China and the United States

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Two Superpowers in the Global Economy 美中两强经济研究

Edited by

Sedat Aybar, Shixiong Cheng, Hugh Dang, Andreja Jaklič and Jian Lu

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PREFACE

This book seeks to analyse dynamic nature of foreign direct investment (FDI) within a dynamically growing economy, China, in connection with a dynamically changing global order linking to the United States' economy. Hence, this book is not yet another one on China merely aiming to explain its ascendance in importance in the realm of global FDI. Readers will detect from the start that the book goes beyond answering a single question on a narrow analytical base about the drivers of China's global presence. The book particularly draws attention to the governing arrangements of the Chinese FDI system within a set of bilateral interactions and emphasizes that they are not quite what they seem. Along the way, it raises some questions, mainly about transformation of China's FDI, whether it has changed with the change in its governing geometry. Finally, the book underlines that the Chinese FDI, as it stands now, for better or worse, is not all that it should be.

Overview of Chinese Foreign Direct Investment

Inward FDI in China has changed dramatically as wages continued to rise and the economy began to mature from a manufacturing basis to be on a consumption and service basis. It is widely reported that Chinese inbound FDI fell nearly 30% for about US$ 170 billion in 2016 from US$242 billion in 2015. The Government responded with a set of new reforms to encourage FDI inflow that would help China to transform its economy to a higher level one within the global value chain. These reforms include reducing market entry barriers for foreign investors; formulating new fiscal policies that would support private sector; improving investment environment of national-level development zones; easing up of entry and exit of foreign workers; and improving the general business environment. Such reforms did not only help increase FDI in China's central region and in high-tech manufacturing but more importantly they were also indicative of a libertarian shift from a more egalitarian economic system.

One could also argue that the new government directives were issued as a part of a progressive political strategy in defence of a stronger global presence. These reforms aimed to advance Chinese manufacturing technology; to improve Chinese high-tech and research and development centres abroad; to secure supply chains in raw materials and energy sources, such as oil, gas, and minerals; to encourage trade, culture, logistical services as well as finance. Reforms, therefore, had also helped to launch on a global scale a more moral and economically equitable stance.

The reformed business environment in China, intentionally or not, brought about arrangements that helped harmonizing inward FDI with China's "Going Out" strategy, now, in its new guise, in the form of One Belt One Road (OBOR) Initiative. Inward FDI is expected to support and encourage smooth progress of investments in the OBOR related projects and infrastructure. In this respect, China's outward FDI flows to the world are not the same as it was for the last two decades. It is also possible to assert that, the OBOR initiative was launched as a Chinese response to the inequitable, unsustainable and unjust "globalisation" that was underway since the ending of the "cold war".

The OBOR initiative announced in 2013 by President Xi Jinping has two main components: Silk Road Economic Belt and the 21st Century Maritime Silk Road. The Silk Road Economic Belt connects China to Europe (via Central Asia) and North America, the Persian Gulf, the Mediterranean (through West Asia), and the Indian Ocean (via South Asia). The 21st Century Maritime Silk Road is planned to create connections among regional waterways. The OBOR aims to establish a modern equivalent of ancient Silk Road by creating a network of fast train tracks, roads, pipelines and smart cities on its destination. This initiative comprises more than physical connections as it also aims to create the world's largest platform for economic, social and cultural cooperation, including development policy coordination, trade and financing collaboration.

As the OBOR grounded on a more concrete footing, foreign investors took cautious approach to investing in China, while outbound investors have become more robust. As China was a capital importing country ever since 1998, the recent surge in its outward FDI initially raised some concern about its future inspirations as a global power. This development was not ignored by the government as new initiatives launched by President Xi Jinping's administration, particularly after the 19th National Congress of the Communist Party of China in October 2017. It is safe to propound that China's "going out" initiative progresses along a larger business reform agenda. In this conjuncture, Chinese investors are provided with new incentives to focus on their investments abroad on a variety of initiatives.

By the same token, central authority has been extremely careful in its new design of global economic policy. China sought to optimize the inter-relation between public and the private sectors on an egalitarian base while pursuing a more libertarian market orientation.

For instance, the increase of outward FDI in 2016 compelled the government to impose new arrangements in the form of capital controls. These restrictions were introduced following “irrational” increase of acquisitions by domestic firms abroad, most of which were financed through loans from publicly-owned banks. The government aimed to prevent the importance of “Grey Rhino” firms by restricting investment abroad that threaten national security or interests; investments in military technology and products; as well as investments into the gambling and sex industries.

These restrictions on outbound FDI have slowed outflows in 2017 but outward FDI in the OBOR projects increased. Since the OBOR initiative now engraved into the Constitution and projects are more smoothly approved by the officials, it is more likely that the New Silk Road investments will increase more rapidly. Accordingly, China also needs to transpire its economic policy and instigate strategies in harmony with its position as a global economic powerhouse, which goes beyond the OBOR.

But all of these are happening during a pivotal point in the Chinese economy. As gross domestic product (GDP) growth continues to slow down, industrial output drops and wages rapidly rise, the Chinese economy evolves, shifting away from an investment and export-led economy. Increasing competition from other developing countries and concerns about the volatility of the RMB after a six percent drop in 2016 has further motivated the government to pay attention to the commodity prices, international trade flows, and automation in order to fine tune the economy. On the other hand, it is likely that, in the near future, we will witness an acceleration of outward FDI as Chinese companies adoptive to the new regulations and refocus their efforts upon “encouraged” sectors. Briefly, Chinese FDI will become an important feature of its economy.

China and the US: two types of economic globalisation

This book tries to uncover and elucidate the ways in which such FDI led economy would function. However, before we focus on how this is done in the book, we need to look at the current global conditions under which

China’s FDI had increased in political importance and economic significance.

In this respect we can start with the more telling evidence captured in President Xi Jinping speech at the World Economic Forum in Davos, Switzerland in 2017. There he delivered a “historic” and “enlightening” speech for a “community of shared future for mankind” and embraced more equitable globalization, implicitly criticizing the current state of affairs around the globe. He was hailed by the mass media as the sole champion of globalization. However, his speech was countered by the U.S. President Donald Trump’s in 2018, again in Davos, where he emphasized that “America first” does not necessary mean “America only.” In fact, the clash of ideas between a “shared future” and “America first” reflects a tug of war between two types of economic globalisation.

Before focusing on that tug of war, just to remind the reader where the main thrust for the idea of “global village” came from, we need to reflect back to the collapse of the Union of Soviet Socialist Republics (USSR), in the beginning of 1990s. The idea of “globalisation” there and then was organised under the banner of ‘neo-liberal’ economics while it has claimed victory over socialism. The process was helped by technological progress as it has facilitated transformative changes in labour markets. Resultant outcome was a growing precariat, unstable and insecure labour market, declining and increasingly volatile real wages, loss of social provisions and a chronic indebtedness of individuals. In the developed world, such as the United States and others, the shifting of production to China has inaugurated a system of financial leverage that led to the erosion of middle class there. Consequently, relatively steady sharing of national income between capital and labour has disappeared. Instead ascending “rentier” class flourished from the proceeding of the ownership of physical, financial and intellectual property. While unequal income distribution has deepened so did the resentments. The mixture of anxiety, incongruity, alienation and fury helped populist politicians to play on xenophobia to build support for their extreme right-wing agendas.

In such a fractured world, a more equitable economic globalisation proposed by President Xi Jinping received a stronger acceptance from the intellectuals and the media, both in the West and in the East. It was argued by many that a collaborative setup not only evades negative impact of globalisation, but it can also help deliver its benefits to all nations.

In contrast, the United States and the European Union leaders of the post-cold war globalisation were criticized for pursuing their own interests at the expense of others. Such globalization did not deliver what it has promised. Instead, it has led to deeper divisions between and within nations, it brought about greater income and gender inequality, poverty, disease, environmental degradation, migration, domestic and international wars and terror. All of these cannot be explained merely around lack of good governance, corruption and mismanagement, even though none of these can be automatically dismissed as they all contributed to the despondency.

Boomerang brunt of globalisation came back to haunt debt burdened, foreign trade and budget deficit clenched American economy. The new administration's response to the misery brought about by "globalisation" had been rather dramatic. The United States Administration came up with policies to counter negative impact of globalisation by building a wall on its southern border, stopping migration, increasing tariffs on some strategic commodities, reducing corporate taxes and implementing a kind economic nationalism.

It appears as though the world has a choice to make or break between two types of globalisations. On the one hand, it exists in the Chinese led globalisation at the heart of which lies the idea of reviving what can be viewed as the manifestation of ancient globalisation, the Old Silk Road, or the Western led, and the other less equitable more market driven globalisation.

Nevertheless, in this book you will read analysis that helps you to understand that the Chinese-led globalisation is not the problem free. Despite President Xi Jinping's impressive and assuring speech in 2017 Davos meeting, it is still unclear how China will open its markets. On the other hand, China is aware that a historic opportunity to achieve its reawakening is at her doorstep. The opportunity for "Socialism with Chinese Characteristics" to rise in importance and provide attraction from around the globe is within reach for the current leadership. As expressed by President Xi Jinping at the 19th National Congress of the CCP, "China has been working for such an opportunity for the last six decades and it is now time to grasp the chance". Tiezzi (2018) reports the views of China specialist Bill Bishop, which captures this situation:

> *President Xi Jinping sees a remarkable opportunity, enhanced by the Trump presidency and its "America First" policies, to reshape the global*

> *order in ways that legitimize the Chinese political system and create more strategic advantages for China.*

Correspondingly, the Chinese government's new policies as explained above have now set the stage for significant shifts in the global economy. Although buying spree slowed down dramatically in 2017, the Chinese FDI still remains an impressive force. Since 2008, Chinese companies, both state-owned and private, dramatically expanded their foreign presence.

About this Publication

Chinese transformation particularly when contemplated within its unusual external milieu proves to be an important subject of investigation. This book exactly does that. In the book such investigation attributes to three important areas of interest to answer the question of why China's dynamic transformation has weighty potential to influence the global economy.

The first area of interest is covered by the selection of articles in the first section of the book. That section investigates the interaction between China and the United States to reveal existing potential for reshaping the global value chain within a highly competitive environment. In this respect China's OBOR initiative is the most prominent area whereby tensions can arise and can be resolved. As far as the OBOR is concerned, Chinese firms are not only investing heavily in infrastructure along the proposed routes, but they also invest in other assets, such as natural resources in frontier markets. The first section of the book scrutinizes Sino-American economic competition vis-à-vis the third parties in East Asia and beyond and in the areas involving new type of assets.

Following on that, the second area of interest rests in the details and particulars of trade and the FDI. By this token, the second set of articles in the book focuses on two interrelated and important spheres, namely nature of labour and the way in which it is organized in the production process. The book investigates the nature of labour process within the spectre of government's new goals that aims to move China up the global value chains. In this respect, outbound FDI is expected to increase competitiveness of Chinese companies, as opening up to foreign markets would provide much needed growth opportunities. Thus, high-tech and advanced manufacturing firms are given priority and placed on the "encouraged" list for outbound investments. The support given to the high-tech sectors is done so with the hope that they would help enhancing

Chinese competitiveness in the global economic realm. This would necessitate knowledge and technology transfers to promote efficiency and innovative capacity of Chinese firms. However, such advancement also has the potential to create trouble spots with the governments of foreign competitors.

The third set of articles aims to tackle the rising geopolitical tensions around strategic sectors and the way in which regulations for arbitration can be established. No doubt in the near future geo-political tensions amongst global powers in the world will be shaped around growing Chinese FDI. But the prospect of growth in China's FDI from 2018 and beyond is likely to face growing resistance. The scope of resistance will be established primarily within the price mechanisms, currency wars, supply of money and stock market volatility in the countries concerned. The articles in the third part of the book carefully scrutinize the FDI procedures whereby such geo-political and geo-economic tensions might occur. Since many Western governments have become increasingly cautious of the influx of Chinese investments in high-tech, infrastructure and natural resources they inaugurated stringent screening programs for such strategic sectors, as is the case with the EU. Americans also expanded the criteria used to review foreign investment in the United States for inward FDI deals. The way in which China handles its FDI scene in tackling with such restrictions will be at the heart of economic, political and legal debate during 2018 and beyond.

Finally, this book could not have been possible if a group of dedicated academics and writers from around the world did not co-ordinate their efforts. Hugh Dang, the editor of the Transnational Corporations Review (TNCR) with his endless energy is the locomotive power for such co-operation. The Earth Institute of Columbia University in New York, United States has been the main hub in producing high quality and cutting-edge research, not only on China but also on other Emerging Markets' FDI. As well as Guangdong University of Finance and Economics in Guangzhou, and Renmin University's Chongyang Institute for Financial Studies (RDCY) are important venues in producing up to date and high-quality research. Istanbul Aydın University's, China Study Centre, in Turkey is lined up to contribute these efforts. Nevertheless, the task at hand is vast and this book by articulating cutting edge research and investigation helps us understand Chinese FDI in its multi-layered complexity.

Reference

Shanonn Tiezzi, (2018), What China's Davos Coverage Reveals about Its Global Ambitions, (2018/ 01/30), The Diplomat, https://thediplomat.com/2018/01/what-chinas-davos-coverage-reveals-about-its-global-ambitions/ accessed on 2018/02/20.

Note: This Preface is contributed by Professor Sedat Aybar, Director of China Study Centre at Istanbul Aydın University in Istanbul, Turkey.

INTRODUCTION

The relationship between China and the United States (U.S.) has always been complex to understand. Sino-U.S. relations have evolved from an “ice age” toward a constructive manner resulting in a composite mix of intensifying diplomacy, growing international rivalry, and increasingly intertwisted economies. A lot has changed since the first diplomatic relation and formal ties between China and U.S. were established in 1979. Not only within the two superpowers, but also around them and especially the modes how these two superpowers influence the world and regions around them. Some countries may be more interested in developments only in one or another of the two superpowers. According to the 2016 World Trade Organization (WTO) Trade Profiles, the U.S. is the top trading partner for 25 countries. Meanwhile, China is emerging in this area and is currently the leading trade partner for 30 different countries, being the second in the world behind the European Union with over 80 countries. Yet, even if neither China nor the U.S. is among their leading trade partners, there is hardly any country in the world that could not attach importance to their bilateral relations. As the most important relation in the world, it concerns the prosperity of the two countries and that of the rest of the world. Especially now when it seems that the U.S. is stepping back from playing a leadership role in support of a more open global market and there are profound concerns across the world about the negative impacts of globalization on income inequality.

China’s Changing Integration

The changes within the two largest economies in the world, especially rapid changes in China, and in their bilateral relationships are evolving ever faster. These have been encouraged by several reasons from the extensive transformation in the production and trade pattern, technological change to political shifts. After China’s 2001 membership in WTO, the trade and foreign direct investment (FDI) statistics show a massive surge. In 2009 China overtook Germany to become the world’s largest exporter. In 2012 China overtook the U.S. to be the world’s largest trading economy, in terms of exports plus imports. By 2013 China also emerged as the world’s third largest outward investor after the U.S. and Japan, and the first among emerging markets. China increased its share of global manufacturing value output from 3% in 1990 to 25% in 2015. Recently, it produces 80% of global air conditioners, 70% of global mobile phones, and 60% of shoes (Economist 2015).

Moreover, with China becoming global in industries and other several areas, more changes are coming soon. The booming e-commerce in China market and outside China is next excellent example, where China goes faster than the rest of the world. While e-commerce was worth some US$100 billion and representing only 3% of private consumption in 2010, by 2015, it had reached US$600billion and 15% of private consumption. According to Boston Consulting group estimates (2016, The New China Playbook), e-commerce is set to further increase three times to 1.6 trillion USD by 2020, representing a 24% of private consumption with 75% of it driven by purchases through mobile devise. Recent data on trade and investment are showing a growing volatility in the last few years. Changes in volume, direction and the structure of trade, investment flows, greater embeddedness in global value chains (GVCs) all influence the competitiveness and dynamics of growth.

The awareness of these changes often comes with delay, but it has been increasing recently. The perception considered to be the leading world's economic power has been changing rapidly. As reported by the Pew Research Centre these perceptions are changing even faster outside the U.S. and China than within the two great powers. The 2017 analysis of global attitudes and trends showed that in the U.K., Germany and Spain now more people see China as the leading economic power. According to the Global Attitudes Survey, China in 2017, China again surpassed the U.S. as a leading economy. In seems that "The challenge from a changing China" due to its rising wealth and status as well as global actorness is more perceived in Europe than the U.S. The EU-China 2020 Strategic Agenda for Cooperation is thus central to the EU's long-term bilateral relation with China. More and more countries see growth opportunities with China in this world.

Simple indicators on growth, trade and investment dynamics may (still) hide the magnitude of qualitative changes and the benefits achieved by greater international exchange and may lead to fears or misleading conclusions. Understanding all these changes remains ever greater challenge and calls for further analysis. One of the approaches to recognize the extent of China's integration with the global economy and its co-dependence with its trading partners, discussed partly also in this volume, is possible through GVCs. According to the United Nations Conference for Trade and Development (UNCTAD) (2015) China was ranked 6th in the world in respect of participation in GVCs, well above Japan (51st) or the U.S. (45th). The China's role in the GVCs was to process goods imported from elsewhere for exports, since the difference in value added between merchandise import and export was only 11.2%. China's relevance as input provider increased rapidly.

Yet, the vast agglomeration of manufacturing capacity assembled in China since 1990 has been continuing to attract manufacturing activity. However, China is moving from this role in international division of labour, with the rise of wages and other costs. As China's low-wage advantage erodes the new economic geography framework predicts a dispersion of activity beyond China – not a disappearance. Interesting insights regarding the nature of the participation of the world's major economic blocs in GVCs arise also from the data on re-exported domestic value added in imports. This can be used as a rough measure of a country's involvement in upstream stages of a GVC, i.e. its involvement in the initial phases of the production chain. These stages can refer to different kinds of activities from the production of raw materials to design and research and development (R&D). Between 2000 and 2011, in its post-WTO status, China experienced a progressive 'upstreamness' of its exports (Antras et al., 2012). Its foreign value-added in exports (measured as a percentage of extra area exports) rose from 17,3 to 21,6. It is also important to refer to the role of China as a source of value added (Amador and Mauro, 2015).

Made in China vs Made in America

This progress is changing the relations among world's major economic blocs, in particular the relation between China and the U.S. According to the U.S. Bureau of Public Affairs "*the U.S. approach to its economic relations with China has two main elements: integrating China into the global, rules-based economic and trading system and expanding the U.S. exporters' and investors' access to the Chinese market.* Two-way trade between China and the U.S. has grown from US$33 billion in 1992 to over US$648 billion in goods and services in 2016. China is currently the third largest export market for the U.S. goods (after Canada and Mexico), and the U.S. is China's largest export market. The stock of the U.S. FDI in China was US$75 billion in 2015, up from US$54 billion in 2012, and remained primarily in the manufacturing sector. "*During the July 2017 meeting of the U.S.-China Comprehensive Economic Dialogue, the two* *countries discussed measures to expand opportunities for U.S. firms in China and made progress on important issues."* (U.S. Bureau of Public Affairs. 2018)

At a recent time, however, changes often produced fears and tensions, induced also by some analysis, which placed extra emphasis on negative effects of this economic relationship. In the U.S. the rising trade deficit, a flood of goods "Made in China" and lost jobs have been arising concerns over merging markets and have been often accompanied with inconvenience or even hostile rhetoric. In *Death by China*, Navarro and Autry (2011) claimed that China has damaged the U.S. economy by stripping manufacturing jobs, through "unfair competition". Fears have often come out from one-sided or limited perspective without the international market analysis, so holistic approaches to examination are increasingly necessary for economic policy to maintain the benefits of globalisation and open international trade. Navarro and Autry ignore that American multinationals are key producers of Chinese exports to the U.S. and those Chinese exports has a significant "Made in America" content. Though the label Made in China is globally present, Chinese made goods present just a fraction of Americans buy daily. Jeremy R. Haft in his book, *Unmade in China* (2015), explained that U.S. – China trade has largely benefited American business and consumers. Exports and investment with China support 2.6 million jobs and US$216 billion in gross domestic product (GDP) in 2015. Chinese imports also lowered prices that Americans pay for consumer goods, allowing them to damp inflation and put more money into their pockets.

While some in the West see China's resurgence as a threat, others see a more benign mixture of market reforms supporting inclusive economic institutions and boosting productivity, combined with the power of centralised political system (Accemoglu and Robinson, 2012). Future discussion on balanced development will no doubt involve the several issues of regulation, including transparency, industrial policies, electronic payments, commercial banking, tariffs and non-tariff measures that discriminate against foreign companies and protection and enforcement of intellectual property rights. Holistic analysis and wisdom are necessary in future trade policies among all major trading blocs. China is in the core of global trade networks. Yet China has not only experience from opening since the recent five decades, but thousands years of experience and knowledge (gained before till 1840), how vital is international trade for growth and development of the world. This book adds rich insights into several above mentioned issues without focusing only on Western perspectives.

The book may thus not only help understand the complexity of relationships, but also opens new horizons to challenges and opportunities for future benefits of cooperation. Several chapters discuss optimistically the approaches and areas for building constructive relationship between China and the U.S. and also stress the importance of mutual learning. The experts' community is well aware that both China and the U.S. have a common responsibility for advancing a global development. The theory teaches us to move forward from mercantilist views toward other trade models that follow better the recent developments in trade. One of the best-known tenets of the "new trade theory" is that countries trade more as they get larger and more similar in size. This suggests that the rapid growth of emerging markets will create more trade than it displaces. Mutual exchange between the U.S. and China has grown and changed toward rising intra-industry and intra-firm trade. Exploring the trading behaviour of individual firms and links between trade and productivity and innovation within the new theories highlight potential benefits and calls for different policies; the gains from trade in new realities may be even larger than they have been in the past, yet we need much more consultation strategies and face much more demanding regulatory coordination.

Volume Summary

The summary of the fifteen individual chapters does not reflect the richness and the quality of the individual contributions and cannot substitute reading. It rather introduces the structure of the analysis given in this volume. The three parts of the volume look respectively at the economic relations between China and the U.S. from both perspectives, continue with the country level insights into the consequences of international trade and investment, and followed by the economic and policy debates. Each of these parts offers five chapters; four theoretical or empirical analysis with a relevant case study.

The set of papers on long-term political and economic relations and macroeconomic analysis in the first part helps the reader to understand the contexts of the current relationship between China and the U.S. Wengui Zhou and Jia Liu in chapter one reveals the *Essence of the Sino-American Relationship*. A brief historical overview of bilateral relations offers insight into unbalances and clearly presents the opportunities and potential benefits of mutual cooperation. By contrasting tensions and potential benefits, accompanied by experiences on mutual cooperation the chapter concludes with optimistic prospects for future cooperation. Weiguo Xiao, Zhiwan Qiu and Wei Yuan in chapter two further explore the *Sino-American economic and financial imbalance* as well as the causes why the global economy become imbalanced on such a scale. A topic has become increasingly discussed especially after the global economic crises. According to their test, financial development and capital mismatch had different effects on Sino-U.S. economic imbalance from 1999 to 2013. External economic imbalance, reflected in the increasing current account deficit of the U.S. along with China's large and long-term trade surplus (against the U.S.) and China's net foreign assets along with the U.S.' net foreign liabilities, are related to internal economic imbalances of the countries. A continuous increase in Sino-U.S. economic imbalance is seen as a result of the capital mismatch rate of China's economic sector and financial service sector, which is higher than that of the U.S.

Huijun Yu, Nanyang Deng and Yanhong Zou in chapter three describe the *China's direct investment in the U.S.* A comprehensive review of investment dynamics, motivation for investing into U.S., major characteristics of investments as well as risks and barriers for Chinese investors is summed up along with policy and firm-level recommendations for Chinese direct investment in the U.S. in the future. In chapter four, Yibing Ding and Xiao Li reveal *China's role in the Asian Economy* and the projections about future changes. As an export platform in the Asian economy, or *Factory China* (as called in the West), China acquired many roles. It not only promoted the exports of capital and intermediate goods to other major Asian economies, but has also stabilized the fluctuations of the Asian economy and deepened the regional production networks under the U.S.-dominated global economic system. China's role in the Asian economy and the global economic system will be changing, especially with China's increased demand for final consumer goods from the region. Zifeng Wang, Liuling Li and Yueming Bai in chapter five presents *Deflation Threat in China*. China's decline in consumer price index since 2014 has been studied along with the U.S. Federal Reserve System quitting of the quantitative easing policy in the same year, in order to study the effects of the U.S.' monetary policy on China's price level through several channels. Their findings show that the U.S. quantitative easing policy as well as public expectations causes a deflation threat for China. Also, the influence transfers more quickly through the capital account than the current account. The response of China's price level to the U.S.' expansionary monetary policy through the capital account appears positive, but the response through the current account is negative.

Part two proceeds with empirical analysis of international trade and investment and policy implications based upon. Kai Liu, Shaomei Zhan and Yazhuo Zhu in chapter six discuss the effect of labour force heterogeneity on FDI through four different dimensions of heterogeneity, which are rarely studied simultaneously: namely health, education, wages, and population structure respectively. Panel data analysis confirmed that higher level of health, low level of wages a, the popularization of secondary education and the child dependency ratio all attract FDI inflows. The popularization of tertiary education does not show a significant effect; and the same was found for the old dependency ratio. In chapter seven Fangfang Wang and Zhexian Lan examine the relation between the Chinese outward FDI and export. Export arising and export-platform outward FDI had a significant effect on China's overall outward FDI, with a strengthening trend over the recent years. The analysis confirmed complementary relationships between exports and outward FDI in the same location, while this is not the case in the neighbouring countries. China’s outward FDI took an obvious agglomeration in the host countries, particularly in high-income countries. The results suggest the use of mixed strategy and combining exporting and FDI more flexibly, as well as targeted establishment of overseas Chinese business alliances. In chapter eight Xiaohua Feng and Zhecong Luo examine how trade pattern transition influences the wage gap. Since the 1990s, China’s manufacturing has changed from inter-industry to intra-industry trade, along with a huge expansion of the wage gap among 27 industries. They discuss policy recommendations for two key findings. Firstly exports increase the wage gap, while imports narrow it, regardless of the trade pattern. Secondly, the commodity price is the main channel through, whichever trade pattern influences the wage gap.

Jonah Bibo Liang in chapter nine discusses the actual value created in the international trade in China by the index of the value-added ratio of its processing trade. Value-added ratio in the processing trade is improving due to deepening involvement in the Global Production Networks, as well as due to technical progress. FDI also plays a positive role in lifting the value-added ratio, while the increase of labour in the processing industries does not have any positive effect. His findings imply that value position in the GVC can be strengthened “passively”, through reforming the institutional environment and raising the technical, which would lay down a solid foundation for the active role in the future. Chapter ten offers case study of *FDI in Russia*. Yudong Xu, Xin Zhang and Riming Cui analyse panel data of the different regions in Russia since 2001 and examine the determinants of FDI inflows. Strategic factors such as regional economic development, industry cluster, economic opening and technological innovation exert a significant influence on FDI inflow in different regions in Russia, while cost-related factors, such as tax burden and labour cost are not conducive (neither statistically significant) to FDI inflow. No statistical significance was found for factors such as system innovation, education and infrastructure. Finally, they discuss enlightenment for Russia's outside investors, such as China.

Economic and Policy Debates in part three start with the discussion on *the U.S. Quantitative Easing (QE) Policy on East Asian Economies*. Yijia Xu and Xiaomei Zhu in chapter eleven study the spillover effect of the U.S. QE policy on major East Asian economies. They find positive effect of the U.S. QE policy on most of East Asia's output, which maintains hard and soft pegs. Moreover, the U.S. QE policy brings an inflation risk to these economies and has a significant negative effect on the output and price level of the floating regime economies in East Asia, except Japan. From transmission channels, for selected hard and soft peg economies, the interest rate is stronger than the exchange rate, which it impacts within a short period of time. Through the trade channel, the U.S. QE policy can enhance output, while also easily promoting inflation. For floaters, both the interest rate and the exchange rate are all stronger channels than trade. Chapter twelve addresses *Imports and Productivity Growth*. Lin Wang and Yihong Tang investigate the import spillovers of developing countries and the existence of inverse spillovers. They confirmed that R&D spillovers from import trade are the main sources of total factor productivity growth for the Organization for Economic Cooperation and Development (OECD) and non-OECD countries, but find that the effects of international R&D spillovers are heterogeneous. Results show that positive spillovers through the imports originate from the OECD countries. Furthermore, the developed countries benefit from the imports of capital goods, while developing countries can only have spillovers from the imports of intermediate and consumption goods. These findings provide important implications for import policy for China and other developing countries.

Chapter thirteen moves to stock markets and examines the effectiveness of the stock connect program. Tingting Wu and Xiaoying Gao test how Shanghai-Hong Kong (SH-HK) Stock Connect contributes to the price difference between A-shares and H-shares. Factors which influence the studied price (asymmetric information, liquidity, demand elasticity, risk preference and the launch of SH-HK Stock Connect) are tested in panel regressions of 53 A-H share dual-listed companies. Findings indicate that the launch of SH-HK Stock Connect enlarges the A-H share price difference due to the limited investment quota, the differential trading amount and the short running period. The other factors have negative relationships with the price difference, consistent with the theoretical analysis. The authors design several policy proposals: the government should improve of SH-HK Stock connect and advance the launch of SZ-HK Stock connect, strengthen A-share investors' education, speed up financial innovation and establish an effective mechanism of arbitrage. Chapter fourteen discusses *Export Green-Sophistication in China*, to better understand the implication of China's growth from the world economy. Changqing Li and Jian Lu provide a theoretical and empirical analysis of the effects of R&D and financing constraints on the greening of Chinese firm exports. They construct an index of export green-sophistication by incorporating the green coefficient in traditional export sophistication and use China's industrial firm database. The study provides evidence that in emerging markets with a poorly-developed financing market, not only R&D limits firm's export green-sophistication, but also a firm's financing constraints will do so.

The last chapter explores the changes in e-commerce environment and the payment scene, where China constantly develops financial innovation. The third-party payment has rapidly grown and has motivated questions on regulation toward fund accretion. Xiping Lv presents Alipay as a case study and discusses the nature and the interest for the accretion of funds. The U.S.' supervision mode serves as a model for a healthy development of China's third-party payment. However, the rapid development of new payment market puts forward a higher requirement for supervision. To develop governance in this area, China needs to improve third-party payment institutions based on learning from American experience and take into account the current situation.

Concluding Remarks

The book timely address many recent challenges, not only the challenge of China-U.S. relations, but also reasons for tensions and highlights list of challenges for business and economic policy within the U.S. and China, which can serve as lecture also for many other emerging and developed economies. Variety of topics and richness of methodological and theoretical approaches used here, not only reflects the complexity of the topic, but also call for further research and discussions on these issues.

Contributions in this volume were also strong incentive for a mutual learning and a constructive dialogue between economics, academic management and business specialists, political scientists and policy analysts that participated. The studies aim to draw attention to new dimensions of bilateral relations between the two superpowers, the potential benefits and risks, and deeper insight into the changes. In a nutshell, the book aims to contribute to the policy and academic debates on China-U.S. relations both in terms of empirical investigations and their policy implications.

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PART I:

ECONOMIC RELATIONS BETWEEN CHINA AND THE UNITED STATES

CHAPTER ONE

ESSENCE OF THE SINO-AMERICAN RELATIONSHIP

Abstract: This Chapter is a discussion about the Sino-United States relation which has become the most important bilateral relation in the current world. Such importance is now having a profound influence over social and economic development in both China and the United States for the operation of the basic international configuration. It is significant to understand and monitor this relation with the essence of the two countries since it greatly concerns the prosperity of the two countries and that of the rest of the world. A trend of mutual benefit, complementarity and cooperation between the two countries has played, is playing, and will play a dominant and decisive role in future development in terms of the Sino-United States relations. The chapter will also discuss optimistically building some relationship between China and the United States by taking some approaches.

1. Introduction

The Sino-US relation is of great importance. Generally speaking, there should be no doubt with some common consensus in the international community. As the former US President Barack Obama indicated, “The Sino-US relation is the most important bilateral relation in the 21st century in this world”. People can easily provide evidence to demonstrate the importance of this relation. China and the United States are both major economic powers in the current world. One is the largest developing nation and the other is the largest developed country. According to the statistics published by the International Monetary Fund (IMF) in April 2015, the United States, as the largest economy in the world, produced its gross domestic product (GDP) valued at USD 17,419 billion in 2014. For China, the 2nd largest economy, its GDP reached USD 10,380 billion in the same time period.

The two countries are mutually the most important partners in economic and trade exchanges. For some reasons the economic relationship between the two countries experienced an “ice age” for as long as 30 years from 1949 to 1979. In that period they were basically isolated from each other. Largely since the end of the 1970s when China started to implement the policy of economic reform and open up to the outside world, especially after China’s accession into the WTO in 2001, the Sino-US bilateral economic and trade exchanges have entered a period of speedy development.

According to China’s official statistics the bilateral trade volume in 1979, when the two countries established the diplomatic relationship, was only USD 2.45 billion. In 2014 this number rushed like a rocket to USD 555.12 billion. People have seen a 224.1-fold increase in those 35 years. While the European Union (EU) is a listed number one trading partner with China, as a single country the United States is no doubt China’s largest trading partner. For bilateral investment the United States is the 3rd largest source of foreign direct investment (FDI) in China. Up until 2014, the investment actually made by United States’ corporations in China reached USD 75.4 billion. China has also made different types of investments in the United States, numbering USD 38.5 billion. For bilateral personnel exchanges, one can also see an earth-shaking change. In the early years after the establishment of the diplomatic relationship there were only about 10 thousand people mutually visiting or traveling yearly. But now we see a flight between the two sides of the Pacific every 20-25 minutes. Every day nearly 20 thousand people are visiting or traveling in each other’s country making a yearly number close to 7 million. Statistics show that by July 2014 a record 275.96 thousand Chinese students were studying in the United States, accounting for 28% of the total international students in the United States. Meanwhile, about 25 thousand United States students are enrolled in China’s colleges and universities. Only in 2014, China received 24,203 overseas students from the United States.

2. Issues and concerns

In addition to the above-mentioned facts and figures, what should be really clear is that the current situation and development momentum related to the Sino-US relation would have profound and far-reaching influence over the existing international configuration and the tendency of its future. In reality, the international community witnesses that the two countries are now taking steps aimed at exerting their respective influence.

Thanks to the rapid development of its exportation in the past several decades, China has accumulated a tremendous amount of foreign exchange reserve of more than USD 3 trillion. Of course, it indeed gives China a relatively tough job to do. Against this background there appears a strange phenomenon in the international financial area. Considering the financial relationship between China and the United States, people amazedly found that China is the largest overseas creditor of the United States. By August 2015 the US Treasury Securities held by foreigners totaled USD 6098.7 billion; 21% of that was held by China valued at USD 1269.7 billion. That fact makes the United States policy makers sensitive or even nervous whenever China increases or decreases its holding of US debts. However, it is known that China is the largest developing country in the world with a population of more than 1.3 billion. A considerable number of Chinese people are still living in poverty according to the World Bank standard.

For many years China’s currency, RMB, has always been a contentious issue between the two countries. Now such a controversy has been turned away from RMB’s value determination to its process of internationalization. Currently more countries and regions receive RMB as the means of payment in settling international trade. As this background, the IMF declared on November 30, 2015 that Chinese RMB would be formally introduced into the currency basket for the value determination of special drawing rights (SDR) on October 1, 2016. That should be an important development with a profound impact on international financial movement and trade settlement. Unfortunately, such a development has been viewed as a potential challenge to the financial hegemony of the United States.

China intends to acquire a relatively stable and peaceful period for development by maintaining stability in the East and South China Seas. The country sincerely wants to peacefully settle disputes with some of its neighbors, for instance Vietnam and the Philippines. But the United States implements the so-called Asia-Pacific Rebalancing Policy. It wades into the affairs of the South China Sea on the excuse of freedom of navigation and freedom of over-flight. At the same time, the United States overtly gives its support to the Japanese in the Diaoyudao Island dispute. China has initiated the establishment of the Asian Infrastructure Investment Bank and implements the “One Belt and One Road” strategy in order to deepen economic relations with its neighboring countries, particularly those countries along the Belt and Road in Asia, Africa and Europe. The United States dominates the Trans-Pacific Partnership (TPP) negotiation. It was hoped that a large free trade zone might be established across the Pacific. But people are so surprised to see that this established economic community obviously excludes China.

Furthermore, in recent years some politicians and the western media have indulged in wild speculation of the G2 (the United States and China) concept. It seems that the world has entered into an era in which the G2 replaces the traditional G7 or G20 as the dominant institutional arrangement. This is to readjust and regulate the operation of the world economy and other sorts of international affairs. In their words, "the G2 must be the world today and tomorrow". Decisions and resolutions about almost all kinds of important international issues, including the world financial system, world economic recovery, raw materials safety and climate protection, should be jointly made by the two giant powers on the two sides of the Pacific. Those people advocated that China and the United States must regularly hold bilateral meetings to negotiate contradictions and to coordinate each other's position. And they believe that this is the best way to deal with the current world economic and political crisis.

Still others affirmed that a new Chimerican era has come true. They argued that Chimerica looks like "a lovely couple". In their explanation the so-called Chimerica is nothing but an interesting community constituted by the world's largest consumer, the United States, and the world's largest saver and producer, China. Superficially, the Sino-US relation appears unbalanced in many ways. But in essence, the Sino-US relation should be actually a symbiotic relationship. With this relationship the eastern Chimericans are making savings, while the western Chimericans are enjoying consumption. The eastern Chimericans are working diligently in manufacturing production, while the western Chimericans are offering service industry products. The eastern Chimericans are exporting, while the western Chimericans are importing. The eastern Chimericans are busy accumulating foreign exchange reserves, while the western Chimericans are happy to live a deficit-life but to print more "green bills" for the eastern Chimericans.

3. Clarification of some arguments

One of the most significant events in the development of the world economy in recent years is China's economic rise. The statistics show that China overtook Japan to become the world's second largest economy right after the United States in 2010. Since then it has steadily widened the gap with Japan and narrowed the difference with the United States. In 2014 China's economic aggregate (USD 10356.5 billion) was about 2.25 times that of the Japanese (USD 4602.4 billion). In 2010 China's nominal GDP only accounted for 40.36% of that of the United States. In 2014 this percentage increased to 59.48%. Different arguments appeared in the international community facing such a development. Those are indeed playing some roles to influence the public opinions on both sides. The policy makers in the two countries are also influenced by them to some extent. In order to clear the air and clarify the arguments, it is necessary to have a rational and realistic analysis with a peaceful mind and scientific attitude.

At the beginning, any analysis should be done based on the basic estimation of the current Sino-US relation. The fact is that since the two countries sent their ambassadors to each other's capital, a great development of the comprehensive economic and trade relationship has firmly linked the two countries together. Such a situation is just like someone's description that the two countries have established a relation of "You have me and I in you". In this sense, neither of the two sides is capable of being far apart from the other. Some observers prefer to compare the current Sino-US relation with the former Soviet-US relation before the disintegration of the USSR (Union of Soviet Socialist Republics). But anyone without political or ideological prejudice must not agree with that comparison. The fact is that the former USSR had generally no relationship in economy and trade with the then United States. That is quite different from the current Sino-US relation. These cannot be confused with each other.

During these years some political figures and analysts worried about the future and potential conflicts even some direct national benefit clash between China and the United States. This kind of anxiety spread especially widely after China overtook Japan to develop into the second largest economy in 2010. Actually, the so-called "Thucydides Trap" is always a lingering nightmare in those people's minds. To deal with this anxiety, at least the following three points should be clear. At first, people know that history is the best text book. China does not possess a national characteristic of aggression. Chinese people deeply appreciate peace and have a tradition to harmoniously deal with people in other countries. Historically, China was in the position of the largest power in the world for more than a thousand years before the middle of 19th century. In today's words, China was then a giant super power in the world. But no historical record testifies that China once invaded other countries and conquered other nationalities by using its economic and military power.

We really see different types of state-to-state conflicts and even some brutal wars occurring between the existing powers. There are some