

Beyond the Great Wall

Why some see China's integration into the global trading system as a competitive threat but others, including global consumers, see it as a boon

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AFTER a long period of isolation, China's visibility within the international trading system has increased dramatically over the past two decades. Its share of world trade has risen from less than 1 percent in 1979 to 5½ percent in 2003. This dramatic (more than fivefold) increase in its share of world exports over a relatively short period has sparked a number of questions and concerns about China's trade practices. Particularly shrill concerns about the impact of Chinese exports have been raised in various industrial and developing countries based on perceptions that Chinese goods are flooding local markets, crowding out exports from other countries, and resulting in domestic job losses.

To get behind the often overheated rhetoric about China's role in world trade, it is useful to examine this topic from a broader set of perspectives. For instance, what are some of the factors that can help explain the sustained growth in China's exports? How have its trade patterns changed during this period? Is a continued expansion of China's trade likely? What effects will this have on its main trading partners and on China itself? Such questions have potentially important implications for the global trading system and, in particular, for other Asian economies.

China's international trade has expanded steadily since the opening of the economy in 1979 (Chart 1). This process began relatively slowly in the 1980s after the relaxation of pervasive and complex import and export controls. The expansion of China's trade gathered steam in the 1990s with a range of trade reforms, including broad tariff reductions, and was further boosted by China's accession to the World Trade Organization (WTO) in 2001. Average tariff levels declined from more than 40 percent in the early 1990s to 12 percent by 2002, with further reductions to 10 percent scheduled to be implemented in the near future. In 2002, China's exports and imports both grew by about 21 percent—faster than in any other major economy—at a time when total global trade was essentially flat. This already remarkable pace of trade growth has strengthened further in 2003, with exports increasing by about 30 percent and imports growing even more rapidly, by over 40 percent.

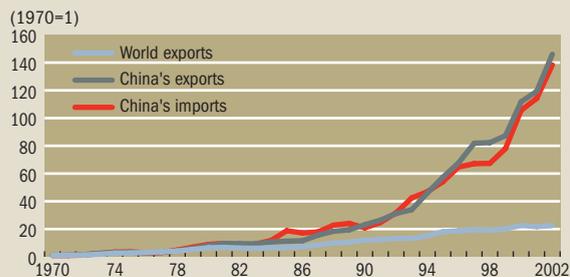
The recent depreciation of the U.S. dollar, to which the renminbi is linked, has no doubt added temporarily to China's competitiveness. But it should be kept in mind that China's low labor costs, supported by a large pool of unskilled as well as skilled labor, have been the primary determinant of China's external competitiveness, especially in the U.S. market. These low labor costs, in turn, have resulted in strong inflows of foreign direct investment that have boosted labor productivity. Indeed, reflecting these underlying competitive strengths, China's exports continued to grow rapidly virtually across the board even when the renminbi and the U.S. dollar was appreciating against other major currencies.

The importance of external trade to the Chinese economy has increased concomitantly, with the sum of exports and imports—a traditional measure of a country's openness to trade—now amounting to more than 50 percent of GDP, compared with 20 percent of GDP in 1989 and less than 10 percent of GDP in 1979. This increasingly outward orientation of the economy, along with the surge in inward flows of foreign direct investment, shows how rapidly China is integrating into the world economy in terms of increased trade and financial links.

Chart 1

Dramatic growth

China's exports and imports have grown much faster than world trade, especially since the early 1990s.



Source: IMF, *Direction of Trade Statistics*.



Making computer hard disk drives in Dongguan, southern China.

Domestic impact

Increasing integration into the global trading system has helped sustain China's economic growth and has contributed to greater domestic efficiency. China's commitments under the WTO accession agreement should also improve the predictability, transparency, and competitiveness of the domestic business environment. Its export base in the 1980s and early 1990s was concentrated in special economic zones in the east coast regions surrounding Hong Kong SAR. In contrast to the initial focus on these tax-exempt zones, recent reforms have liberalized trade through widespread tariff reductions and brought more broad-based benefits, including greater internal integration of the mainland.

But the benefits of trade are still not evenly spread across the mainland. For instance, coastal areas such as the Pearl River delta (including Guangdong Province) and the Yangtze River delta (area around Shanghai) have seen the greatest benefits from export trade. Some of these disparities, of course, simply reflect differences in locational and other comparative advantages that these regions have in catering to the export trade. While some of these disparities are likely to persist, increased competition in transportation and related services that is being stimulated by external trade could significantly reduce transportation costs, especially for more rural areas, and contribute further to domestic interregional integration.

There are also likely to be significant disparities across sectors in the benefits from trade, especially as the Chinese economy continues to open up to imports. For instance, the domestic agricultural sector is likely to be hurt by imports of cheaper agricultural products from abroad. This could result in a further widening of the already large rural-urban income disparities. But policies under way, such as reduced restrictions on labor migration and increased land-use rights for farmers, should soften the impact on rural areas.

Notwithstanding such concerns, there are clearly major net benefits to Chinese households resulting from internal reforms and efficiency gains stimulated by China's opening up to world trade. The rapidly rising average incomes of Chinese households, in part, bear testimony to these benefits.

While the increase in China's trade over the past two decades has been dramatic, it is useful to keep in mind that this is by no means a historically unprecedented phenomenon. In fact, by some indicators, China's experience is less pronounced than those of Japan and Korea during the periods in which those economies underwent rapid industrialization and integration with the global economy (see box). These historical precedents, in addition to China's large pool of available labor and untapped development potential, suggest that China's role in world trade could continue to expand for some time.

Move into hi-tech

Is the traditional image of China churning out low-quality, mass-manufactured export products still accurate? In the 1980s and early 1990s, China's exports were concentrated mainly in clothing, footwear, toys, and other light manufacturing products. Since then, its shares of world exports have risen in nearly all categories and have grown especially rapidly in office machinery and telecommunications products (including electronics), as well as furniture, travel goods, and industrial supplies. More recently, China has made substantial gains in more hi-tech export categories, including automated data processing equipment. Electronic goods now account for as much as 25 percent of China's exports. Another example of this diversification is the number of broad product lines in which China's share of U.S. imports exceeds 10 percent, which has risen from 5 in 1990 to 16 in 2002.

Growth in China's trade in historical perspective

The increases in China's trade over the past 20 years have been dramatic: China's share in world exports is growing rapidly, and the penetration of China's exports into industrial country markets has been equally strong. But such rapid growth of a country's exports is by no means a historical anomaly. Measurements of export growth in U.S. dollars at constant prices show that, during their early periods of industrialization, Japan, Korea, some southeast Asian countries, and other newly industrialized economies (NIEs) maintained double-digit export growth rates, on average, for about 30 years (see table below). In fact, China's exports have grown at a slower pace, on average, than most of these countries (see chart).

Looking at the extent of penetration into key industrial

Deceptive speed

When average annual export growth rates are compared, China's growth is not out of line with the experience of other countries.

(percent change in export values in constant U.S. dollars)

| | Period ¹ | Number of years | Growth rate |
|-------------------|---------------------|-----------------|-------------|
| Japan | 1954-81 | 27 | 14.2 |
| Korea | 1960-95 | 35 | 21.5 |
| Malaysia | 1968-96 | 28 | 10.2 |
| China | 1978-02 | 24 | 11.9 |
| NIEs ² | 1966-97 | 31 | 13.1 |

Source: IMF, *Direction of Trade Statistics*.

¹Selected periods begin when sustained export expansion started and end when the 3-year moving average export growth rate declined below 10 percent.

²Includes Hong Kong SAR, Korea, Singapore, and Taiwan Province of China.

country markets yields similar results. Using the U.S. market as an example, China now accounts for 11 percent of U.S. imports compared with 10 percent for Japan and 3 percent for Korea. However, both Japan and Korea accounted for larger shares of U.S. imports in the past, with Japan's share increasing steadily in the 1960s and 1970s and reaching a peak of 22 percent in 1986. Korea had the fastest export growth rate sustained over a 35-year period, but because of its smaller size (relative to China and Japan), its import penetration of the U.S. market was not as pronounced. Still, Korea's share of U.S. imports reached 4½ percent in the late 1980s before declining slightly in recent years.

Similar footsteps

China's exports are following a path similar to that of some neighbors, but at a slower pace.

Exports in U.S. dollars, constant prices
(index, beginning of period = 1; log scale)



Source: IMF, *Direction of Trade Statistics*.

But the rapid expansion of exports is only half the story. It has been accompanied by sharp increases in imports, especially imports for processing and reexport, which have led to a significant increase in regional trade within Asia. For instance, in line with the increase of its electronics exports, China's imports of electronic components have grown markedly in recent years. In short, China's rising prominence in the world trade system has facilitated the process by which countries specialize in particular stages of the production process of various products, rather than specializing in a small range of products. Such "vertical specialization" in the Asian region has resulted in China's increasingly important role in the final assembly stages of a broad range of export commodities.

These changes in patterns of regional specialization, in turn, have had a profound impact on China's trading patterns with its major partners, with China now serving as a conduit for many exports from Asia to the United States and the European Union. In addition, China's increasing access to advanced country markets since its accession to the WTO has meant that more of its exports now go directly to those markets rather than being routed through third markets such as Hong Kong SAR.

Reflecting these developments, the share of advanced country imports accounted for by China has risen over the past two decades, with particularly sharp increases since the early 1990s in Japan, the United States, and the European Union (see Chart 2). Simultaneously, a rising fraction of exports of other countries, especially those of other Asian

economies, now goes to China (see table, page 49). For instance, China now accounts for 11 percent of Japan's exports, up from only 2 percent in 1990. While Asian products account for most of the dramatic increases in exports to China, the shares of U.S. and EU exports that go to China have also increased, from about 1 percent in 1990 to 3 percent in 2002. Thus, even as China has increased its penetration into advanced country markets, it has itself become a more important export destination, especially for other Asian economies. The efficiency gains from increased specialization in Asia are also seen in strong exports from the region to the United States and other industrial markets.

These changes in China's trading patterns are reflected in the evolution of its bilateral trade balances with some important trading partners (see Chart 3). Consistent with its more prominent role in the Asian region's production chain, China's exports to the United States have increased since the early 1990s, whereas the shares of some other major Asian exporters to the U.S. market have remained stagnant or declined. In particular, the share of U.S. imports of manufactures accounted for by China (and the Asian region as a whole) has risen significantly since the mid-1990s. As a result of this increased penetration of the U.S. market, China's bilateral trade surplus with the United States has mounted, as has its trade surplus with the European Union countries. Interestingly, over the same period, China's trade deficit with major emerging economies in Asia has increased sharply. Consequently, after a sharp rise in China's overall trade sur-

plus during 1993–97, the surplus has remained relatively stable in the range of about \$35–45 billion since 1997. With import growth now outstripping export growth, this surplus is expected to decline to about \$20 billion in 2003.

Implications for trading partners

A great deal of economic research aimed at quantifying the impact of China's WTO accession suggests that, by increasing domestic efficiency and enhancing competition in international markets, the reforms associated with this accession and other aspects of China's integration into the world economy could have significant net benefits for consumers around the world. Many emerging economies in Asia also stand to gain directly from China's expanding trade because they have a complementary trade pattern with China and are already benefiting from processing trade, with rapidly increasing exports of intermediate products and components to China. China has also made far-reaching commitments to open domestic sectors (such as agriculture and financial services) that are important to key trading partners.

However, as its exports continue moving up the value-added chain, China could pose a more direct competitive threat to these economies in the future. And it is clear that a number of economies that specialize in low-skill, labor-intensive exports are already having to make significant adjustments to increased competition from China. The expected future growth in China's clothing exports—in line with the phased removal of trade restrictions in developed markets—could have a further impact, especially for some low- and middle-income economies that benefit from advanced country quotas for their textile and clothing exports.

Overall, however, the benefits to other countries from sustaining China's growth momentum are likely to outweigh the disadvantages. China has become a major importer of a broad range of commodities and raw materials. In addition to the prominent role played by processing trade, imports for final consumption within the country also appear to be rising rapidly as Chinese consumers grow more affluent. Some estimates suggest that more than half of China's current imports are for domestic consumption. In fact, China is now a leading

The China market

The share of exports to China from other countries has increased dramatically since 1990.

Exports of selected countries to China (percent of their total exports)

| | 1980 | 1985 | 1990 | 1995 | 2000 | 2002 | Jan-June 2003 |
|----------|------|------|------|------|------|------|---------------|
| Japan | 3.9 | 7.1 | 2.1 | 5.0 | 6.3 | 9.6 | 11.1 |
| Korea | 0.0 | 0.0 | 0.0 | 7.0 | 10.7 | 14.7 | 16.2 |
| Malaysia | 1.7 | 1.0 | 2.1 | 2.6 | 3.1 | 5.6 | 6.8 |
| India | 0.3 | 0.3 | 0.1 | 0.9 | 1.8 | 4.2 | 4.5 |
| U.S. | 1.7 | 1.8 | 1.2 | 2.0 | 2.1 | 3.2 | 3.6 |
| Germany | 0.6 | 1.2 | 0.6 | 1.5 | 1.6 | 2.2 | 2.3 |

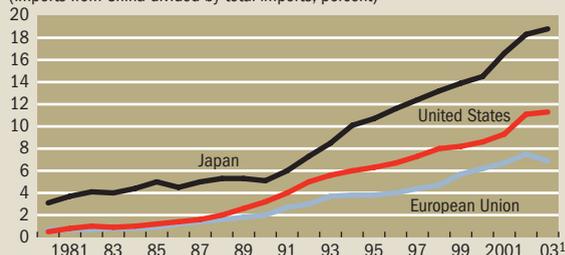
Source: IMF, *Direction of Trade Statistics*.

Chart 2

Increased market penetration

China is taking a growing share of industrial country imports.

(imports from China divided by total imports; percent)



Source: IMF, *Direction of Trade Statistics*.

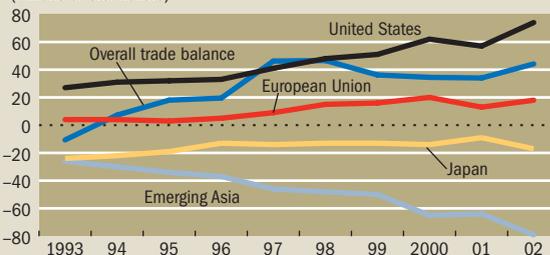
¹January–June.

Chart 3

Changing trade patterns

While China's bilateral trade surplus with the United States and the European Union has increased, its trade deficit with Asia has deepened.

(billions of U.S. dollars)



Sources: IMF, *Direction of Trade Statistics*, and staff estimates.

Note: Figures include Hong Kong SAR.

international importer of final consumer and industrial products. During this decade, these developments have undoubtedly contributed to the ability of the Asian region to perform strongly despite weak growth in the rest of the world.

While the economic changes wrought by this ongoing transformation will no doubt pose many challenges—both to China itself and to its trading partner countries—the potential benefits could be substantial for those countries that position themselves to take advantage of such changes. And, as China assumes a central place in the world economy, its growth and stability will become increasingly important to the world trading system at large. ■

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