

## The Economics of China's Opening Up: Developing an Economic Theory That Explains China's Achievement

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构建中国开放型经济学理论，应突破西方主流国际经济学的局限性。一是揭示围绕“三对关系、六条线索”展开的中国渐进式贸易自由化进程的规律。二是总结互联网、数字技术和人工智能等新业态重塑中小企业微观主体地位，培育和形成国际竞争新优势的经验。三是分析共建“一带一路”建立的合作共赢、海陆贯通的新型国际生产分工模式及其蕴含的贸易盈余与资本输出紧密联系的新型国际经济多元平衡观。四是在习近平重要论述指导下，将人类命运共同体全球经济治理中国方案的理念学理化。

**关键词：**中国特色社会主义 开放型经济学 全球治理 人类命运共同体

Research on the construction of a theory for China's open economy should break through the limitations of mainstream Western international economics. Firstly, we need to reveal the laws revolving around "three relationships and six threads" that governed China's incremental process of trade liberalization. Secondly, we need to summarize China's experience of the way new technologies, including the Internet, digital technologies and artificial intelligence (AI) have fostered and reshaped the position of small and medium-sized enterprises (SMEs) as micro-actors, providing us with new advantages in international competition. Thirdly, we need to analyze the new win-win mode of the international division of labor over land and sea established under the guidelines of the Belt and Road Initiative (BRI), as well as a new concept of pluralist balance in the international economy marked by a close connection between trade surplus and foreign investment. Fourthly, under the guidance of Xi Jinping's important discourses, we should offer a rationale for the Chinese scheme of global economy governance within the community of shared future for mankind.

**Keywords:** socialism with Chinese characteristics, open economics, global governance, a community of shared future for mankind

The great achievements of China's construction of an open economy are the result of the

hard work of the Chinese people under the guidance of the theory of socialism with Chinese characteristics established by the Communist Party of China (CPC). It is not the product of the application of mainstream Western international economics to China, nor can it be explained by any Western theory. Chinese scholars of economics are responsible, on the basis of the great practice of China's open economic construction, for deepening, summarizing, enriching and perfecting the theory of open economics with Chinese characteristics proposed by the CPC, and for develop open economics with Chinese characteristics, a Chinese style and a Chinese manner.

## **I. Major Defects in Mainstream Western International Economics Theories**

### *1. Mainstream Western international microeconomics theories*

Why does trade occur? This thread runs through international economics. The theory of comparative advantage put forward by David Ricardo suggests that each country should specialize in the production and export of products in which it has a comparative advantage, and should import those in which it has a comparative disadvantage. The theoretical foundation of a comparative advantage is opportunity cost. Other scholars, however, argue that opportunity cost is not the only reason for international trade, holding that it is also affected by capital, land and other factor endowments. Heckscher and Ohlin hence proposed the theory of factor-endowment (also known as H-O theory). It is undeniable that while comparative advantages and factor endowments can reasonably explain North-South trade, they cannot interpret the North-North trade. According to H-O theory, the United States should import labor-intensive goods and export capital-intensive ones, but the reality is precisely the opposite; this gave rise to the well-known "Leontief Paradox."<sup>1</sup> Since 1980s, intra-industry trade has become the main form of international division of labor. According to economists represented by Paul Krugman, the basis of international trade has changed fundamentally; that is, differences in factor endowments are not the principal reason for international trade. Outdated traditional trade theories ignore technological changes in production, and the two key assumptions of classical international trade theory, i.e., perfect competition and constant returns to scale, do not actually exist. In imperfect markets, economies of scale based on standardized modular technologies are the main driving force behind international trade, facilitating the generation of the new trade theories that open up a new path for explaining the motivations of international trade. The basic assumption of these new theories is the homogeneity of enterprises in the same industry. But with the further development of international trade, this assumption has been proved to fly in the face of reality. One of its important underlying conclusions is that homogeneity means that as long as one enterprise is engaged in exporting, all enterprises in the same industry should do the same, which is obviously not the case. Accordingly, M. J. Melitz has proposed a trade theory about

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1 See Dominick Salvatore, *International Economics*, 11th ed.

heterogeneous firms to explain their internationalizing behavior. According to his new theory, the firm heterogeneity is primarily demonstrated in the differences in their productivity; only those firms with high levels of productivity can cross the export threshold and enter the international market. A “new-new” trade theory thus came into being.<sup>2</sup> It can easily be seen from the above review that the continuous innovations and developments in international trade theory always occur after overcoming the defects of the existing international trade theory.

According to the classical international economic theory mentioned above, developing countries should export primary products and labor-intensive products; this international division of labor will continue to be reinforced and can easily be “locked into the low end.” Consequently, developing countries like China will fall into the “comparative advantage trap.”<sup>3</sup> Even the widely accepted current theory of weak comparative advantage<sup>4</sup> holds that it is hard for developing countries to change the established pattern of division of labor in the short term. The situation, however, has not evolved in line with the expectations of classical Western theory. Instead of falling into the “comparative advantage trap,” China has a capital accumulation rate that is accelerating, leading to the formation of a comparative advantage in the Chinese capital industry that occurred even faster than that of the United States.<sup>5</sup> The “new-new” trade theory offers a reasonable explanation of the decision-making behavior of developed country enterprises prior to the 21st century, a thesis that has been proven in a great deal of foreign empirical literature. But since the introduction of this theory, which is the latest achievement of mainstream Western international economics, sixteen years have gone by, and the international trade model has changed significantly. Firm productivity cannot explain every country’s trade or the development of cross-border e-commerce since the start of the 21st century. The “paradox of Chinese enterprises’ export productivity” put forward by a number of Chinese scholars in recent years is actually a challenge to the “new-new” trade theory. In China, more than 60 percent of the foreign trade volume is attributable to SMEs, which account for more than 90 percent of the total enterprises and their share of foreign trade volume is still on the rise. Even the “new-new” trade theory finds it hard to interpret this phenomenon.

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2 M.J. Melitz, “The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity,” pp. 1695-1725.

3 The comparative advantage trap means that in accordance with its comparative advantage, a developing country produces and exports low-end products while a developed country produces and exports high value-added products; as a result, although they still benefit, developing countries remain at a disadvantage and thus fall into the “comparative advantage trap.”

4 The theory of weak comparative advantage suggests that countries tend to export lower-priced goods with under closed conditions than under open conditions, and to import higher-priced goods under closed conditions than under open conditions.

5 See Pei Changhong and Liu Hongkui, “An Economic Analysis of Xi Jinping Thought on Opening Up for the New Era.”

Dynamic international trade theory is an extension of static international trade theory, focusing on the development of comparative advantage in international trade and its impact on welfare from a dynamic perspective. The H-O theory, which is dynamic, is based on the assumption of invariant technology. It holds that if full employment and steady growth are maintained, the original static comparative advantage will be reinforced and will be hard to reverse. In a sense, the relationship between a developing country's achievement of its goal of industrialization and international trade norms based on comparative advantage is one in which "you can't have your cake and eat it too." If some factors lead to the reversal of a country's static comparative advantage, its economic growth is bound to suffer. Changes in comparative advantage occur at the cost of a fall in economic growth.<sup>6</sup> Obviously, this theory cannot explain the consonance between China's rapid economic growth and the transformation of its comparative advantage. In recent years, dynamic international trade theory has undergone extensive development. Basically, it has introduced macro-growth, technological evolution, dynamic migration and other elements into traditional international trade theory<sup>7</sup> in an attempt to explain the dynamic evolution of the trade model under the circumstances of capital accumulation over different periods, labor mobility across regions, technological endogeneity, etc. However, the theory remains confined to discussions of the innovation and immigration decisions of heterogeneous individuals, at the expense of research on the government's responsibility to ameliorate externalities (the "enabling government role") and on the issue of the fair distribution of social wealth.

## 2. *Theories of mainstream Western international macroeconomics*

Although mainstream Western international microeconomic theories lag behind in their interpretation of practical problems, their basic logical framework is relatively reasonable in general, and the theories they originally developed can explain some of the trade phenomena of their times, especially as concerns trade between developed countries. But these theories, especially the part about the international balance of payments, have never been verified. At the macro-level, their analysis of international economics is basically dominated by the price-based general equilibrium theory. The exchange rate represents the relative price of different currencies in the international market; it is the exchange rate system and the international monetary system that have become the focus of analysis in mainstream Western international macroeconomics. Using the exchange rate to intervene in the international balance of payments has become a "classical theory" in mainstream Western international economics.

6 See Claustre Bajona and Timothy Kehoe, "Trade, Growth and Convergence in a Dynamic Heckscher-Ohlin Model," pp. 487-513.

7 See K. Desmet, D. Nagy and E. Rossi-Hansberg, "The Geography of Development," pp. 903-983; Lorenzo Caliendo, Maximiliano Dvorkin and Fernando Parro, "Trade and Labor Market Dynamics: General Equilibrium Analysis of the China Trade Shock," pp. 741-835.

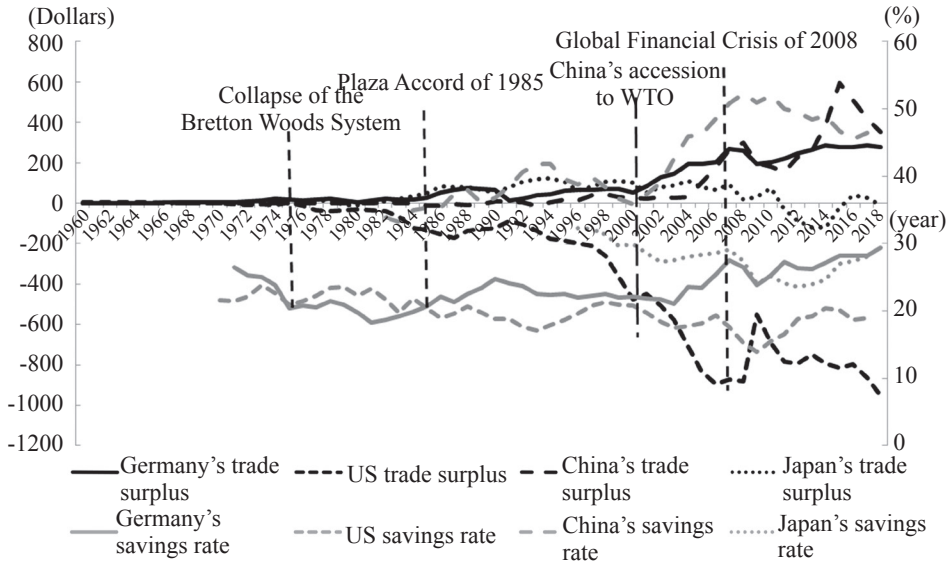
The failing of the international balance of payments theory is mainly manifested in three aspects. Firstly, imperfect markets lead to the failure of exchange rate mechanisms. The basic assumption of exchange rate theory based on the theory of general equilibrium is that the market is perfectly competitive, whereas in the real world no such market exists in international trade. Monopolies of strategic resources (e.g., oil, natural scenic sites) and technology in developed countries and the export controls they impose on developing countries inevitably lead to trade imbalances, which cannot be warded off by exchange rate (price) interventions. Exporters of oil, technology, tourism and other resource monopolies do not change with price adjustments or the international balance of payments. For example, the US trade deficit with China is largely due to its high-tech export controls. Secondly, the export of trade goods that accompanies capital export does not change with the exchange rate. Multinational corporations are the dominant force in the global value chains, and their presence in global industries is bound to promote the cross-border trade of intermediate goods, whereas changes in the exchange rate have no effect on multinationals' internal trade flows. Thirdly, we have the dual role of a low savings rate and currency hegemony. Given the low savings rate in the US, Americans' excessive consumption and reluctance to save guarantee they will be large importers. Some Western scholars even believe that excessive saving in the peripheral countries of the global economy have magnified the US savings gap, and this excessive has been transmitted to the real economy through house prices, stock prices, interest rates and exchange rates, increasing the US current account deficit.<sup>8</sup> Admittedly, the low US savings rate does not fundamentally explain its trade deficit, since EU members with equally low savings rates do not have a marked trade deficit; indeed, Germany even enjoys a surplus (Figure 1). A trade deficit is essentially an external liability that has to be repaid. In order to reduce their foreign debt ratio, EU members make a modest reduction in their imports. The US, on the other hand, relies on the US dollar's position as a world currency, is not restricted by repayments of foreign debt as it can print dollars to cover them. For this reason, exchange rate changes do not alter the trade deficits caused by the hegemony of the dollar. The more a country's sovereign currency function as a world currency, the greater the imbalance in its balance of payments.<sup>9</sup> Trade imbalances are essentially a manifestation of imbalance in the flow of goods and services in the international monetary system.

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8 See B. Bernanke, "Global Imbalances: Recent Developments and Prospects."

9 See Michael P. Dooley, David Folkerts-Landau and Peter Garber, "The Revived Bretton Woods System: The Effects of Periphery Intervention and Reserve Management on Interest Rates & Exchange Rates in Center Countries."

Figure 1 Trade Surplus and Savings Rate Trends in China, the US, Japan and Germany, 1960-2018



Note: The trade surplus unit is expressed in US\$ billion; the savings rate is expressed as a percentage.  
 Source: “World Bank database,” <https://data.worldbank.org.cn/indicator>.

Currency depreciation not only fails to resolve the issue of trade imbalances, but actually makes the imbalance in the international balance of payments even worse. This is mainly manifested in the “currency depreciation trap” and the shock of international hot money. In current account terms, the “J-curve effect” will put the trade deficit even further into the red in the short term. Even after the transmission stage of currency depreciation, many countries (and their commodities) will be unable to achieve the goal of reducing their trade deficit because they do not meet the Marshall-Lena condition.<sup>10</sup> Currency depreciation also creates a “ratchet effect,” leading to competitive currency depreciation. As a result, the country concerned as well as other countries fall into a morass of unfavorable balance of payments. The consequences of the appreciation of the yen and the mark after the Plaza Accord of 1985 have proved that intervention in the exchange rate cannot resolve the issue of trade imbalances.

10 The J-curve effect occurs where a higher trade deficit is followed by deliberate depreciation of the unit of value given that import and export volumes do not undergo a marked change in the initial stage of the transmission of currency depreciation due to market stickiness. The Marshall-Lena condition states that if the depreciation of the local currency leads to a decrease in the trade deficit, the sum of the price elasticity of import and export demand should be greater than 1; otherwise such depreciation cannot effectively reduce the trade deficit.

### 3. *The theory of global economic governance in mainstream Western international economics*

The trend toward multilateralism is evident in the reform of the supply mechanism of global public goods as the G7 summit evolved into the G20 and the General Agreement on Tariffs and Trade (GATT) evolved into the World Trade Organization (WTO). The idea that global public goods should be provided only by a very few hegemonic countries, with the majority of countries merely being passive consumers, is obsolete. Global economic governance based on a theory of “hegemonic stability” has led to an increasing contradiction between the supply and demand of global public goods.

Current global economic governance is essentially a system of “hegemonic leadership” centered on Western countries and fundamentally based on the theory of hegemonic stability. It cannot be denied that this theory made an initial contribution to explaining the 20th century global economic governance system. Daniel W. Drezner believes that it is the size of their domestic markets that endows large countries with unique market power and powers of compulsion which further maintain the normal operation of global economic governance.<sup>11</sup> The hegemonic stability theory has played an irreplaceable role in maintaining the three global economic systems (the world trade system, the international monetary system and the international financial system) over a long period. During the Great Depression of 1929-1933, the failure of global economic governance further deepened the crisis, while the subsequent World War II (1939-1945) led to the collapse of the global economy. The United States took the opportunity to become the global hegemon and, courtesy of the plans of Harry Dexter White, established the Bretton Woods System supported by GATT, the International Monetary Fund (IMF) and the World Bank Group (WBG). Developed countries, especially the United States, using the “principal-agent” relationship of “hegemonic countries and international organizations,” provided global public goods and used their voting rights to selectively supply such goods. This arrangement not only filled the gap in the supply of global public goods, but also guaranteed the interests of hegemonic states, maintaining a relatively stable worldwide economic order for more than a decade after WWII.

Post-Cold War global economic governance was essentially a sort of hegemonic governance that was constantly supported by Western media. Post-hegemonic cooperation theory even holds that unipolar global economic governance will still work in the post-hegemonic age, and that even after the decline of the American economy, “relational authority” can operate independently by virtue of its function, thus maintaining the institutional hegemony of the United States.<sup>12</sup> However, in the post-hegemonic era, instead of becoming a tool for maintaining hegemonic stability after the relative decline of the hegemonic countries, these institutions have become an important means for countries’ discourse competition in global

11 Daniel W. Drezner, “Globalization, Harmonization and Competition: The Different Pathways to Policy Convergence,” pp. 841-859.

12 See Robert Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy*.

economic governance. What has come to the fore in the world political and economic order is the dissatisfaction expressed by countries around the world and their demands for reform to the current system.

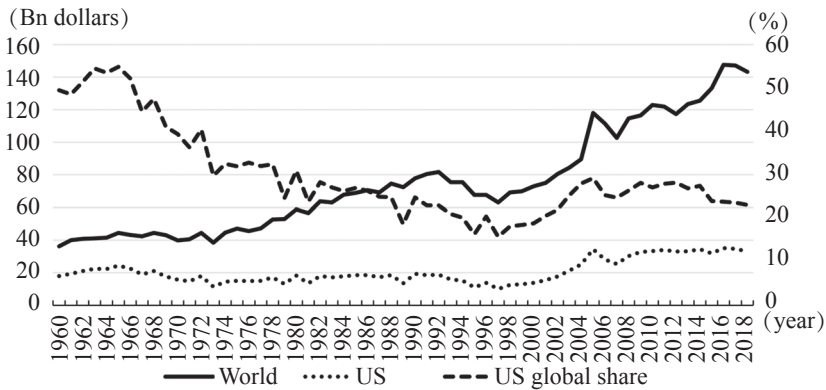
Currently, the economic strength of countries that provide global public goods goes up and down, and showing a marked mismatch between supply and demand. Firstly, in recent years, the willingness of the United States to provide global public goods has decreased significantly, as has the quality of those goods. For example, the temporal trend of official development assistance (ODA) in global and the USODA shows a marked scissors effect. Following the global financial crisis in 2008, there was a steady increase in global ODA but a marked decline in US ODA (Figure 2). In the long run, the reduction in the US supply of public goods is actually a continuation in the international market of its domestic contradictions. Since the sustained trade deficit intensifies these domestic contradictions, the US has had to sacrifice the provision of global public goods to accommodate its electoral politics, which is what is known as the Triffin dilemma in international economic governance.<sup>13</sup> Firstly, the United States wants to retain its discourse right in international economic governance despite its reluctance to provide free global public goods. Secondly, there is a growing willingness among developing countries, particularly economies in transition, to provide such goods. Their growing economic strength means that economies in transition want to have discourse rights in the world economic governance system through the provision of global public goods. Thirdly, there are two structural contradictions in the supply and demand for global public goods. One is the striking mismatch between supply and demand. Currently, global public goods are mainly provided by the hegemonic US, leaving few for other countries. The other is the contradiction between global and regional supply, an imbalance that is mainly evident in the asymmetry of regional supply. At present, global public goods are becoming increasingly unavailable in terms of spatial accessibility and cannot easily be transmitted to “nerve endings,” leading to marginalization of many developing countries. For example, the terms for development assistance of the World Bank and the WTO are politically charged and NGOs cannot directly participate in WTO decision-making. The potential conflict between “strongly politicized” powers and “weakly politicized” network governance mechanisms and “de-levelization” constitutes the inherent tension in the reconstruction of the global economic governance system.

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13 The original Triffin dilemma focuses on explaining the inherent contradiction between the global status of the dollar and the balance of payments. A balance of payments surplus is a prerequisite for maintaining the dollar's world currency status. However, the dollar has to be hoarded outside the US because other countries need to use it as a reserve currency. The two requirements are contradictory, resulting in the paradox set out in the Triffin dilemma. Current international economic governance also has a similar internal contradiction in the field of international finance, that is, the contradiction between the provision of global public goods and the unwillingness of domestic people.



Figure 2 1960-2018 World Trends and US Trends in Official Development Assistance



Source: “OECD Official Development Assistance (ODA),” <https://data.oecd.org/oda/net-oda.htm>.

## II. The Theoretical Implications and Successful Experience of China’s Incremental Opening Up

Mainstream Western international economics comprises international trade theories simply generalized from the perspective of developed capitalist countries and their economic practice in controlling the world market. For the developing countries in general, the first questions are how to reach and how to fit into the world market, and how to solve the major contradictions encountered in integration into the world market. Hence the intellectual elite of developing countries who have returned from study in the West are bewildered by their own immediate problems, since the theories of mainstream Western international economics cannot provide any insights or answers. The first task for the economic theory of China’s opening up is to reveal the basic practices and laws of China’s trade liberalization. Solving this important problem is one of the major points that distinguish this economic theory from mainstream Western international economics, and will also be the greatest theoretical contribution of China’s opening up practice to the opening up of the world economy.

The whole rich and brilliant story of China’s opening up basically revolves around “three relations and six threads,” including 1) the relation between industrial and regional opening up; 2) the relation between residential and non-residential opening up; and 3) the relation between border and beyond-border opening up. China took the path of gradual institutional transition. The special economic zones (SECs) of forty years ago, WTO accession eighteen years ago and the present pilot free trade zones (FTZs) and free trade ports (FTPs) all demonstrate and constantly upgrade these basic relations. Due to the different speeds and rhythms of opening up, the degree of openness within each set of relations was not an initial match, but as opening up gradually deepened, the two factors in each relationship began to move toward integration.

From the perspective of the first pair of relationships, that between industrial and regional opening up, Chinese practice followed the path of “point-axis-plane.” Industrial and regional opening up mostly involved providing industrial and spatial access for foreign products by reducing tariff and non-tariff barriers. Both industrial and regional opening up took an incremental path, starting from certain areas and industries and gradually replicating the successful experience of using a mixture of compulsion and incentives overall industries and the whole country, and then combining the opening up of upstream and downstream linkages in industry and the opening up of regions from within and externally. In terms of industry selection, opening up started from the manufacturing sector with step-by-step tariff reductions in some sensitive sectors. In terms of selection of locations, the concentration of policy resources in a “park-style” opening up model was a basic experience in China’s incremental opening up. From the SECs in the 1980s, the bonded areas under special customs supervision in the 1990s, the export processing zones and bonded port areas in 2000, the comprehensive bonded areas from 2007 on to the FTZs in 2013, China has made “park-style” opening up as the breakthrough point of continuous integration of industrial and regional opening up. At present, China’s opening up has entered a new stage, with its FTAs meeting the highest international standards for opening up. With the continuous acceleration of the opening up process, policies related to economically functional areas have been replicated in different places, and regional opening up and industrial opening up have tended to converge.

In terms of the second set of relationships, that between residential and non-residential opening up, Chinese practice has followed the path of market access from differential treatment of ownership to national treatment. Initially, openness to residents and non-residents also differed. The market access policy for residents was mainly reflected in the continuous revision of the Catalogue of Investment Projects Subject to Governmental Approval. In the early years of reform and opening up, due to the incomplete state of the market economy, the small and scattered nature of private enterprise was and other issues, the government placed market access restrictions on private enterprise in upstream industries related to the national economy and people’s livelihood and had the attribute of public goods, but these restrictions were lifted successively as the market economy improved. Access policies for non-residents were also being relaxed from positive to negative investment access lists and from differentiated treatment to pre-establishment national treatment. The sequence of opening up to residents and non-residents in the financial field was also different, evolving from differential treatment of non-resident fund storage and financial market investments (e.g., the difference between residents and non-residents in stock market investment), to partial integration in the case of qualified institutional investors (QFII and QDII) and the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect programs, and thence to the gradual integration of resident and non-resident financial business in the China (Shanghai) Pilot Free Trade Zone (SHFTZ).

From the point of view of the third relationship, that of the initial opening up of borders

and later opening up beyond borders, China followed the path of opening the border first and then later opening up beyond borders, a practice that was instrumental in solving the main contradictions in different stages. Merchandise trade falls within the ambit of border opening, while services trade and investment mainly involve beyond-border measures. In the initial stage of opening up, the opening up of merchandise trade and services trade were separated. The former was relatively speedier because this sort of trade was less involved in domestic market regulation, enjoyed a comparative advantage arising from labor endowment, showed a stronger drive and had lower institutional barriers. The average tariff rate in China had fallen to 7.5 percent in by 2019, while services trade and investment openness remained at a low level. The opening up of service industries tends to be slow, since China's finance, telecommunications, logistics and other service industries were developing from a low base and domestic institutional reform faced great obstacles. Comprehensive opening up over a wide range would have led to huge economic shocks. In recent years, with the development of its service industries, China has gradually relaxed market access for service industries, leading to a gradual lifting of restrictions on the proportion of shares owned by foreign capital in finance and other fields and expansion of the operations of foreign-funded financial institutions in China. This is also the case in the investment field. At the beginning of reform and opening up, China faced two major problems: the insufficient supply of domestic capital, which entailed an urgent need to attract investment; and the unbalanced development of various industries, which entailed the need to protect those that were still immature. As a result, China implemented differential foreign investment access mechanisms in different industries, lowering the market access threshold for investment in sectors with strong manufacturing competitiveness while retaining part of the restrictions in sensitive industries such as automobiles. The improvement of China's science and technology has enabled great progress in such industries. The relaxation of restrictions on the proportion of foreign shareholdings could fundamentally enhance their competitiveness, allowing China's manufacturing industry to achieve a more balanced and complete development. In the financial sector, the Shanghai Pilot Free Trade Zone (SHFTZ) has developed closed free trade accounts, enabling the successful integration of beyond-border opening up and border opening up by means of electronic monitoring. The combination of electronic and physical networks upper vision has become an innovative way for the SHFTZ to expand opening up in the services trade and develop and integrate border opening up with beyond-border opening up.

In the forty years since the reform and opening up, the basic law of economic openness has been the quest for a breakthrough point in the continuous approach toward and integration of the three relationships' six forms of opening up and the exploration of the country's own development path. China has learned the following basic lessons from its opening up practice: it is necessary to keep breaking down contradictions (including space-time contradictions and object contradictions), to resolve easy problems first and then difficult ones, to cross

the river by feeling for the stones, and to pave the way for its closed economy to shift to an open economy by breaking through institutional constraints with special policies involving top-level design. Revealing the basic practice and laws of China's opening up has not only provided important theoretical support for the theory of an open economy with Chinese characteristics, but has also become its basic academic paradigm: the unity of historical logic and the logic of economic theory.

### **III. Theoretical Contributions of the New Advantages of Chinese Enterprises in International Competition**

Some Chinese scholars used to regard the theory of comparative advantage as a textbook explaining the development of its foreign trade. It is undeniable that the theory played an important role in explaining China's economic development and opening up in the early years of reform and opening up, but a full interpretation of China's current economic affairs has become increasingly difficult as the country reforms and upgrades its economy. The classical theory of comparative advantage needs to satisfy two basic conditions: the failure of the factors of production to flow freely and the absence of change in the supply function in the short term. However, the deepening of financial globalization and the development of information technology have rendered these assumptions invalid. In China, a large number of homogeneous and platform-based enterprises coexist. It is precisely the transformation of micro-level businesses by the Internet and platform-based enterprises that explains the underlying reasons for China's lasting competitive advantage in international trade. Unfortunately, all this has not entered the research horizons of mainstream Western international economics. More importantly, for a digital economy, the inputs into comparative advantage theory cannot fully demonstrate enterprises' subjective dynamism. It is therefore urgent for scholars to give serious thought to the applicability of the traditional comparative advantage theory to China.

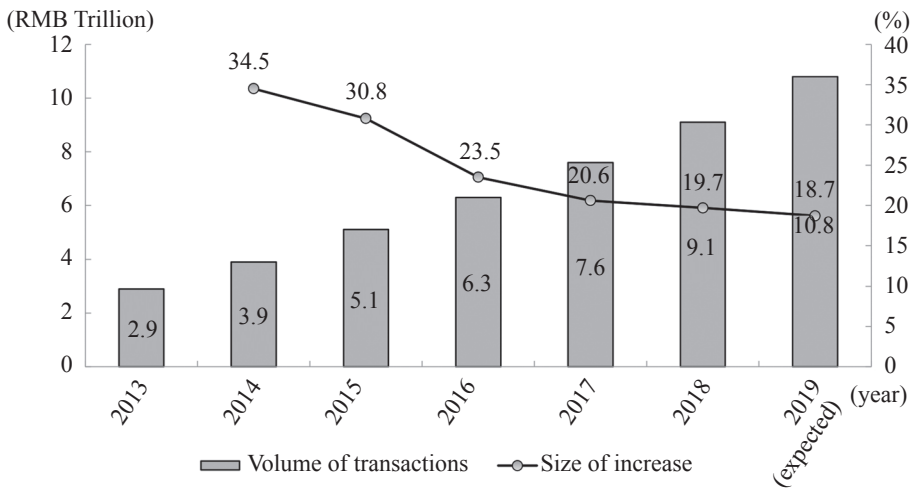
*1. The Internet and digital technologies have changed the micro-level players in the international division of labor, while the "long tail effect" has lowered the threshold for enterprises to enter the international market*

The "new-new" trade classic research conducted by Meritz *et al.*, the latest mainstream Western international economic theory, defines the new comparative advantage from the perspective of enterprise productivity. It explains the decision-making behind enterprise exports in monopoly competition, assuming that demand elasticity is constant, the supply function of different sectors in different countries varies, and cost is the only determinant of the supply function. This theory is reasonable enough as an explanation of the internationalization of firms in developed countries prior to the 21st century. It is undeniable, and has indeed been verified in a great deal of empirical literature, that the heterogeneity of firm productivity has largely been shown to have a significant impact on firms' exports, and

productivity is key for their entry into the global market. But enterprise productivity cannot explain either every country's trade or 21st century online trade. Connection is the essential attribute of the Internet. With the increase in the number and dimensions of relations, nodes of production and exchange are efficiently connected across the world. The borderless nature of the Internet has lowered the threshold for international trade and altered traditional business modes and types.

With the rising trade protectionism of recent years, cross-border e-commerce players are motivated to grow, maintaining an increase of nearly twenty percent (Figure 3) and becoming the major driving force in China's foreign trade.

Figure 3 Transactions and Pace of Increase of China's Cross-Border E-commerce, 2013-2019

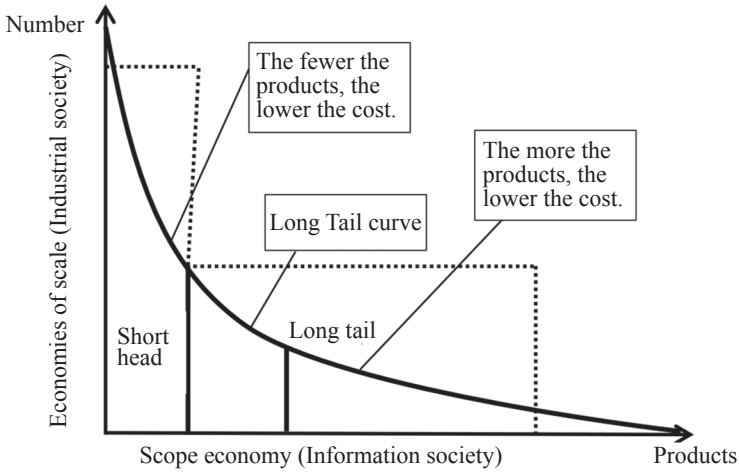


Source: iiMedia Research, "Developmental Trends in China's Cross-Border E-Commerce Industry Research Report (2019)," <https://www.iimedia.cn/c400/67397.html>.

Classical "new-new" trade theory ignores not only all factors other than cost on the supply side but also the heterogenous demands arising from consumer preferences and other factors. Consumer preferences vary with different products, as does the demand function. The immense number of niche markets created by the Internet for a variety of demands is instrumental in small and medium enterprises' ability to take advantage of the Long Tail Effect by means of their flexibility, heterogeneity, diversity and size.<sup>14</sup>

14 Pei Changhong and Liu Bin, "The Dynamic Shift in China's Foreign Trade and the Formation of New International Competitive Advantages."

Figure 4 Long Tail Model



2. *The Internet and digital technology have changed the composition of production materials, and data and response time have become key factors in the global division of labor*

Data are now a key input factor in production function. The key to assessing a production factor depends on whether it can create adequate value. All the scientific revolutions in history have generated new production factors. In traditional agrarian society, labor and land were the essential production factors; in the era of steam power and, later, electricity, mass machine production took the place of manual labor and capital became a key production factor. At the later stage of the second scientific revolution, when the development of the scale economy and the expansion of enterprise size increasingly highlighted the need for internal coordination, management became an essential production factor. When the accelerated development of the information age and the beginning of the artificial intelligence era fundamentally changed the original Cobb Douglas production function, data become enterprises' core production factor. The Internet and big data increase the space-time cognitive efficiency and operability of enterprise resources and sharpen the precision of their production decisions.

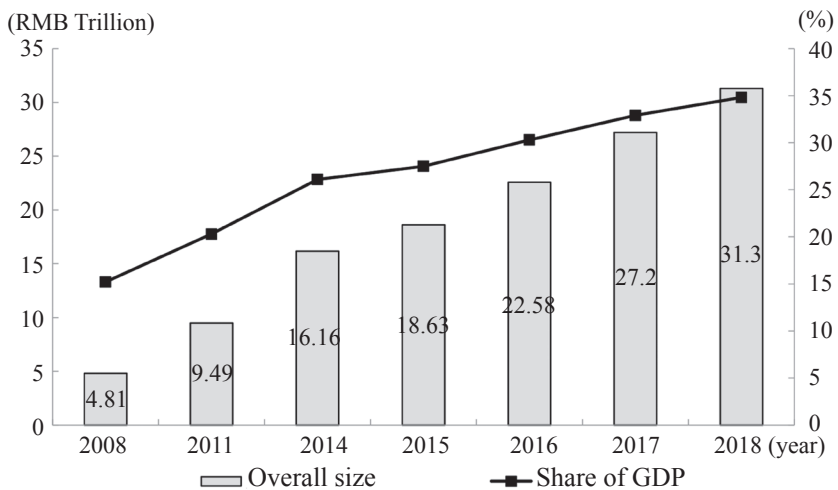
In traditional trade theory, since actual trade time is difficult to measure, its impact on the division of labor in the global value chain is hard to assess. For purposes of simplification, the trade time variable is often ignored. With the development of the Internet and digital technologies, the division of labor in the global value chain can obtain an immediate response; the response time of enterprise production can be fully recorded; inventories can be managed optimally; and the efficiency of the global division of labor can be improved rapidly.

3. *Digital technologies improve the tradability of services and stimulate the late-mover advantage of China's services trade*

Historically, globalization has undergone two “untying” processes. The first industrial revolution promoted the rapid development of industry and transportation, and the

comparative advantage it gave enabled the spatial separation of production and consumption in different countries, leading to the first “unloosing” of the global division of labor. In this division, however, each country node had a relatively independent and complete production chain. In the acceleration of industrialization and the development of information technology, scale economies have enabled cross-border separation of production, resulting in the second “unloosing” of the global division of labor. The first two unloosing processes mainly occurred in merchandise trade. When the development of digital technologies made possible the space-time separation of service production from consumption, globalization will facilitate the third unloosing. Trends in services trade and manufacturing services have become a typical feature of the global division of labor in recent years. According to the *World Trade Report 2018*, more than half of global trade in services is achieved through digital technologies,<sup>15</sup> which have broken through the space-time limitations of the global division of labor and which provide the necessary conditions for improving the tradability of services. Compared with developed countries, China’s services trade is lagging behind, but the development of its digital technologies will stimulate the country’s late-comer advantage in this field. According to the latest data, China’s digital economy ranked second in the world in 2018, accounting for 35 percent of its GDP (Figure 5).

Figure 5 Size of China’s Digital Economy and Its Share of GDP, 2008-2018



Source: China Academy of Information and Communications Technology (CAICT), *White Paper on Development and Employment in the Chinese Digital Economy 2019*, <http://www.caict.ac.cn/kxyj/qwfb/bps/201904/P020190417344468720243.pdf>.

15 World Trade Organization, *WORLD TRADE REPORT 2018—The Future of World Trade: How Digital Technologies Are Transforming Global Commerce*.

#### IV. The Theoretical Contribution of the Belt and Road Initiative

Multiple balances, the core thesis of the macroeconomics of Chinese opening up, breaks through the limitations imposed by the West, which merely pursues trade balances and over-uses exchange rates. In the global division of labor, China, known as the “world’s factory,” has achieved the most efficient factor allocation; this is a necessity of the development of objective economic law. The joint construction of the Belt and Road Initiative (BRI) not only follows this objective law, but also, in accord with the Belt and Road Initiative, radiates outward to the surrounding economies and facilitates the development of these countries and their industrial division of labor according to this objective law. It aims at promoting bilateral and regional trade and investment so as to achieve a multi-balance. By opening up international trade and investment, the initiative avoids the excessive concentration of China’s export markets and reduces trade frictions. Unlike the Western view of balance, the multi-balance concept proposed by China is an innovative practice that balances trade surpluses by expanding and opening up new areas for the division of labor and economic cooperation with win-win solutions.

*1. The Belt and Road Initiative reshapes the economic geography of China and the countries along its routes by paving the way for land route-based international trade and investment*

First of all, the Belt and Road Initiative will not only help to truly realize the global value chain, but also has reshaped China’s economic geography. During the forty years of reform and opening up, China’s opening up strategy focused on the east, keeping coastal cities at the forefront and placing the inland provinces in the central and Western regions at a subordinate position. Despite the implementation of a series of development strategies, including carrying out “large-scale development of the Western region,” “promoting the rise of the central region” and “revitalizing the northeast,” the gap between China’s coastal and inland areas has not been significantly narrowed. The most direct reason for this is that the coastal areas enjoy the advantages of endowments in terms of international logistics that the inland areas do not have. Coastal cities have convenient ocean routes, high-quality ports, sound shipping rules and preferred institutional arrangements, whereas inland cities, which do not have direct access to countries abroad, have to be connected to ocean routes by roads or waterways except in the very few cases where goods are transported by air. Since the division of labor in inland areas cannot be directly connected with the global value chain system, firms’ exports obviously suffer from their initial disadvantage in cost and time endowments. In recent years, the China-Europe Railway Express, a flagship project of the BRI, has developed rapidly, completing more than 14,000 trips covering more than 60 Chinese cities (mainly in inland provinces) by the end of 2018. The Belt and Road Initiative has facilitated inland cities’ conversion to trade ports and opened a window for China to the West. China’s opening up to the West is conducive to the establishment of a new mode of trade that crosses land and sea,



thus further realizing highly integrated regional value chains in the countries along the Belt and Road and its domestic value chains, and finally forming the “conjugate circulation” of the global value chain by East-West cooperation with China at the core.

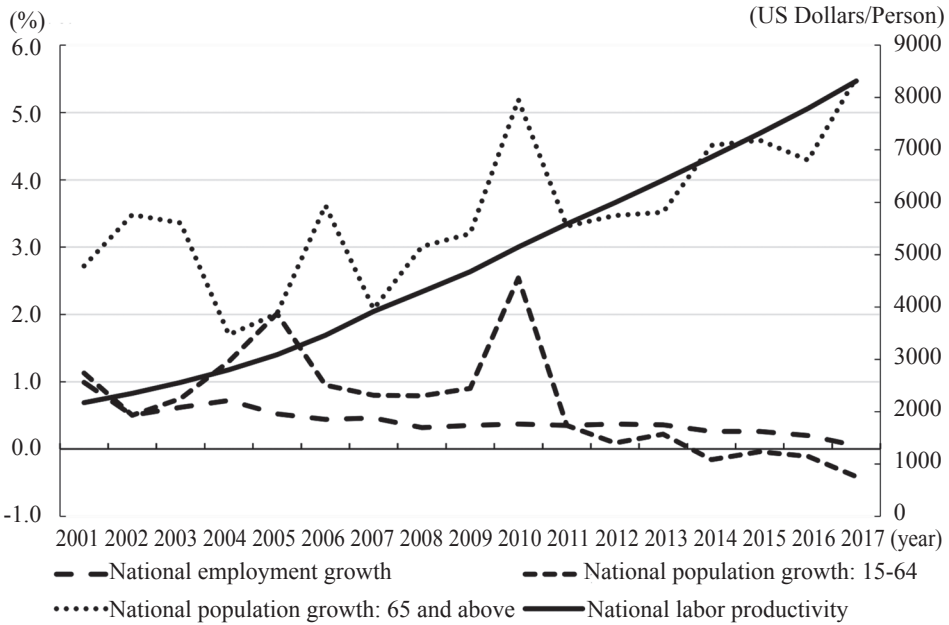
Secondly, the Belt and Road Initiative has reshaped the economic geography of the countries along the routes. Maritime transport has always been the main channel for global division of labor and commodity exchange. In recent years, though air transport has developed rapidly, the limitations of transport costs and the properties of different goods mean that maritime transport remains the major means of international trade, responsible for nearly ninety percent of its entire volume. In a sense, oceanic trade ushered in and established the era of monopoly capitalism. There are obvious drawbacks in a coastal system of division of labor that is dominated by multinational corporations and a few developed economies; the different positions of the division of labor in the global value chain lead to an extremely uneven distribution of value in the international division of labor. The international division of labor never achieved global value chain production and exchange in the true sense; rather, it has achieved this at the level of regional chains. The current global value chains are largely composed of three regional chains in East Asia, Western Europe and North America respectively. Most developing countries along the Belt and Road and other Latin American and African countries are basically excluded from the global division of labor, in which an increasingly fixed “center-periphery” mode of unequal division of labor has gradually taken shape. In a sense, the Belt and Road Initiative will not only help to truly realize the global value chain, but also create a “win-win chain” has incorporated more developing countries into the global division of labor and established a new type of global division of labor and trade through land-sea linkages, further expanding the geographical scope of the global economy. The Belt and Road Initiative will not only help to truly realize the global value chain, but also create a “win-win chain” of equal cooperation in the distribution of benefits across the world.

*2. The Belt and Road Initiative balances trade surpluses through investment and capital export, representing China's commitment to taking on responsibility for upholding the values of justice and shared interests*

The primary way for a nation to balance international deficits has long been to depreciate its own currency or force other nations to appreciate their currencies. From the economic point of view, the overuse of exchange rates as the major way to achieve a balance of payments is inefficient, harming other countries without benefiting one's own. It is even more laughable and foolish of the US government, which has long boasted of “market freedom,” to attempt to make China embrace the planned economy to reduce its trade surplus during the US trade conflicts with China in 2018. In the global division of labor, the fact that China, as the “world's factory” enjoys the most efficient factor allocation is a specific demonstration of comparative advantage and competitive advantage in international trade. There is no such thing as an “excessive exports” issue. The trade surplus pattern of China's manufactured

goods would be hard to change even over a fairly long period, fundamentally because only a small part of China’s tremendous manufacturing capacity could be replaced. Although China’s labor cost advantage has steadily decreased, its advantages of human capital and productivity have become visible (Figure 6), and the “preemptive advantage” generated by economies of scale and the “matching advantage” created by industrial chains cannot easily be acquired by other developing countries in the short term.

Figure 6 Population Growth, Employment Growth and Labor Productivity Trends in China, 2001-2017



Source: World Bank, “Demographic and Employment Data,” <https://data.worldbank.org/cn/indicator>; “Labor Productivity Data,” <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicator>.

The traditional view of balance of payments has always influenced global governance arrangements and China’s trade policy. When the global financial crisis broke out in 2008, the World Bank put forward the governance concept of “rebalancing world economy,” which required surplus countries to take the initiative in reducing their trade surplus. The Chinese government also proposed a trade policy that would reduce its surplus. All this did not fundamentally reverse the trend toward imbalance in the balance of payments; rather, it grew worse. In recent years, China has developed multi-balance proposition covering areas from trade surplus to capital output. As the construction of the Belt and Road continues to advance, China is likely to shift from a period of capital account and current account surplus

to a period of rebalancing, with a capital account deficit and current account surplus. Since its access to the WTO, China has witnessed a rapid increase in its current account surplus and an accelerating pace of overseas investment. Although its current account surplus declined after the global financial crisis broke out in 2008, China's overseas investment maintained a high growth rate till 2016. The country's trade surplus has led other developing countries to participate in economic globalization by transforming their trade surpluses into overseas investment and infrastructure construction. This view of global economic balance, with the highest economic efficiency and the broadest social welfare, will benefit many stakeholders. Japan did once attempt to implement a Surplus Circulation Project. It was constrained by the conditions of the early 1980s, and the strength of its practice and the breadth of its influence were far from those of China's Belt and Road Initiative. The Marshall Plan, with its program of unilateral output, also differed from the Belt and Road Initiative, which entails consultation, co-construction and sharing between China and all the countries along the Belt and Road Initiative routes without attaching any political conditions or targeting any political forces. In fact, the content of the Belt and Road Initiative is much richer than that of the Marshall Plan; more importantly, it embodies the humanistic values of a shared future for mankind.

## **V. Theoretical Contribution of Xi Jinping's Concept of Opening Up in the New Era for Global Economic Governance**

*1. Consultation, co-construction and sharing are the basic principles of establishing a new supply and demand relationship for global public goods in the world system of economic governance*

The initiative of co-constructing the Silk Road Economic Belt and its core concept have been enshrined in important documents of the United Nations, G20, APEC and other international organizations. Consultation emphasizes national consensus and seeks common ground for national cognition, the intersection of cooperation and the division of labor, and the starting point of common development through dialogue and exchange, in order to, with great efforts, build transnational consultation platforms, establish multiple dialogue and dispute settlement mechanisms, and strengthen the role of multilateral and regional mechanism in negotiations. The Belt and Road Initiative fully respects participating countries' religious beliefs, environmental requirements and customs and culture, refraining from "permeable" system export and "mandatory" development model transplantation. The Initiative has involved into a global consensus, with its participating countries being bearers of responsibility and risk-takers as well as constructors and contributors. The idea of co-construction attaches importance to equal participation, plays down power games among the participants, and stresses their sovereign equality. Taking regional cooperation as its basis and development strategy matching as its means, the Belt and Road Initiative gives full play to

the central role of the participating countries, increases localization of enterprise operations, attracts the active participation of local enterprises and governments, and strengthens the endogenous motive forces of economic development in the countries along the BRI routes to cultivate new areas for regional economic growth. Sharing emphasizes distribution of benefits. The Belt and Road Initiative is not a zero-sum game; rather, it is a win-win and all-win solution. Neither excluding nor targeting any economy, it is open to all countries and its achievements benefit all countries along its routes. It covers the economic field and social and livelihood issues of general concern to developing economies in agriculture, poverty reduction, education, science and technology, healthcare, environmental protection and capacity building. It stresses the transfer of sci-tech innovation achievements to countries along its routes. China and participating countries have signed about fifty agreements on sci-tech cooperation, launched China-ASEAN, China-South Asia and other sci-tech partnership programs, and established regional technology transfer platforms and an Alliance of International Science Organizations (ANSO) in the Belt and Road regions. In addition, the Belt and Road Initiative attaches importance to acquiring green production capacity, avoiding pollution and transferring backward industries.

## *2. Building a community of shared future for mankind is China's core idea in reshaping global economic governance*

Since the 18th National Congress of the Communist Party of China, General Secretary Xi Jinping has mentioned “a community of shared future for mankind” more than a hundred times. The world has been impressed by the high frequency, high level and the profound intention of his words. The idea of a community of shared future has had a consistent development process, from a “cross-strait community of shared future” with “blood ties” to an “Asian community” of “close neighbors,” and thence to “a community of shared future for mankind” that “shares weal and woe.” This demonstrates its characteristics of expansion from the domestic to the regional and thence to the global dimension. The idea of a community with shared future for mankind contains criticism and reconstruction of the current contradictions in global economic and trade relations. Sovereign equality across nation states is one of the seven fundamental principles of the Charter of the United Nations. However, the law of the jungle, of “great powers fighting for hegemony” and “the weak falling prey to the strong” has always run through the course of globalization. Relying on the unequal international division of labor, even through wars of aggression, developed countries have completed their plunder of developing countries. This type of “zero-sum game” or asymmetric global development approach must necessarily be abandoned by history. The hypotheses of “economic man” and “profit maximization” are the classical assumptions of Western economics, whose realization accords with the law of the jungle, leading to the marginalization of many countries and peoples in globalization. Therefore, making efforts to solve the problem of equity and justice is the first proposition in establishing a new global economic governance system. General Secretary Xi Jinping

advocates protection of the legitimate rights and interests of emerging market countries and developing countries, ensure equal opportunities, equal rules and equal rights in international economic and trade activities, and work together with the people of all countries to build a human community of shared future. We know that “The Tower of Babel was destroyed by people’s inability to understand each other.” In the era of globalization with its unprecedentedly close economic ties, the mutual benefit and win-win situation of the people of all countries is an inevitable choice for conforming with this trend.

*3. Building an open and transparent multilateral trade and investment governance system is a key measure for China to respond to deglobalization*

Firstly, the suspension of the Doha Round of world trade talks has impeded the WTO-based multilateral trading system. The United States was neither active nor constructive in multilateral negotiations, and even sabotaged the selection of new judges to the WTO Appellate Body, basically resulting in paralysis of its dispute settlement department, known as the crown jewel of the WTO. The emerging giant free trade zones (FTZs) further exacerbate the fragmentation of international trade rules. The major Free Trade Agreements (FTAs), especially the Agreement between the European Union and Japan for an Economic Partnership (EPA), the Comprehensive Incremental Trans-Pacific Partnership (CPTPP) and the US-Mexico-Canada Agreement (USMCA), are reshaping the governance of global trade, whereas the multilateral trading system risks paralysis. Secondly, with regard to the negotiation of investment rules, multilateral investment agreements gone missing on the one hand while bilateral investment agreements spurt out endlessly on the other, creating a prominent “spaghetti bowl phenomenon.”<sup>16</sup> Currently, the closed mechanisms and the fragmented rules of trade and investment have led to a governance dilemma for the global economy. General Secretary Xi Jinping made it clear in his report to the 19th Communist Party of China National Congress that China supports the multilateral trading system and promotes the building of an open world economy. In practice, China has promoted multilateral negotiations through plurilateral negotiations, and has endeavored to call for the establishment of global investment rules on many cooperative platforms including the G20, the Shanghai Cooperation Organization (SCO), the Regional Comprehensive Economic Partnership (RCEP) and the BRICS.

*4. Establishing a pluralistic, fair and efficient global financial and monetary system is key to improving the global economic governance structure*

Currently the financial governance resources are extremely unevenly distributed across the world. The International Monetary Fund is incapable of adjusting the global balance of payments, and the World Bank imposes political conditions on loans to developing countries. The United States and the European Union have absolute control over international financial institutions such as the International Monetary Fund and the World Bank, which are notorious

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16 See Jagdish Bhagwati, “US Trade Policy: The Infatuation with Free Trade Agreements,” <https://academiccommons.columbia.edu/doi/10.7916/D8CN7BFM>.

for the way their inappropriate quota subscriptions and voting rights distribution fail to reflect the dynamic changes in the economic strength of member countries. Although China accounted for more than 15 percent of world GDP in 2018, the Chinese yuan/RMB has only a 10.9 percent weighting in the Special Drawing Rights basket of the International Monetary Fund. The US dollar, by contrast, with its 25 percent share of world GDP, has a weighting of more than 40 percent. General Secretary Xi Jinping has repeatedly mentioned on different occasions the reform of the existing international financial system and the establishment of a diversified system of financing. Firstly, we need to promote the “stock reform” of global financial governance and speed up the process of expanding and increasing capital and reforming quota allocation in the International Monetary Fund and the World Bank to properly protect the legitimate rights and interests of emerging economies and developing countries. Secondly, we should promote the incremental reform of global financial governance and improve its structure. The Asian Infrastructure Investment Bank, whose operational mode complements the existing international development financial institutions, has served as a successful example of an international financial institution of a high standard. Thirdly, we should fully make use of the Belt and Road Initiative to advance the internationalization of the Chinese yuan/RMB so it can first carry out the basic monetary functions of payment, settlement and reserve in countries along the BRI routes, and increase the allocation capacity of Chinese financial resources worldwide.

*5. Grasping the new generation of the technological revolution is a historical opportunity to meet the challenges of structural contradictions in the global economy*

Every technological revolution has led to breakthrough in the productive forces and changed the existing economic structure. Britain became the world's first industrialized country during the first technological revolution, marked by the invention of work machinery and steam engines. The United States emerged as the country with the highest GDP in the world during the second technological revolution, marked by the use of electricity. The third technological revolution, marked by Internet applications, has further strengthened the multipolar trend in the world economy. Xi Jinping believes that grasping the opportunities provided by the new round of technological revolution is key both to maintaining the current high-quality development of China's economy and solving the structural contradictions facing the world economy. At present, the world economy is ushering in the fourth technological revolution, chiefly marked by artificial intelligence. This disruptive technology will lead to the profound reconstruction of global value chains. We should firmly grasp the window of opportunity offered by this new technological revolution. In relatively backward areas, we can engage in imitative innovation, and in relatively advanced areas, we can carry out “destructive” innovation. Although such innovation involves many uncertain risks for production factors, technology, markets, etc., once successful, our enterprises will “escape from competition,” seize the market and “overtake on the corner.”

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