Export-led growth

China in the World Economy, autumn 2024

Repetition from last time

- 1) How does a country finance its imports?

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- 2) What is the role of banks in an economy?

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- In China, **banks** (and other financial corporations) **are** overwhelmingly **state-owned**
- **= control over investment -> a tool of industrial and macroeconomic policy**
- = the government can order the banks to increase lending during a crisis, or to give „soft“ loans to a particular industry

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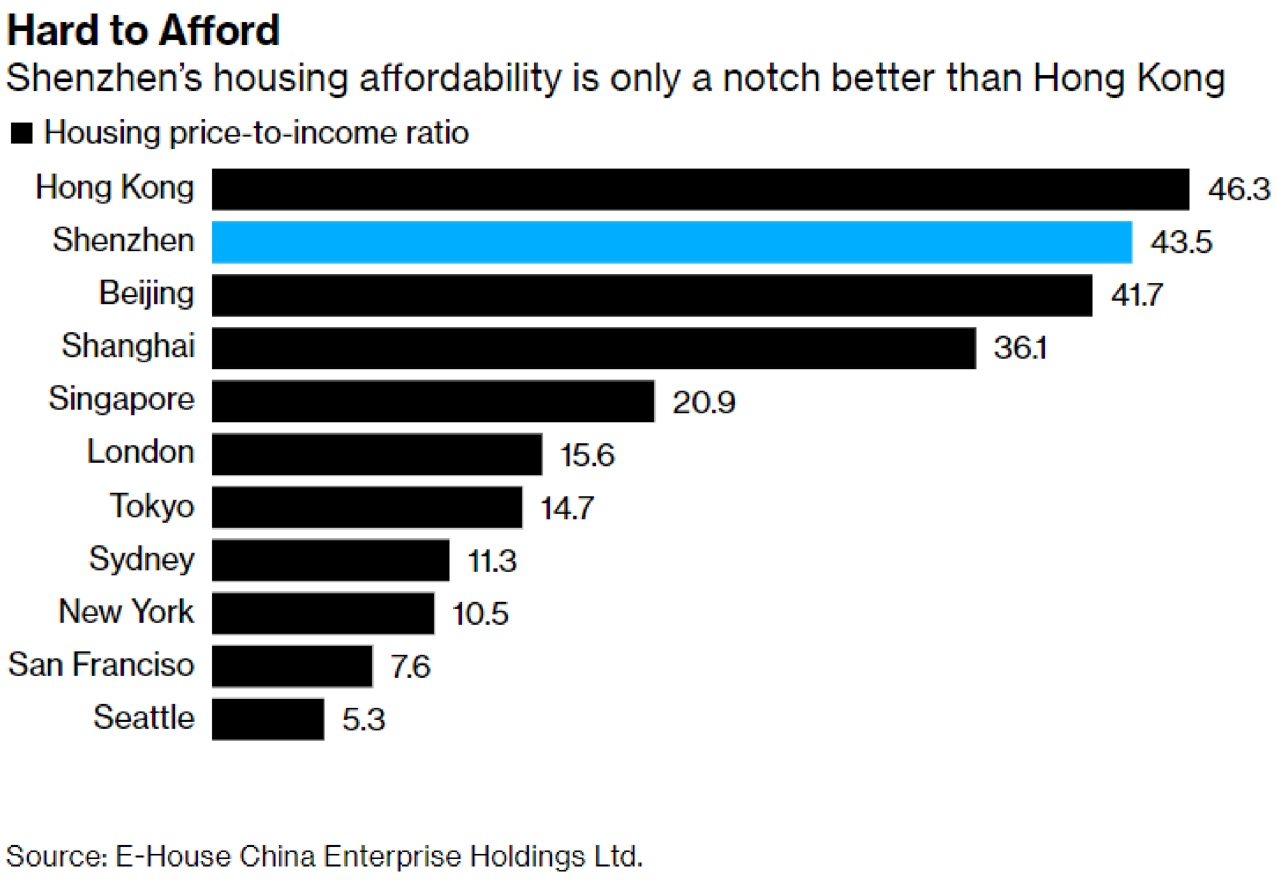
The role of China‘s banks

- Banks – transfer people‘s **savings into** loans -> **investment**
- In the US – the stock market plays a similar role
- China – financial speculation is **heavily regulated** -> **the only avanue for investment is land and real estate** -> **extremely high costs of housing!**


富泰邨


Hard to Afford
Shenzhen’s housing affordability is only a notch better than Hong Kong
Housing price-to-income ratio
Hong Kong
46.3
Shenzhen
43.5
Beijing
41.7
Shanghai
36.1
Singapore
20.9
London
15.6
Tokyo
14.7
Sydney
11.3
New York
10.5
San Franciso
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Seattle
5.3
Source: E-House China Enterprise Holdings Ltd.

Repetition from last time

- 1) How does a country finance its imports?
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- 5) Where did FDI come from in the 1980s? Which areas were opened to it?
- 6) Did China‘s private sector originate is a program of privatization?

Today

- Continuing reforms in the 1990s and 2000s – export-led growth
- Some macro-economic theory dealing with exchange rates

Return to reform and opening up

- 1992 – Deng‘s **Southern Tour** > push for reviving the reforms

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- Jiang and Zhu – from Shanghai – very conservative during the 1980s, almost no liberalization!

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- **Return to a pro-market policy**, but with more **cautious approach** than in the 1980s – fear of another Tiananmen

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- **Higher taxes in for rural farmers and entrepreneurs** > more inequality between cities and villages
- Increased rural illiteracy!
- Resources invested in urban areas

Return to reform and opening up

- Focus on **advanced technologies + large projects + foreign investment + export**

Return to reform and opening up

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- **This time, export and foreign investment really became the engine of growth**

Return to reform and opening up

- **Sophisticated infrastructure** – high speed trains connecting major cities

Return to reform and opening up

- **Sophisticated infrastructure** – high speed trains connecting major cities
- Some SOEs transformed into **joint-stock companies,** but **the Party usually retains the controlling voting block**
- **= mixed ownership –** difficult to interpret who makes decisions

Return to reform and opening up

- Industrial policy

- „**Industrial policy** is defined as the **strategic effort by the state to encourage economic transformation, i.e. the shift from lower to higher productivity activities**, between or within sectors.“

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- x **trade policy** – attempts to **influence import and export**

- **Industrial policy** - takes place **within a country** (subsidies, tax break, grants, privileged access to loans…)
- **Trade policy** – takes place **at the border** – tariffs and non-tariff barriers to trade

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- **> China is far more active in industrial policy!**

Return to reform and opening up

- Industrial policy — **„national champions“ – support of highly advanced companies such as Huawei** – attempts to push them to the global cutting edge

Return to reform and opening up

- „**Letting go of the small**“ – small companies can be privatized and left to their own devices
- If they go bankrupt, who cares?

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- > Chinese foreign investment is based on state-owned capital!

- > „*state capitalism*“

Return to reform and opening up

- Problems – **large rate of investment, relatively small growth of consumption**

Return to reform and opening up

- Problems – **large rate of investment, relatively small growth of consumption**
- = huge growth, but you can‘t enjoy its fruit, new wealth is immediately reinvested

Special economic zones

- New SEZ in Shanghai
- More importantly – **entire coastal region** opened for **„export-processing“**

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%

Special economic zones

- New SEZ in Shanghai
- More importantly – **entire coastal region** opened for **„export-processing“**

- > due to proliferation of export processing + reforms to ordinary trade, **SEZs gradually became relatively less special**


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

Foreign direct investment

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- **= a new firm or a large share in an existing one**

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- vs. **portfolio investment** – smaller piecemall investment – no desire the control the company, only financial profit

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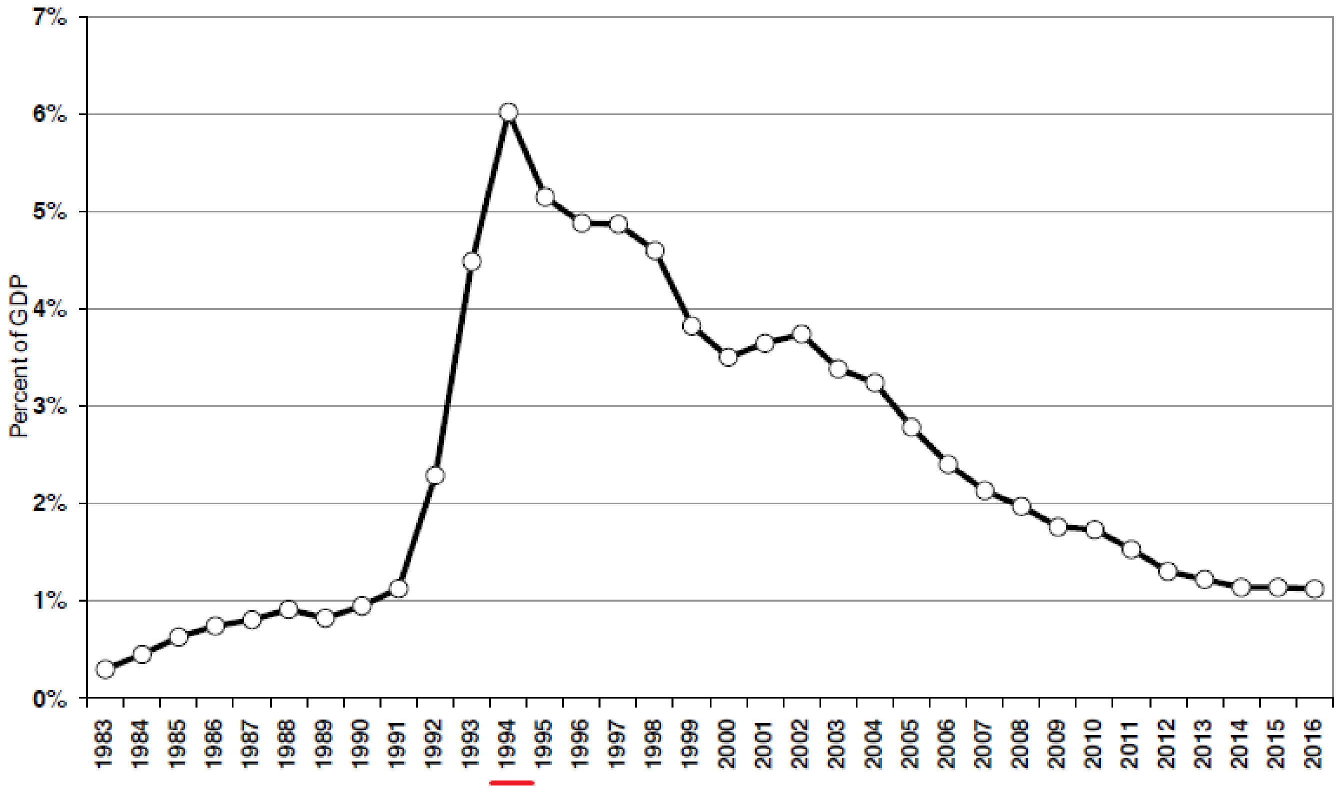
- FDI = **source of foreign technologies**
- Push to attract investors – **financial incentives, offer of access to China‘s already huge market**

FDI as a percentage of GDP



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- **Sources of FDI – now not only Taiwan and Hong Kong, but the US and Europe as well**

Foreign direct investment

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- Source of **foreign savings** („money!“) -> **but China has enough of its own savings**, especially now
- **Foreign technologies, business know-how, connection to global markets**

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- Sometimes outright IP theft

Foreign direct investment

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- **>** best strategy for Chinese companies – get incorporated in Hong Kong, then **do business in China as a foreign company**

Reforms to the „ordinary“ foreign trade

- Last time – **special** economic zones

Reforms to the „ordinary“ foreign trade

- Last time – **special** economic zones
- Now – reforms to the **normal** trade regime
- = the rest of China
- From 1980s onwards

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!**
- **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%

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- After reform – „export and import whatever is profitable in your business area“

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- 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

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- **> FTCs as middlemen**

The exchange rate

- **Gradual devaluation of the RMB**

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- And vice versa

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- Kept there by **currency interventions > the central bank buys or sells the currency**
- **It is always possible to devalue your currency**
- **Revaluation is more difficult** – you need foreign exchange to be able to buy your currency vs. you can always print more of your own money

The exchange rate

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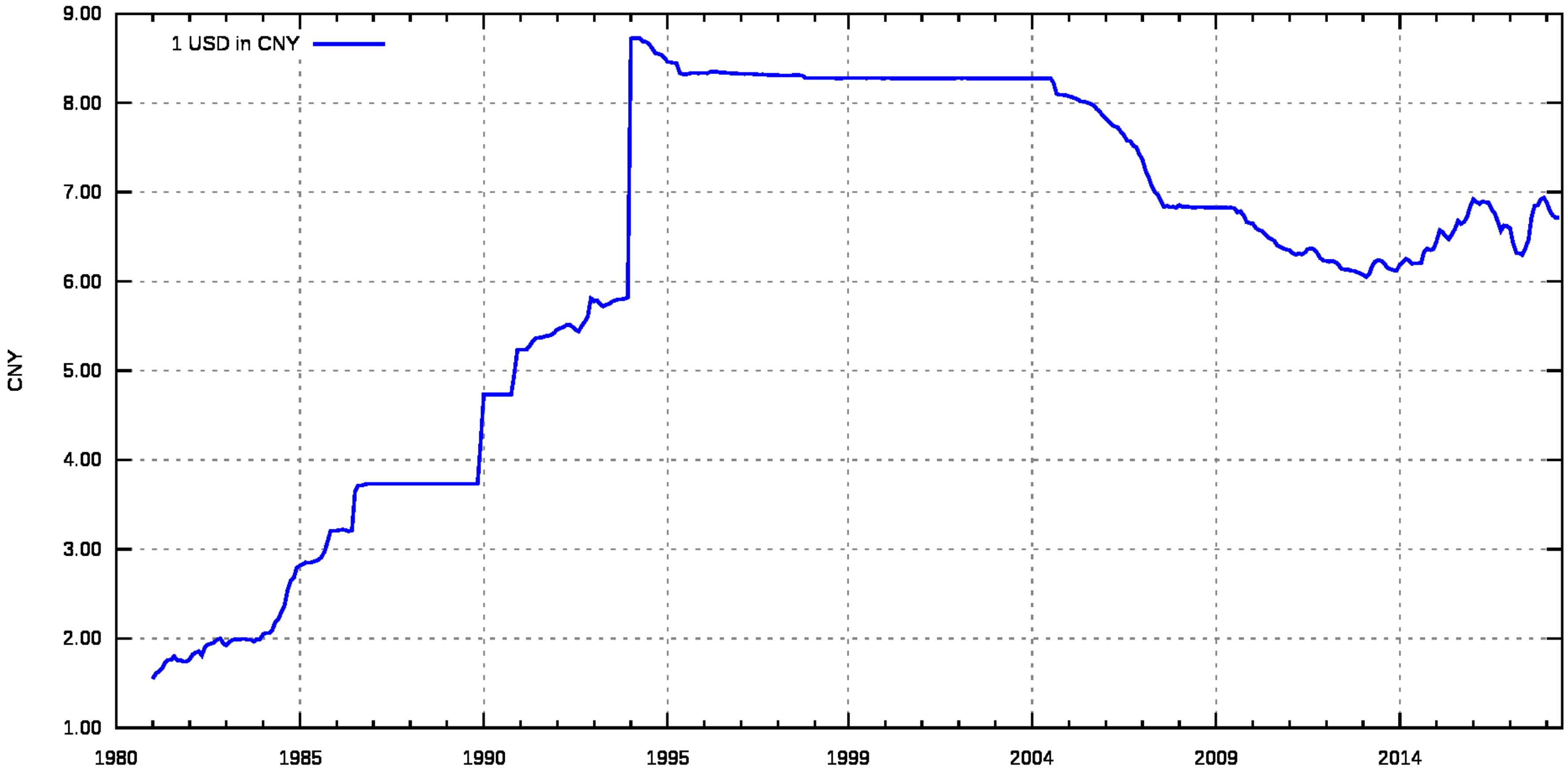
- Frequent adjusted fix since circa 2010 – still probably undervalued, but less

USD to RMB



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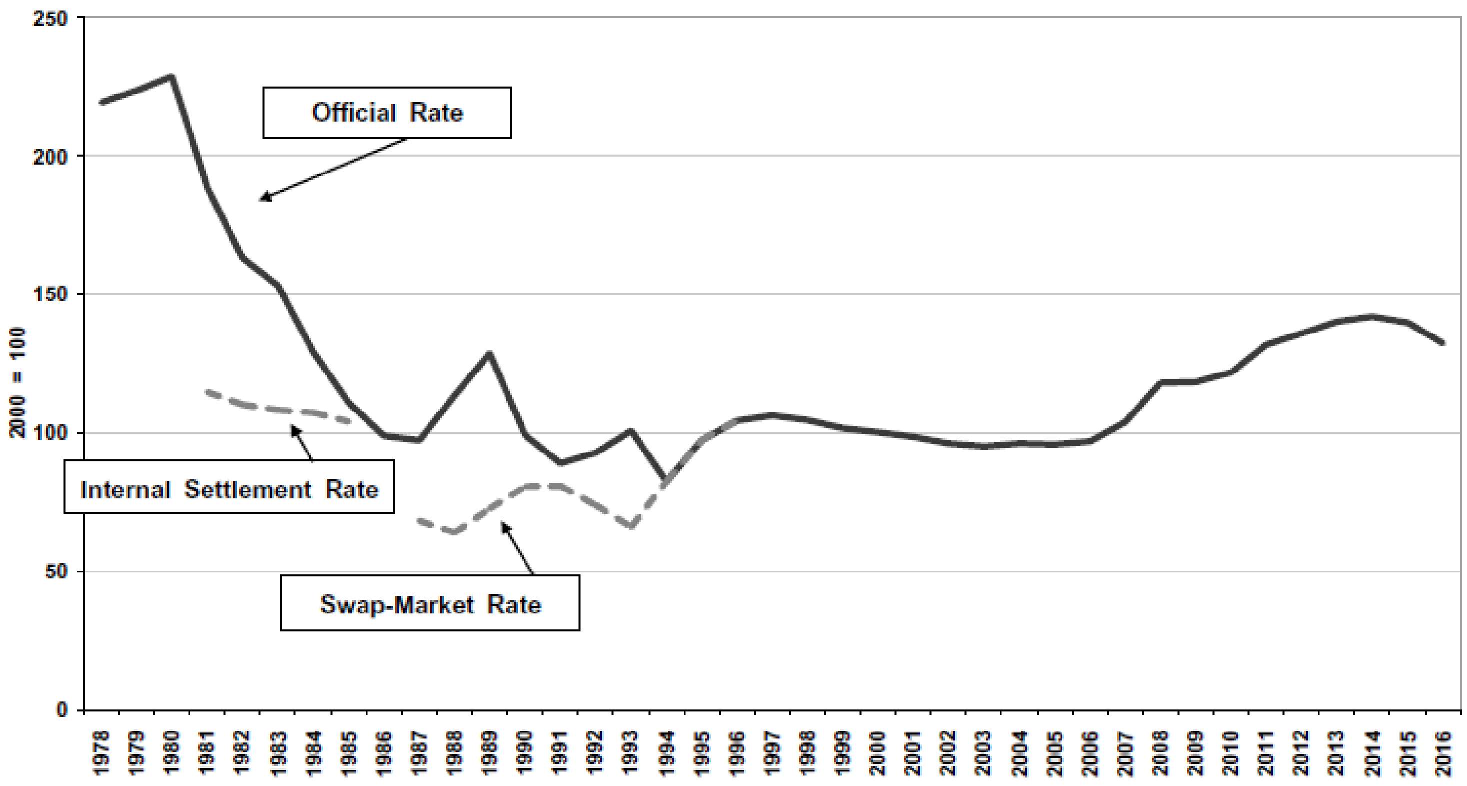
- > **two exchange rates** – the official one and the one used between the companies
- **Fix and floating at the same time** (kind of)
- Which one was lower?

RMB to UDS

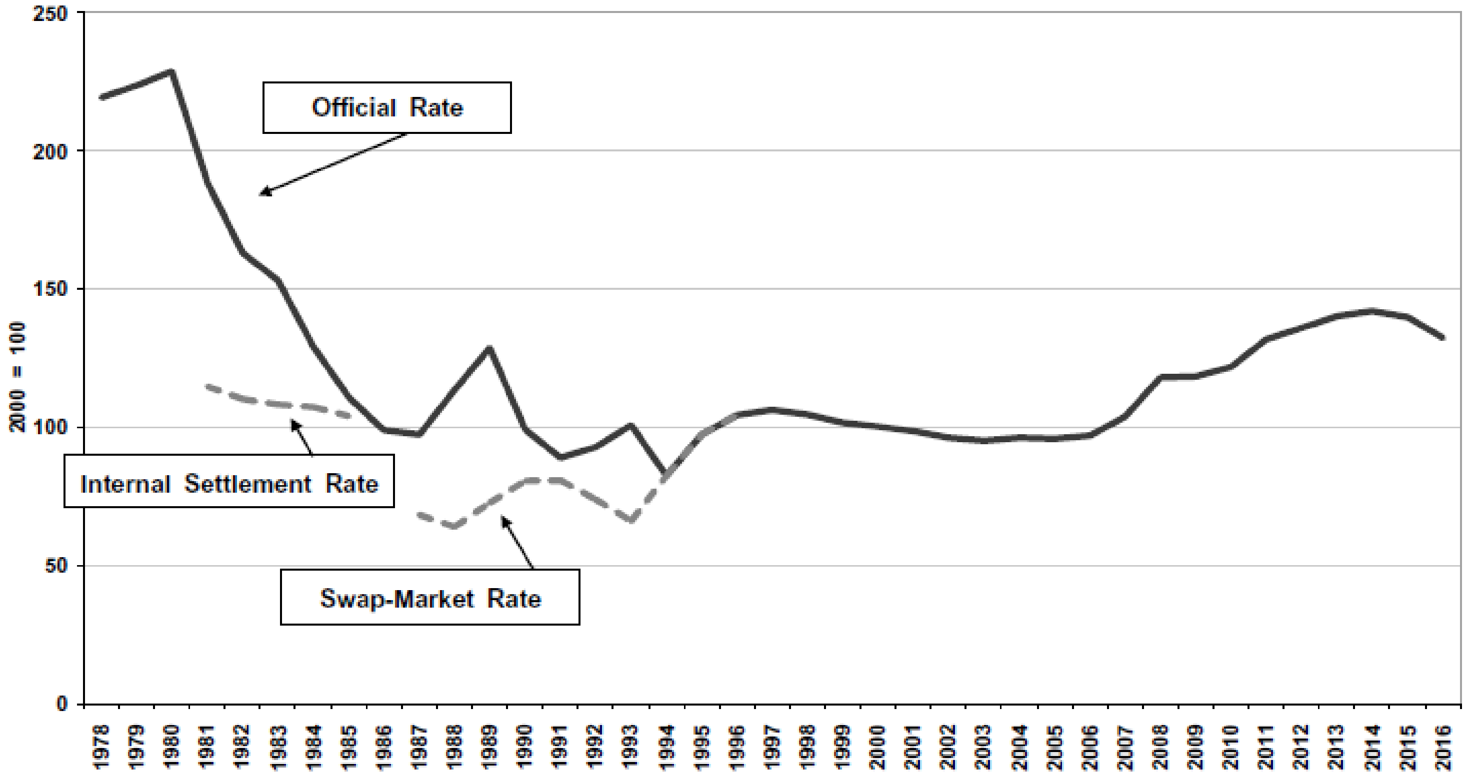


Official Rate
Internal Settlement Rate
Swap-Market Rate
2000 = 100
250
200
150
100
50
0
1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

The exchange rate

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

The exchange rate



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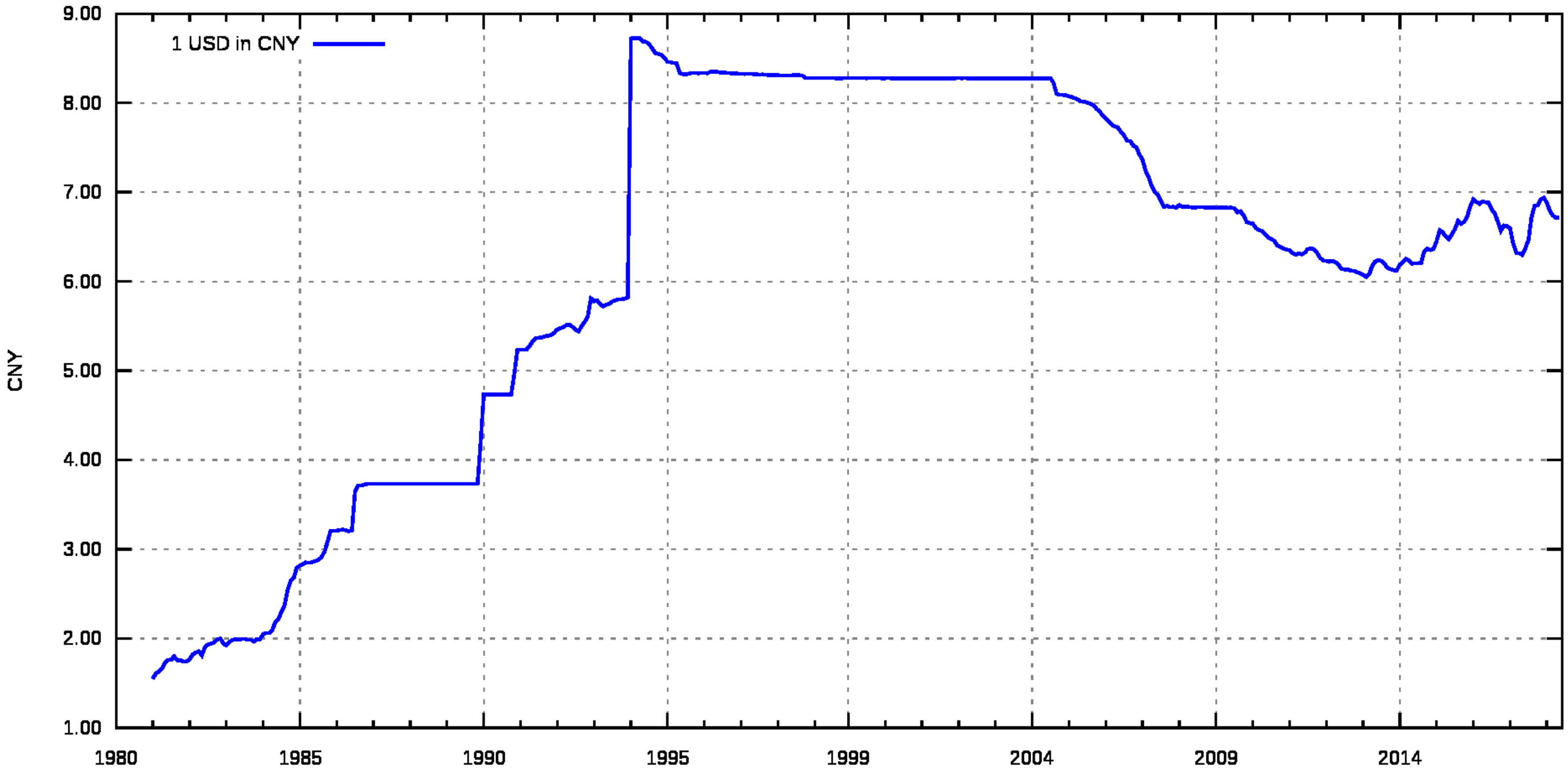

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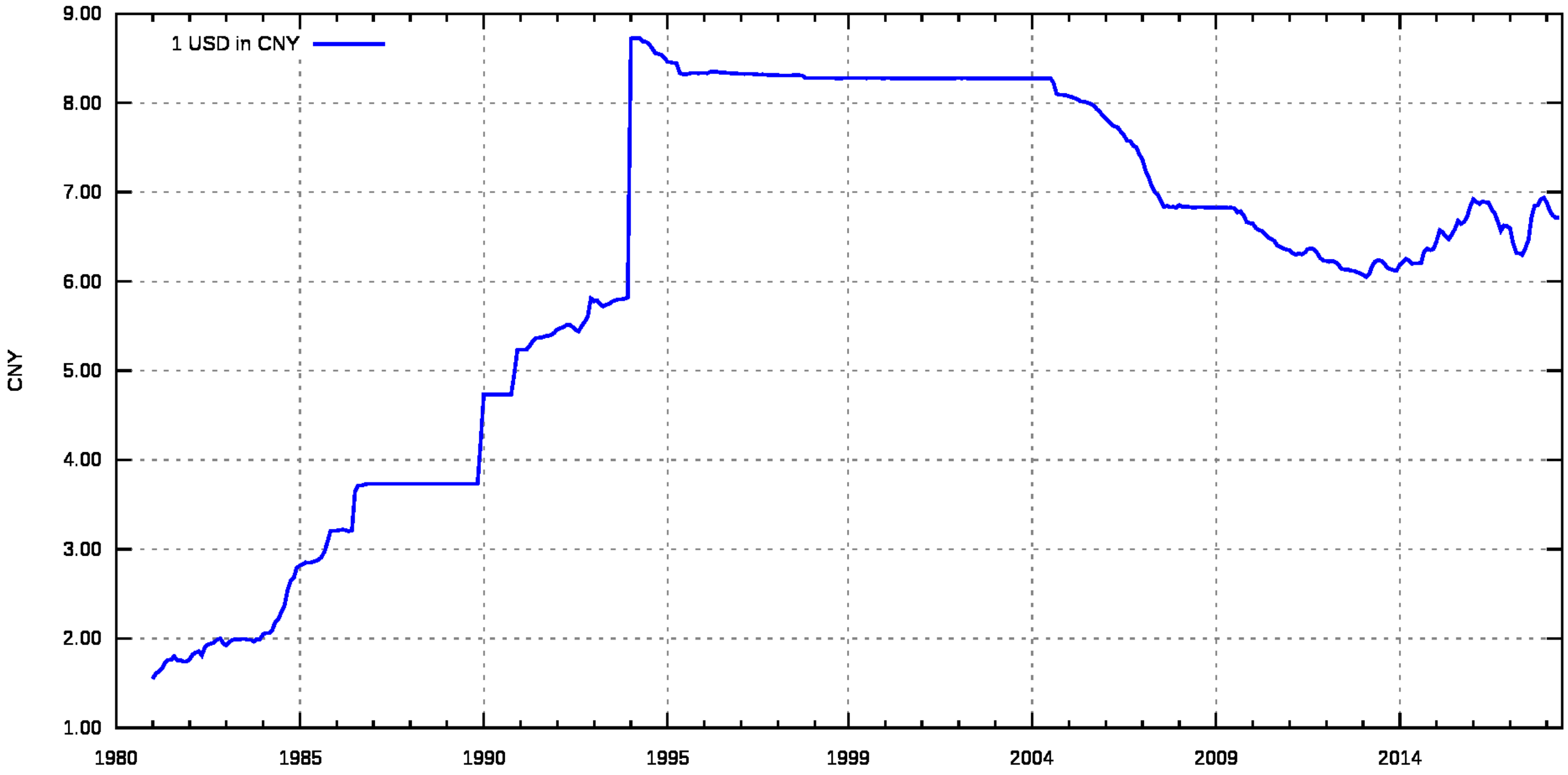
- The rate was competitive and led to a more or less balanced trade
- **Under floating, the rate would appreciate because of growing exports**
- **=** as China became more competitive, the rate should have gone up

The exchange rate

- 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
- > **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

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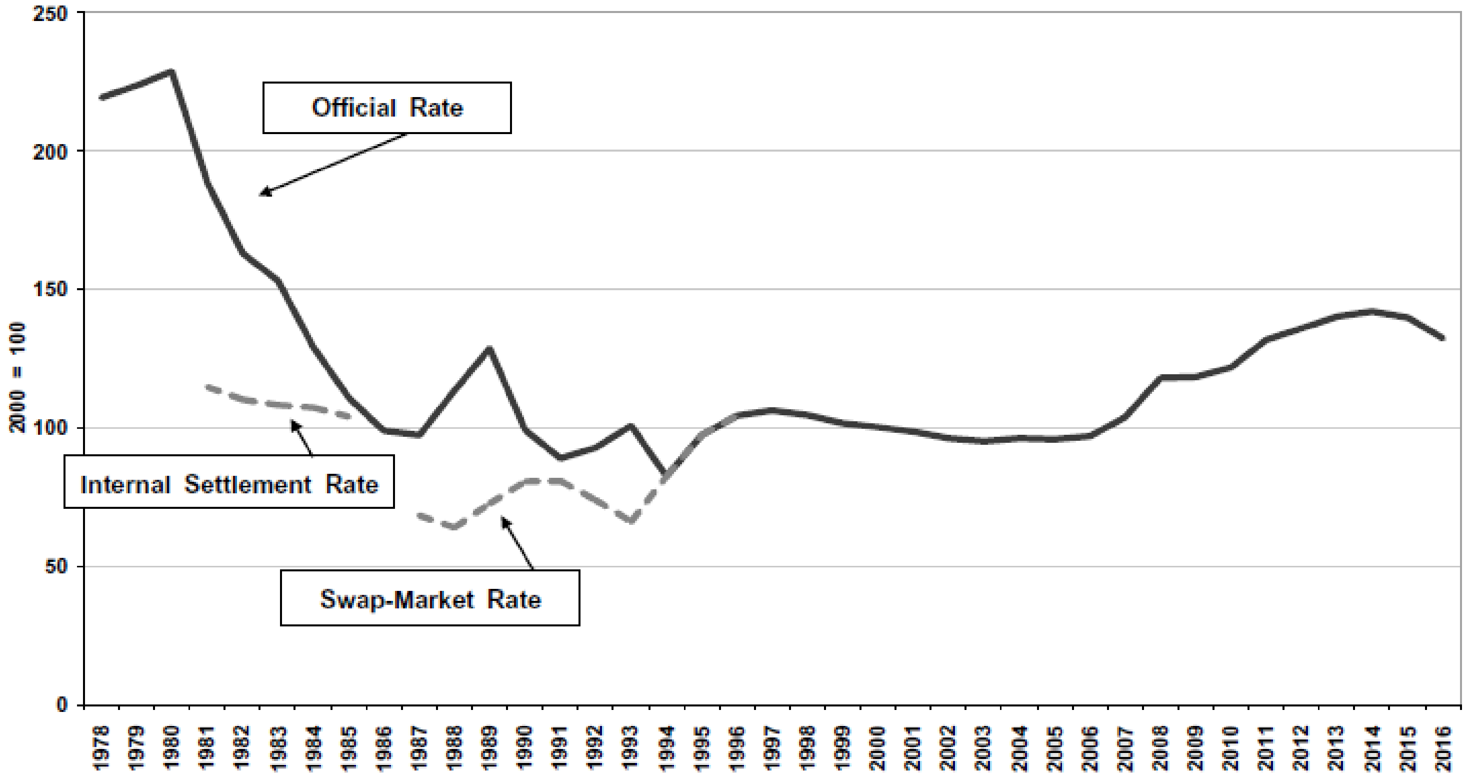
- If your **exchange rate is stable AND you have lower inflation** than a partner country, your currency is undergoing a real depreciation
- > your goods become more competitive > you export more
- **As if you devalued the currency**

The exchange rate



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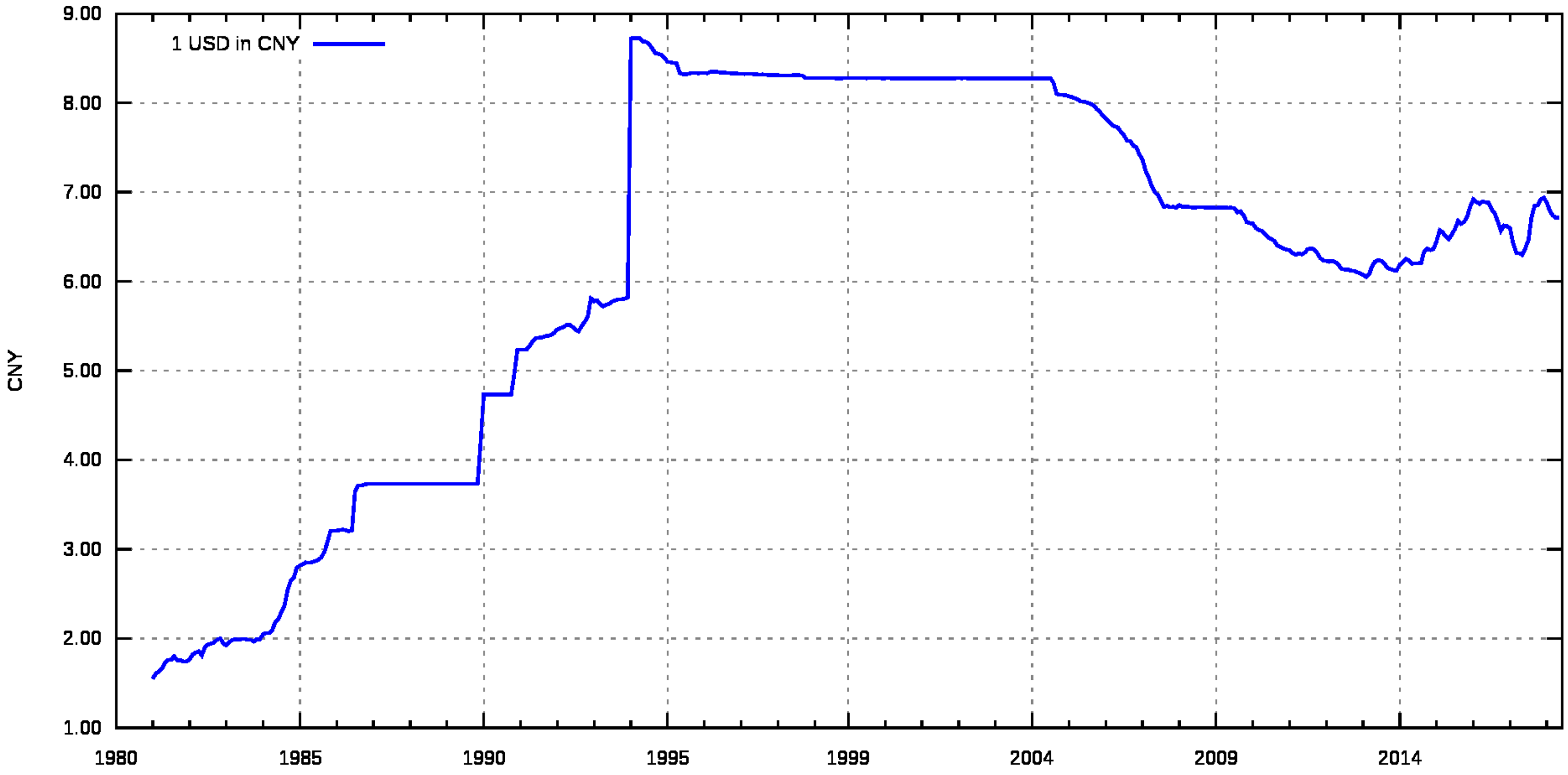

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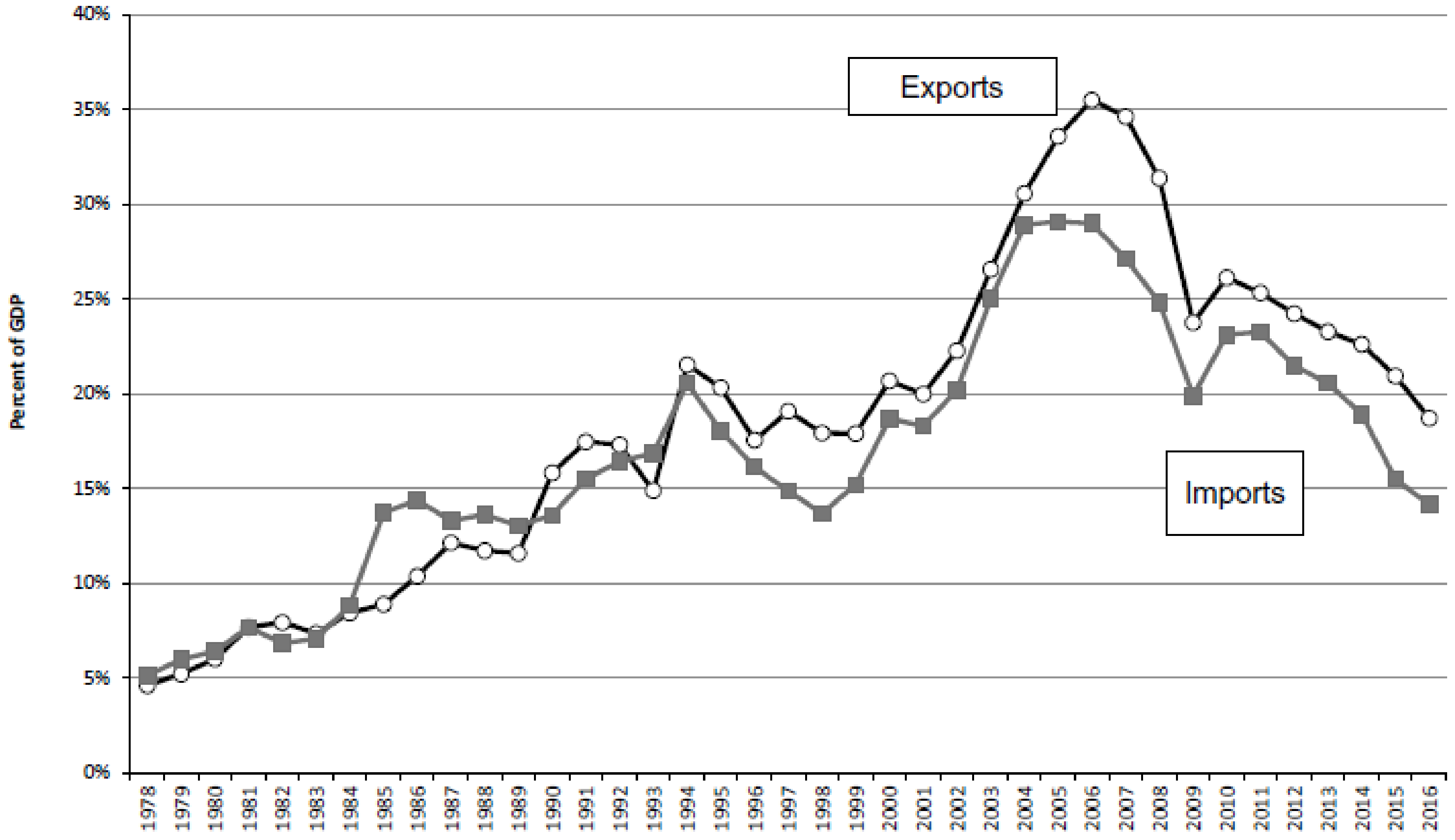
- \+ **real depreciation**
- **> undervaluation, huge trade surpluses!**



Exports
Imports
Percent of GDP
40%
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- **Plans to also abolish capital controls** = to make the RMB convertible for financial account transactions
- Abandoned because of the **1997 Asian Financial crisis**

The 2000s – continuing export-led growth

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- Progress **from textile exports to electronics**

The 2000s – export-led growth

- Slow, gradual liberalization continued into the new millennium

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- **China‘s most capitalist moment** – after entering the WTO in 2001

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- World average is about **20 % for each**

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- **China reached this level by 2001**, its exports continued to soar after entering the WTO
- 2006 – **exports stood at 35 % of GDP, imports at 30 %** > **65 % together**
- In the United States, the **sum is around 20 %!**
- = China was already far more opened than the world average or comparably large countries!

The 2000s – export-led growth

- **2009 – largest exporter in the world**
- **2011 – largest manufacturer**
- **2012 – largest GDP by purchasing power parity**

The 2000s – export-led growth

- **Huge growth of export, current account surplus** (5 % of GDP in 2006)

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- > **accumulation of foreign exchange** (mostly dollars)

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- Anxiety after the **Asian monetary crisis of 1997**

Fixed exchange rates and monetary crises

- A country has a **fixed exchange rate**

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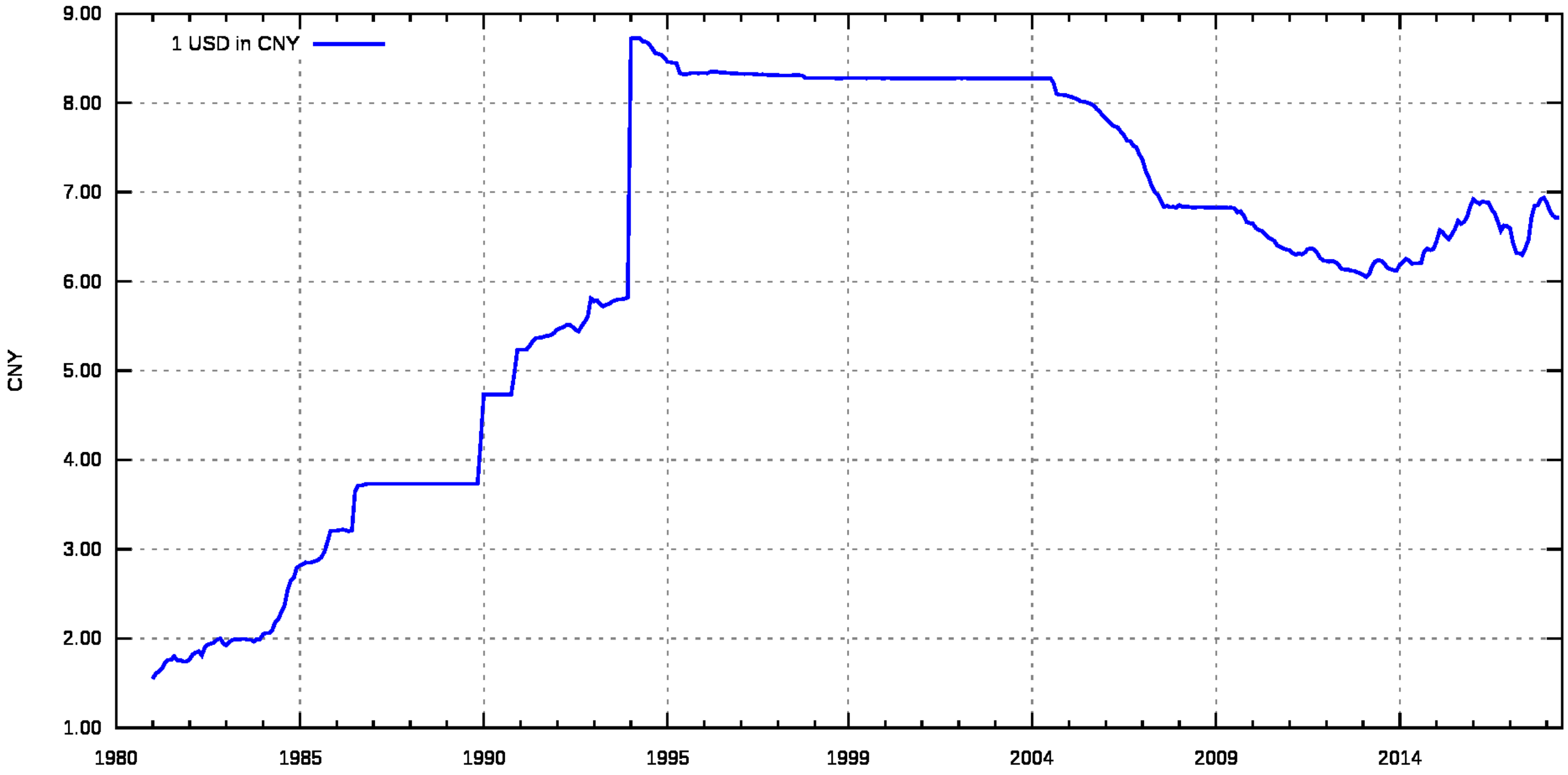
- **-** China does have a fixed exchange rate – the yuan was first tied to the US dollar, since 2005, it is pegged to a basket of currencies

USD to RMB



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- > **pressure for devaluation**

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- Markets (banks etc.) think that the rate **is overvalued and unsustainable > they start to sell the currency**
- > **pressure for devaluation**
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- If they fail > **increased interest rates to stop the capital flight** > drop of domestic credit > **domestic recession**

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- = in the end, the central bank usually **freezes the creation of money**, which stops capital flight, but creates recession

How a monetary crisis works

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- > if you sit upon a huge pile of dollars, you can defeat a speculative attack
- Actually, you can **deter it**

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- **Foreign investment** – purchases of Western companies; **Belt and Road Initiative**

The 2000s – export-led growth

- **Major exporter of advanced technology products already by 2005!**
- = laptops, mobile phones, scanners, cameras, medical equipment

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- Hu leadership – continuation of previous policies
- **More resources devoted to social spending** – healthcare, education, alleviation of rural poverty

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- = biggest story of the decade; the West overlooked it

- Next time:
- The return of industrial policy
- The fallout of the 2008 Financial crisis
- The rise of Xi Jinping and the US-Chinese trade war