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**China's Impact on the Developing World and Implications for US Development
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China's Impact on the Developing World and Implications for US Development Assistance Policy

The evolution of China's foreign policy began more than a decade ago under Deng Xiaoping, with the launching of the "four modernizations policy" that promoted "reform and opening" through greater engagement with the international community.¹ Since the mid-1990s, China has expanded the number and depth of bilateral relationships, joined various trade and security accords, deepened its participation in key multilateral organizations (such as ASEAN and the World Trade Organization), while maintaining its focus on carefully-defined internal modernization and foreign policy goals and interests, even when they conflict with those of the United States.² This greater engagement—described as "Beijing actively [seeking] to manage the course of globalization"³—has created an opening for the international community, including the United States, to address the challenges and opportunities created by China's rise.⁴

The literature identifies a wide range of issues that have arisen with China's new policy of modernization and engagement. Many pertain to regional security issues, territorial disputes, global arms control and non-proliferation, and exports of dual-use technologies. However, China's emergence as "the factory of the world"⁵ and rapid increase in economic and "soft power" engagement has had widespread effects on both developed and developing countries. China's emergence has also created the perception that this ascendance has created both threats and opportunities. This literature review will examine these emerging issues, threats, and opportunities from the standpoints of their effects on the development prospects of the developing countries and on the environment in which the United States provides international development assistance. The literature does not address what the United States or other donors' policies should be to help the developing world adjust to China's emergence.

1. China's Impact on International Trade and Investment

1.1 Direct Impact of China on Other Developing Countries through Bilateral Trade

China has become an essential link in the global production chain for many labor-intensive products. In 1990, capital goods and components were shipped from Japan to Asia's newly industrializing countries for processing and then exported to industrial countries. Now, capital goods are now shipped to Taiwan and South Korea who then ship

¹ Evan S. Medeiros and M. Taylor Fravel, "China's New Diplomacy," *Foreign Affairs*, New York: November/December 2003, Vol. 82, Issue 6, p. 24

² *ibid*, p. 23.

³ Yong Deng and Thomas G. Moore, "China Views Globalization: Towards a New Great-Power Politics?" *The Washington Quarterly*, Volume 27, Number 3, Summer 2004, p. 125.

⁴ Medeiros and Fravel, p.35. See also Naoko Munakata, "The Impact of the Rise of China and Regional Economic Integration in Asia – A Japanese Perspective," Statement before the U.S. China Economic and Security Review Commission Hearing on China's Growth as a Regional Economic Power: Impacts and Implications. Washington, DC, December 4, 2003; and David Hale and Lyric Hughes Hale, "China Takes Off," *Foreign Affairs*, November/December 2003, Vol. 82, Issue 6, p. 36.

⁵ Munakata, p. 1.

capital-intensive components to China for labor-intensive processing and assembly, before being reexported to developed markets. While China may be a threat to certain parts of the global supply chain that rely on low-cost labor, it presents an opportunity through production efficiency gains. Its booming exports are more than matched by booming industrial imports and investment opportunities.⁶

- Since the early 1990s, China has assumed a greater share of eastern Asia's exports, growing from 6.8 percent in 1990 to 15 percent (31 percent counting Hong Kong) in 2003. This compares to Japan which saw its share decline from 20 percent to 10 percent over the period.⁷
- China now runs trade deficits with eastern Asia and trade surpluses with North America and Europe, and has replaced the United States as South Korea's largest trading partner.

China has also emerged as a major consumer on the world's commodity markets. In 2001, China accounted to 30 percent of world iron ore consumption, 21 percent of platinum consumption, and 15 percent of aluminum consumption.⁸ Approximately 45 percent of China's \$400 billion in annual imports comes from developing countries. Increased Chinese demand for basic commodities has pushed up prices for food staples and industrial raw materials such as aluminum, steel, copper, cotton, and rubber, reversing decades of slumping prices faced by the primarily poor countries that produce them.⁹ Continued industrialization and WTO-mandated liberalization will increase consumption of a wide range of raw materials and agricultural commodities and will likely produce an expansion of trade with commodity producers in Africa, Australia, Latin America, and Canada.¹⁰

China's energy consumption has grown to meet the expansion of the economy. China is now the second largest oil consumer. Oil imports have grown by approximately 30 percent per year¹¹, and China is now the third largest net-oil importer behind the United States and Japan.¹² As the source of around 40 percent of world oil demand growth over the past four years, Chinese oil demand already is a very significant factor in world oil markets.¹³ As such, China's energy demand affects both oil producing developing countries and, through the effect on world oil prices, on oil importing developing countries.

⁶ Hale and Hale, p. 46.

⁷ Hale and Hale, p. 46.

⁸ Hale and Hale, p. 48.

⁹ Homi Kharas, "Lifting All Boats: Why China's Great Leap is Good for the World's Poor," *Foreign Policy*, January/February 2005.

¹⁰ Hale and Hale, p. 48; Elena Ianchovichina, Sethapat Suthiwart-Narueput, and Min Zhao, "Regional Impact of China's WTO Accession," *East Asia Integrates: A Trade Policy Agenda for Shared Growth*, Washington, D.C.: The World Bank, 200x, p.65

¹¹ Philip Andrews-Speed, "China's Energy Woes: Running on Empty," *Far Eastern Economic Review*, June 2005.

¹² Department of Energy, Energy Information Administration, *Non-OPEC Fact Sheet 2004*, http://www.eia.doe.gov/emeu/cabs/topworldtables3_4.html

¹³ Department of Energy, Energy Information Administration, *China: Country Analysis Brief*, July 2004. <http://www.eia.doe.gov/emeu/cabs/china.html#oil>

China's transformation from one of the world's greatest opponents of globalization and disrupter of global institutions into an advocate of globalization and committed member of those institutions are profoundly influencing its neighbors, especially India. "Asians schooled in antipathy to foreign investment and Latin Americans with protectionist traditions are going to have to be more open to foreign investment ... This will transform third world strategies of development,"¹⁴ with a much larger potential role for the facilitation of foreign direct investment relative to the provision of grants and loans to promote economic development. China's example also shows how "economic liberalization allowed China to post 9 percent growth rates over three decades and lift 300 million people from poverty during that time."¹⁵

1.2 Indirect Impact of China Trade with Third Countries on Other Developing Countries

The impact of China's accession to the World Trade Organization stands out as the most important issue facing developing countries. A number of developing countries have raised concerns about China's competitive threat in the international market as Chinese exports compete on more favorable terms with other developing countries' exports. For example, the literature notes that Mexico has already suffered from China's emergence and increased access to world markets. Despite the North American Free Trade Agreement and the US investment boom in Mexico, China overtook Mexico as the United States' second-largest trading partner. Mexico is no longer competitive, particularly in light manufactured goods and products that involve assembly operations – its labor is four times more expensive than China's and its electricity is twice as expensive because of government policies limiting private investment in the energy sector.¹⁶

The expiration in 2005 of the Multifiber Agreement, an export quota system for textile production, is also perceived as having potentially adverse effects on other textile-exporting developing countries. China is one of the world's lowest cost producers and the expiration of the quota system may lead to its world textile market share expand at the expense of other low-income countries, particularly Vietnam and Cambodia.¹⁷

The literature has taken three approaches to analyzing this threat. The first utilizes computer models to estimate the impact of WTO accession on developing countries and concludes that China will obtain considerable market shares at the cost of other developing countries, particularly low-income countries in South Asia. The second approach compares general technological capacities of China with those of developing

¹⁴ William Overholt, "China and Globalization," Testimony presented to the U.S.-China Economic and Security Review Commission, May 19, 2005, pps.1-2.

¹⁵ Kharas, 2005.

¹⁶ Hale and Hale, p. 48; S.M. Shafaeddin, "Is China's Accession to WTO Threatening Exports of Developing Countries," *China Economic Review*, Volume 15, 2004, p. 139.

¹⁷ Mary E. Gallagher, "China in 2004: Stability Above All," *Asian Survey*, Volume 45, Issue 1, p. 25; Elena Ianchovichina and Will Martin, "Economic Impacts of China's Accession to the WTO," *China and the WTO*, Washington, DC: The World Bank, 200x; Ianchovichina, Suthiwart-Narueput, and Min, p. 74-76.

countries as a whole, and argues that the threat is greatest for products with labor-intensive production processes, especially those exported by the so-called New Tigers (Malaysia, Thailand, Indonesia, and the Philippines) who still have relatively low-cost labor.¹⁸ A third approach looks at different product categories separately and by breaking broad product classifications down (eg., garments disaggregated into outer garments and undergarments) and comparing structures of exports, finds that the competitive threat of China in the market for traditional labor-intensive products is exaggerated in the short and medium runs. One factor mitigating the potentially adverse effects of China's integration is that as industrialization progresses, China is actually moving away from labor-intensive exports and towards more technology- and skill-intensive products, and therefore more of a threat to advanced developing countries such as South Korea, Taiwan, and Singapore.¹⁹

2. Impact of China's Emergence in Non-Trade Spheres

China has increased its engagement with ASEAN countries in areas beyond trade and investment, having concluded protocols with ASEAN in the areas of human resource development, public health, information and communication technologies, transportation, development assistance, the environment, and nation-building.²⁰ The growing problem of infectious diseases such as AIDS and the Severe Acute Respiratory Syndrome (SARS) has led the Chinese to seek out greater cooperation with other countries. Despite China's initial mishandling of the 2002/03 SARS outbreak and the toll taken on China's economy and international reputation, the subsequent cooperation with other countries in responding to SARS (included the acceptance of approximately \$38 million in assistance from other governments) is cited as evidence of China's new orientation on transnational development issues.²¹

However, the approach that China has taken in achieving greater economic integration and expanded economic ties with other developing countries is in some instances working at cross-purposes to US and other donor's development assistance policies – notably in the areas of governance and anti-corruption, and environmental degradation.

The payment of bribes by transnational corporations to secure trade and investment deals undermines governance and deteriorates the investment environment in developing countries. Transparency International's Bribe Payer's index has ranked Chinese firms as having high propensities to pay bribes in other developing countries,²² a problem

¹⁸ McKibbin and Woo argue that these four countries (the ASEAN-4) will be adversely affect only if foreign direct investment is significantly redirected away from these countries to China, and if the ASEAN-4 fail to absorb new foreign technologies and engage in indigenous technical innovations. Warwick J. McKibbin and Wing Thye Woo, "The Consequences of China's WTO Accession on its Neighbors," *Brookings Discussion Papers in International Economics*, No 157, February 2004.

¹⁹ Shafaeddin, p. 110-111. See also, Sanjaya Lall and Manuel Albaladejo, "China's Competitive Performance: A Threat to East Asian Manufactured Exports?" *World Development*, Volume 32, Number 9.

²⁰ David Shambaugh, "China Engages Asia: Reshaping the Regional Order," *International Security*, Volume 26, Number 3 (Winter 2004/05), p. 75.

²¹ Deng and Moore, 2004, p. 128.

²² <http://www.transparency.org/cpi/2002/bpi2002.en.html#bpi>

illustrated anecdotally in a media report on the lack of transparency in Chinese investment transactions in Africa.²³ However, there is little data on the extent and effects of possible corrupt practices by Chinese firms in developing countries.²⁴

China's global economic integration has also had environmental spill-over effects, though these are not well-documented in the literature. After floods on the Yangtze River killed more than three-thousand people and cost the country billions of dollars in damage, China banned tree-cutting in 1998 in an effort to protect its disappearing forests and to prevent flooding. Since then, Chinese logging companies have looked to other countries for wood. Between 1997 and 2001, China became the second largest importer of wood in the world, after the United States. China is said to be buying wood from the rainforests of Malaysia, Indonesia, Papua New Guinea, Gabon and Russia. Environmentalists say forests in eastern Russia have been sharply reduced to satisfy rising demand in China, as well as in Japan and South Korea. Russia now supplies forty-two percent of all the wood China imports.²⁵

3. Implications for Development Assistance Policy

China's integration into the international economy as a resource-hungry, low-cost labor "factory" providing exports to the world suggests that developing countries may benefit from continued foreign assistance that expands their capacities to meet the growing demand for raw materials, energy, and food staples. Foreign assistance may also play a role in mitigating potential adverse impacts of China's WTO accession by promoting greater competitiveness (at either the country or cluster level), and facilitating enabling foreign investment environments that compare favorably to that offered by China. Given the perception that Chinese firms are more prone to pay bribes to secure deals, activities that strengthen governance and transparency systems may also be warranted to address any potential for corruption.

Development assistance may also need to address the potential environmental effects of the surge in demand for raw materials to avoid a rapid depletion of natural resources (such as forests) and help developing countries manage the increased commercial demand for natural resource-based products. As a large country with strong commercial linkages with the rest of the world, China's domestic policies can have profound impacts on other countries, as was the case after China banned tree-cutting in 1998. Similarly, China's openness and more frequent contact with the rest of the world means that domestic, seemingly localized public health matters may affect more people outside China's borders sooner, as was the case with the SARS outbreak.

However, the literature seems to suggest that China recognizes that with the right to be a world economic power comes the responsibility to cooperate on matters of global interest

²³ "China's Big Investment," News Hour with Jim Lehrer, July 5, 2005.

http://www.pbs.org/newshour/bb/asia/july-dec05/china_7-05.html

²⁴ Communication with Liao Ran, Program Officer, Transparency International, July 26, 2005.

²⁵ Cynthia Moore, "Environmental groups say a ban on tree-cutting in parts of China is threatening forests in Southeast Asia, Russia and western Africa," Environment Report, Voice of America, April 20, 2001.

– particular those of a “low politics” nature like economic interdependence and global health and environmental issues. This willingness to cooperate may provide new opportunities for donors to work with China in addressing the economic and social problems facing developing countries.