FOREIGN AFFAIRS

How the WTO Changed China

The Mixed Legacy of Economic Engagement

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When China joined the World Trade Organization in 2001, the event was hailed as a pivotal development for the global economic system and a bold marker of the country's commitment to reform. It took 15 long years of negotiation to reach the deal, a reflection of the challenge of reconciling China's communist command economy with global trading rules and of the international community's insistence that China sign on to ambitious commitments and conditions. U.S. officials had high hopes that those terms of entry would fix China on the path of market liberalization and integrate the country into the global economic order. U.S. President Bill Clinton called Beijing's accession to the WTO "the most significant opportunity that we have had to create positive change in China since the 1970s" and argued that it would "commit China to play by the rules of the international trading system."

Chinese President Jiang Zemin and Chinese Premier Zhu Rongji evinced similar resolve in securing WTO membership. In their view, joining the organization was not only appropriate for a country of China's size and economic potential; it would also force China to move forward on necessary domestic reforms. Chinese state media noted at the time that entry into the WTO would "expedite the process of China's reform and opening up"; spur the "cleaning up of laws, regulations, and policies"; facilitate the establishment of an "impartial, efficient judicial system"; and bring much-needed external competition to the country's inefficient state-owned enterprises (SOEs). China accepted far more stringent terms than any other new member before or since. These commitments included not just large cuts to tariffs on imports into China but also a sweeping overhaul of domestic institutions and policies to allow market forces freer rein within the economy. Beijing pledged to improve the rule of law by strengthening courts and increasing protections of intellectual property rights, to allow firms greater autonomy and limit the government's interference in their affairs, and to revamp regulation to make governance more transparent.

Such commitments generated widespread anticipation that China's accession to the WTO would bring about major change and tie a rising China more tightly to global economic networks and institutions. But these hopes now seem like wishful thinking. In 2018, the office of Robert Lighthizer, the U.S. trade representative, proclaimed that the United States had "erred in supporting China's entry into the WTO," arguing that China's "state-led, mercantilist trade regime" was "incompatible with the market-based approach expressly envisioned by WTO members." Kurt Campbell and Ely Ratner, two former Obama administration officials, claimed in these pages in 2018 that "the liberal international order has failed to lure or bind China as powerfully as expected." By most accounts, in Washington and more broadly, China's economic model has not turned toward market liberalism since 2001 but instead consolidated into a form of state capitalism that Beijing hopes to export globally. WTO membership, the new consensus goes, has allowed China access to the American and other global economies without forcing it to truly change its behavior, with disastrous consequences for workers and wages around the world. China seems to pay lip service to international norms and still play by its own rules, taking advantage of loopholes and naive policymakers abroad.

But if the hopes for China's WTO accession were overblown, so is this new consensus, which oversimplifies a complex story that holds different lessons about the path of, and prospects for, China's reform and about the future of trade liberalization globally. China has surely not followed the course envisioned by Clinton—or, for that matter, that anticipated by Jiang and Zhu. But rather than judge China's WTO entry in the categorical terms of success or failure, a more productive way forward would be to understand the ways in which WTO membership did lead to positive change within China—and when and why that positive change started to slow and then reverse. Joining the WTO had a stronger liberalizing effect in some parts of the Chinese state than in others, and that liberalization was more forceful at some points in time than at others. At least for a few years, China's accession to the trade body bolstered Chinese reformists and helped authorities push through necessary changes, in the process showing that multilateral institutions can boost domestic reform in China. But the impetus for reform wavered, and other actors within China pushed in opposite directions, steering the economy toward greater state control. It's not impossible to foster positive change in China, but it will be uneven, contested, and require ongoing pressure and engagement from the outside.

THE SUM OF ITS PARTS

China first embarked on the path of reform under Deng Xiaoping in 1978, when the Chinese leader began to gradually open the economy by decollectivizing agriculture. Beijing accelerated these market-oriented reforms in the ensuing years, granting more leeway to private enterprises, opening the door to foreign firms, and steadily privatizing large SOEs. An economy that had become moribund in the 1970s was growing at a breakneck clip of nearly ten percent per year by the late 1990s. But that story of rapid growth and incipient liberalization concealed a much more complicated picture: China's economy consisted of a welter of different actors pursuing different, sometimes contradictory interests. Accession to the WTO in 2001 was a fillip for the country's pro-market liberalizers, but many others evaded or remained hostile to liberalizing reform.

The Chinese state is vast, sprawling, and highly decentralized, especially when it comes to economic policy. The Chinese Communist Party (CCP) comprises about 90 million members, which would make the organization larger than the 16th most populous country in the world (the Democratic Republic of the Congo, which has a population of around 89 million). Its members have a wide range of backgrounds and views, from executives with international business experience to dyed-in-the-wool apparatchiks who eagerly study the ideals articulated by President Xi Jinping. The central government oversees over 30 provinces, hundreds of cities, and thousands of counties. As a result, Beijing has long struggled to coordinate, implement, and enforce policies across the country. Subnational governments enjoy broad discretion over how to run their local economies. Governors and mayors compete with their neighbors to produce ever-higher and more spectacular growth rates, and they enjoy enough autonomy to selectively enact, creatively interpret, and even subvert guidelines from Beijing.

When China was preparing to join the WTO, its system of economic governance was decidedly mixed. Some actors within China's massive party-state advocated liberalization based on free-market principles. Others supported a strategy akin to those adopted decades prior by Japan and South Korea, which involved offering financial incentives and instituting administrative measures to support firms in industries deemed strategic. And still others counseled adhering to China's command economy.

The various actors within China's large and complex economy had to reckon with the seismic shift of entry into the WTO. Accession triggered many significant changes and strengthened the hand of the country's reformists, who in the first few years following WTO entry implemented large cuts to import tariffs, loosened rules around trading licenses to introduce domestic private and foreign competition, shrank the state-owned sector, and enhanced the functioning of market forces in the economy. Beijing strengthened the rule of law and the protection of intellectual property rights to greatly improve the ease and predictability of doing business in China and limit government interference.

The central government drove much of the resulting change, because it felt the pressure of adhering to WTO rules more keenly than did provinces and cities lower down in the administrative hierarchy. WTO membership spurred Beijing to undertake a formidable legislative and regulatory overhaul in order to bring domestic laws and policies into compliance with the international trading system. For example, it amended its law regulating the quality of products, with the aim of improving standards and strengthening the state's ability to guard against counterfeit and subpar goods. It reformed a commodity inspection law to create a common certification process for foreign and domestic goods and put in place similar reforms for customs laws; rules governing pharmaceutical products; and copyright, patent, and trademarks laws. It also overhauled national economic institutions to strengthen the state's regulatory capacity, merging a number of agencies to eliminate overlap. The new General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) took the lead in assessing over 21,000 domestic technical standards, abolishing about 1,400 of them, and revising over 9,000 others to bring the country's standards regime into conformity with WTO rules.

The central government's liberalizing efforts did not stop with legal and institutional reforms. Beijing established research and advisory centers in various parts of the country to provide guidance on matters pertaining to WTO rules and procedures. Authorities launched a national campaign through state media to raise awareness about the consequences of the country's joining the WTO and held training sessions for government officials to help them navigate the complex process of implementing the trade body's rules.

This effort to set in motion greater market liberalization ran up against deep-seated bureaucratic and industry resistance. Those in the state-owned sector feared that foreign competition would crush their businesses. The automotive industry had even petitioned Jiang for greater protection when he was negotiating the entry deal. Powerful industrial ministries within Beijing bristled at the idea that international rules would now curb their autonomy to make policy. The agricultural sector protested the opening up of China's markets to highly subsidized goods from developed countries.

Foreign businesses immediately benefited from the measures that followed China's accession. By 2003, roughly 70 percent of U.S. firms surveyed in China reported that Chinese domestic reforms had improved their business climate "to a great extent" or "to a very great extent." Those measures would not have occurred without the external impetus of entry into the WTO. And they reflected the degree to which China's leaders had succeeded in using multilateral trade commitments to drive forward difficult domestic changes.

But the actions of the central government tell only part of the story. Subnational authorities, which escaped direct WTO scrutiny, did not match Beijing's commitment. China's entry into the WTO reframed local economies, inviting foreign competition while creating opportunities for commerce abroad. Regional governments had to keep their economies growing while dealing with potential import threats and pursuing potential export gains. Some local leaders responded by liberalizing their markets and facilitating more business-friendly regulations, but many found ways to resist opening up and to promote their own interests in other ways.

Anhui Province, for instance, issued an industrial policy in 2001 that drew from South Korea's success in automobile exports, targeting state support to favored firms. Authorities in Shandong Province noted that the territory should "seize the opportunity" created by WTO entry to expand and develop its shipbuilding industry—which meant not liberalization but increased preferential credits and subsidies in order to expand exports out of the province. Other, smaller jurisdictions responded to the threat of intensified competition with even more forceful interventions aimed at suppressing market forces, using administrative directives to reshape local businesses. The autonomous prefecture of Yanbian, in northeastern China, for example, launched a restructuring drive in 2003 to consolidate its cement industry. Rather than let the market dictate which firms would thrive and which would die, the local government picked winners and losers, taking away business licenses, cutting off the electricity supply, and dismantling the machinery and equipment of factories that were deemed to be too small or inefficient.

Accordingly, China's entry into the WTO produced a wide range of shifts, often in contradictory directions. It initially spurred sweeping efforts to liberalize the economy, reshape policies to accord with international rules, strengthen institutions to support the free market, and reduce the role of direct state intervention—transforming China's economic landscape and vastly expanding the scope for private and foreign enterprises to do business in China. But the country did not move in lockstep toward liberalization. Subnational governments adopted a plethora of strategies to pursue economic growth, many of them in clear contrast to Beijing's liberalizing agenda. A stark internal divergence in China's economic policies emerged, with some parts of the state strengthening their commitment to market liberalization and others following more statist paths.

China did fulfill the majority of the terms of its WTO accession within a few years. Tariff rates on foreign imports were slashed, and a multitude of nontariff barriers were eliminated. The authority to engage in foreign trade, previously restricted to SOEs and foreign firms located in special economic zones, was broadened to all firms, including private Chinese enterprises. Beijing substantially improved legal protections for and reduced administrative burdens on businesses. Foreign investment surged once more into China, after having plateaued during the Asian financial crisis in the late 1990s.

THE STATE ADVANCES

Market-friendly reforms, however, would soon lose their luster for the central government. Observers in China use the term *guojin mintui*, or "the state advances, while the private sector retreats," to describe the central government's slide starting around the middle of the first decade of this century toward greater state intervention in the economy. Several domestic and external factors pushed China's powerful central government to embrace state capitalism. In the first few years after the accession, pro-reform ministries in Beijing drove the agenda for market liberalization, empowered by the mandate of China's pledges to the WTO. The Ministry of Commerce, China's trade agency, led efforts to harmonize China's trading regime with international rules. AQSIQ, the new quality-control agency, encouraged the adoption of international standards and established a direct link with the WTO to manage potential conflicts. These agencies further benefited from the leadership of Jiang and Zhu, who were not just ideologically well disposed to reform but also able to wrangle the country's sprawling central bureaucracy to keep the reforms on course. Under the two leaders, the government instituted important macroeconomic reforms to recalibrate revenue-sharing arrangements between the center and localities, better control inflation, and improve central oversight of the banking sector. And in a major administrative restructuring in 1998, Zhu had slashed the central bureaucracy in half, from eight million to four million people, and cut the number of central ministries from 40 to 29.

But as China fulfilled its WTO commitments on schedule, pro-liberalization forces lost momentum; swiftly meeting the terms of China's accession had the effect of sapping the urgency of reform. Without the outside pressure that WTO entry first provided in 2001, it was difficult for reformists in Beijing to keep up the push for greater liberalization. Instead, rival agencies that oversaw industrial policy gained the latitude to expand their influence.

This shift in bureaucratic power dovetailed with a change in leadership in 2003 from Jiang and Zhu to President Hu Jintao and Premier Wen Jiabao. The leaders differed less in their essential views on reform than in their abilities to control the state bureaucracy. Hu and Wen did not have their predecessors' political strength to discipline the state. Wen, in particular, had spent the majority of his career within the central government. He rose to the top with support from networks deeply embedded in the Beijing bureaucracy. Although this milieu might have given him some advantage in understanding the inner workings of the central state, it also left him beholden to that bureaucracy. Unlike Zhu, who was able to halve the size of the central government in 1998, Wen's attempt at administrative restructuring in 2003 was relatively unsuccessful. Reports at the time indicated that Wen planned to whittle down the number of ministries by as many as seven, but he eventually axed only one central agency. Instead, agencies dedicated to industrial policy, such as the National Development and Reform Commission, gained greater influence: the NDRC became informally known as the "mini State Council." In 2008, the newly created Ministry of Industry and Information Technology added to the central government's increasingly activist role in enacting statist industrial policies.

The cause of pro-market reform was dealt a further blow by the failure of WTO members to agree to another comprehensive package for trade liberalization as part of the Doha Round of negotiations in Geneva in 2006. The disagreement over farm subsidies and import taxes underlined tensions within the trade body, and the ensuing impasse strengthened the hand of agencies in Beijing that oversaw industrial policy and did not subscribe to the market-friendly imperatives of the WTO. Dysfunction in the trade body meant that Chinese reformists could not repeat the success of 2001, lacking renewed external impetus for domestic liberalization.

The central government's new policy trajectory started to become clear in the 2006 iteration of the Five-Year Plan, China's periodic policy blueprint. It emphasized domestic innovation and reducing China's reliance on foreign technology, reaffirming the dominant role of the state in the economy—and inevitably dispiriting foreign firms doing business in China. According to the American Chamber of Commerce in the People's Republic of China's annual surveys of its members, positive sentiment among U.S. firms operating in China fell to an all-time low in 2006.

The 2008 global economic crisis and its aftermath reinforced the regime's statist turn by setting the stage for greater government intervention and laying bare the weaknesses of free-market capitalism. China responded to the downturn with a $580 billion fiscal stimulus and channeled the funds largely through SOEs and local governments. This spending strengthened the central state's hand and boosted the ideological justification for statism. While many wealthy countries that had also enacted large fiscal stimulus programs soon shifted back to economic austerity (and a diminished role for the state), China continued on the path that it had embarked on before the crisis, toward greater state control of the economy. The state-owned sector had steadily shrunk in the years following China's accession to the WTO. In 2001, 40 percent of all jobs in China were in the state sector. That figure had fallen to 20 percent by 2008, but this decline came to a halt in the years after 2008 and showed little change up to the end of the Hu-Wen administration, in 2012. Between 2008 and 2012, assets managed by state firms rose from over 12 trillion yuan to more than 25 trillion yuan.

Since Xi's ascent to power in 2012, the state's role in the economy has only become stronger and more pronounced. Private investment had for many years expanded at a faster pace than investment by state entities, but this dynamic began to weaken after 2012, and it even reversed from 2015 to 2016. China has continued to pursue free trade in its foreign relations, inking numerous deals with countries far and near, but the political energy for domestic market reform has all but disappeared. Recent years have seen the country's SOEs become stronger and larger than before, boosted by national policies that reaffirm the dominant role of the state and the overarching supremacy of the CCP over the economy. China's overseas economic footprint has also expanded significantly, most notably through Xi's vast infrastructure and investment program known as the Belt and Road Initiative, sparking fears that China is seeking to export its brand of state capitalism globally. Such fears, however, are overblown.

CONTAINING MULTITUDES

China may have dashed the hope that it would become a liberal free-market economy, well integrated into the international economic system. But even now, its model of state capitalism is not the juggernaut that many make it out to be. In many respects, China still lives under the shadow of its entry into the WTO. Ultimately, the Chinese system is not likely to prove strong enough to completely resist the liberalizing effects of globalization or coordinated enough to effectively pursue its ambitions on the global stage through its SOEs.

In some ways, WTO membership reinforced the central government's inability to prevent local governments from interpreting higher-level directives to serve their own interests. WTO entry brought a new surge of foreign capital into China, reducing the reliance of subnational governments on funding from Beijing and providing them with alternative resources to pursue their own goals—and the flexibility to disregard dictates from the capital. For example, despite Beijing's desire to orient economic growth around increasing productivity, boosting technological development, and training a more skilled workforce, subnational governments have fixated on a quantitative approach to growth that relies on capital investment and high-profile development projects, undermining the overarching national effort. Instead of making long-term investments to raise the productivity of firms and their capacity for innovation, local officials seek out foreign direct investment to expand output for short-term gains, leading to projects that duplicate the work of others and generate problems of excess capacity.

China's policy on so-called new-energy vehicles (electric and hybrid cars) illustrates this divide. In 2012, the central government's State Council issued an industrial policy on such vehicles that stressed the importance of promoting innovation and explicitly warned local governments against "blindly making low-quality investments and duplicating construction." But that same year, Hubei Province issued its own policy, which ignored the central government's focus on technological innovation and high-quality production and instead stressed the need for "investment promotion" and "large-scale production" to scale up the manufacturing of the vehicles. Nor was Hubei alone in pushing for rapid expansion and disregarding the longer-term imperative of improving technological capacity. By 2017, the central government had to issue a new directive to curb the overinvestment of local governments in the production of new-energy vehicles.

Similar conflicts plague China's overseas economic ambitions. Although some SOEs (particularly those in strategic sectors, such as automobiles and shipping) have retained a more statist orientation to trade, not all are faithful agents or reliable exemplars of state capitalism. China's entry into the WTO granted more foreign trading rights to domestic private enterprises, lowered import barriers, and allowed private companies greater freedom to operate. Once exposed to foreign competition and global rules, many SOEs—especially those participating in highly competitive sectors not protected by state industrial policy—came to resemble more traditional commercial actors, responding to price signals in the same way as private firms. It is not a given that China's SOEs will act as agents of China's overseas economic statecraft. The extent to which an SOE might directly serve Beijing's interests is instead determined by a bevy of factors, including the competitiveness or strategic importance of a particular sector, the degree to which the central government can monitor the firm's overseas behavior, and the specific political context of the country in which the firm is operating.

WHAT NOT TO DO

Some Chinese state and nonstate actors see their interests as aligned with international economic rules; others seek to exploit gaps in global governance. Some dependably behave as operatives of Beijing, whereas others actively subvert national policy in pursuit of their own narrow interests. These dynamics have persisted even as Xi has sought to consolidate CCP rule over many aspects of Chinese political, economic, and social life. Despite Xi's efforts, China's global economic posture remains mostly the product of the country's messy internal politics and not the result of a coordinated master plan.

This reality complicates matters for Washington and other governments. Given the multitude of actors and interests involved in Chinese economic affairs, traditional state-to-state diplomacy, centered on communications between national capitals, is necessary but insufficient. Substate actors, such as provinces and cities, wield substantial authority over economic affairs. The actions of Chinese firms do not necessarily represent the will of Beijing. Countries must therefore take a multipronged approach to engage with China at different levels. A policy of overt hostility that overlooks the diversity of interests driving China's massive economy will end up being counterproductive.

Recent U.S. policy has demonstrated how not to encourage greater market liberalization in China. The U.S.-Chinese trade war launched by the administration of former President Donald Trump has created conditions opposite to the ones that spurred market reform back in 2001. Washington levied unilateral tariffs, launched trade-dispute cases, instituted export bans, and placed restrictions on foreign investment in the United States. The Trump administration framed relations with China in terms of a zero-sum competition and even went so far as to threaten the decoupling of the two countries' giant (and thoroughly enmeshed) economies.

Chinese leaders view these actions as part of a hostile U.S. strategy to contain or undermine China's rise. The confrontation has empowered the nationalists and conservatives opposed to market liberalization, who point to U.S. coercion as a reason to further protect China's high-tech manufacturing and secure the country's supply chains. The trade war has marginalized pro-reform officials who have called for many of the changes to Chinese policy that the United States has requested, such as the liberalization of the financial sector and the loosening of rules around foreign investment. China's reformists no doubt have less clout than their more statist counterparts. But their relative weakness has led them in the past to seek external leverage—as reform-minded officials did during China's WTO accession. This dynamic is by no means restricted to trade. China's banking regulators, for instance, have drawn on frameworks put forward by the Basel Committee on Banking Supervision (an international committee of central bankers) to overcome the resistance of state banks, SOEs, and local governments to greater oversight of the banking system.

U.S. policymakers should not abet the nationalists in China by focusing on threats and punishments. A broader strategy of engagement that offers significant benefits in return for Chinese commitments to further liberalization would provide domestic reformists with just the sort of leverage they enjoyed in 2001. Initiatives backed by multilateral institutions would have more legitimacy than would Washington's unilateral demands. Today, segments of the Chinese political elite remain open to adopting the high product standards and market-oriented rules of multilateral trade arrangements. A number of current and former Chinese officials have even spoken positively about the prospect of China's joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, a free-trade deal, a step that would benefit the United States (although it is not a party to the deal) by bringing greater external oversight of problematic issues, such as the governance of

Chinese SOEs and foreign investment in China, into the bilateral relationship.

The sweeping liberalization that China's central government embarked on at the beginning of this century showed the positive effects of the country's joining the WTO. But it was naive then to expect China to fully open up its economy and integrate it into the international trading system, just as it is simplistic now to think that China has abandoned liberal reform for the more familiar comforts of state capitalism. The Chinese economy is neither entirely marketized nor completely state-controlled, and any sensible China policy cannot treat the system as a monolith.

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