Can China Become the New Growth Pole for Asia?

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It's almost official now: the US economy is on the verge of, if not already into, a recession. And as more and more of the economic signals from the US emphasise this, analysts have already started speculating on what this means for the rest of the (increasingly integrated) world economy.

For a very long time now, the US has been the main engine of growth in the global capitalist system, essentially through its voracious demand for imports which have caused significant increases in export growth in both other developed countries as well as the developing world. The most recent global recovery, which has been associated with rising primary commodity prices as well, can also be traced at least partly to the effect of increased US consumption spending, driven by what now have emerged as unsustainable expansions of private debt through the sub-prime loan market.

But the recent boom has had another important element: the rapidly growing demand for imports emanating from Asia, and most particularly from China. It is this feature that has allowed several commentators to be more relaxed about the international implications of a US slowdown. From the London *Economist* to the financier George Soros, a number of voices have argued that the emerging economies of China and India will take up the slack in international demand and provide an alternative growth pole for the world, which will prevent an international slowdown.

As it happens, the Indian economy is still simply too small in global trade to have much of an impact in this way, even though its recent growth rates have been higher than the international average. But the Chinese economy is significantly larger and it also plays a much larger role in world trade, so it could well provide such a positive impetus if it continues to grow at the same rate as the recent past.

Since there has also been a substantial diversion of Chinese trade towards developing Asia, it is more likely to play such a role in that region than anywhere else. So it is worth examining recent trends in Chinese trade to see what they indicate for such a potential dynamic role of China, at least in the Asian region. (In what follows, the data all relate to merchandise trade and are taken from the IMF Balance of Trade Statistics.)

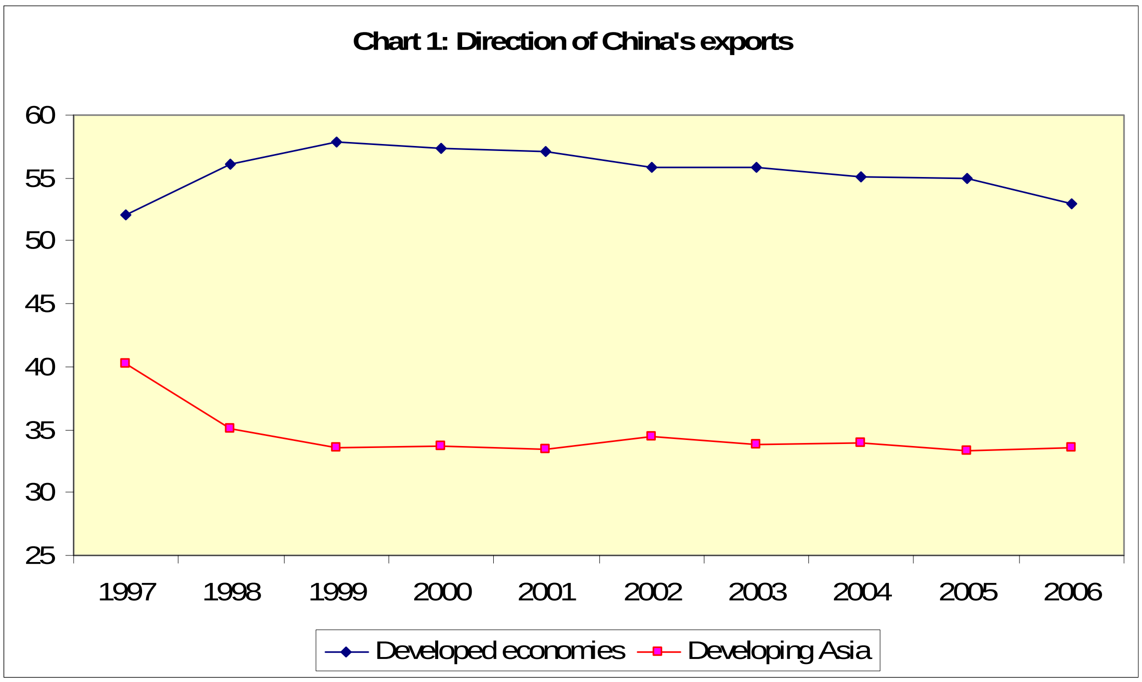
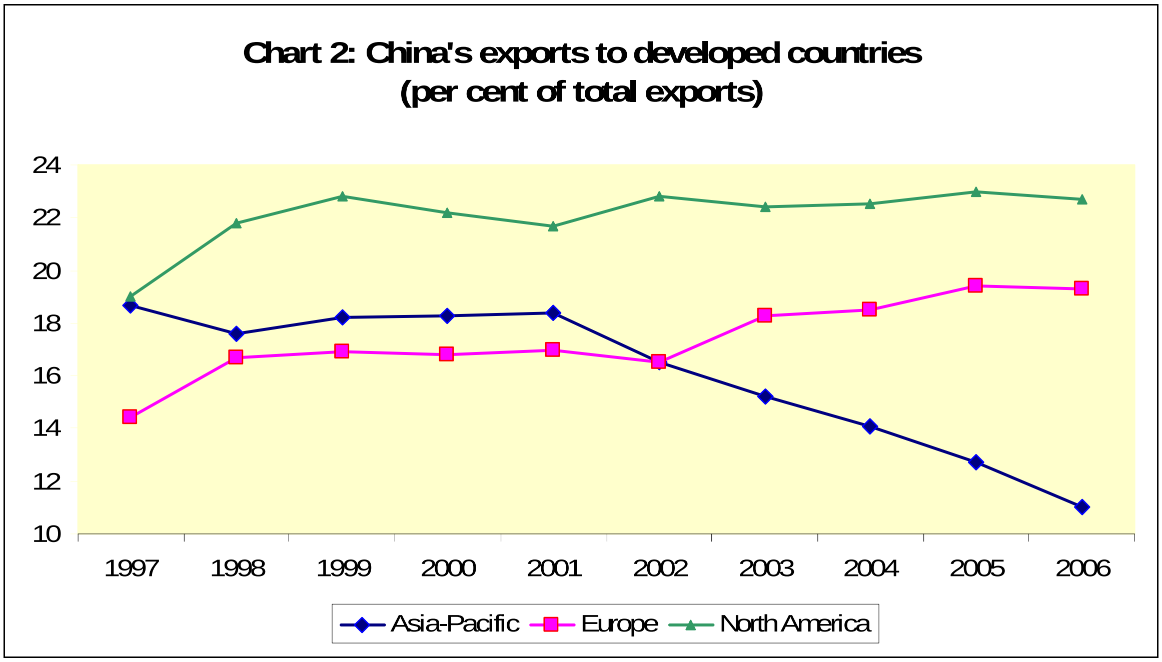
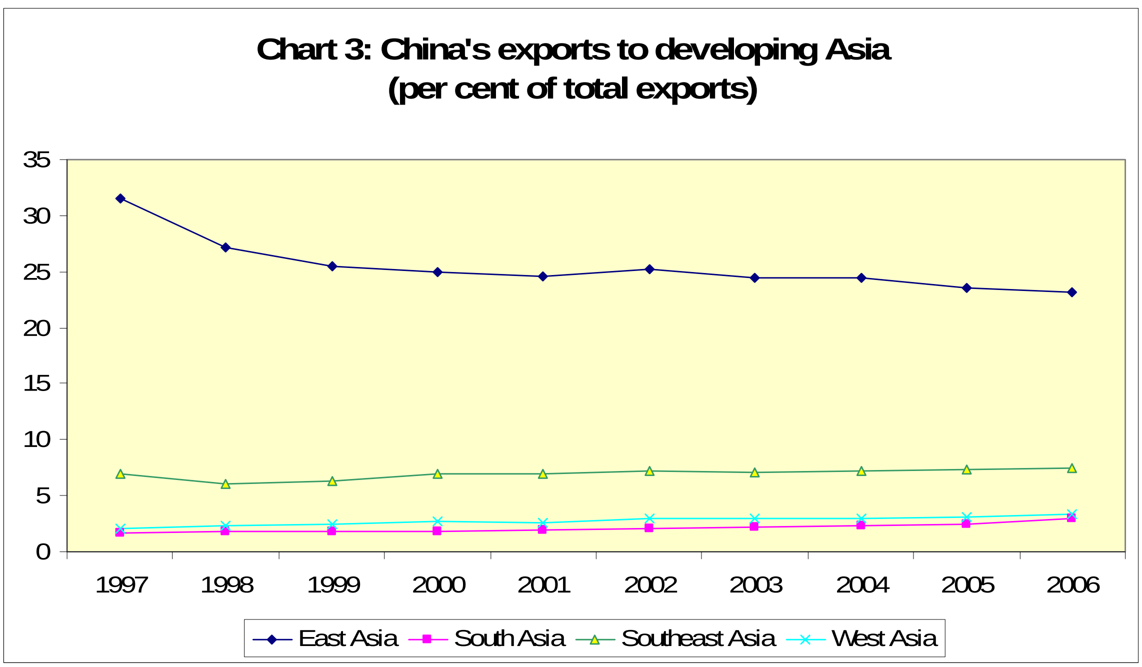


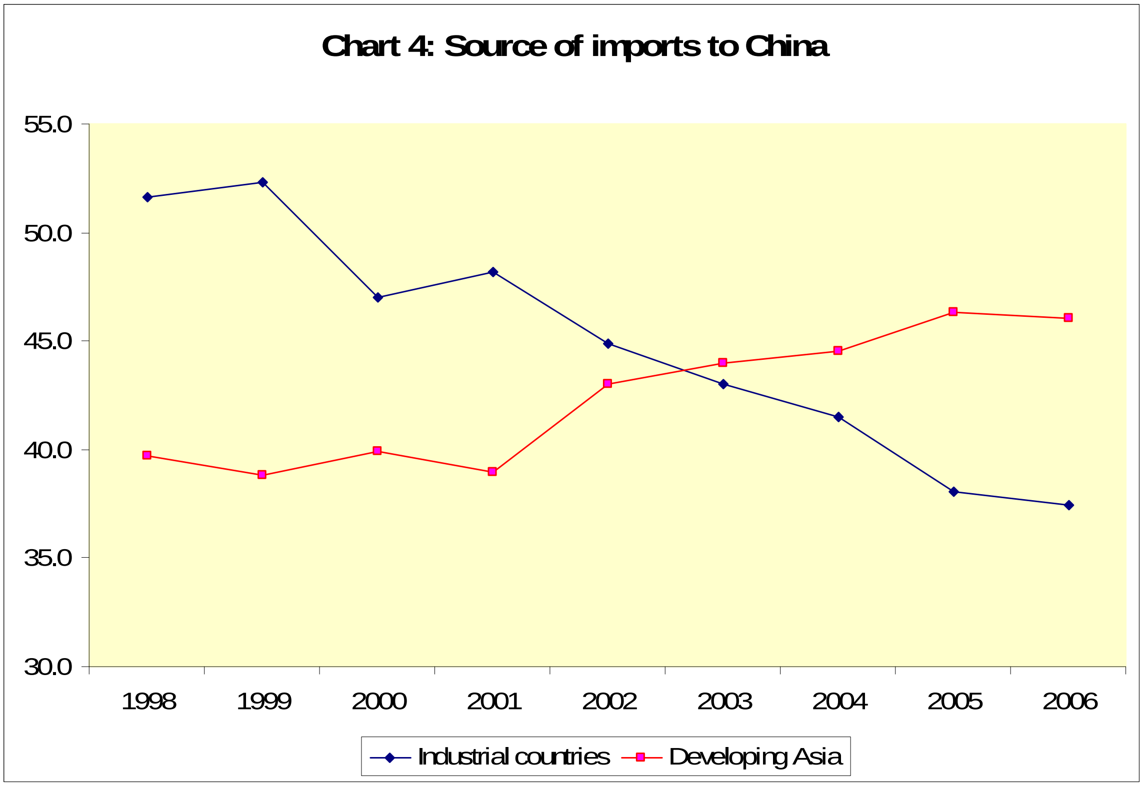
Chart 1 looks at the recent direction of exports from China. It is immediately evident that all the talk of diversification of export markets is rather overplayed. Even in the most recent years, the developed economies continued to play the dominant role as export destination, accounting for around 55 per cent of Chinese merchandise exports. Exports to developing Asia, on the other hand, are not only much lower at around 34 per cent, but also appear to have fallen compared to the late 1990s.

However, within the developed countries there has certainly been a shift, away from Japan and towards the US and the EU. This is amply evident from Chart 2. Exports to the US alone continue to account for more than one-fifth of China's total exports.





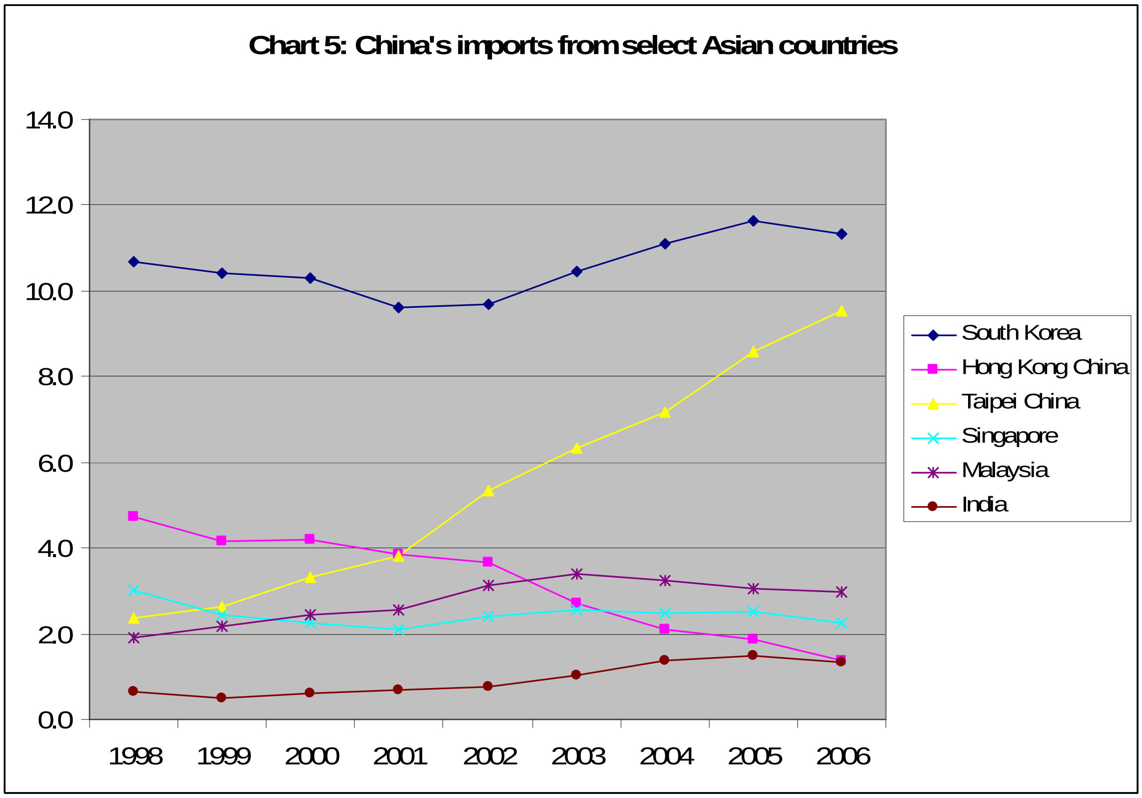
Within developing Asia, the most important export destinations are predictably in East Asia (which here includes the countries of Southeast Asia), as shown in Chart 3. However, the share of East Asia has fallen in recent years. Meanwhile, while exports to other parts of developing Asia have increased, they remain very small in relation to total exports.



The big change, however, and the reason why many analysts are seeing such potential for China as an alternative growth pole, is in the sources of imports. Chart 4 shows how the share of the developed countries has collapsed in recent years, and been overtaken by imports from developing Asia. Indeed, this region now accounts for 46 per cent of China's merchandise imports.

Within this region, as evident from Chart 5, the most significant source of imports has been South Korea, and its share has also increased in recent years. But the largest increase has been in imports from Taipei China, which is now almost as important as South Korea. It is worth noting that these countries have become more significant sources of imports into China than oil-exporters and primary commodity suppliers, despite all the talk of China driving world demand in such sectors.

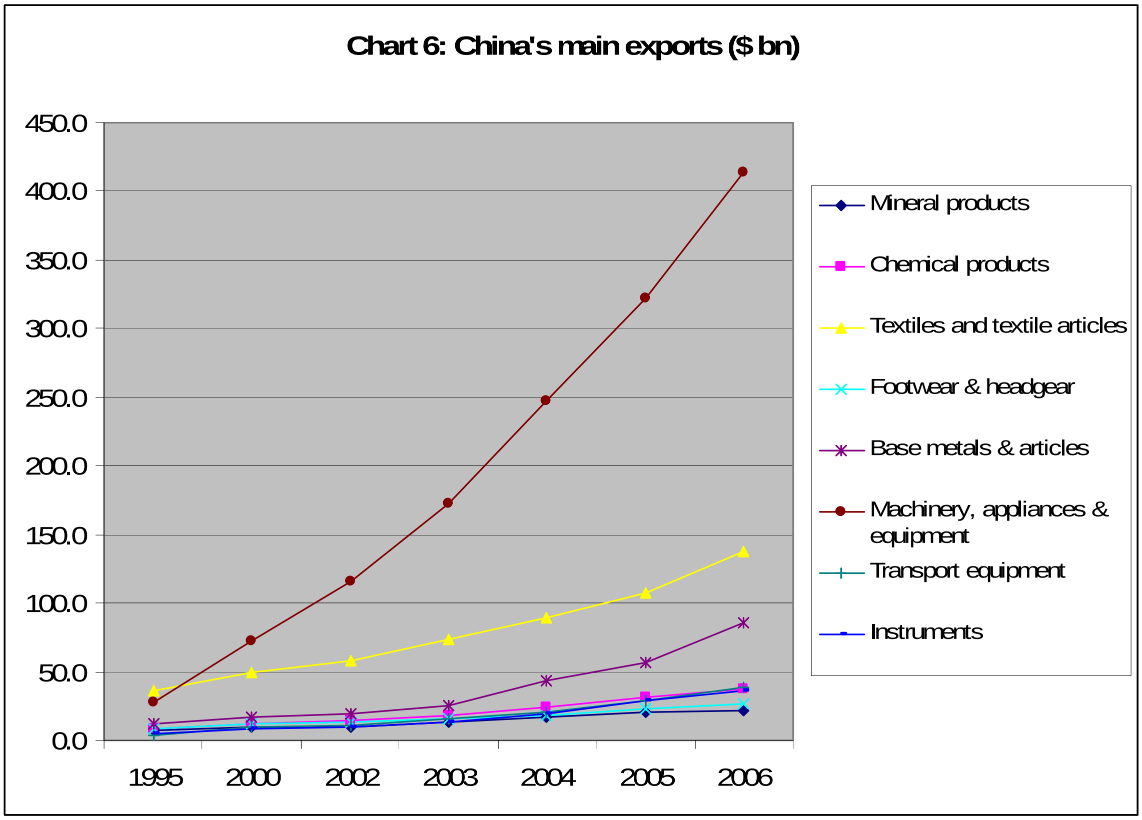
There have been increases in import shares from Malaysia and India as well, but they still remain rather small in overall importance in Chinese trade.



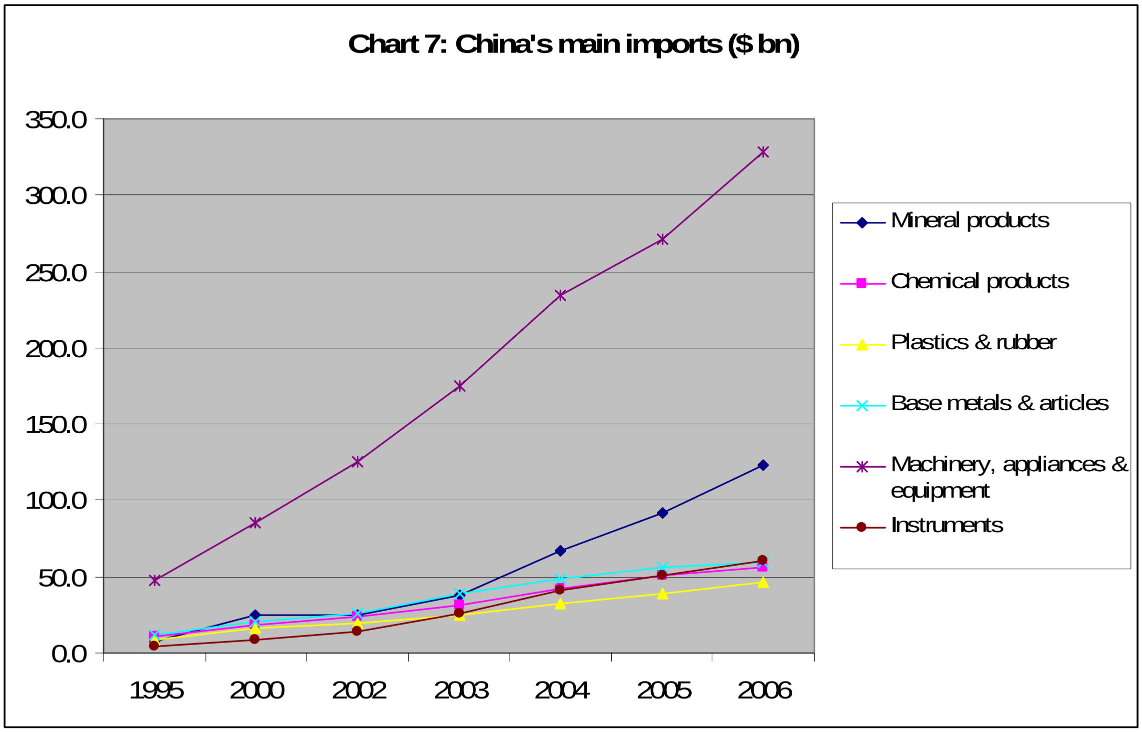
So what exactly is going on? Why have some other Asian countries become such important suppliers for China, even though they are not so significant as export destinations? This is best understood by looking at the commodity composition of Chinese trade.

Chart 6 show that two sectors have dominated in Chinese exports in recent times. The one that is talked about most often is textiles and textile products, and it is certainly evident that these exports have increased dramatically in dollar terms, nearly tripling in the four years after China joined the WTO and increasing by more than 55 per cent in the two years after the MFA restrictions were withdrawn.

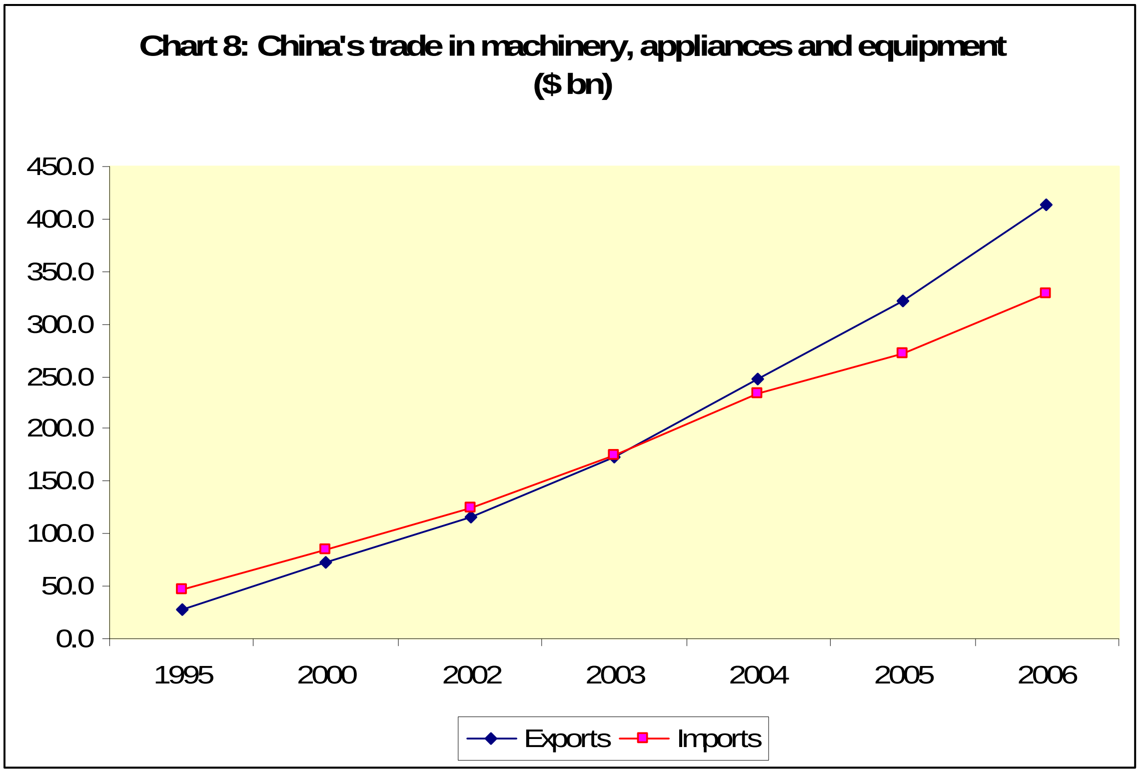
However, the really humungous category of exports is the broad head of "machinery, appliances and equipment" which covers a range of durable and semi-durable products intended for both industrial and domestic use. These exports have increased in value by nearly four times in just five years. In 2006, this category, at $414 billion, accounted for 43 per cent of China's merchandise exports.



It is worth noting that it is exactly this same category that also dominates imports, and has shown the largest increase in the recent period. Chart 7 indicates that imports of machinery, appliances and equipment have been much more significant in absolute value terms than imports of mineral products, including oil. In 2006 they accounted for 41 per cent of total Chinese imports.



What we get, therefore, is a picture of China emerging as a major processing destination for machinery, appliances and equipment, using imports of intermediates and parts from the developing countries in the Asian region to produce final goods for export to the developed countries of the West. Chart 8 shows that the patterns of imports and exports of this category have been broadly similar, with China emerging as a net exporter in this category after 2003. The total volumes and values involved are huge, and even net exports were as much as $86 billion in 2006.



So China is very clearly increasingly involved in a relocative production network with other developing economies in Asia, which has involved massive increases in imports from those countries, to be processed and then exported. However, the problem is that the final destination remains the North, and within that the US and to a lesser extent the EU. If demand for Chinese exports from the US and the EU slows down, as will be likely with a US recession, this will not only affect Chinese manufacturing production, but also Chinese demand for imports from these Asian developing countries.

(Incidentally, this dependence also helps us to understand why Chinese government-controlled wealth funds have recently been so active in trying to refinance troubled US banks and prevent a US economic downslide.)

So, with current trade patterns, China is unlikely to become an alternative growth pole for the world economy, or even for the Asian economy. For that to happen, a different economic strategy would be required in China, which would change both the domestic production orientation more towards the home market and the external orientation more towards trying to diversify exports to other developing countries.

This is both eminently possible and greatly desirable in the current context, given the enormous foreign exchange reserves held by China and the fairly large trade surpluses that continue to be run. It is even possible to think of a Marshall Plan-style aid plan by China, for developing countries who would then import its manufactures. Of course all this would imply significant changes in the international economy that do not immediately seem likely, but a financial crisis in the US could even concentrate the minds of Chinese policy makers in this desirable direction.