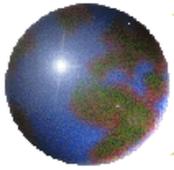


# *Economic Theory Review:*

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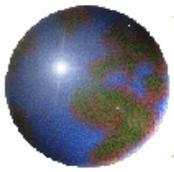
*Dr. Stanley Kwong 邝铁诚*  
*Professor, International Business*  
*University of San Francisco 旧金山大学*  
*San Francisco, CA 94121*

*Strategic Advisor: ChinaSF*  
*Strategic Advisor: Bay Area Council*



## *Economies : 3 Sectors*

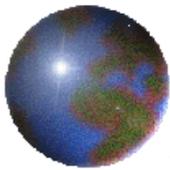
- ❖ Economies are comprised of three sectors.
  - ❖ Primary sector: the extraction and harvesting of natural products from the earth (e.g., agriculture, mining and forestry).
  - ❖ Secondary sector: consists of processing, manufacturing and construction.
  - ❖ Tertiary sector: Services, such as retail sales, entertainment and financial services, intellectual pursuits, like education and research



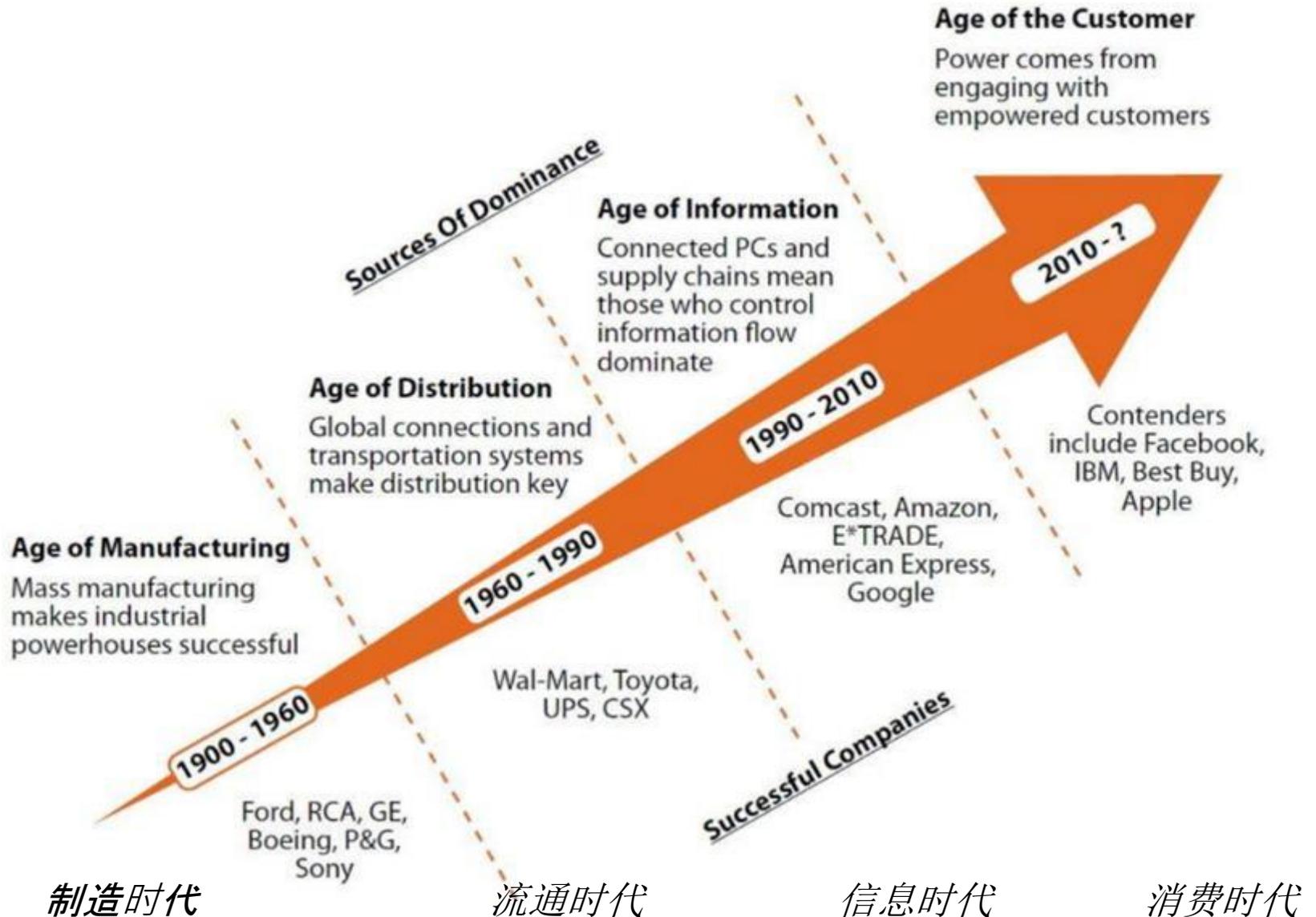
# Economic Structural Transformation

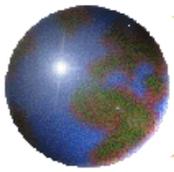
## 经济结构转型

- ❖ Economic shift is important to understand from a sociological standpoint because *it impacts the proportion of the population engaged in various activities that support the economy.*
  - ❖ Structural transformation: Share of workers in China's *non-agricultural sector increased by 20% from 1978 to 1998.*
  - ❖ The Chinese economy is slowly moving away from manufacturing to service
  - ❖ *China's economic growth is gradually slowing as the structural transformation of the economy continues.*
  - ❖ VIDEO: Megatrends - Shift in global economic power
    - <https://www.youtube.com/watch?v=hDHjKHj07qI>



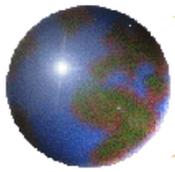
Global business is going through a new industrial revolution, and the future belongs to those who can master the new economic model.





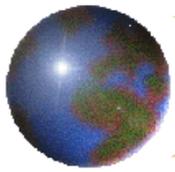
# *Manufacturing*

- ❖ Manufacturing has been the path to development for developed nations
  - ❖ The strategic achievement is to create a high-quality manufacturing sector in order to develop national wealth and power
- ❖ The foundation of global “Great Power”
  - ❖ The most powerful nations are those that control the bulk of the global production of manufacturing technology.. The key to power, then, is to *make* the “means of production.”



# *Manufacturing*

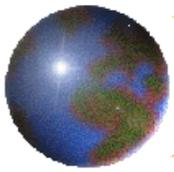
- ✚ Manufacturing is the most important cause of economic growth
  - ▣ Growth and technological improvements of manufacturing machinery output are the main drivers of economic growth.
  - ▣ Example: Microprocessors used in Internet, iPhones, all made by production machinery called semiconductor-making equipment
- ✚ Global trade is based on goods, not services
  - ▣ 80% of world trade is merchandise trade, 20% in services.



# *Manufacturing*

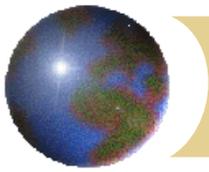
- ✚ Manufacturing creates jobs
  - ✚ Most jobs, directly or indirectly, depend on manufacturing — and reviving the sector could provide tens of millions of new jobs
- ✚ Manufacturing has been the key to prosperity.





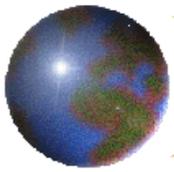
## *The Secondary Sector: Manufacturing*

- ✦ Secondary sector of Economy : consists of processing, manufacturing and construction.
- ✦ As the most productive manufacturer around the globe, China's economy is often nicknamed "*the workshop of the world*".
  - ✦ About 30% of the working population in China is employed in manufacturing in some capacity, creating 44% of the GDP.



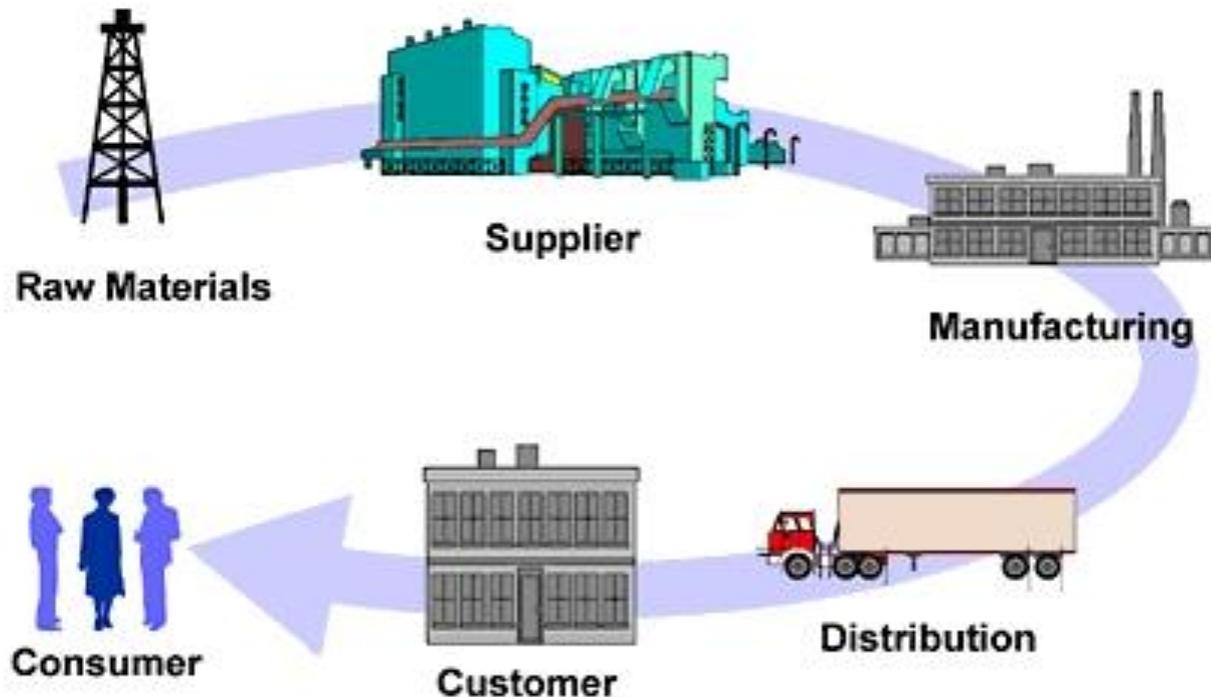
# *“Factory Asia”*

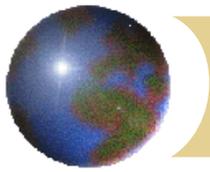
- ❖ Cheap Chinese labor has been crucial to the building of “Factory Asia”, the name given to the region’s complex of cross-border supply chains.
  - ❖ Asia first emerged as a manufacturing power in the 1960s, when Japan began exporting electronics and consumer goods. Taiwan and South Korea followed.
  - ❖ But China’s opening up was the gamechanger. In 1990 Asia accounted for 26.5% of global manufacturing output.
  - ❖ By 2013 this had reached 46.5%. China accounts for half of Asia’s output today. China’s ascent has forged supply chains that reach deep into South-East Asia.
  - ❖ “Factory Asia” now makes almost half the world’s goods.



# *Supply Chain*

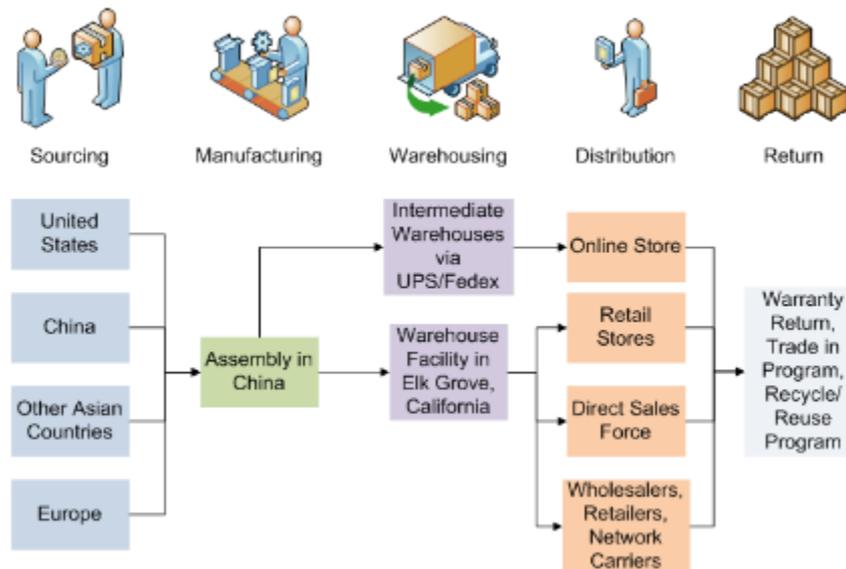
- ❖ A supply chain consists of all parties involved, directly or indirectly, in fulfilling a customer request. The supply chain includes the manufacturer and suppliers, transporters, warehouses, retailers, and customers





# Global supply chains

- Companies in the developed world (e.g. Nike and APPLE), eager to source products and services in places where labor costs are low, have pushed jobs and, in some instances, entire industries offshore — textiles to Asia, call centers to India, auto parts to Mexico.



### Grille

Made in: **Germany**  
Company headquarters: **Germany**

### Hood

Made in: **Netherlands**  
Company headquarters: **Austria**

### Windshield

Made in: **Belgium**  
Company headquarters: **France**  
The Mini's windshield maker, Saint-Gobain, traces its roots to Louis XV, who helped create the glass firm in 1865 to boost the French economy.

### Headliner

Made in: **U.K.**  
Company headquarters: **Spain**

### Outside mirrors

Made in: **Germany**  
Company headquarters: **Canada**

### Seats

Made in: **U.K.**  
Company headquarters: **U.S.**  
Before Johnson Controls made seats for cars, it specialized in heat for houses; its founder patented the electric room thermostat. Today the firm makes the Mini's seats—some with built-in heaters.

### Gasoline engine

Made in: **Brazil**  
Company headquarters: **Brazil**  
Triebec Motors puts the vroom under the Mini's hood. A BMW-Chrysler joint venture, it supplies engines for some DaimlerChrysler models.

### Diesel engine (not shown)

Made in: **Japan**  
Company headquarters: **Japan**

### Front and rear bumpers

Made in: **U.K.**  
Company headquarters: **Canada**

### Exhaust system

Made in: **U.K.**  
Company headquarters: **U.S.**

### Wheel bearings

Made in: **U.K.**  
Company headquarters: **U.S.**

### Wheels

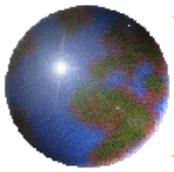
Made in: **Italy, Germany**  
Company headquarters: **U.S.**

## Where do the pieces really come from?

A selection of the Mini's parts reveals the popular little car's complicated global pedigree. Automakers are increasingly turning to international outsourcing to remain competitive. The growing complexity of car designs means there are more parts to find. The Mini's own 250 available options—from chrome-plated roll bars to rain sensors that automatically start the windshield wipers—allow for some 50,000 unique configurations.

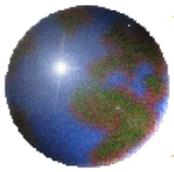


Icon of the 1960s British automobile industry, the old Mini was once a favorite ride of all four of the Beatles. Now German carmaker BMW owns the brand and since 2001 has produced a new Mini (left) in England with parts from companies based around the world.



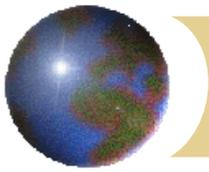
# *US Exports*

- ✪ US Commerce Department's monthly report
  - ✪ 2021: Total exports stood at \$1.64 Trillion.
  - ✪ Total imports: \$2.56 trillion
- ✪ Most of the US exports are manufactured goods.
  - ✪ Boeing is the largest single exporter. Boeing and its local suppliers are part of a global supply chain.
  - ✪ Automobiles are among one of the U.S.'s major exports.
  - ✪ German and Japanese car companies have been locating their auto plants inside the U.S. to avoid tariffs and currency risk, and to have greater proximity to the large U.S. market.
  - ✪ BMW South Carolina is a significant exporters. BMW USA exported over 70% of the plant's total volume.



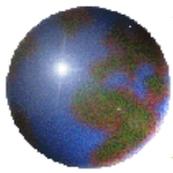
# *USA and global supply chain*

- ⊕ A large share of the fossil fuels produced domestically is being exported.
  - ⊕ Coal miners in Kentucky, oil refinery workers in Texas are key components of global supply chains that funnel crucial energy to consumers and businesses around the world.
- ⊕ In the U.S., services account for about 80% of economic activity.
  - ⊕ U.S. exports \$767 billion of service in 2021.
  - ⊕ U.S. has an annual trade *surplus* in services of \$250 billion.
- ⊕ Thanks to the global supply chain, U.S. service workers are carrying out activity that theoretically could be done in international locations.



# *Service – Supply Chain*

- ✦ Every time one of the 77 million people who visited the U.S. from another country in 2015 conducted a financial transaction, the U.S. national accounts racked up an export.
  - ✦ *People who work at airports, or hotels, or who drive a taxi, are part of the global supply chain.*
- ✦ Employees of universities and colleges are also participating in the offshoring of supply chains.
  - ✦ In 2015–16, more than one million international students studied at U.S. universities.
  - ✦ Every dollar of tuition paid, the rent they pay, the meals and books they buy — is an export.

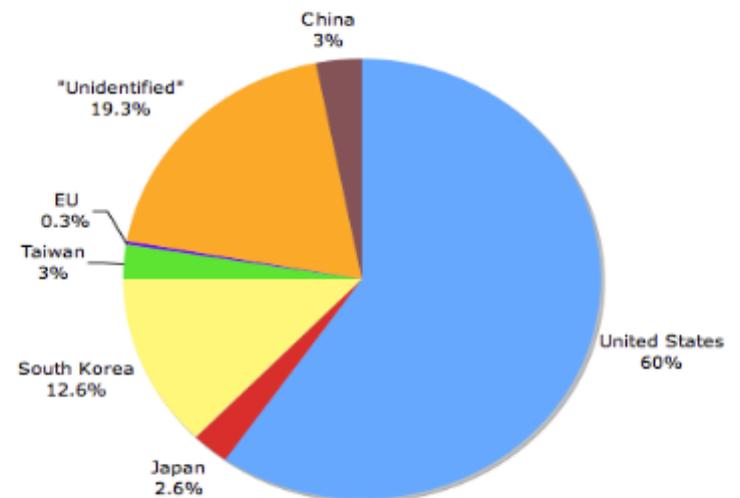


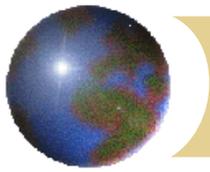
# Processing Trade

- Processing trade refers to the business activity of importing all or part of the raw and auxiliary materials, parts and components from abroad, and re-exporting the finished products after processing or assembly
  - China's processing exports account for more than 50% of its total exports
- "For every \$499 iPad tablet, U.S. takes home \$162. China, which handles the basic task of packing together the final tablet, only grabs about \$8 from the process." 2015*



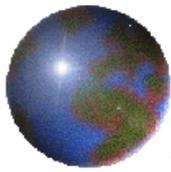
Who Earns Money When Apple Makes An iPad?





# *Processing Trade*

- ❖ Processing trade now accounts for around 40% of China's total international trade (imports and exports).
- ❖ Foreign invested enterprises (FIEs) were attracted to invest in the zones also by favorable tax incentives.
- ❖ FIEs currently account for more than 50% of China's foreign trade and around 84% of its processing trade.



*In China...*

*Everything is possible, nothing is easy.*

*~ McDonald's theorem*

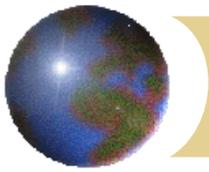


*What is an Foreign Direct Investment?*

[https://www.youtube.com/watch?v=PevMY\\_FaaFQ](https://www.youtube.com/watch?v=PevMY_FaaFQ)

*Understanding Foreign Direct Investment*

[https://www.youtube.com/watch?v=xP3nDn\\_fzGQ](https://www.youtube.com/watch?v=xP3nDn_fzGQ)

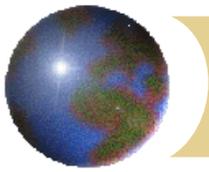


## *FDI and Collaborative Ventures*

**Foreign direct investment (FDI)** is an internationalization strategy in which the firm establishes a physical presence abroad through acquisition of productive assets such as capital, technology, labor, land, plant, and equipment.

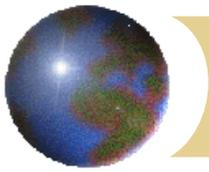
**International collaborative venture** refers to a cross-border business alliance in which partnering firms pool their resources and share costs and risks of the venture.

**Joint venture (JV):** a form of collaboration between two or more firms to create a jointly-owned enterprise.



## *FDI: A Complex Foreign Market Entry Strategy*

- ❖ FDI is the most advanced and complex entry strategy, and involves establishing manufacturing plants, marketing subsidiaries, or other facilities abroad.
- ❖ For the firm, FDI requires substantial resource commitment, local presence and operations in target countries, and global scale efficiency.
- ❖ FDI also entails greater risk, as compared to other entry modes.



## *Patterns in FDI*

- ❖ Companies from both the advanced economies and emerging markets are active in FDI.
- ❖ Destination or recipient countries for such investments include both advanced economies and emerging markets.
- ❖ Companies employ multiple strategies to enter foreign markets as investors, including acquisitions and collaborative ventures.
- ❖ Companies from all types of industries, including services, are active in FDI and collaborative ventures.
- ❖ Direct investment by foreign companies occasionally raises patriotic sentiments among citizens.
- ❖ *China invested \$30 billion on US acquisitions and greenfield projects in 2016. 2013 year marked the 1st time that Chinese investment in the U.S. outstripped US investment to China*

# Motives for Foreign Direct Investment

## Market-seeking motives

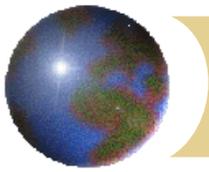
- Gain access to new markets or opportunities
- Follow key customers
- Compete with key rivals in their own markets

## Resource- or asset-seeking motives

- Access raw materials
- Gain access to knowledge or other assets
- Access technological and managerial know-how available in a key market

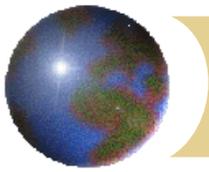
## Efficiency-seeking motives

- Reduce sourcing and production costs
- Locate production near customers
- Take advantage of government incentives
- Avoid trade barriers



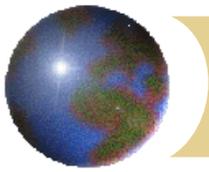
## *Market-Seeking Motives*

- ✦ *Gain access to new markets or opportunities.* The existence of a substantial market motivates many firms to produce offerings at or near customer locations. Boeing, Coca-Cola, IBM, McDonald's, and Toyota all generate more sales abroad than they do at home.
- ✦ *Follow key customers.* Firms often follow their key customers abroad to preempt other vendors from servicing them. E.g, Tradegar Industries, which supplies the plastic that its customer Procter & Gamble uses to manufacture disposable diapers. When Procter & Gamble built a plant in China, Tradegar management established production there as well.
- ✦ *Compete with key rivals in their own markets.*



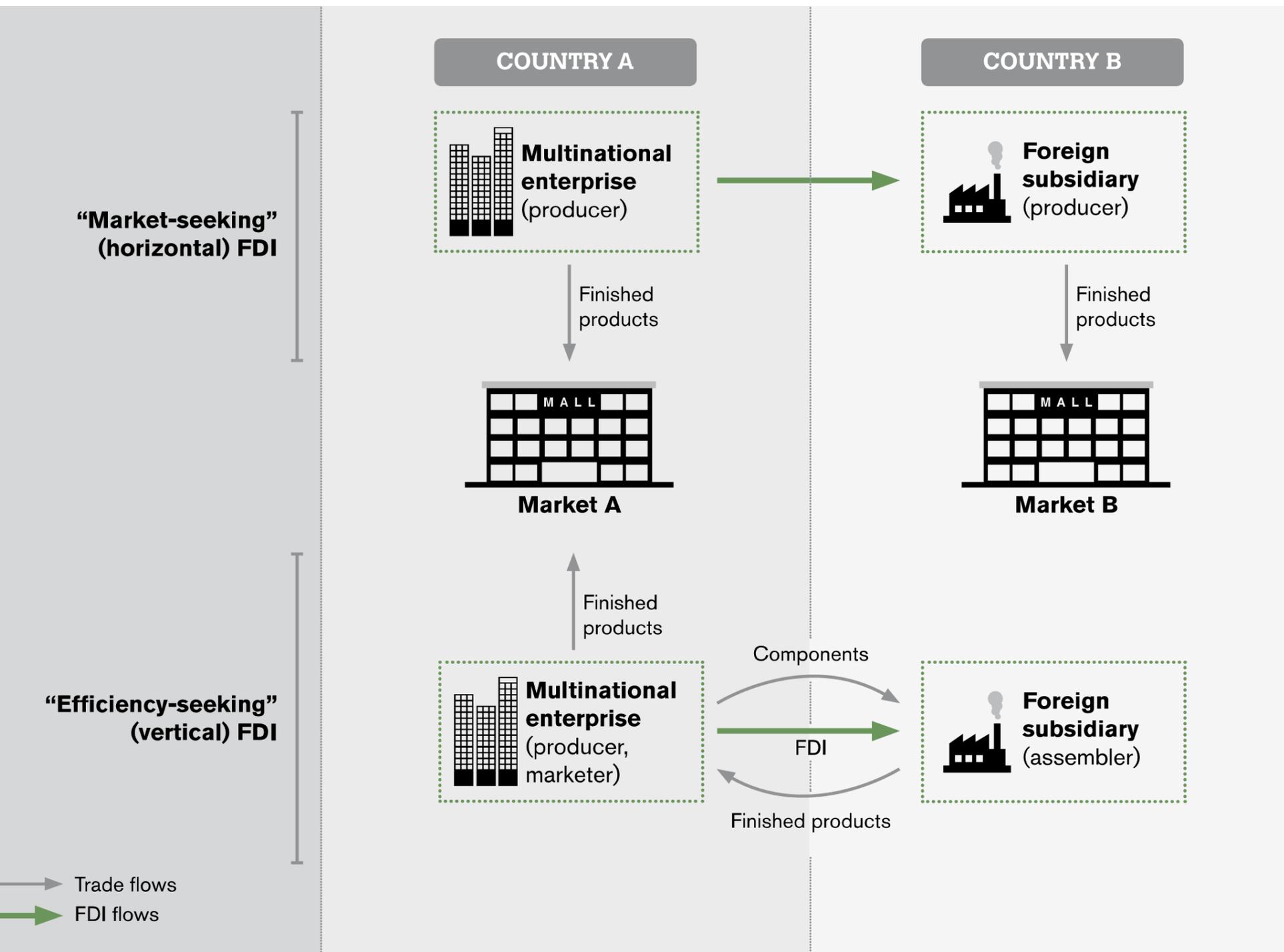
## *Resource or Asset-Seeking Motives*

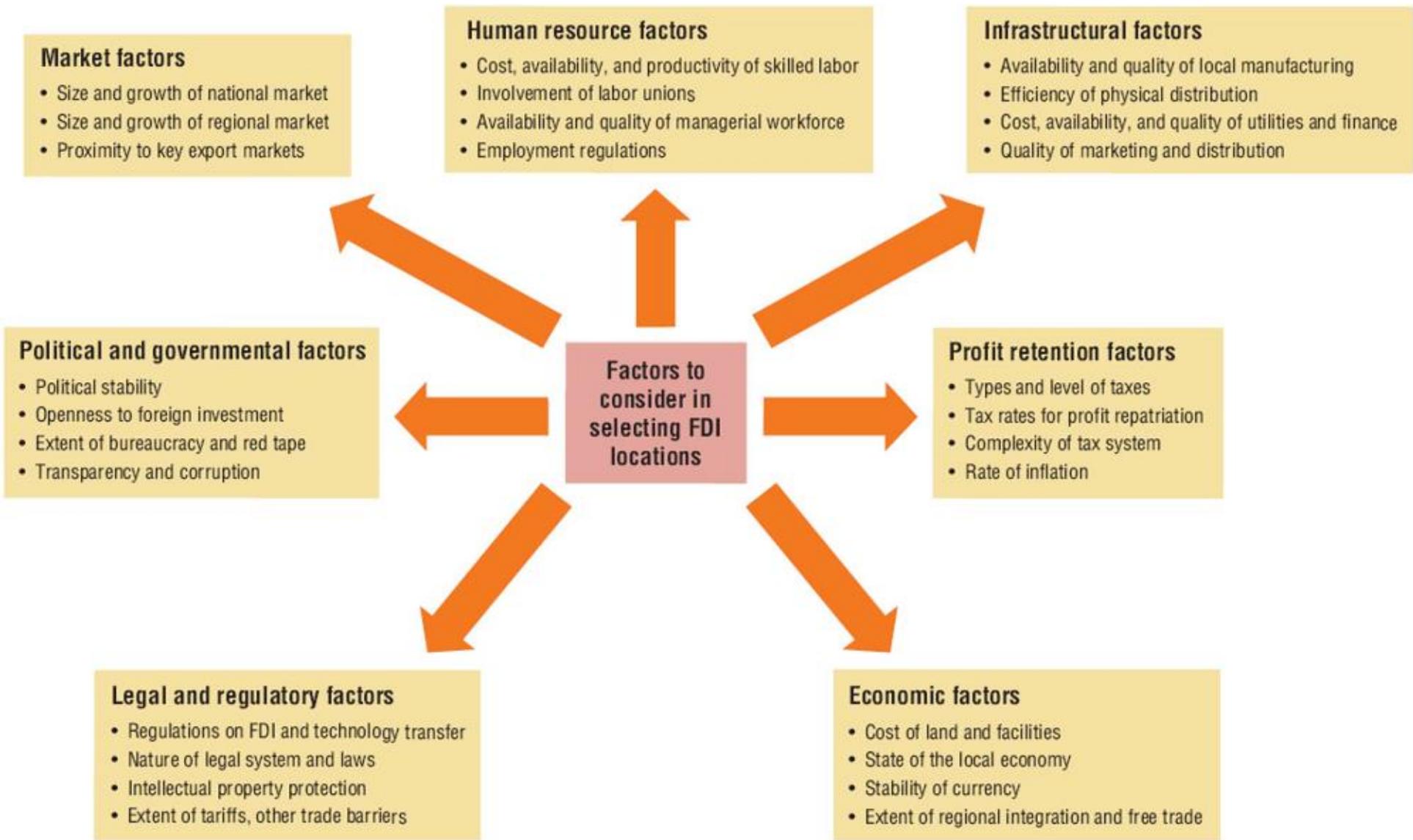
- ❖ ***Access raw materials*** needed in extractive and agricultural industries. E.g., firms in the mining, oil, and crop-growing industries have little choice but to go where the raw materials are located.
- ❖ ***Gain access to knowledge or other assets.*** E.g., when Whirlpool entered Europe, it partnered with Philips to benefit from the latter firm's well-known brand name and distribution network.
- ❖ ***Access technological and managerial know-how available in a key market.*** The firm may benefit by establishing a presence in a key industrial cluster, such as the robotics industry in Japan, chemicals in Germany, fashion in Italy, and software in the U.S.



## *Efficiency Seeking Motives*

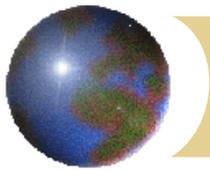
- ✦ *Reduce sourcing and production costs* by accessing inexpensive labor and other cheap inputs to the production process. This motive accounts for the massive development of manufacturing facilities in China, Mexico, Eastern Europe, and India.
- ✦ *Locate production near customers.* In the fashion industry, Spain's Zara and Sweden's H&M locate much of their garment production in key markets such as China, Spain and Turkey.
- ✦ *Take advantage of government incentives.* In addition to restricting imports, governments may offer subsidies and tax concessions to foreign firms to encourage them to invest locally.
- ✦ *Avoid trade barriers.* By establishing a physical presence within a country, the investor obtains the same advantages as local firms. The desire to avoid trade barriers helps explain why Japanese automakers set up factories in the U.S. (1980s).





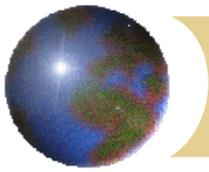
**Exhibit 14.5** Factors to Consider in Selecting Foreign Direct Investment Locations

SOURCE: Adapted from Franklin Root (1994). *Entry Strategies for International Markets*. New York: Lexington Books.



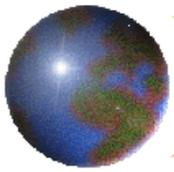
# *Monetary and Fiscal policy*

- ✚ Economic policy-makers have 2 kinds of tools to influence the economy: fiscal and monetary.
  - ✚ Monetary policy involves changing the interest rate and influencing the money supply.
  - ✚ Fiscal policy involves the government changing tax rates and levels of government spending to influence aggregate demand in the economy.
    - *both used to pursue policies of higher economic growth or controlling inflation.*
    - *John Maynard Keynes was a key proponent of government action or intervention using these policy tools to stimulate an economy during a recession.*
    - Reference: <http://www.economicshelp.org/blog/1850/economics/difference-between-monetary-and-fiscal-policy/>
  - ✚ Monetary and Fiscal Policy: Crash Course Government and Politics
    - <https://www.youtube.com/watch?v=tULRch1PRQ>



# *Monetary policy* 货币政策

- ✿ *Monetary policy relates to the supply of money. It is usually carried out by the Central Bank and Monetary authorities*
  - ✦ Setting base interest rates (e.g. Bank of China and Federal Reserve in US)
- ✿ How monetary policy works
  - ✦ Manipulating the supply of money to influence outcomes like economic growth, inflation, exchange rates with other currencies and unemployment.
    - The Central Bank may have an inflation target of 2%. If they feel inflation is going to go above the inflation target, due to economic growth being too quick, then they will increase interest rates.
    - Higher interest rates increase borrowing costs and reduce consumer spending and investment, leading to lower aggregate demand and lower inflation.
    - If the economy went into recession, the Central Bank would cut interest rates

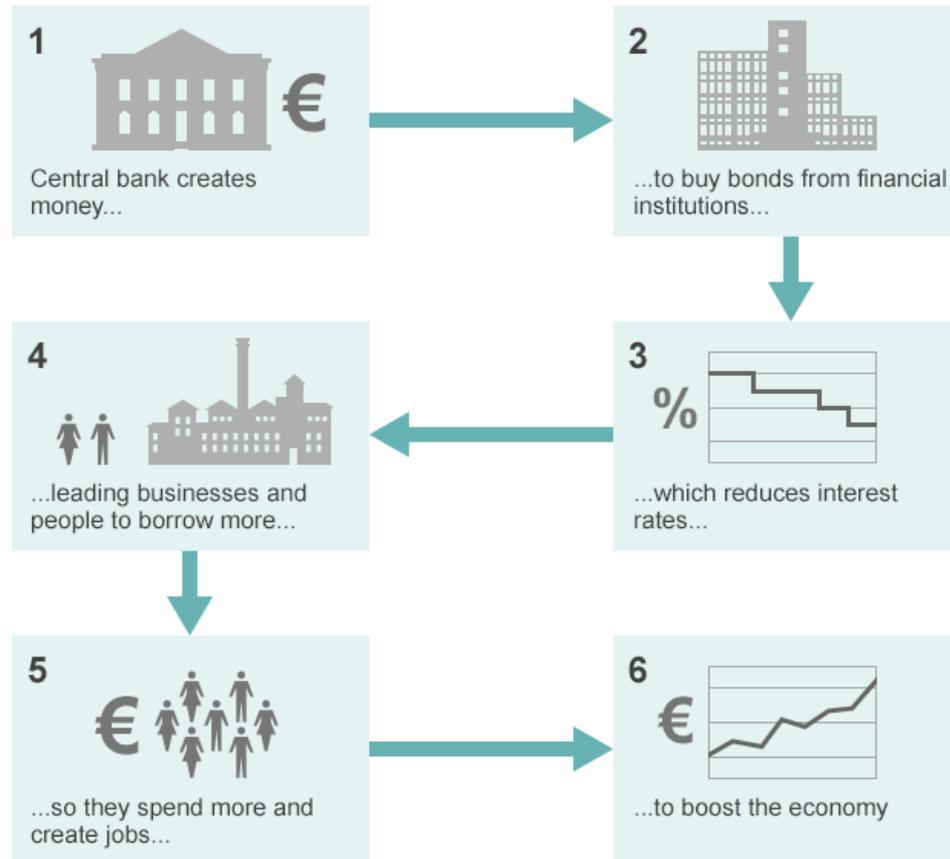


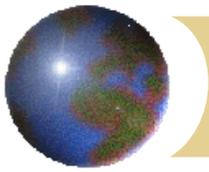
# Quantitative easing 定量宽松货币政策

## Policy of quantitative easing to increase the supply of money

- pumping money directly into the financial system* : The biggest concern is that pumping more money into the economy could ultimately lead to an inflation problem.

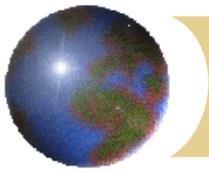
Quantitative Easing: The theory





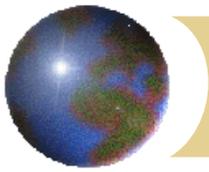
# *Issues with monetary policy*

- ❖ Monetary policy has become more popular because:
  - ❖ Monetary policy is set by the Central Bank, and therefore reduces political influence
  - ❖ Monetarists argue expansionary fiscal policy (larger budget deficit) is likely to cause crowding out – higher government spending reduces private sector spending, and higher government borrowing pushes up interest rates.
  - ❖ Monetary policy is quicker to implement. Interest rates can be set every month. A decision to increase government spending may take time to decide where to spend the money.
- ❖ Monetary policy too can have many limitations.
  - ❖ Targeting inflation is too narrow. This meant central banks ignored an unsustainable boom in housing market and bank lending.



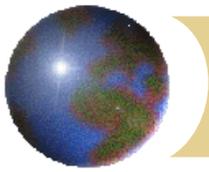
# *Fiscal policy* 财政政策

- ❖ Fiscal policy is carried out by the government and involves changing:
  - ❖ Level of government spending
  - ❖ Levels of taxation
    - For example, when demand is low in the economy, the government can step in and increase its spending to stimulate demand. Or it can lower taxes to increase disposable income for people as well as corporations.
  - ❖ *To increase demand and economic growth, the government will cut tax and increase spending (leading to a higher budget deficit)*
  - ❖ *To reduce demand and reduce inflation, the government can increase tax rates and cut spending (leading to a smaller budget deficit)*
- ❖ Manipulating the level of aggregate demand in the economy to achieve economic objectives of price stability, full employment, and economic growth.



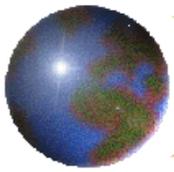
# *Issues with fiscal policy*

- ❖ Fiscal policy can have more supply side effects on the wider economy.
  - ❖ To reduce inflation – higher tax and lower spending would not be popular and the government may be reluctant to pursue this.
  - ❖ Lower spending could lead to reduced public services and the higher income tax could create disincentives to work.
- ❖ Government spending directly creates demand in the economy and can provide a kick-start to get the economy out of recession.
  - ❖ Thus in a deep recession, relying on monetary policy alone, may be insufficient to restore equilibrium in the economy.
  - ❖ In a deep recession, expansionary fiscal policy may be important for confidence – if monetary policy has proved to be a failure.



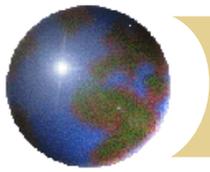
# *Expansionary fiscal policy*

- ❖ In a recession, the government may decide to increase borrowing and spend more on infrastructure spending.
  - ❖ The idea is that this increase in government spending creates an injection of money into the economy and helps to create jobs.
  - ❖ There may also be a multiplier effect, where the initial injection into the economy causes a further round of higher spending. This increase in aggregate demand can help the economy to get out of recession.
  - ❖ *Expansionary fiscal policy (e.g. more government spending) may lead to special interest groups pushing for spending which isn't really helpful and then proves difficult to reduce when recession is over.*



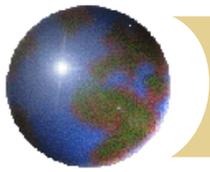
# *Political Economy (PE)*

- ✦ Political economy is the study of production and trade and their relations with law, custom and government; and with the distribution of national income and wealth.
  - ❏ Political Economy (PE) examines the relationship between politics and economics in modern societies and focuses on problems of both domestic and international policy.
  - ❏ The focus is on contemporary issues, such as environmental issues, resource distribution, and the challenges of institutional adaptation and changing political systems.
  - ❏ Political economy
    - <https://www.youtube.com/watch?v=RRWihKcchCE>



# *Washington Consensus*

- ✚ The **Washington Consensus** is a set of 10 market-friendly economic policy prescriptions considered to constitute the "standard" reform package promoted for crisis-wracked developing countries by **Washington**, D.C.–based institutions such as the International Monetary Fund (IMF), World Bank, and the US Treasury Department.



# *Washington Consensus 1*

## ⊕ Fiscal discipline.

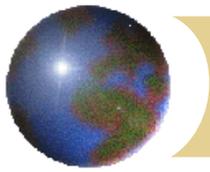
- ⊕ Governments aim to restrict budget deficits to a level that can be financed in a non-inflationary manner

## ⊕ Public spending.

- ⊕ Governments should redirect public expenditure from low-priority expenditures like general subsidies to education, health and infrastructure.

## ⊕ Tax Policy.

- ⊕ In re-designing tax policy, governments should aim to raise revenue by a broad tax base combined with moderate marginal tax rates.



# *Washington Consensus 2*

## ✚ Financial Liberalization.

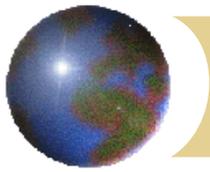
- ▣ Governments should aim for domestic financial liberalization

## ✚ Exchange rate.

- ▣ Should be unified and set at a level that is competitive – neither over- or under-valued

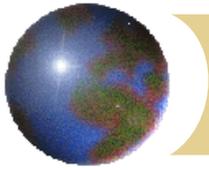
## ✚ Trade.

- ▣ Governments should liberalize trade



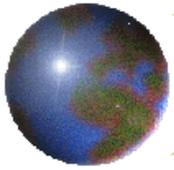
# *Washington Consensus 3*

- ✚ Foreign Direct Investment (FDI)
  - ▣ should be allowed without restriction
- ✚ Privatization.
  - ▣ State enterprises should be privatized – few or no exceptions
- ✚ Entry and exit
  - ▣ industries should be deregulated
- ✚ Secure property rights should be extended to the informal sector



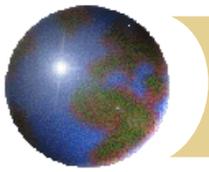
# *Beijing Consensus* (中國模式)

- ❖ Beijing Consensus (Chinese Economic Model) refers to the political and economic policies of China that began with the “Reform and Opening” of China in 1976.
  - ❖ The policies are thought to have contributed to China's "economic miracle" and 8X growth in GDP over 20 years.
  - ❖ Joshua Cooper Ramo framed China's economic development model as an alternative—especially for developing countries—to the Washington Consensus
  - ❖ Ramo has detailed it as a pragmatic policy that uses innovation and experimentation to achieve "equitable, peaceful high-quality growth", and "defense of national borders and interests



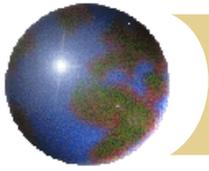
# *State capitalism*

- ✚ State capitalism is usually described as an economic system in which commercial economic activity is undertaken by the state, where the means of production are organized and managed as state-owned business enterprises or publicly listed corporations of which the state has controlling shares



# *China and State Capitalism*

- ✚ China is an autocratic one party state.
  - ✚ State capitalism: China's massive, centrally directed industrial policy, where the government positions huge amounts of capital and labor in economic sectors it intends to nurture.
- ✚ With the West in decline and emerging markets flourishing, China regards state-capitalism as a sustainable model.
  - ✚ China thinks they have redesigned capitalism to make it work better, and a growing number of emerging-world leaders agree with them.
- ✚ State capitalism works well only when directed by a competent state.
  - ✚ Example: Singapore
  - ✚ China has a long history of Mandarin bureaucracy culture.
- ✚ Ian Bremmer: State Capitalism
  - ✚ <https://www.youtube.com/watch?v=4Fn33n4Csi0>
- ✚ State Capitalism Vs. Market Capitalism: Professor T. Miyao USC
  - ✚ <https://www.youtube.com/watch?v=FoahtRKzOfs>



*Thank you*

谢谢