OPENNESS ISN'T ENOUGH: GLOBALIZATION AND POLITICAL CHANGE IN CHINA

BY MARY GALLAGHER

China is proving an exception to the idealized expectation of an internationalized market economy contributing to the development of a liberal democratic political system. Mary Gallagher finds that in fact the liberalized economy has served only to more firmly entrench China's authoritarian political rule.[1]

For the last ten years, the People's Republic of China has attracted more foreign direct investment (FDI) than any other developing country in the world. During several of those years China attracted more FDI than any other country in the world except for the United States. Last year China surpassed even the United States as the most popular destination for FDI. The policy of 'reform and openness" (of which FDI liberalization was a central part) first promoted by Deng Xiaoping in the late 1970s is, of course, widely seen as a great success. So successful, in fact, that by the late 1990s, the Chinese leadership reached an historic and far-reaching agreement to enter the World Trade Organization (WTO), pledging to further rollback and reduce widespread protection of its domestic economy. Accession to the WTO marks China's full-fledged acceptance into the global economy and shows the leadership's determination to continue to pursue increased openness, increased foreign investment, and dramatically increased competition within the domestic economy. China's early decision to open its borders to inflows of FDI has paid off, helping to yield one of the fastest growth rates in the world.

What have been the political and social effects of this rapid growth achieved in large part through increased openness to foreign investment? The literature on the relationship between economic development and political change is varied and complex, much of it launched from the "Lipset hypothesis" first proposed in 1959, which posited a causal relationship between economic development and democracy.[2] Modernization theories like that of Lipset propose a causal link between economic growth (and its corollaries of increased education, communication, and mobilization) and democracy. Indeed, the belief that economic growth, development, and greater integration with the outside world will lead to a more liberal and democratic China has been the foundation of US foreign policy toward China for the last twenty-five years. More recently, theories of globalization have posited that due to increased transnational flows of goods, money, ideas, and people, national economic and political systems would increasingly converge toward the "ideal" system of a market economy and a liberal democratic political system.[3] Other theories of globalization predict a decline in the sovereignty of nation-states and their capacity to govern because of the pressures and demands of an increasingly global economy.[4] In sum, the link between economic development and political change should be positive, especially when economic development is achieved through increased international flows of trade and investment.

The argument presented here challenges these ideas by discussing how economic development amid increasing openness has contributed to the stability of authoritarian rule in China. In opening its borders to large flows of foreign capital, China's Communist leaders have made growth and globalization work for them. A key factor in China's ability to reform the economy without sacrificing political control is the timing and sequencing of its FDI liberalization.

FDI liberalization delayed political liberalization in China because it preceded the other key reforms of a socialist transition: reform and/or privatization of the state sector and the development of an indigenous private business class. The sequencing of reforms is very important for the overall effects of reform on the political and social landscape of the country. Sequencing dictates which groups feel the pain of reform first and which are spared. FDI liberalization in China preceded large-scale, deep reform of the state-owned sector and the development of a large private business class. Its role can be summarized as follows: The formation of a foreign-invested sector of the economy first created a laboratory for reform in the form of Special Economic Zones (SEZs) and open coastal cities. This laboratory tended to attract those who benefited least from socialism. The laboratory's isolation from other parts of the economy also protected groups, especially state enterprise workers, who were the main beneficiaries of the socialist system. Over time, however, this laboratory of capitalism spawned new competitive pressures across different types of ownership for deeper reform. Groups previously protected from the shocks of the market economy began to lose this protection as they were forced to compete with the success of the laboratory reforms. By this time, however, the political power of these groups had already been significantly reduced. "Reform and openness" in this context resulted in a strengthened Chinese state, a weakened civil society (especially labor), and a delay in political liberalization.

A laboratory for change

The creation of a foreign-invested sector alongside the state and collective sectors in 1978 is but one example of China's dual track system of economic reforms. In this system two economic "mechanisms" exist side-by-side. One is controlled by the state plan and the other by the market, and there is little overlap or direct competition between the two. This was particularly true at the beginning of the reform period when SEZs were geographically set off from the rest of China's industry and "disarticulated" from the domestic economy.[5] Barriers and restrictions to sell on the Chinese domestic market further limited contacts between these firms and the domestic economy. Over time, as the FDI sector grew and was allowed to expand first to other coastal cities and then across almost all of China, it became more integrated into the domestic economy. Foreign brands manufactured in China began to have a real presence in the Chinese domestic marketplace.

This early stage of dual-track reform and "disarticulation" between the foreign-invested sector and the rest of the economy is important, however, for expanding the political space for experimentation and radical reform. The foreign-invested SEZs and development zones that sprung up all over China's coast by the early 1990s became laboratories of capitalism, introducing new and destabilizing reforms of employment, social welfare, and enterprise management. Many of these new practices were encoded in laws and regulations expressly designed for the foreign sector, allowing short-term labor contracts, wage and bonus-setting autonomy for enterprise managers, and a sharp reduction in the social welfare burdens of the enterprise. Implementation of these new laws and practices avoided, however, overt conflict with the norms of socialism and the "iron rice bowl"— China's system of lifetime employment and extensive social benefits for urban workers. Workers drawn into the foreign-invested sectors and the development zones of coastal China are overwhelming young, inexperienced, and unfamiliar with the labor practices of socialist firms. Migrant female workers from China's poorer inland regions tend to make up the bulk of the foreign invested enterprise (FIE) production workforce.[6]

At the same time, of course, these development zones attract older and more skilled workers, managers, and technicians away from the state and collective sectors. These

ACFTU vice chairman Zhang Junjiu. Many workers doubt the government-controlled union has their best interests at heart. Photo: Reuters.

workers, while socialized into the socialist enterprise system, are drawn into these capitalist laboratories because they tend to benefit from a much less egalitarian system. The widening of wage and bonus differentials, special perquisites like manager housing and training abroad, and the perception of more opportunity for advancement all drawn in China's special "human talent" (*rencai*) into the foreign-invested sectors.[7] Thus this laboratory of capitalism includes workers who are least invested in or who benefit least from the socialist system of employment. It is only as competitive pressure builds on other sectors of the economy that the effects of this laboratory are felt more broadly.

FDI as a catalyst for reform

The decentralizing aspects of Chinese economic reforms are often credited with creating the appropriate incentives for local officials and unleashing their developmentalist tendencies. A key element of this decentralization process has been the increasing authority of local officials to attract FDI. In addition to this competition between regions for FDI inflows, what Dali Yang has called "competitive liberalization," there are two other modes of competition sparked by the presence of foreign investment in China's domestic economy.[8] This competition has reshaped relationships within firms and firm behavior in the economy more generally. First is the competition between domestic firms for FDI infusions. Second is the competition between foreign-invested firms and other firms in China's domestic economy for market share and skilled labor. Competition between firms for FDI inflows is an extension of the logic of competitive liberalization, which demonstrated the way in which regional and local governments in China competed against each other for FDI. Similarly, within one region, firms woo foreign partners or even more recently foreign buyers. The allure of foreign investment is multifaceted, having to do with the perception of more sophisticated managerial and technical skills, greater access to foreign export markets, capital infusions to replace government support, and more broadly, the cache of internationalization through association with a globally-recognized brand name.

Such competition, on the regional level and between firms, is a powerful force for convergence with capitalist practices of foreign firms.[9] It lowers resistance from those in state enterprise because to stand by and hold fast to "socialist enterprise" would mean losing out on the chance to gain not only capital and technology but also prestige from association with the international economy. At the same time that resistance is lowered, economic reform pushes dynamically forward.

The second mode of competition, that between firms for market share and skilled labor, is also important as an impetus for further reform amid reduced societal resistance. As foreign-invested enterprises began to become more integrated into the domestic economy, competition

Workers seeking jobs in the foreign-invested sector tend to have little bargaining power. Photo: Sinopix.

increased, particularly for state-owned enterprises (SOEs), which had long been used to monopoly positions in the domestic market. Competition between SOEs and FIEs in the domestic economy led to calls from within the SOE sector for a "level playing field." That is, managers in the state sector began to perceive the preferential policies accorded to joint ventures and wholly foreign-owned enterprises as a barrier to their own development and a hindrance to fair competition.[10]

One way to demonstrate how this competitive pressure affected other types of ownership is to examine the development of Chinese labor and employment law. FIEs were the first to introduce and strictly implement employment contracts. In tandem with the rising labor mobility associated with short-term employment came a revolution in firm-level employment relations. Many of these firm-level changes were encoded into Chinese labor law, the development of which had been nearly moribund since the 1950s. At first, these laws were written expressly for the foreign-invested sector and were considered outside of the realm of normal socialist production. Legal analysts argued that workers in FIEs were at greater risk of exploitation and therefore labor laws should be tailored to this particular sector. A related but opposing reason for the development of specific foreign-invested laws was the need to satisfy foreign investor demands for a more flexible labor force and increased managerial autonomy over human resource issues. Labor laws for FIEs reflect both these concerns, although in implementation they tend to favor the concerns of management.[11]

One important characteristic of these laws is that they came to be considered part of a system of "preferential treatment" accorded to foreign firms alone. These laws and regulations increased enterprise and managerial autonomy and flexibility in almost all areas of personnel management. Regulations on hiring, firing, term of employment, non-wage benefits, and the designated role of worker representative institutions granted FIEs significantly more flexibility and reduced burdens related to the employment of Chinese workers. The leadership justified these changes by pointing to the mandated higher wages in the foreign-invested sector. However, these differences in treatment led to the demands for a "level-playing field" among state managers and their supporters in the leadership.

Accordingly, over time laws began to be developed that were not "ownership-specific" – that did not dictate enterprise behavior based on ownership type. Yet laws that were adopted for the whole economy were largely based on the laws already written for foreign-invested firms. The market logic of FIE employment law, with its notions of contract and autonomy, triumphed over socialist notions of guaranteed employment and the "working class as the master class." SOE managers were granted the right to act like capitalist firms in order to be able to compete against them. This resulted in greater managerial autonomy, larger wage differentials between workers and managers in order to stop the drain of top level managers to the FIE sector, a lighter social welfare burden, and the right to lay off redundant staff. More generally, SOE managers won the right to pursue profit and efficiency over socialist goals such as full employment and egalitarianism.[12]

In summation, the competitive pressure unleashed by FDI liberalization operated at both a regional and corporate level. Regions in competition for FDI inflows used the need to compete as a means of pursuing reform faster and more deeply. At the corporate level, the use of preferential treatment for FIEs gradually led to demands on the part of state firms for equal treatment and the extension of practices and regulations to the economy as a whole.

The sequencing of reforms in China, in particular the early and dynamic liberalization of FDI vis-à-vis other reforms, has led to a delay in political change. The foreign-invested sector of the economy acted like a laboratory for the difficult and sensitive reforms of a marketizing socialist economy. Over time, however, the competitive pressures inherent in the liberalization of FDI, across regions and firms, has led to increased convergence with capitalism and reduced societal resistance to reforms. The Chinese Communist Party has survived intact despite their declining commitment to their core principles (state ownership, elevated role of the working class, notions of economic justice). These core principles have been rejected in favor of principles of nationalism, Chinese industry, and the ability of China to compete in the international economy.

Competition and the gradual wearing away of socialism has worked to stifle most demands for political change. There are, of course, workers and groups of workers, particularly in the declining state sector, who have resisted these changes and the concomitant loss of security, employment, and social position. Very often they are also protesting the corruption and malfeasance that have accompanied these moves to the market. These voices have been very severely repressed. Worker leaders who dare to organize for the protection of basic worker rights and interests are often charged with state subversion and other serious crimes and subject to secret trials. The macro-level tools of competition and experimentation are accompanied by micro-level tactics that effectively suppress individual events of worker protest.

At least in the short term "reform with openness" can produce economic change without political liberalization. Reform with openness reduces societal resistance to reform, buying the existing regime time to implement politically difficult reforms and to reformulate the ideological foundation of their legitimacy to rule. In comparison to East European and Soviet Union reforms, the Chinese reforms avoided a full-frontal attack on the existing institutions of state socialism. Instead, these institutions eroded slowly over time in a losing competition with the market. This reform path may come to hinder further economic progress, particularly as foreign competition is expected to increase dramatically with China's accession to the WTO. Up to this point, however, China's early welcoming of foreign capital should be credited with saving the Chinese Communist Party.

The Role of Corporate Social Responsibility

The argument presented above is an analysis of China's reform process and the role that foreign investment has played systemically as a catalyst for competition and deeper reform. However, there are still many positive steps that can be taken by individual foreign firms, especially large multinationals, to mitigate the negative effects that are described above. These include increased attention to the effect of production networks and supplier chains on effective corporate social responsibility (CSR). Multinational companies (MNCs) can and do claim that their labor standards and working conditions are superior to other firms in China's domestic economy. While this claim is often true, MNCs are often linked to inferior firms through their supplier network. Corporate social responsibility must include greater MNC responsibility for the conditions and labor standards at supplier firms.

Advocates should also be aware of the danger that corporate social responsibility, codes of conduct, and external monitoring will become substitutes for fundamental improvements in the civil and political rights of Chinese workers. CSR should be a catalyst to these improvements through spillover effects and employee empowerment. While freedom of association is the most critical right lacking in the realm of Chinese worker rights, greater involvement of workers and worker groups in corporate social responsibility issues can help work toward related goals such as increased legal and rights consciousness and greater awareness of health and safety standards. Even if true freedom of association remains far off, it is possible to work toward that goal incrementally through the participation of employees in the monitoring of labor standards.

Individual MNCs have ample reason to care about reducing the negative effects of China's economic reform. China's large and growing role in the global economy and its accession to the WTO will bring increasing scrutiny on firms investing in and succeeding in China. Success that relies on substandard working conditions, abysmally low pay, and flagrant violations of China's own labor laws will not be ignored. Representatives of countries that believe they are losing markets and investment to China may join with consumer and labor advocates more generally to press for change. MNCs, as leaders in corporate social responsibility, should place themselves at the head of this movement rather than behind it or against it.

1. This article appeared in a different form in *World Politics*, vol. 54 (April 2002), pp. 338-72. The original title was "Reform and Openness": Why China's Economic Reforms Have Delayed Democracy."
2 Seymour Martin Lipset, "Some Social Requisites of Democracy: Economic Development and Political Legitimacy," *American Political Science Review* 53 (March 1959).
3. Held et al. divide this "hyperglobalist" thesis into neoliberal and radical/neo-Marxist camps. There is of course much disagreement on the normative implications of convergence, particularly the debates on the fate of the social welfare state and the environmental and labor implications of globalization. David Held, Anthony McGrew, David Goldblatt and Jonathan Perraton, *Global Transformations: Politics, Economics, and Culture* (Stanford: Stanford University Press, 1999), 3-5.
4. Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996).
5. See Barry Naughton, *Growing Out of the Plan* (Cambridge University Press,)
6. These statements are based on the author's observations while doing field research in foreign-funded and rural collective firms in 1997, 1999, and 2001. Management positions were often filled by former SOE employees (often the partner of the foreign firm), but production positions were almost exclusively filled by young urban residents or young rural migrants. Woman workers make up the vast majority of the workforce in the electronics industry and other relatively labor-intensive industries. See Ching Kwan Lee, *Gender and the South China Miracle: Two Worlds of Factory Women* (Berkeley: University of California, 1998), 68-70.
7. In a speech at the National Conference of Labor Dispute Resolution, an SOE manager complained of the inability of SOEs to retain workers as they left in droves for the private and foreign sectors. Chen Quansheng stated, "presently SOE workers fire the enterprise more than SOEs fire workers." "Speech of Chen Quansheng at the National Conference of Labor Dispute Resolution," *Laodong zhengyi chuli yu yanjiu* (Handling and research of labor disputes) (January 1996). Carrie Lee, "Industry Frustrated by Job-Hopping, *South China Morning Post*, August 9, 1997.
8. Yang (fn.25).
9. Shaomin Li, Shuhe Li, and Weiying Zhang, "The Road to Capitalism: Competition and Institutional Change in China," *Journal of Comparative Economics* 28 (June 2000). This article includes a large quantitative study of firms using China's industrial census. It does not focus on the particular effects of foreign-invested firms but generally finds that cross-regional competition leads to market-conforming behavior by managers of SOEs and collectives.
10. Articles in the national media as well as more scholarly articles on the problems of reform hammered away at this point of an "unequal playing field" between SOEs and FIEs. These articles focused on the heavy employment burden, the gap in managers' salaries, and the inability of SOEs to retain skilled workers. "*Shubaiwanyuan nianxin gaibugai na?*" (Should one take a yearly salary of hundreds of thousand RMB?") *Nanfang Zhoumo*, December 20, 1996, 2; "*Guoqi zenyang liuzhuren?*" (How can SOEs retain people?") *Renmin Ribao*, November 19, 1996, 10; "*Shulirencaiyishi jianquan liangge jizhi*," (Establish a consciousness of talent, perfect the two mechanisms) *Workers Daily*, April 8, 1997, 7. The two mechanisms include the collective contract system (to make it more difficult for workers to leave) and the incentive wage system (to improve skilled workers' wages). "*Jishugongren huhuan zhengce fuzhu*," (Skilled workers call for policy help) *Workers Daily*, December 13, 1996, 3; "*Wanshanqiyegerenshouru fenpei tiaokongjizhi*," (Perfect the adjustment mechanism for the distribution of individual salaries) *Zhongguo Gongshang Shibao*, May 5, 1997, 3; "*Qiyequanyi yebixu weihu*," (The rights and interests of enterprises must also be protected) *Jingji Ribao*, October 9, 1996.
11. Mary Gallagher, "Why Labor Laws Fail to Protect Workers," *China Rights Forum* (Summer 1997).
12. This analysis of legal convergence was first noted in an article explaining how to reduce staff in Japanese-invested enterprises in China. In an interview in 1999, one of the authors described how important the convergence of labor laws was in determining changes in enterprise behavior. Hiroaki Tsukamoto, et al, "*Chugoku niokeru gaisho taishi kigyo no resutora oyobi*," (Restructuring FIEs in China and procedures to cut staff) *Kokusai Shoji Ho* (International commercial law journal) 27:5 (1999); Author's interviews, Shanghai, July 1999.