Globalization and China’s Economic Development
Gregory C Chow

References: *China’s Economic Transformation* (Blackwell, 2002)
*Knowing China* (World Scientific, 2004)
How was rapid growth at a 9.5% annual rate achieved?

• Three economic fundamentals sufficient for rapid growth, given political stability:
  • 1. Abundance of high-quality human capital, from history not schooling
  • 2. Market institutions, though imperfect
  • 3. Position of a late comer to take advantage of available modern technology.
• Examples: Japan, Hong Kong, Singapore,
• Taiwan and S. Korea,
Four Aspects of Globalization

• Globalization is the development of a world market through the flows (to and from China) of
• 1. goods and services- foreign trade.
• 2. capital, physical and financial – foreign investment.
• 3. technology – following other three flows
• 4. people – migration from and to China
1. Foreign Trade

• Total volume of foreign trade increased from 20.64 billion US dollars in 1978 to 1.155 trillion in 2004 and was growing at the rate of 36 percent as compared with 2003 when the volume of foreign trade in RMB had already accounted for 60 percent of GDP. China is the third largest trading country in the world, next to the United States and Germany.
US-China Trade Relations

- Americans benefit from high-quality consumer goods at low prices imported from China.
- US industries producing similar products face competition.
- US workers in these industries may suffer temporarily, but in the long-run the labor market adjusts as new industries are developed to hire the displaced workers. The aggregate unemployment rate (now at 5 percent) has not been visibly affected by the American imports of foreign goods. However, this is a political problem in US.
- About 60 percent exports from China are produced by foreign invested enterprises in China including many American.
US-China Trade Relations-Continued

- Outsourcing of jobs such as having someone in Asia read X-ray or answer phones is import of services having similar effects as imports of goods above.
- China provides a large market for foreign manufacturers and has gained economic power as a result. Demand for imports to China propels economic growth of other countries in the world.
- As a member of WTO China is obliged to lower tariffs.
- US are considering the imposition of restrictions on imports from China, such as quotas and tariffs on imported textiles from China.
Foreign Direct (Physical) Investment

- In 2002, 2003 and 2004, the amounts of direct foreign capital utilized were respectively 55.0, 56.1 and 64.1 billion US dollars.
- Foreign investment has provided physical and financial capital, technology, and management skill and practice to China.
- However foreign investment is not a fundamental economic factor in China’s rapid growth but only a vehicle propelling that growth—recall the three fundamental factors above. Investment could go anywhere in the world.
Export of capital from US to China

- Export of capital from US to China as when a US factory moves from Cleveland to Shanghai is also an outsourcing of jobs as in the import of services. The factory can take advantage of the less expensive and good quality labor in China.

- Such an investment is good for the US as it raises the marginal product of the piece of capital that is moved; otherwise the factory would not have moved. Given a classical production function with capital and labor as factors of production, US GNP will increase because the marginal product of the capital being moved is smaller than its marginal product in China.

- The move, however, has a short-run harmful effect on the workers in Cleveland who lose their jobs when such a factory moves. As in the case of competition from imports from China, this does not affect aggregate unemployment rate in the US.
Export of Capital from China to US

- Reasons for US not to accept capital from China: 1. to protect its control over national assets and world resources; 2. to protect its technology for security reasons.
- Are these reasons justified? Other supplies exist.
Foreign Financial Investment

• Asian financial crisis of 1997-8 did not affect China seriously as the Chinese government had a prudent policy of adopting international financial liberalization slowly especially in allowing only a gradual opening of financial markets (B shares for foreign investors) and of the capital account because economic institutions are not ready.

• Zhu Rongji promoted Chinese membership in WTO in 2001 to encourage foreign competition to speed up financial reform but reform is slow.
The exchange rate of RMB

• In 2002 RMB was undervalued. Large inflow of foreign exchange (US$) into China means price of $ was too high, or price of RMB too low.

• Statistical relations of money, price and output for China confirm Milton Friedman’s proposition: when money supply increases, output will first increase but effect is short-lived; prices will increase later but effect is longer lasting (inflation).

• Failure to raise the exchange rate of RMB led to rapid inflow of foreign exchange and associated increase in money supply in 2002 and subsequent increases in output and prices in 2003-4 or “overheating” via the Friedman proposition.

• China should revalue the RMB for its own good.
Technology and information

• Import of technology benefited China but China is already an exporter of technology to some less developed countries.

• US concerned about transfer of technology to China because it may result in US losing (a) economic leadership, as in the case of the auto industry to Japan and (b) military leadership if China gets military technology.

• China is spending a very large amount on higher education and science research to upgrade technology. Improvement of technology is rapid.
Migration from and to China

• Migration of Chinese to other countries have benefited the host countries including the US.
• Migration of people including ethnic Chinese to China has contributed greatly to China’s economic reform and development. Russia does not have similar assistance in its development.
• No brain drain problem as overseas Chinese are contributing to China’s development and some have and others will return.
Conclusion

• The flow of goods, capital, technology and people to and from China has been essentially beneficial to both China and its partners in the globalization process, although there are short-run harmful effects to some members of the population in China and elsewhere that come with globalization. In general globalization has more benefits than costs.