

The Fourth Asia Development Forum

Trade and Poverty Reduction

3 – 5 Nov 2002, Seoul, Korea

By Kong-Yam TAN*

Comments on PRC's WTO Entry: Impact on Rest of the Region

I broadly agreed with Mari's presentation. In my comments, I will focus on five key points. I like to highlight at the outset that my presentation represents my own view and does not necessarily reflect the official position of the World Bank.

My first point is that China's rapidly changing trade and foreign direct investment (FDI) structure could be moving China gradually from a competitive position to an increasingly complementary relationship with ASEAN. Since the early 1990s, the competitive pressure of China on ASEAN has intensified. This is clear whether one looks at the FDI figures or the competitive pressure on ASEAN exports in third markets in the US, Japan and EU. For example, in 1980, China had about 1.2 percent of the market share in the US but by 2001, it had about 9 percent of the market. On the other hand, the market shares of the other Asian countries like Korea, Malaysia, Thailand, Indonesia etc have either stagnated or fallen. The same phenomenon is observed in the case of the Japanese and EU market. The competitive pressure from China is even clearer when one looks at the detailed product level, particularly export products like textile, garment, toys, footwear, leather bags and other light manufactured products. This competitive pressure of China on ASEAN represented a period when Hong Kong, Taiwanese SMEs and local Chinese companies exported labour intensive light manufactured products to OECD markets and exerted intense competitive pressure on the export oriented development strategy of the other ASEAN countries. Most significantly, these light manufactured products have limited intra-industry and intra-firm trade,

* Senior Economist, World Bank. The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB) or its Board of Directors or the governments they represent. ADB makes no representation concerning and does not guarantee the source originality, accuracy, completeness, or reliability of any statement, information, data, finding, interpretation, advice, opinion, or views presented.

resulting in rising direct competition but limited complementary trade relationship between China and ASEAN. This has led to the “China threat” concern, a giant sucking sound or a black hole that sucks in all the FDI and takes over others market shares.

Could the pessimistic giant sucking sound be gradually evolving into the more optimistic popping sound for ASEAN?

When one examines the changing trade and FDI pattern over the recent three to five years, one can discern the potential emergence of a more complementary relationship between China and ASEAN. This is the rapidly rising trend of electronics in China’s trade and FDI inflows. By 2002, electronics has risen to over 30 percent of total exports, compared to 15 percent in 1995. In the first 9 months of 2002, trade in the electronics segment has risen by 30 – 50 percent, compared to 8 – 20 percent for the other traditional light manufactured products. Unlike trade in the traditional light manufactured products, trade in electronics are driven largely by US, Japanese, EU, Taiwanese, Korean MNCs. Under severe competitive pressure and margin shrinkage, these MNCs are forced to expand their global out-sourcing and distribute various segments of the value added chain in China and other Asian countries to take advantage of the cost and capability structure in these countries. The sourcing of components and the web of procurement linkages spun the network of intra-industry and intra-firm trade among China and the other Asian countries. This broad regional division of labour has resulted in a more complementary trading relationship among these countries. When final demand of these electronic products rise in the OECD countries or in the region, everybody manage to get a piece of the action as they are part of the production network in this value added chain. Consequently, the effect of Motorola’s production of hand phones, Seagate’s production of hard disk drive or Matsushita’s production of consumer electronics are very different in its impact from the Hong Kong and Taiwanese SMEs’ production of garment, footwear or toys.

This greater complementarity in trading relationship between China and ASEAN in electronics product can be observed in the trade pattern between China and ASEAN. For example, by 2002 (Jan – Aug), between 40 to 80 percent of the imports of China

from ASEAN countries consist of electronics rather than raw materials , resources or food products. It has reached 62 percent for Malaysia, 42 percent for Thailand, 84 percent for Philippines, 52 percent for Singapore,39 percent for Korea, 46 percent for Taiwan, 51 percent for Japan, and 43 percent for US. However, Indonesia's export to China has still a very low percentage in electronics, at 15 percent while petroleum (20 percent), wood (12 percent), pulp and paper (19 percent) and other resources and raw materials constitute the bulk of exports. So is Vietnam, where only 3 percent of China's import consist of electronics product.

This leads me to my second point that there could be the danger of a two-speed ASEAN as a result of China's emergence as a major industrial power. More developed ASEAN countries like Malaysia, Thailand, Singapore and Philippines are able to benefit from China's growth, through greater linkages with China's emerging electronics industry as well as benefit from the rise of Chinese middle class through the export of their services industry like tourism. On the other hand, less developed ASEAN countries like Indonesia, Vietnam, Cambodia, Laos and Myanmar are being squeezed by competitive pressure on FDI and export of light manufactured products but are unable to become part of the MNCs network of regional electronics production and hence excluded from this dynamic expansion. Consequently, there could gradually emerge the trend of one group of ASEAN countries seeing China's emergence as an overall positive thing, in the sense that winners outweigh losers in their economies. On the other hand, we could witness in the less developed ASEAN countries with losers outweighing winners. This trend, if correct and persists, could have tremendous economic and political implications. It could lead to greater tension among ASEAN countries, especially with respect to the policies of handling China's rise. Moreover, for China, it could be a complex foreign policy issue. This is because the likely losers, Indonesia and Vietnam, are also the two largest countries in ASEAN which have been historically most suspicious of China's intention. It is in China's interest to ensure that as it becomes an important locomotive in the region, not only the more developed ASEAN wagons are hooked on and get a good ride but also the less developed countries wagon are not left behind in the desolate station.

My third point is that despite the somewhat positive trend of the more developed ASEAN countries being able to be part of the network of regional production in electronics, there is no room for complacency on the part of ASEAN. China is developing rapidly, and the cluster of supporting industries in electronics are expanding and upgrading. For example, Motorola, Seagate, NEC, Matsushita, Siemens, Acer and Samsung, have all been increasing their local sourcing of parts and key components domestically. ASEAN need to be vigilant and upgrade and maintain their competitive edge in the value added chain. In this regard, human resource upgrading, progress on AFTA and eventually in the China-ASEAN, Japan-ASEAN free trade agreement could help to strengthen ASEAN's position in this regional production network but it is too early for ASEAN to celebrate. The future is still fraught with uncertainty and intense competitive pressure.

My fourth point is that ASEAN has not paid sufficient attention to China's domestic economic strategy and this could prove detrimental to ASEAN's own development. China is becoming larger and larger in its impact, particularly on ASEAN and the direct and indirect effect of China's domestic economic strategy will loom larger and larger. Let me be more specific. For example in January 1994, China devalued the Rmb by unifying the exchange rate from 5.8 to 8.3. This represented a significant devaluation, though not as large as the computed over 30 percent as a lot of export had been transacting at the lower market rate. However, it still represented a sizable effective devaluation and if you look carefully at the export figures to the US market, you see that the January 1994 devaluation of the Rmb has had a significant competitive effect on Thailand, Malaysia and Korea's export to the US market. However, nobody in ASEAN paid attention to the 1994 Rmb devaluation, let alone adjusting their exchange rates in response. Of course by the Asian financial crisis in 1998, everybody was aware of the important impact of the Rmb and talking about the implications of Rmb devaluation. That is the past. What about the present and future? Is ASEAN examining and analyzing China's domestic development strategy and assessing its implications on ASEAN? As you are aware, in the past few years there has been a strong focus on the

western development strategy in China. As far as China's domestic economic development strategy is concerned, this is a major strategic move. It is important for western regional development, for poverty reduction, for addressing regional inequality, for resource development, for minority population, for a host of political and strategic considerations. However, what are the implications for ASEAN? So far, I have not seen any serious analysis. I think the implications are enormous. With better infrastructure and more pro-FDI policies in the western region, it is likely that increasingly the labour intensive light manufacturing production will migrate from the progressively more expensive coastal region to the western region. From China's perspective, it makes a lot of sense as it mimics the traditional flying geese pattern, with different parts of the Chinese continental economy representing different stages of development. On the other hand, this movement of labour intensive production towards the inland region implies that wages for labour intensive product in Asia or even globally could be depressed for a sustained period, until the unlimited supply of 800 million peasants in the western region has industrialized. The implication on the wage level and industrialization process of the ASEAN countries like Thailand, Malaysia, Indonesia and Vietnam are enormous. How would ASEAN countries evolve under this competitive challenge? Would ASEAN find coastal China a complementary economic partner while western China a serious competitive challenge? How would different sectors, different industries and income groups in the different ASEAN countries be affected and what should be done about them? How should ASEAN countries respond, individually and collectively? I think these are very important questions for policy makers, think tanks, academics and businesses.

I believe this challenge is significant as the focus on the western region will accelerate with the new leadership after this 16th party congress. This is because the new top leadership emerging are likely to be more focused on the poorer western region, partly because their personal experience have been there and partly because the poverty, regional inequality issues have reached a more serious magnitude. Unlike the present top leadership who made their mark in the central and key coastal cities, the new leadership have more extensive exposure to the poorer inland provinces in Guizhou, Gansu, etc.

My last point is regarding regionalism in the Asia Pacific region. I think the ASEAN-China FTA is very significant and it has helped ASEAN to seize the initiative. Before the momentum started to gather in the ASEAN-China free trade area, ASEAN had been relegated to a marginal position. This is especially so as ASEAN's strategic and political importance has fallen substantially since the end of the cold war. With the Asian financial crisis and the rapid emergence of China, ASEAN's economic importance has also fallen. In the post September 11 world, confidence in regional stability has also been detrimental to ASEAN's economic position. However now that China and ASEAN have started to dance, you see all the other players are getting jealous. Japan has stepped up its discussion with ASEAN on the Japan-ASEAN FTA. India has also proposed an Indian-ASEAN FTA over 10 years. The US has started exploring the US – ASEAN FTA. This increase ASEAN's leverage enormously, with all these big players and also against China. Consequently, ASEAN could get a better deal out of the "early harvest" with China in agriculture in the ASEAN-China FTA. I believe these dynamics are beneficial to ASEAN. It could even be beneficial for regional development and stability. ASEAN as a relatively weak power is now the hub. I think the other stronger players are probably happier that ASEAN is the hub rather than any of the other stronger players.

Thank you for your kind attention.