

**CHINA'S TRADE ACCELERATION AND
THE DEEPENING OF AN EAST ASIAN
REGIONAL PRODUCTION NETWORK**

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Executive Summary

1. After its accession to the WTO in 2001, China has emerged as a global trading power, overtaking Japan since 2004 to become the world's third largest trading nation after the US and Germany. Between 2001 and 2006, China's share in world trade nearly doubled, from 4.1% to 7.3% in 2006. China's trade to GDP ratio also increased considerably, from about 40% to 65%.
2. China's recent surge in trade has been associated with its deepening but varying trade relations with its key trading partners. With the US and EU, overall trade has more than trebled since 2002 with trade surplus with the two hitting US\$ 144 billion and US\$ 91 billion in 2006, respectively. Trade with China's Asian neighbors also accelerated when China becomes a significant export market.
3. To a great extent, China's trade expansion is due to its role as a platform for processing and assembly trade. Indeed, more than half of China's total exports and more than 40% of China's total imports are in process trade. Consequently, China's large and growing trade surplus with the US and EU is largely offset by its trade deficits with Asian economies. In 2006, China's trade deficit with Taiwan, Korea, Japan, and ASEAN amounted to US\$ 66 billion, US\$ 45 billion, US\$ 24 billion, and US\$18 billion respectively.
4. China's trade with its main trading partners is a reflection of growing production sharing and an intensification of an Asian production network, especially in electronics. In 2006, the largest source of Sino-US trade imbalance is in goods under the category of *electrical machinery, machinery, and mechanical appliance*. It is also the largest source of China's trade deficit with its Asian neighbors.
5. Indeed, China's recent trade expansion has coincided with rapidly growing intra-regional trade in Asia, especially trade in intermediate goods. Increasingly, China is serving as an export platform for firms located in the

relatively more advanced Asian economies which export intermediate goods to their affiliates in China for assembling and then shipping to key export markets, such as the US and EU.

6. One outcome of such processing and assembly trade is in the production of more technologically sophisticated goods, such as machinery and transport equipment. The import and export of high-tech products are also gaining due to foreign investment and the activity of foreign affiliates. In fact, the share of foreign invested enterprises (FIEs) in China's total export has risen from one third in the mid-1990s to 58% in 2006.
7. The growth in FIE share from 28% to 45% in the same period is also evident in the export of high-tech products. Accordingly, trade by FIEs is the most significant component of China's increasing trade imbalance with its major trade partners in recent years.
8. China has emerged as a central player in the regional production network facilitated by increasing foreign direct investment and intra-regional trade. In addition to its low labor cost, China is also developing a competitive edge in producing more capital intensive and technologically sophisticated goods. It is likely that China's export would continue to expand while sizable trade imbalances with its major trading partners remain.