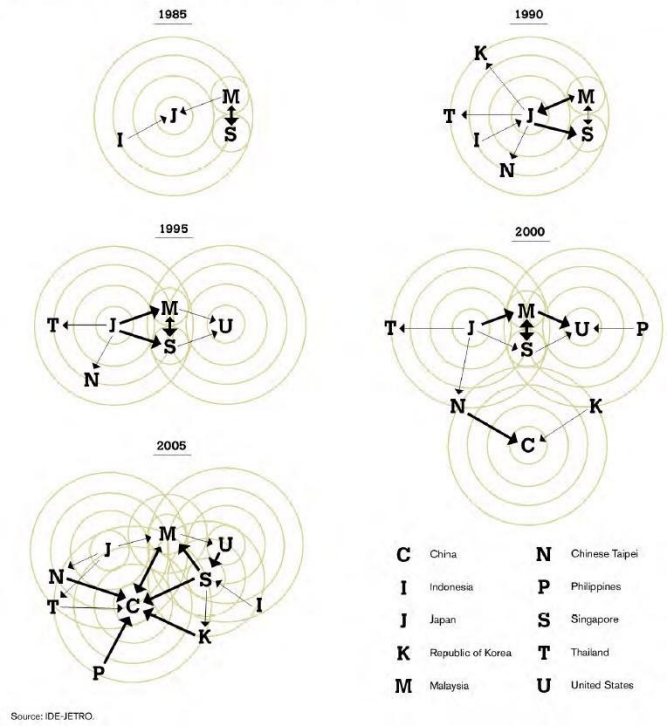
The Chinese Economy: A Low “Value-Added” Production Hub in East Asia

Written by Richard Rousseau, Contributor | 15 September 2012

China has become the world’s leading exporter, and specialists in international relations confirm that it is increasingly exporting high-tech products. However, a rigorous analysis of this development confined to the traditional study of trade flows would be misleading. In fact, from the 1980s onwards East Asia has been characterized by the development of regional production networks and trade patterns that are radically modifying the paradigm of international trade, with important consequences for the dynamics of multilateral trade agreements.

As demonstrated in the figure to the right, this process gained traction at the mid-1980s, after the revaluation of the yen imposed by the United States as part of the Plaza Accord of 1985, when Japanese corporations began to relocate entire value-added production chains from Malaysia to South Korea, Taiwan, and other Southeast Asian countries.

Figure 1
Evolution of regional production networks, 1985-2005



Source: IDE-JETRO.

The 1990s and the first few years of the 2000s witnessed the emergence of the United States and the People's Republic of China (PRC) in the regional production networks. However, by 2005 the production dynamic had shifted toward China, which quickly and incontestably became the region's most important trade hub, both in terms of exports and imports.

In fact, Taiwan, the Philippines, Thailand, South Korea, Singapore, and Malaysia became major suppliers of China, relegating Japan, the traditional regional trade power, to a secondary trade status, even though it remained a relevant regional player by means of its massive investments in Taiwan and Malaysia.

China: Main "Assembler" in Asia

Although China is often referred to as the "world's factory," a more complex picture of its role in the world economy emerges when the value-added content in each unit of Chinese-exported manufactured products is analyzed. Since 2006 China has become the "assembler of Asia," as two-thirds of its imports are intermediary goods from East Asian countries which China then transforms into end products.

China primarily sells its finished products to countries of the European Union and the United States (between 1992 and 2006, Chinese exports of finished products to East Asian countries fell from 55 percent to 26.5 percent of its total exports). Although processing trade (this term refers to the business activity of importing all or part of the required raw and auxiliary materials, parts and components, accessories and packaging materials from abroad in bulk, and re-exporting the finished products after processing or assembly by enterprises within the Chinese mainland) now accounts for a declining share of China's total trade, this share is still significant: In fact, it decreased from 49 percent (55 percent of all exports and 42 percent of all imports) in 2000, to 39 percent in 2010 (47 percent of all exports and 30 percent of all imports). We can therefore deduce that China's growth

depends on exports as much as imports, and that the high technological content of the latter may explain that Chinese exports are now more sophisticated than one would have expected, especially considering the current moderate level of China's industrial development.

In other words, until one computes the domestic value added (DVA) present in the Chinese processing trade, the full significance of the role played by China in world trade can hardly be grasped. For example, the export of an iPod that is recorded in China's trade statistics as having a value of $150 has actually gained an added value of only $4 after being processed in the Chinese manufacturing system. Its remaining value is simply the sum of the costs of the imported components. Moreover, a recent academic study reveals that, while the total manufacturing cost of an iPad is $275, the value added in China is only $10.

Since components for electronic products make up a significant quantity of the goods traded among Asian countries, the difference between the market value (final price) of China's exported products and the value added by processing them in China has huge importance. Moreover, if trade statistics use the value-added criterion for calculating trade volumes, then some interesting numbers can be derived. For example, according to estimates by the weekly magazine *The Economist*, the use of the value-added method would significantly reduce the current account deficit incurred by the U.S. with China in 2011, from $300 billion to only $150 billion. In addition, a report released by the United Nations Conference on Trade and Development (UNCTAD) in 2010 stated that an appreciation of the renminbi would not necessarily lead to a reduction of the U.S. budget deficit, as it would make both Chinese imported goods and U.S. exported goods made with Chinese components more expensive. In essence, the U.S.-China trade imbalance is more due to multilateral then bilateral trade.

Finally, after delineating the value of the imported components, even in the period 2005 to 2006, over 80 percent of exports from China were still made up of labor-intensive goods, an indicator that showed that the rise of high-tech manufacturing would be a long process, and not a particularly obvious one.

Asia's Economically Complementary Countries

The integration of China into global production networks has given East Asian countries new opportunities to specialize in one or more specific value added links in the production process, with the products' final assembly being undertaken in mainland China. Rather than talking about competition between East and Southeast Asian countries, we should interpret the new interconnectedness of these economies as growing complementarily in the production process. For instance, it has been estimated that a 1 percent increase in Chinese exports contributes to a 0.51 percent increase in Japan's total exports, 0.42 percent in South Korea's, 0.70 percent in Thailand's, and even 0.89 percent in the Philippines'. Moreover, a 1 percent increase in its GDP means that China will import 0.7 percent more from East Asian countries than OECD countries.

Two final points are worth mentioning, First, the Chinese leadership is being faced with the dilemma of having to choose between retaining its neoliberal techno-globalism, i.e. continuing to welcome foreign capital (which, as is well known, is heavily concentrated in the final assembly of products for export), or focusing instead on reinforcing the internal technology apparatus, which may mean adopting old and new forms of protectionism ("techno-nationalism").

Second, regionalization without regionalism in East Asia appears to be proceeding without there being a need to create Free Trade Areas (FTAs), a measure traditionally associated with the reduction of tariff barriers. For example, the vast majority of the components for assembling electronic products cross the border under duty-free terms. The recent proliferation of FTAs in the region, however, seems to be more politically than economically motivated, being part of the complex process of forging friendly relations and alliances between trade partners against the backdrop of an emerging new chess game between China and the Unites States.

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