Comprehensively Deepening Reform and the World Economy

Huang Weiping Ding Kai Lai Mingming Liu Yijiao Tang Xuemin

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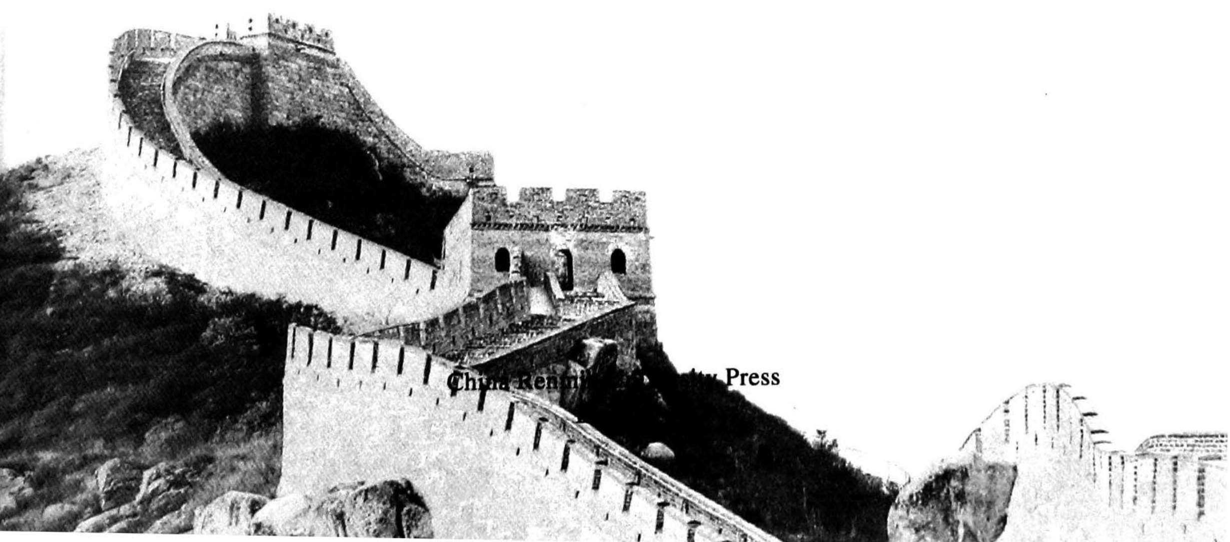

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His works include *Toward Globalization*, *Four Tigers in East Asia*, *International Economics*, *The Myth of the World Economy* (all in Chinese and with other authors) and *A Win-win Future in Globalization* (in English, with others), etc.

Synopsis

The Chinese economy has its own development pattern, but at the same time it is necessarily influenced by the cyclical changes in the world economy. At present, the world economy has entered the stages of technological innovation and expansion, global reduction in dividend, and adjustment in growth patterns. China needs to make corresponding adjustments to the growth pattern attached to the global imbalance, the globalized distribution pattern for bonuses, and the production patterns which are in tune with the conventional division of labor in the world. The 18th National Congress of the Chinese Communist Party proposed the comprehensive elevation of the open economy. Chinese President Xi Jinping also repeatedly stressed that China will better coordinate the domestic and international scene, resolutely persevere its open development and win-win scenario, and be more proactive in its participation in international affairs, so as to meet the global challenges together, and make contribution to global development. At present, the trumpet has sounded for the comprehensive deepening of China's reform efforts. China will carry out scientific planning and evolution adjustments related to the direction, path, speed and goal of its economic transition, with an aim to raising the standard of its open economy on a larger scope and coverage, and at a deeper level. This will enable China to achieve an advanced version in its economy, and ultimately realize the "Chinese dream" of the great renaissance in the Chinese nation. This book sets out to explore the further reform of China in the current context of the world economic scene, using a language and logic that is comprehensible to the international community, and to demonstrate to overseas readers and the international community the determination and ambition of China, as a responsible major power, to build a harmonious world economy.

Chapter 1
The World Economic Setup With Reform

There is the common saying: "To the same question, 100 economists will give 101 answers". This shows that economists hold very divergent views on various issues. However, if I present to them the statement that "the world economy at present is out of balance", we will find that their views are unprecedentedly in agreement.

There is a general consensus that "the world economy is out of balance" and "the world economy needs to be re-balanced". However, views differ dramatically on "who should bear the responsibility of re-balancing the world economy" and "how can the world economy be re-balanced".

We can say that to the world today, the re-balancing of the world economy has gone beyond the realm of pure economic analysis by economists. Indeed, all sorts of factors, including the separation of interests, political pressure, and social reform, are interwined in this matter, which has probably become the most complicated but also most important and most imperative issue.

The stage is set for the re-balance of the world economy, and the curtain for the re-balancing act has risen. Who will be the hero on the stage? What role will China play in this play? Re-balancing is the process of adjustment and reform. Adjustment incurs cost, and so will reform. Who will shoulder these costs? The road of re-balancing in the world economy will be long and winding, and beset with difficulties and hardship.

"Imbalance" and "Re-balance" of World Economic Development

For a long time, people have in general admitted that the world economy is out of balance, and that "imbalance" resulted gradually in the process of economic globalization. Hence there is a consensus that "after the loss of balance there arises the need for re-balance". However, in the past three decades, great changes have occurred in the meaning of "imbalance" and "balance".

This "imbalance" is not that "imbalance"?

With the development of economic globalization, a new interpretation and understanding has arisen around the concept of world economy imbalance, which is a departure from its original sense. This shift of meaning has had colossal impact on China, and this impact has been increasingly negative.

The term "world economic imbalance" is probably not a new concept. In the 20th century, people talked extensively about world economy imbalance, and the need for balance after the imbalance in the world economy, in facilitating the sustainable development of the world economy.

At that time when people explored the imbalance of the world economy, they meant that in this global village there are rich economies and poor economies. They were actually talking about the relationship between the south and the north in the world. The "imbalance" was related to the imbalance between the rich and the poor in the south-north economic relationship and suggested that there is poverty in affluence. Meanwhile, "balance" suggested that the rich economies have an obligation to give assistance to the developing economies in their economic development. It was the issue of how to develop developing economies. It is only when developing economies are developed that the entire global village and the entire world economy can benefit from comprehensive development. Hence the 1990s saw the fully-fledged development under the United Nations *Millennium Development Goals* (*MDGs*).

Under these conditions, China's economic development should benefit from the support. This is because China is the world's largest developing country, embodying the largest number of poverty-stricken groups in the world. We can actually say that the poor populations in China and India add up to over half of the world's poor population. If the problem of poverty in these two countries is solved, half of the poverty-related problems in the world will be solved.

From the perspective of the global fight against poverty, China's reform and liberalization has gained the approval and support of the whole world. Hence in the 1980s and 1990s, the entire world applauded and supported China's reform and liberalization. When China needs capital, foreign capital will flow in. When China needs markets, other countries will open up their markets. When China needs technology, the relevant technological transfers will be made. This arose from one objective—that the world needs to fight poverty, to have balance, and to have sustainable development. The whole world has agreed that the developed countries have the obligation to help the developing countries to eliminate poverty. Hence China's position at that time was highly advantageous.

Into the 21st century, the imbalance of the world economy remained. However, the meaning of world economic imbalance has taken on a different meaning. Now the vocabulary has changed. The imbalance is no longer that between the rich and the poor, but the imbalance between Japan and the US in terms of trade. As a result, people talked about re-balancing the global economy.

This time, the imbalance suggests the loss of balance in the current account of balance of payments between the developed countries and the countries with newly developed markets, leading to the lack of sustainability in the world economy. Now, "re-balance" suggests the re-balancing of the balance of payments, or the enormous trade surplus that newly-developed markets need to eliminate. If we take a careful look, we will see that China is today one of the largest countries on the earth with the greatest trade surplus, and the country with the greatest foreign exchange reserve. The most prominent countries with the greatest surplus and the greatest deficit in world trade are China and the US respectively.

According to the latest trade data released by the International Monetary Fund (IMF) in October 2014, Germany has replaced China as the economy with the largest trade surplus. The result was that Germany was immediately criticized by many countries (including the US) as well as international economic organizations. They thought that to realize economic growth through exporting more than importing resulted in sacrificing other economic interests and hindered the revival of the European economy. This did not address the issue that China has fundamentally improved its own development climate. Although Western countries such as the US, as well as some international economic organizations, have temporarily leveled their criticism against Germany, out of certain immediate interests, the fact remains that in the long run, Western countries such as the US will still treat China as their primary target of their accusation, putting various forms of pressure on China in the areas of economic development and export.

Against this background, developed countries demand that China reduce the trade surplus and contribute to the re-balancing of the entire world. This puts the total development of China in a rather disadvantageous position.

This conveys the message that the past issue of "balance" between the rich and the poor has been relegated to a secondary status, and now the issue is to "re-balance" the unbalanced current account of the world. For countries with newly emerged market economies, especially China, the trade surplus should be drastically reduced in order to help the developed countries, especially the US, to overcome their trade deficits.

We can say that the current theme of the world economy is re-balance in order to create inclusive and sustainable growth. Meanwhile, the past issue of bridging the gap between the rich and the poor is no longer the core issue in the governance and cooperation of the international economy. The development agenda that we can still mention is no longer the balancing of the world economy, but green development. Against this background, contradiction and entanglement will inevitably become the norm.

"Phenomenon" ≠ "original characteristics"?

The imbalance of the world economy is the imbalance between the allocation of global resources and the distribution of income. As pointed out earlier, the imbalance of the world economy is manifested mainly as the imbalance of the current account in balance of payments between developed countries and countries with emerging market economies. Of particular concern is the trade imbalance between China and the US.

In real terms, however, this is also the imbalance of the domestic economic structure between developed countries and countries with newly developed market economies; the imbalance between the real economy and the virtual economy; as well as the imbalance in global financial market development.

While there are Western scholars who maintain that the international economic crisis that started in 2008 was caused by the "world economic imbalance" mentioned earlier, the fact remains that in essence, the international financial crisis of 2008 was the explosive result of the United States' over-development of the financial system and the virtual economy, and also the serious imbalance between the real economy and the virtual economy.

The direct cause of imbalance of the world economy and its important manifestation in the serious imbalance of the China-US current account was the US economic model characterized by over-spending and excessive consumption. As the world economy is driven by demand, the over-demand of the US for global commodities has resulted in over-production and over-supply by East Asian countries, especially China.

We need to point out that the prerequisite for this imbalance is that the US took the initiative to upgrade the industry structure, making the real estate industry and the financial industry as the pillars of the economy. What is worse, the US government encouraged its citizens to over-borrow in order to drive its economic growth, resulting in the over-expansion of the domestic virtual economy, which has become independent from its real economy. This led to crisis.

In essence, the root cause for the imbalance of the global economy is the aggravation of structural contradiction of the domestic economy of various countries. The systemic root is the international currency system led by the US dollar.

The imbalance in China-US trade is an important manifestation of the global economic imbalance. It is also the imbalance in division of work and interest allocation between the US—the world's financial center and China—the world's manufacturing center. It is also the natural result of differences of advantages between China-US in the age of economic globalization. From the perspective of the external environment, this was the product of globalization in breadth and depth, as well as the dynamic changes in the global production network. This reflects the scenario of the two countries in the realm of real economy and in international division of labor. In terms of domestic conditions, it is closely related to the imbalance in the domestic economy of both countries, and reflects the significant discrepancies between China and the US in the realm of virtual economy, in terms of interest allocation and risk diversification.

Suffering from "influenza" but let others take medicine

Rome was not built in a day. The rectification of the world economic imbalance has become the core issue at present in the post-crisis era, resulting from various factors over a prolonged period. In the process of re-balancing the world economy, any structural adjustments will have serious impact on the corporate stakeholders in the country, and on the domestic allocation of interests. The vested interest group and corporate stakeholders within the country will naturally resist any adjustments to the existing structure, and this will become a big hindrance to any adjustments within the country.

Against the background of imbalance between China and the US, which is the key component in the current imbalance of the world economy, the US is shirking its responsibility in the re-balancing of the world economy, in order to protect its own interests, and blaming China for its trade imbalance with the US and even the world.

As reported in UK's *The Daily Telegraph*, US Federal Reserve Board Chairmen Bernanke has pointed his accusing finger at China for taking the risk of "slowing down the velocity of growth in all the countries". Bernanke insisted that allowing currencies such as the RMB to revalue will be tantamount to paying the down payment and deposit for the balancing of global trade and the global current account, and will become the desired result for the long-term stability of the economy and the financial system.

Arguments like these are actually excuses that the US uses for self-defense and for transferring the responsibility of re-balancing the world economy to China. This is like the US suffering from influenza, but insisting that China should take the medicine, and is bound to end in futility. To re-balance effectively, both China and the US need to cooperate in the adjustment. China taking the medicine alone will not cure the US of its "influenza".

Excuse 1: There is serious imbalance in China-US trade

The US has exaggerated the seriousness of the China-US trade imbalance.

First, the US has exaggerated the actual balance in the current account between China and the US.

In traditional statistics for import and export, the current account reflects only the import and export trade and investment return and expenditure of only one country, and does not consider the trade activities of multinational corporations. However, 60% of China's exports were completed by foreign funded enterprises.

It is well known that the actual scenario of China-US trade is this—US enterprises are gradually withdrawing from their domestic manufacturing industry, and moving their production and processing industries to China. Then they will ship their products to the markets in US, the rest of the world as well as China. Large scale US capital operating in China has to a large extent replaced the Chinese need from US export. Here, multinational corporations play an essential role.

Hence we can say that in assessing the imbalance in China-US trade, we tend to miss out this export item. It is inappropriate if we do not take into consideration the activities of multinational corporations that trade between China and the US. In actual fact, there is no consideration of the trade activities of multinational corporations in the calculation of US trade with China, and as a result, the actual imbalance in China-US trade has been exaggerated.

In addition, there are many discrepancies in the statistics of China and US trade in terms of statistical caliber, scope, country of origin, entrepot trade and value added. The US statistical methodology exaggerates the differences in the China-US Current Account. In reality, these statistical discrepancies in the trade balance between China and the US mainly originates from the entrepot trade between these two countries through some economies (such as Hong Kong).

Second, the US has reaped more benefits in the allocation of interests in China-US trade.

So we need to be clear that the trade structure between China and the US is mutually complementary, mutually beneficial and a win-win situation. On the one hand, China is a developing country. While the economy is large in scale, the standard of development is still low. When China exports to the US, it exercises its cost competitiveness, with most of the commodities being labor-intensive products.

On the other hand, the US as a super country enjoys absolute advantage in terms of intangible assets such as capital, technology and branding. As a result, the US enjoys a larger share in the allocation of interests in China-US trade. We can say that there is imbalance in the allocation of interests in China-US trade.

On the one hand, in the global production chain, China mainly engages in low-technology content and less lucrative areas such as processing and assembly. On the other hand, US mainly controls in areas such as research and development, marketing and service.

We can say that US capital firmly commands the rights of control and allocation in the global production chain. In the allocation of interests in China-US trade, US capital enjoys a larger share, and Chinese capital plays a weaker role in participation and interest allocation, and can only take a smaller share.

Hence, although China-US trade is a win-win relationship, yet the allocation of interests in the bilateral trade between the two countries is seriously imbalanced. The US reaps more benefits in this trade relationship, yet it still claims that it was unfairly treated, exaggerating the seriousness of the imbalance.

Excuse 2: RMB should drastically revalue in order to re-balance the world economy

The logic of "RMB exchange rate has been undervalued→China's exports are low-priced→the China-US trade surplus expands→US production is in the doldrums→US unemployment rate remains high" is widely accepted by the Americans, and has become an excuse to force the RMB to revalue. In addition, the RMB exchange rate has become a political tool in the service of the US.

However, evidences related to China-US trade and trade with other newly emerging economies, as well as Japan-US and Germany-US trade history, have proven that adjusting the currency exchange rate is not a panacea for rectifying trade imbalance.

The huge trade surplus between China and the US is mainly caused by structural factors such as over-spending by the US and over-production by China. We can further assert that it is caused by the international currency system led by the US dollar, rather than by the RMB exchange rate. Indeed, as long as the US dollar remains the core currency in the international currency system, it will be impossible for the US to realize a long-term balance in external trade.

The US's own industrial structure has determined this fact—that a trade surplus will not necessarily boost the employment rate in the US, and a trade deficit will not necessarily reduce employment—the trade deficit of the US will boost employment in the areas of research and development, maritime transport, marketing, and financing. Of course, it is necessary to adjust the development modes in spending and corporate governance for both China and the US, in order to address the frail balance in the world economy resulting from China's over-production and the US's over-spending.

In the process of re-balancing the world economy, we need to be clear that on the one hand, exchange rate is only one of the factors that influence international trade, and not the only factor, and not even a basic factor. Other factors, such as division of labor, comparative advantage, the endowment of factors, difference products and demand overlap, market competitiveness, international transfer of capital, technological innovation and product innovation, as well as the supply and demand relationships among related countries and regions, all exert an influence in the trends in international trade.

When analyzing the imbalance in China-US trade, we must not completely neglect these other factors and exaggerate the factor of exchange rate. Otherwise we will be putting the cart before the horse.

On the other hand, we have mentioned earlier in this book that the imbalance of China-US trade is due to the global transfer of industry, the upgrading of the US industry structure, and the relocating of the production of medium to low grade products (ceased in the US) to China, together with the processing and assembly of products in the global production chain. This is a state of imbalance in international trade. This situation cannot be changed just by drastically appreciating the Renminbi (RMB).

From China's perspective, the imbalance of the world economy is a normal state in the process of globalization, with the US being the major beneficiary. The process of re-balance is a long-term task, and China should shoulder a certain degree of responsibility. We have very good reasons to believe that through adjusting China's economic structure, reforming the pattern of economic growth, and upgrading production, China's trade surplus will be reduced, and this will contribute to the re-balancing of the world economy.

In 2013, China's external trade surplus was US$ 259.7 billion, US$ 28.4 billion more than the trade surplus of 2012. Regarding the size of this trade surplus, we must first note that the increase in trade surplus of US$ 28.4 billion was recorded in the light of China's overall trade growth. In 2013, China's total import and export trade increased nearly US$ 300 billion compared with 2012. In other words, the surplus of US$ 28.4 billion was achieved on top of the increase of US$ 300 billion in total trade. If we compare this surplus of US$ 259.7 billion with the highest year (2008) of nearly US$ 300 billion, we can say that there is a decrease in reality. From another perspective, from 2009 to 2012, the ratio of China's trade surplus vs China's total import-export value that year was 8.9%, 6.2%, 4.3% and 5.9% respectively, and the ratio was 6.2% in 2013. Hence we can say that in recent years China's trade surplus has remained stable. China's trade surplus vs the GDP used to reach its highest point at about 6%, but in re-

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