Commentary: China's exportation is able to withstand challenges from trade war

By Wang Yuzhu

How much will China be impacted by the tariff slapped by the US? The question can only be answered after evaluation of multiple factors on production and trading links.

Only when the domestic production cost in China remains on the same level while the US imports has infinite price elasticity of demand, the trade war would severely threaten Chinese industries. But the fact is that the cost of exported commodities usually has enough flexible room during production and trading, thus leaving the impact on China limited.

Under the background of China's supply-side structural reform, a tax reduction would be the most direct approach to cope with trade protectionism by lowering costs.

Having similar effect as fiscal subsidies, a tax cut is in line with the big direction of China's ongoing structural adjustment and economic reform, while not violating related World Trade Organization (WTO) rules such as the anti-subsidy duties.

The exchange rate of the Chinese yuan that would be lower in the medium term will be another factor, in that a downward slide of its exchange rate can effectively ease the negative influence of the increased tariffs.

The intra-trade and internal settlement is another weapon to buffer the costs. After the outbreak of the global financial crisis in 2008, China has seen more and more of its enterprises seeking opportunities overseas, giving rise to a great number of small- and medium-sized transnational corporations.

These enterprises are able to change the rules of origin without making large-scale production transfer through the approaches such as intra-trade and internal settlement, and export their products through third-party countries.

Especially with China's continuous industrial adjustment and upgrading, the country has established its comprehensive competitiveness in the production of intermediate goods that require certain extent of technological integration.

After investing in the large-scale production in Southeast Asia in recent years, China has preliminarily built a regional production and trading network led by Chinese transnational companies. As a result, such labor division adjustment can be easily completed in the production network of Asia.

Besides, China is undergoing industrial transmission and making its economy "real" again. After an over-development of fictitious sector, which was the largest threat for Chinese economy in the last decade, China is now pulling itself back and getting to the track of real economy once again.

Though those irrational days witnessed unwise capital flow into the internet industry and the mismatch of social capitals, the false prosperity is getting back under control with systematic management of financial risks. The difficult financing of some fictitious economy projects in the first half of 2018 was a living proof.

The recovery of real economy, which is structural, can not find a clue immediately in statistics such as purchasing managers' index (PMI), but the trend is unstoppable.

The wholly-owned factory built by the US electric vehicle maker Tesla in Shanghai indicates the coming of a new era. Lingang New Area, where the factory locates, is a cluster of industries including international manufacturers of machine tools and robots. The mass production and supply of production materials will result in wide-ranging reform of technology and raise efficiency of domestic manufacturing industry.

Over the past years, the progress in mechanization has been reshaping China’s competitive edge in manufacturing sector. Thanks to China’s enhanced efforts in intensive, as well as technology- and capital-centered production, its advances in technology will substantially ease the impact of the price elasticity of demand on the industry.

The conclusion can also be echoed by the agreement recently reached by Chinese and German automakers. After years of studies and confusion, China has been policy-ready to face a new round of industrial upgrading and transformation.

The redesign of production layout by BMW and Volkswagen in the Yangtze River economic belt is a response to the call of the Chinese market with huge demand, and also an important proof of Chinese cities’ progress in industry growth and business environment.

(By Wang Yuzhu, Research Associate with Shanghai Institute for International Studies)