ARE WE MAKING A DRAGON OUT OF A DRAGONFLY? UNDERSTANDING CHINA'S ROLE IN GLOBAL PRODUCTION NETWORKS

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China has become the center of virtually any discussion about globalization and its impact on the Canadian economy. According to a recent opinion poll by the Asia-Pacific Foundation of Canada (APFC), Canadians believe that China is the second most important country/region for Canada's prosperity after the United States and before the entire European Union.

Yet the public remains skeptical whether China's emergence as a major economic force is good for the Canadian economy. Many Canadians view the decline of its manufacturing sector as directly related to the rapid growth of low-cost imports from China. According to the APFC poll, more than twice the respondents believe that increased trade and investment between Canada and China will result in Canadian job losses rather than create jobs. And 71 percent of Canadians believe that its industries should be protected from imports that come from countries with very low wages. This fear is fueled by the dramatic rise in Canada's manufacturing imports from China: 11.7 percent of Canada's manufacturing imports currently come from China.

An additional source of concern is the changing mix of Canada's imports from China. If fifteen years ago China primarily exported low-tech products such as apparel, toys and footwear, today it has become Canada's primary supplier of high-technology products such as computers and telecommunications equipment. This has created the fear that China is rapidly moving up the technology ladder, and becoming competitive in technology-intensive industries where Canada should have a strong comparative advantage.

Western firms are often blamed for aggravating these trends. A recurring story is that Western firms are on a large scale closing manufacturing plants in their home countries and are moving them to China to take advantage of its lower labor costs. This has created the rising resentment that Western companies in their search for profits are not only hollowing out their own manufacturing industry, but also building up China's competitiveness as the world's factory.

So, how concerned should we be with the rise of the Chinese dragon? While the evidence of China's rising threat at first sight seems resounding, the reality is less clear-cut once a deeper analysis of the data is conducted. Our study debunks three "myths" about China's role in the world economy:

MYTH 1. More than a tenth of Canada's manufacturing imports are made in China.

While it is true that 11.7 percent of Canada's manufacturing imports come from China, only half of that value is made in China. The other half is the value of the imported components that China uses for the production of its exports.

MYTH 2. China's comparative advantage is rapidly shifting from low-technology to high-technology products.

The share of China's export value that is made in China is lower in high-technology industries than low-technology industries. As a result, even though China's exports have grown most rapidly in high-technology industries, the production activities taking place in China have remained largely low-tech.

MYTH 3. Canadian firms are on a large scale moving their manufacturing plants to China to take advantage of its cheap labor, thus effectively hollowing out Canada's manufacturing sector and building up China as the world's factory.

Western firms that move their production plants to China generally do so as a part of their strategy to improve their access to the large and growing Chinese consumer market, and not to merely reduce their production costs.

Our study provides us with a different picture of China's role in the global economy than is generally portrayed by the popular press. China is not the rising dragon that is single-handedly challenging Western manufacturing firms in both low-technology and high-technology industries. Nor is China the Mecca of cheap labor that is on a large scale used by Western firms to reduce their production costs. Rather, China is used as a labor-intensive final assembly platform for primarily Asian firms that use it to export their final goods to the West. The Western firms that move their operations to China primarily do so to gain access to the large and growing Chinese consumer market.

For more information on the subject, the Burgundy Report is available at
http://www.cirano.qc.ca/pdf/publication/2009RB-03.pdf