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Some Perspectives on China's Role in the East Asian Economies

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10. Some Perspectives on China's Role in the East Asian Economies

Tang Zongming and Tran Van Hoa

10.1 INTRODUCTION

With its fast economic development China has been playing an increasingly important role in the global economy, and especially in the East Asian region. The *New York Times* in mid-2003 even claimed that China would very likely become the engine of growth of Asia instead of the United States. Japan has also reiterated that China is the new force of East Asia's economic development. Will China become the engine of growth or a new force for economic development in this region? What linkages are there between the East Asian nations' economic development and that of China? How will they affect each other in the future? We will discuss all these issues in this chapter.

The chapter consists, after this introduction, of four sections. Section 2 analyses the performance and describes the key features of China's fast economic growth in recent years. In the following two sections, sections 3 and 4, we examine the Chinese economy's impact on the East Asia economies and the influence of East Asia and South East Asian regional integrations, including ASEAN+3 or its subset ASEAN+China, on China's economic development. Finally, section 5 offers some conclusions.

10.2 PERFORMANCE AND FEATURES OF CHINA'S ECONOMIC GROWTH

Since the launching of the reform and open-door-policies programme in 1978 the Chinese economy has achieved continuous and fast growth. According to figures from the Chinese Statistical Yearbook the average annual growth rate for the Chinese economy was 10.75 per cent in the 1980s and 9.71 per cent in

the 1990s respectively.¹ Even under the impact of SARS in the first half of 2003 this figure remained at 8.2 per cent (see Figure 10.1). China's fast economic growth is mainly based on robust domestic demand and increasing foreign demand.

Under its fast economic growth, China's domestic demand has had the following four features. First, China has a sizable consumer market. With a population of one-fifth of the global population, China bears a very big consuming capacity. In recent years there has been a continuous increase in household income in China. The total saving amount for Chinese residents is now over 8,000 billion Renminbi (see Figure 10.2). Meanwhile, the Chinese government has been undertaking reform of income and its distribution in order to narrow the gap between the high and low income classes, raising the average marginal propensity of consumption of the whole society. Therefore, China's domestic consumer market will continuously be one of the main forces promoting China's economic growth.

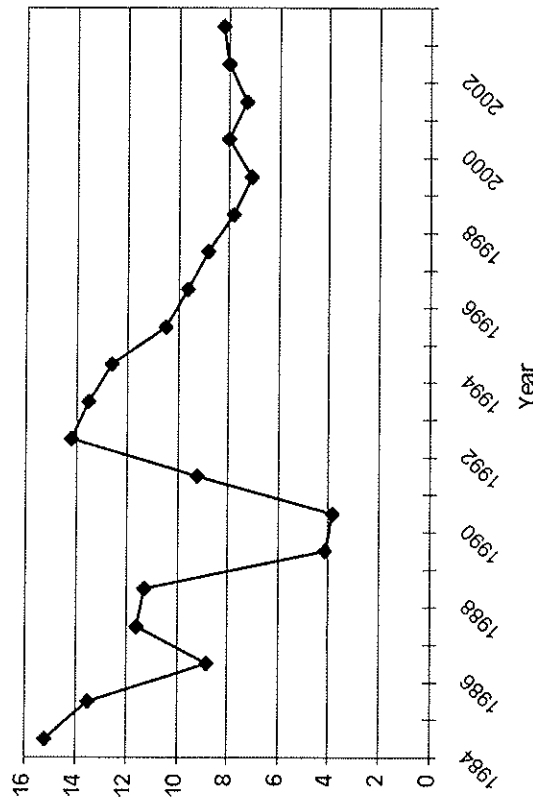


Figure 10.1 China's annual GDP growth rate (%), 1984-2003
Source: China Statistical Yearbook (2003)

Second, new consumer trends emerge and begin to play an important role. Over the past several years, housing expenditure has gained a high percentage of gross expenditure. The real estate industry has become a key force in accelerating China's economic development. Moreover, expenditure

on cars, travel, education and communication is also increasing. For example, in 2002, car sales in China exceeded one million units for the first time, and are expected to rise further due to rising domestic demand in the near future.

Third, government investment contributes greatly to China's economic growth. The Chinese government has implemented an expansionary fiscal policy over the past five years. Every year the government issues about 150 billion Renminbi in long-term treasury bonds to finance many important infrastructure projects, such as the Western Areas Development, Technology Modification in Key Enterprises and Transferring Water from the South to the North. Government investment improves national infrastructure, lowers the transaction costs for distributing production factors and expands domestic demand. All these will definitely stimulate economic development in the country.

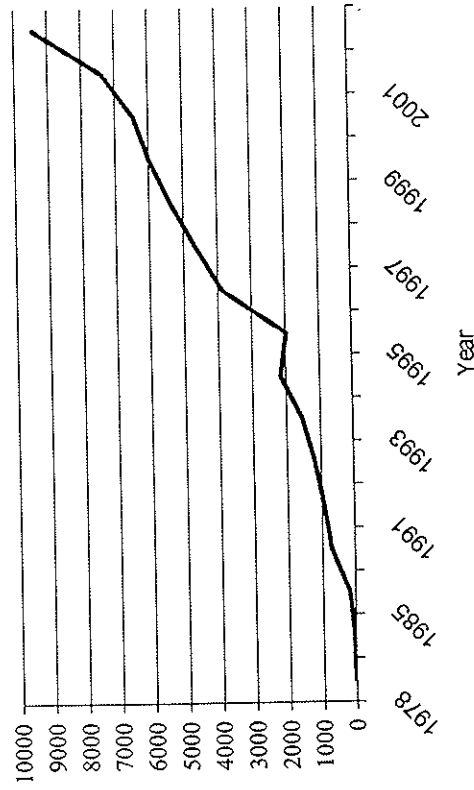


Figure 10.2 Savings deposits in urban and rural areas of China, 1978-2002, (billion yuan)
Source: China Statistical Yearbook (2003)

Finally, private investment has been on the rise. China's private economy is booming although the reform of state-owned enterprises (SOEs) is still experiencing a difficult time. For example, private investment has expanded quickly in recent years and enjoyed an average growth rate of 18 per cent.²

In terms of foreign demand, China's demand structure has the following

two features. First, the volume and value of China's foreign trade keeps on increasing (see Figure 10.3). From 1991 to 2002 the annual average growth rate for China's total value of imports and exports reached 15.4 per cent. The growth rate of total export value amounted to 15.2 per cent. According to research by Lin Yifu and Li Yongjun (2002), every 10 per cent increase in export growth will give rise to one per cent GDP growth. Therefore, over the past twelve years, China's 15 per cent annual export growth has contributed more than one per cent to its annual GDP growth. Second, FDI flows to China keep rising. Foreign capital continues flowing into China as foreign corporations shift labour-intensive divisions of their production networks to China to take advantage of its low labour costs (see Figure 10.4). In 2002 China overtook the United States to become the number one foreign capital absorbing country, attracting a historical record US\$52.7 billion, 37 per cent of the total in-flow of FDI into developing countries, of which 60 per cent flowed into China's manufacturing industries.³

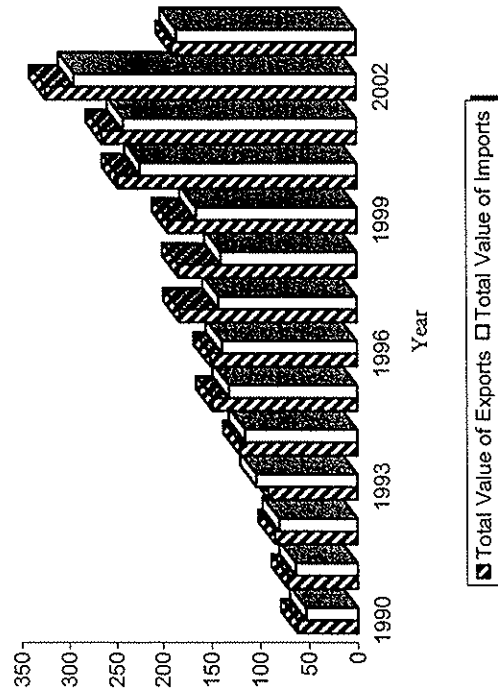


Figure 10.3 China's total value of imports and exports, 1990-2003* (billion US dollars)

Note: * First half of 2003 only

Source: China Statistical Yearbook (2003)

In addition, regional economic growth is also one of the outstanding features in the Chinese economy. In China the economies in the Pearl River

Delta, Yangzi River Delta and the Bohai Gulf grew the fastest, contributing over 60 per cent of the whole Chinese economy. Their total foreign trade value reached more than 80 per cent of China's total value. Meanwhile, they attracted most of the FDI flowing into China (see Table 10.1). Among these three economic areas the Yangzi River Delta is the most active area in China, even in the world. With only 2.2 per cent of the total state area and 10.6 per cent of the whole population, its GDP accounted for about 30 per cent of national income.

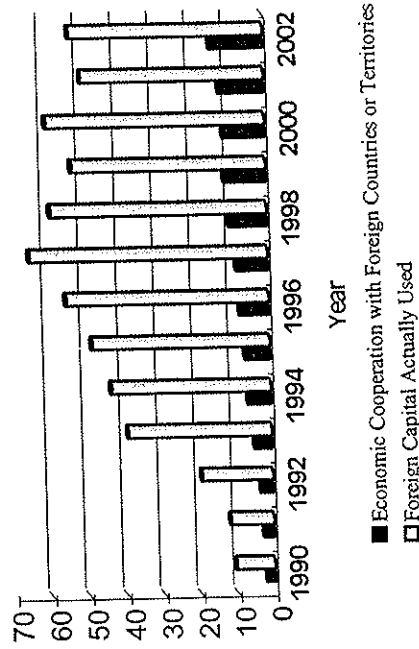


Figure 10.4 China's economic cooperation with foreign countries or territories and its utilization of foreign capital, 1990-2002 (billion US dollars)

Source: China Statistical Yearbook (2003)

In the Yangzi River Delta economy Shanghai plays the most important role. Currently, more than 330 financial institutions from all over the world have set up branches or offices in Shanghai. Half of the Fortune 500 companies have invested in Shanghai. Consequently, Shanghai has gained the reputation of a very high foreign-oriented city. Industries including financial securities, insurance, commercial trade, transportation, communications and real estate have expanded rapidly. Urban and regional linkages have also increased. With the successful bid for the 2010 World Expo, Shanghai has the potential

for unprecedented development opportunities. A new investment and construction peak will be approached in the coming years. Shanghai will continue to keep its two-digit growth rate that it has attained for the past eleven years. Benefiting from the radiating growth and development effects from Shanghai, the Jiangsu and Zhejiang provinces have also developed very rapidly in recent years.

In terms of demand structure, China's fast economic growth has mainly come from its considerable domestic market. These three regional economies, especially the Yangtze River Delta, are the *engine* of China's economic development. For this very reason, China can keep its fast growth in spite of the downturn of the world economy. Certainly, increasing foreign demand will also make an important, although more limited, contribution to China's economic growth.

10.3 IMPACT OF CHINA'S ECONOMY ON THE ECONOMIES OF EAST ASIA

The Developing Potentials of the Chinese Economy

Compared with the global economy China has achieved continuing strong growth over a number of years. The State's political and social stabilities have been the crucial conditions for its growth besides factors including: a large domestic market with a 1.3 billion population; ever more mature government macroeconomic regulating instruments; ever increasing foreign capital; and new opportunities after its accession to the World Trade Organization, have all contributed to China's rapid economic growth. The Chinese economy is still at a preliminary stage in terms of its economic growth and development, and still has huge potential to develop further. In the context of world economic development history the United States has experienced 30 years of high economic growth and 24 years of stable growth. From 1950 to 1987 Japan enjoyed a continuous and high rate of economic growth. The Asian economy was the fastest growth area in the world due to its average annual growth rate of 8 per cent during the 30 years before the Asian Financial Crisis.⁴ The Chinese economy has been growing at a very high rate for 23 years. Therefore, in the light of this international development record and its own economic power, China can be expected to maintain its fast growth for the next ten to 15 years.

Table 10.1 Major economic indicators of three regional economies and the Yangtze River Delta

Year	GDP (billion Yuan)		Total Value of Imports and Exports (Customs Statistics) (billion US dollars)		Total Amount of Foreign Capital Actually Used (billion US dollars)		Revenue of Economic Cooperation with Foreign Countries or Regions (billion US dollars)	
	Total Amount	Ratio to China (per cent)	Total Amount	Ratio to China (per cent)	Total Amount	Ratio to China (per cent)	Total Amount	Ratio to China (per cent)
2000	3529.05	64.21	383.753	82.25	36.195	60.98	3.430	3.028
	Yangtze River Delta	1314.215	29.78	121.88	12.24	20.62	2.068	18.26
	Three regional economies	1314.215	29.78	121.88	12.24	20.62	2.068	18.26
2001	4584.048	62.15	420.222	82.43	43.497	87.57	4.497	3.703
	Yangtze River Delta	2116.544	28.69	145.045	16.262	32.74	2.938	24.2
	Three regional economies	2116.544	28.69	145.045	16.262	32.74	2.938	24.2
2002	5109.412	54.18	515.346	83.01	52.575	99.76	5.965	4.141
	Yangtze River Delta	2371.506	25.15	184.964	29.78	20.56	3.873	26.89
	Three regional economies	2371.506	25.15	184.964	29.78	20.56	3.873	26.89

Sources: Statistics of the Yangtze River Delta are based on that of the Shanghai, Jiangsu and Zhejiang Provinces. Statistics of the Pearl River Delta are based on that of Guangdong Province. Bohai Gulf's statistics are calculated on the basis of that of Beijing, Tianjing, and the Shandong Province.

Impact of China's Growth on the East Asian Economies

According to the *Global Development Finance 2003 Report* released by the World Bank:

'China continued to make strong advances in output - some 8 per cent during 2002 - despite relative stagnation in Japan and volatile US demand. This helped to drive the recovery in East Asia. Together with policy stimulus in other countries, China's performance lifted the region to a growth rate of 6.7 percent in 2002.'

We notice from this that China has helped to stimulate the recovery in East Asia in 2002. Will it continue to play an important role in this area in the near future? First, let us take a look at the economic and trade linkages between China and the East Asian countries.

The Close Economic and Trade Linkages

According to trade value in 2002, Japan, ASEAN and Korea are China's first, fifth and seventh largest trading partners respectively. On the other hand, China is Japan's number two, ASEAN's number six and Korea's number three trading partner respectively. Hence, China has very close trade relations with the East and South East Asian countries. Additionally, from the yearly statistics, China's trade volumes with Japan, Korea and ASEAN keep rising every year, while the trade imbalance between these economies is becoming a serious issue (see Figures 10.5 and 10.6).

From the perspective of FDI, Japan, Korea and Singapore are China's number four, number six and number seven investing countries in terms of FDI inflows in 2002 (see Figure 10.7), respectively. Furthermore, most of the capital from Japan and Korea has been invested in the Yangzi River Delta. On the other hand, China distributed 23.33 per cent of its foreign investment to Asian countries in 2002. The scale of China's investment is expanding in Korea and is at a certain break-through point in Japan. Overall, both China's foreign investment in the East Asian countries and the in-flow of FDI to China from them has been increasing. But China remains a major net in-flow FDI nation.

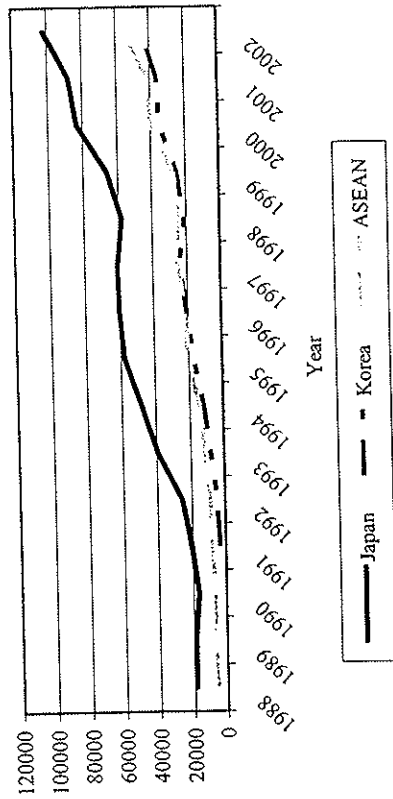


Figure 10.5 China's total value of imports and exports 1988-2002 (US\$ million)

Source: China Statistical Yearbook 1989-2003

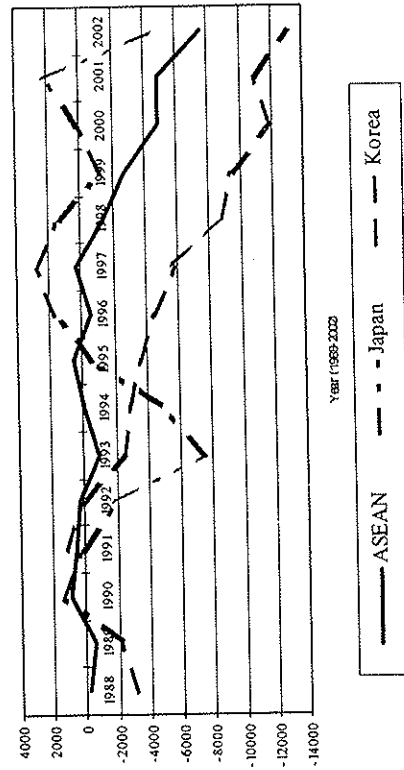


Figure 10.6 China's total value of net exports to Japan, Korea and ASEAN, 1988-2002 (US\$ million)

Source: China Statistical Yearbook from 1989 to 2003.

China's role in the East Asian economies

China and the other East Asian nations are important partners in trade and investment. Yet they compete against each other both in foreign trade and in attracting foreign capital. For instance, China and the ASEAN economies compete in the export of manufactured goods. With regard to attracting FDI, by analysing the layout of Japan's foreign investment in 2002, we find that Japan's investment in China and the ASEAN nations was rising while it was decreasing in Korea, Hong Kong and Taiwan. In this case, some of the East Asian economies are concerned about the fact that the competition from China will threaten their economic development. As to this concern, we hold the view that although there exists some competition between China and the East Asian nations, the negative influence from their competition can be offset by the positive influence from the complementary relations between them. China will still be the important partner for these economies in their future development. We base our views on the following reasons:

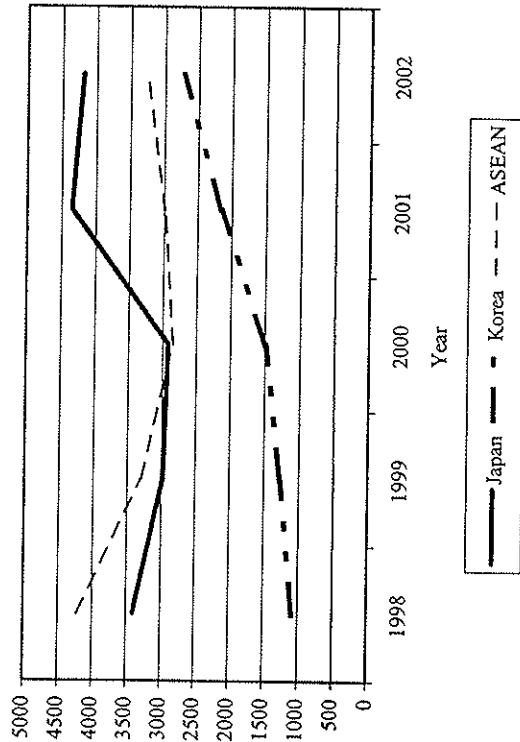
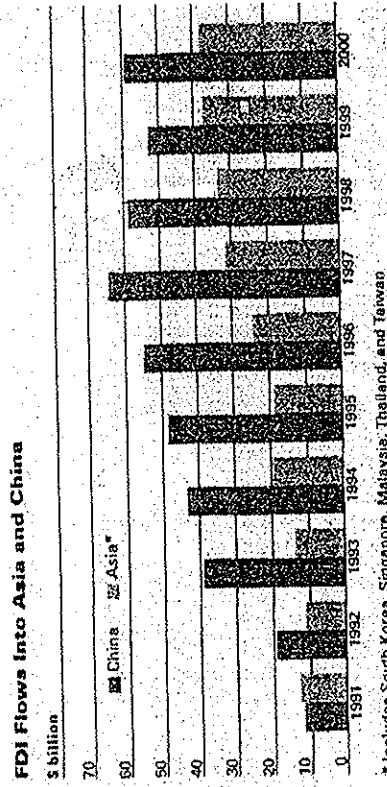


Figure 10.7 Foreign Capital Actually Used 1998-2002 (US\$ million)
Source: China Statistical Yearbook from 1999 to 2002.

First, the rise in China's foreign trade has not crowded the East Asian nations out of the international market. Although the annual growth rate for exports reached 15.37 per cent in 2002, China's imports are also increasing. On average, every US\$100 in exports will produce 50 to 70 US dollars in imports.⁵ Therefore, China not only occupies part of the East Asian market, but it also provides them with access to China's large market. The statistical figures suggest that about half of East Asian exports have been shipped to China and Hong Kong (15.6 per cent), the United States (20.4 per cent) and Japan (13.5 per cent).

Second, China and the East Asian nations compete in terms of attracting FDI, but not seriously. With respect to the sources of China's FDI, two-thirds comes from Hong Kong, Macao and Taiwan, while the remaining one-third is from the United States, Japan and other countries. On the other hand, FDI to ASEAN and other East Asian countries is mainly from Japan and the United States. Thus, China only competes with other East Asian countries in attracting FDI from Japan. Statistical figures also show that FDI from non-Asian economies to China and other Asian countries are both increasing⁶ (see Figure 10.8).



* Includes South Korea, Singapore, Malaysia, Thailand, and Taiwan

Figure 10.8 FDI flows into Asia and China
Source: Chi Lo (2003).

Third, whoever invests in China first will benefit from China's low labour costs and considerable domestic market size. FDI to China favours both China and its investing countries. China covers one-fifth of the world population, and 70 per cent of its population are in the age group from 15 to 65. This age percentage ranks the highest in the world. China's abundant labour makes its labour costs to be ranked at a low level. By combining China's cheap labour with advanced capital and technologies from developed countries, multinational corporations can achieve very high profits in

international and Chinese markets. In fact, Hong Kong and Taiwan have made good use of this combination, and earned considerable returns from their investment in mainland China. Now Japan and Korea are expanding their investment in China to share in this advantage.

Finally, *Made in China* did not dwarf *Made in East Asia*. China's cheap labour costs and ever-favourable investment environment make it an attractive place for increasing FDI, 60 per cent of which flowed into manufacturing industries. However, will this increased manufacturing FDI mean that world manufacturing has shifted to China? Our answer is *No*. We can show this from the following figures. From 1990 to 2000 the share of manufacturing goods produced by developed countries reduced by 11 per cent while it increased by 7.3 per cent in Asia. However, China's growth rate for manufactured goods production was only 2.3 per cent, lower than that of the ASEAN (3.1 per cent).⁷ So we say *Made in China* did not dwarf *Made in East Asia*.

Compared with other East Asian economies, China is characterized as a country with low labour costs and a considerable domestic market. In this case if East Asian countries invest in China, they can combine their extant advanced technologies and managerial experience with China's resources. On the one hand they can take advantage of China's low labour costs to be more competitive in the international market. Or, again, on the other hand, they can gain profits from the sizable Chinese market. Accordingly, their corporations will be more competitive.

From the above analysis we conclude that China's fast economic growth has not, and will not, sacrifice its neighbouring economies. On the contrary, China's low labour costs will add to their cost advantage. China's considerable market will enlarge the East Asian nations' domestic markets. In the future, China will continue to be their important partner in terms of trade and investment. China needs the East Asian economies, and vice versa. Both need to develop on the basis of cooperation. However, China, regardless of its fast growth, has a relatively low total output. The size of China's GDP is around one quarter of Japan's GDP or about one-tenth that of the US. Thus, China will not overtake the US or Japan as the leading force for growth in the Asian economies.

10.4 CHINA, THE EAST ASIAN ECONOMIES AND NEW EAST ASIAN REGIONALISM

Taking the lead in the East Asian region

The spectacular progress in regional economic integration in North America has been attributed to the powerful leading role of the United States. The US has spared no effort in promoting regional integration through the North

American Free Trade Agreement (NAFTA). Meanwhile, the European Union, with France and Germany in the driving seat, has been energetically expanding regional integration out from the economic arena and into the political, military and social fields. However, no single nation or leading group has so far emerged in the leading role for regional economic integration in Asia. In the absence of a strong leader, little progress has been made to date in Asia's regional economic integration.

In terms of the current status of East Asia, there are four candidates: ASEAN, Japan, China or a joint Sino-Japanese leadership. Japan has been trying to lead East Asian economic cooperation single-handedly. However, it did not succeed because of the downturn of its domestic economy in the past decade. The relations between China and Japan can be expected to fall short of full mutual trust unless and until Japan's official attitude to Sino-Japanese history is modified and becomes acceptable to China. So joint leadership by China and Japan could not be considered feasible at present.

Regardless of China's fast growth, it has a relatively low total output. As mentioned earlier, China's GDP is around one quarter of the GDP of Japan or about one-tenth of that of the US. Thus, China has been incapable and will not be able to take over from the US or Japan as the leading force for the growth of the Asian economies in the past and also in the near future. Therefore, China, on the other hand, would rather back ASEAN to take the leading role in Asian regional integration than see Japan or other forces dominate economic cooperation in East Asia.

China should continue to endorse the ASEAN+3 as the main channel for future East Asian cooperation in the longer term. However, the reality of circumstances in East Asia means it would be no easy matter to set up the ASEAN+3 cooperative mechanism. Consequently, China should fully support the establishment of the ASEAN-China Free Trade Agreement. This would neither adversely affect common understanding nor present a barrier to eventual progress towards the ASEAN+3 framework.

China and New Asian Regionalism

In 2002 the ratio of China's total value of imports and exports (openness) to its GDP reached nearly 50 per cent. We can say that the foreign dependency of the Chinese economy has been ever increasing during its 20 years of reform and openness, and almost each of its successful miracles has been linked to foreign economies. From the close economic trade relations between China and the East Asian countries, we can also say that the dependency of the Chinese economy on the East Asian countries has ever increased. China's future economic development will continue to rely on its cooperation with its neighbouring nations.

As to Japan and Korea, Japan is at the top step of the industry ladder with abundant capital and sophisticated modern technologies. Korea, as one of the

newly-industrialized economies, also has advantages in capital-and-technology-intensive industries. Japan, Korea and China have different advantages in industry structure and production factors. So attracting more FDI from Japan and Korea will benefit China in upgrading its industry structure, releasing the pressure from rising unemployment and promoting its economic development.

As far as ASEAN is concerned, China's active attitude toward the establishment of the ASEAN-China FTA implies ASEAN's great importance to China in the near future. China will devote great efforts in forging a close relationship with the ASEAN economies in order to develop its domestic economy.⁶ ASEAN's influence on the Chinese economy can, however, be described as follows.

Trade

In the East Asian economies, ASEAN and China have important and rapidly growing trade relations (see Figure 10.9). From the structure of ASEAN-China trade, we can see that the exports of ASEAN do not compete seriously with Chinese exports. On the contrary, they are complementary to each other.

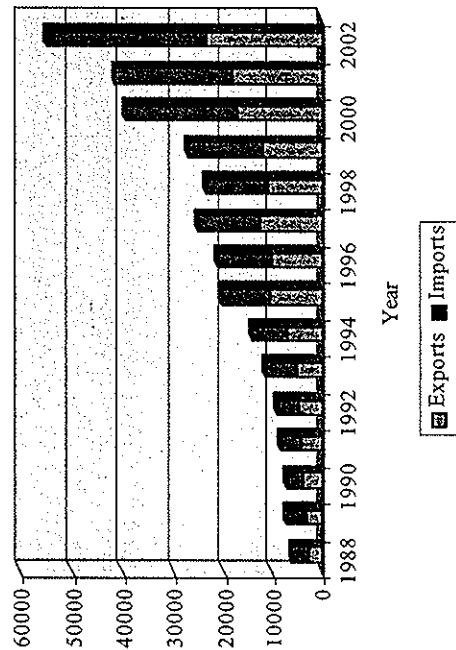


Figure 10.9 China's Total Value of Imports and Exports from/to ASEAN, 1988-2002 (US\$ million)

Sources: China Statistical Yearbook from 1989 to 2002, and Chinese Customs Statistics.

The ASEAN region has advantages in such products as mining goods, plastics and rubber goods, wooden goods, paper pulp and paper goods and grease, which cover 42 per cent of China's imports from ASEAN. China also has advantages in products such as metals and metal goods, textiles, apparel and shoes, vegetables and processed food, automobiles, cements and stones, which in all cover 38 per cent of China's exports to ASEAN. In addition, China and ASEAN are partly complementary in the trade of machinery and electrical appliances, chemicals, optical, and precision and musical instruments. Among them, machinery and electrical appliances account for 39 per cent of China's exports to ASEAN and 41 per cent of China's imports from ASEAN.⁹

Over the last decade the strongest rate of growth has been in the trade of manufactured products, with trade in computers/machinery and electrical equipment growing fastest. The fact that these products were the major exports and imports of both ASEAN and China suggests the importance of intra-industry trade, brought about by product differentiation and economies of scale.

The establishment of an FTA between ASEAN and China will create a huge market with 1.7 billion consumers. It will be the biggest FTA in the world in terms of population size. The removal of trade barriers between ASEAN and China will definitely lower transaction costs, increase intra-regional trade and increase economic efficiency. It is well-known that, if protected by trade barriers, domestic enterprises face little competition and pressure. As a result they operate inefficiently. With the formation of an FTA, and with trade barriers among members eliminated, the ensuing fierce competition will further promote specialization, and, as a result, increase productivity and economic welfare.

According to calculations made by ASEAN experts, after the creation of an ASEAN-China FTA China will gain an increase in real GDP of 0.3 per cent equating to a rise of US\$2.2 billion. China's exports to ASEAN will increase by US\$10.6 billion or by 55.1 per cent. Besides, the establishment of the ASEAN-China FTA will create a sense of community among ASEAN members and China. This will provide another important mechanism for supporting economic stability in East Asia, and allow both ASEAN and China to have a larger voice in international trade affairs on issues of common interest.

Foreign direct investment

Both ASEAN and China are major destinations for foreign direct investment rather than significant investors in each other's economy. With the formation of an ASEAN-China FTA, more investment should be attracted into the region. Not only will more ASEAN and Chinese companies be willing to

invest within the integrated market, but US, European and Japanese companies, which are interested in making inroads into the Asian market, will also be attracted to invest in the region since market risk and uncertainty are lowered. The integration of ASEAN with China can entice more foreign corporations, which each market alone cannot otherwise achieve so successfully.

By applying a general computable equilibrium modelling tool known as the Global Trade Analysis Project (GTAP), Chirathivat (2002) came to the assessment that in terms of attracting FDI the impact of tariff and non-tariff liberalization on China is 0.7 per cent and 3.3 per cent respectively. On the other hand, there will be challenges arising from the establishment of an FTA between ASEAN and China. There would be intensifying competition in each region's domestic market given the similarity in industrial structure. A more liberalized environment under the proposed FTA may entail short-run costs in the form of displacement of workers and rationalization of some industries and firms. There would be the need for adjustments to be made by workers and enterprises, particularly the small and medium-sized (SMEs) enterprises. It should also be noted that trade diversion, in terms of a shift from lower-cost non-FTA members to higher-cost FTA members, could occur due to the preferential tariff reduction and elimination among the FTA members. Trade shifting away from producers with natural comparative advantage would incur implicit economic costs. Closely associated with this would be the loss of tariff revenues.

10.5 CONCLUSIONS

In conclusion, from the perspective of China's demand structure, considerable domestic demand and international market opportunities are the forces of China's fast-growing economic development. In terms of regional economic features three big regional economies, especially the Yangzi River Delta, are the engine of China's economic growth, of which Shanghai is the core engine of the Yangzi River Delta development. Based on the major features of the Chinese economy and international economic development experience, we conclude that China will continue with its fast growth in the coming ten to 15 years.

Objectively, in the context of foreign economic trade, China does compete against its neighbouring countries such as ASEAN and Korea in some aspects. Nevertheless, the negative influence of competition would be offset by the benefits that China offers to these nations as their key trading partner.

China's liberalization, as a result of its accession to the WTO and the formation of an ASEAN-China FTA, would provide an important opportunity for expanding current trade and investment activities between the East and South East Asian countries and China.

China will continue to provide East and South East Asian nations with considerable room for furthering their economic development, due to its low labour costs and a sizable domestic market. In the future, China will surely need other East and South Asian nations including the subcontinent, and vice versa.

NOTES

- 1 According to the World Bank, China's average annual growth rate reached 10.3 per cent over the period 1980-90 and ten per cent over the period from 1991-2001. Source: www.worldbank.org/data/wdi2003.
- 2 *Beijing Youth Daily*, December 9, 2002.
- 3 Xiao Geng, "Interaction between global capital flow and Chinese reform", *Finance*, 2003.
- 4 Cheng Yuansheng, "To develop economic potentials", *People's Daily*, 03 July 2000, p. 7.
- 5 Same as note 4.
- 6 Lin Yifu, Remarks on China's opportunities, *International Finance*, 4 March, 2003, p. 2.
- 7 Same as note 3.
- 8 Van Hoa and Harvie (2003).
- 9 "Forging Closer ASEAN-China Economic Relations in the Twenty-First Century", A Report submitted by the ASEAN-China Expert Group on Economic Cooperation, October 2001.

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