Trade or Tech? China's going global and the truths and myths of decoupling

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Background and Objectives

In recent years, China's global engagement has greatly changed. Since the new leadership took office and the launch of the Belt and Road Initiative (BRI), a number of key turnarounds in Chinese approach to the outside world put the Country under the spotlight of unprecedented international attention, and worries.

Criticisms towards the BRI, the trade conflicts with United States and Australia, the changes into the European Union and many Member States stances and policies towards China and the growing transatlantic consensus on considering China as a strategic competitor and a systemic rival, are all testimonies of the adverse reactions to China's 'new normal' in its global engagement and posture.

Calls and debates about decoupling are to be understood in this context. The rise of this debate is usually dated at the dawn of the trade conflict, with decoupling intended as the prospects of separation between US and Chinese economies. Eventually it gained further strength when the matters of confrontation turned from trade to technologies. However, its roots are in a much longer-term trend originating from the asymmetrical manner China managed its participation and interdependence with the world economy since the opening and reform period. Nonetheless, itself surrounded by scepticism and divergent opinions, decoupling took new momentum with the disruptions created by the Covid-19 Pandemic and strains produced on global supply of industrial and vital goods, to the heights of being deemed potentially capable to put the future of globalisation with China at stake or, at least, to alter its structure (EUCCC, 2021).

Nonetheless, the evolution of the Pandemic and the differentiated responses to its containment in which China has been faster and more effective, to make of it the only major economy having reported economic growth in 2020, rebounded another debate that seemed to have been dismissed under the mushrooming of the adverse reactions mentioned above. The debate about a 'China Model'. Before China's Pandemic recovery started, interests about the peculiar characteristics and motivation of its economic miracle seemed to have lost standing. This not only in industrialised economies, traditionally sceptical about the meaning and even the reasons of existence for this debate, but also in some of the key

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developing and emerging economies candidates to benefit the most of China's most evident going global tool, i.e. the Belt and Road Initiative. At the outset of the Pandemic's outbreak, the diffusion of this scepticism and disrespect reached a global level. But then, with the swifter and accelerated re-opening of the Country, the China Model and the Beijing Consensus (Halper, 2010) strikes back and reignite the debate about state capitalism and related concepts (see Huang, 2008; Lardy, 2014; Gabriele 2010 and 2020).

Within this debate and the recent narrative about China's success, the recent work of Liu and Tsai (2020) sets a new turnaround. According to the authors, Chinese domestic political economy and changing global conditions, the same already mentioned in this work, undercut and restrained China's structural power and hegemonic potential. More specifically, by suggesting that the indicators of success in the current global economy are different from the one traditionally and still widely used, they offer an alternative picture of the presumed success and hegemony prospects of China. They identify three potential sets of weaknesses related to the share of domestic and international markets, the control of the highest end of Global Value Chains and Competitiveness of Transnational Companies (TNCs).

Without the pretentiousness to go as far as the previous authors, the present work focuses on some of the factors mentioned. More specifically the objective is to start disentangling the issue of decoupling by analysing more closely China's actual positioning and participation to global value chains (GVCs). In addition, by relying on the connections between GVCs and innovation set forth by Lema, Pietrobelli and Rabellotti (2019), innovation is introduced into the picture in relation to supply chain resilience. This will lead the work to delve into the issue of dependence of foreign capital and knowledge and to discuss the potential impacts of mechanisms aimed at cutting the flows of knowledge and innovation, such as foreign investments screening mechanisms and other restraints on collaboration (RHG-MERICS, 2019 and 2020). Preliminary findings are discussed to provide some insights and directions to assess what impacts decoupling may actually have China's going global.

Methodology

The main analysis discusses preliminary evidence collected from official international data sources (UNCTAD, OECD and the World Bank) and the China National Bureau of Statistics. Then, under the assumption that decoupling thrives where resilience lacks, a micro-level illustrative case about the analysis of supply chain resilience-related indicators on a sample of Chinese 168 firms at the dawn of the trade war is performed. This latter will help to deepen the considerations of the macro-level analysis and identify directions and instruments for more thorough empirical research on the issue.

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More in detail, the macro-level analysis deals with two main aspects: 1) constraints on “going global” and 2) the dependence on foreign capital and knowledge. Concerning the first aspect, three main topics will be analysed. First, domestic-orientation of Chinese firms using Transnational Index-TNI scores reported into UNCTAD World Investment Report data. Then the work will look at what is referred in here as the *liability of stateness*, which relies and adds to the concept of *liability of foreigness* (Zaheer, 1995) to express the frictions created by the blurred distinctions between State and Private ownership in Chinese firms. In this second regard, evidence of the actual weight of the State in Chinese enterprises is provided by using a re-classification of China National Bureau of Statistics data relying on Petti, Rubini et al. (2018) control-based method. In addition, qualitative evidence from investments screening mechanisms and initiatives on Chinese investments is brought to substantiate the statistics data. Third, an updated picture of Chinese firms’ backward and forward participation to Global Value Chains-GVCs and focus on actual control of property rights by analysing OECD statistics follows. Concerning the latter aspect, some data data from the China National Bureau of Statistics about foreign capital share in exports of several key China industries and main innovation indicators will be used. Eventually, attention will be raised on the extent to which foreign direct investments actually facilitate R&D spill-overs to local firms.

At the micro-level an illustrative case is undertaken about supply chain and innovation resilience via a preliminary analysis on a sample of Chinese firms drawn from the Enterprise Survey for Innovation and Entrepreneurship in China – ESIEC (Zhang, 2018). The case will focus on four sets of factors and variables identified to portrait and detect supply chain crises (Hittle and Leonard, 2011), resilience and flexibility (Rajesh, 2020) integrating demand and financial side factors. These two latters with the aim to include into the picture the exposure to exports, physical channels and customers, as well as to financial distress in order to consider the possible impacts of short and long-term disruptions brought by the Covid-19 outbreak and the Pandemic. Namely, the analytical framework used will consider and distinguish the factors and variables in Supply Side, Production Side, Demand Side and Financial Side

Results

Concerning domestic-orientation of Chinese firms, evidence collected leads to conclude that the constraints exerted on China’s “going global” ambitions and necessities, is a topic that needs to be dealt at the industry (if not at the company level), with more sophisticated indexes than the TNI, and with more qualitative in-depth methods of enquiry. We may discover that in certain industries and sectors is not so weak (or strong) at it seems, with special reference to the high-tech sector.

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Concerning State's weights in Chinese enterprises' sector, findings show that notwithstanding the significant decrease in the assets owned by state-led or related companies, thanks to mixed companies, in 2018 and 2019 (just after the start of the trade war) the State's contribution to the economy overcome the Private one again, after the latter taking the lead between 2014 and 2015. Statistics therefore confirms the anecdotal evidence about the major control of the State in the economy, e.g. the cases about the encouragement of party's cell in private companies or the very recent crackdown on fin-tech companies, with Alibaba at the forefront.

Concerning the participation to GVCs, the fact of China being the 'world's factory' thanks to its huge trade volumes, should not be misunderstood as a clear-cut dominance in Global Value Chains, as the analyses show. As a matter of facts, China's forward participation level has remained relatively flat and still lags behind other major competing economies, including Italy. Altogether, this means that while China's has made incremental progress in import substitution, it has not increased significantly the share of exported components used in other countries' export processing activities. Therefore, China appears as still rather dependent from other countries for its exports. A key factor underlying China's low level of forward participation, as well as its dependence on foreign direct investment has been attributed to the dominance of advanced industrialized countries in controlling intellectual property rights (Liu and Tsai, 2020). In this last regard, data show as China's receipts from intellectual property in international trade, have in fact just only overcame that of Italy and are still dwarfed by the US and the EU, and trails well behind those of Japan and the UK.

Concerning dependence on foreign capital at large, for both trade and knowledge, results provide evidence of dependency on both. With reference to the foreign capital, Liu's and Tsai's (2020) elaborations of CNBS Data, detected peaks of 90% of foreign capital in exports of communications equipment, computers and other electronic equipment's, and an average of 80% in medium and high-tech industries, which remained roughly the same for more than decade. Although thanks to the likeliness of spill-overs, these are not necessarily bad figures, a warning about the real impact of such effects through inward (Fu and Long, 2011) as well as outward (Deng, 2010; Petti, Spigarelli, et al 2019) investments have to be made. Concerning knowledge (and innovation), the picture is quite different since there is an increasing contribution of domestic again foreign-funded enterprises according several innovation indicators, mirroring the foreign-invested enterprises quotas reduction. However, also this phenomenon of minor innovativeness of FIEs in China is to be taken with caution, because of the factors mentioned above (Fu and Long, 2011) as well several other works that identifies a number of reason for this (e.g. Pollio, Barbieri et al., 2016) which can be summarised into the input-vs-outputs paradox highlighted by Gabriele (2020). This latter actually emerges in the analyses made, which shows minor relative weights of domestic against foreign invested firms on the outcomes of innovation.

Overall, these findings demonstrate as the real innovation competition is to be made and

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assessed in the global arena. The cases of ZTE and Chinese Automotive companies shortage in key components, the first produced by the trade-war and the second created by the pandemic value chains disruptions, shed light on the issue of the still relevant dependence of Chinese innovation and value chains on foreign providers and competitors.

About this latter, the illustrative case undertaken on the sample of Chinese enterprises at the micro-level shows as, in terms of supply chain resilience, firms of the sample that are less innovative are more exposed to value chains potentially intended and unintended disruptions. These results provide a potentially viable research direction about the analysis of the relationship between innovation and supply chain resilience.

All-of the above makes assume that Covid-19 shock, combined with the historical situation and environment in which it erupted (i.e. trade-tech conflict and decoupling) may indeed produce a positive push to Chinese micro and aggregate innovation. Recent evidence abound about Chinese heightened policy attention to more independence from US tech, as well as basic R&D expenses increase by enterprises 'forced' by lack or, more precisely, 'denial' of some vital tech inputs. This latter consideration recalls the title of this contribution about the trade and, especially, the tech nature of current disputes and confrontations.

Implications

Findings and discussions highlight research and policy implications.

From the research perspective, the macro-level enquiry and the framework adopted for the micro-level preliminary analyses, leads to the interest and relevance of studying the relationship between resilience and innovation and their recursive nature.

At the edge between research and policy practice, following Gabriele (2020), the work advocates and demonstrates the need for a pragmatic approach in studying, disentangling and providing correct information for rational policy decision-making. It is our work as scholars to avoid framing our researches in a way that could be (mis)used to sustain ideological debates and Manichean juxtapositions. Starting from our own field, we need to frame the issue not as evaluating whether the market on one side, or the government and the state on the other side are good or bad. We need rather to recognize interdependencies and context, distinguishing those fundamental economic relationships that can be defined independently of the institutional-political-juridical set up that a society has adopted from the ones that are specific to a specific institutional setting and society set up (Pasinetti, 2019).

Finally, concerning policy implications, in order to advice and, on some issues, warn policy

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makers on the decisions they are taking, the focus of their reasoning should be mainly on China’s strategy and policies and their interactions in building the big picture, as well as in making it happen, since not all the effects may be intended or foreseeable. These effects, whether single, aggregated, combined, interactive, unintended or divergent are the things to be evaluated and that may be eventually used to label or decide whether a strategy, a reaction and a policy instrument is good or bad. It is belief of the author that it is with this approach that a policy could be made resilient and be able to endure the ups, downs and turn-arounds of political and politics debate, with all its rhetoric, tactics and manoeuvres. A kind of intelligent resilience policy strategy (Di Tommaso, 2020) that helps decision makers to discern the economic reality structure for the political debate conjuncture and, ideally avoid drawing of red lines on the sand or, worst to stumble upon them and producing unwanted, irremediable mistakes. Some suggestion in these regards will conclude the work.

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