
The Chinese Trade-Administration System

The Evolution of China's Trade-Administration System, 1949-96

From 1949 to 1978, China was a planned economy, and trade flows were entirely controlled by the state. Chinese trade policies and regulations were developed in isolation from established international norms. Meanwhile, a few state-owned and state-run trading companies, and their subsidiaries, controlled almost all foreign trade, ensuring monopolies or oligopolies in many goods. Import and export volumes for each trading company were centrally planned, and prices and volumes for traded goods were strictly administered by state directives. The financial management of trading companies was subject to “unified income and payment” rules (the state took responsibility for surpluses or deficits, and it collected all profits and subsidized all losses). Trade’s purpose was to balance foreseen and unforeseen surpluses and shortages of goods and to earn foreign exchange for the government. During the 30 years that the economy was centrally planned, regulations were strict and protection was high.

Since 1978, China has been moving toward a market economy and, thus, a more liberal trade system. We divide changes in China’s trade system resulting from these reforms into two periods, demarked by 1992. (Table 2.1 summarizes major changes in tariff and nontariff structures.)

The First Period: Decentralization of Trade Administration

During the first period, 1978 to 1992, China’s transition toward a market system was gradual. First, it created four special economic zones in the

Table 2.1 Changes in tariffs, taxes, and nontariff barriers, 1986-96

	Tariffs and taxes	Nontariff barriers
1986-91	<ul style="list-style-type: none"> ▪ Reduced rates by 30-85 percent for 81 of 6,300 tariff lines. 	
1992	<ul style="list-style-type: none"> ▪ Reduced rates by an average of 7.3 percent in January and by the same amount again in December for 3,596 tariff lines. ▪ Eliminated adjustment tax that had been levied since 1985 on 16 classes of imports. 	<ul style="list-style-type: none"> ▪ Reduced the number of export goods subject to quota-license regulation from 212 to 183. ▪ Eliminated import-quota license requirements for 16 classes of goods.
1993	<ul style="list-style-type: none"> ▪ Reduced rates by an average of 8.8 percent for 2,898 tariff lines. 	<ul style="list-style-type: none"> ▪ Eliminated import license requirements for 9 classes of goods that comprise 283 goods.
1994	<ul style="list-style-type: none"> ▪ Reduced rates for sedans from 220 and 180 percent (depending on the model) to 150 and 110 percent. ▪ Stipulated a "temporary tariff rate" (a tariff reduction) for 282 tariff lines. 	<ul style="list-style-type: none"> ▪ Stopped issuing mandatory plans for imports and exports. ▪ Eliminated import license requirements for 195 goods.
1995		<ul style="list-style-type: none"> ▪ Eliminated import license requirements for 120 goods.
1996	<ul style="list-style-type: none"> ▪ Reduced rates for 4,997 tariff lines by an average of 35 percent. ▪ Reduced rates for all goods to the simple rate of 23 percent. 	<ul style="list-style-type: none"> ▪ Eliminated 30 percent of remaining quotas.

coastal areas (Shenzhen, Zhuhai, Xiamen, and Shantou), in which freer and more flexible economic policies prevailed. After accumulating experience with the market system in these areas, China extended reforms to 14 coastal cities and to additional cities along its rivers and borders. Although reform on a region-by-region basis, starting with the coastal areas, provided the government with a valuable opportunity to learn how a market economy works, it also led to highly uneven growth among regions. The coastal areas benefited from reforms faster and to a far greater extent than did the interior regions.

In sectoral terms, China first opened its markets for consumables; next, it liberalized trade in certain infrastructure industries and intermediates; thereafter, it gradually opened various service activities to international competition. Again, the cautious sector-by-sector approach to opening facilitated learning by doing, but it created uneven development among sectors and regions.

In administrative terms, China's reforms conferred rights and responsibilities to subordinate bodies—that is, they prompted decentralization.

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First, certain trade-administration powers were passed from the central government to local authorities, encouraging the establishment of local state-owned trading companies. Second, there emerged a contracting-out system and a management-responsibility system, which gave more decision-making power to trading companies. These companies learned to operate in the market and pursue their own interests, such as maximizing profits and expanding market share. Third, trading companies were allowed to retain some of the foreign exchange they earned, enabling them to profit from their trading activities and to operate in the foreign exchange market. These reforms produced incentives sufficient to generate rapid growth in China's foreign trade and allow it to capitalize on its comparative advantage in many less-technically demanding goods.

However, while reform and decentralization moved forward in some aspects, China's trade system suffered from disorder and even chaos in others. The government maintained high tariff and nontariff barriers that discriminated between regions, sectors, and enterprises. For example, enterprise laws and tax laws varied depending on ownership; different regions faced different trade regulations and tax rates; and domestic affairs, foreign affairs, goods, and technology each had its own set of contract law. Meanwhile, the desire to impose uniform trade policies across China conflicted with the newfound independence that decentralization gave local authorities. Much confusion and inefficiency came out of this mixture of centralized regulation and decentralized administration. Meanwhile, the reforms sparked competition among provinces and cities for import relief, and this dynamism created pressures from below for further reform.

The Second Period: Faster Trade Liberalization and Convergence Toward International Norms

A new period of Chinese reform began in 1992. Since that year, China's trade system has begun to better reflect international norms, and trade liberalization has accelerated.

As a first bold measure, the government lowered tariff rates significantly. From 1986 to 1991, China lowered its tariff rates for only 81 of about 6,300 duty codes by 30-85 percent (Tariff Policy Commission of the State Council of China 1991). By contrast, in January and again in December 1992, China reduced import tariffs for 3,596 duty codes by an average of 7.3 percent. China also eliminated an adjustment tax that had been levied since 1985 on the import of 16 categories of goods. In December 1993, China again reduced import tariffs, this time for 2,898 duty codes by an average of 8.8 percent. In January 1994, import tariff rates for sedans were slashed, from 220 percent and 180 percent (depending on the model) to 150 percent and 110 percent (Jingfen 1994). Meanwhile, China stipulated

a "temporary tariff rate" for 282 duty codes. This amounted to a one-year tariff reduction for each good (General Administration of Customs of China 1994; Ministry of Foreign Trade and Economic Cooperation [MOFTEC] 1994a). In April 1996, import tariffs for 4,997 duty codes were lowered by an average of 35 percent. And in December 1996, the government announced reductions that would take the simple average tariff rate down to 23 percent for all goods.

As a second move, nontariff barriers were reduced. China has retracted all lists of "substitute" import goods (the government generally prohibited the import of such goods). Step by step, China has weakened the force of its quota-license regulations. In 1992, the government lowered the number of export goods subject to quota-license regulation from 212 to 183 and eliminated import-quota license requirements for 16 categories of goods. In December 1993, China canceled import license requirements for 9 categories of goods that comprise 283 goods, including steel products, pesticides, civil airplanes, and black-and-white television tubes. In May 1994, China eliminated import license requirements for another 195 goods, including 30 goods that were to be relieved of requirements by the end of 1994 in accordance with a Sino-US memorandum of understanding. Another 120 goods were relieved of import-licensing requirements in 1995 (Jing-fen 1994). In April 1996, 30 percent of the remaining quotas were eliminated. In addition, 1994 was the last year that the government issued mandatory plans for imports, which have compulsory and restrictive characteristics and which were based on centrally controlled foreign exchange, and instructional plans for imports, which are not mandatory and serve only to provide guidance. It also stopped issuing mandatory plans for exports.

In a third move, the government wrote a basic foreign trade law, began to develop regulations, and made the trade-administration system more transparent. The foreign-trade law, the "Law of Foreign Trade of the People's Republic of China," was promulgated in May 1994 and entered into effect two months later. Several regulations that correspond to the law are currently under review, including "Regulations for Import Goods," "Regulations for Export Goods," the "Antidumping Statute," the "Anti-subsidy Statute," "Safeguard Regulations," "Regulations for Punishing Low-price Exports," and "Regulations for Responding to Antidumping Suits against China's Exports."

Since 1992, MOFTEC has been making efforts to improve the transparency of Chinese trade administration. It has repealed many of the foreign-trade laws issued since 1979, many of which fostered opaque administrative practices by confiding large swaths of discretion to the bureaucracy. In addition, MOFTEC has made public 93 classified documents that pertain to the trade regime's operation, and has nullified another 744 classified documents (MOFTEC 1992, 1993, 1994a). MOFTEC has also required that all local authorities similarly clarify their foreign-trade laws.

Recently, the government has made public the *Bulletin of the Standing Committee of the National People's Congress*, the *Bulletin of the State Council*, and the *Bulletin of the Supreme People's Court*. Journals such as the *People's Daily* now publish new national laws and regulations, local newspapers publish local regulations, and the government translates all published documents that relate to foreign affairs into English and publishes them in that language.

As a fourth measure, reforms have been extended, in steps, to services and foreign direct investment (FDI). Beginning in 1992, foreign financial firms were allowed to establish certain types of financial organizations in Beijing, Shanghai, and Guangzhou; foreign law firms were permitted to establish limited operations in the three cities just mentioned; and foreign insurance companies were allowed to underwrite some businesses and establish joint-venture insurance companies. Meanwhile, retail trade, tourism, and real estate have been partially opened to FDI.

As a fifth measure, China has sought to improve its protection of intellectual property rights. In 1992, China signed the Berne Convention for the Protection of Literary and Artistic Works and the Universal Copyright Convention. After these accessions, China revised its patent laws and formulated copyright laws. In February 1995, China and the United States signed a memorandum of understanding on intellectual property rights. In 1996, US insistence that China had inadequately complied with the agreement led to a Chinese crackdown on some firms that had infringed intellectual property rights. Much, obviously, remains to be done in this area, but a start has been made.

To summarize, since 1992, China has actively reformed its trade policies and administration, bringing its practices closer to international norms. Through these measures, China has picked up the pace of liberalization over the past five years.

Features of the Trade-Administration System in 1996

Reforms over two decades lowered the simple average tariff to 23 percent by the end of 1996 (table 2.2). However, high tariff rates still prevailed for some goods. Of China's 6,549 tariff lines, 28 percent had rates in excess of 30 percent (table 2.3). The number of products still subject to quota and licensing requirements was 36. These made up about 15 percent of Chinese imports in 1996.

The system of trade administration in China prevailing in 1996 embodied a number of peculiar features that deserve brief mention here (for full detail, see chapter 4). The first is the coexistence of the new and old trading systems. For example, the present regime includes a system for designating management rights and one for bidding on quota licenses.

Table 2.2 Calculated average tariff rate and tariff revenue, 1992-97

	Average tariff rate ^a (percentage)	Tariff revenue ^b (billion yuan)
1992	42.5	21.28
1993	39.9	25.65
1994	36.4	27.27
1995	35.9	29.18
1996	23.0	33.98
1997	17.0	na

na = not available.

a. Average tariff rate is a simple average of statutory tariff lines.

b. Tariff revenue is the actual collected revenue.

Sources: *China Statistical Yearbook, 1996*, published by the State Statistical Bureau. China's General Administration of Customs (GAC) provided 1996 data.

Table 2.3 Chinese tariff schedule, 1994 and 1996

	Range of tariff rate						Total
	Zero	1-10 percent	11-15 percent	16-30 percent	31-60 percent	Above 60 percent	
1994							
Number of tariff lines	125	587	888	1,948	1,710	1,092	6,350
Percentage of tariff lines	2.0	9.2	14.0	30.7	26.9	17.2	100.0
1996							
Number of tariff lines	125	1,732	1,079	1,784	1,688	141	6,549
Percentage of tariff lines	1.9	26.4	16.5	27.2	25.8	2.2	100.0

Source: The General Administration of Customs of the People's Republic of China, 1994 and 1996.

The former leads to sanctioned monopolies, while the latter points toward a market outcome (the highest bidder wins the license). In some cases, the new and old trade systems mesh well, as with trade in foreign exchange quotas and quota-license bidding. The old mechanism shields vested interests and reduces the cost and impact of reform on established firms and workers, while the new mechanism gives market forces greater sway in dynamic, high-growth areas. The old and new systems do not always exist harmoniously, and conflicts are common. The conflicts, in turn, often create pressure within the system for fresh liberalization.

The second peculiarity is that the present system of trade administration combines central regulation and decentralized administration. In reforming the trade system, China's decentralization has given greater priority to local government, reflecting the financial needs of local governments and local governments' operational control over many aspects of trade administration. China's decentralization has resulted in the administration of many central-government policies differently from region to region, thereby discriminating between businesses and between trading partners, adding much complexity to trade administration. Inevitably, there have been sharp conflicts between central- and local-government authorities and between government and trading firms.

A third peculiar feature of China's current trade system is that it engenders rampant rent seeking by those in power. The incomplete transition to a market economy, high statutory tariff rates, and import quotas created a huge pot of economic rents. Combined with wrenching changes and Byzantine complexities, this has resulted in a scramble for economic rents and has made orderly trade administration almost impossible.

Finally, China's trade administration in 1996 forced a small proportion of imported goods to provide the majority of tariff revenue. As of 1996, China's trade administration still included high tariff rates, multiple exemptions and reductions, designated trading agents, and administrative frictions (see the next section for detail). On top of these, rent-seeking behavior of trading agents has created corruption between administrators and trading agents. As a result, a fraction of imported goods are burdened with high tariff rates, trading agents get semimonopoly privileges, and transaction costs are inflated.

The Drive Toward Liberalization: Obstacles and Prospects

Although China has made significant progress toward liberalization, an efficient, open trading system remains far out of reach. Several obstacles must be overcome before such a system can function in China.

Pressure to Maintain the Status Quo

An inevitable offshoot of trade liberalization is a redistribution of power and income. Groups that benefited under the state-controlled trade system in terms of power, economic rents, or employment naturally want to preserve their positions. Accordingly, these groups pressure the government to slow down or stop liberalization. Meanwhile, other interest groups that stand to benefit from reform try to quicken the pace. A major problem confronting the government is to satisfy the conflicting demands of these

two groups. The *modus vivendi* has been to pursue reforms at a deliberate speed—hence, the Chinese model of “gradualism.”

China still maintains several types of nontariff barriers, including trading rights, quotas, and licenses. Each protective measure creates a certain amount of administrative power and economic rent, which inevitably lead to rent seeking. Unsurprisingly, public and private groups and individuals that benefit from dispensing or receiving economic rents defend the status quo. For example, trading companies that have already been granted rights to import designated products (sometimes after substantial lobbying efforts) do not want the system abolished or similar rights granted to newcomers. Likewise, Chinese firms that dominate the domestic market but are incapable of competing with imported products in terms of quality or price resist liberalization.

Sectors marked by firms insistent on maintaining protection include many electromechanical industries (e.g., automobiles and cameras), iron and steel, sugar, wood processing (e.g., plywood), oil refining, telecommunications, finance, and insurance. Different industries offer different arguments in defense of the status quo. Sectors that must compete with higher-quality imports, such as the camera and photosensitive materials industry, argue that they need sheltered markets to improve their products for future competition. Sectors that exploit China’s natural resources, perhaps inefficiently (e.g., crude oil and plywood), insist on protection to prevent foreign exploitation of these resources. Fledgling sectors, such as the automobile industry, invoke the infant industry argument. Some of these arguments may justify short-term protection. However, over any period of time, innovation and productivity in protected sectors are handicapped by the absence of competition.

Perhaps the greatest opposition to trade liberalization is rooted in the fear that it will cause unemployment and thus create social instability. For example, China’s iron and steel industries employ about 3.5 million workers. The sector’s efficiency is much lower than world levels, and it is not competitive even after allowing for lower Chinese wages—thus, abolishing trade protection overnight could put more than one million people out of work. Of course, the government would probably attenuate the shock by keeping many redundant workers on the payroll for extended periods and granting severance benefits to others. And many of the displaced workers would be reabsorbed fairly quickly into other sectors of the economy. Nevertheless, most workers would rather keep their familiar, relatively well-paid steel jobs, and, hence, they oppose trade liberalization.

Nor is the process of structural adjustment costless even if people are willing to change jobs. The government is particularly sensitive to this problem, especially with the rising unemployment that has accompanied the transition to a market economy. As a result, authorities at all levels place a high priority on ensuring that liberalization be prudent and gradual in order to avert social instability.

China can also be expected to continue to protect agricultural goods that it considers vital, notably grain. Over the past 50 years, many countries have protected their agricultural sectors, reflecting concerns for food security and for the welfare of farmers. Among industrial countries—such as the European Union, the United States, and Japan—agricultural protection is only slowly being dismantled. To China, the concept of agricultural liberalization is still quite foreign, and the government continues to place a high premium on food self-sufficiency. Providing grain for its 1.2 billion people will remain a central concern for Beijing, and there is no prospect that the government will soon relinquish control of the grain trade. However, Chinese grain imports will very likely expand because the level of efficiency in the sheltered agricultural and food processing sectors is low and it will become increasingly costly to maintain a given degree of food self-sufficiency through protective barriers.

Factors Promoting Liberalization

Several factors add weight to the case for a quicker pace of liberalization. The Chinese government, especially the central government, is facing financial difficulties. Revenues from tariffs, a value-added tax for imports, and consumer taxes for imported goods accrue to the central government. In 1994, these three revenue sources earned the government 62.2 billion yuan,¹ accounting for 26 percent of its total tax collection. Many have argued that liberalizing trade and reducing tariff rates would cause a decline in tax revenue. Given the current system of high rates and uneven administration, the opposite has been true (see table 2.2). High tariff rates, coupled with excessive tariff reductions and exemptions for favored firms and regions, have led to rampant smuggling and thus a loss of revenue. A dual strategy—liberalizing trade by significantly reducing tariff rates, while eliminating reductions and exemptions and improving customs enforcement—would not only help to normalize markets, but would also increase public revenue. Toward this end, China is currently adjusting its tariff policies. In April 1996, it undertook large tariff reductions and eliminated a number of special exemptions; as expected, tariff revenue increased.

In addition, the interior provinces of China have been envious of rising living standards in the coastal provinces, and this has heightened public support for liberalization throughout the country. In 1994, foreign trade by the coastal provinces and municipalities accounted for nearly 85 percent of China's total trade. Southern China and the southeast coastal areas are now irreversibly linked with the international economy and serve as

1. The terms *yuan* and *renminbi* (RMB) are commonly used interchangeably for the Chinese currency. In this book, we use the term *yuan*.

models for the extension of trade reform to the interior areas. As liberalization moves inward, people in the interior anticipate similar improvements in their living standards. The decentralized and often chaotic system of trade administration prevailing in China today invites leaders from the interior regions to pressure Beijing for liberalization that benefits their local firms. This political dynamic works in favor of continued reforms.