

# **Economic Reform and Development in China**

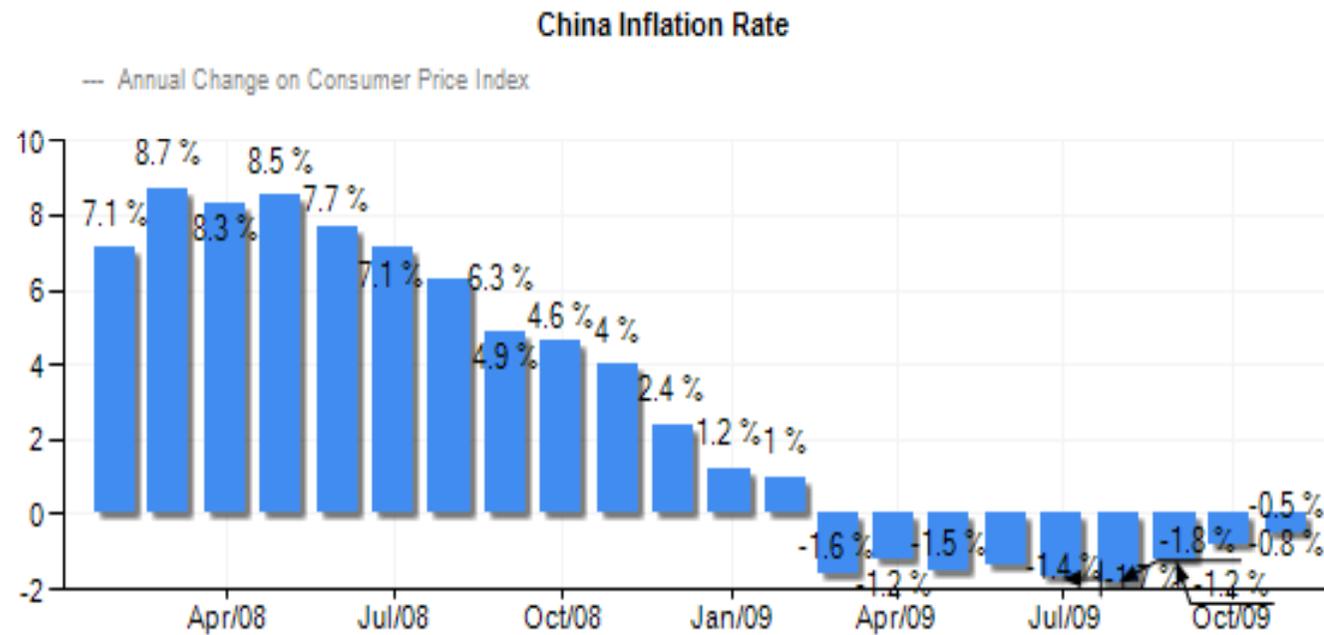


# Structure of the presentation

- 1 Overview of Chinese economy
- 1 The open door policy
- 1 Special Economic Zones (SEZs) and Open Coastal Cities
- 1 The process of separation of politics and economics: privatisation and pricing
- 1 The Chinese Economy and the Financial and Economic Crisis of 2008/2009
- 1 China as the emerging global economic player: China-US relations, China-EU relations



# China Inflation Rate



source: National Bureau of Statistics

[www.tradingeconomics.com](http://www.tradingeconomics.com)

# Open Door Policy

The Open Door Policy had five major goals:

- § Import of foreign Capital
- § Import of advanced technology
- § Import of western management know-how
- § Export promotion and import substitution
- § Employment generation and improvement of skills for the Chinese labor force
- § Landmark: 1979 Joint Venture Law legalized foreign investment (FDI), but took off only after 1984

# Targeted sectors

- 1 China has strategically targeted certain sectors for export growth, including
  - 1 light industrial products,
  - 1 textiles,
  - 1 machinery,
  - 1 electronic goods

**Discussion: why did China have a comparative advantage in these sectors?**

# Special Economic Zones (SEZs) and Open Coastal Cities

- 1 The first four SEZs, set up in 1980, were Shenzhen, Zhuhai, and Shantou in Guangdong Province, and Xiamen in Fujian Province.
- 1 They were chosen specifically because of their proximity to the major regional world trading centers of Hong Kong, Macao, and Taiwan.
- 1 **Discussion: Does location really matter most for the establishment of export promotion zones?**

# Special Economic Zones (SEZs) and Open Coastal Cities.

- 1 Enterprises in the SEZs are offered preferential treatment in terms of taxation, import licensing, and tariffs.
- 1 The most important difference between the SEZs and the rest of China is that investment decisions are made autonomously, not subject to Central planning.
- 1 This has created a climate that is very conducive to foreign investment.

# Special Economic Zones (SEZs) and Open Coastal Cities.

- 1 Enterprises in the zones are both state-owned and non-state owned.
- 1 Non-state owned enterprises can be fully foreign funded and owned, equity joint ventures, or contractual joint ventures.
- 1 SEZs enjoy considerable autonomy in investment, pricing, housing, and labor and land management policies.

# Incentives for joint-ventures in SEZs and Open Cities

- Exemption from state subsidies paid to employees
- Priority in obtaining Bank of China loans
- Tax exemption on profits remitted abroad
- Longer holidays from corporate income tax
- Extra tax benefits on profits reinvested in export- oriented or technologically advanced projects
- Reduced land-use fees and priority in obtaining utilities and access to transport and communication facilities
- Duty exemptions on imported goods used in exports (this applies to all firms, not just joint ventures).

# Pudong New Area

- 1 Objective: to become the major economic, trade, and financial center for China and the rest of Asia.
- 1 preferential policies that are broader in scope than the other SEZs.
- 1 Foreign-owned enterprises can trade their foreign exchange freely
- 1 Foreign insurance companies can be established
- 1 Foreign enterprises can build and operate port facilities
- 1 Approved enterprises can engage in foreign trade without restrictions within a certain subzone
- 1 Foreigners can trade on newly established securities markets

# Success of the Special Economic Zones

- 1 rapid growth in output, particularly labor-intensive manufactured goods,
- 1 exports,
- 1 employment generation in the SEZ provinces with spill-over effects
- 1 and foreign direct investment
- 1 Guangdong shows the most impressive growth
- 1 Guangdong
- 1 province received over half the FDI entering China during the 1980s, most of which was concentrated in the Pearl River delta adjacent to Hong Kong and Macau

# The Hong Kong factor

- 1 foreign capital
- 1 new technology
- 1 modern management practices
- 1 Supervision: a large proportion of Guangdong's export production was supervised by firms in Hong Kong
- 1 links to the rest of the world.
- 1 shared cultural ties
- 1 More than half of China's exports are handled through Hong Kong by the late 1990s.

# Relevance of the Special Economic Zones (SEZs) and Open Coastal Cities

- 1 Between 1978 (when the Open Door policy was implemented) and 1993, China grew from the thirty-second largest trading nation in the world to the eleventh,
- 1 most dramatic growth was in labor intensive manufactured goods
- 1 In 1990, the SEZs and Open Cities accounted for 52
- 1 percent of total realized investment and more than half of total exports. During 1985-90,
- 1 industrial output in Guangdong and Fujian grew at annual rates of 16-17 percent, compared with 6 percent for the rest of the economy.

# From SEZ to the market economy

- 1 the demarcation between so-called open areas and the rest of China have become less sharp.
- 1 In 1984 fourteen coastal towns were opened up to form Open Coastal Zones and in 1988 the island of Hainan received full provincial status and was officially declared the fifth SEZ
- 1 opening up the entire coastal region from Liaoning province in the north to Guangxi province in the south. In
- 1 Pudong New Area (in Shanghai) was opened in 1990.
- 1 In early 1992 preferential policies were also extended to cities in inland provinces, especially those along the Yangtze river.

# Negative consequences

- 1 Private enterprises more successful than state-owned enterprises
- 1 Productivity of some SOE declined
- 1 Migration, exploitation of migrant workers
- 1 Negative social consequences: the Chinese system of allocating housing, social benefits (health, education, entitlements like ration coupons) through the work unit meant that the social consequences of closing state enterprises were more drastic than just increasing the number of unemployed.

# The process of separation of politics and economics

- 1 the withdrawal of the state from economic activities: with or without vision? What vision?
- 1 collecting examples, discussing the consequences
- 1 The „regulatory state“

# The State's withdrawal: pricing of products

- 1 Until late 1970s: planned prices for almost all products; detailed production and sale planning for state owned enterprises
- 1 desire to protect state-run enterprises
- 1 Agricultural prices to producers were initially raised in order to encourage greater output
- 1 consumers were gradually increased to reduce subsidies.
- 1 manufactured consumer goods were freed during the second half of the 1980s.

# The State's withdrawal: pricing of products

- 1 In the 1980s: introducing of market prices for some products
- 1 In the 1990s: firms decide what to produce, how much to produce, using which technology, which marketing approach

# Privatization policies

- 1 Privatization from below, new private firms
- 1 privatization from within (whereby manager sand workers appropriate the assets of state-owned firms), popular in the Ex-Soviet Union and Eastern Europe
- 1 Privatisation with foreign direct investment
- 1 new capital injected by the community of overseas Chinese
- 1 Overseas Chinese
- 1 Investment Enterprises (OCIEs).
- 1 Opening up to foreign direct investment had been a sensitive issue

# Strategies to acquire capital

- 1 Attracting direct investment, including joint ventures, cooperative ventures, joint development, compensation trade, processing and assembly, etc.
- 1 Obtaining medium and long term loans from foreign governments and international finance organizations with low to average interest rates, as well as funds from various development agencies and relief funds.
- 1 Obtaining common commercial loans at market rates of interest. (least desirable)

# Privatisation

- 1 In the 1980s all local authorities had state State Owned Enterprises (SOE), except townships
- 1 State was forced to privatise loss-making SOE since 1992
- 1 Today almost all SME are privatised, very few subordinated to local authorities
- 1 Rapid growth of private enterprises

## Process of privatisation:

- 1 Privatisation of township and village enterprises began in the early 1990s in Jiangsu Province
- 1 SOE privatisation began in the early 1990s in Shandong and Sichuan Provinces
- 1 Often not initiated but debated and later accepted by the Central Government

# Changing Ownership Structure of the Economy

	State Sector's contribution to GDP	Private Sector's Contribution to GDP
1978	99.1	0.9
1997	75.8	24.2
2006	35.0	65.0

# Economy: risks

- 1 A slowing economy might trigger an explosion of discontent among the fastgrowing ranks of unemployed
- 1 Social Blue Book 2008 of CASS, 9.4 % unemployment in late 2008
- 1 Capital-intensive industries have expanded in the last ten yéars at the expense of labor – intensive industrías

# China economy

- 1 US has an interest to reduce its trade deficit with China and demands stronger Yuan.
- 1 depreciation of Yuan will weaken Chinese exports and lead to devalorisation of Chinese investments in US

# Budget

- 1 Would rise to 950 billion Yuan in 2009
- 1 Less than 3 percent (US about 12 percent)
- 1 24 percent total increase
- 1 38 percent increase Central Government spending on health care
- 1 Military 15 percent

# Transformation of the Economy

- 1 China Investment Corporation is one of the country's major sovereign-wealth fund bought shares of Chinese banks in 12/2008
- 1 State controlled China Development Bank negotiating takeover of Shenzhen Development Bank (controlled by foreigners)

# Aviation

State injects capital into:

- 1 Air China
- 1 China Eastern
- 1 China Southern

# Power Sector

- 1 Government injected 1.8 billion USD (13 billion Yuan) after in 2008, the National Development and Reform Commission (NDRC) twice put caps on the maximum price of coal for power generation.
- 1 Government twice raised electricity prices by 0.025 yuan per KWh and 0.02 yuan per KWh.
- 1 Chinas draft Energy Law has been submitted to the State Council's Legislative Affairs Office and will be considered at this year's executive meeting

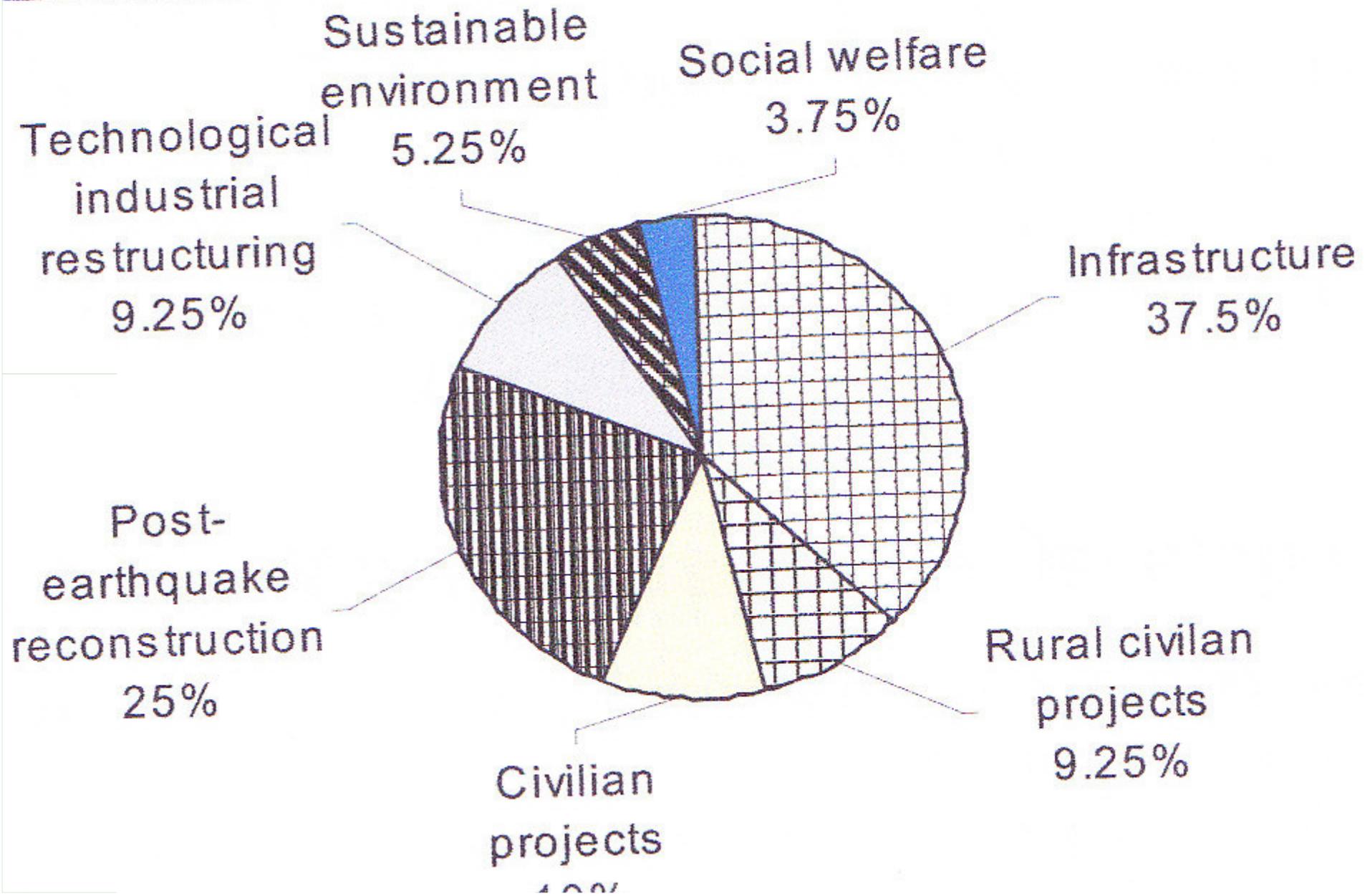
# Power Sector

- 1 China is about to make its 12th Five-Year Plan (2011-15) for the energy sector.
- 1 China's draft Energy Law has been submitted to the State Council's Legislative Affairs Office and will be considered at this year's executive meeting
- 1 This draft of the law includes 15 chapters and 140 articles. A broad piece of legislation, it addresses energy management and supervision, energy strategy and planning, development and supply, conservation and emissions reductions, climate change, taxation and pricing, reserves and emergency response, science and technology policies and international energy cooperation.

# Economic stimulation programme targets

- 1 400 billion Euro economic stimulation programme (announcement in November 2008) targets key industries and consumer spending
- 1 135 billion Euro by Government, remaining funds by banks and provincial governments
- 1 Tax reductions worth 67 billion Euro
- 1 rural infrastructure, public housing schemes, environmental protection, energy efficiency, education and health, reconstruction in Sichuan earthquake area (May 2008), support for poor families

# Breakdown of the 4-Trillion-CNY Stimulus Package



# China and the financial and economic crisis of 2008/2009

- 1 Strong dependence on foreign trade and know-how related foreign direct investment (FDI) vulnerable to external shocks
- 1 High export dependency: 40% of GDP, in particular on North America and Europe
- 1 Between October 2008 and December 2008 export volume shrank continuously
- 1 Light industry exports (toys and textiles) were hit hardest
- 1 More than 20 million migrant workers lost their jobs (at least temporarily)

# Consequences

- 1 Global financial crisis hit China in the middle of a government initiated slowdown of its economic growth
- 1 China's financial sector was not much affected by the global shock waves following the collapse of the U.S. investment bank Lehman Brothers in mid-September 2008

# China is reaching out

- 1 China as protector of free market, second investment tour in Europe in February 2009 (Volvo), contracts worth 10 billion with German companies
- 1 Europe: „Kulturpessimismus“, China heals Europe from pessimism, against Europe's ideological supremacy (takeover from colonial times)
- 1 Germany (unlike GB): production based economy fears Chinese competition, economic nationalism

Reference: China Blue Book 2009, Fürchtet Euch nicht, wir sind bei Euch (M. Siemons FAZ 9.3.2009)

# Key economic figures: **China-USA**

**GDP (2009):** 3566 USD p.c.  
1990-2008: **+536%**

## **Economic Growth**

Average 1990 to 2008: 9,6%  
Forecast: 8,5 % for 2009

**Foreign Trade/Exports to US**  
337,8 billion \$ (2008)

**Foreign Exchange Reserve**  
2,3 trillion \$ (9/2009)

**GDP (2009):** 46 443 USD p.c.  
1990-2008: **+61%**

## **Economic Growth**

Average 1990 to 2008: 2,8%  
Forecast: -2,7% for 2009

**Foreign Trade/Exports to CHN**  
12,9 billion \$ (2008)

**Debts**  
12,9 trillion \$ (6/2009)  
3,4 trillion (foreign debt)

**Trade balance: China-US: China + 268 billion \$ (2008)**

# EU-China economic relations

- 1 1978 first trade agreement, three years after establishment of diplomatic relations
- 1 1985 comprehensive agreement on trade and economic cooperation
- 1 China's accession to WTO boosted trade between EU and China, surge from 2002, In 2003 trade grew by more than 44%
- 1 China-EU trade continued to maintain a double-digit growth rate during 2008
- 1 EU is China's biggest trading partner, China is the EU's second biggest trading partner
- 1 FDI relatively low, less than 5 percent of EU outflow

# EU-China economic relations

## Trade and investment disputes

- 1 Intellectual property rights infringements
- 1 Ownership restrictions
- 1 Standards and certifications
- 1 Procurement practices
- 1 Custom procedures
- 1 Anti-dumping against Chinese products
- 1 Protection of uncompetitive industries in Europe

*Source: Broodsgaard Kjeld Erik/HONG Wai Mun 2009: EU-China Relations: Economics still in Command?, EAI Background Brief No. 484*

# Disunity of the EU:

Recurring divisions and inconsistencies between EU Member States policy toward China

1 Assertive Industrialists (Czech Republic, Germany, Poland)

1 Ideological Free Traders (Denmark, Netherlands, Sweden, UK)

1 Accomodating Mercantilists (Bulgaria, Cyprus, France, Greece, Hungary, Italy, Spain...)

1 European Followers (Austria, Belgium, Ireland)

1 Only assertive industrialists willing to pressure China on both economic and political issues

1 Source: John Fox and Francois Godement: European Council on Foreign Relations 2009)

# EU China: Trade in Good

- 1 **Trade in goods**
- 1 EU goods exports to China 2008: **€78.4 billion**
- 1 EU goods imports from China 2008: **€247.6 billion**
- 1 EU's imports from China are mainly industrial goods: machinery & transport equipment and miscellaneous manufactured articles. EU's exports to China are also concentrated on industrial products: machinery & transport equipment, miscellaneous manufactured goods and chemicals.

# EU China: Trade in Services

- 1 **Trade in services**
- 1 EU services exports to China 2008: **€20.1 billion**
- 1 EU services imports from China 2008: **€14.4 billion**

# EU-China Foreign Direct Investment

- 1 EU inward investment to China 2008: **€4.5 billion**
- 1 China inward investment to EU 2008: **€0.1 billion**

# EU-China High Level Economic and Trade Dialogue

- 1 launched in Beijing in April 2008. The dialogue takes place between the European Commission and the State Council of China, at Vice-Premier level.
- 1 Focus: EU-China trade and economic relations
- 1 provides impetus to progress concretely in sectoral dialogues.

## EU-China Business Summit 2009

- 1 Nanjing 2009; Green Business: Driving the Next Wave of Economic Growth; Innovating a Sustainable Future; Rebuilding Post-crisis Confidence in Global Trade; The Yangzi River Delta: Bridging EU-China Business

# Accession to World Trade Organisation

- 1 Formal accession to the WTO in December 2001 symbolised an important step of its integration into the global economic order.
- 1 Import tariffs and other non-tariff barriers were sharply and permanently reduced.
- 1 Progress but still some outstanding problems.

# Dispute Settlement Understanding (DSU) of the WTO (since 1995)

- 1 China has requested a WTO panel on EU anti-dumping measures on imports of certain iron or steel fasteners originating in China. The anti-dumping measures concerned were notified in the Official Journal of the European Union on 31st of January 2009 and imposed duties on imports of certain iron or steel fasteners originating in P.R. China

# **Dispute Settlement Understanding (DSU) of the WTO (launched in 2009)**

- 1 WT/DS397 - European Communities -  
Definitive Anti-Dumping Measures on  
certain iron or steel fasteners from China**
- 1 WT/DS395 - China — Measures Related to  
the Exportation of Various Raw Materials**
- 1 WT/DS 372 - CHINA – MEASURES  
AFFECTING FINANCIAL INFORMATION  
SERVICES AND FOREIGN FINANCIAL  
INFORMATION SUPPLIERS**

## Critics on China:

- 1 inadequate protection of intellectual property rights, industrial policies which may discriminate against foreign companies
- 1 market access in a number of services sectors including construction, banking, telecommunications, and express postal services).
- 1 Access to raw materials has also been identified as a major trade obstacle as well.

# China-US economic bargain

## China

- 1 2/3 of foreign exchange reserve in USD
- 1 Suffering from US anti-dumping and protectionist measures
- 1 Job losses (25 mio. Migrant workers, e.g. Dongguan shoe and toy industry)
- 1 Political pressure/interference (environmental issues, human rights, Africa)

## USA

- 1 Chinese remain engine of world economy in times of crisis (stimulus program)
- 1 Vision of consensus on energy saving
- 1 Free of nuclear weapons (North Korea talks)
- 1 Appreciation of Yuan
- 1 Cheap imports

# China-USA: Hot Issues

- 1 Take-over of Hummer (General Motors) by Sichuan Tengzhong Heavy Industrial Machinery (near Chengdu); take over of American way of life
- 1 Chengdu software production centre
- 1 China: State Loans: after 10 months of 2009 more than 150% of 2008

## Sources:

- 1 Brodegaard, Kjeld Erik/Hong Wai Mun 2009: EU-China Relations: Economics still in command?, EAI Background Brief No. 484
- 1 Ramachandran, Vijaya/Cleetus, Rachel 1999: Export Processing Zones: The Chinese Experience and its Lessons for Tamil Nadu, Harvard University Archive
- 1 Schueller, Margot/Yun Schüler-Zhou 2009: China's Economic Policy in the Time of the Global Financial Crisis: Which way out?, in: China aktuell, Journal of Current Chinese Affairs 38, 165-181.