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## China's Role in The World Economy

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The Chinese economy grew 9.5% in 2004, and maintained the momentum of the previous several years. China's international trade hit a new record, reaching \$1,154.79 billion; the annual growth rate is 35.7%, and for the first time in the history, China replaced Japan as the world's No. 3 trader, only after the U.S.A. and Germany. Three years after accession to the World Trade Organization (WTO), the scale of China's international trade doubled; and in the last decade, China's international trade quadrupled. This growth rate is really impressive.



EIRNS/William Salisbury

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As far as the inflow of Foreign Direct Investment (FDI) is concerned, the performance of China is also outstanding. In the year 2002, the inflow of FDI in China was more than \$50 billion, that is, \$52.7 billion; in 2004, the inflow of FDI in China was \$60.63 billion.

The performance of the Chinese economy in 2004 was not exceptional in terms of growth rate. In fact, in the last few years, while the world economy has been in recession, the Chinese economy has been growing very fast. For example, from 2000 to 2003, while the growth rate of the world economy was 2.5%, 2%, 3.0%, and 3.9%, respectively, China's economic growth rate was more than 7.3%. While the growth rate of the value term of world trade was 13%, -4%, 4%, and 16%, respectively, the growth rate of China was 32%, 7.5%, 22%, and 37.1%. During the same period, after the world inflow of FDI hit its peak in 2000, amounting to \$1,388 billion, it suffered in the next three years: in 2001 it was \$817.6 billion, in 2002 it was \$678.6 billion, and in 2003 it reached \$559.6 billion. But the situation in China is totally different. The inflow of FDI in China was \$40.7 billion in 2000, \$46.8 billion in 2001, \$52.7 billion in 2002, and \$53.5 billion in 2003. Why is China's economic performance so outstanding; what is the mechanism of China's economic connection with the world economy; and what are the implications of China's economic development?

TABLE 1

**Composition of China's Inward Foreign Direct Investment (FDI) and International Trade**

Year	Share of M&A in the World Inward FDI Inflow, %	Share of M&A in China's Inward FDI Inflow, %	Share of Processing Trade in China's Export, %	Share of FFEs in China's Export, %	Share of FFEs in China's Processing Trade (export), %	Share of Processing Trade in FFEs Export, %
1993	36.51	2.04	48.2	27.5	48.1	84.27
1994	48.95	2.12	47.1	28.7	53.7	88.1
1995	56.46	1.12	49.5	31.5	57.1	89.7
1996	58.79	4.74	55.8	40.7	63	86.31
1997	63.76	4.2	54.6	41	64.1	85.19
1998	76.56	1.82	56.9	44.1	66.2	85.45
1999	70.39	5.94	56.9	45.5	67.2	84.12
2000	76.67	5.51	54.9	47.9	70.6	81.4
2001	80.79	4.96	55.4	50.1	72.3	80.01
2002	56.77	3.93	55.3	52.1	74.8	79.21
2003	53.07	7.14	55.2	54.8	78.7	81.34

Source: *World Investment Report, 2004* and UNCTAD FDI database.

## I. The Special Mechanism of China's Economic Connection With the World Economy

The connection of China's economy with that of world is through two channels: the first is FDI, and the second is international trade.

Compared with other countries, the nature of FDI in China is different. Firstly, the majority of FDI in China is greenfield<sup>1</sup> FDI (**Table 1**). The world's inward FDI is mainly composed of mergers and acquisitions (M&A). The share of this type of FDI is more than 80% in some years. In the last few years, the increase of world inward FDI has come mainly from this type of FDI, and this investment is mainly concentrated in the industrial countries. This type of FDI is highly economic-cycle related. Because of the economic recession, M&A decreased dramatically, and so did world inward FDI. But FDI in China is not M&A, but almost all belongs to the greenfield category. Because of this difference, while world FDI suffered during the world economic recession, FDI inflow into China continues to increase.

Secondly, the majority of greenfield FDI in China belongs to the category of labor-sourcing FDI. According to the assessment of Song and Chai (2002), 70% of the stock of FDI in China is concentrated in the manufacturing sector; of this, 70% belongs to labor-sourcing FDI. This type of FDI is induced by the low cost of production, especially local cheaper labor. During the development process of an economy, along with the increasing level of economic development, the local currency tends to appreciate, while production costs in general, and labor costs in specific, also tend to increase. Therefore, this type of FDI is mainly from a high-income economy,

and is invested in a low-income economy, not countries with a similar income level. The labor-sourcing FDI is intended to take advantage of local cheaper labor, and perform some of the more labor-intensive process or production activities, and the outputs of this investment mainly are exported to a third market, or directly resold to the home market of this FDI. The labor-sourcing FDI in China was initiated by entrepreneurs from Hong Kong in the 1980s, in the Pearl River Delta, and then firms from Singapore, Taiwan, and South Korea followed suit. So, more and more production base and manufacturing activities are transformed from those economies. Japanese firms also joined in the process during the 1990s, especially in the last few years after China's accession to the WTO.

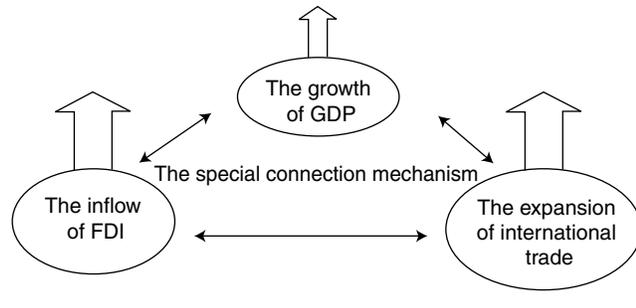
As far as international trade is concerned, it is also different from that of other economies. Since 1995, the share of processing trade in China's exports has been more than 50%. And since 2001, the share of FFEs [Foreign-Funded Enterprises] in China's exports has also been more than 50%.

Most importantly, the inward FDI is closely related to international trade in China. Because the labor-sourcing FDI is export-oriented, the more there is of this type of FDI, the more the exports. The connection of FDI and trade in the case of China is as follows: 1) Internal and external conditions make China a very attractive destination for inward FDI. Since 1996, each year China attracted more than \$40 billion FDI; 2) More than 95% of inward FDI in China is of the greenfield type. That means more new production capacity and manufacturing bases. 3) Seventy percent of these production bases perform processing trade. So, the share of processing trade in China's trade increased very fast, and became the main source of China's trade growth. For example, in 2003, 54.88% of the increase of China's export was from the processing trade. In the same year, 63.12% of China's export

1. Pertaining to new plant and equipment—ed.

FIGURE 1

### The Simultaneous Growth of Inward FDI, International Trade, and GDP



increase was from FFEs. In summary, more than half of the FDI stock in China belongs to labor-sourcing FDI, so, on the one hand, we got more inward FDI, while on the other hand, we exported very fast (Figure 1).

The growth of the whole economy in general and China's export in specific is driven by inward FDI. That is the mechanism of the Chinese economic connection with the world economy. The key point of this mechanism is the export-oriented, labor-sourcing FDI. So, the question is, Why can China attract so much labor-sourcing FDI? What are China's advantages in this respect?

The first reason is China's special advantages. China has four important advantages: 1) China's favorable geographical location. China is the geographical hub of the Asian core economies. She is in the neighborhood of Japan, South Korea, and Singapore, and she is the mainland of Taiwan and Hong Kong. China shares the Yellow Sea and South China Sea with those economies. 2) China's favorable cultural advantage. Chinese culture is the main source of Asian and Japanese cultures, and the most important connection among South and East Asian economies. It is well known that transnational corporations tend to invest in the same or similar cultural regions. 3) Overseas Chinese. There are more than 50 to 60 million overseas Chinese all over the world. They control huge economic resources in the world, and they invest aggressively in China. 4) Local market attractiveness. There are more than 1.3 billion people in China. This is a huge potential market. Along with the fast economic growth during the last two decades, comes a fast-rising purchasing power of local people. A new middle class is emerging in China.

The second reason is China's economic policies. China adopted opening up to the outside and economic reform policies since 1978. In the context of this policy framework, China continues to initiate more and more programs and projects to attract FDI. For example, in 1979 China set up four special economic zones in the Guangdong and Fujian provinces, which are the important coastal areas of China, and the most important homeland of overseas Chinese. In 1986, a new pol-

icy was initiated by China's government which targeted the inward FDI from Hong Kong, Macao, and Taiwan. More favorable incentives were provided for the export-oriented and high-tech FDI. In the early 1990s, Deng Xiaoping's famous south China tour provided a new dynamic for China's economic development in general and inward FDI in specific.

The third reason is the impact of China's WTO accession. Because China wanted to join the WTO, she made comprehensive commitments. 1) China opened up four new sectors for foreign investors. Those sectors are telecommunications, banking, insurance, and professional service. 2) China deepened the extent of opening to the outside world in the already opened areas. For example, full trade and distribution rights were provided to all firms three years after China's WTO accession, no matter what their type. 3) The environment of investment in China has improved dramatically because of China's commitments. China joined the TRIMs [Trade-Related Investment Measures agreement] and TRIPS [Trade-Related Aspects of Intellectual Property Rights agreement], which would provide more favorable/equitable treatment to foreign investment.

The fourth reason is the favorable international economic background. During the second half of the 1980s, because of the appreciation of the Japanese yen and the Asian NIEs' [Newly Industrialized Economies'] currencies, the labor-intensive industries in those economies lost their comparative and competitive advantages. On the other hand, the appreciated currency makes outward FDI more favorable for firms from those economies. China's policy of opening up to the outside world makes it deeply involved in the East Asian industrial restructuring process, and gradually integrated into regional economic development. More and more manufacturing capacity is transferred to China through inward FDI. This momentum built up in the second half of the 1980s, and was maintained in the next two decades.

In summary, these four important advantages allow China to attract much labor-sourcing FDI each year in the last two decades, and to survive the world economic recession and continue to grow faster than other economies in the last few years.

Thanks to that special mechanism of China's connection with the world economy, China's economic growth rate has been one of the highest in the world in the last two decades. From 1979 to 2000, its growth rate was 9.5%, the highest in the world. China's position in world trade improved dramatically, from No. 27 in 1979 to No. 3 in 2004. In terms of inward FDI, since 1993, China has been the favorite investment location among developing countries. By 2004, more than half a million foreign fund firms were approved, and the stock of contracts for inward FDI exceeded \$1,000 billion, while actual investment in China was \$562.21 billion in total. Therefore, the key to China's fast international and economic development in the last 20 years is the mechanism of connection with the world's economies.

## II. The Sharing Economic Development Model And China's Position in Regional Trade

This mechanism also makes China economic development model different, and its international trade position special. First, labor-sourcing FDI and the processing trade makes many economies share in the economic growth of China in general, and its trade expansion in specific. And in this sense, we call China's economic development model the Sharing Economic Development Model, which is totally different from the traditional one—we call it the Non-sharing Economic Development Model. For the traditional development model, economic development is mainly, if not totally, based on indigenous firms, and international trade expansion is also coming from the non-processing trade. So in the model, few foreign firms, and then few foreign economies can take part in the local economic development process, let alone be deeply involved in it. However, for the Sharing Economic Development Model, foreign firms and foreign economies are comprehensively involved in the local economic development process in term of FDI and processing trade. In the case of China, for example, during 1985-2003, 61.64% of the total increase of China's export and import, 62.41% of export increase, and 60.90% of import increase, are from foreign-funded firms, not indigenous firms. During 1981-2003, 57.83% of China's total trade increase came from the processing trade. This is definitely a new economic development model.

In the Sharing Economic Development Model, what are shared, firstly, are the production activities. Transnational corporations move some of their manufacturing activities from industrial or high-income economies to China. Most of those activities are labor-intensive—that is, low-value-added and low wage activities in industrial economies. This transformation of industrial capacity from industrial to developing economies will upgrade and adjust the industrial structure in the advanced economies and promote those economies to perform more high-value-added activities. On the other hand, this transformation also provides many low-skilled jobs for the new workers in China, who have just migrated from the countryside. Every year more than 90 million farmers migrate from the agriculture sector, and find jobs in the urban areas, and each year there are more 500 billion RMB transferred from urban areas to the countryside. Those movements of people and funds between the city and the countryside dramatically promote the economic development of China.

Another important aspect of this Sharing Economic Development Model is the sharing of the market. First, along with the fast increase of Chinese exports comes the expansion of China's imports. In fact, the processing trade has a very high import content. For example, in 2004, \$1 in processing exports required \$0.6761 (two-thirds) in imports. Therefore, from the \$1 in processing exports, China only gets one-third in terms of wages and some local inputs, while another two-thirds is shared by China's trading partners, in terms of all kinds of inputs such as components and parts. The same is

true for another type of trade in China, such as general trade. In 2003, China's imports were valued at more than \$400 billion, the biggest import market in Asia, and this market expanded to \$560 billion in 2004.

Secondly, the Chinese market also expanded quickly because of the fast growth of GDP in the last two decades. One of the important conditions for inward labor-sourcing FDI is the opening of the local market to international investors, because the low cost of production is only the necessary condition for this type of investment, not the sufficient one. If one location can provide some extra incentives when competing for such an investment project, in term of local market access and so on, this type of FDI will pour in. So, one of the important differences between the Sharing and Non-Sharing Economic Development Model is local market access. For the former one, the market opening is a reciprocal opening, while the latter is only overseas-market-oriented. Therefore, the emerging market of China provides good justifications for local market-sourcing FDI<sup>2</sup>. Take China's automobile industry as an example. Due to the rise in income, more and more cities in China have passed the benchmark of the household car purchase. So, the industry expanded dramatically in the last three years. It is well known that this industry is controlled by joint-venture firms. Meanwhile, even if for the processing export activities, not all their output goes to the outside world, and the share of local sales increases gradually.<sup>3</sup>

It is interesting for us to know which economies are sharing in China's international trade increase. Other trade partners share China's trade expansion mainly in two ways. The first is by sharing China's imports and the second is by sharing China's exports, in term of joint-venture or processing trade. **Table 2** tells us the beneficiaries of China's import increase in the last ten years. Japan, four Asian NIEs, Germany, the U.S.A., ASEAN-5, France, Australia, Saudi Arabia, Brazil, India, Russia, and Argentina are the main beneficiaries of China's import increase. Especially, the beneficiaries have been very stable in the last ten years. For example, the list of beneficiaries of 1993-2003 is almost the same as that of 2002-03, except Argentina.

On the other hand, the share of FFEs and processing trade in China's export to her main trade partners is very high. For example, for China's top three export markets, the share of processing trade is all more than or almost 60%, and among them, FFEs deal with more than 76%.

Take China's top three export markets as an example. In

2. It should be noted that because of the market access, much labor-sourcing FDI invested in China continues in business there. The reason for that is that the FDI can easily be transformed from labor-sourcing FDI to market-sourcing FDI. Otherwise they may move again to other locations. The transformation from market sourcing to labor-sourcing FDI also happened in China, and would more in the future.

3. We have no exact number of local sales of the processing trade in China, but we do have the share of local sale of FFEs. FFEs sold more half of their production in China's local market in 2004.

TABLE 2

**Beneficiaries of China's Import Increase**

The case of 2002-2003 import increase			The case of 1993-2003 import increase		
Beneficiaries	Import increase, \$100 millions	Share	Beneficiaries	Import increase, \$100 millions	Share
Japan	206.83	17.67	Japan	508.55	16.54
South Korea	145.6	12.44	South Korea	377.75	12.28
Taiwan	112.99	9.65	Taiwan	364.29	11.85
Germany	79.12	6.76	U.S.A.	232.78	7.57
U.S.A.	66.31	5.66	Germany	182.95	5.95
Malaysia	46.91	4.01	Malaysia	129.03	4.2
Singapore	34.31	2.93	Thailand	82.27	2.68
Thailand	32.25	2.75	Singapore	79.15	2.57
Philippines	30.89	2.64	Philippines	60.93	1.98
Brazil	28.41	2.43	Austria	53.56	1.74
India	19.77	1.69	Saudi Arabia	50.76	1.65
France	18.44	1.58	Brazil	49.82	1.62
Saudi Arabia	17.6	1.5	Russia	48.68	1.58
Argentina	14.9	1.27	France	44.57	1.45
Australia	14.5	1.24	Indonesia	43.02	1.4
Russia	13.19	1.13	India	38.38	1.25
Indonesia	12.47	1.07			
<b>Total</b>	<b>1,170.7</b>	<b>100%</b>	<b>Total</b>	<b>3,075.4</b>	<b>100%</b>

Source: China Customs.

2003, China exported \$92.47 billion to the U.S.A.; of this, 67.52% belongs to processing trade export, and for the processing export, FFEs provides 76.93%. China exported \$76.29 billion to Hong Kong, the shares of processing trade and FFEs are 71.60% and 78.57%, respectively. For the \$59.42 billion exported to Japan, the shares of processing trade and FFEs are 59.11% and 82.79%, respectively. Therefore, China's exports are not exclusively through Chinese firms (that is, belong to general trade) and enjoyed by the Chinese people, but they are shared with her trade partners.

In summary, in the past 20 years, China's economy in general and trade in specific are growing very quickly. This growth is not so much a threat to other economies, but an opportunity to grow together with China. This is a controllable sharing economic development.

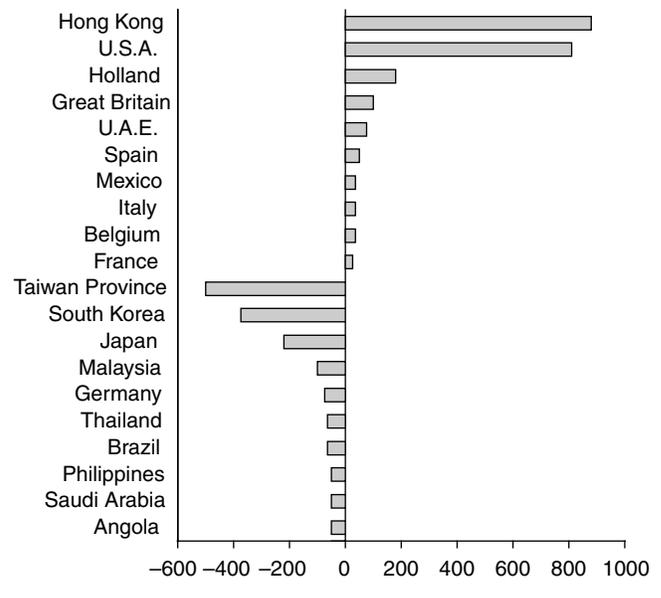
Secondly, because of that integration with the world economy, China is becoming something like a bridge between Asian economies on the one hand, and the U.S. and EU markets on the other. According to the trade balance with her trade partners, since 1990s, China has gradually become the middleman between Asian NIEs, Japan and ASEAN, and the U.S. and EU markets. Every year, China earns a trade surplus from the U.S.A., Hong Kong (re-export to the U.S.A. and EU), and the EU, and transfers most of the surplus to Asian NIEs, Japan, Malaysia, Thailand, and Germany (**Figure 2**).

Finally, because of WTO accession and China's deeper integration into the world economy, more and more economies have gotten involved in China's economic development

FIGURE 2

**China's Trade Balance, 2004: Sources of Trade Surplus and Trade Deficit**

(\$ Hundreds of Millions)



Source: Dr. Song Hong.

TABLE 3

**China's Trade Increase, 2003-04**

Beneficiaries	Increase of Import and Export, \$ billions	Increase of Export, \$ billions	Increase of Import, \$ billions	Share of Export Increase	Share of Import Increase
<b>Total</b>	<b>303.80</b>	<b>155.13</b>	<b>148.61</b>	<b>100%</b>	<b>100%</b>
Asian-Pacific	213.91	105.89	108.02	68.26	72.68
Asia	169.48	72.99	96.61	47.05	65.01
Europe	53.53	34.22	19.37	22.06	13.03
EU	44.59	28.88	15.68	18.62	10.55
ASEAN	27.62	11.97	15.66	7.72	10.54
North America	48.85	35.12	13.78	22.64	9.27
Africa	10.92	3.63	7.29	2.34	4.9
Latin America	13.22	6.37	6.85	4.1	4.61
Pacific	7.61	2.88	4.73	1.86	3.18
Japan	34.33	14.08	20.24	9.08	13.62
South Korean	26.86	7.72	19.11	4.98	12.86
Taiwan Province	19.96	4.54	15.40	2.93	10.37
U.S.A.	43.32	32.46	10.81	20.93	7.27
Germany	12.39	6.31	6.07	4.07	4.09
Australia	6.82	2.57	4.25	1.66	2.86
Malaysia	6.14	1.95	4.18	1.25	2.81
Singapore	7.33	3.82	3.51	2.46	2.36
India	6.01	2.58	3.43	1.67	2.31
Canada	5.51	2.53	2.98	1.63	2.0
Brazil	4.38	1.53	2.84	0.99	1.91
Philippines	3.93	1.18	2.75	0.76	1.85
Thailand	4.68	1.97	2.72	1.27	1.83
Angola	2.56	0.05	2.51	0.03	1.69
Russia	5.47	3.07	2.40	1.98	1.62
Saudi Arabia	2.98	0.63	2.35	0.41	1.58
France	4.19	2.63	1.57	1.69	1.05

Source: China Customs.

process and benefit from it. For example, in 2004 (**Table 3**), some of the resource-abundant countries, such as Canada, also enter the list of main beneficiaries of China's import increase, or improve their position in the list. This is a very important development, because it signals a new stage of the Chinese economy integrating itself into the world economy, that is, from importing from her neighborhood economies parts and components and machinery and equipment, to raw materials and primary commodities. Meanwhile, China's consumption-drive imports are also increasing very fast, because of the quick economic growth and rising per-capita income. For example, because more cars are being sold in the local market, the import of oil has increased dramatically in the last few years. So, the development of Chinese economy provides new opportunities for other countries to share her economic growth.

Moreover, China's non-processing trade (general trade) also provides good opportunities for her partners. According to an analysis published by the IMF (2004), the change of China's general trade has an important impact on her trade partners, especially the Asian economies (**Table 4**). For ex-

TABLE 4

**Effects of 10% Reduction of China's Non-Processing Trade**

	Real GDP, %	Current Account Balance, \$ billions
Asia, excluding China	-0.4	-6.5
Japan	-0.5	-3.5
Asian NIEs	-0.6	-2.0
Other Asian countries	-0.3	-0.7
ASEAN-4	-0.3	-0.5

Source: IMF 2004 *World Economic Outlook*, Chapter 1, Box 1-2, "What Are the Risks of Slow Growth in China?" September 2004, p. 21.

ample, a 10% reduction in China's general trade imports will make the GDP growth rate of Asian economies decrease by 0.4%. Among them, the impacts on Japan and Asian NIEs are most serious. The same change of China's general trade will reduce Japanese GDP growth by 0.5%, and Asian NIEs' 0.6%. Meanwhile, China's general trade decrease also dra-

matically reduces the trade surplus of Asian economies. For example, the 10% reduction of China's general trade will reduce the trade surplus of Asian economies by \$6.5 billion: for Japan, the reduction is \$3.5 billion, for Asian NIEs, \$2 billion.

### III. Challenges and Perspective

The huge inflow of labor-sourcing, industrial-market-oriented FDI establishes a special connection mechanism between the Chinese economy and the world economy. It is this mechanism which is responsible for the quick, stable, and healthy development of the Chinese economy in the last few years in specific and in the last two decades in general. However, the function of this mechanism faces serious challenges.

#### *The Challenges From Inflow of FDI*

1. The reduction of inward FDI: After WTO accession, inward FDI in China has tended to increase, not decrease. However, because of her deep dependency upon inward FDI, it is dangerous and fragile for the Chinese economy to survive a sudden reduction of inflow of FDI.

2. Due to the reduction of labor-sourcing FDI relative to other types of FDI, the effect of the special connection mechanism of the Chinese economy and the world economy on China's economic development will become weaker and

weaker. After WTO accession, thanks to local market liberalization and the gradual rise of labor costs in China, more and more inward FDIs are motivated to target the local market. Moreover, some of the labor-sourcing FDI are being transformed into other types of FDI. This is especially true for Japanese investment in China (*JBIC 2003 Survey*).

3. The share of M&A FDI in China will also increase, and that of greenfield FDI will decrease. Because of this change, the effect of that mechanism will suffer. In November 2003, a new policy was introduced in China. More policy space and more incentives are provided for M&A investment in China. Qualified foreign investors are allowed to buy the A-share in China's stock markets. Moreover, China's government encourages transnational corporations to purchase financially stressed SOEs [State-Owned Enterprises]. This is one of the several most important reform policies to restructuring SOEs. For example, in 2003, Renault and Nissan invested \$1 billion in the DongFeng auto group and acquired 50% of this company. In the same year, Kodak from the U.S.A. invested \$100 million and got the 20% share of Lucky Group. The CITI Group bought \$1.8 billion non-performing loans from Bank of China. So the share of M&A in inward FDI in China reached 7% in 2003, the highest level yet.

#### *The Challenges From International Trade*

1. The limits of the overseas market: Thanks to the inflow of FDI, China's international trade have been growing at more 20% annually since China first opened to the outside world in the late 1970s. Along with the expansion of China's international trade, there also came the constraints of access to overseas markets. China had replaced Japan and Asian NIEs as the world favorite targets of anti-dumping actions. One of seven anti-dumping actions in 1990s, and now one of four anti-dumping actions, is targeting China. And this situation cannot be changed in next ten years, because of the commitments of China's WTO accession. According to these commitments, WTO members can initiate product-specific safeguard measures for imports from China before 2013, and treat China as a non-market economy in anti-dumping and surveillance actions before 2016. As far as textile and clothing imports from China are concerned, a special safeguard mechanism is there before the end of 2008, after the 50-year quota system ended on Jan. 1, 2005. All those treatments are unfair for China, and are not consistent with the basic principles of nondiscrimination. Against this background, we cannot expect free access to the overseas market for China's exports. The textile and clothing trade conflicts between China and the EU, and China and the U.S.A., are the cases in point now. So, what China get from WTO accession is conditional MFN [most-favored nation status], and China's access to other WTO member's markets is partially guaranteed.

2. A difficult role as a bridge: It is obvious that China has been becoming the regional, if not the global, trade intermediary. On the one hand, China earns much more trade surplus

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from the U.S.A., Hong Kong (most of it is also re-exported to the U.S.A. and EU), and EU. On the other hand, China has a huge trade deficit with Japan, Asian NIEs, Germany, and ASEAN. For example, in 2004, China had a \$214.58 billion trade surplus with her top ten trade-surplus providers, and also had a \$116.61 billion trade deficit with her top ten trade-deficit suppliers, even if China only had a \$32 billion trade surplus this year. China now is something like a bridge transforming the trade surplus from the U.S.A. and EU to Japan, Asian NIEs, and ASEAN, with which China has a huge trade deficit. Because of this role of intermediary, China and her trade partners need a new framework to deal with their bilateral trade relations. China needs more appreciation from her trade partners for her role as a bridge. However, it is difficult for each trade partner to appreciate it. Not only China's trade-surplus providers, but also some of China's trade-increase sharers ever take advantage of it. So, the cost of China's development model is very high. This cost is shown itself in trade conflicts with her trade partners.

### ***The Perspectives of This Development Model***

The special mechanism of China's economic connection with the world economy will last for another decade. The reasons are as follows:

Firstly, Chinese economy has not yet finished integration with Asian NIEs, especially Taiwan's economy. Most importantly, deep integration with the Japanese economy is just on the way.

Secondly, the crowding out effect of inward greenfield FDI is not a very serious concern now in China, because the industrial capacity of FFEs is highly complementary with that of the old one China had. In terms of geographical locations, what FFEs have contracted is mainly concentrated on China's coastal areas, while China's old industrial bases are mainly in the west or middle regions. In term of industrial composition, what FFEs have established is mainly the labor-intensive industries, such as textile and clothing and so on, while what China had had was a diverse industrial base, mainly focussed on heavy industries. The former mainly focus on new emerging industries, while the latter the traditional industries. China has an almost unlimited low-cost labor force. Under these conditions, the crowding-out effects from inward labor-sourcing FDI are limited, if not zero. China is still a large developing country, with many investment opportunities untapped, so the crowding out effect is small or limited. However, this effect will increase in the future.

In the long run, the international trade in specific and economic development in general will depend upon the new competitive advantages results from the integrating of the industrial capacity of inward FDI with indigenous industrial bases; and will depend upon the cluster effects of this integration. If the Chinese economy is fully integrated into the world economy, the special mechanism will disappear.