

## **The real victims of China's trade patterns**

Trump has railed against China's massive trade surpluses. But actually China's neighbors have far more reason to be worried

Much has been written about the consequences of China's Belt and Road Initiative (BRI), especially for the developing countries of Asia. Yet another, equally consequential phenomenon has gone largely unnoticed: China's upending of trade relationships with those countries.

Many in the West, especially US President Donald Trump, have railed against China's massive trade surpluses, which emerged after the country's accession to the World Trade Organisation in December 2001. But China's developing-country neighbours have far more reason to be worried.

Since peaking in 2015 – when the surplus in merchandise trade reached nearly USD 680bn – China's trade imbalance has been shrinking. But its surpluses remain very large in absolute terms, and in developing Asia, they continue to grow.

This was not always the case. For years, trade between China and Asia's developing economies was mostly balanced. China was a source of voracious demand for raw materials, energy, and other intermediate inputs needed to fuel its massive processing-export sector. Those inputs came largely from developing economies, especially in Asia.

Chinese demand was highly beneficial for many of these countries. It drew them into (China-centred) manufacturing value chains and produced the combination of larger export volumes and better terms of trade desired by primary-commodity exporters. Exports to China thus became a powerful engine of these countries' economic growth.

## An unbalanced trade relationship

After 2011, however, China's imports from Asia's developing economies stagnated, while its exports to them continued to swell, partly offsetting declining demand for Chinese goods in the advanced economies. In the decade after the global financial crisis, Asia's share of China's total exports doubled, standing at about 15 per cent last year. In 2012, China's merchandise trade surpluses with Asia began swelling as well, reaching some USD 130bn in 2015 and USD 111bn in 2018.

Within the last decade, China's trade balance with the Philippines has swung from persistent deficits to a substantial surplus, and its long-time surpluses with Indonesia, Bangladesh, Vietnam, and India have continued to grow. India's trade deficit with China has experienced the biggest increase, rising nearly threefold from 2010 to 2018. Among Asia's major developing economies, China has had persistent deficits only with Malaysia (from which it generally imports high-tech goods) and Thailand; but even these declined after 2011.

So while China reaps growing benefits from its neighbours, most of the rest of Asia faces a negative net stimulus from the country, as trade deficits drain effective demand. This trend is likely to deepen.

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Chinese imports from developing Asia have risen since 2016, including last year, but not by much. And a sudden surge is unlikely, because China has been developing domestic sources for a range of intermediate inputs – an effort that has steadily reduced its integration into global value chains over the last decade.

In China – unlike in most other economies covered by the OECD's trade in value-added (TiVA) database – the foreign content of exports declined by nearly ten percentage points from 2005 (26.3 per cent) to 2016 (16.6 per cent). Meanwhile, China's contributions to the value-added in partner countries' exports increased, especially for developing Asian economies, several of which showed significantly higher shares of Chinese value-added in their own exports of manufactures, even those that went to China.

## The worries of developing Asia

To some extent, China's de-integration from global value chains also goes the other way: the country is working to decrease its overall reliance on

external demand, by shifting from a manufacturing-focused, export-led growth model to one driven by services and underpinned by domestic consumption. According to TiVA data, foreign demand accounted for less than 17 per cent of domestic production in 2015, down from nearly 24 per cent a decade earlier.

But this trend creates risks for China's trading partners. It will not stem the growth of China's overall trade surpluses with much of developing Asia, because China's exports to Asia will increasingly extend beyond manufactured consumer goods to include the high-tech products that are at the forefront of the country's current growth strategy. This will contribute not just to trade imbalances, but also to growing technological and value-added imbalances.

The pattern can already be seen in trade with India, which exports mainly raw materials (like iron ore) and processed agricultural goods to China, but imports from it manufactured goods (including a growing volume of high-tech items). This implies increasing returns on activities in China. For India, however, less technology-intensive exports do not generate dynamic returns to scale.

Taken together, recent trade trends are the cause of both macroeconomic and sectoral concerns for China's trading partners in developing Asia. But these countries' options for resisting these trends are limited. After all, China has achieved much faster diversification and productivity growth, especially over the last decade, giving it a substantial competitive advantage over its trading partners.

Will China ensure that BRI projects and other financial flows mitigate the damage these trade trends imply for developing Asia's growth? Or will the BRI make matters worse for China's neighbours? As Chinese economic and political influence in Asia continues to grow, questions such as these will become increasingly urgent.

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Jayati Ghosh

New Delhi

Jayati Ghosh is Professor of Economics at Professor of Economics at the University of Massachusetts at Amherst in the United States and Member of the Independent Commission for the Reform of International Corporate Taxation.

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