

China-US Relations: Economic Implications for China and HK

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Why has China (since 1978) been successful

Not the development strategy *per se* which is just the neo-classical, market-oriented model/policies recommended by the World Bank and IMF, the so-called **WASHINGTON CONSENSUS** (Williamson 1989):

1. Prudent, pro-growth fiscal policy
2. Market-oriented interest rates and exchange rates
3. Deregulation of market controls
4. Opening up to trade and investment with liberalization
5. Privatization of SOEs and protection of private property rights

The Actual Reasons (1)

The BEIJING CONSENSUS (not as Ramo 2004) Chinese Economic Model (CEM as Chen 2011):

Implementation Strategy –

The Sequencing (次序) of reforms

1. Economic before political
2. Rural (responsibility system, TVEs 鄉鎮企業) before Urban (SOEs 國有企業 and price reforms)
3. Current before Capital accounts in international payments
4. Financial development before liberalization/internationalization
5. From coastal to inland

The Actual Reasons (2)

The Speed of Reforms –

A gradual, experimental, evolutionary approach (not ‘Shock’ or ‘Big Bang’ as in Eastern Europe and Latin America) 摸著石頭過河

1. Special Economic Zones in selected locations
2. Gradual liberalization of international trade and investment by regions and sectors
3. Gradual liberalization of foreign exchange and interest rate
4. Gradual liberalization of capital markets
5. Gradual reform of SOEs, prices, privatization and decentralization

The Facilitating Factors

1. Demographic Dividend (until 2012) 人口紅利
Working population rising, dependent population stable
2. An era of trade liberalization and globalization from 1980s until recently, from GATT to WTO (China admitted in 2001)
3. An era of regional integration and cooperation: ASEAN, PECC, APEC, multilateral FTAs 多邊自由貿易協議 facilitating regional division of labour – the ‘Flying Geese Theory’
4. Hong Kong’s economic transformation and participation

Prospect 前瞻

Growth of the First Reform and Opening Up losing steam from 2010, entering the 'New Normal' 新常態 and 'Middle Income Trap' 中等收入陷阱

The Second Reform and Opening Up has to overcome:

1. Structural constraints – from manufacturing to modern services, from investment to consumption, from 'perspiration' to 'imagination' (innovations), from trade to financial liberalization, from a dual 雙軌 to a neo-classical 新古典 economy
2. Institutional constraints – government administrative reforms if not yet for political reforms, transparency of policy-decision making, democratization at the local level, a competitive environment for SOEs versus private enterprises and among enterprises

Unfavourable International Environment

1. Geopolitics 地緣政治

USA versus China for supremacy resulting from China's Rise

2. Anti-globalization or Anti-multilateralism leading to trade and investment protectionism

3. Anti-elitism and populism 民粹主義 resulting in a less stable and predictable political and social environment worldwide

4. Probable global financial crises resulting from financial over-expansion and quantitative easing policies

Why US Trade Wars with China

Long Term and Fundamental: US to maintain supremacy

Short-term and Personal: Trump to divert attention, to get re-elected

Trade is only part of the total strategy to contain China

Technology and military supremacy are primary: China 2025 is a target; IP and technology transfer the key negotiation issues

Geo-politics is important to halt the expansion of China's influence overseas: Belt & Road is a target, VP Pence – B&R is a road of no return (for the participating countries)

China-US Trade

China-US trade imbalance is exaggerated:

2017: \$375.2 bn (505.6 – 130.4); 2018: \$419 Bn (540-120)

US deficit should be adjusted by import/export measurement (US: exports on f.a.s. and import on customs basis; China: export on f.o.b. and import on c.i.f.), US-China trade via HK, domestic value added contents in exports, resulting in about \$200 to 300 bn. Also, 30% of China's exports by foreign companies; 60% of trade surplus with US from US companies operating in China; \$54 bn services deficit of China with US. **“China runs a surplus in trade with the US, while the US enjoys a surplus of benefits”- Dept. of Commerce, PRC**

Overall, China's trade surplus only 1.4% of GDP or \$168 bn.

Importance of Trade

The direct impacts of trade for both China and the US are actually not that significant.

In 2017 – China's exports (goods and services) to the world was 18% of GDP, to the US only 3.5%.

In 2017 – US exports to the world was 12% of GDP (8% goods, 4% services), to China only 0.97% (0.67% goods, 0.3% services)

The direct impacts on HK is also insignificant

China-US entrepot trade via HK in 2017 was just 9% of HK's total export and import trade and a majority of the items under trade war so far were not via HK.

Importance of US-China Relations

US and China are the two super powers (if not G-2, it is G.15).

Any worsening of their relationship will impose secondary, tertiary, effects on the world economy in general and the economies concerned in particular, including Hong Kong.

Any trade war and economic conflicts and uncertainties will lead to shrinking of world trade, financial market instability, capital outflow from emerging economies, business, consumer and investment pessimism, diversion of resources to military expenses, etc. **History repeats itself?**

Adverse Impacts on US

- 1. Manufacturing costs rising with higher semi-manufacture imports, hurting both exports and domestic consumption.**
- 2. Consumer prices rising with higher consumer products prices.**
- 3. Less profits for US companies operating in China.**
- 4. Falling exports (esp. soya bean, natural gas, aircraft, cars).**
- 5. Trade balance will not improve. US trade deficit is structural: negative savings, non-competitive lower-end manufacturing, restrictions on hi-tech and strategic products. US will have to buy at higher costs from countries other than China.**
- 6. Hurting the long term China market potentials; US and China economies are actually highly complementary.**

Adverse Impacts on China

- 1. Exports reduction**
- 2. Deterioration in business environment**
- 3. Technological progress hampered (China 2025?)**
- 4. Replacing agricultural and energy imports by domestic production at higher costs**
- 5. Making Belt & Road Initiative more difficult**
- 6. Slower growth than 'new normal' will generate political and social pressure**
- 7. Greater impacts on faster growing regions undergoing reform, thus affecting the Second Reform and Opening Up strategy**

Adverse Impacts on Hong Kong

Mainly from the indirect impacts on business, consumer and investment environment, and financial market uncertainties.

Consumption and investment reduced, higher costs of borrowing.

Any slowing down of the Chinese economy will reduce demand for HK's modern services (banking and finance, professional and technology services, logistics). US-China trade war affects more China's export-oriented and fast growing regions next to Hong Kong.

Escalation of the trade-war will decrease the demand for raw materials and semi-manufactured by China, thus affecting HK's re-exports to China from countries other than the US.

Prospect: Who is Winning

**Not really decided by economics and the trade war *per se*,
But more by the internal political within China and US, and the
changing geo-politics – Politics takes Command**

My surmise is:

***The current war will end in a messy way: not as much as 25% on
all China's exports, China will commit to importing more and
undergoing some structural and institutional changes.***

***China will win the battle in the shorter run, but lose the war in
the longer-term; this is perhaps not too bad for China in the very
long run.***

Prospect: What can Hong Kong do?

1. Deepening and widening economic cooperation and integration

Hong Kong is too small to rely on itself to defend economic recession and instability, too small to capitalize on the opportunities offered by the 4th industrial revolution and further develop its modern services. The island small export-oriented development model is no longer valid.

The Greater Bay Area can be the rescue, given that Belt & Road will face great difficulties. The GBA must be towards a common market concept (interflow of resources, interaction, interconnectedness).

What can Hong Kong do?

2. Market diversification

Southeast and South Asia (ASEAN especially) and later Africa.

3. Supply-side productivity

Land and Housing (land supply equals housing supply?,
domestic demand equals market demand?)

Technology Policy (is a technology eco-system well in place?)

Education and manpower (is STEM enough? How about HELP^R)

Thank You and All the best