There are too many clichés doing the rounds about the powerful Asian locomotive. Countries with highly specialized production, such as Italy, are worried about the devastating impact of Chinese imports, while others such as the U.K. and the Scandinavian countries want low-cost products to keep prices on hold. Here's what we discover when we analyse the main items in China's import-export trade.

China's credit and debit with the rest of the world

ECONOMY

by Stefano Chiarlone and Francesco Giordano

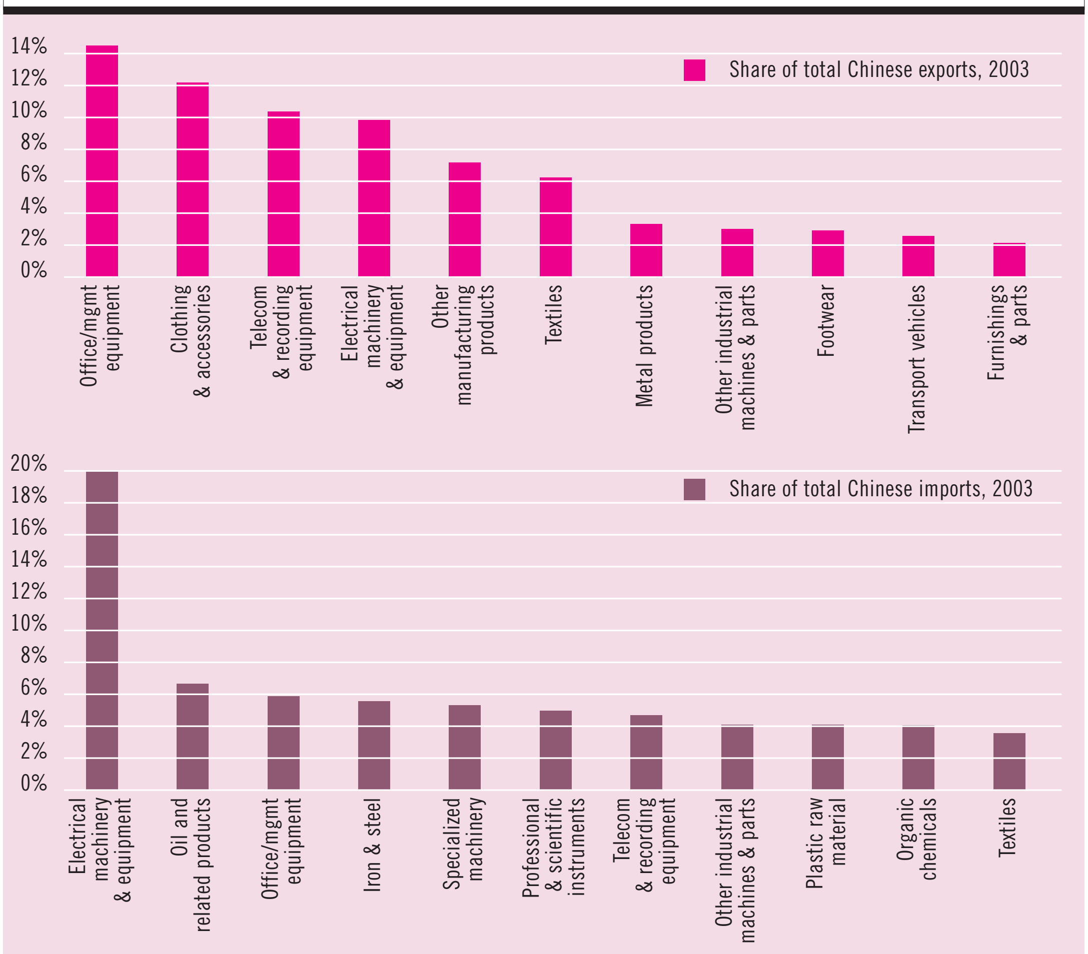
When we talk of China it is generally in terms of its aggressive export policy, which undermines our products, a policy that includes both fair (low costs) and unfair (counterfeiting, dumping etc.) competition. The most recent debate on the subject concerns the situation of the textile and clothing sector following the expiry of the *Agreement on Textile and Clothing*. Some argue that we should adopt a more aggressive stance and perhaps limit imports in every possible way, from customs duties to toughly negotiated bilateral accords. While there is some truth to this talk, there is more to China than low-cost textiles. The fear that competition from goods produced by companies operating in China could have dramatic consequences for European manufacturing has in fact triggered a very heated clash between two different views of Chinese integration.

On the one hand there are those who want new quotas on certain traditional products. These are mainly countries, including Italy, with highly specialized production in these sectors, which fear an immediate and extremely serious impact on their industrial production. On the other hand there are countries that no longer have a large manufacturing capacity but act as distributors, among them Scandinavia and the U.K. These countries consider that importing low-cost products is good for consumers and indispensable to the functioning of major retail chains, which would face a dearth of supply in the short term without Chinese-made goods and shift provisioning in the medium term to other low-cost countries (and not, in any case, to European manufacturers, who are too costly for the middle range).

This contrast between a very Italian view of China, centred on what is held to be unfair competition, and a view that gives more importance to the need for low-cost supplies, explains the relative coolness of Italy's European partners to the more belligerent declarations on the subject and the uphill road that the re-introduction of quotas has faced. It is not our intention to examine whether these measures are opportune. What we wish to show is that the debate on China must have a wider scope; that it cannot overlook the fact that China is a phenomenal exporter but also a major driver of world economic growth, partly because of its increasing imports. A significant share of these imports is due to the fact that many companies – often European ones – are able to dismantle their production process and shift some of the steps to China. This means they need to transfer parts and intermediate goods from the mother company to China. Hence for many countries, including some of our neighbours, China is turning into an economic and industrial growth hub as well as a crucial element in sustaining consumers' purchasing power (the United States is a prime example of this). Let's analyse a few basic facts to understand how. On the one hand China is a buyer of technology (machinery) for its industries; on the other hand, in many sectors it imports, carries out some manufacturing phases and then exports either final goods or those requiring especially fine finishing.

This anatomy of Chinese trade emerges clearly from the weight of different import and export sectors. For example, high-tech machinery tops the list of imports and exports, which shows that many foreign companies have outsourced part of their production to China, with vertical disintegration of the production process, while among the leading imports are goods to equip various types of production. If we look at trade by economic category, the picture is even clearer. In fact 95% of Chinese imports are composed of intermediate goods (66%), capital goods (21.9%) and raw materials (11.9%), while the share of these products among Chinese exports is far more limited. If we look at exports, in fact, we see that over 37% are final consumer goods. *Tables 1, 2*

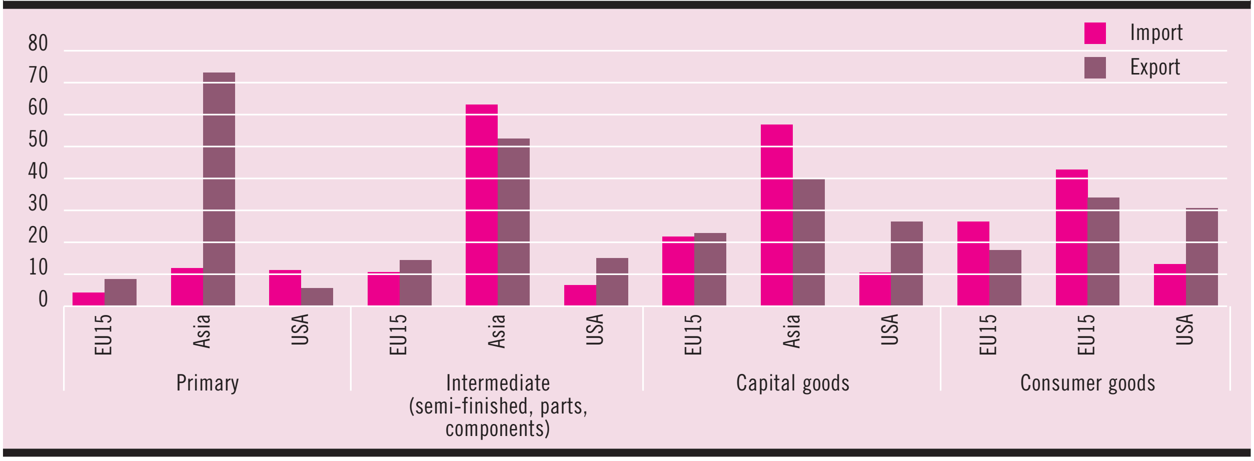
1. CHINESE TRADE: SECTOR-WISE SPLIT
(% WEIGHT OF SECTORS)



Source: UniCredit Banca d'Impresa Strategy and Research's elaboration of United Nations ComTrade data

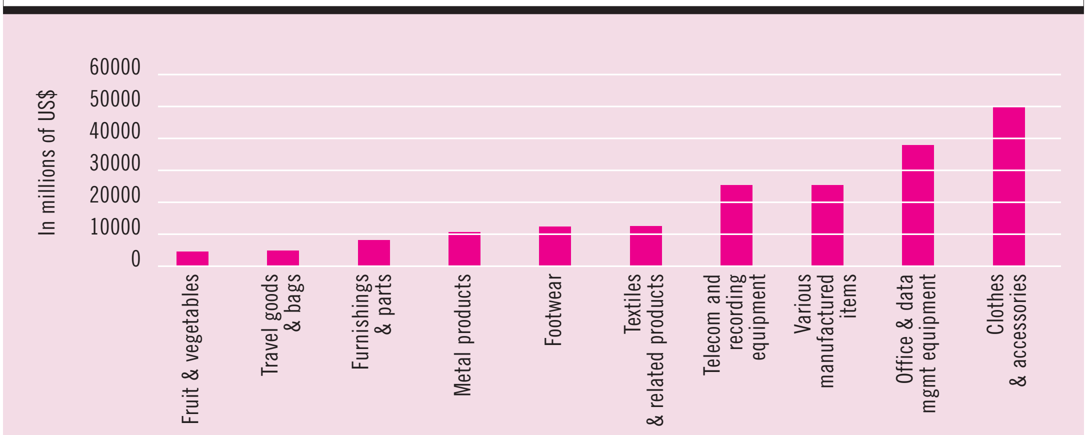
In other words, given that basic goods for many sectors (textiles: furnishings and household linen as well as clothing; raw materials such as plastics, oil and metals, machinery and technology) occupy the top places on the imports chart, China is dependent on other countries for its production, and is hence linked to the dynamics of globalisation. The Asian countries that, like China itself, are importers of investment goods are China's leading suppliers. The U.S. exports mainly advanced and technological goods to China (chemicals, electrical machinery and aeroplanes) and imports consumer goods. Germany, a key supplier of electrical and non-electrical machinery, accounts on its own for over 10% of Chinese imports of capital goods in the engineering sector. As regards primary goods, countries like Russia and Brazil supply 12.6% and 35.7% respectively of China's imports. This situation influences China's trade balance – the surplus is concentrated in consumer products, both advanced and traditional. The deficit is concentrated in investment and technological products (various types of machinery) and raw materials. *Table 3*
The situation we have described suggests which countries would benefit or suffer

2. WEIGHT (%) OF SOME GEOGRAPHICAL AREAS IN CHINA'S TOTAL TRADE BY ECONOMIC CATEGORY, 2003



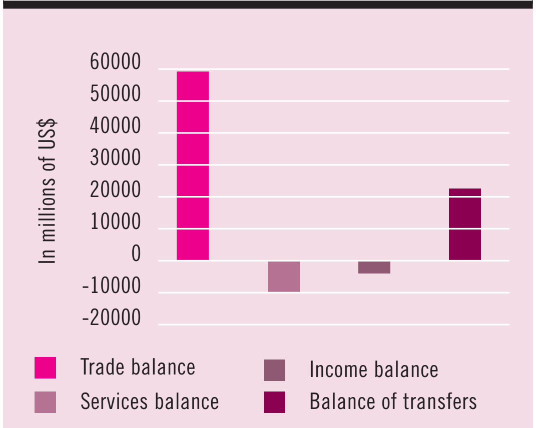
Source: UniCredit Banca d'Impresa Strategy and Research's elaboration of United Nations ComTrade data

3. MANUFACTURING SECTORS WHERE THE CHINESE TRADE SURPLUS WAS HIGHEST IN 2003



Source: UniCredit Banca d'Impresa Strategy and Research's elaboration of United Nations ComTrade data from China's industrial expansion. The integration of China has primarily affected consumer goods manufacturers who have not shifted part of their production to China. They are suffering the effects of competition from China without being able to benefit from the possibility of producing the same quality at lower costs while focalizing resources on producing greater added value. Those benefiting from China's role as an exporter are countries that have abandoned some production sectors because their companies have shifted to pre and post-production activities such as product design and retailing finished products.

4. BALANCE OF VARIOUS COMPONENTS OF CHINA'S BALANCE OF TRADE



Source: UniCredit Banca d'Impresa Strategy and Research's elaboration of EIU data

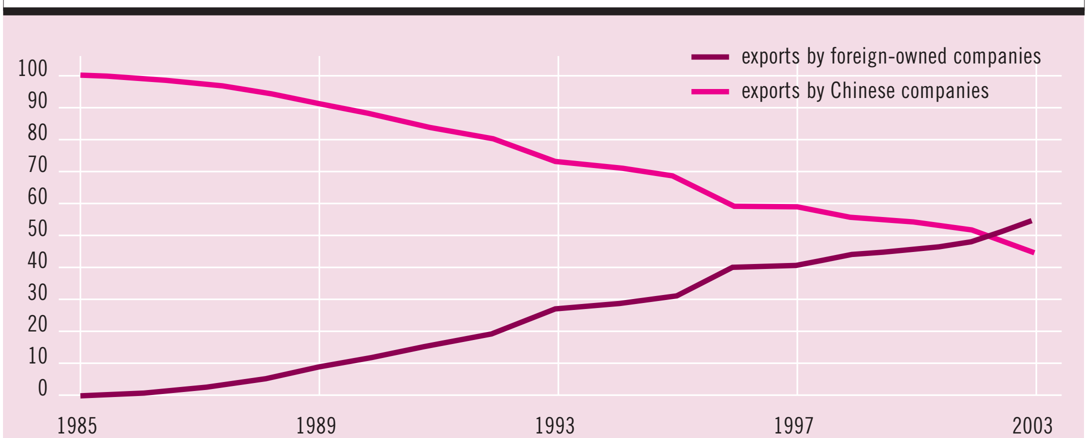
Those benefiting from China's role as an importer are producers of know-how and technology (including machinery) and countries rich in raw materials.

Analysing the flow of goods into and out of China is not enough to understand its role; we need to analyse financial flows and the flow of intangible goods as well. First of all, we should remember that China's trade balance reflects not only a sustained growth in GDP and imports, but also a deficit as regards services trade and repatriated profits from foreign direct investment. *Table 4*

China, in fact, shows a remarkable ability to attract foreign direct investment (over $50 billion per year over the last few years), 63% of which is concentrated in the manufacturing sector. There are over 400,000 multinational subsidiaries in China, about 46% of the world total. These companies account for a major share – over 50% – of China's foreign trade, both in entry (imports) and exit (exports). Their presence, intrinsically linked to the transformation of China into a production hub for various sectors, obliges us to view China's trade surplus differently, because it forces us to take the nationalities of the companies that make up this surplus into account. *Table 5*

The case of the U.S., which has a strong trade deficit with China and which we can use as a benchmark, shows that foreign trade data can be somewhat misleading.

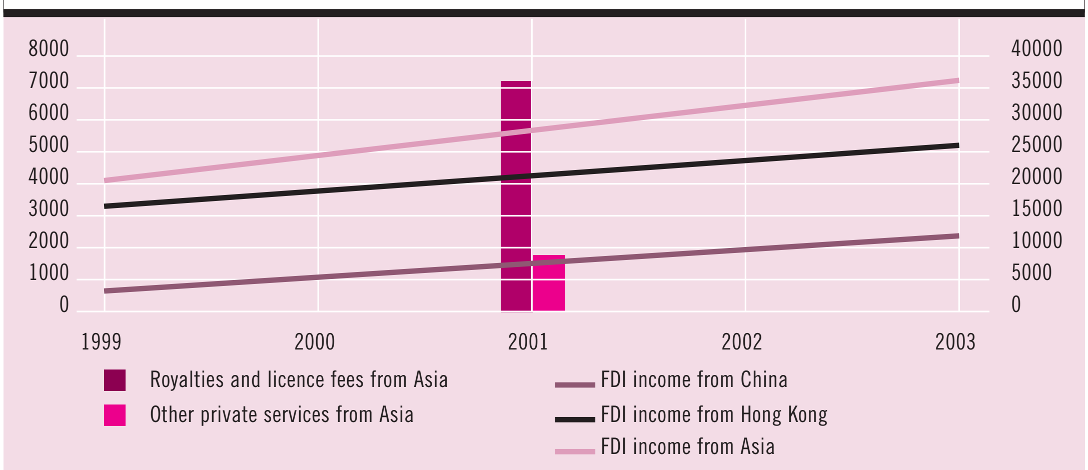
5. WEIGHT (%) OF DOMESTIC AND FOREIGN COMPANIES IN CHINA'S EXPORTS



Source: UniCredit Banca d'Impresa Strategy and Research's elaboration of MOFCOM data

Take, for example, the high-tech information and communication technology sector, where there are strong direct Asian and American investments and where the U.S. deficit with China is concentrated. Over 85% of Chinese imports of office equipment come from Asia, particularly Japan and Korea, but they also come from countries with a medium level of development, and we can estimate that about 30% of Chinese exports of this equipment goes to the U.S.
The U.S. deficit with China is hence not only with China but also, in a certain sense, with other Asian and European countries. In these sectors, foreign multinationals account for over 90% of exports from China. Among the top 10 multinationals operating in China, for example, are Samsung, Nokia, Seiko Epson, Philips, and Sanyo, which on their own represent 2% of total Chinese exports. The deficit originates partly from American companies: three of the top 10 multinationals in China are American (IBM, Motorola and Seagate), and represent 1.4% of total Chinese exports. These considerations can be extended to other sectors as well; in general, over 10% of foreign direct investment in China comes directly from the U.S., and these companies compete with multinationals from other countries to generate over 50% of China's exports. Besides, the U.S. also invests a great deal in other Asian countries (about 16%) that, in their turn, use China as a production base, often on behalf of American multinationals. Hence a triangle is formed, composed of foreign direct investments and the pattern of imports towards and exports from China. *Table 6*
The presence of multinationals in China also translates into financial flows: the U.S. balance of payments shows that the income the U.S. receives from Asia from licences, royalties and other services linked to foreign direct investment abroad is the equivalent of over 15% of its trade deficit with China. Also, the income the U.S. receives in the form of repatriated profits from foreign direct investment in China, Hong Kong and Asia in general is growing as many companies begin to repatriate a portion of the proceeds of their direct investment. It is hard to estimate non-repatriated but locally reinvested foreign profits. However, given the substantial amount of foreign investment that has accumulated over time, it is likely that these are quite sizeable.
Finally, Chinese exports often benefit American consumers: many retail chains use China to produce and import low-cost goods. It is estimated, for example, that Wal-Mart imports goods from China to the tune of over $18 billion, and that it has over 80% of its suppliers in China for traditional products – another sector where

6. FINANCIAL FLOWS FROM ASIA TO THE U.S.A.:
ROYALTIES, LICENCE FEES AND OTHER INVESTMENTS



Source: UniCredit Banca d'Impresa Strategy and Research's elaboration of US BEA data

the U.S. trade deficit is significant – as well as basic electronics products.
To conclude, China's foreign trade mostly shows a deficit *vis-à-vis* the Asian countries (Japan for capital goods and the rest of Asia for basic products) and producers of raw materials (such as Russia and Brazil) and capital goods (such as Japan and Germany). On the other hand, China has a substantial trade surplus with countries such as the U.K. and the Netherlands, which do not have a strong industrial sector and import consumer goods from China to sell on their domestic markets, with obvious benefits in terms of purchasing power for their consumers. But such deficits – and, as we said earlier, that of the U.S. in particular – must be interpreted. In the first place, the U.S. also exports a lot of capital goods to China (over 10% of the total). Secondly, not all the goods China exports are effectively of Chinese origin. Finally, the U.S. has invested a great deal in China and is benefiting from the flow of profits.
Italy's situation is more problematic, because it still has a significant manufacturing sector and has not invested much in China. Hence the debate has focused on China's role as an exporter, which costs Italy more than its European partners. All efforts to coax the Chinese authorities into working in the framework of shared international rules rather than exploiting their unfair competitive advantage should certainly be supported, but the potential benefits that integration with China already allows other nations should also be exploited to the full. Industry should adjust to the changed competitive scenario without hoping for permanent political support in the form of measures to block Chinese exports. In fact, it should not cause any amazement whatsoever that, elsewhere, China's role as a driver of growth and a crucial pivot of competitiveness in some industrial and retail sectors actually comes in for a lot of praise.