

EC2374

# Economy of Modern China

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# Topic 3 (cont) Trade & Foreign Investment

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## key points/questions

- the embrace of globalization is an essential part of China's recent experience in growth and development
- China is one of the most open developing countries after 30-year's of liberalization
- trade and investment contributed significantly to China's growth and transformation
- China's trade continues to face many challenges

# Topic 3 (cont) Trade & Foreign Investment

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## from SEZs to WTO

- trade and development
- China as a trading nation
- China's trade & foreign investment
  - under central-planning: 1949-1978
  - early reforms: 1978-early 1990s
  - reforms and development in 1990s
  - post WTO
- future prospect

# Topic 3 (cont) Trade & Foreign Investment

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## trade and development

- some stylized facts/experience
  - openness & growth
    - foreign investment facilitate trade
    - trade increased faster than global GDP
  - openness & development
    - more open economies achieved higher growth
    - high growth is crucial for poverty reduction
    - Growth & opening increase integration
  - other factors also important
    - domestic: governance
    - external: trade policies in industrial countries

# Topic 3 (cont) Trade & Foreign Investment

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## trade and development

- underlying mechanism: trade
  - reallocation of resources
    - endowment & comparative advantage
  - demand and comparative advantage
    - economies of scale
  - embodied technology
    - imports of machinery & capital intensive goods

# Topic 3 (cont) Trade & Foreign Investment

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## trade and development

- underlying mechanism: FDI
  - capital inflow
    - lack of capital in developing countries
  - technology
    - FDI brings in more advanced technology
  - managerial skills
    - foreign affiliates
    - managers
  - market access

# Topic 3 (cont) Trade & Foreign Investment

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## China as a trading nation

- impressive but not unprecedented
  - China has become a key player
    - third largest in volume (after US & Germany, #2 exporter)
    - high trade to GDP ratio: 70%
    - US, Japan, and India: around 20%; Brazil: 25%
  - following the footsteps of other Asian economies
    - similar to Japan & Asian NIEs in speed of growth
    - reflect greater specialization within Asia
    - China an important exporter and importer

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- autarky under central planning: 1949-1978
  - largely closed
    - trade GDP ratio below 10%
    - limited trade with the communist countries
    - foreign investment discouraged
  - self-sufficiency as a national strategy
    - export goods considered low priority
    - import technologies and other important goods
    - similar to import-substitution



# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- autarky under central planning: 1949-1978
  - trade is managed & dominated by the state
    - all goods are traded by 7 national FTCs
    - government monopolize foreign exchange
    - centralization in trade
  - separate trade & domestic sector
    - trade subject to world price
    - domestic price subject to government planning

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- autarky under central planning: 1949-1978
  - trade was relatively important in the 1950s
    - closer ties with USSR: trade, finance, technology
    - exports are mainly on textiles & food products
  - trade insignificant during the 1960s
    - political split from USSR
    - continued isolation from the West
  - trade began to recover in the 1970s
    - with Japan & Europe to acquire technology & materials
    - also traded with the US toward the later part of 1970s

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- early reforms: gradual and partial
  - key elements of the existing system remained
    - national and provincial FTCs
    - government monopoly of foreign exchange
  - new entrants encouraged
    - SEZs in 1980 & subsequent opening of coastal regions
    - process trade vs. ordinary trade
    - coastal regions opened to trade & foreign investment

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- early reforms: measures
  - decentralization
    - new FTCs at the provincial & city levels
    - allow some firms, FIEs, to export directly
  - liberalization
    - direct export by FIEs
    - replacing state monopoly with tariffs & licenses
    - gradually reduce the coverage of tariffs & licenses
  - export promotion
    - devalue the currency
    - foreign exchange credit & other incentives for export

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- early reforms: outcome
  - rapid overall growth  
16% a year on average (78-93)
  - process trade key  
33% a year (1981-1993), 36% for EX and 30% for IM  
Ordinary trade: 6% a year (1981-1993)  
% of process trade: 6% in 1981 => 41% in 1993
  - become an important player in world trade  
% in world export: 0.7% in 1978 => 2.5% in 1993

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- early reforms: outcome
  - considerable structural changes, 1978-1993
    - share of primary goods decreased from 50% to 18%
    - EX: Machinery & miscellaneous products dominant
    - IM: Raw materials, components, & machinery dominate
  - concentrated in coastal regions
    - % of GD & FJ in total export up from 15% to 44%
    - another 39% export from other coastal regions in 1993

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- early reforms: outcome

- inflow of foreign capital began

FDI become important since mid-1980s

- characteristics in origin & location

FDI mostly from HK, Macau & Taiwan: >70%

concentrated in Southeast China: 50-70%

- forms of foreign investment: flexible

CJV most common in earlier years: 46% in 1979-1982

more in EJV since mid-1980s: 50%-65% in 1987-1993

WFO became popular in 1990s

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- comprehensive reforms in 1990s:
  - main objectives
    - establish an internationally compatible system
    - meet WTO requirement
  - more market-based liberalization
    - unify exchange rate
    - abandoned foreign exchange retention system
    - abandon export/import subsidy gradually
    - improve export rebate scheme
    - lower tariff rates
    - grant trading rights to more firms
    - partial convertibility (trade related sale)



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## China's trade and investment

- comprehensive reforms in 1990s:

- remaining distortions

- domestic subsidy still important

- export rebate

- trade/industrial policy used to protect domestic industry

- foreign invested firms enjoy favorable conditions

- non-tariff measures still used for certain items

- foreign exchange rate

- trading right not to all

- technical standard

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- comprehensive reforms in 1990s: outcome
    - continued trade expansion
    - high dependence on trade

trade to GDP ratio: 50% in 2001

  - become a leading player
- in 2003, become the 4th largest exporter in the world
- in 2004, Became the 3rd largest, after US and Germany
- China's export accounted for >6% of the world total

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- comprehensive reforms in 1990s: outcome
  - dualist trading regime remains
    - high import/export to GDP ratios
    - process trade remain important
    - FDI the main driving force of trade expansion
  - structural change continues
    - % of primary goods in EX down to 8% in 2003
    - machinery and misc. products 78% in 2003
  - concentrated along the coast (89% in EX, 87% in IM)
    - Southeast relatively less important
    - Lower Yangtze region more important

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- comprehensive reforms in 1990s: FDI
  - most important source of foreign capital

FDI accounts for >70% of total

largest FDI recipient among developing countries
  - changes in sources & location

more FDI from industrial countries

share of GD & FJ     ↓
  - WFO more preferred

EJV are falling out of favor

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- comprehensive reforms in 1990s: FDI

- trade & FDI very closely related

- part of the regional & global production outsourcing

- export associated with vertical FDI

- CA due to different technology levels

- CA in unskilled-labor-intensive activities

- other types of foreign investment emerge

- market seeking investment

- “tariff-jumping” investment

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- post WTO: WTO and its promise

- some basics

- the only international organization dealing with global trade rules

- ensure free trade

- benefits for members

- freer trade: lower costs and lower efficiency loss

- effective disputes resolution

- more product variety/better

- easier for governments to curb lobbying

- better government, less corruption, more transparent, etc.

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- post WTO: China's pursuit of membership
  - a long process (>15 years)
  - benefits for members
    - better access to the world market
    - more effective trade dispute resolution mechanism
  - general obligations
    - wider & easier market access
    - reform domestic policy/regulations
    - reform domestic institutions

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- post WTO: China's pursuit of membership
  - some special articles
    - state trading companies for some products
    - government pricing of certain goods/services
    - restrictions on logistic industries
    - eliminate/reduce most non-tariff measures
    - transitional safeguard mechanism after WTO accession
  - reservation by some members
    - Argentina, EC, Hungary, Mexico, Poland, Slovak, Turkey
  - some remaining issues
    - non-market economy status



# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- post WTO: opportunities & challenges
  - better market conditions

better for export, FDI, resolving dispute
  - challenges for some industries

agriculture

monopolized service sectors: telecommunication

protected industries: automobile, petrochemicals

# Topic 3 (cont) Trade & Foreign Investment

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## China's trade and investment

- post WTO: development
  - continued expansion in trade & FDI
    - strong export growth
    - comparative advantage for a wide range of products
    - more trade with regional trading partners
    - an intensification of a China-centered Asian production network
  - increasing imbalances
    - rising trade surplus
    - rising number of trade disputes

# Topic 3 (cont) Trade & Foreign Investment

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## future prospect

- rebalance China's external sector
  - “going out” policy
    - encourage outward investment
  - strengthen multilateral and bilateral trade relations
    - China ASEAN Free Trade Agreement
    - CEPA with Hong Kong and Macao
    - ECFA with Taiwan
    - Doha and Copenhagen
- domestic policies

# Topic 3 (cont) Trade & Foreign Investment

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## future prospect

- rebalance China's external sector
  - from labor-intensive to technology intensive
    - cutting back some of the favorable policies
    - currency appreciation
  - from coastal to inland regions
    - “Go West” policy
    - “empty the nest and change the bird”

# Topic 3 (cont) Trade & Foreign Investment

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## future prospect: current crisis

- Crisis expose China's vulnerability to external shocks
  - demand drop led to sharp slowdown
    - regions dependent on trade affected harder
    - from labor-intensive to technology intensive
  - imbalances reduced considerably
  - global trade conditions
  - currency issues

# Topic 3 (cont) Trade & Foreign Investment

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## future prospect: current crisis

- Policy responses: mainly to support export sector
  - Include export-oriented sectors in the revitalization plan  
Textile, Machinery, Light industry, Electronics & information  
Incentives for technology upgrading
  - Modify policies to assist exporter & exporting industries  
Lift restrictions on process trade  
Raise the rates of tax rebate for exports  
Extend fiscal and credit support to exporting SMEs
  - Stable exchange rate
  - Encourage domestic consumption  
Subsidize rural consumption of various electronic appliance

# Topic 3 (cont) Trade & Foreign Investment

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## future prospect: current crisis

- Recent development:

- growth recovered and trade stabilized
- structural adjustments:

import has outperformed export since 2008

process trade remain important in export and in maintaining trade surplus

FIEs' importance in export recovered

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## future prospect:

- uncertain external conditions:
  - slow and uncertain recovery
    - expected growth for industrial countries is low
  - rising competition and protectionist sentiment
    - growth of world trade slowed down
    - export to some emerging economies dropped more (Brazil, Russia, Korea)
    - increasing usage of protectionist policies



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## Concluding remarks:

- Trade and foreign investment contributed significantly to China
  - remarkable past performance
  - impact of the crisis
- Adjustment required:
  - Current crisis slowed efforts
  - Crisis also validates the need and the urgency for adjustment
- Difficult challenges ahead
  - Industrial countries remain primary as external market
  - Intra-regional trade within Asia is still insufficient
  - Domestic issues