

China and Economic Cooperation in the East Asian Region

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ABSTRACT

The purpose of this study is to explore the emergence of Chinese economy and the possibility of economic cooperation between the East Asian countries, which will facilitate the solution to structural problems in the economy and industries of these countries. This study presents that China will remain essential to the East Asian economy and changes are anticipated in its economic growth rate, growth strategy and risks. How to respond to them will be the critical movement that will determine the future course of the East Asian economy. To solve this question, firstly each government of East Asian countries needs to come up with strategies that will leverage China for their industrial upgrade and economic development even when the risks facing China are realized. Second, each government of East Asian countries should make a wise approach towards a free trade agreement between EATR and China.

Keywords: China, East Asian Trade Region, Economic Performance, Cooperation

1. INTRODUCTION

During the past decade, regional trading arrangements have mushroomed whereby each nation is to reduce its trade barriers against member countries in an attempt to promote trade and economic development of a trading bloc. The European community, the North American Free Trade Agreement, and the Association of Southeast Asian Nations (ASEAN) are good example of such a trend. Each regional integration effort, however, appears to have limited impact so far in both trade and growth of the regional economies.

One notable exception, although not formally organized, is the regional economy, which represents a bloc of Far East Asian countries, Japan, South Korea, Taiwan, Hong Kong, and China. These countries, along with Singapore, all achieved an enviable economy in the past twenty years. The major common characteristic of these nations' economic achievements is that they have all adopted an "outward-looking" development strategy based on trade expansion through vigorous export promotion. They all shared common comparative advantages in relatively labor-intensive industries and competed with each other for the same intra-regional (here "region" is narrowly defined to include East Asian countries consisting of China, South Korea, Japan, Hong Kong, and Taiwan) as well outside the regional market, particularly the North American market.

The emergence of China has gathered attention in the 1990s and particularly since the mid-1990s as a major player in the East Asian region from all corners of the world. China's

gigantic steps towards a market-oriented economy (i.e. opening up its economy to the outside) have begun to have significant impacts on global trade and particularly on the economies of member countries of the East Asian Trade Region (EATR). It is certain that China's open-door policy has caused and will continue to cause 1) competition among regional as well as developed countries for export market opportunities, 2) stepped-up competition among member countries for export market share outside the regional market, particularly for the U.S. market, and 3) the net effect of 1) and 2) may have different implications for each of the member countries.

The purpose of this study is to propose the emergence of Chinese economy and the possibility of economic cooperation between the East Asian countries, which will facilitate the solution to structural problems in the economy and industries of these countries.

2. REVIEW OF LITERATURES

Lawrence Lau (1997), entitled "The Role of Government in Economic Development: Some Observations from the Experience of China, Hong Kong, and Taiwan," presents a comprehensive list of policy instruments the government used in mobilizing resource inputs, allocating them more efficiently (moving to the production frontier), and shifting the production frontier outward. Issues involved in the use of each instrument are illustrated with rich facts from the greater Chinese

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economic zone.

Tetsuji Okazaki (1997), entitled "The Government-Firm Economic Relationship in Postwar Japanese Economic Recovery: Coordinating the Coordination Failure in Industrial Rationalization," describes, on the basis of newly available historical documents, the workings of a government-sponsored deliberation council for resolving particular investment coordination problems facing Japan in the postwar economic recovery period. Based on historical analysis, it identifies historical and institutional conditions under which the deliberation council may function as a device for resolving well-defined coordination problems.

Following this study, Hyung-Ki Kim and Jun Ma (1998), entitled "The Role of Government in Acquiring Technological Capability: The Case of the Petrochemical Industry in East Asia," is a comparative case study of the petrochemical industry in Japan, Korea, and Taiwan in which scale economies, needs for coordination among upstream and downstream activities, and large investment requirements may call for substantive government intervention at the developmental stage. Governments in these economies were involved in the selection of the upstream entry, but at the same time encouraged unbundled (unpackaged) imports of foreign technology and participation of domestic engineers in project design from the outset to nurture indigenous engineering capability. They contrast this approach to those adopted by China, Brazil, and India, where governments also intervened heavily but generated very different outcomes, and derived some lessons to restrain unproductive rent-seeking behavior under the condition of government control.

Kiminori Matsuyama (1998), entitled "Economic Development as Coordination Problems," fundamentally questions the value of state activism as a solution to coordination failure. It contends that coordination failure arises because no one can know the exact nature of the problem he or she is trying to solve. Because of this lack of knowledge, the logic of coordination failures does not justify centralized policy activism. Centralized coordination would pose the greatest danger of interfering with private experiments to discover an even better way of coordination.

Following this study, Meredith Woo-Cumings (2000), entitled "The Political Economy of growth in East Asia: A Perspective on the State, Market, and Ideology," discusses the impact of differences in initial conditions and international environments on the developmental strategy between Latin America and East Asia (Korea and Taiwan). She elucidates the unique imprint of Japanese colonial legacies on the bureaucratic nature of the state in Korea and Taiwan and its relations with business and agrarian interests --- a subject long neglected by economists in spite of its importance. She also discusses how the specific geopolitical positions of these two economies affected their developmental strategies as well as their capabilities to extract "rent" from the United States in the Cold War.

Even though there have been few studies for the growth of Chinese power and economic cooperation in the East Asian region, most of those that were done focused on the fragmentary analysis.

3. TRADE AND GROWTH PERFORMANCE OF EATR COUNTRIES

Since the 1960s, East Asian countries have sought economic development through an outward-looking industrialization policy. Japan has played a pivotal role in this process: East Asian governments have learned heavily from the Japanese experience to foster their own industries, while Japanese companies have helped the fledgling companies across the region by providing them with capital and technology.

Following Japan's lead, China has joined the ranks of exporting countries and its trade performance has been nothing short of spectacular, particularly since 1985. China's joining in to group trade activities of the EATR has made it the fastest growing trade bloc in the world, averaging 13.4 percent per year since 1980.

Hong Kong topped the export growth rate at 14.9 percent, closely followed by China at 14.7 South Korea at 13.6, Taiwan at 13.5 and Japan at 8.8 percent the U.S. market has been the most important export market for these countries. The EATR group as a whole exported \$50.3 billion (19.6 percent of total U.S. imports) in 1980. The EATR's market share increased to \$180.3 billion or 36.2 percent of total U.S. imports by 1992. The volume of intra-bloc trade within the EATR has also grown significantly from \$40.7 billion in 1980 to \$170 billion in 1992.

Of particular to the free market economics of the world is the latest economic performance of China since the "open door" policy began in 1978. The conversion from a centralized planned economy to a gradual market-oriental economy had its beginning when China opened its door to the outside world with the established of Special Economic Zones (SEZ) and subsequent openings of the so-called ECONOCOAS Areas. The immediate result of the open door policy was massive capital infusions from outside into Chinese coastal cities, mostly in the form of direct foreign investment, and on a limited basis, through foreign institutional borrowing.

The massive capital inflows were combined with an ample supply of domestic labor to produce goods, which had comparative advantages. As the economy gradually shifted into a decentralized mode, particularly with liberal policies applied to the foreign trade sector, the result was a rapid increase in foreign trade.

China's trade volume has grown dramatically since its 2001 accession into the World Trade Organization (WTO). Since then, China's annual exports have increased 3.63 times, from US\$266.7 billion in 2001 to US\$969.3 billion in 2006 for 30% annual growth. China's exports are expected to maintain 30% growth in 2007 with a total trade surplus roughly around US\$200 billion for the year.

China's annual imports increased from US\$243.6 billion in 2001 to US\$791.8 billion in 2006, growing 27% annually since China's WTO accession. Given that growth in exports is likely to outstrip imports in 2007, China's trade surplus will not likely fall.

As China's trade volume has grown, the economy's dependence on trade (total amount of trade as a share of GDP) has also increased. The nation's trade dependence increased from 38% in 2001 to 64% in 2005.

Intraregional exports of EATR countries such as Korea,

Taiwan, Singapore, Malaysia, Thailand, Indonesia, and the Philippines rose to an average 43.8% of total exports in 2005, up from 35.8% in 1995. In comparison, their collective exports to the US dropped from 19.8% to 14.7% on the average in the same period.

China fueled the significant increase in intraregional exports. While the share of intraregional exports between the seven countries fell from 22.5% in 1995 to 21.3% in 2005, the portion to China (including Hong Kong) rose from 13.3% to 22.5% over the same period.

China thus plays an increasingly important role in spurring growth of East Asian economies. Every 10% increase in Taiwan's exports to China contributes 2% to Taiwan's GDP, while every 10% rise in Korea's exports to China brings 1% growth effect for its economy.

The Chinese economy has posted an average 9.8% growth rate every year since Deng Xiaoping embarked on a full-fledged opening up of China in 1992 with his "nanxun" or "southern tour." Nine years later in 2001, China officially joined the World Trade Organization (WTO), a powerful symbol of its increased economic influence and commitment to economic reform.

In the wake of that decision, China has continued to increase its influence on a global scale: in 2006, China became the world's 4th largest economy (measured by the total GDP) and the third largest trading power. In recent years, East Asian nations have become the main beneficiaries of China's explosive growth.

In particular, Korea has emerged as one of the biggest winners tapping China's growing market, also benefiting from the Chinese economy. From 2002 to 2006, Korea's exports to China increased 3.2 times, surpassing the US' 2.1 times, Japan's 2.2 times and Taiwan's 2.3 times. In 2005, Korea overtook Taiwan to become China's second largest export partner behind Japan.

The average growth rate of real GNP for the group during the same period was 6.45 percent, but it was 7.1 percent excluding Japan, which grew by 3.85 percent, the slowest rate for the group. The fastest growing country among EATR countries is China, with an annual average real growth rate of 8.0 percent since 1980 but a much faster rate since 1990s.

South Korea and Taiwan registered 4.7 and 6.1 percent annual real growth rate in 2004; Hong Kong grew at an 8.6 percent rate, and Japan at a slower rate of 2.7 percent. These rates are contrasted with a 2.0 percent growth rate by the U.S. and a 4.7 percent rate by OECD nations for the same period.

4. ECONOMIC COOPERATION IN THE EAST ASIAN REGION

Based on the analysis of trade and growth performance, we try to explore the possibility of economic cooperation, and also to propose possible cooperation areas for the East Asian countries.

4.1 History of Economic Cooperation

Economic cooperation between the East Asian countries has

experienced a long period of dormancy. Passing through the isolation policy of Korea and China in the late 19th century, expansion of Japanese imperialism, World War II, and the Cold War, economic cooperation between these countries had broken off for a long period of time. However, the ice began to thaw with the normalization of relations between these countries and China's open-door policy. Beginning with diplomatic normalization of Korean-Japanese relations in 1965, the relationship between the two countries began to recover.

Moreover, the announcement of reform and open-door policies by China in December 1978 became a turning point of economic cooperation between the East Asian countries, stimulating economic cooperation separate from political considerations. In the 1990s, with the dawning of the post-Cold War era and increasing economic interdependency among countries, economic cooperation between the East Asian became more active. Furthermore, with the collapse of the Soviet Union in 1991 and the normalization of Korean-Chinese diplomatic relations in 1992, a substantial foundation for economic cooperation was laid. Especially after the Asian economic crisis in the second half of 1997 together with discussions of economic cooperation among Asian countries to fend off the chance of a future currency crisis in the region, the mood for the relations of East Asian countries has fully ripened.

4.2 Overview

Ever since the new century opened, a mood of economic cooperation between the East Asian countries, China, Korea, Japan, Hon Kong, and Taiwan, is quickly spreading. Especially after the Asian economic crisis, these countries have keenly felt the necessity for economic cooperation. Furthermore, because each of these countries is promoting economic restructuring, it is expected that economic cooperation between them will facilitate the solution to structural problems in the economy and industries of these countries.

As the negotiation between the U.S. and China over China's membership in the World Trade Organization (WTO) reached an agreement on November 15, 1999, the outdated legal system of China, of which there was concern that it might act as a hindrance to the economic cooperation between these countries, is expected to be reformed.

Moreover, the summit talk between Korea, China, and Japan in Manila, Philippines on November 18, 1999 which was held for the first time in the history of the three countries holds great weight in the construction of a cooperative relationship in the East Asian region. Though China showed a conservative attitude due to its political orientation, economic cooperation between the East Asian countries was discussed in depth at the summit.

In the discussions, they agreed to search for cooperative measures in the ten economic areas of trade and tariffs, investment and finance, industry, agriculture, fishery, energy, science and technology, transportation and tourism, telecommunications, and environment.

In September 17, 2001, the accord on China's entry into the World Trade Organization (WTO) was approved by the formal meeting of the 18th WTO Working Party on China's accession.

With China's membership, the WTO will take a major step towards becoming a true world organization. Joining as a member of the WTO, if the construction of a cooperative economic system between the East Asian countries comes to fruition, the opportunity will be ripe for the East Asian region to boost itself as a center of the global economy.

4.3. Problems to be solved

However, the economic relationship between China, Korea, and Japan has many substantial problems. China, Korea, and Japan, for example, intra-trade within those countries is relatively inactive, and the trade balance is seriously lopsided. Trade within the three countries remains at an extremely low level compared with that of NAFTA and the EU, both in terms of scale and weight. While the scale of NAFTA intra-trade amounts to USD 1 trillion and that of the EU nears USD 3trillion, that of Korea, China, and Japan remain at only USD 200 billion. Also, while the weight of intra-trade of the EU is 65.7% and that of NAFTA is 45.3%, the weight of intra-trade for the three Asian countries is only 17.3%. Moreover, the weight of intra-trade between the three countries has been showing an increasing trend since 1990s.

Table 1. Weight of Intra-trade Between China, Korea, and Japan (Unit: %)

1991	1995	1997	2000	2004
13.9	18.7	19.2	20.0	23.5

Note: Total amount of intra-trade between the three countries/Total amounts of trade of the three countries.

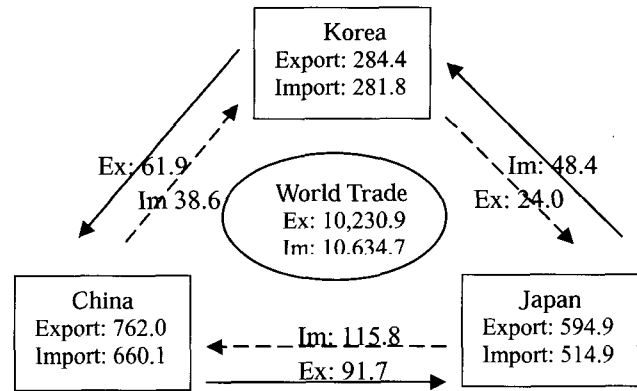
Source: Estimates based on sources from the IMF, DOT, and statistical materials of the three countries.

Table2. Export Growth Rate of East Asian Countries (2002-2004) (Unit: %)

	China	Korea	Japan	Taiwan	Hong Kong	Thailand	Singapore
2002	22.1	8.0	3.3	6.3	5.5	5.7	2.8
2003	34.6	19.3	13.2	10.4	11.8	15.2	15.2
2004	35.4	31.0	19.9	20.7	15.8	21.3	24.5

Note: Figures in the table are year-on-year growth rates
Source: Korea International Trade Association

Figure 1. Trade Structure between China, Korea, and Japan, 2005 (Unit: USD billion, %)



Note: Figures above are the amount of export based on the FOB standard and the weight of export to the direction in the total export.

Source: Trade statistics of each country.

Another characteristic of the trade structure between the East Asian countries is a serious imbalance of trade. Korea continues to record a trade deficit with Japan and a surplus in trade with China. Meanwhile, China has marked a trade surplus with Japan. The imbalance in trade is due to the relationship between the economic structures of these countries and underdeveloped industrial and technological cooperation.

For example, Korea has posted a chronic trade deficit with Japan due to the still significant technology gap between the two countries and Korea's dependency on Japan for core capital goods and parts. China has shown a deficit in trade with Korea due to the import of intermediate goods for its light industries, which remain in their infancy, from Korea. Meanwhile, China is currently recording a surplus in trade with Japan, exporting labor-intensive and low-priced goods. However, as the Chinese economy develops, it is very likely that China will also record a trade deficit with Japan because they will have to import capital goods and parts from Japan.

Investment between the East Asian countries, particularly in Korea, China, and Japan, is also insufficient. Though Japan and Korea occupied fourth and sixth position in the ranking of investment in China in terms of the dollar amount, the scale per investment case is smaller than that of the U.S. and the EU. Meanwhile, investment between Korea and Japan is diminishing due to Japan's high production costs, complex distribution system, and difficult access to its market due to many invisible barriers. In addition, Korea's unstable labor-management relations, complex administrative procedures, and unfavorable feelings toward Japan are also deterrents to inter-country investment between the nations.

In the industrial relationship between the East Asian countries, cooperation and competition coexist. In the overall industrial structure, a vertical division system, in which direct investment or technical transfers flow from Japan to Korea and from Korea to China, exists. For instance, Japan produces technology-intensive products such as core capital goods and parts, materials, and high value-added finished goods. Korea

produces general capital goods, parts, and finished goods. And China produces labor-intensive finished goods based on its low labor cost. China imports capital goods from Japan and depends on Korea for parts and materials, while Korea imports technology-intensive core parts and capital goods from Japan. This divisional relationship has considerably cooled the fierce competition between these countries.

However, while the restructuring of the Japanese industrial structure has been delayed, other countries have been rapidly catching up. As a result, competition between the East Asian countries in the international market has been heated recently. So the relationship between these countries is becoming more competitive, less cooperative. Also, because the industrial structure of the East Asian countries is concentrated on traditional manufacturing industries while the global economy is moving toward knowledge-based service industries, the East Asian countries are very likely to observe a deterioration of their terms of trade in the global market from a mid to long-term perspective.

Historical and political conflicts between the East Asian countries also exist as a hindrance to economic cooperation. For instance, the damage that Japan's imperialistic invasion inflicted on Korea and China during World War II has not completely healed yet. These countries frequently squabble over national borders such as the dispute over an island named 'Diaoyu' in Chinese and 'Senkaku' in Japanese between China and Japan, and the dispute over another island named 'Tok-do' in Korean and 'Takeshima' in Japanese between Korea and Japan. The North Korean problem is also an obstacle to overcome for regional cooperation in the East Asian region. As another socialist country, China has not been able to exclude consideration of political interest related to North Korea for cooperation with South Korea.

4.4 Possibility of Economic Cooperation

Despite the aforementioned problems, the possibilities of economic cooperation between the East Asian countries are limitless. For example, if the high technology of Japan, experiences and intermediate technology of Korea, Taiwan, and Hong Kong, and resources of China are combined, the East Asian bloc will easily achieve global competitiveness. Japan has internationally superior production technology in the manufacturing industry, Korea, Taiwan, and Hong Kong have the experiences of achieving industrialization within a short period of time, and China has rich and inexpensive labor resources. The broad expanse of land and large population of China will provide immense market and business opportunities in non-manufacturing sectors such as construction and telecommunications.

For Korea, she needs to prepare appropriate measures in order to substantially gain from the relationship between the East Asian countries. In the long term, structural reform with consideration for economic cooperation between these countries in the 21st century is necessary. Reform should be made toward a direction in which the division of labor between these countries is made according to the stage of development of each country. For example, for the transition to high value-added industries, Korea needs to resolutely transfer its

low value-added industries to China. This is a lesson learned from the past experiences of Japan, whose transition to a digital economy was delayed because it was negligent in transferring its old industries and technology to Korea and China in the early 1990s.

In addition, emotional factors behind the East Asian countries' economic cooperation should be handled in a more constructive manner. In the past, more weight has been put on moral cause rather than practical gains due to the historical background in the relationship between these countries. However, the trend has to be changed in the future. The joint hosting of the World Cup in 2002 by Korea and Japan and Korea's recent embracing of Japanese pop culture are examples that promote practical gains more than moral cause. Moreover, China has planned to host year "2000 Summer Olympic Game." This event will give another opportunity for the East Asian countries to boost their economy as well as improving economic cooperation in the region.

For company level, the expansion of economic cooperation between the East Asian countries provides great opportunities for market expansion and technological development. Therefore, each company in this region except for China and Japan and/or Singapore needs to promote business restructuring while considering the results of economic cooperation from a long-term perspective. If not, they might lose their position by China, Japan, and other countries' companies.

5. CONCLUDING REMARKS

Starting in the 1960s, East Asian countries achieved rapid economic growth through an outward-looking policy. These countries' economies grew one after another, following the path taken by their predecessors, with Japan taking the lead.

East Asian countries have now come to depend more on China to make up for their sluggish exports to the US and Japan. Clearly, rising foreign investment in China will eventually contribute to the growth of other East Asian economies.

In addition, emerging markets and Southeast Asian economies will have to keep working to capitalize on China's rapid growth, while at the same time acquiring technology and capital from Japan. In other words, the East Asian region will be able to develop between two pillars of strength, China and Japan. Both countries will strive to increase their economic influence over other East Asian countries—as evidenced by the current race to conclude FTAs.

For Korea, East Asian economy is important from the point of industrial division of labor as well as a trading partner. Korea's exports to East Asia have slowed recently but full implementation of the China-ASEAN FTA will deliver further blows.

In Particular, China will remain essential to the East Asian economy, changes are anticipated in its economic growth rate, growth strategy and risks. How to respond to them will be the critical movement that will determine the future course of the East Asian economy.

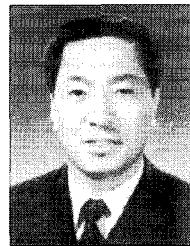
To solve this question, firstly each government of East Asian country needs to come up with strategies that will

leverage China for their industrial upgrade and economic development even when the risks facing China are realized. Second, each government of East Asian country should make a wise approach towards a free trade agreement between EATR and China.

In particular, Korea should endeavor to move into less developed markets in Southeast Asian region to tap into their market potential. Policy must be drawn up to expand investment and trade with the Indochina countries of Vietnam and Cambodia. For this purpose, Korea must be generous in offering its development experience as well as official development aid to these countries.

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