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China and the World Economy

Challenges and Opportunities for New Zealand

Xiaoming Huang, Jason Young

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Executive Summary

Chinese economic development has reached a turning point after 30 years of high-speed economic growth. The pace, scope and quality of future growth will be determined by how sources of economic growth—exports, investment and consumption—strengthen, expand and reprioritize under the evolving institutional, policy and operational environment. Our assessment is that while institutional reform, major policy shifts and profound changes in the conditions of the market economy may take time to be realised and will likely only come in a piecemeal, compromising fashion, the dynamism and energy of the economy, the infrastructure investments, and the interests and value chains built into Chinese economic activities, will continue to keep the economy growing. Consumption's share of contribution to GDP will increase over exports and investment, but not to the extent as hoped for in the broad programme of rebalancing and restructuring of the economy. Internationalization of the economy, urbanization, private investment, reform in primary and secondary distribution of income, and R&D, technology, and education will be key drivers of Chinese economic growth.

A key feature of Chinese economic growth is its internationalization. Our analysis shows Chinese international economic activities have evolved, developed and expanded, from trade concentration to investment expansion, from pursuit of bilateral economic relations to participation in global and regional economic governance and integration, and from movements of products, materials and capital to expansion of business, enterprise, ownership, management and production networks and chains in the world. The internationalization of the Chinese economy affects the global structure of markets, resources, capital and finance, prices and consumer demand, supply and values chains and production networks, and economic governance and organization.

China's emergence as a significant mover and shaper of the conditions and dynamics of the world economic system creates a historical moment for New Zealand to consider how it positions itself strategically in the world economic structure for long-term economic prosperity and social wellbeing. Our analysis shows that the New Zealand economy has limited impact on overall Chinese economic growth and its global interests and activities. On the other hand, a dynamic, competitive, continuously expanding Chinese economy not only provides markets for New Zealand exports, it becomes a principal platform for New Zealand international economic activities. More importantly, through its internationalization, Chinese economic forces come to New Zealand, and have significant impact on the structure and performance of the New Zealand economy and its broad economic and social conditions.

The paper identifies three key areas for consideration in New Zealand's response to China's economic rise in the world economy: (1) to think of the greater purpose and value of New Zealand international economic activities in China and develop a coordinated policy to promote and support them; (2) to nurture a more balanced structure of incentives and interests of both New Zealand and China in their bilateral economic relations; and (3) to incorporate the effects of growing Chinese economic activities in New Zealand into the overall development of the New Zealand economy and consider them in economic policy.

Acknowledgments

The authors are grateful for the advice and insights of members of the advisory group for this project: Professor David Robb, University of Auckland; Professor Gary Hawke, New Zealand Institute of Economic Research; Eaqub Shamubeel, New Zealand Institute of Economic Research; John McKinnon, Asia New Zealand Foundation; Lee McCauley, The Treasury; Andrew Butcher, Asia New Zealand Foundation; Guang Yang, BERL; Fran O'Sullivan, The New Zealand Herald; Kefeng Chu, New Zealand Trade and Enterprise; Tony Alexander, Bank of New Zealand. Needless to say, all the views and errors are those of the authors.

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1. INTRODUCTION

There has been much debate about the rise of China and its impact on the world. Such scholarly debate and policy interest in the problem has followed two streams: one focuses on the geopolitical, diplomatic and strategic dimensions and is interested to see how the rise of China, particularly change in its capacity, influence and interests, affects the arrangements and structure of international politics, strategic relations, and global and regional order. The other stream is more interested in how the rise of China, particularly its growing economic position, influence and interests in the world, affects the working of the world economic system and changes the dynamics and structure of the international economic order, as well as impacting the national economies of individual countries. These present two very different takes on the rise of China.

On the economic rise of China, much of the early stage of the debate and policy discussion has focused on how China seeks a greater role in international economic governance, more specifically, on its changing relations with the governing international economic institutions such as the World Bank, IMF or WTO, and how this would lead to change in the shape and mechanisms of global economic governance. We now seem to understand well how growing Chinese economic power and influence has led to its interests and efforts in seeking a greater role in those international organizations and in international economic governance in general. This is an important area where one measures and understands the impact of the rise of China but alone it is not enough. Something else deserves more attention. How China's economic growth translates into direct and tangible effects on our everyday economic life, patterns and dynamics of economic relations and on the economic growth and development of individual countries and their economic policy and strategy is not straightforwardly clear.

It is evident that the economic rise of China is more than just increased voting rights in the World Bank or IMF. Rather it is a profound change that China's decades of successful economic growth and expansion has brought on the world economic system and on the substance and mechanisms of international economic activities: where manufacturing capacity, markets and resources are; how access to these resources is managed and distribution shaped; what, where and how economic factors and activities move between national economies. This changing world economic structure not only affects world politics and global governance, but more profoundly, it creates different sets of opportunities and constraints in the international economic

environment for individual national economies, in the working of their own economy and their relations with the world economy.

There are a large number of studies and analyses on this issue in different countries. These studies look at how the Chinese economy, its growth and development, shapes the world economic structure, which, in turn, affects the economic growth, policy and relations of their particular countries. Such studies are often from a particular national perspective, such as the United States, Australia, Europe, Korea, Japan, etc. These issues have also generated a lot of interest in New Zealand where there is a strong interest among policy analysts, academics, and private sector representatives in how the China factor features in our economic activities, growth and development, sectors and society, and our position and relations with the world, as well as our policy and relations with China itself.

This paper provides analysis and assessment of the structure and dynamics of the Chinese economy and the driving forces of its growth and development; the internationalization of the Chinese economy with its growing presence and influence in the world and the consequent shifting structure and dynamics of the world economy; the challenge and opportunities this changing world economic structure has presented for New Zealand; the mechanisms and channels in which it affects New Zealand economy and society and its international economic interests, relations and activities.

The paper is built on three underlying premises. First, the 30 years of Chinese economic growth has been generated in a particular growth structure. The pace, scope and quality of future economic growth will be determined largely by how the sources of economic growth—exports, investment and consumption—would strengthen, expand and prioritize under the evolving institutional, policy and operational environment. How the challenge of shifting China's growth structure is dealt with will largely determine the success or failure of the economy to move out of the middle income range toward an advanced economy.

Second, changes brought on by China in the world economic structure have a lot to do with the particular structure and model of Chinese economic growth. China's international economic activities have evolved, developed and expanded to the extent they are no longer interests and activities in select sectors through bilateral economic relations, but rather part of the internationalization of the Chinese economy. This not only changes the global structure of markets, resources, capital, supply and value chains and production networks, and economic governance and organization, but also distributions and flows of products, capital, people, and movement of prices.

Third, China-driven changes in the world economic structure present opportunities as well as challenges for New Zealand. The challenges and opportunities are historical and strategic. They are more profound than what New Zealand experienced in the

early 1970s as export markets to Europe and the United Kingdom contracted and the New Zealand economy experienced long-term economic depression. This changing world economic structure redefines New Zealand international economic interests and relations, impacts the structure and growth sources of the New Zealand economy and affects New Zealand society and international relations. Strategic thinking and planning in government policy and our economic activities will ensure New Zealand will emerge in a more positive position in the changing world economic structure.

The first part of the paper will provide an assessment of the Chinese economy, tracing the development of its growth pattern and discussing key issues in understanding the structure of Chinese economic growth. It will then discuss in turn some of the key forces and factors that affect the shaping of the growth pattern. This part will discuss different scenarios of the evolving structure and transformation of the Chinese economy.

Part II will build on the discussion in Part I and examine the pattern of China's international economic activities, from international trade and finance to overseas investment, consumption and enterprises, from world-wide efforts in market and resource access to global and regional economic governance and integration. This part will expose the connection between the patterns of China's international economic activities and the structure of its economic growth and clarify a picture of the international economic environment that this has created for individual countries like New Zealand.

Part III brings the analysis down to the question of what this all means for New Zealand. More specifically, it will outline the large picture of the world economic structure facing New Zealand and identify specific mechanisms and processes in which China related international economic conditions impact New Zealand. This part focuses on the key sectors and macroeconomic forces shaping New Zealand's economic outlook and shows how New Zealand economic growth and social development is shaped by international and bilateral economic relations and how China is increasingly a major driver of New Zealand's external and internal economic environment.

2. STRUCTURE AND DYNAMICS OF CHINESE ECONOMIC GROWTH

After 30 years of high-speed economic growth, the Chinese economy has reached a turning point. Its growth rate has moved from above 8% in the past 30 years to below 8% (Figure 1). In all post-War rapid economic growth experiences of Asian countries, the 8% annual growth rate has been a critical indicator of the stage or level of economic development of a developing economy. 30 years seemed to be a period of rapid economic growth and expansion of earlier Asian catch-up industrialisation.[1] After that, Asian economies restructure, upgrade, and rebalance, and become a normal or mature economy where growth rates fall below 8% and eventually settle around 3-5% annually.

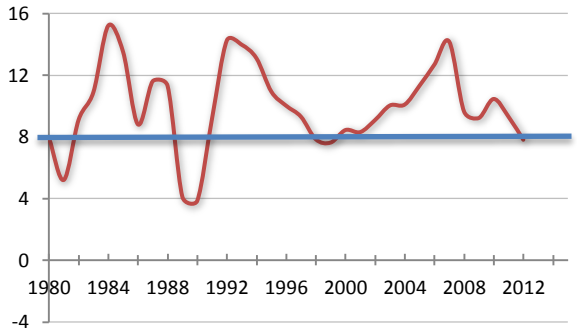

Figure 1 GDP Growth (1980-2012)
Source: IMF (2013), Unit: % on constant prices

8% annual growth is also important as it has become a critical benchmark for economic growth to be kept at a level and speed that is politically (and policy-wise) necessary for a healthy economy. In China's case, it is needed for employment and continual growth of income and living conditions. 8% therefore is critical for us to assess the long term trends of Chinese economy and the structural imperatives for its continual growth, as well as the short term dynamics of macroeconomic factors and conditions for broad economic policy. China has celebrated its successful 30 years of rapid economic growth and development over the past few years but in 2012 the growth rate dropped below 8%, signalling a new era of Chinese growth and development.

While this may have been expected according to the 30 year model, and government policy is well prepared for this challenge, it is highly debated whether this will be a temporary drop or fluctuation as seen previously, such as during the Asian financial crisis in 1997-1998, or whether this is a more structural movement suggesting an end to the 30 year rapid growth period. A key Chinese economist, former World

[1] Japan, Korea, Taiwan, Singapore, for example, had average growth rate of their economies above 8 % for 30 years during their rapid economic growth after World War II (with Japan shorter at 20 years because of the significant conditions in the 1970s) (Huang 2005).

Bank Vice President, Justin Yifu Lin, for example, suggests that Chinese economic growth will continue at the high speed above 8% for another 20 years.

A second indicator of the turning point is China's gross national income (GNI) per capita, considered by economists a principal indicator of the level of economic development and efficiency of an economy.[2] China's GNI per capita grew from USD$220 in 1980 to USD$ 4940 in 2010 (Figure 2). 30 years of rapid economic growth has lifted China from a "low income country" to an "upper middle income country"[3] in 30 years. With GDI per capita at USD$5000 today, China is in the middle of the middle income range.[4] Economic growth and development experiences show countries can be trapped in the middle range income level for a long time, unable to graduate into the high-income range. This can occur because when a country reaches the middle income level, its economic growth can slow down and eventually stop, unable to compete with low income countries for labour/resources-based export competitiveness, nor with high income countries for technology/skills-based competitiveness. This is often experienced through rising labour costs, low investment, weaker competitiveness, inflation and instability. Alternatively, the middle income trap theory suggests countries can "avoid" the middle income trap and transform from a middle-income economy to a high income economy, if structural reform, rebalancing and upgrading take place. The Chinese economy could therefore go in either direction depending on how the structural and institutional problems are addressed.

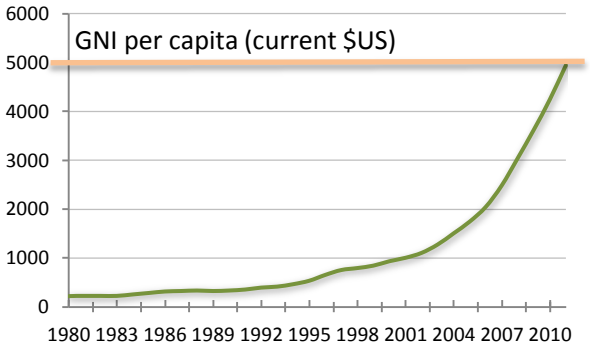

Figure 2 GNI Per Capita (1980-2012)

Source: IMF (2013), Unit: % on constant prices

The third indicator of the turning point is the structure of economic activities for growth. The contribution weight of key sources of growth in China is shifting from exports and investment to consumption and investment. If we look at the evolution of

[2] Douglass North and Robert Thomas (1973) see a long term rise in GNI per capita as a measure of the efficiency of an economy, a key driving force of modern economic development.

[3] World Bank categorization. The World Bank uses the following to classify countries: "Economies are divided according to 2011 GNI per capita, calculated using the World Bank Atlas method. The groups are: low income, $1,025 or less; lower middle income, $1,026 - $4,035; upper middle income, $4,036 - $12,475; and high income, $12,476 or more" World Bank: "how we classify countries," at http://data.worldbank.org/about/country-classifications.

[4] World Bank (2012); Aiyar, al et (2013).

the structure of different types of economic activities that have constituted Chinese economic growth over its rapid growth period of the past 30 years (Figure 3), we see for much of the period, growth has been generated predominantly by exports, about 20% of growth in exports in the 1990s and 2000s, sometimes over 30%; and next by investment, with growth at an average of 11.85% for the period, and 30-40% at some points. Consumption has been a much weaker driver of economic growth so far.

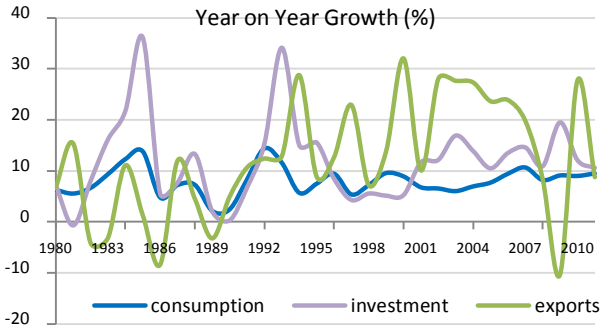

Figure 3 Structure and Shift in Sources of Growth (1980-2012)
Source: IMF (2013), Unit: % based on constant prices

This is important for understanding the dynamism and pattern of Chinese economic growth. It not only reflects different types of economic activities as the driving forces of growth and the relative weight of their contributions to overall economic growth, but it also connects growth to economic policy and shows how macroeconomic policies and structural change programs aim to promote or restrict particular types of economic activities. It is noted in Figure 3 that in 2011 the growth rates of these three major types of economic activities converge at around 10%, suggesting the economy is more balanced in terms of the sources of growth, moving from primarily exports and investment driven. The economy is at a turning point as to whether future growth will rely more on domestic demand, consumption driven economic activities (as the current long-term programme of structural rebalancing, growth strategy change, and domestic demand expansion calls for), or whether it will continue to look upon exports and investment as assuring sources of continual growth, (as the short term policy and political concerns have pointed to).

There are also growing tensions between different income groups, between urban and rural sectors, and between state and private enterprises and capital. These features reflect the type of growth model that has built up in the past 30 years and hence the particular structure of contributions to growth, where growth is generated primarily by exports and investment. These tensions indicate economic development has reached a critical stage beyond the dynamism of growth of the early catch-up period and that China is shifting to a new model of growth. It also reflects the particular institutional and policy environment, which, while having been nurturing for an internationally competitive market economy, has also encouraged or facilitated the rapid expansion of the financial economy over the real economy, shaped access to and contribution of income distribution, and distorted the role of state and private enterprises, as well as that of urban and rural sectors in overall economic growth and development.

The Chinese economy has over the last three decades seen sustained rapid economic growth over and above the growth of advanced economies and the world average. At a very fundamental economic level then, China has clearly become a more important area of the world economy and a driver of global growth. This has significant implications for the New Zealand economy. This section presents a framework for understanding those implications today and over the next few decades by providing a detailed picture of the drivers of Chinese economic growth and the changing structural makeup of the economy. This is done in five parts. The first part reviews the 30 years of rapid growth and development. The second part looks at Chinese growth models to explain this growth and development. The third part overviews the relative and shifting weight of exports, investment and consumption in the economy. The fourth part explores the key drivers of economic growth, namely, industry, reform policy, structural rebalancing and rural-urban integration and improvements in innovation, research and technology, education and the overall strengthening and upgrading of Chinese enterprises. The final part summarises these findings and explores the implications and challenges of a new growth model.

a. **Chinese Economic Growth and Development: 30 Years On**

The China story is one of rapid economic growth and development and the remarkable re-entry of the world's most populated nation into the world economic system. On the back of three decades of above 8% in average annual GDP growth, 500 million Chinese people have pulled themselves out of poverty, China has become the world's largest exporter, manufacturer and the world's second largest economy (World Bank 2012). Those who have visited China take away vivid images of modern architecture and sophisticated transport infrastructure, including a world-leading high-speed rail system, juxtaposed with all the familiar hallmarks of a developing country. China is achieving this rapid industrialization and socioeconomic transformation with limited political instability, in absence of external conflict and through increasing economic and political engagement at the regional and global level.

The early years of the People's Republic of China (PRC), however, were a very different China story. During the period 1949 to 1978, the Chinese economy had very limited economic reach or global impact. China's trade and investment links were poorly developed and the vast majority of the economy remained isolated from developed markets and regions of advanced economic activity. The first thirty years of the PRC was a period of inward focus and national consolidation where state building and the development of government capacity took precedence over global integration. This process was periodically interrupted, including most vividly during the chaos of the Cultural Revolution, but overall the first thirty years of the PRC consolidated the

newly independent Chinese state. This in itself is a significant feat considering the size and complexity of this 'civilization state' and the tumultuous period of revolutionary upheaval following the fall of China's last dynasty in 1911.

The consolidation of heavy industry and a large centrally controlled economic planning system during the early years of the PRC secured the role of government in the state building process, but also had the detrimental impact of institutionalising an inefficient economic structure that relied heavily on central command. Moreover, China's economy remained effectively isolated from the world economy, including most parts of the developed western economies, the Soviet Union from the mid-1960s and even the rapidly industrialising economies of East Asia, once crucial elements of the premodern tributary system. The developmental experiences of this region, first in Japan, then South Korea and Taiwan, showed the leadership in Beijing that alternatives to statist models of development were not only possible but in the case of East Asia a highly effective way to transform underdeveloped economies to first middle income and then advanced economies. By the time of the Dengist reforms, the socialist planned economy had run its practical course and many Chinese leaders and intellectuals began to push through a new growth model.

The growth model that emerged from the late 1970s dismantled many of the most inefficient systems of production and allocation of the Maoist era, but also built upon the highly developed bureaucratic, education and health systems. Most importantly, China seized the opportunity to open to the global economy as the Cold War divide slowly melted and embarked on a series of reforms of the domestic economic structure. At times the reform agenda was systematic, such as carefully targeting the eastern coastline for the development of economic zones for export-oriented activities and the attraction of foreign direct investment (FDI). At other times the reform process was more ad hoc and experimental, such as in the development of the household contract responsibility system (HCRS) or town and village enterprises (TVE) in rural areas, which led to increased entrepreneurialism and productivity gains in the rural economy and unleashed waves of rural-to-urban labour migration. The last three decades of reform has taken many twists and turns but consistently moved China in the direction of increased internationalisation, marketisation and industrialisation.

China's willingness to engage with the world economy has had a marked impact on economic development. This has involved opening a once highly closed Chinese economy to trade, investment and people-to-people exchanges. Differing from the early post-war developmental state in Japan, which was characterised by a high degree of domestic protection of infant industries and low levels of FDI, China's period of rapid economic growth has occurred during a phase of global economic development driven by increasingly open and globalised trade and investment systems and the development of global value chains. China opened the country to international

competition, attracted foreign manufacturers and became an integral part of global value chains dominated by multinational and transnational industry leaders. This provided China with increased employment opportunities, introduced technology and foreign expertise and opened foreign markets for Chinese manufactured and assembled goods providing increased capital formation and driving industrialisation.

At the same time, the reform movement incrementally shifted China away from excessive planning and high levels of state intervention in economic activity. China's approach to marketisation was one of incremental steps to avoid major economic, social and political instability. The planned economy was not immediately dismantled to make room for the growth of the market economy. Instead, reformers chose to 'grow out of the plan' by freezing the size of the command economy and encouraging the market economy to grow alongside it. As the economy grew, market-oriented economic activities came to dominate growth and development (Naughton 1995). The state's planning and command functions decreased as price controls were reduced, allocation of resources and labour shifted into the market and contracting moved outside of state agencies. State owned enterprises were either privatised or market imperatives introduced. The influx of FDI increased marketisation and hurried the establishment of a regulatory framework for supporting the functioning of a market-oriented economy.

China has stepped up industrialisation and urbanisation and has significantly increased the share of the economy involved in manufacturing, construction and assembly. Primary industries accounted for 30% of China's GDP in 1980, but by 2010 accounted for only 10%. Over the same period, the secondary industry and the tertiary (service) industry changed from a 48% and 22% share in 1980 to a 47% and 43% share in 2010 respectively (NBS 2008; World Bank 2012, Figure 13). The Chinese economy has become more urban focused with 90% of Chinese GDP now consisting of non-agricultural activities. With this focus on the urban economy, infrastructure development, construction, manufacturing and light and heavy industries, combined with a growing balance of trade surplus, the Chinese economy has become investment heavy.

b. Growth Pattern and Sources of Growth

When economists, political economists or public commentators debate about China's growth model, there can be several different things involved. Generally, there are three different perspectives on growth models: first, those that focus on structural features of economic organisation; second, those that look to conventional growth accounting on primary inputs; and, third, those that analyse Chinese growth as that generated by three types of economic activities. The Chinese growth model is most often taken as a

unique way in which economic activities are organised. It is often put alongside the Anglo-Saxon model, the Rhine model, the Japanese model, or the East Asian model. This first perspective on growth models focuses primarily on the organisational structure and institutional arrangements in an economy that facilitate gains in efficiency and thus competitiveness of the economy. While this is useful for helping us understand the institutional environment for economic growth, it does not explain or even predict actual growth.

The growth model in the eyes of mainstream economists is slightly different. It focuses on primary inputs into finished goods and services, or the factors of production (FoP), such as land, labour, and capital. The growth accounting method is much more direct at linking "factors" into economic growth and therefore better explains what actually contributes to economic growth. The "factors" in this method are very "primary" ones that are quite "distant" from real economic activities and therefore are not always easy to serve as indicators directly accessible to policy assessment and manipulation aimed at supporting and generating economic activities. It is useful for us to understand the contribution weight of these factors to the total output of an economy, a generic model that can apply to any economy. It is less useful when trying to see the economic interests, relations and activities embedded in the economy, and how they generate economic growth—an understanding of which seems necessary for growth modelling and policy manipulation.

A third perspective in policy and scholarly debate on the Chinese economy focuses on the "sources" of Chinese economic growth: the type of economic activities and how much they contribute to economic growth. In this framework, Chinese economic growth over the past 30 years has been built on three "pillars": exports, investment and consumption, and the consequent growth structure dominated by exports and investment, with increases in consumption and relative decline in exports in more recent time. Focusing on the structure of the contributions by types of economic activities, this approach links actual economic activities (and associated interests and relations) to growth outcomes. The growth structure in this framework not only accounts for the growth outcome, but also reflects the underlying structure of the economy (export concentration, the urban-rural divide, income gaps, domestic demand driven), and therefore connects the state of the economy and prospects of future growth and development to the policy and institutional environment.

c. Structure and Shift in Exports, Consumption and Investment

If we understand Chinese economic growth is generated by these three major types of economic activity, we can show the structure of economic growth, and how that structure has evolved over time.

Figure 4 breaks down the measure of Chinese GDP using the expenditure method over the period of rapid growth. We use exports rather than net exports to highlight the contribution of exports to GDP. As shown in Figure 4, contribution of total consumption to GDP has been steadily declining over the 30 year rapid growth period, from 64% in 1980 to 48% in 2011. In the same period, the contribution of gross capital formation has increased from 36% to 49% of GDP. The increase of the contribution of exports is even more dramatic, from about 10% in 1980 to 39% in 2006. More importantly, in international comparison, China's gross capital formation is significantly higher in contribution to GDP, being 45% in 2011 while the United States was 20% and Japan 25%. The contribution of China's exports to GDP is also unique and much higher than the international average at 31% in 2011, compared to the United States' 8.6% and Japan's 11.3%. The share of total consumption in GDP, on the other hand, is significantly lower internationally: 48% in 2011, compared to the United States, 82%; and Japan, 68%. Clearly, over the last few decades of Chinese style growth, the Chinese economy has developed a growth structure that relies on consumption, investment and exports to contribute to GDP growth but among these three, the contributions of exports and investment are much higher, while consumption is lower than the international average.

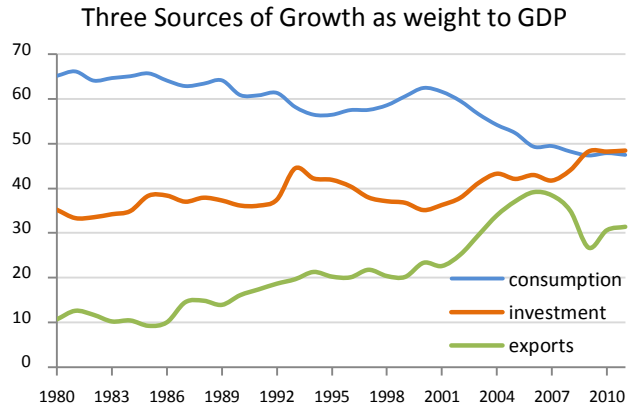

Figure 4 GDP by Expenditure (1980-2011)
Source: World Bank (2012); Unit: % of GDP

(1). Investment

Since the turn of the century investment into China has expanded and 'been a major and increasingly important driver of China's growth' (Lardy 2006:1). Using investments in fixed assets as an example, the last decade of Chinese growth has witnessed amazing growth in investment. The vast majority of this investment has been channelled into urban assets. Twenty per cent of all investment in fixed assets is now in real estate in urban areas. Investment in fixed assets in rural areas has dropped in the new century as a share of total investment in fixed assets and fallen dramatically post-2009.

Figure 5 shows a sevenfold increase in total investment in fixed assets over a ten year period, from 4.35 trillion in 2002 to 30 trillion in 2011. Figure 5 shows this major increase has been driven by investment in fixed assets in urban areas, in particular, investment in urban real estate. In 1995, 77 per cent of all investment in fixed assets went to urban areas, but by 2011 this had increased to 97 per cent. The share of investment in real estate has grown from around 13 per cent in the late 1990s to 20 per cent in 2011. However, while this share has increased, this has not occurred as fast as the increase in investment in other fixed assets in urban China.

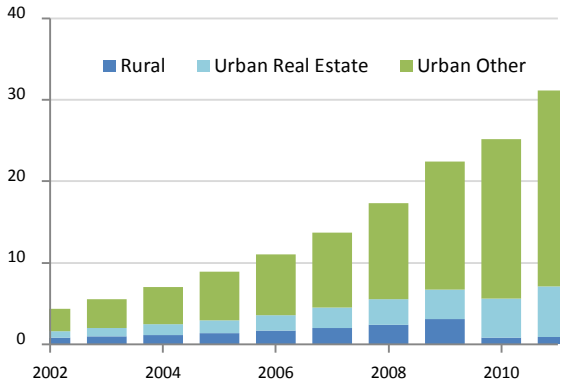

Figure 5 Total Investment in Fixed Assets (2002-2012)
Source: NBS Statistical Yearbook (2012) Unit: 1000 billion Yuan

Moreover, the increasing investment in urban fixed assets and urban real estate is not driven by major increases in domestic loans or the state budget. In fact, the primary source of the growth of investment in fixed assets has been 'self-raising fund and other'. This private investment suggests there is an increasing amount of domestic capital in China for investment.

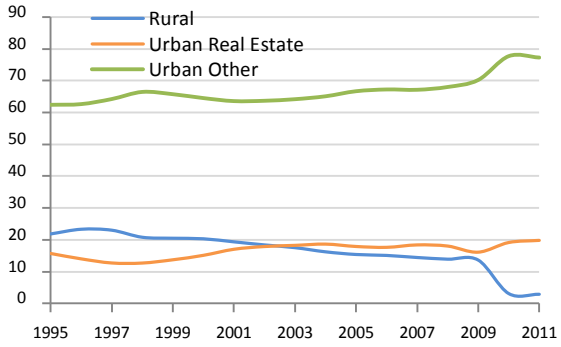

Figure 6 Share of Total Investment in Fixed Assets in Rural and Urban Areas (1995-2011)
Source: NBS Statistical Yearbook (2012), Unit: %

Analysing the share of each source of investment in fixed assets over the last thirty years shows a few important trends (Figure 8). Firstly, the state budget has dropped as a share of total investment in fixed assets. In 1981 the state budget accounted for 28 per cent of all investment in fixed assets, but had dropped to 4 per cent by 2011. The major drop occurred in the latter half of the 1980s. Secondly, domestic loans now sit at a 13 per cent share of investment in fixed assets just as they were in 1981. In the years following the GFC this share increased to 15 per cent as capital constraints were loosened to promote investment, but not to the level experienced from 1985 to 2005 when domestic loans accounted for roughly 20 per cent of all investment in fixed assets. Thirdly, foreign investment has dropped its share from 4 per cent in 1981 to

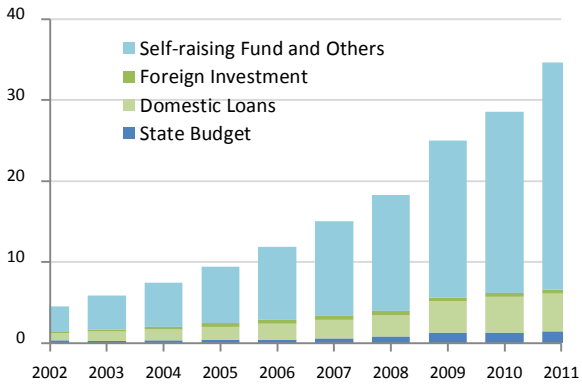

Figure 7 Investment in Fixed Assets by Source of Funds (2002-2011)
Source: NBS Statistical Yearbook (2012) Unit: 1000 billion Yuan

over 1 per cent in 2011. Foreign investment has not been the major driver of investment in fixed assets in China. Finally, and most significantly, are the massive increases in 'self-raising and other investment' in fixed assets in China. This share has increased from 55 per cent in 1981 to a majority 81 per cent share in 2011. This is an important trend in Chinese investment.

The analysis above shows that a great proportion of investment has been sourced from self-raising funds. This suggests a private capital rich environment which provides a good basis for the continual advance of the private sector in the overall national economy. This rich capital is also the source of overseas investment and the driving force of the internationalisation of the Chinese economy. Investment so far is also urban centric. This has contributed to the urban-rural divide in Chinese economic growth and hence will be critical for the structural rebalancing and urbanisation programme to be successful.

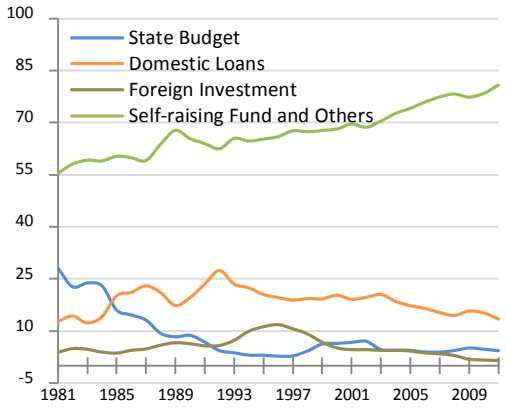

Figure 8 Share of Investment in Fixed Assets by Source of Funds (1981-2011)
Source: NBS Statistical Yearbook (2012), Unit: %

(2). Consumption

Investment aside, the other major component of GDP over the last three decades is consumption. Increasingly, economists are pointing to the growth of Chinese consumption as the most important driver of growth in the coming decades. Due to the major increase in the share of investment/capital formation as a share of GDP, and the post-2000 period of significant increases in the balance of trade surplus, the third component of GDP as measured by the expenditure method, (final consumption expenditure) has decreased as a share of GDP from 62 per cent in 2000 (6 trillion Yuan) to 48 per cent (19 trillion Yuan) in 2010. This share increased slightly in 2011 to

49 per cent on a 4 trillion Yuan increase in final consumption expenditure.

Figure 9 shows large increases in Chinese consumption expenditure since the turn of the century. Household consumption expenditure continues to account for more than 70% of final consumption expenditure, meaning the bulk of this expenditure increase has occurred in household consumption as opposed to government consumption. However, the real value of government expenditure is on the rise. As in many developed economies, the state is increasing social provisions in response to distributional demands from the public, and investing in the development of infrastructure, science and technology and education and training. As the Chinese economy matures we will likely continue to see real gains in government expenditure.

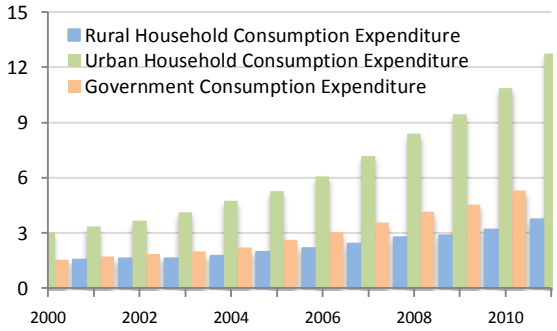

Figure 9 Breakdown of Final Consumption Expenditure (2000-2012)
Source: NBS Statistical Yearbook (2012) Unit: 1000 billion Yuan

The possibility that consumption data are underrepresented in Chinese GDP calculations should also be considered. Studies point to the possibility that household consumption in particular is underreported. For example, a Morgan Stanley report argued private consumption, at 35 per cent of GDP since 2008 by official figures, is according to their 'bottom-up' estimate closer to 45 per cent of GDP (The Economist 2013). If this private consumption data has been misattributed to other categories, then there is also the possibility that the share of household consumption to GDP is even higher than the 45 per cent estimate by Morgan and Stanley. Morgan and Stanley's estimates suggest the structural shift from investment-led growth to consumption-driven growth is already well under way in China.

(3). Exports

Finally, the high contribution of exports of goods and services to the growth of GDP is unique in the Chinese growth model. China, Japan and the United States were at a similar level of export weight to GDP in the early 1980s (Figure 10). Japan and the United States have been moving around 10-15% in contribution of export to GDP. China's GDP has been steadily growing and peaked in 2006-2007. It has decreased remarkably since the global financial crisis (GFC). From 2005 to 2007, growth in

exports contributed around 40% to the growth of GDP in these years. This is a remarkably high level. In 2008, when annual exports reached a 10.04 trillion Yuan, exports were 32% of GDP. By 2011 exports reached a new high of 12.32 trillion Yuan, but had dropped off as a percentage of GDP to 26% due to both growth in the contribution of GDP from investment and consumption and massive increases in imports from 2009 to 2011.

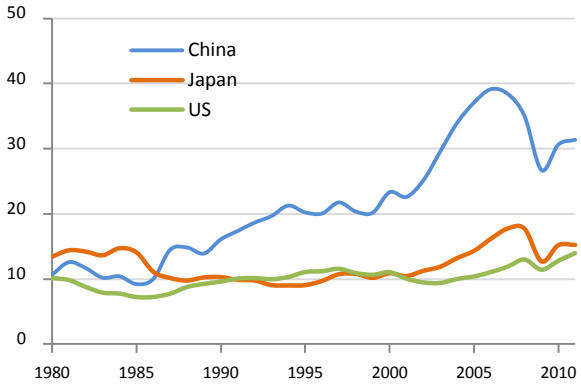

Figure 10 Contribution Share of Exports to GDP (2001-2011)
Source: World Bank (2012) Unit: %

In the years following the GFC, export markets contracted as the advanced economies of the world focused on fiscal consolidation. Investment was boosted through stimulus and credit easing, and final consumption expenditure increased slightly to maintain a more than 40 per cent share in the growth of GDP. While this could be temporal fluctuations in global movement of macroeconomic forces and factors, this is taken as providing strong evidence that the Chinese economy is passing over a turning point. Further sustainable economic growth will require growth model reorientation and structural rebalancing, and in-depth institutional reforms in areas which China has not been able to move on in the past. This will be critical for economic growth on a sound, long-term sustainable structure of sources or contributions to growth.

Reform will require a clear direction from the government in its broad economic policy and development strategy, urban-rural integration, structural rebalancing, income distribution reform, science & technology development and the strengthening of enterprise competitiveness. These are key forces shaping a more rationalised structure of economic growth and indeed themselves important sources for the types of economic activities required for long-term sustainable economic growth, namely, increased domestic consumption and the development of a sustainable investment and export sector contribution to economic growth.

d. Key Forces Shaping Economic Growth

China's growth model over the last three decades of Dengist reforms has therefore been characterised by a high investment to GDP ratio, reaching a high of 48% of total

GDP in recent years, and a growth at any cost mentality as shown by the rapid GDP growth rates and high levels of investment. This has been an effective growth strategy for China to date, but one that is unsustainable in the long run. China has now reached the stage where it must grow out of this model to meet the challenge of maintaining growth, development and socioeconomic transformation as it negotiates the transition from middle-income to advanced economy. China has reached 'another turning point in its development path when a second strategic, and no less fundamental, shift is called for' (World Bank 2012: xv).

The next few decades of development require a rebalancing of the contributions of capital formation/investment and consumption to GDP. As exports are predicted to decrease due to the growth of imports and the relative saturation of Chinese products in a global market characterised by advanced economies focused on fiscal consolidation, domestic demand will need to be an even stronger driver of the Chinese economy. Figure 11 shows The World Bank predicts the ratio of investment to GDP to decrease from more than 46% in 2010 to a 'relatively normal' 38% in 2020 and to a low 34% by 2030. As this drop cannot be accounted for by an increase in net exports, the ratio of consumption to GDP is set to rise from just under 49% in 2010 to 60% in 2020 and to 66% in 2030, a rate not dissimilar to the ratio of consumption to GDP in today's advanced economies.

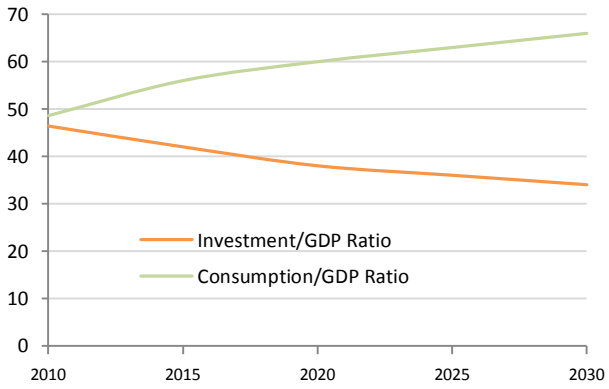

Figure 11 Projected Ratio of Investment and Consumption to GDP (2010-30)
Source: World Bank (2012:9). Unit: %

The shift in the relative weight of exports, investment and consumption reflects a major structural transformation of the economy involving changes in the relative weight of the economic activities in three major sectors, agriculture, industry and services, and in the well-established trend toward the urbanisation of the Chinese population. It also reflects the upgrading of Chinese economic activities through strengthening of Chinese enterprises and large private and state investments in research, innovation, technology and education. These factors, more than any other, are the major drivers of the on-going shift toward an advanced economy that is more reliant on consumption and domestic demand. How successful these drivers of growth are will be determined by the ability of the state to balance policies that ensure short-term growth with an ability to introduce reforms to secure long-term sustainable

development.

(1). General Policy Environment

The overall programme of further economic reform and hence the general policy environment for economic development is a primary factor that determines the direction and structure of future economic growth. There is no lack of debate and tensions within policy circles, and by academics and the political elites over the direction and next step in the reform process, the nature of the problems in the economy and the strategy to rebalance and restructure. Most issues involve tense and assertive interests of different groups, economic sectors, and different parts of society, and therefore any major shift in policy orientation will engage substantive consequences on economic activities. Early signs in the past two years show conflicting evidence between concerns over short term growth performance and the influences of existing interests in keeping up the existing model of growth, driven primarily by investment and exports, on the one hand, and determination to move on to "deep reforms" required for structural rebalancing and growth model reorientation on the other hand. It is possible that the political logic of economic policy has scheduled these reform programmes to roll out in the next couple of years as the new leadership establishes itself from late last year and early this year.[5]

The issues that have dominated the policy agenda are: macroeconomic policy; debate over further marketisation and development of market institutions; debate over the role of state and private enterprises; relations between state and state-owned enterprises; prices of resource products; the exchange rate mechanism and interest rates; organizational competitiveness and R&D innovation; control of core technologies and intellectual property rights protection and promotion; 'going global' and internationalisation of enterprises; and the structural balance between exports and domestic demand, urban and rural sectors. These policy interests and concerns are driven largely by a consensus that seems to have emerged among policy makers and political elites that Chinese economic growth has reached a historical turning point where further economic growth and transformation will require substantial change in the structure of its economy and the way its growth is generated. The current programme of "structural rebalancing and model change" adopted by the government reflects such a consensus and more polices on individual aspects of that are expected to follow.

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[5] The Guidelines of Deepening Reforms in Economic Institutions issued by the State Council in May 2013 includes key tasks of reform this year in seven areas: administration, budgetary and tax; monetary and financial system; investment system; resources product price mechanisms, social security system; urbanization and urban rural integration. It is expected that the third plenary meeting of the CPC later this year, where major economic policy is often decided, will roll out more broad and comprehensive programs of reform, which could include land use rights, the household registration system, urbanization and income distribution reform.

On the other hand, structural rebalancing and growth model reorientation is a long term programme and it will take time to see their expected effects and thus enhanced contributions to economic growth. Moving from export driven to domestic demand driven growth, shifting the weight of investment and consumption to GDP, shifting perhaps from a financial economy to a real economy, and moving away from urban industrial development biases to urban-rural concurrent growth, can initially dampen the growth momentum. Therefore, there is great tension in the government's overall economic policy between firstly its interest and determination to seek structural reform and rebalancing of the economy for long-term economic and social development and secondly its macroeconomic and even political concerns over short term growth performance outcomes.

This tension leads to ambiguity in the direction of the general policy environment: whether and how strongly, for example, the overheated housing and property sector should be controlled; whether the domestic demand drive is more of macroeconomic management through stimulus packages with injection of public sector capital into the economy, or if it should be developed through structural reform and growth model reorientation. The government, for example, promotes and supports major state owned enterprises for their modern transformation, and nurtures them to become leaders of modernisation and globalisation of the Chinese economy. At the same time, it strikes to advance further marketisation and development of market institutions and foster an open and fair market environment for different types of capital, business and enterprises. This is particularly important for private domestic enterprises which have been in a venerable position in the Chinese economic structure dominated by public and international capital and enterprises.

The general policy environment is also shaped by the underlying different interests and forces over the historical direction of China's economic and social development. Deng's 30 year reform and development is seen by many as efficiency-driven, economic growth-centric and world economic structure-dependent, with the growth dividends not fairly distributed in society. This is often labelled as "rightist" in political and ideological debates between factions in the political arena and among different social groups.

The 'left' in China is a mixture of different kinds: those who see the importance and value of the model and system of Mao which Deng's reform and change is considered to have negated; those who see a broad historical picture of China's modern development from the late 19th century and continuity in modern Chinese history across Deng's period, Mao's era, republic era, and late Qing period that has driven China's historical rise; and those who are marginalised from the growth process and emergent economic and social structure and want to see a fair society not driven primarily by efficiency and capital. The debate and fanfare over the Chongqing model

and Guangdong model in the last few years is a reflection of this tension. China has never lacked such tension and conflict over "political lines" throughout its history. These tensions can significantly affect economic growth and the course of economic development and can impact the ability of the government to deepen the reform programme.

(2). Urban-Rural Integration

Urbanisation will be a major driver of China's structural transformation and move to a more consumption-based economy in the coming years. Far more of the economic activity in China will be domestically driven as more citizens become reliant on the urban economy to sustain their lifestyle. China's rural residents will continue to move out of rural lifestyles characterised by a high degree of self-sufficiency and family-based farming on small-scale leased plots and become an integral element of the urban economy. These urban consumers are more likely to demand higher standards of living, have more disposable income for consumption and many will be in day-to-day contact with well-developed and fully integrated production and distribution chains at both the domestic and global levels.

Figure 12 shows how population stabilisation policies and the increasing economic cost of having multiple children have dramatically limited population growth and facilitated the movement of rural labour into urban industries. In 1980, the Chinese population accounted for 22% of the world's population, but only 2% of world GDP as measured in PPPs. By 2010, China's share of the world population had dropped to 19% (Xinhua 2011) and its share of economic activity had risen to 14%. The key driver behind this rapid change has been the movement of low productive agricultural labour into highly productive industrial and service industry employment. As such, we can see the classic Lewis model of labour transition in action.

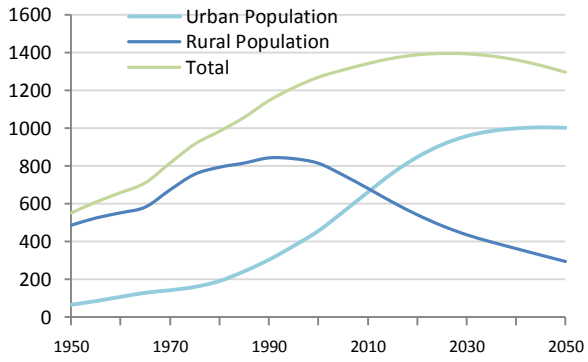

Figure 12 Rural-to-Urban Transition and Population Stabilisation (1950-2050)
Source: World Bank (2012:9). Unit: millions

Lewis (1954) argued that in highly populated countries with large agrarian-based economies, economic growth and development is driven through labour migration to urban areas. As the source of 'surplus' labour from rural areas becomes scarce, wages

increase in both urban and rural industries and a structural transformation of the economy from primarily rural-based to overwhelmingly urban-driven occurs. As shown in Figure 12, China has some way to go before this structural transformation is complete. Moreover, if we assume an industrial agricultural sector would only require a rural population of around 300 million, a further 300 to 400 million more rural-to-urban transfers can be expected.

Even with the brakes put on the rapid growth of the Chinese population, at times through highly controversial family planning policies, the Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat predict that China will reach one billion urban residents around 2040. This is likely to be roughly 300 million more urban residents than today. By that time the rural population will have likely dropped from its high of roughly 840 million in the early 1990s to a low of 360 million, a real loss of 480 million rural residents in a short fifty-year period. This will be facilitated by the fact that the population will likely begin to decrease by 2025, just over ten years from now, and by the trend towards urban living. Based on the experience of previously industrialising economies it seems highly likely that China's citizens will continue to be attracted to urban living in the coming decades.

A key driver of consumption has been and will continue to be the movement of people within the country. The trend of the majority of the rural population moving to urban living is already well underway and is expected to deepen in the coming decades. To date, China remains a country where nearly fifty per cent of the population still live rural lives. This is far higher than the less than 20 per cent urban rate in 1980, but still well below the 85-95 per cent urban rate in advanced economies. Japan, by comparison, reached the fifty per cent urban point in the 1950s, and the United Kingdom and the United States in the early 1900s. Urbanisation in China will be a major driver of the structural transformation of the economy as a further 300 million rural people are expected to transfer to urban living in the coming decades. After this transition, China will be home to 1 billion urban consumers.

There are various assessments of the levels of consumption demand and investment this will bring to the Chinese economy, ranging from 20 trillion to 30 trillion Yuan if 260 million rural residents urbanise over the next 10 years. This will be more than enough to offset the projected decline in export contribution. Urbanisation on this scale will involve substantial government investment in infrastructure, housing and education, and medical and social security. Prime Minister Li Keqiang is a strong proponent of stimulating economic development and modernisation through rural-to-urban migration and the Government's budget planning for the urbanization programme is said to centre around 4 trillion Yuan in new investment. Scholars such as Li Yang from the Chinese Academy of Social Sciences argue urbanisation will not only stimulate urban growth, but will also facilitate integration of rural and urban economies

and stimulate the development of new agricultural practices on larger and more efficient farming systems.

(3). Rebalancing of Industrial Structure

Population changes are accompanied by an on-going relative decline of the agricultural sector, relative stability in the industrial sector and major growth in the services sector, as measured through each sector's contribution share to GDP. This is a development pattern not unique to China. Figure 13 shows how this process occurred prior to 2010 and how it is predicted to progress in the coming two decades. One significant trend in these figures is the growth in the share of the service sector from 20 per cent of GDP in 1980 to 43 per cent today. Services are set to rise to account for more than 60 per cent of Chinese GDP by 2030. While agriculture and industry will likely decrease as a share of GDP in the coming decades, each will remain important elements of the Chinese economy.

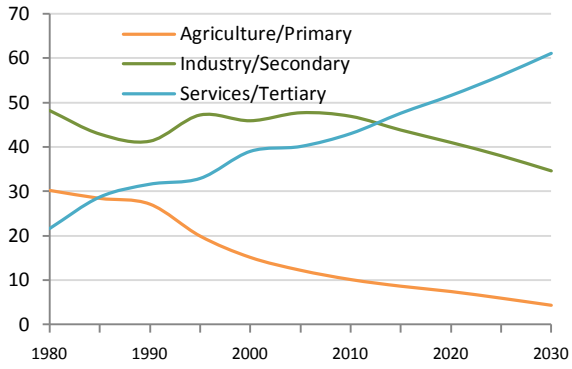

Figure 13 Share of Agriculture, Industry and Services in GDP (1980-2030)
Source: NBS of China (2008:33), and World Bank (2012:9). Unit: %

The growth of urban employment and structural transformation of the economy will be reflected in the rapid increase in the number of people working in the services sector and on-going decline of agricultural employment. Figure 14 shows a steady and predicted on-going transformation of employment in China as people move out of agricultural employment into urban or non-agricultural employment. In 1980, nearly 70 per cent of total employment was in the agricultural sector. This declined to 38 per cent by 2010 and is predicted to decline to 12.5 per cent by 2030. Fewer employees in the agricultural sector will facilitate the industrialisation of agricultural production and the creation of leading agricultural enterprises. China will have the opportunity to move away from an agricultural sector organised around the goal of providing self-sufficiency to rural families and to introduce larger and more efficient agricultural enterprises.

As the share of employment in the agricultural sector declines, we will likely see the on-going importance of industrial sector employment and major growth of employment in the service sector. The share of those employed in the industrial sector

has increased from 20 per cent in 1980 to 28 per cent in 2010. The World Bank predicts this share to remain stable. The service sector accounted for only 17 per cent of employment in 1980 but had doubled its share to 34 per cent by 2010. This share is predicted to grow rapidly to account for nearly 60 per cent of total employment by 2030. The on-going growth of the service sector, and shift in relative weight of this sector in the overall economy, will drive the shift from a middle-income to an advanced economy. These major employment changes will be reflected in structural changes within each sector.

As economies move to modern economic arrangements, a well-established development trend is the relative decline of the agricultural sector. The addition of industrial processes into agricultural production increases agricultural output and decreases the need for a large agricultural labour force. However, these increases are unlikely to lead to productivity and income gains that can match the gains seen in the industrial and service sectors for a number of reasons. First, the agricultural sector in developing countries usually plays the role of providing provision for an urban sector unwilling or unable to make rapid increases in how much they pay for agricultural product. Second, agriculture can be an important export earning, but as the urban population grows, and less people live self-sufficient rural lifestyles, there is increasing domestic demand for agricultural product decreasing product for export. Finally, in the early stages of development the agricultural sector is unlikely to attract the type of investment that goes to urban areas where return on capital is higher and therefore agricultural industries will struggle to expand.

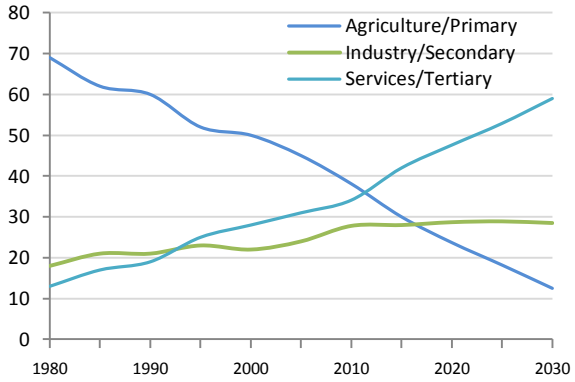

Figure 14 Share of Employment in Agriculture, Industry and Services (1980-2030)
Source: NBS of China (2008:18), and World Bank (2012:9). Unit: %

China, with its large population, has been no exception. The agricultural sector experienced rapid productivity gains in the years following the introduction of the household contract responsibility system and breakdown of the commune system (Lin 1992). However, the agricultural sector was still primarily seen as a source of agricultural supply and effectively continued to act as a labour sink for China's massive population, hiding much under-employment. Now that the rural population is, for the first time in Chinese history, smaller than the urban population, and many of this population are involved in non-agricultural work in rural areas, there is the opportunity

and the structural requirement for the role of agriculture to shift from one of a source of basic subsistence for rural people to an efficient and highly productive industrialised agricultural sector. In recent years, the state has set policy to promote the establishment of a modern, industrialised and large-scale agricultural sector. This is likely to continue to facilitate the movement of the vast majority of China's labour into the more productive urban sector and to strengthen the agricultural industry.

Industry has consistently been an important part of the Chinese growth strategy. Since the Nationalist era and particularly during the Maoist era, the development of heavy industry lay at the forefront of the national growth agenda. During the Great Leap Forward (1958-60), China's stated goal was to overtake the United Kingdom in industrial production. The resources of the state were channelled into this goal and into the development of heavy industry. In the Dengist era, industrial production expanded to incorporate the development of light industries such as textiles, assembly and electronics. These formed an important part of the export-led growth policy but did not replace heavy industries. Today, and into the foreseeable future, heavy and light industry will likely remain central to economic growth and development. As the second section shows, Chinese industries will continue to play a major, but changing, role in the global value chains of the world economy.

Chinese industry conforms to a dualistic model of economy. In the early 1980s as industry expanded, first through the town and village enterprises (TVE) in rural areas and later in urban areas, through the privatisation of many smaller state enterprises, a new dualistic system developed where the state maintained control over important sectors such as oil or electricity and privatised the remainder. The state 'grasped the large and let go the small' state owned enterprises (SOE) allowing both bottom-up entrepreneurialism and competition as well as state direction of the commanding heights of the economy. FDI was also encouraged into special economic zones and industrial parks. Foreign companies were welcomed and encouraged to establish factories through a series of preferential policies and the high (and ongoing) competitive advantage of accessing a well-educated but comparatively cheap labour pool. This spurred a lot of competition in the industrial sector at one level but also entrenched state control of strategic industries. This has created a dynamic industrial economy that lies at the heart of China's competitive global advantage. Industrial expansion has driven the Chinese economy over the last thirty years and this is likely to continue.

The development of the service sector is the most exciting element of the structural transformation of the Chinese economy. This is creating a fundamentally different type of economic structure in China as more people become involved in service provision. This will also contribute positively to the development of a consumption driven economy. It is worth noting here that most advanced economies

are dominated by their service industries suggesting that China's transition from middle-income to advanced economy will require the development of a strong service sector. This will fundamentally reshape the Chinese economy in the coming decades away from a growth at any cost model to a more sustainable and high quality growth model.

These structural changes have become well established over the last three decades of reform. They point to the likelihood of major increases in domestic consumption spending, particularly in urban areas, and to the growth of services in China. In absence of an unlikely major turnaround in these well-established trends, Chinese economic growth will continue as it is stimulated by the urbanisation process and structural changes in the domestic economy. In the coming years, this will likely occur at a much slower and more sustainable rate as workers move into industry and services to meet domestic demand and export-oriented industries are maintained but no longer expand their share of the Chinese economy. This means the Chinese economy will not only be quantitatively different in the coming decades as growth continues, albeit at a slower pace, but will also be qualitatively different as the major drivers of growth shift away from an over-emphasis on investment and exports to the expansion of the service industry and the rise of the Chinese consumer. An important part of this shift will be the internationalisation of Chinese capital and leading brands.

(4). Capital and Enterprise Internationalisation

State market relations have been a core issue in China's economic transition. In many of the early years, it was a problem of how to "grow out of the plan" (Noughton 1995) where inefficient and unproductive state-owned enterprises were allowed to decline, collapse or privatise. At the same time, private capital and enterprises were encouraged to develop, and expand. This was a period of "state capital retreating and private capital advancing."

From the mid 1990s and particularly in the 2000s, there have been a growing number of enterprise restructurings where private capital has withdrawn. The Government's industry promotion scheme and the economic stimulus packages have brought huge resources and capital to state enterprises. In key industries such as steel, coal, airlines and finance the state has built its dominance to almost monopoly status, and expanded further to areas where private capital had been dominant. The IT industry, real estate, private capital markets and private enterprises have been confined to downstream industries or sectors. Entry barriers to many industries are particularly high for private capital. There is therefore heated debate over whether this is a reverse of the early trend and whether we can still see 'state capital retreating and private capital advancing'.

Statistics on gross industrial output value suggest the trend for private industry advancing continues. For example, in 1991 there were 8 million industrial enterprises in China of which there were only 104,700 that were state-owned and 1.6 million that were collective-owned enterprises. In the same year there were 6.4 million 'individual-owned enterprises in urban and rural areas'. However, the vast majority of the gross output value of industry for that year, some 2,662.5 Billion Yuan according to the 1996 *National Bureau of Statistics Yearbook*, occurred in enterprises that were not private. SOEs accounted for 56% of all industrial gross output. Collective-owned enterprises accounted for 33% and 'individual-owned enterprises in urban and rural areas' accounted for less than 5%. By 1995 this share had increased to nearly 13% as 'other' types of ownership and collective ownership increased their share of gross industrial output and SOEs decreased their share to 34% of gross industrial output (NBS 1996). This compares to a height of 90% of gross output value of industry accounted for by SOE activities in 1965 and 78% at the start of the reform era.

By 2000, the share of gross industrial output value in enterprises funded from Hong Kong, Macao, Taiwan and foreign funded enterprises had reached 12% and 15% respectively. The share of gross industrial output value from SOEs had dropped to 24% and collective-owned enterprises had dropped their share to 14%. However, the number of state-owned or state majority share enterprises still represented 47% of total gross industrial output value (NBS 2001). Limited liability corporations, including those with state funding, made up 13% and private enterprises made up only 6% of total gross industrial output value.

By 2011, the share of gross industrial output value in enterprises funded from Hong Kong, Macao, Taiwan and foreign funded enterprises had reached 9% and 17% respectively. SOEs made up only 8% and collective-owned enterprises only 1% of gross industrial value. Private enterprises accounted for 30% of total gross industrial output. Combined with the Hong Kong, Macao, Taiwan and foreign funded enterprises, non-state enterprises accounted for well over half of China's industrial output, the rest coming from SOEs in commanding heights of the economy and a number of limited liability corporations, cooperatives and shareholding enterprises (NBS 2012).

A further way to measure the relative weight of private and state capital in the domestic economy is through total wage bills. In 1995, the total wage bill of employed persons in urban units was 806 billion Yuan. 77% of this was for SOE units, 15% for urban collective-owned units and 8% for units of other types of ownership. By 2011, SOEs had decreased their share of the total wage bill of employed persons in urban units by 29 percentage points to 48%. Urban collective-owned units also slowly

decreased to 3% while units of other types of ownership increased their share of the total wage bill of employed persons in urban units from 8% in 1995 to 49% in 2011, for the first time surpassing the share of SOEs. This shows non-state urban units are becoming the dominant driver of urban wages and therefore the main source of urban household consumption spending in China today.

The relation between state and private capital and enterprises today is no longer an ideological issue as was originally intended in the early years of reform. Nor is it simply about who owns the national economy. It has increasingly become a problem of creating the best business environment for economic growth. There is an embedded tension in the institutional environment shaping these relations. On the one hand, there are consistent efforts by the government to promote core state owned enterprises in key industries to build highly competitive corporations on the basis of large-scale activities and monopoly position. On the other hand, there is great pressure on the government to deepen market reform and nurture a fair and open playing field for all business, state and private, domestic and international. Prime Minister Li Keqiang is reportedly a strong advocate of promoting structural rebalancing and stimulating economic growth by reducing the role of the state and planning for private businesses and for market forces to play a larger role in the economy.

The problem of capital and enterprise has also to do with the international capital and economy. Our early analysis showed that investment has driven the Chinese economy. Both international capital and self-raising funds are dominant in the process of capital formation. Therefore there is great overlap between private and international capital. Private capital "retreat" is therefore also in some way a "retreat" of international capital. An unimproved business environment would leave private/international capital wanting and investors would likely redirect their capital overseas. As shown in the next section, China remains an important host country for global capital flows. These flows and the activities of international enterprises in China have played an important role in the development of the regulatory environment of the market-oriented economy.

The flip (and more recent) side of increasing global capital flows has been the introduction of a wide range of Chinese enterprises to the international economy. In order to enhance the competitiveness of state owned enterprises and further secure global support of Chinese economic growth, there has been almost a state organised campaign for state enterprises to "go out" and establish themselves in the international economy. These state enterprises are key agents of the internationalisation of the Chinese economy but are clearly no longer the only significant economic actors in this process.

The growing importance and presence of China's largest enterprises is already

evident. For example, in 2005 the Global Fortune 500 ranking of the world's largest corporations contained only 16 Chinese companies and only 3 Chinese companies in the top 200. By 2012, the Global Fortune 500 list contained 73 (15%) Chinese companies of which 22 (11%) were in the top 200. Sinopec Group, China National Petroleum and State Grid were ranked the fifth, sixth and seventh largest corporations in the world respectively (Fortune 2013). On the back of this massive growth in Chinese economic output, it comes as no surprise to see that of the 1,426 billionaires listed on the Forbes list in 2013, 161 or 11 per cent were Chinese citizens (including 39 billionaires from Hong Kong) (Forbes 2013).

The tension between these two trends will continue in the development of the ownership model, capital types, corporate organisation and the business environment. The direction of this development will not only define the type of capitalism or market economy China is but more importantly affect the extent to which efficiency gains will continue and whether the economy will continue to grow and expand. While there are very real concerns in the short to medium term, the long-term trend is toward an economy driven by the private sector. Through this process, however, income distribution and socioeconomic inequality has become a major challenge.

(5). Income Distribution and Social Gaps

Income gaps have emerged as a key problem underlying the unhealthy structure of the economy and point to the problems in the existing income distribution system where there are huge income gaps between urban and rural sectors, between costal and inland regions, and between different sectors of society. These problems are exacerbated by the tax system, social security and welfare provision, hidden income and illegal income. In 2013, the Government released the official Gini coefficient for China for the first time since the year 2000. The Gini coefficient is a measure of income distribution where a score of zero indicates all people have the same income and a score of 1 indicates maximum inequality. In 2003, China's Gini coefficient sat at 0.479 but grew steadily to a high of 0.491 in 2008 before dropping slightly to 0.474 in 2012 (Yang 2013). Most modern economies aim for a Gini coefficient between 0.3 and 0.4 as recommended by the United Nations. A score above 0.4 suggests income distribution inequality and social gaps have the potential to create major social issues and impact development and growth.

Tackling this challenge is multifaceted. Income distribution can refer to distribution at two levels. At the primary level income comes directly from factors of production: labour, land, capital and technology. At the secondary level, there is redistribution of "income" not directly gained from work but legally gained through government redistributions such as tax breaks, social security and transfers. Recently, the Chinese

Government have stressed the importance of acknowledging inequality in both levels of income distribution. Both levels are important if China is to avoid the trap of working to address poverty alleviation and potential instability through extreme income disparity by focusing only on redistributive measures. Instead, measures such as improving the income of rural farm workers through reforms to 'taxation, subsidies, salary system, financial regulation, household regulation and social security' (Xinhua Feb 6, 2013) can target key inefficiencies and barriers to further development in rural and less developed regions of China. The potential for income distribution inequality to dampen economic growth by reducing household consumption, however, still remains.

A key structural issue in China's growth model is the relatively weak contribution of consumption to economic growth. This has a lot to do with the income distribution model that has been an effective instrument for rapid economic growth for decades, in part due to household income remaining significantly low, the share of wage income being relatively low in primary income distribution, and government provisions such as social security, pension or unemployment support remaining relatively low as a share of the government budget. This has increased the propensity for household savings that have been channeled into domestic investment. However, this model cannot drive the growth of household or even government consumption as China structurally rebalances its economy. Reform in primary level income distribution, therefore, needs to significantly close income gaps and raise the consumption capacity of middle and low-income groups. At the secondary level, Government redistribution policies are gradually becoming more complete even over the traditionally disparate rural-urban divide. China is building a comprehensive national and local social security system, including health and employment insurance and pension schemes.

Changes in income distribution could therefore positively help meet the challenge of structural rebalancing by increasing the propensity of rural and new urban residents (China's migrant workers or *nongmingong*) to spend more of their income on consumption. Alternatively, if income distribution continues to remain problematic, China not only runs the risk of increasing socioeconomic tension between regions and employees in different sectors, but also of failing to rebalance the economy to meet the challenge of moving toward a middle-high-income society. Income distribution and social gaps are a key driver and an important indicator of China's economic transformation, growth and development over the coming decades.

(6). Research, Innovation, Technology and Education

The on-going structural transformation of the Chinese economy has led to the invigoration of economic activities not traditionally associated with Chinese growth and dynamism. Chinese enterprises are developing highly competitive and, at times,

cutting edge practices within the domestic economy and spurring innovation far beyond the 'shanzhai' model of copying western technology and design. Section 2 shows how Chinese companies are competing more for a global share of leading industries. This section provides the background for understanding the development of Chinese competiveness by analysing the investment in human capital, the rise of Chinese research and development and science and technology and by highlighting the importance of the growth of leading Chinese enterprises. Investments in education, innovation and up-skilling the Chinese labour force are beginning to bear fruit as industries seek more skilled and semi-skilled workers to push Chinese enterprises up the value chain and into the realm of an advanced economic structure.

China is investing heavily in education and training to create human capital for an advanced economy. From 2000 to 2011 the number of annual graduates of institutions of higher education grew from 1 million to 6 million. Each year China now produces more graduates of higher education institutions than the entire population of New Zealand. Figure 15 shows that the number of graduates of technical schools has grown over the last decade to more than a million annual graduates. One challenge for China, a country where education holds a special place in the cultural tradition, will be to incentivise the study of technical skills in order to ensure a balanced and all-round labour force that is required by enterprises in the new economy.

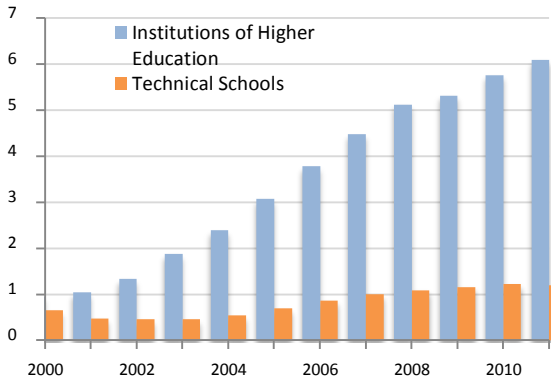

Figure 15: Annual Graduates of Higher Institutions and Technical Schools (2000-11)
Source: NBS of China (2008:20-9, 20-36), and World Bank (2012:9).
Unit: millions

Figure 16 shows the number of annual graduates of postgraduate studies has also increased rapidly over the last decade, from less than 60,000 in the year 2000 to well over 400,000 in 2011. This is a remarkable increase in postgraduate studies and suggests there will be ample highly educated graduates in China to meet the demands of an advanced economy. Along with this quantitative increase, there is some evidence that Chinese institutions of higher learning are becoming higher quality education and research centres. For example, in 2003, only 14 Chinese universities (including in Hong Kong) were ranked in the academic ranking of world universities produced by Shanghai Jiaotong University, which ranks the top 500 universities primarily by academic quality. No Chinese universities were in the top 200 and only 4 were in the top 300. By 2012, 33 Chinese universities made the ranking cut-off, 6 were in the top

200 and a further 6 were ranked in the top 300 (ShanghaiRanking Consultancy 2013). Using scientific articles as an example, there has also been a rapid increase in China's academic output. Kamalski and L'Huillier (2011) predict that China will have the highest output of scientific articles of any country in the world in the post-2013 years and that the quality of those articles are increasing as shown by rising citation rates.

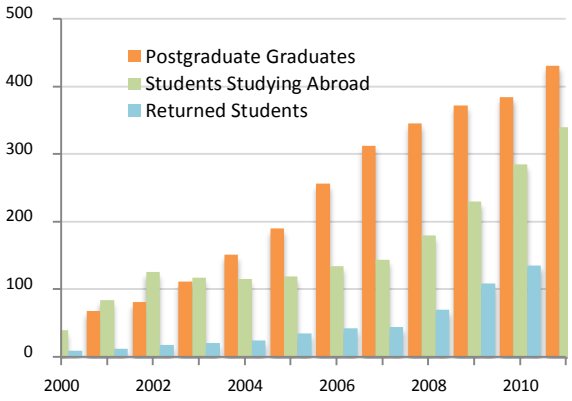

Figure 16 Number of Postgraduates and Students Studying Abroad (2000-11)
Source: NBS of China (2012:10); Unit: Thousands

More Chinese students are also graduating with foreign degrees and returning to China. In 2000, there were only 39,000 Chinese students studying abroad. By 2011, 340,000 Chinese students were overseas studying foreign qualifications, a near ten-fold increase. The number of Chinese overseas students returning to China has also increased from 9,121 in 2000 to 186,000 in 2011, and the ratio of returning students to students studying abroad is narrowing. In 2000, the number of students returning after studying abroad was 15%, the size of the number of students studying abroad. By 2011, the number of students returning to China after studying abroad had grown to 55% the size of the total number of students studying abroad. This demonstrates a greater proportion of Chinese students studying abroad are returning after their studies to take up opportunities in the Chinese economy. This facilitates China's global integration and the cross-fertilisation of knowledge and strengthens the capacity of the Chinese labour force to meet the demands of an advanced economy.

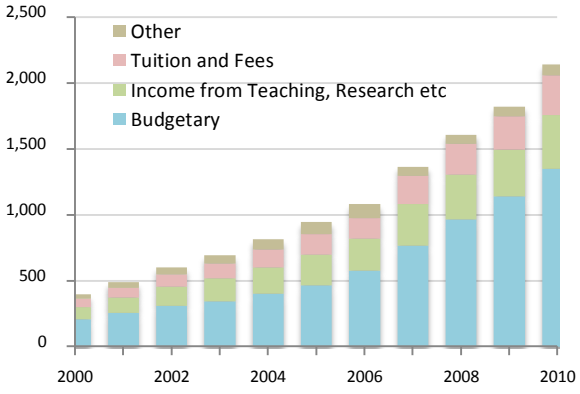

Figure 17 Education Funding (2000-10)
Source: NBS of China (2012:20-39); Unit: billion Yuan

Funding for education has increased dramatically over the last decade from under 500 billion Yuan in the year 2000 to over 2 trillion in the year 2010. This increase has primarily been driven by growth in the government

budget from 208 billion to 1.3 trillion over the same period. Income from teaching and research, as well as tuition and fees charged, are an increasingly important portion of overall education funding. Some scholars even argue that China, along with the other newly industrialised economies of East Asia, 'have created a distinctive model of higher education more effective in some respects than systems in North America, the English-speaking world and Europe where the modern university was incubated' (Marginson 2011). As Chinese higher education to date is ranked behind the world's leading universities in Europe, the United States and Japan, it remains to be seen if higher education can develop to narrow the education and research gap. What is clear, however, is that the state and the Chinese household are increasing the resources these institutions have and Chinese institutions are steadily moving up the global rankings.

As China's economy has grown over the last few decades, the amount of resources dedicated to research and development has also increased. The shift from low-cost production to an economy that is driven by technological adoption and innovation is crucial for the promotion of a high-tech industry and for moving from middle-income to advanced economy. The *National Guidelines for Medium and Long-term Plans for Science and Technology Development*, released in 2006, set the goal of becoming one of the top three spenders on annual research and development by 2020 (along with Japan and the United States) accounting for 2.5 per cent of annual GDP. This guideline also anticipated China becoming the world's leading science power by 2050 (Xinhua 2006a). China has outlined for itself the major strategic task of building an 'innovation-oriented country' (Xinhua 2006b). This is arguably the central economic development policy of the Chinese government (Naughton 2007) and is an exceedingly difficult task that few countries outside of the Western world and East Asia have achieved. China is investing heavily in this goal.

Figure 18 shows the growth of research and development expenditure as a percentage of GDP. 'Expenditures for research and development are current and capital expenditures (both public and private) on creative work undertaken systematically to increase knowledge, including knowledge of humanity, culture, and society, and the use of knowledge for new applications. R&D covers basic research, applied research, and experimental development' (The World Bank 2013a). In 1996, research

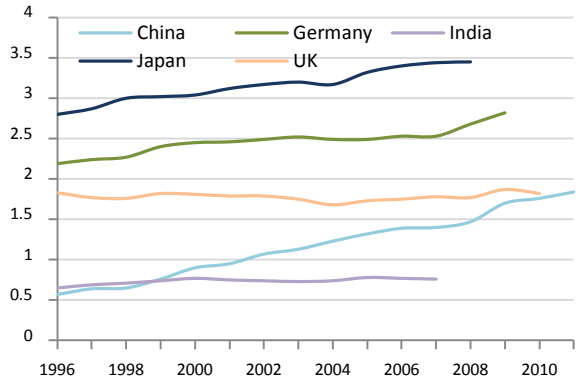

Figure 18 R&D Expenditure by Selected Countries (1996-2012)
Source: World Bank (2013a), NBS (2012: 2-41); Unit: % of GDP

and development accounted for 0.57 per cent of China's GDP. By 2011, China had significantly narrowed the gap with the world's most research-intensive countries, and R&D expenditure accounted for 1.84 per cent of GDP. China is well on the way to achieving the goal of R&D expenditure of 2.5 per cent of GDP by 2020 (Xinhua 2006a).

As China's economy has grown in absolute size, increases in R&D expenditure as a percentage of GDP mean absolute expenditure on R&D is growing rapidly. In a short five-year period, expenditure on R&D more than doubled from 371 Billion Yuan in 2007 to 869 billion in 2011. While a portion of this increase can be accounted for by the growth of government spending on R&D, the majority cannot as government funds as a percentage of R&D have actually decreased over this period. This does not negate the role of the state as an important driver of industrial and technical upgrading of the Chinese economy. It does, however, show that Chinese industrial upgrading is being driven by enterprises in the market supported by the role of the state. As the growth of exports and imports of high-tech products shows, this innovation is also supported by foreign enterprises and institutions. This bodes well for the future of Chinese industrial and technological upgrading and suggests innovation is increasingly an important driver of the Chinese economy.

Table 1 Research and Development, Science and Technology (2007-11)

	2007	2008	2009	2010	2011
Expenditure on R&D (billion Yuan)	371.0	461.6	580.2	706.3	868.7
Experimental Development (percentage of total R&D)	82%	83%	83%	83%	83%
Government Funds (percentage of total R&D)	25%	24%	23%	24%	22%
Number of Patent Applications Granted	351,782	411,982	581,992	814,825	960,513
Export of High-tech Products (billion USD)	347.8	415.6	376.9	492.4	548.8
Import of High-tech Products (billion USD)	287.0	341.8	309.9	412.7	463.2

Source: NBS (2012) 20-41

Table 1 shows the number of annual patent applications granted over the last five years has nearly tripled from 351,782 in 2007 to 960,513 successful patent applications in 2011. The increasing number of patents originating in China is evidence of the growth of innovation and enterprise upgrading. Chinese enterprises are no longer predominantly reliant on foreign technology. Instead, the interaction and in many cases the cooperation of foreign and domestic research institutions and enterprises is driving industrial upgrading and a technological revolution in Chinese enterprises. This is

evident in the fact that expenditure of industrial enterprises for technology acquisition and technology reconstruction has increased dramatically in recent years.

Expenditure for acquisition of foreign technology has increased from 39.7 billion (1,000 million) in 2004 to 44.9 billion in 2011. Over the same period, expenditure on assimilation of technology has increased from 6.1 billion to 20 billion and expenditure on purchase of domestic technology has increased from 8.2 billion to 22 billion. Expenditure on technical renovation has increased from 295 billion to 429 billion (NBS 2012:20-44). Expenditure on acquisition of foreign technology has remained relatively consistent as expenditure for the purchase of domestic technology has grown and the on-going technology costs have exploded. This shows the on-going role of foreign technology in China's economic upgrading and the expanding role of domestic research and technology and science and innovation.

Increased investment, however, does not automatically translate into increases in quality output. Global innovation rankings do not place China in the top ten most innovative countries in the world. For example, Bloomberg's Global Innovation Index, which measures seven factors to give an innovation score, ranked Hong Kong the 36th and China the 29th most innovative country in the world. China was ranked 25th on R&D intensity, 67th on productivity, 9th on high-tech intensity, 40th on researcher concentration, 6th on manufacturing capability, 66th on tertiary efficiency and 4th on patent activity (Bloomberg 2013). However, there has been steady improvement. In the 2008-09 Global Innovation Index China was ranked 37th and Hong Kong 12th (INSEAD 2009). By 2012, China ranked 34th and Hong Kong ranked 8th (INSEAD and WIPO 2012).

On the back of investment in education, research and technology, Chinese enterprises are becoming more globally competitive. The growth of China's high-tech industries has led to a major turnaround in the balance of imports and exports in the field of high-tech. In 1995, China exported 10 billion USD of high-tech manufactured goods but imported 22 billion creating a 12 billion dollar balance of trade deficit. This deficit increased to 15 billion in the year 2000 but remarkably turned to a 21 billion dollar balance of trade surplus in 2005 as exports of high-tech manufacturers surged from 37 billion to 218 billion while imports only grew to 197 billion. By 2011, this surplus had increased further to 85.6 billion as exports of high-tech manufactured goods grew to an annual 549 billion and imports grew to 463 billion. Over the period 1995 to 2011, the share of high-tech products as a percentage of the total value of exports has grown from 7 per cent to 29 per cent while the share of high-tech products as a percentage of the total value of imports has grown from 17% to 27% (NBS 2012:20-64). China's import-export industries are increasingly high-tech. As the next section shows, this growth is closely linked to global value chains and foreign direct investment flows.

e. Prospects of Chinese Economic Growth

In summary, on the back of three decades of more than 8% average annual growth the Chinese economy has significantly increased as a share of the world economy. This major economic expansion has been driven by domestic reforms that moved China from an autarkic centralised economy dominated by heavy industry to a dynamic market-oriented economy and, through opening China to the world economy, through trade, investment and people-to-people exchanges. China has experimented with a variety of transitional institutions and created an environment conducive to the transition from an agrarian-based economy to one in which the majority of employment is in the productive secondary and tertiary industries.

China's economic growth in the past 30 years has formed a unique structure of sources of growth and it has reached a point where the growth model is no longer suited to contemporary challenges. A high reliance on investment to fuel capital formation, and a high balance of trade surplus, has created imbalances in the Chinese economy. As China moves from a middle-income to an advanced economy, these imbalances need to be addressed. This will involve promoting domestic consumption, growing the share of the service industry in the economy, facilitating urbanisation and removing barriers to the realisation of economic efficiency. As evidenced by the massive investment in and upgrading of higher education, research and development and science and technology, this process is already well underway. China's investment in human capital, both through private and public funding, is a necessary prerequisite for this strategic shift.

Furthermore, the factors discussed above, from the general policy environment to programmes to promote research, innovation, science and technology, and education, from urbanisation and urban-rural integration to structural shifts and rationalisation to generate domestic demand and consumption based growth activities, and to income distribution system reform, are key forces that shape the direction and process of economic reform. This transformation is, and will likely continue to, effect structural rebalancing and growth model reorientation in the hope their can be more sustainable sources of growth and new or enhanced types of economic activities that can provide a sustainable basis for long-term, healthy economic growth.

As our analysis has shown, the current growth pattern and momentum can continue for some time. However, given that it is at the end of the catch-up, rapid growth phase, it would not be a surprise if growth slowed to an annual rate below 8%, occasionally, or even permanently. A recent working paper from The Treasury found similar findings arguing 'while there are cyclical risks to China's economic performance in the medium term, these risks are manageable; China's economic growth is likely to ease to a more stable and sustainable rate over the next decade compared to the

previous decade' (Bowman and Conway, 2013a). Moreover, given that the Chinese growth model has been heavily internationally dependent (investment, markets, global value chains), China's economic growth is significantly affected by the global economy. This is especially apparent in the 2008-9 financial crisis in the United States and the Eurozone. Long-term and fundamental confidence in the Chinese economy must therefore be found in the direction and extent of structural rebalancing and growth model reorientation currently underway.

Experiences of the middle income trap and the Asian economic model have shown that significant reform and upgrading are required for a catch-up economy to move on to become a mature or advanced economy with a balanced structure of sustainable growth contributions, thus, meeting the challenge of modern economic development. As our analysis has shown, there are significant tensions in these key areas of structural rebalancing and growth model reorientation, between different interest groups, between different aspects of reform and restructuring, between short-term growth performance and long-term structural adjustment. These tensions can translate into ambiguity and uncertainty amidst the bold declared moves toward reform and restructuring. This, in turn, can have profound effects on growth activities, shaping growth outcomes.

3. CHINA AND THE WORLD ECONOMY

The previous section showed how Chinese economic growth and development has not only increased economic output in the Middle Kingdom but has also reshaped the nature of that activity. China has moved from a closed command economy focussed on state building and consolidation of national borders to an open economy focussed on international markets, attracting foreign investment and developing international centres of science, research and technology excellence. For a developing economy, the level of integration with and dependency on the world economy is almost without precedence. It should come as no surprise then that this high level of integration with such a large country is reshaping the world economy.

Using GDP-based purchasing power parity (PPP) as a measure, this period of rapid growth has increased China's share of global economic activity from just over 2% in 1980 to over 14% in 2011 (IMF 2013). Even now as economic growth has slowed in the wake of the global financial crisis, and there is a new focus on a more sustainable growth model, it has not slowed to the levels of growth seen in the advanced economies and it remains well above the global average. As such, China continues to account for an increasingly large share of world economic activity.

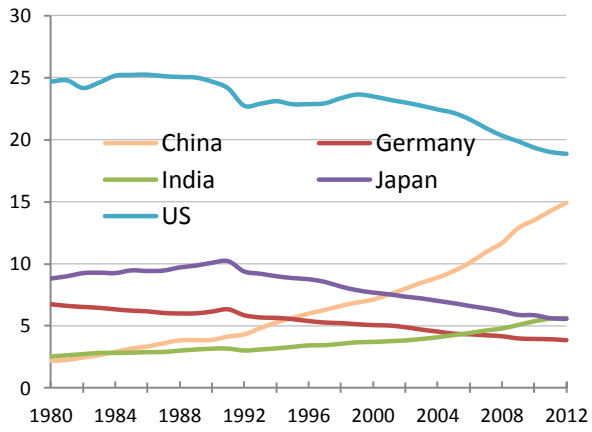

Figure 19 GDP Share of World Total (1980-2012)
Source: IMF (2013). Unit % PPP based

The economic rise of China is as much if not more a story of the world economy as it is a story of China. We seem used to seeing Chinese international economic activities more from the perspective of bilateral trade relations, than of China seeking greater presence in world economy. Our analysis below shows that Chinese international economic activities are more importantly part of the internationalisation of the Chinese economy. Whether this is strategically driven or it just happened that way, the sheer size of the Chinese economy, the international logic of its growth model and the way economic growth is organised and promoted in China has led to the international presence of the Chinese economy in a systemic and coherent way, with growing

activities in each sector covering markets, resources, capital, technology and production supplies on a global scale. Moreover, these activities are changing the structure of the global economy and international economic order and affecting the way economic activities are exchanged, managed and governed in the international system.

This section argues the internationalisation of the Chinese economy, whilst important for all national economies, needs to be conceptualised as a systemic shift in the structure of the world economy. Following the work of the WTO and IDE-JETRO (2011) the section avoids a national level analysis of Chinese economic activities and argues Chinese businesses and people are now an integral part of the world's most important international production networks, particularly those in Asia. Furthermore, the section shows how Chinese international activities, from trade in goods and services, investment and people flows, are interlinked with trade, investment and people flows all supporting the internationalisation of the Chinese economy.

The section proceeds in six parts. The first explores changes in the global trading order that show an increasingly China-dominant trade order. This is followed in the second part by an analysis of Chinese inward and outward investment flows and the activities of Chinese enterprises abroad. The third part explores people flows, including contract labour, migration, tourism and education. The fourth part looks at China in regional economic order. This is followed by an examination of China as a force of stability and movement in global macroeconomic factors, capital, money, currency, rates and credit, before a discussion of the significance of Chinese economic activities for the structural landscape of the world economy.

a. Trade in Goods and Services

China is a major trading nation. Its development has been driven by export-led growth, providing capital, technology and resources. Figure 3 of the first section showed how net exports of goods and services have made major contributions to Chinese GDP, particularly in the middle of the first decade of this century. The following gives a more detailed picture of the growth of China's share of world trade, China's main trade partners and the makeup of that trade. Imports have expanded as resource needs have increased with the rise of Chinese manufacturing. Partially completed products have been imported into China where they are finished and then re-exported. Whether exporting products fully made in China under a Chinese or foreign brand or exporting partially completed products in the region's global value chain, the growth of Chinese trade has been a central feature of China's growth model.

The growth of Chinese trade is realigning global trade patterns. This process began

more than six decades ago with the growth of Japanese trade, followed by the Asian tigers and dragons and the growth of Southeast Asian trade. With the increases in Chinese global and regional trade from the 1980s, Asian trade has risen in 2011 to the world's second largest trading region behind Europe and ahead of North America. While 71% of Europe's exports are intra-regional (destined for a European economy) only 53% of Asian trade is intra-regional with 16% and 17% destined for North America and Europe respectively (WTO 2012:23). Asia is therefore central to the global trading order.

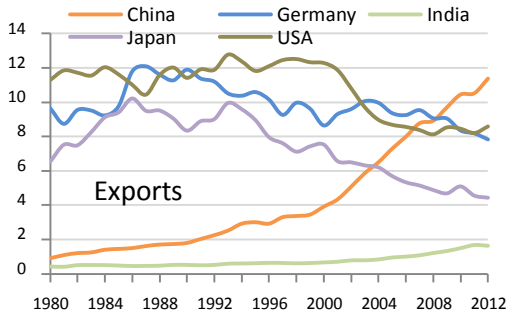

Figure 20 Share of Exports in World Total (1980-2012)
Source: IMF (2013), Unit: %

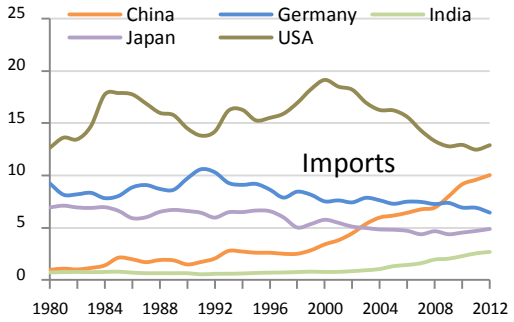

Figure 21 Share of Imports in World Total (1980-2012)
Source: IMF (2013), Unit: %

Figures 20-21 show the United States is one of the largest trading nations globally, easily the largest importer and the second or third largest exporter behind China and Germany. China is the largest exporter as of 2011 but only the second largest importer trailing the United States by a long way, but closing rapidly. The absolute growth of China's purchasing power will see China become the world's largest importer very soon, even as China's per capita income remains well below US levels. Putting the growth of Chinese trade in long historical perspective, it becomes clear that China's dominance of world trade is very recent and has occurred rapidly. Moreover, world trade in 2011 compared to 1953 has become far more multipolar. The growth of Chinese trade has occurred in tandem with the relative shift of trade activity away from the Atlantic to the Asia Pacific.

While China may be the largest exporter of merchandise trade, it remains only the fourth largest exporter and third largest importer of world trade in commercial services in 2011. China's 182 billion dollars of exports of commercial services in 2011 was well behind the United States at 581 billion, the United Kingdom at 274 billion and Germany at 253 billion. This is a reflection of the level of development of the Chinese economy that is better suited to manufacturing exports and has yet to fully develop a strong services sector. The 237 billion dollars of commercial services China imported in 2011 was not that far behind the United States at 395 billion and Germany at 289

billion showing the ongoing need for high-level services in China (WTO 2012:28). Unlike merchandise trade, China remains a net importer of commercial services.

The composition of China's commodity trade has also changed dramatically over the reform era. The value of primary goods exports has dropped from representing 50% of the value of all commodity trade in 1980 and 1985 to only 5% post-2006. The major drop occurred even though the value of primary goods exports continued to steadily increase because of the post-1985 growth in the value of manufactured exports. From 1985 to 1990, the value of manufactured goods increased from 50% of the total value of commodity exports to 75% and then steadily increased to 95% by 2011. Figure 22 shows the early importance of China's light textiles exports followed by the growth of exports of machinery and transport equipment.

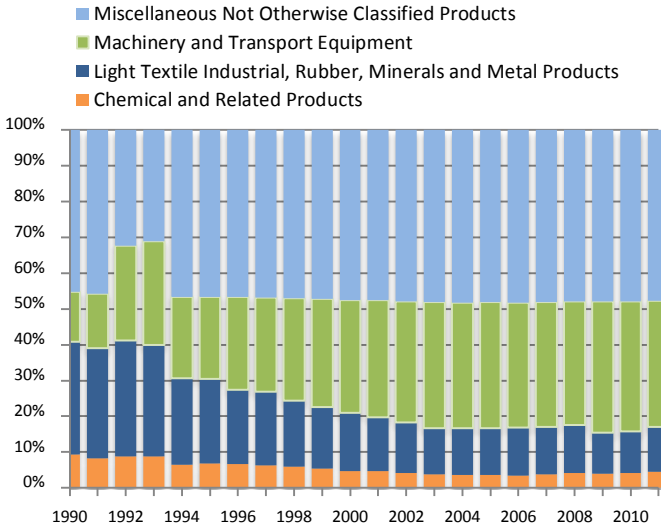

Figure 22 Share of Export Value by Category of Commodity (1990-2012)
Source: NBS (2012) Table 6-4

China's major trade partners are in Asia with Hong Kong, Japan and Korea featuring prominently. Figure 23 shows that 47% of Chinese exports were destined for Asia in 2011, well down from 60% in 1994. 58% of China's imports came from the region in 2011, roughly equivalent to the 60% share in 1994. Over the same period, Europe has increased its significance as an export destination for Chinese products from 16% to 22% of total Chinese exports and North America has maintained a roughly 18% share. Both Europe and North America have decreased as a share of total imports into China. Africa, Latin America and Oceanic and Pacific Islands are becoming more important to Chinese trade, but have started from a very low baseline.

Breaking these figures down for 2011, we get some perspective on the size of Oceanic and New Zealand trade with China. Of the 1,898 billion USD of total exports from China in 2011, Oceania and the Pacific accounted for a mere 2%. Australia, the primary destination for Chinese exports in this region, accounted for 1.79% of total Chinese exports. New Zealand accounted for only 0.2% and the Pacific 0.17% of total Chinese exports. Of the 1,743 billion USD of total imports into China, Oceania and the Pacific account for 5%. Again, Australia makes up the vast majority of this at 4.74%

of China's total imports, leaving New Zealand and the Pacific accounting for a mere 0.29% and 0.07% respectfully.

China's trade with its major trade partners differs by the composition of type of product traded. Table 2 shows that 93% of China's merchandise exports but only 59% of merchandise imports are manufactured products. China's balance of merchandise trade surplus comes from the strength of its manufactured exports. However, this trade surplus comes primarily from exports and limited imports to and from the EU (27), particularly the US and Hong Kong (Hong Kong also re-exports many products). However, the balance of manufacture trade with Japan, South Korea and Chinese Taipei is significantly in these countries favour. Clearly then, China's impressive trade surplus is firstly primarily made up of exports of manufactured products and secondly the trade relations that create this trade surplus are the EU (27) and the US. These two regions take 37% of Chinese exports, but create 53% of China's trade surplus in manufactured product. The surplus with these countries is well over twice the value of China's total merchandise trade surplus.

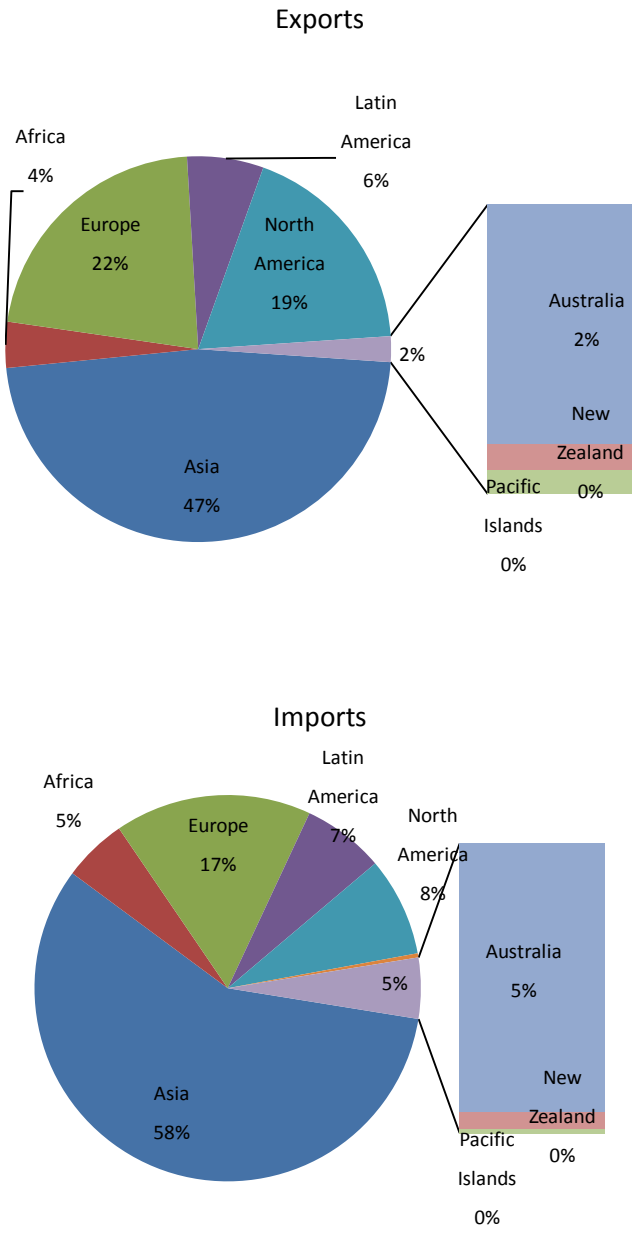

Figure 23 Share of Chinese Exports (left) and Imports (right) by Region (2011)
Source: **NBS (2012) Table 16-7**

Table 2 also shows that China has a significant balance of trade deficit with the world for trade in agricultural products and fuels and mining products. China is now a net importer of agricultural produce in a country where over half the population still

live in rural areas. Even with significant improvements in agricultural productivity, it is unlikely Chinese agriculture will be able to feed a billion urban consumers in the coming decades. It is highly likely China will remain a net importer of agricultural produce creating much opportunity for countries that export value-added agricultural product. The balance of merchandise trade deficit for fuels and mining products is where the majority of China's trade deficit lies. China is a net importer of these resources and this is the primary constraint on increases in China's balance of merchandise trade surplus.

Table 2 China's Merchandise Trade with Major Partners (2011)

	EU (27)		USA		Japan		HK		S Korea		Taiwan		World	
Product	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.	Exp.	Imp.
Agricultural Products	9	12	7	31	11	3	6	0.5	4	2	2	1	65	145
Fuels and Mining Products	6	17	3	11	6	11	10	3	5	17	1	4	60	516
Manufactures	341	183	314	77	130	180	252	7	73	142	32	120	1772	1033
Total	356	211	325	123	148	195	268	15	83	163	35	125	1898	1743

Source: WTO (2012:250 Table A22). Unit: 2011, Billion USD.

Understanding China's trade relations with its major trade partners also requires a closer look at Hong Kong, which still remains the access and exit point for a large amount of Chinese trade. Similar to the trade statistics for China, Hong Kong enjoys a merchandise trade surplus with the EU (27) and the US largely due to exports of manufactured products, but has a trade deficit with Asian economies, notably China, Japan, Singapore and Chinese Taipei. However, differing from China, Hong Kong has an overall trade deficit because it not only imports more agricultural products and fuels and mining products than it exports, but because it also imports more manufactured goods than it exports. In 2011, Hong Kong imported 432 billion of manufactured products, but only exported 408 billion. China was the origin of just under half of all Hong Kong imported manufactured goods but the destination of more than half of all Hong Kong's manufactured exports (WTO 2012:252 A23).

Moreover, the level of re-exports out of Hong Kong is astounding. Re-exports are 'products which have previously been imported into Hong Kong and which are re-exported without having undergone in Hong Kong a manufacturing process, which has changed permanently the shape, nature, form or utility of the product'. Domestic exports are defined as 'the natural produce of Hong Kong or the products of a manufacturing process in Hong Kong which has changed permanently the shape, nature, form or utility of the basic materials used in manufacture' (Census and Statistics Department 2013:I). These statistics exclude goods transiting Hong Kong on a bill of

lading. WTO statistics classify 96% of Hong Kong merchandise exports in 2011 as re-exports. Of the total 438 billion dollars of re-exports in 2011, 237 billion or 43% of Hong Kong's re-exports are bound for China (WTO 2012:254 A24).

Put another way, Hong Kong plays an important role mediating Chinese trade patterns with the world. Many imports to Hong Kong come from China and are re-exported back to China while some are re-exported onto other countries, including the EU (27) and the United States. The composition of Hong Kong exports has also changed over time. In 1988, re-exports only accounted for 56% of total exports. By 2000, this had risen to 88% and to 98% by 2012 (Census and Statistics Department 2013:1). In 2011, 54% of Hong Kong's re-exports were destined for China, 10% for the EU (27) and another 10% for the United States, as well as 4%, 2.4% and 1.6% to Japan, Chinese Taipei and Singapore respectively. This shows the on-going role of Hong Kong as an intermediary of Chinese trade with the world and adds weight to the argument that the Chinese economy is having a large impact on world trade patterns.

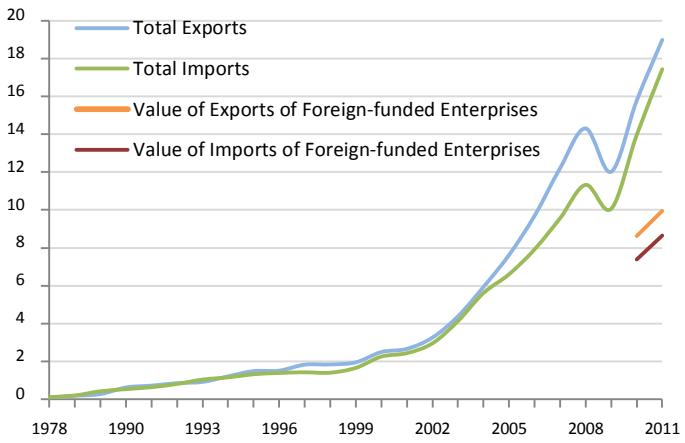

Figure 24 Total Value of Imports and Exports and Value of Imports and Exports of Foreign-Funded Enterprises (1978-2011)
Source: NBS (2012) Tables 6-3 and 6-12; Unit: USD $100 billion

China's balance of trade with the world, in particular trade in manufactured goods with the EU (27) and the United States is not sustainable. Figure 24 shows the rapid increase in exports and imports from around 2003 as well as a sharp drop during the height of the global financial crisis followed by a rapid recovery. From 2005 to 2008, the balance of trade surplus increased from 100 billion to nearly 300 billion USD. Since the global trading recovery in 2010, China's balance of trade surplus has continued to narrow to around 150 billion USD. This is still a significant amount, but it is less than half the previous surplus. Notably, the closing of this gap is driven by a rapid increase in imports suggesting China's shift to a more balanced growth model and domestic consumption is well under way.

Factoring in the rise of multinational companies and joint ownership models in China, a far more complicated picture of the place of the Chinese economy in the global trading order emerges. Around half of all 'China's trade' involves foreign-funded enterprises. In fact, from 2000 to 2005, the share of total exports from foreign-funded

enterprises increased from 48% to 55%. Over the same period the share of total imports from foreign-funded enterprises increased from 52% to 53% (NBS 2012 Table 6-12). In other words, a large part of the share of world trade with the Chinese economy involves non-Chinese capital and businesses, either through joint enterprises, contracting and subcontracting or directly owned foreign enterprises producing in China and exporting out of China. This is a large share and dispels any myth that China's growth strategy conforms to a mercantilist model of national economic development. In more recent years, this share has peaked and may be starting to decrease as China's domestic industries focus on building international markets and global value chains of their own, and as some multinational companies shift production of export industries to developing markets in Southeast Asia. By 2011, the share of exports and imports from foreign-funded enterprises in China's total exports and imports had dropped to 52% and 50% respectively.

Care is needed when analysing China's role in the global trading order. Clearly, China is the world's largest exporter and the world's second largest importer, but a large share of this trade is conducted by enterprises that are foreign-funded. In short, China is part of the global value chain and well integrated into the world trading order. As such, China's presence in global trade should not be thought of simply as an importer and exporter of product but rather as a site of production and assembly of many of the world's products by many of the world's companies.

Finally, another measure of China's role in the world trading system is the OECD's measure of 'exports of value-added'. This measure goes further than simply tracking trade between economies, instead focusing on a measure of export value both 'through direct final exports and via indirect exports of intermediates through other countries to foreign final consumers'. Domestic Value Added Embodied in Final Foreign Demand is the standard OECD measure of 'exports of value-added' and is designed to 'reflect how industries (upstream in a value-chain) are connected to consumers in other countries, even where no direct trade relationship exists' (OECD 2013).

Figure 25 shows industries based in China account for the second-largest economy of exports of value-added. China exported 1 trillion (1,000 million) USD 'exports of value-added' in 2008, a significant increase on the

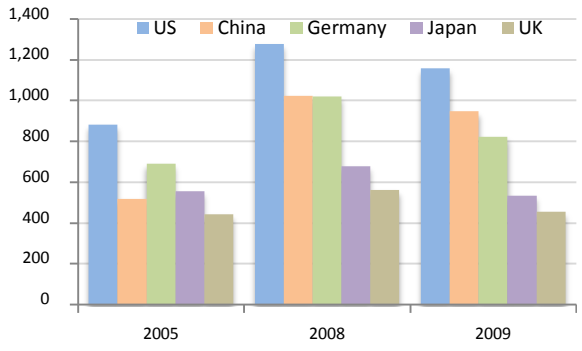

Figure 25 Domestic Value Added Embodied in Final Foreign Demand (2005, 2008, 2009)
Source: OECD (2013); Unit: USD Billion

516 billion USD in 2005 and slightly more than the 946 billion USD in 2009 during the height of the global financial crisis. Over this period China has closed the gap with the world's largest export economy of 'exports of value-added' from a shortfall of 363 billion USD to 210 billion USD, overtaking Germany and Japan in the process.

Figure 26 shows the share of China's value-added exports has changed significantly in a short four-year period. The United States, the EU (27) and Japan accounted for a massive 60% of Chinese value-added exports in 2005, but by 2009, this number had dropped to 47%. For the first time in our contemporary history, the economies outside of Europe, the United States and Japan account for the largest share of value-added exports. The US, the EU (27) and Japan as individual economies and single markets are still the most important final foreign demand for China, but this is slowly changing as developing economies and newly-industrialised nations increase their capacity to absorb Chinese exports both for final consumption and through their integration in global value chains that link China to the rest of the world economy.

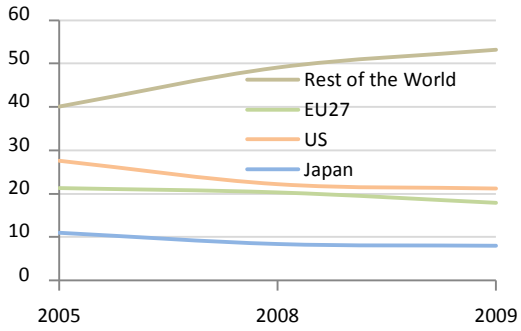

Figure 26 Share of Domestic Value Added Embodied in Final Foreign Demand (2005-2009)
Source: Source: OECD (2013); Unit: %,

Thirty years of rapid economic growth and expansion has established China as a major trading country and an economy driven significantly by exports. Beyond China's great share of the world total of exports and imports, the strength of China's exports and imports are in different industries and sectors. For example, China is strong in imports of agricultural products and raw materials and a major source of exports of manufacturing products. China's trade partners are largely in Asia where there is a lot of trade with other countries indirectly through Hong Kong. This structure matches well with the trade structure of countries such as New Zealand and Australia.

As part of the growth model, much of China's trade involves foreign funded enterprises. This provides a natural link for trade relations to move onto investment relations if it is not originally driven by investment in the first place. Moreover, at this stage of economic growth, China's manufacturing competitiveness is transforming as labour wages increase and increased technology is introduced. With industrial upgrading and campaigns to meet domestic demands for growth, the role of exports in Chinese economic growth will likely be less than in the previous decade. Investment and capital flows are also experiencing large and globally significant change and we can expect these flows to increase in the coming decades.

b. Investment Flows and Chinese Enterprises Abroad

The growth of the Chinese economy has been facilitated by a steady flow of international investment. This is a major and defining difference between the Japanese model of economic growth in the post-war years and the Chinese model since the 1980s. Even today, Japan's balance of inward FDI and outward FDI is well in surplus (see Figure 30). Inward FDI has not been and is still not a major driver of the Japanese domestic economy. China, on the other hand, opened to international flows of capital and worked hard to attract multinational companies to operate in China as part of its growth strategy. Now that Chinese enterprises are developing local brands and looking to secure access to resources and markets overseas, the Chinese economy is going global through a prolonged and steady flow of overseas foreign direct investment.

Inward FDI has been an important driver of China's development. From 1979 to the end of 2011, the total value of direct foreign investments was 1.16 trillion USD (NBS 2012: Table 6-13). Figure 27 shows the total amount of foreign investment actually utilised over the period 1985 to 2011. This shows clearly the importance of foreign loans in the early decades of China's development and opening to the world. However, from the early 1990s, FDI became the major form of foreign investment into China. Foreign loans ceased just after the turn of the century. The on-going growth in the amount of annual FDI utilised in China suggests foreign investors still have confidence in making a good return on their capital even as the state negotiates the complex and challenging shift from a middle-income to an advanced economy. The majority of respondents to the UNCTAD survey asking TNC's for the top prospective host economies for 2012-14 ranked China first in both 2011 and 2012 further suggesting China remains a top destination for transnational investment (UNCTAD 2012:22). China's share of global FDI flows is beginning to resemble the dominance of flows in and out the EU (27) and the US.

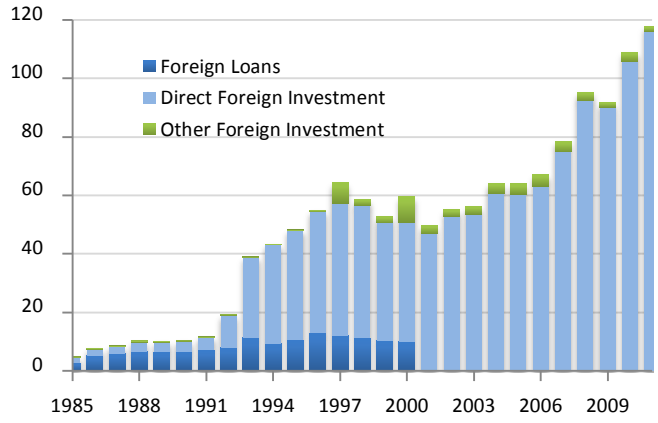

Figure 27 Total Amount of Foreign Investment Actually Utilised (1985-2011)
Source: NBS (2012: 6-13); Unit: USD Billion

The EU27, the United States and Japan have all maintained an important share of global FDI flows but their share is slowly decreasing. Over the 2006 to 2011 period, their respective shares of global FDI inflows fell from 44% to 28% in the EU27, from

16% to 15% in the US with considerable variation and remained negligible in Japan. The share of FDI outflows from the EU27 dropped from 56% to 38% over the same period but increased from 16% to 23% out of the US and increased from 3.6% to 6.7% out of Japan. These markets remain important destinations and sources of FDI. However, a major trend is the rise of the developing world as a destination for FDI and the beginnings of FDI outflows out of the developing world. In 2011, the developing world for the first time accounted for more FDI inflows than the combined developed world, increasing its share of FDI inward flows from 33% to 51% from 2006 to 2011. The developed world's share of outward FDI flows also dropped from over 80% to just over 70% (UNCTAD 2012), showing an ongoing dominance of OFDI by the advanced economies. These increases in the developing world's share of global FDI inflows and outflows, especially China's increasing share, are slowly leading to changes in the share of the stock of global investment.

Figure 28 shows the share of stock of world FDI by region. The main theme in this figure is the on-going dominance of the developed economies in global FDI stock but a slowly decreasing share as the developing world becomes more integrated into global capital markets. However, some qualifiers are necessary. The measurement for Europe, for example, is the total of investments going into all countries in Europe. This means investments into France from Germany are included in the investment total. The table does not illustrate the inward and outward stocks of investments going into and out of Europe per se. Likewise, for China, the relationship between investment stock in Hong Kong and the mainland is a complicated one, with similar dynamics to Europe. Asian trade and investment more generally is, as with Europe, predominantly intraregional. Notwithstanding this, the long-standing dominance of the advanced economies in investment is slowly changing global shares of stock of inward FDI.

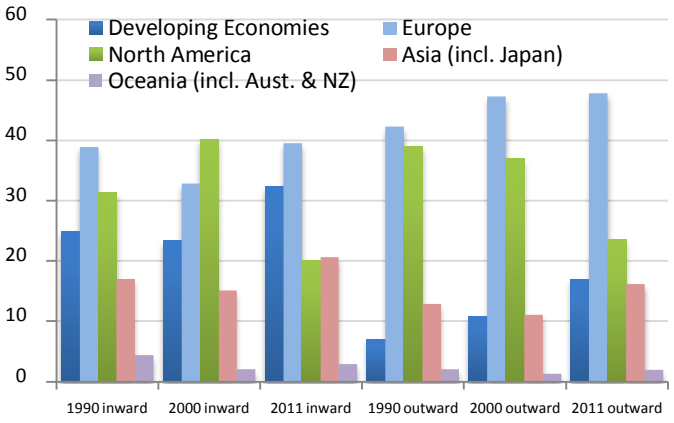

Figure 28 FDI Stock Share of World Total by Region and Level of Development, (1990-2011)
Source: UNTCAD (2012: 173-174) Annex table 1.2; Unit: %

In 1990, developed economies were host to 75% of global FDI stock, representing 1.56 trillion dollars of the 2.08 trillion dollar total. This has decreased significantly to 64% or 13 trillion of the total 20 trillion by 2011, largely due to a rapid decrease in the

share of FDI hosted in the United States. At the same time, the rise of developing economies as important FDI hosts has occurred. China (including, Hong Kong, Macau and Taiwan), the world's largest developing economy, has accounted for a large portion of this increase. In 1990, China hosted 11.2% of global FDI (235 billion) and in 2011, 9.4% (1.9 trillion). This decrease is accounted for by a decreasing share in Taiwan and Hong Kong and is offset by an increasing share of global FDI hosted on the mainland. This is still far behind the share of FDI hosted by developed economies, particularly the 35% hosted by the EU27, but it represents a significant global shift in FDI stock (UNCTAD 2012).

The share of FDI stock originating from developing economies is also increasing, but it has a long way to go before comparing to the stock of FDI originating in developed economies. In 1990, 93% of global FDI stock (1.9 trillion) originated in developed economies. This has decreased to a 78% share (17.1 trillion) in 2011. China has increased its share of outward FDI stock from 2.2% (46 billion) in 1990 to 7.4% (1.6 trillion) in 2011 largely due to increases in outward investment out of Hong Kong and steady increases out of the mainland (UNCTAD 2012). As the previous paragraphs showed, the share of outward FDI flows are still dominated by the developed world but China's shares are increasing rapidly resulting in slow changes in the presence of China as a source of global FDI.

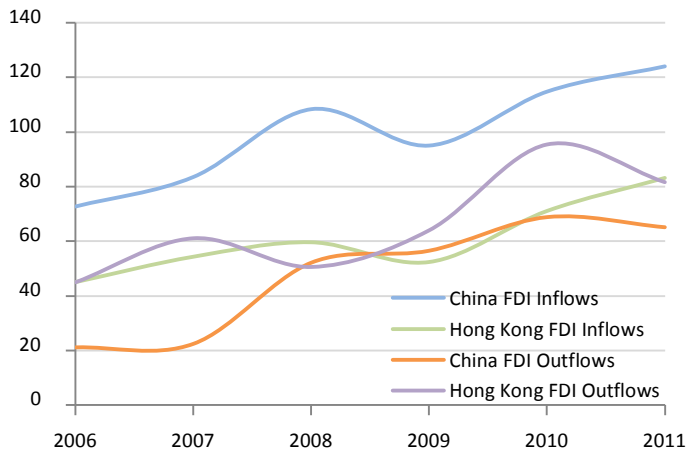

Figure 29 FDI Inflows and Outflows from China and Hong Kong (2006-2011)
Source: UNCTAD (2012: 169-170) Annex table 1.1; Unit: USD Billion,

Placing China's share of FDI inward and outward stock with comparable economies, we get some idea of the rapid increases in Chinese FDI over a short 21 year period. But we also note that China is still not a major player in investment as it is in levels of trade and GDP. Figure 30 omits data for the United States to preserve comparative perspective with other countries. In 1990, the US share of the world's inward FDI was an astounding 26% and its share of outward FDI was an even more staggering 34%. While absolute numbers have continued to increase, the US share of global inward and outward FDI has decreased to 17% and 21% respectively. China is nowhere near this level of dominance of FDI stock. In fact, Chinese FDI stock

remains well below the each of the US, France, Germany, the UK and Hong Kong economies. Japan's share of global outward FDI stock remains far higher than China's, but it is notable to see China's share of inward FDI stock has been consistently well above Japan's.

Figure 30 shows that Chinese FDI inflows and outflows have increased steadily since 2006. Annual Chinese FDI inflows have increased over the period 2006 to 2011 in China from 72.7 billion dollars (1,000 million) to 124 billion, in Hong Kong from 45 billion to 83.1 billion, in Macao from 1.6 billion to 4.4 billion, and dropped in Taiwan from 7.4 billion in 2006 to 2.5 billion in 2010 with 2011 showing a negative flow. Over the same period, Chinese FDI outflows have increased in China from 21.2 billion to 65.2 billion, in Hong Kong from 45 billion to 81.6 billion, and decreased in Macao from 636 million to 62 million and increased in Taiwan from 7.4 billion to 12.8 billion (UNCTAD 2012:170).

These statistics point to the slow changes in China's share of stock of global foreign direct investment. China has increased its share of FDI inflows from around 4% in 2006 and 2007 to around 8% in 2010 and 2011, and increased its share of FDI outflows from around 1% in 2006 and 2007 to around 4% in 2010 and 2011. Over the same period, Hong Kong has increased both its share of FDI inflows and outflows from 3 to 5%. If this trend continues, China will, over time, increase its share of global FDI stock. As with the global shift occurring over the last few decades that has seen the developing world become, for the first time in history, the largest recipient of flows of global FDI, increases in flows of FDI in and out of China will slowly change the dominance of the advanced economies in global capital flows. This has important implications for how the world economy will function, the directions of trade and the nature of economic activity.

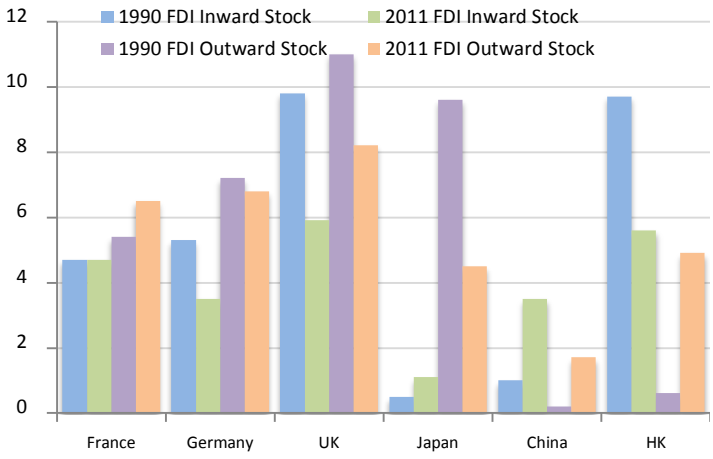

Figure 30 Global Share of FDI Inward and Outward Stock by Select Economies (1990 and 2011)
Source: Calculated from UNTCAD (2012: 173-174); Unit: per cent of total

The stock of FDI in China is dominated by Asian economies. By 2011, Asia accounted for 77% of the stock of FDI in China. The remainder came from Latin

America (10.8%), Europe (5%), North America (3.1%), Oceanic and Pacific Islands (2.3%), Africa (1.4%) and other (0.2%). The major economies investing in China in Asia include Hong Kong with a 61% share of total FDI actually utilised in China, as well as Japan (5.5%), Singapore (5.3%), South Korea (2.2%) and Taiwan (1.9%). In Europe only Germany invested close to 1% of the total share of FDI actually utilised in China and the remaining 4% European share was spread across a wide range of European economies. For Latin America, the Virgin Islands and Cayman Islands made up the bulk of Latin American investment in China on 8.4% and 1.9% of the world total. In North America, the United States represented 2% of all investment in China. In Oceania and the Pacific Islands, Samoa represented 1.8% of global investment in China in 2011. These statistics show a large amount of investment is channelled through Hong Kong and intermediary investment areas such as the Virgin Islands, Cayman Islands and 2% of FDI in China enters through Samoa.

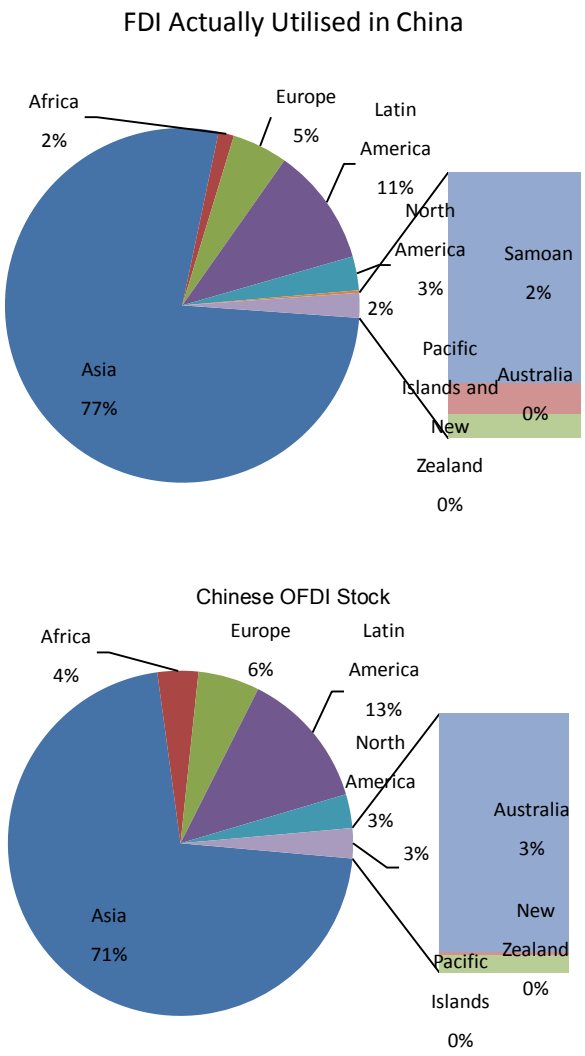

Figure 31 Source of FDI Actually Utilised in China and Chinese OFDI Stock by Region (2011)
Source: NBS (2012) Tables 6-14 and 6-19

The 'foreign direct investment actually utilised' in 1995 already reflected the dominance of Asian economies investing in China. The big investors in the mid-1990s included Hong Kong (53% of the total), Japan (8.5%), Taiwan (8.4%), United States (8.2%), Singapore (4.9%), South Korea (2.8%), United Kingdom (2.4%), Germany (1%) and France and Italy (each less than 1%). In Oceania, Australia accounted for 0.6% of 'foreign direct investment actually utilised' in China in 1995 and New Zealand 0.05% (NBS 1996: Table 16-15). Comparing these shares to shares in 2011, we can see that Asian economies, particularly Hong Kong, have increased their dominance of investment in Asia even as Japan and Taiwan's shares have decreased. Moreover, the United States and Europe have dropped their share. However, the growth of

intermediary regions suggests that much of this investment may now be channelled through the Virgin Islands, Cayman Islands or Samoa (NBS 2012: Table 6-14).

To date, the majority of Chinese OFDI has been destined for Asia. Using data from the NBS (2012), which omits Hong Kong, Macao and Taiwan, of the total stock of recorded Chinese OFDI at the end of 2011 (424.8 billion), 303.4 billion (71%) is stocked in Asia, including 261.5 billion in Hong Kong and 10 billion in Singapore. The nature of the Hong Kong and Singapore economies suggests much of this investment then moves to other parts of the world. The remaining 120 billion of China's OFDI stock is spread over the globe, with 55 billion (13%) in Latin America (though 50 billion of that is 'in' the Cayman Islands and Virgin Islands), 24.5 billion (5.8%) in Europe (less than 1% of total OFDI stock is held in the UK, Germany, France or Russia respectively), 16.2 billion (3.8%) in Africa, 13.5 billion (3.2%) in North America and 12 billion (2.8%) in Oceania. Australia alone is host to 11 billion of the 12 billion Chinese OFDI stock in Oceania, a figure larger than the 8.9 billion OFDI stock in the US and far larger than the 185 million in New Zealand (NBS 2012).

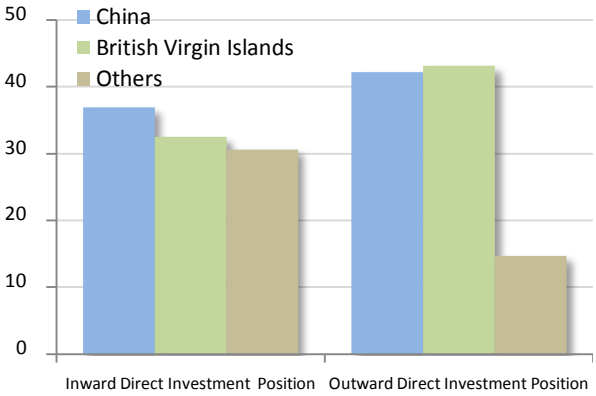

Figure 32 Hong Kong Inward and Outward Foreign Direct Investment Position (2012)
Source: NBS 2012: Tables 24-33 and 24-34; Unit: %,

Looking at OFDI from Hong Kong, the British Virgin Islands holds 43% of the 'position at end of year' of 'outward direct investment' in 2010, some 3.2 billion Hong Kong dollars. Mainland China also accounts for 42% showing a strong two-way investment relationship between Hong Kong and the mainland. These two aside, the remaining countries make up small portions of Hong Kong's stock of outward direct investment, and include Bermuda, United Kingdom, Luxembourg, Cayman Islands, Singapore, Thailand, Liberia and Malaysia (NBS 2012: Table 24-34).

Furthermore, 37% of the 'position at end of year' of 'inward direct investment' in 2010 to Hong Kong was from Mainland China. Coming a close second, on 32%, is the British Virgin Islands, followed by the Netherlands (7.1%), Bermuda (6.5%), United States (3.6%), Japan (2.2%) and the United Kingdom, Singapore and Cayman Islands at more than 1.5%. Interestingly, the Cook Islands have 67.3 billion Hong Kong Dollars of investment in Hong Kong (0.8% of the total) (NBS 2012: Table 24-33). FDI flows and stocks in Hong Kong remain dominated by the Mainland and by

companies hoping to enter China through the financial and economic hub and to do business in Hong Kong where regulatory practices are more familiar and well enforced.

The growth of trade and investment relations and the strength of the Chinese economy have created opportunities for Chinese enterprises to go abroad, perhaps the most visible presence of Chinese global economic activity. The stated government objective since the new century began has been to encourage Chinese enterprises to invest overseas and to increase their presence in foreign markets, including through the promotion of domestic Chinese brands. Since 2005, this policy has begun to bear some fruit. The rationale behind China's "go abroad" strategy is to expand the presence of China's enterprises into consumer markets over the world and to acquire overseas enterprises to facilitate that expansion and secure resource trade. The state continues to facilitate this process and actively promote investment through policies such as the *National Development and Reform Commission's Catalogue for the Guidance of Foreign Investment Industries* (2011). These policies also continue to encourage and prohibit investment flows in and out of China. The recent US-China Strategic and Economic Dialogue in July 2013 started negotiation of a new investement agreement between the two countries to use pre-establishment national treatment with a negative list to futher promote and facilite investment.

For New Zealand this strategy will impact our economic relations with China. For example, China has an increasingly challenging strategic goal of ensuring food security for a large urbanising population. Chapter 4 of the *Medium Term Plan for National Food Security* (2008-2020), *Important Tasks for Ensuring Food Security, devotes a section to Strengthening International Food Cooperation* that directs companies to "Strengthen intergovernmental cooperation and establish long-term and stable agricultural industry (food) cooperation relationships with some important agriculture producing nations. Bring into effect the agricultural 'go abroad' strategy, encourage domestic enterprises to 'go abroad', establish a stable and reliable system of sourcing food imports, [and] increase the ability to safeguard domestic food security" (CCCPC and SC 2008). Chinese firms are keen to acquire both technology and knowhow involved in New Zealand's dairy sector and to own farmland and processing facilities that currently export to China.

But we should also remember that New Zealand has a relatively tiny trade and investment relationship with China and Chinese investors are not exclusively interested in food security. Table 3 shows Chinese overseas direct investment (ODI) stock at the end of 2011 by sector. Over 142 billion USD is invested in the 'leasing and business services' sector, 33.5% of total ODI stock. This is followed by 67.4 billion USD invested in 'financial intermediation' (15.9%) and 67.0 billion USD invested in 'mining' (15.8%). 27.0 billion USD is invested in 'manufacturing' (6.4%) and 25.3 billion USD is invested in 'transport, storage and post' (6.0%). The stock of Chinese overseas direct

investment at the end of 2011 in 'agriculture, forestry, animal husbandry and fishery' was 3.4 billion USD or 0.8% of the total.

Table 3 Chinese Overseas Direct Investment Stock by Sector (2011)

Sector	Overseas Direct Investment (ODI) Stock at End of 2011 (million USD)	Share of Total ODI Stock at End of 2011 (%)
Agriculture, Forestry, Animal Husbandry and Fishery	3,416.64	0.80
Mining	66,995.37	15.77
Manufacturing	26,964.43	6.35
Production and Supply of Electricity, Gas and Water	7,140.56	1.68
Construction	8,051.1	1.90
Transport, Storage and Post	25,261.31	5.95
Information Transmission, Computer Services and Software	9,553.24	2.25
Wholesale and Retail Trades	49,093.63	11.56
Hotels and Catering Services	603.86	0.14
Financial Intermediation	67,393.29	15.87
Real Estate	8,986.16	2.12
Leasing and Business Services	142,290.02	33.50
Scientific Research, Technical Service and Geologic Prospecting	4,388.38	1.03
Management of Water Conservancy, Environment & Public Facilities	2,401.96	0.57
Services to Households and Other Services	1,615.58	0.38
Education	66.57	0.02
Health, Social Security and Social Welfare	17.15	0.004
Culture, Sports & Entertainment Public Management & Social Organizations	541.42	0.13
Total	424,780.67	100.00

Source: NBS (2012) Table 6-20. Unit: millions of USD, %.

Another approach to measuring Chinese economic activities abroad is to look at Chinese statistics on 'economic cooperation with foreign countries or regions' (NBS 2012: table 6-21). These statistics show that the number of contracted projects with foreign countries or regions has increased from 138 in 1980 to 920 in 1990 to 2,597 in 2000 to 9,544 in 2010. The value of turnover fulfilled in these contracted projects has grown from 123 million USD in 1980 to 8.4 billion USD in 2000. In 2011 the value of turnover fulfilled in these contracted projects hit an all-time high of 103.4 billion USD even though the number of contracted projects fell to 6,381.

Overseas investment from China will likely increase in the coming decades due to the growing perception in Beijing that Chinese companies need to secure resources, market share and access to skills and technology and due to the strength of the Chinese economy and Chinese enterprises. This strategy is hardly unique to China, but some have argued the nature of Chinese business practices is creating new dimensions to the global business environment and that it brings businesses in advanced economies into contact with Chinese business practices unfamiliar to them. As with Japan's expansion of FDI in the 1980s, the growth of mergers and acquisitions of Chinese enterprises overseas has created some backlash, particularly in advanced economies where strategic and mercantilist views have led to indirect forms of protectionism. Already however, names such as Sinopec, China National Petroleum Corp, Chery, Huawei or China Investment Corporation (CIC) are becoming well known in developed and emerging markets. Others, such as Non-Ferrous China Africa

(NFCA) or Investor Group, will likely become better known as their investments deepen.

In summary, capital flows and investment into and out of China show different patterns to China's trade flows. Capital inflow as investment in China has been a key enabling factor in Chinese economic growth and has been traditionally higher than capital outflow. FDI has become the dominant form of foreign investment over foreign loans which were crucial in the early years of the reform period. Capital outflow and Chinese overseas investment has also been increasing in recent years but as a share of overall global investment, Chinese overseas investment is still small. Of this small but rapidly growing Chinese overseas investment, an even smaller amount goes to Oceania, where Australia takes the lion's share.

c. People Flows

Since the early European incursions into China in the 19th Century, China has fluctuated between an internationalist and an isolated outlook. The forced opening post-1840 Opium War created unprecedented internationalist areas in China. Shanghai, perhaps the most vivid example of China's partial integration in the international community in the 19th Century, was a potent mix of foreign commerce, education and ideas with some of the best, brightest and most industrious and entrepreneurial Chinese of the era. It was also a city of decadence that bore the worst of industrial excess for some at the bottom of society and the Paris of the East for a select few. After the establishment of the PRC, China once again became isolated from the majority of the world, in particular the established markets in Europe and America, where the most advanced industrial, educational, science and institutional knowledge was rapidly expanding. China was also severed from its relations with many of its Asian neighbours. The post-1978 Dengist reforms once again began to open China to the world, encourage the flow of information into China and to promote collaboration and cooperation through international business, government relations and people-to-people exchanges.

Just as many scholars of Meiji Japan point to the importance of sustained and proactive absorption of global technology, philosophy, science, technology and institutions for Japanese development, the economic development of contemporary China rests heavily on the absorption of foreign information and the integration of China into the global flow of people and knowledge. Even though we live in the information age where people-to-people exchanges through travel are no longer necessary to exchange information, these face-to-face exchanges still play an important role bringing people into contact with each other, for building relationships and trust and for opening people to new information. China has spent three decades absorbing

information and participating in global epistemic communities.

The first area of note when looking at people flows is Chinese labour abroad. The number of people classified as abroad at end of year for labour services and contracted projects has grown considerably over the last few decades. Figure 33 shows large growth from the early 1990s particularly for labour services. Since 1992 the number of Chinese personnel abroad for labour and contracted projects has increased from 130,000 to 800,000. This is a considerable international presence that is closely linked to the domestic Chinese economy and Chinese enterprises going global either through aid work or contracted work tied to government loans from China.

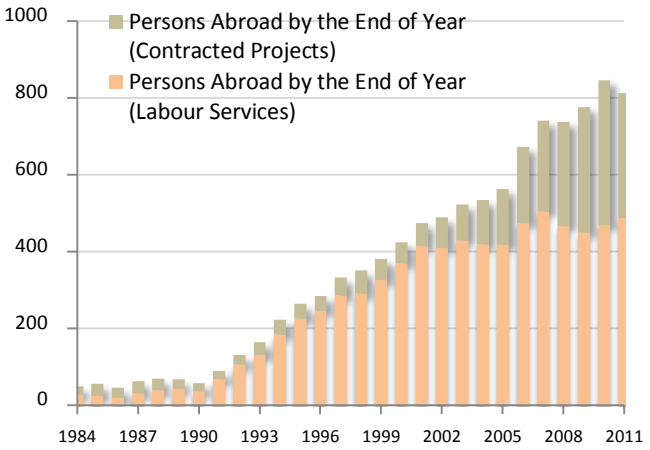

Figure 33 Persons Abroad for Labour Projects and Contract Services (1984-2011)
Source: NBS (2012) Table 6-21; Unit: thousands

Chinese migration is also on the rise. United Nations Population Department statistics on international migrant stock show large increases in the number of people migrating to China and very large numbers of Chinese migrating abroad. In 1990, 376,000 migrants resided in China. By 2010, this number had nearly doubled to 686,000, a faster increase than the increase in the total number of migrant stock in the world from 155 million to 214 million over the same period. In 1990 China was the destination for only 0.24% of the world's migrant stock. This share had increased only marginally to 0.32% in 2010. Excluding Hong Kong and Macao, the major origin countries and regions for migration to China include South Korea, the Philippines, Brazil, Indonesia, the United States and Viet Nam.

The size of the migrant stock in China remains only 8% the size of Chinese migrant stock overseas which has increased from 4.3 million in 1990 to 8.4 million in 2010. The major destination for Chinese migrants is East Asia. In 2010, Hong Kong accounted for 2.2 million Chinese migrants, Japan 585,000 and South Korea 296,000. The stock of Chinese migrants in Japan has more than tripled from 150,000 in 1990. The United States and Europe have also experienced major increases from 610,000 to 2 million and from 234,000 to 887,000 respectively. South-Eastern Asia has increased its share of Chinese migrant stock from 553,000 to 846,000. The size of the Chinese migrant stock in Australia and New Zealand has also increased rapidly, though to a far

smaller size than in the above regions.

Table 4 Chinese Migrant Stock by Destination and Origin (1990 and 2010)

Migrant Stock at Mid-Year in China			Chinese Migrants at Mid-Year		
Country of Origin	1990 (%)	2010 (%)	Region of Destination	1990 (%)	2010 (%)
Australia	2,417 (1)	6,758 (1)	**Africa**	17,319 (0)	54,568 (1)
Brazil	12,090 (3)	93,225 (14)	**Central Asia**	4,687 (0)	7,291 (0)
Canada	3,756 (1)	11,137 (2)	**Eastern Asia**	2,335,783 (55)	3,381,327 (40)
India	4,496 (1)	12,152 (2)	**Southeast Asia**	552,780 (13)	846,311 (10)
Indonesia	21,305 (6)	47,392 (7)	**South Asia**	166,354 (4)	185,888 (2)
Japan	4,547 (1)	7,058 (1)	**Western Asia**	2,511 (0)	15,919 (0)
Philippines	28,155 (7)	98,052 (14)	**Europe**	234,739 (6)	886,882 (11)
South Korea	148,141 (39)	179,646 (26)	**Latin America**	49,102 (1)	85,421 (1)
Thailand	5,839 (2)	18,877 (3)	**North America**	785,099 (18)	2,594,324 (31)
UK	4,737 (1)	10,202 (1)	**Oceania**	104,015 (2)	374,496 (4)
US	16,962 (5)	34,474 (5)	**- Australia**	87,633 (2)	244,867 (3)
Viet Nam	18,063 (5)	25,179 (4)	**- New Zealand**	9,188 (0.2)	118,591 (1.4)
World	376,361	685,775	**World**	4,252,389	8,432,427

Source: UNDP (2012) Tables 1 and 7

Tourism is an increasingly important driver of China's global integration. In 2012, China was the 4th largest destination for international tourists as measured by international tourism receipts. Hong Kong was the 10th largest earner of international tourism receipts and enjoyed a 10% increase in 2012. The volume of international trips by Chinese travellers has grown from 10 million in the year 2000 to 83 million in 2012. This has corresponded with rapid growth in Chinese expenditure abroad as the Chinese currency appreciates, Chinese citizens have more disposable income and the state relaxes restrictions on foreign travel.

An eight-fold increase in expenditure from the year 2000, including a massive 40% increase in 2011, has seen China rise to become the number one tourism source market with an annual expenditure of 102 billion USD on international tourism in the year 2012. In 2005 China was only the 5th largest spender on international tourism but by 2012 it had surpassed expenditure from Italy, Japan, France, the United Kingdom and the second largest spender on tourism, the United States (83 billion USD in 2012). China is leading the increasing importance of emerging markets in the international tourist market (UNWTO April 2013). A recent State Council document, *Outline for National Tourism and Leisure (2013-2020)*, strengthens efforts to ensure employees take annual leave and strongly supports outbound tourism further suggesting the number of international Chinese tourists is likely to increase (UNWTO March 2013).

Chinese international tourists are predominantly Asia-focussed. The only non-Asian economies ranking in the top ten destinations for Chinese international tourists are the United States (#5) and Russia (#10). Rome is the only non-Asian city in the top ten most popular city destinations ranking tenth. This trend has increased over the last decade. From 2000 to 2010, Asia and the Pacific increased the share of Chinese

international tourists from 62% to 67% while Europe decreased its share from 25% to 24%, the Americas dropped from 10% to 8% and Africa dropped from 3% to 1% (Frederik 2012). Annual expenditure by Chinese tourists is now over 100 million. This is perhaps the most vivid example of an important emerging Chinese international economic activity that is 'Asian-centred'.

In recent years, more people are also visiting China, though far below the number of Chinese going abroad. Annual United States arrivals in China have increased by half a million in the short period from 2005 to 2012, growing from 1.6 million to 2.1 million. Over the same period, annual New Zealand arrivals have increased from 78,365 to 128,300 and annual German arrivals have increased from 454,859 to 659,600. Asia continues to dominate arrivals accounting for just over 60% of all arrivals in 2005 and 2012 (China National Tourism Administration 2006 and 2012). Figure 34 shows the on-going dominance of Asian visitor arrivals to China. Korea alone accounted for 15% of all annual arrivals to China in 2012, followed by Japan (13%), Malaysia (5%) and Mongolia (1%) and Singapore (1%). The only non-Asian countries of equivalent arrival shares in 2012 were Russia's 2.4 million arrivals (8.9%) and the 2.1 million arrivals from the United States (7.8%). Annual New Zealand arrivals in 2012 accounted for 0.5% of the total, slightly above the 0.39% of total arrivals in 2005.

Figure 34 Foreign Entrants to China by Nationality (2012)
Source: China National Tourism Administration (2012); Unit: Million

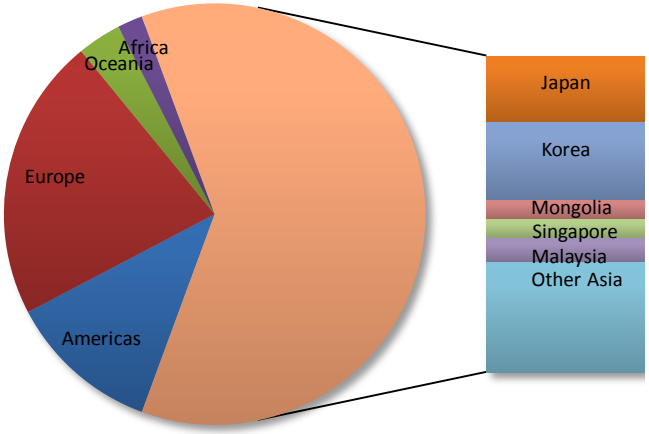

Figure 16 in section one of this paper showed that the number of Chinese students studying abroad has increased significantly over the first decade of the new century from 97,756 in 2000 to 769,894 in 2011. Over half of these students are postgraduate students. The number of returning students each year has also increased significantly from 9,121 in 2000 to 186,200 in 2011. This is significantly increasing China's ability to converge on international best practices in a range of academic fields and has exposed many of China's current and future leaders to life, culture and systems of government and economy in other parts of the world. This is greatly facilitating China's foreign relations, international trade and their ability to expand their domestic companies into foreign markets. Sadly, this approach is only beginning to pick up in the advanced economies where students are more likely to study in other advanced economies than

to experience life in emerging markets such as China. By most accounts, it is these markets that will become the largest economies on the globe and new centres of excellence in a variety of fields. A lack of attention to China will severely hamper the ability of the advanced economies to engage and to partake in emerging global value chains or markets centred on Chinese economic activity, such as the Chinese international tourist market, in the coming decades.

d. China in Regional Economic Integration and Cooperation

The increasing presence of Chinese enterprises in foreign markets, the growing strength of Chinese brands and the domination of Chinese manufacturing are perhaps only the early manifestation of China's global economic presence. We should expect far more in the coming decades from a country with good fiscal and economic policy, a country that values education and technological innovation and a country that contains $1/5^{th}$ of all humanity. As China's economic expansion has progressed, it has become increasingly interdependent on the world and particularly the regional economy. It should come as no surprise that the Chinese Government has in recent years put a concerted effort into developing bilateral, plurilateral and multilateral agreements on trade, investment and cooperation as well as becoming an active participant in regional forums on security and environmental issues.

As Table 5 shows, since the turn of the century China has been proactive in seeking out partners to sign economic cooperation agreements with. This has led to the signing of seven bilateral FTAs, one plurilateral FTA with ASEAN, a series of economic partnership and cooperation agreements between the Mainland and Hong Kong, Macau and Taiwan, and efforts to update the Bangkok Agreement. China is currently negotiating seven FTAs, one of which could be the most important plurilateral economic agreement for Northeast Asia, the China-Japan-Korea or CJK FTA. China and India are also discussing the possibility of an FTA. On top of this is a lot of activity in ASEAN to push forward a Regional Cooperation Framework Agreement (RCEP) involving the ten ASEAN countries and China, Japan, Korea, India, Australia and New Zealand. At the same time, the Trans-Pacific Partnership is negotiating expansion from the original four members, including New Zealand, which could in time also include the Chinese economy.

This flurry of bilateral and regional activity is a response to both China's increasing stake in global and regional trade and investment, as well as the complexity of doing business across borders when standards and institutions differ, and to the stalling of multilateral agreement in the Doha Round of World Trade Organisation negotiations. Similarly, the goal of an Asia-Pacific Economic Cooperation (APEC) FTA has also been postponed in recent years. Since China joined the WTO in 2001, it has learnt a

great deal about international trade negotiation and the potential harm of being isolated from any emerging trade or regulatory/standards bloc. We can expect China to continue to be an active joiner and more of a shaper of these types of bilateral and plurilateral agreements in the near future.

China is also playing a stronger role in the International Monetary Fund, the World Trade Organization, the United Nations and at the regional level is very active in APEC and a whole range of ASEAN-organised regional forum, including ASEAN+3, the East Asian Summit, the ASEAN Regional Forum and the ASEAN Defence Ministers Meeting. These forums are driven by the 'ASEAN way' of cooperative security, open regionalism, soft regionalism and flexible consensus (Acharya 1997). China also joined with Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan to create the Eurasian security organization the Shanghai Cooperation Organization in 2001.

Table 5 China's FTAs, Economic Cooperation Agreements and Negotiations (as of 2013)

Bilateral Free Trade Agreements	
2006	China-Chile FTA
2007	China-Pakistan FTA
2008	China-New Zealand FTA
2008	China-Singapore FTA
2009	China-Peru FTA
2011	China-Costa Rica FTA
2013	China-Iceland FTA
2013	China-Switzerland FTA
Multilateral Agreements	
2002-2009	China-ASEAN FTA (framework agreement; trade in goods; trade in services; investment)
Chinese Economic Cooperation and Partnership Agreements	
2003 to 2009	Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) + supplement agreements
2003 to 2009	Mainland and Macau Closer Economic Partnership Arrangement (CEPA) + supplement agreements
2010	(Cross-Strait) Economic Cooperation Framework Agreement (ECFA)
Preferential Trade Agreement	
1975, 2006	Asia-Pacific Trade Agreement, formerly the Bangkok Agreement (Bangladesh, China, India, Lao, Korea & Sri Lanka)
Under Negotiation (since)	
2004	China-Gulf Cooperation Council (GCC) FTA Negotiations
2004	China-South Africa Customs Union FTA Negotiations
2005	China-Australia FTA Negotiations
2007	China-Norway FTA Negotiations
2011	China-Switzerland FTA Negotiation
2013	China-Korea FTA Negotiations
2013	China-Japan-ROK FTA Negotiations
Under Consideration (since)	
2003	China-India Regional Trade Arrangement Joint Feasibility Study
Source: MOFCOM (2013a, 2013b)	

e. Global Economic Governance and Management

Much has been said about China's increased influence in global economic governance. Indeed, along with 30 years of rapid economic growth, expansion and

internationalisation, China has acquired great influence in international financial organisations and arrangements. While many developing countries are more actively and effectively participating in the working of international financial organisations China has gone one step further to gain a decisive role in these organisations that regulate and govern international economic activities. For example, China's voting rights in both the World Bank and IMF have substantially increased. China's voting share in the IMF has increased from 2.93% in 2006 to 6.1% in 2012. China has significantly increased its influence in global economic governance.

Beyond the greater role and influence in international financial institutions, China has become an important force shaping the global conditions for macroeconomic management. China's influence in this regard was first shown in its role and handling of the Asian financial crisis in 1997-98 when it chose not to devaluate its currency as a counter-measure against the competing devaluations in response to the collapse of currency exchange regime of many countries in the region. China's unique role can also be seen, but in a slightly different way, in the recent credit and financial crisis in the United States and debt and budget crisis in the Eurozone. China's stimulus package and surge in imports helped stabilise global trade and finance at a critical time for the world economy. Global markets and investors react to how China responds to macroeconomic situations, which gives China great power to influence the movement of markets.

A healthy balance of trade combined with large flows of FDI into China has created large current account surpluses and the accumulation of foreign exchange reserves. In 2007, the current account surplus reached 10% of GDP but fell sharply to 3% in recent years (OECD 2013). These two factors have driven major growth in China's foreign exchange reserves since the turn of the century. In 2000, foreign exchange reserves were less than 200 billion dollars. By 2006, they had accumulated to one trillion dollars, reached two trillion by 2009, and 3 trillion by 2011. Growth then slowed in the 2011 and 2012 years but in the first quarter of 2013 increased again to 3.44 trillion dollars. China has also become the largest single holder of U.S. government debt.

China has developed a great number of sets of bilateral and multilateral arrangements for currency clearance and use of RMB for transactions. Even though China's currency is not formally convertible on the existing international currency exchange regime, many countries have chosen to make their currency directly convertible with RMB, taking advantage of the stronger RMB and the benefit of a broader basis for currency stability and predictability. Australia is one of the latest examples and New Zealand is following this trend in its own negotiations.

An important element in the accumulation of foreign currency reserves has been

the low value of the RMB. The basic argument in the policy of maintaining an undervalued currency is that like Germany, Japan, South Korea and Taiwan previously, pursuing an export-led strategy with an undervalued currency provides a short-term competitive advantage to promote rapid economic development. This policy appears to be successful in these economies just as the model of 'import substitution industrialisation' that involved an overvalued currency and mechanisms to block imports from advanced economies resulted in low growth and poor economic development. However, while this has proven to be an effective catch-up strategy, the experience of other countries becoming middle-income economies suggests it is unsustainable in the medium and long-term due to domestic and international economic imbalances.

The world's largest foreign exchange reserve has led some analysts to argue China is running the risk of too much liquidity in the domestic market that could or is creating poor investments and leaving local government in particular with large amounts of bad debt on their books. At the international level many argue China's current account surplus is the primary driver of advanced economies' current account deficits and that this global imbalance is unsustainable in the medium term. Moreover, some analysts argue that currency manipulation in the PRC needs to stop in an effort to enforce some kind of Plaza Accord-like agreement to force faster appreciation of the value of the RMB.

Moreover, internationalisation of China's currency is steadily taking place. In recent years, more economies are setting up currency swaps with Beijing. This year, France, Brazil and Australia added currency swap agreements and on-going negotiations with the Bank of England in the UK suggest advanced economies are now vying to be leading cities for international trade in RMB. These efforts, however, remain well behind Singapore and Hong Kong, which operate as offshore Yuan centres. China already has currency swap agreements with over twenty countries including South Korea and Malaysia. Singapore achieved a currency swap as early as 2010 and recently agreed to double the amount of RMB held. New Zealand set up a currency swap in 2011 (New Zealand Herald 2011) and Australia recently reached a similar currency swap agreement in March 2013 followed by clearance for Australian banks to engage in direct currency trading in April 2013. Japan and the US also enjoy direct currency trading but only Japan also has a currency swap agreement since late 2012.

However, internationalisation of the RMB is only in the early stages and the USD still remains the global reserve currency. The value of the RMB remains pegged to a bundle of currencies, the most important of which is the United States Dollar (USD). Trade and investment in China is still dominated by use of the USD. Only 10% of trade between China and France, for example, is finalised in RMB. It will take decades for the RMB to be internationalised and it is hard to predict if it could ever become a

reserve currency. Notably, even as Japan's economy grew to become the world's second largest economy, the Yen never became a global reserve currency. China, with its on-going challenges in domestic economic reform, the on-going intervention in exchange rates and the challenges of developing offshore Yuan centres means that it will be some time before we can ascertain if the RMB will become an international reserve currency. Perhaps it is more likely that in the coming decades, a bundle of currencies including the USD, the Euro, the Yen and the Yuan, will act as a type of reserve currency.

China's huge capacity and the new international mechanisms it has developed to manage international finance, currency, credit as well as trade and investment gives it great ability to influence global markets, capital movement, currency arrangements and product flows. We are likely to see this influence increase in two ways as the Chinese economy matures. First, when China's economy is strong, Chinese economic actors and the state that represents their interests can have direct influence on global economic outcomes. This can act as a stabilising force in the global economy, due to a healthy diversification of sources of capital, credit and production that minimises others exposure to risk. Second, China's role in supporting, enforcing and developing global and regional governance of the world economy is likely to increase in the coming decades to match its share of and its interests in world economic activities.

f. China, in and of the World Economy

The analysis above has shown that after 30 years of rapid economic growth and expansion, the Chinese economy is an integral part of the world economy. Chinese international economic activities have become a predominant dimension of the global economy in trade, investment, people flows, regional integration, global economic governance and management. More importantly, Chinese international economic activities are a wide ranging, comprehensive, coherent extension of the Chinese economy. The internationalisation of the Chinese economy brings new factors of production to the global economy, affects the structure and dynamics of the world economic system and how economic activities and relations are managed or governed, and provides structural challenges and opportunities.

This emergence remains contingent on the maintenance of a benign international environment. As such, the maintenance of positive relations with the United States and Europe as well as with surounding Asian countries is an important dimension to the internationalisation of the Chinese economy. At present, the long-term trends are positive, but in the short-term there is likely to be some tension requiring deft diplomacy in China and abroad if disruption to international production networks and supply chains are to be avoided. The last few decades suggest China and the existing

economic powers have managed any tensions and the new transition in a manner that has created an environment for these networks to flourish and for the Chinese economy to grow.

China's economic rise should, therefore, be viewed as bringing in a major structural shift in the global economy. Such a shift reflects, first, the fact that China has become a global centre of manufacturing. This has evolved as envisaged under the neo-liberal theory of the 1980s and 1990s that deployment of factors of production is best determined and driven by market allocation for maximum global efficiency. This is where multinational corporations can deploy parts of their production process in optimal locations and outsource their business and operations globally. Global manufacturing concentration in China creates a significant challenge for the global economy where the political economy of economic growth and development is still organized at the national level.

Manufacturing means employment and income for societies organised at the national level. This is a critical challenge, particularly for advanced economies which have increasingly been losing manufacturing competitiveness to China. Manufacturing concentration in China can therefore be seen to be contributing to the "imbalances" in the global economy and significant economic, social and political problems in advanced economies that will require new policies and a more developed global division of labour to be remedied. Recently we see some "rebalancing" of the global economy as US companies move parts of their supply chains closer to their consumer markets in the west through a process of near-shoring. However, as consumption levels continue to grow in Asia, this trend is unlikely to lead to the removal of Asia from the supply chains of the world's largest producers. In fact, manufacturers will be looking to be close to consumer markets in Asia.

Global manufacturing concentration also requires global access to markets, resources, capital and supply chains. While this furthers China's integration into the world economy, it also leads to inevitable tensions between China and other countries over market access, business competitiveness, resource control and respective positions in value and supply chains. This structural shift reflects the presence of Chinese international economic activities and the institutions, mechanisms and arrangements through which they affect the global economy, brings new substance to the world economic system, broadens opportunities and incentives as well as risks and uncertainties to the existing international economic order, and provides a more pluralist and dynamic institutional environment for the global economy.

This structural shift finally reflects the fact that a great part of the global economy is affected or driven by China and indeed related to the internal development of the Chinese economy and the structure and dynamics of Chinese economic growth. The

Chinese economic growth model clearly has had a shaping effect on the structure and direction of international activities in the past, with capital investment into China and manufacturing exports out of China. The emergent new direction and structure of economic growth, particularly under the grand programme of structural rebalancing and growth model reorientation, will bring new dynamics and purposes to international activities. Whether we will see more overseas investment and less export growth from China, more enterprise, business and people from China or less of this are issues clearly affected by which direction internal reform and restructuring go in the years to come and how other actors in the world economy respond to China's changing role.

4. CHINA, THE WORLD ECONOMY AND NEW ZEALAND

China has become an important site of economic activity and a driver of world economic growth with far reaching implications for New Zealand. The world economy of the 20th Century has been shaped by a transformative US-Euro economic system that is likely to continue to sustain its impact. The 21st Century, however, is already one where other economies of significance are matching this impact. The Chinese economy in particular will likely continue to increase its global presence. The rise and structural transformation of the world's most populated economy will have far reaching impacts on the existing system of political economy, many of which will be hard to predict. This presents New Zealand with a dynamic and structurally evolving international environment and the opportunity to consider what that means for New Zealand. How New Zealand fits into this changing, dynamic global economy, and how it should strategically position itself to best serve New Zealand interests in the long-term, remains highly debated. Such discussions will involve important choices in economic and development policy and new modes of international economic strategy.

The first two sections of this paper focussed on two aspects of Chinese economic activity. The first section looked at the drivers of China's re-emergence as a national economy of global significance and the major challenges of development ongoing in China. The second section showed how such a large economy and one so integrated into the world economy has already had a transformative impact on the structure of the world economy, but that China's global impact has a further way to run. This final section asks what all this means for New Zealand economy and society. New Zealand is an internationalist but small economy that is highly dependent on the world economy. As a small economy, the state must live with changes in the world economy by adapting to them, preferably in a proactive manner and with good strategic vision. The growth of the Chinese economy has the potential to be the most significant change in the world economy since the formation of the modern New Zealand state. The economic rise of China is therefore a significant turning point in New Zealand's relationship with the world economy that presents a range of new challenges and opportunities.

The New Zealand economy has of course faced major changes in its relations with the world prior to the recent growth of China. The first such strategic shift came as Britain no longer represented as lucrative an export market and then negotiated to join the European Community in the 1970s. New Zealand lost some preferential trade relations that had grown out of British colonialism and the close links that were maintained with Britain after the adoption of the Statue of Westminster in the post-

war years. This relationship provided New Zealand exporters with a stable and prosperous market, comfortably sending roughly 80% of New Zealand exports to the United Kingdom. The New Zealand economy was born of dependence on the United Kingdom for integration into the international flow of trade, services, finance and knowledge. Loosing this preferential relationship forced New Zealand to seek new trade and investment partners and to take a more internationalist approach to finding New Zealand's place in the world.

What emerged was a strategy to diversify and enter markets in Europe, Australia and the Americas and to develop strong economic relations with the emerging markets in Asia. Today, Australia, Europe and the Americas remain important economic partners for New Zealand. The economic rise of Asia, however, has provided the greatest new opportunity for developing new markets for New Zealand products, and is an important new source of capital, imports and increasingly skilled labour and businesses. Relations with Asian economies require negotiating transactions with non-Anglo-Saxon societies involving much learning on the part of New Zealand businesses and government. At the same time, New Zealand's domestic economy has slowly adapted to a changed ethnic makeup, the dominance of Asian imports and the presence of Asian businesses.

Ultimately, the challenge created by slowing traditional markets, such as the United Kingdom, was the shock needed for New Zealand policymakers and businesses to diversify their focus on the world economy and to actively seek out new economic partners. In retrospect, this had a positive impact on government by forcing it onto the front foot at a time when the emerging markets of East Asia presented the most opportunity for expanding exports and purchasing more efficiently produced goods for the New Zealand market. Through this process, New Zealand trade negotiators have successfully developed a strategy for promoting New Zealand exports by seeking out trade and investment partners in the region, and aggressively negotiating preferential trade agreements at the bilateral and plurilateral level to provide most favoured nation status to New Zealand exporters and to link New Zealand businesses to the dynamism of the newly emerging Asian economies. Three decades of domestic structural reform in New Zealand have created a more open, internationalist and competitive business environment that has made New Zealand an attractive economic partner for many economies in Asia.

The second major strategic shift for New Zealand came as the rise of Japan signalled the end of singular Euro-American dominance of the global trading order. Growing economic dependence on Japan as a market for New Zealand products, the growth in Japanese investment in New Zealand, and the increasing prevalence of Japanese tourists, students and migrants, created New Zealand's first taste of significant economic relations with non-European/North American partners. Many

predicted Japan would soon surpass the United States as the world's largest and most important industrial economy in the 1980s. Fear of Japanese economic expansion and concern at Asian business practices were common. However, during the early 1990s, the Japanese economy experienced major financial crisis on the back of the oil shocks in the 1970s, the Plaza Accord in the 1980s and the hangover from decades of industrial policy and inappropriate investment. A severe banking crisis was averted only by the state taking on large debt obligations. Today, Japan remains the world's third largest economy and one of New Zealand's top 5 trade partners, but Japanese growth has slowed considerably curtailing the rapid growth in New Zealand opportunities in the Japanese market.

Some commentators take the view that the impact of the growth of the Chinese economy on New Zealand's economic policy and business relations will somehow follow what occurred with Japan. As the argument runs, "hysteria" over the Japanese economy, such as calls for learning Japanese language and active promotion of exploration of the Japanese market, subsided with the slowdown and collapse of Japanese growth. Surely then the economic rise of China will follow a similar pattern? This view is however mistaken for two important reasons.

Firstly, Japan's economy in the early 1990s was at a very different stage of development than the China of today. By the time Japanese growth slowed, it had completed an amazing economic transformation from a devastated economy in the post-war years, where over half the population remained rural, to a dynamic and highly advanced urban economy with leading technology, research and innovation and impressive export market saturation all over the globe. Japanese growth slowed in response to a maturing of the economy, the culmination of decades of development and the saturation of the domestic market. Just like the other advanced economies in Europe and North America, we should not expect a mature economy to present rapidly growing markets. Instead, we should expect these markets to remain significant and stable destinations for New Zealand products and sources of imports, capital, skilled labour and technological innovation. China, on the other hand, is still developing and the drivers of economic growth, just as in Japan in the second half of the 20th century, and in Europe and North America even earlier, are still running their course. This suggests China will continue to expand its economic presence for much a longer period.

Secondly, size matters. Japan is home to some 127 million people or 1.8% of humanity gathered on a series of large islands that are not naturally abundant in resources. The level of development Japan has achieved is a remarkable feat and testimony to the good management, diligence and high level of human capital in Japan. However, as the large development gaps in technological, scientific and organisational fields between advanced economies and the developing world are reduced, economic

fundamentals like population size once again become significant. In 2010, the Chinese economy surpassed the size of the Japanese economy with a population more than ten times the size of Japan's, a significant feat at the national level but less significant on the level of individual productivity. Similarly, as China's economy approaches the size of the United States economy, the average productivity of Chinese workers needs to only reach just under a fifth of the average United States' worker for China to be more productive at the national level than the United States. China, the world's most populous nation, therefore, has more potential to impact the world economy than the development of Japan and even the prior development of the United States.

China's economic resurgence presents New Zealand with a series of unknowns that must be grappled with and planned for. The New Zealand economy has never traded in a world where China, India, or more broadly Asia, has been the major region of economic activity even though 'New Zealand and Australia are geographically really an extension of Asia into the southern seas – Australasia' (Alley 1986). Prior to the industrial revolution, however, China and India dominated world economic output. New Zealand only became integrated into the global trading order after European industrialisation, commercial trade and political and military power supplanted this dominance. New Zealand began to trade in the British Empire and was linked to China through the Euro-American treaty port system and New South Wales in the 19th Century at the apex of Chinese economic decline. In the very early years, China and Australia dominated New Zealand trade.

After a century and a half, we have returned to this pattern of trade relations but the overarching British order has been replaced, first by a bipolar cold war order in the post-war years and then by the period of US unipolarity. Most scholars expect China's growing and deepening economic relations with New Zealand, and its impact on global affairs, to increase along with its economic rise, and suggest this presents some challenges for New Zealand (see Elder and Ayson, 2012). The structural change in the international economic system also gives New Zealand the opportunity to strategically think about how to position itself in the world economy, how to manage our economic relations with China and how to develop a broader set of relations with countries in the region. The imperatives of the dynamic and evolving international economic system also means our China focused strategic adjustment in our economic and development policy and in our international economic activities and relations could lead to an over-dependency on China and the Chinese economy. This could spell risk if China does not continually grow and the world economic system is not transformed further toward a China dominant if not China centric economic order. This is a situation for New Zealand with little historical precedence but one nevertheless that is before us.

a. The Growth of China in the New Zealand Economy

Like most countries around the world, the growth of New Zealand's economic relations with Asia has been rapid. In 1990, only 24% of merchandise imports to New Zealand came from Asia, but by 2010, this had grown to 43%. By 2010, Asia was easily the largest origin of New Zealand imports, well ahead of Europe (16.5%) North and Central America (12.3%) and Oceania (18%, including Australia). Similarly, but not as pronounced, Asia is now the destination for the largest regional share of New Zealand exports. In 1990, 30% of New Zealand merchandise exports went to Asia. This had grown to 38% by 2010, well ahead of Europe (11.8%), North and Central America (11.3%) and Oceania (25%) (ADB, 2011). Asia has become a major focus for New Zealand's trade relations on the back of decades of economic growth and development. China is increasingly the major focus of that broader Asian relationship.

New Zealand-China relations have developed steadily since diplomatic ties were established in 1972, but not until the turn of the century has the economic relationship really flourished. This relationship is, as with other economies, primarily driven by the rapid growth in the Chinese economy. New Zealand has put a great deal of effort into nurturing the political relationship to facilitate trade and economic cooperation. Both sides refer to the "four firsts" as the cornerstone of the contemporary economic relationship: New Zealand was the first country to agree bilaterally to China becoming a member of the World Trade Organisation (WTO); New Zealand was the first country to recognise that China had established a market economy system; New Zealand was the first OECD country to begin negotiating a Free Trade Agreement (FTA) with China in November 2004; New Zealand was the first OECD country to sign a FTA with China in April 2008.

Table 6 Goals of the New Zealand China Strategy
Retain and build a strong and resilient political relationship with China;
Double two-way goods trade with China to $20 billion by 2015;
Grow services trade with China (education by 20%, tourism by at least 60%, and other services trade) by 2015;
Increase bilateral investment to levels that reflect the growing commercial relationship with China;
Grow high quality science and technology collaborations with China to generate commercial opportunities.
Source: NZTE and MFAT (2012)

The New Zealand-China FTA (Government of New Zealand and China 2008) in particular represents an important acknowledgement by the New Zealand Government that the Chinese economy will have significant implications for New Zealand's economic prosperity. More importantly, it is a proactive step designed to facilitate economic relations between the two economies and to provide the best opportunities available for New Zealand businesses dealing with Chinese partners. By 2016, all trade from China to New Zealand will be duty-free. By 2019, over 96% of trade from New

Zealand to China will be duty free. Chapters on investment, education, science and technology, and regulatory cooperation ensure the FTA will continue to impact the New Zealand-China economic relationship in the coming years (MFAT 2010).

In February 2012 the New Zealand Government released its 'China Strategy' (NZTE and MFAT 2012) to coordinate government direction and promote strategic economic engagement with China. Table 6 lists the five goals contained in the short strategic document. This is the beginning of a comprehensive China strategy. This report argues the bilateral goals within the existing strategy can be complemented by recognition of the significance of the growth of the Chinese economy in the world economy and acknowledgement of how this is shaping New Zealand's economic place in the world. A more comprehensive strategy would not only proactively position New Zealand to make the most from the growth in Chinese domestic consumption, but also look to position New Zealand well in this systemic shift in the global economy. As the following segments show, these objectives are not mutually exclusive. A China strategy should grapple with systemic changes in the world economy at the same time as continuing to pay attention to the bilateral relationship that has expanded dramatically in recent years.

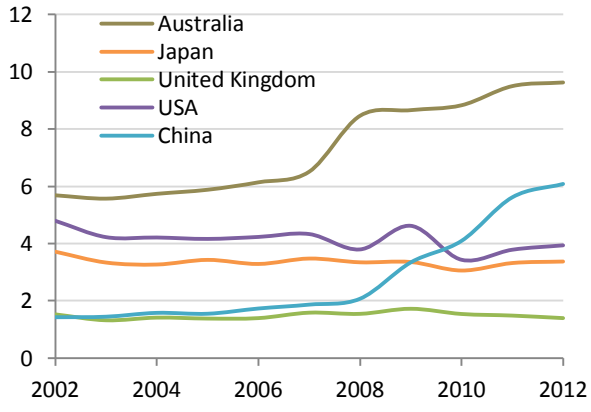

Figure 35: Value of New Zealand Exports to Top 5 Trade Partners (2002-2012)
Source: Statistics New Zealand (2012); Unit: Billion, NZD

New Zealand's economic relations with China have increased significantly since the turn of the century, primarily in the area of increased trade, but other areas are beginning to pick up. Over a ten-year period from 2002 to 2012, annual exports to China to the year to June have more than quadrupled from 1.4 billion New Zealand dollars (NZD) to 6 billion NZD. Annual exports to China have grown by 4.6 billion NZD, with 4 billion NZD of that growth occurring in years following the FTA coming into force. Exports to Australia have grown by 3.9 billion NZD over the same period. Annual exports to Australia remain New Zealand's largest export market by more than 3.5 billion NZD. The remaining three of New Zealand's top 5 trade partners have decreased their contribution to New Zealand export earnings. Merchandise exports to China have grown from the equivalent of 0.8% of New Zealand's nominal GDP in 2000 to 3.3% in 2012, driven primarily by growth in dairy and forestry production exports (Bowman and Conway, 2013).

However, the composition of exports to China lacks diversity and thus increased risks. Over 90% of New Zealand exports to China are primary products, led by dairy and timber, as well as meat, wool and seafood (Goff 2013). The opportunity to strengthen our trade with China by exporting more value-added products and by inserting our businesses in the international production networts located in Asia, and thus diversifying our risks, remains an important challenge for New Zealand businesses. More exports of processed agricultural products can provide further opportunity for growth in New Zealand exports to China. For example, both Fonterra and Synlait are supplementing the sale of milk solids to China with sales of New Zealand produced milk powder products. Fonterra has a major share of the market for cheese in restaurants in China and anyone who has stayed at a hotel in China will be familiar with the dominance of Anchor butter. Knowledge of the Chinese consumer's tastes wants and needs, as well as their buying preferences, their perception of 'Brand New Zealand' and their preference for how products should be presented, can facilitate greater sales of value-added New Zealand products.

New Zealand businesses should also seek opportunity to participate in Asia's international production networks. Rakon is a good example here. Rakon makes crystal oscillators used in smart phones. They partner with a Zhejiang company and create a product that is a major component in the rapidly expanding smartphone market. As most smartphones are produced in international production networks with manufacturing centred in China, Rakon have moved their production to China to facilitate integration into these production networks. Whether through joint ventures and partnerships with Chinese companies or going it alone, New Zealand businesses can create high value products from New Zealand commodities, either in New Zealand or China, that appeal to the Chinese consumer. Moreover, New Zealand companies can find a role in Asia's production networks if they understand how these networks function and are up to date with what opportunities exist.

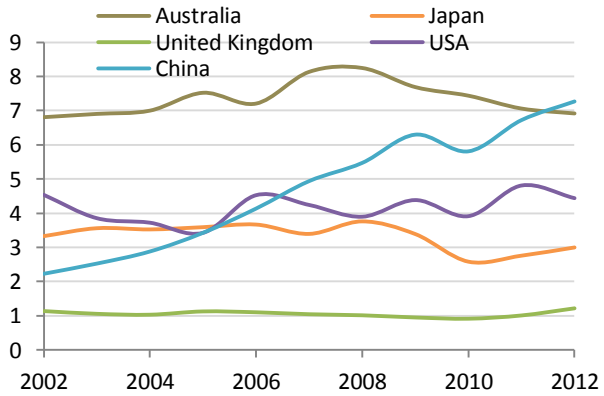

Figure 36: Value of New Zealand Imports by Top 5 Trade Partners (2002-2012)
Source: Source: Statistics New Zealand (2012); Unit: Billion, NZD

The growth of China as a source of imports has been even more rapid. The value of imports from Australia, Japan, the United Kingdom and the United States have remained stable over the last decade with only Australia and the United Kingdom

recording slight increases. Australia has remained a significant source of New Zealand imports with an annual value of 7 billion NZD. Annual Chinese imports have grown by 5 billion NZD from 2.2 billion NZD in 2002 to 7.3 billion NZD in 2012. Chinese imports are now the largest single source of imports into New Zealand overtaking Australia in the 2012-year to June.

New Zealand's economic relations with China are in many ways similar to most of the developed world. Chinese trade with our other major trade partners has grown just as rapidly as it has with New Zealand. China is Australia's largest trade partner. Exports to China have grown from $8.8 billion in 2001 to $77.1 billion in 2011, an annual growth of over 25%. Australia's exports to China in 2011 were dominated by resource and energy commodity exports (80.9%). China is Australia's largest individual two-way goods and services trading partner. In the 2011-12 year, China accounted for 20.4% ($127.8 billion) of total Australian trade. Japan accounted for 12.1% ($75.7 billion) and the United States 9.0% ($56.7 billion). In the same year China accounted for 26.1% ($82.5 billion) of Australian goods and services exports and 14.6% ($45.3 billion) of Australia's goods and services imports (Australian Government 2012).

China is the United States' third largest trade in goods partner. In 2012, China's share of total US imports in goods reached 19% or 426 billion USD of the 1.275 trillion USD total. China's share of US exports in the same year reached only 7% or 111 billion of the 1.547 trillion USD total (United States Census Bureau 2013). China is the US' largest source of imports and the third largest export destination. As with the rest of the globe, China has a large balance of goods trade surplus with the United States, over 295 billion USD in 2012. Japan's largest trade partner is China. China overtook the United States as Japan's largest export market in 2009 on the back of real declines in exports to the US and steady growth in exports to China. The Chinese market purchased 20% of all Japanese exports in 2011. China is also the second largest source of Japanese imports, ahead of the Middle East, accounting for 21% of total imports in Japan in 2011 (Statistics Bureau of Japan 2012). The United Kingdom, once New Zealand's largest trade partner and origin of models of social, economic and political organisation, is now only New Zealand's fifth largest trading partner with exports and imports each remaining below 2 billion NZD over the last decade. China was the 9th largest export market for the United Kingdom in 2011, growing by 21% from the previous year, and the 3rd largest source of imports, growing by 7.1% from the previous year.

We can see that the growth of the Chinese economy has impacted all of our major trade partners significantly. This has important implications for New Zealand. First, China's economic rise is creating systemic change in the world economy not just changes in New Zealand's patterns of trade. In real numbers, the significance of New Zealand's increased trade with China pales in comparison to the growth of US,

Japanese and even Australian trade with China. Second, the level of economic interdependence New Zealand has with China cannot be measured in our bilateral relations alone. Any change in China's economic presence globally will not only have a direct impact on New Zealand through our strong trade relations, but also an indirect impact through our other major trade partners who are also heavily interdependent with the Chinese economy.

Furthermore, New Zealand is a very small economy but the Chinese economy is large. This creates an asymmetrical economic relationship with a series of important considerations for New Zealand policymakers. China may be New Zealand's largest source of imports and second largest export market, but New Zealand's economic significance for the Chinese economy is in no way comparable. New Zealand trade accounts for only 0.2857% of total Chinese imports and 0.1968% of total Chinese exports. New Zealand's share of Chinese overseas foreign direct investment (OFDI) in 2011 was a mere 0.004% excluding any investment through Hong Kong or the Virgin Islands. As a comparison, Australia holds a 4.74% share of Chinese imports and a 1.79% share of Chinese exports and is host to 2.6% of Chinese OFDI.

This asymmetry is partially obscured by the level of development in each country. The stereotypical developed-developing economy relationship is turned on its head in the New Zealand-China case because New Zealand is far more dependent on Chinese trade than China is on New Zealand trade. In this sense, New Zealand businesses must work hard to maintain a presence in China and to brand New Zealand products in a way that is attractive to Chinese consumers. As China has become a larger market and international interest has increased, thus increasing competition for market share, it has become harder for New Zealand companies to do just that.

In summary, the economic rise of China presents New Zealand with a major strategic shift in its global trading relations that is the logical extension of New Zealand's increasing economic relations with Asia. The Free Trade Agreement in 2008 symbolised our efforts to facilitate trade with China, and develop a clear strategic approach to engaging the world's largest developing economy. At the same time, however, New Zealand's major trade partners have also increased their economic interdependency with China. Chinese economic activities have created systemic changes in the world economy that New Zealand policymakers and businesses should watch carefully. China's impact on New Zealand trade will be much more than what is evident in our bilateral relations. All of New Zealand's major trade partners have strong trading relations with China. Any slowdown or growth in the Chinese economy will have a large impact on New Zealand patterns of trade with all our major trade partners, not just with China. Furthermore, New Zealand businesses should be aware of the international production networks centred in China and Asia and seek a place within them.

b. Deepening Economic Relations

This part argues New Zealand's economic relations with China reflect the changing nature of China's international economic presence and that New Zealand is adapting to these changes. It identifies a series of areas that are likely to become more important as Chinese economic development reconfigures trade, investment and people flows and as China's international economic impact deepens. These areas are bilateral investment, people-to-people flows, cooperation in research, science technology and agriculture, and cooperation in regional and global economic management and governance. As recent research shows the increasing importance to New Zealand of growth spillovers from China (Osborn and Vehbi 2013) we argue for more attention to those markers of deeper economic integration with China. Moreover, this part makes two further arguments. First, economic activity in today's world economy is interlinked. Services, investment and flows of people should therefore be seen as supporting trade activities. Second, New Zealand's economic relations with China are far broader than our bilateral relations alone.

Table 7 New Zealand-China Investment Stock (2007-12)

At 31 March	2007	2008	2009	2010	2011	2012
PRC Investment Stock in New Zealand						
Direct Investment Stock	c	c	c	c	c	93
Portfolio Investment Stock	8	35	55	c	c	172
Other Investment Stock	1374	1271	1666	1631	1621	1594
Total Investment Stock	887	808	1811	1877	1836	1860
Estimated FDI	*(-495)*	*(-498)*	*(90)*	*N/A*	*N/A*	*(94)*
Hong Kong (SAR) Investment Stock in New Zealand						
Direct Investment Stock	731	723	966	1127	902	989
Portfolio Investment Stock	c	44	25	241	126	368
Other Investment Stock	2198	2401	1891	2439	2510	1818
Total Investment Stock	3041	3188	2983	3829	3617	3260
Estimated FDI	(843)	(743)	(1067)	(1149)	(981)	(1074)
Taiwan Investment Stock in New Zealand						
Direct Investment Stock	c	c	c	c	c	c
Portfolio Investment Stock	22	21	32	17	c	15
Other Investment Stock	c	2333	2548	2502	2534	2487
Total Investment Stock	2364	2354	2580	2519	2559	2503
Estimated FDI	*N/A*	*(0)*	*(0)*	*(0)*	*N/A*	*(1)*
New Zealand Direct Investment Stock						
In the PRC	40	62	164	123	116	112
In Hong Kong (SAR)	392	506	631	634	574	545
In Taiwan	*c (20)*	*c (n/a)*	*c (n/a)*	*c (109)*	*c (17)*	*c (115)*
New Zealand Total Investment Stock						
In the PRC	160	240	455	541	769	934
In Hong Kong (SAR)	1477	1332	1253	1496	1216	1396
In Taiwan	113	125	201	240	332	267

Source: Statistics New Zealand (2012), C = confidential, N/A = calculation not available, () = estimate. Unit: millions NZD

Previous sections have shown that the level of investment in the Chinese economy relative to consumption expenditure remains high. While not the major component of domestic investment, foreign direct investment (FDI) has been an important driver of Chinese economic growth. Moreover, FDI in China has linked the advanced economies to global value chains and production and assembly networks embedded in China. This 'networking

effect' has been a very important part of how the Chinese economy has become integrated into the world economy and how the existing advanced economies have benefited from Chinese growth.

Notably however, New Zealand's total direct investment stock abroad in 2007 included very little investment stock in China. Only 40 million NZD or 0.19% of New Zealand's total direct investment abroad was invested in China (Statistics New Zealand 2012). This number has increased slightly to 112 million NZD in 2012, representing 0.46% of total New Zealand direct investment abroad. Even more concerning however, is that New Zealand not only invests little in China relative to other advanced economies, which is understandable due to relative economic size, but that the share of New Zealand's total investment abroad that is destined for China also remains small. The 545 million NZD invested in Hong Kong is also only 2.2% of total New Zealand OFDI. This is a very low level of New Zealand OFDI in China at a time when other advanced economies have secured their economic relations and linkage to the increasingly China-centred production networks in Asia. As a comparison, New Zealand OFDI in other major trade partners is much higher. Australia holds 52% of New Zealand OFDI stock, the United States 17% and the United Kingdom 4%. Japan, like China, is a major trade partner but only has 22 million of New Zealand OFDI. New Zealand businesses can trade with Asia but find it hard to invest there.

The previous sections also showed how Chinese overseas foreign direct investment (OFDI) is beginning to play a more significant role in global flows of capital and that Chinese enterprises abroad are beginning to increase their presence and to stimulate the development of more China-centric global value chains. Again however, New Zealand has benefited only marginally from this trend. New Zealand's share of Chinese overseas foreign direct investment (OFDI) in 2011 was only 0.004% (NBS 2012). By 2012, only 93 million NZD of direct investment stock came from China, a minority 0.1% share of total direct investment in New Zealand. Hong Kong direct investment in New Zealand was 989 million or 1% of direct investment stock in New Zealand. In the same year total investment stock from China in New Zealand was 1.86 billion NZD or 0.6% of total investment stock in New Zealand (Statistics New Zealand 2012). These numbers show Chinese investment in New Zealand is not only low by international standards, but also low in comparison to investment from New Zealand's other major trade partners.

Building the investment relationship is therefore an important aspect of deepening overall economic relations with China and linking the New Zealand economy to the international production networks throughout Asia. Investment however, especially investment in land and productive industries, will take time to develop. The New Zealand public take time to warm to investment from new economies as shown in the public debate stimulated by the investment in the bankrupt Crafar Farms by Shanghai

Pengxin. This created a large public backlash at Chinese investment in one of New Zealand's most productive industries, the dairy industry. Notably, investments by Bright Dairy into Synlait, and Yili and Yashili into dairy processing did not elicit the same public reactions or the purchase of Fisher and Paykel by Chinese whiteware manufacturer Haier. Ultimately, the debate created through Chinese investment is healthy. Strategically, it brings the opportunity for the Government and the Courts to consider how investment in New Zealand from China and other places can benefit the New Zealand economy by ensuring it can provide jobs, business activities and through linking the New Zealand economy to China and the broader supply chains in Asia.

There is a need, however, to facilitate a deeper discussion on how foreign investment from China impacts the New Zealand economy and to create the understanding that it is not possible, or desirable, to only trade with China. In today's world economy, sustainable economic relations are built not only on trade relations but also through services, investment and people flows. The media and academia have an important role to play increasing the public dialogue and awareness of the impact of these investments on the New Zealand economy and by illustrating the systemic changes in the world economy brought on through the internationalisation of Chinese economic activities. Just as investment brings people in each country closer and represents a deeper and more sustainable economic relationship, the flows of people to and from China support these investment and trade activities.

As the previous section showed, Chinese economic development has resulted in an increasing flow of tourists, students and migrants globally. Here the New Zealand service industry has developed some capacity to attract these groups from China. There is, however, less evidence to suggest New Zealanders are taking the opportunity to travel to China and engage with this new centre of global growth.

216,832 or 8% of the total 2.6 million short-term overseas visitors to New Zealand in the year to April 2013 were permanent residents of China. A further 27,392 short-term visitors were from Hong Kong and 20,176 were from Taiwan. Of the 1.2 million short-term visitors to New Zealand who arrived for the purpose of holiday/vacation, 158,080 (13%) were from China. Chinese holidaymakers are now the second largest group of international tourists in New Zealand, still well behind Australia's 444,544. Just three years ago Chinese tourists were only the fourth largest tourist group. From the 2012 year to April to the 2013 year to April Chinese tourist arrivals increased by 34.5% or 40,528. This is by far the largest real increase at a time when most tourist arrivals to New Zealand from most other countries are stagnant or reducing.

The growth of China as a source of international tourist earnings has been dramatic. Previous sections showed that Chinese tourists are now the largest spenders on international tourism (102 billion USD in 2012). Tourist expenditure is a significant

driver of the New Zealand economy. The slowdown in visitor arrivals from many parts of the world has increased the significance of Chinese tourist spending. Chinese tourists are now the second largest tourist market by expenditure. In the year ended March 2013, Chinese tourists spent 673 million NZD, a 42% increase on the previous year. China has grown from New Zealand's fifth largest tourist market in 2009 to the second largest market. Australia remains the largest market, with 1.6 billion in expenditure in the year to March 2013.

The China Market Review undertaken by the Ministry of Business, Innovation and Employment projects the Chinese market has potential to grow even further and highlights a number of important changes in the New Zealand tourism industry. These include becoming more 'Asia-ready', targeting the market better and developing high-end tourist offerings for the Chinese market in order to meet the vast potential of the world's largest and still growing tourist market (MBIE 2013). The New Zealand tourist industry is well on the way to grow tourist trade with China by 60% from 2012 to 2015 (NZTE and MFAT 2012) but some changes in New Zealand service provision will be required to attract and satisfy these new service users. This is a radical change in New Zealand's visitor demography.

Such a radical change requires new skills and knowledge. Previously, tourist operators in New Zealand had the advantage of sharing the same language or at least a similar western cultural background with the majority of tourist visitors to New Zealand. The growth of Asian tourism, in particular the recent rapid growth in Chinese tourists, requires a new set of language and cultural skills. This can be as simple as knowing a few words of welcome in Chinese (as all Chinese operators in China know at least a few words of English or Japanese) and having an understanding of cultural norms. It also means having an understanding of what the tourist consumer needs and wants. This could be as simple as providing rice cookers in camping grounds or as intricate as understanding eating patterns and the style of touring practiced in China. Chinese tour operators in the New Zealand market should be studied and partnered with to facilitate the provision of New Zealand tourist services to Chinese visitors.

Along with increasing short-term visits, the Chinese share of permanent and long-term arrivals to New Zealand has also increased. According to the United Nations Development Programme (2012), the stock of Chinese migrants in New Zealand has increased from 9,188, just 0.2% of the 4,252,389 total Chinese migrants in 1990, to 118,591 or 1.4% of the 8,432,427 total in 2010. Statistics New Zealand records China as the third largest source of New Zealand's permanent and long-term arrivals (12 months or more, permanent and returning New Zealand residents). In the 2013-year to April, there were 7,894 permanent or long-term arrivals to New Zealand from China, representing 8% of the New Zealand total.

Table 8 Arrivals in New Zealand by Top 5 Countries of Permanent Residence (2011-2013)								
Short-term Overseas Visitor Arrivals (year to April)								
Country of last Permanent Residence	2011		2012		2013		Change 12-13	
	Number	%	Number	%	Number	%	Number	%
1. Australia	1,120,152	45	1,161,476	44	1,171,504	45	10,028	0.9
2. China	129,588	5	168,164	6	216,832	8	48,668	28.9
3. United Kingdom	222,803	9	216,216	8	189,040	7	-27,176	-12.6
4. United States	190,510	8	183,664	7	188,016	7	4,352	2.4
5. Japan	82,599	3	66,924	3	75,552	3	8,628	12.9
Total	2,516,454	100	2,615,821	100	2,616,292	100	471	0
Permanent and Long-term Arrivals								
Country of last Permanent Residence	2011		2012		2013		Change 12-13	
	Number	%	Number	%	Number	%	Number	%
1. Australia	15,430	18	13,684	16	16,164	19	2,480	18.1
2. United Kingdom	14,190	14	14,412	14	14,102	14	-310	-2.2
3. China (PRC)	6,736	7	7,614	8	7,894	8	280	3.7
4. India	7,285	7	6,416	8	6,255	6	-161	-2.5
5. United States	3,619	4	3,619	4	3,632	4	13	0.4
Total	83,456	100	83,807	100	87,217	100	3,410	4.1
Source: Statistics New Zealand								

Immigration and an ageing population in New Zealand, as well as the growing numbers of New Zealand born Asians, are shifting the ethnic makeup of the country. 'Asian' is now the fastest growing ethnic category in New Zealand census data estimates and projections. In the 1996 New Zealand Census, 194,800 people identified as Asian, just over 5% of the national total. In the 2006 Census this number had more than doubled to 404,400, or 9.6% of the total population. By 2026, in just over a decade, medium range projections estimate that 791,200 people will identify as Asian in New Zealand, representing more than 14% of a total estimated New Zealand population of 5.6 million (Statistics New Zealand 2013).

The China Strategy released in 2012 also made the goal of growing services trade with China in education by 20% from 2012 to 2015. China is already the largest source of foreign students in New Zealand with 21,000 enrolments in New Zealand in 2010. 90% of these students are in the tertiary sector. 6,000 of the total 17,000 international students enrolled in New Zealand universities are Chinese students. Chinese students in New Zealand are estimated to contribute $600 million to the New Zealand economy annually (NZTE and MFAT 2012). Chinese students in New Zealand make a large contribution to New Zealand growth and funding of the tertiary education sector. Increasing the number of Chinese students in New Zealand will require New Zealand institutions to reach out and be better known in China, especially as our main competitors in Europe, North America and Australia aggressively target the Chinese overseas student market and as Chinese institutions increase their standards of education provision.

This may require a more concerted effort on the part of New Zealand education providers to establish a stronger presence in China through joint marketing (Brand New Zealand) and by establishing New Zealand campuses. There seems to be great

need to ensure the experience of Chinese students in New Zealand creates a positive reputation for our institutions in terms of quality of education received and level of pastoral care. The quality of experience is not just important for New Zealand's reputation in China, but is also important for retaining the best and the brightest of Chinese graduates here in New Zealand. Finally, mutual recognition of qualifications, particularly practical skill qualifications, could make New Zealand qualifications more attractive to Chinese students. There is good reason to be positive about the growth of service trade with China in these areas, but it will require structural adjustments in the New Zealand service industry.

Chinese citizens have increasingly ventured to New Zealand for tourism, education and migration, but this positive engagement has not been reciprocated by New Zealanders. The numbers of New Zealanders engaging with China has not grown as rapidly. This is in part due to the asymmetry of the New Zealand-China relationship, but also reflects an ongoing deficit in Asia literacy and knowledge in New Zealand and a lack of understanding of the systemic changes occurring in the world economy. Today, China is just as important economically as our traditional partners. New Zealand businesses and people also need to put in far more effort to reach any sort of parity in understanding this new global actor. This is in part due to cultural similarities with the Anglo-Saxon world (Australia, United Kingdom, United States and Canada), which traditionally dominated New Zealand's economic relations, but it is also due to the rapidity of the transformation of China and the world economy and the growth of East Asia and China as a centre of global economic activity.

For example, China is New Zealand's second largest export market and largest source of imports, but just as New Zealand businesses have a very small share of New Zealand direct and portfolio investment in China, New Zealanders are also less likely to travel to China than to New Zealand's traditional economic partners. China remains only the 6th largest destination for short-term New Zealand-resident traveller departures with only 68,000 departures for China in the year to April 2013. This is only 3.1% of all short-term New Zealand-resident traveller departures in year to April 2013, a slight drop on the 3.3% share of short-term departures for China in the year to April 2011. Australia (45%), the United States (6%), Fiji (5%), the United Kingdom (4%) and the Cook Islands (3.3%) remain more popular short-term destinations. Permanent and long-term departures show a similar trend. China remains New Zealand's fourth largest destination in the 2013 year ended April with 2,452 permanent and long-term departures for China. This is just under 3% of the total New Zealand share.

Looking to cooperation in research, technology and agricultural development, there are large opportunities for leveraging New Zealand's strong reputation in a number of fields that are slowly emerging. This is an area where the asymmetric economic relations between China and New Zealand are moderated by New Zealand's

high levels of all-round education, research and agribusiness skills and technology. This advantage is unlikely to remain as pronounced in the future as China's R&D budget and quality of provision increases and as China's agricultural sector transitions to an industrial and commercial sector. The final goal of the New Zealand China Strategy is to 'grow high quality science and technology collaborations with China to generate commercial opportunities'. The priority areas identified for this goal include 'food, health and biomedical sciences, environmental science, and high technology platforms' (NZTE and MFAT 2012). A Joint Funding Mechanism of 2 million NZD has been established to kick-start this process.

The 2008 China-New Zealand FTA also included a chapter devoted to cooperation in areas of economic cooperation, small and medium sized enterprise, labour and environmental cooperation as well as technical support on food safety and biosecurity programmes and cooperation. The *Environmental Cooperation Agreement* established cooperation in areas of management of water environment, coastal ecological conservation and pollution control, air pollution control and monitoring, environmental awareness and education, management of disposable waste, management of chemicals, environment and trade and biodiversity conservation (Government of New Zealand and China 2008). China and New Zealand have also entered a partnership at the request of the Cook Islands to jointly deliver a 60 million NZD project to improve water quality in Rarotonga. This is 'the very first time China has partnered with a developed country to deliver an aid and development project' (New Zealand Aid Programme 2012).

In summary, the growth of China in the world economy has deeply impacted the New Zealand economy in a number of areas. Bilaterally, New Zealand has worked hard to position itself to take the opportunities presented by the economic development of China. The New Zealand Government has been quite successful at developing good political relations with China to help facilitate that process. The 2008 New Zealand-China Free Trade Agreement remains the main marker of the political relationship that shows how political relations with China are a prerequisite to developing a deep economic relationship.

However, the FTA may have 'opened the door for trade with China more widely than before' but it remains 'up to business in New Zealand to actually go through the door and seize those opportunities' (Goff 2013). The growth in commodity exports has been nothing short of stunning, largely sheltering New Zealand from the slow-down brought on by the global financial crisis of 2009. This growth has not been matched by growth in value-added exports, in the bilateral investment relationship or supported by high levels of New Zealand engagement with China. Chinese tourists, students and businesses are presenting good opportunities for the growth of New Zealand trade in services with China but require some domestic upgrading and up-

skilling if the potential of the growth of Chinese economic activities abroad are to be positively engaged. New Zealand businesses should be aware of the emergence of Asia as the centre of the world's global production networks and seek opportunities to participate in them. Businesses, the public and Government should view the economic relationship with China as one of global integration into these networks and see trade, services, investment and people flows as deeply interrelated economic activities.

The final section looks at this potential and takes a cautionary view on potential risks involved in integrating with the Chinese market and China-centred global economic activities. It asks what New Zealanders need to be aware of when assessing the health and impact of the Chinese economy as well as summarising the systemic impact of Chinese growth on the world economy. The section further asks where the New Zealand economy fits in with this new world economy and focuses attention on the new dynamics in the global economy that New Zealand policymakers, business leaders and everyday people need to pay attention to.

c. China, the World Economy and New Zealand

The early sections of this paper outlined the process of Chinese reform to date and identified the major drivers of growth as well as pointing out the major challenges and possible barriers to transitioning from a middle-income country to an advanced economy. These sections had two major conclusions. The first is that the fundamental drivers of Chinese development are the structural transformation of the economy from an agrarian based society to an urban industrial and service sector and the ongoing role of investment as a driver of economic growth at the same time as consumption begins to play a more significant role. This part of the section suggested growth would continue. The second major finding was that for Chinese growth to continue, a new approach was now needed and that, as the economy structurally transforms growth is likely to slow. As such, both conclusions suggest that irrespective of whether growth remains strong in China or falters, changes in the domestic economy and in how the Chinese economy impacts the global economy will affect the structure of the world economy. The second major section showed that Chinese economic presence in the world economy has increased dramatically since the turn of the century, from trade to investment, to the presence of Chinese enterprises abroad. This section asks how the New Zealand economy can be placed throughout this systemic change in the world economy to best meet New Zealand interests.

New Zealand is an advanced but small and internationally reliant economy with major strengths in agribusiness, science and technology manufacturing and research, creative industries, and tourism. Annual expenditure on GDP in New Zealand has grown from 184 billion NZD in 2008 to 206 billion in 2012 (year to March). Final

consumption expenditure as a percentage of GDP in 2012 reached 80% (165 billion NZD), 20% in general government expenditure (42 billion NZD) and 60% private expenditure (123 billion NZD). Gross fixed capital formation as a percentage of GDP has decreased from 23.5% in 2008 (42 billion NZD) to 18% in 2012 (37 billion NZD). The remaining 2% of expenditure on GDP came from physical increase in stocks (1.8 billion) and net exports of goods and services (1.9 billion).

Table 9 New Zealand Balance of Payments (2008-2012)

Year Ended 30 September	2008	2009	2010	2011	2012
	(dollar amounts in millions)				
Current Account					
Export receipts	42,737	42,452	42,331	47,580	47,588
Import receipts	45,195	40,328	39,057	44,471	45,915
Merchandise balance	(2,463)	2,124	3,274	3,108	1,674
Services balance	(195)	(44)	66	(988)	(788)
Investment income balance	(14,179)	(8,095)	(9,706)	(10,748)	(10,360)
Transfers balance	876	473	103	(197)	(420)
Current account balance	(15,960)	(5,542)	(6,264)	(8,826)	(9,894)
Deficit as % of GDP	(8.6)	(3.0)	(3.2)	(4.3)	(4.7)
Financial account (net)					
Foreign investment in NZ	14,447	(7,194)	12,583	18,791	(36)
NZ investment abroad	(973)	(1,797)	11,688	18,115	(7,056)
Reserves	1,195	10,450	1,034	(4,528)	3,421
Financial account balance	15,420	(5,397)	895	676	7,020
Capital Account					
Balance of capital account	(653)	490	4,334	12,677	(546)

Source: Table 17, p.30 of New Zealand Government (2013)

The New Zealand economy is export driven. Exports of goods and services represent 30% of New Zealand's gross domestic product (GDP). Exports of commodity-based products are the main source of export receipts. The primary sector accounts for 7.4% of GDP and contributes over 50% of total export earnings. New Zealand's manufacturing sector is also dominated by the primary industries. Food manufacturing accounts for 46% of all manufacturing in New Zealand. Exports of meat and dairy products reached 17 billion NZD in the year ended September 2012, roughly 27% of export earnings and 8% of total GDP (New Zealand Government 2013). However, because the New Zealand economy is reliant on imports of raw materials, consumer products and capital equipment for industry, New Zealand needs to maintain a strong exporting sector. New Zealand has consistently run a balance of payments deficit due in part to balance of goods and services trade deficits (primarily services) but mostly due to large deficits in the investment income balance (10 billion NZD in 2012).

> *After late 2008, the investment-income deficit narrowed markedly, driven by lower profits accruing to overseas-owned firms as a result of weak domestic trading conditions. Another factor was the lower interest payments flowing to holders of New Zealand debt as the result of lower interest rates both domestically and internationally. Since 2010, the investment-income deficit has widened again largely owing to higher repatriated profits earned by foreign-owned firms (predominantly Australian-owned banks in New Zealand)* (New Zealand Government 2013).

This suggests the challenges for the New Zealand economy are two-fold. First, the New Zealand economy is reliant on export earnings primarily in the primary industries and the manufacture of food products. These industries are the drivers of New Zealand economic growth and there are signs international demand for these products will continue to grow. Increasing export earnings is the most effective way of decreasing the current account deficit and stimulating the economy. This occurred from 2009-11, but it has been a concern to see once again the 2012 year to September measuring little increase in exports but on-going increase in imports. Second, New Zealand needs to attract more investment into productive industries and direct domestic investment away from unproductive activity. For example, a large portion of the current account deficit can be explained by a poor record of household saving in New Zealand and high levels of household debt to purchase what the International Monetary Fund describes as a housing market 45% overvalued (IMF 2013).

Increasing domestic savings, attracting foreign investment into productive industries and directing New Zealand investors to lucrative overseas investments is needed to address the large 10 billion NZD deficit in investment income balance. An important part of the structural transformation of the New Zealand economy is getting the Government books in order, but even more pressing is managing the broader New Zealand economy's shift from an over-reliance on household and farming debt and investment in unproductive local assets, such as housing, to attracting investment in the export industries and increasing trade and services receipts as well as increasing New Zealand investment abroad. China's economic development provides both opportunities and challenges in meeting those goals.

The economic rise of China presents New Zealand commentators and analysts with the task of constructing new frameworks to understand the world economy and New Zealand's place in it. While this creates much uncertainty and presents more than a few risks, it is also an important opportunity to reflect on New Zealand's place in the world, to diversify our trade, investment and economic cooperation partners, and to address the structural imbalances in the New Zealand economy. In order to achive this, New Zealand will need to increase China capacity in both the public and private sector. This is not just about learning Mandarin, though that is an incredibly important first step, but it is about utilising the connections, skills and knowledge that already exist in New Zealand to build our relations and grow public understanding of the broad role of the Chinese economy in the world. Education, research and debate should be focused on improving knowledge of China and the Chinese economy in order to be able to identify the changes in the world economy as the economic rise of China and Asia transform the traditional economic order. This will create capacity for New Zealand businesses and Government to strategically position themselves to meet these new challenges and opportunities.

5. CONCLUSION

This paper has arrived at three general conclusions. First, Chinese economic development has reached a turning point after 30 years of high-speed growth. The pace, scope and quality of future economic growth will be determined to a large extent by how contributing sources of economic growth, exports, investment and consumption, will strengthen, expand and prioritise under the evolving institutional, policy and operational environment. Our analysis has shown that the dynamism and energy of the economy, infrastructure invested, interests and value chains built in the economic activities, and the on-going efforts in reform and restructuring, will see economic growth continue at a similar pace as seen in the past decade in the next 5-10 years, with small scale fluctuations or permanently slowing down to below 8%. Consumption expenditure will increase over exports and investment, but not to the extent as hoped in the broad programme of rebalancing and restructuring of the economy. Internationalisation of the economy, urbanisation, private investment, reform in primary and secondary distribution of income, and R&D, technology and education will be key shaping forces of growth.

The Chinese economy will continue to consolidate and enhance its position as a leading economy in the world and is transforming itself towards a higher income, mature and rationalised economy. Moreover, the structure of its growth sources and contributions will undergo significant change, where there is a momentum for the economy to grow on greater domestic demand, including public sector investment and private consumption but also on further and greater scope of internationalisation of the Chinese economy. Furthermore, on-going and re-energised efforts in structural rebalancing and growth model reorientation will be a key factor determining the pace and structure of further economic growth.

Second, Chinese international economic activities in the world have evolved, developed and expanded, from trade concentration to investment expansion; from pursuit of bilateral economic relations to participation in global and regional economic integration, management and governance; and from movements of products, materials and capital to expansion of business, enterprise, and production networks and value/supply chains in the world economy. The internationalisation of the Chinese economy affects the global structure of markets, resources, capital and finance, prices and consumer demand, supply and values chains and production networks, and economic governance and organization. The shifting directions and activities of trade, investment, research and development, brand development and tourist flows, are reshaping the world economy.

Third, changing conditions and dynamics in the world economic system, with

China emerging as an increasingly significant mover and shaper, creates a historical moment for New Zealand to consider how it strategically positions itself in the world economic structure for its long-term economic prosperity and social wellbeing. Our analysis shows that the New Zealand economy has limited impact on overall Chinese economic growth and its global interests and activities. On the other hand, a dynamic, competitive, continuously expanding Chinese economy not only provides markets for New Zealand exports, it becomes a principal platform for New Zealand international economic activities. More importantly, through its internationalisation, Chinese economic forces come to New Zealand, and have significant impact on the structure and performance of the New Zealand economy and its broad economic and social conditions.

Important implications can be drawn from the broad conclusions above. First, the finding on the dynamism and structure of the Chinese economy, and hence the short and medium term prospects of Chinese economic growth, is largely positive for the New Zealand economy. It provides a good basis for us to think about our broad international interests and strategy in the dynamic and evolving global economy, and our economic relations with China in particular. However, there is also a level of contingency of prospects in the scope and effectiveness of deeper reforms in structural rebalancing and growth model reorientation and whether the shift in growth structure evolves in the direction as expected. This can spell possible risks for New Zealand.

Second, Chinese international activities in the world are systematically related to the structure and dynamics of Chinese economic growth itself. As such, China's economic impact on New Zealand should be seen as part of the dynamic and evolving global economy where China has become increasingly a key mover and shaper. Our policy and strategy toward China is in a very important way our response and strategy to change and developments in the world economic system.

We need to consider the greater purpose of New Zealand international economic activities with China and to develop a coordinated policy to promote and support them. New Zealand needs to push out into the emerging value chains, growth centres and global capital flows and to make its businesses relevant to new emerging trends. A coordinated agribusiness policy, for example, might help in promoting New Zealand as a leading source of agricultural exports, food production, agricultural and food research, technology and education and for those skills, expertise and resources to be invested in emerging markets where there is a need for them and large space to grow. Our trade and investment activities in China, for another example, can serve New Zealand's international economic interests while also becoming an important part of the working of the Chinese economy, particularly in urbanisation, rural business and development, and promotion of domestic demand and consumption. Furthermore, working with China in regional economic cooperation and integration, and in global

economic management and governance, is clearly areas to broaden our economic relations with China beyond bilateral trade, people movement and investment.

Third, New Zealand's economic relationship with China is asymmetric. China matters a lot more to us than we do to China. This suggests that in seeking to adjust to the dynamic and evolving international economic environment, we need to invest and nurture our economic relations with China to build up greater stakes of both sides in the relations. Policymakers should consider what policy instruments they have to nurture a more balanced structure of incentives and interests for Chinese and New Zealand economic activities.

Finally, the impact of Chinese economic activities is wide and deep on individual countries. The breadth and impact of Chinese economic activities is such that even in sectors where New Zealand businesses or consumers are not directly dealing with Chinese businesses or consumers, China's economic activities will heavily impact, for better or worse, New Zealand's economic interests. Therefore, treating China as a matter of managing and regulating bilateral exchange is insufficient. New Zealand will need to think strategically about Chinese economic activities in New Zealand and how they can be turned into a positive force for the working of our economy both in short and medium term macroeconomic performance and long-term structural adjustment.

New Zealand, like many other countries experiencing the dynamic and evolving new global economy, has its own challenge of staying relevant globally and confronting existing and potential economic imbalances, such as debt to GDP ratios, consumption levels and export promotion activities. The bilateral and structural impact of Chinese economic activities presents an opportunity to revisit New Zealand's model of political economy and to incorporate these new dynamics into domestic economic policy and international strategy.

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