

**CHINA'S ECONOMY REMAINS  
HIGHLY EXPORT-ORIENTED**

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## **Executive Summary**

1. Despite the government's manifest objectives of rebalancing to increase domestic demand, China's economy remains highly export-oriented. Even after experiencing a sharp decline in 2009, export resumed its pre-crisis level and contributed considerably to GDP growth in 2010.
2. Since late 2008 when the global economic crisis started, the Chinese government has implemented a variety of policies to support export, including providing subsidies for the purchase of home appliances, adjusting the rates of export tax rebates, and relaxing restrictions on process trade. The government has also announced policies to strengthen the export of high-tech and high value-added products.
3. The measures have been quite effective in stimulating trade recovery. However, certain policies, such as raising export tax rebates for labor-intensive products, are inconsistent with China's long term objective of industrial upgrading and attaining a more balanced trade.
4. Consequently, only modest changes in China's trade structure have taken place. There is a limited narrowing of gap between export and import. At the same time, the geographic pattern of China's trade imbalance remains largely the same. The EU and the US continue to be China's largest export markets, while China's Asian neighbors the key suppliers for imports.
5. The highly skewed regional composition of China's trade imbalance leaves the country vulnerable to economic difficulties and protectionist measures in major markets. According to the World Trade Organization, China has persistently been the number one target for anti-dumping measures.
6. Process trade has been the main source of China's large trade surplus. Thus the gradual decline in process export since the mid-2000s is a desirable development towards more balanced trade. Various short-term measures that

encourage process export would be best withdrawn once market conditions improve.

7. As the global economy may be heading for another slowdown, China will be forced to accelerate its economic restructuring. The demand for Chinese products will remain weak, as major industrial countries experience economic difficulties. Chinese products will face additional adversity as countries may resort to protectionist measures in hard times.
8. Most importantly, China may be fast losing its comparative advantage in the export of low-end manufacturing products due to domestic production cost increase and currency appreciation. It is estimated that between June 2005 and July 2011, China's trade-weighted real effective exchange rate had appreciated by over 20%.
9. To stimulate greater domestic consumption, measures like higher minimum wage, more effective labor regulations, more flexible exchange rate management, and greater enforcement of environmental regulations are important.
10. China remains a developing country with numerous development challenges, including widening income gap and the lack of a well-functioning social safety net. The role of domestic consumption can only grow gradually as the country continues to industrialize and urbanize. Export is expected to remain a powerful engine of China's economic growth for the coming years.