

China and the WTO: challenges and options for ASEAN

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Outline

- ‡ **Competition pre WTO and evaluating current situation**
- ‡ **Expected impact from WTO accession**
- ‡ **Options and strategies**

Competition pre WTO and evaluating current situation

Competition already felt pre WTO accession

- ‡ Initial opening 1980s and LIBERALIZATION IN THE 1990s
- ‡ Tariffs have fallen by more than half
 - ‡ average of 43% (92) to 17.8% (98)
 - ‡ dispersion 32% (92) to 13% (98)
- ‡ Non tariff barriers have also fallen
- ‡ Depreciation of yuan, opening up for FDI, especially export oriented investments
- ‡ Resulting in rapid export growth of China, but rest of Asia also experienced rapid growth

Pre WTO: China the giant next door?

! **Size of China** - emerging economic power house

! 2nd largest economy in the world PPP terms (11.1% world economy c/f US 20.7%)

! but effective purch.power (current income at current exch rate) China important but not dominant (for '00)

	! China	Japan	Asia 7 (4ASEAN+3NIE)
! Pop.	1,260 m	127 m	483 m
! GDP(\$)	1,157 b	4,749b	1,252 b
! Trade	510 b	748 b	1,197 b (649b w/o intra trade)

! source: Goldman Sachs Research

Pre WTO China: the giant next door?

! Also still small compared with US and EU, each with \$10 t GDP --10x China; in current \$ terms China only 3.5% of world GDP and 4% of trade

Don't over blow China's might

- ‡ China in 2020, with assumptions of growth and trade higher than developing countries and Asian countries
 - ‡ China's share of world trade and output will double and its trade will be higher than Japan and Asia 7, but still half of US and EU
 - ‡ Size of economy smaller than Japan, about the same as Asia 7, and one fourth EU and US

Pre WTO: Asian Export Structure already changing

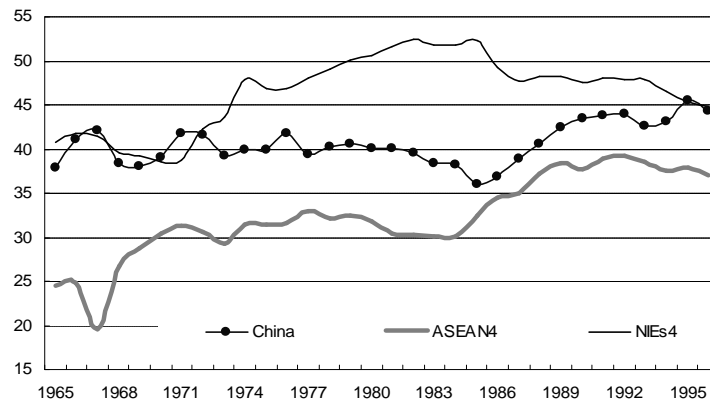
- ‡ All experienced increase in share of manufactured exports in 1990s (mainly 91-96) and changing structure of manufactured exports
- ‡ China - increase in manufacturing, shift from light industrial goods to electronics/telecomm.
- ‡ NIE 4: high share of electronics and IT
- ‡ ASEAN 5: Singapore, Malaysia and Philippines at least 50% from electronics/IT products; Thailand was around 26% and Indonesia much lower at 2% (light industrial products, resource based still important)

Importance of Intra Asian trade and investment : flying geese

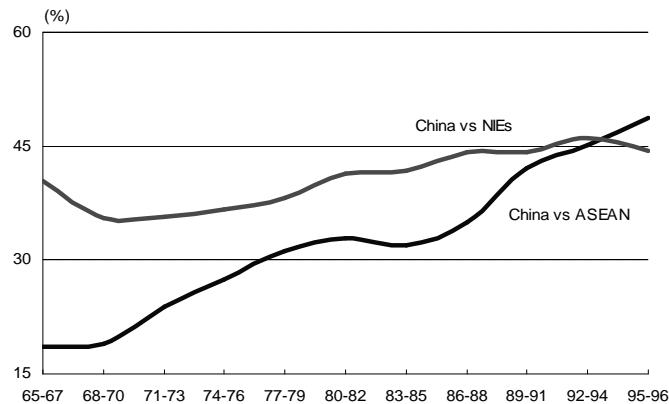
- ∴ Flying geese pattern of industrialization: driven by intra East Asian FDI, Japan leading followed by NIEs, China and ASEAN
- ∴ capital goods from Japan to NIEs, capital intensive and other inputs from NIE to China and Southeast Asia for labor intensive part of production process -- reexport to third markets. More links in network of production.

The China Challenge: flying geese pattern

(export similarity index: source: Ligang Song)



China vs NIEs and China vs ASEAN (export similarity index: Ligang Song)



Scope for Export Specialization

- ! Greater scope for export specialization vis a vis NIEs than ASEAN.
- ! More direct competition with ASEAN: but even so, there is scope for comparative advantage, niche, intra industry trade. Story will vary between sectors, depends on FDI/MNC behavior, sourcing behavior

Scope for Export Specialization

- ‡ What is happening on the ground?
Businesses are already reacting and responding.
 - ‡ Sourcing from China
 - ‡ Sourcing regionally? Changing pattern with growth of demand and capacity in China?
Moving away from regional sourcing to local China sourcing?
 - ‡ What about services?

Competing in US and World Markets

- ‡ ASEAN competing with China in US and world markets for manufactures, especially labor intensive products, and increasingly other higher value added products (semi conductors and high tech exports -- role of Taiwan vis a vis relocation to China)

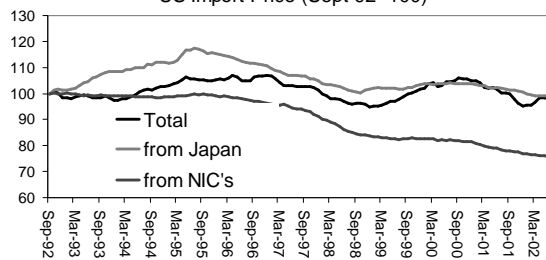
ASEAN China Comp.in US Market limited

- Competition led to unit price decline. East Asia's market share declined to 33% from 40%, as volume response to lower price has been insufficient to offset the price effect.
- China has been gaining market share mostly at the expense of Japan. ASEAN has done reasonably well.
- (Source: Andy Xie, Morgan Stanley Research)

US: Import Market Shares (% of Total)

	Total	China/HK	ASEAN	Korea	Taiwan	Japan
1987	39.0	3.9	4.2	4.1	6.0	20.6
1990	36.9	5.0	5.5	3.7	4.6	18.1
1993	40.1	7.1	7.3	2.9	4.3	18.5
1994	40.1	7.3	7.8	3.0	4.0	18.0
1995	39.6	7.5	8.3	3.3	3.9	16.6
1996	37.1	7.7	8.3	2.9	3.8	14.5
1997	36.8	8.4	8.1	2.7	3.8	14.0
1998	36.5	9.0	7.9	2.6	3.6	13.4
1999	35.7	9.0	7.4	3.0	3.4	12.8
2000	34.8	9.2	7.0	3.3	3.3	12.0
2001	33.4	9.8	6.4	3.1	2.9	11.1
Jan-Jun 02	33.3	10.4	6.4	3.1	2.8	10.6

US Import Price (Sept 92=100)



Source: Morgan Stanley Research

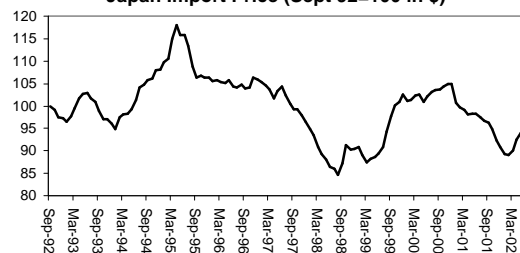
ASEAN-China Competition in Japan Is More Limited

- East Asia's market in Japan's import has increased to 41% from 30% in ten years. China has received all of this gain. ASEAN's market has remained stable.
- China has bigger effect on East Asian NICS than on ASEAN in the Japanese market. But Chinese export most replaces Japanese domestic supply.
- (source: Andy Xie, Morgan Stanley Research)

Japan: Import Market Shares (% of Total)

	China/HK	ASEAN	Korea	Taiwan	USA
1992	8.1	12.9	5.0	4.1	22.4
1993	9.3	13.5	4.8	4.0	23.0
1994	10.8	13.3	4.9	3.9	22.9
1995	11.5	13.5	5.1	4.3	22.4
1996	12.3	14.0	4.6	4.3	22.7
1997	13.0	13.7	4.3	3.7	22.3
1998	13.8	13.1	4.3	3.6	23.9
1999	14.4	13.9	5.2	4.1	21.7
2000	15.0	14.5	5.4	4.7	18.7
2001	17.0	14.3	4.9	4.1	18.1
Jan-Jul 02	18.2	14.1	4.5	4.3	18.1

Japan Import Price (Sept 92=100 in \$)



Source: Morgan Stanley Research

But story will differ by sector: example Textiles & Clothing

- ‡ Maintain market share in the US, although experience falling unit prices and increased competition. Captive market: quota
- ‡ Lose market share in Japan: no quota constrain; relocation by Japanese producers due to liberalization FDI, low cost and productive labor, and political stability.

Falling Share in Japanese Market

‡ Man Made Fiber Knit Apparel		
‡ <u>1996</u>	<u>2001</u>	
‡ 59.1	80.4	China
‡ 3.5	2.5	Vietnam
‡ 1.8	1.7	Thailand
‡ 1.5	0.8	Indonesia
‡ 0.6	0.3	Philippines
‡ 0.5	0.2	Malaysia

Falling Share in Japanese Market

‡ Cotton Woven Apparel

‡ <u>1996</u>	<u>2001</u>	
‡ 69.1	81.6	China
‡ 2.2	2.0	Vietnam
‡ 2.5	1.2	Indonesia
‡ 2.9	1.1	Thailand
‡ 0.9	0.7	Philippines
‡ 0.6	0.2	Malaysia

**Expected impact from
WTO accession**

WTO Accession: what happens

! GOODS

- ! Remove non tariff barriers: licensing and quotas in agric. (rice, sugar, palm oil, rubber, wood prod., urea) -- tariff quotas until 2004/5 then replace with tariffs
- ! Further reduction in average tariffs, and binding
 - ! Manufacturing 6.95% by 2005
 - ! Agriculture 17% by 2005
- ! Only increase in world market access: textiles and clothing with phase out of MFA quotas '05 (but begin to enjoy growth of quota allocations 2002)

WTO Accession: what happens

- ! Investment: removal of local content, liberalize restrictions
- ! Broad and deep liberalization in services: entry, ownership -- over next five years
- ! Other: TRIMS, TRIPS
- ! Rules: anti dumping
- ! Greater transparency and predictability

Expected Impact of China's WTO Accession

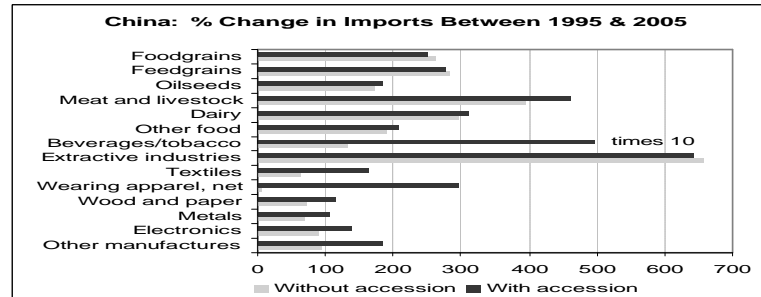
- ‡ Increased market access and investment liberalization in China (services, accel. reloc. in manuf to focus on dom.mkt), and greater transparency and predictability
- ‡ Increased competition in third markets, improved competitiveness in home markets of China's trading partners (reduced prices of imports from China)

China's Trade Growth with WTO Accession

- ‡ World Bank - model (1995-2005) (main benefits from own liberalization and T&C quota phase out)
 - ‡ share of exports will double from 3.7 to 6.8%
 - ‡ share of imports will double from 3.4 to 6.6%
 - ‡ increase import and export of all manufactured products, and increase in intra industry trade
 - ‡ increase in FDI

China WTO Accession an Opportunity

What will China import more?



Agriculture and Raw materials—Sugar, palm oil, wood, oil and gas

Intra-industrial—Machinery and electrical components; fibers and textiles

Services—Professional, tourism

(Source: World Bank model)

Regional impact

- ∴ World Bank model (assumptions of goods and services liberalization and auto sector restructuring):
 - ∴ Northeast Asia will benefit most from China's growth because of greater complementarity, geographical proximity and greater investment-trade nexus. Increase in net exports to China, reduced import prices from China, and also experience increase investment
 - ∴ ASEAN expect to benefit less because more similar. Hurt most in apparel and other labor intensive industries, but offset partially by increased exports to electronics, other manufactures and agriculture to China.

Some country specifics

- ‡ **Japan:** small positive impact, increased demand for sectors which China's exports expand (textiles, metal, electronics, petrochem, other manuf), increased FDI to China (trade-investment nexus), but compete with China in auto
- ‡ **Taiwan:** export semi processed products, parts for assembly (petrochem, textiles, electronics), increase complementarity with China

Some country specifics

- ‡ **Hong Kong:** can still experience increased demand for services related to financial, transport and communication despite China's own development; increased demand for inputs to textiles, manufacturing but apparel sector will slow down.
- ‡ **Korea:** increased exports of textiles, metals, and petrochem, but probably reduced electronics exports because will source from other countries with larger tariff reduction (ITA) (US, India, other South Asia), apparel and auto negatively affected.

Some country specifics

- ‡ **Singapore:** may lose out, electronics, petrochem and other manuf., diversion of investment.
- ‡ **Malaysia:** less affected, apparel slow down but exports of textiles, electronics.
- ‡ **Philippines:** expect negative effect; apparel slow down, terms of trade in third markets fall, diversion of investment, increased exports in agriculture, electronics, other manufactures. Because slow structural adjustment in other manuf.

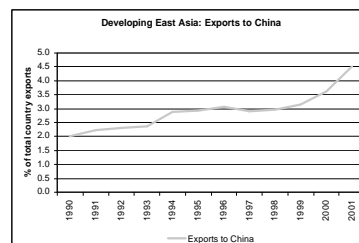
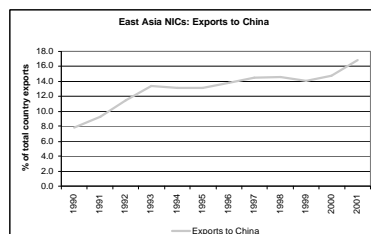
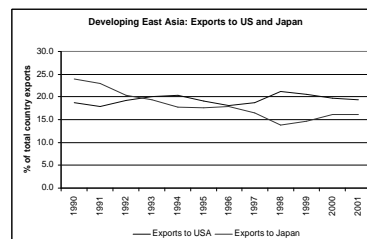
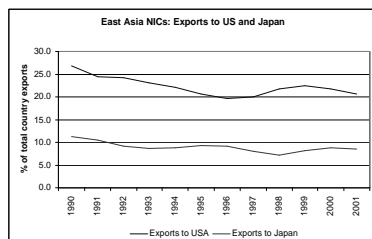
Some country specifics

- ‡ **Indonesia:** reduced investment, apparel sector hardest hit compared to other East Asia, increase in wood and paper products, oil and gas, agriculture products and some light and other manufactures.
- ‡ **Vietnam:** reduced apparel exports though increase in demand for rice, food processing, light manuf., electronics

Changing Network of production

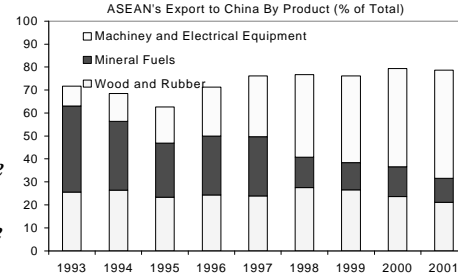
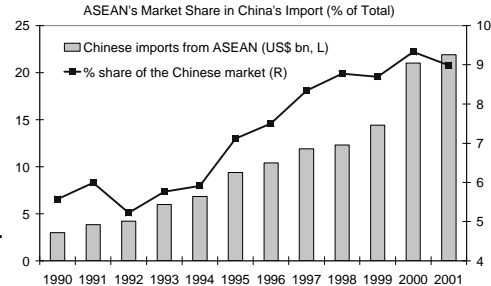
- Real question is how East Asia can be part of new network of production (investment and trade flows in goods and services) of which China is an integral part -- and with reexports to third markets (especially US and EU). Also the growing demand from China itself.

Exports to China are dynamic (source: World Bank)



Division of Labor?

- ASEAN's exports to China has grown at 16.5% p.a. since 1997 and now runs a \$6 bn trade surplus against China.
- Chinese tourists to ASEAN have been rising at 11.5% p.a. since 1997 and reached 8.9 mn in 2001.
- Though ASEAN is more competitive in tourism and natural resources, most trade with China is in other areas
- Source: Andy Xie, Morgan Stanley
ASEAN and China have similar income levels and have room to evolve complementary or even similar industries.



Source: Morgan Stanley Research

Options and strategies

Managing China's Emergence in the Region: ASEAN Perspectives

! ASEAN Issues

- ! should ASEAN economies meet challenge by competing under multilateral trading system whilst undertaking unilateral liberalization, reforms and anticipating competition?
- ! Regionalism: strengthen AFTA/ASEAN and/or enter into formal regional agreements? Who, What and How?

Strategic Option: multilateral

- ! Multilateral process (ensuring China fulfils its WTO commitment) combined with unilateral reforms and anticipation.
- ! Homework starts at home: problem not competition with China, but lack of unilateral reforms and anticipation
 - ! what should be business responses?
 - ! government responses? (reforms, liberalization, investment climate -- make attractive, ensuring soft infrastructure)

Strategic Option: multilateral

- ! Regional cooperation can be to define multilateral stance of mutual benefit (East Asia lead? Asia Pacific lead? Include India?) --- in the past ASEAN has succeeded vis a vis external common interest (e.g. WTO, financial architecture etc)

Strategic Option: regionalism

- ! Who?
 - ! Strengthen AFTA: AFTA plus
 - ! Subregional growth areas: China is made up of many "countries"
 - ! China ASEAN Free Trade Area

AFTA is shallow integration -- what next?

- ! ASEAN + China
 - ! Proposed in November 2001, currently in negotiations and will be announced this week
 - ! Agreed upon to everyone's surprise

Stated Motivations

- ! Take advantage of complementarities, build on existing strengths to promote efficiency and competition, and attract investment (benefits)
- ! Build a sense of community and reduce tensions in the region
- ! Cooperation to enhance cooperation on external front on issues of common interest (WTO)
- ! For ASEAN first mover advantage for sectors of export interest (e.g. quotas on agriculture products, motor vehicle and bike components)

Stated Motivations

- | ASEAN like to see reduction in barriers such as complex import licensing procedures, issues of testing, standard and labeling requirements, investment promotion and protection, visa facilitation and infrastructure development.

Early Harvest

- | Early Harvest comprises of liberalizing tariffs for priority sectors of interest and other trade and investment facilitation measures that are deemed to generate immediate benefits to the ASEAN and Chinese business communities. These measures could include:

Early Harvest

- Measures enhancing market access opportunities for specific products or services of interest to ASEAN and China, such as agricultural and tropical products, textiles and clothing, machinery and electronic products, footwear, oils and fats, foodstuff, forestry and aquaculture products, and energy. The list of products and services will be determined by mutual consultation;
- Extension of MFN treatment of China's accession commitments to non-WTO members of ASEAN in compliance with WTO rules;

Early Harvest

- Technical assistance and capacity building -- to new ASEAN members (Cambodia, Laos, Myanmar, not Vietnam)
- Trade and investment facilitation measures;
- Trade policy dialogue;
- Business sector dialogue;
- Facilitation of visa arrangements for business people;
- Standards and conformity assessment;
- Any other measures delivering immediate mutual benefits.

Assessing ASEAN+China

- | Current negotiations focus on goods and tariffs only:
 - | deliverables? Early harvest (both give), and unclear whether key agric. Included. Two types of offers -- common list (everyone agree on) within 3 years, and specific list (offered by each ASEAN country) by 2010 or 2012 (10 years)
 - | wait and see: concern with lists of long exclusions and lengthy negotiations; ROO

Assessing: ASEAN+China

- | Other parts of agreement will be negotiated beginning next year and with a time frame
- | Will we get lost in the nitty gritty of negotiation? Significance and relevance for market access? Given this -- should we unbundle and focus on what are the obstacles facing business.
- | Familiar conclusion -- benefit may be in process rather than tangibles, real issue is domestic adjustments and reforms.