Is the rise of China a threat or an opportunity for the UK?

Michelle Dadey
Third Year, Runner Up Prize

1. Introduction
China’s rise to world dominance as described by British Prime Minister, Cameron, “is one of the defying facts of our age” (Chapman, 2013). Indeed China’s growth over the past 30 years is likely to be one of the greatest happenings in the 21st century. This growth has centered on expanding exports - a strategy many emerging markets have pursued. China’s ability to grow to unprecedented levels has enabled her surpass Japan in becoming the world’s second largest economy and the sixth power in military terms (Franco, 2012). Thus, the possible emergence of China as the leading global economic superpower threatens the American era. This leaves us with the question, “would China overthrow the existing order or become part of it?” While many argue that much focus should be on China’s intentions as an emerging power, the greatest concern is whether China’s growth poses a threat or opportunity to the current international order. This international order from a contemporary Westphalian perspective refers to a society of states whose principal goals are the preservation of the state system (Franco, 2012). However by focusing on ‘agency’ rather than ‘structure’, it could also refer to a Western or better still US-led neo-liberal hegemonic project. The impact of China’s growth on policy and world peace makes this an important topic. This essay thus aims at discussing the effects of China’s rise on the UK economy.

2. The British governments view on China’s rapid emergence
Undoubtedly, the British government is pleased with China’s success and in a three-day visit to China, Cameron asserts,

Britain’s answer is clear, we want to see China succeed. Whether it is welcoming China’s investment in our nuclear energy sector, or creating a Western hub for the renminbi in the city of London, we believe that the right way forward is openness, dialogue, trade and investment; working together for mutual benefit not against each other in a zero-sum game (Chapman, 2013).

In support of this, Foreign and Commonwealth Office (FCO) minister further advocates that China does indeed present opportunities for UK growth. He argues that the best way to recover from the recession is to increase corporation and create sustainable growth through trade. The question however remains, is China’s growth yielding the benefits the UK government claims or would it lead to devastating effects?

3. Does China create opportunities for the success of the UK economy?
3.1 China and investment opportunities in the UK
The graph above indicates that over the years Chinese investment in the EU has increased tremendously. It is noted that the UK is the second destination for Chinese investment in the EU. In light of this, China’s growth inevitably increases investment opportunities in the UK. The completion of many projects are already underway as British companies become a part of huge building projects such as the Beijing International Airport. Though China may appear to be the major beneficiary, one must note that UK participation in such projects secures her position as the leading European destination for foreign investment. Additionally, the UK is reported to have increased its infrastructure spending by £5 billion due to increased Chinese investment. This £5 billion boost would increase development as the UK government states, “countries that succeed in the future are those with the most modern infrastructure” (The Independent, 2013).

Furthermore, China’s plans to invest £50 billion in Britain’s controversial HS2 rail project would enable the completion of the country’s transport and energy project. This has the benefits of driving growth outside London by making transportation easier for those who aim at setting up businesses away from home. With increased business activity in other cities, there would be an increase in productivity and employment as untapped opportunities are exploited. Moreover, as more people settle in other cities, there should be less overcrowding in London – an indicator of development.

Lastly, China’s willingness to purchase stocks in UK nuclear projects is said to provide approximately a £1.8 billion boost to the UK economy and this could be used in the
completion of other projects (Hope, 2013). Likewise, the China Investment Corporation (CIC) has to the benefit of the UK purchased 8.6% of Thames Water (BBC, 2012). One may argue that selling part of state owned resources is not plausible, however the benefit of this has been stated by former Minister of Trade, Lord Jones, “it is good news because in Britain, and the water company knows this, needs constant repairs, so more funds in to help when its not a drain on the public purse has to be right” (BBC, 2012). This purchase would then ease the strain on government budget and China would be partly responsible for fixing any damages. Also, considering current growth, the Chinese corporation may be able to manage the facility better than was done by the UK. Thus, linking Britain to fast growing economies like China would enable economic development.

3.2 China and job opportunities in UK
The result of increased investment is job opportunities. One can consider Chinese investment in London real estate, which increased from £54 million in 2012 to £1 billion in 2013 (Chunyan, 2014). This increased the flow of funds into the British Financial Services Industry thereby creating thousands of jobs. The BBC (2012) reports that the establishment of 90 new companies in the UK has led to a 2,553 boost to UK jobs and this helps to reduce the current unemployment rate of 7.2%. This has knock-on effects, as with more people working, there is increased disposable income, which translates into better standards of living. Increased disposable income also stimulates consumption, thus serving as incentives for firms to increase productivity. This is a change must needed as austerity measures have caused household spending to decline, slightly dampening the economy. In addition, the reduction in unemployment lowers government budget on unemployment benefits. In 2011-2012, job seekers allowance rose by 7.6% from that of 2010 (The Guardian, 2013). A reduction in this amount would enable government use its budget on other projects or better still support struggling business so that there is a continuous cycle of job creation.

Additionally, with Chinese firms setting up in the UK, local businesses can benefit from possible technology spillovers such as technology transfer and learning. This should lead to an upward trend in productivity cycle and stimulate the entire economy. Also, with the adoption of new working techniques, there is increased innovation, which would expand the Research and Development base of the UK and lead to the development of new world class industries. The Innovation Index Report (2010) indicates that between 2000-2008, innovation contributed to 63% of total factor productivity. This figure however dropped to 51% in 2009 due to the recession. Thus a new era of innovation should help recover previous productivity losses. Furthermore, as Chinese businesses employ British workers, there would be increased diversity in companies. This has the benefit of meeting sophisticated demands of diverse customers as they are able to provide broader insight into economic behaviour. Government then benefits from higher corporate tax revenues.

Furthermore, changing demographics in China due to the ageing population, which makes up 12.5% of the population, is causing shortage of workers in certain parts of the country. This has put upward pressure on wages, therefore creating job opportunities for the UK via rising demand for advanced manufacturing (Warwick, 2010). Considering the UK is the sixth largest manufacturer in the world, with manufacturing contributing 11% to national income, the high demand for manufacturing which leads to higher UK exports would be beneficial.
Moreover, increases in consumption as a result of rising wages have created service opportunities. UK retailer, Tesco, currently with 93 stores in China is a typical example in light of this. China’s bid to maintain low labour costs has caused many businesses to move inland, hence the need to improve agriculture, thus the signing of the Food Security Action Plan in 2009. This plan makes the UK the first country to sign an agreement with China to address global food needs, thereby strengthening relations between the two, the benefit of which are discussed below.

3.3 China and UK trade opportunities

From the above graph, despite the relatively low starting point, growth in exports to China has significantly exceeded the growth rate of total UK goods in every year since the financial crisis. This is due to China’s export-led growth strategy, which involves the importation of raw material and foreign technology. Thus as the nation grows so does its demand for raw materials in order to increase production and then increase exports. The high demand for UK imports contributes to UK income. The friendly ties between these two nations, creates opportunities for a EU-China Free trade Agreement, which has already been recognized by Cameron, “Britain is uniquely placed to make the case for deepening the European Unions trade and investment relationship with China... I now want to set a long-term goal of an ambitious and comprehensive EU-China free trade agreement...which would be worth tens of billions of dollars every year” (The Guardian, 2013). There are many gains of trade to be achieved from this as countries specialize in their comparative advantage. The rationality of
this highlighted by Smith, “It is maxim for every prudent master of a family never to make at home what it would cost him more to make than to buy” (Glassman, 1998).

As the free trade intensifies, UK firms could easily set up in China and this would allow them to take advantage of low labour costs as well as China’s proximity to other Asian countries. Moreover, the elimination of the highest tariffs would go on to save UK exporters $1 billion a year as these sectors with the highest tariffs include pharmaceutical, electrical and mechanical goods, which account for 36% of UK exports to China (BBC, 2013). This would also increase exports from the UK thus increasing national income by reallocating jobs and capital from lower to higher productivity sectors of the economy. This is because the increasing exports require more labour in order to increase productivity, and this in turn contributes to growth.

Increased trade also creates competition, which would serve as an incentive for UK firms to increase efficiency as the need to stay on top drives firms to innovate, thereby possibly leading to the development of new technologies. Thus as stated by the Bureau of National Statistics, “America’s ability to compete and innovate is due to its continual search for new markets through the expansion of free trade” (Eiras, 2004). This allows for multifactor productivity to double and as such given the Americans the opportunity to enjoy higher standards of living, one which the UK could benefit from. The emphasis of this further highlighted by Hoover (1930), “Competition is not the only basis of protection to the consumer, but the incentive to progress”.

4. Is the rise of China a threat to the UK economy?

Contrary to the stance of the British government as earlier mentioned, a study on public attitudes to global economic competition revealed 79% of 2,704 people identified China as the UK’s largest threat (BBC, 2006).

4.1 Currency crisis at Chinese banks could trigger a global meltdown

It has recently been established that China’s rapid growth, which has led to a rise in foreign lending, poses threats for international lenders, of which the UK is no exception. In the middle of last year, the Shanghai interbank offered rate (Shibor) spiked and the failure of the Central Bank to interfere led to problems in the ‘shadow-banking sector’. Shadow banking involves the collection of financial intermediaries that facilitate credit creation, but are not subjected to regulatory oversight, what economist term ‘unregulated activities by regulated institutions’ (Brown, 2013). The problem arises because if the ‘Shibor’ remains high for extended periods, businesses would suffer from higher financing costs thereby harming the growth of Chinese businesses, including those set up in the UK. This is harmful to the UK as Chinese businesses in the UK contribute to job and productivity growth. Also this high rate is likely to increase savings thus worsening the savings glut and global imbalances.

Furthermore, bad loans made by Chinese banks have risen to the highest level since the recession, with non-performing loans made by Chinese lenders reaching £58.3 billion (Telegraph, 2014). As companies struggle to pay loans, the Chinese government may be forced to interfere and this may result in their inability to afford financing UK investments. Whether the government would be able to rescue the banks without crashing the system is
one to worry about as a crash of the system could result in a crisis much bigger than the collapse of Lehman Brothers. The main threat however is that in the face of a crisis, the rest of the world would be a part of it, as debts are estimated to be more than 200% of GDP (BBC, 2014).

4.2 Chinese Slow down- biggest worry in 2014
There has also been much worry this year as to whether China’s growth may run out of steam. This is because in December last year, the stock market reflected the slow down in Chinese manufacturing output. Evident in light of this is the FTSE 100 which has dropped 30 points since the beginning of the year. The FTSE 100 includes companies that are strongly linked to the Chinese economy hence reflect the economy’s performance. The slow down could be due to a number of factors - a cheap currency that makes exports competitive but imports expensive, low interest rates, which though great for borrowers not great for savers, increasing wages, etc. As a result, given the level China has grown to, talks of rebalancing are underway. The aim is to move the economy from over reliance on export and investment and towards consumption. As investment declines, UK projects being handled by China are likely to be left uncompleted, with the possibility of Chinese businesses in the UK closing down, thus having adverse effects on jobs. This could lead to a period of uncertainty and worse still stagnation.

Furthermore, as China relies less on exports, global equity suffers as there’s uncertainty, one investors don’t applaud. The switch to consumption led growth implies a fall in trade surpluses, thus lowering demand for Western bonds. The low demand for bonds would cause a fall in its price and an increase in its yield. The effects of which include higher borrowing costs, potentially leading to a fall in corporate investment. Also the high interest rates lowers consumption in Western countries as savings increase, the result being lower output due to low demand, therefore also resulting in less demand for workers.

4.3 Trade between China and UK poses possible threats for local businesses
Despite the earlier mentioned advantages of increased trade between the two countries, one cannot deny the threats involved. Immense trade and the possibility of a free trade agreement, can be said to have undesirable effects on UK infant industries as such firms are unable to deal with massive competition. This is particular considering the existence of imperfect competition and increasing returns that some Chinese firms benefit from. Also, in the long term, as UK imports from China increase, many local jobs would be lost. The rational behind this being imports displace goods that could otherwise have been made by domestic workers.

Again, with increasing dependence on Chinese exports, sudden fluctuations in market demand patterns would worsen the UK’s terms of trade. In other light, the trade war between China and the EU could potentially hurt the UK. The EU have imposed anti-dumping tariffs on certain Chinese goods such as solar panels, and there is the possibility that what starts of as a small dispute could escalate. This would then suppress growth by hindering world trade as supply chains are internationally interlinked. This would undeniably also affect UK growth.
5. Conclusion
In conclusion, it can be said that China accounts for a substantial amount of the growth in global demand. Indeed China can be described as the secret weapon needed for UK growth and development. The rise of China has undeniably led to rising investment, job and trade opportunities in the UK and contributed to growth. However, just like there are two sides to a coin, the sudden decline in the Chinese economy, together with problems in its banking sector, could lead to potential damage in the UK considering the close relation between the two nations. The biggest threat remains, another global financial crisis one which the UK at present is incapable of handling. Hence if China is able to solve its domestic issues, then the UK has nothing to worry about. If not then the threats remain and that may overshadow any opportunities presented.

References


Chapman, J. (2013): “ China’s opportunity not a threat gushes Cameron”. Mail Online http://www.dailymail.co.uk/news/article-2516619/Chinas-opportunity-threat-gushes-
Cameron-PM-uses-interview-say-nations-rise-defining-fact-age-West-doesnt-like-it.html (accessed 18th March, 2014)

Chunyan, Z. (2014): “Real estate spending spree in the UK will create many jobs”. China Daily


The Independent (2013): “UK would welcome Chinese investment in controversial HS2 project, Cameron says”