



## GROWTH LOCOMOTIVE CHINA

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# 2

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### Economic developments in 2003 and prospects for 2004

*Overall economic growth in China is expected to reach 8.5% in 2003, the highest rate since the Asian economic crisis in 1997/98. However, the expansion was harshly interrupted in the second quarter of the year by the outbreak of SARS (severe acute respiratory syndrome): economic activity in certain sectors and regions was paralysed as a consequence of panic reactions on the one hand and far-reaching preventive measures, including travel-bans, quarantine, etc. on the other. The GDP*

*growth rate declined to just 6.7% in the second quarter, after 9.9% growth in the first quarter of 2003. But growth resumed quickly when the disease was brought under control, reaching 9.1% in the third quarter. This gives an average 8.5% growth rate for the first nine months, which is expected to continue throughout the rest of the year and probably in 2004 as well. Such a scenario would be based on the assumption that the stimulating effects of a faster growing world economy in the year to come and policy measures to prevent an overheating of the Chinese economy will roughly balance each other.*

### Market forces adding fuel to the government-led economy

The fast growth of the Chinese economy in 2003 has been driven by a surge in fixed investment. Total investment in fixed assets in the first three quarters of this year reached 3435.1 billion yuan (USD 415 billion), up 30.5% year on year (in nominal terms), 8.7 percentage points more than in the same period of last year (see Table 1.1). Fixed asset formation thus reached a share of 43% of GDP, which is extremely high by international standards. Moreover, while in the last couple of years, following the Asian economic crisis, public

investment had by far outpaced private investment, the latter has been gaining momentum recently. In the first nine months 'collective and private investment' expanded at a rate of 27.6%. Investment was supported by rapidly rising industrial profits (49%) but fast rising loans as well. The volume of new lending reached 2.75 trillion yuan by the end of October, compared to 1.84 trillion for the whole year 2002.<sup>1</sup> Foreign direct investment was high, too, amounting to USD 42 billion in the first nine months of the year and showing an overall increase of 11%. Yet it remained below last year's levels from July onwards, which may be due to some delay in the realization of FDI projects as a consequence of SARS. In fact, committed FDI continued to rise at a fast pace. This points to continuous, strong inflows of FDI in the future as there will be plenty of opportunities for foreign investors in China's fast growing economy, in particular with the further opening-up of the services sector in line with WTO-rules. Apart from that, a fresh approach to the restructuring of state-owned enterprises (SOEs) allowing for private domestic and foreign participation, and the pressing need for raw materials and energy calling for intensified prospecting and exploration, will provide ample opportunities for direct investment in the years ahead.<sup>2</sup> For the whole year 2003, an inflow of USD 50 billion in FDI is expected.

### **Imports outgrowing exports, driving the regional economy**

Despite the sluggish world economy in the first half of the year and the SARS crisis considerably impeding the placing of orders in spring<sup>3</sup>, Chinese exports have further accelerated: in the first nine months they expanded at a rate of 32.3% as compared to 19.4% in the same period a year earlier. The fastest increase was observed in exports to the European Union (46.2%), taking advantage of the substantial depreciation of the dollar-pegged Chinese currency against the euro. Exports to ASEAN and the USA expanded by 31%, but those to Japan by only 22.8%. However, overall imports rose even faster (40.5%) resulting in a substantially smaller trade surplus (USD 9.1 billion)

as compared to the same period last year (USD 20 billion). Imports were boosted by the investment boom, WTO-related trade liberalization, inputs needed for export expansion and higher prices for many raw materials.<sup>4</sup> Imports from countries in the region showed the highest growth: ASEAN 54.5%; Republic of Korea 52.8%; Japan 39.7%. By achieving substantial trade deficits with these countries, China has supported the economic recovery of the region to a considerable extent. Yet, Chinese trade figures for October and November indicate a faster growth of exports than of imports and rather high (monthly) trade surpluses of USD 5.8 billion and USD 4.8 billion respectively. But this is considered a transitory phenomenon, with exporters advancing deals to take advantage of the more favourable tax rebate regime in effect until the end of this year.<sup>5</sup> (However, some trade experts believe that in addition to that, export revenues are being exaggerated to bring more foreign currency into the country, in expectation of a revaluation of the yuan.) As a consequence, the trade surplus for the whole year 2003 may be (in excess of) USD 20 billion, significantly more than expected. Nonetheless, the net effect of trade on the economy will be less expansive than last year, when the trade surplus exceeded USD 30 billion. For 2004, an even smaller trade surplus is expected, due to further acceleration of imports relative to exports.

### **Bilateral trade China–US under fire**

China has obviously become a hot topic in the run-up to the US presidential elections next year. The focus is on the huge US trade deficit with China and the presumed employment loss in the States due to it. Initially, the blame was put on the allegedly undervalued Chinese currency. But when the Chinese authorities strongly opposed to revaluing their currency for various reasons and even experts in the US became doubtful of the usefulness of such a step<sup>6</sup>, the US government resorted to more direct measures to curb the deficit, such as anti-dumping pledges against wooden furniture and television sets from China as well as quantitative restrictions on Chinese textiles

and clothing imports.<sup>7</sup> The Chinese government for its part has tried to ease the trade tensions by placing extra orders for US products on the occasion of US Commerce Secretary Don Evans visiting China in October and Prime Minister Wen Jiabao's visit to the USA in December this year.<sup>8</sup> Apart from this, general measures have been taken to dampen exports by reducing export rebates and by a relaxation of foreign exchange controls. China has also signalled its willingness to reconsider its current exchange rate regime on a longer-term basis and in conjunction with a financial market reform. However, the Chinese shopping list in the US was a mere drop in the ocean, and the US government is getting under mounting pressure because of the weakening of the dollar and its huge 'twin-deficits' (budget deficit and trade deficit); we thus expect more 'trade-wars' to be waged between the US and China in the near future, possibly impeding trade flows between the two countries. On the other hand, a faster growing world economy will give the Chinese authorities more room to manoeuvre, and rising prices for raw material imports and increasing inflationary pressure on the domestic market will make a revaluation of the Chinese currency more beneficial and thus more likely.

### **Private consumption picking up**

Retail trade turnover as a proxy for domestic demand picked up strongly in the third quarter of 2003 (9.7%), compensating for the meagre expansion in the second quarter (6.7%) due to SARS. But taking the first three quarters together, growth in real terms (9%) stayed below last year's level (10.1%). The investment-driven growth process has evidently not translated into rising employment and incomes across the board. The registered urban unemployment rate has further increased to 4.5% and the actual unemployment rate in China is estimated at about 15%.<sup>9</sup> Also, the already large urban-rural income gap has widened further. Despite favourable developments such as an adjusted product-mix, rising prices for agricultural products and an alleviation of peasants'

tax burdens, rural per capita incomes rose only 3.8% year on year (less than in 2002) while per capita incomes in the cities increased by 9%. That is reflected in a faster expansion of urban retail sales (9.8%) than sales in rural areas (6.4%). Particularly strong was the increase in retail sales of automobiles (77.5%), telecommunication apparatus (74%), building and decoration materials (46.6%) and furniture (42%), as well as petroleum and related products (38.7%). An increasing array of consumer credit products is offered by financial institutions supporting sales of durable consumer goods.

### **Food prices pushing up general price level**

After declining in 2002, the consumer price index (CPI) started to rise at the beginning of this year. In the first quarter this was a consequence of soaring oil prices, mainly in anticipation of the Iraq war; in the second quarter the reason was a surge in food prices largely due to distribution problems and supply shortages as a consequence of SARS. In the third quarter an overall shortage of grain from domestic production, caused by bad weather and by structural factors such as the reduction of grain-sowing areas, pushed up the overall consumer price level. Prices for certain services such as education, medical services and housing increased as well. For the first nine months, the CPI was on average 0.7% higher than the year before. In October and November, the food-price driven CPI increased further (by 1.8% and 3.0% respectively) and the retail price index began to rise as well, although at a low rate. However, given the expected moderate rate of consumer price inflation of about 1% for the whole year and the fact that many industrial products are still in excess supply, inflation is not considered a problem. More serious is the general shortage of electric energy, so far not reflected in price hikes, but this may change soon: on 1 January 2004 a higher electricity price for industrial use will become effective, which may be transmitted to consumer prices later.<sup>10</sup> Pressure will also come from substantial price hikes for major raw materials as recently observed on the world market,

in particular for oil and metals (e.g. nickel, lead, copper, platinum) but for some agricultural products (e.g. cotton and soybeans) as well.

### **Booming manufacturing**

On the supply side, growth has been driven by the industrial sector. In the first three quarters, industrial value added (including mining and construction) increased at a rate of 11.8%, nearly 2 percentage points faster than in the same period of last year. Bigger enterprises (with annual sales revenues above 5 million yuan) expanded even faster (16.5%), with heavy industry outpacing light industry. Some industries growing at particularly high rates – such as the steel and construction material industry – are already showing signs of overheating in the form of capacity constraints and soaring prices. The information technology (IT) industry and the transport equipment industry, too, expanded over-proportionately, but fierce competition kept prices stable or even reduced them.<sup>11</sup>

Value added of both agriculture and the services sector expanded at a slower rate than last year, reaching only 2.8% and 5.4% respectively in the first three quarters of the year. Obviously, the impact of SARS on these sectors has been deeper. In agriculture, in addition, unfavourable weather conditions and an over-proportionate reduction of the sown area of grain resulted in a substantial fall in grain output.<sup>12</sup> The services sector was most heavily affected by SARS: growth in services dropped from 7.6% in the first quarter to 0.9% in the second quarter of the year, but recovered to 7.5% in the third quarter.<sup>13</sup> The generally slow growth of services, held back by government monopolies in some sectors (e.g. in banking) and by welfare considerations in others (e.g. housing, health care, urban transport), poses a particular problem as this sector should create new employment opportunities for labour released in the industrial and agricultural sectors as a consequence of restructuring and modernization. There is the suspicion, however, that the actual value added of services and its dynamics is underestimated by official statistics due to the

extensive 'shadow economy' in this field as well as measurement problems. To get a more realistic picture, a special survey of the sector is planned for 2004, supported by funding of the Asian Development Bank (ADB).

### **Good prospects for 2004**

The prospects for the Chinese economy in 2004 are generally good. The world economy has entered a new phase of expansion and the domestic economy is fast on track, in the midst of an investment-driven upswing. Major markets for Chinese products, such as the USA, Japan and other countries in the region, show particularly strong signs of revival; on the still staggering European market, Chinese exporters will have a competitive edge due to their dollar-pegged currency as long as the US currency remains weak in terms of the euro.

There are, however, certain impediments to an acceleration of growth in China: these are the fast rising raw material prices on the world market, rising inflation, shortages of electric energy, constrained transport capacities at home, and pending trade-wars in view of China's widening trade surplus with the USA and, to a lesser extent, the EU.<sup>14</sup> Furthermore, the proactive fiscal policy introduced in the aftermath of the Asian economic crisis 1997/98 to support growth, will begin to taper off;<sup>15</sup> instead, a restrictive monetary policy may be implemented to prevent an overheating of the economy<sup>16</sup>. On top of that comes the possibility of SARS returning to the region, and the political tensions with Taiwan. Nevertheless, the Chinese economy will most probably expand at a similar pace as this year, at a rate of about 8.5%, perhaps even more.

At a sectoral level, fixed investment growth (in particular public investment) will decelerate, although foreign direct investment may increase further as fresh opportunities open up. With growing multiplier effects, private consumption will expand at a faster pace than this year. While in the first few months of 2004 export growth may decelerate in the wake of export deals advanced to

the last months of 2003, exports over the year will remain strong – as will be imports, because of soaring prices for raw materials and further trade liberalization in line with China's accession treaty to WTO.<sup>17</sup> As a consequence, most Chinese experts expect the trade surplus and thus the current account surplus to decline further.

## Notes

- <sup>1</sup> It is estimated that the total new lending volume may exceed 3 trillion yuan (USD 362 billion) this year, which is the highest level since the beginning of the economic reforms in China.
- <sup>2</sup> From April to September 2003, SASAC, the State-owned Assets Supervision and Administration Commission, approved the property rights and asset transfers of 48 SOEs involving 22.5 billion yuan (USD 2.7 billion) worth of capital and rights. According to SASAC, there will be few wholly state-owned enterprises in the near future. In December, China's leading insurance company, China Life, by listing on the New York and Hong Kong exchanges, raised USD 3 billion in capital. The listing was the largest on international financial markets in 2003. (The Chinese state retains a 72% stake in China Life after listing.) There are also plans for the Bank of China and the China Construction Bank, two of the four big Chinese state banks, to list on the New York and Hong Kong stock exchanges probably before 2006, when full liberalization of the financial sector is stipulated by China's accession treaty to WTO.
- <sup>3</sup> For example, at the prominent 'Chinese Export Commodity Fair' taking place in Guangdong in April each year, this year's deals had reached USD 3.3 billion only, compared to USD 9.3 billion in 2002 (*China Daily*, 23 April 2003).
- <sup>4</sup> Notably, China's crude oil imports rose 29.8% year-on-year to 67.2 million tons in the first nine months of this year (*China Daily*, 22 October 2003).
- <sup>5</sup> Up to the end of this year, value added tax (VAT) charged on many export goods will be refunded in full amount – the VAT rate is on average 15%. Taking effect on 1 January 2004, tax rebates will on average become three percentage points lower.
- <sup>6</sup> 'A rise in the value of the renminbi (=yuan) would be unlikely to have much, if any, effect on aggregate employment in the United States.' (Alan Greenspan, chairman of the US Federal Reserve, quoted in the *Financial Times*, 12 December 2003.)
- <sup>7</sup> On 18 November 2003 the US Committee for the Implementation of Textile Agreements (CITA) decided to set quotas on Chinese imports of knit fabric, dressing gowns and bras. The quotas had been eliminated when China joined the World Trade Organization (WTO) at the end of 2001 (*China Daily*, 20 November 2003).
- <sup>8</sup> On the first shopping tour, focussing on industrial products, the highlight was a USD 1.7 billion deal for Boeing 737 jets. On the second tour, emphasis lay on raw materials (e.g. aluminium worth USD 320 million, natural gas) and agricultural products (e.g. soybeans worth USD 1.6 billion), but machinery, electronic products, medical equipment and coal mining equipment were included as well. Altogether deals worth about USD 8 billion were signed.
- <sup>9</sup> Professor Zeng Xiang-quan from the Renmin University of China, quoted in *China Daily*, 23 December 2003.
- <sup>10</sup> The scheduled increase is 0.7 fen (0.08 US cent) per kwh. For a small-sized iron plant using about 100 million kwh per year, this will raise costs by 700,000 yuan (85,000 USD).
- <sup>11</sup> The production of semi-conductor integrated circuits rose 36.4%, automobiles were up 35.7% and the production of steel and rolled steel grew 21.6% and 19.4% respectively (*China Monthly Statistics*, 9/2003, Report).
- <sup>12</sup> Probably the government campaign 'turn farmland to forest and grassland' in recent years has overshot.
- <sup>13</sup> ADB, *Asia Economic Monitor*, December 2003 issue, Report on China, p. 39.
- <sup>14</sup> The projected trade balance with the US for 2003 is USD 130 billion in China's favour.
- <sup>15</sup> The amount of treasury bonds to be issued in 2004 will be significantly lower than this year's 140 billion yuan – probably reaching 110 billion yuan (USD 13.3 billion) only; it will be used less to back fixed asset investment but more for environmental protection, development of poor regions and boosting the growth of farmers' incomes. Long-term T-bonds valued at a total of 800 billion yuan (USD 96.3 billion) were issued from 1998 through 2003 (*China Daily*, 3 December 2003).
- <sup>16</sup> Already this year, the People's Bank of China (PBC), the country's central bank, took several steps to control money supply growth. In April, it began issuing short-term central bank bills to sterilize the influx of foreign capital. By end-September, these bills amounted to yuan 550 billion. In June, the PBC issued more prudential regulations to control property loans, particularly in high-end housing projects. Then, in September, it raised the bank reserve requirement ratio by one percentage point to 7%. As a result of these measures, there appeared to be some fall in monetary and credit growth in recent months. Growth of outstanding bank loans slowed from 7% during the second quarter to about 4.7% during the third quarter (ADB, *Asia Economic Monitor*, December 2003 issue, Report on China, p. 40). See also *wiiw China Report*, 1/2003, p. 4.
- <sup>17</sup> The average level of import duties will decline from 11% to 10.4% only, but in certain product categories tariff reductions will still be substantial. (In 2003, the average tariff rate was cut from 12% to 11%.)

Table 1.1

China: Selected Economic Indicators

	1990	1999	2000	2001 <sup>1)</sup>	2002	2002 <sup>1)</sup> Jan-Sep	2003 <sup>1)</sup> Jan-Jun	2003 <sup>1)</sup> Jan-Sep	2003 forecast	2004 forecast
Population, mn pers., end of period	1143.3	1259.1	1265.8 <sup>2)</sup>	1277.3	1288.0	.	.	.	.	.
Gross domestic product, CNY bn, nom.	1854.8	8191.1	8940.4	9593.3	10239.8	7168.2	5005.3	7911.4	.	.
annual change in % (real)	3.8	7.1	8.0	7.3	8.0	7.9	8.2	8.5	8.5	8.5
GDP/capita (USD at exchange rate)	339.1	785.7	853.0	907.1	960.5	.	.	.	.	.
GDP/capita (USD at PPP - WIIW)	1307.8	3717.5	4082.6	4444.3	4818.3	.	.	.	.	.
Industrial value added										
annual change in % (real)	3.2	8.8	9.9	8.9	9.9	10.0	11.6	11.8	.	.
Agricultural value added										
annual change in % (real)	7.3	2.8	2.4	2.5	2.9	3.0	2.7	2.8	.	.
Services value added										
annual change in % (real)	2.3	6.9	7.8	7.0	7.3	6.6	4.2	5.4	.	.
Goods transport, bn t-km	2620.7	4049.6	4445.2	4535.8	4787.2	3520.7	2523.6	3954.7	.	.
Total investment in fixed assets, CNY bn <sup>3)</sup>	451.7	2985.5	3291.8	3689.8	4320.2	2583.8	1934.0	3435.1	.	.
annual change in % (nominal)	2.4	5.1	10.3	12.1	16.1	21.8	31.1	30.5	27.0	.
Construction output, CNY bn	194.8	1515.1	1678.1	.	.	.	.	.	.	.
annual change in % (nominal)	-10.2	10.3	10.8	.	.	.	.	.	.	.
Employment total, mn pers., end of period	567.4	705.9	711.5	.	.	.	.	.	.	.
annual change in %	2.6	0.9	1.0	.	.	.	.	.	.	.
Unemployed (urban) reg., th, end of period	3832	5750	5950.0	.	.	.	.	.	.	.
Unemployment rate (urban) in %, end of per. <sup>4)</sup>	2.5	3.1	3.1	3.6	4.0	3.9	4.2	4.5	4.5	4.7
Average gross annual wages, CNY <sup>5)</sup>	2140	8346	9371	10962	12466	11233	12558	12622	.	.
annual change in % (real) <sup>6)</sup>	9.2	13.1	11.1	.	15.5	.	12.5	.	.	.
Retail trade turnover, CNY bn	725.0	3113.4	3415.3	3759.5	4191.1	2911.1	2155.6	3269.9	.	.
annual change in % (real)	0.4	10.1	11.1	10.9	10.6	10.1	8.4	9.0	9.2	.
Retail prices, % p.a.	2.1	-3.0	-1.5	-0.8	-1.8	-1.4	-0.4	-0.5	.	.
Consumer prices, % p.a.	3.1	-1.4	0.4	0.7	-0.8	-0.8	0.6	0.7	1.0	2.0
General government budget, CNY bn										
Revenues	293.7	1144.4	1339.5	1637.1	1891.4	.	.	.	.	.
Expenditures	308.4	1318.8	1588.6	1884.4	2206.3	.	.	.	.	.
Deficit (-) / surplus (+)	-14.6	-174.4	-249.1	-247.3	-314.9	.	.	.	-319.8	.
Money supply, CNY bn, end of period										
M0, Currency outside banks	264.1	1345.6	1465.3	1568.9	1727.8	1623.4	1695.7	1830.64	.	.
M2, Money + quasi money	1468.2	11989.8	13461.0	15830.2	18500.7	17699	20490.7	21356.7	.	.
Refinancing rate of NB % p.a., end of period <sup>7)</sup>	7.9	3.2	3.2	3.2	2.7	2.7	2.7	2.7	.	.
Current account, USD bn	12.0	15.7	20.5	17.4	35.4	.	11.1	.	20.0	17.0
Official forex reserves excl. gold, USD bn	11.1	154.7	165.6	212.2	286.4	258.6	346.5	383.9	.	.
Gross debt, USD bn	52.5	151.8	145.7	170.1	168.5	169.1	182.6	184.0	.	.
Foreign direct investment, USD bn	3.5	40.3	40.7	46.9	52.8	39.5	30.3	41.6	50.0	55.0
Exports total, USD bn	62.1	194.9	249.2	266.2	325.6	232.6	190.3	307.7	.	.
annual change in %	18.2	6.1	27.8	6.8	22.3	19.4	34.0	32.3	.	.
Imports total, USD bn	53.4	165.8	225.1	243.61	295.2	212.6	185.8	299.2	.	.
annual change in %	-9.8	18.2	35.8	8.2	21.2	17.2	44.5	40.5	.	.
Trade Balance, USD bn	8.7	29.1	24.1	22.5	30.3	20.0	4.5	9.1	20.0	18.0
Average exchange rate CNY/USD	4.78	8.28	8.28	8.28	8.2769	8.28	8.2770	8.277	8.2770	.
PPP (CNY/USD), WIIW <sup>8)</sup>	1.24	1.75	1.73	1.69	1.69	.	.	.	.	.

Notes: CNY: ISO-Code for the Chinese yuan. - 1) Preliminary. - 2) Census results from 1 Nov. 2000. - 3) 1990 excluding projects with a value of 20,000-50,000 yuan which are not listed in the state plan. - 4) Ratio of registered urban unemployed in per cent of urban employed and unemployed. - 5) Average gross annual wages of staff and workers, defined as: total wages of staff and workers per average number of staff and workers; since 1998: 'staff on duty' only. - 6) Staff and workers cost of living index is used as deflator for calculating real wage. - 7) Overnight rate. - 8) Purchasing power parity, ICP-method; see Ren Ruoen, The Vienna Institute Monthly Report 1996/2.

Sources: China Statistical Yearbook; International Financial Statistics; China Monthly Statistics; China Daily; Asian Development Bank (ADB, ARIC Indicators).

## China becoming an important regional and global economic player

*As a consequence of its large population and rapid economic growth over the past 25 years, China has become the sixth largest economy in the world and the second largest in the region. Due to its export-oriented growth strategy, China's position is even more prominent in trade, ranking fourth in the world already. Moreover, China is particularly important in certain categories of exports (e.g. textiles & clothing, shoes, electric appliances, TV sets, cameras ) but imports as well (e.g. basic metals including steel, soybeans). It is in these product groups that China may significantly affect world prices and/or may impact on the development of industry in certain countries.*

Not long ago, China was blamed for exporting deflation by dumping ultra-cheap products on the world market and for 'hollowing-out' manufacturing in the more advanced Asian economies, especially Japan. Now the country is praised for supporting the recovery of the world economy and the regional economy in particular, but is simultaneously accused of triggering global inflation by its insatiable appetite for raw materials to fuel both its export industries and its booming domestic retail markets.<sup>1</sup> Both statements reflect the perception of China as an important regional and global economic player.

### The relative size of the Chinese economy

The impressive process of China's 'catching-up' in the world economy and in the region is demonstrated in Table 2.1. After the implementation of the market-orientated economic reforms by Deng Xiaoping in 1978, economic growth in China accelerated quickly: it reached rates above those in the world on average, including Japan, and finally the Chinese economy even outpaced the rapidly growing 'Asian Tigers', symbols of the so-called 'Asian Miracle'. China was also less affected by the Asian crisis in 1997/98

and maintained its position as the fastest growing economy throughout the 1990s and beyond. For the period 1990-2000, the average annual GNP/capita growth in China reached an impressive rate of 9.2%, compared to 2.6% in the world at large.

Table 2.1

### Economic growth, 1970 to 2002

GNP/capita, real growth in %

	1970-1980	1980-1990	(1990-1996) <sup>1)</sup>	1990-2000	2001-2002 <sup>2)</sup>
<b>WORLD</b>	3.7	3.0		2.6	2.7
Japan	3.4	3.5	(1.2)	1.1	0.3
<b>China</b>	<b>4.1</b>	<b>7.9</b>	<b>(11.0)</b>	<b>9.2</b>	<b>7.6</b>
<b>4 Tigers</b>					
Korea Rep.	7.5	8.9	(6.2)	4.7	4.7
Taipei, China	8.1	6.6	n.a.	6.0	0.6
Hong Kong (SAR)	7.2	5.5	(3.7)	1.9	1.4
Singapore	6.7	5.7	(6.6)	4.7	0.1
<b>Second-tier Tigers</b>					
Indonesia	4.8	4.2	(5.9)	2.5	3.3
Malaysia	5.1	2.5	(6.1)	4.4	2.3
Philippines	3.7	-1.5	(1.0)	1.1	3.7
Thailand	4.2	5.6	(6.7)	3.3	3.5

Note: 1) Before the Asian crisis. - 2) GDP growth.

Source: World Bank Atlas 1983, 1991, 2001; national statistics (2001, 2002).

By the year 2000 (the latest year for which consistent data are available for all countries in the world) China had become the second biggest economy in Asia (after Japan) and the seventh biggest in the world (after the USA, Japan, Germany, United Kingdom, France and Italy) – see Table 2.2. By the end of 2002, China's GNP already surpassed that of Italy and today the Chinese economy is ranking sixth in the world. However, China's GNP (converted at current exchange rates) is still just about one tenth of that of the USA, the largest economy by far, and one quarter of that of Japan. But China has already reached the size of a big European economy (Italy) and surpassed another G-7 country, namely Canada.<sup>2</sup>

Within the region, apart from Japan, China is the biggest economy by far. The Republic of Korea, and India, which are coming closest, have both GNPs of less than half the size of the Chinese economy. Indonesia, another 'large' country in the region, reaches only about 10% of China's GNP and Russia, which was a model for China earlier and a rival later, produced but one quarter of the Chinese GNP in the year 2000.

Table 2.2

### Size indicators, 2000

	Population million	GNP (exch) USD million	GNP/c (exch) USD	GNP/c (PPS) USD
<b>USA (benchmark)</b>	<b>281.5</b>	<b>9,601,505</b>	<b>34,100</b>	<b>34,100</b>
<i>Canada</i>	30.8	649,829	21,130	27,170
<i>Italy</i>	57.7	1,163,211	20,163	23,470
<b>China</b>	<b>1,262.5</b>	<b>1,062,919</b>	<b>840</b>	<b>3,920</b>
<b>Japan</b>	<b>126.8</b>	<b>4,519,067</b>	<b>35,620</b>	<b>27,070</b>
<b>Four Tigers</b>				
Korea Rep. of	47.3	421,069	8,910	17,300
Taipei, China (1997)	21.7	285,100	13,198	n.a
Hong Kong (SAR)	6.8	176,157	25,920	25,590
Singapore	4.0	99,404	24,740	24,910
<b>Second-tier Tigers</b>				
Indonesia	210.4	119,871	570	2,830
Philippines	75.6	78,778	1,040	4,220
Thailand	60.7	121,602	2,000	6,320
Malaysia	23.3	78,727	3,380	8,330
India	1,015.9	454,800	450	2,340
Vietnam	78.5	30,439	390	2,000
Russia	145.6	241,027	1,660	8,010

Note: GNP (exch): gross national product converted at market exchange rates; GNP/c: gross national product per capita.

Source: World Bank Atlas 2002.

Looking into the future, China's ambitious plan to quadruple its year-2000 GNP by 2020 would imply an average annual growth rate of about 7.2%, and China's GNP would reach USD 4250 billion in the year 2020 – roughly the size of the Japanese economy today. There are, however, certain concerns that this goal may not be achievable from an economic as well as environmental point of view.

The size of GNP (GDP) is an indicator of the size of the domestic market on the one hand and of the country's production capacity on the other. In 2002, China's GDP accounted for about 3.8% of the world's total (USD 32.2 trillion<sup>3</sup>). But in many important product groups China's share, both as a supplier and a consumer, is much higher. Thus China is the world's largest producer of textiles & clothing, shoes, steel, aluminium and copper.<sup>4</sup> Also, it has very high market shares in selected manufacturing products such as cigarette lighteners (70%), cameras (50%), microwave stoves (40%), TV sets and air-condition apparatus (30%), refrigerators and washing machines (20-25%)<sup>5</sup> and is rapidly increasing its shares of mobile phones, computers and recently motor vehicles as well. On the consumption side, China has 500 million telephone subscribers (fixed line and mobile), more than any other country in the world, and consumed 55% of the world's cement and 36% of the world's steel in 2003<sup>6</sup>. Apart from manufacturing, the Chinese construction market is the third largest in the world and with regard to infrastructure investment, China is leading in many fields, e. g. the building of railways and power plants. In 2000, it ranked third in petrol consumption (after the USA and Japan) and was the fifth largest producer of crude oil (after Saudi Arabia, Russia, USA and Iran). In 2003, it may already have become the second largest petrol consumer. China also consumed 30% of the world's coal production.<sup>7</sup>

A large part of China's manufacturing production is sold on the world market, about 47% of which is produced by foreign invested enterprises (FIEs) taking advantage of the low cost level in China. Although economic growth in China went hand in hand with rising living standards, GNP per capita in China amounted to USD 840 (converted at exchange rates) in the year 2000, classifying China as a 'lower middle income country' in the World Bank terminology. If converted at purchasing power standards (PPS), taking account of the still very low price level in China, per capita income was substantially higher, reaching USD 3920, but still



low compared to the income/wage level in the advanced industrialized countries;<sup>8</sup> see Table 2.2.

### China becoming a major trading power of the world

China's success story is closely linked to the opening-up of its economy to the outside world. Before 1978, China was virtually a closed economy and its share in world trade was negligible. At the beginning of the economic reforms, foreign trade and investment were limited to the so-called 'Special Economic Zones', established at the south-east coast of China, in the vicinity of Hong Kong and Taiwan, to attract investors from there. But in the 1990s, trade and foreign investment were encouraged in other parts of the country as well. By joining the World Trade Organization (WTO) in 2001, China has become fully integrated into the world economy.

Table 2.3

#### Shares in world trade, 2002

	in %					
	Exports		Imports		Trade volume <sup>1)</sup>	
	shares	rank	shares	rank	shares	rank
USA	10.8	1	18.1	1	14.5	1
Germany	9.4	2	7.3	2	8.3	2
Japan	6.5	3	5.1	3	5.8	3
France	5.2	4	4.9	4	5	4
<b>China</b>	<b>5.1</b>	<b>5</b>	<b>4.4</b>	<b>5</b>	<b>4.8</b>	<b>5</b>
United Kingdom	4.3	6	5.1	6	4.7	6

Note: 1) exports + imports.

Source: International Monetary Fund (DOT).

Foreign trade expanded even faster than GDP, at a staggering annual average rate of 15.9% over the period 1978-2002 (GDP: 9.5%), and over the past ten years exports typically surpassed imports, reflecting the country's increasing international competitiveness. By the end of 2002, China held a share of 4.8% in world trade (exports and imports), ranking fifth after the USA, Germany, Japan and France, as shown in Table 2.3. Meanwhile, preliminary data suggest that China has already become the world's fourth largest trading power in

2003 and may rank even third, overtaking Japan, due to the acceleration of its exports by the end of the year. Moreover, in some fields China has already become the world's biggest supplier, e.g. in textiles & clothing and footwear but certain electric and electronic equipment and tools as well. On the demand side, China is the biggest importer of many raw materials, such as iron ore, copper and other basic metals, but of e.g. soybeans as well. Oil imports have not been so prominent in the past, but are rising rapidly.<sup>9</sup>

### Important trading partners of China

Final products are mainly exported to the advanced industrialized countries, the USA ranking top in taking a share of 21.5% in 2002, followed by the EU and Japan, both reaching about 15% (see Table 2.4). Chinese exports to Hong Kong (18%)

Table 2.4

#### China's major trading partners, 2002

	Exports shares in %	Imports shares in %	Trade balance USD billion
USA	21.5	9.2	42.7
EU	14.8	13.0	9.0
Asia	52.3	64.5	-20.0
Japan	14.9	18.1	-5.0
Hong Kong (SAR)	18.0	3.6	47.7
Taipei, China	2.0	12.9	-31.4
Korea Rep.	4.8	9.7	-13.0
ASEAN*)	7.2	10.6	-7.6

Note: \*) Singapore, Malaysia, Indonesia, Thailand, Philippines, Brunei, Vietnam, Laos, Myanmar, Cambodia.

Source: China Monthly Statistics, 12/2002.

represent to a large extent transit trade. Imports of raw materials and intermediate products (e.g. agricultural products, electronic components) are drawn from countries in the region mainly, with the USA holding an import share of just 9% as compared to Japan's 18.1%; trade with the EU is more balanced. Typically, China has huge trade surpluses with the USA and the EU, but a trade deficit with many countries in the region, including Japan. China is thus supporting the growth of the

regional economy to a significant extent, while provoking tensions with its overseas trading partners, especially the USA.<sup>10</sup>

## China's role as a trading partner for other countries

As a consequence of the rapid expansion of its foreign trade, China has become an important trading partner for many countries in the world. For the EU, China ranked already second in imports (after the USA) and third with regard to exports in 2002 (behind the USA and Japan – excluding intra-EU trade). For Japan, China has already become the top source of imports, reaching a share of 18%, and has become Japan's second most important export market. Due to the highly unbalanced trade flows, China ranks third in the USA as a source of imports, but only seventh as a market for US exports.

Within the region, Hong Kong and Macao have the closest trade links with mainland China, also playing an important role in the transit trade to and from other countries. Generally speaking, trade with China plays a greater role for the east Asian economies, including the Republic of Korea and Taipei, rather than for the south east Asian countries, members of the Association of South East Asian Nations (ASEAN). Important exceptions are neighbouring Vietnam and Myanmar, with established political links playing a significant role in the latter case.

For Russia, bordering China in the north, trade with China is significant but still of limited importance; however, the booming border trade may not be fully reflected in the official statistics. Especially in the far east, China is increasingly replacing Japan as an important trading partner.<sup>11</sup> Furthermore, with China becoming increasingly dependent on oil imports, there is a great potential for trade in the future. Regarding oil trade between Russia and China, much will depend on the final decision made by Moscow, whether to build a new oil pipeline from the Angarsk-field (near Irkutsk/Siberia) to Daqing (China) or to the Russian harbour of Nakhodka, from where the oil can be easily

shipped to Japan, but other countries as well. The Russian government is heavily lobbied by both potential customers, China and Japan; given the importance of the project, the decision will depend not only on economic but on political considerations as well.<sup>12</sup>

Table 2.5

### China's role as a trading partner for selected economies, 2002

	exports		imports	
	share	rank	share	rank
WORLD	5.1	5	4.4	6
USA	3.2	7	11.1	3
EU	3.6	3	8.6	2
Japan	9.6	2	18.3	1
Hong Kong (SAR)	39.3	1	44.3	1
Macao (SAR)	15.5	2	41.7	1
Taipei, China	7.6	4	6.9	3
Korea Rep.	14.7	2	11.4	3
ASEAN				
Singapore	5.5	5	7.6	4
Malaysia	5.6	5	7.7	4
Indonesia	5.1	5	7.8	4
Thailand	5.2	4	7.6	3
Philippines	3.9	8	3.5	7
Brunei	6.4	6	4.0	5
Vietnam	6.4	4	11.8	2
Laos	2.2	9	8.1	3
Myanmar	4.7	4	27.0	1
Cambodia	1.3	9	11.2	4
Shanghai Cooperation Organisation (SCO)				
Russia	6.3	4	5.2	5
Kazakhstan	10.6	3	4.8	4
Kyrgystan	8.5	4	10.1	4
Uzbekistan	1.4	17	5.2	7
Tajikistan	0.3	16	1.1	13
India	4.1	5	4.5	3

Source: International Monetary Fund (DOT).

India's trade with China, remarkably low in the past, for economic and political reasons, has been thriving during the past few years. In June 2003, Prime Minister Atal Behari Vajpayee became the first Indian leader in a decade to visit China.<sup>13</sup> The

principal items traded so far are iron ore, primary and semi-finished iron and steel, and other processed minerals. For the future, a great potential is seen in further cooperation in the field of information technology, with China specializing in hardware and India in software.

### Enhanced regional economic cooperation

In order to consolidate its position in foreign trade and to promote economic growth, China has sought accession to WTO and has become increasingly engaged in regional economic cooperation, in particular since the Asian crisis 1997/98. China joined the so-called 'Chiang Mai Initiative' in May 2000. This is a network of bilateral 'swap agreements' comprising the ten ASEAN countries plus China, Japan and the Republic of Korea (ASEAN+3) which should help to prevent (respectively, fight) any potential currency or financial crisis in the region. Also, only a few months after the ASEAN Free Trade Area (AFTA) had become effective on 1 January 2002, a framework agreement was signed between China and ASEAN to stepwise establish a free trade area until 2010; China has already significantly reduced its tariffs on agricultural products coming from ASEAN countries.<sup>14</sup> Beyond that, China is eager to conclude bilateral free trade agreements with individual ASEAN members (e.g. Thailand), to speed up intra-regional trade. China has also initiated a framework agreement (2003) on closer economic cooperation within the 'Shanghai Co-operation Organization' (SCO) comprising China, Russia, Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan. To boost trade and other forms of economic cooperation between mainland China and the two 'Special Administrative Regions' Hong Kong (SAR) and Macao (SAR), two 'Closer Economic Partnership Arrangements' (CEPA) were concluded and will become effective as of 1 January 2004.

Beyond doubt, regional cooperation has become an important issue for China, and China has become an important player in regional economic cooperation in East-Southeast Asia.

### Notes

- <sup>1</sup> See, for instance, *China Economic Review*, December 2003, Commentary, p. 3.
- <sup>2</sup> If purchasing power standards (PPS) were used instead of exchange rates for GNP conversion, China's GNP would amount to USD 4949 billion in 2000, already higher than that of Japan (USD 3432 billion) and more than half of that of the USA. Although it does not make much sense economically, this measure is the basis of those forecasts which predict that the Chinese economy will soon overtake the USA and become the biggest economy of the world. Assuming, for instance, an average annual growth rate of 3% for the United States and of 7% for China and using PPSs for conversion, China would reach a higher GNP (PPS) than the USA already in the year 2018.
- <sup>3</sup> International Monetary Fund (IMF), *World Economic Outlook*, September 2002, Table 1, p. 167.
- <sup>4</sup> H. Sohmen (2003), 'China and Globalization', in G. Kaminski (ed.), *China's Traditions: Wings or Shackles for China's Modernization?*, Vienna, p. 35 f.
- <sup>5</sup> W. Lanz, former Austrian trade representative in Beijing, at ICON (Investment Congress) 2003, Vienna University of Business Administration, 4 November 2003.
- <sup>6</sup> According to Li Deshui, director of the National Bureau of Statistics, quoted in *International Herald Tribune*, 21 January 2004.
- <sup>7</sup> *Ibidem*.
- <sup>8</sup> World Bank, *World Bank Atlas 2002*, p. 42.
- <sup>9</sup> Until 1993, China was self-sufficient in oil. But already in 2002, oil imports reached 80 million tons, amounting to about one third of the country's consumption of about 250 million tons. By 2025, China's oil consumption is projected to rise to 545 million tons, of which two thirds, i.e. 363 million, will have to be imported (*Neue Zürcher Zeitung*, 17 July 2003, p. 19).
- <sup>10</sup> The figures in Table 2.4 are taken from Chinese customs statistics: this accounts for the relatively low trade surplus shown with the USA and the EU. In contrast, the national statistics of the USA and the EU report much higher trade deficits with China, USD 100 billion and EUR 47 billion respectively. One reason is that the Chinese customs statistics do not include re-exports via Hong Kong.
- <sup>11</sup> In 2001, China's trade with the region of Khabarovsk was worth USD 1.4 billion, compared with trade of just 200 million between the territory and Japan. At the time of the collapse of the Soviet Union, there were more than 20 Japanese trading companies with offices in Khabarovsk; now there are just six. In the city of Khabarovsk-on-Amur, production of Sukai fighter planes has recently increased significantly due to strong orders from China (*China Economic Review*, March 2003). China has also replaced Japan as the biggest importer of Siberian wood.
- <sup>12</sup> A framework agreement on the Angarsk-Dauring line had already been signed in Moscow in May 2003, between Russian President Putin and Chinese President Hu Jintao, and a rather detailed contract has been set up between the Russian oil giant Yukos and the China National Petroleum

Corporation (Petro China). However, the two sides will need to sign a final import-export deal for the project actually to go ahead – for which no green light has been given by the Russian government so far (see *China Economic Review*, July 2003, p. 14 and *Handelsblatt*, 22 September 2003, p. 16).

- <sup>13</sup> Accompanied by a large business delegation, Vajpayee's visit was designed to enhance political, trade and investment links between the two countries. In the political field, both sides decided to appoint envoys to resolve their long-standing border disputes. They also agreed to open up border trade at two points along their Himalayan border, one in Tibet and one in Sikkim, a formerly semi-independent kingdom that India annexed in 1975. Until now, China officially regarded it as a sovereign country and not as a province of India. For its part, India made a written pledge that it would oppose the anti-Chinese activities of Tibetan separatists in India (*China Economic Review*, July 2003).
- <sup>14</sup> In another step, China has accorded most-favoured nation status to Vietnam, Laos and Cambodia even before they have joined the WTO.

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