

CHINA AND INDIA THE NEW BIG PLAYERS IN INTERNATIONAL TRADE

After a long absence, China and India are returning to the world economic stage. The breakthrough they have made in international trade has for the past decade borne witness to their strong presence in industries linked to the digital revolution. Their ascension is having far-reaching effects on global supply and demand for goods and services. They are the hubs of a new international division of labour and are making increasingly significant contributions to global growth, even though they cannot yet pull the growth of the rest of the world by themselves.

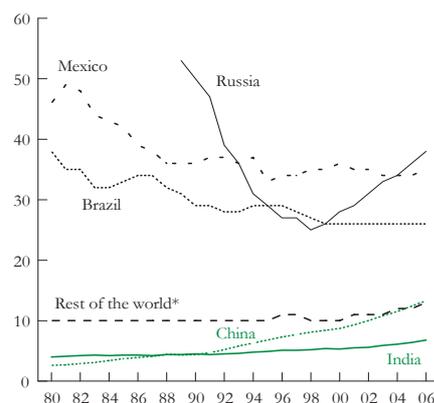
■ Two major emerging markets

If “major emerging markets¹ are defined as those countries that, despite having a lower income per capita than high-income countries², account for at least 1% of the global GDP (in current dollars), five countries fall into this category: Brazil, China, India, Mexico and Russia. Of these countries, China and India are both the most heavily populated and the poorest, with an average standard of living considerably lower than Brazil, Mexico or Russia³. They are demographic giants that have become major economic powers well before becoming rich (Figure 1).

Both countries have recorded a stronger and above all more steady economic growth over the past twenty years than the other major emerging economies. In contrast to Mexico, Brazil or Russia, they have not undergone any significant crises over the past twenty years. Since the beginning of the 1980s, they have been catching up with the leading economic powers at a pace that seems to make their future growth more predictable than that of the other major emerging markets. Their strategies for reform and openness are other similarities between them. In both countries, the governments have carried out a progressive economic liberalisation based on domestic priorities and constraints for over twenty years. Finally, the weight of history should not be forgotten. Both China and India

were major economic powers until the beginning of the 19th Century, but they missed the First Industrial Revolution. They are currently making a comeback to the world economic stage and their trajectory of convergence is heavily based on their breakthrough in industries connected with the digital revolution (new IT and communication technologies).

Figure 1 – Average income level per capita in PPP, high-revenue countries = 100



* excluding high-revenue countries.

Sources: Authors' calculations from the World Bank's "2005 International Comparison Program, Preliminary Results" and "World Development Indicators".

1. There is no precise definition of “large emerging countries”. The boundaries of this group change depending on analyses; it includes as a minimum the BRIC countries (Brazil, Russia, India and China) and sometimes South Africa as well.

2. The World Bank defines high-income countries as those with a gross domestic product per inhabitant higher than 11,116 current dollars in 2006 (cf. WDI).

3. Especially since new estimations for gross domestic product in terms of purchasing power parity have meant that Chinese and Indian GDP are now considered to be 40% lower than under previous estimations; cf. “2005 International Comparison Program, Preliminary Results”, December 2007.

These similarities are even more remarkable in light of the major differences separating the two economies: India has an income per capita of almost half that of China⁴; it is much less open to international commerce, and is still a marginal player in the global market for goods and services (1.3% on average of imports and exports for 2005) compared with China (5.9%).

■ From textiles to ITC

Both countries have become a hub of international division of labour in industries born of the technological revolution of the late 20th Century. This is one of the chief springboards for their rise in international trade⁵.

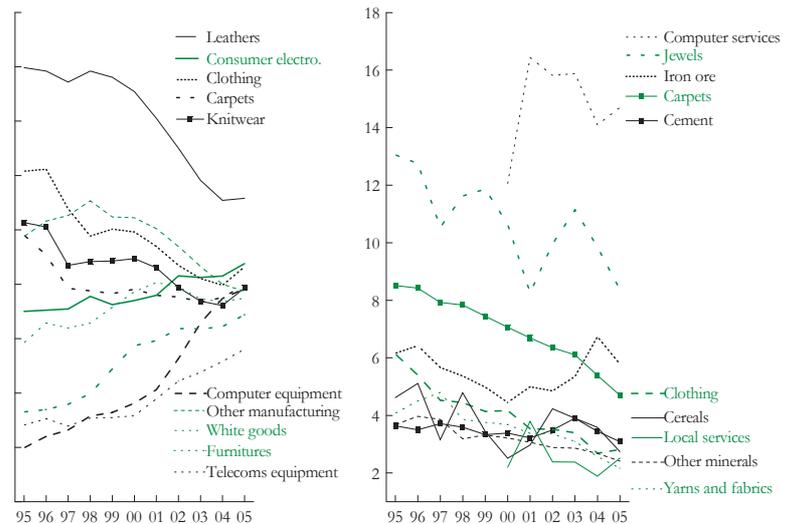
They have maintained their traditional specialisation in textiles, as shown by the share taken by these products in their exports, compared to the world average (Figure 2). However, they have more importantly developed specialisations in new sectors, where they have become global leaders. Thus, China carried out 17% of global electronics exports and India carried out 21% of global exports of computer services in 2005⁶.

The springboards for their rise as trade powers have several characteristics in common:

- ◆ The two sectors where China and India have made a recent breakthrough, represent segments of international trade that have sustained a particularly rapid expansion over the course of the past ten years. World trade of electronic products increased (in value) by 8% between 1995 and 2005, and IT services increased by 24%. China and India have thus tapped into a dynamic global demand.

- ◆ In China, as in India, these sectors have developed outward, focusing strongly on external markets and buoyed by international subcontracting and foreign investment. Their rapid development has benefited from the offshoring and outsourcing strategies adopted by businesses from developed countries. China has in this way become a global production platform for electronic products, and at the beginning of the 2000s, 80% of its electronic exports were from companies with foreign capital. In India, the IT services sector generates 80% of its turnover from exports,

Figure 2 – Main comparative advantages for exports (Balassa indicators)



Source: CEPII, CHELEM-BAL-CIN.

with foreign capital companies providing one third of computer service exports and two thirds of exports of other ITC services⁷.

- ◆ Globalisation has enabled these economies to bypass certain stages of modernisation by adopting the latest technologies. Both countries have created competitive production capacities in new sectors at a far greater pace than they have renewed their traditional sectors, still burdened by obsolete equipment and administration techniques. In China, foreign investment has provided financing to local entrepreneurs, in addition to providing technologies and export markets. In India, IT services owe their rapid development partially to Indian companies working for foreign backers, chiefly English and American, and partially to foreign subsidiaries that have set up in the country. In India, the service sector has moved forward because it is exempt from the regulations that are blocking the expansion of industrial companies⁸ and because it is less affected than other sectors by the deficient infrastructure of the country.

- ◆ In both countries, the rapid development of new sectors is a result of good performance in terms of productivity. The electronics industry in China is enjoying a relatively high level of productivity (higher in 2001 than that of Mexico⁹) and has seen labour productivity increases greater

4. 2,126 and 4,091 dollars per capita respectively in 2005, according to the latest estimations of the ICP; see note 3, page 1.

5. Cf. F. Lemoine & D. Ünal-Kesenci (2007), "China and India in International Trade: from Laggards to Leader", *CEPII Working Document*, no. 2007-19.

6. The size of the markets however is very different: global trade in electronic products reached 1,500 billion dollars in 2005, with commerce in computer IT services reaching approximately 104 billion dollars. Source: CEPII, CHELEM-BAL-CIN database.

7. *OECD Information Technology Outlook 2006*.

8. *OECD Economic Survey of India 2007*.

9. Mac Kinsey Global Institute (2003), *New Horizons: Multinational Company Investment in Developing Economies*.

than the average for Chinese manufacturing industries (24% per year as against 20% between 1995 and 2003¹⁰). In Indian IT services, labour productivity is reckoned to be 44% of that of American companies¹¹. This efficiency in implementing new technologies explains why their comparative advantages are so strong in this sector and why they are so attractive for multinational companies and foreign capital.

■ Moving up with difficulty

China can lay claim to a very rapid improvement in the technological level of its exports. The proportion of its manufacturing exports represented by high-tech products went from 8% in 1995 to 17% in 2004¹². China is now the second-largest exporter of high-tech products in the world, after the USA, largely thanks to its exports of electronics materials. With regard to India, exports of high-tech products, which are mostly pharmaceutical products remain at around 4% of total manufacturing exports. If, however, services are included, and considering that IT services form part of high technology, Indian performance is notably higher. In 2005, the percentage of high-tech products and IT services in total exports of goods and services was 14% for India and 18% for China.

The technological improvement of Chinese exports has not brought about a corresponding improvement in price/quality. Almost three quarters of Chinese manufacturing exports were at the bottom end of the ladder in 2004, a proportion that has scarcely changed at all in ten years. In contrast, Indian exports have recorded a gradual improvement in their positioning in terms of quality range, and in 2005 they included a larger share of medium-range and high-range products than exports from China. The two countries have a similar position in terms of market segments in their high-technology exports, which in both cases consisted mainly of down market products (77% for China and 71% for India). In order to penetrate these high-tech product markets, which are dominated by developed countries, India (which in other respects has a niche strategy) must rely on mass production at low prices, as China does.

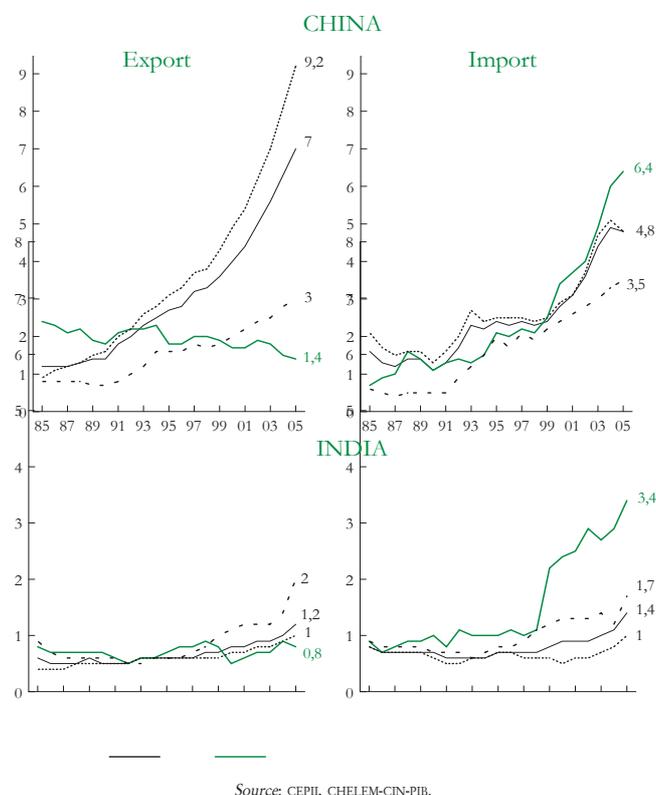
■ Impacts on world trade

The growing presence of China and India is having outstanding effects on international trade in goods and services (Figure 3).

Their emergence has created shockwaves in terms of both supply and demand for goods. Over the last decade, both countries taken together have tripled their share in exports of manufacturing products and in imports of primary products (from 3% to 10% approximately). The supply of Chinese manufactured products at low cost has exerted a downward pressure on the world prices for these products; the increase in demand for imports of primary products in China and India has on the other hand pushed the price of these products up. This double impact has contributed to changing the evolution of relative prices on a global scale. This has been beneficial for exporters of raw materials and agricultural products and has pushed up the demand for goods and services, particularly from countries whose revenues are primarily derived from exploiting their raw material resources, or "rentiers" (Russia and Brazil among the major emerging markets, Gulf countries, etc.).

Finally, the expansion in China and India international trade in goods stimulates an upturn in business for international transport services. Both countries are recording increasing levels of expenditure and payment deficit for freight. Moreover, China has a large payment deficit for royalties, another category of service linked to its goods exports. The country is third in the world in terms of net payments for royalties, after Ireland and Singapore. Even though this

Figure 3 – Shares in global trade per major sector (in %)



10. Calculated on the basis of the *China Statistical Yearbook on High-Technology Industry*, 2004, China Statistics Press.

11. Mac Kinsey Global Institute (2001) : *India: The Growth Imperative*, Mumbai.

12. The analysis of trade in terms of technology and quality/price ranges is here based on data from the CEPII BACI database.

indicates that Chinese exports are dependent on foreign technologies, these payments are relatively small in comparison to the value of high-technology exports from China (they represented 5% of the value in 2005). The demand for services from both countries should be of benefit to the USA and Europe, both of which have maintained strong international positions in these sectors.

■ Impetus for the rest of the world?

In 2007, China generated 5.5% of the global GDP (in current dollars) and recorded a growth of 11.4%, thereby contributing more to global growth than the USA, which generated 27.4% of global GDP and recorded a growth of 2.2%. India, with nearly 2% of global GDP and 9% growth, contributed as much to global growth as Japan¹³. They are raising the global growth average, but can it still be said that these two countries, particularly China due to its size, will pull the growth of the rest of the world?

The answer to this is negative in the short term¹⁴. Since 2005, a larger share of Chinese growth has been “pulled” by foreign demand. Net external demand directed at China (the Chinese trade surplus) has contributed approximately one quarter of its growth. If a slowdown in exports linked to weakening growth in the USA and in Europe were to make this surplus disappear (which from this point of view would restore the country to its situation at the beginning of the 2000s), a rough estimate holds that Chinese growth would be reduced from its current 11.5% to around 9%. It would thus stay rapid, but would not be able to pull American or

European growth. For the USA and Europe, China is still of marginal importance as a market. The USA sends 5% of its exports to China (the same percentage as it sends to Canada). The European Union sends 4% of its extra-Community exports to China (the same percentage as it sends to Switzerland). American imports of Chinese products are five times greater than American exports to China; this ratio is three-to-one on the European side.

However, Chinese economic vitality does lend its impetus to the rest of Asia. The region provides China with two thirds of its imports and records trade surpluses with it. However, since these imports are largely semi-finished products and components used in the manufacture of consumer products or equipment destined for the rest of the world, this impetus is not autonomous¹⁵. The final demand that boosts business in the region at the end of the day originates chiefly from the USA and Europe: 30% of exports of finished goods (consumer goods and equipment) from all of East Asia (including China) are to North America and 20% are to EU¹⁶. Only a greater level of demand from within Asia could produce a real “decoupling” of the region’s growth and make it a genuine engine for the rest of the world.

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13. Growth rates for 2007 are taken from the FMI, *World Economic Outlook*, revision of January 2008. The weightings for current prices and exchange rates are those used by the World Bank, *World Development Indicators*, for 2006.

14. This is a purely conjectural viewpoint, taking into account solely the contribution of the external balance to growth. It does not address gains in efficiency associated with division of labour between China and its partners or their impact on the medium-term growth potential of the countries involved. On this question, with regard to Asia, see World Bank, *An East Asian Renaissance: Ideas for Economic Growth*, 2006.

15. Cf. “China, the price of competitiveness”, *La Lettre du CEPIL*, No. 254, March 2006; World Bank (2006), “East Asia Update, Managing Through a Global Downturn”, November.

16. Regarding the impact of a recession in the USA on emerging economies see FMI (2007), “Spillovers and Cycles in the Global Economy”, *World Economic Outlook*, April.

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