Does China Switch from it’s “Invite-In-Go-Out” Strategy toward a “Block-And-Attack” Strategy?

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China outpaced the “Big Three” in its recovery from the crisis.
China's economy is once again gaining momentum even though its economy grew slower in Q3-2010.

Government's key objection: the upward pressure on prices, which rose by 3.6% in the year to September.
Yet fight on multiple fronts

- undervalued RMB
- growing $ reserves
- internal imbalances
- overcapacities
- emerging "China bubble"
- growing hunger for energy and natural resources
.... puts China’s government on external and internal pressure to react against

- the loss of credibility of the political decision makers
- the danger of global trade and currency wars
- further inflating of the China bubble without risking setbacks in growth
- hidden risks in China’s banks loans
**Minor China**

Trade balance*, $bn

- China
- United States

*Year to each quarter

Source: CEIC

**Figure 3. China's inward FDI flows**

% change year-on-year

- Value of utilised FDI
- Number of newly contracted FDI enterprises

2008

2009

**China's labour market**

Chinese migrant workers' average monthly wage in yuan

- Real wage, % change on a year earlier

2004 05 06 07 08 09

Sources: John Knight, Deng Quheng and Li Shih World Bank

**Friends and others**

Do you have a favourable or unfavourable view of China?

% responding favourable, 2009

- Nigeria
- Pakistan
- Indonesia
- Russia
- Britain
- Brazil
- United States
- India
- South Korea
- Mexico
- Germany
- Japan

Source: Pew Global Attitudes Project
Does the 12th Five-Year-Plan suggest China’s turn from its “Invite-In-Go-Out” strategy toward a “Block-And-Attack” strategy?
“The world is open and the experience has proved that carrying out construction of socialism with the state door closed can not be successful, and the development of China is inseparable from the world.”

Deng Xiaoaping
Figure 2. China's inward FDI flows, 1983-2008

Source: MOFCOM FDI website, www.fdi.gov.cn. Figures are for "actually utilised" FDI.
Opening-up the economy

- End of the 1970s

Experiment with a new framework for trade: HongKong firms were for the first time allowed to sign export processing contracts with Chinese firms in the Guangdong Province. The first Special Economic Zone was set up in Shenzhen, Guandong Province. Products could be imported duty-free if these were used as inputs into export products. Together with the strong support from the provincial and local authorities in facilitating trade, Guangdong Province developed in less than two decades to the world’s most important manufacturing hub.
China top 10 exporting provinces or municipalities and their shares of China total exports, 2007
Parallel to the export promotion policy, foreign investments in the Export Processing Zones and the Special Economic Zones were not only allowed, but pro-actively attracted by granting a package of monetary incentives. The success of the foreign companies (mainly from Hong Kong and Taiwan) spread over to other parts of China after being allowed investing all over China.

53 state level Special Economic Zones ("geographically defined market economy enclaves") are the core of China’s “Invite-in-Go-Out” strategy. Inward FDI transformed China to the leading manufacturer in the world.
The main feature of China’s invite-in-go-out strategy in the 1980s and 1990s has been the active government promotion of FDI inflows by a bundle of policy measures. In two decades the contracted FDI inflow has grown from about US $1.5 billion to more than US $40 billion. In 2008 China celebrated “30 year utilization of foreign capital” with a FDI stock of US $92.4 billion. More than 50% is counted as inflows from HongKong.

Some critical aspects:

The uneven distribution of the gains of foreign investments is contributing significantly to the regional income disparities. Most foreign investors used China to a large extent as a location for outsourcing labor intensive parts of the production chain. Labor intensive parts and components production did not contribute to develop a “deep” production structure
Is China going out and attacking western economies?
China’s ‘go out’ strategy

Initiated in 1999 encourages Chinese companies to invest abroad.

Motives:
- to prepare Chinese companies for competition from global multinationals after China’s entry into the WTO
- to use efficiently huge foreign exchange reserves
- develop national champions into global giants

Also allows avoiding protections actions against Chinese exports, securing natural resources, gaining access to advanced technology, managerial skills and foreign markets.
China OFDI flows (US$100 mln)

Source: MOFCOM (2010)
Chinese government encourages OFDI in 4 key areas:

- securing natural resources that are necessary for domestic economic growth;
- overseas production and infrastructure projects that require Chinese technology, products, equipment and labor;
- R&D projects involving advanced technology, managerial knowledge and professional skills;
- overseas M&As that improve China's international competitiveness and provide access to global markets
... And offers support

- privileged access to raw materials and other inputs
- subsidies
- fiscal incentives
- insurance against political risk
- assistance to private sector in international expansion through government agencies
- enacting bilateral and regional treaties to protect investment abroad
- relaxed approval procedures
- information on foreign investment environment, management training of OFDI related international regulations
By 2009, China Mainland enterprises established 12000 overseas subsidiaries in 177 countries or regions.

As of 2010, 54 Chinese MNCs are listed among Fortune Global 500, a significant rise from only 16 in 2004.

PricewaterhouseCoopers study shows that China produced the most new multinationals between 2005 and 2009, rising from 54 in 2005 to 141 in 2009.

Chinese MNCs represent diverse industries from labor intensive industries to technologically advanced such as telecommunication equipment, energy, green-energy. And this raises complaints/fears among their counterparts from the West that lose market in their strategic sectors.
China’s FDI is **bound to grow**: China owns 6% of the world’s FDI stock while Britain owned 45% in 1914 and USA 50% in 1967; China’s FDI outflows amount to 3.9% of the world’s total which is a small share of its GDP.
China’s growing economic power in the world economy:

- No 1 in global manufacturing
- No 1 in global money lending
- No 1 in investing in Africa and Latin America
- Growing importance as source of R&D
China’s 12th Five-Year-Plan

Main topics currently discussed in China’s media:

There is a growing disparity between the highest income earners and the lowest income earners (the GINI coefficient).

There is a growing disparity between the incomes of urban residents and rural residents.

There is a growing disparity between the incomes of residents of the coastal provinces and the residents of the rest of Western, Central and Northeast China.

These are common complaints of “uneven development” that have been the subject of concern in China for some time. There are the following new, more troubling, concerns consistently expressed:

The percentage increase in the wages of Chinese citizens has not grown as fast as the percentage increase in China's overall GDP. Though China has a high savings rate, the percentage increase in the savings of Chinese citizens has not increased at the same rate as the percentage increase in the Consumer Price Index. This means that even though the Chinese save, they are actually falling behind in terms of wealth accumulation.
Is China heading toward a “Block-And-Attack“ strategy?

Blocking = measures which restrict inward and outward cross-border transactions
Attacking = measures which create artificial competitiveness for domestic firms on the global market place

“China has become a major financial and trade power. But it doesn’t act like other big economies. Instead, it follows a mercantilist policy, keeping its trade surplus artificially high... My back-of-the-envelope calculations suggest that for the next couple of years Chinese mercantilism may end up reducing U.S. employment by around 1.4 million jobs. The Chinese refuse to acknowledge the problem.”


Main concern about blocking: Unfair competition
Main concern about attacking: Undervaluation of the RMB
China's potential to attack:

- Restricting export of „rare earth“
- Restricting import of manufactured products
- Bailing-out companies in foreign countries (even countries?)
- Investing in natural resources abroad and therefore gaining market power in global supply of commodities
- Weakening the US Dollar
- Strengthening its MNCs (blocking foreign takeovers of Chinese firms; providing preferential credits)
- What about the sensitive issue of cyberattacks???
How China blocks: Some examples

- Delay in approval procedures of foreign takeovers of Chinese firms
- Telecoms and financial services – unable to expand due to high capital requirements and complex procedures
- In some industries, such as automobiles, petrochemicals, steel China maintains investment restrictions
- Delay in introduction of IPR protection
The “Block-And-Attack“ strategy should contribute to

- increase domestic consumption
- reduce savings and overinvestment
- change the structure of consumption from foreign to domestic goods
- reduce export dependency
- secure imports of energy and natural resources
- convert risky and unprofitable reserves into high performing foreign assets
On the edge of a new era of EU – China economic relations?

Europe's imports from China have grown by around 16.5% per year for the period 2004-2008. The 27-nation European Union is China's largest trading partner, and in 2009 imported Euro 215 billion worth of Chinese goods.

### EU27 Member States' trade in goods with China (million Euro)

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<td>1-6/2009</td>
<td>37 491</td>
<td>53 462</td>
<td>102 716</td>
<td>124 944</td>
<td>- 65 225</td>
<td>- 71 482</td>
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China %
total extra EU | 7.2 | 8.5 | 17.4 | 17.5 |

In 2009, the EU27 exported 18.5 bn euro of services to China, while imports from China amounted to 13.2 bn, meaning that the EU27 had a surplus of 5.3 bn in trade in services with China, compared with +2.6 bn in 2007 and +5.1 bn in 2008. The surplus in 2009 was mainly due to other business services4 (+2.6 bn) and royalties & license fees (+1.6 bn). China accounted for over 3% of total extra-EU27 trade in services.

### EU27 FDI flows with China (million Euro)

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<th>2006</th>
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<td>EU27 FDI in China (outward)</td>
<td>6 693</td>
<td>6 585</td>
<td>4 734</td>
<td>5 290</td>
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<tr>
<td>Chinese FDI in the EU27 (inward)</td>
<td>2 186</td>
<td>759</td>
<td>-69</td>
<td>317</td>
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EU-China Summit, Oct. 2010:

China is committed to assisting Europe's post-recession recovery by backing a stable euro and not reducing his country's holdings of bonds from EU countries, despite Europe's sovereign debt crisis (WEN Jiabao).

China will address European concerns over investment rules and copyright violations, but wants the EU to relax remaining trade barriers with Beijing in return (WEN Jiabao).
The growing nationalist sentiment expressed by Chinese internet users is making the country more protectionist, according to Joerg Wuttke, President of the European Union Chamber of Commerce in China.

Local firms are also becoming more adept at lobbying Beijing, said the Chamber's President, leading to a slowdown of market-opening reforms.

The EU has frequently expressed concern over the apparently unequal treatment of European firms in China, while Beijing is dismayed by the growing number of anti-dumping measures taken against Chinese products.

EU Trade Commissioner Karel De Gucht has called on China to respect its global responsibilities, saying "splendid isolation is no longer an option."

European businesses have increasingly expressed their frustration at a perceived slowdown in market-opening reforms in the Asian powerhouse economy, saying Beijing is succumbing to the protectionist calls of domestic producers.

EU digital agenda commissioner Neelie Kroes has hit out at Chinese online censorship, saying the government process constitutes an unfair trade barrier that may require WTO action.

In one example, EU companies seeking a wholesale licence to sell petrol in China must first own a refinery and get an import licence. But another law forbids foreign firms from owning a majority stake in Chinese refineries, while in practice, Chinese bureaucracy has never issued an import licence to a foreign company.
Post-crisis stimulus spending across the globe has raised the importance of government contracts for many large European firms. China restricts bidders on most public contracts to companies whose trademark and technology are registered in China - part of its "indigenous innovation" plan.

**Rare Earth**
China has one third of the world's rare earth reserves, but last year produced 97 percent of the global supply. Other states such as the US and Australia have scaled back production in recent years in the face of cheaper Chinese competition.

EU Trade Commissioner Karel De Gucht has warned that recent Chinese restrictions on sales of valued rare earths could be a bellwether of things to come. "[It] hints that China is developing an industrial policy aiming at transferring as much as possible production to China."
The weakening Euro will improve European firms’ competitiveness in Chinese markets, especially in case of a recovery of China’s growth accompanied by rising inflation. Continued growth in investment will be key, as a significant proportion of exports to China is capital goods that have shown strong increases in recent months.

The weakening Euro will reduce Chinese firms’ competitiveness in European markets, especially in EU Member States that suffer from the crisis for a longer period of time. Imports of Chinese low-tech products might lose ground because of the relatively high price elasticity.

Compared to US companies, European MNCs are exposed to a much higher exchange rate risk in their China business.

There are doubts that the Chinese government is willing to support these two likely developments by an active appreciation policy of the RMB.
China is set to pump billions of dollars into Greece's ports this year, with investors also reported eyeing the country's train network. Recently-joined EU members Romania and Bulgaria have also successfully solicited funding from China, as European credit markets suffer from a shortage of liquidity.

But the head of research at the Brussels Institute of Contemporary China Studies, Jonathan Holslag, recently warned that the rising level of investment was not without its dangers. "These growing commercial ties could have important political consequences," he wrote in an opinion piece in the Financial Times. "Especially if Beijing's closer links with eastern Europe undermine the formulation of a more coherent EU policy towards China.

China has indicated its willingness to buy Portuguese government bonds.

China has also previously bought Spanish government bonds.
Finally, a paradigm change depends on China’s 12th Five-Year-Plan 2011-2015!

"The 12th Five-Year Plan should take more active employment policies and provide more jobs. The policies should also support employment and entrepreneurship." Xu Xianping, Vice Director of National Dev't & Reform Commission

Enlarging domestic demand should be the strategic principle for fast, smooth development. The plan should deepening income distribution reform, increase incomes for farmers and urban low salary earners to support enlarging domestic consumption.

Improving people's livelihood should be a fundamental goal.

The plan should promote coordinated development between urban and rural areas. Migrant workers must gradually be given urban residence and a large population of farmers must enjoy the results of reform. The 12th five-year plan must also stress innovation, energy conservation and environmental protection.
What is the impact of China‘s orientation toward more sustainability, internal balance and stability on its foreign trade, investment and currency policy?

Either the „Invite-In-Go-Out“ strategy nor the „Block-and-Attack“ strategy are reasonable choices for setting the course for a new orientation of China‘s outward oriented economic policies, namely because

- China needs the global market place for importing energy and natural resources and for exporting medium-tech and high-tech final products of domestic companies (because China will lose more and more of its former wage advantage in low-tech parts and components manufacturing and low-tech final products.

- China has to strengthen the competitiveness of its large SOEs. This may result in disincentives for IFDI and incentives for OFDI as well as selective trade barriers.

- China is still depending on technology transfer from abroad which requires cooperation instead of confrontation

- China‘s is diversifying its foreign assets operationally and geographically

Therefore, China needs to be an integrated part of the world economy!
Conclusion
Choice: balancing the strategies

- diversifying export structure
- energy saving technologies
- expanding service sector
- improving infrastructure
- integrating domestic markets
- increasing labour mobility
- discouraging speculation in real estate
- cautious RMB appreciation
- liberalization of capital account
- trade arrangements with Central Asian countries
- privatization of SOEs
China heading for superpower?

Basic hypothesis: Opposite to former superpowers nowadays this aim could not be the result of military actions. It needs firstly sustainable domestic growth, secondly domestic political and social stability, thirdly economic openness, fourthly global political cooperation. Furthermore, the currently existing superpower must decline or be outperformed.
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