

### ***Research Focus***

#### ***China's rise and East Asian export performance: is the crowding-out fear warranted?***

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The rise of China as a major trading nation is one of the most momentous developments in the post-Second World War era, surpassing even the stunning rise of Germany and Japan. This phenomenal export expansion has generated concern in policy circles in other East Asian countries that competition from China could crowd out their export opportunities, especially after China's accession to the WTO and the termination of the Multi-Fibre Arrangement (MFA) in 2005. As China integrates rapidly into global production networks in electrical and electronics products, this fear has intensified and led to concern that China threatened the export performance not only of low-income countries but also of newly industrialised economies (NIEs) and advanced industrialised nations. To give this policy debate a firm factual and analytical footing, we need a systematic comparative analysis of both China's export performance in the global context and emerging market opportunities in China, paying particular attention to possible complementarities arising from China's rapid integration into global production networks within vertically integrated manufacturing industries.

For more than a decade during China's post-reform era, conventional labour-intensive manufactures—particularly apparel, footwear, toys and sport goods—were the prime movers of China's export expansion. By the mid-1990s, 'miscellaneous manufacturing', a catch-all commodity group encompassing most of these products, accounted for almost half of total merchandise exports and nearly two-thirds of total manufacturing exports. Since then, the composition of manufacturing exports has shifted noticeably away from conventional labour-intensive product lines towards seemingly more sophisticated product lines, in particular those within the broader category of machinery and transport equipment. Between 1992–93 and 2004–05 the share of miscellaneous manufactures in total exports declined from 49 per cent to 31 per cent and the share of machinery and transport

equipment increased from 17 per cent to 44 per cent.

China's machinery exports expansion has resulted from its highly publicised export success in a wide range of 'information and communication technology' (ICT) products. China's world market share in office machines increased from less than 2 per cent in 1992–93 to over 28 per cent in 2004–05. Today, China is the world's largest global producer as well as the single largest exporter of personal computers; and its world market share of telecommunication and sound recording equipment—dominated by mobile phones, and DVD and CD players—increased from 8 per cent in 1992–03 to 26 per cent in 2004–05, giving a 'high-tech' image to China's export structure. Trade data showing this structural shift have been widely used to argue that China is rapidly becoming an advanced technology superpower and that the sophistication of its export basket is rapidly approaching the levels of advanced industrial nations, but closer examination of data suggests that such an inference is fundamentally flawed.

China's so-called 'high-tech' exports are predominantly 'mass-market commodities' produced in huge quantities and at relatively low unit cost, rather than 'leading-edge technology products'. Virtually all of these products are assembled by affiliates of multinational enterprises (MNEs) from imported parts and components as part of their global production networks. The final assembly stage undertaken in China is the most labour-intensive layer in cross-border production processes spread over many East Asian countries. MNEs' share in total exports from China increased from less than 2 per cent in 1980 to over 58 per cent by 2005. They accounted for 88 per cent of total information technology products exported from China in 2005. Moreover, the share of components in total machinery imports to China increased from 32.5 per cent in 1992–

93 to 63.4 per cent in 2004–05, with the import share of the three ICT products recording a much faster growth. By contrast, final goods (total exports minus components) have continued to dominate China's export composition. Over the past decade the share of final goods in total machinery exports from China has remained around 75 per cent, with only minor year-to-year changes. When components are netted out, more than 80 per cent of China's total manufacturing exports can be treated as labour-intensive products.

So this rapid growth of final goods (end products) exports in highly fragmented high-tech industries does not necessarily imply that China is rapidly gaining maturity as a sophisticated high-tech exporting economy. With international fragmentation of production becoming a symbol of economic globalisation, the classification of final commodities by factor intensity is not the same as the classification of the production process occurring in these countries by factor intensity.

Although China's share of total world manufacturing exports increased from 4.7 per cent to 12.4 per cent between 1992–93 and 2004–05, contrary to popular belief the market share of developing countries as a group has not declined noticeably. The combined market share of developing East Asian countries *increased* from 12.1 per cent in 1992–93 to 13.7 per cent in 2004–05. Labour-intensive product lines in Hong Kong, Korea and Taiwan rapidly 'migrated' to China through strong investment links from the late 1980s. Reflecting complementarity in the emerging patterns of global production sharing, market shares of developing East Asian countries in component trade have generally *increased* despite China becoming a major player in world machinery trade, even though most countries experienced some erosion in market shares of final goods trade. East Asia's share in total parts and component imports to China has *increased* sharply over the past two decades, and by 2004–05 over two-thirds of total components

imports to China originated in East Asia. The share of exports to China in total merchandise exports has *increased* in all East Asian countries over the past one-and-a-half decades. The relative importance of exports to China in total exports is *higher* for all East Asian countries compared to the average level for the rest of the world. East Asia's share in total parts and component imports to China has also *increased* sharply, and by 2004–05 over two-thirds of total components imports to China originated in East Asia.

A new econometric analysis of the determinants of bilateral trade flows, explicitly reflecting China competition in third-country markets, suggests that China's export expansion has not been associated with an absolute contraction in exports from other countries in third-country markets. On the contrary, China has gained market share in an expanding market. East Asia's performance record in withstanding China competition in global markets has been superior to that of countries in the OECD or Central and Eastern Europe (CEEU). At the disaggregated level, East Asia's relative superiority in withstanding China competition (compared to OECD and CEEU) seems to lie predominantly in component trade. The severity of import competition faced by the East Asian countries as a group in both miscellaneous manufacturing and final machinery products is also evident. However, China's rapid world market penetration in these products has occurred largely at the expense of the high-wage East Asian NIEs, which have naturally been rapidly losing comparative advantage in these product lines as part of their export-led industrial transformation.

Data on the direction of trade disaggregated by commodity category clearly point to the growing importance of manufactured goods—in particular, machinery and transport equipment and the parts and components therein—in China's trade with the East Asian countries. East Asia's share of total manufacturing imports increased from 37.3 per cent to 41.9 per cent. The share of machinery and

transport equipment in total East Asian manufacturing exports to China increased from 45 per cent in 1992–93 to 85 per cent in 2004–05. This increase was dominated by imports of parts and components reflecting China's evolving role as an assembly centre within East Asia. By 2004–05 over two thirds of total components imports to China originated East Asia. By contrast, China's final goods exports are heavily concentrated in extra-regional markets, particularly in industrialised countries in Europe and North America. Between 1992–93 and 2004–05, the share of Chinese exports to East Asia in total final goods exports declined from 49.5 per cent to 26.5 per cent while exports to OECD countries (excluding Japan and Korea) increased from 29.3 per cent to 50.1 per cent. The country composition of China's components imports and exports are very similar, with East Asia accounting for the lion's share on both sides. This reflects the multiple border-crossing of components between China and other East Asian countries at different stages of the production process.

Is China's reliance on East Asia for sourcing components for its burgeoning electronics and electrical industries a structural feature of the ongoing process of its rapid economic integration, or simply a passing phenomenon that will last only until China develops its own domestic production capabilities? Evidence indicates that firms involved in vertically integrated global industries are relying increasingly on international production networks embracing different territories and different forms of cooperation to optimise their competitiveness. Because of technological complexities and intrinsic country-specific cost advantages, countries are specialising in specific activities in the value chain and in certain kinds of products. Moreover, over a long period of time, many MNEs (particularly US-based MNEs) have significantly upgraded the technical capabilities of their regional production networks in other East Asian countries and have assigned global production responsi-

bilities to affiliates located in more mature East Asian economies. Naturally, country risk considerations have a much greater bearing on corporate decisions to deviate from these well-established global practices compared to simple relative cost considerations. Furthermore, China is still at the early stage of developing the private property rights, respect for intellectual property, and venture capital financing practices that are important long-run contributors to converting scientific and technological innovations into successful commercial ventures.

China's rapid integration into regional production networks creating an expanding market for parts and components from the other East Asian countries does not, however, lessen East Asia's dependence on the global economy. East Asia's growth dynamism based on this new form of specialisation still depends on its extra-regional trade in final goods, and this dependence has increased over the years. Put simply, growing trade in components has made East Asia increasingly reliant on extra-regional trade for its growth dynamism. Therefore, one can make a strong case for re-examining the economic implications of the 'East Asian Community' that brings together the ten nations of Southeast Asia with Japan, South Korea, and China. This new form of international specialisation cannot be sustained purely as an East Asian phenomenon because of the growing importance of extra-regional markets for final products. Moreover, regional trade liberalisation initiatives are unlikely to make much difference to cross-border trade in components because this trade takes place entirely under zero-duty concessions. Indeed, these countries would be better off upholding universal principles of economic openness.

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