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# ECONOMIC TRANSITION AND TRADE-POLICY REFORM: LESSONS FROM CHINA

by

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## RÉSUMÉ

La réforme de la politique commerciale en Chine est un élément essentiel de sa transition vers une économie de marché. La libéralisation et la décentralisation des échanges ont permis une forte croissance des exportations, mais la réforme du régime des importations est beaucoup plus lente. La persistance de barrières douanières élevées, assorties de nombreuses dérogations, est à l'origine d'un régime dualiste : les entreprises exportatrices importent librement leurs intrants, alors que le secteur domestique reste fortement protégé de la concurrence internationale, ce qui entretient la mésallocation des ressources. De plus, l'inachèvement des réformes empêche la Chine d'accéder à l'OMC, ce qui pourrait, à terme, compromettre la poursuite de sa stratégie d'ouverture.



## SUMMARY

Trade-policy reform is an essential feature of China's economic transition to a market economy. On the one hand, the liberalisation and decentralisation of export activities has boosted exports. On the other hand, the reform of China's import regime has been progressing much more slowly. This has two negative consequences. The persisting combination of high nominal protection rates and numerous tariff exemptions creates a dual regime: export-oriented firms enjoy free access to imports, while the domestic sector remains highly protected from international competition, which allows for continuing misallocation of resources. This incompleteness of trade reforms currently prevents China from joining the WTO, which might eventually hamper its further integration into the world economy.

# PREFACE

Is China at a turning point of its transition to an open-market economy? China's gradualist approach to economic transition has proved successful in generating high growth over the post-reform period. However, to consolidate past achievements and push economic reforms forward, it may now require new policy initiatives. Thus, Kiichiro Fukasaku and Henri-Bernard Solignac Lecomte show that the current import regime is working against much needed domestic enterprise reform on the one hand, and preventing China from being further integrated into the world economy on the other. There is still great scope for further trade reforms to improve industrial efficiency. More generally, it is the consistency of "Chinese gradualism" in the face of new internal and external challenges that is at stake.

Recent political statements suggest that China is ready to accelerate the pace of trade reforms. It remains to be seen though, how this will proceed. In this regard, the successful experiences of Chile in the 1970s and of Mexico in the 1980s, demonstrate the importance of establishing a united, low-tariff import regime in pursuing domestic reform over the medium term. These experiences may provide China with a useful reference in setting the agenda for trade reforms in the coming years.

In examining China's remarkable trade performance from the East-Asian perspective and providing a thorough analysis of its import regime, this paper helps us to understand major reform challenges facing China today. It was prepared within the OECD Development Centre's research on "Reform and Growth of Large Developing Countries" and reflects the growing importance of China in international economies.

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## I. INTRODUCTION

Economic transition is a process of institution building and policy reforms designed to establish an effective system of macroeconomic management and resource allocation based on market mechanisms. There are competing views between "gradualist" and "big-bang" proponents as to how best to achieve that.[1] The former group argues that the step-by-step approach is likely to work better than a "big-bang", because the cost of adjustment involved is so large that the implementation of a comprehensive reform would invite strong political resistance, and because the amount of information needed to make such reform feasible would be never fully available. On the other hand, the step-by-step approach carries the risk of sliding towards a piecemeal and partial reform that would not necessarily lead to a successful outcome in the long run.

The Chinese experience since late 1978 is often referred to as representing a successful case of the "gradualist" approach, compared with reform and growth experiences in the Central and Eastern European Countries (CEECs). However, Chinese "gradualism" stems from political constraints facing policy makers under a communist-controlled political regime, rather than from a clear option in terms of economic policy. In our view, a critical feature of China's transition strategy lies in a fundamental shift in the orientation of trade and industrialisation policies in the 1980s. As in the case of several Southeast Asian economies, developments in China since the mid-1980s represent a successful case of outward-oriented development strategies. Despite the fact that it is demographically and geographically a large country, China is following the trade patterns similar to those prevailing in other East Asian economies. Its export success can only be understood in the context of industrial restructuring taking place in Japan and other labour-scarce economies in the region.

Trade-policy reform is part and parcel of China's economic transition to a market economy. As we will see below, liberalisation and rationalisation of China's import regime is progressing much more slowly than liberalisation and decentralisation of export activities. The lack of China's firm commitment to import liberalisation makes it difficult to integrate its economy fully into the international trading system. In this

respect, the appeal of gradualism has been tarnished by the country's failed attempt to resume its status as a GATT contracting party and become a founding member of the WTO.

Given this background, the purpose of the paper is to draw some lessons from Chinese experiences since late 1978 with respect to the role of trade-policy reform in economic transition. In the next section, we briefly review the main features of China's trade-policy reform, and present some stylised facts regarding the country's changing trade patterns over the post-reform years. Section III is devoted to a detailed analysis of China's import regime using tariff and non-tariff data provided by UNCTAD. Based on this, we then discuss outstanding trade policy issues facing China. Finally, some concluding remarks are presented in Section IV.

## II. TRADE-POLICY REFORM AND TRADE PATTERNS[2]

The process of China's economic transition was set in motion at the landmark Third Plenary Session of the 11th Central Committee of the Chinese Communist Party (CCP) in December 1978.[3] The two most important objectives of the country's economic reform were to decentralise its centrally planned economy — with greater reliance on market forces in economic decision making — and to open up its economy and integrate it more closely into the world market. The transition process began without any comprehensive blueprint or timetable. Rather the government adopted a gradual and pragmatic approach, which may perhaps best be described as a strategy of "groping for stones to cross a river". This strategy led Chinese reformers to conduct various experiments on a limited scale and when they proved successful the government endorsed these policy changes. At the outset of economic reform, gradualism allowed reform-minded members of the CCP to find a pragmatic solution to the politically sensitive issues that might incite resistance from most conservative members. A notable example in this regard was the creation of the Special Economic Zones (SEZs) in which local authorities and enterprises were allowed to experiment with various capitalist practices that could not be applied immediately to the hinterland for political reasons.[4] This section briefly reviews the major steps of the decentralisation process. It then analyses its impact on China's growing integration to the world economy and puts this evolution in the perspective of the regional trade dynamics.

### Decentralising Trade Controls

Before the 1978 reform, foreign trade in China was merely a balancing factor to fill gaps in supply and demand under national plans. There was no need for a trade policy as such. The imposition of tariffs was purely for revenue-raising purposes. However, as decentralisation of export activities took place and as more and more imports were conducted outside of mandatory planning, trade policy came to play an increasing role in China's economic transition from the perspective of development strategies.[5]

The initial focus of China's trade policy was placed on *internal* development with emphasis on the development of import-substituting industries and the agricultural sector which employed about 70 per cent of China's total labour force in the late 1970s. China's exchange rate was also heavily over-valued. Although the ban on foreign direct investment was lifted in 1979, the Chinese authorities remained cautious. As a consequence, China's trade regime was strongly inward-oriented at the inception of economic reform. Since the mid-1980s China's trade policy has shifted fundamentally in favour of export production. This corresponds to China's *de facto* adoption of the coastal development strategy, an active encouragement of FDI through various fiscal incentives and the beginning of large real devaluations of the Chinese yuan vis-à-vis major East Asian economies.[6] China's pursuit of outward orientation has not changed in spite of the temporary setback, both political and economic, in the wake of the Tiananmen Square incident on 4th June 1989.

The laws and associated regulations governing China's trade regime have been undergoing more or less constant change since 1978, but the central feature of China's trade-policy reform is decentralising trade controls. This has two key aspects. One is the decline of mandatory planning in China's foreign trade. On the export side, mandatory planning sets out specific targets in physical quantities for individual export producers and supplies them with the necessary inputs under the materials allocation system. In 1988, 112 export commodities were covered by mandatory plans (Lardy, 1992, pp.40-41), but this number was reduced to 16 by 1993 (Fukasaku and Wall, 1994, p.50). As a result, the amount of exports covered by mandatory planning fell from 100 per cent of total exports in 1978 to 45 per cent in 1988, and down to about 15 per cent in 1992 (World Bank, 1993, p.28).

On the import side, a system of "unified management" was introduced in 1984 to control trade in seven key commodities: steel, chemical fertilisers, rubber, timber, tobacco, grain, and polyester and other synthetic fibres. Taken together, they accounted for 40 per cent of China's total imports at that time, down from more than 90 per cent at the beginning of the 1980s (World Bank, 1988, p.22). Further progress was made in scaling down the role of mandatory planning in imports, and by 1993, imports controlled by mandatory plans stood at less than 20 per cent of China's total imports (Tseng, et al., 1994, pp.4-5).

Another key aspect of decentralising foreign trade is the rapid growth of local foreign trade corporations (FTCs) acting independently of the central government. Starting from the Guangdong province in early 1978, many local FTCs during 1979 began to engage in trade activities in their own right. The practice was officially sanctioned and legislation soon followed to authorise entities other than the twelve national FTCs to engage foreign trade. Central ministries and departments and provincial and municipal governments established their own FTCs, some of which were domestic joint ventures involving production units and trade corporations. By the mid-1980s over 800 FTCs had been authorised and by the end of the 1980s more than 5 000 were in operation. In addition, large state-owned enterprises, initially those with exports in excess of $750 000, were given the right to export on their own account, as in the case of foreign-funded enterprises (Fukasaku and Wall, 1994, p.28).

It is important to note, however, that the decline of trade shares covered by mandatory planning and the growth of local FTCs do *not* mean that a significant proportion of China's trade is now market-determined. In the first place, there is "guidance planning", which allows the government to intervene in trade activities of both national and local FTCs through licensing and foreign-exchange allocations. On the other hand, the principle of independent accounting and responsibility for FTCs to assume any profits and losses from trade activities are not fully realised. In order to remove open-ended financial commitments by the central government to trade activities, the "contract responsibility system" was introduced to national FTCs in 1988 and extended to provincial FTCs in 1991. The contracts specify targets for foreign-exchange earnings, for remittances of foreign exchange from FTCs (both national and provincial) to the central government, and for the balance of profits and losses from

trade activities. The last target implies that there is still some leeway for the central government to subsidise trade losses implicitly, though direct subsidies on exports have been prohibited since 1991.

### Outward Orientation and Trade Patterns

China's trade-policy reform has changed the country's economic links with the outside world dramatically. As Table 1 shows, the share of China in world merchandise trade more than tripled between 1978 and 1994, and at the same time, the degree of trade openness (defined as the mean value of merchandise exports and imports divided by nominal GDP) has been rising substantially during the same period.[7]

Table 1. **Openness of the Chinese Economy, 1970-1994**

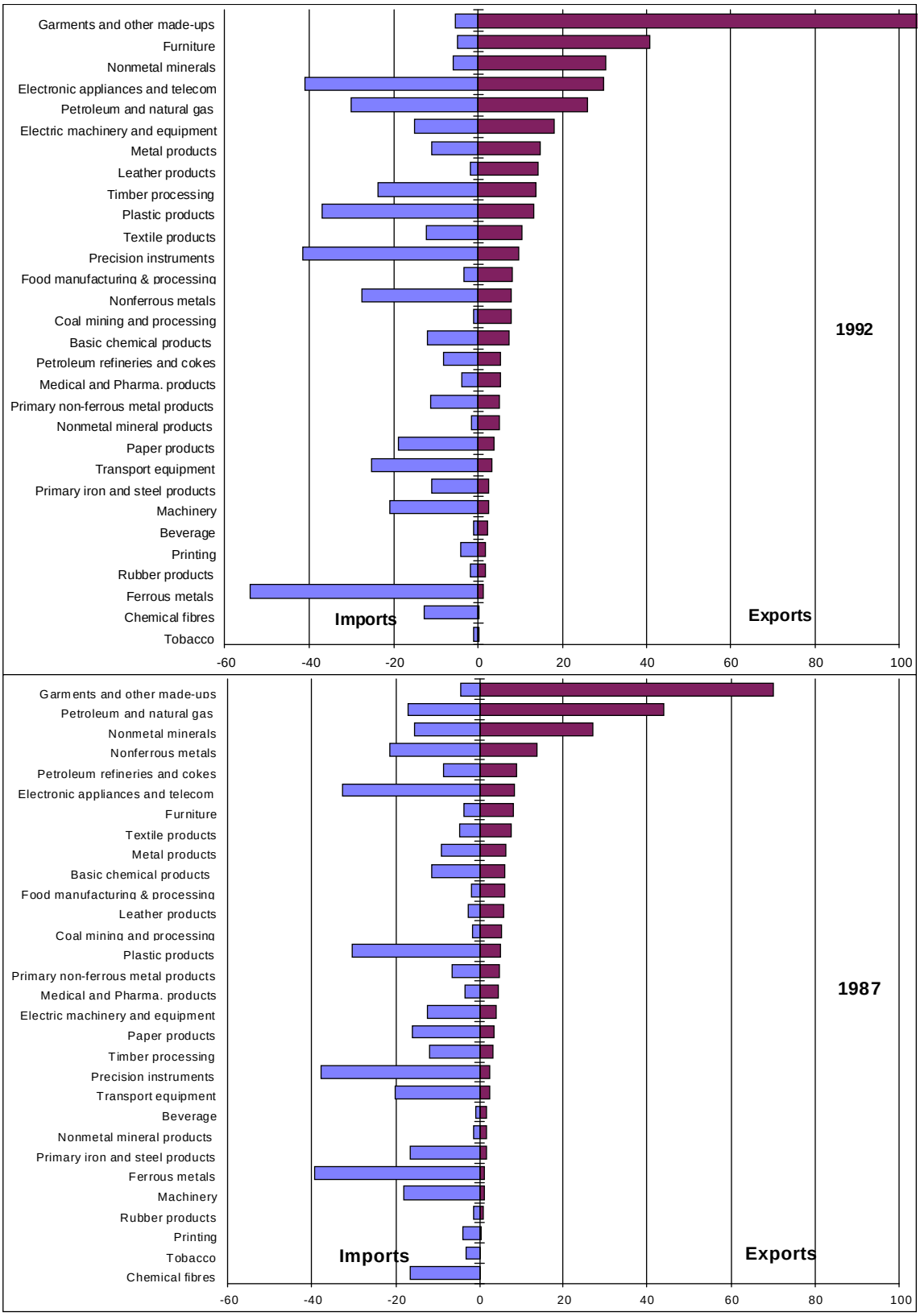
| | Chinese Total Trade* | |
|---|---|---|
| Year | Percent of World Trade | Percent of GDP at current US$ |
| 1970 | 1.16 | - |
| 1975 | 1.37 | - |
| 1977 | 1.01 | - |
| 1978 | 1.22 | 4.73 |
| 1980 | 1.43 | 6.10 |
| 1982 | 1.78 | 7.17 |
| 1984 | 2.08 | 8.25 |
| 1986 | 2.58 | 12.70 |
| 1988 | 2.13 | 13.00 |
| 1990 | 2.49 | 14.81 |
| 1992 | 3.09 | 17.28 |
| 1993 | 3.69 | 17.03 |
| 1994 | 3.85 | 22.13 |

*Sources*: IMF; Statistical Survey of China
* (Exports + Imports)/2

The trade-policy reform has also led to significant changes in China's trade patterns. As the reforms progress and market forces come to play a greater part in resource allocation, China's trade pattern has tended to move towards one which is more determined by its comparative advantage. Most dramatic in this respect are changes in the product composition of China's export structure. The share of manufactures (SITC 5-8) in total merchandise exports increased from roughly 50 per cent in 1980 to 80 per cent in 1992.[8]

Figure 1 compares the degree of trade openness by industry between 1987 and 1992[9], as defined by the share of merchandise exports (and imports) to gross output. It shows that during a short span of 5 years China had increased the degree of specialisation in a relatively narrow range of exports, mainly labour-intensive products (garments and other made-ups, furniture and leather products) as well as some natural resource-based products (non-metal minerals, coals and food products).

Figure 1 : **Openness of Chinese Industries:**
**Percentage of Exports (Imports) to Gross Output, by Industry**




Source: see Annex 2.

(*) Due to inconsistencies between CEPII's database and Chinese Statistics, the figure for Garment exports in 1992 is more than 100%.

Although China started to export several "new" products — such as electronic appliances and telecommunication equipment, electrical machinery and equipment, metal products, plastic products and precision instruments — imports of parts and components needed to produce such products tended to rise as well. As a result of high economic growth, China had become a net importer of petroleum and natural gas by 1992.

A major explanation for such a dramatic improvement in China's trade performance lies in the gradual evolution of its highly centralised trade regime into a more decentralised one, with an increasing number of local enterprises getting engaged in foreign trade activities independently of the trade plan set out by the central government. De Ménil (1995) argues that, while the trade regime *per se* has remained quite restrictive, "broad exemptions from central regulations and controls liberally granted by local authorities (...) were the main secret of China's trade success" (p.28). Nevertheless, while it is clear that, on the supply side, these piecemeal reforms have alleviated the administrative constraints on exports, this is not enough to explain, on the demand side, why China has performed so well on the world market. Locational advantage is a poor explanation, since China is not a neighbour to its major export markets[10]. More convincing is the argument that the liberalisation and the decentralisation of trade controls have released the country's strong comparative advantage in specific activities requiring the intensive use of low-skilled labour. Nevertheless, the rise in China's exports occurred as most of its competitors — NIEs and ASEAN-4 — had already achieved significant progress in exporting to OECD countries. Therefore, the question remains of how China's opening has been connected with trade developments in the region during the 70s and 80s.

Trade developments in East Asia may be best described as multiple "catching-up" processes within a cluster of the region's economies at different stages of industrialisation and development. More advanced economies in the region respond to the immediate followers by moving up the ladder of comparative advantage to exports of more human capital-intensive and/or more technologically sophisticated products, thereby leaving the room for imports of relatively unskilled labour-intensive, standardised products. Led by Japan as the leading economy in the region, and followed by Chinese Taipei, Hong Kong, Republic of Korea, Singapore and other ASEAN countries, the East Asian economies tend to advance together through trade expansion based on shifting comparative advantage over time.[11]

How does China fit in this pattern of trade developments in East Asia? In order to answer this question, we extended the method used by Rana, 1990, and Fukasaku, 1992, to include China in the analysis of shifting comparative advantage in East Asia. Using the "Comparative Advantage Indicator" (CAI) developed by CEPII/CHELEM (see Appendix 1), we first calculated changes in revealed comparative advantage between 1970 and 1992 (the latest year for the trade database provided by CEPII/CHELEM) for 33 industry groups (defined by Appendix 2) with respect to China on the one hand,

and each of 8 East Asian economies on the other. These East Asian economies are 4 NIEs (Chinese Taipei, Hong Kong, Republic of Korea and Singapore) and 4 ASEAN countries (Indonesia, Malaysia, Philippines and Thailand).

Table 2. **Significant Correlations of Changes in Comparative Advantage Vectors for China and Selected Asian Economies, 1970-1992**

| All activities | 1970-92 |
|---|---|
| **China and NIEs** | |
| China - Hong Kong | - 0.87 ** |
| China - Singapore | - 0.05 |
| China - South Korea | - 0.63 ** |
| China - Chinese Taipei | - 0.39 * |
| **China and ASEAN-4** | |
| China - Indonesia | + 0.39 * |
| China - Malaysia | + 0.21 |
| China - Philippines | + 0.44 ** |
| China - Thailand | + 0.50 ** |

** Significant at the 1 per cent level
* Significant at the 5 per cent level

Then we estimated Spearman's correlation coefficients for each pair of economies (say, China and Republic of Korea) to see whether changes in CAI between the two economies are statistically correlated. A *negative* correlation would imply that China gained export competitiveness in those industries where Korea was losing export competitiveness. On the other hand, a *positive* correlation would indicate that the pattern of revealed comparative advantage in both economies changed in the same direction; in other words, these economies tend to compete with each other within the same range of industry groups. The results are reported in Table 2, which suggests that China's trade pattern is complementary to the NIEs' (except Singapore) but competing with ASEAN countries (except Malaysia).[12] Trade developments in China seem to be nicely fit in the "catching-up" model in East Asia.

## III. ASSESSING CHINA'S IMPORT REGIME

The thrust of China's trade-policy reform since the mid-1980s has been the promotion of exports through liberalisation and decentralisation of export activities, while imports remain controlled by the extensive use of non-tariff measures (NTMs). The Chinese authorities have used a variety of NTMs, including a mandatory import plan, canalisation of imports (i.e. imports allowed only through designated FTCs), import licensing, and import controls. These measures are overlapping to a large extent.[13] As discussed above, while the scope of mandatory planning had been cut back to less than 20 per cent of total imports by 1993, import licensing was still imposed on some 53 product categories, accounting for 30 per cent of total imports in 1993 (Tseng, et al. 1994, pp.4-5). Meanwhile, tariffs were increasingly used for protective purposes. Where domestic production of import-substituting industries was high cost but insufficient to satisfy the home market, tariffs were used to raise the price of imports to domestic levels. Such tariffs were as high as 140 per cent or more in the case of least essential products such as tobacco products (see below).

### Tariffs, NTMs and collection rates

Table 3 presents summary information for China's tariff rates (unweighted), effective rates of protection (ERP) and NTM coverage by major industry group for 1987 and 1993. There are 33 industry groups (extraction and manufacturing industries), which, taken together, accounted for more than 90 per cent of China's merchandise imports in 1993. Data for tariffs and NTMs are provided by UNCTAD, and the ERP was calculated for both years based on the 1987 Input-Output Table (see Appendix 3).

It should be noted at the outset that tariff data must be treated with great caution, because tariff exemptions and rebates have been used extensively as an important trade instrument for China's "export push". For example, tariff exemptions are granted for imports used to produce exports; for import requirements of capital goods by enterprises considered to be raising the level of technology in China; for raw materials and intermediate and capital goods imported into the SEZs and ETDZs (Economic and Technological Development Zones); and for those imported by Sino-foreign joint ventures and co-operative enterprises. Tariffs are also reduced by 50 per cent for consumers in the SEZs. Therefore, China's actual tariff revenues collected, relative to total imports, are at a much lower rate of 5.6 per cent in 1992, compared with other developing countries, such as India (51.2 per cent in 1986) and Pakistan (30.8 per cent in 1990).[14] China's exports associated with import-duty concessions amounted to more than 60 per cent of total manufactured exports in 1991 (World Bank 1993, p.60.)

Table 3. **China's Import Tariffs, Effective Rates of Protection and Non-Tariff Measures, 1987 and 1993**

| | Industries | Nominal tariffs (%) | | ERP (%) | | NTM frequency (% of product lines) | | Memo items: Tariff revenues (% of imports value) | Memo items: Imports (% of total) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | 1987 | 1993 | 1987 | 1993 | 1987 | 1993 | 1987 | 1987 | 1993 |
| Extraction (5) | | | | | | | | | | |
| | Petroleum and natural gas | 18.1 | 17.4 | 16.0 | 15.2 | 0.0 | 12.0 | *n.a.* | 3.9 | 4.4 |
| | Ferrous metals | 5.0 | 2.1 | -2.0 | -5.6 | 0.0 | 50.0 | 0.0 | 0.7 | 0.9 |
| | Non-ferrous metals | *n.a.* | 6.6 | *n.a.* | -0.8 | *n.a.* | 0.0 | *n.a.* | 1.0 | 0.5 |
| | Non-metal minerals | 15.8 | 16.4 | 10.8 | 11.5 | 0.0 | 0.0 | 27.8 | 0.3 | 0.2 |
| | Coal mining and processing | 27.8 | 23.8 | 24.1 | 18.4 | 10.8 | 0.0 | *n.a.* | 0.6 | 0.1 |
| Manufacturing (28) | | | | | | | | | | |
| | Transport equipment | *n.a.* | 37.1 | *n.a.* | 43.8 | *n.a.* | 24.0 | *n.a.* | 7.1 | 12.0 |
| | Electronic appliances and telecom | 47.8 | 39.9 | 51.9 | 41.5 | 0.0 | 17.0 | 7.0 | 9.3 | 11.4 |
| | Primary iron and steel products | 14.9 | 14.7 | 8.2 | 7.8 | 0.0 | 70.0 | 7.0 | 10.2 | 9.1 |
| | Ordinary machinery | 27.8 | 26.4 | 28.4 | 25.4 | 1.1 | 6.0 | 7.7 | 9.8 | 9.0 |
| | Specialised machinery | 20.9 | 24.9 | 14.7 | 22.6 | 1.2 | 2.0 | *n.a.* | 8.2 | 8.6 |
| | Textile products | 75.6 | 57.4 | 168.7 | 80.4 | 11.0 | 7.0 | 1.7 | 5.6 | 8.6 |
| | Electric machinery and equipment | 39.4 | 41.0 | 57.9 | 63.1 | 3.7 | 5.0 | 7.1 | 4.9 | 5.2 |
| | Basic chemical products | *n.a.* | 25.6 | *n.a.* | 22.2 | *n.a.* | 1.0 | 7.4 | 7.9 | 4.5 |
| | Plastic products | 42.5 | 47.3 | 63.5 | 81.5 | 0.0 | 0.0 | 3.0 | 5.2 | 4.3 |
| | Other manufactures | 56.2 | 51.5 | 80.9 | 69.0 | 2.1 | 5.0 | 4.8 | 4.0 | 3.7 |
| | Petroleum refineries and cokes | *n.a.* | 56.4 | *n.a.* | 134.0 | *n.a.* | 0.0 | 4.4 | 2.7 | 2.8 |
| | Metal products | 44.0 | 34.3 | 80.6 | 49.5 | 0.0 | 13.0 | 8.8 | 2.6 | 2.5 |
| | Primary non-ferrous metal products | 16.5 | 15.8 | 15.7 | 14.0 | 5.7 | 0.0 | 3.3 | 1.6 | 2.1 |
| | Paper products | 39.2 | 29.7 | 53.4 | 29.2 | 0.0 | 8.0 | 3.3 | 3.0 | 1.8 |
| | Precision instruments | *n.a.* | 16.7 | *n.a.* | 10.6 | *n.a.* | 0.0 | 7.4 | 2.5 | 1.7 |
| | Timber processing | 44.5 | 36.7 | 54.3 | 39.2 | 0.0 | 27.0 | 11.4 | 1.0 | 1.1 |
| | Chemical fibres | 36.2 | 34.4 | 41.8 | 37.6 | 0.0 | 43.0 | 6.2 | 1.7 | 1.1 |
| | Garments and other made-ups | 89.6 | 83.0 | 207.3 | 167.2 | 11.7 | 6.0 | 3.9 | 0.8 | 0.9 |
| | Grain Processing | *n.a.* | 33.0 | *n.a.* | 156.6 | *n.a.* | 0.0 | 14.3 | 1.1 | 0.8 |
| | Non-metal mineral products | 49.6 | 43.1 | 66.3 | 52.6 | 8.0 | 0.0 | 11.4 | 0.8 | 0.5 |
| | Medical and Pharmaceutical | 18.1 | 17.5 | 5.6 | 4.4 | 85.5 | 0.0 | 16.5 | 0.6 | 0.4 |
| | Food Manufacturing | *n.a.* | 53.2 | *n.a.* | 112.6 | *n.a.* | 3.0 | *n.a.* | 1.0 | 0.3 |
| | Printing | *n.a.* | 17.8 | *n.a.* | 5.7 | *n.a.* | 0.0 | 1.8 | 0.4 | 0.3 |
| | Tobacco | 87.5 | 145.0 | 102.5 | 209.2 | 0.0 | 50.0 | 89.3 | 0.7 | 0.3 |
| | Beverage | 119.7 | 102.1 | 2,509.0 | 705.2 | 0.0 | 5.0 | 74.4 | 0.2 | 0.3 |
| | Leather products | *n.a.* | 59.3 | *n.a.* | 90.5 | *n.a.* | 0.0 | 0.7 | 0.3 | 0.2 |
| *n.a. : not available* | Furniture | 72.9 | 72.6 | 155.8 | 154.3 | 0.0 | 0.0 | 13.7 | 0.3 | 0.2 |
| | Rubber products | 37.8 | 29.5 | 35.3 | 17.8 | 6.3 | 32.0 | 9.8 | 0.2 | 0.2 |
| | Total | | | | | | | | 100.0 | 100.0 |
| | Share of industrial products in total imports | | | | | | | | 88.9 | 96.3 |

*Sources:* UNCTAD, Trains Database (1994), UNCTAD, Handbook of Trade Control Measures of Developing Countries (1989), China Input/Output Table (1987), CHELEM Trade Database (1993).

Table 3 shows several salient features of China's import regime. First, it appears that the tariff structure for 1993 is *not* significantly different from the 1987 structure, despite sizeable tariff-rate reductions in 1992 and 1993. In fact, tariff rates were raised between 1986 and 1991 before being reduced in the subsequent years (World Bank, 1994; and Tseng, et al., 1994).

Second, tariff rates tend to be higher for final consumer goods than for intermediate goods and raw materials, so that the ERP in the former group tends to be much higher than nominal rates would indicate. This is particularly so in the case of China's leading *export* sectors, such as garments and other made-ups, furniture, and leather products, though actual rates of tariff collection are very low.

Third, the use of NTMs (in 1993) tends to be concentrated in several key industries supplying basic materials and intermediate products for other domestic industries (e.g. ferrous metals, iron and steel, chemical fibres and rubber products). Between 1987 and 1992, NTMs were actually introduced in a number of new industries, such as ferrous metals, primary iron and steel, chemical fibres and tobacco. The coverage of NTMs was also increased in many other industries. A notable exception was medical and pharmaceutical products which were removed from the list of NTMs. In some manufacturing industries (e.g. transport equipment, chemical fibres, timber processing and tobacco), high tariffs coexist with the extensive use of NTMs.

Finally, China's manufactured imports tend to be concentrated in capital goods and intermediate products. In 1993, 9 out of the ten leading importers were these industries, accounting for nearly 70 per cent of the country's total manufactured imports. Nominal tariffs imposed on these industries ranged from 14.7 per cent (primary iron and steel) to 57.4 per cent (textiles). However, actual tariff revenues collected (in 1987) were significantly lower than nominal tariff rates, indicating that importers of capital goods and intermediate products were main beneficiaries of tariff exemptions and rebates granted by the government.

How protective is China's import regime, compared with other Asian developing economies? Table 4 presents the latest information on tariff rates and quantitative restrictions (QRs) for 11 developing economies in Asia. These economies are divided into two groups. In the case of the first group (Chinese Taipei, Indonesia, Korea, Malaysia, Philippines, Sri Lanka and Thailand), tariff rates have been reduced to moderate levels, and QRs are exceptions rather than rules. The present tariff levels reflect substantial cuts taken unilaterally in the course of the Uruguay Round. In such developing countries as Indonesia, Sri Lanka and Thailand, average tariff rates currently applied are already lower than the post-UR average bound tariff rates. Nevertheless, the UR tariff commitments are useful to "lock in" previous tariff liberalisation through bindings. In East Asia (except the Philippines), average tariff rates had come down to relatively low levels (10 to 15 per cent) by the early 1990s.[15] Yet, there remain significant "peaks" in tariff structure and the dispersion of tariff rates are large as well. (Dean, at al., 1994; and Imada-Iboshi, et al., 1994). On the other hand, in the case of the second group (Bangladesh, China, Pakistan, India and Vietnam), tariff rates are kept at high to very high levels (except Vietnam), and QRs still constitute important trade barriers

in many cases. Despite recent efforts to reduce and rationalise tariffs and NTMs, China's import regime is one of the most protective in Asia, along with India and Pakistan.

Table 4. **Tariff Rates and Quantitative Restrictions (QRs) in Selected Asian Developing Economies**

| | | All products | | |
|---|---|---|---|---|
| | | Average Tariff | Tariff | QRs |
| | Year | Rates (%) | Range (%) | (%) |
| Indonesia (a) | 1987 | 18.1 (18.2) | 0/58 | 91.4 |
| | 1992 | 17.0 (12.6) | 0/40 | 1.9 |
| Korea, Rep.(a) | 1987 | 22.9 (20.2) | 8.1/32.5 | 8.8 |
| | 1992 | 11.1 (10.0) | 3.0/22.3 | 2.6 |
| Malaysia (a) | 1987 | 13.6 (14.7) | 0/49.3 | 3.7 |
| | 1992 | 12.8 (11.2) | 0.9/45.0 | 2.1 |
| Philippines (b) | 1985 | 27.6 (18.3) | 0/100 | ~100 ('83) |
| | 1992/91 | 24.3 (17.9) | 0/100 | <5 |
| (c) | 1993 | 23.5 | 3/30 (by 1995) | |
| Sri Lanka (a) | 1987 | 27.3 (23.6) | 0/78.3 | 8.6 |
| | 1993 | 26.1 (23.7) | 0/58.4 | 3.8 |
| Thailand (b) | 1986 | 13 | | |
| | 1990 | 11.4 | | <5 ('88) |
| Bangladesh (b) | 1986 | 94 | 2.5/508.5 | 39.5 |
| | 1993 | 50.0 (31.0) | 7.5/100 | 10.0 |
| China (b) | 1986/87 | 38.1 (29) | | |
| | 1992 | 43 (32) | 0/143 | 70 |
| (d) | 1993 | 36.4 | | <50 |
| Pakistan (a) | 1984 | 78 (59.7) | 0/150.1 | 79.7 |
| | 1992 | 61.1 (56.2) | 0/90 | 14.5 |
| India (a) | 1987 | 98.8 (90) | 0/160.8 | 73.2 |
| | 1992 | 53.0 (42.6) | 0/65 | 58.8 |
| (e) | 1994 | 55 (33) | | |
| Vietnam (b) | 1991 | 11 | 0/150 | 100 |

*Notes and Sources:*
(a) UNCTAD, Trade Control Measures Database.
Tariff rates: Unweighted average (Import-weighted average).
Tariff range: the lowest/highest tariff rates within each CCCN heading.
QRs: Unweighted average of QR incidence within each CCCN heading.
(b) Dean et al. (1994).
China's QR rates: Percentage of imports covered by licensing, etc. (import weighted).
(c) Imada Iboshi et al (1994).
(d) Tseng, et al (1994).
(e) Ahluwalia (*forthcoming*).

## Import Liberalisation: Unfinished Business

The above analysis of China's import regime suggests that there is much room for improvement in trade policy. Continued efforts to liberalise and rationalise the import regime are necessary for China to sustain the transition process to a market economy in the coming years. There is a significant degree of policy overlapping between tariffs and NTMs. The extensive use of NTMs, which are discretionary, increases uncertainty of market access and reduces transparency and predictability in trade policy making. The current system of high tariffs combined with tariff exemptions and rebates generates distortions in resource allocation and subject to abuse.

China is currently seeking to rejoin the GATT/WTO. It is important to recall that it was a founding member of the GATT, but withdrew in 1949 when the CCP came to power. In 1986 the Chinese government first applied for admission (or re-admission) to membership of the GATT, and subsequently the Working Party on China's Status as a Contracting Party was established in March 1987. China also participated in the Uruguay Round of multilateral trade negotiations. Although the negotiating procedure was suspended for about three years after the Tiananmen Square incident in June 1989, the negotiations were resumed in late 1992 and became very intense in the course of 1993-94, since China wanted to become a founding member of the WTO. It was in this context that the Chinese government undertook new steps to liberalise the trade regime further.[16]

The Third Plenary Session of the 14th Central Committee of the CCP in November 1993 set the objective of establishing a "socialist market economy" in the coming years. The agenda is comprehensive and far-reaching but it does not specify means. The decision by the Central Committee states that "the establishment of this [socialist market economic] structure aims at enabling the market to play the fundamental role in resource allocations under macroeconomic control by the State" (*China Daily*, Supplement, 17 November 1993). The adoption of the five main planks of that objective would imply the continuation and extension of the "opening up" process. One of the planks in the platform of the socialist market economy is the establishment of "a nation-wide integrated and open market system to closely combine the urban market with the rural market and link the domestic market with the international market, so as to optimise the allocation of resources (*Ibid.*)". The decision of the Central Committee also points to "multi-directional opening" of the Chinese economy and further reform of foreign trade and investment regimes.[17] The adoption of the objective of a "socialist market economy" was quickly followed by new policy initiatives during 1994. The dual exchange rates were unified, a new foreign trade law was promulgated, the tax system was restructured, and the financial sector was opened wider to foreign banks. The first two measures actually might help to reduce distortions in China's resource allocation and make trade policy more transparent. However, the distorted nature of the import regime still remains, which is one of the main reasons why the negotiations on China's protocol accession to the GATT/WTO did not reach a successful outcome.

It is an irony that the gradualism which allowed Chinese reformers to undertake policy reforms at the outset of economic transition is now working against the country's full integration into the world economy. Therefore, what China needs today is a firm commitment to a comprehensive overhaul of its trade regime with a clear timetable, without which policy credibility can not be enhanced. In this paper, we argue that the current import regime, which is characterised by an extensive use of NTMs and widely dispersed tariff rates, needs to be replaced by a more transparent, uniform one based on "tariffs-only" measures. Such replacement would not only increase tariff revenues — thereby helping curb the budget deficit — but also clearly demonstrate the commitment of Chinese authorities to achieving a freer and more fairly regulated economy. In this respect, the Chilean experience of trade reform — that is, the progressive rationalisation and liberalisation of the import regime that occurred in the 1970s — may be more inspiring a case than that of Chinese Taipei or South Korea during the same period.[18] Thus, the agenda for trade-policy reform in China includes:

1. Extension of trading rights to all enterprises; discriminatory policies in favour of trade and investment in Special Economic Zones and other development zones should be phased out;
2. Continued reduction in tariff rates, with a pre-announced timetable; tariffs could be kept within a range of 10-15 per cent, which would be compatible with the WTO requirements;
3. Tariffication of non-tariff measures;
4. Rationalisation of tariff exemptions and rebates.

The above agenda would remove a good deal of distortion in China's trade regime and improve access to the Chinese market.

## IV. Concluding Remarks

Three main lessons can be drawn from the Chinese experience of economic transition.

1. *China is not a unique case in the light of both trade-policy reform and the resulting changes in trade patterns*. On the one hand, liberalisation and decentralisation of trade controls resulted in strong export growth not only in China but also in CEECs, though the latter lowered trade barriers more rapidly. On the other hand, the changes in trade patterns following the opening up of China to the outside world are similar to those previously experienced by other East-Asian countries, such as Chinese Taipei, South Korea and several ASEAN member countries. By unleashing strong forces of comparative advantage, trade-policy reforms have boosted exports of labour-intensive goods.

2. *The incompleteness of trade-policy reforms might hamper the effectiveness of domestic enterprise reform*. Despite efforts to further liberalise and decentralise trade activities in 1993-94, China's import regime still remains highly distorted. Piecemeal liberalisation delays the introduction of international competition in the domestic sector, which, as the experience of CEECs shows, is a key element of domestic enterprise reform.[19] This uneven progress may be interpreted as a feature of the "dual track approach" to economic transition.[20] It largely reflects the resistance from vested interests, including state-owned enterprises, to import liberalisation and the reluctance of authorities to letting world prices affect domestic prices too brutally.

3. *The lack of a firm commitment to import liberalisation might delay China's full integration into the world economy*. As mentioned above, this is a major obstacle — though not the sole one[21] — to China's accession to the WTO. Besides, it is also important to see the future of China's trade-policy reform from a regional perspective. In recent years many developing economies in both East and South Asia have unilaterally been undertaking import liberalisation. In particular, ASEAN countries — China's main competitors — have committed themselves to the formation of the ASEAN Free Trade Area, which is to be accomplished by 2003. More recently, the member states of APEC have announced their intention to pursue "free trade in the region" by 2010 (for developed members) or 2020 (for the rest). It should be kept in mind that China's remarkable trade and growth performance during the post-reform period has owed much to its strengthened regional ties with fast-growing East Asian economies. If import liberalisation in China were to proceed too slowly, it would run the risk of not taking full advantage of the current regional dynamics. In this rapidly changing trading environment, the transition strategy which was working in the 1980s may not be the right one for the 1990s and beyond.

## NOTES

1. See, for example, Csaba, 1995; Fan, 1995; Fischer, 1993; Fukasaku and Wall, 1994; Gelb et al., 1993; Lee and Reisen, 1994; Macmillan and Naughton, 1993; Perkins, 1992; Rana and Dowling, 1993; and Sachs and Woo, 1994.

2. The term "trade-policy reform" is used here in a broad sense. To describe changes in China's commercial policy framework better, Fukasaku and Wall (1994) use the term, "open-economy reform", which means the reform of foreign trade and exchange regimes; the establishment of a legal and institutional framework for foreign direct investment; and the establishment of SEZs and other development zones.

3. See Fukasaku and Wall (1994, Chapter 2) for a full description of developments in China's trade-policy reforms since the late 1970s.

4. How to handle foreign direct investment (FDI) was another contentious issue. A key aspect of China's policy reform in this area was to first enact politically crucial but unspecific "enabling laws" that allowed the government to introduce more specific policy measures later when political and economic conditions were met. Due to the legacy of the traditional policy of self-reliance under central planning and suspicious views about foreign-funded firms, which were particularly strong during the Cultural Revolution (1966-76), China had to establish a legal and institutional framework for FDI from scratch. The first measure taken after 1978 when the political wind shifted with respect to FDI was to get the landmark 1979 Joint Venture Law passed, and this was followed by numerous laws and regulations in various areas of direct relevance to both Chinese and foreign firms, including income tax, profit repatriation, labour management, land use and property rights.

5. A word of caution may be in order regarding the role of trade-policy reform in economic transition. That is to say, once the reform process had begun, and as decentralisation and opening up of the Chinese economy continued, virtually *every* aspect of China's economic management system had to change as well. This involves, *inter alia*, ownership and management reforms, the establishment of markets for goods, services and factors of production and price reforms and economic decentralisation.

6. From 1978 until 1983, the real effective exchange rate of the Chinese yuan *appreciated* by some 30 per cent, before depreciating rapidly in the subsequent years. In bilateral terms, the Chinese yuan depreciated substantially and rapidly between 1985 and 1991 against the currencies of Singapore, Chinese Taipei, Malaysia and Thailand, and to a lesser extent, those of Hong Kong and Republic of Korea (Fukasaku and Wu, 1993).

7. Measuring China's GDP in US dollars or purchasing power parities (PPPs) poses a major difficulty for an analysis of trade openness. We used the dollar exchange rate in Table 1, which tends to overstate the degree of trade openness because of successive devaluations of the Chinese yuan. It can be noted that, according to Lemoine (1995, p.10), when using the PPPs, the share of exports in GDP would be around 5 to 7 per cent, instead of 20 per cent when using the current exchange rate. Despite this measurement problem, however, there is general consensus among trade analysts that the Chinese economy is progressively opening up during the post-reform period. See Lardy, 1992, for a detailed discussion of China's national accounts and trade statistics.

8. Based on the *Almanac of China's Foreign Economic Relations and Trade* 1993/94.

9. Due to the limited compatibility of sources, 1992 was the last year for which calculations were possible.

10. Conversely, in the case of CEECs, the re-orientation of trade patterns has benefited by the proximity of the European Union. In 1994, the EU represented over 60 per cent of Poland's total exports and more than 50 per cent for Hungary. See Lemoine, 1995.

11. See Fukasaku, 1992, for an empirical investigation of East Asian trade developments.

12. The case of Singapore may be explained by its special status as an entrepot, since its export statistics includes re-exports in which commodity exports are considered to take a high share. On the other hand, the case of Malaysia may be due to a high concentration of exports of electronic products.

13. Similarly, export licensing and export taxes have been used as the main instruments to control exports, as the mandatory planning for exports was abolished in 1991 (Fukasaku and Wall, 1994, p.50). These measures are used to keep prices up in cases where China is a dominant supplier in the world market (e.g. tin, tungsten and antimony). In addition, export licenses have been applied in order to ensure that China keeps its obligations under international agreements such as the MFA and VERs.

14. The tariff collection rate for 1986 was 9.7 per cent in China (World Bank, 1993, p.60).

15. The Philippine Government adopted new tariff reform measures in July 1991 to bring the average tariff rate down to 14 per cent by 1995 and simplify the tariff structure by reducing the number of tariff categories and lowering the dispersion of tariff rates (Dean et al 1994, p.83).

16. As for different perspectives on the issue of China's accession to the GATT/WTO, see Drysdale and Elek (1992), Garnaut and Huang (1994) and Lardy (1994).

17. The four other planks concern the reform of state-owned enterprises, the establishing of a sound macroeconomic management system, income distribution, and social security.

18. The trade regime reform in Chile started in 1974. It included the removal of all quotas and permits; the reduction in the number of prohibited items from 187 to 6; phasing out import deposits; rationalisation of the tariff structure; and the reduction of maximum tariffs. By 1979, Chile had achieved a uniform set of tariffs averaging 10 per cent. See Bosworth, Dornbush and Labán (1994).

19. See for example the cases of Poland and the Czech Republic, in Bouin and Grosfeld (1995, p. 783).

20. On the "dual track" approach to economic transition, see Fan, 1995.

21. Other problems include rules on state trading, developing country status and the demand of China's major trading partners for special safeguard mechanism.

## Appendix 1:
## Comparative Advantage Indicator

Balassa's Revealed Comparative Advantage index is defined as follows:

$$\text{RCA} = \frac{(X_{ik} / X._k)}{(X_i./X..)}$$

where *X* stands for the value of exports, *i* denotes a country and *k* a product. The RCA index thus indicates the relative export share of country *i* in world trade in product *k* divided by that country's share of total world trade. If RCA = 1, it is usually interpreted as indicating the "normal" export performance of country *i* in world trade in product *k* in terms of the size of that country as an exporter in total world trade. If RCA > 1 (< 1), then country *i* is considered to have comparative advantage (disadvantage) in the export of product *k*.

Two major difficulties arise when applying RCA index to actual data:

1. the change in the market share on which RCA index is based reflects not only the change in the underlying comparative advantage of the exporting countries but also any change in demand from the importing countries. Therefore, it is hardly possible to assume that the RCA index should indicate the *ex ante* comparative advantage of a country, which is determined by the pre-trade relative prices. This raises particular problems when it comes to analysing the evolution of RCA index over time.

2. the RCA index also captures the effect of changes in the volume of total production of item *k*, and not only the change in export performance of the country; besides, it does not take into account product *k*'s relative contribution to the country's export performance.

The calculation of Chelem's Comparative Advantage Indicator aims at overcoming these two limitations of the RCA.

1. The impact of changes in the relative market shares of each product at the world level, which are not specific to country *i*, are neutralised. Export and import figures used in the calculation of CAI are weighted by the changes in the world demand: before they are used in the CAI calculation, exports (*X*) and imports (*M*) are adjusted for all years *n*, based on a year of reference *r*. Adjusted exports (*X'*) and imports (*M'*) are calculated as follows:

$$X'^{(n)}_{ik} = X^{(n)}_{ik} \times e^{(n)}_{k}$$

$$M'^{(n)}_{ik} = M^{(n)}_{ik} \times e^{(n)}_{k}$$

with

$$e^{(n)}_{k} = \frac{X_{.k}^{(r)} / X_{..}^{(r)}}{X_{.k}^{(n)} / X_{..}^{(n)}}$$

where $X_{.k}$ is the total world trade for product *k*.

2. The CAI is based on the calculation of net trade and takes the size of the national market into account. For each country *i* and each product *k*, the share of net trade in GDP (*Y*) is calculated, with *X* and *M* adjusted as mentioned above, by the following formula:

$$t_{ik} = \frac{(X'_{ik} - M'_{ik})}{Y_i}$$

Now the CAI is defined as follows:

$$CAI_{ik} = t_{ik} - g_{ik} \times t_{i.}$$

with:

$$g_{ik} = \frac{(X'_{ik} + M'_{ik})}{(X'_{i.} + M'_{i.})}$$

and

$$t_{i.} = \frac{(X'_{i.} - M'_{i.})}{Y_i}$$

A weighted comparative advantage indicator $CAI_{ik}$ is then obtained, in which the effects of both the size of the country and the changes in demand are corrected:

$$CAI_{ik} = \frac{(X'_{ik} - M'_{ik})}{Y_i} - \left[ \frac{(X'_{ik} + M'_{ik})}{(X'_{i.} + M'_{i.})} * \left( \frac{(X'_{i.} - M'_{i.})}{Y_i} \right) \right]$$

# Appendix 2:
# Chinese Industrial Classification and Codes

| Chinese Industrial Classification | Codes | CHELEM | notes | SITC, Rev.2 |
|---|---|---|---|---|
| **Industry** | | **7 to 89 (excluding 16, 40)** | | |
| **Extraction (5)** | | | | |
| Coal mining and processing | 7, 8 | IA | | 322.1, 322.2, 322.3, 323 |
| Petroleum and natural gas | 9, 10 | IB, IC | | 333, 341.3, 341.4 |
| Ferrous metals | 11 | HA | | 281, 282 |
| Nonferrous metals | 12 | HB | | 286 to 289 |
| Nonmetal minerals | 13 | HC | | 27 |
| **Manufacturing (28)** | | | | |
| Grain processing | 17 to 21 (+26) | KA, KB, KG | (a) | 046 to 048, 41, 42, 022 to 024, 091, 08 |
| Food manufacturing | 22 | KD, KE, KF | | 012, 014, 035, 037, 056, 06, 073, 058.2, 058.3, 058.6, 058.9, 098 |
| Beverage | 23, 24 | KH | | 011, 058.5 |
| Tobacco | 25 | KI | | 122 |
| Textile products | 27 to 32 | DA, DD | | 652, 655 to 659, 651.1 to 651.3, 651.5, 651.6, 651.8, 651.9 |
| Garments and other made-ups | 33 | DB, DC | | 842 to 846, 847.1, 847.2 |
| Leather products | 34 | DE | | 61, 83, 85, 848.1 to 848.3 |
| Timber processing | 35 | EA | | 63 |
| Furniture | 36 | EB | | 82 |
| Paper products | 37 | EC | | 25, 64 |
| Printing | 38 | ED | | 892 |
| Petroleum refineries and cokes | 41 to 43 | IH, IG | | 323, 334, 335 |
| Basic chemical products | 44 to 50 | GA, GB, GC, GD, GE | | 51, 52, 56, 57, 591, 592, 598.1 to 598.3, 43, 53, 55, 598.9 |
| Medical and Pharmaceutical products | 51 | GF | | 54 |
| Chemical fibers | 52 | GG | | 58, 233, 266, 267, 651.4, 651.7 |
| Rubber products | 53, 54 | GI | | 62 |
| Plastic products | 55, 56 | GH | | 893 |
| Nonmetal mineral products | 57 to 63 | BA, BB, BC | | 661 to 666 |
| Primary iron and steel products | 64 | CA, CB | | 671 to 679 |
| Primary non-ferrous metal products | 65 | CC | | 68 |
| Metal products | 66, 67 | FA, FB | | 691 to 697, 699, 749, 812.1, 812.2 |
| Ordinary machinery | 68, 69, 72, 74 | FC, FE, FF | | 711, 712, 718, 723, 728.1, 736, 737, 741 to 744, 713.2, 713.3, 713.8, 713.9, 714.88, 714.99 |
| Specialized machinery | 70, 71, 73 | FD, FG | | 721, 722, 724 to 727, 745, 728.3, 728.4 |
| Transport equipment | 75 to 79 | FS, FT, FU, FV, FW | | 713.1, 714.4, 714.81, 714.91, 781 to 786, 791 to 793 |
| Electric machinery and equipment | 80 to 82 | FP, FQ, FR | | 716, 771 to 773, 775, 778, 812.4 |
| Electronic appliances and telecom | 83 to 85 | FL, FM, FN, FO | | 751 (-751.82), 752, 759 (-759.19), 761 to 764, 776 |
| Precision instruments | 86 | FI | | 774, 872 to 874 |
| Other manufactures | 39, 87 to 89 | EE, FH, FJ, FK | (b) | 269, 667, 882, 883, 894 to 899, 951, 885, 871, 881, 884, 751.82, 759.19 |

(a) including food for animals (Chelem KG, SITC 08)

(b) including "Articles of arts and craft" (Chelem EE; Chinese 39), armament (Chelem FH), clocks (Chelem FJ), optical apparels & cameras (Chelem FK)

## Appendix 3:
## Effective Rate of Protection (ERP)

The Effective Rate of Protection (ERP) is the rate of protection provided to the economic activity that produces the value added in the product concerned. This indicates the extent to which protection policies influence the allocation of resources towards, or away from, particular activities or sectors. We used the 1987 Chinese Input/Output Table to calculate the shares of value added and of various inputs in each product. For each activity *j*, the ERP is defined by the following formula:

$$g_j = \frac{t_j - a_{ij} t_i}{1 - a_{ij}}$$

with

$g_j$ = effective ratio of protection rate for activity *j*; *i.e.* the proportional increase in the effective price resulting from tariffs.

$t_j$ = tariff on product *j*

$t_i$ = tariff on product *i*

$a_{ij}$ = share of *i* in the cost of *j* in the absence of tariffs

As $a_{ij}$ is not easily available, we use $a'_{ij}$, which represents the input shares that results after the tariffs raised both domestic final good prices and domestic input prices:

$$a'_{ij} = a_{ij} \frac{1 + t_i}{1 + tj}$$

We then obtain the following formula:

$$g_j = \frac{1 - a'_{ij}}{\frac{1}{1 + t_j} - \frac{a'_{ij}}{1 + t_i}} - 1$$

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