The Economics of China

International Trade

Western
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International Trade

- During the Socialist Era, China faced autarky and focused on self-sufficiency.
- As a result, China **was** one of the **most closed economies** in the world when it comes to international trade.
- "imports and exports together were only 5% of GDP in 1970 and 1971".
- Since 1978, China has **transformed** "into the **most open large economy** in the world".
- In particular, "China's trade growth accelerated after 2002..[and]...Exports soared to 35% of GDP in 2006–2007".
- "It has done so with a minimum of disruption and trade-related economic distress".

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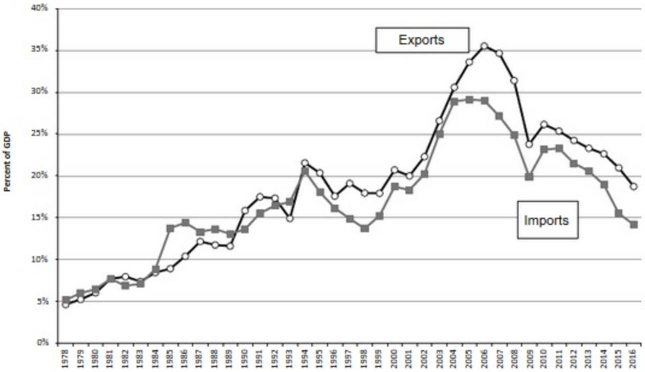

Figure 16.1
Exports and imports (share of GDP).
Sources: *SYC*, updated from General Administration of Customs.

International Trade

- **Background:** Two main points before 1978.
  - **"Controlled flows of both goods and money".**
    - "Twelve national foreign-trade companies (FTCs) exercised monopolies over both imports and exports".
    - "Individuals could not exchange renminbi for foreign currency without special authorization".
  - **International trade only when necessary:**
    - "The purpose of foreign trade was to import goods that could not be produced by Chinese firms and that would resolve domestic shortages...or bring in modern technology".
    - In addition, "exporting was the only way to pay for imports".

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- **Initial Reform Steps**: 1978 and shortly after.
  - "China's first step in opening came in 1978 when Hong Kong (already a a huge trading power) businesses were allowed to sign export-processing (EP) contracts with Chinese firms in the Pearl River delta."
  - "In this way, the export-production network already created by Hong Kong could expand into China, but Chinese industrial firms were not exposed to import competition (since it was required that the goods produced be exported)".
  - "Shortly thereafter, four special economic zones (SEZs) were set up in Guangdong and Fujian."
  - "The zones were enclaves that did not overly threaten the system of domestic protection."
  - "SEZs allowed imports in duty-free as long as they were used in the zone to produce exports."
  - "Guangdong and Fujian Provinces...transformed from economic backwaters into crucial nodes in the global trade economy."

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- **Further Opening of the Foreign-Trade System**: began mid-1980s, four key elements.
  - 1) Reforming the exchange rate policy: from an overvalued official exchange rate to a dual system then a unified system by 1994. At the same time, "access to foreign exchange was dramatically liberalized".
  - 2) Demonopolizing the trading system: "The number of companies authorized to engage in foreign trade was allowed to expand dramatically. By 1988, there were 5,000 FTCs. Direct export and import rights were also granted to some 10,000 manufacturing enterprises...Exports were liberalized much more rapidly than imports."
  - 3) Liberalizing import prices: "World prices were gradually allowed to influence domestic prices".
  - 4) Setting up a system of tariffs and nontariff barriers: "wary of making mistakes and afraid of import surges, trade deficits, and hard-currency debt...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."

- **Dualist Trade Regime:** EP(export-processing) vs OT(ordinary trade)
    - "By the late 1980s, China had established what were, in essence, two separate trading regimes."
    - EP, " which allowed exporters to simply bypass the old centralized foreign-trade monopoly", can be viewed as one of the most important policies to promote Chinese export success while maintaining control over domestic markets (in particular, controlling import flows).
    - "The exemption from duties on imported inputs provided a significant cost advantage to firms in the EP regime."
    - In addition, exporters under the EP regime, were able to sidestep trade restrictions present under the OT regime.
    - "Given these advantages, EP trade grew much more rapidly than OT trade", but was mainly through foreign-invested (mostly from Hong Kong and Taiwan) enterprises.
    - In general, "domestic exporters had to wait for WTO membership to kick in before they could fully realize their export potential."

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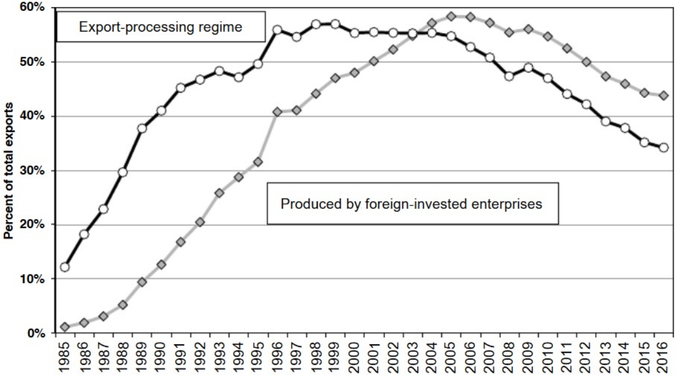

Figure 16.4
Share of exports from export-processing regime and foreign-invested enterprises.
Source: General Administration of Customs.

- **WTO Membership**:
  - "requirement that China open up its OT regime."
  - Lower tariffs: from 43% in 1992 to 17% in 1999 then to less than 10% by 2004.
  - "far from being deluged by rapid import growth, China experienced a surge of exports in the wake of WTO membership".
  - "Chinese domestic firms seized the opportunity for rapid expansion".
  - "China's exports surged from 2003 through 2007".

International Trade

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%

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

- **Main Trade Partners of China in 2015**:

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

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

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

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- Opening up for trade: Good for China, Bad for the US?!
  - "In the United States, imports from China tripled between 2001 and 2007, creating substantial economic dislocation".
  - Who benefited from that process in the US?
    - "higher profits of U.S. firms importing goods".
    - lower prices for some consumption goods.
  - Who lost from that process in the US?
    - "labor markets in the United States that were most exposed to competition from Chinese imports lost the most".
    - "trade-related job losses were not made up by increased employment in nontraded or export-oriented sectors in those localities".
    - "In other words, the frictions involved in adjusting to trade were costlier and longer lasting than economists typically expect."
    - To make things worse, a financial crisis followed by the "Great Recession" happened between 2007 and 2009.

- Composition of Trade: **Exports**
  - "As late as 1985, petroleum was China's largest single export, accounting for 20% of export earnings".
  - "By 1995, all of China's top export commodities were labor- intensive manufactured goods, most strikingly textiles and garment exports, footwear...".
  - "The post-WTO surge was also associated with a dramatic increase in the share of machinery and electronics, from 22% in 1995 to 47% in 2007".
  - "having already shifted to encompass labor-intensive manufactures, China's exports now deepened to include manufactures that are much more capital and technology intensive".
  - "This has left China exporting an extraordinarily broad range of manufactures, an export composition more typical of a developed country".
  - "exports in 2016 were five times what they had been in 2003".

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- Composition of Trade: **Imports**
  - "In 2003, 23.9% of China's imports were capital-intensive commodities, often produced in heavy, process-technology industries".
  - "These commodities have declined to 17% of China's imports, reflecting the substantial growth of China's heavy industrial base".
  - "China now imports an extraordinary quantity of natural resources and mining products: 34.2% of total imports".
  - Of the most important imports today are **semiconductors** in addition to oil and gas.
  - "China has a substantial impact on world markets for several of these commodity groups: copper, iron ore, fertilizers, and, increasingly, petroleum. These are areas where Chinese demand moves world markets".
  - In 2015, "the biggest service import was 'travel and tourism' (56%), much higher than the world average (28%). It follows that nontravel service imports are a much smaller share of GDP than world averages (1.7% versus 4.7%)".

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

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

Source: General Administration of Customs.

- International Trade and Technological Sophistication.
  - "China is by far the world's largest exporter of 'high- technology' goods and accounts for nearly all the increase in global high-technology exports since the turn of the century".
  - "Electronics production worldwide is carried out through global production networks, chains that link production, research, and services that are performed in many different countries".
  - "China is already an integral link in many of these production networks. But inspection of the products exported and the processes carried out in China reveals that China is overwhelmingly concentrated on the final assembly stage of production. This is a labor- intensive, medium-skilled activity, not a high-tech activity".
  - That being said, "the rapid pace of increase of domestic value added indicates that China is rapidly climbing the ladder of sophistication."

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- International Trade and Regional Change.
  - "The steady expansion of the export sector permitted the steady expansion of urban employment during the period when labor supply was growing rapidly".
  - "Foreign trade unsurprisingly benefits the coastal regions of China, and the coastal provinces grew significantly more rapidly than inland provinces on the strength of trade-related demand through 2006".
  - "However, after 2010 several large exporters began to move inland in search of lower wages".
  - That being said, "Guangdong Province is still the single largest exporting province, and has the highest export/GDP ratio, at 55% in 2016."

International Trade

Table 16.4
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%

Source: *SYC* (2016, table 11-9); *SAC* (2017, 96).
Southeast: Guangdong, Fujian, and Hainan.
Lower Yangtze: Shanghai, Jiangsu, and Zhejiang.
Northeast/North Coast: Shandong, Beijing, Tianjin, Hebei, Liaoning, Jilin, and Heilongjiang.

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- International Trade into the Future.
  - "China continues to have strong trade competitiveness".
  - "Trade-related infrastructure in China is among the very best in the world".
  - "China's factor endowments vary significantly from those of the developed countries, [and] China has a lot to gain from globalization".
  - However, "the slowing global economy means that demand from developed countries can no longer be expected to grow as robustly as in the past".
  - "Therefore, foreign trade is unlikely to be as conspicuous a leading sector in the future".