,” and increased the number of actors in the policy sphere. 
As Strange so forcefully put it in response to Krasner in the *Review of Political 
Economy*, “Wake up. The world has changed.” We need the country knowl-
edge and the disciplinary knowledge truly to understand the dynamics at work.

Notes

1 For two recent examples, see Nicholas P. Lardy, *Integrating China into the Global 
Economy* (Washington, DC: Brookings Institution, 2002); and David Zweig.


See, for example, the special issue of The Third World Quarterly, vol. 17, no. 4 (1996), which assessed how different embedded historical, political, social and “cultural” contexts led to different developmental outcomes in East Asian states, notwithstanding similar internationalising contexts.


23 The classic study remains Susan Strange, *States and Markets* (London: Pinter, 1994).


28 Perhaps the best account of the process by which the Party–state elites have “captured” many of the benefits of reform is He Qinglian, *Xiandaihua de weixian – dangdai zhongguo de jingji shehui wenti* (Pitfalls of Modernisation – Contemporary China’s Economic and Social Problems; Beijing: Jinri Zhongguo chubanshe, 1998).


30 This is something we tried to redress in Breslin and Hook (eds), *Microregionalism and World Order.*


35 Specifically, Robert Cox, “Social Forces, States and World Orders: Beyond International Relations Theory,” *Millennium*, vol. 10 (1981); and “Gramsci,

Gamble *et al.*, “Editorial.”


Bundestag Study Commission, *Globalisation of the World Economy*.


Sklair outlines four groups that constitute the new transnational elite class in the South. In addition to globalising state bureaucrats, these are capitalist-inspired politicians, transnational corporation executives and their local affiliates, and consumerist elites. See Sklair (1995): 135–36.


Johnson, “Preconception vs. Observation.”

For example, how component producers move to China to follow their key partners.


58 Saskia Sassen, “Embedding the Global in the National,” in David Smith, Dorothy Solinger and Steven Topik (eds), States and Sovereignty in the Global Economy (London: Routledge, 1999), p. 159.


60 Cox, “Civil Society,” p. 12.


64 Payne, “The New Political Economy of Area Studies.”

2 Soft balancing and reciprocal engagement

International structures and China’s foreign policy choices

Chen Zhimin

Introduction

Locating the determinants of Chinese foreign policy is always a puzzling task. Usually, scholars can identity two general sources of a state’s foreign behavior: domestic and international. In the study of international sources of foreign policy, two approaches have been invoked by scholars: one focuses on the impacts resulting from the interactions among international actors, while a second focuses on the impact of the international structure. China’s speedy rise as a political and economic power during the last two decades is one of the defining developments of the current international system. This paper will use structural theories to analyze the international determinants of Chinese foreign policy at the structural level.

Recently, a number of studies by Chinese and Western scholars have been devoted to this topic. However, these studies are more descriptive than theoretical, more disciplinarily based than inter-disciplinary. Therefore, this paper will confront various theories of international structure, integrate the political, economic and normative dimensions of international structures, so as to reach a fuller understanding of the structural determinants of Chinese foreign policy choices, which will not only explain current Chinese foreign behavior, but also predict its future development.

International structures and state behavior: conceptual issues

Scholars from different disciplinary backgrounds have been arguing that the most decisive causes of a state’s foreign behavior should be found at the structural level of the international system. But what is the structure and how does it condition a state’s behavior? This section will review the main structural theories, and by assuming that states seek security, wealth and identity at the same time, presents a tripartite framework for understanding international structures.
The international political structure

The dominant theory of international relations before the 1970s, realism, is a “reductionist” theory that ignores international structure and assumes that political and economic domains are essentially separate. In his 1979 book *Theory of International Politics*, Kenneth Waltz developed a structural theory of international politics, which tried to remedy the two perceived shortcomings of traditional realism. On the one hand, Waltz articulates a structural theory of international politics, which traces the most important determinants of state behavior to the structure of international politics; on the other hand, he advances a political theory of international politics as well as international economy.

For Waltz, “a system is composed of a structure and of interacting units,” where structures are defined first “according to the principle by which a system is ordered.” That ordering principle is anarchy, or “politics in the absence of government.” In an anarchic world, units, or states, would face three kinds of structural constraints:

- Survival: Though the aims of states may be endlessly varied, “survival is a prerequisite to achieving any goals that states may have.”
- Self-help: In an anarchic world, states first have to rely on themselves for their own survival or any other valued goals. “A self-help system is one in which those who do not help themselves, or who do so less effectively than others, will fail to prosper, will lay themselves open to dangers, will suffer.”
- Balancing: States will engage in balancing behavior, whether or not balanced power is the end of their acts. The balance of power can take two forms: internal balancing and external balancing. The former relies on a state’s own capabilities; the latter relies on the capabilities of allies.

The structure of international politics is defined, secondly, by “the distribution of capabilities across units.” For Waltz, market structure is defined by counting firms; international-political structure is defined by counting states. To put it simply, international structure could be defined as unipolar, bipolar or multipolar, if the number of great powers is one, two, or more than two. Changes in this distribution lead to changes in the system. While anarchy poses structural pressures for states to worry about their survival, to be self-reliant, and to engage in internal or external balancing, the polarity of the structure shapes the expectations and balancing strategy of states.

Waltz intends to build a parsimonious structural theory. In so doing, he tries to omit most of the unit-level qualities in his structural theory. However, he retains two unit-level qualities that are crucial for his theory: an assumption of states being security maximizers and the military capabilities of states. His balance-of-power theory goes on to argue that in an anarchical
world, security-maximizing states will stress the importance of self-help, and balance against the emerging dominating power, or in a world where there is a dominating power, weaker states will ally with each other to balance against that dominant power. Furthermore, the polar structure, which is determined by the distribution of state capacities, will shape the particular balancing strategies of the states.

This paper argues that Waltz's first assumption about states is not adequate. States are concerned about their security and survival; but they also strive for wealth and identity. If that is the case, we should not expect the international political structure alone to explain state behavior. Rather, we might consider the impact of the international economic and normative structures.

Two views challenge the assumption about the international political structure. First, states balance against threats, not power. For example, Walt contends that states do not align solely or even primarily in response to the distribution of balances. Instead, argues Walt, states balance against threat. A threatening power may not be the predominating power, but one with substantial aggregate power, close geographic proximity, offensive capability and aggression. By introducing new unit-level qualities into the structural theorizing and by replacing the distribution of capacities with distribution of threats, Walt claims that his theory “improves on traditional balance of power theory by providing greater explanatory power with equal parsimony.”

The other challenging view concerns Waltz’s assertion that states mainly balance rather than bandwagon. However, writing in 2000, Waltz admits that states employ various survival strategies, with balancing only one of them. In fact, bandwagoning may be less demanding and more rewarding than balancing, requiring less effort and extracting lower costs, all the while promising concrete rewards. So, states with insufficient resources for balancing and little room to maneuver may prefer to bandwagon. Still, Waltz thinks his theory applies to the strategic choices of “major states,” because “the recurrent emergence of balancing behavior, and the appearance of the patterns the behavior produces, should all the more be seen as impressive evidence supporting the theory.” In disagreeing with Waltz, Schweller argues that, other than security, states also seek self-extension: to obtain added values that they covet. “Balancing is driven by the desire to avoid losses; bandwagoning by the opportunity for gain.” To achieve self-extension, states might opt for bandwagoning more than balancing.

**International economic structure**

States seek security, but they also seek wealth. As major states in today’s international system have already become or, like China, are becoming market economies, a chief function of modern states is the generation of wealth. Even a self-professed state-centric realist, such as Robert Gilpin,
argues that, “economic issues certainly have become much more important since the end of the Cold War and have displaced, for the United States and its allies, the prior overwhelming concern with military security.” In a globalizing world, welfare-seeking states and profit-seeking firms within them increasingly produce wealth through international economic activities, such as trade, investment, loans, and global production. In doing so, they are increasingly subject to the constraints and opportunities derived from the emerging international-economic structure. Despite the increased saliency of security since September 11, the pursuit of wealth remains a basic function of the modern state, subjecting state behavior to the influences of the international economic structure.

Since the end of the Second World War, and particularly since the 70s, expanding international economic flows have brought a new phase of globalization which has “not only qualitatively surpassed those of the earlier epochs, but ... also displayed unparalleled qualitative differences.”

In 1950, world exports amounted to seven per cent of world output, but were 17 per cent by 1995. The annual turnover of foreign exchange has grown astronomically from an already huge $17.5 trillion in 1979 to about $300 trillion in 1995, from 12 times the volume of world trade to about 60 times. Production is also increasingly global. In 1998, there were 53,000 Multinational Companies (MNCs) worldwide, with 450,000 foreign subsidiaries. Their global sales reached US$9.5 trillion. The annual turnover of some giant MNCs already surpasses the GDP of many nations. MNCs account for two-thirds of world trade, play a major role in the generation and global diffusion of technology – accounting for 80 per cent of world trade in technology – and are the major source of foreign direct investment (FDI).

Globalization is a product of Western liberal economic policies and reinforces the predominating position of economic liberalism in the post-Cold War era. The collapse of the Soviet command economy, the failure of the Third World's import-substitution strategy, and the outstanding economic success of the American economy in the 1990s have encouraged a general acceptance of the market economy as the only way to achieve economic development. Globalization creates a global market. And although this market relies heavily on the supportive policies and strong interests of major states, it has become an important mechanism, or structure, determining both domestic and international economic affairs, and thus the policy choices of states.

The logic of this global market is marked by freer trade, freer capital flows and global production. For states living in this globalized context, the structural constraints they confront are:

- At both the domestic and international levels, a market system creates a hierarchical division of labor based on specialization and comparative advantage, leading to a dynamic core and a dependent periphery. The
core is characterized principally by its more advanced levels of technology and economic development; the periphery, at least initially, depends on the core as a market for its exports and as a source of productive techniques. However, in the long term, growth and the diffusion of productive technology creates new cores in the periphery which become growth centers in their own right.16

- This global market favors states with good locations, rich factor endowments, and easy access to big markets. With their comparative advantage, these states have a better chance to develop through expanding their international trade and attracting foreign investments.
- This global market also favors states that adopt certain domestic policies: stable government, trade liberalization, prudent fiscal policy, friendly investment policy (taxation, infrastructure, regulation, education, etc.), and a cooperative policy towards major core states. These domestic and foreign policies will provide favorable conditions for trade to boom, for FDI to flood in, for foreign technology to be transferred.

Essentially, this global economic structure rewards states that adopt the liberal economic rules of the WTO and provide windows of opportunity for periphery states to move up to semi-periphery, even core states.

**International normative structure**

The political and economic structures disclose the material configuration of the international political economy. For rationalists, this is enough. However, for the new constructivists, it is not. A full understanding demands an unveiling of the normative structure that gives meaning to the material structures.

In his *Social Theory of International Politics*, Alexander Wendt produced “structural idealism,” which on the one hand adopted a structuralist approach, emphasizing the emergent power of social structures; on the other hand, Wendt argued that the structures of human associations are determined primarily by shared ideas rather than material forces, an “idealist” approach opposing the dominant “materialist” one.17

Wendt accepts Waltz’s notion of anarchy in international politics, defined as the absence of centralized authority. However, Wendt does not see self-help oriented anarchy as the defining feature of the international political structure. For Wendt, anarchy refers to an absence, not a presence; it tells what there is not, not what there is. It is an empty vessel, without intrinsic meaning. “Anarchy is a nothing, and nothings cannot be structures.”18 For Wendt, “the most important structures in which states are embedded are made of ideas, not material forces,” since “ideas determine the meaning and content of power, the strategies by which states pursue their interests, and interest themselves.”19 Rather than seeing anarchy as the structure, Wendt
regards the shared ideas or cultures of an anarchic system as its structures, and he thinks that anarchy can have at least three distinct cultures – Hobbesian, Lockean, and Kantian – which are based on the role relationships of enemy, rival, and friend.

As Wendt argues, Waltz’s version of the international structure is not the international structure per se, but a Lockean culture, which is based on a specific role structure: rivalry. Unlike “the kill or be killed logic of the Hobbesian state of nature,” the Lockean logic is “live and let live;” rivals expect each other to act as if they recognize each other’s right to sovereignty, and therefore do not try to conquer or dominate each other. This Lockean logic generates four tendencies: warfare is simultaneously accepted and constrained; the system has a relatively stable membership or low death-rate over time; states tend to balance power; and neutrality or non-alignment becomes a recognized status. On the other hand, Wendt finds that, after the Second World War, a new Kantian culture began emerging among Western countries, whose logic was “pluralistic security communities” and “collective security.” A broad interpretation of this Kantian culture could also include such post-sovereignty norms as the protection of human and minority rights, promotion of democracy, and humanitarian interventionism.

Wendt’s definition of structure resembles Waltz’s in the way that they both derive their structures from unit-level qualities: for Waltz, the distribution of states’ capacities; for Wendt, the distribution of states’ identities. A structure emerges when a certain distribution of states’ identities is there. Therefore, “if a critical mass of states position each other as rivals, then the system will acquire a Lockean structure with certain hypothesized dynamics; if a critical mass of states begin to treat each other as friends, then this culture will be transformed into a Kantian one.” By bringing in another ideational unit-level quality, Wendt is able to construct a theory of international normative structure, and disclose the structural constraints on the states’ behaviors.

While Keohane praises Wendt’s book as “a classic work on international relations theory,” he criticizes it for not paying enough attention to key features of this normative structure. Although Wendt is fully aware of the co-existence of the Lockean and Kantian cultures, when he observes that Kantian culture emerges from Lockean culture and when he discusses the possibility of a transformation from a Lockean to a Kantian culture, he does not explore the implications for state behaviors of the cohabitation of these two cultures. What we have seen from the post-Cold War years is a competition between the Lockean and Kantian cultures; the former is supported by a majority of the states, mostly developing and weak, and the latter is promoted by a minority of states that are rich and powerful. The uneasy cohabitation of these two cultures is producing inter-national constraints for states holding different positions in this normative structure.
A tripartite framework for understanding international structure

In presenting his structural theory, Waltz refrained himself from developing a theory of foreign policy, namely, a theory explaining and predicting foreign policies of states. However, structural realism’s failure in anticipating the fall of the Soviet Union and the survival of NATO points to the weakness of its explanatory capacity. Therefore, rather than limit us to just studying the distribution of capabilities and assuming states are only security-driven, this paper expands our vision of international structures by relaxing the assumption about states as seekers of security, wealth and identity at the same time. The result is a tripartite framework for understanding international structures that are comprised of an international political structure, an international economic structure and an international normative structure.

As Wendt explicitly, and Waltz implicitly, point out, in a Lockean world, states are still rivals, but they share and internalize the ideas of sovereignty and territorial integrity. National survival is more secure than in a Hobbesian world. Security-driven states are still engaging internal and external balancing to further guarantee their survival, but balancing is not the entire, partial, or even dominant state motive. Besides seeking security, states also seek welfare, or wealth, increasingly through mutual economic exchange. Thus, the unfolding international economic structure, enforced by the globalization process, is displaying strong structural constraints on the foreign policy choices of states.

To be sure, we should not miss the neo-realist point that the current phase of globalization is built on the unipolar system, dominated by the overwhelming power of the United States. As Thomas Friedman puts it: the world is sustained by “the presence of American power and America’s willingness to use that power against those who would threaten the system of globalization. . . . The hidden hand of the market will never work without a hidden fist.” In the eyes of Waltz, that “hidden fist,” American power, is not hidden, but a fist “in full view.”23 With its power and interests, the United States is able and willing to push globalization forward, and by doing so benefits from this process.

Having said that, we also have to acknowledge the relative independence of this economic structure, and thus its relatively independent structural constraints on states. The current phase of globalization, apart from American power and interests, is also driven by the information revolution, transportation revolution, technology advancement, and leading states’ concerted policy. The multiple driving forces behind globalization indicate that the maintenance and continuation of the international economic structure does not totally rely on American power and interests, and does not always follow the logic of the political structure.

Furthermore, since states are both security and wealth-seekers, the search for security will affect the search for wealth, and vice versa. For neo-realists,
states in anarchy must be more concerned with relative gains than absolute gains, and therefore willing to forego the absolute gains that often derive from economic exchange, out of fear that their relative position will suffer. To turn the logic around, structural liberalism argues that, “in a world of advanced industrial capitalist states, the absolute gains to be derived from economic openness are so substantial that states have the strong incentive to abridge anarchy so that they do not have to be preoccupied with relative gains considerations at the expense of absolute gains.” While structural liberalism tries to limit the applicability of this argument to industrial capitalist states, this author sees no reason to exclude other welfare-seeking states.

In addition, we must also acknowledge the important role of the international normative structure, though we may grant less importance to it than Wendt. The Lockean culture established widely accepted norms of sovereignty, and the emerging Kantian culture is introducing new post-sovereignty norms, which are transforming Western countries into a common security community and creating new tensions between Kantian and Lockean states.

To conclude, I would summarize my key points:

- States are security-seeking units, but also welfare and identity-seeking units;
- In an anarchic world, states tend towards self-reliance, concern over relative gains, and engage in bandwagoning or counter-balancing, either through internal or external balancing;
- Balancing strategies can be modified by the prevailing normative structure, which shapes states’ definition of their enemies and friends and encourages or discourages certain balancing options;
- Balancing strategies can also be influenced by the international economic structure, which in the form of a global market, pushes states to liberalize their economic governance, enhance their level of mutual interdependence, and demands that states develop political relationships which are conducive to their economic relationship.

**China’s peculiar structural position**

*A rising power in a quasi-unipolar system*

“The rise of China,” wrote Nicholas Kristof in 1993, “if it continues, may be the most important trend in the world for the next century.”

Looking back from 2006, China’s achievements in the past two decades have been spectacular, both in terms of their speed and potential. With an annual growth rate of around 10 per cent, China quadrupled its GDP in less than 20 years, and is now the world’s fourth largest economy, if the EU is taken as a whole.
From the early 1990s, the World Bank and IMF have tried to use purchasing power parity (PPP) to recalculate the scale of China’s economy (see Table 2.1). In 2003, the World Bank reported China’s gross national income (GNI) at about US$6.4 trillion, more than five times the GNI measured by the exchange rate as of 2005. With an economy more than half the size of America’s, China has thus overtaken Japan as the second largest economy in the world. This economic catching-up further boosts China’s great power status.

As the world’s most populous state, the third largest territory, one of five formally recognized nuclear powers, and one of the five permanent members of the UN Security Council, China played a significant role in world affairs long before its economic take-off. In the Cold War era, China boosted its strategic importance by maneuvering between the two superpowers, joining first the Soviet bloc in the 1950s, and then allying with the West in the 1970s. The demise of East–West confrontation ended this strategic significance. However, economic growth in the last 25 years not only compensates for the loss of Cold War strategic importance, but uplifts China’s structural position in the international political economy.

The rise of China has taken place in the context of a similarly spectacular rise of American power. As Waltz observed, the demise of the Soviet Union made the international political system unipolar. Huntington agreed that there is now only one superpower, but said that this situation does not make the world unipolar. In a unipolar system, only one superpower coexists with no other significant powers. As a result, that superpower could effectively

### Table 2.1 Key indicators of the major states and the European Union

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>World</td>
<td>6,057</td>
<td>133,806</td>
<td>34,491</td>
<td>51,314</td>
<td>3.3</td>
<td>3.6</td>
<td>100.0</td>
</tr>
<tr>
<td>USA</td>
<td>282</td>
<td>9,629</td>
<td>10,946</td>
<td>10,914</td>
<td>3.2</td>
<td>3.4</td>
<td>9.9</td>
</tr>
<tr>
<td>EU</td>
<td>376</td>
<td>3,240</td>
<td>9,116</td>
<td>10,083</td>
<td>2.4</td>
<td>2.5</td>
<td>39.8</td>
</tr>
<tr>
<td>Japan</td>
<td>127</td>
<td>378</td>
<td>4,390</td>
<td>3,641</td>
<td>3.7</td>
<td>0.9</td>
<td>6.5</td>
</tr>
<tr>
<td>China</td>
<td>1,262</td>
<td>17,075</td>
<td>1,417</td>
<td>6,435</td>
<td>10.5</td>
<td>8.6</td>
<td>6.0</td>
</tr>
<tr>
<td>Russia</td>
<td>146</td>
<td>17,075</td>
<td>375</td>
<td>1,279</td>
<td>0.2</td>
<td>0.2</td>
<td>1.8</td>
</tr>
</tbody>
</table>


From the early 1990s, the World Bank and IMF have tried to use purchasing power parity (PPP) to recalculate the scale of China’s economy (see Table 2.1). In 2003, the World Bank reported China’s gross national income (GNI) at about US$6.4 trillion, more than five times the GNI measured by the exchange rate as of 2005. With an economy more than half the size of America’s, China has thus overtaken Japan as the second largest economy in the world. This economic catching-up further boosts China’s great power status.
resolve important international issues alone, and no combination of other states would have the power to prevent it from doing so. Since this is not the case today, Huntington prefers the new term, “uni-multipolar system.” Since 1993, China has defined the international structure as “One Superpower-Multiple Great Powers” (yichao duoqiang). Although we might refrain from declaring it a unipolar system, the current system is much closer to a unipolar one than at any other time in modern history. As Table 2.1 shows, America’s economy comprises more than 30 percent of the world economy. Its economic growth rate in the last two decades surpassed all other major powers except China. Most strikingly, as Table 2.2 indicates, American military power reached its new peak with its military spending dwarfing the combined military budgets of the EU, Japan, China and Russia. As the US added another US$50 billion to its large military budget in 2002, US military supremacy is ever more unchallengeable.

Alongside the rise of China and the rise of the United States, the world’s other major states or powers suffer from their own problems. Russia has weakened and is struggling for economic recovery. Japan is finally emerging from a decade-long economic downturn, and is only now seeing the light at the end of the tunnel. In the early 1990s, Clyde Prestowitz thought Japan led the US in nearly every important industry, and argued that Japan was verging on hegemonic predominance in the world economy. In 1990, 63 percent of foreign policy elites fretted about competition from Japan; that fell to 21 percent in 1994 and a mere 14 percent in 1998. The European Union is steadily moving ahead on its integration course, but its global influence is shadowed by a sluggish advancement in the EU’s political integration. As Waltz argues, the EU’s problem is that, it “has all the tools – population, resources, technology and military capabilities – but lacks the organizational ability and the collective will to use them.” The debacle of the ratification process of the new EU constitutional treaty is yet another example of the difficulties of gathering public support for the grand European project.

The result is that China is rising in a quasi-unipolar system and is becoming the most likely challenger to US hegemony in the 21st century.

An engine of globalization on the semi-periphery

In just over 20 years, China has transformed itself from autarky to a robust engine of globalization in Asia. With the “open-door” policy, China has gradually liberalized its foreign trade and investment policy since the late 1970s. Between 1978 and 1995, the value of exports and imports as a share of GDP quadrupled and China became the world’s second largest recipient of foreign direct investment (FDI) after the United States.

Even in the aftermath of the Asian Financial Crisis and slowdown of the global economy, China’s trade expansion still recorded outstandingly high
growth in both imports and exports, which has led to a steady rise in China’s share of world trade. In 2001, it passed Canada as the fourth largest trader in the world (counting the EU as a single trader and combining exports and imports of merchandise and commercial services). In 2004, the value of China’s foreign trade hit US$1.155 trillion, making it the world’s third largest trading power, after only the EU and the USA.

Not only is China becoming a major trading power, but China is now much more open than Japan and South Korea. FDI in China was $34 billion in 1994 and $38 billion in 1995 – with more renewed capital in one year than Brazil has received since World War Two – which testifies to greater openness. The trend has been reinforced by China’s entry into the WTO. In 2003, China became the biggest FDI recipient in the world and a total of 41,081 new foreign-funded projects were approved, while actually utilized FDI was US$53.5 billion.

At the end of 2001, after 15 years of prolonged negotiation, China finally joined the World Trade Organization. The bilateral and multilateral agreements that China entered for this membership commit China to wide-ranging liberalization of its trade and investment policy. At the same time, China is taking a lead in pushing for trade liberalization in East Asia by launching a free trade government (FTA) with ASEAN. These moves indicate that China is not only a part of the globalization process, but is also a vital driving force behind that process.

Yet, China’s economy still shows many imprints of a peripheral economy. It relies heavily on foreign trade, particularly the markets of the core states; incoming foreign investment accounts for a large part of its economic growth; its overall level of technology still lags behind the West; GDP per
capita in 2004 was just over US$1200; and the domestic income gap is widening to an almost unacceptable level.

A Lockean state in a partially Kantian world

Under the international normative structure, China is subject to the constraints of two competing cultures, Lockean and Kantian. Today Hobbesian culture dominates the relationship between the US and the so-called “rogue states.” Nevertheless, the relationship between China and other states is not shaped by Hobbesian norms.

China adopted the idea of sovereignty and the nation-state in the early 20th century. Since then, China has transformed itself from an empire into a nation-state, becoming a strong supporter of the Westphalian norms of international relations, embracing the concept of equal sovereignty and non-interference in internal affairs, the core elements of the Lockean culture.37

This Lockean culture was reinforced by waves of emerging new states. Since the end of the Second World War, the total number of sovereign states has almost quadrupled. Paradoxically, as the Lockean norm of sovereignty swept the world, the world’s economic core states embraced new post-sovereignty norms, allowing Kantian culture to become a defining feature of inter-state relations. Thus, a more universally accepted Lockean culture is confronted by a Kantian culture adopted by a small number of powerful states.

Embedded in this bifurcated normative structure, China, as a self-committed Lockean state, is the outspoken supporter of the Lockean norms associated with sovereignty, but still suffers the pressures of the Kantian culture. These pressures can be divided into two categories. One set of pressures is the...
challenges China faced from the post-sovereignty norms, such as democracy, human rights, humanitarian intervention, sustainable development, etc. All these norms challenge the view that sovereign states arrange their own affairs. Some argue that, “with a revised normative framework and standard of behavior prevailing in the international system, China’s march to the great power club has suffered significant setbacks since the events of 1989–1991.”

The other set of challenges stems from Kantian culture which structures international relations among Western states. The emergence of a common security community among Western countries modifies the balancing logic of the anarchic world. The absence of balancing efforts from the other major powers, like the European Union and Japan, is partly due to the asymmetrical distribution of power capacities between them and the United States, and partly because of the forging of a “common security community” and collective identity based on common values among these major powers. This trend further restricts China’s international opportunities for seeking balancing partners against the United States. One would not expect second-tier great powers to ally themselves and balance against the hegemon, as the neo-realists would predict, though some kind of loose coordination among them, with the aim of checking the reckless hegemon at certain times and on certain minor issues, might be foreseeable.

To summarize, in this bifurcated international normative structure, China’s position is defensive and constrained. China is under challenge from the post-sovereignty norms, which require China to give up some of its sovereignty as the price of global integration. China’s balancing options are also constrained by the Kantian culture shared by Western countries. Meanwhile, China is not alone in defending the norm of sovereignty, enshrined in the UN Charter. China could find a majority of developing countries as its ready supporters in this struggle. Moreover, America’s unpopular invasion of Iraq prompted key European states to distance themselves from the United States, loosening the bond that ties the Western states across the Atlantic Ocean.

**Assessing the structural impacts on China’s foreign policy choices**

**The need to balance**

Neo-realist theory predicts that major states will engage in balancing to prevent any state from dominating the system. In a unipolar system, the same logic will still apply. Waltz argues in 2000 that, although we see no explicit balancing moves at the moment from other major states against the world’s only superpower, the United States, China is the major candidate as the future balancer. For Waltz, this is because “unbalanced power, whoever wields it, is a potential danger to others.” He believes that, “in international politics, overwhelming power repels and leads others to try to
balance against it. The United States has behaved with benign intent and until its power is brought into balance, will continue to behave in ways that sometimes frighten others.\textsuperscript{40} In the aftermath of September 11, American foreign policy dramatically turned unilateral and embraced the doctrine of pre-emptive military attack. America’s excessive use of its hard power antagonized its enemies, as well as many of its allies, prompting even some of its key allies, like France, Germany and Canada, to oppose openly America’s invasion of Iraq.

The hegemon must also balance against the rise of challengers to his pre-eminent position, particularly when China’s rise has been so rapid. As Gilpin argues, modern states are extremely concerned about the impact of international economic activities on the distribution of economic gains, since unequal distribution of economic gains will inevitably change the international balance of economic and military power, and, in turn, affect national security. Therefore, “states have always been very sensitive to the effects of the international economy on relative rates of economic growth.”\textsuperscript{41} The unparalleled high growth rate of China’s economy and Chinese military power has triggered waves of “China Threat” debates in the West, particularly in the United States.\textsuperscript{42} And some of its policy ramifications have also been displayed: America’s strengthened alliance with Japan, increasing sales of advanced weapons to Taiwan, tightened control on technology exports to China, and most recently, Congressional resistance to the sale of Unocal Oil Company to a Chinese state-owned firm.

Both the unbalanced nature of the unipolar system and balancing acts by the hegemon have led China to balance on its own. Balancing is already under way, though not in the way people expected. China, in fact, is balancing both internally and externally. Internal balancing has involved two aspects: balancing efforts originating in the Cold War, and new balancing efforts from the mid-90s. The former comprised China’s Cold War military build-up, when China developed a small but credible nuclear deterrence, which deterred major conflict between China and the superpowers. Additionally, after the Korean War, China’s conventional military power made “Chinese strategic authority on mainland East Asia. . . a long-established characteristic of the region’s balance of power.”\textsuperscript{43} These capabilities were sufficient to safeguard Chinese security and international status till the mid-1990s. Therefore, in the early 1990s, while the United States was increasingly viewed as a hegemonic superpower, China did not rush to build up a new military capacity. This limited response caused scholars, such as Iain Johnston, to wonder why China was not balancing.\textsuperscript{44} The absence of new internal balancing efforts did not mean China was not engaging in balancing, but reflected the perception of Chinese leaders that existing capacities were enough for a minimum deterrence.

From the mid-1990s, contrary to predictions that Cold War security alliances would not survive, the United States not only pushed for a successful NATO enlargement, but also strengthened its military alliance with Japan.
Additionally, an increasingly pro-Taiwan policy in the U.S. and the launch of a new American, national missile defense system intensified China’s sense of insecurity, hastening its military modernization and the growth of its military budget.

Internationally, China tries soft external balancing, largely by promoting the idea of multi-polarization, and by improving relations with other major powers, including Russia, the EU, and developing states. China is also trying to safeguard the principles of sovereignty and non-interference in domestic politics, and uses its position in the United Nations to forge some international checks on the excessive use of American power.

**Soft balancing and great power cooperation**

While China is employing both internal and external balancing, it is of a soft kind, rather than a confrontational or adversarial one. China’s balancing aims at defending its security and sovereignty, rather than proactively challenging the core interest of the United States. Other clear disincentives in the international structure also discourage China from going beyond soft balancing.

According to the tripartite framework of international structure presented initially in this paper, the international structure that impacts China’s foreign policy is more complicated than Waltz’s theory would assume. On the one hand, China is living in a quasi-unipolar world. Although China is rising, the capability gap between China and the United States has not significantly narrowed, due to overwhelming American economic and military power which has strengthened in the post-Cold War era. This asymmetrical power renders any hard balancing from China futile and would only provoke counter-balancing by the United States.

On the other hand, China exists in a world where other major states see themselves as members of a common security community with the United States. Despite the recent transatlantic rift over the Iraq war, most European states are America’s NATO allies, sharing basic political norms and values. This bond will prevent the Europeans from going beyond a soft balancing approach in their relations with the United States. A similar situation applies to Japan. Even Russia, which possesses a nuclear arsenal as large as the United States, displays a more accommodating policy towards the United States, hoping to gain a seat in the Western club. Russia joined the G7 group, and established a partnership with NATO in May 2002.

Therefore, to explain China’s balancing behavior, we must consider normative variables, as well as the distribution of capabilities, which suggest limited room or opportunity for a hard balancing strategy.

While China would derive nothing from hard balancing, the same is generally true for the United States. The latter has taken some measures to contain China through its own military build-up; its upgraded alliance with Japan; its new partnership with Russia; its new strategic influence in Central
Asia; its weapon sales to Taiwan; and its strong pressure to prevent the EU from lifting its decade-long arms embargo against China. But the United States still avoids launching a head-on balancing against China by challenging or threatening its vital interests. As long as the United States does not exceed a soft containment policy, China will not adopt more robust balancing. Therefore, China will neither be able to pursue hard balancing nor be forced to do so.

The American priority of anti-terrorism after September 11 reduced the chance that great powers would engage in hard balancing. Instead, September 11 created new incentives for the great powers to cooperate. As the Bush administration’s national security strategy of September 2002 stated, instead of strategic rivalry, “Today, the world’s great powers find themselves on the same side – united by common dangers of terrorist violence and chaos.” Indeed, September 11 indicated that the most dangerous threat to the United States and its people is from terrorist networks, rather than from other great powers. From a balance-of-threat perspective, the United States should increase its cooperation with other great powers in an anti-terrorism campaign and not focus on balancing China in a hard way. Nevertheless, the balance-of-power logic will not disappear, since great powers will continue soft balancing games among themselves.

The imperatives of reciprocal engagement

The disincentives for hard balancing also come from the structural constraints of the international economic structure. In today’s international political economy, hard balancing would propel all major states in to placing a high premium on relative gains over absolute gains, thus rendering the pursuit of economic benefits through international economic exchange inconceivable. Political and military confrontation would lead to a total breakdown, or at least a substantial reduction, in economic flows among adversarial states.

As the two major engines and beneficiaries of globalization, China and the United States have a common interest in the stable development and expansion of the global economy and bilateral economic relations. On the Chinese side, throughout the past two decades, China has been adopting reforms at home that are in line with the global market logic, which explains its economic success and its rise. By entering the WTO, China subjects itself further to the logic of globalization and market forces. As in the past, access to the markets, capital and technology of the core economies will be indispensable to China’s future economic development. To secure and stabilize that access, China must avoid strategic confrontation with the core states, particularly the hegemon. The fact that China has been benefiting from its participation in the global division of labor also motivates China to pursue voluntarily a collaborative policy out of its calculated self-interest. Furthermore, by transforming its economic system into a
market economy (with “Chinese characteristics”), and by further deepening economic reforms in the context of WTO entry, China is upholding the norms and rules of a market economy. Using Wendt’s term, we can argue that China is internalizing the norms and logic of the global market in all “three degrees”: coercion, self-interest, and legitimacy. China will observe the norms because of international pressure; because it is in its self-interest to do so; and because it perceives the norms as legitimate. With the internalization of these three degrees, the international economic structure has not only affected Chinese foreign behavior, but also reconstituted China’s identity about what China is and what China wants. Assuming that these three degrees of internalization remain constant, we can argue that China’s foreign policy towards the core states will be constrained by the imperatives of economic integration.

On the side of core states, particularly the hegemon, there are also strong reasons for them to engage China economically. As China has turned itself into a new and vibrant engine of globalization, participating in China’s economic development is of increasing importance to the global multinational corporations (MNCs) and other medium-size firms, both in terms of their profit generation and their global competitiveness. It is a lamentable fact that the footloose MNCs can enjoy strong leverage over most developing countries. But they do not have the same leverage over China and their foot is no longer loose when they come to China: after they operate in China, it is very difficult for them to leave. Unlike most other developing countries, China has a huge and fast expanding market, and an almost unlimited supply of inexpensive yet skilled laborers. While MNCs can exert structural power over other developing countries, their structural power over China is much more limited due to their increasing dependence on the Chinese market for profits and competitiveness. The low cost consideration will continue to be a strong incentive for MNCs to invest in China for a long period. Over the years, seeking a share of the huge domestic market has become a much more important motivation for FDI in China. In 2004, China’s bilateral trade volumes with the EU, USA and Japan all stood at around US$170 billion. Few other bilateral trade relationships are stronger than these ones, a fact that indicates how far China’s economic engagement with core states has progressed. It is indeed in the interests of China and other core states to engage each other economically and to constrain or avoid political and strategic rivalry, so as not to disrupt this economic relationship.

Conclusion

Existing within the current international political and normative structures, China feels structural imperatives to balance, albeit softly. Economically, as a net beneficiary of globalization, China has a strong incentive to integrate further into the global economy and forge a stable relationship with its
powerful trading partners, especially the hegemon – the United States. Because China has become one of the engines of globalization, major powers will also acknowledge China’s indispensable role in the global economy and their own economies, and will refrain from aggressive balancing against China. If this proves to be the case, we would expect that soft balancing and reciprocal engagement will become the two most striking features of Chinese foreign policy in the coming years, if not decades.

Notes


2 Hans Morgenthau stated this explicitly in his book: “Intellectually, the political realists maintains the autonomy of the political sphere, as the economists, the lawyer, the moralist maintain theirs. He thinks in terms of interest defined in terms of power, as the economist thinks in terms of utility; the lawyer, the conformity of action with legal rules; the moralist, the conformity of action with moral principles ... The political realist asks, ‘How does this policy affect the power of a nation?’” See Hans J. Morgenthau, Politics among Nations: The Struggle for Power and Peace (New York: Alfred A. Knopf, 1956), pp. 10–11.


4 Waltz, Theory of International Politics, p. 89.

5 Waltz, Theory of International Politics, pp. 91–92.

6 Waltz, Theory of International Politics, p. 118.

7 Waltz, Theory of International Politics, p. 168.

8 Waltz, Theory of International Politics, p. 97.


10 Waltz, Theory of International Politics, p. 126.


Ibid., p. 425.

Gilpin, *Global Political Economy*, p. 56.


Wendt, *Social Theory of International Politics*, p. 309.

Wendt, *Social Theory of International Politics*, p. 309.


Waltz, “Structural Realism,” p. 27.


For example, see this author’s contribution in Wang Huning (ed.), *Fudan Report of China’s Development, 1994* (Shanghai: Fudan Research Academy of Development, 1994).


On 29 May 2005, 55 percent of French voters opposed the European Union constitutional treaty. It was followed by a more overwhelming “no” vote in the Netherlands a few days later. On 6 June 2005, the British government announced that it would suspend the scheduled referendum in Britain. See Alan Cowell, “U.K. Suspends Vote on EU Constitution,” *The New York Times* (7 June 2005).


In 2003, China’s foreign trade dependence ratio rose to more than 60 percent, even higher than the European Union’s.


A perfect reflection of this is the proclaimed key idea guiding PRC’s foreign policy, the Five Principles of Peaceful Coexistence: mutual respect for sovereignty and territorial integrity, mutual non-aggression, mutual non-interference in each other’s internal affairs, equality and mutual benefit, and peaceful coexistence.


40 Waltz, “Structural Realism,” p. 28.
41 Gilpin, Global Political Economy, p. 80.
45 In Robert Kagan’s view, the rift between Europe and the United States on the Iraq War indicates that, on major strategic and international questions today, Americans are from Mars and Europeans are from Venus: they agree on little and understand one another less and less. See Robert Kagan, Of Paradise and Power: America and Europe in the New World Order (New York: Alfred A. Knopf, 2004), p. 3.
48 As the war on terror seems to be waning, there has been a noticeable shift in Washington back to considering China a threat to free trade and security. For example, in the Asia Security Conference held in Singapore in early June 2005, the US Defense Secretary Donald Rumsfeld bluntly asserted that China’s military spending is a threat to regional security. See Michael Vatikiotis, “U.S. Sights are Back on China,” International Herald Tribune (7 June 2005).
49 Wendt, Social Theory of International Politics, p. 250.
3 China in the world and the world in China

The domestic impact of international institutions on China’s politics, 1978–2000

Su Changhe

Introduction

About one hundred years ago, Liang Qichao, a well-known thinker in modern China, said that since the invasion of the Western countries China’s world had been, not as China in China thousands of years ago, or as China in Asia around hundreds of years ago, but as “China in the world.” The major implication for “China in the world” is that it needs to enter international society gradually instead of trying to remain outside of it.

Since China is a typical late-developing socialist country, with a strong, oriental cultural tradition, it is a difficult choice for it to join an international society dominated by Western ideas. Another challenge for China in joining the world is how to cope with its rise in international and domestic power since the late 1970s. Every country must deal with this challenge as its share of world power increases, a problem confronted by the United States in the early twentieth century. China is no exception. The ultimate consequence of joining the world is that China normatively becomes a member of international society, thus becoming a China in the world, not a China in China. But what role can and will China play in world politics? Perhaps the most demanding question for us is: what impact does engaging with international society have on China’s domestic politics, economics, and diplomatic behavior? If international institutions do matter in China, how and to what extent can they affect China?

From this perspective, China’s dramatic decision to join international institutions constitutes an important question in the study of world politics, especially East Asian politics. However, we must go beyond the perspective of the traditional nation-to-nation relationship, which would limit our study to the level of bilateral diplomatic relations. The most important dimensions of international structure are international regimes, multilateral conventions, and international organizations, which have been constructed by different actors over the last three centuries. When a state wants to join international society, it must engage with international institutions and norms. A nation-to-nation perspective cannot fully grasp the impact of
China’s joining the world – only studying the relationship between China and international institutions can fulfill that goal.

Over the last two decades, engaging international institutions has been an important part of Chinese foreign policy. China’s membership in international governmental organizations grew from 21 in 1977 to 49 in 1995; its participation in international non-governmental organizations grew from 71 in 1977 to 1013 in 1995. Meanwhile, China has participated in many international conventions, among others involving arms control, environmental protection, human rights, law of the sea, jurisdictional cooperation, anti-terrorism, and economic cooperation. It is not an overstatement to argue that international institutions have been involved in almost every area of Chinese domestic and foreign affairs.

However, the reality of diplomatic practice lags far behind the academic study of China and international institutions. This chapter will not explain the impact of China’s engaging international institutions on international society. Instead, we reverse the perspective to explore how international institutions impact Chinese domestic politics and foreign relations.

A literature review

In the past two decades, international studies have paid increasing attention to the question of China’s engagement with international institutions. Gerald Chan’s *China and International Organizations*, published in 1989, initiated the process, but focused more on China’s participation in non-governmental organizations after 1971. Related scholarship has grown rapidly since the 1990s. Jacobson and Oksenberg studied the domestic politics of China’s participation in international economic institutions, especially the IMF and WB. Two later books, *China Joins the World* and *Engaging China*, discussed China’s international behavior on arms control, human rights, energy, and the international financial system. Other topics included the potential influence of international institutions on Chinese foreign policy. Margaret Pearson’s first book showed how foreign firms forced China to liberalize its foreign exchange regime. Thomas Moore’s recent book shows how partial constraints from the international system, such as the Multi Fibre Agreement, which prevented China from increasing the quantity of its textile exports, pushed China to increase the value added in this sector, which could only be done by reforming the entire textile sector. Zweig’s book, too, argues that the relative value of goods and services on either side of the border pushed people with comparative advantage in foreign trade to seek opportunities for global linkages. Finally, Samuel Kim and Ann Kent have written essays relating to China and international institutions.

In mainland China, many scholars have shifted their research interest to this field, due in part to China’s rapid engagement with international institutions after 1992. However, few theoretical books and articles study the
impact of international institutions on Chinese domestic politics and foreign relations. A key international studies journal in Beijing, *World Economics and Politics*, has started a column, called “China and International Organizations,” where essays are published on this subject. But these articles are more descriptive than explanatory or theoretical.

Therefore, many questions remain worthy of further research on China and international institutions. First, how have international institutions affected domestic politics, economics, and foreign relations, as well as various aspects of public policy? Through what channels does this influence occur? Second, while China has participated in many international institutions across almost every sector, how is China’s commitment record viewed? Will China gradually become a responsible, rather than a rogue, country after it joins the international community? This chapter provides a basic theoretical framework to understanding these questions.

**International structure and domestic politics**

This analysis is very different from most current literature. It sheds light on the domestic impact of international institutions. That is to say, it will highlight the role of international institutions on Chinese domestic politics, economics, and foreign relations through the framework of international relations and domestic politics.

In international relations theory and comparative foreign policy studies, research on the interactions of international relations and domestic politics can be traced back to the 1960s. However, the earlier literature on the interactions of international relations and domestic politics is very asymmetrical. Many students of IR theory focused their interest more on the international impact of the domestic structure; they studied how different domestic political arrangements, political culture, bureaucratic politics, and patterns of decision-making can affect a target nation’s foreign behavior. From this perspective, foreign policy is simply the extension of domestic politics. This approach is classically categorized as “the second image” in the study of world politics. However, the research on the domestic impact of international factors is very weak, limited only to theories of interdependence, modernization, and transnational relations. This situation changed after Gourevich introduced “the second image reversed” to the study of comparative politics. Following the waves of globalization and internationalization, researchers on the domestic impact of international factors have become more vocal in comparative politics and comparative foreign policy since the 1980s.

The analytical framework in this chapter is closely related to the “second image reversed.” It does not discuss which domestic factors will affect China’s attitude to international institutions, but how and to what extent international institutions in which China participates affect its domestic politics, economics, and foreign relations. This approach involves two critical concepts:
International institutions in the international normative structure, and domestic structure at the national level. The former is seen as an independent variable which causes domestic change.\(^\text{13}\)

International institutions are simply defined as “persistent and connected sets of rules (formal and informal) that prescribe behavioral roles, constrain activity, and shape expectations.”\(^\text{14}\) They consist of multilateral conventions, regimes, and international organizations. The notion of domestic structure refers “to the political institutions of the state, to societal structures, and to the policy networks linking the two.”\(^\text{15}\) As part of the international normative structure, international institutions can prescribe any state’s activity in different ways and to different degrees, regardless of whether the target state is a member of the institution or not. But the channels that international institutions use to affect domestic affairs are mainly based on the state’s domestic structure. For example, when a state participates in an international institution, it will establish a domestic agency associated with the international institution, and then this state can use this agency to affect domestic affairs directly or indirectly. Therefore, domestic structure provides channels for an international institution’s entrance into the domestic arena, but international institutions can also, but not necessarily, gradually affect and change the existing domestic structure.

Some current international institutions have distributive or hegemonic implications, as many Chinese scholars have asserted.\(^\text{16}\) But this view does not reflect the fundamental nature of current international institutions. A fundamental feature of international institutions is that they operate in the spirit of “embedded liberalism.”\(^\text{17}\) GATT, and its successor WTO, are typical cases. The WTO’s major aim is to facilitate trade and liberalize investment by reducing tariff levels. After the Cold War, the United Nations tried to protect human rights and assist democracy in Third World countries. Also many international environmental regimes have been designed on the basis of liberal market environmentalism theory. So the idea of liberalism greatly affects the creation and operation of international institutions, and constitutes a fundamental feature of the international normative structure. As a result, states are under great pressure to transform their domestic structure, as well as their boundary arrangements, to conform to global liberalism.

The second aspect is that international institutions are fundamentally multilateral. Multilateral institutions, in contrast to bilateral institutions, are constructed on the basis of generalized organizing principles of non-discrimination, exhibit indivisibility and diffuse reciprocity.\(^\text{18}\) Through collective coordination and discussions, multilateral institutions put issues into a collective and public resolution framework. Under this framework, collective will constrains and limits the egoistic behavior of individual states.

In the study of comparative politics, different types of domestic structure have been used to explain the domestic impact of international institutions. Based on distance and proximity in the state–society relationship, and
Centralized and decentralized administration in decision-making authority, Cortell and Davis, in their essay on the domestic impact of international norms, divide domestic structure into four types,\(^\text{19}\) while Risse-Kappen differentiates six types of domestic structures: state-controlled, state-dominated, stalemate, corporatist, society-dominated, and fragile structure.\(^\text{20}\) Both of these essays argue that the impact of international institutions is mediated by the nature of the domestic structures. As Risse-Kappen proposes, if international institutions want to affect domestic policy, they must first of all “gain access to the political system of their target state,” and secondly try to “win policy coalitions in order to change decisions in the desired directions.”\(^\text{21}\) In a state-dominated system with a weak domestic structure, it will be very difficult for international institutions to gain access to it, but, once they do, they can easily affect policy since the centralized authority can implement the norms from top to bottom. On the other hand, in societies that are politically decentralized and have a strong domestic structure, gaining access to them is very easy, but affecting policy may be very difficult, since international institutions not only have to build a winning coalition, but also need to monitor and enforce the desired policy.\(^\text{22}\) This argument highlights the fact that a weak state with a strong domestic structure does not necessarily have a good record of fulfilling its commitments to international institutions, while a strong state with a weak domestic structure does not necessarily have a bad one.

Domestic structure provides channels for international institutions to affect the domestic politics and economy. But domestic structure may also be changed by international institutions, either dramatically or gradually, as the state participates more and more in international institutions. Generally speaking, if a politically decentralized state has a strong domestic structure that is open and flexible, it can resist or absorb influences from international institutions. While strong states with a weak domestic structure may be easily affected by international institutions, it is very likely that they will bear huge transition costs. First, international institutions can affect this type of structure by legally mobilizing transnational resources, establishing “trans-governmental coalitions,”\(^\text{23}\) cultivating civil society, facilitating social movements, and exerting more international pressure on a country’s existing, closed decision-making pattern. Second, the more a state participates in international institutions, the more it is subject to international norms instead of domestic ones. When it engages and participates in international institutions, it has to revise, adjust, and abandon domestic laws and procedures, which previously were in conflict with international norms, and also to design a national policy agenda based on international institutions.\(^\text{24}\) Third, once a state participates, international institutions can transfer domestic problems to the international level, or sometimes in order to gain a competitive advantage relative to other actors, some domestic actors willingly transfer internal decision-making authority to multilateral institutions. Finally, as discussed previously, since most of the current international
institutions are initiated by Western countries and fundamentally reflect “embedded liberalism,” developing countries with strong states that dominate the domestic structure will bear high transition costs when participating in these international institutions.

Domestic structure mediates the effects of external forces on domestic change; but, domestic structures are not the agents of this process. In the process of engaging international institutions, linkage agents emerge rapidly to play a critical role in effecting domestic change. In Rosenau’s words, linkage may be defined as “any recurrent sequence of behavior that originates in one system and is reacted to in another.” Linkage agents are then actors in the internal political environment of a given state who connect the internal and external political environments, and transfer the values, norms, new ideas, policy prescriptions, goods and services, etc., across the borders. They are identified in various ways: as MNCs; as government bureaucrats responsible for monitoring transnational exchange and trans-governmental coalitions; as networks and mass media; as cultural organizations; and as trade unions and business associations. Also, leaders and epistemic communities can enforce norms and float ideas. These actors are heavily engaged in international transactions, share the norms of international society, and have a stake in global resources. They are willing, and have the capability, to intervene in the national-international sphere.

The last part of this argument puts forward a basic research assumption. Empirical evidence shows that democratic countries do not necessarily have a good reputation for committing to international institutions, while centralized countries do not necessarily have bad ones. In other words, the record of national commitment to international institutions is not dependent on the political system. In IR theory, especially recent Democratic Peace Theory (DPT), some scholars argue that democratic countries’ commitment to international institutions is stronger and more credible than those of centralized countries. However, the nature of the domestic system cannot explain this question satisfactorily. First, it is misleading to equate domestic democracy with international democracy. A democratic state operating under the rule of law does not necessarily favor international norms at the international level. Furthermore, public opinion under truly representative political systems may have more difficulty constraining foreign and military affairs than they have influencing other domestic public policy arenas, such as education, tax and welfare affairs. And finally, even countries with democratic political systems often act in a more dictatorial manner on international issues that affect their own self-interest, and transfer domestic policy risks and costs to other countries. Therefore, there is no reason to assume that democratic countries must comply with international institutions.

The variable that best explains a state’s commitment to international institutions is the international structure. International structure is composed of international material structure, the distribution of power, and the
international normative structure or international institutions. While a state’s position in the international distribution of power determines its behavior, more importantly, its identity as constructed by international norms may lead it to act more socially and normally within the international community. As the state interacts with international society, the pressure of international norms will gradually teach the state what to do and what not to do. A state will be punished if it does not comply with international norms, but be rewarded if it does. In this way, socialization may lead the state to act more responsibly.

Some scholars question whether all states, regardless of whether they be totalitarian, authoritarian or democratic, face the same international normative structure. And if so, why do they behave differently? The answer is that state actions are determined by international norms but their responses to those norms may differ, based on their domestic structure. So rather than asking why states with different domestic structures behave differently, it might be more insightful to ask why different states behave similarly under the pressure of the international normative structure. The answer is that state actions, and their commitment to international norms, are explained by the international normative structure, and not by the domestic political system or the distribution of power at the global level.

The domestic impact of international institutions on China

The major aim of this research is to explore international factors in Chinese domestic and foreign affairs. That is to say, how and to what extent will international institutions affect Chinese domestic and foreign affairs after China accepts engaging with more international institutions?

The international normative structure changes discourse in Chinese domestic politics and foreign relations. In governmental documents and civil society, “yu guoji jiegui” (keeping in line with the international track), “anzhao guoji guanli banshi” (behaving according to international norms), and “canyu guojishehui” (engaging international society) started to become part of popular discourse in the 1990s. Additionally, concepts such as “international responsibility,” “multilateralism,” and “international rules of the game” have repeatedly appeared in the press since the 1990s. Their appearance demonstrates that international institutions have gained support in the domestic discourse, and learning about international institutions has been under way in China’s domestic domain. International norms actually reach into China, a process Jeffrey Checkel calls norms empowerment. To some degree, therefore, China identifies with some, but not all, international institutions.

However, when we analyze China and international institutions by focusing on the relationship between international relations and domestic politics, more demanding questions arise. First, will the international institutions in which China participates affect Chinese domestic and foreign policy? If so,
which features of these international institutions matter? And what consequences will they generate for China? Second, how has China’s diplomatic behavior changed after it joined international institutions? Third, what is the record of China’s commitment to international institutions? Finally, can international institutions make China a more responsible member of the international community?

Here we touch upon the first question. My research assumes that international institutions in which China has participated do affect its domestic and foreign policy. First, most current international institutions are designed around the concept of “embedded liberalism.” Second, international institutions operate fundamentally on the principle of multilateralism. And third, some key international institutions have important distributive functions. These three features have important implications for China because China cannot change these features before joining an international institution. So three strong relationships between China and these features of international institutions challenge China in three ways: the embedded liberalism inherent in international institutions challenges China’s socialist ideology; multilateral norms can affect China’s diplomatic behavior; and the distributive consequences of international institutions can affect Chinese domestic society.

China’s domestic structure is a state-dominated, weak society, with a highly centralized decision-making pattern. The potential impact of international institutions on this structure can be briefly described in the following terms.

First, the state-dominated structure has become more relaxed as state intervention in the economy has been rapidly reduced. For example, as China’s trade and investment regime became more integrated into the international economy, the closed and regulated trade mechanisms could not be sustained. Under the pressure of internationalization, the traditional trade system has been gradually decentralized and deregulated. In terms of the deregulation of the national monopoly over foreign trade management, by 1997, ministries, provinces, and cities had established more than 150,000 trading companies. During the negotiating over joining the WTO, China was under pressure from the WTO members to change its trade approval system, which led China ultimately to make its approval system more transparent.

Second, Chinese social groups enhance their linkages with transnational actors in order to expand their scope for domestic activity. A more competitive relationship will develop between these groups and the state, which could constitute an important constraining force on state action. China before 1978 was characterized as having a weak society and strong state. With the retreat of central governmental intervention from social life, the social sector has been cultivated gradually, and many non-political international governmental organizations (IGOs) and international non-governmental organizations (INGOs) have become involved in domestic
society. The expansion of the societal sector will facilitate the growth of civil society in China, helping the public sphere play a new role in China’s democratization.

Third, decision-making authority will be more decentralized and in some specific areas may be transferred more or less to the international arena. Local governments at different levels of the political system from the coast to the inland areas, as well as various industrial sectors, are rushing to take advantage of outside resources. They are self-interested and act rationally. The competition pressures them to manipulate any decision resources they can use to influence the central government. At some stage, they will introduce external influence into internal decision-making procedures. Additionally, with the internationalization of domestic problems, the traditional management authority over these problems in China may be partly transferred to the appropriate international institutional level. As in the case of SARS in 2003, the World Health Organization (WHO) investigative reports, directly or indirectly, penetrated China’s policy making on this disease.

Today, China participates in most key international organizations. Data illustrates that China had joined 51 international organizations by the end of 1996. By comparison, the numbers for Japan, France, the UK, the US, and Russia were 63, 87, 71, 64, and 62 respectively. Additionally, China’s National People’s Congress has ratified many international conventions involving arms control, law of the sea, human rights, and environmental protection. In this way, China is aligning more and more with international norms and has internalized these norms by legislating aspects of them at the domestic level.

Turning to the second question, have international institutions (or will they) affected Chinese foreign policy behavior? In other words, how do international institutions construct China’s international identity and foreign policy? In answering these points, I propose some of the following assumptions.

First, as China engages with international institutions, it redefines its national interest and view on national security. As Kent strongly argues, China’s redefinition of national interest is reflected not only in China’s new domestic legislation, in areas corresponding to the norms and rules of the international organizations and treaties to which it is a party, but also in its institutionalization of norms through the establishment of bureaucracies corresponding to the areas of its new international obligations. Another way China has redefined its national interest and national security is in the emerging idea of new security. The core of new security from China’s perspective is cooperative security among states. No security will be reached and maintained without multilateral cooperation. What’s more, the direct consequence of China’s redefinition of its national interest is that China is gradually changing its concept of absolute sovereignty. China’s large-scale revision of domestic laws to correspond with international economic law is one prime example of this.
Second, China’s identification with international institutions is increasing, a situation sharply different from before the reform period began. China thinks that selectively engaging international institutions, rather than transforming them, serves its national interest. These organizations not only provide institutional resources for expanding China’s international activity, but they also improve the Chinese international image in the international community. Looking at China’s attitude to the UN, Samuel Kim concludes that moving from system-transforming or system-reforming to system-maintaining conforms with China’s attitude to most international institutions.

Third, after participating in international institutions, China has gradually adapted a much more multilateral behavior pattern. Previously, it would have expected to be isolated and constrained by joining particular multilateral institutions. Yet today China plays an active role in the multilateral security dialogue on the North Korea nuclear problem, and is promoting the establishment of the ASEAN+3 Free Trade Zone. The Shanghai Six is the first international organization that China has helped establish since 1840, and reflects the important role of multilateral diplomacy in current Chinese foreign relations.

Finally, the process of engaging international institutions is also the process of learning, adjusting, and adapting. China is slowly being “socialized” and “internationalized,” a process that will facilitate China’s transition from a closed state to an “international state.” Joining international institutions makes Chinese foreign behavior more open and transparent, its goals clearer and explicit, and international actions more predictable.

Linkage agents are intermediaries who transfer international norms and ideas into Chinese domestic politics. Once China joins a particular international institution, such as the IMF, World Bank, WTO, the UN Convention on the Law of the Sea, or another Non-Proliferation Treaty, it will concomitantly establish an agency responsible for managing these transnational exchanges. These agencies play an important role in transferring external factors into the domestic decision-making arena. Sometimes they transfer the domestic decision-making authority to the international institution, which then pressures the Chinese central government to make its policy conform to international norms. Nearly every department in the Chinese government has built an affiliated agency (or agencies) responsible for the related international institution, and they are increasingly becoming sources of linkage power in Chinese politics.

Intellectual groups constitute another factor influencing domestic politics. Even if we believe that cultural realism, as advanced by Johnston, guides China’s leaders’ worldview, liberalism is a strong force in China’s international studies community. In World Economics and Politics, a key journal in international studies, about 30 percent of the essays published over the last three years can be described as having a liberal tendency. This liberal epistemic community is an important linkage factor in affecting China’s attitude to international norms.
Finally, we must address China’s commitment to international institutions. Because of its poor record on the rule of law, and its socialist ideology, China is accused by some Western scholars of behaving irresponsibly after joining the international community. Yet, a state’s record of commitment to international institutions has no relevance to its domestic political system. It is hard to corroborate the view that democratic states maintain their commitments to international institutions, while dictatorships, by their nature, fail to do so. Also, classical realism does not predict that China must project its power around the world, or that it is likely to transform or revise the existing international institutions in accordance with its rising power.

While this analysis reflects a prospective research agenda, it is unlikely to answer questions of democratic peace theory or traditional power transition theory. The degree of credible commitment to international norms depends not only on the degree of legitimization of the international norms, but also on whether international institutions gain legitimization in Chinese domestic society. The more China identifies with international norms, the more credible will its record of commitment become. The international normative structure constructs China’s identity and determines its activity in the international community. As argued in the theoretical section, internalized international norms will be a decisive factor in a state’s foreign behavior.

Furthermore, without cross-national, comparative foreign policy research, it is not easy to decide which state has a record of good compliance with international institutions. Some empirical studies demonstrate that China has at least as good a record in its commitment to international economic institutions as other states. Pearson’s work on China and international economic institutions shows that China maintains its responsibilities in the IMF and the WB.44 But other empirical studies on China’s behavior on international human rights, in the International Labour Organization and/or on intellectual property rights indicate strongly that China has a poor record.45 At this point, it remains to be seen whether China has a good record or a bad one, partly because there is no record of the level of compliance by other powers. Further research on this issue is needed. One of the aims of this essay has been to explain how interaction with international norms can accentuate China’s responsible behavior in the international community. In truth, China’s identification with international norms has improved significantly in the past two decades after engaging with the world.

**Conclusion**

In some respects, this chapter simply outlines a research agenda. It presents a portrait of the impact of international institutions on China’s domestic politics. International institutions – with their dramatic political and economic consequences – invariably influence a given state’s domestic politics.
This chapter bases its analysis on the framework of international normative structure and domestic politics. It assumes that international institutions matter when a state engages and joins them. China is an attractive case for such analysis. Its domestic changes over the past 20 years can be explained mostly by its engagement with international institutions. The challenges of internationalization and socialization will press China to respond dramatically. They will lead China to adjust its domestic politics to meet transnational demands. International norms will firmly socialize China into the world community and as China internalizes these norms, the world will come to view China as a rational and predictable global player.

Acknowledgement

I would like very much to thank David Zweig, Kim Nossal, Fan Yongming, Wu Xinbo, and Chen Zhimin for their helpful and incisive comments on previous drafts. A version of this article benefited from presentation at 21–24 May 2002, Sino-Canada Conference on *Globalization and China's Reforms: An IPE Approach*, sponsored jointly by Fudan University, China, and Queens University, Canada. I acknowledge the generous financial support of Chinese National Social Science Foundation. I also appreciate the support for the initial stages of this research offered by The Asian Christian Foundation on High Education Youth Program at Fudan University.

Notes


According to my statistics, this journal has published 31 essays on China and international institutions since 2000. Broad topics are discussed in these essays, such as China’s relationship to international institutions in the areas of the environment, arms control, nuclear non-proliferation, international law, the WTO, the UN, INGOs, UNCLOS, and so on. Professor Wang Yizhou, editor-in-chief of this journal, contributes much in publishing these essays. He is currently in charge of a program on China and International Organizations in the Chinese Academy of Social Sciences, supported by the Ford Foundation. The author of this chapter is also directing a program on China and International Institutions.


12 Representative research on this topic include: Keohane and Milner (eds), *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1995); and Thomas Risse-Kappen (ed.), *Bringing Transnational Relations Back In: Non-State Actors, Domestic Structures and International Institutions* (Cambridge: Cambridge University Press, 1995). Professor Qin Yaqing also uses this framework to understand US intervention in the Third World during the Cold War. See Qin Yaqing, *Baquan tixi yu guoji chongtu* (Hegemonic System and International Conflicts; Shanghai: Shanghai People’s Publishing House, 1999). However, Qin pays more attention to international material structure than to the international normative structure.


15 Risse-Kappen (ed.), *Bringing Transnational Relations Back In*, p. 20.


20 Risse-Kappen (ed.), *Bringing Transnational Relations Back In*, pp. 23–25.
21 Risse-Kappen (ed.), *Bringing Transnational Relations Back In*, p. 25.
22 Risse-Kappen (ed.), *Bringing Transnational Relations Back In*, pp. 25–27.
25 For this argument, see Geoffrey Garrett and Peter Lange, “Internationalization, Institutions and Political Change,” in Keohane and Milner (eds), *Internationalization and Domestic Politics*, pp. 48–75.
27 See Risse-Kappen, “Ideas Do not Float Freely.”
28 Kurt Gaubatz, for example, argues that some factors, such as political system and preferences, the stability of democratic institutions and foreign policy, should enhance the ability of democratic states to make credible international commitments. See Kurt Gaubatz, “Democratic States and Commitment in International Relations,” in Miles Kahler (ed.), *Liberalization and Foreign Policy* (New York: Columbia University Press, 1997), pp. 27–65.
29 One question posed by Zweig and Nossal on my earlier draft asked if a state with domestic liberal politics is more likely than an authoritarian regime, which has little domestic pressure, to follow liberal norms. In my view, it is not certain that liberal states must follow liberal international norms. The absence of the U.S. from some important international human rights conventions is a persuasive example.
30 Some recent research on international democracy suggests that we should be careful to assume that the foreign behavior of democratic states must be democratic. Keohane’s research shows that the United States has a poor track record in commitment to international conventions. See Keohane’s preface for the Chinese version of *After Hegemony* (translated by Su Changhe, et al., Shanghai: People’s Publishing House, 2001). Furthermore, the United States’ increasingly unilateral action after the Cold War, especially during the Iraq War, shows the paradox of America’s despotism in international politics and its democracy in domestic politics.
31 Key words used to describe the international situation in the CCP’s reports have always been changing. In the latest Report of the 16th CCP, some key words, such as “duobian zhuyi” (multilateralism), “hezuo anquan” (cooperative security), “quangiuhua” (globalization), and “canyu guoji shehui” (engage in international society) are frequently used. It is a pro-liberalism report in some respects.
32 Cortell and Davis argue that the appearance of discourse in domestic politics is frequently the first important sign of an international norm’s domestic impact. See Cortell and Davis, “Understanding the Domestic Impact of International Norms,” p. 70.
34 See John Ruggie, “International Regimes, Transactions, and Change.”
35 Although the institutions are strong, China still rapidly engaged these international institutions in the 1990s. After 1989, China increased its participation in
international institutions for three reasons. First, the Chinese government wanted to improve its image by accepting international human rights conventions. Second, at least in the eyes of Chinese leaders, engaging multilateral organizations could reduce the negative impact of Western economic sanctions on China after Tiananmen Square. Lastly, in order to reduce the spread of the “China Threat” around the world during the 1990s, China was eager to establish a good image for its neighbors. Engaging multilateral institutions was seen by China as an important means to attain this goal.


37 Samuel Kim, “China and the United Nations,” in Economy and Oksenberg (eds), *China Joins the World*, p. 47. China, for example, is not a member of the G-8.

38 China participated in 27 conventions between 1949–1958 and 1971–1977. This number does not include data for 1959–1970. From 1978 through 2002, China has participated in 204 international conventions. I thank Miss Deng Haibing, my graduate student at Fudan, for her helpful work in making *The Database of International Conventions in which China Participated*. Also, China had been a member of only fifty-eight international non-governmental organizations, but by 2000 it had become a member of as many as 1,275 INGOs. See Ann Kent, “China’s International Socialization,” pp. 344–345.


40 Chinese leaders were afraid of being constrained by participating in international institutions before 1978. They thought China would not be able to behave freely after joining international conventions and organizations. Today, things have changed. Also, China is not likely to accept the institutions designed and dominated by a few advanced industrial states, especially the US.

41 Samuel Kim, “China and the United Nations,” in Economy and Oksenberg (eds), *China Joins the World*, pp. 45–49. In their excellent research on China’s attitude to the IMF and World Bank, Jacobson and Oksenberg conclude that the most likely outcome is that China will accept the current basic framework established by the IMF and the WB. A lot of evidence shows that China is not likely to transform the existing international financial system. See Jacobson and Oksenberg, *China’s Participation in the IMF, the World Bank, and GATT*, pp. 124–125.


44 See Margaret Pearson, “Multilateral Economic Institutions Engaging China,” in Johnston and Ross (eds), *Engaging China*, pp. 207–234.

45 See respectively Ann Kent, *China, the United Nations and Human Rights: The Limits of Compliance*; “China, International Organizations and Regimes: The ILO as a Case Study in Organizational Learning”; and Andrew J. Nathan, “China and the International Human Rights Regime,” in Economy and Oksenberg (eds), *China Joins the World*. In their comments, Zweig and Nossal remind me of China’s strategy toward the Missile Technology Control Regime. Since China is not a member of the MTCR, I think this is a unique case.
4 China, Southeast Asia and East Asian economic regionalism

Richard Stubbs

Introduction

Relations between China and the countries of Southeast Asia have improved markedly since 1997. This positive turn in China–Southeast Asia relations has its origins in events that go back to the 1980s. The end of the Cold War, the rapid increase in prosperity that was spurred on by the flood of Japanese foreign direct investment (FDI) from the late 1980s onwards, and the Asian economic crisis of 1997–98, all had major consequences for the way in which the governments of China and the countries of Southeast Asia viewed their external relations. The emergence of a sense of East Asian regionalism, and especially the advent of the Association of Southeast Asian Nations (ASEAN) Plus Three (China, Japan and South Korea) process (APT), has facilitated the rapid improvement in relations between China and the members of ASEAN.

This chapter is divided into three parts. The first part examines the changes brought about by the end of the Cold War and in particular the shifts in relations among the major powers of East Asia – China, Japan and the United States. Changes in relations among the three major powers were also important for the way in which the countries of Southeast Asia viewed the US, their East Asian neighbours and even the European Union (EU). The second part explores the Asian crisis and its impact on China–Southeast Asia relations. In many ways, the crisis was the tipping point which forced the two sides to re-evaluate the relationship and see the emerging benefits from greater cooperation. The final part analyzes the rise of the ASEAN Plus Three process and the ways in which it has been crucial to the development of relations between China and the countries of Southeast Asia.

The end of the Cold War and the changing international environment

The breakdown of the overarching Cold War structure, which underpinned and ordered relations both in East Asia and around the world, brought
major changes for both China and the countries of Southeast Asia. The Cold War was characterized by America’s commitment to containing communism. The priority given to using key countries as bulwarks against the spread of communism in East Asia had a number of crucial consequences. First, it meant that the US government pumped large amounts of capital into the region in the form of military and economic aid to individual front line states such as Japan, South Korea, Taiwan and Thailand. In addition, US spending on the Korean War and later the Vietnam War also fuelled the rapid economic development of the region. Second, in order to maintain the circle of friendly states that enclosed Asian communism, the United States tolerated the emergence of mercantilist, developmental states. These developmental economies included Japan; the newly industrializing economies (NIEs) of Hong Kong, South Korea, Singapore, and Taiwan; and later the near-NIEs of Malaysia and Thailand. All these economies except the free-port city-economies of Hong Kong and Singapore, protected infant manufacturing industries through import tariffs, while at the same time facilitating export manufacturing through various government-sponsored subsidies and other policies. Third, the United States opened up its market to the industrializing Asian states. This was a major concession which was not accorded to many countries of the Third World and gave the Asian economies an enormous boost as they sought to develop their export-manufacturing sector. Even when US interest in the region showed some signs of wavering in the mid 1970s, and Japan stepped in to provide the economic resources needed to keep up the strong growth rates, the US continued to accept East Asian imports into its economy.

The end of the Cold War brought with it a dramatic shift in the way international relations were conducted. The primacy of security was replaced by the primacy of economic relations. The United States in particular switched from having anti-communism as its guiding principle in foreign policy to promoting a “new world order.” At the heart of this “new world order” was the concept of “good governance.” By good governance, the American government, and its allies, the IMF and the World Bank, generally meant the establishment of open economies; the adoption of market-friendly, neo-liberal economic policies; adherence to the rule of law; political pluralism and the pursuit of democratization; and respect for human rights. Under the administration of George Bush (senior), US policy in Asia moved gradually into post-Cold War mode. With the advent of the Clinton Presidency in January 1993, US foreign policy was firmly placed on a post-Cold War footing.

Three of these changes are important to the argument being developed in this analysis. First, although it maintained its policy of allowing manufactured goods from the successful East Asian economies to enter the US, Washington abandoned its policy of tolerating the facilitative economic policies of the developmental state. Instead, the US government started to exert considerable pressure on the region’s governments to abandon their
interventionist strategies and open up their economies to global capital. Former allies from Japan to Thailand, whose front-line status in the battle against Asian communism had shielded them from US pressure to liberalize their economies, came under direct pressure to open up and allow US capital and US multinational companies full access to their economies. Second, preoccupied by the Gulf War under Bush senior, and then looking to pare down its emphasis on security issues under Clinton, the US reduced its military commitment to East Asia, leaving the countries of the region uncertain about how to deal with the new security environment. Concerns about a remilitarized Japan or a rapidly arming China, which preoccupied the smaller countries of East Asia, were not necessarily viewed in the same light by the United States. Third, whereas during the Cold War, Washington had largely been willing to ignore the fact that its allies in East Asia were authoritarian or “soft authoritarian” governments, and as the post-Cold War period became fully established, US officials did not miss an opportunity to advise East Asian states about the benefits of democratization and greater respect for human rights. Overall, the end of the Cold War turned America’s Cold War tolerance for East Asia’s distinctive political and economic practices into steadily increasing pressure to conform to Western liberal economic and political policies and practices.

As a consequence of these post-Cold War developments, the countries of Southeast Asia were forced to re-examine their relations with the major powers – China, Japan and the US. For example, in 1990, Indonesia and Singapore established diplomatic relations with China. Yet China was still perceived as a potential threat both in military and economic terms. China was seen as posing a military threat because of the increase in military spending, especially on new weapons systems, and because of its claims of sovereignty over the South China Sea. The economic threat was viewed as even more of a problem. With the economic reforms taking hold, and China moving out of the 1990–91 recession, the Chinese economy started to become a major competitor of the low-cost producers of Southeast Asia, such as Thailand, Malaysia, Indonesia and the Philippines. Under George Bush (senior), Taiwan was still a major issue between the two countries, but under Clinton and the Democrats, trade and investment relations with China were given greater weight. Certainly, America’s willingness to open up its economy to Chinese manufactured goods was a significant development. This was compounded by Japan’s increasing interest in channelling foreign direct investment into the coastal areas of China. Particularly after the devaluation of renminbi in 1994, Southeast Asian economies found that it was more and more difficult to compete with China as a low-cost manufacturing centre and that Japanese FDI tended to favour Chinese destinations. In other words, as the immediate post-Cold War decade of the 1990s wore on, the members of the Association of Southeast Asian Nations (ASEAN) had to increasingly take note of China’s policies and actions.
At the same time as China was in the ascendancy, Japan was not only reluctant to step forward and play a regional leadership role; it found it increasingly difficult to provide the economic leadership that the governments of Southeast Asia sought. With Japan’s importance to the United States’ strategic policies much reduced by the end of the Cold War, US–Japan ties started to fray. Japan-bashing became fashionable in the US. Japan’s economy also suffered from increasing stagnation. As a consequence, while still relying in good part on Japan for FDI and as a market for their goods, the members of ASEAN started to implement alternative policies such as developing an ASEAN Free Trade Area (FTA) and initiating links with the EU. For all the countries of East Asia, then, the immediate post-Cold War years were a period of uncertainty, as all the governments of the region sought to readjust to the uncertainties of the new strategic and economic environment.

**Liberalization and the Asian crisis**

The end of the Cold War, combined with the series of recessions and booms that swept through East Asia during the 1980s and 1990s, seems to have had a significant impact on the kinds of economic policies followed by regional governments. In turn, these economic policies were important in shaping relations with other countries in the region. The extent to which each of the countries of the region had similar experiences and followed similar policies had an impact on the way they viewed their neighbours. Clearly, there is considerable potential for competition among East Asian states, but at the same time, governments have also been prepared to cooperate when it was thought to be in their interests. The relationship between the countries of Southeast Asia and China was very much influenced by the changing economic policies that circumstances imposed on the region’s governments.

Just as the end of the Cold War ushered in an era in which the US pushed for greater economic liberalization in East Asia, a number of East Asian states were moving in that direction of their own accord. This change in policy was prompted first by the economic recession which engulfed Southeast Asia in 1985–86, and then by the wave of FDI that swept across the region in the aftermath of the Plaza Accord. The recession brought about recognition that in order to move their economies forward, governments would have to attract more foreign capital. By happy coincidence, Japanese companies were looking to move some of their manufacturing to lower cost centres in order to offset the rising costs produced by the appreciation of the Yen in the wake of the Plaza Accord. The influx of mainly Japanese FDI produced a rapid increase in growth rates and more pressure to further liberalize the region’s economies. In countries such as Thailand and Malaysia, the governments liberalized foreign investment rules, cut import taxes, reduced exchange controls and expanded the role of the stock market.4
The wave of prosperity that swept through Southeast Asia from 1987 onwards kept those who favoured liberalization in the ascendancy in many of the region’s governments. Moreover, as ASEAN members prospered in the early 1990s, China, after the recession of 1990–91, also began to experience strong economic growth in its coastal areas. Record growth rates were spurred on by gradual liberalization of the economy and especially by the devaluation of 1994. And just like the main economic powers of Southeast Asia, China also benefited greatly from access to the booming North American market. Liberalization and opening up economies so as to benefit from the opportunities associated with globalization were policies that were widely supported in the region.

This period of prosperity promoted economic cooperation among the ASEAN members, but this cooperation did not extend to include countries such as China, which was seen as essentially too much of a competitor. Among the ASEAN members, economic cooperation emerged in the form of the ASEAN Free Trade Agreement (AFTA). Originally proposed by the Thai Prime Minister, Anand Panyarachun, it was officially launched in January 1992. Following an uncertain initial phase, the ASEAN leaders rededicated themselves to an accelerated implementation of the AFTA agreement at meetings in 1995. While AFTA has reduced tariffs on trade among ASEAN members, the process has been relatively slow and has entailed a series of highly political negotiations. Significantly, one of the arguments which propelled AFTA forward was the recognition of the need to allow goods to be moved freely around the region so as to attract FDI that would otherwise go to China. Governments in the region were very conscious of the fact that by 1993, twice as much FDI was going into China as was going into the ASEAN countries. And this trend would only get worse from the viewpoint of ASEAN governments. In other words, from the perspective of ASEAN, the competition for FDI and for market share in places like the US and Japan precluded any economic linkages with China. Moreover, China was not yet seen as a major economic player that could rival Japan or the US.

All this changed with the onset of the Asian economic crisis of 1997–98. The causes and course of the Asian crisis are not at issue here; they have been extensively reviewed in a number of places. Rather, the importance of the Asian crisis for the relationship between the Southeast Asian states and China lies in the extent to which lessons were drawn from the events of the crisis. First, for many in East Asia, the crisis clearly demonstrated the dangers of being too closely linked into the global economy. The decade of liberalization that had led up to the crisis was seen to be at least partially to blame, both for the initial problems that Thailand encountered and, for the depth and scope of the crisis. Deregulating the capital accounts and allowing short-term capital to flow freely into, and more importantly out of, an economy was pin-pointed by some as central to the crisis. Interestingly, in a number of countries such as Malaysia, Indonesia and Thailand, the
economic nationalists, who had given way to the liberal technocrats for much of the 1990s, regained some of their former power.\(^8\) There was a widespread sense that ways of mitigating the impact of the forces of globalization had to be found. Indeed, key governments in Southeast Asia, and the government of China, appeared to share the view that there was a need for the countries of East Asia to better manage their external economic relations with the global economy.

Secondly, there was, as Richard Higgott has noted, considerable resentment within the region at the influence of the International Monetary Fund (IMF) and the US government in the early days of the crisis.\(^9\) IMF policies are generally believed to have increased the problems faced by Thailand and Indonesia. There is a view in the region that the IMF misdiagnosed the problem and chose to impose a set of inappropriate solutions that only exacerbated the situation. Perhaps wishing to deflect blame from their own policies, regional leaders have given credit to the IMF for turning what was a moderate currency crisis into a full-fledged economic and social crisis. In addition, opposition from the US and other Western governments to a proposed Asian Monetary Fund, which could have provided a regional vehicle for dealing with the crisis, further antagonized East Asian opinion leaders. Many of the governments of Southeast Asia shared with the government of China their distrust of US intentions towards the wider East Asian region and a common search for a way to limit American pressure for Western-style economic and political reforms.

Finally, the East Asian crisis raised further doubts about Japan’s capacity and willingness to play a leadership role in East Asia and underscored the rise of China as a major player in the region. During the late 1980s and into the early 1990s, Japan had provided East Asia with substantial amounts of aid and FDI, and had gradually opened up its domestic market to East Asian manufactured goods.\(^10\) In other words, for many business groups and governments in East Asia, Japan had been the widely acknowledged economic leader of the region. However, the Asian crisis clearly demonstrated the extent to which domestic economic problems had undermined Japan’s ability to play a leadership role. From 1995 onwards, aid to the region had been reduced, Japanese imports from the ASEAN countries were on the decline even before the onset of the crisis in July 1997, and Japanese banks, which in 1997 held a substantial portion of the commercial debt in countries like Thailand and Indonesia, understandably reduced their exposure to the ASEAN economies in the wake of the crisis.\(^11\) Moreover, while Japan did make significant contributions to hard-hit economies during the crisis, its attempt to launch an Asian Monetary Fund failed, in part due to US pressure. Japan’s unwillingness to alienate the US, its long-time ally, was seen in the region as indicative of its lack of commitment to its East Asian partners.

On the other hand, China came out of the East Asian crisis in a considerably stronger position with regard to its East Asian neighbours. Its
economy did not go into the nosedive that nearly every other economy in the region experienced, but instead, continued to expand, although at a much reduced rate. Significantly, during the crisis and in the years afterwards, Chinese leaders refused to devalue the Renminbi, a decision which was widely believed to have forestalled another round of currency depreciations across East Asia which would in turn have only extended and deepened the crisis. In addition, China’s influence in the region increased markedly with the successful re-incorporation of Hong Kong in 1997, and Macao in 1999. With the inclusion of Hong Kong in particular, China’s economic power in the region increased markedly. For example, exports to China (including Hong Kong) by the original six ASEAN members – Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand – surged from just over US$9 billion in 1997 to US$26 billion in 1999 and to US$33 billion in 2000. In general, then, China’s capacity to weather the crisis and to expand its economy provided important lessons for other states in the region. For example, in imposing currency restrictions in September 1998, Malaysia realized that both China and India had insulated themselves somewhat from the negative aspects of globalization by restricting their respective capital accounts and limiting the convertibility of their currencies. As a number of analysts have pointed out, the June 1998, nine-day visit to China by President Clinton, and his decision to bypass Japan, were symbolic of both the growing importance of China as a regional economic power and the relative decline of Japan. Interestingly, by 2000, China’s trade surplus with the US was nearly US$85 billion and had surpassed Japan’s trade surplus with the US.

As a consequence of the East Asian crisis, then, the countries of East Asia have had to take into consideration the rapidly growing economic strength of China. When this is combined with the increasing military capacity of the Chinese, it makes developing a stable and mutually beneficial relationship all the more important. This is especially so for the countries of Southeast Asia for whom China is an economic competitor, as well as an emerging political and economic ally. It is to the framework within which this relationship has developed that this paper now turns.

**ASEAN Plus Three and East Asian economic regionalism**

ASEAN Plus Three (APT) refers to a series of meetings since 1997 that have involved leaders, ministers and officials from the ASEAN states – currently the ten members: Brunei, Burma/Myanmar, Cambodia, Indonesia, Laos, Malaysia, the Philippines, Singapore, Thailand and Vietnam – and the three Northeast Asian states of China, Japan and South Korea. The APT provides an important framework for the development of Southeast Asia–China relations. The idea of an East Asian organization has been broached on a number of occasions in the past, but never really got off the ground. Prior to the ASEAN Plus Three process, the prime minister of
Malaysia, Dr Mahathir, had proposed in 1990 the formation of an East Asian Economic Grouping, later renamed the East Asian Economic Caucus (EAEC), but it had failed to develop beyond a set of relatively informal meal-time caucus meetings at the Asia Pacific Economic Cooperation (APEC) forum meetings.

The APT originated in the preparations for the first Asia–Europe Meeting (ASEM). The idea of an ASEM was first set out by Singapore’s Prime Minister, Goh Chok Tong, in a speech in Paris in October 1994 and approved by both ASEAN and the EU by mid-1995. The ASEAN members then asked China, Japan and South Korea to join them as the Asian representatives at ASEM. Both China and Japan had some reservations. The Chinese government was concerned that, given the EU’s stand on human rights, China’s participation would open it up to criticism from EU members over its policy towards Tibet and its human rights policies more generally. Japan was apprehensive about alienating the US, which was not involved in the proposed forum. However, all three Northeast Asian states agreed to join their ASEAN counterparts in a preliminary meeting in preparation for the first ASEM held in Bangkok in March 1996. At the Bangkok meeting, ASEM leaders planned for a second meeting in London in 1998 and arranged for economic and finance ministers and senior officials to meet during 1996 and 1997. Holding these meetings meant that representatives of ASEM’s Asian members participated regularly in ministerial meetings and caucused every now and again in order to coordinate positions and discuss which issues to pursue. In addition, both China and Japan were requesting regular summit meetings with ASEAN members to further develop economic relations.

In preparation for their 1997 summit in Kuala Lumpur, the ASEAN members decided to capitalize on the newly emerging links created by the ASEM consultations to invite the leaders of the three Northeast Asian states. The Chinese government agreed, seeing it as a chance to build on the economic ties that China was developing with the Southeast Asian economies. Although somewhat reluctant to get involved, Japan could not afford to let China gain an uncontested leadership position in the region and so it also agreed to attend. Since 1997, meetings of the APT heads of government have taken place at each of the annual ASEAN summits. In addition, APT finance ministers, economic ministers, and deputies from key ministries also began meeting regularly. Moreover, meetings have taken place among such groups as the APT Young Leaders, the e-APT Working Group, the APT patent office chiefs, and members of the ASEAN committee on science and technology and their Northeast Asian counterparts. And in a response to a proposal by South Korean president Kim Dae-jung, an East Asian Vision Group (EAVG) was set up at the Hanoi summit in December 1998.

While the foundations for the APT were laid prior to July 1997, it was the East Asian economic crisis that propelled the new process forward.
the Northeast Asian states, the crisis changed the way business and political leaders viewed their relationship with Southeast Asia and increased recognition of the need to develop formal relations to deal with any future crises and ensure continued economic growth. Among ASEAN members, the crisis underscored the potential benefits of more extensive institutionalized links to the major economies of Japan, China and South Korea. Part of the problem, of course, was that the regional organizations that might have helped manage the crisis failed to do so. APEC, which had started to run into problems in the mid-1990s, proved ineffective in dealing with the crisis. The lack of consensus among APEC members, and the U.S. insistence that the IMF be the lead agency dealing with the crisis, condemned APEC to inaction. At the same time, the other regional organization that might have helped manage the crisis, ASEAN, also proved incapable of helping its members. Lack of resources, an unwillingness to intervene in the affairs of other members, and a lack of leadership all contributed to ASEAN’s impotence in the face of the worsening regional economic situation. If collective action was to manage any future crisis, it was clear that existing regional organizations could not be used. A new regional forum was needed. The APT process, which was in embryonic form when the crisis hit, was the best available vehicle for developing some regional, economic management capability.

Underlying the emergence of the APT process was a number of long-term trends that promoted regional cooperation. Some of these trends had been obvious during the debate about the future of the EAEC in the early 1990s, and were essentially reinforced by later events. The importance of network capitalism throughout East Asia; the pervasive influence of the developmental state, and the fact that all have had to face the problems associated with the Asian crisis, have helped to knit a socially and politically diverse and geographically large region together in a distinctive pattern of economic policies and practices. Importantly, China, as it has become more integrated into the region, has adopted a similar approach to economic development to those of its neighbours. Certainly, the Chinese government’s economic policy appears to be following a developmentalist path by actively supporting and promoting export-oriented industries, while at the same time providing protection from global competition for those industries still unable to compete.

In addition to having similar approaches to economic development, a number of governments in the region see the way in which their individual economies articulate with the global economy in somewhat similar terms. As Colin Hay and Ben Rosamond indicate, it is not necessary for all members of a regional economic organization to see the relationship between globalization and their individual economies in the same way; however, China and a number of ASEAN states have a common wish to manage globalization. The countries of Southeast Asia have both benefited and suffered from globalization. They benefited from the waves of FDI from
around the world that came into the region from the mid-1970s onwards and fuelled dramatic growth rates during the late 1970s and early 1980s and also during the late 1980s and for much of the 1990s. They also suffered from the recession of 1985–86, and particularly from the Asian crisis of 1997–98, both of which were in good part caused by global economic developments. Significantly, however, most of the key ASEAN members do not see globalization as an inexorable phenomenon. Rather, the economic nationalists and the liberal reformers in countries like Malaysia, Indonesia and Thailand view globalization as a contingent political and economic project which needs to be managed in whatever way possible. This view was reinforced by the way that China effectively avoided the worst of the Asian crisis. Not surprisingly, this contingent view of globalization is the one that China shares. As Breslin has observed, the “Chinese approach was to accept and encourage globalization where it benefits China and resist it where is does not.” And China sees the need to encourage other Asian governments to do the same. As President Jiang Zemin noted at the February 2001 Boao Forum for Asia, it is important that Asian countries “stand up to the challenge of globalization.”

A major feature of the APT has been the willingness of both Japan and China to take on leadership roles. Interestingly, this is in direct contrast to the EAEC. Although its original proposer, Dr Mahathir, tried hard to get Japan to assume the leadership of the EAEC, it refused, fearing that it might compromise its valuable relationship with the United States. However, as the APT emerged both China and Japan appeared interested in advancing the APT as a regional organization. In part the competition for leadership in the region between the two powers, which developed in the wake of the Asian crisis, has been a fortunate turn of events for the APT process. Each has taken on a specific leadership role, China in terms of trade-based regionalism and Japan in terms of monetary regionalism. Moreover, the interest of the one in the promoting the APT process has encouraged the other to participate and seek ways of providing leadership for the embryonic organization. Together they have moved the APT process forward to the potential advantage of the Southeast Asian states. And while some may argue that this competition will likely lead to coordination problems, or even open conflict over regional leadership, there is no inherent inevitability that this will happen.

China’s interest in a leadership role in the APT is understandable, given the government’s traditional suspicion of America’s role in Asia and its new emphasis on increasing its influence in international affairs. Certainly, China’s negotiation for accession to, and entry into, the World Trade Organization (WTO) has reinforced its obvious need to gain allies in future rounds of WTO negotiations. In this respect, cooperation with its East Asian neighbours, especially those in Southeast Asia, would be advantageous. And for China, there would seem to be every prospect of reciprocal interest, given the distrust of the US that still lingers in the region in the
wake of the Asian crisis. Importantly, former Premier Zhu Rongji announced that China is formally going to implement a “going out” strategy by encouraging its enterprises to increase investment in other countries. In this respect, Southeast Asia is perceived to be an ideal place for Chinese corporations to trade and invest, given its relative proximity and the presence of a large ethnic Chinese population in the region. Chinese investment in Southeast Asia, most notably in Burma, Laos, Vietnam, Cambodia and Indonesia, has recently risen markedly and is targeted at such sectors as energy, low-tech manufacturing and banking. The Chinese government has strongly supported this trend and has also encouraged Chinese tourists to visit Southeast Asia. Indeed, recently the number of Chinese tourists visiting Southeast Asia has increased by 30 to 35 per cent per year.

China sees many advantages in focussing on regional economic integration. As Shi Guangsheng, minister of foreign trade and economic cooperation, has noted, “regional economic co-operation will not only create a favourable environment for China’s modernization but also is in the country’s political, diplomatic and national security interest.” For example, actively participating in the APT buttresses China’s policy on Taiwan. Taiwan has substantial investments and, as a consequence, good links with the governments and business communities throughout East Asia. Winning support from the governments of East Asia by participating in the APT can help China counter Taiwan’s ties to the region and further pressure Taiwan to negotiate with Beijing. Allies in the region also help to counter the support that Taiwan has from the United States. This is particularly important given that the George W. Bush administration has been much more aggressive in its defence of Taiwan than the democratic administration under President Clinton. Complementing China’s active role in the APT has been its sponsorship of the Asian Economic Forum or the Boao Forum of Asia. The idea of such a forum was originally advanced during the Asian crisis by a number of former leaders, including Robert Hawke of Australia, Yasuhiro Nakasone of Japan, and Fidel Ramos of the Philippines. The suggestion was that it be modelled on the World Economic Forum held annually in Davos, Switzerland. The Chinese government responded quickly to the suggestion and expressed its willingness to provide a permanent location for the forum’s secretariat at Boao, Hainan Island. The Chinese government hoped to signal to its East Asian neighbours that it is committed to play a constructive role in the region and that it is interested in trying to alleviate concerns that it is solely an economic competitor. Moreover, another important motivating factor for the Chinese is to provide a counter-weight to APEC, which China perceives to be too dominated by the US and the neo-liberal approach to economic development. Two meetings of the Boao Forum have now been held, the first in February 2001 and the second in April 2002. These meetings have generally confirmed the region’s commitment to increased regional economic cooperation.
Within the framework of the APT, the Chinese government has been especially active on the trade front, and in key cooperative projects. China’s major initiative with regard to Southeast Asia has been a proposal that China and ASEAN negotiate to establish a Free Trade Zone within 10 years. Formally announced in 2001 at the annual APT leaders’ meeting in association with the ASEAN summit in Brunei, it represents a significant step forward in China–Southeast Asia relations. Interestingly, as an indication of goodwill, China will reduce its tariffs on ASEAN goods coming into China before it will require the ASEAN states to reduce their tariffs on Chinese goods coming into ASEAN. The Chinese government also will promote the new initiative in a number of ways. First, the government will provide information to enterprises and enhance the opportunity for successful business linkages with Southeast Asian governments and firms. China will circulate data and news on Southeast Asian markets and the region’s investment environment, assist Chinese banks and corporations entering the Southeast Asian market, and put on ASEAN–China FTA conferences to explore potential opportunities, and adopt special initiatives to enhance China’s cross-border trade with, and investment in, Vietnam. Second, non-governmental channels linking China to Southeast Asia will be sponsored. For example, the China–ASEAN Commerce Council was established in November 2001 to facilitate China’s cooperation with various business organizations in the ASEAN states. Third, the government is intent on encouraging Chinese enterprises to develop a “Southeast Asian consciousness” and pay more attention to Southeast Asia to fully explore the challenges and opportunities that the ASEAN–China FTA will bring. By the end of 2002, both sides expected to have a framework for negotiations in place. ASEAN officials anticipate an initial round of tariff reductions which they call an “early harvest.” Both sides will select products for accelerated tariff reduction that are not sensitive to domestic political pressures, but are of high trading value.

In an obvious attempt not to be left out of any new regional FTA, Japanese Prime Minister Junichiro Koizumi announced at the April 2002 Boao Forum that Japan wanted an East Asian FTA. His aim was to get an agreement on a blueprint for a regional FTA before the APT leaders met in Cambodia in late 2002. The anticipated deadline for the FTA would be 2010, the year when trade among the developed countries of APEC would be fully liberalized. In making the case for his proposal, Prime Minister Koizumi said that the region must integrate more to compete against the North American Free Trade Agreement and the European Union. This Japanese proposal echoes one made by South Korea’s Kim Dae-jung a year earlier. Clearly, China’s initiative drove the APT region forward towards an FTA.

China has contributed to a number of cooperative programmes that promote economic activity in the APT region. The most prominent is the Mekong Basin Development Cooperation scheme. This scheme originated
as an ASEAN project which sought to encourage cooperation among the new ASEAN members. With the addition of China, it brings together the countries through which the Mekong River runs and is designed to improve economic cooperation around initiatives associated with the development of the river basin. The scheme has become one of the key projects of the APT process. In addition, China has provided Vietnam with US$40 million in low interest loans, Indonesia with US$400 million in low interest loans, and Burma with US$100 million in aid.\textsuperscript{33}

If China is intent on providing leadership, are the ASEAN states willing to follow? There is a view that by increasing their engagement with China, in terms of increasing trade and investment, the ASEAN members can transform the so-called China threat into a “China opportunity.”\textsuperscript{34} Certainly, being linked into an economy that continues to grow at seven per cent or better is seen by many in the ASEAN region as helpful to their own growth. For example, in 2001, China’s overall trade (excluding Hong Kong) with the ASEAN countries amounted to over US$41 billion, with ASEAN having a trade surplus of US$5 billion.\textsuperscript{35} Moreover, the Chinese market is viewed as important in the long term in balancing the reliance of many of the ASEAN economies on the US and Japan.\textsuperscript{36} Certainly in the short-term, increased trade with China has lessened the impact of reduced trade with the US and the EU. Notably, in the year ending March 2002, ASEAN trade with China rose by 9 per cent, while trade with the US and the EU dropped by 12 per cent and 18 per cent, respectively.\textsuperscript{37} In addition, a major study prepared for the ASEAN Secretariat forecasts that after accession to the WTO, China’s imports will grow annually by 10 per cent. This will mean that China’s (excluding Hong Kong) imports from ASEAN “will reach US$35.5 billion in 2005, an increase of US$13.3 billion from year 2000.”\textsuperscript{38}

The proposed FTA will ensure that the ASEAN economies are at the centre of any new regional trading arrangement. The study on closer ASEAN–China economic relations undertaken for the ASEAN Secretariat points out that an ASEAN–China FTA would “create an economic region with 1.7 billion consumers, regional GDP of about US$2 trillion and total trade estimated at US$1.23 trillion,” and that such an FTA would “increase ASEAN’s exports to China by 48 percent and China’s exports to ASEAN by 55.1 percent.”\textsuperscript{39} Just as importantly, the FTA should help ASEAN attract FDI from around the world.

But not everyone is anxious to see the new FTA succeed. One concern is that ASEAN could be flooded with cheap Chinese exports, and such an arrangement will not necessarily help ASEAN members to compete for FDI. Indeed, although in the early 1990s two thirds of FDI into Asia went to the ASEAN members, in the wake of the crisis over two thirds have gone to China.\textsuperscript{40} The proposed FTA may simply reconfirm investors’ increasing confidence in China. Some ASEAN analysts are also concerned that ASEAN may be linking itself to a future crisis, in that China’s banking system is so riddled with problems that it could bring the whole economy
crashing down with it at some future date. And some ordinary Southeast Asians fear that increased regionalism will lead to Chinese dominance of East Asia. As the Chinese economy grows, China could dominate the new FTA, rather like the way the US dominates the North American Free Trade Agreement. In this vein, former Philippines President Estrada has been quoted as saying, “I think China wants to take over Asia.” Distrust of China and the overseas ethnic Chinese communities runs deep in some parts of Southeast Asia and will have to be overcome as the proposed FTA and the APT move forward. Moreover, the series of bilateral free trade agreements that have been signed, or are being negotiated by a number of members of ASEAN, most notably Singapore, may compete with the proposed ASEAN–China FTA and make it difficult to implement.

One mitigating factor that may lessen the fear in Southeast Asia of Chinese dominance is that Japan provides a counter-weight to Chinese increasing influence. Japan’s interest in providing a leadership role in the economic development of East Asia has largely been centred on what Dieter and Higgott call monetary regionalism. Despite being rebuffed by the US over the establishment of an Asian Monetary Fund (AMF), Japan has created a network of currency swap agreements that may provide the regional equivalent of the AMF. The origins of the swap agreements go back to the May 2000 Asia Development Bank (ADB) annual meeting in Chiang Mai, Thailand. On the sidelines of the ADB meeting, the APT finance ministers agreed in principle to pool their hard currency reserves. During 2001, Japan reached currency swap agreements with Malaysia, South Korea and Thailand, and in 2002, Japan and China reached an agreement. South Korea has conducted negotiations on bilateral swap agreements with China and Thailand. In addition, the Chiang Mai Initiative, as it is known, provides for the exchange of information on short-term capital movements in East Asia, an early warning system to make governments aware of any problems, regular meetings of deputy or vice-ministers to review developments, and seminars to train officials. Importantly, the Japanese will furnish the expertise required to ensure the success of the enterprise. Generally, the other APT members are very receptive to any initiative that seeks to avoid a repetition of the 1997–98 Asian crisis. More particularly, the members of the APT, including the Southeast Asian countries, see the value in having two engines of growth, Japan and China, in the region.

**Conclusion**

Over the last decade or so, China–Southeast Asian relations have changed significantly. International events, most notably the end of the Cold War and the Asian economic crisis, have required each side to redefine their approach to the relationship. Importantly, the rise of the APT has provided a framework within which each side can approach the other on an equal footing, recognizing their shared goals and aspirations. For China,
increased economic links to Southeast Asia have considerable benefits, not just for the Chinese economy, but for China’s foreign policy generally. For the countries of Southeast Asia, the emergence of the APT has helped them deal with the aftermath of the crisis. Certainly, the APT’s two track approach – trade and monetary regionalism – with regional leadership on each track, has worked well. And the countries of Southeast Asia welcome the interest of both China and Japan in playing leadership roles because regional economic cooperation is likely to move forward at a pace which is comfortable for both China and the Southeast Asia countries.

Notes
1 The author would like to thank Austina Reed and Juliet Lan Zhang for research assistance.
12 Http://www.aseansec.org/Trade/Files/.
14 This section on the APT owes much to Stubbs, “ASEAN Plus Three.”
18 Webber, “Two Funerals and a Wedding?”
24 This parallels the view of globalization said to be prevalent in another country with a history of state interventionism, France. Hay and Rosamond, “Globalization, European Integration and the Discursive Construction,” pp. 156–157.
East Asian economic regionalism

35 BBC Monitoring Asia Pacific, Political, “China to Open Up 1.5 Trillion-dollar Trade Market in Five Years,” 24 April 2002.
PART II

China and the World Trade Organization
5 How reform drove China’s integration into the international community

Fan Yongming

Introduction

In a world where economic globalization is in full swing, China is becoming an increasingly active player in the international community. China has joined most of the inter-governmental international organizations. According to incomplete statistics, China’s membership in international organizations is 80 percent of that of the United States, an important sign of China’s involvement in economic globalization and its integration into the international community. The interdependence between China and international organizations has become an important subject for academic research in international relations. This chapter, taking China’s accession to the World Trade Organization (WTO) as a case study, aims to analyze and explore the interactive relations between China’s domestically engineered political and economic reforms and China’s foreign policy from the perspective of international political economics.

The clash between domestic cohesion and international pressure

Much foreign research focuses on the interactions between China and international organizations. As a summary report, Johnston’s article objectively introduces American scholarly viewpoints on this subject, while Economy’s thesis focuses on the relationship between China’s domestic reforms and WTO accession. Johnston views Economy’s thesis as overcoming other scholars’ inadequacy in research methodology and “sees it as the first major thesis to have compared China’s reforms in different times and in different fields.”

Johnston believes that China’s multilateral diplomatic activities, which have expanded significantly since the start of its reform and opening, are largely due to external forces. Before 1989, China was compelled by economic globalization and international forces to engage in multilateral diplomacy. But after the political turbulence of 4 June 1989, China’s participation in the international community is more a reflection of the major domestic forces with vested interests in China’s relationship with
international organizations. Therefore, China has changed from an opponent of the international order, that calls for reforms of various international regimes, to a supporter of these global norms.\(^4\) Johnston points out that a considerable number of American scholars believe that the aim of China’s further involvement in the international community is to seek domestic legitimacy, i.e., it is the Chinese leadership’s initiative to overcome a crisis of trust caused by the Cultural Revolution and to win popular support. From this perspective, social forces have compelled China to join the international community. Thus, while on the whole, China accepts international rules, in reality, its participation is limited to those treaties that are imposed upon it. Overall then, China’s cooperation with international organizations is either induced by the outside offers of material and social benefits or through material and social restrictions imposed on China.

Economy argues that China’s active participation in multilateral diplomacy is a function of the interaction between domestic economic and political reforms and international pressure for China to transform itself. Generally pessimistic about China’s involvement in the international community, Economy points out that China’s approach to international regimes is at best cautious and, at worst, suspicious. Chinese participation in international regimes is still restrained by issues such as economic globalization, the communications revolution, and environmental degradation, so China’s economic reform is likely to be slow and conflict-ridden, undermining China’s capacity to fulfill international obligations. While economic globalization has on the one hand presented opportunities for the Chinese leadership to enhance state cohesion and stability, it has, on the other hand, weakened the security of the state and the Chinese Communist Party’s capacity to govern. Thus, while some active supporters in China, who are closely connected to the international community, are interested in deeper engagement with international regimes, China’s overall ability to fulfill its international obligations is diminishing. The uncertainty can be attributed not only to the pressures on the Chinese leadership exerted by socio-economic transformations, but also to international impacts that are beyond its control. It is also due to the central government’s failure and unwillingness to rely on local governments, non-governmental organizations, and the legal system to address the new challenges, resorting only to traditional methods, i.e., strengthening the central government’s authority.

The two viewpoints suggest a new perspective for studying the relationship between China and the international organizations, which involves assessing the role of economic reforms in China, pressure exerted by the international community, China’s capability, or lack thereof, to implement its international obligations, and the strategies adopted by the Chinese leadership to deal with challenges from home and abroad. We will, therefore, use these four perspectives to study China’s accession to the WTO.
China’s accession to the WTO in November 1999 has attracted worldwide attention. Joining the WTO is not only a great victory for China’s multilateral diplomacy, but is a “win-win” achievement for all parties: with China on the inside, the WTO has truly become a global system; accession to the WTO has rewarded China with unprecedented opportunities and guaranteed sustained economic development; developed countries/trade entities such as the United States, the European Union, and Japan will now have a trading partner governed by international rules; and developing countries’ positions and leverage in the WTO will be enhanced by China’s accession. However, this “win-win” scenario took 15 years of hard negotiations, mirroring a 15-year process of China’s gradual integration into the international community through its reform and opening policy. Any objective analysis of China’s WTO accession, therefore, must address the relationship between China’s domestic reforms and foreign policies, as well as offer a proper critical analysis of the above-mentioned articles by Johnson and Economy.5

From the market economy to the market opening

It took 15 years of negotiations for China to join the WTO. Progress in these negotiations hinged on concomitant progress in China’s domestic reform and opening policy, rather than being due to compromises made by China’s leadership with external pressures that were beyond its control. China’s reform and opening has been a gradual process, but one that has been in the interest of all stakeholders. Therefore, despite the conflicts arising from reforms, the reforms can only strengthen, rather than weaken, China’s ability to fulfill its international obligations.

The 15-year-long negotiation process can be divided into three stages. In the first stage, from July 1986 to October 1992, the focus of negotiations was whether China should adopt a market economy. The second stage was from November 1992 to November 1999, with the focus of negotiations being the direction, speed, scope, and essential terms for China to open its market. The third stage was from November 1999 to November 2001, and involved detailed procedures by which the results achieved in the first two stages could be turned into multilateral agreements. Therefore, our analysis will concentrate on the first two stages.

Fostering the socialist market economy was the key step for China to join the WTO

On 11 July 1986, the Chinese government submitted its application for resuming China’s contracting party status in the General Agreement on Tariffs and Trade (GATT – the predecessor of the WTO) and the Memorandum on China’s Foreign Trade Regime, in accordance with the request by GATT’s China Working Team. This was the first time after the founding of
the People’s Republic that China, on its own will and in an open manner, exposed to the outside world its economic status, trading regime, and fiscal and taxation system. Based on the Memorandum on China’s Foreign Trade Regime, major GATT contracting parties raised 2,600 questions on the specific operation of China’s economic and trade system. The Chinese negotiation delegation directed these questions respectively to the State Planning Commission, the State System Reform Commission, the General Administration of Customs, and the Ministry of Foreign Affairs, whose answers triggered more follow-up questions. The total number of questions multiplied to over 10,000.

The exponential increase in the number of questions occurred for two major reasons. First, few foreigners truly understood China’s reform and opening, since it had been only seven years since the reform-and-opening policy had been announced at the Third Plenary Session of the 11th Chinese Communist Party Congress in December 1978. The policy’s achievements were just beginning to emerge in coastal provinces, such as Guangdong, and in the Special Economic Zones, such as Shenzhen. Most Chinese people and local officials were still transforming their world-view. Second, there remained serious disagreements as to the direction of reform and opening, both inside and outside China. Domestically, most people continued to see reform and opening as tinkering with the planned economy. In this context, the guideline of taking “planning as the key instrument, with market regulation as a supplement” was first put forward. The slogan of “the state will regulate the market, while the market will guide businesses,” was later created. As to the goal of the economic restructuring, only a vague concept of a “commodity economy” was proposed, which not only aroused continuous debate, but also confused the foreigners. Given the political atmosphere then, openly approving a market economy was still too daring, so the English translation used the term “commodity economy,” rather than “market economy.” In English, commodities refer to staple goods, such as cotton, grains, mineral products, etc. As negotiation participants recall, the members of the American delegation were quite confused, believing that China’s economic restructuring would allow the market to determine the price of staple commodities, such as cotton and steel. However, what China intended was economic development. Moreover, following the tragic events of 4 June 1989 in China and the collapse of communism in the Soviet Union and Eastern Europe, China’s GATT negotiations stalled and failed to make any substantial breakthrough.

It was the political resolution on “Building the Socialist Market Economy,” passed at the 14th Party Congress, in October 1992, that broke the deadlock. During his “southern tour” (nan xun) in spring 1992, the late Deng Xiaoping proposed that under socialist conditions, China could also build a market economy. Relevant resolutions were passed at the 14th Party Congress. In October 1992, and a day before the 11th meeting of GATT’s China Working Team, the resolution of the 14th Party Congress was formally
announced. That evening, China’s GATT delegation put into its speech all the information about the building of a market economy passed at the 14th Party Congress. The next day, the head of the Chinese delegation, Dong Zhiguang, announced explicitly at the Working Team’s meeting that China would also be developing a market economy, which surprised the audience. Not only were all debates about “planning as the key instrument, market regulation as a supplement” ended, but the skepticism of the major contracting parties towards China’s willingness to continue reform and opening after the upheaval in the Soviet Union and Eastern Europe was also dispelled. In later meetings, it was no longer common for one question to develop into two, three, or more questions which had led the previous debates to drag on endlessly. Thus, the 14th Party Congress’s resolution to build a market economy, which finally defined the goal of reform and opening to be the establishment of a socialist market economy, was the very reason for China’s preliminary progress on accession negotiations.

**Progress on economic restructuring drives China’s accession negotiations**

From November 1992 on, China’s accession negotiations entered a new stage, starting to discuss specific issues such as the terms, speed, and scope of China’s market opening. This stage was closely connected with the first stage. It was not enough for China to be verbally committed to a market economy; China had to prove its commitment with real action. WTO principles and agreements represent universal market rules – they are based on a summary of experiences and lessons learned from various market economies. Negotiations on the terms, speed, and scope of China’s market opening were, in essence, negotiations on whether China could abide by WTO rules. On the surface, the WTO might clash with international pressure that was beyond the control of the Chinese leadership. In fact, every success in the negotiations was due to the progress of domestic reforms which, in many cases, exerted more influence than international pressure.

The basic principles of the WTO – to form an open, transparent, and fair market environment; to lower tariffs for trade in goods, services and intellectual property; and to remove non-tariff trade barriers so as to realize sustained economic development and maximize social benefits through orderly trade – do not run counter to China’s objective of reform and opening. This was the goal of the reforms that were begun back in the late 1970s. After applying to resume China’s contracting party status in GATT in July 1984, China’s reforms intensified, and the trend seemed irreversible. The following is a brief review of significant reforms China made to its economic and foreign trade regime, the majority of which were implemented because they liberalized or deregulated the economy and therefore facilitated China’s goal of economic development, not because of external pressure.
From the end of 1979, China began to decentralize foreign trade and break the monopoly enjoyed by several foreign trade companies subordinated to the former Ministry of Foreign Trade and Economic Cooperation. Producers were allowed to engage in import and export. By 1986, there were 1,200 enterprises dealing in imports and exports.

In 1984, the new Import and Export Tariff Headings of the Customs House was formulated on the basis of an international standard, the “Goods Categories and Headings of the Customs Cooperation Council”, which was the first step in line with international tariff headings. Meanwhile, an experiment was introduced whereby foreign trade companies which served as import agents were given the right to set their own domestic prices, putting the responsibility for profits or losses on imported goods sold domestically on the importers themselves.

On January 1985, the internal settlement rate between the RMB and foreign trade currencies was eliminated, and the RMB was pegged to the US dollar. In 1988, foreign exchange markets or swap markets were opened in various provinces, autonomous regions, and economic centers, which allowed foreign firms which earned RMB ways to repatriate some of their profits.

In 1988, based on the experience of Japan and Korea, a Chamber of Commerce was set up for import and export companies, providing advice, information and coordination engaged in six lines, including: native products and animal by-products; textiles and silk; light industry; hardware and mineral products and chemicals; machinery and electronics; and pharmaceuticals.

China adopted the International Harmonization System for Goods Heading and Coding, and lowered import tariffs for 225 headings. In 1991, the number of imports controlled by the directive plan was reduced to 20, accounting for less than 20 percent of all the imports in that year. On 1 April 1992, Ministry of Foreign Trade and Economic Cooperation (MOFTEC) abandoned import and export adjustment duties, and removed license requirements for 16 imports and exports. By the end of 1993, the Chinese government had issued a series of 47 internal documents concerning the management of imports, had abolished 122 internal documents, and had also undertaken to publicize all import and export documents within the year to improve the transparency of the foreign trade regime.

In January 1994, significant changes were made to the Chinese foreign exchange system, with the formation of a managed single floating, foreign exchange system on the basis of market supply and demand. In April of the same year, a nation-wide, common inter-bank, foreign exchange market started its formal operations.

On 1 July 1994, China’s first Foreign Trade Law was promulgated and entered into force. On 13 December 1995, import control measures for 176 headings were removed. On 1 April 1996, China slashed its import duties again, involving over 5,000 headings, lowering the general tariff level from
35.9 percent to 23 percent. The import duty was lowered again on 1 October 1997, reducing the general tariff level to 17 percent.

In 1996, MOFTEC issued the *Experimental Measures for Setting up Sino-Foreign Trade Joint Ventures* to decentralize foreign trading rights further. Foreign capital began to invest in Chinese foreign trade businesses. By the end of 2001, the number of foreign trade businesses across the nation reached 25,000, including 142 private ones and 5 joint ventures. Also, on 1 December 1996, the Renminbi realized convertibility under the current account.

Finally, in January 2001, MOFTEC combed through all internal documents, laws, and regulations in accordance with WTO principles, with the result that 573 laws were abolished, 120 were amended and 26 new laws were to be enacted. Thanks to all these reforms and measures, the Chinese delegation had the cards in their hands, ready to respond during the negotiations, and finally sent China into the WTO. Thus, in most situations, China’s self-initiated, domestic reforms drove the negotiations and mobilized the accession negotiations.

The opening of the retailing sector to foreign investment is a good example. In the Accession Protocol signed in November 2001, the Chinese government agreed to open retailing business to foreign investment in five Special Economic Zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and six cities (Beijing, Shanghai, Tianjin, Guangzhou, Dalian and Qingdao), but only after accession. However, even before accession, China allowed foreign capital to engage in limited retailing in Beijing, Shanghai, Tianjin, Dalian, Qingdao and five Special Economic Zones. In July 1996, upon the approval of the State Council, MOFTEC and the State Planning Commission jointly issued the *Experimental Measures for Foreign Investment in Commercial Enterprises*. According to these measures, all provincial capitals and cities listed in the national plan were to allow foreign enterprises to engage in retailing. Shanghai and Beijing even saw some foreign-controlled shareholding retailers set up, such as Carrefour from France and Metro from Germany.

The negotiations between China and the United States were the most crucial part of the entire accession negotiations. The United States proposed the strictest market access demands, including allowing American agricultural products to enter the Chinese market, permitting American (and therefore all) foreign capital to enter the Chinese telecommunications industry in the form of joint venture, with the foreign share up to 50 percent of a company, and allowing foreign financial institutions to deal directly in Renminbi with Chinese people and businesses. Successful negotiations between China and the United States could not have occurred without the political decisions of the Chinese leadership. More important, had it not been for the reforms already implemented in China, these political decisions could not possibly have been made and accepted. American oranges and beef already appeared in Chinese supermarkets before
negotiations between China and the United States were concluded. American financial and telecommunication companies had already entered the Chinese market. One insurance company was granted operating rights back in 1992 and is a 100 percent foreign-owned company.

**Domestic debates and foreign concessions**

The judgment that China’s WTO accession derives from domestic reform is challenged both within and outside China. Within China, some institutions and individuals still believe that China has made too many concessions in the accession negotiations and national economic interests have been hurt. This is especially true among grassroots administrators and senior managers of monopoly sectors and state-owned enterprises who fail to have a full understanding of China’s accession commitments. Specifically, the attitude to WTO accession varies from region to region and sector to sector. Some adapt to the accession positively while others wait passively. The biggest complaints about WTO accession are: first, the excessive opening of the agricultural product market, which has hurt Chinese farmers, especially soybean and wheat producers and orange growers; second, the scale of tariff reduction, which has led to a tight squeeze on domestic products by imported products, particularly those made by state-owned enterprises (SOEs), thus worsening the predicament of SOEs and causing even more lay-offs and unemployment; and third, the premature commitment to opening the financial sector and allowing many foreign banks to grab market share from Chinese financial institutions, made financial restructuring even more difficult. Due to the Chinese political system, these objections have hardly been made public or been reflected in publications. Only a few hints can be discerned from the news reports on WTO accession. For instance, in April 2002, the Ericsson Company, in Nanjing, switched its 1.9 billion renminbi loan from Chinese banks to Citibank, which aroused widespread media attention. Many similar incidents occurred during the negotiations.

Academic discussions about the national economy in 1992–1994 are another example. While the late Deng Xiaoping’s speech during his southern tour reinvigorated China’s reforms, severe criticism over the entrance of multinational companies into China’s market ensued. Since products, such as beer and washing powder, were already being made by Chinese companies, some asked why China needed to allow foreign companies in? Some people were worried that the national economy would be hurt, endangering the foundation of public ownership. Economic seminars among industries at that time became arenas to criticize foreign products and investors. Although these debates had no direct connection with the accession negotiations then in progress, great pressure was exerted on negotiators. Former Minister of Foreign Trade Mr Gu Yongjiang, then responsible for the accession negotiations, recalled that there were many differences inside
China and concerns over market opening among traditional industries. Owing to the system, the Foreign Trade Minister was only the initiator and coordinator of negotiations, but had no decision-making rights over many issues. Over 20 ministries were involved in the negotiations and when Western countries became more specific in their demands, differences in China widened.\textsuperscript{11} As a result, although China signed the “Final Agreement on the Uruguay Round” as an observer, the negotiations were aborted after China proposed on 28 November 1994 to the Director General of GATT that December 1994 would be the deadline for negotiation after which China would not take any initiatives to restart the negotiation. Since no agreement was reached, China could not become a founding member of the WTO.\textsuperscript{12}

However, China’s accession steps did not falter. To enable people to have a better understanding of the relationship between foreign investment and national economy, on 14 July 1996 the \textit{People’s Daily} published a signed article entitled, “Don’t Waver on the Introduction of Foreign Capital.” The article advocated resolutely that China must adopt an open mindset, an open culture and an open system. A rigid system could only reduce China’s competitiveness. Only through opening could China innovate. Only by reforming could SOEs regain their vitality. And, by breaking the monopoly of the planned economy, the system could resume its vigor. This article in the \textit{People’s Daily} changed public opinion on foreign investment and its role in the national economy and provided a strong boost to the negotiations. Although China proposed a deadline, the negotiations were never suspended. On the contrary, after 1996 significant progress was made in the negotiations. Therefore, although China’s accession process has been tortuous, the overall direction has always been positive. The ups and downs were the result of ideological confusion, which sometimes blocked the reform and sometimes turned the situation around. As a result, accession negotiations lasted 15 years and were overshadowed by several crises before reaching a final agreement.

Other doubts came from outside China. When pressures from different domestic opinions on the accession negotiations were still manageable, pressure from negotiation counterparts, such as the United States and Japan, posed the real barrier to China’s accession. Therefore, not a few Chinese scholars view pressure from outside as a key force driving China’s WTO accession. A typical example is the report during Premier Zhu Rongji’s visit to the United States, which claimed that only huge concessions in agricultural products to the United States had opened the door to WTO. True, China did make concessions on agricultural products, as well as other issues; however, it would be simplistic to view China’s concessions as yielding to foreign pressure or regard foreign pressure as the key driving force of China’s accession. Why?

First, diplomatic negotiations are a process whereby states meet halfway; reaching any agreement is the result of bargaining.
Second, many concessions were essentially voluntary, made to promote the construction of a socialist market economy in accordance with internationally prevalent, market rules. In other words, China joined the WTO to promote domestic reform with the help of outside pressure. It is natural, therefore, that pressure from negotiation counterparts can be used to further domestic economic restructuring. Despite 20 years of reform, China remains a large, traditional, agricultural country, with low productivity, products whose quality is unpredictable, and a chaotic marketing and distribution system. Without the threat of foreign competition, it would be difficult to force Chinese farmers and administrators at all levels of the agricultural sector to recognize the need for reform. It is a Chinese philosophy to “confront a person with the danger of death so he will fight to live.” The same approach was applied to China’s WTO accession. The concessions China made during the negotiation were of its own choice and helped promote China’s domestic reforms.

Third, it is important to consider whether concessions can be accepted by a country. In other words, were concessions made at the negotiation table within the tolerance level of the country’s political and economic situation? In terms of China’s post-WTO situation, the answer is positive. Since joining the WTO, China has enjoyed a stable political situation and smooth economic development. Imports of the most controversial products, such as oranges, grains and soybeans, have caused no social turmoil in China’s rural areas. Although the financial sector was shaken by the “Nanjing Ericsson” incident, most Chinese financial institutions regard foreign challenges as beneficial to China’s banking reforms, as indicated by the remarks of the chairman of Minsheng Banking Corp. Ltd. at a “Forum on Cooperation and Development between Chinese and Foreign Financial Institutions,” which took place soon after the incident. He said that after China’s accession to the WTO, cooperation between Chinese and foreign financial institutions was of great significance and could bring about a win-win situation. Minsheng Banking declared that to cater to the demands of customers such as Ericsson, it had launched new practices in all of its branches, such as bill discounting with interest paid by the buyer, the purchasing of foreign exchange, buying out of accounts receivable, etc. People in the financial industry believed that had it not been for the Ericsson incident, these new businesses would not have been introduced so soon. This example, therefore, shows that concessions China made during the negotiations were more the result of needed domestic reforms, than a yielding to foreign pressure.

**Conclusion: the leading role of domestic reforms in China’s accession**

After this brief review of China’s accession negotiations, a few conclusions can be drawn: China’s process of accession was a clash between domestic
reforms and international pressure. Understanding the nature of the Chinese economic system is key to understanding the accession negotiations. At that time, while the international community was eager to accelerate China’s transformation and bring it into the global market system, it was skeptical about China’s reform and opening due to technical reasons, such as the confusion over the “commodity economy.” Moreover, foreigners were suspicious about the direction of China’s reform and worried that China’s reforms would revert to the old planned economy. Meanwhile, most Chinese people also underwent a gradual change of mindset, accepting concepts, such as “planning as the key instrument, with market regulation as a supplement,” and a “planned commodity economy,” before becoming comfortable with the idea of a “socialist market economy.” In short, international pressure and different domestic schools of thought all competed on the issue of whether China should build a market economy. However, these conflicts helped propel the idea of “building a socialist market economy.” Moreover, Deng Xiaoping’s speech during his southern trip reflected most Chinese people’s frame of mind. Similarly, this clash is also reflected in the negotiations on market access. Yet a common understanding as to whether China should protect its domestic industries, open its agricultural product market, or allow foreign capital to enter the financial service industry was reached gradually during the negotiations. As one member of the Chinese negotiations delegation recalls, at the beginning of the negotiations, many Chinese delegates seated at the negotiation table had the impression that GATT was an instrument employed by developed capitalist countries to exploit developing countries. This impression changed during the 15 years of negotiations. The fundamental cause for the change did not come from pressure from the counterparts at the negotiation table but from the achievements of reforms and opening in China. People started to realize that the more developed the market economy was in one region – such as in the eastern and southern coastal areas – and the more competitive the industry, the greater its vitality. For example, the household appliance industry has managed not only to stand on its own, but also to enter foreign markets. Therefore, as negotiations unfolded, China found a commonality with the WTO and the interactive influence between China’s reforms and WTO rules became more prominent. In the clash between domestic reforms and international pressure, the former has always been the leading and decisive force. The leading role played by domestic reforms is reflected in two aspects. First, domestic reforms conform to the trend of economic globalization. Accession negotiations lasted for 15 years, with the major breakthrough occurring in the late 1990s when China made its most difficult commitments. In April 1999, during his visit to the United States, Premier Zhu Rongji agreed to open China’s agricultural products market to the United States. In November of the same year, with the direct involvement of President Jiang Zemin and Premier Zhu Rongji, China agreed to America’s demand that it open its financial service industry. Certainly there
were some political factors in these decisions. But more importantly, the opening of China’s domestic economy has reached a new level; a common domestic market is in formation; efforts to reform SOEs are paying off; competition is driving the economy, which having overcome the impact of the Asian Financial Crisis, is developing stably. Therefore, China has both the desire and the strength to join the WTO and engage more deeply in economic globalization. Second, a state is subject to international organizations. The initiatives, activeness, pragmatism and flexibility demonstrated by the Chinese government at crucial moments during the negotiations played a key part in moving the negotiations forward. After the political turbulence of 4 June 1989, and the further deterioration of Sino–Western ties after the upheavals in the Soviet Union and Eastern Europe, Western countries harbored deep suspicion towards China. Negotiations were initially deadlocked but then moved forward only because of the resolve and determination of the Chinese government. The political decision to “build a socialist market economy” passed at the 14th Party Congress in 1992 broke the impasse in one stroke; no longer was the bargaining over broad principles, such as whether China should pursue a market economy; instead, negotiations shifted to specific market openings. In 1994, certain developed countries asked an exorbitant price which ignored China’s real situation, demanding that China undertake commitments based on the standard of a developed country. Both intellectual property rights protection and trade in services, which are not governed by GATT, were included in the negotiations. Moreover, foreigners insisted that domestic macro-economic management and judicial powers, such as fiscal and taxation policies and judicial review, were included in the negotiations. China’s response – that December 1994 was the deadline for the GATT negotiations – disillusioned its counterparts, but forced them to accept a reasonable price in a pragmatic and flexible manner.

The Chinese government proposed explicitly three principles for the accession negotiations: (1) China shall undertake proper commitments in line with its level of economic development, following the principle that obligations be balanced with rights; (2) China shall be willing to conduct bilateral and multilateral negotiations with WTO members on the basis of the Uruguay Round Agreements so as to obtain fair and reasonable accession conditions; and (3) as a low-income developing country, China should enjoy the treatment offered to developing countries. These three principles were all accepted by WTO members, which cleared the way for future negotiations. Clearly, a sovereign state plays a role in how it is integrated into the international community; thus during the whole process the active, pragmatic, and flexible attitude adopted by the Chinese government was one of the major reasons for the success of the accession negotiations.

Johnston and Economy are correct to assert that China’s integration into the international community is a process whereby domestic reforms
clash with international pressure. However, their approach, which is influenced by Western values and codes of behavior, ignores the inherent nature and rationality of the reforms that were under way in China, as well as their coherence with economic globalization. Consequently, they have overemphasized external pressures, underestimated domestic reforms, and perhaps even seen the two as contradictory, leading them to wrong conclusions.

Finally, China’s accession process clearly shows that economic globalization and national interest involves the unity of opposites. While economic globalization creates new opportunities for national development, it also inevitably conflicts with national interest. In the medium and long term, economic globalization may be in the national interest. But in the short term, conflicts cannot be ruled out or ignored. This short-term interest is key to managing conflicts. Because critics like Economy fail to see the wise attitude the Chinese government has taken in dealing with the paradox of economic globalization and national interest, they have the wrong view that domestic reforms would undermine China’s ability to fulfill international obligations. In essence, they fail to realize that China’s reform is the common desire of most Chinese citizens. Principles like transparency, non-discrimination, and market opening advocated by the WTO are no doubt right, representing the trend of economic globalization. But it is unrealistic to ask China, which is under transformation, to implement these principles right away and to the standard of a developed country. Not surprisingly, then, during the negotiations it became a focus of contention as to whether China needed a transition period after joining the WTO, how long the transition period should be, and how to make that transition. The endless bargaining and heated contention between the United States and China over issues such as whether and how much China should subsidize its agriculture, whether foreign capital could have over 50 percent ownership in joint venture telecommunications companies, how soon foreign banks could deal with Chinese people and enterprises in local currency, indeed reflect the flexible and pragmatic attitude of the Chinese government in dealing with the seemingly conflicting, but in reality harmonious, relationship between economic globalization and national interest. The reasons that the United States and China could reach compromises are in part due to the tolerance of the WTO, in the sense that while it is clear-cut on promoting trade liberalization, it also “allows exceptions to principles” and “exceptions do not violate principles.” Special preferential treatment is offered to developing countries, encouraging them to come closer to WTO principles. For China to succeed in the current reforms, it must accept the lead of the WTO and take into account whether these reforms are bearable to the people. It is essential to accelerate economic transformation, but in an appropriate time-frame that allows it to deal properly with various domestic interests. China’s goal, building a socialist market economy and integrating it into the international community, will be a hard and subtle process throughout
which China can and must manage conflicts among different walks of life. If domestic interests are ignored, national interest will no longer exist. However, while national interest is more important than the interests of any specific social group or class, responding to economic globalization and protecting the national interest, by resorting to the state’s political power, also involves coping with conflicts of interests among different classes generated by external pressure. Had China not insisted on joining the WTO as a developing country, and not asked for a 5-year phase-in period, no agreement would have been reached. All efforts to join the WTO would have stalled halfway because of the loss of support from the Chinese people. And even if it had been reached, China would have failed to meet its commitments. China’s chief negotiator, Long Yongtu, once remarked that frankly, “during the 15-year-long negotiation, China had adhered to the principle all the time for 15 years. If we had agreed to everything, the negotiation would already have ended.” The principle mentioned by Mr Long Yongtu is that China must join WTO as a developing country, which means the harmonization of economic globalization with the national interest of China.14

Joining this international organization is only the beginning of China’s integration into the international community. After acceding to the WTO, the grinding-in process will take a long time and cannot be neglected. However, the resulting contradictions or even conflicts will not affect China’s involvement in the international community. China will not back down from its international commitments, nor will it pick only those obligations which are favorable to itself and ignore other binding clauses. Needless to say, China’s domestic industries will be greatly affected by WTO accession and there will be more reasons for social instability. But there is an unprecedented enthusiasm for learning about the WTO in China; people are keen to understand and observe the WTO’s rules, and want to find a way out of the great pressure exerted on the Chinese economy. China’s accession process has now moved from the initial stage of official negotiations to a deeper, more gradual acceptance by the Chinese people.

The pace of China’s integration into the international community will now accelerate for the following reasons. First, China can look to international experience for its reforms. WTO summarizes the experiences and lessons that humanity has learned about markets. It can meet the general requirement of China’s reform and opening and offer useful examples for China’s building of a socialist market economy. After accession, China will continue to draw on the experiences and lessons of other countries more directly, constantly finding models for the next step in domestic reform. Second, China now has binding multilateral agreements that will both regulate government behavior and form an interest-inducing mechanism to guide businesses towards the market. For the government, the WTO trade policy review mechanism shall effectively govern its behavior. For businesses, the WTO dispute settlement mechanism shall force them to
realize that they will be protected if they follow market rules but punished if they violate those rules. Third, as China fulfills the various commitments it made during the accession negotiations, its economy will become more open. Problems that have been plaguing China for a long time, such as low efficiency, lack of credibility, and a bifurcated market, will be gradually resolved. Then, China’s economy will truly become a part of the global economy.

Notes
14 Gong Wen, “Rang lishi jizhu zhe 15 nian” (Let History Remember These 15 Years), Zhongguo waijiao (China’s Diplomacy), no. 2 (2002): 60.
6 Trade policy and regulatory politics

China’s WTO implementation in comparative perspective

Margaret M. Pearson

Introduction

The debate surrounding China’s ability to meet the requirements of the World Trade Organization (WTO) accession package (“compliance”) has tended to focus on two levels: whether the Chinese government’s commitment is genuine, or whether (presumably committed) leaders responsible for agreeing to the accession package can enforce its WTO commitments by potentially recalcitrant economic ministries and local officials – especially in the face of social and economic dislocations caused, in part, by WTO-related adjustments. While this discussion about compliance has been important, there are deeper issues raised by the academic literature on comparative and international political economy that cast a different light on the nature of Chinese accession. The purpose of this chapter is not so much to bring to bear new empirical information about China’s WTO compliance but, rather, to examine some key ideas from the broader political economy literature that can help frame our understanding of the relationship between the WTO as a globalizing force and the domestic politics of China’s trade policy. Two parts of the political economy literature – international trade policy and regulatory policy – offer much for us to consider. This chapter attempts to take a modest step in this direction.

The first of these two literatures – on international trade policy – takes an “outside looking in” perspective. Specifically, this literature sets forth crucial assumptions about the nature of a country’s behavior in the WTO and about the behavioral expectations inherent in the WTO as a trade liberalization mechanism. The literature is useful in its suggestion that much about China’s compliance situation is not unique and, indeed, is accounted for in the WTO. The second literature addressed in this chapter concerns the nature of the regulatory state in advanced industrial economies; here, the core interest is in both the extent to which “liberalizing” states regulate and the institutions and means by which they do so. In contrast to the trade policy literature, the comparative political economy literature draws our attention to the internal regulatory structures that mediate trade liberalization. The comparative scholarship on regulatory states suggests that
there are wide variations in how industrial economies actually liberalize their economies – the institutional structures, ideologies, and policy instruments used.

Neither of these two literatures has been written with China explicitly in mind, and initially the two bodies of thought may appear to be too disparate to be linked in the same chapter. (Moreover, each is too broad to be given comprehensive treatment here.) But the implications of both literatures for how we should assess China’s WTO accession are striking and consistent, and it is important that they are both recognized. Taken together, the two literatures suggest that while the impact of WTO on China may be deeper and more rapid than in the case of other earlier liberalizers, the issues involved and China’s reactions are not *sui generis*. Moreover, these literatures argue against a notion, popular in US business circles, that WTO dictates convergence to a single end – institutionally or regulatorily speaking – or that other countries have indeed converged to a narrow norm in terms of regulatory structures.1

This chapter is divided into three parts. The first examines the evolution of trade policy and its implications for national sovereignty in light of the broad trade policy literature. The second examines ideas arising from the literature on regulation and the regulatory state. The final part goes on to examine the ways in which our perspective on China’s implementation of its WTO agreements may be illuminated by these broader literatures, with a particular focus on the emergence of China’s regulatory state in the WTO context.

**From the outside looking in: the familiar story of WTO’s expectations for sovereign states**

To read carefully about international trade policy, and the domestic politics of trade, is to understand that the situation posed by China’s WTO implementation is consistent with much that we know from other countries’ entrance into trade agreements. The purpose of this section is to adjust our perspective on China’s WTO accession – to see that China is in important ways not exceptional – by looking at some of the established truisms about the political economy of international trade. Although the discussion is very basic, much of this perspective gets lost in the discussion when it pertains to China. My purpose is to bring this comparative perspective to the front and center.

When thinking about the broader scholarship on the political economy of trade and the relationship of trade policy to sovereign states, two points stand out. First, the WTO as an institution is the predominant international mechanism for economic liberalization in individual nation states, second only to markets themselves. By its very nature, the WTO attempts not merely to regulate trade at the border of nations, as the General Agreement on Tariffs and Trade (GATT) in its original incarnation was designed to do.
Rather, the WTO explicitly attempts to reach inside the borders to encourage a restructuring of the economic, administrative, and judicial institutions to support trade and investment liberalization. The WTO’s dispute resolution mechanism (DRM) as well as its notification, review and transparency norms attempts to establish a supra-national channel for oversight and enforcement beyond what international market forces might provide.

Jagdish Bhagwati, one of the foremost trade theorists of our time, recognized over a decade ago, as reform of the GATT was being debated, that to try to control “inside the border” impediments to trade would be to open a “Pandora’s Box,” such that the countless other barriers to trade that exist within a country would be revealed. It is no surprise that, as trade agreements reach ever deeper inside borders, more problems in compliance are encountered, and the domestic politics of trade become ever more crucial to implementation.

A second generalization about the nature of WTO’s relationship with the sovereign state is that it greatly constrains the ability of the state to manage its domestic politics insofar as it relates to trade. All countries, including the US, face constraints on sovereignty from any international trade agreement; the WTO, by reaching beyond borders, has taken this constraint to new depths. The net benefits of these constraints are routinely debated in domestic politics, of course. Recollection of the US domestic debate over the Uruguay Round reminds us that there was substantial opposition to a WTO that would undermine the ability of government officials to manage their own economy.

As part and parcel of efforts to make certain “discriminatory” trade practices WTO-illegal, the WTO greatly weakened mechanisms available to sovereign states to manage domestic political conflict over trade. Under GATT, once a liberalizing trade agreement came into effect, side-payments by governments to discontented groups served as a safety valve for siphoning off discontent while adhering more broadly to liberal trade norms. Requests by the US government to the Japanese government for Voluntary Export Restrictions (VERs) often served this function in the 1980s and 1990s. WTO rules substantially restrict the ability of governments to manage domestic groups this way, as VERs and other such arrangements are illegal. The prime protective mechanisms that remain legal are antidumping (AD), safeguards, and countervailing duties (CVDs). Such remaining tools can be powerful, however; the Sino-US bilateral agreement that is the foundation for China’s WTO accession package incorporates very low hurdles for initiating AD, CVD, and safeguard actions. Perhaps these tools of domestic market protection will be constrained or even made illegal in future WTO rounds, but they have not been yet.

WTO, therefore, puts heavy requirements for liberalization on countries, reaches deep inside their borders to do so, and removes some tools states have in the past used to manage the domestic political fallout of trade agreements. These ideas seem to support what might be called the
“globalization as convergence” or “globalization as homogenization” literature. But two further conclusions that might grow from these “homogenizing” features of the WTO do not in fact follow, and actually suggest the continued salience of heterogeneity in trade policy. First, and obviously, the domestic politics of trade have not diminished, even though some states’ most common, previous methods for assuaging losers are now illegal. Domestic debates over free trade agreements continue to take on a similar character: even when nations gain from trade in the aggregate, the benefits and costs are unevenly distributed, and those who are hurt tend to be more well-organized and vocal than those who stand to benefit. It is often up to top governmental leaders – who are more sheltered from such interests – to promote a trade liberalization agenda. Yet even when top leaders are the most important advocates of trade agreements, and publicly articulate adherence to free trade, they look for ways to manage and even protect markets when domestic politics dictate. Domestic politics – parties in control, their domestic constituencies, national development goals – will dictate different outcomes from country to country. Although WTO makes it more difficult to manage national politics, then, domestic politics continues to dominate how states manage their international trade commitments.

If the first conclusion that domestic politics still matters is obvious, a second conclusion is not: even as the WTO reaches inside borders, it does not create or attempt to enforce a uniform outcome in terms of institutional structure and regulatory policy; rather, the WTO, much like the European Union, embraces the possibility that the precise institutions used will vary across countries. Moreover, tools (in addition to the aforementioned anti-dumping, etc.) are amply available, notably use of standards and other prudential requirements, to prevent unfettered market access. One substantive example that is at the core of WTO principles is “national treatment.” National treatment dictates that, within a given country, foreign firms are treated on an equal footing with domestic firms. But the concept is that rules for foreign firms must allow them to be competitive with national firms, not that they are to be treated precisely the same. Obviously, whether different sets of rules allow for “fair competition” will be subject to much political wrangling. Another example centers on “prudential” exceptions – the notion core to WTO agreements that countries are able to establish prudential guidelines for financial institutions, so that countries can safeguard their financial stability. A third example concerns the use of phytosanitary requirements to restrict goods on health reasons. The WTO requirement is that all restrictions are based on “sound science.” But different countries can have different science, and basically credible studies can come to different conclusions. In such cases, the defending nation’s science is likely to be upheld. (All three of these examples are pertinent to China’s ongoing compliance process.) The notion found in the international trade policy literature that there are “wide bands” of acceptable rules, institutional arrangements, and behavior,
requires a more flexible set of assumptions about what constitutes compliance than is often applied by businesses possessing concrete interests to defend (not to mention the governments that represent them).14

WTO therefore constrains to an unprecedented degree the behavior of member states, but still leaves substantial leeway to those states to regulate their interaction. This latter fact suggests the great importance of examining the institutional mechanisms for regulating the economy and the great diversity among states in how they achieve this regulation. This literature on the regulatory state is addressed in the next section.

From the inside looking out: what the comparative political economy tells us about the regulatory state

Some writers on globalization – who have been very influential in shaping popular perceptions – have suggested that globalization forces the deregulation of trade and the decline of the relevance of national borders. In other words, globalization is equated with a “receding state” and minimalist regulatory institutions; liberalization and governmental institutions are considered to exist in a zero-sum relationship. Such views are common to supporters and critics of globalization alike.15

But has this actually been the impact of globalization and trade liberalization on the nature of the state? Undoubtedly the “receding state” vision is true from the long-term perspective of the privatization of state-owned businesses. Certainly the Chinese state, as it has moved to a market economy, has vowed to jettison much of its managerial authority. It would be naïve to argue that the receding state view has no merit. At the same time, no serious student of Chinese political economy would argue that the state has receded to the level of the US state (which itself is still enormous).

Although scholars of China would scoff at the notion that economic liberalization has left an anemic state, too few studies outside of China look seriously at what is left of the Chinese state, or at the important role that it does continue to play – and (the focus here) how it is, in important ways, evolving into a regulator as opposed to owner. In other words, not enough attention has been focused by foreign scholars on the emergence of a Chinese regulatory state. This section attempts to lay the groundwork for such a comparative political economy approach to the question of economic regulation. It uses the comparative literature on regulation to lay out two contrasting models of state intervention in the capitalist economy – the Anglo-American model and the developmental state model.

What is the purpose of economic regulation, i.e., the rules and regulations that govern entry, exit, investment, pricing, and other functions basic to a market economy? To answer this question the literature on regulatory states usually takes as its starting point the rise of the U.S. state in the 1920s and 1930s as a regulator of market failure and protector of the health and safety of citizens. In the Anglo-American tradition, the purpose of regulation is to
provide the framework of rules to “keep markets operating smoothly and as a response to the problems of market failure.” The basis for economic regulation is to enforce antitrust and competition policies. Thus, the core idea is the rolling back of state authority, in favor of the market – again, the receding state. This tradition also assumes an arms’ length relationship between regulators and the regulated – the basis of the notion of an “independent” regulator. Government is, in theory, detached from industry (notably banks who might otherwise preferentially allocate funds). In reality, regulatory efforts are beset by the problem of asymmetric information, whereby the government regulator depends on the information held by the industry to be an effective rule-maker and enforcer, an asymmetry that those subject to regulation can turn to their advantage. Ideally, though, the state’s role in promoting the nation’s economic health and prosperity should be effective macro-economic management. In developing economies undergoing privatization, added to this set of goals is the prevention of the abuse of market power by new private owners.

Nevertheless, despite considerable market power, the state has a prominent role in the Anglo-American tradition. Creation of a legal structure that protects property rights is key. But bureaucratic regulatory institutions are also central. There is a need to develop strong regulatory mechanisms, and strong institutions to enforce these mechanisms, so that governments can formalize and institutionalize their commitments to protecting consumers and investors – without choking off producers’ initiative.

Regulatory transparency and autonomy (to avoid “capture” problems noted above) are seen as crucial. Although liberalization and marketization genuinely mean a reduced role for the state when compared to a direct ownership role, this reduced role does not mean, even in the most liberal economies, that the state gives up its role, just that the function has shifted. Dani Rodrik and others have made clear that open economies often have big governments. Thus, the regulatory state is a crucial and defining aspect of the modern state in industrialized society, even in a globalizing world and even in an outlier-nation such as the U.S. This is not to say that the institutions of the regulatory state are always efficient, but they are pervasive and legitimate. It is crucial that they have the authority and capacity to be effective. This argument – in essence that modern industrial economies are run by regulatory states – helps clarify the importance of understanding the rise of China’s regulatory state that is responsible for administering in detail China’s accession to the WTO.

Steven Vogel, in his work on the regulatory state in advanced industrialized nations, shows how in fact liberalization goes hand in hand with a clear – and even in some cases enhanced – role for state regulatory agencies. Though Vogel is writing about domestic deregulation (largely comparing the Thatcher “revolution” with Japanese reform), his conclusions are applicable to those parts of domestic economies subject to liberalization through multilateral trade institutions, such as the WTO.
The crux of the regulatory state argument, as it relates to China’s WTO accession, is that privatization of business and decentralization of economic activities (including trade) away from central governmental control does not mean that government is out of the picture. No vacuum is created. Even if the state were to extract itself totally from ownership and management, it would retain a huge function; it takes on the role of regulator. As such, liberalization has meant, not the end of state control of the economy, but a reorganization of governmental control. Liberalization has actively required the reformulation of old rules and the creation of new ones. Even the strong vogue toward competition policy, which has as its central goal the international spread of antitrust and other pro-competitive rules, requires a central role for governmental regulation. And even in the ostensibly most “free market” economies, this process has been largely state-driven. Private interests have made their voices felt, of course. But more often, the state has been a (if not the) primary actor shaping the nature of regulation.

The second model of regulation and regulatory reform is that of the “developmental state.” This literature has been most thoroughly developed with reference to Japan, but also is commonly applied to Taiwan and South Korea. Japan’s regulatory state, rather than focusing on competition, embraces an ideology that has developmental state roots (or “late developer” roots, in the language suggested by Gerschenkron), using “economic regulation to actively foster technological development, capacity growth, and competitiveness of targeted industries considered essential to the future viability of the Japanese economy. The industrial policies are oriented toward boosting industrial development. Security concerns have also weighed heavily in the developmentalist state agenda ... including the fostering of the development of dual use (military and civilian) technology, embedding military production in the commercial economy, and the nurturance of domestic industries.”

Growing out of a developmental state, and in stark contrast to the Anglo-American version, regulatory policy in this environment embodies deep suspicion of competition, particularly from foreign business. Economic regulation – and, more recently, deregulation – in Japan is used to sustain the viability of small producers, in large part because they have provided an important electoral base for the Japanese regime. Finally, the Japanese regulatory structure tends to lack transparency and operates to a significant extent by informal rules, in large part to get around formal restrictions on government intervention. These features lead to the conclusion that regulation, in its formal and informal dimensions, retains strong bureaucratic authority (even if not coupled with ownership) so as to preserve large numbers of uncompetitive firms in a privately owned economy.

By considering the distinction between the two models, we reinforce the notion that regulatory institutions and norms of regulation vary substantially from state to state. This conclusion is broadly in tension with globalist assumptions of convergence, and even with the Anglo-American
roots of much of the regulatory reform literature. Yet both models manage the economy and mediate state–business relations. Therefore, they are usefully brought under the same rubric, albeit at opposite ends of the spectrum.

What can we glean for China (and its WTO accession) from this literature on the regulatory and developmental states? I wish to highlight three points. First, the growth of a regulatory state is a fact of life in advanced industrial market-oriented economies. Second, contrary to convergence theories (and in some tension with the goals of the WTO), there is considerable variance in the specific regulatory institutions of advanced industrial economies, and the goals behind them. Determining the specific origins of the nature and shape of a regulatory state is no simple matter. Suffice it to say that, in general, it is shaped by a panoply of variables usually pointed to when discussing the origins of institutions: prior institutions, orientations (which often vary by sector), and organizational structures – particularly the autonomy of various ministries/departments and their institutional capacities. The particular relationship between business and the state is also an important shaping variable – and a factor that in China is a moving target.

Third, as China begins to build a regulatory state, another factor is crucial – the pressure of international economic regimes. This factor is not something that has been deeply considered by the existing literature on comparative regulation, but it cannot be ignored for China. Differences in national institutions are assumed across very different trade policies and, as argued previously, are recognized by the WTO. Yet how pressures for compliance play out in the context of different national institutions, especially when these institutions are evolving, will be crucial for China. This story of course will not unfold for one or two decades (or more), but there is value in flagging the issue for observation at the present juncture.

Thus, as we try to explain the nature of China’s implementation of the WTO agreement, we would be remiss not to look at the nature of the state – specifically the emergent regulatory state, the norms and history that shape it (of which socialism is a part). In other words, we cannot understand the parameters of China’s application of the WTO agreement without understanding the construction of a regulatory state as a key factor in the equation. The next section of this chapter attempts to lay the groundwork for understanding the state of play of the rising regulatory state.

China’s emerging regulatory state

As noted at the very beginning of this chapter, discussions of Chinese implementation of its WTO accession agreement often raise the importance of domestic PRC institutions in implementation. But they fail to focus on the pertinent prior questions that have been so scrutinized in the cases of the U.S., Britain, continental Europe, and Japan: what is the regulatory
structure and how are its interests shaped? Part of the problem is that the regulatory dynamic occurs within a black box, relatively impenetrable to outside analysts. But, more and more, as transparency actually grows, in large part at the impetus of WTO but also with the establishment of an administrative law regime, such questions should be ripe for answering.

This regulatory state is only now in the process of becoming institutionalized. Yet even at this relatively early stage, there are signs that the development of China’s regulatory state is taking its own direction. In contrast to both the Anglo-American and developmental models, the Chinese regulatory state with growing responsibility for administering an increasingly marketized economy is emerging out of a system of a nearly totally state-owned, state-managed, and planned economy. These facts alone would seem to dictate a unique path, despite the fact that the WTO’s dominant members wish to encourage a regulatory structure along the lines of the Anglo-American model rather than the developmental model. The Chinese desire to build a regulatory state is by no means driven purely by WTO accession, however. The government on its own initiative has taken significant steps to build consumer protective mechanisms, as well as certain pro-competitive mechanisms consistent with the Anglo-American model, though without stellar enforcement success. Unlike the developmental model, moreover, China has been quite open to foreign investment. But there are clearly developmental impulses, and these have roots in both China’s state-owned governmental structure as well as in protectionism.

This section has modest goals: it tries to set some broad parameters for understanding the rise of the regulatory state in China, and to offer some implications for how we should further study WTO accession. It is organized around three parameters for defining regulatory structures: organizational structure, bureaucratic autonomy and bureaucratic capacity, and regulatory orientation. The precise shape of Chinese regulatory institutions will inevitably vary from sector to sector (banking vs. autos vs. telecommunications vs. agriculture). These differences will need to be mapped in detail in future research.

**Organization of the Bureaucracy**

Vogel describes two modes of organization, fragmented vs. centralized. Britain’s is a fragmented bureaucracy, meaning decentralized and relatively vulnerable to influence from political leadership and private groups. Japan’s is centralized, with the Ministry of International Trade and Industry (MITI) playing the dominant role. Post-1949, China’s bureaucracy has certainly been less centralized than Japan’s, and perhaps is as fragmented as Britain’s.

There have been many instances of administrative restructuring in post-1949 China, yet until the reform era, such restructurings were not aimed at enhancing market liberalization. During the early post-Mao reform period, the core goal of bureaucratic restructuring was decentralization of govern-
ment decision-making authority. Sometimes this took the form of deregulation as well. One of the earliest instances of deregulation was related to trade and involved the break-up of the monopoly of China’s 12 Foreign Trade Corporations (FTCs) that existed at the initiation of reforms in 1978. Progressively over the course of the 1980s and 1990s, the number of FTCs was expanded, including at the local level, numbering 35,000 by 2001. A large number of sectors were decentralized and deregulated in the mid-1980s, including harbors/shipping, universities, etc. These moves further fragmented bureaucratic control, and though aimed to give greater leeway to market forces, they did not rationalize the state’s regulatory function. Related attempts to redefine the relationship between enterprises and government were made, in the early 1980s, under the broad rubric of promoting enterprise autonomy. (Hence the use of the slogan, “break apart government and enterprises” (zhengqi fenkai)). These efforts by and large failed. There have also been numerous efforts to streamline the bureaucracy; indeed, this was a central part of Deng Xiaoping’s political reform program during the 1980s and early 1990s. However, the mere fact of multiple waves of “rationalization” in itself suggests they were relatively ineffectual.

In contrast to these earlier weak efforts at regulatory restructuring, the March 1998 restructuring of the State Council bureaucracy (usually attributed to then-incoming Premier Zhu Rongji) was a pointed and thought-out (yet undoubtedly politically negotiated) effort to restructure the State Council bureaucracy. The direct goals were to rationalize and streamline the bureaucracy, and apparently had the intention of breaking stalemates on key issues such as enterprise reform. But the institutional structure created is part and parcel of the emergence of the regulatory state. The restructuring involved cutting the number of central government ministries from 40 to 29, and trimming staff in the central government and provincial governments by half. The industrial ministries, the core of the planning system, were a particular target. Some, such as the ministries of machine building and internal trade, were downgraded to state bureaus under the State Economic and Trade Commission (SETC), and then later absorbed into the SETC at the end of 2000. This left the SETC in a very powerful position to coordinate regulatory policy, including that related to WTO. The Ministry of Finance and People’s Bank of China remain powerhouses in macroeconomic management, as does (though to a lesser extent) MOFTEC in the area of trade. The newly formed Ministry of Information Industry (MII) – a merger of the Ministry of Posts and Telecommunications and the Ministry of Electronics Industry, with the absorption of some electronic media and aerospace functions – provided the major exception of an industrial ministry that remained outside of the SETC scope. Regulation of telecommunications is thus positioned to evolve with different structures and norms.

Other sector-specific ministries were reorganized, including science and technology, personnel, national defense industries, education, and labor.
Still other agencies – environment, intellectual property and quality – were upgraded to vice-ministerial status. There was a central–local dimension to the “rationalizing” restructuring as well, as a system of vertical integration (placing offices under direct managerial control of their superior bureaucratic organs rather than local governments) received much attention in 1998–99 in many regulatory systems (such as quality control and safety).

The 1998 restructuring was much more far-reaching than earlier attempts. Moreover, as discussed below, there appears to be a complementary effort in terms of bureaucratic ideology/orientation to make them more pro-competition and pro-consumer, and to refine the role of regulator vis-à-vis business. This reorganization has had a major positive impact on the creation of a regulatory state that was not fully anticipated by outsiders at the time. But the thoroughness and direction of state transformation depends much on the next two dimensions.

**Autonomy from political influence and bureaucratic capacity**

China’s bureaucracy is vulnerable to political influence, not so much from society but from other groups within the government. This contrasts to Japan’s bureaucracy, which has a high degree of autonomy. China’s bureaucracy may have more in common with the “medium” autonomy that characterizes Britain’s bureaucracy. This influence, as well as fragmentation in structure, is captured in the dominant Western explanation of bureaucratic politics in China, “fragmented authoritarianism,” which posits that policy making is largely a function of bureaucratic bargaining and consensus building. This conclusion as to process is supported by several recent studies showing the pluralization of actors in foreign policy making in China, most significantly in the foreign economic policy bureaucracy. But the pluralization of actors may not translate into autonomy of regulatory institutions; indeed, it may mean that there is simply more bargaining to be done. (This was, after all, a key impetus behind the reorganization of ministries into MII in 1998. Even more knotty, perhaps, the question of the relationship between a regulator and the businesses it regulates when those businesses are state-owned is also highly pertinent. An illustrative example here is MII, which lost ownership rights to key telecom businesses to other government ministries (for example, the Ministry of Finance is a 100 percent owner of China Telecom). Can it truly be the case that the Ministry of Finance allows MII total autonomy in regulation, especially when both have influence on the State Council, not to mention the Politburo? Issues such as these abound in the current regulatory environment.

Bureaucratic capacity has also been the subject of reforms – reforms that clearly have influenced the type of regulatory state that will emerge. The Working Party on China’s Accession to the WTO has also flagged this subject as a crucial variable in China’s implementation of the agreement. As
with streamlining the bureaucratic structure, upgrading the quality of bureaucratic personnel was also a central feature of Deng Xiaoping’s reforms, and much was accomplished in terms of raising educational standards and institutional expertise. This effort to attract the “best and brightest” has continued to the present, particularly as it is recognized that the oversight of sophisticated businesses in an increasingly complex technological and international environment requires great expertise. There also appears to be an underlying understanding that through the creation of a bureaucracy of experts, regulatory personnel can insulate themselves from undue political pressure.

A hugely important means for building regulatory capacity is to endow the regulatory institutions with the authority to carry out their jobs, and to define what exactly that authority is. This task is largely the purview of the State Council, and involves legal empowerment – giving legal backing to regulatory agencies, and also the resources to monitor and enforce. In this sense, China is adopting a central part of the Anglo-American model.

Orientation of regulation

Distinctions between the Anglo-American and Japanese models can be made on the dimension of normative/ideational orientation. The former model fosters low governmental intervention in the economy (though far from zero, as discussed above) and the goal of efficiency (via competition and prevention of market failure). It values procedures, that is, regulators place a greater premium on administrative due process – particularly transparency that is achieved through publication of drafts, public comment periods, and open publication of all relevant rules – than on promoting specific industries. The WTO, which reflects this Anglo-American model, promotes the institutionalization of transparency and “neutral” adjudication of conflicts through its dispute resolution mechanism. The Japanese model, on the other hand, fosters a higher degree of intervention, whose goal is strategic: promote industries that can compete internationally, but shield those considered socially important, even if not domestically or internationally competitive.

As in the other dimensions, this story of ideological orientation in the Chinese case is still unfolding, and the current model is a mixture. Some discourse initiated with, and subsequent to, the 1998 reorganization of the State Council hearkened to the Anglo-American model: for example, strong pronouncements that the role of government needs to change, as in the slogan that there should be transformation “from a ‘government of permits and approvals’ to a ‘government of regulation and monitoring’” (you “shenpixing zhengfu” dao “jianguanxing zhengfu”). These commitments have often been noted by the academic community and, increasingly, in the Chinese press. Wang Yong has discussed how the 1998 reorganization left
the surviving government agencies with a redefined mandate “limited to industrial regulation and macroeconomic management rather than direct management of SOEs.” He goes on to write, that “over the past several years, a consensus has been building among leaders and the public that state monopoly must be broken, that more competition will bring a strong economy to the country and better services to consumers. Specifically, they criticize that the finance, telecommunication and distribution industries are the least reformed sectors.”\textsuperscript{48} The development of unified (economic) law-enforcement departments as part of the 1998 reforms was done to promote competition. Even the formation of the MII has been accompanied by some effort to substitute competition through the breakup of China Telecom.\textsuperscript{49} Greater commitment to transparency and more public administrative procedures have become evident to the foreign business community.\textsuperscript{50} These latter transformations, and the related efforts to develop an administrative procedure law, were undoubtedly influenced by the WTO accession process. But the reformulation of government reaches far beyond WTO accession, and should not be viewed as merely instrumental for WTO approval.

At the same time, as indicated by the ambiguities in the telecommunications ownership regulatory structure, China’s emerging system also contains elements of the Japanese developmental model. In telecoms, for example, the regulatory function is coupled explicitly with a “planning” function, whose goal is to expand telecom services to all of China and avoid a deepening “digital divide.”\textsuperscript{51} China’s efforts to carry out such a “universal services obligation” in telecommunication are not unique and are being encouraged and supported by the World Bank. MII, sometimes acting at the behest of the State Council, is also structuring market access to allow competition, but only for a small number of huge state-owned firms.

More generally, despite significant evidence of pro-competitive leanings, aspects of the ideational orientation echo the Japanese model. The language of competition is often coupled with a goal of promoting People’s Republic of China (PRC) industries against foreign competitors.\textsuperscript{52} For example, the State Council and SETC have encouraged some industries (notably autos) to consolidate into “big group” companies that can stave off (or survive) foreign competition. Thus China continues to consider an industrial policy that strengthens its strategic industries (notably services, telecommunications, agriculture, and autos), even though such efforts met with little success throughout the 1990s.

The WTO framework leaves plenty of room to promote aspects of the Japanese model. Technically speaking, industrial policy is not WTO-illegal, even though some of the tools useful to supporting industrial policy are now prohibited. Nor are anti-dumping measures, which China has quickly strengthened in its new and largely WTO-consistent Anti-Dumping Law, and which it has used. Here, China appears to be following Japan’s use of anti-dumping as a powerful yet sanctioned protective measure.\textsuperscript{53} Moreover, as Braithwaite notes, “there has not been a concerted effort to harmonize
competition law” within the WTO, so China (as other countries) can be expected to use whatever latitude WTO offers outside of its specific commitments to promote its strategic aims. Furthermore, the discourse on economic nationalism, sometimes linked to anti-globalization, remains strong and may have strengthened since China’s WTO accession. This discourse serves the interests of industries desiring protection, but the greater importance is that it has taken hold among elites and citizens.

Conclusion

This chapter has cut a wide swath and reaches no firm conclusions. It does, however, suggest that attempts to understand China’s WTO implementation and, more broadly, the impact of globalization on China’s political economy, must include topics raised by the trade policy and regulatory policy literatures. The trade policy literature forces us to examine the ambiguities inherent in the institutional, regulatory, and normative foundation of the WTO that exist even in the face of WTO’s greater power (compared to GATT) and China’s unprecedentedly detailed accession agreement. To understand China’s implementation, distinctions must be made between outright noncompliance and divergences that are tolerated by WTO, even if poorly tolerated by businesspeople or member governments.

The regulatory politics literature turns our attention to the mammoth task that China faces in establishing a regulatory state, especially in the time-compressed fashion that is dictated by both the domestic agenda and WTO. The regulatory state is now taking shape, and will continue to do so for some time. As in the U.S., it is not an even process, and will be subject to myriad domestic forces. Some forces will push in the direction of an Anglo-American model, others in the direction of a Japanese developmental model. It will be influenced by WTO pressures, but not determined by them. Indeed, a key test of whether WTO is actually a globalizing device may be how well it encourages China to avoid moving to the Japanese model. The early signs are that, as is to be expected, China is moving down its own road. It is a road that is well within the parameters of existing models, but mimics none of them.

Notes

1 As a general observation, interviews conducted in the summer and fall of 2002 with both trade lawyers (including former trade negotiators) and foreign business people indicate that the former group well understood the implications for China of the ideas presented here, whereas many more narrowly focused business practitioners were not persuaded by them.

2 Jagdish Bhagwati, “Multilateralism at Risk, The GATT is Dead, Long Live the GATT,” *The World Economy*, vol. 13, no. 2 (June 1990): 155. Writing prior to the completion of the Uruguay Round, Bhagwati was concerned that this effort to
reach inside borders would ultimately fail, and would leave advocates of “managed trade” victorious.


7 Nicholas R. Lardy, Integrating China into the Global Economy (Washington, DC: The Brookings Institution Press, 2002). As I discuss subsequently, the PRC has also recognized the utility of these tools, and has beefed up its own ability to use them.

8 Some of the most responsible examples of work that might fall into this category are found in some (but not all) of the essays in Berger and Dore, National Diversity and Global Capitalism.

9 This general rule about “vocal losers, quiet winners” has held true for China both during negotiations for WTO in the late 1990s and immediately post-accession. An oddity, in terms of comparative politics, is the U.S. debate on permanent normal trade relations status (PNTR) for China. There, a coalition in the WTO was able to form in 1999 in favor of granting China PNTR against those who perceived they would be hurt by such a move.


12 Goldstein, “International Institutions and Domestic Politics.” A country’s position in the world economy and its comparative advantage, in addition to creating concrete trade opportunities and difficulties, will also feed into the perceptions of policymakers. An excellent study of how Chinese policy makers have internalized China’s place in the world economy is Thomas Moore, China in the World Market: Chinese Industries and International Sources of Reform in the Post-Mao Era (New York: Cambridge University Press, 2002).

13 The area of services is especially subject to ambiguity. For example, for the provision of legal services by foreigners, WTO member countries are allowed to set standards for how many years of practice lawyers must have before they are eligible to practice in another country – just as US states are allowed to have their own individual standards. Whether this constitutes a barrier to market access or simply a prudent setting of standards to ensure a credible profession is subject to debate and interpretation. But the fact is that individual countries have the right to set such standards unless, ultimately, WTO dispute resolution panels were to deem them as not allowing national treatment.
14 On this flexibility, see Braithwaite and Drahos, *Global Business Regulation*, p. 211, and Kahler, “Trade and Domestic Differences,” who draws our attention to this notion of “wide bands.” An important exception is tariff rates, where the precise outcome (result) is dictated by the agreement. But questions of national treatment and not tariff rates are where the heart of domestic conflict over WTO is in most countries, including the PRC. Moreover, the bounds of what is permitted are often ambiguous and therefore subject to the kind of political bargaining within the WTO that is, according to Braithwaite and Drahos, at the heart of the WTO reality. See Braithwaite and Drahos, *Global Business Regulation*.


20 On how U.S. law, for example, promotes competition (using the tools of antitrust law, private litigation, disclosure laws, etc.) through defining private entitlements and setting preconditions for government intervention, see Peter H. Schuck, “Law and Post-Privatization Regulatory Reform: Perspectives from the U.S. Experience,” in Manzetti, *Regulatory Policy in Latin America*, pp. 24–48.

21 These elements are a crucial focus of transaction cost theory.


23 Vogel, *Freer Markets, More Rules*.


27 In contrast to the Chinese situation, in Japan the firms that were being preserved often were small-scale. Carlile and Tilton, “Is Japan Really Changing?,” p. 198.
These ideas are also consistent with Vogel in *Freer Markets, More Rules*, pp. 18–19.


29 Vogel, *Freer Markets, More Rules*, pp. 58–61, focuses on two variables determining the nature of deregulation — regime (and sectoral) orientation and organization, especially fragmented (British) vs. centralized (Japanese) bureaucracy and relative autonomy of the bureaucracy. For the rise of the regulatory state in the U.S., see Eisner, *Regulatory Politics in Transition*.


31 This important topic has gone virtually unstudied or even commented on outside of China. Within China there is a vigorous discussion. See for example the volume *Zhongguo jichu sheshi chanye zhengfu jianguan tizhi gaige ketizu* (China Infrastructure Industries Government Regulatory System Reform Task Force; Beijing: *Zhongguo caizheng jingji chubanshe* (China Finance and Economics Publishers), June 2002). This report contains essays written by the well-known scholars Yu Hui (CASS) and Zhou Qiren (Beijing University). Two influential scholars from the PRC, now in U.S. universities, have begun to bring attention to this issue; see Lu Xiaobo, “From Players to Referees: The Changing Role of the State and Bureaucracy in China,” paper prepared for the annual conference of the Association of Asian Studies (Washington, DC: 7 April, 2002); and Dali L. Yang, “Can the Chinese State Meet Its WTO Obligations? Government Reforms, Regulatory Capacity, and WTO Membership,” *American Asian Review* (forthcoming 2002). David Zweig has raised the crucial issue of regulatory reform in mediating the internationalization of China’s economy. See Zweig, *Internationalizing China: Domestic Interests and Global Linkages* (Ithaca, NY: Cornell University Press, 2002), pp. 264–268.

32 A pointed way to think about this is to recognize that a key goal of the U.S. in negotiations was to “avoid another Japan.”

33 Lardy, *Integrating China*.

34 With the exception of bureaucratic capacity, which I have added, these remaining parameters are a subset of the dimensions analyzed by Vogel in *Freer Markets, More Rules*, p. 45. The business–government relationship, while ultimately crucial to any empirical understanding of the regulatory state in China, is not considered in depth in this chapter. In Japan, regulatory policy tends to be dominated by “iron triangles” or regulators, regulated firms, and politicians. See John C. Campbell, “Bureaucratic Primary: Japanese Policy Communities in an American Perspective,” *Governance*, vol. 2 (January 1989): 5–22. The rather large literature on evolving state–business relations in reform China does not parallel the “iron triangle” literature in Japan, however, as the China literature has been aimed at understanding evolving state–society relations and predicting political reform. Therefore, the relationship between regulators and firms is poorly understood and is a ripe area for research. Examples of work on state–business relations in China include, Bruce J. Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs, and the Prospects for Political Change* (New York: Cambridge University Press, 2003); David L. Wank, “Private Business, Bureaucracy,

35 Vogel, *Freer Markets, More Rules*, p. 47 and Table 5.


39 Though not apparently a goal of Zhu Rongji’s at the time, this reorganization also helped the central government in 1999 offer a WTO package to the U.S. in its bilateral negotiations that would eventually be accepted. Wang, “China’s Stakes in WTO Accession – The Internal Decision-Making Process,” pp. 8–9. Wang notes on p. 9 that “about 45 percent of cadres at the State Development Planning Commission had to be retired or get positions in non-government institutions including state-owned companies.”

40 This discussion is based largely on Yang, “Can the Chinese State Meet its WTO Obligations?” The Party organization and local governments (counties, cities, towns and townships) also were downsized.

41 Several ministries did not undergo reorganization: MOFTEC and the ministries of transportation, construction, agriculture, and water resources.


46 An academic version of this is Zhongguo jichu sheshi chanye zhengfu jianguan tizhi gaige ketizu (2002). Lu, “From Players to Referees: The Changing Role of the State and Bureaucracy in China,” p. 5, quotes the phrase from Liaowang, no. 10 (4 March 2002).


50 The foreign business community has noted this widely, though it wishes to see it go further. See, for example, Timothy Stratford, “Testimony at Hearings Before The Office of the United States Trade Representative Regarding China’s Implementation of its WTO Commitments” (Washington, DC, 18 September 2002).

51 Author interviews, Beijing, September 2002.


7 Hinges and latches on the open door

The normative parameters of China’s WTO accession

Jeremy T. Paltiel

Hinges and latches

Regimes form a special kind of cooperative order in political economy, where international actors construct shared rules and norms in pursuit of collective goods. Regimes depend on sovereign nations to enforce these norms and rules domestically and a capacity to deny collective benefits to actors behaving outside the norms. Because of voluntary regimes (as opposed to imperative hierarchies based on power), the interests (both ideal and material) that invite conformity with specific regime norms and rules must have some domestic basis. The sovereign state, defining the unit of participation, is the “latch” of international cooperation, while domestic sovereignty provides a system of norms of reciprocity, contract and the rule of law that acts as a “hinge” of performance. States “latch” onto regimes in order to share their benefits with other states and to deny benefits to those who will not conform. At the same time, effective regimes “hinge” on domestic administrative machinery and commensurate behavioral practices to make transnational norms binding. Sovereignty, therefore, defines both the unit of action and the normative basis of compliance.

China’s membership in the WTO elicits suspicions because it is widely assumed that China lacks the normative basis for regime compliance. If true, sovereignty alone is an insufficient basis for participation in regimes. Sovereign states are presumed to be self-interested actors whose preferences are exogenous (not dependent or derived from external actors or international regimes). Provided a state is sovereign, therefore, adherence to a regime is a matter of will and interest, not capacity. To require that states internalize norms about conforming to rules-based orders, as a condition of adherence to a regime, suggests that regimes have a role in shaping state identities, a conclusion that appears to challenge traditional views of state sovereignty. To argue that China’s distinctive form of governance disqualifies it for membership in the WTO, despite explicit commitments to adhere to the rules of the organization, underestimates the significance of WTO adherence and exaggerates China’s aims at mercantilist subterfuge. This chapter argues that regimes do embody distinctive norms of governance.
China’s willingness to abandon its initial negotiating position and make painful concessions for the sake of WTO entry occurred only once China’s leaders realized the potential of WTO norms to set a coherent framework for the reform of China’s domestic political economy.

On a prima facie level, the People’s Republic of China (PRC) is a sovereign state, with effective control over its borders and its legislative process. The domestic jurisdiction of the Chinese government is not in dispute. The question is whether the Chinese government is willing and capable of transforming its domestic institutions to mesh with global norms. The reason for skepticism is founded on the explicit anti-liberal foundations of the institutions and ideology of the PRC, confronting what is widely seen as an institutional representation of the “embedded liberalism” of the international system of trade and investment.¹

The intention of the PRC to adjust legislation to comply with the requirements of WTO membership is not in serious dispute. Government commitment to WTO obligations is not the central point of controversy. The issue is whether that desire will translate into administrative action at the lower levels and whether the Chinese government can get both lower and regional officials, as well as domestic enterprises, to accept the norms of WTO membership. Analysis of China’s conformity with international regimes in general, and the WTO in particular, must start from an examination of Chinese attitudes towards, and reception of, international norms. This chapter examines the role of WTO accession in China’s ongoing economic reform to show how the prolonged negotiations made implementation of WTO norms plausible.

Norms in Chinese policy have been particularly unstable due to the disruptions of the past century and a half. At least three distinct normative systems have operated in modern Chinese history, which to an important respect overlap. The traditional normative system rooted in Confucianism and the hierarchy of imperial authority broke down completely following the overthrow of the Qing dynasty in 1911. For much of the rest of the twentieth century, these norms were under challenge from revolutionary ideology. The second normative system was that sponsored, fostered and enforced by the Chinese Communist Party. Mao Zedong’s brand of Marxist ideology and the Leninist organization was inculcated through mass political campaigns and enforced in political small groups. During the chaos of the Cultural Revolution, organizational ties were disrupted and ideology failed to give coherent and consistent guidance to policy. Neither the traditional normative system of dynastic Confucianism, nor the normative system of Communism was friendly to markets, property and the contractual ethics of the marketplace.

Private property relations were only gradually legitimated in post-Mao China, as the role of the market gained recognition and approval. Even if a substantial middle class is now emerging, there is no “old money” in China to sustain and promote an ethos and an ethic of market relations and private
property. Market relations are closely identified with a “catch as catch can” attitude. Even those most exposed to Western education, norms and values are tempted to act beyond the norms of sound business practice. There is no social context congruent with WTO norms, nor is the state institutionally accountable to a social base which supports WTO norms of transparency, the rule of law (or due process) and “national treatment.” By contrast with most original contracting parties of the General Agreement on Tariffs and Trade (GATT), China’s WTO accession does not entail reciprocal interstate recognition of norms already present domestically for the sole purpose of lowering barriers to trade. Instead, as critics repeatedly remind us, accession essentially entails *instituting* the domestic norms that make reciprocal lowering of barriers possible. It took 15 years of painful negotiation for China’s leaders to commit to such a process.

How does regime theory illuminate the purposes and implications of China’s WTO adherence? Our purpose is not to examine China’s reasons for joining, but the implications of this choice for China’s identity, including its commitment to implementing internationally recognized standards of the rule of law.

**Regime theory and domestic political structure**

Neo-liberal institutionalism, also called, “neo-liberal functionalism,” adheres to realist tenets of international relations theory, namely, that the international system functions in conditions of anarchy and that states are rational, self-interested actors whose highest interest lies in their own survival. Neo-liberals and realists disagree mainly over two issues: 1) whether and how international regimes or institutions constrain state behavior; and, 2) whether states are concerned with relative or absolute gains. The third school of thought within regime theory is social constructivism, or cognitivism. This school proposes that regimes are both the product and producers of norms that serve as the basis of cooperation.²

Realist and neo-liberal theories both assume that states are analogs to rights-bearing individuals and that regimes form a species of contractual relationship among rational actors. State preferences are exogenous to regime formation with the identities of states derived from sovereignty.³ That is, state interests, their existence, and their characteristics are not derived from the international system. We take issue with this outlook, arguing, along with constructivists, that state identities are at least partially shaped by international norms, including regime norms, and that this is crucial to understanding the process of China’s WTO accession. Keohane acknowledged that regimes could affect state interests, and might affect values as well, but saw this as secondary to a concept of regimes consistent with realist views of self-interested states as international actors.⁴ Neo-liberal regime theory implicitly assumes that regimes have liberal domestic governments. But today, concern is increasing that international regimes are
eroding traditional forms of liberal domestic governance predicated on sovereignty and democracy. In China’s case, however, WTO accession was predicated upon the establishment of new forms of domestic governance that followed WTO norms. Understanding China’s WTO accession requires an assessment of the extent to which the WTO actually constrains China’s state behavior, and what forms these constraints.

By definition, regimes depend on a standard liberal tool-kit of rules, norms, obligations and rights. As contracting parties to regimes, states are expected to behave in a rule-bound, normative fashion in respect of these rights and obligations. Western international law is part and parcel of the Western tradition embedded in regime theory, and the concept of *pacta sunt servanda* (agreements will be kept) is the basis of any rational theory of regimes.

Membership in multilateral bodies confers the right of participation in making common rules, together with a voice in their interpretation and adjudication. Multilateral cooperation differs substantially from the reciprocity principle of bilateral relations that informs much of China’s foreign policy. The standard Chinese response to rules with unfavorable outcomes is to evade, or whenever possible, seek an exception. Bargaining over exceptions is the standard operating procedure in Chinese public and private behavior. This posture undermines domestic and international confidence in China’s public policy. Given an exceptionalist or culturally specific understanding of the rule of law, rights and obligations, and the tension between WTO norms and Chinese governance practices, why did China expend so much political capital gaining entry to the WTO?

Three explanations are possible: first, no fundamental conflict exists between China and the WTO over the normative requirements of membership. Whatever differences remain between the forms of governance practiced by China and other contracting members of the WTO, China is committed to narrowing that gap through the sanctioning authority of membership; second, formalistic adherence is desirable but the actual constraints of membership can be subverted in domestic practice; third, despite underlying value differences, the advantages of membership in the WTO more than compensate for the discrepancies between the values embodied in the WTO and the ideological orientation of the Chinese regime. The latter scenario makes the WTO a forum for China to claim market access, while struggling to defend its governance practices against all critics. To choose among these alternatives, I examine the record of China’s WTO negotiations, as well as the official rhetoric and justification of adherence. Which norms does official China highlight? How does the highlighting of these norms compare with other items on official China’s domestic and international agenda?

The evidence shows that by now Chinese officials are explicitly committed to converge with a particular set of norms emerging at the international level. Contrasting the outspoken objections to conformity with Western
norms on human rights, Chinese officials are candidly committed to changing the domestic institutional order of trade, investment and markets where it diverges from the normative order which they acknowledge operates internationally and in domestic jurisdictions elsewhere. This posture does not contradict China’s bedrock concern with sovereignty. After a quarter century, during which time trade has contributed to an accelerating proportion of China’s economic growth, conformity with the international trade regime is seen as supporting China’s quest for sovereignty. Despite underlying anxieties about security, China sees trade and market access as fundamental pillars of its quest for “comprehensive national strength.”

**China’s strategy for GATT/WTO membership: from right to bargain**

China’s initial strategy to seek membership in GATT was predicated on achieving market access with minimal concessions, especially over domestic governance practices. Shifts in strategy occurred gradually, stimulated by shifts in China’s economic strategy and deepening commitment to market reform; heightened desire for recognition in global economic processes and international organizations; confidence in China’s economic achievement; and, increasing confidence in its domestic capacity for macroeconomic management and market regulation. China’s chief negotiator during the 15 years of China’s accession negotiations confirmed the tension between WTO accession, with its imbedded liberal norms, and Chinese identity as a developing nation bent on challenging the liberal order:

> At the beginning of the 1970s the developing nations … took up the struggle with the developed countries to build a New International Economic Order (NIEO). At that time, the UN put together a Conference on Trade and Development (UNCTAD), in distinct opposition to the GATT. The common current of the time was that the GATT was a “rich man’s club,” with just a few dozen contracting members, mainly from developed countries. UNCTAD was the organization that represented the interests of the developing nations struggling against the GATT. Making a political choice, our country chose UNCTAD over joining the GATT. However this did not mean we could not join the GATT.7

Impetus to join the GATT occurred in the context of the reform and opening up processes that began with the Third Plenum of the 11th Central Committee in December 1978. In 1977, China ranked thirtieth among world trading nations, representing only one percent of world trade. In 2002, China stood in eighth place and represented 5–6 percent of world trade. Once China began to expand foreign trade, it very quickly became an observer of the Multi-Fibre Agreement (MFA) affiliated with the GATT in
1981 and a full participant in the Third MFA in January 1984. Participation in the MFA, essential to gain market access for China’s textile exports, promoted awareness of China and interest in multilateral safeguards available through the GATT. Thus in November 1982, it sent an observer to the 38th General Assembly of the contracting parties of the GATT. By February 1984, following a seminar held by the GATT in Beijing, the Chinese government informally made known its interest in the organization.

Two important reasons motivated China’s initial application to “rejoin” GATT in July 1986. The first was part of a general push for China to seek membership of all multilateral institutions where membership was considered a badge of global influence, and second, to guarantee access to major markets for Chinese exports. This second consideration, as evident from the quotation from Long Yongtu above, could not have come about without a normative reorientation of Chinese economic policy. By 1978, modernization had become the overriding policy goal of the Chinese state, and very rapidly it became clear that trade was a key factor in the acquisition of the technologies and instrumentalties of modernization. In the 1980s, a national economic policy of autarky, where trade was seen as a restricted complement to the planned economy, was set aside in favor of a national economic policy increasingly formulated to maximize gains of trade. China’s total foreign trade, which amounted to only US$20 billion in 1978 had by 1990 risen to US$85 billion, of which 90 percent was carried out with GATT members. Membership would guarantee Most Favored Nation status for China in the important US market, and potentially eliminate the annual debate on China’s status pursuant to the Jackson-Vanik Amendment.

By December 2001, when China acceded to the successor organization to GATT, the World Trade Organization, a sea change had occurred in China’s attitude towards multilateral institutions and towards WTO membership. The simple urge to maximize the gains of trade through membership in the GATT had morphed into a comprehensive effort to “link up the rails” (jiegui) with the global economic system and to incorporate those norms within the domestic economic system. The learning curve of accession began with an awareness of the discriminatory measures to which China was subjected to in bilateral trade as a result of non-membership in the GATT/WTO. These measures ranged from conditional Most-Favoured Nation status (MFN) to discriminatory anti-dumping duties determined through third country pricing due to China’s designation as a non-market economy.

But, awareness of discrimination did not at first diminish the penchant for exceptionalism. Essentially, China aimed for broad market access with minimal reciprocal concessions. Through the long process of bargaining, domestic needs began to converge with international norms. China’s leaders and professionals increasingly came to link China’s interests in trade and investment with promotion of universal norms and felt less protected by
claims of exceptional status. Rather than constantly look for exemptions, China championed transparent rules applicable to all.

Multilateral organizations balance interests by the application of generalized rules that distribute benefits and obligations. Explicit commitment to the WTO’s rules-based governance was a core issue in China’s accession. Multilateral bargaining involves a different paradigm of interest advocacy than the one which China had normally adhered to in diplomatic practice. It was no longer a matter of trading off benefits and concessions on a bilateral basis, Chinese bargainers now had to move from a context where they sought an exception to the rules to one where they saw an advantage in having the rules applied to everyone. Legal sociologists speak of an “elective affinity” between capitalism and law, whereas critics decry the “juridification” of the global political economy brought about by the WTO. China has traveled a remarkable path from skepticism and careful hedging to endorsement of WTO principles. China’s critics must acknowledge the vast difference between claiming an exception to a norm and endorsing that norm as state policy, irrespective of lapses in implementation. To recognize a norm is to assert its validity. Recognition is the formal basis of legal constraint in any institutional framework.

But studies of China’s adaptation to the international system project a dichotomous distinction between “instrumental adherence” and “cognitive identification” with international norms. The transformation of the former into the latter is said to be shaped by cognitive processes at work within shared “epistemic communities.” There is no neat division between internal and external norms, values and processes. Normative identification is a complex process of intended and unintended effects, some of which emerge as part of the negotiation process itself. The very process of bargaining promotes appreciation of shared interests, not just a means to realize them.

**The initial phase of negotiations: blanket access with limited reciprocity**

The unique history of the GATT as a contractual organization for mutual tariff concessions has given rise to a process of accession which combines multilateral negotiations with the GATT Working Party over the terms of accession and bilateral discussions with each member concerning bilateral tariff concessions. China sought to evade the difficult process of bilateral negotiations, both by raising the issue of “resumption” of membership and trying to become a “founding member” of the WTO. Unique strategic circumstances in the 1970s (through collaborative opposition to the Soviet Union) had gained Most Favored Nation status for China from most Western countries without joining the GATT. China’s search for WTO membership was always premised on enhancing this “free-rider” status by borrowing the historical lessons for development in other East Asian countries, especially Japan and South Korea.
According to Chinese sources, the guidelines for GATT accession were laid down by the Chinese government as far back as 1982. These included: first, that China was “rejoining” rather than “acceding” to the GATT; second, China would engage in discussions on the basis of tariff reduction, not on an “import approval” basis as a non-market economy; and third, China would accede as a “developing country” with General Schedule of Preference (GSP) consideration under Article XVIII.

During the initial phase of negotiations to join the GATT, the claim was that China’s “rejoining” was an effort to side-step bilateral negotiations over contracting-in under Article XXXV of the GATT. Second, by insisting that China was a “developing country” under Article XVIII of the GATT and Article XII of the WTO, China sought to evade many obligations and constraints of membership. These two arguments cast suspicion on China’s willingness to live up to the norms and obligations of membership, since these provisions would have obviated the requirements of transparency, national treatment, and removing quantitative import restrictions, as well as the obligation to grant tariff concessions to existing members on a reciprocal basis.

Chinese officials were well aware that they were choosing an exceptional basis on which to claim membership of the GATT. According to Tan, “there was no precedent for “resumption” [as a form of accession] in the history of the GATT. This was a product of the special historical conditions of our country.”

The initial process of accession requires an extensive period of fact-finding concerning a country’s trade system and practices. In February 1987, the Chinese government presented its “Memorandum on the Chinese System of Foreign Trade,” and in the following month the GATT Secretariat set up a Working Group to examine the Chinese application. The following June, 329 questions were presented to the Working Group at the Secretariat, to which the Chinese side responded with a memorandum of its own in November 1987. By June 1989, there were eight rounds of discussions and over 2000 questions had been presented, before the events at Tiananmen in 4 June 1989 effectively suspended negotiations. Had Tiananmen not intervened, China might well have acceded to the GATT on favorable terms. But when the 9th round concluded in January 1990 and the GATT Working Group convened to discuss the Chinese application, the EU and US expressed a wish for China to review its memorandum concerning the operations of its economy in view of changes since 1987. It took 11 more years for negotiations to conclude.

In the end, China’s accession was made possible both by a convergence of domestic norms with those of the international trading system and the diplomatic skills of bargaining and trade-offs that Chinese communist negotiators perfected over half a century. Lessons learned in successive rounds of tough, bilateral trade negotiations with the US during the early 1990s were applied to the WTO negotiations. Confidence gained during
bilateral trade bargaining made the transition to bargaining over accession relatively seamless. The promise of accession was permanent Most Favored Nation status, which would relieve the pressure of ongoing bilateral trade diplomacy. This prospect provided an incentive structure within which China could make unilateral concessions. These unilateral concessions were one-time-only events, not “down payments” on an accelerating schedule of demands. Moreover, the process of negotiation was itself predicated on a schedule of “phasing in” obligations that China would in any case have to undertake. Therefore, bargaining was a learning curve on a sector-by-sector basis of the costs and benefits of accession. The protracted process of the accession negotiations was the most effective device the Chinese government could devise to mobilize domestic actors to take seriously the costs of adjustment. At the same time, the protracted struggle of bilateral bargaining highlighted over time the advantages of universality and generality in gaining market access over its alternative – endless bilateral negotiations with the US and other trade partners in an ever-expanding number of sectors.

**Hard bargaining**

By the time negotiations resumed in earnest in 1993, a sea change had occurred in the circumstances of the Chinese application. The perception of China in Western countries had been changed forever by the events of June 1989. The US also became increasingly concerned that China not be allowed to become a “free rider” on the international trading system, as it was perceived Japan had been. At the same time another change was occurring in China’s domestic and foreign economic policy. Following the collapse of the Soviet Union and Deng Xiaoping’s “southern tour” of 1992, Chinese economic policy had moved decisively towards the market and away from planning as the main lever of economic activity. However, the negotiations that ensued involved a higher “bar” to entry, requiring more specific commitments, and at a higher economic cost in terms of market access. Moreover, China had quickly brought its domestic institutions into conformity with the liberal international trading system. At the same time, negotiations over GATT entry moved from specifying post-accession adjustments towards meeting a specific “down payment” before entry, which included both institutional changes and specific market access provisions. After 1993, negotiations turned to American demands for market opening and institutional change. Placating the US was made to fit in with China’s own agenda for opening up and linking rails with the international economic and trading system.

In 1993–94, China sought to take advantage of the transformation of GATT into the World Trade Organization. China’s leaders optimistically, but wrongly, counted on a consensus for accepting China as a founding member of the new organization. GATT members may have recognized that
China’s growing stature as a trading nation deserved inclusion in a new global organization, but they were not prepared to abandon the contractual form of the old GATT to admit China at any price. Anticipating the requirements of entry, China undertook a series of measures, including the abolition of export subsidies (1991), publication of trade regulations (1992), unification of the foreign exchange value (1993), and progressive tariff reductions (1994–97).22

The increased pressure for trade concessions from the US, exercised initially on a bilateral basis and, after 1995 as part of the process of WTO accession, had a contradictory effect on the learning curve of normative compliance. On the one hand, China proclaimed its earnest desire to link rails and join the liberal multilateral trading order, implicitly or explicitly endorsing a liberal economic order.23 On the other hand, the escalating demands of the US, together with the piling on of new demands for concessions by the EU and other trading partners, fed Chinese visions of the West once again “ganging up” to prevent China from taking her rightful place in the world order. This perception of victimization undermined the values that China was earnestly proclaiming. China balked at the sweeping concessions demanded by the US prior to the founding of the WTO precisely because these concessions went against the discretion China claimed as a right on the basis of its developing country status. China saw any reduction in its “phase-in” and “phase-out” allowances as an affront to its status as both a developing country and as an equal member of the WTO.24 China continues to see the GATT/WTO as primarily a vehicle for achieving the interests of the developed countries.25 China looked to examples of countries which succeeded in using the GATT to promote development by adopting appropriate policies. They cite, for example, South Korea, pointing specifically to its use of neo-mercantilist policies, while exploiting Most Favored Nation status for the purpose of exporting to the US.26 In other words, successful membership was equated with, and predicated upon, getting a free ride in the international trading system.

The decision to contract in

Faced with the threat of remaining outside the mainstream of the world trading system, and having at base a commitment to a market economy, China’s leaders pushed forward the cause of WTO accession. In November 1995, the US handed China a secret 13-page memo laying out a road map for China’s WTO accession, spelling out areas of concern with respect to tariffs, market access, trading rights, investment policy and developing country status.27 The shock of exclusion from the newest world organization, the debilitating annual renewal of MFN status with its largest trading partner, and the rising surplus in two-way trade, prompted China to make greater efforts to achieve WTO entry. Accordingly, at the December 1996 WTO Ministerial Conference, Vice-Minister Long
disclosed that China would no longer insist on blanket developing nation status for WTO accession, and was open to discussion of accelerated timetables for phase-in and phase-outs in particular sectors. This brought China’s position closer to the US demand for a “down payment.” China’s willingness to make concessions was accelerated further by the Asian Financial Crisis of 1997, which gave greater urgency to China’s need to institutionalize a stable climate for trade and investment. At the same time, Sino-American relations recovered from the low points of MFN and human rights confrontations and the 1995–96 Taiwan Straits crisis in President Clinton’s first term. These events improved the atmosphere for negotiation and bargaining.

1997 marked a turning point. In September, the 15th Congress of the Chinese Communist Party adopted a resolution affirming China’s determination to pursue a “socialist market economy.” This was linked with the objective of pursuing a mode of governance characterized by the “rule of law”. These conditions engendered a new spirit of compromise over WTO accession. Gradually, China loosened its principled opposition to compromising its rights to neo-mercantilist exceptionalism, and began to bargain with a clearer vision of costs and benefits. The parallel determination to reform China’s state-owned enterprises (SOEs), also announced at the 15th Party Congress, highlighted China’s increasing dependence on trade and the need to guarantee a flow of inbound foreign direct investment within the context of a regional economic crisis.

The motivation for China to abandon its principled stand on accession, agreeing to specific down payments and shortened phase-ins and phase-outs, was the veto over accession exercised by the US. However, the shift was also facilitated by two sorts of continuities. The first continuity was the central role the US played in the so-called “Quad” countries that coordinated the terms in the bilateral negotiations. The US had for several years insisted that China must join the WTO on “commercially viable” terms. This theme was picked up by the EU, the other senior partner in the quadrilateral negotiations. However, China and the US had been engaged in high-profile and frequently acrimonious trade negotiations since the early 1990s. The accession negotiations carried forward the track of bilateral, Sino-American trade negotiations. China learned through experience in the annual MFN debates that it was capable of defending its interests and that it had key allies within the US business community. Sino-American trade negotiations already intruded into Chinese domestic policy, in particular with respect to implementing intellectual property rights protections. The second factor that facilitated the transition to the new phase was the familiar form of the negotiations. The road to a commercially viable agreement lay through commercial bargaining. From both Chinese and American perspectives, there was no question of bargaining away principles, such as eventual accession, that China’s joining was really a resumption of its membership or China’s developing country status. The only issue was the
price. Once this hurdle had been crossed, negotiations took the culturally familiar character of haggling in the marketplace.

The new objective was to reach an accommodation which would satisfy US demands for a down payment, while assuring a space for China to develop national champions in such “sunrise” service industries as telecommunications, as well as more traditional, but underdeveloped manufacturing sectors, like automobiles. Previously, Chinese concessions were largely limited to tariff reductions and promises to implement WTO rules in full. From 1997 on, negotiations resembled a log-rolling procedure in which China responded to specific demands with quantitative counter-offers relating to specific tariff rates, concessions on phase-ins periods to come into conformity with WTO rules, and accelerated phase-outs of prohibited practices. Previously, Chinese concessions were limited to tariff reductions combined with rigid insistence on pre-stated principles. The new negotiating model sacrificed China’s cherished preference for blanket discretion in favor of negotiating acceptable, sector-by-sector transition costs that would inject competition into industries the Chinese government was anxious to promote. Instead of seeking to eliminate competition in infant industries, China turned to international competition to accelerate domestic restructuring. Administrative guidance would now give way to natural selection. Without changing its outward stand on accession, the Chinese government began to pursue a negotiating strategy more consistent with the idea of “contracting in” – showing a willingness to fulfill specific conditions before accession – an idea that heretofore was an anathema.

The convergence of WTO norms with domestic needs

The emergence of the new strategy of negotiation coincided with the rise of Zhu Rongji. Zhu, as mayor, pioneered a new development model in Shanghai, combining public investment in infrastructure; reduced official discretion; greater transparency; reduced transaction costs; as well as enhanced protection of property rights as a means of encouraging investment. This model transformed Shanghai from being a laggard in growth rates during the 1980s to becoming the pacesetter of economic growth under internationalized conditions in the 1990s. Shanghai became a showcase in utilizing foreign capital to invigorate traditional manufacturing sectors, such as automobiles, as well as to open up new sectors in the services, including finance and telecommunications. Not only did this model approximate the demands of China’s major trading partners in the WTO, it also corresponded closely with Zhu’s domestic political agenda of centralizing executive decision-making, eliminating corruption and reducing principal–agent problems through public enactment of new administrative rules. WTO accession both mandated and facilitated a transition already under way from a system predicated on microeconomic intervention, rooted in administrative discretion, to macroeconomic regulation designed to
facilitate private investment and autonomous economic activity. Initially the decentralization of authority had provided the space for the growth of market reforms. By the end of the 1980s, however, it had bred discretionary controls and fed rent-seeking. The “Shanghai model” swept away departmental permits in favor of unified approvals of investment decisions within single administrative units outside the systems of sectoral micromanagement. When he became a Vice-Premier, Zhu took this model to Beijing.

The central government, fearing the corrosive effect of corruption on political legitimacy and administrative rationality, was anxious to control administrative discretion. Conformity to WTO rules and standards augmented external pressure to the effort to clean up the bureaucratic infighting bequeathed through piecemeal administrative reform.

In carrying out the rules of the WTO in a unified manner, our country must further enact legislation to clarify the exclusive power of the central government and to legislate control over foreign trade . . . Legislation should . . . clarify the universal power of the central government administrative organs to establish the system of rules for foreign trade for use over the entire country and restrict the power of local government to establish rules of foreign trade.32

In April 1999, Chinese Premier Zhu Rongji took a package of concessions to Washington in a desire to break the impasse over China’s WTO accession.33 China had long calculated that meeting US terms would open the door to swift accession. Zhu obviously saw accession as a lever to counteract the serious deflation affecting the Chinese economy and as a necessary plank in his effort to reform the domestic economy. His visit occurred at a sensitive time, in the midst of the NATO campaign in Kosovo, which China’s leaders saw as a threat to the concept of sovereignty. When the US brusquely rebuffed the concessions offered by the Chinese Premier, a chorus of critics denounced the Chinese posture as a “sell-out.” China’s chief WTO negotiator Long Y ongtu was forced to pen an article claiming that China’s market opening gestures were all in China’s own interest!34 What is important, however, is the way in which these interests were defined. National competitiveness was now more seen in terms of international competition and less in terms of protection. Long Yongtu specifically acknowledged China’s obligation to take “make-up lessons” to make up for the several rounds of tariff reduction since China’s initial accession to the GATT in 1947. Because members had continuously liberalized trade since China’s membership fell into abeyance, China had to be prepared to pay a price for membership. Therefore, in defending against criticisms of a sell-out to the US, Long appealed to universal standards and to the importance of meeting universal obligations as a defense against particular concessions to a particular hegemonic power.
Following the tragic bombing of the Chinese Embassy in Belgrade, President Clinton awoke to the strategic urgency of accommodating China within the multilateral system. In November 1999, the US signed a Memorandum of Agreement on Bilateral Terms of Accession that incorporated more modest concessions from China than those on offer half a year earlier. The logjam was broken.

Nothing should suggest that China has abandoned a fundamentally neo-mercantilist approach to world trade and economic development. Improvement of national-level competitiveness took precedence over improvement of material welfare or factor productivity. WTO accession is first and foremost a strategic tool, and not a sign of capitulation or assimilation to Western dominance. Thomas Moore has coined the term “global nationalism” to describe China’s competitive integration into the global economy. Chinese writings focus on the WTO as a challenge and on the need to shift the mode rather than the goal of national economic security. Chinese commentators primarily view WTO norms of transparency, generality and national treatment as instrumental means to the goal of national economic competitiveness, rather than ends in themselves. But however these norms are viewed, accession has the effect of cognitively engaging China with the system of “embedded liberalism” at the international level. Chinese liberal trends have also been challenged by a number of new and old “leftists.” It would therefore be a mistake to see the processes outlined above as universally shared even among officials and intellectual elites. Nevertheless, it is fair to claim a cognitive breakthrough, where both officials and non-officials come to identify certain transnational norms not only as products and symbols of engagement with external actors and external reality, but as values, albeit instrumental ones, to the reconstitution of domestic society.

Russell Moses has divided Chinese views on WTO accession into four schools: the “sovereignists” who fear the erosion of China’s sovereignty; the “Americanists” who fear the WTO as a tool of US hegemony; “integrationists” who view the WTO as a tool for restructuring China’s own political economy; and finally the “partnership school,” who see accession as a badge of China’s acceptance as a great power and therefore as an opportunity to restructure the rules of the international system in China’s favor. However, all four schools are arrayed as varying points within a broad political consensus that views the integration of China into the global economy as indispensable. Former President Jiang Zemin sees a “double-edged sword” of globalization. On the one hand, it represents China’s participation in the mainstream of international economic life, and on the other, a strategy of competition, premised on a struggle against the prevailing global order led by the West, with the US at its head.

No alternative economic strategies are proposed. Instead, debate engages over the speed of integration and restructuring and the limits of neo-mercantilist, economic policy making within a globalized economic system. No one proposes the WTO as the solution to China’s economic problems.
Rather, WTO membership is integrated with economic strategies aimed at national competitiveness.\textsuperscript{40} The adoption of liberal economic norms is, therefore, contingent on correspondence between these norms and Chinese national economic goals.

Without a doubt, globalization – alongside the nationalism produced through mutual interaction – represents historical progress. However, only by keeping one’s political fate in one’s own hands can the accomplishments which the nation state derives from the advance of globalization be made meaningful and dependable.\textsuperscript{41}

**Conclusion: contingent compliance or neo-liberal converts?**

So much of the international debate over China’s accession to the WTO has focused on the strength of China’s commitments to WTO principles and the need to ensure safeguards against willful defiance or negligent compliance with WTO rules.\textsuperscript{42} Economic actors are obviously driven by results. Nevertheless, focus on effective compliance ignores the importance that normative compliance has for the future of governance in China and for China’s relations with the world. China’s chief negotiator throughout the WTO accession process bluntly lectured the Party brass at the Central Party School: “The market system is a rule of law system . . . The first obligation and responsibility that we will have after we join the WTO will be to obey the rules.”\textsuperscript{43}

China’s leaders thus integrate liberal economic thinking with great power competition. Neo-liberalism has been accommodated to a neo-mercantilist strategy focusing on international competition, with the nation-state as the fundamental unit of action. Pursuit of a comprehensive industrial system has been abandoned in favor of strategic choices informed by comparative advantage. Support for industrial champions is now viewed through the lens of international competitiveness within a rules-based multilateral system.\textsuperscript{44} Chinese leaders recognize the constraining effect of globalization on national sovereignty, but see the state as the strategic focus of policy making capable of countering the corrosive effects of globalization and multilateralism on national sovereignty. While many Chinese analysts remain suspicious of the WTO and globalization, they see both as indispensable to China’s national goals.

Nevertheless other authors attempt to refute the notion that globalization implies the retreat of sovereignty:

Sovereignty is decidedly not the outcome of closing oneself off and turning inward. It may only be expressed through mutual relations. For those states that completely close themselves off to the outside world, and stubbornly refuse to engage with others, sovereignty does not exist, or rather, it is meaningless. In so far as we speak of the system of sovereign states and not of a single state, sovereignty is the product of a
market economy. So long as two states participate in mutual, non-random relations, especially economic relations, they must take on mutual obligations at least at some elementary level and engage in mutual self-restraint. The relationships among sovereigns here is just a projection of the relationship of equal exchange among commodity producers. From the perspective that globalization is just a new stage in marketization, globalization and sovereignty are far from contradictory, but form part of a natural process of mutual adaptation.\textsuperscript{45}

The elective affinity between markets and law complements an elective affinity between the interests of the central government and the international community. Accession will reinforce legislative activity to establish a transparent regulatory framework consistent with WTO rules and to establish central control over trade-related activities. In limiting the discretion of local authorities, the accession document represents a functional equivalent of the Trade and Commerce Clause of the US Constitution for the Chinese central government. By serving the interests of centralization, and by maintaining central control over legislative power, WTO accession parallels, rather than counters, the interests of economic nationalists.

The WTO affects the rule of law also at the level of procedure. Judicial review of administrative actions is mandated by accession. Moreover, involvement in the dispute resolution tribunals of the WTO will place an additional layer of scrutiny over China’s domestic legal process. This, for the first time, will integrate the Chinese legal structure into a supranational judicial procedure.\textsuperscript{46} With respect to trade-related law, China will be forced to confront what it has steadfastly resisted with respect to human rights – the evaluation of domestic procedure in the light of externally mandated norms.\textsuperscript{47}

China’s protracted negotiations to accede to the GATT/WTO made normative compliance much more likely than when negotiations began. Conformity with WTO norms is now congruent with the interests of numerous officials at the center of power and a growing public of academic and professional elites. These elites do not always share the same interests – central officials are interested in the centralization of regulatory power and securing market access for Chinese exports, where academics and legal professionals are interested in the rationalization and generalization of procedural norms and judicial review.\textsuperscript{48} Both, however, can seize on WTO compliance as a template for domestic reform.

China’s WTO accession presents a test of liberal or neo-liberal ideology not only for China’s leadership and emergent professional elites. Liberal economic values and norms like non-discrimination (national treatment), transparency and due process achieve greater legitimacy among political elites in direct proportion to their contribution to the wealth of the (Chinese) nation. Just as China claims no special rules in basketball to compensate for a lower stature, it should not claim exceptions as part of the
competition in international trade.\textsuperscript{49} This sports analogy has become a synonym for the norms of non-discrimination embedded in WTO norms.\textsuperscript{50}

At the level of theory, China’s adherence to the WTO represents a special instance of the “second image reversed,” where the international regime not only induces pressure for domestic institutional reform but actually provides a template and repertoire of norms without which the domestic implementation of the regime would be impossible. The test of “instrumental liberalism” may be “comprehensive national strength,” but so long as these goals remain congruent, accession pays dividends in the form of institutionalizing liberal norms. The learning curve of WTO accession shaped an environment where Chinese, both official and non-official, began to identify not only with the benefits of membership – namely market access – but also with WTO norms intended to insure fairness. The latter norms were absent when China first sought accession. Indeed, these ran counter to China’s initial strategy of accession but have now become the basis of popular support. This cognitive process suggests that interests are not exogenously given, but informed by norm giving and norm reproduction.\textsuperscript{51} Put in simpler and more concrete terms, China’s leaders and the informed Chinese public were initially interested in market position as a national interest, but became increasingly persuaded through engagement with the WTO of the importance of fairness in expanding and underpinning market exchange. Moreover, China’s growing power in the global marketplace would only be secured if China were seen to embrace these principles.

In order for us to mitigate, or even eliminate the “China threat” theory, and to create, for the benefit of our own country, a benign international environment, we must, in our international dealings, pledge to follow international rules and do things in accordance with these international rules and regulations and become a responsible member of the international community.\textsuperscript{52}

Notes

2 This discussion draws on Andreas Hasenclever, Peter Mayer and Volker Rittberger, Theories of International Regimes (Cambridge, UK: Cambridge Studies in International Relations, Cambridge University Press, 1997).
3 Robert Keohane, who if not the father, must be considered among the pantheon of patriarchs of regime theory, has confessed that he explicitly formulated his approach with the realist outlook in mind: “Students of institutions, such as I, sought to gain credibility by showing that our theories are as realistically based on interests and power as those of our realist adversaries, that we are not tainted by the idealist brush.” Robert O. Keohane, “Governance in a Partially Globalized World,” American Political Science Review, vol. 95, no. 1 (March 2001): 7.


6 This exact question is raised by Dan Ciuriak in his paper “China After the WTO,” prepared for a panel discussion on “China after the WTO,” organized by the Canadian Institute for International Affairs and hosted by Blake, Cassels & Graydon LLP in Toronto, 27 November 2001. His answers are broadly consistent with the author’s.


10 Tan Dizhou, *WTO guanmao*, p. 74.


15 Tan, *WTO guanmao*, p. 76.

16 Import approval negotiations require detailed negotiation over import rules and customs procedures. Tariff reduction simply requires reduction in the level of nominal tariffs. GSP means “general schedule of preferences” through which individual GATT members can grant preferential access to their markets to developing countries under Article XVIII of the GATT. The GATT, however, did
not define what a “developing country” was, nor did it specify what schedule of preferences should be applied.

17 Chinese officials are forthright about this. Liu Guanxi was special assistant to China’s chief GATT/WTO negotiator Long Yongtu. See Liu, Zhongguo yu “jingji lianheguo,” p. 26.


19 Tan, WTO Guanmao, p. 76.

20 For the circumstances of China’s decisive shift to market reform see Michael E. Marti, China and the Legacy Of Deng Xiaoping: From Communist Revolution to Capitalist Evolution (Dulles, VA: Brassey’s Inc, 2002).

21 “Down payments” refers to the demand by the US, followed by other states, that China make initial concessions towards the rules of the WTO/GATT prior to accession, rather than phasing in compliance throughout the transition period following accession. See Leonard, The Dragon Awakes, p. 98.

22 See the contribution of Fan Yongming in this volume.

23 The very expression “xiang shijie jiegui,” or “linking up the rails to the world,” commonly used in China during the 1990s, metaphorically acknowledges China’s need to adjust its norms and institutions to those prevailing at the global level.

24 “Phase-ins” refer to transitional periods for bringing domestic regulations into conformity with WTO rules. “Phase-outs” refer to the transitional period for abrogating regulations or quotas not in conformity with WTO rules. In each case developing countries are allowed a longer transition period than developed countries. See Tan, WTO guanmao, pp. 79–82.

25 Tan, WTO guanmao, p. 82.

26 Tan, WTO guanmao, p. 83.


32 Yu An, “Fazhan fuhe shijie maoyi zuzhi guifan de woguo xingzheng fa” (Develop Domestic Administrative Law in Keeping with the Norms of the WTO), Xinhua wenzhai, no. 2 (2000): 5.


34 Long, “Join the WTO.”


36 See for example, Yu Xindong, “Zhongguo jiaru WTO hou chanye baohu he chanye anquan yanju ji duice” (The Study of Countermeasures for Manufacturing


39 On the positive side, he cites access to foreign capital, especially foreign direct investment from multinationals as well as access to new markets and trade, in addition to access to new technology and management techniques. On the negative side, he cites the fact that the global political economy is unequally structured, with globalization exacerbating this trend and making developing countries more vulnerable to external economic shocks. See Jiang Zemin, “Speech to Hong Kong Fortune Global Forum 2001,” *Xinhua*, 8 May 2001.


42 For an example of such skepticism see Alan S. Alexandroff, “A Transitional Review Mechanism: Has An Effective Multilateral Mechanism Been Created?” in Sylvia Ostry, Alan S. Alexandroff and Rafael Gomez, (eds), *China and the Long March to Global Trade: The Accession of China to the World Trade Organization* (London: Routledge, 2002), pp. 211–230. Other essays in that volume are relatively sceptical. In return, Chinese officials have been vocal in reassuring the international community of their earnest implementation of WTO accession. See, for example Shi Guangsheng, “Zhongguo renzhen luxing WTO de chengguo” (China is Earnestly Observing its Agreements on WTO Accession) available online at: http://www.people.com.cn./GB/jinji/31/179/20000409/705954.html.


45 See Feng Shaolei, Qin Wenhui, Li Fanjun, “Guanyu quanqiuhua yu minzuxing de duihua” (A Dialogue on Nationalism and Globalization) *Xinhua wenzhai*, no. 11 (1999): 12. This exact quotation is credited to Feng.

46 Again this was recognized by Chinese scholars. See Yu An, “Fazhan fuhe shijie maoyi zuzhi guifan de woguo xingzhengfa” (Our Country’s Administrative Law Developing in Accordance with WTO Norms) *Xinhua wenzhai* (February 2000): 5–6.

47 For China’s participation in the international human rights regime and its implications for regime theory see Ann Kent, *China, the United Nations and Human Rights: The Limits of Compliance* (Philadelphia, PA: University of Pennsylvania Press, 1999). Kent makes human rights the test of international citizenship, arguing from the premise that unlike the political economy regime, its principles directly challenge sovereignty. Our point is nearly the opposite. Because conformity to the international trade regime is in the interest of the state, it is better positioned to generate the normative structures consistent with liberal governance.


“How can you be both the athlete and the referee?” This reader was questioning monopolies on the sale of test review materials and cremation urns. Cao Qing, “Jiaru shimaole guhui hai yao ‘zhuanying’?” (Having Entered the WTO, Must Cremation Urns Still Be ‘Monopoly Controlled’?). Available online at: http://peopledaily.com.cn/GB/guandian/26/20020322/692552.html.


PART III

Outside in or inside out

Case studies
Introduction

This chapter asks, how has China’s integration into the global economy altered the Chinese state, and in turn, how has the global economy been shaped by the state? It examines how the international system has affected the character of the Chinese state, while also giving due attention to how China’s domestic political Institutions and structures have mediated the effects of international integration. It argues that the Chinese state, and its domestic political institutions, are located at the interstices of the country’s internationalization process. This implies reciprocal causation: the Chinese state is changed by, but also actively shapes, the globalization process, resulting in qualitative changes in the form and role of the Chinese state that can be called “the internationalization of the state.” The internationalization of the state in China refers to a process of state restructuring whereby the Chinese state is reoriented from a nationally focused, centrally planned economy to one that is more reliant on international linkages to global markets and investment networks. Prior to this shift, China’s engagement with the international economy was a “residual item.” Since the opening, government priority has been placed on engaging with the global economy as a principal means to promoting national developmental goals.

This line of inquiry transcends the view that globalization occurs from the “outside-in,” and that states merely react to global forces of structural transformation. Chinese political institutions actively mediate the relationship between internationally induced preferences of domestic actors and actual political outcomes, both in terms of policy and institutional change. In so doing, China’s state institutions have shaped the globalization process. In studying how the rapidly changing global environment has affected Chinese domestic politics and policy preferences, this chapter avoids the misleading assumption that globalization is largely an agglomeration of changes in domestic structures which push from the inside-out.
Prior to 1978: foreign trade as a residual item

Although China’s pre-reform economy was never as centrally planned as that of the Soviet Union, the Chinese economy was a central command economy, organized by an administrative-command “superstructure.” Shortly after the establishment of the People’s Republic, the new government created a set of institutions that kept foreign trade under strict administrative control. Article 37 of the 1949 Common Program stated that: “Control shall be exercised over foreign trade and the policy of protecting trade shall be adopted.” More than an import substitution strategy, Chinese suppliers and users were separated from the world market. The Ministry of Foreign Trade (Duiwai maoyi bu), through its foreign trade corporations, exported enough to cover the imports needed to fulfill the central plan. The government also maintained fixed domestic prices and offset changes in world market prices or losses by state trading companies through taxes and subsidies. The Chinese currency was also non-convertible. This rigorous foreign trade system ensured that China’s domestic economic development was insulated from the influence of global capitalism. Trade was relegated to a residual item to make up for deficiencies or dispose of surpluses after the economic plan for the country or locality had been compiled.3

The Ministry of Foreign Trade (MOFT) was created in August 1952 when the Division of Foreign Trade of the Ministry of Trade was expanded into a full ministry. Beneath the MOFT, a vast multi-level structure was established, which operated both domestically and overseas. It carried out primarily commercial but also diplomatic and political functions. In keeping with the needs of a centrally planned economy, MOFT helped formulate and implement the yearly (and five-year) foreign trade plans worked out in conjunction with the State Planning Commission. The MOFT also maintained trade controls through the licensing of foreign trade. From a neo-liberal trade policy perspective, China’s pre-reform foreign trade was administered by a conservative trade ministry. Trade with the capitalist world fell to less than half that with Communist countries for most of the 1950s, and then stagnated during the 1960s after the break with the Soviets.4 From 1970–73, foreign trade rose rapidly relative to GNP (1970–73), however, imports only filled gaps in the domestic system, while exports covered imports. The goal was not “export-oriented” growth, as China did not alter production to take advantage of its international comparative advantage.

The controls on private foreign investment, seen as inherently imperialistic, were even stronger. Foreign operations were for the most part nationalized or closed, and during the first half of the Cultural Revolution (1966–69), foreign investment was virtually nonexistent in China. In the 1950s, China only accepted foreign investment in the form of joint ventures with the Soviet Union and some Eastern European countries. Foreign investment was not welcome again until after Deng Xiaoping’s speech to the
Sixth Special Session of the United Nations General Assembly on 10 April 1974.\(^5\) China began to accept foreign loans to fund trade, and considered foreign investments through joint ventures. Throughout the Mao period, the government had no foreign investment agency; one was only created in 1979 with the formation of the Foreign Investment Control Commission (Waiguo touzi guanli weiyuanhui).

**External pressures to streamline and rationalize**

After the Third Plenum of the 11th Central Committee of the Chinese Communist Party in 1978, the Chinese government fundamentally shifted its foreign economic policy with the launch of the “open door” (kaifang). The new leadership agreed that to promote its reforms, China could draw on foreign capital, technology and technical and managerial know-how to modernize the country.

As the new post-Mao leadership solidified its position and put an end to the factional struggles at the top of the Party, they began to restore China’s international standing. This meant joining international organizations, forcing Taiwan from its seat in major international fora, and ensuring that the KMT in Taiwan would not regain their status in the major international organizations at the cost of the PRC.\(^6\)

In seeking membership to the IMF, World Bank and GATT, Chinese decision-makers encountered the influence of international systemic factors.\(^7\) Keohane has argued that international institutions socialize states into cooperative behavior, and that understandings of “domestic” institutional change must be located in a larger international context.\(^8\)

In response to pressures to liberalize trade and capital flows, and streamline and standardize regulatory procedures, China liberalized its trade regime from 1978–82 by decentralizing foreign trade authority and breaking the foreign trade monopoly held by a dozen state trading companies. Other state agencies, levels of government, and industrial enterprises were allowed to set up trading companies and participate in foreign trade. These trading companies were allowed to retain a portion of their foreign exchange earnings as an incentive to promote exports, and could import goods to sell domestically for large profits. Enterprises were permitted to export their above-quota output freely. New legal reforms protected foreign traders and provided a legal framework for trade. China shifted to a less restrictive use of tariff and non-tariff barriers to encourage new forms of trade. In 1979, the Customs Bureau was elevated to a ministerial-level unit, the China Customs General Administration, to help facilitate trade, and the General Administration for Foreign Exchange was established to administer foreign exchange transactions related to trade. These steps loosened administrative controls in China’s trade regime. While a dozen state trading corporations had controlled China’s foreign trade in 1979, by the mid-1980s, the Ministry of Foreign Economic Relations and Trade (the successor to MOFT) had
approved 800 new import and export corporations, and by 1990, the number had surged to over 5000.  

However, by the early 1980s, it had become evident that the rate of trade deregulation was being outpaced by China’s growing economic interdependence. Foreign traders complained that transaction costs were too high, and that increased efficiencies were essential for sustaining business interest. China’s fragmented trade and foreign investment administration system would need to be streamlined if global norms were to be met. In March 1982, a new unified foreign trade and investment administration ministry was created, called the Ministry of Foreign Economic Relations and Trade (MOFERT). As Pearson has suggested:

The international regime has shaped China’s institutions in several ways. To facilitate trade and investment, China's reformers restructured the institutional framework for foreign economic affairs. They did this in part by organizing the foreign trade administration under one roof during the early 1980s in order to make it more consistent with the desire to push into international markets.

In the words of a senior Ministry official, reorganization was to raise efficiency and “cut red tape.” Internal pressure from both Deng Xiaoping and Chen Yun put rationalizing and streamlining Party-state structures at the top of the Party’s agenda in the late 1970s and early 1980s. However, a desire to respond to external factors was primary in inducing the creation of a single unified foreign economic relations ministry, the Ministry of Foreign Economic Relations and Trade (Duiwai jingji he maoyi bu, MOFERT). The creation of MOFERT marks a key instance in Chinese state restructuring whereby the state is reoriented from a nationally focused, centrally planned economy to one that is increasingly reliant on international linkages.

Bureaucratic compromise: creating MOFERT

The reorientation of the role of the Chinese state has been accompanied by changes in the form of the state. New state agencies have been created; and existing organs have been adjusted to meet the needs of changing circumstances and new priorities. China’s economic internationalization has also entailed changes in bureaucratic institutions. In this section, the creation of the Ministry of Foreign Economic Relations and Trade (MOFERT) is examined as a critical case study.

MOFERT was created in 1982 through the merger of four existing government agencies: the Ministry of Foreign Trade (Duiwai maoyi bu); the Ministry of Economic Relations with Foreign Countries (Duiwai jingji lianluo bu); the Foreign Investment Control Commission (Waiguo touzi guanli weiyuanhui); and the State Import–Export Commission (Jinchukou
This one “Super-Ministry” reduced duplication and overlap in the administration of China’s foreign economic relations, which had actually increased as a result of previous phases of bureaucratic reorganization. The merger also integrated scarce human resources and crucial administrative experience in managing China’s international economic relations under one roof.

The creation of MOFERT was part of the 1982 restructuring of the State Council. The designers of the 1982 reorganization had envisioned a fundamental reorienting of government functions, in addition to streamlining and downsizing the administrative structure, so that the new policies of reform and opening could be properly implemented. MOFERT’s formation, for example, cut staff by two-thirds, and reduced the number of departments by one-third. Both radical and moderate reform factions in the Party leadership strongly supported re-linking China to the world market. The more radical reform faction, led by then Premier Zhao Ziyang, saw the creation of a new ministry for foreign economic relations as useful for overcoming the traditional command-economy orientation of China’s Ministry of Foreign Trade. The new ministry would be geared to the opening strategy, especially the promotion of export-oriented growth and foreign investment into China.

The Foreign Investment and Control Commission (FICC) and State Import and Export Commission (SIEC) were both created in August 1979 during the first phase of post-Mao State Council reorganization. They were powerful trade planning entities that were absorbed into the new ministry. Each Commission was given an important role in the initial reform period (1979–82). The FICC was created to contain the international balance of payments crisis caused by the first three years of Hua Guofeng’s grandiose Ten-Year Plan (1976–1978) which had led to the wholesale importation of large factories and related equipment, and to three successive years of trade deficits. China’s foreign currency reserves had dwindled to less than US$2 billion by the beginning of 1979. The FICC reasserted control over foreign exchange by suspending US$2.6 billion of contracts with Japanese firms, formulating alternative financing options for foreign-invested projects, and maintaining a moratorium on new contracts.

The SIEC worked in concert with the FICC to stabilize the trade balance by focusing on imports of technology and equipment and promoting exports for targeted sectors only. The combined efforts of the FICC and SIEC resulted in substantial trade surpluses in 1981 and 1982, and raised foreign exchange reserves back to more secure levels. The SIEC was also given the more enduring challenge of formulating plans for the four “special economic zones” (SEZs) in Guangdong and Fujian provinces. After much debate in 1981, the NPC approved the SEZ legislation that had been put together by the SIEC.

Both commissions were chaired by Vice-Premier Gu Mu, shared staff, and reported directly to the State Council. Wang Daohan was appointed
Executive Vice-Chair of both commissions. As a patron of future Chairman Jiang Zemin, Wang appointed Jiang as Vice-Chair and Party Secretary to both commissions. By the time MOFERT was created, these two units had outlived their initial functions and were absorbed under the MOFERT umbrella. However, the foreign economic planning capacities “embedded” in these organizational structures would prove to be highly useful to the Chinese government later on for regaining control over import surges, trade imbalances and rapid foreign currency drainage. Although the second task of the SIEC-SEZ development was just taking shape, other means for guiding the development of the experiment had come under consideration, such as creating a Special Economic Zones Office under the authority of the State Council, as well as giving more discretionary authority to local officials to drive the internationalization process inside their respective zones. Nonetheless, inherent in the FICC’s organizational structure was the capacity to review the foreign capital utilization schemes in foreign investment proposals, as well as methods for monitoring foreign trade and foreign exchange levels. These institutional capacities were retained under MOFERT’s new umbrella.

The Ministry for Economic Relations with Foreign Countries (MERFC) was responsible for administering China’s aid to Third World countries in Asia and Africa. This ministry was created in 1960 at the behest of Mao Zedong and Zhou Enlai. It started as a bureau-level unit separate from MOFT, and was later upgraded to a ministry-level unit. MERFC was responsible for delivering large-scale “foreign economic cooperation” (duiwai jingji hezuo) projects, such as the Tanzam Railway project, and the management of the international projects which China was contracted to implement in other developing countries. It also played a political and diplomatic function while delivering resources to China’s allies in non-aligned countries, as well as revolutionary movements which it supported in newly de-colonized states. Politically, MERFC promoted the Maoist model of socialism to these recipient countries. Economically, it promoted Chinese technological expertise in rural development, industrial growth, building and construction, and infrastructural development. MERFC also leveraged China’s foreign aid in return for the diplomatic support of recipient countries for the People’s Republic to represent China in the United Nations and to claim a seat on the Security Council. During the Cultural Revolution, MERFC’s profile increased substantially, especially in comparison with the MOFT and the Ministry of Foreign Affairs due to its role as the “exporter” of Mao’s model of revolutionary struggle to the Third World.

Before its incorporation into MOFERT, MERFC had also gained a reputation for professional competence and integrity, and Chinese insiders saw it as being the most “effective and useful” of the four bureaucratic units that were merged together into MOFERT for the new internationalization agenda. MERFC officials had built up extensive experience delivering large-scale international projects. This “practical international” experience
was seen by reformers as a positive trait and gave MERC officials profile in the process of bureaucratic merger. MERFC’s influence at the time of MOFERT’s creation was reflected in the fact that MERFC’s minister, Chen Muhua, was named the first Minister of MOFERT. MERFC’s absorption into MOFERT coincided with key shifts in the Chinese government’s foreign aid policy. The high levels of Chinese foreign aid to Third World countries was greatly reduced as China would focus more attention on developing its own coastal region. This also meant that China would encourage developed countries to contribute foreign aid to support its domestic economic reforms and development. Inside MOFERT, the old MERFC Divisions were shed of their revolutionary function, and focused on co-ordinating foreign aid projects with China as the recipient.

The amalgamation of these four units created a “Super-Ministry,” responsible for overseeing all foreign economic and trade matters. MOFERT inherited the main functional responsibilities of its institutional predecessors and assumed new responsibilities related to the opening strategy. MOFERT held five responsibilities: First, it inherited MOFT’s responsibilities in planning and managing China’s foreign trade, and the import-export contract licensing responsibilities of the SIEC. Second, MOFERT was responsible for inter-governmental economic negotiation, including representing China in signing multilateral, bilateral and inter-governmental economic and trade agreements; and supervising their implementation. Third, it took on FICC’s role in supervising foreign investment into China, and the oversight of foreign government loans, technology imports(exports, and the import of complete plants. In this role, MOFERT was part of a FDI approval process that involved the State Planning Commission, and went up to the State Council. Fourth, MOFERT took on enhanced responsibility for promoting foreign trade and foreign investment. In addition to MOFERT officials in Beijing and in its sub-national units, this included the staff of the State Foreign Trade Corporations and numerous trade-promotion and research organizations that operated under the guidance of MOFERT, such as the China Council for the Promotion of International Trade (CCPIT) and the International Trade Research Institute. MOFERT also initially supervised the operations of the newly created China International Trust and Investment Corporation (CITIC), which acted as the venture capital arm of the Chinese government. Fifth, MOFERT subsumed the foreign aid management responsibilities of MERFC. However, MOFERT differed fundamentally from MERFC, in that it had a reduced role in dispensing foreign aid and more responsibility for donor-funded aid projects to China.

In theory, MOFERT sat atop what Chinese officials described as a “threetiered self-responsibility system” for profits and losses in foreign trade. Underneath MOFERT, the next two levels consisted of specialized State Foreign Trading Corporations (SFTCs), which also operated under MOFERT’s supervision, and at the bottom were the SFTC branches of the
provincial and municipal governments, autonomous regions, and specific port cities.

**Institutional mediation: the super-ministry shapes internationalization**

The Chinese state’s handling of the country’s “minor” international economic crisis of 1984–86 shows precisely how state institutions have shaped China’s economic internationalization. China experienced uncontrolled imports of consumer goods and alarming trade deficits in 1984 and 1985. In 1985, imports rose 54 percent from the previous year, as exports declined, creating a serious trade account deficit in both 1985 (US$12.1 billion) and 1986 (US$8.7 billion). The Chinese government drew heavily on foreign exchange reserves to cover its imports, reducing foreign currency reserves from US$16.7 billion at the end of 1984 to US$10.2 billion at the end of 1986. In this same period, China had borrowed heavily from international financial markets and foreign donors. Foreign debt grew from US$14 billion in 1984 to US$21.5 billion in 1986. This period saw nearly US$9 billion in new loans.

The speed at which this crisis emerged had given Chinese leaders “dramatic evidence of the extent to which they had lost control over imports.” Stopping or reversing the drain on foreign currency reserves required a curtailing of imports and stimulation of exports. MOFERT Minister Zheng Tuobin described the situation as “chaotic” and attributed the problems to the “decentralized” pattern of foreign trade. Zheng was echoing his predecessor, Chen Muhua, who had called for the recentralization of foreign trade and investment and re-imposing administrative authority to end the “chaos” caused by the local trade competition as early as in 1984.

Chinese authorities responded with a package of economic, administrative and diplomatic measures over three years (1985–87), aimed in particular at stemming the balance of payments crisis. To restrain “unnecessary imports” and encourage exports, they devalued the Renminbi by 42 percent against the dollar between October 1985 and July 1986. This was China’s first attempt to boost exports via a major currency devaluation. Strategists from the State Planning Commission, the Ministry of Finance, and MOFERT together implemented a package of administrative measures from 1985–87 including: re-establishing mandatory quotas for exports, re-asserting import plans; delaying major capital construction projects that required foreign goods; setting tighter controls on the licensing and operations of local foreign trading companies; increasing import contract supervision and approval; imposing foreign exchange controls as well as various taxes; re-introducing tariffs and licenses against imports; and instigating heightened inspection of product specifications and standards. Diplomatically, Beijing pressured its principal trading partners, particularly Japan and the United States, to purchase more Chinese goods (especially textiles).
To stimulate further exports, Chinese planners and trade authorities encouraged the formation of “export production networks,” which aimed to coordinate the design, production, transportation and marketing of exports. The Seventh Five-Year Plan (1986–1990) called for the establishment of export production networks to improve the quality and competitiveness of exports in targeted industries, such as electronics and machinery. Beijing also encouraged the creation of these export networks in these industries by guaranteeing supplies of raw materials and power, investment capital, preferential tax treatment and access to foreign exchange. The import and export licensing system introduced in 1985, and the strict controls on foreign exchange expenditures aimed to insure that machinery, equipment and semi-finished goods, rather than consumer goods, were imported. These controls also supported industrial expansion and modernization, and the growth of capital-intensive exports in sectors that were strategically targeted by the Ministry of Electronics Industry, such as televisions and home appliances. In labour-intensive sectors, specifically textiles and clothing, footwear, toys and sporting goods, the trade control measures aimed to foster economies of scale and stimulate exports rapidly in sectors where China possessed comparative advantages.

Various MOFERT departments were involved in implementing this package of foreign economic controls, specifically the Department for Foreign Investment Administration (Duiwai touzi guanli ju), Department for Treaties and Law (Tiaoye falu ju), Department for Import and Export (Jinchukou ju), and Department for Foreign Trade Administration (Duiwaimaoyi guanli ju). The Department for Foreign Investment Administration (DFIA), previously the Foreign Investment Bureau under the Foreign Investment Control Commission, was responsible for approving investments in China, and it enforced the aforementioned controls on foreign investment projects and foreign capital utilization, including those aimed at reducing imports for the foreign-invested projects and for bringing the foreign debt under control. The Director of the DFIA was future Vice-Premier and MOFERT Minister Li Lanqing. He had previously headed the FICC’s Loan Department, handling loans from Japan and the World Bank. The Department for Treaties and Laws (DTL) negotiated the legal terms and conditions for delaying or cancelling investment projects and joint venture contracts, and managed the insurance coverage for the cancellations. The Department for Import & Export (DIE), formerly the State Import and Export Commission, administered reductions on licensing of import and export contracts. The Department of Foreign Trade Administration (DFTA), responsible for the routine management of foreign trade, MOFERT’s Department for General Planning, responsible for foreign trade planning, and the DFIA’s Planning Division, liaised with the Department of Trade of the State Planning Commission, the Ministry of Finance, and particular line-ministries, to coordinate the implementation of the control measures. MOFERT also worked with the Ministry of Finance and the Customs General Administration to increase the
collection of import-export taxes. An article in the *China Business Review* (1987) prepared by the Fair Trade Subcommittee of the American Chamber of Commerce noted that, “each of these (1985–87) controls is managed by a specialized bureaucracy whose *raison d'etre* is the protection of domestic industries and conservation of foreign exchange,” and whose “zealous bureaucrats are rewarded for slowing or even shutting down certain trades.”

While foreign business commentators disapproved of the measures taken by the Chinese government, and were highly sensitized to the political symbolism of any re-assertion of command-type controls, these steps successfully re-stabilized China’s foreign economic situation. Exports surged to a record 30 percent in 1987, while import growth fell from 55 percent in 1985 to almost zero in 1986–87. China’s trade gap was reduced from US$11.97 billion in 1986 to US$3.75 billion in 1987. The controls imposed in 1986 had improved China’s current account within one year, allowing foreign exchange reserves to rise to US$15.23 billion. The success of these measures demonstrated to Chinese decision-makers, including radical reformers, the usefulness of these administrative tools as control levers for containing economic crises related to China’s opening trend.

The most important determinant of China’s capacity to contain the economic crisis of 1984–86, and influence the internationalization process, were specific historical circumstances of the Chinese state. MOFERT’s internal architecture specifically the institutional legacy of the FICC and the SIEC, and its authority over the State Foreign Trading Companies (FTCs) and local FTCs, account for the successful implementation of the import, foreign investment, and foreign capital utilization policies from 1985–87. Experienced MOFERT staff, formerly in the FICC and the SIEC, curtailed foreign exchange, suspended the issuing of letters of credit to provinces and cities for the import of most consumer durables, imposed new taxes which sharply raised import prices, and cancelled many impending foreign deals.

In short, MOFERT played a pivotal role in shaping the *pace, scale* and *content* of China’s internationalization process.

**Convergence and divergence in state internationalization: the case of China**

The internationalization of the Chinese state involves two dimensions: first, *dismantling* state structures that supported the centrally planned economy and the late-Maoist self-sufficiency strategy; and second, *creating* new institutions and adjusting existing agencies that are geared to the needs of global integration. All of China’s economic-related agencies have been involved in these dual processes, the most obvious being one overseeing foreign trade and investment. After the creation of MOFERT, it then transformed other state agencies. But to accomplish the latter, MOFERT had to compromise, strike bureaucratic bargains and build consensus to
gain the backing of the most powerful agencies – the State Planning Commission, the Ministry of Finance, and the People’s Bank of China. But in interacting with MOFERT, these units have also become increasingly attuned to the need to compete in the global economy.

MOFERT has been the avant garde of the internationalization of the Chinese state. In addition to controlling the country’s trade imbalance and foreign reserve crises in 1985–87, MOFERT pushed towards export-led growth from 1987 onwards. Unlike its institutional predecessors, MOFERT was an increasingly influential ministry within the internal Chinese bureaucracy. By assuming both the responsibilities of its predecessors and taking on expanded authority related to the opening up strategy (such as GATT negotiations), MOFERT was at the focal point of a broad range of economic reform issues. MOFERT’s role in promoting export-oriented growth also meant that it assumed much of the political risk associated with growing imports, exports, foreign investment, and foreign exchange activities. Involvement in administering new forms of fee collection and trade-related profit-retention schemes put MOFERT in the middle of bureaucratic conflicts in the 1980s. Numerous newspaper reports suggested that there was serious arguing between MOFERT and other bureaucratic agencies.

MOFERT took a leading role in pressuring for the relaxation of foreign exchange controls, calling for the revision of exchange rate policies, expanding foreign exchange trading rights, and putting the price of traded goods in line with world prices. MOFERT championed these changes through regulatory adjustment. For example, starting in 1987, MOFERT lobbied internally for currency revaluation, foreign exchange adjustments, and the normalization and easing of customs procedures. Senior MOFERT officials, such as Li Lanqing, lobbied senior Party and government leaders to increase China’s exports growth. He pressed the Bureau of Taxation in the Ministry of Finance (MOF) for tax rebates on exported products, because rebates made China’s exports more competitive. The MOF resisted because tax rebates would reduce the state’s revenues. But MOFERT, the leading bureaucratic promoter of export-led growth, argued that in the long term more exports would increase the budget. Starting from the mid-1980s on MOFERT also lobbied the MOF for more flexible tariff rates so that the trade bureaucracy could use tariff rates as a main lever to increase the volume and composition of exports and imports, and use subsidies to alleviate foreign trade losses on exported commodities in which China would have possessed natural comparative advantages were it not for irrational domestic prices.

China began to clear away institutional barriers to internationalization in the late 1970s, even though it would have been politically safer to follow the path similar to the USSR or Eastern Europe in this period. The foreign trade reforms that were instituted allowed forced competition into the Chinese trade regime, and allowed world prices to signal to Chinese enterprises how they should adjust their production lines, and informed trading
companies on how to alter their supply and purchasing mix. Chinese exporters who benefited from rising international prices saw their own profits rise, and while some of the additional profits were transferred to state coffers, a sufficient share stayed with the enterprises and provided the necessary incentive to drive growth and innovation. The incentives to get prices right were especially powerful in sectors where China had comparative advantage, such as textiles and apparel, footwear, toys, and sporting goods, so MOFERT encouraged the state to alter its prices in these sectors.

However, even as the Chinese state liberalized trade in some sectors, it adopted more stringent and strategic trade policies in other sectors. In both the consumer electronics and automotive sectors, the Chinese government consciously “got the prices wrong” as it pursued a longer-term strategy of cultivating export-competitiveness in more capital-intensive manufacturing sectors.44 This strategy enabled China to move up the value-added chain in the international division of labor. At the same time, lower-tech exports covered the costs of pursuing this longer-term growth strategy. This two-pronged approach to trade laid the foundation for China’s sustained exports and industrial growth through the 1990s and into the new century.

For MOFERT, the reforms in China’s foreign trade and economic administration involved more than dismantling bureaucratic obstacles which impeded market rationality and the global integration of the Chinese economy. Successful integration required the creation of a new matrix of bureaucratic institutions that are geared to a profoundly different development rationale than that of the pre-reform period. This new set of state institutions, built to mediate the internationalization process, have also fundamentally altered the decision-making calculations and raison d’être of all of China’s key state economic agencies. MOFERT has been located at the interface of these changes.

In comparison to the transitional countries in Russia and Central and Eastern Europe, China’s leaders started the internationalization process far in advance of systemic crisis. In contrast, institutional barriers to internationalization in the Soviet Union were never dismantled, even into the late 1980s. These barriers deepened the systemic crisis that preconditioned the collapse of the USSR.45 China, on the other hand, managed the process of integration by promoting overall economic reform, opening and liberalization, while also reasserting some administrative controls inherited from its pre-reform context at strategic moments.46 But these controls were no longer part of a regulatory regime designed to deal with trade as a residual item under central planning; instead, they were integral components of an increasingly internationalized economic development strategy.

China’s internationalization also differs from weaker/smaller nations where the state has become an agency for adjusting the national economy to the exigencies of the global economy, and where the influence of multinational forces are overwhelming. In these cases, internationalization can be
seen as a process that largely works from the outside-in. But the process of China’s internationalization is more akin to other great powers – the United States, Japan, Germany, and post-Soviet Russia – where the state has the capacity to shape internationalization.47

**Conclusion**

This chapter argues that China’s integration into the global economy involves important changes in the form and role of the Chinese state. These changes entail an internationalization of the Chinese state. In terms of changes in the state’s role, bureaucratic units responsible for administering foreign trade and investment have shifted from preventing or controlling international economic flows under a nationally-oriented central planning situation to promoting increased international economic linkages with an increased reliance on global economic flows. In terms of form, Chinese state agencies have been fundamentally re-organized to meet the needs of increased interdependence.

But important organizational continuities have also been maintained. The discussion above highlights how the former FICC and SIEC divisions inside the newly created MOFERT controlled foreign trade, foreign investment and foreign exchange in 1985–87, and their traditional planning methods to balance payments and resolve foreign currency reserve crises. The same institutional levers were used in 1979–80 to correct the trade imbalance and foreign reserve crises caused by Hua Guafeng’s Ten-Year Plan (1976–1978).

While trade reform, begun in 1978, has altered the planned nature of China’s foreign trade, central control of imports and exports was not entirely abandoned. Interestingly, Chinese planning and trade authorities continued to use these levers into the 1990s to control imports. What this control function highlights is that the Chinese state has shaped the process of global integration, specifically by influencing, guiding and even controlling the pace, scale and content of China’s international economic integration. China’s accession to the WTO in December 2001 means, however, that many of the control levers that the Chinese state has relied upon to direct the post-Mao opening and ensure a stable process of international integration can no longer be drawn on to manage the country’s internationalization. This presents significant new challenges to Chinese decision-makers. The latest phase in economic internationalization thus gives impetus to further institutional innovation and state reorganization in China.

**Acknowledgement**

The author wishes to thank Chen Zhimin, Jae Ho Cheng, Margaret Pearson, and especially David Zweig for their comments.
Notes


10 Huang Xiaoling (ed.), *Zhongguo duiwai maoyi gailun* (Abstract of China’s Foreign Trade; Beijing: Duwai jingji maoyi daxue, 2003).

11 Margaret M. Pearson, “China’s Integration into the International Trade and Investment Regime,” in Michel Oksenberg and Elizabeth Economy (eds), *China Joins the World* (New York: Council on Foreign Relations, 1999), p. 188.


14 MOFERT is today’s Ministry of Commerce (MOFCOM) and was the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) from 1993–2002.

15 MOFERT’s staff quota (*bianzhi*) was set at about 1000, a drop of 1500; its departments number 20, down from 60.

16 Interview with former MOFERT official from the Department of Foreign Trade Administration, Ottawa, January 2003.


20 Gu Mu was promoted to Vice-Premier under the premiership of Zhao Ziyang. He was associated with the more radical reform faction headed by Hu Yaobang and Zhao Ziyang during the 1980s, and became Zhao’s chief “internationalizer” as the director of the State Council’s Special Economic Zones Office (SEZO). Gu was reported to have defended the SEZ experiment against criticism from the conservatives, particularly Chen Yun and Yao Yilin.


24 Interview with a former MOFERT official from the Department of International Relations, Beijing, June 2005.

25 Interview with former MOFERT official from Department of International Relations: Beijing, June 2005.


33 In the early 1980s, ministerial departments were called ju. There has since been a reclassification of the central-level (zhongyang) government system and ju are bureaus while departments are now called si.

34 “Fair Trade Subcommittee,” p. 42.


36 Brahm, *Zhu Rongji and the Transformation of Modern China*.


40 Lardy, *Foreign Trade*, pp. 37–82.

41 Lardy, *Foreign Trade*, p. 120.

42 Lardy, *Foreign Trade*, p. 49.

43 Lardy, *Foreign Trade*, pp. 32, 119-120.


45 Matthew Evangelista, “Stalin’s Revenge: Institutional Barriers to Internationalization in the Soviet Union,” in Robert O. Keohane and Helen V. Milner (eds),


9 Dancing with wolves
Opening the pharmaceutical sector in China

Karen Minden and Jeffrey L. Dong

Introduction: the WTO, China and the pharmaceutical industry

In many ways, the pharmaceutical industry is a microcosm for tensions between China’s accession to the WTO and its domestic economic and social development. The interplay of domestic policy and international trade policy reflects the challenges of China’s decision to enter the global trading system. The market reformers in China’s central government are betting that the benefits of increased market share, international capital, and access to technology will outweigh the harm to domestic industries, and the threats of social instability. They are also hopeful that the added clout of international pressure from the WTO will enhance their efforts to overcome local resistance to market opening and reform. At the same time, the government is actively pursuing strategies to strengthen domestic capacity to compete with global firms.¹

From the perspective of international political economy, the framework for this sectoral case study is the extent to which China will conform to international WTO standards, and some factors which will influence this. Studies which assess the extent to which China is willing to adopt international norms of foreign trade present a range of views about China’s willingness and ability to integrate into the global trading system.²

This chapter looks at the impact of WTO accession on the pharmaceutical sector in China from a business perspective. The goal is to understand the interplay of domestic and foreign factors in a particular context, by examining in some detail the intricacies of one industrial sector.

This analysis of the pharmaceutical sector in China uses a stakeholder approach to highlight the impact of the WTO on China’s domestic industry, the foreign pharmaceutical companies, and Chinese consumers. Using this approach as a starting point, we view this industry in China using a business system model, which describes the firms and other players and their economic relationships that create and satisfy customers. Our focus is on the barriers or “soft walls” to market access for foreign firms prior to China’s accession to the WTO, and afterwards. This approach to understanding the pharmaceutical industry and its relationship to the global
industry highlights the “deep integration” issues that are an inevitable part of the globalization process. The intersection of foreign trade policy with domestic policies and approaches to regulatory frameworks, science and technology, human resource development, urbanization, transportation, health and social policy is a compelling illustration of the far reach of global integration. We examine the “soft walls” which influence the rate and depth of the integration of the pharmaceutical sector into world markets: administrative ambiguity and complexity; intricate distribution channels; relational networks based on non-codified and particularistic decision-making; a different legal culture which affects the implementation of intellectual property laws; and national self-interest.

In general terms, China regards the WTO as a tremendous challenge to indigenous industries and to traditional concepts and systems of business and management. Central government policymakers recognize the ferocity of the international marketplace, and the enormous competitive strength of foreign capital, advanced technology, and scientific management practices. However, there is also a sense that China has been up to the challenge before, and should embrace the opportunity to develop world-class competitive industries. An article in *Renmin Ribao* in March 2002 refers to the fact that the “wolf” of foreign competition entered China in the early 1980s, shortly after the “Open Door” policy was adopted. Learning from foreign competition, the electrical appliance industry, for example, has become a player in the global market. The message from central government is to embrace the challenge and learn from the “wolf.”

Government economic development, policy analysts are aggressively crafting strategies to build the foundation for a competitive pharmaceutical sector. According to an executive of a multinational corporation in this field, even if government programs for economic development are only partially successful, these programs will have a cumulative effect over time. It is conceivable that a cluster of strategies, such as training programs to develop managerial capability, investment in government biotechnology research institutes, the development of conglomerates, and investment in urban high technology parks or corridors, will have the combined effect of providing the building blocks for a viable and competitive industry.

A key question for the pharmaceutical sector, as for other industries in China, will be how deeply the principles underlying the WTO agreement will become ingrained in Chinese business practice and domestic policy. Will the state be able to provide a social safety net for the inevitable fallout from industrial restructuring? Will the market reformers in the central government be matched by entrepreneurial leaders who are equally worldly and committed to an open market economy? Will there be the capacity to enforce intellectual property laws? Will legal culture catch up with new legal structures?

Canada’s former ambassador to China, Howard Balloch, lists the “instruments of torture” which are likely to impede the smooth integration of China into the WTO. These include lengthy approval processes, arbitrary
regulations which limit market openness, incomplete application of national treatment, local protectionism, and costly conditions for the development of foreign-owned or invested firms.\(^5\)

**WTO implications for the business system of China’s pharmaceutical industry**

The Chinese pharmaceutical industry has seen rapid development in the past ten years. In terms of drug sales, the average annual growth rate was about 22.6 percent, making it one of the fastest growth industry sectors in the country. This growth momentum is to be maintained by an aging and growing population, an expanding and increasingly affluent middle class, and China’s accession to the WTO. It is expected that by 2005, China will be among the top ten pharmaceutical markets in the world, and may become the largest market by 2020.\(^6\) To meet this market demand, besides imported drugs, currently China has over 6,000 pharmaceutical manufacturers, with the capacity to produce more than 1,300 chemical drugs and 8,000 traditional Chinese medicines.\(^7\) In this section, we present a structural analysis of this growth industry by highlighting the WTO’s possible impacts on the business system of the pharmaceutical market.

**The pharmaceutical sector before the WTO**

Compared to most industry sectors in China, the pharmaceutical industry experienced deeper integration with global pharmaceutical markets, in terms of tariff reduction and the participation of foreign drug manufacturers, well before WTO accession. For instance, the tariff on imported pharmaceuticals in 2000 was about 9.6 percent, much lower than China’s simple import duties of 16.4 percent. This low tariff rate had partially resulted in higher than average foreign participation in the Chinese pharmaceutical market through exports, as well as joint ventures (JVs) with local Chinese firms. With over 1,800 JVs, almost all the leading multinational drug manufacturers had operations in China and the share of foreign drugs (imports and JV products) in the total market increased to over 45 percent by 2000.\(^8\) If we divide China’s industries into low, medium and high categories in terms of openness to global markets, the pharmaceutical industry falls clearly in the medium to high category.\(^9\)

However, when compared to its counterparts in developed countries, the Chinese pharmaceutical market was still less open and efficient, with distorted and constrained competition, because of government protection (tariff and non-tariff) and intervention (regulatory and political). It did not provide all the participants in the market with a level playing field and, more importantly, lacked transparency and legal standards. This becomes quite clear in the following analysis of the business system of the pharmaceutical industry.
As shown in Figure 9.1, the major components of the business system include four functional categories. The first category consists of medical research institutes, financial investors, equipment suppliers, raw chemical suppliers, and the labor force. These players are at the very upstream of the market chain and provide services and products to the second category. The second category includes all drug manufacturers that produce drugs locally (Chinese drug manufacturers, JVs and foreign direct-invested enterprises) or that import drugs into the Chinese market. As these are the core players in China’s drug market, they are the main focus of this chapter.

At the next stage are drug distributors and Chinese trading firms that sell drugs to consumers through hospital pharmacies and independent drug stores. Drug manufacturers in China distribute their products via direct and indirect channels. The indirect distribution channel moves drugs from manufacturers through state-owned pharmaceutical distributors and wholesalersto retailers and hospitals and to consumers. This channel is highly fragmented and inefficient. By the end of 2000, there were 16,000 state-owned pharmaceutical distributors that sold drugs to 120,000 pharmaceutical retailers and 15,000 hospitals. All these companies are regional; none have national distribution capacity. The inefficiency of this distribution system, as shown in Figure 9.2, is made clear by the fact that consumer prices of imported drugs are usually 90 to 100 percent higher than the manufacturing price. Along with this indirect distribution channel, both

![Figure 9.1 The business system of pre-WTO Chinese pharmaceutical market.](image-url)
Chinese and foreign-invested drug manufacturers also market directly to hospital pharmacies and drugstores through their own sales forces.

In a market economy, all the players described above should follow the same set of regulations and compete fairly in terms of price and quality. However, the business system as shown in Figure 9.1 is not fully governed by the free market mechanism. This is explained by the strong presence of various levels of government at almost all stages of the business system. The barriers that protect the market from foreign competition are represented as a barricade at each of the three levels of the system.

For foreign pharmaceuticals, the first barrier is market access or entry regulations. Interviews with senior executives from a number of multinational drug manufacturers indicate that the most important market access barrier was not tariffs, but the lengthy, complex, and opaque registration process with government agencies at multiple levels required to set up operations in China. This applied to manufacturing, importing and distributing drugs.

The second and third barriers concern drug distribution and marketing regulations. Referred to as “Chinese walls” by Western executives working in China, most were not related to WTO regulations. The major obstacles include drug certification and admission procedures conducted by the State Drug Administration, provincial and municipal drug reimbursement lists, the State Economic and Trade Commission’s permissions/licenses for pharmaceutical retail/wholesale distribution, and price-and-profit control regulations. With this bureaucratic net holding tightly onto the business system of the pharmaceutical market, drug manufacturers, particularly foreign-invested enterprises, have to invest heavily in time, patience and resources to develop the social capital required to maneuver in the Chinese business environment. The result is a reduced role for free market forces, greater inefficiency, and higher prices for Chinese consumers.

![Figure 9.2 Drug price components and distribution margins.](image)
The projected business system after WTO accession

Conventional thinking among foreign governments and corporations holds that China’s accession to the WTO will accelerate its market opening and the integration of its economy with the global market. As for the pharmaceutical industry, their goal is to remove the barriers of non-market constraining or distorting forces from the business process, and thus create a more efficient and rules-based transparent market.

To be sure, this reflects the desires and demands of foreign pharmaceutical companies. Realistically, however, we should not expect this goal to be shared by Chinese drug manufacturers and Chinese bureaucrats. They perceive that it is in their best interests that the market opens as slowly as possible and in ways that minimize the damage from increased foreign competition. They understand the urgency imposed by China’s accession to the WTO and hope to find ways to tame the WTO beast. This might explain the current popularity of the analogy “dancing with the wolf.” Some WTO-related barriers or protection measures will disappear, but opening China’s pharmaceutical market will be a long and complex process. As one Chinese saying goes, “The higher authority issues policies, but the local officials have always had their own responses.” There is no reason to believe that the WTO will change this time-honored practice overnight.

As shown in Figure 9.3, changes to the business system of the pharmaceutical market required by the WTO will happen mostly at the upper and

![Figure 9.3 The business system of post-WTO Chinese pharmaceutical market.](image-url)
middle streams of the system. For instance, the barrier to market access is to be both lowered and simplified. Tariffs on imported drugs will decrease 60 percent, from the current level of 9.6 percent to 4.2 percent. At the same time, non-tariff barriers such as the quota and licensing system and investment restrictions are to be abolished. Also, import trading rights are to phase in and distribution/retail restrictions were to phase out three years after WTO accession, by 2003. The Chinese government also committed to better intellectual property protection, transparency through the publication of regulations, and national treatment for foreign drug manufacturers and distributors by abolishing tax privileges and allowing fair participation in public tenders.14

Although some of the “hard” walls will be removed by scheduled WTO agreements, a number of “soft” walls will persist to protect local Chinese companies. The first of these “soft” walls will be the Chinese government’s administrative system. This is likely to remain ambiguous and complex, with functions shared by agencies at the same or different levels, unless political and government reforms are specifically written into WTO agreements. As in the past, foreign drug manufacturers will have to negotiate a bureaucratic maze to obtain the required approvals to operate and market their drugs in China. In addition to the State Drug Administration, they have to deal with the State New Medicine Examination and Approval Committee, State Pharmaceutical Administration of China, Ministry of Health, State Economic and Trade Commission, and provincial and municipal governments. The size of the government relations departments of the major pharmaceutical firms will not be reduced in the near future.

With further reduction of tariffs, and the removal of investment restrictions, quotas, and licences for import, the Chinese pharmaceutical market will be fully opened at the access level. However, access to consumers presents a second “soft” wall. The current drug distribution system is intricate, expensive and inefficient, but competitive foreign drug chain stores have been prohibited from operating in the market. China has three years to restructure its drug distribution system. By nurturing national independent drug distributors, while holding foreign drug chains at bay, domestic firms were expected to be more prepared for the partnership and competition that emerged after 2003.

The third “soft” wall comes in the form of price controls. As a developing country, China will try to control the rising cost of medical care. Over 60 percent of health care costs are expended on drugs, particularly expensive import drugs. Although the government cannot control prices for over-the-counter (OTC) drugs sold through independent drug stores, it has the right to decide which drugs will be on the approved reimbursement list. The National Essential Drugs List, with over 1,400 drugs, functions as a guideline for the local, provincial, and municipal lists which govern actual drug reimbursement. Since 80 percent of drugs are sold through hospital pharmacies, exclusion from those lists means huge losses in sales. Price and
efficacy are the two key listing criteria, although these terms are not defined. They are often negotiated based on relationships and networks, the social capital of the Chinese business environment. Foreign pharmaceuticals will find it difficult to compete with their Chinese counterparts in the ambiguous process of inclusion on the reimbursement list.

The fourth wall is the protection of intellectual property. Acceptance into the WTO is motivating superficial acceptance of IPR principles, but the “devil” is in the implementation of a poorly understood concept. Foreign pharmaceutical companies are very cautious in introducing new drugs to China. It is estimated that the percentage of counterfeit drugs ranges from 10–15 percent, particularly OTC drugs sold primarily in retail stores. The Chinese government has indicated its intention to improve its IPR protection record by reforming its legal system and issuing new laws, but its legal system is still not up to the global standard. As the European Chamber of Commerce observed:

At face value, the Chinese legal system would seem to meet many of the TRIPs requirements in as much as judicial and administrative remedies are available . . . However, the Chinese civil legal system does not provide for a “discovery” process, other than court executed search warrants. For instance, if an employee with a high-level of proprietary information goes to a competitor which all of sudden begins to produce the product of the former employer, the former employer would like the discovery tools of depositions and subpoena of documents both of which are currently unavailable in China. Although a Chinese court may execute a search warrant, it will usually only do so upon at least some degree of proof, which may be hard to obtain without discovery.

In addition, the Chinese court takes action only after a series of warnings. In a developing country like China, the plaintiff will seldom, if ever, be able to recover any meaningful amount of damages. In this case, the task for foreign drug manufacturers is not to break down the wall, but to help the Chinese government to strengthen its IPR protection wall.

Finally, nationalism and local protectionism will continue to exist. The pharmaceutical sector is now the fifth largest industry in the Chinese economy. The Chinese government at all levels will resist foreign pharmaceutical companies gaining control of the huge Chinese drug market at the expense of domestic companies. Individual Chinese pharmaceutical manufacturers may not have devised their long-term development strategy, but the government has undertaken a massive reorganization of its state-owned enterprises. State-owned pharmaceutical companies are now being merged and organized into more strategically capable enterprises designed to compete both domestically and internationally. This round of reform also includes developing large-scale drug distributors with national capacity and the privatization of state-supported medical research institutes. The goal of the
Chinese government is to transfer its success in building competitive companies in the electronic appliance industry to the pharmaceutical industry. This involves the heavy injection of public capital into selected state-owned enterprises and other policy preferences.

With all these soft walls continuing to exist legally after WTO accession, competition in China’s pharmaceutical market will continue to be discriminatory, with distortions existing in different forms.

WTO accession and its impact on market competition

The above analysis gives a structural picture of the Chinese pharmaceutical industry and the changes to its business system caused by China’s WTO accession. These WTO-related changes will affect not only the function of the market, but also the competitive positions of Chinese and foreign pharmaceutical manufacturers, the key player category of the market. In this section, impacts are highlighted using the standard “SWOT” analysis (Table 9.1).\(^{18}\)

Chinese pharmaceutical companies have more weaknesses than strengths compared to their foreign competitors. Their major strengths include social capital or *guanxi*, knowledge of local markets, and lower operating costs. They also enjoy the many competitive advantages offered by a regulated business system. On the other hand, most of the weaknesses are internal to the firm, rather than structural at the industry level. The major weaknesses include minimal investment in research and development (R&D), lack of brand equity, small scale of production, weak management, and outdated technology and equipment. Few Chinese drug manufacturers, even those with high profit margins, have basic research capacity or long-term R&D strategies. In fact, the total R&D expenditure for Chinese pharmaceutical companies amounts to less than that spent by even one of the major Western pharmaceutical groups.\(^{19}\) This fact might explain the generic drug strategy followed by Chinese drug makers for so long. With no alternative, copying was the only cost-effective approach.

The array of strengths and weaknesses of foreign pharmaceutical firms is the reverse of that for Chinese drug manufacturers. The competitive strengths of foreign firms are mostly internal. Their weaknesses relate to the external pressures of the Chinese business system. They are overwhelmingly stronger in terms of R&D, new drug development, brand recognition, product quality, financial resources, global marketing networks, and business management. As for their competitive weaknesses, except for their lack of social capital and knowledge of local markets, they all have restrictions imposed on them by Chinese governments and local business/government networks.

The major threat for Chinese companies prior to the WTO was increasing competition from foreign drug companies as the markets opened gradually. For foreign pharmaceuticals, the threats came from high barriers to
Table 9.1 Pre-WTO “SWOT” analysis of key market player

<table>
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<tr>
<th>Factors</th>
<th>Chinese Drug Makers</th>
<th>Foreign Drug Makers</th>
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<tbody>
<tr>
<td>Strengths</td>
<td>• Strong social capital or ‘guanxi’</td>
<td>• Global brands</td>
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<td>• Knowledge of local markets</td>
<td>• R&amp;D &amp; new drug development</td>
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<td>• Tariff and non-tariff protection</td>
<td>• Economies of scale</td>
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<td>• Traditional Chinese medicines</td>
<td>• GMP and higher product quality</td>
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<td>• Low price</td>
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<td>• Generic strategy</td>
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<td>• Local protectionism</td>
<td>• Management know-how</td>
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<td>• Emergence of leading pharmaceutical groups</td>
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<td>• Financial resources</td>
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<td>Weaknesses</td>
<td>• Brand-less, generic producers</td>
<td>• Social capital</td>
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<td>• R&amp;D or new drug development</td>
<td>• Knowledge of local markets</td>
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<td>• Low production standard and poor product quality</td>
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<td>• Too many unprofitable firms</td>
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<td>• Lack of financial resources</td>
<td>• Strict &amp; complicated market access procedures</td>
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<td>Threats</td>
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<td>• IPR protection: counterfeits</td>
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<td>• Sacrificing long-term development for short-term profits</td>
<td>• Major drugs off-patent protection</td>
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<td>• Corruption</td>
<td>• Price control: domestic or other developing country equivalents</td>
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<td>• Government-backed structural reorganization</td>
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market access and poor legal protection for intellectual property. At the same time, both sides had the opportunity of a huge market with fast growth rate and potential. In the pre-WTO world, foreign pharmaceutical companies entered the market with their hands tied; local drug manufacturers had freedom to capture the market, but did not have the right products or tools. It was in this environment that joint ventures became the strategic choice of the competing sides. By the end of 1999, there were over 1,800 JVs, representing a total investment of $1.5 billion. Approximately 40 percent of Chinese pharmaceutical companies had joint venture projects with foreign companies.20

We believe China’s WTO access will lead to significant changes to the competitive positions of the two strategic groups and their market strategies. Table 9.2, which provides a post-WTO “SWOT” analysis of key market players, highlights those changes. It is interesting to note two major highlighted zones. The first is the disappearance of most weaknesses associated with foreign pharmaceutical companies under the pre-WTO business system, while maintaining all of their competitive strengths. But the market integration process does not offer Chinese drug producers equal benefits. Most worrisome for them is the potential obsolescence of the generic drug strategy followed successfully for decades as China tightens IPR protection. Another major likely change is a decrease in joint ventures (JVs). With the expansion of national treatment, trading and distribution rights, accumulated social capital, and the removal of obvious bureaucratic obstruction, foreign pharmaceutical companies may in the future lose interest in their Chinese partnerships, which usually require intensive management care.21

Foreign pharmaceutical companies stand to gain market share because of WTO-related structural changes to the business system and the competitive positions of the two strategic groups. This does not mean that the winners will take all. The soft walls will persist for the foreseeable future. At the same time, Chinese drug manufacturers will have to pursue strategies, with government assistance, to deal with the “wolf” pack.

What’s next?

Our analysis of the pharmaceutical sector suggests that for foreign firms, the challenge will be to penetrate the soft walls of administrative ambiguity and complexity, intricate distribution channels, non-codified and particularistic decision-making, weak implementation of intellectual property law, and national self-interest. For Chinese firms, the enforcement of intellectual property rights will constrain the current market niche for generic drugs, and eventually compel these firms to find other competitive strengths.

Foreign firms may do well to consider their options for managing the complexity and ambiguity of the Chinese business environment. The WTO offers an opportunity to standardize business practices, and consequently
Table 9.2 Post-WTO SWOT analysis of key market players

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make them more controllable. The reality is that the “soft walls” of deeply ingrained Chinese strategies for dealing with uncertainty are likely to persist for some time.

There are several potential points of tension in China’s pharmaceutical industry, which may reinforce the complexities of the traditional Chinese business system. The first is the competition between the central government and local governments for control of industry development and revenues. Beijing, Shanghai, Hangzhou, Wuxi and Guangzhou are among the top competitors regionally. Add to this the intent of central government policy to establish a small number of national conglomerate firms, compared to the intention of local governments to profit from, and be supplied by, local firms. Another dimension of this competition may be the military’s vested interests in its own pharmaceutical companies. A critical issue will be the central and local governments’ ability to harmonize their authority over the regulation of the industry. The complexities wrought by competing objectives in drug licensing, distribution, production, marketing and quality control may persist, even with the introduction of WTO rules.

John Child, in a study of international business strategies in the Chinese market, suggests that rather than trying to control ambiguities, foreign firms may do better to work within the Chinese preference for complexity, and to absorb this modus operandi through “a greater degree of participation in local relational systems,” in spite of the higher transaction costs of working with local partners. While there is an increasing trend for foreign firms to avoid the high transaction costs of working with Chinese partners by exiting from JVs, it will be interesting to study the impact on profitability of the gradual shift to wholly-owned foreign enterprises.

For Chinese firms, the challenge will be the extent to which the central government supports industrial development, and the extent to which the sector adopts a niche where it can be competitive. Historically, China, and Asian countries in general, have relied on Western investments in research and development. This capital-intensive front-end of the industry is factored into the cost of pharmaceuticals produced by multinational companies. Although China is now investing in biotechnology research institutes, the question remains as to whether the industry will make the necessary investment in costly intellectual capital at the drug discovery and development phase. In the short to medium term, Chinese pharmaceutical companies will not be able to compete with the R&D capacity of foreign multinationals. Their niche is more likely to be production through licensing agreements. Their current strength is in the manufacture of chemical components for pharmaceutical production, and in the production of Traditional Chinese Medicine (TCM). The opportunity to be industry leaders in this latter niche could derive from a focus on R&D which legitimizes TCM using the Western scientific model, and in globalizing the market.

The question which foreign companies ask is whether the indigenous industry will be allowed to fail. Medicine is a critical public good, and the
high cost of foreign drugs is prohibitive for a government that is struggling to meet the health care needs of its vast population. Furthermore, the domestic market for pharmaceuticals in China continues to have huge growth potential. The development of the domestic drug industry will pose a dilemma for Chinese government officials who face the competing demands of international, rules-based competition, and the imperative to provide medicine to their citizens, and economic growth for their country. Evidence from the 10th Five Year Plan, its restructuring of the industry to create large conglomerates, suggests that the central government is committed to nurturing this sector.

A critical question for future research is based on the role of the state in the business system.24 As China’s business system evolves in a post-WTO environment, how will “the pharmaceutical industry” be defined? This question concerns the boundary between government and private investment. Does the sector include government-invested research and development institutes? Will they be publicly or privately owned? Will the distribution system be state-owned or private? How will they interact with the manufacturing sector? In particular, recent and projected trends in the pharmaceutical sector internationally suggest that research and development, including clinical trials, is likely to devolve to companies which service the giant pharmaceutical conglomerates. As the definition of the sector changes, how will the relative roles of the state and private sector evolve?

The theme which runs through each of these questions is the ability and pace of the Chinese system of business and government to converge with, or at least adapt to, international practices. The superficial acceptance of WTO rules and international industry standards is the starting point. The deep integration of vastly different, but equally complex and opaque, systems will take a long time, and it is likely that the influence will be mutual.

Although it is too early to assess the impact of China’s accession to WTO on the pharmaceutical sector, it is clear that the intersection of Chinese and foreign government policy, practice, and business systems will shape the outcomes of a rapidly changing industry in China.

Notes
2 Potter refers to the Chinese response as “dynamic selective adaptation.” See Pitman Potter, “Globalization and Economic Regulation in China: Selective Adaptation of Globalized Norms and Practices,” paper presented at the conference on “Globalization and China’s Reforms: An IPE Approach,” Department of International Politics, Fudan University and Department of Political Studies, Queen’s University, Shanghai (21–24 May 2002). Paltiel’s chapter in this volume analyzes the extent to which Chinese business norms will change to sup-
port the state’s commitment to WTO. See also Margaret Pearson, “China’s Integration into the International Trade and Investment Regime,” in Elizabeth Economy and Michel Oksenberg (eds), *China Joins the World: Progress and Prospects* (New York: Council on Foreign Relations, 1999), pp. 161–205, for a discussion of the competing models of full and partial integration.

3 Interview with Jim McClurg (MDS Pharma), March 2002.


10 Roland Berger, p. 41.

11 Roland Berger, p. 38.

12 Interviews with executives from Eli Lilly, MDS Pharma, CIBA, and MDS Inc, March 2002.

13 Interviews with executives from Chinese pharmaceutical firms, whose identities are kept anonymous as requested, 2002.

14 Roland Berger, p. 37.


16 European Chamber of Commerce, “Pharmaceutical Industry.”


18 SWOT stands for strength, weakness, opportunity and threat.


24 Thanks to Denis Bovin of Bear, Stearns & Co. Inc (NY) for his thoughtful suggestions and provocative questions.
10 How China responds to trade sanctions
Decoding the Sino-South Korean “Garlic War”*

*Jae Ho Chung

Introduction

South Korea has been regarded as one of the countries most successful in engaging China, despite its peculiar status as a divided nation. Seoul’s evolution during the last two decades from China’s permanent enemy to its principal “partner for comprehensive cooperation” (quanmian hezuoxing huoban) has been dramatic. The ever-expanding bilateral trade – amounting to US$100 billion in 2005 – and investment relationships are only part of the story. The popular and favorable perceptions that South Koreans and the Chinese hold for each other has turned their burgeoning bilateralism into a strategic dilemma for Seoul in terms of its security alliance with the US.¹

Since the 1992 normalization, the Seoul–Beijing relationship has almost always been cordial, close, and mutually accommodating – a “honeymoon” in which mutual understanding and amity flourished. Whereas North Korea has often constituted a thorny variable for China, Taiwan has not done so for South Korea.² In the summer of 2000, however, the so-called “garlic war” (dasuan zhi zhan) erupted between the two countries. The pace, magnitude and after-shock of the dispute were so intense that many observers in Seoul believe that the honeymoon finally gave way to a more pragmatic and realistic relationship based on national interests and economic profits.³

The South Korea–China dispute over garlic is important for other reasons as well. First, this case provides us with useful information about the conditions and circumstances under which China may decide to launch economic sanctions beyond verbal threats. While the “garlic war” broke out prior to China’s accession to the World Trade Organization (WTO), it is highly illustrative of the decision-making process pertinent to Beijing’s retaliatory actions against its counterparts in trade disputes. Second, the question as to why China retaliated against South Korea in the way it did begs an answer. Is China generally harsher on a weaker country in foreign economic relations, unlike with its military behavior?⁴ If so, what propels Beijing to adopt harsh measures against weaker parties? What prompts China to opt for retaliatory measures as opposed to negotiations and bargaining?
This chapter on China’s behavior in trade disputes consists of four sections. The first provides a contextual background as to why the garlic war broke out and why it is worthy of scholarly attention. The second section explores five factors deemed responsible for Beijing’s harsh retaliation. The third section closely examines how concessions by South Korea settled the garlic dispute, while the concluding section, which compares the Sino-Japanese trade dispute over mushrooms with the garlic war, makes inferences about China’s behavior in foreign economic relations and trade disputes in particular.

A brief note is due on the sources used here. First, I consulted primary news materials from both South Korea and China, including online resources. Second, I used official announcements from key ministries and commissions in both countries, and academic journals and policy papers. Third, I interviewed both South Korean and Chinese officials knowledgeable about the policy process pertinent to the garlic war. Finally, Japanese media reports and commentaries were used extensively to establish a persuasive comparison between the garlic war and the Sino-Japanese squabble over mushrooms.

**The Sino-South Korean “Garlic War”: facts and anomalies**

On 30 September, 1999, South Korea’s National Agricultural Cooperative Federation filed for a “trade remedy” concerning garlic imports from China. On the basis of the investigation conducted after 11 October 1999, the Trade Commission directly under the Ministry of Commerce, Industry and Energy (MOCIE) recommended on 27 October that a provisional safeguard measure should be taken by the Ministry of Finance and Economy (MOFE). On 18 November, MOFE adopted such a provisional safeguard measure against garlic imports from China for 200 days, until 4 June 2000.

On 2 February 2000, the Trade Commission concluded that imported garlic from China had harmed South Korea’s garlic farmers and proposed a full-fledged safeguard measure – the imposition of additional tariffs for three years on garlic imports from China. On 1 June 2000 (i.e., three days prior to the expiration of the provisional safeguard), MOFE and the Ministry of Agriculture and Forestry (MAF) agreed to act upon the policy recommendation from the Trade Commission, thereby imposing a 315 percent tariff on frozen and pickled garlic and a 436 percent tariff on peeled garlic imported from China.

From the outset, China had been very explicit in its disagreement with South Korea over the garlic controversy. In mid-March 2000, Chinese authorities threatened to restrict imports of South Korean industrial goods should Seoul adopt full-fledged safeguard measures against its garlic exports. In late March, the Chinese, highlighting their successive trade deficit with South Korea, officially demanded that the provisional emergency tariffs on garlic exports be lifted immediately. Despite South Korea’s efforts
to resolve the dispute early, by offering some compensation for China’s potential losses, negotiations failed and the full-fledged safeguard was put in effect. Consequently, on 7 June 2000, the Chinese government retaliated by banning mobile handsets and polyethylene imported from South Korea.\(^8\)

What motivated Seoul and Beijing to engage in this dispute over garlic imports at this time and in such an unexpected manner? Several anomalies can be identified with regard to China’s response to South Korea’s safeguard measures. First, in dispute settlement, retaliatory measures are generally employed only after the concerned parties have exhausted their negotiation efforts and bargaining means. In the garlic war, however, China seemed more intent on relaying certain messages to South Korea than settling the dispute in a constructive manner. Second, although higher tariffs are usually imposed before an import ban is implemented, China immediately resorted to the latter. Third, China’s rather unconventional retaliation transpired just as negotiations with the EU on the terms of China’s accession to WTO were about to take place.

From the Korean perspective, garlic is one of the most important agricultural products in the Korean diet. Approximately one third (over 420,000) of South Korea’s farm households grow garlic, at a value of US$770 million per annum. Although farmers constituted 8.6 percent of South Korea’s total population in 2000, their clout has often proved very influential in Korean politics. Also, the garlic war in 2000 was closely related to interest group politics engineered by the National Agricultural Cooperative Federation and the Ministry of Agriculture and Forestry.

Based on the Uruguay Round of trade negotiations, South Korea could apply a 50 percent tariff to the minimal market access (MMA) quota for garlic and a 400 percent tariff to the over-quota imports of fresh and dried garlic. On the other hand, only a 30 percent tariff was to be imposed on imported frozen and pickled garlic on the grounds that there would be little demand for these two types of garlic in South Korea.\(^9\) Not surprisingly, once MMA import quotas on fresh garlic were fulfilled, garlic merchants had every incentive to import frozen and pickled garlic on which much lower tariffs were levied, as the price of the frozen garlic was now cheaper than imported fresh garlic. Table 10.1 illustrates these unforeseen effects of the Uruguay Round agreements on South Korea’s garlic imports.

Several trends are discernible from Table 10.1. First, the total volume of garlic imports from China increased very rapidly during 1996–98, although the pace of increase slowed significantly in 1999 when South Korean farmers began to voice their concerns about garlic imports from China. Second, once the fresh garlic imports surpassed the MMA quota (10,000 tonnes per year) in 1997, the import volume of frozen and pickled garlic, on which only a 30 percent tariff was imposed, began to increase sharply from 2,043 tonnes and 901 tonnes in 1996 to 18,585 tonnes and 3,631 tonnes, respectively, in 1999. By 1999, the volume of low tariff frozen garlic imports accounted for 50 percent of South Korea’s total garlic imports from China (see Table 10.2).
According to South Korea’s assessment, the sharp drop in garlic prices in 1999 was largely attributed to the surge in Chinese imports. Yet, the official prices, shown in Table 10.2, suggest that the price drop might have been caused by something else, since the garlic price dropped only in 1999 when the garlic imports from China recorded a much slower growth compared to the 1996–98 period (see Table 10.1). The more crucial reason for the price drop was that South Korea’s domestic garlic production increased significantly between 1998–99. As Table 10.3 illustrates, South Korea’s domestic garlic production increased by 22.8 percent during 1998–99, while garlic imports from China rose by only 3.5 percent.

The sudden drop in garlic prices in 1999 can then be attributed not wholly to the rise in imports from China, but to the increase in domestic garlic production as well. However, politically, South Korean farmers had to find a reason for their problem and the National Agricultural Cooperative Federation (NACF) was quick to put the blame on imported garlic. The Ministry of Agriculture and Forestry (MAF) rendered full support for the interpretation of the NACF and garlic farmers. And MAF’s position was seconded by the incumbent party, the New Millennium Democratic Party, which supported the immediate adoption of safeguard measures against the garlic imports from China. While the Ministry of Foreign Affairs and Trade (MOFAT) sought to intervene to talk some sense into the increasingly politicized process, political considerations became superordinate as the National Assembly election scheduled in April was drawing near.10 Eventually, emergency tariffs ranging from 285 to 400 percent were imposed on the imports of frozen and pickled garlic from China.

Table 10.1 South Korea’s garlic imports from China, 1996–1999 (tonnes)

<table>
<thead>
<tr>
<th>Year</th>
<th>Fresh garlic</th>
<th>Frozen garlic</th>
<th>Pickled garlic</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>6,153</td>
<td>2,043</td>
<td>901</td>
<td>9,497</td>
</tr>
<tr>
<td>1997</td>
<td>12,919</td>
<td>3,768</td>
<td>1,633</td>
<td>18,368</td>
</tr>
<tr>
<td>1998</td>
<td>25,633</td>
<td>7,795</td>
<td>2,128</td>
<td>35,977</td>
</tr>
<tr>
<td>1999</td>
<td>14,355</td>
<td>18,585</td>
<td>3,631</td>
<td>37,239</td>
</tr>
<tr>
<td>Increase over previous year</td>
<td>N/A</td>
<td>93.4%</td>
<td>95.9%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

Sources: Ministry of Foreign Affairs and Trade at http://www.mofat.go.kr (08/01/00); and Development Research Center (State Council of the People’s Republic of China) at http://www.drcnet.com.cn (06/15/00).

Note: Figures do not add up as the balance refers to other (mostly dried) garlic imports.

Table 10.2 Garlic price changes in South Korea, 1996–1999 (Won/kilogram)

<table>
<thead>
<tr>
<th>Year</th>
<th>Farm sale price</th>
<th>Wholesale price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>1,638</td>
<td>1,317</td>
</tr>
<tr>
<td>1997</td>
<td>2,001</td>
<td>1,965</td>
</tr>
<tr>
<td>1998</td>
<td>2,719</td>
<td>3,097</td>
</tr>
<tr>
<td>1999</td>
<td>1,520</td>
<td>1,859</td>
</tr>
</tbody>
</table>

Source: http://www.mofat.go.kr (08/01/00).
While the Korean government initiated the trade dispute over garlic imports largely due to the political interests of garlic farmers, we still need to explain the way the Beijing government responded to the safeguard measures adopted by Seoul. Why China opted for harsh measures provides important clues to understanding what specific circumstances are likely to prompt Beijing to resort to retaliatory sanctions in future. While some of the factors discussed below are unique to the South Korea–China bilateralism, this particular trade dispute is highly illustrative of the strategic rationale behind China’s foreign economic policy-making.

As noted earlier, China’s mode of retaliation against South Korea was rather unconventional in the following respects. China seemed deeply offended by the fact that South Korea adopted safeguards against its garlic exports. More importantly, Beijing used the occasion to warn Seoul and other markets for Chinese agricultural products. China’s outright rejection of South Korea’s overture to compensate for Beijing’s loss over garlic imports is most illustrative. Additionally, China chose to impose an import ban instead of going first for a tariff increase. Furthermore, China’s import ban was imposed on two industrial goods, the value of which far surpassed that of the garlic.

What explains this particular mode of retaliation adopted by China? Five factors jointly led to Beijing’s opting for the import ban on South Korea’s mobile handsets and polyethylene: changes of perception after the Asian Financial Crisis, successive Korean trade deficits, domestic politics in China, “face” diplomacy, and post-WTO accession problems.

**Perception changes since the 1997 financial crisis**

Since the late 1970s, the Chinese have been envious and in awe of Seoul’s remarkable economic accomplishments. As early as 1978, the Chinese Academy of Social Sciences (CASS) established a small research group under its Institute of World Economy and Politics to study the developmental experiences of South Korea. On 14 December 1980, Hu Yaobang, General Secretary of the Chinese Communist Party, in an interview with the
official newspaper of the Greek Communist Party, commented that China’s open-door policy was actually based upon the developmental experiences of South Korea and others. In the same month, then Premier Zhao Ziyang reportedly told Yugoslavian reporters that China was studying South Korean experiences in economic development.11

Theoretically, all of the East Asian Newly Industrializing Economies (NIEs) could have been models for China. As one scholar aptly pointed out, “[T]he economic success of East Asia derived from its open economic policy has influenced many nations to rethink how they ought to go about achieving economic development ... Nowhere is the resulting change in thinking more apparent than in China.”12 Among the four East Asian NIEs, excluding Singapore and Hong Kong for their exceptionally small size and Taiwan for potential political ramifications, South Korea might have been the only usable and appropriate model China considered worth emulating.13

Thus, China’s initial goal was to become another NIE by closely following the developmental path of South Korea. Numerous Chinese publications focused on how it could best emulate the “successful recipe” of South Korea’s economic development.14 Some suggest that China’s special economic zones replicated export processing zones in South Korea and elsewhere. China even copied South Korea’s targets of economic growth: Deng Xiaoping’s famous projection of reaching a per capita GNP of one thousand dollars by the year 2000 was allegedly modeled after Park Chung Hee’s figure set for 1980.15

All these favorable and envious perceptions of South Korea, which had led to diplomatic normalization, abruptly ended in 1997 when the severe financial crisis engulfed Seoul. The aftershock of this event was felt very intensely in Sino-South Korean relations. No more books were published on South Korea as a model for emulation after 1997. Instead, South Korea was depicted as a negative example that China must avoid duplicating at all costs.16 Furthermore, many South Korean diplomats previously and currently based in China convey in private their own sense that China’s mainstream view of South Korea has changed since the 1997 crisis. Some within the Seoul policy community even suspect that China’s changing perceptions of South Korea explain in part the particular mode of retaliation adopted by Beijing.17

Successive trade deficits

China’s decision to retaliate harshly can be attributed in part to the structure of Sino-South Korean trade after diplomatic normalization in 1992. Prior to 1992, bilateral trade had displayed an irregular pattern, with South Korea recording deficits with China in 8 of the 13 years between 1979 and 1991. After normalization, however, Seoul consistently had trade surpluses with Beijing, reaching huge volumes: US$5.4 billion in 1998 and US$4.8
billion in 1999. In 1999, South Korea’s trade surplus with China (including Hong Kong) totaled US$13 billion and accounted for almost half of Seoul’s worldwide trade surplus.¹⁸

As for the relationship between the structure of trade after 1992 and China’s mode of retaliation against South Korea, two conjectures seem feasible. First, logically speaking, China must have thought of its agricultural exports as a crucial means for reducing the deficit with South Korea, particularly since China recorded a US$500 million surplus in agricultural products in 1998. Second and, perhaps more importantly, China might have been surprised that South Korea made such a big issue out of the garlic imports, since their volume and value constituted only a tiny fraction of the ever-expanding bilateral trade. Hu Chusheng, spokesperson for China’s Ministry of Foreign Trade and Economic Cooperation (MOFTEC), made it very clear that South Korea’s trade surpluses with China easily outweighed the garlic problem.¹⁹ Interviews with MOFTEC officials in both Beijing and Seoul also suggest that Chinese officials were emotionally offended by South Korea’s intention to cut garlic imports while Seoul consistently reaped huge trade surpluses with Beijing.²⁰

Domestic politics in China: the suicide incident

The most immediate reason Beijing retaliated so forcefully was that Seoul’s emergency tariffs on garlic imports had generated serious political repercussions within China. Once the full-fledged safeguard measures drastically reduced profit margins on garlic imports from China, South Korean importers hurriedly cancelled their contracts with Chinese farmers-cum-exporters. While China had approximately three million farmers producing garlic nationwide, most of South Korea’s imports came from Shandong Province. In 1999, Shandong accounted for about 80 percent of total garlic production in China and 70 percent of China’s total garlic exports.²¹

Within Shandong, two counties are particularly well known for their garlic production: Jinxiang and Changshan. While Jinxiang County’s garlic exports to South Korea have been minimal, Changshan County under Linyi Municipality had exported over half its garlic to South Korea, so Seoul’s safeguard measures were estimated to inflict at least 100 million renminbi worth of losses in this single county. Consequently, six farmers in Changshan, whose garlic farming depended heavily on loans, committed suicide. This story created political sensitivity within China. According to an interviewee from MOFTEC, the news about the suicides in Changshan was reported in Neibu cankao (“Internal References”), which caught the attention of Premier Zhu Rongji. Zhu, allegedly infuriated, personally instructed MOFTEC to pay special attention to the case. Concerns among the highest leadership may explain why the Foreign Trade Department (duiwai maoyi si), rather than the Asian Affairs Department (yazhou si), was to handle the
dispute. Furthermore, close consultation was allegedly offered by the Treaty and Law Department (tiaoyuefalu si).22

Public opinion – whether formal or informal (xiaodao xiaoxi), and whether online or off-line – is becoming increasingly important in the making of foreign (economic) policy in China.23 According to a Chinese survey, nearly 61 percent of urbanites in Beijing, Shanghai, and Guangzhou knew about the “garlic war” with South Korea, which put additional pressure on the Chinese government in coping with the problem.24 While some media reports suggested that the so-called “Shandong connections” (Shandong bang) had been put to use in protecting the province’s interests, thereby escalating the trade dispute, no available sources of information were confirmatory of this. Yet, one Chinese interviewee implied that the geographical location of Changshan County, which is in Linyi, the most well-known “old revolutionary base” (lao geming genjudi) in Shandong, might have had some influence.25

The politics of “face” diplomacy

Chinese foreign policy possesses a unique characteristic, the constant concern with “face” (mianzi). That is, Chinese foreign policy is hinged upon certain cultural attributes constructed historically and influenced by past experiences with foreign powers. The Chinese concept of face refers to its national self-image, which needs to be maintained and protected so that other states will not tarnish its integrity.26 China’s obsession with preserving face can be further illustrated with some notable examples from two different issue-areas. In the realm of military security, China has demonstrated two contrasting characteristics depending on its adversary. When confronting powers deemed stronger than China militarily, Beijing usually holds to the principle that “the best deterrence is belligerence.” China’s involvement in the Korean War against the formidable joint forces of the United States and the United Nations, as well as China’s armed clash with the Soviet Union in Heilongjiang and Xinjiang in 1969, are good examples in point. vis-à-vis weaker countries, on the other hand, China seems to resort to the principles of “virtue” or self-restraint, as its encounter with India in 1962 illustrates.27

In the realm of foreign economic relations, the role of face has been less apparent, not only because face-preserving diplomacy is generally more likely in the positive-sum games of trade and investment than in the zero-sum security arena, but also because foreign economic relations are usually more receptive to the norms of reciprocity. Besides, China has been much more proactive in participating in international economic organizations than in multilateral security or arms control regimes.28 One crucial implication is that many see China as willing to respect the widely accepted “due process” and norms in foreign economic relations. The WTO dictates that no retaliatory measures should be taken against safeguards, so South Korea
seems to have expected, falsely, that China, so anxious to enter the WTO, would abide by this rule, whereas China saw no benefit in doing so. Instead, Beijing relied on Article 7 of the Foreign Trade Law of the People’s Republic of China, which authorizes protective countermeasures in case of “discriminatory prohibition.”

Both documentary sources and interviews suggest that the Chinese regarded South Korea’s safeguard measures as ungrounded and unfair, thus undermining their face. As noted earlier, Beijing did not accept Seoul’s justifications for adopting the safeguard mechanism against Chinese garlic imports. While Article 2 of the WTO agreements stipulates that, for safeguard measures to be employed, one must prove that increases in imports, relative to domestic production, have caused harm to domestic industries, garlic imports from China increased by 3.5 percent in 1998–99, while South Korea’s domestic production rose by 22.8 percent during the same period (see Tables 10.1 and 10.3). Thus, imports could not have undermined domestic production.

China also criticized South Korea for imposing the provisional safeguard measures on its garlic exports “unilaterally,” suggesting that insufficient prior consultation took place. This point is controversial, however, since many in Seoul doubt that prior consultation with Beijing would have produced a different outcome. In any case, the feelings of being offended had a significant impact on the two rounds of negotiation held between Seoul and Beijing. Even South Korea’s proposal to offer compensation for China’s potential loss was rejected outright. According to a knowledgeable interviewee, the Chinese side at the time was less interested in negotiating over the compensation scheme than in sending a strong warning to South Korea – namely, “don’t mess with China.”

Concerns with post-WTO accession domestic troubles

While China had aspired to join the General Agreement on Tariffs and Trade (GATT) since 1986 and the WTO in the 1990s, it had at the same time pondered seriously the potential domestic problems associated with WTO accession. One of the most sensitive areas in this regard has been the countryside that supports 65 percent of the Chinese population. It is not simply the size of the rural or agricultural population that matters to the Chinese government. More important is the increasingly inflammable situation in the rural areas. In addition to the well-known problems of declining agricultural productivity, widespread arbitrary taxation (luan shoufei), and the huge size of the “floating population,” China’s countryside is plagued with socio-political instability. While only 6 provinces had been associated with serious rural instability in 1990, the figure rose sharply to 16 in 2000. As the riot in Jiangxi in August 2000 well illustrates, the formation of “heads of peasant groups” (nongmin lingxiu) is spreading fast and widely.
On top of all these complex problems, China has yet to face the after-shocks of its accession to the WTO. Accessing to the WTO means lifting or at least significantly reducing tariff barriers on imports. That is to say, American corn costing $100 per tonne in Chicago is now allowed into the Chinese market where a tonne of corn costs $160. Potentially, this would in turn lead to a drastic increase in the number of rural unemployed, as well as to an expanding demand for government subsidies for the countryside. This is why, in its protracted negotiations on the terms of WTO accession, Beijing persisted in preserving China’s developing country status, as well as the 8.5 percent ceiling for government subsidies on agricultural production.

When South Korea imposed – “unilaterally” from Beijing’s viewpoint – the safeguard mechanism permitted under the WTO rules, China, as a non-WTO member, might have considered it a good “last” opportunity to employ retaliatory sanctions not authorized by the WTO. More importantly, China must have thought of the entire audience (i.e., other potential importers of Chinese agricultural products) that were closely watching its dispute with South Korea with great interest. China could not afford the image that its agricultural exports were easily susceptible to restrictions and sanctions. Thus, while South Korea’s main consideration was essentially bilateral, China’s core concern was with all potential importers of Chinese agricultural products. In a nutshell, China was playing the “politics of audience” by utilizing the garlic dispute case in hand.

The resolution of the “Garlic War”

When China officially announced its retaliatory measure – banning the import of mobile handsets and polyethylene – the South Korean government was taken by surprise. Seoul did not expect such a harsh response. Despite the dispute over garlic imports, South Korea not only remained in the “honeymoon mood,” but it also held ungrounded expectations that China would operate within the spirit of international norms and practice – i.e., retaliations would be made either against a similar sector or would be in the form of increased tariffs rather than an import ban. Despite Beijing’s warning on at least two occasions that it would retaliate against Seoul’s industrial goods exports, South Korea was not aware of what was forthcoming.

China’s selection of mobile handsets and polyethylene was meticulous; dubbed as “using a missile launcher to respond to gun fire,” China must have wished to gain the immediate upper hand when it chose these two Korean industrial products as its target of retaliation. Table 10.4 starkly contrasts the value of Korean garlic imports versus exports of mobile handsets and polyethylene to China. Not only did China choose industrial products to retaliate against South Korea’s emergency tariffs on China-imported garlic, but the total value of the two industrial products was 57 times higher than that of the garlic imports.
China's retaliation quickly had the desired effect. Within a few days of Beijing's announcement, South Korea's media expressed serious concerns about China's import ban on mobile handsets and polyethylene, noting that China accounted for 47 percent of South Korea's polyethylene exports. The Seoul government reacted immediately. Minister of Agriculture and Forestry, Kim Sung-Hoon, one of the staunch supporters of the safeguard measures against Chinese garlic imports, suggested that the South Korean government should devise a scheme to make up for China's losses on garlic exports. Deputy Minister of Foreign Affairs and Trade, Ban Ki-Moon, also expressed his wish that the dispute be resolved quickly through negotiations.

South Korea's industrial interest groups and business associations disclosed their concerns about the impact of China’s import ban. The petrochemical industries expressed grave worries about losing their market shares in China. The Korean Chamber of Commerce, jointly with the Korean Association for Petrochemical Industries and the Korean Association for the Promotion of the Electronics Industry, proposed that the South Korean government reconsider the emergency tariffs imposed on Chinese garlic imports. These voices certainly put additional pressure on the South Korean government which in late June was then negotiating with its Chinese counterpart.

On 5 July 2000, the Chinese government released 27,700 tonnes of polyethylene and 20,000 sets of mobile phones that had been retained by Chinese customs since 7 June, an act that was interpreted as a benign gesture by Beijing for a swift resolution of the garlic dispute. Further reports in South Korea's media concerned the inevitability of reduced production by the petrochemical and electronics industries. On 14 July, less than seven weeks after South Korea imposed emergency tariffs on Chinese garlic imports, and two weeks after the dispute settlement talks began, China and South Korea reached an agreement.

The most crucial concession was that Seoul would allow up to 20,000 tonnes of frozen and pickled garlic to be imported with tariffs as low as 30 percent. Including the MMA quota of 11,895 tonnes of fresh garlic which could come in with a 50 percent tariff, the total volume of garlic imports from China with tariffs at or lower than 50 percent permitted for 2000 amounted to 31,895 tonnes. And the ceiling of South Korea's garlic imports from China was also raised to 33,728 and 35,448 tonnes for 2001 and 2003, respectively. The Sino-South Korean garlic war thus ended with a
clear victory for Beijing and a great loss of face for Seoul.\(^43\) Whereas Seoul continued its safeguards, the significantly increased low-tariff import quota rendered them practically meaningless.

Immediately after the resolution of the dispute, South Korea’s Ministry of Agriculture and Forestry announced that it would purchase all garlic produced domestically for that year and set aside a fund worth US$100 million to subsidize garlic farmers.\(^44\) These measures, in turn, make one wonder if the controversial safeguards would have been necessary after all, since subsidies could have made up for the losses of the South Korean garlic farmers in the first place. Furthermore, both China and South Korea decided to unify the channels through which decisions for garlic exports and imports were to be made.\(^45\)

However, the garlic dispute did not end there. On 13 April 2001, China warned that it would once again suspend the import of South Korean mobile handsets and polyethylene products if Seoul failed to implement the agreement reached in July 2000. More specifically, a misunderstanding emerged due to the ambiguity of the Korean and Chinese documents pertaining to the dispute settlement.\(^46\) The South Korean government interpreted the July 2000 document in a way that allowed the government to purchase only 11,895 tonnes of garlic at the MMA quota, while the remaining 20,000 tonnes were to be imported by the private sector. By April 2001, however, only 9,500 of the 20,000 tonnes were purchased. On the other hand, the Chinese side argued that the purchase of the entire volume of 31,895 tonnes of garlic had to be ensured by the South Korean government and the July 2000 agreement obliged the Seoul government to guarantee its fulfilment. The Seoul government succumbed to Beijing’s threat and forced South Korean manufacturers of mobile handsets and polyethylene to share the costs of dispute resolution by having them purchase garlic from China. Reportedly, China offered the price of $550 per tonne, which was cheaper than the price China offered to other countries.\(^47\)

The “Garlic War” compared with the Sino-Japanese “Mushroom War”

In order to make some inferences about China’s behavior in trade disputes, this section compares the South Korea–China garlic war with the Sino-Japanese dispute over mushrooms in 2001. These two cases share many similarities in terms of their backgrounds and developments. First, both cases involved Chinese agricultural exports – frozen and pickled garlic to South Korea, and shiitake mushroom, tatami straw rushes, and leeks to Japan. Second, as with the garlic war, due to domestic political considerations for farmers (only 4 percent of Japan’s population) and the pending Upper House election, Japan’s relevant ministries, political parties, and interest groups pushed their government to adopt provisional safeguard measures against agricultural imports from China. In April 2001, Tokyo
applied emergency tariffs of 256, 260 and 100 percent on leeks, shiitake mushroom, and tatami straw rushes, respectively.\textsuperscript{48}

Third, China retaliated against both South Korea and Japan by imposing sanctions on industrial goods – mobile handsets and polyethylene in the case of South Korea, and mobile handsets, automobiles, and air conditioners in the case of Japan.\textsuperscript{49} Fourth, both cases were eventually resolved through negotiations but with significant concessions made by Seoul and Tokyo. Japan withdrew the card of full-fledged safeguards and South Korea, while managing to continue with full-fledged safeguards, had to expand significantly the low-tariff quotas for garlic imports from China.

In many other respects however, the two cases differ considerably. Whereas Beijing was determined to defeat Seoul’s claims at once by imposing severe sanctions, it opted for a much softer stance against Tokyo. China’s response to Japan’s provisional safeguard involved higher tariffs rather than an import ban.\textsuperscript{50} More importantly, mobile handsets and polyethylene amounted to 1.6 percent of Sino-Korean bilateral trade in 2000. On the other hand, automobiles, air conditioners, and mobile handsets comprised only 0.2 percent of Sino-Japanese trade. Furthermore, Japan’s automobile exports to China constituted a mere one percent of Japan’s total car exports in 2000, while 47 percent of the polyethylene produced in South Korea was exported to China in 1999.\textsuperscript{51}

Why these marked differences in China’s response to South Korea and Japan? Several possibilities come to mind. Beijing’s harsher response to Seoul might have been related to the fact that South Korea adopted full-fledged safeguards, while Japan used only provisional ones. While South Korea imposed both provisional and full-fledged safeguards against Chinese garlic imports for 200 days and three years, respectively, Japan only employed provisional safeguards for 200 days. Both Japan and China were keenly aware of the face factor, so caution was the major ingredient in settling the trade dispute over mushrooms and the two other farm products. Also, while Japan, like South Korea, had adopted provisional safeguards, Tokyo was stuck with negotiations for over a month instead of introducing full-fledged safeguards after provisional safeguards expired on 8 November, 2000. China, too, was much more cautious in dealing with Japan than with South Korea. Whereas Beijing retaliated against Seoul after only six days, it waited two months to retaliate against Japan. Additionally, both Chinese officials and media handled the trade dispute with Japan much more carefully.\textsuperscript{52}

China was perhaps also fully aware that Japan could not easily employ full-fledged safeguards against its exports. While South Korea faced few constraints, Japan feared that the world would see it as running away from the principles of market liberalism. Negative comments made by Robert Zoellick, the United States Trade Representative, and Hatakeyama Noboru, JETRO’s Chairman, about Japan’s safeguards against Chinese agricultural imports, as well as several media reports alluding to the rise of a “protectionist Japan,” limited Tokyo’s options.\textsuperscript{53}
Generally speaking, when domestic costs are concentrated – as in the case of garlic production in Shandong – responses to safeguard measures are likely to be more fierce than when interests are dispersed. Interestingly, although the main producers of shiitake mushroom, tatami rushes, and leeks were also concentrated in Shandong, neither an unfortunate incident involving suicides took place, nor did the province actively lobby for stronger sanctions against Japan. The main reason lay in the fact that many producers of mushrooms, tatami rushes and leeks in Shandong for export to Japan were Japanese invested enterprises, not individual Chinese farmers. More importantly, unlike with South Korea, China has had a huge trade surplus with Japan for over a decade.

Furthermore, China has been the number one recipient of Japan’s Overseas Development Assistance (ODA). In 2000, over half of Japanese ODA – amounting to 240 billion yen – was given to China. Obviously, China did not wish to jeopardize Sino-Japanese relations to the extent that the main pillars of their bilateral economic cooperation would break down. In the end, however, Japan had to concede more to China, as Beijing linked the trade dispute with such political issues as Koizumi’s paying tribute to the war dead at the Yasukuni Shrine.

What implications can we derive from this comparison? First, on the basis of these two cases, we cannot assume that China retaliates more harshly against weaker countries. Rather, weaker countries are perhaps less restrained in their own behavior in trade disputes, thereby invoking more severe responses from Beijing.

Second, swift escalations and tough early sanctions may not be a good approach for handling trade disputes with China. Gradual escalation may provide more time for meaningful negotiations, as well as sufficient room for saving each other’s face. Weaker countries, in particular, must be more cautious in escalating their disputes with China.

Third, China seems to respond with tougher measures than the initial ones adopted by its opponent in order to gain an immediate upper hand in the dispute. It reminds one of China’s military strategy: while early warnings are provided, Chinese attacks will suddenly concentrate on the opposition’s weakest point in order to guarantee victory and face-preservation.

Fourth, Robert Putnam’s famous two-level game is now as pertinent in understanding China’s approach to trade disputes as elsewhere in the world. Social and local interests do play an important role and, increasingly, so does the media. This raises an important methodological issue regarding the acute need for research on linkage politics within China.

Finally, despite the expectation that China would follow WTO norms, Beijing took full advantage of its non-WTO member status in retaliating against Seoul and Tokyo. But having now acceded to WTO, will China’s response to trade disputes and safeguards change? After all, it is the deed, not the word, that matters in the end.
Notes


2 See, for instance, Chae-Jin Lee and Stephanie Hsieh, “China’s Two-Korea Policy at Trial: The Hwang Chang Yong Crisis,” *Pacific Affairs*, vol. 74, no. 3 (Fall 2001).

3 See *Hankyoreh Sinmun* (Hankyoreh News), 8 June 2000; *Munwha Ilbo* (Munwha Daily), 3 September 2001; and *Zhongguo jingji shibao* (China Economic Times), 14 June 2000.


5 For Korean media coverage, KINDS (Korean Integrated Newspapers Database System), at http://www.kinds.or.kr, was utilized. For Chinese media coverage, *Renminwang* (at www.people.com.cn) was used. Other than these two main sources, a wide variety of online resources were also consulted.

6 Key Japanese online sources include http://linkserver.nikkeidb.or.jp and http://news.searchina.ne.jp. I thank Yousun Chung for rendering excellent translations of the Japanese source materials used in this study.

7 This chronology has been reconstructed based upon the information provided in the Ministry of Agriculture and Forestry’s website (www.maf.go.kr), as well as upon South Korean media coverage in *Joong-ang Daily*, *Dong-A Daily*, *Chosun Daily*, and *Hankyoreh News*.

8 See *Hankyoreh News*, 14 and 29 March 2000; and for China’s retaliatory measure stipulated by Hu Chusheng, the spokesperson for the Ministry of Foreign Trade and Economic Cooperation, see http://www.people.com.cn (06/07/00).

9 See http://www.mag.go.kr/html/mains/agromail.htm (06/09/00). A South Korean official deeply involved in the negotiations at the time admitted retrospectively that the South Korean negotiators had had no prior knowledge that certain technologies had become available in defrosting frozen garlic.


hanguo zuo shengyi (How to Do Business with Korea; Beijing: Beijing gongye daxue chubanshe, 1995); Han Limin (ed.), Zhanhou hanguo jingji yu zhonghan jingmao guanxi (Post-War Korean Economy and Korea-China Economic Relations; Qingdao: Haiyang daxue chubanshe, 1995); and Zhang Renshou, Zhejiang yu Hanguo (Zhejiang Province and South Korea; Hangzhou: Zhejiang renmin chubanshe, 1996).


16 A Chinese scholar now suggests that the symptoms of the “South Korean problem” should have been spotted as early as 10 years ago, when Chinese officials and scholars were all deeply obsessed with the South Korean model of development. See Ding Yifan, Dachaoliu – Jingji quanqiu hu ya zhongguo mianlin de tiaozhan (Major Trends – Economic Globalization and the Challenges that China Faces; Beijing: Zhongguo fazhan chubanshe, 1998), pp. 191–194.

17 These changing perceptions appeared in China’s critical media coverage of South Korea’s advance to the semi-finals in the 2002 World Cup. The foreign ministries of the two countries even had to get involved in patching up the problem. For critical comments by China’s Deputy Foreign Minister on “biased” coverage of South Korea by the Chinese media, see Dong-A Daily, 26 July 2002.


19 See the full text at http://www.people.com.cn (06/07/00).

20 Most Chinese media alluded to the popular proverb of “only looking at the trees without considering the forest” (zhijian shumu bujian senlin). See, for instance, http://www.people.com.cn (06/09/00); Huangqi shibao (Global Times), 16 June 2000; and Zhonghua gongshang shibao (China Industrial and Commercial Times), 16 June 2000. Also see Su Kewu, “Zhonghan maoyi nicha chixu zeng-zhang de yuanyin ji duice” (The Reasons and Remedies for the Successive Increase in China’s Trade Deficit with South Korea), Dansiai yatai (Contemporary Asia-Pacific), no. 1 (2002): 57.


22 For the report on the suicides, see Zhongguo jingji shibao, 14 June 2000; and Huangqi shibao, 16 June 2000. The information on Zhu Rongji’s personal attention to the issue is from interviews in Seoul with a MOFTEC official and in Beijing with a South Korean diplomat knowledgeable about the dispute.


24 For the survey report, see Zhongguo xinxibao (China Information News), 23 August 2000.


27 See Whiting, Calculus of Deterrence, p. 202; Shih, The Spirit of Chinese Foreign Policy, chapter 5; Yan Xuetong, “Zhongguo lengzhan hou de anquan zhanlue” (China’s Post-Cold War Security Strategy) in Yan Xuetong (ed.), Zhongguo yu yatai anquan (China and Security in the Asia-Pacific; Beijing: Shishi chubanshe,
Of course, China’s war with Vietnam in 1979 stands out as a notable exception to this, although China did not seem to have exhausted its maximum belligerence.


29 For details of Article 7, see http://www.chinatoday.com/law/a07.htm.

30 *Zhongguo jingji shibao*, for instance, makes it clear that “South Korea’s justification does not stand” (hanguo de jieshi bu chengli) and that “South Korea has failed to grasp the garlic market.” See the issue of 14 June 2000.

31 See the remarks by Hu Chusheng (spokesperson for MOFTEC) that “South Korea’s unilateral adoption of restrictive measures in the absence of negotiations with China is in violation of WTO principles.” *Renmin ribao* (People’s Daily), 7 June 2000.

32 See the remark by the spokesperson of South Korea’s Ministry of Foreign Affairs and Trade at http://www.mofat.go.kr (06/06/00) and *Chosun Daily*, 9 June 2000. *Zhongguo jingji shibao* hinted that South Korea had indeed proposed a compensation scheme (importing more sesame to make up for the reduced garlic export), which the Chinese side did not accept (14 June 2000). A South Korean interviewee revealed that Seoul had used safeguard measures against China unilaterally in the past, so Beijing’s retaliation in the garlic dispute was a highly calculated move to pass along a clear warning. Interview on 4 May 2002.

33 See, for instance, Zhang Jianhua (ed.), *Jiejue zhongguo zaidu mianlin de jinyao wenti* (Resolving the Core Problems China Faces Again; Beijing: Jingji ribao chubanshe, 2000), pp. 83–86.


35 In 1999, the share of garlic exports to South Korea in China’s total garlic exports was 12.4 percent. See *Zhongguo duwai jingji maoyi nianjian 2000* (Almanac of China’s Foreign Economic Relations and Trade; Beijing: Zhongguo duwai jingji maoyi chubanshe, 2000), p. 499.

36 I was sensitized to this by a Chinese interviewee affiliated with MOFTEC.

37 Retrospectively, South Korean officials admit that their perceptions and dealings with China at the time were both naive and based on much wishful thinking. Interviews in Seoul in May 2002.


42 See *Dong-A Daily*, 17 July 2000; and *Maeil Economic News*, 31 July 2000. This newly agreed upon total volume is a little bit more than the average of China’s garlic exports to South Korea during 1997–1999. Given that Beijing had insisted the new low-tariff import quota should be based on the average of the past three
years, the Chinese side clearly had an upper hand in negotiations with their South Korean counterpart. See Dong-A Daily, 5 July 2000.

43 See, for instance, Zhonghua gongshang shibao (China Industrial and Commercial Times), 3 August 2000.


46 With regard to important issues, official documents between Seoul and Beijing were usually made in three languages – Korean, Chinese, and English. In this case, for unknown reasons, the agreement was stipulated in Korean and Chinese only. Interview in Seoul on 4 May 2002.

47 See Korea Times, 14 April 2001; Korea Herald, 23 and 25 April 2001; and Weekly Dong-A, 3 May 2001 (online at http://www.donga.com).

48 Iwata Nobuto, “Problems of Japan’s Safeguard System and Some Suggestions,” Boeki to ganzei (Trade and Customs), vol. 49, no. 12 (December 2001).


50 Whether China would have opted for an import ban as well if Japan had upgraded its remedy to the full-fledged safeguards remains a valid question.


57 See, for instance, Asahi Shimbun, 12 March 2002.
11 Globalization and transnational human capital

Overseas and returnee scholars to China

David Zweig, Chen Changgui and Stanley Rosen

Introduction

Globalization entails the increased flows of goods, capital, services and people across international borders. Numerous articles demonstrate the dramatic increase in the transnational flow of goods, capital and humanity over the past 10–15 years. Increased flows are often the result of a lowering of the “at-the-border” controls, which facilitates these increased flows. Therefore, globalization, or what Keohane and Milner call internationalization, can change the value of goods and services, as well as society’s evaluation of individual talent and skills, largely by lowering the transaction costs of global exchanges. Also, as societies undergo globalization, the demand for, and therefore the value of, various goods and services that abet globalization increases as well. This may be particularly true for developing societies that are undergoing a process of economic modernization or structural transformation.

For example, the rise of finance capital, the increased role of technology in economic development and international economic competition, and the emergence of new trade norms, may all mean that a modernizing society needs more lawyers, more financial analysts or investment bankers, or more people with cutting-edge technological skills. Also, for a society to be competitive in a globalizing world, it needs a steady inflow of new ideas and information from overseas — otherwise, it will not be able to compete.

On the other hand, since internationalization and the lowering of barriers to exchange are an ongoing process, continuing blocks to the flow of goods and services, or shortages in the domestic economy that exist during this process, mean that those people who are able to transfer goods, services or technology across the regulated borders may find large profits awaiting them. Similarly, individuals who incorporate new ideas, technologies, or information, or who offer gateways to transnational networks may find enormous opportunities if they themselves cross international borders. Thus while globalization makes flows easier, it also offers people who traverse borders opportunities to increase the value of their human capital and the rewards bestowed upon that human capital.
The focus of our chapter

This chapter presents a case study of how international forces can affect the value of individual human capital, how people with “transnational capital” – defined as the value-added accrued through overseas experiences – can utilize that value to their own advantage, and how domestic organizations and national governments try to benefit from the value-added imbued in their citizens.

Beginning in 1978, China renewed its policy of sending students and scholars overseas. Deng Xiaoping wanted to catch up to the West and these people were expected to return with new information, technology and management skills that would help China modernize. But how valuable are the people who return? The Chinese talk about going overseas to “paint a little gold” (du jing). But does their “transnational capital” indeed make them more valuable? Do organizations, the market, and the state in China reward them for this added value? In other words, does going overseas actually increase a person’s human capital, both in terms of real and perceived value? While one might assume that the answer to this question must be affirmative, it remains an empirical question that needs to be evaluated.

A second set of issues relate to the economic motivations of returnees. China’s market economy remains partially reformed, with regulations limiting the flow of technology into China, but with a growing need for many high- and medium-level technology products. The domestic demand for foreign products, skills or know-how, is particularly strong and overseas students and scholars know this. So, rather than help China expand its exports, they bring back skills and technology which are in short supply in China because of the large profits that can be earned in the domestic economy.

This paper will test hypotheses related to these two themes, drawing on several surveys carried out by the authors in 1997 and 2001. By comparing various characteristics of returned scholars with scholars or businessmen who were trained in China, we can see if there have been greater returns to the returnees. We will also seek to measure the value of a foreign Ph.D. relative to a domestic one. We will also look at whether returnees have been using technology to target the domestic, more than the international, market. Finally, we will look at how China’s entry to the WTO could affect China’s policy on returnees and their situation in China.

The historical, global and domestic context of the overseas students

Changes in the global political economy, and in China’s national and local political economy, have an enormous impact on the perceived value of returnees and the opportunities available to them, generating new incentives for them to return to China or to participate actively from overseas in China’s economic development. China’s improved relations with the
United States, its increased prominence within the global and regional economy, and the significant flow of multinational corporations and foreign direct investment into China, make it a much more inviting location for Chinese who had gone overseas to launch new business endeavours.

Particularly if one has developed new skills or global networks while living overseas, both of which are in great demand within one’s home society, individuals may find that they can have more rapid upward mobility, receive greater financial rewards, as well as increase their social status, if they return home. They may also find more fulfilling lives and a greater sense of job satisfaction.

History suggests that learning skills and technologies available overseas, but in short supply within China, greatly facilitates upward mobility. In the 1870s, a group of students was sent out by the Qing dynasty to attend schools around Hartford, Connecticut. At that time, China was undergoing a rapid and massive modernization programme, which increased the value of skills, such as engineering, which were particularly in short supply in China. As a result, many of these students became important civil servants in the fields of railroads, telegraph, customs, and coal mining when they returned to China; 17 became naval officers; one even became prime minister, all because of the skills learned overseas. In the words of LaFargue,

In all the above capacities, they were the first Chinese to follow these careers. Their technical training placed them in a different category altogether from the old-style Confucian-trained officials whose knowledge of the classics was supposed to fit them for any task that the government might command them to undertake. These newcomers were eyed with dislike and suspicion by most of the old mandarines, but the need for their knowledge gave them many opportunities to direct important enterprises.

A similar process is underway today due to China’s internationalization and engagement with the global economy. After China’s accession to the WTO, skills, such as foreign trade, international law, accounting, and international business are particularly useful. The growth of China’s high tech sector creates new opportunities for those who have developed such skills overseas. Also, a significant upgrading in the status of the private sector by the Chinese government in 1999 improved the economic environment for overseas scholars who wanted to return, but who did not want to work for the state or for state-owned enterprises (SOEs).

**Changes in Chinese government policy**

Changes in government policy and attitudes towards overseas students and scholars also contributed to a “reverse brain drain” in the early 1990s. In
1992, Deng Xiaoping’s emphasis on economic modernization increased the value of overseas scholars to the Chinese state and sparked rapid economic growth, creating a conducive economic environment for people to return. Downturns in the Western economies also pushed overseas scholars to return to China.

Deng also liberalized the policy towards returnees. In January 1992, he said that the government no longer cared what overseas students’ political attitudes had been at the time of Tiananmen. “They can all come back, and after they return things will be well arranged. This policy cannot be changed.” After 1992, returnees were no longer compelled to return to their original work unit, and family members could move to the cities where the returnees had found a job. In August 1992, a State Council notification announced new policies on passport renewal and, most importantly, allowed returnees to decide where they wanted to work.

Jiang Zemin’s role in this “reverse brain drain” should not be understated. According to one returnee, a common saying among returnees is: “For overseas study in the 1980s, people relied on Deng Xiaoping; in the 1990s, returnees relied on Jiang Zemin.” At the Fourteenth Party Congress in 1992, Jiang stated that China “warmly welcomed people who are studying overseas to use various ways to express concern, support and to participate in the motherland’s modernization.” The Third Plenum of the Fourteenth Party Congress in 1993 put out a 12-character slogan to direct overseas study: “Support overseas study, encourage people to return, and give people the freedom to come and go (lai qu ziyou).” Initially overseas scholars were sceptical of this policy – the difficulty of getting out the first time played some role in keeping people overseas. Granting people “the freedom to come and go” built confidence among prospective returnees. Finally, analysts of President Jiang Zemin’s 1 July 2001 speech on letting entrepreneurs into the Chinese Communist Party suggested that this cohort includes returnees from the United States.

In order to expand its high tech sector, the Chinese state imparts particular value to people with technological skills. Programmes such as the Changjiang Scholars Program or the “Bai ren jihua” (100 Talents Program) offer overseas scholars significant financial incentives – such as support for research labs and high salaries – which have drawn back scholars in the natural and applied sciences. Under the 100 Talents Program, returnees receive two million renminbi which they can use to supplement their own salaries, narrowing the gap between overseas and domestic salaries.

The Chinese government’s decision to create world-class universities, and its recognition that this goal could be achieved only by attracting many Chinese scholars with foreign Ph.D.s, changed the climate for returnees in academia. In the late 1990s, China granted its top universities, such as Qinghua and Beijing universities, large sums of money (1.8 billion RMB) to upgrade the quality of their schools; Zhongshan University in Guangzhou received 1.2 billion RMB with 300 million from the Ministry of Education.
and 900 million RMB from the provincial government. Under these pro-
grammes, universities must use 20 per cent of the funds to attract new talent
\((\text{rencai})\), with much of it coming from overseas, while one third is to be used
to increase current faculty salaries. Many universities now encourage their
home grown Ph.D.s to go overseas on post-doctoral fellowships, some
funded by foreign organizations, but also with domestic funds. This policy
will increase the rate of return of overseas scholars – as most of these people
already have established positions in China.

Central and local governments are addressing problems that prevent
overseas students and scholars from returning. Universities and cities have
established special schools, some of them bilingual, which accommodate the
children of returnees who often have weak Chinese language skills. Initially,
Shanghai granted long-term residence permits, a form of green card, to
returnees who wanted to keep their foreign passports, and now the central
government has followed suit. Finally, the central government has intro-
duced a much more liberal policy under the slogan of “serving the country”
\((\text{wei guo fuwu})\), where rather than insist that people “return to the country”
\((\text{hui guo fuwu})\), it accepts that people will remain overseas but encourages
them to become involved in various ways with China’s modernization.

In the early 1990s, cities such as Shenzhen, Shanghai, and Beijing com-
peted among themselves for overseas students and scholars by offering them
“preferential policies” – special car prices, free housing, and permission to
import computers and equipment. At the end of the 1990s, governments
such as Shanghai, encouraged state-owned enterprises to work harder to
attract returnees to work for them. In 2002, Guangzhou’s SOEs were trying
to recruit managers from overseas with yearly salaries of 200,000 RMB.

Due to these changes in government policy and shifts in the global and
domestic market, the number of returnees picked up significantly in the
mid-1990s, increasing annually at a rate of about 13 per cent. And the
numbers continue to grow. According to the Chinese Educational Service
Center, the number of returnees almost doubled between 2001 and 2002,
reaching close to 18,000 in 2002.\(^\text{19}\) By 2005, the number of returnees had
reached 30,000, of whom half were relatively advanced scholars or
researchers. Moreover, by combining data on the number of graduating
students and the number of returnees, Zweig estimated that in the mid-
and late-1990s, of all new job seekers in China who had just received a graduate
degree, approximately 15 per cent had earned that degree overseas.\(^\text{20}\)

**Who paid to train China’s next generation of international
scholars?**

Since the late 1970s, a new generation of Chinese scientists and entrepre-
neurs has been created both within and outside China. In the latter case, a
great deal of capital has been invested to train this cohort. But who paid for
that training? China has bitterly complained about a “brain drain,” and at
times has accused the West of stealing China’s best brains. But if the data show that overseas organizations paid for the bulk of the training, these organizations may have some legitimate claim to the fruits of that investment. Moreover, since China lacked the capital to train a new cohort of scientists, if people trained overseas are now returning, China is reaping the benefits of foreign investment that has increased the human capital implanted within China’s new scientific elite.

Data on financial support for Chinese J-1 students and scholars in the United States in the early- and mid-1980s shows that foreign universities, which wanted links with China, with Chinese scholars, and which hungered for Chinese graduate students, paid for a great deal of the costs of educating the Chinese overseas students and scholars. Moreover, the share of funds from the Chinese government decreased at an astonishing pace. Thus while the PRC government supplied 54 percent of the financial support for J-1 visa holders in 1979, the government’s share dropped dramatically to 25 percent by 1984, and in 1985 the decentralization of educational exchanges lowered the government share to only 17 percent. Most likely, pressure on the Chinese government to increase the number of people it was sending overseas led it to cut funding for scholars after their first year overseas. According to a US government policy paper aimed at Chinese officials, “the consistent under-funding of officially sponsored Chinese students forces them to seek financial assistance elsewhere, rather than continue as PRC government funded students, and thus may contribute to development of ties which encourage them to remain abroad.”

Recent data confirm this situation, and show that even “state-sponsored” scholars (gong pai) have relied a great deal on foreign funds for their education and training. A study of 1,500 state-sponsored returnees asked them who they saw as the major source of financial support for their overseas education or research. The study then reported the sources of funding for different types of “publicly sponsored” students and scholars. For example, among people who went out as “government sponsored” scholars – i.e., were selected or approved by the Ministry of Education or the State Science and Technology Commission – 62.3 percent of their funding came from the Chinese government, while 33.3 percent came from overseas agencies, such as foreign universities, or donor organizations such as the World Bank or the Ford Foundation. The second largest category of “state sponsored” students and scholars were “sponsored by their units” (danwei gong pai). This group relied primarily on overseas agencies (70 percent), while the units themselves only paid 18.7 percent of these scholars’ costs. In many cases, this may simply have been the price of a one-way air ticket overseas.

One gets a clearer picture of the source of funding for the entire 1,500 scholars by treating the total amount of funding received by these scholars as 100 percent. What we find then is that for the entire group of state-sponsored scholars, foreign agencies supplied 57.8 per cent of the funds, while the Chinese government supplied only 30 per cent. According to this
report, “although people going overseas to study as state-sponsored scholars benefited from holding the title of ‘state led,’ they still relied primarily on foreign supplied funds as their major source of funding when they were overseas.”25 Thus foreign funding paid for a great deal of the human capital internalized in this group of returnees.

The value of a domestic versus a foreign Ph.D.

A major controversy that has hounded the open policy in education is the greater value accorded to overseas Ph.D.s (yang boshi) relative to domestic Ph.D.s (tu boshi). The latter group has often felt that they have been treated unfairly and that government efforts to attract the former to return to China through “preferential policies” undervalues and disadvantages their own local degrees. Thus, in the early 1990s, when a university in central China tried to attract overseas Ph.D.s by building a “boshi lou” or Ph.D. building, which had larger flats that were to be reserved for the returnees, local faculty vetoed this idea. Sensible complaints focus on the fact that a returnee who has only recently received a foreign Ph.D. is awarded the status of being a “trainer of Ph.D.s” (bo dao) despite the fact that he or she may not have supervised any graduate students while overseas,26 while a colleague with a domestic Ph.D. degree, who has been supervising research projects for many years, is not.

But is a foreign Ph.D. actually more valuable than a domestic one? Can we verify the existence of “transnational capital” that increases one’s human capital?

To measure the value of an overseas Ph.D., relative to a domestic one, we employ a data set collected by Professor Chen Changgui in 1997, based on a survey composed by Chen, Rosen and Zweig. This database involved 183 Ph.D.s who had spent time overseas; 86 held foreign Ph.D.s, while 97 had received domestic Ph.D.s, but had gone overseas, usually for one or two years on a post-doctoral fellowship. Comparing these two groups, we find that foreign Ph.D.s often did significantly better than domestic Ph.D. holders upon their return to China.27 However, foreign Ph.D.s were significantly older than domestic Ph.D.s, which may have affected their perceived value.

Still, some might argue that it was actually length of time overseas, as compared to the source of their Ph.D. degree, that explains differences in the rewards earned in China by these two groups. So in an initial analysis of this data, we broke the entire sample of 467 returnees, which included Visiting Scholars and people with Masters degrees, into “long-term sojourners” and “short-term sojourners,” with the former having been overseas for three years or more. These two groups – long-term sojourners and overseas Ph.D.s – are highly co-related, as 75 per cent of the foreign Ph.D.s had been overseas for over three years, while only 11.3 per cent of domestic Ph.D.s had been out for over three years. Nevertheless, in the following section, we
sometimes look at which variable – nature of the Ph.D. or length of time overseas – better explains the outcomes.

Our first question is whether or not foreign Ph.D.s were promoted more rapidly than domestic Ph.D.s. In fact, foreign Ph.D.s were much more likely to be promoted soon after returning to China. But that finding may be due to the fact that people who received their Ph.D. overseas had gone out at a very low rank and, therefore, needed to be promoted after returning, while domestic Ph.D.s had been promoted after receiving their Ph.D., before going overseas. A finding that supports this conclusion is that when asked if their promotion had jumped several ranks – what the Chinese call “poge” – 59 percent of domestic Ph.D.s felt they had been rapidly promoted as compared to 36 percent of foreign Ph.D.s ($p<.03$).

Another measure of the value of the foreign degree holder would be whether or not they had switched jobs after returning to China. The hypothesis is that their “transnational capital” makes other units want them, allowing them to switch jobs more easily. Although only 12 percent of this entire cohort had changed their jobs, 17 percent of foreign Ph.D.s switched positions while only 7 percent of domestic Ph.D.s did so ($p<.03$). However, since domestic Ph.D.s were much more likely to have gone overseas with the support of their unit (danwei gong pai) (43 percent vs. 21 percent), they were more likely to return to their home unit than foreign Ph.D.s who went out mostly as “nationally sent scholars” (guojia gong pai) (67 percent vs. 43 percent), or as “self-paying” students. This gave domestic Ph.D.s stronger ties to their unit. Also, the longer time spent overseas by foreign Ph.D.s must have weakened their links to their original home unit, assuming they had one, increasing the likelihood that they would change jobs upon returning.

During their time overseas, did foreign Ph.D.s really improve the quality of their human capital more than the domestic Ph.D.s? When asked about the significance of their overseas study towards their research work, foreign Ph.D.s were more likely to choose “learned a new research methodology” (70 percent vs. 45 percent, $p<.04$) – a response that suggests the learning of a new skill – while domestic Ph.D.s were more likely to select “got to know about new research directions” (22 percent vs. 10.5 percent). Thus we can argue that foreign Ph.D.s, by internalizing the foreign knowledge, really improved their human capital.

If this deeper knowledge helped them get more funding from outside the university, schools were justified in giving them more resources, housing, and other preferential policies. In fact, foreign Ph.D.s were more likely than domestic Ph.D.s to have received a “national-level research project” (60 percent vs. 46.5 percent, though the level of significance was only .07).Foreign Ph.D.s were also more likely to get foreign grants (17 percent vs. 9 percent, $p<.098$). Foreign Ph.D.s were also more likely to use the fruits of their international exchange (guoji jiaoliu chengguo) in their teaching than domestic Ph.D.s (74 percent vs. 60 percent, $p<.04$) – again suggesting an
internalization of foreign knowledge – and they were more likely to establish new courses when they returned (79 percent vs. 66 percent). In this way, they contributed more to the internationalization of the education process and could better prepare their own students for overseas education.

Foreign Ph.D.s were more likely than domestic Ph.D.s to import foreign technology and foreign capital (17 percent vs. 8 percent, p<.06). They were almost twice as likely to import foreign information and materials (32 percent vs. 18 percent, p<.03) as domestic Ph.D.s. And, they were more likely to have established an international collaborative project (48 percent vs. 32 percent, p<.03). Nevertheless, when compared to people who had gone overseas for less than three years, domestic Ph.D.s were 8 percent more likely than short-term sojourners to establish an international collaborative project. Thus, the recent policy of encouraging domestic Ph.D.s to go overseas as post-doctoral fellows does yield positive results by helping them establish an international network. And their better training than the short-term visiting scholars also helps them establish these cooperative relationships.

Because they contributed less to their Chinese organization than foreign trained Ph.D.s, domestic Ph.D.s were disadvantaged in important ways. When asked about their main problems after returning, foreign Ph.D.s, as compared to domestic Ph.D.s, were more likely to select “adjusting to living conditions” (26 percent vs. 13 percent) and “resolving housing problems” (16 percent vs. 11 percent), while domestic Ph.D.s were more likely than foreign Ph.D.s to select “a lack of good research equipment” (43 percent vs. 28 percent). Given that 17 percent of domestic Ph.D.s chose not to respond to this question, we can argue that domestic Ph.D.s were at a significant disadvantage in terms of access to research equipment. But the data also show that if they were given equal access to equipment after returning from overseas, they could be as effective researchers as the foreign Ph.D.s.

How did these two cohorts compare their situations relative to those who had not gone overseas? Foreign Ph.D.s were more likely than domestic Ph.D.s to think that they had received more research funds than people who had never gone overseas (59 percent vs. 46 percent, p<.07). In terms of speed of promotion, 31 percent of domestic Ph.D.s, as compared to 38 percent of foreign Ph.D.s, believed they had been promoted faster than people who had not gone overseas, but this finding was not statistically significant. In housing, universities have rewarded foreign Ph.D.s more than domestic Ph.D.s, as 32 percent of the former group felt their housing was better than those who had not gone overseas, while only 19 percent of domestic Ph.D.s felt that way (p<.04).

**Economic incentives for returning**

In this section we use data from a survey carried out in five development zones – Suzhou, Guangzhou, Shanghai, Wuhan and Hangzhou – to test hypotheses about the economic incentives that motivate people to return.
Our sample includes 65 returnees and 80 domestically trained researchers working in the zones who had not been overseas. We had wanted to find a control group, composed of people who were comparable to our returnees before they went out, but doing so proved difficult. The domestically trained researchers who were much younger – half of them are under 30, while most returnees are between 31–40 – were therefore less likely to be married (with all the generational effects that accrue from these differences). Domestically trained researchers have less education than returnees – many have only a technical college (20 percent vs. 3 percent) or undergraduate degree (50 percent vs. 41.5 percent). Still, 45 percent of our returnees had only a technical college or undergraduate education when they went overseas, so differences between the groups are attributable to their overseas experience. The domestically trained researchers, as compared to the returnees, come from lower social classes, predominantly working class (30 percent vs. 18.5 percent) and peasant families (35.5 percent vs. 17), while the returnees are more likely to come from average cadre families (35 percent vs. 16 percent) or from academic families (14 percent vs. 9 percent), hence the greater chance to go overseas. Finally, the returnees were much more likely to be factory owners (lao ban) than the domestically trained researchers (63 percent vs. 15 percent), while the latter were more likely to be technicians. While the fact that returnees were more likely to own the factory is an important measure of their success, it also affects other findings, such as their level of income or ability to import technology.

Table 11.1 outlines the major differences between these two groups that were statistically significant. Not surprisingly, given their stronger international ties, returnees transfer more goods and services into China. For example, returnees in the zone were much more likely to transfer technology to China than the domestic group (48 percent vs. 21 percent). And of those in the two cohorts who imported technology (Table 11.2), returnees were much more likely to bring in the newest global technology (71 percent vs. 30 percent). They were also much more likely to bring in foreign capital (23 percent vs. 6 percent), to have helped establish international projects (31 percent vs. 10 percent), and to have brought foreign visitors to China (37 percent vs. 16 percent). Finally, their sense of having utilized their own skills (fahui zuoyong) – 32 percent of returnees chose “very well” vs. 3 percent of the domestically trained researchers – suggests that they were more able than the domestic group to put what they learned into practice. In fact, in terms of rewards, returnees received many more national-level awards than the domestically trained researchers (12 vs. 0), but the latter received the same amount of provincial awards and more municipal-level ones.

A good measure of the market’s or the government’s demand for returnees would be whether zones gave returnees more “preferential policies” in order to attract them to the zone. However, in response to various questions – such as whether their firm had received loans or tax breaks, or
help in hiring workers, finding markets, or finding office space – the differences among the two cohorts were not statistically significant. Still, 42 percent of returnees with their own businesses (17/41) did receive tax breaks from the zone; yet so did 8 of 12 of the domestically trained researchers ($p < .12$).

Similarly, for those who were not running their own firms, the differences in the level of benefits given to the two groups were not statistically significant.

Another indicator of market demand for returnees is job mobility. In our survey, 44 of 65 returnees said that they were currently working in a new unit – the result of their move to the zone. And 21 of them reported changing jobs more than once. But, the domestically trained researchers changed jobs more often. Perhaps because they were in China for the entire period,

---

**Table 11.1** Comparing returnees and domestically trained researchers in Development Zones (percentages)

<table>
<thead>
<tr>
<th></th>
<th>Returnees</th>
<th>Domestically Trained Researchers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brought in Foreign Visitors</td>
<td>36.9</td>
<td>16.3</td>
</tr>
<tr>
<td>Helped Establish International Projects</td>
<td>30.8</td>
<td>10.0</td>
</tr>
<tr>
<td>Imported Foreign Technology</td>
<td>47.7</td>
<td>21.3</td>
</tr>
<tr>
<td>Imported Foreign Capital</td>
<td>23.1</td>
<td>6.3</td>
</tr>
<tr>
<td>Perceived Level of Demand for Skills:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) very much in demand</td>
<td>23.1</td>
<td>7.5</td>
</tr>
<tr>
<td>(ii) comparatively in demand</td>
<td>47.7</td>
<td>36.3</td>
</tr>
<tr>
<td>Factory Owners (lao ban)</td>
<td>63.1</td>
<td>15</td>
</tr>
<tr>
<td>Current Job's Relationship to Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) extremely close</td>
<td>43.1</td>
<td>16.3</td>
</tr>
<tr>
<td>(ii) comparatively close</td>
<td>21.5</td>
<td>41.3</td>
</tr>
<tr>
<td>Able to Give Play to Their Skills</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(fahui zuoyong)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) very much able to</td>
<td>32.3</td>
<td>3.8</td>
</tr>
<tr>
<td>(ii) rather able to</td>
<td>49.2</td>
<td>62.5</td>
</tr>
<tr>
<td>(iii) average</td>
<td>13.8</td>
<td>30</td>
</tr>
<tr>
<td>Work Results Received Awards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) national award</td>
<td>12</td>
<td>0</td>
</tr>
<tr>
<td>(ii) provincial award</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>(iii) municipal award</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Frequency of Contact Overseas</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) daily</td>
<td>27.7</td>
<td>7.5</td>
</tr>
<tr>
<td>(ii) once a week</td>
<td>36.9</td>
<td>16.3</td>
</tr>
<tr>
<td>(iii) 2–4 times/month</td>
<td>21.5</td>
<td>10</td>
</tr>
<tr>
<td>(iv) less frequently</td>
<td>7.7</td>
<td>13.8</td>
</tr>
<tr>
<td>Difficulties in Living Situation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>remuneration too low</td>
<td>13.8</td>
<td>35.0</td>
</tr>
</tbody>
</table>


*Note:* All results are statistically significant at the .05 level or above. $N=145$. 

---
the domestically trained researchers changed jobs more frequently, whereas the returnees often came directly to the zone.

A final indicator of the value of their transnational human capital would be whether a returnee’s specialization is in short supply in China. A shortage in their field of specialization could increase their salary, or ensure that the profits they earn are well above normal market value. This point meshes with the idea that a state undergoing economic transition will reward people with skills that facilitate those changes. In our survey of returnees in a zone (Table 11.1), 25 percent of people who answered the question – “How great is the demand within China for the specialization that you learned overseas?” – said that there was “a very great shortage” (feichang jinque), while 52 percent said that their specialization is “in relatively short supply” (bijiao jinque). Among the control group, only 7.5 percent said that there was “a very great shortage” in their field of specialization, while another 36 percent said that it was “in relatively short supply.” Apparently the returnees have brought back skills needed in China. As a result, only 14 percent of returnees in the zones selected “remuneration too low” as their major problem, compared to 35 percent of the domestically trained group.

**Technology transfer and the economic motivations of returnees**

One reason returnees may not have complained about the level of remuneration was because their time overseas, and the technology that they had brought back, gave them an excellent opportunity to make money in China’s domestic economy. A key hypothesis of our study focuses on the economic motivation behind the decision to return. We believe that many
people returned to China, not to contribute to their country or even to find an export platform, but because they saw enormous economic opportunities within the domestic economy.

The flow of goods, services, information, technology and human capital from overseas had been limited for a long time. But the growth of China’s economy in the 1990s meant that this shortage, and the resulting domestic demand for foreign goods, made the experience, knowledge and human capital accrued by overseas scholars potentially very valuable. Returnees know it, and therefore seek large profits available in the domestic market.

One key strategy for earning large profits is to bring back cutting-edge technology that would have a large market in China. This technology could be used for exports, a goal advocated by the central government. But we believe that many returnees targeted the domestic market, where the technology they imported faced less competition and the demand was potentially quite great. Moreover, large profits might be possible and the technology easier to access, even if the imported technology was not globally competitive, but only competitive within China’s domestic market.

Our findings show that while most technology brought back by the returnees was world class (71 percent), 22.6 percent of people who returned to the zones brought technology that was new for China, but not at the cutting edge internationally (Table 11.2). Unless they planned to create an export market using this technology, based on China’s cheap labour, such people could only target the domestic market. Table 11.3 addresses this issue by looking at the quality of technology and the “target market.” Of the 33 cases of technology imports, only two people planned to engage in a serious amount of exports with technology that was not leading-edge internationally.

Table 11.3 Target market by quality of technology import

<table>
<thead>
<tr>
<th>Quality of Technology Import*</th>
<th>Mostly Export</th>
<th>Half Exports, Half Domestic</th>
<th>Mostly or All Domestic Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newest International Technology</td>
<td>4</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>New Technology for China</td>
<td>2</td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>Not New</td>
<td></td>
<td></td>
<td>3</td>
</tr>
</tbody>
</table>


Note: *Using Chi-square test for linear association, the difference is statistically significant at $p<.02$. 

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Instead, 80 percent of those importing technology that was not new internationally, but only new for China (8/10), planned to target the domestic market – as our hypothesis would predict. Moreover, 45 percent of people with globally competitive technology (9/20) were more interested in the domestic market than the international one, while another 35 percent (7/20) with new international technology were also eyeing the domestic market. Also, “import substitution” technology, if cheaper than foreign imports, could earn a significant market share. With 41 percent of the products or services provided by returnees replacing previously imported goods, we cannot reject this hypothesis either.

Thus, returnees do sell a large share of their products domestically. Table 11.4 shows that only 14 percent of returnees in the zones are exporting all or most of their products, while 48 percent of them are selling most of their products domestically. Another 19 percent are selling at least half of their products in the domestic market. These levels are somewhat lower than the domestically trained researchers, largely because over 22 percent of this latter group are selling only in the domestic market, while another 46 percent focus primarily on the domestic market. But while domestically trained researchers may favour the domestic market over the global one because of unfamiliarity with, or a lack of access to, more advanced technology, their local business networks are likely to be stronger than those of the returnees.

Finally, with China seeking to expand its technological capabilities, it should reward those who bring in such technology. Table 11.5, which presents self-assessments of their income by people interviewed in the zone, shows that technology importers receive greater financial rewards than people who do not engage in such activities, regardless of whether or not

<table>
<thead>
<tr>
<th>Target Market</th>
<th>Returnees</th>
<th>Domestically Trained Researchers</th>
</tr>
</thead>
<tbody>
<tr>
<td>All products exported</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Most products exported</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Half exported, half sold domestically</td>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>Most products sold domestically</td>
<td>23</td>
<td>25</td>
</tr>
<tr>
<td>All products sold domestically</td>
<td>0</td>
<td>12</td>
</tr>
<tr>
<td>No response</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>48</td>
<td>54</td>
</tr>
</tbody>
</table>


Note: Level of statistical significance is $p<.02$. $N=102$. 

Table 11.4 Target market for returnees and domestically trained researchers in Development Zones, 2001
they had studied overseas. And, since 48 percent of returnees imported technology, they benefit more from society’s and the marketplace’s willingness to reward technology importers.

Still, while importing technology may be an income-generating strategy, many of the skills returnees bring back, and the products they produce, are needed for China’s economic development. There is a nice synergy between society’s needs and the returnees’ human capital. For example, a very successful company in Shanghai, run by two returnees, created software for the power industry. While an owner of the company said that their world-class technology could be exported, their programmes were designed for the domestic market where demand was more than the firm could manage. They would think about exports five years later, but redesigning the software and developing a sales team to work overseas was not currently part of their business plan.32

**China’s entry to the WTO and its impact on returnees**

China’s entry into the WTO should have a major impact on returnees and the policies related to human capital. Because under the WTO it should become much more difficult for China to limit the outflow of human talent, the Ministry of Education was concerned that the brain drain would increase. Similarly, many talented returnees could leave their positions with Chinese firms to work in the expanding foreign sector. This trend had intensified the pressure on Chinese firms to increase their salaries, another result of joining the WTO.33

More important, the anticipated growth of foreign enterprises could increase the flow of returnees. Head-hunters in Hong Kong and Shanghai
were reporting great demand for returnees by multinational corporations and U.S. firms, with many salaries reaching two to three hundred thousand US dollars. Consulting firms, such as A. T. Kearney, moved their Asian headquarters and back offices from Hong Kong to Beijing. Many international law firms began to do the same, as under the WTO foreign law firms are allowed to open more than one office. Research centres, such as those run by Microsoft, Intel and other multinational companies, afford the Chinese a chance to return under very favourable conditions. The need for more lawyers, accountants, financial analysts and other skills necessary to help make China WTO compliant should grow as well. Returnees became well positioned to serve as go-betweens, helping foreign companies enter the domestic Chinese market. One Chinese architect who was trained in Canada anticipated that the number of foreign architectural firms would increase; but because his firm was already well established in the China market, he expected to serve as an important bridge for incoming foreign companies in the expanding architecture market in China.

**Conclusion**

Our data show that those who studied overseas, and then returned to development zones, have done rather well. Possessing new information, good technology, and rich global networks, some have set up effective companies. They are also doing well financially. But rather than return for patriotic reasons, most came home because they saw excellent opportunities in China’s rich domestic market. Also, the government’s policy of legitimizing the private sector transformed the domestic environment. But, as returnees pursue their own interests, they benefit China’s as well.

Similarly, returned academics surveyed in 1997 did quite well. Their skills, the technology they brought back, and their ability to attract more grants than people who had not gone overseas, gave them important opportunities and rewards. They contributed in important ways to the universities that employed them, suggesting that the rewards were warranted. Moreover, even though going overseas for post-doctoral fellowships has helped domestic Ph.D.s establish global networks, returnees with foreign trained Ph.D.s substantially increased their human capital and internalized their overseas training, creating much more “transnational capital,” an outcome that justified their preferential treatment.

How great an asset are these people to China? In part, the market will determine their true value. University salaries are moving in their favour. However, an inflated sense of their own contributions, and the resentment generated by the greater benefits that accrue to their enhanced human capital, may distort their role and limit their utility to Chinese society. But, as their numbers continue to increase, the added value of each returnee may decline, and, with it, the hostility that their return has generated.
Returnees became more prominent among China’s governing elite in 2002. The new minister of Education, Zhou Ji, was the first minister with a foreign Ph.D. (SUNY-Buffalo). Several other key ministers and State Councillors had been overseas as visiting scholars to the U.S., Canada and Sweden in the 1980s and thereafter had moved up the political hierarchy. In fact, 20 full and alternate members of the 16th Central Committee had educational and/or work experiences in the West or Japan. While the upper echelons of the Communist Party may remain beyond their reach – and their role in democratizing the Chinese polity is likely to remain limited – by 2010 the cohort of returned scholars will emerge in more powerful technocratic posts.

While for many years, the Chinese government expressed anger about the brain drain and Western efforts to perpetrate a “brain theft,” China contributed to this problem by under-financing its overseas scholars. Short of cash, China passed the cost of training its next generation of scientists onto the West, with the result that many established the types of ties that helped them stay overseas. Now, at the beginning of the 21st century, many of those people, trained with foreign funds and imbued with foreign knowledge, are returning, and the direct and indirect economic benefits are considerable. China is set to reap large rewards from its policy of letting the best go abroad, much as Deng Xiaoping hoped would be the case when he encouraged overseas study at the onset of the reform movement.

Notes

1 Funding for this research was provided by the Research Grants Council of Hong Kong and the Social Science and Humanities Research Council of Canada. Research assistance was provided by Lou Shaoling and Gao Yanling. Data analysis was done by Dr Chung Siu Fung.


3 While most analysts of globalization believe that international forces have circumvented the government, Keohane and Milner and much of the IPE literature believe that domestic structures, and particularly governments, play a critical intervening role in managing the impact of global forces. Jeffrey A. Frieden and Ronald Rogowski, “The Impact of the International Economy on National Policies: An Analytical Overview,” in Keohane and Milner (eds), Internationalization and Domestic Politics, pp. 25–47.

4 According to Hayhoe and Sun, people who returned were granted a type of added value that may have far exceeded their true value to society or their unit. Ruth Hayhoe and Sun Yilin, “China’s Scholars Returned from Abroad: A View From Shanghai, Parts One and Two,” China Exchange News, vol. 17, nos. 3–4 (September–December 1989).


7 LaFargue, *China’s First Hundred*, p. 65.


11 “Guanyu zaiwai liuxue renyuan youguan wenti de tongzhi” (Notification on Related Questions Concerning Scholars Overseas) cited in Jiao, “Pengbo fazhan” (Flourishing Development), p. 73.

12 Interview in Shanghai, RSAQ, 3 April 2002.

13 Jiao, “Pengbo fazhan” (Flourishing Development), p. 72.

14 Jiao, “Pengbo fazhan” (Flourishing Development), p. 72.

15 See David Zweig and Changgui Chen (with Stanley Rosen), *China’s Brain Drain to the United States: The Views of Overseas Students and Scholars in the 1990s* (Berkeley: Institute for East Asian Studies, 1995), p. 133.


18 Interview, Changchun, November 2002.

19 Personal communication from Richard Stites, 13 April 2003.


21 In the early and mid-1980s, Visiting Scholars and students sent out by the Ministry of Education would have received J-1 visas. Under such a visa, the visitor had to return to China at the end of their time in the U.S. and could not apply directly for a job. But they could have an 18-month training programme.

Issue Paper, “Student Funding.” May 1987. This paper was probably prepared for the visit of He Dongchang in 1987. We would like to thank the Committee on Scholarly Communication with China in Washington, D.C., which gave us access to their files.

This category was expanded in the late 1980s in order to help units in China maintain closer links with their employees. Under this category, the employee and their family receive many social benefits from the unit, such as housing, healthcare and education.

Comments by Professor Chen Changgui.

See “Zhaolai nuxu qizou erzi – tu yang boshi man hua ‘tu’ yang” (Gaining a Son-In-Law Only to Have the Son Walk Off in Anger – Casual Comments about Domestic and Foreign Ph.D.s), online. Available at http://www.wenxuecity.com, 28 February 2002. Thanks to Wei Liang for finding this article.

We report mostly cases where the level of significance was .05 or lower, but due to the smaller sample size, we also report values of .08 or less. Significance tests with such scores suggest that the differences that we find between these two groups are unlikely to have happened randomly.

This survey was done in 1997, before the Changjiang Scholars Program and the “Hundred Talents Program” (*bai ren jihua*) were as widely implemented. These programmes, which have brought back many very talented professionals, could increase the gap between the foreign and domestic Ph.D.s.

When the group was divided only on time overseas, the findings were significant and the differences far greater, as 48 percent of long-term sojourners versus 27 percent of short-term sojourners thought they had been promoted faster.

Many “domestically linked firms” (*neilian qiye*) moved to Export Processing Zones because of the cheaper transaction costs, not because they wanted to engage in export-processing. See Zweig, *Internationalizing China*, chapter 2.

Interview in Shanghai with a returnee, April 2002.


One returnee in the Microsoft Research Center in Beijing, who had worked for Microsoft in Seattle, had been unable to convince his wife to return. Her views changed completely, however, once they received foreign passports and foreign living privileges.

Interview in Shanghai, April 2002.

We recognize that we have not sought people whose enterprise failed and therefore would not be found in the zone. But people who fail do not want to be interviewed. In fact, according to one report, 20 percent of start-up companies run by returnees fail within the first year, another 70 percent just make ends meet, while only 10 percent continue to grow rapidly. See Ming Ru, “Zhongguo liuxuesheng chuxian huiguo chao?” (Is a Wave of Chinese Scholars Returning from Overseas Emerging?), *Qianxiao yuekan* (*Qianxiao Monthly, Hong Kong*), no. 3, 2002, pp. 92–93.

In 2001, a backlash emerged against returnees, particularly in the financial sector. See “Zixing ‘haigui pai’ yu ‘bentu pai’ de duibi” (Compare the Overseas Returnee Faction and the Local Faction), in Zhongguo qingnian yanjiu (*Research on Chinese Youth*), no. 2 (March 2001), pp. 4–12.

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