Economic Globalization, Marketization Reform and Economic Development in China

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I. Introduction

Economic globalization is one of the hottest topics among academics, government agencies and other concerned organizations. In the past half-century, the barriers to international trade and international investment have virtually been removed in developed countries, and greatly reduced in emerging countries. Investors from developed countries can invest freely in emerging economies, both directly and through purchasing various securities. Large companies in emerging economies can also acquire funding in the stock markets of developed countries. This leads to a great increase in trade and capital mobility. While emerging countries benefit greatly from international trade when international capital freely-flows, they also experience the negative impact of trade globalization on their indigenous industries, especially the impact of financial globalization on capital inflows and outflows. For example, in 1996, the net capital flows into the emerging countries in Asia were as high as 62.4 billion US dollars, while in 1998 the capital flows out of those countries were 46.2 billion US dollars (IMF, 1999). This kind of radical fluctuation makes people evaluate the economic liberalization and globalization very differently. Those who support the economic liberalization and globalization regard them as a panacea, while others view them as the cause of many of the world's problems, especially as the main cause of fluctuations and economic crises. They think the solution to global fluctuation and economic crises is re-imposed regulations and control of international trade in goods and capital flows among countries. The debate over globalization is manifest in academics, government agencies, World Bank, IMF, as well as in public demonstration against the WTO in Seattle in the Fall of 1999. All of these demonstrate great divergence in people's attitudes towards economic globalization. Although some economists believe deregulation of trade in goods should be encouraged, they also hold the belief that complete financial liberalization should not be encouraged (Stiglitz, 1998; Krugman, 1998).

This paper investigates whether the overall benefits of economic globalization are greater than their costs, and discusses the interaction among economic globalization, economic development, and marketization reform in China, so as to present an answer to the question of how China should participate in economic globalization.

The remainder of the paper is as follows: In Section 2 we discuss the benefits and costs of trade and financial globalization and the best way of reducing risks, fluctuations, and economic crises which may be caused by globalization. We will discuss if economic fluctuations and crises are due to globalization or due to the imperfect economic and political institutional environment of a country that is either in the process of transition to a market-oriented economy or is an emerging economy. Our answer is the latter. Hence, the best way to reduce and avoid financial crises is to perfect the economic system and improve the economic and political institutional environment through reform rather than through government interference and regulation. Although improvement in economic and political institutional environments does not necessarily avoid economic crisis, it can alleviate and buffer the impact of the crises. The benefits of economic globalization are long run phenomena while the costs of financial crises are short-run phenomena. In Section 3 we answer the question of how to evaluate the impact of economic globalization and China's entrance into WTO on China's economic development, and will also discuss how various industries in China will be affected. In Section 4 we discuss the interaction between economic globalization and marketizaton reform in China and provide some policy implications and recommendations on how to reduce the negative effects of economic globalization on China's economic development. We believe that the best way to reduce economic fluctuation is to continuously improve the economic and political institutional environment so as to allow the market to operate efficiently and the private funds to be used efficiently through profit maximization. Discussions and concluding remarks will follow in Section 5.

II. The Benefits and Costs of Economic Globalization and Their Evaluation

Economic globalization consists of international trade liberalization and international financial liberalization. In this section we present a general analysis and comparison of the benefits and costs of these two aspects.

2.1 The Benefits of International Trade Liberalization and its Evaluation

2.1.1 The Benefits of International Trade Liberalization

The divergence of attitudes towards international trade among western academics is insignificant. No matter if it is Adam Smith's absolute-comparative-advantage theory, Ricardian's relative comparative advantage theory, neo-classical-trade theory, or Krugmann's returns to scale and imperfect competition theory, they all tell us that, in terms of maximization of social welfare and the allocation efficiency of resources, free trade is the optimal choice. Due to the absolute or relative differentiation in production, the difference in the ratio of factors of production, the difference in production scale, the change and transfer of production technologies, the difference in income level among different countries, the difference in their preferences for commodities, the difference in government policies or even differences in economic environments, there exists differences in production cost and the prices of goods among various countries. These lead to a country that has comparative advantage on certain kinds of products or has a different demand on certain commodities, thus it makes the division of international labor and international trade possible, further promotes a country's economic development, and improves the social welfare of the country.

2.1.2 The Costs of International Trade Liberalization

Since all international trade theories tell us that free trade is the optimal choice in terms of social welfare maximization and the efficient allocation of resources, and any policy that interferes with trade by a country will cause losses to the social welfare in the country and other countries, why do most countries still implement some protection policies on international trade? The main reason is the concern that free international trade may damage or hurt those domestic industries in which imported goods have a competitive disadvantage, as well as "still-in-embryo" industries. For a developing country, many industries are backward or in embryo. If free trade and competition are allowed, they may be destroyed or killed while still in embryo, with no hope of growing up. Only if the government protects these industries for a period of time, until they become mature, will they not be afraid of competition. Although there is a certain cost for such a protection in the short-run, it may still be necessary in terms of long-term benefits. Other concerns about international trade liberalization include possible impact on the employment level inside the country, and trade deficit. Besides these economic considerations, they also worry about non-economic costs. They worry that free trade may impose a negative impact on their country's politics, culture and society such as national integrity, social equity and national safety.

2.1.3 Evaluations on the Benefits and Costs of International Trade Liberalization

Trade protection can defend domestic industries from outside world competition. But the costs, the loss to consumers, and social production inefficiency, are usually greater than those gained by the producer through government customs. Once enterprises are protected by the government, they do not need to compete with foreign firms, and thus they have less incentive to improve economic efficiency. Furthermore, the social cost of trade protection may be very high since these firms do not have incentive to introduce new production technology and learn new knowledge. For instance, in recent years the rapid advances in telecommunications technology surely improves the production efficiency of the whole economy. Although protecting these industries may benefit one sector's interests, it prevents improvement of the whole society's efficiency. The costs can outweigh the benefits by a wide margin. Even if protectionism might be plausible theoretically, due to the imperfection and asymmetry of information, it is difficult for a government to choose which industries should be protected and how to protect them when protectionism is carried out. As a result, what we lose likely offsets what we gain in practice. All in all, economic development of a country should depend on improving its efficiency rather than on protecting the backward industries. To open to the outside world and to participate in international competition are the most effective ways to improve a country's efficiency.

2.2 The Benefits and Costs of the International Financial Liberalization and Their Evaluation

2.2.1 The Benefits of the International Financial Liberalization

Although there is not much divergence on international trade liberalization, there is a significant academic dispute on international financial globalization. Until Asia's financial crises took place in 1997, economists held a positive attitude toward the integration and globalization of financial markets. Generally speaking, the financial globalization can mainly bring the following three benefits: (1) Capital mobility improves the efficiency of investment in the presence of risk, and hence it promotes a country's economic development and growth. By absorbing foreign capital, a country can increase its investment, and hence increase its production. (2) The internationalization of foreign direct investment and diversification of international securities can diversify the risk of investment and reduce the costs of using capital. (3) Capital mobility can improve the corporate governance in that country. Advanced foreign production technologies and management skills can be introduced into the country along with capital, and thus it improves the operation and management abilities of domestic companies. In the following, we give a brief discussion, and detailed discussion can be found in Stulz (2000).

The Free Capital Mobility Leads to an Increase in Investment in Poorer Countries

When all countries have the same aggregate production function and each country consumes the same fraction of its wealth, the wealthier countries need more investment. Therefore, due to the law of diminishing marginal return, the marginal return of investments in developed countries is lower than those in developing countries, therefore developed countries have a lower return on their capital. Since the rate of return on capital in poorer countries is higher, the investors in developed countries have an incentive to invest in poorer countries. As a result, free capital mobility increases the wealth of developing countries. Since the rate of return on capital of investors in developed countries also increase, it increases the wealth of the developed countries, and thus the wealth of the whole world increases.

Free Capital Mobility Leads to a Decrease in Investment Risks

When a country opens up its capital markets to foreign investors and allows its residents to invest abroad and enterprises to collect funds in foreign countries, the domestic investors no longer have to bear all the risks involved in the economic activities of the country; foreign investors also share some of these risks. In exchange, domestic investors, by buying foreign securities, bear some foreign risks. Because of diversification resulting from access to the global capital market, domestic investors can arrange their own investment portfolio to have less risk for the same expected return.

Free Capital Mobility Leads to Improvement of Corporate Governance

Capital flows among countries can also improve a country's production level and the efficiency of corporate governance. Advanced foreign management skills and experts can be imported, along with foreign investment, and thus the management ability and corporate governance can be improved. Foreign direct investment, newly developed products, advanced production technologies, and effective managerial mechanisms can be brought into so that developing countries can fully use their untapped resources and labor, resulting in the fledgling of the economy in the countries. Capital mobility also reduces the comparative disadvantage of capital-intensive products and increases the comparative advantage of labor-intensive products in developing countries, and consequently it reduces imports of capital-intensive products and exports of labor-intensive products. On the other hand, if the foreign capital is invested in labor-intensive products, capital flows can strengthen the comparative advantage of labor-intensive products and further promote exportation of developing countries. Furthermore, foreign capital inflows and the entry of foreign enterprises foster competition in financial and product markets, and thus they improve the efficiency of capita usage and production. Capital mobility can also improve legal and regulatory systems and integrate them into the outside world. To attract more foreign capital, a country needs to create a good investment environment and protect the interests of investors and shareholders so that a country must have an unbinding mature legal and regulatory system. If a legal system is imperfect or binding, contracts between enterprises may not be enforced, the managers will misuse their power for their own interests, and the investors are thus exposed to an increased risk of loss.

2.2.2 *The Costs of Financial Globalization*

While the benefits of free financial liberalization are clear, the costs and the factors that result in the costs are not easy to identify and evaluate. The main negative effect of opening up the financial market in developing countries is that it may lead to large-scale fluctuations in an economy: a dramatic increase in investment is followed by dramatic reduction, and large capital inflows are followed by the same scale of capital outflows. This immense fluctuation in capital may lead to a global financial crisis or regional crisis; the currency crisis or bank crisis in one country can rapidly spread to other countries. Once such crises happens, large amounts of foreign funds escape, interest rates rise, the currency depreciates, foreign reserves drop drastically, large numbers of corporations are shut down, workers lose their jobs, the living standards fall and economic growth slows down. The financial crises that took place in Asia and Latin America in recent years have shown the seriousness of the problem.

2.2.3 The Evaluation of the benefits and Costs of International Financial Liberalization

Because of the destructiveness of financial crises, many policy makers and economists have questioned whether the financial liberalization process has gone too far and whether controls on capital flows should be reintroduced. They think the costs of the liberalization of the financial markets in emerging countries may overwhelm its benefits. They call for a stop or a slowing down of the process of globalization and liberalization in financial markets. While some economists argued that financial liberalization reform should be implemented step by step, some call for greater regulation of capital flows. Is the call for slowing down financial liberalization justified? Only after this question is answered, can people decide whether the costs of financial liberalization offset the benefits.

The main concern about financial liberalization is that capital flows cause economic fluctuation. In the following we will determine if capital flows cause economic instability, and if so, why they cause such a problem. Roughly speaking, capital can flow through three ways of investment: foreign direct investments, investments in stock market, and investments in bonds. In general, foreign direct investment and investment in stock markets cannot cause direct and remarkable economic fluctuation. Most foreign direct investments are middle or long run investments. When the economic environment changes suddenly, it is very difficult or costly for the foreign investors to withdraw their capital immediately since they are constrained by contracts, or capitals have become real material and thus they can make little contribution to economic fluctuation. Economic data in the real world also demonstrated that during the Asia financial crisis; foreign investment in Southeast Asia actually increased from $16.6 billion in 1997 to $18.2 billion.

Capital flows may increase volatility in stock markets, and consequently may have a negative impact on economic growth and development. But recently, many empirical tests by academics show no remarkable statistical correlation between the opening up of financial markets and volatility in stock markets. (Behaert and Harvey, 1998, 2000 and Kim and Singal, 2000).

Although direct foreign investments and investments in stocks cause no significantly harmful fluctuation; bank debt and short-term debt do cause immense fluctuation. From 1988-1997, foreign debt to emerging markets went from $1 trillion to $2 trillion. Much of the increase was short-term debt. As a result of the role that short-term foreign debt played in the Mexican and Asian financial crises, many have argued that short-term debt should be somehow regulated or limited, and mid- or long-term debt should be encouraged. We argue here that regulating short-term debt alone is not the appropriate solution. A domestic corporation cannot issue as much mid- or long-term debt as it wants. Such a suggestion is based on the superficial phenomenon of the issue, it does not find out the fundamental cause of the problem. Before giving the reasoning, we first explain why short-term debt can be a cause of economic instability.

There is a fundamental difference between a reversal of equity flows and a reversal of debt flows. When foreign investors sell their stocks in a country, the firm whose stocks are sold does not have to give the money back. The departure of foreign investors decreases stock prices, but this does not have an immediate impact on the operation of the firm. To the contrary, when lenders of debt leave a country, they take with them the money paid to them by the borrowing firms, and these firms then have to find new funds to replace what they lost. So, equity outflows do not lead to default and bankruptcy; debt outflows do. When debt has to be repaid, a firm may be in a situation where it cannot borrow funds because it would not be able to pay the interest that lenders require, and it may have to be bankrupted. This situation could occur in emerging markets if the company is facing difficulties or if investment in the country has become more risky. When an economic crisis takes place, due to the shortage of capital in the market, the interest rates may be up to a very high level. The company which has already had a large burden of debt may not bear such high interest rates, or lenders may not want to issue new funds to the firm since they may doubt the ability of the company to repay them. Of course, to avoid these kinds of risks, companies limit their leverage and choose the maturity of their debt or have the internal funds to do so. For instance, firms can adopt a portfolio of short-, mid- or long-term debt. If a company expects its situation will improve in a short period of time, they would prefer to choose short-term debt, because they expect they will get better terms when they refinance. Otherwise, companies would choose mid- or long-term debt. However, though mid- or long-term debt provides a company more flexibility, lenders will face a high risk due to the long duration of the loan. Shareholders and managers can take advantage of bondholders in many ways. For instance, a firm will issue a long-term debt when it expects the situation of the firm to worsen, and managers of the firm can extract private benefits from controls that limit cash flows available for bondholders. Also, poor managerial decisions may lead to increased risk of bankruptcy or default by the firm. When bondholders expect they will be taken advantage of, they will require a higher interest rate which the company cannot bear. Even if the company can bear such a high price, due to information asymmetry, the bondholders may worry about the high risk the firm may default debt, and thus they are unwilling to lend long-term debt to the company. Of course, the company, in order to get loans at low costs, may attach covenants to the debt that restrict managers of the company to expropriate bondholders so that the rights of bondholders can be guaranteed. However, covenants are only valuable if they can be enforced. If covenants cannot be used to reduce the cost of long-term debt, firms have to borrow short-term bonds. Thus, if a country is such that covenants cannot be enforced, it is likely to be a country with poor legal systems where long-term debt is a high cost sources of funds. The risk of short-term debt is smaller to the bondholders because the bondholders can control the behavior of the company relatively easily through buying or selling debt. This is why short-term bonds are the main means by which emerging countries get funds. Because financial institutions in emerging countries are immature or imperfect, the costs of long-term debt are higher; companies in emerging countries have to choose short-term bonds.

Unfortunately, when a country has limited foreign exchange reserve, or it has a fixed foreign exchange rate, the phenomenon of large amounts of funds running away will take place there. Once this happens, a large number of companies default or bankrupt, due to lack of cash to repay their debt. At the same time, the domestic currency may suddenly be devaluated, and interest rates for funds rise, and consequently it leads to drastic instability in stock markets. That is the main reason why the Mexican and Asian financial crises happened. Many people propose to reduce short-term debt and increase long-term debt. But based on the discussion above, we know that the immature financial systems in emerging countries cannot support long-term debt for corporations, and thus short-term debt is a crucial financing tool in emerging countries. Therefore, the ultimate solution is to improve the financial institutions and the legal systems of emerging countries rather than to limit financial liberalization. For creditors to be willing to make long-term loans, they have to be assured that bankruptcy rules lead to efficient resolutions of bankruptcies, that large shareholders cannot expropriate them, that inflation is under control, that political risk is minor.

From the above discussion, we know that the benefits of globalization are remarkable, and its costs can be insignificant, dependent on whether the economic and political institutional environments are perfect or not. Trade protectionism may shelter domestic industries from competition from foreign industries, but the price is the loss of consumers' benefits and social production efficiency, which is often greater than the benefits gained by producers and through government's tariff protection. Since enterprises are protected, faced with no competition, they don't have incentives to improve production efficiency. Trade protectionism also has a large social cost: enterprises do not have incentives to introduce advanced production technologies and to renew their knowledge. Although such a protection can protect the interests of companies, it can retard the improvement of economic efficiency of the whole society; its costs outweigh its benefits significantly. The economic development opportunity of a country depends crucially on the improvement of economic efficiency rather than protecting the inefficient. Opening the economy and letting it to be involved in international competition are the most effective and fundamental ways to improve the economic efficiency. Economic withdrawals of funds is, of course, extremely painful for the countries that experience them. This does not mean, however, that a world where such withdrawals could not happen would be a more prosperous world in the long run. The fundamental solution is to perfect financial systems and improve the economic and political institutional environment. An economy with an imperfect or immature financial system does not support long-term debt, so it is fragile in fighting economic crises. A financial market isolated from the outside world can not support sustainable economic growth even though it can avoid the dramatic fluctuation of capital flows. The existence of large capital outflows certainly is not good to an economy, but this does not mean that an economy without this kind of capital outflows is more prosperous. (Just consider the fact that the pro-opening up of China and other countries with a closed economy can not catch up with the outside economically). The flip side of withdrawals is the existence of large capital inflows that enable countries to grow faster than they would otherwise and to help allocate capital efficiently throughout the world. The benefits of capital flows overwhelm its costs in the long run. Therefore, what a country should do is to take advantage of capital flows rather than to restrict it, as well as to reduce the chance and costs of capital outflows.

III. Economic Globalization and China's Economic Development

In the previous section, we have analyzed the benefits and costs of economic globalization. Once we know these, it should be easy for us to analyze the impact of economic globalization on China's economic development. China is now accelerating its pace of participation in the globalization process. What is the role and position of China in the wave of globalization? To what extent can China's economic structure be resilient? What is the impact of China's economic structural reform? These are the important questions faced by the Chinese academics and government policy-makers. Analyzing the motivation, the political and social psychology, the economic structural resilience for China's entrance into the WTO, and its impact on the economic and political situation of the whole world are also hot topics in the academic world. In this section, we emphasize economic globalization and the impact of China's entrance into the WTO on China's economic development.

3.1 The Impact of Economic Globalization on China's Economic Development

What criterion can be used to judge the benefits and costs for China to participate in economic globalization? We think a basic criterion is to see if it can improve economic efficiency, promote economic development and China's participation in economic globalization. Economic globalization has the following impacts on China's economic development.

1. *Conducive to promote the adjustment of the structure of enterprises* Through globalization, China will introduce competitive mechanisms more aggressively to make the economy and enterprise more vigorous. Opening up policy forces enterprises to seek their own future and development, adjust and reform their economic structure, and stimulate firms to develop their potential further. When China opened the appliance market to the outside in the early stage of the opening-up process, some worried about its impact; but the present situation is that exporting appliances have competitive advantage in international markets.

2. *Conducive to China's exports* China's participation in economic globalization will promote international trade, cultivate overseas markets, and abstract foreign capital. Since China's economic reform and open door to the outside, the trade between China and the outside world has been developing very rapidly; the ranking of China's trade volume has been climbing. The correlation between economic development and foreign trade has been growing closer and closer. Under free competition, labor-intensive products are more competitive in international markets, and exports have been increasing at a relatively high speed.

3. *Conducive to foreign capital inflows* Participation in economic globalization can create a better investment environment for foreign investors. Due to cheap labor in China, foreign investors' investment interests in China will increase once their benefits, rights, capital and intellectual property rights can be protected.

4. *Conducive to job creation* Along with an increase in foreign enterprises and joint-ventures, there will be more job opportunities in China. Since China's economic reform and opening up started, foreign enterprises have provided some 10 million job opportunities. Once China enters the WTO, more foreign companies will come to China, and consequently more job opportunities will be provided to Chinese people.

5. *Conducive to the improvement of international trade climate* Along with the spread of economic globalization over the whole world, the influence of the international trade climate on China's foreign trade is getting more and more important. China's products, due to low labor costs, have become main objectives against which some countries, especially the developed countries, discriminate. At present time, most major industrial countries, to some varying degree, adopt such trade-limiting policies towards China's as limited most-favored-nation status, anti-dumping-bonus measures. Once entering the WTO, China can protect its interests by using the relevant provision while fulfilling its obligations, demanding other countries change their discriminatory or unfair trade policies against China, fundamentally improving the trade environment, and promoting China's economic development.

6. *Economic globalization can promote China's financial market reform* The present financial system in China, especially its bank system, has become the main obstacle to China's economic development. China needs to open itself up, not only to the outside world, but to the domestic, allowing various owners to compete in product markets, financial markets, and other factor markets, and gradually eliminating the restrictions that Chinese are not allowed to set up private banks and insurance companies. Also the restriction that individuals cannot trade major agricultural products should be removed, and private companies should be allowed to compete with foreigners on the same stage.

To participate in economic globalization, China of course has to pay a certain price. As a result of globalization, trade is liberalized, tariffs are lowered, non-tariff barriers are removed, the exports of many industrial products increase greatly. So those protected industries, such as auto-making industries, agriculture, telecommunication, financial industries, insurance industries will be affected significantly. Some people worry that these industries will be controlled by foreign companies or foreign governments. In our opinion, such a worry is unjustified since every company takes profit as its criterion for making actions. Is any bank willing to lend money to China's state-owned enterprises that lose money? It is likely not. Russia's banking sector has been opened up for many years, and most foreign banks dare not go there even if they have been invited. As for the insurance industry, foreign companies will think repeatedly before they take an action. At the present time, Chinese people don't have a strong sense of obeying the law, so there may be many cases of forgery. So, in the early stage, we can expect very few foreign companies coming to mainland China to open a business. However, even if foreign banks and insurance companies come to China to open a business, it is a good thing. China needs more money, and the insurance sector in China is very backward. In such a situation foreign companies coming into China will have a positive impact on China's economic development and social stability. Another great concern is that financial liberalization may lead to financial crises. As an emerging economy, China may experience financial crises like that of Asia if it opens its financial markets. From the analysis given in the previous section, we know that such a concern is unnecessary as long as China continues to improve the economic institutional environment.

The inherent cause of financial crisis is the weak economic system itself rather than the financial liberalization. In order to reduce the possibility of the crisis, China needs to implement its opening and reforming policies, continue its economic liberalization and marketization reforms, and perfect its market economic institutions as early as possible.

3.2 The Impact of Participation in the WTO on China's Economy

The marathon negotiation for China to enter the WTO (previously, GATT) lasted fifteen years, while finally last year, a breakthrough was achieved. China and the USA endorsed a bilateral trade agreement, and the bill granting China permanent normal trade status passed by the US Congress on May 24, 2000 confirmed the trade agreement, and it is very likely that China will enter the WTO as expected. Although the 14-year negotiation did not make China a member of the WTO as it desired, it indeed, more rapidly, drove forward China's economic liberalization and market-oriented economic reform, and made China more willing to abide by international trading rules. After entering the WTO, China will exercise its rights and fulfill its obligations according to the essential principles of the WTO rules, (that is, market openness, non-discrimination, fair trade, etc.) both in exports and imports. This will have a far-reaching influence on China's economic development and economic structure. In the long run, it will improve the industrial structure, the product quality, and the labor quality of China's economy, hence promoting China's economic development. Since the opening up and reforming policy started, China's appliance and service industries have emerged as a new strong force in international competition. This provides strong evidence for our positive argument on globalization. In order to join the WTO, China has completed its bilateral negotiation with many members of the WTO on reducing both sides' tariffs. After joining the WTO, China will remove most of its non-tariff barriers and export bonuses, increase the transparency of its trade policy, open its service industry, expand the scope of intellectual property rights protection and loosen the restriction on foreign capital inflows, etc. We can see that China's joining the WTO is a milestone in the process of globalization, and will have a great influence on China's economic development and the adjustment of its economic structure. However, in the early stage of entering the WTO, China will encounter problems in two aspects. First, it will have difficulties in adjusting its legal and regulatory systems to match with the international legal and regulatory systems. At the least, it will have a difficult period of adaptation and transition because China is a very large country, the provisions of the WTO will probably not be strictly carried out by the local government and various other government departments or agencies even if the central government wants it to be carried out. No matter whether it is state-owned or a private business, legal agency, or local government, they will all be overwhelmed by so many new laws. Second, international competition will cause China's industrial structure to change. China's entrance into the WTO will lead more foreign products and enterprises into China, and will have a shock on some industries.

Besides those general benefits and costs mentioned in the previous subsection. Economic globalization will have the following more specific influences:

1. *Conducive to exports and lowering the costs of raw materials imported.* China's entrance into the WTO will create more room for China's exporting companies, providing a good environment for them to grow and develop. This is true, especially for those industries that have relative advantages such as the mechanical engineering sector, textile sector, etc. After entering the WTO, the quote restrictions by developed countries will be removed gradually. Not only will this revive many enterprises (like textile enterprises), but also create many job opportunities. China's joining the WTO will lower the production costs of the companies whose raw materials are imported from abroad, and so improve their production efficiency.

2. *For the enterprises that are until now aimed at domestic markets and are starting to compete with foreigner products, China's joining the WTO will offer them a severe test.* Foreign products brought into Chinese market by lowering tariffs and the removal of trade barriers will cause the companies to be shocked by the losses in their share of markets. This is especially the case for those still in embryo, industries like auto industries and hi-tech industries, but it may not be a bad thing. The existence of quota and other tariff barriers will lead to arbitrary imports and also lead to corruption. The real root cause for weak national industries is corruption, the backward technology, and lack of competition. In the long run, quota in trade cannot protect national industries. To the contrary, the enterprises that experience no competition will never be grown-up. Furthermore, the globalization of hi-tech products requires that their parts be circulated throughout the world. If the tariffs are too high, no one will come to invest and set up factories, and so there is no hi-tech industry. If so, how can China catch up with the developed world? In the short run, after China's entrance into the WTO, the industries affected by the lowering of tariffs and the removal of non-trade barriers include:

Hi-tech industries. Hi-tech industries are the fastest growing industry in China. After entering the WTO, tariffs will be zero and the practice of exchange market shares for foreign hi-technology and quota in export with foreign enterprises will be abolished. This makes the climate more favorable for hi-tech investment from overseas, and will attract more foreign companies to invest and set up factories, bringing in capital, hi-technology and advanced management techniques. This is conducive to the development of hi-tech industries, and benefits consumers in China. For example, at the present time, the telephone toll rate in China is seven times higher than the rate in the United States. Why is there such a great discrepancy? The cause is monopoly. Without competition, the quality of service cannot be improved due to monopoly. There is a sharp contrast between telecommunications inside and outside, so consumers are complaining. This problem also exists in other industries, but it is more acute in the telecommunication industry. Today is characterized by a knowledge economy, with the Internet and globalization. An expensive telecommunications service will impede the development of the economy because the spread of knowledge and information is increasingly dependent on telecommunication channels. A country's strength is directly dependent on how much information and knowledge its citizens have. After entering into the WTO, monopoly will be replaced by free competition in China's telecommunication market, and so it will feel more pressure to lower its prices and improve its service quality. The impact on the telecommunication industries will be mixed and far-reaching. On one hand, their market shares will be affected by foreign telecommunication equipment. On the other hand, the prices of their services will be lowered by a large margin and this will stimulate the growth in demand for these services and will then lead to an increase in the demand for the products of corporations. Furthermore, China's joining of the WTO will also drive companies to compete in international markets and to expand their market shares all over the world. For example, some Tele-companies listed on the stock market have begun to bid for large foreign Tele-projects and have succeeded.

Auto-industries: After entering the WTO foreign cars will pour in. At present, the tariff rate imposed on cars is 80 percent - 100 percent; after entering the WTO, it will be reduced to 25 percent before 2005 and the average tariff imposed on auto parts will be reduced to 10% and the quota on auto exports will be removed. This will intensify the competition in China's markets between foreign automobiles and that of China's. The top thirteen Chinese automakers account for 91% of its whole production at present and has become a scale-economy; the prices of automobiles in domestic markets are higher than those in overseas markets by only 20-25%. When taking into account the 20-25% tariff rate, we can see that the prices in the two markets are almost the same. In the coming years we can solve the issues concerning production scale and efficiency through selling shares to private business, merging, transferring to other industries and bankrupting. As a matter of fact, China's main automakers have already established joint ventures with foreign producers and to some extent have matched up with them. By way of joint venture China can solve the problem of capital and technology, and China can also take advantage of cheap labor. Therefore, the impact of China's entering the WTO on the auto industry may not be as large as some people expected.

Agricultural Products: At the present time, the tariff rates imposed on agriculture products are as high as 45%. After entering the WTO, within four years, the tariff rates will be lowered to anywhere between 16-17% depending on their kind. The agricultural products whose tariffs will be reduced can be divided into three categories. The first one is very competitive, like fruit; the second category includes those products whose prices at the places where they are produced are high, like meat, and so there may be no a big pressure from this category. The third category consists of products which are special to particular tastes of peoples, like dairy. Even if the prices are lowered by a large margin, their consumption may not increase. Besides, the quota of grain accounts for only 5% of the total grain production, and so pressure from this category is also tolerable. However, the pressure from vegetable oil and cotton is relatively heavy. China has advantages on labor-intensive agriculture (like husbandry, fish) rather than on land-intensive products (like grain, cotton, oil). Joining the WTO will promote the speed of China's agricultural industry, the transfer of the labor force in the countryside and the urbanization of China. China's agriculture population is about 70%. China must reduce its agriculture population in the process of modernization. The American population ratio is about 5%. Besides providing agricultural products for themselves, they also export the most agricultural products in the world. Taiwan's agricultural population has decreased from 80% to 15% while developing its economy. China must transfer most of their agriculture population to other sectors. Of course, building factories will occupy farming land and, as a result of it. China can't be self-sufficient in agricultural products. China will have to choose between factories and agricultural products. China needs not worry that no one will sell products to China. Foreign farmers will always do business if they can make money. If the United States did not sell products to China, China could purchase from Europe; and if Europe did not sell, China could turn to Vietnam or Thailand. Could it be that China is so unfortunate that no country will sell China Agricultural products?

Appliance: The impact on the appliance industry may not be large. Appliances made by China have almost caught up with those made overseas in quality, and the prices of them are far lower than those of their counterparts. After joining the WTO, the tariffs on imported appliances will be reduced and the advantage enjoyed by domestic products will be undermined. The advantage of foreign products in quality will offset their disadvantages in prices and so domestic products again are threatened. However, some large scale capital-intensive domestic appliance enterprises with advanced technology may have already successfully passed through the so-called protection period. Some of their products have begun to emerge in international markets. China's joining of the WTO will make it easy to enter international markets, expanding their market shares.

Chemical Industry: Big foreign companies have a marked advantage in R&D and the quality of products, that is why China always has a deficit in chemical products trading. The impact on China's paper manufacturing industry is mixed. The tariffs on timber and paper industry importing will be reduced from 12%-25% at present to 5-7%. The decrease in the price of wood pulp will be conducive to the development of paper-manufacturing industry, but the imports of foreign paper products will have a great impact on the paper products market.

Commercial and Service Industry: The prohibition on foreign enterprises to wholesale their goods will be removed so there will be fierce competition on the wholesale market. The foreign tourist industry, hotels and restaurants will enter Chinese markets in three years. They have advantages due to cross-country operation and their international management standards.

For the enterprises that imitate foreign technology to advance their technology, joining the WTO will be a test to their R&D capability since China's joining the WTO means the enforcement of intellectual property rights protection. Take the medicine industry as an example. After joining the WTO, the tariffs on pharmaceutical products will be reduced to 5.5-6.5%, and the imports of medicine products will increase greatly. Many medicine enterprises lack the ability to develop new drugs after entering WTO. They can no longer imitate foreign technology, they have to pay a large sum for the patents. There will be a great challenge for the pharmaceutical industry.

Conducive to the Development of Non-State Owned sector. After joining the WTO, the field of investment, the location of the investment and the shares the investor can hold will be flexible. This can promote China's so-called all-aspects multi-field, multi-level to open. More and more international companies and foreign investors will enter China and having a positive impact on domestic enterprises. Domestic private businesses should also be allowed to enter those fields which foreign companies are allowed to enter so they can develop more quickly.

Conducive to China's Deeper Involvement in Financial Globalization: After entering the WTO, China will allow foreign banks to run whatever banking service they would like, allow foreign banks to run KMB business after 2005, allow foreign insurance companies to hold more than 50% of the shares, and increase the number of cities where foreign banks and insurance companies can be set up. The opening up of banking and insurance markets will expand the channel through which China's security markets collect funds. The financial industry is an industry in which capital flows very quickly. In order to coordinate the growth of various departments, China should carry out an experiment with sino-foreign common funds on a limited scale. If successful, then China can gradually introduce foreign investing funds into securities markets to support the restructuring ownership of companies. Besides, after entering the WTO, China should take into account the whole picture of domestic/foreign interests rate and market situations when monetary policy tools like interest are used. The stock market may no longer be so insensitive to change in the interest rate as in 1998. With the development of markets, the effectiveness of using relevant policy tools to affect markets by the central government should be improved gradually. Stock markets, as an important part of the market economy, will surely react positively to the joining to WTO. China's success in joining the WTO will provide a good opportunity for an active stock market, and will play a positive role in developing a stock market.

Conducive to the Improvement of Economic Efficiency: We can expect that in the coming years, China's enterprises will polarize. The so-called law of "the superior remains and the inferior out" in competition will be in operation. Only those who have weathered international competition can survive in the market and those that are inefficient will inevitably be kicked out.

IV. China's Marketization Reform and Economic Globalization

In this section we will discuss the interaction between China's marketization reform and economic globalization. At the same time we will present our policy suggestions on how to reduce the negative impact of economic globalization on China's economic development.

From the above two sections we know that China's participation into economic globalization will greatly promote China's economic development and marketization reform. China's would-be joining of the WTO will provide an opportunity never before like for China's economic development, while it also presents a big challenge. The benefits of economic globalization are remarkable. However, without appropriate reforms, the price to pay would be huge. While people are enjoying the great benefits brought about by international trade and financial liberalization, they should also keep an eye on possible adverse effects like industrial crisis, unemployment, and the great instability of financial markets. Not only will China be faced with the competition brought about by economic globalization, but it will be also very vulnerable due to its weakness in economic structure. Then, how can China minimize its costs?

We think the most important thing is to further implement the liberalization and marketization reforms, to establish and improve a market economic system that fits within globalization. Reconstructing China's economic system may minimize the costs caused by the fluctuation brought about by economic globalization. A perfect modern market economic system is not just freeing prices, opening product markets and factor markets, or giving people economic freedom. It consists of a set of economic and political institutions. These include a market pricing mechanism, freely flowing production factor (like labor, capital) market, various kinds of economic laws and regulations, clearly-defined property rights system, modern firm system, macro-regulating system, tax-collecting system, anti-trust system, social security system, etc. Without a mature market system as a guarantee, the liberalization of international trade and finance would not yield the results people are expecting. This is because the free pricing mechanism can transmit economic information (concerning supply and demand) effectively, and a clearly-defined property rights system can provide incentives for the profit-maximizing investors to produce most efficiently, and competitive markets make consumers buy goods and services that satisfy their demand at the lowest price. Without competition, enterprises would have no incentive to improve production efficiency. So a freely competitive market system with clearly defined property rights make it possible for people to exchange products and production factors based on free choice and cooperation, that lead to efficient resource allocation. Of course, in order for the market system to operate normally and to ensure fair competition, there must be various laws and rules to guarantee that the interests of shareholders would not be usurped. The terms of contracts are abided by and the playing field is leveled, which is very important for attracting foreign capital. From the discussion above, we know that, without an authoritative system of laws and rules, business contracts cannot be strictly abided by and managers can abuse their power for their own interests which will increase the risks of usurpation faced by foreign investors. In such an imperfect economic institutional environment, foreign investors are unwilling to make long-term investments, which lead to vulnerability to economic crisis. Thus, we can say, whether China's economy in the process of globalization can develop rapidly depends on whether China can carry forward its marketization reform and liberalize its economy further, and whether China's economic environment can meet the requirements of globalization and can improve China's economic competitive ability. In doing so, we give the following policy suggestions:

1. *Financial Crises can have a very harmful impact on a country's economic development.* The best way to reduce economic fluctuation and the risk of financial crisis is to improve the financial systems and the legal and regulation systems. An imperfect financial system and an imperfect system of rules and laws will increase risks for foreign investors, and cause them to unwillingly make investments or long-term investments, which lends to vulnerability to economic crisis.

2. *Reform the state-owned enterprises so that its property rights are clearly defined, and privatize most of the enterprises.* State-owned enterprises all over the world are generally inefficient. The fundamental reason is that their property claims are not clearly defined, because anyone will be more careful when he spends his own money than when he spends someone else's money. The managers of state-owned enterprises are not really the owners of those enterprises. They do not have the spirit of entrepreneurship, and no one is responsible for loss or profits. Large amounts of state-owned assets are usurped, transferred and dominated by those privileged as a result of it. The playing field is no longer level, the wealth of the state was usurped by very few people. Social unfairness is becoming more and more severe. The issue of state-owned enterprises can only be resolved in the context of globalization and marketization. After China's joining of the WTO, the state-owned enterprises will have a hard time and there will be a more pressing need to reform them. State-owned enterprises must be privatized. A few years ago one of the authors of this paper had proposed to privatize middle and small-sized state-owned enterprises, but for large and middle-sized enterprises, let the government hold a special share which allows the government to have first claim on dividend but no role in direct managing the enterprises. That is, the shares held by the government can have claim on dividends, but can't have the right to monitor and control the enterprise. We should let investors shares determine the fate of the enterprises. The advantage of this approach is that it can guarantee that the state hold the majority of shares from ideological or political consideration and at the same time let those who are genuinely concerned with the future performance to monitor and control the enterprise. For more details, see Tian (1996).

3. *Minimize government's intervention, and let the market accomplish whatever it can.* Only when there is market failure, then the government has a role to play. Many people do not understand the role of the market well. The market is the most efficient incentive and information transmitting mechanism. It can provide information about what goods needed to be produced. When the economy does not work well, the government does not need to get involved in the economic activities, but provide a good environment to let the enterprises do their business in accordance with market rules, such as making standard rules for stock markets and property rights trading markets. They should also make laws and rules to guarantee that the provisions of business contracts be abided by and that the playing field is level.

4. *Pay more attention to the training and use of talents, adopt more flexible policy to attract overseas Chinese students to go back to work or start up businesses.* After 20 years of reform and opening up, many advanced production techniques and management methods are being introduced into China. After joining the WTO, because of strict intellectual property rights protection, China will pay more to acquire new technology. Under these circumstances, China should make full use of its talents and pay more attention to training. If the issue of using and training of talents is not resolved,

China would not be able to achieve the goal of prosperity by depending on its own talent resources. In China, many talents are suffocated or lying fallow by the social and economic structure. Since it started to send students abroad 20 years ago, China has been relaxing such restrictions. Now large numbers of Chinese students are studying abroad, and they have acquired advanced scientific knowledge and technology. But, due to various reasons, students remain aboard rather than returning to China. If the Chinese government can make more flexible policies to attract overseas Chinese students, China will acquire a large pool of talent.

5. *Adopt flexible policy to attract foreign capital, without fear that foreigners are making money.* In order to make money through foreign capital, you must allow foreign investors to make money or they will not come to invest. An old Chinese proverb states that, in order to gain you must first give. If you want to make money or get an advantage from others, you should also allow others to make money or gain an advantage. That is, both sides can gain in a deal. This is a very important economic principle. Economic globalization and joining the WTO can benefit all members and all are winners. In fact, foreign investors coming to China to do business can benefit China. China goes to borrow as competitors and they lend to China also as competitors. Therefore, if China has a good investment opportunity and has laws and rules to guarantee the provisions of contracts can be abided by, China then need not worry that they will not lend to China; they may ask enterprises to borrow from them. According to the same principles, foreign securities companies will come to China. We all know that there are many dishonest actions in the Chinese stock markets. If Chinese investors are allowed to buy and sell foreign securities and foreign security companies are allowed to come into China to compete with Chinese security companies, China's stock markets will be normalized. Meanwhile, Chinese companies can issue stocks in foreign markets to collect funds more easily, and a foreign standardized security monitoring system also can force Chinese companies to standardize their action. In the long run this will benefit China.

V. Concluding Remarks

This paper has analyzed the relationships among economic globalization, marketization reform, and economic development in China. From the analysis, we know that economic globalization will benefit China in the long run, and the problem it created is short-term and solvable. The best way to alleviate those problems caused by economic globalization is to improve the market economic system and economic and political institutional environment, rather than to avoid economic fluctuation by introducing more government intervention and control. Although a mature market system and well developed economic and political institutional environment cannot eliminate these troubles completely, it can alleviate its harmful effects on economic development. The reasons why China=s economy grew so rapidly in last 20 years are mainly based on two policies: Opening to the outside and reforming inside. Its so-called "loose the shackle and grant more rights" economic liberalization inside and marketization reforms greatly motivated the people and drove the non-state owned economy to grow very rapidly. The policy of opening up led to large sums of foreign capital, advanced science and technology and management techniques to pour in, and foreign trade to grow very rapidly, greatly improving the living standards of the people. Since the policy of opening up and reform started, China's exports have been dashing upwards and becoming one of the important factors that drives China's economy forward. We believe that opening up and reform will remain to be China's fundamental policy. A modern society is characterized by hi-tech and telecommunication. It's impossible for China to retain a market economy and remain closed to the outside world. China must further impose its opening up and communicating with the outside. By opening up, China can communicate with the outside world in the fields of technology and economy, which not only complement each other, but also can introduce international rules, perfect the market system, and promote economic development.

The rising of China will be a hard process. At the beginning of a new millennium, the world is facing a tide never before of economic globalization, network communication, and bio-technology revolution. This presents a once in one-thousand year golden opportunity to China, and China cannot afford to miss it. Joining into the economic globalization process will force China to face the challenge of a modern knowledge-based economic society. Some people in China think that China cannot compete with advanced countries, and that once China joins the economic globalization process, it will lose its economic independence and become an insignificant ancillary of advanced economies. This belief belittles Chinese people. Only if they are granted an opportunity to compete freely and fairly, can Chinese people win. The excellent performance of overseas Chinese in business, science and technology demonstrates this. Chinese people are hardworking and intelligent. How can they lose to foreigners? With an economic system that allows people to develop their potential and use it when set up, China's economy will surely catch up. Of course, the transformations of economic systems and globalization processes will be tough and will bring huge pressure to many enterprises, industries and individuals. People have no choice but to go ahead, to continue economic globalization and reforms. Otherwise China's economy will still be in a state of stagnation and lag behind. China will again miss a golden opportunity to rise up.

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