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The People's Republic of China's Future Development and Economic Relations with Asia and Latin America

By Justin Yifu Lin, Peking University

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The People's Republic of China's Future Development and Economic Relations with
Asia and Latin America*

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Since the economic reform started at the end of 1978, the People's Republic of China (PRC) has become the most dynamic economy in the world. In the period of 1978-2003, PRC's GDP growth rate reached 9.4% per year and that of international trade 16.0%.¹ The size of PRC's GDP and international trade increased respectively 9.4 times and 41 times in those 25 years. Currently PRC is the seventh largest economy in the world measured by official exchange rate and the second largest economy in terms of purchasing power parity. PRC is also the third largest importer and the fourth largest exporter in the world in 2003. Especially, PRC's trade dependent ratio, that is the export and import as a percentage of GDP, reached 60% in 2003, the highest among the large countries in the world. With this rapid growth Chinese people's living standard improved significantly. It is noteworthy that the number of people living under extreme poverty reduced from 250 millions in 1978 to 29 millions in 2003, making an important contribution to the world's effort of poverty reduction. PRC's dynamic growth and rapid integration with the world has also made many contributions to other economies. An outstanding example is PRC's policy of maintaining exchange rate stability during the East Asian Financial crisis, which helped the crisis-hit countries avoid competitive devaluations, and contributed to the crisis-hit countries' early recovery.

However, in spite of the rapid growth in the past 25 years, PRC is still a developing country. The per capita income just reached US\$ 1,000 in 2003. There is still a large gap to close before PRC becomes a developed country. With its high trade dependent ratio and large economic size, if PRC is to maintain a dynamic growth in the future, other countries in the world may also benefit greatly from trades with PRC. Therefore, whether PRC can maintain a dynamic growth in the coming decades is important not only for the Chinese people but also many other countries in the world. In the paper, I will first examine the potential of PRC's future growth, the reform necessary to tap into that potential, the impact of WTO accession on PRC's reform, and the implication of PRC's future growth on Asia and Latin American economies.

I. PRC's Growth Potential

From an engineer's point of view, the growth of an economy depends on the increase of inputs, especially the capital, the relocation of inputs from low value-added sectors to high value-added sectors, and technological innovation. Among the above three sources of economic growth, technological innovation is the key. Without a continuous stream of technological innovation, the accumulation of capital will result in diminishing returns to capital, which will depress the incentives to save and obstruct the accumulation of capital (Schultz 1964). Similarly, a higher value-added sector in general is the result of new technology, as exemplified by the continuous emergence of new products and new industries after the industrial revolution in the 18th century.

There are two ways of technological innovation: invention and technological borrowing. Except for a few oil-rich countries, the developed countries have adopted

¹ State Statistical Bureau, *China Statistical Yearbook, 2004*, Beijing: China Statistical Press, 2004, p. 56 and p. 714.

the most advanced technology in their production. Therefore, the main source of technological innovation for the developed countries is invention. In addition to inventing technologies by themselves, the developing countries could also borrow new technologies from the developed countries, as there exists a technological gap between the developed countries and the developing countries. In modern times, invention is mostly the result of intended research and development (R&D), which is a costly and risky activity. In contrast, the cost and risk of technological borrowing are substantially lower than those of R&D. Therefore, the developing countries could potentially benefit from the technological gap by borrowing technology from the developed countries by way of licensing, imitating and so on, and achieve a higher rate of technological innovation than that of the developed countries. In fact, the reliance of technological borrowing was one of the main reasons for Japan and the Four Small Dragons of East Asia, including The Republic of Korea, Taipei, China, Hong Kong, China and Singapore, to be able to maintain a dynamic growth during their catching-up stages in the post World War II period (Hayami 1997). The contrasting growth performance in PRC before and after the reform in 1978 also gives supports to the idea of technological borrowing as an engine of growth in the low-income countries (Lin, Cai, and Li 2003). Before the reform PRC attempted to compete with the high-income countries in the advanced industries by self-reliance on R&D and had a very poor economic performance. After the reform in 1978 PRC started to follow the technological path of Japan and the Four Small Dragons and achieved a miraculous growth in the past 25 years.

If the reliance of technological borrowing could maintain the dynamic growth in PRC, the question is how large the technological potential is left after having relied on this potential for 25 years. Table 1 compares the social and economic indicators in PRC and in Japan. All the major development indicators in PRC today are very similar to those of Japan in the early 1960s, indicating the current level of development in PRC is about that of Japan in the 1960s. Japan had maintained a dynamic economic growth through the years from 1960s to 1980s. Therefore, it is potentially likely that PRC can rely on technological borrowing from developed countries to achieve high rate of technological innovation at lower cost, just as Japan and Asian Little Dragons did in the 1960s to 1990s, for another 30 years or more. PRC is also likely to maintain a high saving rate of around 40% of GDP per year as it was in the past 25 years. Moreover, currently 70.8% of population still relies on agriculture for living. The potential for reallocation of labor force from low value-added agriculture to higher value-added secondary or tertiary industries are still very large. Based on the above reasons, PRC should have the potential to maintain 8-10% GDP growth rate continuously in the coming two or even three decades.²

² Justin Yifu Lin, "Prospect for China's Economy in the New Millennium" *Knowledge Economy and Entrepreneur*, 2000, No. 1("展望新千年的中国经济", 《知识经济与企业家》2000年第1期).

Table 1
Comparison of the Major Development Indicators between PRC and Japan

	China		Japan	
	Female	Male	Female	Male
Life Expectancy (years)	72 (1998)	68	72.9 (1965)	67.7
Infant Mortality Rate (per thousand)	31 (1999)		30.7 (1960)	
Primary Sector as a Share of GDP (%)	15.9 (2000)		16.7 (1959)	
Engle's Coefficient in Urban Areas (%)	39.2 (2000)		38.8 (1960)	
Per Capita Electricity Consumption (kwh)	1071 (2000)		1236 (1960)	

Source: Kwan, C.H. "Overcoming Japan's China Syndrome," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002.

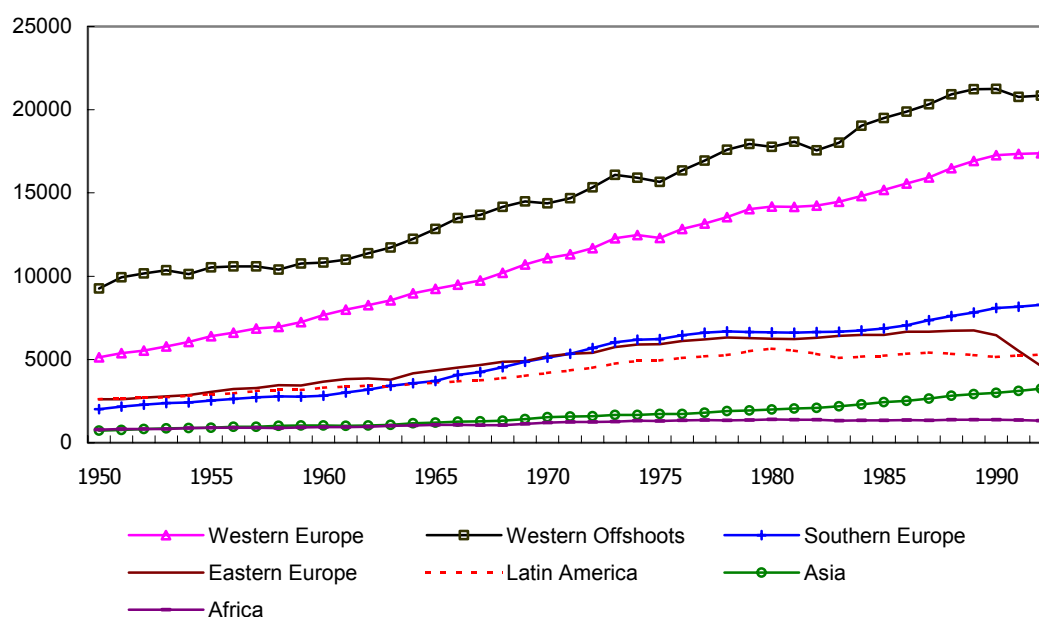
II. Development Strategy and Growth Potential

The technological gap between the developed and developing countries exists at any time. Potentially any developing country can achieve dynamic economic growth by borrowing technology from the developed countries and substantially narrow the income gap or even catching up with the developed countries. However, as shown in figure 1, the gaps of per capita income between the developed countries in Western Europe and other Western offshoots in North America and Australia of and developing countries in other regions of the world widened substantially. Only a small number of economies in East Asia have actually narrowed the gap and converged to the level of per capita income in the developed countries. In fact, neither did PRC benefit from that technological potential before the reform at the end of 1978.

Why the LDCs cannot catch up with the DCs has been a challenging question and puzzling phenomenon to economists. Many economists now believe that developing countries failed to catch up with the developed because of bad institutions due to the government's interventions and regulations, including widespread corruption, weak protection to the investors, and a high degree of social conflicts (Shleifer and Vishny, 1998; Rodrick, 1998; Acemoglu et al., 2001a, 2001b, 2002a, 2002b; Djankov et al., 2003). The legal origin (La Porta et al., 1998, 1999) and the institutional inheritance (Acemoglu et al., 2001a, b; Engerman and Sokoloff 1997) have been emphasized.

Figure 1: GDP per Capita, 1950-1992 (56 countries)

(In 1900 Geary-Khamis Dollars)



Source: Angus Maddison, *Monitoring the World Economy, 1820-1992*, Development Center of OECD, pp. 212.

Lin (2003, 2004) proposes an alternative hypothesis for the failure of a developing country to benefit from the technological gap and realize the convergence of income based on the conflict between the developing country's development strategy and the country's endowment structure and that the bad institutions are consequence of the conflict.³ Many of the early generation of political leaders in socialist and non-socialist developing countries, such as Nehru in India, Nasser in Egypt, Sukarno in Indonesia, Mao Zedong in PRC, and Ho Chi Minh in Viet Nam, were elites taking part in the independent movements or revolutions for the purpose of nation building. The institutions laid down by the early generation of political leaders were endogenously shaped by the conflicts between the elites' ambitious drives of industrialization/modernization for nation building and their nations' economic realities. The key to the argument is the viability issue of firms in the priority sectors of government's industrialization drives.⁴

The term *viability* is defined as follows: "If, without any external subsidies or protections, a *normally managed* firm is expected to earn socially acceptable profits in a free, open,

³ The following discussions in this section draw heavily on Lin (2003).

⁴ The bureaucrats in lower levels of government in developing countries may use the interventions/regulations rooted in the nation-building attempt for their personal grabbing-hand purpose. However, the grabbing hand of bureaucrats should be viewed as a consequence instead of the cause of the distortions and regulations.

and competitive market, then the firm is viable. Otherwise the firm is nonviable” (Lin 2003, p. 280). It is obvious that no one will invest in a firm if it is not expected to earn a socially acceptable normal profit. Such a firm will exist only if the government gives it support.

The viability of a normally managed firm depends on whether the industry the firm enters and the technology the firm adopts in production are consistent with the comparative advantages determined by the economy’s endowment structure. Other things equal, in an economy characterized by a relative abundance of labor (capital), a firm will be viable only if the firm enters a relatively labor (capital)-intensive industry and uses relatively labor (capital)-intensive technology in production because those industries or technology are consistent with their comparative advantages. In a free, open, competitive market, without government’s interventions, only viable firms will exist, therefore, the structure of industry and technology in the economy is endogenously determined by the economy’s endowment structure. Most developing countries are characterized by relative abundance of labor and scarcity of capital.⁵ As such, in a free, open, and competitive market, the structure of industry and technology in a developing country will be relatively labor intensive. However, inspired by the dream of nation building, the political leaders, economists and social elites alike in an LDC often aim to develop capital-intensive industries and adopt advanced technologies similar to those of the most developed countries within the shortest periods of time as the objective of their development drives. Such type of development approach in a developing country can be named as the comparative advantage-defying (CAD) strategy because the government attempts to encourage firms to ignore the existing comparative advantages of the economy in their entry/choice of industry/technology.⁶ Most firms in the priority sectors of a CAD strategy are not viable in free, open, competitive markets. Therefore, the government has to subsidize and protect those firms through various interventional measures. The strategy also makes a developing country difficult to benefit from the technology gap because they may have to pay very high prices to purchase those advanced technologies or have to invent those advanced technologies by themselves due to the reluctance of the developed countries to transfer those new technologies to other countries.

If a government adopts a CAD strategy and the deviation of the firms’ choices of technology/industry from the optimal ones determined by the economy’s endowment structure is small, and the number of nonviable firms that the government attempts to support is limited, the government may subsidize the firms directly by tax transfers as

⁵ The other possibility for a developing country is relatively abundant in natural resources and relatively scarce in capital and labor. The discussions and conclusions in this paper can be easily extended to cover the case.

⁶ The CAD strategy includes the heavy-industry-oriented development strategy in the socialist countries and in developing countries, such as India, and the secondary import-substitution strategy in many Latin America and African countries. The strategy also includes the protection of certain industries that has lost comparative advantage due to the development of the economy, such as the protection of agriculture in many OECD countries.

in the case of agricultural protection in many OECD countries. However, when a developing country adopts a CAD strategy, the distance of deviation is often very large, the number of nonviable firms numerous, and the government's taxation capacity very weak. Therefore, the government often turns toward implicit measures of subsidies through price distortions, limitations on market competition, directly administrative allocation of resources, and so on.⁷ As a matter of fact, the traditional planning systems existed before economic transitions in the socialist economies were typical institutional arrangements for supporting and protecting the non-viable heavy industrial firms (Lin, Cai and Li 2003, chap. 2).

Moreover when a developing country adopts the CAD strategy, the government cannot exactly know how large the subsidies would be enough due to information asymmetry. The firms in the priority sector will have incentives to use their viability problem as an excuse and use resources to lobby the government officials not only for more *ex ante* policy favors, such as access to low-interest loans, tax reductions, tariff protection, and legal monopolies but also for *ex post ad hoc* administrative assistances, such as more preferential loans or tax arrears. The economy will be full of rent-seeking activities and corruptions. Because the firms can use the viability problem as an excuse to bargain for more government support and because it is hard for the government to shun such responsibility, the firm's budget constraints become soft (Lin and Tan 1999).⁸ When the soft budget constraint exists, the firm will face no pressure to improve productivity and the firm's efficiency will be low. Moreover, with the subsidies/protections and soft budget constraints for the firms in the priority sectors, the investments in those sectors become a privilege. The political leaders in a non-socialist LDC may select their own close friends or political supporters to invest in those priority sectors, resulting in the phenomenon of crony capitalism.

Besides, if the government in a developing country adopts the CAD strategy, the economy will become more inward-oriented than otherwise. This is because the CAD strategy attempts to substitute the import of capital-intensive manufactured goods by domestic production, causing the reduction of import. The export will also be suppressed due to the inevitable transfers of resources away from the industries for which the economy has comparative advantages to the priority sectors of the CAD strategy. The exchange rates are likely to be overvalued to facilitate the import of

⁷ From the above perspective, the root of interventions in a developing is not the grabbing hands of government officials or the manipulations of interest group but the dream of nation building of political elites. The corruptions may be an endogenous phenomenon of the distortions and interventions arising from the conflict between the economy's endowment structure and the political leaders' ambitious and unrealistic development attempts. From this perspective, the political target should be separated from the corruption view of grabbing-hand approach or the "Leviathan" approach.

⁸ The soft budget constraint is a term coined by Kornai (1986) to explain the problem in the socialist countries. According to Kornai, the soft budget constraint arises from the paternalistic nature of the socialist government toward the state-owned firm. His argument cannot explain why the soft budget constraint exists in non-socialist economies and why the soft budget constraint still exists 10 years after privatization in Russia and Eastern European transitional economies (World Bank 2002). Dewatripont and Maskin (1995) argue that the soft budget constraint arises from the bank's imperfect information on investment project and the time inconsistent problem of the project. However, this argument cannot explain the prevalence and persistence of soft budget constraint phenomenon in the LDCs.

technology/equipment for priority industries, effectively hampering export opportunities. In addition, under the CAD strategy, the carriers of a government's development strategy are normally large-sized firms. To support the financial needs of nonviable large-sized firms, the government often nationalizes the firms and uses direct fiscal appropriation, skipping financial intermediation, to support these firms. Such was the case in the former socialist planned economies and continues to be the case in many LDCs. Even if the government relies on private firms to carry on the CAD strategy, the financial needs of large-sized firms will be large and can only be met by a heavily regulated oligopolistic banking system or an administratively intervened stock market. In either case, the financial system in the country will be very inefficient. The development of the nonviable firms relies heavily on external financial supports. The government first mobilizes domestic resources to support these firms through the above interventions in the financial system. Once domestic financial resources deplete, the government often turns to international financial markets for supporting the further development of these firms. Fiscal deficits, bad loans, external debts, and financial fragility will exacerbate and macroeconomic stability will become unsustainable, leading to eruptions of financial crises, which may also trigger serious social conflicts and political instability (Rodrik 1998; Caselli and Coleman 2002).

To conclude, the poor growth performance, many observed distortions and the failure to tap into the potential of technological gap for dynamic growth in PRC, the socialist economies, and other developing countries, to a large extent, are attributable to the adoption of a CAD strategy.

III. Economic Reform and WTO Accession

The heavy-industry oriented development strategy adopted in PRC before the reform in 1979 was a typical example of the CAD strategy. The pre-reform economic system had three integrated components: (1) a distorted macro-policy environment which featured artificially depressed interest rates, over-valued exchange rates, low nominal wage rates as well as low price levels for living necessities and raw materials; (2) a planned allocation for credit, foreign exchange, and other materials; and (3) a traditional micro-management system of State-owned enterprises (hereafter SOEs), which were deprived of autonomy, and collective agriculture. These three components were endogenous to the choice of the CAD strategy in a capital-scarce agrarian economy (Lin, Cai and Li 2001). Therefore, in order to bring the technological potential discussed in section I into full play, PRC needs to complete the transition from a planned economy to a market economy.

Unlike Former Soviet Union and the Eastern European Countries, which adopted a shock therapy in their transition process and resulted in economic collapse, high inflation and economic stagnation, PRC started the transition in 1979 with a piecemeal, gradual, dual-track approach. At the beginning of reforms, the Chinese government gave partial autonomy to managers of the SOEs and decollectivized the farms to improve the incentives but the government still provided protections and supports to nonviable SOEs in the traditional sectors to buffer them from the threat of bankruptcy.

This incentive improvement resulted in the increase of productivity in both agriculture and industrial sectors (Lin, 1992; World Bank, 1992). At the same time, the government relaxed its strict control of entries into sectors that were consistent with PRC's comparative advantages and were depressed under the previous CAD strategy. As a consequence of the relaxation of entries, labor-intensive, small and medium-sized non-state-owned firms, such as township and village enterprises (TVEs), joint-ventured firms and private enterprises, were established rapidly.

The continuous supports provided to the firms in the priority sectors and the entry of small and medium-size firms to the repressed sectors in CAD strategy allows PRC to maintain economic stability and enjoy dynamic growth in the transition process simultaneously. However, a country's completion of transition and reform to a market economy will not complete until the viability issue of firms in the priority sectors of CAD strategy is solved. Otherwise the government needs to maintain its interventions in markets in order to protect/subsidize the nonviable firms and the inevitable distortions of such actions will ensue. For example, along with the rapid economic growth in PRC's transition, the share of non-performing loans looms large and the corruption is widespread (Lardy 1998). These problems have their roots on the viability problem of the SOEs and other policy burdens, including the employment of redundant workers and the payment of old-age pensions. After 1983, the approach adopted by the Chinese government to support the SOEs changed from direct fiscal appropriation to offer of low interest-rate loans from the state-owned commercial banks. Currently, over 70% of the bank loans are lent to the SOEs, but due to their poor performance, many SOEs are unable to repay the loans. Therefore, the banks accumulate large amounts of non-performing loans. To support the SOEs, the government also limits market entry to certain capital- and technology-intensive sectors so that the SOEs can enjoy monopolistic rents. Many SOEs (and non-SOEs) seek rents from the government to acquire more low-interest loans or licenses for market entry to those regulated sectors, thus adding fuel to the widespread of corruption.

Only after the problems of viability and other policy burdens are resolved,⁹ the manager will be accountable for the success or failure of the firm. The government will no longer need to find ways to intervene in the markets in order to protect or subsidize the firms. Only then can the complete elimination of distortions and government interventions be carried out successfully.

⁹For the viability problem Lin, Cai and Li (1998) recommend four reform measures to address the issue of an SOE's viability issue: First, if the SOE's output is essential for national defense, the government is required to use fiscal appropriation continuously to support the operation of the firm. Second, if the SOE's output has a large domestic market, the SOE can get access to internal capital by either forming a joint venture with multinational company or listing in international equity market. Third, if the SOE's output does not have a large domestic market but the SOE has good engineer and management capacity, the SOE can rely on its strength in human capital and shift its operation to product that are consistent with the nation's comparative advantage and has large domestic market. Forth, if the SOE's output does not have large domestic market and the SOE does not have engineer and managerial strength either, the SOE should be allowed to bankrupt. However, the number of firms in the last category is small. As long as the economy can maintain dynamic growth, the economy should be able to create enough jobs to absorb workers released from the bankrupted firms and enough resources to compensate for losers in the transition process. As for SOEs' redundant workers and other social burdens, the government should set up social security system to separate those burdens from the SOEs.

PRC's entry into WTO will greatly accelerate the market-oriented reforms. The spirit of WTO is to lower the tariff rates, to eliminate non-tariff barriers for trade, and to give foreign firms market access to domestic investments, commerce and professional services. That is, PRC's domestic economy will fully open to the foreign competition except for the remaining tariff rates. After the accession, the government has less means to support/protect viable firms, which will accelerate PRC's reform of SOEs and ensure that PRC develops its economy in line with its comparative advantages.¹⁰ Therefore, the WTO accession will accelerate PRC's integration into the world economy. The experience from the three years after the WTO accession in 2001 has attested this prediction. PRC's international trade has doubled from USD 509.6 billion in 2001 to an estimated USD 1100 billion in 2004. With the globalization and the reliance on comparative advantage in industrial and technological development after the WTO accession, it will facilitate PRC realizing the growth potential of borrowing technology from the advanced countries and achieving dynamic growth in the coming decades.

IV. Opportunities and Challenges to Asia and Latin America

Because of PRC's rapid growth and acceleration of integration with the world economy, the future development of PRC will have important implications for other economies. Currently, there are two contrasting views: some people regard PRC's growth as a threat, while others view PRC's growth as an engine for their own growth. For those who view PRC as a threat, there are two major arguments. One is the low labor cost making PRC out-compete other developing countries in manufactured product exports. Some people even argue that because of the development of IT technology, PRC may as well overtake Japan and NIEs. The other major argument is that the large domestic market makes PRC a black hole in absorbing foreign direct investment (FDI), depleting all the available funds for other developing countries.¹¹ Whether the above arguments are true or not can only be judged by the empirical evidence.

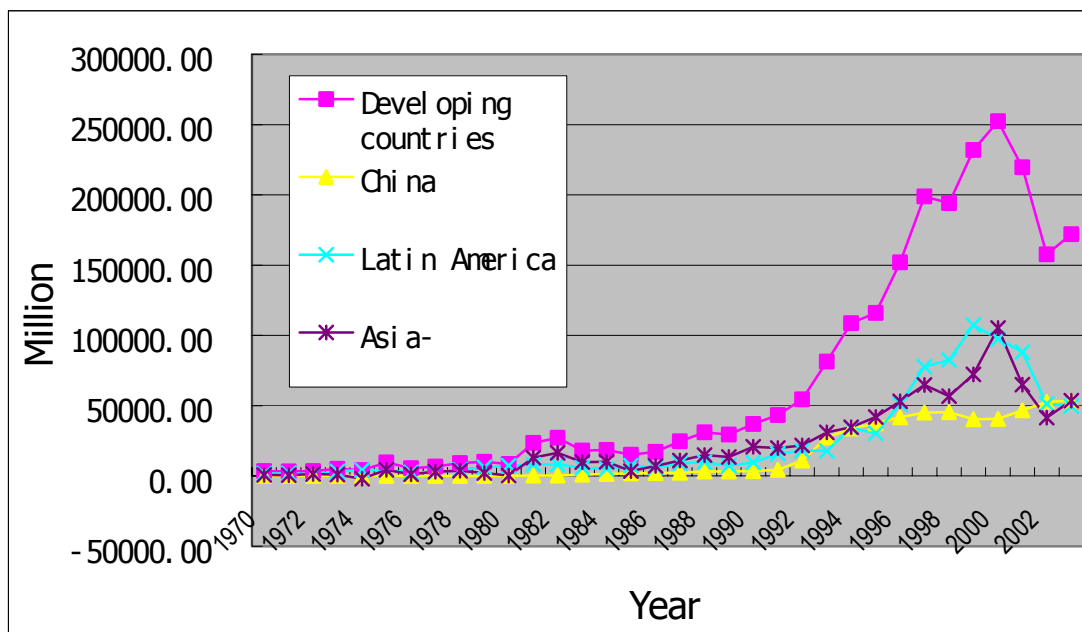
First, let's take a look at the FDI to PRC. Figure 2 shows the FDI flows to developing countries, PRC, Latin America, and Asia excluding PRC. As shown in Figure 2, PRC did not receive significant FDI inflow until 1992. In that year, the FDI increased from USD 4.4 billion in 1991 to USD 11 billion, and the volume further increased to USD 40.7 billion in 2002 and USD 53.5 billion in 2003. PRC becomes the largest recipient of FDI in the whole world in the last few years. The inflow is likely to reach USD 60 billion in 2004. However, as shown in Figure 2, FDI inflow to Latin America, Asia excluding PRC, and the developing countries as a whole all has increased substantially since 1992. The FDIs to Latin America, Asia excluding PRC

¹⁰ Lin, Justin Yifu, "WTO Accession and China's SOE Reform," in Lee, Kyung Tae, Justin Yifu Lin, and Si Joong Kim, eds., *China's Integration with the World Economy: Repercussions of China's Accession to the WTO*, Seoul: Korean Institute for International Economic Policy, 2001, pp. 55-79.

¹¹ Kwan, C.H. "Overcoming Japan's China Syndrome," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002

and the developing countries in 1992 were, respectively, USD 18.1 billion, 21.7 billion, and 54.6 billion. The inflows increased to USD 107.4 billion in Latin America in 1999, to USD 105.4 billion in Asia excluding PRC in 2000 and to USD 252.5 billion in developing countries in 2000. That is, that when FDI inflow to PRC increased about four times between 1992 and 2000, the increases of inflow to Latin America, Asia excluding PRC and the developing countries as a whole exceeded five times in the same period. Therefore, the gain in PRC's FDI inflow was not at the cost of FDI inflow to other developing countries. The more to PRC was accompanied by the more to Latin America, Asia, and other developing countries. Although the inflows to Latin America, Asia excluding PRC and developing countries as a whole declined significantly after 1999 or 2000 and the inflow to PRC continued to increase, as shown in Figure 2, the decline in other countries was again not caused by the crowding out effect of PRC's capital inflow. All these facts show that PRC's development has not taken away the FDI of other countries.

Figure 2: The FDI to Developing Countries



Source: UNCTAD.

Secondly, in term of PRC's labor cost, the wage level in PRC is very low. It is about 1/50 as much as that of Japan and US. However, PRC's labor productivity in manufacturing sector is extremely low, only about 1/25 of America's and 1/26 of Japan's. Because of this low productivity, if we look into the composition of labor cost in manufacturing industry, the American wage level is only 1/3 higher than the Chinese level in terms of per dollar output value. Besides, the value added of PRC's manufacturing industry is comparatively low. In 2000, the average value-added in PRC was only 26%, which is much lower than that of the US and Japan, which are

49% and 43.6% respectively.¹²

PRC's manufacturing exports rely heavily on the processing industries. Table 2 shows that the share of PRC's export from processing industries was 46.6% in 1992, increased slowly and maintained at around 55% in the late 1990s and till now. The share of domestic value added of the processing industries export was only 20.4% in 1992. With the improvement of domestic industrial structure and technologies, the share of domestic value added increased in the latter years. However, in 2003 the share was still only 32.6%. This pattern indicates that the more is PRC's export, the more PRC imports. Take 2003 as an example, for every USD 100 worth of export, PRC imported USD 37.2 worth of materials to produce those export. That is to say, the more PRC exports, the more PRC imports.

Table 2: Export and Processed Industrial Export in PRC, 1992-2003

Year	Total Export (USD Billion)	Export of Processed Manufactured Product (USD Billion)	Share of Processed Product Export (%)	Domestic Value Added of Processed Manufactured Export (%)
1992	84.9	39.6	46.6	20.4
1993	91.7	44.2	48.2	17.8
1994	121.0	57.0	47.1	16.5
1995	148.8	73.7	49.5	20.8
1996	151.0	84.3	55.8	26.2
1997	182.8	99.7	54.5	29.6
1998	183.7	104.6	56.9	34.4
1999	194.9	110.98	56.9	33.6
2000	249.2	137.7	55.2	32.8
2001	266.1	147.4	55.4	36.3
2002	325.6	178.0	55.3	32.1
2003	438.4	241.9	55.2	32.6

Table 3: PRC's Trade Balance, 1980-2003

	Total	Asia	Asia Excl. Hong Kong, China	Latin America	North America	Europe	Oceanic and Pacific Islands	Africa
198	-1.8	4.1	0.3	-0.4	-3.5	-0.9	-1.0	0.4

¹² Chen Qingtai, "Promoting the Regional Economic Cooperation in Asia amidst Economic Globalization," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002

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198 1	-0.1	5.8	1.7	-0.2	-3.7	-0.6	-0.5	0.5
198 2	3.0	7.8	3.9	-0.2	-3.0	-0.6	-0.8	-0.8
198 3	0.8	-7.3	-11.3	-0.7	-1.7	-1.7	-0.5	0.4
198 4	-1.3	3.5	1.5	-0.3	-2.1	-1.7	-0.7	0.4
198 5	-14.9	-3.7	-4.3	-1.3	-3.7	-5.2	-1.1	0.2
198 6	-11.9	-1.4	-5.0	-1.2	-1.6	-5.6	-1.4	0.5
198 7	-3.8	4.8	1.3	-0.7	-2.8	-4.5	-1.2	1.3
198 8	-7.8	4.9	1.3	-1.8	-4.7	-5.1	-1.1	1.6
198 9	-6.6	6.5	0.2	-1.9	-4.1	-5.9	-1.3	0.3
199 0	8.7	15.6	4.8	-0.7	-2.5	-3.5	-1.0	0.9
199 1	8.1	16.2	1.6	-0.8	-2.9	-3.3	-1.1	0.6
199 2	4.4	12.1	-4.9	-0.8	-1.6	-4.7	-1.3	0.8
199 3	-12.2	-9.9	-21.6	-0.2	6.1	-7.5	-1.1	0.5
199 4	5.4	4.7	-18.2	0.2	7.1	-6.2	-1.2	0.9
199 5	16.7	13.9	-13.4	0.2	7.4	-4.8	-1.1	1.1
199 6	12.2	7.8	-17.3	-0.5	9.6	-3.8	-2.0	1.1
199 7	40.4	20.6	-16.2	0.8	16.3	3.2	-1.3	0.7
199 8	43.5	11.1	-20.9	2.3	20.9	7.1	-0.5	2.6
199 9	29.2	0.9	-29.1	2.3	22.6	2.8	-1.1	1.7
200 0	24.1	-9.0	-44.1	1.8	29.2	4.7	-2.0	-0.5
200 1	22.5	-6.2	-43.3	1.5	27.4	0.8	-2.2	1.2

200 2	30.4	-19.9	-67.5	1.2	43.4	5.8	-1.5	1.5
200 3	25.5	-50.3	-115.5	-3.1	59.9	18.5	-1.3	1.8

Table 3 reports PRC's trade balances in 1980-2003 with various regions. It is interesting to note that PRC had trade deficits annually with Latin America from 1980 up to 1993 and with North America up to 1992. PRC is a developing country with abundant well-trained, low cost labor. However, PRC is poorly endowed with natural resources and capital. The above trade patterns with Latin America and North America reflected the import of natural resources-related products from Latin America and the import of capital-intensive products from North America. After 1992/1993 the balances tilted favorably to PRC. Between 1994 and 2003, PRC had trade deficits with Latin America for two years, that is 1996 and 2003. The other years, PRC has trade surpluses. For North America, PRC had trade surpluses annually after 1993 and now North America becomes the major source of PRC's trade surpluses, reaching USD 59.9 billions in 2003. The changes in PRC's trade pattern with Latin America and North America may be explained by the large inflow of FDI and the relocation of labor-intensive manufactured industries from the Asian NIEs. The inflow of FDI to PRC surged after 1992. As shown in Table 4, over 80 % of the FDI came from Asia before 1995. The share from Asia declined. However, the share is still 63.74% in 2003.¹³ The FDI from Asia came with the relocation of labor-intensive industries and export markets to PRC. Therefore, the inflow of FDI from Asia on the one hand strengthens PRC's exports of labor-intensive processed industrial products to North America and other countries and on the other hand increases PRC's import of intermediate products from Asia. Therefore, Asia excluding Hong Kong, China has enjoyed large trade surpluses with PRC since 1992, reaching USD 115.5 billion in 2003. The trade deficit with Asia, excluding Hong Kong, China, is likely to persist in the future.

Table 3 also shows that PRC had a persistent trade deficit with Oceanic and Pacific Islands in the period 1980-2003. The region of Oceanic and Pacific Islands, which includes Australia, is well endowed with natural resources. As PRC is relatively poor in natural resources, PRC's economic growth will increase the import of natural resources. As a region with rich natural resources, it is likely that PRC will increase the import of minerals, grains and other resource-related products from Latin America as long as PRC continues its dynamic growth in the coming decades.

¹³ Most FDI from Cayman Islands and Virgin Islands are Chinese firms from Mainland PRC.

Table 4: Sources of PRC's FDI

year	Total	Asia	Africa	Europe	Latin America	Latin America(excluding Cayman Islands and Virgin Islands)	North America	Oceanic and Pacific Islands	Others
	USD billion	%	%	%	%	%	%	%	%
1992	11.0	89.78	0.03	2.73	0.20	0.16	5.17	0.35	1.75
1993	27.5	86.62	0.14	2.84	0.17	0.12	8.06	0.45	1.73
1994	33.7	83.98	0.04	4.94	0.50	0.10	8.17	0.72	1.65
1995	37.5	81.30	0.05	5.98	0.92	0.08	9.19	0.88	1.67
1996	41.7	79.06	0.03	7.19	1.61	0.19	9.26	0.71	2.14
1997	45.3	75.70	0.18	9.80	4.42	0.28	8.15	1.29	0.45
1998	45.5	68.92	0.35	9.48	10.03	0.45	9.52	1.17	0.52
1999	40.3	66.55	0.49	11.90	7.95	0.42	11.45	1.26	0.41
2000	40.7	62.59	0.71	11.70	11.34	0.39	11.75	1.70	0.20
2001	46.9	63.17	0.70	9.57	13.46	0.43	10.87	2.16	0.06
2002	52.7	61.75	1.07	7.68	14.32	0.48	12.31	2.69	0.19
2003	53.5	63.74	1.15	7.98	12.91	0.49	9.65	3.24	1.33

Data source: China Foreign Economic Statistical Yearbook

V. Concluding Remarks

In conclusion, as a developing country, PRC has the potential to maintain dynamic growth in the coming decades by borrowing technology from the advanced countries. To realize the potential, PRC needs to complete the transition from a planned economy to a market economy. The WTO accession limits the Chinese government's ability to subsidize nonviable firms and requires PRC to complete the market-oriented reform before the expiration of the grace period in the WTO accession agreement.

Therefore, PRC will develop its industries along its comparative advantages and is likely to maintain dynamic economic growth in the coming decades. PRC's economic growth will not become a threat to other countries in Asia, Latin America, and other regions. PRC's rapid economic growth in the coming decades will provide other Asian economies with a much larger market and at the same time provide them with an ideal place to reallocate their non-competitive labor-intensive industries. PRC's growth will also increase the imports of minerals, grain, and other natural resources-related products from Latin America. Therefore, it is safe to say what is good for PRC is also good for other Asian countries. And as PRC maintains its rapid growth, it will serve as an engine of growth of many other countries in Asia, Latin America and other parts of the world.

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