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The Belt and Road Initiative Under the New Era

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***Abstract*—The opening strategy of a country should be adapted to the stage of its economic development. Since the reform and opening-up in 1978, the economy of China has entered a new stage of development-the new normal. The new normal not only means that the strategy of domestic economic development in China turns to supply-side structural reform, at the same time, the new normal is also the logical starting point for China's new opening up strategy- the Belt and Road Initiative. Belt and Road Initiative means that China will look for its own peripheral countries through Belt and Road Initiative. For the peripheral countries of China, China should no longer pursue export and trade surplus, but should promote large imports and trade deficit with RMB. For this reason, Belt and Road Initiative must also go out with the internationalization of RMB and foreign direct investment in RMB.**

Keywords: new normal, the Belt and Road Initiative, the opening strategy

I. INTRODUCTION

Xi Jinping's economic thought should include at least the following three keywords: "new normal", "supply-side structural reform" and "Belt and Road Initiative". Among them, the new normal is the expression of economics in the new era. The supply-side structural reform under the new normal is the internal reform in the new era, and Belt and Road Initiative under the new normal is the opening to the outside world in the new era. They form the reform and opening up of China in the new era. In this paper, Belt and Road Initiative in the new era (the new normal) will be mainly discussed [6][9].(Gong, 2016a;2017)

II. THE PREVIOUS OPENING STRATEGY OF CHINA

Economic development strategy is the basis of the system design, policy formulation and action planning of a country, and the basis of the national economic activities of a country. Among them, the opening strategy is the core part of the national economic development strategy of a country, which includes at least the following aspects: foreign trade strategy; foreign currency strategy; foreign investment strategy; coordination and cooperation between the above foreign economic strategies.

A. The Foreign Trade Strategy and Foreign Investment Strategy of China

It has been nearly 40 years since the reform and opening-up. China is no longer a closed economy, but an open economy. In terms of foreign trade, China has adopted an export-oriented trade strategy aimed at pursuing export and trade surplus (Gong, 2016b)[7].

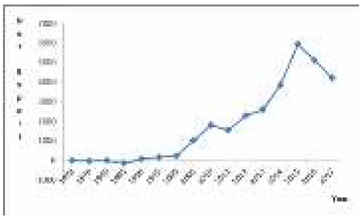

Figure 1 Net exports of China
Data sources: the State Statistical Bureau(2017)[14]

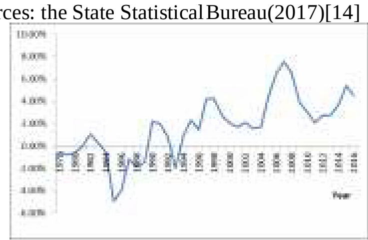

Figure 2 the proportion of net exports to GDP of China Data sources: the State Statistical Bureau(2017)[14]

Figures 1 and 2 show the net exports (exports minus imports) of China and the proportion of net exports to GDP since 1982 respectively. As can be seen from the figure, the values of China's net exports have been positive in almost all years since 1994.

The encouragement and attraction of foreign direct investment is the main measure taken by China over the past three decades in the strategy of foreign investment. In order to attract and encourage foreign direct investment, China has even adopted a variety of tax-free and subsidy policies, although many of the policies have been phased out.

B. The Foreign Currency Strategy of China

In terms of the choice of foreign currency strategy, what the United States and the developed countries implement is a strong currency strategy. The strong currency strategy is about how to make the local currency stronger and stronger in the international competition environment. In essence, the strong currency strategy is a strategy to promote the internationalization of the home currency, the strategic goal of which is to enable other countries use and hold the home currency and currency-denominated assets (bonds, etc.) as much as possible, such as the acceptance of home currency in international trade. (Gong et.al, 2012)[4] The strong currency strategy has three main elements: 1) the open capital market; 2)

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the freely floating exchange rate;3) not only does not accumulate the currencies of other countries, but also owes large amounts of foreign debt, that is, a large number of local and local currency-denominated assets are held and used overseas. Among them, the first two are system guarantee, the latter is its specific strategic goal-currency internationalization. The dollar strategy is undoubtedly the most typical strong currency strategy, the same is true for the euro, yen and pound [5].(Gong,2013)

China's choice of foreign currency strategy is different from that of the strong currency of the United States. For the purpose of ensuring the security of its own economy, China has chosen a weak currency strategy [7]. (Gong, 2016b) Corresponding to the strong currency strategy, the weak currency strategy also has three main elements: 1) the capital market is not open; 2) the exchange rate control; 3) not only does not owe debt, but accumulates a large number of strong currency and its denominated assets, that is, it does not pursue a large number of overseas holdings of local currency and local currency-denominated assets[2][3]. (Gong, 2008; 2012)

C. Driving the External Demands - The Basic Starting Point of China's Foreign Economic Strategy

The above-mentioned opening strategy of China can be regarded as the engine of domestic economic growth: foreign direct investment and trade surplus are mostly external demand, while the reason why China adopted the weak currency strategy (such as a fixed or managed floating exchange rate system that devalues its currency for a long time) is, on the one hand, that it is unable to bear the major responsibility of a strong currency because of the limitations of national strength. On the other hand, more consideration is that the implementation of weak currency strategies is more conducive to attracting foreign direct investment and promoting exports to achieve a trade surplus. In the demand-determined economy, it is reasonable to seek factors from the demand side to promote economic growth, so the opening strategy of China is in line with the development stage of China in the past.

III. THE NEW NORMAL

A. Theory of Economic Growth in Macroeconomics

According to the Theory of Economic Growth (Solow, 1956)[13], the development process can be understood as the process of increasing per capita output. The increase of per capita output benefits from the improvement of per capita capital and technological progress. In reality, the improvement of per capita capital is usually manifested in the combination of rural surplus labor force from land into the city and capital. In fact, such a process is the gradual transformation of the mode of production from labor-intensive to capital-intensive, that is, the process of increasing per capita capital ownership. However, in the absence of technological progress, there is a limit to the increase in per capita capital and output driven by capital intensity. When the economy reaches this limit, only the technological progress can further increase per capita capital and output. Therefore, under the framework of growth theory, the mode of production has two stages of development, it shifts from labor-intensive to capital-intensive and from capital-intensive to technology (or knowledge) intensive.

B. Inflexion Point Theory in Development Economics

There are various types of inflection theory in development economics. The first is the "Lewis Inflection Point" (Lewis,1954)[12]. The so-called Lewis Inflection Point refers to the turning point of labor force from surplus to shortage, at this time, further growth will make wages rise rapidly.

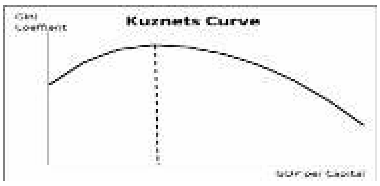

Figure 3 the Kuznets Curve

The Kuznets Curve (Kuznets,1955)[11] is another inflection point theory. According to this theory, the income distribution of a country tends to deteriorate first and then improve with the country's economic development (measured by the level of GDP per capita). Such a law of change can be represented by the Kuznets Curve of figure 3. With the help of the curve, we can find the "inflection point" in the process of the economic development of a country.

C. The New Normal and the Two Stages of Economic Development after Getting Out of the Poverty Trap

The completion of the transfer of production mode from labor-intensive to capital-intensive usually means that the rural surplus labor is gradually absorbed by the modern industrial sector, and the labor market begins to change from surplus to shortage, that is, the so-called Lewis Inflection Point appears. At this point, further growth will lead to a rapid rise in wages. The rapid rise in wages also necessarily means that income distribution is beginning to improve, that is, the inflection point of the Kuznets Curve appears.

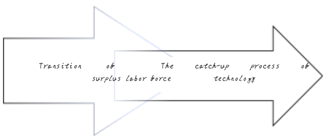

Figure 4 Two Stages of Economic Development after Getting Out of the Poverty Trap

As a result, we can divide the development process of developing countries out of the poverty trap into developed countries into two stages (see figure 4). The first stage is the digestion process of surplus labor force. At this time, the economic position preceded the Lewis Inflection Point and the Kuznets Curve Inflection Point, the mode of production changed from labor intensive to capital intensive, which belongs to the stage of development from low income country to middle income country. The second stage is the catch-up process of technology. At this time, the inflection point of Kuznets curve and Lewis inflection point appear. The mode of production changes from capital-intensive to knowledge-intensive, which belongs to the development of middle-income countries to high-income developed countries.

The new normal means that the economy of China has entered the second stage of development. First of all, China is already a middle-income country. Secondly, after more than 30 years of rapid growth, the large-scale surplus labor force no longer exists in China. In reality, "recruitment difficulties" and "recruitment director" and other situations have appeared from time to time in the eastern coastal areas. Studies show that the current comprehensive unemployment rate in China is about 6.6 per cent (Xu, 2015)[15]. This unemployment rate is lower than that of developed countries in Western Europe (such as France, etc.). Third, the shortage of surplus labor must also mean that wages are rising rapidly (faster than GDP), so that income distribution begins to improve and the inflection point of the Kuznets Curve begins to appear. For example, according to the study of Asian Development Bank, the Gini coefficient of China peaked at 0.491 in 2008 and fell to 0.463 in 2015.(Gong et al., 2017)[10] Fourth, as a developing country, the economy of China has the characteristics of capital-intensive economy to a large extent. Steel production has ranked first in the world for more than a decade, and overcapacity is usually concentrated in capital-intensive industries (such as steel and iron, etc.).

To sum up, China's economy has entered the second stage of its economic development after breaking out of the poverty trap-the new normal.

D. The new normal means that China is no longer a demand-driven economy under normal conditions.

As the labor force has shifted from surplus to shortage, the major feature of China's entry into the new normal is that the economy is no longer a "demand-determined economy", but a "supply-determined economy". This actually means that the supply side is the main driver of economic growth, but not the demand side, which is no longer the demand side of the troika of investment, consumption and import[6][9]. (Gong, 2016a, 2017)

Overcapacity is a structural distortion caused by misallocation of the mode of economic growth. In the face of labor shortages, overcapacity caused by structural distortions does not mean that the economy can be demand-oriented. The operation of any production capacity requires labor. When there is a shortage of labor in the economy and society as a whole, the demand increases, even in those industries with excess capacity, the labor force can only be transferred from one industry to another because of the level of wages. The result is bound to be an increase in production in some industries, a decrease in some, and a limited, or even no increase, in general. But inflation accelerated as wages rose. Because of this, as long as there is a shortage of labor, the economy and society as a whole is a supply-determined economy determined by the supply of labor.

IV. THE BELT AND ROAD INITIATIVE UNDER NEW NORMAL

As mentioned earlier, when a country enters a new stage of development, its economic development strategy needs to be adjusted, otherwise, there will inevitably be a mismatch in the mode of production (or mode of growth, mode of development), thus distorting the economy. Therefore, Belt and Road Initiative should be understood not only from today's world economic order, but also from the new normal of China's economy.

A. On Belt and Road Initiative from the Perspective of the Core-Periphery System

Today's world economic order can basically be regarded as a Core-Periphery System (Dooly, et al.,2003)[1]: the United States and some developed countries are the center region, and the developing countries such as Asia are the peripheral region. The main driving force driving the world economic growth is the large amount of surplus labor force in the peripheral countries and its economic growth model-the Asian model. Countries that adopt the Asian model usually implement a fixed or managed floating exchange rate system, so that the exchange rate can be controlled and the local currency depreciated, thus attracting foreign direct investment from the central countries, promoting the export of their own commodities, and at the same time inhibiting imports and thus accumulating foreign exchange reserves. As a result, the Core-Periphery System is essentially "American production of dollars-world production of goods" (Gong, 2013)[5].

In the case of peripheral developing countries, the depreciation of their currencies through a fixed or managed floating exchange rate regime leads to the pursuit of foreign direct investment and exports, as well as trade surplus. There is no doubt that this is to use external demand as the driving force of domestic economic growth, which can not only consume the country's surplus labor force and promote domestic economic growth, but also accumulate a large number of dollars to guard against financial risks. As mentioned earlier, in a demand-determined economy, it makes sense to look for factors on the demand side to promote economic growth.

There is no doubt that China has been the most important peripheral country in the Core-Periphery System for more than three decades. That is why there has been more economic cooperation and win-win between China and the United States over the past three decades.

However, China has entered a new stage of development-the new normal. The new normal means that not only does China no longer have unlimited surplus labor, but it is no longer a demand-determined economy. Because of this, after entering the new normal, China is no longer suitable as a peripheral country. The opening goal of China in the future should be to gradually make itself a central country. To make yourself a central country, it must find its own periphery. Belt and Road Initiative can be understood as China's attempt to find its own peripheral countries through Belt and Road Initiative in the new era (or the new normal), which embodies the basic thinking of China's opening up in the new era (or the new normal).

B. China's Foreign Trade Strategy under the New Normal

If in the new normal, the general state of China's economy is supply-determined. Then, in order to adapt to the new stage of development of China, its foreign trade strategy should also be adjusted accordingly. Instead of blindly pursuing exports and trade surplus, China should give up gradually. Because the export and trade surplus are usually the export of domestic resources and materialized labor force to serve other countries. If the resources owned by the country are surplus or idle, then the country can solve the excess production capacity through export and trade surplus, and export the surplus products to foreign countries to improve the utilization rate of resources, thus stimulating the growth of the domestic economy. At the same time, it can also increase domestic foreign exchange reserves and effectively prevent and resolve the risks of international financial markets. However, under the new normal, a large number of surplus labor force has been exhausted, the cost of domestic labor force has risen, and the economic development of our country has been restricted by the bottleneck of domestic resources. If we continue to pursue export and trade surplus at this time, we will use our already scarce resources to serve other countries. This will not only not stimulate domestic economic growth, on the contrary, it will worsen the level of welfare in the country. At this time, the import and trade deficit can alleviate the shortage of domestic resources and increase domestic investment through the import of resources and materialized labor of other countries, thus promoting domestic economic growth. For example, if the import is consumer goods, the resources originally used to produce consumer goods can be alleviated and thus used to increase domestic investment.

In fact, under the framework of the neoclassical growth model (that is, the supply-determined economy), we can demonstrate the following trade theorem (Gong, 2016c)[8].

Trade Theorem: In a supply-determined economy, compared with trade balance, the trade deficit will promote economic growth and lead to higher per capita output. The trade surplus is the opposite.

It should be noted that the above discussion is based on the general state of a supply-determined economy, that is, when we only discuss economic growth and not the business cycle. It also means that when the economy is in crisis (or insufficient demand), the pursuit of a trade surplus is not a reasonable choice. For example, when the United States requires RMB to appreciate, it is usually at a time when its economy is in crisis.

C. Trade Transition Supported by RMB Internationalization and Going Out Strategy

We already know that in a supply-determined economy, the trade surplus will dampen economic growth, while the trade deficit can promote economic growth. Therefore, under the new normal, China’s trade strategy should gradually shift from the original pursuit of trade surplus to the pursuit of trade balance, and finally to the pursuit of trade deficit. However, it is undeniable that a long-term trade deficit is unsustainable.

Under the balance of international payments, the current account deficit of a country is either financed by a capital account surplus or will reduce its foreign exchange reserves. Since the foreign exchange reserves of any country are limited, if a country’s trade deficit cannot be paid in local currency, the long-term trade deficit must be covered by sustained capital inflows under the capital account. Whether there can be a sustainable international capital inflow under the capital account depends on a variety of factors, including the rate of return on investment, exchange rate fluctuations, the convertibility of the capital account and the international economic environment. Any factor that affects the expected return of investors at home and abroad may lead to the sudden stop or reversal of capital inflows, thus leading to a currency crisis. Therefore, for most countries, it is impossible to rely on the inflow of international capital under the capital account to maintain a long-term trade deficit.

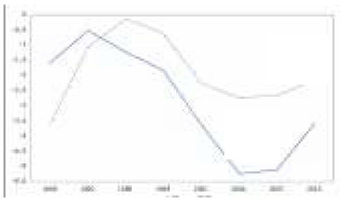

Figure 5 trad deficit of United States and the United Kingdom

However, if the home currency is an international currency, so that its imports can be purchased in the domestic currency, the long-term trade deficit is sustainable. In the mainstream economy and society of the world today, only the United States and the United Kingdom have been long in trade deficit (see figure 5), and the currencies of the two countries, the dollar and sterling, are significantly higher than the only two currencies in global trade in which their countries account for their share of global trade.

In the data of the global international trade, the national currencies with the highest proportion of currency payments

(non-regional currencies) are the United States dollar and sterling, in 2013, US dollars accounted for 39.52%, while US trade accounted for less than 10.37% of global trade. Pound Sterling accounts for 9.13 per cent of payments, while British trade accounts for only 3.17 per cent. It can be inferred that Britain and the United States settle their trade almost in pounds and dollars. That is why the two countries have been able to maintain long-term trade deficits (see figure 5). At the same time, it also shows that if a country wants to pursue a trade deficit, its currency should first be internationalized. For the supply-determined economy, the trade deficit will stimulate its economic growth. Just like the two developed countries, Britain and the United States, domestic economic and social production is more constrained by supply-side factors than by the demand side. The reason why Britain and the United States are willing to be in the position of trade deficit for a long time is that under the stage of their economic development, the long-term trade deficit can effectively drive their economic growth.

Of course, we must acknowledge that China is not currently able to import from developed countries with RMB. However, this does not mean that China cannot import from developing countries that lag behind China in terms of development and still have a large number of surplus labor with RMB. In international trade, what kind of currency pricing and transaction is generally made by the party that is in the active position of both parties. Because of the large number of surplus labor in the developing countries in China, the pursuit of trade export is an inevitable choice for enterprises in these countries. As such, China will be in an active position in the trade process with the enterprises of these countries. Thus, it is entirely possible to pay a large amount of imports with the RMB. It also means that the peripheral countries along the belt and road are mainly those of the developing countries that are backward in development and have a large number of surplus labour. Only in this way can they form a complementary and win-win situation with China.

In addition, the going out strategy of China is another important measure to support trade transformation and RMB internationalization. In the past, the foreign investment strategy of China was mainly to introduce foreign investment and encourage large-scale introduction of foreign direct investment. Under the new normal, the strategy should be transformed into a strategy that encourages the combination of high-level introduction and large-scale going out. Among them, the large-scale going out refers to the transfer of labor-intensive industries to peripheral countries under the background of “Belt and Road Initiative”, which does not accord with the existing comparative of China. The introduction of high level refers to the need to improve the quality of the introduction of foreign capital (that is, the introduction of foreign capital should contribute to the upgrading of Chinese industries). At this stage, the introduction of foreign capital should pay more attention to the quality of foreign capital than not just the quantity of scale.

The strategy of going out of China is by no means simply opening up capital markets. In addition to some necessary strategic high-tech technologies that can use the foreign exchange reserves of China for mergers and acquisitions and investment, China’s going-out strategy should mainly be reflected in the going out of RMB, that is to invest RMB in China’s peripheral countries, transfer to them labor-intensive industries that do not conform to China’s existing comparative advantages, and then sell their products back to China in the form of RMB settlement. This will not only help China to use the RMB to import the scarce resources it needs from peripheral countries on a large scale, and use the resources of other countries, such as cheaper labor outside China, to promote China’s rapid economic growth, but will also help RMB to go out and internationalize the surrounding areas of China.

IV. CONCLUSION

In conclusion, the strategy of opening to the outside world of a country should be adapted to the stage of its economic development. In a demand-determined economy, it makes sense to seek factors from the demand side to promote economic growth, so the foreign economic strategy of China is in line with its past stage of development.

However, after nearly 40 years of reform and opening-up, China has entered the new normal and the second stage of its economic development. The new normal means that China is no longer a “demand-determined economy”, but a “supply-determined economy” in the new normal. For this reason, the main power of economic growth is the supply side.

In a supply-determined economy, the export and trade surplus mean that China not only exports scarce resources and materialized labor to serve other countries, but also reduces its own investment and capital accumulation, thus inhibiting its own economic growth. On the contrary, the import and trade deficit alleviates the shortage of domestic resources by importing other countries’ resources and materialized labor, increases domestic investment and, in turn, promotes domestic economic growth. Therefore, when the economy enters the new normal, the foreign trade strategy of China should shift to import and trade deficit in due course.

However, a long-term trade deficit is unsustainable unless the country can import in its currency. Therefore, the transformation of the foreign trade strategy of China also requires the transformation of the foreign currency strategy, that is, the foreign currency strategy of China should change from the previous weak currency strategy to the strong monetary strategy aimed at the internationalization of RMB. The import and direct investment of RMB from peripheral countries is an important measure to promote trade transformation and RMB internationalization, which is also the main content of the “Belt and Road Initiative” construction of China in the new era.

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