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CHINA AND THE
PROSPECTS FOR ECONOMIC
INTEGRATION WITHIN APEC

by

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Table of Content

- I. Introduction**
- II. The Relative Strength of China and the APEC Economies**
- III. Trends in China's Trade with APEC Economies**
- IV. Implications for Economic Integration with APEC Proper**
- V. Conclusion: Prospects for the APEC Tariff Agenda**

CHINA AND THE PROSPECTS FOR ECONOMIC INTEGRATION WITHIN APEC

Y. Y. Kueh

In the last few years it has been widely argued that the world's centre of gravity for economic activities will inevitably shift from the Atlantic to the Asian Pacific region in the 21st century. This popular perception has clearly been prompted by the spectacular economic growth of China in the past 15 years, following accelerated domestic reforms and, in particular, her "opening-up" to the outside world. There is no doubt that the 'China factor' has greatly assisted in sustaining the growth dynamism of the newly industrialized economies in Asia, (notably Taiwan and Hong Kong, but also - and increasingly - South Korea). The strength and global importance of the Japanese economy leads further weight to the emerging scenario for the 21st century.

There are two dimensions to the rising expectation of the emergence of an "Asian Pacific era". The first, reflecting a broader consideration relates to the involvement of the countries of the East Pacific, (above all the United States). The second - a narrower consideration - embraces the likelihood that self-sustaining development by the Asian-Pacific economies into a fully integrated regional economic entity, with China and Japan as the critical core by virtue of their industrial status and the market size.

In some questions, it has become a foregone conclusion that the perspective of the "Asian Pacific era" is already imminent. After all, "intra-regional" trade among member countries of the Asian Pacific Economic Cooperation (APEC), including the US and other North and South American economies facing the Pacific Ocean already accounted for 47

percent of total world trade in 1993. In addition, the APEC economies are responsible for the overwhelming share of global GNP, with the United States and Japan ranking first and second, and Mainland China approximating (after Germany) fourth in terms of purchasing power parity (PPP) estimates of GNP made recently by the World Bank.

Against this background, we propose to confine our analysis to the "APEC proper", by excluding countries on the American side of the Pacific. We do not, however, follow Premier Mahathir of Malaysia, whose radical concept of the East Asian Economic Caucus (EAEC) excludes Australia and New Zealand, as well as Taiwan and Hong Kong.

Several major issues follow in respect to the economic potential of the "narrower" APEC or "APEC proper", as just defined. It is as well to emphasize that it is not this paper's intention to examine the domestic growth prospects of individual member countries. Our major task is to address the overall potential for intra-regional trade, as opposed to trade with outside world.

The main focus is, then, on trade and related investment issues. It is clear that China holds the key to many of these issues: after all, while "APEC proper" constitutes countries with economies which are already open and market-orientated - and whose potential for growth is marginal - , the Chinese economy remains in a state of flux. Any relaxation in market access restrictions, in terms adjustments to of tariffs and non-tariff barriers and the removal of impediments to foreign investment, promises substantially to alter the patterns of trade, service, and capital flows within the APEC region, in accordance with fundamental patterns of regional comparative advantage.

We shall therefore focus on China in order to show how, as an emerging economic power, it may help to promote economic integration in the Asia Pacific. In what follows, we first give a brief review of the relative strength in terms of GNP size, output structure, degree of industrialisation, and trade volume of the Chinese economy relative to that of the various APEC economies . This provides a background for assessing possible future patterns of economic interaction between China and other APEC economies.

In the second section, we examine the changing trends in China's trade within APEC, vis-a-vis trade with countries outside the region since the early 1980s. This serves to reveal the impact of China's economic and trade reforms in the past 15 years on regional trade, as well as indicating the potential for economic cooperation within APEC in the future.

Section three attempts to identify the major obstacles and constraints inherent in the present Chinese economic system and policies for further economic integration within APEC and with the outside world in general. This provides the necessary basis for assessing the prospects of China as a member of an APEC trading bloc.

Against this background the concluding section discusses the basic implications for China of the APEC tariff agenda established under the Bogor Declaration of November 1994, under which the long-term goal of free and open trade and investment in the Asia Pacific region is to be achieved no later than 2020, or by 2010 for the industrialized economies of APEC.

Underlying the analysis are overlapping, multifaceted and enormously complex

problems. For almost every issue raised, in-depth careful research is needed before any firm statement can be made. To that extent the goals of this paper are limited: that is, we seek to illustrate the broad contours of the fundamental issues and point to possible outcomes, rather than put forward firm conclusions and proposals. In short, the exercise generates more hypotheses and questions than it does answers.

The Relative Strength of China and the APEC economies

The Chinese economy assumes a leading position within the APEC context, whether defined as the broader APEC (including the American side of the Pacific) or the narrower APEC (merely embracing the Asian Pacific Rim (APR) economies). There are several aspects to this. The first is the sheer size of China's population and economic power. Adjusted by the PPP-estimate (which gives a multiple of around 6.6 over the official Chinese figure in terms of US Dollars, based on the depreciated official Renminbi rate), China's absolute GNP has already surpassed that of Japan, and is 11 times larger than that of South Korea - the next largest APR economy. It is also nearly 15 times the size of Australia's GNP in 1993/1994, as revealed in Table 1.

Second, with around 48 percent of her national gross output generated from manufacturing and construction, China is clearly also an industrial giant, standing alongside Japan within APEC. It is evident too that after four decades of forced-

Table 1: Major economic indicators for China in comparison with other major APEC economies, 1993/1994

	Population (1994)		GNP (1993)		Per Capita GDP (1993)	Output structure (1993)			Export (1994)		Import (1994)		Trade/GNP ratio	
	Millions	Percent	US\$ million	Percent	US\$	Percent			US\$ million	Percent	US\$ million	Percent	Percent	
	(1)	(2)	(3)	(4)	(5)	(6) A	I	S	(7)	(8)	(9)	(10)	(11)	
China	1,191.8	68.11	581,110 (3,864,382)	11.75 (46.97)	361 (2,401)	20	48	33	104,672	9.43	114,564	11.12	37.73 (5.67)	
Japan	124.0	7.09	2,996,052	60.59 (36.41)	31,558	3	32	65	360,705	32.49	238,716	23.18	20.01	
Hong Kong	6.3	0.36	104,730	2.12 (1.27)	19,600	0	17	83	151,399	13.64	161,841	15.71	299.09	
S. Korea	44.5	2.54	338,060	6.84 (4.11)	7,496	7	43	50	96,013	8.65	102,349	9.94	58.68	
Taiwan	21.0	1.20	226,240	4.58 (2.75)	10,703	4	37	59	92,833	8.36	85,489	8.30	78.82	
Singapore	2.9	0.17	55,370	1.12 (0.67)	18,458	0	37	63	96,457	8.69	102,400	9.94	359.14	
Malaysia	19.5	1.11	60,060	1.21 (0.73)	3,384	16	44	40	58,147	5.24	59,414	5.77	195.74	
Indonesia	190.7	10.90	136,990	2.77 (1.66)	773	19	39	42	39,487	3.56	35,132	3.41	54.47	
Philippines	68.6	3.92	54,610	1.10 (0.66)	747	22	33	45	12,124	1.09	22,638	2.20	63.66	
Thailand	59.4	3.39	120,240	2.43 (1.46)	1,892	10	39	51	45,061	4.06	54,365	5.28	82.69	
Australia	17.5	1.00	233,109	4.71 (2.83)	14,485	3	29	67	42,723	3.85	43,476	4.22	36.98	
New Zealand	3.5	0.20	37,956	0.77 (0.46)	10,809	8	25	67	10,430	0.94	9,649	0.94	52.90	
AP total	1,749.7	100.00	4,944,527 (8,227,799)	100.00	3,298 (4,690)	5	34	60	1,110,051	100.00	1,030,033	100.00	43.28 (26.01)	

Table 1

Notes:

- (1) The two bracketed GNP/GDP figures for China are derived by applying to the given official figures the ratio (6.65) of the World Bank's 1992 GDP figure for China (US\$2,460 per capita) based on the "purchasing power parity" (PPP) estimates to the corresponding official Chinese figure (US\$370 per capita) obtained by conversion at the official exchange rate. The International Monetary Fund (IMF) has made a similar PPP estimate for China, also for 1992, and come up with a lower per capita GDP of US\$1,700 compared with the Bank's figure cited above. The IMF estimate would give a lower multiple of 4.59 (i.e. US\$1,700/US\$370), and therefore a lower total GNP of US\$2,667,295 million and per capita GDP of US\$1,657, but a higher trade/GNP ratio of 8.22.
- (2) Output figures for the A (agriculture), I (industry) and S (service) sectors are all in gross value rather than in value-added term.
- (3) The statistics for population, export and import for Japan, Australia and New Zealand are all 1993 figures.

Sources:

- (1) All population, GNP/GDP, and trade statistics are from Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries, 1995; except those for Japan, Australia and New Zealand which are given in World Bank, World Tables 1995 and United Nations, International Trade Statistics Yearbook 1994; and the Hong Kong population figure which is from Hong Kong Government. Hong Kong Yearbook 1995.

- (2) All gross output figures are from World Bank, World Tables 1995; except those for Taiwan which are taken from Council For Economic Planning and Development (Taipei). Taiwan Statistical Data Book 1995.
- (3) The PPP-estimates are reported in The Economist, 15 May 1993 exports (for World Bank's) and Dagongbao (Hong Kong), 18 May 1993 (for IMF's).

draft industrialisation under a highly protective trade regime, the country has built up an independent, comprehensive, and largely self-sufficient industrial system characterized by considerable technological sophistication. This is unmatched by any other APR economy except Japan.

Third, by the same PPP measure, per capita GDP in China (USD 2401) was as of 1993 already substantially higher than that of Indonesia, the Philippines and Thailand and only 30 percent below that of Malaysia. Note that the original, unadjusted Chinese per capita GDP (USD 360 in 1993) conveys no economic logic. The figure is indeed almost the same as that of the early 1980s, which was obtained by simply converting the official Renminbi value into US Dollar according to the prevailing official exchange rate. The accelerated Renminbi devaluation against the US Dollar since the mid 1980s has undoubtedly greatly distorted the comparative Chinese income strength. The reality is, however, that per capita GDP in China has grown, in real terms, by an average of 8.4 percent per year from 1980 to 1994, based on consistent Renminbi reckoning.¹

In any case, the readjusted figure of USD 2401 for China clearly suggests a per capita GDP level which is substantially above the threshold of subsistence - implying indeed rising

consumerism and increased potential for external trade. But it is also clear that substantial income disparity has emerged between coastal and interior Chinese provinces. In Guangdong province, for example, per capita GDP was probably around USD 4100 in 1994 (by the same PPP-measure), thus trailing behind South Korea by less than half of its level.² From this perspective, the prosperous Chinese coastal belt already constitutes a powerful base for economic cooperation with member APEC economies.

Consider next the relative “openness” of the Chinese economy in terms of her external trade volume relative to GNP size. Surprisingly, the trade/GNP ratio given in Table 1 suggests that China is currently even more “open” than Japan and is comparable with Australia, even if it still lags far behind such entirely trade-dependent APEC economies as of Hong Kong and Singapore. If Guangdong province and Greater Shanghai municipality (another provincial-level unit) are taken as the basis for comparison³, their ratios are certainly comparable with those of South Korea, Taiwan and Thailand, which are all heavily export-oriented.

Here again the real Chinese picture seems to have been highly distorted as a result of the statistical bias associated with the official Renminbi exchange rate used for the estimates. The reason is simple. While export and import statistics are normally based on the original US dollar quotation, Chinese GNP figures in US dollar are derived from straight-forward conversions from officially reported Renminbi values according to the highly depreciated yuan rate against the US dollar. This has helped grossly to understate Chinese GNP in Renminbi denomination.

Thus, if we were instead to apply the PPP-estimates of the World Bank in order to estimate China's GNP, the trade/GNP ratio would probably be reduced from 37.7 percent to no more than 6 percent (1993/94). Or, if the similar, but more conservative IMF estimate were used, the estimated trade ratio would be only around 8.2 percent in 1993 (see notes to Table 1). Ultimately, no unambiguously precise estimate is possible. But it is safe to propose that the relative openness of the Chinese economy is substantially less than the "official" trade/GNP ratio would suggest.⁴ The implication is that there still is considerable potential for enhancing trade and investment flows between China and other APEC members.

To sum up, given the size of the Chinese economy, which accounts for nearly 50 percent of the total GNP of APEC proper by the PPP-estimate, (or 12 percent by the nominal official statistics), there is a *prima facie* case for believing that China will join Japan to become one of the two preeminent forces in the economic integration of the Asian Pacific region, and, in the context of APEC, play a much more significant role than that of the United States in the global economy. Against this background, we now consider China's trade relations with member APEC economies since the early 1980s.

Trends in China's trade with APEC Economies

The basic question here is whether, as a result of China's domestic reforms and accelerated opening up to the outside world, her trade flows with other APEC economies have been enhanced to any significant extent, vis-a-vis those with other countries outside of the Asian Pacific region. The widely-held view is that trade among APR countries has increased substantially in the past 15 years, highlighting strengthened economic integration within APEC

proper. This view is further strengthened by the general perception that in addition to the benefits of geographical proximity, the APEC proper economies are complementary to each other, by virtue of their great diversity, (in terms of GNP size, factor endowment, stage of development, and technological levels).

However, the picture which emerges from the statistical trends shown in Table 2 is at best a mixed one. The figures there offer evidence of the changing magnitude of China's trade flows with various APEC proper economies relative to North American (NA) and selected western European countries (E) for the benchmark years 1980, 1985, 1990 and 1994. A number of points may be made.

First, in support of the general perception, China's merchandise trade (exports plus imports) with APEC countries as a whole did indeed increase from 46 percent (1980) to 57 percent (1994) of its global trade. However, such increases seem to have taken place at the expense of ROW (rest of the world) countries, (the share falling from 27 to 16.2 percent between 1980 and 1994), rather than "NA + E" countries (share remaining at 27 percent from 1980 to 1994, despite a marginal decline to 22 percent in both 1985 and 1990). To the extent that the ROW share consistently declined after 1980 through the interval benchmarks 1985 and 1990 to 1994, it would appear that a realignment of China's trade links with APEC countries, away from such remote ROW trade partners as Africa, Latin America, and the Middle East countries, has taken place.

Second, however, China's increased trade share with the APEC countries seems to have essentially, if not exclusively, derived from the remarkable increases with Hong Kong

Table 2: China's trade with APEC proper (AP), North America (NA) and major European countries (E), and with rest of the world (ROW), 1980-1994									
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	Export								Import								Export + Import			
	1980		1985		1990		1994		1980		1985		1990		1994		1980	1985	1990	1994
	US\$m	%	US\$m	%	US\$m	%	US\$m	%	US\$m	%	US\$m	%	US\$m	%	US\$m	%	%	%	%	%
World	18,139	100.0	27,329	100.0	62,876	100.0	120,822	100.0	19,505	100.0	42,534	100.0	53,915	100.0	115,629	100.0	100.0	100.0	100.0	100.0
AP	9,831	54.2	16,257	59.5	41,492	66.0	68,517	56.7	7,613	39.0	22,354	52.6	29,226	54.2	66,803	57.8	46.3	55.3	60.6	57.2
NA & E	3,087	17.0	4,195	15.3	10,010	15.9	33,012	27.3	7,084	36.3	11,171	26.3	15,199	28.2	29,722	25.7	27.0	22.0	21.6	26.5
ROW	5,221	28.8	6,877	25.2	11,374	18.1	19,293	16.0	4,808	24.7	9,009	21.2	9,490	17.6	19,104	16.5	26.6	22.7	17.9	16.2
Japan	4,032	22.2	6,091	22.3	9,210	14.6	21,490	17.8	5,169	26.5	15,178	35.7	7,656	14.2	26,319	22.8	24.4	30.4	14.4	20.2
S Korea					433	0.7	4,376	3.6					236	0.4	7,318	6.3			0.6	4.9
Taiwan					320	0.5	2,242	1.9					2,254	4.2	14,084	12.2			2.2	6.9
Hong Kong	4,353	24.0	7,148	26.2	27,163	43.2	32,365	26.8	570	2.9	4,762	11.2	14,565	27.0	9,488	8.2	13.1	17.0	35.7	17.7
Singapore	421	2.3	2,063	7.5	2,016	3.2	2,563	2.1	190	1.0	241	0.6	849	1.6	2,481	2.1	1.6	3.3	2.5	2.1
Malaysia	180	1.0	186	0.7	370	0.6	1,118	0.9	240	1.2	198	0.5	852	1.6	1,623	1.4	1.1	0.5	1.0	1.2
Thailand	312	1.7	116	0.4	854	1.4	1,159	1.0	140	0.7	263	0.6	386	0.7	864	0.7	1.2	0.5	1.1	0.9
Indonesia	21	0.1	124	0.5	401	0.6	1,052	0.9	14	0.1	330	0.8	849	1.6	1,589	1.4	0.1	0.6	1.1	1.1
Philippines	258	1.4	314	1.1	205	0.3	476	0.4	70	0.4	97	0.2	90	0.2	272	0.2	0.9	0.6	0.3	0.3
Australia	224	1.2	183	0.7	468	0.7	1,488	1.2	1,063	5.4	1,124	2.6	1,361	2.5	2,448	2.1	3.4	1.9	1.6	1.7
New Zealand	30	0.2	32	0.1	52	0.1	188	0.2	157	0.8	161	0.4	128	0.2	317	0.3	0.5	0.3	0.2	0.2
4 DRAGON	4,774	26.3	9,211	33.7	29,932	47.6	41,546	34.4	760.0	3.9	5,003	11.8	17,904	33.2	33,371	28.9	14.7	20.3	41.0	31.7
SK & TWN	0	0.0	0	0.0	753	1.2	6,618	5.5	0	0.0	0	0.0	2,490	4.6	21,402	18.5			2.8	11.9
HK & SING	4,774	26.3	9,211	33.7	29,179	46.4	34,928	28.9	760.0	3.9	5,003	11.8	15,414	28.6	11,969	10.4	14.7	20.3	38.2	19.8
ASEAN (expt SING)	771	4.3	740	2.7	1,830	2.9	3,805	3.1	464.0	2.4	888	2.1	2,177	4.0	4,348	3.8	3.3	2.3	3.4	3.4
AUS & NZ	254	1.4	215	0.8	520	0.8	1,676	1.4	1,220.0	6.3	1,285	3.0	1,489	2.8	2,765	2.4	3.9	2.1	1.7	1.9

Notes: AP covers the individual countries as listed, NA United States and Canada, and E United Kingdom, Germany, France and Italy.

Source : International Monetary Fund, Direction of Trade Statistics Yearbook, various years.

and Taiwan - and latterly South Korea. Such trends helped to boost China's combined trade share vis-a-vis the "four little dragons" (including Singapore) from 15 percent (1980) to 32 percent (1994).

Third, it is striking that the Chinese trade share with ASEAN (with or without Singapore), has remained virtually the same - a little more than 3 percent - during the past one and a half decades. It is interesting that this should be so, given the strategic aspiration voiced both by China and Malaysia in the context of APEC negotiations in Bogor with respect to the tariff agenda for the years 2010 and 2020,⁵ as well as the continued improvement in political relations between China and ASEAN (whose exports and imports were 25 and 45 percent larger than those of China in 1994, excluding Singapore).

Fourth and most remarkably, the combined share of Australia and New Zealand in China's external trade falls quite consistently from 3.9 percent (1980) to a mere 1.9 percent (1994). This decline took place despite massive efforts by the governments of both countries to boost their trade with China from the early 1980s. Moreover, Australia consistently enjoyed trade surpluses with China after the establishment of diplomatic relations, and was for many years a net recipient of Chinese capital, intended to develop iron ore and aluminum smelting for export back to China. Amongst China's major trading partners, Australia has also had fewest bilateral trade policy disputes with China.

The Australian and the New Zealand markets are of course too limited in size to exploit any scale economies in trading with China merely in order to sustain their share against the United States, Germany, Britain, France or Japan - all of whom can offer China

much more advanced technology exports, as well as providing a larger export market.

These broad contours of change in China's trade relations clearly suggest that if economic integration within APEC is to be the main reference point, such integration has essentially taken place within what is popularly known as the "Greater China economic growth triangle", comprising the Chinese Mainland, Taiwan, Hong Kong and Macau. But in this context too, the nature of economic integration, as shown by the statistical evidence in Table 2 and discussed above should be interpreted with care.

Indeed, careful examination of the export and import statistics in Table 2 reveals that the increases in China's trade share with Hong Kong reflect changes in both exports and imports, with the latter perhaps assuming greater weight in the long-run. This apparent paradox is easily resolved.

Increases in China's exports and imports vis-a-vis Hong Kong derive from two different sources. The first is trade related to so-called "outward-processing" (OP) activities, commissioned by Hong Kong-based manufacturers from enterprises based in China. The latter include both the tens of thousands of joint ventures of Hong Kong origin, as well as a large number set up by local Chinese producers. While OP has become a familiar phenomenon in South China, it may still be a surprise to anyone unfamiliar with the scale and intensity of the economic synergy that the magnitude of associated Hong Kong exports (of raw materials, semi-manufactures, and machine and equipment) to and imports (essentially processed goods) from China should have reached such spectacular levels. According to official estimates by the Hong Kong government, in 1994 OP related goods flowing from

Figure 1 : Taiwan's Trade With Hong Kong and the Chinese Mainland, 1975-1994, (USD million)

Note : The predicted values are derived from a linear time trend fitted with the 1975-86 data.

Sources : Taiwan Statistical Data Book, 1995

China accounted for 76 percent of Hong Kong's total imports from China, while goods outward bound for China within the same OP context constituted 69 percent of Hong Kong's domestic exports and 43 percent of total re-exports to China.⁶

Since 1987, Taiwan's trade relations with Mainland China have followed the same pattern as Hong Kong's, except that most of the island's exports to and imports from the Mainland have, for well-known political reasons, had to be channelled through Hong Kong. Figure 1 shows that, after the adoption of a new political reorientation towards Mainland China in 1987 (allowing "indirect" personal and business contacts with the Mainland counterparts through third parties), Taiwan's trade with Hong Kong soared dramatically. There is no doubt that the overwhelming proportion of Taiwan's exports to and imports from Hong Kong during this period, as may be measured by the discrepancy between the actual and predicted values shown in Figure 1, have been bound for or have originated from the Mainland. To the extent that these flows officially constitute trade with Hong Kong, the estimated Taiwanese shares of exports to and imports from the Mainland may already have been subsumed in Hong Kong's trade statistics with China.⁷

The share of South Korea in China's export and import trade also increased sharply following the establishment of diplomatic relations in 1992, (see Table 2). The major difference between Taiwan and South Korea in this respect is that the latter engages in direct trade with China and possesses no major political leverage for restricting imports from China, compared with Taiwan. As a result, its positive trade balance appears to be less impressive than that of Taiwan.

Given the preeminence of outward-processing-related trade, it is a matter of debate whether increased trade flows between China and Hong Kong/Taiwan/South Korea really do indicate enhanced economic integration within Greater China or, more generally Northeast Asia.

Before we consider this further, let us look at the second source of the increases of Hong Kong's share in China's external trade. This involves the accelerated increases in re-exports, both to and from China (in the latter case, especially to the United States).

According to our recent estimates made in a different context, the share of Hong Kong's total imports from China subsequently re-exported to the United States increased from 4.86 percent (1979) to 41.6 percent (1994), - an average growth of 12.8 percent p.a., in absolute terms. While the re-export value comprises a substantial proportion of OP-related imports from China - and should therefore be counted more as Hong Kong's than China's exports to the United States - it remains astonishing that Hong Kong's exports to China comprise goods of US origin which accounted for an average of 51 percent of the total during 1990-1994, (and which, as a share of total US exports to China increased from a negligible 1.6 percent in 1980 to a remarkable 29.6 percent in 1994).⁸

In other words, nearly one-third of total US exports to China are now channelled through Hong Kong. Nor is there any reason why European exports to China should not have followed the same pattern in the last 15 years in order to take advantage of the trading facilities offered by Hong Kong in respect to sourcing, marketing, telecommunication, shipping, banking, financing, insurance, etc.

But in accordance with the United States' statistical reporting convention that, indirect exports to China count as exports to the immediate importing destination (in this case Hong Kong), the figures in Table 2 clearly understate China's trade shares with the "NA+E" countries. If the Hong Kong connection, as described above, is taken into account, the corresponding AP share must be substantially readjusted downwards in favour of the "NA+E" share. That is, since the mid-1980s China's trade with "NA+E" may have grown even more rapidly than with the AP countries as a whole, at the expense of ROW countries.

Implications for Economic Integration with APEC proper

The foregoing discussion suggests that the most visible process of economic integration among APEC countries has taken place within the "Greater China" growth triangle. The accelerated increases in trade flows between Mainland China, Hong Kong, and Taiwan have also been accompanied or preceded by impressive direct investment made by Hong Kong and Taiwanese investors in the Chinese Mainland.⁹ While this bears all the hallmarks of increased economic interaction among the three "Greater China" economic entities, the nature and intensity of the perceived integration demands careful interpretation. Several points may be made in respect to these findings:

The first is that massive OP-related trade flows have been associated with direct investment from Hong Kong and Taiwan in Mainland China, which has reflected no more than the massive relocation of Hong Kong and Taiwanese manufacturing activities to the vast Chinese hinterland. Such relocation has indeed resulted in a radical restructuring of the Hong Kong economy - and increasingly that of Taiwan - with significant implications for their

output, employment, income and income redistribution.¹⁰ The manner in which the Hong Kong and Taiwan economies have readjusted through increased economic interaction with the Chinese Mainland is a clear case of economic integration. The impact on both of these small open economies has also predictably been much more effective and intensive than the impact of such integration on the vast Mainland economy.

Second, however, by virtue of China's policy towards foreign direct investment (FDI) in China, the effect of the relocation of both Hong Kong and Taiwanese manufacturing activities onto the Chinese hinterland has inevitably been quite limited. It is well known that unlike the experience of many industrializing Asian countries, the Chinese government's FDI policy has leap-frogged from import-substitution to export-orientated foreign investment. This inherently denies "national treatment" to foreign investment, while requiring foreign investors (of Chinese policy practices) to "balance their own foreign exchange requirements" by generating as much foreign currency earning as possible from their joint venture exports to the outside world.

The upshot has been the emergence of a "one-country, two economies" system, under which a highly protective industrial system has received high priority in the national development and investment strategy, but has co-existed with a widely open sector catering for foreign investment and export drives.¹¹ Moreover, the chief mission of the latter has mainly been to use joint ventures with foreign investors to help generate sufficient foreign exchange earnings to finance investment in the forced-draft industrialization programme. Viewed this way, the "two-economy" dichotomy implies an absolute denial of a strategy of full integration with outside economies.

Third, the China's "open-door" strategy for courting foreign investment has nonetheless helped - in a most impressive manner - to establish a new, sui generis economic system along the Chinese coastal belt, which has become increasingly and comprehensively integrated with the outside world and which has simultaneously assumed great economic importance in the national context. This is reflected not only in the growing importance of the "outward-processing" trade flows involving Hong Kong and Taiwan, but who - and more importantly - in the fact that FDI in China now constitutes about 20 percent of annual domestic fixed capital formation, with Sino-foreign joint venture exports accounting for around 40 percent of the national exports. In this respect, therefore, the "open-economy" sector of China has become fully integrated with the outside world.

The fourth point relates more specifically to the role of the "Greater China" growth triangle as a source of foreign exchange for the Chinese Mainland. The interaction with Hong Kong and Taiwan, both of whom have traditionally enjoyed huge trade surpluses with the United States, has decisively helped to transfer the surplus to Mainland China by way of investment and export-processing. In other words, economic synergies have enabled both Hong Kong and Taiwan to export their bilateral trade deficits with the US to the Mainland. Put differently, Mainland China has been able increasingly to resort to the traditional export markets of Hong Kong (latterly, Taiwan's too) to finance its trade deficits with the United States, Western Europe, and Japan.

Table 3 sets out China's balance of payments vis-a-vis Hong Kong and the outside world. Between 1979 and 1993, in every year except one China incurred a bilateral trade deficit with the United States. The combined total of US\$23 billion for the period was

however easily offset by its accumulated trade surplus of US\$142 billion with Hong Kong. Indeed, that same surplus was more than 2 times greater than Chins's combined deficit with the United States and Japan.

[Table 3 Here]

In short, China's total export earnings from Hong Kong alone, net of the corresponding import expenditure, have been more than sufficient to finance China's net import bills incurred with the United States and Japan, or even the world at large, for the entire period 1979-1993. Even if the outward-processing (sanlai yibu) component is omitted from China's exports to Hong Kong, its trade surplus with Hong Kong has still been more than sufficient to offset the country's combined deficits with the United States and Japan for the period 1989-93 taken as whole. This unequivocally highlights the pivotal importance of Hong Kong in both Sino-American and Sino-Japanese trade relations, or indeed in the entire Chinese foreign trade system.¹²

This specific dimension of "economic integration" explains the accelerated growth of China's trade relations with APEC proper and with our aggregate category of "NA and E" countries, at the expense of ASEAN, and Australia and New Zealand.

Ignoring the economies of Australia and New Zealand, which are both small and remote, the ASEAN countries would appear to assume a competitive not complementary, position vis-a-vis the Chinese economy, in terms of its export drive. This would explain ASEAN's stagnating or shrinking relative trade volume with China, with economic integration

Table 3: China's Trade Balance with Major Trading Partners, 1979 - 1994 (in USD 100 million)

Year	All Countries	USA	Japan	Hong Kong		Ratio 1	Ratio 2	Ratio 3
	(1)	(2)	(3)	Gross of Sanlai yibu	Net of Sanlai yibu	(4)/(1)	(4)/(2)	(4)/[(2)+(3)]
				(4)	(5)			
1979	-20.10	-12.62	-11.80	33.33	-	1.66	2.64	1.36
1980	-19.00	-28.48	-11.37	40.34	-	2.12	1.42	1.01
1981	-0.10	-31.49	-13.95	40.33	-	403.30	1.28	0.89
1982	30.30	-25.23	9.07	38.67	-	-	1.53	2.39
1983	8.40	-10.45	-9.83	41.05	-	-	3.93	2.02
1984	-12.70	-16.05	-30.86	39.60	-	3.12	2.47	0.84
1985	-149.00	-27.51	-89.26	24.07	-	0.16	0.87	0.21
1986	-119.60	-20.85	-76.59	41.75	-	0.35	2.00	0.43
1987	-37.80	-17.94	-36.76	53.41	-	1.41	2.98	0.98
1988	-77.60	-32.86	-31.41	62.93	-	0.81	1.92	0.98
1989	-66.00	-34.54	-21.39	93.76	46.69	1.42	2.71	1.68
1990	87.40	-14.09	14.23	123.96	55.67	-	8.80	-
1991	80.50	-18.49	1.88	146.74	39.36	-	7.94	8.83
1992	43.50	-3.07	-20.04	169.79	24.61	-	55.31	7.35
1993	-121.90	-12.13	-74.74	241.95	115.91	1.98	19.95	2.79
1994	53.46	74.91	-47.48	229.08	-	-	-	-8.35
21 Total	-320.24	-230.89	-450.30	1420.76	282.24	4.44	6.15	2.09
Average								
1979-85	-23.17	-21.69	-22.57	36.77	-	1.59	1.70	0.83
1986-94	-17.56	-8.78	-32.48	129.26	56.45	7.36	14.72	3.13
1979-94	-20.02	-14.43	-28.14	88.80	56.45	4.44	6.15	2.09

Note: Figures for 1981-1983 are converted from RMB yuan to US Dollar by using the official annual average exchange rates.

The two 1993 figures for trade balance with HK are tentative estimates, and could be very problematic. The reasons are as follow: The year 1993 saw curiously both Chinese export (USD 22.1 billion) to and import (USD 10.5 billion) from HK being drastically curtailed from the previous year's high of USD 37.5 billion and 20.5 billion respectively. A likely explanation for the precipitous drop is that the 1993 figures do not include the sanlai yibu components with HK. This is because HK Government's statistics show that both outward-processing(sanlai yibu) consignments(USD 20.7 billion) to China and sanlai yibu imports(USD 38.2 billion) from China in 1993(as given in Table 1 Panels A and B) are themselves even very substantially larger than the given Chinese total exports to and imports from HK. Thus, barring any other better explanation, we simply regard the original Chinese export and import figures as net of the sanlai yibu component. This results therefore in the trade balance with HK of USD 11.6 billion for 1993 as given for the net series. This figure is of course not directly comparable to those for 1989 - 92 (which are derived from HK Government statistics) and seems to be biased upward. For the 1993 trade balance(with HK) figure, we have in turn added the Hong Kong's "outward processing" - related exports and imports to the original Chinese figures to derive the trade balance gross of the sanlai yibu components. In the estimates, the HK's sanlai yibu import figure of USD 38.2 billion is adjusted downward by 10% and the comparable export figure adjusted upward by 5% to account for the possible f.o.b./c.i.f. discrepancy. This gives therefore the trade balance figure of USD 241.95 for 1993.

Source: State Statistical Bureau, Zhongguo Tongji Nianjian (Statistical Yearbook of China), various issues.

with their northern neighbour remaining a distant prospect. The reality is that individual ASEAN countries have increasingly felt the full weight of Chinese export competition in the past decade or so.¹³

A few words about the Sino-Japanese economic relations are in order in this respect. Unlike its ASEAN counterparts, Japan has played a role for China which has been very similar to that of the United States, first, as a supplier of industrial producer goods needed to feed China's massive industrialization programme; second, as an increasingly important export market for China as well. A very substantial proportion of Japanese exports to China has been channelled through Hong Kong. However, unlike the models of Hong Kong and Taiwan, re-exports of Japanese origin seem to have been more closely related to Hong Kong and Taiwanese FDI in China (in the form of industrial inputs, transport equipment, and machinery) than to Japanese FDI itself.¹⁴

In this context, it is interesting that the Japanese have contributed a much smaller share of FDI in China than Hong Kong, and have lagged behind Taiwan since the early 1990s. This has been widely interpreted as signalling a lack of Japanese interest in effecting technology transfer to China. No doubt there is an element of truth in this. However, a more potent consideration is, in our view, that the Japanese have simply not recognised an urgent need to expand their share in the Chinese FDI market, because of their involvement, albeit indirect, as suppliers to Hong Kong and Taiwan investors of the bulk of the necessary industrial inputs as a back-up to their FDI in China. We would argue that this indirect involvement represents a more rational economic strategy, given widespread Japanese concern that the FDI market in China is still full of uncertainties associated with an undeveloped legal

framework, bureaucratic complications, inadequate patent protection and, above all, pervasive restrictions to domestic market access.

From the Japanese perspective, it may well be more worthwhile to pay the tens of thousands of small “rent-seeking” firms from Hong Kong and Taiwan to expand their commodity export share in the Chinese market, rather than to become personally involved in establishing small export-processing plants in China in pursuit of the last margins of earnings from “second-round” exports to the third countries.

Conclusion: Prospects for the APEC tariff agenda

The main issues arising from the Bogor Declaration (1994) address the tariff agenda for the year 2020 more than for 2010. There is no doubt that the advanced industrialized APEC member economies should be able to meet the 2010 free trade and investment requirements with relative ease. But for the developing APEC economies (with the notable exceptions of Hong Kong and Singapore) reconciliation of tariff concessions could still pose serious problems. China’s unweighed average tariff level was 35.9 percent in 1995. Even following the massive reductions by around 33 percent following the voluntary offer made by President Jiang Zemin at the APEC Summit meeting (Osaka: November 1995), it remains at 22 to 23 percent. This is much higher than the average of 8-13 percent for other major developing APEC economies, let alone the 3-4 percent for advanced countries. Thailand is the only country within APEC which has a higher average tariff level than China (39.6 percent in 1993).¹⁵

It is difficult to predict when China will effect a further adjustment of tariff rates in line with those of other APEC countries. The target set in the 9th Five-Year Plan (1996-2000) is to reduce the average level to 13 percent by the year 2000. Even if fulfilled, this would still be higher than the average for major developing APEC economies. Whether in such circumstances it would then be possible for China to further accelerate the process of tariff-reduction in pursuit of the long-term Bogor target of zero tariffs by 2020 is a matter for conjecture. Both China and Malaysia made it clear in Bogor that while they agreed, in principle, with the Declaration, they did not wish officially to be bound by it.

In any case, from the present perspective, any accelerated tariff reductions undertaken by China could prove to be detrimental to many key branches of her infant industries, including electronics, chemicals, pharmaceuticals and - above all - the car industry. This is what is at stake in the prolonged Chinese negotiations with the United States for an early entry into GATT/WTO.¹⁶

Malaysia's reservations over the Bogor Declaration for an entirely free trade and investment regime by 2020 clearly reflect similar aspirations and concerns. Nor is there any apparent reason why the policies of other major Asian APEC members, such as Indonesia and Thailand, should not be driven by similar considerations.

In a sense, the WTO predicament facing the Chinese is compounded by their ambitious pursuit of foreign capital inflows. Exemptions of import duties for imports of raw materials, semi-manufactures, machine and equipment, for joint venture investments are still widely applied. In the framework of "one country two economies" (see above), nominal import

tariffs may have to be kept at a relatively high level to compensate for concessions made to foreign investors, and to protect sizeable import-substitution and inward-orientated priority sectors. This basic policy orientation may obviously continue to hinder the major dismantling of the Chinese tariff system.

Nonetheless, the more fundamental issue raised in the context of this paper is whether, in the light of the Bogor target of 2020 for APEC to become a free trade and investment region, the Chinese economy will become more closely integrated with the advanced APEC economies, (Japan, the United States) and Western Europe, or with ASEAN and Australia. This is clearly not a zero-sum game situation and it deserves careful consideration.

First, what is certain is that for many years to come, China will continue to trade with Japan and the highly industrialized western countries to a much greater extent, in terms of bilateral flows of goods, investment and services, than with the countries of APEC proper. This trend will intensify, as the huge Chinese industrial system becomes increasingly mature and diversified.

Second, the South China growth triangle (comprising Hong Kong, Taiwan, and Guangdong province) is likely for many years to remain the driving force behind Chinese re-export and export processing activities, generating the necessary foreign hard currencies for financing the country's industrialization programme. Shanghai apart, this will also remain the "Greater China" window for attracting foreign capital and investment in China in the foreseeable future.

Third, early admission of China into the WTO is likely merely to further enhance China's integration with the advanced industrialized west, or with the northern APEC, than to affect its relations with countries of the southern APEC proper. It is self-evident that any further concessions which China may make in order to facilitate GATT/WTO membership - whether in relation to tariff and non-tariff barriers, investment impediments, or market restrictions to such service sectors as banking, insurance, telecommunication, transportation - will attract more complementary goods and capital inflows from the North rather than from the South.

The southern APEC members, especially ASEAN countries are, by virtue of their factor endowments and the stage of development each has reached, in basic competition with China for a share in the export markets of major western countries as well as for foreign investment. It is likely that they will lose out, as China's influence expands further.

However, such arguments are not intended to imply that growing Chinese economic power will marginalize the importance of the southern APEC member economies. A more likely scenario is that as China gradually becomes an industrial powerhouse of Asia, it will fuel growth and industrialization within APEC proper, joining Japan to become a crucial source of supplying the bulk of industrial producer goods to her Asian neighbours. Moreover, the huge and highly diversified Chinese economy promises to provide sufficient market niches for the highly export-orientated ASEAN countries to diversify their overseas markets. It is not too much to hope that such developments will eventually help to make the APEC agenda for a free trading bloc a reality.

In the context of the massive export drive of all export-orientated members of APEC proper, China currently represents the very tail of the “flying geese” formation by reason of its comparative advantage in labour-intensive manufactures exports. However, the Asia-Pacific region must anticipate the time when the emerging industrial giant will join Japan as the dragon head of economic growth in the region. With or without the creation of a trading bloc under APEC, the economic centre of gravity of the world will then have shifted to the Asian Pacific region.

Notes

1. As reported by the State Statistical Bureau (SSB) (1995, p. 21), China's GNP/GDP grew at an annual average rate of 9.8 percent and population 1.4 percent from 1980-1994.
2. The figure is obtained by applying the GDP growth rates of the province for 1992-1994 (SSB, 1995, p. 33) to the estimated 1992 GDP of US\$2806 as given in Kueh and Ash (1996, p. 151).
3. Cf. Kueh and Ash, *ibid*.
4. An alternative estimate was made by Lardy (1992, pp. 150-155) for the trade ratio for 1988. He made use of the comparative indices of growth of GNP and trade (in real terms) for 1978 to 1988 (which are made available in official sources), and related the growing discrepancy to two different western PPP-based estimates of China's GNP for 1980, respectively by Herbert Block and Summers and Heston. The first estimate gives a trade/GNP ratio of 5.8 percent (in 1978) and 9.4 percent by (1988), while the second generated corresponding figures of 2.1 percent (1978) and 3.4 percent (1988). Lardy regards the higher estimate as more acceptable. However, it seems quite curious, in our view, that China's trade ratio could already stand at as high as 5.4 percent in 1978, after decades of self-imposed trade autarky.
5. China and Indonesia reestablished normal diplomatic relations in 1990 after a long break and the normalization was then expected to give a great boost to bilateral trade.

6. See Kueh and Voon (1996) for more details in this respect.

7. As shown in Table 2, the IMF statistics give a separate entry for Taiwan's trade with Mainland China, as part of the catch-all category of "Asia not specified" in the original IMF compilation. It is not known, however, how the statistics are exactly obtained. Perhaps they are derived from the given statistics on Taiwan's trade with Hong Kong as shown in Figure 1. This would imply the possibility of double counting in the context of Table 2. However, it seems nonetheless inappropriate to assume that IMF should engage in such a double counting.

8. For a detailed study and interpretation of the significance of the role played by Hong Kong in Sino-American economic relations see Kueh and Voon (1996). Consult also Ho and Kueh (1995) for the increasing magnitude of Hong Kong's re-export business in general.

9. For a more comprehensive study of FDI in China and the importance of Hong Kong and Taiwan as FDI supplier in Guangdong province and in China as a whole, see Kueh (1996) and Kueh and Ash (1996).

10. See Ash and Kueh (1995), and especially the paper by K. C. Lei (1996), for a more systematic input-output analysis of the impact on the Taiwanese economy of increased FDI outflows to the Chinese Mainland.

11. For an elaboration on this point see Kueh (1990).
12. See Kueh and Voon (1996) for details.
13. Thomas Voon (1996) gives a detailed analysis in this respect.
14. Elspeth Thomson (1996) reveals that Japanese exports to China are barely related to their FDI in China.
15. For an illustration of the comparative tariff and non-tariff trade barriers existing among the APEC countries, see the recent comprehensive survey made by Pacific Economic Cooperation Council (1995).
16. See Kueh (1995) for an elaboration on the Chinese predicament over joining WTO.