

## **Appendix T**

# **WTO and the Development Strategies of Chinese SMEs**

# WTO and the Development Strategies of Chinese SMEs

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After entering WTO, China will participate in world economic activities as an equal member of the world economic community. Undoubtedly, this will speed up the Chinese economy's integration into world economy, but it will also bring about a rather rigorous challenge. After all, China is a country with 1.3 billion people. The gradual integration into modern society of so many people in the next few decades represents an unprecedented and never to be seen again task in the world's industrialization history. China is an ancient country with over 5,000 years of civilization history and its history and culture tradition is completely different from that of modern western countries, which have established the WTO rules. This means that China will face an enormous challenge of how to adapt to WTO rules and situations after its WTO entry. Whether China can successfully conquer this challenge, or whether China can occupy an important position and play a key role in the future world after its wider and deeper integration into the world economy depends on how she faces this challenge in the years to come.

It should be noticed that the maker of WTO rules, the western advanced countries, are a society good at science and technology and production organization and with a long nomocracy tradition. As early as over 1,000 years ago, in the simple commodity production ages, the ancient Rome had established a systematic and complete set of law systems and civil laws had become the major instruments for relation adjustment among social members and the fundamental rules governing economic life. Even in those days, people took the same respects to laws as their belief on religion. This is one of the important factors that later made western society the source of world industrialization.

But as China lacks a history tradition of nomocracy and it does not have social resources of this aspect. For a long time, China was a country under patriarchal clan and family system. Bringing honor to one's ancestors and producing a male heir to continue the family line were two major life targets for most people. The patriarchal clan and family system awareness was very strong. When such an ethic conception diffused and penetrated into social and political fields, a social control system characterized by patriarchal clan and family system, commonly known as individual governance and ethic governance, was formed. Therefore for a long time, in China social conflicts were mainly adjusted on the basis of Confucian ethics and morals and laws just played a secondary role. Besides, the laws mentioned here are just criminal laws, not civil laws. As in China no one was regarded independent individual in laws from ancient times, there was no civil laws. From the tenet "criminal punishments on behaviors exceeding the limit of ethics", we can see that criminal laws were just considered the final instruments for conflict settlement.

The Chinese is a nationality paying much attention to sentiment. To date, people still cherish the ties with family members, friends, and native people. Emphasizing sentiment tends to

sacrifice rationality because sentiment is irrational in nature. This creates some disharmony with the rationality, order, and democracy requested by industrialization. After China's WTO entry, such disharmony may prick up disputes and conflicts. Whether we can adjust the sentiment, rationality, and laws we are used to and adapt to the new rules that we are not familiar with will be a rigorous challenge. Another huge challenge is whether we can set up a set of law systems able to both suit market economy and the Chinese culture tradition. From this point of view, the challenge is to the organization mode of Chinese society.

## **I. The Challenges Chinese SMEs face after WTO entry**

The Chinese government's commitments to WTO mainly include cutting its overall tariff level from the 14% in 2001 to 10.1% by 2005. In particular, the tariff on industrial products should be reduced from 13% to 9.3% and that on agricultural products should be decreased from 19.9% to 15.5%. Besides, the tariffs on automobiles and motor parts and components should respectively fall to 25% and 10% by July 1<sup>st</sup> 2005. The tariff cuts on some chemical products can be finally finished by 2008.

The commitments to lifting non-tariff barriers are abolishing the non-tariff barriers on commodities under over 400 existing tariff numbers before the end of 2005, including quota, license, and special bid invitation requirements. The products involved consist of automobiles, machinery products, natural rubber, and sensitization materials. Meanwhile, the quotas should grow at an annual speed of 15%.

As for the commitments on tariff quotas<sup>1</sup>, China will increase the quota through using 1995 to 1997 as the base period and the products involved are such agricultural products grains, cotton, oil, sugar, and wool and such industrial products as fertilizer and wool strips. For example, in 2002, China's quota for wheat import is 8,468,000 tons and by 2004, the figure should rise to 9,636,000 tons. Within the quota, the tariff range is between 1% and 10%. For imports without quota, the tariff rate will fall from 71% to 65%.

As for service trade, such as telecommunications, banking, insurance, securities, video and audio and retail sectors, the Chinese government has also set some tariff cut lists. Some statements and commitments have also been made on IPR protection, including copyrights, trademarks, industrial designing, patents, and integrated circuits.

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<sup>1</sup> According to relevant WTO rules, the tariff quota for an imported product should not be lower than 3% of the country's annual consumption quantity, besides, certain annual increase in such quota should also be promised.

### **A. The challenges that SMEs will face in the near future**

According to the fundamental WTO rules and the commitments made by the Chinese government, with tariff cuts, the lifting of non-tariff barriers, and the gradual opening of tertiary sector, in the short term the challenges to Chinese SMEs will mainly come from the market aspect.

In terms of different industries, SMEs of such labor-intensive industries as garments, stationery, leather, foodstuff, textile, furniture, metal products, rubber, building materials, and plastic products are the fields in which Chinese SMEs have comparative advantages. These industries, especially textile and garment industries, are also the major sources of China's trade surplus. But China lacks talent, fund, technology, and equipment advantages in these industries. Consequently, top and medium grade products of these fields will face impacts from product imports from advanced countries. Due to resource condition restrictions, China's resource processing industries, such as wood pulp and wood product industries will face challenges from countries with abundant resources. For the limited capacity of world market, Chinese SMEs will also face the fierce competition from other developing countries with low labor costs. For example, in 1996, the average hourly wage of a textile worker was 0.58 US dollar in China, higher than the 0.56 US dollar in India, the 0.43 dollar in Indonesia, and the 0.44 dollar in Pakistan.

In capital and technology intensive industries, like ordinary machinery, metallurgy, chemicals, transportation facilities, telecom equipment, paper making, instrument and apparatus, as well as chemical fiber industries, there are also many SMEs engaged in providing secondary services to large enterprises or produce some investment products or unfinished products whose demand is not large. These industries concentrate a lot of China's talents and with their strong technical and fund power, they occupy a larger share in China's total industrial output. But as China generally lacks competitiveness in fund and technology, the products of these important sectors do not have comparative advantages on the world market. They are also the major sources producing China's deficit in foreign exchange payment. Undoubtedly, after WTO entry, SMEs of these fields will face even tougher challenges. For instance, more imports of medium and top grade products and quality commodities of these industries will impose even bigger impacts on the Chinese market. As the prices on Chinese market is much higher than world market, raw materials and other upstream products that highly rely on resources, fund, and technologies, are liable to suffer from the impacts of more imports. The emerging high-tech, high added value, refined, and fully processed products will also face enormous impacts if they can not be listed as projects of infant industries subject to government protection or other special measures are taken.

Besides, several tertiary industries in which concentrate a lot of SMEs are generally very backward and their development are unbalanced. For example, although tourism and construction industries report rapid development, but their services are of poor quality. Professional service, release, consulting, and real estate development industries are still in the takeoff stage. The gradual opening up of service markets will make SMEs of these sectors fall into great difficulty

in the short term.

This is especially true in the financial sector. To respond to the entry of foreign banks, the 4 big Chinese State-owned commercial banks are shrinking their business scope and adjusting their client structure. They have set the objectives of targeting large enterprises and large cities and will gradually retreat from financial market at county or lower level. If small and medium financial institutions can not realize corresponding development in the process, the mass SMEs will face unprecedented difficulty.

In summary, China's WTO entry will bring about challenges to its SMEs in the short term. First of all, changes in market environment will make the SMEs face even fiercer competition. More quality but cheap foreign products will flow into China and the competitors will be even stronger. For the losing of some market, in industries of higher technology content and added value, the competition space will become very narrow. The price competition the Chinese enterprises are used to will be regarded as dumping and arouse anti-dumping charges. As a result, the competition rules will also face some changes.

Secondly, the administration system on SMEs will face large impacts. Although China's economic system reform over the past 2 decades have achieved some results, gap between the current situation and the demands of market economy is still enormous. After WTO entry, it will be difficult for the local protection and department protection practices to go on. Many inanimate SMEs with ambiguous ownership structure and responsibility division, too much government interference in their operation, and poor management, which had fallen into difficult in the seller's market years ago, will find it even tougher to survive after WTO entry. Under such situations, SMEs may lose many of their excellent employees.

The result is a large proportion of SMEs facing survival crisis. Some SMEs small in size, with poor financing capabilities, weak technology power, and limited market information obtaining capabilities will go bankrupt. The SMEs currently under the protection of high tariffs and some SMEs using agricultural products as raw materials will be subject to some impacts. SMEs of high-tech and high value-added fields, such as computer and telecom products, will also find it more difficult to expand and maintain their market share.

### **B. In the long run, the challenges to be faced by SMEs**

After passing the transition period following WTO entry, the market factors with enormous influences on the Chinese economy, tariff, non-tariff barriers, and market accession, will gradually become steady. But the factors from fundamental system and regulation aspects will rise to the surface and have increasingly enormous influences. When China is more widely and deeply integrated into the world economy, as a developing country, the challenges she faces can never be solved in a short time, instead, they will last for a rather long time. For this reason, such impacts on China's economic system and structure are the real challenges to be cautioned about. In the long term, the challenges Chinese SMEs are in face of mainly come from basic

systems and rules, specifically, from the elementary competitiveness of SMEs, capabilities of SME founders, the corporate organization of SMEs, and the industrial structure of SMEs, as well as the transition of government functions.

1. Challenges faced by the SMEs' elementary competitiveness. Most of the Chinese SMEs are founded by farmers after opening up and reform and a lot of their managers and workers are farmers without receiving any professional training. Therefore, their staff employees are of low quality, their technology level is low, and their management is poor. They also lack fund and their equipment is backward. These factors lead to their low efficiency, poor product quality, disorder corporate management, high material and energy consumption, as well as high costs.

2. The SME founders' competence faces some challenges. Most of the resident savings in China are made in the form of bank deposits or other financial assets, and only a small proportion is used for business investment purposes. This indicates that there lacks real investors and entrepreneurs among Chinese residents. Although numerous SMEs have been set up in China in the past 20 years, a remarkable feature of these SMEs is that their founders are farmers without much expertise and there are not many senior talents actually establishing enterprises of their own. The MBA programs of some famous universities and colleges do not have courses for small entrepreneur training. Obviously, they only want to train white-collar workers, not "bosses". In the United States, about one fourth of the people with a MBA diploma set up their own enterprises. From this we can see that if a country's talented group try to become "high-wage earners" and "white-collar workers" instead of becoming entrepreneurs, the society will lose the force for job creation and corporate system innovation.

3. The corporate organization of SMEs faces some challenges. The challenge first is shown in the form of confused ownership relations in these enterprises and this is common among various collective enterprises. Confused property relations, unspecified input nature, and vague assets ownership lead to insufficient protection on collective rights and interests. Severe losses in collective assets make the SMEs' shareholders and employees reluctant to offer more investment. Secondly, the public ownership of these SMEs is not properly positioned and their legal position is not specified. In principle, the various State-owned and collective enterprises organized by government and administrative organs at various levels should only conduct public product providing and non-profitable activities and they should be forbidden to conduct business activities for profit-earning purposes. Otherwise, these SMEs will either end in losing market competition because of their inflexible management for assets security considerations or suffer major public assets losses because they are offered much flexibility to satisfy the requirements of market competition.

4. The SMEs' industrial organization faces some challenges. On one hand, their scale is not economic. After the reform and opening, the interest-driven mechanism has been strengthened, but the system reform lags behind and department and local segmentation still prevail. This

makes some industries with enormous scale economy effects and requesting concentration still dominated by enterprises too small in size. Small textile factories, small breweries, small paper makers, small cement plants, small steel factories, small oil refineries, and small thermal power plants boom throughout the country, causing severe repeated construction problems. Meanwhile, excessive competition leads to low overall profitability among these SMEs and such negative influences as resource waste and environment pollution.

On the other hand, the cooperation level of SMEs is still very low. Their management system with excessive government interferes determines the market of these SMEs often limit to a small region and they tend to produce final products. Under such situations, it is difficult for them to organize intermediary product making and provide supplementary products to large enterprises. Such limitations impede the further deepening of specialization labor division. Of course, there do exist large enterprises' extrusion on SMEs. At the same time, market blocking has become the most convenient way to protect local benefits and formed the situation that "it's hard for good enterprises to win the market and bad enterprises to be eliminated though competition".

5. The government's function-transition faces some challenges. Market economy is often called nomocracy economy because only through observing rules and being honest can business efficiency be improved. Only through legal governance, can the lots of disputes occurring in commodity transactions be settled in an established way. Only through "punishing all dishonest activities" can the dishonest activities be effectively reduced. Obviously, market economy requests strict prevention against cheating behaviors in commodity production and exchanges. Therefore, the government undertakes a heavy supervision and administration task of maintaining market order. Undoubtedly, conducting administration according to laws and sticking to rules represents a rather rigid challenge to the Chinese governments at various levels that are accustomed to issuing administrative commands and unfamiliar with law-based administration.

Additionally, SMEs belong to the society's weak groups and they should get more support from the government. But presently, the SMEs do not have the necessary legal protection and their social burdens are heavy. The enterprise establishment approval and registration procedures are too complicated and time consuming and in the course, the SMEs are even required to pay various unreasonable charges and fees. Governments of all advanced countries are doing their best to help SMEs. If the Chinese government does not transit its functions in this aspect, it will be difficult for the Chinese SMEs to win the competition.

In fact, in some Chinese areas, the local governments do not service the SMEs whole-heartedly, but are enthusiastic about establishing more SMEs. Therefore, many SMEs rely on local governments' protection for survival and development. After WTO entry, if the Chinese governments continue to make local protectionism settlement on administrative lawsuits, business disputes, and IPR conflicts involving foreign businesses, other WTO members will use such cases as evidences in their charges about China violating WTO rules. These actions can seriously damage China's reputation.

## II. The Strategy Positioning of SMEs after WTO entry

WTO entry will have far-reaching influences on the Chinese economy and in no way will SMEs be a kind of economic organization transitory in nature and bound to extinct. Therefore, in the formulation of policies on SME development, we should not only consider current situations, but also think about the industrialization and industrial structure upgrade tasks China will face in the next few decades. The government should make the millions of SMEs full of energy and vigor and become the vibrant cells of China's socialist market economy and the major organizations of modern production, and a kind of necessary preparation for future high level industrial organization. Only in this way, can China actively participate into world labor division and actually improve its industrial competitiveness and improve its position in the world market. This is the effective way in which China can overcome the challenges brought about by WTO entry.

In the long run, SMEs' functions in the following 4 aspects can never be replaced by large enterprises and they are of strategic importance to the entire national economy's development.

### **A. SMEs plays a key role in job creation and social stability maintenance**

WTO entry means that China will accelerate its industrialization and modernization process and the diversion of agricultural labors will become an even prominent issue. Redundant rural labors are a major source of social instability in the industrialization process of many countries because industrialization itself does not provide an effective mechanism for the farmers to share the benefits of industrialization. When farmers constantly become the sacrifice of industrialization, they are bound to impact industrialization. Industrialization is not only a process of creating large quantity of material wealth, but also a process distributing the material wealth created. Usually, a society's distribution relation adjustment capabilities (solving the relations among different people) lag behind the improvement of its productivity (solving the relations between people and nature) and the acute social turbulence hereby aroused almost penetrates the entire industrialization process of every country.

In China's industrialization and accompanying urbanization process (which may last at least for 40 to 50 years), 400 to 500 million jobs must be created in non-agricultural sectors. Therefore, no matter in the long term or in the short term, the diversion of agricultural labors will be an extremely tough task. The SMEs, were, are, and will continue to be the places absorbing the hundreds millions of agricultural labors. Without a sound development environment for SMEs, the numerous redundant labors diverted from agricultural field could not be absorbed. Not only would it be difficult to realize the country's industrialization and modernization, China would also face the enormous negative impacts in the modernization process. Based on such a conception, it is reasonable for us to attach strategic importance and give priority to the development of SMEs.

## **B. SMEs plays a significant role in upgrading industrial organization level**

Small and competent enterprises provide a major foundation for modern production. Without quality SMEs, it is impossible to create top large enterprises. Without small excellent and specialized enterprises acting as foundation, it is impossible to improve the professional degree of large enterprises and the whole industry's organization can only remain on a rather scattered and backward level without any international competitiveness.

Currently, China's industrial specialization labor division still remains on the stage of product specialization. Enterprises tend to rely on their internal organizations to provide many parts and components and developing production techniques. They even have to provide various consumer services to their employees and their families. Besides, governments at different levels are still a major stakeholder in practical economic operation. The "region and interest group" they represent are actually the beneficiaries of the enterprises under their administration. The economic power controlled by local governments is a feature in China's social and economic life. The interest groups represented by various administrative agencies have actually formed the foundation of China's economic operation. This leads to the "small and complete" basic economic interest communities in China (such as towns, villages, and counties) and the "small and complete" industrial organization, which greatly decreases China's overall economic efficiency.

After WTO entry, more foreign companies and multinationals will come and invest in China and international competition on the Chinese market has started. But it should also be noticed that the SMEs are actively conducting production and technology cooperation with foreign enterprises (including providing parts and components and setting up joint ventures or cooperative enterprises). Such cooperation offers an important opportunity for improving the labor division and specialization cooperation degree of Chinese SMEs. Simultaneously, it can also strengthen the ties between foreign businesses and local economy and improve the quality of foreign projects introduced.

## **C. SMEs are of key functions in industrial structure adjustment and upgrade**

The establishment and dying out of numerous SMEs is the theme in the economic structure adjustment and upgrade of advanced countries and forms a refreshing, solemn, and stirring landscape in their vigorous economic life. After joining WTO, the Chinese economy will be influenced by international economic fluctuations to a greater extent. Changes in the industrial structure of other countries are bound to have more rapid and frequent influences on China's industrial structure. As large enterprises' reactions tend to be slower because of their big sizes, the significant functions of SMEs in industrial structure adjustment must be fully utilized.

In the past, China was used to pinning its hope on industrial policies because we had some successful experiences in this aspect in the whole 1980s and the first half of 1990s. But these successes were made in a market dominated by sellers and in those days, the market demand was

obvious. “Shortage” was the guide for industrial policy formulation. But in the current buyer’s market, it is not only difficult to forecast future demands, even the current demand is also constantly changing. This greatly reduces the effects of industrial policies. In less than 6 months after China fixed its pillar industrials for the 1995 to 2000 period, a heated discussion on searching new economic growth engines were aroused because people doubted about the pillar industries fixed. This meant the structural industrial policies set before were out of date and it is necessary to find new ways and means to solve the issue of industrial structure adjustment and upgrade.

Developed countries rarely implement structured industrial policies in an organized way because in an economic environment subject to market demand restriction, it is very difficult to forecast future society demand. “Correctly forecasting future is beyond anyone’s capability”. Governments’ such predictions are at enormous risks. Therefore, people can only rely on market system to distribute resources to places with highest efficiency. Thus the historic tasks of industrial structure adjustment and upgrade naturally fall on the shoulder of innovative and adventurous enterprises, especially SMEs.

#### **D. The SMEs’ remarkable functions in technology advancement and innovation**

As SMEs often face survival risks in market competition and they are subject to much greater pressure than large enterprise, they tend to perform better in technology advancement and innovation than their bigger counterparts. The technology innovation advantages of SMEs mainly lie in the fact that their management is keen-witted and capable and can make innovative decisions in a short time based on market changes. Their flexible management environment is favorable for conducting innovation activities and benefiting from the science and technology research personnel “overflowed” from large enterprises. SMEs tend to use innovation as their major weapon in market competition and they are more enthusiastic about conducting minor and not so important innovations. For these reasons, the technology innovations of SMEs are of very high level in terms of both quantity and quality. For example, from 1900s to 1970s, more than half of the US science and technology development projects were finished by SMEs; after entering the 1980s, about 70% of the innovations were realized by SMEs. In the 20<sup>th</sup> century, major technology breakthroughs made by US SMEs include airplanes, DNA fingerprint technologies, manmade insulin, recorder, pulse starter, optical scanner, and personal computers.

### **III. The Strategic Tasks Chinese SMEs undertake in their development**

Enterprises are the cells of national economy. Under market economy situations, enterprise competitiveness is the factor determining the different national economy level of countries with similar natural resources. The gap between China and developed countries lies in comprehensive power. Productivity improving process is a course involving not only improvement in science and technology level but also the upgrading of social organization capabilities. Here the term “social

organization” usually includes corporate organizations and industrial organizations. From a wider point of view, it should also include the macro management organization of a society, namely the government, as well as various social intermediaries. After joining WTO and gradually integrating into world economy, in their development, the SMEs should consider how to improve the whole country’s overall industrial competitiveness and upgrade the general competence and quality of national economy. This is the long-term strategic tasks of Chinese SMEs and mainly consist of contents of the following 4 aspects:

#### **A. The upgrade of production factor structure**

Production factor structure is the comparative contributions of natural resources, labor, and capital in an economy. The Chinese is a diligent nationality with abundant labor resources and this is a favorable and fundamental precondition for our participating in international competition. But we should ceaselessly improve the production factor structure of SMEs and help them transit from labor intensive to capital intensive, and further to technology intensive or even information intensive operation mode. Such transition in the comparative advantages of production factors is an important indicator showing a country’s development level.

But possessing comparative advantages in production factors does not mean having competition advantages because only through competition advantages can the comparative advantages be embodied and brought into play. Besides, competition advantages can break the limitations of comparative advantages and are more strategic. From the viewpoint of international economic relations, comparative advantages mainly involve relations between different countries’ various industries. But competition advantages are related to the same industry of different countries. Therefore, we should not only continue utilizing our comparative advantages that are based on our rich labor resources, but also devote to cultivating and utilizing the competition advantages of Chinese SMEs on the world market. This includes improving the SMEs’ science and technology level, corporate organization standard, and industrial organization level and upgrading the whole country’s strategic actions.

Undoubtedly, the technology advancement of Chinese SMEs should focus on capital saving and resource saving. But as these are not the strong points of development countries, we can only rely on our own innovations to explore a technology development route that suits China’s practical conditions.

To adapt to the SMEs characteristic weak fund-raising capabilities, the technology innovation strategy of stressing actual effect should be followed. In view of the SMEs features of depending on external technology resources, the technology resource networking strategy should be implemented. We should not only stimulate the rapid development of high-tech SMEs, but also pay attention to encouraging high-tech enterprises to transfer techniques to SMEs in traditional industries.

Systems are more important than technologies. We should not only pay attention to the technology advancement and the use of such technology advancement, but also attach importance

to system arrangements favorable to technology innovation. This is because only with proper systems can we fully utilize the potential of human resources and fundamentally solve the issue of offering driving force to technology advancement, hereby guaranteeing the vigor of SME technology innovation and the healthy development of high-tech industries.

### **C. The upgrade of corporate organization level**

Though long period of economic and legal practices, various countries have fixed three corporate forms in their laws, namely wholly funded enterprises, partnerships, and companies (independent legal persons in law). Such a three-type mode reflects the common understanding of various countries and has been proved to be effective in practice. Following the *Corporate Law* and the *Partnership Law*, the “*Law on Wholly-funded Individual Businesses*” was passed in China in 1999, marking the end of confusion in China’s corporate law system and the establishment of legislation framework on market economy players. These laws lay an important legal foundation for the establishment of socialist market economy system.

Based on the cooperation difficulty degree of ownership relations, obviously, wholly funded enterprises are better than partnerships, which are better than limited companies. Therefore, on the basis of clarifying ownership relations, Chinese SMEs should first establish the traditional natural person enterprise systems on wholly funded enterprises and partnerships, then the attention should be paid on the enterprise systems on various companies.

Besides, there is a kind of very important SME form that is often neglected by us, which is non-profit agricultural cooperation. This is a kind of agricultural organization prevailing in many countries. As a kind of self-protection organization set up by farmers and related to the government’s agriculture protection policies, it is also a significant way for the farmers to share the benefits of industrialization.

### **D. The improving of industrial organization level**

Since industrial revolution, developments in labor division among enterprises and the specialization degree first took the form of product specialization, then the specialization of parts and components, and finally the specialization of production services. The deepening of such labor division and specialization degree relies on the improvement in the cooperation degree among enterprises. Cooperation among SMEs can be classified in two categories. In one category, the SMEs producing end products, especially consumer goods, as the production process is short, there is not much inter-enterprise cooperation. In the other category, SMEs make semifinished products and have close relations with other enterprises. In terms of labor division, the former is in the stage of product specialization, while the latter is in the stage of component and technique specialization stage.

In the past two decades, a kind of industrial organization that can be called soft production method has appeared. Namely, the production activities with industrial connections are divided among multiple enterprises and each enterprise realizes specialization. They tend to concentrate in a geographic area and form cooperation networks. The enterprises are linked together through contracting, strategic alliance, service contracts, and sales contracts and can obtain higher

economic benefits.

Advanced specialization labor division and cooperation is a process of long term evolution. To change China's 'big and complete' and "small and complete" economic organization mode and improve the labor division and cooperation level of SMEs, the government needs to provide fundamental system support. To a country lacking democracy and especially lacking civil law tradition and for a long time using individual governance and ethics governance as basic control system on the society, there will be a rather tough journey waiting for us.

#### **IV. Strategic measures to be used to promote the development of SMEs**

The rapid development of Chinese SMEs can be contributed to policy support and their further development also needs further policy support. An SME-supporting policy system including policy focuses, policy targets, and policy measures should be formed step by step and made an integrating part of the whole country's strategic actions.

Supports to SME development should be under the guidance of correct thinking. To realize the transitioning of economic system and growth patterns and make the whole economy full of vigor, the social and economic position of SMEs should be greatly improved. The status of SMEs should be changed from the representatives of backward productivity in the age of planning economy and gleaning and vacancy filling units plays of a secondary role in national economy to driving power in socialist market economy. Unfavorable factors blocking the development of SMEs should be conquered and economic, legal, and market environment favorable to the survival and development of SMEs should be actively improved and created. The government should help SMEs solve major obstacles in their development and improve their competitiveness. Cultivating good SMEs should be regarded a significant basis to industrial organization and structure optimization, industrial competitiveness enhancement, overall national economy quality improvement, and international competitiveness increasing so as to overcome the challenges after WTO entry.

Strategic measures for SME supporting should be designed in view of the common features of SMEs (differences from large enterprises) and considering the unique characteristics of Chinese SMEs (differences from overseas SMEs). In the short term, the work should focus on creating sound regulatory environment and offer a space favorable to the survival and development of SMEs. Later, the work should concentrate on establishing social service systems that are sound and complete and designed for SMEs and offer good development environment for SMEs. Finally, the work should center on improving the internal management of SMEs and training a lot of talents with high expertise so that the SMEs can have higher competitiveness. Below some suggestions are put forward on the policy measures to be taken in the first 10 years of the 21<sup>st</sup> century.

##### **A. Major policies for SME development supporting purposes**

1. Adjust government functions to provide a sound regulatory environment for SMEs. In this stage, to great extent the development of Chinese economy still relies on the depth of system reform and the basic symbols will be government function transition. In socialist market economy, the role of government is steering instead of rowing. Governments at various levels should actually shift their attention from enthusiastically establishing SMEs to whole-heartedly service enterprises, especially SMEs. They should replace individual government with nomocracy. In other word, they should restrict enterprises' activities with laws and regulate the power of government agencies. Besides, the civil law system should be used to exert fundamental adjustment functions in the whole society's economic life and the basic frame of socialist market economy should be actually set up. Only in this way, can we actually encourage individuals to invest in SMEs.

**2. Strengthen and improve the government's basic administration on SMEs.** With the ongoing reform, on the basis of clarifying the ownership of SMEs and withdrawing the government from direct involvement in enterprise operation, the administration functions of relevant government agencies on SMEs should be merged and an State SME Administration with comprehensive adjustment power should be established. SME committees can be established in the people's congress and CPPCC as important organizations hearing the voices of SMEs and protecting the legal rights and interests of SMEs. Besides, nationwide uniform SME classification criteria should also be established to enhance the statistics work on SMEs.

**3. Formulate industrial guidance and planning on the development of SMEs and guide the SMEs on the track of healthy development.** When drafting long-term government work plans, relevant government agencies should formulate special plan on how to boost the development of SMEs and regularly issue directive "Industrial Catalog on the Development of SMEs" to the society. The technical standards for relevant industries and industrial development information should be released. For the industries that may suffer huge impacts, the government should try to pilot the healthy development of SMEs as early as possible through such means as economic leverages, ownership relations, and administration instructions. Meanwhile, detailed plans on the development of SMEs should also be fixed, e.g., SME establishment plans, technology innovation plans, and education and training plans.

**4. Continue to deepen SME reform.** Based on recent situations, further deepening SME reform is still a key measure that can help accelerate SME development. Business connections between SMEs and government agencies should be actually broken and so that the SMEs can become fully independent market players. This is a major measure to prevent some corrupted officials from using public administration rights to obtain personal benefits. The government's various SME-supporting measures should offer preferential treatments to reformed SMEs and the policy supports to SMEs which have not undergone modern corporate system reform should be reduced or even stopped.

## **B. The government's countermeasures against WTO entry**

China's WTO entry will impose huge pressure on SMEs in the short term. Therefore, to

minimize the negative impacts brought about by WTO entry, fully utilize the various opportunities accompanying WTO joining, and enable the numerous SMEs continue healthy development in the fierce competition of the 21<sup>st</sup> century, we must take some active countermeasures.

**1. Strengthen the study on WTO rules.** In no way does WTO entry mean the government playing a less important role in supporting Chinese enterprises and industries. The things to be changed are the forms and ways to offer such supports. But we are not familiar with these forms and ways. Therefore, we should collect and carefully study relevant WTO rules, agreements, and the trade laws and regulations of relevant countries, such as “Anti-dumping Law”, “Fair Trade Law”, “Patent Law”, and “Trademark Law” to know our own situations and our competitors’ conditions. And when disputes arise in foreign trade and other business activities, we can expertly use laws to protect our own economic and trade interests.

We should strengthen legislation and learn to protect our national interests with the weapon of laws. We should fully utilize such theories and principles as WTO exception rules, international practices, infant industry theories, national security theories, all-around development theories, international payment balancing theories, technology protections theories and combine the China’s actual situations and other major trade partners’ experiences to formulate relevant trade and economic laws as soon as possible. Through issuing such laws and regulations as *Foreign Trade Law*, *Import Administration Ordinance*, and *Infant Industry Protecting Ordinance*, we can take effective legal measures to protect our domestic industries when they face impacts. This is of extraordinary importance to the Chinese SMEs in capital and fund intensive industries.

We should try to cultivate senior professional talents familiar with international laws, especially international economic laws, so as to minimize the restrictions of WTO rules on China’s sovereignty and their limitations on the Chinese government’s freedom to independently formulate and implement policies. At the same time, we should fully unite other developing WTO members and use the “majority voting decision-making system” to influence the establishment of new WTO and world trade rules and try to protect the interests of China and other developing countries.

Government agencies closely related to SMEs should thoroughly study WTO entry’s influences on relevant industries and regions and the reaction strategies to be taken and formulate various specific protection measures, anti-dumping measures, and quality criteria for various industries that do not violate WTO principles.

**2. Bring into full play the adjustment functions of tariffs.** Under the principle of WTO permitting tariff protection, we should impose discriminatory tariffs on different products. Specifically, the tariff rates on raw materials should be low, those on semifinished products should be higher, and the tariff rates on finished products should be highest. Low tariffs should be imposed on the machinery products that China is unable to produce and high tariffs should be imposed on the imports of products China has redundant production capacity. To protect the

development of infant industries, importing products of these industries should also be requested to pay high tariffs. Meanwhile, the government should also consider using appropriately opening up the market as exchanging conditions to make developed countries lift their restrictions on importing labor intensive products from China and create favorable economic and social conditions for the diversion of redundant agricultural labors.

**3. Encourage SMEs to adopt new technologies and adjust their product structure.** To shorten the SMEs' product development circle, improve their fund utilization efficiency, and make them rapidly react to market changes, the government should accelerate the spreading and application of mature technologies that have gotten some applications among SMEs. Such organizations as productivity promotion centers and technology transfer centers should be established to offer a technical support and service system and spread various advanced and suitable technologies among SMEs.

Give priority to the development of some shortage products with short production circle and huge market demand and indicating economic power and level. Restrict the production of some products with long production circle, redundant production capacity and facing server oversupply. Decisively eliminate some backward products made with backward technologies, causing serious resource waste, and leading to severe environment pollution. Boost the development of some high-tech products.

**4. Optimize the industrial organization of SMEs and actively participate in international labor division.** Especially in machinery industry, while large enterprises strengthen research, development, designing, installation, debugging, and service capability construction, some "small giants" engaged in specialization cooperation should be cultivated to form an industrial organization of "large enterprises leading the development of small ones and small enterprises supporting the development of large ones". In investment attraction and promotion activities, we should change the current practice of only emphasizing foreign investment attraction quantity and neglecting encouraging the cooperation between local SMEs and foreign-funded enterprises. In China, under the current situations that most large enterprises' modern corporate system reform has not been finished yet, setting up joint ventures or cooperation relations with foreign enterprises and supplying components and parts to them is a major way to improve the industrial organization level of SMEs. Only in this way, can we realize the target of exchanging market for technologies and avoid the awkward situations that development areas are only a piece of isolated land designed to service foreign enterprises. Besides, we must decisively close some SMEs lacking scale economy efficiency, backward in techniques, and causing severe environment pollution.

**5. Try to expand exports.** The SMEs should improve their export quality, increase their foreign exchange earning capabilities and the profitability of their export businesses, speed up the adoption of international standards, implement brand strategies, actively develop their own feature products, and try to occupy international market through supplying brand products. The major exporters in coastal areas should create some competitive products and feature products

and try to make their products of top grade, elegant in style, and with exquisite packages, and keep pace with international fashion. Meanwhile, the principle of focusing on ordinary trade and supplementing ordinary trade with processing trade should always be followed.

The market diversification strategy should be implemented. While continue paying close attention to such traditional major markets as USA, Japan, and Europe, we should actively adopt the all-around, diversified, and multiple channel, and multiple port export strategies and try to increase exports to Russia, eastern Europe, Middle East, Australia and some other regions as well as the markets of other developing countries and regions. Besides, we should also try to increase border trade and labor exchanges.

The textile industry should make full use of the limited textile quota and improve the utilization efficiency and profitability. The structure of export commodities should be further improved. Developing finished high value-added products should continue being the main tenet in export expansion and the share of top grade product exports should be increased. The study on WTO, especially the articles of Agreement on Textile and Clothing (ATC) and the research on the trade policies of relevant textile importing countries should be strengthened. Textile exports should be increased through adopting flexible measures.

Machinery industry should shift its development strategy from focusing on import substitution to all-around development and fight against the accession of foreign products through occupying international markets. Some feasible measures should be taken to encourage the SMEs of machinery sector to open up international markets and comprehensively participate in international labor division and trade. Examples of such measures include increasing such SMEs' foreign exchange reservation rate, perfecting export rebate policies, introducing new export insurance, setting rules to offer priority treatment to export enterprises, and establishing taxation support policies. Speed up the establishment and improvement of various industries' quality warranty systems, especially the international standard certification, strengthen the quality examination and supervision on exporting products, constantly improve the quality reputation of Chinese products, and stop price competition. SMEs should be encouraged to go abroad to set up branches, purchase enterprises, make investment, set up joint ventures or cooperative enterprises, establish sales networks, and occupy international market.

### **C. The measures to be taken by SMEs in face of WTO entry**

In face of the rigorous situations, the SMEs can never sit still and await death. Instead, the only way out is fighting to win or die and face the challenges brought about by WTO entry with an active attitude.

**1. Energetically conduct technology innovation.** The SMEs must rely on the force of science and technology innovation and ceaselessly improve their existing techniques and equipment, lift their product grade, and upgrade their products and technologies through adopting high and new technologies. Particularly, the machinery SMEs that provides parts and components to large enterprises should not just maintain some technology advantages and pay attention to improving their technology innovation capabilities. They should also attach importance to setting

up joint ventures and cooperative relations with large Chinese enterprises and multinationals so that they can use their partners' advanced technologies and management methods for reference.

**2. Product structure adjustment.** The SMEs must carefully study the product development trends on international market, conduct product market segmentation, and find out advantage products through market analysis. They should properly perform market positioning, satisfy market demand, and timely guide market, and win competition advantages through making their customers satisfied.

At present, the structural characteristics of some textile and other light industrial products on which China have comparative advantages are low-end and similar to each other. As a result, there exist some vacancies in top grade product markets while the competition among medium and low-grade products are competing fiercely with each other. To win a favorable position in international competition, the processing degree of products must be improved. More attention should be paid on science and technology innovation to development top grade, high value added, high science and technology content, low pollution, and low material and energy consumption products. The SMEs should reduce the share of low-end products and enter the international market for medium and top grade products step by step.

**3. Improve marketing work.** The SMEs should change their old conception of "emphasizing production and neglecting sales" and establish modern marketing conceptions. They should find out sales strategies and marketing methods that are suitable to them and establish efficient and expedite sales channels and consolidate network marketing.

The enterprises should actively get Internet accession when conditions permit and some personnel should be organized to study market information and perform market development. Internet accession can enable the SMEs to obtain large quantity of international and domestic information in a short time so that they can rapidly react to market changes. At the same time, they can use the Internet to conduct advertising and information release to get more market opportunities. Particularly, exporting enterprises can cooperate with local competitive sellers of their targeting market and use their partners' sales network and sales advantages to enter certain international markets and certain regional markets. Through establishing overseas wholesale and retail networks, they can rapidly know about and satisfy the demands of and changes in overseas markets and implement global operation strategies.

**4. Actively enlarge exports.** Although textile and light industrial products of Chinese SMEs occupy a large share of the international market, but the market is gotten through price competition and such an extensive trade strategy should see some changes. On one hand, enterprises should improve the quality and grade of their export commodities, develop brand products with their own features, and go on the track of expanding export and increasing profitability on the basis quality and brand names. On the other hand, the market diversification strategy should also be emphasized. In addition to maintain such traditional market sales markets as USA, Japan, and Europe, the export to such areas as Asia, Russia, Eastern Europe, Middle East, and Australia should also be enlarged. The SMEs should not only develop ordinary trade, but also

try to expand border trade and labor exchanges.