

## 59. *Economic Policy toward China*

### ***Congress should***

- normalize trade relations with China by ending the annual recertification process,
- accelerate China's entry into the World Trade Organization by dropping accession criteria that are inconsistent with the nondiscrimination principle,
- phase out protectionist measures against imports from China and against U.S. exports to China,
- avoid trade sanctions and use alternative measures to resolve disputes and to show displeasure with China's human rights violations, and
- recognize that advancing economic freedom in China has had positive effects on civil society and personal freedom.

In the next 20 years, China could surpass Japan as the second largest trading nation, and between 2020 and 2030 the People's Republic could emerge as the world's biggest economy. To do so, however, China must continue to liberalize its economy, establish a modern financial system with a sound currency, and conform to international norms for protecting property rights. The United States should help move China in the direction of greater economic and personal freedom by adopting a consistent, long-run policy that normalizes trade relations, integrates China into the global trading order, and promotes exchange on a broad front.

Congress should uphold the principle of free trade and defend human rights; trade sanctions should be used only in extreme cases and only when they have a high chance of success. Too often well-intended sanctions end up harming the parties they were designed to help and delaying real reform.

The U.S. policy of engagement has been successful and should be continued and deepened. Congress should not let the bilateral trade deficit

with China interfere with that strategy. Any movement away from freer trade and toward protectionism would only delay China's progress toward freedom and prosperity and harm the global economy.

### ***Normalize Trade Relations***

The annual debate over China's trade status, necessitated by the Jackson-Vanik amendment to the Trade Act of 1974, should be ended in favor of establishing permanent "normal trade relations" with China. Congress should repeal the Jackson-Vanik amendment as a relic of the Cold War. That amendment was designed to deny most-favored-nation (MFN) trade status to communist countries, notably the Soviet Union, in order to encourage more open emigration. In fact, Jackson-Vanik was not an important factor in the collapse of the Soviet Union and is unsuitable for China. To deny people the right to trade because their government denies them the right to emigrate is a lose-lose policy for promoting human rights.

President Clinton's decision in 1994 to delink trade and human rights and the decision of Congress in 1998 to substitute the term "normal trade relations" (NTR) for MFN were steps in the right direction. Now Congress must act to reduce uncertainty in U.S.-China economic relations by ending the annual NTR certification spectacle and making NTR unconditional and permanent. Both Hong Kong and Taiwan support such a move and would benefit from it.

### ***Accelerate China's Entry into the WTO***

In recent years, China has begun to liberalize its foreign trade regime by expanding the number of foreign trade corporations (which now number in the thousands), allowing large state-owned enterprises (SOEs) and a number of foreign-affiliated enterprises to have direct trading rights, and reducing tariff and nontariff barriers to trade. According to the World Bank, China's trade-weighted average tariff declined from 31.2 percent in 1992 to 19.8 percent in 1996 and is scheduled to drop to 16.2 percent by 2005. Furthermore, China has promised to eliminate most of its nontariff barriers upon accession to the WTO. However, China continues to offer SOEs a high level of effective protection for fear of social disruption.

China's growing foreign-trade sector has been led by foreign-invested firms and domestic nonstate enterprises, especially township and village enterprises. State enterprises have done little to spur export growth and remain uncompetitive. The inefficiency of SOEs and the large number of

workers they employ, especially in urban areas, have made SOE reform essential but politically difficult.

China's domestic problems, including the need to restructure and recapitalize banks, may slow its progress toward meeting the criteria for accession to the WTO. Yet, in the long run, it is in China's interest to be a member of the WTO. It is also in the interest of existing members, especially Hong Kong, to have China join the WTO and abide by international norms and rules.

The United States can accelerate China's accession to the WTO by applying to China the same rules for accession that are applied to other members, thereby adhering to the nondiscrimination principle, which lies at the heart of a liberal trading order. In particular, Congress should reject the stringent requirement that China accept special "safeguard" provisions for imposing tariffs or quotas on its exports in order to qualify for WTO membership. Congress should also reject the requirement that China be admitted to the WTO only as a developed country rather than as a developing nation. China's size and power require special attention, but China is still a poor country, as measured by per capita income, and should be admitted as a developing country—if the WTO is to honor its commitment to nondiscrimination.

By taking those two steps, Congress would open new avenues for bargaining and would help accelerate China's accession to the WTO. Membership would give China a greater incentive to "play by the rules" and to further liberalize trade. Keeping China out of the club, because current members fear the added competition, would undermine the credibility of the WTO. Denying China access to the WTO will not foster China's nascent market economy. If China is willing to further reduce its tariff and nontariff barriers, and some compromise can be reached on the speed with which SOEs are to be dismantled, mutual gains from accelerating China's entry into the WTO will result.

Bringing China into the WTO will contribute to the growth of the nonstate sector and put further pressure on China's leaders to dismantle SOEs and strengthen property rights by adopting more transparent rules. In turn, the price system will work more efficiently, trade will be more in line with comparative advantage, and both China and its trading partners will share in the increased wealth from greater specialization and exchange.

### ***Repeal Protectionist Measures against China***

Instead of waiting for multilateral agreements to liberalize trade with China, the United States should immediately begin to phase out protection-

ist measures against China. Restrictions on imports from China harm U.S. consumers, and banning exports to China that pose no serious security threat injures American industry. Congress should review U.S.-China trade policy from a free-trade perspective and recognize that the gains from freer trade will far exceed the short-run adjustment costs of lowering trade barriers.

The World Bank calculates that if the United States and other signatories to the Multi-Fibre Arrangement abolished quotas, China could use its comparative advantage in apparel to generate significant benefits for itself and its trading partners. Indeed, a simulation study by the bank found that abolishing quotas under the MFA and eliminating restrictive trade practices in China could produce net benefits for China of up to \$116 billion a year by 2005, and gains to the world trading order could reach twice that amount.

MFA quotas are being phased out by 2004, but the reductions are back loaded so that most of the decreases come in the last few years. Congress should push for accelerating the phaseout so that the gains to the world economy can come sooner rather than later.

The United States restricts a considerable amount of sales to China by citing national security and foreign-policy goals. While some of those goals, such as preventing China from acquiring sensitive missile technology, are no doubt legitimate, many simply serve to protect special interests and cost the American economy billions of dollars in lost business. The Institute for International Economics found that controls on U.S. sales to China have had only a small impact on achieving foreign-policy goals but have cost American businesses up to \$13.5 billion per year in lost export sales.

China has unilaterally reduced its tariff and nontariff barriers to trade; the United States should do the same. There will then be greater scope for agreement in nontrade areas as trade expands. History has shown that freer international trade has positive spillover effects and is a key factor in reducing world tensions and bringing about a more civilized dialogue among nations. U.S.-China economic relations could benefit from that lesson.

### ***Avoid Trade Sanctions to Advance Human Rights***

The use or threat of trade sanctions to advance human rights in China has done relatively little to change policy in Beijing. Congress should consider alternative measures to improve human rights in China.

Trade sanctions are a blunt instrument; they often fail to achieve their objectives and end up harming the very people they are intended to help. Placing prohibitively high tariffs on Chinese products entering the United States, in order to protest China's dismal human rights record, would cost U.S. consumers billions of dollars and slow the growth of China's nonstate sector, which has allowed millions of Chinese to move to more productive jobs outside the reach of the Communist Party. Isolating China would reverse the progress that has occurred since economic reform began in 1978 and would create political and social instability.

A better approach is to continue to open China to the outside world and, at the same time, use nontrade sanctions and diplomacy to advance human rights. When China violates trade agreements or intellectual property rights (IPRs), however, it should be held accountable, and carefully targeted trade sanctions may be warranted.

The piracy of intellectual property is a serious problem for Western firms. China has been a major offender of copyright laws and needs to comply with the rule of law. China's membership in the WTO should be conditioned on China's adherence to international law. The problem is that most less developed countries, and even some developed countries, violate IPRs. Using economic sanctions to punish pirates sounds good in theory, but in practice sanctions are seldom effective. The real solution to piracy may have to wait for technological changes that make it very costly to steal intellectual property and for the rule of law to evolve in China and other less developed countries.

As China develops its own intellectual property, there will be a demand for new laws to protect property rights. The uncertainty created by China's failure to protect IPRs can only harm China in the long run. Investors will not enter a market if they cannot reap most of the benefits of their investments. Fan Gang, an economist at the Chinese Academy of Social Sciences, predicts that things will change in China as people discover that clearly defined and enforced property rights are to their advantage:

[People] are bound to find that all this cheating and protecting yourself from being cheated consume too much time and energy, and that the best way to do business is playing by a set of mutually respected rules. New rules and laws will be passed, and people will be ready to abide by them.

The United States has considerable leverage in dealing with China and should not let China dictate U.S. foreign policy—for example, toward Taiwan—or allow human rights to be a nonissue. The United States is

China's largest export market, and U.S. investors rank third in foreign direct investment in China. Clearly, China would be harmed by any significant cutback in trade with and investment from the United States. The problem is that any sizable cutback would also harm the United States and the world economy.

To avoid the high costs (and low probable benefits) stemming from the use of trade sanctions, Congress should consider using nontrade sanctions such as cutting off the flow of taxpayer-financed aid to China—including aid from the International Monetary Fund, the World Bank, and the Asian Development Bank—and making public the names of companies known to be using prison labor or companies run by the People's Liberation Army so that U.S. consumers could boycott their products. The China Sanctions and Human Rights Advancement Act (S. 810), introduced in the 105th Congress by Sen. Spencer Abraham of Michigan, lists those and other measures designed to move China toward a free society. The 106th Congress should return to that and other legislation designed to change China's stand on human rights and to liberate the Chinese people from religious and political prosecution. (The passage of H.R. 2647, one of four "Freedom of China" bills enacted by the 105th Congress as part of the 1999 Defense Authorization Act, is a step in the right direction. That bill requires publication of the names of PLA-run companies operating in the United States.)

### ***Recognize That Economic Freedom and Personal Freedom Are Inseparable***

The freedom to own property, to use it, and to exchange it is a fundamental human right. When the state owns all property, dictates its use, and prohibits voluntary exchange, no one is free. Congress should recognize that advancing economic freedom in China has had positive effects on the growth of China's civil society and on personal freedom. According to Chinese dissident Wang Dan, "Economic change does influence political change. China's economic development will be good for the West as well as for the Chinese people."

Today, millions of Chinese are able to travel freely, own their own homes, choose their own clothes, show affection in public, select their course of studies, and work where they want to. Economic life and social life are less politicized, and people can look toward the future with greater confidence than they could in the past. Commenting on China's cultural transformation, Jianying Zha writes in her book *China Pop*:

The economic reforms have created new opportunities, new dreams, and to some extent, a new atmosphere and new mindsets. The old control system has weakened in many areas, especially in the spheres of economy and lifestyle. There is a growing sense of increased space for personal freedom.

No one will deny that China has a long way to go before its people are truly free. But restricting trade is not an effective way to move China in the right direction. Trade can help to familiarize the Chinese with Western values and the rule of law, and Western firms can help to spread the ethos of liberty to China. Moreover, as a middle class develops in China, there will be pressure for political liberalization, just as there was in Taiwan and South Korea. Congress, therefore, should listen to Taiwanese president Lee Teng-hui, who recently said,

Vigorous economic development leads to independent thinking. People hope to be able to fully satisfy their free will and see their rights fully protected. And then demand ensues for political reform. . . . The model of our quiet revolution will eventually take hold on the Chinese mainland.

## **Conclusion**

The fact that there is a link between economic freedom, economic growth, and political liberalization does not mean that China will be transformed overnight. Ultimately, the Chinese people will have to determine their own system of government. But in the meantime, Congress and the American people should exercise moral leadership and help to educate the Chinese people about the differences between an economic, social, and political order based on consent and one based on coercion.

At the forefront of that educational effort should be an understanding of the principle of spontaneous order—that is, the idea that once the institutions of private property and freedom of contact are established, and government is limited by the rule of law, or what Nobel laureate F. A. Hayek called a “constitution of liberty,” the price system will operate to coordinate the actions of millions of individuals and increase personal and national wealth.

China’s own ancient Taoist tradition should make the concept of spontaneous order appealing. In the *Tao Te Ching*, written more than 2,000 years before Adam Smith’s *Wealth of Nations*, Lao Tzu instructed the sage (ruler) to adopt the principle of noninterference as the best way to achieve happiness and prosperity:

Administer the empire by engaging in no activity.  
 The more taboos and prohibitions there are in the world,  
 The poorer the people will be.  
 The more laws and orders are made prominent,  
 The more thieves and robbers there will be.  
 Therefore, the sage says:  
 I take no action and the people of themselves are transformed.  
 I engage in no activity and the people of themselves become prosperous.

Indeed, the popularity of Hayek's *Constitution of Liberty* in China (more than 20,000 copies have been sold) shows that China is ready for further movement toward market liberalism and away from market socialism.

In an interview in the *Asian Wall Street Journal*, on June 12, 1998, the chairman of China's Unirule Institute, Mao Yushi, stated that, in establishing the relative priority of liberty and democracy, "liberty is more important." For him, and others who have lived through the Cultural Revolution and experienced 50 years of Chinese communist rule, "the gradual introduction of a rule of law and order is the most important [reform]." Drawing on Hayek's work, he notes, "The idea that we should expect the sudden arrival of freedom is simplistic. We need to build up the order [spontaneously] from the bottom, with experience and the exchange of information from different cultures and systems."

The fact that Hayek's ideas are being openly discussed and taking root in the People's Republic of China attests to the positive effect the U.S. policy of engagement is having in moving China toward a more open society. Congress could improve that policy by permanently normalizing trade relations with China, accelerating China's entry to the WTO, ending U.S. trade restrictions against China, and using measures other than trade sanctions to resolve disputes and to advance human rights in China.

### **Suggested Readings**

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