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The dragon takes flight.
China trade policies in the 1990s: issues and concerns in ASEAN and in the world

Victor Franco M. Canalog[1]

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1 Department of Management, College of Arts and Sciences, Ateneo de Manila University,
Loyola Heights, Quezon City, The Philippines.

1. Introduction

The tragedy at Tiananmen square in June 1989 did not provide a good welcome for the 1990s. The violent crackdown on student demonstrations brought widespread condemnation, severe international economic and military sanctions and diplomatic ostracism which threatened to disable ten years of successful reforms where growth of annual GDP averaged 8.9%[1]. Deng Xiaoping remarked that the next three to five years would be most critical to the survival of the Chinese Communist Party (Hsu, 1995), and he had reason to worry: Barely six months after the Tiananmen crackdown in China, popular protests against Communist rule in other parts of the world erupted and eventually brought down regimes in Eastern Europe; by the end of 1991, the Soviet Union itself had disintegrated. What would the 1990s hold for China and its stated “open-door” policy of allowing the entry of capitalism and free enterprise into its command economy? Was it really opening its doors? Could it handle the many structural and political challenges inherent in developing economies? All eyes were on China as the last decade of the 20th century began to unfold.

This study of China’s foreign trade policy in the 1990s will follow this methodology: A summary of the reforms begun in 1978 up to 1988 is presented to put developments in the 1990s into perspective. A brief section is devoted to the transition from 1988 to 1990, which is straddled by the events surrounding Tiananmen. Trade policy during the 1990s is then presented. After each section, economic data is analysed in order to determine the relative influence of trade reforms in the development of China’s economy. Conclusions are presented at the end of the paper, including trends in Chinese politics, economy and society which may significantly affect trade policy in the future. The regional effects of the Southeast Asian currency crisis and China’s changing role in ASEAN are presented as part of the conclusions. Finally, appendices are included on information and analysis which are important but which are only tangentially related to China trade policies.

2. Prologue to the 1990s: Foreign trade reform from 1978 to 1988

China underwent major changes in trade policy in the decade following the Party conference of December 1978. The ascendancy of Deng Xiaoping as the paramount leader of the Communist Party signaled a new socialist transformation that promised to lift China out of poverty and developmental stagnation.

2.1 Structural reforms: Decentralisation and export-led growth

From 1979 to 1984, major structural reforms were carried out, allowing state-owned corporations which engaged in foreign trade (FTCs, or foreign trade corporations) freer rein in the business functions of exporting and importing at the national, provincial, municipal and county levels. This was a major shift from traditional central planning to relatively independent decision-making. Whereas foreign trade used to be the dominion of 12 monolithic FTCs organised according to product lines and

[1] This figure varies from 8.9% to higher than 14%, depending on the source. This figure was taken from the China Statistical Yearbook of 1990.

under the direct supervision of the Ministry of Foreign Trade (MFT), now the government allowed branch offices of FTCs to deal with specific foreign trade needs. By 1990, there were 5,000 FTCs in operation nationwide (Panagariya, 1993). Special Economic Zones (SEZs) offering incentives to foreign investment were established in the coastal cities of Shenzhen, Zhuhai, Shantou and Xiamen; in 1984, 14 coastal cities and the Island of Hainan were also opened to foreign investment. State-owned enterprises (SOEs) slowly began the process of privatisation, which continues to this day.[2]

The years following 1984 led to further independent powers granted to FTCs, marked by the Report on Reform of the Foreign Trade System as approved by the Ministry of Foreign Economic Relations and Trade (MOFERT). Authority was granted to the lower levels of administration, and the start of the Seventh Five-Year Plan (1986 to 1990) provided for the creation of Production Export Networks (PNEs) to improve the quality and competitiveness of the export industry, particularly in sectors like machinery and electronic goods, where development was encouraged.

2.2 Systems for foreign exchange management: Reforms from 1978 to 1988

Systems for foreign exchange also went through dramatic changes. Central planning used to govern the exchange of foreign currency in China, but in 1979, FTCs were granted limited foreign exchange retention rights at the provincial and enterprise levels. Throughout the 1980s, the retention system went through several changes, culminating in a contracting system much like fiscal and enterprise contracts. Each enterprise signed a contract specifying a quota of foreign exchange earnings for the year and were entitled to retain a fixed percentage of the quota earnings. If earnings exceeded the quota, the enterprise usually retained a much higher share of the excess (typically 80 percent).

Swap markets also emerged as part of the effort to liberalise foreign exchange management. The first swap market opened in Shenzhen in 1985, followed by a second one in Shanghai in 1986. By 1988, there were 39 such centres facilitating the exchange of foreign currency at rates approximating market values. The total volume of transactions reached $6.3 billion in 1988 (Asian Development Bank, 1996).[3]

2.3 Barriers to trade: Duties, tariffs and subsidies

In the early 1980s, import tariffs generated a total of 50 billion yuan in revenues;[4] this was roughly 15 percent of import value from 1981 to 1985. In 1988, special duties were introduced to limit imports of luxury consumer goods like television sets, refrigerators and air conditioners in response to a ballooning trade deficit. The fact that the domestic demand for these products was growing is indicative of the rising purchasing power of the Chinese people. The average nominal rate of import duties during this period was 38.4%, but the actual receipts were only 16.3% of import values - only slightly higher than

[2] This may be the biggest challenge that China will face in the future. Most formal policies voiced by Jiang Zemin and Zhu Rongji during recent Party meetings focused on privatization and modernization concerns directly related to SOEs.

[3] Similar to other economies based on the Soviet model, China in its pre-reform period suffered from a highly overvalued currency which gave rise to parallel markets. Since 1978, the State has instituted policies which more closely aligned the renminbi with its market value.

the 15 percent average for developing-country members of the General Agreement on Tariffs and Trade, this difference between the effective rate and the nominal rate may be accounted for by the fact that there were numerous exceptions to the enforcement of import duties. Goods qualifying for exemption included imports used in the production of exports, capital goods imported “to further the objective of technical transformation of industry,” and imports for the SEZs, coastal open areas and joint venture enterprises. Export tariffs were imposed on products like aluminium, copper and pig iron, mainly because exports of these products would worsen domestic shortages (Asian Development Bank, 1996).

It is difficult to determine a clear picture of export subsidies during the 1980s because the government prohibited the publication of export subsidy figures for fear of eliciting anti-dumping charges or countervailing tariffs against Chinese products. One source reports subsidies of $4 billion in 1990 and a total of $30 billion since 1986 (*Far Eastern Economic Review,* 8 August 1991). FTCs gave subsidies to production enterprises and supply organisations producing for export, sometimes taking the form of subsidising losses when enterprises were besieged by high prices for imported raw materials. Alternatively, FTCs also gave direct subsidies to companies supplying these raw materials to ensure that supply prices to domestic exporters would remain unchanged. Because several direct and indirect taxes also insulated domestic prices from competition, many Chinese economists found it difficult to determine the real resource costs of production. Consequently, it was extremely difficult to identify where China had a comparative advantage.

China’s policies slowly conformed to international pressure by the late 1980s, reporting that they had eliminated all export subsidies in 1991. Some provinces, on the other hand, have reportedly continued to subsidise local exports, contrary to national policy (Asian Development Bank, 1996).

Import subsidies were used to shield domestic prices from foreign competition. Before 1979, most imports were sold at domestic prices, with FTCs absorbing the cost difference through subsidies. Reforms introduced in 1984 shifted the burden of import subsidies from FTCs to importing enterprises; imports that were priced at actual import costs rose from 20 percent in 1981 to 43 percent in 1984, 80 percent in 1986 and to over 90 percent in 1990 (Lardy, 1992). Import subsidies were no longer needed as the portion of imports sold at cost approached 100 percent. In recent years, only grain and a few agrochemicals were enjoying import subsidies.

2.4 Results of foreign trade reforms in the 1980s

Foreign trade reforms in the 1980s focused on transforming the highly centralised pre-reform system to introduce a combination of mandatory plans and market regulation to establish a trade system deemed proper for a command economy interacting openly with its capitalist neighbours. Along with structural and economic policy reforms, the gradual liberalisation of trade resulted in incredible growth of the Chinese economy in terms of GNP, Foreign Direct Investment and Total Trade figures, as evidenced in Table 1.

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[4] Figures released by Chinese customs administration offices.

Table 1: Growth performance of China, 1979-1988 (percentage growth per annum)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
GNP	11.43	11.81	6.78	8.80	10.60	19.85	22.92	13.30	16.55	23.74
FDIs	-	-	-	-	15.27	53.06	123.73	-59.8	55.58	42.81
Total Trade	42.1	28.95	6.77	-2.67	3.64	22.19	21.06	-0.25	13.04	18.18
Exports	40.10	33.75	14.34	4.45	1.74	10.00	6.14	4.21	28.51	17.08
Imports	43.99	24.68	-0.36	-10.27	6.00	36.86	35.37	-0.36	0.97	19.31

Source: Various editions of the China Statistical Yearbook from 1981 to 1990. “Percent growth per annum” reflects increases based on previous years’ nominal figures.

3. Foreign trade policy in the 1990s

3.1 The road to the 1990s

Since 1988, foreign trade reform has undergone three major stages.[5] The first stage ran from 1988 to 1990, when the Contract Responsibility system was formally[6] instituted for China’s production, foreign exchange, circulation and fiscal systems. Essentially, this meant that the central government and its lower ranks would determine quotas for various localities and foreign trade enterprises (characteristic of a command economy) and sign a “contract” to give authority to these enterprises to operate in a relatively independent manner to maximise their earnings to meet these quotas (characteristic of a market economy). Foreign exchange systems were established to further encourage the growth of swap markets, which jumped from 39 in 1988 to almost 100 in 1991. The total volume of transactions leaped from $6.3 billion in 1988 to over $18 billion in 1991 (*China Business Review,* March-April 1992).

Implementing the contract responsibility system provided incentives for foreign trade enterprises. Even if the economic quotas were set by the state, it was now up to the enterprises and localities to become more cost-efficient in their production processes and innovative in attracting foreign capital to meet their profit objectives. In other words, they could more or less operate as capitalists -- the only difference being that their corporate goals were set by the central government and not by their own executive board. But these companies could set even higher goals for themselves, meeting quotas set by government and keeping the excess.[7]

The Tiananmen Square incident landed smack in the middle of this period, and economic data shows that even though the event was a serious blow to the Chinese Communist Party’s credibility to the international community, the economy bounced back rapidly after a short lull.

Table 2: Growth performance of China, 1988-1991 (percentage growth per annum)

	1988	1989	1990	1991
Gross Domestic Product	23.74	12.12	12.81	10.3
Foreign Direct Investment	42.81	5.72	17.79	25.21
Total Trade	18.18	2.60	3.37	17.49

[5] These stages were defined by, then vice-minister of MOFTEC (November 1996); see the complete text of his writings at Gu Yongjiang (1997).

[6] We say “formally” because many enterprises engaged in foreign trade and foreign exchange management had been operating de facto under limited contract responsibility systems since the reforms started in 1978.

[7] Individual goal setting based on government quotas and market projections which are quite similar to how companies operating in capitalist environments behave!

	1988	1989	1990	1991
Exports	17.08	6.89	18.18	14.4
Imports	19.31	-1.78	-9.70	18.5

Source: China Statistical Yearbook 1992; percentage growth based on increases from previous year's value.

The second period started in 1991, when the government cancelled state subsidies for exports, and held state trading corporations responsible for profits and losses. Macroeconomic reforms included realigning the prices of several key producer and consumer goods like coal, crude and edible oil, urban grain and housing, to market values. The government also reduced the scope of administrative allocation, so that by 1992 over 90 percent of retail sales were based on market prices, as were 80 percent of the sales of producers' goods and 85 percent of the sales of agricultural prices. New foreign exchange retention shares were also established, allowing enterprises to retain even more foreign currency for their own disposal. Deng Xiaoping's much-publicised "Southern Tour" in January and February of 1992 and the 14th Party Congress held later that October officially redirected reform from its former goal of moving toward a "socialist commodity economy" to building a "socialist market economy" (Asian Development Bank, 1996). An important ideological shift which had been brewing for the past ten years was now confirmed.

The pace of reform accelerated sharply from 1992 to 1993, which marks the end of the Second Period.[8] While reducing the number of licensed import and export commodities, China withdrew regulatory taxes on imports and lowered import tariffs. These changes prompted a huge jump in imports and foreign investment, which carried over into large values of exports in the following years. These were the sunshine years for the economy and for foreign trade in terms of posting record growth.

Table 3: Growth performance of China, 1991-1994 (percentage growth per annum)

	1991	1992	1993	1994
Gross Domestic Product	9.3	14.2	13.5	11.8
Merchandise Imports	18.5	28.3	34.1	10.4
Merchandise Exports[9]	14.4	18.1	8.8	35.6
Foreign Direct Investment	25.2	115.52	146.64	22.79

Source: Asian Development Outlook 1997 and 1998, published by the Oxford University Press for the Asian Development Bank, 1997.

3.2 The overheating Chinese economy puts on its brakes

By 1992 China's economy had been growing at an average rate of 10.5% for twelve years[10]. 1993 marked the start of a three-year austerity programme to curb the alarming rate of inflation, which peaked at slightly over 20% in 1994. In 1993, programmes which urged moderation in fixed-asset investments (particularly by state-owned enterprises the SOEs) and over public expenditure, were instituted to cool the economy. Tight fiscal and monetary policies were enforced to rein in the overheating economy; at the same time, further reforms in foreign trade marked the start of 1994.

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[8] We have included a list of specific reforms instituted by China during the period of 1991 to 1993 in Appendix 1 of this paper.

[9] We see that the huge jump in exports in the 1994 may be largely due to the tremendous growth in imports and especially foreign direct investment of the preceding years. In 1995, exports grew by 24.9%.

The Third Period in the evolution of the Chinese foreign trade system started in 1994 and continues to the present.[11] Major reforms in taxation, banking, exchange rates and foreign exchange management were introduced.

3.3 The foundation for trade: Financial services and foreign exchange management reform

Three new policy banks[12] were created in 1994 to govern macroeconomic concerns like infrastructure, trade and agriculture. China's first Central Bank Law was passed in March 1995, strengthening the role of the People's Bank of China (PBOC) as a central bank with added macro-management functions. In July 1995, China's first Commercial Bank Law came into effect to promote the commercialisation of state-owned banks, and as recently as April 23, 1997, the People's Bank of China established a Monetary Policy Committee to manage China's monetary policies.

On January 1, 1994, China abolished the dual-track exchange rate system (as mentioned in previous sections) and created a unified rate based on a managed floating system. Since the implementation of these policies, the renmimbi RMB exchange rate appreciated by 4.8% from US$1 = RMB8.7 in the start of 1994 to US$1 = RMB8.288 on May 19, 1997.[13] Swap centres continued to act as the official channel for the foreign exchange requirements of enterprises, but these are slowly being phased out in favor of the National Foreign Exchange Trading Centre and its designated banks (which include domestic and foreign banks).[14]

All these reflect concrete steps towards institutionalised policy-making procedure in China not directly governed by the central government. Financial services and foreign exchange management are coming into their own, creating the foundation for an even greater push for economic growth in the coming years.

3.4 External trade and investment policies from 1994 to the present

The period from 1994 to the present time has been characterised by alternating policies of tight control on one hand, and market-oriented, export-led growth on the other. Alarmed by the prospect of an overheating economy in 1993 and an imbalance between the development of coastal cities and inland provinces, the government started taking away some incentives to foreign trade enterprises, particu-

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[10] Figures from various editions of the China Statistical Yearbook.

[11] Much of the information in this section was taken from the website of the Trade Development Council of Hong Kong, which provided well-updated information up to the first quarter of 1997. Check their website at www.tdc.org.hk, particularly Hong Kong Trade Development Council (1997) (http://www.tdc.org.hk/main/china.htm)

[12] The State Development Bank (SDB), for infrastructure projects, the Export & Import Bank of China (EIBC) to support trade finances and the Agriculture Development Bank (ADB) for agriculture-related borrowings and financing.

[13] China is currently under a lot of pressure from the international financial community to devalue the renminbi in response to the Southeast Asian currency crisis. Appendix 3 discusses the possibility (some say inevitability!) of devaluation, its implications, and the challenges China needs to face in the near future because of regional currency depreciations and economic volatility.

[14] The National Foreign Exchange Trading Center (NFETC) started operations in Shanghai in April 1994. It is linked with authorized financial institutions in more than 20 major cities. In 1995, the total transactions handled by the NFETC amounted to over US$65.5 billion. Foreign trade enterprises were allowed to transact with the NFETC and its designated banks on July 1, 1996.

larly foreign-invested enterprises (FIEs). The value-added tax (VAT) introduced in 1994 has become the largest source of government revenue in 1996, accounting for over 40 percent of the total. There used to be a VAT rebate granted to exporters, but this was reduced to 14 percent in July 1995 to 9 percent in January 1996, keeping with a policy of control.[15]

China has announced that it will gradually extend "National Treatment" to FIEs during the Ninth Five-Year Plan (1996-2000), when preferential tax treatments will be gradually phased out. Beginning April 1996, equipment and raw materials imported by FIEs were no longer exempt from import tariffs. China has tried to soften the blow by granting grace periods ranging from six months to two years to FIEs which were established before this period or whose investment capital fell below US$30 million. China announced its first anti-dumping and anti-subsidy regulations in April 1997 to protect domestic industries and promote fair competition in foreign trade. The SEZs, the traditional haven of foreign investors, face imminent loss of special privileges as other Chinese provinces demand a more level playing ground (Wu Zhong, 1997).

Although these policies smack of tightening, these are balanced off by further liberalisation of trade barriers. China cut import tariff rates on more than 4,900 product categories by over 30% on April 1, 1996, bringing the average tariff rate down to 23%. At the APEC Summit held in November 1996, China announced further plans of reducing average import tariff levels to 15% by the year 2000. At present, import tariffs on raw materials and industrial supplies are low (in many cases, less than 20%) compared to consumer goods, which are generally subject to tariffs ranging from thirty to 60%. China's external trade liberalisation extends to the reduction of administrative barriers to imports. China lifted import quotas, licensing and other controls on more than 170 tariff categories in April 1996. Export commodities subject to export quota controls have been reduced by 50% to 143 by the end of 1996, and China has agreed to reduce the number of commodities under license control from 385 to 152 by the year 2000.

In July 1996, China adopted the "Duty Security System" for the export processing trade. Overseas enterprises will continue to enjoy tariff-free imports of raw materials, but they would now be required to open a "duty-security account" where they will register their imports. This reflects the current policy of China for greater control without curbing the growth of trade. The alternating policies of tight control combined with continued liberalisation of external trade reflects the government's concern for a more level playing ground on two levels:

1. FIEs face a gradual loss of privileges to promote fair competition in foreign trade vis-à-vis domestic producers, and;
2. Foreign investment is being directed towards the central and western provinces, which have lagged behind the coastal cities in terms of growth and development.[16]

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[15] A survey conducted by the Hong Kong Trade Development Council in January 1997 reported that while most Hong Kong companies found the reduction in rebates on exports was acceptable, 13.9% of the respondents expressed that the impact brought about by this measure was "serious." See the full text of the survey on Hong Kong Trade Development Council (1997).

[16] In September 1996, local authorities of the central and western provinces were empowered to give approval to overseas-funded projects with total investment capital of under US$30 million (up from US$10 million) to encourage overseas investment in these areas. The officials of these provinces are also the ones lobbying for a reduction in SEZ privileges, indicating sentiments for a more level playing ground.

At the same time, both FIEs and domestic producers will enjoy lower levels of barriers to trade in both imports and exports, accessible and more efficient financial services institutions as a backbone to their operations, and more market-driven foreign exchange rates. All these reflect a system which is all too similar to the free market ideal of perfect competition.

3.5 The results of foreign trade reform in the 1990s

Foreign trade and investment has provided much of the growth experienced by China during the 1990s. Although there was a slight decrease in growth in terms of GDP and trade during the last few years which may be attributed to continued tight fiscal and monetary policies from 1993, this could also be explained by a general slowdown in world trade, particularly in electronics. As it is, China's 1996 GDP growth rate of 9.7% is already among the highest in the world.[17]

Table 4: Growth performance of China, 1991-1998 (percentage growth per annum)

	1991	1992	1993	1994	1995	1996	1997	1998
Gross Domestic Product	9.3	14.2	13.5	11.8	10.2	9.7	9.0	8.0
Per Capita GDP	7.9	12.9	12.2	10.6	8.0	8.6	7.9	7.0
Merchandise Exports	14.4	18.1	8.8	35.6	24.9	1.5	10.0	12.0
Merchandise Imports	18.5	28.3	34.1	10.4	15.5	5.1	15.0	14.0
Foreign Direct Investment	25.2	115.5	146.6	22.79	10.98	7.0	-	-
Retail Price Index	2.9	5.4	13.2	21.7	14.8	6.1	6.0	8.0
Value-Added in Manufacturing	13.3	21.7	20.7	17.4	13.6	12.3	11.1	9.2
Value-Added in Agriculture	2.4	4.7	4.7	4.0	4.5	5.1	4.5	4.5
Value-Added in Services	10.0	11.6	9.5	8.2	8.0	8.2	8.0	8.0

Source: Asian Development Outlook 1997 and 1998, published by the Oxford University Press for the Asian Development Bank, 1997. Projections based on ADB sources and official publications from the IMF.

Inflation rates were successfully controlled by tight monetary and fiscal policies. Agricultural production enjoyed good growth because of a record grain harvest during 1996. The rise in real incomes resulted in a stronger demand for higher-value food items, contributing to further growth. Industrial expansion moderated during 1996, reflecting the tight control over fixed-asset investments, especially by the SOEs. The services sector also displayed strong potential for future growth (more on this topic later).

The decline in the growth rate of exports in 1996 after strong performance during the preceding years was due to weaknesses in some export markets (particularly electronics) and to the discontinuance of VAT rebates to exporters, which prompted accelerated export deliveries ahead of the July 1995 deadline. One other cause of the slowdown would be the rising costs stemming from the overheating economy of the past few years.

However, the first few months of 1997 showed that the Chinese economy was in no way slowing down. In the first five months of 1997, China's total external trade increased by 12.5% over the same period of 1996. Exports surged by 26.45% to US$65.48 billion and imports declined by 1.2% to

[17] China's 9.7% GDP growth led the pack in Asia, followed by Vietnam at 9.5%. The rest of the countries in Asia experienced growth of under 8% (Asian Development Bank, 1997).

US$51.56 billion.[18] Total foreign trade surplus went up to US$13.93 billion -- a far cry from the US$0.45 billion foreign trade deficit during the same period in 1996 (Hong Kong Trade Development Council, 1997). The machinery for reforms and liberalisation which Deng Xiaoping set in motion has kept on gathering momentum, over and above his death in early 1997.

4. Issues and concerns

4.1 Enter the Southeast Asian currency crisis[19]

In the middle of 1997, Southeast Asian nations faced what is at heart a crisis of confidence: Investors started pulling out of the region's most promising economies, sending regional currencies through fits of volatility and depreciation, as countries saddled with bad debt, underperforming industries and poor balance-of-payment figures tried to handle capital flight. The currencies of the countries most affected - Thailand, Indonesia, Malaysia and the Philippines - plummeted to all-time low levels, sending cataclysms through financial markets across the world. Asian economies like China, Taiwan, Hong Kong and Singapore were not affected directly, partly due to the fact that they had huge foreign exchange reserves and relatively healthy capital markets. But the intricate web of trade and economic relationships soon revealed that the crisis could not be confined to the Southeast Asian region alone.

Nearly half of China's exports go to the affected region, which means that Beijing's regional trading partners will be importing little from China or anywhere else over the next couple of years due to weaker currencies. This comes at a time when China needs to sustain its powerful economic growth in order to keep up with concerns like SOE transition, stemming unemployment and others. At the same time, Chinese exports will be competing against other markets with currencies that have fallen 30% to 50% in value against the renminbi. Some sources estimate that these factors alone could slash China's growth rate by one-third (Hajari, 1998). Hong Kong, now an integral part of China and traditionally regarded as the shopping capital of Asia, has been suffering from poor sales because the government has refused to remove the Hong Kong dollar's peg to the US dollar, a move effectively rendering Hong Kong products more expensive compared to the bargains that can be found in Bangkok or Jakarta.

At the same time, however, China has tried to turn the regional crisis to its advantage by playing up its role in Southeast Asia.

4.2 China and ASEAN: Shuddering and salivating

For Asia and the world as a whole, with the variety of economies at different stages of development, the rise of China offers a lot of opportunities and challenges at the same time. ASEAN member na-

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[18] The electronics industry, in particular, is bouncing back from a worldwide slump in 1996. The Ninth Five-Year Plan places the electronics industry as a pillar of the economy, with goals of keeping annual growth of the industry at over 20 percent, see CCPTI (1997).
[19] The Southeast Asian Currency Crisis is a topic in itself, and is best handled separately. This paper will focus on the implications of current regional woes for China's trade policies.

tions at the same time shudder and salivate at the prospects of China's seemingly unstoppable rise. Countries relying on labour-intensive industries look to China as cutthroat competition: The dragon could eat up much of the labour-intensive, export-oriented businesses that have helped make the region the world's foremost economic performer during the past decade. The following Tables reveals just how much comparative advantage China possesses in terms of labour costs, vis-a-vis other Asian economies:

Table 5: Comparative advantage indicators for selected Asian economies

Country	Exports (2nd Q, 1997) in billions	Export Growth (Year Ago) in %	Net FDI, 1996 (billions)	Average Hourly Wage, 1997
China	$46.1	25	$38.5	$0.90 (Shanghai)
Hong Kong	$47.8	4	$6.2	$7.30
Indonesia	$13.1	7	$5.3	$1.80 (Jakarta)
Malaysia	$19.7	(-) 0.2	$3.3	$4.60 (Kuala Lumpur)
Philippines	$5.9	24	$1.2	$1.30 (Manila)
Singapore	$32.1	4	$2.0	$5.20
South Korea	$35.8	9	(-) $1.6	$6.20 (Seoul)
Taiwan	$30.7	7	(-) $0.5	$7.50 (Taipei)
Thailand	$14.0	0.8	$1.3	$3.00 (Bangkok)

Sources: Datastream, UBS; Institute of International Finance; Goldman Sachs; HK Monetary Authority
Time Magazine, 29 September 1997

The countries that have the most to fear from China are Southeast Asia's populous economies: Indonesia (200 million), the Philippines (72 million), Thailand (61 million) and Malaysia (21 million). Prior to the currency crisis, all of them did well with huge foreign investment and healthy exports, but they need to deal with serious structural problems (economic and political reform) before they could get back on their feet. Their weaker currencies might offer some comparative advantage over China's renminbi in terms of export competitiveness, but production capacity of labour-intensive, export-oriented goods is one area that China clearly will dominate in the next few decades. Politically, China has also made moves to take advantage of Southeast Asia's economic woes to foster closer ties and head off American containment, meeting with Southeast Asian leaders and participating in regional ASEAN summits. Statements made by Premier Li Peng during his August 21-26, 1997 visit to Malaysia were pointedly aimed at Western countries: "Some countries attempt to lead while some attempt to bully others into accepting their standards." (*Far Eastern Economic Review* 11 September 1997)

On the other hand, three original Asian tigers look to China with the eyes of opportunity, salivating at the thought of 1.2 billion consumers providing cheap labour and a ready market for exports. Singapore, Hong Kong and Taiwan share the most symbiotic relationship with China, owing in large measure to the Mainland's ties with these nation's highly influential Overseas Chinese families.[20] More than three-fourths of all contracted foreign investments in China from 1979 to 1993 came from Hong Kong and Taiwan, with much of the investments from Hong Kong provided by Overseas Chinese sources from all over the world (Weidenbaum and Hughes, 1996).

[20] The tremendous influence of the Overseas Chinese cannot be overemphasised. This topic demands a publication in itself. Suffice it is to say that China's future growth may depend largely on how Overseas Chinese capital and influence is directed. For a complete picture of how the Overseas Chinese are helping build the Mainland, Weidenbaum and Hughes (1996) is highly recommended.

In the end, however, the most compelling reason for entering China is not so much the enormous production possibilities, but the vast market which is rapidly opening up. And this is the paradox that Southeast Asia's rising economies will have to face - The Dragon is rising and will prove to be an extremely formidable competitor. But it may also be the most enticing customer and most powerful partner - if one can cultivate the wisdom and courage to ride alongside the Dragon as it takes flight.

4.3 Knocking at the doors of the World Trade Organisation

China's application for entry to the WTO has been held up for more than 10 years, largely due to policies of several western countries to "contain" China's economic advances, which can only grow more powerful upon entry. Unified tariff conditions are key to gaining entry into the WTO, and China has shown that it has slowly dropped both tariff and non-tariff barriers to trade in almost twenty years of reform. The explicit reasons given by Western countries (particularly the US) for not allowing China into the WTO are often non-trade issues like human rights. Another thorny issue is intellectual property protection.

Human rights constitute an area better suited to philosophical discussion, so this will not be discussed here. There is no question that regular violations of intellectual rights in the form of counterfeiting, unauthorised copying and others occur regularly in China - it continues to be a problem in other emerging economies such as Korea, Taiwan, Singapore, Thailand, Vietnam and Malaysia (Brahm, 1996). The more proactive approach may be for western governments to cooperate with China, encouraging western companies to work closely with local authorities to implement stricter rules, instead of firing threats of sanctions.

There are many reasons cited by Western nations, particularly the United States, for not allowing China into the WTO. Perhaps the most compelling reason is that of containment: From 1984 to 1994, US annual exports to China rose from US$3 billion to US$8 billion - which is pretty good. But during this same period, China's exports to the US rose from US$3.2 billion to almost US$38 billion (Brahm, 1996). The explosive growth of China's economy shows that the Middle Kingdom is indeed waking up, and perhaps the Western world is afraid of - as Napoleon so appropriately put it - China's "shaking the world to its foundations."

China is garnering positive feedback from WTO member nations like the United States for taking a strong stand against devaluing the renminbi. Devaluing the renminbi would restore the competitiveness China has lost to its neighbouring countries, whose depreciated currencies offer competitive advantage by way of cheaper exports. However, China will most probably exacerbate regional volatility by choosing to devalue its currency, aside from adding to inflationary pressure within its domain and further threatening the fragile Hong Kong dollar's peg to the US dollar. With its eye on WTO membership, it would do good for China to avoid an explosion of cheap exports that would widen its trade surplus and trigger further strains on China's relationship with America and Europe. But would deflationary domestic trends and slackening economic growth push Chinese authorities to devalue the renminbi? Such a choice would cause reverberations across the region and the world; the next 18 months is filled with anticipation regarding this issue.

Continuing reforms in trade and other sectors of the economy, combined with investments in support infrastructure like financial services and foreign exchange management, act as the pillars upon which the country is poised for future growth. With the resumption of Chinese sovereignty in Hong Kong, the impending turnover of Macau in 1999, and prospects of Taiwan's reunification with the mainland[21], China keeps on gathering momentum - despite (and perhaps even more so because of) recent regional downturns - moving inexorably towards its seemingly inevitable destiny of becoming the biggest and most powerful economy in the world.

4.4 Possible glitches in the machinery of growth

The future of China is not completely picture perfect. Structural strains in both the economy and society are becoming more apparent as tremendous growth puts pressure on several sectors. China has made several large investments in infrastructure development,[22] but it will take a lot more to ease the several bottlenecks which have appeared because of burgeoning economic growth, particularly in the industrial sector which is still plagued by inefficiencies. Related to this is the question of actual productivity in China: Exports and imports have been growing at approximately the same rate - is China therefore really adding value to its exports through productivity in processing its imports, or is it heavily import-dependent, acting as a mere conduit for imports to pass through the country and exit as exported goods and services without much value added?

SOEs are also being forced to become more efficient;[23] competition from the non-state sector has been growing in importance and SOEs are being pushed to lay off many redundant workers. This is one particularly thorny source of urban unrest - privatisation concerns will mean laying off approximately 23 million people[24], but what will the government do with them?[25] Lack of controls in the privatisation process also lead to worker abuse and already, thousands of protests have been staged by both rural and urban workers. One researcher at a government-affiliated think tank in Beijing says that the number of labour protests alone jumped from 50% to about 3,000 last year from 1995 - after a comparable rise the previous year. Among those held in 1996, 400 involved 1,000 or more partici-

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[21] As of 1996, combining China, Taiwan and Hong Kong's total trade figures will amount to US$888 billion, just a notch below the United States' figure of approximately US$1 trillion plus - and China is growing faster than the United States.
[22] Particularly in the agricultural sector; the growth of this sector can be attributed as much to good harvest in 1996 as to the investments made in infrastructure development (Asian Development Bank, 1997).
[23] Just how inefficient are the SOEs? Most sources estimate that SOEs soak up approximately 50% of investment, 65% of the urban labour force, and 70% of bank credit *while accounting for only 34% of industrial output.*
[24] Some sources go so far as to estimate the actual number of redundant workers to be close to 110 million people (*Time Magazine* 16 March 1998). What government could hope to survive the social instability of having enough unemployed people to populate an entire country?
[25] An interesting article reported in a recent issue of the Hong Kong Standard (Reuter, 1997) sheds some light on government attitude towards unemployed workers. The article, taking its cues from *The Workers' Daily* of Mainland China, was telling the jobless to "get on their bikes and look for work" instead of "sitting around and waiting for the government to get them a new job." Smacking of a capitalist attitude to career planning, it seems like quite a departure from the old communist ideal - ironic that it should come from a publication titled *The Workers' Daily*. Karl Marx must be turning in his grave!

pants. China recorded some 1,400 protests, including 200 large-scale ones, in the first half of 1997 (Chen, 1997).

One way out may be the services sector, which has been gaining prominence as more services are needed to support industrial and agricultural sector development. Displaced labour could be channeled to this sector, which has been growing at an annual average of eight to ten percent for the past few years.

But investment in human capital is required to fill the services sector: Education and skill are the prerequisites for an effective services sector. Currently, for example, China looks to Hong Kong and its vast armies of financial wizards for its transactions, which have been growing more complex in line with its developing economy. Education in China is particularly suspect. Since 1980 government expenditures on education has hovered from four to five percent as part of the Gross National Product[26], but during the 1990s, government expenditure as a percentage of GDP has not been keeping up in terms of growth[27].

A quick look at figures on education (see Appendix 2) shows that China has not done much for further development in this area[28] - unlike fellow Asian tiger economy neighbours Singapore and South Korea. Literacy rates in China are still hovering at approximately 80 percent, when the other powerful Asian economies boast literacy rates of over 95% (Statistical Abstract of the World 1994).

Finally, China needs to install a systematic legal and regulatory framework to govern the day-to-day concerns of the growing economy. It has made several efforts at this, but enforcement of the law continues to be a problem. Foreign capitalists abuse workers and children under the wing of local governments which are all too eager for investment to be channeled to their area. Crime and corruption continue to be a problem. For example, a recent article urged officials "to stop imposing random fees on businesses and purchasing luxury cars using funds for education" (Reuter, 1997). The cars, however, were not confiscated (Xinhua News Agency)! Party bureaucrats gifted with more power and autonomy continue to spread corruption in developing cities.

5. Conclusions and Final Assessments

The cracks in the framework of China's growth may be considered as "temporary nuisances" in a developing economy. It can be argued that explosive growth, worker abuse and corruption are part of the package of development - Hong Kong during the post-1945 years was not so different. The important question to ask therefore is how the central government will address these situations.

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[26] Data gathered from the China Statistical Yearbook of 1991.
[27] As a pct. of GDP, government expenditure represented in 1996 11%, against 15.7% in 1991 (Asian Development Bank, 1997).
[28] "Not done much" is an understatement. Statistics on education found in Appendix 2 show that *no significant growth was experienced in any of the main indicators of education for* ***thirteen years*** - years when the economy was growing by leaps and bounds.

So far, China's development in trade and other sectors of its economy has been nothing short of phenomenal. It has clearly moved into what Gregory and Stuart (1992) call a "market socialist economy" since 1978. However, social stability is one very important factor in any form of economic development. The "temporary nuisances" created by China's explosive growth may undermine this stability which the country has so often sought [29] - can the numerous protests and unrest created by unemployment, abuse and unbalanced development of the country spark an uprising on the level of the Tiananmen incident? In July 1997, Sichuan police broke up a huge protest by factory workers, where thousands were supposed to have been involved. Public security officials ordered hospital personnel not to treat wounded demonstrators, comparing them to the "counter-revolutionary thugs of Tiananmen" (Staff reporters, 1997). Will future disputes such as these push Communist hard-liners to dam the flow of capitalism with measures as brutal as the ones in Tiananmen?

Reforms and a better way of life may prevent such a confrontation, but only more equitable wealth distribution could help ease the burden on the predominantly poor and overworked Chinese population. Corruption and the imbalanced development of coastal and inland regions act as barriers to this - China has already formulated several reform initiatives to address these problems. Still there is the persistent fear in knowing that China is not below using strong-arm tactics to get its way. Clearly, the most important decision China must make is to consider the role which government will play in the new, evolving internal and external economic environment.

The 15th National Congress (September 1997) reaffirmed the government's stand towards further reform and modernisation initiatives and ushered in new confidence regarding China's leadership under President Jiang Zemin. Zhu Rongji, a man well respected by the international community for his hard-line policies for reform, modernisation and economic soundness, ascended as Premier last March 19, 1998. Amidst regional crisis and painful economic transitions, the Dragon is rearing its head, preparing to confront social and structural problems that threaten to strangle its rise. Will further changes lead to solid, lasting improvements in government and the economy, or will growing pains prompt another uprising and crisis like Tiananmen in 1989? All eyes are on China as the 21st century looms, holding predictions of the Middle Kingdom's ascendancy as the biggest economy in the world. And in the process of achieving this might, China has staked much of its growth on trade policies which have been successful so far. Only time will tell if the deeply intertwined relationships of political power, social stability and international trade will work towards the betterment of the Chinese economy and its people, as well as the rest of the world.

[29] Historians often refer to threat of *luan* (chaos) as a tool used by governments from the early dynasties down to the present-day Communist system to induce people to stop popular protests in order to preserve "stability" in Chinese society.

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Appendix A:
Chronicle of New Policies Related to Foreign Trade
People's Republic of China, 1991 to February 1993

Date of Implementation or Publication of Information	Policy
1 January 1991	Abolished state financial subsidies for exports; state trading corporations held responsible for profits and losses
1 January 1991	Established new foreign exchange retention shares: exports of petroleum 96 percent to central government and 4 percent retained by oil company; exports of electrical motorised goods and specific science and technology products 30 percent to central government (compensation at swap market exchange rate) and 70 percent retained by the producer; exports of ordinary commodities 50 percent to central government (of which 30 percent compensated at swap market exchange rate), 10 percent to local government, and 40 percent retained by producer; exports from processing of imported raw materials 10 percent to central government and 90 percent retained by producer.
October 1991	Stopped publishing the Ministry of Machine Building and Electronics Industry's list of "products recommended for import substitution."
Early 1992[a]	Reorganised the State Council Production Office into the Economic Trade Office (ETO) and elevated the ETO to level of state council commission
1 January 1992	Implemented the Harmonised Commodity Description and Coding System (HS) for reporting exports and imports.
1 January 1992	Lowered tariffs in 16 categories covering 225 products.
First quarter of 1992	Published in *International Business*, MOFERT's newspaper, 47 internal, or secret, trade regulations. MOFERT has designated this newspaper as the official register of trade policies, rules and regulations.
1 April 1992	Eliminated regulatory import tax (a separate surcharge imposed over and above the applicable tariffs) for 18 kinds of commodities.
First half of 1992	Abolished some commodities under categorised commodity import license control and announced a catalogue of commodities under new import license control.
September 1992[a]	Changed the foreign exchange retention ratio for light industry and textile industry from a "reverse 30-70 percent" to a reverse "20-80 percent" ratio.
September 1992	Mapped out or revised more than 530 inspection standards for import and export commodities, including 76 standards for the inspection of trade pesticides in export food. The State Administration for the Inspection of Import and Export Commodities announced the major categories for inspection: canned products, meat, foodstuff casings, eggs and dairy products, tea, wine and other beverages, vegetables, sugar, honey and candy.
September 1992	Drew up a new measure to introduce a commission pricing system for all commodities imported with central foreign exchange. The measure calls for one-time use of each import license issued, with the bank in charge of exchange settlement clearly indicated.
23 October 1992	Implemented rules for the Inspection Law on Import-Export Commodities.
October and November 1992	Expanded import and export rights to more than 1,000 industrial enterprises (including 11 textile and garment companies in Shanghai, private firms in Guangzhou).
November 1992[a]	Announced that foreign exchange earnings from exports in excess of the planned volume could be retained by the enterprise at a ratio of 10 percent.
November 1992[a]	Had set up more than 100 foreign exchange swap centers since 1988.

November 1992[a]	Allowed enterprises to retain foreign exchange earnings in cash instead of vouchers on a trial basis in Shanghai, Shenzhen, Zhuhai, Jiangsu and Hannan.
November 1992[a]	Announced that 53 categories of products were controlled by import permits in China
December 1992[a]	Eliminated the licenses for second-category and third-category commodities. Reports indicated that 121 export commodities fell under the second category, which included meat products and textiles, while 3,000 export commodities were under the third category, which included local products and minerals.
December 1992[a]	Published 32 internal documents still in force concerning import and export administration and abolished 122 internal regulations.
31 December 1992	Reduced import tax rates for 3,371 items. The goods made up 53.6% of the total taxable items under the Customs Import and Export Tariff. Reduction of the tax rates lowered the general level of China's customs tariff by 7.3 percent.
February 1993	Announced that China Investment Bank would issue foreign-currency bonds to Chinese citizens in the first half of 1993. The bonds, worth US$50 million, would have a term of one year and carry an interest rate 1 per cent higher than the rate for term deposits in banks (banks currently pay 3.75% for hard-currency deposits).
March 1993	Allowed Chinese citizens and foreigners visiting and leaving China to carry in and out 6,000 yuan or renminbi in cash.

[a] Date information published, not clear when implemented.
Source: US Bureau of Census, from Asian Development Bank, *From Centrally Planned to Market Economies: The Asian Approach (Volume 2, 1996)*, pp. 270-273.

Appendix 2:

Statistics on Education in China

Item	1980	1985	1990	1992	1993
Number of Schools (units)					
Institutions of Higher Learning	675	1016	1075	1053	1065
Secondary Schools	124760	104848	100777	97784	96744
Primary Schools	917316	832309	766072	712973	696681
Number of Full-Time Teachers (1,000 persons)					
Institutions of Higher Learning	247	344	395	388	388
Secondary Schools	3171	2967	3492	3624	3668
Primary Schools	5499	5377	5582	5527	5552
New Student Enrollment (1,000 persons)					
Institutions of Higher Learning	281	619	609	754	924
Secondary Schools	20118	17898	18158	19398	19837
Primary Schools	29423	22982	20640	21832	23535
Student Enrollment (1,000 persons)					
Institutions of Higher Learning	1144	1703	2063	2184	2536
Secondary Schools	56778	50926	51054	53544	53837
Primary Schools	146270	133702	122414	122013	124212
Graduates (1,000 persons)					
Institutions of Higher Learning	147	316	614	604	571
Secondary Schools	16299	12791	14975	14994	15419
Primary Schools	20533	19999	18631	18724	18415
Student/Teacher Ratio					
Institutions of Higher Learning	4.6	5.0	5.2	5.6	6.5
Secondary Schools	17.9	17.2	14.6	14.8	14.7
Primary Schools	26.6	24.9	21.9	22.1	22.4
Government Expenditure (1,000,000,000 yuan)			**54.87**	**72.88**	
Budgetary Education Expenditure			42.61	53.87	
Administration Expenditure			35.25	45.40	
Capital Construction Investment in Education			2.96	3.38	

Source: China Statistical Yearbook of 1994

A quick look at these figures shows the dismal state of education in China. *In all of these indicators, there has been no significant improvement or growth for thirteen years*. Some areas even showed a deterioration - for example, the number of graduates from institutions of higher learning and primary schools are declining.

Education in China has the potential of acting as a safety-net for the vast majority of the population whose occupations in rural agrarian communities as well as industrial state-owned enterprises are being threatened by liberalisation and privatisation. People with better education and training can opt to look for opportunities for alternative careers in growing industries like the services sector in China. Unfortunately, the government has yet to focus its concern on this particular sore spot of infrastructure investment - human capital.

Appendix 3: Will China Devalue the Renminbi?

Issues and Implications

The Southeast Asian currency crisis dealt a serious blow to the economies directly affected, putting on hold rosy forecasts for growth and further development. However, one benefit that may be derived from weaker currencies is export competitiveness. Some struggling low-tech export industries from Southeast Asia already exhibit signs of a modest upturn.

The possibility of China's devaluing the renminbi, however, may dash all hopes for Southeast Asian export competitiveness. Devaluing the renminbi may induce another round of staggering economic shockwaves, further worsening investor confidence and postponing economic growth and development for the entire region. Chinese administrators have all promised not to devalue the renminbi, but the next 18 months will show whether the Chinese currency can indeed defend its position against macroeconomic pressures.

What factors are pressuring the renminbi to devalue?
China's double-digit economic growth was fueled by several interrelated factors; the focus of this entire paper - the liberalisation of trade policies - was one major force behind the Chinese economy's rise. However, the Southeast Asian currency crisis attacked China on two fronts when it came to trade:

1. Regional demand has slumped because of weaker Asian economies. This is bad news for China, which exports nearly half of its products to the embattled region.
2. China's exports lost some of its competitiveness in global trade markets due to cheaper products from Southeast Asian countries with weaker currencies.

Added to these factors are many other problems that China has to face: Domestic consumption has been slowing down and foreign investment projections are not as rosy as in previous years because of the risk associated with the unstable Asian region. All these add up to slower growth projections.

This is a terrifying scenario for a country that needs high growth to create jobs and to prevent the spread of social unrest. Economists generally hold that China must keep growing at or above 7% to 8% to create enough new jobs to absorb the unemployed. In September 1997, President Jiang Zemin reaffirmed China's commitment to modernise its moribund, inefficient state-owned enterprises. With an estimated 109 million redundant workers, China is well justified in worrying about what such a large cadre of unemployed workers could do to affect social stability, which is already teetering over a dangerous edge.

China has several options to reverse this trend: It could try to attract more foreign investment, but this option is unlikely given the general instability of the region. It could try to halt the modernisation of state-owned enterprises to preserve jobs, but that would only mean spending its money for the welfare of unproductive labour - a move that would only be counterproductive in the long-run. Or it can take the fast and easy route to boosting foreign exchange earnings: Devaluation.

Most analysts fear that China will flood the world with cheap exports and wreak havoc in the international trade scene if it chooses to devalue the renminbi, upsetting the competitive structure not only of Southeast Asia, but the rest of the world as well. Some countries like Malaysia may not be as greatly affected if their mix of exports is different from China. But countries which produce textiles, shoes and low-level electronics like Thailand, Indonesia and the Philippines would be in for serious competition, the likes of which these countries certainly do not need, given their embattled currencies.

Asian companies which invested in China could be hit hard as well. Charoen Pokphand from Thailand, for example, has invested heavily in Shanghai's property market, whose strength may have been overestimated. On top of less-than-rosy earnings from China, a lot of Charoen Pokphand's investments are financed by loans denominated in U.S. dollars - interest and principal repayment would therefore be so much more difficult with a devalued renminbi.

However, China is weighing the choice of devaluing its currency against the possible regional implications of such a move. It will place Hong Kong in a precarious position, since the Hong Kong dollar may also be forced to lift its peg against the U.S. dollar. Also, China may want to avoid an explosive increase in exports driven by a devalued renminbi, since this would widen its trade surplus with partner countries and further strain its relationships with the United States and Europe - effectively barring its long-awaited and much desired admission into the World Trade Organization.

The next 18 months will reveal whether China can live up to its promises of defending the renminbi amidst great pressures from domestic concerns and regional woes.

Sources:
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