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An old Chinese myth

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Contrary to popular wisdom, China's rapid growth is not hugely dependent on exports

MOST people suppose that China's economic success depends on exporting cheap goods to the rich world. If so, its growth would be seriously dented by a stuttering American economy. Headline figures show that China's exports surged from 20% of GDP in 2001 to almost 40% in 2007, which seems to suggest not only that exports are the main driver of growth, but also that China's economy would be hit much harder by an American downturn than it was during the previous recession in 2001. If exports are measured correctly, however, they account for a surprisingly modest share of China's economic growth.

The headline ratio of exports to GDP is very misleading. It compares apples and oranges: exports are measured as gross revenue while GDP is measured in value-added terms. Jonathan Anderson, an economist at UBS, a bank, has tried to estimate exports in value-added terms by stripping out imported components, and then converting the remaining domestic content into value-added terms by subtracting inputs purchased from other domestic sectors. At first glance, that second step seems odd: surely the materials which exporters buy from the rest of the economy should be included in any assessment of the importance of exports? But if purchases of domestic inputs were left in for exporters, the same thing would need to be done for all other sectors. That would make the denominator for the export ratio much bigger than GDP.

Once these adjustments are made, Mr Anderson reckons that the "true" export share is just under 10% of GDP. That makes China slightly more exposed to exports than Japan, but nowhere near as export-led as Taiwan or Singapore (which on January 2nd reported an unexpected contraction in GDP in the fourth quarter of 2007, thanks in part to weakness in export markets). Indeed, China's economic performance during the global IT slump in 2001 showed that a collapse in exports is not the end of the world. The annual

rate of growth in its exports fell by a massive 35 percentage points from peak to trough during 2000-01, yet China's overall GDP growth slowed by less than one percentage point. Employment figures also confirm that exports' share of the economy is relatively small. Surveys suggest that one-third of manufacturing workers are in export-oriented sectors, which is equivalent to only 6% of the total workforce.

Even if the true export share of GDP is smaller than generally believed, surely the dramatic increase in China's exports implies that they are contributing a rising share of GDP growth? Mr Anderson's work again counsels caution. Although the headline exports-to-GDP ratio has almost doubled since 2000, the value-added share of exports in GDP has been surprisingly stable over the same period (see left-hand chart). This is explained by China's shift from exports with a high domestic content, such as toys, to new export sectors that use more imported components. Electronic products accounted for 42% of total manufactured exports in 2006, for example, up from 18% in 1995. But the domestic content of electronics is only a third to a half that of traditional light-manufacturing sectors. So in value-added terms exports have risen by far less than gross export revenues have.



Many of China's foreign critics remain sceptical. They argue that China's massive current-account surplus (estimated at 11% of GDP in 2007) proves that it produces far more than it consumes and relies on foreign demand to buy the excess. In the six years to 2004, net exports (ie, exports minus imports) accounted for only 5% of China's GDP growth; 95% came from domestic demand. But since 2005, net exports have contributed more than 20% of growth (see right-hand chart).

This is due not to faster export growth, however, but to a sharp slowdown in imports. And even if the contribution from net exports fell to zero, China's GDP growth would still be close to 9% thanks to strong domestic demand. The boost from net exports is in any case

unlikely to vanish, even if America does sink into recession, because exports to other emerging economies, where demand is more robust, are bigger than those to America. According to Standard Chartered Bank, Asia and the Middle East accounted for more than 40% of China's export growth in the first ten months of 2007, North America for less than 10%.

Multiplier effects

China's economy is driven not by exports but by investment, which accounts for over 40% of GDP. This raises an additional concern: that weaker exports could lead to a sharp drop in investment because exporters would need to add less capacity. But Arthur Kroeber at Dragonomics, a Beijing-based research firm, argues that investment is not as closely tied to exports as is often assumed: over half of all investment is in infrastructure and property. Mr Kroeber estimates that only 7% of total investment is directly linked to export production. Adding in the capital spending of local firms that produce inputs sold to exporters, he reckons that a still-modest 14% of investment is dependent on exports. Total investment is unlikely to collapse while investment in infrastructure and residential construction remains firm.

An American downturn will cause China's economy to slow. But the likely impact is hugely exaggerated by the headline figures of exports as a share of GDP. Dragonomics forecasts that in 2008 the contribution of net exports to China's growth will shrink by half. If the impact on investment is also included, GDP growth will slow to about 10% from 11.5% in 2007. This is hardly catastrophic. Indeed, given Beijing's worries about the economy overheating, it would be welcome.

The American government frequently accuses China of relying excessively on exports. But David Carbon, an economist at DBS, a Singaporean bank, suggests that America is starting to look like the pot that called the kettle black. In the year to September, net exports accounted for more than 30% of America's total GDP growth in 2007. Another popular belief looks ripe for reappraisal: it seems that domestic demand is a bigger driver of China's growth than it is of America's.