

Assessment of the normative and policy framework governing the Chinese economy and its impact on international competition

**Presentation of the Report prepared by THINK!DESK China Research & Consulting
for AEGIS EUROPE – Cross-sector Alliance Representing European Manufacturing**

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The Chinese Economy between Plan and Market

1. China's economic development is a success-story and China has substantial impact on the global economy

Size of economy

**# 2 – 17.6 trillion PPP\$ or 16.3% of global total economic output (EU-28 is still # 1)
(IMF WEO 2015)**

Role in global division of labour

1 – largest trading nation with 4.303 trillion US\$ total trade value

1 – largest exporter with 2.343 trillion US\$ export value

(WTO ITS 2015)

Role in global foreign direct investment activity

2 – second most attractive host country for foreign investors, 124 bn. US\$

3 – third most active investor abroad, 101 bn. US\$

(UNCTAD WIR 2014)

Foreign exchange reserves (incl. gold)

1 – 3,880 trillion US\$: three times larger reserves than # 2

(IMF data bank 2015)

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2. China has left the realm of central planning, but has it arrived in the world of market competition ?

How has China accomplished its «economic miracle » ?

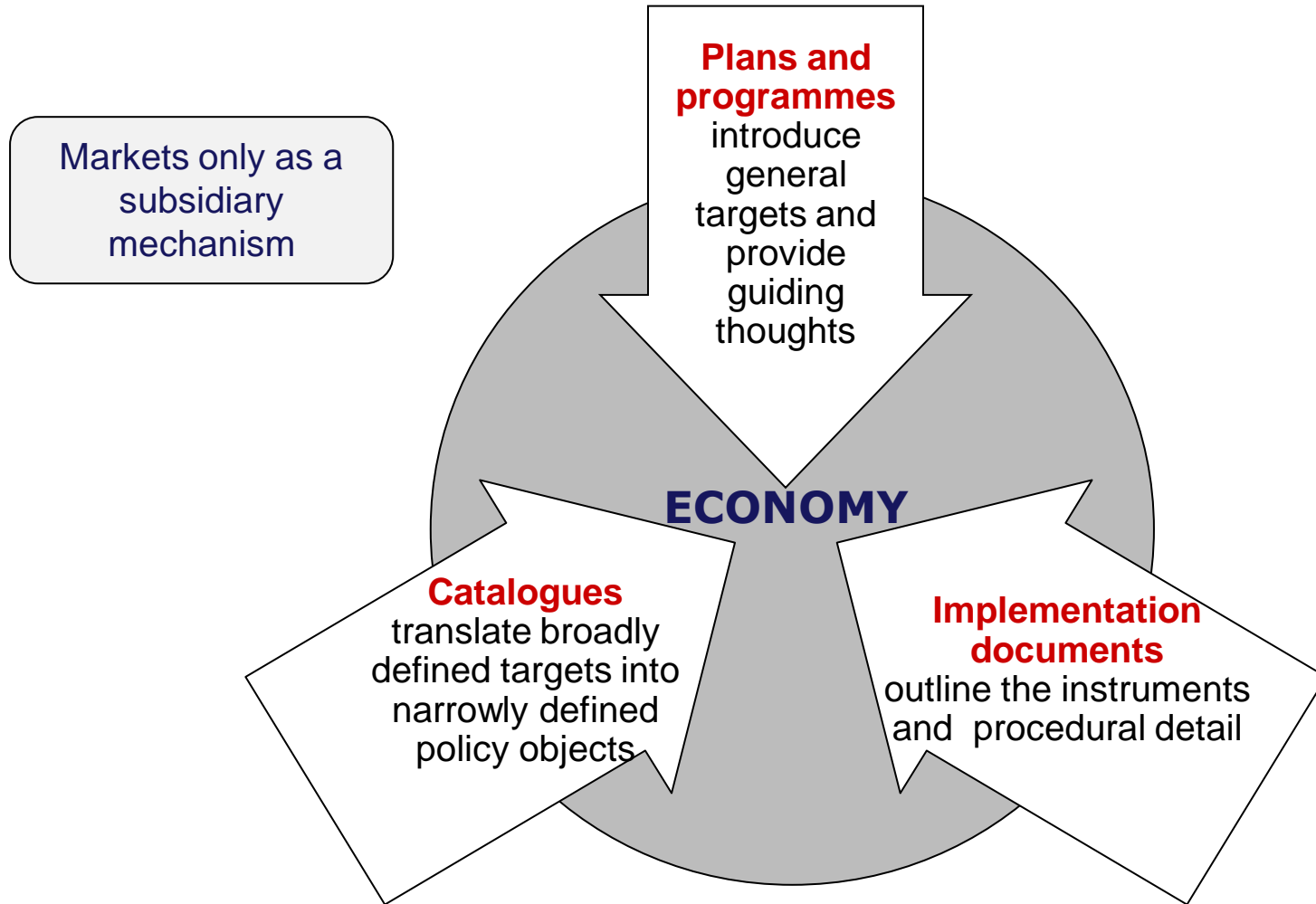
- “catching-up growth”
- state-capitalist growth paradigm

This Report takes an in-depth view at:

- The role of **state plans** in economic and industry development as well as corporate behaviour
- The role of governmental **programmes** for steering of industry development
- The close **interrelationship** between business leaders – government cadres – CPC leaders
- The role of **markets** for economic co-ordination and business
- The existence and capacity of **market supporting complementary institutions**
- The organisation of the **interface** between the Chinese economy and the rest of the world (i.e. trade, FDI and exchange rate regimes)

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3. China's 3-tiered planning system



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3.1 China's "Planning Universe"

National 5-Year-Programme

Derivative Plans Along Administrative Hierarchy

- Provinces
- Cities / Prefectures
- Districts/ Counties
- Townships
- Villages

Derivative Plans Along Institutional Lines

- Government units
- State-owned Enterprises
- State-run research institutes
- State-affiliated organisations

Derivative Plans Along Overarching Topical Areas

- Innovation
- Resource conservation
- Western and central region development

Derivative Plans Along Sectoral / Industry Lines

- Various industries
- Technology initiatives (e.g. ocean economy, strategic emerging industries)

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3.2 China's "Planning Universe" – A 12th 5-Year-Programme ABC

- **Aluminium Industry**
- **Bee-keeping Industry**
- **Chemical Fibre Industry**
- **Dangerous Chemicals Industry**
- **Explosion-proof Electrical Industry**
- **Fibreglass Industry**
- **Grape Wine Industry**
- **High-end Equipment Manufacturing Industry**
- **Integrated Circuit Industry**
- **Light Industry**
- **Machine Tool Industry**
- **New Materials Industry**
- **Optical Fibre and Optical Devices Industry**
- **Potato Processing Industry**
- **Rubber Industry**
- **Silkworm Industry**
- **Termite Control Industry**
- **Vanadium and Titanium Comprehensive Resource Utilisation**
- **Wind Power Industry**

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4. State Programmes for discretionary industry steering

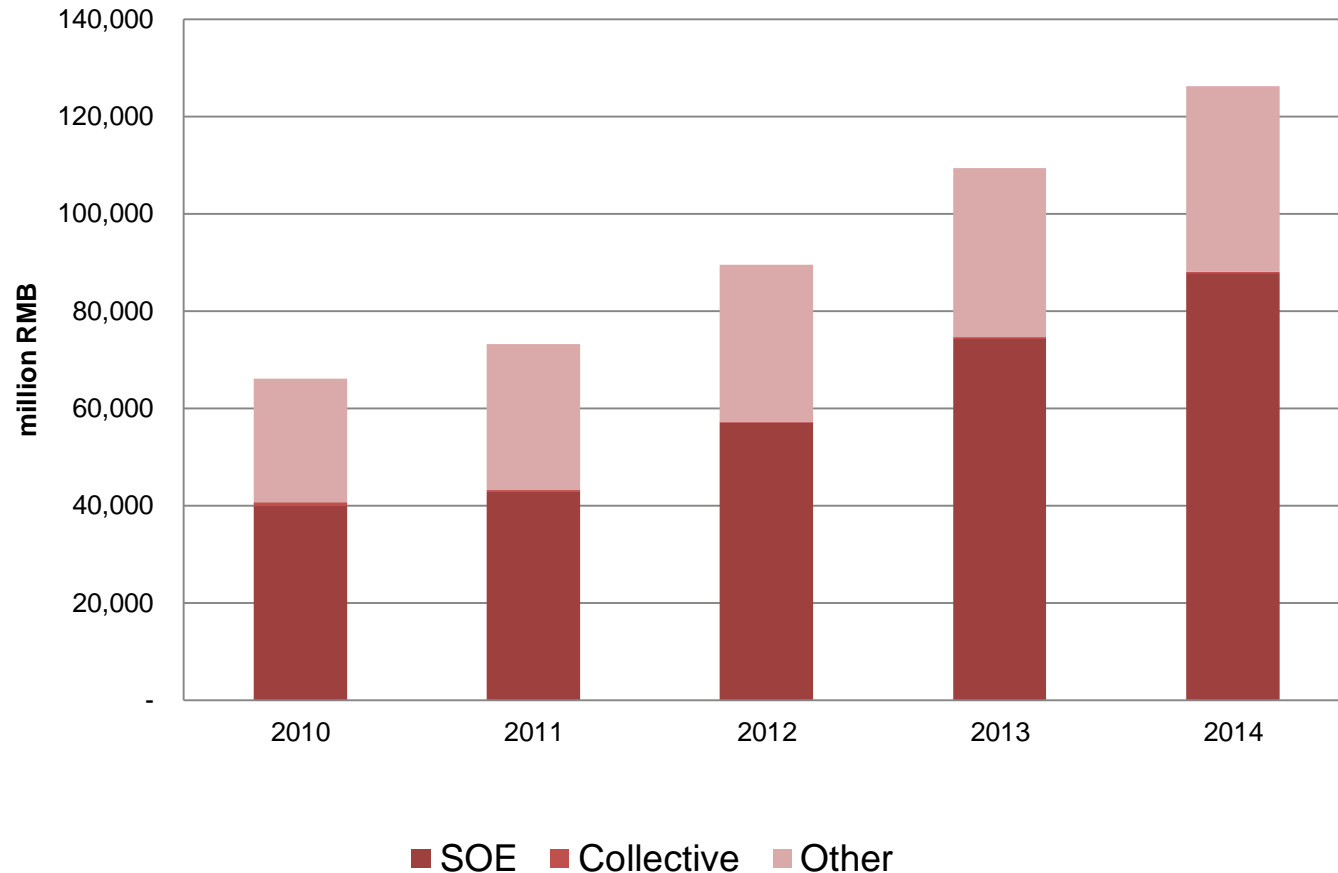
Chinese government remains committed to a hands-on approach to economic development. Plans and industry programmes are **backed up by subsidies and support programmes**. These constitute a cornerstone for government initiatives designed to steer the economy towards specific goals.

The targets of subsidies and like support programmes are highly diverse, but focus on the following fields:

- **Technology innovation and commercialisation**
- **Technology upgrading**
- **Promotion of “Strategic Emerging Industries”**
- **Environmental protection**
- **Transformation and adjustment of the industrial structure (e.g. M&A, relocations, compensations for enterprises leaving industries with high overcapacities)**
- **Employment and training (e.g. re-settlement of displaced workers, social security premiums, housing and amenities for employees, maintaining staff levels)**
- **Foreign trade (imports of encouraged goods, general export promotion, export brands, export insurance, foreign market exploration)**

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4.1 Subsidies to enterprises of different ownership types Increasing volumes - favouring SOE (Figure 9)



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4.2 Enterprises that reduced their losses by means of subsidy income in 2014 (Table 7)

	Net losses	Subsidy income	Reduction of net losses
Qinghai Huading Industrial Co., Ltd.	-5,387,138	25,963,808	-83%
Yangmei Chemical Co., Ltd.	-30,360,015	118,443,048	-80%
Shenzhen Topraysolar Co., Ltd.	-5,377,434	20,301,752	-79%
Wus Printed Circuit (Kunshan) Co., Ltd.	-12,109,197	39,784,879	-77%
Shenzhen Nanshan Power Co., Ltd.	-330,513,285	511,637,613	-61%
Shandong Jining Ruyi Woolen Textile Co., Ltd.	-1,794,185	2,326,651	-56%
Fujian Yongan Forestry (Group) Joint-Stock Co., Ltd.	-20,665,872	20,245,406	-49%
Hunan Corun New Energy Co., Ltd.	-45,938,879	38,839,466	-46%
BGRIMM Magnetic Materials & Technology Co., Ltd.	-28,335,545	22,260,205	-44%
Hunan New Wellful Co., Ltd.	-48,963,311	36,918,160	-43%

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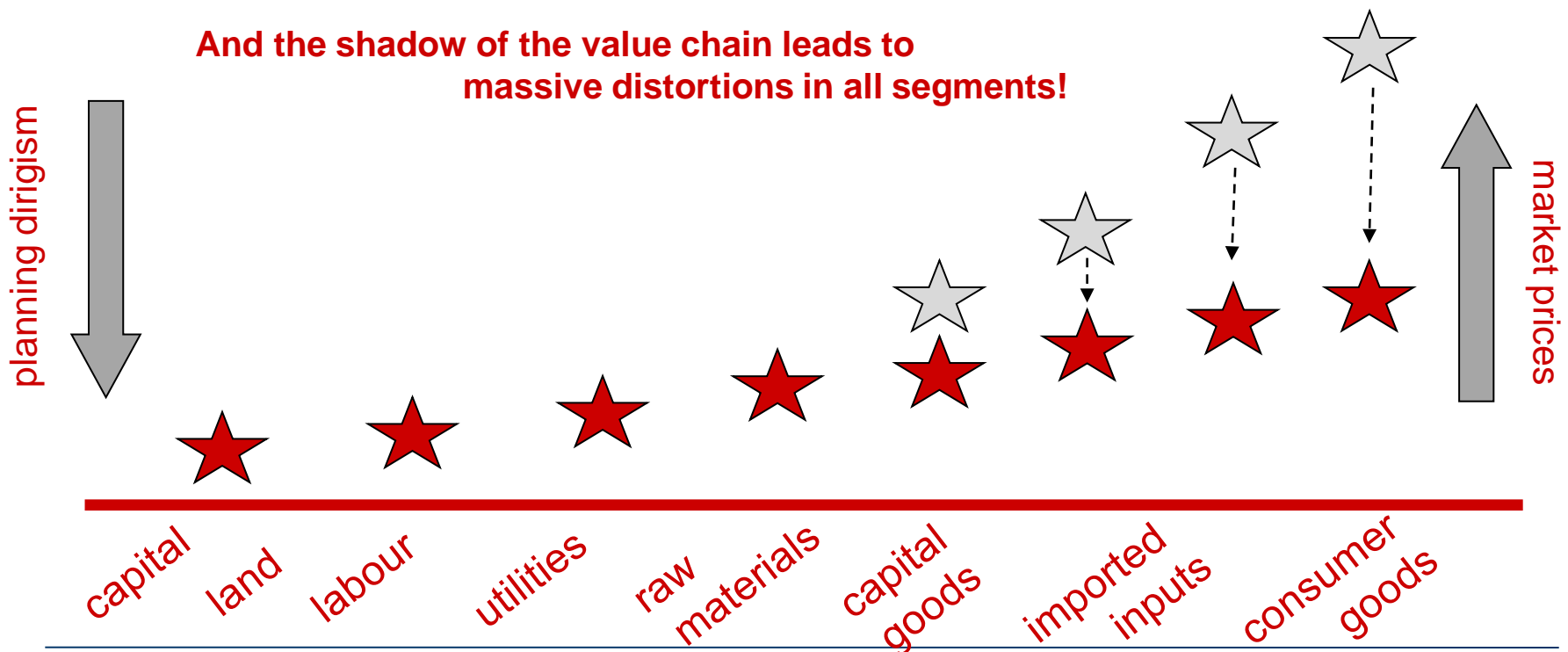
5. Markets as secondary ordering mechanisms

The litmus-test for the existence of a market system is the prevalence of prices that truly reflect relative scarcity, i.e. the relation between demand and supply.

China's prices are beginning to have a role.

But, the role of markets changes systematically with the markets' position in the value chain.

And the shadow of the value chain leads to massive distortions in all segments!



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6. A «harmonious society»: business leaders – government cadres – CPC leaders

**In China's socio-economic system
political and party careers go hand in hand with corporate careers.**

At least in the state-owned enterprise sector, success in the latter sphere is impossible without corresponding accomplishments in the CPC hierarchy.

Markets – for political capital:

Given the close interdependence between the political (government, CPC) sphere and the business sector in China, there exists a substantial **demand for fora at which representatives of these two spheres can meet** – especially by those who are not already integrated in formal institutional settings linking politics and business.

The multi-tiered system of **People's Congresses**, reaching from the village level via the township, town, district, and provincial level up to the National People's Congress, constitute such meeting points and play an important role for the interaction between entrepreneurs, politicians and administrative bureaucrats in China.

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7. China's interface to the global economy is distorted as well



**Import substitution / state trading /
import cartels / gov. procurement**

**Export quota and duties / state
trading / discriminatory VAT rebates
/ multitude of export promotion
programmes**

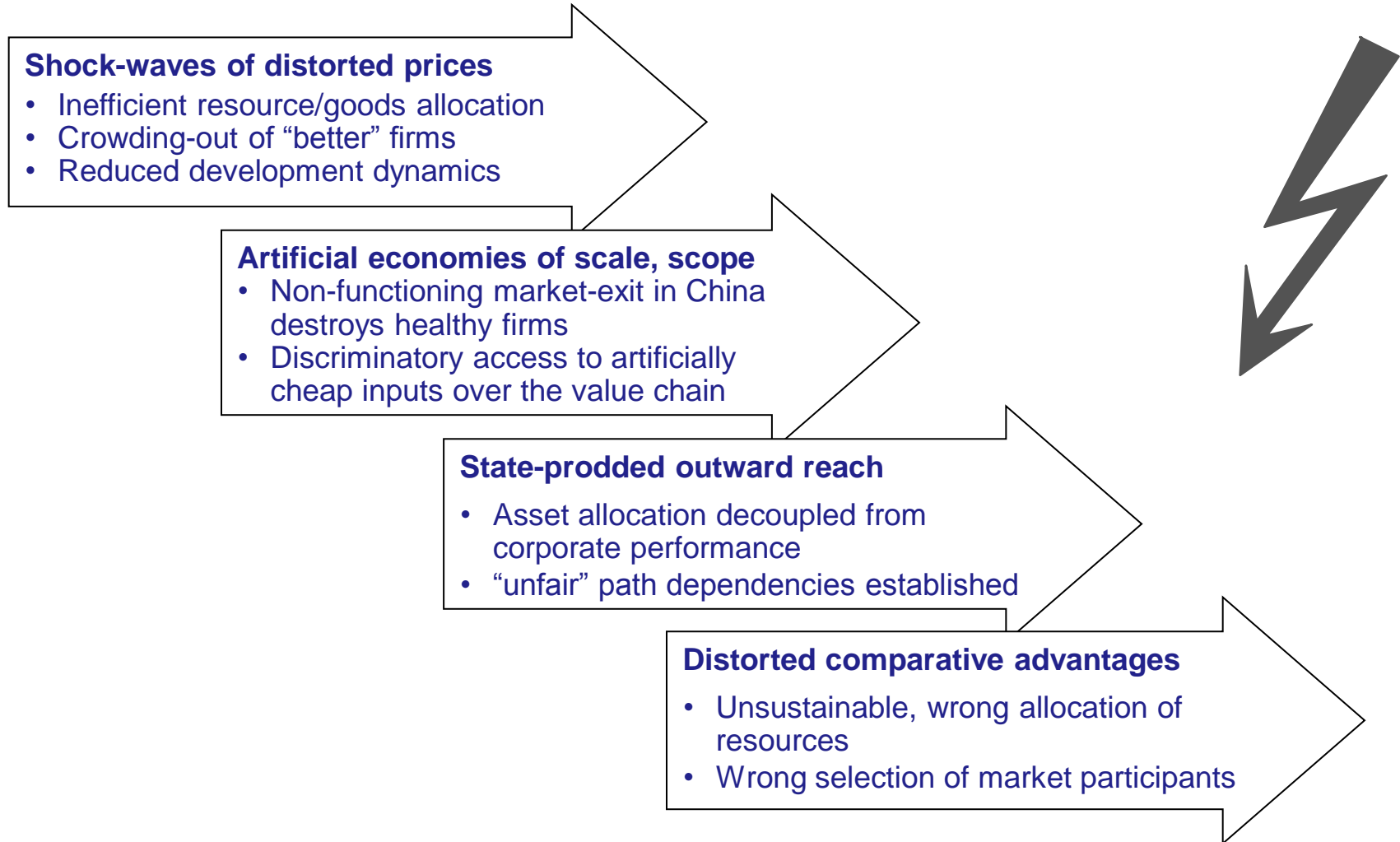
**Discretionary filtering and steering of
FDI inflows / state promotion of FDI
outflows**

**The exchange rate regime remains
under full governmental control.
RMB rates are government directed**



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8. Impact on European industry



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9. In a nutshell

China features a state controlled market system which is distorting the global markets !

The role Chinese firms play in the global value chains are not compatible with any comparative advantages China possesses or individual firms' true competitive strengths.

While this allows Chinese firms to gain unjustifiably large market shares and corresponding revenue income, other, actually more competitive firms are being crowded out and must leave the market.

In global perspective this results in

- a reduction of global welfare in the present,
- reduced dynamics for global economic development and growth and consequentially reduced levels of global welfare in future periods,
- a global redistribution of business activity and employment as well as tax-income based state capacity.