SOUTH CENTRE

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DUE TO GLOBAL CRISIS, CHINA AND EAST ASIA NEED TO RETHINK THEIR GROWTH STRATEGY

As the global economic crisis evolves, China and other East Asian developing countries will be profoundly affected as their old growth strategies will no longer be able to serve them as before. Changes in economic policies and strategies that rely less on exports to the West will thus be required in China -- and even more so in the other Asian countries.

This is the conclusion of a new Research Paper by the South Centre, "Export Dependence and Sustainability of Growth in China and the east Asian Production Network." It is authored by the Centre's Special Economic Advisor and Chief Economist, Yılmaz Akyüz.

The paper is attached as a file. It can also be accessed at the South Centre website (www.southcentre.org) or at following internet link:

http://www.southcentre.org/index.php?option=com_content&view=article&id=1326%3Aexport-dependence-and-sustainability-of-growth-in-china-and-the-east-asian-production-network&catid=142%3Aglobal-financial-and-economic-crisis&Itemid=67&lang=en

According to the paper, the global crisis exposed the high dependence of China and other East Asian developing countries on exports for their growth. This makes these countries economically vulnerable as prospects for global economic recovery have become more gloomy recently, with growth likely to weaken considerably in Europe and with American consumers reducing their high spending.

China is vulnerable to an export slowdown and has to increase domestic consumption through a higher wage share in GDP

Using new methods of calculation, the paper shows that China has been much more deeply dependent on exports for its growth that previously estimated. The

Centre estimates that exports contribute about 50% of China's recent pre-crisis growth.

This high export dependence makes China more vulnerable than normally perceived to the slowdown in the US and Europe. In the medium term, China will not be able to return to reliance on exports to maintain its pre-crisis growth of 10% or more.

If its exports expand at the moderate rate of 10% a year (instead of the 24-30% in 2002-2006) its growth may barely reach 7%. Returning to a path of 10% growth requires raising domestic consumption much faster.

In recent years the share of consumption in GDP has gone down from 55% in late 1990s to 36% in 2008. The paper found that a major cause of under-consumption in China is the low share of household income in GDP, as wage increases lagged behind productivity increases. As a result the share of wages in GDP fell to about 40% at present from 50-55% in the 1990s.

The paper makes the following suggestions in the way forward for China:

- In view of bleak export prospects, a return to trend growth in China crucially depends on a sizeable increase in the share of household income in GDP and a corresponding decline in corporate profits, savings and investment.
- This calls for a higher share of wages in value-added and significantly greater government transfers to households, particularly in rural areas where incomes remain depressed.
- There should be greater public spending on social infrastructure in health, housing and education. These can be financed by dividend payments by state-owned enterprises.
- A shift from export-led to consumption-led growth would also require significant industrial restructuring.

Little of China's Exports To The US Is Retained As Income in China

China has come under criticism in the United States for having a large trade surplus with the US. However, the South Centre paper points out that in reality, little of the gross surplus is retained in China.

In 2005, China's gross trade surplus with the US was $172 bil but in value added terms (what is earned by the respective countries after deducting the import content of their exports) it was only $40 billion.

Further, a large part of the the Chinese trade surplus in value-added terms was earned by foreign firms in China as profits ent to the profits of foreign firms. As a result, income left in China was no more than 30 per cent of total value of exports to the US.

Therefore the criticism that China enjoys extraordinarily high trade surpluses with the US is misplaced.

Other Asian Countries Face Deeper Problems and Need to Rethink Their Growth Strategy

According to the paper, the slowdown in global growth may impact other East Asian developing countries more seriously than China. This is because they are even more export dependent, and their exports not only to the West but also to China will be affected, even if China continues its high growth.

In Indonesia, Korea, Taiwan and Thailand exports contributed over 60% to growth, compared to 40-50% in China. The export dependence of Malaysia, Singapore and Vietnam is even higher.

The indirect exposure of these countries through China to a slowdown in exports to the US and the EU can be as important as and even more important than their direct exposure.

China's assembly-manufactured exports depend a lot on inputs from other Asian countries. For every $100 worth of processing exports of China to the US and EU, about $35-$40 go to East Asian developing countries and $20-$25 to China. Thus a slowdown of Chinese exports to the US and EU can have a strong impact on these countries.

This means that the other Asian countries are more vulnerable to a sustained slowdown of Asian exports to the US and the EU than China.

Further, while China is a major importer from these countries, it is not a major market for them since an important part of Chinese imports are destined to exports to advanced economies rather than used internally.

The paper shows that domestic consumption and investment in China generate proportionately much less demand for imports from East Asian DEEs than its exports to the US and the EU.

Consequently, a shift by China from export-led to a consumption-led growth and a shift by the US in the opposite direction would result in a significant slowdown of their combined imports from East Asian developing countries.

A $100 increase in Chinese consumption increases imports by less than $10 while a $100 decline in US consumption reduces imports by some $25. In other words, at its current pattern of domestic spending, the Chinese market is not a good substitute for the US and the EU markets for the other East Asian countries.

To become a regional locomotive, China would need to raise not only its domestic consumption as a proportion of GDP, but also its import content and, in particular, its imports of final goods from the region.

Moreover, the other Asian countries will need industrial restructuring even if there is a rapid increase in domestic consumption and its import content in China. The same problem would also be encountered in reducing dependence on exports by shifting to domestic markets.

The paper also notes that a main reason for excessive reliance on exports is under-investment. In several economies including Malaysia, Singapore, Philippines, Taiwan and Indonesia, investment rates have been hovering around 20 per cent of GDP in recent years, less than half the rate in China.

In none of these economies have investment rates recovered the levels attained before the 1997 crisis. Recent investment rates are too low to generate a rapid growth of either productive capacity or effective demand.

Private consumption has also been weak in most East Asian countries, barely reaching 55% of GDP in Korea, Malaysia, Taiwan and Thailand and below 40% in Singapore.

There is thus a great deal of re-thinking of future growth strategies needed – both for China and the other East Asian countries -- as the uncertainty of a global recovery continues.

NOTE:

The full South Centre paper is attached as a file. It can also be accessed at the South Centre website (www.southcentre.org) or at the following internet link:http://www.southcentre.org/index.php?option=com_content&view=article&id=1326%3Aexport-dependence-and-sustainability-of-growth-in-china-and-the-east-asian-production-network&catid=142%3Aglobal-financial-and-economic-crisis&Itemid=67&lang=en

For more information, contact Vice Yu of South Centre at Tel: +41 22 791 80 55, E-mail: yu@southcentre.org

The author can be contacted at yilmaz.akyuz@bluewin.ch