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# China and the WTO: *Interview with Franklin Allen (edited transcript)*

**Knowledge@Wharton:** When China joined the World Trade Organization (WTO) in 2001, the country's share of global exports was just 4% percent. Today, China is the world's top exporter with a share of more than 10%. How did this come about, and how has Chinese business been transformed as a result?

**Franklin Allen:** It's partly due to WTO, but a large part of it is just due to the growth of China which since then has been phenomenal. It has gone from being quite a small economy at that stage in global terms to having overtaken Japan last year and become the second largest economy in the world.

**Knowledge@Wharton:** How has China's membership in the WTO brought about the transformation of Chinese enterprises? How have they become more competitive and globally oriented? Could you speak about that transformation process?

**Allen:** That's a long-run process and WTO membership has spurred that along. It has done that faster than it would have done without WTO. But China has been on this process now for some 30 years. One of the main effects was the opening up of the financial system to some extent, and that has been ongoing and has been important. But also, all the other aspects of WTO membership have been important.

**Knowledge@Wharton:** Speaking about the financial sector, how has joining the WTO affected the way in which the Chinese financial sector and the capital market have evolved?

**Allen:** International firms have been able to enter China in a way that they weren't able to before. China's economy stopped opening in a complete sense, but that will be a matter of time in my view.

**Knowledge@Wharton:** Which sectors of the Chinese economy have been affected the most after China's entry to the WTO? Which ones are lagging behind and why?

**Allen:** Obviously manufacturing has done very well in this environment. Services are still not as forward as manufacturing, so there's a ways to go in [terms of] globalization in the Chinese economy still.

**Knowledge@Wharton:** What are some of the opportunities and challenges that China faces as a result of participation in the WTO?

**Allen:** The main problem is still to build global brands. Chinese companies are very good at certain types of exports, but there are not too many Chinese companies that have global names that people recognize. There are some, of course, like Lenovo and Haier, but not too many. The next big challenge is to create these global firms.

**Knowledge@Wharton:** You said that China has now become the world's second largest economy, overtaking Japan. What has China's growth meant for the world economy? Can this growth be sustained? As we know, the U.S. and Europe have been the primary markets for Chinese goods. As growth slows in the Western economies, do you anticipate any negative consequences for the Chinese economy in the future?

**Allen:** I think China will continue to grow at a high rate -- maybe not as high a rate as it has done the last few years, but that has more to do with problems in the global economy rather than anything else. I think their growth will probably slow to 8% or even 7%, but it's unlikely to go below that, simply because so much of their spending is on infrastructure. China's current plan is to build out the tier two and tier three cities. That plan will take some time to implement and keep growth high.

**Knowledge@Wharton:** Do you believe growth in China's internal market will be enough to offset the decline in demand from abroad?

**Allen:** There will be some effect of that. People usually say global trade accounts for 35% or so of the Chinese GDP, but that is a gross figure. It includes imported energy, materials and so on. The net figure is about 10% -- that is the number people usually quote. It's not that large compared to investment, for example, which is around 40% of China's GDP. This is the real driver of the Chinese economy, and they can compensate for a lot with that as opposed to exports.

**Knowledge@Wharton:** After China joined the WTO, what are some of the biggest challenges that the country has faced, especially in the form of trade disputes?

**Allen:** There are the classic ones like the tires and so on. These will be somewhat problematic going forward. There are always going to be issues about whether the terms of trade are fair, if there are subsidies and so on. Of course, such disagreements exist among all countries -- not just China and the U.S., but also between China and the EU, the EU and the U.S. and so on. I think there will be isolated incidents, but hopefully they will not get out of hand and become full-blown problems.

**Knowledge@Wharton:** Do you see protectionism becoming a problem?

**Allen:** I'm sure that there will be some protectionism. I don't think it's going to be a major factor. At least I hope not.

**Knowledge@Wharton:** Let us turn now to what's happening with the Chinese currency. China has been making efforts to globalize the renminbi (RMB). Could you help our audience understand what is going on and what you think is likely to happen over the next few years?

**Allen:** China has been doing a number of things recently to move in this direction. For one thing, the Chinese government has been encouraging settlement of trade in RMB. That is growing fast, albeit from a low level, but it is occurring. It will increase, particularly in Asia. The second thing China has been doing is to allow companies to issue RMB bonds in Hong Kong. McDonald's and a number of other U.S. firms have been doing that, and that's again growing quite fast.

I think what remains is the most difficult -- and that is to have full convertibility of the RMB, both on the current account and the capital account. In the U.S., we tend to emphasize the current account. There is a deficit -- particularly a bilateral deficit with the U.S. -- but I think the more important issue is what is going to happen with the capital account. The

Chinese domestically have relatively few investment vehicles. I'm sure that if the capital account were to open up, there would be a large outflow of RMB. At the same time, I think many people would like to invest freely in Chinese assets and so there would also be a big inflow.

It's difficult at this stage to say which of those flows would be bigger and which way the RMB would move in the long run. What we've seen in the last few months and the last couple of years is that the capital account has become very important for the determining of exchange rates. A classic example here is Switzerland. I think that is a big issue and although people assume that the exchange rate will strengthen, it's not entirely clear that that's the case. I think when we get the new generation of leaders in China, one of the hard things they'll have to decide is at what speed to move towards a fully convertible RMB. I hope they will do that, and that in maybe five to 10 years, we will have made significant progress in that direction.

**Knowledge@Wharton:** What do you think will be the implications for other currencies like the dollar or the euro?

**Allen:** In the long run, we'll move towards a multi-polar financial system where the dollar will lose its primacy as the only currency.

The euro had moved up significantly in recent years, of course, but that's now threatened by the problems in Europe. My own guess is that there will be a bumpy road ahead for the euro, but I don't expect it to disappear.

In the long run, I expect there to be three global currencies. The U.S. dollar will presumably still play the lead role, but there will be two major alternatives -- the euro will be used widely in Europe and to some extent in Africa, and the RMB will be used in Asia and maybe also in Africa. And then the dollar will be used in North America and Latin America.

**Knowledge@Wharton:** How do you see the Chinese economy evolving over the next 10 years? What will be the major implications for other countries?

**Allen:** China will continue to grow. The IMF predicts that it will overtake the U.S. in terms of GDP and purchasing power parity in 2016, so we're not that far away. With all the dislocation in the world economy, it may happen sooner or slower than that, but at some point in the next 10 years, China will become the largest economy in the world.

The big issue is how much bigger than the U.S. will the Chinese economy get, and what is the time frame for that. Within 20 to 30 years, China may well be a multiple of U.S. GDP, and this is going to have enormous consequences for the U.S. and for other countries in the world. The U.S. may grow and increase its growth rate by allowing more immigration and those kinds of things. But the way that people think about the world will change significantly if China does indeed become the largest economy.

**Knowledge@Wharton:** What could be the consequences for the U.S. economy, Europe and other parts of Asia?

**Allen:** The big issue is going to be competitiveness. At the moment, as we discussed a few minutes ago, China doesn't have a lot of brand names or a lot of well-known corporations.

China had intended to develop a high-tech sector. One way it is doing that is through partnerships with companies like Sweden's Ericsson, which signed a big contract with Chinese phone companies [China Mobile and China Unicom]. However, there have been setbacks, and the Chinese need to think hard about how to build their credibility in the high-tech sector. That will take some time, and clearly that's the area where the U.S. and Europe are still able to compete in a significant way.

**Knowledge@Wharton:** Do you see internal risks within China that could destabilize growth over the next 10 years? For example, do you see risks in real estate or in the financial system that could in effect puncture the growth prospects?

**Allen:** What we're seeing in the Chinese economy at the moment is a bursting of the real estate bubble in some parts of the country. That will have an effect on the financial system, but as long as China is able to keep growing at 7% to 8%, it can grow out of these issues, and I expect that to happen. There will be a bumpy time, but I don't expect the long term to be significantly affected.

**Knowledge@Wharton:** Any final words of advice for companies around the world on what their China strategy should be over the next decade?

**Allen:** I think they should be involved in China but they should hedge their risks and be involved in many places around the world.