Pacific Economic Review

Pacific Economic Review, 21: 1 (2016) pp. 32–34
doi: 10.1111/1468-0106.12149

INTRODUCTION TO THE SPECIAL ISSUE OF CHINA'S GROWING TRADE AND ITS ROLE TO THE WORLD ECONOMY

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This special issue examines how China's growing international trade plays a substantial role in its own economy as well as the global economy.

We start by considering the overall gains from trade theoretically. The most widely-accepted monopolistic competition model in international trade predicts three sources of gains from trade: (i) consumer gains from access to more import varieties; (ii) firms' markup reduction due to tougher import competition; and (iii) firms' self-selection of more efficient firms into the export markets. Such theoretical predictions have gained empirical support using firm-level data in many countries, including developed countries like the United States and developing countries like China and India. With the present heterogeneous works such as Melitz (2015) and Chaney (2008), the last source of gains from trade (self-selection of more efficient firms) is already well established. However, it is interesting that the first two sources of gains are absent in many theoretical trade models of heterogeneous firms.

Where are the missing gains from trade? The first article by Robert Feenstra insightfully highlights that the missing gains are completely due to the application of the Pareto distribution of firms' productivity, which is set to have no upper-bound. He argues that if the Pareto distribution is bounded above, all three gains from trade once again operate. Without an upper-bound Pareto parameter, the tougher import competition will drive out a mass of domestic varieties, which, in turn, exactly cancels out the welfare gain from increased import varieties. Accordingly, the first two sources of gains from trade mentioned above are completely absent. We then come back to a simple world in which the gains from trade depend on a simple function of the share of expenditure on domestic goods, as demonstrated by Arkolakis *et al*. (2012). Thus, Feenstra's important finding guides us to use a more flexible distribution functional form of firms' productivity if we want to find those *missing* gains from trade.

We then come back to ask how much we know about the global influence of China's growing trade and its fast economic development. Larry Qiu and his

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coauthors provide an excellent review of the recent literature on this issue. After searching the related published literature, they conclude that China's influences on the developed countries are significant. The effects may be strongest in the labour market, with the trade effects on the labour markets of the United States larger than those of other European countries. In particular, China's imports significantly affect employment in the destination countries.

Qiu and his coauthors also ask whether we can observe a phenomenon of export deflation as China exports huge quantities of manufacturing goods with relatively low prices to the rest of the world. They conclude that recent studies overall indeed confirm the low price reduction effects from China's import competition. They then go further one step to explore whether trade leads to resources reallocation within firms and within industries, as well as across industries. Finally, they document that China's growth and integration into the world economy benefit the entire world, although unevenly across regions and over time. They recognize that the overall global influence of China's growing trade and economic development are significantly positive. In addition, the whole world benefits from China's high productivity growth, particularly since China's accession to the WTO in the new century.

China's outward foreign direct investment (FDI) has also increased dramatically in the new century, as has its trade growth. In 2014, China's outward FDI was US$140bn, surpassing its inward FDI flow. China's outward FDI flow accounts for approximately 7.6% of global FDI flow and it has become the third largest FDI country. As recognized by previous studies like Yu (2015), Chinese firms also enjoy a fast growth rate of productivity. However, as documented by Yiping Huang and his co-authors, Chinese manufacturing firms face stringent credit constraints, which was especially the case during the global financial crisis in 2008, as confirmed by other studies, such as Feenstra *et al.* (2014). Huang and his co-authors thus examine the endogenous nexus among outward FDI, firm productivity and credit constraints. Using confidential data on China's firm-level outward FDI volume, Huang and his co-authors obtain a number of interesting findings. First, they confirm that more productive firms are more likely to engage in outward FDI. Such a finding is consistent with the prediction of Helpman *et al.* (2004) and other related works such as Tian and Yu (2015). However, the novel finding of the paper is that the release of credit constrained significantly benefits both the extensive margin and the intensive margin of outward FDI. Finally, even if firm productivity is controlled for, the access to working capital still plays a significant role in firms' decision to participate in outward FDI.

In addition to the possible credit constraint, Chinese manufacturing firms also bear another important input cost: that of land acquisition. This is exactly the topic that is picked up by Liugang Sheng and his co-authors, by observing an interesting feature of the institutional trinity in the land market: state ownership, local political competition and the unbalanced fiscal structure. The paper by Sheng and his co-authors argues that the main objective of land sales for Chinese local governments is to promote industrial growth and to increase their own fiscal capacity. Their findings provide support to the argument of 'state capitalism' in China from a particularly interesting perspective, that of land acquisition.

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Finally, based on the intellectual foundation of the new structural economics initiated and proposed by Lin (2011), Lin and his coauthor provide a proposal to address the issue of infrastructural finance. They propose a strategy of transforming nature resources to productive assets, which is a novel and constructive idea to provide a growth-lifting strategy to the world in the future.

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