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China in Asia Seminar Series

National Defense University— INSS

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Seminar 5: "China and the New Economic Geography of Asia"
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SUMMARY
Mr. Daniel Rosen (Institute for International Economics & China Strategic Advisory)

Mr. Rosen's presentation described the changing face of economic relationships in Asia and between Asia and the rest of the world since 1993, with particular focus on China's role. Using statistics from the UN Comtrade database and other sources, Mr. Rosen highlighted the broad trends in trade and investment flows in the region. He specifically addressed the geographic composition of Asian trade, especially trade in agricultural products, petroleum, electronic goods, and textiles and clothing, as well as foreign direct investment and official development assistance. Based on the data, Mr. Rosen provided some observations and implications for Asia and the United States. "Asia" in this context refers to the countries comprising the Association for South East Asian Nations (ASEAN), Japan, South Korea, Hong Kong, Taiwan and China.

China's overall trade with the world is relatively balanced. However, China's share of Asian trade with the rest of the world has been growing rapidly, while other Asian countries' share of trade with the rest of the world has declined or remained stable. ASEAN's share, which increased prior to the Asian financial crisis, has shrunk back to its pre-crisis level of around 20%. South Korean trade has stayed relatively stable and Hong Kong's share has declined, though much of China's trade goes through Hong Kong. For Taiwan, the importance of trade with China has grown dramatically since the early 1990s, but because of Chinese diplomatic pressure, Taiwan has been locked out of bilateral and regional trade agreements in Asia.

China's importance as a trading partner for other Asian countries has increased, but the role of other Asian countries in China's trade has remained relatively unchanged. Hong Kong and Japan have declined somewhat in relative importance as Chinese trading partners, while Taiwan, South Korea, and ASEAN have seen a moderate increase in their share of China's trade. From the perspective of other Asian countries, however, China's importance has risen dramatically on both the import and export sides. As a percentage of South Korea's trade, for example, trade with China increased from 5% to 19% from 1993 to 2004. China's exports to Japan increased from $15.8 billion to $73.5 billion in the same time period.

Mr. Rosen began his presentation on agricultural trade by introducing a distinction between land-intensive and labor-intensive farming. Cereals and grains are products of the former and fruit and vegetables of the latter. Neither China nor the rest of Asia has a clear comparative advantage in land-intensive production. Yearly figures vary considerably because the trade volatility of land-intensive agricultural products is high. However, for labor-intensive agricultural crops there is a clear and dramatic trend. Although Asia still maintains high tariff and non-tariff barriers on agricultural products, China has been steadily exporting more labor-intensive products to Asia, first to wealthier countries like Japan and more recently to ASEAN.

Even more dramatic is the increase in China's imports of labor-intensive crops from Asia, particularly from Thailand. The China-Thailand FTA, signed in 1993, is unusual in that it front-loads the liberalization of trade in agricultural products. Thai exports of labor-intensive agricultural products to China have risen significantly as a result. China still imports a fairly small percentage of Asia's total labor-intensive agricultural imports from the rest of the world, although China's share has grown sharply (from 1% in 1993 to 14% in 2004).

In petroleum products Asia's importance to China has been eclipsed by the Middle East and Angola. (China also buys oil from Sudan.) This pattern might shift somewhat as China imports more natural gas from Asia.

In terms of value, electronics tops the list of both China's exports and imports. China's global trade surplus in this general category is moderate or non-existent because of value-added production and re-exports. Asia's share of China's electronics imports has grown sharply. China's four largest electronic categories are radio/TV transmitters, video recording apparatus, radio and television transmission parts, and integrated circuits. In three of the four categories exports and imports have grown in a relatively balanced fashion, but the growth of China's imports of integrated circuits has far outstripped import growth in other electronics sectors. In percentage terms, China's exports of integrated circuits and micro-assemblies are still small (4.3% of global exports in 2004, compared with 66.6% for the rest of Asia), but as China continues to expand its global market share, the rest of Asia could suffer.

Turning to textiles and clothing, Mr. Rosen observed that in 1993, China was among the top six Asian exporters. But while the other five countries' exports have remained stable, Chinese exports have risen significantly -- to a level nearly three times higher than the next largest Asian textile and clothing manufacturer.

Because of the lack of accurate data, what is happening in the area of foreign direct investment (FDI) is more difficult to discern. Hong Kong remains the number-one source of Asian FDI flows into China, although as much as half comes from Chinese companies routing money through Hong Kong. With the possible exception of South Korea, whose investment in China has risen, Asian investment in China has remained steady. Due to the lack of data, sporadic reports of FDI flows from China to Asia do not reveal much. In 2002, there was a large spike in reported Chinese investment in Laos. For the most part, Chinese investors probably filter their investment in the same way that American and other foreign companies do – by setting up companies in places like the Cayman Islands and the British Virgin Islands, where the nationality of the firm is difficult if not impossible to identify.

Data on Official Development Assistance (ODA) tell us even less. With the exception of Japan, Asian assistance to China is minimal. ODA figures from China to the rest of Asia are highest to Vietnam, Cambodia, and Myanmar. There are likely to be more significant flows from China into the region this year as a consequence of the Indian Ocean tsunami disaster.

In his closing remarks, Mr. Rosen commented that mounting interdependence and deep integration characterize many sectors in the Asia Pacific. Underlying this pattern, however, is the growing asymmetry vis-à-vis China's trade relationships with Asia and the rest of the world. But the United

States should not single out China for criticism, because these patterns also apply to much of the rest of Asia, including (in some cases) our allies.

Compared with the Europe Union and the United States, Asia appears to be much less reluctant to sacrifice the oft-protected agricultural sector and undertake structural adjustment in return for greater gains achieved through deeper integration. Of course, this shift also brings serious domestic strains and social pressures. Some farmers in China are going to have to begin producing other more specialized, higher-value, labor-intensive products such as apples or kumquats.

Finally, Mr. Rosen stated that the United States tends to focus defensively on "containing" China's advantages. Asian countries, on the other hand, recognize the weaknesses of the Chinese economy and are instead building on the advantages. Mr. Rosen displayed a list of 14 competitive *dis*advantages that he observes in China, including the relative inefficiency of capital markets and environmental degradation. In addition to relative U.S. strengths in such areas, the United States also has a dominant role in several regimes that manage regional economic issues. Americans should therefore focus on their strengths rather than their weaknesses.

Dr. Ellen Frost, Institute for International Economics & National Defense University

Four major political trends mark Asia's new economic geography. First is the momentum toward regional integration, centered on ASEAN and ASEAN+3. (The "+ 3" are China, Japan, and South Korea.) Although the movement takes a predominantly economic form (e.g., trade agreements and currency swap arrangements), it is also spilling over into diplomacy, regional politics, and even security. A prominent example is ASEAN + 3's intent to establish an "East Asian Community," to be announced at a summit meeting in Malaysia this December. There certainly remain areas of contention within this grouping, but the competition centers on a subtle balance of influence rather than a zero-sum struggle for power.

The second trend is that China has become a skillful practitioner of commercial diplomacy, having taken advantage of opportunities stemming from the Asian financial crisis of 1997-98. Governments in the region perceive that the United States turned its back on them when the crisis erupted and then turned around and helped Mexico. By contrast, China is seen as having extended help in a time of need.

The third trend is strategic. China's activities in the Asia Pacific have triggered strategic interest from Japan and India. Japan has long been active, and India has pursuing a policy known as "Look East." New Delhi has negotiated (or offered to negotiate) free-trade agreements and has signed ASEAN's Treaty of Amity and Cooperation. India has been invited to attend the December summit and is actively looking for more opportunities in the region.

The final trend is not about nation-states. Several kinds of gaps are growing – between cities and rural areas, between coastal and inland areas, and between globalized and non-globalized areas. Piracy and other kinds of crime are also serious problems. Some of these trends could be reversed by sound and equitable development policies, but narrowing the gaps will require both hard work and political will.

If the United States continues to downplay Asian regional arrangements – demonstrating an attitude of "benign neglect" and a preference for bilateral agreements only – the U.S. voice will gradually lose influence, especially relative to China.

Mr. Dan Blumenthal, American Enterprise Institute

Much of the world is benefiting from China's increasing global activities, but they are not without strategic overlays.

China is neither a revisionist state nor an aggressive one, but instead an emerging power. For China, increasing regional economic engagement is a key characteristic of such a power. However, China is looking for the win-win dynamic and growing regional economic engagement serves two main purposes: securing much needed energy resources and reassuring the region that China's intentions are benign.

China has been trying to mitigate its dependence on the Straits of Malacca for transit of its energy resources coming from the Middle East, by supporting road and rail links and building up port facilities. In Myanmar, China has provided $3 billion in assistance. In Thailand, China is assisting in the Kra Isthmus land bridge. In Cambodia, there has also been a growing amount of trade and assistance, including a port facility. China has invested $198 million in the first phase of Pakistan's deep-sea port at Gwadar and provided funds for a road link between Pakistan and western China.

Q&A

A member of the audience observed that Mr. Rosen seems to be assuming that China's engagement in the world economy will have favorable political effects in China.

Mr. Rosen responded that his concern is that U.S. views tend to assume that the political process in China is dictatorial, monolithic, and designed to be hostile. This is wrong. Mr. Blumenthal added that the difference among various U.S. views is whether engagement has worked. Economically it has; strategically, there is disagreement.

Another question expressed alarm about a looming energy crisis. We have experienced a supply shock (the OPEC embargo), but we are facing a demand shock, especially from Asia. But there are no institutions set up to handle this.

Mr. Rosen responded that we do have an institutional mechanism to handle energy – markets.

Mr. Barfield of AEI referred to Edward J. Lincoln's book, *East Asian Economic Regionalism*, which observes that the economic case for East Asian economic regionalism is weak.

Mr. Rosen responded that in his view, some aspects of East Asian regionalism are forced and some are natural. He added that much of the anxiety about China has subsided compared with, say, two years ago. East Asians are adjusting to the economic necessity of reforming agriculture. In fact, the Chinese are doing almost everything an economist would ask them to do, including structural change and agricultural reform.