

Chandos Asian Studies Series:
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Cass Business School
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WTO Accession and Socio-Economic Development in China

Edited by Parikshit K. Basu
and Yapa M. W. Y. Bandara



CHANDOS PUBLISHING

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Chandos Publishing
Oxford · Cambridge · New Delhi

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Avenue 4
Station Lane
Witney
Oxford OX28 4BN
UK
Tel: +44 (0) 1993 848726
Email: info@chandospublishing.com

Chandos Publishing is an imprint of Woodhead Publishing Limited

Woodhead Publishing Limited
Abington Hall
Granta Park
Great Abington
Cambridge CB21 6AH
UK
www.woodheadpublishing.com

First published in 2009

ISBN:
978 1 84334 547 3

© The contributors, 2009

British Library Cataloguing-in-Publication Data.

A catalogue record for this book is available from the British Library.

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Typeset by Macmillan Publishing Solutions.

Printed in the UK and USA.

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Printed in the UK by 4edge Limited - www.4edge.co.uk

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CHANDOS
ASIAN STUDIES SERIES:
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CONTENTS

Contributors

v

-
- | | | |
|----------|---|----------|
| 1 | Introduction: Socio-economic development in China – WTO accession and related issues | 1 |
| | <i>Parikshit K Basu and Yapa M W Y Bandara</i> | |

EDUCATION, ENVIRONMENT AND SERVICES

- | | | |
|----------|---|-----------|
| 2 | Reform of China's economic system with WTO accession and its impact on tertiary education | 19 |
| | <i>Shi Yutian and Yu Ping</i> | |
| 3 | The relationship between economic globalization and higher education internationalization in China | 43 |
| | <i>Kou Xiaoxuan, Zhu Hong, Liu Lijun and Yue Jibo</i> | |
| 4 | Green strategies for enhancing economic growth and ecological sustainability in Xinjiang province in China | 59 |
| | <i>Fenghua Zhang, Munir A Hanjra, Yong Hui and Shahbaz Khan</i> | |
| 5 | Services in China: Prospects for growth and implications for Australia | 79 |
| | <i>John Hicks, Richard Sappey and Parikshit K Basu</i> | |

FINANCE AND ACCOUNTING

- | | | |
|----------|--|-----------|
| 6 | Trend and pattern of Foreign Direct Investment in China's economic boom | 99 |
| | <i>Nihau Jiang, Wang Li-ping and Kishor Sharma</i> | |

| | | |
|-------------------------------|--|------------|
| 7 | FDI Spillovers - the strategy for Chinese economic development | 111 |
| | <i>Wang Wei and Yapa M W Y Bandara</i> | |
| 8 | The convergence of International Financial Reporting Standards in China: A view on the influence of political ideology on Chinese accounting profession | 135 |
| | <i>Zhang Ying, Jane Andrew and Henry W. Collier</i> | |
| 9 | Accounting standards development in China | 149 |
| | <i>Xuan Qi and Chris Deeley</i> | |
| SOCIO-ECONOMIC IMPACTS | | |
| 10 | Socio-cultural challenges to economic growth in China – looking ahead | 165 |
| | <i>Parikshit K Basu, John Hicks and Richard Sappey</i> | |
| 11 | Community development in China: problems and prospects | 185 |
| | <i>Manohar Pawar</i> | |
| 12 | Concluding remarks | 211 |
| | <i>Parikshit K Basu and Yapa M W Y Bandara</i> | |
| | Index | 219 |

Chapter 1

INTRODUCTION: SOCIO-ECONOMIC DEVELOPMENT IN CHINA – WTO ACCESSION AND RELATED ISSUES

Parikshit K Basu
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1. BACKGROUND – THE ECONOMIC MIRACLE

China has achieved remarkable economic growth over the three decades since the initiation of the open policy reforms in 1978. The achievement of an average annual economic growth of around 10 per cent is a testimony to the success so far achieved in the market reform's process. Despite the failed attempt to secure a membership in GATT in 1995, the continued thrust towards market orientation secured China the all important World Trade Organisation (WTO)¹ membership in 2001, after 14 years of discussions and negotiations. The commitment of the political regime to transform a huge 'planned economy' to a 'market oriented' economy has been a significant factor in the success story. In a way, it is an interesting case of transition to a market economy under socialist ideology, which is changing gradually. This process has been smooth, but intricate. The hard work has paid off. By 2005, China had become the fourth largest economy in the world in nominal dollar terms and the second largest measured in PPP dollars (Wei et al 2008).

China's economic policy reforms were associated with five basic principles of GATT and the WTO. These are (i) non-discrimination, (ii) market opening, (iii) transparency and predictability, (iv) undistorted trade and (v) preferential treatment for developing countries². In line with these principles, China has introduced many reforms that consisted of the phasing out of restrictions on internal and external trade, including tariff and non-tariff barriers, revamping the institutional set up, including the judiciary, and eliminating exchange control restrictions. These reforms paved the way for the influx of much needed Foreign Direct Investment (FDI) to kick start and run the growth engine. From an almost isolated economy status prior to the late 1970s, China has progressed to become the world's largest FDI recipient within one year since its accession to WTO. By 2005, China had accumulated FDI worth US\$622 billion (Zhang 2006).

¹ The successor organisation of GATT.

² Martin et al (2004) used these five principles as a useful framework to analyse the impact of China's accession to WTO. See Gertler (2002) for an outline of these principles. Studies by Fewsmith (2001), Martin (2001); and Graham and Wada (2001) are few among many that discusses various aspects of China's accession to WTO and its implications on China and other countries .

As many writers agree, these reforms have brought about impressive economic growth and development in various sectors of the economy (OECD 2000; Fung et al. 2002; Zhang 2006). The Chinese economy, which grew at an annual average growth rate of 7 per cent during the early years (1979-81) of the post reforms era, realised a growth acceleration during the 1982–1995 period - recording an annual growth rate of about 10 per cent consistently, except for 1989 and 1990 during which the growth rates were 4.1 per cent and 3.8 per cent respectively. In some of the years during this period, for example, in 1984 and in 1992, the growth rates reached unprecedented levels, 15.2 per cent and 14.2 per cent respectively. During the period 1996-2005, the annual average economic growth rate hovered around 9.6 per cent (Fung et al 2002; Zhang 2006). By 2007, the growth rate reached the level of 11 per cent. This exceptional growth story was in line with developments in other related areas such as international trade, private and foreign enterprises in the economy, and the manufacturing sector.

In the area of international trade, the growth is phenomenal. China's total trade, under the monopoly of eight state enterprises, stood at US\$ 20.64 billion in 1978, comprising US\$ 10.89 billion of imports and US\$ 9.75 billion of exports. By 2007, the value of China's total trade increased to US\$ 2,173.83 billion, comprising of US\$ 1,218.02 billion of exports (about 35 per cent of its GDP) and US\$ 955.81 billion of imports. China is the third largest exporter in the world at present.

With trade oriented policy reforms, the contribution by the private sector enterprises (both local and foreign invested) to total output (GDP) in the Chinese economy increased from zero in 1978 to about 61 per cent by 2005, while the contribution to GDP by the state sector enterprises significantly dropped from a 100 per cent planned economy status to about 39 per cent over the same period (Li 2006). Further, with FDI liberalisation, foreign invested enterprises became the driving force of import-export trade. For example, by 2005, the contribution by FDI enterprises to total exports was 58 per cent, while the contributions by State-owned enterprises (SOEs) and private enterprises to total exports were 22 per cent and 20 per cent respectively. In terms of total imports, the contribution by FDI enterprises, state-owned enterprises and private enterprises was 59 per cent, 30 per cent and 11 per cent respectively by 2005 (Li 2006).

These figures clearly suggest that the Chinese economy has transformed and realised the private sector impetus in driving the growth engine of the market oriented economy. Consequently, manufacturing exports in the country gathered momentum supported by an ever increasing inflow of FDI. The manufacturing sector's contribution to total exports increased to 93 per cent by 2005 as against about 47 per cent in 1986. Of the total export by the manufacturing sector, about 59 per cent was by foreign invested enterprises (Zhang 2006). The growth in manufacturing production and exports was further enhanced with the expiration of the Multi-Fibre Agreement (MFA) in 2005. As a result, the growth in the manufacturing sector and the developments in other related areas of the economy have generated higher employment and higher income to the average populace.

2. SOCIO-ECONOMIC IMPACTS OF CHINESE ECONOMIC GROWTH

There is no doubt that China has achieved miraculous economic growth in the recent past. However, doubts have been raised as to whether the accession to the WTO has significantly increased income and hence the well-being of the average Chinese population. It is also argued that higher income is brought about at a higher cost of deteriorating environmental standards which affect the health of the Chinese people, especially those who live in major industrial cities. Also, there is a wide spread perception that China's accession to WTO has significantly increased social shocks, especially among the farming community, which comprises 70 per cent of China's population, and contributed to poor health outcomes among the rural population. Moreover, studies suggest that the inequality in the distribution of economic benefits has widened after the introduction of far reaching economic reforms.

Spatial disparity is one of the widely discussed issues in terms of inequality in recent Chinese economic development. One aspect of the spatial polarisation is in the distribution of FDI itself. It is evident that the majority of the FDI flowing into the country is attracted by the eastern and coastal provinces and, hence, the benefits of economic growth are not trickled down to the people living in the inland and western

provinces. As cited in Graham and Wada (2001), FDI has significantly benefited the coastal regions, while most of the rest of China has benefited much less. Lemoine (2000) and Dayal-Gulati and Husain (2000) provided evidence to suggest that this outcome is not wholly the consequence of natural locational advantages held by the coastal provinces, but it is, in part, the consequences of deliberate Chinese policy. In such a situation, policies more favourable to minimising an unequal distribution of FDI should be formulated and implemented soon. Even more recent studies suggest that this significant unequal FDI distribution still exists, and sufficient policy changes have not been introduced to address the issue. For example, Wei et al (2008) examined this issue using a large panel dataset covering all the Chinese regions over a much longer period since initial policy reforms in 1978 (1979-2003), and concluded that FDI is highly unevenly distributed across the regions, with a very small share in the west region. Hence, it is this uneven distribution of FDI, rather than FDI itself, that has been the cause for regional income inequality. The study clearly stressed that FDI has to be directed to the west and central regions through preferential policies, and government intervention is needed to create a better environment for absorbing FDI to these relatively backward areas.

Another factor that seems to reinforce the unequal distribution of the economic benefits of policy reforms is some existing policy barriers themselves that inhibit movements of labour between urban and rural areas. As Martin et al (2004) observed, the Chinese labour market has been adversely affected by the various types of regulations that restrict the movement of workers from rural to urban areas³. Another hindering factor is the restrictions on the sale of farmland usage rights. Due to these restrictions, the farm families that move permanently out of agriculture may have to give up their land rights with no compensation (Martin et al 2004). At the same time, earnings of rural and urban households differ extensively, even for households with labourers of similar skill levels (Sicular and Zhao 2002). Thus, as Martin et al (2004) pointed out, the significant barriers that exist between urban and rural labour markets, particularly for poor

³ For example, '*hukou*' system of residence permits regulates movements between urban and rural employment.

households, depress income levels and make it more difficult for workers to respond positively to economic challenges and opportunities that emerge.

The consequences of the uneven conditions in the Chinese labour market, in the rural sector in particular, should have adverse effects on poverty. Apparently, there exists a sharp contrast between urban and rural households in terms of the incidence of poverty (Martin et al 2004). Studies that reviewed the impact of WTO accession on income distribution and poverty revealed that most urban households and those who are relatively poor in particular, gained more from WTO accession. But it was not the case for rural households, the poorest of which experience noticeable reduction in their living standards. Further, these reductions reflect a combination of falling rural wages and an increase in the prices of goods consumed by poor households. (Chen and Ravallion 2004; Ianchovichina and Martin 2002)

Inequality and the incidence of poverty could easily lead to deterioration in the level of human well-being, including health, education and welfare. Although income inequality in China has been widely studied over the years, existing evidence suggest that studies on the impact of income inequality on other dimensions of human well-being are limited. Zhang and Kanbur (2005) provided some important insights in this regard. In general, Zhang and Kanbur (2005) find that inequalities have increased across provinces and within provinces, between rural and urban areas and within rural and urban areas since the beginning of the reforms. Until the 1980s, China's distributional policies had a strong bias towards urban residents, and compared to the level of social expenditure in cities, rural areas received far less. Despite the government's certain (and limited) measures to minimise this gap, it seems to be widening with accession to WTO. After the policy reforms, most rural residents have been left out of healthcare coverage of any kind and paying for a health visit has become the norm (Zhang and Kanbur 2005). This implies that increasing rural income inequality would translate into increasing health inequality, as village authorities do not have much fiscal power to provide public goods and services in poor areas under current fiscal arrangements. With the economic policy reforms, access to education and health care by the rural populace has further declined.