

ASEAN-CHINA ECONOMIC RELATIONS INTO THE 21ST CENTURY

Maria Socorro Gochoco-Bautista*

In recent years, the Chinese economy has grown dramatically largely as a result of China's commitment to open up its economy to the rest of the world and adopt more market-oriented policies. How ASEAN-China economic relations develop depends on many factors including the ability of either or both to attract FDI which will induce the correct path of industrial restructuring. There is reason to believe that as both ASEAN and China move on to higher tiers of manufacturing, there will be enough room for complementarity in their economic relationship via greater intra-industry trade, greater FDI to each other, and spillover effects arising from the actions of third parties.

Introduction

There is no question that China has experienced tremendous economic gains since the onset of economic reforms in 1979. These reforms sanctioned the greater reliance on market institutions in the overall economic system and committed China to a greater openness to the outside world. The results of these have been dramatic: China is today the eleventh largest exporter in the world and it is the single largest destination of foreign direct investment (FDI). While China's internal policies have had much to do with the economic success which has come its way, external factors such as the globalization of production have likewise contributed significantly to China's growth.

* Professor of Economics, University of the Philippines, and Research Fellow, Institute for Strategic and Development Studies.

China is an important economic actor in the Asia-Pacific (AP) region, the fastest-growing region in the world. Despite this, however, China's current economic relationship with ASEAN as a group has not been quite as impressive.

This study examines the China-ASEAN economic relationship in light of external factors and internal events and policies in China, possible points of competition and/or complementarity between ASEAN and China, and the potential for more meaningful economic interaction between ASEAN and China.

China's Recent Economic Experience

After completing an austerity program and entering the rapid growth phase of economic reforms in 1991, China recorded a real GDP growth rate of 13 percent in 1992, a low rate of inflation, and a current account surplus equivalent to 1.9 percent of GDP (Harold and Lall, 1993, p.xi). It was able to attract US\$58B of FDI, although it was only able to utilize US\$11B of it, at a time when the world economy's performance was unimpressive. GDP growth continued into 1993, with GDP growing at 14 percent. This was helped by a relatively loose monetary policy in which the money supply grew by over 30 percent in 1992 and 1993. Then the Chinese economy began to overheat. Given the high growth in GDP, import demand likewise increased by about 25 percent. Export growth fell to less than 5 percent as output was diverted from world markets to the domestic market. The domestic currency depreciated.

The sequence of events described above points to the importance of internal policies in determining a country's economic fate. It also emphasizes the fact that despite the speed with which economic reforms are being implemented in China, a deepening and widening of the reforms is necessary, as is a certain amount of macroeconomic management ability on the part of policymakers, in order to sustain growth. Trade policy, for example, has a very important role to play. A greater degree of liberalization

would allow importation to alleviate supply constraints and inflationary pressure. Importation would also lead to a decline in foreign exchange reserves and reduce money supply growth and inflation. Excess domestic demand can be met in part also by selling goods in the domestic market rather than the world market. In other words, policies in one area have effects on other macroeconomic variables.

China's Trade Relations with the Asia-Pacific Region

China's growth has been facilitated greatly by, and has simultaneously led to, growing trade and investment relationships with countries in the Asia-Pacific (AP) region. China is a dominant actor in the Asia-Pacific region's trade. The AP region absorbed 68 percent of China's total exports in 1991, an amount greater than the corresponding share of the NIEs, ASEAN, or Japan (Wong, 1995, p. 270). Between 1978 and 1992, China's exports to the AP region relative to its total exports grew from 49 percent in 1978 to 65 percent in 1992 while its imports from the AP region relative to its total imports grew from 32 percent in 1978 to 51 percent in 1992 (Wong, 1995, p. 270). Hence, relative to other regions, the AP region is the most important export destination and import source for China.

Looking more closely at the AP region, it is China's trade with the NIEs, particularly Hong Kong, that accounts for much of its trade. Of the 68 percent of China's exports to the AP region in 1991, for example, 50.4 percent went to the NIEs, making the latter the largest bilateral group recipient of China's exports. The reason for this is apparently because not only are the NIEs geographically close to China, their economies are also highly complementary to that of China. By comparison only 14.3 percent, 9.5 percent and 9.4 percent of China's total exports went to Japan, the EC, and the US, respectively, in 1991 (Wong, 1995, p. 272). Of the NIEs, Hong Kong is the most important conduit of trade for China. It has been

pointed out that Hong Kong, unlike the other NIEs, is largely a service economy as the demand for the service sector increased with the opening up of China. Meanwhile, much of Hong Kong's manufacturing is located in mainland China.

ASEAN-China Trade Relations

ASEAN as a whole and China are similar in economic strength. In 1990, the GDP of ASEAN collectively stood at US\$290.6B while China's stood at US\$338.8B. ASEAN is the fourth largest trading partner of China in the AP region, after Hong Kong, Japan, and the US (Zhang and Feng, 1994, p. 65).

Nevertheless, the share of bilateral trade between ASEAN and China is still low and slow-growing. Since 1978, only about 5-6 percent of China's exports have been destined for ASEAN, while a more open China bought slightly more of its exports from ASEAN, rising from 4.7 percent in 1978 to 6.1 percent in 1991 (Wong, 1995, p. 270).

Trade between ASEAN and China has traditionally been dominated by trade in primary commodities. (Wong, 1995, p. 275). This is largely because most ASEAN countries are rich in natural resources whereas China is not as rich in natural resources on a per capita basis, and hence, some complementarity is thought to exist between the Chinese and ASEAN economies. Indonesia exports mostly crude oil and plywood to China, Malaysia exports mostly timber, palm oil, and crude petroleum, Thailand exports mostly rubber, sugar, and man-made fibers, while the Philippines exports sugar. China exports oil seed and cotton to Indonesia, rice and oil seed to Malaysia, and crude oil to Singapore. The prospects for greater horizontal integration between China and ASEAN depend to a large extent on how fast China industrializes, which would generate a greater demand for ASEAN exports, including primary products.

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In terms of export markets, both China and ASEAN depend heavily on the industrialized countries of the West and Japan. Even though it appears that China sells a small share of its exports to the West, in reality most of its exports end up in the West via Hong Kong.

Foreign Direct Investment in China

From 1986 onwards, developing countries in Asia received more than half of all FDI flows to developing countries. Many attribute this to the large wave of Japanese investment that occurred after the Plaza Accord in 1985, in which the yen appreciated, causing many Japanese industries to look for cheaper production sites abroad. By this time, many developing countries, including those in the AP region, had already begun courting FDI and opening up their economies as part of the necessary adjustments to be undertaken after the second oil shock in the early 1980s. By 1989, FDI in Asia amounted to US\$16.5B, of which 50 percent went to the NIEs, 26 percent went to ASEAN, and 19 percent to China (Blomquist, 1995, p. 281).

Today, China is the world's favorite destination of foreign direct investment. By 1993, total foreign investments amounted to US\$110B, of which about US\$25.8B had been utilized (Wong, 1995, p. 269). There is no doubt that this has come about largely as a consequence of its decision to open itself up to the world. China established special economic zones, open cities, and economic and technological development zones to encourage the inflow of FDI. In addition, the greatly improved political relations between Southeast Asia and China have encouraged investment, particularly by overseas Chinese, via Hong Kong.

Trade and investment are closely linked. Not surprisingly, the NIEs, China's most important bilateral group trade partner, is also its largest source of FDI. About 90 percent of foreign investment in China comes from the AP region, especially from the NIEs like Hong Kong and Taiwan, as

well as Japan. In contrast, ASEAN's most important trading partners are the developed countries, and these countries are likewise their most important sources of inward FDI. The same is true of the NIEs, with the exception of Hong Kong. Given Hong Kong's economic role vis-a-vis China, Hong Kong and China share a similar feature in that most of their inward FDI come from other developing countries. As far as sources of inward FDI are concerned, for the moment at least, while China and ASEAN may be in competition for greater FDI, they each source from different types of countries.

The reason given for the difference in preferred investment sites between developed countries and developing countries is the difference in demands on the skills of the labor force. Developed countries prefer to invest in the NIEs where highly-skilled labor and high quality infrastructure are available. In contrast, developing countries and the NIEs may have less of a demand for highly-skilled labor and thus invest in other developing countries.

ASEAN and China, as shown earlier, are not significant bilateral trading partners at the moment. Hence, it is not surprising that they are likewise not significant bilateral sources of FDI. About 67 percent of China's outward investment went to developed countries in 1989 (Blomquist, 1995, pp. 290-291). In the same year, Hong Kong received 16 percent of China's outward FDI. Of the ASEAN countries, the Philippines received the largest amount of FDI from China in 1989, valued at US\$67M, compared with the next largest recipient of Chinese FDI in ASEAN, Malaysia, with US\$10M.

ASEAN, in general, is not a significant source of outward FDI. Even intra-ASEAN investment is not large. Keeping in mind that the Philippines received the largest amount of FDI from China among the ASEAN countries in 1989, it is curious to note that Philippine investment to Taiwan is one of a few cases of major concentrations

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of ASEAN capital (the other being Thai investment in Hong Kong). There are some who suspect that some of this investment to Taiwan makes it way to China.

In terms of the sectoral distribution of output, ASEAN and China display different patterns. ASEAN has a strong emphasis on the service sector, such as hotel services and banking, while China's is more evenly distributed among manufacturing, agriculture, and services. The relevance of this fact to China is that China's industrial restructuring plan aims for a balanced industrial development and the technical upgrading of backward industries (such as machinery, electronics, and other export-oriented industries) (Tan and Zhou, 1994). Understanding that foreign capital infusions generate industrial restructuring in recipient countries, it is feared that too many investments in the service sector will not enhance balanced industrial growth, improve the quality and extent of industrial upgrading, nor introduce new technology. In this sense, at the moment at least, ASEAN's emphasis on the service sector may not be complementary to China's needs.

ASEAN and China: Competition vs. Complementarity

Several trends in the world economy have had profound implications for the extent of economic relations among countries and the growth prospects of individual countries. Among these, the increasing globalization of production and investment networks facilitating trade, technology transfer, and industrial restructuring has probably been the most important one. Other trends include the emergence of regional economic groupings, the rising importance of trade in services, the decreasing importance of labor costs in the determination of an industry's degree of competitiveness, and the diminishing commodity intensity of manufacturing output (Tan, 1994, pp. 1-2).

Both China and the individual ASEAN countries have certainly been affected by these trends. China's opening up and the subsequent explosion of its exports and massive

infusions of foreign investment into China have made China more integrated with the world economy and led to important industrial restructuring. China's exports of miscellaneous manufactures and basic manufactures have grown tremendously and were its two largest groups of exports by industry classification, amounting to US\$38.9B in 1992 and US\$16.3B in 1993, respectively (ADB, 1995).

Individual ASEAN countries started to pursue export-oriented industrialization strategies in place of inward-looking import-substitution policies sometime ago. Some of them are now poised to join the ranks of the NIEs. As with China, manufactured exports are the most important exports of ASEAN to the developed countries. Of total ASEAN exports to the US in 1989, 80 percent were manufactured exports, compared to a mere 12 percent in 1970 (Ariff, 1994, p. 20). The pattern of comparative advantage has been shifting over the years, reflected in the types of manufactured goods exported by ASEAN. While machinery, wearing apparel, and chemicals constitute about two-thirds of ASEAN's manufactured exports, machinery exports, particularly electrical/electronic items have risen dramatically.

The fact that manufactured exports to the developed countries are the most important exports of both China and ASEAN has led some to conclude that it is in this area that potentially intense competition between ASEAN and China exists. However, several factors have to be considered. (Ariff, 1994, p. 34). First, while China enjoys relatively lower labor costs compared with ASEAN, in general, its labor force is less skilled than that in ASEAN. This of course has implications on the types of manufactured goods that can be produced (basic and miscellaneous manufactures in the case of China, as seen earlier). Second, technological innovations which give rise to productivity increases serve to counteract the relatively higher labor costs in ASEAN. Third, the non-wage component of manufacturing such as infrastructure, international exposure, managerial ability etc. have become more important relative to labor costs. In this regard, ASEAN is currently ahead of China.

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On the other hand, China could enhance its economic network with Hong Kong and Taiwan, or its Taiwan/Fuchou/Hong Kong/Kuangchou connections and more than overcome its weakness in terms of international exposure etc. (Ariff, 1994, p. 34).

How the economic relationship between ASEAN and China evolves depends on many factors. While ASEAN is poised to move on to higher tiers of manufacturing activity, this will depend on its ability to attract FDI into these areas, its ability to absorb technological capacity, and its ability to upgrade its technological capabilities. Since FDI induces industrial restructuring, these factors are not mutually exclusive. Rather, they are mutually reinforcing. While at the moment, China's role in the global production network seems to be to provide low-skilled labor for labor-intensive manufacturing, this will change as product cycles change, as FDI is attracted into higher tiers of manufacturing, necessitating a more skilled labor force and transfer of technology.

Internal policies are important also. Some have said that because of the opening up of the coastal areas of China where the special economic zones are located, these areas may develop stronger economic ties with ASEAN than with its own hinterland (Ariff, 1994, p. 35). China has to reexamine its investment policies to ensure that a more balanced regional industrial growth is achieved and in areas that will allow it to participate in higher-tiered manufacturing processes.

A more complementary economic relationship between ASEAN and China is possible. There can be greater intra-industry trade as both ASEAN and China move up the manufacturing ladder. Even if they compete in finished manufactured goods in third markets, it is possible for them to trade with each other in intermediate products within the same industry classification. While ASEAN investments in China are currently small, they are growing, and this will lead to a greater degree of production complementarity. Even if either ASEAN or China does not intend to do

this, the actions of a third party could induce this to happen. For example, if Japan invests more in either ASEAN or China, there is likely to be a spillover effect which will lead to greater economic ties between ASEAN and China. Hence, even if China, for example, is able to attract a large amount of FDI from elsewhere, it is highly unlikely that other countries will not benefit from this as well. Consider the simple fact that with more resources at its disposal, China can buy more goods from other countries as well as invest in other countries, including those in ASEAN.

China, like the individual ASEAN countries, is a member of APEC and is attempting to regain its membership in GATT-WTO. These facts are likely to reinforce the commitment of China to a more open and market-oriented economic system. It also gives China a means of participating in discussions which will shape policies regarding its important economic relations with other countries and its ability to more fully integrate itself into the world economic system.

Summary and Conclusions

The Chinese economy has grown dramatically largely as a result of China's commitment to open up its economy to the rest of the world and adopt more market-oriented economic policies. It has been able to take advantage of the globalization of the production process, becoming the world's eleventh largest exporting country and the largest destination of FDI. It has become more economically integrated with the Asia-Pacific region, the largest market for its exports and source of its imports, as well as source of FDI. Within the Asia-Pacific region, it is the NIEs with which China has become most economically integrated with.

At the present time, ASEAN-China trade is still insignificant and slow-growing. Neither is a significant source nor destination of FDI for the other. Both ASEAN and China export large amounts of manufactured goods to

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the developed countries and some see a potential area for intense competition in manufactured goods developing between ASEAN and China. Both of them also compete for FDI, although at present, China sources more of its FDI from the NIEs and other developing countries, while ASEAN receives much of its FDI from developed countries. The difference may be attributable to the relatively lower skilled labor force in China which may be more complementary to the production needs of developing countries in the same way that the more skilled labor force in the NIEs complements the production needs of developed countries.

How ASEAN-China economic relations develop depends on many factors. The ability of either or both of them to attract FDI which will induce the correct path of industrial restructuring seems paramount. This will likewise largely dictate the role each will play in global production and trade and the degree to which both ASEAN and China become more integrated into the global economic network. Internal policies, such as those having to do with FDI and general macroeconomic stability, and their interplay with external factors or trends are very important. There is reason to believe that as both ASEAN and China move into higher tiers of manufacturing, perhaps at different speeds, there will be enough room for complementarity in their economic relationship via greater intra-industry trade, greater FDI to each other, and spillover effects arising from the actions of third parties.

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