REFORM OF CHINA'S FOREIGN TRADE SYSTEM AND PROSPECTS FOR FREER TRADE

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U.S. Bureau of the Census
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SUMMARY

China launched a new round of major trade reforms at the beginning of 1991 after reversing a six year run of trade deficits with a $8.7 billion trade surplus in 1990. The impetus for further trade reforms was to reduce the government's financial burden, increase exports, improve trade efficiency, and bring China's trade regime into closer compliance with the international rules of the General Agreement on Tariffs and Trade (GATT). Furthermore, China was receiving pressure from the United States to open its markets to U.S. exports and reduce its trade surplus with the United States. The market access agreement reached between China and the United States in 1992 calls for China to expand trade reforms that increase trade transparency and eliminate trade barriers.

A review of recent trade reforms indicates they are wide ranging affecting foreign trade enterprises, the distribution of foreign exchange, and tariff and nontariff trade barriers. In this latest round of reforms, the government increased the number of authorized traders by extending trading rights to 100 scientific research institutes and over 800 large and medium enterprises. The distribution of foreign exchange was altered by basing the retention rate on the type of commodity exported rather than on the location of the enterprise. The number of foreign exchange swap centers and regional markets continued to expand. The total volume of foreign exchange swapped at these centers increased by an average annual rate of 34 percent from 1988 to 1992. China reduced import tariff rates for 3371 goods, accounting for 50 percent of all commodities subject to tariffs, at the end of 1992. This action lowered the real tariff rate to 22.5 percent. The government also eliminated the regulatory import tax that had been imposed on 18 kinds of commodities. The Ministry of Foreign Trade and Economic Cooperation began publishing laws, regulations, and policies pertaining to trade that were previously considered to be *neibu* (internal use only).

With the dismantling of trade barriers many Chinese industries are bracing for the onslaught of foreign competition. An examination of the impact of foreign trade reforms on China's economy reveals that the machinery and electronics, automotive, and chemical sectors are expected to be the most seriously affected. Parts of the textile and agriculture sectors also will be affected but to a lesser extent. Individual enterprises and industry associations are starting to position themselves to cope with foreign competition. Many enterprises are seeking to improve the quality of their products by adopting advanced technology. Large state enterprise groups that achieve vertical integration by combining production, investment, and trading are being formed. The government also announced plans to establish a foreign trade bank to assist Chinese enterprises in developing overseas markets.

U.S. trade prospects with China are in large measure dependent on China's commitment to reforming their economic system to regain GATT membership. China has made great strides in price reform while in the area of banking reform it has made the least progress to date. Achievements in price reform serve to diminish the incentives for local protectionism and encourage freer trade which will benefit U.S. exporters. On the other hand, lack of reform in the financial system and continued conflicts between the functions of government and the management of enterprises means foreign trade corporations still

are not completely independent. The absence of competition in trade for a number of commodities will limit improvements in the U.S. trade balance with China.

While it is still too early to evaluate China's compliance with the market access agreement, there are indications of how events are likely to proceed. Thus far, many of China's attempts to fulfill the requirements of the agreement have been viewed by U.S. officials as incomplete and not going far enough to reduce trade barriers. In some cases, the appearance of noncompliance may be attributable to a lack of understanding of what is expected owing to the vagueness of the agreement on some points. In other cases, footdragging occurs because the government still has few macroeconomic levers and desires to retain flexible administrative measures to control the flow of imports.

While many sectors and industries will be hurt by the dismantling of trade barriers and will seek to limit certain aspects of trade reform, there are also numerous industries relying on imports that stand to gain from trade reform. Other beneficiaries of trade reform include China's consumers. In particular, urban consumers with their rising purchasing power expect to benefit from the increased availability of higher quality and less expensive goods, ranging from food products to consumer durables to electronic products. Throughout China consumers have a strong preference for U.S. goods which bodes well for increased U.S. exports as trade barriers are removed. Also, a number of officials and scholars are strong proponents of freer trade, arguing there are large efficiency gains to be realized from trade liberalization.

A major test of the government's resolve to carry through with reforms is the trade deficit incurred in the first half of 1993. In the short run, there may be some backsliding in the reform process, as there has been in the past. However, the government's long run commitment to freer trade may remain firm. The economic boom of the past two years is presenting enormous opportunities for foreign companies to invest, sell technology, participate in infrastructural projects, and supply the vast consumer market. While the U.S. will face competition from other countries, U.S. technology and products are viewed very favorably in China. Foreign trade reforms are offering challenges and benefits to not only China but also to U.S. exporters.

PREFACE

The Center for International Research conducts economic and demographic studies, some of which are issued as Staff Papers. A complete list of these papers is included at the end of this report. The use of data not generated by the U.S. Bureau of the Census precludes performing the same statistical reviews the Bureau does on its own data.

The author gratefully acknowledges helpful comments from Penelope Prime and Barry Kostinsky. The author is responsible for any remaining shortcomings.

Comments and questions regarding this study should be addressed to Loraine West, China Branch, Center for International Research, U.S. Bureau of the Census, Washington, D.C. 20233-3700; telephone (301) 763-4012.

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I. INTRODUCTION

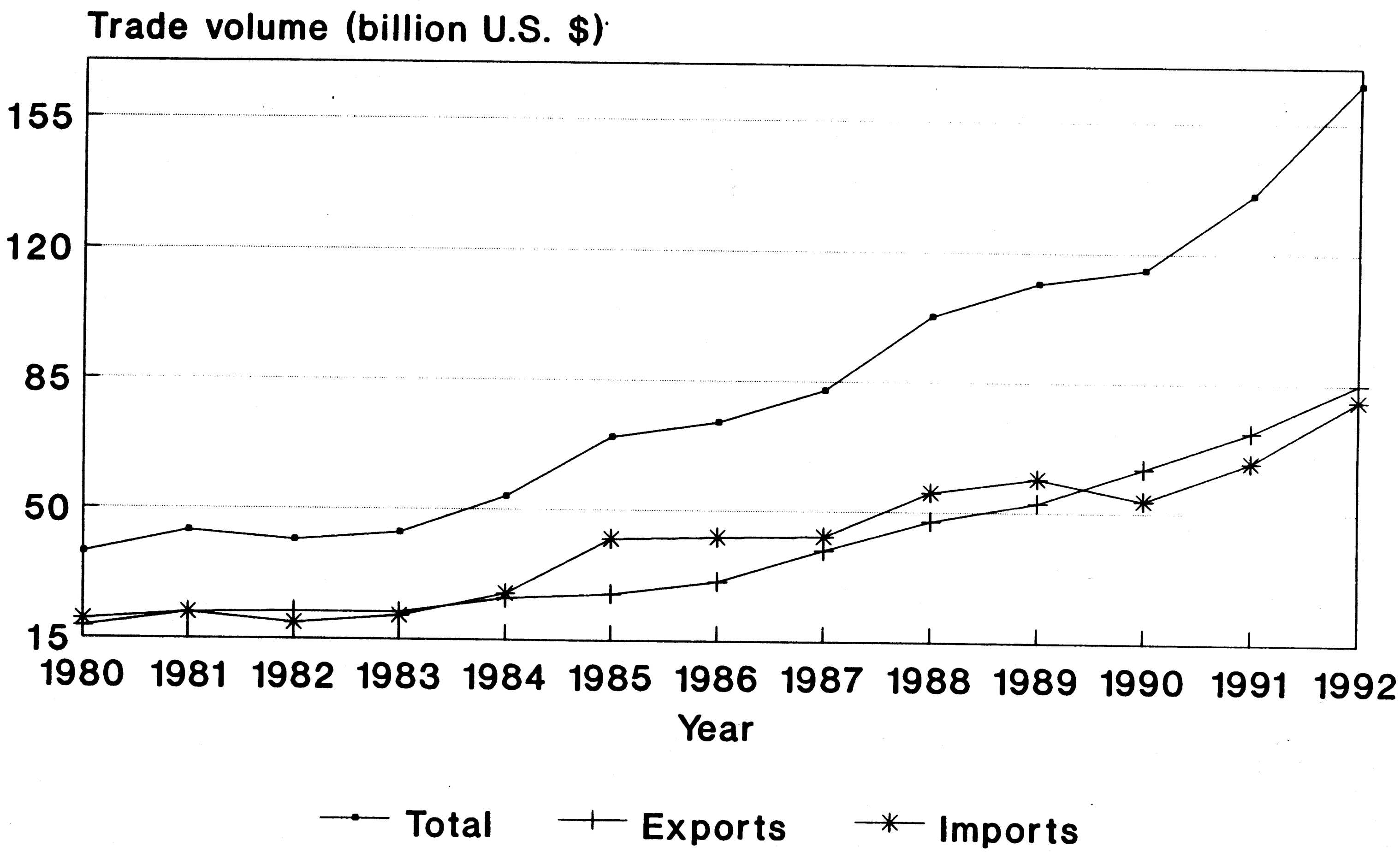
Following the decision to open up in the late 1970s, foreign trade has played an increasingly important role in China's economic development. In addition to accelerating the rate of development, foreign trade growth also has advanced the structural and technical transformation of the economy [Lardy 1992a]. China's combined imports and exports grew by an average annual rate of 12 percent from 1980 to 1992, more than a fourfold increase from $38 to $166 billion (see Figure 1), while total world trade growth averaged 5 percent over this same time period.

Since 1978, China's foreign trade system has undergone a series of reforms. From the beginning, one major goal of the reforms has been to decentralize trade decision-making by increasing the number of foreign trade corporations and reducing the scope of the foreign trade plan. Prior to the onset of reforms nearly all foreign trade fell under the plan, and 12 state foreign trade corporations monopolized exports and imports. By 1988, only 45 percent of exports fell under the plan (divided roughly equally between mandatory and guidance plans), and only 40 percent of imports were under the plan. The number of foreign trade corporations rose to a peak of over 5000 in 1988 before the Ministry of Foreign Economic Relations and Trade (MOFERT) revoked the foreign trade authority of 1083 local foreign trade enterprises in 1989 and 1990 [Tao 1992, p.30].

Another goal of reforms has been to expose more tradeables to world prices and reveal China's comparative advantage. Imports began to be priced on the domestic market at their world prices. The periodic devaluation of China's currency throughout the 1980s reduced the bias against exports and the implicit subsidy for imports. To encourage exports the government granted enterprises, trade corporations, and local governments the right to retain a portion of the foreign exchange earnings. Furthermore, the State Administration of Exchange Control established foreign exchange swap centers where a foreign exchange rate more closely approximating a market rate could be determined. In response to these various actions, China's trade composition changed. The share of primary products among exports fell from 50 percent in the early 1980s to less than 25 percent in 1991. On the other hand, exports of textiles and other light manufactured goods experienced rapid growth.

However, the trade reform process slowed down at the end of the 1980s. The trade gap was nearly closed in 1987, with the deficit down to less than US$4 billion or 10 percent of total export value, when the gap suddenly doubled in 1988 to nearly US$8 billion (Figure 1). One factor contributing to the rising trade deficit was rapid inflation and a resulting surge in imports of consumer durables. In 1989, the government began to implement a number of administrative measures to curtail imports. These measures included banning imports of some consumer goods, expanding the list of import substitute products, and recentralizing decision-making for imports. At the same time, the government continued to encourage exports. Even with the retrenchment program that was in place in 1989 and 1990, the government placed high priority on credit and inputs for exporters. As a result of these measures, imports fell $5.8 billion, exports rose $9.5 billion, and China achieved a trade surplus of $8.7 billion in 1990 (Figure 1).

Figure 1. China's Foreign Trade 1980-1992



Note: Chinese Customs Data.
Sources: 1992 Statistical Yearbook of China, and Statistical Communique.

Having erased the trade deficit, China began to move forward again with trade reforms in 1991. According to Li Lanqing [1992b], then minister of MOFERT, a new round of major reforms began on January 1, 1991. The impetus for further trade reforms was to reduce the government's financial burden, increase exports, improve trade efficiency, and bring China's trade regime into closer compliance with the international rules of the General Agreement on Tariffs and Trade (GATT).[1] Furthermore, China was receiving pressure from the United States to open its markets to U.S. exports and reduce its trade surplus with the United States (Figure 2).[2] Trade tensions culminated in the U.S. Government launching an investigation of market access barriers maintained by China.[3] The investigation was successfully concluded with the signing on October 10, 1992 of a Memorandum of Understanding between the U.S. and China calling for the dismantling of a number of trade barriers.

This paper reviews recent foreign trade reforms and examines the impact on both the Chinese economy and future U.S. exports to China. The following section lists and briefly discusses major foreign trade reforms implemented since 1991. Section III identifies individual products and sectors expected to be adversely affected by the requirements of the U.S.-China Memorandum of Understanding and future GATT membership. Reasons for China's lack of competitiveness are explored. Next, the major strategies China is employing to cope with future foreign competition are outlined. Section IV summarizes the status of economic reform in other sectors of the economy that are linked to successful foreign trade reform. Factors affecting U.S. trade prospects with China are analyzed in section VI. Finally, the paper concludes with a discussion of the sustainability of China's foreign trade reforms and the benefits of freer trade to China's consumers, producers, and government.

II. FOREIGN TRADE REFORMS: 1991 - PRESENT

China's leaders have implemented numerous new trade-related policies since 1991 which are chronicled in Figure 3. In this latest round of reforms, a number of policy measures are directed at bringing China's trade system into conformity with international practices. In 1992, China adopted the United Nations Harmonized Commodity Description

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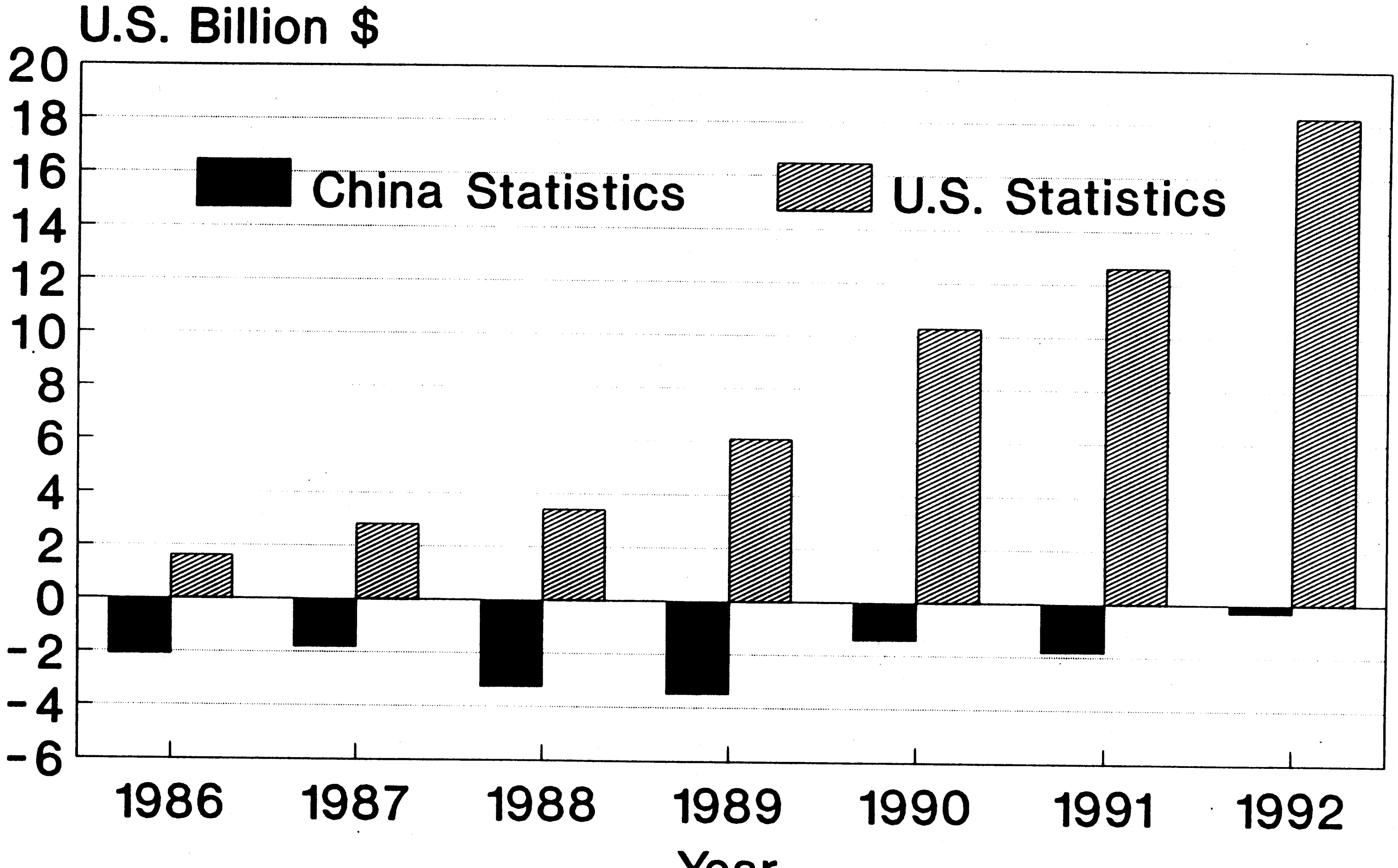
[1] Prior to June 1989 discussions on China acceding to the GATT were well underway. Following Tiananmen, further discussions were largely put on hold. In early 1991, China requested that meetings of the GATT working party on China resume.

[2] There exists a sizeable and growing discrepancy between U.S. and China trade statistics.

[3] The investigation was conducted under section 301 of the Trade Act of 1974. Under terms of the section 301, the U.S. government would engage the Chinese government in discussions and negotiations to resolve the trade barriers. If, after a year, no satisfactory resolution was reached, the U.S. could implement retaliatory measures.

Figure 2. China's Trade Balance with the United States: 1986-1992



Sources: <u>1992 Statistical Yearbook of China</u>, Statistical Communique, and U.S. Department of Commerce, Bureau of the Census.

Figure 3. Chronicle of Actions Taken Related to Foreign Trade: 1991 - present

Date of Implementation or Information	Action
January 1, 1991	Abolished State financial subsidies for exports, stated trading corporations responsible for profits and losses. [Zhongguo Qinggongye Nianjian 1991, p.83]
January 1, 1991	Established new foreign exchange retention shares based on type of product exported rather than based on geographic location. [Zhongguo Qinggongye Nianjian 1991, p.83]
April 9, 1991	Began a managed float of the official exchange rate. [Renmin Ribao 27 December 1992, p.2]
October 1991	Lowered tariffs in 16 tariff categories covering 225 products. [Guangzhou Jingji No. 2 1993, p.4]
October 1991	Stopped publishing the Ministry of Machine-Building and Electronics Industry's list of "products recommended for import substitution." [Renmin Ribao 22 August 1992 p.2 in JPRS-CAR-92-075 5 October 1992, p.39]
Early 1992*	Reorganized the State Council Production Office into the Economic and Trade Office (ETO) and elevated the ETO to level of State Council commission. [The China Business Review January-February 1993, p.27]
January 1, 1992	Implemented the Harmonized Commodity Description and Coding System (HS) for reporting exports and imports. [International Economic Review July 1992, pp.6-7]
First quarter 1992	Published in Guoji Shangbao [International Business], MOFERT's newspaper, 47 internal, or secret, trade regulations. MOFERT has designated this newspaper as the official register of trade policies, rules, and regulations. [International Economic Review July 1992, pp.6-7]
April 1, 1992	Eliminated regulatory import tax (a separate surcharge imposed over and above the applicable tariffs) that had been imposed on 18 kinds of commodities. [International Economic Review July 1992, pp.6-7]
First half 1992	Abolished some commodities under categorized commodity import license control and announced a catalogue of commodities under new import license control. [Wen Wei Po 8 Dec. 1992 p.8 in FBIS-CHI-92-237 9 December 1992, p.36]
September 1992*	Changed the foreign exchange retention ratio for light industry and textile industry from a "reverse 30-70 percent" to a "reverse 20-80 percent" ratio. [FBIS-CHI-92-175 9 September 1992, p.36]

September 1992	Mapped out or revised more than 530 inspection standards for import and export commodities, including 76 standards for inspection of trace pesticides in export food. The State Administration for the Inspection of Import and Export Commodities announced the major categories for inspection include canned products, meat, foodstuffs casings, eggs and dairy products, aquatic products, tea, wine, and other beverages, vegetables, sugar, honey, and candy. [Xinhua in FBIS-CHI-92-182 18 September 1992, p.34]
September 1992	Drew up a new measure to introduce a commission pricing system for all commodities imported with central foreign exchange. The measure calls for a one-time use for each import license issued with the bank in charge of exchange settlement clearly indicated. [FBIS-CHI-92-175 9 September 1992, p.36]
October 23, 1992	Implemented rules for the Inspection Law on Import-Export Commodities. [Xinhua 23 Oct. 1992 in FBIS-CHI-92-206 23 October 1992 p.29]
October and November 1992*	Expanded import and export rights to more than 1000 industrial enterprises. {For example, 11 Shanghai textile and garment companies; private firms in Guangzhou}. [China Daily 21 October 1992, p.2 and China Daily Business Weekly 14-20 February 1993, p.4]
November 1992*	Announced foreign exchange earnings from exports in excess of the planned volume can be retained by the enterprise at a ratio of 70%. Spending of these earnings are not restricted by the exchange spending quotas of the province or municipality in which the enterprise is situated and may be spent in importing profitable commodities for domestic sale. The foreign exchange earnings retained by localities may be spent as circulating funds for importing materials for processing purposes. [Ching Chi Tao Pao 16 Nov. 1992, p.18 in FBIS-CHI-92-235 7 December 1992, p.40]
November 1992*	Set up more than 100 foreign exchange swap centers since 1988. [China Daily Business Weekly 22-28 November 1992, pp.1,8]
November 1992*	Allowed enterprises to retain foreign exchange earnings in cash instead of vouchers on a trial basis in Shanghai, Shenzhen, Zhuhai, Jiangsu and Hainan. Before only foreign-funded ventures and a small number of state enterprises allowed to retain foreign exchange in cash. [China Daily Business Weekly 22-28 November 1992, pp.1,8]
November 1992*	Announced People's Insurance Company of China (PICC) will start to offer long- and medium-term export credit insurance in 1993. [China Daily 20 November 1992, p.2]
November 1992*	Announced that at present 53 categories of products are controlled by import permits in China. [Liaowang Overseas 16 Nov. 1992 pp.12-15 in FBIS-CHI-92-236 8 December 1992, pp.42-46]

December 1992*	Lifted the licenses for second and third category commodities. Reports indicate that 121 export commodities fall under category two, which include meat products and textiles; while 3000 export commodities fall under category three, which include local products and minerals. [Zhongguo Tongxun She 6 Dec. 1992 in FBIS-CHI-92-235 7 December 1992, pp.39-40]
December 1992*	Published 32 internal documents still in force concerning import and export administration and abolished 122 internal regulations. [Xinhua 9 December 1992 in FBIS-CHI-92-238 10 December 1992, p.6]
December 31, 1992	Reduced import tax rates for 3,371 items. The goods account for 53.6% of the total taxable items of the "Customs Import and Export Tariff." Reduction will lower the general level of China's customs tariff by 7.3%. [China Daily Business Weekly 20-26 December 1992, p.2]
January 1993	Reduced the number of export commodities subject to the quota/license system by 52%. [Xinhua 21 January 1993 in FBIS-CHI-93-012 21 January 1993 p.30]
February 1993	Announced China Investment Bank will issue foreign-currency bonds to Chinese citizens in first half of 1993. The $50 million worth of bonds will have a term of 1 year and carry an interest rate 1% higher than terms deposits in banks (currently banks pay 3.75% for hard currency deposits). [China Daily Business Weekly 14-20 February 1993, p.3]
March 1993	Allow Chinese citizens and foreigners visiting and leaving China to carry in and out 6000 yuan of renminbi cash. [China Daily Business Weekly 21-27 February 1993, p.2]
May 1993	Announced State Council will lift license control over majority of import commodities within 5-6 years. [China Economic News No. 18 17 May 1993, p.2]
August 1993	Announced that the number of export commodities planned by the state was reduced to 19 varieties from 27 and the number controlled was reduced to 10 varieties from 11. [Xinhua 9 August 1993 in FBIS-CHI-93-153 11 August 1993, p.25]
* Date information published, not clear when implemented.	

and Coding System (HS) for reporting exports and imports.[4] China also began to publish laws, regulations, and policies pertaining to trade. The Ministry of Foreign Trade and Economic Cooperation (formerly MOFERT) publishes them in their newspaper *Guoji Shangbao* [International Business] and is considering publishing the laws in a journal called the MOFERT Gazette (*Jingmaobu Gongbao*). In the past, many of these regulations were considered to be secret or for internal use only. The State Administration for the Inspection of Import and Export Commodities is in the process of revising, establishing, and implementing inspection standards for import and export commodities, incorporating international standards.

Other recent foreign trade reforms include the evolution of new institutions and changes in the functions of existing institutions, adjustments in the distribution of foreign exchange, and removal of tariff and nontariff trade barriers. The following sections discuss these reforms in more detail.

Institutional Changes

The further shift in emphasis away from a planned economy and towards a market economy in the 1990s has led to several institutional changes. The decentralization of trade decision-making continues in the current reform period with changes in the operations of foreign trade enterprises, including foreign trade corporations and other enterprises with direct trading rights. A number of ministries and commissions directly and indirectly related to trade have also been established and reorganized.

Foreign Trade Enterprises

One of the first trade reforms in the 1990s was the elimination of direct budgetary subsidies from the central government to foreign trade corporations for export losses. In trying to establish independent management, the government stated that foreign trade corporations were to be responsible for their own profits and losses. However, national foreign trade corporations continued to receive direct subsidies for losses incurred on planned imports of goods sold on the domestic market at subsidized prices, such as food grains and chemical fertilizers.

In some localities it is argued that foreign trade corporations have continued access to a line of credit authorized by the State and therefore have been responsible only for profits and not for losses. Furthermore decision-making power granted to foreign trade corporations is still limited. For example, one specialized trade corporation wanted to take advantage of a world price drop for a certain chemical raw material that was typically imported in large quantities. However, its business scope was under rigid control and its plan had to be examined and approved by authorities at higher levels. Before the plan passed such approval procedures, the market price had gone up again.

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[4] The Harmonized System is commonly used by GATT member countries, including the United States.

Another piece of evidence that contradicts the independence of foreign trade corporations is the existence of mandatory export targets. While the number of commodities subject to mandatory export planning decreased over the years and all commodity mandatory plans were terminated in 1992 [Lardy 1993b], a system of mandatory plans for total value of exports remains. Effective January 1, 1991 MOFERT, the Ministry of Finance, and the State Planning Commission, in accordance with the annual export and foreign exchange plans approved by the State Council, assign to the provinces and municipalities targets for foreign exchange submission to the State and for total value of exports. Provincial and municipal trade commissions in turn allocate a contractual obligation to foreign trade enterprises under their jurisdiction. This new system provides localities with considerable discretion in the export mix but not in the total export volume. Beginning in 1991, rebates of domestic taxes levied on export goods were linked to fulfilling targets for exports and the remission of foreign exchange to the center [Lardy 1993b, p.9].

Adoption of the agency system is frequently mentioned in the current round of reforms.[5] The government has been promoting the development of the agency system since the mid-1980s with limited success. In general, foreign trade companies have rejected the agency system and continue to purchase goods from production enterprises and then sell them internationally on their own account. The foreign trade companies' principal objection is that under the agency system trade companies have no claim to the foreign exchange earnings from exports, all retained foreign exchange accrues to the production enterprise. Producers also have complaints about the agency system, claiming agency fees are too high, reported to be 1-3 percent of the value of the contract, and the service offered by the foreign trade companies is not always good. Only 10 percent of all exports in the early 1990s were carried out under the agency system [Lardy 1993b, p.11].

Given the lack of success in popularizing the agency system, the government now appears instead to be concentrating on extending direct trading rights to more production enterprises. Granting producers direct trading rights is one way to provide them with access to foreign exchange and to ensure that domestic production is oriented towards world market demand. Presently, enterprises holding direct trading rights represent a small percentage of all firms, but the number may be set to expand rapidly in the near future.

In the late 1980s, the government granted direct trading rights to a few hundred large state-owned production enterprises. Trade autonomy evidently was also granted to some retail businesses; indirect evidence of this is the withdrawal of these rights from the Shanghai Friendship Store in 1991 [Tao and Wang 1992]. By the end of 1992, at least 839 large and medium enterprises had been granted trading rights [Department of Commerce 1993b], including Shanghai Hua Lian, the second largest department store in China in terms of sales volume [Tao and Wang 1992]. Textile enterprises are being singled out to receive trading authority because they produce a large percentage of China's

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5 Under an agency system, production enterprises sign export contracts directly with international buyers and accrue the profits or bear the losses on these transactions. Production enterprises pay a commission fee to the foreign trade company for shipping and processing services. The trade company bears no responsibility for the financial outcome of the transaction.

total exports [Xinhua 1992i and Wu Yunhe 1993]. All textile firms in Shanghai are to be granted export and import autonomy by fall 1993 [Xinhua 1992g]. Of course, the 90,000 foreign-invested enterprises also have trading authority. In early 1993, trading rights were extended to 100 scientific research institutes. The government has established guidelines for determining which organizations qualify for trading authority (Table 1). The principal criterion is the recent export volume of the enterprise or institute. Enterprises meeting the criteria may apply to the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) which has the general responsibility for handling the licensing of trade rights.

Competition is rising not only because the number of authorized traders is growing but also because the types of products foreign trade corporations can trade is expanding. The net result is foreign trade companies are starting to see their trading business diminish. Several of the specialized national foreign trade corporations continue to deal in just a few commodities, and some foreign trade companies have geographical and product limitations. However, in 1992, the majority of foreign trade companies were authorized to trade in any product not subject to trade management, such as quotas [Department of Commerce 1993b]. The expansion of foreign trading companies and the extension of trade rights to production enterprises have led to a wave of personnel defections from major trade corporations in the past year [Blass 1993].[6] Figure 4 summarizes the various types of foreign trade enterprises.

On the other hand, foreign-invested firms and production enterprises with direct trade rights are generally authorized to import only production equipment, raw materials and resources required by the enterprises themselves, and to export goods of their own production. Furthermore, most production enterprises and research institutes lack trading experience and some are initially hesitant to exercise their direct trade rights. They also need access to financing, such as trade credits, and to warehouses in ports. Lardy reports that in 1990 and 1991 the Bank of China extended 85 percent of total export credits to foreign trade companies [1993b, p.11]. Consequently, in 1991, only about 10 percent of all exports were handled by enterprises with direct trading rights [Lardy 1993, p.11].

Data on the share of trade handled by the various types of trade enterprises are limited. Table 2 shows the distribution of foreign trade in Guangdong Province for 1992. The situation in Guangdong is unusual because of the large number of joint ventures: these foreign-invested companies arranged over 40 percent of exports and handled 53 percent of total imports. Local foreign trade companies played a larger role in handling imports than the specialized foreign trade companies. Nationwide in 1992, the top 500 trading companies, including national and local foreign trade companies and production enterprises with direct trading rights, accounted for 66 percent of total trade: 61 percent of exports and 74 percent of imports. Topping the list for the twelfth year in a row was China

[6] Beijing's Foreign Economic Relations and Trade Commission (*jingmaohui*) has been trying to hire professionals with backgrounds in foreign trade, accounting, financing, real estate, futures trading, and foreign languages. The city's state-run foreign trade organizations have recently lost 500 senior professionals lured away by new local trading corporations and other enterprises offering higher salaries.

Table 1. Direct Trading Rights Eligibility Criteria

Type of Organization	Annual Export Volume
Enterprise manufacturing mechanical or electrical products	1,000,000 RMB
Enterprise manufacturing high technology products	1,000,000 RMB
Other manufacturing enterprises	4,000,000 US$
Research organizations	500,000 US$

Source: Department of Commerce 1993b.

Enterprise manufacturing industrial products	1,000,000 US$
Enterprise processing agricultural products	1,000,000 US$
Guangdong enterprise processing agricultural products	500,000 US$

Source: personal interview with Guangdong Agriculture Commission Deputy Director June 1993.

Figure 4. Categories of Foreign Trade Enterprises

1. <u>Specialized foreign trade corporations</u>

   These are mostly specialized import/export corporations under the Ministry of Foreign Trade and Economic Cooperation (formerly MOFERT). They undertake a large portion of the import/export business of the State and are responsible for handling the import orders placed by different sectors from all over the country. They also handle the trading of commodities facing keen competition in world markets and bulk commodities closely related to the people's livelihood. They are also in charge of all imports and exports governed by official bilateral trade agreements. These companies are classified according to the products they handle.

2. <u>Central industrial, agricultural, and technology trading corporations</u>

   These are mainly foreign trade companies established by the various industrial ministries. They are mainly concerned with the import of products or technology required by their respective ministries and the export of their own products.

3. <u>Local foreign trade corporations</u>

   These are foreign trade companies set up by the provinces or municipalities. They are involved in a wider sphere of business. With the exceptions of those products exclusively assigned to specialized foreign trade corporations by the state, they can engage in all kinds of import/export business that local governments are authorized to handle.

4. <u>Production enterprises</u>

   These are enterprises with the right to conduct import/export business. They include foreign-invested enterprises and other enterprises with direct trading authority. Generally speaking, they are only authorized to import equipment, materials, and resources required by the enterprises themselves and to export goods produced by the enterprise.

5. <u>Research Institutes</u>

   These are scientific research institutes with exports of more than $500,000 per year.

Source: Hong Kong Trade Development Council Research Department 1991, pp.6-7 and Department of Commerce 1993b.

Table 2. Guangdong Province Composition of Trade by Foreign Trade Agencies: 1992

Trading Agent	Share of Total Exports (percent)	Share of Total Imports (percent)
Specialized foreign trade companies	28	17
Local foreign trade companies	23	30
Production Enterprises		
Foreign-invested companies	43	53
Export processing companies	6	0

Note: The classification of trading agents in this table does not necessarily match the classification shown in Figure 4. For example, it is not clear if central trading companies are included under the category of specialized foreign trade companies or if Guangdong Province does not have any trade handled by central trade companies.

Source: Brudvig 1993, pp.21-22.

Chemical Industry Import/Export Company with nearly $8 billion in total trade volume, accounting for more than half of the country's total trade volume in chemical and related products [China State Statistical Bureau 1993, p.102]. In 1992, there were 12 companies with a trade volume exceeding $1 billion and 224 enterprises exceeding $100 million. The 500th company handled a trade volume of nearly $39 million [Guoji Shangbao 1993a].

State Economic and Trade Commission

One new institution that has emerged and risen in prominence is the State Economic and Trade Commission, formerly the State Council Production Office and then the Economic and Trade Office. The Economic and Trade Office was officially elevated to State Council commission level in March 1993 at the first session of the Eighth National People's Congress. The Economic and Trade Commission (ETC) is divided into six groups with six deputy directors. Wang Zhongyu, former deputy director, is the present director.

The responsibilities of the ETC are numerous and wide ranging. The commission is tasked with resolving the problems of state industries, namely overproduction and inefficiency. Last fall the 14th Party Congress agreed to reform China's state enterprises by selling the assets of most enterprises as shares on the fledgling domestic and established foreign securities markets and charged ETC with overseeing this process. In addition, the ETC participates in approving the establishment of new companies and ETC is also involved in coordinating efforts and emergency arrangements to ensure that farmers receive payment, not white chits, for agricultural products. ETC is to coordinate with the relevant departments to guarantee the necessary funds are available. This past year in coastal provinces, such as Guangdong, white chits were not a problem. However, other provinces, including Jiangxi, Henan, and Sichuan, were unable to redeem farmer IOUs prior to Spring Festival [personal interview April 1993]. The ETC and Zhu Rongji, former director of ETC, were credited with making significant progress in clearing the "debt chain" in 1992.

The role of the ETC in formulating foreign trade policy is still limited. The ETC participates in granting approval to enterprises for foreign trade authority and oversees the newly formed electronics and machinery import and export office [Shi, L. 1993c]. However, MOFTEC continues as the functional ministry responsible for the comprehensive management of the country's foreign economic and trade work [Ching Chi Tao Pao 1992a].

State Planning Commission

Following the promotion of vice-premier Zhu Rongji, then director of the Economic and Trade Office, to membership on the Politburo Standing Committee at the 14th Party Congress in October 1992, speculation was rife concerning the abolishment of the State Planning Commission. The State Planning Commission (SPC) remains, but the emphasis of its work has shifted from setting targets, allocating materials, and examining and approving investment projects to formulating economic development strategy and major policies and goals [Wang, Yuling 1992]. The SPC continues to draw up, in collaboration with other relevant central government agencies, export value plans and foreign exchange plans for the country.

The State Commission for Restructuring the Economy, SPC, and ETC are all charged with the general task of identifying macro economic regulations and controls which will be suitable for a socialist market economy. The existence of three government agencies with the same mandate hinders the formulation of appropriate policies for macroeconomic management of the economy [Harrold 1993].

Ministry of Materials and Equipment

Another bureaucratic institution undergoing major reform is the former Ministry of Materials and Equipment (*Wuzi Bu*). Previously this ministry was responsible primarily for the allocation of production inputs and outputs. At the March 1993 National People's Congress, the Ministry of Materials and Equipment and the Ministry of Commerce were combined to form the Ministry of Internal Trade. The decontrol of prices for most capital goods, and the increased reliance on markets for the distribution of most goods reduced the traditional role of the Ministry of Materials and Equipment.[7] Prior to the reorganization, the ministry was already changing its functions. By 1992, the ministry had established 40 general corporations to participate in market competition and circulation, and had expanded their business scope to cover industry, high technology, transportation, information, and real estate. Its income from businesses other than domestic trade accounts rose to 10 percent. The ministry branched into foreign trade with 28 corporations which engage in large-scale import and export businesses with their management scope covering rolled steel, nonferrous metals, chemical products, machinery and electronic products, fertilizers, and textiles. According to former Minister Liu Suinian, the ministry had 50 Sino-foreign joint ventures across the country and 15 enterprises overseas [Xinhua 1993c].

Distribution of Foreign Exchange

Recent reforms have altered the allocation of foreign exchange and affected both the official and swap foreign exchange rates. China's foreign exchange retention system switched from geographically-based rates to product-based rates in the early 1990s. After 1988, the Special Economic Zones were no longer allowed to retain 100 percent of foreign exchange earnings. Since January 1, 1991, the retention rate has been uniform across all regions but has varied by the commodity exported.[8] This policy change removed one source of regional friction since previously some provinces, such as Guangdong, had enjoyed higher retention shares.

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[7] Materials distributed under the mandatory plan of the ministry were slashed in 1992 from 72 kinds to 22 kinds with the quantities distributed also declining [Zhang, Zhiping 1993].

[8] According to Lardy [1993b, p.5], Tibet was allowed to continue to retain 100 percent of its modest export earnings.

In general, 20-30 percent of foreign exchange earnings is remitted to the central government and the remaining 70-80 percent is distributed among local governments, foreign trade companies, and export producers (see Figure 5). The actual exporter, regardless of whether it is a foreign trade company or production enterprise with direct trade rights, is required to sell all the foreign exchange earned to the state bank. According to the retention rates, the state bank reserves a certain amount of foreign exchange for the foreign trade company (if the trade is handled by one), the production enterprise, and local government. All of these units are actually given vouchers which they can redeem for foreign exchange according to State Administration of Exchange Control regulations. Among the levels of local government, cities and counties receive less foreign exchange than provinces and autonomous cities. The system also allocates a larger share to central trade companies than to local trade companies [personal interview June 1993].

The government has undertaken several other measures to increase access to foreign exchange. All enterprises now are allowed to keep 70 percent of foreign exchange earnings from exports in excess of the planned volume. The government also has eased restrictions on the use of foreign exchange earnings. Foreign exchange earnings from exports in excess of the planned volume are not to be restricted by the local government exchange spending quotas and may be spent importing commodities for domestic sale.

The new system is still very complicated as indicated by its name "export-generated foreign exchange cancellation-after-verification system." The foreign exchange retention system has been described by officials in provincial foreign economic relations and trade commissions as incomprehensible even to those administering it. They must refer to numerous tables of exchange rates to determine the appropriate compensation rate for producers, foreign trade companies, and local governments. Listed foreign exchange rates can vary by export commodity, type of production enterprise, location of enterprise, and whether the export was within the quota target or over. Factored into the exchange rate is the rebate of domestic taxes paid on export goods and, in the case of certain products, the relationship between production costs and the amount of foreign exchange earned (export earnings rate). The export earnings rate is determined by forming a ratio of the production cost in yuan and the amount of foreign exchange earned [personal interview June 1993].

If an enterprise wishes to use their foreign exchange retention quotas to import goods in the future, it can use renminbi to buy back the foreign exchange from the bank according to prevailing exchange rates as long as the amount does not exceed the reserved amount and its use meets regulations. The enterprise can use retained foreign exchange for importing equipment and technology in order to improve its ability to earn more foreign exchange, import raw materials, or make overseas business trips. If the enterprise does not use its retained foreign exchange or has a surplus, it can sell the foreign exchange to other enterprises through the swap centers.

Figure 5. Foreign Exchange Retention Shares

1. <u>Exports of petroleum</u>

   96% to central government (at listed exchange rate)
   4% retained by oil company (at listed exchange rate)

2. <u>Exports of mechanical and electrical products and specific science and technology products</u>

   30% to central government (at swap market exchange rate)
   10% to export producing enterprise (at listed exchange rate)
   60% to foreign trade enterprise (at listed exchange rate)

3. <u>Exports of general merchandise</u>

   20% to central government (at listed exchange rate)
   60% to foreign trade enterprise (one-third may be purchased at swap market exchange rate by central government if needed, otherwise at listed exchange rate)
   10% to export producing enterprise (may be purchased at swap market exchange rate by central government if needed, otherwise at listed exchange rate)
   10% to local government (at listed exchange rate)

4. <u>Exports from import processing</u>

   10% to central government (at listed exchange rate)

   if import processing contract is between a production enterprise and a foreign client,
   80% to export producing enterprise (at listed exchange rate)
   10% to supervisory authorities (at listed exchange rate)

   if import processing contract is between production enterprise and foreign trade enterprise,
   60% to export producing enterprise (at listed exchange rate)
   30% to foreign trade enterprise (at listed exchange rate)

Note: Listed exchange rate is the official exchange rate adjusted for various factors. See text for discussion of details.

Sources: Hong Kong Trade Development Council Research Department 1991, pp.17-18 and China Light Industry Development Strategy Research Center (Ed.) 1991, p.83

Since 1986 over 100 foreign exchange swap centers (*waihui tiaoji zhongxin*) and 15 regional foreign exchange swap markets have been established across China [Jin 1993]. The State Administration of Exchange Control (SAEC) also opened the National Foreign Exchange Swap Center in Beijing with representatives from the local centers to bring about greater uniformity in the foreign exchange rate quotes nationwide. The national market also deals with foreign exchange swaps between state enterprises in Beijing as well as between various provinces and municipalities. The yuan and U.S. dollar are the only currencies currently traded on the national market. All provincial capitals, autonomous cities, Special Economic Zones and many major and medium-sized coastal cities have established swap centers which handle sales of foreign exchange for enterprises within their jurisdiction. The total volume of foreign exchange swapped at these centers increased by an average annual rate of 34 percent from 1988 to 1992 (Table 3). In some provinces, retained foreign exchange is being transferred via telephone or through a computer network.

Beginning over a year ago, selected enterprises in Shanghai, Shenzhen, Zhuhai, Jiangsu, and Hainan were allowed to retain foreign exchange earnings in cash (spot exchange retention) instead of vouchers (foreign exchange quota retention) on a trial basis.[9] However, these experimental enterprises are required to open a foreign exchange deposit account in an authorized bank. These accounts can only be utilized according to state regulations and are under the supervision of SAEC. The introduction of spot exchange retention is considered a necessary step prior to convertibility of the currency. The foreign exchange quota system has many limitations, including carrying no interest, offering limited currencies (usually only the dollar), and no hedge against exchange risk.[10]

Reductions in Import Tariffs

After raising tariff rates sharply for selected commodities in the period from 1988 to 1991, China commenced lowering tariffs in the latest round of reforms. In January 1992, China lowered tariffs in 16 categories covering 225 products [Tong, Z. 1993]. By late 1992, China reported an overall nominal tariff rate of 42.5 percent while its real or trade weighted average tariff rate was 22.5 percent [Liang 1992, p.42]. In comparison, the real average tariff rate for industrialized GATT member countries is 4-5 percent and for developing GATT member countries is 13-14 percent [Liang 1992]. One source reported an average import tariff on unspecified manufactured goods of 91.2 percent and on consumer goods of 130.7 percent in 1992 [Qingnian 1992].

At the end of 1992, China reduced import tariff rates for 3371 goods, accounting for 50 percent of all commodities subject to tariffs [Yu, J. 1992]. Table 4 presents a

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[9] Previously only foreign-funded ventures and a small number of state enterprises were allowed to retain foreign exchange in cash.

[10] The enterprise must fill in an approved import form before it is allowed to convert the foreign exchange quota into cash, leaving the enterprise exposed to foreign exchange risk in the meantime.

Table 3. Swap Market Foreign Exchange Volume	
Year	Foreign Exchange Volume (billion US$)
1988	6.3
1990	13
1991	20.4
1992	25

Sources: Ren, K. 1992a p.1; Tao 1992, p.31; Lardy 1993b, p.3.

Table 4. Partial Schedule of Tariff Cuts Effective December 31, 1992

Commodity	Change in Tariff Rate
Minerals	cut an average 6.9%
crude oil	down from 3% to 2%
naphtha	down from 15% to 10%
fiber asbestos	down from 20% to 15%
gems	down from 9% to 7%
Machinery and electronics products	cut an average 6.2%
household sewing machines	down from 60% to 50%
computer software	down to 9%
electric hand tools	down from 80% to 75%
condensers	down from 25% to 23%
instant cameras	down from 50% to 5%
ordinary cameras	down from 80% to 50%
camera parts (such as lenses)	down from 80% to 25%
Transportation equipment	cut an average 5.2%
large aircraft	down from 6% to 5%
automobile shock absorbers and radiators	down from 80% to 50%
Chemicals	cut an average 4.2%
ethylene, propylene, butylene	down from 15% to 12%
polyethylene, polypropylene	down from 30% to 28%
dyes	down from 25% to 23%
Building materials	cut an average 9.2%
ordinary slate and brick	down from 70% to 60%
cement products	down from 50% to 40%
quartz glass for optical fibre	down from 12% to 9%

Table 4. Partial Schedule of Tariff Cuts Effective December 31, 1992, continued	
Metal and metal products	cut an average 7.3%
pig iron	down from 3% to 2%
silicon steel	down from 15% to 12%
copper	down from 6% to 5.5%
Farm produce	cut an average 8%
cattle fat	down from 50% to 10%
sheep fat	down from 20% to 10%
cowhide	down from 12% to 10%
chocolate and non-cocoa sugar	down from 40% to 15%
Textile raw material and product	cut an average 9.6%
man-made cotton and acrylic fiber	down from 25% to 20%
polyamide fiber	down from 50% to 45%
chemical fiber product	down from 100% to 90%
garment	down from 100% to 95%
Timber and paper	cut an average 9.4%
ordinary logs	down from 3% to 2.5%
high-grade timber	down from 25% to 20%
frankincense	down from 12% to 3%
agallock eaglewood	down from 15% to 3%
ferula	down from 12% to 3%
sheet wood for making polywood	down from 12% to 9%
Source: Wang Ya 1992, p.2 and Yu, J. 1992, p.2]	

partial list of these goods. This round of tariff cuts reportedly lowered the average nominal tariff rate by 7.3 percentage points. There are strong indications that the reported real tariff rate of 22.5 percent already reflects this latest round of tariff reductions. These tariff reductions were quite modest with a few exceptions: instant cameras dropped from 50 percent to 5 percent (satisfying the recently signed Memorandum of Understanding with the United States) and camera parts fell from 80 percent to 25 percent. Overall, machinery and electronics products, which have high tariff rates, were cut by only 6.2 percent on average. Two agricultural commodities saw significant declines in tariff levels: cattle fat from 50 percent to 10 percent and chocolate and noncocoa sugar from 40% to 15%. Goods selected for tariff reduction favored raw and semi-finished materials that are in short supply domestically.

In March 1993, the government announced that starting in 1994 the import tariff on 486 computers would decline to 20 percent from the present 50 percent [Department of Commerce 1993d].

Reductions in Nontariff Trade Barriers

China has employed a vast array of nontariff trade barriers or direct administrative intervention to protect domestic producers, including quotas, licenses, prices, and import examination. The government relied on these barriers to a larger extent than tariffs to curtail imports in the late 1980s. Recently China has taken steps to dismantle some of these barriers and in other cases has announced plans to remove barriers in the future.

In April 1992, the government eliminated the regulatory import tax (a separate surcharge imposed over and above the applicable tariffs) that had been imposed on 18 kinds of commodities [Shi, M. 1992]. In addition, government officials have stated that import substitution lists announced by industrial production departments will serve only as recommendations and will no longer be binding on domestic importers [Li, M. 1992]. The State Administration for Inspection of Import and Export Commodities promised to simplify and improve the examination process for machinery and electronic imports [Liang 1992].

In January 1993, a total of 138 categories of export commodities were subject to license control by the State, reportedly 52 percent less than a few years ago [Xinhua 1993d]. By April 1993, when MOFTEC introduced a system of issuing export licenses at different levels of administration, the number of controlled export commodity categories had risen somewhat to 143. The new procedures spell out which government administrative level is responsible for issuing licenses, the principles for issuing an export license, and the valid term of an export license [Yu, J. 1993].

Similarly, MOFTEC issued provisions for the licensing system of import commodities. Presently 53 categories of goods require import licenses. U.S. officials are not satisfied that the information released by MOFTEC (concerning the application process and which administrative departments are responsible for issuing import license approvals) adequately meets the requirements of the market access Memorandum of Understanding. Two important items are missing: first, the criteria used to approve issuance of the certifying document needed to get the license, and second, provisions for administrative and judicial review [Department of Commerce 1993f].

MOFTEC has announced a schedule for removing import licenses, with over two-thirds to be removed by the end of 1994 [China Economic News 1993a]. This schedule, shown in Figure 6, closely matches the schedule agreed to in the U.S.-China market access agreement.

III. PRODUCT AND SECTOR IMPACT ASSESSMENT

This section turns to the question of the impact of the recently signed Memorandum of Understanding with the United States and future GATT membership on China's economy. In the past year, Chinese officials and scholars have addressed this question and identified a number of sectors and products that are likely to be affected. Once the market is open, the impact will be greater on capital-intensive industries and milder on labor-intensive industries. The effect on these sectors and industries will not be uniform nationwide. For example, affected industries in Guangdong Province, with its outward-looking economy, will be less vulnerable to foreign competition than the same industries in inland provinces. Figure 7 is an illustrative list of those products frequently mentioned in the press as most likely to suffer from foreign competition. The machinery and electronics, automotive, and chemical sectors are singled out as the most likely to be seriously affected. These sectors represent nearly 40 percent of all manufacturing. If linkages with other sectors of the economy are taken into consideration, then the scope of the effect will be even greater. Parts of the textile and agricultural sectors will also be affected but to a lesser extent. Each of these sectors is discussed below.

Automotive

The China National Automotive Industry Corporation (CNAIC) believes that severe competition with Western automakers is imminent. Although reduction of trade barriers for the automotive industry is rather limited under the market access agreement, reductions will be far reaching under GATT.[11] After China accedes to GATT, its fledgling auto industry will be vulnerable in the face of an influx of high-grade, low-priced foreign automobiles.

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[11] In the Memorandum of Understanding, China agreed that current and future U.S. joint ventures producing motor vehicles and parts will no longer face quantitative restrictions on imported parts and kits.

Figure 6. MOFERT Announced Schedule for Lifting Import License Control	
Date	Commodities Affected
December 31, 1993	rolled steel, billet, waste steel, waste vessels, southern medicines, cobalt and cobalt salt, polysodiumcarbonate, coffee and its products, civil airplanes, 34 kinds of processing and assembling lines, fruits, picture tubes for black/white TV sets
December 31, 1994	chemical fiber silk glue, beer, grape wine, refined vegetable oil, pulp and timber, ABS resin, sodium hydride, civil dynamite equipment, synthetic glue, refrigerators, washing machines, tobacco products, cigarette filters, diacetate fiber tow, plywood, petroleum, chemical fiber except polyester fiber and acrylonitrile, some chemicals, computers and external equipment, x-ray machines and nuclear magnetic resonance medical equipment, air conditioners over 4000 kilocalorie, refrigerating compressors over 5000 kw and reciprocating or piston motors with discharging capacity over 1000 ml for car use
December 31, 1995	duplicators, integrated circuits, film, other chemicals, other vegetable oils, other wines, air conditioners without refrigerating equipment, automobile chassis and automobile driving bridges
December 31, 1996	pesticides and carbonate beverages
Source: China Economic News 1993a, p.2.	

Figure 7. Sectors and Products Negatively Affected by Market Access Agreement and GATT

Machinery and Electronics Sector	
electric hand tools	calculators
cameras	video recorders
sewing machines	photocopiers
refrigerators	communications equipment
televisions	industrial measuring devices
air conditioners	computers
washing machines	broadcasting equipment
Automotive Sector	
automobiles	motorcycles
auto parts	light duty trucks
Chemical Sector	
ethylene	drugs
polyethylene	dyes
Textiles Sector	
synthetic fibers	garments
Agricultural Sector	
tobacco	vegetable oilseeds
fruit	grain
Source: Various Chinese press accounts.	

The country now has over 100 vehicle manufacturing plants of which only two have a production capacity of more than 100,000.[12] In comparison, large automakers in industrialized countries commonly have production capacities exceeding one million vehicles. China's automotive production scale is well below standard profit making levels. However, small car factories in China have a profit margin of 30-60 percent compared to an average 10 percent for foreign manufacturers [China Daily 1993c]. For each of China's top eight automakers, the annual gross profit exceeds their net fixed capital value. However, in terms of labor productivity, the best performance in China was 0.24 car per laborer per year, a striking contrast to 17 cars in Japan and 13 cars in the United States. Furthermore, Chinese-produced vehicles are of inferior quality. The high profit rates are the result of domestic production control, protectionist barriers limiting auto imports, and rising domestic demand. Domestic automobile prices that are as much as three times the international market price have attracted a large number of enterprises to enter the automotive industry. Local governments eager to collect extra revenues for their budgets are often directly involved in auto production [China Daily 1993a].

China has several foreign joint ventures in the automobile industry, including Peugeot in Guangzhou, Volkswagen in Shanghai, and Chrysler in Beijing. The government has extended protection to these joint ventures as well as to domestic automakers, thereby allowing joint ventures to cash in on China's closed market. Most of these joint ventures are reproducing foreign car models under licensing arrangements. They begin by assembling cars with imported parts, gradually rely on more local parts, and finally -- it is hoped -- achieve complete domestic production. China is using this licensing method to produce the Volkswagen Santana, Audi, Peugeot, and Charade. To encourage the shift to domestically produced parts and to limit domestic production, imported parts incur a tariff of 200 percent. In addition, the State adds substantial taxes on domestic sales of autos, accounting for nearly 30 percent of the sale price in some cases [China Daily 1993c]. A Shanghai-made Santana, a sedan, costs approximately $30,000, nearly three times the cost of a similar car on the international market.[13] Motorcycles are also produced under licensing, and tariff rates on imported parts are 100-150 percent.

Machinery and Electronics

China suffers from a sizeable competitive gap for a number of products in the machinery and electronics sector. The price of Chinese copiers is roughly 1.6 times that of a similar imported product, including tax and charges. The price of domestically made cameras is 1.75 times the import cost of a Minolta camera. The problems plaguing this sector are similar to those of the automotive sector. Rising income levels have led to high demand for electronic consumer durables. When combined with import protection, producers face opportunities for high profits. Various localities then vie with each other to

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[12] In 1992, more than 1.05 million vehicles were sold in China of which 85 percent were sold on the market and the remainder allocated by the State. The State plan calls for production of 1.2 million vehicles in 1993 of which 300,000 will be sedans [Bian 1993].

[13] In early May 1993, the government announced a nearly 33 percent reduction in the price of Santanas in preparation for GATT.

produce these high profit goods, giving rise to the continuous and increasingly serious phenomena of redundant construction and production. The production scale is typically small, production costs high, and quality lacking compared to imports. Incomplete market information prevents a particular locality from knowing about investment and production in other regions until it is too late resulting in overcapacity. In these situations local government response has all too frequently been to protect local production through domestic trade barriers and subsidies.

Table 5 indicates the extreme imbalance between supply and demand that has developed for a number of popular consumer durables. Air conditioners are the latest hot consumer item but production capacity already exceeds demand. Nevertheless, more plants are planned by regional authorities. Refrigerator stockpiles grew larger in 1992 despite efforts to curb excess production. However, famous and quality brands are in short supply on the market. With 100 refrigerator manufacturers, sales of the 10 best brands account for 70 percent of the total sales. According to a consumer survey, 48.7 percent of urban families had refrigerators by mid-1992. Projected nationwide demand by 1995 is 8 million refrigerators annually, half of existing production capacity. A World Bank survey of several of China's largest color television factories concluded that the costs are 70-80 percent higher than similar factories in the world, and among the 76 color television factories in China there are only 10 boasting a productive capacity of 300,000-400,000 sets [Yang, H. 1993]. According to the Memorandum of Understanding, China is to lift license and import quotas for air conditioners, refrigerators, and washing machines by the end of 1994.

China describes its electronics industry as being at the level of developed countries in the mid-1970s. Production of high technology electronic products, such as cellular telephones, camcorders, and computers, have only recently begun.[14] Microcomputer technology lags the cutting edge by about 15 years with China's integrated circuits three development stages behind [Yang, H. 1993]. Lower quality electronic products will find it difficult to compete with imports.

Chemicals

Most enterprises under the Ministry of Chemical Industry are large and state-owned. The prices of their products are generally 10 percent higher than those on the international market, and product quality is rather low. China is the second largest agri-chemical producer in the world, second only to the United States. Since China signed an intellectual property rights agreement with the United States (effective January 1, 1993), enterprises in the chemical industry can no longer freely use worldwide chemical research achievements. Having to pay for the right to use these achievements will cut into their profits.

[14] For example, about 200,000 personal computers were sold in 1992 and sales may reach 300,000 in 1993 [Department of Commerce 1993d].

Table 5. Overcapacity in Consumer Durables

Product	Year	Demand Sales	Production	Capacity	Yearend Inventory
Air Conditioners	1990		245,000		
	1991		630,000		
	1992	<3,000,000	1,500,000	3,000,000	
Refrigerators	1991				1,400,000
	1992	3,771,000	5,143,000	16,000,000	
Washing Machines	1992	6,000,000		16,000,000	
Televisions	1991	5,420,000	11,940,000		
	1992	6,050,000	12,530,000	21,250,000	

Sources: Chang Weimin 1992b, p.2; China Daily Business Weekly 1992a, p.1; China Daily Business Weekly 1992b, p.1; Huang, Xiaoling 1992, p.4.

The production capacity of ethylene, the main feedstock for petrochemicals and plastics, is expected to reach 9 million tons in the year 2000 from nearly 3 million tons at present. However, demand is projected to be no more than 4 million tons [Huang, Xiang 1992]. Moreover, most of the crude oil needed for production of these products would have to be imported. Nevertheless, more than 10 provinces, cities, and departments are still trying to start new ethylene and oil-refining projects.

The rubber industry expects to be negatively affected by foreign trade reforms. For some types of tires, supply is less than demand; however, production scale is small and efficiency low. For example, a Guangzhou tire factory has an annual production of less than one million tires but employs more than 2000 workers. A similar factory in South Korea employs less than 100 workers. The Korean factory sells meridian tires on the international market for $25 while production costs for the same tires in the Guangzhou factory exceed 200 yuan [Long, et al. 1993]. When the exchange rate was 6 yuan/$1, these tires were not competitive. However, at a 10 yuan exchange rate, the story is very different. Hence, the exchange rate will be an important determinant of the extent of the impact on many products.[15] License and quota restrictions on polypropylene and rubber imports are to be lifted by the end of 1994 according to the market access agreement.

Producers of chemical raw materials used in the pharmaceutical industry also are identified by China's press as vulnerable to trade liberalization [Long, et al. 1993]. The market access agreement calls for most pharmaceutical import quotas to be removed by the end of 1995. Current tariff levels are over 30 percent for chemical raw materials used for medicine and over 40 percent for medicine preparation and capsule type medicine.

Textiles

To support the domestic textile and apparel industry, imports of synthetic fibers have risen dramatically, outpacing imports of natural fibers. One-third of China's textile and apparel enterprises suffered losses in 1991 due to an uncertain international market climate and economic retrenchment in the domestic textile and apparel industry. The cotton and wool textile industry now has 38.82 million spindles, one-third more than required to satisfy domestic demand and exports. According to the Research and Development Center under the State Council, the problem with cotton is that consumers are demanding a higher quality than most manufacturers can produce [Huang, Xiang 1992]. In order to compete once the market access agreement has been implemented, industry officials say technological standards must be raised, efficiency increased, quality improved, and a greater variety of products developed. License restrictions for imports of synthetic fibers and garments are to be removed by the end of 1994 according to the Memorandum of Understanding.

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[15] Similarly small chemical fertilizer factories were hurt in 1991 and 1992 by fertilizer imports. In 1993, with a devalued yuan domestic fertilizer factories were doing better [personal interview April 1993].

Agricultural Products

Historically, China has undervalued agricultural products relative to world prices. But as price and production controls on agricultural products have been gradually lifted, China's true comparative advantage is being revealed. Grain, the most important staple, had been subject to production, price, and trade controls. Presently, all that remains is monopolized foreign trade by CEROILS, the specialized trading company for grain and oilseeds. China maintains self-sufficiency in rice with the domestic market price of rice slightly lower than the world price. China imports and exports small amounts of rice, although imports of high quality Thai rice are rising with income levels, especially in Guangdong Province. According to Chinese officials, the grain that will be most affected by trade liberalization is wheat. China has been a major wheat importer for nearly a decade with the domestic price tending to be higher than the world price. In the first half of 1992, the price of imported wheat transported inland was 0.82 yuan/kilogram. During the same period, domestic wheat was selling at 0.86 yuan/kilogram in the Zhengzhou market [Wang Fu et al. 1993]. Imported (U.S.) wheat also yields 7-8 percent more flour than domestic wheat. Under the Memorandum of Understanding, grain quotas are to be lifted by the end of 1994. The phytosanitary restrictions, which have banned the import of U.S. wheat from the Northwest because of a TCK smut problem, are to be revised and based only on objective scientific standards. With the dismantling of these import barriers, the amount of wheat imported may rise markedly [Deng and Cai 1992].

In spite of substantial tariffs, the cost of imported edible oil is still much lower than domestic oil [Wang Fu et al. 1993].[16] Furthermore, the purity of imported oil is much higher. The market access agreement calls for a reduction in tariff levels for oilseeds by the end of 1993 and the removal of quotas by the end of 1995. Consequently, officials expect a substantial impact on domestic vegetable oil production.

Fruit will be affected somewhat by the market access agreement and GATT membership. In spite of a ban on U.S. fruit: Washington State apples, Sunkist oranges, and grapes are readily available in urban areas of Guangdong Province [Molstad 1993]. In May 1993, the price of imported apples was 18 yuan/kilogram as compared to 6-12 yuan/kilogram for domestic apples. There is an increasing share of consumers who are willing to pay higher prices for high quality, imported fruit. Throughout China higher income consumers are willing to pay a premium for U.S. products.[17] While this is a growing market, it is still limited. The majority of consumers cannot afford imported fruit and they will continue to buy domestic fruit. Nevertheless, domestic fruit growers will feel some effect, especially Shandong apple growers producing varieties very similar to those of the United States. The phytosanitary restrictions and quotas on fruit are to be removed by the end of 1993.

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[16] In 1991 China raised the tariff rate for palm oil to 50 percent and for soybean oil to 230 percent [U.S. Department of Agriculture 1992, p.9].

[17] U.S. agricultural trade officers reported that some Canadian apples are imported and then labeled as U.S. Fruit vendors have been known to place a sticker on domestic apples hoping to imitate the Washington State apple sticker [personal interview June 1993].

Guangdong agriculture commission officials said that where China will really be hurt is in imported frozen meat and processed dairy products, such as powder milk. They describe China's processing technology for meat and milk as poor and expensive. U.S. agricultural trade officers in China do not agree that these agricultural products would be hurt by freer trade. The Memorandum of Understanding does not directly address either of these products..

IV. REACTION TO TRADE REFORMS AND COPING STRATEGIES

According to Y. W. Sung, an economist at the Chinese University of Hong Kong, provincial governments and ministries have only just begun to consider how they would be affected and how many factories could be put out of business by liberalizing trade and joining GATT. Nevertheless, various strategies to cope with the imminent changes are already beginning to emerge. One option available to China and allowed under GATT is infant industry emergency protection. However, this protection can only be used selectively and the protection period lasts only 3-5 years. Ultimately, China will need to rely on other strategies to survive.

Adopt Advanced Technology

One major strategy many firms hope to follow is to import advanced technology so they will be able to produce high quality products that can compete with imports. China recently raised its import goal for the 8th five year plan (1991-1995) from $350 billion to $400 billion [Department of Commerce 1993h] and announced that technology imports will make up a higher proportion than originally expected. The government is encouraging this strategy by raising industrial depreciation rates so that enterprises can put aside old equipment and purchase new. The government is also encouraging enterprises to make more extensive use of international competitive bidding for purchasing imported equipment. The use of this method will lower costs and assure better quality. China is pushing the implementation of international standards, such as ISO 9000, to help make Chinese enterprises and products more competitive on the world market.

Many firms in the automotive, machinery and electronics sectors are eagerly seeking foreign investors to establish joint ventures that will include a transfer of new technology. China's computer industry is urging the government to grant it priority rights in using hard currency to import advanced computer technology. The general secretary of the Chinese Computer Federation said China should open its computer market wider and ease some restrictions on foreign imports in a bid to lure foreign companies to introduce their latest technology to the domestic computer industry. The Computer Federation has set a goal that the computer industry would be virtually self-sufficient in high technology by 1995. This goal will be very difficult to achieve. The Ministry of Textile Industry negotiated a package of technology transfers with partners from Japan, Germany, Italy, and Switzerland to enable domestic manufacturers to produce updated textile machines. The textile industry's import of these advanced technologies and equipment exceeded $1.8 billion in 1992 [Xinhua 1992e].

Another method to promote the introduction of new technology from abroad has been the establishment of development zones. In 1992, the State approved 25 new industrial development zones, bringing the total number of such zones to 52. Moreover, local authorities approved more than 100 high technology development zones [Xinhua 1993e].

Raise Investment Funds

Second, firms are seeking access to investment funds to expand production to take advantage of economies of scale and lower production costs and to adopt new technology. The two principal channels for raising investment funds are establishing development funds and issuing bonds and stocks. According to the director of the State Pharmaceutical Administration, the government will put 1 percent of pharmaceutical sales into a special fund for the development of new drugs and for setting up national development centers, laboratories, pilot production centers, and a data bank. The special fund will also be used to encourage inventors and enterprises to develop new drugs. The China National Automotive Industry Corporation (CNAIC) has asked the central government to establish a development bank for funds to upgrade the auto industry.

The CNAIC also has asked permission for enterprises to issue bonds and stocks at home and abroad . Many other enterprises have been converting to share-holding enterprises to raise funds. More than 350 share-holding enterprises were set up in 1992 [Xinhua 1992h].[18] In 1992, another 34 enterprises joined those already listing public stocks on the Shanghai and Shenzhen markets [Xinhua 1992h]. By the end of 1992, 20 billion yuan of stock securities had been issued [Jin 1993]. Early this year, China announced that two shareholding companies in each mainland province will be permitted to be listed on the Shanghai and Shenzhen stock exchanges in 1993. However, by early summer 1993, the central government told local governments that if they had not met their assigned treasury bond sales quota, enterprises within their jurisdiction would not be allowed to issue A shares on these stock exchanges [Tong, I. 1993].[19] By October 1992, 17 enterprises were selling B shares on the Shanghai and Shenzhen stock exchanges to overseas buyers.

A total of 10 Chinese companies are to be selected in 1993 to raise capital and seek listings in foreign countries. On June 19, 1993 Hong Kong and China signed a Memorandum of Understanding on securities regulations, clearing the way for mainland enterprises to sell shares denominated in Hong Kong dollars on the Hong Kong stock exchange. Tsingtao Brewery Company announced it would begin trading shares on the Hong Kong stock exchange in July, becoming one of the first mainland firms to list directly

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[18] In most cases, shares are restricted to the firm's employees or, in a few instances, other approved state enterprises.

[19] With rising inflation, treasury bond sales had fallen off.

on a foreign stock exchange.[20] Tsingtao plans to use nearly half the $110 million proceeds from the share offering to repay US dollar-denominated loans and the remainder on expansion of its four breweries.[21] Anheuser-Busch Inc. is investing $16.4 million in Tsingtao Brewery by purchasing 14 percent of the shares offered for sale. Anheuser-Busch anticipates personnel exchanges, technology transfers, and new product development between the two brewers in the future [Smith 1993]. Shanghai Petrochemical is approved to follow Tsingtao in listing on the Hong Kong exchange and expects to raise $320 million in capital [Hewett 1993]. Other companies will be allowed to list only after restructuring and conforming to International Accounting Standards. Table 6 presents financial information on nine companies expected to list on the Hong Kong exchange.

Enterprises are also beginning to issue bonds. The China National Metallurgical Import and Export Corporation became the first enterprise to float foreign currency bonds in China when it issued $40 million of bonds this summer.

Change Organizational Structure

Many firms and industries are changing their organizational structure in anticipation of increased foreign competition. By the end of 1992, 55 large state enterprise groups had been formed achieving vertical integration by combining production, investment, and trading [Xinhua 1993e]. This strategy is often initiated by the foreign trade corporations to ensure their survival after the loss of monopolistic trade rights. Several examples are described below.

* The State Council approved the establishment of the China National Machinery Import and Export Conglomerate. The conglomerate, with the China National Machinery Import and Export Corporation as the core, consists of 351 units including foreign trade companies, productive enterprises, Sino-foreign joint ventures and overseas enterprises.

* The China International United Petroleum and Chemicals Company (Unipec) is a joint company set up by Sinopec (China Petrochemical Corporation) and Sinochem (China National Chemicals Import and Export Corporation) in February 1993 [Wang, Yong 1993a]. Unipec connects China's largest manufacturing complex for petrochemical products and China's sole trader in crude oil.

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[20] Other state-owned enterprises have formed subsidiaries abroad that have already listed on foreign exchanges. In October 1992, the China Brilliance Automotive Company was the first Chinese subsidiary company to list on the New York Stock Exchange. By July 1993, a total of three Chinese subsidiary companies were listed on the New York Stock Exchange.

[21] Tsingtao Brewery is anxious to pay off foreign loans because of the continued devaluation of the yuan.

Table 6. Companies to be Listed on Hong Kong Stock Exchange

Company	Number of Workers	Fixed Assets	1991 Profits	Capital to be Raised through Stock Issue
		million yuan		
Tsingtao Brewery	2700	128	28	600
Shanghai Petrochemicals	61000	5500	1500	2500
Guangzhou Shipyard	8000	220	100	300
Beiren Printing Machinery	5600	190	60	100
Maanshan Iron and Steel	77000	3300	750	1000
Dongfang Electric Company	2300	63	1600	100
Tianjin Bohai Chemical	34000	1800	18	400
Jiangsu Yizheng Chemical	19000	3400	720	1500
Kunming Machine Tool	4700	110	11	100

Source: HG Asia in Hewett 1993, p.Business 3.

* The president of China National Metals and Minerals Import and Export Corporation (Minmetals) established the China Metals and Minerals Group with 280 associated subsidiaries [Wu, Yue 1992a]. By forging links with a number of manufacturers of nonferrous metals and minerals, they hope to upgrade the quality of products for export. The reconfiguration is also designed to secure domestic export bases and overseas footholds. In overseas markets, the company will establish more wholly-owned or joint venture projects to tap and import natural resources which China is short of, such as iron ore [Wang, Yong 1992].

China has resurrected an old strategy of merging weak state enterprises with healthy enterprises and also has been experimenting with bankruptcies. In Sichuan province alone, more than 2000 enterprises were merged, one-fourth the nationwide total. Outstanding enterprises are to serve as the nucleus in developing partnerships and mergers. The government has been encouraging state-owned enterprises to convert into joint ventures, particularly among the chemical sectors 6600 state-run enterprises, introducing both foreign capital and management. As new joint ventures they would be able to trade independently rather than having to go through national trade agencies. Some enterprises have actually declared bankruptcy, closed, and layed off workers. In 1993, a steady stream of skilled and professional people from Sichuan were arriving in Guangdong seeking employment [personal interview June 1993].

Develop Markets

A fourth major strategy being employed to cope with increased competition is developing markets, including expanded markets for output, service markets, and information and price markets. The Ministry of Chemical Industry set up a "window" company in Hong Kong to gather information on the international market. In recent years, the government has supported the establishment of wholesale markets for spot and forward exchanges. One of the earliest and most successful is the Zhengzhou grain market. This market allowed the government to free up grain prices. Now the grain surpluses and deficits of individual provinces are handled through exchanges on this market rather than through central government planning. A tobacco and cigarette wholesale market for domestic tobacco products is forming in Beijing. A functioning wholesale market is considered a first step in legalizing the import of foreign cigarettes which up to now are brought in largely through smuggling. Shanghai opened its fourth national exchanges market, a chemical products market in early 1993. Membership includes 36 chemical product manufacturers, circulation units, foreign trade companies and financial institutions of notable scale and influence from around China. In total over 20 large wholesale markets or exchanges were newly established in 1992 [Xinhua 1993e].

Various local governments are eagerly establishing "futures markets" in spite of a limited understanding of how such markets function and an absence of regulations. Most futures markets are in reality spot and forward exchanges and no futures contracts are traded. Thus far, futures contracts are only traded on the Nonferrous Metals Exchange in Shenzhen, the Metals Exchange in Shanghai, and the Grains Exchange in Zhengzhou. At the end of 1992, officials announced the establishment of China's first futures brokerage company - Guangdong Wantong Futures Brokerage Company. Since then brokerage companies have multiplied rapidly and provide access not only to the domestic exchanges but also the major international futures exchanges. It is hoped these markets will increase the efficiency of trade.

The major function of the exchange markets is to reveal or identify prices by reflecting the domestic and international supply and demand conditions. It will then be up to the government and individual industry associations to establish information channels by publishing on a regular basis supply and demand trends, price changes, and new product development for both domestic and foreign markets. The information channels are to serve producers, traders, and consumers.

Foreign Trade Bank

One institution that is being established to assist Chinese enterprises in developing overseas markets is a state-run foreign trade bank or import-export bank. The specialized bank's scope of business is to include providing import and export credits, export credit insurance, and project financing. Credit will be targeted to promote the export of certain products, especially machinery and electronics, and to diversify trade partners. Once this bank is established it would most likely assume the existing trade credit program under the Bank of China. For example, the Bank of China announced in 1992 plans to provide $100 million in export-buyer credits every year for the next three years. These credit loans are particularly targeted to imports of Chinese large and complete sets of equipment, ships, machinery and electronic products, worth no less than $1 million. The maximum loan term is 10 years and credit is supplied in US dollars. Interest rates are set in line with the OECD standards [China Daily 1992]. The foreign trade bank is expected to help market diversification by providing longer payment periods to move into markets that are higher risk, such as some African and Latin American countries [Guoji Shangbao 1993b].

Tong Zhiguang, Vice-Minister of MOFTEC and chief negotiator for China's return to GATT, is in charge of preparing for the new bank. In June 1993, Tong said he hoped the trade bank would become operational soon and would meet international standards.[22] The major source of funding will be the State and the new bank will probably float bonds at home and abroad [Zhu, L. 1993].

[22] Mr. Tong may be referring to the fact that there are GATT rules against direct subsidies for exports. However, China argues that several major industrialized countries have set up official or semiofficial foreign trade banks. These banks are often run with funds directly appropriated by the government.

V. LINKS WITH OTHER ECONOMIC REFORMS

The impact of foreign trade reforms and China's ability to satisfy the requirements of the market access Memorandum of Understanding ultimately are intrinsically linked with successful reform in other sectors of the economy. Principal among these reforms are price reform, including the price of foreign exchange and capital, and separation of government administrative functions from enterprise activities.

Price Reform

China has promised the signatories to GATT that it will rationalize prices during the 8th five year plan (1991-1995). After more than a decade of deregulation, the value of capital and consumer goods sold outside the state plan in 1992 accounted for 81.8 percent of the state's total sales figures, a 10 percentage points increase over 1991. Tables 7 and 8 show the history of price decontrol for purchases of agricultural and sideline products and retail sales of industrial commodities, respectively. In January 1993, price controls remained for 89 categories of capital goods and communications and transportation services, down from 737 at the end of 1991 [Xinhua 1993e]. As of mid-May 1993, price controls on grain and edible oils, major consumer staples, were removed in more than 80 percent of China's cities and counties. Only Ningxia, Tibet and Hainan continued partial control of grain and edible oil prices [China Daily 1993b]. These regions are expected to decontrol prices in the near future. In fact, Hainan began liberalizing grain purchasing and distribution in July [Department of Commerce 1993j]. Following the abolishment of grain and oil coupons, the State Statistical Bureau stated that 90 percent of all capital and consumer goods sales were at guidance or free market prices [personal interview May 1993]. However, it should be pointed out that while plan pricing (*dingjia*) is being abolished for virtually all commodities, this still leaves both guidance and market pricing which can be quite different. For example, the price of Daqing crude oil is 784 yuan per ton in the international market. In the domestic market, the plan or *dingjia* price is 204 yuan and the guidance price is only 355 yuan, less than half the market price.

Goods still subject to state control include a few light industrial products, such as salt and important medicines, and several agricultural products, such as cotton, tobacco, and silkworm cocoons. For several means of production only a portion of output is distributed at plan prices. For example, about one-third of rolled steel, 20 percent of timber, and only 7 percent of cement were under planned quotas in 1992 [Zhang, Zhiping 1993]. The Planning Department of the State Planning Commission recently contrasted the prices of 18 major means of production and agricultural products with the prices on the world market and analyzed the differences. Results showed that domestic plan prices of the major products are generally lower than the prices on the world market. For example, the price of crude oil is only 26 percent of the world market price. [Tao, S. 1993]

Prices in two major sectors - energy and transportation services - still need to be reformed and currently also are underpriced relative to supply and demand. Yu Xiaosong.

Table 7. Percentage Distribution of Total Purchases of Agricultural and Sideline Products by Type of Price

Year	Government Fixed Price	Government Guided Price	Market Regulatory Price
1978	92.6	1.8	5.6
1979	88.4	4.9	6.7
1980	82.3	9.5	8.2
1981	79.1	11.5	9.4
1982	78.3	11.5	10.2
1983	76.1	13.4	10.5
1984	67.5	14.4	18.1
1985	37.0	23.0	40.0
1986	35.3	21.0	43.7
1987	29.4	16.8	53.8
1988	24.0	19.0	57.0
1989	35.3	24.3	40.4
1990	25.0	23.4	51.6
1991	22.2	20.0	57.8

Source: Ling 1992, p.21 (statistics of the State Pricing Administration).

Table 8. Percentage Distribution of Total Retail Sales of Industrial Commodities by Type of Price

Year	Government Fixed Price	Government Guided Price	Market Regulatory Price
1978	97.0	3.0	0
1985	47.0	19.0	34.0
1986	35.0	25.0	40.0
1987	33.7	28.0	38.3
1988	28.9	21.8	49.3
1989	31.3	23.2	45.5
1990	29.8	17.2	53.0
1991	20.9	10.3	68.8

Source: Ling 1992, p.21 (statistics of the State Pricing Administration).

vice-director of the State Economic Trade Commission, said crude oil, coal and electricity are expected to come under closer market regulation. The share of coal output sold outside of plan is scheduled to increase until 1996 when all coal is to be sold on the free market.[23] In July 1992, the government permitted a price rise of 10 yuan per ton, thus pushing State prices up to 45 yuan per ton [Chang, W. 1992a].[24] On the free market, coal sells for 100 yuan or more a ton. Roughly half the provinces and autonomous cities and regions raised their electricity rates this summer and the other half will raise rates later this year.[25] Residential users in Beijing are facing a 38 percent rise from 0.16 yuan/KWH to 0.22 yuan/KWH [Chang, W. 1993b]. Industrial users are also facing a price increase, albeit smaller. Railway transport fees were raised in 1992; however, excess demand continued to be very evident in 1993. The State Statistical Bureau estimates that railways carried only 60 percent of demand in 1992 [personal interview May 1993].

Officials have stated that the prices of most commodities and labor services will be decontrolled. Only a small number of products directly related to nonrenewable resources, public utilities, products often in short supply, and products related to national security concerns will continue to be managed by the government. In a number of cases, the price management of these remaining products will be decentralized with provinces having the right to adjust prices based on their local conditions. For all products remaining under control, the government plans to adjust the prices to more accurately reflect their scarcity value. Commissions will be set up to regulate the prices of utilities with the commissions taking into consideration the interests of producers, distributors, and consumers. Prices are to ensure that producers can meet production costs, recoup investment, and make profits. Decades of undervaluing energy has left the power industry with some 90 billion yuan in debt [Chang, W. 1993].

Foreign Exchange Reform

China continues to maintain a dual-rate foreign exchange system: an official state-set bank rate and the swap center determined rates. Table 9 shows official and swap rates between 1987 and 1993. From 1987 to 1989 the official exchange rate was 3.72 yuan/1$ while the swap center rate was 45 to 90 percent higher. In April 1991, the State Administration of Exchange Control began a managed float of the official exchange rate. The official exchange rate rose incrementally from 5.43 yuan/$1 in early 1992 to 5.76 yuan/$1 in December 1992 and has held steady since. The gap between the swap and official exchange rates was nearly closed in Fall 1992 but has widened since. Factors contributing to the widening gap include: 1) increased demand for foreign exchange as a

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[23] Coal constitutes 70 percent of the energy China uses.

[24] The plan price of coal was raised but the quantity of coal distributed under plan did not decline because of rail transport limitations [Zhang, Zhiping 1993 and personal interview May 1993].

[25] Electricity accounts for about 12 percent of total energy consumption in China [Chang, W. 1993b].

Table 9. Official and Swap Foreign Exchange Rates (yuan/US$)

Date	Official	Swap Market (average)
1987	3.72	6.5
1988	3.72	6
June 1989	3.72	6.7
December 1989	4.2	5.7
December 1990	5.2	5.5
December 1992	5.76	7.2
February 1993	5.76	8
June 1993	5.76	10

Sources: Lardy 1992b, pp.58, 65; Xin 1992, p.2.

result of rising imports and foreign investment; and 2) speculation that the swap rate will continue to depreciate [Brudvig 1993].

The importance of the swap rate has grown over the past 5 years with a proliferation of swap centers and the total transaction volume of foreign exchange in these centers rising from $6.3 billion in 1988 to over $25 billion in 1992 (see Table 3). Lardy estimates that 80 percent of foreign exchange earnings in 1992 were priced at the swap exchange rate [Lardy 1993a].

There exists a third exchange rate: the black market rate. The black market exchange rate was about 6 yuan/1$ as recently as fall 1992. In 1993 it had risen to 9 by early spring and to 11 in early summer. The rate fell to about 9 after Zhu Rongji assumed the position as head of the People's Bank of China on July 2.

The rise in the swap and black market exchange rates offer protection to domestic products from imports. A number of provincial officials believe that the recent sharp devaluation of the yuan is not fully due to economic forces but rather partly based on speculation about a future official devaluation of the yuan. These officials also recognized that inflation is a major determinant of the exchange rate [personal interview April 1993].

Chinese citizens with foreign exchange income can convert it to renminbi on the swap markets or deposit it in foreign exchange bank accounts. Typically, the Bank of China and/or People's Bank of China act on behalf of the swap center to buy and sell foreign exchange for these individuals. Since late February, the foreign exchange swap markets throughout China set rate ceilings of 8-8.2 yuan/US$. Furthermore, the one year interest rate on foreign exchange bank accounts was only 3 percent and inflation was approaching 15 percent. Therefore, more foreign exchange started to flow out of the government-controlled channels (banks and swap centers) and into the private sector or black market.

The ceiling and inflation affected not only individuals but also traders and joint ventures. Joint ventures began to encounter difficulties in obtaining sufficient foreign exchange on the swap markets [personal interview May 1993]. This led the Guangdong branch of the State Administration of Exchange Control to seek approval from Beijing to set up a pilot project allowing foreign tourists to change directly their foreign currencies into renminbi. With this additional demand for renminbi, the yuan was to float against other currencies on an open foreign exchange market [personal interview May 1993 and Chen, Kent 1993]. The proposal was never approved and instead on June 1 the ceiling on the swap market was lifted.

China has declared their long-term goal of making the renminbi a freely-convertible currency. Yin Jieyan, director of the State Administration of Exchange Control, said this reform will occur in two stages. First, the renminbi will be convertible on current accounts (trade, tourism, aid, and donations). Later, the renminbi will become convertible on capital accounts (direct investment, securities investment, and loans). Officials expect this to be a slow and gradual process. One of the first steps the government has taken is to allow renminbi to be taken abroad. Effective March 1, 1993 foreigners and Chinese can bring up to 6000 yuan into and out of the country.[26] Another important first step in moving towards a convertible currency is the adoption of the spot exchange retention system which was discussed earlier in this paper. The spot exchange system is reportedly working well in trial operations.

The spot exchange retention system is considered a necessary but not sufficient condition for introducing uniform exchange rates. Also needed is a unified market exchange rate. Plans call for linking the segregated regional foreign exchange swap markets by computers. In the recent past, the spread between centers frequently exceeded 15 percent.[27]

Planned additional steps in the process of achieving convertibility include the following: 1) formulating and promulgating national rules and regulations to manage the foreign exchange market; 2) developing forward trading of foreign exchange; 3) increasing the types of foreign currency traded at swap centers (presently almost all only trade in US dollars); 4) introducing interbank lending in foreign exchange; 5) developing the use of exchange-rate stabilization funds; 6) gradually bringing trade, nontrade, and individually held foreign exchange all to the same market; 7) allowing some border trade to be priced and settled in renminbi; and 8) allowing financial institutions to issue foreign currency stocks and bonds in China.[28]

Lardy [1993a] feels China is close to achieving convertibility of renminbi for trade and tourism transactions soon. However, he believes convertibility on the capital account will have to wait about 10 years because China's banking system still needs major reform. Chinese officials also urge caution and say reforms should proceed slowly to secure nontrade foreign exchange earnings and avoid unfavorable balance of international payments [Tao 1993].

Banking Reform

It is in the area of banking reform that there has been the least progress to date. Policy loans continue to dominate, and interest rates are still set by the People's Bank of China and approved by the State Council. There has been no shortage of admonitions urging the replacement of planning and administrative controls with macroeconomic levers

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[26] In spring 1993, gold shops and money changers in Hong Kong started to exchange Hong Kong dollars and yuan. The Po Sang Bank is evidently backed by the Chinese government in exchanging yuan in Hong Kong [Lee 1993].

[27] During the week of January 4-9, 1993 the average swap rate ranged from 7.11 at the Xiamen market to 8.34 at the Beijing market [China Economic News 1993f]. When the ceiling was in effect from late February through May 1993, the spread narrowed to less than 5 percent.

[28] The China Investment Bank announced it will issue foreign-currency bonds to Chinese citizens in the first half of 1993.

in directing the economy. However, there still are no macroeconomic levers that actually work or have any effect.

Interest rates were raised in mid-May 1993 for the first time since 1990. The interest rate for private and institutional fixed-term bank savings was raised by 2.18 percentage points with the interest rate on one-year fixed deposits reaching 9.18 percent. Bank loan interest rates were increased by a margin of 0.82 percent. The interest rate on treasury bonds was raised at the same time: five-year bonds to 14.06 percent from 11 percent and three-year bonds to 12.52 percent from 10 percent [Ren, K. 1993a]. After these modest adjustments, real interest rates remained negative.[29] The State Council was reluctant to raise interest rates higher because it would raise the operating costs of state-owned enterprises, one-third of which are already operating at a loss.

A second round of interest rate hikes went into effect on July 11. Interest rates on deposits were raised an average of 1.72 percent and loans were raised by 1.38 percent. The interest rate for one-year deposits is now 10.98 percent. The People's Bank of China also announced that three year and longer savings accounts will have their interest rate pegged to the inflation rate.[30] The Ministry of Finance also increased interest rates for three-year and five-year state treasury bonds to 13.96 and 15.86 percent, respectively. This round of interest rate hikes appeared to finally attract new savings from the private sector. The Beijing branch of the People's Construction Bank of China, for example, received 8.98 million yuan in new savings on July 11 compared to the daily average of 4 million yuan in June [Beijing Review 1993e].

Partial reform of the banking system was launched in 1992. Banks are now starting to retain a portion of their profits and losses under a responsibility system rather than handing it all to the upper levels. Banking institutions began to separate their policy loans from merit loans. The next step in the reform process is not yet clear. One option under discussion is creating a separate bank responsible for all policy directed loans [Department of Commerce 1993g]. This option would allow existing banks to make only merit loans. However, the bank for policy loans will need capital to operate. If the government is not to interfere with other banks, it needs to reduce the deficits of state enterprises and/or raise more government revenue for policy loans.

Separation of Government Administration and Enterprise Management

In 1992, China began a program to seriously streamline government bureaucracy by reducing the size of the staff and budget expenditures. National and local government agencies were told to spin off enterprise activities and their associated staff. Government officials were given permission to continue working in these enterprises but they would no longer be government employees. In numerous instances, former government officials continue to draw on their connections or *guanxi* to benefit their enterprises.

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[29] Inflation rose 12.5 percent nationwide and 17.4 percent for 35 large and medium cities in the first six months of 1993 over the same period in 1992.

[30] Long-term interest rates were adjusted for inflation in 1988 and 1989 as well.

China continues to reduce the scope of its mandatory production plan at the central level. The proportion of output value under the state mandatory plan dropped from 12 percent in 1992 to 6.5 percent in 1993 [Xinhua 1993f].[31] A total of 25 of the state's 55 large enterprise groups have been granted permission to set their own production plans.

On the other hand, local government agencies are increasingly searching for profitable industries to invest in and control. In most cases, they do not seek to manage these enterprises directly but rather need a revenue stream from these investments. Many government agencies find direct budget allocations insufficient to carry out their work, especially in the areas of agriculture and education, and need an outside source of funds to adequately compensate staff and purchase vehicles.

During their March 1993 session, the National People's Congress approved the abolishment of the ministries of textile and light industries. This reorganization served to weaken the sectoral management system that has prevailed for decades. Traditionally sector- or industry-specific ministries have controlled a certain level of resources which are then used only within that sector. This system has constrained resources from flowing optimally across all sectors. Now that the market economy dominates the planned economy, the responsibilities of these former ministries for allocating inputs and outputs has diminished greatly. They have been cut back to councils or bureaus, and are to assist enterprises in their industry to improve product quality and expand domestic and international markets [Department of Commerce 1993g; Beijing Review 1993a].

Conflicts still exist between the functions of government and the operation of enterprises. One of the most serious affecting trade is the provincial foreign economic trade commissions (*jingmaohui*) which have established and operate several foreign trade companies while also being responsible for distributing import and export commodity licenses to foreign trade companies under their jurisdiction. A Guangdong provincial official predicted that in 2-3 years the system will have evolved so that this conflict would no longer exist [personal interview June 1993]. Some officials are supporting the introduction of quota auctions to help resolve this conflict. Forcing foreign trade enterprises to bid competitively for export quotas would help ensure they truly operate autonomously. Quota auctions would also encourage export producers and trading corporations to increase exports of high quality, value-added products to earn as much foreign exchange as possible with a limited export quota. Proponents of quota auctions say the resulting income could be used to establish a foreign trade development fund and subsidize the export of infant industry products.

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[31] Mandatory production plans for Capital Steel and Iron and Chongqing Capital and Iron were canceled on a trial basis [Xinhua 1993f].

VI. REFORM AND U.S. TRADE PROSPECTS WITH CHINA

China's commitment to the Memorandum of Understanding on market access and to reforming their economic system to regain GATT membership is the most important factor affecting improvement in U.S. trade prospects with China. While it is still too early to evaluate China's compliance with the market access agreement, there are indications of how events are likely to proceed. GATT negotiations have reached the stage of drafting an agreement on China's rights and obligations in relation to the GATT. China is facing many demands from other GATT members and must weigh those demands against benefits of membership. There are also other potential obstacles to increased U.S. exports to China.

Memorandum of Understanding

Thus far, China's attempts to fulfill the requirements of the market access agreement have met with mixed reviews. U.S. agricultural trade officers are pleased with the reduction in the tariff level for chocolate and non-cocoa sugar but are not yet satisfied with tariff levels on other agricultural products, such as vegetable oilseeds. Recently published import license approval procedures were viewed by U.S. officials as incomplete. As the October deadline for protocols on standards and testing approaches, U.S. officials are becoming anxious. However, protocols regulating live cattle, bovine semen, bovine embryos, and live hogs were drafted in June that would satisfy the requirements of Paragraph 3 Article IV of the Memorandum of Understanding. China has assembled a medfly experts group to review material supplied by the Animal and Plant Health Inspection Service of USDA. They expect to complete their review and be prepared to meet again in August to discuss revising phytosanitary restrictions on U.S. fruit.

In some cases, the appearance of noncompliance may be attributable to a lack of understanding of what is expected. For example, the concept of a federal register of trade laws is nonexistent in China. In other cases, footdragging occurs because the government still has few macroeconomic levers and desires to keep flexible administrative measures available to adjust the flow of imports. Evidence indicates little will be accomplished ahead of schedule and the U.S. will have to wait until deadlines arrive to see if China complies. Nor is it very likely that China will go beyond what was explicitly stated in the agreement.

GATT

The GATT China working committee has almost completed stage one, the examination of China's foreign trade system, and is now drafting China's protocol of accession.[32] Since a sizeable gap exists between China's economic management system

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[32] China is one of the 23 founding signatory states of the GATT which became effective in 1948. However, in 1949 the Kuomintang government sent a letter to the GATT offices suspending China's membership. In 1982 China received observer status and in 1986 officially applied for resumption of GATT membership.

and the GATT's basic requirements, some exceptional provisions are being added to the agreement stipulating China's rights and obligations upon entry into GATT. GATT signatory nations have set five provisions for China's return to GATT: 1) it must unify the country's foreign trade policies and regulations;[33] 2) it must make its foreign trade policies and regulations transparent; 3) it must rationalize its nontariff measures and promise that tariffs will remain the main method of protection; 4) it must promise to provide a schedule for price reform; and 5) it must accept selective protection regulations before the completion of price reform.[34]

Given all these restrictions and demands on China's trade system, why does China want to participate in the GATT? First, China would be able to play an active role in shaping future international trade conditions as a member. GATT accession will complete China's participation in the major international organizations.[35] Second, China has stated that GATT membership will give it the right to multilateral, unconditional most favored nation (MFN) treatment. However, there is disagreement on whether this is necessarily the case. According to U.S. officials, China's MFN status would remain subject to the review and renewal provisions of the Jackson-Vanik amendment even after accession to the GATT. Membership in the GATT could be expected, however, to make China less susceptible to the annual controversy now surrounding its status.

China's readmission to the GATT would also make it eligible, as a developing country, for further claim to the benefits of preferential tariff treatment under the generalized system of preferences (GSP). China now enjoys some GSP benefits under the laws of 21 other GATT members, including 12 EEC countries. However, the world's biggest market, the United States, does not presently extend GSP to China. The United States has said it may not be willing to extend the General System of Preferences to China unless the program strictly limits or excludes a number of commodities produced by U.S. domestic industries already feeling competition from Chinese goods, such as textiles, apparel, footwear, small electrical appliances, and toys.

GATT membership would bolster China's position in talks related to antidumping and antisubsidy litigation. In recent years, China has become the target of charges of dumping, particularly by the United States. China can call upon GATT's mediation mechanism to ease increasingly severe trade frictions.

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[33] GATT members are requiring that preferential policies granted to special economic zones and development zones gradually be abolished to ensure the uniformity of foreign trade policies, rules and regulations all over the country.

[34] When the price advantage of a certain Chinese commodity harms or produces an impact on a similar commodity of a signatory to the GATT, the country will have the right to terminate the market access it has promised to China.

[35] China attained membership in the World Bank and International Monetary Fund in 1980.

Taiwan is also seeking GATT membership and is willing to come in as a customs area following China. China's officials believe that if Taiwan also becomes a member of GATT, it will no longer be able to refuse to establish direct transport, trade, and postal relations with the mainland.[36]

Competing Against Other Countries in the China Market

The dismantling of trade barriers will serve to open China's market to U.S. exporters as well as to exporters from other countries. While U.S. companies and products will have greater access to China's market in the future, they still must compete against others. U.S. exporters also will have to deal with certain trading practices, which in the past have tended to hurt U.S. exports.

China prefers, and is used to receiving, concessionary loans to finance foreign contracts for infrastructural investment or imports of plant and equipment. When foreign companies bid on infrastructure-development contracts, they usually are backed by low-interest financing by their home governments. To their detriment, U.S. companies seldom have had such financing available. In early 1992, the U.S. convinced other OECD countries to restrict soft loans when a project in China or other selected developing countries is deemed to be "commercially viable." The OECD agreement (in spite of its subjective nature), recession in Europe, and China's ambitious plans to carry out a large number of projects in this five year plan mean that China will have to look to other sources of funding, including commercial-rate loans [Whitcomb 1992]. This change in circumstances should improve the chance of U.S. businesses participating in these contracts.

China is also more used to dealing with industrial-government coalitions that offer packaged projects, rather than individual companies. U.S. businesses seldom operate in unified groups as businesses in Japan do. One recent exception is a group of American companies (U.S.-China Transit Group) bidding to participate in the $800 million Guangzhou subway project.

As was discussed earlier, one of China's major strategies for coping with increased foreign competition is to import and adopt new technology. This strategy and the fact that U.S. companies are more willing than Japanese and European businesses to sell and license technology or participate in joint ventures that transfer U.S. technology have led China to prefer U.S. companies in some circumstances [McGregor 1992].

With so many producers from various countries vying to get a share of the China market, China is often in a position to bargain hard. One example affecting U.S. companies is the Guangzhou subway project. The U.S. Eximbank has pledged to provide $100 million in favorable financing for any contracts awarded to U.S. companies. However, MOFTEC has indicated to the U.S. Eximbank that they want a subsidized interest rate on the financing package for U.S. companies supplying materials for the

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[36] Hong Kong and Macao have already joined GATT as separate tariff regions.

project. MOFTEC wants a 5 percent interest rate, more than a 10 year term, and 100 percent rather than 85 percent financing. MOFTEC said the Guangzhou subway group can import U.S. equipment duty free if these loan conditions are met and the Eximbank provides an official letter.[37] MOFTEC is expecting the American suppliers to subsidize the interest rate. MOFTEC said suppliers in other countries are doing this, and it does not violate OECD guidelines that countries should not subsidize commercially viable projects. It appears MOFTEC does not realize how much this would cost U.S. companies [Department of Commerce 1993i].

A booming consumer market, ambitious government plans for infrastructural development, and keen interest in upgrading domestic production technology provide U.S. companies with a wide range of opportunities. U.S. businesses are using various information channels to identify the specific products and services in demand. Some U.S. companies have gone so far as to establish joint ventures or representative offices in China. Other firms have commissioned marketing studies or tapped into the U.S. foreign commercial service network supplying information on trade opportunities. Figure 8 is a representative list of prospective U.S. commercial sales based on information gathered in southern China. Table 10 provides projections for U.S. exports to China. The lists include a variety of products and services for which the U.S. has successfully established markets elsewhere in the world.

VII. CONCLUSION

This section discusses the sustainability of current foreign trade reforms. While central government leaders are making commitments to foreign trade reform in the U.S. Memorandum of Understanding on market access and to GATT member countries, it is important to understand whether they will be able to carry through with these reforms or whether some reforms may be thwarted by other interests in China. Two specific questions of special concern are addressed. First, do trading firms conduct trade transactions on a competitive basis? Second, will local governments attempt to negate the effects of foreign trade reforms through protectionist measures? To answer these questions one needs to consider what reforms have already been implemented and evidence of how the reforms are functioning as well as links with reforms in other areas of the economy.

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[37] Normally these duty free import privileges are reserved for projects that are funded by concessionary loans provided by foreign governments.

Figure 8. Best Prospects for U.S. Commercial Sales
electrical power generation equipment
food processing equipment and supplies
petrochemical industry equipment
construction equipment
railroad and subway equipment
electronic production and test equipment
electronic components
airport equipment
telecommunications equipment
consumer products
computer software
aircraft and engines
automobiles, parts and service equipment
oil and gas field equipment
retail ventures
banking and financial services
fast food ventures
advertising
packaging equipment
Source: Department of Commerce 1992 (U.S. Commercial Office in Guangzhou, Guangdong).

Table 10. Projected U.S. Exports to China, 1992-94

Product	China's Annual Market Growth (1992-94) (percent)	Current Imports From US* ($ million)	Annual Import Growth From US (1992-94) (percent)
Electrical power systems	10	1200	7
Aircraft & parts	20	1000	15
Industrial chemicals	10	1000	6
Agricultural chemicals	5	660	10
Textile fabrics	13	600	20
Chemical production machinery	10	300	10
Machine tools	3	250	2
Plastics	10	250	5
Oil & gas machinery & services	10	220	10
Mining equipment	15	198	10
Paper & paperboard	3	130	2
Computers	10	130	20
Automotive parts & service	15	120	15
Scientific instruments	5	110	5

* 1992 estimate

Source: The China Business Review 1993, p.11 (US and Foreign Commercial Service).

Competition in Foreign Trade

The U.S. Government and other GATT member countries are concerned whether China's foreign trade system has been reformed to the point that monopolized trading no longer exists. Reforms in the 1980s and 1990s have certainly increased competition among trading institutions. Most commodities now are handled by several different foreign trade corporations. In some cases, the producer or user also can directly arrange trade. However, foreign trade corporations still are not completely independent. Their independence is held back by the lack of reform in the financial system and failure to separate completely government administration from enterprise management. The management authority of specialized foreign trade corporations, which are state-owned, has yet to be clearly defined by the state. Their current business scope and import-export plans are still controlled by the planning mechanism rather than the market mechanism [Wu Yue 1992a]. A number of foreign trade enterprises are still caught up in the debt chain. Therefore, the government feels compelled to provide these trade corporations with continued access to subsidized lines of credit.

It is in China's interest -- particularly with regard to exports -- to have foreign trade corporations financially independent. Only when world prices are passed through to the domestic market and there is no separation between production costs and trade earnings will China be able to achieve an optimal mix of exports and imports and maximize the value of exports. While reform is clearly heading in the direction of increased competition among trading institutions, specialized, major foreign trade corporations will resist some reforms. These foreign trade corporations are still very powerful and will not easily relinquish their privileged access to credit, foreign exchange, and personnel.

Local Protectionism

Another major concern is whether local governments, faced with the prospect of increased foreign competition, will respond by trying to protect local industries. Historically, protectionism has been a common response to domestic competition and has resulted in overcapacity for a number of commodities. However, the incentives for protectionism have diminished recently, and in the future, it will be increasingly expensive to maintain protectionism.

In the past, the skewed pricing system was a major incentive for protectionism. Under the state-controlled pricing system, most of the profits were made in the final processing stage. Therefore, it was more advantageous to engage in final processing and not to supply raw materials or intermediate goods. With industrial development more concentrated and advanced in the coastal provinces, the inland provinces were particularly hurt by this pricing system. In response, local governments sought to establish their own processing factories and, to ensure inputs, prevented raw materials from leaving their jurisdictions.

The scope of the state plan has been shrinking leading to higher real prices for raw materials and intermediate goods. As price reform nears completion in this five year plan (1991-1995), this motivation for protection will be eliminated.

Reform of the banking system is key to making it too expensive for local governments to engage in protection. If subsidized credit is no longer available to support the excess production capacity of factories, whether they produce televisions, refrigerators, air conditioners, or other products, local governments will be less inclined to spend real resources to support them. Without bank reform, every factory will attempt to obtain cheap credit to import technology and modernize in order to compete with higher quality imported goods. The continued availability of subsidized credit would serve only to exacerbate the problem of overcapacity.

As China's infrastructure develops, transportation will improve and market information will increase and a more unified national market will emerge. In this economic environment, it will become more difficult to maintain regional blockades as a form of protection. Local consumers will want better and cheaper products regardless of whether the product comes from another region in China or from abroad. Local governments will be pressured by consumers to remove blockades for consumer goods.

In Guangdong Province the attitude of local governments and enterprises towards trade liberalization appears to be more positive than in other areas in China. A number of enterprises expect to benefit from trade reforms and protectionism is not a common response of local government [personal interview April 1993]. A primary reason for the attitude difference is that Guangdong is more integrated with the world economy. In addition, price reforms began earlier and have progressed further than in other parts of China. Guangdong consumers' purchasing power gives them leverage in demanding access to a variety of goods. Local governments feel they cannot afford the cost of protectionism.

As other regions reach Guangdong's stage of development, more local governments will accept that while some enterprises will be able to improve quality, reduce costs, and compete in the new trade environment, many firms will not survive. Local governments will then recognize that it is in their best interests to help enterprises identify other profitable activities rather than implementing protectionist measures.

Beneficiaries of Freer Trade

A significant portion of this paper has focused on the negative impacts of trade liberalization on China's economy. However, there are significant benefits associated with China's foreign trade reforms. Various aspects of reform will benefit producers, consumers, and the government.

While many sectors and industries will be hurt by the dismantling of trade barriers, the numerous industries relying on imports stand to gain. For example, petrochemical end-users generally welcome the market access agreement. They feel the agreement will bring down domestic prices by exposing Chinese companies to stiffer international competition as a result of lower tariffs and the phasing out of import licensing and quotas by 1995. Zhou Mingtao, president of Hope Computer Company, one of the largest high-tech enterprises under the Chinese Academy of Sciences, believes the academy will benefit from trade liberalization through lower costs of many imported parts [Xinhua 1992f].

China's consumers expect to benefit from the increased availability of higher quality, greater variety, and less expensive goods, ranging from food products to consumer durables to electronic products. Throughout China consumers have a strong preference for many U.S. goods which bodes well for increased U.S. exports as trade barriers are removed. Chinese officials believe urban consumers with their rising purchasing power are an important constituent to satisfy.

U.S. officials argue that by legalizing imports and reducing excessively high import barriers the amount of smuggling would decline and more trade would go through official channels allowing the government to benefit from higher tariff revenue collections.[38] If this is the case, it would also mean that actual U.S. exports would not increase as much as official U.S. exports. Instead a portion of U.S. exports to other destinations would be reclassified as to China. For example, if China removes the ban on U.S. fruit, the smuggled fruit would no longer be classified as exported to Hong Kong.

There are officials and scholars who strongly advocate trade liberalization. An article by Li Gang in Guoji Maoyi (Intertrade) [1992, p.11] stated that "Rejoining GATT affords a golden opportunity for the reorganization and restructuring of the national economy." Li [1992, p.12] concedes that an expansion in imports may displace similar domestic products. However, he says limited resources should then be shifted away from inefficient domestic enterprises and steered toward efficient enterprises. There are others who feel China should take advantage of the opportunity presented by GATT membership to accelerate the process of structural reform. They encourage the government to move forward with coordinated reform in the price, financial, taxation, and monetary systems.

Yang Jingyu [1992, p.54] argues China "must abolish the compulsory export plan and at the same time reform prices and exchange rates so they will reflect the real costs of the use of resources." Yang [1992, p.54] further states "it is counterproductive to make export targets compulsory. It is better to let domestic producers decide based on domestic and world market conditions what and how much to export."

There is, of course, a limit to how quickly China can reform its entire economic system. It is difficult to always keep reforms on track and properly coordinated. China has made remarkable progress in price reform over the past 14 years. While the dual exchange rate remains, an increasing share of foreign exchange earnings are valued at a nearly "free" market price. The remaining steps to achieving a fully convertible currency are identified and convertibility on the current account may well be a reality within two years.[39] The burden of state enterprises has inhibited banking reform and contributed to

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[38] In 1992 China's customs tracked down roughly 10,000 smuggling cases involving 1.32 billion yuan worth of smuggled goods. Most of the goods smuggled in were large household electrical appliances, cigarettes, motor vehicles, chemical fiber raw materials, and drugs [Yu, R. 1993].

[39] A Guangdong official predicts that in 4-5 years the government will enter the market to purchase foreign exchange and will abolish the complicated retention system [personal interview June 1993].

government budget deficits. An inadequate tax system leads to insufficient government revenue and continued links between government and enterprises.

A major test of the government's resolve to carry through with reforms is the current trade deficit. For the first six months of 1993 exports reached $37.15 billion, up 4.4 percent and imports reached $40.69, up 23.2 percent over 1992. The question is whether the government can resist administrative intervention when it still has no well functioning macroeconomic levers. In the short run, there may be some backsliding in the reform process, as there has been in the past. However, the government's commitment to freer trade may remain firm in the long run.

The economic boom of the past two years is presenting enormous opportunities for foreign companies to invest, sell technology, and participate in infrastructural projects. Foreign businesses are also gaining increased access to China's vast consumer market. While the U.S. will face competition from other countries, U.S. technology and products are viewed very favorably in China. Foreign trade reforms are offering challenges and benefits to not only China but also to U.S. exporters.

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