China's Extraordinary Export Boom

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The story of the expansion of China's exports is a remarkable one by any standards. In 1978, China's exports were valued at around $20 billion, and its rank among world exporters was 32nd. Since then, exports have grown at an average annual rate of 30 per cent, such that in 2004 China overtook Japan to become the world's third largest exporter, with exports of nearly $600 billion.

In 2005, export growth has continued unabated, with even more breathtaking increases recorded in the first quarter of this year. Exports grew by more than 35 per cent compared to the same period last year, while import growth slowed down to 15 per cent. As a result, the Chinese economy posted a trade surplus of $16.6 billion, compared to an overall trade deficit of $8.4 billion in the first quarter of 2004.

This extraordinary growth has already given rise to backlash, especially in the United States, where protectionist pressures and anti-Chinese sentiments are on the rise. There have been calls for China to revalue upwards its currency the yuan (or RenMinBi), which is currently pegged at 8.28 per US dollar, not only from the US administration, but from the OECD, the G-7, and the IMF.

What is the story behind this apparently unstoppable export growth? Many observers have attributed this to the benefits of international economic integration, which is why the Chinese economy is typically cited as the great success story of globalisation. There is no doubt that such integration has played an important role, but the point to remember when analysing the Chinese experience is that this integration has not been purely market-led, but has been closely monitored, regulated and indeed controlled by the state.

This is clearly evident from a look at the external trade policy regimes in China, which have gone through several major phases. For two decades after Government Administration Council adopted the Interim Regulations on Foreign Trade Management in 1950, China's trade was based on complete state monopoly and dominated by trade with the former Soviet Union and other Eastern European countries. From 1979, along with various internal reforms especially related to the peasant contract system in agriculture, there was some opening up of trade.

From 1979 to 1987, there was a process of delegating authority with respect to foreign trade to lower levels and decentralising the highly concentrated planning management system. National purchase and allocation plans were replaced instructive plans with market regulation and implementing import and export licenses and a quota system. The pattern of trade was also diversified to include compensation trade, processing with supplied materials, trade on commission basis, border trade, local trade, small-deal trade, processing and assembling with imported materials, processing for export, chartering and leasing trade.

Between 1988 and 1990, foreign trade subsidies were frozen and a contract responsibility system in foreign trade was implemented. From 1991 to 1993, the foreign exchange mechanism was readjusted and a double-track exchange rate was adopted. Foreign trade enterprises (still dominantly State Owned Enterprises) were allowed to retain part of their foreign exchange earnings, but all financial subsidies to them were stopped and they were made to take on the responsibility for their own profits and losses.

In 1994, the unification of the dual rates in foreign exchange and adopting a unified floating exchange rate for Renminbi on the basis of market need and supply effectively meant a substantial devaluation of the RenMinBi. At the same time, the practice of allowing foreign trade enterprises to retain part of their foreign exchange earnings was abolished. The tax refund system for exports was implemented, and the range of import and export quotas and licenses was substantially cut.

On July 1, 1994, the “Foreign Trade Law” was officially put into effect, which stated that China practices a unified foreign trade system and, while giving appropriate protection to domestic enterprises, adopts such internationally conventional anti-dumping, anti-subsidy and guarantee practices. Controls were lifted over more than 90 per cent of export commodities, where market prices were to be dominant, and a bidding system was introduced for some important export commodities.

The WTO Accession Agreement of 2002 marked a new phase of intensified liberalisation of trade, with China making sweeping commitments to reduce quota controls, tariffs and so on especially with respect to agricultural products. Nevertheless, despite the apparent drastic trade reforms, the Chinese government retains substantial control over trade through two important levers.

First, nearly half of all exports are still accounted for by State Owned Enterprises, although the share of foreign owned enterprises has been increasing recently. Second, control over the banking system and the ability to direct and regulate the allocation of credit has been the most important instrument both of macroeconomic control and of direction of investment and production, which has had direct effects on both exports and imports. The recent deceleration in import growth, for example, is a clear result of the controls on credit implemented by the Chinese authorities on fears of overheating in the economy.

These various phases have also been associated with different degrees of integration into the world economy, based on indicators like trade dependence in GDP. The share of total trade (imports and exports) in GDP rose in a stable fashion from 9 per cent in 1978 to 25 per cent in 1989. In the 1990s, influenced by the dual impact of the RMB's devaluation and the accelerated growth of GDP value counted in terms of RMB, China's foreign trade dependence ratio experienced great fluctuations. From 2000, the rise in trade shares of GDP has been very rapid, going up from 43.8 per cent in 2000 to 60 per cent in 2003 to 70 per cent in 2004.

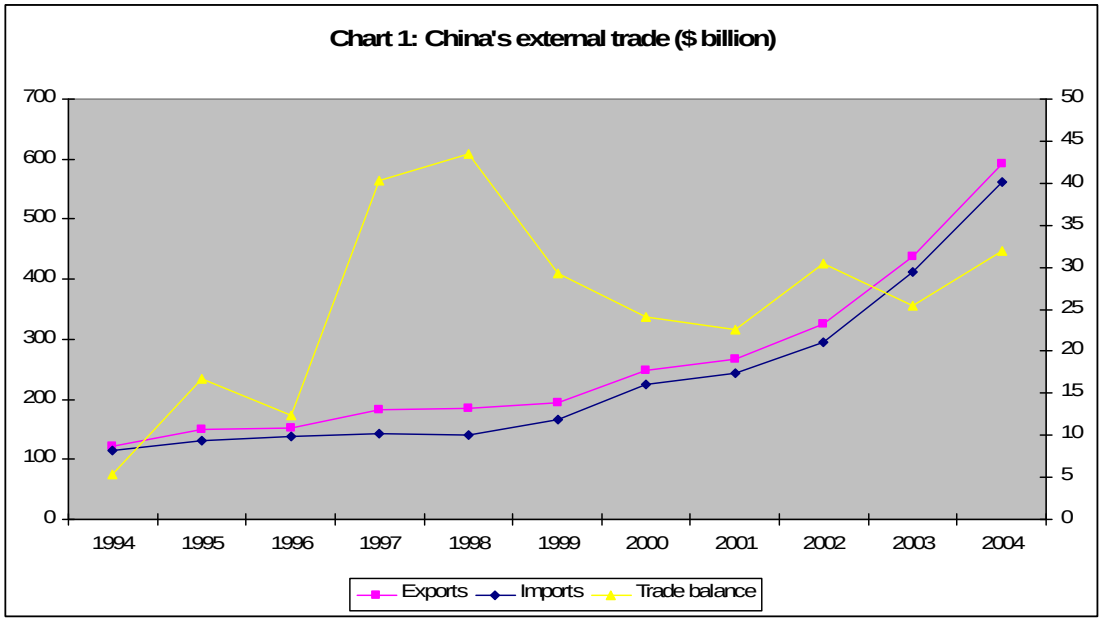
Despite the past experience of major exporters of the 20th century like Japan and South Korea, this experience is historically unique in its rapidity and extent, since no other country has been through such a massive increase in trade shares in such a short time. This can be attributed to a number of special features of China’s current trade, which is particularly based on the globally integrated production which is a relatively new feature of the world economy.

The proportion of processing trade is rather high in the makeup of China's foreign trade, which accounts for high imports being associated with high exports. Further, the Chinese expansion is still dominantly driven by manufacturing, and the tertiary sector still accounts for only one-third of GDP.

It is also true that China's GDP has probably to some extent been devalued because of statistics reasons. The overall GDP value of the country is lower than the summation of the production values of all regions, which suggests that the aggregate GDP data could be underestimates. The sums of the regional GDP values were 8.7, 9.7, 11.7 and 15.6 per cent

higher respectively than the overall GDP values in the years from 2000 to 2003. This would make the trade share of GDP appear to be higher than it actually is.

This is the context in which the recent trends in China's trade have to be viewed. Chart 1 shows the pattern of overall trade since 1994. It is evident that both exports and imports have been rising rapidly, but the trade surplus (on the right axis) has been relatively moderate and indeed has declined from its peak of 1997. The perception of overvaluation of the yuan is not justified from the point of the of the overall trade balance, which is currently showing a surplus of only around $32 billion, or only 2.3 per cent of GDP, which is hardly large by international standards.



What is of greater interest is the pattern of recent trade. The conventional view is that it has been driven by export of textiles and clothing, after the withdrawal of MFA quotas and the entry of China in the WTO. But Table 1, which indicates the top ten categories of export, suggests that apparel or garments has been only one of the factors behind the big export push. Toys, which was the other great export success of the 1990s, is also relatively less important in recent exports, which have been dominantly driven by capital goods.

Table 1: Top ten exports of China

Commodity Description	2003 ($ mn)	2004 ($ mn)	Per cent change
Electrical machinery & equipment	88,977.6	129,663.7	45.8
Power generation equipment	83,468.9	118,149.3	41.7
Apparel	45,759.2	54,783.6	19.7
Iron & steel	12,864.8	25,216.4	96.0
Furniture & bedding	12,895.5	17,318.6	29.1
Optics & medical equipment	10,564.3	16,221.0	53.6
Footwear & parts thereof	12,955.0	15,203.2	17.4
Toys & games	13,279.9	15,089.2	13.6
Mineral fuel & oil	11,110.2	14,475.7	30.2
Inorganic & organic chemicals	10,734.8	13,937.6	29.8

This indicates some shifts in trade pattern. Toys, clothing, furniture and television sets have dominated Chinese exports for years, but now newer products like portable electric lamps and even radio navigation equipment are now being shipped in growing quantities to countries ranging from Britain and Spain to Brazil and Indonesia. At the same time, China is becoming a large exporter of industrial commodities like steel and chemicals, importing fewer cars and less heavy machinery as Chinese companies and multinationals manufacture more of these in China.

These changes are reflected in imports, which are again dominated by capital goods rather than raw materials. Even though China became the most significant marginal consumer in the world oil market in 2004, oil imports are only the third largest element in the total import bill, as Table 2 indicates.

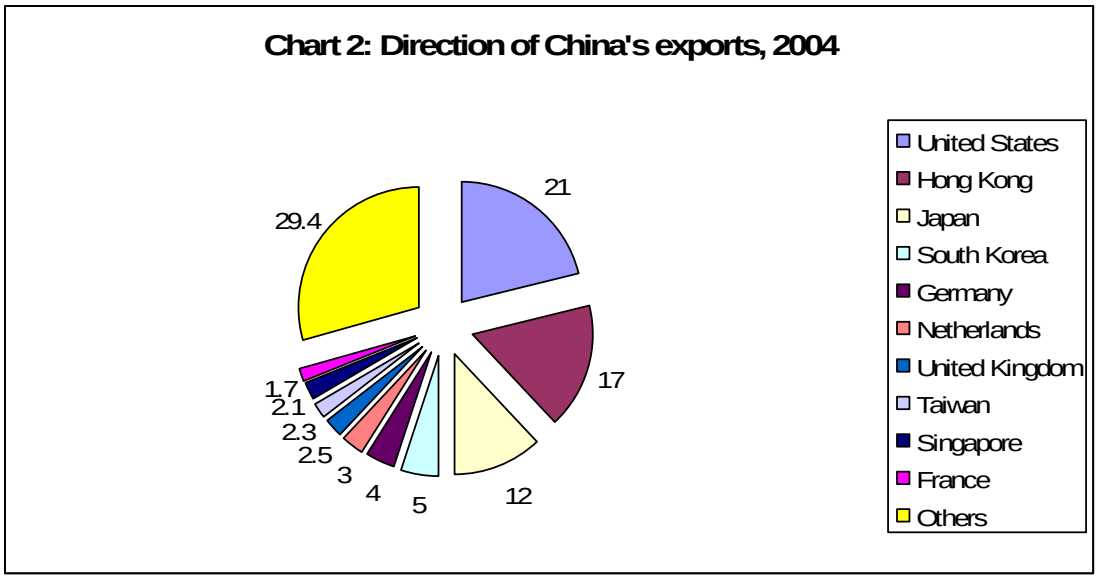
Table 2: Top ten imports into China

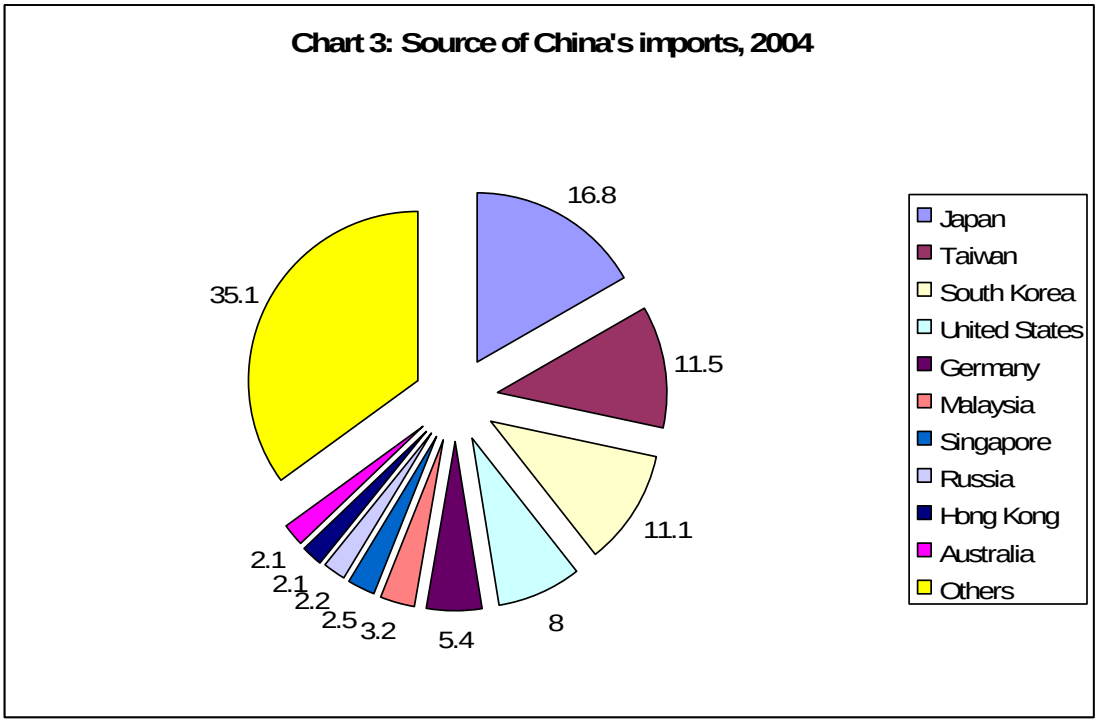
Commodity Description	2003	2004	% change
Electrical machinery & equipment	103,925.9	142,073.6	36.7
Power generation equipment	71,500.2	91,631.6	28.2
Mineral fuel & oil	29,272.5	48,036.6	64.2
Optical & medical equipment	25,137.5	40,154.9	59.8
Iron & steel	25,596.9	28,387.1	10.9
Plastics & articles thereof	21,032.6	28,060.1	33.4
Inorganic & organic chemicals	18,736.9	27,809.0	48.4
Ore, slag, & ash	7,171.9	17,292.7	141.0
Vehicle & parts other than rail	11,814.8	13,102.7	11.2
Copper & articles thereof	7,165.4	10,484.3	46.3

The changes in the steel industry are perhaps the most illustrative of what is going on. China has become the world's largest steel consumer, because of its massive construction boom and investment in road infrastructure. But Chinese steel production has risen even faster, as practically every province has erected steel mills. So many of these mills produce steel reinforcing bars, known in the industry as rebars and used in concrete construction, that China has gone from a shortage of rebars to a glut, and Chinese rebars are now being exported all over the world.

China became the largest foreign supplier last year of steel tubing and casing for oil wells in the United States, another technologically simple steel product that Chinese mills have mastered. Over all, China remains a net importer of steel, but by a shrinking margin. In 2004, steel imports fell 11.3 per cent, to $3.82 billion, while exports rose 389 per cent, to $2.62 billion.

These changes are also mirrored in the direction of trade, which has shown less dependence upon the United States in very recent times, and more concentration of Asia. This is reflected in Charts 3 and 4, showing the destination of exports and the source of imports respectively in 2004.





This is part of a conscious policy of the Chinese government, to diversify trade patterns and increase interaction not only within Asia (as exemplified by the China-ASEAN deal of late last year) but also attempts to reach out to Latin American and African countries.

All this indicates the hard-headed and practical nature of the Chinese economic leadership, which has so far resisted the increasingly oppressive calls for currency revaluation and tried alternative methods like an export tax, which it has already imposed on garments exports. Clearly, the Chinese trade strategy is one which involves far greater and more consistent state intervention than almost any other country, and its current expansion must be seen in that light.