ACESA NEWSLETTER

ASSOCIATION FOR CHINESE ECONOMIC STUDIES, Newsletter No. 2 (April 2000)

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ABOUT ACESA

The Association for Chinese Economic Studies (ACESA) was founded in 1987 at the Australian National University and was incorporated in 1998 in Canberra. ACESA is a non-profit and non-partisan organisation aimed at promoting research and exchange activities related to the Chinese economy. It strives to become a leading China research network in the West Pacific region. Its current members come from Australia, mainland China, Hong Kong, New Zealand, Singapore and Taiwan.

ACESA runs an annual conference and organises a regular policy conference series in China. The proposal for an academic journal is being evaluated by a sub-committee. The Association is run by the Executive Committee within the general policy guidelines set by the Council of Management. The Secretariat of the Association is located at the Australian National University. ACESA also maintains a website (**http://ajrcnet.anu.edu.au/acesa.htm**) and an emailing list (**cesa-oz@anu.edu.au**).

LETTER FROM THE PRESIDENT

My belated Chinese New Year wishes to all of you. May the Year of Dragon bring you prosperity and a lot of academic achievement.

As usual, the annual conference is a big event for our Association. I believe this year's conference will draw our largest attendance. We have secured financial support from Ford Foundation, which will help to bring at least five guests from China to the conference. Arrangement is underway to bring Professors Dwight Perkins, Justine Lin, Wing Woo and John Bonin to the conference as well. I thank Drs Ligang Song, Yiping Huang and Yongzheng Yang. The Association also owes Professors Ross Garnaut and Peter Drysdale for their support.

I would like to urge everyone, particularly research students, to make it to the conference. The conference is a good venue to exchange ideas, establish contacts and explore collaboration possibilities. Given the foreseeable size of the conference and the reputation of the guests, the return to your investment in coming to the conference is surly quite substantial.

We have approached the Economic Research Journal (Jingji Yanjiu) and China Center for Economic Research for jointly launching a journal. Discussions were also held with our UK counterpart on organising a workshop in China. Not unexpected, there are still some practical problems to be resolved. The Committee is still working on these issues. Any suggestions from you will be appreciated (Guanghua Wan, University of Sydney, **g.wan@agec.usyd.edu.au**).

CURRENT AFFAIRS

Membership

ACESA members receive the following major benefits:

- discount on ACESA conference/workshop registration fee (usually 20%) and further subsidy towards accommodation and travel expenses for students;
- access to the wide network of expertise for student members through the Student Academic Coordinator;
- free Newsletters and free subscription to the electronic mailing list;
- discount on subscription for the proposed ACESA journal (once launched);
- the input and assistance of other members into your research/thesis/projects/China contacts.

The membership fee is $30 a year for regular members, $10 a year for student members, $150 for 5-year membership and $400 for life-time membership. The application form can be downloaded from the ACESA webpage or obtained by contacting the Secretary directly.

Forthcoming election

The term of the current ACESA President, Secretary, Treasurer and Council members will expire in July 2000. ACESA is now calling for nominations for these posts.

Sub-committee on journal proposal

At the 1999 Melbourne conference, there was a renewed interest in founding a high-quality academic journal on Chinese economic studies. A sub-committee was formed to evaluate the feasibility of this proposal. The committee members are Drs Yiping Huang (chair), Harry X. Wu, Yanrui Wu and Yongzheng Yang. Prof. Ross Garnaut is the adviser.

Academic coordinator for students

Dr Ligang Song has been appointed as the Student Academic Coordinator (SAC) to help students locate relevant expertise and introduce them to senior economists in their fields. Student members who need assistance or advice from senior members of the Association for their research are encouraged to contact SAC directly.

Mailing list

The ACESA mailing list is administered by Dr Yongzheng Yang. To subscribe to the mailing list, send an email message to:

listproc@anu.edu.au

Do not put anything on the subject line. The body of your message must have the following in the first line:

sub cesa-oz <your name>

If you find it difficult to subscribe, email your name and email address to **yongzheng.yang@anu.edu.au**. To post a message, send it to: **cesa-oz@anu.edu.au.**

ANNOUNCEMENTS

ACESA 2000 conference

The 12th annual conference of the Association for Chinese Economic Studies (Australia) is going to be held at the Australian National University (ANU) in Canberra on 9-10 September this year. The conference theme is: Growth Sustainability in the 21st Century. The China Economy and Business Program at ANU will co-host the international conference, which offers a good opportunity at the turn of the century for scholars, policy-makers and practitioners from across the world to discuss the challenges facing the Chinese economy and to explore its growth prospect. Special sessions led by leading scholars in the field include: deflation, macroeconomic stability and growth potential, banking and financial system reform, reform of the state-owned sector, challenges of China's accession to the WTO, income distribution and unemployment, and private sector development in China. Papers on other subjects are welcome. Graduate students are especially welcome to present their work at the conference. Selected papers will be included in an edited book to be produced after the conference. Please look at the Association's homepage for more detailed information about the conference including registration **(http://ajrcnet.anu.edu.au/acesa.htm).**

New books

Yanrui Wu, 1999, *China's Consumer Revolution*, Cheltenham: Edward Elgar.

Zhou, Z.Y., Chudleigh, J.W., Wan, G.H., and MacAulay, T.G. (eds.), 1999, *Chinese Economy towards the 21st Century*, volume 1, the University of Sydney.

VIEWPOINTS

China's accession to the WTO

On 15 November 1999, China and the United States signed a deal on China's entry into the World Trade Organisation (WTO). The deal was hailed as a breakthrough and cleared the biggest hurdle to China's accession to the WTO. According to a White House Summary of the US-China Bilateral WTO Agreement **(http://www.uschina.or/public/99115a.html)**, China has agreed to reduce its tariffs on agricultural commodities from the present 32 per cent to 17 per cent by January 2004. All tariffs are to be bound. In the most sensitive sectors, mostly grain, China will adopt tariff-rate quotas (TRQs). In-quota tariff rates will be minimal ie. 1-3 per cent. Above-quota tariff rates were not announced, but initial quotas are generally well above the present import levels and the growth rates of the quotas seem to be generous. US companies will be able to import and distribute products in China independently. China will also eliminate sanitary and phytosanitary (SPS) barriers that are not based on scientific evidence. In addition, China has committed not to subsidize agricultural exports.

On industrial products, China has agreed to allow freedom for US firms to import, export and distribute their goods within China; significant reductions and binding of all tariff levels; and the phasing out of all quantitative restrictions on imports in five years, but most within two or three years after accession. It is estimated that China's average tariff on industrial goods will decline from the present 25 per cent to 9 per cent. In addition, China will sign the Information Technology Agreement (ITA), eliminating all tariffs on products such as computers, telecom equipment, semiconductors, computer equipment and other high technology products. China will also allow US companies to trade and distribute manufactured goods.

On service industries, China has made comprehensive commitments to eliminate most foreign equity restrictions with reasonable transition periods, mostly within five years. The commitments cover banking, insurance, distribution, telecommunications, securities, professional services, audio-visual, travel and tourism. These were the areas where the United States and China had most of their differences during the negotiations in April 1999 when Premier Zhu Rongji was visiting the United States.

On the rules embodied in the draft Protocol of China's WTO Accession, China will comply with the TRIMS Agreement and the Agreement on State Trading. The United States will continue to treat China as a non-market economy for the purpose of antidumping and countervailing purposes. This means that the United States will be able to use third country reference prices to determine whether Chinese exporting firms are dumping or their exports are subsidised. This practice will remain effective for 15 years after China's accession to the WTO. Further more, the United States can unilaterally apply restraints on Chinese exports based on standards that are lower than those in the WTO Safeguard Agreement. This provision will last for 12 years after China's WTO accession. Finally, the agreement stipulates that textile and clothing quotas on China will be phased out in 2005, but the United States will be able to use a safeguard provision drawn from the 1997 Sino-US Textile Agreement to restrict Chinese textile and clothing exports until 2008 — four years after the quotas imposed under the Multi-fibre Arrangement (MFA) will have been phased out for all other WTO members.

Overall, the Sino-US Agreement, if successfully implemented, will substantially increase the openness of the Chinese economy and greatly facilitate domestic reform. The long-term economic and social benefits can be enormous. Short-run adjustment costs are, however, inevitable as the economy restructures in response to foreign competition. The market-opening reform will also carry substantial risks, particularly in the banking sector. It is widely acknowledged that China's banking sector in its present form is susceptible to external shocks. A banking crisis is not impossible if fundamental reform to the state sector is not completed in time. The five year transition period has certainly set a tight time frame for banking and SOE reform. Past experience suggests that it needs extraordinary political will and management skills to accomplish such a task in such a short period of time.

Some of the protocol provisions in the Sino-US agreement will benefit both China and its trading partners. In particular, China's commitment to constraining state intervention in commercial activities, the abolishment of foreign exchange balance, local content and technology transfer requirements will reduce domestic distortions and increase policy transparency. Together with increased market access, this will help lay the foundation for a rules-based Chinese economy.

In contrast, the provisions on anti-dumping and countervailing will not enhance the economic interest of China or the United States, as they are protectionist in nature. These provisions are inconsistent with the transition periods allowed for market opening and failed to reflect the current state of marketisation in China. If China commits to accomplish reforms in compliance with WTO rules in five years in almost all industries, the current US anti-dumping and countervailing practices and discriminatory unilateral import restrictions should be phased out at the end of the transition period when the Chinese trade regime is deemed to have become consistent with WTO rules.

Since the continuation of the current US antidumping and countervailing laws is supposed to address any unfair competition by individual Chinese firms practicing predatory pricing and/or receiving government subsidies, then it is natural that any other contingency protection should be invoked under the normal WTO safeguard provisions. To allow the United States unilaterally target Chinese products at the standards lower than the WTO safeguard provision is clearly unfair to Chinese exporters.

The agreement on textile and clothing is just a further violation of the non-discrimination principle. It is widely acknowledged that most of China's textile and clothing exports are produced by the non-state sectors, especially the so-called township and village enterprises (TVEs) and foreign invested firms. To subject China's textile and clothing exports to a special safeguard provision beyond the Agreement on Textiles and Clothing discriminates against the very sector of the Chinese economy that is the most market-oriented.

All these set a precedent for discrimination against transition economies under the auspice of the WTO. While some form of discrimination may be justified before these economies are sufficiently market-oriented, the time frame for such discrimination to exist should be guided by the transition periods allowed of these economies. The notion that these economies are transitional does not necessarily mean that their competitive exports are distorted by firm pricing behaviour or government subsidies.

Several hurdles have to be overcome before China becomes a WTO member. Apart from the fact that China is yet to conclude bilateral negotiations with another 20 or so WTO members and formalities to be completed in Geneva, the Sino-US Agreement has to pass both the Chinese and US legislatures. Given the nature of Chinese politics, there is little doubt that the National People's Congress will pass the deal. Getting the deal through the US Congress will not be so easy. Since the signing of the Sino-US Agreement, a coalition comprising a broad spectrum of political interests, ranging from trade unions, human rights and environment groups to pro-life and region groups, has geared up its campaign to block China's entry into the WTO. Inspired by their successful disruption of the WTO meeting in Seattle, many of these groups are more determined than ever to defeat the business interests which have also strengthened their lobby for China's WTO accession.

The political balance in this market is a delicate one in a US election year and any significant developments either domestically or internationally could tip the balance. The most sensitive issue to watch is the March 18 Taiwan Presidential Election. What policy the newly elected president will pursue toward the China-Taiwan relationship and how China and the United States react to it will have a critical impact on the accession process. One can only hope there is no major disruption to the process so that China will enter the WTO in 2000, and with it, Taiwan too. If this opportunity is missed, the strain on the Sino-US relationship will be much greater than that inflicted upon by the US bombing of the Chinese Embassy in Belgrade in May 1999. No further chance of WTO accession will come until both the United States and China feel that an improvement in their bilateral relationship has become imperative again (Yongzheng Yang, Australian National University, **yongzheng.yang@anu.edu.au**).

Is the world ready for free trade?

When the last WTO conference was held in Seattle in late November last year, I was on my sabbatical leave at UC-Davis in the USA. To my surprise, there were many protests and parades against WTO not only in Seattle but also in many other cities, including the small town, Davis, where only some 50,000 people reside.

I soon gathered that people held protests for two major reasons: (1) For social interests, e.g., for environmental protection, for preventing exploitation of child labour in developing countries; (2) For group interests, e.g., in the interests of members of local labour unions.

For whatever reason, the fact is that the WTO has attracted much opposition from even ordinary people worldwide, including those in the USA. Isn't it strange and sad that the WTO boss had to be protected in a recent meeting he attended in order to avoid the possibility of attacks like the one received by the outgoing IMF boss? Should this draw people's attention to ask the question: Why? It has been so heavily promoted that free trade, pushed by WTO, will make people's life better. Why, then, will many people not buy this? Are they crazy? Are they not as smart as those economists who spare no efforts to promote the WTO movement?

It is true that, theoretically, free trade across countries will increase world output. However, is the world ready for a free trade regime? Perhaps not. The push by WTO for free trade has gone too far and is primarily in the interest of the rich countries. When the Uruguay round was completed, it was said that the poor countries would benefit most, but this has not been the case (*The Economist*, 25 September 1999).

In the case of agricultural trade, surely, liberalisation in developing countries will be good for those major exporting countries. However, each nation, as a sovereign state, has its own interests and priorities to look after. If a country is not ready to open its agricultural markets but is forced to do so (under the so-called WTO rules), will this yield an unwanted long-term effect which will not only hurt that country but also the rest of the world? It may.

For example, in developing countries like China, India, and Indonesia, agricultural industries provide important sources of income for many. If these are robbed by cheaper imports, the affected farmers will be a source of many problems, first to those countries themselves, and then to the rest of the world; i.e., reduced purchasing power of the farmers will affect the development of non-agricultural sector in their own country and subsequently the country's import capacity, and thus there will be international repercussions.

Shifting those large number of farmers out of the agricultural sector and asking them to take jobs in other industries (thus earning a higher income and enjoying a higher standard of living) is a brilliant ideal, but can hardly be easily done, especially, in a short time span.

In recent years, using words such as "free trade" and "globalisation" has been in vogue. It seems if one does not promote and advocate trade liberalisation or free trade, he/she then should feel guilty (in our profession, one would have difficulty in having articles published, particularly in US journals). What I would suggest is that we do not have to bow to the pressure of stereotypes. When we try to promote something, we need always to try to think carefully about its likely impact not only for a country in the short term, but also for the development of the whole international community in the long term.

The WTO, on the surface, seems to be trying hard to work for the betterment of all the member countries by pushing for free trade. However, does the fact that many developing countries are not happy with many of its rulings reflect the fact that WTO is biased towards developed countries? Has the concept of WTO been hijacked by some rich countries primarily for their own interest? If that is the case, and if the WTO movement is not modified or not cooled down, would rich countries become richer and poor countries become poorer? Would that be disastrous for the world in terms of its long-term peaceful development?

Is there a need to pour a bucket of iced water onto the WTO movement? (Zhangyue Zhou, University of Sydney, Orange, **zzhou@orange.usyd.edu.au**).

PROJECT/FIELD REPORTS

Private sector development

The China Economy and Business Program (CEBP) at Asia Pacific School of Economics and Management of the Australian National University was commissioned by the International Finance Corporation (IFC) to undertake a study on private enterprise development in China in 1999. The project was undertaken in cooperation with the China Centre for Economic Research (CCER) at Beijing University. The State Economic and Trade Commission (SETC), and various other official institutions of the People's Republic of China, such as the All-China Federation of Industry and Commerce (ACFIC), provided necessary support and assistance to the research team during the fieldwork in China.

The key focus of the project is to identify internal and external constraints to the development of private enterprise in China. To this end, a major survey of private enterprises was conducted in July and August in four cities in China: Beijing, Chengdu in Sichuan Province, Shunde in Guangdong Province and Wenzhou in Zhejiang Province. The survey consists of mail-outs of questionnaires to firms, CEO interviews and structured official and non-official interviews at the central, provincial, and local levels. A stratified sampling strategy considering location, rural-urban and ownership was adopted in the survey. Aggregate data on private sector development in China such as its share in GDP have also been collected and calculated by the research team during the fieldwork.

The survey and interview results enabled the research team to discuss various issues surrounding the development of the private enterprise in China, such as macroeconomic environment and market competition; business finance; taxation; internal governance; labour and management skills; technological challenges; laws; government administrative regulations and social infrastructure. A technical report was prepared for the IFC and the Chinese government on the current status of the private sector in China and how to nurture the development of private enterprise. The IFC will publish the final report in May 2000.

The private sector was suppressed in China during the period of central planning (1957-78) and has re-emerged since reform started in late 1970s and grown quickly in the past 20 years. The number of registered private firms and their employment figures, as well as their share in total GDP, are now growing even more quickly in the current improved policy environment. Furthermore, a large number of small and medium size SOEs are currently being restructured based on market conditions in which private firms are allowed to play an important role.

Yet, there are still many remaining problems and constraints associated with the development of private enterprises in China, which need to be overcome. For example, various unwarranted fees and taxes are still being levied on private enterprises by various local government agencies. Access to business finance particularly from state financial institutions by private firms is still difficult. There is an urgent need to improve the skill base of private enterprises, particularly those of medium and small size, at both managerial and employee levels. The transparency of private enterprises in management and operation particularly in their accounting and auditing practices needs to be increased. Policy support to private enterprise by different levels of government needs to be strengthened and materialised in areas such as business registration, land use, finance, market entry and law enforcement. The legal and regulatory environment needs to be improved. Market systems particularly financial and labour markets need to be further developed and a more competitive environment in which all different types of firms are competing on an equal footing is yet to be established.

Finally, problems of structural imbalances in the Chinese economy characterised mainly by over-capacity and over-supply in many manufactured goods (both producer and consumer goods) markets, are persistent and have become one of the fundamental causes for the ongoing deflation in the economy. Such imbalances and the resulting price deflation are putting severe pressure on both state-owned and non-state-owned including private firms.

To overcome these constraints facing private enterprises, policy recommendations have been made in the following areas. The government should speed up its reform on the financial system for it to be more accommodating to a large number of medium and small size enterprises especially private enterprises since the financial constraint on these enterprises seriously restricts their development and growth.

The government taxation and revenue system needs to be further reformed in order to curb the collection of unwarranted fees since the heavy collection of fees increased the burden on enterprises, caused unnecessary uncertainty; and distorted market signals and firms' incentives. It also resulted in more government corruption.

It is important for the government to continue the ongoing government reform aimed at cutting the size of bureaucracy and increasing efficiency and transparency since a lot of irregularities especially in taxation, fees and regulations are due largely to the over-expansion of local governments and rent-seeking behaviour of government officials. The legal system needs to be further improved and law enforcement needs to be strengthened to curb irregularities and increase transparency, to protect intellectual property rights, to enhance competition and to reduce transaction costs.

The constraints to private firms' investment in R&D and other activities conducive to development of technological capabilities include shortages and weaknesses in human capital, financial resources, information and effective protection of intellectual property rights. The government should adopt more pro-active policies on education and other investments in human capital, technical innovation such as investment in R&D and information services systems. Non-government institutions should also be allowed and encouraged to participate in these efforts.

A fundamental cause for the steady decline in growth rate and persistent deflation over the past two years is that growth has been driven mainly by the large-scale government investments (fiscal expansion), which have not been matched by the increases in domestic non-state investments including private investments. Faced with satiated product markets due to over-supply and low profit margins due to increasing competition and in reaction to the weak market demand, investments from the non-state sector have been slowing down considerably during the past few years.

It is believed that the expansionary fiscal policies by the government will not work effectively in fighting the current deflation unless they are able to generate increases in non-state sector investments. This also means that the current price deflation could be prolonged if the government policies, including various credit schemes (such as housing and consumer durables) to boost consumption, imposition of taxes on interests from savings and increases in wages, fail to boost domestic demand and revive the non-state sector's investment in the short term.

A practical way of resolving this issue is to open more sectors for investments from the non-state sector by relaxing market entry barriers which have limited the participation in certain sectors by non-state firms including private firms. In so doing, it is anticipated that the economy as whole will benefit since the non-state sector in general performs more efficiently than the state sector. Further relaxing market entry barriers to the non-state sector can also increase pressure for faster reform in SOEs, banking and financial areas. As a result, the share of the non-state economies in the total economy will further increase.

The development of private enterprise in China warrants further study, especially in areas where various issues relating to private enterprises can be developed into a deeper analysis of entrepreneurship, privatisation and transaction costs associated with transitional economies. To carry on the effort in studying this important phenomenon in the Chinese economy, an academic book entitled, *Private Enterprise in China*, is being prepared by CEBP (Ligang Song, Australian National University, **ligang.song@anu.edu.au**).

Microfinance in China

Since its introduction into China in 1993, there has been a rapid expansion of microfinance schemes in China. The growing interest in microfinance has been caused by the low efficiency in the use of poverty alleviation funds in China, the lack of access of microentrepreneurs to formal credit and a high expectation for the effects of microfinance programmes on poverty alleviation and financial development in China.

Currently, the international donors are undertaking microfinance experiments in more than 20 provinces in China. These include multilateral donors, such as the World Bank, ADB, UNDP, UNICEF and IFAD, and bilateral donors like Aus-AID, CEDA and GTZ). Most of these programs are conducted in the western part of China where China's core poor are located. For example, the World Bank has programs in Sichuan and Shaanxi, and AusAid has programs in Qinghai, Inner Mongolia, Guangxi and Chongqing.

Since late 1996, governments, of particularly the provincial and county governments in poor areas of China, have initiated their own microfinance experiments. Many of these microfinance experiments have been undertaken and co-ordinated by the local Poverty Alleviation Leading Groups, using the poverty funds from the central and local governments. In some cases, the poverty loans from the Agricultural Development Bank of China have been used for microfinance experiments.

Microfinance experiments in China, whether supported by international donors or local governments in China, are basically Grameen replicates, targeting at the poor in state designated poor counties and confined to rural China. Individual households, particularly poor women, are the main clients. The ongoing microfinance projects in China usually have the following common elements:

- Project offices: almost all the experiments are implemented and managed by project offices established at either township, or county levels, or both. County project offices are usually the profit centres. These project offices are basically independent.
- The grassroots units of these pilot projects are farm groups and centres: five members in a group and five to six groups form a centre. Collaterals and loan guarantee are usually not demanded, but group guarantee is required for loan access. Loans are provided to individual households, instead of farmer groups. Frequent centre meetings (weekly or by-weekly meetings) are held.
- Loans are disbursed to group members at 2-2-1 order. That is, loans are provided to two member of the groups initially. After about two weeks' successful repayment by the two members, the loans will be provided to two another members of the group. The group chair will be the last to receive the loan from the project. At the time of loan disbursement, half of interest calculated at nominal rate is deducted.
- Compulsory saving programs: at the time of loan disbursement, clients are required to pay five per cent of loans to the project as the group fund (or group tax). In addition, they are required to contribute one yuan per week as the compulsory savings to the project. Clients are able to take their compulsory savings back when they successfully repaid all the loans.
- Loan terms and size: the duration of the loans is usually for one year, and loans are repaid in weekly (bi-weekly) instalments, usually at centre meetings. The ceiling for the first loan is usually 1,000 Rmb, with an increment of some 500 Rmb for the successive loans based on successful loan repayment.
- Rate of interest: the nominal rate of interest is usually set at eight per cent per annum. With frequent loan repayment, the effective rate is about 16 per cent per annum.

This loan package has a number of advantages over the conventional rural loans provided by the formal financial institutions in China. First, the micro loans target at rural households that usually have a lower credit risk compared with township and village enterprises in poor areas of China. The targeting of poor households has been assisted by the design of the loan package, including small loan size and relatively high rates of interest. Moreover, no collaterals and guarantee are required for the loan access. Second, credit risk of micro loan is reduced further by small loan size, group guarantee, frequent loan repayment and positive incentive for loan repayment, notably, households are given access to a larger loan after they successfully repaid their debt. Finally, the microfinance schemes have been combined with social objectives, such as the provision of agricultural technical and marketing support services and empowerment of women.

Nevertheless, compared with the best microfinance practice, Chinese microfinance schemes still have a long way to go. The operation costs for many Chinese programmes have been high, but the rates of interest charged are not high enough to cover the operation costs. Moreover, the standard one year loan with frequent repayment in instalment may not suit the income generating cycles in different areas of China. Finally, insufficient training has been provided to microfinance practitioners in China (Enjiang Cheng, Victoria University of Technology, **enjiang.cheng@vu.edu.au**).

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Editor's note: The editor acknowledges members of the Association, in particular Enjiang Cheng, Ligang Song, Guanghua Wan, Yongzheng Yang and Zhangyue Zhou for their support and generous inputs, and James Fogarty for editorial assistance. (Yanrui Wu, UWA, **yanrui.wu@uwa.edu.au**