

China and the World: Win-Win Strategies for Economic Development

中国与世界：双赢的经济发展策略

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Introduction

- ◆ China has made tremendous progress in its economic development since it began its economic reform and opened to the world in 1978. China is currently the fastest growing economy in the World—averaging approximately 10% per annum over the past 30 years.
- ◆ Between 1978 and 2007, Chinese real GDP grew fifteen-fold, from US\$228 billion to US\$3.42 trillion (2007 prices) (4th largest economy in the world) and real GDP per capita grew more than ten-fold from US\$236 to US\$2,571. By comparison, the U.S. GDP (approx. US\$13.84 trillion) and GDP per capita (approx. US\$45,671) were respectively 4 and 18 times the comparable Chinese figures in 2007.

Introduction

- ◆ Despite its rapid growth, China is still a developing economy in terms of its real GDP per capita. An economy is generally considered to be developed if its GDP per capita exceeds US\$10,000 (if we take into account inflation, this threshold probably should be raised).
- ◆ It will probably take another 20-25 years before China joins the ranks of developed economies, and a further 20-25 years before China reaches the same level of real GDP per capita as the United States (some time around the middle of the 21st Century).

The Chinese Real GDP and Real GDP per Capita: Past, Present and Projected Future

	1978	2007	2020
	US\$	(2007 prices)	
Real GDP (trill.)	0.228	3.42	8.00
Real GDP/capita	236	2,571	5,500

Introduction

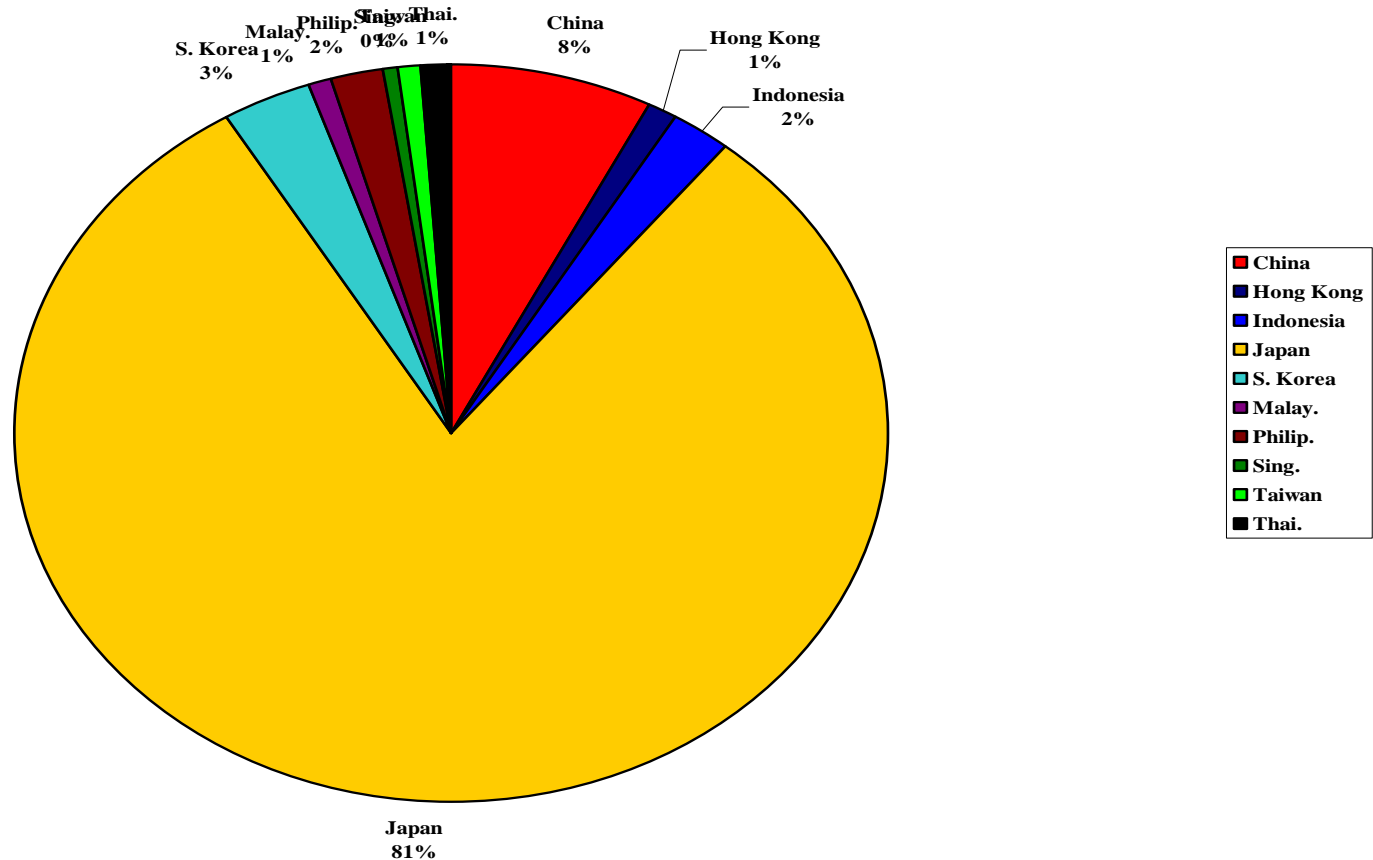
- ◆ Moreover, Chinese economic growth has not been at the expense of the Rest of the World. It has not been a zero-sum game. Almost every country has benefitted from China's economic progress and its opening to the world. For example:
 - ◆ The consumers in the developed economies are able to enjoy low and stable prices for their everyday light-manufactured consumer goods.
 - ◆ China has become the most important importing country for and runs a trade deficit with almost every country and region in East Asia, including Japan.
 - ◆ China has become a major donor of development aid and assistance to developing countries, especially those in Africa.

The Chinese Economy in the World: The Shifting Economic Center of Gravity

- ◆ The economic center of gravity of the world has been gradually shifting to East Asia from the United States and Western Europe.
- ◆ In 1960, the GDP of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam) + 3 (China (Mainland only), Japan, and South Korea) was approximately 40% of US GDP, with Japan contributing more than 80% of total East Asian GDP, followed by China (Mainland only), with not quite 8%.
- ◆ In 2006, the GDP of ASEAN + 3 was approximately comparable to that of US GDP, with Japan contributing a little more than a half of total GDP, followed by China (Mainland only), which contributed somewhat more than 20%.
- ◆ South Korea, and Hong Kong, Macau, and Taiwan combined, contributed between 10% and 15%.
- ◆ ASEAN + 3 is also comparable to the Zone Euro in terms of the order of magnitude of its GDP.

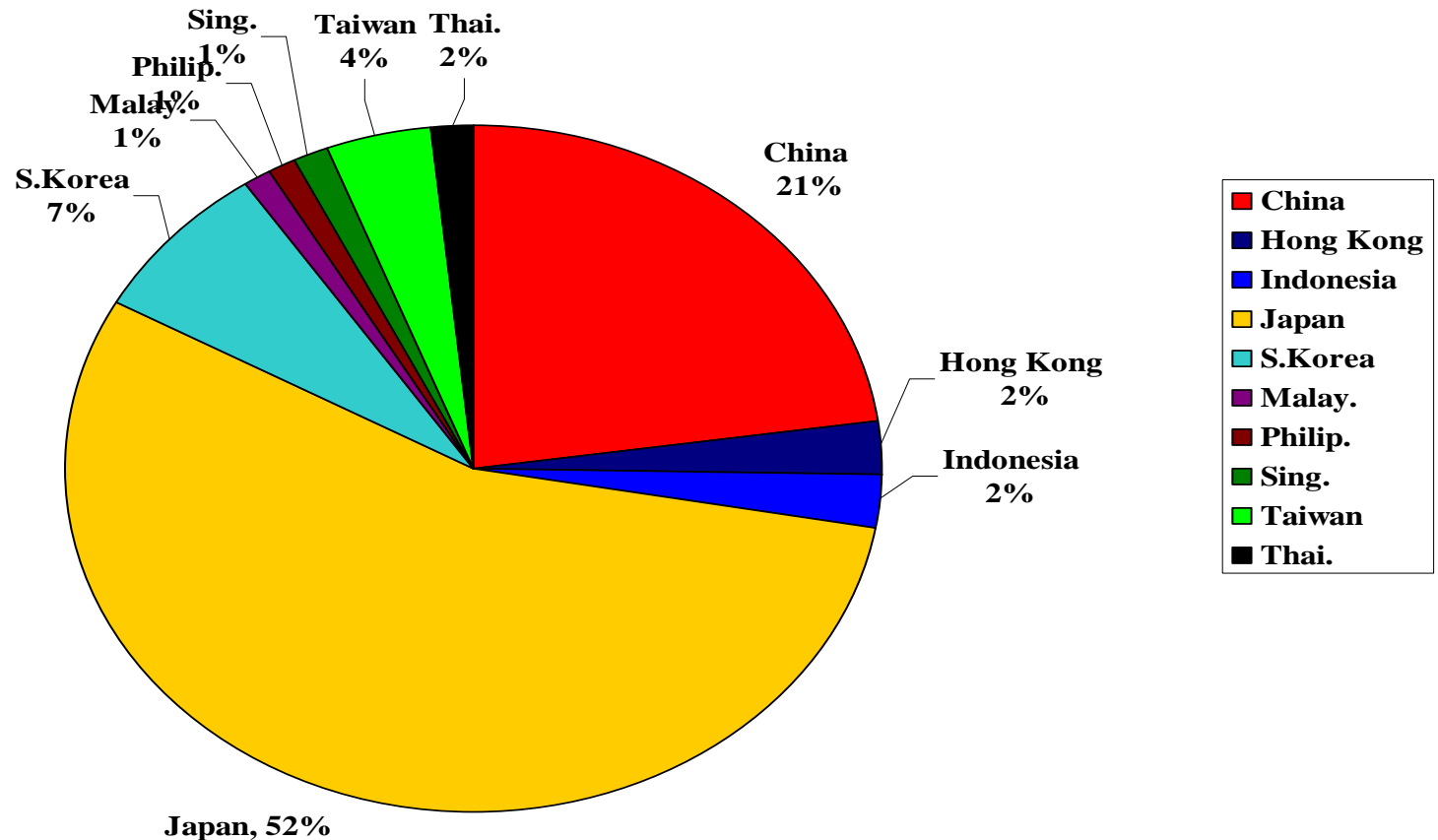
Composition of East Asian GDP, 1960

Figure 2.1: Composition of East Asian GDP, 1960



Composition of East Asian GDP, 2006

Figure 2.1: Composition of East Asian GDP in 2006 (in 2000 prices)



The Shifting Economic Center of Gravity

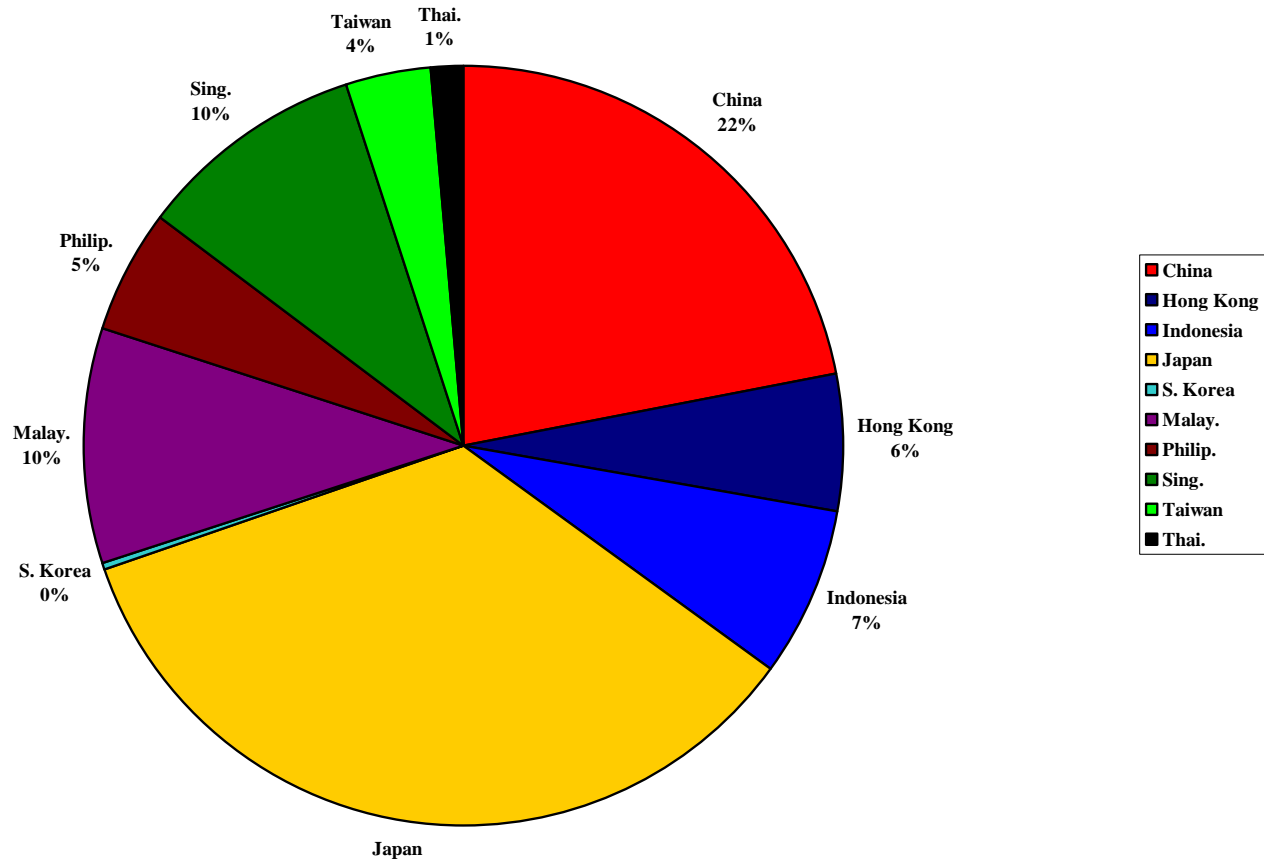
- ◆ These figures and percentages are sensitive to the exchange rates used for the conversion, but the general conclusions that (1) The contribution of East Asia to total World GDP has increased significantly; (2) The contribution of East Asia other than Japan to East Asian GDP has also increased significantly; and (3) Japan remains for the time being the leading economy within East Asia in both aggregate and per capita terms are reasonably robust to exchange rate changes.
- ◆ However, given the trends in current rates of economic growth, ASEAN + 3 will probably surpass the United States in terms of aggregate GDP with China contributing an increasing proportion of the total before the end of the decade.
- ◆ This is what gives credence to the idea of “de-coupling” of the world economies—that the Chinese and East Asian economies can continue to do reasonably well despite the current economic problems in the U.S. and elsewhere.

The Chinese Economy in the World: The Changing Pattern of World Trade

- ◆ Because of the rapid economic growth of China and the rest of East Asia, and the demand and supply that such economic growth has generated, the East Asian economies now trade more with one another than with economies outside of East Asia, including the United States. This is a sea change compared to say thirty or even ten years ago.
- ◆ Interdependence of the East Asian economies has been rising sharply over the years and East Asian dependence on the United States and Western Europe has declined.
- ◆ China has overtaken Japan to become the largest exporting country in East Asia. China has also overtaken Japan to become the largest importing country in East Asia and the most important export market for almost all East Asian economies and runs trade deficits vis-à-vis almost every one.
- ◆ The ASEAN Free Trade Area as well as its variations (+1 (China); +3 (China, Japan and South Korea)) are rapidly becoming a reality.

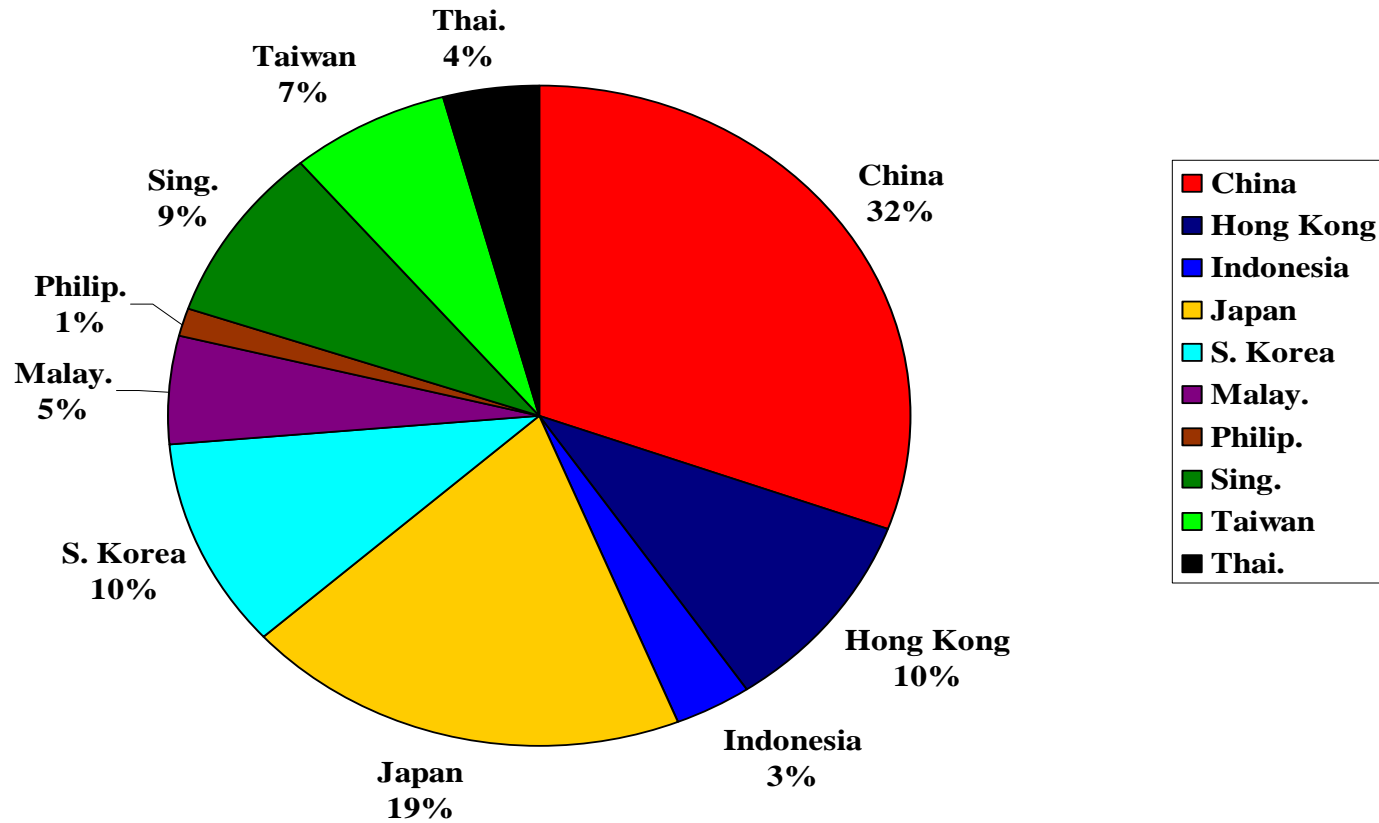
Composition of East Asian Exports, 1960

Figure 3.1: Composition of East Asian Exports, 1960



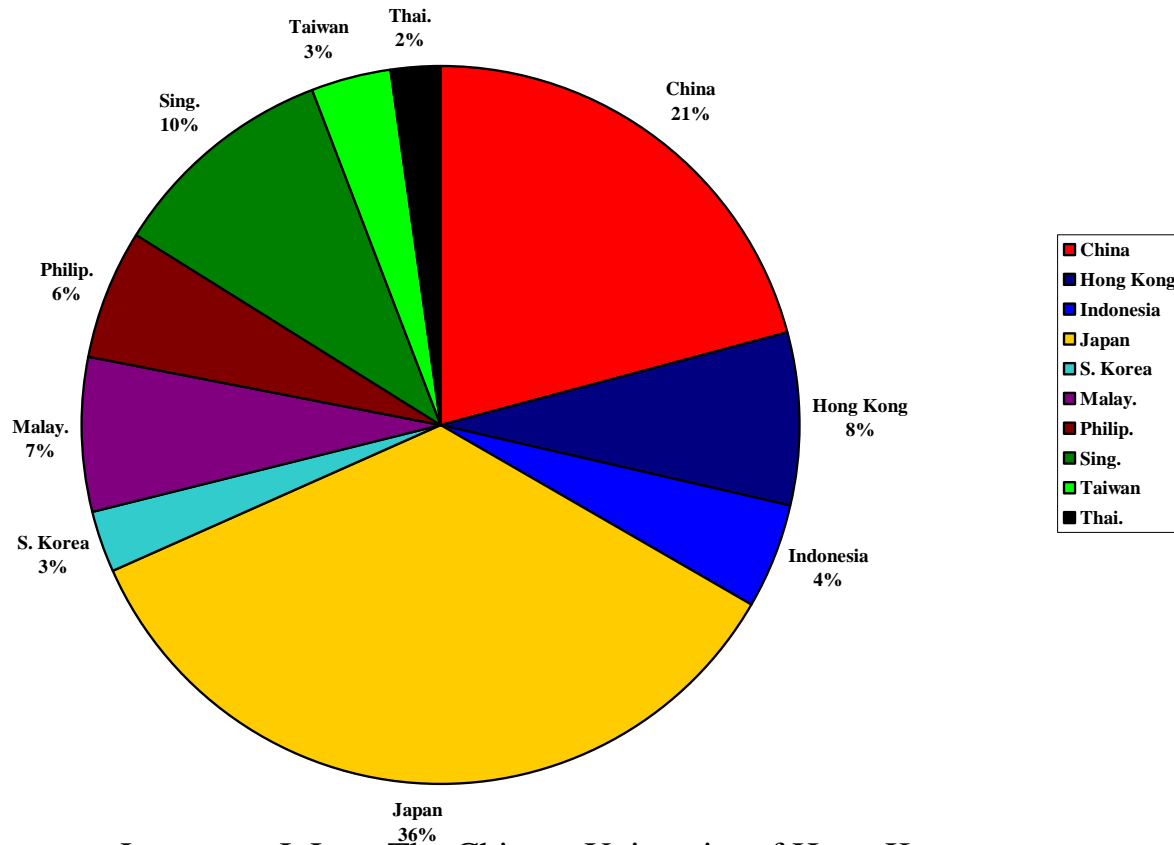
Composition of East Asian Exports, 2006

Figure 3.1: Composition of East Asian Exports, 2006



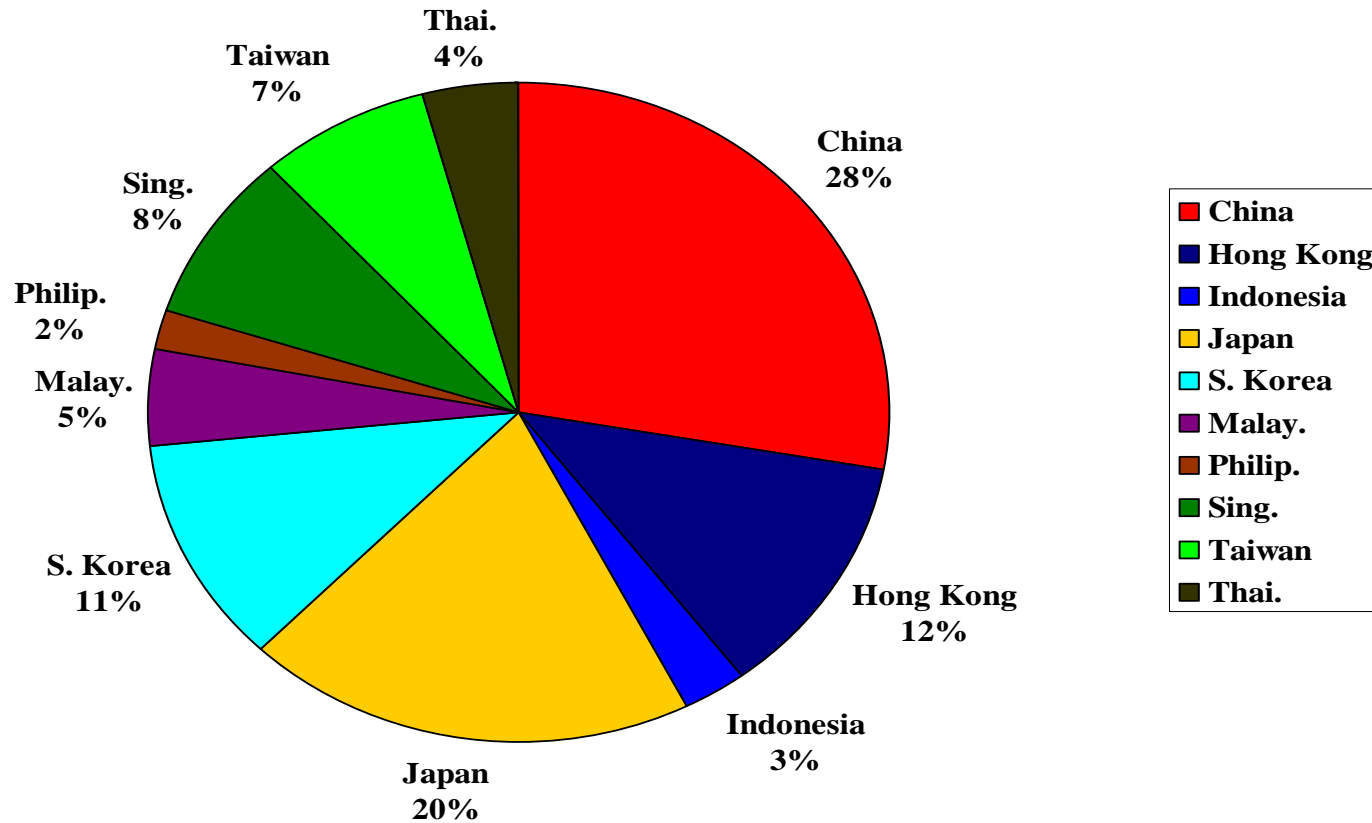
Composition of East Asian Imports, 1960

Figure 3.3: Composition of East Asian Imports, 1960



Composition of East Asian Imports, 2006

Figure 3.3: Composition of East Asian Imports, 2006



Win-Win Strategies for Economic Development

- ◆ The peaceful rise or peaceful progress of China is a concept introduced by Prof. ZHENG Bijian.
- ◆ Economic cooperation with the Rest of the World as opposed to economic competition has facilitated China's peaceful rise. China's peaceful rise in turn has also enabled further economic cooperation.
- ◆ China can and should assume more responsibilities in promoting the common interests of other developing and developed economies by seeking, identifying, creating and exploiting win-win opportunities.

Win-Win Strategies for Economic Development

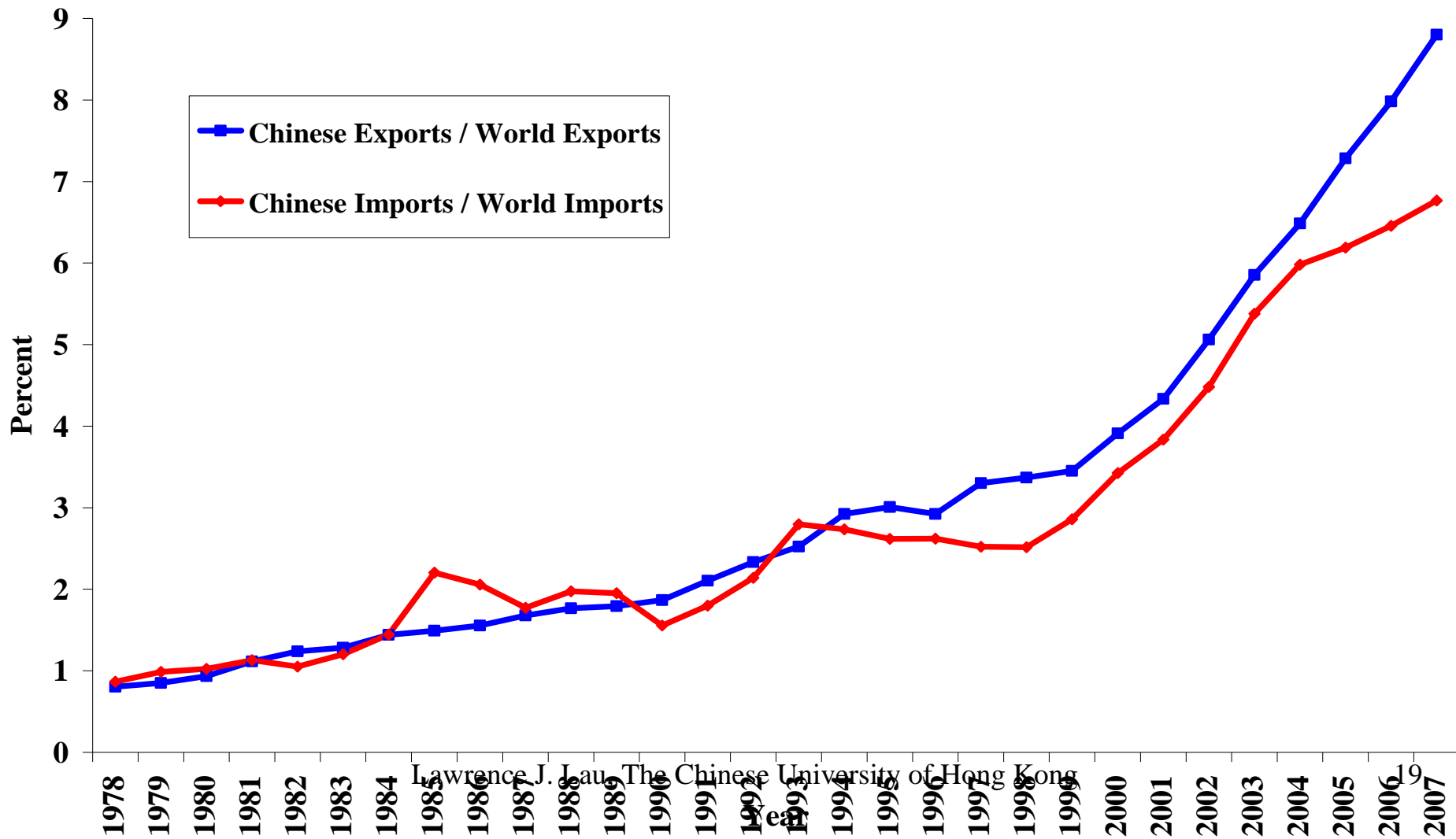
- ◆ There are a number of initiatives that China can undertake, by virtue of its economic influence, that will benefit not only China but also the Rest of the World.
- ◆ (1) Both China and the Rest of the World benefitted and will continue to benefit from China's opening of its economy to the Rest of the World. China can take the lead to try to revive the Doha Round of trade negotiations to promote the free(r) flow of goods and services and direct investment around the world.

Win-Win Strategies for Economic Development

- ◆ (2) China can play a leading role among the developing economies in the world in helping to craft a global post-Kyoto Accord agreement on energy conservation, environmental protection, and the prevention of global warming that every country and region can accept.
- ◆ (3) China can also play a leading role in the world to enhance the stability of the international exchange rate mechanism, creating an environment that facilitates the stability and sustainability of international trade, direct investment and capital flows, and enables the sustained growth of developing economies.

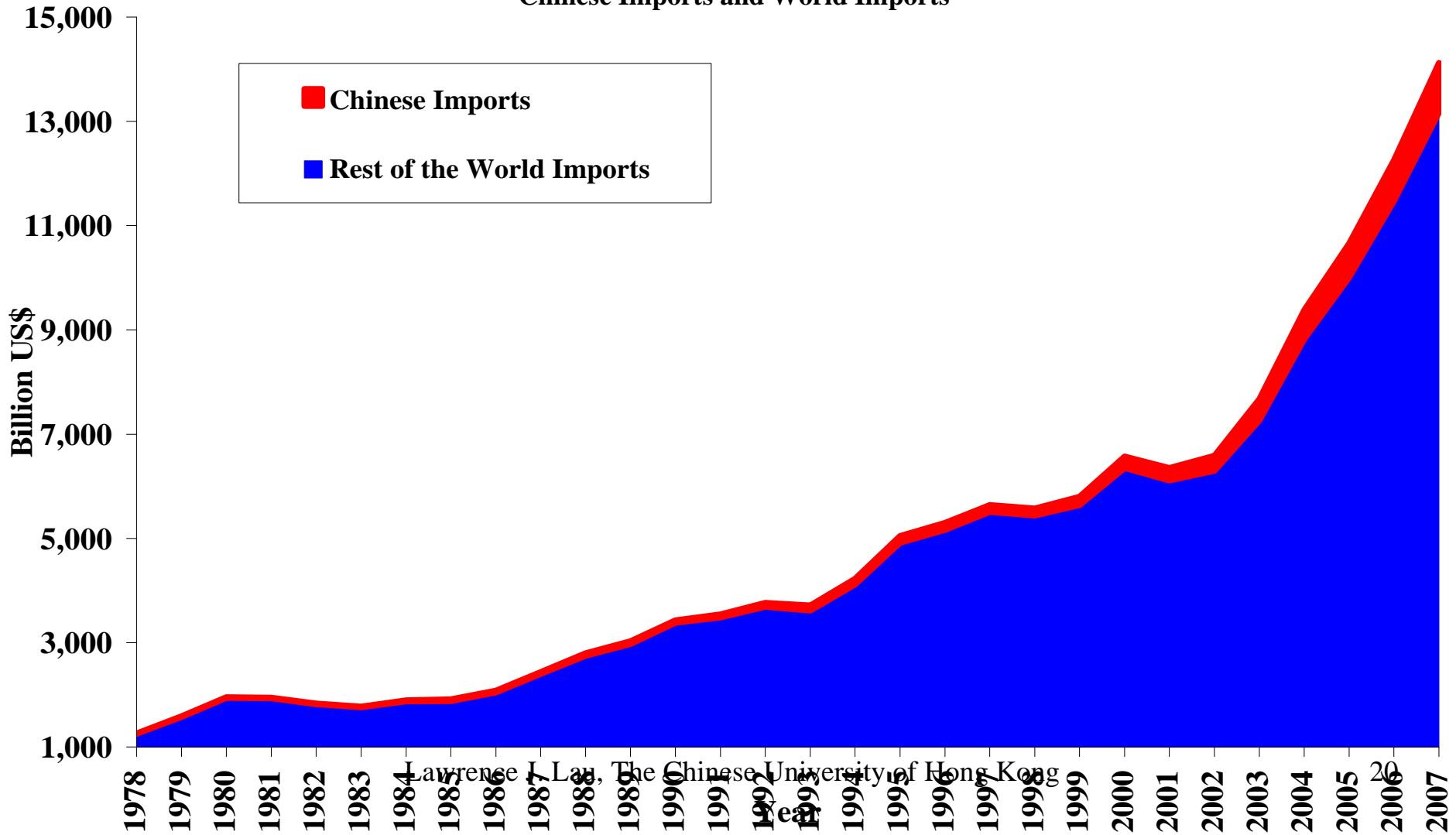
The Rising Ratio of Chinese Trade in Total World Trade

The Ratio of Chinese Trade to World Trade



Chinese Imports and World Imports

Chinese Imports and World Imports



Enhancements in the World Trade System

- ◆ A major stumbling block in the Doha Round of trade negotiations is that of international trade in agricultural commodities. It appears that both the developed and the developing economies are concerned about the possibility of imports of agricultural commodities “harming” the domestic farmers.
- ◆ A related problem is the role of farm “subsidies” in the exports of agricultural commodities. Of course all countries oppose subsidies that enable imports of agricultural commodities to compete with domestic agricultural production.

Enhancements in the World Trade System

- ◆ It would seem that these problems apply mostly to spot transactions, that is, opportunistic transactions that arise because of unexpectedly abundant supplies due to exceptionally bountiful harvests in the potential exporting countries.
- ◆ Moreover, not all countries can be exporting (or importing) at the same time, at least not the same agricultural commodity.
- ◆ Furthermore, the supply elasticities of agricultural commodities in developing countries are, on the whole, quite low. The only countries with potential excess supply capacities are the developed countries.

Enhancements in the World Trade System

- ◆ Thus, if short-term, i.e., one-off, trades in the spot markets are regulated; whereas long-term (multi-year) supply contracts with fixed quantities and prices (or price formulae) are freely permitted and encouraged; international trade in agricultural commodities can become much more predictable and stable, and this serves the interests of both the potential buyers and sellers, the developed and developing countries.
- ◆ China itself can set an example by entering into long-term fixed quantity and fixed price (or price formulae) supply contracts with major producers in countries such as Argentina, Australia, Canada, France and the United States.

Enhancements in the World Trade System

- ◆ Other possible initiatives include (1) the simplification of the application of the “Rules of Origin” to World trade, which is out-dated and incompatible with the increasing global division and sub-division of labor; and (2) the simplification, rationalization, and ensuring greater transparency of the rules on the resolution of common trade disputes such as dumping, anti-dumping and import surge.

Simplification of the Application of the “Rules of Origin”

- ◆ The existing implementation of “Rules of Origin” is outdated and incompatible with the increasing global division and sub-division of labour.
- ◆ A final product can utilize inputs, components, parts and raw materials from many different countries and can actually be physically processed in and transported through many countries before it is finished.
- ◆ China and other developing economies should take the lead to simplify and reform the existing system.

Some Possible Alternatives for the “Rules of Origin”

- ◆ The “origin” of a product can be determined on the basis of the origins of the value-added embodied in the product—the country of origin can be deemed to be the one with say the highest value-added in the product. For example, semiconductor chips made in the U.S., tested in Singapore and packaged in Malaysia should be considered to be U.S. origin rather than Malaysian origin.
- ◆ A trading system, including a system of tariffs (if any), can also be based solely on commodity and product categories regardless of origin, so long as certain conditions are satisfied. (For example, so long as the entire chain of production occurs within members of the World Trade Organization (WTO)—or among a sub-group of subscribing members within WTO—the “origin” does not matter. A separate protocol may be required).

Simplifying Rules on Common Trade Disputes

- ◆ Dumping and anti-dumping rules should be based on the comparison of the levels of the actual export prices and actual wholesale prices in the markets of the exporting country.
- ◆ Import surge and safeguard rules should be based on changes in the total imports of a commodity category rather than changes in the imports of a commodity category from a given country of origin. If there is no surge in total imports of a commodity category, then presumably no domestic production is being replaced and no domestic worker is being damaged. There is a change in the composition of total imports of the commodity category by countries of origin but presumably that is a voluntary choice of the consumers of the importing country and should result in a net increase in the welfare of such consumers.

Energy Conservation, Environmental Protection & Prevention of Global Warming

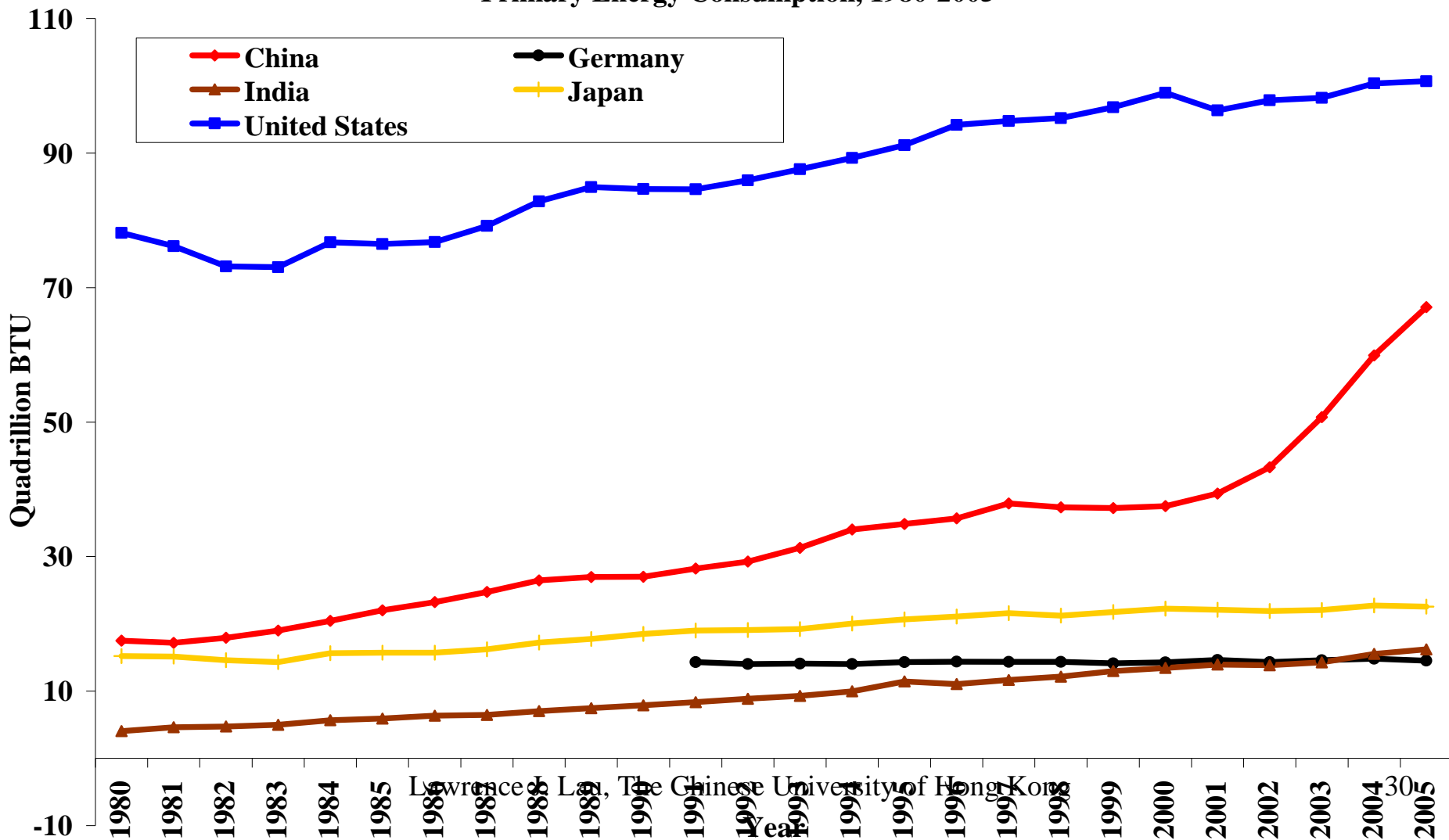
- ◆ Without a global post-Kyoto Accord agreement, it is unlikely that one can achieve the goal of reducing carbon dioxide and avoiding global warming. A global agreement must require sacrifices from all: the developed economies must be willing to reduce their consumption per capita and the developing economies must be willing to consume much less energy than the developed countries at the latter's comparable stage of development. Thus, both sets of countries will have to make some sacrifices.

Energy Conservation, Environmental Protection & Prevention of Global Warming

- ◆ However, these sacrifices must take into account the status quo—that the developed countries have vastly higher energy consumption per capita than the developing countries. It is not really equitable to ask both set of countries to make equal proportional reductions. Nor is it likely to be accepted by developing countries.
- ◆ China can provide leadership by setting achievable targets and implementing policies (including pricing) for national energy conservation and environmental protection, which are in Chinese own national interests.

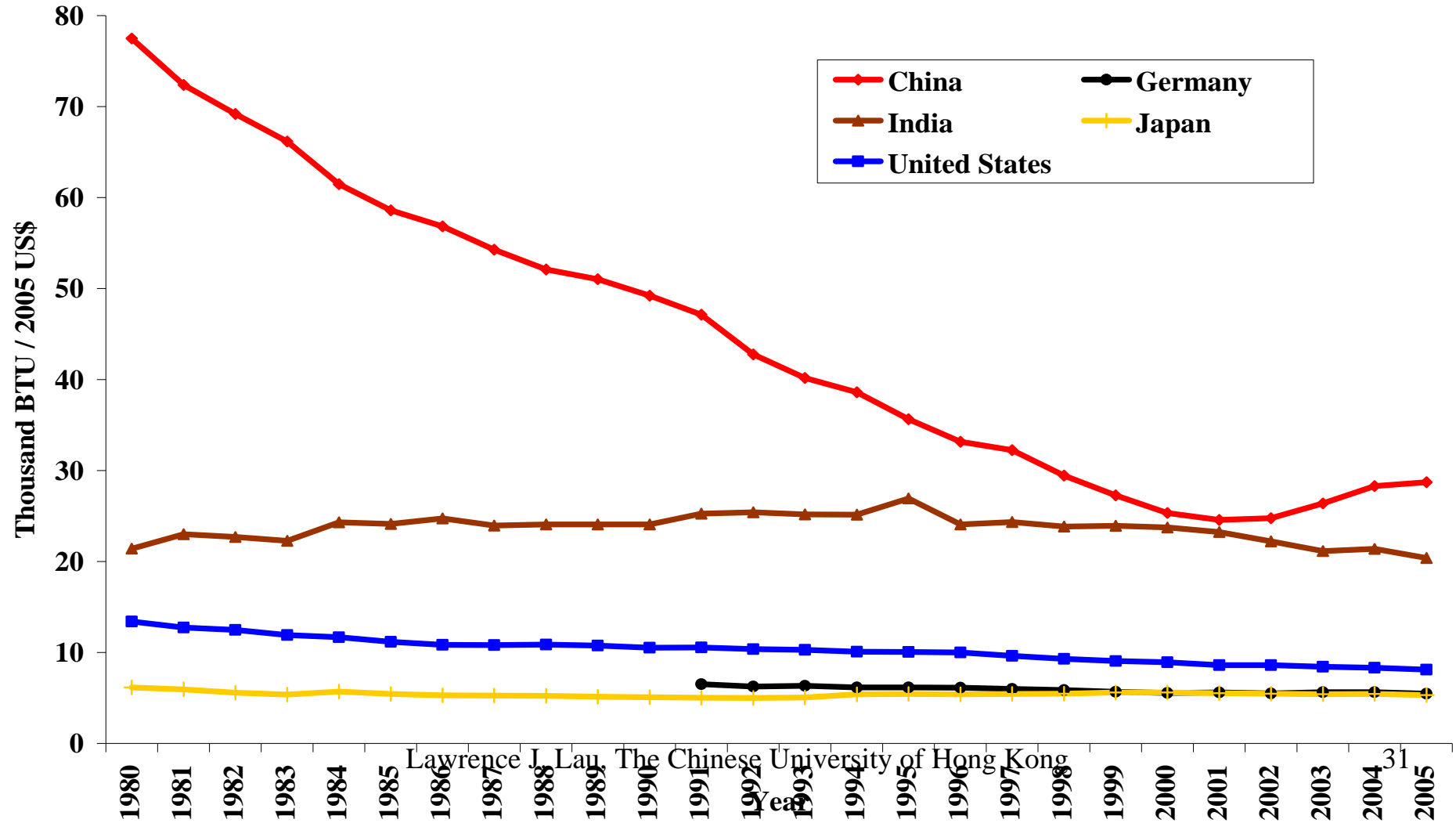
Primary Energy Consumption: Selected Countries

Primary Energy Consumption, 1980-2005

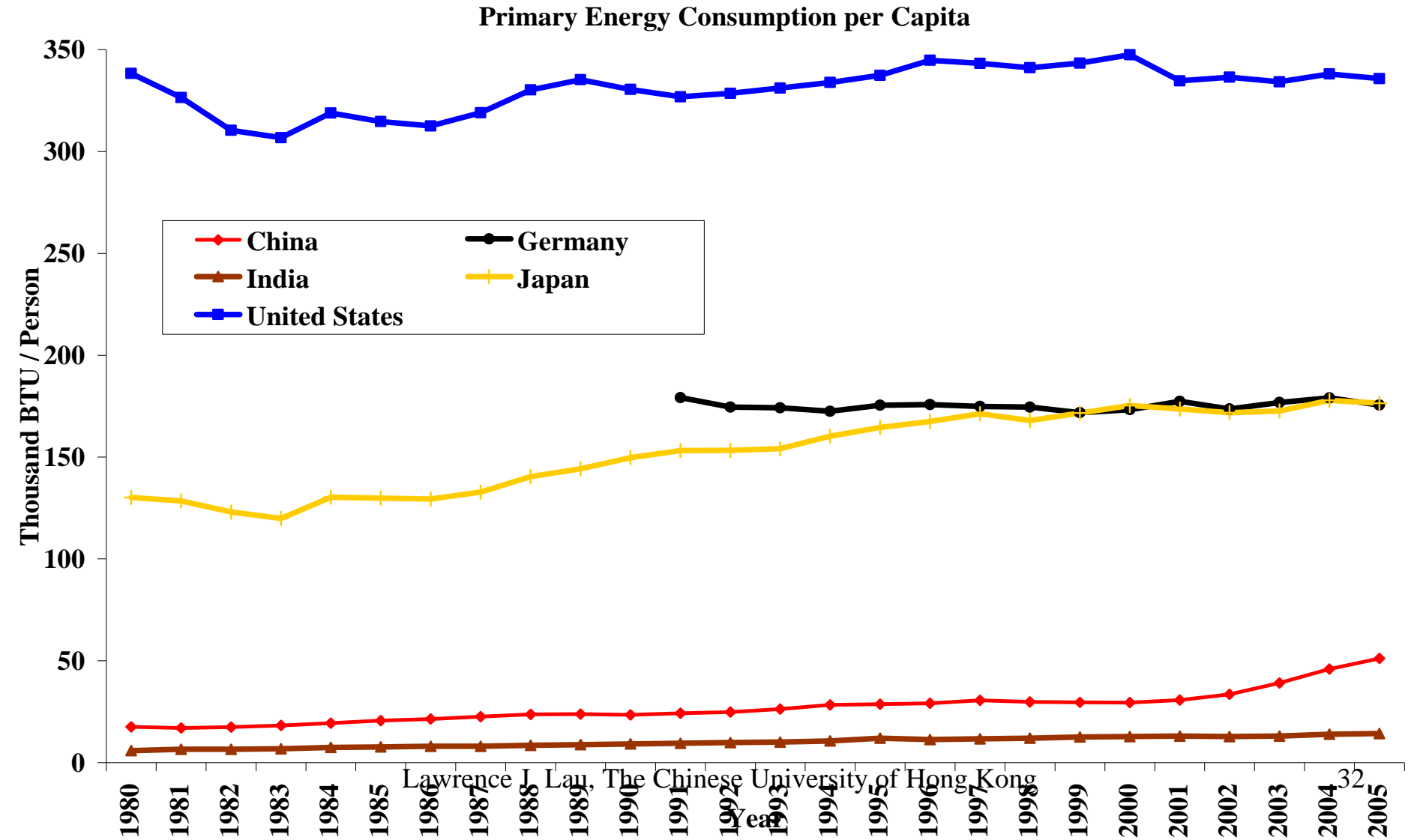


Primary Energy Consumption/Real GDP Ratio: Selected Countries

The Ratio of Primary Energy Consumption to Real GDP



Primary Energy Consumption per Capita: Selected Countries



Energy Conservation, Environmental Protection & Prevention of Global Warming

- ◆ A reasonable way to proceed on an implementable version of a global agreement to avoid climate change is the following:
- ◆ All countries will subscribe to a global scale of primary energy consumption per capita standards calibrated to a first approximation to the real GDP per capita so that when the GDP per capita of a specific country or region reaches a certain level, it should have adopted and implemented policies so as to stay below the corresponding target energy consumption per capita. That is, there is a global “life-style” energy consumption standard linked to real GDP per capita.

Energy Conservation, Environmental Protection & Prevention of Global Warming

- ◆ This will imply that for some developed countries, they will need to be willing to reduce the energy consumption per capita; and for some developing countries, they will need to adopt policies that will prevent them from exceeding the standard as their real GDPs per capita grow.
- ◆ In long-run steady-state, all countries will become developed and their energy consumption patterns should become largely similar. For example, when China achieves the same real GDP per capita as, say, the European Union, its energy consumption per capita should be at or below the energy consumption per capita of the European Union at the time (assuming that such a global agreement is already in place).

Energy Conservation, Environmental Protection & Prevention of Global Warming

- ◆ It is possible to introduce modifications of these standards to reflect possible differences across countries based on climate, location, size, on the proportion of primary energy consumption that is non-carbon dioxide producing, and the carbon dioxide emission quota owned (assuming that trading in such quotas continues). For example, those living in cold climates arguably may need to consume more energy for heating purposes. These possible modifications to the basic scale will have to be part of the overall agreement.

Stabilization of the International Exchange Rate Mechanism

- ◆ China contributed greatly to the recovery of East Asia from the East Asian currency crisis of 1997-1998 by maintaining the exchange rate of the Renminbi vis-à-vis the U.S. Dollar unchanged and earned the gratitude of the East Asian economies.
- ◆ Subsequently several mutual assistance agreements have been concluded among the East Asian economies to prevent the recurrence of another currency crisis.
- ◆ However, there is a strong case for real exchange rate coordination among East Asian economies, except for possibly Japan.

Real Exchange Rate Coordination among East Asian Economies

- ◆ Uncoordinated competitive devaluation can lead to great instability, both for the individual countries and for the region as a whole (as well as globally).
- ◆ It is beneficial for East Asian economies to coordinate their relative real exchange rate parities not only because such coordination avoids the disruption of the significant and growing trade and direct investment flows among themselves and enables long-term planning by firms and households in these economies, but also because unilateral exchange rate adjustments, especially upward adjustments, are difficult and rare for any economy because of the expected asymmetric responses on the part of its trade partners and competitors.

Real Exchange Rate Coordination among East Asian Economies

- ◆ If a country revalues its currency (thus making its exports more expensive relative to its competitors), no one else follows, which means the revaluating country will lose export market share. If a country devalues (thus making its exports less expensive relative to its competitors), everyone follows with a similar devaluation so that the devaluing country will not gain any export market share.
- ◆ There is therefore little to be gained for any country to change its exchange rate unilaterally either up or down in the absence of any coordination.

Real Exchange Rate Coordination among East Asian Economies

- ◆ Consequently, very few countries are willing to revalue, unless they can be assured that their competitors will match its revaluation so that it is not likely to lose market share. In addition, very few countries will devalue because they know their devaluation will be matched.
- ◆ Thus, exchange rates are likely to be “sticky”—there is everything to lose with a revaluation and nothing to gain with a devaluation—and moreover are probably more “sticky” upwards than downwards—a “Nash equilibrium.” And that is why a fixed relative parity agreement may actually help to make the exchange rates among blocs of currencies more flexible, since the aversion of each country to a revaluation is significantly reduced if they are all doing it together.

Real Exchange Rate Coordination among East Asian Economies

- ◆ Predictability and stability of the real relative exchange rates over the medium to long term facilitate international specialization and division of labor, cross-border direct investment, and economic growth.
- ◆ Stable relative real parities facilitate de-verticalization and global relocation and out-sourcing, and in particular, intra-firm and intra-industry trade, and flows of foreign direct investment, which is primarily long-term in nature.
- ◆ Even in the absence of significant trade between two countries, it may still be advantageous for them to maintain a relatively fixed real exchange rate parity between them if they compete in the same export markets.

Real Exchange Rate Coordination among East Asian Economies

- ◆ The most feasible principle for exchange rate coordination is the maintenance of relative real exchange rate parities among the economies.
- ◆ Coordination allows adjustments to be made simultaneously (either up or down) by several economies so that no one economy is particularly advantaged or disadvantaged. This enables and facilitates the collective adjustment of exchange rates vis-à-vis a reserve currency such as the U.S. Dollar or the Euro outside the East Asian region.

Real Exchange Rate Coordination among East Asian Economies

- ◆ And at the same time, maintenance of such intra-East Asian real exchange parities also facilitates and promotes long-term economic cooperation including but not limited to international trade and direct and portfolio investment among the East Asian economies by greatly reducing or eliminating the exchange rate risks within the region.
- ◆ Such reduction in exchange rate risks has, in the case of the European Union, proved to promote cross-border trade and direct investment much more than the reduction in tariff and non-tariff trade barriers.
- ◆ In time, the coordination mechanism may evolve into an East Asian currency “snake,” providing a possible basis for a common East Asian currency in the future.

Development and Promotion of Bond Markets in Developing Economies

- ◆ Developing economies often have to borrow internationally because their aggregate investment needs are greater than their aggregate domestic savings. However, they can rarely borrow in their domestic currencies and often need to borrow in a foreign currency. A currency crisis occurs when foreign lenders decline to roll over their loans and demand repayment in foreign currency.
- ◆ Developing economies can be encouraged to issue bonds internationally in their own local currencies indexed to their own domestic rate of inflation (their own versions of Treasury Inflation-Protected Security (TIPS)). Thus, purchasers of these bonds can receive a real rate of return in terms of the local currencies.

Development and Promotion of Bond Markets in Developing Economies

- ◆ These bonds can be enhanced with a put option by the bondholders to sell the local currencies so received to the People's Bank of China (or a consortium of East Asian central banks including the People's Bank of China and the Bank of Japan, or to multilateral agencies such as the Asian Development Bank) in exchange for hard currencies, e.g., US\$, Euro and Yen. Such enhancements should be sufficient for a secondary market to develop for such bonds.
- ◆ China is potentially a large exporter of capital on account of its high savings rate—China can lend in Yuan but provide the option of repayment in indexed local currency by the borrower; or lend in local currency (which it can purchase or otherwise acquire) and require repayment in real terms.

Development and Promotion of Bond Markets in Developing Economies

- ◆ Issuance of inflation-protected government bonds in the domestic currencies by individual countries provides both the domestic savers (of high savings-rate economies) as well as foreign portfolio investors with a credible financial instrument. (For example, while domestic as well as foreign investors may be unwilling to hold bonds denominated in Rupiah, they may be willing to hold bonds denominated in Rupiah that are inflation-protected, that is, indexed to the rate of inflation in Indonesia, thus guaranteed a positive real rate of return.)
- ◆ This would enable the development of bond markets in local currencies and make it unnecessary for a country to try to issue foreign-currency denominated bonds, which require foreign exchange earnings to service and to repay.
- ◆ The probability of an exchange rate/currency crisis will thus be greatly reduced.

Concluding Remarks

- ◆ There is a great deal of scope for China to exercise its leadership in important initiatives that can be beneficial for all East Asian economies and for the world. The key is assure that the resulting outcomes are win-win for all.
- ◆ Continuing economic integration of the East Asian economies is inevitable—East Asian economies now trade more with one another than with either United States or Europe and are likely to continue to do so, especially given the economic problems being faced by the United States.

Concluding Remarks

- ◆ The experience of the East Asian Currency Crisis in 1997 shows that the downturns were sharp when they occurred simultaneously but the upturns were also rapid and sharp when all economies recovered together. This shows that the East Asian developing economies as a group can grow independently of the U.S. and Europe.
- ◆ The de-coupling of global economic growth is a new phenomenon. But with the rapid economic growth of not just East Asia, but also the other BRIC economies (Brazil, Russia and India), the world should be able to manage even as the U.S. economy slows down or goes into a recession.