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World Pays a Price for China's Growth

CAPITAL ACCOUNT

By Greg Ip

Pop quiz. Who has contributed more to the rest of the world's growth this year: China or the United States?

The answer is the U.S., and it isn't even close. Even as the U.S. rolls out tariffs, its imports are up 10% so far this year from a year earlier. And as China moralizes against protectionism, its imports are down 3%, in dollar terms.

The U.S. figures might be an anomaly, reflecting frontrunning of tariffs. China's are not. In the past five years, its export volumes have soared while imports have flatlined. China is swallowing up a growing share of the world's market for manufactured goods. This reveals an uncomfortable truth: Beijing is pursuing a "beggar thy neighbor" growth model at everyone else's expense.

A recent report by economists at Goldman Sachs starkly laid this out. In the past, they wrote, 1% more output in China would raise the rest of the world's output by 0.2% as it pulled in imports.

In their new forecast, the Goldman team has concluded that the relationship has turned negative. China's growth, they write, is being driven by its "leadership's determination and capability to further advance manufacturing competitiveness and boost exports."

Note

This is positive for other countries insofar as cheaper Chinese goods boost purchasing power. But that benefit is more than offset by the hit to their manufacturing sectors from Chinese competition. The upshot is that Goldman sees China growing about 0.6 percentage point a year faster over the next few years, but that will reduce the rest of the world's growth by 0.1 point a year.

China's growth is still good for the Chinese people, and for some countries that sell inputs to its export machine. But Goldman projects it will generate growing headwinds for other industrial economies in Europe and East Asia, and for

Mexico.

Afundamental axiom of economics is that when two individuals or countries trade, both are better off. In the decades after World War II, the U.S. was the world's largest exporter and economy and as it grew, it imported more, helping its partners. As they grew, they bought more of what the U.S. made. Expanding trade helped everyone specialize, leading to more competition, innovation and choice, and lower costs.

Note

China is now the world's second-largest economy and its largest exporter, but its philosophy is quite different. It has never believed in balanced trade nor comparative advantage. Even as it imported critical technology from the West, its long-term goal was always self-sufficiency. In 2020, Chinese leader Xi Jinping codified this approach as "dual circulation." This would, he said, "tighten the international industrial chain's dependence" on China while ensuring China's production was "independent" and "self-sustaining."

Note

WOW!

And as China expands into high-end manufacturing such as aircraft and semiconductors, Xi has decreed it must not relinquish low-end production such as toys and clothes. Beijing has discouraged Chinese companies that invest abroad from transferring key know-how, such as in the production of iPhones and batteries. Xi has rejected fiscal reforms that would tilt its economy away from investment, exports and saving and toward household consumption and imports.

Note

Of course, China isn't the first to pursue export-led growth or industrial policy (government support of favored sectors). West Germany, Japan and later South Korea all did the same, eventually running up surpluses that became longstanding irritants with the U.S.

But as part of the democratic West, they didn't fear economic interdependence nor seek to eliminate imports. And as they moved up the value chain, they allowed lower-end manufacturing to migrate to poorer countries.

Those countries "were driven by a desire for prosperity," said Rush Doshi, a China expert who served on President Joe Biden's National Security Council. "China is driven by a fortress mentality and sees industrial dominance as key to wealth and power. These are longstanding goals deeply rooted in nationalism and the Communist Party."

Two decades ago, China's economy was small enough that its trade surplus mattered little to the world. Today China accounts for 17% of global gross domestic product. Goldman estimates its surplus on the current account—the broadest definition of trade—will reach 1% of world GDP by 2029, larger than any country at least since the late 1940s.

As recently as 2020, international automakers supplied around 60% of the roughly 20 million units sold in China, usually from local factories operated with domestic jointventure partners. Their executives insisted they would never cannibalize sales outside China by exporting from those joint ventures, recalls Michael Dunne of market research and advisory Dunne Insights.

In the years since, Chinese automotive brands moved into electric vehicles, driving foreign brands' market share below 40%. Saddled with excess capacity for internal-combustion- engine cars, those joint ventures began exporting.

Cannibalization has begun. Four of the top five Chevrolet models sold in Mexico are made in China by **General Motors'** joint-venture partners, Dunne said. They would previously have been made in Mexico or South Korea.

Note

China's dominance of so many categories of manufacturing gives it formidable leverage. When the Netherlands took control of Dutch chip maker Nexperia from its Chinese owner for national security reasons, China barred the company from exporting chips from its Chinese operations, crippling auto-assembly customers. The Netherlands suspended its action.

The most effective way to turn back China's export onslaught would be for the U.S. to coordinate with likeminded partners, such as imposing common restrictions on its autos while maintaining low restrictions on each other.

President Trump has to date shown no interest in such a united front. Still, his bilateral deals do include incentives for resisting China's exports. Malaysia, for example, agreed to match U.S. restrictions imposed on China for national security.

North America would be a natural candidate for a united front. To preserve the low tariffs codified in the U.S.-Mexico-Canada Agreement, Canada and Mexico might be willing to join the U.S. in raising barriers to China.

But time is running out. Canada last year copied the U.S.'s 100% tariffs on Chinese electric vehicles. Then Trump hit Canada with auto tariffs, and China retaliated against Canadian agriculture. Caught in a two-front trade war, Canada is reviewing its tariffs on China.

