

Trade Balance and Government Policy in China

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Abstract

Chinese central government has adopted a series of policies since last year to reduce the surging foreign trade surplus and as well as to adjust domestic industrial structure. All of these policies have attained the desired effect to some extent in the short-term period.

However, despite of the policies, there is possibility for firms to make a profit and reduce the cost and rely on foreign markets. And the government especially the local governments in China have diversified policy goals including economic and political targets, which caused the local governments to acquiesce in the production expansion and countermeasures from firms. Consequently the policies adopted by Chinese central government failed on the whole in cutting trade surplus and adjusting domestic industrial structure. The total trade surplus in China during the period from January to December of 2007 had unexpectedly reached 262.2 billion US dollars and showed no tendency to decrease. By the end of September in 2008, Total surplus has reached 180.9 billion US dollars, even from different contribution in provinces.

The uncontrollable surplus means that on the one hand, in the game between firms and the central government the harsh measures taken by the central government to restrict export have been counteracted by firms to a large extent, and on the other hand, the countermeasures by firms have got acquiescence and implicit support from local governments. That is to say, it is the countermeasures taken by firms and the implicit support from local governments that aborted the central government's plan of changing production method by restricting export and adjusting industrial structure. The phenomenon that the central government policies was out of control resulted from the power of laws of market economy and the conflicts in economic as well as political goals between the central government and local governments in China. When the goals pursued by firms differ from those of governments, there are always countermeasures following the released policies. And furthermore such behavior of firms is to a large extent encouraged by local governments with interest motivation.

We also know that some of firms in Eastern area have to close, leaving for inland or western area or Southeast Asia, such as Viet Nam. The readjustment of contribution to export and surplus reflect some meanings. The central government policy to supply side has some impact on regional distribution of export not balance of China. Chinese government policy just has some impact on contribution of production in different provinces, not total volume of export or balance of payment.

The following suggestions are given in this paper. Firstly, economic policies adopted by governments should have specific pertinence in modern economic situation. Secondly, the central government should take the regional economic disparity into account, especially industrial policy not trade policy, while making policies. Finally, central government policy just changes the distribution of region in contribution of surplus.

1. Introduction

Chinese central government has adopted a series of policies to reduce the surging foreign trade surplus and as well as to adjust domestic industrial structure since 2006. All of these policies have attained the desired effect to some extent in the short-term period.

However, despite of the policies, there is still possibility for firms to make a profit and reduce the cost and rely on foreign markets. In addition, the government especially the local governments in China have diversified policy goals including economic and political targets, which cause the local governments to acquiesce in the production expansion and countermeasures from firms. We could say that the policies adopted by Chinese central government failed on the whole in cutting trade surplus and adjusting domestic industrial structure. The total trade surplus in China has unexpectedly reached 262.2 billion US dollars in 2007 and reached 180.9 billion US dollars in first 9 months of 2008.

This paper intends to examine the reasons why it is difficult to control the growing trade surplus in China. Section 2 reviews recent changes of the export rebate policies. Section 3 examines the effectiveness of the latest policy change, and Section 4 analyzes the reasons why the policies have not taken effect as expected. In the last section some suggestions are provided.

2. Review on recent changes of export constrict policy

On June 18, 2007, the Chinese Ministry of Finance and the State Administration of Taxation jointly issued 'Notice Regarding the Reduction of Export Rebate Rates for Certain Commodities' (State Finance Circular [2007] No. 90). This circular covers 2831 commodities which account for 37% of customs tariff codes. The major changes are as follows. Firstly, exporters can no longer obtain export rebates for 553 commodities, all of which are high energy-consuming, high pollution-inducing and resource-intensive products. They include endangered animals and plants and their products; the mineral products such as salt, solvent naphtha, cement, liquefied propane, liquefied butane and liquefied petroleum gas; fertilizer, chlorine, dyes and other chemicals (refined chemical products excluded); metal carbides and activated carbon products; leather; certain wood boards and one-off wood products; ordinary plain carbon welded pipe products (petroleum casing pipes excluded); simple products processed from nonferrous metals such as non-alloyed aluminum bars; segmented vessels and non-motor vessels. Secondly, export rebate rates have been reduced for 2268 commodities which are likely to trigger trade disputes. These commodities include vegetable oil; certain chemical products; plastic, rubber and rubber products; boxes; leather and fur products; paper products; garments; shoes and caps; umbrellas; feather products; stone materials; ceramic; glass; pearls; jewelries; precious metals and their products; steel products; base metals and their products;

planers; slotting machines; cutting machines; broaching machines; diesel engines; pumps; fans; exhaust valves and the parts thereof; rotary furnaces; coke furnaces; sewing machines; staplers; golf carts; over-snow vehicles; motorcycles; bicycles; trailers; elevators and the parts thereof; faucets; soldering machines; furniture; clocks and watches; toys and other miscellaneous products; wood products and viscose fiber. Thirdly, 10 commodities will be exempted rather than rebated from export duty. These products include peanut kernels, canvas, decorative carved boards, postage stamps and duty stamps.

Earlier on November 3 of 2006, some policies aimed at lowering or canceling export rebate rates for certain commodities were announced by the central government to restrict the export.

On September 14, 2006, five administrations including the Ministry of Finance, the National Development and Reform Commission, the Ministry of Commerce, the General Administration of Customs and the State Administration of Taxation jointly released 'Notification Regarding Adjusting the Export Rebate Rate for Certain Commodities and Supplementing the Prohibitive Catalog for Processing Trade'. This circular adjusted the export rebate rate for certain commodities and enlisted the commodities in the prohibitive catalog for processing trade whose export rebate were abolished in previous and this circular. Import duty and import linkage tax would be imposed on those commodities enlisted in the prohibitive catalog. Since September 15 of 2006, the commodities for which the rebate rate has been adjusted were related to many industries, including coals, nonferrous metals, steels, construction materials, machinery, textile products, bio-medical products, IT products and agriculture products. For example, the export rebate rate for textiles and furniture in this circular was lowered by 2 per cent to 11 percent; for steel, ceramic, cement, glass and some ready-made leathers, the rate was lowered from 13 per cent to 8 and 11 per cent respectively; for some nonferrous metal materials, the rate was reduced by 2 per cent to 8 per cent; for resource products like coal, stannum, zinc, the export rebate was abolished. Meanwhile, the export rebate rate for technology-related products whose export is encouraged by the government was raised. For example, for important machinery, bio-medical products and high-tech products, the rate was raised from 13 per cent to 17 per cent; for some processed products using agricultural products as raw materials, the rate was raised to 13 per cent from 5 per cent or 11 per cent.

On January 1 of 2005, the export rebate for high energy-consuming products like electrolytic aluminum, ferroalloys, yellow phosphorus and carbide was abolished. In April, the export rebate for primary products of iron and steel was abolished and the export rebate rate for steel was lowered from 13 per cent to 11 per cent. On May 1, the export rebate for rare-earth metal, rare-earth oxide, rare-earth salts, silicon metal, molybdenum ore and its concentrate, light sintered magnesium, fluorspar, talc, carborundum, wood particles, wood powder and wood chip was abolished and the rate for coal, wolfram, tin, zinc, antimony and products was decreased to 8 per cent. On August 1, the export rebate for electrolytic manganese was canceled.

In retrospect of the taxation reform in 1994, China confirmed the policy of unifying the rebate rate and value-added tax for export. Later in 1995 and 1996, the government reduced the export rebate rate extensively under the pressure of economic situation, fiscal burden, taxation affair and fraud. In 1997, 1998 and 1999 China respectively raised the export rebate rate for some commodity allowing for the end of tight policies and the impact of Asian Crisis. From 2000 the export rebate rate schedule in China had had the form of 17%, 15%, 13%, 6% and 5%, with the rebate rate for export covered by excise tax subject to the change of excise tax. In 2004, the export rebate schedule was adjusted to 17%, 13%, 11%, 8%, 6% and 5%. Besides, the coverage was expanded for complete elimination of the export rebate. For those resource intensive and high pollution products like crude oil, rough wood and paper pulp, the rebate was totally abolished. We could say that the adjustment of export rebate policy has been an effective instrument for Chinese central government to encourage or restrict the volume of foreign trade and especially the change of export.

3. Effectiveness of the latest policy reform

The government policies in the latest policy reform came out in two steps and were expected to exert direct effects. In November of 2006, the Ministry of Commerce, the Ministry of Finance and the General Administration of Customs in China made a joint announcement that the country would cut or eliminate export rebates for certain commodities, especially for commodities with high pollution, high energy and resource consumption. Besides, the government would reduce tax rebate on exports of commodities which tend to cause trade frictions. On June 18th of 2007, related administrations made another announcement of policy adjustment in order to restrict the trade surplus, promote upgrading of industrial structure, reduce the export rebates on commodities with high pollution, high energy and resources consumption and low added value. The adoption of these policy measures has suppressed the production of export of certain commodities and slowed down the growth rate of trade surplus in China significantly in March and August 2007. Statistics from the Ministry of Commerce shows that in terms of a broader category of commodities, from January to October of 2007, the export of coal, crude oil, tape recorder, television and camera had negative growth compared with that during the same period of last year. The growth rates were respectively -17.6%, -42.8%, -13.3%, -47% and -38.7%. In the mean time, the growth rate of some commodities tended to slow down including cotton yarn (2.7%), fabric (5.8%), plastic products (5.2%) and shoes (9.1%). The negative or lower growth rates of the above products had inevitable correlation with the measures to restrict exports adopted by the central government.

In the meanwhile, the growth rate of production of commodities with high energy and resource consumption and high pollution, especially production of alumina, ceramics and petroleum products, was decreased in some provinces, and some firms were even closed consequently. In addition, although in some other provinces, the growth rate of total export remained high, the export structure in these places was greatly improved. In this situation, some firms called out that the government should consider the

interests of firms, especially the interests of local medium and small-sized firms, and private owned firms. (For example, the industry association cited five reasons to oppose the elimination of export rebate for the sealed battery.) Besides, production profit was also extruded for the products which tend to cause trade frictions or trade dispute. Added the appreciation of RMB, firms were faced with pressure of reducing production and even exiting from the market, especially from the international market.

Many firm owners said that although they had had preparation in mind about the policy reform, they found it too sudden and the adjustment magnitude too big and felt badly 'hurt'. Yu Yuefeng, associate general manager of Shanghai Phoenix Import and Export Company, thought that the policy adjustment had a huge influence on the export of Phoenix bicycles. He said, "In the year before last when the export rebate for bicycles was reduced from 17% to 13%, we could barely come through it for there was still some profit left. But this year the situation was completely different after 4% of reduction of the export rebate rate. Yu Yuefeng said, that the export cost of bicycles had reached a critical point faced with the more expensive raw materials and as well as the continuing appreciation of RMB, and that the 4 percent of reduction of the export rebate rate were sure to impact the export of bicycles. A manager of some ceramics company in Foshan believed that the reduction of export rebates would further extruded the ceramics firms. He said, that the cost was increased by 5% because of the reduction of export rebate rate and another 3% because of the appreciation of RMB, and that allowing for higher priced raw materials, 'the cost of the whole industry was increased by about 15% and the profit was reduced by tens of millions each year'. For the paper production, the State Development and Reforming Commission could predict that the volume of export rebate would be 46 million US dollars for the second half year of 2007 if the export growth rate remained as 26.5% in 2006. This would be 73 million US dollars less than that before adjustment. Even supposing that all the influence was taken by domestic paper production firms, we predict that the profit for paper products export would decrease 7% in the second half year of 2007 if there were no countermeasures from firms and no changes in export environment. Of course, some firms would have taken measures to transform to produce high-tech products and to change their export structure as soon as possible.

We should admit that all of these showed that the combined policy measures of the central government have had some effect to a certain extent. However, we could yet see that the trade surplus in China has resumed increasing in an irregular way since after except in April and August. And the trade surplus in the following couple of months outnumbered that of last year. Until end of October of 2007, the trade surplus in China has reached 212.57 billion US dollars, much higher than 177.48 billion US dollars of last year. It seemed that the trade surplus was out of control by the central government and became much bigger under restriction policies. The surplus of trade has reached 180.9 billion dollars in the first 9 months.

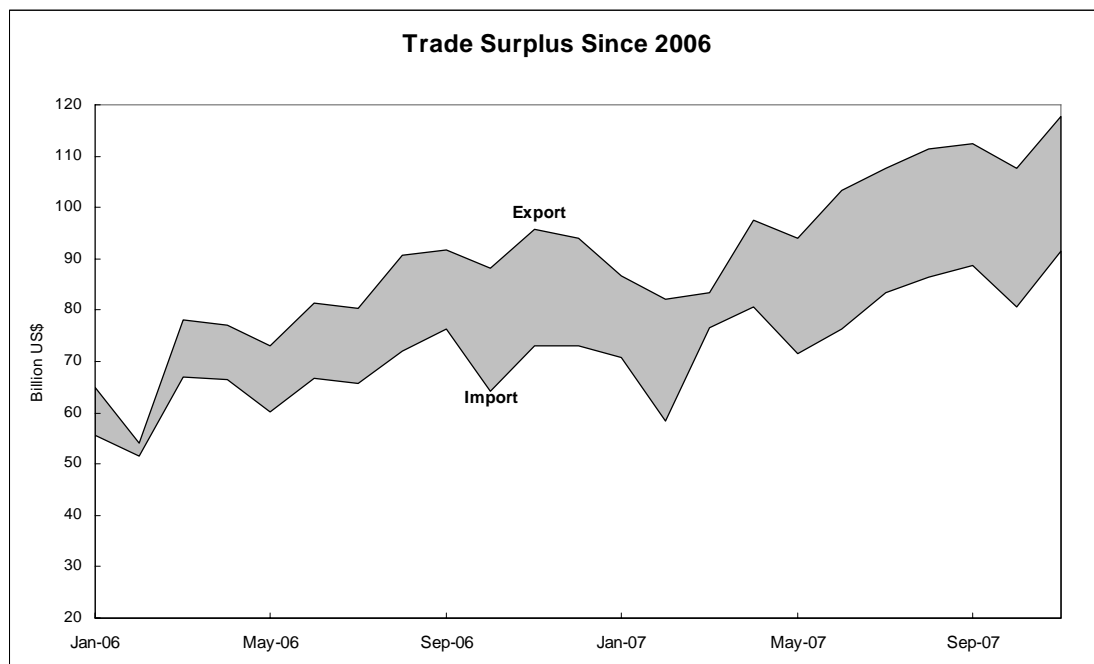
Table 1 Monthly and Accumulated Trade Surplus In 2007

Unit: Hundred Million US dollars

Month	Surplus for each month			Accumulated Surplus		
	Current	Last year	Percent change	current	Last year	Percent change
January	158.8	96.3	64.8	158.8	96.3	64.8
February	237.0	25.3	837.8	395.8	121.6	225.4
March	68.0	111.5	-39.0	463.7	233.1	99.0
April	167.9	103.8	61.7	631.6	336.9	87.5
May	224.1	129.5	73.1	855.7	466.3	83.5
June	268.4	144.2	86.2	1124.1	610.5	84.1
July	243.3	145.7	67.0	1367.5	756.2	80.8
August	250.2	188.1	33.0	1617.6	944.3	71.3
September	237.6	153.1	55.2	1855.2	1097.5	69.0
October	270.5	238.3	13.5	2125.7	1335.7	59.1
November		229.0			1564.7	
December		210.0			1774.8	

Source: Statistics by China General Administration of Customs

Figure 1 Trade Surplus for Each Month Since 2006



Source: Statistics by China General Administration of Customs

4. Reasons of the policy failed in reducing the trade surplus

The reasons why it is difficult to control the increasing trade surplus lie in three games. They are the games between firms and the government, games between firms and local governments and games between local governments and the central government.

4.1 The game between firms and the central government

Firms usually pursue maximum profit in a market economy. Under complete competition circumstances, a larger production scale would lead to more profit when the price being equal. If the social cost caused by pollution and high consumption of resources and energy is not integrated into the actual production cost of firms, any threat by the government for social goals would have no influence on firms. Hence the government needs to take measures to internalize these social costs to firms' production cost. By taxation or less subsidy, the government could increase the production cost and accordingly the market price. Consequently the demand especially foreign demand for the products would be reduced and the export would be decreased. Import being equal, less export means less trade surplus. This is supposed to be the basic logic and principle for an effective policy adopted by the central government.

However, firms have multi-choices to counteract the policy measures aimed at increasing production cost. Firstly, firms could transfer the increased cost to consumers by increasing the price, which could suppress the demand for the products. Secondly, firms could on their own take the additional cost. By so doing, the price and production scale would be the same as before but the profit for the firms would be reduced. Thirdly, whilst firms take the additional cost, they would increase the production and reduce the price, and thus to obtain a profit no less than before.

Firms would choose to increase the sales price if they have confidence in their capability of controlling over the market. The additional production cost caused by the change of export rebate policy would thus be transferred to the trading stage. The statistics on Chinese export showed that most commodities had a higher price than before. This reflected the existence of pressure faced by firms and the according countermeasures from firms.

Table 2 shows that it was by increasing the price for export commodities that some strong foreign firms succeeded in digesting the increased production cost. Only if firms are able to sell all of their products and obtain some profit, they would choose to continue increasing the production and export.

Table 2 Price and Quantity for Certain Exports from Jan. to Oct. In 2007

Value Unit: US Dollar

Commodity	Quantity Unit	Quantity		Average unit price	
		Jan.---Oct.	Change%	Jan.---Oct.	Change%
Corn	10000 tons	475	100.4	176.5	36.2
Coal	10000 tons	4326	-17.6	60.8	3.7
Rude Oil	10000 tons	291	-42.8	406.1	-4.6
Oil product	10000 tons	1299	30.4	573.3	0.4
Cotton Yarn	10000 tons	50	2.7	3312.3	4.5
Cotton Woven Fabrics	10000 meters	591168	5.8	1.2	1.3
Plastics	10000 tons	633	5.2	1895.0	3.9
Shoes	10000 pairs	697659	9.1	2.9	5.6
Steel	10000 tons	5376	63.8	691.0	15.3
Containers	10000	253	41.2	2850.4	5.0
Video Camera and Player	10000	13250	-13.3	43.9	8.2
TV sets	10000	4056	-47.0	172.7	86.8
Camera	10000	1871	-38.7	3.8	7.0
Auto-data processing equipment and components	10000	118473	2.7	83.4	32.6
Portable or car-borne wireless phone	10000	37590	26.5	74.3	-9.7
Motorcycle	10000	914	4.7	350.2	12.5
Bicycle	10000	5023	2.9	36.2	8.7
Car and car chassis	10000	47	62.6	10910.6	34.4

Source: Statistics by China General Administration of Customs

Other firms chose to bear the additional cost and bear the reduction of profit. Firms could have two ways to adjust to the policy change. One is to increase the sales price but resulting in losing some market share, the other is to keep the previous market share but having to accept a lower profit. In this situation, firms usually prefer the latter since on such occasion they could survive and avoid losing years of efforts to accumulate assets and clients and market share. Actually in China, the majority of private firms or medium and small sized firms would like to take the additional cost caused by the change of export rebate policy and to maintain the previous export volume. Table 3 shows that there is difference in the capability of dealing with a lower export rebate rate across various kinds of firms.

Table 3 Statistics of Export by Different Firms

Unit: Hundred Million Dollar

Nature of export firms	October		From Jan. to Oct.	
	Value	Change %	Value	Change %
State-owned	1077.2	22.3	9858.4	26.5
Foreign-owned	633.6	21.7	5601.3	24.0
Others	256.0	32.4	2417.3	40.9
Collective-owned	38.6	9.4	386.0	13.0
Private	215.5	37.8	2003.3	47.6

Source: Statistics by China General Administration of Customs

As shown in Table 3, after restrictive policies for export were adopted, foreign-owned enterprises and private enterprises have continued to keep a rapid growth on exports. While the state-owned enterprises and collective-owned enterprises have a slower growth. This suggests that foreign-owned enterprises and private enterprises have greater flexibility and stronger abilities to respond to negative policy changes. They could raise the sale price, or bear the cost, or cut wages of employers. Statistics showed that in the first three quarters the employment of State-Owned Enterprises and collective-owned enterprises has experienced a decline in spite of the enlargement of the total employment in the economy. It meant that the employment of enterprises with other types of ownership has steadily increased. The increasing need for workers in such enterprises helped to drive down wages and maintain a low wage level.

Finally, firms would increase their exports instead of cutting them down if a larger scale of production brings smaller profit but more sales. Obviously, the profit margin will decline due to the reduction of export rebate rate if firms bear the cost. Firms believe that they could offset the decreased profit by increasing export unless there is

a numerical limit on export volume. That is to say, the economy of scale production allow firms to reduce the unit production cost and thus to cover the additional cost caused by the reduction or elimination of export rebate. As a result, the total profit remains unchanged or even increased with increasing export volume.

Table 2 shows that the export quantity of oil products, steel, containers, cars and car chassis has increased by 30.4%, 63.8%, 41.2% and 47% respectively. The increased cost has been to a certain extent balanced off by the rising production and export. And this caused some enterprises to reject small orders.

For instance, a lithium electronic products company requires a production order with a minimum of 1000. Meanwhile, the payment was required to be made by T/T in advance for an order with value of less than 10,000 dollars, and L/C at sight was not acceptable, which is because the production cost of a small quantity would be too high to be offset. Xingan Group, a company of toy and other light industry products in Fujian Province, received an order for some electronic toys on May 2007. One of the containers included 15 articles and the average quantity required for each article was only 20 boxes/300 pieces. For the production, since every article required a special production line, they had to change different production lines frequently. Moreover, since the wage was calculated based on pieces, the return for this production was only half as much as it would be in mass production. The revenue for the company was lower as well and the average output was 26% less than it would be in mass production. Pan Wenlong, marketing manager of this company, said that ‘we have fulfilled the orders by working overtime but both the workers and the company were completely exhausted’.

As a result, the export enterprises or the enterprises affected by export rebate policy change have not decreased but increased their export with a higher growth. Our statistics indicate that export for a majority of manufacturing products has obviously increased since the central government put forward a series of policies to restrict or discourage export. Some quantitative increase went with the rise in price, but others went with the drop in price.

When firms chose to transfer the additional cost, they acted on a premise that distributors would accept the higher price. Statistics on the export structure of China suggests that processing trade still accounts for over 53% of the gross trade in 2007, and continues to grow at a relatively rapid speed.

Processing trade is marked by the relative stability of the market. Most of processing trade has been involved in the value chains of multinationals. The stability results from the basic pattern of international division of labor. Up to date, in the international division system carried by multinationals, China still specializes in labor-intensive products or assembling processes. Actually this pattern would not change in the short term. It is understandable that multinational firms would balance off the fluctuation of the cost structure and the cost in the process of manufacturing and assembling in their global network. In this sense, the rising cost of Chinese export is likely to be covered by other manufacture and assembling processes.

Table 4 the Trade Pattern of China's Exports in 2007**Unit: Hundred Million Dollar**

Trade pattern	October		From Jan. to Oct.	
	Value	Change	Value	Change
Total value	1077.2	22.3	9858.4	26.5
General trade	448.9	21.2	4392.4	30.8
Processing trade	572.8	21.2	4972.9	21.4
processing on order	110.7	27.7	938.3	24.8
processing imported materials	462.1	19.7	4034.6	20.6
Others	55.5	47.3	493.1	46.0

Source: Statistics by China General Administration of Customs

The results indicate that multinationals are strong in digesting the pressure on their exports. They would not change current production network in the globe. Of course there was some adjustment for certain processed products to the reduction of export rebate rate. And therefore production and export for these commodities have been reduced to some extent. A typical instance was the reduction of the processing trade with imported materials.

When enterprises prefer to bear the additional cost, they act on a premise that they can still make a profit even after they bear the rising cost. In terms of the effect of the policy change announced on November, 2006 and July 1, 2007, the profit may be reduced by about 3—6% for textile and clothes, and resource-consuming products. Based on the average profit margin calculated by China's productive investment in the trade sector, most companies have a profit margin of 6—8%. Coupled with the appreciation of RMB, the profit margin would be 3—6%. Hence the second best strategy for those enterprises which need to retain market share is to continue expanding export. Special mention should be made that it is still profitable and sound for exporting enterprises to export to foreign markets since there are a lot of similar firms competing with each other in domestic market. And therefore the export of traditional products with comparative advantages has been increased by a large scale and at a high speed in provinces like Guangdong, Jiangsu and Zhejiang, where production of textile and clothes, toys and other labor-intensive products plays an important role.

If they could get access to cheap labor, firms would take the third countermeasure. The statistics shows that the labor supply in China does not only come from migrant

workers from rural areas but also from the laid-off workers caused by reform and restructuring of state-owned enterprises. With the sufficient supply of labor, the exporting enterprises and the enterprises which engage in processing trade are likely to transfer the cost to workers. Enterprises intend to offset the rising cost by increasing the labor intensity or lowering the wage for workers. Otherwise, they could employ more workers to expand the production and export and thus to obtain more profit. This behavior leads to an increase both in export and employment in China in 2007.

In conclusion, the central government expected that the introduction of various policies and measures would increase the cost burden of enterprises, and that the unique response for the enterprises was to obey the government's guidance to decrease exports, slow down the export growth, cut the trade surplus, reduce international trade friction, and furthermore improve the industrial structure. However, when faced with more than one choice, firms would make their own choices according to the law of market economy and pursue maximum profit rather than 'listen to the government' and comply with the government's guidance.

4.2. The game between firms and local governments

In terms of the relationship between firms and local governments, firms play a critical role in determining the scale, the quality and the speed of local economy. Thus on the one hand, the local economic development is one of the major performances of government work; on the other hand, the survival and development of firms rely on the support of local governments. Therefore, after the central government released the policy measures, firms, particularly foreign-invested enterprises and private firms, would send two possible signals when faced with the according constraints. One signal is to ask local governments for compensation of the loss resulted from policies adopted by the central government. Otherwise, the firms would shrink production and even be closed down. The other signal is to threaten local government by transferring investment and abandoning the local business. For these two signals, the prior choice for local governments should be following the central government and guiding firms to make adjustments (For example, most of local governments released official documents and expected the firms to adjust their strategies.). However, this choice is obviously against firms' expectation. It would be rather difficult for firms to change their business strategy especially when the adjustment cost is very high. In turn local governments would be concerned about the reducing production or transferring of investment.

In a word, if the signal sent by firms is responded positively by local governments, local governments would prefer to retain the firms and help them get over difficulty. And hence the majority of local governments made quick response and pointed out or reported to the central government about the relevant effects especially the negative ones after the adjustment of export rebate rates. By so doing, they had the potential excuse for possible export declining or maintaining the previous export scale. In reality, some provinces did make a report of the possible 'great losses' to local areas

caused by adjustment of export rebates. Nevertheless, foreign trade record, especially the export record of every province for the following 10 months indicated that foreign trade maintained a growing tendency at a high speed and a high trade surplus in the provinces where there was a strong claim.

Table 5 shows that there has still been a high growth in export for all provinces in China. Even after the restriction policies were released by the central government, the growth rate still exceeded 15%. Hence we could say that local governments prefer the interest of local firms to that of the central government.

4.3. The game between local governments and the central government

The economic and political targets of local governments are highly the same with those of the central government in China. On one hand, it is the central government that examines the performance of local governments. On the other hand, there is apparent disparity in the development stage of economy and economic problems across provinces as a result of different resource and geographic features. In better developed eastern China, the main task is to upgrade the industry structure and improve the quality of economic growth. Whereas for the less developed middle and western China, they are still in the stage of exchanging resources for funds. That is to say, their development is driven by resource consumption. Consequently, the same policy may cause different effect in different areas.

From perspective of the central government, although the reduction of the export of resource intensive products and petrol products and even the products causing severe pollution cause economic loss to local governments in the short run, it could lead to the gradual transformation of production methods and the upgrading of the industrial structure and sustainable economic development. While from perspective of local governments, they have wide economic and political tasks, many of which are from the central government. Hence for the developed areas, the economic goal is aimed at keeping a high quality growth, and especially accomplishing adjustment of the industrial structure and transformation of producing patterns, and maintaining high employment. In the meanwhile, the political goal is to achieve harmonious development. For less developed areas, the main task is to attain economic growth and development of industrialization, improve the income level of local residents and eliminate poverty as soon as possible. To this end, they need to speed up economic growth according to local conditions and pay attention to environment protection and sustainable development at the same time. At a result, local governments have discrepant policy goals due to different economic development.

Table 5 the change of export quantities of provinces from Jan. to Oct. 2007

Unit: Ten Thousand US Dollars

Region	Total trade	Export	Import	Change compared to last year %		
				Total trade	export	Import
Total	175911704	98584478	77327226	23.5	26.5	19.8
Bei Jing	15356838	3930238	11426600	17.3	30.8	13.3
Tian Jin	5846086	3115194	2730892	12.2	16.1	8.1
He Bei	2034515	1380442	654073	35.2	33.6	38.8
Shan Xi	924119	521769	402350	79.6	57.6	119.4
Inner Mongolia	624685	240115	384570	27.2	32.7	24.0
Liao Ning	4831460	2890655	1940805	24.7	28.0	20.1
Da Lian	3162217	1767782	1394435	23.3	27.1	18.7
Ji Lin	803703	295709	507994	23.6	29.7	20.2
Hei Long Jiang	1481246	1053536	427711	37.0	48.2	15.6
Shang Hai	22968674	11647958	11320716	23.8	25.3	22.3
Jiang Su	28435925	16494157	11941767	24.2	28.1	19.2
Zhe Jiang	14516322	10567811	3948510	28.7	28.2	30.0
Ning Bo	4636531	3157137	1479394	36.9	34.6	41.9
An Hui	1288159	708070	580090	29.3	26.5	33.0
Fu Jian	6002334	4024294	1978040	18.2	21.0	12.8
Xia Men	3220415	2066999	1153416	21.4	25.2	15.3
Jiang Xi	765601	436860	328741	60.5	48.2	80.6
Shan Dong	9835298	6008891	3826407	26.9	27.0	26.6
Qing Dao	3741733	2303501	1438232	16.8	20.8	11.0
He Nan	1030737	677327	353410	31.2	26.7	40.7
Hu Bei	1186254	651750	534504	23.6	31.6	15.0
Hu Nan	794295	534347	259947	39.0	35.2	47.6
Guang Dong	51329527	29861917	21467610	21.2	23.9	17.6
Shen Zhen	23000892	13515746	9485146	23.1	27.5	17.4
Guang Xi	713565	396533	317032	35.6	40.3	30.0
Hai Nan	269183	110845	158338	13.6	-3.5	29.8
Si Chuan	1152952	686676	466276	29.4	29.7	28.9
Chong Qing	594018	364235	229783	32.0	32.9	30.6
Gui Zhou	177316	113860	63456	35.4	36.0	34.4
Yun Nan	693071	366731	326340	37.0	37.3	36.6
Tibet	29873	24828	5045	27.4	56.1	-33.1
Shan Xi	552061	372893	179167	31.1	32.1	29.2
Gan su	448392	133827	314565	58.2	11.7	92.2
Qing Hai	50052	30153	19899	6.3	-23.2	154.4
Ning Xia	125410	85629	39781	7.5	13.3	-3.3
Xin Jiang	1050038	857231	192807	45.3	56.1	11.1

Source: Statistics by China General Administration of Customs

In relatively developed areas, a rapidly growing foreign trade and economy is not only what the central government requires but also necessary to maintain local economic stability and sustainable development. The development of foreign trade could keep firms well operating and foster sustainable economic growth. Hence the development of production and export is the goal for local governments as well as for firms. As for the long-term macroeconomic goal and requirement of the central government, each province or each city is just a part. Only when the target and requirement of the central government is consistent with that of local economic development would the local government accept it as the guideline for their economic activities. Otherwise, the policy could be assimilated by countermeasures.

For relatively less developed areas, economic development is always the priority. The best way to create fortune in short time is to increase the production and export of resource intensive products. Firstly, the pursuit of economic growth makes local governments acquiesce in and even support the increase of production and export. Although it is well known that producing and exporting products with high resource and energy consumption and high pollution would cause a cost in the long run, the development in the long run is not priority of current local administrations. In this situation local governments would support the rapid production growth of resource products at the cost of long-run development. Especially when a strong demand for high resource and energy consuming products at home and abroad and rich profit make the attraction of increasing production and export exceed the pressure, it is no wonder why local governments would like to increase the production and export of such products.

Secondly, the less developed areas usually get more preferential policies from the central government. Although the general principle is to explore the west and to narrow down the development gap between the middle and western part and the eastern part, there are conflicts among these policies. For example, on one hand the local government in western China is required to rely on its own resource advantage and use market economic lever to encourage production of private firms and speed up local economic growth. On the other hand it is required to reduce the consumption of resources and energy and to protect environment. Such policies would have serious negative influence on the developing exploration and processing of resource products. Eventually, the local government has to choose one of the conflicted policies adopted by the central government in order to achieve a favorable result. According to an investigation, the local government has taken all kinds of countermeasures to offset the possible negative impact caused by the policy announced on November 3, 2006. Later on eight inspection panels consisting of officials from eight ministries including the National Development and Reform Commission went separately to some provinces in succession, in order to investigate and clear the illegal preferential price policies for electricity, land and taxation in favor of the high resource and energy consuming industries. Through this special comprehensive investigation, the central government wished to employ more effective policies to control the rapid growth in the high energy-consuming and high pollution industries, and thus to form the

long-term mechanism of accelerating adjustment of the industrial structure and the transformation of growth pattern. We could see that on one hand, local governments was able to counteract the negative effect of policies adopted by the central government when the policies are not consistent with the economic goal of local development; on the other hand, it is rather difficult for the central government to achieve the goal of adjusting industry structure and reducing export only by economic instruments, and finally it had to resort to administrative instruments. It showed that the policy issued by the central government is seldom implemented effectively by local governments. Instead only when the policies of the central government consist with the goal of local economic development could the policies be implemented in an effective way. Otherwise, it is difficult to attain the expected result only by administrative inspection.

In conclusion, in the game between firms and the central government the rigorous measures taken by the central government to restrict export have been counteracted by firms to a large extent. And the countermeasures by firms have got acquiescence and implicit support from local governments. That is to say, it is the countermeasures taken by firms and the implicit support from local governments that aborted the central government's plan of changing production method by restricting export and adjusting industrial structure.

5. Further thinking and some suggestions

The ineffectiveness of Chinese trade policies in 2007 could arise from lack of policy focus and diversity, and the increasingly integrated world economy under which the policies were implemented.

Firstly, the economic policies adopted by governments should have specific pertinence in modern economic situation. Tinbergen's rule shows that each policy instrument should focus on one target. For the problem with the increasing trade surplus, it results from more than growing export. To some extent it is something to do with the production. And therefore, according to the Tinbergen's rule, a most effective instrument to solve the problem associated with production should be industrial policies, while trade policies are the best way to deal with the problem with international trade. We could not achieve our goal by using one instrument to solve a complicated problem. Generally speaking, industrial policies would be helpful to reduce the production and export of resource products with high energy consumption and high pollution, while the best way to control the products causing trade confliction would be trade policies.

Secondly, the central government should take the regional economic disparity into account while make policies. There is significant difference currently in economic situation among various provinces in China. And therefore these provinces pursue different development goals. A proper policy should be multi-level and differential in order to comply with the realistic economy in local provinces. The uniform central policy will definitely cause the conflict between the central and local government, and

consequently for every measure from the central government, there would be a countermeasure at the local level. And furthermore, the more the central government pursue a uniform policy, the further away from local interest and economic reality the policy will be. Hence, the central government should set a uniform goal but with diversified policy measures in consistent with the local situation.

Last but not least, economic globalization raises many new questions. Would the trade policies of individual country change the basic profile of international specialization in context of globalization of production and trade? If so, how long will it take for these policies to take effect and how much would the influence be? All of these questions need further research in the future.