

# GENERAL AGREEMENT ON

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## TARIFFS AND TRADE

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### WORKING PARTY ON CHINA'S STATUS AS A CONTRACTING PARTY

#### Examination of the Foreign Trade Regime - Part I

##### Note by the Secretariat

### 3. Examination of the Foreign Trade Regime

3.1 As requested by the Council, the Working Party examined the foreign trade regime of China. The Working Party used as the basis for its examination the document containing the questions and replies concerning the Memorandum on China's Foreign Trade Regime (L/5270). The following paragraphs summarize the information China provided in response to follow-up questions raised by members of the Working Party.

#### (a) General Questions

3.2 Members of the Working Party noted that China had originally assumed contracting party status by accepting the Protocol of Provisional Application dated 30 October 1947, which exempted from the obligations under Part II of the General Agreement measures taken pursuant to mandatory legislation in force on that date. These members wondered how China reconciled its request to resume its original membership with its request that the date relevant for the existing legislation clause in the protocol of resumption, proposed by China, be the date of that protocol rather than 30 October 1947. The representative of China replied that the founding of

the People's Republic of China in 1949 had not altered China's status as a subject of international law. The withdrawal from GATT in the name of China by the deposed regime in 1950 was therefore not legally valid. The United Nations, in a resolution adopted in October 1971, had recognized the representatives of the Government of the People's Republic of China as the only legitimate representatives of China, and the GATT, on the understanding that it should generally follow decisions of the United Nations on essentially political matters, had expelled in November 1971 the observer from Taiwan. For these reasons China was, both legally and politically, justified in requesting a resumption of its original membership. However, given the considerable changes that had taken place during the suspension of China's relations with the GATT and given China's readiness to negotiate its resumption, a non-retroactive approach to the changes during the period of suspension was appropriate and in the interest of all contracting parties.

3.3 In reply to questions as to whether China would be ready to hold periodic consultations on its trade practices, the representative of China stated that his authorities would be ready to consult under the existing GATT provisions and relevant additional procedures that might be agreed in the Uruguay Round but that they did not consider a special consultation requirement to be justified.

(b) Reform of the Economic Structure in China

3.4 The overall objective of the reform and the role of planning. The representative of China explained that the declared objective of the Chinese government was to establish a planned commodity economy based on public ownership. What was meant by "planned commodity economy" could best be described as "socialist market economy". The crucial difference between a socialist and a capitalist market economy was the difference in the ownership of the means of production. However, as far as economic mechanisms and principles were concerned there was no

difference. Under the new system, planning and market mechanisms were combined. The state regulated the market through monetary, fiscal and industrial policies and, to the extent necessary, administrative means and the market guided enterprises towards decisions ensuring a proper allocation and optimal use of national resources. When the State established plans it took into account the supply and demand situations. The plans provided for either mandatory or guidance targets. Mandatory targets had been completely abolished in the agricultural sector and were playing a declining role in the industrial sector. Only large and medium-sized enterprises were subjected to mandatory plan targets. Of the 15 million enterprises in China, only about 8.000 fell into that category and of these only a small portion was presently subjected to mandatory targets. These enterprises were free to determine their production in accordance with market conditions after having fulfilled their targets. Under guidance plans no compulsory targets for individual enterprises were established. These plans were implemented primarily through fiscal and regulatory means inducing enterprises to adjust their production to the plan. In the field of agriculture, the State ensured the fulfilment of the guidance plan targets essentially by three means: first, the State improved the basic conditions for agricultural production, for instance by making agricultural inputs available, developing industries that produce fertilizers, pesticides, plastic films and other inputs into agricultural production and by promoting the use of advanced agro-technology. Second, the State used price incentives to influence the structure and level of agricultural production. Thirdly, the State concluded purchase contracts for important agricultural products, such as grain, cotton, edible oil and sugar plants and provided farmers with financial incentives (for instance, the sale of inputs at the State price or advance payments) to ensure the fulfilment of the contracts.

3.5 The representative of China emphasized that during the course of the reforms China had greatly reduced the scope of direct state intervention in production, commerce and distribution. The number of

industrial products subject to mandatory production targets had dropped from over 300 in 1978 to 60 in 1986; the number of capital goods and industrial inputs subject to the unified state distribution from over 250 to about 20; the number of products subject to planning by the Ministry of Commerce from over 180 to 22. In the past, China's foreign trade had been tightly controlled by highly centralized planning and mandatory plan targets. Export products subject to mandatory planning were estimated to account in 1988 for roughly 30 per cent of total exports and those subject to guidance plans for 15 per cent. The remaining 55 per cent were liberalized and consequently no longer included in any export plan. In 1988 products subject to mandatory planning had accounted for 20 per cent of total imports. For another 20 per cent of total imports, the import plan had specified only a certain amount of import values for particular purposes. The remaining 60 per cent had been liberalized. Statistics on the portions of the economy that remained subject to direct controls were not available but, as the above figures showed, the progress in the reforms had been such that the Chinese economy could no longer be categorized as a centrally-planned economy.

3.6 The Price System. The representative of China said that there were now basically three types of prices: the state price, the state guidance price and the market-regulated price. The state price was set by the price administration authorities at or above the county level and could not be changed without the approval of these authorities. The state guidance price was a more flexible form of pricing; it left scope for enterprises to take the market situation into account. There were various modalities of guidance. The price administration authorities stipulated either (a) the basic price and a floating range, or (b) rates of price differences, or (c) profit margins, or (d) a ceiling price and a minimum price. Enterprises could, within the limits of the guidance, make their own decisions on prices. As to the market-regulated prices, the enterprises were free to determine the prices in accordance with supply and demand to the extent permitted by generally applicable laws and regulations.

3.7 The products subject to state prices were those having a direct bearing on the national economy and the basic needs of the people. In the first half of 1987 rice, wheat, maize and cotton had been among these products. The products subject to state guidance prices presently included: (a) Purchase prices of agricultural products: live pig, timber from collective-owned forests, sheep wool, jute, kenaf, tea, musk, licorice root, cortex eucommiac, cortex magnoliae; (b) ex-factory prices of industrial products: household enamel ware, machine tools, machinery of general purpose, automobiles, most of the electronic products, and mining and refining equipment; and (c) retail prices of consumer goods: pork, tea, timber from collective-owned forests in Southern China, household enamel ware, and cotton shirts and bed sheets. In formulating the state prices and state guidance prices the following four elements were taken into account: the normal costs of production under efficient operations, the supply and demand situation, the government policies and the prices of related products. The prices of industrial goods were determined by taking into account the average production costs, taxes and profits. In order to keep prices stable, the state guidance price for industrial products was generally set at a level somewhat lower than the market price but not below the level of profitability. The purchasing prices of agricultural products were determined by taking into account the production costs under efficient operations in normal weather conditions, the agricultural tax and a reasonable profit margin. Not only the market situation was taken into consideration, but also the interests of the producers and the ability of consumers to bear the price. The agricultural production costs included those of seeds, fertilizers, pesticides, the depreciation of agricultural machinery, irrigation and drainage, and manpower. In calculating the costs of inputs, such as chemical fertilizers, pesticides and farm machinery, the actual prices were taken into account, of which some were state prices, some state guidance prices and others market prices. The price of the products sold by farmers to the state through purchasing contracts (grain, cotton, etc.) was based on the state prices; any excess production could be sold at market-regulated prices. Agricultural products

currently subject to supply rationing were grains (wheat flour, rice and corn) and edible oils. For social reasons, the retail price of these products was lower than the state purchase price paid to the farmers. The difference was covered by the state budget. The needs of urban residents that went beyond the rationed part of supply were supplied at market-regulated prices. There were differences in the prices of goods sold in different provinces. This was due to differences in supply and demand situations. For instance, in mid-January 1988, the price of steel rods was 1,350 yuan per ton in Shenyang, 1,400 yuan in Taiyuan, and 1,540 yuan in Shantou. The prices for government services, railway transportation and postal services did not distinguish between domestic and imported goods.

3.8 Of the total value of agricultural products sold by the peasants, the portion under state price had dropped from 92.6 per cent in 1978 to 35 per cent in 1987; the portion under state guidance price and market price had risen from 7.4 per cent to 65 per cent during the same period. Of the total value of retailed consumer goods, the portion subject to state prices had decreased from 97 per cent in 1978 to 47 per cent in 1987. In the case of light industrial products the decline was from 95 per cent to 45 per cent and in that of heavy industrial products from 100 per cent to 60 per cent. As these figures indicated, the rôle of market forces had been substantially strengthened. The price system now tended to be rational and therefore provided more equitable market conditions for enterprises. However, it was recognized that further adjustments were needed to achieve a completely rational price system. The pace of further price reforms depended on fiscal, economic and social factors and no time schedule could therefore be established for them. However, the Government's aim was to gradually establish a framework in which the state controlled the price of only a few products and services vital to the national economy.

3.9 Pattern of Ownership and Management Autonomy of Enterprises. The representative of China explained that in the rural economy the previous system of three-level state ownership (people's commune, production

brigade, production team) had been replaced by a system in which households were the basic unit of production. In addition to the individual households there had emerged specialized households (4.5 million), self-employed industrial and commercial households (over 9.2 million), joint production units (0.48 million) engaging in the production and sales of merchandises, and other forms of associations.

3.10 The relations between the households and the state were governed by a contract responsibility system. Under that system peasants could obtain the right to use state-owned land by accepting a contract setting out, among other things, the agricultural tax to be paid to the state, the public welfare contributions to be paid to the local Villagers' Committee (or Group) and the quantities and prices of the products to be delivered. The contract responsibility system now covered 98 per cent of all rural households. The system permitted peasants to plan their own production in accordance with their contract and market demand, which significantly increased their productivity. Sales of agricultural products over and above the contracted quantities had increased from 45 per cent of the total agricultural and sideline production in 1978 to around 60 per cent at present.

3.11 In the industrial field, the principles of enterprise management had also substantially changed. A contractual responsibility system had been introduced to implement the principle of separation of ownership and managerial authority of enterprises. Under that system, the competent government bodies concluded contracts with the manager of enterprises which set out management objectives, such as efficiency, profit rates, product quality or annual income, but otherwise gave the manager full authority for independent management. The managers were selected on the basis of open competitive recruitment. At the end of 1987, 80 per cent of all state-owned enterprises had already adopted a system under which the manager was fully responsible for the enterprise. The recently adopted "Law on State-owned Industrial Enterprises" had codified these practices.

3.12 The contract generally stipulated the portion of profits to be surrendered to the state and in some cases also technical, financial and other targets to be achieved. In 1987, mandatory production targets had been fixed for only 17 per cent of industrial output. The total volume of wages was also fixed, usually in relation to the profits earned. If the manager failed to meet his obligations under the contract he had to pay penalties; his personal property was mortgaged as security for that eventuality. The contract left it to the manager to decide without government interference how to achieve the agreed targets. The profit-sharing arrangements were such that a successful operation of the enterprise benefited not only the state but also the manager and the workers and therefore gave them incentives to raise productivity and to promptly respond to changes in market demand. A new share-holding system had recently emerged. Under that system enterprises and government bodies could acquire shares of enterprises and thereby become entitled to participate in their decisions and to receive part of their profits. The system, which was still in an experimental stage and therefore not yet subject to specific regulations, was now mainly used by enterprises which wished to create mutual horizontal ties.

3.13 Private enterprises. In 1987 there were 15 million industrial and commercial households providing 20 million jobs. There were also 115,000 private enterprises with a total of 1.84 million employees. The individual households and private enterprises did not enjoy any privileges but in practice they tended to be very competitive and responsive to market changes. There was at present no specific legislation permitting households and private enterprises to engage in foreign trade. These, in any case, generally lacked the size and expertise necessary to engage in foreign trade directly. A recent amendment of the Constitution provided: "The State permits the existence and development of the private economy under relevant laws. The private economy is a supplement to the socialist economy of public ownership. The State protects the legitimate rights and interests of the private economy and exercises guidance, supervision and administration over the private economy". The legislation implementing this constitutional amendment was being drafted and the rôle of the private economy in foreign trade was therefore as yet undefined.

3.14 Foreign investments. The representative of China said that, by the end of 1987, businessmen from over 40 countries and regions had invested in China. Of the more than 10,000 enterprises with foreign investment in China, 4,600 were Chinese-foreign equity joint ventures, 5,190 Chinese-foreign contractual joint ventures, and 183 wholly foreign-owned enterprises. Moreover, 44 contracts for offshore oil exploration projects had been concluded. The total contracted value of foreign investment had reached US\$22.8 billion, of which US\$8.5 billion had been already invested in China. The investment was spread over a wide range of sectors, including energy, transportation, metallurgy, electronics, chemicals, machinery, building materials, telecommunications, light industry, textiles, pharmaceuticals, agriculture, animal husbandry, fishery and tourism. In October 1986, the State Council had promulgated "Regulations Concerning Encouragement of Foreign Investment" and had subsequently issued 14 follow-up rules to implement the regulations. The "Law of the People's Republic of China on Sino-Foreign Contractual Cooperative Enterprises" had entered into effect on 13 April 1988 and the detailed rules for the implementation of the "Law Concerning Enterprises with Sole Foreign Investment" were being drafted.

3.15 The specific rights and obligations of enterprises with foreign investments were determined through negotiations. The State did not impose any export requirements as a result of such negotiations nor were there any general legal requirements to export. The foreign investors were obliged to keep their foreign exchange accounts balanced. Most of the enterprises had found that, once they had balanced their foreign exchange accounts through exports, they could sell their remaining output in the Chinese market. To help enterprises with foreign investments balance their foreign exchange accounts, the State allowed the sale of foreign exchange against domestic currency by enterprises with foreign exchange surpluses to those with shortages. These transactions were made under the supervision of the foreign exchange administration authorities at foreign exchange swap centres at a floating rate determined by supply and demand. Moreover, the

foreign investors could reinvest their profits in domestic currency in export-oriented projects. They could sell their products to domestic users in foreign currency provided their products were competitive or purchase with domestic currency goods not subject to export controls and sell these goods outside China. For these reasons, most of the enterprises with foreign investment could balance their foreign exchange accounts.

3.16 Future reforms. The representative of China emphasized that China was in a period of transition during which features of the old economic system and those of the new one coexisted. The full realization of the new planned commodity economy required further reform efforts. The tasks ahead were five-fold. First, the management mechanisms for state-owned enterprises and their autonomy vis-à-vis the state needed to be further refined to ensure their efficiency and competitiveness. Second, long-term and short-term financial markets and markets for stocks, foreign exchange, technology, labour and real estate needed to be developed and expanded, and the pricing and price administration for merchandise had to be further reformed with a view to limiting price controls to a few essential items. Third, as the direct state controls over enterprises declined in importance, the government's macro-economic controls of the economy had to be improved. Fourth, as China's integration in the world economy continued to expand, foreign trade enterprises would need to be given full management autonomy and responsibility for their profits and losses so as to improve the coordination between domestic industry and foreign trade. Fifth, the legal system and its enforcement would have to be further strengthened so as to ensure the implementation of the new planned commodity economy system.