Econ Pol Europe conference: Europe and China

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Europe’s China syndrome

1. Parallels and differences with NIC s/Asia scare during 1980/90s.
2. Trade versus investment
3. ‘System’ (and some geo-strategic) competition.

(see also https://www.ifo.de/DocDL/CESifo-Forum-2019-1-gros-us-china%20trade-war-march.pdf)

Parallels and differences with NICs during 1990s.

Similarities:

- high savings economy, directed credit,
- taking over ‘high tech’ sectors.

(Krugman on Myth of Asian Miracle 1994! ‘All Perspiration’)

https://www.foreignaffairs.com/articles/asia/1994-11-01/myth-asias-miracle

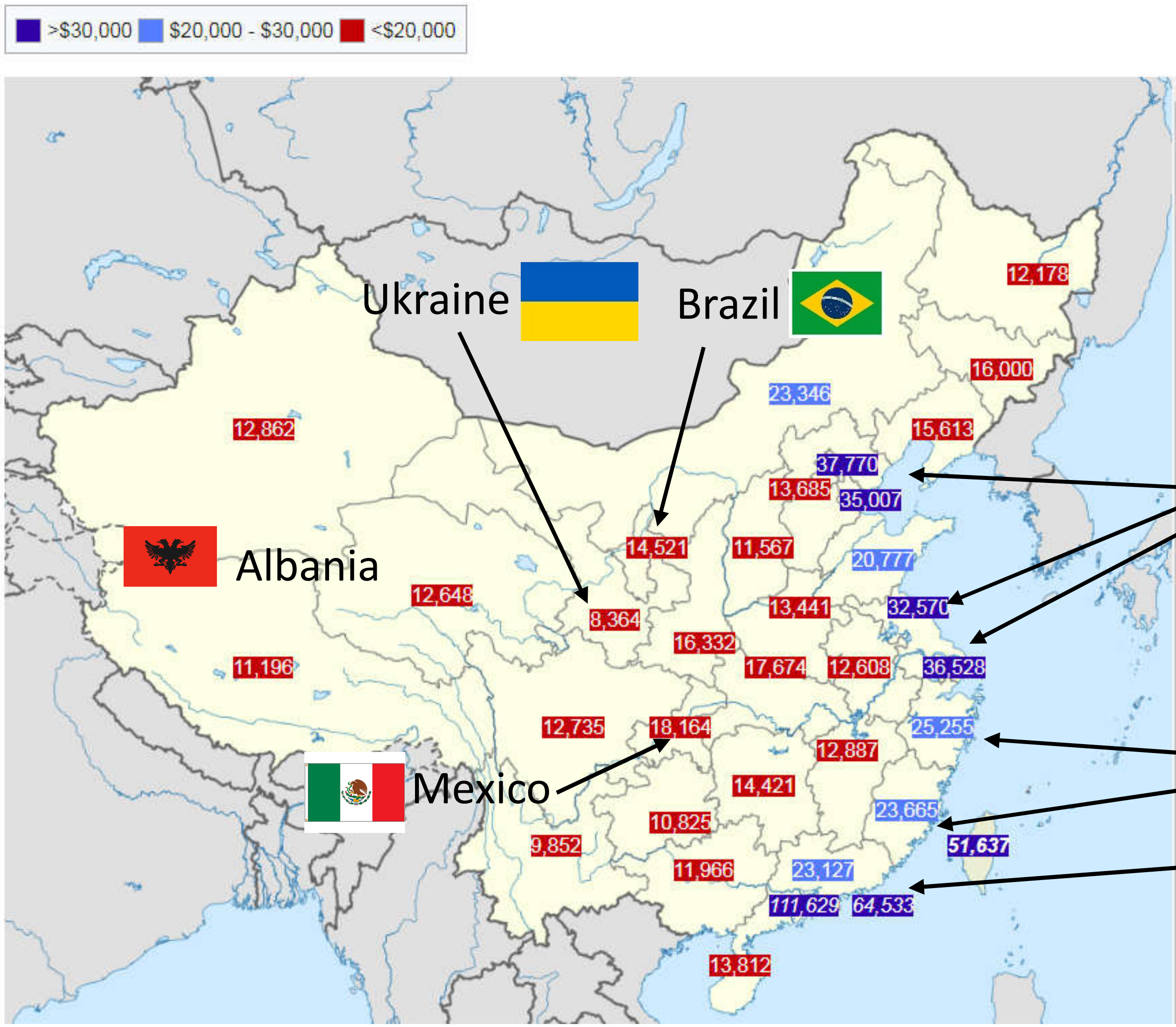
Parallels and differences with NIC/Asia scare during 1990s.

Differences:

- Size (China 10 time bigger – but world economy also bigger)
- Gradient – speed of rise of China even quicker than NICs then.
- Mostly about trade then, today more about investment.

https://europa.eu/rapid/press-release_MEMO-93-1_en.htm

Many Chinas: Chinese provinces and SARs by GDP PPP per capita in USD , 2017



Pop. Provinces close to EU average: 15+24+21+80= 140 mill. = IT+D > Japan

How the EU views China:

China is, in different policy areas,

1. a <u>cooperation partner</u> with whom the EU has closely aligned objectives,
2. a <u>negotiating partner</u> with whom the EU needs to find a balance of interests,
3. an <u>economic competitor</u> in the pursuit of technological leadership, and
4. a <u>systemic rival</u> promoting alternative models of governance.

https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf

How the (official) EU views China:

In concrete terms:

1. a <u>cooperation partner</u> : climate change, multilateral trading system (?),
2. a <u>negotiating partner</u> : bilateral investment treaty (no progress so far),
3. an <u>economic competitor</u> : China 2025?
4. a <u>systemic rival</u> : ‘Belt and Road’, state versus market capitalism?

https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf

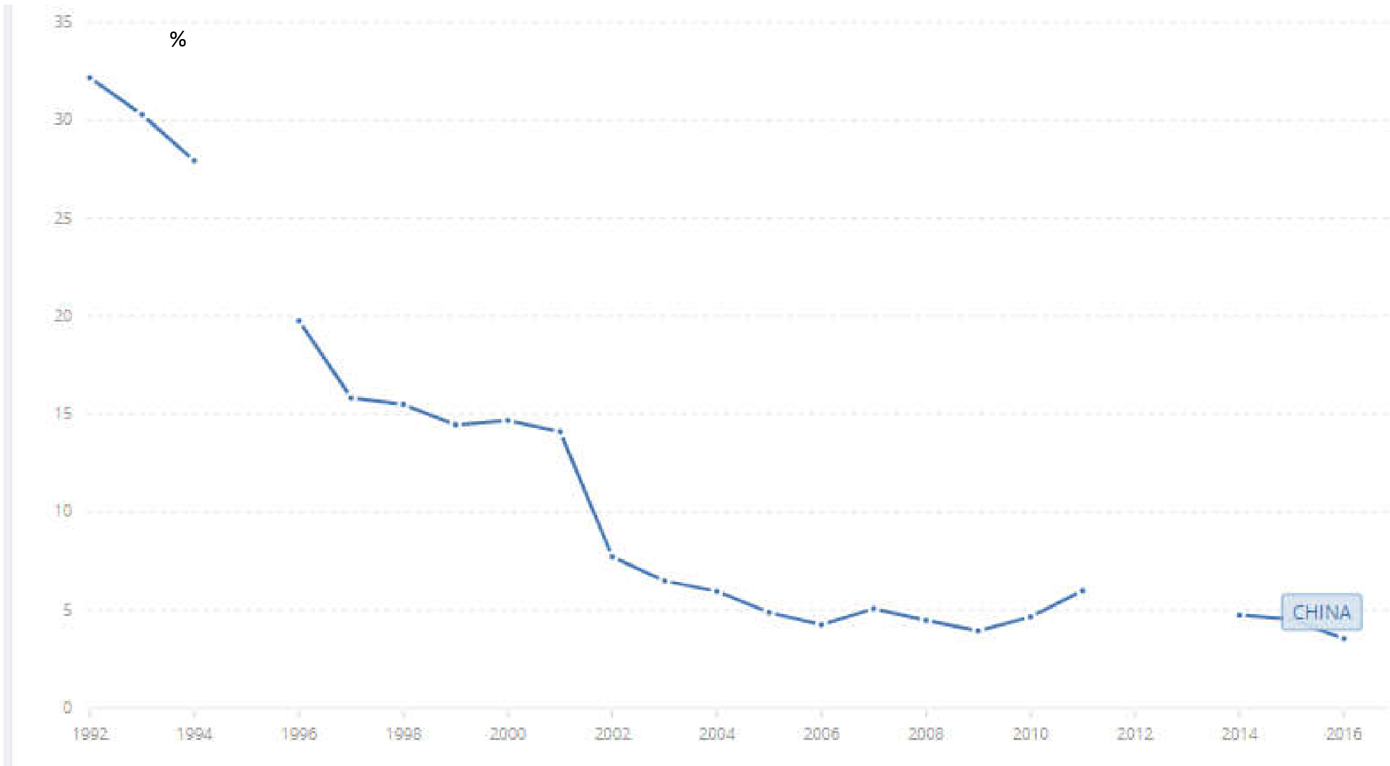
Trade versus investment

Trade:

- China shock mostly finished? Europe adapted (surprisingly) well.
- Tariffs low (both sides) – but could foster trade through deep FTA.

China: tariff rate, applied, weighted mean, all products: 3.5% in 2016

https://www.ceps.eu/publications/tomorrows-silk-road-assessing-eu-china-free-trade-agreement-2nd-edition



CEPS_thinktank

Trade versus investment

Trade:

- China shock mostly finished? Europe adapted (surprisingly) well.
- Tariffs low (both sides) – but could foster trade through deep FTA.
- Standard trade defense instruments sufficient (?) for sectoral problem (and SOEs).

Investment:

- used to be one-sided, no more.
- Fewer global rules for investment.

An aside: Implications of US China trade war

- General theorem: <u>Discriminatory</u> tariff (by US or China) = tax on consumers plus subsidy for Rest of World producers.
- => RoW benefits from trade diversion!
- (Trade war = 'negative' Customs Union)

Model based estimates welfare impact of US 'China tariffs'

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
USA	-0.3	-0.6	-1.8	-3.1
ROW	0.1	0.1	-0.9	-26.8
EU	0.1	0.1	-0.2	-0.3

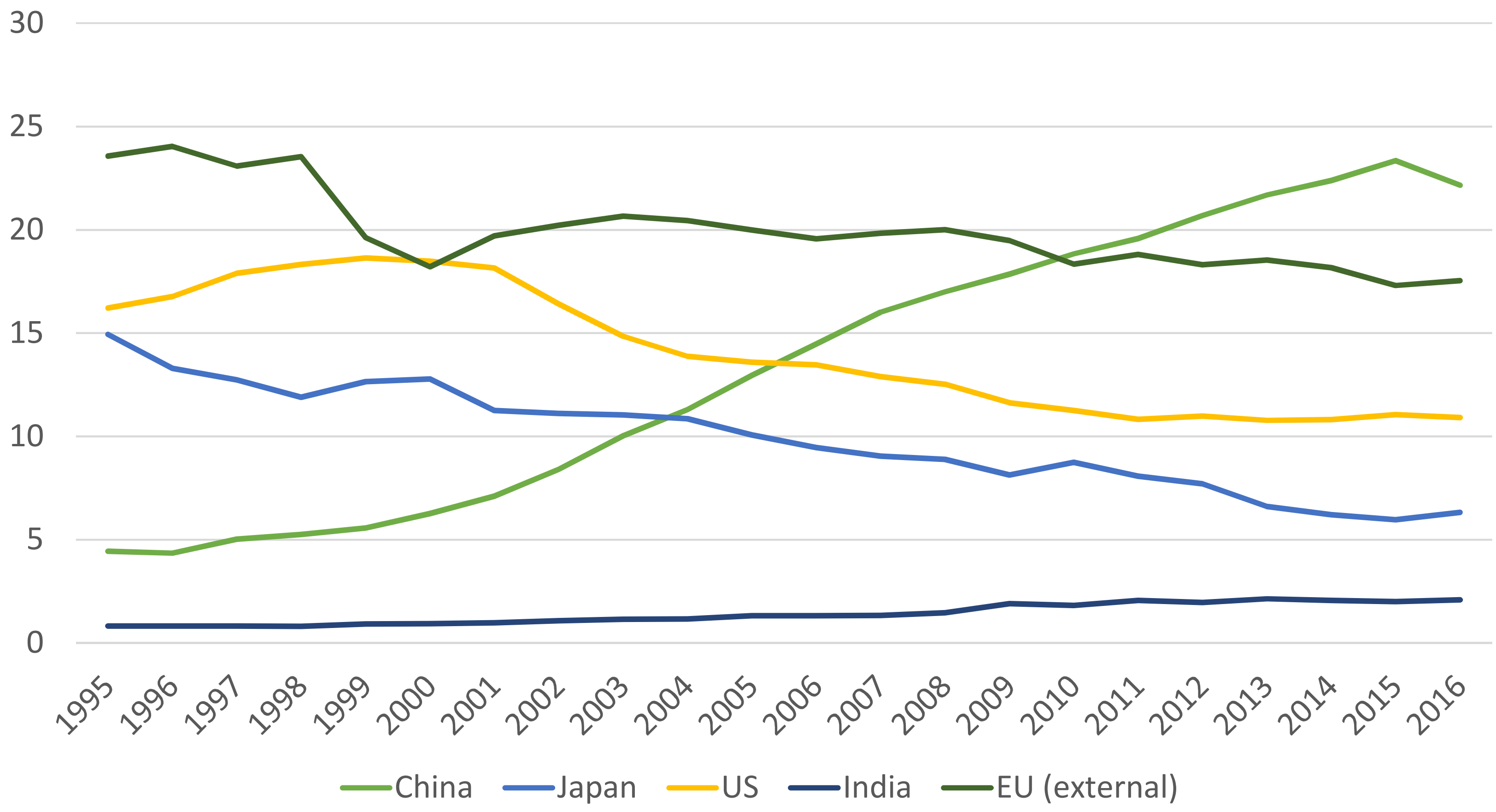
Scenario 1: US increases its tariffs on its imports from CHN by 15%
Scenario 2: US increases its tariffs on imports from CHN by another 15% - by 30% compared to existing tariffs)
Scenatio 3: US increases its tariffs on its imports from all partners by 15%
Scenario 2: US increases its tariffs on imports from all partners by another 15% - by 30% compared to existing tariffs) ht

Trade

Should not look a <u>bilateral</u> balances:

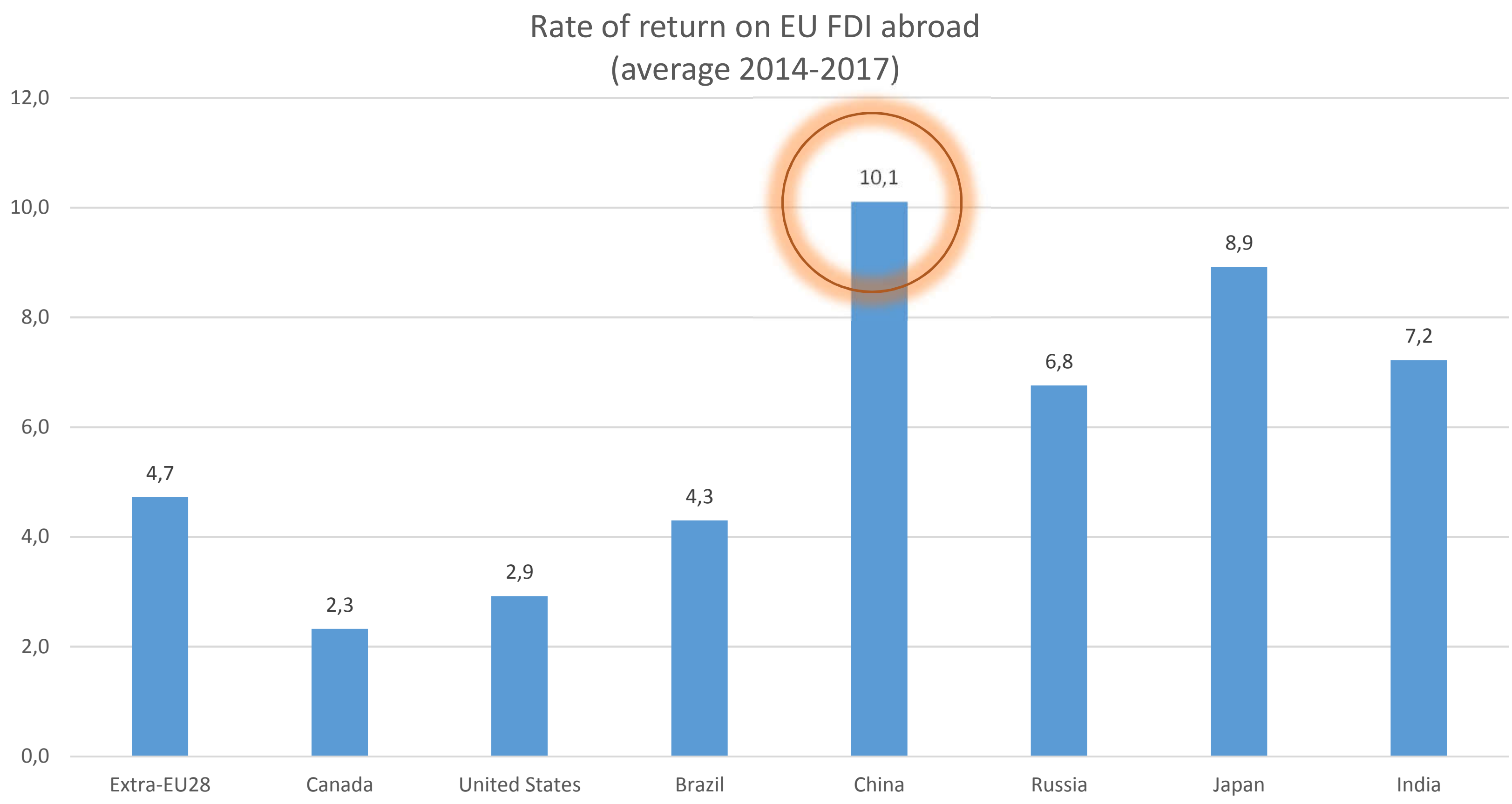
- General theorem: (Krugman model) everybody benefits from new entrant to global economy.
- Little evidence that China has somehow ‘displaced’ EU exports.
- (Also no terms of trade loss.)

Shares in global manufacturing exports



Investment: Does China treat foreign investors badly?

Do EU firms make profits in China?



FDI and IP issues

- EU firms complain about IP theft and unfair treatment.
- Might be true, but returns still good.
- ‘Forced IP transfer’ misnomer. Can just stay out of market.
- => Most complaints ‘we would like the Chinese to change so that we can make even more profits.

‘System competition’

- Budget constraint: State can only support some sectors at the expense of others.
- State better at picking winners?
- This time is different(?): ‘New New Industrial Policy’ now for soft- instead of hard-ware?)

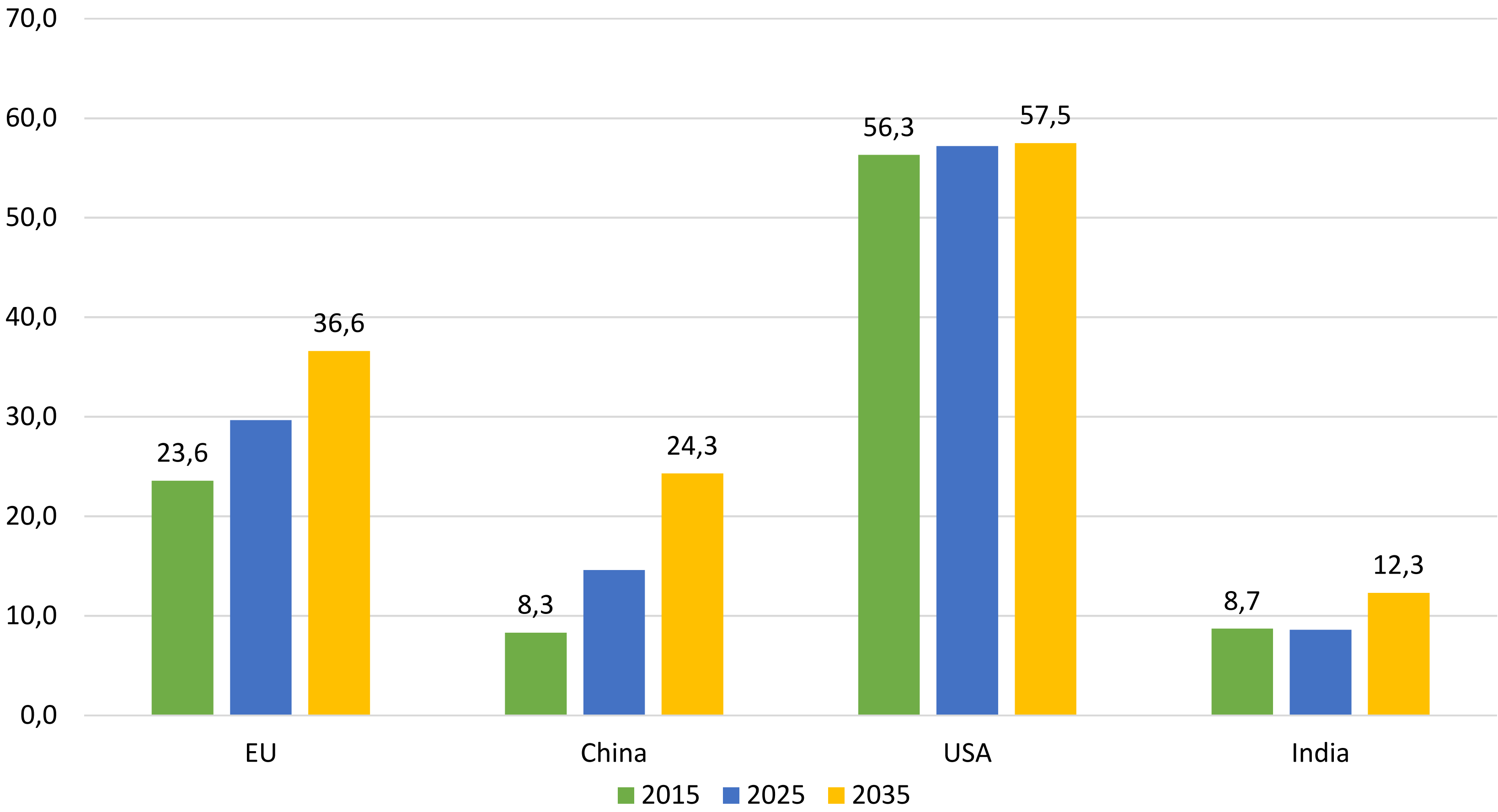
‘System competition’

- China unlikely to change system because of external pressure.
- Europe should have more confidence in its system based on competition and openness to trade and investment.
- https://www.economist.com/briefing/2010/08/05/picking-winners-saving-losers

China = Asian model ‘squared’

- Extremely high savings and investment, both physical and human capital (> Japan and Korea).
- Human capital: progress limited by demographics
- Physical capital: High savings => high investment => low returns (or high current account surplus).

Share of tertiary education in working age population, G-4



Capital/Output ratios in the major economies

- Capital output ratio (C/Y) good indicator of return to investment (ICOR very variable).
- Long term relationship between growth and investment ratio (I/Y):
- Given any trend growth rate, the higher I/Y the higher the resulting capital/output ratio (= lower returns). See table.

Capital/Output ratios in the major economies

Fundamental equation:

Investment rate which keeps capital output ratio constant.

Steady state I/Y = (C/Y) * (g + d)

With g = potential real growth and d = depreciation.

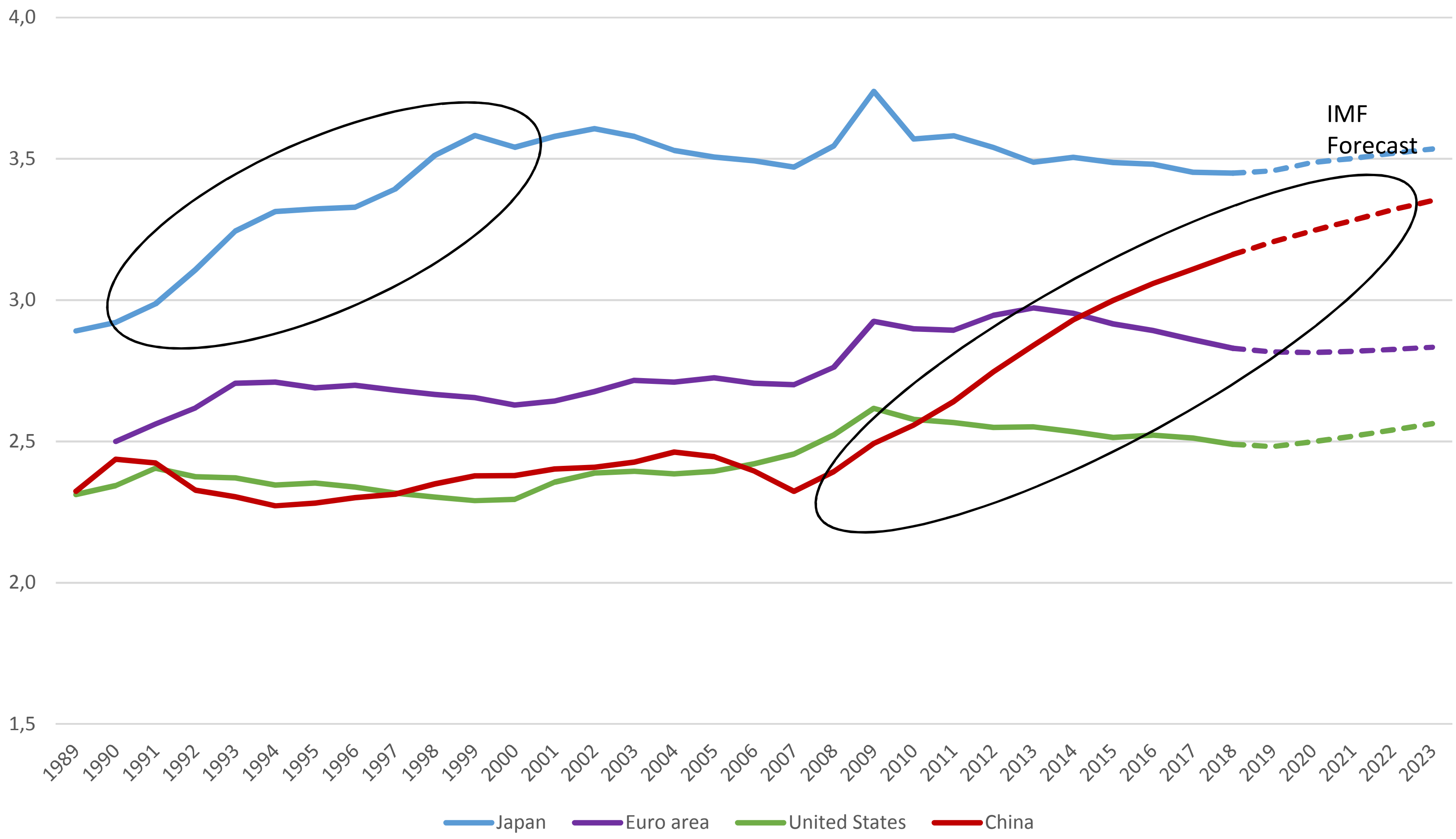
If growth falls investment rate should fall.

See table

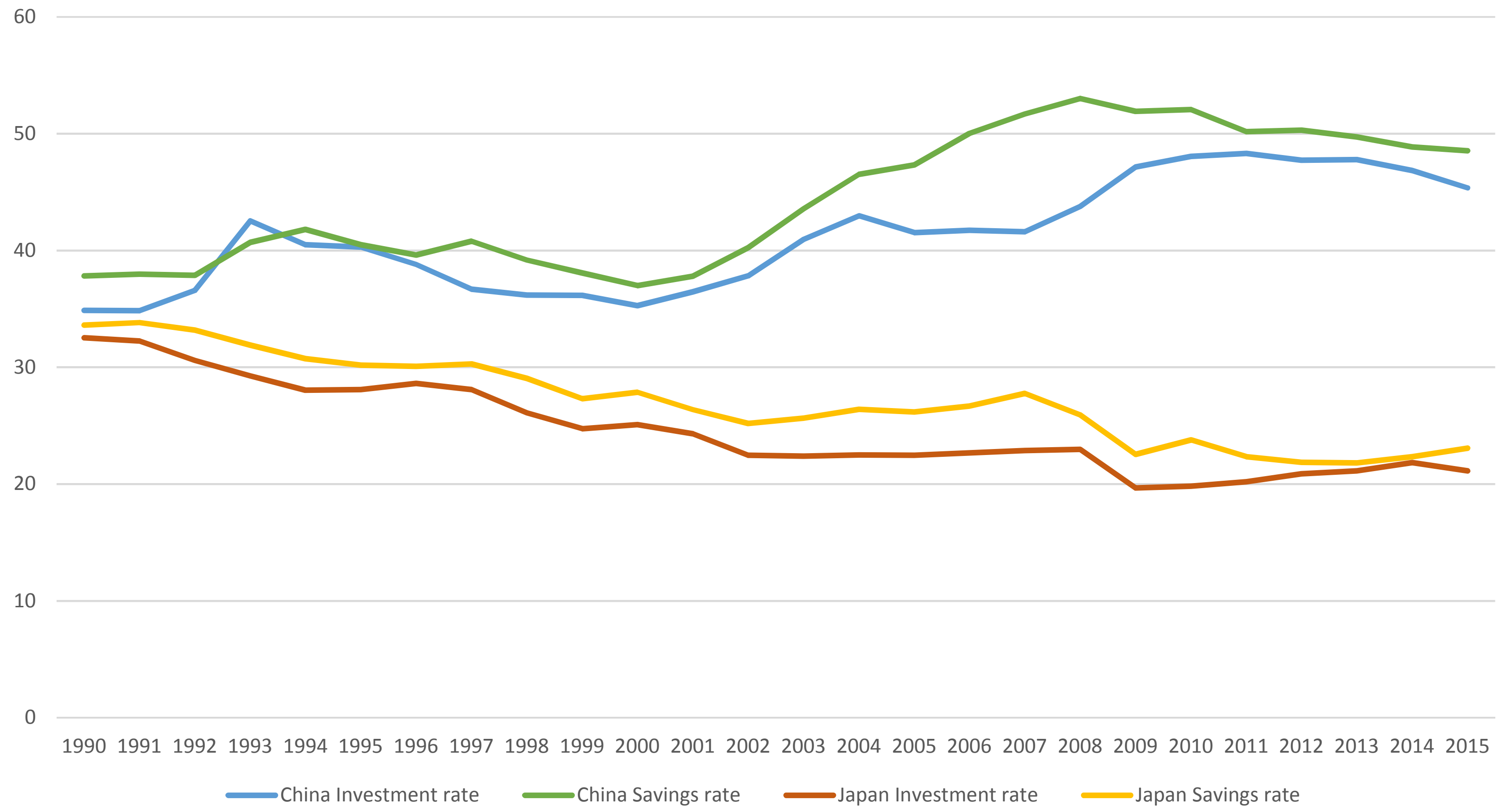
Steady-state capital-to-output ratio Result of combination of growth and investment rates

I/Y / *g*	*20*	*25*	*30*	*35*	*40*	*45*
10			1.9	2.2	2.5	2.8
8		1.8	2.1	2.5	2.9	3.2
6	1.7	2.1	2.5	2.9	3.3	3.8
4	2.0	2.5	3.0	3.5	4.0	
2	2.5	3.1	3.8	4.4		

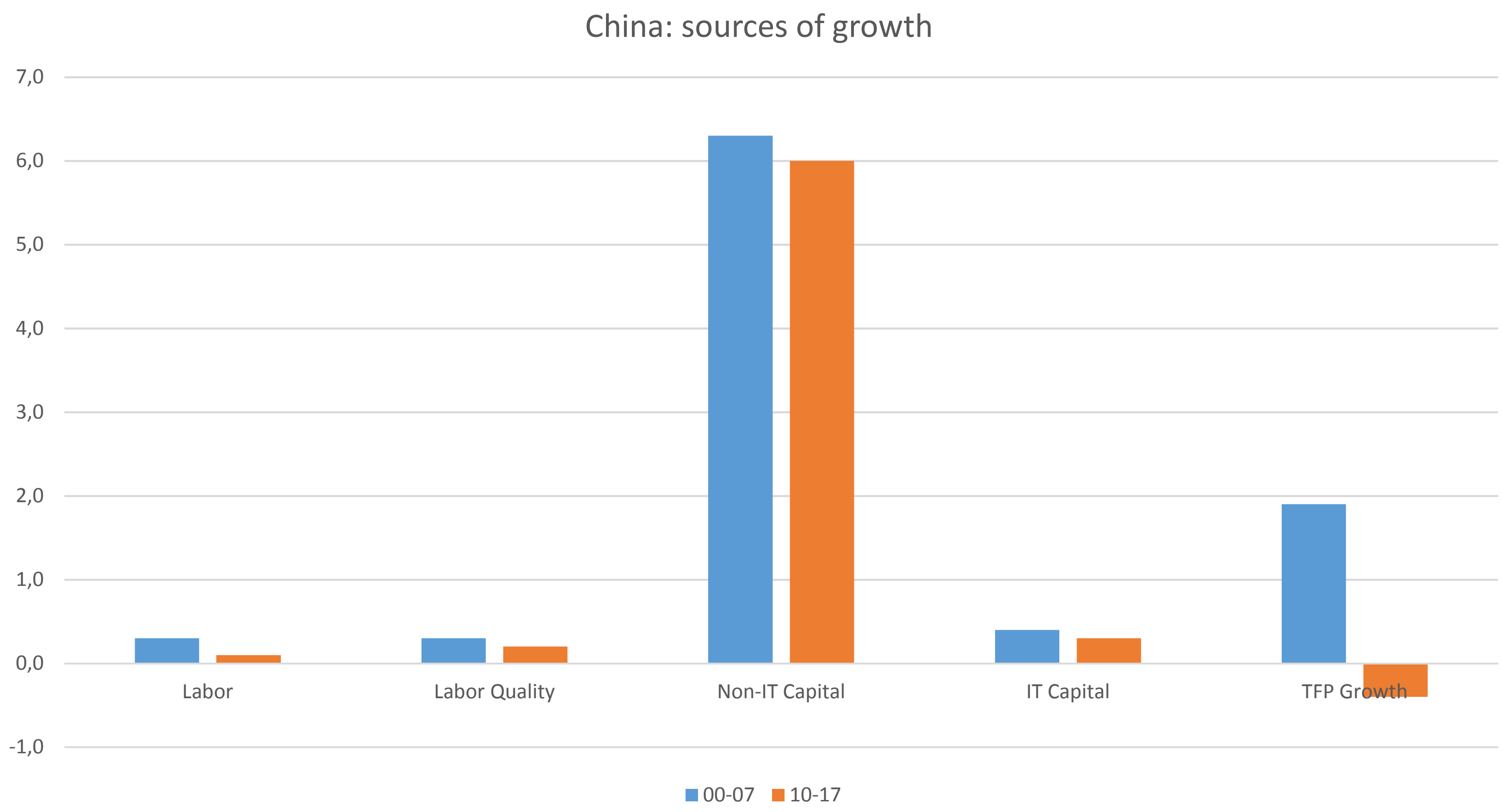
Capital output ratio across the G-3 and Japan



China beats Asia’s other high savers



Another take on role of investment in growth: low TFP



Conclusions on Chinese growth model

- Domestic savings of 45 % of GDP cannot be productively invested in an economy which grows at less than 10 %.
- Private sector will invest only with leverage.
- Keeping investment up today (seems preferred policy choice) => low return today and less demand tomorrow!
- SOEs: used to be seen as drag on growth, now suddenly as drivers!

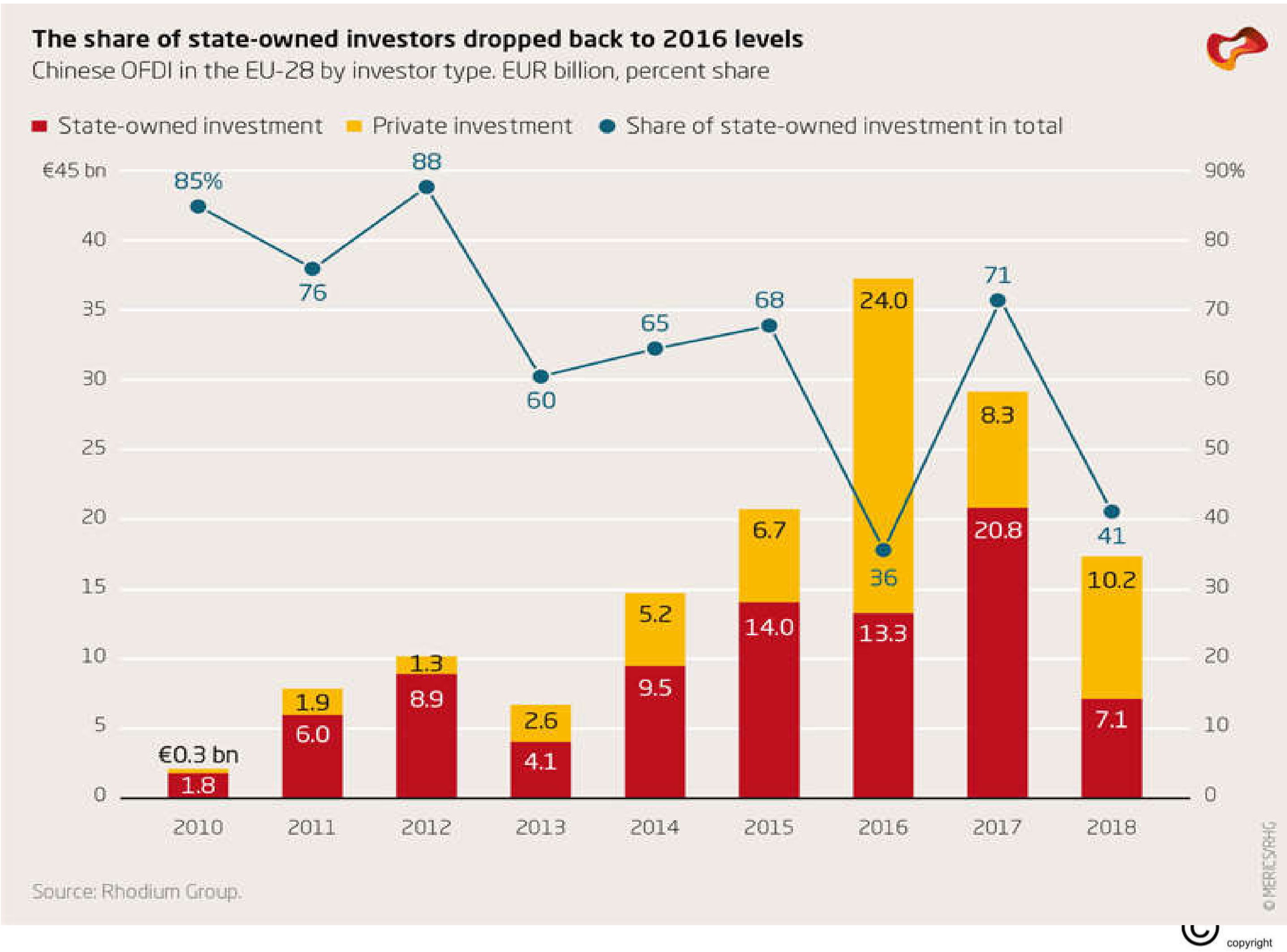
Belt and Road: geo-strategic competition

- Most states along Belt and Road poor and corrupt, of little interest to EU, economically or politically. (Big hole in BRI: India)
- Can buy allegiance as long as new credit flows, but allegiance wanes when debt has to be serviced.
- BRI investment in Europe small, mostly in Balkans. Strategic? Piraeus port as example?
- Best 'counter'-strategy: strengthen ties with India (much bigger economy than rest of BRI) and avoid competition in cheap funding.

Conclusions on EU China policy

- On trade: Europe should not be afraid of competition. Idea of FTA remains valid (alternative join TPP-11). https://www.ceps.eu/ceps-projects/tomorrows-silk-road-assessing-an-eu-china-free-trade-agreement/
- On investment:
- Outbound: would like China to open more sectors, but returns on existing investment still respectable.
- Inbound: much ado about very little
- http://trade.ec.europa.eu/doclib/press/index.cfm?id=1993

China buying up Europe?



Overall Conclusions

- China has very strong fundamentals, but recent growth mainly capital intensity based, thus likely to decelerate.
- Should not be afraid of 'state directed' growth, certainly not imitate.
- There are many Chinas, the part at EU level is already as large as Japan – China will become unavoidably a major technological power.
- Little danger from inward 'state sponsored' FDI.
- Developing EU cyber defenses and integration of telecoms markets (frequencies!) best way to safeguard 'cyber security'.