Geofile Online

JANUARY 2004

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CHINA: RECENT INDUSTRIAL DEVELOPMENT AND TRADE PATTERNS

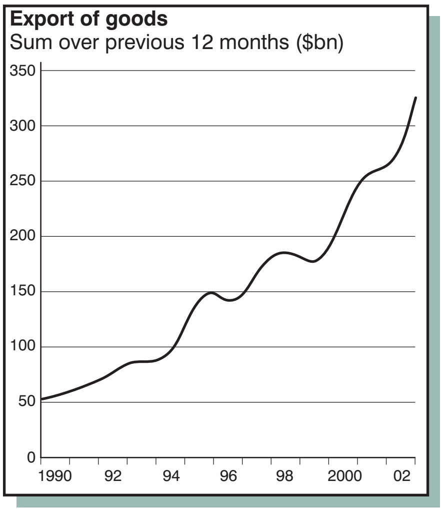
The new workshop of the world?

The Chinese economy has attained such a size and is continuing to grow so rapidly that it is now being called the 'new workshop of the world', a phrase first applied to Britain during the height of its industrial revolution in the 19th century. Exports from China to all other countries increased by 21% in 2002 to $322 billion, growing over sixfold from 1997 (Figure 1). Chinese consumption of raw materials such as steel and copper has now overtaken that of the US. The steel industry expects China to account for more than a quarter of global consumption of steel in 2003, to be used in construction, car manufacture, white goods, general engineering and a range of other activities. A Global Development Finance 2003 Report published by the World Bank in April 2003 stated that China is increasingly becoming the engine of the East Asian regional economy. China now exports more to the USA than Japan (Figure 2) and has also overtaken the USA as the biggest exporter to Japan. The Chinese economy grew by 8% in 2002.

China makes 60% of the world's bicycles and over half of the world's shoes. It accounts for 20% of the world's garment exports, with the prediction that this will rise to 50% in 2010 as quotas on imports are eliminated around the world. Already China accounts for the manufacture of half of the computers in the world.

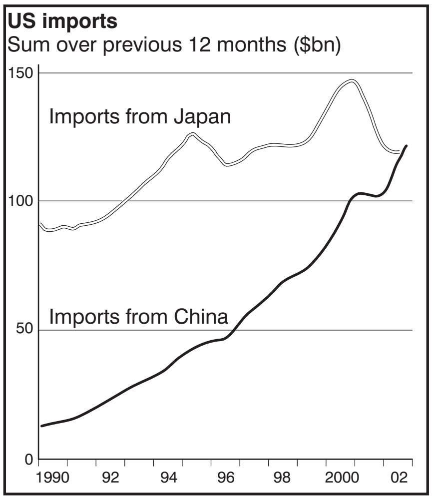
The concerns that other countries have about China's rapid industrialisation are similar to those expressed when other economies, the UK, USA, Japan and South Korea, went through similar phases of rapid growth at various times in the past. However, worries about Chinese goods swamping global markets seem to be exaggerated. China's share of world trade is still only 4% (Figure 3) with an annual trade surplus of about $30 billion (similar to Canada's). Although China is steadily producing more capital intensive goods, these are mainly destined for the domestic market where demand is rising rapidly. In fact China has bilateral trade deficits with most neighbouring countries including South Korea, Malaysia and Thailand.

Figure 1: Growth in Chinese exports



Source: *Financial Times*, 5 February 2003

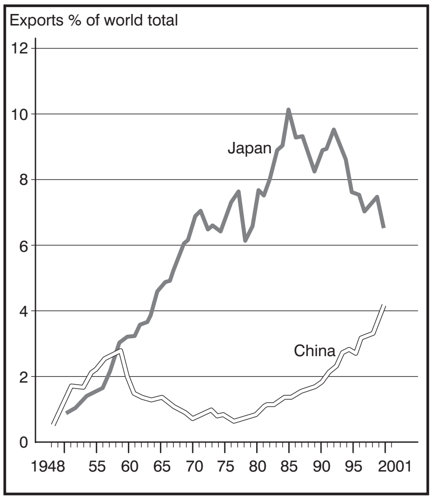
Figure 2: Comparison of Chinese and Japanese exports to the US



Source: *Financial Times*, 5 February 2003

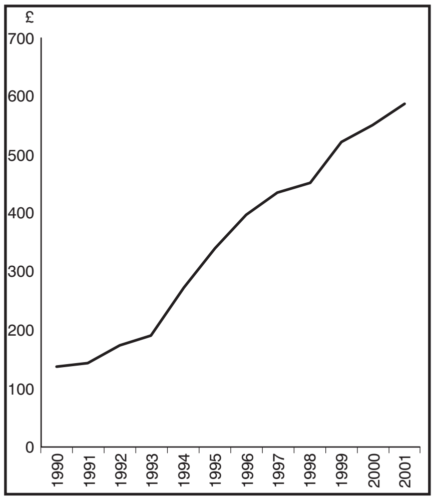
China's average income per head is $1000 and rising. Over 300 million earn over $2000. Figure 4 shows the growth in per capita income for urban households. The National Bureau of Statistics of China predicts that China's economy is likely to grow by at least 7% in the next 15 years. Under the traditional calculation of GDP, China today ranks sixth in the world. But measured according to purchasing power parity (PPP), whereby the figures are adjusted to take account of price differences between countries, China ranks second in the world.

Figure 3: Comparison of Chinese and Japanese exports as % of world total



Source: *Financial Times*, 5 February 2003

Figure 4: Per capita income of Chinese urban households

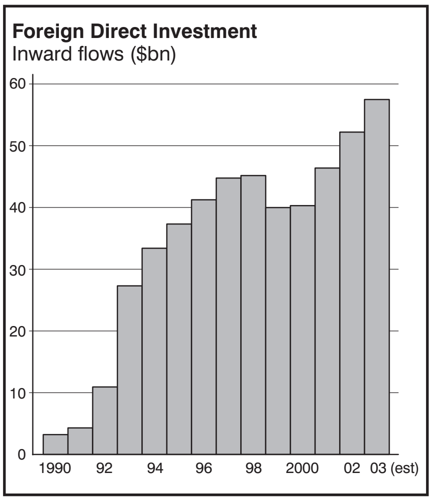


Source: *Business Review*

Foreign direct investment

China attracted a record $52.7 billion in foreign direct investment in 2002 (Figure 5), taking over from the USA as the world's biggest net recipient of FDI. The Chinese government expects to attract about $100 billion in FDI a year between 2006 and 2010. The major attraction to manufacturers is the cheap labour market where wages are less than 5% of those in the USA.

Figure 5: Chinese reliance on foreign investment



Source: *Financial Times*, 5 February 2003

The huge concentration of investment in China has pulled investment away from industrial centres in the rest of Asia and elsewhere. For example 23,000 Japanese companies are now operating in China. To remain competitive they have to manufacture where production costs are lowest. For example, Matsushita has invested $558 million in 31 joint ventures in China. Some Chinese companies are now buying up distressed businesses in Japan where the long-running economic slump has caused major problems. In most cases the Chinese company has relocated manufacturing to China where wages are as little as one-tenth of their Japanese equivalents.

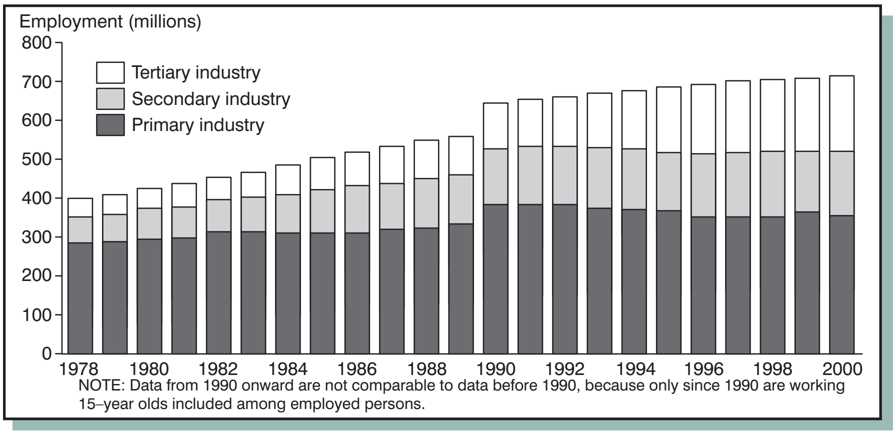
Changing employment structure

Figure 6 shows how China's employment structure changed from 1978 to 2000. The secondary and tertiary sectors now make up half of all employment. The share of the primary sector fell from 71% in 1978 to 50% in 2000. During the same period the secondary sector increased from just over 17% to almost 23% while the tertiary sector rose from slightly more than 12% to almost 28%. In China, mining and quarrying, manufacturing and construction are classified as secondary industries. Normally, we would regard mining and quarrying as being in the primary sector.

China's emergence as a major industrial nation

Soon after the death of Mao Tse-tung in 1976, China's economic policy changed significantly. Mao's

Figure 6: Changes in Chinese employment by industrial sector, 1978–2000



Source: *China Statistical Yearbook*, 2000

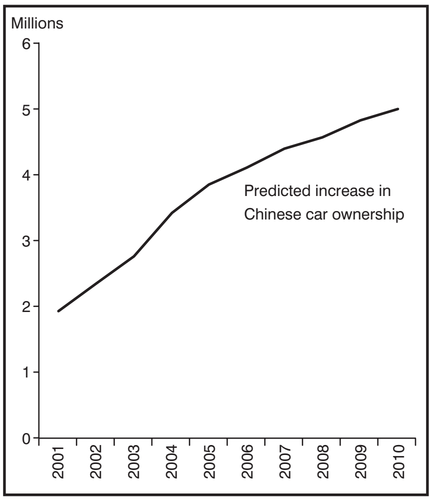
successor, Deng Xiaoping sought to end the relative isolation of China from the world economy and to imitate the export-led success of neighbouring countries such as Japan and South Korea. Economic growth increased by an average of over 10% a year and exports (by value) by 15% a year in the 1980s and 1990s. During this 20 year period the Chinese economy grew eight times bigger and between 1990 and 1998 the number of Chinese living on less than a dollar a day fell by 150 million. Since the Chinese economy began to open up to the outside world in 1978, China's share of world trade has quadrupled.

China joins the World Trade Organisation (WTO)

The most significant recent event in the history of the WTO has been China's entry into the organisation, in October 2001. For the MEDCs in particular the main benefits of Chinese entry are:

- Its huge market potential. For example, car sales are taking off, exceeding 1 million in 2002 for the first time (Figure 7). China is now VW's biggest market outside Germany. China now imports more from the rest of Asia than does Japan. As WTO membership opens China's markets to competition, its importance as a source of demand will grow.
- That China would be bound by WTO rules on a range of issues concerning production and trade. Before WTO membership, many countries were concerned that China was 'breaking the rules' in various ways.
- Before WTO membership, TNCs were not allowed to set up wholesale, retail, distribution and after-sales networks. The changes

Figure 7: Predicted increase in Chinese car ownership



Source: *Business Review*

brought about in 2001 explain why Wal-Mart, the US supermarket chain, has invested heavily in China over the last two years in copying its American model in another vast market.

The main concerns for China in the WTO are the problems caused by the new rules that China had signed up to as the country struggled to identify and specialise in fields of comparative advantage. In 1999 the World Bank estimated that up to a third of the 140 million workers employed in China's state-owned industries, many of which were considered to be very inefficient, may be surplus to requirements.

Infrastructural improvements

Such a high rate of economic growth has demanded equally rapid improvements in infrastructure. China's rail network is expanding rapidly. A $24 billion high-speed rail link between Beijing and Guangzhou is being planned which would reduce train travel time between the two cities from 23 hours to 10. A multitude of new road schemes have either been completed or are in progress. The Three Gorges Dam on the Yangtze River is the most spectacular feature of China's changing infrastructure.

Rural to urban migration

There are now about 150 million migrant workers in China. The great majority have moved from inland provinces to coastal cities. According to the *Financial Times* (6/2/03) 'the rising cost of education, healthcare and living in rural areas has created a powerful force pushing workers to the coastal factories.' In Beijing the construction industry now employs some 850,000 migrant labourers.

However, during the two-week period of the Spring Festival in early February this population flow is reversed. During this period a population several times larger than the UK's leaves the cities of southern China and Shanghai and Beijing to go home to see their families. The government estimated that in 2003 there were 1.8 billion train, bus and aircraft journeys over the Spring Festival. Every year this huge movement of people proves to be a massive logistical problem for transport managers. For the rest of the year the remittances sent home by migrant workers are vital for the survival of rural communities. Migrant workers from Sichuan, one of China's most populous provinces, sent back around Rmb40 billion (£2.9 billion) in 2002. This was more than the provincial government's own fiscal revenues.

The coastal areas

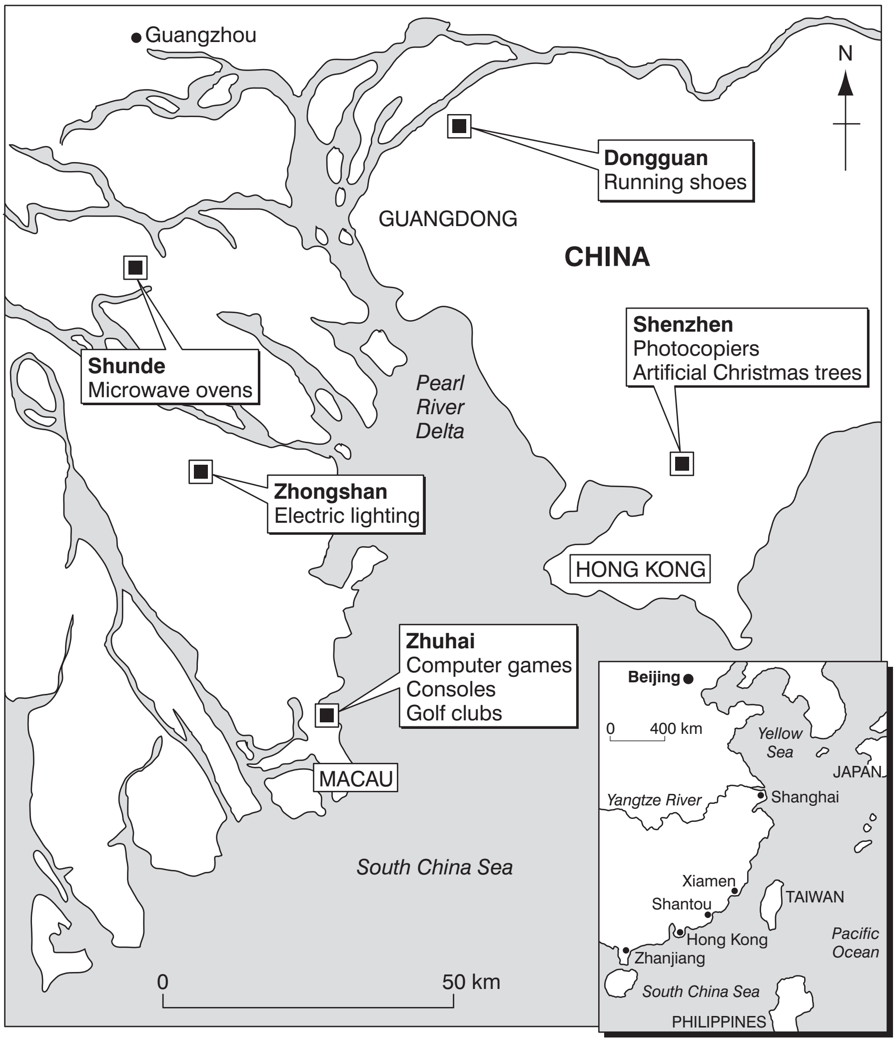
The bulk of foreign investment is in China's dynamic coastal region, which includes five Special Economic Zones, 14 Open Cities, and 36 Economic and Technological Development Regions. China's economic reforms began in the coastal region. The initial opening up of the economy attracted a foundation of large overseas investors. Their presence led to a kind of 'critical mass', which has acted as a magnet for an increasing number of foreign investors. The Special Economic Zones have led the process of privatisation in China. The location factors which have attracted foreign investment to the coastal areas are as follows.

- **Favourable government policies:** central government policies have empowered the coastal regions to attract foreign investment, import advanced technologies and participate in international trade projects.
- **Labour cost and productivity:** labour is relatively inexpensive throughout China. Although the cost benefit is even greater in the Middle and West of China, the labour force in the coastal areas are better educated, more skilled and boast significantly higher productivity. The lack of trade unions is also a significant factor in attracting inward investment.
- **Proximity of suppliers:** for example, the Singapore electronics manufacturer Flextronics, located in Doumen, received only 5-10% of the plant's components from local factories in 1999. Now it is between 50 and 70%. The efficiency of the supply chain now rivals the low cost of labour as the major location factor for some companies.
- **Superior infrastructure:** all aspects of infrastructure (rail, road, air transport, telecommunications etc) are more highly developed in the coastal region, compared to the middle and west of China.
- **Geographical advantages:** 90% of China's international trade passes through its seaports. Production facilities located at or near the ports are likely to encounter fewer delivery delays and lower domestic transportation costs.

Case Study: The Pearl River Delta

The Pearl River Delta region, an area the size of Belgium in south east China (Figure 8) is the focal point of a massive wave of foreign investment into China. This is the heart of China's new industrial revolution. In early 2003 it was estimated that the region was attracting $1 billion investment and producing $10 billion worth of exports a month in one of the fastest bursts of economic

Figure 8: The Pearl River Delta



Source: *Financial Times*, 4 February 2003 development in history. The Pearl River drains into the South China Sea. Hong Kong is located at the eastern entrance to the delta, with Macau situated at the western entrance. Within the region the main centres of industrial expansion are: Shunde, Shenzhen, Dongguan, Zhuhai, Zhongshan and Guangzhou. The region's manufacturing industries already employ 30 million people but this will undoubtedly increase in the future.

The Pearl River Delta rivals the Yangtze River Delta anchored on Shanghai as the major economic region in the country. Home to less than 3% of China's population, it contributes almost 7% to its GDP. In addition to the location factors cited above, proximity to Hong Kong and the Cantonese work ethic, that was so important in the rapid development of Hong Kong, has also been very significant.

Initial foreign direct investment came from Hong Kong, which moved 70% of its industrial capacity to the region in less than a decade, and then from Taiwan. Since the mid-1990s, large volumes of FDI have also come from Japan, the USA and other countries.

The Pou Chen shoe company moved from Taiwan to the Chinese mainland to significantly reduce its costs. Its plants in Zhuhai and Dongguan employ 110,000 people, making 100 million pairs of shoes a year for Adidas, Nike, Timberland, Reebok, Puma and other well-known brands. These branded shoes sell for five times their production costs in overseas markets. Pou Chen workers receive about $100 dollars a month, or 36 cents an hour for up to 69 hours a week with many sleeping in dormitories for migrant workers where strict curfews apply. Apart from Pou Chen there are more than 800 other shoemakers in the Pearl River Delta. Pou Chen and other shoe makers are beginning to experience higher labour turnover as other industries attract workers away with higher wages. The result is that Pou Chen is opening a factory further inland where labour is more plentiful.

The conditions in foreign-owned and foreign-affiliated factories have improved considerably in recent years and are better than many people in the West believe as TNCs have become more and more aware of the potential damage of bad publicity to their corporate images.

Although early investment in the region focused mainly on routine products, more and more foreign companies are now manufacturing higher level products in the region. For example the Japanese company Ricoh, which makes most of its photocopiers in Shenzhen, now produces models in China months after they are first developed in Japan.

The three main concerns about the future prosperity of the Pearl River Delta are:

- Increasing environmental pollution, particularly surface water and air quality - the entire delta is heavily polluted, with the worst problems around Guangzhou.
- Suburban sprawl – the competition between different urban areas for industrial investment and real estate development has been so intense that there has been little concern for environmental impact and the loss of agricultural land.
- The need for more coordinated planning between different municipal governments – current duplications of infrastructure and services are failing to take advantages of economies of scale and are creating huge inefficiencies.

Economic Hotspots in the Pearl River Delta

Shunde: the largest centre for the production of microwave ovens in the world. 40% of global production comes from just one huge factory (Galanz) in Shunde. Galanz exported 70% of the 15 million microwave ovens it made in 2002.

Shenzhen: the special economic zone estimates that it produces 70% of the world's photocopiers and 80% of its artificial Christmas trees. In 2002, the port of Shenzhen overtook both Rotterdam and Los Angeles to become the world's sixth largest container terminal. Shenzhen's huge shopping malls attract large numbers of wealthy residents from Hong Kong. The city attracts huge corporate buyers too. It is the global purchasing centre for Kingfisher and Wal-Mart, which together sourced $10 billion of goods from China in 2002.

In 2002 it was announced that seven new towns, each capable of supporting 500,000 people, are to be built outside Shenzhen's Special Economic Zone in the next decade.

Dongguan: specialises in running shoes with 80,000 people employed in a single factory. The population of migrant workers is higher here than in any other Chinese city.

Zhongshan: the major centre of the electric lighting industry in the world.

Zhuhai: a major manufacturer of computer games, consoles and golf clubs. Land is being reclaimed from the South China Sea to facilitate further industrial expansion.

Guangzhou: the site of a large export-only Honda car plant. Nearly 70 of the top 500 transnational corporations are represented in the Guangzhou Development Zone. Industries include photoelectron, biology and pharmaceuticals, specialist steel, cars, food, beverages, chemicals, electronics, electrical appliances. The Guangzhou metropolitan region's population of 14.4 million is the second largest after Shanghai.

Focus Questions

1. Why is China increasingly referred to as the new workshop of the world?

2. Why did China join the World Trade Organisation in 2001?

3. Discuss the location factors which have attracted foreign investment to the coastal areas of China.

4. Draw an annotated sketch map to illustrate the economic characteristics of the main foci of development in the Pearl River delta.