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China's Consumer Revolution: Distribution Reform, Foreign Investment and the Impact of the WTO

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The Chinese leaders have stated that domestic consumption is the key to China's further economic development. An examination of consumer trends since the initiation of China's open-door policy in 1978 suggests market segmentation based on growing personal and regional income inequalities. There is also greater quality discernment as markets mature. Furthermore, credit provision is designed to stimulate consumption. It is argued that consumption will additionally be spurred by ongoing reform in the distribution system. Under the command economy, wholesale and retail services were a state monopoly, and this legacy has impeded the development of a nationwide market. Foreign companies have been playing a major role in the transformation of China's distribution system. Thus, companies like Walmart and Daiei, active in supermarket chains, introduce high levels of service, the use of information technologies in selling and marketing, and scientific management. In response, Chinese domestic concerns need to institute economies of scale and greater integration between supply and retail networks. Finally, membership of the World Trade Organisation (WTO) will force China's leaders to open the country's service sector to foreign investors. In conclusion, WTO membership will provide impetus towards greater competitiveness in China's distribution system, thereby facilitating expansion of consumer markets.
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Introduction: Consumer Trends in China

China is no exception to the general rule that, as an economy develops in complexity, the role of its service sector grows. Echoing the government's goals, Chinese sources, taking an international perspective, outline a time table of development informed by changes in consumption patterns.

In the first stage, consumption is focused on basic necessities like food and clothing, while the second phase, characteristic of Western countries when they entered industrial society, is typified by the provision of consumer goods, cars and improved housing. The third, and as yet final stage, is a knowledge economy of information products and services, to which advanced Western countries have begun the transition. A refinement of these themes will now be applied to contemporary China.

As stated above, initially consumption is focused on cheap basic necessities for daily life, and in the Chinese context this is equivalent to a demand structure of 4,000 Chinese yuan gross domestic product (GDP); at the second level of 4,000–7,000 yuan GDP, the need for essentials has been satisfied and further goods and services are consumed; in the third instance at 7,000–15,000 yuan, sometimes known as the *xiaokang* or reasonably well-off phase, the main contents are consumer durables together with commercial housing and higher level services; and finally, at 15,000 yuan and above, often referred to as the *fuyu* or prosperous stage, wealth confers personal development through sophisticated products and advanced information services. The trend during the transition from the lower to higher stages is for the proportion spent on commodities to fall and that on services to rise. Currently, much of urban China is entering or has just entered the second stage, even though the middle-class lifestyle of the Eastern seaboard is more representative of the third phase. Lastly, wealthy entrepreneurs and others advantaged by ventures with foreign investment are more typical of the *fuyu* stage (Chen, 1999; Hu, 2000).

Between 1949 and 1978, however, under China's command economy, accumulation was stressed at the expense of consumption; for the general population only basic needs were satisfied, and the country played only a minor role in the international economy, foreign trade being seen as an adjunct to remedy capital and technical deficiencies rather than as a means of raising living standards through the importation of consumer goods. Nevertheless, by the early 1980s, Deng Xiaoping and his supporters had launched the open-door policy and from then until the mid-1990s high rates of economic growth were achieved. Development has been regionally uneven, however, with considerable urban–rural inequalities, and while major coastal cities and special economic zones (SEZs) are on the threshold of the information society, with markets for certain consumer goods already satiated, much of the countryside remains in the first phase of development outlined above.

The sophistication of consumer demand, enhancing the quality of life is, however, only one factor stimulating the growth of the service sector. To promote global competitiveness, Chinese leaders have initiated the restructuring of the inefficient and over–manned state enterprises, thus highlighting the role of services in mitigating resulting unemployment. The service sector is more labour-intensive than manufacturing. A report issued in 2000 by China's State Development Planning Commission stated that the service sector had created 5.71 million jobs in 1999, accounting for 69 per cent of new employment. Significantly, by the end of the latter year, 192.5 million people were said to be in the service sector, contributing to 34.8 per cent of China's GDP. This figure nevertheless trailed far behind developed countries, where the equivalent was nearer 70 per cent (Luo, 2000; Summary of World Broadcasts (SWB), 2000c). The service share in the Chinese economy, however, may have been underestimated, given under-reporting in areas like legal services and accountancy, but in any case the industry is expected to account for about half of China's GDP over the next 20 years, an increase that will be at least partly due to China's membership of the WTO eventually doubling the country's share of world trade. The estimated six million urban service sector jobs will thus include the specialists demanded by China's growing role in the world economy (Luo, 2000; Xu, 2001).

Furthermore, such trends are set to accelerate under the direct stimulus of government policy. That the Chinese leaders have staked their legitimacy on rising living standards has been reflected in the priorities of the Ninth and Tenth Five Year Plans (1996–2000 and 2001–2005). Given the transition to a market economy, goals have been expressed in discretionary rather than directive terms, with the key factor in growth having shifted from expanding production to increasing demand. To Chinese economic planners, however, the Asian financial crisis of the late 1990s demonstrated the undesirability of excessive reliance on foreign markets, and there is a sense in which countries like China, with abundant natural resources and a large population, may be less dependent on international trade, while the investment in production redolent of the command economy is less suitable for the encouragement of buyers' markets. Thus, the strategic option for maintaining growth is stated to be expanding domestic demand. Consumption embraces both goods and services, with the development of the latter necessarily dependent on the former (Chen, 1999; Summary of World Broadcasts (SWB), 1999a; Economic Research Institute Group of the State Planning Commission, 2000; Hu, 2000; Wu, 2001).

Common to the expansion of demand in both sectors, however, is the need for greater discretionary income, increases in which are in addition generally correlated with rises in GDP. Economists refer to the potential for more diversified consumption in terms of a fall in the ratio of expenditure on food to total spending, and the measure of this, the Engel Index, has been falling since the 1990s. Significantly, the Engel Index for China's urban areas went down from 49.9 per cent in 1995 to 41.9 per cent in 1999, while the equivalent for rural areas fell from 58.6 to 52.6 per cent. It is estimated that this will fall very soon to 40 per cent for the cities and 50 per cent for the countryside. Ultimately, however, diversity in consumption is attendant upon higher personal income; thus the priority given to raising this for both urban and rural residents in the Ninth Five Year Plan. In fact, during that period objectives were more than fulfilled, with a 5.6 per cent per capita increase for urban residents and one of 5.4 per cent for rural residents. Such growth was even higher in 2001, according to preliminary estimates. This in turn has fuelled consumption of goods beyond basic necessities, with growth in expenditure on consumer durables like electrical goods and, in some cases, even cars, hitherto beyond the reach of most Chinese, as well as spending on leisure pursuits like entertainment and travel. Importantly, expenditure on housing, a harbinger of future consumer spending, has been growing (U, 2000; Summary of World Broadcasts (SWB), 2000b).

Reference has been made above to differing regional consumption patterns and these remain hindrances to the emergence of a nationwide market in China. Urban–rural income differentials have already been briefly alluded to and in 1999, the Central Committee of the Chinese Communist Party (CCP) resolved to stimulate rural consumption by extending the land tenure contracts of households, thus enhancing economic security and incentives to spend. More fundamental, however, have been central government measures to improve infrastructure, including transport and utilities, as well as commercial services like marketing and storage, the latter especially having proved an impediment to the distribution and utilization of consumer durables, particularly in the countryside. A major constraint governing consumer spending in transport and utilities has been pricing. While the prices of most commodities in China have been decontrolled, those governing state monopolies like electricity, fuel, petrochemicals, telecommunications and railways are still not subject to market forces. Accordingly, in early 2000, the central government announced measures to stimulate electricity consumption, equalizing charges between urban and rural areas. Simultaneously, competitive pricing mechanisms were to be introduced in public transport sectors to restrain costs, with positive implications for commodity distribution (Chen, 1999; Summary of World Broadcasts (SWB), 1999b, 2000b).

In spite of these government measures and incentives which, in any case, are yet to take effect, there has, since the late 1990s, been a tendency for the rate of increase in the consumption of goods to fall and that of savings to rise. At the turn of the 21st century, China's domestic savings rate was estimated as between 30 and 50 per cent of GDP, and in 1998 savings deposits exceeded loan volume by US$110.8 billion. During the early reform years of the 1980s, the discretionary purchasing power of Chinese and thus potential rates of consumption were higher than at first sight, given that social welfare expenses like housing, education and pension funds were covered by state industrial enterprises and governmental institutions in the cities, even though provision in the collectives of the countryside was much less generous. Consequently, there was a reservoir of income that could be tapped in the consumer goods boom of the early 1990s. Since the mid-1990s, however, accelerated state enterprise reform, with attendant redundancies and inability of employers to discharge pension and other welfare obligations, has bred an atmosphere of insecurity and stimulated a propensity to save among those able to do so. Since the passing of new labour laws in 1995, there have been moves towards the creation of a new national system of social insurance. Under its terms, a greater burden in contributions will be placed on private individuals, with consequent implications for discretionary income and spending on commodity consumption. There is, however, a related positive feature: recent moves towards a commercialized housing market in place of subsidized rented housing on site for state enterprise employees will likely boost production in industries producing consumer durables, even though personal budgeting for mortgage payments may serve as a limiting factor (Shang, 1999; Jingji Daobao, 2000; Hu, 2000; Yong, 2000).

Another factor in consumption is growing income differentials and, to further social equity, in 2000 the Fourth Session of the Ninth National People's Congress, China's parliament, emphasized the need to increase new employment opportunities and raise the income of the low-paid. This is intended to facilitate purchase of commercial housing and similar services. In spite of such palliatives, however, there are growing differentials; increasingly prominent among diverse income sources are negotiable securities and property. Significantly, higher income households represent just 21 per cent of the total (Sun P, 2000; Wu, 2001).

In fact, growing income differentials are being reflected not only in the extent but the diversity of consumption, one feature being greater consumer discernment. Urban markets for certain consumer goods are already satiated, but there is a dearth of high technological quality commodities. Thus, in some sectors supply exceeds demand, while in others the pattern is reversed. Research bears this out. A survey conducted in late 1999 by the Beijing-based Mainland Marketing Research Company, in cooperation with consulting agencies in other major cities like Shanghai, Nanjing and Guangzhou, on the basis of a sample of 6,400 urban residents, indicated major trends in urban consumption. This had shifted from expenditure on colour television sets, for example, to spending on private housing, home decoration, cars, travel and education, indicating consumer attention to quality, with 64.4 per cent of those interviewed declaring interest in the purchase of newly introduced items. In the case of two of these, cars and housing, however, an impediment to purchasing is pricing. Local taxes on housing in some areas account for up to 50 per cent of value; cars are expensive because production scale is still small, with a tradition of supplying public institutions under the command economy rather than sales to private individuals (Hu, 2000; Summary of World Broadcasts (SWB), 2000a).

Among low-income urban dwellers and in the countryside, however, certain consumer durables are by no means universal. For instance, the number of colour television sets in China's villages had reached 4.72 per hundred households in 1990 and even though the number increased to 22.9 in 1996, this was far below the level found in the cities (Economic Research Institute Group of the State Planning Commission, 2000). Needless to say, the potential for the future sale of consumer goods in the countryside is considerable. But, regardless of the above income inequalities and differentials in consumption, increasing migration of the present village population to the cities will itself provide further impetus to consumer markets, given that the urban consumption level is 3.3 times that of the villages, and it is estimated that nationally China's urbanization ratio will rise to 37 per cent by 2005 (*ibid.*).

To document this revolution in consumption, this paper will focus in the second section on the reform of the distribution system and concomitant trends towards the emergence of a nationwide market. The third part will examine foreign direct investment (FDI) in the wholesale and retail sectors as well as the likely impact of China's membership in the WTO on the distribution sector in the light of foregoing analysis.

Reform of the Distribution System: Towards a Nationwide Market

The trend in distribution reform has been towards the creation of a unified nationwide market. When state industrial enterprises were first subjected to market forces in the 1980s, consumers gradually gained greater freedom of choice. Consequently, state-dominated circulation channels were increasingly seen as inadequate to face the challenges born of competition among both domestic and foreign producers.

State control during the years from 1949 to 1978 is the background against which ongoing distribution reform must be understood. During the pre-reform years, production and distribution were governed by Soviet-style central planning, with market forces playing a minimal role. Production quota output passed through state distribution, administration of which was in the hands of the Ministry of Commerce for consumer commodities, while industrial consumer goods were the prerogative of the Ministry of Materials and Equipment. The main feature was a hierarchical vertical structure, which has left a legacy in the post-reform era. The distribution network was divided into tiers: wholesalers at the first level were located in Beijing, Guangzhou, Shanghai and Tianjin; their counterparts in the second layer were placed in provincial capitals and other medium-sized cities, and distributors on the lowest rung operated from smaller cities and towns.

The dominating factor was state allocation, not market forces, as state retailers and enterprises received commodities for sale to end-users. Finally, distributors were responsible for physical support like transportation and warehousing but, because of a relative lack of consumer choice, marketing was unnecessary. The end result was the lack of a service ethic: no attempts were made to improve quality. Moreover, there was little, if any, competition from foreign goods and in any case imports were monopolized by state-run foreign corporations, which were not allowed to sell the goods downstream and thus had no contact with end-users. In order to introduce market-driven incentives, in 1986 the central government opened up the distribution system by permitting manufacturers to sell directly to retailers, thereby bypassing state distributors. Products were decontrolled, with the exception of strategic goods like agricultural commodities, and there have been undoubted moves towards the creation of a free market in distribution. The state system, however, still remains, although its monopolies and rigid hierarchical structure have been removed, and it is increasingly in potential competition with private distributors (Baldinger, 1998).

Reform, however, is ongoing, and China's distribution is a mixed system, with lingering influences from the command economy. Currently, government officials maintain influence through their official connections, invaluable to commercial entrepreneurs. Thus, as Ellen Hertz has illustrated in another context, tributary relationships hold sway between private enterprise and officialdom (Hertz, 1998; Wang, 2001). The example of distribution moreover demonstrates that, while institutions may be reformed, new mindsets, in relation, for example, to customer satisfaction, attention to quality and modern management techniques, take longer to inculcate.

It is the task of the Chinese government to institute the macroeconomic measures characteristic of a market economy. The first priority is the effective implementation of legal and fiscal measures. While China's laws will need fine-tuning, the problem is generally not legislation but proper enforcement. The key solution lies in central government control of the localities. Ironically, restrictions in the form of restraint of trade, born of local protectionism, are a direct consequence of reform. One aspect has been decentralization, with devolution of certain responsibilities to the localities. Some state industrial enterprises are under local government control. Moreover, in order to maintain and increase employment in their areas, local governments have sought to exploit the consumer boom by encouraging the manufacture of cars, television sets, refrigerators, washing machines and beverages like beer, thus creating a glut of some commodities and inhibiting regional specialization. Provincial governments have indulged in protectionism, often preventing the flow of commodities and capital across local boundaries, the root cause being the failure to coordinate reform between the centre and the localities (Zang, 2001). Fiscal measures, like the tax-sharing arrangements between central and local governments instituted since the mid-1990s, are intended to mitigate tendencies towards provincial particularism.

There are other areas in which state regulation may relieve market distortions, protecting both consumers and commercial operators. Consumer demand for designer-label foreign products has stimulated supply of counterfeit goods priced higher than genuine domestic articles, and the practice is rampant in the pharmaceutical sector, prompting the central government to order commercial administrations to institute strict checks on medicine manufacturers and distributors. Simultaneously, China's State Development Planning Commission lowered the prices of costly medicines, including 24 domestic and 114 imported items, by 5 and 10 per cent respectively. In addition, the government holds in reserve legal and other disciplinary sanctions (Liu, 1999; Summary of World Broadcasts (SWB), 1999d). A related issue, consumer protection, is increasingly governed by legislation designed to encourage free and fair competition; similarly, city governments, like that of Shanghai, have sought to boost consumption, by introducing consumer credit facilities, especially for cars, the inequitable pricing of which has already been noted above. Finally, small-scale commercial distributors, an important element in the reformed system, are to be assisted through fiscal and bank lending measures (Chen, 1999; Sun YX, 2000).

Given the huge expenditure involved, the government also necessarily plays a major role in perfecting the physical infrastructure of distribution. In fact, in the pre-1978 period, an inadequate national transportation network combined with a centrally imposed regional autarchy to prevent the emergence of a nationwide market. Thus the central government is now giving priority to investment in the water, rail, air and road transportation systems (Gates, 2001; McDaniels, 2001).

In addition to such measures, the central government is playing a role in the reform of the wholesale and retail sectors. Over the Tenth Five Year Plan Period, it is intended to replace administrative with professional management in commodity circulation. A buyer's market for consumer goods has been emerging since the 1980s, but government monopoly of wholesale and retail markets has prevented distributors from effectively addressing demand. Thus, since the early 1990s, China's commodity circulation has been in transition, the first policy objective being to separate commercial enterprise from government ownership, which will bring in its train substantial cultural change as management adjusts to competitive markets nationwide. As the wholesale system was not previously market-driven, policy is to inject competitiveness through the infusion of private enterprise and capital. Reform is dual track. Firstly, private enterprise in distribution is encouraged in order to discipline state-run circulation through competition. Secondly, private investment through share ownership or limited liability in state-owned enterprises is similarly designed to further efficiency and managerial expertise. The dual-track rubric applies to a range of wholesale markets, with the exception of those dealing in grain and other strategic goods. It is officially acknowledged , however, that these measures could bring casualties and so the intention is to 'grasp the great and let go of the small', thereby allowing weaker wholesale enterprises to fall victim to competition. One source reported that by 1995 there were over 500 enterprises under the share system and of these about 40 were listed on stock markets. In 2000 the deputy mayor of Tianjin stated that, in the wake of reform, a number of state enterprises had suffered from private competition, and their share of that city's commerce had fallen as a result of poor-quality service. Moreover, 375 small state enterprises had already been sold by auction to the private sector. Nevertheless, in spite of such progress, the private sector only controlled a quarter of wholesale enterprises in 2000 (Chen, 1999; Li and Wang, 1999; Wang, 1999; Han, 2000; Ren, 2000; Xia, 2000).

Advances in reform nationwide are now reviewed. A number of stages in the restructuring of wholesale markets may be discerned. Informing these stages has been a trend towards increased scope in the reach of commercial enterprises nationally, accompanying the amalgamation and economies of scale just discussed. The first stage, from 1979 to 1984, in the wake of state enterprise reform, saw prices of some industrial commodities decontrolled. Additionally, governments at various levels began to encourage the development of market-driven distribution, with its scope gradually extended to service wider and wider areas. Secondly, during the period 1992–1997, wholesale markets for consumer goods opened. After 1995, especially, both general and specialized markets expanded in scope, reaching out from cities and major centres, spanning whole provinces and autonomous regions and forging closer links between production and sales. Since 1998 wholesale markets have been consolidated and, based in major cities, cover most of China. Establishment of nationwide coverage, however, will be but one element in success as China's distributors face competition from foreign firms; if more sophisticated consumer needs are to be satisfied, capital must be more effectively concentrated and advanced technology utilized. Already there have been instances of commercial enterprises enhancing their market reach and profit potential. Food and drink companies have amalgamated into groups, taking advantage of greater capital resources.

By late 1999 China had more than 90,000 registered wholesale markets, with nearly 1,000 of these reporting annual sales of over 100 million yuan. In the early 1980s they traded in agricultural products, but later diversified into industrial commodities, basic materials for production and consumer goods like home appliances and computers. In 1999 Yiwu Commodity Bazaar in Zhejiang Province was China's largest wholesale market, with annual sales worth 20 billion yuan. Increasingly, as indicated above, wholesale markets are cutting across provincial boundaries. Hunhe Commodity Market in Shenyang, capital of Liaoning Province, projected to be the largest market in China and in the process of completion in 1999, was being designed to attract purchasers from further afield through the opening of transportation routes, linking the market to other provinces. Wholesale distribution has also been linked to cross-border trade; the city of Mudanjiang in Heilongjiang Province has set up branch markets in Russia for the sale of fruit, vegetables, electronics and building materials (Ma, 1998; Summary of World Broadcasts (SWB), 1999c; Ren, 2000; Xia, 2000).

Closely linked to the creation of nationwide wholesale markets have been government moves to encourage a competitive retail sector. Like wholesale distribution, retailing remains a mixed half-reformed system, with the state enjoying a monopoly in certain sectors. For example, all retail pharmacies must by law be state-owned, but many have contracted day-to-day management to entrepreneurs who pay a small percentage of profits to the government, thus creating a tributary relationship present in some wholesale sectors (Zakreski and He, 2001). Prior to the open-door policy, retail distribution was predominantly under direct state control and characterized by low-quality products and poor service; only slowly has a buyer's market begun to emerge under the stimulus of private enterprise (Xu *et al*., 1999).

During the early 1990s, especially, the rapid increase in retail outlets exceeded the growth in consumers' purchasing power, and this reduced profit margins markedly, to the detriment of state enterprises, which now proved less competitive than private operations. By the end of 1996 the role of non-state enterprises, including those financed by individuals, shareholding and foreign investment, had grown and accounted for 72.6 per cent of consumer goods sales (Xu XM, 2000). The role of private enterprise has also been reflected in the changing scale and scope of retail outlets. Until the 1980s, retail distribution under the old command economy tended to be fragmented, being dominated by state-owned general stores and small-scale shops. However, since the1990s, retailing has become increasingly competitive, resulting in economies of scale on the part of both state and private enterprises, including foreign-invested outlets, even though, as discussed later, expansion of the latter has been restricted by law. Finally, because of price-cutting, a number of traditional general stores have ceased trading (Ma, 1998; Zhou, 1999).

These trends will now be examined in greater detail. Horizontal integration, through chain-store business, is still in its infancy in China, whereas in developed countries such outlets account for at least a third of the retail market. In fact, a Chinese source stated that in 1999 China had only a thousand chain store operators, running an average of 15 shops each, although the number has been growing rapidly in the 21st century. In line with the consumption trends discussed earlier, chain supermarkets, for instance, are heavily concentrated in the high-income cities of Shanghai and Beijing in addition to the coastal province of Guangdong, but they are a harbinger for future retail development in smaller cities and towns and, ultimately, villages. Thus chain stores, which first began to emerge in the early 1990s, will gradually replace small food outlets, and convenience stores will supersede confectioners and tobacconists. Official statistics indicate that already chain stores sell all goods ranging from necessities to 27 kinds of consumer durables, with foods representing 62.9 per cent and clothes 4.4 per cent of sales. The success of chain stores in China lies in their proven ability to address the growing diversification and sophistication of consumer taste. They reduce costs and enhance competitiveness through bulk buying and economies of scale; their marketing is assisted by reporting back, from company headquarters to producers and manufacturers, the changing structure of consumer demand. Small retail operators are thereby disadvantaged. Thus, a key to chain store success is a closer liaison between retailers and producers, and horizontal concentration may in turn foster tendencies towards vertical integration. As chain stores increase market share, their leverage over manufacturers grows, facilitating takeover, through direct purchase or share ownership, of industrial enterprises, which can then exclusively supply their retail network under their own brand name (Li and Wang, 1999; Xu & Zeng, 1999; Xu *et al.*, 1999; Zhou, 1999; Sun P, 2000; Xu XM, 2000).

To date, chain stores have been able to capitalize on rising consumer demand, but to remain competitive they need to develop management systems equal to the challenges of the global market. Lack of attention to soft skills like marketing is a legacy both of traditional Chinese government antipathy to entrepreneurship and the seller's market of the command economy. However, legislation regarding services, introduced in 1991, acknowledged the rights of the consumer and thereby stimulated market research. Integral to scientific management is tracking and creating markets; thus articles in China's commercial journals stress computer software needs for monitoring stock control, setting prices and gathering financial information from retail operations so that domestic and global market trends may be addressed. Finally, crucial in this context is a management cadre trained in service orientation (Shu, 1999; Fan, 2000; Zhang LM, 2000).

Market research follows greater consumer choice and the latter is in turn aided by the provision of credit facilities. On the one hand, a high savings ratio, discussed earlier, furnishes the means by which banks may lend; on the other, increased consumption of big ticket items like housing and cars stimulates the growth of consumer credit in the long term. By 1988, although still impeded by the high prices which curbed market expansion, mortgage credit and hire purchase, assisted by information systems software, were becoming available, even if unevenly distributed nationally (Liu, 1999; Zhen, 1999; Hu, 2000; *Renmin Ribao*, 8 March 2001).

In the light of these developments, China's consumer market offers enormous potential for both domestic and foreign distributors; the following section will assess the impact of ongoing direct investment from overseas on the Chinese distribution system, especially in the context of the country's WTO membership.

China's Distribution Sector: FDI and WTO Membership

Foreign Direct Investment has played a role in rendering China's state industrial enterprises more competitive and effecting the diversification of consumer markets. The tertiary sector has been the last arena to be opened to overseas interests. In anticipation of China's entry to the WTO, in 1992 State Council regulations initiated trial legislation, permitting foreign participation in the retail sector in Beijing, Tianjin, Shanghai, Guangzhou, Dalian and Qingdao as well as the Special Economic Zones. In addition, foreign-invested manufacturing joint ventures and wholly owned foreign enterprises were allowed to sell up to 30 per cent of their output on the domestic market (Shu, 1999; Luo, 2000).

Officially, there was still a tight rein of control, however. Regardless of the amount of investment, only the central government could approve retail joint ventures which were also specifically prohibited from conducting wholesaling or operating import-export agencies. Nevertheless, once again the tension between the centre and the provinces came into play; while the former had sanctioned 20 ventures, local authorities had approved 277 enterprises by 1999 (Sun YX, 2000). Clearly, foreign-invested ventures were lucrative because investment gathered momentum and, in response, the central government offered further limited concessions, allowing certain Dutch and Japanese enterprises to open chain stores in Beijing from 1995 (Shu, 1999). In general, the trend was towards liberalization, and even though in 1997 the State Council again expressly forbade local governments' approval of foreign investment in commercial enterprise, the 1999 Measures concerning Pilot Projects for Commercial Investment were a further step towards liberalization. Geographical reach was extended; retail joint ventures could now be established in all provincial capitals, cities directly under the central government and SEZs, even though only one or two retail joint ventures would be likely to be approved in each pilot area. Additionally, chain stores could now be operated, provided that they were organized as branches of the joint venture.

Furthermore, while prior to the 1999 legislation the Chinese party had to have a dominant share, the new measures permitted the foreign partner to hold up to 51 per cent of the registered capital in convenience, speciality and single-brand chain stores. Majority interest was also encouraged in retail supermarket joint ventures, with the proviso that they have not more than three branch stores. If that limit were exceeded, however, the Chinese partner should contribute at least 51 per cent of the registered capital. Central government approval was still mandatory. Finally, the 1999 measures also permit joint ventures in wholesale commerce, with one such enterprise to be approved in each of the cities of Beijing, Tianjin, Shanghai, and Chongqing, subject to strict requirements based on minimum average annual sales, asset holding and registered capital. Moreover, a Chinese partner must hold at least 51 per cent of the capital investment (Lauffs and Lin, 1999; Luo, 2000). Nevertheless, it must be contended that while such concessions were designed to discipline domestic retailers, restrictions in place were intended to allow the latter the time to become competitive on domestic and global markets.

While the Chinese seek the managerial and technical skills of joint venture distributor partners, retailers and wholesalers from overseas are attempting to stake out a strategic position in the Chinese market in view of the greater competitiveness inherent in China's WTO membership. Moreover, while spending power among Chinese consumers is increasing and demand remains high, for foreign products, China's markets are more competitive and limited than at first sight. In some consumer goods sectors, supply exceeds demand and, given that 70 per cent of the population still lives in the countryside, and urban income earners are in a minority, the real potential market for imported luxury consumer goods stocked by foreign invested retail outlets is limited, it is calculated, to a population of about 60 million (Zakreski and He, 2001).

Nevertheless, by 1998, there were over 14,000 foreign invested wholesale and retail enterprises in China and very many more have since been established (Luo, 2000). In September 2001 a report in the *Renmin Ribao* noted that in the first 8 months of that year 16,344 foreign-invested commercial ventures had been approved, with investment totalling over US$43 million (*Renmin Ribao*, 19 September, 2001).

To illustrate the success of foreign distributors, attention is now focused on the direct entry of overseas companies to China's retail sector, which to date has been more open than the wholesale network. Since 1992, when retail commerce was first opened to foreign interests, a number of major names have entered the Chinese market. In the mid-1990s, for instance, the Japanese retailer, Daiei, opened supermarkets in Beijing and Tianjin, while the American giant, Walmart, began operations in Shenzhen (Xu and Zeng, 1999). As newcomers to China's market, foreign retailers have certain advantages over domestic competitors and the wherewithal to compete. The former do not, for instance, suffer from overmanning and the burden of pension provision. Their vast resources also permit a long-term view and the development of economies of scale in China; superior managerial and technical skills leading to higher productivity contrast with relatively backward Chinese domestic practices. The main area of competition is customer satisfaction, and here foreign firms like Walmart, Metro AG of Germany and Carrefour of France, as well as a few Chinese domestic operators such as Shanghai Hualian Supermarket Company, have been advantaged by buying power. The utilization of modern information systems like point of sale (POS) has made it possible to satisfy consumer demand on both quality and price, especially as foreign retailers open branches beyond major centres. Such firms have served to introduce Chinese consumers to international brand products; Walmart, for instance, has also sought to localize supply in line with local consumption habits, and in its Shanghai outlets the ratio of goods of Chinese origin reached 95% in 2000. Computer systems relay information on such diversified demand; automatic order replenishment software enables firms to gain cheap wholesale prices through high sales volume on favourable payment terms and priority service. Consequently, the foreign presence has reduced the profits of large and medium-sized Chinese retailers, resulting in some store closures. This has led some commentators to suggest that organizational renewal is only possible through judicious mergers or the greater capital resources and managerial competence available via the medium of Sino-foreign joint ventures (Shu, 1999; Xu and Zeng, 1999; Xu *et al.*, 1999; Sun YX, 2000; Powers, 2001).

An examination of the conditions inherent in WTO membership and resulting Chinese legislation point to an intensification of the trends discussed above, with a potential to benefit Chinese consumers as well as foreign and domestic retailers. The Chinese formally joined the WTO on 11 December 2001, but the general scope of Chinese commitments in most sectors had already been set in a Sino-American bilateral agreement reached in November 1999, even if there have been modifications in subsequent negotiations between China and major trading nations such as EU countries (China Business Review, 2000). In distribution, as in other sectors, China's accession will be gradual. China will allow foreign business to form wholesale joint ventures to distribute all imported and domestically produced goods one year after accession, while within two years of entry, foreign majority ownership will be permitted, with all geographical and quantitative restrictions phased out. After 3 years no restrictions will apply, except in a few sectors like crude oil. The retail sector will be opened immediately, with some exceptions; for example, pharmaceutical outlets will only be permitted 3 years after accession. Foreign chain-store operators also face certain conditions. Nevertheless, the WTO service schedule refers to continuing geographical restrictions related to retailing, although these will be phased out 5 years after accession (Zeng, 2002). In addition, foreign firms will be permitted to provide such auxiliary services as storage and warehousing, packaging and advertising, thereby improving market access and facilitating the integration of their Chinese operations into global networks (China Business Review, 2000; Zhang LM, 2000).

Thus, while honouring the general conditions of WTO membership, the Chinese have taken full advantage of temporary exceptions granted under the terms of most favoured nation Treatment (MFN) in services, and similarly been able to protect, for example, agricultural goods from competition by reserving them for state trading, even if the establishment of tariff rate quotas permits foreign enterprises with trading rights to import commodities like cotton (Zeng, 2002).

There is a sense in which China's enabling legislation in relation to WTO membership is the latest phase in China's economic reform programme, in that it is designed to come to terms with global competition. The government must now create a transparent, stable and predictable framework of law to ensure successful integration into the world economy. In terms of legislation, China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) intends to amend or repeal quota and import licences inconsistent with WTO membership, even if these may remain for a transitional period. Perhaps more importantly, under the Tenth Five Year Plan, the Chinese government is committed to the abolition of monopolies in the trading sector (*ibid*.; Zhang LM, 2000). In turn, pressures born of WTO commitments could prove a useful weapon for the government in impelling the distribution sector towards greater efficiency (China Business Review, 2000). While initially, for example, domestic enterprises will suffer from foreign competition, long-term effects could result in chain-store operations for retailers and regional alliances for wholesalers, in response to an increasingly national market (Baldinger, 1998; Han, 2000). These developments will necessarily entail new management styles, probably Sino-foreign hybrids, focusing on better service techniques and quality. To this end, experts in marketing, commercial law, accountancy, computing, e-commerce and foreign languages will be recruited and trained, under the stimulus of foreign managerial and capital input in services, thereby aiding China's ongoing entry into global commerce (*ibid*.; Zhang LM, 2000). Additionally, such trends will benefit China's consumers as, with lower tariffs, foreign imports become cheaper and domestic commodity markets more diverse, with a growing proportion of high-value-added quality goods. Finally, the entry of Chinese companies to global service markets will be expedited (*ibid*.; Zhang HX, 2000).

Summary and Conclusions

This paper has discussed contemporary trends in China's consumer markets, specifically diversification of demand, the growing role of services and the reform of the distribution system, the latter increasingly impelled by foreign investment and the potential impact of WTO membership.

China's consumer revolution has been taking place in the general context of the restructuring of state enterprises, and reform in one sector mandates reform in others. Thus distribution reform is seen as crucial: the service sector is labour-intensive and can provide work for a growing number of unemployed. Consumer demand is born of income source diversity, and in spite of a growing propensity to save for social insurance, remains a priority of the Chinese leadership as a motor of economic development. Consequently, to satisfy such demands, the delivery of goods and services must become even more efficient through subjection to the rigours of competition. Nevertheless, obstacles to distribution reform include the lack of a nationwide market, given regional and personal income inequalities, and, as importantly, a poorly coordinated transportation infrastructure. The pre-reform distribution system was also fragmented, with vertical control but poor horizontal integration. The sector is now in a transitional stage from a seller's to a buyer's market, with substantial input from private enterprise and capital. Prerequisites for a burgeoning consumer market, however, are legal and fiscal measures, the removal of local protectionism and provision of consumer protection and credit facilities.

Retail operations have been increasing in scale and scope with the development of, for example, chain supermarkets, while foreign participation, hitherto restricted, is bringing greater efficiency through scientific management and computer information systems, Walmart in Shenzhen being a prominent example. Such foreign input in the distribution sector, including wholesale services, is set to accelerate in the wake of China's WTO membership even though, taking advantage of permitted exceptions, the Chinese have opted for gradual accession and a staged phasing out of restrictions on market entry. In fact, WTO requirements could prove a useful weapon for the Chinese government in convincing domestic constituents of the need for reform, while resulting benefits could include both better quality goods and service techniques. Finally, China's distribution sector will become more customer-oriented, with greater potential to compete on global markets.

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