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深圳大学经济学院
College of Economics Shenzhen University

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# Introduction to International Trade

## Lecture 2 A Brief History of China’s International Trade

Xieer Dai

**SHENZHEN UNIVERSITY, SPRING,2023**

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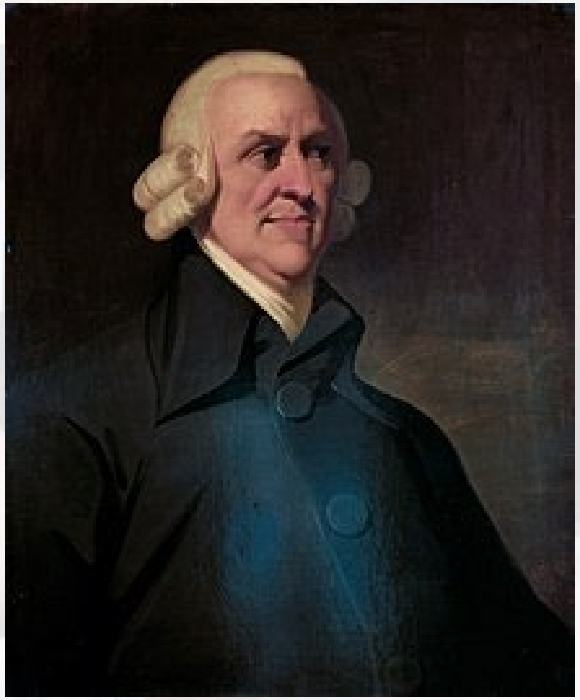
# Section 1 International Trade Theory

# Adam Smith's model

- Adam Smith describes trade taking place as a result of countries having absolute advantage in production of particular goods, relative to each other.
- Within Adam Smith's framework, absolute advantage refers to the instance where one country can produce a unit of a good with less labor than another country.
- In Book IV of his major work the Wealth of Nations, Adam Smith, discussing gains from trade, provides a literary model for absolute advantage based upon the example of growing grapes from Scotland. He makes the argument that while it is possible to grow grapes and produce wine in Scotland, the investment in the factors of production would cost thirty times more than the cost of purchasing an equal quantity from a foreign country.
- The minimization of aggregate real costs and efficient resource allocation through trade without strong consideration for comparative costs form the basis of Adam Smith's model of absolute advantage in international trade.



Born: c. 16 June [O.S. c. 5 June] 1723
Kirkcaldy, Fife, Scotland
Died: 17 July 1790 (aged 67)
Edinburgh, Scotland
Alma mater
University of Glasgow
Balliol College, Oxford
Notable work
The Theory of Moral Sentiments (1759)
The Wealth of Nations (1776)

# Ricardian model

- The Ricardian theory of comparative advantage became a basic constituent of neoclassical trade theory. Any undergraduate course in trade theory includes a presentation of Ricardo's example of a two-commodity, two-country model. For the modern development, see Ricardian trade theory extensions
- The Ricardian model focuses on comparative advantage, which arises due to differences in technology or natural resources. The Ricardian model does not directly consider factor endowments, such as the relative amounts of labor and capital within a country.

Member of Parliament for Portarlington
In office 20 February 1819 – 11 September 1823
Preceded by Richard Sharp
Succeeded by James Farquhar
Personal details
Born 18 April 1772
London, England
Died 11 September 1823 (aged 51)
Gatcombe Park, Gloucestershire, England

# Ricardian model

## Ricardo's Example: How Many Workers to Make a Unit of a Good

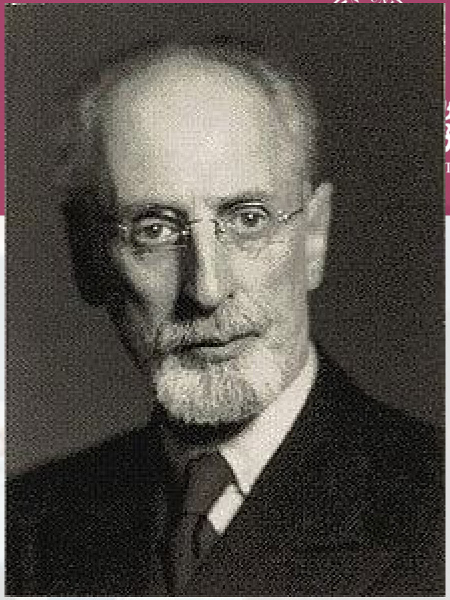
| | *Cloth* | *Wine* |
|---|---|---|
| England | 100 | 120 |
| Portugal | 90 | 80 |

# Specific factors model

- The specific factors model is an extension of the Ricardian model. It was due to Jacob Viner's interest in explaining the migration of workers from the rural to urban areas after the Industrial revolution.
- In this model labor mobility among industries is possible while capital is assumed to be immobile in the short run. Thus, this model can be interpreted as a short-run version of the Heckscher-Ohlin model. The "specific factors" name refers to the assumption that in the short run, specific factors of production such as physical capital are not easily transferable between industries. The theory suggests that if there is an increase in the price of a good, the owners of the factor of production specific to that good will profit in real terms

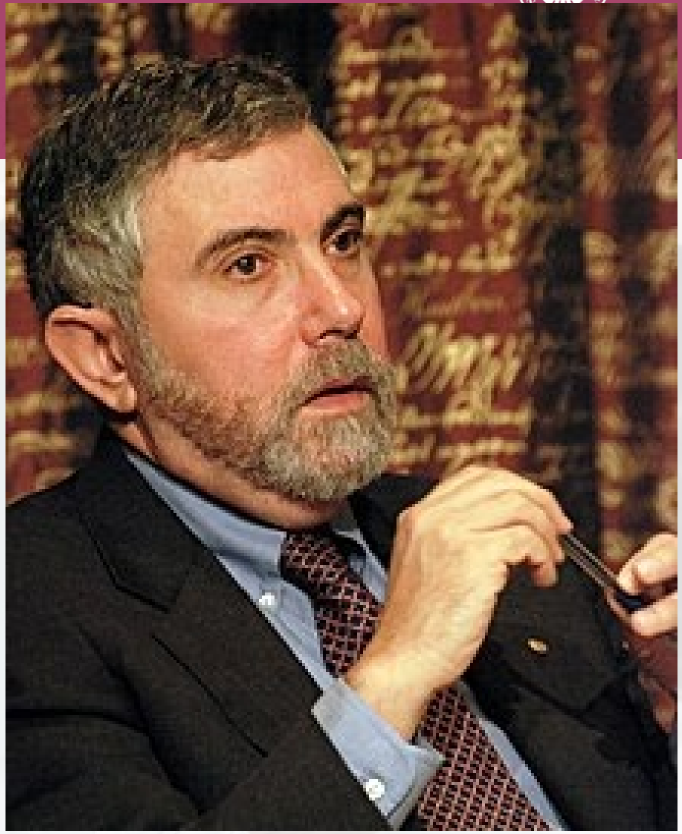
# Heckscher–Ohlin model

- In the early 1900s, a theory of international trade was developed by two Swedish economists, Eli Heckscher and Bertil Ohlin. This theory has subsequently become known as the Heckscher–Ohlin model (H–O model). The results of the H–O model are that the pattern of international trade is determined by differences in factor endowments. It predicts that countries will export those goods that make intensive use of locally abundant factors and will import goods that make intensive use of factors that are locally scarce.
- The H–O model makes the following core assumptions:
- Labor and capital flow freely between sectors equalising factor prices across sectors within a country.
- The amount of labor and capital in two countries differ (difference in endowments)
- Technology is the same among countries (a long-term assumption)
- Tastes are the same upon countries



# New trade theory

- New trade theory tries to explain empirical elements of trade that comparative advantage-based models above have difficulty with.
- These include the fact that most trade is between countries with similar factor endowment and productivity levels, and the large amount of multinational production (i.e., foreign direct investment) that exists.
- New trade theories are often based on assumptions such as monopolistic competition and increasing returns to scale. One result of these theories is the home-market effect, which asserts that, if an industry tends to cluster in one location because of returns to scale and if that industry faces high transportation costs, the industry will be located in the country with most of its demand, in order to minimize cost.



Krugman in 2008
Born Paul Robin Krugman
February 28, 1953 (age 70)
Albany, New York, U.S.
Institution
City University of New York
Princeton University
London School of Economics

# History and Facts of International Trade in China

# Modern History

- In the nineteenth century, European nations used military force to initiate sustained trade with China.
- From the time of the Opium War (1839–42) until the founding of the People's Republic in 1949, various Western countries and, starting in the 1890s, Japan compelled China to agree to a series of unequal treaties that enabled foreigners to establish essentially autonomous economic bases and operate with privileged status in China.
- One classic account of this period is Carl Crow's 400 Million Customers, a humorous but realistic guide which has lasting insights. Foreign privileges were abolished when the People's Republic came into being.

- Trade is a key factor of the economy of China. In the three decades following the dump of the Communist Chinese state in 1949, China's trade institutions at first developed into a partially modern but somewhat inefficient system.
- The drive to modernize the economy that began in 1978 required a sharp acceleration in commodity flows and greatly improved efficiency in economic transactions. In the ensuing years economic reforms were adopted by the government to develop a socialist market economy.
- This type of economy combined central planning with market mechanisms. The changes resulted in the decentralization and expansion of domestic and foreign trade institutions, as well as a greatly enlarged role for free market in the distribution of goods, and a prominent role for foreign trade and investment in economic development.

# Open Door Policy

- At the same time, in December 1978, Deng announced a new policy, the Open Door Policy, to open the door to foreign businesses that wanted to set up in China. For the first time since the Kuomintang era, the country was opened to foreign investment. Deng created a series of Special Economic Zones, including Shenzhen, Zhuhai and Xiamen, for foreign investment that were relatively free of the bureaucratic regulations and interventions that hampered economic growth. These regions became engines of growth for the national economy.
- On January 31, 1979, the Shekou Industrial Zone of Shenzhen was founded, becoming the first experimental area in China to "open up".
- In July 1979, China adopted its first Law on Joint Venture Using Chinese and Foreign Investment. This law was effective in helping to attract and absorb foreign technology and capital from advanced countries like the United States, facilitated China's exports to such countries, and thereby contributed to China's subsequent rapid economic growth.


The slogan "Time is Money, Efficiency is Life" from Shekou, Shenzhen, representing the "Shenzhen speed".

# Trading partners

- During the 1950s China's primary foreign trading partner was the Soviet Union. In 1959 trade with the Soviet Union accounted for nearly 48 percent of China's total.
- By the mid-1960s Japan had become China's leading trading partner, accounting for 15 percent of trade in 1966. Japan was China's most natural trading partner; it was closer to China than any other industrial country and had the best transportation links to it.
- Beginning in the 1960s, Hong Kong was consistently the leading market for China's exports and its second largest partner in overall trade.
- The United States banned trade with China until the early 1970s. Thereafter trade grew rapidly, and after the full normalization of diplomatic and commercial relations in 1979, the United States became the second largest importer to China and in 1986 was China's third largest partner in overall trade.

# Trading partners

- Western Europe has been important in Chinese foreign trade since the mid-1960s. The Federal Republic of Germany, in particular, was second only to Japan in supplying industrial goods to China during most of this period.
- Third World countries have long served as a market for Chinese agricultural and light industrial products. In 1986 developing countries purchased about 15 percent of Chinese exports and supplied about 8 percent of China's imports. China has increased trade and investment ties with many African countries such as Chad, the Sudan, and the Democratic Republic of Congo, partly to secure strategic natural resources such as oil and minerals.

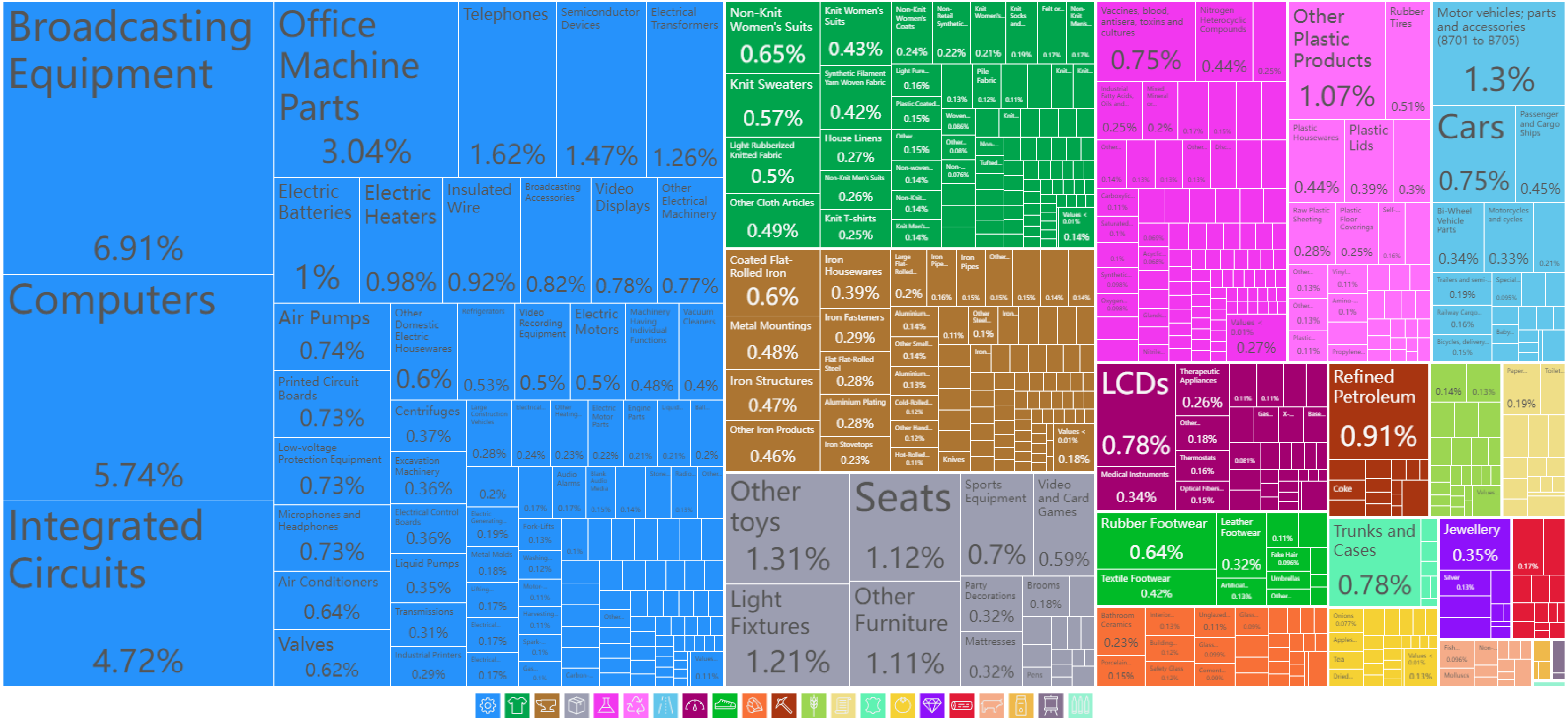
- In 2013 China surpassed the United States as the largest trading nation in the world and plays a vital role in international trade, and has increasingly engaged in trade organizations and treaties in recent years. China became a member of the World Trade Organization in 2001.
- China also has free trade agreements with several nations, including China–Australia Free Trade Agreement, China–South Korea Free Trade Agreement, ASEAN–China Free Trade Area, Switzerland and Pakistan.

# Trade Decomposition

- In 2021, China exported a total of $3.34T, making it the number 1 exporter in the world. During the last five reported years the exports of China have changed by $1.12T from $2.22T in 2016 to $3.34T in 2021.
- The most recent exports are led by Broadcasting Equipment ($231B), Computers ($192B), Integrated Circuits ($158B), Office Machine Parts ($101B), and Telephones ($53.9B). The most common destination for the exports of China are United States ($530B), Hong Kong ($323B), Japan ($168B), South Korea ($140B), and Germany ($134B).
- https://oec.world/en/visualize/tree_map/hs92/export/chn/all/show/2021/

# Visualize Trade Data





# Regional Trade Agreements

- Regional trade agreements (RTAs) have risen in number and reach over the years, including a notable increase in large plurilateral agreements.
- Non-discrimination among trading partners is one of the core principles of the WTO; however, RTAs, which are reciprocal preferential trade agreements between two or more partners, constitute one of the derogations and are authorized under the WTO, subject to a set of rules.

# Regional Trade Agreements

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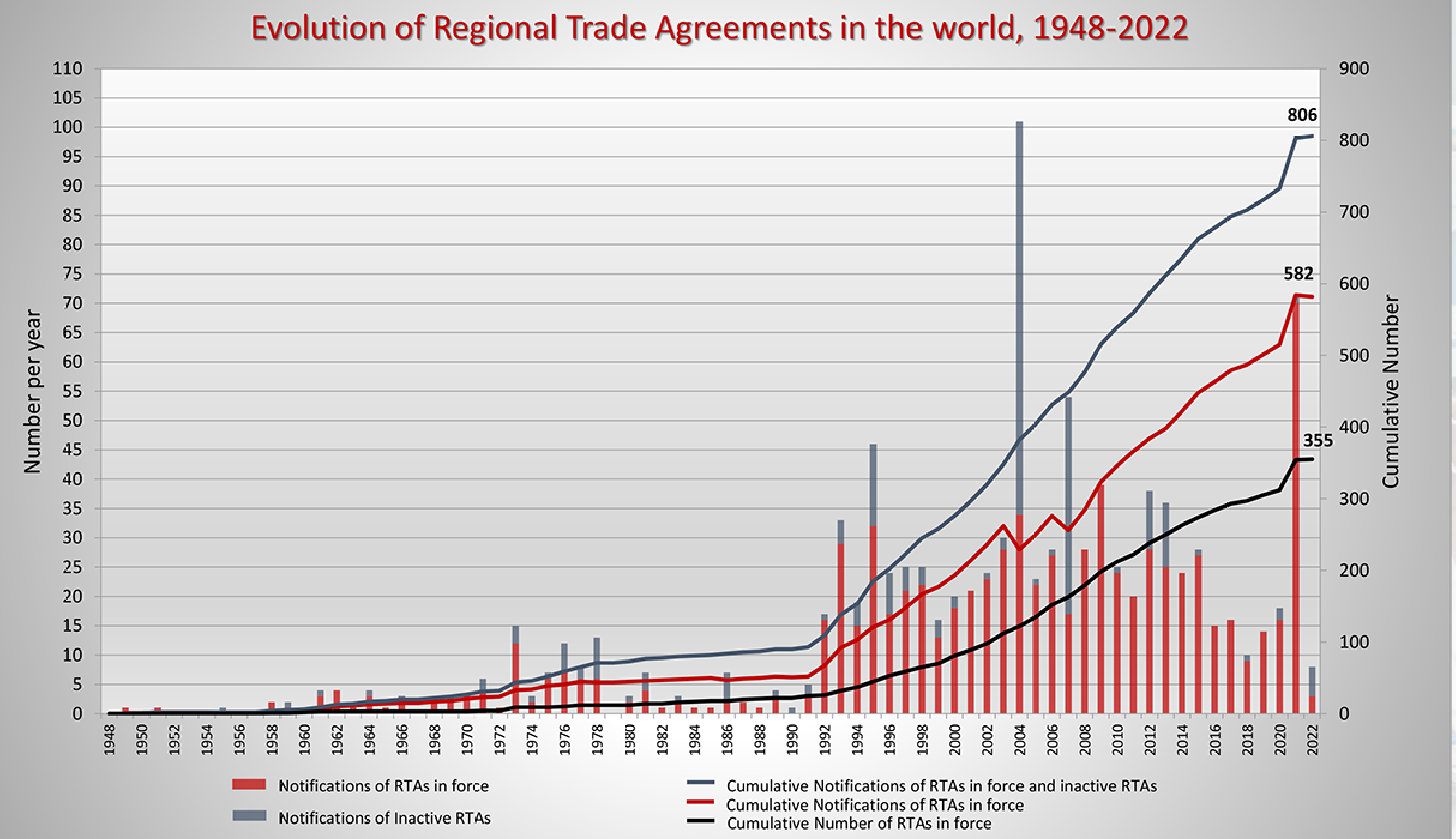
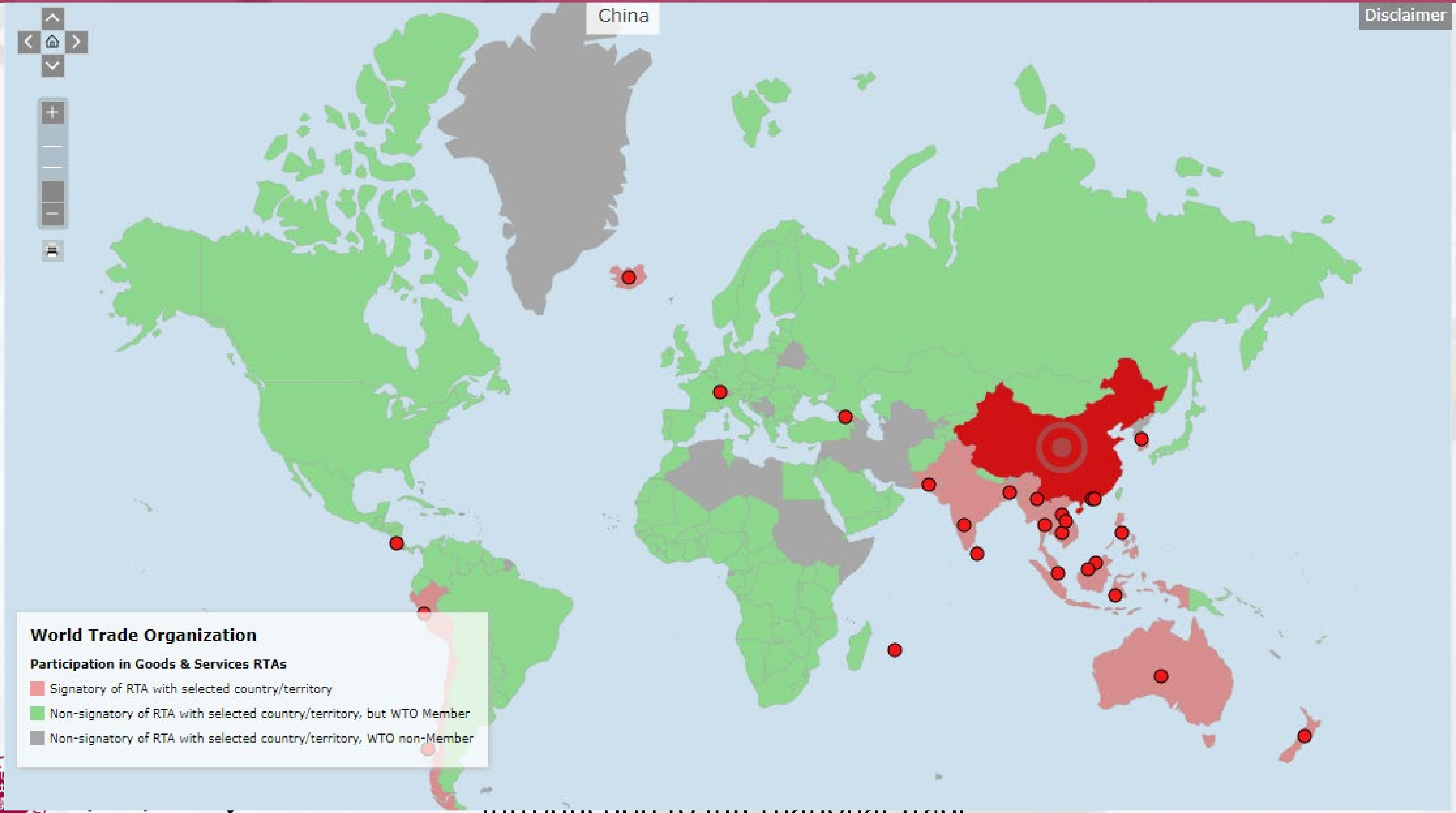



Note: Notifications of RTAs: goods, services & accessions to an RTA are counted separately. The cumulative lines show the number of RTAs/notifications that were in force for a given year. The notifications of RTAs in force are shown by year of entry into force and the notifications of inactive RTAs are shown by inactive year.

Source: RTA Section, WTO Secretariat, December 2022.

# Participation in Regional Trade Agreements



# WTO

The World Trade Organization (WTO) is an intergovernmental organization that regulates and facilitates international trade.

With effective cooperation in the United Nations System, governments use the organization to establish, revise, and enforce the rules that govern international trade.

It officially commenced operations on 1 January 1995, pursuant to the 1994 Marrakesh Agreement, thus replacing the General Agreement on Tariffs and Trade (GATT) that had been established in 1948. The WTO is the world's largest international economic organization, with 164 member states representing over 98% of global trade and global GDP.

# Section 2 Macroeconomics of International Trade

# Production approach

- Also known as the Value Added Approach, it calculates how much value is contributed at each stage of production. This approach mirrors the OECD (Organisation for Economic Co-operation and Development) definition given above.
  1. Estimate the gross value of domestic output out of the many various economic activities;
  2. Determine the intermediate consumption, i.e., the cost of material, supplies and services used to produce final goods or services.
  3. Deduct intermediate consumption from gross value to obtain the gross value added.
- Gross value added = gross value of output – value of intermediate consumption.
- Value of output = value of the total sales of goods and services plus value of changes in the inventory.

# Income approach

- Total income can be subdivided according to various schemes, leading to various formulae for GDP measured by the income approach. A common one is:

$$GDP = Compensation\ of\ employees(COE) + gross\ operating\ surplus(GOS) + gross\ mixed\ income(GMI) + taxes\ less\ subsidies\ on\ production\ and\ imports(TP\ \&\ M - SP\ \&\ M)$$

- Compensation of employees (COE) measures the total remuneration to employees for work done. It includes wages and salaries, as well as employer contributions to social security and other such programs.
- Gross operating surplus (GOS) is the surplus due to owners of incorporated businesses. Often called profits, although only a subset of total costs are subtracted from gross output to calculate GOS.
- Gross mixed income (GMI) is the same measure as GOS, but for unincorporated businesses. This often includes most small businesses.

# Expenditure approach

- The third way to estimate GDP is to calculate the sum of the final uses of goods and services (all uses except intermediate consumption) measured in purchasers' prices.
- Market goods that are produced are purchased by someone. In the case where a good is produced and unsold, the standard accounting convention is that the producer has bought the good from themselves. Therefore, measuring the total expenditure used to buy things is a way of measuring production. This is known as the expenditure method of calculating GDP.

# Expenditure approach

- Components of GDP by expenditure
- U.S. GDP computed on the expenditure basis.
- GDP (Y) is the sum of consumption (C), investment (I), government Expenditures (G) and net exports (X – M).

$$Y = C + I + G + (X - M)$$

- Here is a description of each GDP component:
  - C (consumption) is normally the largest GDP component in the economy, consisting of private expenditures in the economy (household final consumption expenditure).
  - I (investment) includes, for instance, business investment in equipment, but does not include exchanges of existing assets.
  - G (government spending) is the sum of government expenditures on final goods and services.
  - X (exports) represents gross exports.
  - M (imports) represents gross imports.

# International trade theory

- International trade theory is a sub-field of economics which analyzes the patterns of international trade, its origins, and its welfare implications. International trade policy has been highly controversial since the 18th century. International trade theory and economics itself have developed as means to evaluate the effects of trade policies.

# International trade theory

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# List of sovereign states by current account balance

| | Economy | CAB (million US$) | Year |
|---|---|---|---|
| 1 | Germany | 280,238 | 2019 EST. |
| 2 | Japan | 185,644 | 2019 EST. |
| 3 | China | 141,335 | 2019 EST. |
| 4 | Netherlands | 90,207 | 2019 EST. |
| 5 | Switzerland | 79,937 | 2019 EST. |
| 6 | Russia | 65,311 | 2019 EST. |
| 7 | Taiwan | 65,173 | 2019 EST. |
| 8 | Singapore | 63,109 | 2019 EST. |
| 9 | South Korea | 59,971 | 2019 EST. |
| 10 | Italy | 59,517 | 2019 EST. |
| 11 | Thailand | 37,033 | 2019 EST. |
| 12 | Denmark | 30,935 | 2019 EST. |
| 13 | Spain | 29,603 | 2019 EST. |
| 14 | United Arab Emirates | 26,470 | 2017 EST. |
| 15 | Hong Kong | 22,469 | 2019 EST. |
| 16 | Sweden | 22,339 | 2019 EST. |
| 17 | Israel | 20,642 | 2020 EST. |
| 18 | Macau | 16,750 | 2017 EST. |
| 19 | Norway | 16,656 | 2019 EST. |
| 20 | Saudi Arabia | 15,230 | 2017 EST. |


| | Country | CAB (million US$) | Year |
|---|---|---|---|
| 1 | United States | -480,225 | 2019 EST. |
| 2 | United Kingdom | -121,921 | 2019 EST. |
| 3 | Kenya | -57,594 | 2019 EST. |
| 4 | Brazil | -50,927 | 2019 EST. |
| 5 | Ireland | -44,954 | 2019 EST. |
| 6 | Canada | -35,425 | 2019 EST. |
| 7 | Indonesia | -30,359 | 2019 EST. |
| 8 | India | -29,748 | 2019 EST. |
| 9 | Algeria | -22,100 | 2017 EST. |
| 10 | France | -18,102 | 2019 EST. |
| 11 | Colombia | -13,748 | 2019 EST. |
| 12 | Lebanon | -12,370 | 2017 EST. |
| 13 | Romania | -11,389 | 2019 EST. |
| 14 | Chile | -10,933 | 2019 EST. |
| 15 | Oman | -10,760 | 2017 EST. |
| 16 | South Africa | -10,626 | 2019 EST. |
| 17 | Egypt | -8,915 | 2019 EST. |
| 18 | Kazakhstan | -7,206 | 2019 EST. |
| 19 | Pakistan | -7,143 | 2019 EST. |
| 20 | New Zealand | -6,962 | 2019 EST. |

# Exchange Rate

- In finance, an exchange rate is the rate at which one currency will be exchanged for another currency. Currencies are most commonly national currencies, but may be sub-national as in the case of Hong Kong or supra-national as in the case of the euro.
- The exchange rate is also regarded as the value of one country's currency in relation to another currency. For example, an interbank exchange rate of 131 Japanese yen to the United States dollar means that ¥131 will be exchanged for US$1 or that US$1 will be exchanged for ¥131. In this case it is said that the price of a dollar in relation to yen is ¥131, or equivalently that the price of a yen in relation to dollars is $1/131.

# Exchange rate regime

- Floating (or flexible) exchange rate regime exist where exchange rates are determined solely by market forces and often manipulated by open-market operations. Countries do have the ability to influence their floating currency from activities such as buying/selling currency reserves, changing interest rates, and through foreign trade agreements.
- Fixed (or pegged) exchange rate regimes, exist when a country sets the value of its home currency directly proportional to the value of another currency or commodity. For years many currencies were fixed (or pegged) to gold. If the value of gold rose, the value of the currency fixed to gold would also rise. Today, many currencies are fixed (pegged) to floating currencies from major nations. Many countries fixed their currency value to the U.S. Dollar, the Euro, or the British Pound.

# Exchange rate regimes

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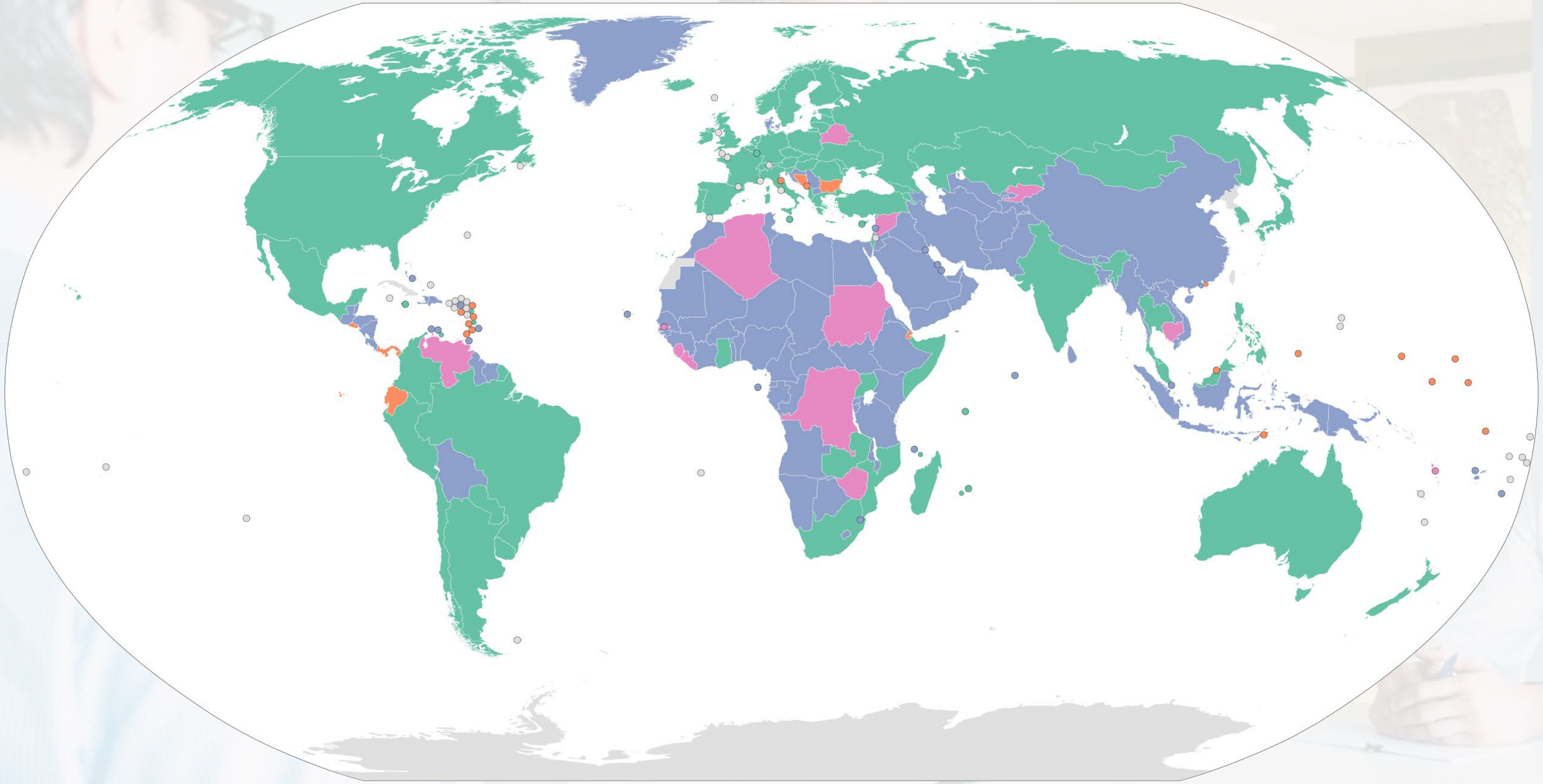
| SN | Regime type | Regime | Example |
|---|---|---|---|
| 1 | Floating rate | Free float | No example. |
| 2 | | Managed/Dirty float | US Dollar |
| 3 | Intermediate rate | Band (Target zone) | European monetary system |
| 4 | | Crawling peg | |
| 5 | | Crawling band | |
| 6 | | Currency basket peg | |
| 7 | Fixed exchange rate | Currency board | Gold standard |
| 8 | | Dollarization | |
| 9 | | Currency union | |

# De facto exchange-rate arrangements in 2018 as classified by the International Monetary Fund.



- Floating (*floating* and *free floating*)
- Soft pegs (*conventional peg*, *stabilized arrangement*, *crawling peg*, *crawl-like arrangement*, *pegged exchange rate within horizontal bands*)
- Hard pegs (*no separate legal tender*, *currency board*)
- Residual (*other managed arrangement*)

# Real exchange rate

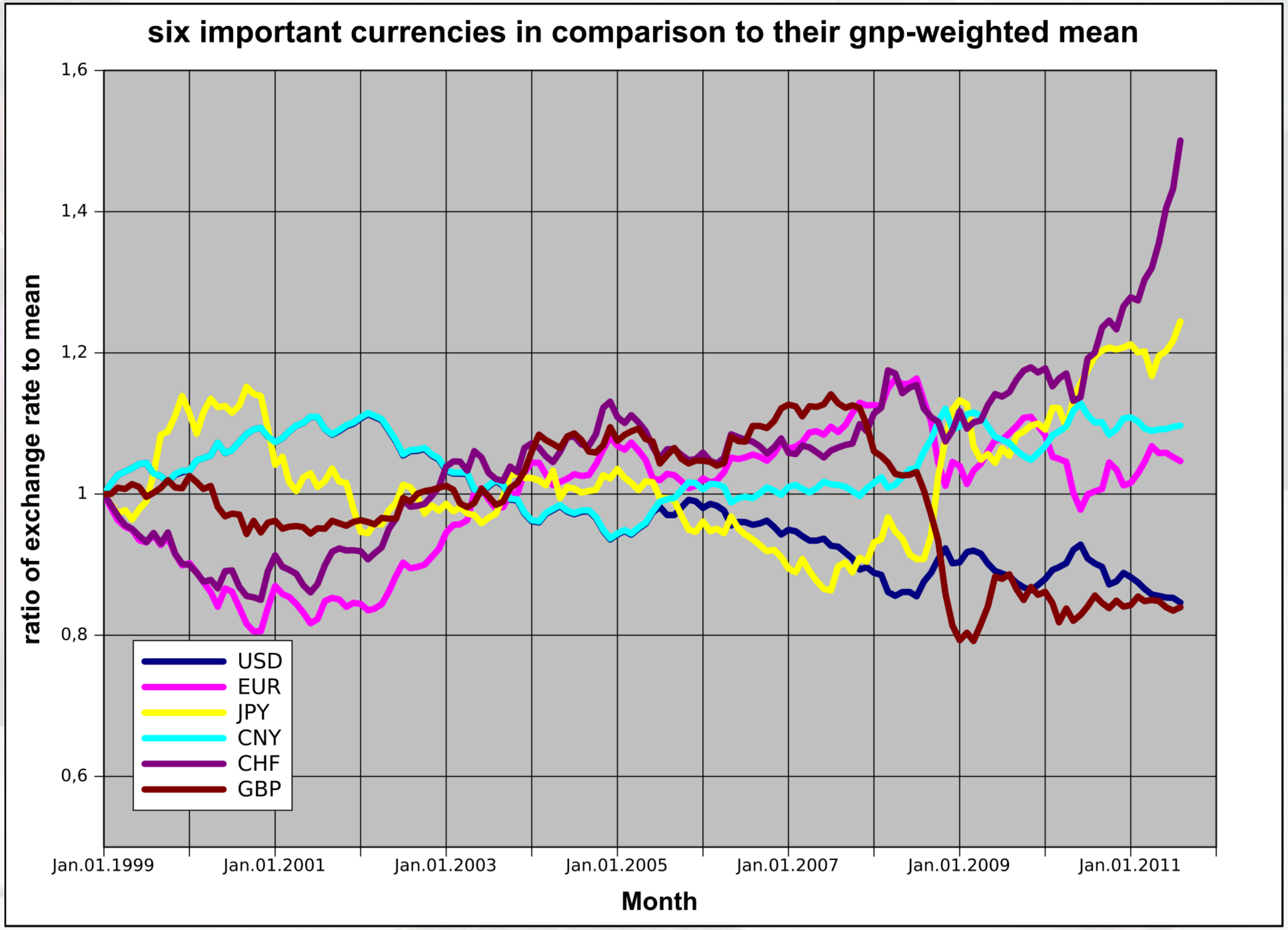
- The Real Exchange Rate (RER) represents the nominal exchange rate adjusted by the relative price of domestic and foreign goods and services, thus reflecting the competitiveness of a country with respect to the rest of the world.
- More in detail, an appreciation of the currency or a high level of domestic inflation reduces the RER, thus reducing the country's competitiveness and lowering the Current Account (CA). On the other hand, a currency depreciation generates an opposite effect, improving the country's CA.

# Bilateral vs. effective exchange rate

- Bilateral exchange rate involves a currency pair, while an effective exchange rate is a weighted average of a basket of foreign currencies, and it can be viewed as an overall measure of the country's external competitiveness.
- A nominal effective exchange rate (NEER) is weighted with the inverse of the asymptotic trade weights. A real effective exchange rate (REER) adjusts NEER by appropriate foreign price level and deflates by the home country price level.
- Compared to NEER, a GDP weighted effective exchange rate might be more appropriate considering the global investment phenomenon.

# GDP weighted effective exchange rate

- Example of GNP-weighted nominal exchange rate history of a basket of 6 important currencies (US Dollar, Euro, Japanese Yen, Chinese Renminbi, Swiss Franks, Pound Sterling



# Interest rate parity

- Interest rate parity is a no-arbitrage condition representing an equilibrium state under which investors interest rates available on bank deposits in two countries.
- The fact that this condition does not always hold allows for potential opportunities to earn riskless profits from covered interest arbitrage.
- Two assumptions central to interest rate parity are capital mobility and perfect substitutability of domestic and foreign assets.
- Given foreign exchange market equilibrium, the interest rate parity condition implies that the expected return on domestic assets will equal the exchange rate-adjusted expected return on foreign currency assets.
- Investors then cannot earn arbitrage profits by borrowing in a country with a lower interest rate, exchanging for foreign currency, and investing in a foreign country with a higher interest rate, due to gains or losses from exchanging back to their domestic currency at maturity.

# Uncovered interest rate parity

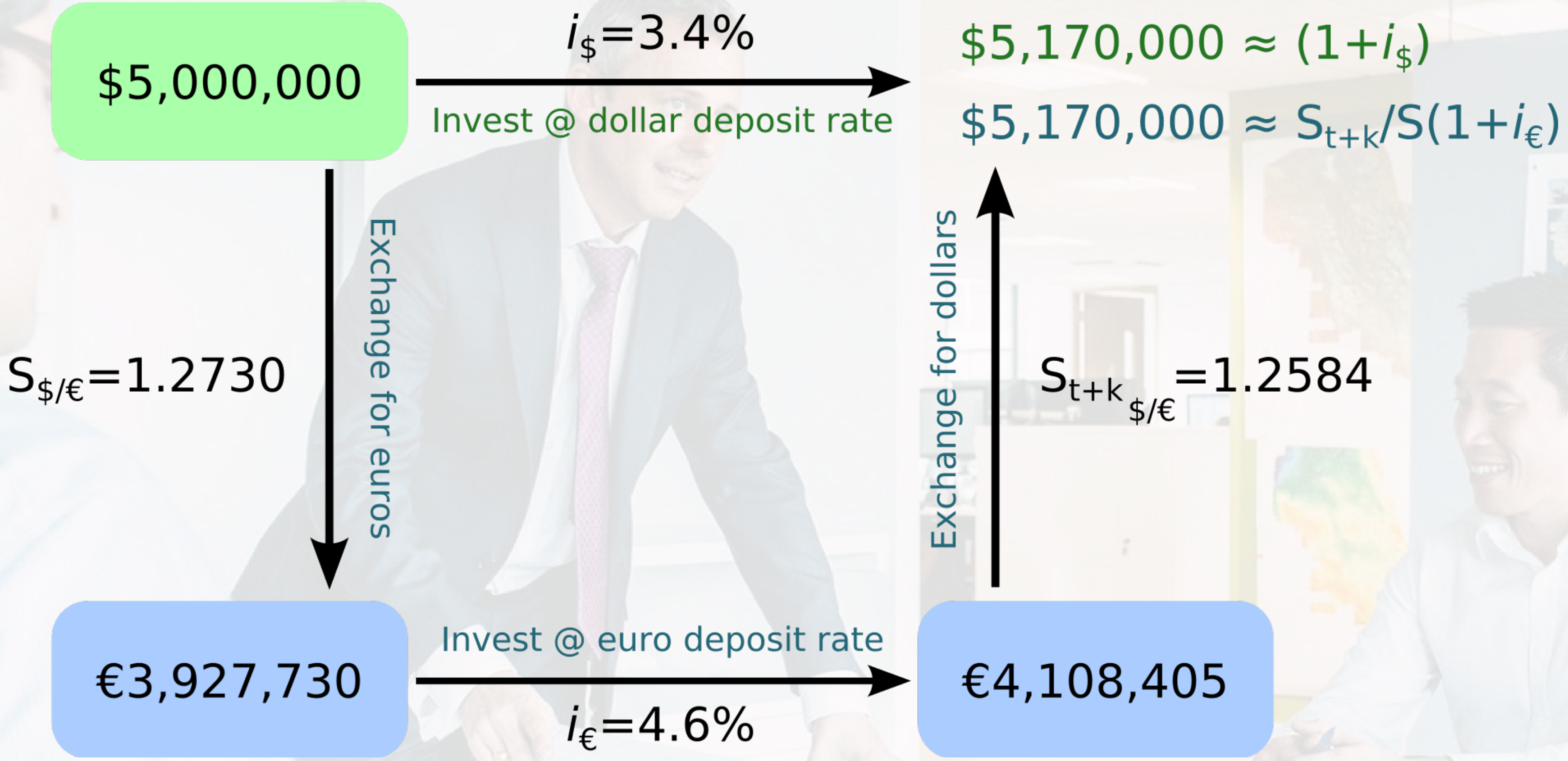
When the no-arbitrage condition is satisfied without the use of a forward contract to hedge against exposure to exchange rate risk, interest rate parity is said to be uncovered.

$$1 + i_{\$} = \frac{E_t(S_{t+k})}{S_t}(1 + i_c)$$

where

- $E_t(S_{t+k})$ is the expected future spot exchange rate at time t + k
- $k$ is the number of periods into the future from time t
- $S_t$ is the current spot exchange rate at time t
- $i_{\$}$ is the interest rate in one country (for example, the United States)
- $i_c$ is the interest rate in another country or currency area (for example, the Eurozone)

# Uncovered interest rate parity




A visual representation of uncovered interest rate parity holding in the foreign exchange market, such that the returns from investing domestically are equal to the returns from investing abroad.

# Covered interest rate parity

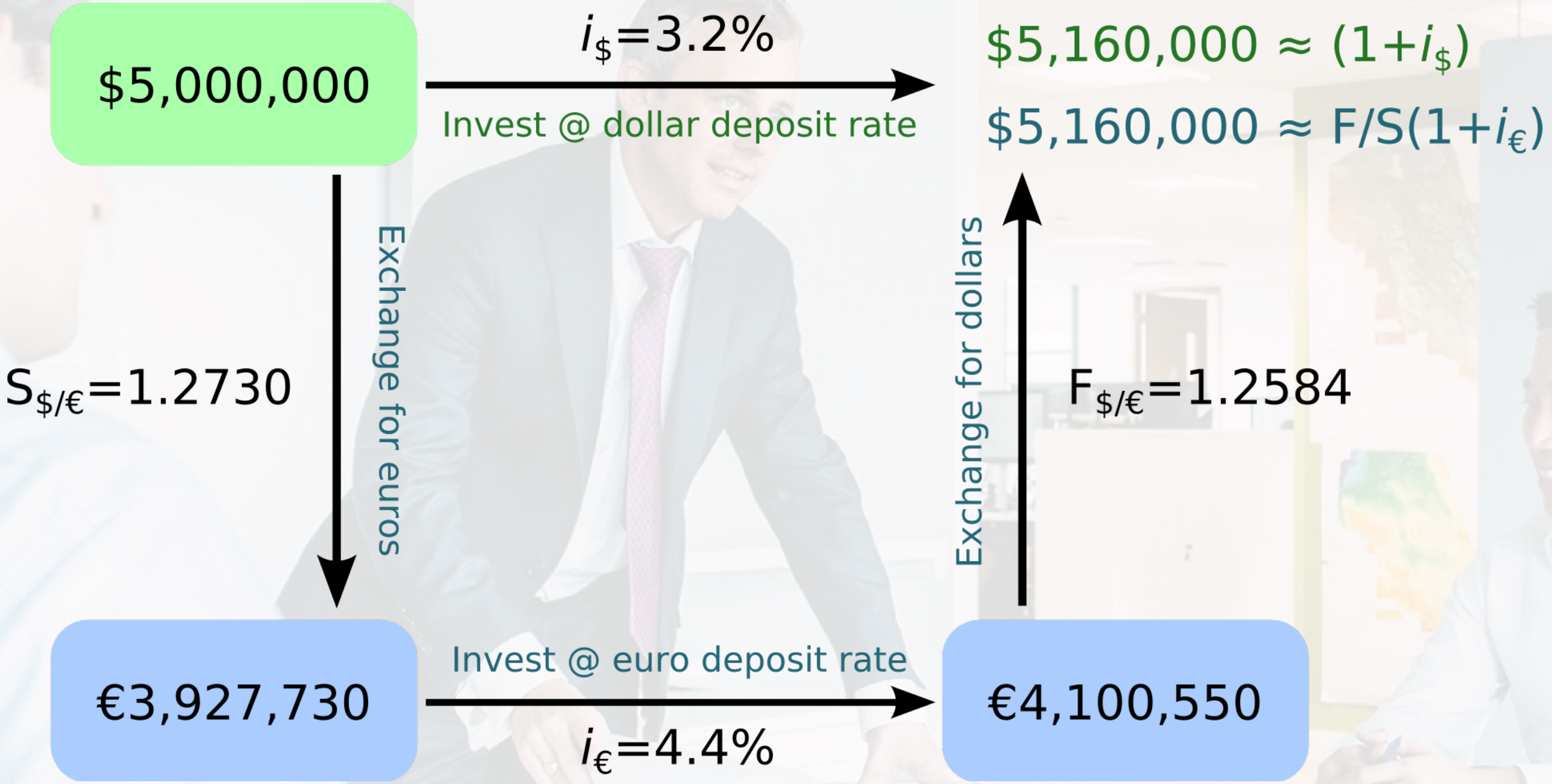
When the no-arbitrage condition is satisfied with the use of a forward contract to hedge against exposure to exchange rate risk, interest rate parity is said to be covered. Investors will still be indifferent among the available interest rates in two countries because the forward exchange rate sustains equilibrium such that the dollar return on dollar deposits is equal to the dollar return on foreign deposit, thereby eliminating the potential for covered interest arbitrage profits.

$$1 + i_{\$} = \frac{F_t}{S_t}(1 + i_c)$$

where

- $F_t$ is the forward exchange rate at time t
- The dollar return on dollar deposits, $1 + i_{\$}$ is shown to be equal to the dollar return on euro deposits, $\frac{\mathrm{F_t}}{\mathrm{S_t}}(1 + i_c)$.

# Covered interest rate parity




A visual representation of covered interest rate parity holding in the foreign exchange market, such that the returns from investing domestically are equal to the returns from investing abroad.

# Section 3
# Development Strategies in Trade

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# What is globalization

- Globalization is the process of international integration arising from the interchange of world views, products, ideas, and other aspects of culture.
- Advances in transportation and in telecommunications infrastructure have been major factors in globalization, generating further interdependence of economic and cultural activities.
- Large-scale globalization began in the 19th century. In the late 19th century and early 20th century, the connectivity of the world's economies and cultures grew very quickly.
- The term globalization is recent, only establishing its current meaning in the 1970s. In 2000, the IMF identified four basic aspects of globalization: trade and transactions, capital and investment movements, migration and movement of people, and the dissemination of knowledge.

# Background

- Early Days
  - In the early days of the People's Republic of China, from 1949 through 1960, China dramatically reoriented its trade away from the Pacific and toward the Soviet Union.
  - Although the traditional Pacific trade was shut down, China remained open to trade and aid, which now came almost entirely from the Soviet bloc. More than two-thirds of China's trade between 1952 and 1960 was with Communist Party–led countries, and 48% was with the Soviet Union alone.
- Economic Isolationism
  - The break with the Soviet Union after 1960 meant the virtual end of trading relations with China's biggest trade partner. Imports from the Soviet Union dropped sharply, and by 1970, trade with the Soviet Union accounted for only 1% of total Chinese trade.

# Foreign trade reform

- The initial stage (1978-1991)
  - Administrative decentralization of trade planning, foreign exchange retention, the foreign trade contract responsibility system, adoption of a more realistic exchange rate
- The second stage (1992-2000)
  - Quantitative important restrictions and tariffs
- The third stage (post-WTO accession)
  - Regulations and laws; tariffs; non-tariff barriers; trade-related investment measures; trade-related intellectual property rights; trade in services
- The fourth stage (2017-)
  - De-globalization and trade wars

# Dates of establishment of diplomatic relations with the People's Republic of China

- Upon its establishment in 1949, the People's Republic of China was recognized by Eastern Bloc countries. On 4 January 1950, Pakistan became the first Muslim country to recognize China.
- Among the first Western countries to recognize China were the United Kingdom (6 January 1950), Switzerland (17 January 1950) and Sweden (14 February 1950).
- The first Western country to establish diplomatic ties with China was Sweden (on 9 May 1950). Until the early 1970s, the Republic of China government in Taipei was recognized diplomatically by most world powers and held China's permanent seat in the UN Security Council, including its associated veto power.
- After the Beijing government assumed the China seat in 1971 (and the ROC government was expelled), the great majority of nations have switched diplomatic relations from the Republic of China to the People's Republic of China. Japan established diplomatic relations with the PRC in 1972, following the Joint Communiqué of the Government of Japan and the Government of the People's Republic of China, and the U.S. did so in 1979.

# Exports and imports (share of GDP).
# Sources: SYC, updated from General Administration of Customs.

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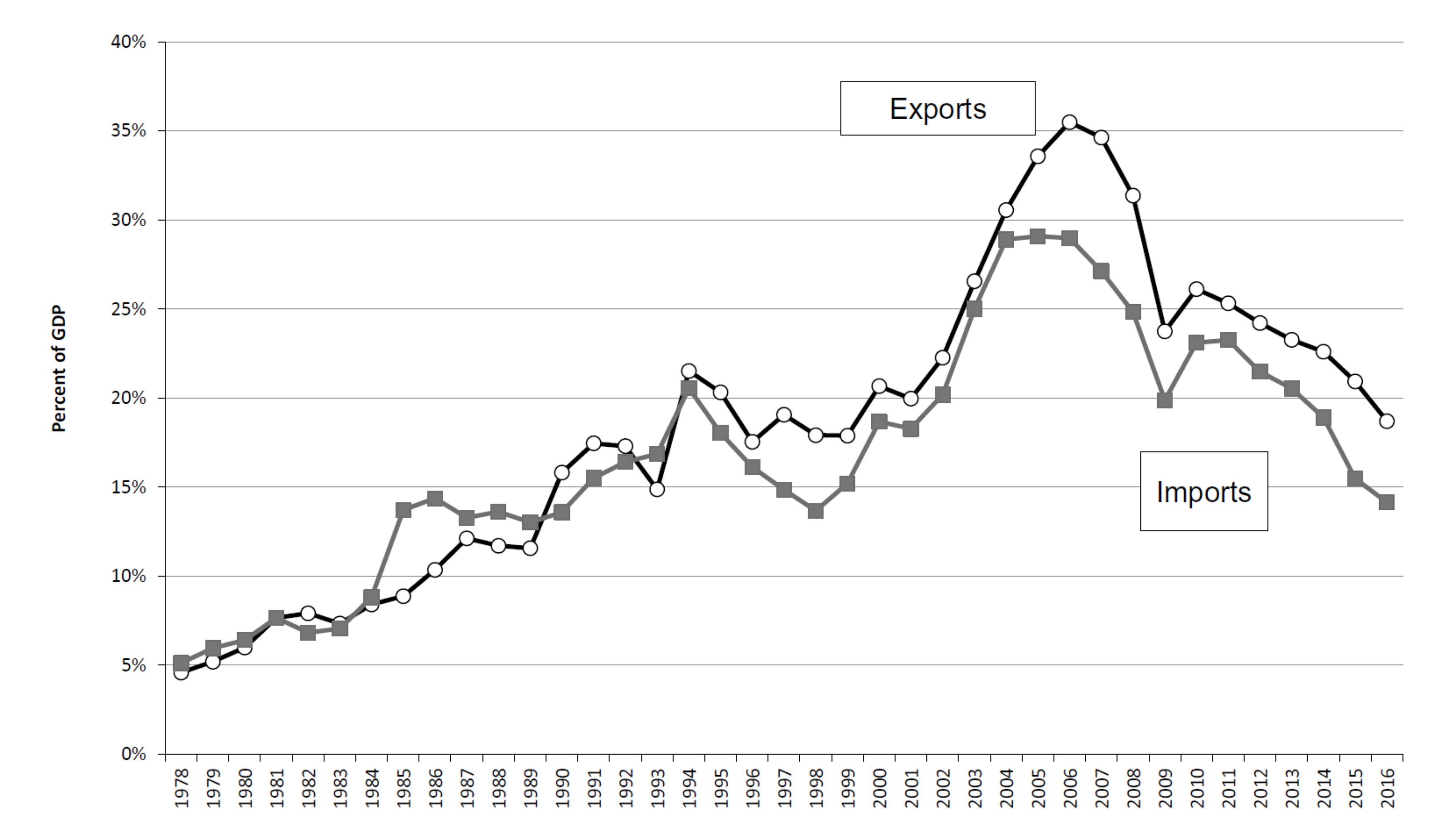
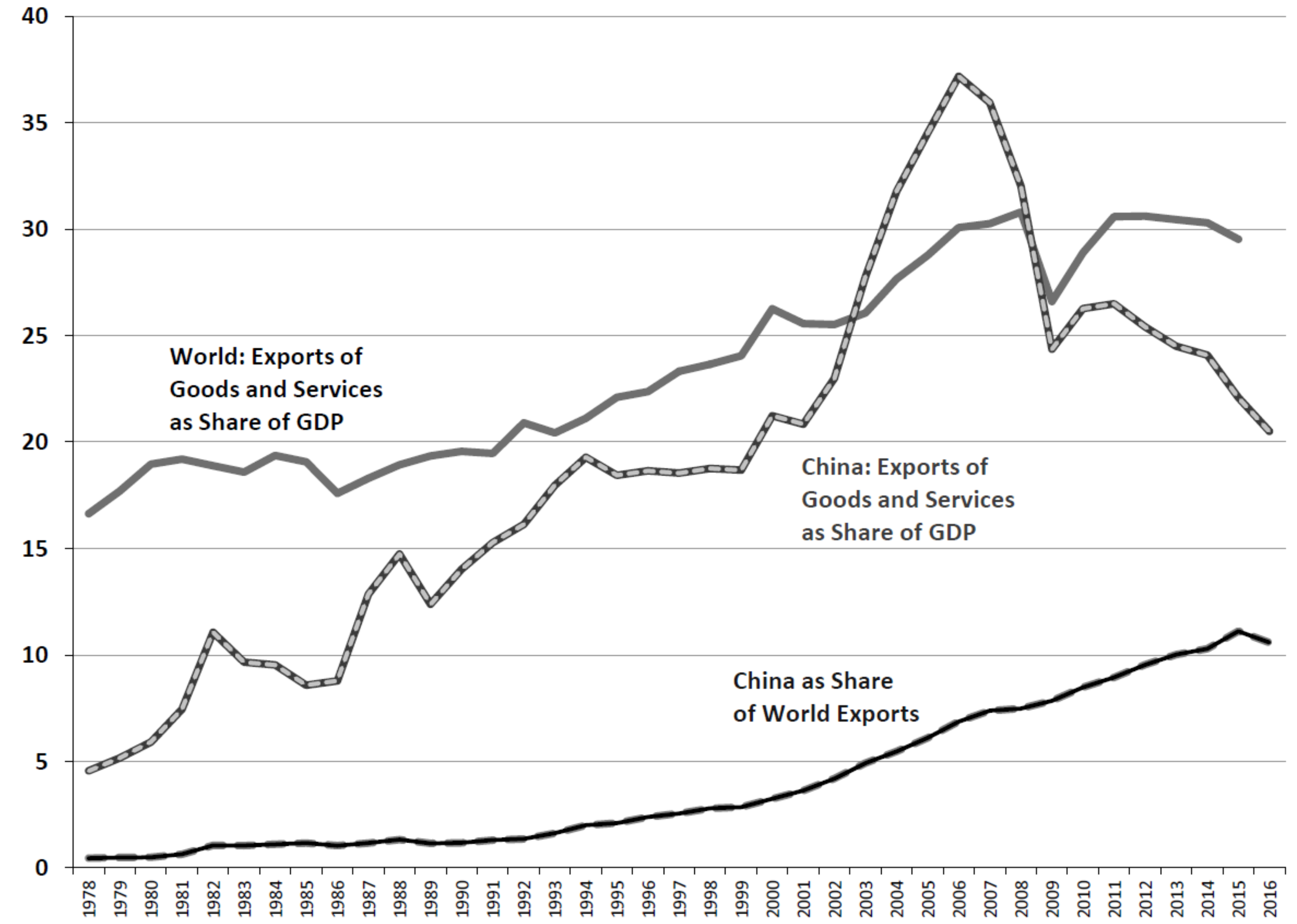


# China's exports in global context.
# Source: World Bank, World Development Indicators (WDI).



# Reforming the Trade System

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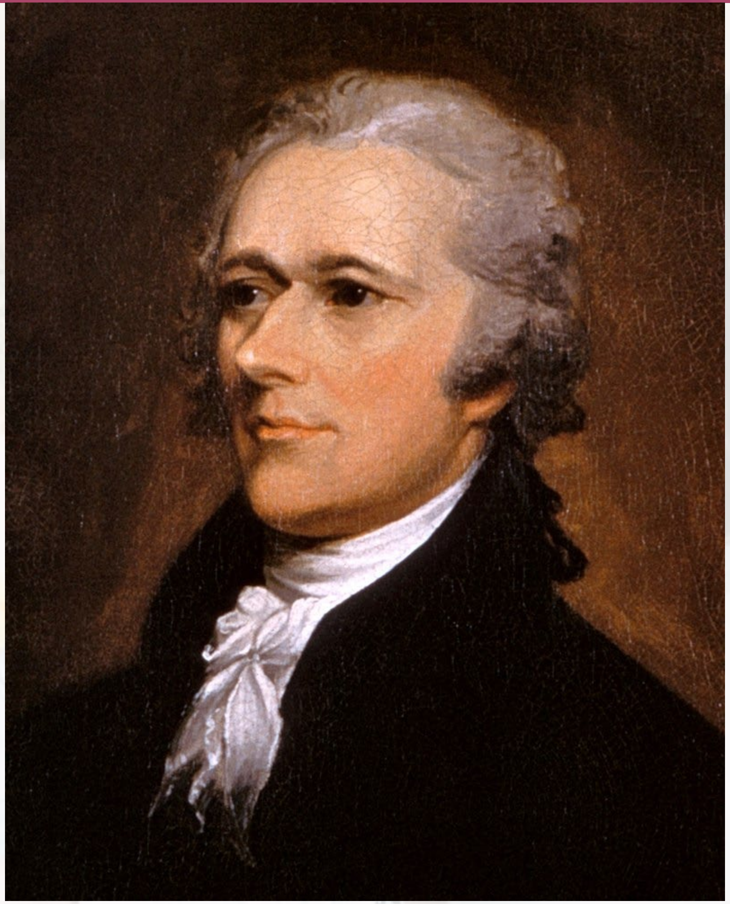
- The Challenge
  - The foreign-trade system that Chinese leaders sought to reform in the late 1970s was a typical Soviet-style command-economy trading system that had been adapted to serve China's economic isolation.
  - Twelve national foreign-trade companies (FTCs) exercised monopolies over both imports and exports. Only authorized goods were allowed to pass through this layer of control. The second air lock was the foreign-exchange system.
  - The value of the Chinese currency (the renminbi, RMB, or yuan) was set arbitrarily, and it was not convertible.
- The double-air-lock system was designed to insulate the domestic economy from the world economy while allowing a few key commodities to pass through the air locks.

# Import-substitution-industrialization

- The socialist price system is an extreme version of the price relationships created by the common "import-substitution-industrialization"
- (ISI) development strategy. In ISI strategies, developing countries erect barriers against industrial imports, thereby protecting their new industries and (they hope) fostering industrialization. In China as well, one of the functions of the traditional foreign-trade system was to protect state-owned industries.

# Infant industry argument

- The infant industry argument is an economic rationale for trade protectionism.
- The core of the argument is that nascent industries often do not have the economies of scale that their older competitors from other countries may have, and thus need to be protected until they can attain similar economies of scale.
- The logic underpinning the argument is that trade protectionism is costly in the short run but leads to long-term benefits.



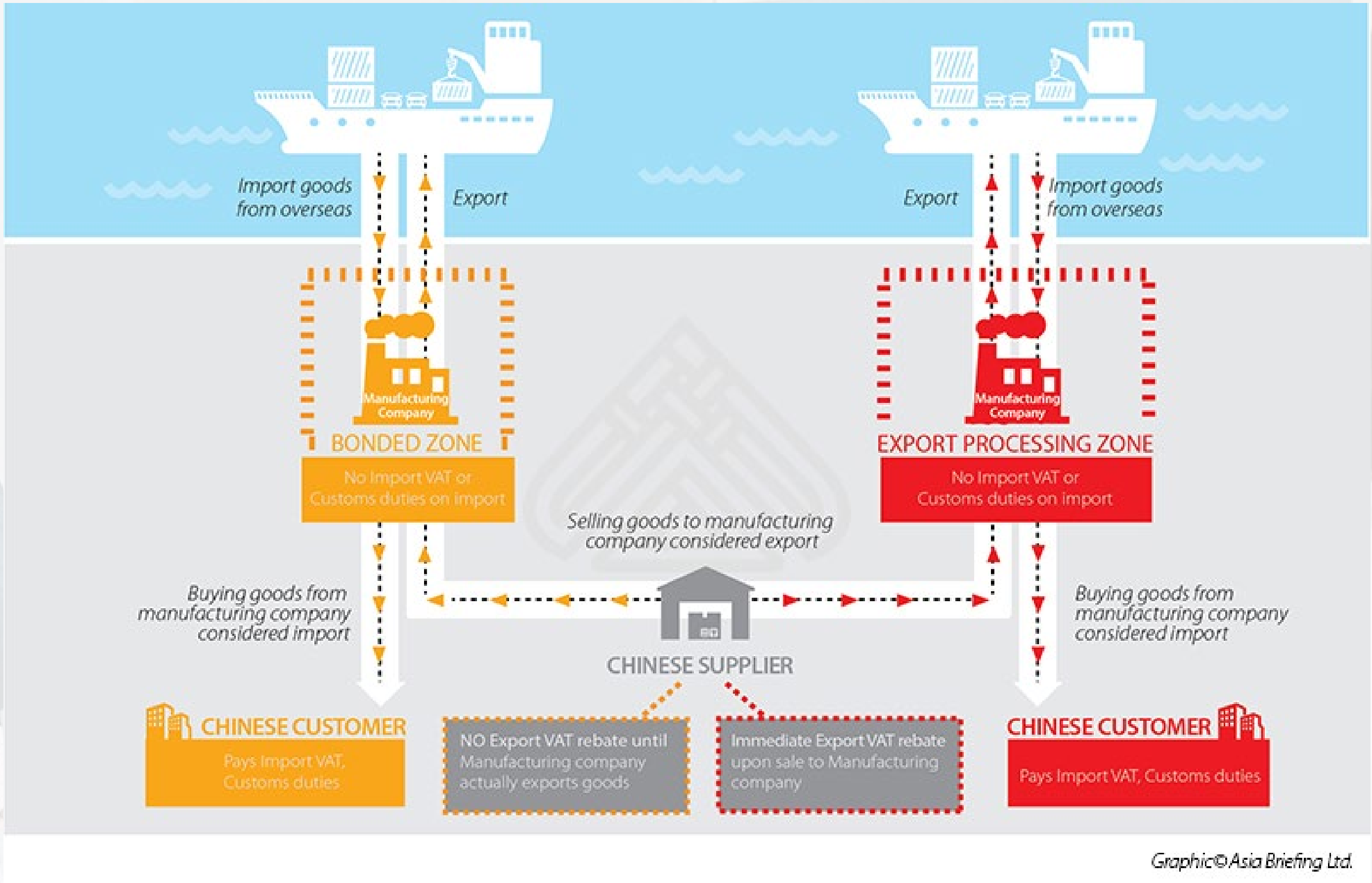
Alexander Hamilton first codified the infant industry argument.

# Initial Reform Steps

- Chinese policy-makers initially took modest but innovative steps to open up new trade channels in the southern provinces of Guangdong and Fujian in 1978–1979.
- The objective was to make use of the proximity of these provinces to Hong Kong and, to a lesser extent, Taiwan.
- China's first step in opening came in 1978 when Hong Kong businesses were allowed to sign export-processing (EP) contracts with Chinese firms in the Pearl River delta.
- Shortly thereafter, four special economic zones (SEZs) were set up in Guangdong and Fujian. The SEZs—described more fully in chapter 17—gave foreign businesses a foothold for their EP trade.

# Export Processing

- An Export Processing Zone (EPZ) is a Customs area where one is allowed to import plant, machinery, equipment and material for the manufacture of export goods under security, without payment of duty.



# Huaqiangbei

- Huaqiangbei (Chinese: 华强北; lit. 'Huaqiang North') is a subdistrict of Futian, Shenzhen, Guangdong Province, China, one of Shenzhen's notable retail areas, having one of the largest electronics markets in the world.
- The area's status as a major electronics manufacturing hub, and sprawling electronics marketplaces have earned it (and Shenzhen) occidental nicknames such as "China's Silicon Valley", and the "Silicon Valley of Hardware". Multiple malls contain various businesses.

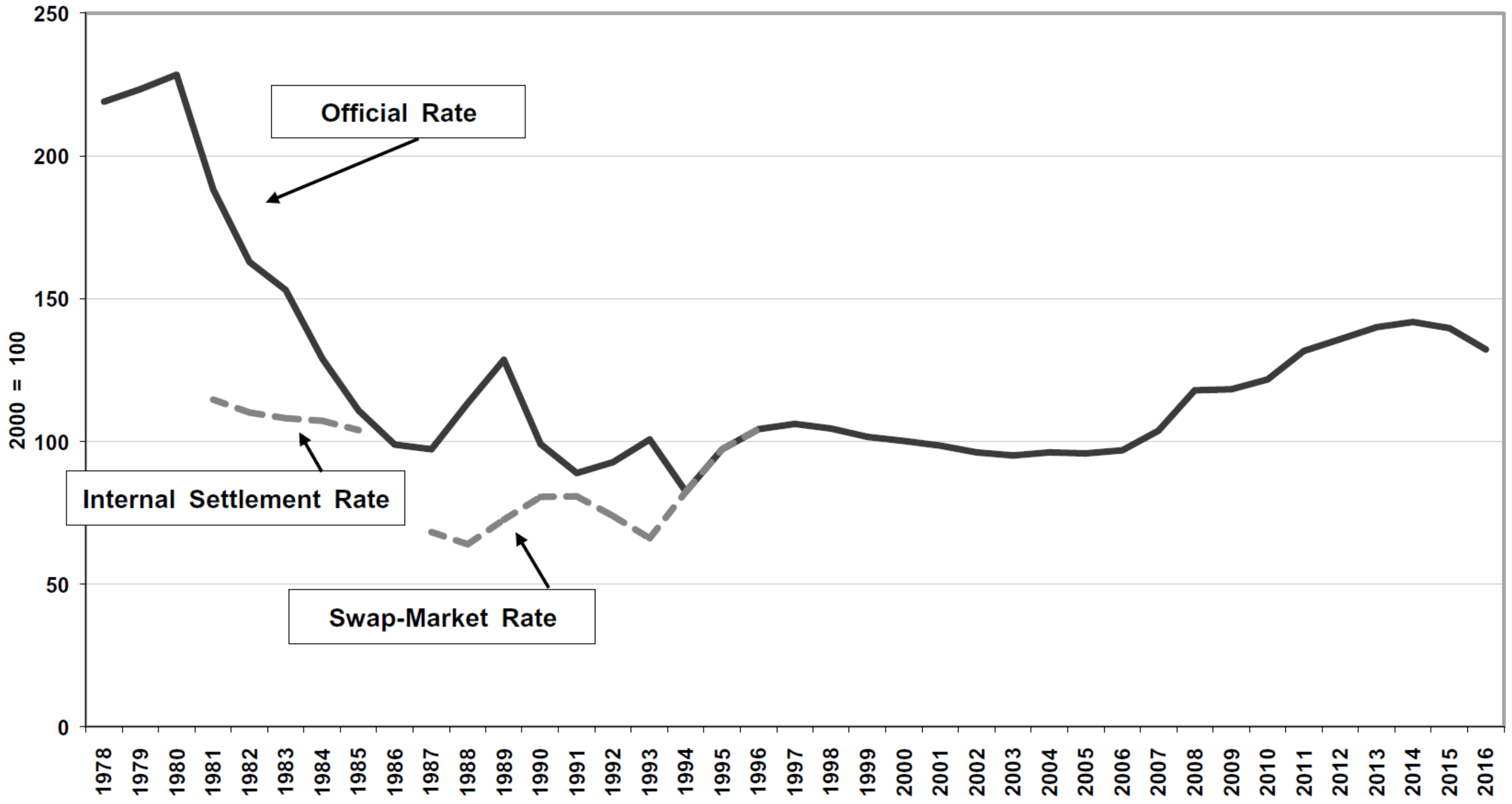
# Liberalizing the Foreign-Trade System

Despite some occasional missteps (imports surged more than 50% in 1985), between 1984 and 1986, reformists created a provisional modified trade system. There were four key elements:

- setting a realistic exchange rate,
- demonopolizing the trading system,
- liberalizing import prices, and
- setting up a normal tariff system.

Within a few years, they had transformed the rules for trade, largely dismantled the old foreign-trade monopoly, and created a framework for the subsequent growth of trade and investment. The policy stages in this transformation are worth noting:

# Devaluation




- Real dollar value of the renmibi (2000 = 100).
- Sources: Annual nominal RMB/USD rate, deflated by the Chinese CPI and U.S. implicit GDP deflator;
- SYC and Saint Louis Federal Reserve Bank.

# Demonopolization of the foreign-trade regime

- The number of companies authorized to engage in foreign trade was allowed to expand dramatically.
- Industrial ministries were allowed to set up FTCs; the provincial branches of the former national foreign-trade monopolies became independent; and many local governments and SEZs set up trading companies.
- By 1988, there were 5,000 FTCs, every single one of which was state owned. Direct export and import rights were also granted to some 10,000 manufacturing enterprises.

# Pre-reform trade regime

- The State Planning Commission
- The export plan was quite comprehensive, specifying the physical quantities of more than 3,000 individual commodities
- China's trade volume declined from 1.5% of the world trade in 1953 to 0.6% in 1977

Table 16.1. *Growth in companies authorized to conduct foreign trade*

| Year | Number of companies |
|---|---|
| 1978 | 12 |
| 1985 | 800 |
| 1986 | >1,200 |
| 1988 | >5,000 |
| 1996 | 12,000 |
| 1997 | 15,000 |
| 1998 | 23,000 |
| 1999 | 29,528 |
| 2000 | 31,000 |
| 2001 | 35,000 |

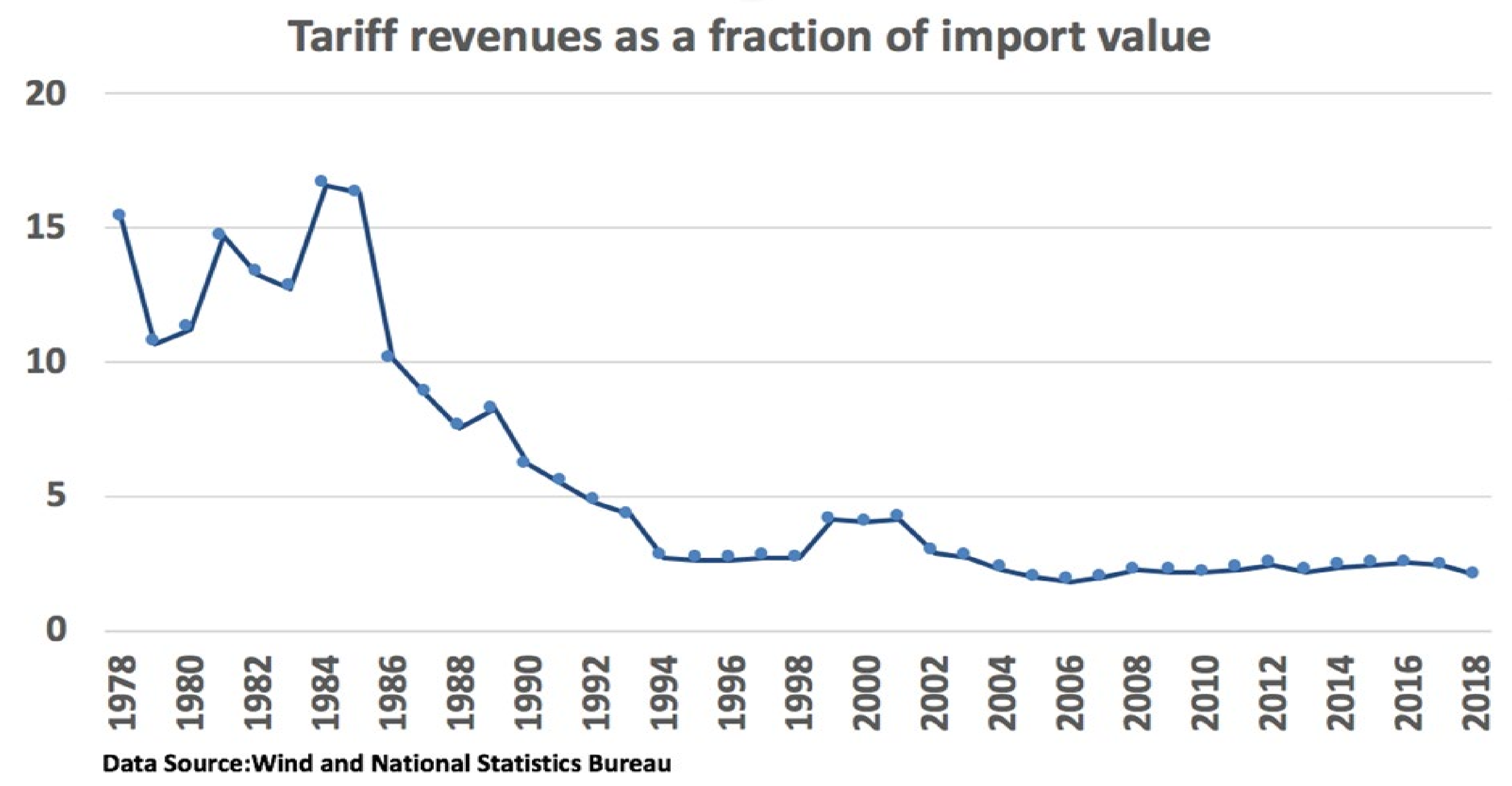
# Liberalizing prices

- World prices were gradually allowed to influence domestic prices.
- On the export side, competing FTCs became much more cost sensitive: exporting predominantly on their own account, FTCs recontracted with domestic enterprises in an effort to lower costs.
- FTCs sought out cheap producers of labor-intensive goods, which were often township and village enterprises (TVEs).
- The share of exports produced by TVEs increased rapidly, accounting for one-fifth of procurements by FTCs by the mid-1990s.

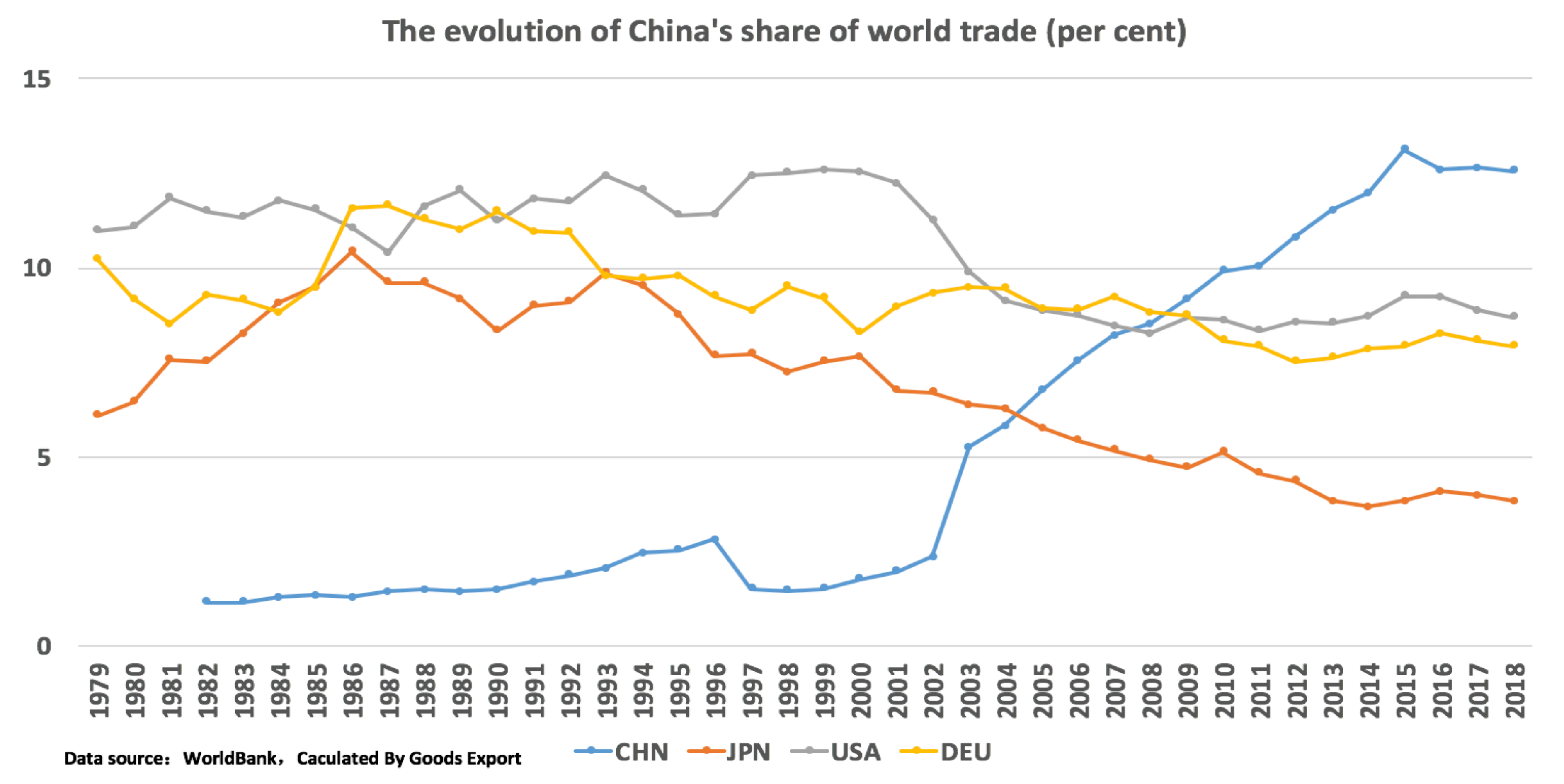
# A system of tariffs and nontariff barriers

- Chinese reformers proceeded cautiously. They were wary of making mistakes and afraid of import surges, trade deficits, and hard-currency debt.
- Therefore, even as reformers dismantled the planned trade system, they erected high tariff walls and substantial nontariff barriers to maintain a degree of protection of the domestic market.

# Trade liberalization



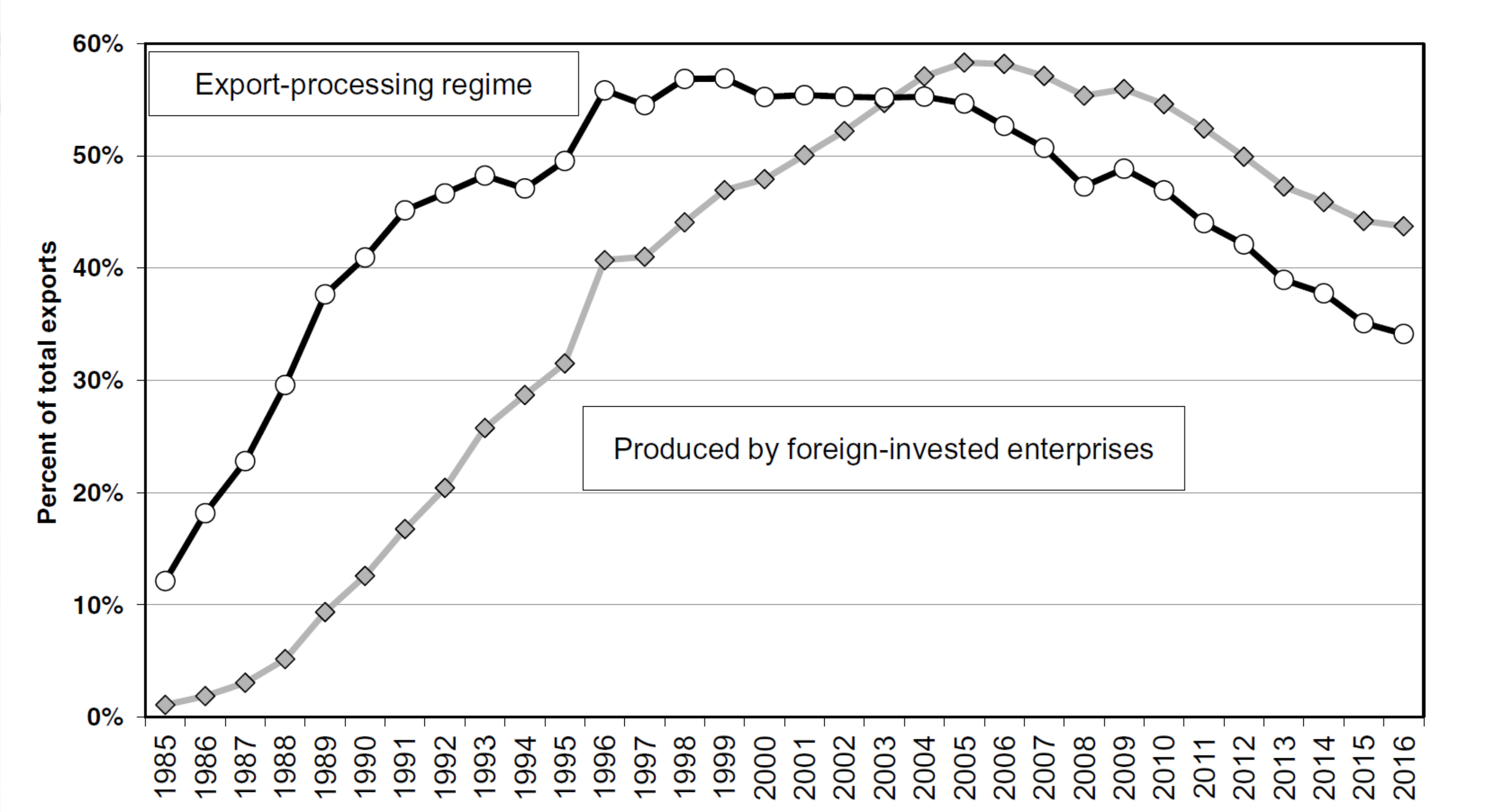
# Trade liberalization



# One country, two systems

- Special privileges extended to firms involved in export processing, which were set up in 1979
- In 1987, the government expanded the incentives to provide for duty-free import of all raw materials, parts, and components used in the production of goods for export (especially for FDI firms)
- By the mid-1980s, China had two trade regimes – a very open one for foreign firms and domestic enterprises engaged in export processing and a more restrictive trade regime for all other enterprises
- Potential problems of the 'dual-track' trade regime: 'trade diversion' from domestic firms and protection from foreign competition

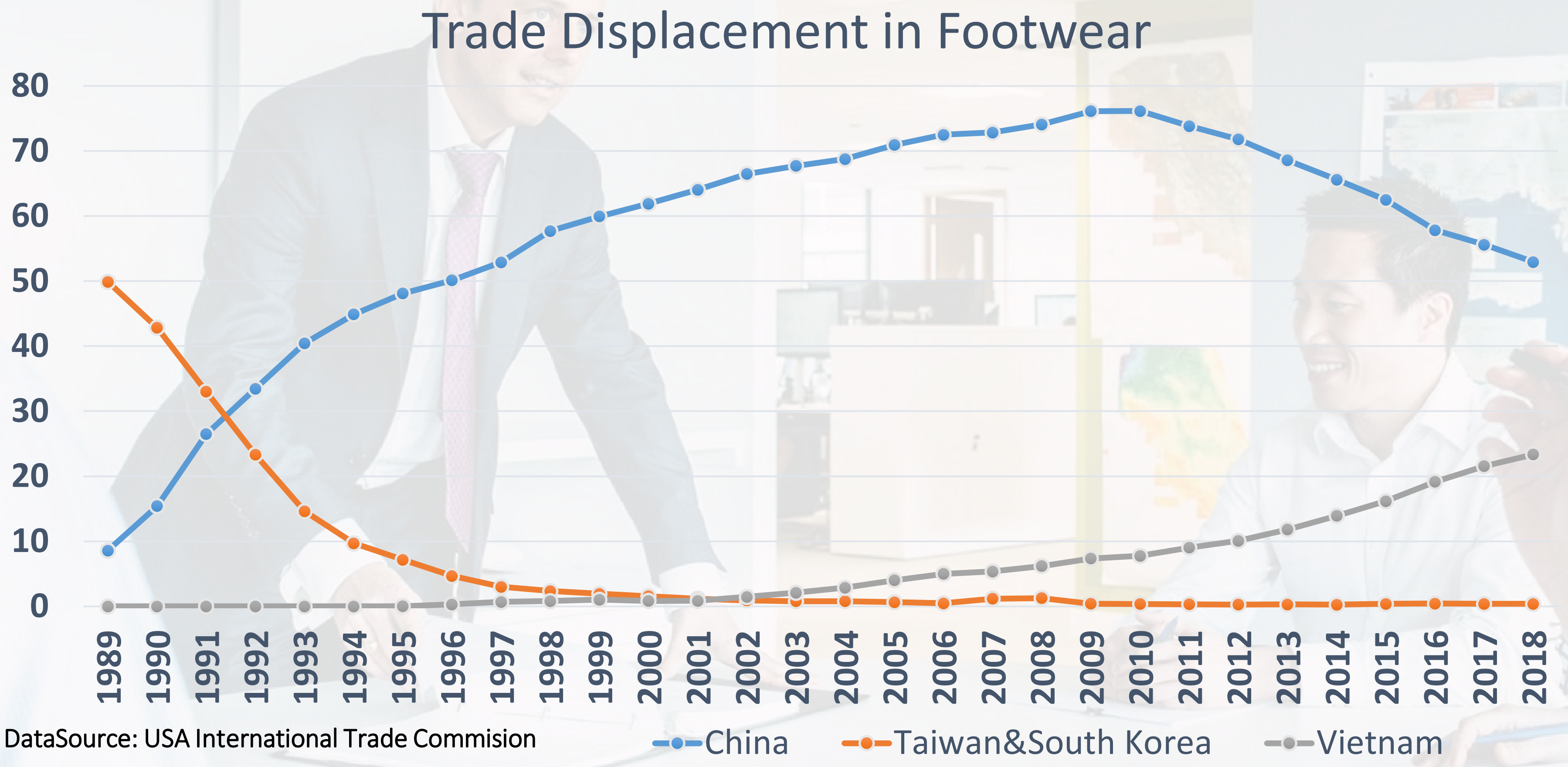
# Share of exports from export-processing regime and foreign-invested enterprises. Source: General Administration of Customs.



# “Leakage” of the dualism

- Substantial quantities of parts and components imported on a duty-free basis have been illegally sold in the domestic market
- Despite China’s virtual ban on imports of U.S. citrus products, U.S. oranges and other fruits were widely available from vendors on street corners in cities throughout China in the 1990s

# Footwear exports by China and Korea/Taiwan




DataSource: USA International Trade Commision

# The Impact of China's WTO Membership

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- WTO accession provoked substantial anxiety among Chinese policy-makers and, to a certain extent, the Chinese public.
- There were worries about whether Chinese industries were competitive with sophisticated foreign firms, and whether Chinese agriculture could withstand an onslaught of imported food.
- These worries turned out to be unfounded. Chinese industry responded well to the competitive challenge of import liberalization, and even the automobile industry (the focus of many fears) entered a golden age of expansion after WTO membership.

# 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% |

Sources: China Customs Statistics (1995, 12; 2005, 12); General Administration of Customs.

# Progresses

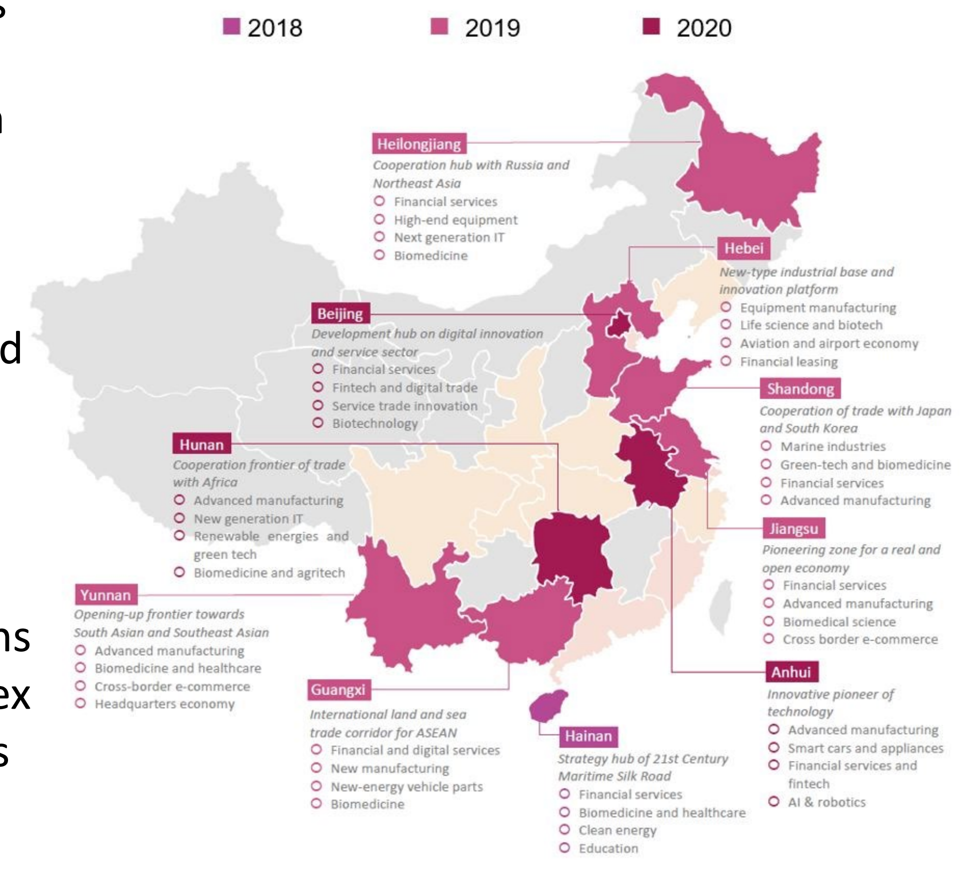
- China achieved a great degree of openness to foreign trade in manufacturing ahead of the WTO accession
- Additional openings mandated under the WTO accession agreement would probably make China the most open of any large developing country
- Development of China's trade and investment generally conformed to its pattern of comparative advantage
- China's current exchange rate regime is no longer compatible with its macroeconomic fundamentals
- Where will the US-China trade war likely take us?

# Comparative advantage

- “You do what you do best, in relative terms.”
- Comparative advantage is not absolute advantage
- Comparative advantage, division of labor and scale efficiency

# Regional Inequality and Industrial Agglomeration

- Industrial agglomeration refers to the concentration of industrial activities in a specific geographic area. It occurs when firms in similar industries cluster together, often in close proximity to each other. This clustering can be driven by various factors, such as access to inputs and resources, labor market advantages, knowledge spillovers, and economies of scale.
- Researchers have developed various theories and models to explain industrial agglomeration patterns. Some prominent theories include Alfred Marshall's industrial district model, which emphasizes localized external economies; Michael Porter's cluster theory, which highlights the role of competitive advantage; and Paul Krugman's new economic geography model, which focuses on transportation costs.
- Empirical studies on industrial agglomeration often analyze spatial patterns using measures such as location quotient (LQ), Herfindahl-Hirschman Index (HHI), or employment density maps. Additionally, econometric techniques such as spatial regression models or gravity models are employed to examine the determinants and impacts of agglomeration on firm performance, productivity, innovation, and regional development.



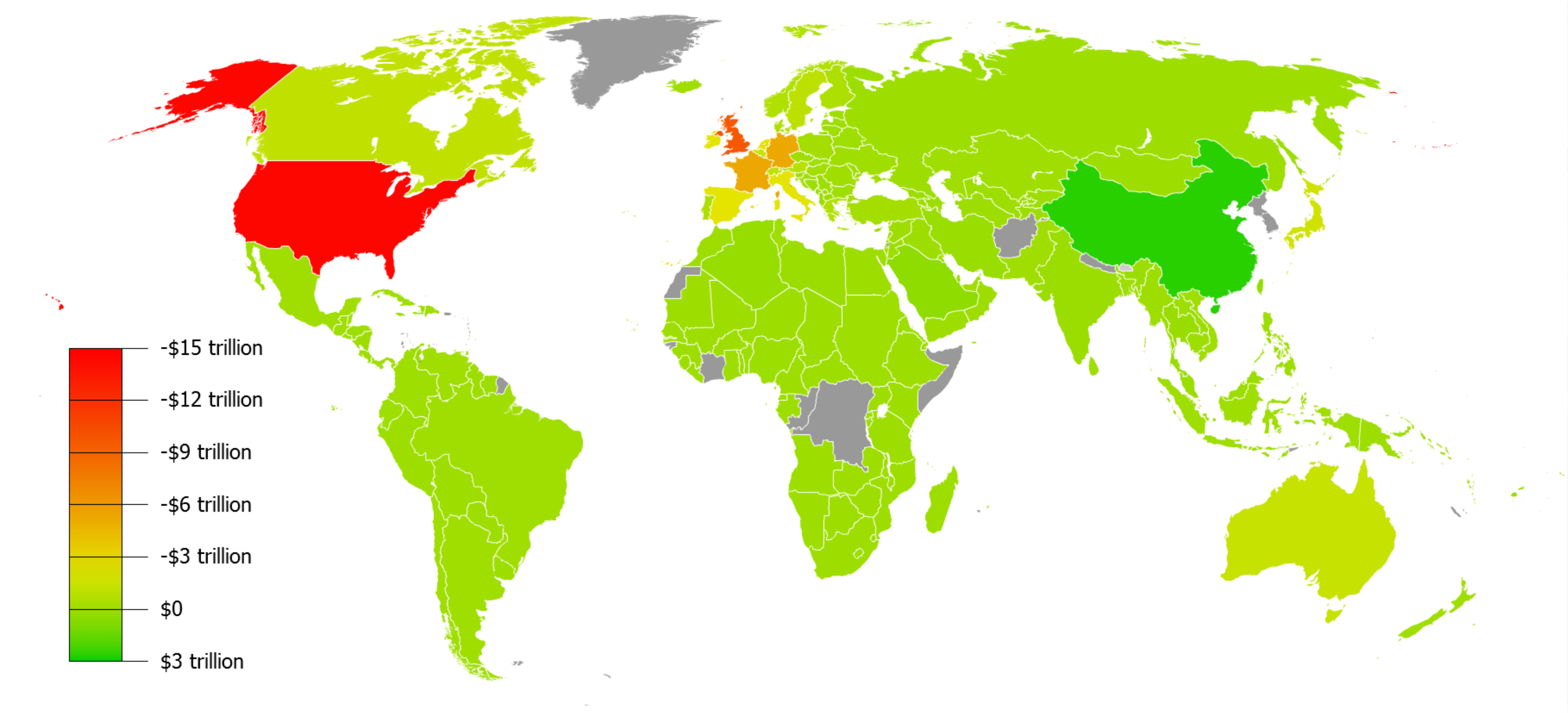
# Section 4 Foreign Investment and the Capital Account

# Trade and Flows of Factors

# Balance of payments

- In international economics, the balance of payments (also known as balance of international payments and abbreviated BOP or BoP) of a country is the difference between all money flowing into the country in a particular period of time (e.g., a quarter or a year) and the outflow of money to the rest of the world. These financial transactions are made by individuals, firms and government bodies to compare receipts and payments arising out of trade of goods and services.
- The balance of payments consists of two components: the current account and the capital account.
- The current account reflects a country's net income, while the capital account reflects the net change in ownership of national assets.

# Balance of payments




Country foreign exchange reserves minus external debt

# Balance of payments

- The balance of payments (BOP) is the record of all international financial transactions made by the residents of a country.
- There are three main categories of the BOP: the current account, the capital account, and the financial account.
- The current account is used to mark the inflow and outflow of goods and services into a country.
- The capital account is where all international capital transfers are recorded.
- In the financial account, international monetary flows related to investment in business, real estate, bonds, and stocks are documented.
- The current account should be balanced versus the combined capital and financial accounts, leaving the BOP at zero, but this rarely occurs.

# Formula for Balance of Payments

- What Is the Formula for Balance of Payments? The formula for calculating the balance of payments is:

$$\begin{gathered} current\ account\ + \\ capital\ account\ + \\ financial\ account\ + \\ balancing\ item\ =\ 0. \end{gathered}$$

An actual balance sheet will typically have numerous sub headings under the principal divisions. For example, entries under Current account might include:

- Trade – buying and selling of goods and services
  - Exports – a credit entry
  - Imports – a debit entry
    - Trade balance – the sum of Exports and Imports
- Factor income – repayments and dividends from loans and investments
  - Factor earnings – a credit entry
  - Factor payments – a debit entry
    - Factor income balance – the sum of earnings and payments.

# Current account (balance of payments)

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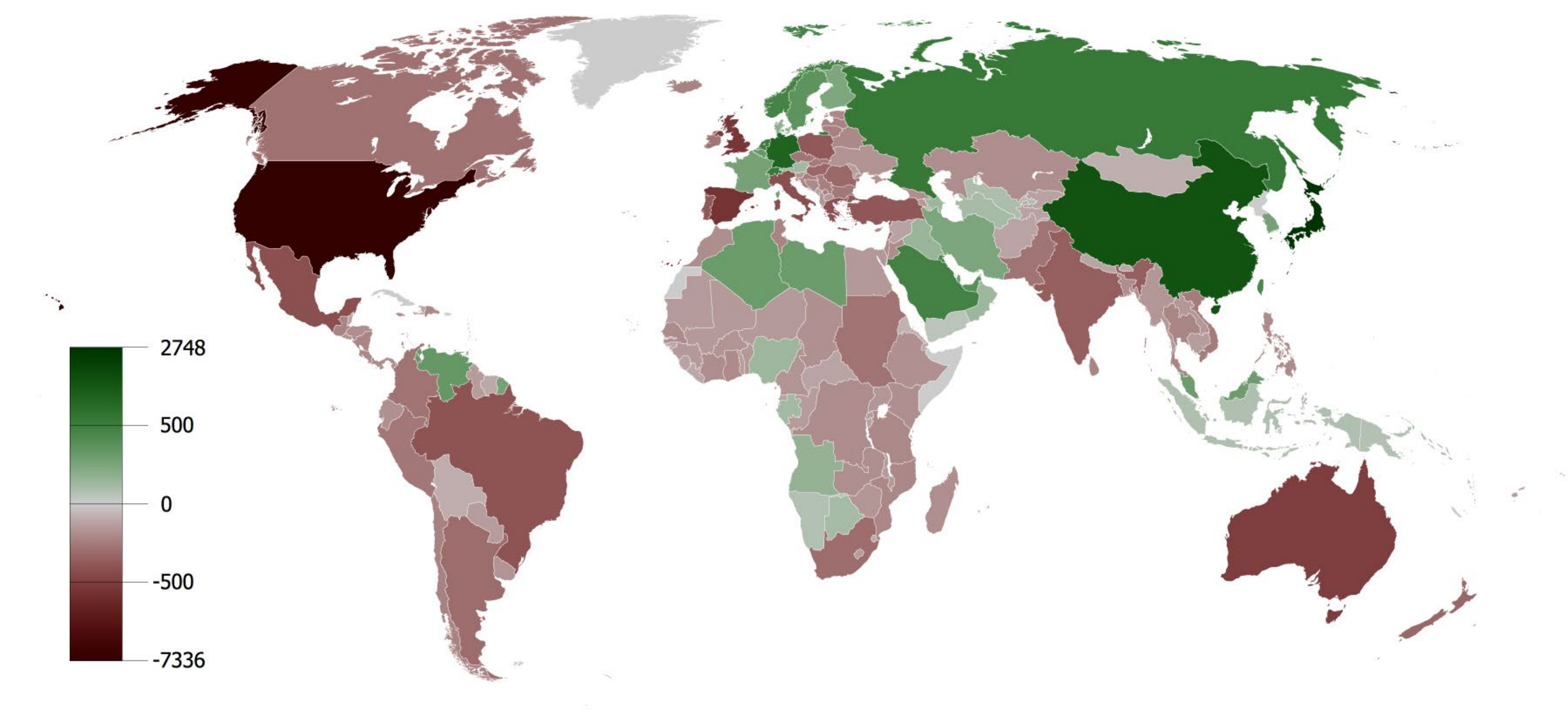
- In economics, a country's current account records the value of exports and imports of both goods and services and international transfers of capital.
- It is one of the two components of its balance of payments, the other being the capital account (also known as the financial account).
- Current account measures the nation's earnings and spendings abroad and it consists of the balance of trade, net primary income or factor income (earnings on foreign investments minus payments made to foreign investors) and net unilateral transfers, that have taken place over a given period of time.
- The current account balance is one of two major measures of a country's foreign trade (the other being the net capital outflow).
- A current account surplus indicates that the value of a country's net foreign assets (i.e. assets less liabilities) grew over the period in question, and a current account deficit indicates that it shrank. Both government and private payments are included in the calculation. It is called the current account because goods and services are generally consumed in the current period.

# Cumulative current account balance 1980–2008 (US$ billions) based on the International Monetary Fund data



- Foreign direct investment is just one item on the capital account, along with portfolio investment (stocks and bonds) and other investment (including bank lending).
- However, until well into the twenty-first century, FDI was the only quantitatively significant form of capital inflow to China.
- FDI began to pour into China after 1992, and China became by far the largest developing-country host of FDI, accounting for about one-third of total developing-country FDI.
- The global manufacturing networks created by FDI in China reshaped China and the world and continue to play a critical role in the world economy.

# Capital account

- In macroeconomics and international finance, the capital account, also known as the capital and financial account records the net flow of investment transaction into an economy. It is one of the two primary components of the balance of payments, the other being the current account. Whereas the current account reflects a nation's net income, the capital account reflects net change in ownership of national assets.

# Calculation

- At high level:

$$Capital\ account$$
$$= Change\ in\ foreign\ ownership\ of\ domestic\ assets$$
$$- Change\ in\ domestic\ ownership\ of\ foreign\ assets$$

Breaking this down:

$$Capital\ account = Foreign\ direct\ investment + Portfolio\ investment + Other\ investment + Reserve\ account$$

# Overall Trends

- Foreign direct investment had been important in China's early industrialization: the famous Bund on Shanghai's riverfront preserves a vivid physical reminder of the prominent role foreign companies had in 1930s Shanghai.
- However, after 1949, China closed to FDI, with the minor exception of a few joint ventures operated with other socialist countries that were wrapped up in the late 1950s.
- When China decided to accept foreign investment in 1978, it broke sharply with socialist orthodoxy by establishing special economic zones (SEZs) in 1979 and 1980.

# Financial Account

- In macroeconomics, a financial account is a component of a country's balance of payments that covers claims on or liabilities to nonresidents, specifically concerning financial assets. Financial account components include direct investment, portfolio investment, and reserve assets broken down by sector.

1. A financial account is a component of a country's balance of payments that covers claims on or liabilities to nonresidents concerning financial assets.
2. Financial account components include direct investment, portfolio investment, and reserve assets broken down by sector.
3. The financial account involves financial assets such as gold, currency, derivatives, special drawing rights, equity, and bonds.

# Subaccounts

- The first subaccount includes domestic ownership of foreign assets, such as foreign bank deposits and securities in foreign companies.
- The second subaccount includes foreign ownership of domestic assets, such as the purchase of government bonds by foreign entities or loans provided to domestic banks by foreign institutions.

# The Bund, Shanghai in 1926 as seen from the US Consulate General on Huangpu Road

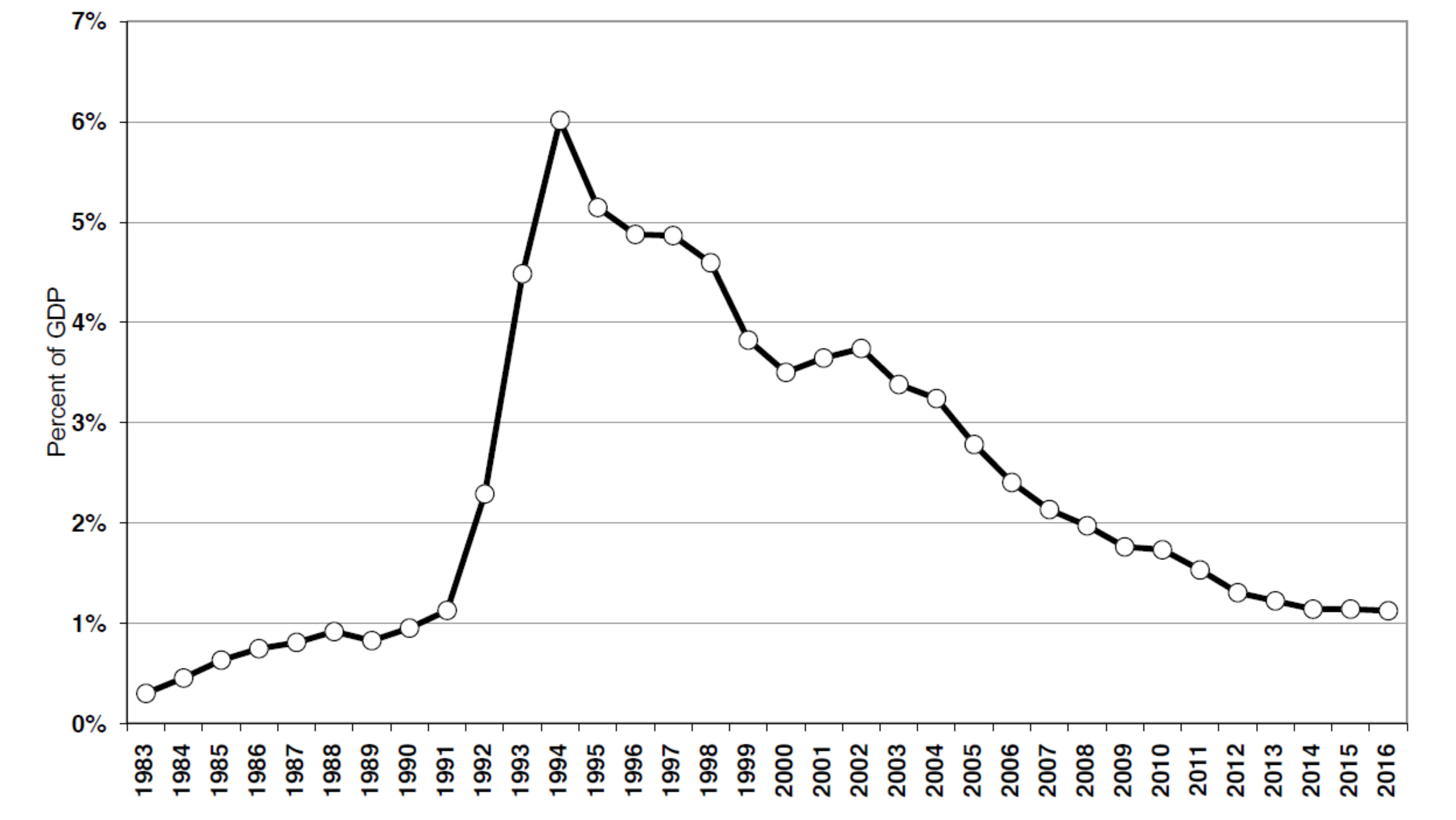
Photo by R. V. Dent.

THE BUND, SHANGHAI, SEEN FROM THE CONSULATE GENERAL

# The Bund Today

The area centers on a section of Zhongshan Road (East Zhongshan Road No.1) within the former Shanghai International Settlement, which runs along the western bank of the Huangpu River in the eastern part of Huangpu District. The area along the river faces the modern skyscrapers of Lujiazui in the Pudong District. The Bund usually refers to the buildings and wharves on this section of the road, as well as some adjacent areas. From the 1860s to the 1930s, it was the rich and powerful center of the foreign establishment in Shanghai, operating as a legally protected treaty port.

# FDI in the Chinese Economy



# Size of China's S and Asian EPZs (square kilometers)

| | Initial 1980 size | Size in 1990 |
|---|---|---|
| Shenzhen | 327.5 | 327.5 |
| Zhuhai | 6.8 | 121.0 |
| Shantou | 1.6 | 52.6 |
| Xiamen | 2.5 | 131.1 |
| Kaohsiung, Taiwan | | 0.7 |
| Penang, Malaysia | | 1.2 |
| Batam Island, Indonesia | | 36.6 |
| Bataan, Philippines | | 3.4 |

# The Impact of FDI

- Contribution to Aggregate Saving and Investment

FDI is a form of fixed capital formation financed by foreign companies. It contributes to saving and investment and thereby facilitates structural change.

- Contribution to Foreign Trade

The largest and most unambiguous contribution of FDI to the Chinese economy came through its contribution to trade. The earliest foreign investors were exporters of light manufactures from Hong Kong and Taiwan.

# The Impact of FDI

- Technology Transfer

As described in chapter 15, FIEs were the largest source of new technology in Chinese industry through the turn of the century, after which China's domestic R&D effort accelerated and surpassed the contribution from foreign investment.

- Competition and Emulation

Foreign firms provide competition for domestic firms. This competition pushes down product prices and cuts into profit margins, forcing firms to respond.

- Spillovers and Upgrading

One of the most important spillover mechanisms is supplier relations.

# Economic growth and productivity spillovers

- First, FDI inflows increase demand for labour and create employment. FDI firms hired 29.6 million workers, or 7.5 per cent of China's total urban employment, in 2014. The increase in employment contributes to an increase in total output, thus promoting economic growth.
- Second, FDI inflows increase China's fixed capital formation. By the end of 2016, China had attracted US$1.35 trillion in FDI stock, which has contributed to the country's fixed capital formation and, therefore, boosted its economic growth.
- Third, FDI is a leading source of technology transfer and human capital augmentation in developing countries (Dunning 1993). FDI is therefore expected to accelerate China's economic growth through technological progress.
- Fourth, through knowledge spillovers, FDI is expected to increase the productivity and efficiency of domestic Chinese firms.

# productivity spillovers

- Some empirical studies find that the economic and technological conditions of a recipient economy influence the extent to which FDI contributes to growth.
- For example, Buckley et al. (2002) find that the growth-promoting effects of FDI are more evident in the more developed provinces than in those that are less developed, and that the full benefits of FDI are realised when competition in local markets is at its strongest.
- Yao and Wei (2007) find that FDI has positive and significant impacts on China's economic growth; however, the positive impact is greater in the eastern than in the central and western regions.

# Export promotion

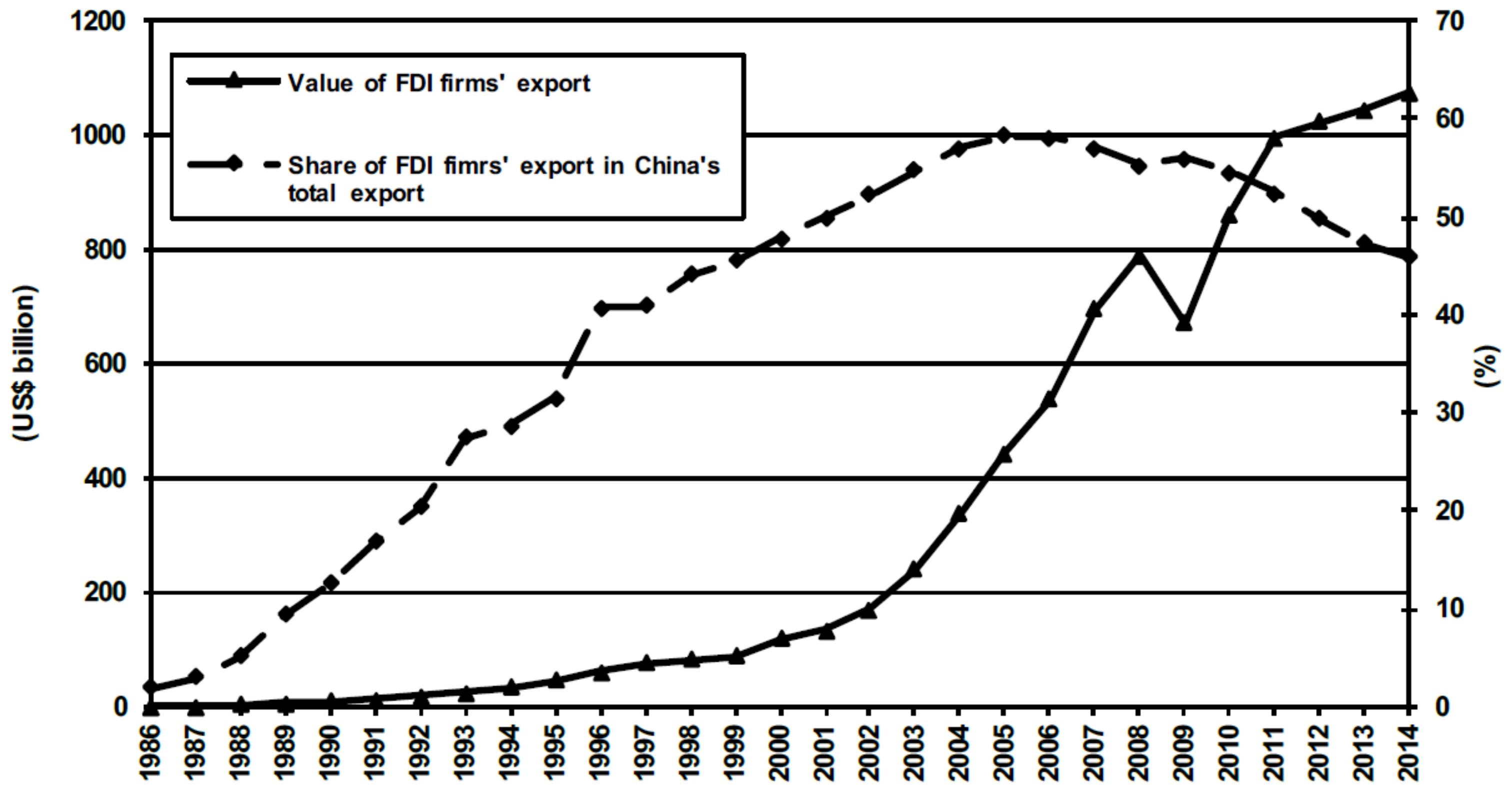



Figure 29.7 Export performance of FDI firms, 1986–2014 (current US$)

Source: MOC (2015).

# The performance of FDI firms' processing trade, 2002–12

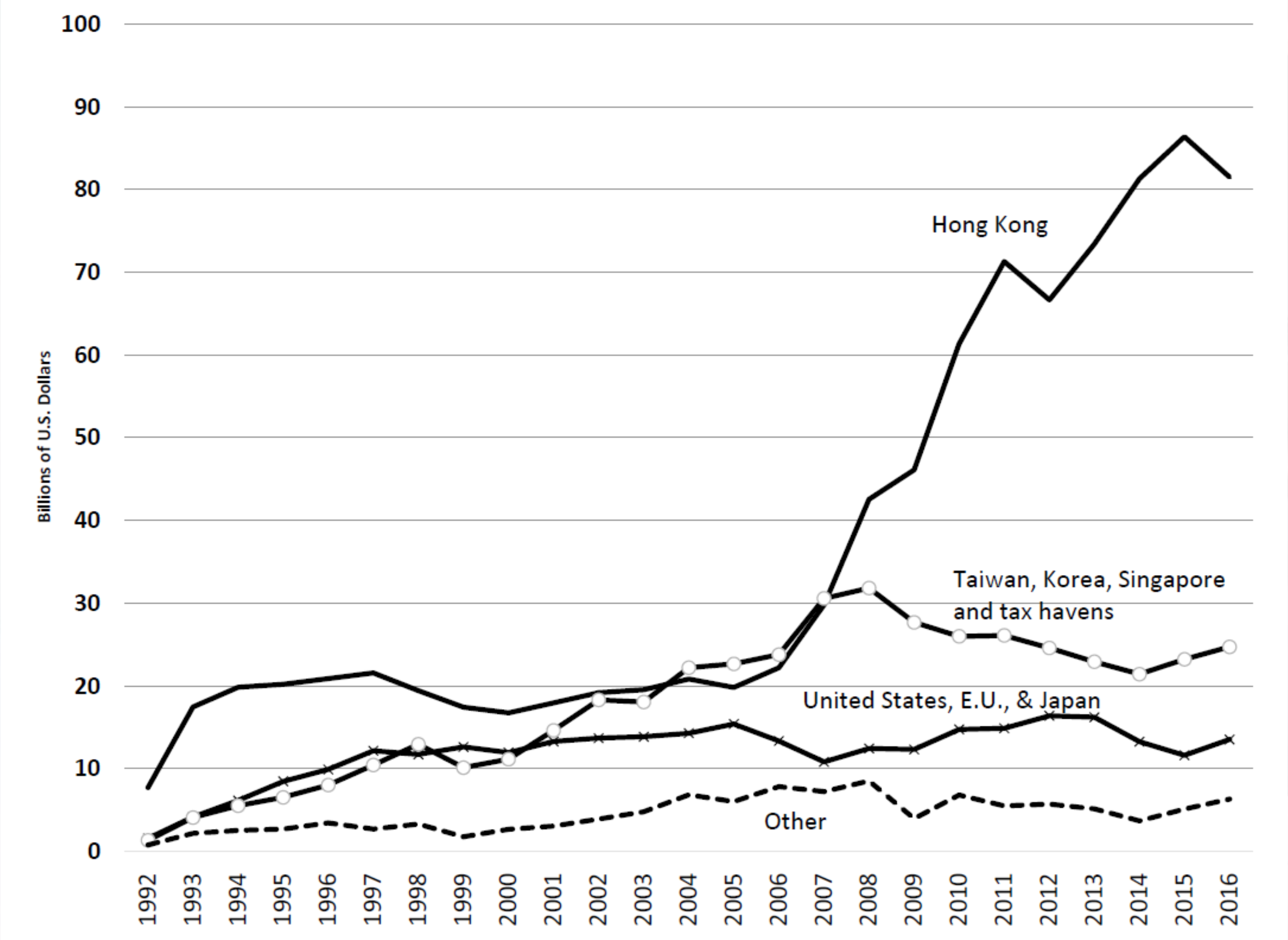
| Year | FDI firms' processing trade as a percentage of China's total processing trade | FDI firms' processing trade as a percentage of FDI firms' total trade | FDI firms' processing exports as a percentage of FDI firms' total exports |
|---|---|---|---|
| 2002 | 75.7 | 69.3 | 79.2 |
| 2003 | 79.6 | 68.2 | 79.2 |
| 2004 | 81.9 | 67.9 | 78.7 |
| 2005 | 83.7 | 69.5 | 78.0 |
| 2006 | 84.9 | 68.1 | 76.5 |
| 2007 | 84.3 | 66.1 | 74.9 |
| 2008 | 84.5 | 63.1 | 72.4 |
| 2009 | 84.1 | 62.8 | 73.4 |
| 2010 | 83.9 | 60.7 | 72.0 |
| 2011 | 83.1 | 58.3 | 70.3 |
| 2012 | 81.7 | 58.0 | 69.9 |

Sources: Calculated from MOC (various issues; 2015).

# Main Source Regions

- China is distinctive as a host country for incoming FDI in that most of the investment comes from its near neighbors and a limited share from developed countries.
- This is an important real feature of Chinese FDI, but it is also overstated by the way China collects FDI data.
- According to official Chinese data, Hong Kong is indisputably the biggest investor in China, accounting for 52% of the cumulative total from 1985 to 2016 ($934 billion out of $1.8 trillion). Equally striking is that the developed-country triad of the United States, the EU, and Japan has accounted for only 17% of incoming FDI, about $300 billion. Also noteworthy is the prominent role played by Taiwan, Korea, and, especially recently, Singapore.

# Main FDI source regions.
# Source: SYC (2016, table 11-14; and earlier volumes).



# The Special Role of Hong Kong

- Hong Kong is not just the largest investor in China; its role is special in almost every respect (for example, with respect to outgoing investment; see section 17.6).
- On July 1, 1997, the former British colony of Hong Kong became a special administrative region (SAR) of China. Thus China's largest foreign investor is not really foreign. However, there are abundant reasons to treat Hong Kong as "foreign" beyond habitual practice.
- Hong Kong has a dramatically different economic and administrative system from that of China; it has a much higher level of economic development than the rest of the mainland; the SAR government has decision-making authority over virtually all important economic decisions, including trade regulations; and, in recognition of this, Hong Kong has long been an independent member of some international organizations, including the World Trade Organization.

# The China Circle

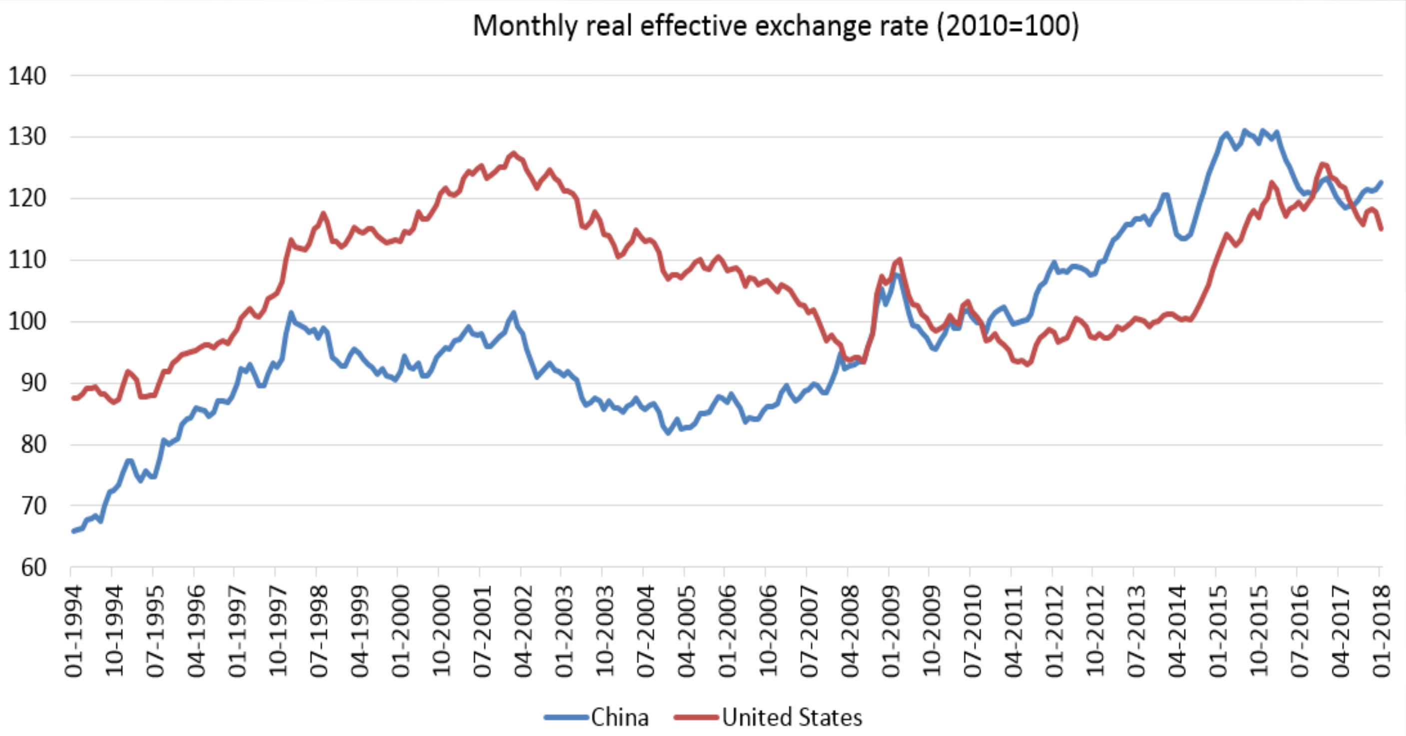
- The close economic association among the economies of the People's Republic of China, Hong Kong, and Taiwan warrants calling them the "China Circle."
- The basis for the emergence of the China Circle was the success of Taiwan and Hong Kong in developing labor-intensive manufactured exports during the 1960s and 1970s, particularly to the U.S. market.
- Both economies produced an enormous range of light, labor-intensive manufactures, beginning with plastic flowers in Hong Kong and extending through a vast range of sporting and travel goods to the huge garment and footwear sectors.

# Foreign exchange reform

- CNY/USD = 1.5 in 1980 (the official rate), the currency was grossly overvalued
- The government had to gradually devalue the currency, initially in the form of internal settlement rate
- In 1994, a unified exchange rate of 8.7, with managed floating
- In 1997, fixed at 8.28
- In 2005, managed floating with reference to a basket of currencies (more rigid regime during 2008-2010)
- 2015, central parity reform

# Exchange rate policy

- Three often stated policy objectives
- One, greater flexibility
- Two, more market-determin
- Three, basic stability
- Should China move toward floating exchange rate?



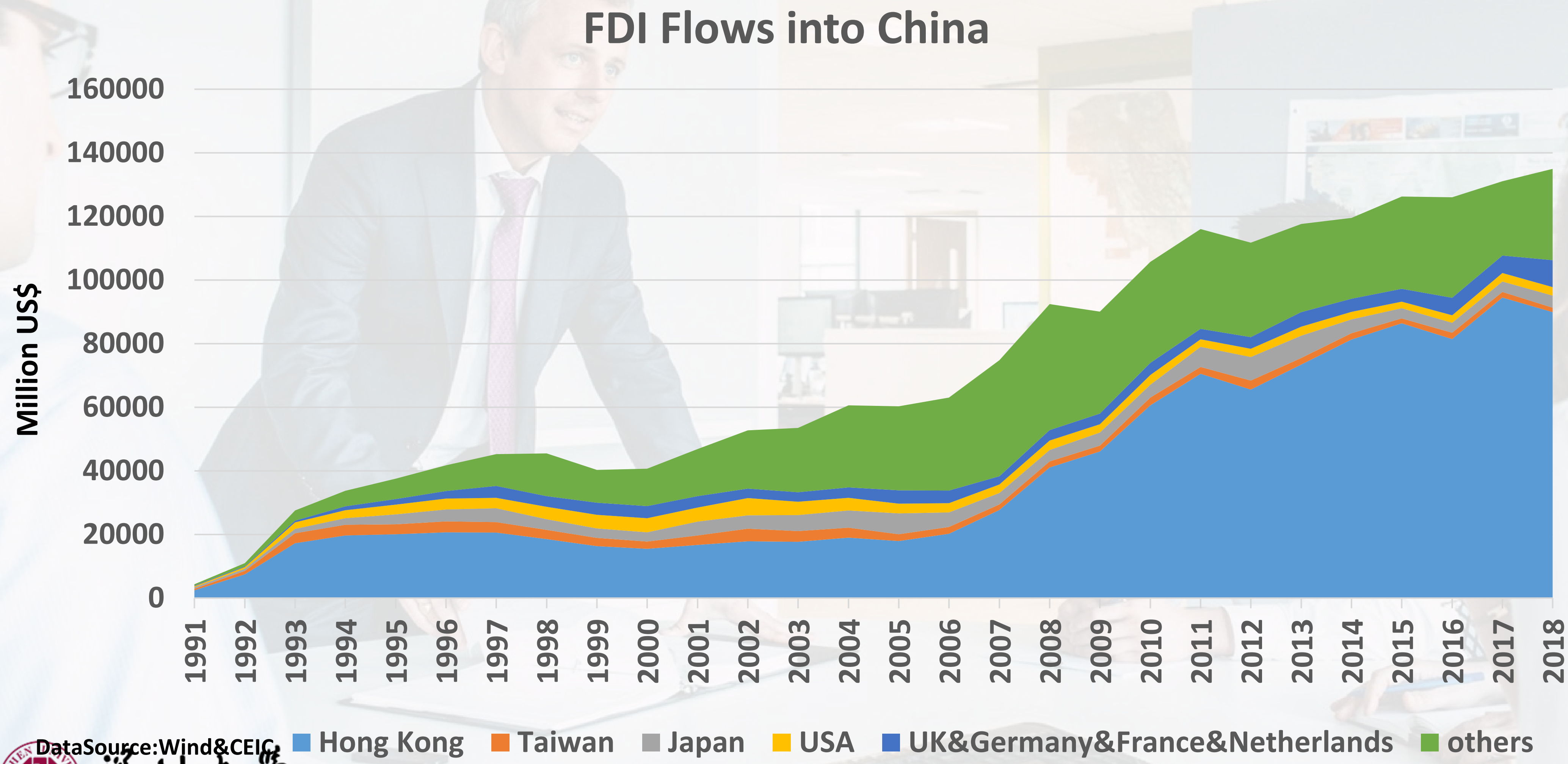
# FDI: Market-for-technology policy

- In 1979, the Law on Joint Venture was passed
- Four SEZs were established in which foreign firms were offered preferential tax and administrative treatment and given an unusually free hand in their operations
- In 1984, the government, in abid toattract FDI, granted similar exemptions from taxes and administrative procedures to fourteen additional administrative units, mostly municipalities on China’s Pacific coast.
- In 1993, the government adopted the policy of “market for technology”
- In the following 20 years, China remained the largest recipient country of FDI in the world
- The “spillover effect” of FDI

# FDI in the early years

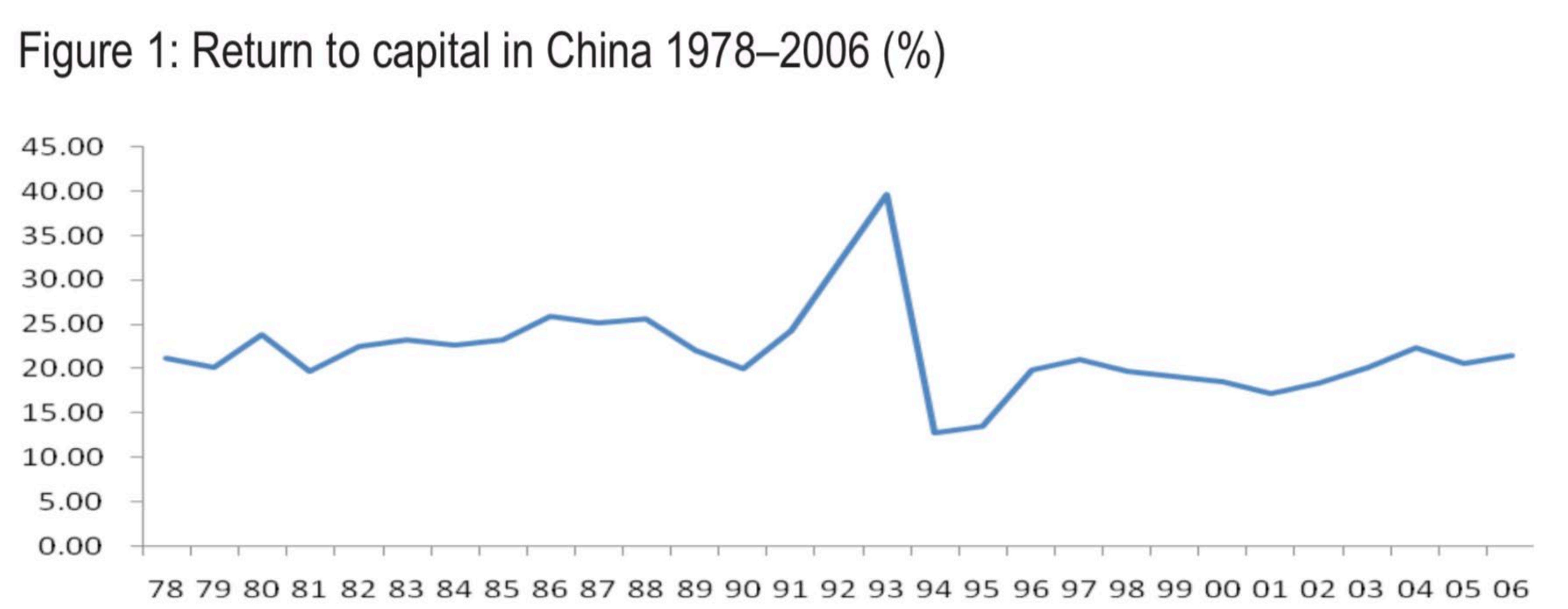

DataSource: National Statistics Bureau, No updated contracted amount released by official any more

# FDI by source country




DataSource:Wind&CEIC

# Why FDI Flows into China




PictureSource: Understanding China’s High Investment Rate and FDI Levels: A Comparative Analysis of the Return to Capital in China, the United States, and Japan
by *Wenkai Sun*, Renmin University of China *Xiuke Yang,* Peking University
*Geng Xiao*, Columbia University

# Outward direct investment

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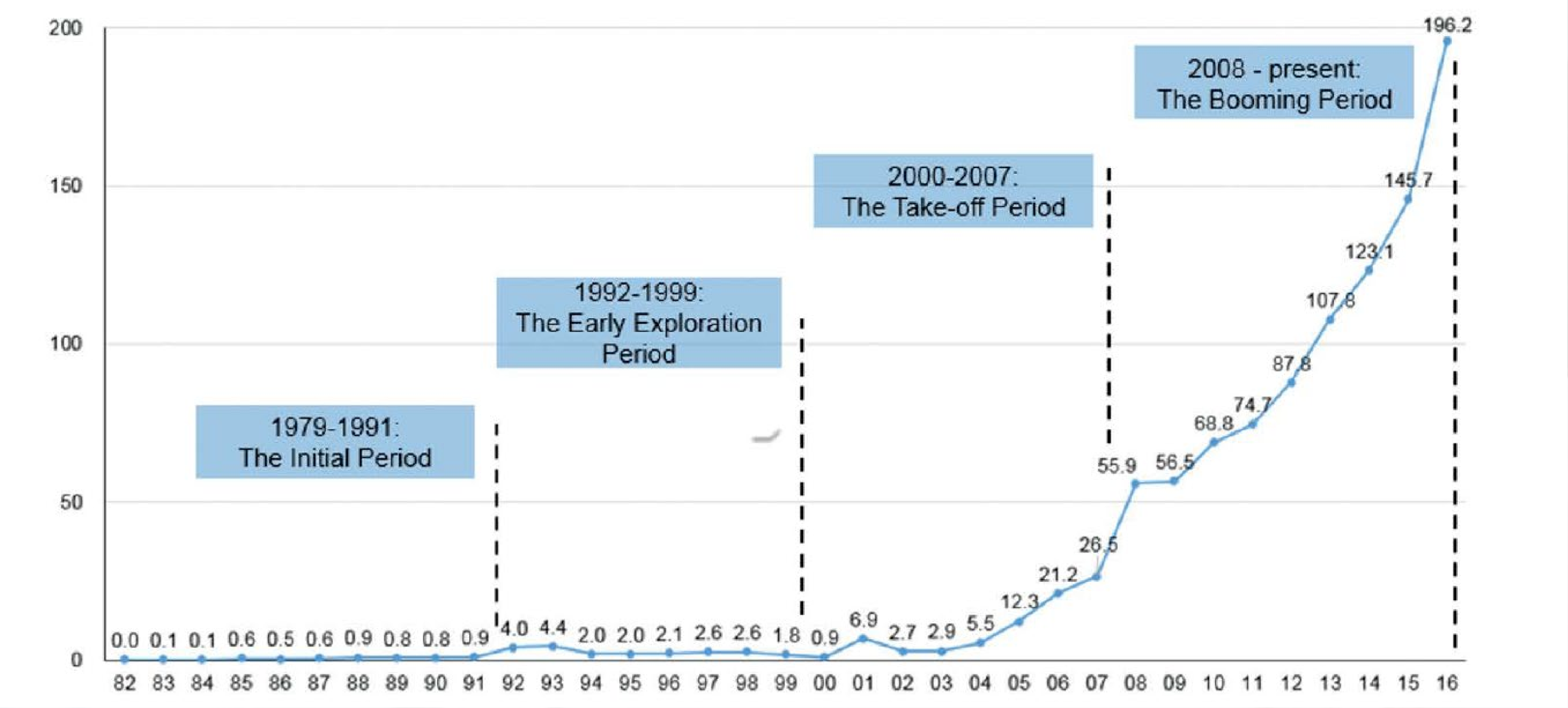
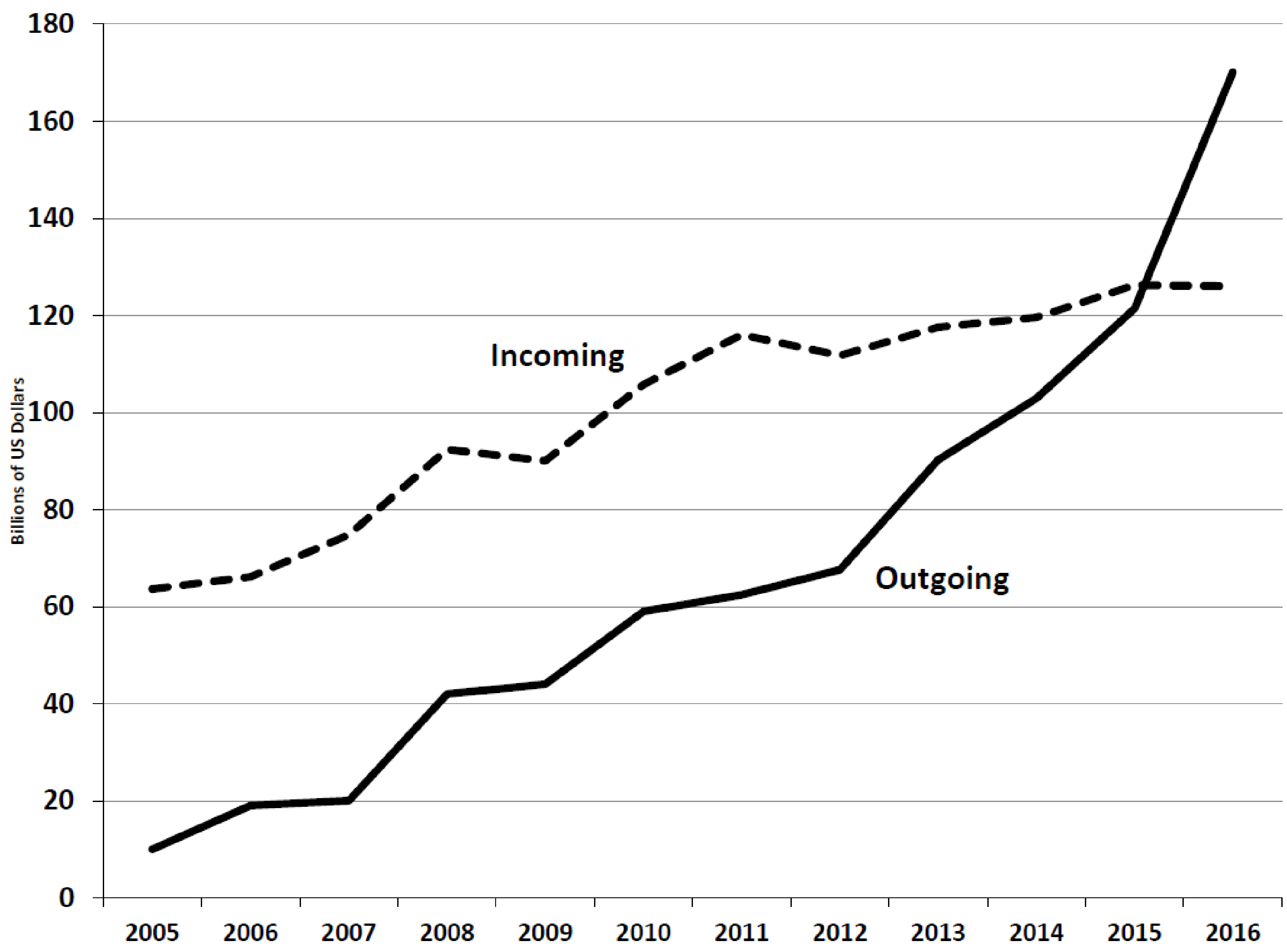
China’s four decades of economic reform have been aimed at liberalising markets, upgrading the industrial structure, enhancing enterprises’ competitiveness and integrating China into the global economy.

China’s foray into outward direct investment (ODI) took shape gradually. In 2016, China became the world’s secondlargest outward investor after the United States, with $196.2 billion of ODI flows.

# Development stages of China's ODI flows ($ billion)
Sources: ODI flow data for 1982–2001 from the UNCTAD Statistics (unctadstat.unctad.org/EN/); and for 2002–16, from NDRC (2017a).



China FDI: Incoming and outgoing.
Sources: Incoming: SYC (2016, table 11-13); Outgoing: Ministry of Commerce, http://www.mofcom.gov.cn.

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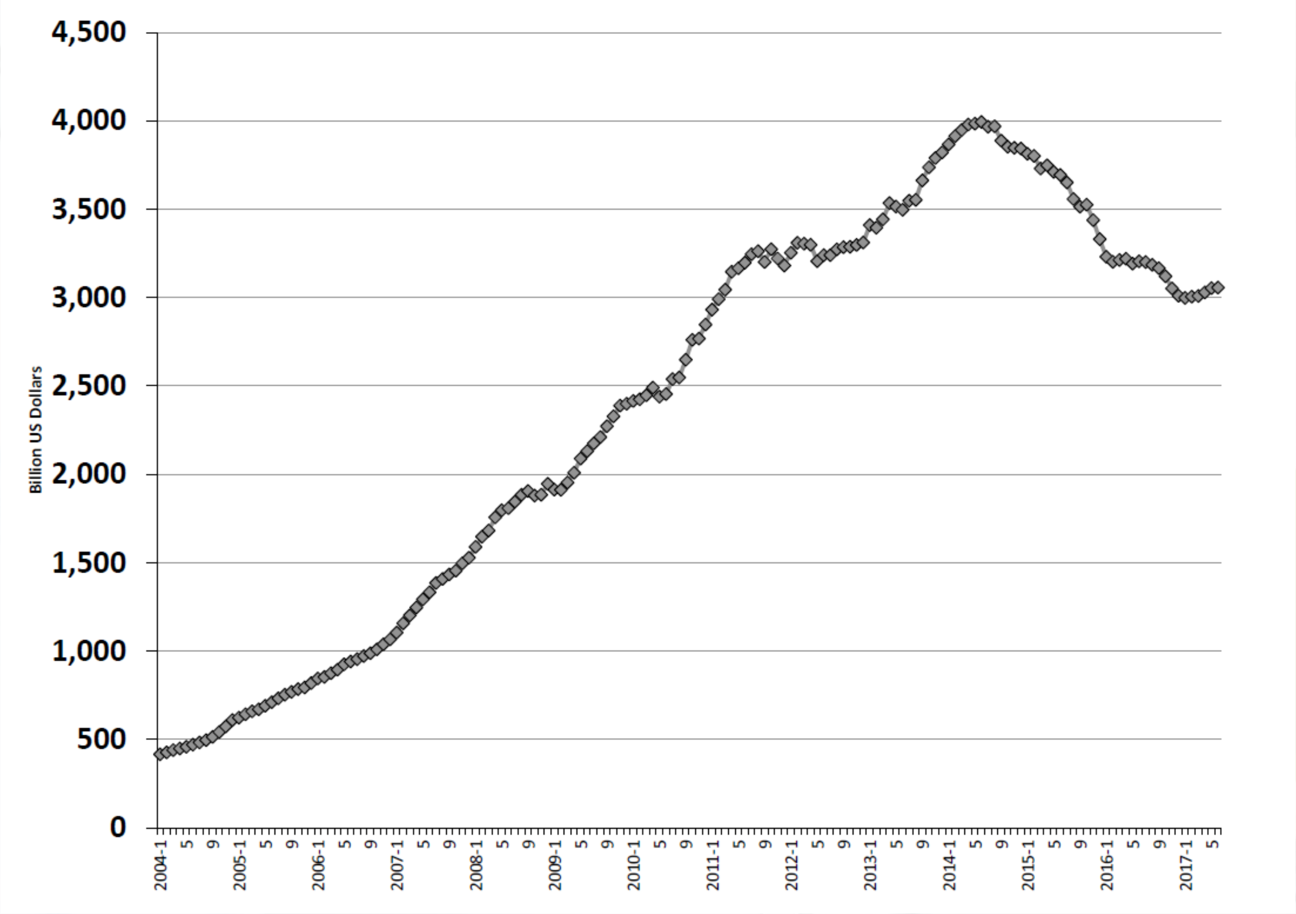
# The Balance of Payments and the Capital Account

- The balance of trade in goods and services has generally been about +2% to 3% of GDP, although it surged higher between 2005 and 2009, when it averaged 6.8% over five years (as discussed in chapter 16).
- Net FDI has been positive, before drifting down gradually and then turning negative in 2016 (note that balance of payments data on FDI differ from the Ministry of Commerce data used in previous sections).
- The circle-line shows changes in official foreign exchange reserves. An increase in official reserves shows up as a negative number, that is, it corresponds to a capital outflow. When the central bank accumulates reserves, it invests the money in low-risk securities, such as U.S. Treasury bonds.
- Thus the increase of official reserves is a special kind of capital outflow, since a domestic actor is purchasing foreign securities.

# Official Reserves Accumulation



# “Go Out”: Outgoing Direct Investment

- Restricted stage, 1978–99

Before 2000, capital shortages prompted China to invite capital inflows and restrict capital outflows.

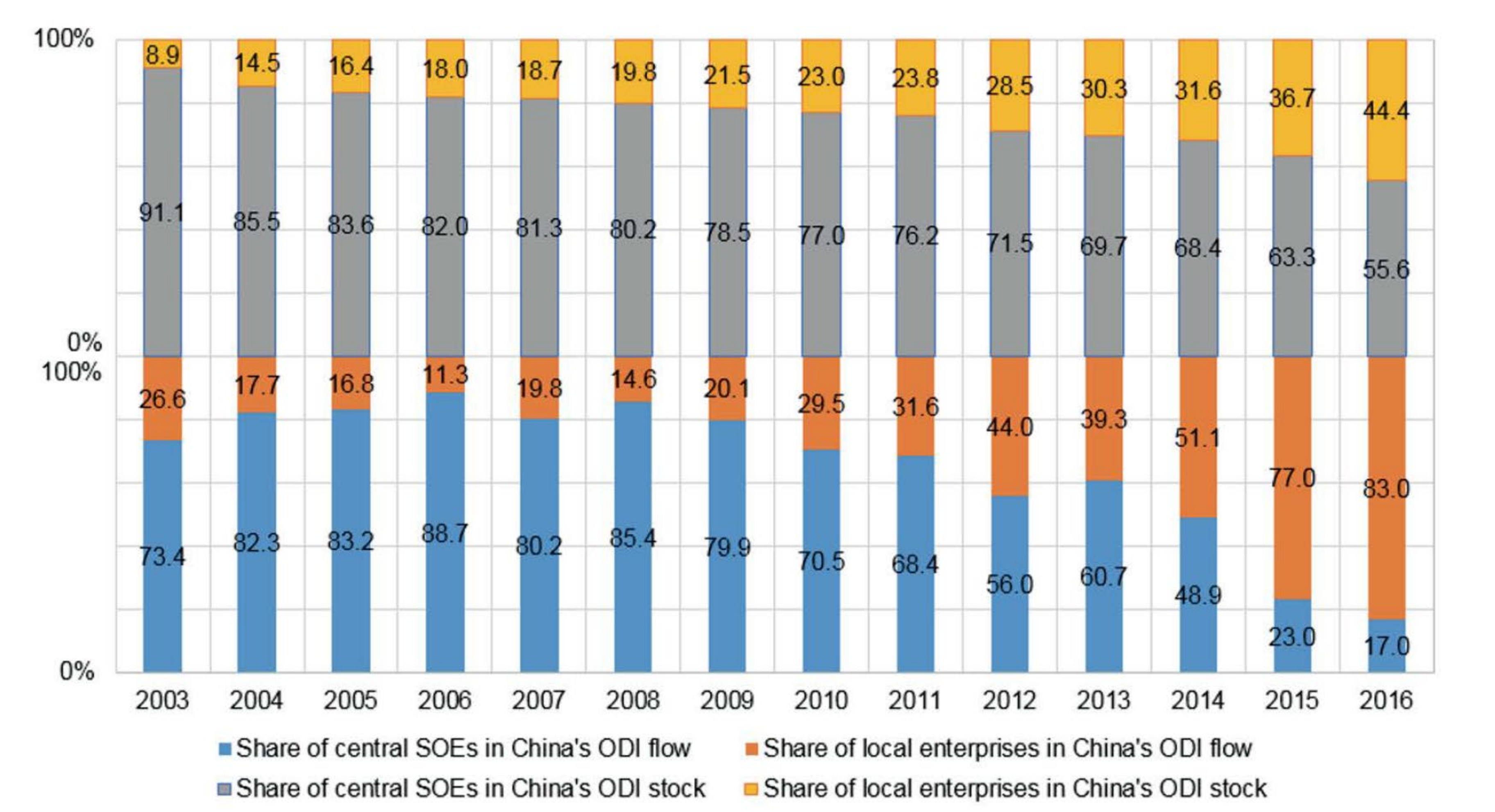
- The initial period, 1979–91

Before 1991, few laws or regulations were directed at ODI.4 Only state-owned enterprises (SOEs) were allowed to invest overseas and approval on a case-by-case basis was required regardless of the investment amount.

- The early exploration period, 1992–99

In the 1990s, persistent trade surpluses and high foreign direct investment (FDI) inflows helped China accumulate foreign exchange. Its foreign reserve holdings increased from $21.7 billion in 1991 to $154.7 billion in 1999. Meanwhile, China gradually transformed from a planned to a socialist market economy, and the market increasingly became an important channel of resource allocation.

# Shares of central SOEs and local enterprises in China's ODI flows and stock, 2003–16 Sources: MOFCOM et al. (various issues).



# Concluding remarks

- China is now the significant player in the international investment arena; however, ODI can be a double-edged sword.
- At present, the negative impacts of China’s ODI are reflected mainly at the micro-enterprise level, including frequent investment mistakes, huge investment losses, difficulties in integration after M&A and failures to assimilate into host countries.
- At a national level, capital flight has taken place under the cover of outward investment. Firms’ misconduct abroad has not gravely damaged China’s international image, because there are mainly sporadic cases.

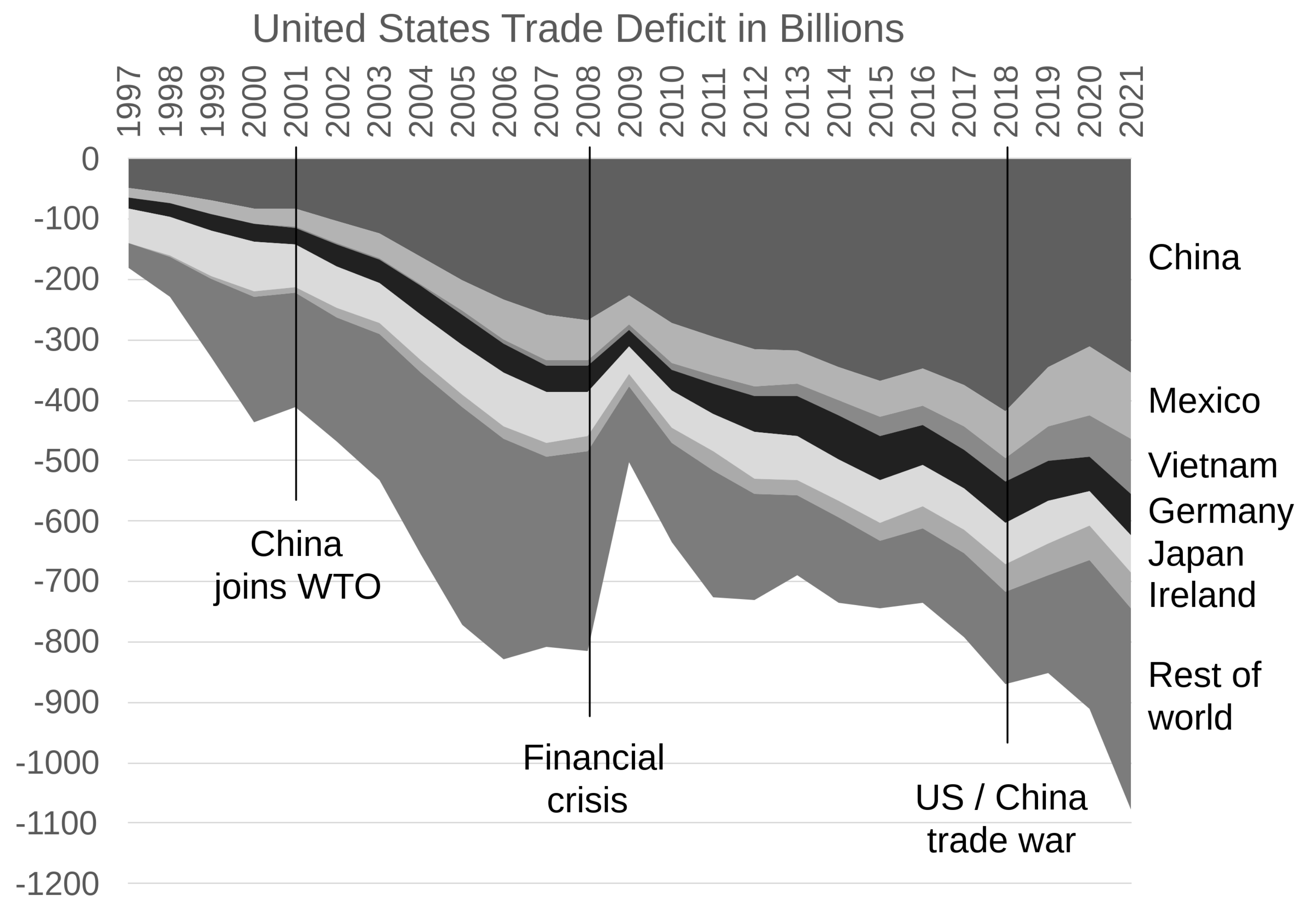
# WTO accession agreement

- China agreed in 1999 to lower its average tariff levels on industrial products to 8.9%. Even more importantly, China agreed to eliminate all quotas, licenses, tendering requirements, and other non-tariff barriers to imports of manufactured goods by 2005
- China agreed in principle to cease the practices of pressuring foreign firms to transfer technology to local partners and to increase the domestic content of automobiles assembled in China
- Average statutory tariff rate for agricultural imports reduced from 21% to 15% (but limited imports of some sensitive agricultural commodities with quotas)

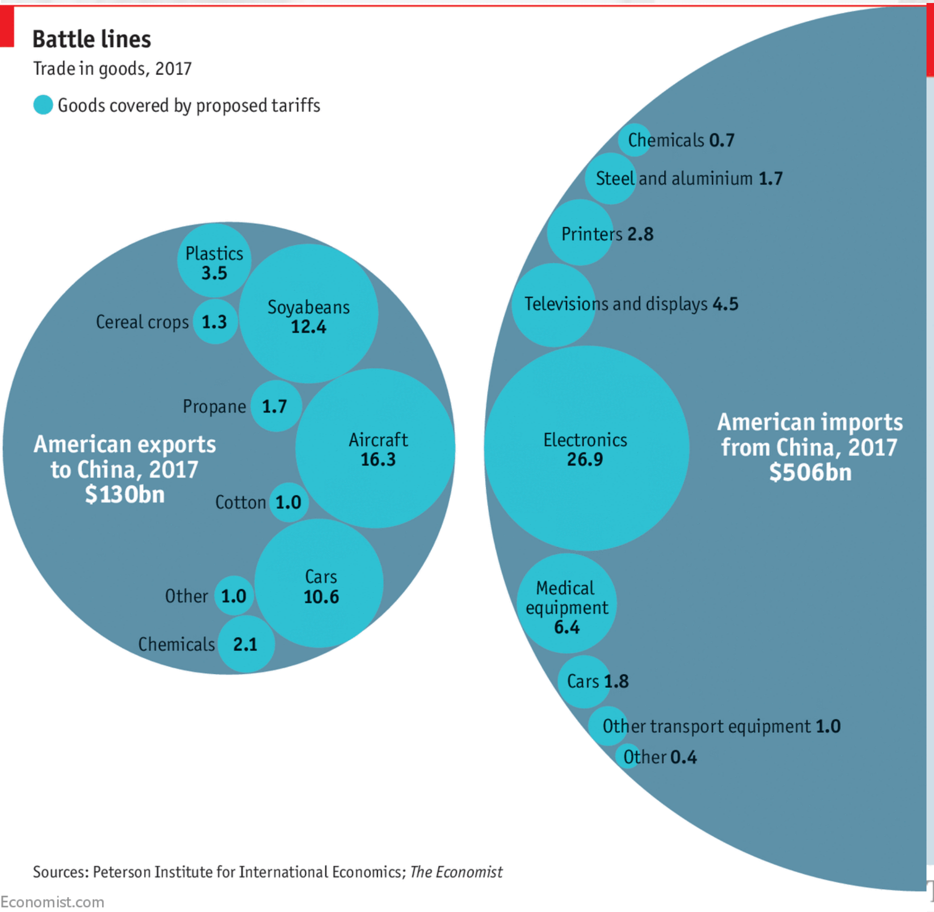
# Section 5 China–United States trade war
# Globalization and Deglobalization

- An economic conflict between China and the United States has been ongoing since January 2018, when U.S. President Donald Trump began setting tariffs and other trade barriers on China with the goal of forcing it to make changes to what the U.S. says are longstanding unfair trade practices and intellectual property theft.
- The Trump administration stated that these practices may contribute to the U.S.–China trade deficit, and that the Chinese government requires transfer of American technology to China.
- In response to US trade measures, the Chinese government accused the Trump administration of engaging in nationalist protectionism and took retaliatory action. After the trade war escalated through 2019, in January 2020 the two sides reached a tense phase one agreement; it expired in December 2021 with China failing by a wide margin to reach its targets for U.S. imports to China.
- By the end of the Trump presidency, the trade war was met with some criticism. His successor, Joe Biden, however, has kept the tariffs in place.

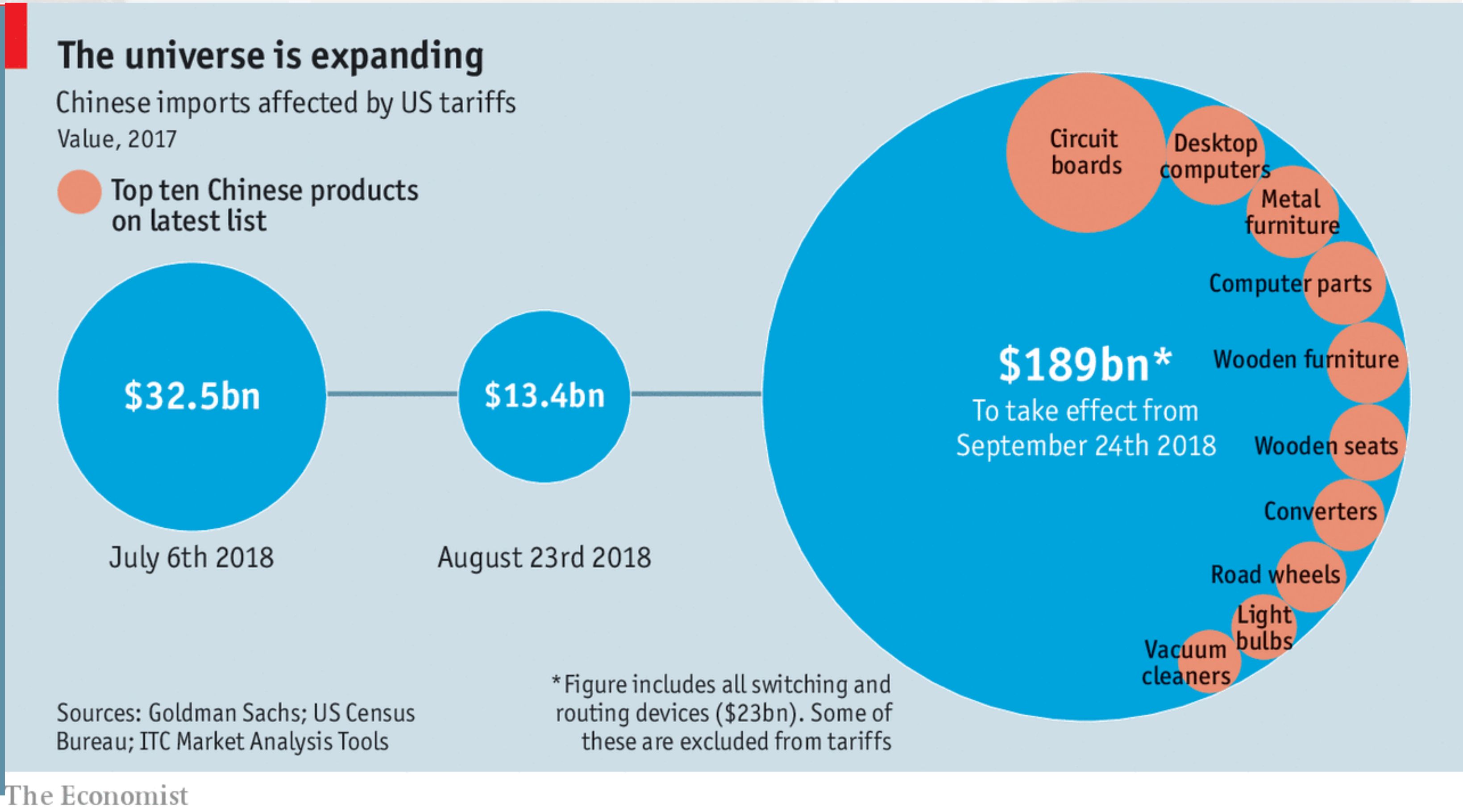
United States trade deficits from 1997 to 2021. Deficits are over 50 billion dollars as of 2021 with the countries shown. Data from the US Census Bureau.



# Tariffs

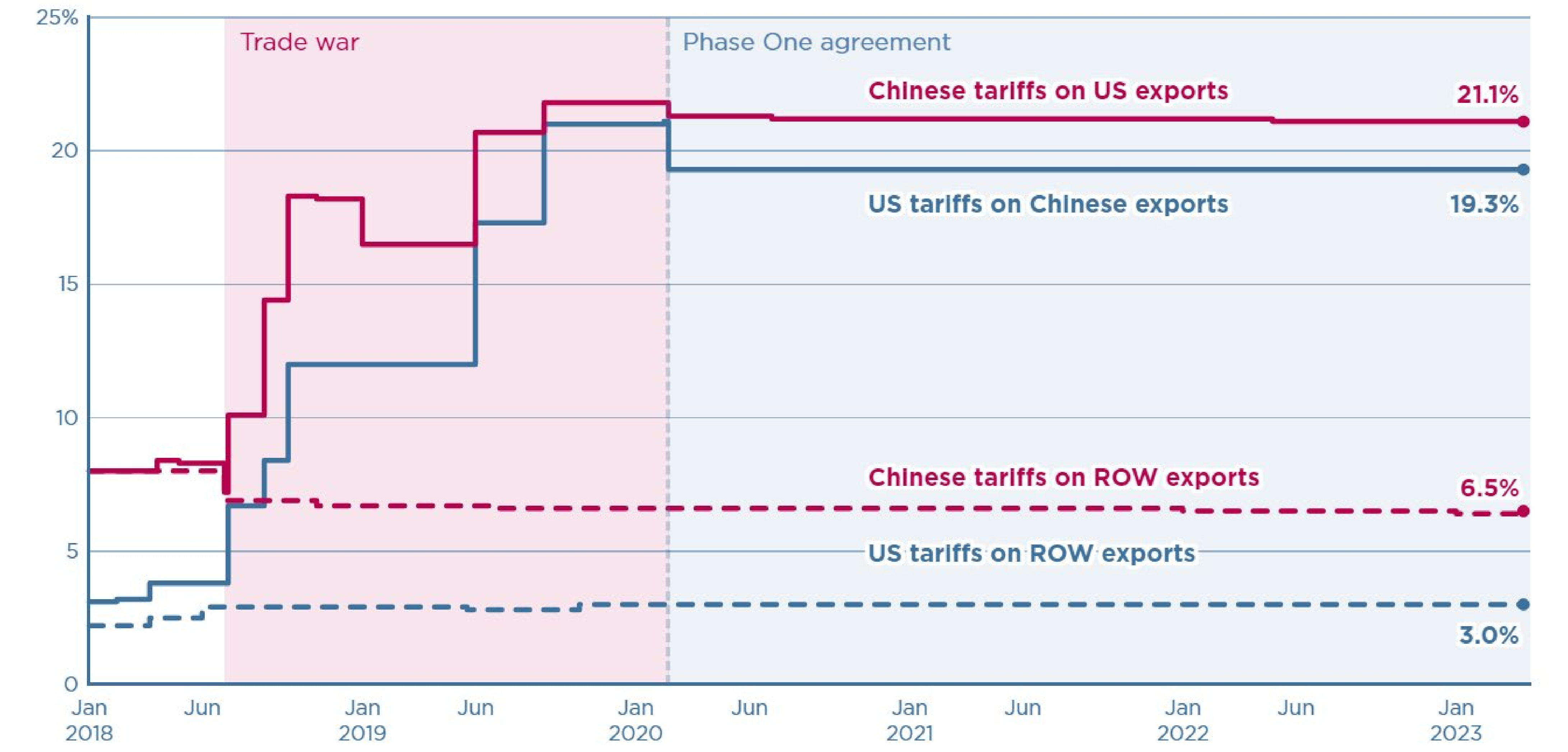


Battle lines
Trade in goods, 2017
Goods covered by proposed tariffs
Plastics 3.5
Soyabeans 12.4
Cereal crops 1.3
Propane 1.7
Aircraft 16.3
American exports to China, 2017 $130bn
Cotton 1.0
Cars 10.6
Other 1.0
Chemicals 2.1
Chemicals 0.7
Steel and aluminium 1.7
Printers 2.8
Televisions and displays 4.5
Electronics 26.9
American imports from China, 2017 $506bn
Medical equipment 6.4
Cars 1.8
Other transport equipment 1.0
Other 0.4
Sources: Peterson Institute for International Economics; The Economist
Economist.com

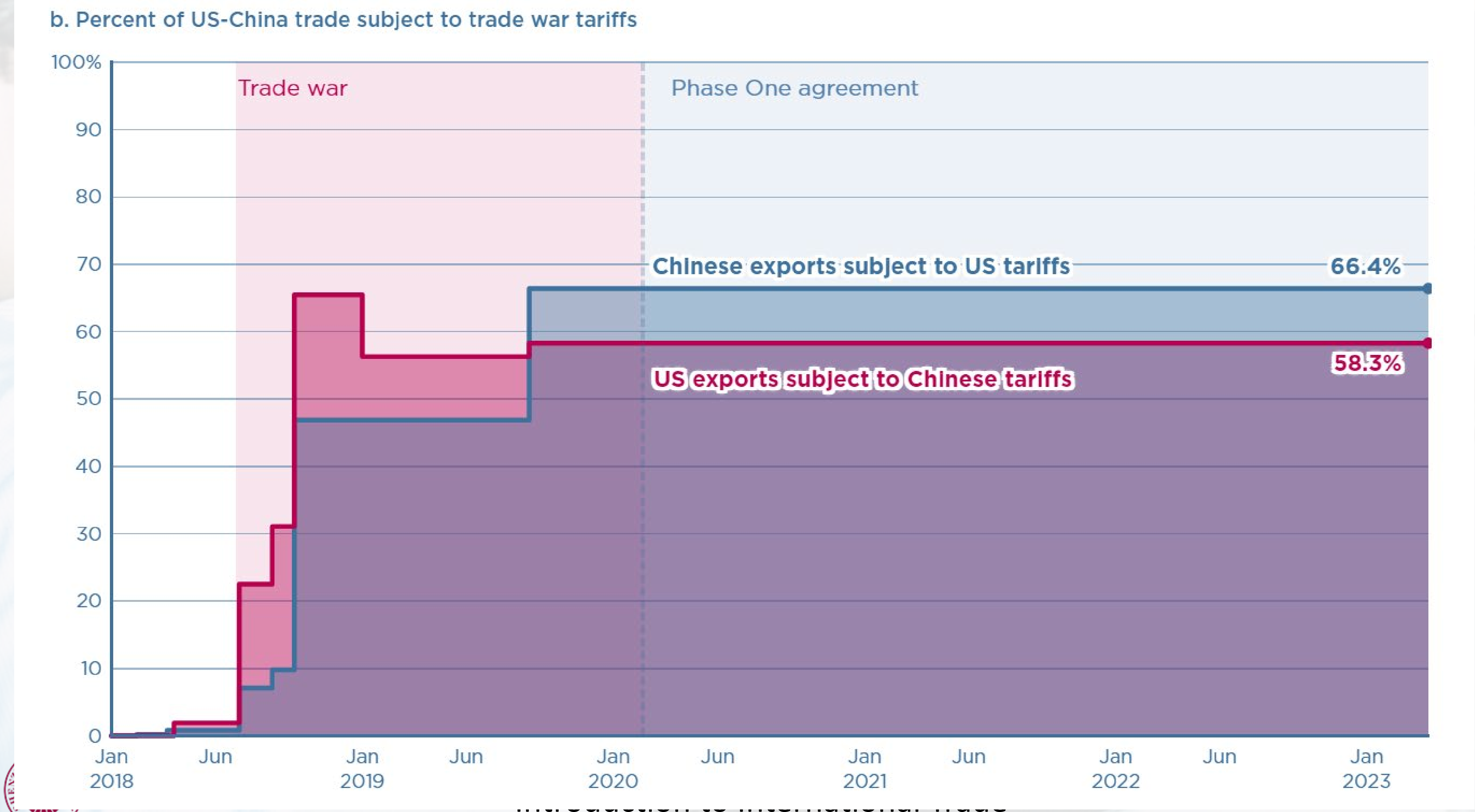



The universe is expanding
Chinese imports affected by US tariffs
Value, 2017
Top ten Chinese products on latest list
$32.5bn
July 6th 2018
$13.4bn
August 23rd 2018
$189bn*
To take effect from September 24th 2018
Circuit boards
Desktop computers
Metal furniture
Computer parts
Wooden furniture
Wooden seats
Converters
Road wheels
Light bulbs
Vacuum cleaners
Sources: Goldman Sachs; US Census Bureau; ITC Market Analysis Tools
*Figure includes all switching and routing devices ($23bn). Some of these are excluded from tariffs
The Economist

# US-China tariff rates toward each other and rest of world (ROW)



# Percent of US-China trade subject to trade war tariffs



# Entity List

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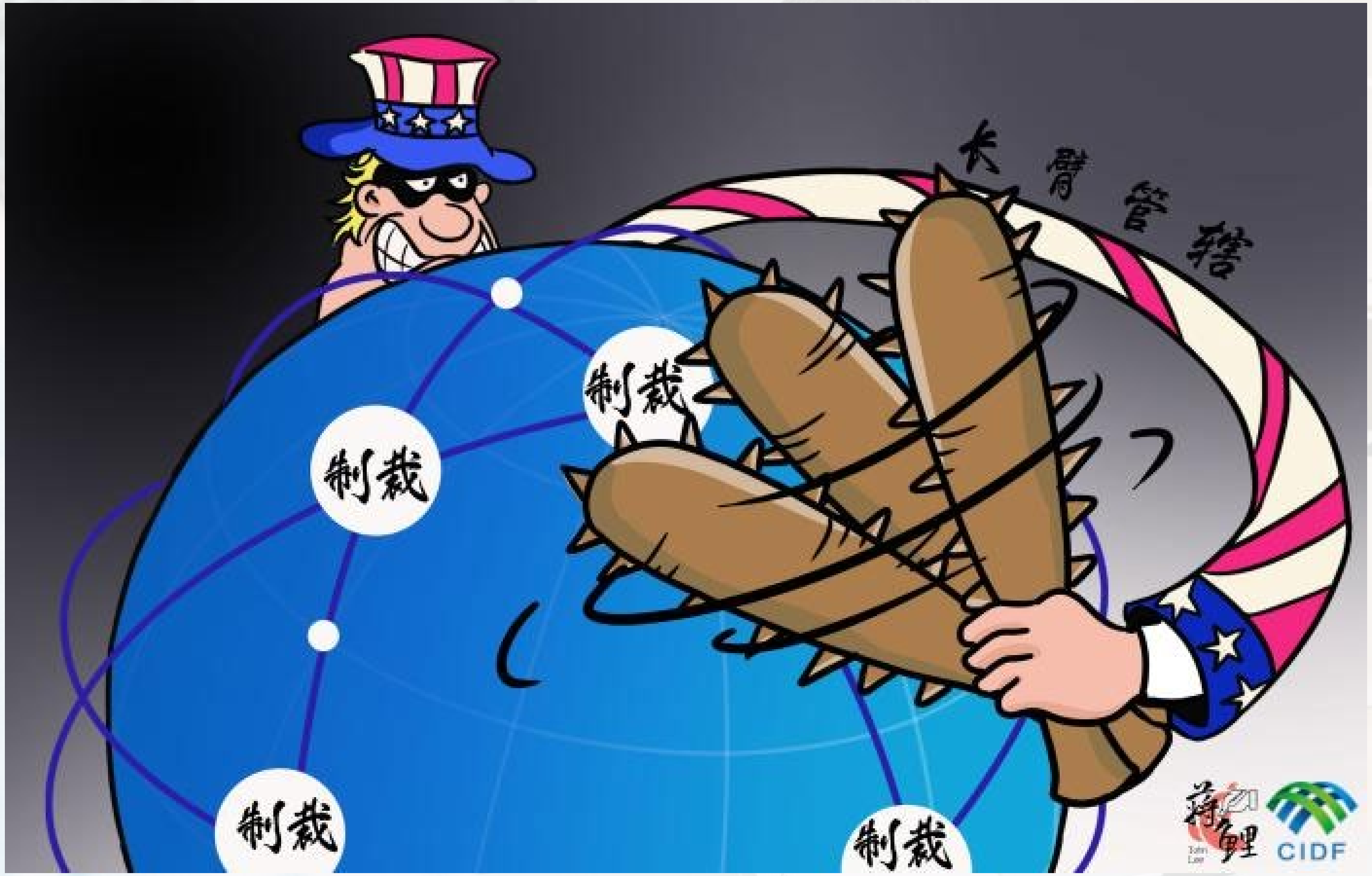
- The Entity List is a trade restriction list published by the United States Department of Commerce's Bureau of Industry and Security (BIS), consisting of certain foreign persons, entities, or governments.
- Entities on the Entity List are subject to U.S. license requirements for the export or transfer of specified items, such as some U.S. technologies.
- However, U.S. persons or companies are not prohibited from purchasing items from a company on the Entity List.
- Being included on the Entities List is less severe than being designated a "Denied Person" and more severe than being placed on the Unverified List (UVL).
- According to the Bureau of Industry and Security, there are approximately 600 Chinese entities on the Entity List.

# Entity List

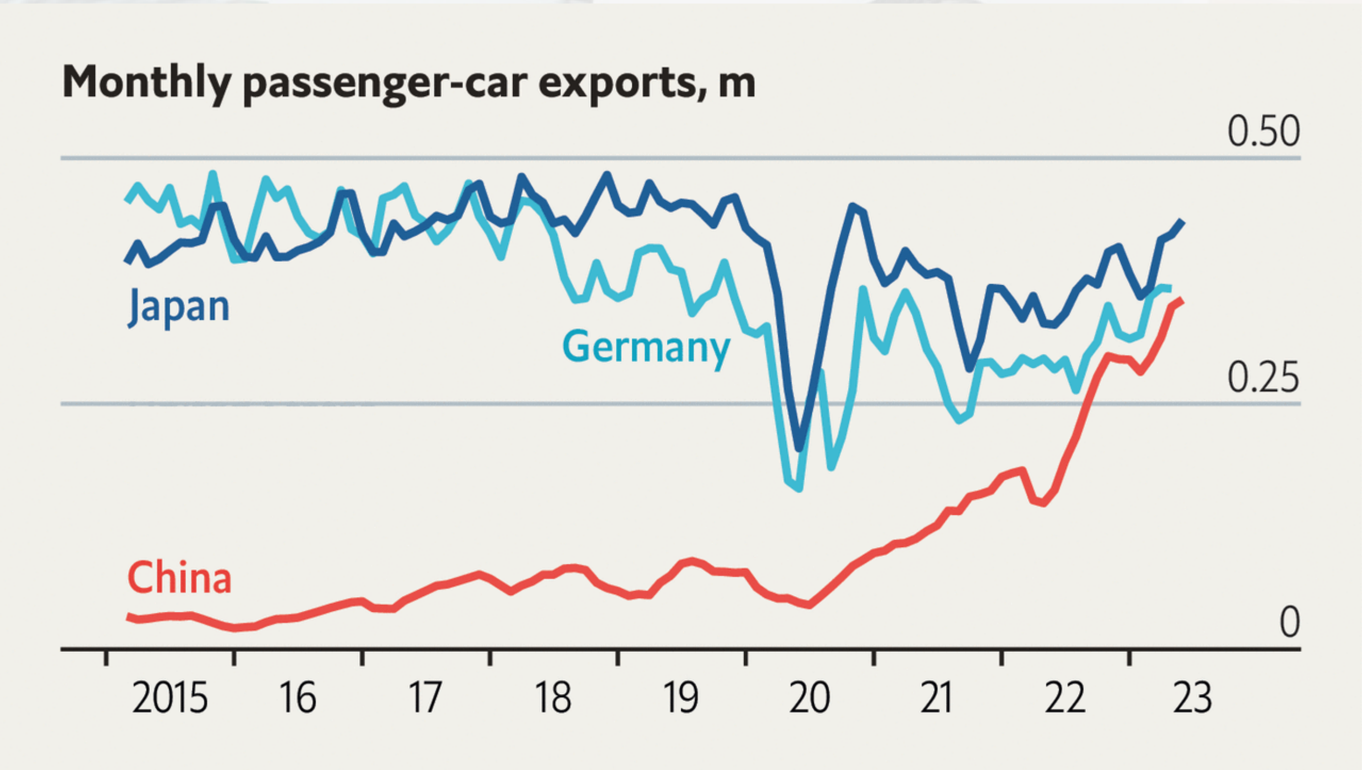

RESTRICTED
IN THE US

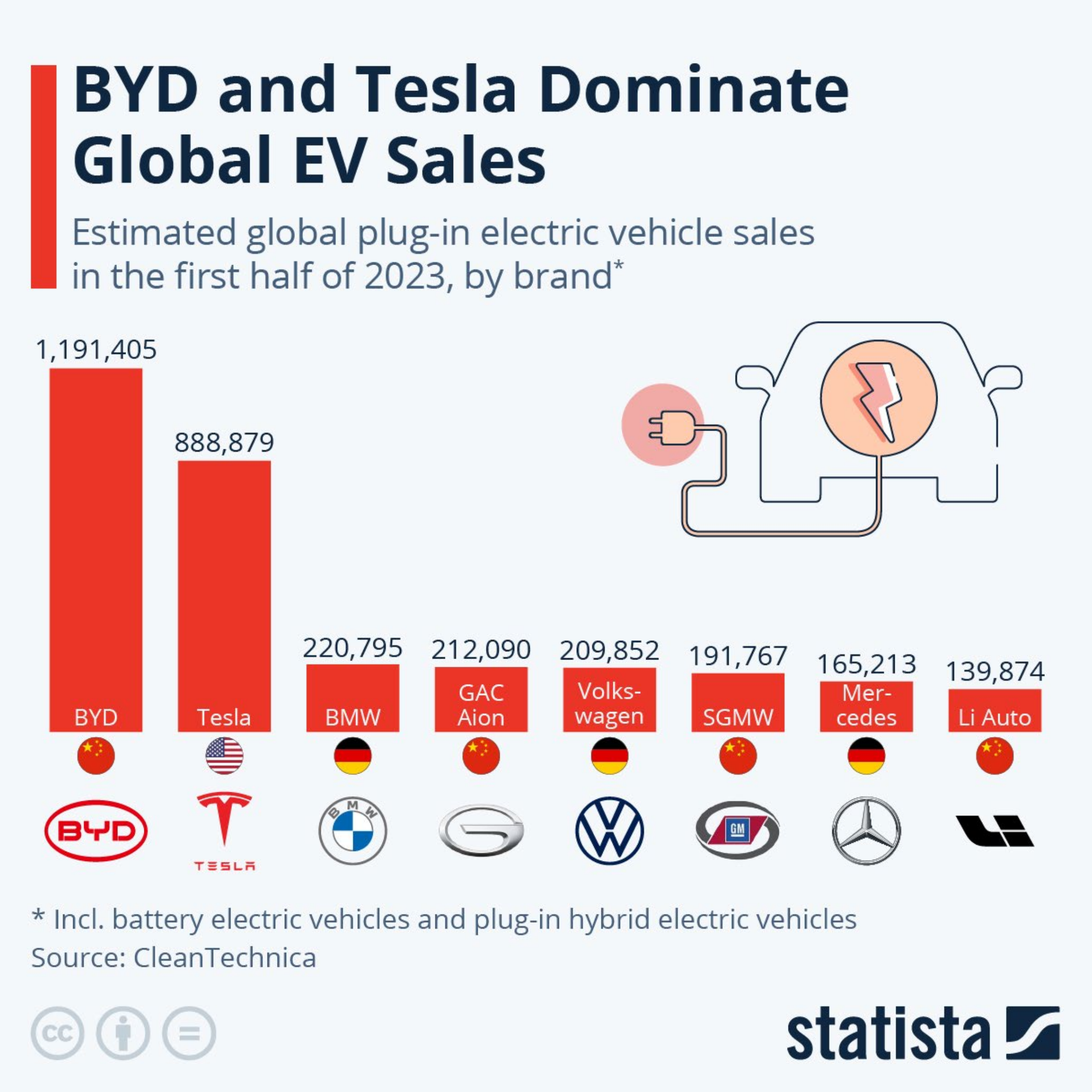

商汤
sensetime
科大讯飞
iFLYTEK
Face++ 旷视
依图 YITU
HIKVISION
海康威视
Meiya Pico
美亚柏科
alhua
TECHNOLOGY
颐信科技有限公司
颐信安防有限公司

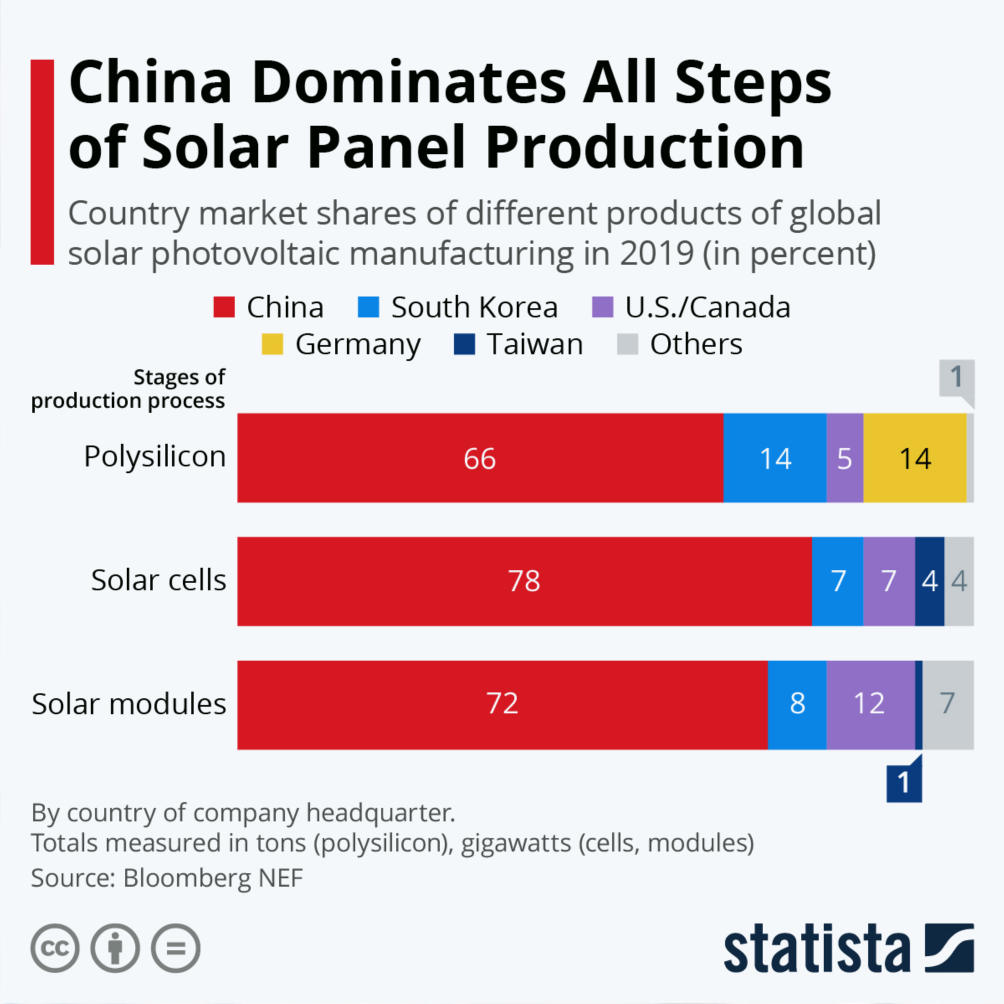
# Long-arm jurisdiction



# New Energy Cars




China Dominates All Steps of Solar Panel Production
Country market shares of different products of global solar photovoltaic manufacturing in 2019 (in percent)
China
South Korea
U.S./Canada
Germany
Taiwan
Others
Stages of production process
Polysilicon
66
14
5
14
1
Solar cells
78
7
7
4
4
Solar modules
72
8
12
7
1
By country of company headquarter.
Totals measured in tons (polysilicon), gigawatts (cells, modules)
Source: Bloomberg NEF
statista


MAVIC 2

# Thanks 感谢