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THE IMPACT OF CHINA'S ACCESSION TO WTO ON THE EXPORTS OF DEVELOPING COUNTRIES

S.M. Shafaeddin

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DISCUSSION PAPERS

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* Fax: (4122) 907 0274; E-mail: mdpb-ed.assistant@unctad.org

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S.M. Shafaeddin

United Nations Conference on Trade and Development

Abstract

Using the "revealed competitive advantage indices" for exports and imports, the paper is devoted to the analyses of the vulnerability of selected developing countries if China's competitive position is improved due to its entry to WTO. In contrast to the existing literature which concentrates on labour-intensive products as a group, this paper considers products at a disaggregate level since products in the same group are not often homogeneous.

In labour-intensive manufactured goods, China competes mainly with South Asian countries and a few Latin American and African countries. But it also provides them with little demand complementary effects. Nevertheless, some Latin American and African countries may benefit from the expansion of China's imports of foods and agricultural raw materials. In the final market for capital goods China competes with Asian newly industrializing economies (NIEs) and Association of South-East Asian Nations (ASEAN) countries, and in a limited number of goods with Mexico and Costa Rica. For NIEs, unlike others such competition involves complementary effects, through the import of parts and components, which will over-offset the competition effects in the short- and medium-run. As China develops its capacity to produce components, however, the "competition " effect may dominate.*

China's export structure is similar to that of the Republic of Korea and Malaysia in the final market for a number of "finished" capital goods. By contrast, Thailand is vulnerable in clothing, miscellaneous household equipment and electric machinery. Indonesia has little to worry except for furniture. India concentrates mainly on undergarments, and China in outer garments. Bangladesh, Sri Lanka, Pakistan, Viet Nam and Nepal have similar export structure with China in some clothing items, but overall they, particularly Viet Nam have been aggressive in exportation of these products. Sri Lanka and Pakistan also compete with China in toys and sporting goods, but both have shown some strength in their exports.

Except Mexico, Costa Rica, Haiti and to some extent Uruguay, the export structure of the Latin American countries is mostly different from that of China. Mexico has a strong competitive position vis-à-vis China in a number of clothing items, but weaker in a few assembly operation. Costa Rica's competitive advantage has noticeably improved for a number of clothing items and a few assembly operations. Haiti competes with China in 8 products, mostly clothing. It has a strong competitive position in footwear, one clothing item and some base metal. Uruguay's relative competitive position is weak in a number of labour-intensive products. The export structure of African countries is different from that of China, except for Egypt, Morocco, Tunisia and Malawi. These countries have improved their competitive position in their clothing.

China's entry into the WTO will not change, for some time, its market access for textiles and clothing for it to be a threat to other developing countries. In fact, China's growth in quota for exports to developed countries will increase far less than other developing countries. Nevertheless, if China attempts devaluation the situation could change radically. China's devaluation is however unlikely. Over a longer-term, much depends on what policy China will pursue in its trade and industrialization. China's attempt in increasing domestic value added in exports could lead to improvement in its competitiveness in technology/skill intensive products of interest to NIEs and the ASEAN.

** South Asian countries in this paper include India, Pakistan, Bangladesh, Sri Lanka and Nepal.*

I. INTRODUCTION

The purpose of this paper is to examine the possible impact, on developing countries, of China's accession to WTO by looking into main export items of individual countries at 3-digit level. The aim is not to prove any theory, but to clarify the issue as literature on the subject suffers from some shortcomings by exaggerating the competitive effects of China's accession.

China has joined WTO. It is a large and growing exporter of labour-intensive products. Serious concerns have been raised among developing countries, particularly those heavily dependent on those products in their export structure, about its increased competitive threat in the international market. The literature so far has taken two different approaches in dealing with this issue and has reached similar conclusions. One approach is the application of General Equilibrium Models, mainly through Global Trade Analysis Project (GTAP), to simulate the impact of the Chinese accession on developing countries. In this approach various countries are lumped together in different groups, so are different products such as those that are labour intensive and capital intensive. Although their quantitative results vary, a common conclusion of these studies is that China will obtain considerable market shares at the cost of other developing countries, particularly low-income countries in South Asia (Gilbert and Wahl (2000) for a summary). Similar conclusions have been reached by those who have studied the impact of China's bilateral agreement with the United States (e.g. Noland (1998), Hufbauer and Rosen (2000), USITC (1999) and Naughton (1998)). In some cases the figures obtained from the simulations are colossal. For example, the result of a simulation on the impact of changes in Chinese tariff rates – let alone other liberalization measures – undertaken by the World Bank staff shows that the share of China in the world exports of clothing will reach over 47 per cent in 2005 as a result of the accession as against 18.5 without accession (Ianchovichina and Martin (2001), table 6).

The second approach applied is to compare the industrial and technological capability of China at the general level. For example, it has been concluded that:

> "…China *will* be a major competitive threat to developing countries as liberalization proceeds and it gains access to world markets. The threat will be most immediate and intense in labour-intensive products and processes, but it is broader and is likely to quickly affect the entire technological spectrum" (Lall, 2001, p. 26).

Some of the shortcomings of the first approach has been intensively discussed elsewhere (UNCTAD, *Trade and Development Report, 2002*). We refer here to two main methodological problems and unrealistic assumptions of the models used. One is the lack of consideration of realities of the terms and conditions of the protocol of accession and exaggeration of improvement in Chinese access to market, especially for labour intensive products. The particular case of textiles and clothing which are the main export items of China as well as that of the majority of other developing countries is the outstanding example. There is also an exaggeration on the supply side; that is, the unrealistic assumption that the removal of tariff barriers will shift the structure of production in favour of exports due to the resulting change in the incentive structure, instantaneously or rapidly. Thus as China has comparative advantage in labour-intensive products, it would flood the international market for these products. This literature overlooks the fact that even if market access were not a problem, shift of resources from one industry/sector to another, and development of capacity in a new one(s), often take a long time after such decision is made by investors. The gestation period of investment is long because the skill requirements of industries vary, and training, product development and improvement of marketing capabilities take time.

Moreover, a common problem of both approaches is that implicitly they regard labour-intensive products, or each category of products, as homogeneous and do not consider individual export items of specific countries. In reality each category of goods involves different, or differentiated, products. For example, all clothing items are regarded as one product in the related literature. Setting aside the question of quality and brand, there exists various types of clothing: outwear, underwear, men's clothing, women's clothing, knitted, woven, cotton, wool, silk or synthetics items. Countries may specialize in different items, and/or in different qualities or brands of the same item.

A. The theme and the analytical framework

The data available does not allow research on different items, or differentiated products of each item in detail. Nevertheless, as a first step we will go beyond product categories at general levels and look into product exports of China and its specific developing country competitors at 3-digit levels. In doing so, we will argue that except for a few products of a few countries, the competitive threat of China in the market for traditional labour-intensive products is exaggerated at least in the short- and medium-term, not only because accession provided little additional market access to China (UNCTAD 2002), but also because the structure of labour-intensive products of China and other developing countries are not always the same and many countries have been able to compete with China successfully. Moreover, at least in the case of more advanced developing countries, notably NIEs and ASEAN, the competitive effect of China's expanding trade is accompanied by important complementary effects in favour of these countries. Competition of China's export with developing countries exports and domestic production could be referred to as "competitive" effect and the prospect for expansion of China's imports from developing countries as "demand complementarity effects" – or to abbreviate, complementarity effect. In the longer-run, China's structure of exports will most probably be changing towards more technology- and skill- intensive products as it continues to deepen its industrialization, thereby reducing its reliance on labour intensive products for exports.

To the extent that the accession has a positive impact on the expansion of China’s exports, it would also involve competition in the world export market as well as in the internal markets of importing countries. The accession also provides trade opportunities for other countries through expansion of China’s imports. These influences will be further strengthened if the Government of China intensifies its export drive policies. The more advanced developing countries, mainly in Asia, will benefit mostly from complementarity effects of China's accession. In the case of less advance countries, whose pattern of exports is more similar to China, the "competition effects" will prevail.

China's exports compete with those of other developing countries, mainly Asian countries, in the third markets as well as in the own market of developing countries. Such competition possibilities in the international market depend, *inter alia*, on sources of competitiveness of China, its ability to gain market shares, similarities of its export structure with the export structure of its competitors and its trade links, i.e. its already established markets. China's export competition in the domestic market of developing countries would depend, *inter alia*, on similarities between the structure of China's exports and the structure of these countries' imports and their trade links. Whether or not developing countries would benefit from the expansion of China's import is related, among others, to the similarities of China's import structure with their export structure as well as their trade links. The established trade links are important, because they are indications of the existence of trading channels that facilitate further expansion of trade when relative prices are changed. Otherwise, establishing new links takes time. These issues will be taken-up in more detail in the following sections after having considered low wages as the main source of China's competitive advantage.

II. CHINA'S LABOUR COST ADVANTAGES

Low wages are the main source of China's comparative advantages. Unfortunately, comprehensive data at the sectoral level is not available for labour costs. Some data are, however, available for the manufacturing sector (table 1), and textiles and clothing (table 2). In table 1 average wages for China's manufacturing sector as a whole is much lower than those for all other countries. The relative position of China deteriorates considerably when one uses unit labour cost as an indicator. In other words, differences in productivity performance have adverse effects on relative unit labour cost of China for the manufacturing sector as a whole, which includes many inefficient State-owned enterprises. Notwithstanding productivity differences, China still shows lower labour unit costs than the majority of its competitors in developing countries.

Table 2 compares hourly labour costs in textiles and clothing of China with a number of developed and developing countries. Both textiles and clothing in developed countries are more skill