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Reform in China's foreign trade : decentralization and diversification

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REFORM IN CHINA'S FOREIGN TRADE:

DECENTRALIZATION AND DIVERSIFICATION

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INTRODUCTION

China's foreign trade has played an essential role in the economic reform launched 12 years ago in 1978.[1] The ambitious economic reform programs require tremendous foreign currency. More than 80% of the foreign currency in China comes from export.[2] About $27 billion was spent on import of the advanced foreign technology and equipment since 1978, and nearly 60% of the net increase in China's national income during this period was due to import and export activity.[3] Because of the importance of foreign trade in China's economy, continuous studies have been conducted by scholars and students of business in this area in order to provide implications for U.S. trade policy towards China. The purpose of this paper, therefore, is to analyze the problems in China's foreign trade system, to explore the policy issues in reforming that system, and to make some predictions about future prospects in China's foreign trade.

The reform in the foreign trade system has really lagged behind the pace of reform in other areas. The foreign trade organizations were strongholds of economic planning, yet were among the very last to reform themselves. One event in particular, the suppression of the pro-democracy movement in June of 1989, has cast a great shadow on China's foreign trade reforms launched in the beginning of 1988 by the now-ousted Party chief Zhao Ziyang.[4] Why has it been so hard to reform the foreign trade system? What changes would reform bring to China's foreign trade system if it had gone through? What impact would it have on the nation's economy? These are the questions this paper will attempt to answer.

To intelligently discuss the current state of China's foreign trade, we first need a brief review of its history. Some authors have preferred to go back to the time long before the establishment of the People's Republic.[5] This, of course, provides a broader historical background of China as a nation, but the reality is that this nation was separated at the time of Mao's revolution and the two parts of China adopted totally different systems. In order to maintain focus and vigor, this paper will concentrate on mainland China after the Communist Party took power: the history starting with the founding of the People's Republic in 1949. China's foreign trade in historical perspective is covered by Chapter one.

Chapter two also provides background historical material, but focuses upon a second post-revolution phase: the post-Cultural Revolution period of 1976 to 1990. The Chinese society has undergone a tremendous change since the Cultural Revolution. The "open door" policy has brought in ideas and concepts that used to be absolutely forbidden, such as the concept of free enterprise. The meeting of western and eastern cultures and the mixture of the socialist and capitalist practices have caused great confusion among the Chinese people and their leaders. This chapter describes the complicated environment of China's social, economic, cultural, political, and legal factors, centering on the economic reform which gave rise to the long-awaited reform in the foreign trade system.

Chapters three and four cover the central topics of the paper: the structure of foreign trade organizations and policy issues in foreign trade. The structural changes in Chinese foreign trade are extremely important -- the change from centralization to decentralization and from specialization to diversification. Without such changes, the competition mechanism can not be brought into this giant machine, and without competition there will never be any vitality injected into the many bureaucratized trade organizations. Discussion of other important issues such as the composition of commodities, the management of foreign investment and foreign financing, the trade between U.S. and China, necessarily follows. Based on these facts and analysis, the future prospects of China's foreign trade are discussed. Following Chapter four is the summary and conclusion of the foregoing four chapters' discussions from the author's perspective.

As the nature of this paper is non-experimental, the data collected are secondary -- mainly from the newly published _China's Foreign Economic Relations and Trade Year Book -- 1989_, compiled by a government commission headed by the minister of Foreign Economic Relations and Trade, Zheng Tuobin. Statistics from other sources are also taken into consideration in the analyses.

Chapter 1

CHINA'S FOREIGN TRADE IN HISTORICAL PERSPECTIVE

In 1988, China's total imports and exports amounted to $79.4 billion, according to the statistics from the Ministry of Foreign Economic Relations and Trade (MOFERT).[6] This was a dramatic 285% increase over 1978 foreign trade. The average growth rate was above 16%, far surpassing the average growth rate of the world's total trade.[7] This growth rate made China the twelfth biggest country in external trade in the world.

Even in 1989, a year with enormous political turmoil in Beijing, the total import and export value still reached $81.15 billion. Exports were $43.128 billion -- an increase of 6.5% from that of the previous year. Imports totalled $38.127 billion -- a decrease of 3.9% from that of 1988.[8]

Yet the history of China's foreign trade since the founding of the new People's Republic in 1949, was far from being so impressive. The new government tried to establish her foreign trade system immediately after it took power from the National Party's government that fled to Taiwan. There were many obstacles ahead. The major external obstacle was the embargo of the new People's Republic of China by the western countries. At that time most of the western countries didn't recognize the new China, therefore it didn't have many trading partners even if China wanted to develop her foreign trade. The major internal obstacle was ideological: "self-sufficiency" and "self-reliance" were the fundamental principles of the new government's policy. Under this guiding policy, the foreign trade that the new government was willing to engage in could only be between communist countries.

Major business in the '50s was conducted solely with China's "big brother"-- the Soviet Union, who provided loans and technical assistance to China in the first ten years until relations were broken off in 1959. Because of the ideological and political disputes arising later between the Russian and Chinese Communist Party, especially between the two leaders Khrushchev and Mao, the Soviet loan was almost halted in 1957 after Mao's visit to Moscow, and the relationship began to become worse at the end of the decade. The Soviet loans to China during the First Five Year Plan period (1950-1955) came to $1.4 billion. After this period, the repayments of loans exceeded the new credits.[9]

The leading policy for China's foreign trade was, as the Ministry of Foreign Trade (MOFT) put it, "Exports are for imports, and imports are for the country's industrialization." Under this policy, equipment, machinery, technology, and even whole plants were introduced to China from the Soviet Union and other eastern block countries. This importation helped the new China establish a primary basis of her industry after years of wars. In 1959, China achieved an import and export value of $4.38 billion, and half of this amount was with Soviet Union. The ratio of foreign trade to national income was about 12%.[10]

The termination of the Party relations with the Soviet Union marked the beginning of another period of China's foreign trade. Trade with eastern block countries dropped precipitously. Trade with other developing countries and a handful western countries was sparse. The three years "natural disaster" -- caused by a setback in grain production and bad weather, brought unbearable famine to the Chinese people from 1960 to 1962. The grain production fell below 150 million tons to about three quarters of the 1957 level of production.[11] The government had to further reduce export of agricultural products and to import food to feed the hungry. In 1962, import and export value dropped to $2.66 billion, down about 50% from 1959's total. The ratio of foreign trade to national income dropped to about 8%.[12]

After 1962, the economy began to reverse a little. This brought about a reversal in foreign trade. In these few years, China began to do more business with non-communist countries, even with Japan -- a traditional enemy without diplomatic relations. China resumed import of machinery and plants, though on a small scale. And the government was trying to expand foreign trade to boost the economy, but had great difficulty. It had to heal the wounds from the recent natural disasters as well as to repay all loans from the Soviet Union (with final payments in 1965).

Leftist ideology and the power struggle within the Party, compounded by long term isolation from the world, resulted in the Cultural Revolution in 1966. Mao launched this mass movement in order to get rid of his major opponents in the Party led by Liu Shaoqi -- then President of the State, and to strengthen his own power base. This was easily achieved, but the movement became so massive that it went out of his own control. A renowned American scholar observed: "The Great Proletarian Cultural Revolution was from any point of view one of the most bizarre events in history. To western observers it made China even more mysterious than usual. Something like one hundred million people were active participants in it, many of them as victims, while at least five hundred million can be said to have been significantly affected by it."[13]

The damage of the Cultural Revolution to foreign trade was enormous. Efforts at expanding foreign trade in the preceding few years were disrupted, trade relations with a number of western countries were suspended, and the very idea of foreign trade was severely criticized and attacked by the radical Maoists. Imports and exports remained at about $4 billion in the following five or six years, a decrease in real terms from 1959. Until 1971, the total import and export value came to $ 4.84 billion, only 5.8% of the national income.[14]

In 1971, China reentered the United Nations. After that year, China gradually established diplomatic relations with Japan, European countries, Australia, New Zealand, and other countries. It also resumed trade relations with the United States. In 1979, China established full diplomatic relations with the United States, marking a new era for China, an era ending thirty years of isolation, a reentrance into the world trading family. From then on were years exciting to many of the world countries doing business with China. One observer described the trade of this period as "exploding." Only in 1978, "according to U.S. estimates, overall trade increased by close to 40% (in current prices), from about $15 billion (in 1977) to roughly $21 billion, with import (cost, insurance, freight) increasing by 56%, from $ 7.1 billion to $ 11.1 billion, and exports (free on board) rising 26%, from just under $8 billion to $11 billion."[15] According to official Chinese statistics, this U.S. estimate was quite close. The import and export value for 1978 was $20.64 billion, a 3.26% increase from that of 1971. This was the beginning of a new era of economic reform.

Chapter 2

BUSINESS ENVIRONMENT IN 10-YEAR REFORM

I. Laying The Political Foundation

In order to initiate the 10-year economic reform, Deng Xiaoping had first to clear his political path. After the late Marshal Yie Jianying and Mao's appointed successor Hua Guofeng managed to put Mao's widow and three other leftist leaders in jail, Deng became vice premier. Step by step, Deng strengthened his power-base. The only thing he had to do was to get rid of Hua Guofeng, who was the Chairman of the Party. Hua insisted on two principles after Mao's death: "Whatever Mao says must be followed strictly; whatever policy was laid by Mao must be carried out thoroughly."[16] Deng took this as a major weapon against Hua, and his position was reaffirmed in the Third Plenum of the Eleventh Party Congress at the end of 1978.[17] In a matter of about three years, Deng made it clear to the nation and to the world, through the communique of the Fifth Plenum of the Eleventh Central Committee, that he was the number one man in the Party.

Deng's political philosophy was well embodied in one of his famous sayings: "Whether it's white or black, as long as it catches mice, it's a good cat." By catching mice, he clearly meant getting things done -- making China rich. To achieve this overall goal, he called for more freedom of both expression and creativity. But he also made it clear at the outset that this freedom was limited. It had to be in line with political unity and stability: it must not challenge his power nor the power of his Party. To clear the way for change, he pensioned off more than one million senior Party cadres. In September 1985, 131 high-ranking veterans resigned. Generally they retained their perquisites as members of a new Central Advisory Commission of the Party headed by himself.[18]

Deng came to power at a time when the Chinese economy was brought to the brink of collapse by the catastrophic Cultural Revolution. Economic recovery was therefore of preeminent importance both to the country and to Deng's political position. Deng knew very well that a healthy economy was essential for the consolidation of his power. With political power in hand and political tone set, Deng began to advocate his economic reform.

II. General Social Conditions

After years of state manipulation of people's political ideology, loosening of such control and calls for the emancipation of the mind brought great changes in people's outlooks. With the restoration of the formal education system so disrupted and severely damaged during the cultural revolution, young people began to bury themselves in books again to regain what had been lost. Entrepreneurs engaged in new ways of making money. Intellectuals were encouraged to do research and write papers and books. There were often lively public debates on what should be done for the economic reform. New cadres were recruited from those with higher education and Party loyalty. International reactions were positive. People began to see more and more foreign tourists visiting China. Many people resumed correspondence with their overseas relatives and family members that was cut off during the cultural revolution. The social conditions were indeed quite stable and people were full of hope. Reform began to spread in major fields of the economy.

III. Overview of Economic Reform

In the post Mao-era, the issue of economic reform had received much publicity, but it was Deng Xiaoping's policy of market economy mixed with administrative control that provided a solid foundation for economic recovery from the cultural revolution. His theorists termed it as an "economic system with China's socialist characteristics." They drew four policy conclusions from their analysis of administrative segmentation.

First, there should be greater separation between the spheres of administration and economics, the latter having more scope to operate according to its own organic logic. This implies the formation of natural economic zones crossing administrative boundaries and the promotion of inter-plant integration, particularly through cross-boundary companies or associations. Secondly, central planning organs had to be strengthened to curb branch-based departmentalism and to establish a more rational division of labor between central and local departments. Central planners henceforth had to concentrate on macro-economic management, regulating the micro-economy less by directive means and more by economic levers or guidance methods. Thirdly, market processes were to be resuscitated, with a new ideological outlook recognizing the commoditized character of the socialist economy. Fourth, the bedrock of the reform programme, the decision-making autonomy of industrial enterprises, had to be expanded.[19]

Agricultural Reform

The reform experiment first started in rural areas. Two policies were adopted to restructure and readjust the relationship between peasants and the production units. The first one was the redistribution of agrarian land. Under the condition that the land was still collectively owned, the land could be contracted in the form of lease to individual peasants. This practice gave peasants incentive to work hard on the land and laid the overall foundation for agricultural reform. The second policy was to increase the state purchasing price of agricultural products. In 1979, prices were increased by 20.1%, and in 1980, another 8.1%. Consequently, incremental income for these two years was 46 billion yuan (the unit of RMB[20] -- the Chinese currency).[21]

With these two initial policies implemented, a series of measures were then introduced. The people's commune was previously a combination of local government and production units. This mixed creature was eliminated and the government was separated from the production units. This change enabled adoption of the responsibility system of joint contracting -- several peasants' households contracted for a piece of land and had the responsibility of remitting a certain portion of the products or profits to the state after the harvest at a pre-fixed purchasing price. This system applied not only to agricultural production but also to other associated businesses as well.

A second measure involved creation of a new purchasing policy for agricultural products. As the basis for readjusting state purchasing prices, prices for agricultural products were deregulated in 1985 (except for the portion retained to supply city residents). Thus, peasants began to have more autonomy in deciding what to do with the surplus left after state contracts were fulfilled. They could sell it on the free market or sell it to the state at a negotiated price. This was a great change from rigid planned economy to planned commodity economy.

A third measure entailed readjusting the structure of the agricultural enterprise and the composition of agricultural products, and encouraging the agrarian commodity economy. The state government allocated certain capital and loans to assist peasants in establishing private businesses. Many rural small scale factories, shops, services, schools were established, leading the rural economy to develop in the direction of specialization, commodization, and modernization.

Reform changed the outlook of the vast countryside in China. On the basis of 1980 prices, total agricultural output increased from 232.7 billion yuan in 1982 to 312.76 billion yuan in 1987 -- a growth rate of 6.2%, almost 100% greater than the growth rate of 3.22% in the 26 years prior to 1978. Crop output increased from 350 million metric tons in 1982 to 400 million metric tons in 1987.[22] From 1984 on, crop output could basically satisfy the needs of 1 billion Chinese people.

The birth of rural enterprises changed the relation between the countryside and the cities: many rural areas became industrialized. In 1986, the total income of rural enterprises was 222.355 billion yuan -- 32.31% of the total rural income and 11.73% of the national income.[23]

Ownership Reform

The reform in ownership of production means was one of the boldest moves of this period. The reformers claimed that the country was still in the primary stage of socialism, the level of productivity was low, and that the development of the economy was not balanced. It was argued that, to boost the economy, the dominant form of ownership should be changed from single public ownership to a multi-person public ownership. In the meantime, management should be distinguished and separated from ownership in publicly-owned enterprises. This would give the management more responsibility and more say in running the business. Thus there appeared many different forms of management.

Management under contract and management under lease were the two major forms. Management under contract for medium and big sized enterprises proved to be especially successful. Contracting the right of managing the enterprise to one person or a group of people made contractually clear the responsibility, power, obligation and profit sharing between management and the state government. This was a new kind of management mechanism for the publicly-owned enterprises.

According to statistics, more than 80% of publicly-owned enterprises adopted this contracting management responsibility system in 1987. A survey of 2171 enterprises adopting this system indicated that productivity was increased by 9.4% between January and September of 1987 over figures for the same period of the previous year.[24] For state owned small enterprises and business, leasing was the main form of experimentation. Those businesses leased out were primarily the ones suffering losses. The lessee was usually selected from a group of ambitious individuals via bidding or public exam. These experiments demonstrated sharply increased economic benefits and most of the businesses turned out to be making a profit after leasing.

Foreign investment, joint ventures, and joint management were also new forms of ownership. The reformers argued that as China was still in the primary stage of socialism, the existence of national capitalism, semi-socialism, and complete capitalism would introduce competition and make the state-owned enterprises better-managed domestically and more competitive internationally. By the end of 1987, there were about 9000 such enterprises -- still a very small proportion in the economy.

Enterprise Autonomy

Strengthening the vitality of business enterprises was a major concern of city-based reform. To accomplish this, enterprises needed more autonomy and power. The state government took the following measures:

1) Enlarged production planning power: Enterprises could decide their own production and new-product development planning according to the market demand, provided state planning was conformed with.

2) Enlarged buying and selling power: Enterprises could purchase raw material from the market according to their

production needs. Surplus products could be sold at will.

3) Enlarged pricing freedom: Along with more and more loosening of price regulations, enterprises could decide the prices for many products according to production costs and market demand.

4) Use of retained capital: Earnings retained by the enterprises have been growing year by year, from 3.7% in 1978 to about 30% in 1982, and 40% in 1987. Concomitantly, the power of deciding how and where to use these retained earnings also increased greatly.

5) Distribution of wages and benefits: Only the government could decide the aggregate amount of salaries and their growth rate. Enterprises would decide how to distribute increases among employees. Usually, salaries and bonuses were related to profit realized.

6) Parallel economic ventures: Enterprises could decide whether they would like to have parallel ventures in different areas, different professions, different ownership, etc.

7) Personnel power: Enterprises could decide upon their own criteria for recruiting and also upon promotion and demotion of medium and/or lower lever managerial personnel.

Another important reform in this area was in labor salary. It was the first attempt to break the "iron rice bowl" -- the state guaranteed job, since the founding of the People's Republic of China. Many experiments were conducted to find out the most effective way of giving monetary incentive to employees in order to increase productivity. Efforts were made in associating bonuses with relevant economic responsibility.

Macro Economic Management

The objective of the economic reform was to establish an economic system combining the advantages of a planned economy with the vitality of a market economy. Around this objective, the following measures were taken at the macro economic management level:

1) Planning System: The government reduced the scope of compulsory planning and decentralized the power of planning management in order to have more market force adjusting demand and supply. Approval of investment projects was also decentralized to a lower level of government. Projects of a non-manufacturing nature could be approved at provincial level. Complete return of investment was contracted to the relevant units for the sake of safety.

2) Financing system: The single state payment and reimbursement system was reformed to contract the budgeted amount to each level of government so that each had to manage financing carefully. Financing was no longer solely a state business. New forms of financing were also experimented with, such as public stock, joint management, credit loans, etc. Taxes took the place of turning in profits to the

state, and new forms of taxes were created to function as an economic lever.

3) Monetary System: A new monetary system was established, with the central bank as the main body and many other monetary institutions supporting and cooperating, including investment and trust firms. The insurance business was resumed. In a few big cities there even appeared several primary securities markets.

Circulation And Price System

Great efforts were made to develop a market system for a commodity economy. In order to achieve this, the old system of one channel purchasing, wholesaling, and retailing was changed. Primary and secondary wholesale shops directly administered by the Commerce Ministry were restructured to be administered by the commerce departments of the major cities, enlarging the autonomy of these state-owned commerce units. They had incentive to develop multi-channel buying and selling networks, the result many big trade center, shopping malls, and wholesaling markets. Also, private-owned business boomed like mushrooms after rain. These changes made consumers' lives much easier.

The major issue in price reform was the so called "two-tier" price system. This system was characterized by its supplementary regulatory role.[25] Instituted in 1984, the two-tier pricing system was designed so that for major production material such as crude oil, coal and steel, there was no longer a unified state-fixed price. The price was to be made into three categories -- fixed price, floating price, and market price. The fixed price was used for the quantity of the output within the state plan. The floating and market prices were used for surplus quantities. This policy was only applied to important industrial products. For consumer products and some of the agricultural products, the prices were gradually deregulated.

Reform In Cities

After initial success in the rural area, there were also experimental reforms in the cities. The major underlying idea was enabling cities to get rid of bureaucratic bondage and allowing for a functional atmosphere for organizing and managing. The major measures taken were the following:

1) The administrative power of all the functional areas were decentralized, the autonomy of all enterprises and businesses was enlarged.

2) In big and economically important cities, conglomerates no longer needed to affiliate with their provincial governments. They could make their own economic plans and budget directly with the state council, enjoying more freedom in implementing their economic strategies within the guidelines of government regulations.

3) Reform also touched municipal governments: they had to

simplify the governmental hierarchy and make each department more professional and efficient. Their economic activities were also supposed to be supervised by the residents of the cities.

IV. Legal Conditions

In order to manage the economy by means of law and to meet the requirements of the opening reform policy, the Sixth Convention of the National People's Congress[26] and its standing committee continued to give creation of economic law priority. In the past few years, most of the laws passed or submitted for examination by the People's Congress concerned the economy or the policy of opening to the outside world.

As early as 1981, The Law of Economic Contracts was drawn up. In April 1986, the General Civil Law was passed, a basic law adjusting the relations of the commodity economy. Injecting vitality into business enterprises has been a key link in the economic reform. The separation of ownership and management was therefore required by the reform, so as to give more power and initiative to the management of state-owned enterprises. The General Civil Law stipulated the regulations governing the enterprise legal person and gave the sole power of management to the enterprise. It also stipulated rules for joint-management between legal persons, promoting crosswise economic alliances between enterprises. The State-owned Industrial Enterprise Law (draft) defined the separation of ownership and management, including the responsibilities of the factory director. In December 1986, The Enterprise Bankruptcy Law (tentative) was passed to promote independent management of the state-owned enterprises and to let them assume sole responsibility for their profits and losses. Meanwhile, the Statistics Law and the Accounting Law were also written to ensure central control and state supervision of all socioeconomic activities.[27]

Laws were also made regarding the use and management of natural resources. Such laws like the Forestry Law, the Prairie Law, the Fishing Law, the Mineral Resource Law, the Land Management Law, the Water Law, and so on, were all basic laws addressing the use and management of various natural resources.

In order to ensure the proper implementation of the open-door policy, Laws were also formulated to govern all activities involving foreign nationals. Such laws include the Law for Economic Contracts with Foreign Nationals, the Law for Foreign Investment Enterprises, and the Law for Jcint Venture Enterprises.

In the process of economic reform and opening to the outside world, new problems requiring immediate legal regulation frequently arose. Because China was inexperienced in legislative reform and there were circumstances where the conditions calling for legislation were as yet immature, the People's Congress authorized the State Council to make temporary rules and regulations for issues involved in economic reform and opening to the outside world, as long as such rules and regulations did not contradict the basic principles laid down by the People's Congress and its Standing Committee.

Chapter 3

THE STRUCTURE OF CHINA'S FOREIGN TRADE ORGANIZATIONS

I. The Organization

China's foreign trade organizations were established in imitation of the Soviet model after the founding of the Peoples' Republic. The Ministry of Foreign Trade (MOFT) had the sole responsibility of planning, supervising, and implementing all the foreign trade businesses and activities. Because of the ideological concern over "self-sufficiency and self-reliance" and the fear of undue foreign influences, the Ministry of Foreign Trade was one of the most strictly controlled ministries, probably second only to the Ministry of Foreign Affairs.

One of the most distinctive features of this organization is its dual structure of internal administrative control and external business management. It has three area policy bureaus in charge of Europe, Africa, and America and the Atlantic, as well as a dozen functional bureaus within itself in charge of functional divisions such import and export, international cooperation, foreign loan and foreign investment, quota and licenses, regulation and law, planning and financing, etc. Its overseas's organs are the commercial offices of the Chinese embassies in each country. Its internal agencies outside the ministry itself are the foreign trade bureaus in each province, autonomous region, and the cities directly administered by the State Council. These agencies represent each level of government. From the administrative and personnel standpoints, they are part of the provincial government. The MOFT didn't have administrative and personnel power over its bureaus. All the directors of the foreign trade bureaus were assigned by the organizational department of the provincial Communist Party Committee. However, the MOFT did have the power to assign the overseas's personnel though. There used to be a Ministry of Foreign Liaison that was in charge of economic cooperation with, and aid to, other communist and developing countries. For the purpose of simplifying the bulky bureaucratic government organizations, this ministry was merged with MOFT in 1982 and the new ministry became the Ministry of Foreign Economic Relations and Trade (MOFERT).

Another important subordinate to MOFERT is The China Council for the Promotion of International Trade (CCPIT). This is a semi-ministerial level organization representing non-governmental business affairs. The director of CCPIT is often an ex-vice minister of MOFERT. The CCPIT does not get directly involved in trade. Its main function is what MOFERT cannot do -- establish business relations with countries with which China has no formal diplomatic relations. Its other functions include organizing international trade exhibitions, arbitration, foreign business related legal publication, trademark registration, and so on.

We find similarities in China's foreign trade corporations (FTCs) to that of MOFERT. The FTCs are supposedly non-governmental business entities but they are directly administered by the MOFERT. All the presidents and general managers are assigned by the personnel bureau of MOFERT. These dozen FTCs have exclusive trading rights over their specialized products such as textiles, chemistry, silks, foodstuffs, light industry, and so on. Foreign trading rights are approved and assigned only by MOFERT. These FTCs have their "branches" in each province, autonomous region, and municipality directly administered by the state council. These branches are the basic trading units in China, actually conducting most of the import and export business with foreign customers. The Chinese refer to the FTCs as "head offices." This exposes another important distinction between FTCs and western corporations. Corporation would refer to the organization as a whole, while "head office" here only refers to the group of people in Beijing under the MOFERT. Prior to 1978, the head offices had more power in business over the branches even though the head offices didn't have personnel power. Most of the contracts were only signed by the head office people for control purposes. After the business was concluded, a copy of the contract was then sent to the relevant branches for execution. After 1978, the "branches" of the FTCs were becoming increasingly independent of the head offices and more affiliated to the foreign trade bureaus who had administrative and personnel power over these branches, than to the head offices who only supervise their businesses. They actually became more like "companies" with independent accounting units than "branches" as suggested by their names. Under this authoritarian system, administrative and personnel power often carried more weight than the supervision of business. We can see clearly the management dilemma the head offices and the branches have with these conflicting and vague affiliations and control structures.

Besides these specialized foreign trade corporations directly administered by MOFERT (See Appendix D for the major FTCs under MOFERT), there were growing number of corporations administered by other industrial ministries that also had foreign trading rights authorized by MOFERT. These corporations tended to be very specialized in their relevant industries such as shipbuilding, aero-technology, automotive, postal and telecommunications appliances, and so forth (See Appendix E for selected FTCs administered by ministries other than MOFERT). Provincial governments were also establishing their general-purpose trading corporations to grab a share from the FTCs, especially in import. Businesses done by these corporations used to have only about 10% of the total import and export value. Due to the reform and open-door policy, these corporations were increasing their share of the business tremendously. The 1988 World Bank Country Report estimated that business done by corporations other than FTCs increased from 11% to 28% in the four years from 1981 to 1984.[28]

The head offices under MOFERT had a lot of power with respect to some major industrial and agricultural products. MOFERT gave the exclusive trading rights of these economically weighty products such as crude oil, wheat, rice, food stuffs, cotton, wood products, and so on to the head offices, who in turn established specialized departments to deal with these products. They could assign the task of purchasing products to the branches, while keeping the selling rights to themselves. These products are usually big in volume and easy to control process-wise, making it possible for the head offices to handle these transactions all by themselves. For smaller volume products like light industrial products, arts and crafts, garments, animal by-products, etc., the head offices had to rely on the branches to handle all transactions. The head offices' major tasks were thus planning and budgeting the import and export business for the branches. They also organized trade fairs, trading delegations to visit their foreign customers, statistical record-keeping, data preparation for the ministry's negotiations with foreign governments on trade agreements, and the set up of overseas representative's offices and joint ventures.

II. The Operation

Planning is the first stage of operation. During the latter half of each year, the State Planning Commission (SPC) assembles representatives of MOFERT, the Ministry of Finance, the People's Bank of China, the Bank of China, and the FTCs' head offices to formulate an initial plan for the year's exports. Prior to this, SPC will collect each ministry's import plans. The export plan is formulated with an starting objective of determining how much export is needed in order to realize the necessary imports, then, how much of the import plan cannot be covered by the export plan and must be financed elsewhere. The import plan is primarily an aggregate of plans submitted by the different ministries. Unless a constituent plan is either unrealistic or does not conform with the import policies (e.g., calls for the import of consumer goods instead of other more needed industrial goods), MOFERT usually cannot change its composition without consent from the relevant ministry.

Formulation of the export plan is MOFERT's major task. A plan's structure is based upon two conditions: one is available historical data, the other is the capability of providing more suitable goods and more export capacity for existing products from each FTC. Of course, the head offices would have already gathered these data and information from the branches by the time of the yearly meeting. After 1978, there was no real ideological barrier preventing export. Anything that could be exported was encouraged to be exported. The only guiding policy was to export more finished products than semifinished products and raw materials.

The planning process is initially a bargaining process. MOFERT always wants to impose more export upon the head offices. The head offices always lay out different kinds of exportation or production difficulties in an attempt to reduce the planned amount. Nobody wants a big plan that could hardly be fulfilled, it would sound bad in the year-end report and could jeopardize some benefits and bonuses. Once the head offices reach an agreement on the amount of export, there would come the second round of bargaining between the head offices and the branches. The aggregate plan becomes mandatory once the head offices accept MOFERT's plan. The only room for adjustment would be among different branches, the results depending on bargaining power of the branches. Even after the plan becomes mandatory, in the face of extreme hardship or unforeseeable market changes, the head offices can always appeal to MOFERT for changes in the plan such that the benefits and bonuses budgeted for the branches would remain unaffected.

The implementation of the plan rests mainly on the branches, as the branches deal with most of the products. The head offices have some administrative control over the operations of the branches in areas such as issuing import and/or export licenses, allocation of quotas, allocation of the foreign exchange budget, trade group organization, organization of trade fairs, and so forth. Prior to 1978, the head offices were signing all the contracts. The branches didn't have the authority to sign contracts, even though they were the ones to execute the contracts. Along with the furthering of reform, the branches have acquired more and more authority. If the products are not required by MOFERT to be dealt with by the head office, some of the branches don't even deal with the head offices any more, unless the products need quota or other licenses controlled by the head offices.

There are two important fairs held biannually in Canton for export commodities. These two fairs are the biggest events in China's foreign trade each year and provide the best means for the head offices to control the branches. The head offices used to allow the branches to accept orders only during these fairs. All the contracts would be signed by the head offices and copies of these contracts were retained by them. After the fair contracts would be fulfilled. If business was concluded outside the fair, it had to be accomplished during the trade groups' visits abroad, as organized by the head offices. Whenever foreign customers visited China on business, discussions were supposed to be held exclusively in the head offices in Beijing. If customers insisted on going to the branches, then usually the head offices would send someone to accompany the customers to visit the branches. These practices proved impossible to continue during the years of reform.

III. The Reform

With the deepening of reform in China's overall economic structure, the old structure of the foreign trade organizations was no longer sufficient to meet growing demands. Enterprises having business with the monopolized FTCs began to feel more and more dissatisfied with the bad service they received. The major problems were the sluggish bureaucracy, the insensitivity, the inefficiency, the corruption and excessive costs that the FTCs accrued in dealing with manufacturers, buyers, and suppliers. Many industrial ministries openly challenged the monopolistic power of FTCs under MOFERT. In 1985, the Ministry of Textiles Industry, led by the Minister Wu Winying, complained to the then Premier Zhao Ziyang about the inefficiency of MOFERT and its FTCs, and demanded drastic reform, including handing over foreign trading rights to the industrial ministries such as the Ministry of Textile Industry, in order to overcome the "airlock" between the FTCs and the industrial suppliers and users.[29] The report by the

Minister actually accused MOFERT of being responsible for creating barriers between the domestic suppliers and international buyers and thus preventing textile exports from growing as fast as they could.

It was not a new problem. Prior to that, MOFERT had conducted some studies about the existing problems within its organizational settings. They made some efforts in decentralizing control to lower level units to achieve better and more efficient management. MOFERT was forced to do this because of competition from the newly established institutions that were authorized by the State Council to have similar power in international dealings. One such institution was the China International Trust and Investment Corporation (CITIC), a ministerial institution headed by Rong Yiren, Vice Leader of the People's Congress. This institution was primarily designed to attract foreign capital investment in China. Observers could smell that if the boss of CITIC was more powerful than the minister of MOFERT, then his corporation would be more influential in business than the FTCs under MOFERT.

MOFERT submitted a report to the State Commission on Reform of the Foreign Trade System in 1984. In the report MOFERT proposed to reform the foreign trade organizations along the following five dimensions.

1) Separate government functions from enterprise management and strengthen the administrative management of

foreign trade. This proposal aimed at MOFERT's leaving all day-to-day functions related to trade to the FTCs so that MOFERT could concentrate on such areas as drafting regulations, formulating long term plans, advising on the appropriateness of economic levers related to trade, conducting negotiations with foreign governments, and conducting research and training.

2) Simplify administration and transfer power to lower administrative levels, bringing into full play the managing initiative of the various foreign trade enterprises.

This proposal was meant to free the foreign trade enterprises from their administrative departments, while keeping their own accounts, assuming responsibility for their own profits and losses, and developing in the direction of specialization and socialization.

3) Adopt an import and export agency system to improve the operations and management of foreign trade.

This proposal meant that the foreign trade enterprises should provide the diversified services that a normal foreign trade agent would provide, besides their designated product line. This practice would introduce the competition mechanism into the foreign trade organizations. When these enterprises failed to provide good services, the manufacturer and the user could go to other "agents" for better service.

4) Reform the foreign trade planning system and simplify the contents of the yearly export/import plan.

5) Reform the foreign trade financial system and strengthen the economic means of regulation.

The last two proposals were designed to give the foreign trade enterprises more power in their planning and decision making, giving them more responsibility for their own profits and losses.[30]

The general direction of these proposals was decentralization and diversification. MOFERT described the spirit of their proposals by a four character expression -- an English equivalent of which could be: "Simplifying the Administration and Decentralizing the Power." Yet implementing these proposals proved harder than formulating them.

Structurally, head offices are under direct administration of MOFERT. They are in many ways the arms of MOFERT and are much closer to MOFERT than the foreign trade bureaus of the provincial governments. These foreign trade bureaus are supposed to be the local agencies of MOFERT, but for personnel and administrative reasons they are more associated with the local governments than with MOFERT. The head offices had a lot of the administrative functions of MOFERT in the period of 1978 to 1986. A good example would be the allocation of textile quotas with the then EEC. MOFERT would allocate the quota to each specialized head office, then the head offices would allocate them to their provincial branches. Quota allocation is obviously an administrative function. Many branches that didn't have enough quota for export would be unhappy with the head offices and would come to complain to the foreign trade bureaus that they couldn't fulfil their export plan because they didn't have enough quota, and that the head offices had given preferential treatment to certain other branches. This kind of controversy was quite common under that structure. MOFERT was in great dilemma about what to do: they were really reluctant to cut the power in their head offices and thereby decentralize their own power amongst the local foreign trade bureaus.

Despite the difficulties, growing competition forced MOFERT to change. CITIC was establishing its branches in big cities and provinces. Foreign trade bureaus were establishing their own foreign trade companies under their control. MOFERT tried to implement some of the proposals, achieving the following:

1) The previous "branches" of the FTCs became more independent of the head offices, especially those dealing with products not MOFERT-prescribed to the head offices. This change gave the provincial companies more decision-making power and made them look more like companies than "branches".

2) Experiments introducing the "agency" system made the head offices and branches pay much more attention to the adequacies of their services. Previously, the manufacturers

had no choice but to go through the designated company to export their products. Now if they were unhappy with the service they received, they could go to a company of a different province for business. This system also allowed FTCs with particular specializations to deal with other products. Although these experiments were limited to only a few FTCs, the significance of bringing the competition mechanism into these FTCs who had previously taken their privileges for granted was far reaching. With this new flexibility, companies could easily diversify into different lines of business as long as they operated efficiently.

3) A great change was taking place in management objectives. Previously, foreign trade enterprises were only concerned with fulfilling the import and export plan, because any loss was born by the state in the form of a subsidy. Now they had to be concerned not only with fulfilling the plan, but also in breaking even or making a profit. The planning process was also simplified. Not all the plans are mandatory. The part of the plan that is mandatory is now called the "command plan", while the part of the plan that is not mandatory became known as the "guidance plan." This left the foreign trade enterprises much more room and responsibility to formulate their own business goals and strategies.

However, with all the efforts taken by MOFERT to reform its organizations, the most basic change didn't take place until the beginning of 1988. Essential change lay in structural change -- change that would redefine the relationship between the head offices and the branches, as well as the relationship between the head offices and MOFERT itself. This structure was created more than 30 years ago in imitation of the Soviet model, to fit the old ideological necessity and the centrally planned economy. Under the new economic and political conditions, any reform measures taken in China's foreign trade would be superficial without a restructuring of the whole system. But restructuring was no easy matter: restructuring a giant, complex 40-year-old organization took great courage and tremendous efforts.

In the beginning of 1988, then-premier Zhao Ziyang was quite decisive in his actions to restructure the foreign trade organizations, despite very strong opposition. His policies centered around the overall pursuit of contracting a management-of-responsibility system. This policy was aimed at changing the old foreign trade system which dispersed responsibility, authority, and profits into a new system which unified these three, and therefore made the new system an entity responsible for its own profit and losses, instead of the state. The major policies undertaken were the following:

1) The provinces, autonomous regions, state-council administered municipalities, and the FTCs which undertake execution of the export plan were to contract directly from

the state the export plan for foreign exchange and turn in the foreign exchange to the central government after fulfillment of the plans. If the basic target of the contract was attained, then a percentage of foreign exchange could be retained by the contracting units. If there was any excess foreign exchange realized beyond the basic target, most or all of the excess foreign exchange could be retained by the contracting units.

2) All the foreign exchange earning enterprises enjoyed tax breaks, including relief from the product tax incurred in the production process, the commercial tax incurred in the circulation process, and the value-added tax.

3) The local governments, and other contracting units that retained foreign exchange could use it without prior approval if the usage was in accordance with relevant state regulations.

4) With the exception of the head offices and their relevant branches that are regulated to exclusively deal with certain products, all other branches of FTCs were to be decentralized to the local governments and managed by the unified state policy. The local government was to divide the export plan contracted by each foreign trade company and the relevant manufacturer and to push forward the export agency system.

5) The specialization system was to be liberalized. Except for a few important, resource-oriented commodities

dealt with exclusively by one or a few FTCs in import and export, most of the commodities and products were to be freed from regulated specializations and dealt with by any foreign trade companies having the foreign trade rights.

6) After the reform; the head offices were to develop themselves in the direction of multi-functional, multi-national conglomerates, to develop the international markets, and to provide better service for the foreign trade.

These new policies shocked the head offices. They had been too powerful for so many years and had gotten used to their power. The very idea that the branches would not listen to them any more made them nervous; and the very idea that the manufacturers and users would decide whether they need the services of the head offices made them unable to accept the reality. Many head offices protested, but to no avail. They had to reexamine what to do when power was decentralized to the branches. The major strategy was to establish more subsidiaries and joint ventures overseas. Overseas operations were regulated to get prior approval from MOFERT. It was much easier for the head offices to get the approval from MOFERT than for the branches. The FTCs did develop a better network of overseas representative offices. Another possibility was to transform the head offices into business associations, such as a textile importers and exporters association. This would still enable them to retain a certain power as a industry group.

The branches seemed to gain their own footing. Many of them were trying to formulate new, competitive strategies. Some branches were thinking of having joint ventures with the head offices so that they could use the overseas network of the head offices to their advantage. In any case, this was a extremely dynamic period for the foreign trade organizations.

Outside the MOFERT system, an important measure was taken to grant foreign trading rights to major export-oriented manufacturing enterprises. This was aimed at eliminating the "airlock" between foreign buyers and domestic producers. These enterprises were authorized to recruit personnel for international business. Many people were recruited from foreign trade companies and foreign trade schools in starting their own direct foreign business. The results of this experiment were mixed. Some enterprises achieved more efficiency in producing and selling, especially in meeting customers' needs. Some others handled production well but selling poorly, as international sales required specific knowledge in business transactions and communications. Comparatively speaking, foreign trade companies had a broader customer base and more knowledge in daily transactions and customs regulations.

Chapter 4

POLICY ISSUES IN CHINA'S FOREIGN TRADE

I. Composition of Trade

China has a vast territory, rich in resources. Yet China's huge population reduces the actual resource per capita to a value much smaller than the world average. Therefore, exporting raw materials and primary products cannot be a policy in China's foreign trade. Under the open-door policy, China has intentionally tried to change the composition of the import and export commodities.

In the '50s, agricultural products and other primary products accounted for as much as 79.4% of the total export, industrial products only 20.6%. Until 1966, primary products were still more than 60% of the total export. In the '70s, industrial products exportation slightly increased, such that by 1978, they accounted for 46.5% of the total export.[31] From then on, China's economy came into a period of steady and fast growth. Industrial structure changed greatly, bringing changes in the composition of export commodities and providing the necessary conditions for further processing and finishing of the products. In this time, besides continuing to export the traditional products, China increased its pace of export for equipment, machine tools, ships, consumer appliances, and so forth. Domestic-made airplanes also joined in the export commodities and came onto the international market for the first time. In 1988, primary products exported were $14.453 billion, only 35.6% of the total export, while exports of finished industrial products were $ 26.186 billion, 64.4% of the total export.[32] This change improved China's economic conditions and was in accordance with the direction of the world trade.

There are still serious problems in the composition of China's exports. Taking 1987 for example, industrial products exported were $21.259 billion, 61.2% of the year's total export. Among them, light industrial and textile products were $14 billion, 40.3% of the total export. Under the prevailing conditions, to export as much as these products for foreign exchange was good policy. Yet these products are still low-value products. When there is demand in the domestic market and competition is very strong in international market, excessively reliance upon these products for increasing export is not in the best interest of the country's economy. After careful study of the products being traded in the world market, MOFERT decided that machinery and electronic products were the most promising for export. These products constituted about 20% of the world trade in the '50s, about 25% in the '60s, and about 33% presently, and will increase more in the future. More than fifty percent of some developed countries' export is represented by machinery and electronic products. China has tried hard to increase production and export of these goods. From 1986 to 1988, the increase of these products in export was more than 50%. The total export of these products in 1988 came to $6.2 billion, 13% of the total export.[33] This is still a small percentage. Priority is given to the expansion of these industries.

II. Foreign Debt and Investment

China's foreign debt increased very rapidly after 1979, with recent years seeing accelerated increases. From 1985 to 1988, the foreign debts were respectively $15.8 billion, $21.5 billion, $30.2 billion, and $40 billion, for an average growth rate of 36%. The composition of this debt was also changing in a desirable direction. Short term debt decreased from 41% in 1985 to 18% in 1988.[34] U.S. dollars, Japanese Yen, Hong Kong dollars, West German Marks, French Francs, and Special Drawing Rights constitute the major currencies of the debt. Among them, U.S. Dollars and Japanese Yen represent the biggest share. The foreign debts were mainly invested in basic industries such as agriculture, transportation, energy, and the chemical industry. Consideration was also given to industries such as machinery, light industry, textile industry, electronics, education, health, and so on.

The general principle of the debt management is termed as "unified leadership and specialized responsibilities." That is, the State Council takes charge of making foreign borrowing policies and separate government agencies take care of borrowing plans plus the management of debts from different resources. The Ministry of Finance is in charge of borrowing from the World Bank. MOFERT is in charge foreign governmental loans. The People's Bank of China is in charge of loans from IMF and the Asian Development Bank. The Ministry of Agriculture, Husbandry, and Fisheries is in charge of loans from the Organization of International Agricultural Development Funds. Finally, the Bank of China is in charge of energy loans from Japan's Import Bank as well as with issuing bonds internationally. In order to facilitate commercial borrowing, the State Council approved 10 "windows" through which foreign commercial loans could be made. These windows are the Bank of China, the Bank of Transportation, the Bank of Investment, and the CITIC and its branches in Tianjin, Shanghai, Dalian, Guangdong, Fujian, and Hainan provinces.

There are three ways of borrowing and repaying the debt in China. The first is unified borrowing and unified repaying. This refers to the kind of borrowing done by governmental agencies, where the interest and the principles are in turn repaid by these government agencies. This kind of debt includes the loans from international monetary organizations and foreign governments, and is used mainly in basic industries and within the country's infrastructure. The second type of credit transaction is unified borrowing and self-repaying. This kind of borrowing usually comes from the local governments and enterprises. It is approved by the central government and then borrowing is carried out by the central government but repaid by the local governments and enterprises. This kind of borrowing has increased greatly in recent years. The third type of transaction is self-borrowing and self-repaying. This kind of borrowing is enacted by the borrowers themselves through authorized windows and repaid by the borrowing entities.

In order to supervise and monitor external borrowing, the State Council approved the Tentative Regulation For Monitoring External Debt. This regulation rules that all the borrowers within the territory of China must report borrowing to the General Administration of Foreign Exchange Control and register the loans, reporting any changes occurring after the initial registration. These measures were aimed at completely controlling the external borrowing, which was a major recommendation from the World Bank. In the latter's country report of 1988, it specifically called for "setting limits on the aggregate amount of external borrowing consistent with the medium-term BOP (balance of payment) outlook" and "approval and control procedures are required" to ensure that "limits are adhered to and composition is met."[35] The Chinese government seemed to be taking this advice seriously. But how to balance the control of the debts by the government and the adjustment of the debts by the market mechanism which has been introduced into the Chinese economy through the reform programs? This is a bigger challenge to the Chinese government than simply controlling the debts themselves.

Foreign investment is the highlight of the "open door" policy. The import of foreign technology and equipment has always been given priority, but in many instances those imports fail to produce the results and efficiency expected by the various Chinese industrial users. The Chinese government gradually realized that foreign managerial know-how should accompany the import of foreign technology and equipment and the need for more capital investment plus the need for direct foreign participation in management became a major consideration in the government's determination to attract more foreign direct investment. To achieve this, a series of laws and regulations have been promulgated. They include: law on joint venture, regulations on the registration of joint ventures, regulations on labor management in joint ventures, an income-tax law on joint ventures, the law of economic contracts, regulations on the exploitation of offshore petroleum resources in cooperation with foreign enterprises, the laws of Special Economic Zones, etc.[36]

There are six kinds of arrangements that comprise foreign investment in China. They are the wholly foreign-owned ventures, equity joint ventures, contractual joint ventures, joint development, compensation trade, and processing and assembling. Contractual joint venture is very similar to equity joint venture, only it is more flexible than the latter in the form of partnership: it can do whatever the contracting parties agree to. Joint development is mainly used for foreign-Chinese cooperation in exploiting natural resources -- most commonly for offshore oil. Compensation trade is different from other forms in that the purchase of machinery from abroad, by a local enterprise, is financed in whole or in part by goods produced after the purchase. In processing and assembling, the foreign parties provide some or all the inputs to a product, then the Chinese enterprise uses the inputs to make the product which is then returned to the foreign party for a fee.[37]

The results have been amazing. From 1979 to 1988, the number of foreign direct investment (FDI) enterprises was 10,052, government approved agreements numbered 15,997, and the capital actually invested amounted to $11.517 billion.[38] The Chinese government made FDI easiest in the Special Economic Zones (SEZ), with flexible regulations and various tax breaks. In Shenzhen, the best known SEZ, for example, "by the end of 1986 some 760 foreign enterprises had industrial contracts in Shenzhen, and there were 3,000 additional agreements for export processing.... already $600 million had been invested in industry."[39] The year 1988 turned out to be a record year for FDI in China. The number of government- approved FDI agreements was 5,903, and actual invested foreign capital totalled $2.6 billion.[40]

In 1986, an American company made a survey of 70 joint venture enterprises in China. 60% of those surveyed expressed satisfaction with FDI results, 25% were unable to reply because the businesses had just been opened, and 15% replied as having real difficulties. In 1988 this company resurveyed the same enterprises again. This time, 91% of those surveyed were satisfied, while only 9% were having difficulties. This probably is a very favorable survey to the Chinese government as it is quoted by Liu Yimin, the director of the Bureau of the Administration of Foreign Investment under MOFERT.[41]

In investment, the U.S. businesses came to agreement with China on 252 projects in 1988, amounting to $325 million. Since 1979, the U.S. has always been one of the biggest investors in China.[42] Sino-U.S. joint ventures include the much-watched Beijing Jeep, a joint venture with Chrysler Co., Tianjin-Otis Elevators, Kentucky Fried Chicken, Caterpillar, etc. Such cooperative ventures have had mixed results: the history of the Beijing-Jeep probably embodies a lot of bitterness for both sides,[43] while joint ventures like Tianjin-Otis Elevators and Kentucky Fried Chicken have had steady growth.

III. Trade With U.S.

The "Shanghai Communique" signed in 1972 between the U.S. and Chinese government paved the way for U.S. reconciliation with China. The Nixon administration regarded normalization of relations with China as a key strategic goal for the stability of the far east. In January 1979, the two countries established a full diplomatic relationship. This turned a new page in trade between these two countries.

In 1979, the two governments reached their first Trade Agreement, which granted mutual MFN (Most Favored Nation) status for each other, facilitating bi-lateral trade between the two countries -- such as allowing the Bank of China to operate in the U.S. and the U.S. banks to operate in China, and recognizing that China is a developing country in order to clear the way for the possible granting of duty-free imports through the Generalized System of Preference (GSP), if China joins the IMF and GATT.

China needs U.S. as a trade partner in its four-modernizations program. China especially is interested in advanced U.S. technologies and capital equipment, and is also a big buyer of U.S. agricultural products. China strives to lure U.S. investment. In return, China is becoming an increasingly important supplier of textiles, toys, and light industrial consumer products.

1988 was a good year in the history of U.S.-China trade. According to the Chinese statistics, total trade amounted to $8.262 billion, a 22% increase from a year before; China exported $ 3.21 billion, and U.S. exported $ 5.052 billion.[44] U.S. statistics gives a different picture: total trade was $14.3 billion; U.S. exported $5.3 billion, which is close to the Chinese figure; and U.S. imported $9.3 billion.[45] There is no explanation why the Chinese figure is so low. The statistics from the Chinese customs sometimes is higher by $20 billion than that of MOFERT, due to different accounting methods. The U.S. figure should be more reliable here because the Chinese has run a significant surplus in recent years. And the Chinese figure does show that. In 1989, total trade rose by 31% to a historic high of $17.8 billion. U.S. exported $5.8 billion, and China exported $12 billion, leaving a U.S. trade deficit of $6.2 billion.[46] The major Chinese products sold in the U.S. were textiles, garments, oil, foodstuffs, animal by-products, arts and crafts, porcelain, metals, and chemical products. The major U.S. products bought in China were crude oil equipment, chemical equipment, aircraft, computers, steel, rubber and related products, fertilizer, chemical materials, medical equipment, paper, and so forth.

IV. June 4th: Turning Back

June 4th, 1989 was the day the Chinese students' pro-democracy movement was brutally suppressed. This day marked a turning back of modern Chinese history. More than ten years' economic reform was put to an end that day by the very man who initiated it.

After the suppression, economists and scholars were busy calculating how many man days of work were lost from April through June.[47] The figure came close to 10 to 15 billion. These 15 billion man-days were really not that important when compared to the real loss -- the changing of political and economic direction and the loss of life's meaning for many Chinese people. The Wall Street Journal quoted one Chinese as saying: "Once Chinese believed that building a socialist society gave meaning to their lives. Now Chinese wonder why they were born. We don't have the means to live life, nor do we even have something to die for. We merely consume time."[48]

The immediate impact of the pro-democracy movement on international business was the halt of foreign investment and loans. Major international financial institutions, such as the World Bank and Asian Development Bank (the two world leading lenders to China's ambitious economic programs) suspended their loans to China after the suppression. This caused great financing problems for many infrastructural projects then under construction in China. The World Bank didn't resume its loans until eight months later. Its first loan to China was made in February, 1990, and was aimed at agricultural projects.[49]

In November 1989, five months after the Tiananmen suppression, debt issued by China and Hong Kong was downgraded by Moody's Investors Service Inc., a world lending-rating agency. The business community's concern over the dependence of Hong Kong's economy on the mainland's political and economic weather immediately reflected this downgrade in status. Some observers say that the rating itself will have little new impact on China's borrowing because the increased risk had already been reflected in the new recent loans to the mainland, but will make it more difficult for China to tap the capital market.[50]

The freeze on lending greatly affected foreign trade, especially imports. "The import pie will shrink", many business people cried. Import growth, as compared with the year before, slowed to 16% in July and 7.1% in August, in contrast with an average growth rate of 26% in the first half. The whole year's import was $38.127 billion, a decrease of 3.9% from the previous year.[51] It may take years to see the negative impact of this decrease in import on the growth of export. The import of urgently needed raw materials and high-tech equipment for China's industrialization has slowed down, this in turn will slow down the growth of industrial output which was expected to represent a major part of export commodity in the years ahead. Because of this response-time lag, it is difficult to accurately and completely assess the damage now, but we can be quite certain that damage has been done and will gradually show itself.

Among things that will suffer most from the change of direction are the reform programs begun under the now-purged Communist Party chief, Zhao Ziyang. According to a foreign correspondent in Beijing, many of the programs "have been scrapped indefinitely. Aborted programs include decontrol of prices, sales of state-owned enterprises and strengthening the private sector -- all of which seemed likely to move forward a year ago. Instead, the leaders are preaching austerity, socialist orthodox and even recentralizing sectors of the economy that had been well on the way to decontrol."[52]

The reform program aimed at foreign trade system is one of the economic sectors being severely affected. Actually, foreign trade corporations were the first group of units targeted for shake-up and reorganization after the suppression. This was intended to purify the foreign trade organizations in order to calm down the public indignation for the party's corruption, as these organizations were known for their nepotism -- their organizations are full of the sons and daughters of high ranking Party officials. The Party's central committee hurried to make public a decision that the family members of the central Party leaders are not allowed to work in these organizations. This really reflected the sensitivity and importance of these organizations in Chinese society.

According to reports, the decision to recentralize major segments of the Chinese economy came from a plenum of the Communist Party's Central Committee in November 1989. A Chinese economist who had seen documentation of this plenum remarked that a central theme prevails in the documents -- centralization, politically and economically. Taking Guangdong Province for example, an official of the Commission of Foreign Economic Relations and Trade of the province estimated that 40% of the 1512 companies in Guangdong engaged in foreign trade would be closed or merged. The companies that survived closure and merger would be severely restricted in what they can trade. "The crackdown will return China to the system of the early 1980s, when a few specialized state-owned trading companies handled the nation's trade," the Wall Street Journal article commented.[53]

V. Future Prospects

Suppression of the pro-democracy movement has created severe aftershocks within Chinese society as a whole, not to mention its economy and foreign trade. The prospects of China's foreign trade naturally have become of great concern to the international business community.

Some analysts think China is in a recession, as there was a sharp plunge in industrial output in January, 1990.

Output fell 6.1% from a year earlier to $27.1 billion, according to China's State Statistical Bureau figures. That was the worst decline ever during the 11 years of reform. A recession is defined as two consecutive quarters in which a nation's economic output contracts. While China doesn't provide quarterly figures, some economists believe that China's GNP declined in the 1989 fourth quarter and perhaps in the third quarter as well. Yet overall in 1989, China's GNP grew 4%. The Chinese government attributed declines to the four days' holidays of the traditional Chinese lunar year -- the biggest holiday in China.[54]

Other analysts pointed out that China could exhaust foreign reserve sometime this year unless imports are cut drastically to help narrow the balance of payment. A country is considered financially healthy if its reserves cover three months of its imports and China's $14 billion reserve could cover just that if the previous import pace to continue. But what indeed transpired was a drastic cut in imports. In January, 1990, imports declined by as much as 12.6% from that of the last year, to $5.4 billion, while exports came to $2.84 billion, an increase of 1% from that of the previous year.[55]

In overall foreign trade for 1989, the total import and export value came to $81.5 billion. Export was $43.128 billion, with an increase of 6.5% from a year before; import was $38.27 billion, a decrease of 3.95% from a year before.

These figures actually are surprisingly positive, taking into consideration the effects of the Tiananmen repression: the huge loss of man-days, the economic sanctions of the western countries, and the freeze of loans.

There are several possible explanations for why China managed to do quite well in such a politically and economically chaotic year. First, growth rate was so great in previous years that this year's chaotic situation merely slowed it down. The average growth rate of the last 11 years in total foreign trade was 16.1%, while the growth rate of 1989 from that of 1988 was only 1.3%, a sharp plunge already, which was especially affected by the cut in imports. Secondly, external trade is very much controlled by market forces when the government does not constrain them. The past 11 years of expansion had built up demand and supply of Chinese trade in the world market. The demand from within can be controlled by the government at their will, but the demands from other countries remain and are not easily shifted elsewhere once business channels are established. Besides, the Chinese government still tried hard to encourage foreign trade because more trade could only contribute to a better economy -- the basis for the political stability, the latter being the foremost concern of the ruling Communist Party. This may in one way demonstrate that economic sanctions do not work well economically. They may work very well politically -- political pressure veiled as economic in nature.

Thirdly, half a year is really too short a time to assess the full economic impact. There could be a time lag, a delayed causation. It may take several years or more for these to manifest themselves. Also, longer-term data will be more reliable in substantiating any assessment.

From the above explanations and statistics we can see that the prospects of China's foreign trade do not look as bad as some observers have thought. Though the political suppression in June has indeed negatively influenced China's economy and therefore also her foreign trade, and the economic recentralization and political tightening have also set back trade reform programs, officially the Chinese government still claims to maintain the economic reform and the "open door" policy. We have every reason to believe these claims, as a reasonably good economy provides a stable basis for their political rule. Their problem is that their political policies are not in harmony with their economic policies. Political expedience is often at the expense of economy, and the economy cannot keep the pace of previous growth. Even during the period of reform, ".... occasional recourse to the familiar rhetoric of self-sufficiency suggest that the legacy of the Maoist era may influence the pattern of activity for some time."[56] Yet the economy still grows, even though at a slower pace. The road of reform is full of twists, but the trend is forward and upward.

Secondly, the dynamic market forces give the advantage to economic development. While most businesses are waiting to see what will happen in China, some firms are again becoming active in investment activities there. The leading U.S. firms are AT&T, Pepsi Cola, and MacDonald-Douglas and Du Pont. AT&T's new investment, in the name of its Dutch subsidiary, is on optical fibre communication equipment in Shanghai. And at this time when most western firms are hesitating, investors from Taiwan are pouring into China seeking investment opportunities. The recent exposure of the investment intent of Taiwan Plastic -- one of the largest conglomerates in the world, shocked all of Taiwan like the detonation of an atom bomb.[57] Taiwan has the largest foreign exchange reserve in the world, putting Japan in the second place. These new investments will certainly fill up some vacancies left by western investors and thereby inject new blood into the Chinese economy and provide new impetus to foreign trade. The law in Taiwan does not permit direct investment in mainland China, so these investments are being made and will be made in the names of their foreign subsidiaries.

Thirdly, the Chinese government recently eased its austerity program. Some economists say that this new move should breathe life into its sagging economy and give a boost to many cash-strapped Sino-foreign joint ventures. Probably it will start a new boom-bust cycle.[58]

Even under the austerity policy, some of the joint ventures were still successful. Tianjin-Otis Elevator is a good example. In the past five years, it has produced about 6 thousand elevators and the profit comes to 135 million yuan, about 30 million in U.S. dollars. It has 17% of the domestic market share and has established 16 branches around China. Otis has reached a new five year agreement with its Chinese partners to increase yearly production capacity from 1500 elevators to 3000. This is a fine example of Sino-U.S. joint ventures.[59] Another successful example is the Oregon-based Nike Inc. After years of struggling with the Chinese bureaucracy, its patience has paid off. "Its five factories in south China are now making 650,000 pairs a month, and Nike hopes to export $100 million of shoes from China next year. Moreover, the China operation has just started turning a profit."[60]

SUMMARY AND CONCLUSIONS

This paper has explored many issues regarding the recent reforms in China's foreign trade system. After analyzing these issues, the major problem seems quite clear: the old-machine bureaucratic structure alienates the personnel administration and the business operation of these organizations in such a way that they cannot function as an organic whole. An effective organization is one that has blended its structure, management practices, rewards, and people into a package that in turn fits with its strategies.[61] The alienation of people from their organizations, and the alienation of branch offices from head offices, makes it impossible for this organization to achieve such a fit.

The reform launched in the beginning of 1988 was aimed at eliminating this alienation and was a very bold step in the right direction; had it continued, the effects upon these organizations would be unprecedented in their history. If it had been successful, the organizational structure would be in much better harmony with its task and mission, and each operating unit would have much more vitality and efficiency in their performances. Unfortunately, the suppression of the pro-democracy movement in June of 1989 abruptly changed the directions of politics and economics, and consequently made effective reform impossible.

Under the previous Chinese political situation, it took strong leadership and great courage to attempt reform of the strongholds of the command planning system. In this connection, the ousted Party chief Zhao Ziyang deserves credits for the attempted reform. Singapore's Prime Minister Lee Kuan Yew once remarked:"It took Zhao Ziyang 10 years to build a team of economists who understood how the western economy works and now that the team is part in exile, part being rusticated and part missing." Rebuilding that team, Mr. Lee predicted, will take another ten years.[62]

The Chinese constitute one fifth of the world population. Whoever is in power in China in the future, the conservatives or the reformers, will bear in mind that a sound and healthy economy provides a stable basis for political power. The one billion people need to eat, to live, to develop and to prosper. The present regime must therefore stick with the open-door policy, at least in some aspects, even though politically they are regressing in most other respects. But the open-door policy embodies a funny sort of "Catch 22" for the Chinese leadership: it has opened people's eyes and minds; the twelve years' reform has brought about rapid economic growth and greatly raised people's living standards. There is no way to efface the people's political awakening or to bog down the economy. Under current conditions, China's economy will grow, even though at a much slower rate than it would under the original reform. Foreign trade will also grow. China is still the largest untapped market per capita in the world. The big potential of this market exists apart from China's political situation. It is therefore unwise to neglect or to abandon this market. Of course, it is inevitable that China's political situation will affect the conscience of the people dealing with China as well as the economic exchanges with China. But adjustments should be made in strategy, not in policy.

Appendix A: SELECTED FIGURES ON CHINA'S EXTERNAL TRADE (1950-1989)

(In $ 000,000,000)

Year	Export	Import	Total
1950	5.52	5.83	11.35
1951	7.57	11.98	19.55
1952	8.23	11.18	19.41
1953	10.22	13.46	23.68
1954	11.46	12.87	24.33
1955	14.12	17.33	31.45
1956	16.45	15.63	32.08
1957	15.97	15.06	31.03
1958	19.81	18.90	38.71
1959	22.61	21.20	43.81
1960	18.56	19.53	38.09
1961	14.91	14.45	29.36
1962	14.90	11.73	26.63
1963	16.49	12.66	29.15
1964	19.16	15.47	34.63
1965	22.28	20.17	42.45
1966	23.66	22.48	46.14
1967	21.35	20.20	41.55
1968	21.03	19.45	40.48
1969	22.04	18.25	40.29
1970	22.60	23.26	45.86
1971	26.36	22.05	48.41
1972	34.43	28.58	63.01
1973	58.19	51.57	109.76
1974	69.49	76.19	145.68
1975	72.64	74.87	147.51
1976	68.55	65.78	134.33
1977	75.90	72.14	148.04
1978	97.45	108.93	206.38
1979	136.58	156.75	293.33
1980	182.72	195.50	378.22
1981	208.93	194.82	403.75
1982	218.19	174.78	392.97
1983	221.97	185.30	407.27
1984	244.16	253.56	497.72
1985	259.15	343.31	602.46
1986	270.14	330.83	600.97
1987	347.11	333.99	681.10
1988	406.40	398.50	804.90
1989	432.80	382.70	815.00

Source: China's Foreign Trade Year Book-- 1989

Appendix B: SELECTED U.S. EXPORTS TO CHINA, 1988

(U.S. $ 000,000)

	Value	Share of Total(%)	Growth over 1987(%)
Total U.S. Exports	5,032.9	100	44
Of which:			
Grain	698.9	14	199
Plastics, resins	595.9	12	134
Wood Products	447.1	9	167
Fertilizers	378.7	8	40
Aircraft	341.1	7	-32
Specialized machinery	334.0	7	42
Organic chemicals	256.7	5	71
Scientific equipment	200.1	4	20
ADP equipment	200.1	4	6
General Industrial machinery	171.6	3	-3

Source: U.S. Commerce Department.
Exports calculated freight on board (f.o.b.).

Appendix C: SELECTED U.S. IMPORTS FROM CHINA, 1988

(U.S. $ 000,000)

	Value	Share of Total(%)	Growth Over 1987(%)
Total U.S. Imports	9,269.8	100	34
Of which:			
Clothing	2,212.6	24	1
Toys, sporting goods	1,838.4	20	42
Yarn, fabrics	608.0	7	9
Telecommunications equipment	528.6	6	112
Petroleum	496.7	5	-6
Household electrical appliances	465.6	5	198
Travel goods, handbags	461.9	5	45
Shellfish, seafood	331.1	4	131
Metal manufactures	266.0	3	66

Source: U.S. Commerce Department.
Imports calculated free along-side ship (f.a.s.).

Appendix D: Major Foreign Trade Corporations Under The Ministry Of Foreign Economic Relations and Trade

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China National Cereals, Oils and Foodstuffs I/E Corp.
China National Native Produce and Animal By-Products I/E Corp.
China National Textiles I/E Corp.
China National Light Industrial Products I/E Corp.
China National Arts & Crafts I/E Corp.
China National Chemicals I/E Corp.
China National Metals & Minerals I/E Corp.
China National Machinery I/E Corp.
China National Instruments I/E Corp.
China National Technical I/E Corp.
China National Medicines & Health Products I/E Corp.
China National Silk I/E Corp.
China National Embroidery & Drawnwork Associated I/E Corp.
China National Packaging I/E Corp.
China National Foreign Trade Transportation Corp.
China National Complete Plant Export Corp.
China Economic and Trade Consultants Corp.

Source: Directory Of Chinese Foreign Economic Relations And Trade Enterprises (Beijing: China Foreign Economic Relations And Trade Publishing House, 1987)

Appendix E: Selected Foreign Trade Corporations Under The Line Ministries.

China National Agricultural Machinery I/E Corp.
China National Seed Corp.
China Rural and Town Enterprises I/E Company.
China Textile Machinery and Technology I/E Corp.
China International Water & Electric Corp.
China National Offshore Oil Corp.
China Petro-Chemical International Company.
China National New Building Materials I/E Corp.
China National Nonferrous Metals I/E Corp.
China National Machinery & Equipment I/E Corp.
China National Electric Wire & Cable Export Corp.
China North Industries Corp.
China Great Wall Industry Corp.
China Nuclear Energy Industry Corp.
China National Aero-Technology I/E Corp.
China National Automotive Industry I/E Corp.

Source: Directory Of Chinese Foreign Economic Relations And Trade Enterprises (Beijing: China Foreign Economic Relations and Trade Publishing House, 1987)

Endnotes

1. See China: External Trade and Capital (Washington, D.C.: The World Bank, 1988) xix.

2. The editorial staff, "Forty Years History of China's Foreign Trade," China's Foreign Trade Oct.-Nov. 1989: 3.

3. Xinhua News Agency, "PRC Imports Technology and Equipments," The World Daily 21 Feb. 1990.

4. Zhao Ziyang, one of the most ardent market-oriented reformers in the Chinese Communist Party, was expelled from the post of the Party's general secretary in June 1988, right after the suppression of the pro-democracy movement.

5. See Communist China's Economic Growth And Foreign Trade, Alexander Eckstein, (New York: McGraw-Hill Book Company, 1966) 87.

6. See China's Foreign Economic Relations and Trade Year Book -- 1989, (Beijing: China Zhanwang Publishing House, 1989) 299.

7. Donald A. Ball, and Wendell H. McCulloch, Jr., International Business (Plano, Texas: Business Publication, Inc.,1988) 360.

8. See "$5 billion Favorable Balance In China's Foreign Trade in 1989", The World Daily, 23 Jan. 1990.

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10. The complete annual figures of import and export from 1950 to 1989 are give in Appendix A.

11. See China: Socialist Economic Development, (Washington D.C., The World Bank, 1983), 58.

12. Gregory C. Chow, The Chinese Economy (New York: Harper & Row, 1985) 276.

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14. Gregory C. Chow, 276.

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16. Peter N.S. Lee, Industrial Management and Economic Reform in China, 1949-1984 (Hong Kong, Oxford,New York: Oxford University Press, 1987) 145.

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19. S. Feuchtwang, A. Hussain, and T. Pairault, ed. and trans., Transforming China's Economy in The Eighties, (Boulder, Colorado: Westview Press, 1988) 10.

20. The present exchange rate of RMB per US dollar was devalued 21.2% to RMB 4.72/$ in late December 1989.

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22. The State Commission of Economic System Reform, 20.

23. The State Commission of Economic System Reform, 20.

24. The State Commission of Economic System Reform, 20.

25. Diao Xinshen, "The Role of the Two-Tier Price System," Reform in China: Challenges & Choices (New York: M.E. Sharpe, Inc., 1987) 35.

26. The Convention of this Congress was held in Beijing, 1983.

27. This section is based on the report "The Five Years' Big Development In Constructing The Socialist Democratic and Legal System" by the Office of People's Congress. See Reform And Development, (Beijing: China Planning Publishing House, 1988) 49.

28. The World Bank, 1988, 22.

29. According to the World Bank China Report, the "air lock" was created explicitly in the beginning to isolate the Chinese enterprises from getting harmful influences from the western companies. See China: External Trade and Capital, (Washington, D.C., The World Bank, 1988) x.

30. The World Bank, 1988, 21.

31. Zheng Yan, "China Will Further Improve The Composition Of Export Commodities," China's Foreign Trade July 1989: 4.

32. Zheng Yan, 4.

33. Zheng Yan, 4.

34. Guo Zhihang, "China's Foreign Debt And Its Management," China's Foreign Trade Feb. 1990: 2.

35. The World Bank, 305-306.

36. N.T. Wang, China's Modernization and Transnational Corporations (Lexington, Massachusetts: D.C. Heath & Company, 1984) 94.

37. The World Bank, 1988, 247-249.

38. Chu Baotai, "An Analysis of Foreign Direct Investment," China's Foreign Trade July 1989: 5.

39. Ezra F. Vogel, One Step Ahead In China: Guangdong Under Reform (Cambridge, Massachusetts: Harvard University Press, 1989) 146.

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48. See "In China, We Merely Consume Time," The Wall Street Journal April 20, 1990: A14.

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51. Julia Leung, "China Trade Slumps After June Killings," The Wall Street Journal Oct. 23, 1989: A7C.

52. Adi Ignatius, "China's Economic reform Program Enters Hibernation," The Wall Street Journal 26 Sept. 1989: A18.

53. Julia Leung,"Beijing Will Reassert Centralized Control," The Wall Street Journal, 28 Nov. 1989: A10.

54. Adi Ignatius, "China Might Be In A Recession, Analysts Say, After Sharp Drop In January Output," The Wall Street Journal 12 Feb. 1990: A10.

55. See "Import decreased while Export Increased In January," Xinhua News Agency, The People's Daily 10 Feb. 1990.

56. Thomas P. Lyons, Economic Integration and Planning in

Maoist China (New York: Columbia University Press, 1987) 280.

57. See "Instructions From The Very Top Of The Communist Party: Provide Everything For Investment by Wang Yongqing," The World Daily, 20 May, 1990: 2.

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59. See "American Business Began to Invest in Mainland China Again," The World Daily, 14 Apr., 1990.

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61. James B. Quinn, Henry Mintzberg, and Robert M. James, The Strategy Process (Englewood Cliffs, New Jersey: Prentice Hall, 1988) 304.

62. Karen E. House and Barry Wain, "Singapore's Prime Minister Lee Kuan Yew Surveys the Region," The Wall Street Journal 1 Nov. 1989, A13.

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