

# China in the World Economy

China in the World Economy, autumn 2022

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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?

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

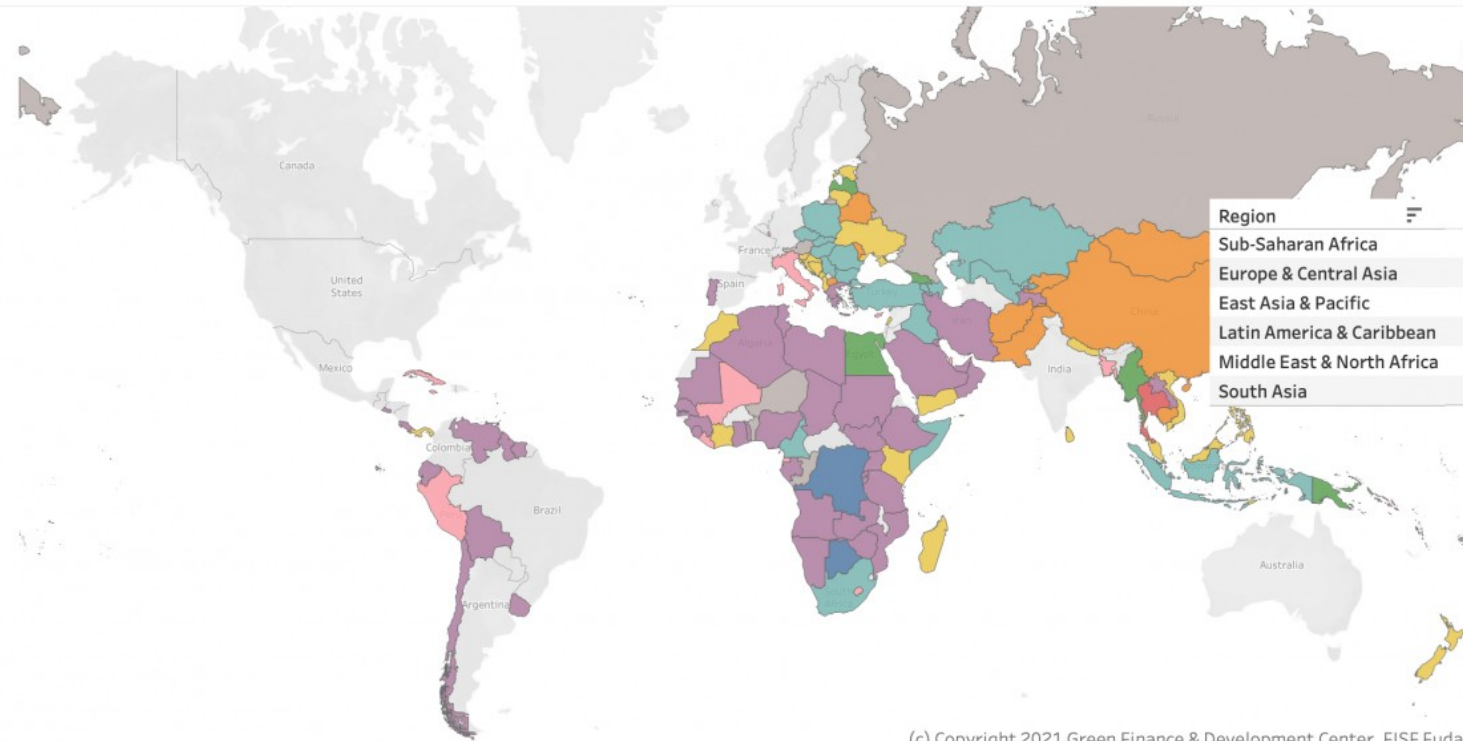
- The Belt and Road Initiative in Europe
- **Summary and extension of topics we have discussed**
- > joining together what you already know, adding new angles and details
- Main focus – opening to international trade and foreign investment

# BRI in European Union member states

# Countries of the Belt and Road Initiative

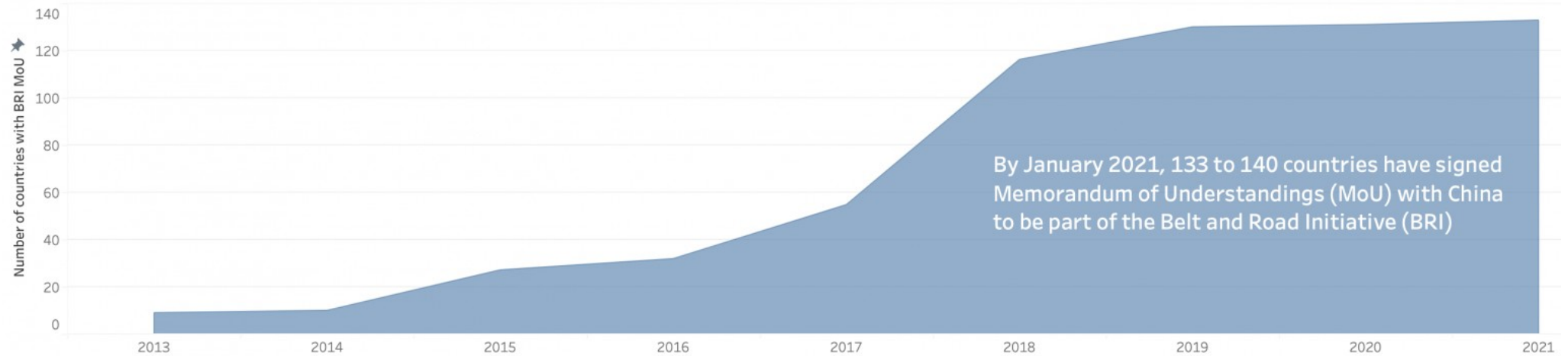
## Year of MoU signature

- Unclear
- 2013
- 2014
- 2015
- 2016
- 2017
- 2018
- 2019
- 2020
- 2021



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# BRI in European Union member states

- Hungary, Italy, Greece
- Countries frustrated by EU leadership
- Facing economic decline, or insufficient convergence with core states

# 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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# 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

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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

- 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

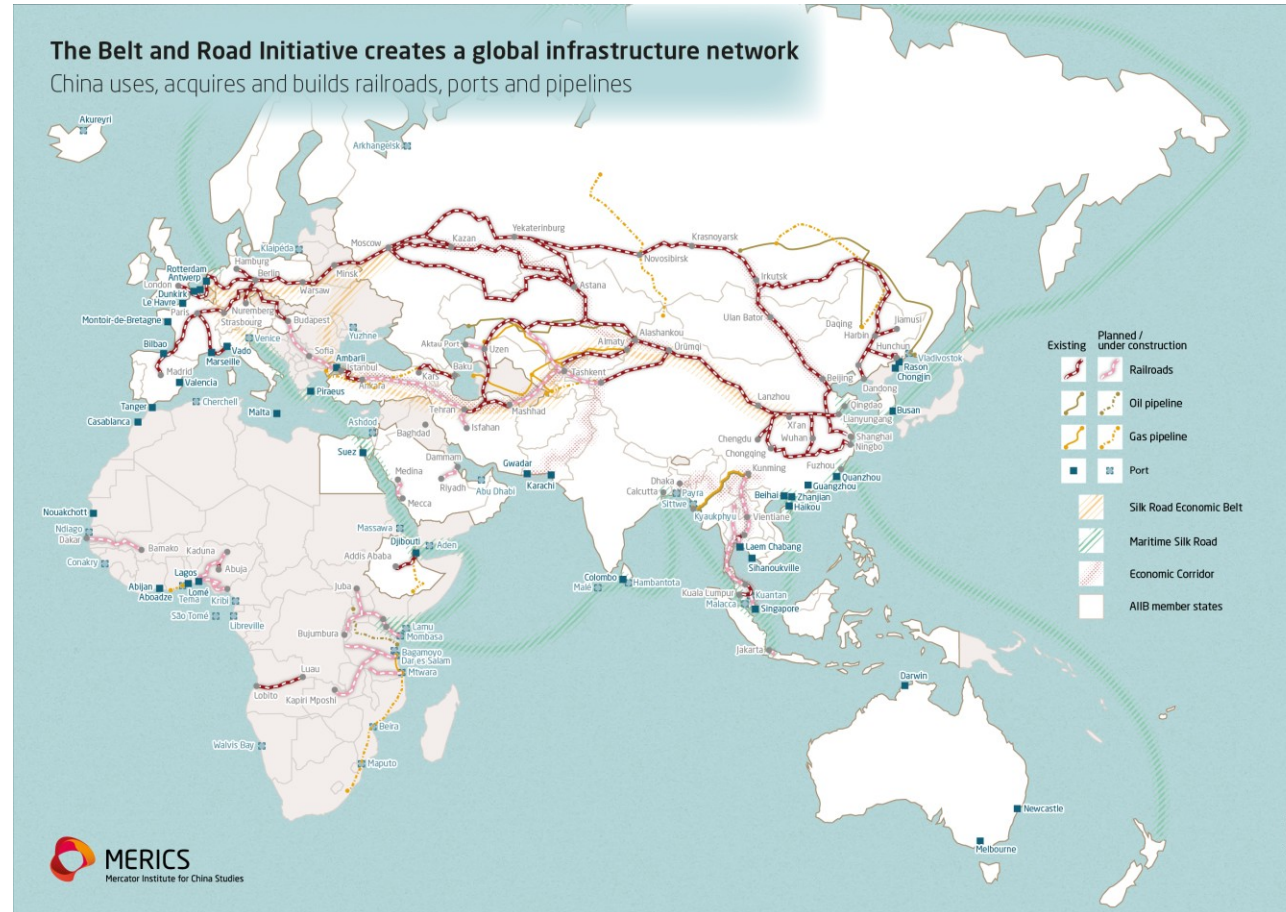
# BRI in European Union member states

- 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

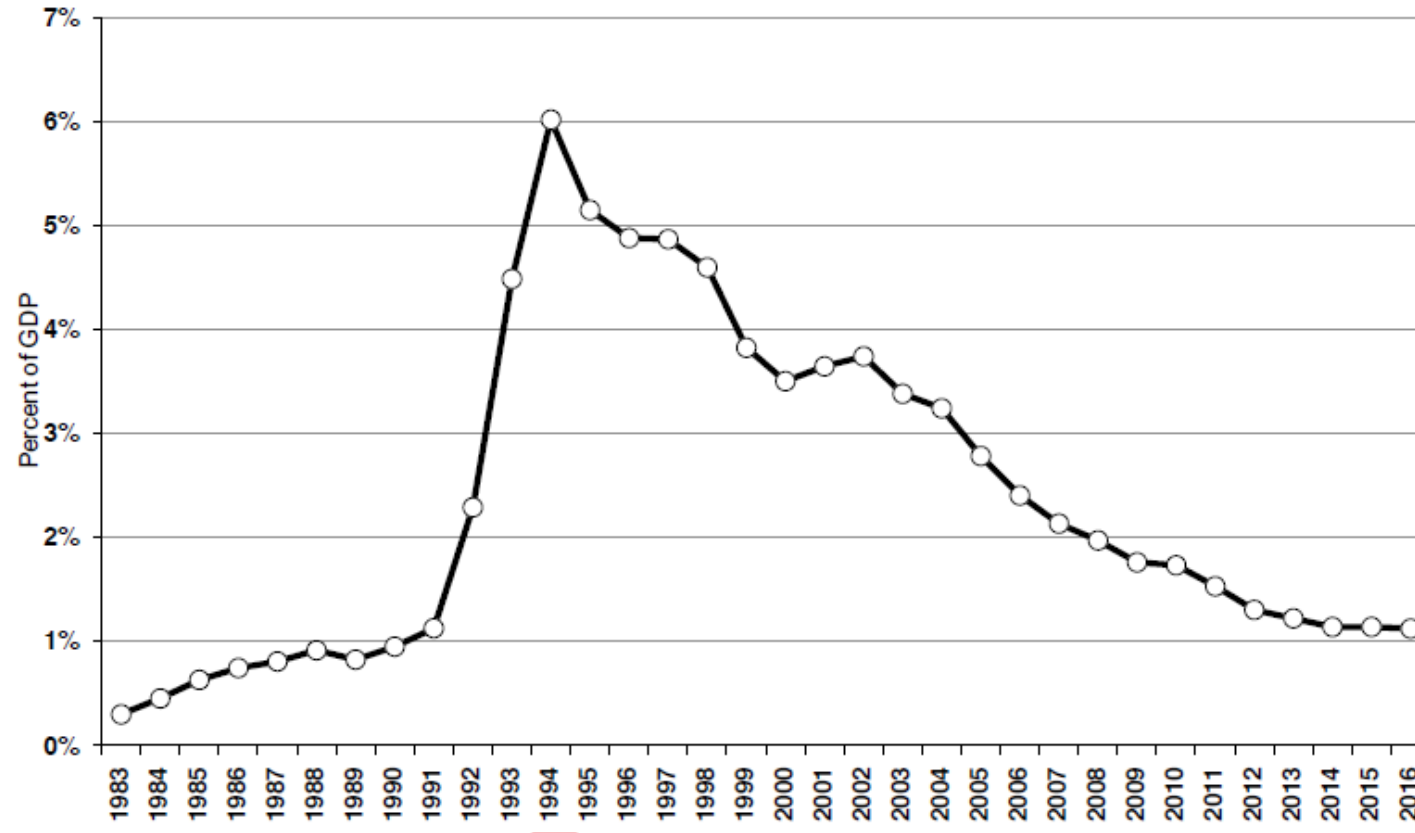


# The BRI in Europe

- 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 going to pay for itself > **skepticism in most EU states**

# Foreign direct investment in and out of China

# Foreign direct investment



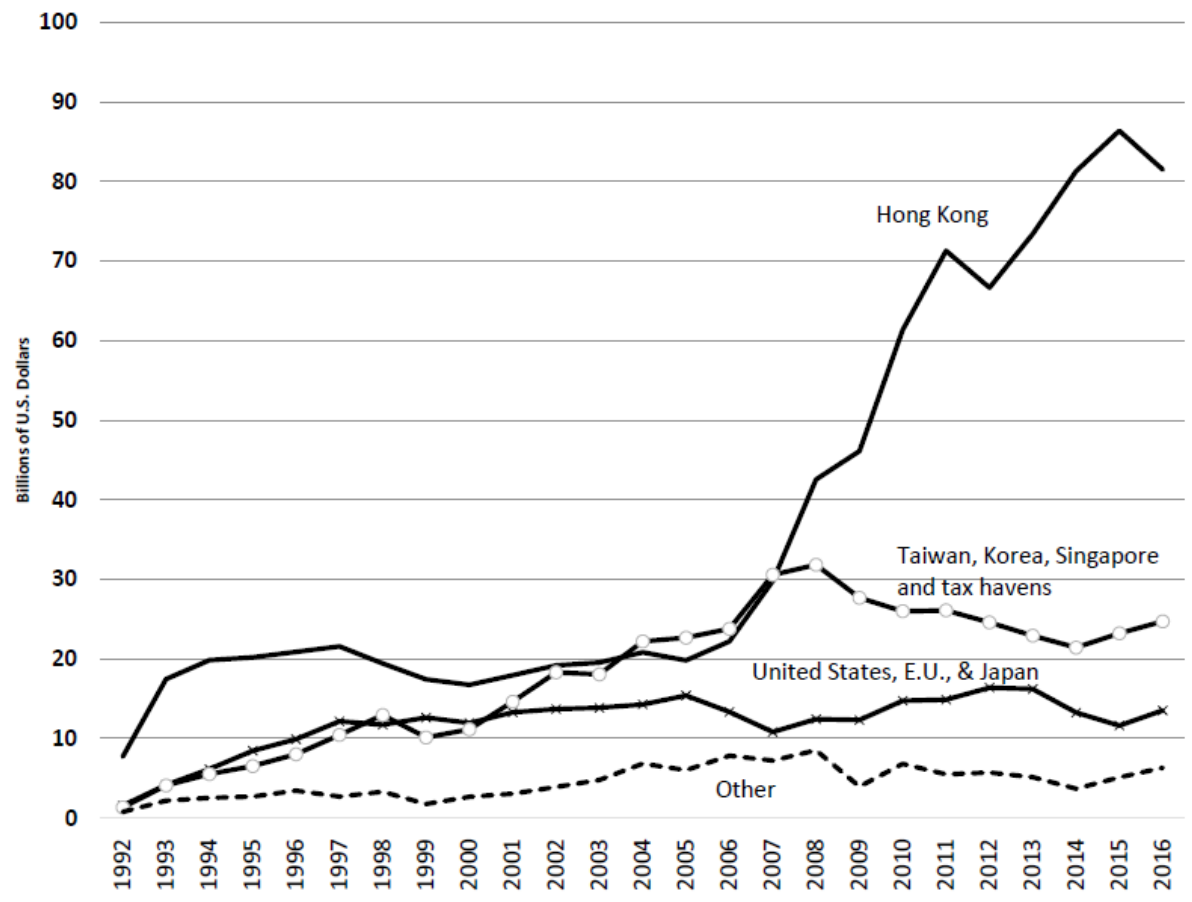


# Foreign direct investment

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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

- 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

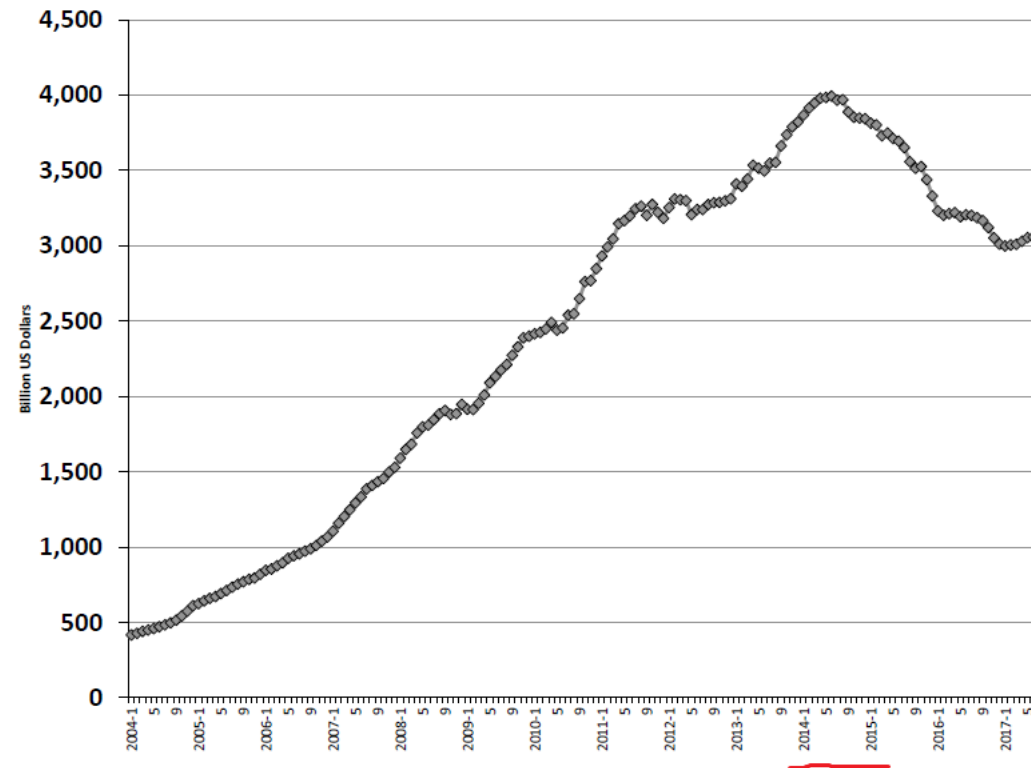
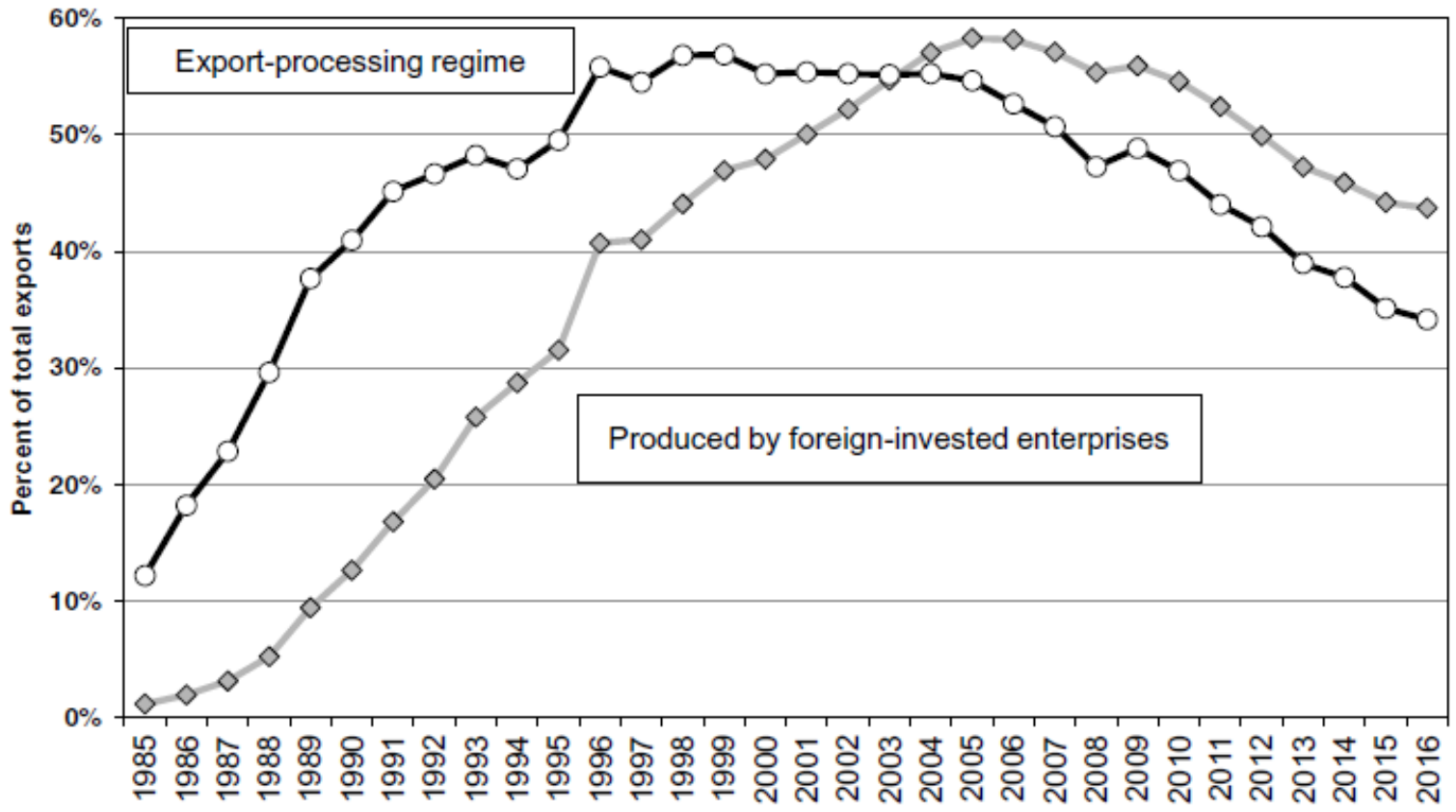


Figure 17.5  
China: Official foreign-exchange reserves.



# Outgoing Chinese FDI

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



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

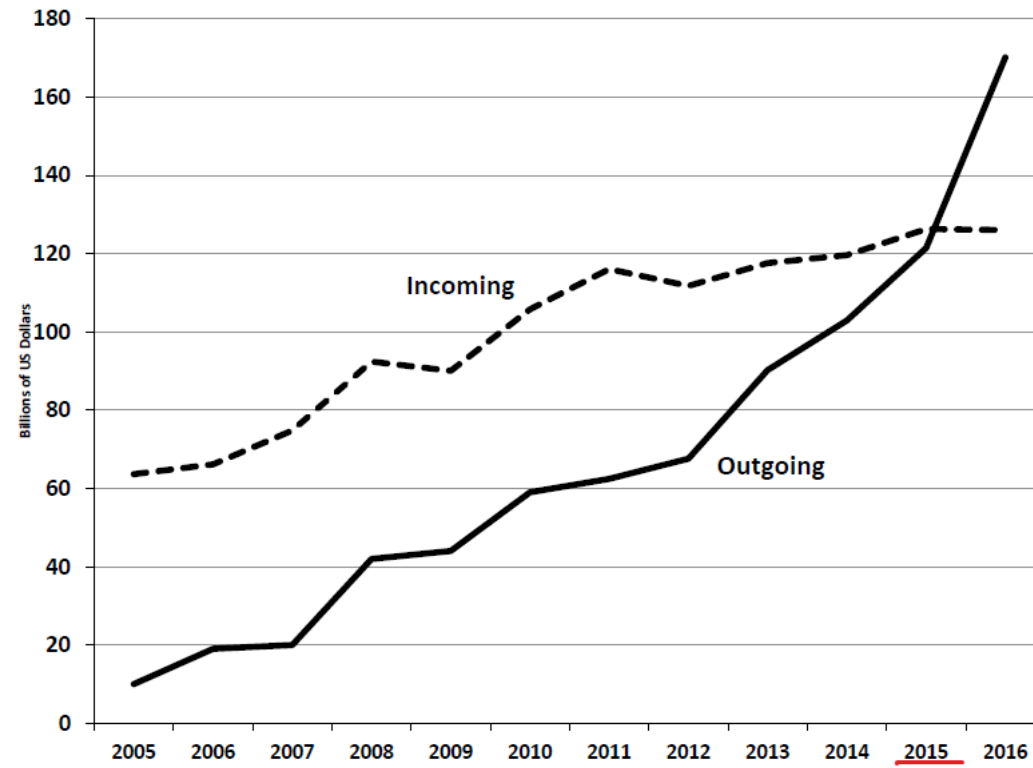
# Outgoing Chinese FDI

- China has the **potential to become the world's largest foreign investor**
- It has an unusually **high rate of savings**
- It also still has quite a **large trade surplus**
- > 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**
- 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

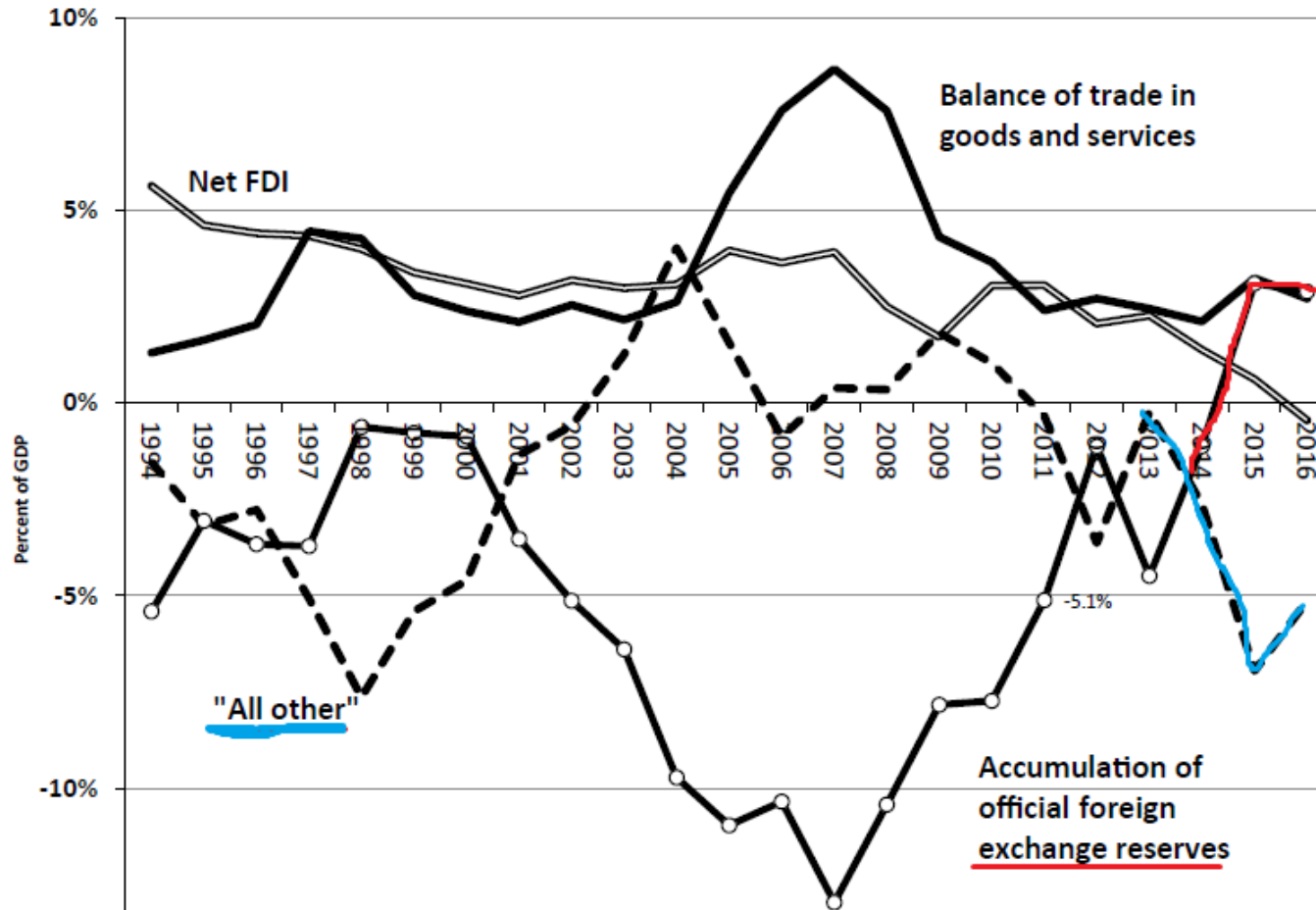
# Portfolio investment

- = short term, more speculative than FDI
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- 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**

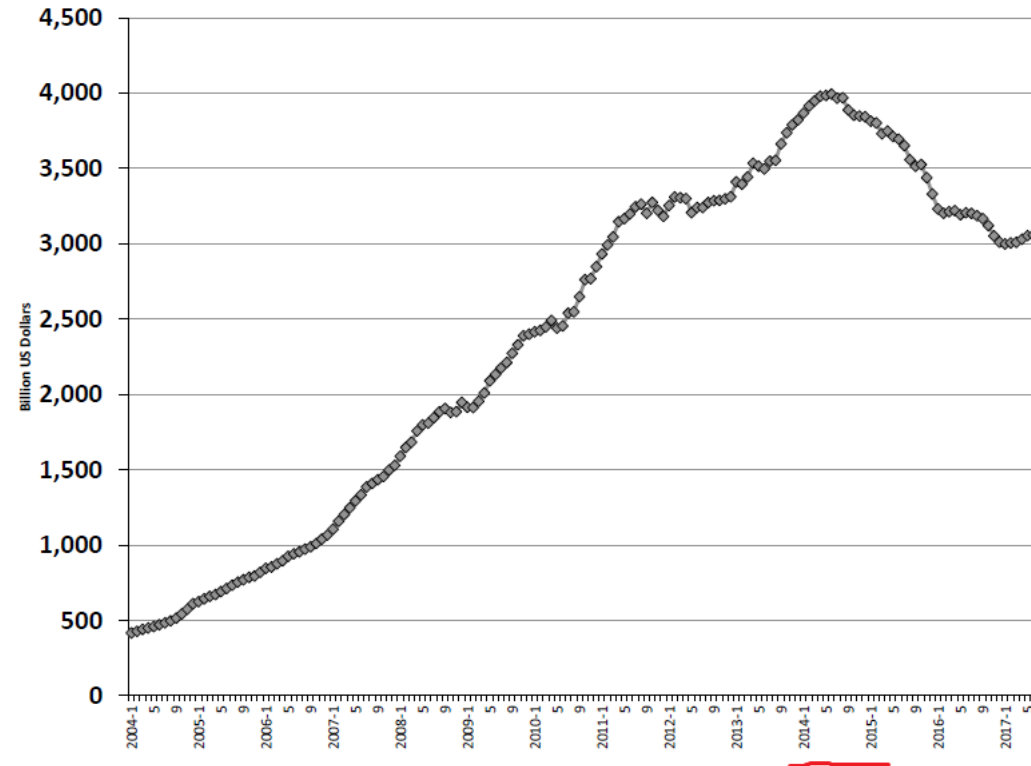
# All other = speculative flows



**Figure 17.4**  
Simplified balance of payments.

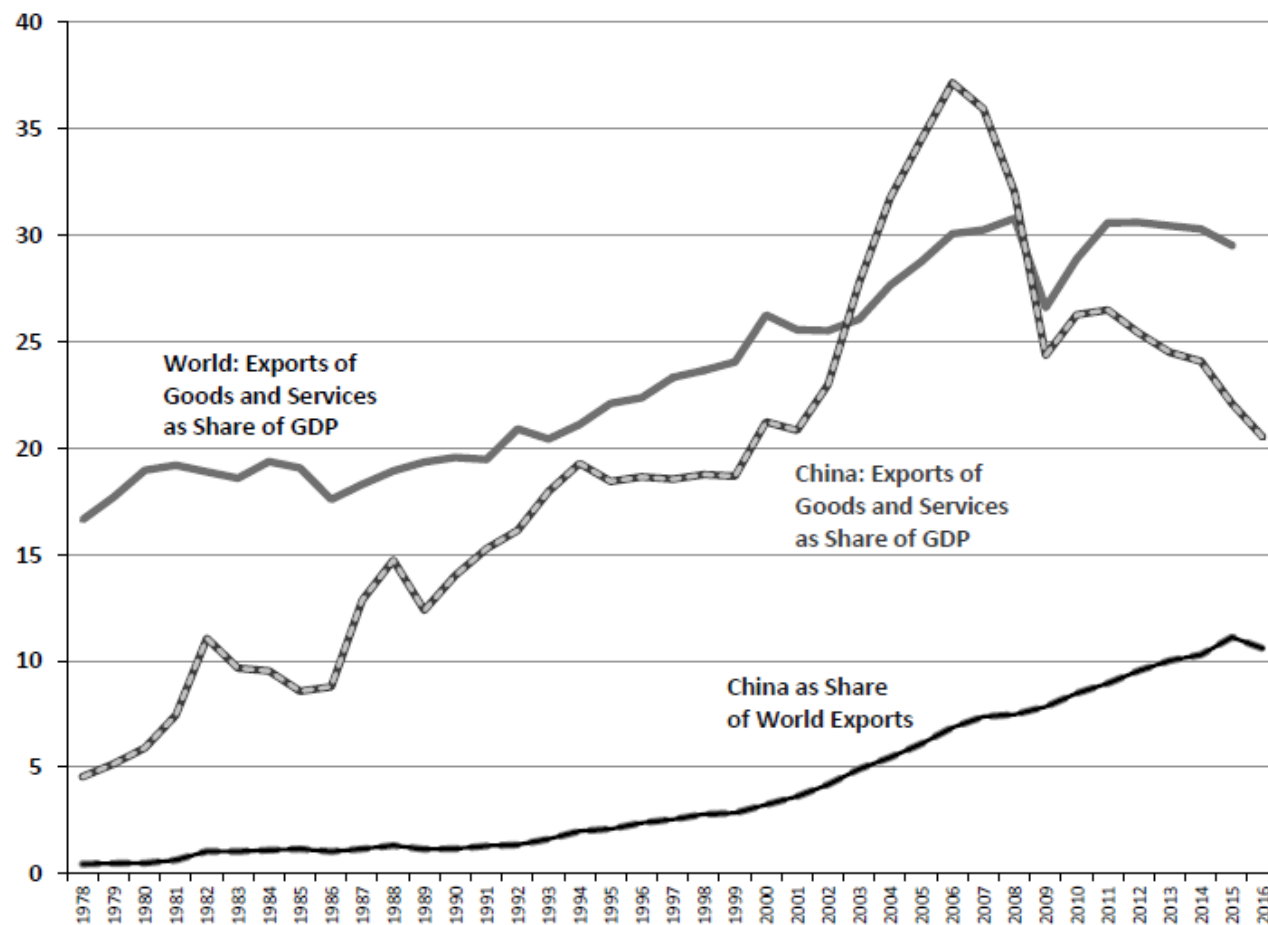


# Foreign exchange reserves



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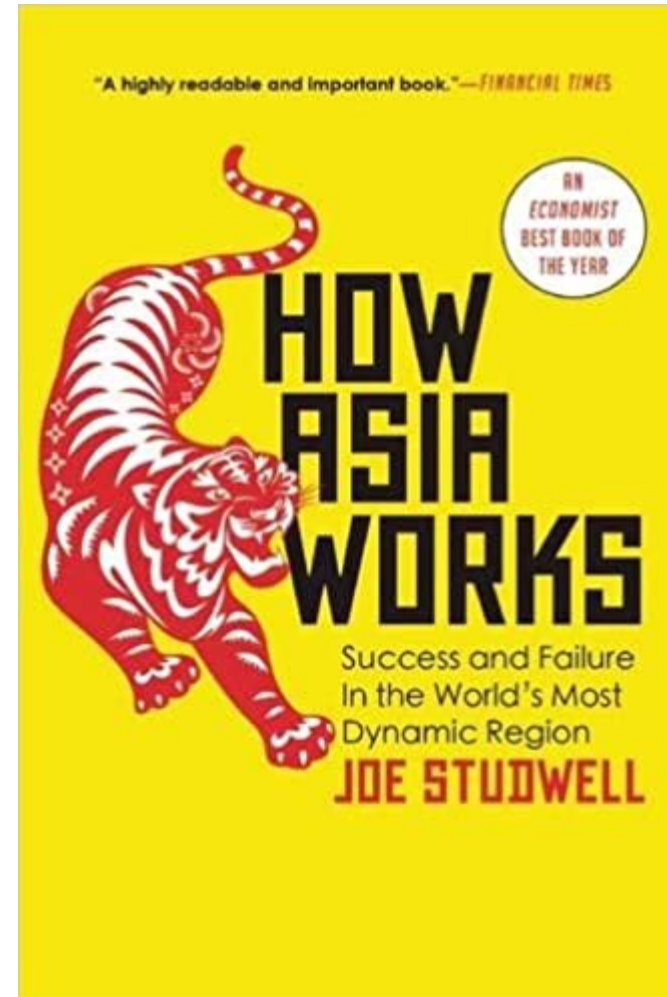
# One final graph



# The Chinese economic model in an international comparison

# Asian developmental state

- „How Asia works“ – Joe Studwell



# Asian developmental state

- „How Asia works“ – Joe Studwell
- 1) Land reform
- 2) Industrial policy > promotion of exports
- 3) State owned banks – also promotion of industry

- Similar thesis – **Ha-Joon Chang**

# Asian developmental state

- New firms are not going to succeed on their own, **they need protection and help from the state (x free trade)**

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# Asian developmental state

- New firms are not going to succeed on their own, **they need protection and help from the state (x free trade)**
- But they must be tested so that they don't become complacent > „**export discipline**“ – they must be able to sell products abroad
- Why abroad? Success in the closed domestic market doesn't prove anything

# Asian developmental state

- **Undervalued currency** – helps with export

# Asian developmental state

- China – **somewhat similar, but even more statist**
- Most large enterprises continued to be state-owned (to this day)

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- China – **somewhat similar, but even more statist**
- Most large enterprises continued to be state-owned (to this day)
- **No liberalization after successful growth**
- **J, K, T attempted to catch up, not to become the undisputed leader**  
(x China's ambitions for next generation Internet, AI....)

# Asian developmental state

- J, K, T – **developmental state as a necessary evil**, a precursor to **capitalism** which isn't possible yet
- = more or less in line with Western theorists of protectionism – Alexander Hamilton, Friedrich List

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# Asian developmental state

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- = more or less in line with Western theorists of protectionism – Alexander Hamilton, Friedrich List
- CH – **developmental state as a necessary evil**, a precursor to **socialism** which isn't possible yet
- = **China does not yet possess the capacity for planning and redistribution necessary to achieve socialism, so it has to accept markets**



# Asian developmental state

- CCP – China's advantage continues to be the ability to mobilize resources

# ISI

- **Import-substituting industrialization (ISI)**
- **Not so important for us**, but often discussed in IPE
- Latin America, circa 1945-1980

# ISI

- **Protectionism, state-owned banks and large enterprises – similar to Asia**

# ISI

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- **1980s – bankruptcies, transition to free trade (IMF, WB)**



# ISI

- Economists – identification of ISI with protectionism and Asia with free markets
- = **misinterpretation**

# ISI

- China transitioned towards something reminiscent of ISI in the 1980s, then they moved on towards an export-driven model

# Shock therapy/Neoliberalism

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- Eastern Europe after 1989
- = **full transition towards free market capitalism**
- = **privatization** of enterprises, market prices, free trade

# Shock therapy/Neoliberalism

- Main idea – the Communist regimes have collapsed > **there is no power capable of overseeing central planning**

# Shock therapy/Neoliberalism

- Main idea – the Communist regimes have collapsed > **there is no power capable of overseeing central planning**
- > we must move quickly towards markets, **otherwise the managers of the SOE's will plunder the assets**
- = the need to dissolve public ownership relatively quickly, before it's completely hollowed out

# Shock therapy/Neoliberalism

- **Derided and discredited today** – collapse of Russia, Ukraine etc, poverty, rise of oligarchs

# Shock therapy/Neoliberalism

- **Derided and discredited today** – collapse of Russia, Ukraine etc, poverty, rise of oligarchs
- But – **Baltic countries, Poland, Czechia, Slovakia, Slovenia, Hungary...**
- > often reasonably successful!



# Shock therapy/Neoliberalism

- **Eastern Europe after 1989**
- = **full transition towards free market capitalism**
- = **privatization** of enterprises, market prices, free trade
  
- **Succesfull cases – attract FDI into manufacturing – like China**
- FDI as a source of **both capital and technology**
- **No national industrial policy** or plans to create national champions – the key role remains with foreign capital – unlike China

# Shock therapy/Neoliberalism

- China – We don't want shock therapy, because:
  - 1) **we still basically believe that socialism will win in the end**
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# Shock therapy/Neoliberalism

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  - 2) **doing so would drastically curtail the Party's power**
- Eastern Europe – We don't want Chinese-style mixed economy because:
  - 1) **we no longer believe in socialism**
  - 2) **doing so would mean keeping the security apparatus to oversee the SOEs**

# Threats to China's success story

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- **1) Backlash from industrialized countries**
- Even EU, CANZ, Japan etc. are starting to turn against China

# Threats to China's success story

- **2) An uncertain wager on digital technologies**

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# Threats to China's success story

- 2) **An uncertain wager on digital technologies**
- Normally, industrial policy **is about catching-up**
- There are existing technologies to be copied – **it is faster to copy something than to develop it**
- Even if you decide for domestic innovations, **it is still clear that the technology is viable and can work**

# Threats to China's success story

- **2) An uncertain wager on digital technologies**
- **As you get near the frontier, it is more and more hard to say which way to go**

# Threats to China's success story

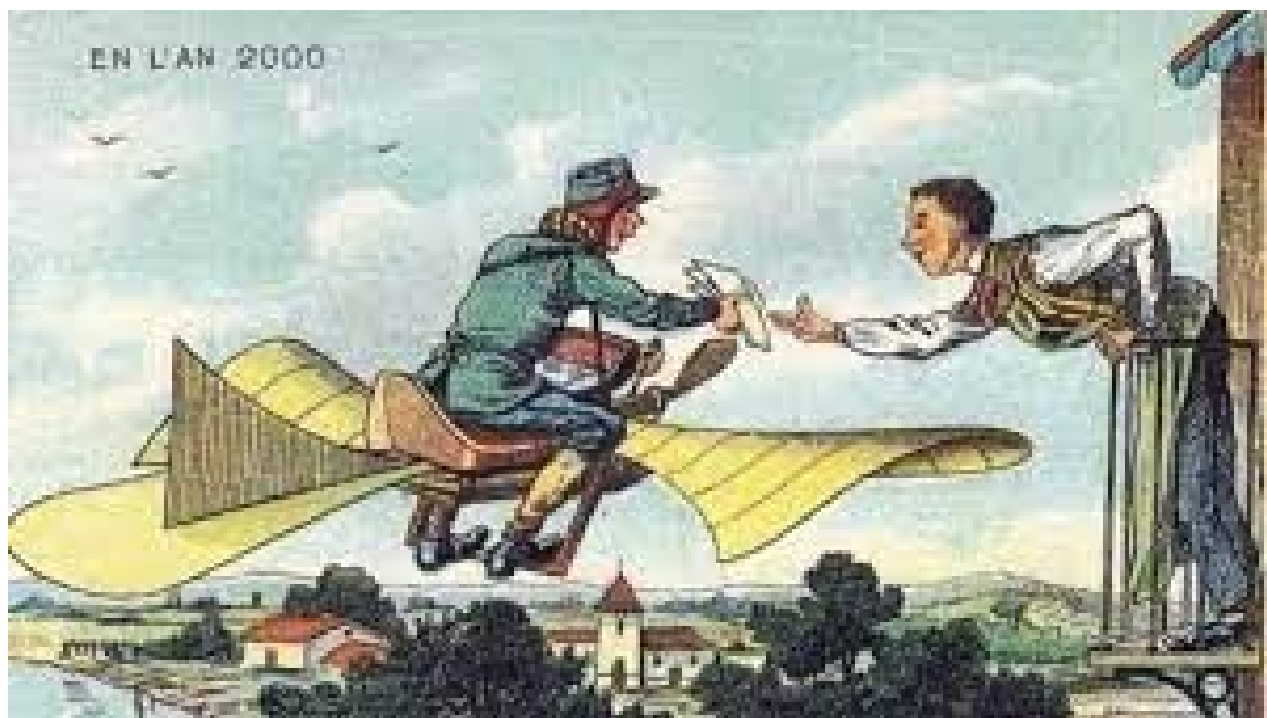
- 2) **An uncertain wager on digital technologies**
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- Most countries (J, K, T) **liberalize at this point** > so that markets can experiment and find the way

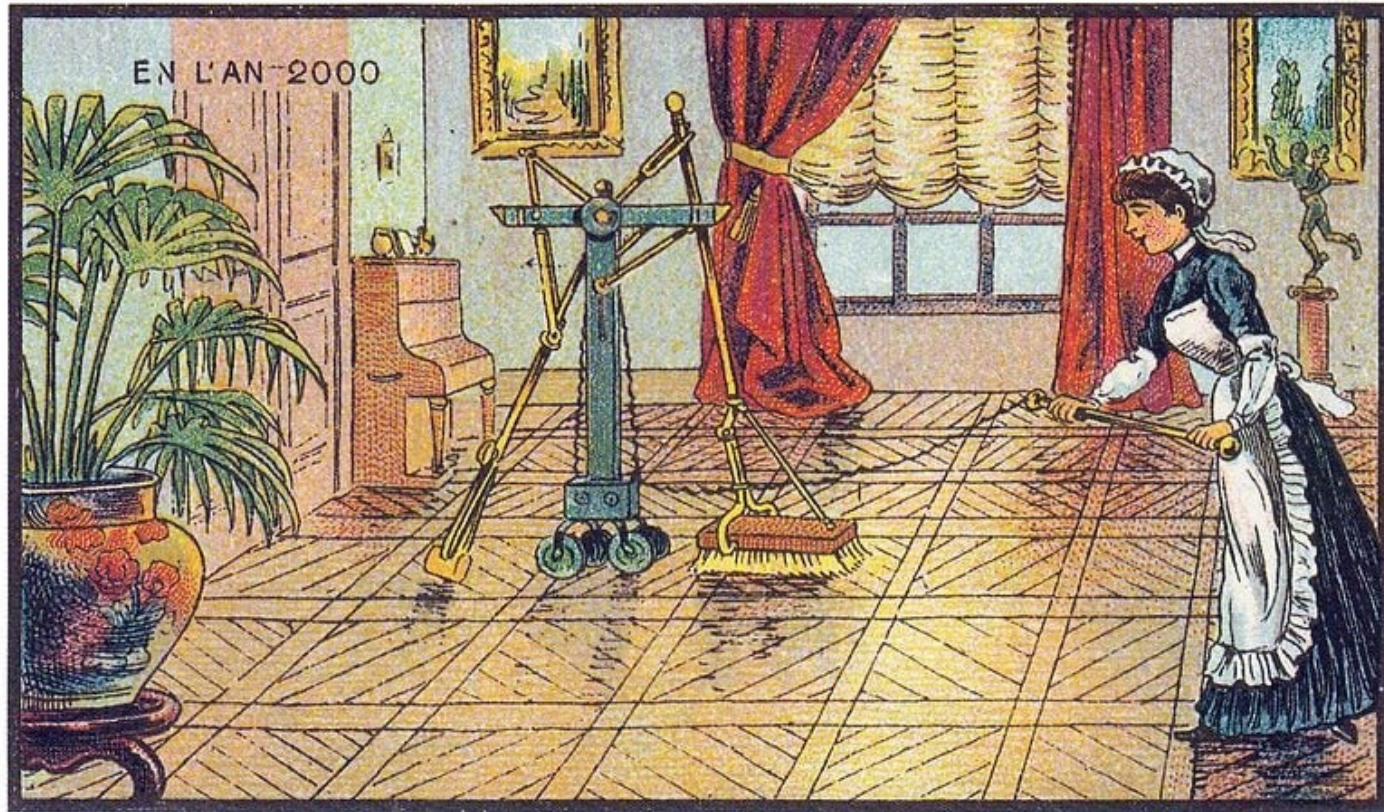
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- **China has decided to bet huge resources on a technological revolution that is yet to emerge**

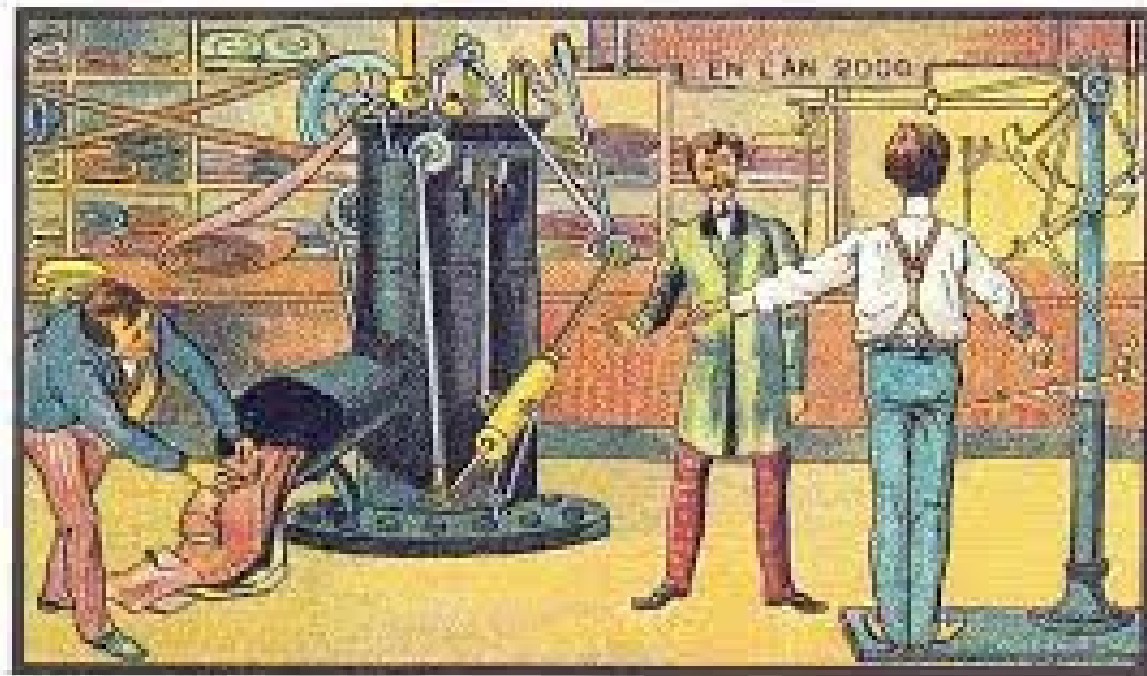
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- Most countries (J, K, T) **liberalize at this point** > so that markets can experiment and find the way
- **China has decided to bet huge resources on a technological revolution that is yet to emerge**
- > What if the future doesn't work the way Beijing imagines?



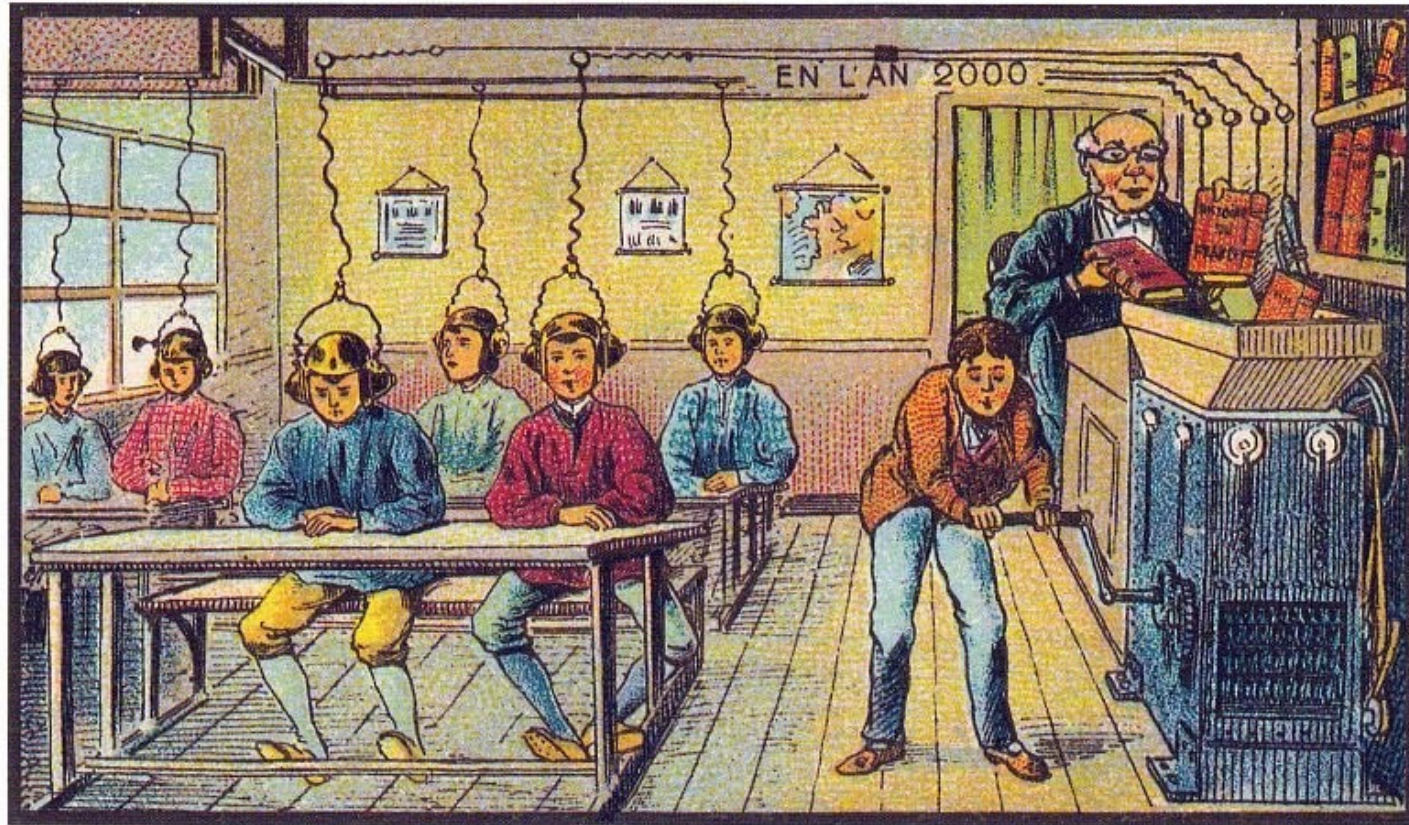


Electric Scrubbing



A Tailor of the Latest Fashion





At School

- „The future will be just like the present, only more so“

# Threats to China's success story

- **2) An uncertain wager on digital technologies**
- Huge resources might be wasted creating unproductive industries
- At the expense of the actually promising sectors

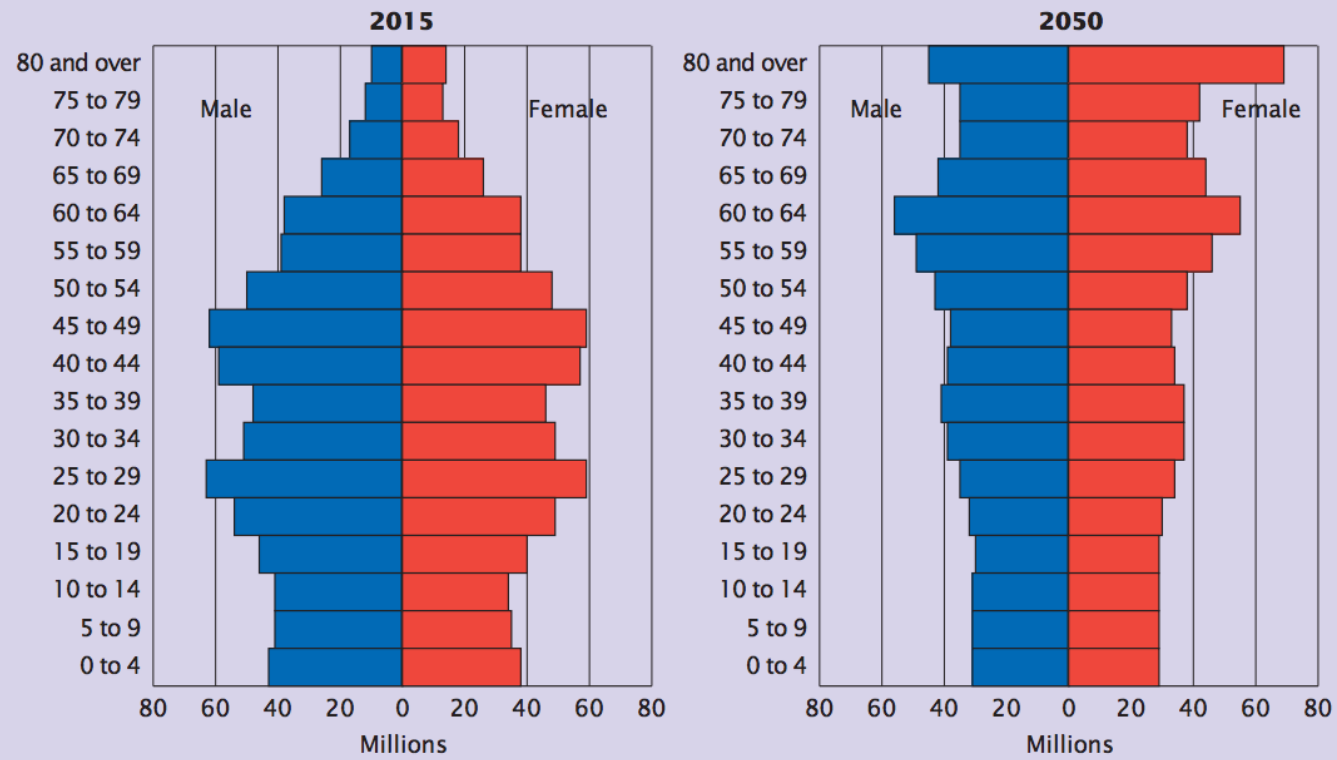
# Threats to China's success story

- **2) An uncertain wager on digital technologies**
- Huge resources might be wasted creating unproductive industries
- At the expense of the actually promising sectors
- **Bursting of a bubble x permanent support for an entrenched interest**

# Threats to China's success story

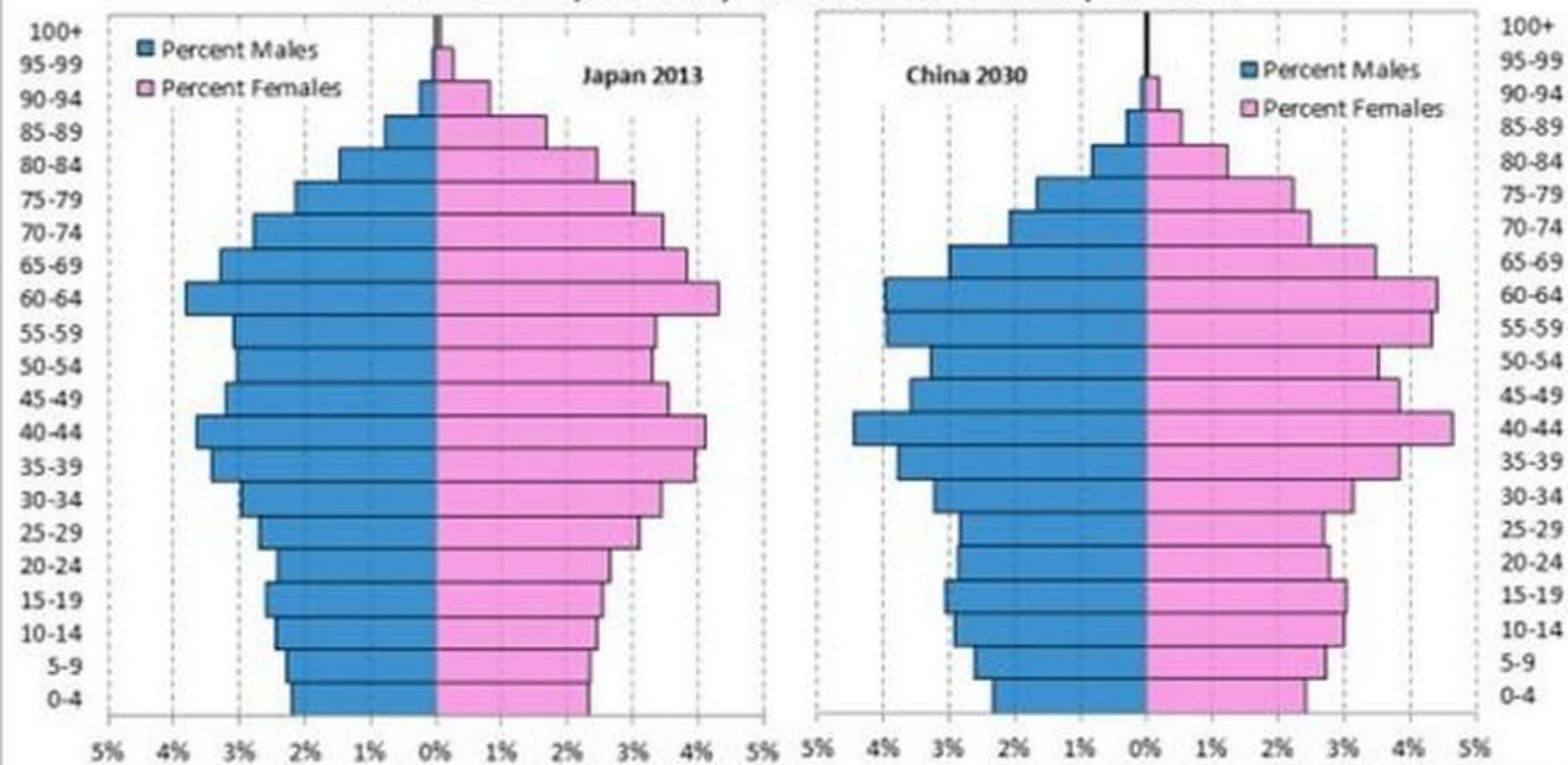
- **3) Ageing population**

Figure 3-2.  
**Population by Age and Sex for China: 2015 and 2050**



Source: U.S. Census Bureau, 2013; International Data Base.

### China's 2030 Population Pyramid Looks A Lot Like Japan's Now



Source: U.S. Census, Bloomberg

BloombergBriefs.com

# Threats to China's success story

- **3) Ageing population**
- > need for far greater spending on **pensions, healthcare spending**



# Threats to China's success story

- **3) Ageing population**
- > need for far greater spending on **pensions, healthcare spending**
- China currently only has a tiny welfare state
- Because „it promotes laziness“

# Threats to China's success story

- **4) A real-estate bubble**

# Threats to China's success story

- **4) A real-estate bubble**
- **Huge build up of real estate since 1990**



# Threats to China's success story

- **4) A real-estate bubble**
- **Huge build up of real estate since 1990**
- Also infrastructure

# Threats to China's success story

- **4) A real-estate bubble**
- **Huge build up of real estate since 1990**
- Also infrastructure
- **Financed by state banks, built by SOEs**

# Threats to China's success story

- **4) A real-estate bubble**
- **During every crisis > financial injection > even more build up**

# Threats to China's success story

- **4) A real-estate bubble**
- **During every crisis > financial injection > even more build up**
- „Keynesianism with Chinese characteristics“ was based around real-estate

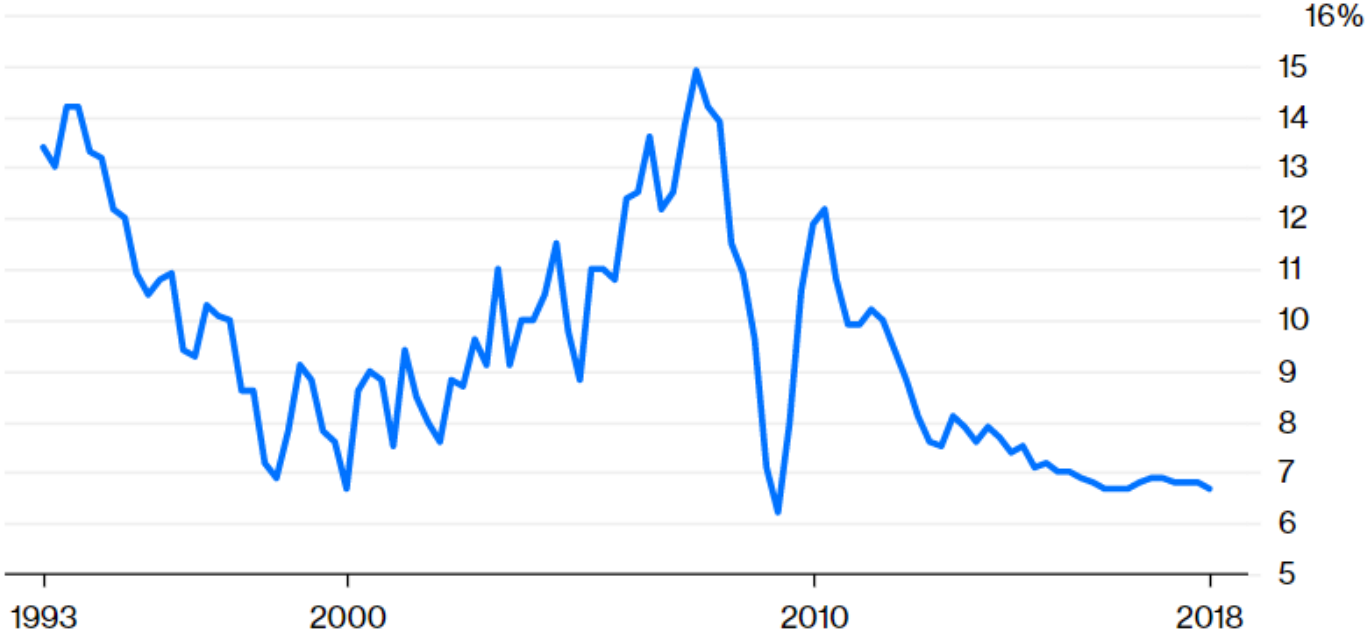


# Threats to China's success story

- **4) A real-estate bubble**
- **During every crisis > financial injection > even more build up**
- „Keynesianism with Chinese characteristics“ was based around real-estate
- **> near miraculous ability to escape recessions**

### No Recession Here

China real quarterly annualized gross domestic product growth



Source: Bloomberg

# Threats to China's success story

- **4) A real-estate bubble**
- 2008 – the biggest injection of them all > **overproduction, redundant capacity**

# Threats to China's success story

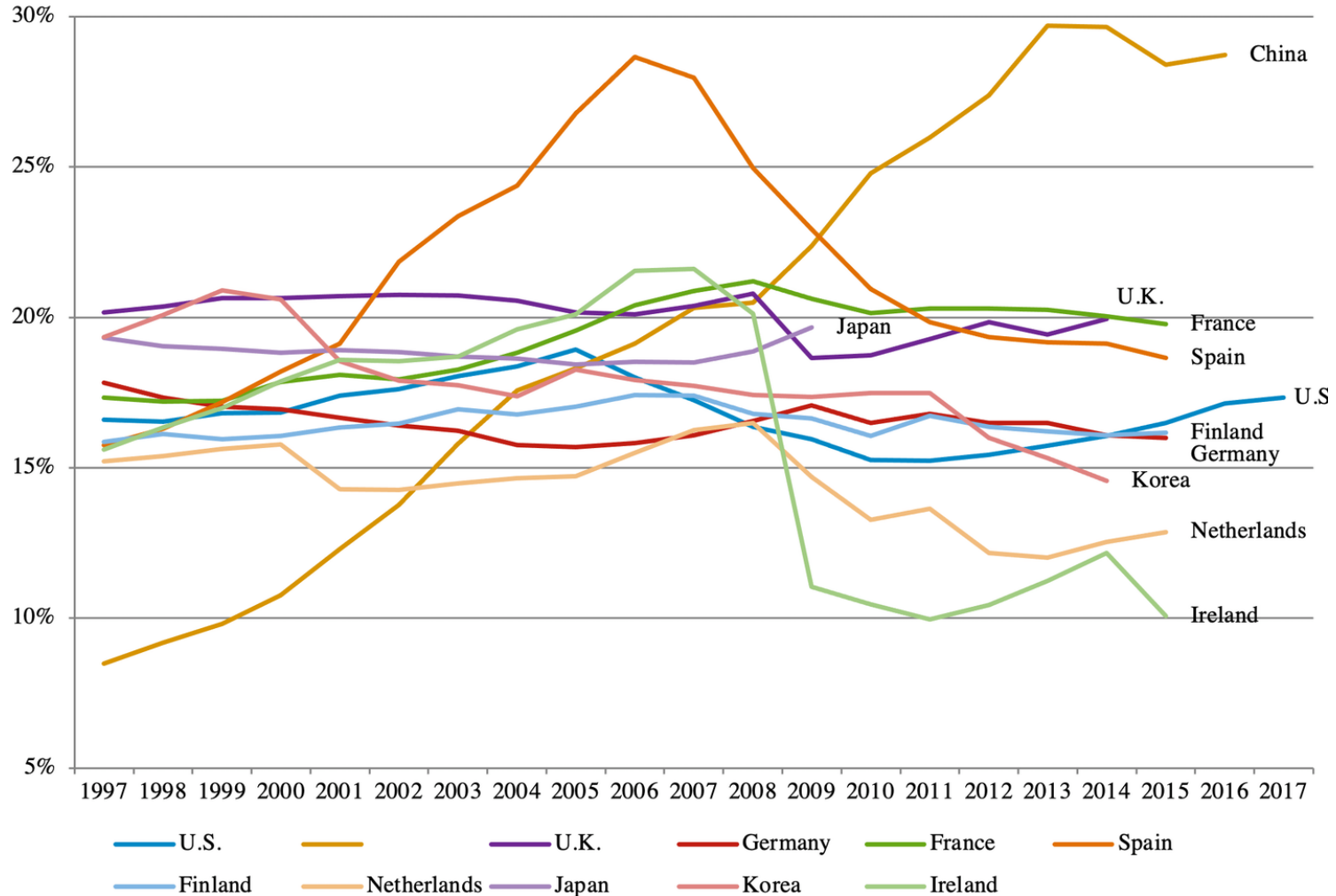
- **4) A real-estate bubble**
- 2008 – the biggest injection of them all > **overproduction, redundant capacity**
- Also – **since finance is controlled by the party-state, real estate is the one asset into which households can invest**

# Threats to China's success story

- **4) A real-estate bubble**
- 2008 – the biggest injection of them all > **overproduction, redundant capacity**
- Also – since finance is controlled by the party-state, **real estate is the one asset into which households can invest**
- Empty suburbs of investment flats



# Real estate share of GDP



# Threats to China's success story

- **4) A real-estate bubble**
- Local governments get income from selling land > **will they have to switch to higher taxes?**



# Threats to China's success story

- **4) A real-estate bubble**
- Local governments get income from selling land > **will they have to switch to higher taxes?**
- **What about the middle class and their savings?**

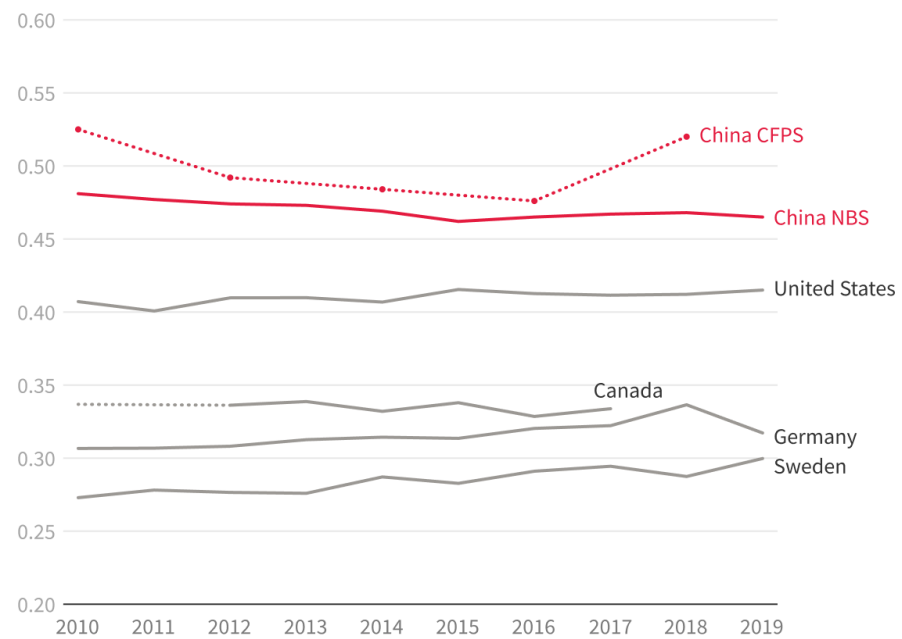
- Do we still have time?

- Do we still have time?
- Probably not...

# Looking ahead

- What else is a problem?

## Inequality in China Is High and May Be Increasing According to Gini Coefficient Estimates



Data for the CFPS Gini Coefficient was only available for years 2010, 2012, 2014, 2016, 2018.

Data for Canada was not available for years 2011, 2018, 2019

Source: National Bureau of Statistics of China; Kanbur, Wang, and Zhang, "The Great Chinese Inequality Turnaround;" UNU-WIDER, World Income Inequality Database (WIID).

CSIS

- Inequality
- Endless lockdowns
- Lack of rule of law

- Final essay
- Tests
- Informal meeting...?