

China and the WTO: The Coming Collapse?*

Gordon Chang's *Coming Collapse of China* holds that China's entry into the World Trade Organization (WTO) could trigger a political crisis that will lead to the collapse of the current regime. He posits that the first signs of this are already apparent in the wrenching restructuring of the past few years, as rapidly increasing imports have forced inefficient firms to cut jobs, sending the number of jobless rising to levels unprecedented in recent decades.

Unemployment is sure to rise even higher as China implements its WTO commitments to further open its domestic market. Chang and others believe that this, combined with endemic corruption and rapidly rising income inequality, makes it only a matter of time before the regime's position comes under threat. Such predictions are reinforced by claims that the Chinese economy has already been in a severe slump for the past four years, with the real rise in gross domestic product (GDP) only a fraction of the 7 percent-plus a year claimed by the authorities.

Beijing has contributed to outside suspicions of its official data on economic growth by not disclosing how it adjusts what are clearly exaggerated numbers passed up by the Chinese provinces. While the national

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statistical authority does knock at least a couple of percentage points off the unrealistic claims of growth it receives from the provinces, it is questionable if this is enough.

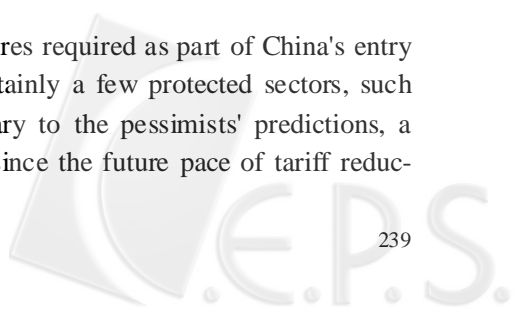
But before swallowing forecasts of a looming crisis due to a collapse in economic growth, it is worth checking the official claims against economic variables that are easier to measure than GDP and for which there is no incentive to exaggerate. For example, official figures show that Chinese imports rose 70 percent between 1997 and 2001. These figures are very unlikely to be overstated because the customs service, which compiles China's trade data, has to turn over tariff revenue on imports to the Ministry of Finance.

Although tariff reductions reduced the price of imports relative to domestic goods during that period, these reductions were relatively modest and unlikely to explain more than a fifth of the growth of imports. Since the value of the Chinese currency is now about the same as in 1997, the most plausible explanation for the rest of the growth in imports is an expansion in GDP.

Another eyeball check on the plausibility of official growth claims is the expansion of government revenue. This too is unlikely to be exaggerated since the government is hard-pressed to meet growing demands for social services, including unemployment compensation and severance payments for workers laid off from state-owned companies, mitigating environmental deterioration, and financing military modernization.

Reported government revenues in 2001 were 90 percent more than in 1997. In all economies, when growth declines sharply, an even greater slowdown in the growth of tax revenue is almost inevitable as corporate profitability slumps and personal incomes and consumption stagnate. The claim that Chinese economic growth has slumped badly over the past four years is difficult to reconcile with the backdrop of such robust growth in tax revenues.

Will the market-opening measures required as part of China's entry into WTO spark a jobs crisis? Certainly a few protected sectors, such as banking, will suffer. But contrary to the pessimists' predictions, a more general crisis seems unlikely since the future pace of tariff reduc-



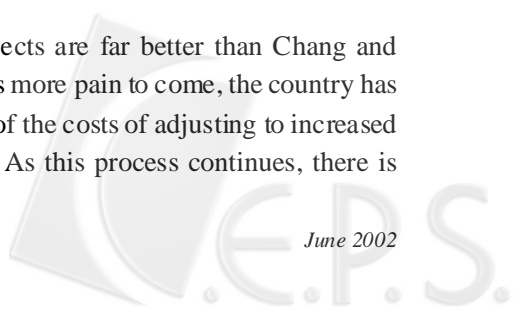
tion will be lower than during the past decade. By the time China entered the WTO late last year, it had already cut its average tariff rate by more than three-quarters from the peak level of 1982. It is a similar picture with non-tariff barriers. Nine-tenths of the import quotas and licensing requirements that existed in the early 1990s had already been eliminated prior to WTO entry.

Significant competition already exists within the domestic market where foreign firms with access to Western technology, machinery, and management now produce a fifth of all manufactured goods. That is similar to the share foreign firms have of the market for manufactured goods in the United States, where there are few restrictions on foreign ownership.

There are signs that the growing role of market forces and increased competition has led to economic restructuring. Employment in the state sector fell by 34 million, almost a third, in the last four years. Many state-owned firms have been privatized and the private sector has become the major source of new jobs. Wasteful inventory accumulation, reflecting the old priority of maintaining growth in output and employment regardless of the effect on the bottom line, is down sharply. Profitability in the shrunken state sector has actually increased in the past three years, reversing a twenty-year slide.

The picture is not all good news. Much depends on the openness of foreign markets since China's adjustment process requires not only a shrinkage of inefficient sectors but an expansion of sectors in which the country is internationally competitive, notably labor-intensive manufacturing and high-value agricultural products such as fruits and vegetables. If world markets are not prepared to absorb significant increases in Chinese goods, then China's leaders may feel forced to slow the growth of imports into their own markets rather than allow unemployment to rise to politically unacceptable levels.

That caveat aside, China's prospects are far better than Chang and other pessimists believe. While there is more pain to come, the country has already absorbed a substantial portion of the costs of adjusting to increased competition in its domestic markets. As this process continues, there is



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a good prospect of the burgeoning private sector creating enough jobs to compensate for layoffs by state-owned enterprises—and leaving the pessimists who predicted mass unemployment and a political crisis scrambling to find something else to worry about instead.

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