

**Government-Industry Relations After Decentralisation:
From The Five-Year Plan To The World Trade Organisation**

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SUMMARY

A decentralisation of autonomy to firms in the urban sector of China was carried out from the late 1970s in a gradualist or experimental manner to ensure a “reform without losers”. Both line ministries and local governments were “early winners” who became in favour of the status quo. A meaningful economic reform stopped by the end of the 1980s. The 1990s was spent fixing the political, economic and social damages caused by the reform. A series of efforts have been implemented by the central government to “get the economy back to plan” since the mid-1990s. The relationship between government and industry was dancing at the tune of two-step forward and one-step backward.

China’s entry into the World Trade Organisation (WTO) was an opportune move to reap the fruits of the reforms. On the threshold of opening up its foreign trade regime, the central state reclaimed its authority as final decision makers, although the local authorities had been the “driving forces in the process”. A comparative analysis of sector-specific government-industry relations since the Five Year Plan (FYP) reveals a tendency on the part of the industry to “drag its feet” throughout China’s WTO negotiations.

This dissertation has developed a “ministry-sector horse trading” model to understand China’s trade concession for entering the WTO. The three independent variables are government-industry relations, sectoral competitiveness and market structure. The negotiators refused to give concessions on “high stake” sectors where the economic bureaucracies have high incentives to develop the industries; on uncompetitive sectors due to their loss-aversion tendency to minimise domestic political, economic and social damages; and on concentrated sectors for the presence of unified pressure from the enterprises. To maximise gains, negotiators tend to fight hard for “high stake”, uncompetitive and high concentration sectors, but easily back down on “low stake”, competitive and low concentration sectors. A horse-

trading strategy was adopted by negotiators after weighing the three indicators. That explains the dependent variables of huge concession on the agricultural and textile industries, but little concession on the banking, telecommunications and automobile sectors.

As a consequence, the WTO negotiation outcome was “efficiency-reducing”. It allowed the economic bureaucracies some time to decide if they were willing to give up their control of “high stake” sectors, impose great adjustment costs on sectors that were internationally competitive, and protect monopolistic profits of concentrated sectors. The “efficiency-reducing trade concession” challenges the common belief that China’s WTO accession would have a huge positive impact on the country’s marketisation reform.

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LIST OF ABBREVIATIONS

ABC	Agricultural Bank of China
ADB	China Agricultural Development Bank
BOC	Bank of China
CBC	Construction Bank of China
CBRC	China Banking Regulatory Commission
CDB	China Development Bank
CEWC	Central Enterprise Working Commission
CFO	Commission on Filipino Overseas
CHINASILK	China National Silk Import and Export Corporation
CNAIC	China National Automotive Industry Cooperation
CNAIF	China National Automotive Industry Federation
CNHTC	China National Heavy-duty Truck Corporation
CNPTAC	China National Postal and Telecommunications Appliance Corporation
CNTC	China National Textile Council
CSIC	China Silk Industrial Corporation
CSCDRC	China's State Council Development Research Center
DFM	Dong Feng Motors;
FAW	First Automotive Works
HRS	Household Responsibility System
ICBC	Industrial and Commercial Bank of China
IEB	China Import & Export Bank
IMF	House Bill
MEI	Ministry of Electronic Industries
MEP	Ministry of Electric Power
MFA	Multi-fiber Agreement
MII	Ministry of Information Industry
MMB	Ministry of Machine Building
MMBEI	Ministry of Machine Building and Electronics Industries
MMI	Ministry of Machinery Industry
MOA	Ministry of Agriculture
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOFERT	Ministry of Foreign Economic Relations and Trade
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
MOR	Ministry of Railway
MPT	Ministry of Post and Telecommunications
MRFT	Ministry of Radio, Film, and Television
MTI	Ministry of Textile Industry
NDRC	National Development and Reform Commission
NPLs	Non-performing Loans
PBOC	People's Bank of China
PTB	Post and Telecommunications Bureau
SAGR	State Administration for Grain Reserves
SAIC	Shanghai Automotive Industry Corporation
SASAC	State-owned Assets Supervision and Administration Commission
SBC	State Bureau of Commerce
SBAI	State Bureau of Automobile Industry
SBMBI	State Bureau of Machine Building Industry
SBT	State Bureau of Textile

SDPC	State Development and Planning Commission
SETC	State Economy and Trade Commission
SOEs	State-owned enterprises
SPC	State Planning Commission
SRRC	State Radio Regulation Commission
TVEs	Township and Village Enterprises

Chapter 1: China's Entry into the World Trade Organisation

Financial market, agriculture, telecommunications, and automobile were the sectors on which we would not give concessions to the counterpart during the negotiation of WTO membership. China's automobile industry was the most protected sector. They imposed significant pressure on the negotiators.

-----Long Yongtu (2005: 24)

1.1 Introduction

The People's Republic of China officially entered the World Trade Organization (WTO) in December 2001. It took 15 years for China to conclude the negotiations on its accession. Mr. Long Yongtu, chief negotiator of the Chinese WTO negotiation team, provided us with a rough picture of the government stance towards trade negotiation. But he also provided some misleading information. Although the government was supposed to protect the agricultural sector from competition after trade liberalisation, the effort to protect it was much less than those for banking or telecommunications services. The bilateral negotiation between China and the United States ended up with the sacrificing of the Chinese agricultural sector for an early conclusion of other issues. Thus, the trade concession which is the dependent variable of the study should be understood clearly.

In China's "big bang" trade liberalisation, all sectors were supposed to give certain but varying concessions. Negotiators adopted a "horse trading" strategy by protecting some industries while giving up the others. Accordingly, the concession was relatively little in the former sectors but huge in the latter. The definition of concession in this thesis is consistent with de Dreu *et al.*'s (1995: 119) argument that

a competitive industry that seeks to maximise gains regards the decreases in their gains as concession, while an uncompetitive industry that seeks to minimise losses regards the increases in their losses as concession.

This thesis selects five industries, namely, agriculture, textile and clothing, automobile, telecommunications services and banking, for the purpose of observing the variations of the dependent variable. These five sectors were among the final seven issues in Sino-American negotiation for China's WTO accession. These issues were put aside to the year 1999, as no party was willing to accept the counterpart's offer. However, they had to make further concession to break the deadlock for the purpose of sealing the deal by the end of that year.

1.2 The Central Argument

This thesis has developed a "ministry-sector horse trading" model to understand China's choice of trade concessions for entering the WTO. The three independent variables are government-industry relations, sectoral competitiveness and market structure. The negotiators refused to give concessions to their foreign counterparts in first, "high stake" sectors where the economic bureaucracies have high incentives to develop the industries; second, uncompetitive sectors due to their loss-aversion mindset of minimising domestic political, economic and social damages; and third, concentrated sectors for the presence of unified pressure from the enterprises. To maximise domestic support, negotiators tend to fight hard for "high stake", uncompetitive and high concentration sectors, but easily back down in "low stake", competitive and low concentration sectors. A horse-trading strategy was developed between negotiators through weighing the three indicators. That explains the

dependent variables of huge concessions on agricultural and textile industries, but little concessions in banking, telecommunications and automobile sectors.

The independent variables of sectoral competitiveness and market structure have been widely discussed in the literature of international political economy. This dissertation is different from prior efforts in its incorporation of these variables into its model that includes the discussion of government-industry relationship. Government-industry relations are essential to the understanding of the various foot-dragging efforts of economic ministries in the central government during the process of trade liberalisation negotiation. The central government's decision to grant autonomy to firms during the decentralisation process casts a doubt on the convergence of sectoral and bureaucratic interests. The devolution has been successful in some sectors like textile industry, but not in others like telecommunications services. Accordingly, the relation between the government and industry is sector-specific. A close relationship implies that the government has strong incentives to work for the benefit of its subordinate industry. A loose relationship on the other hand implies that the government's decision is primarily driven by its bureaucratic interests that are not necessarily beneficial to the industry.

During the Sino-American negotiation on China's WTO accession, the Ministry of Information Industry, Ministry of Finance, and State Planning Commission (SPC) had strongly opposed the liberalising of trade in their respective subordinate industries, namely telecommunications services, banking services and automobile sector. The two ministries and SPC were closely related to the industries that were not willing to join the WTO. On the other hand, the Ministry of Agriculture had exerted much less effort in protecting its sector as the ministry had little control over household production; the sector had seen more challenges than opportunities after

trade liberalisation. In another case, the State Bureau of Textile, which has kept a loose relationship with the textile and clothing industry, did not fight hard to lift US quota on Chinese products during the bilateral negotiation; this was inspite of the fact that the industry was eager to join the WTO for the bigger market it offered.

As a consequence, the WTO negotiation outcome was “efficiency-reducing”. It allowed the economic bureaucracies some time to decide if they were willing to give up their control of “high stake” sectors, impose great adjustment costs on sectors that were internationally competitive, and protect monopolistic profits of concentrated sectors. The “efficiency-reducing trade concession” challenges the common belief that China’s WTO accession would have a huge positive impact on the country’s marketisation reform.

1.3 Significance of the Issue

1.3.1 Theoretical Significances

Structural force is fundamentally important to the study of international relations (IR) theories, including international political economy (Waltz, 1959; Axelrod and Keohane, 1985; Wendt, 1992; Gilpin, 1987). Polanyi (1944) reminds us of the state’s resistance towards the transformation of global market integration. The New Political Economy has prompted an understanding of the state as “the new hierarchies of the global economy cut across national boundaries” (Gamble *et al.*, 1996: 10). In a more specific issue like the negotiation of trade liberalisation, Putnam’s (1988) “two-level games” leads us to open up the country’s black box of the country as a unitary decision maker (also see Evans, 1993).

The focus of the literature on contemporary Chinese politics has been changing from leadership of the government to leadership of the society. Most China specialists

admit that Mao Zedong and Deng Xiaoping made almost all of the “big decision(s)” during their respective terms (Barnett, 1985: 7; Bachman, 1986). However, political reforms in the last three decades had witnessed a change of focus from elite factions towards bureaucratic politics (Unger ed., 2002). Lieberthal and Oksenberg’s (1988) “fragmented authoritarianism” snapshots the evolving relationship between leaders and government (also see Lieberthal and Lampton eds., 1992). The influence of the bureaucracy was on the rise (Teiwes, 1995: 21; Paltiel, 2001; Lin, 2004a). Although state leaders, like Jiang Zeming and Hu Jintao still make the ultimate decisions (Swaine, 1995: 3; Fewsmith, 1999; Groombridge, 2000: 183; Goldstein, 2001: 837-8; Breslin, 2005), the emerging technocrat-style bureaucracy has become an indispensable force in the decision making of economic policies.

In the specific issue of China’s trade liberalisation, Political scientists concentrated on the studies of the leadership and bureaucratic interests that influenced the process of China’s WTO accession (Satchit, 1999; Pearson, 2000; Lai, 2001; Sheng, 2002; Liang, 2002; Zeng, 2004; Zeng ed., 2007). However, scholars who emphasised the role of leadership found it difficult to explain Why the Chinese government reneged on the trading offer immediately after chief negotiator Long Yongtu concluded the negotiation with the United States in 1997 (Pearson, 2000: 343) and why Zhu Rongji’s offer in April 1999 brought him serious criticism among the ministries. While the scholars who noticed the importance of bureaucratic interests could not easily answer how the leaders managed to return to the negotiation table and conclude the deal with their US counterparts in the same year that they were under harsh domestic backlash.

On the other hand, economists analysed the same process through the understanding of comparative advantage and market structure of the Chinese

economy (Bach et al., 1996; Anderson, 1997; Wang, 1999b; Chen and Feng, 2000: 324; Wu, 2001; Lardy, 2002; Chen, 2002a). However, that is confusing as we realise that concession was made in both competitive and uncompetitive sectors, where the former is textile industry and the latter is agricultural industry. The analysis on market structure is also misleading, as the concession was made on textile industry but not on automobile industry, both of which were relatively low concentrated.

Besides, there is a lack of communication between political scientists and economists. Some analyses of political economy incorporated the two explanations by simply assuming that bureaucratic and sectoral interests are identical (Wang, 1999a: 43; Pearson, 2000: 350-2, 361; Liang, 2002; 717; Lawrence, 2008: 163-4). However, validity of such an assumption is questionable. We may get some clues from emerging literature on government-industry relations of contemporary China, like developmental state (White, 1988; Breslin, 1996; Xia, 2000) or regulatory state (Yang, 2004; Deans, 2004). But the two theories are hardly applicable to this issue as they did not treat the relationship as sector-specific (see Chapter 2 for an extensive review of the literature on government-industry relations). Studies on government-industry relations in individual sectors like Mueller (1998) on telecommunications sector or Harwit (2001) on automobile sector did not provide us with satisfactory answers because of a lack of comparative perspective. This “tiny” difference among sectors becomes huge when negotiators are not willing to make any concession and have to resort to “horse trading” to break the deadlock.

This thesis contributes to the literature in a number of ways. It identifies some key variables of domestic causes to trade liberalisation and fills a void by developing a comparative perspective of government-industry relations across sectors in a single country. The theoretical framework helps us understand the “big bang” trade

liberalisation of post-socialist states during their transition of marketisation. Especially applicable to China, the thesis captures the dynamics of the state's withdrawal from the economy through market-oriented reform. It compares the relations between governments—at both central and local levels—and industries across different sectors and different time periods. It provides a supplementary understanding to the evolution of a developmental state or regulatory state.

1.3.2 Empirical Significances

The study of government-industry relations on the threshold of trade liberalisation throws light on the underlining lyrics sang by Chinese leaders and the government at the negotiation. Top leaders were pushing for an early conclusion of WTO accession, while economic ministries with vested interest in their subordinate industries were reluctant to make concessions. What is more significant is the discovery that the government intended to comply with WTO commitment after its accession, regardless of its capability of doing so. According to Elizabeth C. Economy's (Yu *et al.*, 2003: 16-7) observation, there were a number of bureaucratic actors that attempted to block China's GATT/WTO accession; and when China became a WTO member, "these same bureaucracies are rising up and trying to put up bureaucratic blockades to the actual implementation of China's WTO commitments". The thesis explains and highlights the agencies that are likely to refuse to comply with its commitment or develop other measures to protect its subordinate industry. It provides testable evidence for Chinese decision makers to figure out which industry needs further market-oriented reforms to minimise the risk of trade disputes. It also helps foreign investors and traders make wiser decisions in dealing with China within the WTO framework.

1.4 Review of and Scholarly Explanation to Government-Industry Relations

1.4.1 Line Ministries vs. Local Authorities in Government-Industry Relations

In the 1970s, the SPC helmed the central-planning system. It took charge of formulating the five-year-plan (FYP), a top-down initiative that other relevant ministries will have to follow. The yearly plan, which was prepared by the State Economic Commission (SEC) and based on the framework provided by the FYP, would then be disseminated to the economic ministries for their implementation. The ministries would then work out short-term plans for their respective sectors and set out directives for the implementation of the SOEs. Ministry of Finance (MOF), the collection and distribution body for all revenue, allocate funds to the SOEs based on the state budget for the following year (Hassard *et al*, 2007). Sector-specific contracts were signed between the SPC and the economic ministries that used to behave as intermediaries between the higher authorities and grass-roots SOEs in the FYP. The contracts or industrial policies were different across the sectors, partially due to the strategic concern of the SPC and bargaining power of the supervising agencies.¹ In order to fulfill the contract, the ministries retained certain administrative and fiscal/financial control of the enterprises in their subordinate industry (Ministry of Finance, 1983, 475-8; Zhang, 1991: 28; Shen ed, 1999: 534).

Local governments became significant players and further complicating government-industry relations. A large number of SOEs came under the jurisdiction of the local governments (Montinola *et al*. 1995), although some of big SOEs were

¹ In 1981, the central government assigned the contract of input and output to nine sectors (*hangye baogan*), namely, petroleum, non-ferrous metals, petrol chemicals, metallurgy, civil aviation, coal, railway, post and electric power. For example, the petroleum sector signed a three-year output contract in 1981 and another seven-year contract in 1984. The sector of non-ferrous metals signed a contract of fixed-rate of finance (*caizheng dingbi baogan*). Petrochemical National Corporation agreed to be responsible for the loss and profit after tax remittance. Metallurgical sector signed an input-output contract while the civil aviation agency adopted a profit and foreign exchange retention system. The coal industry signed an input-output contract among the coalmines in the unified distribution system. The railway agency agreed to finance the railway construction.

retrenched in the 1990s (Cai and Treisman, 2006). The local governments were made responsible for the day-to-day supervision of these enterprises. Meanwhile, a revenue-sharing system was introduced in 1980 and reformed in 1994 between central and local governments. The system gave local authorities more incentives to intervene in the business practices of the SOEs (Lee, 1986: 68; Oi, 1992: 100; Yusuf, 1994: 75; Walder, 1995; Zhang, 1999b; Wong, 2000; Zhao, 2003a).

Taking into account of the authorities of both line ministries and local governments, the firms were struggling in a “tiao-kuai” structure, especially in the late 1980s (Qian and Stiglitz, 1996). The 1990s saw a “soft centralisation” of authorities to counter “local protectionism” which worked in favour of the line ministries (Mertha, 2005). The central state’s capacity to implement nationwide supervision started to draw more scholarly attention when a trend of recentralisation, reregulation and retrenchment became apparent (Lin, 2004b, 2007; Pearson, 2005). Besides, as the dependent variable is the concessions in bilateral trade talks, the government-industry relations in this thesis refer to the link between line ministries and their subordinate industries, as most local governments were not actively involved in the negotiations, nor were they aware of the negotiation details (Wei, 2007: 5).

1.4.2 Sector Specific Government-Industry Relations: “High Stake” Sectors and “Low Stake” Sectors

As Kitschelt (1991: 455) reviewed, “national institutions explain why *similar* sectors in different countries are associated with *varying* governance structures and why *different* sectors in the same country develop *similar* industrial strategies”. However, by identifying industrial strategies as *similar* does not provide sound policy recommendations in a country. To explain the different origins of successful industrial

sectors and less successful sectors in Japan, Kitschelt developed a technology-driven theory of sectoral governance structures.

Kitschelt's view was echoed by scholars who studied sector-specific government-industry relations. For example, although France was widely believed to have a "strong" state compared to that in the United States, Cawson *et al.*'s (1987) study showed that government-industry relations in France differed in the telecommunications and consumer electronics sectors. Atkinson and Coleman (1989) agree that traditional treatment of state-society relations at the macro level failed to explain the rich diversity at the lower levels—meso or micro level. Accordingly, they recommend that scholars pay enough attention to government-industry relations at sector level to supplement or even supersede the existing studies.

On the assumption that the government serves the society in democratic countries, the analysis of government-industry relations at sector level placed great emphasis on the autonomy or strength of the state. Katzenstein ed. (1978) regards the autonomy of the bureaucracy as an important criterion of the "strong" state in advanced industrial countries. Hall's (1983: 46) study of Britain and France explains that the state would be "strong" if a small number of government officials were capable of making final decisions.

However, in central-planning economies like China, the government dictated activities and decision making in the industry. The research interest changes to varying degrees of sectoral autonomy against the government. In China, during the transition period of marketisation, bureaucratic politics is responsible for much of the variation in government-industry relations across sectors. The "contracts" between government and industry or "industrial policies" in the early 1980s were different across sectors due to the strategic concern of the SPC and bargaining power among

the supervising agencies. Spearheading the hierarchical system, the SPC had holistic rather than sector-specific concern. The line ministries tried to obtain favourite industrial policies for the development of their subordinate sectors. However, the bargaining could not always satisfy all the requests of sectoral governors. For instance, losers, like the Ministry of Agriculture (see Chapter 4 for details), could not get enough state budget to support their sectoral policies. To rectify, the ministry decided to maintain a loose and separate government-industry relationship. Hence, although the agricultural sector became a “low stake” sector to the government, it gained from the greater autonomy attained.

This thesis differentiates the sectors by comparing the autonomies granted by the central government. The sector is “low stake” if it has minimal government intervention. Firms in the sector can make independent decisions regarding the plan of production, capital investment, alliance management, and etc. The separation of the government from the industry allows the latter to determine its own area of interest that may not be convergent with that of the government. The government has less capability and incentive to protect sectoral interests. In contrast, the sector is “high stake” if it cannot make independent business decisions. The sector does not have its own interests. Sectoral interest is a reflection of bureaucratic interest. Accordingly, the government had more incentive to protect the sector.

The relationship between government and industry in contemporary China varies across sectors in different time periods. Although scholars are aware of this fact (MacIntyre, 1990; Wade, 2002; Haggard, 2004), only a handful adopted a comparative approach to interpret the variations in a particular country, especially China. Pearson (2005: 297) selects some strategic sectors to support her argument that

the pattern of government-industry relation lies somewhere between state control and state regulation; however, she did not give a systemic sector-specific comparison.

This thesis will not attempt to uncover the causes of these variations, but will focus on the impact of these varying government-industry relations on the policy-making of the “big bang” trade liberalisation by the central government. Kitschelt (1991: 493) in his conclusion recommends that trade policies should be sector-specific, as “no single trade regime, whether it encourages open competition or erects protectionist barriers, is likely to further industrial growth across all sectors”.

Adopting a sector-level analysis does not mean the irrelevance of national characteristics. For example, Anderson and Hayami (1986: 1) observe a pattern of agricultural protection in East Asian countries that “as economies grow they tend to change from taxing to assisting or protecting agriculture relative to other sectors, and that this change occurs at an earlier stage of economic growth the weaker the country’s comparative advantage in agriculture”. However, this proves that the evolution of government-industry relations in China’s agricultural sector took a much longer time and did not necessarily yield the same result because of its uniqueness.

1.4.3 Separating the Government from the Industries

There were two attempts to separate the government from the industries in the 1980s and 1990s. *Temporary Provisions for Further Expanding the Autonomy of State-Owned Enterprises* promulgated in 1984 granted decision-making autonomy to the SOEs in ten areas with partial success (Walder, 1984: 65; Blecher, 1989; Child and Lu, 1996: 76).² The second attempt was made by the State Council in 1992 to grant autonomy in 14 areas but the effort did not fully achieve its goals, either.³

² Six of them were retained by the supervising agencies, including plan of production management (*shengchan jingying jihua*), capital investment (*zijin shiyong*), allocation of wage and bonus (*gongzi jiangjin fenpei*), asset

Administrative reform and industry restructuring in 1998 was arguably a decisive move to separate the government from the industries. Dali Yang (2004) observes an evolution of government-industry relation, as the government was changing from “planner” to “regulator” (also see Deans, 2004). According to Yang, China’s government restructuring since the late 1990s has seen a gradual rationalisation of the administrative state and enhancement of the regulatory apparatus. The planning agencies were remade to cut off government-industry relations so as to prevent arbitrary intervention. A regulatory body was established to regulate activities in the sector and to ensure a level playing field.

1.5 The Emergence of a Regulatory State and Its Implications to Trade Negotiation

The idea of a regulatory state was introduced by the United States after the Progressive Movement and widely implemented by the largely different European countries in the 1980s. The American experience reconciles the rival terms of regulation and competition by developing a new rationale of “regulation-for-competition”. The country has seen a huge expansion of public authority since the New Deal (Moran, 2002). In Europe, the new form of government-industry relations is replacing the positive, interventionist state (Bugaric, 2007). The emergence of a

management (*zichan chuli*), personnel and labour management (*renshi laodong guanli*), and procurement of materials that are under unified redistribution (*tongpei wuzi xuangou*). Besides, autonomous right of alliance management (*lianhe jingying zizhuquan*) did work in practice and the right of floating production price along the planned price (*chanpin jiage fudongquan*) was guided by the price regulatory agency. Only two autonomies, the right to establish internal organisation (*neibu jigou shezhi quan*) and sales (*chanpin xiaoshou zizhu quan*), were effectively granted to the enterprises (*Qiye shiquan sheng duoshao*, 1990: 37).

³ The second attempt at decentralisation was based on the principles of the first one in 1984. Among the ten areas of autonomy in 1984, the right of sales was divided into two autonomies of domestic sales and international trade; management of labour and personnel was separated into management of labour and management of personnel; the right of allocating working capital (*liudong zijin zhipai quan*) was carved out of the right of asset management; the right of refusing extralegal payments to the government (*jujue tanpai quan*) was also added. According to a survey by the SETC, production, procurement of input material, sales, and pricing were fully decentralised to the enterprises; the other rights, especially management of personnel, management of labour, investment, rights of international trade, and the right of refusing extralegal payments to the government were not transferred to the enterprises at all (SETC, 1995, quoted from Pan, 1994: 8).

regulatory state in Europe reflected the triumph of market and business interests over the state. The regulatory state in capitalist economies is “premised upon a neo-liberal combination of market competition, privatized institutions, and decentred, at-a-distance forms of state regulation” (Braithwaite, 2000: 222).

Few studies have expanded the understanding of regulatory state to the field of trade negotiations. Scholars of regulatory state agree with Adam Smith “by eliminating both public and private monopolies and liberalizing trade” and also agree with Keynesian forms of regulating banking, stock markets and labour standards (Braithwaite, 2000: 226). The liberalisation of global trade, as Vogel (1993) argues, requires the re-regulation of different countries. However, the emergence of “regulatory protectionism” reminds us to give more attention to the much overlooked regulatory body (Baldwin, 2000). Convergence of domestic rules in different countries facilitates the spread of freer markets (Lutz, 2004). A divergence generates a new form of protectionism.

This author agrees that regulatory rules matter in international trade to gradually become the primary concern in bilateral or multilateral trade disputes. However, a more fundamental question must be raised here: To whose interests have the regulatory rules been serving in trade issues? The illusion of *independent* regulation, as Moran (2002) pointed out, is never clear. The regulation power would be apportioned out to the regulated interests (Wolfe, 1986), or be promoted by vote- and money-seeking politicians, powerful business interests and powerful bureaucrats (Stigler, 1971). If the regulatory body is not independent as designed, the “regulatory protectionism” would not be based on the grounds of “economic efficiency and risk management” (Moran, 2002: 398), but attributed to other factors. These factors vary

between countries and between sectors. Three scenarios need to be examined: public interest scenario, the regulated interest scenario and the “powerful outsider” scenario.

“Public interest” scenario: The regulatory body was designed by economists as selfless and altruistic. The regulatory rules were implemented to rectify “market failures” by protecting the public from monopolistic behavior at one end and preventing destructive competition at the other end. The “public interest” scenario takes place in a political situation where costs and benefits are widely distributed (Wilson, 1980). Accordingly, public interest determines trade preferences.

“The regulated interest” scenario: The “capture” theory contends that regulatory rules primarily serve regulated interest rather than the public. According to Stigler (1971), by voting for and providing resources to the party, the industry is capable of influencing the regulatory state in exchange for subsidies, control of entry, inter-industry cooperation, and price fixing. The capture theory was improved upon by a group of studies, including Lowi’s “interest-group liberalization” (1969), Edelman’s “symbolic politics” (1985), Bernstein’s “life cycle” (1993), and Peltzman’s “vote maximizer” (1984). The capture scenario mostly happens in a political situation where costs and benefits are narrowly concentrated, or benefits concentrated but costs are widely distributed (Wilson, 1980).

If the capture theory holds true, we should expect to see interest groups initiating and controlling the process of trade negotiations. Furthermore, interest group pressures should account for the outcome of trade negotiations. We should see a conflicting pattern: powerful businesses gaining from trade negotiations or sectors with powerful businesses making no concession. Concession can only be made if domestic compensation is guaranteed by the negotiators.

“Powerful outsider” scenario: Bureaucracies that are shielded from the interest groups are powerful enough to influence the regulatory body. Levine and Jennifer (1990) call the rationale “post-revisionism”, study of the process of politics. As Derthick and Quirk (1985) argued, the bureaucratic interests overcame the regulated interests in the development of deregulation in the United States. The regulatory commissions in the United States at the time were heavily dependent on the three major branches of government, namely the President, Congress and Federal Courts, which were powerful enough to make the regulatory bodies deregulate the industry. Destler’s (1995) study of American trade politics revealed a similar causality. The Congress that was particularly susceptible to pressure from organised interests was able to channel trade pressure to the executive branch of the government. That was one of the major reasons for the implementation of the American liberal trade policy through most of the post-war period.

By the logic of the “Powerful outsider” scenario, the regulatory body is inferior to other organisations that hold the relatively unexercised authority of revising the regulations. The bureaucracies or political entrepreneurs must be powerful enough to overcome the pressure of interest group, especially in a situation where the costs are concentrated but benefits are widely distributed (Wilson, 1980). The President primarily responds to the voters. This is consistent with the public interest scenario. However, if the regulated industries are powerful enough to generate enough votes, it may also serve the regulated interest. If that is the case, the result is consistent with the regulated interest scenario. The bureaucratic interest is relatively independent of the voting preference of the President. Their interests are probably shaped by economic ideologies. They will intervene if they believe that a new form of governance is serving public interest. But a lack of economic ideology makes us

believe that the regulation will be “manipulated” by bureaucracies that have their own narrow-minded interests.

1.6 The Emergence of a Regulatory State in China and Its Implications to WTO Negotiation

Dali Yang (2004) observes an evolution of a regulatory state out of the Western capitalist economies (also see Deans, 2004). The emergence of a regulatory state in China was primarily driven by the need to separate the government from industry through the abolishing or transforming of deeply embedded economic bureaucracies into regulatory bodies at a distance. The reform, according to Yang (2004: 56), “helped reduce overlapping functions” in the central government “that induce infighting and gridlock”. For example, the Ministry of Information Industry (MII) founded in 1998 provided “more even-handed” regulation among telecommunications services providers and “engendered competition by breaking up” existing monopolies that were questioned by the American negotiators (Ibid: 56). By curbing the bureaucrats’ parochial interests, “the government reorganisation made it easier for Chinese negotiators to strike trade deals that require sacrifices in some sectors that had previously possessed much bureaucratic clout” (Ibid: 57). Having constrained governmental power, the role of the Chinese leadership became more “crucial” in the conclusion of the WTO agreement (Ibid: 58, 303).

Yang identifies three major factors for the origin of regulatory state in China, namely, the importance of leadership, the rhythm of domestic politics and the role of crisis as catalysing events for politicians to adopt certain reforms. Accordingly, his understanding of regulatory state in China was, to a large extent, consistent with that of a “powerful outsider”.

The reforms in China since the late 1990s have been in the situation of concentrated loss and divided gains that needed strong political entrepreneurs. Yang identifies the importance of leadership, but not the ideology that was prevailing among political entrepreneurs at that time. Idea is one of the important variables in the understanding of the regulatory state. The regulatory body that serves public interest needs the guidance of an economic ideology to reach its goal. A new idea is necessary for political entrepreneurs if they want change in the status quo. It provides strong moral, theoretical or instrumental support to reformers in the face of resistance from incumbent regulatory bureaucracies and interest groups. Yang's analysis did not provide us with a comprehensive picture of prevailing economic ideology at the moment. If crisis, as Yang argues, is the catalysing force, it would be more convincing to say that the reform is reactive rather than proactive. In China, there was a lack of a clear agenda for reforms guided by the ideas. It just shows the similarities between reforms and regulatory reform, which may or may not have the same goals.

Empirical evidence since the "regulatory reform" in 1998 has proved that government-industry relations did not evolve into a form of regulatory state as expected. Firstly, the supervising ministries that were supposed to transform into regulatory bodies were reluctant to delink themselves from the industries. They remained a significant factor in the trade negotiation. Government reform in the late 1990s did not leave an institutional void for the emergence of a "regulatory" state. The economic bureaucracies refused to give up their stakes in the industries. A consensus was reached in the central government right before the industry restructuring that in the ninth FYP (1996-2000) that the state would retain 1,000 SOEs in the sectors of electric power, automotive, electronics, iron and steel, machinery, chemicals, construction materials, transport, aerospace and pharmaceuticals. These

SOEs held around 70% of SOE fixed assets and generated about 80% of profits and taxes (Hassard *et al*, 2007: 96; Nolan, 2001). The decision to reform SOEs through “retaining the large state enterprises and releasing the small ones” (*zhuada fangxiao*) was controversial, as it separated the government from small SOEs but enhanced its relationship with the large ones.

The results prevented the newly transformed or established regulatory bodies from regulating the economy at a distance. The specialised economic departments that were downgraded and reorganised into industrial bureaus (*gongye ju*) and placed under the management of the State Economic and Trade Commission (SETC) did not necessarily make a shift from direct management to macroeconomic regulation. Yang’s observation might be applicable to the textile sector where the supervising agencies under the SETC “lost the right to supervise and intervene in the enterprises and institutions” that in turn guaranteed relatively fair regulatory rules in non-SOE-dominated sector (2004: 41). However, the State Bureau of Textile retained its corporatist interests in 20 SOEs. It also has the discretion of allocating 20% of the export quotas that always go to its subsidiaries, undermining fair-play in the sector (Lu, 2001: 14). The newly founded “regulatory body” also did not function as expected. For example, Yang (2004: 38) believes that the creation of the MII as a “regulatory power” in 1998 was “used not to monopolize but to promote competition through a breakup of China Telecom and the entry of new players”. However, this author regards the breakdown of one monopoly (China Telecom) as an attempt to create four monopolies in their respective subsectors. There was little competition between the monopolies across the subsectors. Under the umbrella of the MII, their dominance was not challenged by the entry of new players either. China Unicom is still subject to the discriminatory policies of the MII until the latter becomes the major

stakeholder (Liu, 1999: 16). The relationship between Telecom and Unicom changed from competitive to supplementary accordingly. The government reorganisation did not make it easier for Chinese negotiators to strike trade deals in telecommunications services as argued by Yang (2004: 57). The “China-China-Foreign” (CCF) joint investment system allowed foreign companies to hold more than 70% of the shares that was much higher than what had been agreed with the United States in 1999. The MII terminated fragmented supervision by incorporating rival ministries in 1998. The unified supervisor fought hard to prevent Chinese negotiators from giving majority shareholding to foreign companies. The founding of the State-owned Assets Supervision and Administration Commission (SASAC) was considered by Yang (2004: 61) as another attempt to “further separate government ownership, enterprise, and management”. However, the SASAC’s practice of reshuffling leadership between the four telecommunications service providers indicated a continuous political intervention rather than a conduct “in accordance with the Company Law”.

To conclude, an effective and independent regulatory state has yet to take shape. A government-industry nexus is still significant. The government refused to stay back and perform only in case of market failure. “Regulatory” bodies with the vested interest of benefiting certain subordinating enterprises found it hard to clear away man-made obstructions to smoothen trade. An embedded “regulatory state” did not stay back in trade negotiations for the sake of its stake in the industry.

However, it should be reminded that government-industry relations vary across sectors. Sectors with a loose government-industry nexus, like textile, have greater potential of seeing the emergence of regulatory state in the future. In contrast, it would be difficult for the government to give up intervention if it has tight

relationship with the subordinate industries, like banking and telecommunications services.

All in all, the study of government-industry relation sheds light on the convergence/divergence of bureaucratic-sectoral interests. It is the prerequisite to understand the state's decisions on trade liberalisation. By incorporating the independent variable of government-industry relations into the model of "ministry-sector horse trading", we will have a better understanding of China's trade concessions made for WTO accession.

Chapter 2: A Comparative Perspective of Government-Industry Relations and Sector-Specific Trade Concessions

2.1 Introduction

The central state in the early 1980s decided to grant autonomy to SOEs that used to operate according to the Five Year Plan. Government-industry relations then became sector-specific. The comparative study of government-industry relations across sectors contributes to the sectoral analyses of the post-socialist economy during the transition period of marketisation. The result casts doubts on the emergence of a regulatory state in contemporary China.

The emergence of a regulatory state requires a limited role for economic bureaucracies in trade negotiations. Trade preferences are primarily shaped by market and business interests. However, the “regulatory” bodies in China were not created in an institutional void. The economic bureaucracies with high stake in their subordinate industries continuously intervened in trade negotiations.

This chapter develops a “ministry-sector horse trading” model to understand China’s trade concession for entering the WTO. The three independent variables are government-industry relations, sectoral competitiveness and market structure. The negotiators refused to give concessions to their foreign counterparts in “high stake” sectors where the economic bureaucracies have high incentives to develop the industries; they were also reluctant to release their uncompetitive sectors to foreign competition due to their loss-aversion mindset of minimising domestic political, economic, and social damages; likewise they were under unified pressure from enterprises not to release their concentrated sectors. To garner domestic support, the negotiators tend to fight hard for “high stake”, uncompetitive and high concentration

sectors, but easily back down in “low stake”, competitive, and low concentration. A horse-trading strategy was adopted by negotiators through weighing the three indicators. That explains the dependent variables of huge concessions on agricultural and textile industries, but little concessions on banking, telecommunications and automobile sectors.

As a consequence, the WTO negotiation outcome was “efficiency-reducing”. It allowed the economic bureaucracies some time to decide if it is willing to give up their control of “high stake” sectors, imposed great adjustment costs for sectors that were internationally competitive, and protected monopolistic profits of concentrated sectors. The “efficiency-reducing trade concession” challenges the common beliefs that WTO accession would have a huge positive impact on China’s marketisation reforms.

2.2 The Domestic Sources of Trade Concession

Hiscox (2008) mentions that the political economy approach should combine both economic and political analyses in the understanding of trade policies. Economic analyses, such as the Heckscher-Ohlin model and Stolper-Samuelson theorem, emphasise economic effects as one of the important factors determining trade preferences. Political analyses, on the other hand, explain how the same preferences lead to different trade policies between different kinds of political institutions. This section reviews the domestic sources of trade concession and explains why they are not directly applicable to the understanding of China’s trade concessions made to its US counterpart.

2.2.1 Comparative Advantage

The Heckscher-Ohlin model identifies three basic factors that determine a country's trade politics. These are land, labour and capital. Accordingly, China, which is well endowed with cheap labour, is expected to export labour-intensive goods (textile and clothing), and import products that require intensive use of land and capital (agricultural products and automobile). The former sectors are willing to maximise their gains through trade liberalisation while the latter is willing to minimise its loss through protection. No sector is supposed to make concessions to its foreign counterpart. Thus, Heckscher-Ohlin model does not provide answers to why the state gives concessions in some sectors but not the others. Similarly, Jones (1971) and Mussa (1974) argue that trade preferences differ between sectors with export industries and sectors with import-competing industries. Jones and Mussa, however, are also unable to explain why a state made concession on one sector but not the others.

2.2.2 Individuals Divided by Real Incomes

The Stolper-Sameulson theorem (1941) could not provide us with satisfactory answers, either. According to the Stolper-Sameulson theorem, trade benefits sectors that are locally abundant, but not sectors that are locally scarce. By this logic, in China, trade policy preferences should be different between workers and the people who own the capital. The former is relatively abundant and is likely to support greater trade openness for a raise in wages. The latter is relatively scarce and is more likely to adopt a protectionist approach, as it is unable to see the potential of open trade. However, a political division between workers and owners was not significant enough to influence trade policies at the threshold of China's WTO accession. The workers'

union that was supposed to impose great impact on trade policies was not as well organised as those in United States or Australia. Unions at that time were quasi-governmental institutions. Without an effective channel to voice their preferences, the workers' influence on Sino-American trade talks was minimal.

2.2.3 Political Institutions

As Hiscox (2008: 112) emphasises, political institutions determine how the policy preferences of different groups are “weighted” in the final policy outcome. The analysis of China's political institution usually starts with the consensus that its system is a non-democratic regime. Compared to democratic systems, the analysis of non-democratic regimes, like China, is usually straightforward. The trade policy is, to a larger extent, determined by the leadership. Leaders who are insulated from public election would adopt a trade policy that benefits their own interests. By studying the non-democratic leadership, we should be able to understand the intricacies of its trade policies.

However, the literature on contemporary Chinese politics has been changing its focus from the leadership to the government and to the society. Most China specialists admit that Mao Zedong and Deng Xiaoping made almost all of the “big decision(s)” during their respective terms (Barnett, 1985: 7; Bachman, 1986). However, political reforms in the last three decades had witnessed a change from elite politics to bureaucratic politics (Unger ed., 2002). Lieberthal and Oksenberg's (1988) “fragmented authoritarianism” snapshots the evolving relationship between the leaders and government (also see Lieberthal and Lampton eds., 1992). The influence of the bureaucracy was on the rise (Teiwes, 1995: 21; Paltiel, 2001; Lin, 2004a). Although state leaders, like Jiang Zeming and Hu Jintao, still retain the power of

making ultimate decisions (Swaine, 1995: 3; Fewsmith, 1999; Groombridge, 2000: 183; Goldstein, 2001: 837-8; Breslin, 2005), the emerging technocrat-style bureaucracy has become an indispensable force in the decision making of economic policies.

The “capture” theory might be more helpful to explaining the domestic political source of foreign trade policy in China. Having discussed in the literature of regulatory state, bureaucracies captured by the industry would have “important effects in terms of foreign economic policies” (Hiscox, 2008: 118). However, the “capture” theory could not summarise the government-industry relations in China (see pages 16-20). A more subtle understanding of government-industry relations would help to develop a clearer model to explain China’s trade concessions.

2.3 “Ministry-Sector Horse Trading” Model of Trade Negotiation

Putnam’s (1988) “two level games” suggests that negotiators have to engage in the game at both national and international levels and cannot overlook either of them. At the national level, negotiators seek power by forming coalitions among domestic interest groups. At the international level, negotiators seek to maximise their own ability to satisfy domestic pressure and at the same time minimise the adverse consequences of foreign developments.

At that critical round of Sino-American negotiation, then Chinese Premier Zhu Rongji with strong political support from the President sat at the international bargaining table. The political leaders did not have any private interest in protecting any particular sector. They just wanted to conclude the WTO agreement on an early date. At the international level, the WTO members requested China to liberalise its planned economy. The request was sector-specific because of imbalanced

development among the industries. In the final year of negotiations, there were seven issues that no party was willing to make voluntary concessions. A horse-trading strategy became the only possible way to sign the deal. It requires negotiators to protect some sectors while giving up the others. The selective concessions created a win-set for negotiators at the national level. To enlarge the size of the domestic win-set, negotiators had to compare sectors by weighing their competitiveness, market structure and relationship with the government. An aggregate of the three variables using the ministry-sector horse-trading model accounts for the final result of Sino-American negotiation for WTO accession.

Hypothesis 1: Trade concessions are usually made on “low stake” sectors

A “low stake” sector is the sector where the government has no relationship with the industry. As the government cannot directly benefit from the sectoral interest through administrative or fiscal/financial links, it places its prior concern on its own bureaucratic interests. The difference between sectoral and bureaucratic interests causes a divergence in trade preference. Accordingly, trade concessions are usually made on “low stake” sectors. In contrast, a “high stake” sector where the government has strong links and similar trade preference and is willing to protect the sector.

The Chinese governments have a special interest in industries inherited from the central-planning period that in turn influences their decision towards liberalisation (Hillman, 1989). By identifying the “low stake” and “high stake” sectors, this author differentiates supervising agencies with sectoral interest from those with bureaucratic goals. Trade preferences are divergent in “low stake” sectors like agriculture and textile where their supervising agencies are primarily concerned about their bureaucratic interests. In contrast, trade preferences are convergent in “high stake”

sectors like telecommunications services, banking and automobile as their supervisors are primarily concerned about sectoral interests. Accordingly, trade concession is easier to concede to in “low stake” sectors than “high stake” sectors.

Sub-Hypothesis 1.1 The Closer the Administrative Relation between Government and Industry, the Higher the Stake the Bureaucracy has in the Sector

Although the government had attempted to cut off ties with enterprises in the 1980s and 1990s, the line ministries still retained certain administrative power to supervise the industry. This thesis hypothesises that the closer the administrative relation between them, the higher the stake the bureaucracy has in the sector.

The administrative control the supervising government has over the industries can be in the decision making of the production plan, procurement of input materials, pricing of the product, etc. The government considers enterprises under its control as a part of its planning organ. The success of a subordinate industry is considered the supervising agency’s administrative accomplishment. An unsuccessful industry casts doubts on the supervisor’s administrative ability and jeopardises the agency’s interest of maximising “its likelihood to remain in office or its legitimacy to rule” (Chen and Feng, 2000: 324). Accordingly, the supervising agency will be supportive of the opening-up of the trade regime if the industry expects greater returns from its involvement in international trade or it helps to prevent the dismantlement of the trade barrier if the industry is not ready for international competition. The government that has little administrative relations with the industry has relatively less incentives to work for sectoral interests. It does not have direct responsibilities for the performance of the industry.

Sub-Hypothesis 1.2 The Closer the Fiscal/Financial Relation between Government and Industry, the Higher the Stake the Bureaucracy has in the Sector

Since the fiscal decentralisation in the early 1980s, the Chinese state permitted revenue sharing among the supervising ministries, local authorities and firms in a “tiao-kuai” structure (Qian and Stiglitz, 1996) that varies across industries.

In the presence of a strong fiscal/financial incentive, the government will be active in working for the interest of the industry whether in the form of corporate governance or predatory governance. The government exercising corporate governance is profit-seeking (Nee and Su, 1996). Better performance of the industry generates more returns to both the government and firms. Meanwhile, the government relies on the firms to evaluate the prospects of opening up to international competition. Suppose the industry is reluctant to join international free trade, its supervising agencies that value fiscal/financial benefits will prevent the dismantlement of the entry barrier. The government that exercises predatory governance is rent seeking. The supervising agency has less concern for the performance of individual firms. Instead, it pays more attention to its political control of the rent generated by the industry (Lin and Zhu, 2001: 312). The external competition imposes a threat to domestic enterprises that are disadvantaged by their fiscal/financial burden. The declining returns of the subordinate enterprises cannot sustain rent paid to the supervising agency. For example, the MOF had more predatory interests than corporatist interests in the banking industry and therefore strongly opposed to the opening-up of the sector (see Chapter 8 for details). Thus, both corporatist and predatory states have reasons to protect their subordinate industry if the industry is not competitive in a free market.

To conclude, an institutional embeddedness of domestic political economy shapes the responses of economic bureaucracies to the trade negotiation. The supervising agencies would not bother to be involved in trade negotiations if they have high stake in their subordinate industries.

Hypothesis 2: Trade concessions are usually made on more competitive sectors

A sector is considered competitive if it enjoys some comparative advantages in the global market, like productivity, profitability, labour or capital intensity, economy of scale, technology and quality of service. The industry that enjoys these comparative advantages tends to join international trade, as an expanded market brings more profit that in turn contributes to the further development of the industry (Ricardo, 1971). The illusion of a state-run export-oriented strategy is actually based on the industry which is able to gain from trade liberalisation (Krueger, 1990: 109).

If an industry is not competitive in free trade or is in its infancy stage, it will ask the government for protection (Corden, 1974; Dixit and Norman, 1980; Baldwin, 1985). Although fierce competition provides industry players with a good opportunity of learning advanced technology, managerial skills, etc. that are beneficial to the industry in the long run, it also heightens the industry's chance of collapse or takeover by long established multinationals. It is not a serious problem from the *Ricardian* point of view or the Heckscher-Ohlin trade model as the force of international specialisation will push enterprises and workers to other industries that are internationally competitive. However, the industry would of course like to prolong the protection for as long as possible (Francois and Wooton, 2001: 401).

During the trade talks, negotiators tend to give concessions on competitive sectors to protect uncompetitive ones. According to de Dreu *et al* (1995: 97; also see

Carnevale and Pruitt, 1992), “losses are more aversive than equivalent gains are attractive, loss framed negotiators should display greater resistance to concession making and settle less easily than negotiators with a gain frame”. The hypothesis is also confirmed by Keohane’s (1986: 4) observation of US-Japan trade talks in the 1980s where negotiators tended to seek “unilaterally to repeal the law of comparative advantage” for the purpose of “moving toward a (trade) balance with Japan”. As the Japanese government did not guarantee American firms’ market share in Japan’s semiconductor chips sector, the United States did not fight hard to secure potential gains in the sector but impose retaliatory tariffs to minimise its potential loss in the other sectors (Bhagwati, 1987: 567).

In China, giving concession in uncompetitive sectors jeopardises the survival of the domestic industry. The closure of factories and the large number of layoffs may lead to social unrest. Accordingly, the negotiators have made concerted efforts to shield losses making firms (Chen and Feng, 2000). Besides, Chinese negotiators had more incentives to give up potential gains to prevent equally weighted potential losses. The competitiveness of China’s export is, to a large extent, determined by its cheap product pricing and acceptable quality. Cheap labour and undervalued RMB guarantee cheap Chinese products in the international market. The joint venture with the injection of foreign direct investments (FDIs) and transfer of technology and management know-how help Chinese products meet world specification and quality requirement (Adams *et al*, 2006). Exports generated by foreign-invested enterprises accounted for about 46% of China’s total exports in 1999 (Zhang and Song, 2000). China has less incentive to help the FDIs maximise their competitive potential.

As concluded by Frieden and Rogowski (1996: 38), the impact of the exogenous easing of trade is sector-specific; political cleavages will be sectoral, a divide between

those relatively competitive on world markets and those relatively not; and their trade preference will differ accordingly. Although comparative advantage accounts for much of the sectoral differences, it is more complicated if we take into consideration the interests of individual firms. As Yoffie (1993: 1) argues, despite the relevance of comparative advantage, firms and governments are “what really matter in determining international trade”. The next section explains how market structure influences the result of trade concessions.

Hypothesis 3: Trade concessions are usually made on less concentrated sectors

Market structure describes the status of individual firms in the industry. This thesis simply categorises the market structure into two, namely, competitive market and oligopoly/monopoly. Competitive market is characterised by a very large number of enterprises producing a homogeneous product or service. Oligopoly is a market dominated by a small number of firms that own more than 40% of the market share. Monopoly is the market with only one provider of the product or service.

Oligopolies or monopolies in a closed economy determine their profit mainly through the control of price and volume of products offered to the market (Atje and Hufbauer, 1996: 24). Their interests are representative of the sector because of their market status. The interests of other small enterprises are usually overlooked for their small presence in the market. Monopolies/oligopolies are capable of lobbying the government in a unified voice.

In a competitive market with an absence of monopolies or oligopolies, enterprises' interests are diversified and their action is poorly organised. For example, intra-industry disputes in French and American footwear and semiconductor sectors in the 1970s prevented the industries from realising their preferred trade policy (Milner,

1987: 651). Business association may solve the collective-action problem in the industry (Caves, 1976). However, its action is still less efficient than the monopoly as a unitary actor.

As mentioned earlier, negotiators are loss averse. They tend to give up potential gains to prevent potential losses. The argument is reinforced by Bauer *et al.*'s (1972) observation in the United States where an uncompetitive industry exerted more political pressure on protection than a competitive industry's pressure for liberalisation. From enterprises' point of view, according to Bauer *et al.*, the benefits of trade liberalisation will be small and diffuse, while the benefits of protection will be sizable and tangible. However, after introducing the variable of market structure, the difference in competitiveness is less significant. Milner (1987: 651) challenged that in a concentrated sector that consisted of a small number of enterprises, the benefit of liberalisation and protection was equally weighted. As the benefit of trade liberalisation is not diffusively distributed in the sector, the competitive enterprises "may act to realize their preferences just as much as protectionist groups do". Thus, a concentrated market structure minimises the difference of sectoral impact of competitive and uncompetitive industries. However, it does not have any impact on negotiators' preference. Even though the sectoral pressures from competitive and uncompetitive groups are equally strong, the negotiators tend to give up potential gains to prevent potential loss.

In China, sectoral pressure as an independent variable has become more and more apparent since the separation of government and industry (Pearson, 2000). The enterprises became vocal at the threshold of WTO accession to make their interests heard. The sector with high concentration, like banking, had reportedly pushed negotiators to protect their interest. In contrast, Chinese peasants who were much less

organised did not manage to prevent negotiators from giving trade concessions. China's market structure has some relatively unique features that are different those of capitalist countries. Firstly, non-cooperative action between oligopolies/monopolies is treated as a special case that is more in common with the competitive market. Eyal's (1994) analysis of non-cooperative natural monopolies reminds us of the possibility of non-cooperative behaviours between oligopolies or monopolies that challenge the existence of coherent sectoral interests. The research on natural monopolies that are characterised by increasing returns to scale of production is primarily based on the assumptions that their actions were mainly driven by pure economic reasons and they are free from political repression. In China, the assumption should be treated more carefully, as the firms become monopolies for political reasons rather than economic reasons. They are usually SOEs or SOE-inherited firms controlled by different supervisors in the central government.⁴ If each of the dual-monopolies is connected to different bureaucracies that have competitive claims of supervision of the industry, a unitary support by the government will be constrained after its power and resources are consumed by the in-fighting (Pearson, 2005: 309; for empirical analysis, see China's telecommunications industry in Chapter 6). Secondly, in China, business associations did not represent sectoral interest at that time. They exist as quasi-governmental organisations that mainly respond to requests from higher-level agencies. The presence of economic associations in China during the period of study can be overlooked.

⁴ According to Tang (2007: 189), the uniqueness of China's monopoly is the combination of three different kinds of monopolies, namely natural monopoly as the excuse, behavioural monopoly as the means, and administrative monopoly as the institutional guarantees.

2.4 A Holistic Concern for Horse Trading Concession

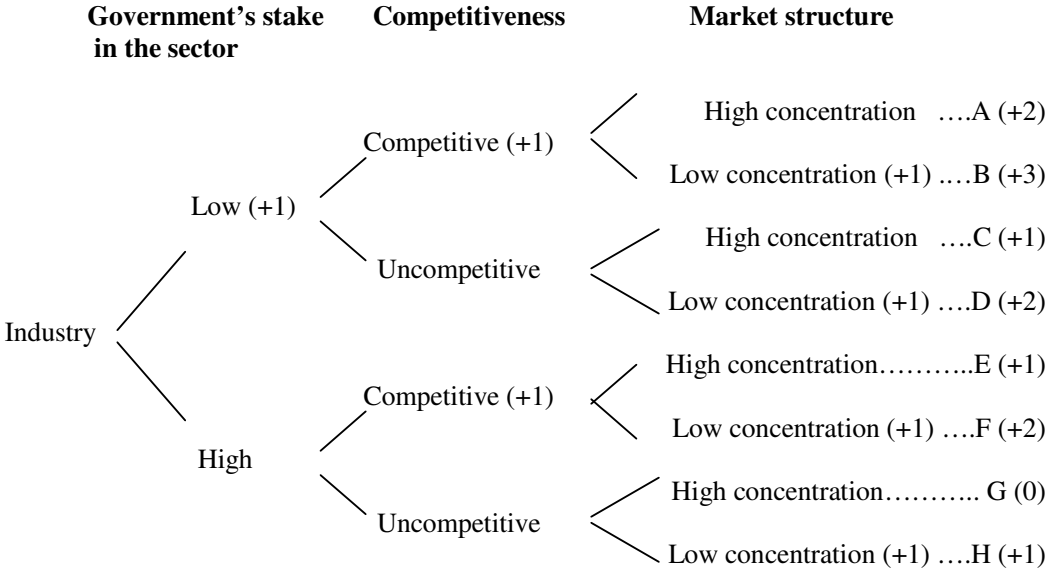
Government policy maximises the net support it can obtain from the populace. A horse trading strategy was adopted by negotiators through weighing the various concerns. Taking into account all these factors, there are eight scenarios leading to different degrees of government's incentives for concession (Figures 2.1 and 2.2).

Scenario A-D: The supervising agency refrains from intervening in "low stake" sectors. Having cut off government-industry relations with the sector, the supervising agencies lose its sectoral interests and switch to bureaucratic interest that might not be convergent with that of the industry. The negotiators thus have more incentive to give trade concession on "low stake" sectors. In "low stake" sectors, firms are predominately non-state actors. Less concentrated sectors have less capacity to protect their interests, because it is difficult for a large number of enterprises to speak in one voice. The incentive for concession is the strongest when the sector is internationally competitive, as the negotiators tend to give up potential gains to prevent potential loss.

Scenario E-H: The supervising agency has vested interests in protecting its "high stake" sectors. It has few incentives to give trade concession on its subsidiaries. The incentive will be fewer if the sector can generate a unified pressure on the government. The reason for concession will be the least if the negotiators are in a loss-framed position.

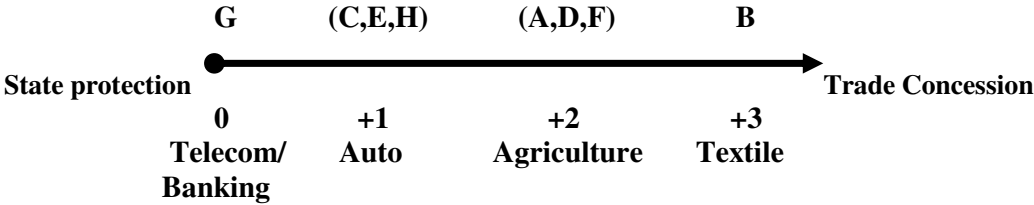
An aggregate concern of the three variables (Figure 2.2) tells us that negotiators tend to fight hard for sector G while easily back down on sector B. The concession is usually made on sectors that stay at the right end of the arrow.

Figure 2.1 Independent Variables in the Model of Ministry-Sector Horse Trading Concession: Sectoral Strength, Competitiveness and Market Structure



Note: (+1) =stronger incentive for concession; high concentration includes monopolistic and oligopolistic markets; low concentration includes a situation of competitive market and uncooperative monopolies/oligopolies
 Examples: B (textile and clothing sector); D (agricultural sector); G (telecommunications service; banking industry); H (automobile industry: non-cooperatives oligopolies);
 Source: compiled by the author

Figure 2.2 An Aggregate Result of the Model of Ministry-Sector Horse Trading Concession



Note: B (textile and clothing sector); G (telecommunications service; banking industry); H (automobile industry); D (agricultural sector)
 Source: compiled by the author

2.5 Methods of Measuring the Independent Variables

The independent variables in the thesis are competitiveness, market structure and government-industry relations. The measurement of competitiveness and market

structure is based on the review of economists' analysis of the industry. The focus of this thesis is to adopt a new way of analysing government-industry relations.

As mentioned earlier, the enterprises started to gain autonomous rights in 10 areas in 1984 and again in 14 areas in 1992. For analytical convenience, this thesis incorporates them into 10 areas of autonomy, including plan of production management, capital investment, allocation of wage and bonus, asset management, personnel and labour management, procurement of materials, autonomous right of alliance management, right to decide on pricing, right to establish internal organisation, and sales. A qualitative analysis is adopted to understand how the autonomy was nominally granted to firms but effectively retained by the government. Government's control of these 10 areas of autonomy is also quantified by coding each of them as 10% of government-firm connection. For each autonomy (A_n), state control (C_n) is coded as full control (100%), partial control (50%) and little control (0). Thus, the formula is:

$$\text{Administrative connection with the firms (AF)} = A_1 * C_1 + A_2 * C_2 + \dots + A_{10} * C_{10}$$

As the government is probably connected with some enterprises but not all in the industry, the thesis will examine the market share of these enterprises to understand the significance of the relationship to the whole industry. The market share (MS) is also applied to quantify the relationship between the government and industry:

$$\begin{aligned} \text{Administrative connection with the industry (AI)} &= MS * AF \\ &= MS * (A_1 * C_1 + A_2 * C_2 + \dots + A_{10} * C_{10}) \end{aligned}$$

The thesis also analyses the fiscal/financial connection between the government and industry to understand the extent the government is fiscally relied on by the industry. Aside from the tax revenue remitted to the MOF, this thesis is interested in the amount of profit to be transferred to the supervising agencies in form of either dividend or rent.

To conclude, this chapter reviews the domestic sources of trade concessions. As the existing theorem or model is not directly applicable to an understanding of China's trade concession for entering the WTO, the thesis develops a "ministry-sector horse trading" model to explain the topic. Having introduced the independent variables through the model, the next chapter provides a comprehensive analysis of the dependent variable through a review of the state's decision on trade concessions.

Chapter 3 China's Trade Concessions in Sino-American WTO Negotiation

3.1 Introduction

This thesis selects five industries, namely agriculture, textile and clothing, automobile, telecommunications services and banking to observe the variations of the dependent variable. The five sectors were among the final seven issues in the Sino-American negotiation for WTO accession. These issues were put aside to the year 1999, as no party was willing to accept the counterpart's offer. They had to make further concessions to break the deadlock so that they could seal the deal by the end of the year.

The thesis evaluates the concession by taking into account the three sources of information: negotiators' statements through both internal and public documents, a comparison of sectoral requests with the final Sino-American agreement and a comparison of sectoral expectation prior to WTO accession with sectoral performance in the post-WTO era. Having considered the three sources of information, the dependent variable across sectors is China's concession in agricultural, textile and clothing, but not in automobile, telecommunications and banking sectors (see Table 3.1).

Table 3.1 Indicators of Trade Concessions

Sectors	Agriculture	Textile and clothing	Automobile	Telecommunications service	Banking
Internal document and public statement claimed a concession in the sector	Yes	Yes	No	No	No
Sectoral request was NOT met by the final agreement	N.A.	Yes	No	No	No
Sectoral performance in the post-WTO era was worse than expected	Yes	Yes	No	No	No
Concession	Yes	Yes	No	No	No

Note: N.A. = not available

Source: compiled by the author

3.2 Concessions on Agricultural Sector

At the WTO negotiation table, major issues on the agricultural sector for Chinese representatives were to terminate export subsidies and eliminate non-tariff measures as requested by their American counterpart. Chinese and foreign scholars found that the agricultural sector was under-protected by the government in the 1980s and 1990s. The cheap agricultural products gave the US and other WTO members an illusion that the Chinese government must have provided huge export subsidies to the peasants. They requested that the Chinese government maintain its subsidies for the agricultural sector at a zero level.⁵ Though the Chinese government did provide some subsidies to the agricultural sector, the amount was not as huge as what the US had estimated. Besides, the subsidies did not go to the peasants alone. Most of them went to the intermediate agencies (Chen, 2000). In the Fifth WTO Working Meeting, China decided to terminate its export subsidies on the agricultural sector (Chen, 2000). The decision exposed the agricultural sector where the low price was caused by domestic industrial-agricultural price scissor to the danger of foreign anti-dumping suits.

⁵ China had officially abolished its direct export subsidies in 1991.

The Sino-US Agreement on Agriculture that was signed during former Premier Zhu Rongji's visit to the US in April 1999 was mainly to eliminate China's non-tariff measures against American agricultural products.⁶ Wen Tiejun from the Ministry of Agriculture (MOA) complained that when US Minister of Agriculture celebrated the conclusion of the bilateral agreement in April 1999,⁷ his Chinese counterpart never even had the chance of reading the document. Ma Youxiang, vice leader of the State Bureau of Development and Planning in the MOA, managed to join the Sino-American trade talks, but had little influence on the final deal (Yang, 2000: 88). The MOA was very pessimistic when China entered the WTO (He, 2000). They complained that the biggest challenge for China's economy would be in the agriculture sector. The sector expected a RMB 6-7 billion loss because of the Sino-American agricultural agreement (Ministry of Agriculture, 1999: 44).

Sino-US Agreement on Agriculture was reached earlier than the other issues—like automobile and telecommunications—because it was easier for Chinese negotiators to make concession on agricultural issue first (China Rural Economy Editorial Board, 2000: 355). In return, American agreed to firmly support China's accession within the year 1999 (*China, U.S. Issue Joint Statement on China's WTO Accession*, April 10, 1999). Because of the Sino-American agricultural agreement, other WTO members, including the EU, Canada and Japan, also became supportive of China's entry by the end of 1999 (Zuo and Song, 1999: 645). A stricter regulation on China's subsidies on agricultural sector was made to other WTO members to conclude the negotiations.

⁶ In accordance with the agreement on agriculture, China lifted the 30-year ban on American wheat from the seven states in the Northwest where was bothered by disease, lifted the ban on citrus fruit from Arizona, Texas and 18 counties in Florida, 21 counties in California except for Los Angeles County that experts considered had some technical problems and needed more explanatory data, and ratified American quarantine regulations on meat while retaining the right of random inspection.

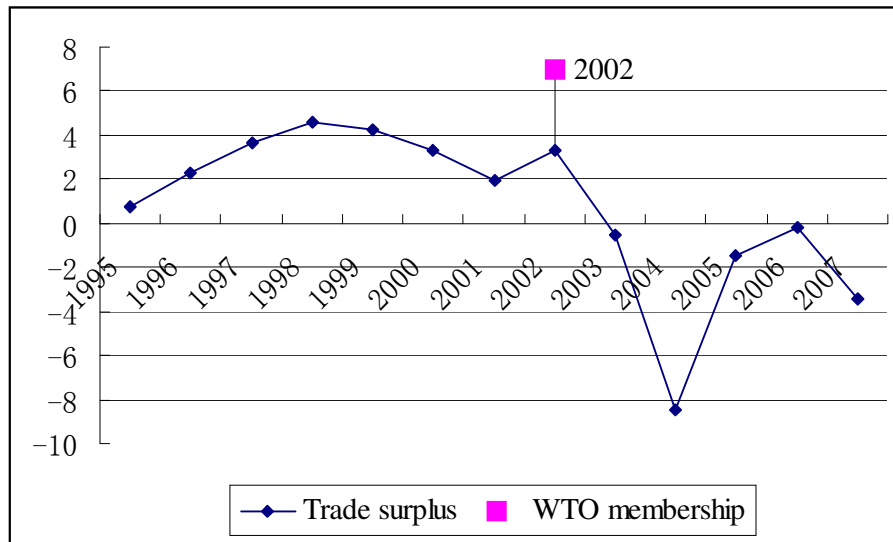
⁷ American Minister of Agriculture praised the deal as "a breakthrough for American agriculture sector".

In the end, China agreed to terminate import quota for all categories of agricultural products. A tariff rate quota was applied on some goods that were not competitive in international trade, like oil crops, wheat, corn, rice and cotton. China pledged not to provide export subsidies to the agricultural sector, something that neither the US nor the EU had agreed to implement for their own sector (Johnson, 2000; Wen, 2000: 92).⁸ China's average agricultural tariff rate, committed to decline from about 21% in 2001 to 17% by 2004 and from 31% to 14% on American priority agricultural products in the same time period, would even be lower than most of the developing countries (Yu and Frandsen, 2002). The reduction rates in grain, cotton, meat and soybean oil were much greater than the requirement by the Uruguay Round of agricultural agreement. The transition period for China was only five years compared to the 10-year transition period granted to developing countries.

Chinese peasants ended up as the only losers of the deal (Bhalla and Qiu, 2004: 77; Zuo and Song, 1999: 651). Former Premier Zhu Rongji repeatedly stated that the greatest impact after China's WTO accession would be on the agricultural sector and the billions of peasants (Ma, 2001; Sun and Meng, 2002; Lin and Zhang, 2003: 71). His concerns were confirmed by the performance of Chinese agricultural trade after accession. China's trade surplus experienced a slight growth in the first year of WTO membership before dipping significantly (Figure 3.1). China's agricultural trade moved from surplus to deficit in the post-WTO era.

⁸ It managed to secure farm subsidies at 8.5% of the value of domestic farm production in the range allowed by the developing country.

Figure 3.1 China's Trade Surplus in Agricultural Industry from 1995 to 2007 (US\$ billion)



Source: compiled from data in *China Agricultural Yearbook*, various issues.

3.3 Concessions on Textile and Clothing Sector

China's textile and clothing (T&C) sector was competitive in global trade in the 1980s and 1990s. The enterprises requested for the lifting of export quotas from importing countries through the negotiation. Prior to the negotiation, the State Bureau of Textile (SBT) was informed by the State Council to prepare for any possible concessions. The SBT accepted the decision without any complaints (interview, January 2009).

In face of pressure from American negotiators, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) easily backed down on T&C issues. Without protest from the SBT, Chinese negotiators decided to protect the automotive sector by sacrificing the T&C sector. Some key results of Sino-American negotiations on T&C sector with reference to China's WTO accession are as follows:

The Sino-American agreement in 1994 that produced the first quota on several classes of top-of-the-bed products effectively reduced China's exports to American

market (Scaling the Great Wall hard for U.S. home, 1997: 12). The two parties also agreed to limit the growth in Chinese exports of silk to the US to 1% each year (Chen and Nomani, 1994: A3). Although the US adopted a sweeping method of effectively reducing T&C imports from developing countries in the mid 1990s, “China was alone in having its growth rate cut back so severely” (Moore, 2002: 68).

During the fifth negotiation in February 1997, both sides agreed to sign a safeguard provision until the end of 2008 against all products subject to the Agreement of Textile and Clothing (ATC).⁹ During the 2005–2008 period, China would be the only WTO member that was subject to quota restrictions on its textile and apparel products (Lardy, 2001). The deal was consolidated in the final agreement of China’s WTO accession (World Trade Organisation, 2001). The agreement was also applicable to countries that did not impose quotas on China’s T&C exports previously (Liu and Sun, 2004: 60).

To maintain China’s quotas on foreign cars and spare parts imports till 2005, the MOFTEC in November 1999 allowed other countries to keep their quotas on Chinese textile and clothing products till the same year when the MFA expires.¹⁰ According to the agreement, Chinese negotiators would maintain 86.5% of textile products under American quotas until 2005 and 73.3% under EU quotas (Dickson, 2001, quoted from Williams *et al*, 2002: 580). American negotiators insisted on extending their quota for another five years from 2005 when the MFA was finally phased out as a condition for their support of China’s WTO membership (Moore, 2002: 70). Chinese negotiators rejected the request. In response, the US realised that emergency safeguard measures remained “the only realistic option which countries can lawfully take to combat fair

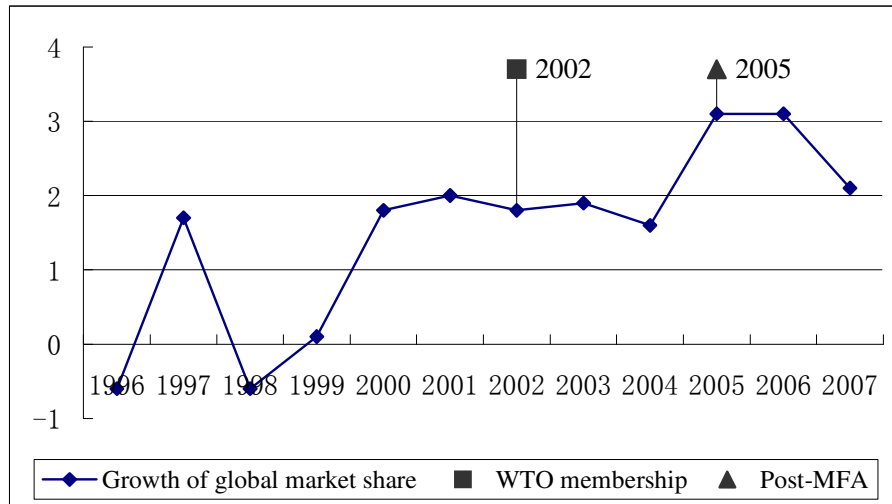
⁹ The safeguards can be applied “almost automatically” with no necessity of consulting Chinese government (Hufbauer, Wong, and Sheth, 2006: 30).

¹⁰ The GATT members reached the Agreement on Textile and Clothing (ATC) during the Uruguay Round to terminate the MFA by 1 January 2005.

import competition from China” (Panitchpakdi and Clifford, 2002: 76). Accordingly, they pushed Chinese negotiators to make a further concession in the final agreement, a special safeguard against China’s T&C exports, effective until 2013. According to the special safeguard agreement, “(I)n the event a WTO Member believes that imports of Chinese origin of textiles and apparel products covered by the ATC as of the date the WTO Agreement entered into force, were, due to market disruption, threatening to impede the orderly development of trade in these products, such Member could request consultations with China with a view to easing or avoiding such market disruption”(WTO, 2002).

In short, the T&C sector did not benefit from the WTO agreement. Its demand was turned down by the negotiators. Not only were export quotas retained but a new safeguard measure was imposed. Chinese T&C products were extremely competitive in global trade at that time. Its exports should have experienced notable increase after WTO accession. However, WTO membership did not have any impact on the growth trend of China’s global market share, compared to the phasing out of the MFA (Figure 3.2).

Figure 3.2 Annual Growth of Global Market Share of China's T&C Products from 1996 to 2007 (%)



Source: compiled from data in *China Textile Industry Development Report*, various issues.

3.4 Little Concession on Automobile Sector

On October 10, 1992, Tong Zhiguang, chief negotiator from the Ministry of Foreign Economic Relations and Trade (MOFERT) agreed to lower tariffs on automobile and auto parts imports and gradually remove import quota permits. The concession from Chinese side was significant enough to push Americans to promise that the “US staunchly supports China’s entry into GATT” (Wei, 2002: 695). However, the promise made by the MOFERT in bilateral negotiation was not well coordinated by domestic players, especially the State Planning Commission (SPC). The first voluntary reduction of overall tariff rate was on April 30, 1993. The tariff rates of 3,382 categories of imported products were reduced. The automobile products were not included in this round after extensive internal debate. The tariffs for automobiles were reduced during the second round on December 31 of the same year, from 180%-220% to 110%-150%. However, a controversial increase in tariff rate of foreign “448-Engine” produced by the First Automotive Works (FAW) from 25% to 45% was also made. The third round of voluntary reduction, including automobile

products in 1994, was opposed by the SPC at the Taxation Committee (*shuishou weiyuanhui*) Meeting in the State Council.¹¹

In 1994 when Chinese negotiators planned to seal the deal before the formalisation of the GATT, Li Xiaosong, vice director of the MOFTEC, publicly pledged that it would keep 10% (or 600) of the different categories of products in the extra-list that did not conform to the tariff reduction schedule.¹² There were 300 different categories in the automobile sector with a tariff rate higher than 40%. Automotive enterprises' purpose was to keep all these 300 categories in the extra-list and leave the other 300 to the rest of sectors. The SPC promised that the passenger car would be the last item to give up protection.¹³

Requested by the SPC in 1994, the Ministry of Machine Building (MMB) collected opinions towards the GATT/WTO from major automobile manufacturers. A report submitted to the SPC in September 1994 clearly stated that among the 150 categories of products, 61 categories should be protected (39 of the whole vehicle, 22 of the spare parts); 67 categories were allowed for some competition; and 22 categories were able to join a fair competition (interview, January 2009). The report has requested for the protection of the sector for another 5-8 years since China's entry into the WTO, with a possible extension to 8-10 years (Ibid.).¹⁴ Besides, they requested for the acceptance of China as a developing country, as the "special and differential" provisions of the GATT/WTO allowed developing countries to protect their infant industry (Anderson, 1997: 764; Chen, 2002a: 147). Their demand was met

¹¹ For details, see *Qichesi fusizhang Miao Yu zai quanguo qiche hangye zhiliang gongzuo yantaohui shang de jianghua* (Vice-director of Automobile division Miao Yu's speech at national conference of quality control in the automobile sector), 1994.

¹² But their bottom line was to keep at least 5% of different categories in the extra-list.

¹³ *Qichesi fusizhang Miao Yu zai quanguo qiche hangye zhiliang gongzuo yantaohui shang de jianghua* (Vice-director of Automobile Division Miao Yu's speech at national conference of quality control in the automobile sector), 1994.

¹⁴ See WTO regulations on Government Assistance to Economic Development with a special reference to the protection of infant industry.

by the government during the 1990s by comparing industry-required tariff rate and government-enforced tariff rate (Table 3.2).

Table 3.2 Comparison of Industry-Required Protection and Government-Enforced Protection in Automobile Industry

Year	Passenger car			Imported engine		
	1994	1995	2000	1994	1995	2000
Lowest import tariff rate required by the industry (average)	96.67	70.00	43.33	20	20	19
Government-enforced tariff rate	180	110	80	35	35	35

Source: compiled from data in *Tariff System of People's Republic of China* (from 1995 to 2001)

China and the United States started a new round of negotiations after China failed to enter the WTO as a founding member. American negotiators again requested for the liberalising of the automobile sector (Zhou and Wang, 2001). In response, the SDPC expressed its strong stance of protection.¹⁵ Finally, Chinese negotiators decided to protect the automobile sector by sacrificing the textile and clothing sector. In order to sustain the import quota of foreign automobile products till 2005, they allowed other countries to keep their quotas on Chinese textile till the same year. They also made American negotiators allow them to reduce the tariff rate from 80%-100% to 25% by the year of 2006 instead of 2005, a five-year transition period acceptable to the industry. In exchange, Chinese guaranteed a faster reduction in the first few years since its entry into the WTO (Table 3.3). Although the tariff rate was reduced especially in the first two years of the entry, foreign automobile products did not enter Chinese market as they expected. The passenger car industry was considered as one of the most uncompetitive sectors before the WTO accession. Thanks to government

¹⁵ Although there was some disagreement between the Department of Machinery, Electronics, Textiles, and Light Industry (DMETI) and the Department of Long-term Planning and Industrial Policy (DLPIP) within the SDPC (Wang, 2002: 34), the Commission spoke up in one voice that the automobile sector should be protected. The DMETI, a result of a merger between MMI and other ministries, was the immediate agency under the SDPC to regulate the central SOEs in the automobile sector. The DLPIP was responsible for the annual plan and coordination among different sectors. The DLPIP's request for making further concession in the automobile sector was opposed by the DMETI.

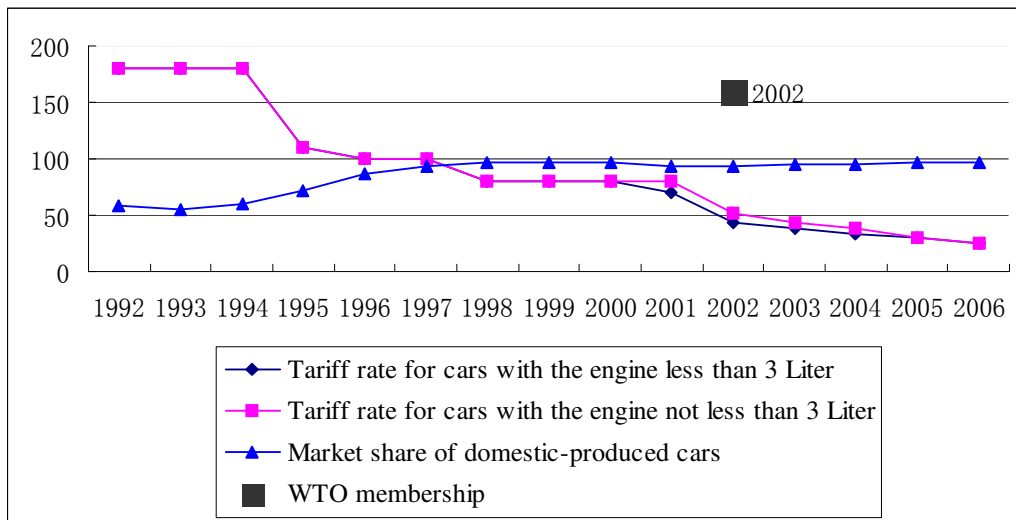
protection in terms of non-tariff barriers, the automobile sector did not hurt with China's accession to the WTO. The market share of imported passenger cars experienced a slight increase in the first two years, but shrank again in the following years. By 2006, foreign passenger cars accounted for only 3% of sales in the Chinese market (Figure 3.3). The automobile industry became one of major beneficiaries of the WTO accession.

Table 3.3 Tariff Rate Reduction and Reduction Rate in Passenger Car Industry from 2001 to 2006 (%)

Products	2001.1	2002.1	2003.1	2004.1	2005.1	2006.1	2006.7
<3Litres	70	44	38	34	30	28	25
Reduction rate	N.A.	37	14	11	12	7	11
≥3Litres	80	51	43	38	30	28	25
Reduction rate	N.A.	36	16	12	21	7	11

Source: compiled from data in Ministry of Commerce: Zhongguo jiaru shijie maoyi zuzhi falv wenjian (legal document concerning China's WTO accession), quoted from the CEI, 2004: 85

Figure 3.3 Tariff Rates for Foreign Cars and the Market Shares of Domestic-Produced Cars from 1992 to 2006 (%)



Source: compiled from data in *China Automotive Industry Yearbook*, various issues

3.5 Little Concession on Telecommunications Services

The US request for telecommunications services were to 1) create an independent regulatory agency and completely separate the administrative link

between the government and China Telecom; 2) formulate a transparent and non-discriminatory law or regulation on telecommunications sector; 3) grant foreign telecommunications service providers national treatment, open domestic value-added market to foreign investors immediately, and allow foreign companies to invest and operate value-added business; 4) provide an agenda of gradually opening up other value-added telecommunications service, wireless mobile communication service and wire communication service to domestic and foreign companies; 5) terminate China Telecom's monopoly on international telecommunications service and dual-monopoly (China Telecom and China Unicom) in the field of basic telecommunications services (Quan, 2002: 157).

However, Chinese negotiators did not show any intention of lifting the ban on foreign entry during Sino-American talks (Johnson, 1999a). It also squeezed the room of domestic competition from other state-owned telecommunications companies controlled by the other Ministries. In 1998, Wu Jichuan, representing the telecommunications sector, clearly stated that they were not ready to open up the sector (Guojia dianxin zhuguan bumen fuzenren Wu Jichuan shuo, woguo dianxin yewu duiwai kaifang tiaojian shangbu chengshu, 1998: 43).

Minister Wu's statement, however, did not stop Premier Zhu from making concessions during Zhu's April trip to the United States in 1999.¹⁶ The American media reported that Chinese negotiators had already agreed on the deal offered by their US counterpart. According to Zhu's offer, China would end geographic restrictions for mobile and cellular within six years and allow 49% foreign investment in all services and 51% foreign ownership for value-added and paging services in four years.

¹⁶ According to Johnson (1999a), a ministry official said, "When we left, we had agreed to allow foreigners 30% [stake in Chinese companies]...Now suddenly Zhu is offering 49% or 51%. There was no consultation with us."

However, Minister Wu had insisted upon giving only the minority stake to foreign companies (Kim, 2002: 448, fn.15). In order to protect sectoral interests, the MII uncovered internal disagreement to the public for the purpose of preventing the Chinese negotiation team from making too many concessions to WTO members in the final deal. He was rumoured to have tendered resignation on two occasions, one of which was at a Cabinet meeting to discuss reforms that Premier Zhu proposed during his April trip to Washington (Johnson, 1999b).

Minister Wu and the MII eventually won the internal battle in the State Council. The MII, according to Cooper and Chan (1999), considered lifting the ban on foreign involvement in the internet sector during talks in September, but insisted on protecting long-distance calls and value-added services. The final agreement between China and the United States in November 1999 allowed for 50% foreign ownership in paging service and internet content provision, and a 49% cap on basic telecom services (Lu and Wong, 2003: 79-80).

China's telecommunications services were less developed in global trade of services. WTO accession would have seen significant inflow of foreign investment, but did not. By 2008, there was very little foreign investment in the Chinese market, especially in basic telecom services, like fixed line and mobile. Some notable exceptions were Telefonica's 9% equity stake in China Netcom, Vodafone's 3% equity stake in China Mobile, and AT&T in the joint venture called UNISITI (Hsueh, 2008: 95).

3.6 Little Concession on Banking Industry

On 22 July 1993 when GATT members were about to conclude the Uruguay Round, the newly appointed negotiators from the American side brought up the issues

of trade in services in Sino-American negotiation (Bangsberg, 1993: 3A). As a result, more ministries such as the Ministry of Post and Telecommunications, PBOC, China Insurance Regulatory Commission, and China Securities Regulatory Commission were added to the coordination group.

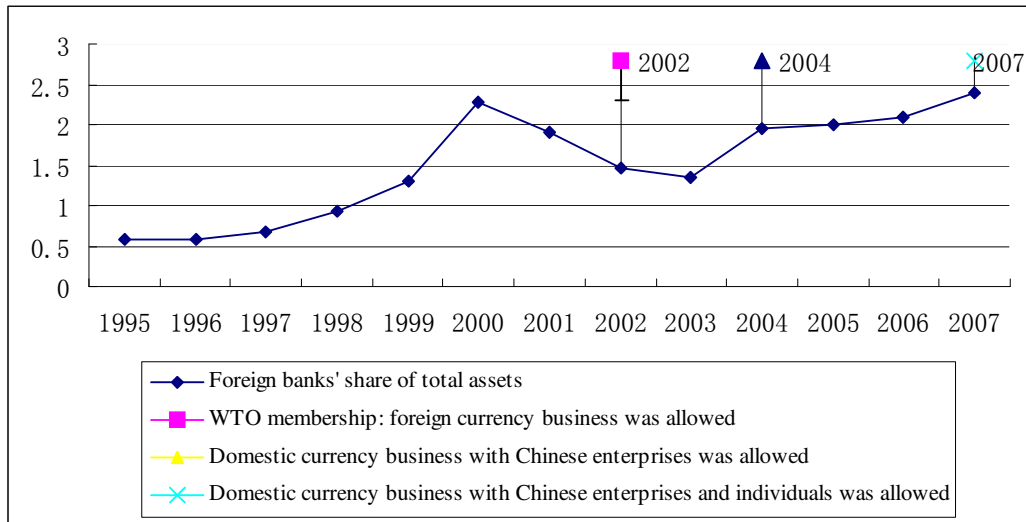
No concrete concession on the banking industry was made by the MOFTEC-led coordination group. Premier Zhu at the 1997 annual meeting of the World Bank and IMF in Hong Kong stated that a step-by-step approach was needed for the opening of the banking sector. In April 1998, Chinese negotiators, mainly staff from the MOFTEC, complained that they were not ready to make concession on banking industry due to the problems of “domestic coordination” as state banks wanted the large domestic market for themselves. The negotiators suggested putting the issue to the last (Satchit, 1999: 14-5). Rumours had it that the coordination group decided to give up their agricultural sector in exchange for certain benefits for the financial sector that was important to the MOF and PBOC (He, 2000). An early agreement on the agricultural sector between China and the United States in April 1999 paved the way for the negotiation of the other issues. A tentative agreement on the banking industry was also reached during Zhu’s April trip. The agreement to gradually open up the domestic banking industry included allowing American banks to conduct foreign currency business with Chinese clients one year after China’s accession. China will allow local currency business with Chinese enterprises starting two years after accession, and allow local currency business with Chinese individuals from five years after accession. China should allow the joint-invested bank on accession and allow the joint-invested bank become American bank five years later.

SDPC, SETC, MOF and PBOC representatives with interests in the banking industry were allowed to sit in at the Sino-American negotiation in November 1999 to

negotiate on any further request for concession from the sector. According to Long Yongtu (2009), among seven toughest issues in the final round of talks, Chinese negotiators successfully protected the interests of the banking industry by not submitting to requests for majority shareholding of foreign companies in the sector. They had tried “very hard to get the longest transitional periods” for opening up the banking sector (Long, 2008a).

Chinese banks were not competitive against global giants at that time. Their capability of surviving foreign competition became a great concern after WTO accession. Thanks to the effort of the negotiators, the banks had done much better under the WTO mechanism when “foreign-funded banks actually account for a smaller share of bank assets in 2003 than they did in 1997” (Naughton, 2007: 459). According to data from People’s Bank of China, foreign banks’ share of total banking system assets has decreased since WTO accession. It stood below 2% in 2004, 2% in 2005 and climbed to slightly over 2% by 2006 and 2.4% by 2007. When the agreement took effect by end 2006, foreign banks’ share in 2007 was just slightly higher than that in 2000 (Figure 3.4).

Figure 3.4 The Change of Foreign Banks' Share of Total Assets in Banking System from 1995 to 2007 (%)



Note: Total assets include the assets of state-owned banks, Rural Credit Cooperatives, Urban Credit Cooperatives, Insurance companies, Trust and Investment Corporations, Non-deposit Intermediaries, other commercial banks and foreign banks.

Source: compiled from data in *People's Bank of China* (China's Central Bank), 2000 – 2006, quoted from Allen *et al.*, 2007. Data of 2005, 2006 and 2007 foreign assets is from Xinhua (2006), the USTR (2008: 82) and Tong (2008), respectively.

3.7 A Brief Introduction to the Comparative Case Studies

Independent variables including competitiveness, market structure and government-industry relations determine the result of trade concession in each sector will be explained in detail from Chapters 4 to 8. The thesis will first make a sector-specific analysis over different time periods before making a comparative analysis across sectors.

Chapter 4 explains relations between the Ministry of Agriculture (MOA) and the agricultural industry. Since 1978, agricultural production has been pretty much laissez-faire as individual households is left very much on their own. Although the sector expected more challenges than opportunities from trade liberalisation, the MOA had little incentive to protect the sector. A concession on agricultural industry was made for potential gains to the banking industry through “horse trading”.

Chapter 5 examines relations between the textile and clothing industry and its supervising agencies that were downgraded from ministry to state bureau level. The industry was filled with a large number of small and medium-sized enterprises that were competitive in international trade. The State Bureau of Textile that had little connection with the industry gave “limited” support to the trade liberalisation. The sector’s request for lifting import quota against Chinese products was not raised. Its interest was sacrificed in exchange for the protection of the automobile industry.

Relations between SPC and automobile industry were analysed in Chapter 6. Since 1987, the autonomy granted to the automobile industry by the SPC has been gradually withdrawn, a reversal of major trends of separating government from the industry. Although fragmented oligopolies exerted a less coherent pressure on the government, the SPC had done a great job in protecting its subordinate enterprises.

Chapter 7 explores relations between the Ministry of Information Industry (MII) and telecommunications services. The Ministry of Post and Telecommunications (MPT) has gradually granted autonomy to local authorities since the early 1980s. The industry became dual-monopolies because of the entry of new players in 1994. However, the lack of cooperation between the monopolies controlled by different ministries has challenged the control of foreign entry barrier. The problem was solved in the 1998 government restructuring. The MII’s re-centralised control of the uncompetitive industry gave the ministry strong impetus to protect the sector.

Finally, Chapter 8 analyses relations between the MOF and banking industry. The government started to relax its control of the oligopolies gradually in the early 1980s, but regained certain control of the sector in 1995 and again in 1998. Because of close connection, especially strong rent-seeking incentive, the MOF effectively protected the sector that was not competitive in international trade of services.

Chapter 4: Agricultural Sector with Little Protection from the Ministry of Agriculture

4.1 Introduction

Anderson and Hayami (1986: 1) observed a pattern of agricultural protection in East Asian countries. The pattern showed that, as economies grow, the governments “tend to change from taxing to assisting or protecting agriculture relative to other sectors, and that this change occurs at an earlier stage of economic growth the weaker the country’s comparative advantage in agriculture”. However, scholars studying China’s agriculture suggested that China’s agricultural policy did not follow the same pattern in the 1980s and 1990s, as they did not see an evolution in protective measures. For example, Huang *et al.*’s (2007) calculation of the Nominal Rate of Assistance (NRA) in China’s agricultural sector implied that the agricultural sector during this period was under-protected.¹⁷ The policy outcome was shocking as seen through a comparison of the NRA between the agricultural and non-agricultural sectors (Table 4.1). The Chinese Academy of Social Sciences (1998: 44), Carter and Estrin (2001), Chen (2000: 40–3), and Du (2001: 57) also found that the agricultural sector had never been protected by the state in international trade before China’s entry into the WTO. In response, Anderson, Martin, and Valenzuela (2007) explained that experience from the last two decades proved that China was still in the early stage of taxing the agricultural sector; a protective policy was foreseeable in the long run.

¹⁷ According to Huang *et al* (2007: 23), the NRA that is constructed by estimating an NRA on output is used to compare the price of a commodity in the domestic economy at the port with the international price of the commodity at the border, taking into account inherent differences in product quality where appropriate. A positive NRA indicates that the sector is being protected, while a negative NRA points to forms of taxation.

Table 4.1 Nominal Rates of Assistance to Agricultural Relative to Non-Agricultural Industries, China, 1981 to 1999

Item/year	1981-84	1985-89	1990-94	1995-99
All agricultural tradables*	-45.2	-35.5	-14.3	6.6
All non-agricultural tradables	41.6	28.3	24.9	9.9

Note: Assuming all agricultural production is tradable and including product and non-product specific subsidies.

Source: Huang et al (2007: 60).

Politically, the support from the peasants is fundamentally important to the Communist governance. Throughout Chinese history, there were plenty of lessons that the government would be overthrown by the peasants' rebellions. The central state in contemporary China takes rural stability as the "overwhelming concern" (Han, 2005). However, its good will and supporting policies that were meant for gradually revising deteriorating position of the agricultural sector were always distorted by the local authorities (Bernstein and Lü, 2000). On the threshold of WTO accession, the level of rural instability was already significant, "preoccupying Chinese leaders" (Han, 2005). If that is the case, how could Chinese negotiator make such a huge concession on the agricultural sector, which would in turn escalate the state-peasant tensions?

This study suggests that Chinese negotiator adopted a horse-trading strategy. In order to enlarge the size of the domestic win-set, it had to give up the agricultural sector, as the negotiators received much less pressure from either the Ministry of Agriculture at the top of the hierarchical system or the peasants at the grass root. The negotiators did not have to bear the major responsibility of escalating the state-peasant tension, as the protests were always scattered and primarily targeted at the local authorities. Besides, the process of moving to a protective policy on the agricultural sector would be *very* long due to the divergent interests of the Ministry of Agriculture (MOA) and Chinese peasants. China's concessions for WTO accession in the

agricultural sector prior to the emergence of protectionist pressure, which is different from the experience in Japan and South Korea, made this process even longer and more costly.

4.2 Government-Industry Relations in the Agricultural Sector

4.2.1 The Agricultural Industry

The agricultural sector in China includes four different subsectors, namely forestry, animal husbandry, fisheries, and agriculture (which can be further separated into grain crops (e.g., wheat, rice, and corn) and cash crops (e.g., cotton, oil crops, sugar crops, fruits, and vegetables)). The reliance on grain crops and cash crops remained significant but had been declining as their composition of total output value in the sector decreased from 80% in 1978 to 57.7% by the end of the 1990s (Table 4.2). Fisheries and animal husbandry emerged as important alternatives as the two subsectors together accounted for almost 40% of the total output value in agricultural industry in 1999.

Table 4.2 Composition of Total Output Value of Agriculture, Forestry, Animal Husbandry and Fisheries (%)

Sector/year	1978	1985	1996	1999
Fisheries	1.6	3.5	9.0	10.3
Animal husbandry	15.0	22.1	26.9	28.6
Forestry	3.4	5.2	3.5	3.6
Agriculture (grain crops and cash crops)	80.0	69.2	60.6	57.5

Source: China Agriculture Yearbook (2000: 12).

4.2.2 Supervising Agencies in the Central Government

Central control of the agricultural sector was fragmented, as there were as many as fourteen different governmental agencies supervising the sector (Shi, 2008: 48). In the State Council, the State Planning Commission (SPC) –changed to the State Development and Planning Commission (SDPC) during the 1998 Administrative

Reform – stayed at the top of the hierarchy. Other agencies at the ministerial level were the MOA, the Ministry of Commerce (MOC) (downgraded to the State Bureau of Commerce (SBC) in 1998), the Ministry of Foreign Economic Relations and Trade (MOFERT) (changed to the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) in 1993). Certain agencies were assigned to supervise the subsector of grains that was strategically important for food security (Wen, 2000: 86). These were the State Grain Bureau (SGB) and State Administration for Grain Reserves (SAGR) which came under the SDPC in 1998.

The replacement of the commune system with the Household Responsibility System (HRS) in the early 1980s significantly restrained the MOA's control of agricultural sector. The SGB under the MOC/SBC and the MOFERT/MOFTEC became more connected with the sector for their own interests. This section analyzes the administrative and fiscal/financial links between individual households and different governmental agencies at the national level. The result explains their different efforts to protect the sector in the WTO negotiations.¹⁸

4.2.3 “Decentralisation” in the Agricultural Sector

The agricultural sector in the 1980s and 1990s experienced three distinctive stages of development.¹⁹ The first stage (1978–1986) freed the peasants from administrative control by the MOA in agricultural production through decollectivization (Findlay, Martin, and Watson, 1993: 45). The second stage (1985–1995) liberalized the domestic market controlled by the MOC and the price control by

¹⁸ The MOA's administrative and fiscal control of township and village enterprises (TVEs) is not the focus of this study. The commune and brigade enterprises under the MOA in central-planning period transformed to TVEs since the introduction of the HRS (Zweig, 1993: 421). Although the TVEs remained supervised by the MOA, most of them did not engage into agricultural production.

¹⁹ For example, de Brauw, Huang, and Rozelle (2002) divided the period of economic reforms in agricultural sector into two stages: the early reforms (1978-84) were dominated by decollectivization and the rise in incentives for peasants and the later reforms (1985-95), in contrast, have focused on the gradual attempt by leaders to liberalize the economy and develop market institutions.

the SPC. During the third stage (1995–1999) at the threshold of China’s WTO accession, the central government implemented a series of policies to regain control of the domestic market and international trade in the grain sector (Wang, 2001).

4.2.3.1 Granting Autonomy to Individual Households by the MOA, 1978–1986

Separating the MOA from individual households was carried out in a manner of successful “shock therapy”. The idea of giving autonomy to the industries in China’s economic development first appeared in the sector of agriculture.²⁰ Chinese peasants “invented” the Household Responsibility System (HRS) in 1978 in drought-stricken Fengyang County, Anhui Province. It would be more appropriate to say that the Chinese peasants had no choice but to break the central planning system. They risked their lives to sign the contract which allowed individual households to use land that was still collectively or state-owned.²¹ Under the HRS, the peasants had incentive to invest in the contracted land for higher agricultural production.²² In the early 1980s, the strongest opposition to the HRS in the State Council came from the Agriculture Commission and the MOA (Zhang, 1997). They refused to give up their administrative control of the communes. However, the State Council approved the HRS and agreed that it would be a possible way to free its investment in agricultural production. Chen Yonggui (the Vice Premier supervising the agricultural sector) and Wang Renzhong (Head of Agriculture Commission) who opposed the HRS were removed from their positions. In March 1982, the Agriculture Commission was broken down into two consultation agencies called the Rural Group of the Policy Research Section of the Central Committee of the CCP (*Zhonggong Zhongyang*

²⁰ China’s reform started with the agricultural sector. See Ash (1993).

²¹ For details from Fengyang County, see Hinton (1990: 48-73) and Beijing Youth Daily (1993).

²² As de Brauw, Huang and Rozelle (2002) found out, the HRS led to sharp increases in output and greater efficiency. Also see McMillan, Whalley, and Zhu (1989).

Nongcun Zhengce Yanjiushi) and Research Centre of the State Council on Rural Development (*Guowuyuan nongcun fazhan yanjiu zhongxin*). Having cleared out hurdle of central opposition, the HRS was set for nationwide implementation. In 1984, the government assured the peasants by promising that the division of land would remain in effect for at least 15 years. By 1986, almost all China's peasants had adopted it (Jae, 2000: 77).

The prevalence of the HRS brought an end to the administrative control of the MOA through state-owned communes. The communes under the MOA used to be effective in controlling the production management during the central planning period. The introduction of the HRS system in the early 1980s granted individual households the autonomy to plan their agricultural production (Kojima, 1988: 720; Findlay, Martin, and Watson, 1993: 16). The MOA had shifted its priority from micro-planning to macro-supervision.

The communes used to be an effective planning organ for the MOA to control land, labour, and capital. During the central planning period, the commune was the basic unit of organisation. The MOA encouraged nationwide communes to copy the structure of Dazhai (*xuedazhai*) (Wu, 2003: 237). Thanks to the HRS, the communes were broken down into individual households that became the basic unit of organisation (Jiang, 2003: 264).²³ The HRS allowed the peasants to rent land and invest in infrastructural construction on the designated land.²⁴ Their rights were extended on the base of 15-year land contracts in 1985 and extended again in 1998 based on 30 years of land use. Labour management was not on longer subject to the communes under the MOA. The peasants were responsible for their day-to-day work on the contracted land (Hartfort, 1991: 492–4). They were even allowed to leave the

²³ The rural cooperatives emerging after the elimination of the communes were different, as they were privately owned by the peasants (Tuan, 1991: 506). Their internal organization was free from supervision by the MOA.

²⁴ For large projects in the region, households' investment was collected through various forms of local taxes.

land if they wanted to become urban residents.²⁵ The MOA also lost control of the peasants' wages and bonuses calculated using "work points" in the communes (Naughton, 2007: 241). Instead, under the HRS the peasants' income was determined by the investment and effort they put into their land. According to Huang and Yang (1999: 72–4), by the mid-1990s more than half of the peasants' net income came from non-agricultural activities. The central state had thus successfully freed itself from investing in the sector with the introduction of the HRS. State budget on fixed assets investment in the agricultural sector decreased by almost half after 1984 (Table 4.3), and state banks systematically shifted funds away from farming (Huang and Ma, 1998). Local governments also passed the responsibility of financing the construction of rural infrastructure to private farming families (Wang et al., 2005). Consequently, the peasants ended up as the primary investors (Findlay, Martin, and Watson, 1993: 16, 33).

**Table 4.3 Investment in Fixed Assets of State-Owned Units by Sector
(Composition Percentages: %) (1981-1994)²⁶**

Sector/year	1981-1984	1985-1988	1989-1991	1992-1994
Total investment	100	100	100	100
Agriculture*	4.5	2.4	2.6	2.1
Energy industry	22.3	22.8	27.4	19.8
Transport, post, and telecommunication	11.7	12.4	12.0	18.2

Note: agriculture sector includes farming, forestry, animal husbandry, fishery, and water conservancy.

Source: *Zhongguo guoqing baogao 1978-1995* (1996: 69)

²⁵ For the analysis on land disposal, see Liu (1999: 114-5).

²⁶ According to China Statistical Yearbook (2001, quoted in Huang and Rozelle, 2002: 4), the ratio of agricultural investment to agricultural gross domestic product (AGDP) has monotonically declined since the late 1970s. In 1978, the state invested 7.6% of AGDP. By 1995, the proportion of AGDP committed to investment fell to 3.6%. In 1990, the MOA requested for a growth of state investment. According to the request, the rate of state investment on rural infrastructure construction to the state gross investment on infrastructure construction should increase from 3.2% in 1989 to 6% in 1995; the rate of rural budget to the state budget should rise from 5.94% in 1989 to 8% in 1995; and the rate of rural loan to national loan should grow from 8.4% in 1989 to 10% in 1995 (Ministry of Agriculture, 1990: 37). However, the data in 1995 shows that their request was not approved. Also see World Bank (1991: 37) and Hu (1991: 6).

4.2.3.2 Granting Autonomy to Individual Households by the MOC and the SPC, 1985–1994

The agricultural sector experienced three instances of relative overcapacity from the mid 1980s to 1999. The first was in 1984.²⁷ The state freed itself from purchasing all agricultural products by signing contracts with peasants allowing them to sell their surplus products on the market. Because of the shortfall in budget, the state gave up its monopoly of purchase and marketing (*tonggou tongxiao*) in 1985. The government decided not to pass the rising cost of agricultural products to urban consumers. Meanwhile, the government was not willing to absorb all that the peasants produced. A dual-track price was the only possible means at the time (Harding, 1987: 103).²⁸ In 1984, the MOC effectively controlled the sales of nine agricultural products on the domestic market (Kojima, 1988: 721). The state gradually liberalized the domestic market of agricultural products (Sicular, 1995; de Brauw, Huang, and Rozelle, 2002). Meanwhile, the SPC started to relax its control of pricing agricultural products since the early 1980s (Sicular, 1995; Tan and Xin, 1999: 51). In addition, the MOC started to devolve its control of the procurement of input materials to the Chinese Supply and Marketing Cooperative (OECD, 2005). Being responsible for their own income, the peasants were free to purchase input materials from domestic market like seeds, fertilizer, and agricultural machinery. However, international procurement of fertilizer remained the monopoly of the MOFTEC (OECD, 2005: 90).

²⁷ The second time of relative overcapacity was from 1990 to 1991. The third time was after 1996.

²⁸ For the details of the government decision, see *People's Daily* (1985). However, as Lin Yifu found out, a policy change of the government's monopoly for purchase and marketing to contract system did not change their practice in 1985. As the agricultural sector experienced huge contraction in 1985, the government retained its control of the purchase and marketing (Peng et al, 2008: 238).

4.2.3.3 Decentralisation by the MOA vs. Centralisation by the SPC and the SGB, 1995–1999

Partially in response to Brown's (1995) terrifying assertion that China could not feed itself, the State Council introduced the "governor's grain bag responsibility system" (*midaizi shengzhang fuzezhi*) in 1995. Thereafter, a food self-sufficiency policy was promulgated under which 95% of food consumption should be supplied by domestic products (Chen, 2002: 52). The MOA's authority in planning grain production was further encroached by provincial leaders after the new policy (Xu, 2001: 162; Song, 1997).²⁹ The MOA reserved its opposition to the policy on the date of implementation, but stated publicly in 2000 that the policy that granted provincial governors the power to manage grain production and marketing had restrained the MOA's efforts at controlling agricultural production through its nationwide policy (Dang, 2001: 52).

In contrast, both the SPC and the SGB strengthened their control during this period. The SPC re-imposed a mandatory price on grain products in 1995. By the end of the 1990s, the grain price in the domestic market consisted of two parts, namely the floor-purchasing price set by the SDPC and operation cost/profit of the SGB (Colby, Diao, and Tuan, 2001: 177–8).³⁰ The grain price for exportation was determined by three parts including the floor-purchasing price set by the SDPC, the operation cost/profit of the SGB, and the operation cost/profit of the MOFTEC (Crook, Langley, and Tuan, 1999: 47). In 1998, private companies' rights to directly purchase grains from peasants were terminated. The SGB regained exclusive control of

²⁹ Although provincial leaders were ultimately responsible for balancing agricultural production and marketing in their respective regions, a survey done by the Center for Chinese Agricultural Policy revealed that the peasants still made the planting decision with no intervention from local officials (Rozelle *et al.* 2006).

³⁰ The SDPC introduced the floor purchasing price in the purpose of protecting peasants' interests. Meanwhile, the State Council mandated the SGB to secure profit from grain trade to reduce already huge subsidies. In order to guarantee the profit and prevent the inflation, the SGB forced the peasants to lower their sale prices that were even lower than the floor prices introduced by the SDPC.

domestic grain market, including wheat, rice, corn, and soybeans (Brummer et al., 2006: 65).³¹

4.2.4 Administrative Connection between the Government and the Industry in the Agricultural Sector by the end of the 1990s

The replacement of the commune system with the HRS in the early 1980s significantly restrained the MOA's control of the agricultural sector. The SGB under the MOC/SBC and the MOFERT/MOFTEC became more connected with the sector. This section analyzes the administrative connection between individual households and different governmental agencies at the national level by the end of the 1990s.

A detailed explanation of this complexity is as follows (Table 4.4): 1) Plan of production management. As the agricultural production (especially grains) was in relative overcapacity in the late 1990s,³² no central agency effectively intervened in the production at the time.³³ 2) Capital investment. The peasants became primary investors (Findlay, Martin, and Watson, 1993: 16, 33). The SPC/SDPC had little chance of flexing its approval authority as household investment did not exceed US\$ 30 million, which was the minimum requirement for SPC/SDPC's involvement. Foreign investors were hesitant due to non-guaranteed returns and usually chose small-scale project investments for the convenience of negotiating with local governments rather than the SPC/SDPC (Rozelle, Pray, and Huang, 1999: 36; Ni, 2001). 3) Allocation of wage and bonus. The peasants' income was determined by the investment and effort they devoted to their land. According to Huang and Yang (1999: 72–4), more than half of the peasants' net income came from non-agricultural

³¹ Domestic marketing of cotton started to be liberalized in 1999, although foreign trade was still under strict control (Fang and Babcock, 2003: 8).

³² According to the SBC, 97.3% of agricultural products were balanced between supply and demand, 50% of which were relatively overcapacity in the end of 1990s (Lin and Zhang, 2003: 13).

³³ As Sicular (1988: 678) documented, central concern of "loss of control" waned, when grain surpluses began to emerge after the introduction of HRS. The rationale was applicable to explain the situation in the late 1990s.

activities by the mid-1990s. 4) Asset management. Except for the projects sponsored by the MOA – which was in a small number – for public use (Vermeer, 1997), the central government had little control of fixed assets on contracted lands (Findlay, Martin, and Watson, 1993: 16).³⁴ 5) Personnel and labour management. The peasants were responsible for their day-to-day work on their land (Hartfort, 1991: 492–4). For regions where there was a short of labour, the rules of hiring labour were stricter but still subject to the interpretation of local leaders (Rozelle, 1994: 107–8). For regions where there was a labour surplus, the peasants were given more freedom to choose their careers in other sectors (Sicular, 1997: 206).³⁵ 6) Procurement of material. The MOC which was downgraded to the SBC under the State Economic and Trade Commission (SETC) in 1998 gradually devolved its control of procurement of products like seeds, fertilizer, and agricultural machinery in the domestic market, to the Chinese Supply and Marketing Cooperative by the end of 1990s (OECD, 2005).³⁶ However, the international procurement of fertilizer remained to the monopoly of the MOFTEC (OECD, 2005: 90). 7) Alliance management. Individual households were able to combine their lands for mass production, subject to the approval of the leaders in the village. The central government had little influence on their decisions. 8) Price. The prices of most agricultural products were market-determined except for strategic ones like grain. Grain price in the domestic market was set by the SDPC and SGB, while grain price for exportation was determined by the SDPC, SGB, and MOFTEC. 9) Internal organisation. The MOA lost control since the abandonment of the commune system in the first half of the 1980s. 10) Sales. The SGB regained monopolistic control of some prime food grains, including wheat, rice, corn, and

³⁴ Veeck ed. (1991) describes how the contract was disrupted by local leaders in Heilongjiang province.

³⁵ Farm labours chose to work in either private enterprises or rural township and village enterprises (TVEs) in the region or construction sector and service sector in coastal cities (Gale, Somwaru, and Diao, 2002).

³⁶ Zhang et al. (2005, quoted from Huang et al. 2007)'s survey of households in eight provinces revealed that the peasants were able to purchase all of their chemical fertilizer on their own.

soybeans (Brummer et al., 2006: 65).³⁷ The export of agricultural products was supervised by central agencies including the SDPC as the ultimate decision maker and the Cereal, Oil, and Foodstuffs Importing and Exporting Corporation (COFCO) under the MOFTEC as the practical trader (Crook, Langley, and Tuan, 1999: 47; Carter and Rozelle, 2002: 28; Carter et al., 1998).³⁸

A brief survey reveals the fragmented nature of state control over the agricultural sector. Surprisingly, the MOA exerted little administrative supervision of the sector.³⁹ As long as the precondition of food self-sufficiency was guaranteed, the MOA was relatively irrelevant. Instead, the SGB and MOFTEC had more exposure in the sector (10% and 15% of full control respectively).⁴⁰ They were able to influence peasants' agricultural production through their administrative control of price, sales, and importation of foreign input materials. The agricultural sector was relatively "low stake", enjoying a lot more autonomy (85% of full autonomy) than other sectors. The next section explores the fiscal/financial ties between central agencies and agricultural sector.

³⁷ Domestic marketing of cotton started to be liberalized in 1999, although foreign trade was still under strict control (Fang and Babcock, 2003: 8).

³⁸ As Crook, Langley, and Tuan (1999: 48) documented, the central COFCO had been competing with provincial COFCO branches under local authorities since 1992. According to Carter and Rozelle (2002: 28), there were about 200,000 foreign trade companies engaging in agriculture trade. However, strategic agricultural products, like food grains, were still subject to state control.

³⁹ Among the 10 areas of autonomy in individual households, full control was coded as 100% control, partial as 50%, and little as zero. Accordingly, the administrative connection between the MOA and agricultural sector in 1999 was: (AC)=0

⁴⁰ The administrative connection between the SGB and agricultural sector in 1999 was: (AC)=10%*50%+10%*50%=10%. The administrative connection between the MOFTEC and agricultural sector in 1999 was (AC)=10%*50%+10%*50%+10%*50%=15%

Table 4.4 Administrative Connection between Government and Industry in the Agricultural Sector by the end of the 1990s

Items	Degree of control	Supervising agency	Items	Degree of control	Supervising agency
1. Plan of production management	Little	MOA	6. Procurement of the materials	Partial	MOFTEC
2. Capital investment	Little	SDPC	7. Alliance management	Little	MOA
3. Allocation of wage and bonus	Little	MOA	8. Price	Partial	SDPC, SGB, MOFTEC
4. Asset management	Little	MOA	9. Internal organisation	Little	MOA
5. Personnel and labour management	Little	MOA	10. Sales	Partial	SDPC, SGB, MOFTEC

Source: compiled by author

4.2.5 Fiscal/financial Connection between the Government and the Industry in the Agricultural Sector by the end of the 1990s

Fiscal connections between the MOA and individual households were few at the threshold of China's WTO accession. Chinese peasants remitted their tax revenue to the MOF at the centre and township/village administrations at the local. The MOA did not receive private revenue income from the industry like the MII did.⁴¹ Its sectoral policy was mainly supported by the central budget allocated by the MOF. The budget covered the administrative expenditure of the MOA, central investment on irrigation system, and education and research in its affiliated institutions.

"Peasant burden" was a well-known problem and could not be effectively solved up till then. However, the MOA did not bear direct responsibility for it. By the end of the 1990s, peasant burden was generally composed of four categories. They were: tax revenue remitted to the MOF, five *tongchou* to the township, three *tiliu* to the village, and other fees paid to various governmental institutions (OECD, 2005:

⁴¹ The MOA retained its private revenue income from the TVEs. But most of the TVEs were not doing business in agricultural sector.

99). Since the dissolution of the communes, townships and villages were responsible for collective welfare in the countryside. Five *tongchu* and three *tiliu* were used for education, infrastructure construction, and administration expenses. These were the main sources of the huge burden on the peasants. Although the central government had repeatedly mandated township and village administrations to relieve the burden, little was done.

The amount of tax revenue remitted to the MOF did not change after the implementation of the HRS. As documented by Aubert and Li (2002: 162), the agricultural tax by 1999 was fixed at 15.5% of the normal grain yield according to the law promulgated in 1958. The practical tax collected from the peasants was at a lower rate of 12.5% (Table 4.5).⁴² This part of the tax was less than the fees remitted to the townships and villages (Kwiecinski and Li, 2002: 43) but had been rising since the late 1990s.⁴³

**Table 4.5 Agricultural Tax Remitted to the Central Government
(RMB Million-current prices)**

Year	1991	1993	1995	1997	1999
Tax revenue	5665	7265	12812	18238	16308

Source: Ministry of Finance (2004)

To conclude, there were very few fiscal/financial and administrative connections between the MOA and individual households after the introduction of the HRS. Surprisingly, the SGB and MOFTEC had exerted more administrative intervention than the MOA in the sector. Since the agricultural reforms, the sector became “low stake” which in turn led to the possibility of divergent interests between the government and peasants. The following sections will explore the sectoral interest and

⁴² Other agricultural-related tax included animal husbandry tax, land-use tax, contract tax, and special agricultural products tax.

⁴³ According to Aubert and Li (2002: 166-7), agricultural-related tax was on the rise in the late 1990s. In the year of 1999, the distribution of tax and fees shouldered by Chinese peasants was: agricultural tax (31%), village *tiliu* (28%), township *tongchou* (21%), and other administration fees (20%).

bureaucratic interests of individual supervising agencies at the threshold of WTO accession.

4.3 Sectoral Interests on Trade Negotiation

Generally speaking, the agricultural industry as a whole had expected to see more challenges than opportunities if Chinese negotiators accepted American requests to lift its non-tariff barriers against US products.

Economists disagreed on the potential competitiveness of China's agricultural sector in a liberalized international trade. Mainstream researchers preferred to analyze the competitiveness through the understanding of its international comparative advantages. They generally agreed that Chinese agricultural products were competitive if they were labour-intensive, but uncompetitive if they were land-intensive (Table 4.6) as China's agriculture was labour-rich but land-scarce.⁴⁴ Accordingly, the sector as a whole was not competitive. To be specific, in the subsectors, land-intensive agricultural products including grains, vegetable oil seeds, cotton, and wool accounted for more than 50% of the total output value in the agricultural industry in 1999. They requested for state protection as they were not competitive. In contrast, labour-intensive agricultural products including animal products, horticultural products, and processed agricultural products accounted for less than half of the total output value. They requested for trade liberalization as they expected more exports under the WTO mechanism.

⁴⁴ Also see Wen (2000: 90)

**Table 4.6 Scholars' Estimates of the Competitiveness of
China's Agricultural Industry**

Features Products	Labour-intensive		Land-intensive		
	Animal products	Horticultural products	Grains	Cotton	Oil crops
Lin (2000)	Competitive	Competitive	Uncompetitive	Uncompetitive	Uncompetitive
Huang, Chen, and Rozelle (1999)	Competitive	N.D.	Uncompetitive	N.D.	N.D.
Tuan, Cheng, and Peng (2001)	Competitive	N.D.	Uncompetitive except wheat	Uncompetitive	Uncompetitive
Schmidhuber (2001)	N.D.	Competitive	Uncompetitive	N.D.	Uncompetitive

Note: N.D.: not discussed
Source: compiled by author

Carter (1999) questioned the methodology by asserting that comparative advantage was an important variable but it was not the only one. According to his analysis, not all of the trade flows in agricultural products were determined by comparative advantage. For example, the demand of sugar was strongly affected by domestic output and weakly by per capita household income and relative prices. Increasing importation of wheat after the WTO accession was expected as the key reason of increasing income. Wang et al. (1998) also contended that the comparative advantage in terms of relative price would have little impact on bilateral agricultural trade between China and the United States. Chen, Xu, and Duan (1999) found that China's growing exports of agricultural products during the period from 1980 to 1996 correlated with the decreasing comparative advantage. As the negative correlation challenged mainstream views, they explained that the growth of world demand and a favourable market distribution effect were the alternative causes of export growth. He and Tian (1999) indicated that the comparative advantage of the labour-intensive sector such as livestock had been declining due to inferior product quality and poor marketing that had become important indicators of competitiveness.

The government's evaluation concluded that the agricultural sector was not competitive in international free trade, as some individual researches by MOA

officials hinted that their analyses were in line with mainstream argument. For example, Du Ying (2001) (Director-General, Department of Sectoral Policy and Law, Ministry of Agriculture) argued that China was competitive in labour-intensive subsectors (such as animal products and horticultural products) but uncompetitive in land-intensive subsectors (like grains and cotton). As the production of grains and cotton that were strategically important for food security accounted for more than half of agricultural output (National Bureau of Statistics of China, 2000), the sector overall was believed to be uncompetitive.

4.4 Sectoral Pressure on Trade Negotiation

Huang et al. (2007) characterized China's agricultural production in the 1980s and 1990s as *laissez faire*. Since the introduction of the HRS in the early 1980s, individual households enjoyed autonomy in the areas of investment, asset management, and production. They had been responsible for their own survival in domestic market. According to Crook (2001: 16), most peasants had little knowledge of the WTO and the impact of joining the WTO at the time. Besides, there was no administrative channel for them to express their requests. It explains Anderson and Hayami's (1986) assertion that "farmers in China are not yet in a position to form a strong lobbying force for agricultural protection".⁴⁵ In contrast to hot debates among economists, the voice from agriculture producers was almost absent. Accordingly, agriculture producers exerted little pressure on the MOA to protect the sector, compared to enterprises in other sectors.

In addition, though agricultural production was *laissez faire*, the domestic market and international trade of agricultural products remained the monopoly of

⁴⁵ Frederick Crook who retired from the Markets and Trade Division of the Economic Research Service at the US Department of Agriculture also said that, "China's farmers had little input in China's decision to join the WTO" (Chen, 2002).

state-owned enterprises (SOEs) (Sicular, 1988, 1995; Perkins, 1988; Lin, 1992; Watson, 1988; de Brauw, Huang, and Rozelle, 2002; Carter et al., 1998). These enterprises were reluctant to lift entry barriers, as foreign competition would jeopardize their monopolistic profit. They were able to influence their supervising agencies – the MOC or MOFERT/MOFTEC – to retain state control.

To conclude, regarding the competitiveness of the agricultural sector, both independent economists and the MOA generally agreed that the sector was competitive in labour-intensive products, but uncompetitive in land-intensive products. The sector as a whole expected to see more challenges than opportunities after China's WTO accession. However, agriculture producers in the sector could not effectively express their concern to the government. They imposed little pressure on the MOA to protect the sector during the WTO negotiations. Having given up control of the sector, the MOA directed its focus to bureaucratic interests which were not convergent with sectoral interests at the time. The next section explores the bureaucratic interests of individual supervising agencies in trade negotiation.

4.5 Bureaucratic Interests in Trade Negotiation

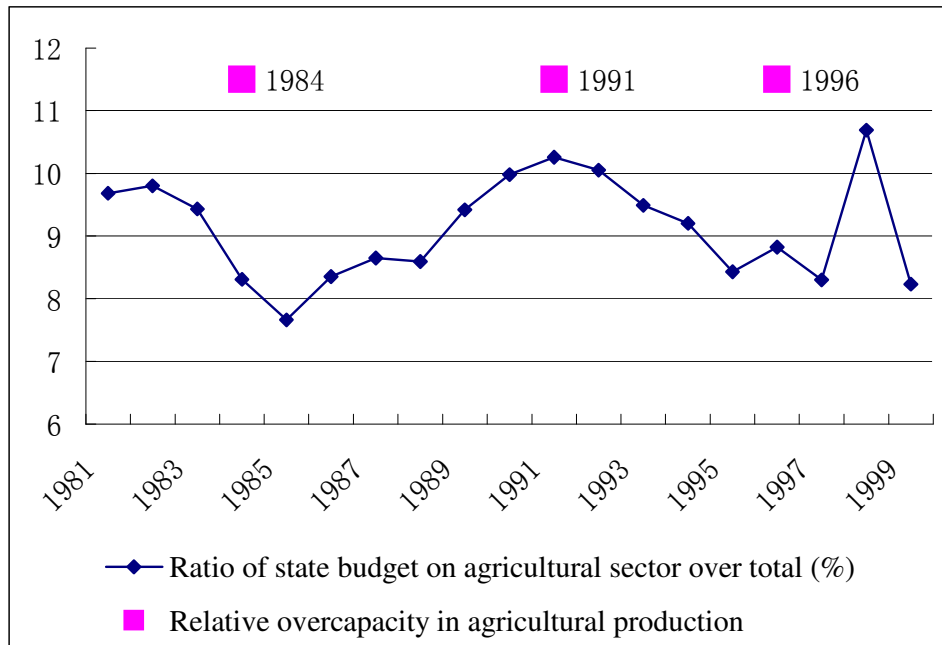
Relations between the agricultural sector and different central agencies determined the degree of their efforts to protect the sector during the negotiation. The MOA, SGB, and MOFTEC were close scrutiny.

The MOA was pursuing its own bureaucratic interests which were not necessarily convergent with sectoral interests. The MOA's bureaucratic interests were to achieve administrative accomplishment and maintain fiscal sustainability. It was supposed to control agricultural production. Its major tasks were to preserve

agricultural productivity and guarantee food security.⁴⁶ However, by achieving these goals, its importance in the State Council decreased, which in turn led to the possibility of a lower state budget from the MOF (Chern and Yu, 1999: 199; Yang and Huang, 1999: 272). By comparing the state budget allocated to the MOA and agricultural production (Figure 4.1), we can see that when China experienced relative overcapacity in agricultural production (in 1984, 1991, and 1996 respectively), the ratio of budget on agricultural sector over the total state budget declined immediately in the following years. The dilemma between administrative goals and fiscal target imply that the MOA was less concerned about the potential impact of the WTO negotiations. Unreasonable concessions for the sector could be used as a good excuse for the MOA to request for central funding for further development. The MOA cared more about its own interests rather than the needs of the peasants. Its stance was consistent with the negative protection of the sector in the 1980s and 1990s observed by both Chinese and foreign scholars.

⁴⁶ Other functions of the MOA included research and development, infrastructure construction, inspection service, and etc. However, the MOA's capability of regulating the sector was weak. For example, empirical evidence by Jin et al. (2002) demonstrates the declining effectiveness of China's agricultural research capabilities.

Figure 4.1 State Budgets Allocated to the MOA and Overcapacities in Agricultural Production from 1981 to 1999



Source: *Zhongguo caizheng nianjian* (Finance Yearbook of China). (2001: 357)

The SGB under the MOC/SBC was preoccupied with its own financial problems caused by institutional reasons and consequently had little interest in protecting the sector. First of all, food security or food self-sufficiency was a national strategy that needs coordination from all government agencies. The SGB's administrative task was to guarantee the smooth flow of agricultural products from peasants to consumers. In order to protect the peasants, the SGB was requested to purchase as much grain as the peasants were willing to sell to the government since 1998. However, overcapacity in agricultural production led to a huge financial burden on the SGB (Cheng, 1997). Accordingly, the State Council requested that the SGB guarantee its profitability by selling agricultural products at a higher price than its purchase price. In order to protect urban residents and curb inflation, the SGB had to decrease the purchasing price even lower than the floor price recommended by the SDPC (Schmidhuber, 2001: 34; OECD, 2005: 86; Shangguan et al., 1998: 124). During the WTO

negotiation, the SGB had no incentive to protect the agricultural sector. Instead, importation of foreign agricultural goods might reduce domestic production that in turn might relieve the SGB's financial burden, as long as food self-sufficiency was secured.

The MOFTEC's major task was to enter the WTO which would increase China's foreign trade and partially benefit the trade companies under its control. The trade companies had frequently complained that the MOFTEC pursued its own "narrow interests" without any concern for protecting the domestic agricultural sector.⁴⁷ In order to exploit the differences between domestic and international prices, there were several times during the 1980s and 1990s when food shortage was associated with huge exports while overcapacity confronted huge imports.⁴⁸ In face of great pressure from WTO members to open up China's economy, the MOFTEC would push domestic the agricultural sector for more concessions but at the same time protect its trading companies for its own monopolist profits (Yang and Huang, 1999: 272).

The MOA's indifference, together with the SGB and MOFTEC's interests in exploiting the sector, shed light on the fate of the agricultural sector in China's WTO negotiations.

⁴⁷ The legal procedure of importation documented by Crook, Langley, and Tuan (1999: 44-5) was: the SGB submitted an import proposal to the State Council through the MOC; after the approval by the State Council, MOF allocated foreign exchange to SGB through the MOC that purchase foreign agricultural products from China's National Cereals Oils and Foodstuffs Import and Export (COFCO) under the MOFTEC.

⁴⁸ According to Shangguan et al (1998: 128), there were four times of grain shortage between 1984 and 1996, three times of which were associated with grain net export. Among the nine years of overcapacity, five of them saw net import. The most serious case happened in 1995 and 1996.

4.6 China's WTO Commitment and Its Compliance in the Post-WTO Period

4.6.1 Concessions in the Agricultural Sector

The American negotiators strongly requested for China to open up its agricultural and automobile sectors (Zhou and Wang 2001). The GATT/WTO coordination group was founded in the State Council accordingly. As national security pertaining to food self-sufficiency was not a great concern at the time, bureaucratic interests prevailed throughout internal coordination on agricultural issues. The MOA was always purposely excluded from the meeting by the organisers (Interview in Beijing, February 2009). Through domestic coordination, Chinese negotiators were able to make great concessions in the agriculture sector (Wen, 1999: 35). It was also rumoured that Chinese negotiators decided to give up the agricultural sector in exchange for some benefits for the financial sector that was important to the MOF and the People's Bank of China (He, 2000).

China agreed to terminate import quota for all categories of agricultural products. A tariff rate quota was applied to some goods that were not competitive in international trade like oil crops, wheat, corn, rice, and cotton (Table 3.4). China pledged not to use export subsidies in the agricultural sector, something neither the United States nor the European Union had agreed to (Johnson, 2000; Wen, 2000: 92).⁴⁹ Its average agricultural tariff rate, committed to being reduced from about 21% in 2001 to 17% by 2004 and from 31% to 14% on American priority agricultural products, would be lower than those in most developing countries (Yu and Frandsen, 2002). The reduction rates in grain, cotton, meat, and soybean oil were much greater than the requirement set in the Uruguay Round of agricultural agreement. The

⁴⁹ It managed to secure the farm subsidies at 8.5% of the value of domestic farm production in the range allowed by the developing country.

transition period for China was only five years, half of the 10-year transition period granted to other developing countries.

Table 4.7 China's Commitment to the Agricultural Sector

Features	Labour-intensive		Land-intensive		
	Animal products	Horticultural products	Grains	Cotton	Oil crops
Competitiveness	Yes	Yes	No	No	No
Tariff rate quota (TRQ)	N.A.	N.A.	TRQ	TRQ	TRQ
Final rate of state ownership of the trading companies	0	0	90% for wheat, 60% for corn, 50% for rice	33%	0 by 2004
Average tariff rate by commitment	10% for live animal, 20% for processed meat	10%	1% for in-quota tariff, 65% for out-of-quota tariff	1% for in-quota tariff, 40% for out-of-quota tariff	9% for in-quota tariff, 9% for out-of-quota tariff by 2005

Note: N.A.: not applicable

Source: compiled by author

However, the trade monopoly of the MOFTEC did not change significantly. Although China committed itself to granting a certain amount of trading rights to non-state-owned enterprises, hidden barriers remained (Goodman, 2003). According to Hsu and Tuan (2001: 4), domestic quota-holders had no right “to import directly from abroad, to choose their trading partners, or to choose a specific type of commodity”. Chinese peasants ended up as the only losers in the deal (Bhalla and Qiu, 2004: 77; Zuo and Song, 1999: 651). Premier Zhu Rongji had repeatedly stated that the greatest impact after China's WTO accession would be on the agricultural sector and billions of peasants (Ma, 2001; Sun and Meng, 2002; Lin and Zhang, 2003: 71).

4.6.2 China's Compliance in the Post-WTO Period

Agricultural industry as a “low stake” sector did not receive enough support from the MOA during the negotiation. In the first year of WTO membership, the MOA decided to regain its control of production plan. The MOA directed the peasants to adjust their output according to regional comparative advantages, like producing

wheat in the areas of Hebei-Shangdong-Henan provinces and producing corn and soybean in North-eastern provinces (Ke et al., 2003: 5). However, government-industry relations in the agricultural sector were very loose compared the other sectors.

The MOA, which had divergent interest with the industry, found it easier to comply with the WTO commitment, even though the commitment was huge concessions. As Zhang (2000: 7) observes, Chinese government did not change its discriminatory policy toward the agricultural sector after giving concessions either. As expected, by complying with the concessions, the agricultural industry which was not competitive in global trade suffered from the flood of imports.

One of the major commitments was to reduce the tariff rate as scheduled. The Chinese government has done more than commit to the duties. China pledged to reduce its simple average import tariffs for agricultural products from 21% in 2001 to 18.5% in 2002 and 17 % in 2004 (Huang and Scott Rozelle, 2002: 12). However, the actual tariff rate was reduced to 15.8% in 2002 and 15.57% in 2004 (Table 4.8).

Table 4.8 China's Tariff Rates for Agricultural Products in 2002 and 2004 (%)

All agricultural products	2002	2004
Simple average rate committed	18.50	17.00
Simple average rate fulfilled	15.80	15.57

Source: simple average rate committed in 2002 and 2004, see Tian (2002), quoted from Ke et al. (2003: 2); simple average rate fulfilled in 2002, see Ke et al. (2003: 2); simple average rate fulfilled in 2004, compiled from the data in *Customs Import and Export Tariff of the People's Republic of China, 2004*

There was a significant drop of the tariff rate in the subsectors of soybean, wine, and beef. For example, the import tariff rate for soybeans was reduced from 114% before 2000 to 3% in 2000 due to the Sino-US agreement (Lapres, 2000). The import quotas and import licences on soybeans were also phased out immediately (Lin, 2000: 105).

According to the United States Trade Representative's (USTR) report on China's WTO compliance (2004: 6), "China has become one of the fastest growing overseas markets for U.S. farmers", as American agricultural exports largely fulfilled the potential recognized by the negotiators during the years leading up to China's WTO accession.

If there was any incompliance to complain about in the agricultural sector, it would go to the SDPC/SDRC and the "regulatory body" at the border. By 2004, the SDRC continued to retain price control on certain agricultural products (USTR, 2008: 64–5). It also controlled the quotas in the TRQ system by allocating them primarily to the state trading enterprises (Ibid: 7). Also, American exporters complained that Chinese customs and quarantine officials at the borders did not provide predictable and transparent regulatory regime for sanitary and phytosanitary standards (Ibid: 33).

The Chinese government's little concern for protection led to the poor performance of Chinese agricultural trade after the WTO accession. From 2002 to 2005, its annual growth rate of agricultural imports was 31.5%, much faster than the annual growth rate of exports that was 11.6% (Chen, 2006: 227). Imports from the United States in 2003 exceeded US\$5.4 billion, which was more than twice the level in 2002 and more than five times the level in 1999 (USTR, 2004: 51). The figure jumped to over US\$8 billion in 2008 (USTR, 2008: 64). China's trade surplus experienced a slight growth in the first year of WTO membership and then dropped significantly (Figure 1.1). China's agricultural trade moved from surplus to deficit position in the post-WTO era. As Chen (2006: 234–6) indicated, "China's agriculture as a whole has been losing comparative advantage at an accelerated rate since entry into the WTO". Affected by the flood of imports, its comparative advantage in labour-intensive products has been declining and its comparative disadvantage in capital-

intensive products has been worsening dramatically. China's WTO accession most certainly did not benefit its agricultural sector.

4.7 Conclusion

All in all, the agricultural sector expected to see more challenges than opportunities under the WTO framework. Chinese peasants, in contrast to their counterparts in Japan, Korea and Taiwan (Hayami, 1988), were not organised enough to impose effective pressure on their government for agricultural protection. It might be true that the peasants would become more and more powerful, as the reduction of producers makes them easier to organise, but a lack of administrative and fiscal connections between the agricultural sector and the MOA implies that the sector would face sustained discrimination at home and fierce competition from abroad. An evolution of protective measures suggested by Anderson, Martin, and Valenzuela (2007) is not foreseeable in the near future.

Chapter 5: China's Textile and Clothing Sector Left to Fend for Itself

5.1 Introduction

The world textile and clothing (T&C) industry that did not require high technical input or a highly skilled labour force (Comino, 2007: 821) witnessed a shift in global comparative advantage from developed industrial economies to less developed industrial economies, especially China, during the second half of the twentieth century. Almost at the same time of this transformation, the T&C sector has become “one of the least liberalised and most highly protected industries in the international economy. Treated as a special case, this sector was exempt from most trans-industry regulations developed under the auspices of the GATT/WTO” (European Commission, 2004: 259).

The Multi-fibre Agreement (MFA) was to “achieve(ing) the expansion of trade, the reduction of barriers to such trade, and the progressive liberalization of world trade in textile products” (GATT, 1975: 3-19). The agreement allowed the United States some time to adjust to foreign competition from China, while at the same time gave Chinese companies orderly access to the American market (Wang, 1987). The MFA was widely criticised as a discriminatory policy against developing countries (see for example Cline, 1990). According to Chadee and Jing (2003, 228), China's T&C exports to markets affected by the quotas accounted for 30% of the total volume of export in the late 1990s. It was widely believed that China's export would experience dramatic increase after WTO accession, as the international trade regime would help to lift export quotas from importing countries (For example, Zhong and Yang, 2000). China's State Council Development Research Center (CSCDRC) was

pretty optimistic about the prospects of the T&C sector after China's WTO accession. According to CSCDRC's estimate, the exports of textiles would double between 1998 and 2005, creating 2.85 million jobs in the textile industry (23.5% increase) and 2.61 million jobs in the clothing industry (52.3% increase) (Egan and Steinhoff, 2000: 18; Liu and Sun, 2004: 56). However, the sectoral performance after China's WTO accession shows that the entry seemed to be irrelevant to the strong growth trend of its exports. WTO membership did not significantly promote the exports as expected by most scholars. But it did prevent China from fully exploring its huge potential as indicated by a comparison of its entry to WTO entry since 2002 with the MFA phase-out since 2005 (Figure 3.2).

The sector was less strategically important than the other sectors in the final round of WTO accession negotiation. However, a trade concession would exaggerate the effect of the massive labour force reduction in the textile and clothing sector which was labour-intensive. It seemed that the former explanation is plausible as the fear of political instability brought by a massive laid-offs did not prevent negotiators from backing down on American requests. By contending with the "political instability" explanation, Blecher (2002) provides us with the argument of the ideological hegemony of the market and state. According to Blecher, the vast majority of working class remained politically passive. Their protest or strike was not threatening enough to determine the government's decisions, like trade negotiation. However, the social class explanation is not valid here, as the workers were divided between those from central SOEs and other sorts of enterprises, including local SOEs, private enterprises, and etc. As Frazier (2006) observes, the decline in state sector employment and the release of the small or median SOEs were "major contributing factors" to the massive laid-offs. Cai (2002), from the perspective of social

movement, concluded that laid-off workers from small SOEs were less able to take forceful action.⁵⁰ Accordingly, we cannot simply conclude that trade concession was made on the textile and clothing sector because the sector became less strategically important or the working class were not powerful enough to influence the government's decision.

This chapter argues that little administrative and fiscal/financial connections between the supervising agency and T&C industry caused a low degree of interest convergence that in turn made a request for trade liberalisation impossible. The decision was made to retain the central SOEs' privilege at the expense of the rest of the sector to prevent large-scale worker unrest. Chinese negotiators adopted a horse-trading strategy by sacrificing the T&C sector for protecting other sectors in the final China-US agreement. WTO accession had made limited impact on China's T&C industry, as the agreement allowed importing countries to retain most of their quotas against China's exports till the phase-out of the MFA.

5.2 Government-Industry Relations in T&C Sector

5.2.1 The Textile and Clothing Industry

By the end of the 1990s, China's T&C sector can be divided into two different sub-sectors, namely textile sector and clothing sector. The textile sector includes primary manufacturing industries of natural fibre, cotton textile, wool textile, bast fibre textile, silk textile, knitting and others (Table 5.1). The clothing sector includes garments, hand wears and foot wears. The industry in the 1980s and 1990s composed of three different groups of enterprises in terms of their relationship with the

⁵⁰ According to Cai (2002), laid-off workers from enterprises under the central government accounted for about 9 per cent of the total, whereas those from small and medium enterprises constituted more than 90 per cent in 1998 reform.

government: non-SOEs, local-government-controlled SOEs and central-government-controlled SOEs. The number of SOEs under the central government significantly decreased through the years. It reduced from 65 to 39 by end 1989 (Wu ed., 1999: 52) to only 20 by the end of the 1990s.

Table 5.1 Share of Gross Output Value among different Sub-sectors of T&C industry (%)

Item	1995	1996	1998	1999
Textile Industry	74.77	72.33	68.95	70.02
Primary manufacturing industry of natural fibre	3.51	3.93	3.19	3.73
Cotton textile industry	36.94	34.33	33.31	34.45
Wool textile industry	9.93	10.15	9.06	8.71
Bast fibre textile industry	1.32	1.13	1.30	1.21
Silk textile industry	12.98	12.39	11.80	12.01
Knitting industry	8.40	8.42	8.18	8.30
Others	1.69	1.97	2.12	2.36
Clothing industry	25.23	27.67	31.05	29.98
Garments	22.01	24.26	27.08	26.15
Hand wares	0.30	0.38	0.56	0.48
Foot wares	1.84	1.92	2.20	2.06

Source: compiled from data in *Almanac of China's Textile Industry*, 2000: 127

5.2.2 Supervising Agencies in the Central Government

The Ministry of Textile Industry (MTI) was the supervising agency of the sector till 1993 when it was replaced by China National Textile Council (CNTC). The function changed from micro-regulation to macro-guidance. The CNTC was renamed and upgraded to State Bureau of Textile (SBT) under the direct supervision of the State Economy and Trade Commission (SETC) in the 1998 administrative reform. However, the number of administrative staff was reduced from 500 to 280 in 1993 and to 80 in 1998. The SETC took over the function of supervising the restructuring of the T&C sector, signalling the institutional demise of the SBT. Specifically, the chemical fibre industry has been administratively controlled by China Petrochemical Corporation since April 1983 while the machinery industry has been co-administrated by the MTI and the Ministry of Machinery Industry (MMI) since 1982. MTI is

responsible for issuing the orders and MMI is responsible for supervising the production; the rest of the subsectors were directly supervised by the MTI/CNTC/SBT.⁵¹

5.2.3 Reforming the T&C Sector

The T&C sector reforms, the core of government efforts to reform state-owned industries inherited from the central-planning era, experienced two significant developments in the 1980s and 1990s. The first concerned the government's pilot efforts to separate the MTI/CNTC from individual T&C firms through 1984 to 1997. The second has been the industrial restructuring of "retaining the large state enterprises and releasing the small ones" (*zhuada fangxiao*) since 1998.

5.2.3.1 Separation of T&C Enterprises from the MTI/CNTC, 1984-1997

The MTI separated from the Ministry of Light Industry (MLI) in January 1978 to oversee the production of the textile industry throughout the country. In the early 1980s, the State Council at the Second Session of the Fifth National People's Congress granted "six priorities" to the sector, including the supply of raw materials, fuel and power, innovation and its transformation and infrastructure construction, bank loans, foreign exchange, imported foreign advanced technology and transportation. However, this did not last long as the Ministry of Finance experienced a shortfall in budgetary resources in 1981 (Almanac of China's economy, 1982: V-88-92); since 1982, it has been a buyers' market for the textile sector (Ministry of Textile Industry, 1984: 323).

⁵¹ The silk textile industry came under the administration of the MTI in 1987. The clothing sector was transformed from the MLI to the administration of the MTI in 1987. See *Guowuyuan bangongting guanyu fuzhuang hangye huagui fangzhi bumen shixing hangye guanli de tongzhi* (The notification by the General Office of the State Council regarding the transformation of the clothing sector to the industrial management under the Ministry of Textile Industry), 29 November 1986.

In the same year, the central government decided to decentralise the administrative control of the development plan from the MTI to local governments (Findlay and Li, 1992: 115).

In 1984, the State Council No. 67 Document clearly granted ten rights of autonomy to the SOEs. However, as Moore (2002: 117) argues, the administrative departments refused to give up their supervisory roles that in turn led to an incomplete reform. Except for production plan management, capital investment and asset management, the MTI decided to give up its authority in seven areas (Zhongguo fangzhi gongye gaige kaifang 30nian biao zhixing shijian, 2008: 11).

After the T&C sector became buyers' market in 1982, the administrative control of the production has been in the form of limiting the output, especially in the cotton textile and wool textile industries (Gu ed. 2002: 7). The MTI retained its control of production capacity of the cotton textile and wool textile industries, issuing production quotas to different provinces through central planning. As for other sub-sectors, the MTI has delegated its authority to the local governments.⁵² The MIT and its successors have gradually strengthened control of output cutbacks as they believed that the devolution had contributed to the duplication of projects and the misallocation of resources in the sector (Wei, Shen, and Wang, 2002: 193-9). The State Council since 1991 has started a long-term programme for reducing capability and limiting production (Moore, 2002: 127). The policies seemed controversial, as the government strengthened its control of T&C production on one hand but reduced the categories of textile products that were under the central planning (Editorial Office of Textile China, 1986: 173). There were 19 categories of textile production under mandatory

⁵² For official document, see *Guowuyuan bangongting zhuanfa fangzhibu, guojia jiwei, guowuyuan shengchanban guanyu yange kongzhi mianfang, maofang shengchan nengli he jiaqiang huaxian shengchan nengli guanli yijian de tongzhi* (The notification by MTI, SPC, and State Council Production Office, transmitted by the General Office of the State Council regarding the suggestion of strictly controlling the production capacity of cotton textile, wool textile, and chemical fibre textile), 24 January 1992. For an analysis of surplus production capacity in the cotton textile industry, see Jiang (2001: 132-3).

planning by the MIT in 1983 (Jackson, 1992: 232). In 1984, the number of textile productions that were under mandatory planning was reduced to three, while 13 were under guidance planning and another three were opened to market forces (Almanac of China's Economy, 1985: V-43-5). The policies implied that the central agency would not intervene in the production management of the local SOEs so long as the sector was not over-producing.

To cut production, the MTI looked at putting a cap on capital investment and to the purchase of textile machineries. The MTI formulated three-year and five-year plans for the investment on infrastructure construction and technology upgrading. The percentage of after-tax profit paid into the Production Development Fund was also reduced in 1983 when the MTI decided to cut production (Jackson, 1992: 254). Small projects were subject to the decision of local governments. The MTI had the authority to approve the medium-sized project. The investment on big project would require the approval of the State Planning Commission (SPC) (Almanac of China's Economy, 1997: 182-4). The policies had been followed to the end of the 1990s.

Any purchase of textile machineries, especially advanced textile manufacturing equipment,⁵³ transfer of the fixed asset from one SOE to another, lease, upgrade and replacement of the asset would have to be submitted for the approval.⁵⁴ The CNTC, in 1993, retained the right to approve the purchase of important textile machineries.⁵⁵

However, the MTI/CNTC's supervision in these areas was not successful. The market mechanism was gradually taking shape in the sector. As the number of non-state enterprises had been increasing over time, the supervising agencies felt less

⁵³ *Zhongyang caijing lingdao xiaozu bangong huiyi tingqu fangzhi gongyebu huibaoshi lingdao tongzhi de jianghua yaodian* (key points from the leadership responding to the report by the Ministry of Textile Industry at the Central Finance and Economics Leading Group working meeting), January 3, 1986

⁵⁴ See provisional regulations regarding the production management of textile industrial enterprises in March 1982, regulations of asset management in textile industrial enterprises on 22 August 1988, and regulations of asset management in textile machinery and equipment enterprises on 24 February 1992 (Chapter 7).

⁵⁵ For example, see *Zhongguo fangzhi zonghui guanyu yinfa "guanyu mianfang xishaji shengchan xukezheng he mianfang xishaji zhonggouzhang de shishi banfa" de tongzhi*, 10 October, 1996.

capable of planning for the sector. For example, the MTI implemented its first Industrial Policy in 1989 to stop the “over-construction” of the sectors of cotton textile, wool textile and silk for the purpose of protecting the urban SOEs. However, the policy could not put a stop to the development of Town and Village Enterprises (TVEs).⁵⁶ MTI was replaced by the CNTC in 1993. The function of the CNTC was one of macro-guidance rather than micro-regulation as in the days of the MTI. In 1996, the CNTC, with the approval by the SPC, promulgated that the SOEs’ annual output plan would be governed by market forces (*Yazhou fangzhi yuekan*, 1996, Vol.27, No.5: 80-1).

Other than these three areas, the MTI/CNTC had gradually granted autonomy in seven areas to enterprises or local governments.

Allocation of wage and bonus: Prior to 1984, wages were paid in accordance to a centralised wage fixing system.⁵⁷ After the reform, enterprises had the right to decide on the wages of their staff and allocate profit within the enterprises so long as the tax revenue remitted to the central government was guaranteed.⁵⁸ However, Sabin (1992) and Woo (1992)’s survey of individual enterprises revealed that the local bureaus of the MTI have taken charge of the administrative control since then.⁵⁹ When the local bureaus were gradually transformed into independent corporations after the abolition of the MTI, the effective control of wages and bonuses went to the corporations or local governments.

⁵⁶ Light industries had the same problem; the MLI failed to prevent competition in the sector of appliance electrics (Zhou, 1998: 15-6). The market system took root in these two sectors. The central-planning ministries became useless. See *Zhu Rongji fuzongli zai quanguo fangzhi gongyeting juzhang huiyi shang de jianghua* (The speech by vice-premier Zhu Rongji at the meeting with the governors of the national textile bureaus), 26 December 1991.

⁵⁷ See provisional regulations regarding the production management of textile industrial enterprises in March 1982. The MTI and the Central Bureau of Labour that was renamed Ministry of Labour and Personnel in 1982 were both held responsible for the wage system.

⁵⁸ Record of the 55th State Council Executive Meeting.

⁵⁹ According to Sabin (1992: 244)’s study of Qinghe Woolen Textile Mill, after paying taxes and fees, the mill was allowed to designate 40% of the remaining for production development, 30% for the welfare fund, 20% for bonuses, and 10% for the reserve fund. The rate was different from that of the Nanning Silk and Ramie Textile Mill. According to Woo (1992: 283), the Nanning Textile Bureau allowed the mill to designate 20.6% of the retained profit for production development, 47.9% for the welfare fund, and 31.5% for bonuses.

Personnel and labour management: Prior to the reform, the appointment of management cadres in the SOEs was the responsibility of the MTI, while the overall recruitment, promotion and dismissal of workers was left to the enterprises and labour bureaus of local governments.⁶⁰ The higher management reported directly to the ministries or local government and was responsible for meeting the production targets. After reforms in the 1980s, the task of deploying professionals, usually university graduates, to the “textile system” was assigned to the regional government. In the 1990s, the allocation of about 10-20% of graduates to the SOEs was done by the CNTC; by the end of the 1990s, this “textile system” of job allocation was discontinued when the arrangement with the universities was terminated (Li, Shuwan. 2003: 458).

Procurement of material: The MTI retained nominal authority of supervising the purchasing practices of most domestic supplies from companies under the jurisdiction of the Ministry of Commerce (MOC).⁶¹ The import quota of international procurement comes under the SPC and the import permit requires the approval of the MOFERT. The local SOEs usually sought for local branches of the MOC and the MOFERT/MOFTEC for the channel of domestic and international procurement respectively. Prior to 1984, the procurement price of the input was tightly controlled by the MOC and gradually subject to market mechanisms since then.⁶² The MTI and its successors did not have the administrative power to decide on the procurement price.

Alliance management: Since the early 1980s, management autonomy was granted to the enterprises. Local SOEs were allowed to go into joint ventures with

⁶⁰ The local governments were usually in charge of the labor quotas.

⁶¹ The SOEs ran the risk of purchasing the input resources by circumventing the central-planning system when the resources were scarce (Qian et al, 1991).

⁶² The central government relaxed its control of the cotton price in the mid 1980s, but readopted strict controls in 1987 when the product was in shortage.

domestic or foreign companies. However, the authority of supervision was varyingly taken over by the local governments. The practice of amalgamating enterprises into regional conglomerates usually came under the jurisdiction of local governments which also provided the financial backing (Williams, Kong, and Shen, 2002: 585).

Price: The SPC, assisted by the specialised economic departments, played the key role of determining the price of procurement throughout the 1980s and 1990s. Since the early 1980s, T&C manufacturers were allowed to adjust the pricing of their products. The MTI, after the 55th State Council Executive Meeting in 1984, decided to loosen its control of the prices of cotton products and polyester-cotton blends. Deng and Yang's (quoted from Jiang, 2001: 143) field study in 1991 indicated that although textile products are determined by the government, most textile transactions between manufacturers and commercial departments were regulated by the market.

Internal organisation: Provisional regulations regarding the production management of textile industrial enterprises in March 1982 laid out the guidelines for the internal organisation of the SOEs. The hierarchical structure included three layers of administration, namely, factory (*changbu*), workshops (*chejian*) and work groups (*banzu*). The governor of each layer was accountable to the immediate authority higher up regarding the number of workers, quality of output and production efficiency. The local SOEs were gradually allowed to make adjustments to their internal organisation.

Sales: The administration of domestic trade has been controlled by the MOC since its founding in 1952. T&C products from the SOEs were distributed to the MOC or its local branches under the supervision of MTI or its local bureaus. Since 1983, the SOEs have enjoyed limited autonomy in domestic market and are able to sell their

above-plan output (Aggarwal, 1994: 69).⁶³ As for international trade, the export rights were fully controlled by the MOFERT-CHINATEX alliance and their local branches in the 1980s. The MTI started to share the authority through the operation of China Textile Resources Company in the early 1990s.⁶⁴ However, their control has been gradually restrained through the reforms of the allocation system. The mechanism of auction that covers 27 textile products has been introduced since 1994 (Qiu, 2005: 19). As for the export quota, the MTI had “petitioned” China’s leadership for a greater role in quota management for a long time in the 1980s, but failed (Moore, 2002: 145).

5.2.3.2 Restructuring the SOEs in the T&C Industry, 1998-1999

In the face of heavy losses incurred by the SOEs,⁶⁵ Beijing initiated SOE reforms with the priority given to the T&C sector in 1998. The central government shrugged off its responsibility of supervision through streamlining the work-force and eliminating the loss-making enterprises. The number of the SOEs decreased from 2839 in 1997 to 2226 by the end of 1999. By selling the assets of small SOEs to the private sector, the government concentrated its effort on restructuring the large-sized SOEs. The T&C industry came under the SBT by the year 1999. Meanwhile, the government started to grant trading rights directly to textile manufacturers (China: Textile industry reform in China: WTO accession may boost efforts, 1999: 12).

5.2.4 Administrative Connection between Government and Industry in the T&C sector by the End of the 1990s

⁶³ Lack of budgetary resources in the early 1980s, the MOC was unable to purchase all the products from the T&C sector (Naughton, 1995: 125-6). Accordingly, the MOC gradually lost its control of internal trade. For example, in 1992, the MOC controlled only 22.6% of domestic trade of T&C products (Almanac of China’s Economy, 1993: 154-5).

⁶⁴ In the sub-sector of silk textile, the China National Silk Import and Export Corporation (CHINASILK), one of the major trading companies, was affiliated to the MOFERT/MOFTEC, while the China Silk Industrial Corporation (CSIC), as a rivaling company, was under the control of the CNTC.

⁶⁵ According to Yeung and Mok (2004: 943), 1,667 or 55% of SOEs in the T&C sector were loss-making ones in 1996.

The T&C industry by the end of the 1990s composed of three different groups of enterprises in terms their relationship with the government. They were non-SOEs, local SOEs, and central SOEs. Administrative connections between the central government and different groups of enterprises varied.

Sectoral reforms in the 1980s prevented the central government from directly supervising the SOEs that came under the control of the local governments (Table 5.2). The SBT shared authority with local governments in certain areas like management, including production plan, capital investment and asset management. The SBT controlled only 20% of export quotas and left the majority to the MOFTEC (Lu, 2001: 14).

Table 5.2 The SBT's Effective Control of the Local SOEs in 1999

Items	Degree of control	Items	Degree of control
1. Plan of production management	Partial (production ceilings)	6. Procurement of the materials	Little
2. Capital investment	Partial	7. Alliance management	Little
3. Allocation of wage and bonus	Little	8. Price	Little
4. Asset management	Partial	9. Internal organisation	Little
5. Personnel and labour management	little (senior leaders)	10. Sales	Little (exports quotas)

Source: compiled by author

Although the SBT had gradually lost its administrative control of the local SOEs, its control of the central SOEs remained effective. As the absolute majority stakeholder (over 50% of the share) or the relative majority stakeholder (less than 50% of the share) of the central SOEs, the SBT managed the day-to-day affairs in all ten areas mentioned earlier.⁶⁶

As for the non-SOEs, the SBT had little effective control of them. The share of the non-SOEs in the sector in terms of output value, added-value and taxes has been

⁶⁶ See *Zhongguo fangzhi gonghui xingshi guoyou guquan xingwei guifan yijian* (China National Textile Council's opinions regarding the practice of its rights of holders of state-owned shares), 3 June 1997.

growing significantly since the early 1980s. For example, the non-SOEs' output value accounted for 70% of the national total in 1999 (Table 5.3). Accordingly, the central agency felt less capable of controlling the whole sector.

Table 5.3 Performance of T&C Enterprises of Different Ownerships in 1999 (%)

Item	SOEs	Collective enterprises	<i>Sanzi</i> enterprises	Others
Share of gross output value	29.7	26.6	28.7	15
Share of added-value	32.6	24.8	30.6	12
Share of total value of profits and taxes	27.5	24.5	29.4	18.6

Note: State sector refers to SOEs and majority state-owned enterprises
Sanzi enterprises refer to Sino-foreign joint investments, Sino-foreign cooperative projects and wholly owned foreign investments)

Source: Almanac of China's Textile Industry. (2000: 2)

A brief survey of the administrative relations between the central government and various forms of the enterprises indicated that the SBT, in the late 1990s, had little control (or 8.75%) of the T&C sector.⁶⁷ The T&C sector was relative "low stake" as it enjoyed a lot more autonomy than the other sectors. The next section explores the fiscal/financial tie between the central agency and the T&C sector.

5.2.5 Fiscal/financial Connection between Government and Industry in the T&C sector by the End of the 1990s

Before the 1978 reform, the local bureaus were the revenue collecting authorities of the Ministry of Finance (MOF) which would then redistribute the money to different ministries and provinces through central planning. There was no fiscal connection between the central agency and the SOEs in the T&C sector.

⁶⁷ This author estimates that the central SOEs' output value accounted for 5% of the national total. The SBT was able to fully control the central SOEs. Among the 10 areas of autonomy in local SOEs whose output value accounted for 25% of the national total, full control was coded as 100% control, partial as 50%, and little as zero. Accordingly, the administrative connection between the SBT and the T&C sector in 1999 was $(AC)=70\%*0+25\%/10*(50\%+50\%+0+50\%+0+0+0+0+0)+5\%*100\%=8.75\%$

The MTI operated separately from the MLI in 1978 to become a specialised economic department supervising the SOEs. The MTI's data indicates that the Ministry allowed 60% of the SOEs to retain part of their profits in 1980. The rest of the SOEs were granted the same autonomy by the end of 1981. In practice, the SOEs were allowed to retain 10.8% of the profit that was further distributed between the local bureau of the MTI and the enterprises. The rest of the profit (89.2%) would be transferred to the central government.⁶⁸ The MTI retained 30% of the profit from the SOEs as the Fixed Capital Asset Depreciation Fund (*guding zichan zhejiu jijin*).

With fiscal decentralisation in 1984, the Fixed Capital Asset Depreciation Fund was transferred to local governments. After 1987, the SOEs have been allowed to retain the revenue (Wu ed., 1999: 145). According to Moore (2002: 146), the T&C manufacturers, by the early 1990s, paid an annual “nominal, lump-sum fee” to the MTI. In return, the ministry provided the enterprises with a limited amount of investment funds. The CNTC, the successor of the MTI since 1993, has relied on administrative budgets allocated by the MOF and the membership fee paid by enterprises in the sector.⁶⁹ Apart from revenue generated by levies on local SOEs and non-SOEs, the CNTC/SBT raised revenue from share dividend payments held in the central SOEs it was directly affiliated with.⁷⁰ However, there were only 20 SOEs directly under the supervision of the central agency. There was scarcely any financial connection between the SBT and the T&C sector.

⁶⁸ *Huiyi jilu, quanguo fangzhi gongyeting juzhang huiyi de xingkuang huibao* (the record of the report at the national textile bureau governor meeting), December 20, 1983. The rate was determined by the State Economic Commission and the Ministry of Finance.

⁶⁹ *Li Lanqing fuzongli zai fangzhi zonghui chengli dahui shang de jianghua* (speech by vice-premier Li Lanqing at the meeting of celebrating the foundation of the CNTC), 21 June 1993

⁷⁰ See *Zhongguo fangzhi zonghui guanyu jiaqiang zonghui zhishu qiye caikui gongzuo de yijian* (China's National Textile Council's opinions on improving the accounting system of CNTC-affiliated enterprises), 1 March 1996; and *Zhongguo fangzhi gonghui xingshi guoyou guquan xingwei guifan yijian* (China's National Textile Council's opinions on the practice of its rights as state-owned shareholders), 3 June 1997.

To conclude, in China, the fiscal and administrative connections between the T&C sector and MTI/CNTC/SBT have been diminishing significantly since the early 1980s. By the end of the 1990s, the T&C sector became “low stake”, resulting in a divergence of interests between the government and industry. The SBT had little incentives to protect the sector with a large number of non-SOEs whose output accounted for almost 70% of the national total.

5.3 Sectoral Interests on Trade Negotiation

The export of T&C products experienced rapid growth in the last 40 years (Lardy, 2002) and contributed to more than one fifth of the national export annually (Table 5.4).⁷¹ Generally speaking, China’s T&C sector at that time was very competitive in global trade in spite of some minor disadvantages. In order to reduce and finally lift the export quotas from importing countries, the sector was supportive of China’s WTO accession.

Table 5.4 Export Value and Share of T&C Sector from 1970 to 1998

Item	1970	1980	1990	1998
Export value (US\$ million)	495	4409	16786	42889
Share in national (%)	21.9	24.1	27	23.3

Source: Statistical Yearbook of China, various years.

The evaluations of China’s advantages in the T&C sector were generally based on the variables of labour cost, vertically integrated structure and developmental phase. Cheap labour cost was China’s major advantage (Anderson and Park, 1989). The large pools of unemployed and underemployed labour in rural China would sustain its comparative advantage for a long time (Zhong and Yang, 2000: 188).

⁷¹ The MTI adopted an industrial policy of giving priority to exports in 1986 (Zhong and Yang, 2000: 178). According to the statistics from Almanac of China’s Textile Industry (1997-99), most of China’s T&C products led the market share in global trade.

Abernathy and Volpe (2006: 2214) argued that China, together with India, was competitive in terms of cost of labour, material and freight. As for the vertically integrated structure, China has the capability of carry out all stages of production itself and is not dependent on importing raw materials like many other producers (Blume, Rohwetter, and Tenbrock, 2005, quoted from Comino, 2007: 827). Shi (2000: 136-8), by adopting Toyne *et al's*. (1984) model of progressive shift of comparative advantage, argue that earlier accession to the WTO brought better prospects to China's T&C industries, as the sector had moved from a golden phase of development in the 1990s into a mature phase in the 2000s.

Economists might agree that although China's T&C sector in general was competitive, the clothing industry would fare better than the textile industry. Chi and Kilduff (2006), adopting the RSCA (Revealed Symmetric Comparative Advantage) analysis, argue that China was competitive in the T&C sector with all but the low-income group. Generally speaking, China's competitive strength decreased in the textile industry, but increased in the clothing industry during the period of 1985 to 2003 (Table 5.5). Yang and Zhong's (1998) simulations of the GTAP model predicted that China would benefit more than ASEAN, but less than NIEs, South Asia, and Latin America in respect of the export of textiles through trade liberalisation.⁷² As for the export of clothing, China would benefit more than NIEs, ASEAN and Latin America, but less than South Asia. However, Chen and Shin (2004) argue that it would be difficult for the clothing manufactures to stay in business because they were largely small non-SOEs that had little access to information and suffered from unfair competition.

⁷² GTAP is a multi-sector and multi-region global general equilibrium model. It was developed under the Global Trade Analysis Project led by Thomas Hertel of Purdue University. See Yang and Zhong (1998: 13, fn.8).

Table 5.5 Summary of China's Revealed Comparative Advantage with Selected Countries for T&C 1985-2003

Country group	Country	Average RSCA 1985-2003 in textile	Direction of RSCA shift in textile	Average RSCA 1985-2003 in clothing	Direction of RSCA shift in clothing
High income countries	Japan	0.69	-	0.97	+
	United States	0.75	-	0.88	-
High-medium income countries	Mexico	0.72	-	0.70	-
	Malaysia	0.75	-	0.62	+
Low-medium income countries	Turkey	-0.09	-	-0.26	+
	Thailand	0.43	-	0.24	+
Low income countries	India	-0.15	-	0.04	+
	Bangladesh	-0.22	+	-0.56	-

Note: a positive RSCA refers to comparative advantage and a negative RSCA refers to comparative disadvantage.

Source: Chi and Kilduff, (2006: 184-5)

Economists also pointed out that China's competitiveness was dampened by some diminishing advantages in the major fields and some disadvantages in the minor fields. In the major fields that significantly determined the comparative advantage, like the cost of labour force and input materials, China's competitive margin had been shrinking. For example, China's advantage in cheap labour cost had been diminished because of latecomers, like India and Pakistan (Zhang, 1999). China's advantage in cheap input material, like cotton, also disappeared.⁷³ In the minor fields, Shi (2000: 135-6) warned that China's T&C productions were poor in terms of quality, after sales service, packaging, damage control, etc. Crowley, Findlay, and Gibbs (1992), by analysing China's export marking performance in Australia, also point out that China's T&C sector was not competitive in packaging, fashion content, the time to finalise an order, responses to messages, language problems, delayed shipments and the flexibility in responding to adjustments in orders.

⁷³ The domestic price of cotton increased from 65.47% of international price in 1988 to 93% of international price in 1990 (Tang and Shen, 2000: 101).

To conclude, the T&C sector was competitive in global trade in the 1980s and 1990s. The sector would benefit from the phasing-out of the MFA requested by GATT/WTO rules. The enterprises were generally supportive of China's WTO membership as it would help to finally lift export quotas from importing countries. Although the T&C manufacturers had common final goals, they disagreed on certain issues. An in-depth analysis of the market structure will be helpful to understand the different agenda of WTO accession.

5.4 Sectoral Pressure on Trade Negotiation

The market structure of the T&C sector in the late 1990s in China can be characterised as imperfect competition. The sector consisted of a very large number of enterprises producing homogeneous products. The SOEs, collective enterprises and *Sanzi* enterprises had roughly equal weight in the market.⁷⁴ As discussed in the previous section, enterprises in the sector were generally competitive in global trade. However, state intervention is a contributing factor to the difference in agenda to China's WTO accession for enterprises with different relationships with the government.

China's central-planning system tended to emphasise the importance of heavy industry in the 1960s and 1970s. Non-state actors were allowed to exist in the T&C sector because of a shortfall in state budget.⁷⁵ After 20 years of development since the 1978 reform, the T&C sector has become a pluralist industry with enterprises of different ownerships having an equal weight. As listed in Table 5.3, SOEs, collective enterprises, and *Sanzi* enterprises, each accounted for almost one third of the sector in terms of output value, added value, and taxes and fees. Of the number of enterprises

⁷⁴ *Sanzi* enterprises refer to Sino-foreign joint investments, Sino-foreign cooperative projects and wholly owned foreign investments.

⁷⁵ Before reforms, the non-SOEs accounted for less than 20% of the whole T&C sector (Qiu, 2005: 10).

in the sector, less than one quarter were accountable to the government in any meaningful way in the 1990s (Moore, 2002: 128). However, most of these were large- or medium-sized manufacturers in the more capital-intensive branch of the sector, like cotton textile industry, while having little presence in the most labour-intensive branch, like clothing industry (Table 5.6).⁷⁶ This supports Chadee and Jing's (2003, 224) claim that China's T&C industries had yet to be dominated by state sector by the end of the 1990s.

Table 5.6 Share of SOEs in Enterprises in the T&C Sectors in 1995 (%)

Sector	Small size enterprise	Median size enterprise	Large size enterprise
Primary manufacturing industry of natural fibre	7.10	60	33.33
Cotton textile industry	9.67	63.92	78.70
Wool textile industry	11.19	49.21	71.90
Bast fibre textile industry	27.62	75	79.31
Silk textile industry	7.46	45.21	68.71
Knitting industry	6.35	56.54	67.09
Clothing industry	3.82	19.86	31.67

Source: Compiled from data in *China National Textile Council*, 1996

The sector as a whole was competitive in global trade, so T&C enterprises usually competed with each other rather than with foreign companies. Economists disagreed on the comparative advantages of SOEs and non-SOEs that in turn led to different implications. One group argued that SOEs were less competitive than non-SOEs. For example, Williams, Kong, and Shen's (2002) findings indicated that very few SOEs were ready and able to take advantage of new opportunities after China's WTO entry and the others would decline for their lack of sophistication and for the reason that competitive pressure eroded their domestic market. Yeung and Mok's (2004) research indicated that the reduction of Chinese import tariffs and export quotas by importing countries benefitted foreign-financed enterprises more than locally funded ones in the sector. This implies that SOEs were less eager to enter the

⁷⁶ According to Crowley, Findlay and Gibbs (1992: 123), the textile industry tends to be more capital-intensive than the clothing industry.

WTO. However, Wu's (1996) research indicated that SOEs were more competitive in terms of availability of better machineries and skilled workers and therefore higher technical efficiency. Industrial restructuring since 1998 has accentuated Wu's argument by removing the constraints of "administratively imposed high cost structures, the employee welfare obligations and inflexibility of the State-owned Enterprises" that used to dampen the competitiveness of SOEs against the TVEs (Brown, Waldron, and Longworth, 2005: 106). Their argument led to an opposing implication that the SOEs were more eager to enter the WTO.

State intervention was a determining factor in the analysis of SOEs' relative competitiveness. Constrained by the international regime of MFA, state intervention in China at that time was in the form of granting trading permits and allocating export quotas. The prospect of getting trading permits and export quotas was one of the top concerns of enterprises in the face of WTO accession.

Trading rights were granted exclusively to large- and medium-sized SOEs in the sector (Almanac of China's Economy, 1989: V-60-64). T&C exports by large- and medium-sized SOEs accounted for 70% of total value in 1998 (Almanac of China's Economy, 1999: 172-4). Most non-SOEs without trading rights sold their products through trading companies. The prices of their products were subject to the manipulation by these intermediary players.

Both the SBT and the MOFTEC were authorised to distribute export quotas. The SBT preferred to distribute the quotas among SOEs, primarily the central SOEs, because of their administrative and financial linkages. On the other hand, the MOFTEC preferred to give the quotes to non-SOEs, especially the TVEs, as it was

easier for MOFTEC local branches to bargain with small enterprises for their rent-seeking profit.⁷⁷

By considering the variable of state intervention, this section concludes that the sectoral interest in terms of WTO accession was diversified. Although enterprises in T&C sector were supportive of WTO membership to increase their export, they disagreed on the time frame for removing export quotas imposed by importing countries and trade restriction imposed by Chinese government. The large SBT-affiliated SOEs could easily obtain the trading permit and export quota from the SBT. Though they would like to increase their export, they were generally comfortable with quotas with a specified time frame that could at least provide them with secured orders from foreign companies. Non-SOEs that were able to get the trading permit and export quota from the MOFTEC generally had the interest in common. However, they had more reasons to ask for an earlier reduction of the quotas and termination of trade restriction. Their contracts with the MOFTEC were at risk of being taken advantage of by the supervising agencies. The entry into the WTO would benefit those non-SOEs in the long run. For many T&C manufacturers—both non-SOEs and small local SOEs—that were unable to obtain these privileges, they hoped for an earlier lifting of export quotas and deregulating of trading permits. They also expected to be protected by WTO rules.

Fragmented interests in the T&C sector accounted for the lack of unified pressure on the government prior to the WTO negotiation. It increased the possibility of a divergence in interests between the government and industry. A study of government interest becomes necessary.

⁷⁷ See *Zhu Rongji fuzongli zai quanguo fangzhi gongyeting juzhang huiyi shang de jianghua* (The speech by vice-premier Zhu Rongji at the meeting with governors of national textile bureaus), 26 December 1991.

5.5 Bureaucratic Interests on Trade Negotiation

The MOFTEC was responsible for negotiating with American representatives on China's GATT/WTO accession and communicating with the SBT through domestic coordination. The MOFTEC, SBT and T&C sector did share some interests but not all.

The MOFTEC was supportive of China's WTO accession for the reason of expanding exports. Its vested interest was to promote exports, which were not necessarily relevant to the profits of domestic manufacturers, and maximise its foreign exchange revenue and administrative accomplishments (*zhengji*). Accordingly, the MOFTEC was willing to help reduce export quotas on T&C products. However, the situation was more complicated than this. Because of China-US trade disputes and strong pressure from American negotiators, the MOFTEC could not insist on a reduction of quotas for fear of triggering retaliation from the United States. The MOFTEC implied that it would not let the quota issue disrupt the overall trade flow in other sectors. Besides, the MOFTEC had the authority of distributing exports quotas to mostly domestic T&C enterprises for its rent-seeking gains. As a result of these two factors, both the MOFTEC and the trading companies under its control were willing to maintain the quotas against China's exports during the transitional period after the accession (Lu, 2001: 14).

As for the SBT, its administrative and fiscal interests were largely based on a small number of central SOEs in the sector. The market mechanism had already taken root in the sector since devolution. The SBT's administrative control was limited to granting some trading permit and distributing export quotas. In order to keep its institutional existence meaningful and the central SOEs profitable, the SBT would be reluctant to give up this supervisory role. It might have foreseen its demise in the near

future and would like to slow down the process by accepting American requests of maintaining the quotas.

In short, the sectoral interest was fragmented at that time. As discussed in section 4.3, the enterprises in the T&C sector were supportive of WTO membership as it would potentially increase their export. However, they disagreed on the time frame for the reduction of quota by importing countries and the permit deregulation of the central government. A loose connection between the government and industry increased the possibility of a divergence in interests. This throws light why the MIT/CNTC/SBT was indifferent to China-US negotiations throughout the 1990s.

5.6 China's WTO Commitment and Its Compliance in the Post-WTO Period

5.6.1 Concessions in the T&C sector

The interests of the MOFTEC and SBT differ from those of the T&C sector on the issue of export quotas. A tiny pressure from the United States would be enough for the central agency to make concessions. Prior to the negotiation, the SBT was informed to be prepared for any possible concession. The SBT accepted the decision without any complaints (interview, January 2009).

To keep China's quotas on the imports of foreign cars and spare parts till 2005, the MOFTEC in November 1999 allowed other countries to keep their quotas on Chinese textile and clothing products till the same year when the MFA expires. According to the agreement, as shown in Table 5.7, Chinese negotiators allowed 86.5% and 73.3% of textile products under American and European Union quotas to be extended till 2005 respectively.

Table 5.7 Number of Tariff Lines under Quota: All Textile and Clothing

Market	Figures	Number	%	%
US	US 10-digit tariff lines subject to ATC integration	3654	100	-
	Lines under quota in 2000	2067	56.6	100
	Lines under quota in 2001	2015	55.1	97.5
	Lines under quota 2002-05	1788	48.9	86.5
	Lines under quota after 2005	0	0	0
EU	EU 8-digit tariff lines subject to ATC integration	1410	100	-
	Lines under quota in 2000	730	51.8	100
	Lines under quota in 2001	677	48.0	92.7
	Lines under quota 2002-05	535	37.9	73.3
	Lines under quota after 2005	0	0	0

Note: ATC stands for Agreement on Textiles and Clothing

Source: Dickson (2001), quoted from Williams *et al.* (2002: 580)

5.6.2 China's Compliance in the Post-WTO Period

As a “low stake” sector, the T&C industry did not receive enough support from the SBT during the negotiation. The SBT was abolished in 2000. The duty of supervision came under the SETC and transferred to the SDRC when the SETC was abolished in 2003. The central SOEs that used to be affiliated with the SBT became the subsidiaries of the SASAC. After the 2003 government restructuring, SDRC and SASAC became the major players in T&C sector. The former was to draft sector-wide policies and the latter was to supervise the central SOEs. Although the supervisors had been changed, the government-industry relation in T&C sector remained the same. The government had little difficulty complying with the commitment because there was little to give up.

The matter of compliance was, to large extent, on the American side rather than on the Chinese side, as the elimination of export quota from importing countries was a major concern in the sector. The Chinese government had timely implemented tariff rate reduction in the T&C sector since its entry to the WTO (The law offices of Stewart and Stewart, 2005: 135). However, this had nothing to do with the American quota. Figure 1.2 clearly shows that WTO agreement on T&C sector had effectively restricted the growth of exports from China. Without a keen protector in the central

government, the sector's competitiveness in global trade was dampened by the protection from importing countries. The Yeung and Mok's (2004: 948) field survey revealed that Chinese-based firms had complained of a lack of regulatory authorities responsible for protecting sectoral interests in trade disputes, like anti-dumping suits.⁷⁸

China's T&C exports reached its potential in 2005 when the MFA was phased out in December 2004. The Chinese government foresaw that the flood of Chinese products in American market might threaten the T&C sector in the United States that could resort to adopting special protectionist measures. To prevent trade disputes, China has voluntarily imposed tax on its own exports of selected T&C products since 2005. However, the effort has little impact on slowing down the increase in its global market share. Under the pressure of the EU, China's Ministry of Commerce imposed its own control on licensing requirement of T&C exports in 2008 to restrict export restriction, but refused to continue with the practice in 2009 (Lu, 2009).

5.7 Conclusion

In sum, among the sectors in the negotiation package, the T&C industry was the one that expected to gain from WTO accession. Chinese negotiators tended to make concession on T&C sector because of loss-aversion on other sectors. Enterprises in the sector that disagreed on the time frame for the quota reduction from importing countries failed to exert a unified pressure on the negotiators. Finally, as it was a low stake sector to the government at that time, the government preferred to pursue bureaucratic interests over sectoral interest. Accordingly, the SBT was relatively indifferent to the final result, compared to the supervising agencies of other sectors.

⁷⁸ For an analysis of the institutional vacuum and its impact on the T&C sector, especially the wool textile industry, see Brown, Waldron, and Longworth (2005:111-3).

Trade concessions gave other WTO members the opportunity of retaining their quotas against China's T&C exports. That explains why WTO accession was irrelevant to the growth trend of China's T&C exports. In contrast, the WTO agreement frustrated the efforts of China's T&C sector in reaching its full potential.

Chapter 6: Automobile Industry under Direct Control of the SPC/SDPC

6.1 Introduction

The global automobile industry is dominated by a few oligopolies featured with tensions and frustrations between a state-based political economy and the economic outlook of essentially transnational cooperation (Munkirs *et al*, 1993). As the industry is capital intensive, technology intensive and labour intensive (Chen, 1997: 107), it is not easy for late entrants to become competitive in a short time. Governments have played a key role in overcoming these difficulties in emerging economies like South Korea, Brazil, China and India (Mukherjee and Sastry, 1996). The success of South Korea's automobile sector provided a model of developmental state for Chinese decision makers to follow (Huang, 2002). However, China's automobile industry was extremely fragmented in the early 1980s (Yang, 1994). Few scholars understand the relationship – cooperative or uncooperative – between different developmental agenda at central and local levels, which could influence decision on trade liberalisation in China's automobile sector.

This chapter argues that the existence of a developmental, corporatist or entrepreneurial state at local level could lead to regional protectionism and relative production overcapacity that could undermine the effectiveness of a developmental state at the national level. The central state, especially the State Planning Commission (SPC), managed to gradually centralise supervision authority over major automobile manufacturers to regain its control of the industry. After strengthening relations with enterprises at the expense of disrupting local developmental plans, the central state

became more interested in and capable of protecting the sector from foreign competition.

6.2 Government-Industry Relations in the Automobile Sector

6.2.1 The Automobile Industry

By the end of the 1990s, the automobile sector was divided by the Chinese government into eight different subsectors, namely passenger truck, off-road vehicle, dumper, trailer, special purpose vehicle, bus, passenger car, and semi-trailer (China Automotive Technology and Research Centre, 1990: 25). First Auto Works (FAW), Dong Feng Motors (Second Auto Works) and Shanghai Automotive Industry Corporation (SAIC) were the major auto manufacturers in the sector. The “Big Three” concentrated their efforts in certain subsectors in the late 1990s. They dominated the passenger car industry, leaving the subsectors of commercial vehicles, mainly buses and trucks to small and medium SOEs (Lee, 2000: 281-4; Lee, 2003: 288) (Table 6.1). The presence of the “Big Three” in “fragmented” auto parts sector was also negligible (Maxton, 1994: 34). The total sales value of the top 10 auto parts manufacturers accounted for only 18.2% of the market in 1999 (Council for the Promotion of International Trade, 2002: 3). Among the 150 major categories of auto parts, the “Big Three” were the largest producers in only 16 categories (China Automotive Industry Yearbook, 2000: 369-71).

Table 6.1 Auto Production in 1999

		Total production (unit)	The Big Three's share (%)
Truck	Heavy	47074	77.2
	Medium	184847	96.5
	Light	386698	25.7
Bus	Heavy	7641	13.8
	Medium	29426	57
	Light	184397	23.4
Car	Mid-high	24734	94.2
	Medium grade	270164	93.8
	Common	134821	86.1

Source: Compiled from data in *China Automotive Industry Yearbook* (2000)

6.2.2 Supervising Agencies in the Central Government

The immediate supervising agency of the automobile industry in the central government experienced dramatic changes in the 1980s and 1990s. The sector first came under the State Bureau of Automobile Industry (SBAI), to be later replaced by the China National Automotive Industry Cooperation (CNAIC)⁷⁹ and then the China National Automotive Industry Federation (CNAIF)⁸⁰. The CNAIC⁸¹ later regained control of the sector, again to be later taken over by the SBAI⁸². The current supervising agency is the State Bureau of Machine Building Industry (SBMBI)⁸³ (Figure 6.1). Throughout these changes, the SPC that was renamed the State Development and Planning Commission (SDPC) in the 1998 Administrative Reform retained ultimate power of decision making in the sector.

⁷⁹ The State Economic Commission initiated a plan to replace the SBAI under the First Ministry of Machine Building (1st MMB) with CNAIC in December 1981. The CNAIC was founded in 1982. The number of personnel was about 200. Accordingly, the SBAI under the 1st MMB was abolished.

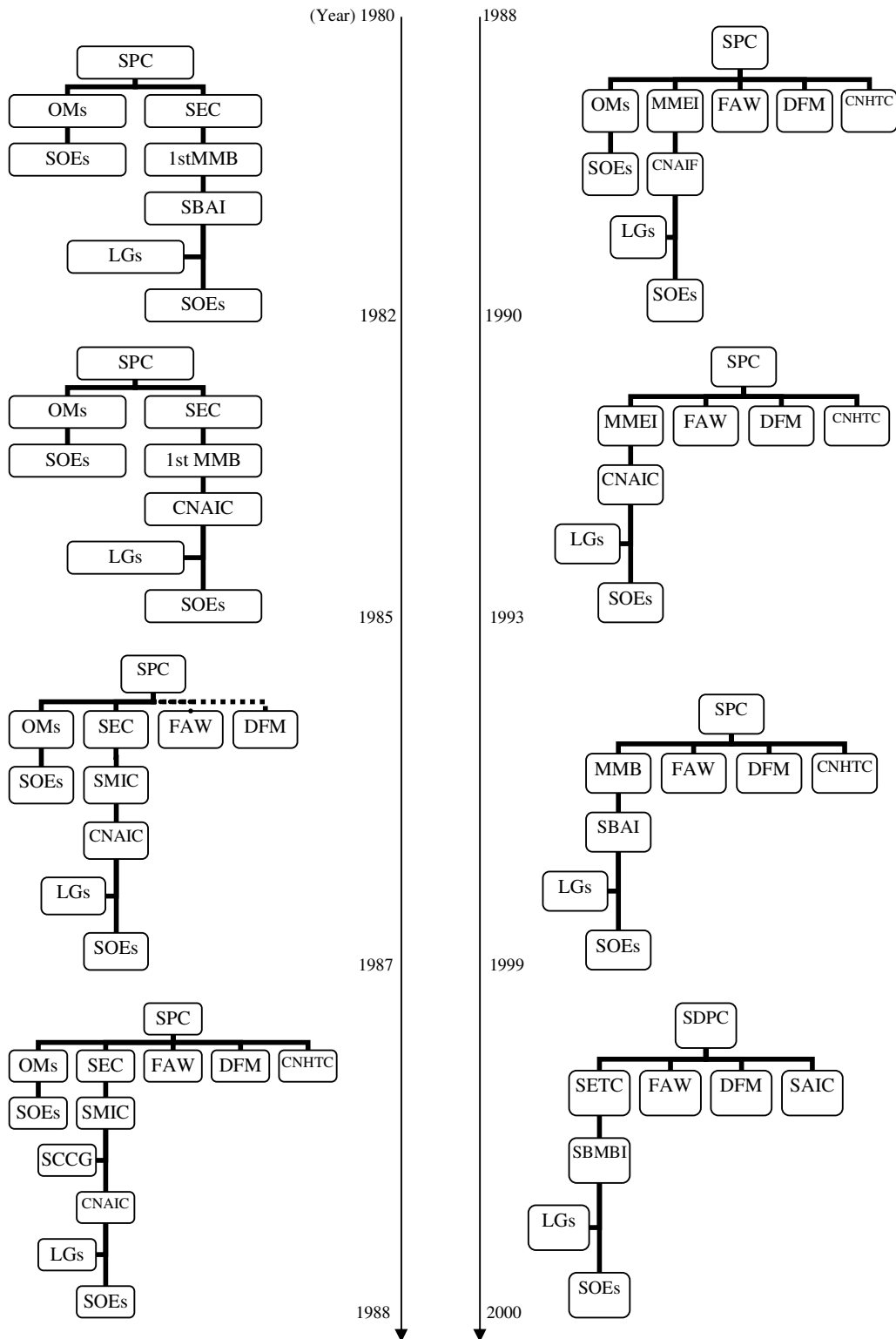
⁸⁰ The CNAIF replaced the CNAIC in 1987. The federation was relatively autonomous from central control, compared to the CNAIC. It composed of voluntary companies and institutions. However, the CNAIF was still under the administration of State Machinery Industry Commission (SMIC). The appointment of council members had to be approved by the SMIC. The administrative expense and necessary subsidies also came from the government.

⁸¹ The CNAIC was re-founded in 1990. It was under the administration of the Ministry of Machinery and Electronics Industry (MMEI) as a bureau. The CNAIF was replaced by the China Automotive Industry Association (CAIA) that was under the CNAIC (Almanac of China's economy, 1991: III127-8).

⁸² In 1993, the Ministry of Machine Building (MMB) operated separately from the MMEI. The State Bureau of Automobile Industry (SBAI) was constituted under the MMB in December 1993 to directly control the sector. The MMB took back the regulatory power from CNAIC that consequently became a normal corporation like the First Automobile Group Corporation. The restructuring indicates the government's will to tighten its control over the automobile sector (Almanac of China's economy, 1994: 168-70).

⁸³ Between 1998 and 2002, the sector was regulated by the SPC/SDPC and the State Bureau of Machine Building Industry (SBMBI) under the State Economic and Trade Commission (SETC). The MMB was downgraded in 1998.

Figure 6.1 Evolution of Supervising Agencies in the Automobile Sector from 1980-2000



Note: Formal supervision: ——— ; Informal supervision: - - - -

1st MMB: First Ministry of Machine Building; CNAIC: China National Automotive Industry Corporation; CNAIF: China National Automotive Industry Federation; CNHTC: China National Heavy-duty Truck Corporation; DFM: Dong Feng Motors; FAW: First Automotive Works; LGs: Local governments; MMEI: Ministry of Machinery and Electronics Industry; OMs: other ministries, including Ministry of City Construction, Ministry of Chemical Industry, Ministry of Communications, Ministry of Justice, Ministry of Light Industry, Ministry of Military, and Ministry of Rural Industry; SAIC: Shanghai Automotive Industry Corporation; SBAI: State Bureau of Automotive Industry; SBMBI: State Bureau of Machine Building Industry; SCCG: State Council Coordination Group on Rehabilitating Automotive Sector; SDPC: State Development and Planning Commission; SEC: State Economic Commission; SETC: State Economic and Trade Commission; SMIC: State Machinery Industry Commission; SPC: State Planning Commission,
Source: compiled by author

6.2.3 Centralisation of the Automobile Sector

The theme of reforms at the start of the 1980s was to decentralise the economy. However, the restructuring of the automobile sector (Figure 6.1) saw a reverse in trends. There was an attempt by the Beijing government to take control away from the local governments and to put automobile manufacturers into enterprise groups under the direct control of the central government (Marukawa, 1995: 334; InterChina Investment Consulting Company, 1997: 24). Unlike other sectors, the automobile industry was directly supervised by the SPC/SDPC in the late 1990s. The intermediary agency, unlike the Ministry of Information Industries in the telecommunications sector, gradually lost its functions of regulating the auto industry.

The SPC/SDPC-led centralisation of automobile sector in the 1980s and 1990s took place in three phases. In the first phase (1987-1993), the FAW, DFM and China National Heavy-duty Truck Corporation (CNHTC) were identified as central SOEs and were removed from the jurisdiction of line ministry and local governments. The second phase (1994-1998) saw the imposition of certain control on both central and local SOEs through the promulgation of an industrial policy in 1994. In the third phase (1999), which was at the threshold China's WTO accession, the SDPC restructured the industry by devolving the CNHTC but centralising the SAIC.

6.2.3.1 Direct Supervision of the FAW, DFM and CNHTC by the SPC, 1987-1993

The SPC/SDPC began its direct supervision of a small number of auto manufacturers by naming them central SOEs in 1987. The FAW, DFM and CNHTC became independent planning units under the auspices of the SPC through the centralisation.⁸⁴ The SPC directly appointed the president of each of the three central SOEs. The high-level managers were responsible for achieving the production plans and reporting to the central government. Meanwhile, the SPC adopted a partial control of the internal organisation of these SOEs. It allowed the enterprises to choose different management structures,⁸⁵ but follow the same principle of highly centralised functional lines (World Bank, 1993: 51). The other automobile manufacturers were supervised by either the local authorities or other ministries in the central government. For example, the SAIC, along with the “Small Three” (Beijing-Cherokee, Tianjin-Charade and Guangzhou-Peugeot) in passenger-car industry, was controlled by the local governments. And the “Mini Two” (Chang An Automobile Co., Ltd. and Guizhou Aviation Industry Corp.) came under the administration of the Ministry of Aviation and Space Flight.

6.2.3.2 Strengthening Control of both Central and Local SOEs by the SPC, 1994-1998

The Automotive Industrial Policy of 1994 was promulgated by the SPC to strengthen its control of both central and local SOEs. The SPC was authorised to issue

⁸⁴ A Third Automotive Works specialising in heavy-duty truck industry was planned in 1978. However, the plan was abandoned in 1981 due to a shortfall in state budget (Lo, 1992: 35). Accordingly, the CNHTC was selected to be the central SOE in the subsector. The SPC had informally announced that the FAW and DFM would be treated differently from other automobile manufacturers in 1984. The decision was promulgated formally by the SPC in its Industrial Policy of 1987.

⁸⁵ For example, the FAW established a central management committee to institutionalise the leading decision-making role of the top management, while the DFM built a management structure around a Board of Directors. See University of Michigan (1992: 3-36), Lo (1992: 37), and Mok (1994: 247). For a detailed explanation of DFM's internal structure, see Chen (1997: 113-7).

approval certificates and approval marks for approved products and decide on approved product lists (Harwit, 1995: 46-7). The enterprises could only design or manufacture the products after they were approved by the SPC. The SPC's control of the investment on passenger car production was exclusive. The industrial policy clearly steered financial aid to major auto manufacturers and banned domestic investments that were not on the projects designated by the SPC (Huang, 2002: 546).⁸⁶ Enterprises' decision of acquiring capital from foreign investment or issuing stocks also required the approval of the SPC, ultimate decision maker in the State Council (Automotive Industrial policy of 1994, Chapter 5, Clause 23 and Clause 6).⁸⁷

The nationwide allocation of input materials also came under the SPC and Ministry of Material Supply (MMS), which gave priority to central SOEs. The SPC also strengthened its control of international procurement through "local content strategy". Sino-foreign joint ventures of assembly makers gradually lost their autonomy of purchasing auto parts from outside.⁸⁸ The authority to approve the procurement of foreign equipment and technology by the enterprises was transferred from the China National Automotive Import and Export Corporation which was under the CNAIC to the SPC by the end of the 1990s.⁸⁹

The SPC also firmed up its control of alliance management between Chinese enterprises and foreign companies through a list of requirements in the industrial

⁸⁶ The Construction Bank, the largest lender of capital investment to the automobile sector, was controlled by the SPC (University of Michigan, 1992: 3-35).

⁸⁷ Small foreign investment would be approved by the SEC/SETC and MOFERT/MOFTEC. Project that exceeds the quota should be approved by the SPC.

⁸⁸ Between 1980 and 1995, China imported 687,000 sets of auto parts mainly through foreign companies that were in joint ventures with local firms (Zhao, 2003: 193). China National Machinery and Equipment Import/Export Corporation under the administration of the MMI handled the import and export of automotive equipment before the 1998 administrative reform.

⁸⁹ The international procurement was nominally controlled by the CNAIC. The import that exceeds the quota should be approved by the SPC. The SPC strictly controlled international procurement of auto parts through import quota. See "Jiwei fuzhuren Zeng Peiyan jianghua," (SPC's vice director Zeng Peiyan's speech), *Guojia qiche gongye zhengce xinbian* (Collection of New Auto Industry Policies), 1994-1995: 94.

policy.⁹⁰ The SPC/SDPC would determine the joint venture projects of both central SOEs and other enterprises. Li Lanqing, Vice-Premier in 1993, clearly stated that all foreign companies would have to seek approval from Zeng Peiyan who was the vice-director of the SPC at that time.⁹¹ Foreign enterprises were not free to choose their joint venture partners (Dennelly, Mellahi, and Tally, 2003: 202).⁹²

6.2.3.3 Centralisation of the SAIC and Devolution of the CNHTC by the SDPC, 1999

By the end of the 1990s, the SDPC restructured its subsidiaries by centralising the SAIC and devolving the CNHTC to further strengthened its control of the sector. The SAIC was the biggest producer of passenger cars (44.9% of total production) and generator of the highest tax revenue (34.11% of total revenue) (Almanac of China's Auto market, 2000: 7-8).

On one hand, the supervision of the SAIC was transferred from Shanghai municipal government to the SDPC in 1999. The move was proposed at the National Machinery Industry Conference from 6-10 January 1999. Prior to 1999, the SAIC was mainly affiliated with local authority as 75% of its capital assets were owned by the municipal government and the rest by the Shanghai International Trust and Investment Company, the financial arm of the municipal government (Thun, 2006: 103). Although the SAIC “would not divert its development efforts from the municipality” in a short time (ibid: 189), the administrative relationship had made

⁹⁰ For example, the Chinese party's share in the joint venture must not be less than 50%; the establishment of a research and development centre for the purpose of indigenisation is a must; and a single foreign company could not engage in more than two alliance management practice to produce the same type of vehicle (Automobile Industry Policy, 1994, Clause No.28, 31, 32). For data on the share of stake in each joint venture, see InterChina Investment Consulting Company (1997), Wang and Liu (1999: 233).

⁹¹ See *Guowuyuan fuzongli Li Lanqing zai zhongqi jituan shenhua gaige he fazhan huiyi shang de jianghua* (Vice-premier of the State Council Li Lanqing's speech at CNHTC's meeting on deepening reforms and development) 22 December 1993.

⁹² The Chinese government had the upper hand of initiating joint venture projects because of the growth in the Chinese automobile market and the production overcapacity in developed countries in the 1990s (Lee, 2003: 291).

several changes after the introduction of the Board of Directors requested by the SDPC.

On the other hand, the automobile enterprises affiliated with the CNHTC were devolved to local governments. The devolution started with the Sinotruk (Zhongguo Jiang Zhengdun Qicheye, 1999: 44). The immediate supervising agency—SBMBI—previously in charge of project approval and production planning—was assigned to supervise the devolution (Chen *et al.*, 2004: 290).

The next two sections analyse the administrative and fiscal connection between the SDPC and the two groups of auto enterprises, namely the central SOEs and the other enterprises. The finding is that the SDPC in 1999 exerted extensive administrative control over the sector but remained fiscally unattached.

6.2.4 Administrative Connection between Government and Industry in the Automobile Sector by the End of the 1990s

As mentioned in previous section, the FAW, DFM and CNHTC were independent planning units under the auspices of the SPC/SDPC from 1987 to early 1999. As the SDPC restructured its subsidiaries by centralising the SAIC and devolving the CNHTC in 1999, the central SOEs changed from “FAW-DFM-CNHTC” to “FAW-DFM-SAIC”. The other automobile manufacturers were supervised by local authorities. Enterprises in the sector had to comply with industrial policies imposed by the SPC/SDPC.

The SDPC’s administrative control of automobile sector involves the following areas: (Table 6.2) 1) Plan of production management. The enterprises could start designing or manufacturing the products only after they were approved by the SPC. The replacement of getting approval (*shenpi zhi*) with filling the record (*bei’an zhi*)

did not loosen the SDPC's control of the sector. The practice became more arbitrary instead (Interview, January 2009). The SDPC would scrutinise the annual plans for production after approval for the three central SOEs, but left the other enterprises to local governments. 2) Capital investment. The SPC/SDPC reviewed and approved all capital investment of more than US\$ 30 million. However, local governments circumvented the rules by breaking up the investment into several small ones (World Bank, 1993:37; Wang and Liu, 1999: 241).⁹³ 3) Allocation of wage and bonus. Both central and local SOEs were granted the autonomy of determining workers' wage and bonus within the limits imposed by the SDPC.⁹⁴ Compared to central SOEs, local SOEs and other enterprises' autonomy of determining the salary and bonus received less intervention.⁹⁵ 4) Asset management. The SDPC retained the nominal rights to reallocating manufacturing equipment, production lines and associated skilled workers among the central SOEs, but became less and less inclined to disrupt their production.⁹⁶ All the enterprises had been granted the autonomy of leasing, upgrading and replacing their fixed assets. However, the introduction of Complete Knock Down (CKD) was still subject to the approval of the SDPC. 5) Personnel and labour management. The SDPC retained its control through the appointment of the President and high-level managers of each of the three central SOEs. The SDPC has delegated the authority of recruiting, promoting and dismissing workers to the enterprises and labour bureaus of the local governments since the 1980s (University of Michigan,

⁹³ To prevent this circumvention, the People's Bank of China centralised the banking system whose local branches used to be the major financial sources for local governments (InterChina Investment Consulting Company, 1997: 29; for details, see Chapter 7).

⁹⁴ The central SOEs have been allowed to experiment with reforming the allocation system left from the central-planning period since 1980 (Jiang, ed. 1986: 255-7). Although the SPC retained the ultimate power of approval, it seldom disrupted the implementation if the allocation scheme was proved to be effective during the experimental stage. For example, in DFM, the allocation scheme was to divide the profit retention into three parts: 70% for development fund, 20% for welfare fund, and 10% for workers' bonus (Jiang, ed. 1986: 45). Also see *Dier qiche zhizaochang neibu gongzi gaige shixing banfa* (Tentative methods of reforming wage system in the SAW), 1984.

⁹⁵ For an analysis of salary system of the SAIC before 1999, see (Maxton, 1994: 21) and Thun (2006: 119-21).

⁹⁶ The FAW had greatly suffered from the disruption from the central government in the 1980s.

1992: 3-33).⁹⁷ The enterprises used to shoulder huge social burden of employing unskilled workers imposed by either central or local governments (Byrd, 1992: 406; Thun, 2006: 177). With industrial restructuring, this problem was rectified in the late 1990s. 6) Procurement of material. For domestic procurement, both central SOEs and other enterprises had gradually got the autonomy of procuring raw materials from the MMS and auto parts from the CNAPAC (China National Automotive Parts and Accessories Corporation) under the CNAIC.⁹⁸ However, international procurement remained subject to the intervention by the SDPC. 7) Alliance management. The central government had loosened its control of alliances among domestic enterprises for the purpose of promoting the formation of a “horizontally divided division-of-labour system” (Marukawa, 1995: 332).⁹⁹ However, alliance management between Chinese enterprises and foreign companies were still controlled by the SDPC. 8) Price. The SPC gradually allowed enterprises to determine the prices of the commercial vehicle, but retained tight control of the prices of the passenger cars (Chen, 1997: 112; Chen, 2002b: 144). In 1994, the SPC adopted a guidance price system for the passenger car sector, allowing the enterprises to adjust their prices not more than 10% higher or lower than SPC’s guide prices.¹⁰⁰ The system was challenged by Shanghai-VW in 1996 and 1997 by decreasing the selling price of its Santana by 20% for the purpose of getting more market share through domestic competition (Wang and Liu, 1999: 240). To prevent price competition among the 13

⁹⁷ For example, the mayor of Shenyang appointed the head of the Gold Cup Automotive Manufacturing Corporation in the 1980s (Mok, 1994: 250). For the analysis of personnel and labor management of the SAIC, see Thun (2006: 103-21).

⁹⁸ Central SOEs retained more administrative link with the SDPC than other enterprises to enjoy the privilege of preferential allocation of resources, especially during the period of shortfall in resources. According to a survey by (Zhongguo qiye guanli xiehui zhuanhuan jingying jizhi diaoyan pingjia ketizu), central allocation of input materials in to the central SOEs decreased from 100% to 10% by the year 1995.

⁹⁹ Vice-premier Li Lanqing in 1994 indicated that the practices of alliance management in the DFM and FAW were voluntary agreement among enterprises that were encouraged by the central government. See *Li Lanqing fuzongli dui qiye dongye fazhan de yici tanhua* (Vice-premier Li Lanqing’s talk on developing automobile industry), *Guojia qiye gongye zhengce xinbian* (Collection of New Auto Industry Policies). (1995: 79).

¹⁰⁰ See *Guojia jiwei guanyu dui guochan jiaocheshixing zhidao jiage de tongzhi* (Notification by the SPC concerning implementing guide pricing on domestic-made passenger cars), 2 September 1994.

major manufacturers, the SDPC stepped in and tightened the price controls (Almanac of China's economy, 1999: 237-42; Sit and Liu, 2000: 663). 9) Internal organisation. The SPC adopted a partial control of internal organisation in central SOEs. The other enterprises were left to the monitoring of the local authorities. For joint ventures, Chinese partners usually gave or were forced to give managerial control to international partners through negotiation and compromise for the purpose of learning advanced management know-how (Robinson and Stones, 1998: 138-9; Maxton, 1994: 21; Mukherjee and Sastry, 1996: M-77; Gallagher, 2006: 51). 10) Sales. The central government had significantly loosened its control of the marketisation of automobile products.¹⁰¹ In 1980, automobile manufacturers were obliged to turn over 92.7% of their products in accordance with mandatory planning (Byrd, 1992: 375). The share of these products had been decreasing over time, from 58.3% in 1984 to 22.2% in 1989, 15% in 1992 (Zhang, 2003) and 4% in 1995 (InterChina Investment Consulting Company, 1997: 105).¹⁰² A market had been gradually established to replace mandatory planning by 1996 (Wang and Liu, 1999: 231). But the SDPC retained its control of the sale of passenger cars through the issuing of operation licences to retailers.¹⁰³

¹⁰¹ According to Yang (1995: 132-3), the Ministry of Material Supply was unable to procure all the products due to budgetary constraints in the early 1980s.

¹⁰² However, the aim of creating a nationwide integrated market was undermined by local governments that used regulations and policies to favour the purchase of vehicles produced within their jurisdictions (Mok, 1994: 251).

¹⁰³ In the early 1980s, the two-track system was allowed. In fact, the sale of passenger cars was the responsibility of the SPC and not the SDPC.

Table 6.2 The SDPC's Control of the Automobile Sector in 1999

Items	Central SOEs	Other enterprises	Items	Central SOEs	Other enterprises
1. Plan of production management	Full	Partial (production ceilings)	6. Procurement of materials	Partial (international procurement)	Partial (international procurement)
2. Capital investment	Full	Partial	7. Alliance management	Partial (Sino-foreign)	Partial (Sino-foreign)
3. Allocation of wage and bonus	Little	Little	8. Price	Partial	Partial
4. Asset management	Partial	Little	9. Internal organisation	Partial	Little
5. Personnel and labour management	Partial (president)	Little	10. Sales	Little	Little

Source: compiled by author

A brief survey of the SDPC's control of central SOEs and other enterprises indicated that the SDPC in 1999 had a close administrative connection with the automobile sector as a whole (or 33.97% of full control).¹⁰⁴ The SDPC's administrative control was the strongest in the passenger car industry (or 47.9%), moderate in truck industry (or 37.5%) and bus industry (or 31.5%), and weakest in the auto parts industry.¹⁰⁵ The automobile sector was relative "high stake" as it enjoys much less autonomy than the sectors of agriculture and textile. The next section explores the fiscal tie between the SDPC and the automobile sector.

6.2.5 Fiscal Connection between Government and Industry in the Automobile Sector by the End of the 1990s

Generally speaking, the SPC/SDPC had no fiscal connection with any specific sector or individual enterprises. The profit retention system introduced by the State

¹⁰⁴ Calculating by gross output value, the share of central SOEs in 1999 was 35.87% and the share of other enterprises was 64.13% (Table 5.6). Among the 10 areas of autonomy, full control was coded as 100% control, partial as 50%, and little as zero. Accordingly, the administrative connection between the SDPC and automobile sector in 1999 was: $(AC)=35.87\%/10*(100\%+100\%+0+50\%+50\%+50\%+50\%+50\%+50\%+0)+64.13\%/10*(50\%+50\%+0+0+0+50\%+50\%+50\%+0+0)=33.97\%$

¹⁰⁵ Calculating by the number of output, the share of central SOEs in 1999 in passenger car, truck, and bus industry was 91.4%, 50.8%, and 27.5% respectively (Table 5.1).

Council in the early 1980s gave the intermediary agencies in each sector a chance to exploit the system. In order to protect the automobile enterprises from being taken advantaged of, the SPC allowed the enterprises to retain most of their profit after taxes by taking away the authority from the immediate supervising agency.

Within the State Council, the responsibility of the SPC/SDPC was to plan the expenditure while the collection of revenue went to Ministry of Finance (MOF). Before the 1978 reform, all the revenue collected by the local bureaus were transferred to the MOF and redistributed to different ministries and provinces through a central plan formulated by the SPC.

In the early 1980s, the central government introduced the profit retention system in automobile industry. The SPC had successfully prevented the central SOEs from being subject to various rent-seeking practices through its developmental agenda. For example, the DFM requested for retaining certain amount of the profit for self-financing development. The DFM's request was supported by the SPC but opposed by the MOF, as the profit was supposed to be transferred to the MOF rather than the SPC. Finally, the SPC helped the DFM overturn the MOF's rejection (Mok, 1994: 258-60). According to Mok (Ibid: 259), the DFM could retain 40% of profits, 60% of depreciation funds and 50% of major repair fund to form a "enterprise self-raised fund" in the early 1980s. Since 1983, the State Council has allowed the DFM to transfer the profit, at an annual growth of 7%, from a base of RMB 140 million in the year of 1982 (Jiang, ed. 1986: 38; Byrd, 1992: 388). In 1986, the base of transferred profit for the DFM increased to RMB 200 million (Byrd, 1992: 387-8; Mok, 1994: 262). The CNAIC, as the immediate authority between the SPC and DFM, took the opportunity to exploit the profit retention system. As Wang and Liu (1999: 231) document, the CNAIC tried to improve its revenue income by "taking away some

profitable and strategic segments of business from the enterprises” (also see Yang, 1995: 133 and Byrd, 1992: 385). After complaints from the enterprises, CNAIC’s privilege of collecting various taxes from the enterprises was terminated by the SPC in the early 1990s.¹⁰⁶ The profit retention system was also introduced to the FAW in the 1980s (Table 6.3).

Table 6.3 Ratio of Profit Retention to Gross Profit in the 1980s (%)

Enterprise/year	1982	1984	1986	1988	1990
FAW	11.9	58.8	82.6	56.9	-196.2*
DFM	36.1	54.5	57.1	71.5	38.0

Note: *: The FAW received a capital injection from the government in 1990.

Source: Mok (1994: 263, 335)

At the time of providing generous packages of profit retention to the central SOEs, the SPC had to bargain with local authorities for the fiscal control of local SOEs. However, the fiscal connection between local SOEs and the SPC/SDPC had been loose, especially in regions where the authority was financially capable of supporting its subordinating enterprises and politically powerful to negotiate with central government. Thun’s (2006: 132) interview revealed that the Shanghai municipal government controlled-SAIC turned down the SPC’s request to transfer half of its proceeds to the central government in the early 1990s. Although the SAIC had to turn a portion of the proceeds over to the centre, it was fiscally unattached to the SPC.

To conclude, in terms of administrative supervision, the SDPC in 1999 exerted significant control over the automobile sector. With regard to fiscal connection, the SDPC did not rely on the automobile sector for revenue generation. Among the subsectors, the SDPC’s role varied from a developmental agency in the passenger car industry facilitating the growth of a few central SOEs to a regulatory agency in the auto parts industry providing relatively impartial market rules. Its efforts to protect a

¹⁰⁶ *Guowuyuan guanyu zhongguo qiche gongye zonggongsi tizhi youguan wenti de pifu* (Official Reply by the State Council concerning relevant questions to the CNAIC’s managerial system), 22 October 1993

sector were dependent on the roles played. The following sections will examine sectoral interests and bureaucratic interests at the threshold of China's WTO accession.

6.3 Sectoral Interests on Trade Negotiation

It was widely agreed by economists, entrepreneurs, government think tanks and politicians that China's automobile sector was not competitive in global trade at the time of negotiation. An extensive research conducted by economists after the China-US agreement in November 1999 indicated that the severest blow from international competition would be in the automobile sector. For example, Chen and Feng (2000), Zhou (2001), and Yin and Gates (2002) predict that China's automobile industry would suffer from international competition after its entry into the WTO. Cheap input resources and labour cost would figure strongly in the textile and clothing sector but not the automobile sector. For Dennelly, Mellahi, and Tally (2003: 204), the most important factors are technological managerial know-how, highly trained workforces and excellent information system. China's automobile sector was weak in all of these factors. Zhang (2004: 87-90) provides a list of the major comparative disadvantages of China's automobile sector, including fragmented industrial system, low concentration ratios, poor research and development (R&D), low production efficiency, high production cost and insufficient capital supply.¹⁰⁷ Zhao's (2003: 185-6) analysis of the economy of scale shows that China's automobile manufacturing enterprises were lagging far behind their foreign counterparts in this area.¹⁰⁸ After breaking down the whole sector into different subsectors, the economists generally agreed that domestically produced normal trucks and buses enjoyed a comparative

¹⁰⁷ See also Cooke (2008: 123-7).

¹⁰⁸ Generally speaking, large manufacturers enjoy cost advantage over small ones.

advantage in terms of prices, but not in the case of passenger cars and advanced commercial vehicles (World Bank, 1993: 54; Almanac of China's auto market, 2000: 16) (Table 6.4).

Table 6.4 Comparison of Domestic and International Prices in 1999

		Inferior-quality products	High-quality products
Truck	Heavy	Competitive	Competitive
	Medium	Competitive	Competitive
	Light	Competitive	Uncompetitive
Bus	Heavy	Competitive	Uncompetitive
	Medium	Competitive	Uncompetitive
	Light	Competitive	Uncompetitive
Car	Mid-high	Uncompetitive	Uncompetitive
	Medium grade	Uncompetitive	Uncompetitive
	Common	Uncompetitive	Uncompetitive

Source: Compiled from data in *Almanac of China's auto market*. (2000: 16)

Harwit's interviews with entrepreneurs in different time periods showed a growing confidence in their products in spite of the coming competition. In 1992, his interview with SVW's Chinese managing director recorded that "at the moment, we are not competitive. If they were to open the market, we could not compete" (1995: 171). In 2001, another interview revealed "guarded optimism" from several joint venture company leaders.¹⁰⁹ Finally, nearer date to China's WTO accession, SVW officials showed much confidence when they replied that "(W)ith good quality, we will have no disadvantages against imports" (2001: 166).

The governmental think tanks and politicians generally agreed that the automobile industry expected to see huge loss after WTO accession. A research by the Development Research Centre of China's State Council concluded that China's automobile sector was not competitive at that time because of its inferior technology, high pollution, high prices, and low productivity (Thun, 2006: 207-8; Gallagher, 2006: 26). The Industrial Policy of 1994 released by the SPC clearly stated that

¹⁰⁹ Harwit (2001) conducted interviews with the following companies in Beijing and Shanghai in the summer of 2000: Asimco, Beijing Jeep, Shanghai Volkswagen, Shanghai General Motors and Toyota.

China's automotive industry was still not internationally competitive (Industrial Policy of 1994, Chapter 7, Clause 34). Chinese officials again in 1998 expressed their concern for the future of the automobile sector, estimating that China needed at least nine years to be competitive under WTO rules (Harwit, 2001: 662).

Although many scholars and officials were very pessimistic about China's automobile sector after its WTO accession, Yang (2000a: 438) holds a more positive view that "when the government monopoly in the automobile manufacturing is abandoned, private Chinese automobile manufacturers may develop the most competitive automobile manufacturing sector in the world within quite a short period of time".¹¹⁰ However, the prospect of developing the private sector was not favourable in the government-controlled automobile industry. A study of market structure in the automobile sector in the next section reveals that one of the reasons for governmental protection was to prevent private actors from entering the sector.

6.4 Sectoral Pressure on Trade Negotiation

In the early 1980s, China's automobile industry composed of a large number of small and medium state-owned auto manufacturers. Thanks to the industrial restructuring, the sector gradually developed into an oligopoly, but remained fragmented.

State ownership is significant in the global automobile industry as in the cases of Renault and Volkswagen. As Sit and Liu (2000: 654) summarises, state intervention was one of the major factors for establishing an auto industry in the developing countries.¹¹¹ China was no exception. Generally speaking, the SOEs dominated the automobile industry in the 1980s. Their domination started to decline

¹¹⁰ Also see Hu (1999: 20-3).

¹¹¹ Although the automobile enterprises in South Korea were privately owned, they still relied on governmental planning to survive the competition from giant multinational corporations (Chaudhuri, 1989).

in the 1990s with the introduction of foreign companies in the form of joint ventures. However, the state sector remained the most important force before China's WTO accession (Table 5.3). Thanks to governmental protection, the SOEs were "extremely sheltered from all sources of competition", especially from private actors and foreign companies (World Bank, 1993, xi). They were the status quo players who did not want to see any changes after WTO accession, particularly the entry of private players (Huang, 1993, 88). The private enterprises were competitive, as they did not have to shoulder social burdens. The first application in 1997 by Geely did not reach the SPC, the decision-making body. It was turned down by the local government. Chery Automobile, another private manufacturer, had no choice but to join the SAIC. It surrendered 20% of its share to the SAIC to produce the passenger car under SAIC's production licence (Interview, February 2009; Chen, *et al.*, 2004: 214). The SOEs were also willing to keep the import quota and high import tariff rates that were used to protect the sector from foreign intrusion. According to Posth (2002: 75), purchase prices of imported passenger cars were 250-300% higher than comparable prices abroad. These measures guaranteed a huge profit for domestic automobile manufacturers.¹¹² Thus, the SOEs in general did not have any incentive to voluntarily liberalise the sector. Foreign direct investment was allowed to enter the sector as long as it did not challenge domestic state control.¹¹³ By the end of 1995, there were 381 *sanzhi* enterprises (Sino-foreign joint investments, Sino-foreign cooperative projects and wholly owned foreign investments). Among them, there were 214 enterprises (56.325%) with shares controlled by the Chinese, 106 enterprises (27.895%) with share controlled by foreigners and 60 enterprises (15.79%) with equal domestic share

¹¹² For example, a Xiali passenger car was sold at RMB 94,000 with the net profit of RMB 20,000-30,000 in 1993. See "Xiali, Meiling, Yilaguan..." *Jingji ribao (Economic Daily)*, 1993.3

¹¹³ For example, in the early 1980s, several Beijing automotive manufacturers set up Sino-foreign joint-investment venture with American companies. In the late 1980s, the FAW set up a Sino-foreign joint-investment venture with German Volkswagen Company.

and foreign share (Interview, January 2009). In 1999, domestic firms still dominated the sector (Table 6.5). The majority of state ownership was not allowed to be challenged.

Table 6.5 Market Structure of the Automobile Sector in 1999 (%)

Item	Domestic Firms		HKMT	Sanzi
	Total	SOEs		
Share of number of enterprises	88.61	45.09	3.85	7.54
Share of gross output value	69.62	34.52	3.62	26.76
Share of added value	66.76	34.53	4.79	28.45

Note: Domestic firms include SOEs, collective-owned enterprises, share cooperatives, domestic joint ventures, closely held corporations (*youxian zeren gongsi*), publicly held corporations (*gufen youxian gongsi*) and private enterprises. HKMT: investment from Hong Kong, Macao, Taiwan; Sanzi: Sino-foreign joint investments, Sino-foreign cooperative projects and wholly owned foreign investments

Source: Compiled from data in *China Automotive Industry Yearbook*, 2000: 291-2.

Although the SOEs in general did not have any incentive to voluntarily liberalise the sector, their voice of protection was not as unified as those in the telecommunications sector and banking sector. The interest in state protection was slightly divergent between central SOEs and local SOEs. The strongest request for protection in the automobile sector came from the central SOEs whose share of gross output value account for only 35% of the sector (Table 6.6), compared to China Telecom's 91% in telecommunications services and the "Big Four" state-owned commercial banks' 71% in the banking industry. Accordingly, the state sector in the automobile industry needs further scrutiny.

Table 6.6 Performance of the Three Central SOEs in the Automobile Sector in 1999 (%)

Item	FAW	DF	SAIC	Total of the three
Share of gross output value	13.31	7.12	15.44	35.87
Share of added-value	13.56	5.94	18.72	38.22
Share of total value of profits and taxes	13.61	3.24	34.11	50.95
Share of vehicle production	18.69	11.23	13.97	43.89
Share of passenger car production	17.31	7.10	44.90	69.31

Source: Almanac of China's Auto market. (2000: 7-8)

Although most enterprises in the domestic automobile sector were state-owned, they were in various situations that were largely determined by the positions of their supervisors. The central SOEs had tried to prevent competition from not only private actors and foreign companies but also local SOEs. The government policy at that time was primarily formulated to benefit the central SOEs. It had prevented local SOEs from entering the sector with the control on production licence, investment and input supply. The SPC in 1987 allowed only three companies to manufacture passenger cars. They were the FAW, DFM and SAIC. FAW's products were meant for reducing domestic demand of foreign cars and DFM's products were planned for export (Lin, 1987). The administrative control of the SAIC was initiated by the municipal government after extensive lobbying effort to obtain approval of the central government. Private enterprises or even the local SOEs did not have the channel to lobby for the production licence of passenger car assembly (Ngo and Chen, 2009: 175). The development of the central SOEs was also guaranteed by the state budget. In order to meet the SPC's plan of developing the automobile sector, the government expected an investment of RMB 150-180 trillion — including RMB 40 trillion for the “eighth five-year plan (1991-1995)”, compared to a gross investment of RMB 22 trillion from 1949 to 1990 —when actually RMB 58.8 trillion was needed. As the amount of investment exceeded state budget, the government decided to mobilise domestic and international capital market. The central SOEs were strategically positioned to receive financial benefits from these channels. For example, in 1999, the FAW got RMB 8.6 billion, about 80% of its total debt owing to the state banking system, as a favourable “switch from debt to equity” from the central government (Ping, 2001: 4). Finally, local SOEs were not able to turn their production plan into a physical reality when there was a shortfall in good-quality materials, which were

primarily supplied to the central SOEs through the nationwide allocation system supervised by the SPC and MMS.

As discussed, there were certain barriers that prevented the local SOEs from competing with the central SOEs. By keeping foreign players away, the central SOEs had the priority of receiving limited investment and good-quality input materials in the closed market. The FAW, according to Harwit (2001: 662), “was among the most vocal of the large companies to express its worries”. One FAW official in 1999 expressed that they need another two or three years before the automobile sector could be opened up (Businessweek Online, 22 November 1999, quoted from Harwit, 2001: 662). For the local SOEs, the gradual opening-up not only invited foreign competition, but also lifted domestic barriers that had been preventing their development. Superior to private enterprises but inferior to the central SOEs, the local SOEs presented a mixed stance towards market liberalization. A survey of 80 domestic automobile manufacturers including both local and central SOEs in 1994 showed that the request by local SOEs for lowest import tariff rate and minimal foreign entry was lower than the requests from the central SOEs (Interview, January 2009, for details of the average, see Table 6.7). The request for lowest import tariff rate by the sector in general was much lower than the nominal rate (Table 6.8). The automobile industry as a whole failed to present a unified opposition to market liberalisation.

Table 6.7 Request for Lowest Import Tariff Rate and Minimal Foreign Entry from the Automobile Sector

Year	Lowest import tariff rate allowed (average, %)			Minimal foreign entry allowed (average, %)		
	1994	1995	2000	1994	1995	2000
Passenger cars	96.67	70.00	43.33	46.67	43.33	16.67
Other vehicles	51.83	45.67	24.67	15.60	19.00	35.50
Spare parts	40.04	38.63	25.76	27.98	28.27	33.81

Source: compiled by author (Interview, January 2009)

Table 6.8 Comparison of Industry-Required Protection and Government-Enforced Protection in the Automobile Industry

Year	Passenger car			Imported engine		
	1994	1995	2000	1994	1995	2000
Lowest import tariff rate required by the industry (average, %)	96.67	70.00	43.33	20	20	19
Government-enforced tariff rate	180	110	80	35	35	35
Minimal foreign entry allowed (average, %)	46.67	43.33	16.67	N.A.	N.A.	N.A.
Practical foreign entry (%)	40	29	3	N.A.	N.A.	N.A.

Source: compiled by author, data of nominal tariff rate from *Tariff System of Peoples Republic of China* (various years from 1995 to 2001)

6.5 Bureaucratic Interests on Trade Negotiation

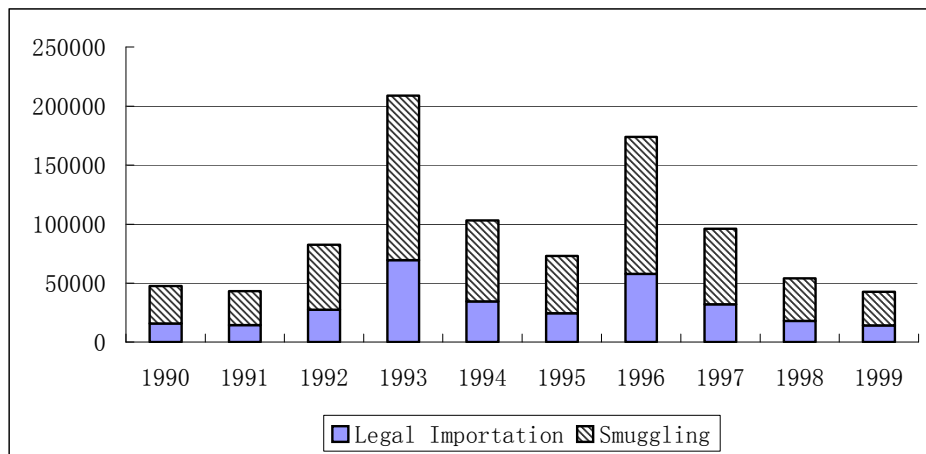
Both the central and local governments opposed to the opening of the automobile industry to foreign competition, but for different reasons. At the central level, the SPC has taken a great interest in the automobile sector since the second half of the 1980s (Hope and Jacobson, 1989: 103). The automobile sector was promoted by the SPC as the important national “pillar industry” in 1987. “The Guidelines on the 1990s National Industrial Policies” (*90 niandai guojia chanye zhengce gangyao*) looked at the distribution of limited resources of selected sectors—including machinery electronics, automobile, chemical and construction—through various preferential policies on bank loans and foreign investment. Their supervising ministries would have to work with the SPC on the implementation of these industrial policies. However, the SPC was not financially capable of supporting these sectors except the automobile (Quan, 2002: 236; Sun, 2007: 189). The automobile industry was the only pillar industry that the SPC was capable of promoting. The development strategy including output, tax, investment and tariff was planned till 2000 by the SPC from the early 1990s. The SPC was not ready to give up its developmental plan during the period of WTO negotiation.

However, the SPC's developmental plan was hampered by the local governments. In the early 1980s, a large number of under-specialised manufacturers competed for investment and material resources to produce as diverse variety of outputs. The central government failed to prevent the development of small and median-sized manufacturers (Almanac of China's economy, 1990: III132-3). The early attempt to solve the problem of duplicate construction (*chongfu jianshe*) among regions was to form enterprise groups, like the DFM and FAW, by transferring the ownership of these enterprises from local governments to central government. For example, the SOEs belonging to the local governments of Kunming, Liuzhou, Hangzhou and etc. were transferred from local to central government to form the DFM (Chen, 1997: 114). The decision was well accepted by local authorities of loss-making enterprises were loss-making but resisted by those with profit-making subsidiaries (Byrd, 1992: 413; Yang, 1995: 134-5). Besides, the effort to form integrated domestic market and develop a nationwide resource allocation system to foster the growth of giant SOEs had never been successful (Mok, 1994: 244). The sector was extremely fragmented because of local protectionism (Gao, 1999: 78; Yang, 1995: 176-7; InterChina Investment Consulting Company, 1997: 27; Denny, Mellahi, and Tally, 2003: 205). Regional protectionism by local governments had hampered the central state's schedule of upgrading the whole sector to international standards (Gallagher, 2006: 41). The disruption prevented the central government from giving concessions to foreign negotiators at an earlier date. The divergent interests between central government and local authorities had influenced China's GATT/WTO accession.

The central and local governments also had different incentives to keep high import tariff rates. The central government had adopted a series of protective

measures, including import quotas, foreign trade licences, and foreign exchange control to protect the domestic industry, especially the central SOEs. Local governments that were against market liberalisation usually had two concerns. The first one was to protect their regional automobile enterprises. However, as the authorities had been gradually recentralised they were no longer interested in protecting the sector. The second was to profit from the loopholes of a highly protective trade regime, like the smuggling practice in Hainan province in 1984 (Posth, 2002: 77). A large number of foreign passenger cars flooded China's market through illegal means, jeopardising the development of the domestic infant industry (Figure 6.2). If the central government could effectively prevent the rent-seeking opportunities of the local governments, the two parties would not have the preference in common.¹¹⁴

Figure 6.2 China's Import of Passenger Cars in the 1990s (Unit)



Source: Zheng (2007: 75), quoted from Li (2009: 8)

To conclude, in the early 1980s, the automobile sector was uncompetitive in global trade and in a domestic market populated by a large number of SOEs. A series

¹¹⁴ Protecting their auto sector from the importation of cheap and good-quality products after the deduction of tariff rates was not the prior concern of the local governments. Instead, domestic competition from conglomerates supported by the central government was their major concern at that time.

of industrial policies were promulgated by the SPC to restructure the sector. The SPC gradually centralised its control to give further to the central SOEs at the expense of private actors, foreign companies and local SOEs, but at varying degrees. Disrupted by local developmental plans, the central effort to nurture the infant industry proved futile.¹¹⁵ The sector was reluctant to lift the barriers for foreign competition, but failed to exert a unified pressure on the government to protect the sector. Thanks to the centralisation of administrative control, the SPC/SDPC became active in protecting sectoral interests, especially the central SOEs' interests. The next section explains the outcome of WTO negotiation in the automobile sector.

6.6 China's WTO Commitment and Its Compliance in the Post-WTO Period

6.6.1 Little Concessions in the Automobile Sector

The automobile industry was one of the least competitive manufacturing sectors, one of the least open, and one of the most vocal in terms of requesting a protectionist trade policy (Li, 1999: 253). The MOFTEC was responsible for coordinating with the automobile sector and the SPC/SDPC in the WTO negotiation. In face of strong opposition from the SDPC, the MOFTEC did not offer much concession on the sector.

In the end, Chinese negotiators decided to protect the automobile sector by sacrificing the textile and clothing sector. In order to sustain the import quota of foreign automobile products till 2005, they allowed other countries to keep their quotas on Chinese textile till the same year. They also managed to negotiate with American negotiators for a reduction in the tariff rate from 80%-100% to 25% by the

¹¹⁵ The fact was widely accepted by Chinese politicians in the national convention of 1992.

year of 2006 instead of 2005. In exchange, the Chinese guaranteed a faster reduction in the first few years after its entry to the WTO (Table 3.3).

6.6.2 China's Compliance in the Post-WTO Period

The automobile industry as a “high stake” sector received tremendous support from the SDPC during the negotiation. The SDPC which was renamed SDRC in 2003 took over the authority from the State Bureau of the Machinery Industry under the SETC in the same year (Noble et al, 2005: 13). At the same time, the central government made a further effort to centralise control of the sector from local governments by abolishing all the local rules (Nine PRC agencies launch campaign to rectify auto market, 2004). The sector enjoyed little autonomy and even less six years after WTO accession. The SDPC/SDRC was responsible for protecting the sector. It would be very difficult for the SDPC/SDRC to give up its control of the sector, although its top-down intervention approach was not compatible with its WTO commitment.

Dong Yang from the State Bureau of the Machinery Industry indicated immediately after the conclusion of the WTO agreement that there would not be any significant change in pricing within the next two years of China's entry to the WTO. Although Chinese negotiators promised to reduce the average tariff rate on foreign cars to 25% by 2006, the supervising agencies believed that they could develop a way of sustaining their protection of the sector (Zhang ed., 2001: 174). The import quota was one of the measures. The United States Trade Representative (2007: 30-1) found that the import quota system in the auto sector was one of the most difficult to deal with among the sectors, which disrupted wholesale and retail operations of imported vehicles. Through US pressures, the import quota system was finally phased out by

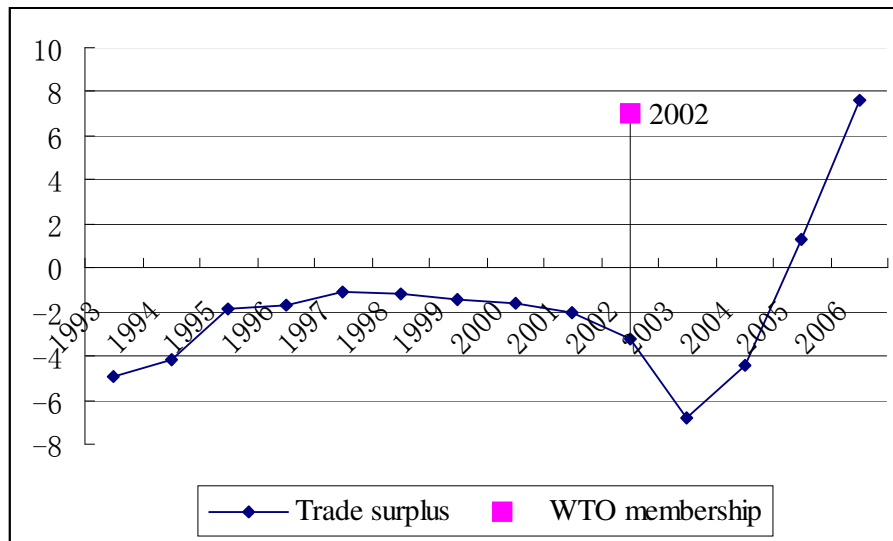
January 2005 as scheduled. Besides, the Industry Policy of 1994 was considered by US negotiators as incompatible with WTO rules. Although China agreed to revise the policy in a separate agreement before the entry, it has not fulfilled its promise since its entry (USTR, 2004: 48). Instead, in 2003, the SDRC drafted a new automobile industry policy to limit foreign-ownership to 50% and half of all sales in China to “wholly owned domestic firms using their own technology” by 2010 (Economist Intelligence Unit, 2005: 83). The Industry Policy released in 2004 “raised barriers” for foreign entry by setting large minimum investment requirements at RMB 2 million and local content requirement (Noble et al, 2005: 14). A series of regulations that contained discriminatory policies against auto imports were promulgated by the central government in the following years.¹¹⁶ The United States, together with the EU and Japan, expressed their concerns accordingly (USTR, 2004: 48). In 2006, the United States brought WTO case against China’s use of prohibited local content requirements in the sector (USTR, 2007: 3). The WTO’s Appellate Body judged in December 2008 that “China has been applying WTO-inconsistent taxes on imported auto parts whenever they are used in the assembly of motor vehicles that fail to meet certain local content requirements” (USTR, 2008: 5).

Thanks to the efforts of government protection in terms of non-tariff barriers, the automobile sector did not do badly after WTO accession. Although the tariff rate was reduced especially in the first two years of entry, foreign automobile products did not enter Chinese market freely. Considered as one of the most uncompetitive sectors before WTO accession, the passenger car industry experienced a slight increase in market share of imported passenger cars in the first two years to shrink again in the

¹¹⁶ These regulations were *Implementing Rules for the Administration of Brand-Specific Automobile Dealerships* by MOFCOM, the SDRC and the State Administration for Industry and Commerce (SAIC) in February 2005, *Measures on the Importation of Parts for Entire Automobiles* issued by the SDRC in February 2005, *Rules for Auto External Marks* by the SDRC in November 2005, and *Implementing Rules for the Evaluation of Eligibility of Auto General Distributors and Brand-specific Dealers* in January 2006 by the MOFCOM.

following years. In 2006, foreign passenger cars accounted for only 3% of sales in Chinese market. China's trade surplus in the automobile industry turned positive in 2005 to grow dramatically in the following year (Figure 6.3). The automobile industry became one of the major beneficiaries of China's WTO accession.

Figure 6.3 China's Trade Surplus in the Automobile Industry from 1993 to 2006 (US\$ billion)



Source: compiled from data in *China Automotive Industry Yearbook*, various issues

6.7 Conclusion

In the 1980s, the SPC adopted a national developmental agenda to enhance the competitiveness of China's domestic automobile industry in the international market. However, the existence of a developmental state at the local level had undermined the effectiveness of the industrial policies promulgated from Beijing. To overcome local constraints, the SPC had gradually centralised its control of the enterprises with partial success. The close government-industry relation guaranteed the convergence of interests between the SDPC and sector, which remained slightly fragmented. The SPC had effectively protected the sector in the 1990s, as the tariff rate in 2000 was much higher than the bottom line requested by the automobile enterprises (Tables 5.7 and

5.8). Its successor was equally effective in the WTO accession. The agreement protected the sector that was considered “high stake”, uncompetitive and fragmented. Continuous intervention in the automobile sector casts doubts on its compliance in the post-WTO period. It also prevented the sector from gaining more autonomy or becoming competitive in terms of R&D and production efficiency.

Chapter 7: MPT/MII and Telecommunications Services

7.1 Introduction

Scholars on China's telecommunications services usually assumed a close tie between the Ministry of Post and Telecommunications (MPT)/ Ministry of Information Industry (MII) and major enterprises in the sector but failed to provide detailed explanations. For example, Zhang (2001: 478) asserted that the MII and local postal, telephone and telegraph branches (PTTs) share common values in ideology, ownership, and ultimate goals. But he overlooked the intervening role of the local governments. Mueller and Lovelock (2000) suggested that there was an effective alliance of interests between China Telecom and the "state", which gave rise to a bargain whereby China Telecom was effectively shielded from foreign competition in return for advancing the state's interests in the expansion of infrastructure into more remote areas of China. However, they failed to identify the fragmented nature of the central state that implied that the interest of the "state" as a whole was not always representative of the individual ministries. Both studies could not uncover to what extent the interests of the ministry and sector converged and how this relationship varied in different time periods. It might not be a concern for Yang (2004: 38) who believed that the creation of the MII as a "regulatory power" in 1998 was "used not to monopolize but to promote competition through a breakup of China Telecom and the entry of new players". According to Yang, the emergence of the "regulatory state" in the telecommunications sector would have helped to liberalize the industry by allowing more foreign entry. The contending evidence shows that some Chinese authorities allowed foreign companies to hold more than 70% ownership from 1995 to 1998, which was much higher than stated in the final agreement with WTO members

in 1999. The evidence also cast a doubt on the simple explanation that the telecommunications sector was too strategically important to give up for negotiators. Thus, government-industry relations in the telecommunications sector is worthy of study as its evolution by the end of the 1990s influenced the result of WTO negotiations that in turn impacted their relationship in the future.

This chapter argues that administrative structure in telecommunications services in the 1990s was fragmented as Lu and Wong (2003: 21) had observed. Uncooperative behavior between China Telecom (supervised by the MPT) and China Unicom (supervised primarily by the Ministry of Electronic Industries (MEI)) jeopardized their monopolistic profits in the sector and created loopholes for foreign entry. Both China Telecom and China Unicom came under the MII's supervision in 1998 in an effort to terminate their uncooperative actions. The breakdown of one monopoly (China Telecom) was an attempt to create four monopolies in their respective subsectors. Under the umbrella of the MII, their dominance would not be challenged by the entry of new players. Having successfully protected its subsidiaries through the negotiation of WTO accession, the MII would continue with its political intervention after the entry. The regulatory body in telecommunications services is not taking shape yet.

7.2 Government-Industry Relations in the Telecommunications Services

7.2.1 The Telecommunications Services

The MPT had been solely providing telecommunications services in China till September 1994 when China Unicom was set up by the State Council for the purpose of "bringing in some competition to the sector" which was defined as "controlled competition" by DeWokin (2001: 632). In response, China Telecom, separating from

the MPT, became an “independent” company. In 1999, China Telecom was divided into four companies, namely China Telecom, China Mobile, Guoxin, and China Satellite, each specialized in the services of fixed-telephone lines, mobile communications, paging, and satellite transmissions respectively.

7.2.2 Supervising Agencies in the Central Government

The MPT changed its role from service provider to supervising agency since China Telecom was carved out in 1995. The founding of China Unicom in 1994 brought the MEI, the Ministry of Railway (MOR) and the Ministry of Electric Power (MEP) in supervising group. The MII was created in 1998 during administrative reform to supervise the industry. The newly established “super ministry” incorporated the MPT, the MEI, the Ministry of Radio, Film, and Television (MRFT), the State Radio Regulation Commission (SRRC), the satellite administrations of the China National Aerospace Industry Corporation, and the Aviation Industries of China.

Telecommunications equipment manufacturing officially separated from the sector in 1984 when the State Planning Commission (SPC) mandated that the Ministry of Machine Building and Electronics Industries (MMBEI) was the main telecommunications equipment manufacturer and the MPT was the primary user. The development of two sectors was subject to different industrial policies. The manufacturing sector has followed China’s overall pro-foreign investment policy with a conventional goal of helping indigenous manufacturers to acquire foreign capital, advanced technologies, management knowledge, and market accesses. In contrast, the “no foreign direct investment” policy has been instituted in China’s service provision sector, based on its economic, political, and social concerns (Tan, 2002: 18; Mueller and Tan, 1997). The telecommunications manufacturing sector was liberalized earlier

and closely connected with the MEI. The MEI supervised the manufacturers that dominated three quarters of the market share in the sector.¹¹⁷ Accordingly, the MEI was mainly responsible for coordinating telecommunications equipment manufacturing and the MPT/MII was mainly responsible for telecommunications services throughout the GATT/WTO negotiations. Although the MII incorporated both supervising agencies through administrative reform in 1998, the manufacturing sector was in the trade category of goods while the service sector was in the trade category of services. This chapter focuses on the MII's effort to protect the service sector.

7.2.3 “Decentralisation” in the Telecommunications Services

Government-industry relations in telecommunications services experienced three periods of development in the 1980s and 1990s. The first period started from the MPT's attempt to clarify the division of labour between the central MPT and local PTBs in 1984. The second period was marked by the entry of China Unicom that led to uncooperative behaviour among the monopolies in 1995. The third period commenced from the administrative reform in 1998 when the MII strengthened its control of the sector through incorporating China Unicom.

7.2.3.1 Clarifying the Division of Labour between Central and Local Authorities in the Telecommunications Services, 1984–1994

Before the 1980s, the telecommunications administration system was dysfunctional. The MPT could not effectively control the local branches (Lu and Wong, 2003: 36). In 1979, the MPT, no longer tolerant of the administrative structure

¹¹⁷ The other telecommunications equipment manufacturers were affiliated with MPT or MOR or cooperated with foreign companies in the form of joint venture (Liang and Ding, 2001: 73-4).

that fragmented its management, filed a report to the State Council to fight for its lost administrative power. In 1984, by recognizing the authority of local governments, the MPT clarified the division of labour between the central MPT and local Post and Telecommunications Bureau (PTB). By doing so, the MPT effectively regained administrative control.¹¹⁸

The central MPT took full administrative control of the inter-provincial, national, and international telephone services, while granting some autonomy to the provincial PTBs on intra-provincial telephone services. Rural telephone networks were operated by companies owned and run by county-level or town-level governments. Enterprises at village level were collectively owned by peasants. The MPT did not have any administrative or fiscal control of the rural telecommunications service providers (Lu, 1994). However, their gross assets and revenue were so little that their presence in national-wide statistics was negligible. Thus, rural telephone networks are not included in this study.

Intra-provincial telephone services throughout China were supervised by provincial authorities. The PTBs were more closely aligned with the local governments than the central MPT (Ken, 1994: 88–9). However, the MPT did retain the power of overriding the will of local government in certain areas (Table 7.1). A closer look at the central MPT's administrative control of the local PTBs reveals the following: 1) plan of production management. The MPT, in consultation with the provincial government, developed annual contracts with the PTBs on the basis of production quotas; 2) capital investment. The local governments were allowed to approve the capital investment of less than RMB 20 million that was usually sufficient for the intra-provincial network construction (Wan, 2001: 168); 3)

¹¹⁸ See "MPT report on the reorganization of the management system of posts and telecommunications 1979", in *China transportation yearbook 1986* (Beijing: China Transportation yearbook press, 1986), 342-3, quoted from Zhou (1997: 74).

allocation of wage and bonus. After remitting the revenue to the MPT and the state, the PTBs had the decisive role in allocating the wage and bonus within the bureau; 4) asset management. By signing contracts with the PTBs, the MPT authorized them to manage their own assets; 5) personnel and labour management. The MPT retained its right of appointing senior officers of the PTBs while leaving other personnel and labour management to the local branches;¹¹⁹ 6) procurement of material. The MPT controlled nation-wide procurement through its supervision of the China National Postal and Telecommunications Appliance Corporation (CNPTAC). For state-allocated equipment, the PTBs were willing to purchase through the CNPTAC for a cheaper price. For imported equipment, the PTBs preferred to bypass the CNPTAC through the use of provincial trading companies; 7) alliance management. It was not allowed. The PTBs were still local branches of the MPT. Investment was allowed on the precondition that the investors would not be directly involved in internal management;¹²⁰ 8) price. The MPT adopted a price cap system and allowed the PTBs to float their charges of installation fee and intra-province calls below the cap, subject to the approval of local governments' price control authorities;¹²¹ 9–10), internal organisation and sales. The MPT also significantly restrained itself from disrupting organizational management and sales after having devolved authority to local governments.

To conclude, the MPT fully controlled the inter-provincial, national, and international telephone services. It also effectively controlled certain functions in

¹¹⁹ Since 1986, 4-year appointment was signed between the central MPT and local director. The MPT decided if the directors should be reappointed, promoted, or dismissed, basing on their performance (Xu and Pitt, 2002: 22).

¹²⁰ There might be some horizontal alliance between them and non-MPT companies as Lin Sun (1993: 185) argued. However, this kind of management alliance remained informal and mainly concentrated in manufacturing area.

¹²¹ The MPT started to authorize the PTBs to collect installation fees since 1980. In 1990, the decision making regarding installation charges has been completely decentralized to the local bureaux. At the end of 1990, the MPT set a price cap on the intra-province telephone rates according to the local telephone company's average costs plus a mark-up for profit (Sun, 1992: 36-7).

intra-provincial telephone services, although its influence *varied* in different provinces in what by Harwit (2008: 36) calls a “double administrative system”.¹²² The administrative connection between the MPT and telecommunications sector was close (or 65%)¹²³ in the late 1980s and early 1990s.

Table 7.1 Effective Control by the MPT by 1994

Items	Degree of control by the MPT	Items	Degree of control by the MPT
1. Plan of production management	Partial (contract)	6. Procurement of the materials	Partial (CNPTAC)
2. Capital investment	Little (above RMB 20 M)	7. Alliance management	Full
3. Allocation of wage and bonus	Little (remittance)	8. Price	Partial (price cap)
4. Asset management	Little	9. Internal organisation	Little
5. Personnel and labour management	Partial (senior leaders)	10. Sales	Little

Source: compiled by author

7.2.3.2 Entry of Rival Players in the Telecommunications Services, 1995–1997

The relationship between the MPT and its local PTBs did not experience significant change in the 1980s and early 1990s. In 1988, the MPT set up the Directorate-General of Telecommunications (DGT) to build, manage, and operate domestic long-distance and international services. The DGT was supposed to be an independent body in 1994 and incorporated as China Telecom in 1995 (Lovelock, 2009). However, the creation of China Telecom was not followed by any change to the administrative system (Chen, 2001: 203–4). The DGT and later China Telecom did not own any telecommunications assets or provide any services per se. The PTBs reported directly to the MPT (Liang and Zhang, 2001: 1). China Telecom remained as

¹²² According to Mueller and Tan (1997: 32-3), the Beijing, Shanghai, and Tianjin PTBs had the most autonomy because their first responsibility was to the municipal government. Wealthy and distant provinces, like Guangdong, had also achieved more latitude than many others. According to Ken (1987: 15), the nearer the province is to Beijing, the more deference is likely to be made to the MPT’s planning sentiments.

¹²³ This author codes the division of function between the central MPT and the PTBs as 50%-50% division. Among the 10 areas of autonomy in the intra-provincial telephone service operated by the PTBs, full control was coded as 100% control, partial as 50%, and little as zero. Accordingly, the administrative connection (AC)=50%+50%/10*(50%+0+0+0+50%+50%+100%+50%+0+0)=65%

one of the subordinate departments of the MPT that still fully controlled areas such as investment, finance, and personnel (Xu, 2001: 517; Xu and Pitt, 1999; Gao and Lyytinen, 2000: 722).

However, the setting up of China Unicom and Jitong Network Communications Company (Jitong) in 1994 did make some but minimal changes to the government-industry relations in telecommunications services. China Unicom was controlled by the MEI, MOR, MEP, and some other SOEs. Jitong was under the MEI to oversee the so-called “three golden projects” (Golden Bridge, Golden Customs, and Golden Card). Neither of the two telecommunications service providers was required to report to the MPT. Conflict between the enterprises usually needed arbitration from the State Council (Xu and Pitt, 2002: 71). Consequently, the MPT’s administrative connection with the sector diminished until 1998.

7.2.3.3 Incorporation of the Rival Players by the MII, 1998–1999

The MII was founded during the 1998 Administrative Reform to incorporate both the MPT and the MEI.¹²⁴ At the core of the new ministry was the old MPT whose officials claimed eight of the thirteen directorates. These included leadership of the most politically sensitive areas of the MII’s activities: policy, planning, regulation, economics, wireless administration, personnel, and foreign affairs (Lovelock, 2009).

The newly established MII did not carry out the restructuring programme of separating China Telecom from the Ministry as requested by Premier Zhu Rongji. Premier Zhu ordered Minister Wu to submit a restructuring plan for China Telecom four times without a satisfactory answer (Johnson, 1999c). Instead, the Ministry

¹²⁴ The MEI controlled the telecom equipment manufacturing before the merger. The MII started to control both service suppliers and equipment suppliers since it incorporated the MEI. The service supply was fully controlled by the SOEs, while the equipment supply was provided by not only the SOEs but also non-state actors (Fernandez and Fernandez-Stembridge, 2007: 231).

started to grab administrative control of China Unicom.¹²⁵ The MII gradually rooted out the MEI and China Unicom's former leadership from the government and the enterprise. Liu Jianfeng, former chief of China Unicom, was removed from the position of MII vice minister. The MPT's Yang Xianzu, MII's vice minister, became the chairman of China Unicom in February 1999. Wang Jianzhou, director of the MII's planning department, took the position of China Unicom's executive vice president and became CEO in 2000. Shi Cuiming, director-general of China Telecom, was also transferred to China Unicom as director. Their inauguration led to a complete termination of Li Huifen's leadership authority in the company.¹²⁶ After gaining control of the top-level management, the MII started to impose effective control on China Unicom's local branches through the regulation of personnel and labour management that was previously applied to China Telecom (Caijing Zazhi Bianjibu, 2003: 65).

Having failed to separate the MII from the enterprises during the 1998 Administrative Reform, the State Council took further efforts to restructure the sector. However, these also proved unsuccessful. For example, the decision of dividing China Telecom into four companies—China Telecom, China Mobile, Guoxin, and China Satellite—which was made in early 1999 and implemented in 2000 did not make any changes to the administrative system. They became four monopolies in their respective subsectors and their businesses were restricted to their designated services (Zhang, 2001: 472). The Central Enterprise Working Commission (CEWC) was established for the purpose of supervising the top 100 large-scaled SOEs whose managers were directly nominated by the CEWC and endorsed by Wu Bangguo, the Vice-Premier of the State Council. Although China Telecom was included in the

¹²⁵ The MII's action of regulating China's internet since 1998 also revealed its effort of centralizing its administrative function through the hierarchical structure. For the details, see Tan (1999).

¹²⁶ For the details of the bureaucratic reshuffling, see Harwit (2008: 62-3).

scheme, its relationship with the MII was not changed in practice. In other words, China Telecom was not a real corporation; it remained as an administrative agency under the MII. As Zhang (2001: 478) observed, the MII still held the power to appoint, promote, and dismiss key officials in China Telecom, China Telecom (HKT), China Mobile Communication Groups, China Unicom, and provincial PTBs.

7.2.4 Administrative Connection between Government and Industry in the Telecommunications Services by the End of the 1990s

The MPT effectively reinforced its control of telecommunications services in the early 1980s by clarifying the division of labor between the central MPT and local PTBs. The MPT, fully controlling the business of inter-provincial, national, and international telephone services, shared administrative authority with the local governments on the business of intra-provincial telephone services. Its administrative connection with the sector was close (65%) in the late 1980s and early 1990s. The setting up of China Unicom diluted the connection between the MPT and the sector. However, the newly established MII regained its control over the previous level through incorporating China Unicom. The telecommunications services sector was extremely “high stake” and had much less autonomy than the agriculture and textile sectors. The next section explores the fiscal tie between the MPT/MI and the telecommunications industry.

7.2.5 Fiscal Connection between Government and Industry in the Telecommunications Service by the End of the 1990s

Before the 1978 Reform, all revenue collected by the local bureaus were remitted to the Ministry of Finance and then redistributed to different ministries and

provinces through central planning. There was no fiscal connection between the MPT and local bureaus.

According to Lu Ding (1994: 200), there was no independent accounting at the PTB level before 1985. In 1980, the PTBs transferred an agreed amount of profit and taxes to the MPT and the state respectively, while retaining the rest of the profit. In principle, of the after-tax profit (ATP) calculated by this method, 80% would be retained by the enterprise and 20% would be handed over to the central MPT. Industrial policy on the telecommunications sector was promulgated by the State Council in 1982 to allow the PTBs to remit 10% of its profit as tax to the state which was much lower than the tax rate of 55% for other industries. The MPT also introduced a contract system with the local bureaus by the end of 1985. According to the World Bank (1992), the PTBs should transfer 10% of net allocated profit (AP), 70% of depreciation of long distance investment (DL), 30% of new technology development fund (TF), and Operating Surplus (OS).¹²⁷ In 1989, MPT decided to ask the PTBs to remit 20% of net allocated profit together with other transfers.

China Unicom was created by the State Council in September 1994 for the purpose of bringing in some competition to the sector. The proposal of introducing a competitor was initiated by the MEI, MEP, and MOR, each of which had 25% ownership along with 13 other state-owned investors. Its revenue was directly remitted to the shareholders. After signing the CCF agreement, according to Yu Xiaomang, 75% of China Unicom's profit was handed over to foreign investors. In some provinces or cities, foreign companies took as much as 90% of the total profit from these local China Unicom branches (Caijing Zazhi Bianjibu, 2003: 48). The MPT did not have any fiscal connection with the Unicom. As MPT-supervised

¹²⁷ Operating surplus=actual profits-allocated profits. For the fiscal data, see East Asia Dept. II., Asia Technical Dept. (1992: 17-8).

enterprise's market share (MS) started to decline since 1994, its fiscal connection with the sector as a whole was weakened as well.

Thus, the fiscal connections (FC) between the MPT/MII and the telecommunications services in different time periods from 1980 to 1999 were as follows:

$$\begin{aligned} \text{FC (1980-1985)} &= 20\% \text{ATP} \\ \text{FC (1985-1988)} &= 10\% \text{AP} + 70\% \text{DL} + 30\% \text{TF} + \text{OS}; \\ \text{FC (1989-1994)} &= 20\% \text{AP} + 70\% \text{DL} + 30\% \text{TF} + \text{OS}; \\ \text{FC (1995-1999)} &= \text{MS} * (20\% \text{AP} + 70\% \text{DL} + 30\% \text{TF} + \text{OS}). \end{aligned}$$

Note: FC: fiscal connection; ATP: after-tax profit; AP: net allocated profit; DL: depreciation of long distance investment; TF: new technology development fund; OS: Operating Surplus; MS: market share of China Telecom

Although China Unicom came under the MII's supervision in 1998, their fiscal tie was not strengthened immediately. In order to take fiscal control of the enterprise, the Ministry asked foreign investors to withdraw their investment. By September 1998, all of the foreign investors in the CCF scheme were notified that their agreements were to be terminated. The MII, in October 1999, decided not to pay revenue to the foreign companies that refused to terminate their contracts. At the same time, the state poured RMB 12.6 trillion into China Unicom, including 6.9 trillion from MII-supervised Guoxin Paging Corporation and 5 trillion from the Ministry of Finance. After fiscal restructuring, the MII became the biggest stakeholder of China Unicom, as the share of previous domestic investors was cut to less than 20% of total assets (Caijing Zazhi Bianjibu, 2003: 69). Having regained its control of China Unicom, the MII's fiscal connection with the sector was strengthened again.

Before fully eliminating foreign investment in China Unicom, the ministry continued its discriminatory policy against the enterprise even though it had started to administratively supervise the enterprise. In 1999, in order to guarantee the profit of

China Telecom, the MII stopped China Unicom's right to provide DII service which was extremely profitable (Liu, 1999: 16). In the same year, Minister Mu discouraged lower level governments and other agencies from developing the telecommunications industry, saying that any unnecessary competition would disrupt the state's strategic plan in the sector (Xinxi chanye bu zhang Wu Jichuan zhichu, fazhan xinxi chanye buneng yihong ershang, 1999: 42). Especially in the business of domestic and international long-distance calls that produced a huge profit and had great potential for development, the Ministry did not allow any competitor to enter the market.¹²⁸ Discriminatory policy against China Unicom was finally ended when the fiscal restructuring programme was completed.

To conclude, in China, the fiscal and administrative connections between the telecommunications services and MPT/MII were very tight, in turn leading to a convergence of their interests. The next two sections will study the sectoral interests and bureaucratic interests in face of trade negotiation.

7.3 Sectoral Interests on Trade Negotiation

Petrazzini's (1995) comparative analysis on telecommunications reform in developing countries in Asia and Latin America concluded that the status of the domestic economy at the moment of liberalization and how investors assessed market prospects explained the variations among them. Accordingly, competitiveness of telecommunications service providers is a key variable in identifying their stance towards market liberalization.

¹²⁸ The average charge for telephone call was seven times of that in the United States in the year of 1999 (Jiaru Shimao dui Woguo Butong Hangye de Yingxiang, 1999: 33).

Generally speaking, China Telecom and China Unicom at the time were not competitive in global telecommunications services. In order to protect their interests, the sector opposed fierce competition brought about by China's WTO accession.

China's telecommunications services were not competitive in terms of sector size, productivity, production efficiency. Measured by sector size, China's telecom revenue was only \$37.1 billion in 2000, 21% that of the United States's and 40% that of Japan's in 1995. As for productivity (revenue per employee), the average world level was \$126,000 in 1996: \$203,000 in the United States and \$438,000 in Japan. In China, revenue per employee was only \$54,000 (Yu, Berg, and Guo, 2004: 728). Measured by production efficiency (total subscriber lines—fixed and mobile—per employee), Zhang (2001: 470)'s calculation showed that China Telecom only accounted for 51.7% of Nippon Telegraph and Telephone Corporation (NTT)'s production efficiency in 1997. More seriously, know-how and experience about competition were extremely limited. A report by the World Bank in the early 1990s showed that the efficiency of telecommunications supply in China was among the lowest in the world and service quality was not up to standard (He, 1994: 208).

Whether the domestic telecommunications sector could survive the competition through liberalization was not clear before its entry into the WTO. However, one thing was certain: domestic telecommunications providers were not able to get any benefits in the near future. Thus, they could not be expected to be supportive of lowering the entry barrier for foreign competitive players. In fact, the uncompetitive nature became a good excuse for the sector to ask for extending the protection.

7.4 Sectoral Pressure on Trade Negotiation

Cooperative behaviour is usually guaranteed among monopolies, as the cooperation guarantees their monopolistic benefits. It is not easy for a latecomer to develop into a monopoly, as the incumbent monopolies would prevent new competitors from jeopardizing their monopolistic interests. However, it can happen when the government intervenes. China's telecommunications industry in the 1990s was a good example. China Unicom was able to become the second monopoly since 1994 because of state intervention. Two monopolies supervised by different ministries led to uncooperative behaviour that in turn created loopholes for foreign entry. Administrative reform in 1998 called for an end to uncooperative competition. A unified voice against market liberalization was strong, as both China Telecom and China Unicom came under the supervision of the same protector—MII.

The global trend of liberalizing the telecommunications sector, starting from Britain and then spreading to Asia and Latin America, took place in the 1980s and 1990s. However, it did not change the Chinese mindset of protecting the sector. China's telecommunications services were far from privatization and market liberalization. State-owned enterprises monopolized the services of international long distance calls and allowed only limited competition in local calls, mobile phones, and paging services between state-owned providers (Singh, 2000: 886).

Measured by market share, China Telecom dominated all subsectors in telecommunications services (Table 7.2). Its degree of domination varied between paging services, mobile phone services, and long-distance calling services. For example, there were more than 2,100 enterprises competing in radio paging services (Liang and Zhang, 2001: 102). China Telecom, the biggest radio paging operator, had 34.19 million paging subscribers by the end of 1997. However, its total market share

was only 67.68% and floated around 60% in the late 1990s (Liang, Zhang, and Yang, 1998: 58; Caijing Zazhi Bianjibu, 2003: 20).¹²⁹ There were only two companies, China Telecom and China Unicom, in mobile phone services.¹³⁰ Although China Telecom's market share started to decline since 1995, it remained as high as 91% by 1999 (Table 7.3). China Telecom monopolized the services of domestic and international long distance calls. It did not allow any competitor in the area.¹³¹ In 2000, the approximate market shares for telecommunications as a whole were as follows: China Telecom, 57%; China Mobile, 34%; and China Unicom, 8%. All three were supervised by the MII at the time. Their total share was 99%. Other very minor players included Jitong and Netcom that were owned by other ministries or state-owned enterprises (SOEs) (Wu, 2004: 221–2).

Table 7.2 Major Players and Their Business in Telecommunications Services

Item/year	Before 1994	1994	1997	1999
International long distance calls	MPT	China Telecom	China Telecom	China Telecom
Domestic long distance calls				
IP long distance calls				China Telecom, China Unicom, China Netcom, Jitong
Intra-city calls		China Telecom	China Telecom, China Unicom	China Telecom, China Unicom
Mobile calls		China Telecom	China Telecom, China Unicom,	China Telecom, China Unicom

Source: Chen, 1999: 120–30

Table 7.3 Major Players and Their Market Share in Mobile Phone Services (%)

	1994	1995	1996	1997	1998	1999
China Telecom	100	c.100	c.99	97	94	91
China Unicom	-	0.3	1	3	6	9

Source: Harwit, 2008: 52, 65

¹²⁹ China Unicom's market share was 6.8% in 1996 and 7.2% in 1997 (Liang and Zhang, 2001: 113).

¹³⁰ Greatwall Telecom, affiliated with the People's Liberation Army (PLA), had been less than 1% of the market share by the end of 1998 (Wan, 2001: 170).

¹³¹ China Unicom was allowed to offer local fixed telephone services in only three cities: Tianjin, Chengdu, and Chongqing.

China Telecom as an incumbent in telecommunications services was reluctant to share monopolistic benefits with any other players. Throughout the 1980s and early 1990s, the MPT claimed sole monopoly of the sector through its branches. The other ministries were eager to enter the sector for the huge profits stemming from preferential policy.¹³² The monopolistic profit in the sector was huge and not transparent. Domestic pressure on reducing the monopolistic profit pushed telecommunications services to set the charges for basic telecommunications services, but failed. China Telecom could always find ways of maintaining its monopoly, like cross-subsidies and dumping strategies. It had successfully minimized competition from China Unicom in the domestic market. For example, the State Council pushed China Telecom to hand over the business of mobile telecommunications services to China Unicom. However, China Telecom refused and postponed the provision of its fixed telephone network to China Unicom for its GSM services (Global System for Mobile communications). At the same time, China Telecom requested to stop charging both end-users (*shuangxiang shoufei*) in mobile phone services. Its aim was to subsidize the mobile phone business with profits from fixed-line telephone services (cross-subsidies), while China Unicom whose main profits came from charging both end-users could not follow suit. Consequently, China Unicom could not pose any serious challenge to China Telecom. In the other subsectors like paging service, China Telecom continuously used dumping strategies in the paging business to eliminate other competitors. In face of great pressure from the State Council to lower monopolistic profit, China Telecom lowered the fees for long-distance calls and Internet access. However, it covered the loss by increasing the fees for intra-city calls

¹³² The telecommunications sector was promoted for priority development in early 1980s by the State Council. Accordingly, the government issued the “three 90%” policy, that is, telecommunications enterprises could retained 90% of their profits, foreign exchange earnings, and central government’s investment as non-repayable loans. For the details, see Xu and Pitt (2002: 30-1).

and postage. Through this arrangement, the benefits outweighed than the losses for the China Telecom.

China Unicom as a latecomer could not survive without political intervention from the State Council. Disadvantaged by scarce budgetary resources, China Unicom looked to foreign investors as a solution. It made use of the “China-China-Foreign” (CCF) joint investment system. According to the system, a company owned by Chinese local government and one of China Unicom’s shareholders could establish a joint venture with foreign companies (for the details, see Xu and Liang, 2001: 141–2). The practice created loopholes for foreign entry that in turn undermined the coherent industrial policy protected the sector from liberalization (Gao and Lyytinen, 2000: 725). It allowed foreign companies to hold more than 70% ownership, which was much higher than stated in the final agreement with WTO members in 1999.

Administrative reform in 1998 terminated uncooperative actions between the dual monopolies through putting both of them under the supervision of the MII. The relationship between the two corporations was changed from competition to supplementation. China Unicom switched its interests and policies accordingly. Having claimed the “CCF” illegal, the MII strengthened its control of the barrier against foreign investment in telecommunications services. The sector was able to exert unified pressure on the government to protect its uncompetitive service providers at the threshold of China’s WTO accession.

In short, compelled by the nature of uncompetitiveness and state monopoly, the sector was strongly against the liberalization requested by the GATT/WTO members. Close administrative and fiscal connections between the supervising ministry and subordinate sectors caused a high degree of convergence of interests that in turn implies that the ministry had strong incentives to protect the sector.

7.5 Bureaucratic Interests on Trade Negotiation

The telecommunications sectors were monopolized by government agencies or companies in almost all countries in the 1980s. Krasner's (1985) argument implies that international structural constraints forced Third World countries to protect their telecommunications sector through state intervention. State monopoly in the sector did not allow any domestic or international competitor to enter the sector that could in turn potentially challenge its monopolistic control. The MPT/MII in China's telecommunications services was not an exception.

The MPT effectively regained control of telecommunications services in the early 1980s by clarifying the division of labour between the central MPT and local PTBs. The MPT, fully controlling the business of inter-provincial, national, and international telephone services, shared administrative authority with the local governments in the business of intra-provincial telephone services. For fiscal reasons, China Telecom and China Unicom (after 1999) were reliable contributors of revenue to the Ministry. China Telecom was one of the largest taxpayers in the country (Johnson, 1999c). The revenue of the MPT/MII was one of the highest among the ministries. Its revenue grew from RMB 20.1 trillion in 1992 to RMB 85.5 trillion in 1995, and RMB 278.8 trillion in 1999 (*Almanacs of China's Economy*, various issues, 1992–2000). The MPT/MII was reluctant to give up its administrative authority and revenue from the sector as required by market liberalization.

Close ties between the government and the industry are more tangible when we consider the absence of any legal framework or clear policy guidelines in

telecommunications services.¹³³ In the early 1990s, the Ministry repeatedly called for strengthening the administrative planning of telecommunications and retaining its monopoly over the sector (DeWoskin, 2001: 630). The regulations passing through the administrative and fiscal links from the MPT/MII to the enterprises became the only guidance for the development of the sector. The Ministry did not allow any market mechanism or foreign competitors into the domestic sector that would potentially disrupt the administrative and fiscal connections.

The MPT/MII's exclusive control faced continuous opposition from rivalling ministries in the State Council. The MEP, MOR, Ministry of Defence (MOD), and Ministry of Petroleum (MOP) wanted to enter the sector and share the monopolistic benefits. The MPT saw to it that their participation was extremely limited. Most of the ministries, including the SPC, pushed the MPT to reform the sector. They blamed the Ministry for keeping the high price of telecommunications services that had become a "bottleneck" in economic development.¹³⁴ However, even the SPC was not capable of influencing the sector through its pressure on the MPT/MII. The SPC decided to relinquish its control over price and allowed the MPT to collect the installation fee for fixed-line telephones in 1979. Since then, the SPC's role in the sector has been to cooperate with the MPT/MII on setting the price of Internet access and telecommunications services and funds for infrastructure. However, the Ministry had avoided dependency upon the central budget. In 1992 and 1993, the MPT requested to

¹³³ The sector was regulated by the Ministry without a clear-cut telecommunications law. For example, the installation fee of the fixed line remained high and arbitrary. The Ministry refused to cooperate on releasing a clear-cut law that might restrain its action.

¹³⁴ Intensive debate between the two groups ensued, with both sides mobilizing their think tanks and drawing lessons from other countries to support their argument. Hardy (1980) and Norton (1992)'s works were usually cited for reference. Hardy's analysis shows a positive correlation between the development of telecommunication facilities and the growth of GDP. Norton's finding also implies that the development of telecommunication helps to reduce the transaction cost. The idea was instrumental for the MPT to get more budgetary resources from the central government and for the rivalling ministries to break up the MPT monopoly. By claiming it as instrumental is because the counter thesis that potentially went against their interests never got accepted by the players. For example, Gronin et al (1991) argue that the reversed causality can also be supported. For the analysis on the negative impact of telecommunications on economic growth, see Sieber (1993).

keep all revenue in the Ministry's hands for the purpose of re-investing in infrastructure development (DeWoskin, 2001: 630). The investment in infrastructure construction increased from RMB 4.9 trillion in 1990 to RMB 13.7 trillion in 1992 and RMB 449.4 trillion in 2000 (*Almanacs of China's Economy*, various issues). Around 80% of the investment came directly from revenue sources (Lovelock, 2009). According to Quan Yi (2002: 161), total investment in the telecommunications sector from 1979 to 1995 was about RMB 270 trillion, two-thirds of which came from the installation fee of fixed-line telephones. As the MPT did not financially rely on the SPC, its authority of pricing was relatively independent, compared to other ministries. Facing pressure to lower the charges for telecommunications services, the SPC organized the Public Price Hearing in 1998. However, the MII refused to make any concession. The SPC even recommended having a third party to investigate the MII's accounting system (Li).

The situation changed slightly when the MEI, MOR, and MEP entered the sector as supervising agencies in 1994. The fragmentation of control in turn caused a fragmentation of interests in the sector. The rivalling ministries were willing to accept foreign investment in the sector. The "illegal" practice of CCF that practically lowered the entry barrier for foreign companies was out of MPT's control. A fragmented regulation at the time (1995–1998) might have led to a greater concession if the Sino-US final agreement was made in 1997 rather than in 1999, as China's entry into the WTO was considered as a good opportunity for other ministries to break up the monopoly of the MPT.

The MPT evolved into the MII and strengthened its control over the sector. MII, a "super agency", assumed all the authority that was previously shared by the former MPT and MEI. The MII had rooted out foreign investors by claiming that the CCF

agreement was illegal, and Chinese negotiators did not show any intention of lifting the ban during Sino-US talks (Johnson, 1999a). It left little room for domestic competition from the other state-owned telecommunications companies controlled by the other ministries. In 1998, Minister Wu clearly stated that they were not ready to open up the sector (Guojia dianxin zhuguan bumen fuzhenren Wu Jichuan shuo, woguo dianxin yewu duiwai kaifang tiaojian shangbu chengshu, 1998: 43).

To conclude, it was very difficult for the negotiators to give concessions in the area of telecommunications services as the industry was not competitive at the time. The service providers who enjoyed monopolistic status in the sector were able to exert unified pressure on the government for protection. The convergence of sectoral and ministerial interests helps us understand why the MPT/MII was so proactive in protecting the interest of the telecommunications companies in the late 1990s.

7.6 China's WTO Commitment and Its Compliance in the Post-WTO Period

7.6.1 Little Concessions in the Telecommunications Services

The telecommunications services sector expected to see more challenges than opportunities after entering the WTO. The SETC was responsible for coordinating with the telecommunications companies and the MII. In the face of strong opposition from the MII, the SETC failed to offer much concession in the sector.

The final agreement between China and the United States in November 1999 allowed for 50% foreign ownership in paging services and Internet content provision, and 49% for the other basic telecommunications services (Lu and Wong, 2003: 79–80). The MII's loose administrative and fiscal control of paging services and Internet content provision correlated with the greater concessions in these two subsectors.¹³⁵

¹³⁵ The MII's administrative and fiscal connections with the sector of internet content provision were weak at the time. There were four interconnected national networks in China in the late 1990s. They were CERNET owned by

7.6.2 China's Compliance in the Post-WTO Period

The telecommunications services as a “high stake” sector received a lot of protection from the MII during the negotiations. The enterprises did not gain more autonomy after the WTO accession. Having given relatively more concessions in value-added telecom services in the agreement, the authority of approving licences was devolved to local governments, especially those in the coastal regions. In contrast, the authority of approving licences to basic telecom services providers was still retained by the MII (Loo, 2004: 708).

A fragmented regulation is taking shape again in the sector because of the rise of the State Asset Supervision and Administration Commission (SASAC) and the decline of the MII. On the one hand, the ownership of the major telecom services providers was transferred from the MII to the SASAC when it was established. With the approval of State Council, the administration of China Railcom, along with its original stocks, was also transferred from the MOR to the SASAC on January 20, 2004 (*China Business News*, 2004). By then, the SASAC “owned” all of the six major telecommunications service providers. The SASAC’s actions of reshuffling the leadership of major telecom companies were suspected of being attempts to gradually remove former MPT officials in the sector. On the other hand, the Ministry of Industry and Information Technology (MIIT) was founded in 2008 to incorporate the MII. The MII was re-named “State Bureau of Telecommunications” and downgraded to sub-ministerial level. Although the Bureau remains the major regulatory body in the sector, the SASAC has been aggressively taking over the authority of supervising

the Ministry of Education, CSTNet owned by the Chinese Academy of Sciences, ChinaNET owned by MII (former MPT), and ChinaGBN owned by the MII (former MEI). They were the only ones that could licence the internet content provision. As a large portion of China’s Internet content providers were non-MPT owned corporations (Tan, 1999: 271), the MPT/MIIT’s effective control of the sub-sector was limited. Its administrative and fiscal connection with the sub-sector was not as close as those with the fixed line telephone service and mobile phone service.

the companies.¹³⁶ A fragmented supervision, similar to the one from 1994 to 1997, was re-emerging.

The sector remained “high stake” six years after WTO accession. The MII bore the responsibility of protecting the sector. It would be very difficult for the MII to give up control of the sector, although its style of top-down intervention was not compatible with its WTO commitment.

The MII failed to keep to its commitment of separating the government from the industry and adopting pro-competitive regulatory principles (USTR, 2004: 75). The decision of breaking down the China Telecom into four separate entities was to create four monopolies in their respective subsectors, namely fixed-line services, mobile services, satellite telecommunications services, and paging services. A competition across subsectors was not encouraged. The decision of separating the old China Telecom into two components (south and north) in 2002 also cast a doubt on the competition across regions. A leadership swap in 2004 among the major operators contributed to a rise of their shares in the stock market, as investors believed that the action would reduce competition in the sector (CMI, 2004). Again, in 2008, six major telecommunications service providers in the sector were merged into three. The move, according to Li (2009: 2–3), reflected a “political will” that was not compatible with the new PRC Anti-Monopoly Law enacted on August 30, 2007.

Foreign investors have been frustrated at not being able to enter the Chinese market easily. China’s telecommunications services were less developed in the global trade of services. The WTO accession would have potentially seen a significant inflow of foreign investment but did not. The government adopted a strategy of allowing foreign investment through public issue of shares in the stock markets

¹³⁶ For example, The SASAC has the authority of asset management in the companies. In 2008, SASAC made China Mobile to transfer about RMB 50 billion to China Unicom to boost Unicom’s working capital (ChinaVest, 2008).

abroad rather than direct joint venture. The practice was believed to ensure that “even this foreign equity is too thinly distributed to offer any serious problems of control” (A Note on FDI Regulations in Telecom, 2004: 10). By 2004, the SASAC held more than 75% of equity in all of these oligopolies (CMI, 2004). Although the option for forming joint ventures was open, the MII had developed various ways to prevent foreign investors from entering the market. For example, it set the requirement of registered capital as high as RMB 2 billion for foreign companies. Although the requirement was decreased to RMB 1 billion in September 2008, it was still high compared to international norms (USTR, 2008: 80). Besides, the application process was slow according to the USTR (2004: 76). No application for value-added services was completed by the end of 2004. Regarding 3G telecommunications standards, China’s regulatory authority continued to promote its unique home-grown TD-SCDMA standard after having repeatedly committed to technology neutrality (USTR, 2008: 6). By 2008, there was very little foreign investment in the domestic market, especially in basic telecommunication services, like fixed-line telephones and mobile phones. Some notable exceptions were Telefonica’s 9% equity stake in China Netcom, Vodafone’s 3% equity stake in China Mobile, and AT&T’s participation in the joint venture called UNISITI (Hsueh, 2008: 95).¹³⁷

7.7 Conclusion

All in all, trade concessions were not made in the telecommunications sector, and it remained “high stake”, monopolistic, and uncompetitive. The WTO agreement left many loopholes for the government to exercise continuous protection. The WTO

¹³⁷ According to Chang (2000), the MII approved the establishment of Shanghai Symphony Telecommunications Company in December 2000, a joint venture of AT&T, the Shanghai branch of China Telecom and a Shanghai municipal government company, to provide broadband networks in the commercial Pudong areas of Shanghai. The AT&T was to hold 25% of the equity.

mechanism could not help the sector gain more autonomy or become competitive in terms of service quality. The political will of the state is still significant in the sector. Compared to the other sectors, a proper regulatory entity in telecommunications in China was far from emerging.

Uncooperative behaviour between the two monopolies from 1995 to 1998 suggests that sectoral characteristics are more significant than variations in national characteristics. Japan, which differed in political regime and economic structure, also saw a fragmented state control between MITI and MPT over the sponsorship and regulation of Nippon Telephone and Telegraph (Wilks and Wright, 1987: 288). Now, a fragmented supervising board is emerging again in China. Tensions exist between the SASAC that operates the industry and the MIIT that regulates the industry. Their relationship determines the future of China's telecommunications services and its compliance to the WTO framework.

Chapter 8: The Banking Industry as a Planning Organ

8.1 Introduction

Many emerging market economies, with a few important exceptions, had been reluctant to open up their banking sectors to foreign competition (Dobson and Jacquet, 1998: 2).¹³⁸ However, as Riedel, Jin and Gao (2007: 111-3) review, the impact of foreign bank entry did not inflict any significant damage to the domestic sector in three relevant issues: competition and efficiency, banking sector stability and allocation of credit across sectors of the economy. For example, Classens and Laeven's (2003) finding indicates that the limited presence of foreign banks has led to an improvement in the competition and efficiency of the whole industry (also see Saez, 2004). Demircug-kunt, Levine and Min's (1998) observation of East Asian countries after the 97/8 financial crisis reveal that the existence of foreign banks functioned as a stabilising force to the industry.

Economic logic suggests that an uncompetitive banking industry would not be easily flattened after lowering entry barriers. It is thus not surprising if Chinese state-owned commercial banks could survive the foreign competition after market liberalisation. To be exact, Chinese banks have done much better under the WTO mechanism with foreign-funded banks actually accounting for "a smaller share of bank assets in 2003 than they did in 1997" (Naughton, 2007: 459). According to data from the People's Bank of China, foreign banks' share of total banking system assets has decreased since WTO accession. Their share was only 2.4% in 2007 inspite of the

¹³⁸ It is common for developing and developed countries to protect their infant industries against external competition. In the case of China, Chinese leaders perceived foreign domination of domestic banking sector as a threat to their sovereignty. China's domestic banking sector finances the real economy and guarantees sound economic environment through capital reserve, monetary policy, and payment services (Trachtman, 1996: 48-9).

Chinese government's timely commitment to its agreement by the end of 2006 (Figure 1.4).

Political intervention was usually cited as the explanation for the phenomenon, as the government had erected new barriers against foreign entry that were tolerable under WTO mechanism. However, without a cross-sector comparison of government-industry relations, it is difficult to understand why state protection in the banking industry has been so successful before and after WTO accession.

This chapter argues that the move to separate the government from the industries since the early 1980s has not changed the fact that the Chinese banking system remains as a "high stake" sector. A convergence in interest between the banking industry and its supervisors is enough reason for the central government to persist in its protection of the sector. Under a holistic consideration, Chinese negotiators adopted a horse trading strategy to protect the banking sector by sacrificing the agricultural sector. Compared to other sectors, the concession on the banking sector was negligible. The final agreement for WTO accession left Chinese government with a lot of room to develop new forms of political intervention for protecting the banking sector. This explains foreign banks' declining share of banking assets in the post-WTO era.

8.2 Government-Industry Relations in the Banking Sector

8.2.1 The Banking Industry

The banking industry in China by the end of the 1990s composed of three different groups of banks, namely "central banks", "local banks" and foreign banks (Table 7.1). The "central banks" consisted of four state-owned commercial banks (the Big Four) and three policy banks. The Big Four were the Agricultural Bank of China

(ABC), the Bank of China (BOC), the Construction Bank of China (CBC) and the Industrial and Commercial Bank of China (ICBC).¹³⁹ The three policy banks, namely, the China Agricultural Development Bank (ADB), China Development Bank (CDB), and China Import & Export Bank (IEB), have been established to take over the policy-lending activities from the Big Four since 1994.¹⁴⁰ The “local banks” included 11 national shareholding commercial banks, 90 city banks and many prefectural level urban credit cooperatives and rural credit cooperatives by 1999. Although some of them had branches nationwide, they were usually affiliated to the local governments (Naughton, 2007: 457; Guo, 2002: 31).¹⁴¹ The presence of foreign banks in China at that time was few with limited business scope (Figure 8.1). The tolerance of foreign banks in China reflected decision makers’ concern for facilitating smooth inflow of foreign direct investment (FDI) for the development of non-strategic capital-scarce sectors rather than the banking industry (Tong, 2002: 64).

¹³⁹ The BOC was established in 1912 as a private bank. It was recreated in 1979 to specialise in foreign exchange that was previously controlled by the People’s Bank of China (PBOC). The CBC was established in 1954. It became active again in 1979 to specialise in fixed investment, especially in the manufacturing sector. The ABC established in 1979 was responsible for state investment, government procurement, and subsidies in the rural sector. The ICBC was established in 1984 to carve out the function of commercial transactions of the PBOC. Each of the Big Four enjoyed a monopolistic power in its specialised field of the economy, especially in the early 1980s. For a comprehensive analysis of China’s banking industry before 1949, see Kirby (1995).

¹⁴⁰ The ADB was established to facilitate state procurement of agricultural products and support rural infrastructure construction. The CDB was responsible for policy lending on national development project. The IEB was to provide necessary fund for national trade flow.

¹⁴¹ The Bank of Communications was an exception among the national shareholding commercial banks. Its registered capital asset in 1984 was RMB 2 trillion. PBOC, representing the central government, controlled RMB 1 trillion and allowed local authorities, enterprises, and individuals to share the other half. According to the *Regulations on Communications Bank*, individuals’ share could not exceed 10%.

**Table 8.1 Performance of Banks in China's Banking Industry
in 1999**

Banks/items	Asset		Saving		Loan	
	Value (RMB billion)	Share (%)	Value (RMB billion)	Share (%)	Value (RMB billion)	Share (%)
"Central banks"						
Policy banks	687.607	4.69	0	0	517.557	5.94
Big Four	10404.096	71.03	7618.799	72.40	6241.106	71.59
"Local banks"						
National shareholding banks	1447.7	9.88	1031.4	9.80	695.7	7.98
City banks	554.7	3.79	441.3	4.19	271.1	3.11
Prefectural level urban credit cooperatives	119.8	0.82	95.4	0.91	70.0	0.80
Rural credit cooperatives	1432.9	9.78	1335.809	12.69	922.559	10.58
Total	14646.803	100	10522.708	100	8718.022	100

Source: calculated from PBOC data (2000: 24-5)

8.2.2 Supervising Agencies in the Central Government

During the time of WTO negotiation, the industry was supervised by a group of central agencies including the State Development and Planning Commission (SDPC), State Economic and Trade Commission (SETC), People's Bank of China (PBOC) and the Ministry of Finance (MOF) with varying degrees of control. The MOF was the most influential supervisor, while the PBOC performed as just an intermediary regulator in the State Council. The PBOC was administratively closer to the SDPC, SETC and MOF than other agencies at ministerial level. In other words, it was less autonomous than the other economic ministries. The PBOC was modelled after the US Federal Reserve System to prevent intervention from local authorities by replacing its nationwide branches with nine trans-provincial offices in 1998 (Naughton, 2007: 456; Lardy, 2003).¹⁴² However, unlike its counterpart in the United

¹⁴² The PBOC recentralized all of its lending power from the branches to the head office in July 1993 (The Banker, 1999a).

States, it had little incentive or capacity to carry out independent decision making in the central government (Lardy, 1998: 172; Wu, 2005). In terms of incentives, as argued by Chow (2007: 239), extensive political pressure from political leaders and the incompetency of central bankers made the PBOC less willing to make independent decisions. In terms of capacity, the MOF was the sole owner of the Big Four (Huang, 2002c: 385; Lardy, 2004: 98). The PBOC had little fiscal power to make independent decision that might contradict with MOF's interests. The board of directors of the PBOC included a governor, a deputy governor, vice ministers of the MOF and other Commissions, a deputy director of the SPC and the presidents of the Big Four (Saez, 2004: 107-8). The governor of the PBOC could not make independent decision. The banking reforms since the early 1980s have changed the roles of these central agencies.

8.2.3 "Decentralisation" of the Banking Industry

The SPC controlled the banks through a strict cash and credit plan prior to the reforms (Wong and Wong, 2001: 19-20). Economic reforms in the early 1980s that included decentralisation of financial resources contributed to the development of the banking industry. The MOF has granted autonomy to the PBOC and the Big Four since the early 1980s and transformed policy loans from the Big Four to the policy banks since 1994. In 1995, the PBOC decided to impose its control of the "local banks" that have been allowed to enter the sector since 1986. In order to constrain local authorities' administrative intervention of the "central banks", the PBOC centralised its control in 1998 by restructuring their local branches. Before WTO accession, the MOF remained the most influential supervisor in the banking sector.

8.2.3.1 Separation of State-Owned Banks from the MOF, the early 1980s--the early 1990s

The banking industry has become prominent in China's economy since the introduction of the *Bogaidai* policy (replacement of state budget with bank loan) by the SPC and MOF in the early 1980s.¹⁴³ Prior to the reform, savings deposits in the banks primarily came from the central government and the SOEs. The MOF was responsible for funding the SOEs according to the allocation plan by the SPC. The decentralisation of financial resources led to a boom in household savings. According to Tong (2002: 38), the share of gross domestic savings by households increased from 23.6% in 1979 to 70.5% in 1991. In the early 1980s, when the banking sector saw a significant growth of household savings, the central government decided to pass the financial burden of investing in state-owned sectors from the MOF to the PBOC (Cull and Xu, 2000: 5; Chen and Shih, 2004b: 6; Chiu and Lewis, 2006: 190).

The banking industry before 1978 was characterised by a mono-bank system dominated by the PBOC that was under the supervision of the MOF, with a moderate presence of rural credit cooperatives in the countryside. It was a part of the central-planning system that guaranteed monetary supply to the SOEs. It did not have any influence in lending decisions however (Roland, 2008: 52). In 1979, the PBOC broke away from the MOF to become a separate agency. Following its footsteps, the Big Four also separated from the PBOC to become policy-lending agencies in their individual subsectors in the early 1980s. Meanwhile, the PBOC was transferred to become a super "regulatory agency" and gave up engaging into the profit-making

¹⁴³ The *Report Concerning Investing Basic Construction through the Means of Loan* was first initiated by the SPC and MOF in August 1979. The policy was tested in the sector of light industry and textile industry in Beijing, Shanghai and Guangdong Province. The experiment was carried out in other sectors and nationwide in 1985. Another regulation passed by the SPC, MOF and CBC in December 1985 showed that the government decided to abolish the *Bogaida* policy and return to government allocation in ten sectors, including national defence, science and education, public administration, and etc, that were not able to pay back the bank loan. See the State Planning Commission, Ministry of Finance and China Construction Bank (1985). The *Bogaidai* policy was replaced by the *Daigaitou* policy (replacement of loan with investment).

business. However, it was practically reluctant to do so in the end of the 1990s (Zhou, 2008: 145; Cai, 1999: 171).

After the reform, the SPC's role in the Big Four was restricted to two areas, namely the credit plan and loan market. The Big Four were responsible for channelling the savings to the SOEs according to the annual plan by the SPC (World Bank, 1991b). The credit plan remained closely supervised by the SPC in the 1980s and early 1990s (Branstetter, 2007: 31; Shih, 2008: 33). According to Park and Seht's (2001: 616) interview with provincial governors and Big Four managers, the SPC "determined credit targets for each bank branch in each province". The SETC became involved by the end of the 1990s, as it decided which loss-making SOEs were eligible for debt-equity swaps.

The MOF retained its ultimate authority of capital investment, wage and bonus, asset management, and interest rates of savings and loans. It also determined capital investment in the Big Four and three policy banks.¹⁴⁴ The PBOC set the reserve requirements in the banking sector with the approval of the MOF (Dernberger, 1999: 610). The requirement was raised from 13% to 20% in 1992, but gradually decreased to 6% in 1999 (Roland, 2008: 62). The banks could not write off their non-performing loans (NPLs) without the permission of the MOF (Peng, 2007: 15; Karacadag, 2003: 155). However, this restriction was relaxed when the Big Four were allowed to make special provisions to write off loans caused by bankruptcies and mergers (Mo, 1999: 98). Besides, both interest rates paid for deposits and interest rates for loans were set by the PBOC, together with the MOF holding the approval authority (Duncan, 1995:

¹⁴⁴ The MOF established the policy banks in 1994 by channelling investment from the Big Four. For example, the registered capital of the CDB—RMB 50 billion—was paid by the MOF (Duncan, 1995: 46). As the policy banks could not get funding from household savings, their funds primarily came from the central government. As Tong (2002: 57) calculates, in 1996, more than 70% of the funds in SDB and IEB were issued by financial bonds that were purchased by the Big Four through the requirement of the MOF, while some 85% of funds in ADB came from PBOC's loans (also see Yang, 2003: 40).

33; Almanac of China's Finance and Banking, 1994; Cousin, 2007: 22).¹⁴⁵ The Big Four have enjoyed some freedom of floating interest rates within the suggestive rates since the late 1980s. The autonomy was withdrawn in 1989, but granted again in 1993. The MOF decided to narrow the floating range in 1996 but expanded it again in 1999.¹⁴⁶ As for wages and bonuses, managers of the Big Four started to sign employment contracts with the central government that determined their wages and bonus in the late 1980s (Park and Sehr, 2001: 619). The salaries of lower-level employees remained under the strict control of the MOF. They were considered as governmental employees with a fixed salary irrespective of their performance (Chen and Shih, 2004b: 26-7).

The three policy banks have been established to take over the policy-lending activities from the Big Four since 1994.¹⁴⁷ The Big Four have taken a market-oriented approach to selecting the customers since then. They have been formally allowed to extend their loans to small and medium enterprises since 1997 (Firth *et al*, 2009). Only 80% of the credit plan in 1997 was fulfilled, as the Big Four became more selective of their customers (Mo, 1999: 100). However, a significant portion of their lending was still directed to financing infrastructure constructions, bailing out of loss-making SOEs and purchasing bonds from policy banks (Table 8.2, also see Lardy, 1998, 1999; Cull and Xu, 2000).¹⁴⁸

¹⁴⁵ By imposing an interest rate ceiling, the central government was able to guarantee a provision of cheap credit to the SOEs (Riedel, Jin, and Gao, 2007: 71). In contrast, the interest rate for the private enterprises was much higher than that for the SOEs. For example, Nanan District Committee of Jiusan Academic Organization's (2000) field study in Chongqing reveals that the interest rate for the private enterprises (7-8%) was 3% higher than that for the SOEs (4.5-5%).

¹⁴⁶ According to Roland (2008: 61-2), the interest rate ceiling for commercial banks decreased from 20% of the suggestive rate in 1993 to 10% in 1996 to be consistent with the floor rate (10%). The ceiling rate reached a final 30% by 1999. The ceiling rate by rural credit cooperatives increased from 40% to 50% in 1998 (Chen and Shih, 2004: 9). In 1999, the commercial banks were allowed to choose between fixed rate loans and floating rate loans (Guo, 2002: 97).

¹⁴⁷ The policy banks in principle only lend to customers identified by the SPC/SDPC (Lardy, 2003: 76). However, according to Tong (2002: 58), they could also reject some policy loans mandated by the SPC. For example, 10% of proposed projects were rejected by the SDB in 1994 for not meeting the SDB's lending requirements.

¹⁴⁸ Vice Premier Wen Jiabao in 1999 clearly mandated that the Big Four should place their priority on supporting the SOEs, especially the ones in strategic sectors (Financial Times, 1999). By the end of 1999, over 80% of

**Table 8.2 Bank Loans Received by Non-SOEs
from 1991 to 1997 (as % of gross bank loans)**

Year	1991	1992	1993	1994	1995	1996	1997
Bank loans from all financial agencies	8.76	9.93	10.66	13.27	12.38	12.83	14.24
Bank loans from state-owned banks	7.16	7.50	7.51	9.05	7.98	8.10	8.85

Source: Fan (2000)

8.2.3.2 Centralisation of Local Banks from Local Authorities by the PBOC, 1995

The entry of “local banks” since 1986 has brought local governments onto the supervising board.¹⁴⁹ City banks, like the Bank of Shanghai or Bank of Beijing, have mushroomed across the country since the mid 1990s. As the “local banks” were largely former rural cooperatives or urban cooperatives, their majority shareholders were usually local governments (Roland, 2008: 57). They were administratively and fiscally controlled by local authorities. A sample survey in 2005 showed that local governments hold an average of 24.2% share in the capital of the sample and another 73.6% through wholly owned subsidiaries (Cousin, 2007: 254). The MOF also allowed the local governments to be responsible for the day-to-day operations of their subsidiaries, while retaining its say on interest rates on savings and loans. Unlike the policy banks and the Big Four, “local banks” were not subject to the credit control of the central government (Wong and Wong, 2001: 30; Duan, 2003: 35).¹⁵⁰ Credit ceiling plan on “local banks” was abolished in 1995 and 1996 (Brandt and Zhu, 2007: 104).

The *1995 Central Bank Law of China* helped the PBOC to centralise “local banks” to prevent the local authorities from exercising exclusive control of personnel

outstanding loans extended by Chinese banks were channelled to the SOEs (He, 2002: 146; Yang, 2003: 39). Lardy (2004: 102) –also points out that loans to households accounted for only 0.2% of the loan portfolio of Chinese banks in 1997.

¹⁴⁹ The Bank of Communications was re-founded in 1986 while the Shenzhen Development Bank and China Merchants Bank were established in 1987. Guangdong Development Bank was established in 1988.

¹⁵⁰ As major shareholders of these banks were mostly SOEs or local governments, they did not have full autonomy of choosing the customers, either.

and labour management, alliance decisions and internal organisations of their subsidiaries. All commercial banks in China would also have to abide by the *Commercial Banking Law of 1995* that set the education background and skill requirements of their employees (Chen and Shih, 2004b: 4). For example, at least 60% of the employees should hold a degree in finance at minimum college level or have working experience in the banking sector. As for alliance management, “local banks” were allowed to go into mergers based on commercial principles (Zhu, 1999: 308) that were, nevertheless, subject to the intervention of local governments or SOEs as shareholders. Alliance between domestic banks and foreign investors were exclusively determined by the PBOC. Finally, although the PBOC abstained from interfering in internal organisation of “local banks” (Duan, 2003: 35), it supervised organisational expansion through quotas on the establishment of new branches in each year (Wong and Wong, 2001: 29).¹⁵¹

Besides, the PBOC was authorised to approve the inclusion of some marginal financial products and determine their associating fees for the “local banks”. For example, the marketing of new financial products, like mortgage, car loans and consumer credit, was subject to the approval by the PBOC (Tong, 2002: 148).¹⁵² The interest rates and service fees for these financial products provided by the “local banks” were also determined by the PBOC.¹⁵³

8.2.3.3 *Centralisation of Central Banks from Local Authorities by the PBOC, 1998*

Banking reforms since the early 1980s have not only invited the local authorities to develop their subsidiaries but also given them an opportunity to intervene in the

¹⁵¹ It evolved as a discriminatory policy against the “local banks” through controlling their expansion (Karacadag, 2003: 164).

¹⁵² See *Yinhangka yewu guanli banfa* (Regulations on the business of bank card), 5 January 1999.

¹⁵³ Ibid.

business of the Big Four's local branches. For example, the implementation of the credit plans was interrupted by local authorities because of their regional investment projects (Zhou and Zhu, 1987). The actual lending between 1991 and 1996 exceeded the central plan by an average of 31.9% (Shih, 2008: 36). Mr Li Guixian, governor of the PBOC, was removed from the position in 1993 for his incapability of controlling its branches in the regions (Leung, 1993: A11).

The problem of NPLs was a damper on the development of the banking industry as the banks have to play the role of an effective planning organ after the reform. The Big Four and two credit cooperatives (Urban Credit Cooperatives and Rural Credit Cooperatives) determined their credit loans based on the SPC's selective loan policy.¹⁵⁴ The reforms since 1978 have not hardened budget constraints. Instead, the budget constraint for the SOEs in these sectors became softer over time.¹⁵⁵ The SOEs gradually realised that they did not have to settle the loans with the state banks just as they had done in the government allocation system. Although state-owned banks were in financial difficulties to write-off their NPLs,¹⁵⁶ or paid off the outstanding debts in case of bankruptcy, they were not threatened. They knew that the government would always step in to help them out. At the same time, the central government was also

¹⁵⁴ Credit loans to enterprises were extended based on three major criteria: industrial sector, length of loan and ownership structure (Pei, 1992: 34). Guided by the SPC's selective loan policy, the banks would prefer short-term loans to SOEs that were in strategic industry or "pillar industry". Long-term loans to non-state-owned enterprises that were not in strategic industry were always disallowed. For example, the TVEs, compared to the SOEs were discriminated by the financial policies. Total credit going to the TVE sector was no more than 8 percent of the total outstanding loans, despite the fact that this sector produced more than 25 percent of total industrial output at that time (Almanac of China's Finance and Banking, 1992). The situation for private enterprises was even worse. Only 0.46% of the loan went to private enterprises in 1996. In the year 1989, "about three million TVEs went bankrupt or were taken over by other TVEs. In the same year almost all loss-making state-owned enterprises were bailed out by the state" (*People's Daily*, 1990).

¹⁵⁵ Dewatripont and Maskin in 1989 explained the institutional cause of soft budget constraint in centralised economy. According to Dewatripont and Tirole (1994), a soft budget constraint is not necessarily a bad policy, as it is essentially useful for the completion of long-term projects. A diversified financial policy, including both soft budget constraint and hard budget constraint, can effectively prevent the dilemma of a soft budget constraint. But the positive effect of soft budget constraint was hardly noticeable in China because of the absence of hard budget constraint at the same time.

¹⁵⁶ For example, in 1991, capital assets (*zibenjin*) of Chinese banks against gross capital assets was lower than 8%, the standard set by the Basel Committee on Banking Supervision. The rates were 3.6% for ICBC, 4.9% for ABC, 5.6% for BOC and 7.0% for CBC (Chen, 1993: 15).

aware of the need to maintain a healthy banking system. The SPC indicated that the priority of the ninth FYP for the tertiary industry was to develop the banking sector and insurance sector (*95 sanchan fazhan zhongdian*, 1996: 41).¹⁵⁷

The effort of reforming the banking sector became urgent in the wake of the 97/98 Asian financial crisis (Huang, 2001: 384; Mar and Richter, 2003: 50; Naughton, 2007: 461). The PBOC copied the model of the US Federal Reserve System and replaced its 30 provincial branches with 9 cross-provincial regional branches in 1998 for the purpose of completely eliminating local incentives. With centralisation, the PBOC had the authority of appointing the senior staff and trans-provincial Head of the Big Four (Wu, 2005: 231). The managers of the Big Four were ranked as vice-ministers and branch managers were also appointed with corresponding official ranks (Peng, 2007: 8).¹⁵⁸ The Head of PBOC's cross-provincial branches that had a higher administrative rank than the local governors were empowered to resist political intervention. The central government thus regained its effective control of the banking industry's credit plan (Shih, 2008: 38) even though the branches at lower levels remained less regulated than those at upper levels (Shin, Zhang and Liu, 2007: 18; Branstetter, 2007: 33). In the same year, the credit plan was replaced by a more flexible ratio management that granted more autonomy to the Big Four as long as the loans did not exceed the asset/liability ratio set by the PBOC to guarantee the stability of banking industry. Although they gained more freedom from local authorities in the

¹⁵⁷ To deal with NPLs, the MOF launched a special bond of RMB 270 billion to increase capital assets of the Big Four (Feng, 1999: 24). Another RMB 1.4 trillion of NPLs was passed to the four state-owned asset management companies (China Xinda, China Oriental, China Great Wall, and China Huarong) established by the MOF in 1999 (Almanac of China's Finance and Banking, 2000: 15).

¹⁵⁸ As mentioned by Johnson and Leggett (2000), the employees were still treated as "civil servants" with rigid evaluation and pay systems.

determining of loans for each year, the new approach did not effectively prevent the intervention of the central government (Yang, 2003: 39).¹⁵⁹

8.2.4 Administrative Connection between Government and Industry in the Banking Sector by the End of the 1990s

The banking industry differs from primary and secondary sectors in its production of financial products rather than physical goods. The business scope of Chinese banks by the end of the 1990s was overwhelmingly limited to deposit-taking and credit-lending, while the other banking activities were relatively underdeveloped (He, 2002). According to Li (2000), the share of net interest income in 1998 accounted for 96.84% of total banking income in the Big Four, and 84.32% in 10 national shareholding commercial banks. Thus, by the late 1990s, the Chinese banking industry had developed its own terminologies. For example, plan of production management in secondary sectors is credit plan for the banking industry; procurement of material refers to deposit-taking; price corresponds with interest rate on loan and sales are equivalent to loan market in the banking industry.

In 1999, the three groups of banks had established their own kind of relations with the government. The policy banks were fully controlled by the central government, except for partial autonomy in floating interest rates on loan. Having transferred policy loans to the policy banks, the Big Four were able to enjoy autonomy in deciding their credit plan and selecting loan targets. Unlike “central banks”, the “local banks” had much less administrative intervention from the central government. However, the central government retained the right to recruiting and

¹⁵⁹ The co-existence of credit plan and asset/liability ratio was named as “dual management” (Shih, 2008: 35).

managing staff, managing alliance and internal organisation, and setting interest rates for both deposits and loans.

Government-industry relations in 1999 also varied among ministries in the State Council. The SDPC did not give up its control of the credit plan and loan market, but it allowed commercial banks to adopt more market-oriented loan-lending policies and a more flexible ratio management of credit planning. The SETC has been active in requesting the Big Four to finance debt-equity swaps in loss-making SOEs since 1998. The MOF was the final decision maker on the issue of interest rates of both savings and loans. It also controlled capital investment if it was the major stakeholder, determined wage and bonus for the “central bank” and closely supervised capital asset management especially regarding NPLs. The “local banks” were free from MOF’s supervision in these areas. Finally, thanks to the *Commercial Banking Law of 1995* and the sectoral restructuring in 1998, the PBOC was authorised to look into personnel and labour management, alliance management and the internal organisation of both central and local banks. However, it still had to share the authority of supervising “local banks” with local governments.¹⁶⁰

To sum up (Table 8.3), considering the market share of different banks, the MOF had the strongest administrative control of China’s banking industry (or 37.5%), especially the Big Four (or 45%).¹⁶¹ The PBOC, an intermediary regulator in certain areas under the MOF’s approvals, had less control of the banks as an ultimate

¹⁶⁰ Unlike state-owned banks, the governors of shareholding banks were nominated by the board of directors who enjoyed certain autonomy from the central government (Jia, 2009: 79), while the managers of the city banks were appointed by the municipal government. As Cousin (2007: 48) documents, managers of “all banks” were subject to the supervision of different levels of authorities.

¹⁶¹ Among the 10 areas of autonomy in banking industry, full control was coded as 100%, partial as 50% and little as zero. The share of banks’ asset, according to Table 7.1, was put as 5% for policy banks, 70% for the Big Four, and 25% for the “local banks”. Accordingly, the administrative connection between the MOF and banking sector in 1999 was: (AC)=5%*(0+10%+10%+10%+0+10%+0+5%+0+0) + 70%*(25%*(0+0+0+0+0+10%+0+5%+0+0))=37.5%. The administrative connection between the MOF and the Big Four was: (AC)= 0+10%+10%+10%+0+10%+0+5%+0+0=45%

decision maker (26.25%).¹⁶² The SDPC and SETC also had some interest in the sector (8% and 3.5% respectively).¹⁶³ Together, the four agencies held 71.75% of the authority. The government's stake in the banking sector was the "highest" among the sectors covered by the study. The next section explores the fiscal ties between central agencies and banking industry.

Table 8.3 Governmental Control of Different Kinds of Banks in 1999

Items	Policy banks	Supervising agency	Big Four	Supervising agency	"Local banks"	Supervising agency
1. Credit plan	Full	SDPC	Partial	SDPC	Little	SDPC
2. Capital investment	Full	MOF	Full	MOF	Little	MOF
3. Allocation of wage and bonus	Full	MOF	Full	MOF	Little	MOF
4. Capital asset management	Full	MOF	Full	MOF	Little	MOF
5. Personnel and labour management	Full	PBOC	Full	PBOC	Partial	PBOC
6. Deposit-taking	Full	MOF	Full	MOF	Full	MOF
7. Alliance management	Full	PBOC	Full	PBOC	Partial	PBOC
8. Interest rate on loan	Partial	MOF	Partial	MOF	Partial	MOF
9. Internal organisation	Full	PBOC	Full	PBOC	Partial	PBOC
10. Loan market	Full	SDPC	Partial	SDPC/SETC	Little	SDPC

Note: LGs=Local governments

Source: compiled by author

8.2.5 Fiscal/financial Connection between Government and Industry in the Banking Sector by the End of the 1990s

As mentioned in the first section, both the policy banks and the Big Four were "wholly owned" by the MOF by the end of the 1990s. Local governments and the

¹⁶² The administrative connection between the PBOC and banking industry in 1999 was: (AC)= 5%*(0+0+0+0+10%+0+10%+0+10%+0) + 70%*(0+0+0+0+10%+0+10%+0+10%+0) + 25%*(0+0+0+0+5%+0+5%+0+5%+0)=26.25%.

¹⁶³ The administrative connection between the SDPC and banking industry in 1999 was (AC)= 5%*(10%+0+0+0+0+0+0+0+10%) + 70%*(5%+0+0+0+0+0+0+5%) + 25%*0=8%. The administrative connection between the SETC and banking industry in 1999 was (AC)= 5%*0 + 70%*(0+0+0+0+0+0+0+0+5%) + 25%*0=3.5%.

SOEs had majority stake in most of the “local banks”, including national shareholding banks, city banks, urban and rural credit cooperatives. All of these banks suffered fiscal repression by the MOF through the taxation system.

The primary concern of the MOF was to “maximise its fiscal income” (Langlois, 2001: 615). Prior to the taxation policy change in 1997, the income tax rate for the Big Four, “local banks” and foreign-funded banks were 55%, 33% and 15% respectively (Fu, 1998: 212). The Ministry heavily relied on the Big Four for tax revenue. For example, in the mid-1990s, about one sixth of central government revenues came from the Big Four (Lardy, 1998: 170).¹⁶⁴ A new tax remittance system in the banking industry was introduced in 1997. According to the new policy, the income tax rate for the SOEs in all sectors would be decreased from 55% to 33%, but the turnover tax rate imposed on bank loans was increased from 5% to 8%. The change in the remittance system did not release the burden of the Big Four. Instead, it became the MOF’s further attempt at repressing the sector. The increase in turnover tax rate which seemed insignificant was effectively huge, because the levy was based on total income that included the interests and fees on NPLs. As a result of the new scheme, the Big Four had to remit an extra RMB 8,915 million to the MOF in 1999 (Table 8.4). In consequence, the profit margin of the banking sector was marginal. As Karacadag (2003: 156) calculates, the effective tax burden on the banks accounted for 70-80% of their profits.¹⁶⁵ Most of it had to be transferred to the MOF. A quoted statement by Jin Liqun, Chinese Vice-minister of the MOF, defended that the MOF, as a stockholder of these commercial banks, had the right to the revenue as a form of dividends (Chow, 2007: 245).

¹⁶⁴ As Branstetter (2007: 34) observed, a conflict of interest between the MOF and the Big Four existed, because the MOF was reluctant to allow them to write off the NPLs that in turn would reduced their operating income and, thus, tax revenue for the MOF.

¹⁶⁵ According to Lardy’s (1999: 38) calculation of the ABC in 1997, the bank’s effective rate of taxation exceeded 91%.

**Table 8.4 Changes in Tax Revenue from the Big Four to the MOF in 1999
(RMB Million)**

Item	ICBC	ABC	BOC	CBC	Total
1. Extra revenue transferred after the increase in turnover tax rate from 5% to 8%:	4452	2090	2067	2805	11414
2. Revenue saved after the decrease in income tax rate from 55% to 33%:	865	0*	240	1394	2499
3. Changes: 2-1	-3587	-2090	-1827	-1411	-8915

Note: *: ABC's income in 1999 was in red. Thus, the tax revenue to the MOF was zero.
Source: Almanac of China's Finance and Banking (2000: 579).

To conclude, the central government, especially the MOF, had been administratively supervising the industry and financially relying on it for tax revenue generation by the end of the 1990s. The banking sector still functioned as a planning organ in “socialist market economy”. There was no doubt that sectoral and bureaucratic interests on trade liberalisation were strongly convergent.

8.3 Sectoral Interests on Trade Negotiation

As a planning organ, China's banking industry had both advantages and disadvantages in the face of foreign competitions in the market. Bonin and Huang's (2002b: 1078) review clearly identified “two extreme sentiments among economists and officials” towards the impact of foreign competition on China's domestic banking sector”. They generally refused to give a straightforward answer to whether China's banking industry could survive the liberalisation after the WTO accession.

Generally speaking, China's banking industry as a late developer was not competitive compared to global giants. It did not perform as efficiently an intermediary as their foreign counterparts. Policy lending contributed to many NPLs that squeezed their profit (Table 8.5). Primarily devoted to the channelling of household savings to the SOEs, the banks offered very few financial products. Their

services were also poor for a lack of market incentives. As such, both Chang (2001) and Lin (2000) hold a very pessimistic view as they believe that the entry of foreign banks, which enjoy advantages in complete service network, better services and sound financial position, would put China's banking industry at a strong disadvantage. Chen and Shih (2004b: 86) estimate that competitiveness and security would be major concerns of the banking sector for its under-performing assets, high operating costs and high non-performing loan ratios (also see Chen, Skully, and Brown, 2005). Yang (2003) is worried that the banking industry's huge burden of financing the central plan together with its outdated technology and bad loans problem would lead to a financial crisis and contagion. He (2002) also warned of strong competition from foreign banks after comparing the factors, including size, profitability, liquidity, access to market, sophistication in the provision of services, market reputation, etc

Table 8.5 Comparison of the Big Four with the Global Giants in 1997/1998

Ranking	Banks	Strength (Capital: \$m)	Size (Asset: \$m)	Profits (Pre-tax profit: \$m)	Performance (Profits on Av. Capital: %)
1	Citigroup (12/98)	41,889	668,641	9,269	29.4
2	BankAmerica Corp (12/98)	36,877	617,679	8,048	29.7
3	HSBC Holdings (12/98)	29,352	484,655	6,591	23.2
4	Credit Agricole Groupe (12/98)	25,930	457,037	3,765	15.2
6	ICBC (12/98)	22,213	391,213	417	2.5
18	BOC (12/98)	14,712	299,007	425	3.4
65	CBC (12/97)	5,988	203,116	1,215	21.2
88	ABC (12/97)	4,802	190,095	95	2.0

Source: The Banker (1999b: 137, 180).

However, Chinese banks did enjoy certain advantages by marginal criteria that were too significant to overlook. The huge amount of household savings had afforded Chinese banks the opportunity of becoming strong, large-sized banks that were

comparable to global giants (Table 8.5). The nationwide branches were so convenient to customers that they sustained an inflow of financial resources. These advantages could be easily amplified through political intervention to prevent foreign entry. Thus, some scholars hold an optimistic view towards the upcoming competition. Although Mar and Richter (2003: 57) anticipate “enormous pressure” on China’s the Big Four “struggling with mountainous bad loans” after WTO accession, they were confident that the banks would retain their dominant market share through a gradual opening up. OECD’s (2003) calculation indicates that Chinese banks were competitive in terms of their extensive branch network and familiarity with the customers, but disadvantaged by its low profitability, poor asset quality together with inadequate capital and the inability to control loan quality. Taking account of all these factors, foreign banks would play an important but limited role in China’s banking industry after liberalisation. Woo (2002: 391) is more optimistic as he emphasises on the importance of geographic location. He argues that Chinese banks would be extremely competitive in the countryside. Huang (2002c) disagrees on the significance of geographic location by warning that the negative impact would be huge because 95% of the Big Four profits came from the coastal cities (Shenzhen, Guangzhou, Xiamen, Shanghai, Tianjin and Beijing) that would be the target market for foreign banks. But both Woo (2002) and Huang (2002c) believe that the central government would be fiscally capable of stabilising the domestic banking industry.

In short, Chinese banks were uncompetitive in the international trade of services. However, their extensive networks across the country guaranteed that they would not be easily knocked out in any upcoming competition. Although the industry as a whole was reluctant to open up to foreign actors, the banks with different statuses in the market might have different agendas. The study of market structure in the next

section is to explain whether the Big Four—dominant players in the sector—had an interest that was from the others.

8.4 Sectoral Pressure on Trade Negotiation

The Big Four's oligopolistic status in the banking industry was not without its privileges. The four state-owned commercial banks under the PBOC absorbed 80% of the savings and dominated 75% of China's commercial banking business (Ji and Thomas, 2002: 678). The high level concentration of the Big Four in terms of deposits, loans and assets reveals that the Chinese banking industry was controlled by these four oligopolies (Table 8.1, also see Chen and Shih, 2004b: 13). The high concentration allowed the industry to speak in one voice against trade concessions. The increase in new commercial banks and the diversification of the ownership structure of these banks did not impose any challenge to them.

Competition among the Big Four was very limited, although some would argue that intra-competition has been noticeable since the mid-1990s (Berger, Hasan, and Zhou, 2009: 116-7). The establishment of the three policy banks, to a certain extent, freed the Big Four from policy loans that in turn contributed to more intense competition among themselves (Wong and Wong, 2001: 20; Tong, 2002: 22). However, the effort to lift restrictions that were promulgated in 1985 to limit each bank to its own designated sector did not introduce any meaningful competition to the banking industry because the Big Four lacked the requisite autonomy to compete with each other. A lack of competition among the Big Four prevented uncooperative behaviours among the oligopolies. It explains Schlichting's (2008: 39) assertion that state-owned banks were a "strong lobby group" that were heavily interested in the protection of their economic interests.

However, the status of the Big Four in the banking industry did not guarantee oligopolistic profits.¹⁶⁶ Their profits, to a large extent, were influenced by strict interest rate controls of the government (Fu and Heffernan, 2009). Onerous taxation on the sector further squeezed their profit margin. What was more important was the fact that being a planning organ in the sector means more governmental intervention on policy lending and more NPLs. Taking into account of these factors, it is reasonable to believe that the Big Four's opposition to trade liberalisation was not caused by the concern of a potential loss of oligopolistic profits.

To conclude, Chinese banks were generally reluctant to lift entry barriers to global giants because they were not competitive in the international trade of services. Because of the Big Four's dominant position in the sector, they were able to impose a coherent pressure on the government for protection. However, they did not express a special resistance to the liberalisation, as their monopolistic position in domestic market did not provide them with corresponding profits. The next section explains why the MOF and PBOC had been so actively protecting the sector.

8.5 Bureaucratic Interests on Trade Negotiation

The close relationship between the MOF and banking industry, especially the Big Four, implies that the government would protect the interest of the Big Four during the process of domestic liberalisation and protect the sector as a whole against foreign competition.

¹⁶⁶ Jiang, Yao and Zhang (2009) find out that national shareholding banks performed much better than the Big Four in terms of profitability. Shih, Zhang and Liu's (2007) empirical study does not suggest a correlation between the size of the banks and their performance in China. Instead, mid-size national shareholding banks perform better because of less government intervention than the Big Four and because they are larger in size than the other "local banks". Berger, Hasan and Zhou's (2009) study of China's banking industry from 1994 and 2003 reveals that the Big Four were the least efficient, although they were the biggest.

Although economists have not reached a consensus on the causality between banking development and economic growth in China,¹⁶⁷ the Party seemed to believe that a sustainable banking system was pivotal to national economic development (Shin, 2008). The liberalisation of the domestic banking industry was one of the ways to sustain growth of the sector. However, the government played a counter move, as it refused to cut its relations with the sector. For example, the *Commercial Banking Law of China in 1995* seemed to promote a more market-oriented banking system (Barth, Koepp, and Zhou, 2004: 10), but it did not liberalise the sector. China's concentration ratio in the banking sector, according to Demirgüç-Kunt and Levine (2001), has been falling since 1997 with the entrance of many non-state actors that might be the result of the commercial banking law. However, the central government's control of deposits and loan through the regulation of interest rate, number of branches, policy lending, multiple accounts, limits of loans and licencing requirements had effectively retained the oligopoly of the Big Four in banking industry (Wong and Wong, 2001). Private enterprises were finally allowed to enter the sector.¹⁶⁸ China Minsheng Bank (established in 1996) was the first bank whose shareholders were mainly non-state enterprises.¹⁶⁹ However, its total asset of only RMB 20 billion in 1998 could not make any change to the monopolistic policy in sector. Even the Ministry of Agriculture (MOA), one of the central agencies, was not allowed to enter the banking industry to develop its own financial institutions. Although the ABC was reluctant to be fully engaged in the agricultural sector that did not generate sufficient returns for the

¹⁶⁷ Economists, like Lin and Li (2001), observe a positive relationship between banking development and economic growth using provincial level data between 1985 and 1998; Boyreau-Debray (2009) disagrees by saying that the banking development in China had a negative impact on economic growth; Aziz and Huenwald (2002) do not find any correlation between the two after analysing data from 27 provinces from 1988 to 1997.

¹⁶⁸ The *China's Banking Regulations of 1986* forbids local governments and individuals from setting up banks. The need for financial support from private enterprises, TVEs and even small-sized SOEs led to the emergence of an underground banking system (*dixia qianzhuang*). In 1996, the loan from the underground banking system accounted for more than RMB 100 trillion. See "1996 nian zhongguo minjian jiedaie yi gaoda 1000 duoyiyua renminbi," (Loan from underground banking system was more than RMB 100 trillion in 1996), *Inside Information on Economic Reform*, No.9 (1998), 45

¹⁶⁹ But its major shareholders, according to Chiu and Lewis (2006: 195), were state-owned corporations.

investment (Woo, 1999), the MOA's request for legitimising the existence of rural cooperative foundations was rejected by the PBOC.¹⁷⁰

The government had been a lot more careful in opening up to foreign competition. The regulations on foreign banks imposed strict controls on the operation of foreign banks in China through the minimal amount requirement of working capital, maximum rate of deposit on the bank's assets and a limit to the scope of business. As Lu (2007: 55-9; also see Fu, 1998: 209) documents, in 1985, each of foreign banks' branches should have a minimum RMB 40 million as working capital. This was increased to RMB 100 million in 1995. In 1990, the deposits of foreign banks in China were not allowed to exceed 40% of their assets. The maximum rate decreased to 30% in 1995. As for the business scope, the foreign banks primarily served foreign customers in China to facilitate the inflow of FDIs. Beijing was reluctant to open the *renminbi* business to them. Two short-term experiments were however conducted in two foreign banks in 1988. The HSBC (Hong Kong and Shanghai Banking Cooperation) and IBPS (International Bank of Paris and Shanghai) were allowed to accept deposits in *renminbi* in 1997 on an experimental basis (Fu, 1998: 211). These moves were in preparation of possible concession in the banking

¹⁷⁰ The MOA required the ABC to play the fundamental role of investing in the agriculture sector (MOA, 1990: 38). However, there was no feedback to its request. The data shows that the loan in the agriculture sector from the ABC was extremely low. For example, of ABC's RMB 100.7 trillion bank loan from 1986 to 1989, only 30.6% (RMB 30.9 trillion) was used to procure agricultural products (Xiao, 1990: 23). MOA's effort in creating its own financial agencies in the agriculture sector was turned down by the PBOC. It was a bottom-up approach from the underground finance in the countryside. Because of the scarce financial resources in the agriculture sector, underground finance began as borrowings and lendings between relatives and friends. It was at zero interest and not for commercial purpose. The purpose of the loans was then mostly for agriculture production; this gradually changed to investment for private enterprises and TVEs. Underground finance took a variety of forms, like rural cooperative foundations (*nongcun hezuo jijinhui*), private money houses (*siren qianzhuang*), pawnshops (*diandang hang*), etc. A survey of 24 cities or counties in 15 provinces in China 2001 shows that various kinds of underground finance could be found in 95% of the locations (Wen, 2005). The emergence of underground finance was supported by the MOA. In December 1992, the MOA promulgated *A Few Comments on the Standardization and Institutionalization of the Rural Cooperative Foundations* (Guanyu jiaqiang nongcun hezuo jijinhui guifanhua, zhiduhua jianshe ruogan wenti de yijian). In 1993, MOA No.8 Document affirmed the advantages of having rural cooperative foundations as complement to rural finance. However, the existence of rural cooperative foundations challenged the monopoly of state-owned banks that were regulated by the PBOC. Accordingly, the PBOC issued *Measures to Eliminate Illegal Financial Institutions and Illegal Financial Business* (*feifa jinrong jigou he feifa jinrong yewu huodong de quid banfa*) in July 1998. Six months later, the State Council decided to eliminate the rural cooperative foundations (Kuang: 2007).

sector after WTO accession. Zhou Xiaochuan (2008: 175), governor of the PBOC since 2003, comments that all of these supervising agencies were reluctant to give up their control of the industry; as a result, a voluntary reform of the sector was not possible without a significant external force.

In short, an extensive survey of administrative and fiscal relations between the government and industry reveals a concordant effort by central agencies to protect the Big-Four-dominated, uncompetitive banking industry. The conclusion was consistent with Huang's (2002b: 121) observation that the "Chinese banking system, in effect, acts as a giant redistributive mechanism to transfer savings from the private sector to finance the investment and social obligations of the state sector". The relationship implies the difficulty of market liberalisation and WTO negotiations.

8.6 China's WTO Commitment and Its Compliance in the Post-WTO Period

8.6.1 Little Concessions in the Banking Industry

Internal coordination was not easy in the case of divergent interests and imbalanced status among the central agencies. For example, the MOFTEC's priority was to finalise WTO accession agreements with possible concessions from all industries, including the banking sector. Its request was not well accepted by the MOF that relied on the Big Four as the last resort for its macroeconomic policies (Lardy, 1998: 221). The MOFTEC was usually less capable of pushing the PBOC and MOF to liberalise their subordinating sectors, because they were of the same administrative level. The MOF was in fact more powerful than the MOFTEC in the decision making of finance and banking (Yang, 2004: 40). As a consequence, no concrete concession in the banking industry was made by the MOFTEC-led coordination group.

The internal coordination group was restructured, replacing the MOFTEC with the SETC to coordinate with the tertiary sector in 1999 in the hope of finalising the agreement by the end of the year. The MOFTEC could not deal with the resistance from the MOF nor could it put pressure on the Ministry of Information Industry (MII), a super agency after the 1998 administrative reform. Thus, the SETC, a commission that was at a higher level than ministries in the State Council had been assigned to replace the MOFTEC. The SETC as a new coordinator also needed short-term support from the Big Four because its priority at that time was to restructure loss-making SOEs through debt-equity swaps. As such, the SETC with a special interest in banking industry exerted less pressure on the MOF than on the MII.

The rearrangement of domestic coordination implies the government's decision to protect domestic banks. The key success was to impose a 49% equity ceiling on foreign investment in banking industry. The agreement to gradually opening up the domestic banking industry included allowing American banks to do foreign currency business with Chinese clients one year after China's accession. China would allow local currency business with Chinese enterprises two years after accession, and allow local currency business with Chinese individuals five years after accession. China should allow the joint-invested bank on accession and allow the joint-invested bank to become an American bank five years later.

Immediately after the negotiations, Mr Long was optimistic about the future of the domestic banking industry, as he publicly stated that although the agreement "allowed" foreign investors to have 49% of the share in banking industry, it did not necessarily mean that they were able to achieve this goal; the agreement also allowed the government to develop new barriers to delay and frustrate foreign investors from entering the domestic market.

8.6.2 China's Compliance in the Post-WTO Period

The banking industry as a “high stake” sector received a lot of protection from the MOF during the negotiation. In the post-WTO period, a competition for the control of the Big Four took place in the central government. In 2003, the China Banking Regulatory Commission (CBRC) was established to take over the regulatory power of the PBOC. In the same year, the ownership of the BOC and CBC was transferred from the MOF to the PBOC-led Huijin Investment Company through the purchase of shares (He, 2003). In response, the MOF “forced” the PBOC to sell these shares to the MOF-led China Investment Corporation (Anderlini, 2008). Huijin was handed over from the PBOC to the MOF. By October 2009, the MOF-led Huijin owned majority stakes in all of the Big Four with 35.42% in the ICBC, 76.53% in the BOC and 57.09% in the CBC (AFP, 2009).¹⁷¹ The PBOC ended up as the loser as it has surrendered its regulatory control of the sector and failed to grab the ownership of the Big Four. However, the division of functions between the PBOC and CBRC is not clear as they have overlapping control of the sector. The banking sector remained “high stake”. It did not gain any autonomy in the restructuring of the supervision board. Regardless of the agency governing the sector, it would have difficulties complying with the WTO commitment.

The government had committed to the agreement timely, but imposed new non-tariff barriers immediately to buffer the devastating impact of foreign competition. As such, foreign banks' share of the total banking system assets was only 2.4% in 2007, roughly the same as that in 2000—one year prior to the WTO accession (Figure 3.4).

¹⁷¹ By 2005, the largest foreign stakeholders in the CBC were the Bank of America Corporation (9%) and Temasek (6%). The largest foreign stakeholders in the BOC were the Royal Bank of Scotland-Merrill Lynch-Li Ka-shing (10%), Temasek (about 10%) and the United Bank of Switzerland (1.6%) (Podpiera, 2006: 6-7). In January 2006, Goldman Sachs Group Inc., Allianz AG and American Express Co. bought a total 10% shares of ICBC (Berger *et al*, 2009: 119).

The first commitment was to allow foreign currency business in 2002. To qualify, a foreign branch was required to have a working capital of no lesser than RMB 500 million, a new criterion set by the PBOC in the same year. In comparison, a domestic bank branch requires only RMB 300 million to qualify. Besides, foreign banks were not allowed to open more than one branch in a year (USTR, 2008: 81-2). The second commitment was to allow domestic currency business with Chinese enterprises as from 2004. At the same time, the working requirement was reduced by RMB 100 million and the restriction of new branches was also removed. However, the government restricted the establishment of Chinese-foreign joint banks. The equity share of a single foreign investor in a joint bank was limited to 20% and the total equity share of all foreign investors was limited to 25% (Ibid: 82). The third commitment was to allow the domestic currency business with Chinese enterprises and individuals since 2007. Many additional requirements were imposed on foreign banks, however. Foreign banks must be incorporated in China as the first step. The requirement of incorporation is to have a representative office in China for two years and have total assets exceeding US\$ 10 billion. After incorporation, they need to prove that they have been in operation in China for three years and with profits in two consecutive years. After meeting these requirements, they are allowed to take domestic currency deposits of RMB 1 million or more from Chinese individuals but not issue any domestic currency loans to Chinese individuals (Ibid: 83). These conditions have delayed foreign banks' access to the Chinese consumers (Berger *et al*, 2009: 118).

8.7 Conclusion

The banking industry performed the role of a planning organ by the end of the 1990s. The central government, especially the MOF, administratively supervised and financially relied on the banking industry through its close relationship with the Big Four. The Chinese banking industry expected a great deal of competition after WTO accession. A concordant effort by the vested SETC, MOA and PBOC successfully avoided giving concession on the sector. To meet the commitment of opening up the sector in a step-by-step manner after WTO accession, the government erected a series of non-tariff barriers to minimise the impact of foreign competition. China's WTO accession did not help the banking sector develop into a more sustainable system as it is still a "high stake" sector. The Big Four is still in control of the sector and the industry remains uncompetitive in terms of NPLs, limited business scopes and less sophisticated services.

Chapter 9: Conclusions

9.1 Government-Industry Relations

The effects of the foot-dragging tactics adopted by economic ministries in the central government during the WTO negotiation process are best understood in the perspective of government-industry relations. The central government's decision to grant autonomy to firms during the decentralization process casts doubts on the convergence of sectoral and bureaucratic interests. The devolution was successful in some sectors like the textile industry, but not in others like telecommunications services. This means that the relation between the government and industry was sector-specific. A close relationship reflects that the government had high stakes in its subordinate industry and would do its utmost to protect it. A loose relationship implies that the government's decision is primarily driven by its bureaucratic interests and not necessarily beneficial to the industry.

During the China-US negotiation on WTO accession, the Ministry of Information Industry, the Ministry of Finance and the State Planning Commission had strongly opposed the trade liberalisation of their respective subordinate industry, namely, telecommunications services, banking services and automobile sector, as they were closely related to the industries that were not willing to join the WTO. On the other hand, the Ministry of Agriculture exerted much less effort to protect its sector as the ministry had little control over household production; the sector had seen more challenges than opportunities after trade liberalisation. For the textile and clothing industry that was willing to join the WTO for greater market, the State Bureau of Textile did not fight hard to lift US quota on Chinese products during the bilateral negotiation as it had low stakes in the sector.

In short, the study of government-industry relations explains the convergence/divergence of bureaucratic-sectoral interests. It is the prerequisite to understanding the state's decisions on trade liberalisation. The incorporation of the independent variable of government-industry relations into the model of "ministry-sector horse trading" affords a better understanding of China's trade concessions for WTO accession.

9.2 "Ministry-Sector Horse Trading" Model

This dissertation develops a "ministry-sector horse trading" model to understand China's trade concession for membership to the WTO. The three independent variables are government-industry relations, sectoral competitiveness and market structure. A horse-trading strategy was adopted by negotiators after weighing the three indicators. It explains the dependent variables of huge concessions on the agricultural and textile industry, but little concessions in banking, telecommunications and automobile sectors.

More importantly, the model explains the Chinese government compliance or non-compliance with its commitment in the post-WTO period. Having given concessions in certain sectors, the government finds it less difficult to fulfill its commitment in these sectors. In sectors which the Chinese government was reluctant to give concessions to American negotiators, the government receives a lot more complaints for its failure to comply with its commitment. In order to protect the protected, the government erected new non-tariff barriers that were not consistent with the rules of free trade.

In the agricultural sector, Chinese peasants expected to see more challenges than opportunities under the WTO framework. However, in contrast to their counterparts

in Japan, Korea and Taiwan (Hayami, 1988), they were not organised enough to impose effective pressure on their government for agricultural protection. Though peasants are likely to grow in strength, given the dwindling number of producers and the resultant ease in mobilisation, a lack of administrative and fiscal connections between the agricultural sector and the MOA implies that the sector would face sustained discrimination at home and fierce competition from abroad. An evolution of protective measures suggested by Anderson, Martin, and Valenzuela (2007) is not foreseeable in the near future.

Among the sectors in the negotiation package, the Chinese T&C industry was expected to gain from WTO accession. Chinese negotiators tended to make concessions on T&C sector because of loss-aversion in other sectors. Enterprises in this sector failed to exert a unified pressure on negotiators to shorten period of quota reduction from importing countries. Finally, as the government had low stake in the sector during that time, it prioritised bureaucratic interests over sectoral interest. Hence, the SBT was relatively indifferent to the final result compared to supervisors in other sectors. Trade concessions were made on sectors that were considered “low stake”, competitive and less concentrated.

For the automobile sector, the SPC adopted a national developmental agenda to enhance the sector’s competitiveness in international trade in the 1980s. The close government-industry relation guaranteed the convergence of interests between SDPC and the sector, with the sector remaining slightly fragmented. The SPC had been effectively protecting the sector in the 1990s as the tariff rate in 2000 was much higher than what the sector had requested for (Table 6.7 and Table 6.8). This protective stance was adopted by its successor in the WTO accession. Hence, sectors that were “high stake”, uncompetitive and fragmented were protected in the

negotiation. Continuous intervention in the automobile sector explains its non-compliance in the post-WTO period.

Trade concessions were not made in the telecommunications sector and it remained “high stake”, monopolistic and uncompetitive. The WTO agreement left many loopholes for the government to exercise continuous protection. The WTO mechanism could not help the sector gain more autonomy. The political will of the state is still significant in the sector. Compared to other sectors, a proper regulatory entity in the telecommunications sector in China was far from emerging. Instead, a fragmented governance structure is taking shape in the post-WTO period. Tensions exist between the SASAC that operates the industry and the MIIT that regulates the industry. Their relationship determines the future of China’s telecommunications services and its compliance with the WTO framework. It suggests that sectoral characteristics are more significant than national characteristics. Japan, which has a different political regime and economic structure, also saw a fragmented state control between MITI and MPT over the sponsorship and regulation of Nippon Telephone and Telegraph (Wilks and Wright, 1987: 288).

The banking industry functioned as a planning organ by the end of the 1990s. The central government, especially the MOF, administratively supervised and financially relied on the banking industry through its close relationship with the Big Four. The Chinese banking industry expected great competition after WTO accession. A concordant effort by the vested SETC, MOA and PBOC successfully blocked efforts to give concessions on the sector. To fulfil its commitment to open up the sector in a step-by-step manner after WTO accession, the government erected a series of non-tariff barriers to minimise the impact of foreign competition.

9.3 “Efficiency-Reducing Trade Concessions”

The objective behind China-US trade negotiation for WTO accession was to liberalise China’s state-controlled trade regime. However, through horse-trading bargaining, the government retained most of its rights to issuing licences, quotas, permits, approvals, etc. These economic rents provided by the government lured the industry for competition. The rent-seeking behaviours created social losses that reduce the efficiency that was supposed to be enhanced through WTO accession. The negotiation outcome turned out to be “efficiency-reducing” as it gave economic bureaucracies some time to decide if it was willing to give up its control of their “high stake” sectors, imposed great adjustment costs on sectors that were internationally competitive and protected monopolistic profits in concentrated sectors. The “efficiency-reducing trade concession” challenges the common beliefs that WTO accession would have a huge positive impact on China’s reforms of marketisation.

Chinese peasants ended up as the major losers of the deal. China’s agricultural trade registered losses after WTO accession from a surplus position before. Affected by the flood of imports, its comparative advantage in labour-intensive products has been declining and its comparative disadvantage in capital-intensive products has been worsening dramatically. Similarly, China’s T&C sector did not benefit from the WTO agreement. Export quotas were retained. New safeguard measures were imposed. Chinese T&C products were extremely competitive in global trade at that time. Its export should have experienced notable increase after WTO accession. However, China’s WTO membership contributed little to the growth of China’s global market share, compared to the period after the phasing out of the MFA. Trade concessions helped other WTO members retain their quotas against China’s T&C exports. That explains the irrelevance of WTO accession to the growth trend of its

exports. On the contrary, the WTO agreement frustrated China's T&C sector and prevented it from exploring its potentials.

What was worse was that sectors that received state protection failed to grow in strength. China's automobile sector remained subject to state intervention. Foreign competition was extremely limited. It prevented the sector from gaining more autonomy or becoming competitive in terms of R&D and production efficiency. As for the telecommunications sector, state monopoly remained after WTO accession. Unfair or illegal competition prevails among service providers. Although the sector has become globally competitive in terms of sector size, it remains low in productivity and production efficiency.

Finally, China's WTO accession did not help develop a more sustainable system for the banking sector. The sector is still a planning organ; the Big Four still control the sector; and the industry remains uncompetitive in terms of NPLs, limited business scopes and less sophisticated services.

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