ASIA-PACIFIC JOURNAL

DECEMBER 2002
ISSUE No. 7

Bonded Labour in Pakistan: Directions for National Policy and Action

A Ercelawn, Karamat Ali and M Nauman
Pakistan Institute of Labour Education & Research (PILER), Karachi

Impacts of Trade liberalization under the Agreement on Agriculture (AoA) of the World Trade Organization A Case Study of Rice-

Rural Reconstruction and Friends Alumni (RRFA)

From Beijing Consensus to Washington Consensus: China's Journey to Liberalization and Globalization

Kavaljit Singh

The Cancun Agenda: Expanding Globalization through the WTO

Jennifer T. del Rosario-Malonzo
Research Department
IBON Foundation, Inc.

JOURNAL OF THE ASIA-PACIFIC RESEARCH NETWORK

From Beijing Consensus to Washington Consensus: China's Journey to Liberalization and Globalization

Kavaljit Singh

There is a strong tendency among many commentators and analysts to equate China's liberalization with neoliberal Washington Consensus based on rapid privatization, deregulation and globalization. However, it would be erroneous to equate Chinese journey to economic reforms with Washington Consensus because the country followed a completely different route to economic reforms than the one adopted by several third world countries, such as former Soviet Union and Eastern Europe in the eighties and the nineties. Economic reforms in China were not in the form of 'shock therapy' injected by the international financial institutions or experts from Harvard. Chinese economic reforms were homegrown and the authorities had complete control over the contents, timing and phasing of the reform program. The Chinese journey to economic reforms has been different in the following ways.

Firstly, China launched economic reforms in 1978 on the achievements of the earlier regime. Before launching economic liberalization, the country removed poverty in a massive way. Some of important social indicators in China (for instance, education and health) were very high before the liberalization regime. Thus, the liberalized regime was not built overnight by completely dismantling the older regime. Instead, the new regime was built on the legacies of the older regime. Whereas we have seen in the case of several third world countries and Eastern Europe how the new market regime was installed by destroying the earlier state-centered regime.

Secondly, the need for economic liberalization in China was different from other developing countries. For instance, India, Pakistan and Brazil launched economic reforms when their economies were faced with serious one or other type of economic and financial crises (balance-of-payment, debt, or currency crisis). In the case of China, one does not find any financial crisis forcing the country to open up its economy. China faced none of such crises when it launched reforms in 1978. Rather, the Chinese political leadership on its own launched economic reforms, as it was dissatisfied with the slow pace of growth and lack of modernization in the economy. As a result, one finds that there is wider domestic support to economic reforms in China. The kind of domestic ownership to the economic reform program that exist in China is not visible in any other developing country including India. For this reason, one also finds that international financial institutions such as the IMF and World Bank or experts from Harvard had no say in the content, speed and overall direction of economic reforms in China. This puts China's economic reforms in a completely different position vis-à-vis other developing countries where the role of such financial institutions and foreign governments, which control these institutions, in dictating the content and speed of economic reforms has been very evident.

Thirdly, China followed a sequential approach to economic liberalization rather than a blanket approach. Economic reforms were introduced in phases: first in the agricultural sec or, then in foreign trade and investment sectors and then in industry. The financial sector has remained under the control of the state and very limited liberalization of the financial markets has taken place till now. Thanks to the controls on capital account and non-convertibility of its currency, the contagion effects of East Asian financial crisis that hit the entire region in 1997 did not affect China. This is an important lesson to be learnt from China about the limited and gradual approach towards deregulation and globalization of financial sector because the country has been able to insulate its economy from international speculative financial flows.

Fourthly, economic liberalization program in China were not introduced throughout the country. The reforms were introduced on local experiment basis only in limited areas. For instance, investment, tax and foreign exchange regimes were restricted to a few special economic zones (SEZs) situated in the coastal and eastern regions. Based on the successful outcomes of these experiments, such zones were extended to more areas later on.

Fifthly, unlike Russia and Eastern European countries where public enterprises were sold overnight at throwaway prices with no regulatory framework and as a result "mafia capitalism" developed in these countries, China followed a different route to deal with state-owned enterprises (SOEs). Instead of privatizing SOEs on a massive scale, the Chinese authorities exposed these units to more competition through town and village enterprises

(TVEs), owned collectively by villages and townships. It is important to emphasize here that all these developments took place within the appropriate legal and regulatory framework to ensure that competition is promoted and monopolistic tendencies are curbed. This policy not only helped in introducing competition in the domestic economy but also in containing the political resistance against introducing private property rights.

There are several misconceptions regarding foreign direct investment (FDI) in China. Undoubtedly, China has been on top of the list for several years as far as the total amount of FDI flows to the developing countries is concerned. However, unlike other countries of the developing world where investments by TNCs and giant conglomerates constitute the FDI, China has witnessed a different kind of FDI in terms of ownership, composition and nature of investments. More than three-fourth of total FDI to China in the initial years of economic liberalization has come from overseas Chinese, located in Hong Kong and Taiwan.

The overseas Chinese relocated labor-intensive industries from Hong Kong and Taiwan to the special economic zones (SEZs) in China. They not only brought in capital but also technology, marketing skills and trading experience. They took advantage of cheap labor, natural resources and locational advantages offered by China to cater to their export markets. Although the share of overseas Chinese in total FDI flows has declined in recent years yet it accounts for over 50 per cent of the total flows.

Bulk of FDI is in the form of greenfield investments. Cross-border mergers and acquisitions (M&A) account for just 6 per cent of total FDI flows. The substantial portion of FDI is in terms of joint ventures between foreign and domestic investors. Since government-owned banks in China were prohibited from lending to private firms, the domestic private sector joined hands with foreign investors to attract capital. The presence of TNCs with 100 percent subsidiaries is quite limited.

One popular misconception about economic liberalization program in China is that total freedom has been given to foreign investors. China granted freedom to foreign investors only in the SEZs in the coastal regions. In the rest of the country, severe regulations were imposed so that foreign investors conform to overall developmental goals. Restrictions on the inflows and outflows of capital, performance requirements and geographical limits were imposed on foreign investors.

It is also important to emphasize here that FDI and other forms of foreign investments in China have supplemented the domestic savings and investments. The annual FDI flows are in the range of $40 billion, about 4 per cent of the GDP The saving rates have remained quite high in China. Particularly after the post-liberalization period, saving rates have

increased rapidly, from 35 per cent of the GDP in 1979 to 44 per cent in the late 1990s. China's saving rates stand next to Singapore in the world. The domestic investment rate is also very high in China, above 35 per cent of GDP This is not an insignificant achievement given the fact that the domestic saving rates in former USSR, Eastern Europe and other emerging markets declined substantially after the onset of economic liberalization.

All these facts point out that China followed a completely different route to economic liberalization which could be termed as "Beijing Consensus" rather than "Washington Consensus"

However, despite such remarkable achievements vis-à-vis other emerging markets, China is facing a multitude of problems thanks to the liberalization program. The foremost concern is the growing disparity which exists at various levels. Since bulk of investment is concentrated in eastern and southern coastal belts of China, regional disparity has widened. The rich coastal regions are no match to the impoverished central and western regions.

Income disparities between the rich and the poor Chinese are also on the rise. According to official figures, the annual income of urban residents grew by 8.5 per cent in 2001 or nearly 6900 yuan ($835), but rural incomes registered only an increase of 4.2 per cent or roughly 2400 yuan ($290). According to some observers, the gap between the rich and the poor Chinese is nowadays wider than what it was in 1949 when the communists came to power.

Unemployment in rural areas is rising and as a result some 115 million migrant workers are seeking jobs in booming cities in the coastal region. Similarly in the urban areas, the number of workers retrenched by State Owned Enterprises (SOEs) is also on the rise. According to government figures, over 25 million people were laid off by the state enterprises between 1998 and 2001 Another 10 million workers are expected to be retrenched in the coming years. Majority of job losses are in hospitals, schools and farms, which were set up by SOEs to provide services to their employees. Consequently, the social security services are under increased stress.

The urban unemployment rate in 2001 was closer to 10 per cent. With China's accession to the WTO, further large-scale retrenchment is expected. Even the social security program launched in 1997 to provide a basic living allowance to the urban residents who lost their jobs due to economic restructuring has failed to provide adequate safety net. The average national basic living allowance of $18 is too meager to guarantee minimum living standards for the urban poor The growing unemployment and shrinkage of social and

welfare schemes could unleash massive protests by poor people in both rural and urban areas with wider social and political consequences in the near future.

China is beset with massive capital flight. The claim that a substantial amount of foreign investment in China is "round tripping" (that is, money going from the mainland and coming back to coastal regions to get tax and other concessions) cannot be overlooked.

Besides, environmental questions, particularly air and water pollution, are not being given due attention.

Undeniably, in some sectors, particularly manufacturing, China is poised to make gains by its entry into the WTO. But this would also pose new challenges to the Chinese authorities. The major implication of China's entry into the WTO is that the country would have to depart from "Beijing Consensus" in a big way. Instead of steering economic liberalization on its own pace, the leadership would have to adjust to one-size-fits-all strategy. The earlier strategy of experimentation in selected areas has to be replaced by well-defined time-tables covering almost every sector of the economy.

Given such a drastic shift in China's developmental strategy in such a short time span, the big question remains. Why China was so keen to join the WTO? In my view, there were several reasons that pushed China to join the WTO but the most important one is that the Chinese political leadership wanted to lock in the economic liberalization program.

The other significant reason has to do with the emergence of new upper and affluent classes which are very keen to integrate with the global economy whatever be the costs. In the last one decade, China has witnessed the emergence of a new generation of Chinese elite, also known as *Taizidang*. Mostly educated abroad and having substantial business interests at home, *Taizidangs* have developed substantial clout in the management of country's economic and political affairs. The vision of *Taizidangs* has nothing to do with the earlier political leadership that created an egalitarian society.

Economic reforms, however, do not exist in vacuum. The Chinese leadership cannot remain oblivious to the fact that economic reforms would sooner or later pave the way for political reforms. Is the Chinese leadership prepared for it?