

## China in the Asia-Pacific: Regional Adjustment to China's Growing Importance in the Region and Globally

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### [SLIDE 1] – Introductory Page

- Good morning. As you have seen from the remarks of the first two speakers, the focus of this session is on imbalances and their impact in the region.
- Unlike the other speakers, I am not an expert in financial flows or currency valuations. I am going to talk about some of the very imbalanced trading patterns in the Asia-Pacific region centred on certain APEC member countries' relations with China.
- The trade imbalances seem to be leading China and its APEC trading partners to adopt strategies designed to facilitate policy adjustments that would in turn mitigate the negative or enhance the positive aspects of the trade patterns in development between China and its partners.
- But if there is one thing that is clear, it is that this is a very dynamic region of the global economy and in some cases the apparent trade patterns seem to have led China and its partners to policy choices that may not in the end be the best given the underlying circumstances.

### [SLIDE 2] – China's Trade Imbalances

- Between 2000 and 2005, China's trade surplus with the United States grew by 283 percent. In part because it started from a lower base, China's trade surplus with the EC-25 grew by some 631 percent over the same period.
- At the end of 2005, China's combined trade surplus with the EC-25 and the United States stood at more than \$184 billion.
- But at the same time, China's trade deficit with Asia, not counting Hong Kong, amounted to more than \$134 billion.
- This chart shows the roughly symmetrical relationship between the surpluses with the US and EC and the deficits with other Asia.
- I will come back to the reasons for this parallelism a bit later.

### [SLIDE 3] – FDI Imbalances

- Not surprisingly, patterns of foreign direct investment have also not been reflective of any kind of balance among countries.
- By far, the greatest share of FDI accrues to developed countries as you can see from this chart derived from UNCTAD's 2005 World Investment Review.
- But a very large percentage of this (78% or \$716 billion) is mergers and acquisition activity, whereas a very large proportion of the FDI flowing to the developing world is creating new production and trade.
- Not surprisingly, the Asia-Pacific region of developing countries received a much greater share of the global FDI pie, than did other regions.
- China, of course, had a lot to do with this pattern.

### [SLIDE 4] - Unbalanced FDI in Asia

- Within Asia, the distribution of FDI is far from balanced. East Asian developing countries saw \$118 billion in FDI inflows in 2005 - \$72.4 billion of which went to China.
- The other big “chunk” of the investment went to South East Asian developing countries. \$37 billion flowed to these countries in 2005.
- Everybody knows that notwithstanding the very high amounts of money crossing borders today as FDI, the bulk of investment is still domestically generated in most countries. But patterns of FDI will show us where the world's multinational companies think the action is. In terms of new investment in plant and equipment, it's pretty clear that they see China and its South East Asian partners as the place to put their money.
- Why? Is it because these are dynamic growing developing countries?

### [SLIDE 5] – Components Trade in China Trade

- Remember the slide showing the parallel relationship between China's trade surpluses with the US and EC and its deficits with South East Asian countries?
- The chart on this slide goes a long way to explaining what is going on. China is importing components – or as some refer to them, product fragments – from its Asian trading partners at an ever growing rate.
- Between 1992 and 2004, the regional share of total Chinese imports of components rose from 37.6 to 77.7 percent. In the same period, the combined share of the AFTA countries in this components trade rose from less than one cent to nearly twenty percent.
- China's manufactured exports might appear high tech in composition, but some China experts like Nick Lardy suggest a better label might be “mass market commodities” simply assembled from foreign components.

- Most of the firms involved are foreign, accounting for three-fifths of all Chinese exports, with four fifths of exports assembled from imported parts and components and nearly nine-tenths of high tech products.

#### [SLIDE 6] – Flags Showing Direction of Trade

- So what is really going on – and this has now been extensively documented by economists like ANU's Prema-Chandra Athukorala – is that China is sucking in ever growing amounts of components from its developing Asian neighbours.
- But it's not a two-way trade. The final products after assembly are heading for the US and European markets.
- On the export side, China's aggregate intra-regional share has declined persistently in both total manufacturing and component exports.
- Far from being indicative of regional integration, China's evolving export patterns are showing a clear and increasing extra-regional bias.
- And this, of course, is what we see when we look at the persistent and growing trade imbalances.

#### [SLIDE 7] – Will assembly stay competitive?

- So far so good. China's Asian neighbours are benefiting from China's exports to the US and EC and they have established ever growing supply chain patterns centred on assembly operations in China where wages are low and labour intensive assembly can be organized to maximum profit.
- But China's got competition. This slide shows what's going on with developments in monthly wage rates in manufacturing in China and its neighbours.
- And if you read the recent article on China in the Economist, you would know that the World Bank country director for China is on the record as pointing out that wages in China are now rising two or three times faster than in other low-income Asian countries.
- The interesting thing here is that this model - where South East and other East Asian countries feed components into the Chinese assembly operations for export to the developed world only works so long as Chinese wages stay low.
- Imports aimed not at re-export but at feeding the local Chinese economy are rising rapidly, but are mainly raw materials like oil, copper, gas and timber.

#### [SLIDE 8] – China's RTA Initiatives

- Just a few short years after joining the multilateral system of the WTO, China is embarked on an aggressive program of negotiating regional and bilateral trade deals.
- If all of the 27 negotiations now underway come to fruition in agreements, about ¼ of all Chinese trade (\$350 billion) would be conducted under the auspices of preferential deals.
- Why is China doing this and to what extent do all these initiatives reflect some effort on the part of China and its trading partners to adjust to the dynamic environment of a rapidly growing China?

#### [SLIDE 9] – China-ASEAN

- When Pascal Lamy went to Beijing last September and complained about this bilateral activity, MOFCOM's spokesman told the press that China saw FTAs as important complements to the WTO and that they are in keeping with the "trend of regional economic integration underway in the Asia-Pacific region."
- Following this line of thought, it should surprise nobody that an early target for an FTA should be one between China and ASEAN. On its own merits, the FTA negotiated between China and ASEAN looks pretty good, even if it is a work in progress. Full liberalization of trade in goods by 2015 is impressive.
- But is what is going on between ASEAN's AFTA and China the kind of two-way exchange that you might normally associate with "economic integration" or is it a slightly fragile supply chain relationship? In other words, what is the likely or anticipated value added from this FTA?

#### [SLIDE 10] – China - Chile

- It seems to me that to some extent we can ask the same questions about the recent FTA between China and Chile. It may be nice to see cooperation in an agreement between such distant neighbours, but could we call this an economic integration agreement?
- Probably not, but at the same time the agreement likely reflects both side's efforts to adjust to China's growing role in the region and more globally.
- For China, it's a way of locking in access to a very important raw material - copper - that the country needs in ever increasing amounts, much of it to feed growing domestic demand for household appliances, air conditioners, etc.
- For Chile, it's probably not an agreement necessary to sell more copper or bulk wine into the Chinese market but there is a hint of Chilean reasoning in the government document discussing the FTA -- Chile wants to be the jumping off point for Chinese investment in Latin America.

## [SLIDE 11] – Conclusions

- This has been a fairly brief treatment of a considerably more complicated subject, but I think we can still point to a few useful conclusions.
- First, China's current trade patterns do not appear to reflect deepening regional economic integration so much as they portray a very active global supply chain.
- Second, the base on which the supply chain relationship has been built may be more fragile than might otherwise be our first impression because it depends upon continued low Chinese wages in assembly operations and continued Chinese access to developed country markets.
- Third, in light of our first two conclusions, local or even trans - Pacific FTAs probably add very little value to the trading relationships. If it is important for economic development considerations to keep the trade going on this supply chain, China and its Asian neighbours would do better to concentrate their efforts on ensuring a continued healthy global trading environment so that China might continue to enjoy access to important markets in developed countries.
- Thank you for your attention.