

# WTO Entry and Opportunities for a Second Life in China's Military Enterprises

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**Synopsis:** *WTO entry will be conducive to China's military enterprises in facing up to direct international competition. It will help the military industry speed up its reforms, introduce advanced Western technology, internationalize products on the world trade market, create more breathing space and scope for further development and collect more financial resources through multi-channels for their products made for civilian use. At the same time, China's military enterprises face many challenges. They include huge competitive pressure from multinational arms manufacturer and various restrictive policies of many Western countries when trading with China's military enterprises. There are also many other internal and external factors that serve to restrain the import of technology, export of their products and investment opportunities in China's military enterprises. Confronted with both opportunities and challenges, China's military enterprises must step up the process of readjustment, mergers and restructuring within the industries, increase the import of advanced technology, break more widely into the world market, expand export of military products and experiment more boldly with foreign investment ventures.*

Economic globalization has become an irreversible trend in history, which calls for China's entry into the WTO. Entry into the WTO means China will become an integral part of the ever-strengthening global economy. The original production environment and competitors for China's military enterprises will both change significantly. There will be more opportunities for attracting foreign technology, participating in world arms trade and generating capital. At the same time, the overwhelming advantages of multinational arms manufacturing groups will put enormous competitive pressure on China's military enterprises in terms of their assets, technology, equipment, quality of employees, and the general corporate structures.

Since China started reforms, the transformation in China's national economy and the overhaul of the defense strategies have led to structural readjustment and reforms in the military enterprises, giving them a "second life." The following essay attempts to address the issues of opportunities and challenges brought upon the military enterprises by the WTO entry and discuss measures for the "second life" phase in those enterprises.

## **1. Opportunities and challenges brought upon China's military enterprises by entry into WTO**

1) WTO entry will bring China's enterprises that produce military products face to face with international competition, which will trigger further reforms and help step up structural upgrading. At the same time, enormous international competition will directly confront those enterprises. After the WTO entry, the vast market in China will no doubt attract vast numbers of multinational arms manufacturers, which will significantly change the market and operational environment for China's existing military product manufacturers. Under such inevitable pressure, these enterprises will have no choice but to stand up against the competitors through speedier reforms and gradual intergration into the world economy.

In July 1999, in an effort to increase the size efficiency, China regrouped and merged its defense product enterprises into the "Big Ten" group companies. They are: China Nuclear Energy Industrial Group Company, China Nuclear Industrial Construction Group Company, China Aerospace Science and Technology Group Company, China Aerospace Mechanic Electronic Group Company, The First China Aerospace Industrial Group Company, The Second China Aerospace Industrial Group Company, China Shipping Industrial Group Company, China Heavy Industrial Group Company and China Weaponry & Equipment Group Company.

This is the first step towards preparing for the challenges and opportunities following China's WTO membership by the defense enterprises. However, with the mergers of the "Big Ten" group companies, China's military enterprises still cannot compare with the Western multinational corporations in size and scale. The size efficiency achieved by the U.S. and European multinational corporations help to greatly reduce their production cost, which gives them enormous competitive price edge over smaller companies. In comparison, China's defense produce enterprises still mainly follow an extensive management style, and although their total assets have grown, profits have been slipping every year.

Once entering the international market, the profit margins of China's military product companies will probably drop at an even greater speed. The enormous competitive advantages from Western multinational counterparts would no doubt threaten the existence and further development of China's

military enterprises. Therefore, in order to meet the pending international competition with China's WTO entry, the military product companies must carry out further reforms, readjust and reorganize the inner structure, complete the upgrading process of the products, increase the technological content of their products and strive to reduce production cost.

2) Although China's WTO membership will offer a much wider range of opportunities for the enterprises to import Western technology, some non-trade elements will restrict China's military product companies from obtaining advanced Western technology. A globalized economy will determine the globalization of information and technology. The WTO membership will open China's defense product companies to all kinds of opportunities for obtaining more advanced technology through a freer, more open and globalized trade environment. Although China's defense industries have never opened up the investment sectors to Western countries, they have always welcomed technological trading opportunities. The Chinese military product manufacturers started off during the early period after the founding of New China with massive imports of Soviet technology and equipment. For instance, among the 156 major projects the former Soviet Union offered to China, 13 projects were in areas of airplane manufacturing, aerospace engine production and airborne equipment manufacturing, which formed the first pillar enterprises of New China's aerospace industry.

China has never given up any possible opportunity to import advanced technology. The thawing of the U.S.-China relations in 1972 opened the trading doors to importing modern technology. However, in the same way, the U.S.-led Western countries have never let up their trading blockade to China for imports of technology, especially military technology. The U.S. government has randomly categorized a large amount of civilian merchandise as both military and civilian products, which have to go through strict censorship resulting in the breaching of many signed contracts. For example, in 1886, China's Northern Industrial Company signed a contract with the U.S. ISC Corp. to import its CAD integrated circuit, but the U.S. authorities refused to issue an export permit saying the product could be involved in military use. During Clinton's visit to China in 1998, he insisted that the United States could only resume export to China of energy preservation and environmental protection technologies, while maintaining strict control of other high tech products.

With China's entry into WTO, the Western countries will have lost their excuse for discriminating China in technology trade, which means the technology trade blockade will be broken and more possibilities will arise for China's military enterprises to import Western advanced technology (especially high tech). At the same time, however, China must clearly recognize the ideological differences between China and other major Western powers. The U.S.-led Western countries will not want to see a stronger China and will inevitably use various trade or non-trade means to prevent the flow of advanced Western technology into China's military product companies and restrict technological cooperation and communication between China's military product producers and the Western arms manufacturers.

3) WTO entry will be conducive to internationalizing China's military products on the world trade market, which will naturally create more living space for the enterprises. But at the same time, the U.S.-led Western nations will no doubt attempt to prevent China's defense products from entering the world market through bilateral negotiations. Although the low technology content of China's military products is one disadvantage, the advantage is that China's products have stable performance and are generally quite reliable. Also the extremely cheap labor in China still manages to give the Chinese products a relatively competitive edge in price over similar Western products. Therefore, the Chinese products do hold a spot on the world arms market. In certain areas, for instance, aerospace industry (international commercial Satellite launching market) and international commercial shipping industry both have quite strong competition against other countries. But because of the unjust discrimination and rejection against the Chinese military products from the United States and other Western countries, export of the Chinese military products in the 1990s has had a downward trend.

After the entry into WTO, the trade blockade against the Chinese military products will be broken, along which trade restrictions from Western countries against the Chinese technology and products will also be eased. The result will be further internationalization of the Chinese military products and a further step towards the world for China's defense product industry. The Chinese manufacturers should take advantage of the favorable trade regulations within WTO to expand the market share of the Chinese products and therefore give the Chinese defense product manufacturers a second life.

However, we must also recognize that entry into WTO does not mean that the United States and other Western countries will stop their efforts in creating various excuses to restrict the export of Chinese products. Apart from the existing non-trade protection and other restrictive measures, they will frequently attempt to use certain gray areas within the WTO regulations such as automatic export restrictions reached through bilateral trade negotiations to restrict export of China's military as well as civilian products. We can see from this that although WTO membership and equal trade opportunities offered in a globalized economy will bring more export possibilities to the Chinese military enterprises, more trade and non-trade restrictions will prevent more export of these military products, which means Chinese defense product companies might lose their existing share of the market and the chance for further expanding their market.

4) WTO entry will open up more channels for generating capital for the Chinese military product manufacturers, but at the same time various internal and external constraints might cause the loss of many opportunities. In 1999, the revenue generated from civilian-use products by China Aerospace Mechanic Electronic Group Company accounted for 65% of its total revenue, and sales of products for civilian use accounted for 70% of its total sales. China Weaponry Industrial Group Company has already established three major series of products in machinery, chemical products and optical electronics, led by automobile manufacturing for the civilian market.

The limited defense budget has forced the military product producers to turn to civilian channels and use profits from civilian products to support their main military lines. Therefore, with the entry into the WTO, the civilian sectors of the military product industry should and must be open to the outside market. At present, civilian products produced by the military product industries have already had a stronghold on the domestic market, but the capital-intensive and labor-intensive parts of those products will be the first to encounter great shock from foreign products. Therefore, in order to attract more investment, the civilian lines in the military product industry will probably adopt a pattern to attract outside investment while in alliance with domestic investors. At the same time, the advantages enjoyed by the military enterprises such as credibility, improved technology, advanced equipment and a better-trained labor force will probably make them prime business partners in China for Western multinational corporations. With such prospects for mutual benefit and interest, investment will naturally

come to the military product industry. The conclusion, therefore, is that WTO entry will benefit the Chinese military product industry in opening up more investment channels and thus breaking away from various restrictive regulations. But at the same time, there is the possibility that certain people are still under ideological restraints and might refuse to allow foreign investors into China's military enterprises. In this case, these factors will make the enterprises sit back and lose a golden opportunity for attracting foreign investment and speeding up further development.

## **2. The rational choice is for the Chinese military enterprises to face challenges brought by WTO membership and create opportunities for a second life**

- 1) Measures should be applied to speed up the process of merger and alliance between strong companies in order to reach certain size efficiency in the military product industry. Presently, the economies of various countries have been involved in such communication, cooperation and integration that globalization is irreversible. This trend has already appeared in the international military product market. More and more international alliances between multinational conglomerates have been formed with the purpose of linking the strong with the strong between international companies to create greater size efficiency. In 1996, two conglomerates in the world aerospace industry formed an alliance - Boeing merged with McDonald Douglas, which immensely advanced Boeing's competitive power on the international market especially in the area of civilian aircraft manufacturing. At the same time, the supreme size of the new Boeing gave it an unchallenged competitive edge over its number one rival the European Airbus. Mergers and regrouping between international conglomerates will no doubt create much stronger competitive power, which will give even bigger shocks to China's military product industry.

The forming of the "Big Ten" group companies in 1999 does not mean the merger process is over for the Chinese military enterprises. The task is far from being completed. Enterprises have not established their main product lines or brand-name products. For instance, the 245 subsidiary enterprises under China Aerospace Industrial Group Company have been producing more than 5000 types of illegal non-aerospace products in order to survive, while their main products - aircraft - are only major products in the military

airfields for certain reasons, and 98% of the civilian aircraft market in China has been taken over by foreign products such as Boeings or Airbuses.

The status quo of China's military product industry is characterized by such patterns: big companies produce all the components, small companies also include the production of all the components; they are divided and subdivided into many departments in charge of all kinds of products, and all kinds of production and research activities and projects. This situation is clearly not in line with a military product industry, the nature of which requires centralization, streamlining and strict regulations. Therefore, the immediate task facing the enterprises is to introduce a complete overhaul and speed up merger and regrouping process. During the process, emphasis should be placed on alliance between the strong to increase size efficiency and firmly disposing the no-hope products and industries.

- 2) The guideline for the optimizing process should be mainly through self-reliance in research and production while supplementing it with foreign technology. The situation in the world military product market shows that as long as the country has enough money, then it can always find the needed product. China's airlines have benefited in this way from imported Boeings and Airbuses. But once the product is connected with a country's national security or classified information, then no matter how much money one has, the product will not be available. It is very much the case in the military product industry. The existence of conflicting national interest between nations means that no country will allow its crucial product or technology to get into the hands of other countries. The ideological difference between China and other Western countries is still there, and the leading thought among Western countries is still to break up, Westernize and contain China. So although the WTO membership will earn China the access privilege of some technology from Western countries, this kind of technology will only be insignificant technology to the exporter. Therefore, self-reliance should still be the key factor for China's military enterprises.

Compared with the international manufacturers, China's military product industry is only the follower. To compete against such powerful conglomerates, price advantage is one thing, the other is the technological content of the products. China's industry needs to increase its technological advancement at a greater speed than its foreign counterparts. On the one hand, the discriminatory trade blockade by the United States and other

Western countries makes it difficult for China to import advanced technology, but on the other hand, China's enormous market offers extremely tempting opportunities for the Western military product companies. To them, the best choice might be to give away technology in exchange for the chance to enter China's market. For China's military product enterprise, to give up some market for the return of technology might also be a practical choice. For instance, in order to get into China's enormous aerospace market, the U.S. MD formed joint venture production lines with Shanghai Airplane Manufacturer to produce MD80 and MD 90. The latter is no longer assembled in China, but produced with Chinese equipment and labor, after the MD allowed China the intellectual property right. Although the merger of Boeing and MD deprived China of an export market for the MD 90 and forced the end of the production line, China's aerospace industry has learned considerable technical know-how from the experience.

At the present time, many military enterprises are labor-intensive and their products have low technological content. Therefore whether it is possible to instill enough technology to turn these traditional industries into high tech enterprises will be a key issue for the development of China's military product industry. The companies should grasp the WTO opportunity to step up the process for technology import and use Western technology to transform the traditional enterprises. In the process, the key is how to digest, dissolve and recreate from the imported technology. This means there will always be a combination between imported technology and self-creation.

3) The enterprises should consider the domestic market as the main goal and the international market as a supplementary target while expanding both domestic and international markets. The military enterprises are strategic industries of China and form the winning material basis in the future hi tech warfare. Therefore, the domestic market will be the main goal, but the world market represents another development space for the enterprises. At the present time, because the military construction has been subordinate to the national economic construction, there have been limited orders for military supplies and products. The supply exceeds demand and the part of hi tech production is not large enough to benefit from the size efficiency.

After China enters WTO, the fewer trade restrictions from Western countries on China's military products might mean more export opportunities. With

such opportunities, China's enterprises should try to push their products on the export market and improve the exporting environment and products in ways that will make China more in line with the accepted international standards. These steps will enable China to suffer from fewer non-trade restrictions in exporting military products. If China can make the best use of WTO entry opportunities to push its military products onto the international market, higher size efficiencies will certainly follow, so will more capital and investment for further research and production. Therefore, the Chinese military product companies should be based on the domestic market but seek to expand into the international market in order to establish competitive advantages of the products quickly in both markets.

4) The enterprises should open up their minds and liberate their thinking and try to allow foreign investors into the industry. Since China enforced reforms, economic construction has taken the priority while investment into the defense enterprises has been reduced. Severe shortage of capital is the main ailment plaguing the entire industry and holding back any development opportunities. To give the military product industry a second life, there should be intensive technological transformation in the traditional production lines, which will need sufficient funding. Under such circumstances, the military product companies have made the choice to turn to producing civilian lines, which at the time is probably the only realistic option. However, after China enters the WTO, the civilian lines will be among the first to open up to outside competitors, especially their capital-intensive and labor-intensive sectors. If these civilian products cannot withstand the shock from the outside world and lose their shares of the domestic market, then the strategy of using profits from civilian products to supplement military products will fall through. But at the same time, China's WTO membership will attract many potential Western investors who are eager to enter China's huge market to sell technology and make investment, which will limit cooperative opportunities between China's military product manufacturers and their Western counterparts. However, there will be much more opportunities for the civilian product manufacturers to form joint ventures. In this case, China's decision makers in the military product industry should open up their minds and liberate their thinking when dealing with the new business opportunities and challenges. While importing Western technology, they should try importing foreign capital too. No doubt they need to be cautious when dealing with classified military information in their cooperative endeavors. As long as classified information is well

kept, they should make more effort in promoting their products, trying to win over investors to form joint ventures, cooperative ventures or joint-stock companies.