››› China's rapid rise affects other developing and emerging countries at various levels

No. 166, 18 April 2017

Author: Dr Martin Raschen, phone +49 69 7431-2434, research@KfW.de

China owes its impressive rise to the status of global player to its economic opening, among other factors. That has benefited not just advanced economies but also the other developing and emerging countries (DCs / ECs), as exporters and investors. It has also made the DCs / ECs dependent to a significant degree on China's development, thus creating an external risk. Furthermore, although the flows of goods and funds from China to the partner countries constitute a welcome expansion of supply, they also represent undesirable competition for their local economies. After all, the country's great global significance means that developments in China also influence other economic regions through world market prices of commodities and finished goods and through the spread of sentiment, and this certainly does not move in one (positive) direction only. In this paper we discuss the most important economic interconnections from the perspective of the DCs / ECs.[1]

China' rise to economic superpower

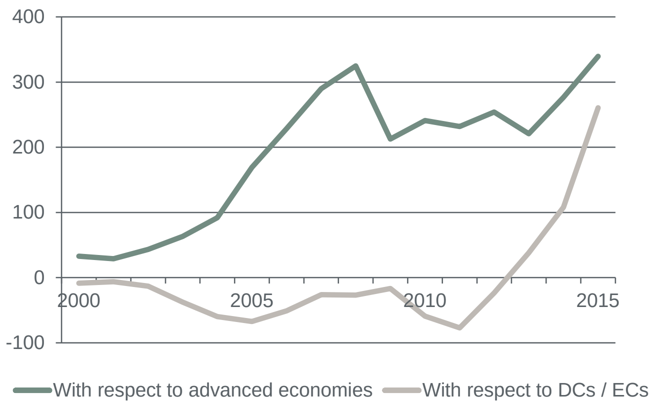
As recently as in the 1980s, China was a low-income country in which two thirds of the population was living below the poverty line. In the quarter-century since 1990, its real GDP has grown tenfold (at an average rate of 9.4 %), making it the world's biggest economy (by PPP exchange rates). The share of the population living in poverty has dropped to only 2 %. China's economy has slowed considerably since 2010, although the current growth rate of more than 6 % is still extraordinary. China's success is based on internal and external economic liberalisation and sustained by its enormous labour force potential as well as a targeted innovation strategy. It has enabled the country to significantly improve its technological competitiveness and increase its share in global trade to 12 %.

Trade with DCs / ECs

As China is not only a very large but also a very open economy, the country's development through the trade channel has significant consequences for the rest of the world. This correlation is the subject of debate in all advanced economies, and there is concern over weakening economic activity and – particularly in the USA – the high Chinese trade surplus with advanced economies (Figure 1). But China's economic influence on DCs / ECs is also extremely strong. Chinese imports from other DCs / ECs have grown enormously between 2000 and 2015 not just in absolute terms (from USD 111 billion to USD 969 billion) but also in relative terms, from 49 to 58 % of total imports. In other words, China now imports significantly more from DCs / ECs than from advanced economies. China's trade balance with the remaining DCs / ECs was in deficit up to 2012. Since 2013 it has built up a trade surplus with this group of countries as well (Figure 1). This change is due to the predominance of commodities in Chinese imports (see below).

Figure 1: China's trade balance with advanced economies as well as other developing and emerging countries

In USD billions

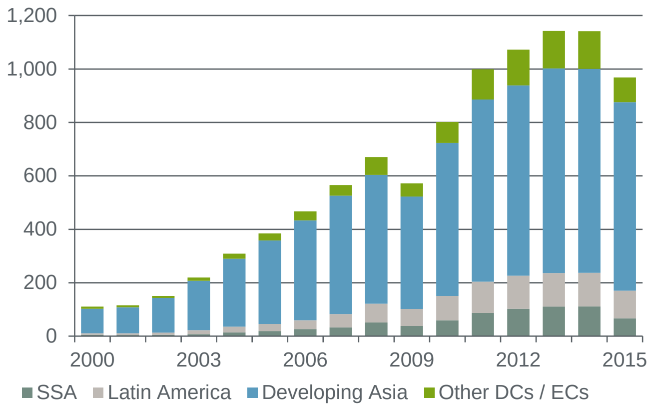


Source: UNCTAD, own calculation

Comparing exports from DCs / ECs to China provides for an interesting analysis, both regionally and by groups of goods. China's most important trading partner region by far is Developing Asia, with Latin America and Sub-Saharan Africa trailing far behind (Figure 2). China has a special interest in expanding its economic relations with Asian neighbours, now even more as a result of the protectionist plans of the US administration. After the failure of the planned Trans Pacific Partnership (TPP), efforts to facilitate trade under the Regional Comprehensive Economic Partnership (RCEP) between ASEAN and China, India and the advanced economies of the region have become more important. However, China's imports from Developing Asia have been stagnating or even falling since 2013 (Figure 2), confirming the spillover hypothesis established by empirical research that an economic slowdown in China affects Asia more than any other region.

Figure 2: China's imports from developing and emerging economies, 2000–2015

In USD billions

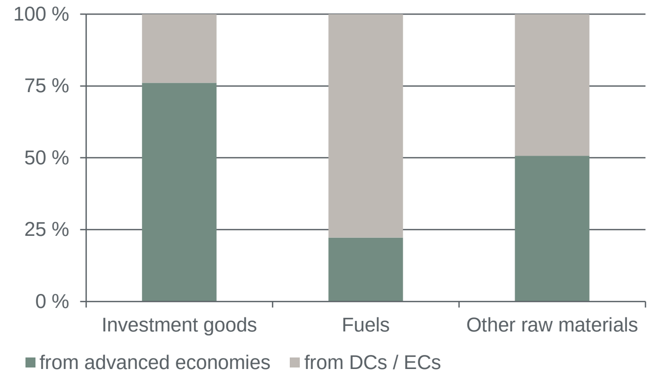


Source: UNCTAD, own calculation

A breakdown of China's total imports by groups of goods illustrates that DCs / ECs supply mostly commodities while advanced economies dominate in the supply of capital goods to China (Figure 3) – which is hardly surprising. What is more remarkable, however, is that the (few) capital goods delivered to China from DCs / ECs come almost exclusively from Developing Asia. Sub-Saharan Africa and Latin America – a region that does have a number of advanced emerging economies – are practically absent on the Chinese market for capital goods.

Figure 3: Origin of China's imports by groups of goods

Percentages, average 2012–2015



Source: UNCTAD, own calculation

China's demand for commodities imports affects DCs / ECs not just in terms of quantities but also through prices. For example, 40 % of global demand for metals comes from China (iron ore, copper, nickel, aluminium). China even consumes half the world's production of coal, which hardly shows in its external trade because it is the leading coal producing country, but significant price influence exists nevertheless. In the period of rising global market prices, resources-exporting DCs / ECs have thus benefited from China's development – through quantities and prices. Similarly, they have been dealt a double blow in the past years in the wake of China's economic slowdown and the decline in global commodities prices.

China's commodities imports are crucially responsible for the fact that DCs / ECs actually had a trade surplus with it up to 2012. That surplus had formed even though China's exports to the DCs / ECs had grown massively (by a factor of ten in nominal terms since 2000). China mostly exports consumer goods to the DCs / ECs. The Chinese industry owes much of its rise to its achievements in the consumer goods segment with unsophisticated technology, which is precisely where high demand exists in DCs / ECs. Many of them deplore, however, that Chinese consumer goods are crowding the local industry out of the market, for example by undervaluing the renminbi as an unfair way of promoting exports. In the meantime, however, China has ended this exchange rate manipulation and local industries in DCs / ECs definitely face positive prospects in the future. The fact is that if China continues developing into an advanced economy, DCs / ECs in low-wage and low-technology sectors can (re-) gain market shares.

Direct investment from DCs / ECs

Opening its economy to foreign investors has been and remains an essential element of China's reform policy since the end of the 1970s. However, the country directs and controls the influx of foreign capital. Investments with high value added, production with peak technology and activities in modern services, renewable energies and environmental protection are particularly welcome. These criteria make it obvious that foreign direct investment (FDI) in China comes almost exclusively from advanced economies. But it is difficult to trace this with statistics, which has to do with the special status of Hong Kong. Statistics identify Hong Kong as the place of origin of more than half the FDI portfolio in China, with more than USD 600 billion, seven times more than FDI from Japan, the second most important country of origin. But much of Hong Kong's FDI in China is round tripping. It is composed of circular investments by Chinese companies in Hong Kong that flow back to China, which endows these investors with certain privileges.

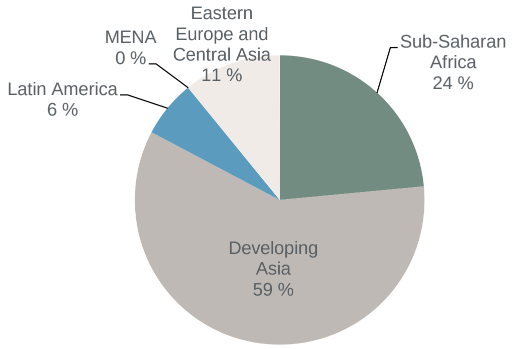
Therefore, if we disregard FDI statistics from Hong Kong we see that, in 2015, 86 % of FDI thus adjusted came from advanced economies (with Japan and Germany being the biggest investors). One would expect the remaining 14 % from DCs / ECs to come predominantly from emerging Asian economies, but that is not the case. Ninety per cent of investment from DCs / ECs comes from South Africa.[2] Noteworthy investment from developing Asia consists of only minor FDI operations from Thailand, Malaysia and the Philippines.

Thus, while investors from DCs / ECs are hardly present in China, the country is quite active as a direct investor in DCs / ECs. China started a 'Going Global' strategy in 2000 and announced a similar 'Made in China 2025' industrial strategy in 2015. They are aimed at building up transnational Chinese enterprises and achieving global market supremacy, securing sources of raw materials, and increasing China's innovative power by acquiring peak technology. The target countries of Chinese outward foreign direct investment (OFDI) are therefore broadly scattered. Among the group of

DCs / ECs, China is the country with the highest level of OFDI. Here, too, Hong Kong distorts the relevant statistics. Chinese OFDI is conducted to a significant extent through subsidiaries in Hong Kong (offshoring). Without Hong Kong figures, 58 % of OFDI in 2015 went to advanced economies (primarily to Australia, with Germany ranking 10th).

Figure 4: Chinese direct investment in DCs / ECs (without Hong Kong), 2015

Basis: Portfolio in USD



Source: IMF, own calculation

If we look at the DCs / ECs only (without Hong Kong), developing Asia is the predominant region with nearly 60 % of Chinese OFDI, ahead of sub-Saharan Africa with just under one fourth (Figure 4). The most important developing / emerging markets for investment are Singapore, Nigeria, Indonesia, South Africa and Thailand. No official statistics are available on the sectoral distribution of Chinese OFDI in the individual countries. Existing studies on Africa, for example, illustrate that Chinese investors follow the strategic objectives mentioned and invest primarily in agri-culture and mining / oil extraction, but also in energy and manufacturing. Most investors are state-owned but include private Chinese enterprises (ownership is often difficult to determine).

Capital market links with DCs / ECs

China's integration into the global financial markets is still relatively limited as the country is still imposing heavy restrictions on capital movements. Yet in spite of this, the stock market turmoil in China in the summer of 2015 and January 2016 took a heavy toll on the financial markets, not just in advanced economies but also in emerging economies, particularly in Asia (Figure 5). It is true that these develop-ments were only short-lived and the effect on the real economy also remained quite limited. But the mere fact that spillover effects from China also flow into the financial markets is definitely noteworthy.

In addition to spillover effects, reciprocal capital flows with other DCs / ECs can also be observed. In addition to FDI, the cross-border movement of capital between countries includes portfolio investments and what are classed as other capital flows (bank loans, business loans, account movements, etc.) and changes in forex reserves. Statistics capture capital flows in the capital account, which together with the current account forms a country's balance of payments[3]. Unlike China's current account surpluses, its capital account is in deficit, that is, China is a net capital exporter. But the supply of data is unsatisfactory for the issue addressed in this paper. While data are available on the origin and destination of FDI, no data exist on the regional distribution of other capital flows. How the gigantic Chinese forex reserves of currently around USD 3,000 billion are invested is actually a state secret. Experts are convinced that most of these reserves are invested in the USA. But they also serve as a source of funding for capital investments in DCs / ECs.

Figure 5: Stock market index MSCI Emerging Markets Asia 2015/2016

Source: Bloomberg

Therefore, only fragmentary statements can be made about China's capital transfers with DCs / ECs.[4] Capital flows between China and Developing Asia[5] should clearly dominate in a regional comparison of DCs / ECs. China's effort to strengthen the international role of the renminbi is a positive move in this context. China has therefore entered into currency swap agreements with central banks of DCs / ECs, the volume of which the IMF estimates at around USD 258 billion for the Asian region. In the period from 2010 to 2014, China's large state-owned commercial banks made foreign loans totalling some USD 400 billion, of which a considerable portion is presumed to have gone to Asian countries. The capital transfers made in the reverse direction, from developing Asia to China, are also significant. The share of loans outstanding to China in total assets is estimated at 32 % for banks in Hong Kong, 12 % in Singapore and 8 % in Taiwan, and total China exposure of all Asia-Pacific banks at USD 1,200 billion (as at 2014). China will generally maintain its restrictions on capital movements for the time being and will likely loosen them only gradually and cautiously. If this continues to an extent where the country is admitted to global/regional share market indexes such as the MSCI, for example, portfolio investment in and by China will likely increase significantly.

Chinese loan commitments to African countries are estimated at USD 86 billion for the period 2000–2014[6]. President Xi announced further commitments of USD 60 billion for Africa at a China-Africa summit in Johannesburg at the end of 2015. In the emerging eco-nomies of the Caucasus / Central Asian region, China's lending exploded from USD 300 million to USD 4.4 billion between 2007 and 2014[7]. China has very limited financial relations with the North African / Middle Eastern region[8]. Its existing operations in Latin America/the Caribbean were estimated at over USD 100 billion for 2015[9]. It is striking that China is also involved in countries whose creditworthiness is low, or that are even in default, such as Zimbabwe or Venezuela.

China's New Silk Road

In 2013, President Xi announced China's One Belt, One Road initiative, a new large-scale project also known as the Silk Road Economic Belt. In ancient times and in the Middle Ages, the Silk Road connected the Mediterranean region and East Asia with a network of caravan routes. The idea behind the new Silk Road is to improve the transport links between Western Europe and China by including the Caucasus, Southeast Europe / Turkey, Central Asia, the Middle East, East Africa, South and South East Asia. The project comprises a number of investments in the road network, seaports, pipelines, industrial parks, railroads, energy and telecommunications. It is to be funded both through FDI and with loans from China. According to its own information, China has funded over USD 50 billion in projects in various countries so far. Major players are to be the Asian Infrastructure Investment Bank and the Silk Road Development Fund, which has been established and is being managed by China, and which is open to financial investors from other countries. China presents this initiative as a move aimed at helping to develop and deepen its partnership with neighbouring countries. Clearly, however, it is primarily pursuing national interests – not just to develop the economy under its Going Global strategy, but also to wield geopolitical influence.

Conclusion

China's rise to an economic superpower provides benefits for the other DCs / ECs. But it also requires adjustments. When China coughs, the DCs / ECs risk contagion. It would therefore be in their best interests that China avert a hard landing and systematically continue its efforts at reform to make its economy fit for the future. ■

[1] Other important points of contact between China and the other DCs / ECs, such as global aspects of security and climate policy at UN level or China's quest for military supremacy in the Asia-Pacific region, for example, are not addressed in this paper, or mentioned only briefly (see section 'China's New Silk Road').

[2] Data source IMF: Inward Direct Investment Positions. IMF statistics on FDI are deemed reliable. They report very high FDI of USD 63.4 billion from South Africa in China for 2015, a level comparable to FDI from Germany, the USA and South Korea. Neither the IMF nor South African nor English-language Chinese statistics nor the literature provide details as to which South African investors are active in which sectors.

[3] Moreover, the balance of payments includes a 'residual item' that captures unregistered transactions or those that cannot be attributed. In the case of China, this item is definitely significant as it is presumed to conceal an upward manipulation of import accounts in order to conduct (illegal) cross-border capital transfers.

[4] Supplementing the following estimates, two further aspects are worth mentioning. First, the topic of capital transfers also includes the activities of the new supra-regional development banks Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB). China has been instrumental in their establishment; they started their business operations in early 2016. In the same year these banks built up a loan portfolio of USD 1.7 billion (AIIB) and USD 1.5 billion (NDB). Second, China often declares its transfers as aid for the recipient countries, especially in Africa, Latin America and the Middle East. However, they do not match the (Western) profile of development cooperation and China is not a member of the Development Assistance Committee of the OECD either. In this area, China is not primarily offering disinterested aid but mainly implementing its Going Global strategy in an effort to secure and expand economic and political influence in partner countries that are important to it.

[5] Information source IMF: Regional Economic Outlook Asia and Pacific, April 2016.

[6] Brautigam, D. and J. Hwang: Eastern Promises: New Data on Chinese Loans in Africa, 2000 to 2014. CARI Working Paper No. 4. China Africa Research Initiative, Johns Hopkins University School of Advanced International Studies, Washington D.C. 2016.

[7] Information source IMF: Regional Economic Outlook Middle East and Central Asia, October 2016.

[8] Ibid.

[9] EIU-Report "The evolving role of China in Africa and Latin America", London 2016.