

Reform Strategies of China's Supply Side from the Evolution of the Global Value Chain Division

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Since the beginning of 1990s, the international division of labor has experienced significant transformation. The model global value chain division has become a new normal for economic globalization and international labor of division. The global value chain is better embodied by the global supply side that is closely related to our life, including the domestic supply side of our own nation. Therefore, an objective understanding of the trend of global supply side, especially the characteristics of the division evolution of global value chain, contributes to a clearer general guidance and strategy of Chinese domestic supply side reform.

I. The Trend and Characteristics of the Division Evolution of Global Value Chain

i. Enterprises, specially the multinational corporations are the micro-foundation for the division of global value chain.

At present, enterprises, especially the multinational companies, through foreign direct investment or / and non-equity methods such as outsourcing, distribute different phases of production in different countries and regions, which in return help them to grab the commercial chances by the international differences, such as the natural resources, policies and regulations, and institutional circumstances etc. In this way, a product or service entails the cooperation of many enterprises from many economies, and the different production processes and its added value are achieved in different economies.

ii. North America, Europe (mainly Western Europe), East Asia, Australia and New Zealand are the three core areas leading the global value chain division.

The production, trade and investment of the rest parts of the world are revolved around three regions. At present, the United States, Germany, Japan, respectively, are the three core areas of the dominant countries in these regional divisions and other economies' division of labor is subject to these three core countries. These three regions have a clear picture of division where the United States is the major leader for "innovation" in the North American division of labor and trade zone, Germany, for European division of labor and trade zone, Japan for East Asia, and

The central government has emphasized on the supply side reform. The division of labor in the global value chain weighs heavily to a nation's economic growth. Thus China should be engaged in the supply side reform and earn itself a better place in the global value chain division.

Australia and New Zealand for “manufacturing” in their part.

iii. There is a coincidental consistence in the evolution of the global value chain division and the development of regional economic integration.

The North America Free Trade Area (NAFTA) and the European Union (EU) are the two successful models of regional integration. They happen to cover the global value chain division of the two core areas. In order to link up the three core regions, the key economies such as the United States, Japan and the European Union, try to build organizations across regions and those are the TPP and TTIP. If the TPP, TTIP and NAFTA are combined together, we will see a huge free trade zone group, dominated by the United States and other developed economies, which is likely to evolve into a new multilateral system. It can be expected that the global value chain division of labor is reshaping the pattern of the world economy, the new rules and system of international economic and trade.

iv. The economies with higher per capita income are more likely to become China's "friends" rather than “enemies” in the sense of the global value chain.

On one hand, China is still a "double low" state (i.e. a country with a low per capita income and leveled at a low end in the global value chain); on the other hand, whether at the overall level or at individual industry level, China tends to import more added value from higher-income economies and to export more added value to the higher-income economies.

v. China is becoming much more involved into the global value chain division, even more than the United States.

Measures by the proportion of foreign added value, China's correlation with the world is kept increasing, whose extent is higher than the one measure by imported intermediate goods. China's association with the United States, Japan, South Korea, China, Taiwan, and Germany is closer; but judging from the trend, China's correlation with the United States and Germany is on the rise while the connection with Japan, South Korea and Taiwan is become loose. Most Chinese industries' value chain correlation indexes, based on the input and output, exceed over 1.5, even higher than the United States. The number of increasing indexes is much larger than the falling ones.

II. Policy advices for China's reform of the supply front

That the global value chain belongs to the global supply side is the solid fact that China is faced with. It should be our strategies for supply side reform to level China up in the global value chain, promote the

transformation and upgrading of the domestic supply side in order to escalate Chinese economy to the medium and high level. Thus, the policy suggestions are as follows:

i. The global value chain factors should be concluded in the reform to form a global value chain oriented strategy.

Whether the new opportunities brought by the division of global value chain can be translated into the actual benefits of the participants, to a large extent depends on the participants' strategies and policies. For a long time, the United States has been closely concerned about the value chain, industry chain, supply chain and its security issues. The U. S. Department of Homeland Security early in 2007 had in particular issued the "Enhancement Strategy for Global Supply Chain Security". In 2008, America proposed the "Comprehensive National Cybersecurity Program" to establish a comprehensive approach to manage the global supply chain risk. Furthermore, in 2012, the White House released the "National Strategy for Global Supply Chain Security" and introduced in 2013 "National Strategy for Global Supply Chain Security: the Updated Version for Implementation". In 2014, America released the "Framework for Improving Critical Infrastructure Cybersecurity". The United States' strategic intentions require our specific attention, and China needs to pay close attention to make a difference in this regard.

ii. China should establish and improve the statistical methods and system based on global value chain as soon as possible with the international community.

The reality shows that the division of the global value chain has posed threats to the conventional statistical methods and system. For example, the traditional customs' gross trade statistics greatly overestimated the China's trade surplus with the US; if measured by the added value of trade, this surplus is lower about 25%. Besides, if the real effective exchange rate of RMB against the U.S. Dollar is measured by the global value chain method, the result is about 6.8 and in this way, RMB is likely to continue to depreciate. To cite another example, the revealed comparative advantage (RCA) indexes of China's industries or products, calculated respectively according to the value added trade and gross trade, will vary largely. It suggests that a new statistical methods and system based on global value chain is beneficial not only to the accurate calculation of the current situation of Chinese domestic supply side, but to the reassessment of many aspects of the existing supply side reform, such as the exchange rate policy, FTA strategy and trade and investment policy, as soon as possible.

iii. China should improve its position in the global value chain division

through the continuous upgrading of its endowment structure and institutional structure.

The ultimate factor that determines a country to smoothly and successfully climb the global value chain and promote the transformation and upgrading of the domestic supply side mainly includes two aspects: endowment structure and institutional structure. First of all, the kind of endowment structure decides the kind status and supply side in the division of labor status and supply side. China should effectively enhance the endowment structure through education and technology development, and thus to provide human resources for getting a higher position in the global value chain and for the transformation and upgrading of the supply side. Secondly, the evolution of global value chain is the result of the ongoing specialization of division. Division of labor booms productivity, and thus reduces the degree of scarcity, but it may increase transaction costs on the other hand. A good economic organization and institutional structure is defined by its ability to reduce transaction costs and improve the efficiency of specialization. With a good economic organization and system structure, endowment structure can be effectively upgraded.

iv. China needs to pay special attention to the development of the private sectors, especially the multi-national corporations, which works to provide a solid micro basis for rising in the global value chain and transforming the domestic supply side.

The status quo of the world division of labor is an objective reflection and result of the evolution of the global value chain division which by its own is the result of the choices of the market and the enterprise. Enterprises, especially multinational companies, the embodiment and realizer of all kinds of advantages, are main body for a nation to climb up in the global value chain. Data show that compared with the major developed economies, China's world-class multinational companies are inferior to the other counterpart, in terms of the number and internationalized level, which doesn't match with China's rapid development and status in the world economy. It also impairs China's rising in global value chain and the transformation and upgrading of domestic supply side.

v. China should actively participate in global value chain management and international cooperation of global value chain security.

The specialization of the global value chains is an unavoidable trend. For China, the crucial question lies not in the participation in the global value chains specialization, but in how to achieve effective involvement in that division of labor and in the process to gradually improve their own status in the international division of labor. China needs to improve the international cooperation in the global value chain management and

security with the "double high" countries (i.e., a country with the higher level of per capita income, located at a high position of the global value chain). This cooperation is as important as the international cooperation in monetary and fiscal policies. Creating a friendly international environment for the global value chain will eventually benefit all the parties concerned, and also help China to promote the reform, upgrading and transformation of its domestic supply side.

Translator/Huang Ruixin