

Formation and Alteration of Multistage Distribution System of Consumer Goods in China¹

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Abstract: Emphasising the social and historical background of the People's Republic of China, this paper analyses the transition in distribution policy since the birth of China, and traces the history of wholesale systems. The purpose of this paper is to investigate the transition of distribution system in China, in particular wholesale structures, by dividing the history of China into four different periods. Then it discusses how multistep distribution mechanisms came into being, why they have changed, and why they remain in existence.

Keywords: distribution system, consumer goods, China

JEL Classification Numbers: F14, L81, N75

1. Introduction

Following China's adoption of 'the reform and opening-up policy', its distribution system of consumer goods has undergone drastic changes. Many foreign-affiliated companies gained access to Chinese markets in 1990s, and China became a member of the WTO in December 2001. These events exposed China a powerful tide of globalization in business practice and in actual distribution systems. For example, sales channels became more multifaceted, the structure of Third Party Logistics (3PL) was introduced, and supply-chain management has become more prevalent.

In general, the modernization of distribution channels means that several constraints between production and consumption are removed or reduced in importance, such as the pattern of vertical integration and price administration in the stages of wholesaling and retailing. In other words, if competition in wholesaling and retailing, improved distribution to customers, and stabilized retail prices are promoted, these factors should serve to increase in real national income and improve the quality of life of consumers.

However, multistep distribution mechanisms, which are a remnant of former times, are still operational in China. How did these distribution structures come into being? What has made them change? Why do they still remain? Literature on the distribution systems in China, particularly a study written by the Institute of Japan, Chinese Academy of Social Sciences (1994) has begun to influence studies of business economics in China. Other comparative studies of Chinese distribution systems also

deserve examination: Nanbu (1986), Huang (1997), Matsue (1999), Xie (2000), Kondoh (2001), Ye (2002) and Terashima and Hong (2003). In addition to these studies, Shioji (2002) explains the system of motor vehicle dealers, Sekine (2005) considers distribution routes for household electrical appliances and Takahashi (2004) analyzes the transitions in Chinese distribution systems by focusing on the beer industry. Although a large number of studies involving analyses of distribution systems in China have been carried out, little is known about the formation and transformation processes of multistep distribution mechanisms.

This paper's primary objective is to summarize the transition in distribution policy since the establishment of the People's Republic of China, and to trace the history of wholesaling systems. While emphasizing the social and historical background of China, this paper focuses on four periods: (1) from 1949 to 1978 (i.e., from the birth of the People's Republic of China to pre-reform and openness era), during which time multistep distribution structures initially arose, but a state of chaos made the government implement various types of public policies for marketing that triggered off stagnation in the distribution system towards the end of this period; (2) from 1979 to 1992 (i.e., from the beginning of the 'Open Door Policy' to the establishment of the socialist market economy), when the shift to the policy of reformation and opening in the 1980s promoted the development of individually and privately owned commercial entities, with retail business spreading rapidly; (3) from 1992 to 2000 (i.e., the period when various efforts to get the socialist market economy into full swing, and the policy of opening the country to distribution by foreign companies started), when the government promoted the rationalization and modernization of distributive trading aimed at qualitative advancement and opened up trade to foreign enterprises more actively; (4) From 2001 to the present (i.e., after China gained membership of the World Trade Organization (WTO)), when China has placed greater emphasis on the fulfillment of the goal of a 'harmonious society' rather than on socialism, and when, following the accession of China to the WTO, it drastically opened up distributive trade that was previously strictly restricted for foreign capital enterprises. This paper is intended to provide the results of an investigation of the transition of distribution systems in China, particularly wholesale structures, by dividing the analysis into separate periods. The effects of China's accession to the WTO on domestic distribution systems, however, are too complicated to be examined in detail here.

2. The Formation and Stagnation of Distribution Systems

Following World War II and the third domestic revolution war (the civil war between the Chinese Communist Party and the Kuomintang Party), the People's Republic of China (PRC) was established in 1949. The development of the Chinese economy from this time until the end of the Great Cultural Revolution can be divided into two stages separated by the Great Leap Forward, which was predominantly pursued in 1958. With that in mind, this section analyzes the transition in public policy regarding marketing and the process of the generation and development of a distribution system

involved in this transition. The first part of this section refers to the period from the foundation of the country to the First Five-Year Plan (1949-57), and the latter part refers to the period from the Great Leap Forward to the start of the reform period (1958-78).

The framework of three-stage wholesaling (i.e., primary dealers, secondary dealers, and tertiary dealers) was almost complete in 1950s. Indeed, China changed its administrative structure several times, but sustained these multi-stage wholesaling systems until their abolishment and integration after the 1980s. It is illuminating to understand the distribution policies of this period.

2.1. The introduction of a centralized distribution system

Around the time that the PRC was established in 1949, some investors monopolized the goods market, prices went up sharply, and distribution systems across the country were plunged into chaos. Therefore, the authorities established state-owned enterprises to engage in distributive trade and tightened control over speculative dealings. Regarding the political measures that were taken, the government established the Department of Trade to control the state-owned enterprises under a unified command in 1949, when the Government Administration Council announced the decreed 'Administrative Ruling on the Unification of Public Finance and National Economy' and the 'Administrative Ruling on the Unification of the Manner of Practicing Nationwide State-controlled Trade'. The Government Administration Council had control over the balance of payments and directly managed all state-owned enterprises involved in trade; it also acted as a government institution to consolidate production and valorize planned commodities. Centralized distribution systems appeared and been developed from this period.

During this time, the government emphasized the fact that industries created value, but was also conscious of the assertion that trade could not create value, but rather would lead to inflation because of exploitation by intermediaries. In order to stop inflation, the state took control of wholesale trade from the time of the founding of PRC. In 1954, the government issued 'Instruction on Market Management and Increased Conversion of Private Trade', and encouraged private wholesalers to follow the 'Liu', 'Zhuan', or 'Bao' policy. 'Liu' meant that dealers were to interpret the situation themselves and suspend activities or stay in business under state-owned wholesale agents as in the past. 'Zhuan' meant that the government directed dealers to change occupations, and they became involved in 'new' wholesale trade on behalf of state-owned distributive firms. 'Bao' meant that dealers wound up their companies, conducted job training for their employees, and assisted them in obtaining employment in state-owned distribution firms. This policy was essentially the shifting of private trade to socialism, and began with the restriction of private wholesale trade. After the 'Liu', 'Zhuan', or 'Bao' policy, the proportion of state-owned wholesale dealers rose from about 70% at the end of 1953 to about 90% at the end of 1954. At this point, the government had nearly completed the shift from private wholesaling dealers to socialist practices.

In tandem with the changeover, the government conducted the forced acquisition of foreign-affiliated enterprises in the early 1950s and the socialization of private enterprises by joint

management with the government in 1956. Jointly-managed private enterprises meant that government officials were now participating in the management of private enterprises, in other words, national capitalism. Under this process, the state converted private enterprises into semi-governmental corporations by investing money, with the government paying interest on private enterprises' financial contributions according to the amount of investment, thereby substantially taking control of management. The government also adopted a form of joint management with the privately operated retail trade and implemented its conversion. As stated above, the government shifted industry and business to socialist practices by focusing on the exclusion of a commodity economy. As a consequence, as shown in Table 1, the proportion of privately operated businesses decreased rapidly from 85.0% in 1950 to 2.7% in 1957. At the same time, the proportion of trade that was state-operated expanded from 14.9% to 65.7%, and the percentage of jointly managed commerce with the government went from 0.1% to 31.6%. This distributive management structure under the control of the administrative authorities lasted for 30 years until the government took a bold course of modernizing to a commercial management system in 1978.

Table 1 Shifting from private management to socialism (percentage)

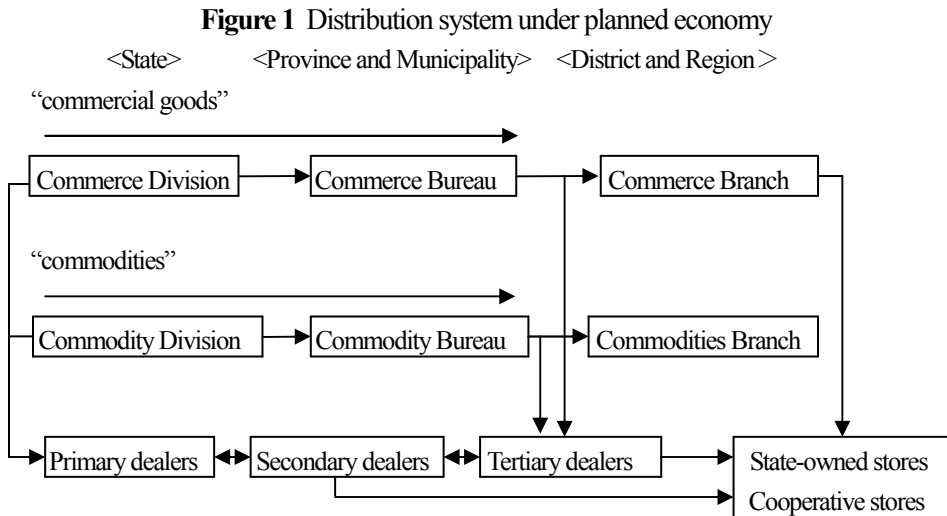
Annual	Governmental management	Joint management with the government	Private management
1950	14.9	0.1	85.0
1951	24.4	0.1	75.5
1952	42.6	0.2	57.2
1953	49.7	0.4	49.9
1954	69.0	5.4	25.6
1955	67.6	14.6	17.8
1956	68.3	27.6	4.2
1957	65.7	31.6	2.7

Source: National Bureau of Statistics of China (1959) p.34.

2.2. The classification of 'commodities' and 'commercial goods'

The socialist system established a classification system to control products by classifying them as either 'commodities' or 'commercial goods'. The supply system for commodities dealt with raw materials, machinery and equipment, and automobiles among government-owned enterprises. The supply system for commercial goods dealt with general consumer goods, agricultural products, and producer goods for agriculture. It must be kept in mind that this classification is based on socialist theory, and the same item can be considered as a 'commodity' in one instance and as 'commercial goods' in another depending on who is buying or selling it. In addition, the government allocated commodities on

the basis of planning, while commercial goods were divided into two groups: those under planned control and those for free sale.



Note: Arrows indicate the order and direction of command by administrative departments and the flow of logistics.

Source: Huang (2002) p.81.

In urban areas, units affiliated to the General Merchandise Division conducted administrative inspections on the supply system of commodities, and units affiliated to the Commerce Division did the same on the supply system of commercial goods (see Figure 1). In fact, the central government introduced a Commerce Division and a Commodity Division, provincial and municipal governments a Commerce Bureau and a Commodity Bureau, and district and regional governments a Commerce Branch and a Commodity Branch. Under the planned economy, the central government issued a commission and order first, then the provincial and municipal governments, and finally the district and regional governments. The logistics flow was dependent on this structure.

It must be kept in mind, however, that the administrative control agency was different from the department of production and distribution management. For instance, provincial and municipal governments established a first trade agency that had jurisdiction over industrial distribution and department stores. They also established a second trade agency, which had jurisdiction over food distribution and private stores, and a drinking and eating service agency, which took control of diet and services. All of these agencies belonged to the administrative control agency. Meanwhile sub-food wholesaling firms, fruit firms, and sugar, tobacco and alcohol firms were established under the Commerce Division, but all of them were part of the departments of production and distribution management. Figure 1 delineates ‘Primary dealers’, ‘Secondary dealers’, and ‘Tertiary dealers’ for convenience; in brief, these dealers played a central role in the actual supply system of commercial

goods.

On the other hand, supply and marketing cooperatives were responsible for distribution in rural areas, for example, the supply of articles for daily use and production materials for peasants and the purchase of important agricultural products, which were required as industrial raw materials. However, even during the planned economy period, the government did not completely exclude non-planned distribution such as free market activities in urban and rural areas and the exchange of commodities between each area.

Control over food distribution took the following course. The government established the new Ministry of Trade based on the Central Trade Branch in 1949 and arranged for it to manage domestic commerce and foreign trade. It then founded fifteen national specialized companies under the Ministry of Trade between 1950 and 1951, eight of which were involved in domestic commerce. The government then abolished the Ministry of Trade and divided it into the Ministry of Foreign Trade and the Commercial Department in order to prepare for the First Five-Year Plan (from 1953 to 1957) in August 1952. Furthermore, the Ministry of Food was established by merging the Food Firm (originally belonging to the Ministry of Trade) and the Total Food Control Agency (originally belonging to the Ministry of Finance). Afterwards, by readjusting the National Commerce Control Agency, these institutions were developed into five central divisions: the Ministry of Commerce, the Ministry of Food, the Ministry of Urban Service, the Ministry of Fisheries, and supply and marketing cooperatives. At the same time, the government formed the production network based on the division of labor by the state-owned enterprises that belonged to each department under such standard as commercial goods, urban or rural.

2.3. Restructuring of wholesale trade: the establishment of wholesaling stations based on economic zones

As the government shifted the trading system to socialism, it put a framework in place to enable ‘Unified Guidance’ and ‘Mechanism of Classification’, which meant that the central government led in a unified way, granted power to local governments, and both governments took on administrative tasks at each stage. Specialized companies that were established at every administrative level and district had previously mainly conducted two types of activities: administration and management; however, this was modified to establish institutions to manage enterprises.

Accordingly, the government delegated the management of commercial goods to wholesale stations of each class, which is what is referred to by the establishment of wholesale stations based on economic zones. As shown in Figure 2, the primary wholesale agents (the first-class wholesale stations) were established under chief specialized companies in large cities such as Shanghai, Tianjin and Guangzhou. Similarly, the secondary wholesale agents (the second-class wholesale stations) were founded in provinces, cities, and autonomous regions, and the tertiary wholesale agents (the third-class wholesale stations) and retail shops were placed in municipalities and counties, respectively. The arrows in Figure

2 indicate the flow of goods. Goods were put into circulation according to their prescribed order. The three-staged wholesaling system was now completely established. Despite later alterations of the department of management, this system remained in place until 1984 when the government abolished and integrated the three-stage wholesaling structure.

Primary wholesale agents were formerly specialized companies that belonged to the Ministry of Commerce, and they were established in big cities where the manufactures congregated and the main import ports. These agents delivered merchandise from the given area or surrounding regions, collected and transported imported goods, and took charge of distribution and supply across China. They dealt with the secondary wholesale agents in the region and a few large-scale retailers; primary agents numbered in the dozens in 1957.

Secondary wholesale agents were the parent companies of the specialized companies that dealt in the items available in the provinces, cities, and autonomous regions, and they were based in provincial capitals or transportation hubs. These agents delivered merchandise from the primary wholesale agents, bought goods in the area, and controlled the distribution and supply within regions. They dealt with intraregional tertiary wholesale agents and large-scale retail stores; there were a few hundred such agents in 1957.

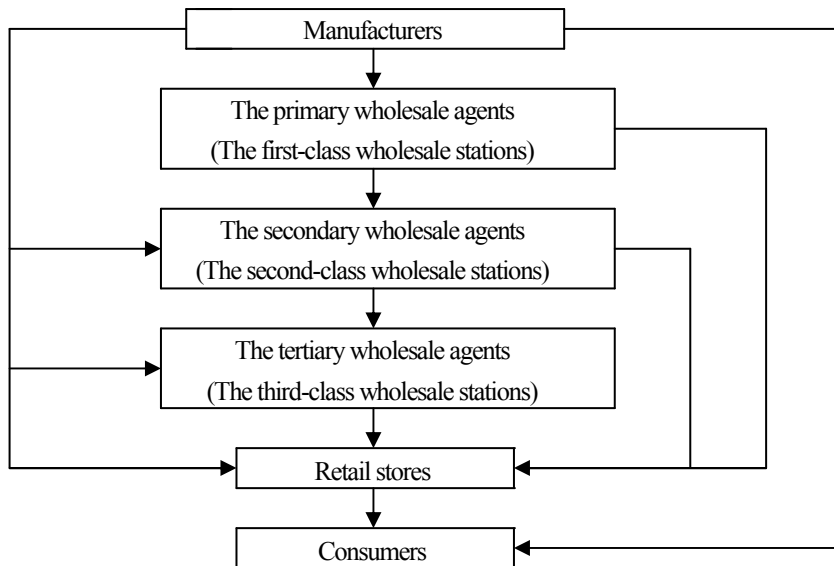
The tertiary wholesale agents were the parent companies of the specialized companies that dealt with the items available in each municipality and county, and they were located in the boroughs of small cities or counties. These agents delivered merchandise from secondary wholesale agents, bought goods in the district, and supplied commercial goods to the retailers in the zone. They were also required to create stockpiles, and some of them doubled as retailers. There were more than 10,000 such agents in 1957.

Under this distribution system, the most important task was the allocation and distribution of goods according to the plan of the central government, with each agent being assigned certain tasks within this plan that had been designed by the planning authority. It was essentially impossible for both manufacturers and wholesalers to make any independent decisions. The main reason for this was that the government had adopted the 'Three fixed' policy. In brief, this involved limiting supply areas, specifying the supply targets, and fixing the profit margins. Commercial distribution did exist among each wholesale dealer, but they did not exchange information, because the dealings were limited to designated business partners. The resulting situation was far removed from an appropriate distribution system. Furthermore, there was no competition in single distribution routes, so some companies enjoyed monopolies in their respective sectors. Conversely, the manufacturers could not provide the necessary articles for certain markets. Thus, the system during this period was extremely inefficient.

The structure of socialist commerce, as mentioned above, was constructed during this period. At the same time, a mechanism of distribution, which was characterized by exclusivity, a small number of channels and a multiple-step form, was established. The public policies for marketing at that point achieved the set goals to a satisfactory degree in terms of market stability, the curbing of inflation, and the recovery of the national economy. However, the exclusion of privately operated trading and the

introduction of a centralized distribution system reduced the advantages of trade such as market vitality and competition among firms.

Figure 2 The three-stage wholesaling system in China



Source: Institute of Japan, Chinese Academy of Social Sciences (1994) p. 25.

2.4. Social chaos and stagnation of the distribution system

Because of massive political campaigns and natural disasters that caused the suffering of a large number of victims due to famine, China fell into a state of chaos between 1958 and 1978. Specifically, these incidents were the ‘Great Leap Forward’, the ‘Three Years of Natural Disasters’, and the ‘Great Cultural Revolution’. This period can be roughly divided into four phases. The first phase is the years of the ‘Great Leap Forward’ (1958-60), when the government eliminated the market mechanism by disregarding the overall economic order and the abusing the distributing program. The second phase is the period of adjustment of the national economy (1961-65), when the government corrected some of the errors of the ‘Great Leap Forward’ and simultaneously carried out certain adjustments by emphasizing planned management and market balance. The third phase is the age of the ‘Great Cultural Revolution’ (1966-76), when the normal marketing order was entirely destroyed, as were the regulatory effects of the market mechanisms. The fourth phase is the period of adjustment after the ‘Great Cultural Revolution’ (1977-78), when the government restored the focused and unified management of planning. Over the twenty years from 1958 through 1978, the government implemented various types of public policies on the market in order to resolve the food crisis, and it created stagnation in the distribution

system as a result.

As for the distribution policies of the period, the State Council issued 'The regulation on the administrative structure of commerce' in November 1957. The government not only relegated the management of companies that were engaged in commerce to a less competent subordinate agency, but it also merged the governing structures of firms and the administrative branch of the government. This scheme made it possible for each local government to supervise all enterprises that belonged to the commercial sector, with the exception of the primary wholesale agents. Additionally, some local governments relegated the management of companies engaged in commerce in the latter-half of 1958 to less competent organizations. That is, they authorized the authorities of specialist areas to manage the secondary wholesale agents, and they authorized cities or counties to manage tertiary wholesale agents and retail stores. Therefore, the number of secondary wholesale agents rose from 600 to 800, and the number of cities that established wholesale stations increased from 150 to about 200.

This resulted in overlapping commerce organizations, and the distribution stage increased as well. Systemizing goods based on provinces forced market segmentation, enough so that mutual exchanges among districts vanished. In addition, the operation system of specialized companies was interrupted, the distribution of goods was hindered, and a large amount of inefficiency was generated. On the other hand, agents reorganized into family-based operations to jointly manage retail outlets with the government during the period of the 'Great Leap Forward', so the number of distribution routes decreased. Furthermore, in addition to the policy failures during the 'Great Leap Forward' and the 'Three Years of Natural Disasters', the shortage of goods within the country became a serious problem.

The corrective measures that the government enacted in 1961 fixed the economy, but the effects of the 'Great Cultural Revolution' demoralized the economic order again and disrupted the distribution of goods. In 1970, the government again relegated the management of commercial entities to less competent organizations by authorizing regions to manage the thirty-nine primary wholesale agents and the authorities of specialized areas to do the same for the secondary wholesale agents. However, this decision posed many problems for merchandise procurement. At the time there were three types of commercial organization: state-owned organizations, organizations that were jointly managed by public and private groups, and free markets. However, the organizations that were jointly managed by public and private groups were placed under the control of state-owned agents, and free markets were closed down in 1976. The result was that state-owned agents exclusively controlled the domestic commercial bodies, the level of service deteriorated markedly, and the black market flourished.

3. Policy Changeover and Diversification of the Distribution System

Since the 3rd Plenum of the 11th Chinese Communist Party Central Committee (CCPCC) in 1978, China began a new epoch with the slogan of 'the policy of reformation and opening'. Despite many twists and turns, the basic approach of this epoch can be described as market-oriented economic reform.

After the 14th Congress of the CCPCC in October 1992 when the government introduced ‘the Establishment of Socialist Market Economy’, the direction of reform was clear and efforts to shift completely to a market economy took hold.

The purpose of this section is to consider the transition of the distribution policy from the period of reform and openness to the present, and to consider the substantial changes in distribution, especially in terms of the demise of the traditional wholesaling structure and retail development. Similar to the previous section, this period can be divided into two periods: (1) from 1979 to 1992 (i.e., from reform and openness to the first mention of the establishment of a socialist market economy); (2) post-1993 (i.e., when the efforts to shift to a market economy really took hold).

The former period is the important transitional period from a planned economic system to a market-oriented economic system, and the latter period is the time when the government accepted private ownership and eased restrictions on distributive trading in order to allow distribution with the rest of the world. Moreover, China’s accession to the WTO in December 2001 is discussed in this section.

3.1. The development of retailing

The defining event for the distribution of Chinese goods was the decision of the government to promote reform of the distribution structures of the commerce sector at the 3rd Plenum of the 11th CCPCC in 1978. The government made it clear that ‘collectively owned commerce has the nature of socialism, whereas privately operated commerce is a necessary complement to socialistic commerce’ in 1979, and this decision encouraged privately operated commerce to develop along with the traditional planned economic system. The government enacted reform in the public administration of distribution, and the Ministry of Commerce, the Ministry of Food, and the supply and marketing cooperatives were merged to form a new Ministry of Commerce. In addition, the trend toward the separation of politics and enterprises proceeded, and corporate authority increased on the basis of *The Report of Certain Issues on Urban Commerce Structure Reform* by the Ministry of Commerce in 1982.

These policies created an opportunity for manufacturers to involve themselves in distributive trade and open businesses separate from the state-owned enterprises, collectively owned enterprises, and goods cooperatives that had been engaged in commercial distribution thus far. Moreover, departments that were not concerned with commerce moved into retail business, and the phenomena of ‘the whole nation conducts trade’ and ‘wholesale business is useless’ arose.

Above all, the retail sector quickly paved the way for reform. Since it was easy for various firms to enter into retailing, retail businesses spread rapidly as a sector that absorbed redundant workers. Agricultural reforms post-1979 encouraged the labor force that had been limited to rural communities to transfer into the commercial sector. Therefore, agricultural reforms can be considered as part of the reason for the growth in retailing. As Table 2 indicates, the number of retail outlets rose dramatically—from about one million in 1978 to about ten million in 1992.

Table 2 The shift in the number of retail outlets and their employees

Annual	No. of retail outlets (million)	No. of employees (million)
1957	4.2	7.09
1978	1.04	4.47
1992	10.06	24.35
1996	13.96	31.89

Source: National Bureau of Statistics of China.

On the other hand, the speed of wholesaling reforms was slower than those of retailing. The government empowered state-owned enterprises that were engaged in commerce to operate voluntarily. This increased authority enabled the enterprises to freely expand their sphere of activities from the traditional approach, such as the administrative branch of government and geographic division. In 1984, the State Council approved ‘*The Report on a Number of Problems in an Immediate Reformation of the Urban Commerce System*’, which prescribed that the subcontract system should be carried out by large- and medium-sized enterprises engaged in retail and in the restaurant business, and that some small-sized companies should be transformed into organizations run by group management and lease management. The report also prescribed that the reform of the wholesaling structure should be promoted. The main points were as follows: the three-staged wholesaling structure based on administrative boundaries should be abolished and integrated, the Ministry of Commerce should transfer the authority over Primary and Secondary wholesale agents to the cities concerned, and each city should construct a trading center for household goods. In 1991, the State Commission for the Restructuring of the Economy System and the Ministry of Commerce promulgated a public document to initiate reform based on ‘Four open policies’ to be carried out in Chongqing. The document announced the delegation of authority to privately owned enterprises and further promoting market-oriented mechanisms in enterprises according to the principles that ‘state-owned enterprises engaged in commerce widen the range of options available in terms of management, commodity prices, distribution, and the labor force employed in industries,’ ‘the state is reducing regulations but placing strict controls on state-owned enterprises’, and ‘there is regularity that is open but restrained’. The ‘Four open policies’ in 1991 initiated the gradual dissolution of the three-stage wholesaling structure, and the rights to autonomy in managing state-owned enterprises engaged in commerce increased.

The deregulation of wholesaling enabled retail outlets to purchase directly from manufacturers, and the manufactures could now establish distributive firms that sold their products. Therefore, the wholesaling enterprises that were previously secure in their niche began to encounter intensified competition. The number of wholesaling enterprises rose from 158,000 in 1978 to 304,000 in 1992.

Thus, the distribution system shifted gradually to ‘San Duo Yi Shao’, that is, a large variety of

economic components, distribution channels, and management styles, and few distributive stages. However, 'The regulations for the implementation of corporate law on the joint capital management between Chinese funds and foreign ones in PRC' (established in 1983) prohibited the flotation of foreign-affiliated retailing and wholesaling enterprises, so the adoption of an open-door policy towards distributive trade was delayed.

3.2. The transition to a socialist market economy and the Open Door Policy for distributive trade

The 14th National People's Congress in October 1992 set the goal of establishing a socialist market economy when making future economic reforms. Its main policy was the allowance of private ownership and the elimination of unnecessary regulations for distributive trade. The 3rd Plenum of the 14th CCPC in November 1993 adopted 'The decisions of the Chinese Communist Party Central Committee on certain problems regarding the establishment of the socialist market economy', and it was not until then that the government specified 'the implementation of modernization in distribution' in an official governmental document. This decision was intended to shape an orderly unified distribution system and to ensure an open competition mechanism, so it was extremely important for the development of the Chinese economy (Zhang, 1994: 73). Until then, the government had only emphasized the quantitative expansion of the total amount of distributive trade, but rationalization and modernization of trade as methods of ensuring qualitative expansion were adopted from that time.

The government established the State Economic and Trade Commission in March 1993 as an organization whose purpose was to manage distribution. This organization promoted the reform of state-run enterprises and distribution system, so the government could focus the powerful state department on managing both industrial and trade policies consistently. The government enacted stock reforms for state-owned trading enterprises as part of the effort to reform of state-run enterprises. More than 200 corporations that were based on the state-owned trading enterprises were established across the country in 1992, and they were involved in many areas such as food, non-staple food, industrial products, restaurant business, wholesaling, and retailing. There were about 3,700 corporations at the end of 1992, 1,000 of which were enterprises engaged in commerce. The number of enterprises involved in commerce accounted for 27% of the total.

Since the shift to a policy of reformation and opening, the reforms of the Chinese distribution structure have enabled swift development of individually and privately owned companies, and these generators of commerce accelerated growth. To cite an example, the number of commercial organizations under individual management reached 11.54 million and the number of privately owned enterprises engaged in commerce reached 150,000 at the end of 1994; these firms played an important role in the distribution of goods.

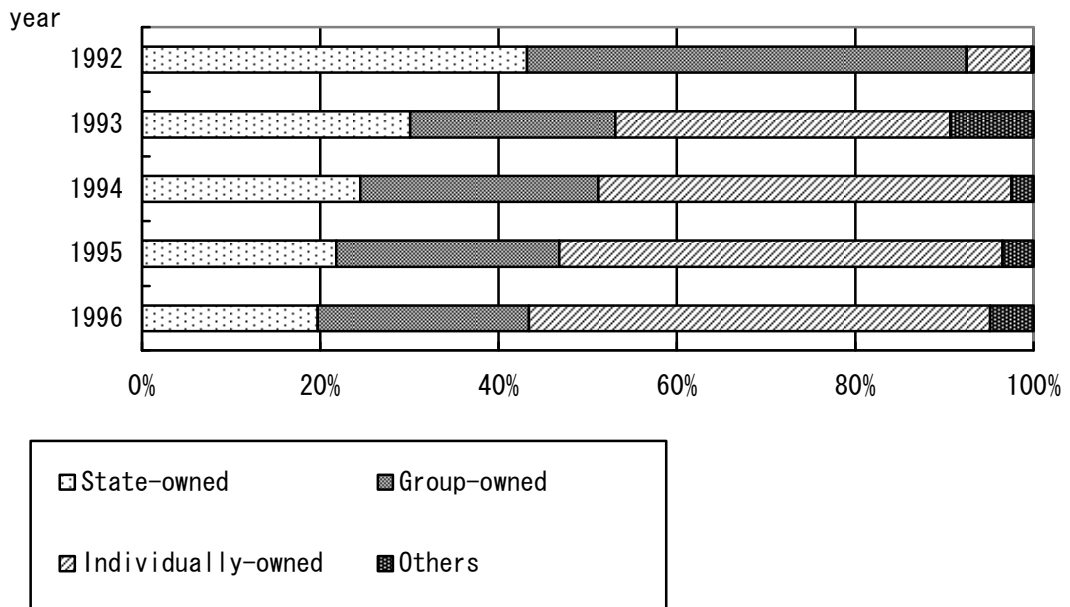
On the other hand, the government opened up distributive trade to foreign-owned enterprises, although this was restricted. China completely prohibited the establishment of foreign-owned

distributive firms both subsidiaries and joint capital ventures, before 1992. As China paved the way for economic reform, the government announced the policy to ‘develop outward-looking commerce’, in order to raise the number of domestic trading enterprises and promote market competition. The Central Committee of the Communist Party in China and the State Council released ‘the decision on accelerating the development of the tertiary industry’ in June 1992. Under this decision, the government implemented new policies such as promoting the development of the service industry and providing foreign capital incentives. The State Council filed ‘the notice of the problems on utilizing foreign capital in the field of retailing’ in July 1992. The State Council approved ‘*The Report on the Basic Principle of the Plan toward the Development of the Tertiary Industry Across the Country*’ in March 1993. This report, which the State Planning Commission compiled, stated that the government allowed joint capital retail firms and commodity supply and marketing cooperatives to become tentatively established in parts of cities and districts that were under state control. Table 3 shows a summary of the open-door policies in the area of distribution. As Table 3 indicates, the open-door policies at the time triggered a gradual foreign presence in the field of commerce.

Table 3 Outline of the open door policies in the area of the distribution (1995~99)

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| 1995.6. | State Council issued “the provisional rules to point the direction of the investments by foreign capital enterprises” and “the enumerations to guide the industries that foreign capital enterprises invest in.” Both retailing and wholesaling were left open conditionally. |
| 10. | State Council permitted two chain stores managed jointly by Chinese and foreign firms to do business tentatively in Beijing and Shanghai. |
| 1996.4. | State Council exceptionally ratified the establishment of a retailing enterprise managed jointly by Chinese and foreign firms (the name was Wuhan City’s Future Department Store) in Wuhan. Furthermore, the government approved the opening of multiple shops by individual companies, in other words, chain-store operation. |
| 10. | Ministry of Foreign Trade and Economic Cooperation issued “the provisional rules on the experimental establishment of trading firms managed jointly by Chinese and foreign companies,” and gave foreign capital enterprises conditional permission to enter the import-export business. |
| 1997.5. | State Council delivered “the message that the government immediately prohibited the examination and approbation of foreign fund enterprises engaged in commerce in the provinces.” |
| 12. | State Planning Commission, State Economic and Trade Commission, and Ministry of Foreign Trade and Economic Cooperation partially amended “the enumerations to guide the industries that foreign capital enterprises invest in.” |
| 1998.4. | State Council decided to successively expand the field that foreign capital enterprises could invest in. The trial areas where the foreign capital trading companies could invest in were expanded to 31 cities including the inland provincial capitals. |
| 1996.6. | State Economic and Trade Commission, Ministry of Foreign Trade and Economic Cooperation announced officially “the rules on the experimental establishment of trading firms funded by foreign capital” and prescribed the range of operations of retail outlets that were jointly managed. |
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Figure 3 The classification of the number of the wholesaling enterprises by capital owning (Composition ratio)



Note: "Others" includes enterprises under joint management, corporations, and foreign capital enterprises.

Source: National Bureau of Statistics of China.

3.3. The breakdown of the traditional wholesaling structure

With the shift to a socialist market economy, some changes occurred in the traditional wholesaling structure. The wholesaling structure had once been a monopoly of state-owned enterprises prior to the policies of reformation and opening, but was now replaced by individually owned companies, collectively owned companies, corporations, and foreign capital enterprises. Overall the proportion of individually owned wholesaling companies accounted for more than half of the total number of wholesalers. This is shown in Figure 3, where it can be seen that wholesaling distribution became diversified by the entry of various types of firm, whereas the importance of state-owned enterprises decreased year by year. According to Figure 3, the proportion of individually owned companies rose dramatically from 7.3% in 1992 to 51.7% in 1996. On the other hand, the proportion of state-owned enterprises declined from 43.2% in 1992 to 19.7% in 1996. This conversion is clear proof of the collapse of the traditional wholesaling structure. It is noteworthy that the multistep distribution mechanism, which was a remnant of former times, was completely eliminated. The point I wish to emphasize is that the wholesaling system became diversified with tri-level, bi-level, and single-stage wholesaling systems or a disintermediation. However, China still retained some remnants of the

centralized governance structure.

The collapse of the traditional wholesaling structure proceeded, while the emergence of the wholesaling enterprises that had various forms of ownership made it possible for retail stores to stock merchandise freely. For example, according to a survey conducted in Shanghai and Jiangsu province in 1991, the proportion of direct purchasing by mass merchandising stores accounted for more than 90% of the total, and that of mid-size stores exceeds 70%. The Chinese Distribution Workshop conducted a survey targeting department stores in China; it was found that the proportion of merchandise obtained from wholesaling agents accounted for 25%, whereas that obtained directly from manufactures reached more than 68% (Xie, 1999: p.114).

The commodity market in China had entered a new stage of development. Some wholesaling agents established cold stores and refrigerated warehouses, cargo trucks, and a system managed by computers. The wholesale industry itself changed significantly. New characteristics of the retailing industry could also be observed. These can be summarized as follows: (1) rapid growth in the free markets that connect urban areas with rural ones; (2) functioning market competition, with the market regulating the prices of merchandise; (3) retail distributors promoting reform of the business management system, and beginning to recognize the importance of service and the promotion of consumer interests.

3.4. The accession of China to the WTO

China has gradually advanced policies of opening its country up to foreign commercial interests. This opening up of distribution, however, was very limited compared with that in other industries. Indeed, there was an increase in the inflow of foreign capital owing to the granting of permits by local governments, but the central government only tentatively authorized market entry of foreign retailers within regions such as specific large cities and special economic zones. The accession of China to the WTO drastically opened up the areas of distributive trade that had been strictly off limits to foreign capital enterprises. From this viewpoint, China's accession to the WTO was a major turning point, which we may refer to as 'the secondary reform and openness'. The process of the accession of China to the WTO is presented in Table 4.

Table 5 depicts the schedule of opening the market in the distribution services sector. We shall now examine the essentials of the agreement of the accession of China to the WTO with regard to commission agents' services, wholesale trade services, and retailing services in more detail. First, the key points concerning commission agents' services (excluding salt and tobacco) and wholesale trade services (excluding salt and tobacco) are as follows: (1) Within one year of China's accession to the WTO, foreign service suppliers could establish joint ventures to engage in the commission agents' business and wholesale business of any imported or domestically produced products, except for a certain group of products. (2) As for easing regulations on regulated items, foreign service suppliers were permitted to engage in the distribution of books, newspapers, magazines, pharmaceutical products, pesticides, and mulching films within three years of China's accession, and to engage in the distribution

of chemical fertilizers, processed oil, and crude oil within five years of China's accession. (3) Within two years of China's accession to the WTO, foreign majority ownership was permitted and no geographic or quantitative restrictions were to apply. (4) Foreign-invested enterprises were given permission to deal in such items as chemical fertilizers, processed oil, and crude oil within five years of accession. (5) Foreign service suppliers were permitted to provide a full range of related subordinate services, including sales services for the products they distributed.

Table 4 The process of China's accession to the WTO

1986.7.	China made an application to the General Agreement on Tariffs and Trade (GATT) for "resumption of its status as a GATT contracting party."
1987.3.	The Council of GATT established a working party to examine the request of the Government of the People's Republic of China for resumption of its status as a GATT contracting party.
1995.12.	China made a new application for accession to the WTO, because GATT had been dissolved.
1997.9.	China came to an agreement over market access of goods with Japan.
1999.7.	The bilateral negotiations reached a settlement and China came to an agreement over market access of services with Japan.
11.	China came to an agreement over bilateral negotiations with U.S.
2000.5.	China came to an agreement over negotiations with EU.
10.	U.S. enacted a law to confer permanent most favored nation status on China.
2001.9.	The working party on the accession of China adopted documents related to the accession.
11.	The WTO Ministerial Conference Fourth Session in the State of Qatar approved the accession of China to the WTO.
	China submitted the acceptance form to the bureau of the WTO.
12.	The accession of China to the WTO came into effect.

Source: Ministry of Economy, Trade and Industry, "External Economic Policy Site, METI,"

(http://www.meti.go.jp/policy/trade_policy/wto/accesion/data/chaina_keii.html)

Second, the essentials on retailing services (excluding tobacco) were as follows: (1) Foreign service suppliers could supply services only in form of joint ventures in five Special Economic Zones and six cities. (2) Foreign service suppliers were permitted to engage in the retailing of all products, except for books, newspapers, and magazines within one year of accession, the retailing of pharmaceutical products, pesticides, mulching films, and processed oil within three years of accession, and the retailing of chemical fertilizers within five years of accession. (3) Foreign-invested enterprises were given permission to deal in chemical fertilizers within three years of accession; and those chain stores that sell products of different types and brands from multiple suppliers with more than 30 outlets. (4) Cross-border supply is unlimited except for mail order.

The details regarding commission agents' services, wholesale trade services, and retailing services are much the same, such as those concerning goods, investment ratios, and the scope of management, as stated above. In the area of retailing, there was already a great deal of competition in the market before

China's accession to the WTO. However, China had still not fully opened up global wholesale trade. China's accession to the WTO had and will continue to have a great impact on wholesaling institutions, which were lagging behind in terms of the opening up of markets. Table 6 shows the major items slated for tariff cuts.

Table 5 The timetable for opening up the market in the sector of distribution services in the Protocol of China's WTO Accession

	Wholesale Trade Services		Retailing Services			
	Geographical Restrictions	Investment Restrictions	Geographical Restrictions	Investment Restrictions (exc chain stores listed right)	Investment Restrictions (Automobile, Chain store)	Investment Restrictions (exc chain stores dealing with a range of products)
Upon Accession			13 cities	Below 50%	Below 50%	Below 50%
Within one year		Joint ventures permitted (Below 50%)				
Within two years	Unlimited	Joint ventures permitted (Above 51%)	All provincial capitals, Chongqing and Ningbo	Joint ventures permitted (Above 51%)		
Within three years		Unlimited	Unlimited	Unlimited		
Within five years					Unlimited	

Source: Huang (2002).

The excessive opening up of distribution to foreign-affiliated enterprises has drawn criticism from the executive officers of distributive firms in China. They have begun to clamor for a governmental response such as a restriction on foreign investment. However, some are of the opinion that the accession to the WTO offers the best chance for distributive trade in China, in the sense that reforms to the domestic distribution structure and structural adjustments will continue. Others take the view that the accession will not result in a massive amount of foreign capital enterprises entering the retailing market, and that the inflow of foreign capital will not have much of an impact on domestic retailers. The Ministry of Commerce of the People's Republic of China promulgated 'Measures for the Administration on Foreign Investment in Commercial Fields ([2004] No.8)', with the regional restrictions for wholesale dealers being eliminated on June 1, 2004. Those for retail sellers were eliminated after December 11, 2004. There is now no limitation on the entitlements of foreign investors,

and these measures encourage large international commercial entities to enter markets.

Table 6 The schedule for tariff reduction in China (Principle items)

items		Tariff Rate in 1998	Final Tariff Rate	Time Limit (Year)
Electric Appliances	Air Conditioner (for home)	25%	15%	2004
	Air Conditioner (for Automobile)	40%	20%	2005
	Refrigerator (500L)	30%	15%	2004
	Cleaner	35%	30%	2002
	Color TV	35%	30%	2002
General Machinery	Forklift	18%	9%	2004
	Printing Product	16%	9%	2003
IT devices	Computer	25%	0%	2005
	Display	15%	0%	2003
	Fax Machine	12%	0%	2003
	Copier	22%	10%	2004
Automobile	Bus (more than 30 seats)	50%	25%	2005
	Bus (less than 29 seats)	70%	25%	2005
	Car	100-80%	25%	2006
	Cargo truck (less than 5 ton)	50%	25%	2005
	Chassis	60%	45%	2003
Precision equipment	Camera	25%	20%	2002
Agricultural goods	Agricultural goods (977 items)	22.7%	15.7%	2010

Source: Ministry of Economy, Trade and Industry, "External Economic Policy Site, METI," (http://www.meti.go.jp/policy/trade_policy/wto/accession/data/pro_tariff.pdf)

It is debatable whether foreign-affiliated enterprises will rapidly invade distribution in China, whether domestic capital enterprises will maintain dominant or whether both sides will coexist. At this time of writing, however, the effects of China's accession to the WTO remain too unclear to be able to say to

what degree and in what sectors or field wholesaling activities have actually been opened up to foreigners. In brief, the effects of China's accession to the WTO on domestic distribution systems can be divided into (1) easing and abolishing the restrictions on foreign investment significantly, (2) constitution and enforcement of protective policies to domestic chain stores, (3) regulation for large-scale commercial facilities. This issue needs further consideration based on a long-term perspective, e.g., for twenty or thirty years.

4. Conclusion

The study set out to investigate how multistep distribution mechanisms came into being in China, and what caused the change by tracing the history of distribution policies in the country. The following results were obtained:

First, the government controlled wholesaling from the foundation of the PRC, by processes such as socializing the privately owned enterprises engaged in commerce. As for the distribution of goods, specifically, the central government took administrative control, and the wholesale dealers assumed the management of production and distribution—there was a division of roles. Then, on the basis of economic zones where wholesale stations were located, the three-stage wholesaling system was almost complete by the 1950s. This was a distribution structure characterized by exclusiveness, few channels and a multiple-step form. The distribution policies at that time achieved their original goals to a satisfactory degree in terms of market stability, curbing of inflation, and recovery of the national economy. However, the exclusion of privately operated trade and the introduction of a centralized distribution system reduced the trade advantages such as market vitality and market competition among firms.

Secondly, China fell into a state of chaos in the period between 1958 and 1978 during the 'Great Leap Forward', the 'Three Years of Natural Disasters' and the 'Great Cultural Revolution'. The government implemented various types of market policies in order to resolve the food crisis. These policies created the stagnation of the distribution system, free markets were closed down, and black market dealings flourished.

Thirdly, since the shift to the policy of reformation and opening in the 1980s promoted the development of individually and privately owned commercial entities, retail businesses have spread rapidly. The central government abolished and integrated the three-stage wholesaling structure that was based on administrative boundaries. Therefore, the distribution system shifted gradually into a large variety of components such as economy, distribution channels, and management styles, with few distributive stages. It should not be overlooked that the wholesaling system became diversified, with tri-level, bi-level, and single-stage wholesaling systems or a disintermediation. Multistep distribution mechanisms still remain today.

Fourthly, from 1992, China began to deploy various efforts to establish a socialist market economy,

and the government enacted stock reforms for state-owned trading enterprises. In other words, rationalization and modernization of distributive trading system was promoted, with the aim of achieving qualitative advancement. At this point, individually and privately owned commercial entities played an important role in the distribution of goods. On the other hand, the government opened up distributive trade to foreign-affiliated enterprises, although this was limited. Some changes occurred in the traditional wholesaling structure, with the leaders in wholesale distribution becoming diversified by the market entry of various types of firms. The emergence of wholesaling enterprises that had various forms of ownership made it possible for retail outlets to stock merchandise freely. Directly purchasing goods from manufacturers has been increasing among mass merchandising stores in order to bring down costs.

Finally, the accession of China to the WTO drastically opened up distributive trade, which had been strongly restricted to foreign capital enterprises. The impacts of this on distributive trading in China are still being generated. In the area of retail business, there was already a great deal of competition in the market before the accession of China to the WTO. However, China has still to fully open up its wholesale trade to the world. Therefore, we can say with a fair amount of certainty that China's accession to the WTO has had a great impact on wholesale institutions that has lagged behind in terms of opening up markets. However, further consideration based on long-term analyses, for example, over twenty or thirty years, is necessary.

Notes

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