3

The Rise of a New "Trading Nation"

David Zweig

In 1978, Deng Xiaoping recognized that the only way to rebuild China's economy, enhance its comprehensive national power, and return to its former leadership position in the world was through engaging in domestic economic reform and "opening to the outside world." Strengthening relationships with the developed world was central to this strategy. China sought capital, technology, management skills, and to educate a "lost generation" of scientists who had been cut off from the creative minds of the world by the Cultural Revolution.[1] The initial reform movement, therefore, ignored the developing world and placed most of China's eggs in the basket of the developed world.

Emphasizing ties to the developed world was a major shift in Chinese foreign policy. Mao had seen the path to world revolution passing through the Third World. By leading the developing world to surround the developed world, he had internationalized the strategy of the Chinese revolution—"using the countryside to surround the cities." But by the mid-1990s, particularly after China became a net importer of oil, China's leaders recognized that the country needed strong ties with both the developed and the developing world, and since then, has made ties to the Third World a pillar of its global strategy. As this volume demonstrates, China has rediscovered the developing world. China's leaders travel frequently to Africa, Latin America, Southeast Asia, and the Middle East.

China's booming economy and its emergence as the world's newest "trading nation," drives much of these enhanced relations.[2] As a "trading nation," China's need for oil and gas, raw materials and minerals, and foreign markets, and its position in globalized manufacturing networks that are closely tied to Southeast Asia, strengthen its ties to developing economies. And while economic ties to the Third World are only one part of China's global economic strategy, three aspects form the core of its economic relations with the Third World:

1. As a "trading nation," China challenges many developing countries for export markets in the developed world, even as it swamps the developing world with low-cost, quality products.
2. China competes with other developing nations for technology and foreign direct investment (FDI) from the developed world, consolidating its dominance over most of the developing world's economies.
3. China's need for resources, particularly energy and a variety of raw materials, sent Chinese firms on a whirlwind shopping spree, buying companies, mines, and oil fields around the world. Especially since the global "tsunami" in 2008, China's huge dollar reserves have allowed it to buy foreign assets even more aggressively. These purchases affect China's selection of partners and allies.

China as a "Trading State": The Theory

Since World War II, few states have expanded their national power through territorial acquisition.[3] Instead, trade allows states to turn labor power into value, create greater wealth, enhance technology, and grow rich. Trade surpluses become the road to national wealth, as states accumulate foreign exchange with which they can buy resources, companies, technology, and increase their influence worldwide. And while Ricardian economics stresses that states engage in successful trade based on their comparative advantage, the East Asian model shows that states can "create comparative advantage,"[4] doing what Alice Amsden calls, "getting the prices wrong."[5] Even within a liberalizing world trading system, states employing mercantilist strategies—protectionism, export subsidies, suppressed labor costs, and cheap energy prices—gain significant advantage in an open trading system.[6]

Engaging the global economy has been a major boon to China. No state has benefited more than China from trade liberalization and globalization. To enter the World Trade Organization (WTO), China had to meet strict targets imposed by the United States and the European Union (EU), opening the Chinese economy to the outside world more than any other WTO entrant. According to Nicholas Lardy, China's real tariffs in the 1990s were as low as 6 percent, making China's domestic market more open than South Korea or Japan.[7]

Dependency theorists would predict the failure of such a strategy, due largely to the structure of the international economy. They note that Latin America failed to break out of the dependency trap. Even in China, some nationalists criticize China's export-led growth strategy as "dependent," rather than "autonomous."[8] But the East Asian "miracle" fundamentally challenged the dependency model, as China's trade has enhanced its industrial structure, helped it move up the product cycle, and strengthened its global competitiveness.[9]

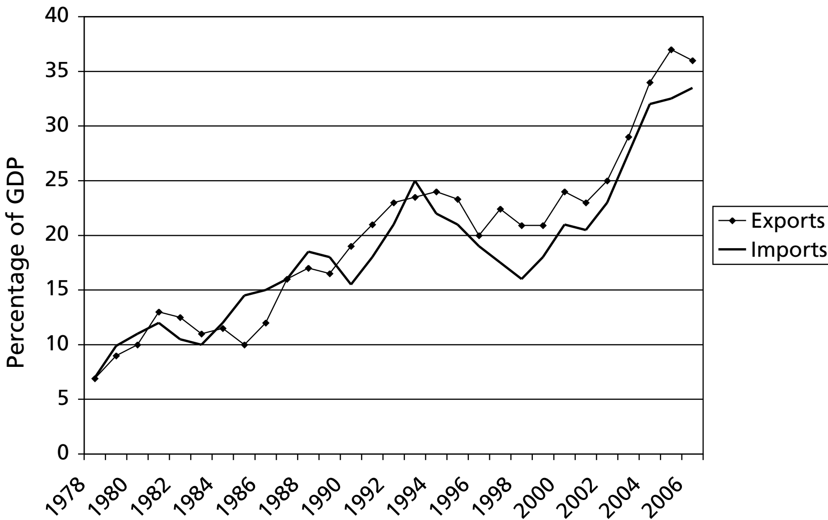
Admittedly, China has become the final assembly "hub" for products de-

signed and manufactured by enterprises owned or operated by ethnic Chinese in Southeast Asia, Taiwan, and Hong Kong, rather than the initiator of such products. Similarly, it has become the "world's workshop" for firms throughout the developed world. And by producing goods that are subsequently resold to the developed world, it challenges the developing world for those markets. Moreover, the enormous capital reserves accumulated through exports has enhanced China's state power, as the "trading nation" theory would predict. Still, according to Homi Kharas, "if economic liberalization allowed China to post 9 percent growth over three decades and lift 300 million people from poverty during that time, then surely other countries can make significant gains by knocking down barriers."[10]

China as a "Trading State": The Data

China's trade has grown at an annual rate of 15–17 percent for almost thirty years, well above the 7 percent growth rate for world trade over the same period.[11] Trade, as a share of gross domestic product (GDP), is far greater than for any country of similar size (Figure 3.1).

Figure 3.1 China's Exports and Imports as a Share of GDP, 1978–2006



Source: Barbara Stallings, "China's Economic Relations with Developing Countries," unpublished paper, Brown University, December 12, 2007.

Despite Albert Keidel's assertion that China's growth has been driven predominantly by the domestic market,[12] since 2004, the role of exports in China's overall growth has increased significantly (Table 3.1). China's emergence as a "trading nation" has enormous implications for its economic policy, particularly as it relates to the developing world. These implications are addressed in the remainder of this chapter.

"Resource Diplomacy" and China's "Going Out Strategy"

Both domestic demand and its transformation into a "trading nation" have led China to adopt a strategy of "resource diplomacy." As the "world's factory," China needs raw materials, in particular nickel, copper, iron ore, and aluminum, making China deeply dependent on states that possess such materials. According to Credit Lyonnais Securities of Asia's aptly named report, "China Eats the World,"[13] China's combined share of world consumption of aluminum, copper, nickel, and iron ore doubled from 1990 (7 percent) to 2000 (15 percent), and by 2004 was about 20 percent. Chinese demand for these commodities expanded throughout the decade until the 2008 global economic downturn. The domestic drivers behind this demand for commodities—housing and infrastructure construction, consumption of appliances and autos, and transportation of goods and people—also persisted through 2008, "leaving the Chinese dragon very, very hungry."[14] And according to Stallings, the "dominance of industry in lieu of services exacerbates resource requirements."[15]

With a very significant share of the world's resources lying under the ground in the developing world, China's National Development and Reform Commission, Ministry of Commerce and Foreign Ministry, mobilized Chinese firms to "go out" and purchase resources around the world. Thus, in 2004 they promulgated a "Guidance Catalogue on Countries and Industries for Overseas

Table 3.1 Share of Net Exports to Gross Domestic Product Growth in China, 2003–2007 (in percent)

Year	GDP	Net Exports as Share of GDP Growth
2003	10.0	0.1
2004	10.1	0.6
2005	10.4	2.6
2006	11.1	2.3
2007	11.4	2.7

Source: Asian Development Bank (ADB).

Investment" which listed resources and industries that the state saw as the appropriate targets for foreign investment.[16] The list included 68 countries, with 23 in Asia, including all 10 Association of Southeast Asian Nations (ASEAN) countries, 13 African countries, 15 countries in Europe, 11 in the Western Hemisphere, and 5 in Oceania. Key industries included farming, forestry, mining, oil drilling and refining, natural gas, and manufacturing, particularly textile and electronic manufacturing, as well as service industries, such as construction and shipping. If one looks at the lists attached to each country, the key target states are Thailand, Myanmar (Burma), Vietnam, the Philippines, Malaysia, India (for manufacturing), Pakistan, Saudi Arabia, South Africa, Nigeria, Australia, Canada, and Russia. States not on this list, but key targets nonetheless, would include Iran, and other energy-rich states listed below. What makes the list significant is the enunciated policy that "any enterprise that complies with the Guidance Catalogue and holds an overseas investment approval certificate . . . shall have priority to enjoy preferential treatment under policies of the State in respect of funding, foreign exchange, tax, customs, and import and export, etc."[17]

The guidelines were promulgated in response to an instruction by the Chinese State Council to "strengthen coordination and guidance for overseas investment," which wanted to avoid competition and duplication by domestic Chinese firms, expand and diversify trade, enhance the quality of such trade, and get the Chinese to fully use domestic and foreign markets. The dramatic jump in foreign trade and firms going abroad probably was affected by this policy. (Table 3.2 shows the growth in the number of firms going overseas and in the number of companies that Chinese firms are establishing overseas.) But even as early as the mid-1990s, the State Economic and Trade Commission had selected 120 "national champions" to lead China's engagement with the world and to prepare these firms for the global competition that accession to the WTO would entail.[18]

Interestingly, the Ministry of Commerce issued new guidelines in April 2009, which supplied important information about the laws in the various countries in which Chinese firms might be looking to invest. The guidelines were intended to cover more than 160 countries and regions around the world. The information was supplied by the business departments of Chinese embassies and consulates around the world, suggesting a much more systematic policy of "going out." The guidelines also pointed out the types of problems that firms might face, all the while suggesting solutions for such problems.[19]

China's external FDI shows a pattern similar to the data on Chinese firms going overseas (Table 3.2). China's outbound FDI rose from US$2.8 billion in 2003 to US$26.5 billion in 2007, a tenfold increase in five years. It then doubled in 2008, and as of April 2009 was on course to double again.[20] The annual average for 1990–2000 was US$2.2 billion, indicating an enormous jump in the past few years. Investment in the developing world has increased concomi-

Table 3.2 Chinese Companies Going Overseas, 2002–2007

	2002	2003	2004	2005	2006	2007
Number going out	n.a.	n.a.	3,000	4,000	5,000	7,000
Number of overseas enterprises established	6,960	3,439	5,163	6,426	10,000	10,000

Source: Ministry of Commerce of China, 2007 Statistical Bulletin of China's Outward Foreign Direct Investment, available at http://hzs2.mofcom.gov.cn/accessory/20080928/1222502733006.pdf, and other years. Thanks to Daniel Rosen for his assistance on this data.

Note: Some companies establish more than one enterprise overseas, so that by end of 2007, 7,000 enterprises had established over 10,000 companies. n.a. = not available.

tantly, particularly in Africa and Asia (Table 3.3). However, as a share of total FDI, the developing world does not get the lion's share. In fact, in 2007, half of China's total overseas investment went to Hong Kong (US$13.7 billion). Still, much of that money could have been invested in the developing world by mainland Chinese firms. Also, while investment in Africa increased fifteenfold in five years, investment in Latin America has not increased so rapidly.

What drives this overseas investment? While Aaron Friedberg, a hardline realist, sees "going out" as part of an undisclosed "grand strategy" for global dominance,[21] Philip Saunders believes that "China's increasing demand for economic inputs and for access to export markets follows a logic and geography independent of strategic concerns."[22] Friedrich Wu believes that Chinese firms, facing fierce domestic competition and declining domestic revenues, "go out" in search of new sales and distribution networks, cutting-edge technology, manufacturing know-how, and global brands.[23] And while Wu recognizes that the government was pushing its national champions to secure access to overseas resources, he sees increased Chinese investment overseas as boosting the global economy, allowing China to recycle its massive foreign exchange holdings and massive domestic savings, and promoting the world's poorer economies.

Yet both the "Guidelines" and surveys show that Chinese firms are seeking to penetrate the developing world with their exports. A World Bank survey of 132 Chinese firms that were investing abroad in 2005 found that the dominant reason for going overseas was the search for markets. Among numerous explanations deemed to be "most important" or "very important" for going out, 85 percent were seeking markets, 41 percent were making use of domestic production capacity, 39 percent wanted to enhance their efficiency, while 36 percent were tariff-jumping, that is, manufacturing in the host countries in order to avoid import duties. Finally, 12 percent of firms reported that they were investing abroad because of pressure from domestic competitors.[24] Also,

Table 3.3 Regional Shares of China's Outward Foreign Direct Investment, 2003–2008 (US$million)

	2003	2004	2005	2006	2007	2008
Asia[a]	1,505.0	3,013.9	4,484.1	7,663.2	16,593.2	n.a.
Africa[b]	74.8	317.4	391.6	519.8	1,574.3	n.a.
Latin America[c]	1,038.1	1,762.7	6,466.1	8,468.7	4,902.4	n.a.
North America	57.7	126.4	320.8	258.0	1,125.7	n.a.
Europe	145.0	157.2	395.4	597.7	1,540.4	n.a.
Oceania	33.8	120.1	202.8	126.3	770.1	n.a.
Total	2,854.6	5,497.9	12,261.1	17,633.9	26,506.1	52,150

Sources: 2006 data were from the Ministry of Commerce of China, "2006 Statistical Bulletin of China's Outward Foreign Direct Investment," pp. 17–20, 53–57. 2007 data are from the State Statistical Bureau website. 2008 data are from *People's Daily Online,* February 20, 2009, http://english.peopledaily.com.cn/90001/90776/90884/6597575.html.

Notes: a. As of 2006, China's outward direct investment (ODI) to Asia mainly includes Hong Kong, Indonesia, Iran, Japan, Kazakhstan, Laos, Mongolia, Saudi Arabia, Singapore, and Vietnam.

b. As of 2006, China's ODI to Africa mainly includes Algeria, Congo, Nigeria, South Africa, Sudan, and Zambia.

c. As of 2006, China's ODI to Latin America mainly includes Cayman, British Virgin Islands, Cuba, and Venezuela.

n.a. = not available.

51 percent of these companies were searching for strategic assets, and 39 percent said they were "resource seeking." A similar survey in 2003 by Roland Berger Strategy Consultants found that the search for "new markets" motivated 56 percent of industry-leading firms; 20 percent were securing resources, and 16 percent were obtaining technology and brand names. However, the search for technology and brand names is unlikely to play a role in China's ties to developing countries.[25]

The behavior of these overseas firms can be contentious, as Chinese firms have not always followed global norms in their treatment of local workers. Reports have circulated of problems in Peru, the Philippines, and especially in Zambia.[26] Thus, consulting firms, such as Price Waterhouse Coopers, train Chinese corporate executives before they head overseas.

Chinese companies have developed much more independence under a public policy that promotes "resource diplomacy." When Chinese leaders go abroad on trips, they now are often accompanied by a coterie of business leaders, whose interests are seen to be one and the same as those of the Chinese state. Leaders, such as Wen Jiaobao, offered important foreign aid to the Kenyan government to help the Chinese oil firms win contracts for oil extraction.

But some Chinese scholars do not see this symmetry of interests, particularly when the businesses are engaged in activities in "pariah" states, and worry that Chinese diplomacy has been "hijacked by the oil companies."[27]

Zhu Feng, professor at Beijing University's Centre for International and Strategic Studies, has written that some state-owned enterprises, such as the oil company Petro-China, are now very powerful interest groups. "They even hijacked China's foreign policy in Sudan."[28] Zhai Kun, of the China Institute of Contemporary International Relations in Beijing, said that while large state companies are driven by "economic considerations. . . . more and more regulations should now be created by the government to constrain their behavior overseas."[29] In 2007, Zhang Yunling, of the Chinese Academy of Social Sciences, dispatched a team of international relations specialists to Sudan to prepare a report on China's conduct in the country. "The companies feel great pressure as a result of being linked to politics," he said. "They don't care a lot about politics but it cannot be avoided. This kind of situation will emerge in many other places as well."

Thus, while many Western scholars see a centrally controlled mercantilist strategy as the core of China's "going out strategy," both Western and Chinese scholars wonder whether the "dog is wagging its tail, or if the tail is wagging the dog." According to Zha Daojiong, the main direction of influence is that the national oil companies (NOCs) push the government to help them compete with foreign oil companies, rather than government pushing oil firms to go overseas.

> For over a decade China has lived without a central ministerial agency to oversee the country's energy industry. . . . [It is] difficult to ascertain whether a particular oil/gas venture overseas is the result of the Chinese government dictating its state-owned energy company to carry out a governmental mission or the domestic energy industry seeking diplomatic assistance from the government.[30]

Similarly, Xin Ma and Philip Andrew-Speed see only tacit encouragement coming from the Chinese government in support of the expansion and diversification of the NOCs. "In most cases, there is little evidence to suggest that the government is doing [anything] other than support an initiative led by the NOC, develop associated economic activities and provide a coordination role."[31] Still, while the Foreign Ministry may face problems justifying ties to globally isolated governments, such as Sudan and Zimbabwe, Chinese firms still appear to be following the overall directive outlined by the state: accumulate resources.

Searching for Energy in the Right and "Wrong" Places

The search for energy has played a major role in expanding China's economic links with the developing world. In 1993, China became a net importer of oil and natural gas, and by 2007, was the world's number three importer of oil.

And despite a wealth of coal, China became a net importer of coal as well. To resolve this growing dependence on imported energy, China's NOCs have moved out into the world to get the nation the energy it needs.[32]

According to the *Economist*, in many parts of the developing world (as well as Canada), Chinese firms are gobbling up oil, gas, and coal; paying for the right to explore for them; or buying up firms that produce them.[33] Before the 2008 global recession, African and Latin American economies grew at their fastest pace in decades, thanks largely to heavy Chinese demand for their resources, which promoted that growth.

The sources of China's oil imports in 2007 (as shown in Table 3.4) show both the dominance of the developing world and the diversification of China's energy security policy. "The turning point in China's energy strategy was the Iraq war," said Tong Lixia, an energy expert at the Chinese Academy of International Trade and Economic Cooperation, which is affiliated with China's Commerce Ministry. "After 2003, both the companies and the government realized China could not rely on one or two oil production areas. It's too risky."[34]

Still, almost half of China's oil imports come from the Middle East, of which Saudi Arabia provides 16.6 percent and Iran provides 12.9 percent, and supplies from the Middle East are expected to expand in the coming years. Africa supplied 32.2 percent of China's oil imports in 2007, with Angola topping the list. Sudan supplied 6.5 percent; China has poured billions into Sudan, developing its oil industry, making it one of the fastest-growing countries in Africa.

In Latin America, the US backyard, China has become quite active in Venezuela, with over 1.5 percent of China's oil imports in 2005 coming from Venezuela; and imports from Venezuela are on an upward trajectory. In fact, China replaced some US oil producers in Venezuela because they accepted a minority equity share of 40 percent as proposed by Venezuela's nationalistic president, Hugo Chávez. China is also busy in Central Asia; the first oil pipeline from overseas brings oil into China from Kazakhstan.[35] According to Adam Blinick, while the total amount of oil in the pipeline is not very significant, China looms as an alternative source for oil exports that can give countries in Central Asia, such as Kazakhstan, room to maneuver outside Russia's orbit. Natural gas purchases also contribute to China's growing ties with the developing world, as most natural gas is found in Qatar, Iran, Saudi Arabia, and the United Arab Emirates, with Russia the only major source of natural gas that is not a developing nation.[36]

Many Chinese oil purchases are sweetened with foreign aid, which fosters economic development in these developing countries. Throughout Africa, Latin America, and Central Asia, concrete bridges constructed with Chinese capital build political and economic bridges. For example, since 2002, China, which supported the losing side in the Angolan civil war, has tried to improve ties with the victorious Popular Movement for the Liberation of Angola

Table 3.4 China's Crude Oil Imports, Major Suppliers, 2007

	Oil Imported (tonnes)	Percentage of Total
Middle East		
Saudi Arabia	26,332,088	16.59
Iran	20,536,769	12.94
Oman	13,677,798	8.62
Kuwait	3,632,297	2.29
United Arab Emirates	3,650,908	2.30
Yemen	3,236,839	2.04
Iraq	1,412,108	0.89
Total Middle East	72,478,807	45.66
Africa		
Angola	24,996,499	15.75
Sudan	10,306,048	6.49
Congo	4,801,420	3.02
Equatorial Guinea	3,280,093	2.07
Libya	2,906,872	1.83
South Africa	2,327,152	1.47
Algeria	1,612,828	1.02
Nigeria	895,179	0.56
Total Africa	51,126,091	32.21
Southeast Asia		
Indonesia	2,284,087	1.44
Thailand	1,101,774	0.69
Vietnam	496,358	0.31
Total Southeast Asia	3,882,219	2.45
North and South America		
Venezuela	4,115,231	2.59
Brazil	2,315,485	1.46
Argentina	1,566,434	0.99
Colombia	842,216	0.53
Peru	1,178,139	0.74
Canada	469,459	0.30
Ecuador	234,595	0.15
Total North and South America	10,721,559	6.75
Russia and Central Asia		
Russia	14,526,283	9.15
Kazakhstan	5,997,948	3.78
Total Russia and Central Asia	20,524,231	12.93
Total	158,732,907	100.00

Source: General Administration of Customs, People's Republic of China, *China Customs Statistical Yearbook 2007* (Beijing: General Administration of Customs, People's Republic of China, and China Customs Journal, 2008), pp. 216–221.

(MPLA) through more than US$5 billion in low-interest loans; in return, China was able to replace the French oil company Total in several oil fields.

Western states express concern about China's energy diplomacy. But according to the International Crisis Group's 2008 report entitled *China's Thirst for Oil,* China should not be faulted for this massive drive for energy acquisition. According to their data, heavy industry makes up over two-thirds of China's energy demand, which "is mostly driven by the manufacturing of goods sold on global markets. . . . Much energy in China is dedicated to the creation of infrastructure factories, roads, and ports—that makes possible an economy that supports overseas consumption."[37] In other words, China's energy and resources hunger is largely driven by the Western firms that go to China for its lower production costs.

Still there is little doubt that China's largesse to the developing world has allowed many authoritarian governments to persist in political oppression and corruption. Angola is a case in point. The MPLA leadership has formed a predatory ruling class that systematically steals funds from the state coffers to invest overseas. Under pressure from the International Monetary Fund (IMF) and the West to open its books and explain the disappearance of US$4.2 billion in 1997–2001, Angola reneged on the deal once China came up with a US$2 billion loan.[38] However, despite concerns commonly heard in the West that China has proposed that a "Beijing Consensus," which ignores government misbehavior, replace the "Washington Consensus" that dominated commerce since World War II, the *Economist* argued that

> concerns about the dire consequences of China's quest for natural resources are overblown. China does indeed treat some dictators with kid gloves, but it is hardly alone in that. Its companies do not always uphold the highest standards, but again, many Western firms are no angels either. Fifty years of European and American aid have not succeeded in bringing much prosperity to Africa and other poor but resource-rich places. A different approach from China might yield better results. At the very least it will spur other donors to seek more effective methods.[39]

Moreover, some of China's sharpest critics saw a significant shift in 2007–2008, as China began to pressure its resource suppliers, such as Sudan and Iran, to respond to Western concerns about human rights and nuclear proliferation.[40]

Competing with the Developing World for FDI?

To promote economic development and technological upgrading, Chinese policy is remarkably hospitable to FDI, making China the number two country in the world for foreign investment, after the United States. Developing countries, such as India, are amazed by the level of FDI in China, which is about

ten times the levels coming into India.[41] Moreover, that growth in FDI—average annual FDI in 1990–2000 was US$30.1 billion, but reached US$72.4 billion in 2005—could have serious implications for the developing world if China's magnetism draws FDI away from other developing countries.

After the 1997 Asian financial crisis, leaders in Southeast Asia worried that FDI that had been flowing their way was moving to China, and the aggregate data supported that argument. Whereas in the early 1990s, the ASEAN attracted around 30 percent of the FDI coming into developing Asia, by 2000, ASEAN's share had dropped to 10 percent.[42] However, UN Conference on Trade and Development (UNCTAD) data show that despite remarkable growth in the level of FDI flowing into China between 1995 and 2007, the flow of FDI into Southeast Asia also increased significantly (Table 3.5).[43] In fact, the annual rate of growth of FDI into Southeast Asia between 2002 and 2007 was far higher than it was for China. Therefore, it is impossible to argue that Southeast Asia suffered any loss of FDI due to China's attractiveness to foreign investment.

Also, according to UNCTAD, India—the largest recipient of FDI in South Asia—and most member countries of ASEAN also attracted larger inflows, as did postconflict countries and Asian less developed countries, such as Afghanistan, Cambodia, Sri Lanka, and Timor.[44]

Moreover, much of the FDI going to China came from Hong Kong and Taiwan, and included a great deal of mainland capital that first went to the Grand Cayman Islands or the Grand Bahamas, before returning to China as overseas capital, making it eligible for the preferential policies given to foreign investors. Thus, much of China's FDI is actually mainland capital that is engaged in "round tripping." On the other hand, Thailand, Malaysia, Indonesia, and the Philippines actually received five times as much FDI from the United States as China in the year ending March 2001. The totals were US$2.6 billion to US$512 million, respectively. This finding reflects

Table 3.5 FDI Inflows for China and the Developing World, 1995–2007 (US$ billion)

	1995–2000 (Annual Average)	2002	2003	2004	2005	2006	2007
China	41.8	52.7	53.5	60.6	72.4	72.7	83.5
Southeast Asia	28.0	18.1	24.6	35.2	39.1	51.2	60.5
Africa	9.0	14.6	18.7	18.0	29.5	45.8	53.0
Latin America and Caribbean	72.9	57.8	45.9	94.4	76.4	92.9	126.3

Source: UNCTAD, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge* (New York and Geneva: United Nations, 2008), annex table A.I.16.

> an important qualifier to the reality that China has displaced Southeast Asia as the target for most FDI into Asia. The bulk of "overseas" capital heading into China originates from Hong Kong and Taiwan. Some of it represents factories moving from those territories into the mainland in search of lower labour costs or less restrictive environmental regulations. The money going into Southeast Asia tends to be in more capital-intensive, niche areas where China is not yet competitive—higher-end electronics, pharmaceuticals or auto parts.[45]

Thus the great "sucking sound" that everyone is so nervous about is just that, nervous anxiety. Moreover, China's economic growth is positive for Southeast Asia; as demand in the United States and Japan drops, China absorbs many exports from the developing countries of Southeast Asia.

China: Importing from the Developing World

As a "trading nation," China is open for imports from developing countries, albeit mostly natural resources rather than manufactured goods, and despite charges that it employs a mercantilist strategy, China lowered tariffs significantly through the 1990s, even before joining the WTO.[46] Almost every time former president Jiang Zemin traveled to an ASEAN meeting, he slashed tariffs as a goodwill gesture. While overall tariffs were at 55.6 percent in 1982, and at 42.9 percent in 1992, they nosedived from that time forward, hitting 23.6 percent in 1996, 17.6 percent in 1997, and 12.3 percent in 2002. Moreover, if one averages out the official tariffs that were on the books by the value of imports in each of China's major import categories, the "weighted" tariff level in 2002 was only 6.4 percent.[47]

In truth, China is one of the developing world's best customers.[48] In 2003, imports from Latin America increased by 81 percent and from Africa by 54 percent; as of 2004, China was the third largest importer of developing country exports after the United States and the European Union.[49] According to Kharas, 45 percent of China's US$400 billion in imports in 2002 came from developing countries, rising by another $55 billion in 2003. While some worry that China's demand for commodities has inflated resource prices, Kharas sees this as a positive factor.

> Chinese demand for basic commodities (produced primarily in poorer countries) is so strong that it has pushed up prices for food staples and industrial raw materials such as aluminum, steel, copper, cotton, and rubber. For the millions of farmers around the world who depend on revenue from these products, the global price boom has come at just the right time, reversing decades of slumping prices.[50]

Several newspaper articles in May 2008 focused on how China's hunger for food led it to pour money into the agricultural sector around the world.[51]

UNCTAD data documents China's role in helping the developing world grow. China's imports from developing economies in the Western Hemisphere rose fivefold between 2000 and 2007, from US$5.2 billion in 1999, to US$11.63 billion in 2003, US$23.24 billion in 2005, reaching US$35.54 billion in 2007. Imports from the least developed countries doubled between 1999 and 2003, from US$2.67 billion to US$4.37 billion, almost doubled again by 2005 to US$7.80 billion, and then more than doubled again by 2007, reaching US$14.18 billion.[52]

The impact of China's resource hunger on Africa has been huge and largely positive.[53] China has suddenly become Africa's third trading partner, behind only the United States and France. The *Financial Times* cites the widescale impact of China's purchases of commodities beyond the oil sector, including cotton, cocoa, and phosphate.[54] To get these commodities to sea, China has built new harbors and railroads, promoting widespread economic development in a region of the world that has severe need for infrastructure investment.

Deepest Impact on East Asia

While China is having an important impact on the world's economy, its regional impact is even greater, as a unique pattern of trade flows has emerged. The export-oriented growth strategies of the emerging Asian economies have been reflected in a steady increase of their share of world trade, reaching 34 percent in 2006, up sharply from 21 percent in 1990. Thus, it is not surprising to find that China's imports and exports with "developing Asia" have grown significantly.

But much of this trade is with the rapidly developing territories of East Asia, which ships parts for assembly to China, which then exports those assembled goods to the developed world. China, therefore, has become the core to a multiplicity of networks for the manufacture of electronics and other manufactured goods whose high-level components are first produced in more advanced Asian economies and then assembled in China. Table 3.6 shows what the IMF refers to as the "China Hub."[55] To facilitate the flow of goods, China has established a free trade agreement with ASEAN, as well as free trade agreements with other countries of the region.

The Downside of China's Growth on the Developing World

China's impact on developing countries depends in part on whether Chinese goods compete directly with their exports. Businesspeople in El Salvador feared Chinese competition in textiles and towels.[56] But the case of China's im-

Table 3.6 The China Hub: Direction of Exports

	Direction of Exports				
Exporting Region or Country	NIEs[a]	ASEAN5[b]	China	Industrial Asia	Rest of the World
NIEs	14.0 (1.7)	12.2 (3.7)	25.4 (17.5)	8.3 (–5.1)	38.3 (–18.7)
ASEAN5	21.6 (0.3)	9.7 (5.4)	11.1 (8.9)	16.0 (–10.9)	39.6 (–5.1)
China	22.8 (–18.4)	4.6 (1.7)	—	11.5 (–3.8)	59.7 (19.1)
Industrial Asia	21.4 (2.6)	8.9 (1.1)	14.8 (12.5)	6.6 (–0.7)	46.9 (–16.2)

Source: IMF Direction of Trade Statistics, and staff circulations.

Note: First number is share of the direction of exports in 2006, and number in parenthesis is change in the shares from 1990 to 2006.

a. NIEs = newly industrialized economies.

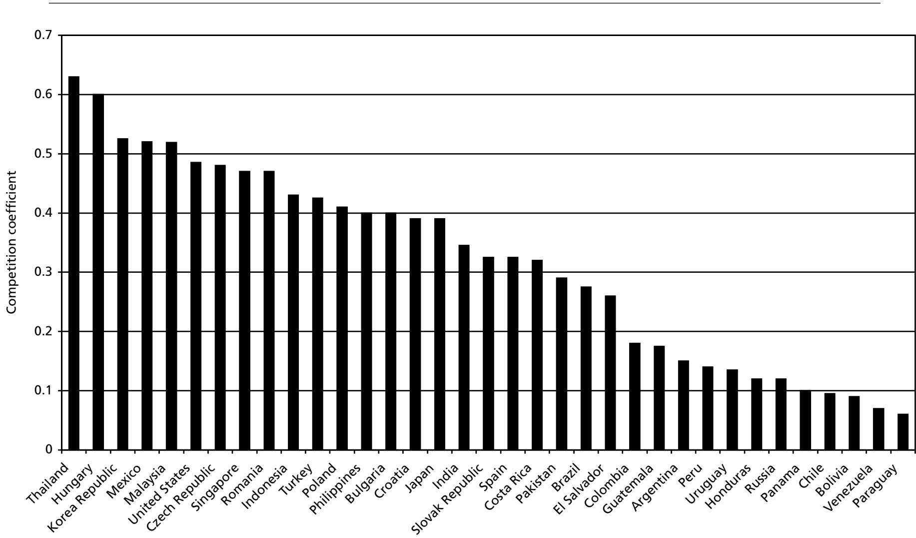
b. ASEAN5 = Indonesia, Malaysia, Philippines, Singapore, and Thailand.

pact on global trade in textiles and garments is complicated. As long as the Multi-Fibre Arrangement (MFA) was in effect, China's exports of textiles was limited by quotas, which distributed imports to the United States and the European Union among different countries, particularly some poor countries in Africa. Chinese firms, therefore, moved their plants to those countries to take up the quota of allotted sales to the developed world. But the MFA expired on January 1, 2005, affecting 87 percent of US quotas and 73 percent of the EU's, and now that the global system of quotas has disappeared and Chinese firms can return to the mainland, garment workers in countries such as Bangladesh and Cambodia, whose jobs and wages depend on protected markets, are being hurt. According to Ian Taylor, African textile and clothing manufacturer exports to the United States fell by 16 percent from 2004–2005, while US imports from China went up by 44 percent and EU imports from China went up by 78 percent.[57] But again, much of the exporting to the developed world before the end of the MFA was by Chinese firms that had relocated to the African continent.

Similarly, maquiladora industries in Central America that exported to the United States under special agreements that are now deemed unfair trade are already exiting the market, fearing the coming competition with China. Figure 3.2 shows which countries are China's direct competitors and therefore are likely to be hurt by China's growing exports. Mexicans are deeply concerned because they produce half of Latin America's exports. Assembly plants there are moving to China, Chinese products are flooding Mexican markets, and China has now surpassed Mexico as the second largest supplier to the United States.

Similarly, Barry Eichengreen and Hui Tong find that China has had a positive impact on resource exporters, such as Australia and Brazil. Countries such as Peru, Chile, Angola, and Congo have also seen positive results, al-

Figure 3.2 Export Competition with China for Selected Countries, 2000–2005



Source: Latin American Economic Outlook 2008, OECD Development Centre (2007).
Note: Export competition is measured by comparing the trade structure of each country with China's. A high measure indicates a high degree of similarity in export structures, as determined by specialization and conformity coefficients, and vice versa.

though in these countries, China may be perpetuating the use of low-quality labor for resource extraction, in return for the importation of Chinese manufactured goods.[58] Also helped are countries that produce components that fit into the production networks for the manufacturing of electronic components, such as Malaysia or Singapore. But China creates serious problems for countries such as Bangladesh, Pakistan, or Vietnam that compete with it directly in the production of goods like shoes or textiles.

China's export drive has also depressed the price of many manufactured goods, hurting the economies of other developing countries. According to Mary Amiti and Caroline Freund, many of China's gains to trade are from extensive growth—exporting more of the same goods at cheaper prices, thereby increasing China's world market share—rather than expanding the number of new product lines.[59] Thus, while China appears to be dramatically changing its comparative advantage by increasing its level of specialization, in fact, it continues to specialize in labor-intensive goods. The result is downward pressure on prices of a wide array of goods, generating serious implications for the developing world. Thus, between 1997 and 2005, most of China's export growth was in existing varieties, allowing the importing countries—mostly developed

economies—to benefit from lower import prices. Indeed, between 1997 and 2005, the average prices of goods exported from China to the United States fell by an average of 1.5 percent per year, whereas the average prices of these products from the rest of the world to the United States increased on average by 0.4 percent per year.[60]

Competing with Developing Countries for the US Market

One of the most important markets in the world is the United States. Sales to the United States powered Japan's growth in the 1960s as well as Asia's Four Little Dragons (Hong Kong, Singapore, South Korea, and Taiwan) since the 1970s. And while inter-ASEAN trade has surpassed trans-Pacific trade in the past few years, the battle over the US market is critical to the growth of developing countries around the world. So Mexicans have reason to worry now that in 2003, China replaced Mexico as the second largest source of imports for the United States. Yet according to Neil Hughes, it is often US firms who are bringing the US market to the Chinese, not Chinese who are aggressively seeking to export to the United States:

> Almost 60 percent of Chinese exports to the United States are produced by firms owned by foreign companies, many of them American. These firms have moved operations overseas in response to competitive pressures to lower production costs and thereby offer better prices to consumers and higher returns to shareholders. US importers with dominant positions in China, such as Wal-Mart and Hallmark, have the power to compel Chinese suppliers to keep their costs as low as possible. . . . So who is really "to blame" for China's "exporting deflation" and for the surge of Chinese exports? American importers, the American consumers who buy their Chinese goods at very low prices, and their American shareholders who demand results.[61]

In fact, a large part of China's export drive is powered by foreign firms that have relocated to China from the developed world or from other countries, such as Korea, Japan, or Mexico. Table 3.7 shows the important role of foreign-invested firms in China's exports.

A good example of a sector where China has drawn business away from both developed and developing countries is the computer equipment industry. According to Wayne Morrison and Marc Labonte, imports of computer equipment have shifted from other countries in East Asia to China.[62] In 2000, Japan was the largest foreign supplier of US computer equipment (19.6 percent of total shipments), while China ranked fourth (12.1 percent share). In just seven years, Japan's ranking fell to fourth, the value of its shipments dropped by over half, and its share of shipments declined to 7.0 percent (2007). Mexico and Singapore have also lost out to China, but Malaysia's exports between 2000 and 2007 have more than doubled (Table 3.8). Still, China was by far the

Table 3.7 China's Exports and Imports by Foreign-Invested Enterprises in China, 1986–2007

		Exports by FIEs		Imports by FIEs	
Year	Annual FDI (US$ Billion)	US$ Billion	Percentage of Total Exports	US$ Billion	Percentage of Total Imports
1986	1.9	0.6	1.9	2.4	5.6
1990	3.5	7.8	12.6	12.3	23.1
1995	37.5	46.9	31.5	62.9	47.7
2000	40.7	119.4	47.9	117.2	52.1
2001	46.9	133.2	50.0	125.8	51.6
2002	52.7	169.9	52.2	160.3	54.3
2003	53.5	240.3	54.8	231.9	56.0
2004	60.6	338.2	57.0	305.6	58.0
2005	60.3	444.2	58.3	387.5	57.7
2006	63.0	563.8	58.2	472.6	59.7
2007	75.0	695.5	57.1	559.4	58.5

Source: Morrison and Labonte, "China's Currency," p. 25.

largest foreign supplier of computer equipment in 2007 with a 51.5 percent share of total US imports. While US imports of computer equipment from China rose by 436 percent over those seven years, the total value of US imports from the world of these commodities rose by only 26 percent.

The Problems of a Trading Nation

China has emerged as a major global economic force whose rapid development has enormous implications for the Third World. China is both partner and competitor. Its demand for resources and raw materials translates into investment that cranks up the economies in much of the developing world. Its overseas investment has brought life to mines and oil fields that languished due to the high cost of extraction. Its cheap products have allowed poorer people in many parts of the world to dress better and maybe even enjoy their lives more fully. Yet China's growth also challenges many developing countries as China's lack of trade unions and its coercive local state keep wages low, bringing many new enterprises to China. China's ability to attract so much FDI comes, in part, at the expense of other developing countries, which see their share of new FDI falling.

Still, while China has maintained it comparative advantage over much of the developing world, the rising price of its labor has pushed some products to

Table 3.8 Major Sources of US Computer Equipment Imports, 2000–2007 (US$billion)

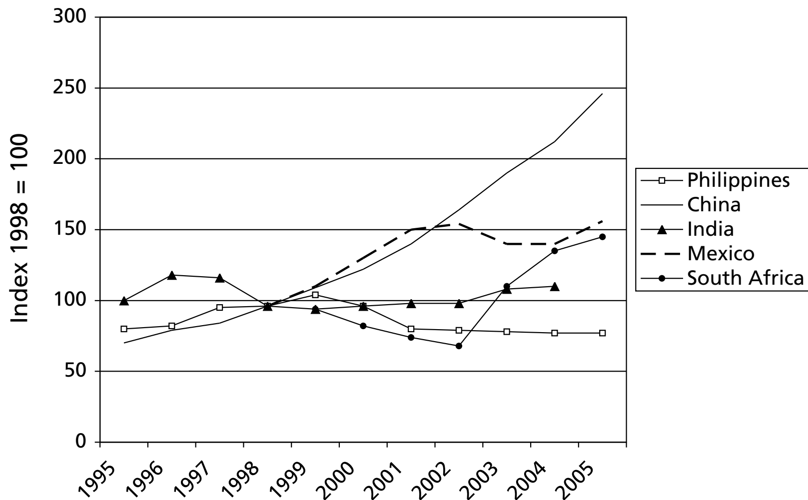
	2000	2002	2004	2006	2007	Percent Change, 2000–2007
China	8.3	12.0	29.5	40.0	44.5	436.1
Malaysia	4.9	7.1	8.7	11.1	10.9	122.4
Mexico	6.9	7.9	7.4	6.6	6.6	–4.3
Japan	13.4	8.1	6.3	6.3	5.0	–62.7
Singapore	8.7	7.1	6.6	5.6	4.3	–50.6
Total	68.5	62.3	73.9	83.8	86.3	26.0

Source: Morrison and Labonte, "China's Currency," p. 26.
Note: Ranked by top five suppliers in 2007.

Vietnam, India, and other low-wage countries. This process has been at work since 1998 (Figure 3.3). Great concerns in China have emerged, even among government officials in the republic, as the new labor code, introduced in 2008, which insures fairer treatment for Chinese factory workers, further undermines China's dominant position as the "workshop of the world."[63] Fortunately for China, its infrastructure (particularly transport facilities), energy supply, and skilled workforce help it compete with countries such as the Philippines or South Africa, whose labor costs are now below those in China. Serious trade competition also exists with Mexico, given Mexico's geographic advantage over China in terms of access to the US market.

But the dilemmas do not end there. As a newly emerging trading nation, China must deal with the world as it is—that is, it must compete within an economic structure dominated by the United States, Japan, and the European Union. Several ironies emerge from this situation. First, with the West so dominant in the energy sector, and China's external energy dependence expanding daily, China has been forced to turn to states deemed "pariahs" by the United States and the European Union to gain energy more easily. These are often countries from which the West, or particularly the United States, has withdrawn. Hence China's close ties to states such as Venezuela, Sudan, and Iran, and its willingness to protect them from UN sanctions. Despite Western opprobrium for such foreign policy behavior, China feels a great need to maintain such bilateral ties. Second, since many resource-rich developing countries are, at best, illiberal democracies or are dominated by thuggish authoritarian regimes, China, if it wishes to fuel its economic growth and maintain social employment and stability, finds it must bring development projects and capital to these countries, even though it perpetuates dictatorship. Moreover, these rulers laud China as an alternative model of development (hailing a "Beijing

Figure 3.3 Average Rise of Wages in China Compared to Other Low-Income Countries, 1995–2005



Sources: China Statistical Yearbook 2005, People's Bank of China, ILO (the Philippines, South Africa), IBGE (Brazil), Banco de Mexico, Ministry of Statistics and Programme Implementation (India); exchange rates from *IMF International Financial Statistics*.

Notes: Internationally comparable average wage rates have been used. Wages are average wages for China, the Philippines, and South Africa, average private sector wages in Brazil, and manufacturing wages for India and Mexico. Wages for 1998–2000 for the Philippines have been estimated using observed wages from 2001 and projecting them backward using GDP per capita growth rates.

Consensus") that can challenge the "Washington Consensus"—free trade, democracy, and government transparency—which challenges their political power. These ironies color China's ties to much of the developing world, all the while complicating its ties to the West.

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