

Successful models in economic diversification - China as a Model -

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Published:30/06/2024

ملخص: تعاني الدول التي تمتلك ثروات طبيعية كبيرة من هيمنة هذه الموارد على إنتاجها وتجارتها الخارجية وموادها المالية. وبالتالي تتحول هذه الدول إلى دول أحادية الإنتاج والتجارة. ونظراً للمخاطر التي يفرضها هذا الوضع أو ما يعرف بلعنة الموارد، فإن وضع سياسات لتنوع الإنتاج والتجارة (التنوع الاقتصادي)، وكذلك الموارد المالية للدولة يصبح ضرورياً، لأن أسعار هذه الموارد الطبيعية متقلبة للغاية وقد يحدث انخفاض في حدود الصرف. يهدف هذا البحث إلى دراسة قضية التنوع الاقتصادي من خلال تناول عدد من المعايير والمؤشرات المعتمدة، وكذلك سبل تنوع الاقتصاد من خلال تطبيق سياسات التنمية لبناء اقتصاد يقل فيه الاعتماد على الموارد الطبيعية ويحقق النمو الاقتصادي، وهناك العديد من التجارب الدولية الرائدة التي يمكن الاستفادة منها في هذا المجال. الكلمات المفتاحية: التنوع الاقتصادي، التجمعات الاقتصادية، استراتيجية التنوع الاقتصادي، مؤشرات التنوع الاقتصادي، الاقتصاد الصيني.

Abstract :

Countries with large endowments of natural resources suffer from the dominance of these resources over their production, foreign trade and financial materials. Accordingly, these countries turn into mono-production and trade. In view of the risks posed by this situation or what is known as the resource curse, the development of policies to diversify production and trade (economic diversification), as well as the financial resources of the state become necessary, because the prices of these natural resources are highly volatile and there may be a decline in the exchange limits.

This research paper aims to study the issue of economic diversification by addressing a number of approved standards and indicators, as well as ways to diversify the economy by applying development policies to build an economy in which dependence on natural resources is less and achieves economic growth, and there are several pioneering international experiences that can be used in this field.

Keywords: : Economic Diversification, economic clusters, Economic Diversification Strategy, Indicators of Economic Diversification, Chinese Economy.

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1. INTRODUCTION

Economic growth is one of the primary goals pursued by governments, and people aspire to it, because it represents the material summary of the economic and non-economic efforts exerted in society; It is one of the necessary conditions for improving the standard of living of societies, and it is also an indicator of their prosperity. Economic growth is linked to a group of fundamental factors, and diversification of economic activity is a difficult task for oil-exporting countries. Few countries have succeeded throughout history in diversifying their economic activities and reducing their dependence on oil, especially when their oil production was still abundant and sufficient for them for a long time. There are a number of major obstacles that often impede diversification, such as economic fluctuations arising from dependence on oil revenues, and what often results from oil revenues from weakening the governance system and institutions, and the risks arising from oil revenues, often from overestimating real exchange rates. Malaysia, Indonesia, Mexico, Saudi Arabia and others are perhaps the best examples of countries that have succeeded in diversifying away from oil, while Chile has somewhat succeeded in diversifying away from copper. Based on the foregoing, the problem of this study is crystallized in the following question:

How did China achieve Economic Diversification?

2. Generalities about Economic Diversification

There is no doubt that the dependence of any economy on a single source or limited sources is very dangerous, as its fluctuations subject to global markets entail great challenges in terms of direct impact on the state's general budgets and financial stability, and on its economic growth, and therefore it cannot be relied upon to advance the process of sustainable development. in its various dimensions.

2.1 The Concept of Economic Diversification

Diversification is usually known as export diversification, referring to policies aimed at reducing dependence on a limited number of export commodities that are subject to global fluctuations or declines in price and volume. And if economic diversification may take the form of diversification in exports or in production or diversification of sources of income, it generally represents the process through which the economy becomes more diversified

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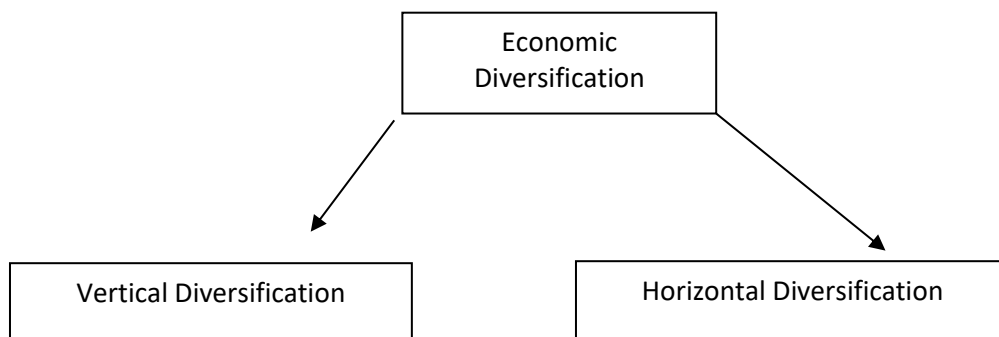
in terms of the goods and services it produces. (KEPKA, 2021)

It is also known as reducing dependence on a single resource and moving to the stage of strengthening the industrial and agricultural base and creating a productive base. It means building a healthy national economy that is heading towards self-sufficiency in more than one sector. Hence, we can define economic diversification as:

"Diversifying the sources of national income through restructuring the economy and raising the level of the contribution of the various economic sectors to the income by building a broad base of local and exported products through which it does not depend on a single source, which makes it vulnerable to economic fluctuations in the event of any change in this source."

In the political economy, diversification is meant in the general sense as "diversification of exports, and it expresses, in particular, the policies aimed at reducing dependence on a specific number of exports that are subject to price and quantity fluctuations. Political economy divides diversification into two parts: horizontal diversification and vertical diversification, as shown in the following figure:

Figure1 Economic Diversification Sections



Source: Prepared by the researchers

a. Horizontal diversification: is the creation of new opportunities for new products (such as mining, energy and agriculture).

b. Vertical diversification: is the use of the outputs of one activity (such as copper) to be inputs for another activity, such as electrical wires.

2.2 The Types of Diversification Strategies

There are three different types of diversification strategies that are commonly used today. These are:

a. Concentric Diversification

Concentric diversification refers to the development of new products and services that are similar to the ones you already sell. For example, an orange juice brand releases a new “smooth” orange juice drink alongside its hero product, the orange juice “with bits”.

b. Horizontal Diversification

Horizontal Diversification refers to the development of new products that are somewhat related to your original lines. For example, while your original product was plant pots, you are now selling seeds for many varieties of herbs and flowers.

c. Conglomerate Diversification

Conglomerate diversification refers to the development of new products that are unrelated to your original lines. For example, your t-shirt company has now decided to start stocking apple products.

Conglomerate diversification is a much riskier strategy than both concentric diversification and horizontal diversification. This is because it requires more outlay in terms of product development and advertising. Plus, due to the goal of penetrating a new industry- this diversification strategy has more likelihood of failure.

2.3 The goals of economic diversification

The most important objectives of economic diversification can be identified as follows:

Achieving economic growth and sustainable development that enhance living standards, generate wealth and job opportunities, and encourage the development of new knowledge and technology.

- Securing a stable economic environment that encourages domestic and foreign investment and enhances the appropriate business climate.
- Structuring the national economy in a way that makes it more diversified

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and productive and less vulnerable to the risks of dependence on a single source or limited resources.

- Achieving diversification in the sources of national income and relying on more than one source to reduce dependence on the revenues of the single sector.
- Raising the level of contribution of various economic sectors to the national income and improving the efficiency and effectiveness of these sectors and their interdependence, especially the manufacturing sector.
- Reducing the risks of fluctuations in the prices of exported commodities and raising the rate of trade exchange through diversifying exports.
- Increasing the creation of jobs in the private sector for citizens through the development of various economic sectors.
- Raising labor productivity and human capital, and thus economic growth rates.

Laying the foundations of a non-oil economy that will be needed over time when oil revenues begin to decline, and this has happened significantly over the past year.

2.4 The importance of economic diversification

There are many benefits that can arise from a more diversified economy, the most important of which is that the economy becomes less exposed to external shocks, increases commercial gains, achieves higher rates of capital production, helps more regional integration, and creates diverse job opportunities that accommodate the labor force looking for these opportunities. Therefore, the importance of diversification for oil-producing countries lies in:

- Building a sustainable economy for present and future generations, away from oil while encouraging the private sector and foreign investment.
- Regionally and socially balanced economic development.
- Achieving stability in the general budget, by activating other productive sectors.
- Encouraging the implementation of future plans by providing what planning needs in terms of local and foreign expertise, administrative institutions and a social environment by providing the required funds.

2.5 Criteria for economic diversification

In order to evaluate the success of the economic diversification policy in any country, some quantitative indicators and criteria must be studied through which we can measure the degree of economic diversification for that. Some criteria are as follows:

- Increasing the effectiveness of the private sector in the formation of the gross domestic product.
- Evolution of the diversification of exports.
- Evolution of total employment by sector.
- Rate and degree of structural change.
- The degree of stability of the gross domestic product and its relationship to the stability of the prices of the only resource

2.6 Indicators for measuring Economic Diversification

The Herfindal-Hirshman index is considered one of the most famous indicators that measure the degree of economic diversification of any economy. Its value ranges between 0 and 1, so that whenever this indicator approaches 0, this indicates economic diversification, and whenever the indicator approaches 1, this indicates lack of diversification. Economic i.e. economic concentration. There are several indicators considered as evidence of the level of diversification, mainly related to macroeconomic performance, namely: (KEPKA, 2021)

- Degree of structural change.
- The degree of instability of the gross domestic product and its relationship to the instability of oil prices.
- Evolution of oil revenues as a percentage of total state revenues.
- The development and composition of non-oil exports.
- Sectoral distribution of the workforce.
- Percentage of the public and private sector's contribution to the gross domestic product.
- Ownership of assets is distributed between the public and private sectors.

3. China's experience in Economic Diversification

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Since China began to open up and reform its economy in 1978, GDP growth has averaged over 9 percent a year, and almost 800 million people have lifted themselves out of poverty. There have also been significant improvements in access to health, education, and other services over the same period.

3.1 China's Economic Challenges

Significant property sector challenges and export weakness are major contributors to China's economic malaise. New home prices faced their steepest decline last year since early 2015.² Property investment fell 10.1% on a year-over year basis from January to May 2024. Average new home prices have declined for 11 consecutive months.³ Exports, an important linchpin for China's economic growth, fell 4.6% in 2023, the first annual decline in export activity since 2016.⁴ More encouraging data emerged in early 2024, with China's exports growing 7.6% in the one year period ending in May 2024.⁵ Despite recent weakness, China remains the largest global exporter of manufactured goods.⁶ However, ongoing trade battles with the U.S. and other countries aren't likely to help boost exports.

At the same time, slowing domestic demand remains a challenge. "One reason for concern about China's property weakness is that consumers have limited savings, having spent it down during the pandemic, and much of their wealth tied up in housing, which has dropped in value. So they are not in a strong position," says Haworth

3.2 China's Growth

Following the government's open and reform economic policies in the 1970s and 1980s, China's rate of economic growth has been unparalleled. Economic output per person, for instance, has increased by [roughly 3,000%](#) in recent decades, leading many analysts to refer to China's economic growth as a "miracle."

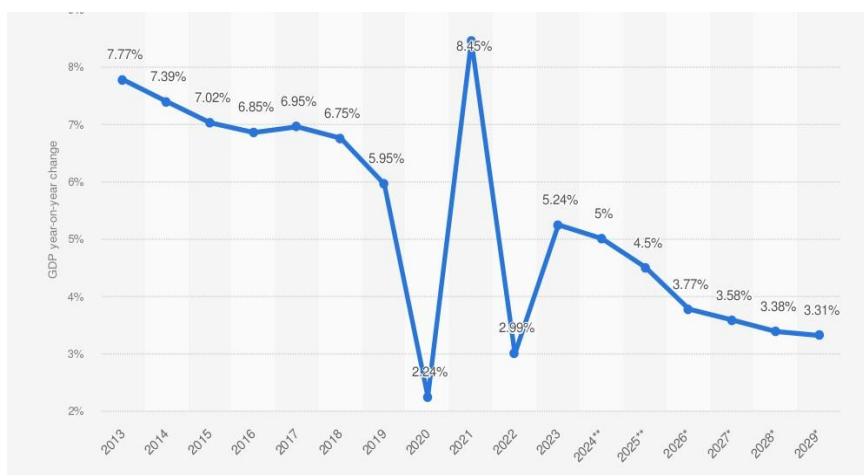
Economic growth in China, however, has slowed in recent years. Growth is [projected to decelerate](#) to 3.3% by 2029, according to the International Monetary Fund (IMF).

Experts maintain that new avenues of growth will be required for China to retain steady growth. This includes expansion in new and transforming industries like artificial intelligence, digital financial services

and green technologies like electric vehicles.

Already, China's expanding clean energy sector accounted for an estimated 40% of the country's economic expansion in 2023. Meanwhile, private sector spending on research and development has doubled in the past five years.

Figure 2. Growth of GDP in China during (2013 – 2023)



Source : IMF, National Bureau of Statistics of China, Statista 2024

Nevertheless, China's status as the second largest economy in the world continues to position it as an important player on the global economic stage.⁸ With Chinese manufacturing back online, [global supply chain](#) issues have eased.

China's economic transformation from an agrarian-based society to the more urbanized and industrialized China of today began in the late 1970s, and since then, rapid growth has been a staple of China's economic story. Until the last decade, China's economy often grew by more than 10% per year, resulting in an expansion of the country's middle class.

"Two key factors at play are the fact that China now has a well-developed middle-class, and it also faces demographic issues," according to Haworth. It has an aging population, causing some of its economic challenges. This includes fewer working-age people to support the needs of

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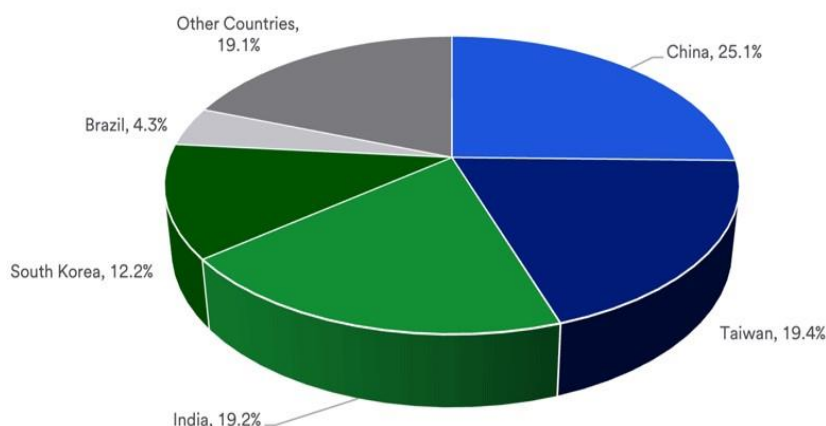
its elderly population, and ultimately, a potential decline in the country's overall population, which could hamper future economic growth. For the first time in history, India in 2023 supplanted China as the world's most populous nation.

3.3 Investment Market Impact

3.4 Domestic Investments

China's stock market alone makes up one-quarter of the MSCI Emerging Markets Index. "Any investor who puts money to work in a broad, emerging market index likely owns a significant position in Chinese stocks".

Figure3. China's Stock Market Index



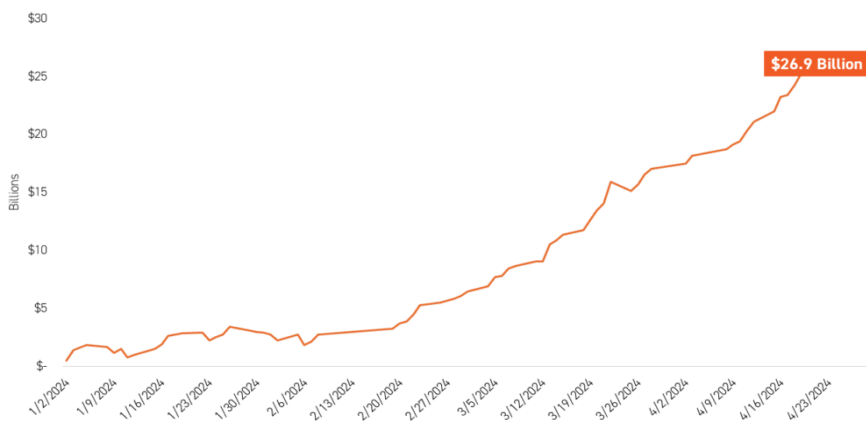
Source : <https://www.usbank.com/investing/financial-perspectives/market-news/chinas-economic-influence.html>

Long-term funds entering the market give full play to the advantages of minimizing short-term market fluctuations. In fact, institutional investors have developed rapidly in China's stock market in recent years, and the weight of tradable stocks held by professional institutional investors has increased from 18% in early 2019 to 24.6% in late 2021, during which the share of various asset management products grew from 9.3% to 14.2%. This demonstrates the accelerated institutionalization of China's stock market.

Institutional investors usually are able to engage in longer-term investments, which plays an important role in the stability and development of the market. "Institutionalization" is a key indicator of market maturity, and the proportion of institutional investors in developed markets is high, on average. Globally, institutional investors generally hold a high percentage of market capitalization in traditional developed markets such as the United States and United Kingdom. The shareholding ratio of domestic institutional investors was 41% in the United States in 2019, 31% in Japan in 2018, and 26% in Britain in 2016. In comparison, according to the statistics from the Shanghai Stock Exchange on market capitalization, the shareholding ratio of Chinese local institutions was only 16% by the end of 2020.

China is still on the long journey towards "institutionalization". As of the first quarter of 2021, the calculation of A-share investor structure under market capitalization showed that the shareholding ratio of retail investors was second only to that of general legal persons, accounting for 33.27%. It is obvious that retail investors will remain leading participants in China's stock market in the foreseeable future. Therefore, the investment behavior of retail investors is also worthy of attention.

Figure4. China's Stock Inflow



Source : <https://kraneshares.com/5-reasons-chinas-recent-stock-market-rally-is-fundamentally-different/>

Investors with positions in overseas stocks may look for opportunities

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to put money to work in China, the world's second-largest economy (behind the U.S.). China is still classified as an emerging market, but its equity values represent the largest among all emerging market countries.

3.5 Investing in International Stocks

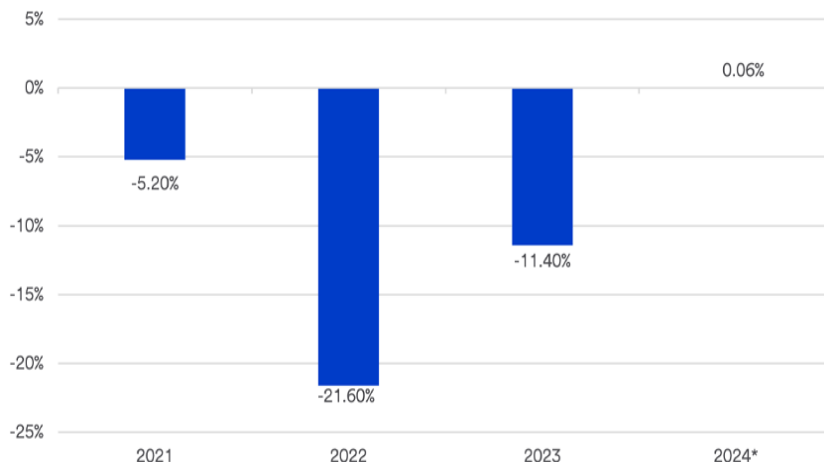
International stocks can contribute to a [well-diversified portfolio](#). “There are reasons to include emerging market exposure in your asset mix”. “After all, despite trade tensions, we’re still a globalized economy.” Emerging market stocks struggled significantly in 2022 and lagged performance of developed global markets in 2022 and 2023. However, in 2024’s first half, emerging market stocks began to recover ground. The MSCI Emerging Markets Index gained 5.0% in the second quarter (outpacing the S&P 500 and the MSCI EAFE Index measuring developed market performance). From January through June, the MSCI Emerging Markets Index is up 7.49%.

“A significant part of the emerging markets index is technology-oriented, and as was the case in the U.S., those stocks did particularly well, especially companies based in Taiwan and South Korea,” says Haworth. “The emerging markets index provides significant exposure to Chinese stocks since they make up about one-quarter of the MSCI Emerging Market Index. But it also provides exposure to other markets that help diversify investors away from potential risks arising from investing exclusively in Chinese markets.” Haworth notes that in recent times, a [stronger dollar](#) created headwinds for emerging market investors. When U.S. investors put money to work in overseas stocks, a stronger dollar detracts from net performance.

China’s equities market declined in three consecutive years between 2021 and 2023. “Earnings weakness and investor skepticism about future earnings have put pressure on Chinese stocks,” says Haworth. “For China’s stock market to stage a turnaround, investor confidence needs to stabilize.”

China’s stock market started 2024 in a positive direction, but currently stands relatively flat for the year. China’s economic trajectory may ultimately determine whether stocks can muster a sustained rally.

Figure5. Investing in International Stocks



Source : <https://www.usbank.com/investing/financial-perspectives/market-news/chinas-economic-influence.html>

4. Trade of China

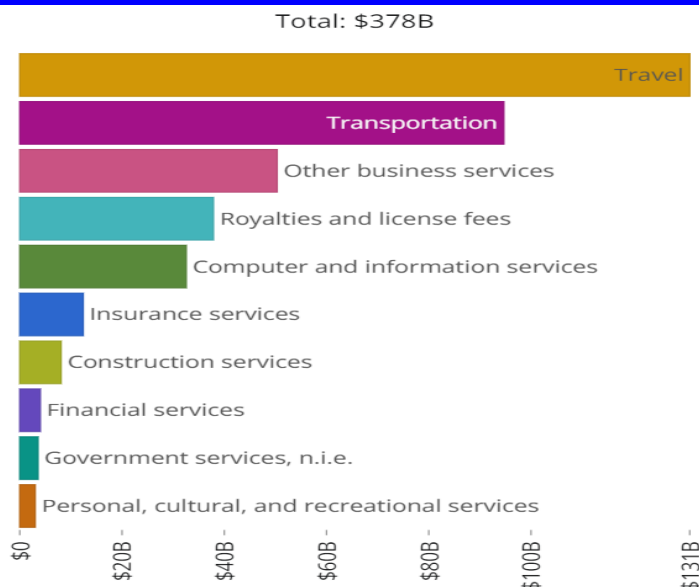
4.1 Imports

The following are the top 10 Chinese imports during 2022. This top 10 accounts for over 76% of the total US\$ value for all imports to China.

1. Electrical Machinery and Equipment – US\$644.7 billion (23.7% of total imports to China)
 2. Mineral Fuels – US\$535.3 billion (19.7% of total imports)
 3. Ores – US\$224.7 billion (8.3% of total imports)
 4. Machinery including Computers – US\$202.1 billion (7.4% of total imports)
 5. Gems & Precious Metals – US\$103.7 billion (3.8% of total imports)
 6. Optical, Technical & Medical Apparatus – US\$82.0 billion (3% of total imports)
 7. Vehicles – US\$80.8 billion (3% of total imports)
 8. Plastics & Plastic Articles – US\$75.2 billion (2.8% of total imports)
 9. Copper – US\$68.7 billion (2.5% of total imports)
 10. Oil seeds – US\$68.6 billion (2.5% of total imports)
- Plus other imports that are shown on the figure below (Figure 4):

Figure6. China Major Import sources

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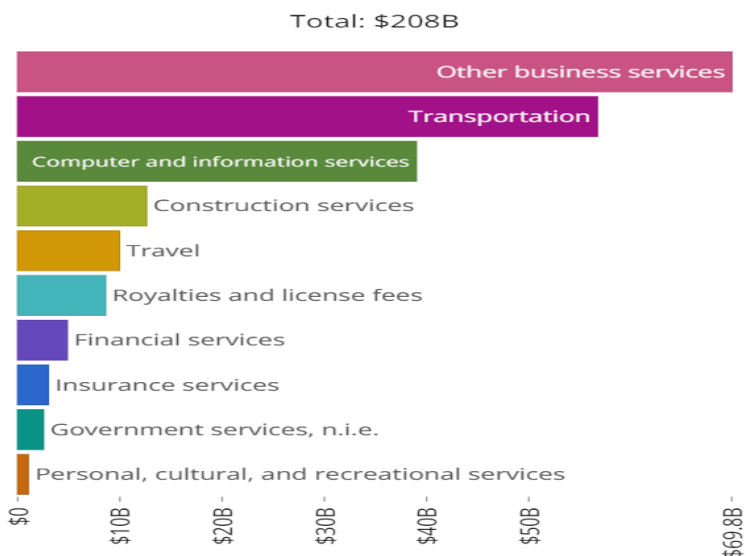
Source : <https://oec.world/en/profile/country/chn>

4.2 Exports

The following are the top 10 Chinese exports during 2021. This top 10 accounts for 68.4% of the total US\$ value for all exports from China.

1. Electrical Machinery and Equipment – US\$804.5 billion (26.6% of total exports from China)
2. Machinery including Computers – US\$492.3 billion (16.3% of total exports)
3. Furniture, Bedding, Lighting, Signs & Prefabricated Buildings – US\$126.3 billion (4.2% of total exports)
4. Plastics & Plastic Articles – US\$118.1 billion (3.9% of total exports)
5. Vehicles – US\$108.9 billion (3.6% of total exports)
6. Toys & Games – US\$94.0 billion (3.1% of total exports)
7. Optical, Technical & Medical Apparatus – US\$88.8 billion (2.9% of total exports)
8. Articles of Iron & Steel – US\$85.4 billion (2.8% of total exports)
9. Clothing & Accessories – US\$78.2 billion (2.6% of total exports)
10. Organic Chemicals – US\$73.0 billion (2.4% of total exports)

Figure7. China Major Exports



Source : <https://oec.world/en/profile/country/chn>

5. China Export and Import Partners

Trade has become an increasingly important part of China's overall economy, and it has been a significant tool used for economic modernization. The direction of China's [foreign trade](#) has undergone marked changes since the early 1950s. In 1950 some three-fourths of the total was accounted for by trade with noncommunist countries, but by 1954—one year after the end of hostilities during the [Korean War](#)—the situation was completely reversed, and communist countries accounted for about three-fourths. During the next few years, the communist world lost some of its former importance, but it was only after the Sino-Soviet [breach](#) of 1960—which resulted in the cancellation of Soviet credits and the withdrawal of Soviet technicians—that the noncommunist world began to see a rapid improvement in its position. In 1965 China's trade with other socialist countries made up only about one-third of the total.

A significant part of China's trade with the developing countries has been financed through credits, grants, and other forms of assistance. At first, from 1953 to 1955, aid went mainly to [North Korea](#) and North Vietnam and some other communist states; but from the mid-1950s large amounts—mainly grants and long-term interest-free loans—were promised to politically

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uncommitted developing countries. The principal efforts were made in Asia—especially to [Indonesia](#), [Burma](#) (Myanmar), [Pakistan](#), and [Ceylon](#) (Sri Lanka)—but large loans were also granted in Africa (Ghana, Algeria, Tanzania) and in the [Middle East](#) (Egypt). After [Mao Zedong's](#) death in 1976, however, the Chinese scaled back such efforts.

During the 1980s and '90s, China's foreign trade came full cycle. Trade with all communist countries diminished to insignificance, especially with the [demise](#) of most socialist states. By contrast, trade with noncommunist developed and developing countries became predominant. In general, China has had a positive [balance of trade](#) with its trading partners since 1990. [Hong Kong](#) became one of China's major partners prior to its reincorporation into the country; it remains prominent in domestic trade, notably in its reliance on the mainland for agricultural products. [Taiwan](#) also has become an important trading partner.

Most of China's imports consist of machinery and apparatus (including semiconductors, computers, and office machines), chemicals, and fuels. The main import sources are Taiwan, [South Korea](#), [Japan](#), the [United States](#), [Australia](#), and the countries of the [European Union](#) (EU). Regionally, almost half of China's imports come from East and [Southeast Asia](#), and some one-fourth of its exports go to the same countries.

Table 1. China Top 5 Export and Import Partners

Market	Trade (US\$ Mil)	Partner Share (%)
United States	577,125	17.16
Hong Kong, China	349,442	10.39
Japan	165,823	4.93
Korea, Rep.	148,847	4.43
Vietnam	137,905	4.10

Source : <https://wits.worldbank.org/countrysnapshot/en/chn>

6. Conclusion

China's economy has strongly rebounded from the deep dive following the COVID-19 outbreak and has returned to its gradually slowing path. The rebalancing from investment to consumption, from manufacturing to services, and from rural to urban migration have all been set back by the pandemic, but need to restart to make growth sustainable and inclusive. The investment-driven recovery kept investment efficiency low, indicating continued capital misallocation. Corporate debt climbed to pre-pandemic highs: borrowing has been fuelled by crisis-related and more long-standing factors, including implicit guarantees for state-owned enterprises and other public entities. Slowing growth and continuing tax cuts will imply lower fiscal resources to make growth more inclusive, thus stable revenue sources from personal income taxes and dividends from state-owned enterprises are needed. Although the population is aging rapidly, China can still reap the "reform dividend" with measures to keep up the sustained growth of productivity. Reforms that enhance competition in product markets are among those that can potentially bring about significant productivity gains.

The potential for the current China rally to continue depends on several factors and we believe many of those factors are already in place. The current rally could be fundamentally different because state-linked investors are actively promoting their stock purchases, global investors are returning, albeit slowly, shareholders are being supported by top-down policies, the economy is recovering meaningfully, and valuations are more attractive than ever with improving earnings expectations for internet companies.

For onshore China A-shares (Mainland China stocks), we prefer the top 50 largest and most liquid stocks available through the Northbound Stock Connect program, which can be accessed through the KraneShares MSCI China A 50 Connect Index ETF. For offshore China shares (Hong Kong and US-listed stocks), we prefer top internet companies, which can be accessed through the KraneShares CSI China Internet ETF.

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