

Foreign Economic Policy of Peoples Republic of China: Theoretical Background and Structural Characteristics

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I. Introduction

In 1979 China proclaimed official transformation of the traditional self-reliance policy to active open-door policy. Such a more or less liberal attitude toward the international division of labour is one of the important constituents of the overall economic reform in China. Chinese leaders seem to be aware of the fact that a closed economy would substantially reduce the allocative efficiency of the national economy. The scope of the open-door policy contains thereby not only international trade, but also liberal gesture toward foreign capital, technology and direct investment of western enterprises.

Since the proclamation of the so called "Nordpolitik", Korean firms show great interest in trade with and direct investment in China. Even though there are some political obstacles, both countries share a certain amount of complementary factors: China is surely a huge potential market, rich in manpower and natural resources; Korea has accumulated technological know-how of intermediary level, which is not so sophisticated for China to absorb as the western high-tech. At the same time, as the Chinese industrialization through integration in the world market proceeds, China might pose an additional competitive pressure on Korean export. Thus, economic relationship of the two countries is characterized by the complementary and competitive factors.

Bearing this in mind, this paper begins with an overview of theoretical background of the open-door policy in China. In the following chapters, we deal with adjustment process of visible account in trade balance and some structural features of the foreign trade. The policy implication of China's open-door policy for Korea will be summarized in the last chapter.

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II. Theoretical Background of the Open-Door Policy

Especially in socialist countries, economic theory assumes two functions: The one is explanation of economic mechanism, the other is normative justification of existing system of the countries concerned. Theory of international trade is no exception in this regard. Viewed from the history of socialist economic theory, the international trade played only minor role in the case of Marxist theory. It was Lenin who showed vigorous interest in foreign economic relations. In his theory Lenin used the conceptional category "imperialism" in interpreting roles of foreign economic relations during the second half of the 19th century. Supported by this Leninistic version of trade theory, China maintained until the end of the 70s virtually economic strategy of "self-reliance". Foreign trade had been kept on a minimal level, and this with the socialist countries.

During the 70s, discussions on functions of international trade in China had been partly influenced by the dependency theory. Chinese economists argued in line with R. Prebisch that relative prices of industrial and agricultural products-or of raw materials-change through foreign trade in such a way that a country which specializes in the export of agricultural products or raw materials must accept unfavourable terms-of-trade. Such a restrictive view on foreign economic relations was strongly influenced by the theory of unequal exchange, developed by Emmanuel(Emmanuel, 1972). Further, it was the philosophy of Mao Ze-dong that economic dependency on capitalistic countries would inevitably jeopardize political independence of China(Wang Yaoting, 1974:19).

In transforming such traditional "trade aversion policy" to more or less liberal attitude, it seems that economic theory of Ricardo have played important role. His theory that international trade would, according to the degree of specialization, benefit all the trading partners dominated in the theoretical discussion in China since the beginning of the 80s. Apparently from the ideological point of view, the Ricardian theory must have been far more comfortable than the neo-classical version of trade theory, since Ricardian theory is based on the labour value theory, one of important pillars in the Marxist theory of socialism.

Meanwhile, among some Chinese economists there have been continuous dispute on the benefit of international division of labour(Ma Shu-yun, 1986:294). In this regard, some economists argue that the foreign trade can at best increase the "value in use", but not necessarily "the value in exchange".

The former is created in the consumption process, and the latter through exchange as gain in utility. According to the traditional theory of labour, value of a commodity is determined solely by the amount of socially necessary labour-time. Thus, international trade can not increase the value in exchange, since the amount of necessary labour does not change through trade. For this reason, they recommend to conduct foreign trade only in case when there exists disequilibrium in material balance of national economy, i.e. to export commodities in surplus and to import commodities in shortage. However, majority of articles on international trade deals with the labour-saving effect of trade, and recommend liberal attitude toward the international division of labour.

Another popular way to justify the open-door policy is the inference to historical experiences of China. In stressing the importance of the open-door policy, a Chinese historian illustrated comparative history of Han(206 BC-220 AD) and Tang(618-901) dynasties on the one hand, and that of middle and late Qing Dynasty(1644-1911) on the other hand(Yue Qingping, 1987:23-24). The Han and Tang dynasties represent flourishing periods in China's feudal society, whereby the opening up to the outside world was the dominant feature of foreign policy pursued during both periods. The Han dynasty expanded its trade relations through silk road to West Asia, India, Persia, the Arab Empire and the Eastern Roman Empire. And the Tang dynasty also developed extensive economic ties with many foreign countries, too. Tang's Capital Changan, Guangzhou and Yangzhou were open to free entrants for foreign merchants.

To the contrast, the Qing dynasty gradually turned to a closed-door policy. At the end of 18th century, British envoys asked Emperor Qian Long, so the author, to open up China's ports for trade. However, the emperor's instructions were: "China has plentiful natural resources, and has everything that other countries have. ...China is a rich country. Does China then need inferior products from small countries?"(Yue Qingping, 1987:24) Based on such philosophy, which originates surely from the traditional Sino-centrism, China imposed strict restrictions on foreign trade. The author concluded, that the policy of the Qing dynasty cut the Chinese people off from the outside world, hindering the economic development of China. While the Qing dynasty maintained its closed-door policy, European capitalism developed rapidly, "demonstrating its superiority over the feudal system. ...Looking back at their history, the Chinese people have come to realize that the nation's prosperity is closely linked to an open-door policy. ...In a sense, the open-door policy being carried out in China at present is essentially the result of summing up historical experience."(Yue Qingping, 1987:24)

III. Adjustment Process of Visible Account in Trade Balance

One of the important features in the pattern of resource allocation in China is the rather dramatic increase in the share of exports since 1978. During the long period from 1957 to 1978 it remained more or less constant at about 6 per cent of the net material product. However, it had risen to about 10 per cent already in 1982, reflecting China's active participation in the global division of labour. Another indicator for the recent change from an internally oriented to an outward-looking development pattern is the changing elasticity of imports with respect to income. As the Table 1 shows, in the periods prior to 1978, the elasticity was slightly above one, but in the short period after 1978, it rose sharply. Since 1978 imports have raised 2.5 times as fast as net material product.

Table 1. Import Elasticity, 1957-82.

	1957-78	1978-82
Average annual growth rate(%)		
Imports	6.5	15.8
Net Material Product	5.3	6.3
Elasticity	1.2	2.5

Source: K. C. Yeh, "Macroeconomic Changes in the Chinese Economy During the Readjustment", in *The China Quarterly* Dec. 1984, p. 705.

In december 1978, when the first phase of the Economic Readjustment began, the situation in foreign trade was one of serious difficulty. The large trade surplus of 1977 had turned into a deficit in the final quarter of 1978. Nonetheless, China decided in 1979 to establish the Special Economic Zones and the China International Trust and Investment Corporation(CITIC) to effectively facilitate the economic integration in the world market.

In 1979 the visible account was in deficit by US \$ 906 million. By 1982 China had achieved a surplus of US \$ 6.868 billion. This surplus was achieved in spite of a deteriorating world trade environment and it enabled China to accumulate substantial foreign exchange and also to repay, ahead of schedule, loans from the International Monetary Fund.

The way in which different sectors contributed to the surplus of the visible account is illustrated in Table 2.

Table 2. Contribution of Commodity group to the Improvement of Trade Balance

Commodity Group	Total Balance 1979	Total Balance 1982	Net improvement in the Trade Balance	Contribution to the improvement of the Balance(%)
I. Food, Meat	+ 806	+ 158	- 648	- 8
II. Raw Material, Chemical Products	- 989	+ 298	+1,296	15
III. Oil	+2,289	+5,243	+2,954	35
IV. Semi-Products, Manufactures	+ 473	+4,662	+4,189	49
V. Machinery	-3,417	+7,716	+ 772	9
Total	-3,417	+7,716	+8,563	-

SITIC: I=0, 1, 4; II=2, 5; III=3, IV=6, 8; V=7

Source: Y.Y. Kueh/Christopher Howe, "China's International Trade: Policy and Organizational Change and their Place in the Economic Readjustment," in *The China Quarterly*, December 1984, Nr. 100, p. 822.

Column 3 shows the improvement between the two years, and Column 4 the percentage contribution made by each group to the total improvement accounted for by all five groups together. In this regard, following points are worth mentioning: First, the balance for group I (mainly foodstuffs) actually deteriorated, making a negative contribution to the improvement. This is mainly due to accelerated increase in grain imports. Secondly, Column 3 shows that the mineral sector (mainly petroleum) contributed 35 per cent to the improvement in group IV, manufactured and semi-manufactured goods (49 per cent). Here, the net balance has increased almost tenfold, from US\$ 473 million to US\$ 4.662 billion. For this group, exports increased by 73 per cent, while imports marginally declined between 1979 and 1982.

As to the regional structure of China's trade balance, Figure 1 shows some interesting features. The 45° line in the Figure represents a state of balanced trade. The rates of increase of exports to both Hong Kong and ASEAN countries declined between 1978-80 and 1981-82, this was offset by improvements of the balance with Japan and the United States. The particular importance of Hong Kong as revealed in the Figure is also noteworthy. The surplus generated for China during 1978-80 being sufficient to cover four-fifths of the total trade deficit with the United States, Western Europe and Japan in the same period.

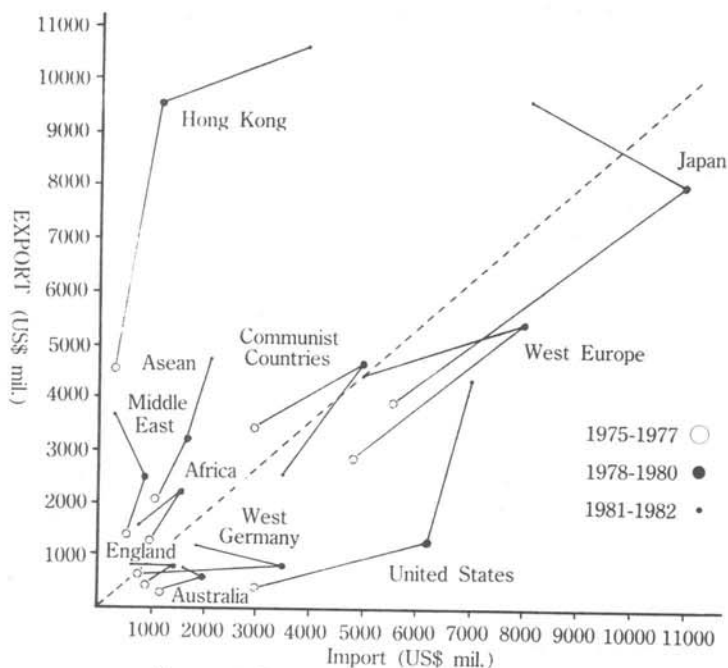


Figure 1. Regional Structure of China's Foreign Trade

Figure: China's Exports, Imports, and Trade Balances, FOB, by Major Region and Country: Totals in Million US \$ for 1975-77, 1978-80 and 1981-82.

IV. Structural Aspects of China's Foreign Trade

From 1982-84, China's economic development was stable and there was a foreign trade surplus. As a result, foreign exchange reserves increased. However, the year 1985 witnessed a growth rate of the national economy above the average of the past five years. This, combined with decentralized trade system, led to a rapid increase in imports. The result was a huge deficit in the current account. Shocked by this external imbalance the Chinese government adopted measures to encourage export and restrict imports. At the same time the renminbi has been continuously depreciated. The renminbi has been tied to the US \$ since the middle of 1986 and is therefore effectively depreciating against stronger currencies as the dollar falls. Over the year to October 31(1987), it fell 16.8 per cent against sterling, 12.3 per cent against both the yen and the Deutschmark, by 10.5 per cent against the French franc. This improves Chinese competitiveness on the world market on the other

hand, but intensified domestic inflation to the extent that China has to import technology and consumer durables from Japan on the other hand (Economic Intelligence Unit, 1987:10). If no real change is foreseeable in the US trade deficit, China may have to consider detaching the renminbi from the fast falling US\$ in order to protect the volume of earnings from exports to countries other than the USA and Hong Kong. As a result of such policy measures, China succeeded again to realize surplus in the visible account.

Viewed in the longer perspective, exports in 1986 were 177.2 per cent higher than in 1978, which means an annual average increase of 13.6 per cent, a rate that is substantially higher than the growth rate of China's total output value of industry and agriculture (Economic Intelligence Unit, 1987:11). In the structural terms, the proportion of industrial and mineral products in China's total exports increased from 37.4 per cent in 1978 to 49.4 per cent in 1986; while that of farm and processed products fell from 35 per cent to 31.3 per cent during the same period. Imports of advanced technology and equipment accounted for 27 per cent of the total between 1979 and 1986 (Zhang Zeyn, 1987:22).

During the Seventh Five-year plan period (1986-90), the country's total export value is expected to increase by average of 7 per cent a year. By 1990 exports are expected to reach US \$ 83 billion.

As to the regional structure of China's foreign trade, four countries have played dominant role in the recent years, i.e. Japan, Hong Kong, the United States and West Germany. However, the relative position of these countries experienced remarkable change. Hong Kong moved into second place by increasing its share of exports from 11.2 per cent in 1985 to 19.7 per cent in 1987, and the share of West Germany increased from 5.8 per cent to 7.5 per cent. The share of both the United States and Japan suffered substantial decrease. The rapidly growing trade volume of Hong Kong with China reflects its proxy status for China's expanding unofficial trade with South Korea and Taiwan, estimated at a total of US \$ 1.2 billion and US \$ 2.3 billion respectively for 1987. Further, Hong Kong also continues to play its more traditional role as the prime entrepot for US and Japanese trade with China.⁽¹⁾

(1) In 1987 the United States exported a total of US\$ 500 million worth of goods, mostly office machinery, inorganic chemicals, tobacco and specialized machinery through Hong Kong to Chinese markets. And Japan exported US\$ 166 million through Hong Kong, primarily telecommunications equipment, electronic machinery apparatus and appliances photographic equipment and applies. *The China Business Review*, May-June 1988, p. 26.

After suffering a slight decrease in 1984, West Germanys exports more than doubled in 1985 and increased 29 per cent and 22 per cent in the following two years. Like other countries in the EEC, West Germany has used government aid and subsidies for its China exports, and has pursued an active technology transfer policy. As mentioned above, Japans share of the China market has fallen substantially, triggered by Chinas reluctance to become dependent on any single foreign trading partner. Additionally sharp appreciation of the Japans currency in the past two years has made it much less competitive vis-a-vis the United States in particular. Other more sensitive issues complicate the picture and have helped improve the position of the United States and Western European exporters. Japan made surplus in worth of US\$ 5.99 billion and US\$ 4.18 billion in bilateral trade with China in 1985 and 1986 respectively, which convinced the Chinese that Japan was not doing enough to open its markets to Chinese exports. Also the Chinese are dissatisfied with Japans reluctance of direct investment and technology transfer, which lag substantially behind Hong Kong, the United States and West Germany.

The development of economic and technological cooperation between China and the Eastern European countries has passed through two stages. Prior to 1984, there were just a few cooperative projects involved and they constituted a very small part of the total trade. Since 1984, it shows an increasing tendency, whereby the barter trade forms the main form of economic transaction. The barter trade can be easily arranged since the socialistic countries are in general suffering a shortage of foreign exchange.

Relating to the open door policy of China, two further points might be worth mentioning. The one is the situation of technology import, and the other is the institutional reform to facilitate the foreign economic policy.

Since 1979, China has imported technology on an unprecedented scale. Before 1979, China mainly imported complete sets of large equipment for the construction of new factories. After 1979, various forms of technology import, with the licenced trade as the main form, flourished. At the same time the proportion of imported software, including patent technology, has increased substantially. Finally, technology import since 1979 has been closely linked with the utilization of foreign capital. To overcome the lack of qualified manpower, China favours such forms as joint-ventures and co-operative production, through which manpower training and dissemination of technical and managerial know-how might be possible (Bai Yiyang, 1987).

From 1979 to the end of 1986, China imported more than 14,000 items of technology and key equipment from abroad, worth US\$ 10 billion. Especially, between 1984 and 1986, the State Economic Commission imported 3,000 items

of advanced technology for transforming existing enterprises, and up to the end of 1986, about 60 per cent of the imported technology went into operation.

According to the Chinese evaluation, the proportion of electronic products that have reached the advanced world level of the late 70s and early 80s has increased from 15 per cent in 1982 to 30 per cent in 1987. And machine-building departments have in recent years imported more than 500 items of technology, involving over 6,000 kinds of products. The Chinese source estimates that about 10 per cent of the products turned out to the machine-building industry have reached the advanced world level of the early 80s (Bai Yiyang, 1987).

However, there are some problems as to the import of technology. After the central authorities relaxed control over technology import, there is no coordination between department or within a department itself. This resulted in the overlapping imports of technology. Further, due to enterprises behaviour of short term maximization of benefit, import of hard ware has been generally preferred to that of soft ware. The last, perhaps most important, aspect relates to the problem of how to link the technology import with the domestic R & D activities, a problem, which might be difficult to solve, so far as China lacks the qualified technological manpower.

As to the legal and institutional reform, China has continued the decentralization of the trade system. Especially, the Draft Plan for Restructuring the Foreign Trade System in 1988 gives a substantially greater role in foreign trade decisions to enterprises, trading companies, and governments at the provincial and local level. However, at the same time, the number of rules governing their decisions has also increased.

These rules are more indirect than in the past. Laws, regulations, and contract obligations are replacing strict quantity quotas and other forms of direct administrative regulations. Whether such indirect controls will work remains to be seen; previous attempts at decentralization have not been always effective.

A new "contract managerial responsibility system is an important one of the current foreign trade reform. Each of China's provinces and provincial-level municipalities must now sign annual contracts with the Ministry of Foreign Economic Relations and Trade (MOFERT) specifying their projected export value, foreign exchange earnings and the amount of foreign exchange they will turn over to the State. To meet such obligations, the provincial governments contract, in turn, with the trading corporations based in their province. The foreign trade corporations (FTCs) then sign import and export contracts directly with individual enterprises. However, some enterprises need no longer trade through FTCs at all. In recent years, a few dozen large enterprises have

been authorized to conduct foreign trade on their own.⁽²⁾

Major principles governing the China's Foreign trade system can be summarized as follows:

- Through reform of the export planning system, the proportion of mandatory plans in the plan total is to be reduced. The State will control through mandatory plans only a small number of large export items, resource-intensive goods and sensitive commodities. In case of other products, only small number of commodities will be handled by the state in a unified way.
- China will cut or cancel import subsidies and will strengthen the regulatory role of tariff and other economic levers. The mandatory plan of the State on imported goods will also be reduced.
- China will integrate agricultural and industrial production -including the development of technology-with foreign trade.

V. Prospects of China's Foreign Economic Policy

As to the future strategy of foreign economic policy, a concept on the so-called "orbit of an international circulation" has stirred recently great interest among Chinese economists. Wang Jian, associate research fellow of the State Planning Commission, recently proposed that China's economic development should be brought into the orbit of an international circulation (Wu Jingcai, 1988:26). According to Wang, China's economy is currently facing a dilemma. To develop the capital intensive basic industries, infrastructures and heavy industry, China will need a large amount of capital. Further, with the reform of the rural economic structure, large numbers of rural surplus labour have been transferred to non-farming enterprises which also need a huge amount of funds for equipment.

As China suffers from scarcity of funds, it has to decide the priority of investment. In this regard, Wang's theory suggests following points: First, China should make the best of its labour-intensive, export-oriented industry mainly in coastal areas. In this stage, the heavy industry should temporarily slow down its development in order to help light industrial products enter the world market. Second, part of the foreign exchange earned from exports should be used to improve a) basic industries and infrastructure, b) the heavy indus-

(2) In the machinery and electronics sector, for example, factories whose export value exceeds US\$ 1 million per year will be permitted to sign counteracts with foreign companies on their own.

try, and c) to import technology for the production of export goods. In the last stage, high-value processing industries should be promoted. In this stage, capital-and technology-intensive products will begin to enter the world market and the relative ratio of labour-intensive products in the Chinas total export will decrease. To achieve this, according to him, China should:

- Readjust the structure of its export market and open up more markets in developing countries;
- Make township industries its main exporters;
- Control the growth rate of consumption at home; and
- Develop labour-intensive, export-oriented products.

Whatever the concrete strategies may be, China will not change its active open door policy in the foreseeable future. In the 13th Communist Party congress, the government declared China to be in the "primary phase of socialism", in which economic reform and the open door policy are "the only alternatives for the development of productive forces". This means that private enterprise shall be regarded as a necessary evil in the struggle to overcome economic backwardness. The Party Secretary said that the stage covers a long process of historical development, that "we do not yet know much about the conditions, contradictions and changes in this stage or the laws governing its development", and that "many of our policies and theories have yet to be ...improved through continuous testing in practice". The government plans that only 30 per cent of the economy will be within the scope of the state plan by 1990(at present: 50 per cent)(Economic Intelligence Unit, 1987:10).

VI. Economic Relations of Korea with China

In recent years, China formulated an additional strategy of the offensive open door policy. According to the strategy, China's coastal areas, which cover 320,000 km² and have a population of 160 million, will introduce flexible preferential policies to attract more foreign funds and technology, and to expand foreign trade with capitalistic countries.

In pursuing such a development policy, it seems that Korea will assume an ever increasing role. Such a strategy coincides with Koreas "Nord-politik" in economic terms. For Korea, it badly needs to diversify its regional structure of foreign economic relations: Korea is heavily dependent on the US market for export, and on the Japanese market for import. Actually, the trade volume of Korea with China has increased rapidly in recent years. For all the optimistic prognosis on the bilateral economic relations in the future, there are some obstacles that must be taken into consideration.

First, the both countries have no diplomatic relations, so that risk of economic transaction increases and possibility of legal arbitrage in case of need is virtually limited. This is especially the case for direct investment of Korean firms in China. A possible outlet for Korea might be a tripartite cooperation, participating in a jointventure with a firm of the third country, which has diplomatic relation with China.

Second, even though China has de jure liberalized its attitude toward foreign firms in China, the possibility for foreign firms to exploit the internal market is de facto limited. In many cases, foreign firms import part of input factors, such as raw materials and components from foreign sources. Since it is very difficult for these firms to get the hard currency from the Chinese authorities, they are forced to export their products to balance the foreign exchange on their own.

Last problem relates to the lack of infrastructure. Notwithstanding the increasing investment in the social overhead capital in the coastal areas, foreign firms at present are suffering from the lack transportation and communication facilities. Further, due to the lack of qualified manpower, the labour productivity is so low that the benefit of relative low wage cost is virtually limited.

Another important point to be considered is the fact that the both countries share not only complementary, but also competitive factors which will be intensified as the China's industrialization proceeds.

As mentioned above, share of not only labour-intensive products, but also standardized products in China's total export has been rapidly increasing in recent years. Such a competitive pressure from China will necessarily narrow strategic options on the world market. Korea is thus forced to transform its export and production structure into a more capital and technology-intensive one. And such a structural adjustment will be accompanied with some macroeconomic side-effects for Korea, for example structural friction on the labour market. This is the reason why it is important for Korea to balance such complementary or competitive factors in formulating its foreign economic relations in the Asian Pacific in general, and with China in particular.

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