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China exerts influence Asia wide on trade and investment

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***Although the growth of China’s economy is slowing, Beijing’s influence in Asia and beyond is growing. But China is facing challenges both internally and externally, that could make it difficult to leverage the Middle Kingdom’s rising influence.***



The Middle Kingdom’s economy is faltering after decades of solid double-digit growth. Trade logistics policies and regional initiatives are attempts by the central government to attract more investments, boost exports and take Asia region leadership. In August, the Ministry of Commerce of the People’s Republic of China (PRC) announced setting up seven new free trade zones (FTZ) after Shanghai and three other pilot FTZs started in 2013 and 2015, respectively. There is also more focus on reducing logistics costs for enterprise competitiveness. Regional initiatives are based on the Asia Infrastructure Investment Bank (AIIB) and the Regional Comprehensive Economic Partnership (RCEP) for trade.

**The Magic Number**

The PRC’s economy is expanding in the 6% range as measured by gross domestic product (GDP) for this year and forecasted for next year, which is the slowest rate in 25 years. This rate needs to stay at 6.5% in order to reach the goal of doubling per capita income by 2020, avoid social unrest from layoffs and create jobs. However, as a nation of savers, Chinese total household wealth rose $6.3 trillion to $23 trillion over the past 15 years, a gain of 265%, and on an average 9.4% annual rate over the next five years will reach $40 trillion by 2020. But the United States still remains the world leader at $86 trillion in total household wealth.

The economy managed to sidestep the 2008 global financial crisis brought on by the United States’ mortgage crisis by adding its own massive debt and real-estate speculation. At present, China has $30 trillion of debt for a $10 trillion economy, which grew from 150% of GDP in 2008 to almost 300%, a *Barron’s* report stated in November. Economists indicate that this debt could lead to another global financial and economic crisis.

In addition, the Chinese economy is faced with U.S. trade protection by higher tariffs considered during the campaign by now president-elect Donald J. Trump. Voters in the U.S.A. expressed their fear of more job losses from globalization and Chinese dumping of low cost goods. After the November election, the currency markets are showing a stronger U.S. dollar and a weaker Chinese yuan currency of 6.88 to the dollar, which could cause more Chinese exports or possible trade wars. In fact, globalization of merchandise goods, services and people that began in the 1980s during the Reagan administration may be at a pause or in a long-term downward trend. The World Trade Organization (WTO) recent report stated average global trade flows grew 10% a year from 1949 to 2008, but dropped to 1.3% from 2009-2015.

**FTZs and a Service Led Economy**

Amid this global economic and trade uncertainty, a PRC consumption and services led economy is slowly emerging. In the meantime, government leaders are initiating international trade and services arrangements to spur growth in the trade component of GDP (exports minus imports) similar to those that began in special economic zones in the 1980s and before China joined the WTO in 2001. A recent report in the *Wall Street Journal* shows that China’s original export growth were from strategically situated special economic zones (SEZ) and free trade zones along the coast “when exports rose 14.2% a year from 1994-1999.”

In August, the Ministry of Commerce announced the arrangement of seven new free trade zones that will be in various parts of the country. The plan is for the following provinces: Liaoning in the northeast, Zhejiang near Shanghai, Henan, Hubei, Sichuan and Shaanxi and in Chongqing municipality. The Shanghai pilot FTZ began in 2013 followed by Guangdong, Tianjin (near Beijing) and Fujian (across from Taiwan) in 2015. These pilot FTZs are to test economic reforms of more openness to foreign investment, international trade and easier flow of capital. Most comments requested for this report from various business sources in the PRC were not answered. However, the US-China Business Council (USCBC) referred to their recent survey report of September 2015.

The USCBC has 220 US companies as members of which 40 companies are registered in the Shanghai pilot FTZ. As of June 2016, 5,984 Foreign Invested Enterprises established in this Zone, according to the Hong Kong Trade Development Council. A few U.S. companies invested in the Tianjin, Fujian and Guangdong FTZs as of the end of 2015. Boeing, Honeywell and GE already have factories in Tianjin since the 1990s and have a presence in the Tianjin FTZ. The Shanghai FTZ is a three-year test lab for reform and subject to revision to be implemented nationwide, eventually. The report stated, “the Shanghai FTZ as having limited to moderate impact on improving access to the China market and certain sectors are still closed to investment or listed on the negative list to foreign investors. Some companies operating in the FTZ have benefited from expedited licensing approvals, importation, access to e-commerce, Renminbi (RMB) remittance and exchange.”

Each of the eleven FTZ has investment and trade objectives based on their geographic location. Shanghai Zone is to support the goal of becoming a global financial center; Guangdong is to attract services such as shipping and trading for access to Hong Kong, Macao and Southeast Asia; Tianjin is to attract capital-intensive and technologically advanced manufacturing oriented toward north and east Asia; and Fujian FTZ is designed for financial leasing, e-commerce and logistics focused on Taiwan.

**Magnificent Seven?**

The seven new pilot FTZs announced in August also have specific characteristics to deepen economic reforms and are aligned with the national strategies like the belt and road initiatives. Liaoning’s goal is to transform the northeast old industrial base into a more competitive area; Zhejiang is to focus on commodity trade liberalization; Henan is to build a modern transport and logistics system to link the east with the west and north with the south; Hubei in central China will focus on emerging industries and build high-tech industrial bases; Chongqing is to open up western gateway cities; Sichuan is to open up western gateway cities for inland and along the sea, border and rivers, and Shaanxi is to facilitate the Belt and Road initiative to drive western development, according to the latest Hong Kong Trade Development Council report of September 2016.

The Negative List is a sticking point for foreign investors trying to enter the Chinese markets through these new pilot FTZs. The FTZs share the same list of investment restrictions, “The Notice of the Special Management (Negative List) of China Pilot Free Trade Zone on the Approval of Foreign Investments,” issued by the State Council in April 2015. In 2015, an annual survey of 370 members of the American Chamber of Commerce in Shanghai “found that almost three-quarters believed the Shanghai FTZ offered no tangible benefits for their business.” Chinese authorities claim that the negative list was cut twice down from 190 categories in 2014 to 122 categories closed to foreign investors. However, the European Chamber of Commerce noted that many “industries and sectors have merely regrouped” in the negative list. In addition, financial services and telecommunications are key sectors dominated by the state-owned companies.

DHL Global Forwarding (China) Ltd. has regional integrated warehouse services operating in the Shanghai pilot FTZ. Their business is spread out across all areas in the Wai Gao Qiao and Yang Shan Port FTZs and covers most sectors except perishables and dangerous goods. They found “no big difference for a logistics company including Customs processing before or after the so called China (Shanghai) Pilot Free Trade Zone.” Since opening, the Shanghai FTZ expanded an additional area of 91.94 square kilometers (35.5 sq. miles) by including: Lujiazui Financial District, Jinqiao Development Zone and Zhongjiang Hi-Tech Park to reach 120.7 square kilometers (46.6 sq. miles). Despite lukewarm business sentiment, Shanghai Customs statistics show import and export volume reached $113 billion through August 2016, grew 6.5% over last year and Customs clearance time dropped by 3.68 and 2.17 hours, respectively for imports and exports from 2015.

Deeper reforms at the operating level are proposed by the State Council in August by a six-year plan to reduce logistics costs as a percentage of GDP for higher economic growth and enterprise profitability. The PRC has higher logistics costs as a percentage of GDP of 18% than India whereas the U.S. is 7.8%. Their goal is 16% by 2020 and they believe that by reducing the ratio of logistics costs to GDP by one percent can help industries save over $135 billion. This savings will be accomplished by cutting highway tolls and removing illegal fees charged by airports, ports and railways. The implementation and enforcement will be a challenge to the sprawling and fragmented logistics sector.

**Dueling Pacts: TPP and RCEP**

The demise of the United States led Trans-Pacific Partnership (TPP) trade pact of 12 Pacific Rim countries after the election of Donald J. Trump as president will cede Asia trade leadership to the China led Regional Comprehensive Economic Partnership (RCEP) excluding the U.S.A. in a 16 country trade liberalization pact. This will bolster China’s global and regional cooperation and integration already underway from several strategic initiatives. These include the Belt and Road Initiative for construction contracts worth over $84 billion directed toward 65 countries and regions in 3 continents with a total population of 4.4 billion; the Silk Road Economic Belt; the 21st Century Maritime Silk Road started in 2013 by President Xi Jinping; and the 57 member nations’ Asia Infrastructure Investment Bank (AIIB) funded with $100 billion that the U.S. has not joined.



China President Xi Jinping

The TPP has roots in the Bush administration to counter China’s growing influence in Asia and the RCEP began meetings among the 10 ASEAN countries and Japan, South Korea, Australia, New Zealand and India in 2011. The TPP sought to reduce or eliminate tariffs on 18,000 categories of goods, but also bring developing countries into better labor and environmental standards and to cut nontariff barriers to trade such as enterprise subsidies and theft of intellectual property. The RCEP is planning to only reduce tariffs and not involve trade in services and investment or nontariff issues. There is much at stake since the Asia-Pacific accounts for 40% of the world’s population, 48% of world trade and 57% of global output and set to grow as multinational manufacturers seek lower labor costs and China imports less materials for manufacturing. Moreover, there are already more than 200 free trade agreements (FTAs) in the region with conflicting policies on rules of origin of which the Free Trade Area of the Asia-Pacific (FTAAP) is addressing for better harmonization among FTAs. The FTAAP concept has roots in the 21-member Asia Pacific Economic Cooperation (APEC) in 2006. In 2014 the APEC Connectivity Blueprint 2015-2025 was written in a Beijing APEC meeting.

A divergence of views on globalization clouds the prospects for trade agreements. The 24th APEC meeting concluded on November 20th in Lima, Peru (attended by President Obama) and touted the benefits of cooperation. IMF (International Monetary Fund) Managing Director, Christine Lagarde commenting on the APEC meeting said, “globalization is here to stay.”

But there is a real pushback against globalization as the Brexit, the Trump election in the US (it is also worth noting that Hillary Clinton was also opposed to the TPP) and dozens of other incidents large and small from all corners of the globe illustrate. China’s leadership is betting on regionalization over globalization and that all the Silk Road’s highways and byways lead to Beijing.

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