# II CHINA'S ECONOMIC RISE: IMPLICATIONS FOR EAST ASIAN GROWTH AND INTEGRATION

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## China in the regional perspective

Since 1979 China's economy has experienced spectacular growth as a result of its successful economic reform and open-door policy. China has also become more closely integrated with its neighbouring economies, including those of ASEAN, with both positive and negative spillover effects on the region in the process. Initially, the more developed Japan and the four East Asian newly industrialized economies (NIEs) of Hong Kong, China; the Republic of Korea; Singapore; and Taiwan Province of China, captured most of the benefits by actively trading with and investing in China. As China continued to press ahead with its export-oriented development strategies, it started to cast a large shadow on the less developed ASEAN economies, many of which were competing head on with China to attract FDI and export manufactured products to the same third-country markets.

***The striking emergence of China as an economic powerhouse and a positive force in regional complementarities …***

The rise of China was at one time considered a disruptive force to the region's economic growth, which lost much of its former dynamism after the 1997 Asian financial crisis. To allay ASEAN's growing apprehension, China took the bold step of arranging an FTA with ASEAN, which would operate to increase mutual trade and investment to the benefit of both sides. Signed in November 2002, this landmark China-ASEAN FTA has since exerted a great deal of pressure on Japan and the Republic of Korea to follow suit by intensifying their economic relations with ASEAN under the general regional cooperation umbrella of "ASEAN + 3" (ASEAN plus China, Japan and the Republic of Korea). With China as a rising regional political and economic power, its FTA initiative with ASEAN has thus sparked a new momentum towards the so-called New Age economic integration in East Asia.

***… is expected to be a further stimulus to development and integration within East Asia in the long run***

Over the longer run, the economic rise of China can be seen not only as a new engine for the region's economic growth, but also as a powerful force for integrating the East Asian economies. In fact, China in recent years has been the main driving force behind East Asia's growing regional trade interdependency, as most East Asian economies have experienced the largest percentage-point increases in their exports to China. It may be said that the rise of Japan provided the engine for the first wave of East Asian growth and integration in the 1960s and the 1970s. The rise of the four NIEs marked the

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second wave to sustain the region's continuing growth and integration in the 1970s-1980s. The rise of China will now constitute the third wave. As China is a vast and diverse economic entity, its participation in the region's growth and development will not only boost the region's overall growth potential, but also profoundly affect the region's patterns of production, trade and investment, and resource flows.

In the 1980s, on account of the dynamic growth of the East Asian economies, it was common for commentators to refer to the rise of the Pacific Century. But the subsequent (relative) economic decline of Japan coupled with the increasing economic and technological predominance of the United States has rendered this notion much less credible. The rise of China, together with Japan's economic recovery, rekindles new hopes of making the twenty-first century the Pacific Century. To realize this, China will have to sustain its economic growth momentum and develop even closer economic symbiosis with its neighbouring economies so that the East Asian region as a whole can benefit from China's economic rise. Continuing economic growth and integration are essentially what all these East Asian economies aim to achieve in the long run.

## The economic rise of China

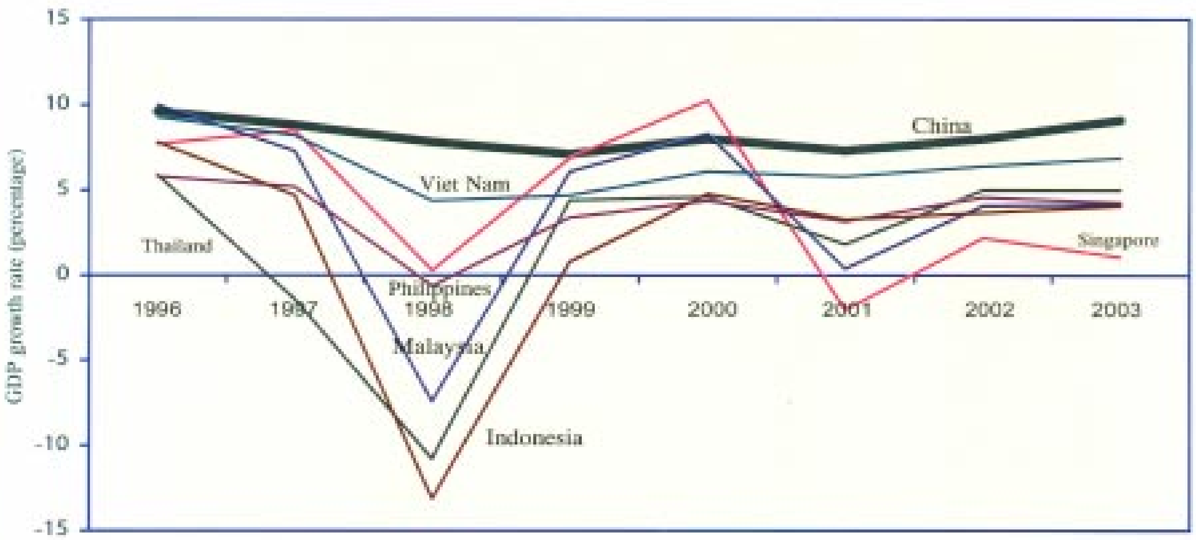
***The record of economic growth in China has been highly impressive***

The Chinese economy grew at a highly impressive rate of 9.4 per cent a year during the period 1978-2003. Whereas the 1997 Asian financial crisis brought down many East Asian economies, China's economy was hardly affected by the crisis as it continued to grow at 8.8 per cent in 1997 and 7.8 per cent in 1998. After the crisis, China's economy was steaming ahead with strong growth and, despite disruptions caused by SARS and global economic recession, it still chalked up a hefty 9.1 per cent growth (figure I). Furthermore, high growth was carried over to 2004, up by a sizzling 9.7 per cent in the first half.[2] In fact, the Chinese Government is currently much concerned over economic overheating, having taken a number of vigorous administrative and macroeconomic control measures to cool down over-heated economic activities in order to achieve a soft landing.

China has been relatively unaffected by external economic shocks, mainly because over 80 per cent of its economic growth is generated by domestic demand (i.e., domestic consumption and domestic investment). At the same time, China's exports (i.e., external demand) have also been growing very rapidly, averaging 16 per cent per annum over the past two decades, rising from US$ 9.8 billion in 1978 to US$ 438 billion in 2003. China is now the world's fourth largest exporter after the United States, the EU and Japan. As regards FDI, China has since the early 1990s become the world's most favoured destination in comparison with all other developing countries. By mid-2004, China had attracted a total of US$ 535 billion in FDI. In fact, China in recent years has consistently captured more than half of all FDI in Asia. Not surprisingly, over 80 per cent of the world's 500

[2] "National economic performance is good in the first half of 2004", National Bureau of Statistics of China, 16 July 2004, <www.stats.gov.cn/english/>.

**Figure I. Crisis and prolonged recovery of selected ASEAN economies, 1996-2003**




*Source:* ADB, *Asian Development Outlook* (2001, 2003).

largest companies have set up businesses in China. Above all, on account of its strong external balance, by mid-2004 China's total foreign exchange reserves had soared to US$ 470 billion to become the world's second largest. This, in turn, has led to mounting international pressures on China to revalue the yuan renminbi.

***China is now the world's sixth largest economy …***

In 2003, China's total GDP reached Y11.7 trillion (US$ 1.24 trillion) – or more than twice the combined GDP of Indonesia, Malaysia, the Philippines, Singapore and Thailand. China's per capita GDP in 2003, at US$ 1,000, is about the same as that of the Philippines but higher than that of Indonesia. In nominal-terms GDP, China is the world's sixth-largest economy. In terms of purchasing power parity (PPP), the Chinese economy today is already the world's second largest after the United States – one needs, of course, to be aware of the problem of overstating China's real GDP by the PPP measure[3] (table 1).

***… with massive demand and output covering a wide range of goods and services***

Indeed, when a huge country like China is industrializing so rapidly, every indicator of its economic activities inevitably turns out to be a jumbo number owing to the combined effect of scale and speed. In 2003, for example, the country produced 222 million tons of steel, 65 million colour TV sets, 50 million air conditioners, 22 million refrigerators, 182 million mobile phones and 32 million PCs.[4] China also became the world's third-largest automobile

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[3] World Bank, *World Development Report 2002* and *2003* (New York, Oxford University Press).

[4] National Bureau of Statistics of China, "Statistical communiqu€ of the People's Republic of China on national economic and social development in 2003", *China Daily*, 27 February 2004.

## Table 1. Performance indicators of China and ASEAN-5

| | Population (millions) | GNP per capita (US dollars) | PPP estimates of GNP per capita (US dollars) | GDP growth (percentage) | | | | | | | | | | Gross domestic investment as a percentage of GDP | Annual export growth (percentage) | Mfg. exports as a percentage of total exports | Exports as a percentage of GDP |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2002 | 2002 | 2001 | Total GDP (billions of US dollars), 2002 | 1960-1970 | 1970-1980 | 1980-1990 | 1990-2001 | 1998 | 1999 | 2001 | 2002 | 2003 | 2001 | 1990-2000 | 2001 | 2001 |
| China | 1 285 | 952 | 3 950 | 1 266 | 5.2 | 5.5 | 10.3 | 10.0 | 7.8 | 7.1 | 7.3 | 8.0 | 9.1 | 39 | 14.5 | 89 | 26 |
| Japan | 127 | 33 550 | 25 550 | 3 973 | 10.9 | 4.3 | 4.1 | 1.3 | -1.1 | 0.8 | 0.4 | -0.3 | 2.1 | 26 | 4.1 | 93 | 10 |
| **NIEs** | | | | | | | | | | | | | | | | | |
| Republic of Korea | 48 | 10 014 | 15 060 | 476 | 8.6 | 10.1 | 8.9 | 5.7 | -6.7 | 10.9 | 3.0 | 6.3 | 2.7 | 27 | 10.1 | 91 | 43 |
| Taiwan Province of China | 23 | 12 900 | n.a. | 282 | 9.2 | 9.7 | 7.9 | 5.7 | 4.6 | 5.4 | -2.2 | 3.6 | 3.2 | 17 | 7.9 | n.a. | 51 |
| Hong Kong, China | 7 | 24 532 | 25 560 | 162 | 10.0 | 9.3 | 6.9 | 3.8 | -5.3 | 3.0 | -0.2 | 2.3 | 3.0 | 27 | 8.3 | 95 | 144 |
| **ASEAN-5** | | | | | | | | | | | | | | | | | |
| Indonesia | 211 | 780 | 2 830 | 173 | 3.9 | 7.2 | 6.1 | 3.8 | -14.2 | 0.8 | 3.3 | 3.7 | 4.1 | 22 | 8.1 | 56 | 41 |
| Malaysia | 25 | 3 609 | 7 910 | 95 | 6.5 | 7.9 | 5.3 | 6.5 | -7.4 | 6.1 | 0.4 | 4.2 | 4.7 | 24 | 12.2 | 80 | 116 |
| Philippines | 82 | 1 034 | 4 070 | 78 | 5.1 | 6.0 | 1.0 | 3.3 | -0.6 | 3.4 | 3.2 | 4.6 | 4.3 | 18 | 18.8 | 91 | 49 |
| Singapore | 4 | 20 613 | 22 850 | 87 | 8.8 | 8.3 | 6.7 | 7.4 | -0.1 | 6.9 | -2.0 | 2.2 | 0.8 | 24 | 9.9 | 85 | 174 |
| Thailand | 63 | 1 960 | 6 230 | 126 | 8.4 | 7.1 | 7.6 | 3.8 | -10.5 | 4.4 | 1.8 | 5.0 | 6.2 | 24 | 10.5 | 74 | 66 |

*Sources:* World Bank, *World Development Report 1995, 2000/2001* and *2002*; and *World Development Indicators 2003*, World Bank web site; Institute of Southeast Asian Studies (ISEAS), *Regional Outlook: Southeast Asia* 2003-04 (Singapore, 2003); Ministry of Economic Affairs, Taiwan Province of China, <www.moea.gov.tw>; Economist Intelligence Unit (EIU) Data Services; *Taiwan Statistical Data Book*, 2002.

*Notes:* (1) 2003 GDP growth figures for China and Singapore are official figures; the rest are real GDP growth estimates from EIU.

(2) 1998-2001 GDP growth rates extracted from ISEAS, *Regional Outlook: Southeast Asia*, 2003-04.

(3) Per capital GNP figure for Taiwan Province of China extracted from *Taiwan Statistical Data Book*, 2001.

(4) 1996-2002 GDP growth rates for Japan represent real GDP growth rates.

(5) Figures for gross domestic investment (percentage of GDP) derived from ADB, *Asian Development Outlook 2003*.

manufacturer, with a total output of 4.4 million units, after the United States and Japan. By 2003, China had surpassed the United States as the world's largest telephone market (263 million fixed lines plus 269 million mobile phones (290 million by mid-2004)). Also, by mid-2004, China's registered Internet users had reached 87 million to form the world's second-largest "web population" after the United States.[5]

Accordingly, the meteoric rise of China's economy has become a "hot" topic in international and regional media.[6] Many economies in East Asia are concerned about the potential displacement effect of China becoming the factory of the world. Others even point the finger at China for their own economic woes, including the accusation that China is exporting deflation to them. Even Japan was worried by China's recent dynamic industrial expansion; Kenichi Ohmae used the sensational title "Asia's next crisis: 'Made in China'" to talk alarmingly about the rise of China.[7] Many small and mid-size American manufacturers see China as "a company killer and a job killer", largely responsible for the disappearance of 2.7 million United States factory jobs since 2001.[8]

***The prospects for a sustained, high trajectory of economic growth in China are promising***

A crucial question can be posed: Is China's dynamic economic growth warranted? Can it be sustained? To begin with, China's high economic growth of the past two decades (as reflected in its official GDP statistics), though very impressive, is actually not exceptional in the historical context of many high-performance East Asian economies. As shown in table 1, Japan had near double-digit rates of growth in the 1950s and 1960s and most of the 1970s. The four NIEs had such high growth for more than three decades, the 1960s through the 1980s, while several ASEAN economies also experienced similar high growth performance in the 1970s through part of the 1990s.

China is a much larger country than its East Asian neighbours. It should therefore have much more internal dynamics to sustain an even longer period of high growth, as China has virtually a whole continent to develop for itself. Of course, it is not possible for any economy to repeat a near double-digit rate of growth year after year without becoming overheated or running into physical and economic bottlenecks. But considering the

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[5] "China now second most wired nation on the globe", *China Daily*, 21 July 2004.

[6] Recently at the World Economic Forum in Davos, "everything is China, China, China" according to one observer ("The talk of the town at Davos: China", *International Herald Tribune*, 26 January 2004). Indeed, China's emergence as the world's manufacturing powerhouse after two decades of dynamic growth has invited prominent worldwide attention. The international media have recently portrayed China's economic resurgence as an economic threat. David Roche, a famous Wall Street economist, commented on China being a source of global recession with its mass production of a wide range of low-priced manufactured products for the world market. In early 2003, Japan's *Nikkei Weekly* reported about China setting the pace in markets for commodities around the world. The Chinese media and academia have since come out to defend China's position.

[7] "Asia's next crisis: 'Made in China'" , *The Straits Times*, Singapore, 3 August 2001.

[8] Charles Stein, "The rise of China Inc.", *Boston Globe*, 19 August 2003.

historical pattern and structural conditions of China's past economic growth, its future growth potential remains highly promising.

It may be remembered that, even before the reform, the Chinese economy was still growing at over 5 per cent a year during 1952-1978, despite its inherent inefficiencies and all the political disruptions. The economic reform introduced by Deng Xiaoping after 1978 set free the latent dynamic economic and social forces to further fuel China's economic growth. Nevertheless, China's growth potential remains dependent on the unfinished business of economic reform, particularly in the financial sector and the State-owned enterprises. It must also come to grips with several urgent problems like uneven development, income disparities and rural poverty (Wong, 2004).

## East Asian growth and interdependence

***Despite intraregional diversity, East Asian growth will also entail greater economic interdependence among economies in East Asia …***

East Asia is commonly defined as comprising Japan, China, the four NIEs and ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand). Historically speaking, the growth and integration process in East Asia is marked by three waves, as noted earlier. As the East Asian economies sustain that growth momentum, they will also increase their economic interaction with each other. Thus, an important feature of these economies is their deepening interdependence. Despite their inherent political, social and economic divergences, these economies can actually integrate quite well as an informal and loosely constituted regional economic grouping. This is essentially the underlying meaning of the "flying geese" principle. To start with, Japan is the natural economic leader of the group and has in fact been the prime source of capital and technology, first for the NIEs and then for China and ASEAN. The resource-based ASEAN-4 complement the manufacturing-based NIEs well, while both are also complement the more developed Japanese economy. The huge potential of China, with its vast resource base and diverse needs, offers additional opportunities for all.

Accordingly, the East Asian region has already developed a fairly high level of intraregional trade. In 2001, despite the economic slowdown, intraregional trade still absorbed 39-54 per cent of the export value of individual economies in East Asia. As to intraregional export dependence over the past two decades, table 2 shows Japan's remarkable shift in export orientation over the years towards a greater focus on East Asia, with its export share to the region increasing from 22 per cent in 1980 to 39 per cent in 2001. The four NIEs have similarly made significant shifts in the same period by reorienting their exports towards the region, mainly as a result of the opening up of China. China, however, has moved in the opposite direction, slightly reducing its export dependence on the region to one which has, in recent years, been geared more to the United States and EU markets. Likewise, ASEAN-4 has also shown a slight reduction in export dependence on the East Asian region from 51 per cent in 1980 to 44 per cent in 2001.

**Table 2. Intraregional trade in East Asia**

| *East Asian economy* | *Year* | *Total exports (million of US dollars* | *Share of total exports destined for (percentage)* | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | *United States* | *EU* | *Japan* | *China* | *Republic of Korea* | *Taiwan Province of China* | *Hong Kong, China* | *Singa-pore* | *ASEAN-4* | *East Asia* |
| Japan | 1980 | 130 441 | 24.5 | 14.6 | | 3.9 | 4.1 | – | 3.7 | 3.0 | 7.0 | 21.7 |
| | 1988 | 264 856 | 34.1 | 19.7 | | 3.6 | 5.8 | 5.4 | 4.4 | 3.1 | 4.9 | 27.2 |
| | 1992 | 339 885 | 28.5 | 19.7 | | 3.5 | 5.2 | 6.2 | 6.1 | 3.8 | 8.1 | 32.9 |
| | 1996 | 410 901 | 27.5 | 14.3 | | 5.3 | 7.1 | 6.3 | 6.2 | 5.1 | 12.4 | 42.4 |
| | 2000 | 479 249 | 30.0 | 16.4 | | 6.3 | 6.5 | 7.5 | 5.7 | 4.3 | 9.5 | 39.8 |
| | 2001 | 403 496 | 30.4 | 16.0 | | 7.7 | 6.3 | 6.0 | 5.8 | 3.6 | 9.3 | 38.7 |
| China | 1980 | 18 099 | 5.4 | 13.7 | 22.3 | | – | – | 24.1 | 2.3 | 4.3 | 53.0 |
| | 1988 | 47 540 | 7.1 | 10.4 | 16.9 | | – | – | 38.4 | 3.1 | 2.8 | 61.2 |
| | 1992 | 80 517 | 10.7 | 10.8 | 13.8 | | 2.9 | 0.8 | 44.2 | 2.5 | 2.8 | 67.0 |
| | 1996 | 151 197 | 17.7 | 13.1 | 20.4 | | 5.0 | 1.9 | 21.8 | 2.5 | 3.4 | 55.0 |
| | 2000 | 249 297 | 20.9 | 15.3 | 16.7 | | 4.5 | 2.0 | 17.9 | 2.3 | 3.7 | 47.1 |
| | 2001 | 266 620 | 20.4 | 15.3 | 11.0 | | 4.7 | 1.9 | 17.5 | 2.2 | 3.8 | 41.1 |
| Republic of Korea | 1980 | 17 505 | 26.4 | 16.3 | 17.4 | – | | – | – | 1.5 | 4.6 | 23.5 |
| | 1988 | 60 696 | 35.4 | 14.7 | 19.8 | – | | 1.6 | 5.9 | 2.2 | 2.8 | 32.3 |
| | 1992 | 76 632 | 23.7 | 12.8 | 15.1 | 3.5 | | 3.0 | 7.7 | 4.2 | 7.0 | 40.5 |
| | 1996 | 129 715 | 16.9 | 11.4 | 12.2 | 8.8 | | 3.1 | 8.6 | 5.0 | 9.3 | 47.0 |
| | 2000 | 172 268 | 21.9 | 13.6 | 11.9 | 10.7 | | 2.0 | 6.2 | 3.3 | 7.2 | 41.3 |
| | 2001 | 150 439 | 20.8 | 13.1 | 11.0 | 12.1 | | 3.9 | 6.3 | 2.7 | 6.8 | 42.8 |
| Taiwan Province of China | 1980 | – | – | – | – | – | – | | – | – | – | – |
| | 1988 | 60 667 | – | – | – | 3.7 | – | | – | – | – | – |
| | 1992 | 81 470 | 28.9 | 17.7 | 10.9 | 12.9 | 1.4 | | 18.9 | 3.1 | 6.9 | 41.2 |
| | 1996 | 115 942 | 23.2 | 13.6 | 11.8 | 17.9 | 2.3 | | 23.1 | 4.0 | 8.3 | 50.1 |
| | 2000 | 148 321 | 23.5 | 14.8 | 11.2 | 16.9 | 2.6 | | 21.1 | 3.7 | 7.4 | 48.8 |
| | 2001 | 122 866 | 22.5 | 14.8 | 10.4 | 17.9 | 2.7 | | 21.9 | 3.3 | 7.2 | 49.4 |
| Hong Kong, China | 1980 | 19 730 | 26.1 | 24.5 | 4.6 | 6.3 | 1.2 | – | | 4.4 | 6.8 | 23.3 |
| | 1988 | 63 163 | 24.8 | 16.9 | 5.9 | 27.0 | 2.6 | 3.6 | | 2.8 | 3.2 | 41.9 |
| | 1992 | 119 512 | 23.1 | 17.1 | 5.2 | 29.6 | 1.6 | 3.5 | | 2.6 | 3.1 | 45.6 |
| | 1996 | 180 750 | 21.2 | 12.7 | 6.5 | 34.3 | 1.6 | 2.4 | | 2.7 | 3.7 | 51.2 |
| | 2000 | 201 860 | 23.3 | 15.3 | 5.5 | 34.6 | 1.9 | 2.5 | | 2.3 | 3.3 | 50.1 |
| | 2001 | 189 894 | 22.3 | 14.5 | 5.9 | 36.9 | 1.8 | 2.4 | | 2.0 | 3.3 | 52.3 |
| Singapore | 1980 | 19 375 | 12.5 | 12.5 | 8.1 | 1.6 | 1.5 | – | 7.7 | | 20.8 | 39.7 |
| | 1988 | 39 306 | 23.6 | 13.5 | 8.6 | 3.0 | 2.0 | 2.8 | 6.2 | | 20.3 | 42.9 |
| | 1992 | 63 483 | 16.6 | 11.9 | 4.4 | 1.8 | 2.6 | 2.4 | 7.2 | | 14.3 | 32.7 |
| | 1996 | 125 014 | 18.4 | 12.7 | 8.2 | 2.7 | 3.8 | 3.9 | 8.2 | | 25.5 | 52.3 |
| | 2000 | 137 804 | 17.3 | 13.2 | 7.5 | 3.9 | 3.6 | 6.0 | 7.9 | | 24.9 | 53.8 |
| | 2001 | 121 751 | 15.4 | 13.4 | 7.7 | 4.4 | 3.9 | 5.1 | 8.9 | | 24.2 | 54.2 |
| ASEAN-4 | 1980 | 47 100 | 18.8 | 13.8 | 34.5 | 1.1 | 1.7 | – | 1.9 | 11.8 | | 51.0 |
| | 1988 | 80 080 | 16.4 | 12.6 | 19.5 | 2.2 | 2.8 | 2.0 | 2.9 | 9.0 | | 38.4 |
| | 1992 | 112 788 | 21.0 | 17.6 | 21.9 | 2.6 | 2.9 | 3.1 | 3.9 | 13.6 | | 48.0 |
| | 1996 | 204 270 | 18.6 | 13.7 | 17.8 | 3.3 | 3.5 | 3.4 | 5.1 | 14.0 | | 47.1 |
| | 2000 | 269 099 | 20.4 | 14.8 | 16.0 | 3.4 | 3.7 | 4.2 | 4.2 | 12.5 | | 44.0 |
| | 2001 | 250 656 | 20.0 | 14.7 | 16.1 | 4.4 | 3.7 | 3.8 | 4.1 | 11.8 | | 43.9 |

*Source:* IMF, *Direction of Trade Statistics Yearbook* (1987, 1993 and 2002 issues).

*Note:* Taiwan's indirect trade with mainland China is calculated from data available at < www.seftb.org > .

***… with trade-driven FDI being a powerful catalyst for integration***

Intraregional FDI flows have also operated as a powerful integrating force in East Asia, especially since a great deal of regional FDI is trade-related in nature. With its essentially open and outward-looking economies, the region is highly dependent on foreign trade and foreign investment for its economic growth. Both China and ASEAN have devised various incentive schemes to vie for FDI, which is generally treated not just as an additional source of capital supply but, more important, as a means of technology transfer and export market development. In particular, China in recent years has become the most favoured destination of all developing economies for FDI. By 2001, the East Asian share of FDI in China had declined to 57 per cent, down from 88 per cent in 1992. Suffice it to say that the rise of China has completely altered the FDI landscape of East Asia.

It is thus clear that China's economic growth fits in quite well with the overall development patterns in East Asia. China has been able to harness the region's vast trade and investment opportunities to facilitate its own economic growth. At the same time, China's economic growth and increasing integration with the region provide new opportunities to enhance the region's overall growth potential and new impetus for regionalism.

***The emergence of China will have both positive and negative spillover effects on other regional economies***

However, the actual impact of the fast-growing Chinese economy on East Asia is quite uneven. By and large, Japan and the four NIEs have been able to benefit from China's open-door policy by exporting more high-tech products and by investing in China. Indeed, in the past two decades, Japan's share of exports to China almost doubled from 3.9 per cent in 1980 to 7.7 per cent in 2001. The relative share of the four NIEs also exhibited a similar upward trend, which was outstandingly steep in the case of Hong Kong, China: 6 per cent in 1980 and 37 per cent in 2001. In time to come, these five economies, which are inherently complementary with China, are set to be even more closely integrated with China.

Table 3, using a "trade intensity index" to measure the actual strength of the trading relationship between two countries relative to all their respective trading partners, brings out a clearer picture of East Asian intraregional trade than that indicated by simple trade share analysis. An index higher than "one" means that countries are trading with each other above the "normal" level. Thus, for the period 1998-2000, Japan's trade with ASEAN was more intensive than with China, while Japan was trading more intensively with China than with the United States. The Republic of Korea and Hong Kong, China, have a very intense trade relationship with China, more than with ASEAN. The ASEAN countries, however, are trading far more intensively with each other than with China, even though Indonesia, Singapore and Thailand are still trading with China above their "normal" levels. In short, China has become a strong trading partner with Japan and the Asian NIEs.

***Pressures on China's economic relations with ASEAN***

However, the economies of China and ASEAN (minus Singapore) at their present stages of development tend to be more competitive than complementary with each other. In many ways, China's dynamic economic growth has exerted strong competitive pressures on the ASEAN economies,

**Table 3. Intraregional trade intensity index for East Asia, 1998-2000**

| | *Japan* | *China* | *Republic of Korea* | *Taiwan Province of China* | *Hong Kong, China* | *Singapore* | *Indonesia* | *Malaysia* | *Philippines* | *Thailand* | *ASEAN* | *United States* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Japan | - | 1.8 | 2.5 | 3.5 | 1.6 | 2.0 | 2.3 | 2.2 | 3.6 | 3.0 | 2.3 | 1.6 |
| China | 2.8 | - | 1.7 | 0.8 | 6.2 | 1.1 | 1.5 | 0.7 | 1.1 | 0.7 | 1.0 | 1.3 |
| Republic of Korea | 1.9 | 3.2 | - | 2.3 | 1.9 | 1.5 | 3.2 | 2.1 | 3.9 | 1.3 | 2.3 | 1.1 |
| Taiwan Province of China | 1.8 | - | 1.0 | - | 6.6 | 1.7 | 2.0 | 1.9 | 3.6 | 2.0 | 2.1 | 1.4 |
| Hong Kong, China | 1.0 | 11.1 | 0.7 | 1.0 | - | 1.2 | 0.8 | 0.7 | 1.8 | 1.0 | 1.1 | 1.2 |
| Singapore | 1.3 | 1.2 | 1.5 | 2.1 | 1.8 | - | 4.3 | 14.0 | 4.4 | 4.8 | 8.1 | 1.0 |
| Indonesia | 3.8 | 1.6 | 3.0 | 2.0 | 0.9 | 5.7 | - | 2.5 | 2.4 | 2.0 | 3.7 | 0.8 |
| Malaysia | 2.1 | 0.9 | 1.4 | 2.3 | 1.4 | 8.9 | 2.9 | - | 2.9 | 3.7 | 5.9 | 1.2 |
| Philippines | 2.6 | 0.5 | 1.3 | 4.0 | 1.5 | 3.6 | 0.7 | 3.5 | - | 2.8 | 2.9 | 1.8 |
| Thailand | 2.7 | 1.2 | 0.8 | 1.9 | 1.6 | 4.6 | 3.7 | 3.2 | 2.9 | - | 4.1 | 1.2 |

*Source:* Computed from data in IMF, *Direction of Trade Statistics* (various issues).

*Note:* The trade intensity index is defined as:

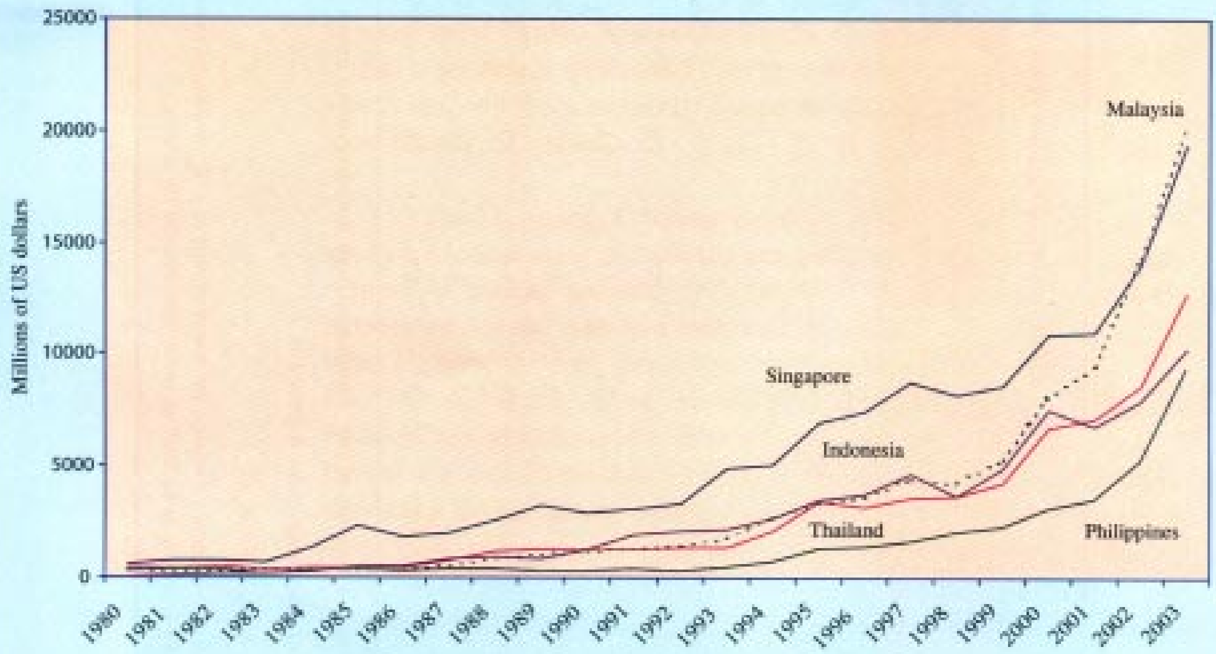
$$T_{ij} = [x_{ij}/X_{it}] / [X_{wj}/X_{wt}]$$

where $x_{ij}$ and $X_{wj}$ are the values of i's exports and world exports to j, $X_{it}$ is i's total exports and $X_{wt}$ is total world exports. As such, the index reflects the ratio of the share of country i's exports going to country j, relative to the share of world trade destined for country j.

which are vying for FDI with China as well as competing head on with China's manufactured exports in developed country markets.[9] The structure and pattern of China's economic relations with ASEAN have been shaped by many complicated factors. Traditionally, China's relations with "South-East Asia", referred to as "Nanyang" (or literally "south sea") by the Chinese, have been extensive and deep-rooted on account of history, geography and migration. After the Communist revolution in 1949, their relations assumed new dimensions, with complex ideological and political elements coming into play, and this gave rise to a period of "Cold War relations". With the advent of d€tente in the early 1970s, individual South-East Asian States started to normalize their relations with China (Wong, 1984).

Initially, China's success in economic reform and development had produced very little impact on the ASEAN countries to its south. China-ASEAN trade was very small – in fact, only a small fraction of each other's total trade and with a large part being centred in Singapore (figure II). Even by the early 1990s, when massive FDI began to flow into China, there was no evidence that China had been the recipient of much capital from the ethnic Chinese in South-East Asia (Wong, 1998). However, it was a different scenario towards the end of the 1990s. While many ASEAN countries were plagued by persistent economic crises and domestic political instability, China

**Figure II. China's trade with ASEAN-5, 1980-2003**




*Sources:* United Nations, *Statistical Yearbook for Asia and the Pacific*, 1991 and 2000; *China Statistical Yearbook* (various issues).

[9] For a further discussion of this topic, see Prakash Loungani (2000).

has been intent on its single-minded pursuit of economic modernization. This has resulted in the further narrowing of development gaps between ASEAN and China. In fact, ASEAN risks being left behind by China's relentless economic growth. Not surprisingly, many ASEAN economies are watching the recent economic rise of China with apprehension.

## New impetus for East Asian economic integration

***China's bold FTA initiative with ASEAN***

Mindful of ASEAN's worries over the possible disruptive effects of its rapid economic growth, China in recent years has been under mounting pressures to dispel the fears of a new "China threat" by improving its overall relations with its ASEAN neighbours. During the 1997 Asian financial crisis, China's determined efforts to maintain the exchange value of its currency were much appreciated by ASEAN as a devaluation would have aggravated the region's economic crisis. But the single most important step undertaken by China in recent years to upgrade its long-term political and economic relations with the ASEAN region is the bold FTA scheme.

At the ASEAN-China Summit in November 2001, former Chinese Premier Zhu Rongji proposed the establishment of a free trade area between China and ASEAN within 10 years. On 4 November 2002, China and ASEAN formally signed a landmark framework agreement in Cambodia to establish an FTA by 2010.[10] The China-ASEAN FTA covers an economic region of 1.7 billion consumers with a combined GDP of US$ 2 trillion. It offers an effective means for smaller ASEAN economies to overcome the disadvantage of smallness by pooling resources and combining markets. This will in time lead to greater economic integration between China and ASEAN, clearly a win-win situation for both sides. The perceived economic threat of China will then become an opportunity for ASEAN (Wattanapruttipaisan, 2003; and Wong and Chan, 2003a).

***Uneven distribution of short-run costs and benefits but significant mutual gains in the long run***

In the short run, however, ASEAN has to deal with the initial risks of a potential trade diversion effect and related structural adjustments. In general, the FTA scheme will give rise to an uneven distribution of costs and benefits between different industries, different sectors and even different ASEAN countries. After the initial process of adjustment, individual ASEAN economies will then develop their own niches in their economic relations with China. In particular, apart from its primary commodities, ASEAN's resource-based products will be in great demand in China. Beyond merchandise trade, FTA also promotes trade in services, including tourism. China may generally have a strong comparative advantage in manufacturing because it enjoys economies of scale which, however, may not apply to many service activities. In fact, many of China's service activities, on account of their socialist legacies, are known to be more backward than those in ASEAN.

[10] The framework agreement signed by the 11 States sets out a road map for trade liberalization in goods and services for most countries by 2010 and for the less developed ASEAN nations (namely, Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam) by 2015.

In recent years, many economies in East Asia have started to experience the positive spillovers of China's economic growth. Apart from the surge in Chinese tourists to other Asian countries, imports by China from other East Asian economies plus India and Australia for the past two years exceeded its exports to those economies, thereby resulting in trade deficits with them, which were offset by China's trade surplus with the United States and the EU. In the past two years, for example, China had been a major source of export growth for many economies in East Asia, among other regions.

Over the years as the FTA scheme is gradually phased in, multinationals in the region will gradually restructure their supply chains and rationalize their production networks by taking China and ASEAN together as a single market. This will eventually lead to a reshuffle of regional production networks and hence a redistribution of regional FDI flows. The new regional production patterns will be based on a larger and more diverse market. In short, both trade and FDI in the region should continue to grow under the impact of the ASEAN-China FTA. And this will certainly be a boon to both ASEAN and China.

***China is also a catalyst for greater integration between North-East and South-East Asian economies***

In addition to creating a new source of economic growth for the region, China is also seen as a new force for revitalizing the region's economic integration process. China's FTA with ASEAN has exerted a tremendous pressure on Japan and the Republic of Korea to follow suit, prompting similar responses from them. Indeed, in the wake of the China-ASEAN FTA, Japan had to take action by signing a framework for a comprehensive economic partnership with ASEAN, which is not an FTA but which can comprise Japan's bilateral FTA arrangements with individual ASEAN member countries.

In June 2003, China signed the Closer Economic Partnership Arrangement with Hong Kong, China (and subsequently with Macau) (Wong and Chan, 2003b). Prior to this, China had agreed to initiate a joint study with Japan and the Republic of Korea on possible North-East Asian economic cooperation. At the Ninth ASEAN Summit in Bali in October 2003, China, Japan and the Republic of Korea signed the Joint Declaration on the Promotion of Tripartite Cooperation among these three North-East Asian countries. This tripartite cooperation is also aimed at strengthening the process of ASEAN economic integration with East Asian economies, i.e., a more concrete way of accelerating the realization of greater East Asian economic integration through the ASEAN + 3 process.

Of equal importance, at the same Summit, China also signed the Treaty of Amity and Cooperation (TAC) with ASEAN in order to express China's goal of establishing a strategic partnership with ASEAN for "peace and prosperity". China is the first country to accede to ASEAN's TAC, which is a distinctive regional code of conduct governing State-to-State relations within ASEAN. The most important principle in TAC requires all parties involved to renounce the use of force in the settlement of any dispute. In concluding this historic treaty, China has signalled to ASEAN its acceptance of ASEAN's norms and values and its willingness to play by the rules. Since India also followed China by concluding a similar TAC with ASEAN, Japan was once again under tremendous pressure to follow.

Viewed in a larger context, China's FTA initiative with ASEAN not only marks the most important first step in the "ASEAN + 3" scheme. It also plays a crucial catalytic role in galvanizing what may be called the New Age economic integration process for the East Asian region as a whole. As long as China's economy sustains its dynamic growth, its regional integration initiatives will carry weight and keep the momentum going. In short, the spate of new cooperation initiatives in recent years has shown that such an economic integration scheme for East Asia is no longer an abstract notion, but something that is achievable once major players like China and Japan are serious about it.

***Some broad geopolitical implications in the region***

As a rising regional political and economic power, China is destined to play a more important role in the growth and development of the ASEAN region. However, there is still a great deal of uncertainty as to how China will play out its geopolitical role in the region. Additionally, what kind of new security architecture will the region eventually develop? Moreover, will China push for a greater leadership role in the region in order to counter Western (American) influence?

It is commonly assumed that, as China grows stronger economically, it will also become politically more assertive in its dealings with neighbouring countries. However, if China were able to manage its rise as a gradual process of its "peaceful ascendancy" (*heping jueqi*), the total spillover effect on the region would be much less disruptive.[11] On balance, ASEAN should have no problem adjusting to the rise of China, particularly when China's economy is operating as another engine of economic growth and a means for closer East Asian integration. China, for its part, is likely to continue its warm relations with ASEAN so long as the latter subscribes to China's core principles, like the One-China principle.

[11] Yoichi Funabashi, "China is preparing a 'peaceful ascendancy'", *International Herald Tribune*, 30 December 2003. See also Bruce Klingner, "'Peaceful rising' seeks to allay 'China threat'" (www.atimes.com).

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