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Trade Policy and Trade Patterns During Transition: a Comparison Between China and the CEECs

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Politiques commerciales dans les économies en transition :
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Les démarches réformatrices différentes suivies en Chine et en Europe de l’Est au cours de la transition s’expliquent largement par les contextes différents : contexte politique interne, caractéristiques structurelles de ces économies liées à leurs niveaux de développement, impact de leur environnement international immédiat. Dans le domaine du commerce extérieur, ces différences jouent un rôle particulièrement important. Le degré d’industrialisation, la taille, la localisation géographique influencent fortement la manière dont ces pays peuvent s’intégrer à l’économie mondiale. Pourtant, malgré des stratégies de réformes radicalement différentes, la politique d’ouverture sur l’extérieur apparaît comme une composante centrale des changements autant en Chine qu’en Europe centrale et orientale. La comparaison des politiques commerciales menées au cours de la transition s’articule donc autour des questions suivantes: quels moyens ont été mis en oeuvre pour répondre un objectif identique de recherche d’une meilleure insertion internationale ? Comment ces politiques commerciales s’articulent-elles avec les stratégies globales de réforme ? Quelles contraintes internes et externes et quels types de spécialisations ont présidé à la dynamique de leurs échanges au cours de la transition ? On examine d’abord les politiques commerciales puis les modalités de l’insertion internationale de ces pays au cours de la transition.

Depuis 1979 en Chine et depuis 1989 en Europe centrale et orientale, les changements qui sont intervenus dans l’organisation des relations économiques extérieures consomment la rupture avec le passé: fin du monopole du commerce extérieur, progrès de la convertibilité, conditions favorables offertes aux investissements étrangers. Cependant, des priorités différentes ont présidé aux réformes économiques et elles se sont traduites dans les politiques commerciales : pour les pays d’Europe centrale et orientale (PECO), la libéralisation commerciale a été une pierre angulaire de la politique globale de libéralisation économique ; pour la Chine, l’ouverture a été un moyen de promouvoir la croissance et la modernisation de l’économie. Les politiques commerciales diffèrent donc non seulement parce qu’elles s’inscrivent dans des approches réformatrices plus ou moins rapides (thérapie de choc contre gradualisme) mais parce qu’elles ont obéi à choix différents de stratégie économique. Les pays d’Europe centrale et orientale ont mis l’accent sur la libéralisation commerciale et en particulier sur celle des importations car l’ouverture était un moyen d’y introduire de la concurrence sur le marché intérieur et d’aligner les prix internes sur la structure des prix mondiaux. La Chine a opéré une large décentralisation du commerce extérieur, sans libéraliser pour autant l’accès à son marché intérieur, et elle a mis l’accent sur des mesures de promotion des exportations. Leur environnement international immédiat a été pour ces pays une source d’opportunités et de contraintes spécifiques qui ont fortement influencé leurs politiques commerciales. En Europe centrale et orientale, celles-ci ont été dominées par l’objectif d’intégrer l’Union européenne, alors que la Chine a trouvé un modèle dans l’expérience des pays dynamiques d’Asie orientale.

Les performances commerciales de la Chine et des PECO sont, à première vue, très contrastées. En 1988, l'ensemble des PECO et la Chine pesaient chacun d'un poids équivalent dans le commerce international, mais en 1994 le commerce extérieur de la Chine a atteint le double de celui des PECO. Cette divergence tient essentiellement à l'effondrement des échanges intra-CAEM, car le commerce avec l'OCDE a connu, dans les deux cas, une progression rapide. Les ressorts de la poussée à l'exportation vers les marché occidentaux, ont cependant été différents : l'expansion commerciale chinoise s'opère dans un contexte de forte croissance économique interne, alors qu'en Europe centre-orientale, la percée à l'Ouest traduit au moins dans un premier temps (jusqu'en 1992-1993) la réorientation des capacités de production existantes vers de nouveaux marchés, sans augmentation de l'offre. Alors que la progression des exportations chinoises est remarquable par sa durée, on manque encore de recul pour juger de la capacité des PECO à soutenir durablement la progression de leurs exportations. Cette capacité dépendra désormais en grande partie de l'évolution de l'offre dans ces pays. A cet égard, la généralisation de la croissance à partir de 1994 qui est allée de pair avec une forte progression de leurs exportations en 1994 et 1995 tend à conforter l'hypothèse selon laquelle la plupart des PECO continueront à jouer un rôle dynamique dans le commerce international.

La croissance des exportations vers l'OCDE s'est accompagnée de changements dans leur composition par produits ; le rythme de ces changements n'a pas été plus rapide en Chine que dans les PECO, ce qui accrédite l'idée que les restructurations industrielles prennent du temps, quelles que soient les stratégies de réformes adoptées. Les modalités d'insertion de ces économies dans le commerce international demeurent contrastées : le commerce de la Chine avec l'OCDE reste fondé sur des complémentarités intersectorielles, alors que celui des pays d'Europe centrale (Hongrie, Pologne, ex-Tchécoslovaquie) est dominé par une division intra-sectorielle du travail.

Enfin, bien que les flux d'investissements étrangers directs en Chine soient de plus grande ampleur que ceux dirigés vers les PECO, la taille respective des pays fait que leur poids dans les économies internes d'Europe centrale est au début des années quatre-vingt est du même ordre de grandeur qu'en Chine. Ils jouent ainsi un rôle décisif dans l'expansion des capacités d'exportation en Hongrie comme en Chine. L'insertion internationale des pays en transition passe ainsi par leur intégration de leurs systèmes productifs dans les réseaux mondiaux de production et d'échanges.

SUMMARY

Most research works comparing the transition to market economy in China and Eastern Europe, come to the conclusion that the initial conditions explain much of the dissimilarities observed in the reform strategy as well as in the economic performance that have characterised the two areas. The differences in their the level of economic development, in their size, in their international surroundings are of special significance regarding the foreign trade policies and patterns as they directly affect the way the CEECs and China can be integrated in the world economy. Nevertheless, although the countries have chosen different approaches to market reforms, opening up to international trade has been a key element of their transition. The comparison in this field raises several questions: through what means these highly different countries have pursued the same target and have intensified their involvement in international trade and capital flows?, how have their trade policies been connected with their overall reform strategy?, how domestic and external constraints have influenced their trade performances and what prospects can be drawn from their evolving position in world trade?

The paper first sketches out the experiences of the CEECs and of China concerning trade policy and trade reforms and then turns to trade development and to the changes in their trade patterns during the transition period.

The trade reforms that have been implemented in China since 1979 and in the CEECs since 1989 have displayed some similar features: demonopolisation of foreign trade, progress toward convertibility, provisions to attract foreign direct investments. But the opening up of domestic economies responded to different concerns and priorities. For the CEECs, trade liberalisation has been a cornerstone of overall economic liberalisation. For China, opening-up has been a means to promote economic growth and modernisation. The differences in trade policies can be traced back to the respective global strategies of reforms that implied not only different timing (radical changes versus gradualism) but also different policy choices. The CEECs have emphasised trade liberalisation and namely import liberalisation as an instrument to enhance competition from outside, and to import the world relative prices. China has emphasised the decentralisation of foreign trade decisions, but this has fallen short of import liberalisation, and it has implemented export promotion measures. The international environment and the regional context have provided these countries with specific opportunities and constraints that influenced their strategies. While the CEECs have emulated European trade regimes with the aim of integrating the European Union, China’s trade policy has found an attractive model in the East Asian countries experiences.

Since the beginning of the 80s, China and CEECs foreign trade have displayed diverging trends. In 1988, the CEECs taken together had about the same weight in international trade as China and in 1994 China’s foreign trade was about twice as important as the CEECs trade. But to a large extent this gap results from the collapse of intra-CMEA trade and in both cases the trade with the OECD has increased rapidly. Nevertheless, the engine of the export drive to the OECD has been different: in China, it has been supported by a high rate of economic growth, whereas in the CEECs, the export capacities have been reoriented

towards new markets while the production has been falling, up to 1993. China has sustained this export drive during fifteen years, and the times series are still too short to draw a definite assessment of the CEECs export performance that will now depend on the supply side. The economic recovery that has spread to all the CEECs since 1994 and has been associated with sustained export performance gives ground for considering that in the years to come most CEECs are going to keep a dynamic part in international trade.

In both the CEECs and China, the development of export was accompanied by substantial changes in their commodity composition. The pace of these structural changes has not been faster in China than in the CEE, and this tends to confirm that export and industrial restructuring takes time in any reform strategy. A major difference lies in the relative importance of intra versus inter industry trade: China's trade with OECD is still based on inter-sectoral complementarities, while intra-industry trade prevails in the case of the Central European Countries (Hungary, Poland, fermer CSFR).

Finally, although foreign direct investment flows to China have been much larger than those going to Central European countries, due to the small size of the latter, their role in their domestic economy was as important as in Chinese economy in 1992-1993. In Hungary and in China, they form the core of the foreign trade sector. The expansion of foreign trade is thus a part of a trend towards the internationalisation of the transition economies, which have been more and more integrated in the world-wide productive and trade networks of foreign firms.

TRADE POLICY AND TRADE PATTERNS DURING TRANSITION: A COMPARISON BETWEEN CHINA AND THE CEECS[1]

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INTRODUCTION

Most research work comparing the transition to a market economy in China and Eastern Europe, come to the conclusion that the initial conditions explain much of the dissimilarities observed in the reform strategy, as well as in the economic performance that has characterised the two areas (*Sachs*, *Csaba*). The differences in their level of economic development, in size, and in their international surroundings are of special significance regarding their foreign trade policies and patterns as they directly affect the way the CEECs and China can be integrated in the world economy.

Nevertheless, the comparison of trade policies and trade patterns during transition is relevant if it is for only one reason: although the countries have chosen different approaches to market reforms, opening up to international trade has been a key element of their transition. The comparison in this field raises several questions: through what means have these highly different countries pursued the same target and intensified their involvement in international trade and capital flows? How have their trade policies been connected with their overall reform strategies? How have domestic and external constraints influenced their trade performance and what prospects can be drawn from their evolving position in world trade?.

This paper first sketches out the experiences of the CEECs (the four Visegrad countries, Bulgaria and Romania) and of China concerning trade policy and trade reforms. It does not enter into the details of the liberalisation measures in each CEECs since the aim is not to compare their respective trade policies but to point out their broad outlines in order to highlight the similarities and dissimilarities between the East-European and Chinese trade strategies. Two opposite approaches emerge: liberalisation (CEECs) versus decentralisation (China), and import liberalisation (CEECs) versus export promotion (China).

The analysis then turns to trade development and to the changes in the trade patterns of the CEECs and of China during the transition period. Two factors introduce a bias in the comparison of trade performance. First, the time lag: China began its economic transformation in 1979, that is ten years before the CEECs (1990). Although the time series appear to be rather short to make a definite assessment of the CEECs trade strategy,

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the few years of transition have already induced major changes in their trade performance. Second, the impact of the CMEA collapse for the CEECs. To avoid this latter bias the analysis focuses on the export trends to OECD markets. It points out that some of the CEECs have, up to now, registered export growth to OECD that is not dissimilar to that of China during the first years of its transition. This raises the question of the CEECs' ability to sustain this export drive in the long run, as China has done during the last 15 years. The answer will depend on the CEECs economic growth and industrial restructuring. It will also depend on FDI flows into these countries although their experience suggests that an increase in FDI flows to the CEECs can be only one of the elements contributing to their economic growth and trade expansion.

I. TRADE LIBERALISATION AND TRADE POLICY

A lot of studies assess the CEECs trade liberalisation and trade policy (*Drabek and Smith, EBRD (1994), Messerlin, Toth, Winters*); other studies analyse the China's opening up (*Fukasaku and Solignac Lecomte, Fukasaku and Wall, Lardy, World Bank (1994)*); but few take a comparative approach (an exception is *de Ménil*). This part of the paper brings together the conclusions drawn by the different analyses of the CEECs' and of China's trade policy, and highlights the similarities and differences.

1.1. Similarities

1.1.1. Initial Institutional Setting

In the CEECs as in China, the trade reforms broke away from their inherited, centralised and inward-looking economic system. Prior to the beginning of the reforms, the organisation of foreign trade in China followed closely the Soviet model, and foreign trade activity remained completely under central control. This contrasted with the situation in other areas of the Chinese economy, where the hold of central planning was less comprehensive, due to the size of the country, its level of development, and as a result of Maoist policies that promoted decentralisation. On the eve of the reforms in China (1978) and in the CEECs (1988), foreign economic relations thus had a similar institutional setting, and were run in the same centralised way. This was associated with a strategy of import substitution.

There were nevertheless some differing features. Limited foreign trade reforms had been implemented in the 1970s and 1980s in the CEECs: for instance, some big industrial firms enjoyed foreign trade rights, and foreign direct investments were allowed in some countries. But these reforms had a marginal impact on the CEECs foreign trade. A more significant difference in their respective situations came from the fact that a large fraction of the CEECs foreign trade was locked into the CMEA, whereas most of China's trade took place with market economies. In contrast to China, the CEECs trade liberalisation thus implied a breakdown of the institutional and economic dependencies established in the CMEA (*Csaba*).

1.1.2. De-Monopolisation, New Entrants

A common feature of the reforms, in China and in the CEECs, was the de-monopolisation of foreign trade that allowed new entrants in foreign trade activity. As Georges de Ménil puts it "the dismantling of central planning, the introduction of decentralised initiatives (...) uncovered large, previously hidden opportunities for commercial gains, and unleashed previously suppressed entrepreneurial energies" (*de Ménil*).

In the CEECs, as the state monopoly on foreign trade and foreign currencies was ended in 1990 or 1991, and as foreign trade corporations were dismantled, all firms and individuals could take part in export and import operations. The number of firms engaged in foreign trade increased. Private enterprises grew rapidly, especially in import activities. As large industrial entities were split up and new enterprises were created, the concentration of exports on a few exporters declined strongly **(Table 1.1.)**.

Table 1.1.
The Growing Number of Exporting Firms in Manufacturing Industry

	Czech Republic		Hungary		Poland	
	Total Firms	Export. Firms	Total Firms	Export. Firms	Total Firms	Export. Firms
1989	613	482*	4.000	...	4.651	2.619
1991	...	...	9.660	2.576	11.100	2.865
1992	1.759	1.342	11.670	3.582	...	...

Source: National Statistic Office and Ministry of Finances.
* Firms exporting in convertible currencies.

In China, the reforms progressively relaxed the monopoly on foreign trade. In 1984, "the provincial branches of the national foreign trade corporations (FTC) became independent financial, operating bodies, and each province was allowed to create its own FTC" (*World Bank, 1994*). As a result the number of foreign trade corporations increased from 12 in 1978 to about 1.000 in 1986 and to 9.000 in 1994. This generated increased competition upstream and downstream: FTCs had to compete for foreign markets, and had also to compete for domestic supply as production units progressively acquired the capacity to choose their FTC (*Lardy; Zweig*). Nevertheless, beyond the joint-ventures with foreign capital, a number of production firms, the big exporters, were given the right to carry out foreign trade operations directly.

In China and in the CEECs, the most dynamic part of foreign trade activity was located outside the state sector, and this non-state sector accounted for an increased share of trade flows **(Table 1.2.)**. In the CEECs, the increased share of private firms in foreign trade resulted from the creation of new private firms and from the privatisation process. In China, township and village enterprises (TVE) became important suppliers of goods for exports. In the CEECs, as in China, joint-ventures with foreign capital gained increased importance both in exports and imports **(Table 1.3.)**. In fact joint-ventures and the non-state sector are two overlapping categories and their respective roles in foreign trade cannot be assessed specifically. Despite these changes, the State-owned enterprises still retain an important position in export supplies in China, in Poland and in the Czech Republic. This confirms the fact that in the area of foreign trade the SOEs were also able to adjust their behaviour to the new incentives (*Naughton*).

Table 1.2.
The Private (Non-State) Firms in Foreign Trade

	1992	1993	1995	
	Czech Republic	Poland	Romania	China
Private (Non-State) Firms				
In % of Exports	7.5	44.0	40.9	29.0
In % of Imports	...	59.8	47.4	52.0

Sources: Czech Republic: Kolanda; Poland: OCDE, 1994; Romania: Monthly Bulletin of Statistics; China: Customs Statistics.

Table 1.3.
Joint-Ventures in Foreign Trade

	In % of Exports		In % of Imports	
	Hungary	China	Hungary	China
1986	...	1.6	...	...
1988	6.5	...	3.7	...
1990	11.3	12.5	9.1	...
1992	30.4	20.4	32.8	...
1993	35.0	27.5	...	...
1994	50.0	28.6	...	45.8
1995	...	27.0	...	48.0

Source: Hungary: Hamar (1993); Holcblat (1995); OECD (1995); China: Lardy (1994); Customs Statistics 1995.

1.1.3. Toward Currency Convertibility

The liberalisation of the foreign exchange system has been a component of the trade policy. The CEECs introduced convertibility for current account operations in one stroke, and have adopted different exchange rate regimes since then. The progress toward convertibility has been much slower in China (*Chen)*. As a first step, swap markets for foreign currencies were established in the mid-80s and they progressively enlarged the scope of their operations; on 1 January 1994, the official and market exchange rates were unified, but this still falls short of the convertibility for current account operations that is expected to take place in 1996.

All transition countries resorted to devaluations in order maintain their export competitiveness and protect domestic markets. In most CEECs, the initial devaluations were followed by the reappreciation of the currencies (*IMF, 1994 (c)*), but in China, the real exchange rate of the RMB depreciated steadily (*Lardy; World Bank, 1994*). In 1993, the exchange rate deviation index (*ERDI*), which measures the discrepancy between the current exchange rate and the Purchasing Power Parity exchange rate, was much higher for China than for the CEECs **(Table 1.4.)**. This does not come as a surprise, since it is generally observed that the lower the level of per capital revenue, the larger the ERDI.

Table 1.4.
Exchange Rate Deviation Index*

	1993
China	0.17
Bulgaria	0.36
CSFR	0.42
Hungary	0.67
Poland	0.46
Romania	0.41

Source: CEPII, Chelem Data Base.
* Current exchange rate/purchasing power parity exchange rate.

1.1.4. Attracting FDI

For transition countries, foreign direct investments have been considered as essential to ensure their successful integration into the world economy.

In China, attracting foreign direct investments has clearly been a priority of the trade policy. The first measure of the opening-up policy was to allow in FDI, and to create special economic zones to attract foreign investors. The policy toward FDI included both strong incentives, as well as severe constraints. Joint ventures benefited from tax exemptions and reductions, along with concessional import duties (*World Bank, 1994*). These preferential schemes were applied selectively, depending on the industrial branches and geographic areas in question. The “open zones” were progressively extended to a large part of the coastal area. But currency inconvertibility, and the requirement to balance their foreign exchange operations has been a major obstacle for foreign investors. The development of Foreign exchange adjustment centres (FEACs), since the middle of the 1980s, has been a way to alleviate the difficulty.

The CEECs have also tended to attract inflows of foreign capital but expected them to result mainly from their economic liberalisation. In the CEECs, currency convertibility for current account operations and the free transfer of profits have been a decisive move for foreign investors. In the first years of the transition, preferential fiscal treatments for foreign investors also aimed at attracting foreign direct investments. A general tendency in Central Europe has nevertheless been to reduce these fiscal concessions and to provide equal treatment for domestic and foreign enterprises. Some preferential measures may be still granted on a case-by-case basis (Poland; Hungary). Institutional incentives have evolved towards streamlining administrative controls (from authorisation to simple registration of FDI). Trade policy has also been used actively to attract foreign capital since measures to protect the domestic market have been taken, frequently under the pressure of the foreign investors (*EBRD (1994); Messerlin*).

1.2. Differences

Integration into the world economy has been a common target of the reform policies in the CEECs and in China. But the opening up of domestic economies has responded to different concerns and priorities. For the CEECs, trade liberalisation has been a cornerstone of overall economic liberalisation. For China, opening-up has been a means to promote economic growth and modernisation. The differences in trade policies can be traced back to the respective global strategies of reforms that implied not only different timing (radical changes versus gradualism) but also different policy choices. The CEECs have emphasised trade liberalisation and especially import liberalisation; China has emphasised the decentralisation of foreign trade decisions and export promotion policies. The international environment and the regional context also have provided these countries with specific opportunities and constraints that have influenced their strategies (*EBRD, 1994*).

1.2.1. Imports: Liberalisation Versus Decentralisation

The CEECs

In the Central European countries (Hungary, the Czech Republic, Slovakia and Poland), "trade liberalisation was accomplished in a record time" (*Sapir, 1995*). Between 1989 and 1991, the trade monopoly was abolished, quantitative restrictions on imports sharply reduced or eliminated for most industrial products, and in contrast to what often occurs in the first stage of trade liberalisation process, the termination of quantitative restrictions was not associated with raising tariffs (*Toth, 1992*); tariff barriers were set at a low, or moderate level (*IMF, 1994 (b)*). Currency convertibility for current account operations complemented this liberalisation package. The protection of domestic markets relied on sharp devaluations of the national currencies, and to some extent on the differentiation of tariff rates according to the degree of processing (*OECD, 1994 and 1995*).

The choice of a policy favouring rapid import liberalisation can be explained by several factors. First, the CEECs import liberalisation was part and parcel of their overall liberalisation strategy. Its main aim has been to enhance competition from outside, in order to counter the effects of a highly-monopolised industrial structure, and to import the world relative prices (*Sapir*).

Second, it could also be argued that as the real comparative advantages of Central European economies were highly uncertain, it was thus less hazardous to let them emerge under market forces and competition (*Audretsh*). Furthermore, import liberalisation was also meant to stimulate sectoral modernisation and eventually export capacity.

The lack or the inefficiency of pressure groups in the initial phase of the transition made it possible to enforce such a policy, all the more so that its consequences may not have been fully understood (*Sapir, 1995*). At the same time, "the role of certain elites (among them economists), and the general advice the CEECs were receiving" were among the major forces pushing in favour of trade liberalisation (*Messerlin*).

Thus both the domestic political situation and external pressures resulted in initial, rapid import liberalisation, despite the arguments that could have been put forward in favour of a more cautious approach and of some degree of protection. These arguments could be based on macroeconomic considerations (to increase fiscal revenue and to ensure foreign trade balance) as well as on microeconomic ones (to protect infant industries, to allow for a gradual phasing out of declining industries, and to give some time to the restructuring of potentially competitive firms).

Nevertheless, pressures in favour of an increased protection began to emerge very soon after this initial radical liberalisation, and they led to reversals in trade policies (*Drabek and Smith, Messerlin, Toth, Csaba*). This general trend was reinforced by the recession, which was much more severe than expected, by the rise in unemployment and in some cases by the deteriorating balance of payments (Poland in 1992; Hungary in 1995). The revival of pressure groups (domestic enterprises and joint ventures) has tended to strengthen this move. This has led the authorities to raise the level of tariffs, and to resort to different instruments of protection: border barriers (fees, quotas, quality controls) and non-border protection measures (discriminatory domestic taxes on imported goods, standards) (*Messerlin*).

These reversals can be interpreted as the indirect effect of a too-rapid liberalisation. In the mid-nineties, the tariffs levels of the different CEECs range from a low level, comparable to that of industrial countries (as in the case of the Czech Republic), to relatively high levels, close to those of developing economies **(Table 1.5.)**. As the European Union now accounts for about half of the CEECs total trade, the Association Agreements that provide for further tariff liberalisation will continue to be a powerful means to influence CEECs trade policies (*Sapir*). As the move toward tariff reductions may go together with the use of contingent protection, their trade regimes will converge with that of the West European economies (*Messerlin*).

China

In China, the open-door policy was initiated as early as 1979, and gained momentum in the second half of the 1980s, and again in the early 1990s, in phase with the overall economic reforms. It introduced far-reaching changes in the field of FDI (see above) and favoured export-oriented activities. But on the import side, liberalisation measures clearly lagged behind (*World Bank, 1994; Fukasaku, 1995*).

Table 1.5.
Tariffs on Industrial imports

	(Weighted Average)
Industrial Countries*	5.0
European Union	5.7
Japan	1.9
United States	5.4
Czech Republic	4.5
Hungary (1995)	13 + 8% surcharge
Poland (1995)	9.2 + 6% surcharge
Bulgaria (1995)	16.0
Romania (1995)	7.0
China (1995)	32.0
Brazil	15.0
India	54.0
Thailand	35.0

Source: IMF (1994) (b); WIIW (1995).
* Pre-Uruguay Round.

In the early 1990s, the import regime displayed the following characteristics:

a) The foreign trade reforms led to a phasing out of mandatory planning and to a decentralisation of decision-making and of responsibilities *(Lardy, 1992; Fukasaku and Wall, 1994*). The scope of the foreign trade plan was reduced, and in 1992, mandatory planning covered less than 20% of imports. "The process of scaling down the plan has been accompanied by the decentralisation of responsibility for implementing the plan, and by an increased number of foreign trade companies, mainly at local level" (*World Bank, 1994*). The activities of these foreign trade companies remained subject to administrative control (local or central).

b) The level of protection remained high. It resulted from the high tariff rate, which stood at 32% (weighted average) but also from multiple and overlapping, non-tariff barriers, administered by the national or provincial authorities. In 1992, these included:

- import licensing (covering 25% of total imports in 1992);
- import rights given to one, or a few FTC for specific products (this channel concerned 32% of imports);
- direct control on imports of some commodities in the sector of machinery and equipment (this covered about 7.7% of imports);

- foreign exchange allocations: imports outside the plan were indirectly regulated through the control of enterprises' access to foreign currency. The authorities controlled about 50% of imports in this way.

According to the memorandum of understanding on market access signed with the US in October 1992, China has committed itself to dismantle most of these barriers. The measures it has committed itself to take are among those being considered by the members of the WTO, who are examining China's membership. These measures amply show that China' trade regime was still very far from liberal. They included: publishing trade laws and regulations; restrictions on internal directives, identifying agencies involved in the import-approval process, lower tariffs, and the elimination all import licensing requirements, quotas and controls by 1997.

c) As the implementation of the trade policies has become decentralised, assessing the precise degree of liberalisation is complicated. The whole system of tariffs and non-tariff barriers is characterised by a low degree of transparency and a lack of neutrality (*Panagarya, 1993; IMF, 1993*). The tariffs are set at a high level, but there are many tariff exemptions that benefit exporters: the materials and components imported for export processing, as well as equipment and machinery imported by joint-ventures and by export processing enterprises are exempt from customs duties. As a result of these concessions, which encompass half of all imports, the tariff revenue actually collected as a percentage of total imports declined steeply during the transition, and the ratio stands much below that of the CEECs **(Table 1.6.)**. The level of actual protection provided by tariffs appears to be extremely low in China.

Table 1.6.
Revenues Collected from Customs Duties

(Tariffs/Imports %)

	1991	1992	1993	1994
Hungary	...	10,7	10,7	9,7
Poland	10,4	12,2	12,9	10,0

	1978	1983	1988	1993
China	15,3	12,8	7,5	4,3

Sources: National Statistics.

While the CEECs trade regime tends to follow the European model, China's trade policy is moving along the track of the Asian fast-growing countries (*Fukasaku, 1995*), where import liberalisation has been slow (*Helliwell, 1994*) and trade regimes could be defined as "mixed" (*World Bank, 1993*). China's present trade regime looks to be very different from that of the CEECs, and close to that implemented by the NIEs. The bias in favour of exports in the China's trade regime reinforces these characteristics.

1.2.2. Export Policy

The CEECs

In the CEECs strategy, the export policy relied mainly on macroeconomic instruments, namely on the exchange rate policy. As part of this logic, the domestic and trade liberalisation process, and the macroeconomic policy were to provide the necessary and sufficient conditions to stimulate exports. The initial sharp devaluations of domestic currencies were intended to ensure a balance in trade through dampening import demand, and supporting the competitiveness of exports. In face of high domestic inflation since 1992, the real exchange rates have tended to appreciate, putting at risk competitiveness and forcing some countries to subsequent devaluations.

The Association Agreements with the EC, as well as the free trade agreements with the EFTA countries were an important part the CEECs' trade policies. They provided their industries with better access to Western European markets and this stimulated cooperative links between Western and Eastern European firms.

Of course some indirect subsidies to industrial firms still exist (through non-performing loans and fiscal arrears), as do incentives apply to subcontracting and assembling (tariff rebates on inputs) (*OECD, 1994*), and these operations have played a decisive role in the export expansion of sectors such as textiles (*Lemoine, 1995 (b)*). But the CEECs have not designed selective export policies. Specialised agencies for export financing were created recently (1994 in Hungary; 1995 in the Czech Republic). As mentioned above, many factors including the uncertainty about the CEECs comparative advantages have inhibited the design of selective export policies, but the rejection of any kind of industrial policy may now appear too radical (*Portes, 1995*).

China

By contrast, export promotion was at the core of the Chinese strategy of opening up. Since its very inception, it has aimed at developing a modern export sector. This strategy was supported by the existence of strong comparative advantages in labour intensive industries. As Audretsh pointed out such traditional industrial policies, with selected targets (firms or industries), proved to serve well in a situation of industrial catching-up, where comparative advantages are relatively evident (*Audretsh, 1995*).

The export-oriented strategy relied on a broad set of devices:

Export plans were progressively phased out and were abolished at the beginning of the 1990s (*World Bank, 1994*), but they were replaced by different instruments that combine to form a vigorous policy of export promotion. Contracts signed by the Foreign Trade Corporations with the Ministry of Foreign Trade and Economic Relations set the targets for foreign exchange earnings. As an incentive for implementing these foreign exchange targets, exporters were allowed to retain a fraction of these foreign currency earnings *(Chen)*. The retention schemes were highly differentiated, according to geographic locations and industrial sectors. The reform of foreign exchange since January 1994 has abolished the retention scheme, and all exporters are required to change all their foreign currency earnings. In return, buying foreign currency for import purposes was to be mode easier. Under the new foreign exchange guidelines the RMB is “conditionally” convertible for certain trade transactions. This means that a Chinese importer with a valid import contract and required licenses or quota permits can, in principle, purchase foreign exchange without receiving prior authorisation from the State Administration Exchange Control.

Another incentive scheme relied, as mentioned above, on tariff exemptions and concessions that were implemented to stimulate export-oriented activities. Furthermore, in the second half of the 80s, the authorities have created “production networks for exports”, in order to stimulate high-performing enterprises, in selected industrial sectors, using investment financing and the guaranteed supplies of inputs. Lastly, the policy of attracting FDI also has aimed at expanding export capacities as joint-ventures are required to balance their foreign exchange imports and exports.

Up to the mid-nineties, China and the CEECs followed diverging trade policies. In China, the reforms consisted in a decentralisation of foreign trade decisions that allowed for a wide range of direct and indirect controls on imports, and that was accompanied by export incentives. In the CEECs, import liberalisation has been a key element in the transition to market economy, and a selective export policy did not appeared to be a prime concern of the trade policy during the first years of transition. China has found an attractive model in the East Asian countries experiences, whereas the CEECs tended to emulate the trade policies of the Western European countries.

In November 1995, China announced major trade reforms that include substantial tariff cuts that would reduce its average tariffs to 24-25%; as well as the elimination of quotas, licences and other import controls on over 30% of the commodities subject to such restrictions. These measures together, with the new policy towards foreign direct investments (that intends to remove the preferences enjoyed by the coastal provinces and export-processing operations) would mean a substantial change in China's trade policy. They would reduce the bias in favour of exporting activities and lead to a readjustment of imports in favour of domestic demand.

II. TRADE PATTERNS

2.1. Global Trade Performance

Since the beginning of the 80s, China and CEECs foreign have trade displayed diverging trends. CEECs have lost ground in world markets during the 80s and this decline accelerated in the first half of the 90s as a result of the CMEA collapse. In contrast, China’s trade has expanded much more rapidly than world trade, and has accelerated since the end of the 80s.

In 1988, the CEECs taken together had about the same weight in international trade as China, but the gap widened afterwards, and in 1994 China’s foreign trade was about twice as important as the CEECs trade **(Table 2.1.)**.

Table 2.1.
CEEC and Chinese Trade as a % of World Trade, 1980-1994

	1980	1985	1988	1989	1990	1991	1992	1993	1994
China									
Exports	1.0	1.5	1.8	1.8	1.9	2.1	2.3	2.5	2.9
Imports	1.1	2.9	2.0	2.0	1.6	1.9	2.2	2.8	2.8
CEECs									
Exports	2.6	2.5	2.0	1.7	1.5	1.3	1.2	1.2	1.3
Imports	2.8	2.4	1.8	1.6	1.4	1.3	1.4	1.5	1.5

Source: CEECs: ECE, UN. 1994. China: China Customs Statistics; World Trade: IMF, Direction of Trade.

The fall in the CEECs' export and import levels from 1989 to 1992 reflected the collapse of CEECs trade with the CMEA, which used to be a major market for their industrial products. In 1994, the CEECs share in world trade was still below their share in 1989. More precisely, in 1994, trade flows of Central European countries (former-CSFR, Hungary, Poland) had recovered their pre-transition level, thanks to the redirection of their trade toward the OECD countries, but this was not yet the case for Bulgaria and Romania, which have not succeeded in compensating for the loss of Eastern markets (**Table 2.2.**).

Table 2.2.
CEECs Trade: 1988-1994

(In 1994, in % to 1988)

	CSFR	Hungary	Poland	Bulgaria	Romania
Exports	126	107	117	53	67
Imports	143	156	168	51	117

Source: ECE, 1995; WIIW, 1995.

During the period, the openness of these countries measured by the share of exports in GDP did not display any well defined trends, as several factors came into play: the changes in the overall export level, the fall of domestic output, and the exchange rate movements **(Table 2.3.)**.

This instability contrasts with the steady increase in the degree of openness of the Chinese economy, measured by the export/GDP ratio which reflects both accelerated growth of foreign trade and the devaluation of the currency. As a result, with exports accounting for more than a fifth of GDP, China’s economy appears more open than Poland or Romania in 1993, despite its size. It must be mentioned that the high share of exports is inflated by the undervaluation of the Renminbi's current exchange rate, and that at the Purchasing Power Parity exchange rate, this share would be around 5-7%.

Table 2.3.
CEECs and China: Degree of Openness

(Exports as % of GDP)

	1988	1989	1990	1991	1992	1993	1994
Ex-CSFR	25	23	23	33	32	32	33*
Hungary	35	33	29	31	29	23	26
Poland	21	18	29	19	16	17	18
Bulgaria	33	31	25	33	37	35	41
Romania	22	19	12	15	19	19	21

	1978	1983	1988	1991	1992	1993	1994
China	6.7	10.0	16.4	19.0	20.3	21.6	23.7

Source: World Bank, 1995 and National Statistics.
* Czech Republic: 33%; Slovakia: 34%.

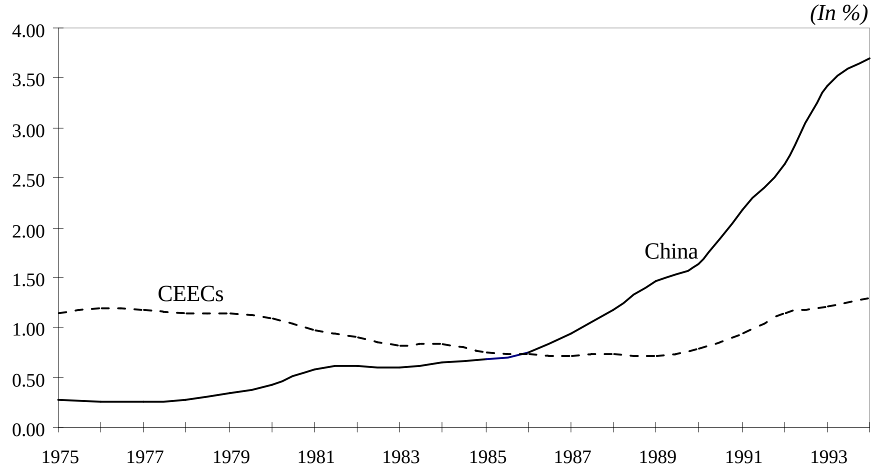
Given the disruptions that affected the CEECs trade during the initial phase of their transition, it seems more relevant for the sake of comparison with China to focus on the trade with OECD. The OECD area has been the main target of the CEECs' as well of China's export drive during transition, and it now accounts for an overwhelming share of their total trade: more than two thirds of the CEECs exports and imports; 80% of China's exports and 60% of its imports (according to the CEPII's data base, China's trade with the OECD includes the trade flows with the OECD countries that pass through Hongkong). The trends observed in their trade with the OECD thus provide a significant indication of their performance and position in international trade.

2.2. Export Trends to the OECD

For China, as well as for the CEECs, the trade policy associated economic reforms has led to a rapid increase in exports to OECD markets. For the CEECs, this trend was all the more remarkable given that it was in sharp contrast with their past performance: their share in OECD markets had been shrinking regularly since the mid-70s and began to increase rapidly in 1990. By 1994, this reversal brought them back to the position they held in OECD imports in 1975 **(Graph)**.

Graph
China and the CEECs in OECD Imports
(Manufactured Industrial Products)

(In %)



In China, the reforms began about ten years before those of the CEECs (1979 versus 1989), and China's international trade has thus benefited from the policy of opening up during a time span about three times as long as that of the CEECs. This time lag should be taken into account in assessing trade developments. Even assuming that the reform strategy undertaken in the CEECs should bring about more rapid changes than the gradualist approach implemented in China, it would not be appropriate to compare the outcome of five years of foreign trade liberalisation in the CEECs with the outcome of fifteen years of foreign trade reforms in China, since it is now well established that restructuring exporting industries requires time.

To overcome this asymmetry, the analysis of China's trade has been divided into three periods of five years, which correspond to the different phases of China's economic reforms: 1978 to 1983; 1984 to 1988; and 1988 to 1993/1994. This allows the development of the CEECs trade in their first five years of transition to be compared with that of China during these different periods.

Rapid growth and significant commodity changes characterise the CEECs' and China's exports to OECD.

The Rapid Increase in Exports

Since 1988, most CEECs recorded rapid growth of their exports to OECD **(Table 2.4.)**. From 1988 to 1994, the exports of the Visegrad countries taken together more than doubled. Among the CEECs, the ex-CSFR, Bulgaria and Poland registered the greatest increase. Hungary lagged behind, while only Romania experienced a fall in exports.

Table 2.4.
The CEECs' and China's Exports to the OECD
Average Annual Change

(In %)

	Exports	
	Total 1988 to 1994	Manufacturing Ind. 1988 to 1993
Former CSFR	19.3	22.9
Hungary	9.0	14.5
Poland	13.0	20.1
Bulgaria	15.8	23.0
Romania	-7.2	-2.0

China's Exports	1978 to 1983	1984 to 1988	1989 to 1993	1978 to 1993
Total	21.3	21.5	23.4	21.8
Manufacturing Ind.	23.9	33.0	29.7	28.8

Source: CEPII, CHELEM Database; OECD.

China's export performance stands above the CEECs' average, but it is not so much ahead of the best CEEC exporter, namely the ex-CSFR. In the first years of reform, the trade results achieved by the CEECs that performed the best in OECD markets were not so different from the Chinese ones. From 1988 to 1994, CSFR annual export growth to the OECD reached nearly 20% per year, whereas China's annual export growth stand at around 22% per year from 1978 to 1993.

The Engine for Export Growth: Manufacturing Industry

The analysis will focus on manufactured industrial products, since the trade of raw materials and agricultural products is influenced by external factors that are not connected with trade competitiveness: changes in oil prices in the case of China's exports and restricted OECD market access in the case of agricultural and food products from the CEECs.

For the CEECs, as well as for China, the manufacturing industries stood at the centre of their export drive, while the share of raw materials, energy, agricultural and food products declined. This shift toward manufactured exports accelerated in the case of China, during the second half of the 1980s (**Table 2.4.**).

From 1978 to 1983, the growth rate of China's manufactured exports stood at 24%, whereas from 1988 to 1993, the growth rates achieved by three CEECs (the former-CSFR, Poland, Bulgaria) were above 20%. Thus, the immediate first phase of the gradualist strategy in China cannot be credited with much better results than the rapid liberalisation in the CEECs. During the five first years of their transition, the CEECs' exports to the OECD were boosted by the trade liberalisation measures, and by their shift away from CMEA markets, whereas in China the changes affecting the organisation of trade were still very limited in the early 1980s, and the export drive was mainly the result of central government policy. At that time, the fate of Chinese economic reforms and of opening up was still uncertain, and vulnerable to political shifts and policy changes, and consequently FDI remained at a low level.

China's exports of manufactured products accelerated in the subsequent phases of economic reform. From 1983 to 1988, domestic economic reform gained momentum and far reaching changes were implemented in the organisation of foreign trade, together with a bold export promotion policy (decentralisation of foreign trade operations to local FTC, as well as de-monopolisation, devaluation and the creation of foreign exchange adjustment centres, the generalisation of the foreign exchange retention schemes, and a multiplication of "open areas" in the coastal provinces). As a result of specific measures to attract FDI, and of the increased confidence of foreign investors in the Chinese economic strategy, the inflow of FDI started to expand rapidly.

Two conclusions can be drawn from this comparison:

> 1) the first phase of transition in both areas created a push in exports, although for different reasons. In China, the export drive took place in a context of strong economic growth, that was supported by a high rate of investment and large inflows of labour into industry. In the CEECs, the export drive towards OECD resulted from the redirection of trade away from CMEA, and was achieved despite a deep industrial recession that lasted until 1992-1993.
>
> 2) Up to 1994, the export performance of some of the CEECs was roughly in line with that of China during the initial period of its gradualist strategy. It must now be asked whether the CEECs will be able to sustain this pace in the long run, as China has done. Their export prospects will now depend on supply side factors. The economic recovery that started in Poland in 1992 spread to all the CEECs in 1994. It was associated with sustained export growth in 1994 and in 1995. This supports the belief that these countries will play a dynamic part in international trade, and mainly in European trade in the years to come.

2.3. Changes in the Commodity Structure of Exports

In both the CEECs and China, the development of exports was accompanied by substantial changes in the commodity composition of exports. An index of structural changes can be calculated as the sum of the differences in the commodity structures in 1988 and 1993, measured in absolute terms. It shows that the structural changes in CEEC exports were of the same magnitude as those which occurred in China's exports, in each five year period. This tends to confirm the fact that gradualism is a matter of necessity in export restructuring as well as in other areas of economic transformation, as pointed out by Zecchini (*Zecchini, 1995*) **(Table 2.5.)**.

Table 2.5.

Index of Structural Changes in Exports to the OECD*

	Total Exports	Manufactured Exports
CEECs 1988-1993		
CSFR	58	54
Hungary	46	43
Poland	49	43
Bulgaria	63	68
Romania	72	47
China		
1978-1983	47	48
1984-1988	60	49
1989-1993	58	36
1978-1993	120	91

Source: CEPII, CHELEM database.
* Sum of absolute differences in the commodity structures:
Sum (i) = (Share (i,t) - share (i, t-5), where (i, t) is the sectoral share of the sector i, in year t.

Research work on the commodity pattern of CEEC exports during the transition period has pointed out some disappointing developments (*Faini and Portes, 1995; European Commission, 1994; Landesmann, 1995*). First, exports in engineering industries have shown some retrenchment, due to the loss of Eastern markets and to the fact that these industries could not find alternative Western markets to compensate for this loss. Second, the CEEC export structure to the West has shown relative inertia as the CEECs have not succeeded in increasing their market shares in new sectors; instead, they have relied on the comparative advantages, inherited from the pre-transition era, in capital intensive, low-tech industries, and in exports of labour intensive products.

The changes in the commodity composition of their exports to the OECD **(Table 2.6.)** confirm that for all the Central European countries (ex-CSFR, Hungary, Poland,) the export drive has been led by labour intensive industries (such as clothing, leather or furniture). But they also provide evidence that several branches of machinery have also been among the fastest growing export sections. This was the case of electrical equipment, cars, commercial vehicles and engines in the exports of the ex-CSFR; for electrical equipment and appliances, telecommunications equipment, engines, in Hungarian exports; and for cars and electrical appliances in Polish exports. The importance of equipment goods increased substantially in ex-CSFR and Hungarian exports. Although this trend towards a diversification of export structures may still appear limited and vulnerable (dependant on FDI and on cooperation with Western firms), it nevertheless points to emerging, new export capacities in Central Europe.

Table 2.6.

Commodity Changes in Central Europe an Exports to the OECD in Manufacturing Industry: The Ten Commodities That Registered the Largest Increase in the Export Structures From 1988 to 1993*

Hungary		CSFR		Poland	
Electrical Appliances	4.8	Miscel. Hardware	2.9	Clothing	6.8
Telecomm. Appliances	3.3	Clothing	2.8	Furnitures	2.5
Knitwear	2.5	Electrical Equipment	2.7	Cars	2.0
Engines	1.4	Cars	2.4	Wood Articles	1.9
Clothing	1.4	Commercial Vehicles	2.0	Electrical Appliances	1.3
Plastic Articles	1.1	Cement	1.1	Metal Structures	1.1
Commercial Vehicles	0.9	Metal Structures	1.4	Cement	0.9
Miscel. Hardware	0.9	Miscell. Manuf.	1.3	Electronic Compo.	0.7
Electrical Equipment	0.8	Engines	1.3	Fertilisers	0.6
Metal Structures	0.7	Ceramics	1.1	Knitwear	0.5

Source: CEPII, CHELEM Database.
* In Percentage Points.

In China, the structural changes accumulated in a period of fifteen years look impressive. Over the whole period, the index of structural change in manufactured exports reaches 90 **(Cf. Table 2.5.)**, nearly half the maximum value (i.e. had the exported commodities been completely different in 1993 from 1978, the index would have been 200). In fact, five of the top ten products exported in 1993 did not appear in exports in 1978. This restructuring has taken place in three waves. In the first period, 1978 to 1983, the export gains were concentrated on apparel (the restructuring of textile exports from semi-finished to finished products). In the second period, new industrial sectors emerged: miscellaneous articles (toys, sports equipment), leather, consumer electronics, domestic electrical appliances, telecommunication appliances, electronic consumer goods. In the third period, the industrial exports accentuated their diversification toward computer equipment, electrical equipment **(Table 2.7.)**. The rate of structural changes in China's exports has slowed down since 1988, and may indicate a stabilisation of comparative advantages.

Table 2.7.
Commodity Changes in China's Exports to the OECD in Manufacturing Industry: The Ten Commodities That Registered the Largest Increase in the Export Structures*

Between 1978 and 1983		Between 1983 and 1988		Between 1988 and 1993	
Clothing	11.05	Miscell. Manuf.	6.40	Leather Goods	5.8
Knitwear	4.43	Consumer Electronics	3.91	Electrical App.	2.5
Miscel. Hardware	2.19	Leather Goods	3.34	Computer Equip.	2.1
Basic Org. Chemic.	1.39	Iron and Steel	2.37	Telecomm. App.	1.5
Pharmaceuticals	1.06	Domest. Electric. App.	2.22	Plastic Articles	1.2
Basic Inorg. Chem.	0.92	Telecomm. Equip.	0.99	Miscell. Manuf.	1.2
Plastic Articles	0.80	Electrical Appliances	0.84	Electrical Equip.	0.9
Ships	0.34	Knitwear	0.61	Optics	0.6
Consumer Electronics	0.30	Clockmaking	0.56	Furniture	0.4
Construction Equip.	0.27	Non-Ferrous Metals	0.56	Cars	0.3

Source: CEPII, CHELEM Database.
* In percent points.

Inter-Industry Versus Intra-Industry Trade

As put forward by Fukasaku (*1995*), Chinese gains in Western markets have been concentrated in a limited range of products and Chinese exports appear more and more concentrated. In 1993, ten commodities, out of the seventy commodities of the CHELEM nomenclature, accounted for more than 3/4 of China's exports to the OECD, whereas in Central Europe (Hungary, Poland, ex-CSFR), the first ten commodities accounted for 50 to 60% of exports; the concentration of Bulgarian and Romanian exports being closer to China's.

These dissimilarities between the CEECs and China coincide with the relative importance of inter- and intra-industry trade that mirrors the differences in the levels of economic development. Inter-industry trade, based on complementary products is the traditional form of trade between the industrialised countries and the LDCs. Intra-industry flows usually prevail in trade between industrialised countries and reflect a higher degree of economic integration between countries. The Grubel-Lloyd index was used to characterise the situation of the CEECs and of China in this respect **(Table 2.8.)**. In 1978, inter-industry flows accounted for the overwhelming share of China's trade with the OECD. Subsequently, this share decreased significantly, especially during the 1983-1988 period, but it was still dominant in 1993. Despite the structural changes that were the basis of China's export drive, its position in the international division of labour is still characterised by sectoral complementarities. Furthermore, the very impressive export performance in the early 90s was accompanied by a relative stagnation of intra-industry trade.

Table 2.8.

Index of Intra-Industry Trade*
Trade with the OECD in Manufacturing Industry

	1988	1989	1990	1991	1992	1993
CSFR	52	53	52	60	60	65
Hungary	58	58	58	60	60	61
Poland	49	50	47	45	48	51
Bulgaria	49	49	44	41	43	48
Romania	43	40	41	40	36	36

	1978	1983	1988	1991	1992	1993
China	18	21	28	32	32	32

Source: CEPII, CHELEM Database.

* Grubel-Lloyd Index $1 - \frac{\Sigma\left|x_i - m_i\right|}{X + M} x100$

The CEECs are in a quite different position. For the Visegrad countries, intra-industry flows represented at least half of trade with the OECD in 1988, and during the transition period this share has increased more or less rapidly, depending on the country. The Balkan countries, and especially Romania, display the opposite trend; in the case of Romania, the growing importance of inter-industry is leading to a convergence with China's situation.

It must be pointed out the trends in inter- and intra-industry trade have been influenced not only by the changes in export structures, but also by changes on the import side. In this respect, the CEECs and China display contrasting trends, as the former have enlarged their imports of consumer goods, whereas the latter has concentrated its imports on machinery and capital equipment. This may partially explain the difference in the respective importance of inter- and intra-industry trade.

Compared with the Chinese export performance over fifteen years, the CEECs export growth still appears fragile. Although the CEECs have recently returned to economic growth, this recovery is still vulnerable. In contrast with China, which had its trade expansion supported by clear-cut comparative advantages, the integration of the Central European countries in international trade is more in line with that of the industrial countries. They have to take part into the international division of labour within industrial sectors. This can be carried out in different ways: they can develop cooperative links with foreign firms in order to take part in the vertical division of the productive process; or they can rely on specialisation in lower range goods.

III. FOREIGN DIRECT INVESTMENT AND RESTRUCTURING

This part of the paper compares the flows of FDI to China and the CEECs, and then highlights the role of FDI in the expansion of foreign trade, taking the cases of China and Hungary.

3.1. Foreign Direct Investments in the CEECs and in China

In 1993-1994, foreign direct investment flows to China stood well above those directed to Eastern Europe. But it took a long time for China to attract such large inflows: the surge of FDI into China began in 1992, and was prompted by its rapid economic growth, and by the opening of new sectors to foreign investors (retailing, real estate, infrastructure). For the CEECs, FDI has increased rapidly since 1991, and in 1993 the CEECs received more FDI than China did in 1991 **(Table 3.1.)**. The real contrast between the two areas lies in the amount of accumulated FDI in China from 1979 to 1994 ($ 80 billions) compared to that realised in the CEECs from 1988 to 1994 (around 17 billions).

Table 3.1.
FDI in China and the CEECs

(USD Millions)

	1979	1980	1981	1982	1983	1984	1985	1986
China	...	57	265	386	543	1.124	1.030	1.425

	1987	1988	1989	1990	1991	1992	1993	1994
China	1.669	2.344	2.613	2.657	3.453	7.156	23.115	29.200
CEECs	...	7	180	400	1.839	3.240	5.265	4.750

Source: World Bank (1995); 1994: CEECs UN (1995); China: MOFTEC.

Taking into account the relative sizes of the countries, the importance of FDI in Central European countries does not appear to be marginal as in often stated, and in some cases larger than in China. In 1993, FDI amounted to 2% of GDP in Poland, to 3.5% in the Czech Republic and to 6.3% in Hungary, versus 5.4% in China **(Table 3.2.)**. In the Central European countries, the FDI represents an important share (between one third and half) of the net capital inflows they received in 1992 and 1993. In China, net foreign borrowings have become negative since 1990, and the FDI has become the only source of net foreign financing.

The importance of these flows must nevertheless be appreciated by taking into account not only the sizes of the economies, but also the very different domestic context in Central Europe and in China. In the former, economic activity and domestic investments have been depressed, whereas in the latter accelerated growth has been supported by a high level of domestic investment.

Table 3.2.
Balance of Payments: Capital Flows

(In % of GDP)

China	1979	1980	1981	1982	1983	1984	1985
Current Acc. Bal. before Official Transfes	-1.4	-1.6	0.6	2.9	1.9	0.8	-4.0
Official Transfers, net	0.0	0.0	0.1	0.0	0.0	0.1	0.0
Foreign Direct Investment, net	0.0	0.0	0.1	0.2	0.2	0.5	0.4
Foreign Borrowings, net	1.8	1.7	0.0	0.1	-0.3	-1.2	2.7

China	1986	1987	1988	1989	1990	1991	1992	1993
Current Acc. Bal. before Official Transfers	-2.5	0.1	-1.3	-1.4	3.4	3.4	1.4	-2.8
Official Transfers, net	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Foreign Direct Investment, net	0.5	0.7	0.8	0.8	0.7	0.9	1.7	5.4
Foreign Borrowings, net	1.3	1.1	1.3	0.4	-0.8	-0.6	-3.7	-2.3

Czech Republic	1988	1989	1990	1991	1992	1993
Current Acc. Bal. before Official Transfers	...	...	...	...	1.4	1.2
Official Transfers, net	...	...	...	...	-1.9	-1.9
Foreign Direct Investment, net	...	...	...	...	3.5	3.4
Foreign Borrowings, net	...	...	...	...	-0.7	6.9

Hungary	1988	1989	1990	1991	1992	1993
Current Acc. Bal. before Official Transfers	-2.0	-2.0	1.2	1.1	0.9	-11.2
Official Transfers, net	0.0	0.0	0.0	0.1	0.0	0.1
Foreign Direct Investment, net	0.0	0.6	0.9	4.4	4.0	6.1
Foreign Borrowings, net	2.5	2.0	-3.3	-0.2	-2.9	11.7

Poland	1988	1989	1990	1991	1992	1993
Current Acc. Bal. before Official Transfers	-0.2	-1.8	4.4	-2.8	-4.0	-6.9
Official Transfers, net	0.0	0.6	0.5	1.2	3.2	2.6
Foreign Direct Investment, net	0.0	0.0	0.1	0.4	0.8	2.0
Foreign Borrowings, net	1.0	1.5	-2.0	-0.2	0.7	2.2

Source: World Bank, World Tables (1995).

In Central Europe, investments and savings have dropped sharply from their high levels of the pre-transition period **(Table 3.3.)**. Enterprise savings declined as their profits fell during the recession. The government sector also registered declining savings, due to falling fiscal revenue and an increase in social spending. Only households have maintained or increased their savings (*European Commission*). Recent studies have pointed out that the widening of the CEECs' current account deficits in 1992-1993 reflected mainly an increase in consumption (essentially private consumption) rather that in investment (*Calvo A.G.*).

Table 3.3.
Investment Levels in Central Europe and in China

(In %)

Czech Republic	1988	1989	1990	1991	1992	1993	1994
GDI/GDP	27.5	26.8	28.8	29.7	24.0	17.1	20.0
FDI/GDI	...	...	...	...	14.4	20.1	...
Hungary	...	...	...	...	...	...	...
GDI/GDP	25.0	27.0	25.0	20.0	15.0	20.0	21.0
FDI/GDI	0.2	2.4	3.7	21.6	26.6	31.2	...
Poland	...	...	...	...	...	...	...
GDI/GDP	33.0	38.0	28.0	22.0	15.0	16.0	19.0
FDI/GDI	...	...	0.5	1.7	5.2	12.7	...

China	1978	1979	1980	1981	1982	1983	1984	1985
GDI/GDP	35.3	33.3	30.1	27.0	28.9	29.8	31.4	38.6
FDI/GDI	0.0	0.0	0.0	0.1	0.2	0.2	0.5	0.4

China	1986	1987	1988	1989	1990	1991	1992	1993
GDI/GDP	38.9	37.3	38.1	36.8	33.2	32.7	34.4	41.2
FDI/GDI	1.3	1.8	2.1	2.2	2.1	2.8	4.9	13.1

Sources: World Bank (1995); EBRD, 1995.
GDP: Gross Domestic Product. GDI: Gross Domestic Investment. FDI: Foreign Direct Investment.

Hungary has received half the total FDI directed to the CEECs since 1990, and these inflows represented more than 30% of the total gross domestic investment in 1993 **(Cf. Table 3.4.)**. But despite this important contribution from FDI, the Hungarian economic growth and export trends have not out-performed those of the other Central European countries. This suggests that FDI alone is not sufficient for ensuring high growth and high investment rates.

The economic recovery in the CEECs should foster both domestic savings and investments; in 1994, there were indications that such changes have begun to take place (*European Commission, 1995*). Given the underdevelopment of the financial system and the poor situation of the banking sector, most of the financing for investment will have to come from enterprises. As shown by J. Sgard, Polish enterprises have already shown their capacity to finance investment out of an increase in productivity *(J. Sgard)*.

In contrast to the CEECs, the increase in FDI in China was accompanied rising by domestic investment **(Cf. Table 3.3.)**. This would fit in with the observation made by Borensztein - based on a sample of 69 developing countries- which states that the inflows of FDI are generally associated with an increase in the total capital accumulation, and concludes that one of the ways FDI influences economic growth is through "crowding in" domestic investment (*Borensztein*). In China, the gross national savings reached 40% of the GDP in 1993; most savings (40% of the total) come from households, which amounted to about 16% of the GDP (that is twice the ratio observed in Hungary). Government savings accounted only for 5% of the total savings, the rest coming from the company sector and from extra-budgetary funds (especially at the local level) (*Wing Thye Woo*).

3.2. FDI and Foreign Trade: The Cases of Hungary and China

In both China and Hungary, joint-ventures have contributed to the development of an outward-oriented sector. The joint-ventures have played a decisive role in exports and even more so in imports; due to their heavy reliance on imported equipment they became a main channel for the modernisation of the countries' industrial capacities.

In the small sized Hungarian economy, joint-ventures have rapidly taken on a major role in foreign trade and industrial restructuring. These firms formed the core of the industrial exporting sector: in 1992: they accounted for half of the firms with an export/output ratio above 40%, while a quarter of joint ventures exported more than half of their output (*Lemoine, 1995 (a)*). Joint-ventures were entirely responsible for the increase in exports in 1992 and 1993, and in 1994 they generated about half of the total Hungarian exports (compared to 30% in 1992). Their share in exports was over 80% in a few industries (tobacco, electrical machinery, paper products, office machinery and computers) (*OECD, 1995*).

This situation highlights the positive impact of joint-ventures on Hungarian foreign trade, but it also reveals the relative inertia of domestic enterprises. It confirms the analysis according to which, only the firms with foreign investments have engaged in “strategic restructuring” in the CEECs, whereas domestic industrial firms have in most cases implemented measures consisting only in “defensive restructuring” i.e. in cutting costs and production in order to survive (*Grosfeld and Roland*). The contribution of joint-ventures to domestic investments provides evidence of this: according to the OECD country-study on Hungary (*OECD, 1995*), firms with foreign capital accounted for 47% of the countries' gross domestic investment in manufacturing industry, in 1993. They generated more than half of new investment in 18 out of 22 manufacturing branches.

But joint-ventures are not exclusively oriented towards foreign markets. Although more export-oriented on average than other Hungarian firms, they have also developed their sales in the domestic market, and accounted for 40% of domestic sales in 1994.

Due to China's size, joint-ventures play a much less prominent role. But as a result of the deliberate export promotion strategy, they have become central part of the Chinese foreign trade sector. The joint-ventures accounted for about 10% of the total industrial output in 1993, but for more than one fourth of the total exports and nearly half of imports in 1994.

The policy aimed at attracting foreign direct investment in order to promote industrial exports has proved to be a success. Nevertheless there is evidence that joint-ventures have developed their foreign trade activity without substantial forward and backward linkage with the rest of Chinese industry. In fact, up to 1995, most exporting joint-ventures were mainly involved in export processing operations. In 1995, more than 95% of joint-ventures exports resulted from the processing of imported materials; and 60% of their imports were made up of materials and components to be processed for exports **(Table 3.4.)**. A large proportion of their foreign trade, activity takes place without connections with the rest of the industrial network. This situation is a result of the measures taken for the last decade to promote export-oriented activities, and that provide export-oriented companies concessionnal access to imported goods. It also results from the fact that the majority of FDI originates from Hongkong and Taiwan, and corresponds to the relocation of their labour intensive industries to China (*Lemoine, 1995 (b)*).

This bias toward export processing has also affected the State-owned enterprises, though to a lesser degree. One third of their foreign trade stems from the processing of imported materials (**Table 3.4.**).

Table 3.4.
China's Foreign Trade by Type of Enterprise and Customs Regimes

	Exports		
	Total Exports	Processing Exports	Exports Except Processing
All Firms	100	47	53
Foreign Affiliated Firms	29	25	3
Chinese Firms	71	22	49

	Imports		
	Total Imports	Processing Imports	Imports Except Processing
All Firms	100	41	59
Foreign Affiliated Firms	45	24	21
Chinese Firms	55	17	38

Source: ITC UNCTAD/GATT.

The outcome of this export promotion has been an outstanding drive in foreign trade, which as led China to become a major exporter and importer in world trade. But the direct effect on the whole of Chinese industry has remained relatively limited, as more than 45% of China's foreign trade is based on the transformation of imported materials. This strategy has taken full advantage of the low cost of the labour force, but has implied expanding exports will relatively low local content, and a low level of value-added. Moreover, it has been associated will strong bias in favour of economic growth in the coastal regions (*Lemoine, 1995 (d)*). For these reasons, the Chinese authorities recently decided a new policy toward FDI that aims at limiting the development of the low value-added and labour intensive industries in the coastal areas, and at stimulating FDI into more basic industries in the inland provinces.

CONCLUSION

China and the CEECs have followed contrasting trade policies that not only mirror the differences between gradualist and radical reform processes, but are derived from different policy choices. Aside domestic factors, their international surroundings appear to be a key element in these policy choices. The CEECs have adopted trade policies that aimed at integrating the European Union, while China has sought to take advantage of its participation in the international division of labour in Asia.

In all cases, the result of the trade policies adopted has been a rapid rise of these economies in international trade, as measured by their export performance in OECD markets. This export drive has been associated with changes in the commodity structures of exports. Nevertheless, China and the CEECs are in a different position in the international division of labour. Despite the far-reaching changes in the commodity pattern of exports that have taken place during the last fifteen years, China's trade remains characterised by the inter-sectoral division of labour. The relocation to China of Hongkong and Taiwanese industries that generated China's trade expansion has confirmed its comparative advantage in labour-intensive activities. In contrast, the Central European countries have an international trade structure dominated by intra-industry specialisation.

In both areas, the expansion of foreign trade has been part of a trend towards the internationalisation of these economies, which have been more and more integrated into the world-wide productive and trade networks of foreign firms. FDI flows to China have been much larger than those directed to Central Europe, but given the respective sizes of the countries, their relative importance was not so different in Central Europe and in China in the mid-nineties.

The CEECs and China are now involved in the process of economic globalisation that encompasses trade, direct investments, and transnational business networking. These integration activities will continue to be an important factor for the industrial restructuring and the evolving patterns of specialisation of the CEECs. China's trade policy faces new challenges: first, it is most likely that export growth will slow down in the future. If Chinese exports would continue to increase a 15% per year in volume (the rate achieved since 1990), their share in world trade would reach 8% in 2005 (provided that world trade would increase at 5% per year). Chinese exports will also have to diversify. Second, the progress toward import liberalisation will now be crucial both for China's economic development and for its integration in the world economy.

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