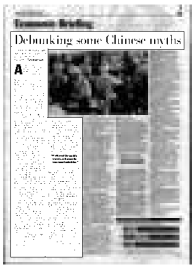

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Debunking some Chinese myths

China's impressive growth is not a zero-sum game – it will benefit other nations too, writes **Tim Harcourt**.

Are we all becoming a bunch of panda-huggers? At least on the trade front, we may be. In a recent survey of Australian exporters, the bilateral free-trade agreements (real and proposed) being negotiated by Australia were assessed in terms of their costs and benefits. Almost 45 per cent of exporters surveyed thought an agreement with China would be positive (20 per cent said very positive), 45 per cent were neutral and 10 per cent negative (4 per cent very negative).

This compared with a 25 per cent positive rating for the agreement with the US (67 per cent neutral, 8 per cent negative) and a 21 per cent positive rating for Thailand (75 per cent neutral, 4 per cent negative).

Generally speaking, in these surveys exporters usually take time to warm to the free-trade agreements, but in the case of China they took to it positively in terms of the potential business opportunities almost straight away.

Significantly, 31 per cent of these exporters were also importers (who re-exported 55 per cent of their imports). As Laurie Smith, Austrade's China-based regional director for North-East Asia, says: "We have no trouble marketing China to Australian exporters – China just markets itself. The key task for us is to ensure that companies get a balanced and realistic view of the market."

Should we be surprised? Not really. After all, even with the policy by the Chinese monetary authorities to cool the economy down, China is still going gangbusters. Its gross domestic product is still growing at above 9 per cent. And even with the state-sponsored "cooling", the economy is forecast to register an 8 per cent-plus growth rate.

China is punching well above its weight in terms of its share of world trade and output. According to the Reserve Bank of Australia: "While accounting for only 5 per cent of world trade, China contributed approximately 15 per cent of the increase in trade in 2004 and became the world's third-largest merchandise importer. In contrast, the G7 [Group of Seven] industrialised countries, despite accounting for nearly half of world trade, contributed only a third of the increase in 2004."

The world's most populous nation is indeed changing at a rapid pace. It is undergoing transition from a state-controlled collectivist economy to a market-based system on a massive scale. It is big, it's fast, it's impressive, it's dynamic. And, believe it or not, China's progress is making a significant impact on the Asia-Pacific region and the whole global economy.

But the strength of China's growth is a two-edged sword. Many commentators fear its size and believe that China's expansion will only come with contraction everywhere else.

Articles about China in the US press commonly feature alarmist headlines such as "Fear of the Chinese Giant" or "The China Syndrome" and concentrate on threats rather than opportunities.

These commentaries talk about Chinese low-cost labour eventually becoming the workshop of the world with manufacturing virtually being wiped out in all nations except the People's Republic. The fears of Chinese economic power expressed in these articles often spill over to the strategic arena. They influence political candidates, and fears of China now replaces fears of Japan or Mexico in the US primaries.

This is occurring in Europe too. On a recent visit to the European Union, I found the threat of China to European manufacturing – in both the west and the former communist east – was frequently raised by European bureaucrats.

"It will need the world's imports as it grows its own export industries."

How much is overreaction? Let's round up the usual suspects in terms of the common claims about China to see if they have any validity.

The first is that the speed at which China is turning into an economic superpower is unprecedented in world economic history. Research by Goldman Sachs shows that this claim is exaggerated. China's economic performance since 1978, impressive as it is, is not in the same league as the rise of Japan or that of the Asian tigers or newly industrialising economies (NICs). According to Goldman Sachs, China's growth performance "is not unprecedented – and not particularly impressive by Asia-Pacific standards".

The second claim is that China will hollow out global manufacturing. This fear is also misplaced. China largely re-exports manufacturing inputs from the rest of Asia – the amount of Chinese value-added in a lot of China's exports is quite small, since there is a high imported component from its Asian neighbours.

Hence, the large increase in trade between China and the rest of the world (such as the US) should be seen in the context of the marked increase in intra-Asian trade over the past two decades. In particular,

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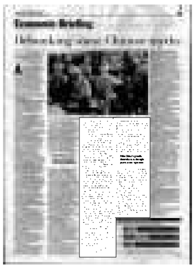

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the increasing US trade imbalance with China is being almost precisely offset by decreases in the US trade imbalance with other Asian countries that are supplying China's imported inputs.

In other words, countries that used to send their labour-intensive exports direct to the US now send them to China to be assembled or processed, and they are shipped from China to the US. Essentially, China's imports will grow together with its exports and the whole region will benefit as well as the rest of the world.

The third claim is that China is a threat to high-tech manufacturing and this will ultimately threaten high-tech, knowledge-based manufacturing industries in other economies. However, it must be emphasised that while China may be a growing producer of information and communication technology (ICT) products, biotechnology, cars and even space technology, it is still not a net-exporter in these industries. China still imports large amounts of capital goods and high-tech manufactures so it can concentrate on industries where it has a comparative advantage – mainly labour-intensive assembly and processing.

The fourth claim is that China's low labour costs will undercut everyone else. However, China's low labour costs do not imply that all Chinese outputs are "undervalued" and that this is going to undermine the region. What matters is not absolute costs but relative costs. China will export what it can produce relatively cheaply and import what it cannot; hence its imports and exports will grow accordingly. As a result, China will not produce everything under the sun, despite the fact that it may have lower costs than most other countries.

Furthermore, China is coming from a low base and economic isolation. Its real incomes have only one way to go and that is up. Rising real incomes will be induced by demands for greater living standards and consumer goods. As Chinese from the poorer provinces see what is available on the richer coastal areas, they will aspire to higher living standards and consumer goods.

The fifth claim is that China's entry will undermine the economies of Japan and the Association of South-East Asian Nations (ASEAN). However, during the phase of strong growth in China, Japan and ASEAN undertook structural adjustment and have moved out of areas where China has a competitive advantage. In fact, many economists in Japan see China's rise as a benefit, not a threat.

The sixth claim is that China's entry into the World Trade Organisation will cost the rest of the world. This is not so. Trade is a two-way street and China will need the world's (and the region's) imports as it grows its own export industries.

"With China's growth, Australia is in the right place at the right time."

And it has not been plain sailing for China. Cambridge University's leading China specialist, Peter Nolan, argues that "most of the burden of adjustment from WTO entry has actually fallen on the Chinese people themselves – especially those working in sectors under pressure". This, he says, includes land intensive agriculture, capital-intensive heavy industry and domestic financial services providers.

In Nolan's analysis of Chinese state-owned enterprises (SOEs), he found that "large oligopolistic businesses like the SOEs that don't respond adequately to price signals will find themselves under intense competitive pressures".

According to the Nolan thesis, the entry of China into the WTO is symbolic of the pressure put on China's domestic economy as it opens up to the world. Economic reform will require major social adjustments and the development of social safety nets to enable those affected to cope with the massive economic changes already underway.

What does all this mean for Australia? Despite our historical fears of the tyranny of distance it may well be that, with China's surge of growth, Australia is in the right place at the right time. The tyranny of distance may have been replaced by the power of proximity.

Australia has exactly the kind of products and services that China needs to fuel its industrial expansion. Iron ore, wool, crude petroleum, coal and liquefied natural gas are important components of Australia's massive $12 billion plus export account with Beijing.

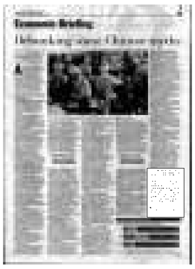
Last year, China was Australia's third-largest trading partner and export destination and our second-largest source of imports.

However, Australia's relationship with China is not just about commodities and deals at the top end of town. In fact, Austrade research shows that there are 3245 Australian companies exporting to China. And Sensis data shows that 10 per cent of small and medium-sized exporters have chosen China as a destination.

There is evidence for this on the ground too. Australia's senior trade commissioner to Beijing, Kym Hewett, says he sees many small Australian businesses as well as the blue-chip companies.

"We expect more services companies over here in the lead up to the 2008 Olympics – particularly in environmental technology, engineering and construction to supplement the strong growth we are seeing in education, tourism and architectural services," he says.

There is no doubt that China's growth is impressive – but it is important not to exaggerate the claims made about the Chinese economy.



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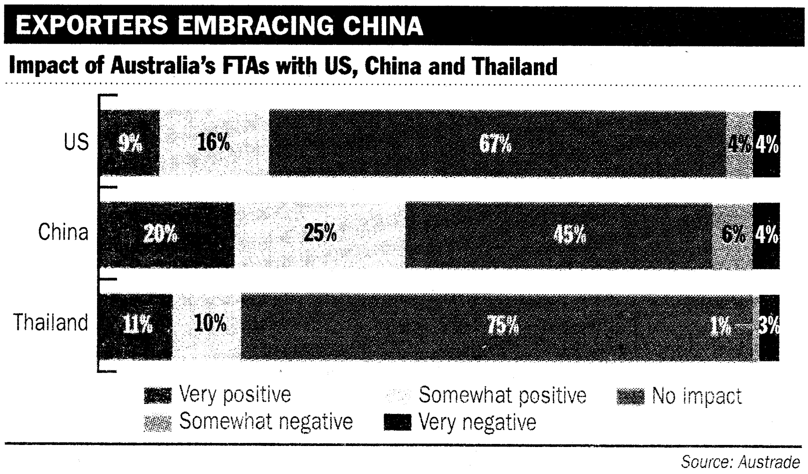
The opening up of the Chinese economy will mean more exports for China, but also more imports for other nations in Asia. China's triumph is not a zero-sum game – it can benefit other nations too and ultimately improve the lives of the Chinese people.

Australia will play an important role in China's development, and as shown in the initial response to a possible Australia-China free-trade agreement, the Australian exporter community sees closer links with China as being full of promise and opportunity.

■ *Tim Harcourt is chief economist at the Australian Trade Commission, www.austrade.gov.au/economistscorner.*



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