EE463 GLOBALIZATION AND INTERNATIONAL DEVELOPMENT

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China's trading with the US and its future policy development

GROUP 6

Members

Varitha Rotjualalak 6204640467

Chalisa Ngoachintarak 6304640136

Chanamon Nimcharoen 6304640151

Warintorn Nilsart 6304641779

FACULTY OF ECONOMICS

THAMMASAT UNIVERSITY

Background

Long before its economic reformation in the 1980s, China's economic output was mostly managed by the state — the production goals, price setting, and the allocations of resources. Trade was not a major agenda, and private and foreign-invested companies were still prohibited. However, as China's population grew quickly along with consumer demand, and that reliance on other countries for food consumption made it vulnerable to political events[1], Thus de-collectivization[2] was introduced. The State had come to understand the need for modernization and the importance of China's export industry as one of the important foundations of its economy, resulting in the adjustment of its foreign aid policy and the proactive promotion of its exports.

Following China's modernization, it began to expand its product categories and export goods[3] other than crude oil, which would require resources both from the State as well as foreign investors. Several efforts to attract investors included decentralization in decisions regarding imports, loosening restrictions on exports, and the creation of special economic zones. To support the growth of its export sector, China negotiated trade agreements with other countries and provided tax incentives for exporters. China, as one of the most popular countries in Asia, has the advantages in terms of low labor cost; hence, this gives an incentive that attracts foreign investors and domestic producers. The low-cost production enabled China to mass produce any product needed for the world's rise in market demand.

In 1995, the export of machinery and electronics increased, leading to an upgrade from traditional labor-intensive exports to non-traditional labor-intensive products. Foreign-Invested businesses (FIE) have contributed to China's growth in more innovative industries, with exports from 1992 to 2012 dominated by manufactured goods. China's entry into the WTO led to an increase in total trade at an average annual rate of 35%, and the export structure has been quickly improving. China also imports products from various countries. Most of China's imports are mainly machinery, apparatus, chemicals, and fuels which the main import sources are from Southeast Asia, Taiwan, Japan, South Korea, the EU and the U.S. (Figure 2).

China has experimented with Special Economic Zones and openness to Foreign Direct Investment to transition from an exporter of heavy industry and primary products to a leader in

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1 In 1949, the Chinese encountered a lack of food in urban areas along with the American coastal blockade, resulting in the Chinese leader becoming an alliance with the Soviets1. Furthermore, in the 1960s, China ceased its relationship with the Soviet Union and emphasized the "Great Leap Forward" strategy that was based on the idea of self-reliance, resulting in huge investments in physical and human capital.

2 The de-collectivization of farming began in the Deng Xiaoping era after the failure of Mao's collectivization or Great Leap Forward strategy, which encouraged competition and provided rewards to stimulate China's productivity and economic growth in a labor-intensive, export-promoting, and market-driven development process.

3 China's major exports are electronics, machinery, textiles, and consumer goods, which primarily focU.S. on countries in Asia, Europe, and North America.

labor-intensive manufacturing. China's export sector is a critical component of its economy. The country's significant exports are electronics, machinery, textiles, and consumer goods, which primarily focus on countries in Asia, Europe, and North America, the major Chinese goods markets. The Chinese government has been actively promoting the country's export sector, and they have implemented several measures to support the growth of its exporter by making trade agreements with other countries and providing tax incentives for exporters. China, as one of the most populous countries in Asia, has the advantages in terms of low labor cost; hence, this has become an incentive that attracts foreign investors and domestic producers into china, also as China has low-cost production so this creates an ability to mass produce any product is needed for the world's rise in market demand. Besides, China's central government has a goal to pursue a policy to revolutionize economic development to compete with the world market; therefore, in a later stage of the Chinese manufacturing industry, more advanced technology was adopted into the industry, which has benefited china to export a large volume of the consumption good and high-quality technical products used as input in industrial production for the importing countries in most Europe and Asia. Moreover, China has effectively adapted technological innovation to its trade which has far surpassed many of its competitors according to many distribution centers that set up cross-border e-commerce overseas, facilitating the delivery and more cost-effective distribution of goods. As a result, China's e-commerce market[4] is growing at an amazing speed and has already become the world's largest e-commerce market.

Aside from the advantages, China also has some comparative disadvantages. Firstly, although the industry is specialized in labor-intensive however as China's labor supply is not infinite, and the labor wage is continuing to rise for both skilled and unskilled workers; hence it can be implied that for some industries, labor is not the main determinant of cost, the rates of substitutes labor with technology is likely to happen. Secondly, the unstable trade relationship between the U.S. and China has caused many manufacturers to lose confidence in trading with China; thus, the manufacturers choose to invest in another country with lower labor costs, such as Vietnam. Lastly, China is a country that has very sensitive topics that many trading partners need to be aware of when trading with them. In addition, China also takes advantage of foreign investors by releasing policies that force U.S. companies to transfer new technology to the government or manipulate its currency to make its goods look attractive. Eventually, these occasions lead to conflicts between them.

4 China's e-commerce market contributed to more than half of the world's e-commerce retail sales in 2021, with more than 780 million U.S.ers and sales value surpassing the combined total of Europe and the United States.

Key Issues & Challenges

China is experiencing one of the most rapid trade growths. The transition in trade in China consumes a long period. In each period, China has different issues that occur. The discussions in the key issues section include de-collectivization, exchange rate regimes, intellectual property problems, and the American blockade of China’s trade.

During the 1950s, Mao believed that collectivization was the most efficient way to elevate China's economy. Still, the Great Leap Forward disaster occurred due to central planners' desire to extract grain surplus from rural people to support industrialization. Consequently, the output collapsed along with a severe famine in China between 1959 and 1961. As a result, the government decided to close China’s grain export policy in order to recover domestic output and to make grain production sufficient within Chinese consumption.

Afterward, China foresees the importance of Exports for economic growth, as they bring money into the economy. The Chinese Yuan or Renminbi (RMB) has been pegged to the U.S. dollar since 1994, making Chinese exports cheaper and more attractive to the global market. From the end of 2004 to the end of 2014, the People's Bank of China increased its foreign exchange reserve by 3.8 trillion U.S. Dollars to support export activity. In addition, Currency manipulation has enabled China to gain a 25% to 26% share of global manufacturing output since 2014. Therefore, the Chinese economy is growing rapidly, and the yuan peg has granted Chinese companies unfair advantages, leading U.S. lawmakers to call for revaluing the currency, and China has been gradually lowering barriers to international capital flows and promoting greater usage of the RMB in international transactions. In addition, The trilemma in international monetary policy management involves a fixed exchange rate, independent monetary policy, and the free flow of capital. Mutual exclusivity makes only one side of the trilemma triangle achievable at a given time. Independent monetary policy is unachievable if fixed exchange rates and free flow capital are mutually exclusive. To become a full-fledged global currency, China must meet certain conditions, such as full convertibility, open capital markets, and the rule of law and protection of property rights.

However, China's lack of legal protection for intellectual property before WTO entry raised concerns in the 1990s. With the transfer of technology and the training of local labor, technicians, and management staff, FDI in China increases the productivity of the domestic industry. China's exports are now more technologically advanced than predicted. However, China's exports are restricted to low-cost labor due to its lack of independent intellectual property and core technological know-how, causing various problems in the high-tech trade sectors. China's licensing regulations limit international corporations' ability to negotiate fair, market-based terms when they want to license intellectual property or transfer technology to Chinese enterprises. Moreover, it exploits legal and regulatory restrictions to force international corporations to transfer technology. For example, EU businesses face invalidation procedures against their parents due to Chinese infringement of standard essential patents, such as the 4G communications standard, without paying the required royalties.

The trade war between China and the U.S. started in 2018 since the US believed that China had been engaging in unfair trade practices due to intellectual property theft of American technology, China manipulating its currency to gain an advantage in international trade, and the US also accused China for violating international rules by subsidizing its industries and limiting access to its market which the trade war has negatively affected the Chinese economy. In addition, China believes the U.S. is trying to restrict its rise as a global economic power. The U.S. has implemented several measures that could be considered a blockade on China’s trade. The U.S. has imposed tariffs on Chinese exports which make Chinese exporters face higher costs but it also makes them more expensive for American consumers and businesses, resulting in a loss of $550 billion dollars of Chinese goods. The U.S. has imposed restrictions on Chinese investment in certain industries due to concerns over national security and intellectual property theft. This includes blacklisting technology companies such as Huawei and ZTE, and banning U.S. companies from selling them. Furthermore, the U.S. has put Chinese companies on a trade blacklist for breaching U.S. sanctions by the Chinese for sending U.S. technology to third parties such as Iranian entities. The U.S. has tightened export control to prevent China on certain Chinese products from developing advanced weapon systems and surveillance infrastructure. However, The export controls imposed by the U.S. on China to protect commercial technologies and manufacturing threaten high-wage jobs and high-value-added manufacturing in the U.S. The trade war has caused a significant slowdown in China’s economic growth rate since many exports of China products have been hit with the tariff, which has reduced demand for Chinese goods. Foreign investment in China decreased due to fear of the trade war.

Government Policies

China's trade transition has brought about various challenges that have required the government to adapt its policies accordingly. This section suggests how the Chinese government adapted its policies to address trade challenges at different stages.

In response to the issues of collectivization arising from the insufficient grain output among the Chinese, de-collectivization was introduced which encouraged competition and provided rewards to stimulate China's productivity and economic growth through the labor-intensive, export-promoting, and market-driven development processes. For example, Citizens were allowed to own businesses and able to export their specialized production to overseas markets. Apart from that, an open-door policy of China was adapted from the new economic development introducing foreign capital and technology. This has increased the inflows of foreign investment and transformed China's economy resulting in a rising national income and economic development. However, as the policy benefited China, there are still some areas where the policy cannot effectively solve, that is the trade-off between rising national income and Chinese living standards. Firstly, the policy has promoted some regions to be wealthier than others. Secondly, as foreign investment was encouraged, this led to many foreign-own or private enterprises competing with the existing state-owned enterprises in China. Basically, those foreign companies operate the business more efficiently hence it has created a growing income gap between the employees of enterprises and state-owned enterprises. Thirdly, due to the two reasons mentioned above, there was an obvious income gap between the Chinese; therefore, many issues arose. For example, the danger of food shortage due to the lack of rural labor who choose to migrate into the cities and the corruption in the government.

Since it is internationally believed that RMB is undervalued due to the currency manipulation done by the Chinese government due to the vast trade surplus with the U.S. and the rest of the world. China was blamed for job losses around the world and accused of threatening the world's economic equilibrium — making it a so-called "currency manipulator." Eventually, around the mid-year of 2005, the Chinese government shifted its exchange rate regime to a market-oriented exchange rate based on supply and demand with reference to a basket of currencies as a political move responding to external pressure to revalue the RMB after a 2.1 percent appreciation. It is widely believed that the RMB exchange rate was undervalued and in disequilibrium due to the intervened purchase of foreign exchange reserves. However, the exact composition of the currency basket was not disclosed, and the announced regime maintained its close ties to the dollar. In particular, a daily rate (the central parity rate, commonly referred to as the "fix") that would serve as the midpoint of the range in which the RMB/U.S.D rate might fluctuate on that day would be issued before the commencement of trade.

In recent years, China has made significant progress in strengthening its intellectual property right (IPR) protections, including copyright, trademarks, patents, and trade secrets. The country's Patent Law has helped promote innovation development and advance science and technology. To safeguard against registrations made in bad faith, it is crucial to register a Chinese translation of a foreign trademark. Foreign enterprises also undertake preventive patenting, trademarking, and copyrighting to stave off competition from Chinese companies and goods. Chinese businesses are becoming aware of the importance of intellectual property rights, leading to more intensive R&D expenditures and stronger capacities for innovation. Improvements in patent laws also stimulate domestic exporting firms to import high-technology inputs or invite FDI and inward technology transfer. New products reflect Chinese firms' ability to transform R&D spending into final product achievements that can better satisfy consumers. However, Chinese intellectual property law enforcement efforts are lower than developed countries and the world average, making IPR protection and enforcement a major concern for foreign companies. In addition, China’s IPR cases are often brought to intermediate courts at the municipal level. may suffer from local judicial protectionism. This can give plaintiffs, including Chinese companies, who bring suits in their hometowns, a stronger chance of winning. However, this advantage disappears when the case is appealed to higher courts.

During the trade war between the U.S. and China, China responded to the U.S. to strengthen its economy and global influence. To counter the U.S. tariffs on Chinese goods, China implemented tariffs on American exports, including agricultural products, automobiles, and aquatic products, at 25% (Figure 3). These tariffs aimed to protect China's domestic industry. China also lifted an import ban on live poultry products from the U.S. China pursued a strategy of diversifying its trade partners by lowering tariffs on imports from other countries. This move sought to reduce China's dependence on the U.S. market and increase its trade ties with other regions, such as Europe, Southeast Asia, and Africa. China's investment in these regions increased, deepening economic ties and strengthening its global economic position. Meanwhile, the Chinese government implemented several domestic policies to reduce its reliance on American technology and promote the development of the domestic high-tech industry. China's investments in artificial intelligence and semiconductors increased. This move aimed to reduce China's dependence on American technology and increase its ability to compete with the U.S. in the global technology market. China's response to the U.S. in the trade war has focused on minimizing the impact of U.S. tariffs on its economy.

Conclusion

China has undergone structural changes in economic and policy development but still faces many problems due to the polarization of power. To address these, each challenge requires different strategic implementations. Starting in the 1950s, collectivization was one of the first Chinese economic models where Mao believed that doing so would allow China to achieve economies of scale, equality, and industrialization eventually failed. Later, Deng introduced a new de-collectivization model that promoted the wealthy classes who could determine the production level in the market. As a result, China's economy has revolutionized for the better, increasing national income and expanding its export to the international scale. Next, though the pegged yuan gained loads of benefits for China in terms of exports, it negatively affected the U.S. due to the intervention of the foreign exchange reserve, resulting in a perception of an undervalued RMB. These policies take advantage of others, such as stealing intellectual property and the exchange rate regime; consequently, they cause the U.S.-China conflict.

Issues and challenges in China have led the Chinese government to handle them by implementing policies. According to improper management from the government during the open-trade policy, the Chinese are struggling with a vast wealth gap as the government gave incentives that were biased toward those who have the capital to support the new policy development; thus, inequality still needs to be concerned to have an equal income distribution throughout the country. For the exchange rate regime, though it may seem to be a satisfying political strategy; however, the lack of information on the reference basket of currencies somehow made RMB seem still linked to only the U.S.D though it has somewhat more flexibility than before. Although the reform announcement stated the PBC's intention to permit non-U.S. currencies to move more than the RMB/U.S.D rate, it seemed impossible for this to occur since two currencies can barely correspondingly fluctuate in the same level and direction. China has experienced increased trading due to the exchange rate policy and continues to develop its intellectual property rights while adapting them to the international system. However, from a foreigner's perspective, it is still weak and biased toward a domestic country rather than an outsider. China's response to the U.S. in the trade war effectively mitigated the negative impact on its economy. China implemented tariffs on American exports, diversified its trade partners, and pursued domestic policies to promote the development of the domestic high-tech industry. China has learned several lessons, including recognizing the significance of developing domestic high-tech industries and promoting intellectual property development to increase its competitiveness in the global market.

Appendix

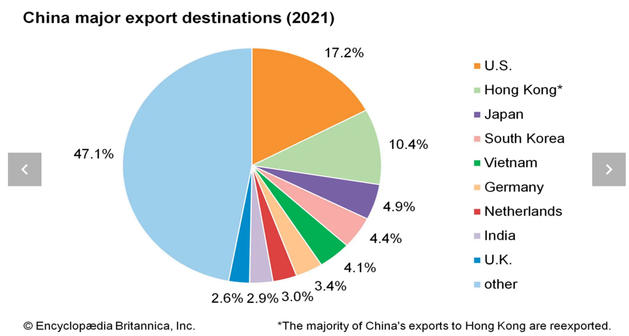

Figure 1 :China's export partners

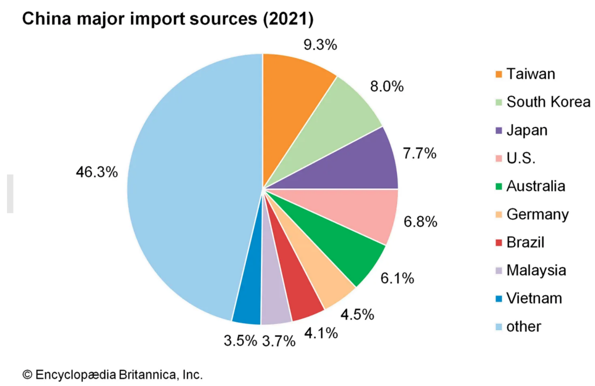

Figure 2: China's import partners

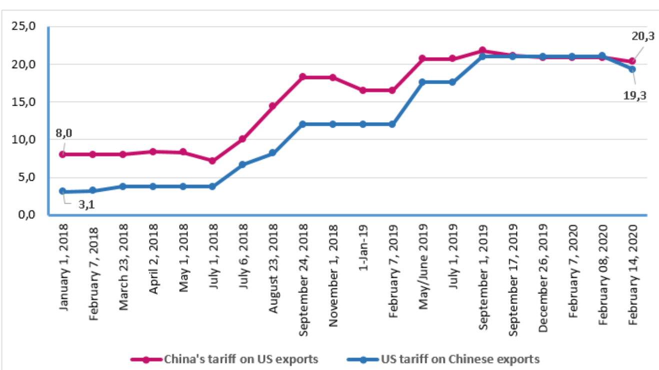

Figure 3: U.S.-China Trade War Tariffs, %

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