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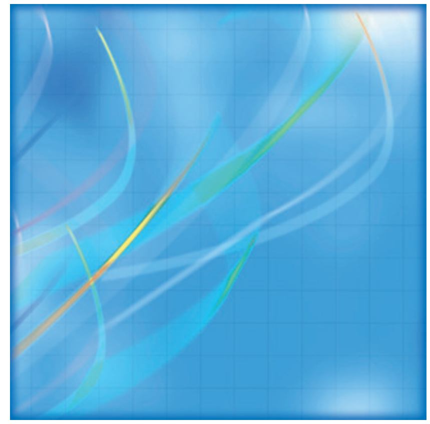

Canada's Trade with China

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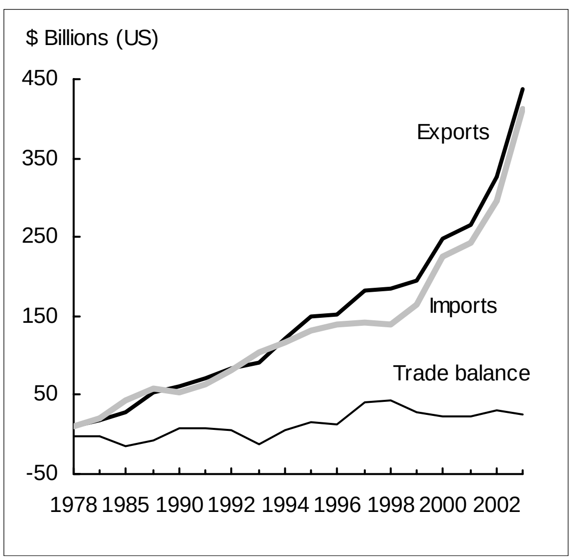
Abstract

This article documents how Canada's trade with China has evolved over the last 15 years in the context of the broad shifts in China's trade with the world. Canada has benefited both from the direct effect of higher exports to China and indirectly from the upward pressure on commodity prices from China's rapid industrialization. Canada diversified its exports away from its traditional dependence on wheat to industrial goods and forestry products. Meanwhile, Canada's increasing imports from China have raised incomes in that country while supplying a new source of low-priced goods, especially to firms in North America investing in machinery and equipment. China's increasing integration into the world economy has been a textbook example of the benefits of trade.

1. Canada's Trade with China

China is now the world's second largest economy after the United States, as measured by the purchasing power of GDP. Its export sector represents about one-quarter of GDP[1], five times more than in 1978 when economic reform began to progressively open it up to the rest of the world. In 2003 alone, it rose three places in the World Trade Organization's (WTO) ranking to third with 5.3% of global imports, behind only Germany (7.7%) and the U.S. (16.8%). China's growth has contributed to the recovery of its Asian neighbours, and more recently to rising exports from North America. At the same time, China continued to meet most of North America's growing appetite for imports. This boosted it to fourth place in global exports with a 5.9% share, behind Japan (6.3%), the U.S. (9.7%) and Germany (10.0%).

Figure 1. China's Total Trade



1. World Development Indicators, The World Bank, various issues.

This article documents how Canada's trade with China has evolved over the last 15 years in the context of the broad shifts in China's trade with the world.[2] Canada has benefited both from the direct effect of higher exports to China and indirectly from the upward pressure on commodity prices from China's rapid industrialization. Meanwhile, our imports from China have shifted from toys and trinkets to productivity-enhancing goods.[3]

China is not only an exporter, but also consumes and imports at an increasing rate. Chinese imports took off in the second half of the 1990s, culminating in China's entry into the WTO in December 2001.[4] After rising 8.2% in 2001, China's imports jumped 21.2% in 2002 and 39.9% in 2003, even as global trade stalled. As a result, the Chinese trade surplus fell $4.9 billion (U.S.) to $25.5 billion in 2003 and then swung into a deficit of $8.4 billion in the first quarter of 2004, its first shortfall in 10 years. The growth of imports was driven by lower tariffs on imports, rising domestic demand and an increasing need for raw materials and energy.[5]

Recently, China has become a growing source of export demand for the recovery of its neighbours, particularly Japan, many of whom suffered severely from the Asian currency crisis in 1997. Closer to home, U.S. exports to China doubled between 1999 and 2003, led by electronic equipment. Our exports also have risen sharply, more than recouping a 30% drop between 1995 and 1997 when commodity prices collapsed (especially for forestry products). Canadian exports to China are driven by resource products, which year in and year out account for about 80% of our shipments to China.

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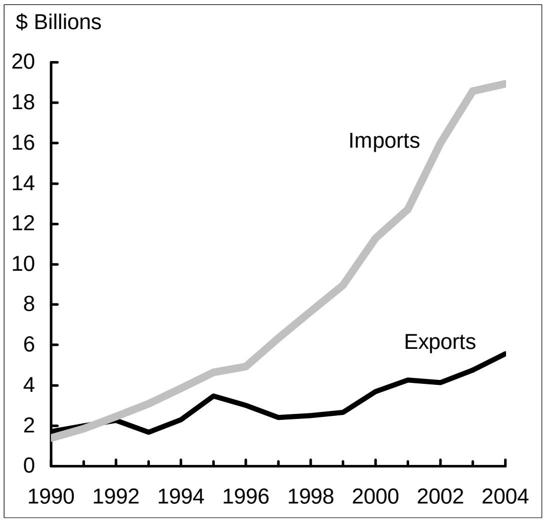
2. All data for Canada – China trade is on a customs basis, from International Trade Division. A world of caution is in order here. Customs based merchandise trade statistics are more accurate at measuring imports than exports. Customs based data for exports to non-U.S. destinations often understate the actual value of trade for various reasons, including misallocation and undercoverage. For a brief discussion of the problem, see 'Canadian Merchandise Trade – Customs Basis: Data Quality Statement', Statistical Data Documentation System Reference Number 2201, available free of charge at Statistics Canada web site (www.statcan.ca).

3. See Jean-Marc Siroën, "L'OMC et la mondialisation des économies," working paper of EURIsCO, no 98-02, juin 1998.

4. In becoming a member, China undertook to open its economy and trade to the rest of the world; most China trade commitments were to be completed by the end of 2003.

5. People's Daily online, April 21 2004.

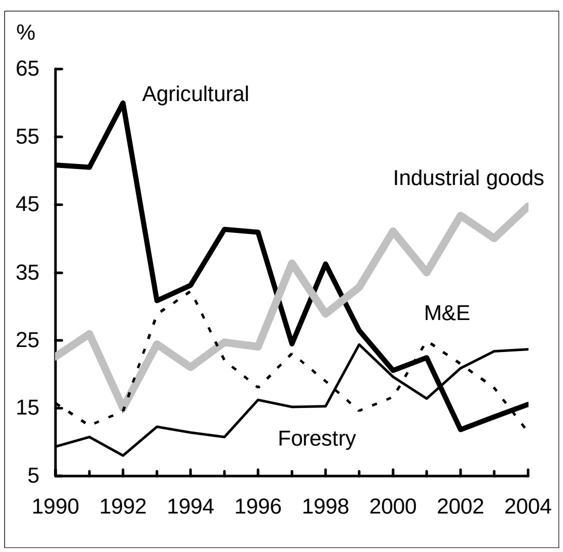
Figure 2. Canada's Trade with China



2. Exports

Wheat used to dominate our exports to China up to the early 1990s; as recently as 1992, it accounted for 60% of our shipments to China. Since then, the share of wheat has slipped to just a little over 10%, supplanted by rapid gains for industrial materials (which rose to 45%) and forestry products (24%). Capital goods are about 11%, a share which has changed little over the last 15 years. Exports remained much smaller for autos (2%), energy (2%) and consumer goods (0.1%) over this period.

Figure 3. Share of Exports to China by Economic Use



Within agricultural products, the drop in wheat masked sharp gains for our exports of seafood, meat and oilseeds from practically nothing in 1990. Seafood led the way, rising from $3.2 million to $250 million in 2003, equivalent to half of agricultural exports to China. This follows the dietary trend in China: between 1990 and 2002, its per capita consumption of grain in urban households fell 40% while meat rose 30% (chicken alone tripled) and seafood increased 70%. Total Chinese imports of seafood grew from $1.8 to $4.1 billion in 2001.

Our exports of industrial materials accelerated with the surge of Chinese industrial production starting in the 1990s. Metals led the increase, rising to 15.8% of our shipments to China at the start of 2004. Iron and steel, and nickel dominate, with shares of 6.3% and 4.1%. The shares of copper and aluminum were negligible, although they have risen sharply in 2003 and early in 2004. Chemical products and fertilizer represented 11.7% and 6.8% of exports, benefiting in part from China's shift from importing wheat to growing its own grain.

Forestry products also have seen rapid gains, raising their share of resource exports to China from only 9% in 1992 to close to one-third. China is now the largest importer of pulp in the world, and Canada the largest supplier in the world (and the second largest supplier to China after the U.S.). Pulp alone accounted for nearly one-fifth of all our exports to China in 2003. The increase would have been even more spectacular if prices had maintained their 1995 level, instead of falling 40% between 1995 and 1997 and staying around that level ever since.

Lumber in 2003 remained only a fraction of the importance of pulp, but exports have risen ten times since 1999. China has become one of the largest importers in the world, equalling the United Kingdom in 2002 behind only Japan and the United States. This increase followed better forestry management in China after severe floods[6], which lowered supply just as demand took off (banking reforms increased the supply of household credit[7] and homeownership, while rapid urbanisation continued–cities grew 6% annually after 1995, double the rate between 1990 and 1995). China's National Bureau of Statistics reported that housing was up 34% in the first quarter compared to a year ago.

China's appetite for raw materials has risen so fast in recent years that, along with leading the world in pulp imports, it now stands behind only Japan and the U.S. as a market for wood and is second only to the U.S. for iron and steel and crude oil. Rapid growth in Chinese demand has been an important factor behind the recent boom in commodity prices, especially metals as well as fats and oils, which have risen 54% and 28.8% respectively in the year ending in May 2004.[8] This reversed the downward trend of commodity prices from 1980 to 2001. Canada, as a large net exporter of resources, has benefited from this surge in demand.

6. See D. Lague, "Felling Asia's Forests", Far Eastern Economic Review, December 2003.

7. Mortgages came into more general use only over the past few years, auto loans since 2001, and credit cards in 2002. China has allowed some commercial banks to make more consumer loans on a trial basis since the late 1990s.

8. Using the CRB price indices for 23 sensitive basic commodities.

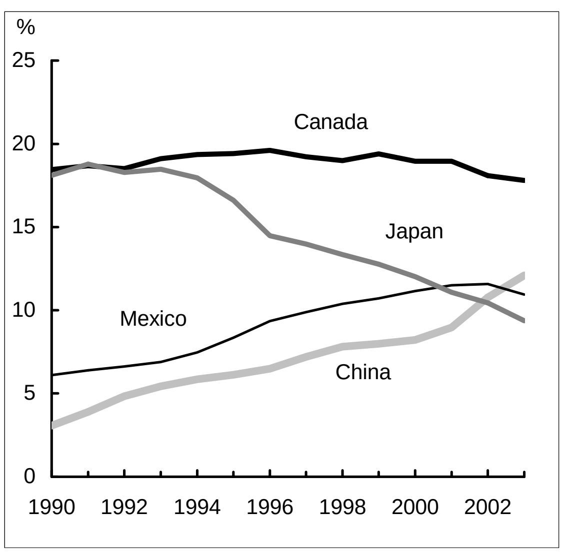
Table 1. Canada Trade with China

$000'	1995	2000	2001	2002	2003	2004*
Exports						
Agricultural and fish products	1,362,521	673,993	890,152	428,407	540,250	187,511
Energy products	3,067	455	1,157	2,994	67,903	26,378
Forest products	354,460	643,481	650,402	757,270	920,747	285,294
Industrial goods	813,087	1,348,752	1,390,107	1,572,632	1,575,989	540,020
Machines and equipment	724,667	545,117	987,260	778,089	706,665	138,106
Automobile products	22,112	65,585	38,717	73,694	113,240	27,062
Consumer goods	13,256	3,389	9,803	9,249	9,935	1,415
Re-exports	170,666	404,113	285,693	492,849	810,558	183,265
Total	**3,464,801**	**3,697,622**	**4,264,170**	**4,129,744**	**4,760,724**	**1,390,836**
Imports						
Agricultural and fish products	198,183	320,591	355,104	424,586	495,467	130,378
Energy products	8,337	26,632	52,823	41,633	44,593	4,699
Forest products	6,823	29,237	35,540	67,739	115,470	41,463
Industrial goods	560,626	1,125,392	1,223,664	1,509,874	1,736,013	447,708
Machines and equipment	1,111,855	3,789,002	4,340,509	5,869,485	7,477,347	2,121,708
Automobile products	26,926	228,783	170,699	167,235	229,619	91,278
Consumer goods	2,710,321	5,763,225	6,529,001	7,902,830	8,454,866	1,894,017
Total	**4,638,947**	**11,293,811**	**12,723,511**	**15,999,129**	**18,571,251**	**4,735,854**

* First three months.

China has supplanted Japan as the leading Asian exporter to the U.S. (although China has also boosted imports from Japan). This shift in trade between China and Japan explains the stability of the overall U.S. trade deficit with Asia (2.5% of GDP in 2000 and 2.4% in 2003). China has supplied nearly all of the increase in U.S. import demand since the turn of the decade. In 2003, China overtook Mexico as the second largest supplier to the U.S., behind only Canada.

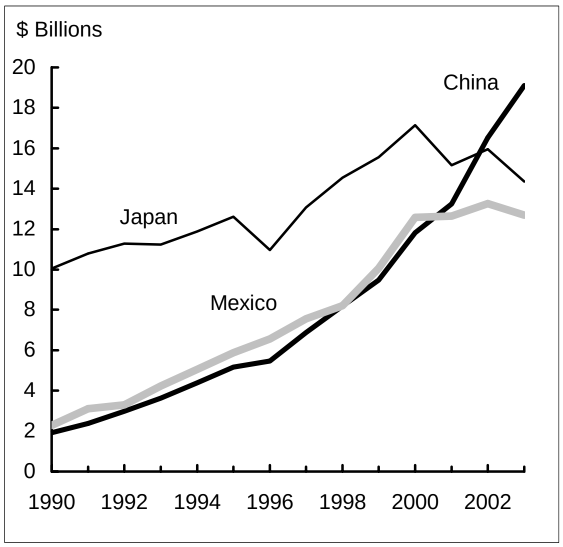
Figure 4. Share of U.S. Imports by Country of Origin



3. Imports

As a share of GDP Canada's trade balance with Asia is almost the same as the U.S., with our overall deficit moving from 2.7% in 2000 to 2.6% in 2003. At $13.8 billion (Canadian) last year, Canada's trade deficit with China was the same percentage of GDP (1.1%) as the $124 billion deficit of the United States. Our imports from China have risen as rapidly as the U.S.'s, also surpassing Mexico but two years earlier in 2001. By 2003, our imports from Mexico had slipped to just 66% of those from China, partly as the absolute level of imports from Mexico has levelled off since 2000 while that of China has soared.

Figure 5. Imports by Canada by Country of Origin

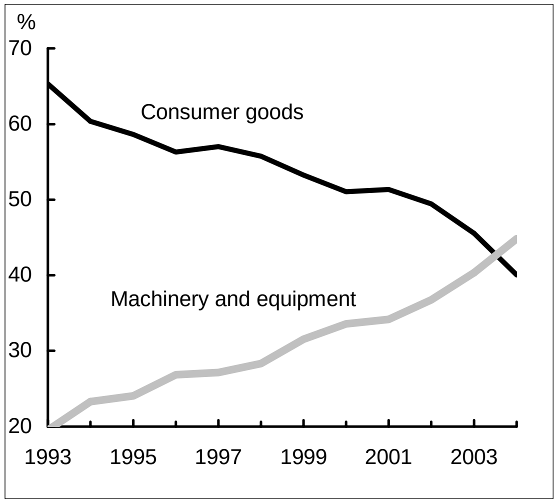


In 2003, goods from China represented 5.5% of Canada's imports. Every one of the 21 major commodity groups[9] contributed to this increase. But capital goods have dominated, reflecting increased investment by firms. Capital goods represented 44.8% of all imports from China early in 2004, up from 19.5% in 1993. Early in 2004, imports of Chinese capital goods passed consumer goods for the first time ever, despite falling prices for most capital goods. Electronic equipment and mechanical machinery led the way.

Conversely, the share of consumer goods in imports from China fell from 65% in 1993 to 40% in 2004. Toys dominate this group. The rest of our imports are spread among the following groups, all of which have changed little since 1993: industrial goods (9.5%), agricultural products (2.8%), autos (1.9%), forestry products (0.9%) and energy (0.1%).

9. Using 2-digit merchandise detail in the Harmonised System.

Figure 6. Share of Imports from China by Economic Use



Our bill for imports from China also has risen because of the drop in our exchange rate over the last decade (China maintains a fixed exchange rate against the U.S. dollar, and the depreciation of the Canadian dollar before 2003 would have raised the cost of imports). At the same time, we have turned to markets that produce at a lower cost. For example, in 2003, around 50% of our footwear imports and more than 40% of leather imports came from China.

The composition of U.S. imports from China is very similar to Canada's. Electronic equipment and mechanical machinery have soared over the last 15 years to dominate their imports from China. Toys are in second place, followed by clothing and footwear.

4. Conclusion

China's increasing integration into the world economy has been a textbook example of the benefits of trade. Its increasing exports have raised incomes in China while supplying a new source of low-priced goods, especially to firms in North America investing in machinery and equipment. As a result, China has surpassed Japan and Mexico as a source of imports for both Canada and the United States.

At the same time, China's increased demand for imports has opened up new markets for a wide range of goods. Canada has taken advantage by diversifying our exports to China away from our traditional dependence on wheat to industrial goods and forestry products. Prices for our commodity exports also have benefited from the boost from China's growth.