China in the World Economy

China in the World Economy, autumn 2021

Questions from last time

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- 4) How are Belt and Road projects financed?

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- 3) What are „memoranda of understanding“ and „cooperation agreements“?
- 4) How are Belt and Road projects financed?
- 5) How do financing conditions compare to concessional development lending (World Bank etc.) and commercial loans?

Questions from last time

- 6) What type of projects are typically financed via BRI?

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- 7) What leads developing countries to join BRI?
- 8) Name some important partner countries and explain why they may be important for China.
- 9) Can the Chinese navy use a port leased by Sri Lanka to a Chinese company?

Today

- The Belt and Road Initiative in Europe

Today

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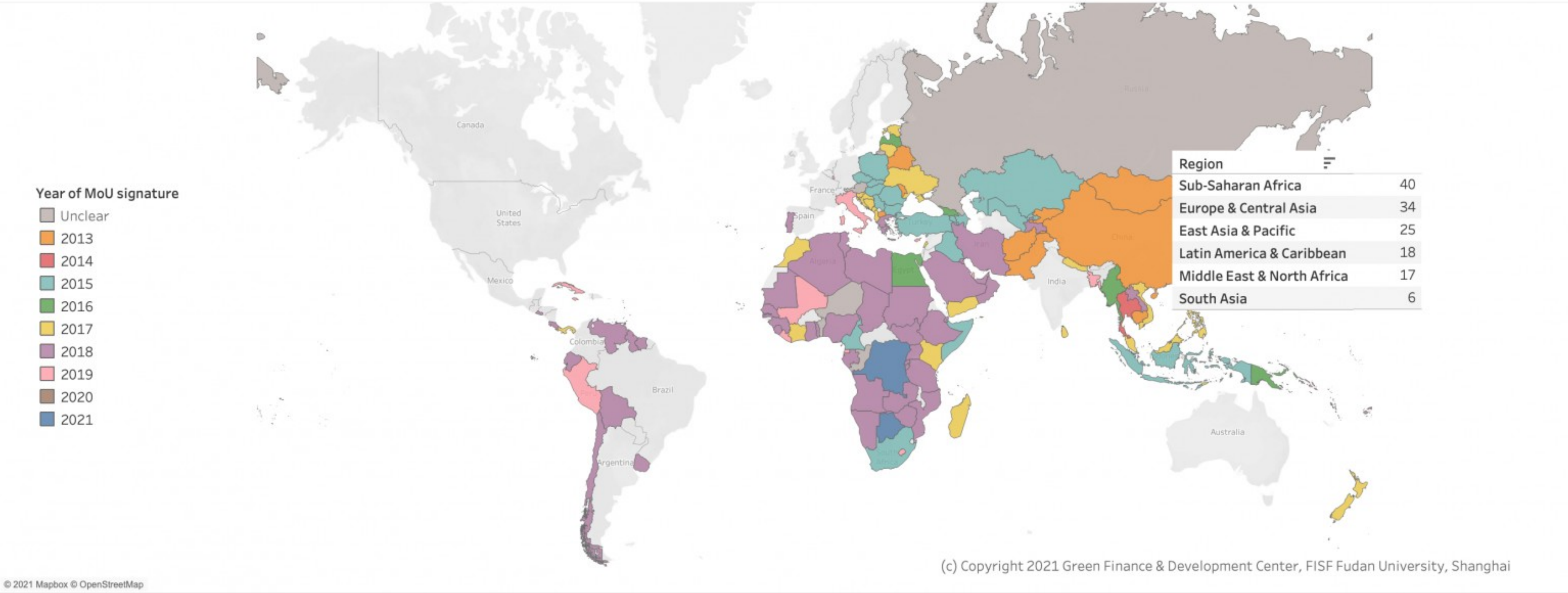
- **Summary and extension of topics we have discussed**
- > joining together what you already know, adding new angles and details

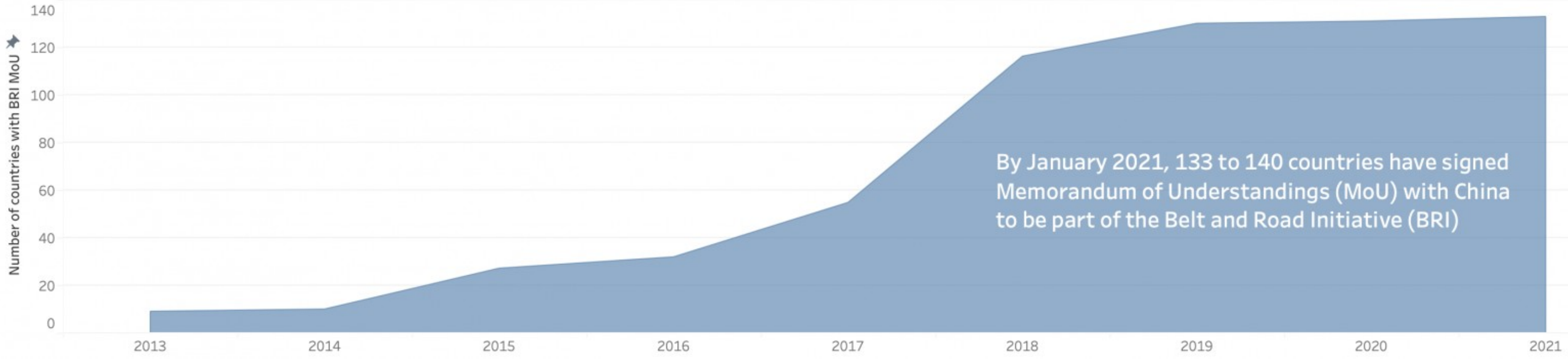
- Main focus – opening to international trade and foreign investment

BRI in European Union member states

Countries of the Belt and Road Initiative



Region	
Sub-Saharan Africa	40
Europe & Central Asia	34
East Asia & Pacific	25
Latin America & Caribbean	18
Middle East & North Africa	17
South Asia	6



BRI in European Union member states

- Hungary, Italy, Greece
- Countries frustrated by EU leadership
- Facing economic decline, or insufficient convergence with core states
- Eastern member states – disappointed by their unequal relationship with Germany

BRI in European Union member states

- **Main problem for BRI: EU law**
- Regulates **competition** and rules for **public procurement**

BRI in European Union member states

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- > **need for transparent tenders**
- > it is not possible to do a backroom deal with a Chinese bank

BRI in European Union member states

- **Main problem for BRI: EU law**
- Regulates competition and rules for public procurement
- > **need for transparent tenders**
- > it is not possible to do a backroom deal with a Chinese bank
- Competition law – state guarantees would be seen as giving Chinese SOEs and banks and **unfair advantage** over competition > it cannot be done

BRI in European Union member states

- Also – EU states are relatively rich

BRI in European Union member states

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- + have access to EU funds + to private lending

BRI in European Union member states

- Also – EU states are relatively rich
- + have access to EU funds + to private lending
- > **they have their own funding and don‘t need China‘s money**
- > they are higher on Maslow‘s pyramid and care about things like the environment or potential political interference

BRI in European Union member states

- Also – **better institutions and less corruption**

BRI in European Union member states

- China underestimated all of this
- > their offers are often unacceptable

BRI in European Union member states

- China underestimated all of this
- > their offers are often unacceptable
- > overall, the Belt and Road project is a failure in Europe, without the EU even having to have some strategy against it

BRI in European Union member states

- When Chinese companies do successfully win construction contracts, its under European rules:
- 1) **Based on a public tender**

BRI in European Union member states

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- 2) **Financed by European resources**
- > do debts, no collateral, no ownership of the infrastructure for the Chinese

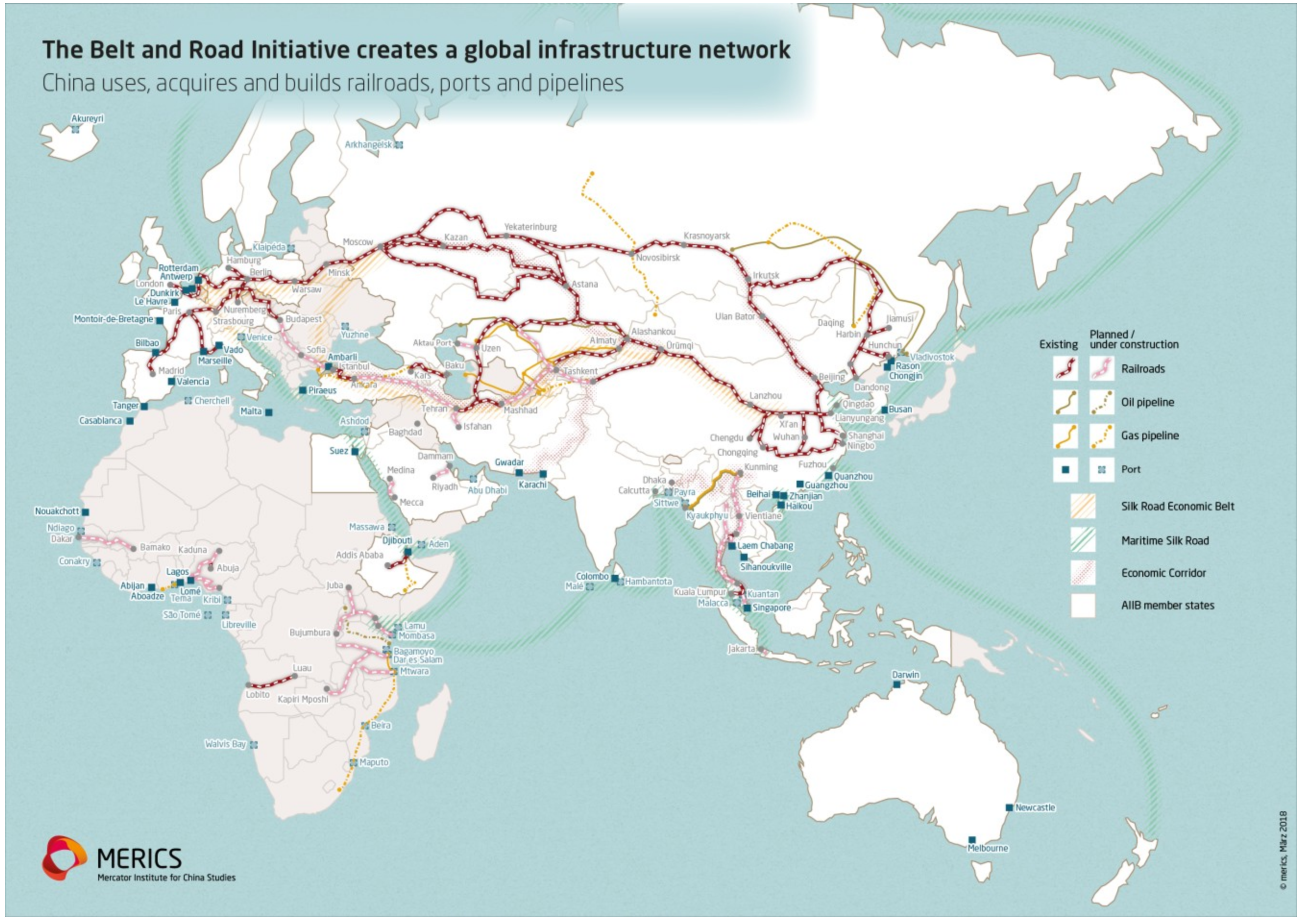
BRI in European Union member states

- When Chinese companies do successfully win construction contracts, its under European rules:
- 1) **Based on a public tender**
- 2) **Financed by European resources**
- > do debts, no collateral, no ownership of the infrastructure for the Chinese
- 3) **No guarantees and obligatory renegotiation of prices**
- > China‘s companies must behave like any other company without any special regime

The BRI in Europe

- China‘s big plan – **building a railway from the port of Piraeus through Hungary to Germany**

The BRI in Europe



The BRI in Europe

- China‘s big plan – **building a railway from the port of Piraeus through Hungary to Germany**
- Only the Hungarians decided to jump on this bandwagon
- Like many BRI projects, it is probably too expensive and is never gong to pay for itself > **skepticism in most EU states**

China‘s opening revisited

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- 1978 – all trade handled by special FTCs – **12 foreign trade companies = FTCs**

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- Why?

China‘s opening revisited

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- **Low tariffs and overvalued exchange rate**
- Why?
- Because they were not necessary – the state controlled all the flows of goods without a need for a competitive exchange rate or protective tariff wall

China‘s opening revisited

- Two simultaneous processes (**dual-track reform**):

China‘s opening revisited

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- 1) **Reform and gradually open up the statist system** > ordinary trade
- - inland provinces

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- Two simultaneous processes (**dual-track reform**):
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- - inland provinces
- 2) **Create special rules for foreign companies to process goods in China – completely outside the old system** > export processing
- - coastal provinces

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- - inland provinces
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- - coastal provinces

- **These two coexist to this day!**

Ordinary trade

- Number of monopoly FTCs increased – **from 12 to several thousands**

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- **But all of them were, at least officially, SOEs!**

Ordinary trade

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- **But all of them were, at least officially, SOEs!**
- **The FTC system was only completely abolished in 2004**, after entering the WTO!

Table 16.1
Chinese exports: Share of total by firm ownership.

	1995	2005	2016
State-owned enterprises	66.7%	22.2%	10.3%
Foreign-invested enterprises	31.5%	58.3%	43.7%
Private domestic firms	0.2%	14.7%	43.6%
Collective and other	1.5%	4.8%	2.4%

Ordinary trade

- **Liberalized prices** – the **foreign trade companies were encouraged to make money** instead of fulfilling a plan

Ordinary trade

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- Before – artificial prices totally detached from the world market, trade guided by state direction
- After reform – „export and import whatever is profitable in your business area“

Ordinary trade

- **Liberalized prices** – the **foreign trade companies were encouraged to make money** instead of fulfilling a plan
- Before – artificial prices totally detached from the world market, trade guided by state direction
- After reform – „export and import whatever is profitable in your business area"
- > **give the central government a part of the foreign exchange**, keep the rest as use it to do more business

Ordinary trade

- „**Canalization**“ – if you wanted to import something and you did not have the license to do it, you had to persuade one of the monopoly SOEs to do it for you

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- **> FTCs as middlemen**

Ordinary trade

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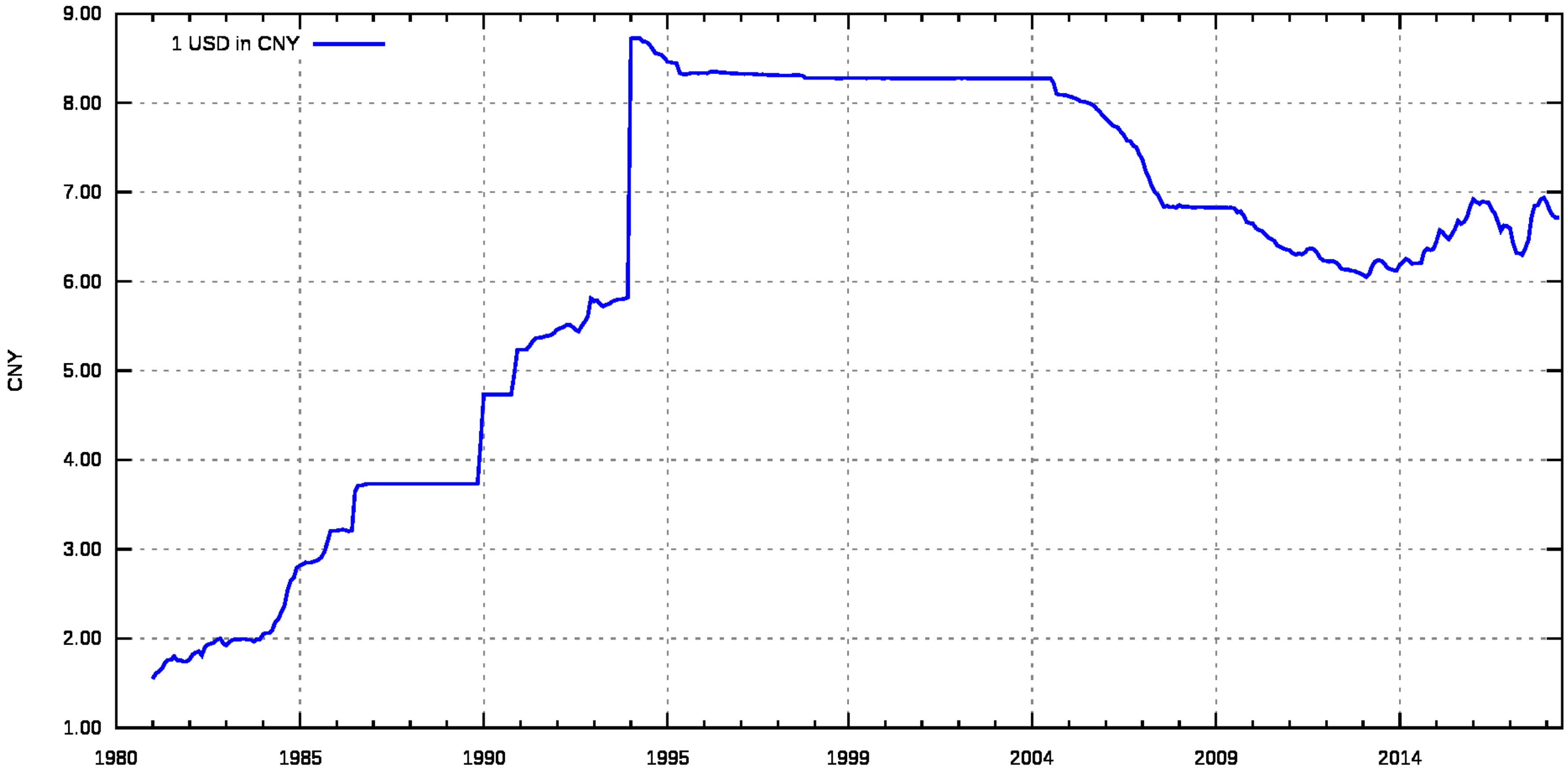
- By 1994, the **average tariff stood at 43%** - similar to protectionist Global South countries such as Brazil
- Increasing tariffs as a by-product of liberalization!

- **After entering the WTO, it was lowered again to circa 10 %**

Ordinary trade

- **Gradual devaluation of the RMB**

USD to RMB



1 USD in CNY
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1980
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Ordinary trade

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- **Separate foreign exchange market** – foreign trade companies could exchange money and ignore the official rate

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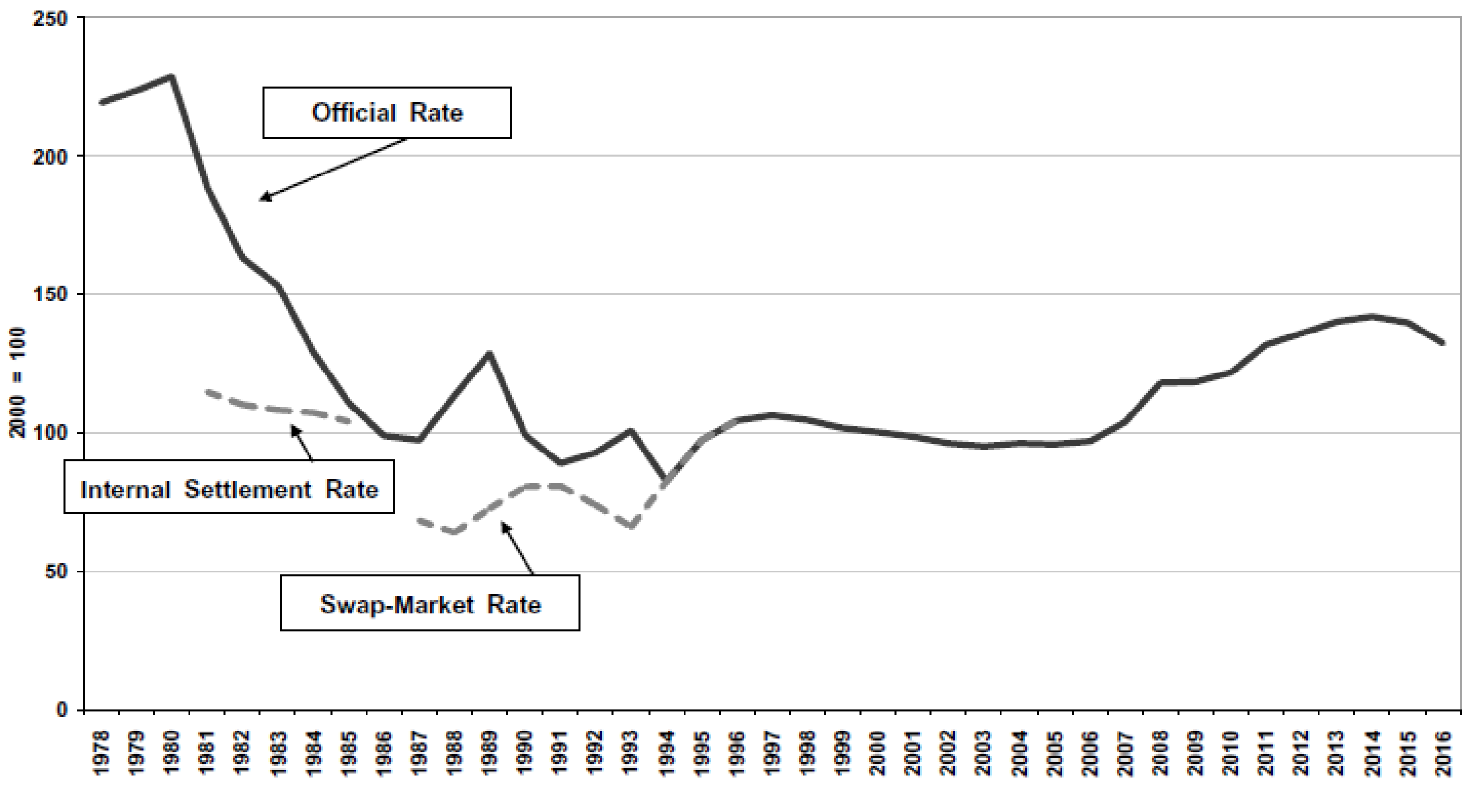
- > **two exchange rates** – the official one and the one used between the companies
- **Fix and floating at the same time** (kind of)

Ordinary trade

- **Gradual devaluation of the RMB**
- **Separate foreign exchange market** – foreign trade companies could exchange money and ignore the official rate
- > **two exchange rates** – the official one and the one used between the companies
- **Fix and floating at the same time** (kind of)
- Which one was lower?

RMB to UDS



Official Rate
Internal Settlement Rate
Swap-Market Rate
2000 = 100
250
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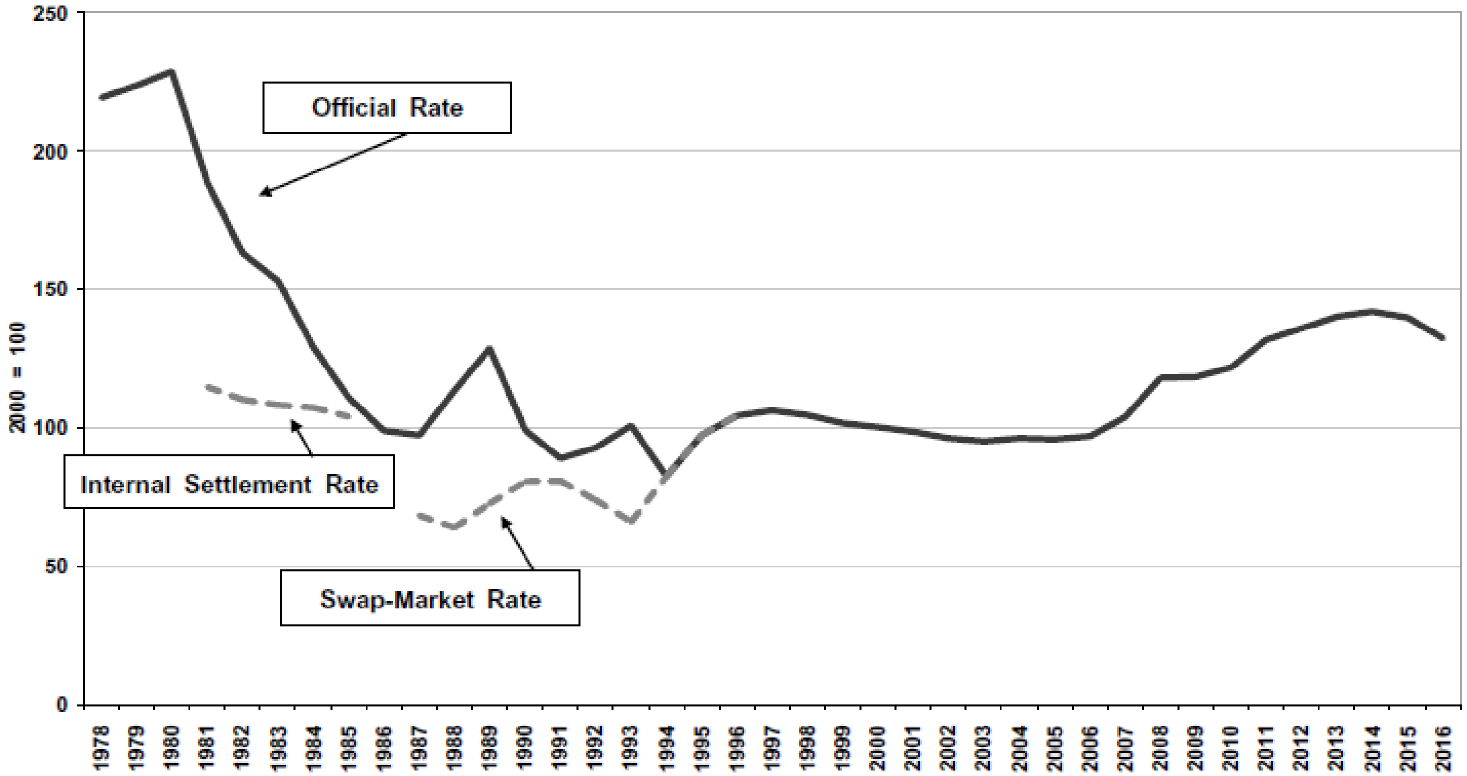
Ordinary trade

- **Main devaluation – 1994** – official rate set and fixed at the previous unofficial rate



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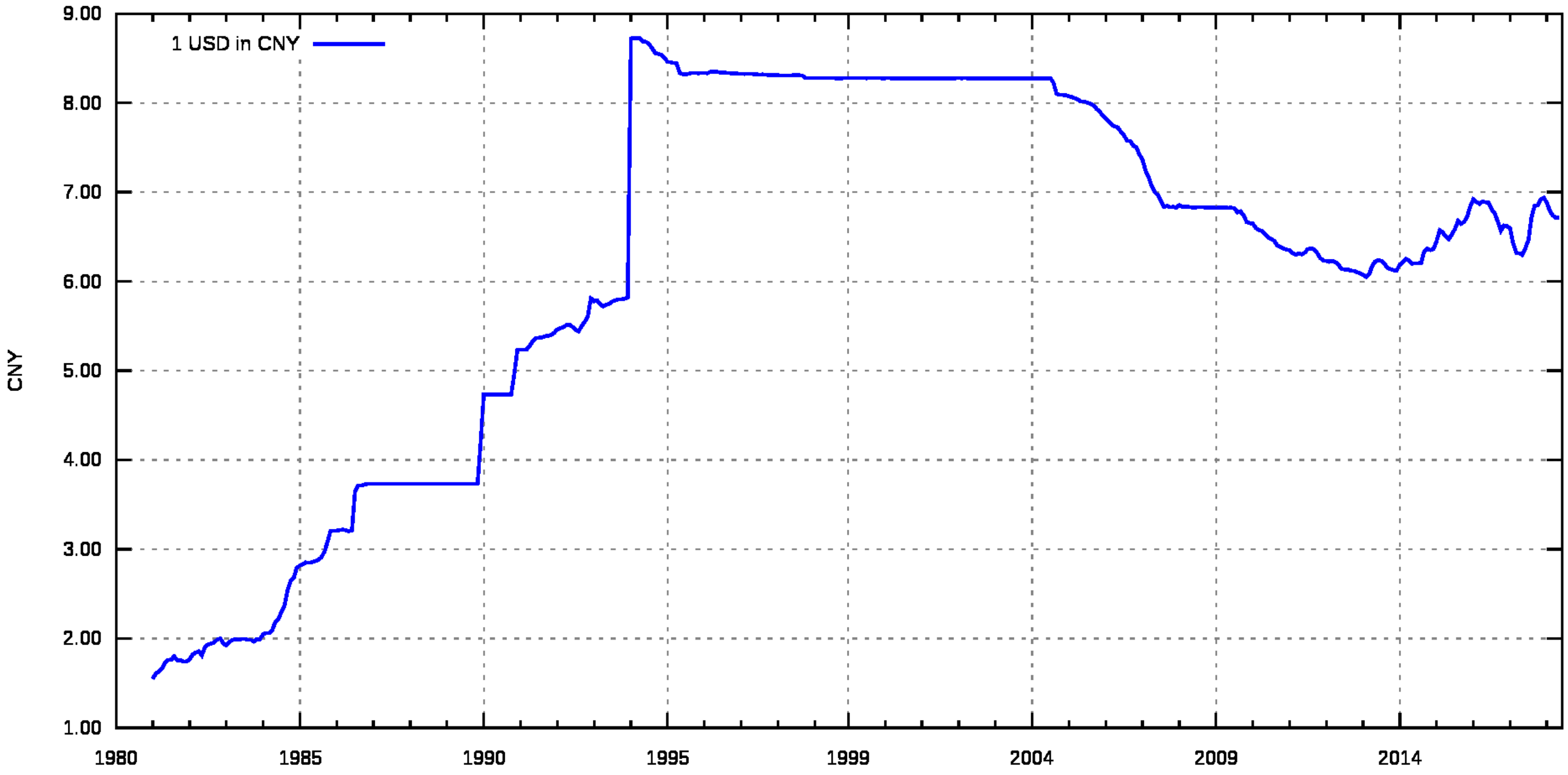

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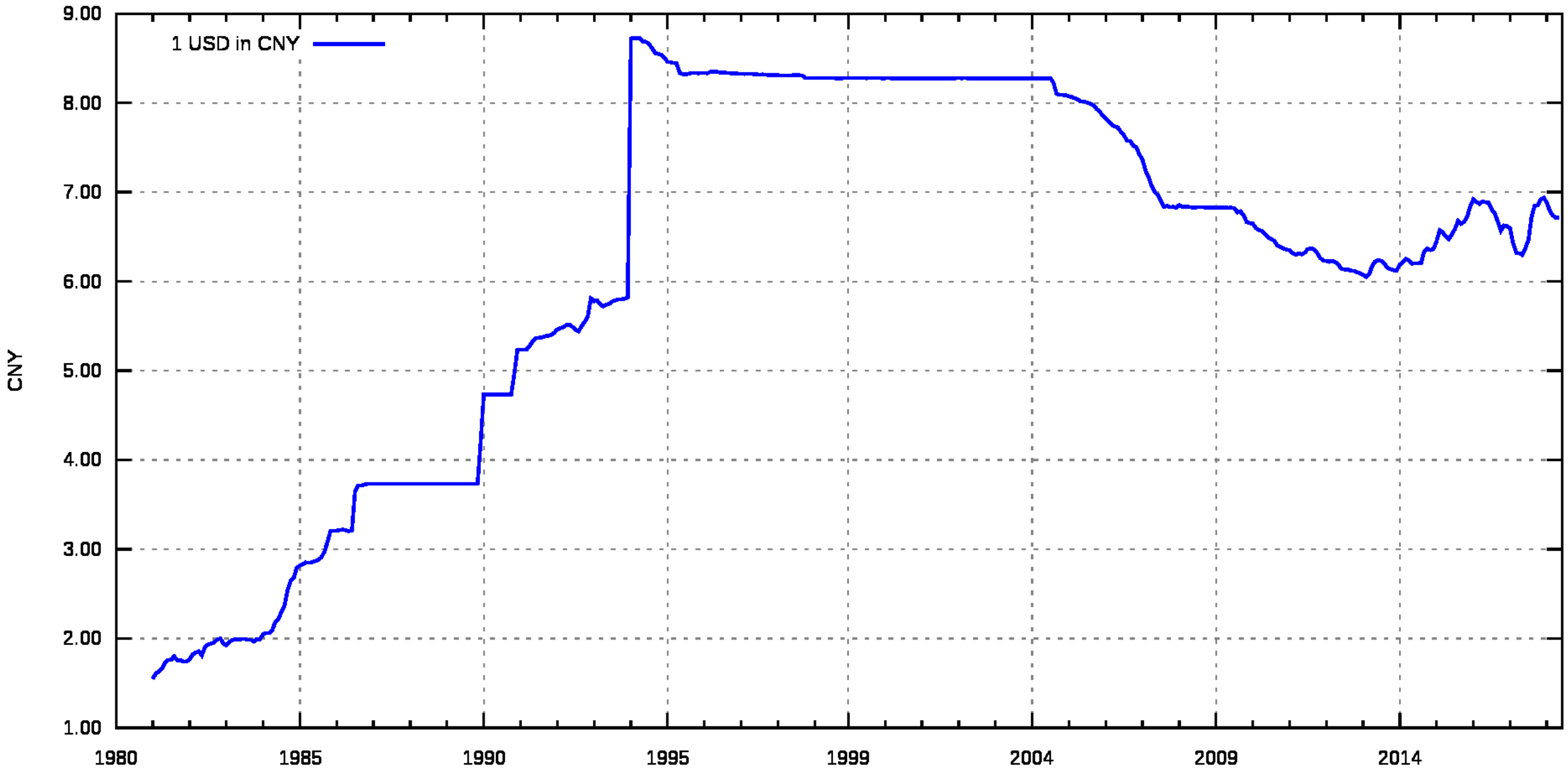
- The rate was competitive and led to a more or less balanced trade
- **Under floating, the rate would appreciate because of growing exports**
- **=** as China became more competitive, the rate should have gone up

Ordinary trade

- But China **artificially kept the rate at the 1994** level all the way until 2005

USD to RMB



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- The **price level** in China rose more slowly than in the US and most other capitalist countries

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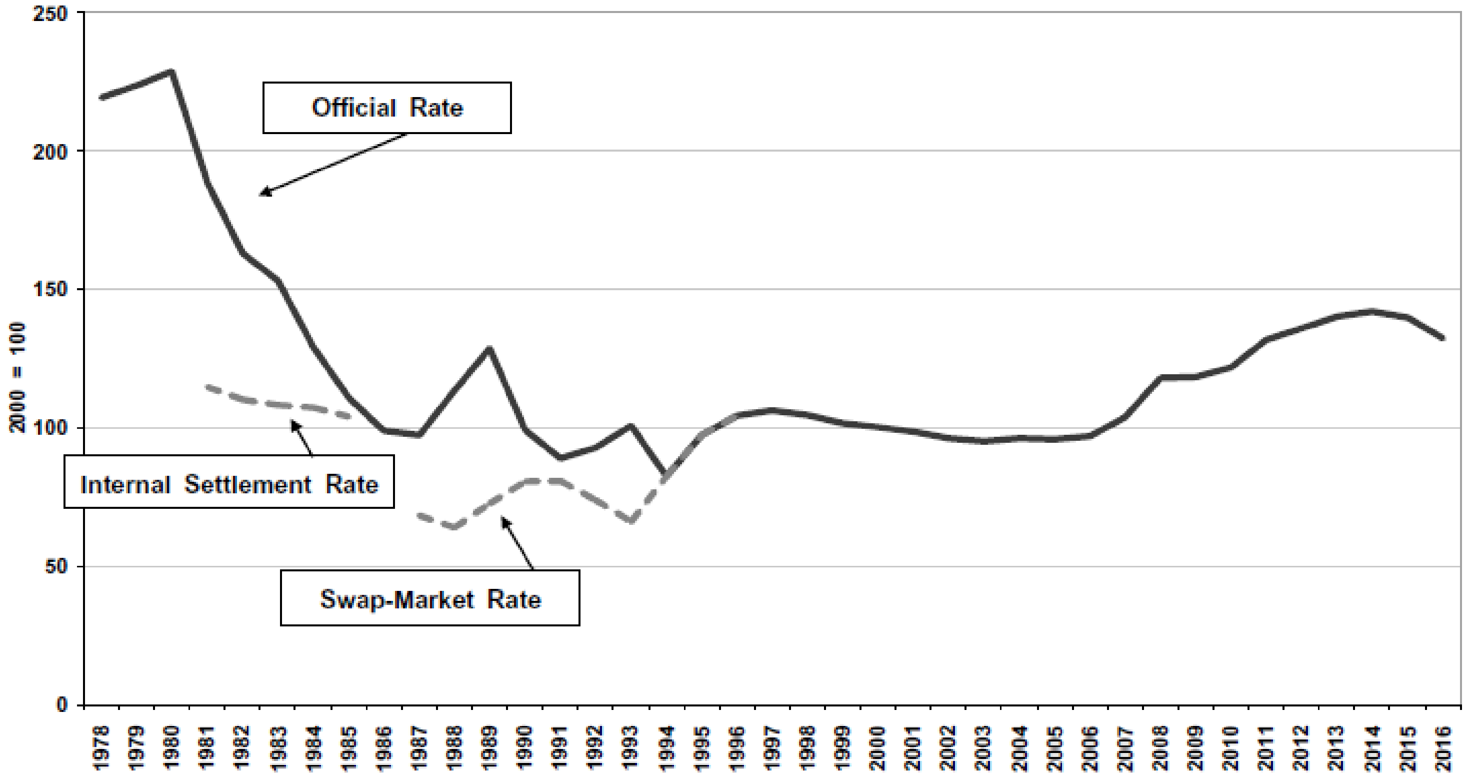
- The **price level** in China rose more slowly than in the US and most other capitalist countries
- > **Chinese goods became relatively cheaper**

Real appreciation / depreciation

- If your **exchange rate is stable AND you have lower inflation** than a partner country, your currency is undergoing a real depreciation

Real appreciation / depreciation

- If your **exchange rate is stable AND you have lower inflation** than a partner country, your currency is undergoing a real depreciation
- > your goods become more competitive > you export more
- **As if you devalued the currency**



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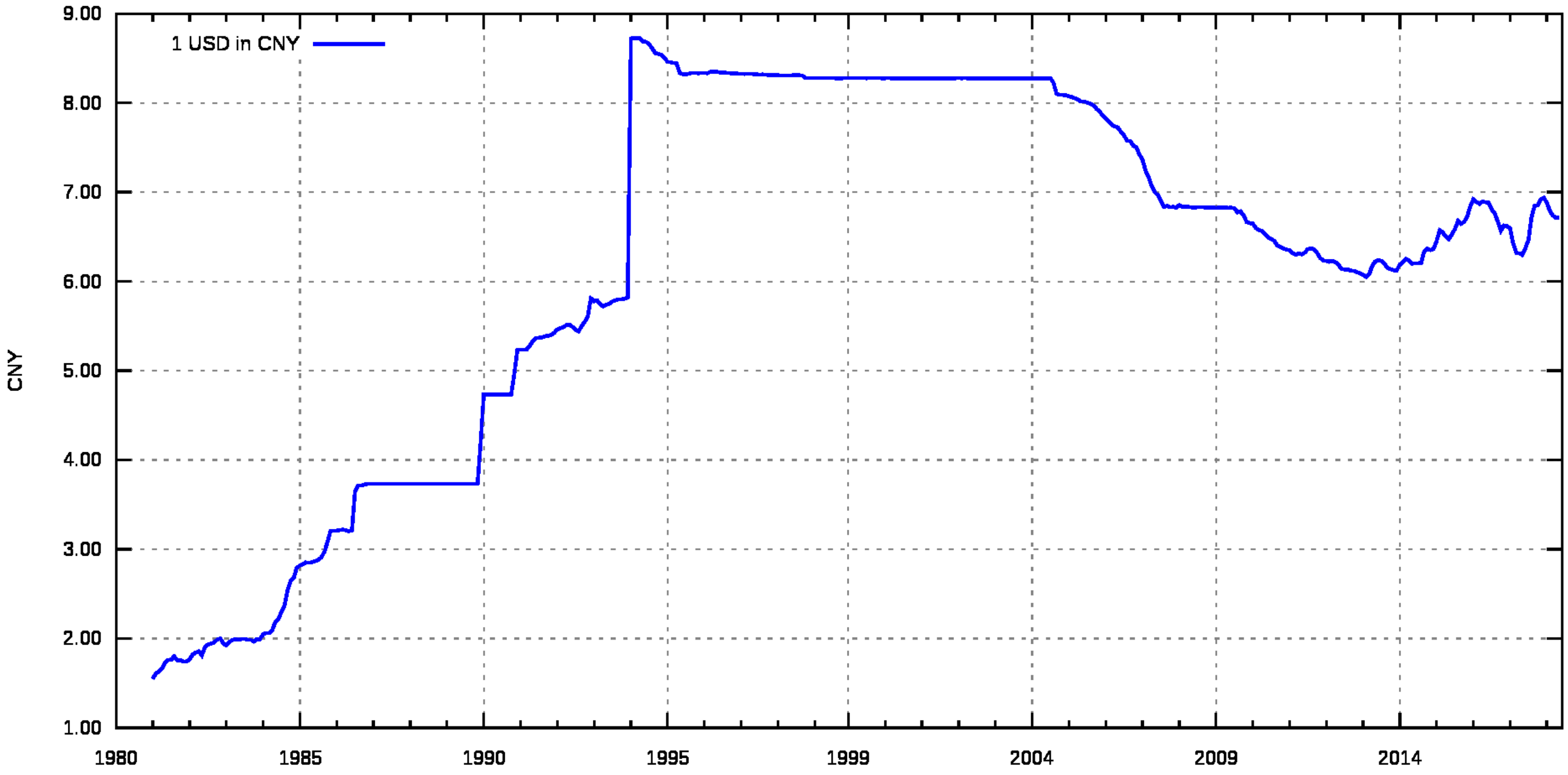
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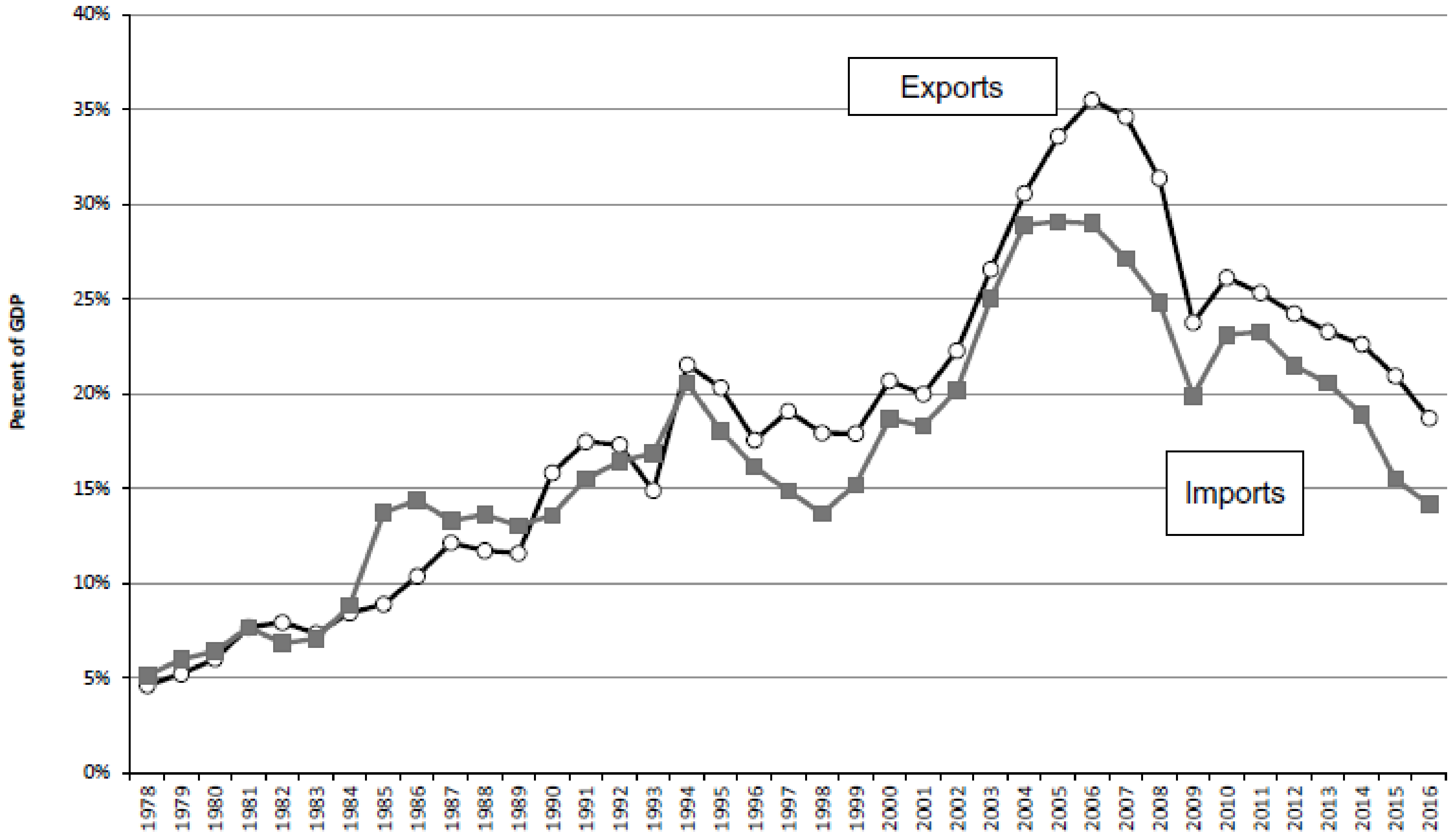
- **> undervaluation, huge trade surpluses!**


Exports
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Ordinary trade

- The 1994 reform was connected with **making the RMB convertible for current account transactions**
- Yeah, I know, the balance of payments stuff is back! ☹

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- **= liberalization**
- **Plans to also abolish capital controls** = to make the RMB convertible for financial account transactions
- Abandoned because of the **1997 Asian Financial crisis**

Export processing

Export processing

- **Special economic zones adjacent to HK and TW**

Export processing

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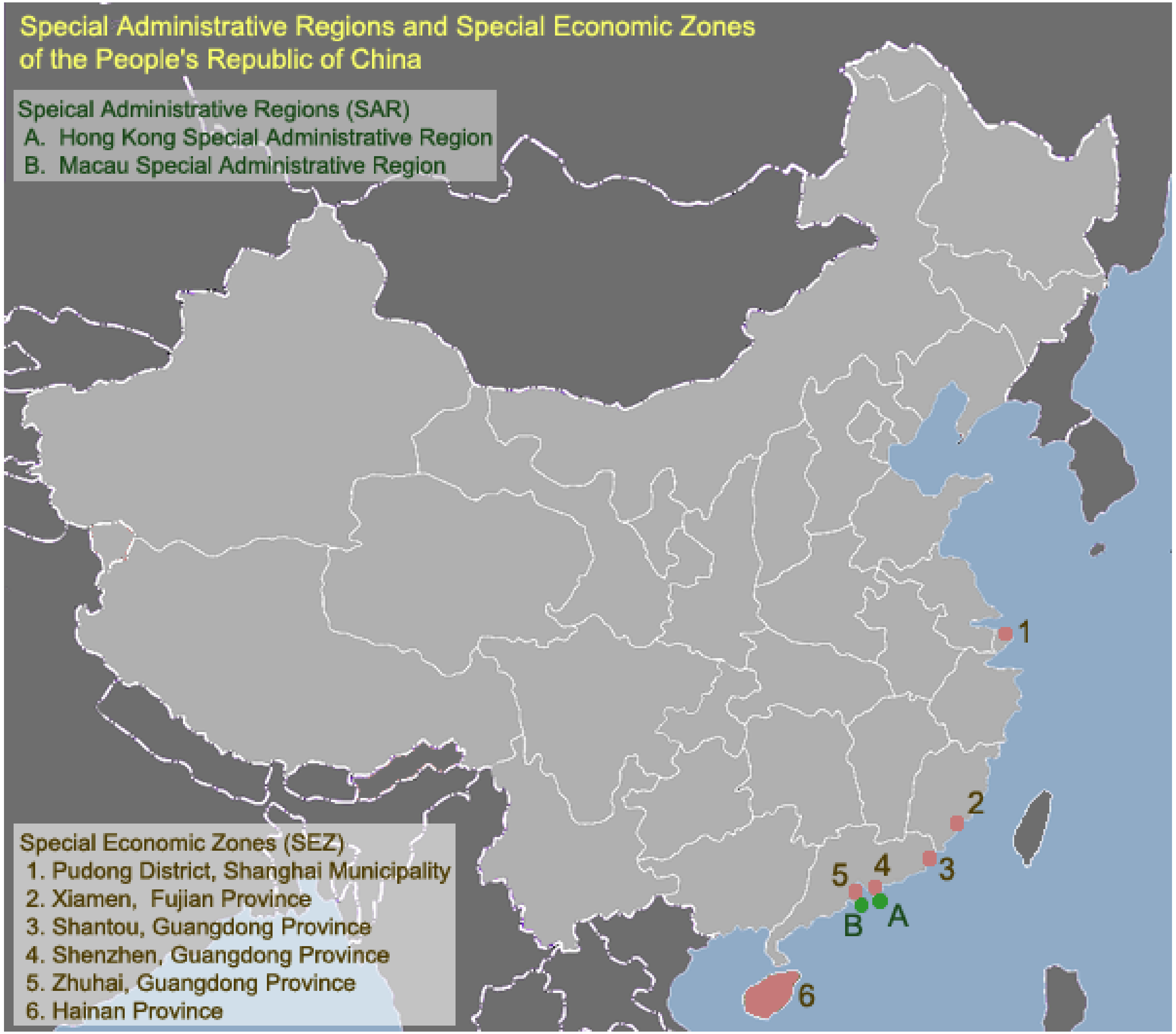
- The largest and most important one – **Shenzhen** – right next to Honk Kong


Special Administrative Regions and Special Economic Zones of the People's Republic of China
Speical Administrative Regions (SAR)
A. Hong Kong Special Administrative Region
B. Macau Special Administrative Region
Special Economic Zones (SEZ)
1. Pudong District, Shanghai Municipality
2. Xiamen, Fujian Province
3. Shantou, Guangdong Province
4. Shenzhen, Guangdong Province
5. Zhuhai, Guangdong Province
6. Hainan Province
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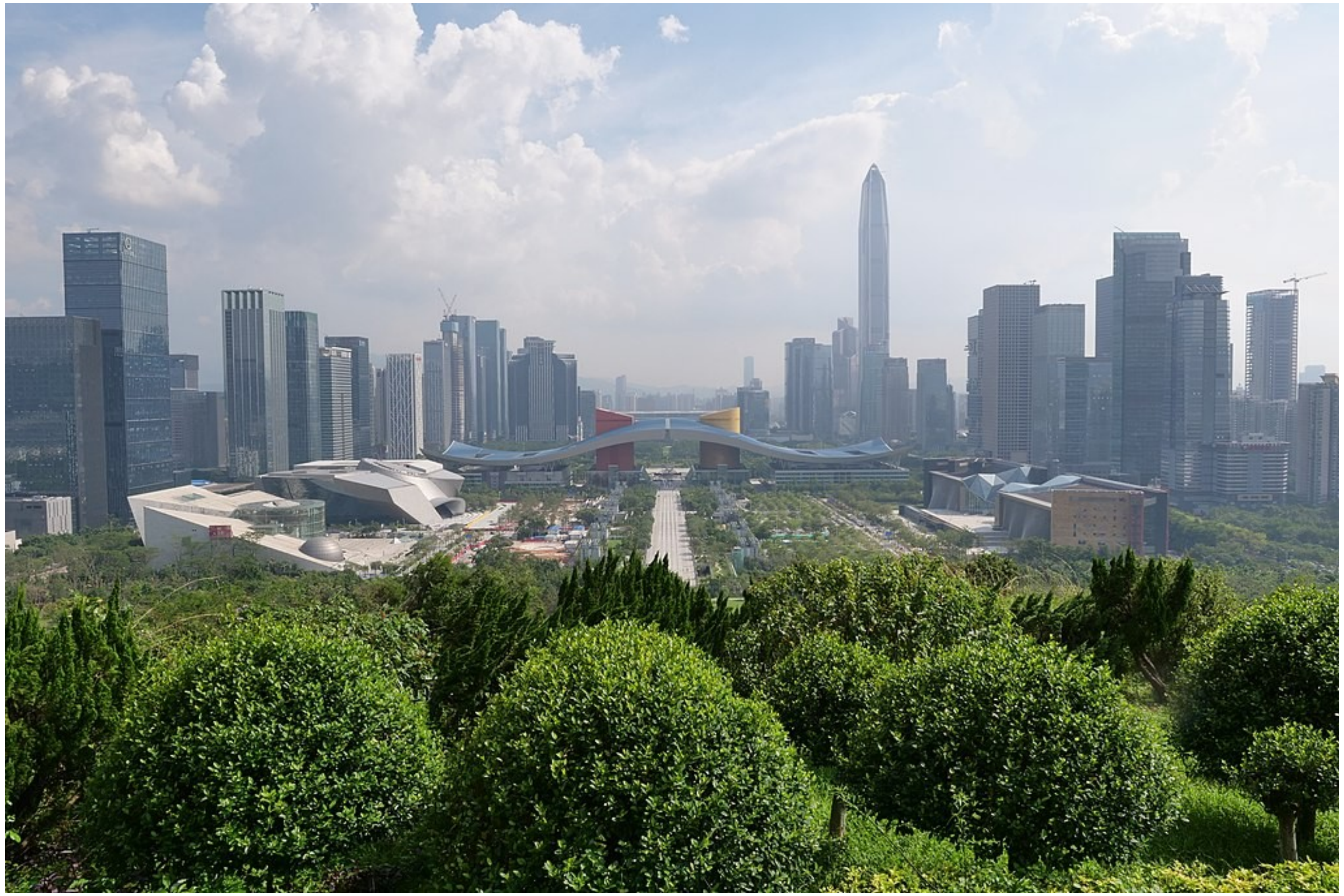

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Export processing

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- The largest and most important one – **Shenzhen** – right next to Honk Kong
- **FDI** was allowed in these zones
- Most importantly – **foreign companies could bring goods in and out duty free, with no tariffs or taxes or FTC middlemen**
- > they could operate outside the confines of the heavily regulated „ordinary trade“

Export processing

- **Processing of products** – Chinese companies, including small TVEs, did simple, labor-intensive tasks for foreign companies
- The products were then **re-exported**

Export processing

- **Not necessarily connected to investment!**
- - in principle, the foreign company could just send its inputs to China and than take the final product back

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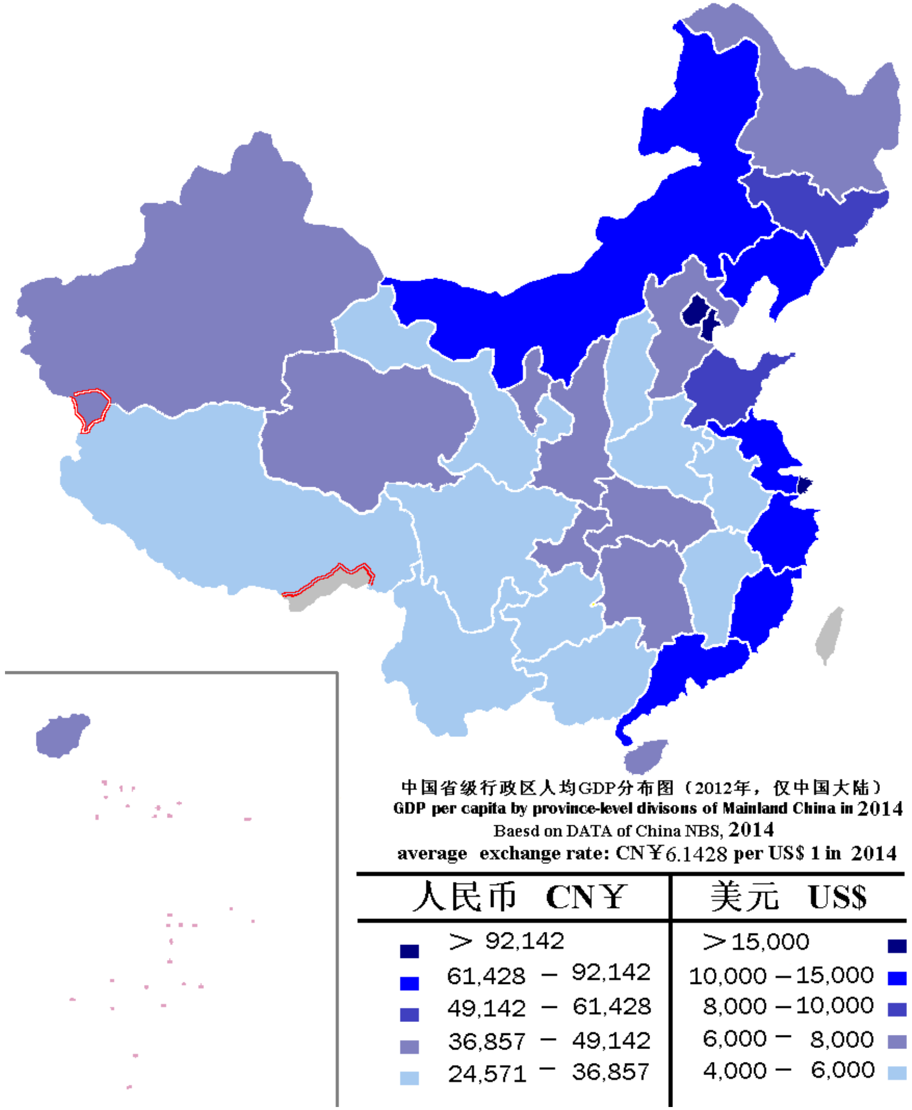
- **FDI itself was not allowed outside the special zones**


中国省级行政区人均GDP分布图（2012年，仅中国大陆）
GDP per capita by province-level divisons of Mainland China in 2014
Baesd on DATA of China NBS, 2014
average exchange rate: CN￥6.1428 per US$ 1 in 2014
人民币 CN￥
美元 US$
＞ 92,142
61,428 – 92,142
49,142 – 61,428
36,857 – 49,142
24,571 – 36,857
＞15,000
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Export processing

- What emerged was a **triangular pattern of trade**

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- These inputs are finished and then exported – to the US or the EU

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- Survives to this day, even though the specifics have changed!

Triangular trade

Table 16.3
China's largest trading partners, 2015 (billions of US$).

	Exports	Imports	Total trade	Surplus
United States	502.6	150.5	653.2	352.1
Japan	160.6	143.1	303.7	17.5
Hong Kong	261.1	12.8	273.9	248.3
Republic of Korea	90.2	174.6	264.8	–84.3
Germany	103.3	87.7	191.0	15.7
Taiwan	44.9	143.3	188.2	–98.4
Australia	46.3	73.9	120.2	–27.6
Malaysia	33.2	53.3	86.5	–20.0
United Kingdom	63.0	18.9	81.9	44.1
Thailand	40.9	37.2	78.1	3.7
Brazil	30.7	44.3	75.1	–13.6
India	61.6	13.4	75.0	48.2
Viet Nam	49.4	25.1	74.6	24.3
Singapore	42.1	27.6	69.7	14.6
Netherlands	38.4	8.8	47.2	29.6

Source: *SYC* (2016, table 11-6).

Triangular trade

Table 16.2
Top import and export categories, 2016 (billions of US$).

	Imports	% of total		Exports	% of total
Semiconductors	227.0	14.3	Computers, components, LCDs	163.2	7.8
Petroleum and products	144.1	9.1	Clothing	157.8	7.5
Autos and auto parts	74.4	4.7	Telephone handsets	117.1	5.6
Agricultural products except grain	69.1	4.4	Textiles	105.0	5.0
Computer components, LCDs	59.2	3.7	Agricultural products	72.6	3.5
Iron ore	57.7	3.6	Semiconductors	61.0	2.9
Copper and copper ore	47.1	3.0	Finished steel	54.5	2.6
Grain	41.5	2.6	Furniture	47.8	2.3
Plastic raw materials	41.3	2.6	Shoes	47.2	2.3
Coal	24.5	1.5	Automobile parts	45.6	2.2

Source: General Administration of Customs.

Imports

- 1) Raw materials
- 2) Agricultural products – grain etc.
- 3) Capital intensive products – steel, chemicals, machinery
- 4) Technologically advanced products – chips

Imports

- 1) Raw materials
- 2) Agricultural products – grain etc.

- First two – **result of lack of natural resources and fertile land** + successful countries often import this > **no problem**

Imports

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- 3) Capital intensive products – steel, chemicals, machinery
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- First two – **result of lack of natural resources and fertile land** + successful countries often import this > **no problem**
- Second two > **result of backwardness**

Imports

- 1) Raw materials
- 2) Agricultural products – grain etc.
- 3) Capital intensive products – steel, chemicals, machinery
- 4) Technologically advanced products – chips

- First two – **result of lack of natural resources and fertile land** + successful countries often import this > **no problem**
- Second two > **result of backwardness** > **China became self-sufficient in 3), now it is chasing self-sufficiency in 4)**

Geographical shifts

- Industrialization progresses not only in level of sophistication, but also **shifts to new locations with lower labor costs**

Geographical shifts

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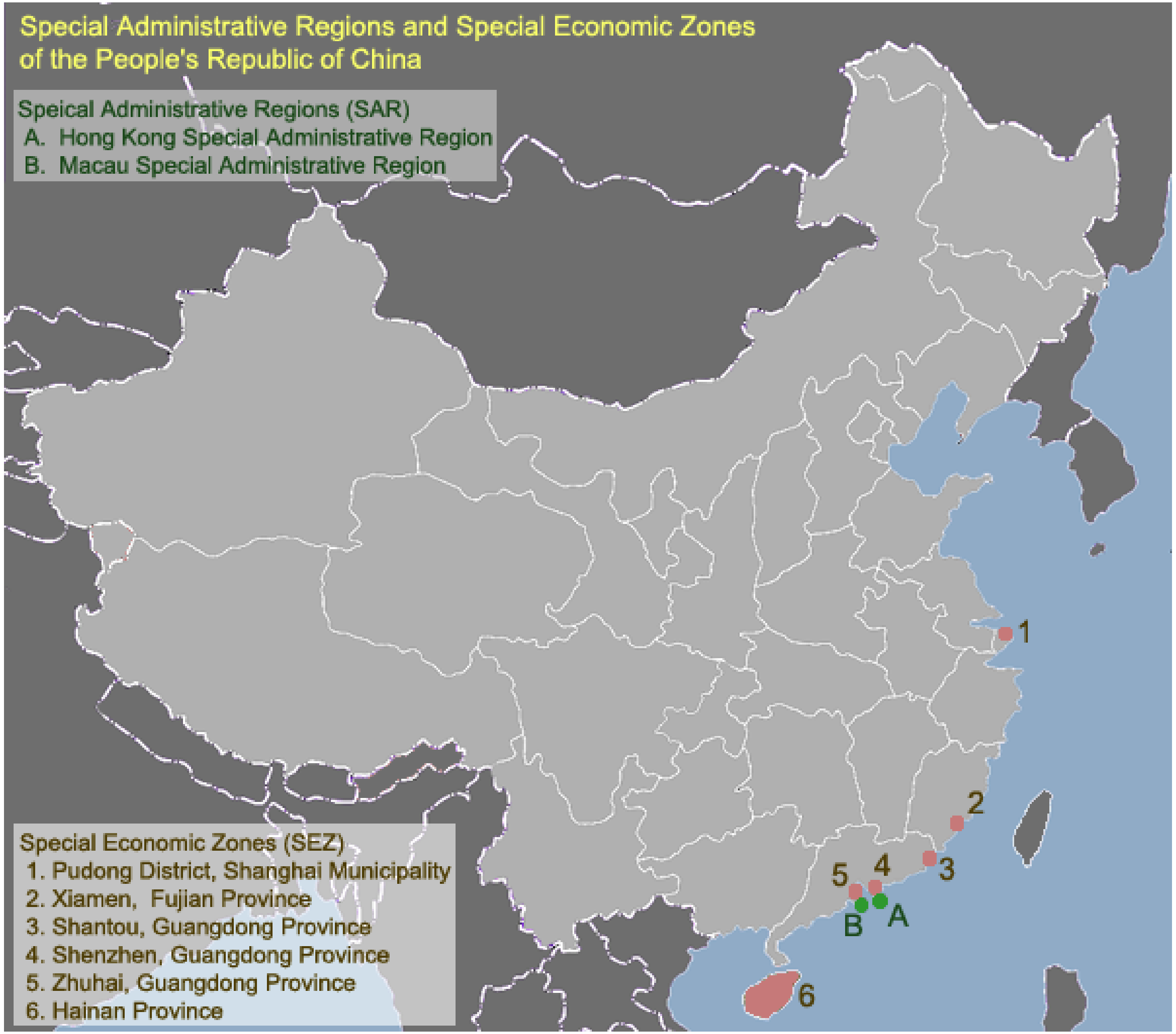
- **The frontier keeps moving**

Geographical shifts

- Industrialization progresses not only in level of sophistication, but also **shifts to new locations with lower labor costs**
- **The frontier keeps moving**
- 1980s – **Guangdong** as a „fifth Asian tiger“
- **Main focus – textile**, shoes, sport gear


Special Administrative Regions and Special Economic Zones
of the People's Republic of China
Speical Administrative Regions (SAR)
A. Hong Kong Special Administrative Region
B. Macau Special Administrative Region
Special Economic Zones (SEZ)
1. Pudong District, Shanghai Municipality
2. Xiamen, Fujian Province
3. Shantou, Guangdong Province
4. Shenzhen, Guangdong Province
5. Zhuhai, Guangdong Province
6. Hainan Province
1
2
3
4
5
6
A
B


Heilongjiang
Jilin
Liaoning
Beijing
Tianjin
Xinjiang
Inner Mongolia
Gansu
Hebei
Ningxia
Shanxi
Shandong
CHINA
Qinghai
Henan
Jiangsu
Shaanxi
Shanghai
Tibet
Hubei
Anhui
Sichuan
Zhejiang
Jiangxi
Hunan
Guizhou
Fujian
Yunnan
Guangxi
Guangdong
Hainan

Geographical shifts

- 1990s – **industrialization of Shanghai and the lower Yangtze**
- = China‘s traditional economic and demographic heart


Heilongjiang
Jilin
Liaoning
Beijing
Tianjin
Xinjiang
Gansu
Inner Mongolia
Hebei
Ningxia
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Hubei
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Sichuan
Zhejiang
Jiangxi
Hunan
Guizhou
Fujian
Yunnan
Guangxi
Guangdong
Hainan


China Major Rivers Map
Amur River
Songhua River
Liao River
Japan Sea
Haihe River
Yellow River
Tarim River
Qinghai Lake
Yellow Sea
Huaihe River
Namtro Lake
Nu River
Yangtze River
East China Sea
Pearl River
Lancang River
Mekong River
South China Sea
The Pacific
The Indian Ocean
Yangtze River
CRUISES

Geographical shifts

- 1990s – **industrialization of Shanghai and the lower Yangtze**
- = China‘s traditional economic and demographic heart
- At first also textile, **by 2000 – switch to Electronics!**

Geographical shifts

- Around 2010 – **some industry moves deeper inland**, into places like Chongqing or Sichuan


Heilongjiang
Jilin
Liaoning
Beijing
Tianjin
Xinjiang
Inner Mongolia
Gansu
Hebei
Ningxia
Shanxi
Shandong
CHINA
Qinghai
Henan
Jiangsu
Shaanxi
Shanghai
Tibet
Hubei
Anhui
Sichuan
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Jiangxi
Hunan
Fujian
Guizhou
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China Major Rivers Map
Amur River
Songhua River
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Yangtze River
East China Sea
Pearl River
Lancang River
Yangtze River
CRUISES
Mekong River
South China Sea
The Indian Ocean
The Pacific

Regional shares of China's exports.

	1978	1995	2005	2010	2016
Southeast	16%	45%	36%	34%	36%
Lower Yangtze	35%	21%	38%	42%	37%
Northeast / North Coast	40%	22%	18%	17%	15%
Rest of China	9%	11%	7%	8%	13%

Geographical shifts

- **Previous frontier retains its wealth**, more labor-intensive jobs move on somewhere else

Geographical shifts

- **Previous frontier retains its wealth**, more labor-intensive jobs move on somewhere else
- The previously industrialized area moves towards very technologically advanced parts of production
- **Or towards services – marketing, finance, RaD**

Geographical shifts

- Same process has happened in Europe over centuries – a previous center of industry never loses its wealth (northern Italy, Netherlands)

Foreign direct investment

- **By the early 1990s, direct access for foreign investors was expanded**

Foreign direct investment

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- > growth of FDI, **new influx of new FDI from America and Europe**

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- Attempts to attract investors – **permanently low taxes for „foreign investment enterprises“ – FIEs**
- Tax holidays, free land….

Foreign direct investment

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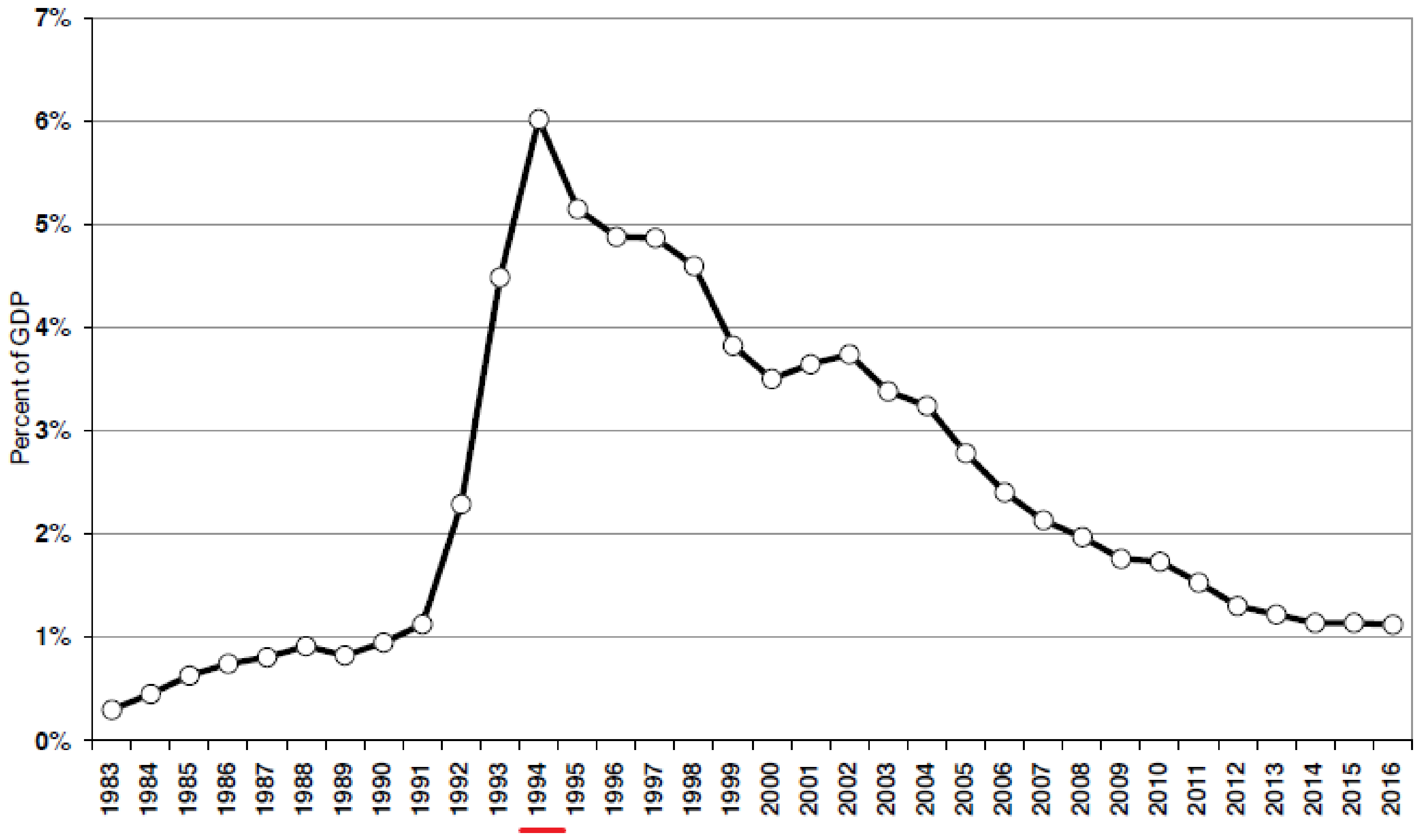
- > growth of FDI, **new influx of FDI from America and Europe**
- Attempts to attract investors – **permanently low taxes for „foreign investment enterprises“ – FIEs**
- Tax holidays, free land….

- > FIEs were treated better than private domestic firms!

Foreign direct investment



Foreign direct investment

- **Source countries – most importantly US, Taiwan, Korea, Japan**

Foreign direct investment

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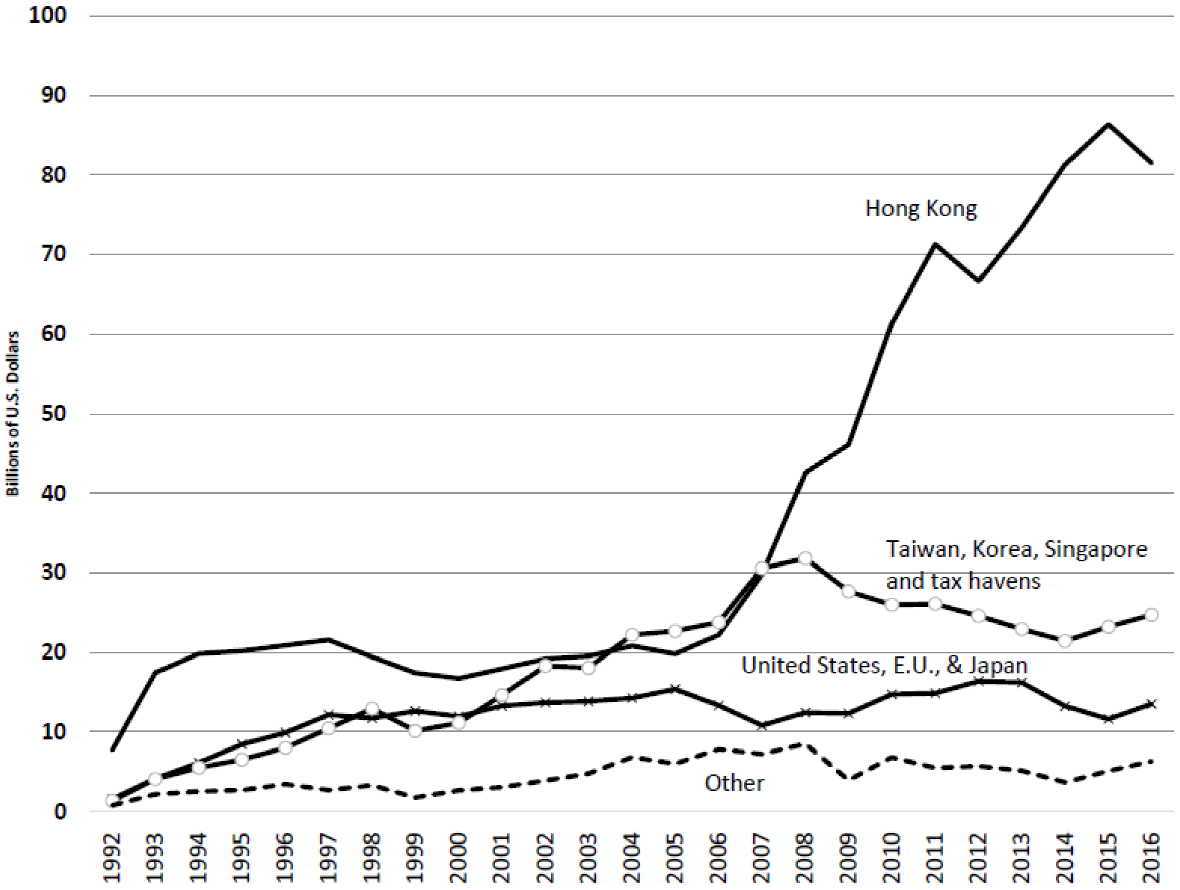

Figure 17.2
Main FDI source regions.

Foreign direct investment

- **Source countries – most importantly US, Taiwan, Korea, Japan**
- Often **routed through Honk Kong** or tax havens (British Virgin Islands)

- Largest single investor – Samsung
- Typical example of triangular trade – brings in chips from Korea, exports completed phones overseas

Foreign direct investment

- What did investors bring in?
- **Savings, foreign exchange, technology, management and marketing know how**

Foreign direct investment

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- **Savings, foreign exchange, technology, management and marketing know how**
- = they knew how to sell products in rich countries, had contacts and established supply chains overseas

Foreign direct investment

- **Technology was not decisive at first**, it grew in importance as China became more advanced

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- Technology transfer – not driven merely by compulsory joint-ventures, but also by strategy of the foreign companies

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- Technology transfer – not driven merely by compulsory joint-ventures, but also by strategy of the foreign companies
- - **they often decided to teach local companies how to make inputs so they did not have to import them**
- Flow of workers between domestic and foreign firms spread knowledge
- = typical „spillover effect“

Foreign direct investment

- As time went on, FDI became **less important as a source of investment and foreign currencies**
- Because China has **a very high rate of savings** and also acquired a trade surplus

Foreign exchange reserves

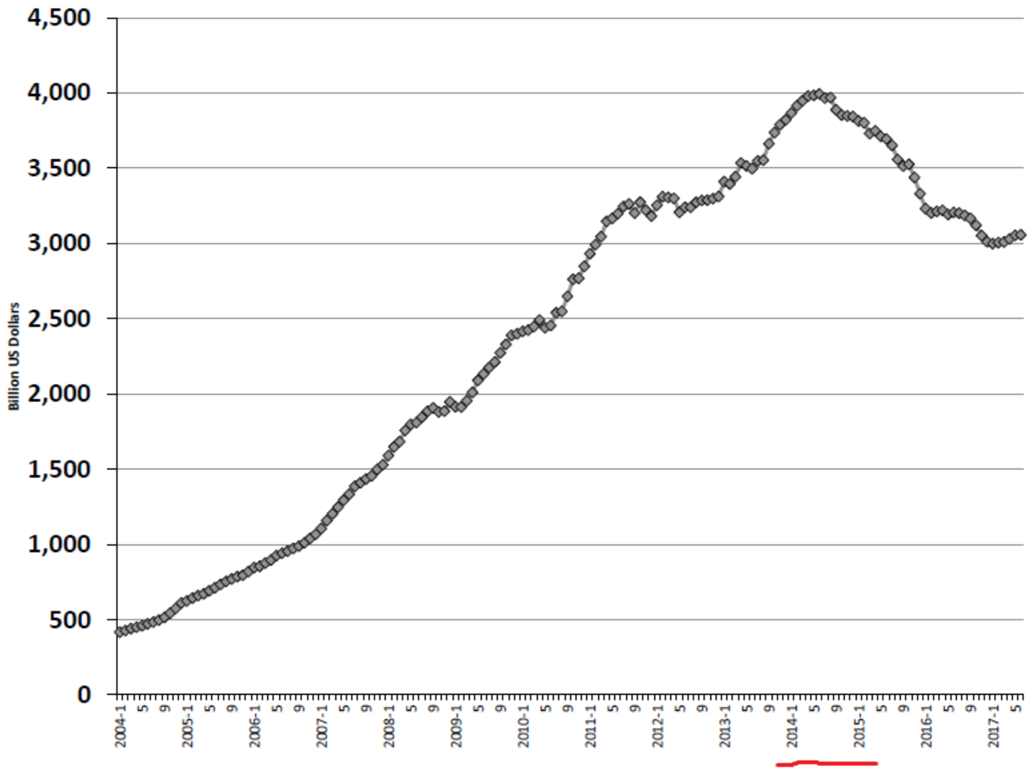


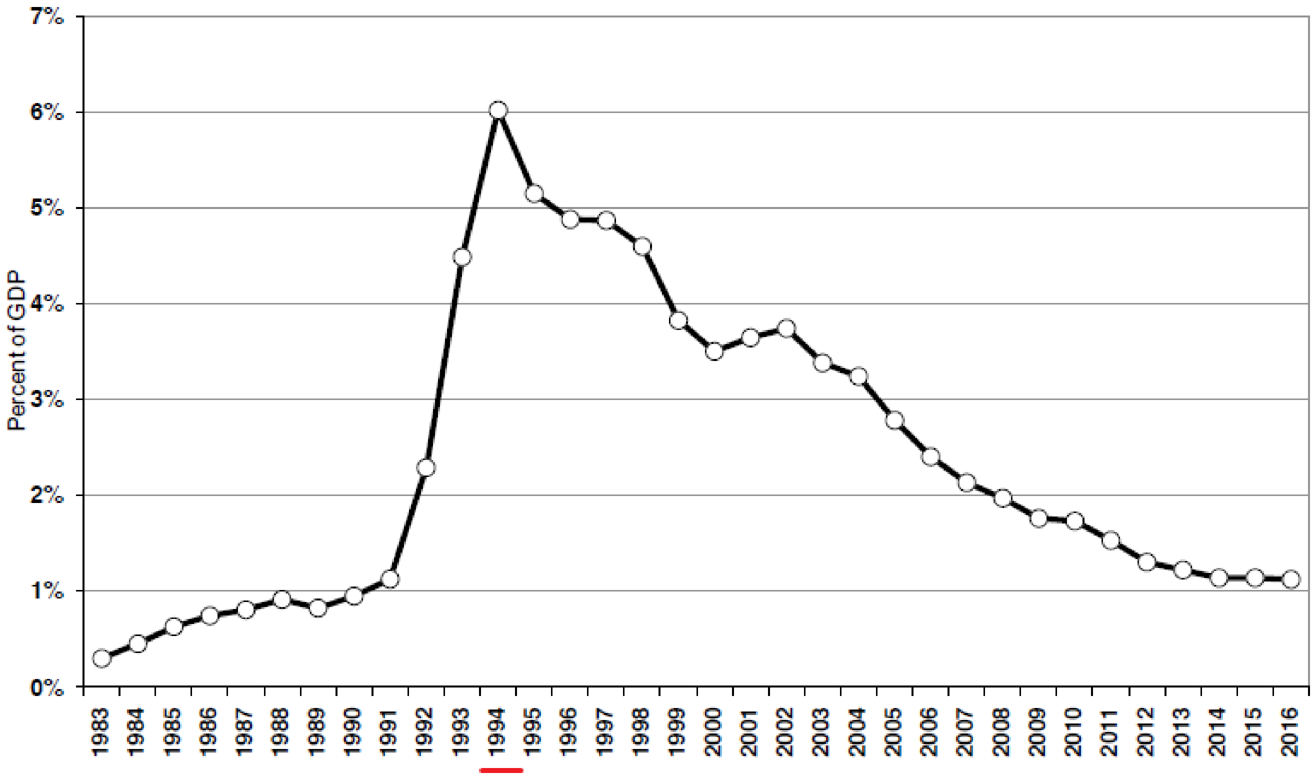
Figure 17.5
China: Official foreign-exchange reserves.

Foreign direct investment

- As time went on, FDI became **less important as a source of investment and foreign currencies**
- Because China has **a very high rate of savings** and also acquired a trade surplus
- **After circa 2000, technology became the main objective** for attempting to attract FDI

Foreign direct investment

- At the same time – **the role of FIEs in the economy decreased**



Percent of GDP
7%
6%
5%
4%
3%
2%
1%
0%
1983
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1985
1986
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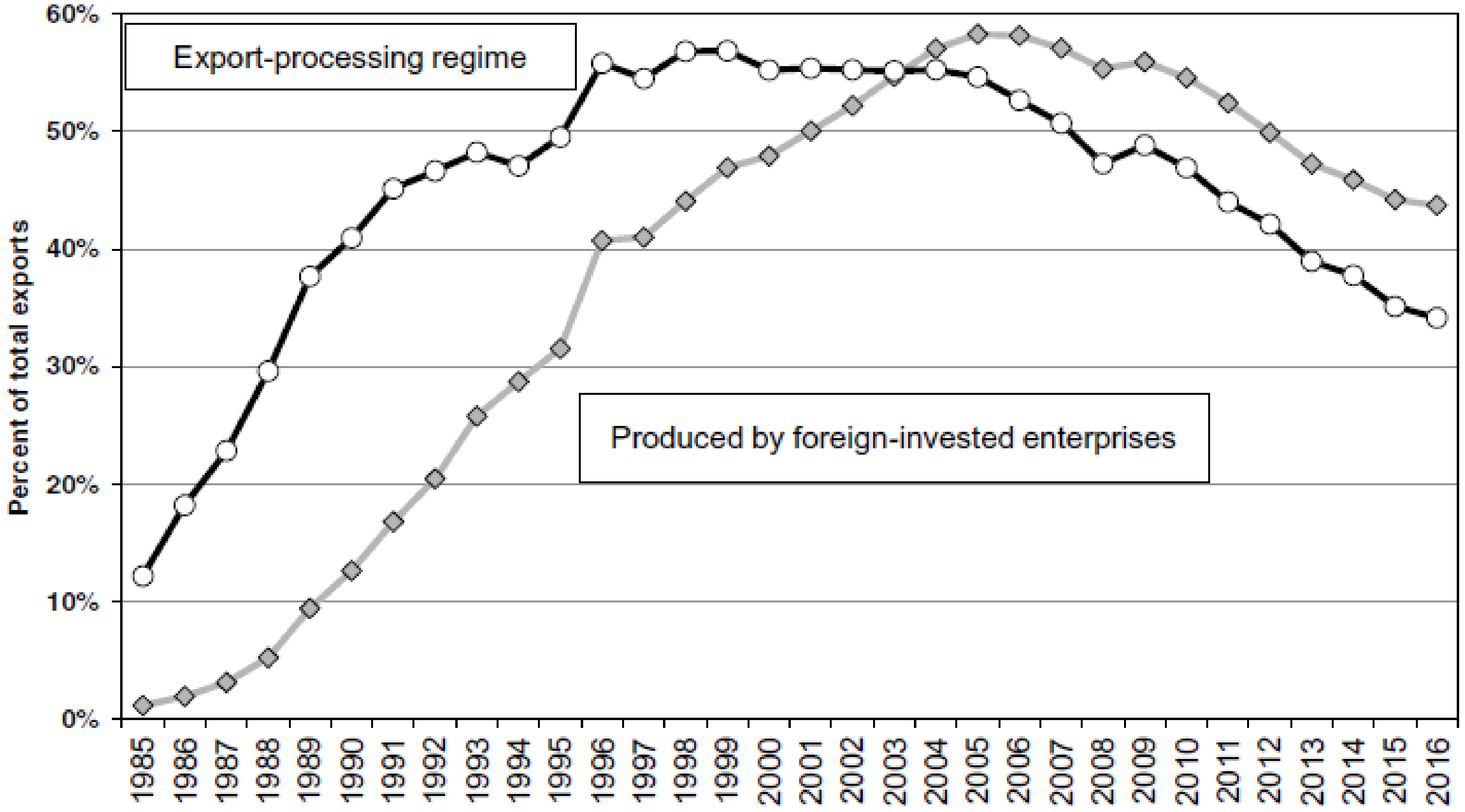
2015
2016



Export-processing regime
Produced by foreign-invested enterprises
Percent of total exports
60%
50%
40%
30%
20%
10%
0%
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
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1997
1998
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2006
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2008
2009
2010
2011
2012
2013
2014
2015
2016

Foreign direct investment

- At the same time – **the role of FIEs in the economy decreased**
- **China does not need them so much anymore**
- > fewer advantages, more taxes

Ordinary trade and export processing

- In the 1980s, they were completely different

Ordinary trade and export processing

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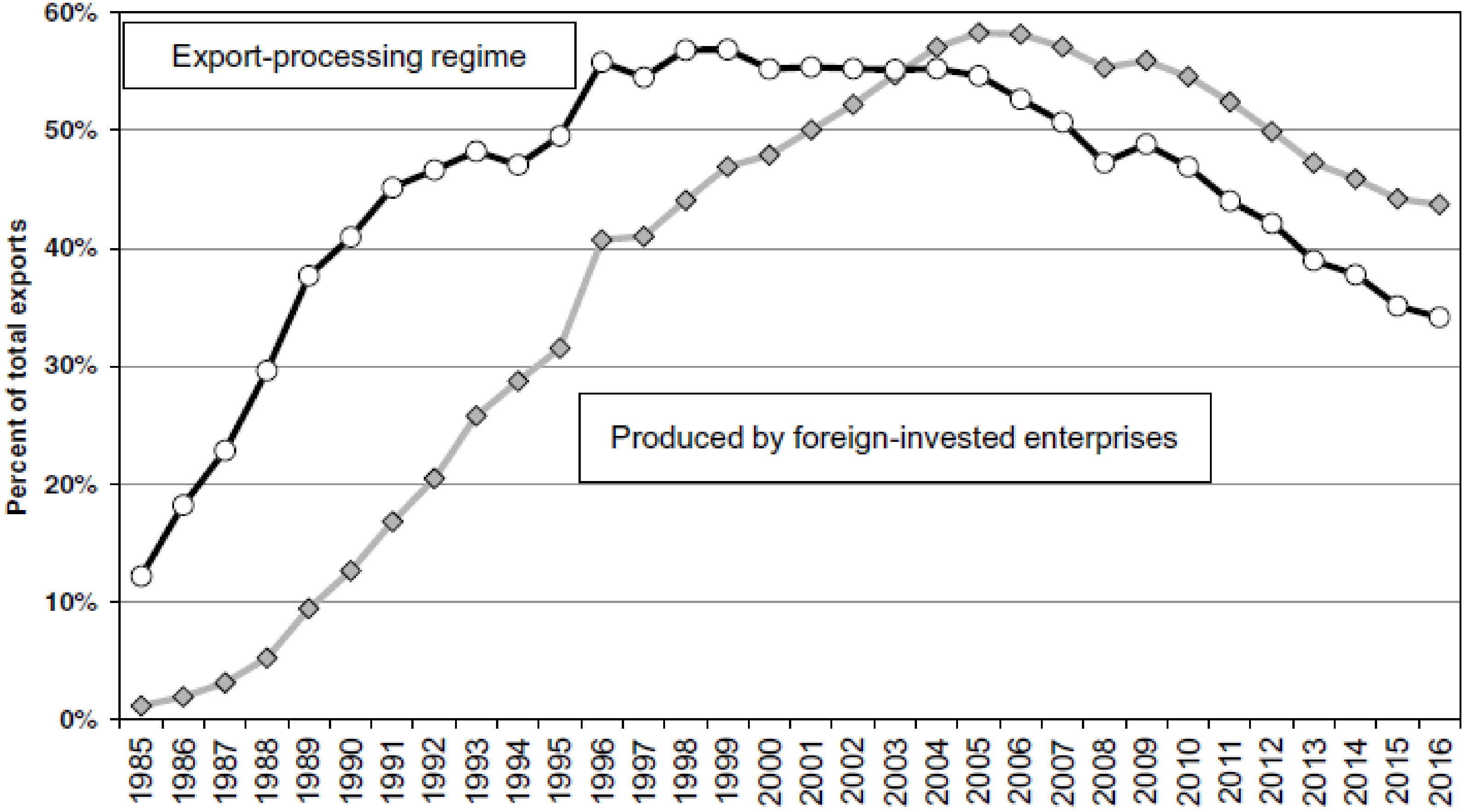
- **Overtime, as the hinterland liberalizes, they converge closer together**
- Special zones are not THAT special anymore

Ordinary trade and export processing

- In the 1980s, they were completely different
- **Overtime, as the hinterland liberalizes, they converge closer together**
- Special zones are not THAT special anymore
- **Export processing is in a relative decline** as a share of exports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Ordinary trade and export processing

- More and more stuff is being produced by Chinese domestic companies
- **Special rules and privileges for coastal provinces are being eroded** - they are not needed anymore

Ordinary trade and export processing

- More and more stuff is being produced by Chinese domestic companies
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- **But the division has never been completely abandoned!**
- In the 2010s, China launched a new special economic zone in Shanghai meant to attract FDI into services

Return to industrial policy

- Around 2005, **China was the world‘s largest exporter of advanced technology products**
- But remained confined into **low-value added parts of the supply chain**

Return to industrial policy

- > industrial policies such as Made in China 2015 seek to redress this problem
- > **desire to put China at the center of global value chains**
- „We will not play second fiddle to foreign capitalists“

Outgoing Chinese FDI

- China has the **potential to become the world‘s largest foreign investor**

Outgoing Chinese FDI

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- It has an unusually **high rate of savings**
- It also still has quite a **large trade surplus**

Outgoing Chinese FDI

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- It has an unusually **high rate of savings**
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- > lots of money that can be converted into dollars and invested abroad

Outgoing Chinese FDI

- By 2005, the party-state realized that they have **too much foreign exchange on their hands**

Outgoing Chinese FDI

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- Keeping money as exchange means **you are not investing them in any productive way**

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- Keeping money as exchange means **you are not investing them in any productive way**
- They started to create **incentives for companies to invest abroad**

Outgoing Chinese FDI

- By 2005, the party-state realized that they have **too much foreign exchange on their hands**
- Keeping money as exchange means **you are not investing them in any productive way**
- They started to create **incentives for companies to invest abroad**
- Sovereign wealth funds
- **BRI**

FDI

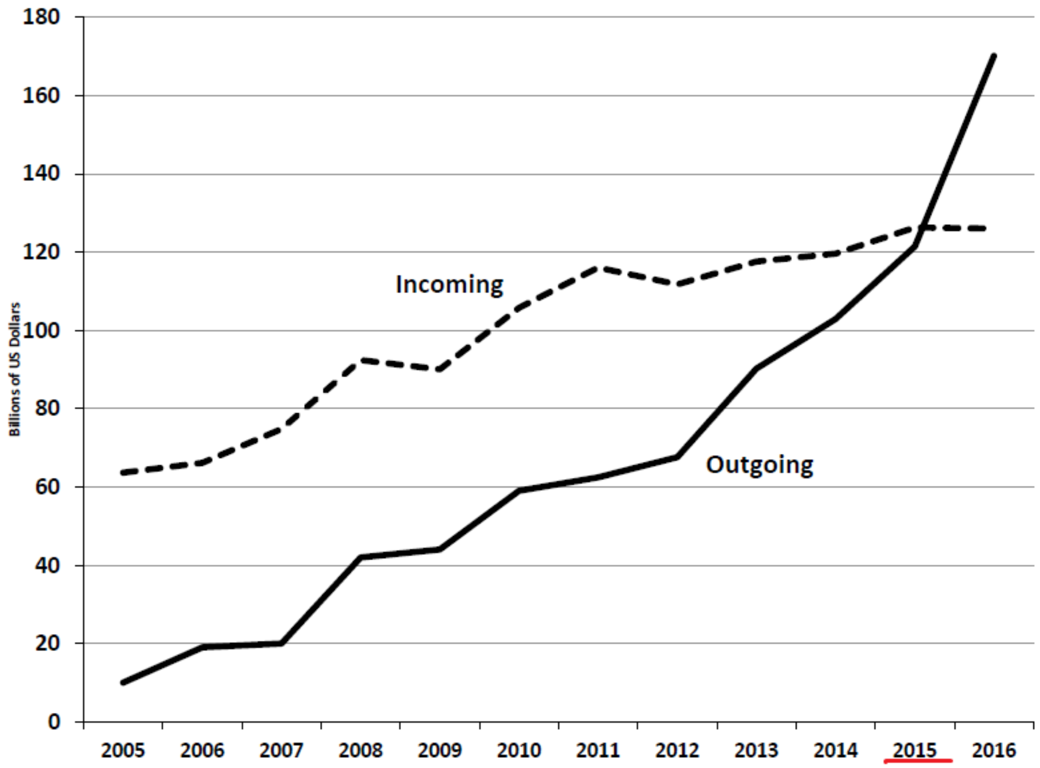

Figure 17.3
China FDI: Incoming and outgoing.

Portfolio investment

- **= short term, more speculative than FDI**
- **Officially – tightly regulated by capital controls**

Portfolio investment

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- **Officially – tightly regulated by capital controls**
- Chinese nationals are **avoiding these controls** by masquerading these speculative flows as something else
- = they say that they want to pay for foreign goods, but actually use this transaction to shift money abroad and invest them

Portfolio investment

- **= short term, more speculative than FDI**
- **Officially – tightly regulated by capital controls**
- Chinese nationals are **avoiding these controls** by masquerading these speculative flows as something else
- = they say that they want to pay for foreign goods, but actually use this transaction to shift money abroad and invest them
- It seems that are very **large and unstable flows of speculative investment in and out of China**

All other = speculative flows

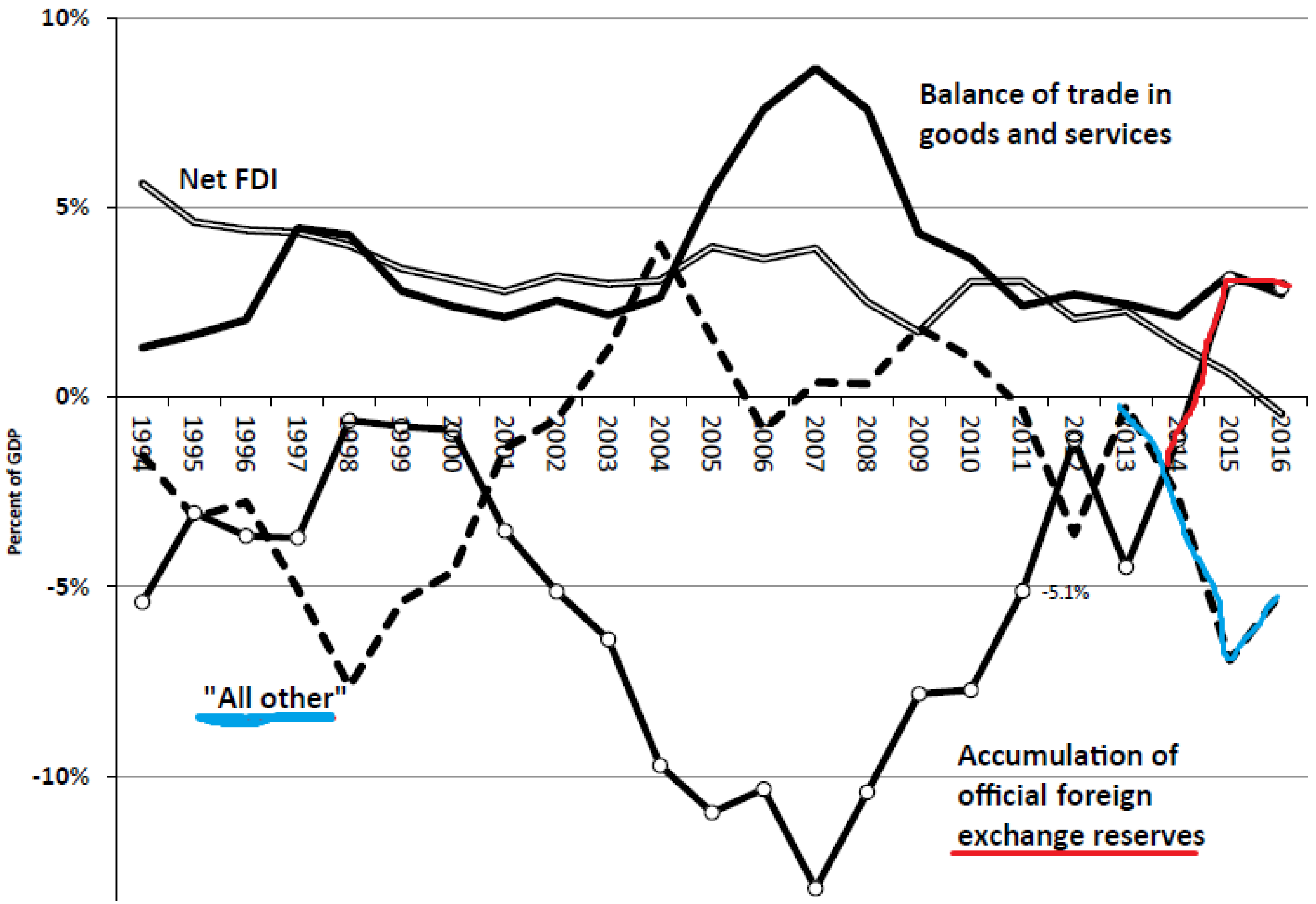


Figure 17.4
Simplified balance of payments.

Foreign exchange reserves

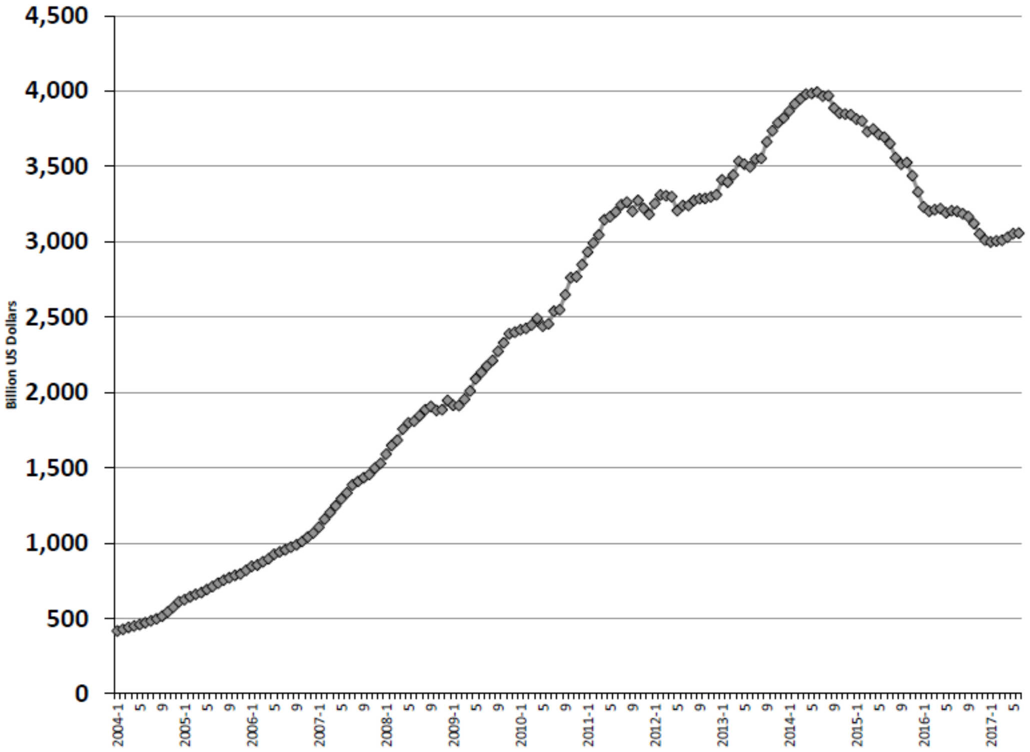
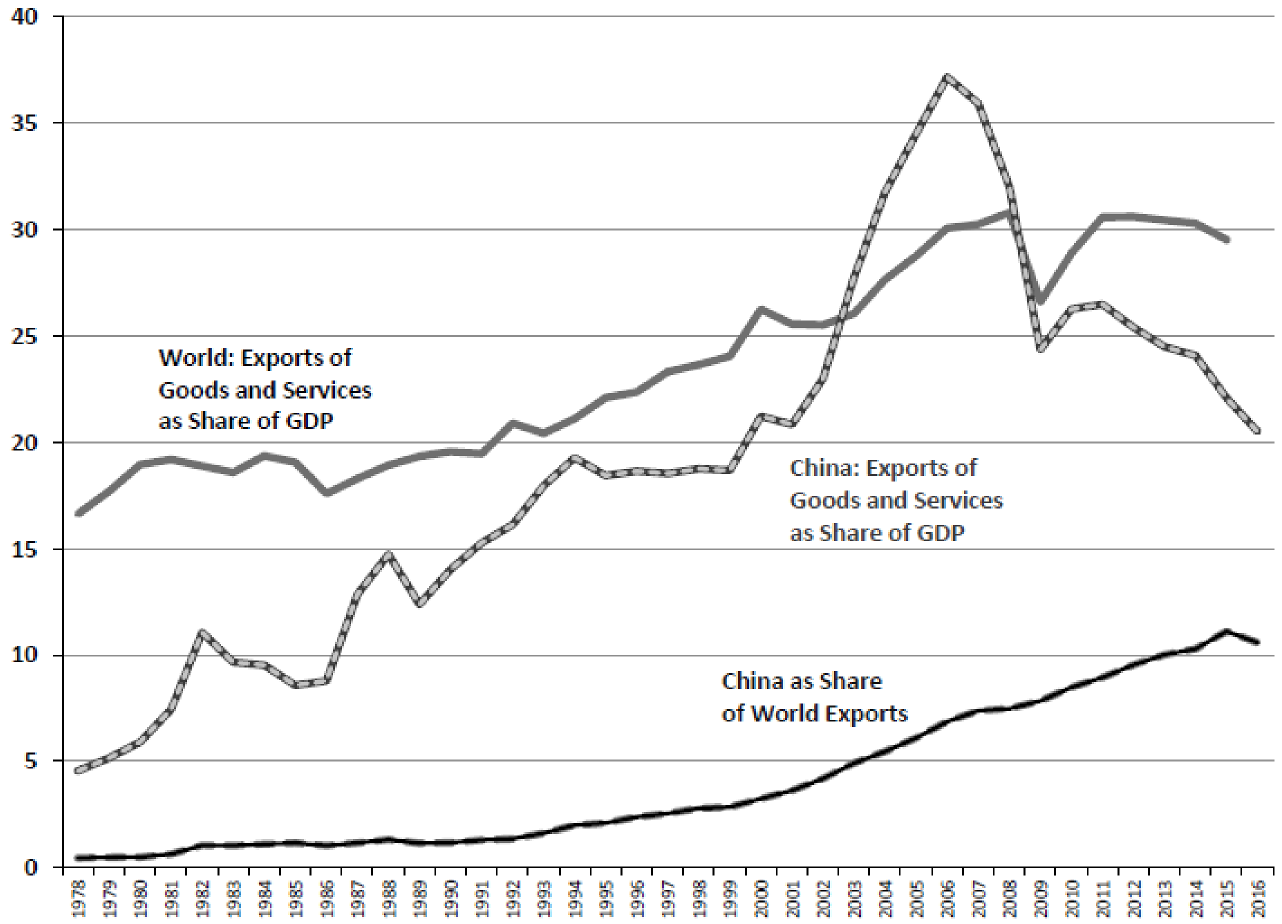


Figure 17.5
China: Official foreign-exchange reserves.

One final graph



Next time - seminar

- Each group has 10 minutes to present the findings of their paper
- + 5 minutes for discussion

Final essay

- Shorter
- Alternative topic

Looking ahead