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**Office of the Chief Economist
Emerging Economies Study Series**

CHINA

The Awakening of a Giant

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Foreign Affairs and
International Trade Canada

Affaires étrangères et
Commerce international Canada

Canada



Overview

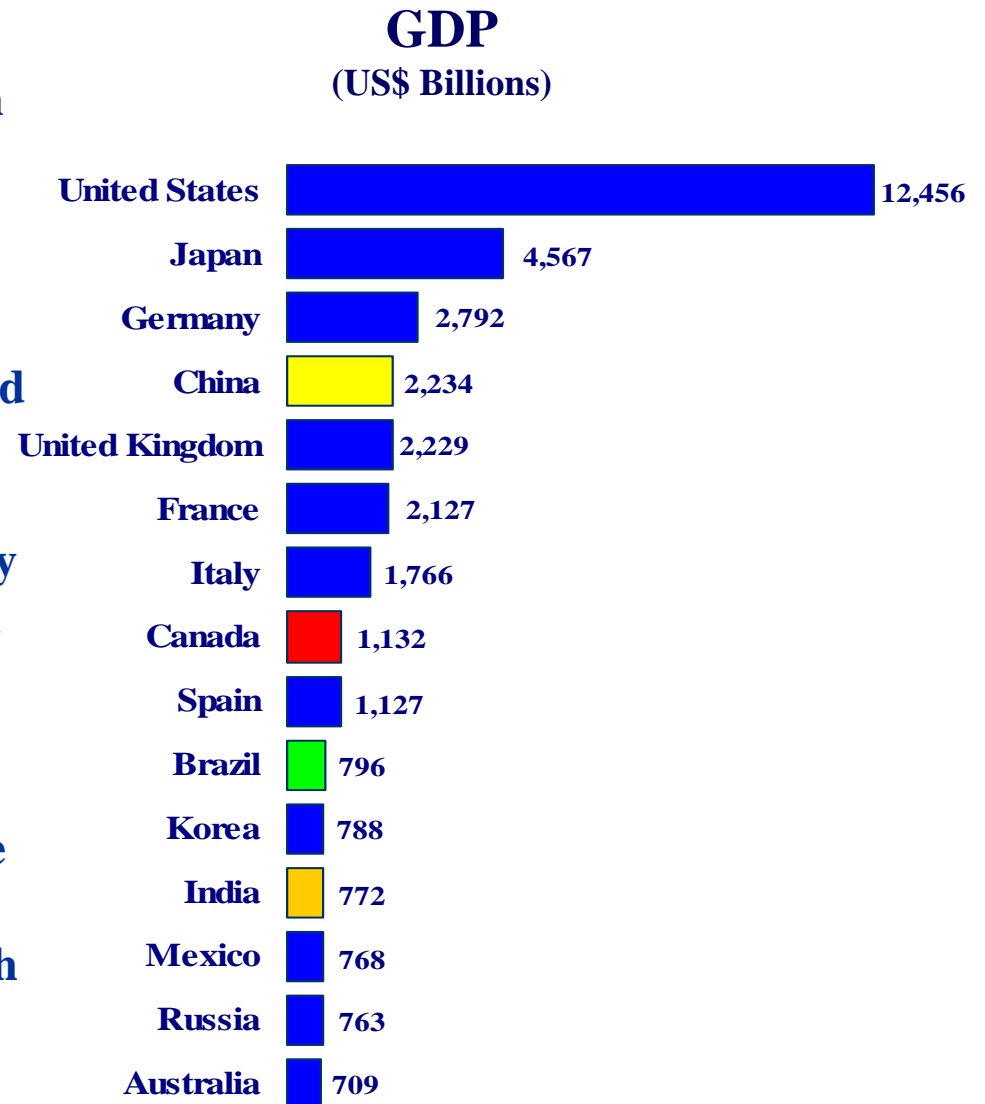
- **China's huge population and rapid economic growth have captured the world's attention for both the challenges, as well as opportunities that it raises.**
- **The opportunity is that of a vast market growing by leaps and bounds, but we must be cautious to not overstate its importance. China will continue to remain a relatively poor economy for some time to come and its distance from Canada will put a natural limit to how much of that market can be served from Canada.**
- **The challenge is that of a low cost competitor to Canadian companies not just in Canada, but also in our most important markets. The threat is also to workers who face the challenge of a Chinese labour force willing to work for a fraction of the wage in Canada and of firms shifting production to China. But this fear should also not be overstated, as China faces its own challenges to stay competitive and develop further.**
- **An important impact of the rise of China for Canada will be China's growing importance as a link in global value chains. Canadian firms will face increasing competition from firms that use China as a link in their value chain in order to lower costs and be as efficient as possible. Canadian firms will need to adapt and create their own value chains in order to survive and government will need to design policies and programs to facilitate this transformation.**



China has captured the world's attention due to its large size and strong economic growth

- China is the most populous country in the world with an estimated 1.3 billion people as of 2004.*
- China is the 4th largest economy in the world and, by a wide margin, the largest developing economy, well ahead of Brazil and India.
- China is also the fastest growing of any large economy. GDP growth in China has averaged 10.1% per year since 1990.
 - This rate of growth is comparable to the post war growth of Japan (10.4%, 1960-70) or 1980's growth of South Korea (8.6%, 1980-90).

* For the purposes of this analysis China refers to only mainland China and does not include Hong Kong, Taiwan, or Macao, which are separate customs territories.

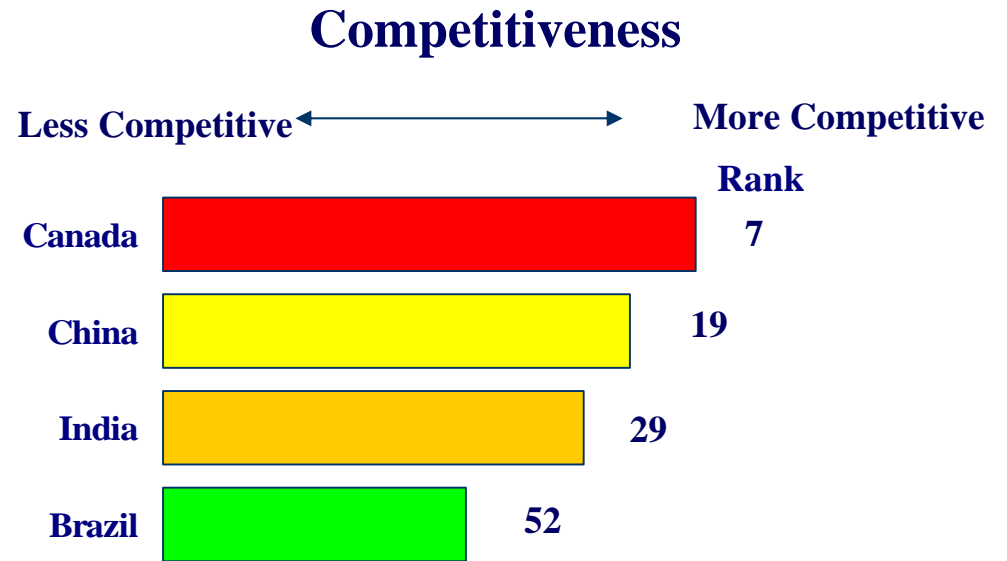


Data: IMF, World Economic Outlook as of 2005



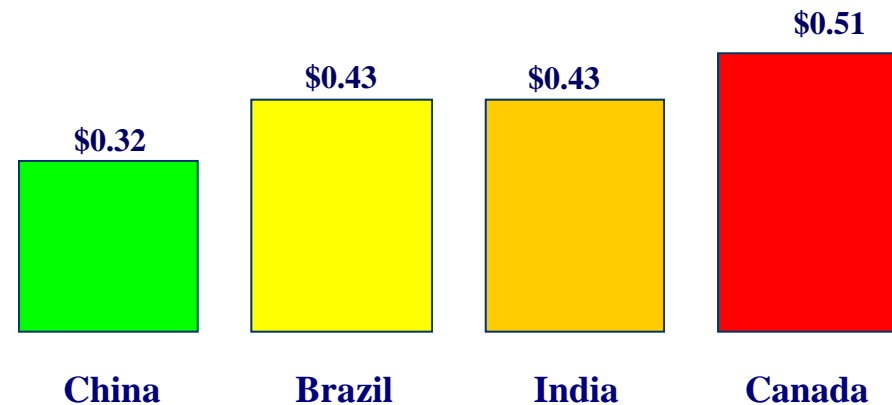
Reforms begun in 1978 have made China an attractive location to do business...

- According to the World Competitiveness Report China's main strengths are its large labour force as well as the size of its domestic market. It is also relatively strong in R&D.
- China's unit labour cost, not surprisingly, is much lower than Canada's but also beats out other emerging economies such as Brazil and India.
- But, as China develops, wages are rising quickly and China may begin to lose its cost advantages over other economies.



Source: IMD: World Competitiveness Yearbook

Unit Labour Cost in Industry (Compensation per dollar output)



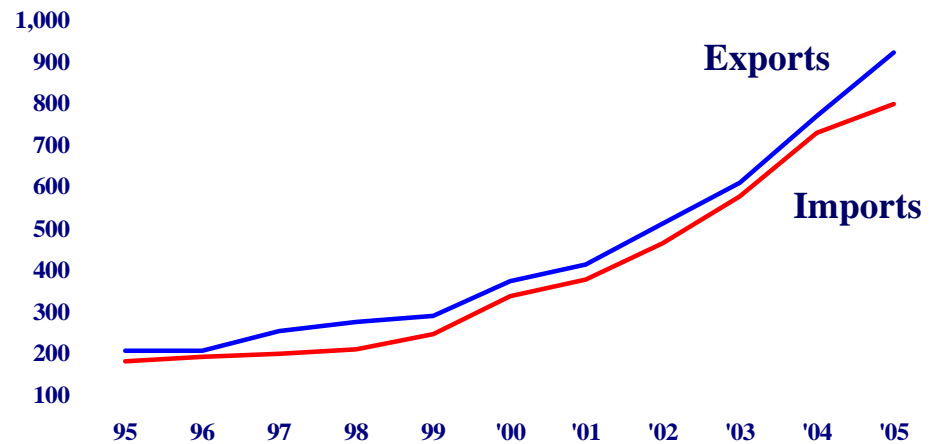
Source: IMD – World Competitiveness Yearbook (data for 2003)



... and have transformed China into the “workshop of the world” Merchandise Trade

- Chinese merchandise exports have increased nearly five-fold in only the past ten years and have grown particularly fast since China joined the WTO in 2001.

Billions Cnd\$



Data: World Trade Atlas

- China's share of global merchandise exports has increased from 2.9% in 1995 to 7.4% in 2005.



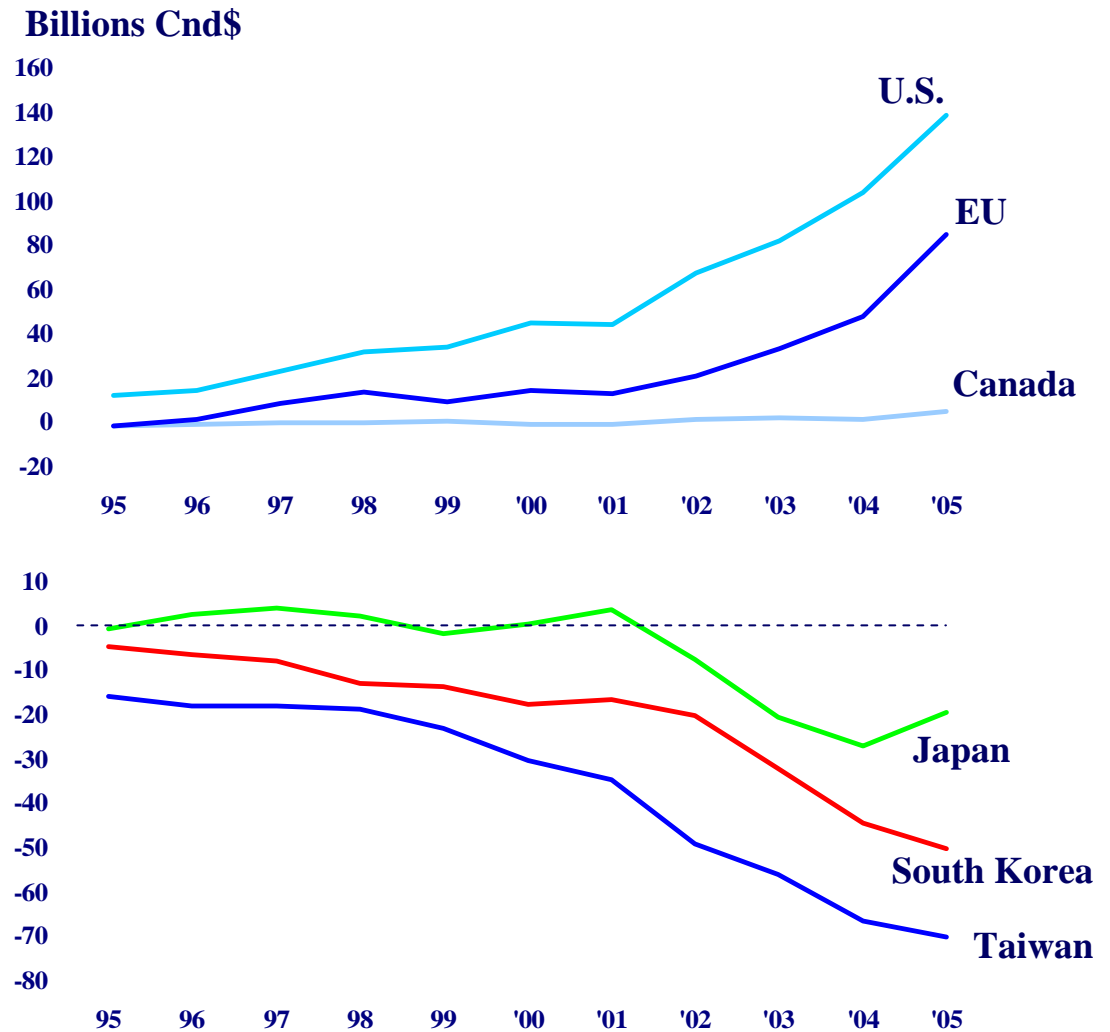
Data: IMF



China has a large trade surplus with the U.S. and E.U., but has mostly deficits with its Asian neighbours...

- China has a very large trade surplus with the U.S. (\$138.0 billion in 2005), with merchandise exports to the U.S. over three times greater than imports. China exports almost twice as much to the E.U. than it imports, giving China a surplus of \$84.9 billion in 2005.
- China has a smaller trade surpluses with Canada (\$ 5.0 billion*), with exports to Canada worth one and a half times the value of Chinese imports from Canada.
- However, China has a trade deficit with most of its immediate neighbours.

Merchandise Trade Balance



Data: World Trade Atlas, China Customs

*Note: \$5 billion surplus is according to China customs statistics, Statistics Canada records a surplus of \$23 billion.



...this reflects a movement of production from within the region toward China...

- **China's share of U.S. merchandise imports has increased from 6.1% in 1995 to 14.5% in 2005.**
- **Over the same period many other economies in the region have experienced a decreasing share of U.S merchandise imports.**
 - **This reflects the regional shift of production to China. China has become the final assembly point for many of the region's exports.**

Share of U.S. Merchandise Imports

	1995	2000	2005
Japan	16.6%	12.0%	8.3%
South Korea	3.2%	3.3%	2.6%
Taiwan	3.9%	3.3%	2.1%
Singapore	2.5%	1.6%	0.9%
Hong Kong	1.4%	0.9%	0.5%
China	6.1%	8.2%	14.5%

Data: World Trade Atlas



...as well as greater regional integration

- **China has strong economic linkages with the other major countries in the region. 40% of China's merchandise exports are to its Southeast Asian neighbours, and 51% of China's merchandise imports come from Southeast Asia.**
- **China has entered into free trade agreements with both ASEAN (entered into force July 1st 2003) and Hong Kong (entered into force January 1st 2004).**
- **China is also becoming an important trading partner for many countries in the region.**

China's Regional Trade Linkages

(Percent of total merchandise exports or imports in 2005)

	China's Trade		Trade with China	
	Exports	Imports	Exports	Imports
ASEAN	7.3%	11.4%	7.5%*	9.7%*
Hong Kong	16.3%	1.9%	44.7%	44.1%
Japan	11.0%	15.2%	13.4%	21.0%
South Korea	4.6%	11.7%	21.8%	14.8%
Taiwan	2.2%	11.3%	21.6%	11.0%

Source: National sources as reported by World Trade Atlas

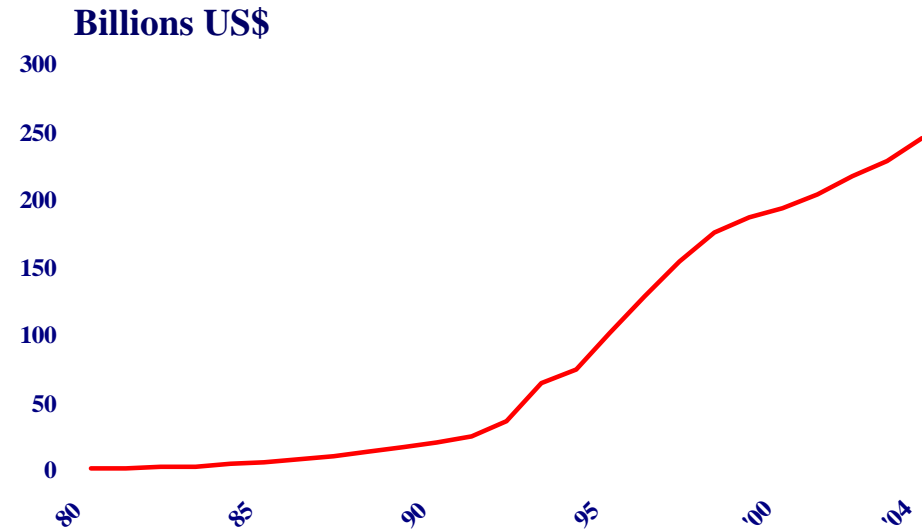
*Only includes Philippines, Singapore, Thailand, Malaysia, and Indonesia



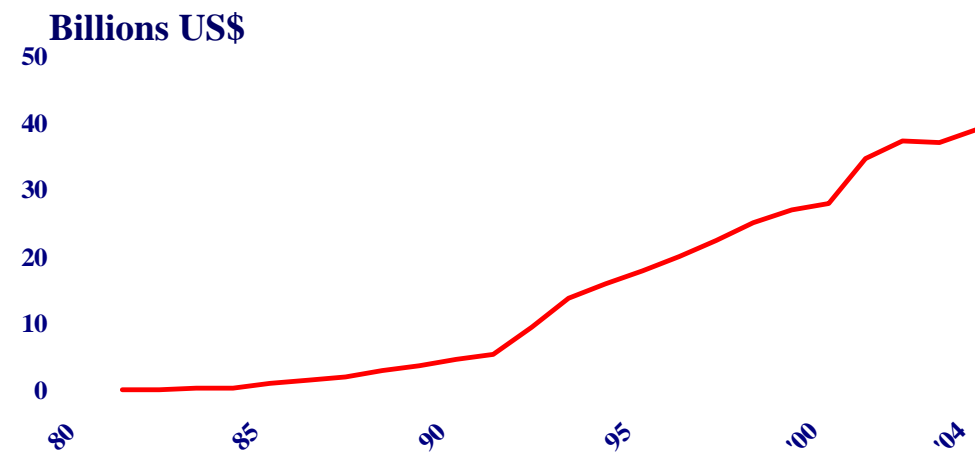
FDI into China is also booming, but outward FDI is still relatively small

- FDI reflects foreign firms entering China as both a location from which to serve other markets, as well as to access the growing Chinese market.
- FDI stocks in China have surged after 1992. In 2004 China had \$245 billion US worth of FDI stocks, making China the 11th most important destination of FDI in the world and the largest in the developing world.
- Chinese outward FDI remains relatively small but has increased sharply, rising from only \$39 million in 1981, to \$38.8 billion in 2004.

China's Inward FDI Stocks



China's Outward FDI Stock



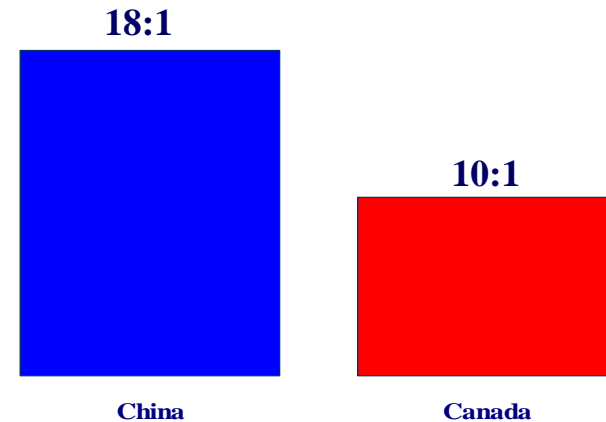
Data: UNCTAD World Investment Report



But, China will also face challenges to sustaining its growth

- One problem is inequality. In China, the richest 10% of the population holds, on average, 18 times the income of the lowest 10%. This compares to 10 times in Canada.

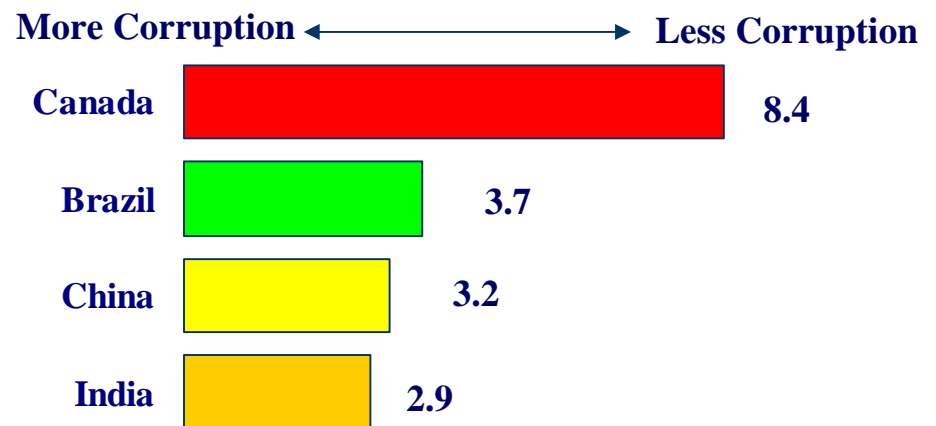
Ratio of income Highest 10% over lowest 10%



Data: UN - World Development Indicators
Data is 2001 for China, 1998 for Canada

- Another problem is the high perceived level of corruption. China does not score well in Transparency International's perceived corruption index, ranking 78 out of 158 countries.

Corruption Perceptions



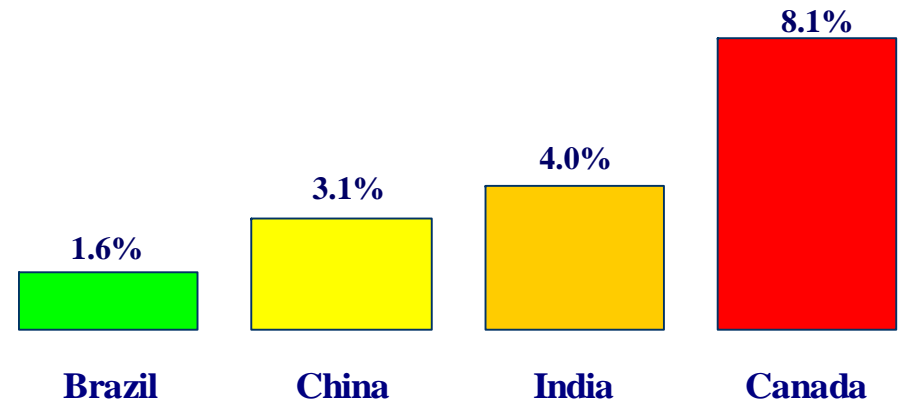
Source: Transparency International's Corruptions Perception Index 2005.



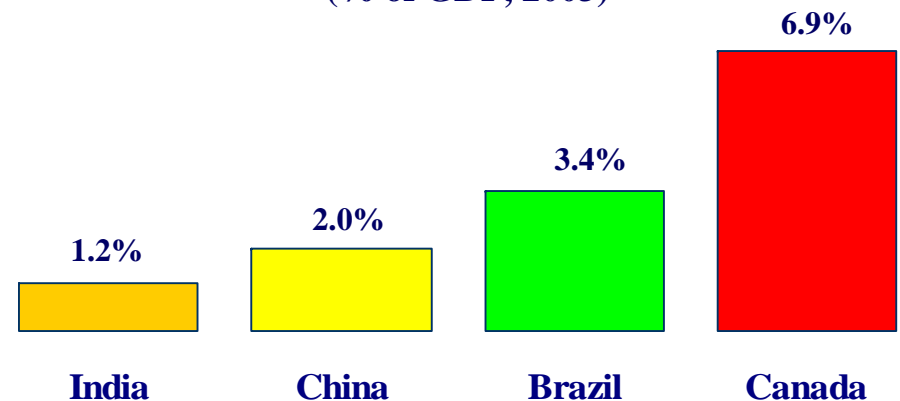
A low level of funding for education and health care are of particular concern

- China's education system is poorly funded, with expenditures on education equivalent to 3.1% of GDP.
- China's health care system is much less developed than that of Canada, but it also ranks poorly compared to some other developing economies.
- Although China's public expenditures are low, it should be noted that public spending differs widely by region from the averages indicated here. As noted in a recent OECD study; public spending is much lower in the poorer interior provinces than in the wealthier coastal provinces*.

Public Expenditures on Education
(% of GDP, 2002)



Public Expenditures on Health Care
(% of GDP, 2003)



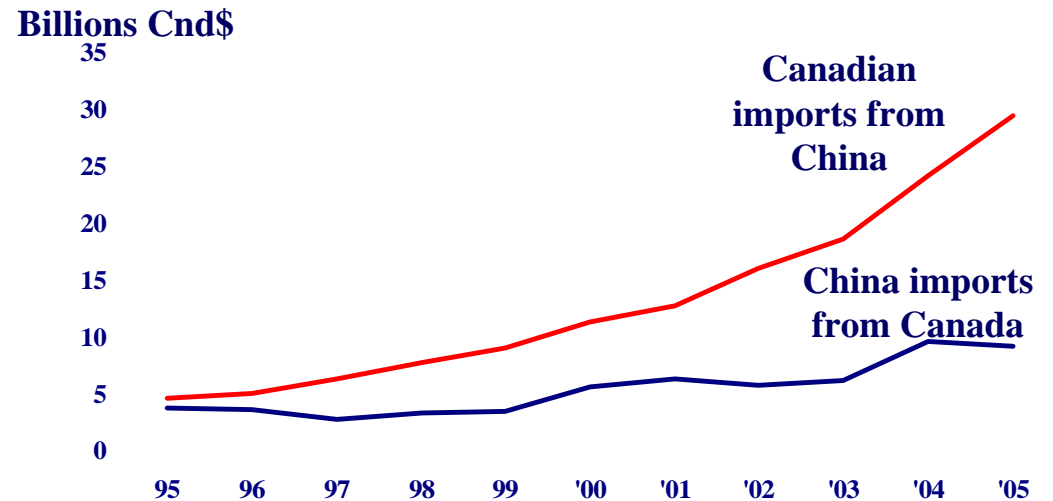
* OECD, Feb 2006, Challenges for China's public Spending.



China's trade linkages with Canada are growing... ...particularly for imports...

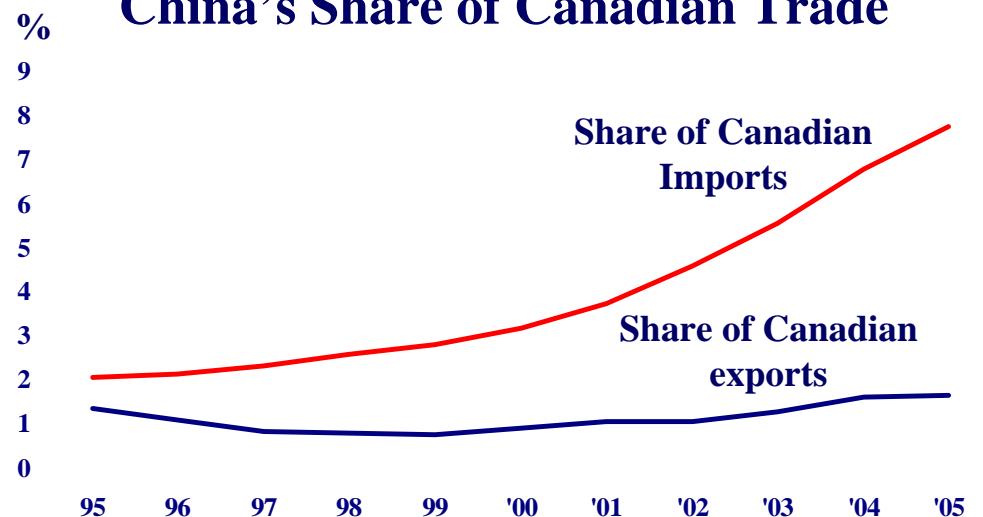
- Trade between Canada and China has been growing strong.
- In 2005 Canada imported \$29.5 billion in merchandise goods from China, accounting for 7.7% of Canada's total imports. Canada's exports to China were \$7.1 billion, making up 1.6% of Canada's total merchandise exports.
- Although both imports and exports between the two countries are growing, Canada's imports from China are growing much faster; increasing 536% between 1995 and 2005, while Canadian exports to China increased 104% over the same period.

Canada-China Merchandise Trade



Data: World Trade Atlas

China's Share of Canadian Trade



Data: World Trade Atlas

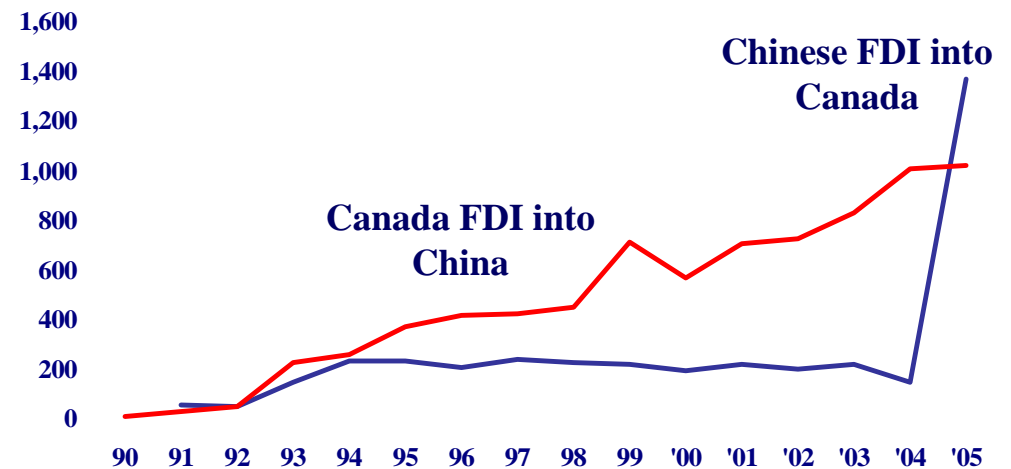


...but FDI linkages remain weak

- **FDI Between Canada and China is still relatively small, China had \$1.4 billion invested in Canada in 2005 while Canada had \$1.0 billion worth of investments in China.**
- **The large increase in FDI from China in 2005 is likely due to China's increasing investments in Canada's energy sector, and also the acquisition of IBM's computer division by Lenovo, which also included assets in Canada.**

Canada-China Direct Investment

Millions Cnd\$



Data: Statistics Canada