THE CHINESE ECONOMY: MAKING A GLOBAL NICHE

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> China's rapid economic growth has had a great impact on the global economy, but this is not a 'zero-sum' game some worry about.
>
> ~Joseph E. Stiglitz (2006)

1. China and the Global Economy: A Fundamental Repositioning

The role of the People's Republic of China (hereinafter China) in the global economy has radically increased since 1978. Its emergence as a powerhouse economy is unprecedented in its implications for the global economy. During the early reform phase, China's resolve to globalize appeared feeble. However, with the passage of time the political leadership recognized the invaluable contribution that globalization could make to their economy. Realization of China's impact over the global economy also dawned on them. This self-reinforcing two-way process is likely to continue in the foreseeable future. Towards the end of 2007, after the post-sub-prime mortgage crisis in the United States (US) economy, it seemed increasingly evident that the global economy was on the cusp of a defining historic transformation; economic power was in the process of making a secular shift from the industrial economies to China and the major emerging-market economies (EMEs)[1].

China's economic presence in several geographical sub-regions steadily increased. Africa, the Caribbean, Latin America, Middle East and South and Central Asia were the regions with which China did not have close economic and

[1] Emerging-market economy is a term coined by Antoine W. van Agtmael of the International Finance Corporation in 1981. It is a sub-set of developing economies. See Das (2004), Chapters 1 and 2 for an explanation of what emerging-market economies (EMEs) are and how are they defined.

political relations. However, in the recent past, China has cultivated countries in these sub-regions, essentially for ensuring reliable supplies of industrial raw materials, energy as well as developing trade. Business leaders in China tended to target those regions that were resource rich and neglected by other major economies for political or other reasons. China's heavy investment in the oil industry of Angola, Nigeria, Sudan and mining sector in Congo, Zambia and Zimbabwe are some cases in point. China has been assiduously developing these and other African economies as trade partners. Consequently, China's trade with Africa grew at a rapid pace.

China's re-emergence and economic status is often compared to the growth performance of "miracle" Asian economies that came into their own during the post-War era and carved a niche for themselves in the global economy.[2] While there are many commonalities, this comparison is not entirely correct because, unlike them, China's economic ascent as it is progressing is going to be to the status of an economic superpower. It has more in common with the ascent of the US economy a trifle over a century ago and the United Kingdom (UK), where the industrial revolution started during 1760-1830. An appropriate comparison should instead be made to the US economy instead of China's modern Asian predecessors.

That China's present growth performance is comparable to that of the US and the UK is confirmed by the historical growth statistics for these two economies and post-1978 China. In table 1 below, drawing on Maddison's (2003), growth differential of China has been compared to the UK and the US during the 18th and the 19th centuries. This reveals that neither economy "administered such a large shock to the global economy as has China" (Winters and Yusuf, 2007). Column 1 shows that China started with 2.9 percent of world's income; for 26 years its average annual growth rate was 6.6 percent higher than that of the global economy. Column 2 shows that China had an initial income world income

[2] See Das (2005) for a detailed exposition on this issue.

share of 4.9 percent and for 25 years its growth differential was 4.4 percent. In comparison to this, historical growth rates of the UK and the US were much lower in terms of the growth differential. Only the US economy came close to China's performance during the 1820-70 period, when its growth differential was 3.3 percent for five decades.

Table 1

Comparative Industrialization

(GDP at PPP)

Factor for Comparison	China, WDI 1978-2004	China, Maddison 1978-2003	UK 1700-1820	UK 1820-70	US 1820-70	US 1870-1913
	1	2	3	4	5	6
Industrializer's Initial share (%)	2.9	4.9	2.9	5.2	1.8	8.8
Industrializer's annual growth (%)	13.3	7.5	1.0	2.1	4.2	3.9
Global annual growth rate (%)	6.8	3.1	0.5	0.9	0.9	2.1
Growth differential	6.6	4.4	0.5	1.2	3.3	1.8
Number of years	26	25	120	50	50	43

Source: Computed by Winters and Yusuf (2007) from Maddison (2003) and World Development Indicators, various volumes.

Three decades of macroeconomic reforms, sustained growth and global integration have turned China into a future economic power of global magnitude, with unmatched breadth of resources and a robust manufacturing sector. The proficient political leadership of China is committed to world-class economic achievements and to being an economic power to reckon with. Barring a major domestic or global economic crisis, the economy has an enormous potential to be one in the foreseeable future. Numerous macroeconomic projections have been made regarding the time point when the size of China's GDP will achieve parity with that of the US, or surpass it. Goldman Sachs (2003 and 2004) projected that China could be the largest economy in the world in 2041, if appropriate macroeconomic policies are followed. However, some analysts disagree and argue that China can get there sooner (Shenkar, 2006).

Even before reaching that much vaunted status, China's surging economy is comprehensively affecting the lives of people around the globe. Such rapid growth in an open economy cannot possibly take place in isolation. Not only China's exports have gained significant market shares in global markets but also its rapidly increasing imports have supported strong growth performance in many countries. It has been having a good deal of impact over national economies, global businesses as well as employment and consumption patterns. China has been swaying inflation rates, interest rates, wages, corporate profits, real estate prices in the industrial economies and commodity and petroleum prices[3] in the world markets. In pervasive ways, China has been driving "economic trends that many countries assume to be domestically determined" (*The Economist,* 2005).

[3] The supply-demand fundamentals for crude oil were in clear deficit. Towards the end of September 2007, average petroleum spot price (APSP) of benchmark West Texas Intermediate (WTI) shot up to $83.90 per barrel and in early November it topped $99. This was 65 percent increase in petroleum prices in one year. On January 2, 2008 they hit $100 a barrel, and a psychological barrier fell. The global consumption of oil has been growing at an average annual rate of 1.9 percent; however the production growth rate is 1.5 percent per annum. The last year, 2007 was the sixth consecutive year of oil price increases.

As China continues to grow, and even if this growth occurs at a somewhat moderate pace, its global economic impact will continue to ratchet up. Economies and firms in a large part of the world will need to devise their strategies to cope with impact China's rapid growth.

Can this be termed 'dislocation' caused by Chinese rapid growth? An ingenuous answer will have to be in the negative because it is not a cyclical or transitory change that China's growth is causing, after which circumstances will be back to normal. Our perspective needs to change. It is a fundamental structural change. Both China's increasing economic weight and escalating integration in the global economy have been rebalancing the global economy. To be sure, some national economies will face significant challenges in adjusting to it and the adjustment process may not be effortless. There will not be a return to *status quo.* China's rapid on-going growth calls for a fundamental repositioning of both macro- and micro-economies. That is, essential adjustments that are required will need imaginative strategies from both public policy makers and managers of business firms. Even households are being and will be influenced by China' brisk growth, which has been changing relative prices and incomes. The new global economic and business milieu that is being engendered by China's rapid growth will call for new ground rules for competing successfully. The positive supply-side shock that it has given to the global economy has far-reaching implications. Both global employment and consumption patterns have been changing accordingly and will continue to change. Economies, firms and households will need to inventively prepare for these basic transformations in the global economic structure. China's future growth trajectory will continue to matter to the global economy.

1.1 An Unprejudiced Assessment

China's rapid clip growth of the preceding three decades has made it an economic force to reckon with, not only regionally but also globally. A tangible outcome of brisk growth in an economy is amplification in the global shares of production, investment and trade. Consequently, this economy endeavors to make a new niche for itself in the global economy and formulates a new role. A lesson of economic history of the last two-and-a-half centuries is that whenever an economy starts growing rapidly, it inevitably causes some disruptions, displacement and imbalances in the prevailing *status quo* in the global economy. This happens more during the initial phases of vertiginous growth of this economy than in the latter. When the initial phases end, the economy emerges as a more significant global economy than that in the past. The industrial revolution began in 1760 in Britain.[4] Several episodes of such economic expansion have occurred since then. In each case the rapidly growing economy succeeded in locating a new niche in the old global economic order. The rise of a united Germany in the early 19th century and the US in the late 19th and early 20th century are two cases in point.

The rapid growth and global integration episodes of Japan, the newly-industrialized Asian economies (NIAEs)[5] and subsequently the ASEAN-4[6] during the post-1955 period are some of the recent illustrations of successfully growing economies making a new niche for themselves in the global economy. China is doing something identical to what several other Asian high-performing economies (AHP)[7] did in the preceding half century. During their comparable rapid-growth periods Japan, the NIAEs, and the ASEAN-4 economies also had similar impact over the global economy. They initially caused some disruptions and even consternation. In case of the ASEAN-4 this disruption was minor, but eventually their emergence benefited the global economy. It led to all the boats rising due to their tidal influence.

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[4] Although there is a disagreement on dates, Professor T.S. Ashton, an authority on industrial revolution and the author of *The Industrial Revolution 1760-1830,* regarded it as starting in 1760.

[5] The four newly-industrialized Asian economies (NIAEs) Hong Kong SAR, Republic of Korea, Singapore and Taiwan.

[6] The acronym ASEAN stands for the Association of South East Asian Nations, which has ten members. The ASEAN-4 economies are Indonesia, Malaysia, the Philippines and Thailand.

[7] The ten Asian high-performing (AHP) economies that turned Asia into the rapidest growing region of the recent past comprised China, Hong Kong SAR, Indonesia, Japan, Republic of Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand. This dynamic group of Asian economies was led by Japan. China is the latest entrant to this group of dynamic economies.

The Chinese economy is presently in the throes of its initial phase of growth, expansion and global integration. Its pace has been remarkable, comparable to those of the other AHP economies. While it has faced resentment and antipathy from some quarters, a lesson of the history is that antagonism is hardly warranted. A realistic and dispassionate estimate of the impact of China's economic emergence and global integration would lead one to infer that while some short- or medium-term problems are natural and to be expected, the global economy is likely to have a positive impact on balance after the initial phase of disruptions are over. However, the outcome of this problem phase would be far from uniform and its impact will necessarily vary across countries, industrial sectors and socio-economic groups. An economy's trade structure and its trade and investment relations with China will determine the nature and magnitude of this so-called China-effect on it. In this paper we shall explore which countries and sectors will reap the largest opportunities and who may have to bear the heaviest adjustment burdens.

As China grew to be the fourth largest economy in the world (in 2005) in a short time span of three decades, should the other countries be apprehensive of rapidly growing Chinese economy completely dominating the global economy and thereby inflicting harm on their economies? Let us take one prominent eye-catching variable, trade. China was a marginal trading economy and its share in world merchandise exports was 0.6 percent in 1977 (Lardy, 1998). In 2005, China accounted for 7.3 percent of the total multilateral exports and 6.3 percent of total imports (WTO, 2006). In 2004, China became the third largest global trader. Startled non-economist often construe that China will manufacture and export everything soon and the other economies of the world will have nothing left to trade. This is inappropriate, if simplistic, extrapolation of the past developments to reach an illogical conclusion. In accordance with the classical principle of comparative advantage, China's rapid growth will change the global division of labor, and it will produce goods in which it has comparative advantage, which will be determined by its factor and organizational endowments. According to the changing division of labor, China will export goods and subsequently services in which it has comparative advantage and imports those in which it does not. As Chin's status as an exporter grew, so did its status as an importer. Economies, large and small, trade on the basis of their comparative advantage, which in turn is a dynamic concept. Therefore, this apprehension is basically futile. However, what a concerned public policy maker or business decision taken need to know is where is China going to fit in this changing global division of labor.

1.2. Ascendance as a Soft-Power of Global Magnitude

While some government bodies and legislatures in some countries have been aggrieved by China's economic ascendance and expressed unbridled indignation, world public opinion does not find it startling and more or less accepts its emergence and global economic impact in an equable matter-of-fact manner. According to a 2007 multi-nation survey conducted jointly by the Chicago Council on Global Affairs and Washington-based WorldPublicOpinion.Org, most people in the US and 19 other industrial and developing countries believed that the size of China's fast-growing economy will one day be equal to that of the US economy, and that they were largely untroubled by the prospects. The survey reported that 60 percent of Americans believe that China will soon reach economic parity with the US. In 19 other countries, more people agreed with that proposition than disagreed. In none of the surveyed countries did majority view China's ascendancy as a negative occurrence to be alarmed about.[8]

China's potential catching up with the US is for sure a tectonic geo-economic and geo-political occurrence, which was not viewed by the Capitol Hill as a change in the positive direction. This stance is striking because, as noted above, overall the

[8] The detailed results of these surveys can be accessed on the website of WorldPublicOpionion.org at http://www.worldpublicopinion.org/.

world public's response to this potential development was low-keyed, almost philosophical, and the middle-America concurred (Peseck, 2007). Part of the reason behind the red-meat rhetoric from the Capitol Hill was the fact that 2008 is an election year in the US. In the 1970s and 1980s, Japan inspired similar negative reaction among the US politicians. The hysterical predictions made about the Japanese economy never came true. In the recent past, China has helped the US economy by keeping the interest rates low and containing inflation by providing reasonable-priced consumer goods. Global expectations from China have been on the rise.

Public opinion in Russia is not averse to China's economic ascendance. It was reflected in Russia declaring 2007 as the year of China. A string of cultural, educational, sports and of course business events were planned for the year. President Hu Jintao paid a state visit to Russia in April, was warmly welcomed by the Russian political elite, numerous cooperation agreements were signed and the two sides agreed to align their stances in the international fora, including the United Nation. A public-opinion poll found that Russians think of China, an old adversary, as "a positive impact on the world"[9].

A decade ago, China was not public image conscious and was not accustomed to managing one. It did not have much presence in Africa, Latin America and Eastern Europe. In a small way, China's self perception began changing under President Jiang Zemin (1993-03), when China tried for the first time to project an image of an international player of some consequence. Under a younger leader, President Hu Jintao, efforts to make a global impact accelerated appreciably. In the recent years China has consciously tried to work on its public image management globally, including in Africa, Asia and Latin America, extending its charm offensive beyond the political leaders, to general public. China's public image has been steadily improving. Its outreach endeavors included foreign aid, investment, deft diplomacy, tourism and education. In view of large accumulation

[9] Cited in Kurlantzick (2007).

of foreign exchange reserves, Chinese experts are mulling over spending ideas. An important one is to create a Chinese Peace Corps, with thousands of humanitarian workers (Newsweek, 2006). Although an EME, China's role in the development of sub-Saharan Africa (SSA) has gone on increasing. It has sharply stepped up development assistance to SSA. It is remarkable from a country that is still among the 10 largest recipients of official development assistance (Jacoby, 2007). Chinese aid to SSA takes the form of technical assistance, grants, interest-free loans, preferential loans that have an interest subsidy and debt relief.[10]

These efforts began to bear fruits and ordinary global denizens have begun to view China more warmly than ever before. Public opinion polls conducted by the Program on International Policy Attitudes and the BBC revealed that majorities of people regard China as a positive global influence, not as a threat. These sentiments were found to be particularly strong in the developing countries. A similar poll conducted by the Lowy Institute in Australia found that Australians found China as acceptable as the US.[11] Historic foes like India and Vietnam, with whom China went to war not a long time ago, are also being cultivated as future economic partners and have become part of China's charm campaign. With its trade surplus, foreign exchange reserves, soft loans and investments increasing, China's influence has been on the rise and it has been emerging as a soft power of global magnitude (Bersick, 2006).

1.3 The Geo-Strategic Stance of Peaceful Ascendancy

The geo-strategic stance of "peaceful rise" was widely discussed among the Chinese politicians and strategists, who preferred China to be a responsible and benign power of the future. This doctrine basically posits that China can and should rise economically and acquire the status of an economic super power

[10] As China is not a member of the Development Assistance Committee (DAC) of the OECD, which reports on members' international aid, information and statistics in this regards are scratchy.
[11] Cited in Kurlantzick (2007).

peacefully. In Zhou Bian's (2004) terms China needs to emerge as "a gentle giant". Notwithstanding the occasional livid threats regarding Taiwan, for the most part, China's international relations and conduct has been that of a responsible stakeholder in the global community of nations. It did not create an image of a spiritedly aggressive country, which is incapable of looking beyond its narrow self-interest in its international dealings. China's political leadership gives an impression of understanding that its prosperity cannot be achieved without support and goodwill of the global community. Therefore the "peaceful rise" doctrine received the endorsement of the highest level political leadership. So far China has not projected a hegemonic image or a surreptitious future plan of hegemony. "Reassuringly, at least in its relations with America, China for now seems to be guided more by pragmatism than by competition" (*The Economist,* 2006).

Bijian (2005), a noted Chinese strategic thinker and Vice President of the Central Party School, referred to China's rise as "peaceful ascendancy", and called it *heping jueqi*[12] . Premier Wen Jiabao publicly discussed it eloquently and it was a part of his Harvard University speech in 2002. Since then President Hu Jintao has further refined the concept and referred to it as peaceful "development" or *heping fazhan*. The logic behind this change was that even the term rise may appear provocative to some. This concept has remained highly popular with the Chinese academics and strategists and many have contributed serious strategic writings in western academic and policy journals on this theme.

One rationale behind this suave line of thinking was the utterly wasteful power play of cold war era, which Chinese politicians and strategic thinkers were eager to steer clear of. Transition of power has been a complex, even a dangerous, process and needs to be dealt with in a delicate manner. In the past, it was observed that a rising power did not win the conflict because the existing powers became alarmed. If startled, an economically ascending China could possibly be

[12] In Mandarin *heping jueqi* means peaceful ascendancy.

thwarted by the reigning military powers, or the super power. According to this philosophy, both Germany and Japan made mistakes that led to two World wars. It was erroneous to aggressively plunder global resources and pursue hegemony as an all important objective.

Learning from these experiences of the last century, China is so far determined not to vie for global supremacy in a cold-war-like manner. If China's economic rise does not take place peacefully, the other countries may become anxious and impatient to see it stopped in its tracks. Therefore, economic interdependence and symbiotic relationship—both regionally and globally—has been important for China. It is for these considerate and sensible reasons that the Chinese political leaders "recognize the necessity of having a peaceful international environment if they are to achieve a great power status" (Tanaka, 2006). They express these and similar sentiments both in their domestic and international discourses.

That China has become economically larger than several of the Group-of-Seven (G-7) countries is, as noted above, a tectonic shift in the global economy. China should logically be incorporated in deliberations on the global economic issues. This could pose a challenge to countries that dominated global economy and institutions since the 1940s, meaning primarily the US. Supra-national institutions, largely at the behest of the US, endorsed and promoted multilateral trade liberalization, open capital markets, nuclear non-proliferation, ensuring relative peace and prosperity for six decades. However, unless emerging powers like China "are incorporate into this framework, the future of these institutional regimes will be uncomfortably uncertain" (Drezner, 2007). The most telling recent illustration of this was the maladroit handling of the Asian crisis (1997-98) by the International Monetary Fund (IMF). Governments of the AHP economies were absolutely—if somewhat astringently—certain about it. While the European Union (EU) has made its bilateral accommodations with China and cooperated with the other larger emerging-market economies (EMEs)[13], whether these economies like to see their global clout trimmed and representation in the multilateral institutions pared is a moot point.

1.4 Modest Role in the Global Economic Fora

The influential Group-of-Seven (G-7) was established in 1985 to facilitate global economic and financial cooperation among the largest seven industrial nations. The summit meetings of the member nations, nations, Canada, France, Germany, Great Britain, Italy, Japan, and the United States, had begun earlier in 1975. The G-7 has been the dominant forum for deliberations and discussions as well as it coordinates its members' actions on economic, financial and commercial matters and works to assist the economies of other nations. The leaders of the G-7 nations meet annually in member countries. The Group-of-Eight (G-8), which consists of the G-7 nations plus Russia, was officially established in 1998.

The US, Japan and Germany are the three largest global economies, in that order. Although in 2005 China was the fourth largest economy, it was on course to overtake Germany in 2007. As these measures are at market exchange rate, they grossly understate the real size of the Chinese economy. However, if adjustment is made for China's relatively low cost of living and the nominal GDP is measured in purchasing power adjusted currencies, China became the second largest economy in the world in 2004, after the US. It provided significant impulses to global growth. Its impact on the global economy has been pronounced and growing. According to the 2004 statistical data, China is also the third largest trading economy in the world after Germany and the US, in that order. Surging economic growth is moving the Chinese economy towards the center of the global stage, adversely affecting the hitherto overbearing authority

[13] Emerging-market economy is a term coined by Antoine W. van Agtmael of the International Finance Corporation in 1981. It is a sub-set of developing economies. See Das (2004), Chapters 1 and 2 for an explanation of what emerging-market economies (EMEs) are and how are they defined.

of the Quad (Canada, the EU, Japan and the US). The business world will need to develop new global axes of operations and in an increasingly multipolar world business and political leaders will need to have an authentically global collaborative mindset.

As the realization of China's global economic significant grew, it was invited to the G-7 deputies meeting in 2003 and to the G-7 meeting held in Boca Raton, Florida, in February 2004. However, the fourth largest economy and the third largest trader, China is still not a formal member of the G-7 or G-8. A G-7 without China cannot be rationally regarded as the true representative of the global economy. It does not reflect the present division of economic and financial powers and has become obsolete. Martin Wolf (2007) made a stronger proposal in his *Financial Times* column to replace the G-7 with a Group-of-Four (G-4), China, the Euro Zone, Japan and the US, so that a "global dialogue among the leading economic players" can take place. I concur with this suggestion.

That G-7 was losing its relevance was realized by some global leaders and this realization gave birth to the concept of Group-of-Twenty (G-20) during the Cologne Summit of the G-7 on June 18, 1999. The leaders of the G-7 industrial economies declared their intention to work together to establish an informal mechanism for dialogue among systemically important countries within the framework of the Bretton Woods institutional system. The intention of the G-7 leaders was to broaden the dialogue on the crucial economic and financial issues related to the global economy. The objective was to promote cooperation to achieve stable and sustainable global economic growth that benefits all. The G-20 was formally created at the September 25, 1999 meeting of the G-7 Ministers. It was launched with fanfare in December 1999 in Berlin, where the first meeting of the G-20 took place. Representative of the EU, International Monetary Fund (IMF) and World Bank, were made a part of G-20. The French and Italian governments were opposed to the concept of this G-20. The reason they gave was that it would undermine the authority of the IMF. Instead, they supported the new International Monetary and Financial Committee (IMFC). The US and Japan were very much in favor of the new body. Britain, while supportive, was somewhat reserved, for fear that the G-20 might undercut in practice the prominence of the new IFMC, which Britain's erstwhile finance minister Gordon Brown was chosen to initially chair. Canada threw its weight in favor of G-20. It was largely because it wished to see a broader consultative structure that was more formalized, linked to other supranational institutions and less controlled by the US. The G-20 was chaired for its first two years by Canadian Finance Minister Paul Martin, who declared that the mandate of the G-20 was to "promote discussion and study and review policy issues among industrialized countries and emerging markets with a view to promoting international financial stability." Its initial 18 country members consisted, in addition to the G-7, of Argentina, Australia, Brazil, China, India, Mexico, Russia, Saudi Arabia, South Africa, South Korea, and Turkey. Canada hosted the second meeting in 2000. It was decided that the chair would rotate among participants with two year terms, and with the initial chairs being chosen from among the G-7 countries. Over the years the G-20 emerged as a valuable piece of global architecture, albeit some of its participants are more active than others (Sobel and Stedman, 2006).

A different Group-of-Twenty (G-20) was born before the Cancún Ministerial Conference of the World Trade Organization (WTO) in 2003. This G-20 coalition included some developing country members of the Cairns Group (Argentina, Brazil and Thailand) which were interested in improving market access for their agricultural exports. It also included other developing countries (India, Mexico, Bolivia, and Ecuador) which were concerned with defending their domestic markets from import surges. The leadership of the G-20 was collegial; it was jointly led by Brazil, China, India and South Africa. China is the larger trader among the G-20. It not only played a meaningful role in Cancún Ministerial Conference but also at the WTO meeting in Geneva, held in the last week of July 2004, which put together the July Package or the July Framework Agreement, which revived the moribund Doha Round.[14] For the members of the G-20, one lesson learned at Cancún was that, to avoid later frustrations, they need to approach future ministerial conferences, multilateral trade negotiations (MTNs) and other important WTO meetings with well beefed-up teams of trade economists and better preparations in terms of research for negotiations (Das, 2007a). As a G-20 member, China could influence in the formulation of multilateral trade rules more than it has so far done. However, Brazil and India consistently remained more active than China during the Doha Round of MTNs.

Established in 1989 by Australian and Japanese cooperation, Asia-Pacific Economic Cooperation (APEC) has emerged as one of the most important regional groupings. This 21-member group spans four continents, home to almost 2.7 billion people. The member countries represent 57 percent of the global GDP and 46 percent of multilateral trade (APEC, 2007). In 2005 its members committed to achieving the Bogor Goals of free trade and investment in the Asia-Pacific region by 2010 for the developed members and 2020 for the developing country members. A member since 1991, China is an active member of this trade enhancing group and is a signatory of the Bogor agreement.

Although its economy is growing and importance and participation in the global policy arena has been increasing, China has so far played a modest role relative to its economic weight and heightened status. To be sure, China has abandoned its previous aversion to multilateral organizations. During the Deng Xiaoping (1978-94) period, it was believed that they could constrain China and therefore it was proper either to keep a distance from them or be a passive member (Medeiros and Fravel, 2003). As China is a member of virtually all the important supranational institutions, the general expectations of the global community is that it should play a role that is compatible with its global economic status. So far

[14] At the time of writing, the G-20 has the following 21 members: Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, Egypt, Guatemala, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, Peru, Philippines, South Africa, Thailand, and Venezuela. The role of collegial leaders of G-20 was played by Brazil, China, India and South Africa.

China has lagged behind and projected an image of a reluctant leader. In addition, the principal global economic powers expect China to assume its global responsibilities, get engaged and play an active role in ensuring continued health of the global economic system (USTA, 2006). However, these large economic powers are negligent of not inviting China as a full-fledged member to the G-7 table, although China has participated in the G-7 finance minister and central banker's meetings.

In the late 1980s, China began its drive to expand its bilateral relationships. It normalized and established diplomatic ties with 18 countries and with the successor government in the Russian Federation. In the post Deng Xiaoping era China's worldview began to amend. The next step forward that China took was was to develop "various levels of "partnerships" to facilitate economic and security coordination". A crowning achievement of this new approach was signing of the Treaty of Good-Neighborliness and Friendly Cooperation with the Russian Federation in 2001. In bilateral relations, in multilateral organizations and in security issues, China began to adopt an unforeseen flexibility and finesse. This change in comportment and approach reflected "an attempt by China's recent leaders to break out of their post-Tiananmen isolation, rebuild their image, and protect and promote Chinese economic interests" (Medeiros and Fravel, 2003).

2. China as a Source of Global Growth

The latter half of the 20th century belonged to the US economy; it gallantly played the role of the principal locomotive of global economy. It was a domineering, trend-setting economy, having deterministic influence over majority of the economic trends. As China has grown into a large size economy, growing at a rapid pace and steadily globalizing, it has begun influencing the global economic growth trajectory. As an important link in the production chain, a large exporter of numerous manufactured products, an important destination (and lately source of) foreign direct investment (FDI), consumer of sizeable quantities of energy, raw materials, consumer goods, commodities (like aluminum, steel, copper, coal) and technology, China will significantly affect both supply and demand sides of the equation in the global economy. International commodity prices can no longer be regarded as exogenous for China. It has been influencing them in a discernible manner. In future, they will grow increasingly responsive to China's growth prospects. This would not only be limited to raw materials and commodities but also to high-priced high-technology products like commercial airliners. In 2007, China was the second largest market for them after the US. Thus viewed, while it's positive supply-side shock to the global economy has been conspicuous and widely discussed in the academic and business conclaves, its large array of demands also carries great weight in the global economy.

Evidence of China's influence over contemporary global economic growth is easy to see. Over 1986-2006, China added $2 trillion to the global GDP and created 120 million jobs (Aziz and Dunaway, 2007). These impressive statistics amount to annually adding an economy of the size of Portugal to the global economy and annually creating jobs equal to the total number of people employed in Australia. An oft-cited proof of China's influence on global economy was its impact on it during 2000-01. When the so-called IT-bubble burst in the US and the global economy went into a modest recession, China's contribution to global recovery was significant. Without China's robust growth, this global recession could be severe and long-lingering because at this point both the other two large economies, the EU and Japan, suffered from weaknesses and failed to pick up the gauntlet.

Since the beginning of this decade, China is being regarded as a secondary engine of growth after the US. Between 2000 and 2005, China's contribution to global GDP growth in purchasing power parity (PPP) terms was "more that half as big as the combined contribution of India, Brazil and Russia, the three next largest emerging-market economies" (*The Economist*, 2006). China's large and increasing demand for imports for meeting domestic demand and that for exports has become an important source of growth for the global economy. In the first half of 2007, China made the largest contribution to global growth evaluated at both market and PPP exchange rates and counterbalanced the moderation of growth in the US (WEO, 2007)[15].

Broad measures like GDP growth rates tend to conceal important trends in the global production. When the US economy grows at a steady pace, it increases per capita income by 2 percent per annum. Although it appears modest, 2 percent of $33,000 is $660 worth of goods and services produced per capita. Conversely, when the Chinese economy grows at, say, 9 percent per annum, it increases per capita goods and services worth around $320 per capita. Over the 1990-2005 period, the era of rapid globalization, China and the US were able to add maximum to per capita goods and services production in the global economy. Taking their respective GDP growth rates, Dollar (2007) computed that China accounted for 28 percent increase in the global GDP during the period under consideration, while the US for 19 percent. Together they generated almost half of all global GDP growth for the 1990-2005 period. Over the 2006-2020 period, there is a likely possibility of China accounting for a greater proportion of increase in the global economy. If China's annual GDP growth averages 7 percent over the 2006-2020 period and the rest of the economies of the world continue performing at the same pace as they did during 1990-2005 period, China will account for 37 percent of growth in the global GDP during 2006-2020. In this scenario, the US will be responsible for merely 16 percent of global GDP growth (Dollar, 2007).

Although China's GDP is still one-fourth that of the US at market exchange rate, its growth rate has been steadily much higher. Therefore, China's contribution to the global GDP growth rate may be higher than that of the US. According to the World Bank (WB, 2007), China's it may reach 16 percent at market exchange rate in 2007. China's contribution to global growth, when considered at PPP exchange rate, was found to be higher. The PPP exchange rate is a better indicator for commodity demand.

[15] See Chapter 1, *World Economic Outlook,* October 2007.

To be sure, the US economy will continue to be an important engine of global growth. However, if the current growth trends in the global economy persist, China and the US will be the two principal sources of future global growth, which is an indisputably wholesome development. As noted above, under certain assumptions China may even start playing a relatively larger role than the US. After the sub-prime mortgage woes in the US in September 2007 and a precipitous decline on Dow Jones, a recession in the US became a veritable probability.[16] The need for a second engine of growth for the global economy became more imperative. Towards the end of the 2007, China was beginning to be seen as this kind of force for stabilization of the global economy.

A second related plausible scenario is that as the Chinese economy is well integrated with those of its dynamic neighbors, in partnership with the other Asian high-performing (AHP)[17] economies, China may well emerge the principal growth pole of the global economy in the future. This growth pole, led by China, may become the driving force behind the contemporary global economy. Its influence will certainly be felt during the rest of the 21st century in shaping the contours of the global economy. It will not be far-fetched to believe that global economic environment will then depend more upon how well the Chinese economy performs than how does the US economy.

3. Channels of Impact over the Global Economy

As trade and foreign direct investment (FDI) have expanded at a remarkably high pace in the recent past in China, these two variables have become important

[16] In a BBC interview on October 1, 2007, Alan Greenspan notes, “The most credible worst case scenario is a recession in the US, driven by further fall in US house prices as people feel less wealthy and spend less money”. Even in the best case, “a substantial slowdown in the US, with repercussions across the globe” cannot be ruled out. Available on BBC News on the Internet at http://news.bbc.co.uk/go/prfr/-/2/hi/business/7022117.stn.

[17] The ten Asian high-performing (AHP) economies that turned Asia into the rapidest growing region of the recent past comprised China, Hong Kong SAR, Indonesia, Japan, Republic of Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand. This dynamic group of Asian economies was led by Japan. China is the latest entrant to this group of dynamic economies.

channels through which China has (and would continue to) impinged upon the global economy. The former would affect other economies by way of changes in terms-of-trade (TOT), while the financial channel can have a wider impact. As China is still a large exporter of labor-intensive light manufactures, the world market prices of this category of products have softened because it became the price setter for this category of tradable goods. The developing economies that were labor-abundant like China and exported labor-intensive light manufactures, and competed against Chinese exports in the third-country markets, fond that their TOT turned against them. This country group suffered due to intense competition from China. In an extreme situation, China's competitive pressure could even create a price deflation in these countries. Often the same logic is extended further, resulting in fears of extreme deterioration in the TOT for this group of developing countries. It is even argued that competition from China may completely eliminate labor-intensive products of the other developing economies from the global markets, for sure a despondent scenario. This kind of thinking led to some analysts arguing that competitive pressure from China was partly responsible for triggering the Asian crisis of 1997-98 (Parker and Lee, 2000; Loungani, 2000). Conversely, this trend has benefited some developing economies that are net importers of labor-intensive manufactures. These developing economies would benefit from China's competitive pricing and the resulting improvement in their TOT.

Secondly, China has been liberalizing its domestic markets and emerged a large buoyant importer as well. Increase in China's domestic demand has benefited those economies that were exporters to the large Chinese market. These economies benefited from price increases, that is, the turn of TOT in their favor. Countries that exported capital- and skill-intensive products, food, energy, minerals, raw materials and other primary products as well as intermediate inputs and commercial services have been the principal beneficiaries of China's large and expanding import market. The TOT gains for the commercial services sector exporters were large because China's trade in several services has been growing rapidly. Telecommunications, financial services and information processing were the most rapidly growing services trade areas; their imports were expected to grow fast (IMF, 2004)[18].

Expanding Chinese demand has firmed up the world market prices of oil and several other commodities. Countries that were importers of oil and commodities have lost because they had to pay higher import prices, meaning an adverse turn in TOT. This is a good example of negative TOT impact on several economies. Average spot prices (APSP) were driven high by large Chinese, and other emerging-market, imports and they crossed $99 a barrel,[19] the highest level ever reached. China's petroleum consumption has been projected to surpass that in the US in 2010. Many commodity prices were also driven to record levels. Countries that exported oil and commodities benefited from the TOT turning in their favor. In addition, economies that were capital goods exporters to China, like the EU, Japan and the US, gained because of growing demand from China. This trend is also likely to continue in the short- and medium-term.

If its export structure is similar to that of China, a developing economy may lose its export share in the third-country market with expansion in China's trade. But at the same time this developing economy's exports to the Chinese market may increase. This would offset the volume losses in export for this developing economy in the third-country market. In addition, China's competitively-priced exports will improve the TOT for this developing country in its own market. It is likely that this developing country's gains in its own and Chinese markets will outweigh its losses in the third-country markets. However, for this to happen one condition that is necessary is that its exports need to be China's major imports

[18] See IMF (2004) Chapter 2 for a detailed discussion.

[19] Towards the end of November, 2007, average petroleum spot price (APSP) of the benchmark West Texas Intermediate (WTI) shot up to $99 per barrel. This *inter alia* reflected imbalance in the supply-demand fundamentals. The demand outpaced supply significantly. Global consumption was growing on average by 1.9 percent per year during this period, while supply growth lagged. The 2007 was sixth year of consecutive year of price increases. On January 2, 2008 the petroleum prices hit $100 a barrel.

and its imports need to be China's major exports (Yang, 2006). Two large empirical studies, despite methodological differences, have concluded that unskilled-labor intensive consumer goods from low-income developing countries faced a great deal of competition from Chinese export growth in the third-country markets. At the same time, China's rapid growth produced little domestic demand for the exports of this country group (Eichengreen and Tong, 2006; Ianchovichina and Martin, 2006). The reason was that China had considerable domestic capacity to produce these goods at home. Thus, China's trade pressurized the trade of low-income developing countries more than that of the high-income ones.

The developing economies that find their TOT turning against them and loosing market shares in the third-country markets due to China's expanding exports can adopt a defensive strategy. If they are being out-competed in labor-intensive manufactures, they should strive to move up the technology ladder and enter into manufacture and exports of technology- and skill-intensive products. Such a shift in productive resources could insulate their trade from the Chinese competitive pressure. To this end, they would be required to invest more in initial imports of technology and its adaptation as well as in human resource development.

The TOT changes described above will impinge upon the sectoral composition of output and on income distribution within as well as across countries. China has a surplus of unskilled and low-skill labor, as assumed in the Arthur Lewis model of economic development.[20] As China's influence increases in the global economy, world-wide return for capital and skilled-labor is bound to increase. China's trade expansion will also result in world-wide lowering of the reward for unskilled labor. The implication of this impact would be that certain sectors, and socio-economic

[20] The two-sector model of economic growth, developed by William Arthur Lewis (1915-91), is a classical model of economic growth. Lewis believed that neoclassical economists did not describe the circumstances of the developing economies accurately because they assumed that labor is in short supply. Lewis' model posited that a developing economy has two sectors, one modern and the other traditional. The modern sector is small and capital-intensive, while the traditional sector is large and non-capital intensive. A large amount of excess labor exists in the traditional sector; therefore, marginal product of labor is zero.

groups, in some countries would become highly vulnerable to competition from China.

As China has emerged as a highly competitive economy in attracting FDI and it is not likely to quit its high perch soon. Therefore, it is widely believed that China is likely to influence FDI flows to the other developing economies negatively, hurting their growth endeavors. In addition, China's share in receiving private portfolio capital from the global capital market has been increasing and may continue to rise in future. In 2007, the authorities raised the annual limit for portfolio capital inflows from $10 billion to $30 billion. This would help provide global investors higher returns and portfolio diversification opportunities. However, some developing countries may certainly find it difficult to compete with China in attracting scarce capital from the global resource pool. Policy mandarins in these economies feel concerned about China's ability to draw large amounts of FDI in absolute terms leaving little for the other developing economies. They can not help seeing a zero-sum-game here.

However, this may not be the situation for all the countries. For instance, for foreign direct investors who are assessing the possibilities of investing in Africa, Eastern Europe and Latin America, the so called China factor will not be even a remote consideration. Second, there can be a group of countries which experiences complement FDI inflows with increasing FDI flows to China. Empirical evidence shows that China's neighboring Asian economies come under this category. Evolution of networked production and supply chain development are the principal driving forces behind this trend. There is a third plausible scenario. As the new policy focus in China is on reining in of the investment rate in the economy and increasing domestic consumption, the FDI inflow in future may decelerate. When this policy is implemented, firms and households may move to expand their both portfolio and direct investments abroad. Economies at the receiving end of this capital outflow would indeed benefit from the outward capital flows from China. The working out of this scenario will necessarily depend on China's timing, pace and form of capital account liberalization.

China's growth and global integration can also have a positive dynamic impact by way of demonstration, which could prove to be significant for the global economy. This demonstration effect may prove to be a sound incentive for the other developing economies to accelerate their factor accumulation endeavors and productivity growth for emulating China's growth performance. Also, competitive pressure from China may force them to take macroeconomic reforms and restructuring more seriously than before. It was observed in India and the other south Asian economies, which did not take reforms seriously until quite late. When they did launch reform programs, their implementation was tardy and slipshod (Das, 2007b). However, once they observed the tangible results of reforms and liberalization in China, they beefed up their endeavors and became more earnest about implementation, which had a discernible positive impact on output and welfare in these economies.

A positive contribution of rapidly growing Chinese economy has been in dampening down the magnitude of the global business cycle. China's increasing weight in the global economy and its low or no correlation with industrial-country output growth trends contributed to reducing the cyclical swings in the global economy. Between 1979 and 2003, China's business cycle displayed almost no relations with those of the world and the US. The correlation between China's business cycle and that of the global economy and the US economy over the period under consideration was 0.0 and 0.2, respectively (IMF, 2005).

4. WTO Accession and Its Consequences

One undisputable result of China's 2001 accession to the WTO is its continuing, if not intensifying, closer integration with the global economy by way of trade and investment. The WTO membership brought China in the fold of the multilateral trade regime. While preparing for accession and during the implementation phase (2001-2006) of the Protocol of Accession, China lowered trade and non-trade barriers on goods and services. This should work towards improving opportunities for both trade and investment by China as well as with China. Under its WTO commitments, China has reduced tariffs on many products that are potential export items for the other WTO member economies. Generally applied tariffs tend to be lower than bound tariffs.

The Global Trade Analysis Project (GTAP) is a computable general equilibrium (CGE) model that was developed at Purdue University. Notwithstanding its limitations it is highly functional. It computes in detail the geographic and sectoral structure of trade flows. It is a static model and takes resource endowments and technology as constants. According to computations based on the GTAP-5 data base Ianchovichina and Martin (2006) concluded that the largest gains of China's WTO membership accrued to the EU, Canada and the US. Almost half of these gains to them were generated by elimination of quotas they had imposed on exports of textiles and apparel from China. These quotas had high costs in terms of efficiency losses in the domestic economy and rent transfer to China. Also, the same countries and Japan gained from China's reduction in trade barriers, which resulted in efficiency increases in the Chinese economic system rendering it a superior supplier of products as well as a larger importer of products from Canada, the EU, Japan and the US.

China's buoyant demand for many tropical and sub-tropical products, like palm oil, coconut oil, rubber, banana and sugar, has increased considerably during the recent years. Therefore, developing economies that are exporters of these products will find their markets expanded and possibly prices higher. During the negotiations for accession, industrial economies, particularly the US, had insisted upon lowering or eliminating barriers against trade in services and China had accepted this condition. Therefore, China's trade with the industrial economies in the commercial services sector is bound to increase rapidly.

Due to the post-WTO accession liberalization of China's trade regime, several developing and industrial economies can reasonably expect to export higher volumes to China, albeit there will be no uniformity across exporting countries in this regard. Some will be able to increase trade volume much higher than in the past, while others none at all. Yang (2006) is correct in assessing that the most significant reduction in tariffs took place "in industries in which industrial countries and the large, more advanced developing countries (for example, Brazil, India and Russia) have comparative advantage". These industrial sectors, like automobiles and heavy chemicals, were highly protected in the past. Likewise, the EMEs that are into exports of basic electronics (like DRAM, SDRAM, mother-board, graphic video cards, PCMCIA cards etc.) will also receive a sharp lift in their export volumes to China because for its own swiftly expanding electronics sector and rising exports China's demand for basic electronics will rise appreciably. In the post-WTO accession period industrial economies and EMEs are likely to gain more from trade than the other economies.

Tariffs on minerals and mineral products were low in China before the WTO-accession. However, following the accession their binding and market opening up increased. This improved the predictability of export market size in these products. The developing economies that export these products will face a better market potential than they did in the past. China's large demand has firmed up the global market prices for minerals and mineral products and the exporting developing countries have benefited form it. The flip side of this coin is that the developing economies that are net importers of minerals and mineral products had to pay more because of higher world market prices. Similarly exporters of primary products like Argentina, Australia, Brazil and Indonesia that export bauxite, timber and other primary products, will benefit from China growth.

4.1 Expanding International Competitiveness and Global Impact

China's rising level of international competitiveness, so noticeably reflected in its flourishing export performance, was not only a concern for the Asian economies but it was also an issue for the rest of the global economy. The concept of competitiveness has not been without controversy (Krugman, 1994). Here it implies simply the process of upgrading of an economy, which results in broadening the competitive advantage of its firms. This advantage enables the producers to command world markets (Porter, 1990). Such a rapid increase in competitiveness could not be mono-causal but necessarily emanated from a combination of several factors. They included low wages, an inexhaustible supply of mobile unskilled labor force, low transportation and communications costs, large FDI inflows, foreign management expertise underpinning production capabilities, a large domestic market, opening of world markets and a skillful adoption of outer-oriented strategy of growth. It is widely believed that the renminbi yuan has been undervalued and has propped up China's competitiveness of exports, albeit the degree of its undervaluation is a matter of serious disagreement. At this stage, China's high competitiveness and export growth is more than likely to be maintained even if exchange rate is no longer undervalued. For quite some time, competitiveness will be supported by the low wages of fresh inflows of mobile labor from the rural areas. Competitive exports from China will continue to displace low-cost export production from different sub-regions of the global economy.

Chinese firms have grown progressively proficient at producing goods that are regarded world-class in terms of quality and product design. A liberal and well-designed FDI strategy and the large number of foreign-invested enterprises (FIEs)[21] have facilitated this process of honing international competitiveness. The fact that Chinese exports shifted towards technologically advanced, or had higher

[21] The term "foreign-invested enterprises" stands for subsidiaries of TNCs and joint ventures. The assets of FIEs are owned in full or in part by foreign firms. This term is somewhat of a misnomer in China. It stands for local affiliates of foreign-owned firms. Many of these local affiliates are joint ventures with Chinese enterprises. Until 1992, almost all FDI in China was in the form of joint ventures. The expression "foreign-invested" was used to reassure that these ventures were domestic firms with foreign participation. Since 1992, a growing proportion of local affiliates of foreign firms are majority-owned or wholly-owned by foreign investors, but the use of the term "foreign-invested" continues to be applied to them. Presently FIEs consist of wholly-owned FIEs and joint-ventures like Sino-Foreign Contractual joint ventures ans Sino-Foreign Equity Joint ventures.

technology content, at an early stage notably buttressed its international competitiveness. In addition, Adams *et al* (2006) regard China's huge and growing domestic market as "ace in the hole". Foreign firms of all breeds sought entry into China not only for taking advantage of its potential as a low-cost export base, but also to position themselves well for catering to the potentially mammoth demand. Only a small number of EMEs have comparable market potential.

Two industrial sectors on which China is going to have a strong negative impact in many developing economies are textile and apparel and electronics. In these two industries China is exceedingly competitive and most developing economies find it difficult to compete with it. This state of affairs is going to continue in future. In the post-multifiber arrangement (MFA) era, China's export expansion in textile and apparel will be at the cost of other developing country exporters of both Asia and Latin America. Under the Agreement in Textiles and Clothing (ATC) some textile quotas were removed in 2002 and then in 2005 the MFA was dismantled. As a result, for these products China's exports recorded a sharp jump, while many developing economies lost their markets. Countries like Bangladesh, Costa Rica, Nicaragua, Pakistan, Vietnam, that have relatively large and growing textile and apparel sectors will suffer serious setbacks in their textile and apparel exports. A simulation exercise conducted by Yang (2006) using GTAP-5 data base and another by Wang (2003), which utilized 25-sector CGE model demonstrated that all the developing economies were hurt and lost market shares due to competition from China in textiles and apparel. Future is not likely to be very different in this regard. Proximity to the final consumer may play a role here. This implies that China's competitive strength may affect Nicaragua textile exports differently from those from Vietnam because of former economy's closeness to the US market. Some developing countries may specialize in products in which they have comparative advantage due to proximity to the final market. They may not be affected by China's competitive prowess.

China is also a signatory of the Information and Technology Agreement (ITA) of the WTO. It has been highly competitive in electronics industry and its exports are expected to continue expanding rapidly. Most developing economies will find it difficult to compete and China's success will be at their cost. The silver lining to this dark cloud is that China is a large importer of intermediate inputs in electronics, which will increase its imports of basic and intermediate electronic products from the other EMEs. Countries like Republic of Korea (hereinafter Korea), Taiwan and Singapore export electronic components and subassemblies to China in a big way and will benefit from China's increasing imports. Gradually China's demand for higher-end electronics components and parts will increase, which will give an impetus to intra-industry trade between China and other major EME producers of electronics products. The EMEs in this case will be those that are at a higher technological rung than China. Also, EMEs like India have been benefiting from significant trade they have been able to develop with China, since the late 1990s, in the ICT sector, IT-enabled services (ITeS), software and other professional services.

5. Outward FDI and the "Going Global" Strategy

During the mid-1980s, Chinese firms began investing in other industrial and developing countries and the EMEs, with its largest investments going to neighboring Asian economies, Australia, the US and two Caribbean islands that are prominent financial centers. At a later stage, FDI in the Latin American and African economies followed. FDI outflows increased from a measly $100 million a year in the mid-1980s to $12.3 billion in 2005. The outward stock of FDI at this point was $57.2 billion, which was 2.6 percent of Chinese GDP. Being a new outward investor, China accounted for merely 0.5 percent of global outward FDI stock (UNCTAD, 2007).[22] With the adoption of "going global" strategy and present forex reserves level of $1,400 billion,[23] China is vying to become one of the largest FDI source countries in the foreseeable future.

[22] See UNCTAD (2007), Chapter 3, Table III.1.
[23] At the end of August 2007.

Chinese firms began with small investment in neighboring Hong Kong and Macao in the mid-1980s. At this point, they not only lacked knowledge and experience needed for investment abroad but also suffered from a shortage of foreign exchange. Government had stringent control over foreign exchange outflows. In the late 1980s, government promoted flexible arrangements to promote outward FDI. Chinese firms invested abroad by providing production equipment, technological know-how and raw and processed material. Until 1990, all FDI projects were small, only a handful exceeded $5 million. A dramatic increase occurred after this point, both in terms of number of projects and value of investment. By 2000, Chinese firms had invested in 6,296 projects in 140 countries. In terms of stock of FDI, Hong Kong was the largest destination country in 2005, followed by Cayman Islands and British Virgin Islands. Korea, the US, Macau and Australia followed in terms of volume of stock (UNCTAD, 2007). Neighboring Asian economies, in particular Hong Kong, remained the favorite host region for the Chinese firms. Latin America stood second and until recently Africa was marginal.

Whether FDI projects were chosen with proper business acumen or not is obvious from the fact that one third of them yielded a positive rate of return while another third managed to breakeven. FDI outflows are not only a mode of operating and competing in the global markets for Chinese firms but also an integral part of China's increasingly global economic role. Driven by objectives of market and asset expansion and resource seeking, Chinese firms have started taking far greater interest in investing abroad. In that, they were being encouraged and supported by the strategy of "going global" that was adopted in the late 1990s. It was a thoroughgoing strategy that included provision of preferential bank loans for the investing firms, streamlined border procedures, preferential tax policies and special trade laws. In 2004, numerous laws were promulgated to encourage outward investment. In addition, both National

Development Reform Commission (NDRC) and the Export-Import Bank of China (EIBC) jointly began promoting outward FDI.[24]

Chinese authorities were aware that their enormous foreign exchange reserves were to be used in lucrative and productive outward investment. After investing heavily in low-yielding liquid assets like the US Treasury securities, they were looking for avenues for higher returns on their global investments. High profile transactions like acquisition of IBM's personal computer business for $1.25 billion by Lenovo in 2004 portended to China's ambitions for better returns as well as to improve its global stature by acquiring high-value, if ostentatious and glitzy, assets. In 2005, another large global investment made by a Chinese company, China National Petroleum Corporation, was in Canadian-listed PetroKazakhstan; its acquisition was made for $4.18 billion. In mid-2007, cashed-up giant was trying to acquire the Barclays Bank, Britain's third largest lender. The government-run China Development Bank (CDB) announced taking a stake in Barclays (*The Economist*, 2007). CDB's total investment in this venture was **€** 9.8 billion, making it China's biggest overseas investment. Under the deal, China Development Bank took an initial 3.1 percent stake in Barclays for **€** 2.2 billion. Its total stake was expected to be extended further.

6. Modeling China's Global Integration

Given the importance of the issue and advancing techniques of measurement, the impact of China's integration into the global economy has been extensively modeled. Numerous studies have attempted to quantify the impact of China's global integration. Not only new theoretical developments have taken place but also analytical techniques have been devised, which helped researchers in finessing their techniques. In addition, computational and data processing capability of computers increased (Piermartini and Teh, 2005). However, due to poor availability of data and information, not many of these studies had tried to assess the impact of liberalization and trade expansion in the commercial

[24] See UNCTAD (2005 and 2007).

services sectors. Space considerations deter me from traversing over this entire landscape and covering these empirical and econometric analyses. Therefore, a brief reference to them and their conclusions is being attempted here. The CGE model is an oft-used tool for economic impact analysis. As noted above, GTAP is a useful CGE model. It is adaptable and has several useful adaptations, many of which have been used for quantifying China's impact over the global economy.

Two concise surveys of the earlier impact studies are available, namely, OECD (2002) and Gilbert and Wahl (2002), which reviewed 16 empirical studies and 30 studies, respectively. These can be regarded as somewhat dated. Also, analysts conducting these modeling exercises did not know about the composition of China's Protocol of Accession to the WTO. While their conclusions differed markedly, one common strand that ran through them was that both China and global economy will have welfare gains from China's global integration. Large welfare gains to Chinese economy stem from reforms, restructuring and unilateral liberalization of the domestic economy.

A large modeling exercise was conducted by the International Monetary Fund (IMF), with full knowledge of the Protocol of Accession. It used an updated data base for 2002 bilateral trade flows and macroeconomic aggregates and used GTAP-5 model. This study attempted to quantify the impact on TOT and trade flows of different regions of the global economy under various scenarios for a period up to 2020. To this end, a 10-region, 7-sector GTAP was constructed. Under the "fast" Chinese integration scenario, this study estimated that by 2020 China's share of world GDP and trade doubled, in the NIAEs GDP growth picked up, but the share of the industrial economies declined by 10 percent. The results of this scenario show China as the largest welfare gainer. Despite deterioration in the TOT, China overall welfare increases sharply. Also, labor-abundant regions like South Asia suffer under Chinese competitive pressure in the "fast" integration scenario and commodity importers suffer due to higher prices. These regions are net losers. Africa and Middle East gain on average because of their exports of oil and commodities. In Latin America economies benefit from shifting trade patterns. In all the regional economies, structural adjustments take place and 1 percent to 2 percent work force moves to different sectors. Under the “slow” Chinese integration scenario, China’s growth rate unrealistically declined to 2.5 percent annually. In this case China’s share of GDP remains the same in 2020, with little difference in shares of world trade (IMF, 2004).

The results of the IMF (2004) seem plausible and demonstrate that the over all welfare impact of China’s rapid integration into the global economy will be identical to the three previous historical episodes of integration of Japan, NIAEs and ASEAN-4 economies. Long-run projections reveal that “China is likely to play a much larger global role than any of these economies”. The results of this modeling exercise also show that the impact on the rest of the global economy will not be huge, albeit beneficial. While some individual sectors do show significant losses, such costs will typically be offset by gains in other sectors. The bottom line would be net welfare gains to these economies. Finally, China’s “fast” integration could also induce sizeable dynamic productivity gains in the global economy.

A recent Organization for Economic Cooperation and Development (OECD) CGE modeling project on quantifying the impact of China’ rapid growth on the 30 OECD member economies was even more comprehensive and ambitious than the studies attempted so far (OECD, 2006). China’s economic, particularly trade, ties with the EU, Japan and the US are close, therefore it is logical to expect that these economies will engender a good deal of mutual impact. China is Japan’s largest trading partner. It has close relations with many other OECD economies and is one of the top three trading partners of majority of the OECD economies. This modeling exercise took into account role of investment, particularly FDI, in the Chinese growth paradigm and included services sector liberalization. This analysis used the GTAP-6.1 Interim Release data base and FTAP model[25] to

[25] FTAP stands for Foreign Direct Investment and Trade Analysis Project.

study the impact of foreign direct investment. The GTAP 6.1 database covers 57 broad economic sectors and 92 countries. Also, to enable the analysis of liberalization of services sector, a bilateral capital stock matrix was developed.

This modeling exercise included phenomenon like China's global economic impact through proactive participation in global production networks, impact on the world market prices, rapid productivity growth in the domestic economy and changing TOT of the Chinese and other global economies. The results of this exercise show that liberalization of the analyzed sectors would lead to increase in China's real income and per capita welfare by 3 percent. Conversely, it found limited impact for the OECD economies. The maximum direct impact is expected through improved export performance of OECD countries that have close trade and investment ties with China but still face significant market access barriers. This impact is more important for Japan, Australia and New Zealand. Second impact of China's liberalization that can affect the OECD economies is through increased competitiveness of Chinese exports into the OECD countries. This will cause TOT improvement for the importing economies. Many OECD economies will be able to import their intermediate goods at better prices. A caveat that must be mentioned is that this analysis did not account for the dynamic impact of China's growth and therefore it is "likely to provide lower-bound estimates of China's integration into the world economy" (OECD, 2006).[26]

7. How to Dance with China? Formulating a Functional Strategy

This section presents a stylized strategy of living, coping with and possibly benefiting from the rapidly expanding Chinese economy. *Prima facie* this circle seems difficult to square. However, at the risk of advocating simplicity, I would propose a broad two step strategy: First, policy mandarins should identify both threats and opportunities emanating from China's rapid growth, and second, adjust to them in a flexible a creative manner. Flexibility is a high-value policy variable in this situation. To cope with and benefit from China's brisk growth,

[26] For more detailed, country-wise results, see Table 14, 15 and 16 in OECD (2006).

macro- and microeconomic responses will *inter alia* entail swift movement of productive resources. Policy-makers are obliged to create a macroeconomic environment in which firms are "able to experiment, expand on success, and withdraw from failure" (Winters and Yusuf, 2007). While the proposed strategy is a broad and indicative one, it is an intelligent response that has wide-ranging implications. The fine-tuning of the strategy will call for the knowledge of the development status, income level and resource base of the country concerned. It is these variables that determine how a country interacts with the global economy. For instance, let us take the group of low-income, natural resource rich developing economies that suffers from the scarcity of human capital. For this group of developing economies, it is possible to build low-technology industrial sectors, which could compete with China due to its low-wages in labor-intensive manufactures. Due to rapid industrialization, in the southern and eastern provinces of China, wages have constantly been rising, although not the same can be said about the interior provinces of the west and the north. In the medium-term, as the wages in China climb above the level necessary to keep the labor-intensive manufacturing sectors competitive, an opportunity will be created for this group of developing countries. A number of developing economies in Africa and Asia come under this category, which sees opportunities in climbing Chinese wages. This is not a unique situation. It has happened in the past. Two decades ago, China benefited from the rising wages in the NIAEs. The preconditions for success in adopting this strategy is that these developing countries will have to improve the level of governance, create or improve industrial infrastructure and eradicate bureaucratic hurdles that stifle industrial growth and efficiency and poison macroeconomic environment. They will also have to learn to achieve the quality standards required by consumers in the importing countries. Those developing economies in Africa and Asia that succeed in fulfilling these preconditions, will indeed find China's rapid growth as an opportunity. China could become a large import market for their products.

As China has become a large importer of energy, mineral, commodities and natural resources, the developing or industrial economies that are exporters of these primary items will experience their real exchange rates appreciating with increasing exports. However, there is a downside of this. If these exporters are developing economies, they will face difficulties in building a labor-intensive manufacturing sector. Some sub-Saharan African economies are in this situation since middle of the decade. The increase in income from the primary sector exports resulted in stagnation of exports of their low-technology, labor-intensive products.

The middle-income countries of Asia and Latin America have been facing a large challenge from China’s economic rise because it is encroaching into their product space. In future, China is likely to continue to encroach more into this product space than at present. Wages in these economies are higher that those in China, albeit their education levels are comparable. Thus, in some sectors in which they enjoyed comparative advantage in the past, they will have to throw the towel and step out of the ring. However, they need not be defeatists. This group of economies has so far been able to compete with China in the skill-intensive products. Sustained improvement in human capital development will enable them to main this competitiveness. Also, moving on to higher-technology products and facilitating FDI in this range of products will be a functional strategy to out-compete China.

Many Latin American economies have not been able to face increasing competition from China. This applies to both domestic and third-country markets. It has forced many Latin American firms out of production (Alvarez and Claro, 2007). Investments in skills and technology improvements at the firm level are the correct approach for these Latin American economies. Intense competitive pressure from China failed to perturb the NIAEs because they were ahead of China in both human capital endowment and development and technological sophistication. The NIAEs have been making sustained endeavors to maintain their lead. They are cognizant of the fact that their inability to stay ahead will push them into loss of market shares. The Latin American economies need to take this leaf from the NIAEs' book and emphasize on building technological capability, diversifying product mix, honing human resources and upgrading the quality of the products. Efforts also need to focus on advancing of design capability of the domestic firms.

The high-income industrial economies can face ascending China without ham-fisted, politically motivated interventions in the economy. If they take a realistic view of China's strengths, for the next two decades they need not be overly concerned about competition in the high-technology, skill- and knowledge-intensive industrial sectors and commercial services. The latter is an area of weakness for the Chinese economy. Building of these industrial sectors took industrial economies highly educated labor forces, large accumulations of knowledge as well as innovation supported by long-term heavy investment in R&D. To be sure, this country group has lost its comparative advantage in low-technology products and is large importers of them from China, in that they are benefiting from the low-priced imports. Although the US has been suffering from a large trade deficit vis-à-vis China, a large part of it is due to exceedingly low savings in the US rather than trade barriers in China. Besides, China export drive should loose some its momentum in the near future because of rebalancing endeavors in the economy as well as continuing efforts to strengthen domestic consumption.[27]

Industrial economies cannot be seen as static economies. Over the next two decades they will develop comparative advantage new high-technology, skill- and knowledge-intensive industrial sectors as well as in commercial services. While they will lose their domestic markets at the lower- and medium- technology ends of industries, they will gain in the high-technology, skill- and knowledge-intensive industrial sectors and in commercial services. In these sectors China is

[27] This section draws on Winters and Yusuf (2007), Chapter 1.

likely to become their large market. Industrial history of the last two centuries confirms that such dynamic adjustments have always taken place in the global economy.

Lastly, as stated in section 1.1, no country can manufacture everything and produce all the commercial services. A large, resourceful and rapidly growing Chinese economy will also find its areas of comparative advantage and cash in on it. Equally, it will find its areas of comparative disadvantage, where the other economies will have comparative advantage. This will make China a large market for the other global economies, be they developing or industrial economies. As the present is a period of flux and most economies are having to adjust to the high-speed expansion of the Chinese economy from a low level of income and development, the costs for some economies are higher than the benefits. This need not always be the case. Sinophobes need not be believed.

8. Summary and Conclusions

Over the last three decades significance of China has radically increased and it has traversed from the periphery of the global economy to the core. For all appearances this progress is likely to continue in the foreseeable future. Three decades of macroeconomic reforms, sustained growth and global integration have turned China into a future economic power of global magnitude, with unmatched breadth of resources and a robust manufacturing sector. Its re-emergence and economic status is often compared to the growth performance of “miracle” Asian economies that came into their own during the post-War era and made a niche in the global economy. A more appropriate simile for China is the economic rise of the US over a century ago. That China’s growth performance is comparable to that of the US and the UK is confirmed by the historical growth statistics for these two economies and post-1978 China. One tangible outcome of its brisk growth is amplification in the global shares of production, investment and trade.

China has grown to be the fourth largest economy in the world in a short time span of three decades and the third largest trader. It is endeavoring to make a new niche for itself in the global economy as well as formulate a new role. This cannot be termed dislocation or displacement but it is a fundamental structural change in the global economy brought about by China's vertiginous growth. Both China's increasing economic weight and escalating integration in the global economy have been rebalancing the global economy.

China's potential catching up with the US is for sure a tectonic geo-economic and geo-political occurrence. It seems that the parity will be attained in the foreseeable future. In some countries China's economic rise has caused unbridled indignation, world public opinion does not find it startling and more or less accepts its emergence and global economic impact in an equable matter-of-fact manner. The policy makers in China have made conscious endeavors for ascendance as a soft-power. The geo-strategic stance of "peaceful rise" was favored by the Chinese politicians and strategists, who preferred China to be a responsible and benign power of the future. This doctrine basically posits that China can and should rise economically and acquire the status of an economic super power peacefully.

Although its economy is growing and importance and participation in the global policy arena has been increasing, China has so far played a modest role relative to its economic weight and heightened status. To be sure, China has abandoned its previous aversion to multilateral organizations. Yet, its eagerness to assume a leadership role is conspicuous by its absence.

For some time now, China has become a source of global growth. Evidence of China's influence over contemporary global economic growth is easy to see. It is being regarded as the second engine of growth after the US. While it will not replace the US as the leading economic power, in partnership with the other AHP economies, China may well emerge the principal growth pole of the global economy in the future. This growth pole, led by China, may become the driving force behind the contemporary global economy. Its influence will certainly be felt during the rest of the 21st century in shaping the contours of the global economy. A positive contribution of rapidly growing Chinese economy has been in dampening down the magnitude of the global business cycle. China's increasing weight in the global economy and its low or no correlation with industrial-country output growth trends contributed to reducing the cyclical swings in the global economy. As trade and FDI have expanded at a remarkably high pace in the recent past in China, these two variables have become important channels through which China has (and would continue to) impinged upon the global economy. The former would affect other economies by way of changes in TOT, while the financial channel can have a wider impact.

One undisputable result of China's 2001 accession to the WTO is its continuing, if not intensifying, closer integration with the global economy by way of trade and investment. The WTO membership brought China in the fold of the multilateral trade regime. Empirical studies concluded that the largest gains of China's WTO membership accrued to the EU, Canada and the US. Almost half of these gains to them were generated by elimination of quotas they had imposed on exports of textiles and apparel from China.

In their endeavors to go global, Chinese firms began investing in other industrial and developing countries and the EMEs, with its largest investments going to neighboring Asian economies, Australia, the US and two Caribbean islands that are prominent financial centers. At a later stage, FDI in the Latin American and African economies followed. Chinese firms also have been making high profile acquisitions of world-class assets. Several modeling exercises were undertaken to assess the outcome of China's global integration. This paper presents their conclusions in a concise manner.

A stylized strategy of living and coping with the rapidly expanding Chinese economy has been profiled at the end of the paper. At the risk of advocating simplicity, I have proposed a broad two step strategy: First, policy mandarins should identify both threats and opportunities emanating from China's rapid growth, and second, adjust to them in a flexible a creative manner. Flexibility is a high-value policy variable in this situation. To cope with and benefit from China's brisk growth, macro- and microeconomic responses will *inter alia* entail swift movement of productive resources. Policy-makers are obliged to create a macroeconomic environment in which firms are able to experiment, expand on success, and withdraw from failure.

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