

## The Temporal Features of China's Opening to the Outside World and Its Theoretical Construction

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### Abstract

Over the past 40-plus years of reform and opening up, China has taken a unique path of development that complies with both its national conditions and the laws of development. This paper analyzes the uniqueness and the universality of Chinese experience and the theoretical logic that has permeated the process of China's opening up and kept pace with the times. Within this framework we analyze the key issues and suitable options for China's future opening up.

**Keywords:** opening up, incremental opening up, opening up strategy, institutional opening up

### I. The "General Theory" of Opening Up and the Opening Up Model

The classical theories explaining the decision to open up include "absolute advantage," "comparative advantage," and "factor endowment," while the models explaining the features of opening up can be divided into the "vertical division of labor" and the "horizontal division of labor."

*1. The theories of absolute advantage, comparative advantage and factor endowment: explaining the causes of international trade*

With the start of the Industrial Revolution in the eighteenth century, production capacity and economic conditions began to differ from one country to another, and the characteristics of the economic structure of each country began to stand out. At the same time, the increased capacity of long distance sea and land transportation brought about a significant decrease in transport costs. The rapid development of international trade thus became a marked feature of the era.

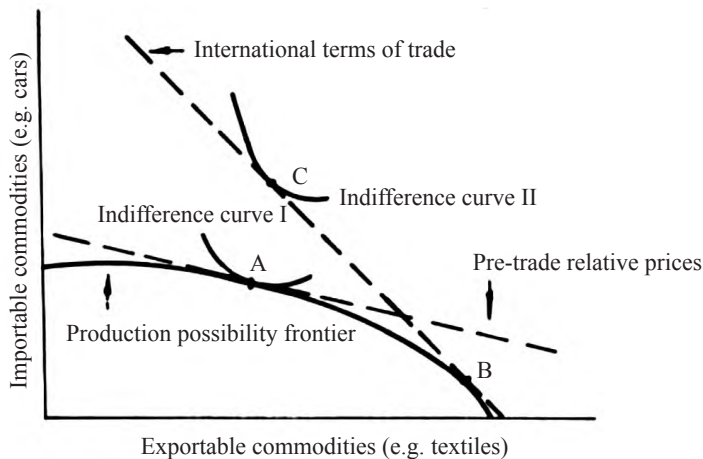
At the time, trade goods consisted of the products of different industries, such as grain, textiles, porcelain, and furniture. From the second half of the eighteenth century, scholars became aware of the importance of international trade and thus began to discuss the significance of the international division of labor and free trade, and ways to ensure

that all participants benefited. Adam Smith, for example, believed that the international division of labor under absolutely favorable conditions of production would increase labor productivity.<sup>1</sup> The theory of comparative advantage advanced by David Ricardo, however, proposed that each country could still make a profit if it exclusively produced and exported products in which it had a comparative advantage even though it lacked absolutely favorable conditions.<sup>2</sup> Heckscher and Ohlin further explained how comparative advantage is generated and why the domestic price ratios of various commodities differ from one country to another; in other words, they put forward the theory of factor endowment,<sup>3</sup> which seeks to locate the causes of international trade in the differences in each country's factor endowment structure and in the international differences in relative factor prices caused by the structural differences in question.

Under the comparative advantage model of the structure of international trade, a country will gain more from trade if it exports those products that use the factors it has in abundance and imports those produced with factors that are scarce domestically. For example, countries with more land resources will export cotton, and those with more technical resources will export textiles. These analyses, which corresponded to the actual trade situation of the time, dealt with trade questions involving different industries, that is, with inter-industry trade.

The diagram in Figure 1 below shows the theories of comparative advantage and factor endowment. It describes how, when a country with abundant labor resources but scarce capital has not yet started trading, it needs to produce textiles and a certain amount of cars; here,

Figure 1 Benefits of International Trade



1 See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, p. 28.

2 See David Ricardo, *On the Principles of Political Economy and Taxation*, pp. 110-118.

3 Bertil Gotthard Ohlin, *Interregional and International Trade*, pp. 7-24.

maximum utility will occur when production and consumption are at Point A, where the indifference curve I is tangential to the production possibility frontier. But once the country engages in trade, it will be able to export textiles and import cars at world market prices, so will produce more cloth and fewer cars. It will thus maximize utility at Point B, where world trading terms are tangential to the production possibility frontier. As can be seen from Figure 1, in such cases the country can consume a little more of both types of goods, that is, it can reach Point C where the international terms of trade line are tangential to the indifference curve II. Since the second indifference curve is above the first one, engaging in trade means that both countries improve their consumer satisfaction and national income.<sup>4</sup>

## 2. *Inter- and intra-industry trade theory: explaining the characteristics of international trade*

The analysis above shows that according to the theories of comparative advantage and factor endowment, any two countries engaged in international trade should exchange products that differ greatly in terms of each country's factor structure. In other words, Country A, with abundant land resources, should export land-intensive commodities such as food, while Country B, with a large population, should export labor-intensive products such as textiles. These products belong to agriculture and manufacturing respectively, so the trade involved is inter-industry.

From the 1960s on, a striking change took place in the content of international trade, as "intra-industry trade" between developed countries became the main part of international trade; that is, the products exchanged in international trade came from the same industry. For example, the two trading countries would import cars, household appliances and other products from each other. Traditional trade theory based on comparative advantage fails to provide a rational explanation for this situation. Therefore, a group of economists interested in trade practice drew on industrial organization theory to develop a new theory of international trade. Michael Michaely (1962) calculated differential data for commodity imports and exports in 36 countries and found that the commodity composition of imports and exports among developed countries was very similar.<sup>5</sup> On this basis, Bela Balassa (1966) introduced the concept of intra-industry trade for the first time, holding that an important cause of intra-industry trade was product differentiation.<sup>67</sup> Product differentiation can be divided into the horizontal and the vertical; the former means that products have the same quality but different features, while the latter means that they have the same features but differ in quality. Horizontal intra-industry trade emphasizes the heterogeneity of the same products, with features including economies of scale and diverse consumer preferences. It mainly occurs between countries at similar economic and technological levels. In correcting

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4 Jiang Xiaojuan, *Study on China's Industrial Development and Foreign Economic and Trade Relations*, p. 6.

5 Michael Michaely, *Concentration in International Trade*.

6 Bela Balassa, "Tariff Reductions and Trade in Manufacturers among the Industrial Countries."

7 Harry Flam and Elhanan Helpman, "Vertical Product Differentiation and North-South Trade."

some of the preconditions of the Heckscher-Ohlin [H-O] model, Grubel and Lloyd (1975) explained part of intra-industry trade by introducing trade-related costs into their revised H-O model.<sup>8</sup> On the basis of the Dixit-Stiglitz [D-S] model, Paul Krugman (1979) proposed a relevant model for horizontal intra-industry trade and used this model to explain how trade between developed countries allowed them to reduce the unit costs of production by increasing firm size, thus obtaining higher profits and satisfying a diverse range of consumer preferences.<sup>9</sup> These models provide a rational explanation for the widespread intra-industry trade between countries with similar technologies and resource endowments. Vertical intra-industry trade, on the other hand, is based on specialization in the production of intermediate goods arising from differences in factor endowment, etc. This is essentially a kind of “vertical trade,” and mainly occurs between industrially developed countries and developing countries. On the basis of the theory of comparative advantage, Falvey and Kierzkowski (1987)<sup>10</sup> put forward a theory of vertical intra-industry trade which held that the use of capital varied with variations in product quality, and that high-quality products had a relatively high capital/labor ratio. In general, those countries with relatively high wages enjoyed a comparative advantage in producing high-quality products, while those with lower wages had a comparative advantage in the manufacture of low-quality products. Because income is unevenly distributed, no country is exempt from economic inequality, so demand for products of different quality exists in all countries.

It can be seen that at this stage, international trade was concentrated on intra-industry trade, so the focus of international trade theory and the content of research were adjusted accordingly.

### *3. The global industry chain: explaining the complex division of labor and trade patterns*

Since the 1980s, the development of information technology has brought about a continuous decline in the cost of communications and transactions, while transportation technology has compressed spatial “time/distance” and greatly reduced transport costs. In order to make the best use of developing countries’ labor forces and market advantages, multinational corporations have transferred those parts of their industry value chain that can be broken down into separate manufacturing and assembly operations from developed countries to developing ones, advancing the evolution of the international division of labor from the original inter- and intra-industrial division to a division of labor and trade involving different parts and processes of the same product, in the intra-product specialization of labor or global industrial chain.<sup>11</sup> The global industry chain has come into being partly because countries on the chain, unable to produce the entire product on their own, produce part of it through the global industry chain, and partly because even when a country can produce

8 Robert E. Lipsey, “Review of Herbert J. Grubel and P.J. Lloyd’s *Intra-Industry Trade: The Theory and Measurement of International Trade in Differentiated Products*.”

9 Paul R. Krugman, “Increasing Returns, Monopolistic Competition, and International Trade.”

10 Rodney E. Falvey and Henryk Kierzkowski, “Product Quality, Intra-industry Trade and (Im)perfect Competition.”

11 Li Xiaohua, “The Embargo on Huawei and the Risk of the Collapse of the Global Value Chains.”

the product itself, it may not be the best at doing so, and so will seek to benefit from the cooperative global division of labor.

The main benefits will be economies of scale and specialization.<sup>12</sup> Statistically, more than two thirds of global trade is driven by global value chains.<sup>13</sup> The emergence of the global value chain facilitates the deepening of the international division of labor and coordinates industry shifts, while participation in a global value chain can enhance a country's economic development. The complementarities of imported inputs and domestic products can raise productivity, and this is more significant than obtaining direct gains from lower prices or higher-quality foreign inputs.<sup>14</sup>

## II. The Laws Governing China's Opening Up and Its Unique Character

China's opening up not only conforms to general laws, but also has a strikingly unique character. From the viewpoint of general laws, changes in the structure of import and export commodities and in the import and export of capital and technology can be explained by the theories of comparative advantage or factor endowment. From the viewpoint of uniqueness of the process, its originality lies in its incrementalism and in the fact that it was used to drive reform.

### *1. The basic situation of China's opening up: compliance with theories and laws*

Since China adopted the policy of reform and opening up, its international trade and cross-border capital flows have complied with the requirements of the factor endowment theory and the laws common to first movers.

(1) In the early stage, China was typically an exporter of labor-intensive products and an importer of capital and technology

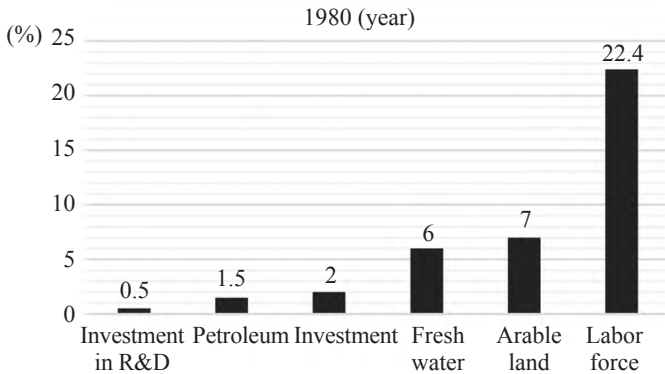
At the beginning of opening up, China suffered from an extreme imbalance of factor endowments, with several of its main factors of production being either high or excessively low as a proportion of the global total. It had an abundance of labor, accounting for as much as 22.4 percent of the world total in 1980, but technology and capital were extremely scarce, with capital accounting for only 2 percent of the world's gross capital formation and gross research and development amounting to only 0.5 percent. In addition, its arable land, fresh water, and petroleum resources accounted for 7 percent, 6 percent and 1.5 percent of the global total respectively. See Figure 2.

12 B. Los, M. Timmer and G. de Vries, "How Global Are Global Value Chains? A New Approach to Measure International Fragmentation."

13 United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2013: Global Value Chains—Investment and Trade for Development*.

14 Pinelopi Koujianou Goldberg, Amit Kumar Khandelwal, Nina Pavcnik, and Petia Topalova, "Imported Intermediate Inputs and Domestic Product Growth: Evidence from India"; László Halpern, Miklós Koren and Adam Szeidl, "Imported Inputs and Productivity."

Figure 2 China's Main Factors of Production in 1980 as a Proportion of the Global Total<sup>15</sup>



Data source: China General Administration of Customs

According to factor endowment theory, products using those factors that are abundant cost less to make and are thus competitive in international markets. Such theoretical analyses make it clear that we should export a large quantity of labor-intensive products, import advanced equipment and raw materials, and draw on foreign capital and technology. This indeed occurred: at the beginning of opening up and for the next three decades, the processing trade played an important role in China's foreign trade, accounting for more than 50 percent of its total foreign trade volume for many years and for more than 55 percent of its total exports. The processing trade was a classic example of labor-intensive export products. The trade thus conformed to China's national characteristics at that stage: abundant labor and low costs. See Figure 3.

(2) The upgrading of the export commodity structure and the increase in outbound investment in the last ten years

Figure 3 Proportion of Processing Trade in Foreign Trade from 1985 to 2008



Source: China General Administration of Customs

15 See Jiang Xiaojuan, *New China's Seven Decades of Opening Up*.

After three decades of development, China’s factor endowments are still changing. The net growth of the labor force has gone from slow to stagnant and thence to a decline; by 2019, China’s share of total world labor had dropped to 20 percent. By contrast, China’s investment capacity has enjoyed continuous rapid growth, and capital has become its most abundant factor, with gross capital formation accounting for as much as c. 26.7 percent of the global total.<sup>16</sup> This is followed closely by investment in R&D, which reached 22.5 percent of the global total,<sup>17</sup> both are higher than the proportion of the labor force. See Figure 4.

Figure 4 China’s Main Factors of Production as a Proportion of the World Total in 2019<sup>18</sup>

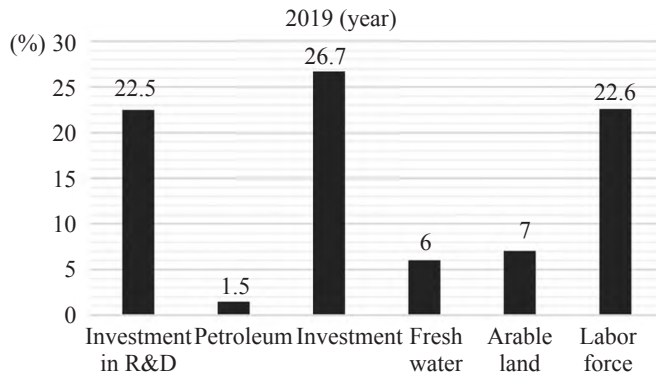
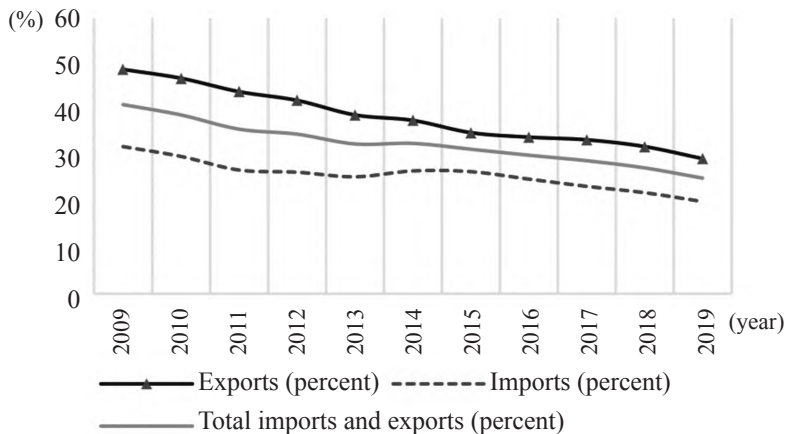


Figure 5 Processing Trade as a Proportion of Foreign Trade from 2009 to 2019



Data source: China General Administration of Customs

16 According to the data from the World Bank, China’s gross capital formation accounted for 25.2 percent, 26.8 percent and 26.7 percent of the global total from 2017 to 2019, and it was forecast that the proportion would be 27 percent or so in 2020.

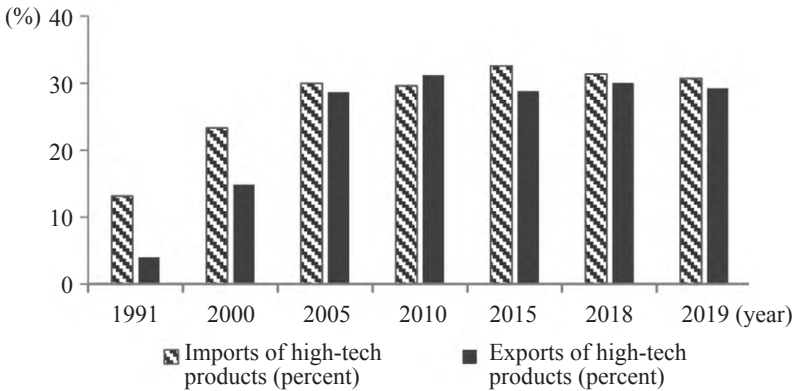
17 The data come from “2021 Global R&D Funding Forecast Released.” The global share of Chinese R&D investment in 2020 is a forecast, <https://www.rdworltonline.com/2021-global-rd-funding-forecast-released/>.

18 See Jiang Xiaojuan, *New China’s Seven Decades of Opening Up*.

The changes in China’s national conditions in the last ten plus years have led to a fall in the share of the processing trade in China’s export commodities trade. It accounts for about one-third of total exports. See Figure 5.

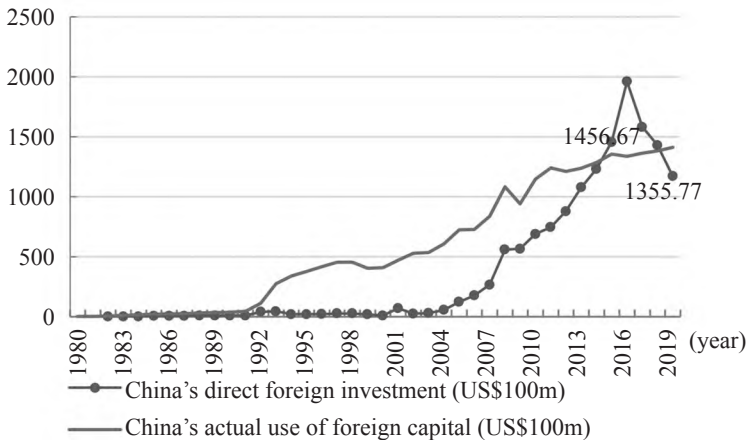
At the same time, the export of capital and technology-intensive products has grown faster and accounted for a higher proportion of total trade. High-tech products as a proportion of export commodities, for example, have been increasing since the 1990s, and now account for about one-third of exports. See Figure 6.

Figure 6 Structural Changes in Import Commodities over Several Years (percent)<sup>19</sup>



Data source: National Bureau of Statistics of China

Figure 7 China’s Direct Foreign Investment and Actual Use of Foreign Capital 1980-2019



Source: National Bureau of Statistics of China

At the same time, China began to change from being a country with a major capital inflow

19 Before 1992, China imported fewer high-tech and new-tech products.



to having equal amounts of capital inflows and capital outflows. Due to the sharp increase in its stocks of capital and investment volume, China's share of total global investment has grown rapidly. For example, China's gross capital formation reached 42.7 trillion yuan in 2019, equivalent to c. 6.2 trillion US dollars and accounting for 26.7 percent of global gross capital formation. Compared with its fresh water resources, which are 6 percent of the world total, its available land resources, which are 7 percent of the world total and its oil resources, which are 1.5 percent of the world total, or even its labor force, which occupies about 20 percent of the world total, capital is already a relatively abundant factor in China. As a result, investors have begun to look toward foreign countries for higher returns to investment. As can be seen from Figure 7, China is now a transnational investor and capital exporter.

## *2. Incremental opening up: a prominent feature of China's opening up path*

(1) The first two decades: incremental opening up from special economic zones to coastal areas and thence to the whole country

Opening up to the outside world was a significant decision made by the Communist Party. The Third Plenary Session of the 11th CPC Central Committee held in December 1978 was an important milestone for China's reform, opening up and modernization. With respect to the outside world, the plenary session pointed out that China should "actively expand economic cooperation on terms of equality and mutual benefit with other countries on the basis of self-reliance, striving to adopt the world's advanced technologies and equipment."<sup>20</sup>

Opening up to the outside world was something new in the economic construction of the PRC. At the time, the whole country faced many political doubts and concerns as well as many economic challenges and uncertainties, and industry was poorly equipped to cope with opening up. In this environment, it was neither feasible nor optimal to carry out opening up all at once. Therefore, the policymakers decided to adopt a "small cut" and "small step" approach to opening up, and in practice created an incremental opening up mode. This incrementalism was evident regionally and in industry, trade, investment and so on, with incremental opening up in the regions being the most representative and comprehensive. A brief description of this process is given below.

The CPC Central Committee and the State Council issued a document on July 10, 1979, deciding to set up pilot zones in Shenzhen, Zhuhai, Shantou and Xiamen.<sup>21</sup> Over the next twenty years, opening up zones enjoying preferential policies were gradually expanded from coastal areas to river and border areas and to inland provincial capitals. By the year 2000, when the strategy of large-scale western region development was implemented to open the region to foreign countries, opening up had been achieved throughout China.<sup>22</sup> This process is

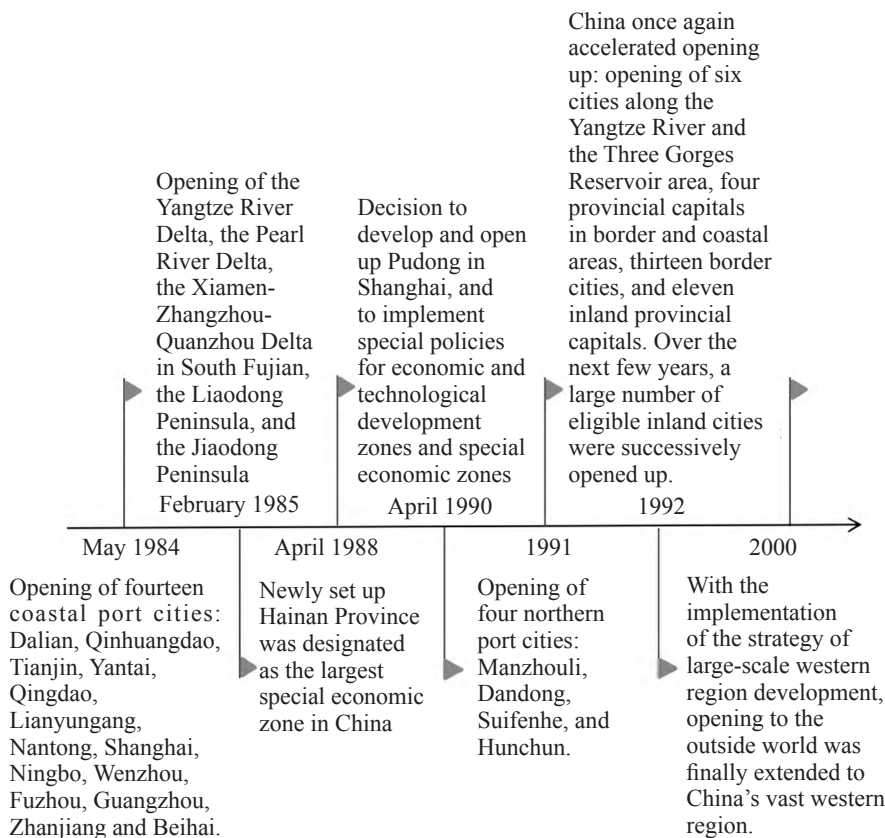
20 Communiqué of the Third Plenary Session of the 11th Central Committee of the Communist Party of China, [http://www.bjreview.com/Special\\_Reports/2018/40th\\_Anniversary\\_of\\_Reform\\_and\\_Opening\\_up/Timeline/201806/t20180626\\_800133641.html](http://www.bjreview.com/Special_Reports/2018/40th_Anniversary_of_Reform_and_Opening_up/Timeline/201806/t20180626_800133641.html).

21 Jiang Xiaojuan, "China's Thirty Years of Opening Up: Retrospect and Prospect."

22 Wang Zixian, "China's Road to Success in Promoting Institutional Transformation through Opening Up."

summarized in Figure 8.

Figure 8 The Course of China's Incremental Opening Up



Data source: Jiang Xiaojuan *et al.*, Appendix, "Major Events and Important Documents in the Thirty Years of Opening to the Outside World," in *Thirty Years of Opening Up in China: Growth, Structure and Institutional Change*. Beijing: People's Publishing House, 2008.

The areas open to the outside world enjoyed more relaxed and preferential policies in foreign trade, utilization of foreign capital and foreign exchange, foreign economic and trade management, etc. For example, in the four earliest special economic zones, a special economic management system was implemented: their governments were granted provincial-level powers of economic management, they were allowed to adopt market regulation measures, the operation of diversified economic sectors was allowed, income tax on foreign-invested enterprises was reduced to the rate of 15 percent, and so forth. The first four special economic zones, especially the Shenzhen Special Economic Zone, went through immense changes in a few short years. The whole country looked up to them

as a development model; their practice provided strongest support for maintaining and expanding opening up.

(2) The next two decades: the accelerated opening up of domestic markets after China's accession to the WTO

After fifteen years of efforts, China finally joined the World Trade Organization (WTO) in 2001. Having fully fulfilled its commitments and multilateral obligations, China achieved a smooth alignment with the world's multilateral economic and trade system during this new stage of its opening up.

Accession to the WTO was a major strategic decision taken by the CPC Central Committee and the State Council thanks to their holding a long-term view, assessing the situation, and seizing the initiative to meet the challenges of economic globalization. Both before and after accession to the WTO, Chinese leaders repeatedly pointed out that China's accession to the WTO would boost domestic structural reform, while competition would enhance the competitiveness of Chinese industry.<sup>23</sup> The 16th Party National Congress held in 2002 reaffirmed the important idea of facilitating reform and development through opening up, stating, "In response to the new situation of economic globalization and China's entry into the WTO, we should take part in international economic and technological cooperation and competition on a broader scale, in more spheres and on a higher level, make the best use of both international and domestic markets, optimize the allocation of resources, expand the space for development and accelerate reform and development by opening up."

Since its accession to the WTO, China has fulfilled its commitments in stages, with the level of large-scale market opening being constantly raised. Its average tariff has dropped from 15.3 percent at its accession in 2001 to 9.9 percent in 2006, with the average tariff on agricultural products falling from 23.2 percent to 15.2 percent and the average tariff on industrial products falling from 14.8 percent to 9.0 percent over the same period. Among the most representative of the tariffs on industrial products was the tariff on complete vehicles, which fell from 69.2 percent to 25 percent, and that on auto parts, which fell from 22.9 percent to 10.4 percent. By January 1, 2005, China had honored the great majority of its commitments on tariff reduction. Moreover, non-tariff measures such as import quotas, import licenses and special tenders, had also been completely abolished by January 1, 2005, as promised. In 2018, China voluntarily lowered its tariff level further, to 7.5 percent.

### III. Augmenting Reform through Incremental Opening Up

#### 1. *Why incremental opening up was chosen*

A marked feature of China's opening up is its incrementalism. For a long time, the opening

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23 Zhu Rongji, "Adapting to the New Situation Following China's Entry into the WTO and Opening Wider to the Outside World."

up of different industries and regions was “incomplete” and “dual-track.” This situation had long been subject to criticism; critics held that it had resulted in long-term market distortion and the misallocation of resources, and so was unsustainable.<sup>24</sup> However, China’s opening up process has been an achievement rarely matched anywhere. This part of the “China story” merits review and summation.

(1) The forging of a consensus rested on practical results

At the beginning of China’s opening up, policy makers were clearly conscious of the need to unify opinion and reach a gradual consensus by demonstrating the beneficial effects of limited opening up. The establishment of special economic zones alone was met with doubts and pressures from different quarters.<sup>25</sup> In these circumstances, laying out a case might be persuasive, but the beneficial results of actually opening up were more important. For example, only a few years after its opening, the Shenzhen Special Economic Zone had made remarkable progress in export growth, attraction of foreign investment, increased employment, urban construction, development of the service industry, residents’ incomes, etc., making the area the cynosure of all eyes for the Chinese people and the rest of the world. The special economic zones played their part in “exploring the way for the national construction of socialism and institutional reform” as required by the CPC Central Committee,<sup>26</sup> thus ensuring that the expansion of opening up would proceed smoothly.

(2) Gaining time for the improvement of domestic industries’ competitiveness

Incremental reform and opening up was a means of lifting controls over additional resources to promote growth while leaving space and time for the adjustment of existing stocks. In its early stages, it allowed the growth of new export enterprises engaged in the processing and assembly of imported materials and compensation trade (*san lai yi bu*), alongside foreign-invested enterprises. However, this did not fundamentally jeopardize the vested interests belonging to the original system, such as state-owned trading companies and manufacturing enterprises. The process thus caused less economic and social disruption and encountered less resistance. At the same time as opening up was under way, domestic reform was launched and developed. The entry of foreign-invested enterprises and the increase in domestic enterprises with a variety of ownership forms resulted in competitive pressure. This led to the rapid growth of private enterprise and also to a significant improvement in the competitiveness of state-owned enterprises, which underwent a continuous reform and adjustment that increased their ability to compete. This meant that the overall strength of domestic industries was on the upswing. Overall, China acquired the ability to compete with

24 For foreign scholars’ analysis of this question, see Nicholas R. Lardy, *Integrating China into the Global Economy*.

25 For the vivid account on this historical period, see Li Lanqing, *Breaking Through: The Birth of China’s Opening Up Policy* (Chinese edition).

26 Sun Changxue, “The Structural Reform Exploration of Shenzhen Special Economic Zone and Its Demonstration Value.”

multinational companies in an open environment. From the perspective of industry economics, an enterprise's move from the domestic to the international market entails a complex process of the transformation of information processing mechanisms, a process to which the enterprise can only adapt gradually through practice.<sup>27</sup>

(3) China's incremental opening up had particularly advantageous conditions

In its early stages, China's national conditions had two features conducive to incremental opening up. One was the enormous labor force gathered in the countryside, where their work brought an extremely low return; this enabled the transfer of hundreds of millions of workers who were ready to accept relatively low wages. These initial conditions offered support for manufacturing industry's long-term absorption of large quantities of new workers at a relatively low cost and also supported the long-term growth of labor-intensive export industries. The other factor was Hong Kong and Macao. The presence of "compatriots" and "controllability" greatly reduced resistance to the establishment of special economic zones.

In short, in the course of opening up, policy makers kept weighing the various factors involved in the relationship between reform and opening up on the one hand and development and stability on the other. In doing so, they gained time for adapting and adjusting to macro-economic regulation, improving industry competitiveness, and reforms in a number of areas, thus ensuring the achievement of consensus and the stability of the overall situation.

*2. Opening up created both the demand for reform and systemic supply*

Opening to the outside world facilitated the establishment and improvement of the socialist market economic system.

(1) Opening up created new systemic demands: the source of reform choices

Establishing special economic zones, attracting foreign investors to set up enterprises in China, expanding foreign trade through *san lai yi bu*, etc., necessarily placed demands on the operation of the market. This demand-led reform option promoted the foreign trade system within the sphere of the special economic zones, and enhanced the formation and development of such institutional frameworks as commodity markets, factor markets, labor markets, enterprise ownership structures, economic management systems, and legal and regulatory systems. The special zones thus provided comprehensive laboratories for the reform of the domestic economic system.<sup>28</sup>

(2) Opening up provided a new systemic supply: reference material for the direction of reform

27 For more examples, see Jiang Xiaojuan, *Foreign Investment in China: Contributions to Growth, Structural Upgrading and Competitiveness*.

28 Zhou Xiaochuan has commented that the early reform measures on opening up the economy and trade to foreign countries were quite effective, with demonstration effects that boosted reform as a whole; they were at least as effective as reform in the countryside. See Zhou Xiaochuan *et al.*, *Transformed Mindset for an Open Economy*.

The establishment of special economic zones enabled China to learn from, draw on and introduce international experience. In market operations, China learned about modern enterprise management from foreign-invested enterprises; it grasped the institutional mechanisms needed for enterprises to increase output and expand exports; and it learned how to make good use of the price mechanism, what an effective investment system was, how to manage foreign exchange, etc. The establishment of the special economic zones facilitated the alignment of the Chinese and international accounting systems, thus furnishing a basis for China to improve corporate transparency and build market confidence and expectations in the global market. The new accounting system, which basically matches international practice, has been implemented across the country since July 1993. In particular, China's entry to the WTO encouraged benchmarking of the global multilateral trading system and the building of an all-round socialist market system.<sup>29</sup>

(3) Opening up created a demand for the making of laws: the choice of legislative order

The establishment of a legal system in China that would be compatible with the market economy started with the enactment of laws on the raising of foreign capital. The Law on Chinese-Foreign Equity Joint Ventures was promulgated in July 1979. The drafting of this law drew on the relevant codes and regulations of more than thirty countries, providing a stimulus to China's market-oriented reform. It was soon followed by the Income Tax Law on Chinese-Foreign Equity Joint Ventures; the Regulations on Foreign Exchange Administration; the Measures for the Administration of the Registration of Chinese-Foreign Joint Ventures; and the Regulations on Labor Management in Joint Ventures Using Chinese and Foreign Investment, etc. Between 1983 and the end of 1991, the National People's Congress and the State Council alone promulgated more than two hundred economic laws and regulations to do with foreign relations. These laws and regulations, which introduced the market economy's most necessary and most basic concepts and institutional frameworks, played an important pioneering and illuminating role for subsequent market-oriented reform.

(4) China's accession to the WTO encouraged comprehensive benchmarking

Before and after its accession to the WTO, China took action to meet the requirement that the economic and trade systems of a WTO member country should be consistent with the WTO's multilateral system. A large-scale clean-up of laws and regulations was undertaken; managerial systems that were unsuited to the market economy were vigorously reformed; and a system of foreign-related economic management was established that not only conformed to international rules but also suited China's national conditions. The basic WTO principles of national treatment, transparency, non-discrimination, and fair competition were all embodied in the laws and policies formulated and revised during this period. With China's entry to the WTO, the construction of its legal system made great strides on the basis of the laws

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29 Long Yongtu, "The Profound Influence of China's Entry to the WTO on China's Society and Economy."

governing the market economy.

At the same time, in order to encourage domestic enterprises to participate more in international competition, China began to accelerate domestic reform. As a result, it made significant progress in transforming government functions, deepening the reform of the administrative system, perfecting a unified and fair market system, and strengthening the protection of intellectual property rights. This gave a strong stimulus to overall reform, with expanded opening up providing a further impetus to domestic reform.<sup>30</sup>

After its accession to the WTO, China accelerated many aspects of its domestic reforms, especially the opening of its domestic market. The table below shows some important measures taken before and after China's accession to the WTO; they cover the making of laws, the opening up of the service sector, transparency, the foreign trade system, and the foreign capital system.

Table 1 Important Opening Up Measures Taken by China before and after Entry to the WTO

Classification	Related Policies
Laws	In order to make China's trade-related legal system consistent with multilateral rules, the central government formulated, amended or abolished more than 3,000 laws, administrative regulations, and departmental rules between the end of 1999 and the end of 2005.
	The Law on Legislation and the Regulations on Procedures for the Formulation of Administrative Ordinances were enacted in 2003.
	The Foreign Trade Law was amended in April 2004.
	The Trademark Law, the Anti-Unfair Competition Law, the Patent Law and the Copyright Law have been amended in recent years.
	The Foreign Investment Law was enacted in 2020.
Opening up Service Industries	Since 2001, China has formulated or amended a series of laws and regulations for further opening up in a number of service sectors, including banking, insurance, securities, telecommunications, etc. Its commitments on the services trade have effectively been met.
	Of the more than 160 service trade sectors classified by the WTO in 2006, China has opened up 100, accounting for 62.5 percent of the total. This is close to the average level of developed member countries.
	In 2007, China met its commitment to opening up the services trade on its accession to the WTO, opening up 100 sub-sectors in nine categories as classified by the WTO.
Transparency	In the Special Administrative Measures on Access to Foreign Investment (Negative List) (2018 Edition), promulgated on June 28, 2018, restrictions on the services sector were limited to 22 sub-sectors. Restrictions on entry to some fields will either be removed or will have a prolonged transition period. After the expiry of the transition period, the restrictions on entry will either be cancelled or relaxed.
	A new Administrative License Law was enacted in 2003, imposing stricter and more specific requirements on the regulation and transparency of government actions.
Transparency	On January 1, 2005, China abolished all import non-tariff measures for 424 tariff categories, including import quotas, import licenses and specific tenders, fulfilling the commitment it had made in Annex 3 of the Accession Protocol and thus establishing an open and transparent system of tariff quota management.

30 Long Guoqiang, "Ten Years after China's Accession to the WTO: A New Starting Point."

Foreign Trade System	<p>According to the amendment to the Foreign Trade Law in April 2004, China fulfilled its commitment to grant foreign trade rights half a year ahead of schedule on July 1, 2004, abolished the system of examination and approval for foreign trade rights that had been implemented for fifty years, and began to implement a system of registration and documentation for foreign trade operators.</p> <p>Since July 2004, the system of examination and approval for import and export operation rights has been superseded by a system of recording and registration which has brought new dynamism to enterprises' foreign trade activities.</p>
Foreign Capital System	<p>Three basic laws on attracting foreign investment have been amended: the Law on Chinese-Foreign Equity Joint Ventures, the Law on Chinese-Foreign Cooperative Joint Venture Enterprises, and the Law on Foreign-funded Enterprises, as well as their implementing rules or regulations. The amendments abolished the requirement for a foreign exchange balance.</p> <p>The Special Administrative Measures for Foreign Investment Access (Negative List) (2018 Edition), promulgated on June 28, significantly reduced restrictions on foreign investors.</p> <p>The entry into force of the newly formulated Foreign Investment Law in 2020 gave foreign-invested enterprises national treatment.</p>

Data sources: Long Guoqiang, "Ten Years after China's Accession to the WTO: A New Starting Point," *International Economic Review*, 2011, no. 4; Jiang Xiaojuan, *New China's Seven Decades of Opening up*. Beijing: People's Publishing House, 2019.

#### IV. Future Deployment and Prospects: Institutional Opening Up and Opening Up to a High Standard

The Decision of the CPC Central Committee on Some Major Issues Concerning Comprehensively Deepening the Reform passed at the Third Plenary Session of the 18th CPC Central Committee in 2013 explicitly called for "carrying out a new round of high-quality opening up," and the report by the 19th Party National Congress in 2017 proposed the creation of a new situation of "all-round opening up" with active participation in and promotion of economic globalization, and the development of an open economy at a higher level. The raising of these top-level strategies shows that China has entered a new stage of opening up marked by four distinctive characteristics.

##### 1. *Shifting from policy-based opening up to institutional opening up*

The Fourth Plenary Session of the 19th CPC Central Committee in 2019 and the Fifth Plenary Session of the 19th CPC Central Committee in 2020 both proposed promoting institutional opening up in terms of rules, regulations, management and standards. Over the past forty years, China has adopted differential policies to guide its opening up in different times, places, and industries. China had always pursued opening up policies that tended to encourage exports but restricted imports, that called for capital inflows but constrained capital outflows, and that gave preferential treatment to foreign-invested enterprises. This tendency—the result of China's national conditions, developmental stage and industrial competitiveness—is the strategy adopted by many other countries when they were at the same development stage. After four decades of reform and opening up, huge changes have



taken place in the country's conditions and environment, and the socialist market economic system has been largely established. Correspondingly, China has entered a new stage of economic development; we basically have the conditions and environment for institutional opening up. In future, therefore, China should improve and shape its system of institutional opening up, should continue to improve its foreign-related economic laws and regulations, should adhere to the principle of giving equal status to all types of economic entities and equal protection to all types of property rights, and should improve enforcement of the laws. Firstly, exports and imports should be treated equally. Using exports to expand one's markets and benefit from economies of scale and division of labor is just as important as using them to draw on foreign resources and improve the technological level and competitiveness of domestic industries. Secondly, China should treat absorption of inward foreign investment and outbound investment equally: adopting the capital, technology, advanced products and management experience brought by foreign investors is as important as the gains from investment income, the expansion of exports, production in a host country, and the acquisition of foreign technology brought by outbound investment. Third, China should treat foreign and domestic enterprises equally, enabling both to improve domestic economic development and international competitiveness. Fair competition can sort out those enterprises that enjoy strong and comprehensive competitiveness while encouraging industry as a whole to become more efficient and competitive and realizing high-quality internal and external circulation.

## *2. Entering into high-standard trade agreements improves opening up*

In recent years, new multilateral and bilateral trade agreements of a high standard have emerged under the influence of a variety of factors. They include the Japan-EU Economic Partnership Agreement, the United States–Mexico–Canada Agreement, and the EU-Canada Comprehensive Economic and Trade Agreement. These trade agreements cover such items as zero tariffs, the opening up of services, trade in services, e-commerce market access, intellectual property rights protection, environmental protection, etc. At the APEC Economic Leaders' Meeting on November 20, 2020, President Xi Jinping announced that China “will give positive consideration to the idea of joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP),”<sup>31</sup> a move that has attracted wide attention and a big response at home and abroad. The CPTPP, signed by eleven members, is characterized by its ambitious scope, high standards and new rules, and is representative of the high-standard free trade agreements since 2018. These agreements, if they all enter into force, will cover more than 55 percent of international trade and investment and will thus facilitate a new round of globalization in related fields. In 2021, China joined the Regional Comprehensive Economic Partnership (RCEP) and applied for membership of the Digital Economy Partnership Agreement (DEPA). This will certainly

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31 Xinhuanet.com, “China Positive to Joining CPTPP: Xi.”

enhance domestic construction and its linkage with institutional opening up, act as reverse transmission on domestic reform, and fuel both supply-side structural reform and institutional innovation. Furthermore, China will be contributing to the future formation and development of a global governance system.

### *3. Establishing free trade zones and exploring new paths for high-quality opening up*

Since 2013, China has set up 21 pilot free trade zones at different stages in the expectation that they will provide experience for further opening up and greater freedom in trade and investment. Moreover, the Hainan Free Trade Port, established in 2018, has made considerable progress in the promotion of high-quality opening up. The Fifth Plenary Session of the 19th CPC Central Committee called for improving the disposition of pilot free trade zones and granting them greater autonomy in pursuing reform. The Outline of the 14th Five-Year Plan (2021-2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035 is another enterprise that stresses the need to implement the strategy of upgrading free trade zones, deepening trade and investment liberalization, and forming a network of high-quality free trade zones open to the world. The Outline also specifies that in negotiations on new trade and investment rules and issues, such new areas as trade facilitation, investment, e-commerce, the environment, and government procurement should be given priority. It emphasizes that China should make use of free trade areas' practice and experimentation to provide experience and direction for China's entry into high-quality trade agreements.

### *4. Accelerating the creation of a better competitive environment*

In the course of further opening up, imbalances in basic domestic economic variables and market distortions will have an impact that extends beyond national boundaries, magnifying their negative influence. For example, enterprises could overuse and even export large quantities of a particular factor if market supply and demand or opportunity costs are not promptly reflected in the price. Again, domestic enterprises can raise funds at home and attract foreign capital, and can also invest overseas. However, unless capital allocation in the domestic financial sector can show a marked improvement in its efficiency level, international investment and financing will occur most frequently. Furthermore, major overseas securities markets and exchanges everywhere are fiercely competing for high-quality Chinese enterprise listings. If China fails to make its securities markets efficient and transparent, its high-quality enterprises will seek to be listed overseas. Future reforms should have a high starting point and should correct factor market constraints and distortions so as to efficiently allocate resources in a system of dual circulation in which domestic and overseas markets reinforce each other.

To promote this dual circulation development at a higher level, the government should shift from its traditional focus on drawing up industry policy to creating a high-quality competitive environment. It should be committed to maintaining market order, preventing monopolies and unfair competition, improving the quality of factor supply, researching and publishing information on industry development, and conducting the necessary management

of industry access according to law in the areas of environmental protection, energy saving, product safety and national security. Industry subsidies should be significantly reduced or even eliminated, and any necessary subsidies should be made more transparent so that they comply with the principle of fair competition. The government should strictly crack down on intellectual rights infringement, counterfeiting and fraud. In addition, we must achieve a regularized and law-based business environment in furthering reform, so as to provide clear and stable rules for businesses that will foster stable expectations; in other words, we need to further improve institutions for protecting personal and property rights. In short, China should intensify its efforts to develop its market and competition systems, and build a developmental environment that meets the requirements of high-level dual circulation.

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