8

Global Capital Flows and the Position of China: Structural and Institutional Factors and their Implications

Young Rok Cheong and Geng Xiao

Global capital flows into developing economies have been driven by two fundamental factors: profit opportunities in the emerging economic frontiers and the physical and institutional barriers to international capital mobility. Advancement in transportation and communication technology has greatly reduced the physical costs of cross-border mobility of capital and goods while the spread of global development knowledge has also led to new profit opportunities in less developed economies, such as China.

Since the early 1980s, China has emerged as a major global development frontier, following its open-door policies and economic reforms initiated by Deng Xiaoping. Since that time, the barriers to foreign trade and investment in China have declined steadily, leading to China's accession to the World Trade Organisation in late 2001 – after one-and-a-half decades of tough negotiations. By the end of 2002, only a year after joining the WTO, China overtook the US in FDI inflows, becoming the most attractive FDI destination in the world, receiving $52.7 billion in FDI.

China's recent dramatic achievement seems to suggest that today's global economy is unprecedented in terms of openness and the amount of foreign capital flows into developing countries.

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Unfortunately, this optimistic impression is not confirmed by facts. Foreign capital flows into developing countries today are far below historical record achieved before World War I. The gross value of foreign capital stock in developing countries increased from 8.6% of their GDP in 1870 to a peak of 32.4% in 1914. This ratio dropped to 4.4% in 1950 due to the interruption to the global trade and investment during the war and by 1973, recovered only to 10.9% and 21.7% by 1998 (Maddison 2001, p. 28). Hence, in spite of technological advances during the last century, the world is actually less open for capital flows to less developed countries than one hundred years ago.

Capital flows among developed countries are much freer than between developed and developing countries because of better protection of property rights and less capital control in the developed economies. High capital mobility among developed economies has led to a dramatic change in the holding of net foreign assets among developed countries during the last decade. For example, from 1989 to 1998, Japan's holding of net foreign assets increased from $294 to $1.153 billion while the US obligation in net foreign liabilities jumped from $49 to $1.537 billion (Maddison 2001, p. 137). Clearly, Japan has exported a substantial amount of capital to the US in search of better risk-adjusted return and in preparation for its aging population, even while the policy environment in Japan, such as the volatility of the exchange rate and the secular appreciation of the yen, is unfavourable to Japanese investment in foreign assets.

In the last decade, foreign direct investment in China increased from about $3 billion in 1990 to $52.7 billion in 2002. As impressive as this is, on a per capita basis, China's FDI inflow in 2001 was still below the average of FDI inflows to the rest of developing countries. Per capita FDI inflows in 2001 was only $37 for China, compared to an average of $120 for the world and $42 for all the rest of developing countries.

Foreign invested enterprises in China have contributed to more than half of China's exports. China has been generating current account surpluses for the last nine years. Since current account surplus simply means net savings or net export of capital, China is taking in FDI on the one hand and exporting capital to capital-rich economies like the United States on the other hand. How can we reconcile these seemingly inconsistent patterns of capital flows?

Is China attracting too much FDI? What happened to China's investment in US bonds? What is the impact of foreign portfolio investment on the stability of the Chinese financial markets and other Asian regional markets? Is China generating global deflation? How serious is China's impact on its competitors? Is China saving too much? Should China revaluate its currency? Is China becoming a growth engine for the world? These are questions we examine in this chapter.

The next section presents the basic facts on the patterns of global capital flows and the position of China. Section 2 explains the uniqueness of China's economic conditions in attracting capital inflows. Section 3 assesses the impact of China's rapid integration into the global economy on the rest of the world. Throughout our analysis, we emphasise structural and institutional factors such as the gaps in development, population structure, and financial and legal institutions and their effects on the patterns of global capital flows and global economic development. Section 4 concludes.

1 Global Capital Flows and the Position of China

In this section, we first summarise the pattern of global trade and foreign direct investment based on the extensive information from the WTO and the World Investment Report of UNCTAD. Then we review global portfolio investment using detailed IMF and US Treasury surveys. Our purpose here is to provide a concise and comparative background to determine China's position in the global capital market.

US Trade Deficits with China and the Asian Region

Global merchandise trade increased from $124 billion in 1948 to 12.7 trillion in 2000, an increase of more than 100 times over a period of half-century. Western Europe and North America have maintained about 40% and 20% of the global trade respectively throughout this period. Asia's share has risen from about 14% to about 24% at the costs of Latin America, Africa, and other regions.

During the last two decades from 1982 to 2001, the growth rate for global merchandise trade varied from -5.8% in 1982 to 19.5% in 1995, averaging about 6.1% a year. The global trade in commercial

services was relatively stable at a level of about 23% of the merchandise trade (see Table 1.1[1]).

In 2000, Asia's share of global exports (at 26.7%) is 3.9% higher than its share of imports (at 22.8%) while North America's share of exports (at 17.1%) is 6.1% lower than its share of imports (at 23.2%) due to exceptional export performance in Japan, Asia's newly industrialising trading economies and China. From 1948 to 2000, Japan increased its share of global export from 0.4% to 7.7% and six Asian traders (see Table 1.2) increased their share from 3% to 10.5%. In the last quarter of the 20th century, China increased its share of global exports from 1.2% in 1983 to 4.3% in 2001, with a strong momentum for further gains of market share in the future (see Table 1.2).

In 2001, the US current account deficit (net capital import) reached $393.4 billion. On the other side, current account surplus (net capital export) was $87.8 billion for Japan, $57.1 billion for the six Asian traders, $17.4 billion for China, and $39.6 for transition economies (see Table 4.7). Except for Japan, many countries with a current account surplus (net capital exporters) are not capital-rich economies. In 2000, according to the IMF, the US absorbed 64% of global net capital exports (i.e. the sum of the current account surpluses of the rest of the world).

Who is financing the net capital import to the United States? Table 4.10 shows the exports, imports and balance of goods account for the US in 2002. The US goods deficit, which is the major part of its current account deficit, is as high as $484 billion. The US goods account deficit is financed by and distributed among the rest of the world: 18% by North America, 18% by Western Europe, 14.5% by Japan, and 21.3% by China. The importance of China in US trade deficits is at the centre of the globalisation debate. Is China taking away jobs from American workers or financing American consumers? Is China generating global deflation? Is China saving too much? Should China revaluate its currency? We discuss these questions later.

Due to rapid regional integration of production through the so-called supply chain management, China's strong export performance is intimately related to the export activities of its neighbours. This modern management model, pioneered by Hong Kong

[1] All tables and graphs are at the end of this chapter.

entrepreneurs, separates the whole value-added chain into different parts and searches for the best deals in distribution and production among global providers of production and services. This innovation makes our traditional concept of "made-in-China" or "made-in-Japan" much less relevant as many parts of final goods and services are produced or provided by countries other than the one where final goods are exported.

Table 4.9 and Graph 5.2 show the rising US current account deficits with the greater China, including Hong Kong and Taiwan. It is clear that the part of trade deficits attributable to Hong Kong and Taiwan are either declining or stabilising while the part due to China is rising rapidly. This is largely because the production of final goods has been rapidly relocated to China from Hong Kong, Taiwan and other Asian economies over the last decade. But the key components or high value-added parts of the supply chain are still kept in the more developed Asian economies. If this part of the contribution to the production of final goods is excluded, China's own value added in exports to the US would be very small. This point needs to be remembered as we attempt to assess China's impact on the world. About two-thirds of China's FDI is coming from its neighbours such as Hong Kong, Macao, Taiwan, Japan, Singapore and Korea, in part for the purpose of assembling final products to be exported to North America and Europe.

Steady FDI Flows into China

Foreign direct investment is much more volatile than foreign trade, but it is becoming increasingly important in recent decades for both developed and developing countries. The growth rate for global FDI fluctuated widely from 56.7% in 1999 to -50.7% in 2001, averaging about 16.3% in the last two decades. As a result of rapid FDI growth, global FDI flows as a percentage of global merchandise trade increased from about 1.5% in the early 1980s to between 6% and 12% in the last five years. But the scale of global FDI flows is still much smaller than the global service trade, which is about 23% of merchandise trade. At its peak in 2000, global FDI reached $1.5 trillion, or about 15% of the United States' GDP (Table 1.1).

Most of global FDI, especially FDI among developed countries, is through mergers and acquisitions (M&A) rather than green-field investment. In 2001, M&A amounted to as much as 80% of global

FDI. Among all the M&A in 2001, 83.5% was conducted in the developed countries, 31.1% in the US alone, and only 5.8% in Asia and the Pacific region.

Developed countries are key hosts of FDI with their share of global FDI at levels ranging from 60% to 80%. At the regional level, North America has been expanding its market share at the costs of European countries although the latter have been picking up in the late 1990.

Graph 5.1 shows the trend since 1979 of FDI inflows to US, China, Asia and the Pacific region, and all developing countries excluding China. The US has been dominating the global FDI inflows with its share ranging from 11.2% or $19 billion in 1992 to 26% or $283 billion in 1999. Asia and the Pacific region have increased their market share from 15.2% in 1991 to 24.3% in 1996, but the Asian financial crisis depressed their share to only 9% in 2000.

China's share of global FDI increased from a low base of 1.7% in 1990 to a peak of 13% in 1994. After 1994, China's share of global FDI declined steadily to only 2.7% in 2000 largely due to massive M&A activities in the developed economies during the tech bubble. After the burst of the tech bubble, global FDI dropped 50% in 2001 but China's FDI was growing steadily, contributing to a recovery of China's share in global FDI to 6.4%, which is consistent with its trade expansion to 4.3% of the global export by 2001.

FDI into China has exceeded $40 billion since 1996 and has been growing steadily every year since 1990. This puts pressure on other developing countries, especially its Asian neighbours. As shown in Table 1.3, the Asia-7, including India, Indonesia, Malaysia, Philippines, Republic of Korea, Singapore, and Thailand, with more population than China, only had $33 billion FDI inflows at their peak year of 1997. After the Asian financial crisis in 1997-1998, the Asia-7's FDI inflows declined dramatically to only $18 billion by 2001. The Asian financial crisis however did not slow FDI flows into the developing economies as a whole. FDI into developing economies excluding China recorded a steady growth from $34 billion in 1990 to $147 billion in 1997, and peaked at $197 billion in 2000, and then fell to $158 billion in 2001.

In 2001, per capita FDI inflows are $120 for the world, $420 for the developed economies, $42 for the developing economies excluding China, $37 for China, and only $12 for the Asia-7.

Apparently China is winning the competition for FDI inflows and its neighbours are very much concerned about this trend.

Table 1.6 shows inward FDI stocks for selected regions and countries over the period from 1980 to 2001. Global FDI stock increased from $636 billion in 1980 to $6258 billion in 2000, an increase of almost ten times. During the same period, the world trade volume only increased about three-folds from $4 trillion in 1980 to $12.5 trillion in 2000. This clearly shows the increasing importance of FDI in the world economy and the expanding scope and depth of globalisation.

However, the access to foreign capital is unequal with 5 billion out of a 6.1 billion world population in the developing countries receiving only $2.1 trillion out of $6.8 trillion in the FDI stock by 2001. In 2001, per capita FDI stock is $1,118 for the world, $3,763 for the developed economies, $478 for all developing economies excluding China, $309 for China, and only $220 for the Asia-7.

The developed economies provided most of the global FDI stock but its share is declining from 95.8% in 1980 to 87.8% in 2001. In the last decade, Hong Kong emerged as a major financial centre for facilitating capital flows into China. Hong Kong's outward FDI stock increased from $2.3 billion in 1985 to $375 billion in 2001, exceeding Japan's $300 billion. In 2001, Hong Kong captured 5.7% of global FDI outward stock, compared with only 4.6% for Japan. A significant part of Hong Kong's outward FDI into China is "round-tripping" Chinese capital, perhaps as much as one-quarter (World Bank, 2002, p. 41).

The pattern of global FDI flows raises a few core questions. Is China attracting too much FDI? Is China hurting its Asian neighbours and competitors? These questions can only be discussed meaningfully after examining many special development conditions in China.

Two-Way Flows in Cross-Border Portfolio Investment

Based on the recent *Global Portfolio Investment Survey* by the IMF (Table 2.1), the derived portfolio investment liabilities for the world in 2001 are $12.5 trillion, about twice the amount of the global FDI stock and almost equal to the sum of global merchandise exports and imports. The IMF survey is so far the best estimate on the stock of global portfolio investment. Compared to IMF's last survey for

1997, the global portfolio investment stock doubled in only four years. The top three targets for portfolio investment stock are very stable, including the US, UK and Germany, sharing 24.5%, 10%, and 9.2% of the global total respectively. Japan fell from the fourth place in 1997 to the sixth in 2001, now behind France and the Netherlands. Japan's share dropped from 6.5% in 1997 to 4.2% in 2001, reflecting its weakening economy (see Table 2.1).

China made little progress in attracting foreign portfolio investment during 1997 to 2001. The derived amount of foreign portfolio investment in China increased slightly from $19.3 to $20.1, reflecting its stagnant "B shares" market, which is a tiny experimental stock market designed for foreign investors with share prices quoted and traded in foreign exchange.

In March 2001, China opened its "B share" market to domestic residents with foreign exchange savings. This opening caused a brief surge in prices and many foreign investors took profits and dumped many shares to domestic residents. At the end of 2002, China announced its plan to allow the Qualified Foreign Institutional Investors (QFII) to invest in its "A share" market designed for domestic investors with RMB savings. The Chinese authorities are also studying actively the mechanism of Qualified Domestic Institutional Investors (QDII), which would allow Chinese residents to invest in overseas securities markets, including Hong Kong markets, where many Chinese companies are listed but their shares cannot be sold to Chinese residents through legal channels. Compared to China's inward FDI stock of $395 billion, its foreign portfolio investment stock of about $20 billion is insignificant. However, the potential for foreign investment in China's securities market is bright as its stock market capitalisation is almost the same as that of Hong Kong at $463 billion at the end of 2002, compared to $2 trillion in Japan and $11 trillion in the US. China's financial sector is still underdeveloped and is the major bottleneck for China's sustainable growth and development as will be discussed further in the next section. But with China's commitment to WTO and its recent efforts on modernising its financial regulation and development, it is just a matter of time, perhaps as long as another decade, for China's foreign portfolio investment to catch up with its FDI and foreign trade.

To understand the potential foreign portfolio investment in China, it is useful to take a look at the experiences of China's more developed neighbours. This is possible by examining the bilateral

long-term securities investment data collected and maintained by the US Treasury. Since the US is the largest player as assets and liabilities holder in cross-border portfolio investment, the picture we get from this data set should be illustrative. Some of the findings, such as China's huge investment in US bonds, are not only surprising as new development but also have important implications for building global capital market order.

Graph 6.1 shows the cross-border gross purchases and sales of stocks and bonds between the US and the rest of the world. Clearly the rest of the world traded much more US stocks and bonds than the US traded the rest of the world's stocks and bonds. In the most recent period, the monthly gross purchases of US bonds by the rest of the world are in the range of $600 to $800 billion. The monthly gross purchases of US stocks by the rest of the world are in the range of $200 to $400 billion. The monthly gross purchases of foreign bonds or stocks by US residents, on the other hand, have never exceeded $200 billion. A similar pattern can be seen in Graph 6.3 for the cross-border trading of stocks and bonds between the US and Asia. Asia's love with US bonds went back to the 1980s. Asian countries have accumulated large amounts of net holdings of US bonds, led by Japan and followed now by China.

Table 2.2 to 2.5 show the summary trends on cross-border trading of long-term securities between the US and major Asian economies. The transaction data reported monthly are added up to get the annual numbers. The net purchases are derived by subtracting the gross sales from gross purchases. During the ten years from 1988 to 1997, Asia's net purchases of US bonds reached $415 billion, compared to $1.447 billion by the rest of the world. In 2001, Asia's net purchases of US bonds were as high as $147 billion, compared to $405 billion by the rest of the world. China's net purchases of US bonds in 2001 were as much as Japan's at about $52 billion. Both Japan and China have increased their net purchases of US bonds after the Asian financial crisis. During the ten years from 1988 to 1997, China's net purchases of US bonds were only 11.5% of the Asia total. But it increased to 23% in 1999, 19% in 2000, and 35.2% in 2001. Given China's $280 billion official reserves and about $260 non-official reserves foreign exchange credit in the banking system, China's increased net purchases of US bonds are inevitable. But it is still surprising to know that China's share is as much as 35.2% of the Asia total.

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Table 4.8 also shows a summary account of China's balance of payments since 1982. Two items are related to China's capital outflows. One is the current account surplus and the other is the errors and omissions. China's accumulated current account surplus since 1982 reached $135 billion while the accumulated errors and omissions since 1982 were even higher at $140 billion, both at about 12% of GDP. Table 4.8 also shows China's external debt at the end of 2001 was only about $170 billion or 14.7% of GDP. Clearly China is putting a lot of official and private savings in US dollars. Why? A simple explanation is property rights! Like other foreign investors in US assets, the Chinese government and the Chinese people certainly believe that the property rights of their US investment are well protected. On the other hand, China also provides better protection for property rights in FDI in China than on domestic assets. Hence, on the whole, both sides are happy and better protection of property rights enhances value and productivity of capital.

It is interesting to note that the private foreign bank lending to China is not as important as FDI. This can be seen from the changes in cross-border banking capital flows between Hong Kong and Mainland China during the last decade. As shown in Graph 5.3 and Table 4.11, Hong Kong used to be an important centre in Asia for making syndicated loans to China and other Asian economies. From 1994 to 1999, Hong Kong was a net lender of banking capital to Mainland China. After 2000, however, Hong Kong turned into a net borrower of banking capital from Mainland China. Since 1997, there has been a steady decline in Mainland's gross banking liabilities to Hong Kong from more than $50 billion in 1997 to less than 20 billion after 2001. This was triggered by the bankruptcy of the GITIC (Guangdong International Trust and Investment Corporation), which borrowed from foreign banks in Hong Kong with the implicit understanding that the Chinese government would guarantee the loans. The Chinese government, however, decided not to use its money to save this regional state-owned holding company in order to avoid moral hazard problem in similar cases for other companies and in the future. After the GITIC bankruptcy, foreign banks became very cautious in extending syndicated loans to China.

During the Asian financial crisis in 1997, Hong Kong suffered a huge withdrawal of foreign banking capital. Hong Kong's foreign

banking funds fell from $630 billion in June 1997 to $250 billion by April 2002, a drop of 60%. Among the total withdrawal of $380 billion, $251 is by Japan (see Table 4.11). In spite of fluctuations in capital flows, Hong Kong's banks have been extremely resilient during and after the crisis with NPLs staying no more than 5%.

During the Asian financial crisis, short-term capital flows were blamed as a driver for financial market instability. Hence, there have been calls for caution on liberalisation of capital accounts and portfolio investment. The role of foreign investors in the stability of local markets becomes an interesting topic. Graphs 6.3 to 6.8 examine this issue using data after the Asian financial crisis and show a strong negative correlation between the size of trading by foreign investors and the level of the local stock market turnover. What it means is that, at least, during the non-crisis period, the participation of foreign investors in the Asian local stock markets enhances the local market stability: the lower the local turnover, the higher the share of trading by the US investors. This pattern appears in Japan, Hong Kong, Singapore, Taiwan, Korea, and even the tiny "B share" market of Mainland China. It appears that the US investment, probably helped by their institutional investors, is more rational than that of the local investors.

2 China's Structural and Institutional Conditions for FDI

In spite of the large volume of literature on China's foreign trade and investment by scholars (Lardy, 2002), investment bank economists (Lehman Brothers, 2002 and Goldman Sachs, 2003), and international organisations (OECD, 2002), in our view, the implications of recent development in China relating to its foreign trade and investment are not appreciated properly in their scale, scope and depth. This is partly due to China's many unique development conditions as well as an inclination to use the standard equilibrium tools of economics to deal with intrinsically a disequilibrium problem of development with unlimited supply of cheap labour in China and other developing economies. This section examines this Lewis type dual-sector development issue in order to answer many of the questions raised in the previous questions. The Lewis model of dual-sector development has many new implications when the cross-border mobility of capital and

capitalist institutions become possible for a country as large as one-fifth of the world in terms of population.

Development Gaps and Unlimited Supply of Labour

China is large with one-fifth of the world's population. China's labour force is larger than the sum in all developed economies. China's total GDP at purchasing power parity prices is about $5 trillion, or roughly half of the United States' GDP at current prices. However, China's GDP at current prices is much smaller, about one-fourth of Japan's and one-tenth of US's. However, for some manufacturing products, China's market share can be more than 50% of the global total. The size of China allows it to enjoy economies of scale and scope. China can afford to have all major global auto producers set up joint-venture production bases inside China. However, China's size in monetary terms is limited by the extremely low market prices its labour and products have to face now and for the next decade or so, a fact of life due to its effectively unlimited supply of labour.

As shown in Table 3.4, in global context, China's population is mature, not too young and not too old, with 70% in working age of 15 to 65. China currently has only 7% population above age 65 and 23% under age 15.

China's population compares favourably with both the aging population in the developed economies and the less than mature population in developing economies. The share of working age population in China is among the highest at 70%, compared with only 60% in other less developed countries and 67% in developed countries.

The old age population in the developed countries reaches 15%, or eight percent higher than in China. On the other hand, the population under 15 in other less developed countries is as high as 36%, or 13 percent higher than in China.

Compared with both the developed and the other less developed countries, China's population structure in the past two decades and next two decades is particularly favourable for rapid growth in China, independent of other policy and institutional factors. China's advantage in population structure during these decades is further enhanced by globalisation and the sustained prosperity in the developed economies after World War II. Large amounts of

retirement savings from the aging and rich economies accumulated in the last half-century need to be invested in young, growing and productive economies such as China.

China's population structure today is almost the same as Japan's in 1975. Japan's outstanding growth performance during the one-and-half decades since 1975 could suggest that China should have at least one more decade to enjoy the favourable population structure for growth. However, Japan's lost decade since 1990 also reminds China of the challenges ahead. China has a window of opportunities to reform its financial and legal system in the next decade to deal with its future aging problem.

China is poor and has effectively unlimited supply of cheap, mature and educated labour at least for the next one or two decades. China's per capita GDP at purchasing power parity prices of 2000 is $3,920, slightly higher than the average for other less developed countries at $3,470, but well below the level of $22,060 for the developed countries. If using per capita GDP as a rough estimate for average wage, China's average wage at PPP would be about $1.86 an hour ($3,920/[12mx22dx8h]). Since China's GDP per capita at current prices is only about $1,000, China's average wage at current prices would be only $0.47 an hour, compared to $10 an hour for the developed economies under the same assumption.

At an average wage of less than half a dollar an hour, China has added 150 million non-farm jobs over the last two decades and reduced the number of people with income less than $1 a day by 150 million. This number, i.e. 150 million, is as large as the entire population of Western Europe and its Western Offshoots (including US, Canada, and Australia) in 1820 and is more than twice the net migration to the Western Offshoots during the 129 years from 1870 to 1998 (Maddison 2001, p. 28). With this unprecedented achievement in employment creation, China still needs to create at least the same amount (150 million) of non-farm jobs perhaps over the next one to two decades.

China's case clearly fits well into W. Arthur Lewis's dual-sector economic development model of unlimited supply of labour except that the Lewis model has never been applied seriously to an economy as large and as open as the Chinese economy today. Also, China has made great progress not only in providing primary education for most of school age kids but also in higher education. China produces more engineers in one year than Taiwan and Hong

Kong could do in ten to twenty years. Hence, China has not only unlimited supply of cheap labour but also unlimited cheap talents. This is confirmed by the fact that it is now more and more difficult for China's college graduates to find good jobs. China's top executive MBA programmes are as expensive as Hong Kong's. China's overseas students have been putting pressures on their classmates from other foreign countries.

Cross-Border Mobility of Capital and Capitalist Institutions

China's economy is open, in many ways much more open than today's Japanese economy. China attracted much more FDI flows and stocks than Japan. In 2001, Japan, with its half a century long rapid economic growth and development, attracted only $49 per capita in FDI flows and $395 per capita in FDI stock, compared to the world average of $120 in flow and $1,118 in stock and China's $37 in flow and $309 in stock. At official exchange rates, China's foreign trade is more than 40% of GDP while Japan's is about 20%. China allows a large amount of processing trade, which requires a large amount of imported components. Large scale processing trade is only possible for very open economies with close to zero transaction costs, including tariffs and other taxes. China has committed itself to this close to zero transaction costs for processing trade since early 1980s, drawing lessons from its successful neighbours of newly industrialised Asian traders.

China's experiences in opening up its economy have effectively relaxed two crucial assumptions in international trade and development theories: the mobility of capital and the replication of capitalist institutions. Capital is mobile across the Chinese borders on a large scale now as our review in the previous sections show. Traditional trade theories based on factor immobility needs to be modified to take capital mobility into account. For example, capital-intensive industries such as auto and IC manufacturing can be profitable in China because of the capital and technology brought in by FDI and MNCs. The development of these capital-intensive industries is not constrained by the lack of capital. Instead, it is determined by the total costs of internationally linked supply chains and the global demand, including the demand from China itself. Supply chain management theory and global market equilibrium may be more important than the simple application of traditional trade, investment, and macro theories.

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China's imitation of capitalist economic institutions is also unprecedented in scale, scope, depth, and speed, ranging from central banks, modern public corporations, labour markets, stock markets, and social security systems. The transfer of capitalist institutions and practices is facilitated greatly by the existence of mature market economies in the overseas Chinese communities in Hong Kong and Taiwan as well as large amount of returning overseas students and overseas Chinese business communities. In this regard, the recent success and failure of Japan, Korea and other Asian economies in development and modernisation also set useful examples for China.

It is now possible for MNCs to combine unlimited supply of Chinese cheap labour and cheap talents with advanced international capital, technology and capitalist institutions by relocating some major parts of their production and research in China. MNCs not only benefit from access to China's domestic markets but also gain international competitiveness when they export some of their products from their China bases. Since China allows MNCs to have complete control on their China operations, they can get around China's underdeveloped financial and legal systems, at least for their day-to-day operation. In other words, their risks of operation in China are much lower than in other places in the region.

China's rapid improvement in infrastructure over the last two decades is also an important factor in attracting FDI. This is especially relevant for a few key economic centres along the eastern coast, including the Pearl River Delta region around Guangdong and Hong Kong and the Yangtze River Delta region around Shanghai. China now has more telephone lines than the US. Its highway length is second only to that in the US and will form a complete national network connecting all major cities across China after the current five-year plan. Satellites are used not only for television but also for clearing and settlements in banking and securities transactions. Hong Kong has the world's busiest seaport and airport, handling 60% of China's container shipments. However, major port development planned in Shanghai and Guangzhou are likely to increase their capacity to Hong Kong's current level in one or two decades. This rapid improvement in infrastructure is coordinated by China's forward-looking planning authorities and led by innovative local leaders. China's population structure and its low level of development also allow fast catching up

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of investment in infrastructure. China's obsession with infrastructure investment is also encouraged by a generation of leaders with engineering backgrounds who see investment in infrastructure as much more valuable than investment in loss-making state-owned enterprises. China's government-directed infrastructure projects may not make profits but will certainly facilitate the mobility of labour, goods, and capital across China's vast western, inland, and coastal regions. They have laid a good physical foundation for China's further integration with the global market economy.

However, in the near future, China's financial and legal systems will come under great pressure to price the risks and returns for millions of large and small projects, which would challenge even the best bankers in the world. In spite of great achievements in legislation, the legal system is still weak in the enforcement of property rights and contracts. This weakness directly affects the robustness and efficiency of China's banking sector and capital markets.

China's financial system is efficient in generating savings but is not effective in allocating them to productive investment. China's banking deposits increased from about 30% to 160% over the last two decades. However, about 20% to 30% of these deposits have difficulty finding productive investment outlets. A substantial part of China's surplus deposits ended up in government bonds. The local governments are then forced to invest these funds in infrastructure projects in order to keep the economy growing at 8% a year.

The flood of savings in China's banking system is partly due to a loose monetary policy during the early 1990s and after the Asian financial crisis. China's money supply (M2) increased ten times from 1990 to 2001 while its nominal GDP rose only five times during the same period. Hence, China's money supply is growing twice as fast as its nominal GDP. China's NPLs is in the range of 25% to 55% of GDP by the official and private estimations. However, China's banking system is still stable for a number of reasons. First, the government is still the owner of most banks in China and is determined to reform its state-owned banks. So, the Chinese people do not feel any risks to their bank deposits. Second, the Chinese economy, although growing at 8% a year, still has ample surplus labour and other unemployed resources, which are looking for employment opportunities following two decades of a gradual but steady loosening of migration policies and control of private

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enterprises. Third, China's capital account is not open for its domestic RMB deposit holders.

The traditional equilibrium model may not be useful for understanding China's macroeconomic conditions because of China's disequilibrium in the labour markets with unlimited supply of labour. Unlike the situations in Japan and the newly industrialised Asian economies, where the supply of labour quickly hit the limits with wages shooting up, China's market wages for the unskilled labour in major manufacturing centres such as Guangdong have been stagnant at a subsistence level of around $100 a month for more than a decade.

China's weak and inefficient financial system is creating a puzzle of co-existence of surplus labour and capital. For 16 out of the 21 years since 1982, China ran current account surpluses, including the last 9 years. The accumulated sum since 1982 of China's current account surpluses and the errors and omissions reached 23.8% of GDP in 2001. As China reforms its financial system and opens up its financial sector under the WTO commitment, the efficiency and speed of China's integration into the world economy will be improved steadily. This implies that more and more of China's labour will work directly or indirectly for the global market although their wages will be kept from rising due to ample surplus labour. This trend of development in China is determined by the interaction between China's structural and institutional features and prompts us to further examine the role of China as a world factory and as a regional competitor in the next section.

3 Implications for the Rest of the World

To appreciate the impact of China's development and integration into the global economy, it is useful to review the history of global capitalist development as articulated by Angus Maddison. For thousands of years before 1000, the global economy was stagnant but living standards as measured by GDP per capita were pretty much equal across regions. During the first millennium, per capita GDP of the world declined slightly from $444 to $435 (at the 1990 international prices for this and all other numbers cited from Maddison, 2001) while world population increased only from 231 to 268 million.

During the period from 1000 to 1820, global economic growth picked up but slowly. Although the world population increased from 268 million to 1 billion, average per capita GDP for the world increased only from $435 to $667. The world started to diverge in development and income during this period. By 1820, the first world, including Western Europe, Western Offshoots, and Japan, increased their per capita GDP to $21,470 while the rest of the world, or the third world, only had a per capita GDP level of $573.

From 1820 to 1998, a great divergence in development and inequality in income emerged between the first and the third world. The share of population in the first world declined from 16.8% to 14.2% but its share of GDP increased from 28.5% to 53.4%. By 1998, world population reached 5.9 billion with 5.1 billion in the third world, including 1.2 billion in China.

The above are the global conditions under which W. Arthur Lewis developed his dual-sector theory on economic development under unlimited supply of labour (Lewis, 1954). Lewis pointed out that the non-capitalist traditional sector in the rural area provides a reservoir for unlimited supply of labour at a fixed urban wage slightly higher than the subsistence rural wage. The urban wage is checked not only by the surplus labour in the rural area but also by rising unemployment in the urban area. This is exactly the condition we see in China now. China's leaders have been working hard to raise the income for peasants. But that is a mission impossible with the Lewis type development reality.

Lewis also points out that the capitalist modern sector is able to generate profits and net savings for investment in capital that is critical for sustained growth. He cites the evidences from Britain where net savings increased from 5% before 1780 to 7% in early 1800s, and 12% around 1870. Similar rises of net savings are also observed in the US between 1840s and 1890s, and in Asia after World War II. Consistent with the Lewis dual-sector model, Britain's Manchester, US's New England, New York, and Chicago, Japan's Tokyo and Osaka, and cities in Asia's newly industrialised economies have become the world factories one by one over time. Now, the centre of global manufacturing is once again on the move towards low costs economies. This time it goes to China's Guangdong and Shanghai, where access to unlimited supply of labour is facilitated by low transportation and declining transaction costs.

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China as a World Factory: Changes in Global Relative Prices

There is little disagreement on the trend that China will become a world factory. Instead, the debates are on the impact of that trend on the rest of the world. In our view, the single most important impact of China's outstanding development performance is on changes in global relative prices. There is no doubt that new labour supply to the global market will lead to a secular fall in the prices of labour-intensive manufacturing products.

Before China's opening up, the world economy was largely a capitalist open market economy dominated by the developed economies. The majority of the third world population, including those in China, were not very relevant to this global market. Let's use the population of age 15 to 65 in Table 3.4 to estimate the impact of China's opening on the labour supply in the world market. The world's working population at age 15 to 65 is 896 million in China, 2,242 million in other less developed countries, and 802 million in more developed countries. Let's assume for simplicity that about one-quarter of the labour force in China (224 million) and other less developed countries (560 million) are working for the world market now while the rest are effectively isolated from the world market. Then, the total labour force working for the world market today would be 1,586 million (224m+560m+802m). Since China's labour force was entirely outside of the global market twenty years ago, China's opening has added 224 million to the 1,363 million (560m+802m) labour force that have already been integrated into the global market. That is a net addition of about 16.4% over two decades. If China's past success in integrating its labour into the global market can be continued and replicated in other developing countries, the world market would certainly have no shortage of labour.

It is clear that the additional supply of China's labour force to the global market has concentrated in the manufacturing export sector. This means the global prices for manufacturing products have to fall dramatically. For example, the prices of televisions in the US have been dropping by 8% a year since 1988. The deflation in manufacturing products has started from the traditional labour-intensive products such as toys, plastics, clothing but has been spreading to less labour-intensive products such as electronics and machinery as China advances in its production and technology capability.

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As the Say's law predicts, supply creates demand, if there is a perfect market. China's opening leads to growth in income and demand for final products. But it is clearly impossible for China to consume all of its manufacturing products such as televisions, DVDs, motorcycles, and bicycles. Because of China's extremely low level of per capita wealth, the Chinese people's savings rate has been as high as 40.3%, compared to 16.5% in the US, 20.3% in the European Union, 26% in developing countries, and 27.3% in Japan. China's high savings depress its domestic current demand. Hence, export is the most convenient way out and China's export significantly depresses global prices on some specific products such as toys, televisions, and bicycles.

China's impact on deflation in the manufacturing products, however, is not going to cause a global deflation because the weight of manufacturing products made in China is too small in the total expenditure basket of the developed economies. China's exports, which usually incorporate a high proportion of imported components, are only about 4.3% of the world total in 2001. There is a long way to go before China has a direct impact on global deflation.

This is partly due to terms-of-trade effect. The more China exports, the lower the product prices, and the lower the share of China's exports in the total expenditure of the developed economies, other things given.

Anderson and Hu (2003) highlighted that China's net export of manufacturing goods is negligible for causing global deflation in manufacturing prices. This is true but the large deflation effects on specific products are hidden within the net manufacturing exports. The export value is likely to be depressed because of falling prices on China's export while the import value is likely to be high, partly due to stronger demand from China for key components which China can not produce.

In monetary terms, China's impact on the rest of the world is small. But in terms of specific product prices and welfare, or the so-called consumer surplus, China's contribution to the increase of the standards of livings in both developed and developing countries is huge but invisible in statistics. Today's lucky kids around the world can testify to this with their made-in-China toys. Without China's production, most toys may cost five to ten times more.

As we have emphasised, China's impact is on changes in global

relative prices. The deflation in manufacturing sector is accompanied by inflation in commodity and skills, which are needed to support the rapid increase in the volume of manufacturing goods and the rising living standards in China and elsewhere. China has turned from a net exporter of oil to a net importer and its imports of oil have increased steadily in the last decade to about 60 million tons a year by 2001. China's net commodity imports since 1990s have tripled. China's tuition for top rank executive MBA programmes is as high as in Hong Kong or even in the US.

Changes in global relative prices are followed by structural changes in the global economy. The most important change is the shift of manufacturing to China. However, China is only becoming a platform for global manufacturing in order to take advantage of China's favourable labour supply and domestic markets. It is clear that this competition is not between China and the foreign manufacturers. Instead, it is a competition among foreign manufacturers themselves with China only participating as a supply of labour and domestic markets. Foreign invested firms produce half of China's exports with only a small part of the value-added going to China's labour and with a high proportion of imported components. FDI in China concentrated mainly in a few clusters of manufacturing bases in the coastal region (see Table 4.5). The unskilled labour for the export industry is, however, largely coming from poor and remote western and inland regions of China.

China's development and integration with the capitalist world economy is not a miracle if we compare it with the industrialisation in the UK, the US, Japan, and the newly industrialised Asian economies. But the size and structure of China's population and the mobility of capital and capitalist institutions – made possible by today's advances in technology and development knowledge – make China's case special, especially for many of its neighbours.

China as a Regional Competitor: Benefits Versus Costs

For many Asians, it is amazing that China weathered through the Asian financial crisis with few changes in its high growth rate of around 8%. Many are wondering whether China's growth is at the costs of others by siphoning off market shares in foreign trade, investment and domestic jobs. There is no doubt that China has become a major competitor in the world market, especially for its

Asian neighbours. The competitive pressure from China can best be seen from Table 1.6 on the share of global inward FDI stock. China increased its share from only 1% in 1980 and 1985 to 5.8% in 2001 while the Asia-7, which has more population than China, did not gain much from 4.2% in 1980 to 4.8% in 2001. China's per capita inward FDI stock reached $309 by 2001, moving towards Japan's $395, and well above Asia-7's $220. However, China's per capita FDI stock is still less than the average for all developing countries, which is at $478. Table 1.3 shows per capita inward FDI flows and gives similar pattern.

China's competitiveness in labour-intensive manufactures is well recognised and attracted 60% of China's total FDI as shown in Table 4.3. However, FDI is also significant in the non-labour-intensive real-estate sector that has 12% of China's FDI. The services sector also attracted substantial FDI.

What is particularly relevant for our discussion in this section is the concentration of China's FDI in a few clusters of coastal super cities, which have critical mass for global scale production, distribution and financing.

Table 4.5 ranks China's 31 provincial level regions by their FDI inflows in 2001 and provides a number of indicators for the provincial economies. The provinces and cities are then divided into three groups by their ranking in FDI inflows: the top-9, the middle-12, and the bottom-10. The top-9 includes, in descending order of the share of average FDI during 2000-2001, Guangdong (25.7%), Jiangsu (14.9%), Shanghai (9.3%), Fujian (8.5%), Shandong (7.6%), Liaoning (5.4%), Zhejiang (4.8%), Tianjin (4.6%), and Beijing (3.8%). Many foreign visitors are impressed by the physical changes in the cities such as Shanghai and Beijing but the real stars of productive investment and manufacturing capacity in China are Guangdong and Jiangsu, where land prices have not been driven up to international levels as in Hong Kong, Shanghai and Beijing while access to finance, research and other services provided by the big cities is still convenient.

The concentration of economic activities in the top-9 is impressive, if not surprising. This group has about one-third of China's population but produced half of China's GDP, attracted three-quarters of China's FDI, and generated 90% of China's foreign trade.

The middle-12 includes mostly inland provinces while the

bottom-10 consists of all western provinces, the poorest region of China. The middle-12 has half of China's population and one-third of China's GDP but only attracted one-seventh of China's FDI and 8% of China's foreign trade. The bottom-10 has 18% of China's population, 10% of GDP, 3% of foreign trade, and 1.8% of FDI.

Given the diversity of China's regions, it is natural to ask which parts of China we would like to compare with its neighbouring countries. With China's huge population, it is also important to compare FDI per capita.

In 2001, China's top-9 attracted $97 per capita in FDI, much higher than the Asia-7 of $12. But the Asia-7 did much better than China's middle-12 at $10 per capita and bottom-10 at $4 per capita. Both China's inland and western regions face similar concerns as the Asia-7 countries. They are working hard to improve their investment environment as well as lobby for more support from China's central government. China's central government is also working very hard to help the less developed regions, particularly through the "Go West" strategy. The central government has invested heavily in highways, railroads, airports and other infrastructural works in the western regions but their effects on attracting FDI did not generate the intended results. Instead, the poor people in the western and inland regions continue to rush to the eastern coast for jobs, riding on the new roads built by the government. These unintended results, however, may be better than the plan, as the migrant labourers send remittances, knowledge, and even skills they learnt in the big cities back to their hometowns.

For the Asia-7, labour mobility to China's eastern coast is out of question except for a few highly skilled professionals. But intra-industry trade is expanding as can be seen from the rising trade volume for the six Asian traders (Taiwan, Hong Kong, Korea, Malaysia, Singapore, and Thailand, re-export excluded; see Table 1.2). While China's share of global export increased from 2.5% in 1993 to 4.0% in 2000, the six Asian traders' share increased from 9.7% to 10.5%. During the same period, Asia as a whole increased slightly its share of global exports from 26.3% to 26.7% with a significant decrease in Japan's share from 10% to 7.7% and Australia and New Zealand's share from 1.5% to 1.2%.

There is no doubt that China's export growth is much faster than its neighbours' as shown in Table 4.1. During 1990-2000, China's export growth was 14.9%, compared to 8.4% for the export growth

in Asia. But it is due to two factors. First, China started from a very low share of only 2.5% of global trade in 1993. Even in 2001, China's share of global exports was only 4.3%. Second, as discussed in the previous section, China's exports include many components imported from Asian and Western economies. The value-added from China is small.

Table 4.2 compares the market share in global manufactures exports in 1990 and 2000. This table should ease the concerns by China's competitors in Asia a bit as it shows clearly that they can grow with China at the costs of more developed economies in terms of market shares in manufacture export. From 1990 to 2000, the developed economies lost 11 percentage points of market share in global manufactures exports. Asia's gain is as high as 7.3 percentage points. China gained 2.3 percentage points while the six Asian traders gained 3.1 percentage points, more than the gain by China. The rest of Asia excluding China and the six Asian traders also gained 1.3 percentage points.

Hence, China is not only a regional competitor but also an important partner in terms of the integration of Asia's global-scale manufacturing. China not only has an unlimited supply of labour and talents but also large markets for consumer products and manufacturing equipments and parts, which are all opportunities for its neighbours. Hong Kong and Taiwan are the first in seizing the opportunities, followed by the US, Europe, and Japan.

The competitive pressures from China will not go away until most of China's surplus labour is absorbed by the expanding modern sector. The key is how to best position oneself in the increasingly competitive global economy. The pressure to force China to revalue its currency would not affect China's export competitiveness, simply because the real wage in China is not set by the nominal exchange rate. China's wages are extremely flexible at the low end. The real wage for unskilled labour is determined by the subsistence-level income in China's rural areas. The reliable and sustainable way for China's real wage to increase is to help China to develop its poor regions in the western and inland provinces.

However, a revaluation in RMB is likely to put large deflation pressure in the coastal regions' real estate and services sectors as these modern sectors are already substantially integrated with the world economy. The price structure there, except for the wage of unskilled migrant labour, are much more sensitive to changes in

nominal exchange rates. In particular, large amount of assets and liabilities concentrated in the more advanced regions of China are denominated in foreign exchange. Any attempt to adjust the currently fixed exchange rate of RMB would be equivalent to redistribution of wealth among holders of foreign exchange assets and liabilities, similar to redistribution among creditors and debtors during inflation or deflation. Given China's sustained surplus in current account and rising official and private foreign exchange reserves, it is entirely creditable for China to maintain the current fixed exchange rate regime. Then, China can leave any adjustments in real wages and other prices to domestic price adjustments. Given China's disequilibria in many markets, including the labour markets, China's fixed exchange rate provides an anchor and a reference for gradually rationalising China's price structure. Partly due to the fixed exchange rate, China's price structure today is largely consistent with the requirement of a market economy.

As discussed in the previous section, China's current account surplus implies that China is exporting capital, which does not seem consistent with China's unlimited supply of labour. Would a revaluation of RMB help to turn China's current account surplus into balance or deficit? Not really! China's excessive savings are not due to exchange rates but are a result of its underdeveloped financial system, which is not able to identify good projects and enforce lending contracts. Revaluation of RMB would depress the best parts of the Chinese economy and lead to less lending and more surplus savings, and hence more current account surplus, just like what happened in Japan when the yen appreciated. So, for those who would like to see a reduction in current account surplus in China or Japan, they need to help China and Japan reform their financial system, and not tamper with the exchange rates. After all, we all have learnt from the Keynesian and Monetarist debates about the neutrality of money and monetary policy in the long run. Exchange rate policy is only part of the monetary policy. The role of China in the region and in the global financial system is real, not just a monetary phenomenon. The aging populations in Japan, Europe and the US also need real returns from their savings, not nominal or monetary illusions.

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4 Conclusion

This paper reviews global capital flows and the position of China. We have found that the rapid FDI inflows into China, following its economic opening and reform, are essentially driven by two factors: China's unlimited supply of labour and talents and China's declining barriers for cross-border mobility of capital and capitalist institutions.

The combination of China's unlimited supply of labour with foreign capital under capitalist institutions is transforming China into a world factory much like what happened before in Europe, America, and Asia. The consequences of this are also similar to what we have seen in the past: a decline of prices for labour-intensive manufacturing products and a relative rise in the prices for raw materials and skills.

The catching up of China in economic development provides competitive pressures as well as productive opportunities for the world and especially for its neighbours. The aging populations in the developed countries also need to rely on the much younger and mature population in China and Asia to secure good returns on their retirement savings.

However, due to the underdeveloped financial system in China and other developing economies, global savings have refused to flow into these developing economies with growth potential. Even China is having a net export of savings as the Chinese government and people are accumulating foreign assets, especially US bonds and stocks. The global savings and capital flows, although driven by structural factors such as the costs of labour, are hindered by institutional factors, such as the quality of domestic banks and capital markets in the less developed countries. This flight to quality is partly responsible for the tech bubbles in the US and lies at the heart of volatility in global capital flows.

The solution to these global mismatches in capital flows lies not in manipulating exchange rates and other monetary tools, which cannot change the real wages and potential competitiveness of developing economies like China. Instead, developed economies need to focus on real development problems in the developing countries, which have more than 80% of the world's population.

FDI is successful in China largely because foreign investments do not rely on the domestic financial system and foreign investors have complete control over the companies they establish.

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China has not yet become an engine of growth for the global economy in cash terms. However, in terms of GDP measured by PPP or the welfare of the global population or the global consumer surplus, China is becoming an engine of growth for the world. This is why we need to study China's success and its problems seriously since they have profound implications for all of us.

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Table 1.1. Global Trade and Investment, 1982-2001
(in billions of dollars and percentages)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Level										
FDI	59	51	60	58	86	140	164	193	203	160
M&A							116	140	156	81
Service Trade	805	775	800	783	902	1,069	1,218	1,336	1,601	1,673
Merchandise Trade	3,780	3,684	3,889	3,931	4,326	5,050	5,737	6,156	6,982	6,982
Growth										
FDI	-13.2	17.0	-4.3	50.1	61.8	17.1	17.6	17.6	5.3	-21.0
M&A										
Service Trade	-2.4	-3.7	3.2	-2.2	15.3	18.5	13.9	9.7	19.8	4.5
Merchandise Trade	-5.8	-2.5	5.6	1.1	10.1	16.7	13.6	7.3	13.4	0.0
As percentage of Merchandise Trade										
FDI	1.6	1.4	1.5	1.5	2.0	2.8	2.9	3.1	2.9	2.3
M&A							2.0	2.3	2.2	1.2
Service Trade	21.3	21.0	20.6	19.9	20.9	21.2	21.2	21.7	22.9	24.0

Table 1.1. (continued)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Average 1982-2001
Level											
FDI	171	228	260	331	386	478	694	1,088	1,492	735	351.9
M&A	79	83	127	187	227	305	532	766	1,144	594	206.2
Service Trade	1,863	1,897	2,077	2,387	2,536	2,627	2,662	2,713	2,872	2,870	1,773.4
Merchandise Trade	7,484	7,464	8,485	10,142	10,585	10,950	10,797	11,204	12,538	12,601	7,638.3
Growth											
FDI	6.9	32.9	14.1	27.3	16.8	23.8	45.3	56.7	37.1	-50.7	16.3
M&A	-1.8	4.8	53.0	46.8	21.7	34.3	74.4	44.1	49.3	-48.1	27.8
Service Trade	11.4	1.8	9.5	14.9	6.3	3.6	1.3	1.9	5.9	-0.1	6.7
Merchandise Trade	7.2	-0.3	13.7	19.5	4.4	3.5	-1.4	3.8	11.9	0.5	6.1
As percentage of Merchandise Trade											
FDI	2.3	3.0	3.1	3.3	3.6	4.4	6.4	9.7	11.9	5.8	3.8
M&A	1.2	1.1	1.5	1.8	2.1	2.8	4.9	6.8	9.1	4.7	1.9
Service Trade	24.0	25.4	24.5	23.5	24.0	24.0	24.7	24.2	22.9	22.8	22.8

Source: UNCTAD, *World Investment Report 2002*, website.

Table 1.2 World Merchandise Trade by Region, 1948-2000
(in billions of dollars and percentages)

	1948	1953	1963	1973	1983	1993	2000
World export in value	58.0	84.0	157.0	579.0	1835.0	3641.0	6186.0
			Export Share				
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	27.3	24.2	19.3	16.9	15.4	16.8	17.1
Latin America	12.3	10.5	7.0	4.7	5.8	4.4	5.8
Western Europe	31.5	34.9	41.4	45.4	38.9	43.7	39.5
C./E. Europe/Baltic States/CIS	6.0	8.1	11.0	9.1	9.5	2.9	4.4
Africa	7.3	6.5	5.7	4.8	4.4	2.5	2.3
Middle East	2.0	2.7	3.2	4.1	6.8	3.4	4.2
Asia	13.6	13.1	12.4	14.9	19.1	26.3	26.7
Japan	0.4	1.5	3.5	6.4	8.0	10.0	7.7
China	0.9	1.2	1.3	1.0	1.2	2.5	4.0
India	2.2	1.3	1.0	0.5	0.5	0.6	0.7
Australia and New Zealand	3.7	3.2	2.4	2.1	1.4	1.5	1.2
Six East Asian traders*	3.0	2.7	2.4	3.4	5.8	9.7	10.5
World import in value	66.0	84.0	163.0	589.0	1881.0	3752.0	6490.0
			Import Share				
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	19.8	19.7	15.5	16.7	17.8	19.8	23.2
Latin America	10.6	9.3	6.8	5.1	4.5	5.2	6.0
Western Europe	40.4	39.4	45.4	47.4	40.0	42.9	39.6
C./E. Europe/Baltic States/CIS	5.8	7.6	10.3	8.9	8.4	2.9	3.7
Africa	7.6	7.0	5.5	4.0	4.6	2.6	2.1
Middle East	1.7	2.0	2.3	2.8	6.3	3.2	2.6
Asia	14.2	15.1	14.2	15.1	18.5	23.4	22.8
Japan	1.0	2.9	4.1	6.5	6.7	6.4	5.8
China	1.1	1.7	0.9	0.9	1.1	2.8	3.5
India	3.1	1.4	1.5	0.5	0.7	0.6	0.8
Australia and New Zealand	2.6	2.4	2.3	1.6	1.4	1.5	1.3
Six East Asian traders*	3.0	3.4	3.1	3.7	6.1	9.9	9.5

Note:
* Asia six: Taiwan, Hong Kong, Korea, Malaysia, Singapore, and Thailand; Significant re-exports excluded.
Source: WTO.

Table 1.3 FDI Inflows in Selected Regions, 1990-2001
(in billions of dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Population (million)	2001 FDI Inflows per capita
Total World	203	160	171	228	260	331	386	478	694	1,088	1,492	735	6,125	120
Developed countries	165	113	107	137	145	203	220	268	484	838	1,227	503	1,197	420
United States	48	23	19	51	45	59	84	103	174	283	301	124	287	433
Japan	2	1	3	0	1	0	0	3	3	13	8	6	127	49
Asia and the Pacific	25	24	33	59	69	76	94	106	96	103	134	102		
China	3	4	11	28	34	36	40	44	44	40	41	47	1,281	37
Hong Kong, China	3	1	4	7	8	6	10	11	15	25	62	23	7	3358
Taiwan Province of China	1	1	1	1	1	2	2	2	0	3	5	4	23	183
Greater China sub-total	8	7	16	35	43	44	53	58	59	68	108	74	1,310	56
India	0	0	0	1	1	2	3	4	3	2	2	3	1,050	3
Indonesia	1	1	2	2	2	4	6	5	0	-3	-5	-3	217	-15
Malaysia	3	4	5	6	5	6	7	6	3	4	4	1	24	23
Philippines	1	1	1	1	2	1	2	1	2	1	1	2	80	22
Republic of Korea	1	1	1	1	1	2	2	3	5	9	9	3	48	66
Singapore	6	5	2	5	9	9	9	11	6	12	5	9	4	2050
Thailand	3	2	2	2	1	2	2	4	5	4	3	4	63	60
Asia-7 sub-total	13	14	13	17	20	26	31	33	24	29	20	18	1,486	12
Developing countries	38	44	59	83	109	113	153	191	188	225	238	205	5,018	41
All developing countries minus China	34	40	48	56	75	77	113	147	144	185	197	158	3,737	42

Source: UNCTAD, *World Investment Report 2002*, website.

Table 1.4 Share of Global FDI Inflows by Selected Regions, 1990-2001
(in percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Developed countries	81.2	70.6	62.7	60.3	55.7	61.5	57.0	56.0	69.7	77.0	82.3	68.4
United States	23.9	14.2	11.2	22.3	17.4	17.8	21.9	21.6	25.1	26.0	20.2	16.9
Japan	0.9	0.9	1.6	0.0	0.3	0.0	0.1	0.7	0.5	1.2	0.6	0.8
Asia and the Pacific	12.2	15.2	19.4	26.0	26.5	23.0	24.3	22.2	13.9	9.5	9.0	13.9
China	1.7	2.7	6.5	12.1	13.0	10.8	10.4	9.3	6.3	3.7	2.7	6.4
Hong Kong, China	1.6	0.6	2.3	3.0	3.0	1.9	2.7	2.4	2.1	2.3	4.2	3.1
Taiwan Province of China	0.7	0.8	0.5	0.4	0.5	0.5	0.5	0.5	0.0	0.3	0.3	0.6
Greater China sub-total	4.0	4.2	9.3	15.5	16.6	13.2	13.6	12.1	8.5	6.2	7.2	10.0
Singapore	2.7	3.1	1.3	2.1	3.3	2.7	2.2	2.2	0.9	1.1	0.4	1.2
Republic of Korea	0.4	0.7	0.4	0.3	0.3	0.5	0.6	0.6	0.8	0.9	0.6	0.4
India	0.1	0.0	0.1	0.2	0.4	0.7	0.7	0.8	0.4	0.2	0.2	0.5
Indonesia	0.5	0.9	1.0	0.9	0.8	1.3	1.6	1.0	-0.1	-0.3	-0.3	-0.4
Malaysia	1.3	2.5	3.0	2.5	1.8	1.8	1.9	1.3	0.4	0.4	0.3	0.1
Philippines	0.3	0.3	0.5	0.5	0.6	0.4	0.4	0.3	0.3	0.1	0.1	0.2
Thailand	1.3	1.3	1.2	0.8	0.5	0.6	0.6	0.8	0.7	0.3	0.2	0.5
Asia-7 sub-total	6.6	8.9	7.6	7.3	7.7	8.0	8.0	6.9	3.4	2.6	1.4	2.5
Developing countries	18.5	27.7	34.6	36.6	41.9	34.0	39.5	40.0	27.0	20.7	15.9	27.9
All developing countries minus China	16.8	25.0	28.1	24.5	28.8	23.2	29.1	30.7	20.7	17.0	13.2	21.5

Source: UNCTAD, *World Investment Report 2002*, website.

Table 1.5 Shares in M&A Sales by Selected Regions and Countries
(in percentages)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Developed countries	91.7	86.2	81.4	87.0	87.9	82.6	76.1	83.4	88.7	92.3	83.5
United States	35.0	20.0	24.1	35.2	28.5	30.0	26.8	39.4	32.9	28.4	31.1
Japan	0.2	0.3	0.1	0.6	0.3	0.8	1.0	0.8	2.1	1.4	2.6
Asia and the Pacific	2.7	4.6	8.8	3.7	3.8	5.9	7.1	3.0	3.8	1.9	5.8
China	0.2	0.3	0.7	0.6	0.2	0.8	0.6	0.2	0.3	0.2	0.4
Hong Kong, China	0.7	2.1	6.4	1.3	0.9	1.4	2.4	0.2	0.5	0.4	1.7
Taiwan Province of China							0.2	0.0	0.2	0.1	0.4
Greater China sub-total							3.2	0.3	1.1	0.7	2.6
Singapore			0.1	0.3	0.1	0.1	0.5	0.1	0.1	0.1	0.2
Republic of Korea	0.2	0.3	0.2	0.2	0.4	0.2	0.1	0.1	0.2	0.1	0.6
India	0.2	0.1	0.6	0.3	0.1	0.3	0.1	0.2	0.2	0.0	0.2
Indonesia	0.1	0.5	0.2	0.7	0.6	0.2	1.4	0.4	0.2	0.0	0.3
Malaysia	0.8	0.0	0.0	0.0	0.1	0.2	0.3	0.7	1.3	0.6	0.6
Philippines	0.3	0.3	0.4	0.3	0.7	0.3	0.1	0.1	0.4	0.1	0.8
Thailand	0.1	0.6	0.1	0.1	0.1	0.1	0.2	0.6	0.3	0.2	0.2
Asia-7 sub-total			1.6	1.8	2.1	1.5	2.7	2.2	2.6	1.2	3.0
Developing countries	7.2	10.3	17.2	11.8	8.8	15.7	22.0	15.5	9.7	6.2	14.4

Source: UNCTAD, *World Investment Report 2002*, website.

Table1.6 FDI Inward Stock by Selected Regions and Countries, 1980-2001
(in millions of dollars and percentages)

	1980	1985	1990	1995	2000	2001	1980	1985	1990	1995	2000	2001	Population (million)	Inward FDI Stock per capita
Total World	635,534	913,182	1,871,594	2,911,725	6,258,263	6,845,723	100.0	100.0	100.0	100.0	100.0	100.0	6,125	1,118
Developed countries	389,715	568,670	1,382,978	2,021,303	4,124,261	4,504,122	61.3	62.3	73.9	69.4	65.9	65.8	1,197	3,763
United States	83,046	184,615	394,911	535,553	1,214,254	1,321,063	13.1	20.2	21.1	18.4	19.4	19.3	287	4,597
Japan	3,270	4,740	9,850	33,508	50,323	50,319	0.5	0.5	0.5	1.2	0.8	0.7	127	395
Asia and the Pacific	161,196	228,970	317,663	570,625	1,246,700	1,329,431	25.4	25.1	17.0	19.6	19.9	19.4		
China	6,251	10,499	24,762	137,435	348,346	395,192	1.0	1.1	1.3	4.7	5.6	5.8	1,281	309
Hong Kong, China	124,286	129,750	148,183	174,063	429,036	451,870	19.6	14.2	7.9	6.0	6.9	6.6	7	66,451
Taiwan Province of China	2,405	2,930	9,735	15,736	27,924	32,033	0.4	0.3	0.5	0.5	0.4	0.5	23	1,424
Greater China sub-total	132,942	143,179	182,680	327,234	805,306	879,095	20.9	15.7	9.8	11.2	12.9	12.8	1,310	671
Singapore	1,177	1,075	1,668	5,652	18,916	22,319	0.2	0.1	0.1	0.2	0.3	0.3	1,050	21
Republic of Korea	10,274	24,971	38,883	50,601	60,638	57,361	1.6	2.7	2.1	1.7	1.0	0.8	217	264
India	5,169	7,388	10,318	28,732	52,748	53,302	0.8	0.8	0.6	1.0	0.8	0.8	24	2,185
Indonesia	1,281	2,601	3,268	6,086	12,440	14,232	0.2	0.3	0.2	0.2	0.2	0.2	80	178
Malaysia	1,327	2,160	5,864	9,991	62,786	47,228	0.2	0.2	0.3	0.3	1.0	0.7	48	976
Philippines	6,203	13,016	28,565	59,582	95,714	104,323	1.0	1.4	1.5	2.0	1.5	1.5	4	24,839
Thailand	981	1,999	8,209	17,452	24,468	28,227	0.2	0.2	0.4	0.6	0.4	0.4	63	451
Asia-7 sub-total	26,412	53,210	96,774	178,095	327,709	326,991	4.2	5.8	5.2	6.1	5.2	4.8	1,486	220
Developing countries	245,819	344,463	484,954	849,915	2,002,173	2,181,249	38.7	37.7	25.9	29.2	32.0	31.9	5,018	435
All developing countries minus China	239,568	333,964	460,193	712,480	1,653,827	1,786,057	37.7	36.6	24.6	24.5	26.4	26.1	3,737	478

Source: UNCTAD, *World Investment Report 2002*, website.

Table 1.7 FDI Outward Stock in Selected Regions and Countries, 1980-2001
(in millions of dollars and percentages)

	1980	1985	1990	1995	2000	2001	1980	1985	1990	1995	2000	2001	Population (million)	Inward FDI Stock per capita
Total World	521,486	691,745	1,721,462	2,854,853	6,086,428	6,552,011	100.0	100.0	100.0	100.0	100.0	100.0	6,125	1,070
Developed countries	499,428	656,276	1,630,443	2,577,550	5,316,292	5,751,947	95.8	94.9	94.7	90.3	87.3	87.8	1,197	4,805
United States	215,375	238,369	430,521	699,015	1,293,431	1,381,674	41.3	34.5	25.0	24.5	21.3	21.1	287	4,807
Japan	19,610	43,970	201,440	238,452	278,445	300,115	3.8	6.4	11.7	8.4	4.6	4.6	127	2,356
Asia and the Pacific	6,206	11,699	47,813	185,931	583,524	603,290	1.2	1.7	2.8	6.5	9.6	9.2		
China	-	131	2,489	15,802	25,804	27,579		0.0	0.1	0.6	0.4	0.4	1,281	22
Hong Kong, China	148	2,344	11,920	78,833	365,803	374,780	0.0	0.3	0.7	2.8	6.0	5.7	7	55,115
Taiwan Province of China	97	204	12,888	25,144	49,187	54,667	0.0	0.0	0.7	0.9	0.8	0.8	23	2,430
Greater China sub-total	2,679	27,297	119,779	440,794	457,026	0.0	0.4	1.6	4.2	7.2	7.0	1,310	349	
Singapore	235	250	281	495	1,311	2,068	0.0	0.0	0.0	0.0	0.0	0.0	1,050	2
Republic of Korea	-	55	77	1,295	2,339	2,464		0.0	0.0	0.0	0.0	0.0	217	11
India	197	1,374	2,671	11,143	18,688	18,955	0.0	0.2	0.2	0.4	0.3	0.3	24	777
Indonesia	171	171	155	1,220	1,965	2,126	0.0	0.0	0.0	0.0	0.0	0.0	80	27
Malaysia	127	461	2,301	7,787	50,552	40,825	0.0	0.1	0.1	0.3	0.8	0.6	48	844
Philippines	3,718	4,387	7,808	35,050	53,009	63,225	0.7	0.6	0.5	1.2	0.9	1.0	4	15,054
Thailand	13	14	404	2,173	2,439	2,610	0.0	0.0	0.0	0.1	0.0	0.0	63	42
Asia-7 sub-total	6,712	13,698	59,163	130,304	132,274	0.9	1.0	0.8	2.1	2.1	2.0	1,486	89	
Developing countries	22,058	35,469	90,404	270,925	751,632	776,065	4.2	5.1	5.3	9.5	12.3	11.8	5,018	155
All developing countries minus China	22,058	35,338	87,915	255,123	725,828	748,486	4.2	5.1	5.1	8.9	11.9	11.4	3,737	200

Source: UNCTAD, *World Investment Report 2002*, website.

Table 2.1 Derived Portfolio Investment Liabilities in Selected Countries, Year-End 1997 and 2001
(in millions of dollars and percentages)

	Equity Securities		Long-term Debt Securities		Short-term Debt Securities		TOTAL		Share in TOTAL	
Investment in:	1997	2001	1997	2001						
United States	427,579	997,821	886,325	1,653,419	36,192	417,850	1,350,096	3,069,090	22.18	24.46
United Kingdom	313,962	705,331	232,378	395,148	7,099	153,795	553,439	1,254,346	9.09	10.00
Germany	143,058	271,367	446,255	798,524	2,437	81,488	591,750	1,151,378	9.72	9.18
France	163,195	388,422	105,150	332,358	2,222	55,209	270,567	775,990	4.44	6.19
Netherlands	164,443	285,897	116,817	368,280	1,938	37,417	283,199	691,594	4.65	5.51
Japan	241,804	333,581	144,855	157,246	7,382	36,553	394,041	527,380	6.47	4.20
Hong Kong SAR of China	62,952	79,056	9,884	8,829	1,188	505	74,024	88,390	1.22	0.70
Korea, Republic of	6,085	51,666	31,259	22,650	706	2,018	38,050	76,334	0.62	0.61
Singapore	19,316	35,850	4,918	7,330	129	1,236	24,363	44,417	0.40	0.35
Taiwan Province of China	9,302	38,808	2,545	2,004	21	65	11,868	40,877	0.19	0.33
Russian Federation	10,937	10,753	17,530	14,831	1,687	318	30,154	25,902	0.50	0.21
Malaysia	14,645	11,508	10,541	9,526	417	293	25,603	21,327	0.42	0.17
China, P.R.	4,618	13,210	14,112	5,504	610	1,457	19,340	20,103	0.32	0.16
India	10,396	13,252	4,404	1,793	203	214	15,003	15,260	0.25	0.12
Philippines	4,658	3,452	7,206	8,823	98	332	11,962	12,607	0.20	0.10
Thailand	4,526	7,684	8,108	3,837	276	349	12,909	11,870	0.21	0.09
Indonesia	4,258	3,800	5,226	1,607	870	79	10,354	5,486	0.17	0.04
Total value of investment	2,567,784	5,134,498	3,421,999	6,373,367	98,430	1,038,297	6,088,217	12,546,226	100.00	100.00

Source: IMF, *Global Portforlio Investment Survey*, 2003.

Table 2.2 Net Purchases of Foreign Stocks by US Residents
(in millions of dollars and percentages)

	All-ex-US	Asia	Japan	Hong Kong	Singa-pore	Taiwan	Korea	China
				Amount				
1988-1997	349,729	127,033	80,211	19,773	4,625	202	8,737	1,400
1998	-6,212	8,594	3,694	1,385	929	487	1,907	8
1999	-15,640	46,873	46,134	-2,777	-149	1,767	1,965	222
2000	13,088	-11,198	-16,461	3,254	-3,038	767	2,057	251
2001	50,113	27,523	19,938	4,823	-2,487	2,949	2,006	-40
				As percengate of Asia Total				
1988-1997	275.3	100.0	63.1	15.6	3.6	0.2	6.9	1.1
1998	-72.3	100.0	43.0	16.1	10.8	5.7	22.2	0.1
1999	-33.4	100.0	98.4	-5.9	-0.3	3.8	4.2	0.5
2000	116.9	-100.0	-147.0	29.1	-27.1	6.8	18.4	2.2
2001	182.1	100.0	72.4	17.5	-9.0	10.7	7.3	-0.1

Source: US Treasury website.

Table 2.3 Net Purchases of Foreign Bonds by US Residents
(in millions of dollars and percentages)

	All-ex-US	Asia	Japan	Hong Kong	Singa-pore	Taiwan	Korea	China
				Amount				
1988-1997	302,824	15,001	-865	-10,045	-2,532	-7,619	9,627	-825
1998	17,349	-4,602	-1,952	-2,452	-2,445	-815	3,161	-1,716
1999	5,676	-3,912	-2,497	-1,458	-334	-2,173	-719	-336
2000	4,054	-13,290	-4,509	-984	-893	-2,762	-1,365	-1,808
2001	-30,393	-15,654	178	-3,298	-293	-3,792	-1,856	-4,033
				As percengate of Asia Total				
1988-1997	2018.7	100.0	-5.8	-67.0	-16.9	-50.8	64.2	-5.5
1998	377.0	-100.0	-42.4	-53.3	-53.1	-17.7	68.7	-37.3
1999	145.1	-100.0	-63.8	-37.3	-8.5	-55.5	-18.4	-8.6
2000	30.5	-100.0	-33.9	-7.4	-6.7	-20.8	-10.3	-13.6
2001	-194.2	-100.0	1.1	-21.1	-1.9	-24.2	-11.9	-25.8

Source: US Treasury website.

From: China's Role in Asia and the World Economy - Fostering Stability and Growth, FONDAD, December 2003, www.fondad.org

Table 2.4 Net Purchases of US Stocks by Foreign Residents
(in millions of dollars and percentages)

	All-ex-US	Asia	Japan	Hong Kong	Singa-pore	Taiwan	Korea	China
				Amount				
1988-1997	115,571	9,615	6,617	1,031	8,828	409	-29	28
1998	50,020	-13,781	-1,171	-2,223	-8,438	-69	-84	1
1999	107,522	3,379	5,723	-156	-852	37	-78	204
2000	174,890	21,683	2,070	215	10,788	-147	-160	-103
2001	116,386	22,516	6,788	675	13,078	261	-76	3
				As percengate of Asia Total				
1988-1997	1202.0	100.0	68.8	10.7	91.8	4.3	-0.3	0.3
1998	363.0	-100.0	-8.5	-16.1	-61.2	-0.5	-0.6	0.0
1999	3182.1	100.0	169.4	-4.6	-25.2	1.1	-2.3	6.0
2000	806.6	100.0	9.5	1.0	49.8	-0.7	-0.7	-0.5
2001	516.9	100.0	30.1	3.0	58.1	1.2	-0.3	0.0

Source: US Treasury website.

Table 2.5 Net Purchases of US Bonds by Foreign Residents
(in millions of dollars and percentages)

	All-ex-US	Asia	Japan	Hong Kong	Singa-pore	Taiwan	Korea	China
				Amount				
1988-1997	1,447,448	415,223	202,793	52,694	36,900	22,701	2,900	47,890
1998	227,771	45,092	21,432	9,223	9,935	-2,996	15,812	3,519
1999	242,639	74,155	37,643	6,844	-7,417	-483	11,273	17,053
2000	282,938	82,474	49,936	10,181	-4,574	-5,240	5,839	15,656
2001	405,413	147,141	51,873	29,274	389	9,930	533	51,784
				As percengate of Asia Total				
1988-1997	348.6	100.0	48.8	12.7	8.9	5.5	0.7	11.5
1998	505.1	100.0	47.5	20.5	22.0	-6.6	35.1	7.8
1999	327.2	100.0	50.8	9.2	-10.0	-0.7	15.2	23.0
2000	343.1	100.0	60.5	12.3	-5.5	-6.4	7.1	19.0
2001	275.5	100.0	35.3	19.9	0.3	6.7	0.4	35.2

Source: US Treasury website.

Table 3.1 Corporate tax comparison among Asian countries
(in percentages)

	Regular	Preferential rate for foreign investment
Korea	27	
Singapore	22	
Hong Kong	16	
China	33	15
USA	35	
Germany	25	
Japan	30	

Source: *Joongang Daily*, March 5, 2003, p. 3.

Table 3.2 Foreign Exchange Reserve to GDP Ratio

	1990	1994	1995	1996	1997	1998	1999	2000	Average
Singapore	73.5	79.3	81.8	83.2	84.5	89.2	89.5	86.8	83.5
Hong Kong	33.8	37.7	39.8	41.4	54.3	55.1	60.9	66.2	48.7
Taiwan	44.5	37.2	33.6	31.0	28.5	33.6	36.6	34.0	34.9
Malaysia	21.8	32.6	26.2	26.1	27.6	33.0	37.6	31.8	29.6
Yemen	12.7	17.3	17.8	17.2	16.3	18.6			16.7
Venezuela	17.1	14.5	12.1	18.0	16.3	12.5	12.1	10.7	14.2
Norway	12.4	14.0	14.4	16.0	14.7	11.6	12.9	12.2	13.5
Swiss	12.8	12.3	11.0	13.5	14.5	13.9	14.1	12.5	13.1
China	7.4	9.3	10.5	12.8	15.5	15.0	15.6	15.3	12.7
Indonesia	6.9	6.8	6.8	8.0	11.9	18.8	16.8	21.0	12.1
Korea	5.7	6.1	6.6	6.7	7.4	14.1	17.4	23.4	10.9
Saudi Arabia	8.2	4.9	5.6	9.1	9.2	9.9	10.8	10.4	8.5
Spain	10.0	8.2	5.7	9.9	12.9	9.1	5.5	5.2	8.3
Austria	5.5	7.8	7.6	9.8	9.4	9.4	7.1	7.0	8.0
Denmark	7.8	5.3	5.6	7.5	11.1	7.5	12.7	0.9	7.3
group average	7.8	7.1	6.3	9.1	11.1	8.7	8.4	4.4	7.9
Sweden	7.6	10.5	8.9	7.1	4.2	5.3	5.8	6.3	7.0
Finland	6.8	9.1	7.2	4.9	6.4	6.3	5.6	6.0	6.5
Brazil	1.7	9.0	7.5	7.8	6.5	5.6	6.5	5.8	6.3
Mexico	3.8	2.3	6.3	6.0	7.2	8.1	6.4	6.2	5.8
India	0.4	6.0	5.2	5.2	6.3	6.5	7.1		5.3
Netherlands	5.7	8.9	7.5	6.1	6.0	4.3	1.7	1.9	5.2
Belgium	5.7	5.2	5.3	5.9	6.1	6.0	3.5	3.5	5.2
France	5.3	5.2	4.9	5.0	5.1	4.2	3.9	3.8	4.7
Japan	2.3	2.3	3.6	4.7	5.2	4.6	5.5	7.8	4.5
Australia	5.3	3.0	3.1	3.4	4.4	3.8	4.9	4.6	4.1
Italy	5.5	3.0	2.9	3.5	4.7	2.0	1.7	2.1	3.2
Canada	2.8	1.9	2.1	3.0	2.5	3.4	3.6	4.1	2.9
Great Britain	3.3	3.6	3.5	2.9	2.2	1.9	2.1	2.8	2.8
Germany	2.3	1.1	0.9	1.0	1.4	1.7	1.7	1.7	1.5
USA	0.9	0.6	0.7	0.5	0.4	0.0	0.3	0.3	0.5
Average	11.3	12.2	11.8	12.6	13.4	13.8	14.1	14.1	12.9

Table 3.3 GDP by Country (at current price and official exchange rate)

	1990 Rank	1999 Rank	1990	1999	2000	2001
USA	1	1	5,743.8	9,268.6	9,872.9	10,082.2
Japan	2	2	2,970.1	5,015.0	4,454.6	4,172.5
Germany	3	3	1,503.6	1,991.5	1,891.0	1,845.3
United Kingdom	6	4	983.6	1,448.3	1,397.6	1,423.7
France	4	5	1,195.4	1,355.7	1,308.9	1311
Italy	5	6	1,094.0	1,112.9	1,084.7	
China	10	7	387.8	991.1	1,080.1	1,139.8
Canada	7	8	573.8	675.7	703.9	705.6
Spain	8	9	492.0	565.6	563.9	
Brazil	9	10	442.9	538.8	555.9	
Mexico	15	11	247.0	482.3	567.5	
India	11	12	306.0	450.0	0.0	
Korea	14	13	253.7	424.2	408.9	422.2
Australia	12	14	294.8	397.7	361.1	357.1
Netherlands	13	15	283.5	375.3	373.2	
Taiwan	19	16	162.7	290.5	313.9	282.4
Switzerland	17	17	228.4	242.9	247.1	
Belgium	18	18	193.8	237.1	230.8	
Sweden	16	19	229.8	231.3	218.4	
Austria	20	20	158.4	198.0	191.7	
Denmark	22	21	129.1	166.2	163.6	
Hong Kong	26	22	72.6	158.0	162.5	
Indonesia	24	23	106.1	156.7	134.5	
Norway	23	24	115.5	148.4	158.6	
Poland	27	25	59.0	148.3	165.5	
Saudi Arabia	25	26	104.7	142.9	173.3	
Finland	21	27	134.8	121.0	122.5	
Venezuala	28	28	48.6	96.5	117.8	
Singapore	31	29	37.5	85.3	91.9	85.6
Malaysia	29	30	42.8	78.9	89.9	
Nigeria	33	31	32.4	34.5	36.5	
Kuwait	34	32	18.2	29.8	38.0	
Romania	30	33	38.3	29.6	30.7	
Yemen	32	34	33.6	0.0	0.0	

From: China's Role in Asia and the World Economy - Fostering Stability and Growth, FONDAD, December 2003, www.fondad.org

Table 3.4 Global Population by Region and Age
(in millions of habitants and percentages)

	Habitants				Share in Region Total		
	All	Below 15	15 to 65	Above 65	Below 15	15 to 65	Above 65
China	1,281	295	896	90	23	70	7
Less developed countries excluding China	3,737	1,345	2,242	149	36	60	4
More developed countries	1,197	215	802	180	18	67	15
East Asia	1,512	333	1,058	121	22	70	8
U.S.	287	60	190	37	21	66	13
Western Europe	184	31	123	29	17	67	16
Japan	127	18	87	23	14	68	18

Source: Population Reference Bureau, *World Population Data Sheet*, 2002.

Table 4.1 China in World Trade
(in percentages)

	Merchandise Exports		Merchandise Imports	
	World Total in 2000	Growth 1990-2000	World Total in 2000	Growth 1990-2000
World	100.0	6.0	100.0	6.0
Asia	26.7	8.4	22.8	7.6
Japan	7.7	5.2	5.9	4.9
China	4.0	14.9	3.5	15.5
Hong Kong	3.3	n.a.	3.3	n.a.
	Commercial Service Exports		Commercial Service Imports	
	World Total in 2000	Growth 1990-2000	World Total in 2000	Growth 1990-2000
World	100.0	6.0	100.0	6.0
Asia	21.1	9.0	25.4	7.0
Japan	4.7	5.0	8.1	3.0
China	2.1	18.0	2.5	24.0
Hong Kong	2.9	0.09	1.8	0.09

Source: WTO.

Table 4.2 Share in World Exports of Manufactures, 1990 and 2000
(in percentages)

	1990	2000	Gain/Loss
World	100.0	100.0	
Developed countries	80.4	69.4	-11.0
Developing countries	17.5	27.4	9.9
Asia	12.6	19.9	7.3
China	1.9	4.7	2.8
Asia-Six*	9.1	12.2	3.1
Other Asia	1.6	2.9	1.3

Note:
* Asia Six: Taiwan, Hong Kong, Korea, Malaysia, Singapore and Thailand; Significant re-exports excluded.
Source: WTO.

Table 4.3 Foreign Direct Investment in China by Sector
(in millions of dollars and percentages)

	Value			Share		
Sector	1999	2000	2001	1999	2000	2001
Manufacturing	22,603	25,844	30,907	56.1	63.5	65.9
Electric Power, Gas and Water Production and Supply	3,703	2,242	2,273	9.2	5.5	4.8
Wholesale & Retail Trade and Catering Services	965	858	1,169	2.4	2.1	2.5
Transport, Storage, Post and Telecommunication services	1,551	1,012	909	3.8	2.5	1.9
Farming, Forestry, Animal Husbandry and Fishery	710	676	899	1.8	1.7	1.9
Mining and Quarrying	557	583	811	1.4	1.4	1.7
Construction	917	905	807	2.3	2.2	1.7
Scientific Research and Polytechnical Services	110	57	120	0.3	0.1	0.3
Health Care, Sports and Social Welfare	148	106	119	0.4	0.3	0.3
Education, Culture and Arts, Radio, Film and Television	61	54	36	0.2	0.1	0.1
Banking and Insurance	98	76	35	0.2	0.2	0.1
Geological Prospecting and Water Conservancy	5	5	10	0.0	0.0	0.0
Other Sectors	753	1,453	1,051	1.9	3.6	2.2

Table 4.4 China's FDI Inflows by Source Country, 1995-2001
(in billions of dollars and percentages)

	1995	1996	1997	1998	1999	2000	2001
				Level			
Hong Kong and Macao	20.5	21.3	21.0	18.9	16.7	15.9	17.0
Japan	3.1	3.7	4.3	3.4	3.0	2.9	4.4
Taiwan	3.2	3.5	3.3	2.9	2.6	2.3	3.0
Singapore	1.9	2.2	2.6	3.4	2.6	2.2	2.1
Korea	1.0	1.4	2.1	1.8	1.3	1.5	2.2
Neighboring Countries	29.7	32.0	33.4	30.5	26.2	24.7	28.7
USA	3.1	3.4	3.2	3.9	4.2	4.4	4.4
Virgin Island	0.3	0.5	1.7	4.0	2.7	3.8	5.0
Great Britain	0.9	1.3	1.9	1.2	1.0	1.2	1.1
Germany	0.4	0.5	1.0	0.7	1.4	1.0	1.2
Others	3.2	3.9	4.1	5.2	4.9	5.6	6.5
Total	37.5	41.7	45.3	45.5	40.3	40.7	46.9
				Share of total			
Hong Kong and Macao	54.7	51.0	46.5	41.6	41.4	38.9	36.3
Japan	8.3	8.8	9.6	7.5	7.4	7.2	9.3
Taiwan	8.4	8.3	7.3	6.4	6.5	5.6	6.4
Singapore	4.9	5.4	5.8	7.5	6.5	5.3	4.6
Korea	2.8	3.3	4.7	4.0	3.2	3.7	4.6
Neighboring Countries	79.1	76.7	73.8	67.0	64.9	60.7	61.1
USA	8.2	8.2	7.2	8.6	10.5	10.8	9.4
Virgin Island	0.8	1.3	3.8	8.9	6.6	9.4	10.7
Great Britain	2.4	3.1	4.1	2.6	2.6	2.8	2.2
Germany	1.0	1.2	2.2	1.6	3.4	2.6	2.6
Others	8.5	9.4	9.0	11.4	12.1	13.7	13.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: National Bureau of Statistics, *Statistical Yearbook of China*, 2002.

Table 4.5 FDI and Trade Patterns by Province and Ranked by Provincial FDI Amount in 2001
(in millions of dollars and percentages)

Province	Population (2001, million)	GDP (2001, current price)	FDI (2001)	Population share (2001)	GDP share (2001)	FDI share (2000-2001 average)	Trade share (2000-2001 average)	Trade contribution by FIEs (2000-2001 average)	FDI as share of Fixed Capital Formation (2001)	FDI per capita (2001)	GDP per capita (2001, current price)
National Total	*1,276*	*1,286*	*46,367*	*100.0*	*100.0*	*100.0*	*100.0*	*50.4*	*23.7*	*36*	*1,008*
Guangdong	78	128	11,932	6.1	10.0	25.7	36.1	53.6	75.0	153	1,648
Jiangsu	74	115	6,915	5.8	8.9	14.9	10.5	62.1	49.6	94	1,558
Shanghai	16	60	4,292	1.3	4.6	9.3	11.7	60.8	49.7	266	3,696
Fujian	34	51	3,918	2.7	4.0	8.5	4.8	61.4	80.9	114	1,490
Shandong	90	114	3,521	7.1	8.8	7.6	6.2	49.8	27.5	39	1,258
Liaoning	42	61	2,516	3.3	4.7	5.4	4.2	59.6	32.0	60	1,446
Zhejiang	46	81	2,212	3.6	6.3	4.8	7.0	31.0	16.7	48	1,762
Tianjin	10	22	2,133	0.8	1.7	4.6	3.6	79.2	51.3	212	2,208
Beijing	14	34	1,768	1.1	2.7	3.8	5.3	31.7	26.8	128	2,479
Top 9 by FDI	*404*	*666*	*39,207*	*31.7*	*51.8*	*84.6*	*89.4*	*54.0*	*43.3*	*97*	*1,647*
Hubei	60	56	1,189	4.7	4.4	2.6	0.8	29.3	14.3	20	940
Hunan	66	48	810	5.2	3.7	1.7	0.6	17.5	15.9	12	728
Hebei	67	67	670	5.2	5.2	1.4	1.1	29.9	6.6	10	1,003
Sichuan	86	53	582	6.8	4.1	1.3	0.6	21.0	7.1	7	617
Hainan	8	7	467	0.6	0.5	1.0	0.3	45.8	35.1	59	826
Henan	96	68	457	7.5	5.3	1.0	0.7	18.0	5.7	5	711
Jiangxi	42	26	396	3.3	2.0	0.9	0.4	15.5	14.5	9	626
Guangxi	48	27	384	3.8	2.1	0.8	0.4	23.2	11.6	8	561
Shaanxi	37	22	352	2.9	1.7	0.8	0.5	14.3	6.1	10	607
Heilongjiang	38	43	341	3.0	3.3	0.7	0.8	11.4	4.3	9	1,126
Jilin	27	24	338	2.1	1.9	0.7	0.7	40.1	8.5	13	910
Anhui	63	40	337	5.0	3.1	0.7	0.7	26.4	7.0	5	626
Middle 12 by FDI	*637*	*482*	*6,322*	*49.9*	*37.4*	*13.6*	*7.7*	*24.4*	*11.4*	*10*	*756*
Chongqing	31	21	256	2.4	1.6	0.6	0.4	16.1	8.3	8	681
Shanxi	33	21	234	2.6	1.7	0.5	0.6	11.5	5.9	7	655
Inner Mongolia	24	19	107	1.9	1.4	0.2	0.5	7.9	3.6	5	784
Gansu	26	13	74	2.0	1.0	0.2	0.2	9.0	2.1	3	502
Yunnan	43	25	65	3.4	1.9	0.1	0.4	10.1	1.3	2	583
Qinghai	5	4	36	0.4	0.3	0.1	0.0	6.6	2.6	7	693
Guizhou	38	13	28	3.0	1.0	0.1	0.2	7.0	0.9	1	344
Xinjiang	19	18	20	1.5	1.4	0.0	0.5	4.3	0.4	1	954
Ningxia	6	4	17	0.4	0.3	0.0	0.1	11.6	1.5	3	639
Tibet	3	2	-	0.2	0.1	-	0.0	3.2	0.0	-	636
Bottom 10 by FDI	*226*	*139*	*838*	*17.7*	*10.8*	*1.8*	*2.9*	*8.7*	*2.7*	*4*	*614*

Source: National Bureau of Statistics, *Statistical Yearbook of China*, 2002.

Table 4.6 China's External Borrowing in 2000
(in thousands of dollars and percentages)

Borrower / Type of Loan	Foreign Govern-ment	Interna-tional financial institutions	Foreign Banks	Buyer's Credit	Borrowing by exporters, foreign companies and individuals	Issuing Bonds	Delayed Payment (Usance?)	Savings by Foreigners	Lease	Portion of Hard Currency Payment related with Counter-trade	Trade Credit	Total	Share in Total
State Council, Ministries	1,655,869	2,679,027	43,935			603,039						4,981,869	29.3
Chinese Banks	712,225		593,240	1,130,712	5,919	336,999	176,839	49,764	117			3,005,815	17.7
Chinese Non-Banking Financial Institutions			182,602	4,522		249,900		284	591			437,899	2.6
Foreign Invested Enterprises	1,668	77,601	800,517	157,978	2,314,315	76,998	59,498		31,262	154		3,519,989	20.7
Chinese Enterprises	596		89,457	9,432	25,054		13,709		976,296	10,328		1,124,871	6.6
Foreign Financial Institutions			1,581,144				20,036	103,375				1,704,556	10.0
Others			57,947	2,460	8,718		4,821		1,378			75,324	0.4
Trade Credit	2,370,358	2,756,627	3,348,841	1,305,105	2,354,006	1,266,935	274,903	153,424	1,009,643	10,482	2,161,000	17,011,323	100.0
Share in total	13.9	16.2	19.7	7.7	13.8	7.4	1.6	0.9	5.9	0.1	12.7	100.0	

From: China's Role in Asia and the World Economy - Fostering Stability and Growth, FONDAD, December 2003, www.fondad.org

Table 4.7 Population, GDP, Savings and Current Account Surplus by Selected Regions and Countries, 2001
(percentages and billions of dollars)

	Population (% of World)	GDP at PPP (% of World)	GDP (PPP) per capita as % of the World Average	Saving (% of GDP)	Investment (% of GDP)	Net Lending (% of GDP)	Current Account Balance ($ bn)
China	21.0	12.1	58	40.3	37.9	2.4	17.4
India	16.7	4.7	28	20.3	22.9	-2.6	-0.1
Developing Asia	52.2	22.2	43	32.3	30.3	2.0	39.4
Developing countries	78.0	37.6	48	26.8	26.2	0.6	39.6
Countries in transition	6.6	6.2	94	24.0	21.0	3.0	11.8
Newly industrialized Asian Countries	1.3	3.3	254	29.0	23.9	5.1	57.1
Japan	2.1	7.3	348	27.3	25.2	2.1	87.8
European Union	6.2	19.9	321	20.3	20.2	0.1	3.2
United States	4.6	21.4	465	16.5	19.1	-2.6	-393.4

Sources: IMF, *World Economic Outlook*, September 2002 and World Bank website.

Table 4. 8 China's Balance of Payments, 1982-2001
(in millions of dollars and percentages)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Current Account Balance	5,674	4,240	2,030	-11,417	-7,035	300	-3,803	-4,317	11,997	13,270
FDI into China	430	636	1,258	1,659	1,875	2,314	3,194	3,393	3,487	4,366
Net Errors & Omissions	279	117	-932	92	-863	-1,371	-1,011	90	-3,134	-6,748
Reserve Assets Change	-6,291	-4,137	-95	2,353	1,954	-4,931	-2,318	503	-12,118	-14,554
GDP in dollars at average exchange rate				304,423	294,247	321,277	400,000	448,913	389,259	406,443
Accumulated CA since 1982				527	-6,508	-6,208	-10,011	-14,328	-2,331	10,939
Accumulated FDI since 1982				3,983	5,858	8,172	11,366	14,759	18,246	22,612
Accumulated capital flight (E&O) since 1982				444	1,307	2,678	3,689	3,599	6,733	13,481
Accumulated official foreign exchange reserves	6,986	8,901	8,220	2,644	2,072	2,923	3,372	5,550	11,093	21,712
External debt				15,830	21,480	30,200	40,000	41,300	52,550	60,560
Accumulated CA since 1982 as % of GDP				0.2	-2.2	-1.9	-2.5	-3.2	-0.6	2.7
Accumulated FDI since 1982 as % of GDP				1.3	2.0	2.5	2.8	3.3	4.7	5.6
Accumulated capital flight (E&O) since 1982 as % of GDP				0.1	0.4	0.8	0.9	0.8	1.7	3.3
Official reserves as % of GDP				0.9	0.7	0.9	0.8	1.2	2.8	5.3
External debt as % of GDP				5.20	7.30	9.40	10.00	9.20	13.50	14.90

Table 4. 8 (continued)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Current Account Balance	6,401	-11,903	7,658	1,618	7,242	29,717	29,324	15,667	20,519	17,405
FDI into China	11,156	27,515	33,787	35,849	40,180	44,236	43,752	38,752	38,399	44,241
Net Errors & Omissions	-8,252	-9,804	-9,775	-17,812	-15,566	-16,952	-16,576	-14,804	-11,893	-4,856
Reserve Assets Change	2,102	-1,767	-30,527	-22,481	-31,643	-35,724	-6,426	-8,505	-10,548	-47,325
GDP in dollars at average exchange rate	481,389	601,223	542,749	701,250	818,873	903,241	960,789	992,353	1,079,481	1,157,211
Accumulated CA since 1982	17,340	5,437	13,095	14,713	21,955	51,672	80,996	96,663	117,182	134,588
Accumulated FDI since 1982	33,768	61,283	95,070	130,919	171,099	215,335	259,087	297,840	336,238	380,479
Accumulated capital flight (E&O) since 1982	21,733	31,537	41,312	59,124	74,690	91,642	108,218	123,023	134,916	139,771
Accumulated official foreign exchange reserves	19,443	21,199	51,620	73,597	105,029	139,890	144,959	154,675	165,574	212,165
External debt	69,320	83,570	92,810	106,590	116,280	130,970	146,040	151,830	145,730	170,110
Accumulated CA since 1982 as % of GDP	3.6	0.9	2.4	2.1	2.7	5.7	8.4	9.7	10.9	11.6
Accumulated FDI since 1982 as % of GDP	7.0	10.2	17.5	18.7	20.9	23.8	27.0	30.0	31.1	32.9
Accumulated capital flight (E&O) since 1982 as % of GDP	4.5	5.2	7.6	8.4	9.1	10.1	11.3	12.4	12.5	12.1
Official reserves as % of GDP	4.0	3.5	9.5	10.5	12.8	15.5	15.1	15.6	15.3	18.3
External debt as % of GDP	14.40	13.90	17.10	15.20	14.20	14.50	15.20	15.30	13.50	14.70

Source: National Bureau of Statistics, *Statistical Yearbook of China*, 2002 and People's Bank of China website.

Table 4.9 US Current Account Deficits with Greater China
(in millions of dollars and percentages)

	Amount				Share of Greater China Total			
	China	Taiwan	Hong Kong	Greater China	China	Taiwan	Hong Kong	Greater China
1985	-6	-11,697	-5,610	-17,313	0	68	32	100
1986	-1,665	-14,267	-5,861	-21,792	8	65	27	100
1987	-2,796	-17,209	-5,871	-25,876	11	67	23	100
1988	-3,490	-12,585	-4,550	-20,625	17	61	22	100
1989	-6,235	-12,978	-3,431	-22,644	28	57	15	100
1990	-10,431	-11,175	-2,805	-24,411	43	46	11	100
1991	-12,691	-9,841	-1,141	-23,673	54	42	5	100
1992	-18,309	-9,346	-716	-28,371	65	33	3	100
1993	-22,777	-8,934	319	-31,391	73	28	-1	100
1994	-29,505	-9,597	1,745	-37,357	79	26	-5	100
1995	-33,790	-9,682	3,940	-39,532	85	24	-10	100
1996	-39,520	-11,447	4,102	-46,865	84	24	-9	100
1997	-49,695	-12,263	4,829	-57,129	87	21	-8	100
1998	-56,927	-14,960	2,387	-69,501	82	22	-3	100
1999	-68,677	-16,073	2,124	-82,626	83	19	-3	100
2000	-83,833	-16,097	3,133	-96,797	87	17	-3	100
2001	-83,096	-15,253	4,381	-93,968	88	16	-5	100
2002	-103,115	-13,805	3,283	-113,637	91	12	-3	100

Source: US Census Bureau website.

Table 4.10 US Exports, Imports and Balance of Goods in 2002
(in millions of dollars and percentages)

	Amount			Share of the Total		
	Balance	Exports	Imports	Balance	Exports	Imports
Total Balance of Payments Basis	-484,353	682,586	1,166,939	100.0	100.0	100.0
North America	-86,962	258,360	345,322	18.0	37.9	29.6
Western Europe	-89,218	157,080	246,298	18.4	23.0	21.1
Eastern Europe/FSR	-8,283	6,599	14,883	1.7	1.0	1.3
Pacific Rim Countries	-215,005	178,561	393,567	44.4	26.2	33.7
Australia	6,606	13,084	6,478	-1.4	1.9	0.6
China	-103,115	22,053	125,168	21.3	3.2	10.7
Japan	-70,055	51,440	121,494	14.5	7.5	10.4
Newly Industrialized Countries(NICS)	-22,073	69,823	91,896	4.6	10.2	7.9
Hong Kong	3,283	12,612	9,328	-0.7	1.8	0.8
Korea	-12,979	22,596	35,575	2.7	3.3	3.0
Singapore	1,429	16,221	14,793	-0.3	2.4	1.3
Taiwan	-13,805	18,394	32,199	2.9	2.7	2.8
Other Pacific Rim(3)	-26,369	22,162	48,531	5.4	3.2	4.2
South/Central America	-17,902	51,643	69,544	3.7	7.6	6.0
OPEC	-34,482	18,852	53,334	7.1	2.8	4.6
Other Countries	-36,397	28,956	65,353	7.5	4.2	5.6

Source: US Census Bureau website.

Table 4.11 Cross-Border Banking Capital Flows in Hong Kong, 1997-2002
(in millions of dollars and percentages)

	Period	Outside Banking Claims on HK (HK Gross Borrowing)	Outside Banking Liabilities to HK (HK Gross Lending)	Net Outside Banking Liabilities to HK (Net HK Lending)
All Outside Hong Kong	1997-06	629,554	640,490	10,936
	2002-04	249,541	389,987	140,446
	Change	*-380,013*	*-250,504*	*129,509*
	Change in %	*-60.4*	*-39.1*	*1184.2*
Japan	1997-06	309,067	361,423	52,357
	2002-04	57,942	81,484	23,542
	Change	*-251,125*	*-279,939*	*-28,814*
	Change in %	*-81.3*	*-77.5*	*-55.0*
Singapore	1997-06	48,863	37,597	-11,266
	2002-04	24,214	39,700	15,486
	Change	*-24,649*	*2,103*	*26,753*
	Change in %	*-50.4*	*5.6*	*-237.5*
UK	1997-06	50,679	28,231	-22,448
	2002-04	18,753	60,207	41,454
	Change	*-31,926*	*31,976*	*63,902*
	Change in %	*-63.0*	*113.3*	*-284.7*
US	1997-06	24,974	23,606	-1,368
	2002-04	12,491	31,806	19,315
	Change	*-12,482*	*8,201*	*20,683*
	Change in %	*-50.0*	*34.7*	*-1511.7*
Mainland China	1997-06	40,087	50,105	10,018
	2002-04	39,312	16,651	-22,661
	Change	*-776*	*-33,454*	*-32,679*
	Change in %	*-1.9*	*-66.8*	*-326.2*

Source: Hong Kong Monetary Authority website.

Figure 5.1 FDI Inflows, 1979-2001
(in billions of dollars)

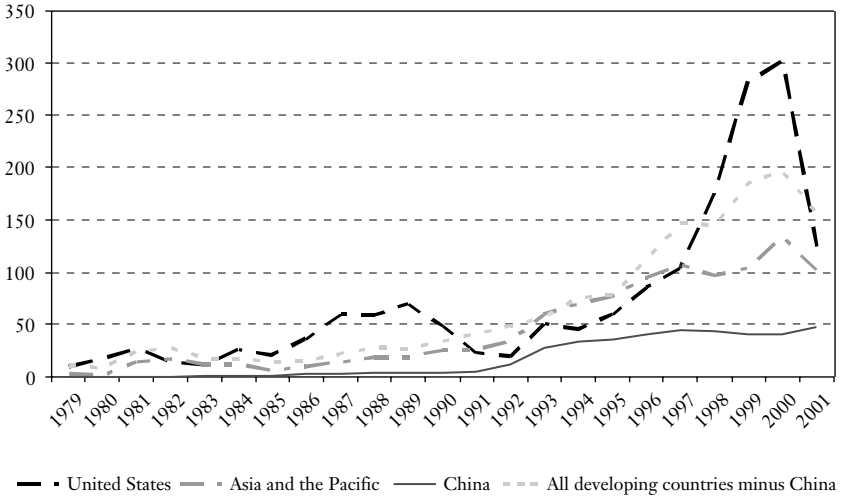

Figure 5.2 US Current Account Deficits with Greater China
(in billions of dollars)

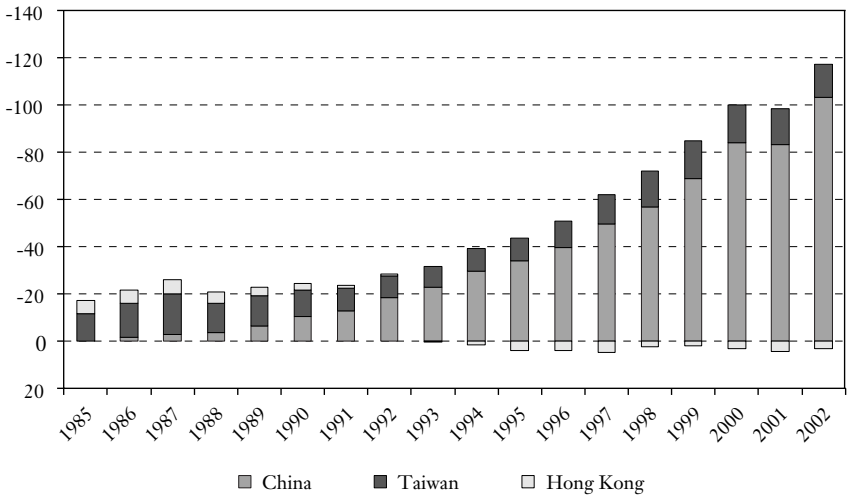

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Figure 5.3 Banking Capital Flows between Hong Kong and Mainland China
(in billions of dollars)

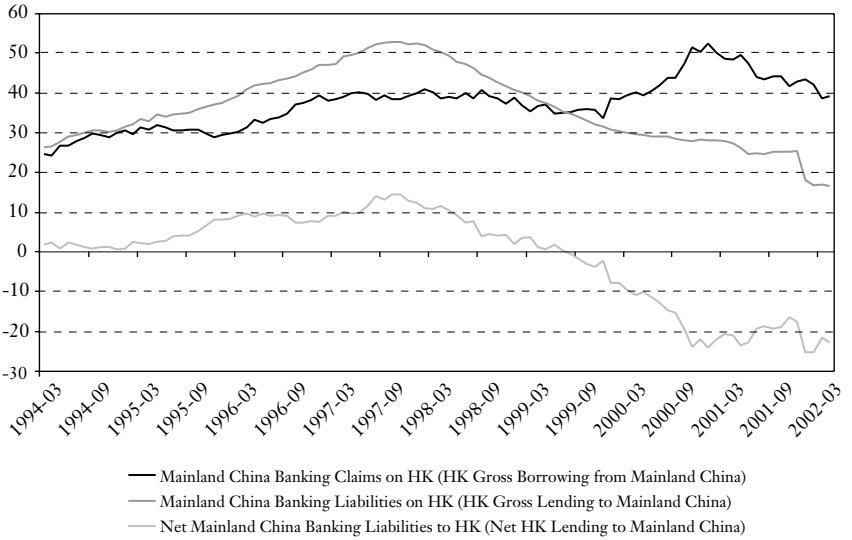

Figure 6.1 Cross-Border Trading between US and the Rest of the World
(in billions of dollars)

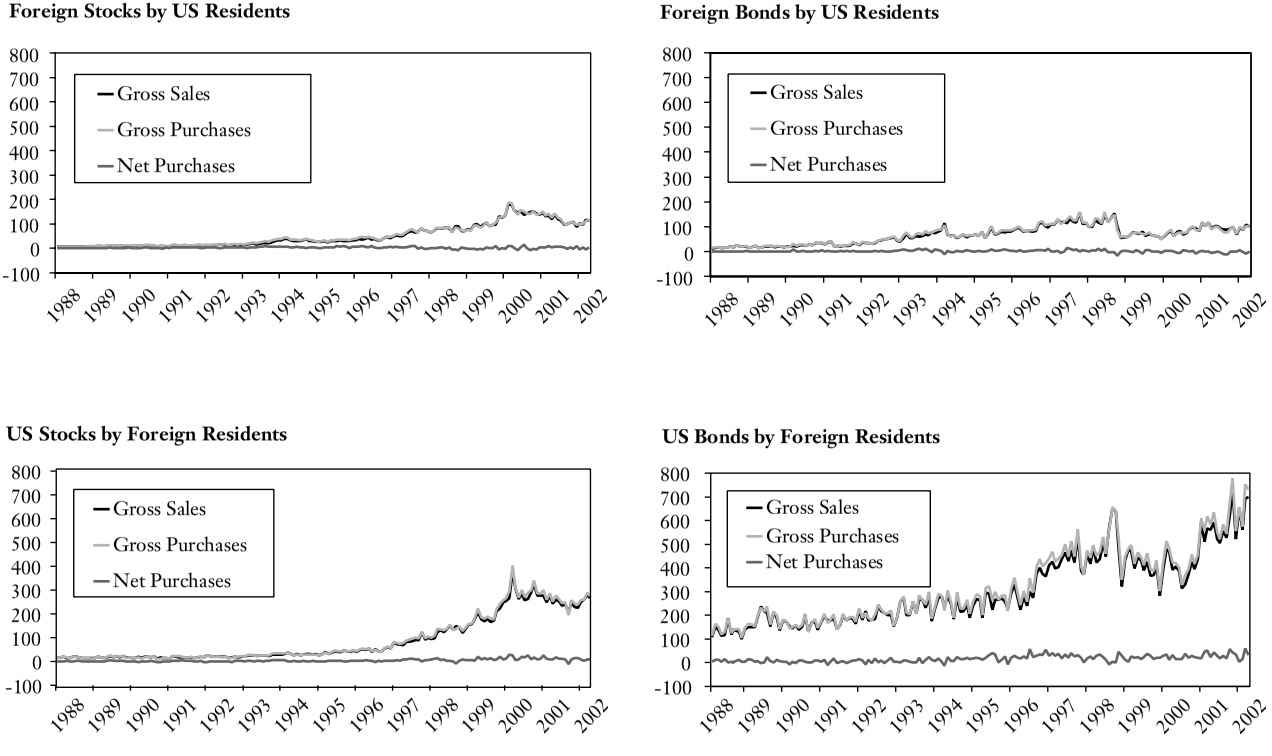

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Figure 6.2 Cross-Border Trading between US and Asia
(in billions of dollars)

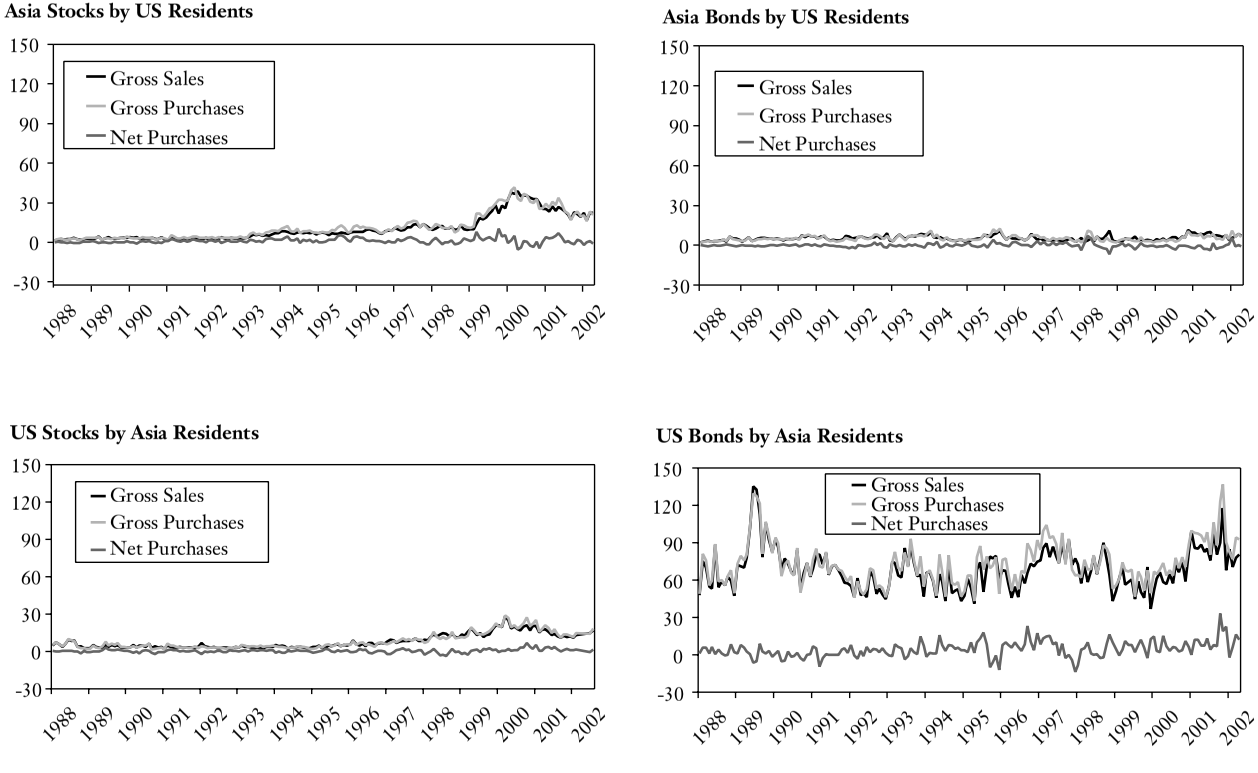

Figure 6.3 The Lower the Local Turnover, the Higher the Share of Trading by US Residents, The Case of Japan
(in percentages and billions of dollars)

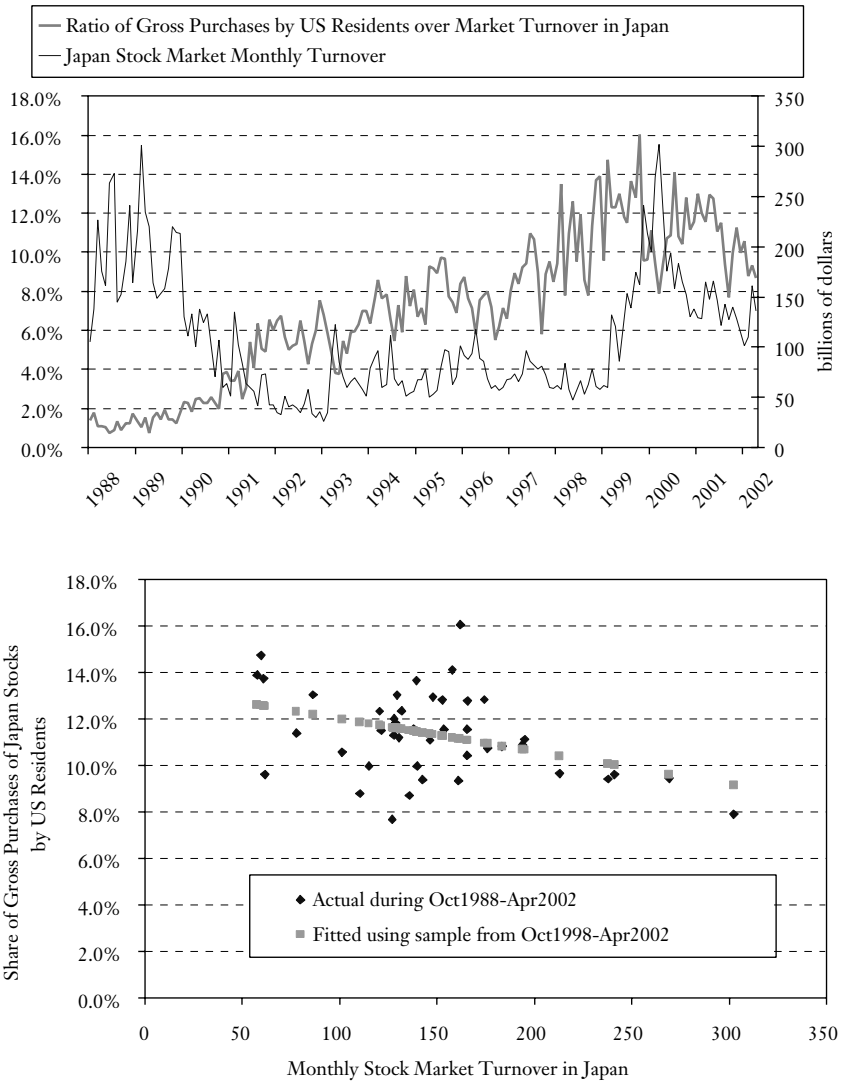

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Figure 6.4 The Lower the Local Turnover, the Higher the Share of Trading by US Residents, The Case of Hong Kong
(in percentages and billions of dollars)

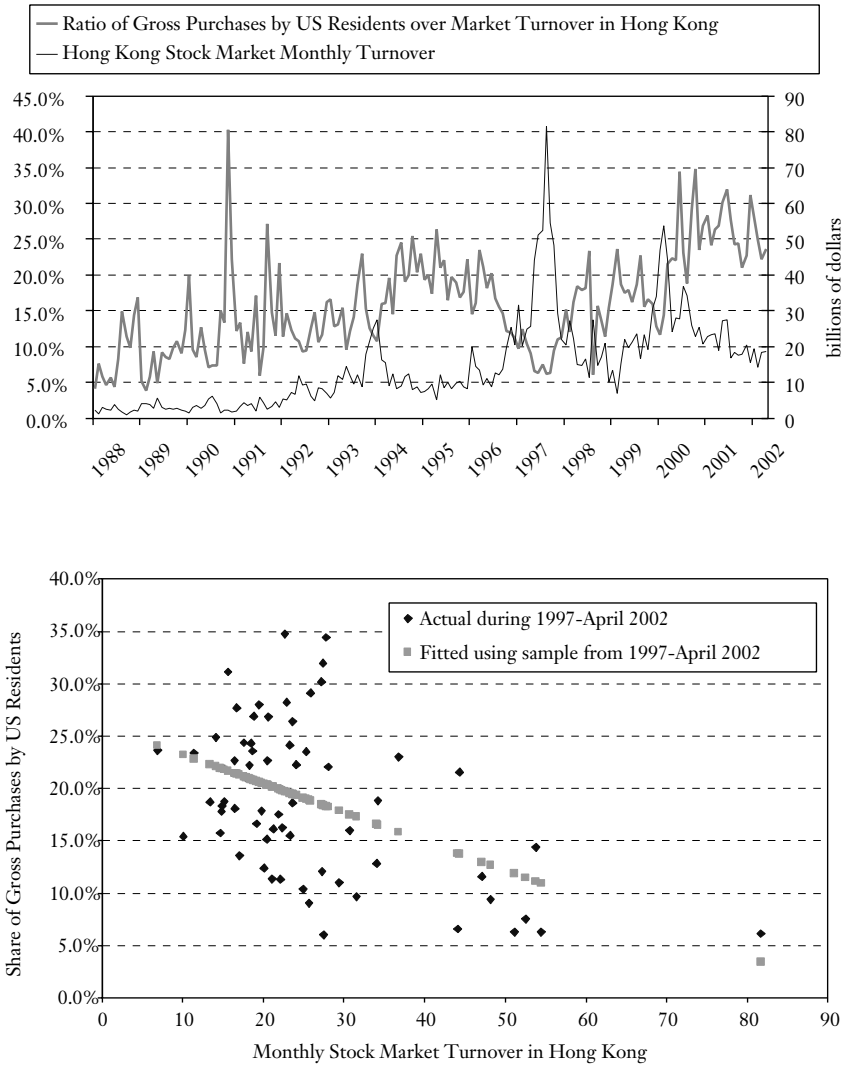

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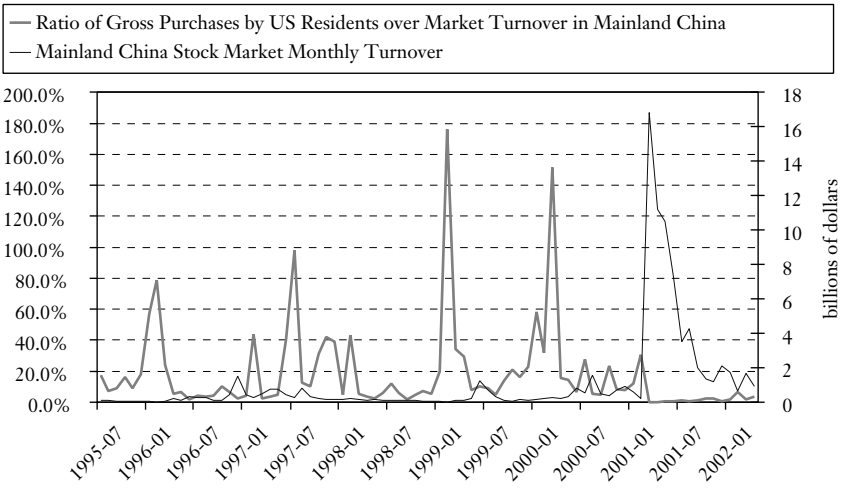
Figure 6.5 The Lower the Local Turnover, the Higher the Share of Trading by US Residents, The Case of Mainland China
(in percentages and billions of dollars)



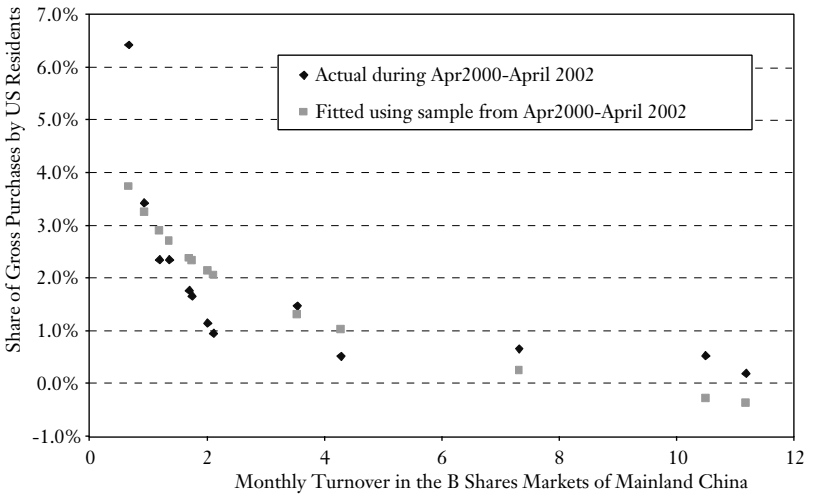


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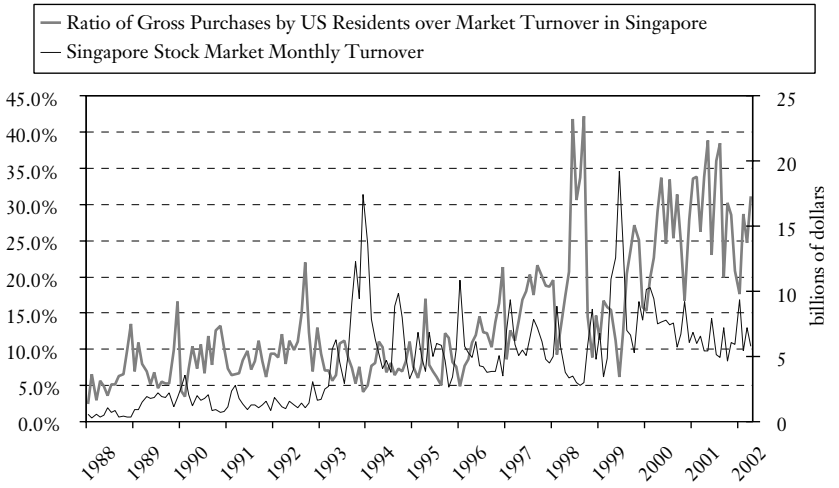
Figure 6.6 The Lower the Local Turnover, the Higher the Share of Trading by US Residents, The Case of Singapore
(in percentages and billions of dollars)



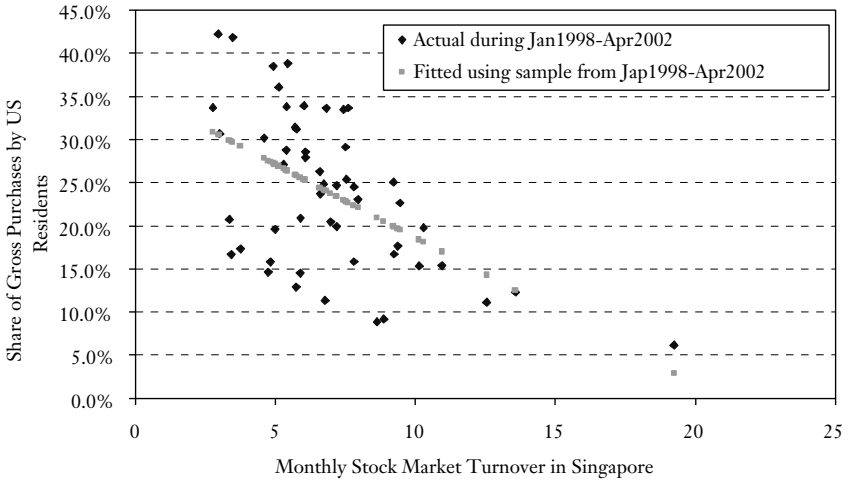


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Figure 6.7 The Lower the Local Turnover, the Higher the Share of Trading by US Residents, The Case of Taiwan
(in percentages and billions of dollars)

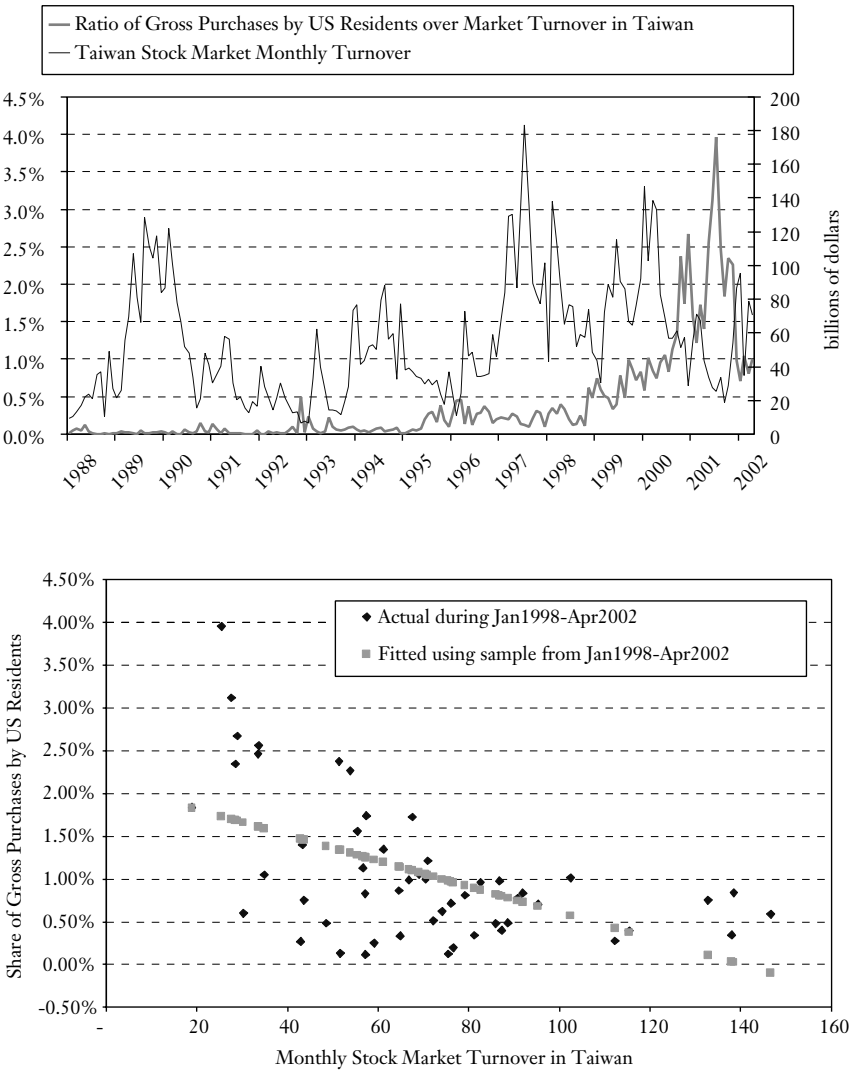

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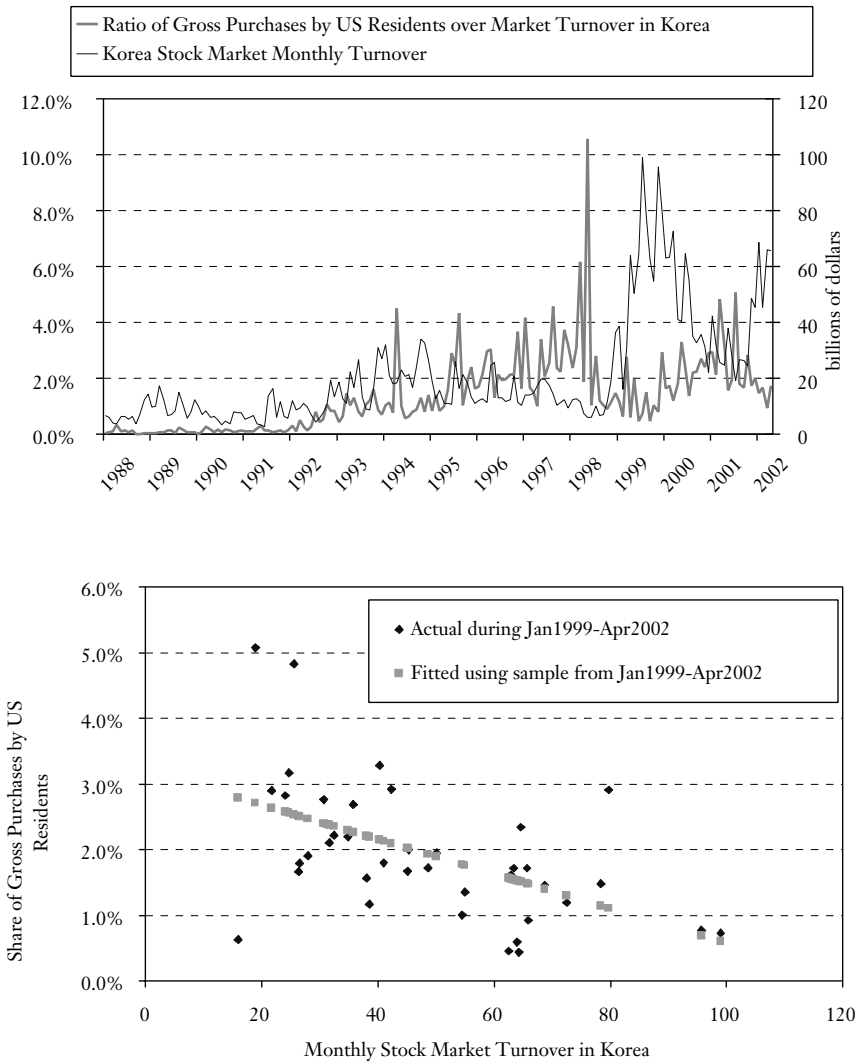
Figure 6.8 The Lower the Local Turnover, the Higher the Share of Trading by US Residents, The Case of Korea
(in percentages and billions of dollars)



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9

Comment on Young Rok Cheong and Geng Xiao

*Li-Gang Liu**

This overview paper is very thought-provoking. It has raised many important issues facing the Chinese and world economies. The authors have painstakingly compiled a wealth of data, as indicated in 38 tables and charts, to provide evidence for their argument. The paper raises many interesting issues – each of which would be sufficient for a paper itself; but it is also styled so well that we can understand these complex issues with ease.

Let me give a quick review of key points of the paper. Essentially, the authors raise nine questions.

The first one is how to reconcile the fact that China is exporting capital and, at the same time, importing a large amount of capital. The answer they provide is that China used its trade surplus to finance its main customers, mainly the US customers.

The second question is whether China is attracting too much FDI. The answer appears to be 'yes'.

The third question is what happens to China's investment in US bonds. The authors' figure indicates that China has become the second largest bondholder of the US treasury. Indeed, by 2001, China purchased the same amount of bonds as Japan.

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* The discussant was formerly a senior research fellow at the Asian Development Bank Institute in Tokyo. He now is an assistant professor of Public Policy and Finance at the School of Public Policy of the George Mason University in Arlington, Virginia, USA.

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The fourth question is: What is the impact of foreign portfolio investment on the stability of the Chinese stock markets? At this moment, the impact is negligible given that China's capital account is closed, but we may expect more impact in the near future as the Qualified Foreign Institutional Investors (QFII) plan to allow foreign institutional investors to set up joint-venture mutual funds in the Chinese stock market.

Fifth, they ask if China is generating global deflation. The answer is 'yes' in the labour-intensive manufacturing products but 'no' in overall manufactured products since China's share in world trade is still rather small, around 4 percent in 2000.

Sixth, they are interested in determining the seriousness of China's impact on its competitors. As Geng Xiao mentioned in his presentation, there are both benefits and costs of China's emergence in the world economy. Perhaps the rational strategy is for other countries to respond proactively and deal with the challenge of the emergence of the Chinese economy.

Seventh, they raise the issue of whether China is saving too much. Their answer is affirmative. Demographics and growth can explain this phenomenon. However, Chinese savings are not well utilised. The existing financial system is the root problem.

Eight, given large capital inflows and domestic savings, they ask a hotly debated question: Should China revalue its currency? Their qualified answer is, 'No, but perhaps some domestic price adjustment should be used.'

The last question they entertain is whether China has become a growth engine for the world. From the paper the answer is not that clear. Although China has become a major trading nation in the world and its GDP size in PPP is the third largest in the world, it is not obvious that China is an engine of global growth at this moment.

Having recapped the key points of the paper, I would like to make the following observations and comments.

The first one concerns the sustainability of the current trade-FDI pattern in China. There is a big difference between 'made in China' and 'made by China'. At present, more than 50 percent of Chinese exports is conducted in the form of processed trade: China imports intermediate components, mainly from Japan, South Korea, and Taiwan, and then assembles them for exports. The assembled products are then disproportionately exported to the US market.

This pattern of triangular trade has allowed China's powerful exporting neighbours, South Korea, Taiwan, and to some extent, Japan, to divert their previously US-bound exports to China, thereby reducing their trade surplus with the US. If this triangular feature of the China-US trade were to be taken into consideration, the adjusted real trade balance between China and the US would be far smaller than the current number since China's value-added in the processed trade has been rather minimal, mostly in the form of low wages of the assembly workers. Indeed, this feature is evidenced by the fact that although China has a large trade surplus with the US, it runs a similarly large trade deficit with South Korea, Taiwan and Japan. Therefore, China's global trade surplus is small, accounting for only 2 percent of its GDP per year. As the US-China trade deficit balloons, it is not surprising that China has become a new target of US trade policies, similar to Japan and other East Asian economies in the 1980s. Thus, it is very doubtful whether the current pattern is sustainable and whether China can continue to export its trade surplus to the US. At this moment, China's trade-to-GDP ratio is close to 50 percent and the US current account deficit is historically high, possibly reaching 7 percent of its GDP by the end of this year. One would have to wonder whether this size of US current account deficits could be maintained. There will have to be some kind of adjustment on both sides.

Second, I am puzzled by the fact that the wage rates in the export sector have been rather stagnant over the last ten years despite an impressive improvement in the sophistication of Chinese exports. The authors mention that FDI-funded firms are the main drivers of China's export growth contributing to 50 percent of China's exports. Indeed, China has become the largest FDI recipient in the world for the first time this year. Then it is puzzling that the wage rates in the exporting sector have not gone up much over the last ten years. Empirical evidence indicates that, normally, a country with a large amount of FDI like China would experience a rapid growth of wages in the export sector. The authors mention that in Guangdong province, over the last ten years, the average wage for manufacturing workers is only 100 dollars per month. I suspect that this rather stagnant wage pattern has a direct connection with the ongoing restructuring in the state-owned enterprise sector and the unlimited supply of labour from China's vast rural area. Because of these two factors, the wages in the export sector have not led to an overall

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domestic wage growth, as is usually observed in a country with large inflows of FDI. However, without wage growth, it will be difficult for China to raise domestic demand. This is perhaps why China's growth is so dependent on export growth, as indicated by its trade-to-GDP ratio.

If you look at the nominal GDP among China, the US and Japan over the last 30 years, China's GDP in nominal US dollars as a share of United States' GDP has not changed much; it stayed more or less below 10 percent of United States' nominal GDP. On the other hand, if you look at Japan, its GDP as a share of United States' GDP has converged to the size of the US GDP until the bubble collapsed in the 1990s.

It is quite puzzling that although China has experienced quite high growth, it has not grown much in terms of nominal value of US dollars. This seems to indicate that the wealth from FDI-generated income is located overseas rather than within China. I wonder whether this is because the net value added in China's exports has been minimal, mainly in the form of cheap labour income.

The third issue I would like to comment on is whether there is an FDI diversion from ASEAN to China. This is a controversial issue, especially among Asian countries. However, I want to put this in perspective by asking whether the current trend of high FDI in China is a cyclical issue or a permanent phenomenon. If you look at the overall FDI flows to less-developed countries, excluding China, over the last several years, they have increased. Why have ASEAN countries received less FDI from the rest of the world? I think domestic factors play the major role. ASEAN countries were hit by the financial crisis of 1997-98 and the recovery from the crisis was further exacerbated by the September 11th terrorist attacks in the US. In addition, Islamic countries such as Indonesia and Malaysia may have suffered from a higher investment premium. Western investors may view these countries as quite risky, so they prefer not to move their assets to these countries for the time being.

If we look at the adjusted per capita flows and stock figures of FDI, as the two authors mention, 25 percent of FDI from Hong Kong to China is round-tripped FDI. That is, Chinese money or investment is first taken to Hong Kong or other offshore facilities and is then taken back to China in order to enjoy tax incentives, favourable land use concessions, better property protections, and

other types of subsidies. If these tax incentives are going to be phased out with China's WTO commitment, I feel that such capital flight may not return. After the dust has settled in the ASEAN economies, perhaps such capital from China will go to Malaysia or Indonesia, rather than go back to China.

The fourth issue I would like to discuss is an interesting and rather controversial one, that is, the prediction of the Lewis model the authors used: If the Lewis model is applicable, China is going to contribute to world deflation, or wage deflation at least. According to the authors, currently 224 million of Chinese would be participating in the world market, while two-thirds of the population are still waiting in line. If we think those people are waiting in line to get into the labour-intensive industry only, perhaps that kind of prediction could materialise. However, if we qualify this assumption by assuming that China will continue to grow with industrialisation and urbanisation, the non-tradable service sector will increase to a normal size as we have seen in most of the industrialised countries, and, as a result, the immiserising impact of Chinese export growth on the rest of the world will not take place.

Thus, the participation ratio of Chinese workers in the world economy will be much lower than the authors' prediction, and it is likely that a majority of people in China will engage in the non-tradable service sector rather than compete internationally. Also, as I mentioned, China cannot maintain a 50 percent trade-to-GDP ratio forever. This ratio is obviously unsustainable for a continent-sized country like China.

However, the issue is, as China's nominal GDP ratio to Japan and the US shows, that China's terms of trade have been flat over the years, despite the fact that it has been climbing the value-added product ladder. Perhaps the average wage rigidity, due to a lack of active bargaining power of the workers in the foreign-owned firms, might be the reason why wages cannot go up. And perhaps because of this problem, the income inequality in China in the 1990s has become worse. The problem is that local governments have great incentives to attract FDI, so in a sense, they tend to collude with foreign investors and the interests of workers may have been ignored here.

What is the policy implication then? Wing Thye Woo has mentioned that one should try to increase the income of the rural sector. I think we should go a bit further and also look at the wage

issue of FDI-funded firms. The question is whether the bargaining power of workers can be increased so that their wages can be increased through the bargaining process. In fact, this will be one of the solutions if China wants to sustain its growth by creating sustainable domestic demand in the future. Almost 90 years ago, when Henry Ford offered his workers a wage of 5 dollars a day, a much higher wage than usual, he had an economic insight not apparent to most people at the time. If a majority of his workers could not afford to buy his Model-T automobiles, who would demand them after productivity and efficiency were improved so immensely that the mass production of cars was no longer a fantasy? His insight proved to be right.

Today, the world is facing a similar challenge: integrating large, populous and poor developing countries into the world market. If this succeeds, it will boost their manufacturing capacities because of their large pool of semi-skilled industrial workers and, at the same time, it will directly impact the welfare of industrial workers of the developed world. To address this challenge, the wage rates and income of those developing countries will have to go up so that their own large internal markets can demand some of the goods produced. Besides waiting for the labour market alone to adjust the wage rates in developing countries, this process can also be facilitated if governments in both developed and developing countries collectively pay attention to and enforce their labour laws so as to allow wage bargaining between workers and capitalists to take place. On the other hand, the beneficiaries from the globalisation process, mostly the transnational corporations, will have to share some of their profits with the industrial workers in the developing countries. Similar to the insight of Henry Ford, it may be a difficult policy for some to accept at the moment. But for the sake of global prosperity, such measures will prove to be beneficial for everyone. Presumed as a champion for the welfare of workers and peasants, the Chinese government can play a decisive role in initiating a global movement that will benefit its own millions of industrial workers and peasants at home.

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10

Floor Discussion of "China's Role in the Region and in the Global Financial System"

The Park and Wang Paper

Masaru Yoshitomi, former dean of the Asian Development Bank Institute (ADBI), wondered whether China's economic boom would eventually end in a financial crisis and what could be done to prevent such a crisis from occurring. "The main reason for the Chiang Mai Initiative is that we want to prevent a crisis similar to the capital account crises that struck Asia in 1997, and to better manage such a crisis when it would occur. First of all, we have to understand the real nature of the capital account crises of 1997. At the ADBI we have just released a report[1] that develops a set of policy recommendations for China on how to sequence its financial liberalisation, given that the sequencing order of financial liberalisation was clearly the missing link when the World Bank published its Asian miracle report in 1993 and only four years later the Asian crisis erupted.

The ADBI found that there was a huge gap between the new risks arising from financial liberalisation and deregulation (changing the incentives of borrowers and lenders), on the one hand, and the pre-existing, old kind of institutions including prudential regulation and supervision, on the other hand. The old regulatory frameworks

[1] ADBI, "Policy Proposals for Sequencing the PRC's Domestic and External Financial Liberalization", October 2002.

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and institutions were clearly not prepared for managing the new risks under liberalisation because they had no idea about how to do capital account liberalisation. That is quite natural because under the old, regulated financial markets we did not need such concepts at all.

The capital account crisis did, in fact, happen in the 1990s in Asia, and it might happen in the future in China as well. I have come to the conclusion that big financial crises usually occur after a real economic boom with some technological improvements. In this decade, the Chinese economy will continue to boom at least until we have the Olympics in 2008, and probably until 2010 when we have the World Expo, financed by the banks and so on. The WTO accession will liberalise financial services transactions in China by inviting all kinds of financial institutions. So at the end of this decade, there is likely to be a risky combination of a continued economic boom together with a real estate bubble financed by the banks, not by the securities market like in Japan in the 1980s.

The *de facto* capital account liberalisation in China will probably end up in a capital account crisis because such crises tend to take place, not every year but every ten or fifteen years. In order to prevent a crisis from occurring in China, besides implementing the kind of policy recommendation on the sequencing order of financial liberalisation that we at the ADBI have suggested, we may also need the arrangements beyond the Chiang Mai Initiative that Yung Chul Park and Yunjong Wang have suggested in their paper. In my later panel presentation I will talk more about the kind of recommendations we have made in our ADBI report." (See Chapter 17 of this volume.)

Xie Ping, of the central bank of China, thought that it was not yet clear to the Chinese government how regional financial cooperation beyond the Chiang Mai agreement should be developed. "It is not clear because China receives too many different suggestions. One day the ADB makes a suggestion, one day the World Bank, one day the IMF, and another day the BIS. It has been suggested, for example, that we create an Asian bond market, and that such a market would be very useful for the Asian countries including China. In the context of the Chiang Mai Initiative, last year we agreed on currency swaps with Japan, Thailand, Korea and some other countries, amounting to about 10 or 20 billion dollars. Some people say that this amount is very small and that, if China

would face a financial crisis, it would be absolutely nothing. So maybe this currency swap agreement is just symbolic. It may just mean that China participates actively in efforts at East Asian financial cooperation. Also, we have been discussing this Asian Monetary Fund proposal for a very long time. Some people are upset with it and are saying, 'You cannot do this!', while others are saying, 'This is a good idea'. There are so many people with different opinions about the Asian Monetary Fund.

Last week Professor Mundell from Columbia University, was in Beijing for a week. I met with him and he suggested to me that in the next 10 years, Asia should be united with one currency, and that this currency should be based on the Chinese yuan and the Japanese yen. He also thought that the Chinese yuan should be fully convertible before the 2008 Olympic Games. He gave us, the central bank, a lot of suggestions."

Wing Thye Woo, of the University of California, said that in every regional or global arrangement there is always an issue of economic power involved. "Look at Japan's experience in the IMF. For many years, the Japanese tried to enlarge the capital base of the IMF to increase Japan's voting power, but the Americans and the others resisted it. So any kind of regional financial institution set up now in Asia would mean locking in the present distribution of economic power. The president of such an institution would possibly be a Japanese, the executive vice-president a Chinese, the deputy vice-president a Korean. But let us say that we wait 20 years from now, perhaps the president and the next 5 executive vice-presidents would be all Chinese. So what's the incentive for China to lock-in the present status-quo distribution of power?

Another question is why China should be in favour of a regional bloc when its trade relationship is global in nature. It should be in favour of an Asian bloc only if this would be a building block toward multilateralism. Then the Chinese would be more enthusiastic about it. If you look at China's aspirations for the future, I think it would see its interests better served by a multilateral world rather than a regional bloc; and if it has to be a regional bloc, it should be seen as a bargaining chip to push the multilateral agenda. That's why I think the Chiang Mai Initiative has no life beyond monetary cooperation."

Geng Xiao, of the University of Hong Kong, agreed with Wing Thye Woo on the economic power issue in the Chiang Mai Initiative. "The difficulty of the Chiang Mai Initiative sort of effort

is that, at present, there are no credible leaders. Japan has a problem with its financial system, and nobody knows how to fix it. China is basically free-riding on the US system, pegged with the US dollar and trading with the US. So it is indeed very important to go back to fundamentals, as Yoshitomi and the ADBI people have done, and look at the so-called Asian miracle. If you look at Japan, Korea, Singapore, Hong Kong and all of these countries, they are all special cases of Asia in the sense that they are all small countries with a limited amount of labour supply and when the growth starts, the labour supply hits the limit and then wages go up. But in Asia, which has 50 percent of the world's population, the typical Asian situation is the case of unlimited supply of labour, fitting into the traditional Lewis model, the dual sector model. When China started growing, we had a huge population at subsistence level wages and an unlimited supply of labour, and that had an immediate effect on the ten years of growth. If you look at the Asian countries, we have all these successful economies of Japan, Korea, Taiwan, and now China, and you always see these huge current account surpluses, which mean that these countries are exporting capital, are having huge savings. But at the same time we have a huge surplus of labour in Asia. This means that we have a surplus labour economy exporting capital to the capital-rich US economy instead of investing it in the unlimited supply of labour economies in Asia. If capital and labour combine in Asia, these two things will continue to drive Asian growth. But the problem now is that the capital cannot go to Asia, it can only go to the US, and from the US it goes back to Asia through FDI. So we are actually free-riding on the US system, largely because the US financial system is the most competitive system in the world.

So in this sense, we have to go back to these fundamentals, to assess whether the free-riding on the US system is the best solution for Asia. Hong Kong is the typical case, it is just free-riding, and there is no monetary policy. If Japan would resolve its banking problem, the Japanese interest rate would rise, which would help to better allocate resources because at a 0 percent interest rate, this capital just does not know where to go, it just goes to the US.

We are all without choice just investing in the US, but at the same time we have so many resources in terms of labour, in terms of oil in Indonesia, all kind of resources. We have technology in Japan and in Taiwan, and we have financial markets in Hong Kong, but we

are not using it. Last year, even Hong Kong had capital flight to the US. In Asia there is no leader, we are still relying on the US. But we have to ask ourselves whether that is the best solution."

Yung Chul Park was not sure that China would face a financial crisis in the next 10 to 15 years. "Whether China is going to be the next epicentre of a financial crisis within the next ten years or so depends upon a couple of assumptions. The first is, to what extent China is going to borrow from abroad, from the global market. The second is, to what extent China is going to borrow from other Asian countries. In the next 10 to 15 years, I don't think China is going to borrow so much from outside. Since the savings rate is still very high, China will continue to run a current account surplus for some time. But the foreign debt of China will not go up to the level of Korea or Thailand or Indonesia, so the foreign debt-to-GDP ratio will remain very low.

I am more concerned about domestic financial turbulence in China because of this non-performing loan problem and the bankruptcy of the state-owned banks. And this domestic instability may spill over to other East Asian countries and that might be something to worry about even though I think the spillover would be relatively small. So I am not as much worried about the possibility of China getting into a serious financial crisis as Yoshitomi."

Li-Gang Liu, of the ADBI, was puzzled about the leadership issue in Asian financial cooperation that Park and Wang raised at the end of their paper. "I am not sure that the analogy of Germany and France, as leaders in European integration, necessary applies to China and Japan as leaders of Asian integration. In terms of economic size, China is just one-fifth of the Japanese economy. Also, if the rest of the Asian countries are further advanced in terms of financial services liberalisation, capital account liberalisation and domestic financial liberalisation, why can't they start some kind of a financial cooperation framework? China can always join at a later stage. The IMF system started without Russia, and the WTO did not have China as a member for many years, so why should the other countries, if they are willing to go ahead, wait for China?"

Zdeněk Drábek, of the WTO, thought however that Chinese cooperation was of key importance. "Since the stability of the exchange rate in the region is important, the Chinese role in that context is important. It would be very useful for Korea, for Thailand, for Indonesia to know whether the Chinese are going to devalue their

currency or not. So in that sense monetary cooperation with the Chinese is not premature but highly important."

In his reply to the comments, Yunjong Wang stressed that the basic aim of the Chiang Mai Initiative (CMI) and the Asian Monetary Fund (AMF) is to prevent financial crisis and manage the crisis better. "In terms of crisis prevention, we need two things: one is the swap facility and the other is the monitoring and surveillance system. Regarding the facility, the current CMI just links to the IMF, so if we are really satisfied with the current Chiang Mai swap scheme, we should probably be happy with the way in which the IMF deals with crisis prevention and management as well. Then we don't need to go any further. But if we are dissatisfied with the role of the IMF and the current scheme of the CMI, then we should think about what kind of elements could be introduced to better prevent the crisis. Regarding the monitoring and surveillance system, the main task is to identify the emerging problems in East Asia. The policy dialogue has already started, but that's not enough, we need a secretariat to detect and initiate a discussion about the emerging issues.

Probably ASEAN+3 will just have to forget about exchange rate coordination, because it is too early. Currency union and currency unification is a delicate political issue. In terms of exchange stability, European countries have a different past, they started with the fixed exchange system, and they didn't need to care too much about exchange rate stability. The Bretton Woods system guaranteed exchange rate stability through various ways, and for two decades the European countries had quite stable exchange rates and also capital controls.

In East Asia there are now different degrees of capital market opening. Geng Xiao talked about China's free riding, but I think that China's monetary policy is independent because China has a restrictive capital market opening. Hong Kong has a currency board system and its capital market is open, so it is very sensitive to US monetary policy. But China can maintain an independent monetary policy.

Talking about currency unification, there is indeed this fact of status quo in economic power. It is a very important factor. If we pursue monetary unification, political will is important. Political scientists are trying to explain why the East Asian countries have no particular political will. European leaders have a kind of new

functionalistic vision underpinning the European system. In Europe there is a lot of interaction between the countries and the spillover effects are large, so there is a natural need for policy coordination. But in East Asia we still have a relatively low degree of intra-regional trade. It is increasing but it is still low. We also have minimal financial integration among the countries, but that is a less important factor. The most important factor is that countries have different policy objectives. For China, economic development is a more important issue than regional integration, and Japan may have yet another policy objective. Different political instruments are required for these different policy objectives. My conclusion is that it is probably still too early to say much about a high level of economic integration in East Asia."

The Cheong and Xiao Paper

Robert McCauley, of the BIS, wondered whether the Lewis model, in the modern monetary world, would be the right way of looking at wages and employment in China. "The current world is quite different from the employment model when potential growth was reasonably well defined. For example, if the renmimbi were to revalue, would that mean that the nominal wage would simply go down more or less in proportion to the devaluation?"

Geng Xiao explained that in the Lewis model, the real wage is determined by subsistence labour and the unemployment rate. "There is a lot of unskilled labour in China, and labourers are competing with each other to find a job. On the one hand, the wage level has to be higher than their incomes in the countryside and, on the other hand, they have to face the unemployment in the cities. So these two conditions more or less determine the wage rate. Chinese people have lived so many years of endurance and frustration in real income that they can deal with low wages. An exchange rate revaluation would probably have an effect on real wages, but not too much. On the longer time horizon of 5, 10, 20 years, wages are hard to change, largely because you have so many people coming out of the countryside who are looking for a job. Wages will go up largely when things become cheaper and the living standard increases. Food has become cheaper for everybody in China, including the people in the countryside, and that has increased their living standards."

Masaru Yoshitomi wondered how one could reconcile the fact that income in China has increased and, at the same time, a large part of the population still lives at a subsistence level. "How does the Lewis model apply to China? On the one hand, we are hearing that the income of people in China has increased over the past 20 years and that it will continue to increase in the next 20 years. But, on the other hand, Geng Xiao insists that the Lewis model applies because the wage level will continue to be based on wages at the subsistence level. How do you reconcile these two sort of conflicting facts?"

Young Rok Cheong thought the explanation was quite simple. "These facts go together because there is a large inequality in income in different areas. Look at the per capita GDP in the cities, and at the difference between the top rich 9 cities and the rest. The gap is widening."

Yoshitomi insisted: "But the question is: Have the wages of the labourers who migrated to the coastal areas remained constant over the past 20 or 30 years? And are the wages in the coastal areas still determined by the subsistence level in the very remote areas in China? That is what I'm asking."

Cheong explained: "You will be surprised to know that wages for the workers in Guangdong in assembling lines in foreign investment enterprises are actually lower than probably in the whole nation because the competition in the labour market is so perfect that labourers are coming from all over China. If you want to find a job you go to the coastal cities. The wages there are not higher than in the interior cities."

Yoshitomi continued: "What kind of immigrants are they? Are they coming into the cities from relatively near or from remote areas?"

Cheong: "Both, they are coming from the Western part of China, and they are coming from within the province. Many of the migrating workers are not seeking the job by themselves but are being sent by provincial governments. They organise the provision of cheap labour, as cheapest as possible, and export the labourers to the coastal areas. I visited many companies and they have their own dormitories and maintain a very low level of wages."

Geng Xiao added that for skilled labour, wages are increasing rapidly in China. "The wage income of the professors and the technicians is going up very fast, every year. The gap between skilled and unskilled labour is increasing rapidly. Wages for unskilled

labour, on the other hand, remain low because you have plenty of supply. For example, when you advertise for a waitress, there are hundreds of people applying. How can you then increase the wage? Even in Hong Kong the wage for unskilled labour has not changed much, it is still the same as 10 years ago."

Charles Adams thought that at the time Lewis developed his model, he did not make a distinction between product wages and consumption wages and that the subsistence argument is about the consumption wages. Second, he found it very odd to be talking about China's exporting deflation. "At best it is an issue of relative prices. But in the case of the US, manufacture prices have been rising less rapidly than service prices for a long time, and well before China was potentially on the scene. So I suspect it has something to do with differential productivity. And just to make a provocative point: while it seems that one can make the case that the RMB does not need to appreciate vis-à-vis the US dollar, one can also make the case that the RMB should appreciate against the rest of Asia. What would happen if the US dollar weakened against the other Asian currencies and the RMB did not change?"

Geng Xiao said that his quick answer would be that most Asian economies are pegged to the US dollar, "so when the US dollar changes everyone just follows".

Adams observed that there might be a *de facto* pegging, but on paper, most countries were floating. "So if we see adjustments in other Asian currencies, then there will be an issue about the cross-rate between those currencies and the RMB. So all I'm asking you is, if you think on that margin, what would be your answer?"

Xiao: "According to economic theory it is very simple: you just don't mess with the exchange rate. The issue of prices and price changes is confusing in China because the country is not an equilibrium economy. The exchange rate is about inflation; it is about the price. In China, there are many sectors and many regions, all fragmented, and they are all trying to find equivalent prices. So the exchange rate is used as an anchor."

Adams: "I may be old-fashioned, but nominal exchange rate changes have quite a profound effect on real exchange rates, for a sustained period, in many countries."

Xiao: "That is true, but exchange rate fluctuations in China would also have a huge wealth impact in the sense that China's holding of foreign assets are huge. I did some rough calculations:

once you change the exchange rate by, say, 10 to 20 percent, there is going to be a redistribution of wealth in China of the range of 7 to 8 percent of GDP. That is why I doubt whether China should have floating exchange rates. The monetary system in China relies so heavily on the US dollar, 45 percent of China's central bank assets are in US dollars, and 24 percent of China's GDP is in US dollars. So if you mess with the exchange rate, you will stimulate huge speculations of people who will be trying to make money out of the exchange rate changes. That's why the exchange rate in China should remain fixed. By remaining fixed, the renmimbi remains credible – at least, as long as China continues to have a surplus. And a fixed rate substantially reduces the risks for traders, producers, foreign investors and Chinese people. So, in my view, the current monetary system is the best for China. I don't believe in the traditional IMF recipe because that is only right for an economy based on an equilibrium model. It is better to give China an exchange rate anchor, so that it can fully employ its labour force. Once that is realised, we can talk about floating and all the other traditional arguments coming into effect. But first China has to address the basic question of development."

Xiao stressed that China's trade-to-GDP ratio of 45 percent was rather meaningless because of the minimal value-added in China's exports, and that China would remain a very attractive country for foreign investors. "As a percentage of GDP, the value-added is very small and China's GDP, in PPP terms, is highly undervalued. It is the opposite in Japan. Japan's exports are only 10 percent of GDP because its GDP, in PPP terms, is overvalued. I don't think that the potential of FDI into China is going to decline, largely because once every major multinational corporation has production facilities in China, you generate an economy of scale and scope that is going to have its own momentum. Look at what happened earlier in history in Manchester, New York, Chicago, Tokyo, Osaka – they have all become major manufacture centres of the world. The same is now happening in Shanghai and in Guangdong."

Yunjong Wang shared Xiao's view that China would continue to attract foreign investors, because of its own large population and that of neighbouring India. "I cannot see a turning point in foreign investment in the near future. India, with its large English speaking population, is trying to establish special economic zones along its coast. Just like China, India also has an unlimited supply of unskilled

labour. The two countries together may have 1 billion unskilled labourers. That is going to attract a lot of capital. But we should be careful. There are still many foreign investors who do not want to invest in the western part of China. To attract foreign capital, you need a good infrastructure and a good working discipline. Foreign factories are mostly concentrated on the coastal line and this might create growing inequality, undermining social cohesion and stability. However, both India and China have an enormous potential for foreign investments."

Geng Xiao emphasised that the competitive pressure of China in the world is just there, not only because of the Lewis model and the unlimited supply of labour, but also because of the mobility of institutions and of capital. "The successes of Shanghai and Hong Kong are tremendously important. You cannot believe how many people are focused on China, and how much advice is given to China. Look at the whole world, look at the major US and European corporations, or at the major international, US and European institutions, they all have China experts who study China, advise China, and think about China. All the high techs are in Hong Kong. So this is real. If China continues its success, the implications for the whole world are tremendous. It is so simple, I mean, 1000 or 500 years ago we spent most of our time on getting food and shelter, but today one hour is for food and the other time is for entertainment. In a way, this relative price adjustment is good news, it means that now, in principle, it should be easy for everyone in the world to have a decent basic life. We have the technology, the knowledge and the institutions to realise that."

Zdeněk Drábek wondered about the importance of FDI for China's growth. "How important is the foreign sector? What is really driving the growth? I would think that most of the aggregate demand is domestic and that most of the investment must be domestic investment. So I don't think that foreign investment is the engine of economic growth in China. What is much more important is what the government is doing. I think that the fiscal policy and the investments by state enterprises are driving this big investment drive in China."

Young Rok Cheong agreed. "The magic is not just FDI or the unlimited supply of labour. The magic is to put everything together. The Chinese government is a very stable government and very open-minded to foreigners. And indeed, the infrastructure investments are huge and unprecedented in China."

Cheong ended the discussion with three policy suggestions. "The first is that the Chinese government can and should allow the market to work. The market is working at the global level and it should also work at the national level. Second, once China fully employs all its surplus labour, it can apply the traditional recipes of economic equilibrium theory. China's labour force provides competitive pressure to other countries, but it also harbours domestic risks, social risks. Third, the development of the domestic financial system in China is of key importance for sustained growth. Economic growth is facilitated by the protection of property rights, and the protection of property rights in China is coming through in the wrong way, through the foreign investment enterprises. Only when the foreigners came in, the government started to secure property rights and apply other standards of international practice in, for instance, the hiring of workers. Property rights protection is going to be the key for China to have success in the next stage. The financial sector is a derivative of the real sector and anything that goes wrong will be reflected in the financial sector. So by tracing the road for the financial sector in China, we can trace the road for maintaining growth and development."

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