China's Rapid Trade Growth and Impact on the World Economy

China's foreign trade tripled in just five years (1977-81) and is continuing to grow rapidly. This growth rate for the People's Republic outstripped that for all other countries except Mexico, a major new oil exporter.[1] By 1981 China's exports and imports totaled more than $40 billion. Only six other nonindustrial economies traded more. However, aside from Saudi Arabia, all these countries had significant trade deficits, with large import purchases boosting their trade figures. China, in contrast, ran a large trade surplus. On exports alone, the People's Republic ranked fourth among developing countries (Table 1).

China's emergence as a major world trader is clearly highlighted by the current trade dispute between the People's Republic and the United States. In January America unilaterally set textile import quotas on China, now its fourth largest textile supplier, when negotiations failed to produce a bilateral quota agreement. China, in turn, banned all further imports of American cotton, soybeans, and chemical fibers. Although this ban will cause a relatively small loss to the United States (at most $300 million), given the low level of previously anticipated sales of these goods to the People's Republic, China has warned it is considering banning the purchase of other American products. With total American sales to China about $3 billion in 1982, exceeding Chinese sales to the United States by over a half billion dollars, further trade bans could potentially have a significant impact on American exports. This article will not deal with the specifics of this bilateral dispute but rather with the broader patterns and implications of China's emergence as a major trading country.

China's sharp trade growth follows the radically changed economic behavior of the People's Republic since the end of Mao Zedong's rule six years ago. Since then, China has seen the succession of two leaders—Hua Guofeng after Mao and Deng Xiaoping following Hua—as it moved gradually to more pragmatic economic policies. It has formalized its international position by entering the United Nations, the International Monetary Fund (IMF), and the World Bank It normalized relations with the United States (1979). It also has opened its borders much more widely to trade. Although China had made movements in this direction earlier (President Nixon paid his historic visit in 1972), the changes initiated in 1977 marked a distinct and dramatic shift in China's focus of attention from seeking domestic political "purification" during the tenure of Mao to pursuing rapid economic growth thereafter. China is currently reorienting its whole economy. Increased foreign trade is an important part of the transformation.

The rapid emergence of China as a major trader in international commerce raises many important issues:

- China's trade growth has been both fast and unexpected. Chinese exports and imports have grown at varying rates, however, with the People's Republic currently running a large trade surplus. Are the policies behind this growth

[1] This paragraph refers only to countries who report their trade figures to the International Monetary Fund Chinese trade-figures reported in this article are those released by Chinese trade authorities Trade partner figures often differ due to accounting practices, category definitions, timing, and similar discrepancy causes

Table 1

Trade of China, Compared with Selected Developing Countries in 1981

In billions of U.S. dollars

Country	Total trade	Exports	Imports	Trade balance
China	41.4	21.6	19.8	1.8
Saudi Arabia	148.6	113 3	35.3	78.0
Mexico	50 3	21.2	29 1	— 7.9
Singapore	48 6	21 0	27.6	— 6.6
Hong Kong	46.6	21.8	24.8	— 3.0
Korea	45.3	20 2	25.1	— 4 9
Brazil	42.7	19.7	23 0	— 3.3
Indonesia	35 6	22.1	13.5	8.6
Venezuela	32 4	19.6	12.8	— 6.8
United Arab Emirates	29.6	20.1	9.5	10 6
India	22.9	7.8	15 1	— 7.3
Malaysia	22.8	11.2	11 6	— 0.4
Number of developing countries exceeding China	6	3	6	
Of which nonoil	4	1	4	

Sources: International Monetary Fund, *International Financial Statistics* and *Direction of Trade Statistics Yearbook 1982*.

Table 2

Examples of Special Trade Arrangements

Term	Description	Example
Compensation trade	A foreign firm provides machinery, equipment, technology, supervision, and at times raw materials and is paid back with finished products, usually at an agreed-upon price.	Mitsubishi Corp. with two other Japanese firms agreed to be compensated with talcum powder by two Chinese mining units.
Export processing	A foreign firm pays a fee to a Chinese enterprise to process or to assemble products for which the former supplies raw materials, semiprocessed goods, and other components	Sanhill Co. of Hong Kong contracted for a Chinese radio factory to assemble radio receiver instruments.
Cooperative production	A foreign firm provides technical assistance to a Chinese enterprise to produce an item under license from the foreign firm. Payment is made in the form of the goods produced.	Aalborg Vaerft of Denmark agreed to coproduce ship auxiliary boilers along with a Chinese shipbuilding firm.
Joint ventures	A foreign firm provides equity capital—usually 50 percent or more—with profits distributed according to capital shares.	Gillette Co. of the United States agreed with a Chinese firm jointly to produce razor blades, plastic razors, and uncoated blades for industrial use.

Source: The National Council on U.S.-China Trade, *Chinese Business Review*, various issues.

and current surplus position the result of short-run trading decisions or do they reflect more fundamental change in the economy?

- China's trade growth has been relatively concentrated among three partners: Japan, the United States, and Hong Kong. The composition of China's trade differs among the three, however How have these partners fared in terms of import and export growth? What are the future prospects for the three as China's trade composition shifts over time?

- The large population of the People's Republic makes it a significant world producer and consumer of certain goods. China may thus affect international markets for some of these items. To what extent has China's new presence altered conditions in individual product markets and what is likely to happen in the future?

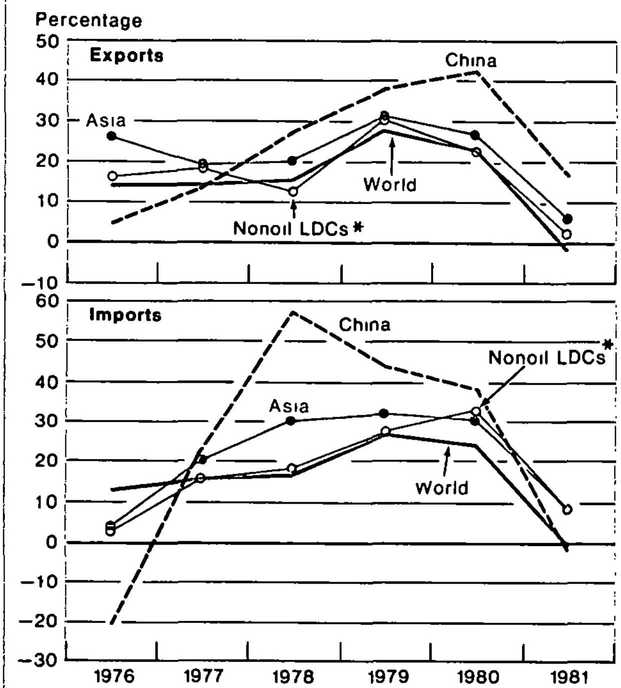
- China has borrowed relatively little in world credit markets even though it has been able to obtain commercial loans on very favorable terms. Rather, the People's Republic has relied primarily on the concessional funds available from official lenders. This could have significant implications for other poor-country borrowers as China assumes a large international presence and position at concessional lending institutions. Where does China stand in both world official and private credit markets?

- Where does China stand in general? How does the experience of the People's Republic compare with those of other countries who have experienced export surges? How will China's trade growth affect its development prospects?

The following sections will offer some answers to these questions.

Chart 1

Trade Growth Rates



*Less developed countries

Source International Monetary Fund, Direction of Trade Statistics Yearbook 1982

China's trade accomplishment

China's exports and imports each grew in value by an average of about 30 percent a year during 1977-81. This was double the average annual growth of trade for industrialized economies and 50 percent greater than the average for nonoil-developing countries (Chart 1). China, consequently, moved from being the twentieth largest nonindustrial country trader in 1976 to being the seventh largest in 1981.

China's exports and imports did not expand uniformly during this period, however. Exports grew relatively strongly throughout the five-year period. Even during the world recession year of 1981, they were up 20 percent notwithstanding a 1½ percent decline in total world trade Only in 1982 did their growth slow significantly to about ½ percent. Imports, in contrast, grew extremely fast only until the end of 1980 Then in 1981 imports fell slightly below their 1980 level. In 1982 they again declined, this time by about 2 percent. As a result, China moved from substantial trade deficit ($2 7 billion in 1980) to substantial surplus ($1.8 billion in 1981).

The evolution of China's trade reflects the country's pragmatic economic policies since 1976 One early aspect of this policy approach was the recognition that imports are essential to China's rapid modernization because they embody important technology. However, in 1980 China's leaders made a reassessment of general economic progress to date. They appear to have decided that the large trade deficits running from 1978 through 1980 should not be continued in 1981 or 1982 because the benefits of the large import purchases did not justify the finance costs involved.

China's general pragmatic philosophy since 1976 has led to some broad changes in the economy which, although not specifically meant for this purpose, did result in spurring foreign trade and, later, improving the trade balance. A major change was emphasizing decentralization of economic institutions, giving provinces and other government agencies more autonomy. As a consequence, these units have become more attuned to market prices and profits and more trade oriented. Since 1980, increasing emphasis has also been placed on agriculture and consumer goods production. There has been, correspondingly, a decreased emphasis on industrial goods production and major capital investment projects which have a higher import content. This switch contributed to a fall in China's import bill.

Specific measures dealing with trade have been taken as well. Special economic zones catering to export markets have been established. Legal structures related to trade have been put in place. These include regulations dealing with foreign banking and finance, joint ventures and the taxes they must pay, oil exploration and development, and labor issues (hiring, firing, compensation) in the special economic zones. Material incentives, such as tax advantages, are given to firms manufacturing for export. China has eagerly sought innovative trade and financing arrangements, including compensation trade (a foreign firm provides capital and expertise in exchange for finished products), export processing, cooperative production, and joint ventures (Table 2). The People's Republic has even encouraged the establishment of wholly owned foreign enterprises on its soil, provided they manufacture for export. On the import side, China has dramatically cut purchases since 1980, using its centralized planning system. Almost all foreign exchange must be turned over to the Bank of China. A central government decision is made on how to disburse this money. The central government also sets tariffs and quantitative restrictions to manage the demand for foreign goods. More directly, it purchases the large import items, such as plant and equipment. Starting in 1981, the government also cut import growth by postponing or canceling large industrial projects that entailed heavy foreign imports.

China's trade partners

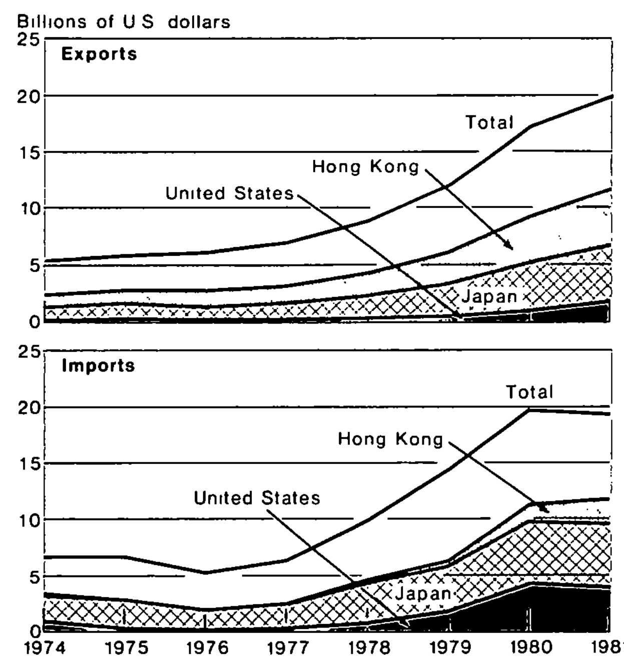
The most rapid expansion in China's trade has been with Japan, the United States, and the developing countries. Most of the developing country trade, however, is channeled through the entrepôt of Hong Kong. Japan, the United States (particularly after official relations were normalized in 1979), and Hong Kong accounted for most of China's trade growth since 1977, and they are continuing to grow in importance. By 1981, China sold over half its exports and purchased over 60 percent of its imports from these three trading partners. Export and import values and balances, however, differ among the three (Charts 2 and 3).

Japan is the largest exporter to the People's Republic and the second largest market for China's goods. Imports from Japan are primarily machinery and equipment. The People's Republic sells most of its exportable fuels (crude oil and coal) to Japan in return. Sino-Japanese trade was near balance in 1981 but turned more in China's favor in 1982 as its exports continued to expand while its imports shrank.

The United States is the second largest exporter to China and the third largest buyer of its products. Sino-American trade has doubled since full-fledged diplomatic relations were established in 1979. The com-

Chart 2

China's Trade Partners*



*Excluding trade with socialist countries, averaging about $2 billion during 1978-81

Sources: International Monetary Fund, Direction of Trade Statistics Yearbook 1982 and International Financial Statistics position of Sino-American trade differs from that of Sino-Japanese trade. The United States supplies mainly agricultural products, rather than machinery. Wheat, corn, and other grains made up about 40 percent of the \$4 billion worth of goods China bought from the United States in 1981. On the other side, textiles and other light manufactures dominate China's exports to the United States. (Japan and the United States import about the same total amount of Chinese textiles, but the United States does not make the large fuel purchases that Japan does.) In 1981 the United States had a substantial trade surplus—about \$2 billion—with the People's Republic. This surplus fell to about a half billion dollars in 1982.

The third largest supplier of goods to China is Hong Kong. Chinese imports from there include both products made locally—about one quarter of the total—and goods reexported to the People's Republic via Hong Kong from producers in other countries. In return for these exports, Hong Kong provides the largest market for China's goods. But 40 percent of sales to Hong Kong is reexported from there to other countries, particularly to developing economies. The larger part of this trade is in manufactured goods. In 1981, China had a large trade surplus of over \$3 billion with Hong Kong. The surplus in 1982 will probably be even greater.

The remaining 40 percent of China's exports are split about evenly between other industrialized and other developing economies. Textile sales predominate with the first group and simple manufactured goods sales with the second. On the import side, China buys about one quarter of its foreign goods, primarily machinery and fertilizer, from industrial countries other than Japan and the United States. About 15 percent of Chinese imports, mainly food and raw materials, come from developing countries other than through trade with Hong Kong. In 1981 the People's Republic had a \$1½ billion deficit with these other industrialized economies and a \$2 billion surplus with these other developing economies.

China's trade pattern—surplus with developing countries, moderate deficit with industrialized countries—leaves the People's Republic in a strong medium-term position. It is in surplus in the developing country market, which has had the fastest growth rate in world trade and will likely continue to grow fastest in the next decade despite the prospect for some near-term weakness. Other economies with income levels as low as China's, in contrast, typically sell very little to one another. On the other side, China benefits from the fact that it has oil and coal it can sell to industrialized countries, enabling it to hold down its deficit with those economies (Chart 3). More development can be expected in these fuel exports.

The evolving structure of China's trade

As China's total trade expanded and the People's Republic consciously moved from trade deficit in 1980 to trade surplus in 1981, the structure of both its exports and imports has changed (Chart 4). The most striking development on the export side is the rise in oil and coal sales. These energy exports now account for a quarter of total Chinese exports, up from about 10 percent in 1977. Currently, growth of both oil and coal production has leveled off. The volume of these exports is not expected to change much until offshore oil fields start producing at the end of the decade. This should slow the rapid growth of Japanese imports from the People's Republic, since Japan is the major purchaser of these fuels.

Chinese manufacturing exports have also done well in the past five years. They now account for over half of total exports, up from 45 percent in 1977. China is currently emphasizing light manufactures production, which requires less investment funds per factory and quickly generates foreign exchange earnings. Textiles and other light manufactures (such as rubber shoes, carpets, porcelain, paper) account for about two thirds of manufactured exports. But these products are expected to decline in importance, as exports of simple machinery and electrical equipment (*e.g.,* electrical components, fans, sewing machines) increase in coming years. Sales to developing countries, the primary buyers of these latter products, should increase accordingly.

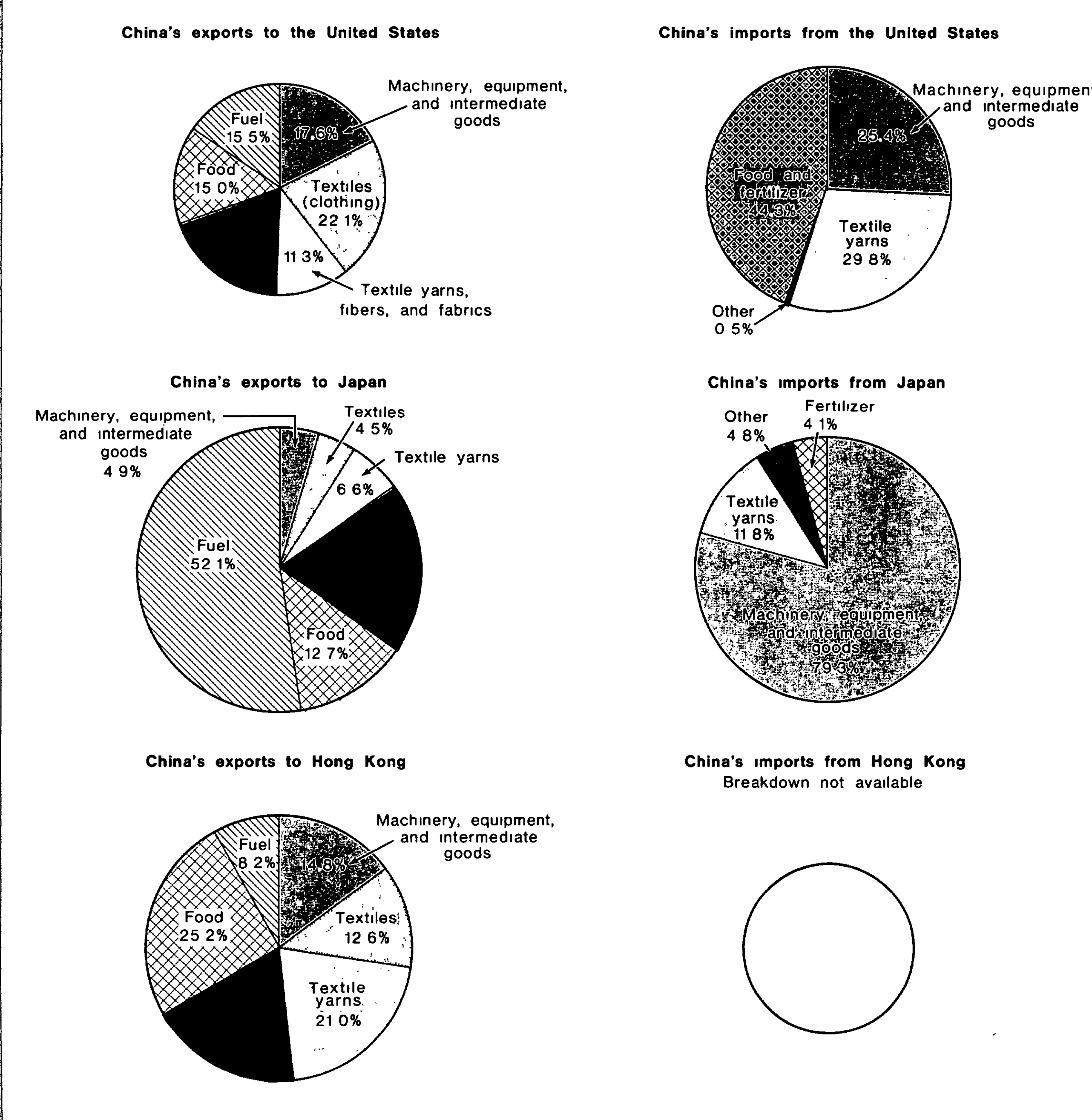
The most striking change on the import side is the sharp drop in machinery and construction goods purchases since 1980. This is primarily due to the cancellation or postponement of a number of large industrial projects. Imports of capital and construction materials fell 20 percent in 1981. In the first half of 1982, they fell even more sharply. Concomitant with this decline was an increased share in total imports of consumer products and inputs for agriculture and light industry. These goods now account for 60 percent of total foreign purchases, up from 42 percent in 1979.

China is likely, however, to reverse this import composition pattern somewhat in the next few years. The People's Republic has acquired a high level of international reserves (about \$10 billion) and may start increasing imports rather than continue running large trade surpluses. Materials for the canceled or postponed industrial projects will probably be given first priority when purchases pick up. Negotiations have already resumed for some of these items.

The considerable manipulability of China's trade structure contrasts with many other developing countries. Large natural resource endowments and com-

Chart 3

China's Trade Pattern in 1981



Sources: United States Department of Commerce, Business America; and China Trade Report.

petitive prices (discussed in the concluding section) have helped the People's Republic expand and diversify its export market. Significant domestic production of most essential goods—food, oil, raw materials—has kept China's essential import needs relatively low. There was considerable room, consequently, to compress the total import bill in 1981, when China decided it no longer wanted to run trade deficits.

China's relative size and impact on major goods markets

Increased trade growth has meant increased market size for China in a number of areas. For some traded goods, there is potential for China to affect world prices or to cut significantly into other producers' market shares or to become a major world consumer. As total trade continues to grow, this may become an even more important factor in the future. Trade now equals about 15 percent of China's approximately $250 billion gross domestic product (GDP). China's exports and imports are, therefore, substantial. However, China's GDP per capita is a low $250. As the People's Republic grows, exports and imports will likely grow as well.

Textiles are the most prominent case of China's increased market size. The People's Republic has already faced quota restrictions on some particular textile exports to both the European Community and the United States. As noted in the introduction, China is currently involved in a trade dispute with the United States over the issue. In general, because the United States and Europe follow policies of providing a certain level of overall protection to their domestic textile producers, increased Chinese textile exports have had some crowding-out effects for other sellers.

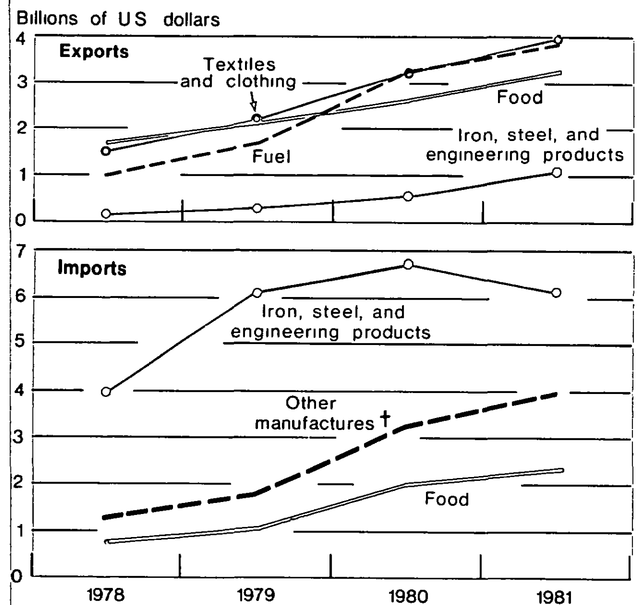
Although China's petroleum sales are a significant part of its total exports, they were well below 1 percent of world oil trade in 1981 and are unlikely to change much during the decade. China, consequently, has too small sales to have major impact on the world oil market.

But China could potentially affect world market conditions for a number of strategic minerals. The People's Republic has major deposits of tungsten, tin, antimony, zinc, vanadium, titanium, lepidolite, gold, copper, lead, molybdenum, bauxite, mercury, nickel, and iron. Deposits of the first seven metals are thought to be the largest in the world. China's iron deposits rank third in the world, and its gold output ranks fourth. The People's Republic helped depress the world price of vanadium in 1981 with its expanded sales.

Chart 4

China's Trade Composition Changes

Selected commodities traded with major trade partners*



*Canada, the European Community, the European Free Trade Association members, Hong Kong, Japan, Singapore, and the United States

†Includes both heavy and light industry goods

Source General Agreement on Tariffs and Trade, International Trade, 1980-81 and 1981-82

China also has had a significant impact on world agricultural trade. In 1981-82 China was one of the three largest wheat importers in the world, accounting for 13 percent of total world wheat imports. China accounted for 13 percent of world raw cotton imports and about 10 percent of world rubber imports at that time. It has also been the largest importer of chemical fertilizers in recent years. On the other side, Chinese rice exports amounted to 5 percent of the world's total rice trade in 1981-82.

China is expanding exports rapidly in certain chemicals, certain pharmaceuticals, and shipbuilding. Some trade analysts in these fields argue that the People's Republic may have a significant effect on world trade for these goods. For imports, China is unlikely, however, to have significant market influence through its purchases of goods other than agricultural products in the near future. Its import demands are for fairly diverse items. For none of them is China likely to account for a significant proportion of world trade.

China's international borrowing position

China has not yet been a major borrower in international credit markets, although in the past three years it has attracted credit commitments estimated as high as $30 billion. The People's Republic has drawn only a small fraction of these funds. For 1981 it reported lining up about $9 billion in official and private long-term foreign credits but drew only $2 billion of this. Japanese sources provided approximately one third of the 1981 capital inflow, the IMF one quarter, Hong Kong sources about one fifth, and American sources perhaps one tenth.

Chinese external debt outstanding is very small by international comparison (Table 3). Total debt is estimated at $8 billion. Long-term debt of about $6½ billion equaled only 2 percent of China's 1982 gross domestic product (GDP) and 25 percent of its goods and services exports. This contrasts sharply with most other developing countries. For these countries as a group, debt averaged 25 percent of GDP and over 100 percent of exports. For the lowest income countries (comparable to China), the figures are 25 percent and over 200 percent, respectively. In terms of net debt, China's holdings for foreign exchange exceeded its foreign obligations by about $2 billion in 1982, making the People's Republic a net creditor to the world. In 1981, China had long-term net debt of about $1½ billion, equaling ½ percent of its GDP, whereas this ratio for all developing countries, as well as for the lowest income countries, was 20 percent. Banks in industrial countries reported only $1.3 billion in claims on China in mid-1982, accounting for less than 1 percent of all the external claims on developing countries held by these banks. China's 1982 long-term debt service payments amounted to about $2 billion. This equaled only 7 percent of Chinese exports. In contrast, the overall developing country ratio of long-term debt service payments to export receipts was over 20 percent. For lowest income countries the figure was nearly 15 percent.

China's low overall borrowing level reflects its strongly expressed sensitivity to high interest rates as well as to high debt burdens. China has been able to obtain about $2 billion, around one third of its long-term borrowing, on concessional terms, through international agency loans, intergovernment loans, and suppliers credits arranged with foreign export-credit agencies. Japan has been the primary source of such low-cost funds.

Although a substantial amount of China's long-term borrowing is already on concessional terms, the People's Republic could borrow a great deal more from official sources. This it may do in the next few years. Trade partners have been willing to offer concessional export financing and other subsidized credits, partly to sell their goods. China could borrow more. From its largest bilateral aid source—Japan—the People's Republic has drawn less than 5 percent of the concessional loan money offered. The low actual drawings in part reflect postponements and cancellations of large plant and equipment imports from Japan. This may change if China decides to cut its current large trade balance surplus.

International institutions are only beginning to include China in their fund disbursements following its formal admission to these organizations. From the World Bank's soft loan window—the International Development Association (IDA)—China has borrowed $459 million to date. (This contrasts with India, the country most comparable to China, which in recent years has been drawing about $1.5 billion annually from the IDA.) The People's Republic was admitted by the institution only in 1980, after most of the currently available funds had been committed. China will likely obtain increased concessional money from the World Bank after settlement of the IDA replenishment now being negotiated. In the future, large Chinese borrowing from concessional lenders could have a significant impact on the availability and international distribution of concessional loan funds to other borrowers.

Table 3

International Bank Claims on China and Selected Developing Countries*

In billions of U.S. dollars, December 1981

Country	Liabilities to banks	Net position with banks†
China	2.3	3.3
India	1.4	1.5
Indonesia	7.2	0.3
Malaysia	4.4	− 1.2
Brazil	52.7	−47.5
Korea	19.9	−16.3
‡Hong Kong	31.3	− 2.7
‡Singapore	36.6	0.1
Mexico	56.9	−44.6

* Banks in industrialized countries.

† Country assets held by the banks minus country liabilities owed to the banks.

‡ Offshore banking centers.

Source: Bank for International Settlements.

Long-term commercial bank borrowing accounts for only about one third of China's total debt. To avoid high interest charges, China has repayed in advance large amounts of commercial bank debt, especially in 1981. The People's Republic was able to do this because of its strong current account position. In turn, China's low borrowing level has buttressed its current account position as interest payment outflows have been kept low.

China's low level of commercial borrowing helps make it very attractive to banks. By the end of 1981, banks in industrial countries reported $5 billion in binding commitments to China, a figure greater than for any other developing country and more than twice the value of current outstanding claims on the People's Republic. China received interest rate spreads as low as ⅛ to ½ percent over LIBOR (the London interbank offer rate) on 1981 loans. This compares with an average spread of 1 percent for developing countries as a group that year. China continues to receive favorable terms even as spreads for most developing countries are widening.

China's trade growth and its development strategy from an international perspective

Several economies have achieved high income growth rates from export-led growth strategies, notably economies in Asia. Export-led growth may be defined as a conscious policy effort to promote exports and to attain rapid GDP growth. Fast GDP growth should result from the benefits gained by trade. Increased employment for the production of export goods is one benefit. Another is the rearrangement of production to concentrate on goods that can be produced efficiently—*i.e.,* those goods a country has a comparative advantage in producing—while trading to obtain other desired commodities. Trade also allows a country to manufacture goods in sufficiently large volume to benefit from the cost savings of large-scale production. Finally, an economy gains vitality from production subject to international competition.

Factors within specific economies determine the degree to which those economies gain from each of these benefits. For example, larger economies may have less to gain from the potential economies of scale benefit. Due to different country situations, then, the boost to GDP growth obtainable from fast export growth varies greatly.

China may try to pursue a pattern of rapid export growth followed by rapid GDP growth, as have other countries. A clue as to whether it will follow this pattern may be found in comparing China's recent trade expansion with similar spurts in six other developing economies that experienced comparable periods of growth and in analyzing the degree to which China will be able to benefit from this expansion (Table 4).

China's export performance is impressive, even by comparison with the export spurts in other countries, particularly since it occurred during a time of slow world trade. The international environment was much more favorable during the trade spurts of the other economies. China may or may not continue with rapid export growth. If export growth continues, the question arises whether China can successfully convert to sustained rapid income growth. The question does not have a clear-cut answer. However, certain characteristics of

Table 4

Trade and Domestic Economic Growth of China, Compared with Other Developing Countries with Export Surges

Country	Years	Average export volume growth rate (percent)	Average export value growth rate (U S $)	Average real GDP growth rate (percent)
China	1978-80	22 3	34 2	7 5
Brazil	1968-70	10 6	18 4	10 3
India	1974-76	10 5	23 4	6 6
Israel	1959-61	19 4	26 9	10 1
Japan	1954-56	25 2	29 8	7.3
Korea	1964-66	36 1	42.2	9.2
Malaysia	1976-78	25 1	12 7	8 7

Source: International Monetary Fund, *International Financial Statistics.*

the Chinese economy may affect the degree to which it will benefit from trade.

China's size distinguishes it from other export-led growth economies. Large size will probably dampen the benefits China can expect to achieve from an export-led growth strategy Three reasons may be cited. The first is that China may not be able to sell internationally the goods that it has a comparative advantage in producing without adversely affecting the market for these goods. If China produced for export the same amount of textile fabrics and garments, for example, per member of its labor force as did the other Asian economies when they successfully pursued export-led growth, it could easily swamp world markets. The resulting sharp price declines and/or increased trade restrictions would significantly cut into China's trade benefits A second consideration is that China has the potential to reap the benefit of large-scale production with manufacturing for domestic use. It, therefore, should gain less of this benefit from international trade than have smaller economies with smaller domestic markets A final factor is that China could potentially have gained significant comparative advantage benefits through its own internal trade. This would contrast with the situation of smaller countries before they opened their international trade doors. China, therefore, may have less to gain from this benefit often provided by expanded international trade.

China's type of economic regime also distinguishes it from other export-led growth economies which are typically capitalist. The distinction will be less pronounced the more flexible China makes its price system and the more adeptly it handles its managerial and incentive issues. However, the more there is such a distinction, the more likely it is that the People's Republic will find less benefit in the export-led growth strategy. This may be seen from the problems experienced by other centrally planned economies in Eastern Europe and the Soviet Union. Four problems have typically arisen:

- With domestic prices determined apart from market forces, trade patterns may depart from what comparative advantage analysis would recommend. This would cut potential international trade gains.

- With nonmarket determined prices, investment decisions may cause subsequent trade patterns to be even further away from the comparative advantage criterion, again cutting potential trade gains.

- Problems of quality control often have been encountered. These are generally attributed to strict adherence to production plan levels rather than product marketability. These problems dampen world demand for the products and, hence, trade growth.

- Problems of significant consumer goods rationing also have occurred because prices are relied on to a very limited extent as a means to allocate goods. This may cut the incentive to produce in order to buy since increased income need not yield increased consumption. This lack of incentive may be an obstacle to greater trade growth.

These constraints may explain why the unweighted average ratio of hard currency exports to GDP is relatively low, at about 10 percent, for the Eastern European and Soviet economies. The ratio for the Soviet Union is about 2 percent China's ratio is estimated to be 8 percent.

China's trade strategy

What does China's recent trade performance suggest about its trade plan relative to other countries? China may be following a straightforward pattern of exporting the goods it can produce cheaply in exchange for the goods that would be expensive or prohibitive to make. On the other hand, there may be reasons why China's trade may reflect more than this simple type of comparative advantage analysis.

China has been selling its exports, generally labor-intensive products, at very competitive prices relative to other countries' exports of the same goods. In return, the People's Republic has been purchasing technological products (plant and equipment) more advanced than those which it produces domestically (as well as food staples). China's pricing strategy is clearly indicative of a desire to gain market share. However, it also indicates that the People's Republic is willing to accept a less favorable relative price ratio between its Chinese labor (embodied in Chinese exports) and imported technology than most other developing countries accept. China's lower price ratio may simply reflect standard analysis of China's comparative advantage in trade. The People's Republic may have a cost advantage resulting from its abundant, fairly well-educated labor force. It may also reflect a well-developed organization of production units and an established goods distribution network. Perhaps due to these factors China can produce more goods for the same amount of effort than can other countries and, thus, is able to charge less for each item produced.

However, the very competitive price ratio the People's Republic is setting between its own labor and imported technology may also be attributable to certain aspects of technology purchases and centrally planned economic regimes. One aspect is that benefits of technology generally become widely diffused throughout an economy, rather than captured entirely by the initial purchaser. For example, imported technology can be copied by others once a prototype is supplied. Licensing and other controls can reduce this problem, not completely eliminate it. Only an authority responsible for the total economy will, consequently, gain all the benefits of purchased technology. This, of course, is exactly what a centrally planned economic regime is. Such a regime or authority will be most likely to pay a price that reflects the total value of the benefits received from the imported technology. This contrasts with firms in a private market economy who are likely to pay only in accordance with the benefits they privately obtain from the technology purchase. A centrally planned economy may be willing to supply more labor effort than a free market per unit of foreign exchange earned to increase its foreign exchange revenue and foreign technology purchases.[2]

There is another reason why a centrally planned economy might act this way. Innovation may be slower for this type of regime than for a free market economy. This may be because individual inventors are unable to capitalize privately on their innovations in a noncapitalist economy. Imported technology may as a result be more important there than it is for a free market economy.

To what extent each argument—standard cost advantages or placing a distinctly high premium on technology imports—explains China's competitive prices and export success cannot be determined. China, of course, is not alone among developing countries in relying on other than free market mechanisms. However, most other developing economies do not take such direct responsibility for total investment or such a direct role in pricing exports (through central setting of input prices and the exchange rate). They are, thus, less likely to place such a premium on imported technology relative to the product of their labor.

What lies ahead?

China's future pricing strategy as well as its future trade performance could change significantly. The current strategy and trade surge occurred after a dramatic change in political outlook by the People's Republic. Such sudden wide changes could occur again and alter China's present trade orientation. Given current policies, however, it is likely that China's trade will continue to grow although at a declining rate. Exports will rise because of the recent growth of foreign investment (which is primarily aimed at exports) and the large number of compensation trade and cooperative production projects that are yet to be paid off. But, as the absolute size of China's export base increases and market size limitations become more pressing, the growth rate should slow. Imports by the People's Republic will rise with exports because China's demand for foreign technology and basic foodstuffs is likely to continue. However, conservative policy should limit growth of imports to China in line with that of exports to avoid large current account deficits.

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[2] This is another way of saying a centrally planned economy may be willing to sell its labor-intensive exports at a cheaper price than a capitalist economy would. Implicit in this is the assumption that the price elasticity of excess demand in the rest of the world for these goods is greater than one. This assumption is generally valid for labor-intensive manufactures.