

# IMPACT OF THE OPEN-DOOR POLICY ON FOREIGN TRADE OF CHINA

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## INTRODUCTION:

Foreign trade plays an important role in the economic development of a country. Through foreign trade, the reserves of foreign exchange are enlarged. There is no country in the world at present, which produces all the commodities. Therefore, every country tries to produce those commodities in which the said country has comparative advantage.

China inherited an under developed economy in 1949. The policy makers framed the various plans for the development of the country with the passage of time. This research paper describes the open-door policy of China to promote foreign trade and investment during 1980's in the context of three regions viz. Eastern coastal, Central region and Western region.

## THE "OPEN-DOOR" POLICY:

Since 1979 China's foreign economic relations have been based on the principle of the "open-door" to promote foreign trade and investment. In contrast the past policies stressing "self-reliance", the Chinese leadership now sees major benefits from International specialization and trade. This includes some acceptance of the principle of comparative advantage as well as the benefits of International competition. However, economic policies generally support protection of the domestic market in sectors where domestic producers exist. Administrative controls persist, limiting many types of import and some exports.

China's exports to the rest of the world increased rapidly during the 1970's and especially the 1980's. By the mid-1980's exports were over ten times their 1970 level. Over time, China's imports have risen roughly in balance with export as China has tended to pursue a goal of trade balance. In practice the growth of exports usually limits imports. However, in the mid-1980's a

major trade deficit emerged as a result of stagnating exports and rising imports. In 1987, export growth, combined with limits on imports, had again balanced foreign trade, leaving a small surplus of US \$1.9 billion.<sup>1</sup>

China has also sought to diversify its trading links, perhaps still mindful of the problems of dependents on the Soviet Union during the 1950's, and its subsequent International isolation. China's biggest trade partner is Japan, with which 30 percent of total trade was conducted in 1985. Next come Hong Kong with 17percent, and the USA with 11 percent. Trade with European countries constituted 21 percent of the total. China's trade is therefore centered on its neighbours, and on the more advanced industrial countries, rather than on the third world or other socialist countries-through three percent of trade was with the Soviet Union.<sup>2</sup>

Reversing previous policies, China now encourages foreign investment, mainly through establishing joint ventures, but also be permitting wholly-owned subsidiaries of foreign firms. A number of laws have been passed concerning joint ventures, and in the mid-1980's further measures were put forward to boost foreign investment, of the two types of investment open to foreign companies-joint ventures with Chinese partners or wholly-owned subsidiaries in China-the central authorities generally prefer joint ventures, of which there are two types, equity and contractual. They have tried to encourage, in particular, equity joint ventures, which involve establishing a completely new company with shareholdings from China and abroad. Contractual joint ventures are preferred by many foreign investors, and have a legal contract specifying the contributions and benefits on both sides.

China has been successful in stating to attract foreign investment, specially from Hong Kong. By September 1987 there were 8,943 enterprises with foreign investment. Although US\$21 billion of investment had been agreed, only US\$7.6 billion of this had actually been utilized.<sup>3</sup>

At the end of 1986, 46 percent of such enterprises equity joint ventures, 51 percent contractual joint ventures and 2 percent

wholly foreign-owned. China had also set up 385 enterprises abroad (including Hong Kong and Macao) with a US \$ 0.6 billion investment, many as joint ventures with foreign partners.<sup>4</sup>

Although most joint ventures are climbed by China to be operating well, there are many problems for foreign investors, including, in particulars, weak infrastructure, administrative bureaucracy, foreign exchange constraints and the quality of the labour force. There have been conflicts related to objectives: China wants to increase exports and observe advanced technology, whereas some foreign investors are looking for a means of entry into China's domestic market. Currently such access is limited, although recent regulations have extended preferential treatment to import-substitution as well as exports. The management rights of foreigners are being extended, for example through proposals by Communist Party General secretary Zhao Ziyang for foreign managers to bid to run Chinese enterprises under contract.

#### THE REGIONAL PATTERN:

The Seventh five-year plan embodies the official promotion of regional differentiation in development, and this is reflected in the pattern of China's trade during the 1980's. the policy of the "open door" has been limited in its impact largely to the coastal areas, particularly the SEZ's and coastal cities. In addition, the expansion of foreign trade implies a greater role for ports and other transport centers. Generally, the coastal areas of China are seen as the leaders in both "opening up" and overall economic reform.<sup>6</sup>

However, in examination of the three regions specified in the Seventh FYP indicates that the Eastern Coastal Region is even more dominant in foreign trade than in production, as shown in Table 1. Over three-quarters of China's exports come from the Eastern Coastal Region, compared with about half of national income and 40 percent of population. Thus the position at the start of the Seventh FYP is one of major regional differences between a more prosperous Eastern Coastal Region and less



prosperous Central and Western ones, with the latter much less involved in foreign trade.

TABLE – 1

*Population, income and trade by  
Seventh FYP region, 1986*

Region	Population (1985, m)	National Income (Ybn)	Export (US\$bn)	% Population	% of National Income	% of Exports	Export/ National Income%
Eastern Coastal	430	405	17.7	41	52	77	13
Central	371	247	3.9	36	32	17	5
Western	240	127 (GNP, US\$bn)	1.2	23	16	5	3
Taiwan	20	73	39.8	n.a	n.a	n.a	55

Source: *Country profile, The Economist Intelligence Unit 1988-99, London, pp.9 and 47.*

An index of the importance of foreign trade to each region can be derived from the export statistics. The shows that the Eastern Coastal Region is much more involved in foreign trade relative to its overall level of national income than either the Central or the Western Regions. In fact, the main gap is between the Eastern Coastal Region and the rest of China. However, even in the Eastern Coastal Region the involvement in foreign trade is still low in World terms – with an average of around US \$40 exports per person. In the Central Region, exports were only US\$ 11 per person and even lower – at US\$ 5 per person – in western region, as shown in Table 2.

TABLE - 2

**Population, national income and exports by  
Seventh FYP region and province.**

Region	Population (1985, m)	National Income (Ybn)	Exports (US\$m)	National Income Person(Y)	Exports/ person (US%)	Exports/ National Income %
Eastern						
Coastal	429.96	405.29	17.65	943	41	12.8
Central	371.25	247.01	3.91	665	11	4.7
Western	239.87	126.55	1.24	528	5	2.9

**Source:** *Country profile, The Economist Intelligence unit 1987-88, London, pp.6 and 31.*

### THE SOUTHERN COASTAL PROVINCES:

Reforms in foreign economic relations have developed furthest in Guangdong and Fujian. In the future, Hainan Island is likely to go further still. All three provinces have been given special powers in dealing with foreign exchange, and encompass all China's SEZs.<sup>7</sup>

At provincial level, Guangdong and Fujian both have the right to decide on, and use, foreign loans subject to a centrally-set ceiling, as well as greater autonomy in overall provincial finances.<sup>8</sup>

This is essentially "geographical" decentralization to local government rather than to individual enterprises. In principle, state enterprises should go through provincial or national trade organizations for foreign trade. However, some state and all collective-sector enterprises-notably rural industries-may also deal directly with foreign customers. But there are limits: rural entrepreneurs, for example, found themselves forbidden by regulations to export canned mushrooms.<sup>9</sup>

While this means a complex set of relationships for foreign investors, the overall effect is to create a more receptive environment for foreign trade and investment compared with most of the rest of China.

Guangdong and Hainan are also going faster than other regions in implementing a wider set of economic reforms. The Chinese government has approved a ten – point reform plan put forward by Guangdong, which includes liberalization of foreign – exchange controls, and the setting of prices through market forces within five year, except for energy, grain, transport and communications.<sup>10</sup>

Throughout the southern coastal provinces the expansion of processing and export production has led to much greater imports. Part of this has been in upgrading production facilities of increase capacity and improve quality. In 1986, equipment imports into Guangdong were US \$ 500 million. Imports of raw materials are likely to rise significantly as a result of the shift in policy towards obtaining imported materials for export – processing industries.

The other southern coastal province, Guangxi, has changed less, though it has direct access to the outside world through its ports, in particular Beihai– designated an open coastal city. However, Beihai has been seen as the weakest of the fourteen coastal cities. By 1987, it had only attracted about US\$20 million in foreign investment.<sup>12</sup>

Hong Kong companies have been increasing their contacts with China by both direct investment and contracts with Chinese enterprises. By 1987, Hong Kong and Macao firms were contracting processing and assembly work to some 10,000 factories employing almost one million workers in neighbouring Guangdong province. China has also been increasing its direct and indirect investment in Hong Kong, as well as through direct trading links. By mid-1986, it was estimated that PRC – based companies had over HK\$1 billion invested in Hong Kong.<sup>13</sup>

#### **EASTERN AND NORTHERN COASTAL PROVINCES:**

The growth of South China's foreign trade has reduced the previous dominance of east China, in particular that of Shanghai. Guangdong has overtaken Shanghai as the province with highest exports. The coastal provinces of Jiangsu, Zhejiang



and Shandong have expanded their economic role dramatically relative to Shanghai. As a result, Shanghai has been told it should learn from Guangdong in 'deepening reforms and in pursuing [an] open policy.'

Shanghai's previous reputation for relative flexibility was tarnished by the mid of 1980s, probably as a result of the speed of change elsewhere in China. Increasing exports is now seen as a policy goal, and machine tools in particular, is a target sector for expanding exports. Aims for the future imply lower exports growth rate than in the south, with a 1990 target of US\$ 4.5 billion and a seventh FYP target of 8.4 percent a year—little more than overall economic growth.<sup>15</sup>

In contrast to Shanghai, other provinces on the coast have been expanding their involvement in foreign trade rapidly. Part of this has been based on agricultural products and food-processing. Shangdong's 1986 grain exports, mainly of maize and sweet potatoes, have increased to six times the 1984 figure.<sup>16</sup>

One in every three farmers in Shangdong is producing some export products making a total of around US \$1 billion a year.<sup>17</sup>

In the future, the potential of Shangdong for links with South Korea is substantial, assuming that current moves to improve political and economic relations with China continue.

The area around Suzhou, Wuxi and Changzhou, part of the yangtze open economic zone, which expects to double its exports to US\$2 billion, accounting for 20 percent of the area's GNP figure.<sup>18</sup>

The coastal areas of north and north-east China are also increasingly involved in foreign economics relations, but to a lesser degree than most of the southern or eastern provinces. Tianjin plays the most prominent role in foreign economic relations of those areas of China. It is one of the fourteen coastal cities and has been give special rights to use up to US \$1 billion of foreign investment by 1990, mainly in export-oriented industries, including

textiles, food-processing, light engineering and computer software. The exact level of autonomy which the city will have is unclear, but reports indicate local autonomy up to 200 million yuan R.M.B.<sup>19</sup>

Tianjin's reputation as a port has been growing, partly as a consequence of its autonomy, for example in importing needed equipment from abroad.<sup>20</sup>

It is also attempting to ease the problems of foreign investors by setting up a centre to manage some of the necessary contacts with local government departments.<sup>21</sup>

Beijing and surrounding Hebei province also have significant exports and have attracted foreign investment. For example, Beijing has agreed around US \$3 billion in investment.<sup>22</sup>

Textiles are a major part of exports, forming over a quarter of Beijing's 1986 exports.<sup>23</sup>

Liaoning, the most northerly coastal province, has been active in moving towards the world market as well as being the leader in some aspects of economic reform, as for example, the new procedure for bankruptcy. Dalian (Luda) has been particularly active in making use of its status as a coastal city, with fifty-four foreign investors already in place. More generally, Liaoning aims to build 200 export-oriented bases and enterprises, aiming at US \$5 million exports each as part of its effort to increase exports faster than the economy as a whole.<sup>24</sup>

Liaoning intends to create fifty-oriented agricultural bases, with foreign investment being sought in food production.<sup>25</sup>

Further moves include opening one hundred of the province's major enterprises to joint-venture operation or management under contract by foreigners; substantially extending its "open areas" with special terms for foreign investment; and advocacy by the provincial Communist Party secretary that South Korea should be studied.<sup>26</sup>



Liaoning also has some relations with neighbouring North Korea, including a joint-venture power station.

### THE CENTRAL REGION:

The Eastern Coastal Region has moved rapidly towards strong involvement in foreign economic relations, such moves have been more restricted in the Central Region. Except in the northern and north-eastern provinces of inner Mongolia, Jilin and Heilongjiang, there are no land borders or coastal ports to act as channels for foreign trade.

China's north-east has historically been its heavy industrial base, as well as having had some of the closest links with Japan in the 1930's and the U.S.S.R in the 1950's. Much of its production is still oriented towards the domestic market. However, trade is being expanded with the U.S.S.R, which equipped much of the region's industry in the past. Increasing links with the U.S.S.R could facilitate the re-equipment of existing enterprises as well as provide export opportunities. In addition there is the potential for more local links. Heilongjiang and Inner Mongolia are allowed to undertake cross-border trade, out side the state plan.<sup>27</sup>

The trade is still at a low level but is expanding fast that between the U.S.S.R and Heilongjiang, by 80 percent in 1987 according to a Soviet report.<sup>28</sup>

Inner Mongolia has also been increasing cross-border trade with the Mongolian people's Republic since 1985.

Although current policy for the central region is more concerned with domestic market, effort are being made to increase trade and investment. For example, Hunan has been taking a range of measures above those decreed nationally to boost exports. Enterprises are allowed to retain extra profits if they expand exports above their quota. Tax-free bonuses can be given to workers in enterprises, which increase their foreign-exchange earnings by more than 10 percent over the previous year.<sup>29</sup>

However, the bulk of such exports are sent through overloaded and often inefficient ports in coastal provinces, and are frequently sold by national corporations.

Henan has been looking to increase exports by dealing directly with foreign customers. It has targeted the USSR and Eastern Europe, which are its largest customers after Hong Kong, accounting for 21 percent of exports in 1986 compared with only 4 percent in 1984. It setup a container station in Zhengzhou, and is using this to send containers of the Trans-Siberian railway to speed up transport times-by 40 days compared with the time taken if goods are sent by the sea through China's ports.<sup>30</sup>

In 1988 parts of the central region were allowed to create zones for foreign investment with preferential treatment for foreign investors, through on a much smaller scale than in the Eastern coastal region.

The other major potential for foreign trade in the central region is energy and materials exports. Shanxi is seen very much as an energy production center in the seventh five-year plan. Its coal output is planned to increase by 90 percent and electric power generation by a factor of five.<sup>31</sup>

However, the potential for development of foreign (as well as internal) trade, is hampered by transport bottlenecks. Shanxi, in particular, could export more coal if transport were available.

#### THE WESTERN REGION:

The Western Region's involvement in foreign trade is less still than that of the central region. The most populous province in China, Sichuan, was a leader in economic reform during the late 1970s and early 1980s, but its involvement in foreign trade and related reforms is still low. There appears to have been some success in developing co-operation within this region but much less success in developing foreign trade and attracting investment.<sup>32</sup>

In fact, Sichuan's economic strategy is to concentrate on the domestic market, accepting a subordinate role relative to coastal areas in foreign economic relations.

However, it is misleading to regard the Western region as completely uninfluenced by the "open door" policy. To take but one example, in Tibet the Zhaxi Lhunbo monastery set up the Tibetan Gangjian Development Co-operation, with an investment of 3 million yuan RMB, which has signed export contracts with the United States, United Kingdom, Italy, Switzerland and Hong Kong.<sup>33</sup>

Non the less; the Western Region's involvement in foreign trade remains low.

Animal products are certainly potential export earners. Xinjiang's first joint venture is a cashmere sweater factory, which exported goods the value of more than US\$12 million in the first eight months of 1988. Another opportunity is to be found in trade with neighboring countries. For example, Xinjiang's border trade with the Soviet Union was about 5 percent of the province's total export (at SFr 17 million) in 1986.<sup>34</sup>

This may well increase when a new rail route is opened. Xinjiang also has a small amount of border trade with Pakistan, a total of US \$0.6 million in 1986.<sup>35</sup>

In the longer term, there is the potential for mineral exports of various types.

Although manufactured goods now form the majority of the China's exports, primary products are still of major importance. China is rich in many natural resources, with noteworthy reserves of many non-ferrous metals such as tungsten. It also has the largest coal reserves in the world and substantial amounts of oil. Domestic demand, especially for energy, will remain high, but there is still potential for substantial increases in export, especially of mineral and non-ferrous metals. Agricultural products are a source of export growth, well their value could be increased by processing. In regional terms, mineral and related exports would



benefit the Western and Central Regions, and agricultural exports could be expected to come mainly from Eastern Coastal Region. Given the shortages of raw materials and energy in China's domestic market, it is likely that government policies will continue to encourage the Western and Central Regions to serve the Eastern Coastal Regions needs.

The greatest potential growth is in manufacturing. Currently China's main source of advantage in manufactured is labour costs, and in some cases cheap raw materials. However, many foreign investors have found that other aspects of Chinese operations are expensive. Office and other overhead costs in cities are high, while labour productivity is often low. The level of management skills and understanding of international market requirements are often low, implying a need for more expatriate managers than would be the case elsewhere, thereby increasing total costs and making China less competitive than some countries with high labour costs.

The result is the China is often a low-wage but not a low-cost location for foreign investment. It therefore needs to increase productivity and decrease management costs for foreign investors, while also increasing the value of its own exports. This is recognized by top leaders, notably Zhao Ziyang, who argued in September 1987, the textile exports were too often of low quality, while the proportion of raw and semi-processed products were too high.

In the Eastern Coastal Region there will be demand for imported consumer goods (and not only materials and equipment) as the economy looks more to the world market. Regional autonomy and foreign exchange retention will make it more difficult for the central state to exert control than in the past. In contrast, central and western areas are likely to seek a redistribution of foreign exchange to allow upgrading of their equipment. Some of the same problems may arise at enterprise level. In the longer term, the logical solution is to increase the convertibility of the Chinese yuan so that administrative boundaries and decisions play less of a role in allocating foreign exchange to imports.

If the more export-oriented policies for coastal regions are successful, the likely outcome is that those areas develop higher wages, and lose some of their cost-advantage in labour-intensive products. This will create regional differentiation in living standards, while creating incentives for labour-intensive operations to be shifted further inland. Elsewhere, this would often mean an international move and its consequent costs. China's size makes an internal transfer less costly and hence more likely. China's regional development strategy may therefore move away from development of the Central and Western Regions, through Central investment in industry, towards development on the basis of comparative regional cost.

In terms of the categorization of the Seventh FYP, there is evidence to date of some widening of regional differences in both industry and agriculture. The changes in gross output value during 1980 to 1985 are shown in Table 3.

TABLE - 3

**Growth in output value by region, 1980-1985 (%)**

Region	Industry	Agriculture
Eastern Coastal	+ 80%	+ 52%
Central	+ 72%	+ 50%
Western	+ 71%	+ 46%

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**Source:** *"Economic Growth in different areas". Beijing Review, 8 Dec. 1987, pp.21-4.*

It indicates a clear growth in regional inequalities:

Important influences have been the role of foreign trade and investment, as well as the more rapid growth in rural industry and non-farm employment in the more eastern areas. The implication is therefore of a more dynamic and open Eastern Region, using the Central and Western Regions as sources of materials, energy and cheaper labour. Although foreign trade is by no means the only reason for that increased differentiation,

its role will not be insignificant, especially in the more export-oriented areas like Guangdong.

### CONCLUSION:

The main purpose of open-door policy was for promoting foreign trade and investment in China. Besides, economic relations were to be extended with other countries. China's exports increased during the 1980's. By mid 1980's exports were over ten times their 1970 level. During this period, China's biggest trade partner was Japan, with which 30 percent of total trade was conducted in 1985. Next came Hong Kong with 17 percent and the USA 11 percent. Trade with European countries constituted 21 percent of the total. As per open-door policy, China selected three regions viz. Eastern Coastal, Central region and Western region from the foreign trade point of view. The region wise exports are given in Table 2, and it indicates that through this policy the trade of China has been extended with the countries of the world. It is further concluded that each region has its trade relations with different countries. One could therefore expect northern and western provinces to be most concerned about improving relations with the Russia and Mongolia, while south-western ones might have similar concerns over Vietnam. In contrast, coastal provinces were concerned about relationships with capitalist economies, including Japan and the USA as well as Hong Kong and Taiwan.

Regions will have different interests in central government policies towards foreign exchange and related issues. For example, the energy producing regions of the north-west would dislike certain foreign exchange relation policies when much of their export potential is under central government control.

Coastal areas will probably seek to use the foreign exchange they have generated for consumer goods imports, while inland provinces would prefer it to be used for re-equipment of their industrial plant. Inland provinces may also be more inclined towards policies of local and national protectionism as the coastal areas become more competitive under greater exposure to international competition.



This research article has outlined the emerging regional pattern of foreign economic relations, which has arisen from China's reforms and "opening up" to the world economy. The picture is one of the greater regional differentiation with the coastal region moving towards export-orientated industrialization, notably in Guangdong, while other regions are still based essentially on their local economy. The emerging pattern is one in which coastal areas act as channels for inland ones, developing faster but relying to a large degree on inland provinces for energy and materials.

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