An Overview of China's Emergence and East Asian Trade Patterns

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Contents

Introduction

- China's accession to the WTO is a watershed event, for the global economy generally and for East Asia in particular.

- Initial reactions of regional partners, who perceive China as a strong export competitor and magnet for FDI, have been somewhat defensive.

- Our research reveals a more complex picture of China's emergence, one that may present as many opportunities as threats to East Asian policy makers.

Introduction

Because of its size and stage of development, China will play two roles in the region with unusual prominence.

1. It will stiffen export competition in a broad spectrum of products, particularly in extra-regional markets.

2. The growth of China's economy will make it the region's largest importer, and this absorption will create unprecedented opportunities for regional exporters.
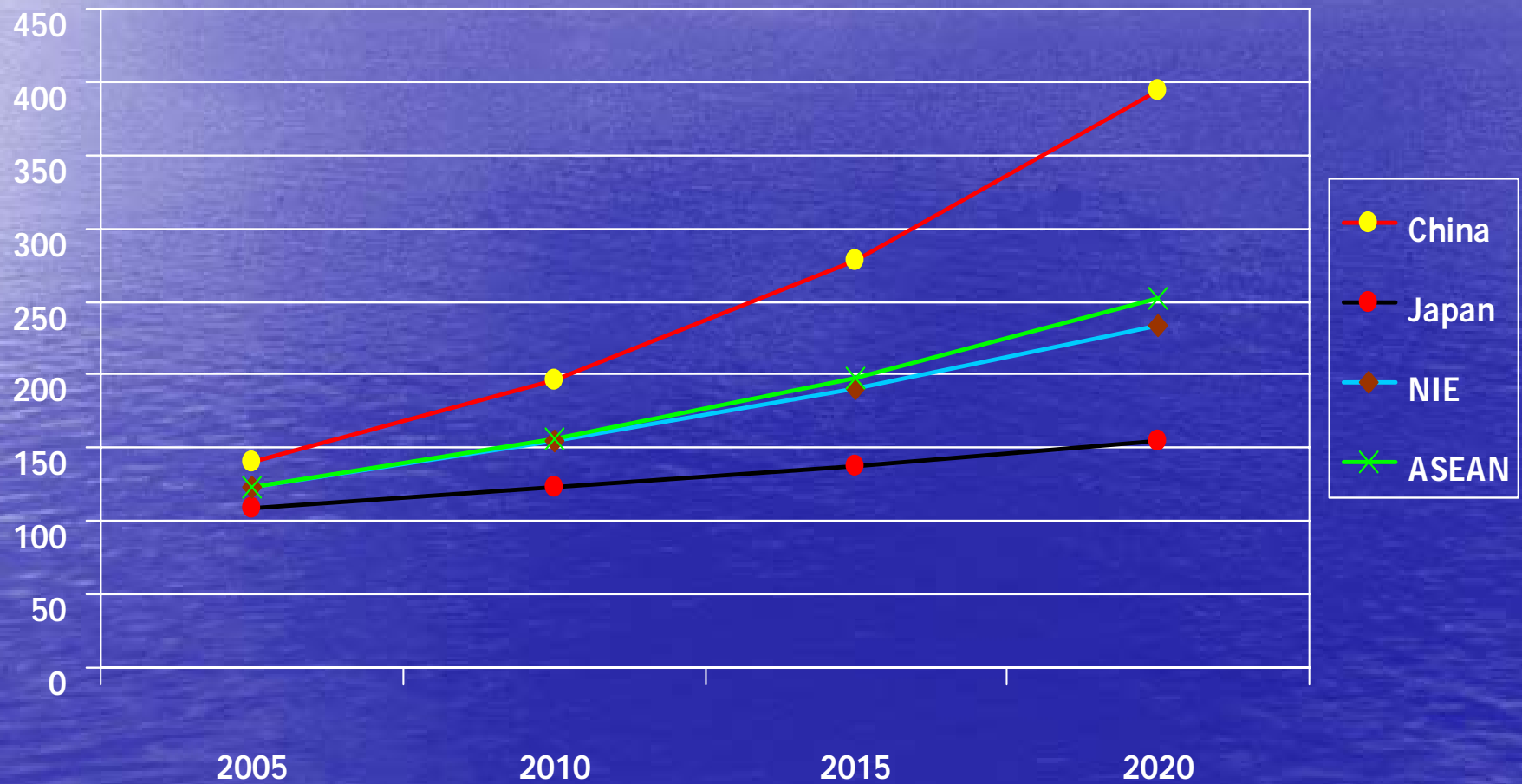
I.   China's Emergence and the Asian Trade Triangle
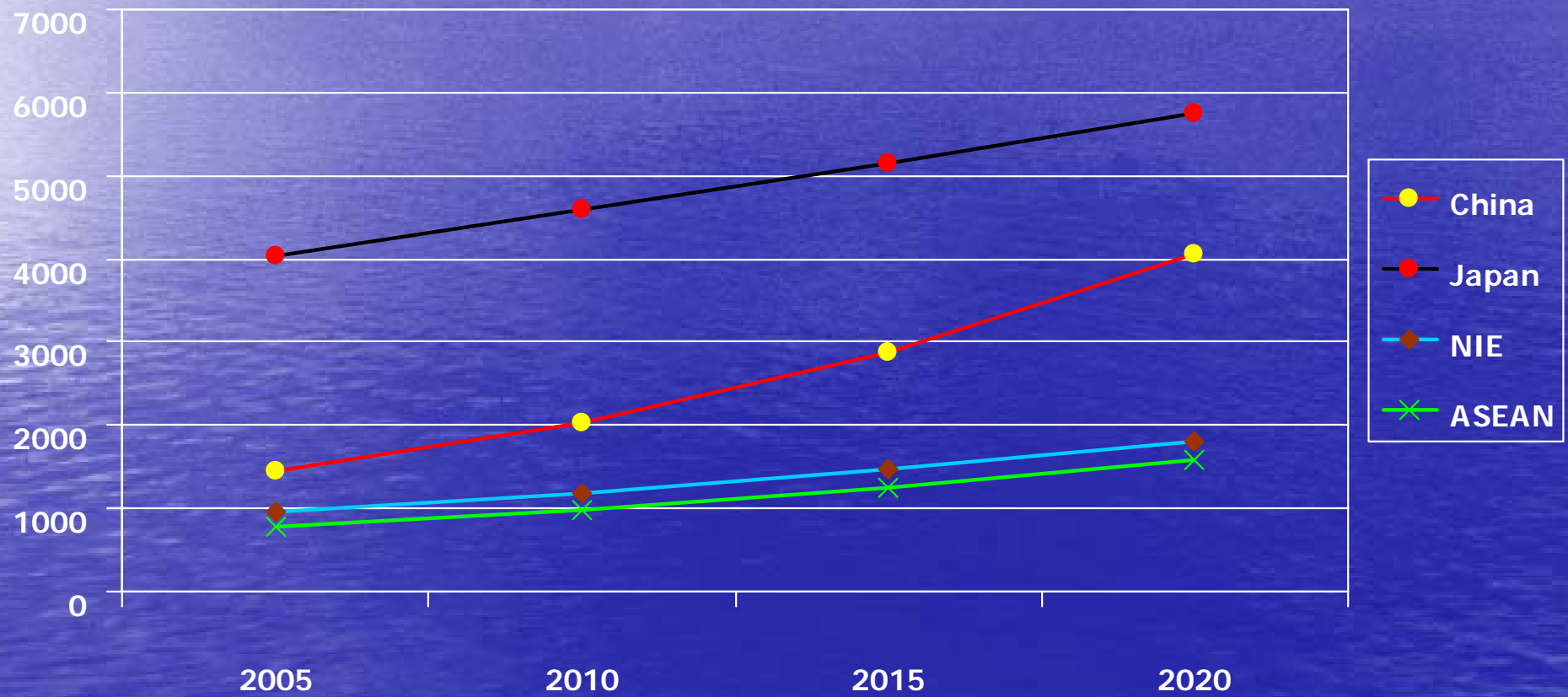
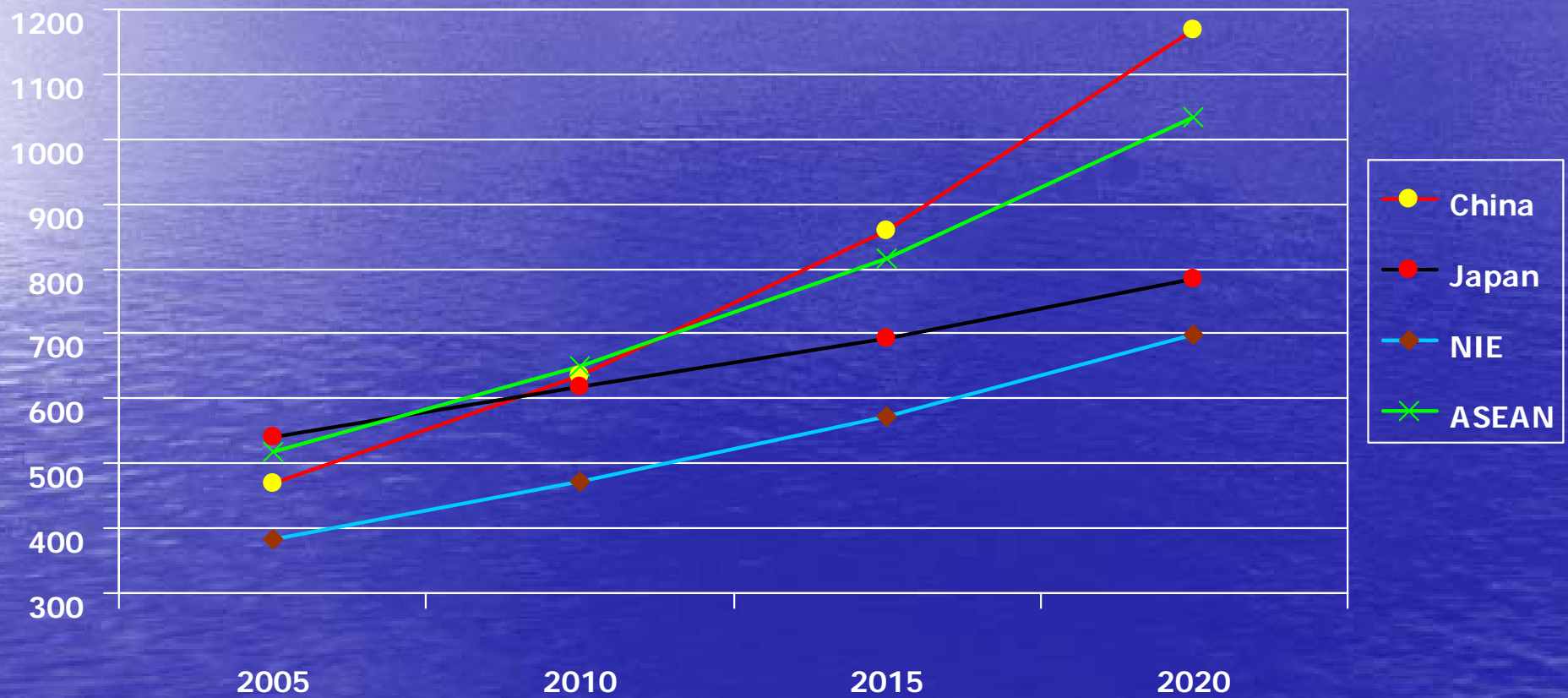# Projections to 2020

Using a global forecasting model.

Real GDP
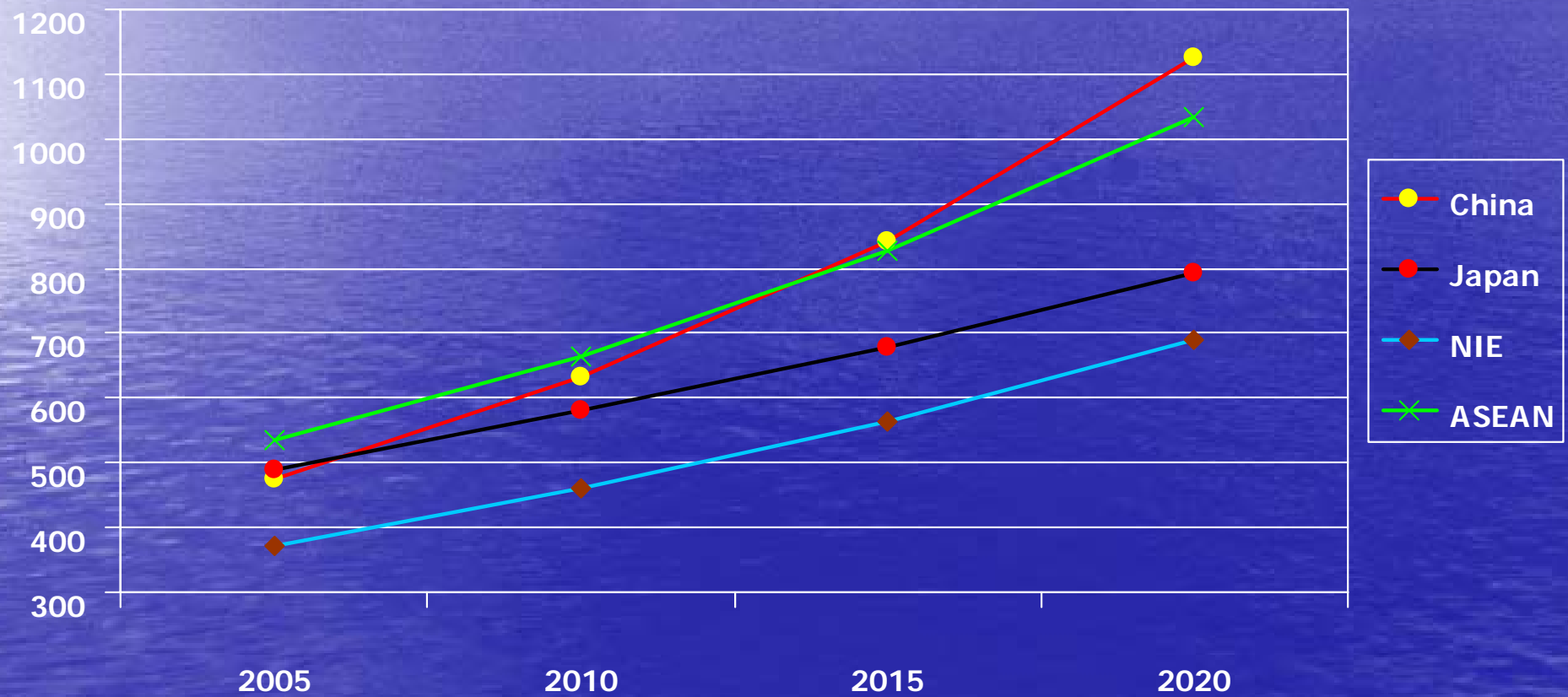## (billions of 1997 USD)

Real Exports
(billions of 1997 USD)

Real Imports
(billions of 1997 USD)

The Asian Trade Triangle

- Our forecasts indicate the emergence of a systematic pattern of triangular trade between China, the Rest of East and Southeast Asia, and the Rest of the World

- This Trade Triangle reveals that China's export expansion offers significant growth leverage to its neighbors.

- Chinese absorption will emerge to dominate regional demand. Provided Asian economies do not isolate themselves from this process, the net effect of China's growth can be hugely positive.

Trade Triangle 2000

China

Rest of E&SE Asia

?

Rest of World
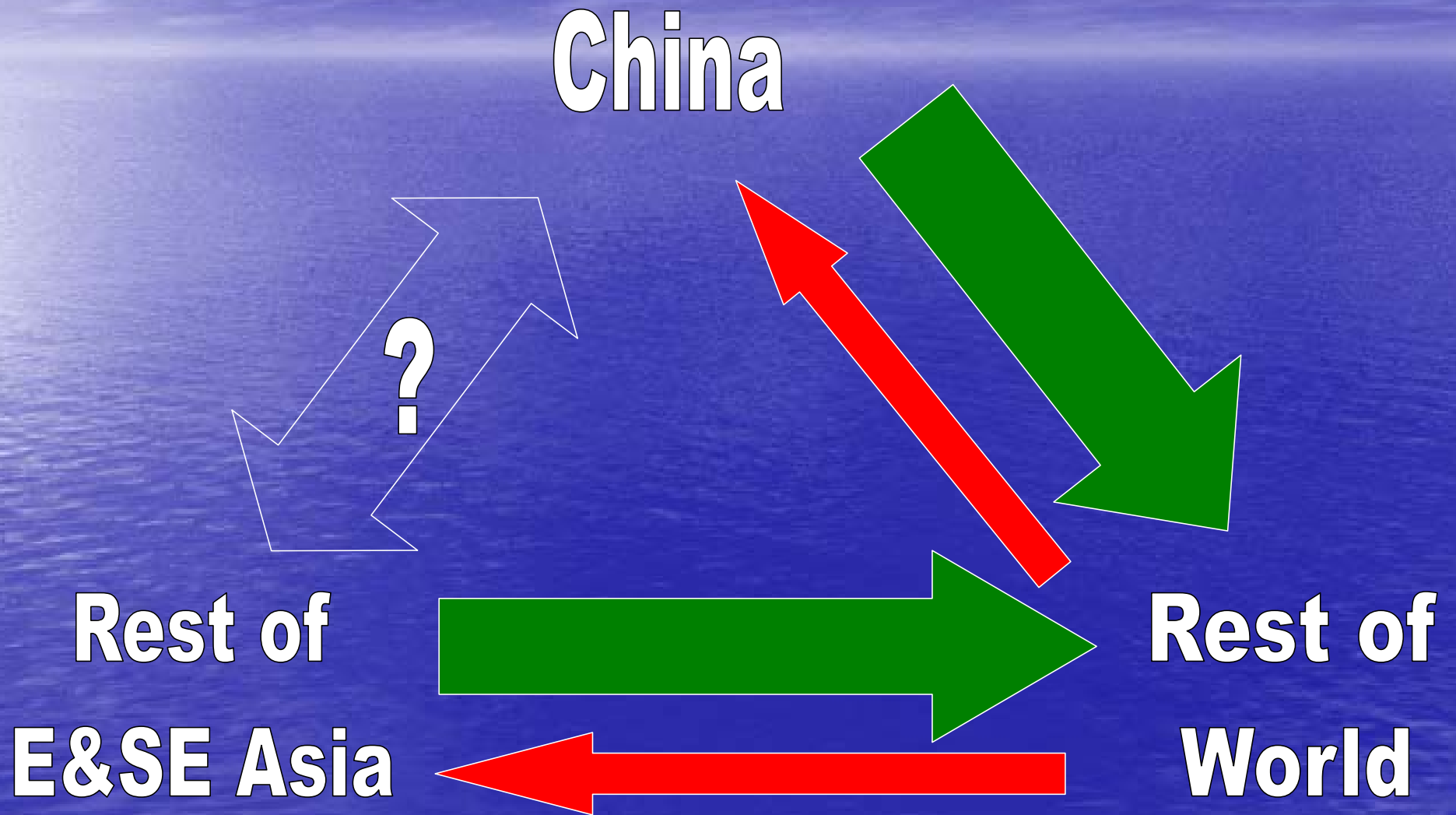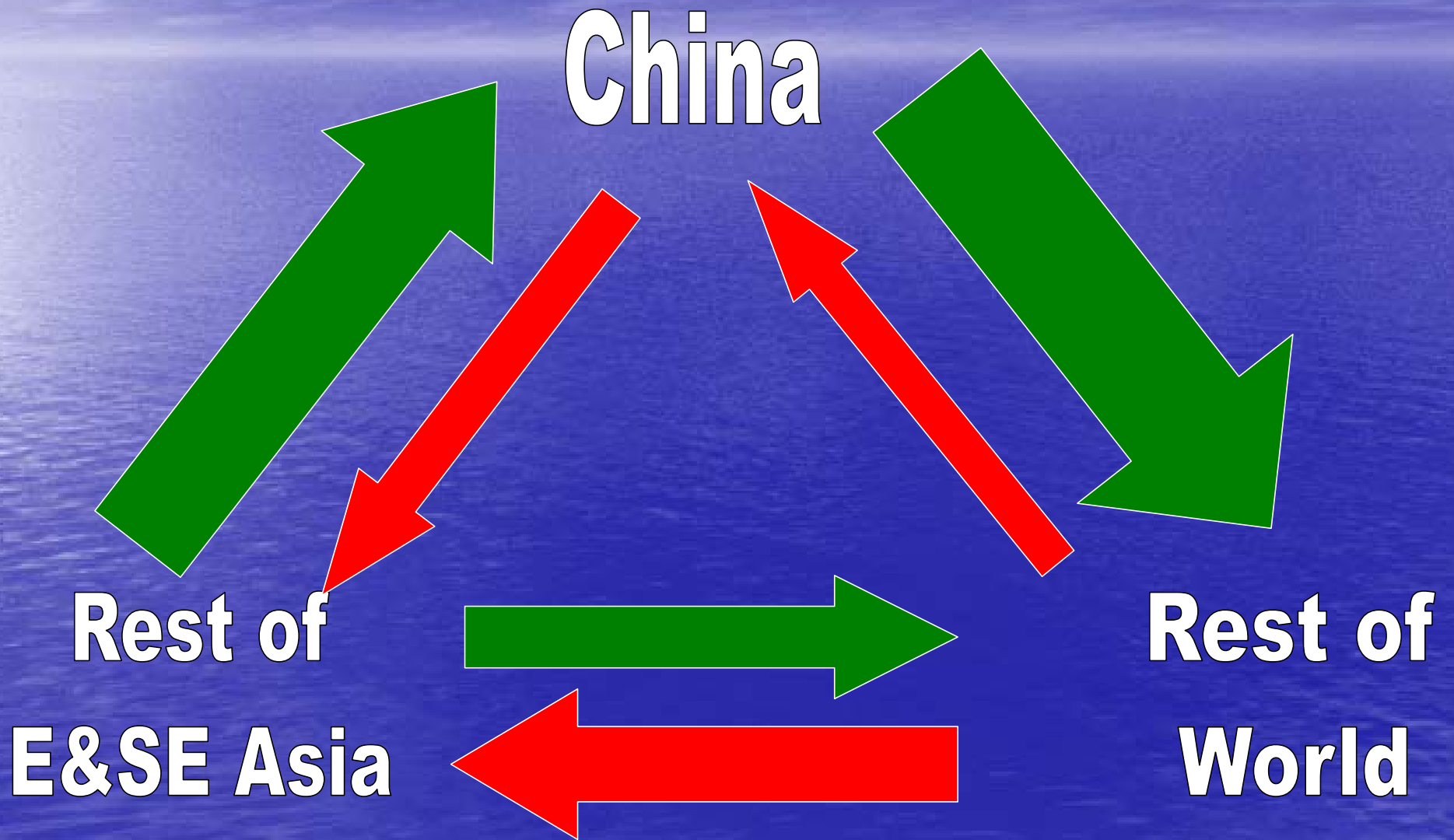
II. China and East Asia

- ⭐ China is in a relatively unique position in East Asia. This country can apparently "go it alone" to globalization. It also possesses two carrots and one stick in regional negotiations:
  - Carrots: Access to domestic market and the "bandwagon" effect, selling into China's export growth.
  - Stick: Denial of access.
- ⭐ However, this strategic leverage appears to be limited for two reasons:
  - Chinese imports are essential to its export capacity
  - WTO standards will not sustain exclusion

Regionalism and Globalism

* East and Southeast Asia can capture most of the absolute export growth expected from full globalization by just forming ASEAN+3.

* Thus, head-to-head export global competition is less important than leveraging opportunities presented by East Asia's fastest growing internal market.

* The best strategy for East and Southeast Asia is to pursue globalism through more comprehensive regionalism.

III. China's Labor Markets

- ★ In China, labor is the ultimate source of comparative advantage. Domestic labor allocation patterns appear to be changing in important ways, however:
  - Rural to Urban migration is continuing. Transactions costs to this activity are rising, but the opportunity cost of labor in the rural sector continues to decline.
  - Skilled labor demand is rising faster than supply. This trend is being accelerated by FDI, for which skilled labor appears to be a complement.

Conclusions

1. China will be the largest trading economy in East Asia by about 2010.

China will be the region's largest exporter by about 2010, but it's largest <u>importer</u> by 2005. The latter situation presents an unprecedented opportunity for neighboring economies.

Conclusions

2. The growth of China's internal market will accelerate other East Asian export growth significantly and create historic opportunities for regional investors.

   Provided East Asian economies do not isolate themselves from the process of Chinese trade liberalization, the net effect of China's growth will be hugely positive, as Chinese absorption emerges to dominate regional demand.

Conclusions

3. An East Asian Trade Triangle will emerge, where China develops a sustained trade deficit with East Asia and a surplus with Western OECD economies of nearly equal magnitude.

    In other words, most of China's trade surplus will ultimately accrue to its regional neighbors. This has profound implications for patterns of both North-South and regional capital accumulation.

Conclusions

4. The Trade Triangle enables China to "deliver globalization" to the region by joining the WTO.

   The other EA countries should negotiate collectively with China, with an eye toward broader objectives.

   Our results indicate that, in the wake of China's WTO accession, the best strategy for East Asia is to pursue globalism through more comprehensive regionalism.

Conclusions

5. China can "go it alone" on the path to globalization.

   By conforming to its existing WTO commitments, China will realize most of the gains it would enjoy in a world of free trade. Thus its unilateral initiative makes it less reliant on regional and bilateral commitments.

Conclusions

6. China has a special position in the regional trade matrix, but its strategic leverage appears to be limited.

- Preferential access to individual EA exporters is not sustainable under its WTO commitments. The carrots are real, but their strategic value is limited.
- Furthermore, EA imports are essential to China's export capacity. The stick is not credible against most EA partners.

Conclusions

7. China's conditions of comparative advantage are likely to experience rapid evolution for two reasons:

  – Significant and relatively sustained inbound FDI is rapidly expanding production capacity and altering patterns of factor productivity and returns.

  – Labor markets are entering an important transition period:

  • Migratory patterns for unskilled labor are likely to intensify.

  • Supply conditions for skilled labor may not keep pace with demand.

  • Economic reform may adversely affect short term aggregate labor demand.