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China's Economic Growth: Implications to the ASEAN (An Integrative Report)

Ellen H. Palanca

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ABSTRACT

The rise of China's economy in the last couple of decades can be attributed to the favorable initial conditions, the market-oriented economic reforms, and good macroeconomic management in the nineties. As China continues to struggle with the problems of its SOEs, its trade and investment volumes have grown at unprecedented rates making China a major global economic player. Contrary to expectations based on traditional trade theories, the study found that overall, China's economic growth has not been a competing force in the region but instead has provided a synergy for greater growth in the region. Between 1975 and 1990, all the ASEAN nations have established diplomatic ties with China and since then have developed favorable political relations so as to give economic relations full opportunities to develop from extremely low levels in the seventies. The growth of the ASEAN economies and their total trade volumes increased rapidly since China opened up to the outside world. Bilateral trade with China increased even more sharply although shares remain small. In particular, exports to China have increased faster than imports from China. With respect to direct foreign investments, China's growing economy has made the East Asian region a focus for investors. The project also found that while in the past decades it was the general political relations between China and the ASEAN nations that set the conditions for bilateral economic cooperation, more recently, with China's economy becoming more market oriented, most bilateral trade and investment decisions have been based on profitability considerations.

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EXECUTIVE SUMMARY

Introduction

The research looks at China’s economic growth and its implications to the ASEAN-5 countries, given their past political and economic relations. The study essentially covers the period from 1980 up to 1996.

Since its opening up to the outside world in 1979, China’s economy has grown at an average annual rate of over 10 percent, quadrupling GDP by 1995. In conjunction with its open trade policy was the policy focusing on export industrialization. In the 1990s, exports and utilized direct foreign investments grew at phenomenal rates of almost 20 percent and 45 percent per annum on the average respectively.

Most of the ASEAN-5 countries, which adopted the export-led growth strategy since the early seventies, were, up to 1997 when the Asian economic crisis struck, also growing at impressive rates. With such developments, ASEAN countries have a paradoxical view at China, which they see as both a competitive force in exports and direct foreign investments as well as a huge growing market of ASEAN’s resource products and consumer goods.

China’s Post-Reform Economic Growth

China’s reform policies have brought about gradual changes in its industrial structure and trade commodity structure. Rural industrialization has attracted direct foreign investments and promoted export-oriented development strategy. Trade, financial and fiscal reforms have been formulated to support the structural changes. Moreover, growth has been rapid since the reforms were built on some initial conditions such as agricultural reform, physical and social infrastructure, development of basic industries, a high degree of provincial and local autonomy, and the reduction in income disparities. Other important factors are the strong historical ties with Hong Kong and the Southeast Asian ethnic Chinese as well as the strong role of the state in providing political stability and a coherent economic program.

The major economic problem China still faces is its state-owned enterprises (SOEs). Although reform of this sector was undertaken since 1979, political considerations have made it difficult to drastically reform the sector. Hence reform of this sector has been too slow to cope with the increasing competition from the non-state sector and imports. Recently a solution to this huge problem was made by the creation of asset management corporations which, through debt-equity swaps, intend to help restructure many major SOEs.

With the Asian economic crisis, China faces a less favorable world environment. However, the crisis provided China lessons and the sense of urgency for structural and institutional reforms. China’s expected accession to the World Trade Organization also exerts pressure for reforms towards greater efficiency. If the reforms are realized, it can be expected that, given a positive world environment, China will be heading towards real economic development.

China’s External Sector Growth

The external sector is the largest factor contributing to China’s economic growth. Market-oriented economic reforms brought about expansion in trade as well as changes in its commodity structure. China’s trade pattern is gradually moving towards conforming to its resource structure. Both exports and imports shifted from agriculture to industrial products. The rapid increase in China’s export sector since reform took place has been essentially in the area of labor-intensive exports as the manufacturing sector takes advantage of China’s low wage of labor. Dominating imports are machinery, technology, as well as materials necessary for the manufacturing of exports. With increasing economic prosperity, the demand for consumer goods imports is also on the rise.

Direct foreign investments in China have also increased phenomenally as a result of more economic liberalization and structural changes in the domestic economy. China’s potentially expansive market and abundant supply of low cost labor, devaluation in 1988 and 1994, as well as the incentive policies package to foreign investors in special economic zones all contributed to the rapid increase in its DFI inflow. Most of the DFI in China are in the industrial sector, resulting in the tremendous expansion of export manufactures. Capital outflow from China is extremely small compared to its inflow. However, with the high reserve position, China expanded its scope of enterprises eligible for overseas investments in 1985. Hence, the period 1986-1990 witnessed the rise of a few big Chinese transnational corporations.

ASEAN-China Economic Relations

The value of Southeast Asia is to China mainly strategic rather than economic. Hence China’s economic relations with the ASEAN are essentially politically motivated. On the other hand, the ASEAN countries have increasingly been exploring China as an alternative market to the developed countries in the last couple of decades, given the prolonged recessions in both the United States and Europe in the eighties.

Between 1975 and 1990, all ASEAN-5 countries established diplomatic ties with China, giving economic relations full opportunities to develop from the extremely low levels of the seventies. Statistics show increasing dependence of the ASEAN on China’s market while the reverse is not as evident. From 1980 to 1996, the bilateral trade of each individual ASEAN-5 nation with China increased at a rate greater than the total trade of each.

The leading trader with China among the ASEAN-5 countries is Singapore, which accounts for a two-fifths share for total trade of the ASEAN-5 with China. However, in terms of growth rate, Indonesia tops the five ASEAN nations. Hence, by mid 1990s, its share of trade with China in the country’s total trade became the highest among the

ASEAN-5. Thailand and Malaysia each maintained a 15 to 20 percent share in ASEAN-5 trade with China. The Philippines consistently lagged behind the ASEAN countries in its trade with China, both in terms of growth rate and the ratio of the country's total trade.

ASEAN-China trade has been vigorous despite similarity in their trade structures. In varying degrees, China and the ASEAN countries are losing their comparative advantage in agricultural exports and increasing their comparative advantage in labor-intensive manufactured exports. The study observed a convergence of the top commodities in their bilateral exchanges towards labor-intensive manufactures. Certain resource exports such as petroleum of Indonesia, rubber of Malaysia, and rice of Thailand are still important trade commodities. Other than these exports, the share of manufactured goods within total exports for all these countries has increased sharply. The bilateral trade between China and the ASEAN countries has been based on complementarities within manufacturing industries, exploiting horizontal division of labor. Diversity of manufactured products in aspects of designs, etc. as well as niche products make trade possible despite similar export profiles and seemingly competitive nature of trade structures.

Besides trade, direct foreign investment is also an active component of ASEAN-China economic relations. Since its open-door policy, China has benefited from investment inflow from the ASEAN-5, made mostly by the ethnic Chinese in the region. In turn China¹s investments in these countries have been quite insignificant although growth has picked up since the early 1990s. On bilateral terms, Thailand and Malaysia have been able to establish active two-way DFI flows with China based on the complementation with respect to raw materials, labor skills, and technology, aside from the rationale of easier access to China¹s enormous market.

Effects of China's Growth on the ASEAN

The study concludes that China's rapid economic growth in the last two decades has not been a competing force in the region but instead has been an impetus for greater growth. The synergy effect can be seen by the rapid growth of the external trade of the ASEAN-5 countries in the late eighties and the nineties, after the liberalization of China's external sector.

With respect to direct foreign investments, the study shows that massive flow into China did not have any crowding out effect on the ASEAN-4. Global supply of DFI increased significantly as a result of China's open door policy.

The positive effects of China's growth on the ASEAN countries are contrary to expectations based on traditional trade theories which explain trade based on comparative advantage determined by factor and resource endowments. The findings show that, so far, China¹s economic growth has presented to the ASEAN countries market opportunities rather than impediments to their economic growth. Manufactured products dominate trade between the ASEAN countries and China. The broad spectrum of goods in the manufacturing industry and the product differentiation of manufactured goods provide opportunities for intra-industry exchanges of such goods.

In the past decades, the general political relations between China and the ASEAN nations set the conditions for bilateral economic cooperation. More recently, with China's economy becoming more market oriented, many bilateral trade and investment decisions have been based on the profit opportunities available to them. However, from a long-term perspective, the study recommends that ASEAN and China expand their mutual trust and define the norms that will guide their political, security as well as economic relations.

CHINA'S ECONOMIC GROWTH: IMPLICATIONS TO THE ASEAN
(AN INTEGRATIVE REPORT)

Ellen H. Palanca*

Introduction

The last couple of decades saw the prominent emergence of China in world economy. China's economic growth, the fastest among the major countries in the world, has been at an average annual rate of over 10 percent since 1979 when it adopted an "open door" policy and undertook economic reforms. With such economic performance, China's GDP of 1980 quadrupled by 1995, five years earlier than the target year 2000. In conjunction with China's open trade policy was its policy focusing on export industrialization. For the period 1980-1996, total exports grew at an average annual rate of 14.2 percent. The rate accelerated in the 1990s, averaging close to 20 percent. Direct foreign investments (DFIs) also grew at unprecedented rates, averaging at an annual rate of 57 percent in terms of contract amount and 45 percent in terms of utilized amount.

For about three decades up to the onset of the Asian economic crisis in 1997, the original ASEAN countries, except for the Philippines, were also growing at rates that impressed the entire world.[1] Singapore grew at an average annual rate of 8.5 percent for the period 1965 to 1980, slowed down to 6.6 percent in the 1980s, and then picked up to grow at almost 9 percent in the 1990s before the Asian crisis. In the 1970s, the other countries -- Indonesia, Malaysia, Philippines, and Thailand (called ASEAN-4) forsook the import-substitution industrialization growth strategy and adopted also the export-led growth strategy that transformed Singapore, as well as Hong Kong, Taiwan, and Korea, into newly industrialized economies. Since the 1970s up till 1997, Malaysia, Thailand, and Indonesia grew at impressive rates of between 7 and 9 percent annually. In the case of the Philippines, although a trade liberalization program was adopted since 1981, it could not fully implement the program due to the presence of political and economic crises in the eighties. Its average annual economic growth of 3 per cent for the period 1980-1996 lagged very much behind those of the other ASEAN countries.

Perceptions of China as a Rising Power in Southeast Asia

Due to the size and dynamism of its economy, China has been perceived by the countries in Southeast Asia to be a competitive force as an export market and a foreign capital destination. At the same time, China is a cheap source of raw materials and, with its huge population enjoying rising incomes, has also become an ideal market for food and other consumer goods. Because of this growing economic strength as well as its political influence and military strength, China is considered a security threat by most of

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[1]The original ASEAN consists of five nations: the Philippines, Indonesia, Malaysia, Singapore, and Thailand. These nations are now referred to as the ASEAN-5.

the ASEAN countries. With the pending South China Sea dispute that involves China and four of the ASEAN-10, some sectors in these ASEAN countries consider this threat imminent.[2]

The perception of China as a threat in the region is the rationale for the research project "China's Economic Growth and Its Implications to the ASEAN." This project analyzes the effects of China's growth on the ASEAN-5 nations considering the past bilateral economic and political relations of these Southeast Asian countries with China. It is expected that understanding the situation will enable one to have a rational approach to the rapidly changing scenario in the region that has been taking place since China opened up.

This paper integrates the six research studies conducted for the project. J. Lim's study on China's macroeconomy analyzes the country's economic performance in the 1990s as well as the problems it faces since the Asian economic crisis. Fabella presents a theoretical analysis of what the outcomes on the region would be with the opening up and the subsequent dynamic economic growth of China. Palanca investigates the pattern of trade between China and the ASEAN-5 countries since China opened up while Tan analyzes China's foreign direct investments, both inflow and outflow, in the post-reform era.

Economic cooperation between countries is, to a great extent, influenced by their political relations. This is more so for relations with China where economic relations are mostly state-level and easily influenced by the state-to-state political relations. Cognizant of the importance of politics on economic relations, the project also investigates the political economy of China's relations with the ASEAN countries. Baviera considers the political economy of China's relations with Singapore, Malaysia, Thailand, and Indonesia; while B. Lim looks at the political economy of Philippines-China relations.

ASEAN-China economic ties are generally on bilateral basis. Gradually, however, the Association, which now consists of 10 countries, is working towards joining economic forces with China and the other major powers in Northeast Asia. For lack of a formal name, ASEAN-Plus 3 is the formed alliance between ASEAN-10 and China, Japan, and South Korea. Welcomed by all members, such a confederation can be seen to be a very positive approach in acknowledging China's growing economic power and the mutual dependence between the ASEAN as a region and China. The ASEAN had already invited China in 1991 to become a "consultative partner" and eventually to become a full dialogue partner. The large intra-regional trade volumes and investment flows in East Asia are a rational basis for such an economic cooperation. With the experience of the Asian economic crisis, both Northeast and Southeast Asia have come to realize the importance of East Asia regionalism even in the face of globalization and Asia-Pacific regionalism. Such a cooperating association is expected to provide a forum to address not only East Asian economic interests but political and security issues as well. ASEAN countries feel that it is no longer sufficient to simply work towards faster economic

[2] These four countries are the Philippines, Vietnam, Malaysia, and Brunei.

integration of the member countries but it is necessary to also adopt a more coordinated approach to economic development with China, Japan, and South Korea.

China's Post-Reform Economic Growth

The phenomenal growth of China's economy since 1980 has been attributed to the market and incentive reforms undertaken since then. These reforms were, however, built on some initial conditions that were very fundamental and important for the growth process. From 1949 to 1979, despite periods of turbulence, the Chinese socialist government was able to bring about some important structural and distributional changes. These changes include agricultural reform, physical and social infrastructure, development of basic industries such as steel and textiles, a high degree of provincial and local autonomy, and reduction in income disparities. Another important favorable condition is that China enjoys strong historical ties with Hong Kong and the ethnic Chinese in Southeast Asia. Moreover, the state, which provides political stability and a coherent, credible economic program, has always been strong.

Nevertheless, the self-reliant system before the reforms suffered the lack of competition and incentive to improve the products and increase productivity. The market reforms that were instituted with the opening up changed the incentive structure. A mix of policies was designed to integrate China into the global economy while, at the same time, strengthen its domestic base and market. Such reforms include rural reforms, the opening up of the country to foreign direct investments, foreign trade, reforms in state-owned enterprises, as well as financial and fiscal reforms.

The reform policies have brought about gradual changes in its industrial structure and trade commodity structure. Rural industrialization, the core of rural reform, has attracted direct foreign investments and promoted export-oriented development strategy. Export of light manufactured products has gradually replaced primary resource-intensive products. Needless to say, trade, financial and fiscal reforms have been formulated to support such changes. While the foreign sector and rural areas have successfully responded to market reform, much remain to be desired in the transformation of the state-owned enterprises to more efficient production units through reform. Continuing reforms, particularly in the fiscal and financial sectors, have been instituted to support and improve the state-owned enterprise sector that faces increasingly difficult situation due to competition from the non-state sector and imports. This will be discussed in a separate section later.

The changes and growth that followed have, nonetheless, been met with problems of inflation, corruption, and periods of slowdown in the 1980s and 1990s. These problems have prompted some analysts to doubt the capability of China to sustain the initial growth it experienced after undertaking reforms. However, the favorable initial conditions and the gradualist approach to reforms seem to have distinguished China from the Eastern European countries in the transition from a planned economy to a market one.[3] Aside from the much faster growth, China has shown greater resilience with respect to the economic obstacles it faces. It was able to address the spurts of high inflation in 1988-89 and 1993-95 and to easily bounce back from the political and economic difficulties in 1989-90.

In the 1990s, with very strong macrofundamentals, China grew at rates highest in the world. Its gross domestic savings and gross investments in the last decade were more than 40 and 34 percent of GDP respectively. Performance in the external sector was also spectacular. Exports grew by an average annual rate of more than 15 percent in the nineties, enabling the international reserves in 1997 to reach a level more than 12 months equivalent of its imports. Foreign inflows were mostly direct investments, which increased 275 times from 1983 to 1996. Fiscal deficits were reduced from more than 2 to 1.5 percent from early nineties to 1996, and inflation was reduced from double digit in 1993 to 1995 to 8.3 percent in 1996 and 2.8 percent to 1997. With these strong macrofundamentals, combined with the non-convertibility of its currency, China was not affected by the Asian economic crisis the same way other Asian countries were affected.

Impact of China's Economic Growth: A Theoretical Analysis

For three decades since 1949 when the communists took over China, its foreign trade reflected its international relations as well as its economic needs in the development process (Eckstein 1997). In the 1950s, foreign trade with Soviet Union and other socialist countries expanded rapidly. When the political relations with Soviet Union turned sour, China became relatively autarkic as it adopted a self-reliance policy. In the 1970s, China's foreign trade became more open (this time toward Japan, the United States, and West Europe) although import-substitution strategy continued to guide its foreign trade. And in late 1978, China really opened up its economy and embarked on major economic reforms. It embraced the growth strategy of export industrialization, the same strategy adopted by the newly industrialized economies and the ASEAN countries. Such a drastic policy has enabled China's exports and foreign investments to grow at remarkable rates in the last couple of decades.

The impact of China's growth on the ASEAN countries based on theoretical analysis is rather forbidding. Following the Heckscher-Ohlin-Samuelson theory, which relates the resource endowment of a country to the economic characteristics of the commodities traded, it is expected that countries that produce labor-intensive commodities for the world market would be affected by the rapid growth in China's

[3]There is, however, a theoretical debate on Chinese path to development. The gradualist or 'experimental' school believes that the tremendous productive forces in China have been released with the gradual opening of the economy by giving market- and performance-based incentives to market players and exposing them to domestic and foreign competition. This school is espoused by Peter Nolan, Barry Naughton, Thomas Rawski, Gary Jefferson, and, more recently, Joseph Stiglitz. Opposed to the gradualist school is the convergence school represented by Jeffrey Sachs, Michael Bruno, Gang Fan, Geng Xiao and Wing Thye Woo. Also called the 'big bang' theory, the convergence school "views the Chinese economic success as the typical East Asian success story of countries opening up their markets and trade sectors. It defends the one-shot and blanket liberalization and privatization of the economy and the state sector as the best path for transition economies" (Lim 1999).

external sector. Before China opened up, the ASEAN-4--Thailand, Malaysia, Indonesia, and the Philippines—were the principal suppliers of labor-intensive manufactures for the developed world market. In the 1970s, these labor-abundant ASEAN countries adopted the export promotion strategy of development and supplied the world much of its light manufactured imports. They also were destinations for foreign investments of the developed and the newly industrialized countries. On the other hand, China, despite its labor abundance, did not have a share of the market and capital from the West because of its dormant external sector. Consequently, labor productivity in China declined as its rapidly growing population had less and less capital to work with.

With the opening up of China, whose comparative advantage in labor-intensive products is stronger than those of the ASEAN countries, it gradually took over the supply of such import demand of the developed economies. Nevertheless, the labor-intensive light manufactured products produced by China and the ASEAN fell within a broad spectrum of products with different capital-labor ratios. Hence, it is expected that there would be specialization within this spectrum of manufactured exports among the countries concerned. Being more advanced than China, the countries which used to supply these labor-intensive products would now concentrate on the relatively more capital-intensive items among these light manufactured goods, while China would specialize in the labor-intensive goods that have lower capital-labor ratio.[4] Aside from having such specialization in their supply of manufactured goods to the rest of the world, China and these Asian countries would also trade with each other based on such specialization. China, which would be growing and industrializing rapidly by then, would become a market for the relatively more capital-intensive among the labor-intensive goods of the ASEAN countries while the ASEAN countries would find it cheaper to import from China labor-intensive goods with lower capital-labor ratio.

Another significant impact of China's open economy on the rest of the world would be on international capital flow. Growth in China would certainly attract investments. Moreover, capital in China would be expected to become more productive vis-a-vis the other Asian countries because of the bigger labor force to work with. With trade between China and the other labor-abundant Asian countries now based on the relative degree of labor intensiveness in the production of light manufactures, this development of capital flow would again affect the structure of trade between them. With more capital from the West as well as from the more developed Asian countries, China (where there is no mass labor emigration) would now be able to produce labor-intensive export products with higher capital-labor ratio. With the increase in China's labor force productivity, the ASEAN countries would lose their comparative advantage vis-à-vis China in the production of higher capital-labor ratio labor-intensive goods. Because China would now be enjoying higher capital endowment than the ASEAN countries, it would become more productive in exports where scale economies are significant. This would give China an absolute Ricardian advantage in most of the labor-intensive exports over these countries. The exception might be the technologically more advanced, higher

[4] This is due to the large pool of labor China has; there are some sectors in which China is technologically advanced.

capital-labor products in the spectrum of labor-intensive exports of the newly industrialized Asian economies.

Based on the Hechscher-Ohlin-Samuelson theory of trade, the impact of China's phenomenal growth could be very detrimental to the growth of the developing countries in Asia. The potential negative effect of China's economic growth on the ASEAN has led to conjectures concerning the likely significance of China's role in the recent Asian economic crisis (Fabella 1999a). China could be putting pressure on the rest of Asia through its lower real wage rate and its capture of a large share of direct foreign investment aside from the higher exchange rate at which China pegs its currency.

Fortunately, the empirical investigations of this project do not substantiate such theoretical prognoses. The research findings show that, so far, China's economic growth presented to the ASEAN countries market opportunities rather than impediments to their economic growth.

China's External Sector Growth

The largest component contributing to China's growth is the external sector. With respect to trade, the market-oriented economic reforms brought about expansion in its trade with the rest of the world as well as changes in its commodity structure. With trade liberalization policies and some institutional changes, the demand for economic efficiency has gradually moved its trade pattern towards conforming to its resource structure (Song 1996).

Another important objective of the open-door policy was to absorb foreign investments for capital and foreign exchange. Focus was on direct foreign investments as they also introduced management skills and production technologies.

China ranks tenth among the world economies in terms of export value of goods and commercial services in 1997. Total trade volume grew at an average of 13.5 percent in the period 1980-1996. The average growth rate for total exports and imports were 14.2 and 12.9 percent, respectively, for the period. Hence, trade dependence, i.e., trade as a percentage of gross domestic product, grew significantly. Despite its large internal market, export and import dependence ratios (export/import as a percentage of GDP) both grew from less than 10 percent in the 1980s to more than 20 percent in the 1990s.

China now trades with 220 economies in the world, from 173 in the late 1980s. Its major trading partners remain the developed economies—Japan, the United States, and Europe—on which China is heavily dependent for its imports. In 1995, Hong Kong ranks first among China's trading partners as a buyer of its exports although it is only second to Japan in terms of total trade. Trade with the ASEAN trails far behind these countries although the growth rate of this trade has been rapid. Exports and imports from the ASEAN-5 each constitute around 6 to 7 percent in China's totals in 1995. Since 1980, the share of imports from the ASEAN-5 in the total imports of China has increased while the share of exports to these countries in its total exports has declined slightly.

The commodity structure of China's trade also transformed dramatically from the 1980s to the 1990s. China's exports and imports have adjusted to the country's changing comparative advantage over time. Trade liberalization and economic structural development have transformed China's competitive advantage profile significantly. China has lost comparative advantage in many of its agricultural and mineral products and gained instead comparative advantage for capital-intensive products (Song 1996).

Both exports and imports shifted from agricultural to industrial products. For exports, the ratio of primary products to manufactured goods changed from 50:50 to 18:82 from 1980 to 1993. Rural reform and direct foreign investment promote the growth of non-state enterprises and export-oriented industrialization. The share of rural enterprise export in total exports increased from 5 percent in 1985 to 16 percent in 1991 (Findlay, et al. 1992). By 1995, this share increased to 33 percent (Liu 1997). Many of the export-oriented enterprises are foreign-funded. China's DFI exports grew from US$320 million in 1985 to US$61,506 million in 1996, contributing 1.1 percent and 41 percent respectively to total exports (Lardy 1996).

The rapid increase in China's export sector since reform took place has been essentially in the area of labor-intensive exports as the manufacturing sector takes advantage of China's low wage of labor. This phenomenon is expected to continue for several more decades. The wage rates in the coastal areas are likely to rise, but labor in the inland is still cheap and foreign and domestic investments are moving further inland.

In the case of imports, the ratio of agricultural to manufactured products declined from 35:65 to 14:86 for the period 1980-1993. Capital-intensive imports also rose very rapidly. In 1993, they occupied 72 percent of total imports and 82 percent of manufactured imports (Song 1996). Dominating China's imports are machinery and technology, as well as materials necessary for the manufacturing of exports. With increasing economic prosperity, the demand for consumer goods imports is also on the rise and is expected to continue to increase more sharply.

Direct foreign investments in China have also increased rapidly as a result of more economic liberalization and structural changes in the domestic economy. China's potentially expansive market and abundant supply of low cost labor are important pull factors for investors. Devaluation of its currency in 1988 and 1994 also increased foreign investments. The Chinese government also provides incentive policies that further attracted foreign investors to China. The incentive package to foreign investors in special zones is comparable, if not better, than those offered by the ASEAN-4 (Tan 1999).

The impact of China's foreign direct investments on its income growth has been found to be strong—in fact, much stronger than the impact of domestic capital (Tan 1999). The share of foreign direct investments in China's gross capital formation has increased from less than half a percent in 1980 to 15 percent in 1994.

Of the direct foreign investments that totaled US$175 trillion from 1979 to 1996, most were invested in Beijing, Shanghai and the coastal areas where the Special Economic Zones are located. Hong Kong is the largest source of DFI in China, although its share has declined from 67 percent in 1987 to 56 percent in 1990 and 49 percent in 1996. The United States and Japan occupy the second place, each having a share of between 10 to 14 percent. Taiwan, Southeast Asian countries, Europe and Korea also have substantial investments. The historical and cultural affinity of the ethnic Chinese in Taiwan and Southeast Asian countries is an important factor for investments from these areas.

China's capital outflow in terms of long-term investments abroad is minuscule compared to its inflow although overseas investments have increased in recent years. With the high reserve position it gradually acquired, China expanded its scope of enterprises eligible for overseas investments in 1985. The period 1986-1990 witnessed the rise of big Chinese transnational corporations such as China National Metals and Minerals Import and Export Corporation and China National Chemical Import and Export Corporation. Based on the number of Chinese enterprises set up overseas from 1979-1996, the recipients of Chinese investments were the United States, Russia, Hong Kong and Macao combined, and Thailand. In terms of the value of investments, Canada, the United States, Australia, and Hong Kong and Macao combined were the biggest recipients.

We have mentioned the growing share of foreign-funded enterprise exports in China's total exports. The regression of total exports versus the amount of inward investments shows a high correlation between the two variables and indicates a significant positive effect of foreign investment inflows on exports: each US dollar of DFI inflow generates US$2.55 of exports (Tan 1999). Most of the DFI in China are in the industrial sector, resulting in the tremendous expansion of export manufactures.[5]

China's Trade with the ASEAN-5

From China's perspective, the value of Southeast Asia is mainly strategic rather than economic. Therefore, to a certain extent, China's economic relations with the ASEAN are politically motivated. In the last couple of decades, the ASEAN as a whole has become an important trading partner of China although still lagging behind China's major partners. During this period, the trend shows that China's imports from the ASEAN are increasing faster than its exports to the ASEAN. The ASEAN countries have increasingly been exploring China as an alternative market to the developed countries during this period, given the prolonged recessions in both the United States and Europe in the 1980s.

Between 1975 and 1990, all ASEAN-5 countries established diplomatic ties with China giving economic relations full opportunities to develop from the extremely low levels of the seventies. The share of trade with China in a particular country's total trade

[5] The share of investment value in industry was as high as 80 percent in 1991. However, the share declined in mid-1990 as investment in the real estate sector increased.

for all the ASEAN-5 has increased from less than one percent in the early 1980s to almost 3 percent in 1996. The share of these exports in China's imports was around 3 percent in the early eighties and increased to almost 7 percent in 1996. These increases show increasing dependence of the ASEAN on China's market. On the other hand, China's dependence on ASEAN's market is not as evident. The share of exports to ASEAN-5 in China's total exports peaked at 10.3 percent in 1985 and gradually declined to around 6 percent in 1995 and 1996. China's exports constituted an average of 2.45 percent of ASEAN's imports for the period 1980-1996. Hence, although for the most part of the period, China's export value to the ASEAN exceeded its import value from the bloc, the trade imbalance has declined as exports of the ASEAN countries to China has been increasing much faster than the countries' imports from China. Trade between China and ASEAN as a bloc is now roughly balanced.

In terms of value, however, growth in trade with China has increased dramatically. This is because the total trade volume of China and the ASEAN countries has increased at unprecedented rates. Both the ASEAN's export to China and China's export to the ASEAN have grown at increasing rates. The value of ASEAN-5 exports to China grew from US$539 million in 1981 to US$9553 million in 1996, an increase of 1600 percent! On the other hand, the value of China's exports to the ASEAN increased 638 percent during the period, from US$1196 million in 1980 to US$8829 million in 1996.

In the last couple of decades, ASEAN-China trade has been vigorous despite similarity in resource endowment between China and the ASEAN countries. In varying degrees, China and the ASEAN countries are losing their comparative advantage in agricultural exports and increasing their comparative advantage in labor-intensive manufactured exports (except Singapore and to some extent Malaysia). The commodities topping the exports of these bilateral exchanges are converging towards labor-intensive manufactured products. Certain resource exports such as petroleum of Indonesia, rubber of Malaysia, and rice of Thailand are still important trade commodities. Other than these, the ASEAN countries and China have engaged each other economically "by exploring diversity in their similar resource endowment and exploiting differences in their developmental needs" (Palanca 1999). The trade structure of these industrializing countries has rapidly changed in the same direction. The share of manufactured goods within total exports has increased sharply as these countries exploited their low-cost labor comparative advantage in manufactured exports. With such developments, the bilateral trade between the ASEAN countries and China has been based on complementarities within manufacturing industries, exploiting horizontal division of labor. The products in the machines, transport, and equipment industry dominate the bilateral trade of China and the ASEAN countries in more recent years making intra-industry division of labor the basis for bilateral exchanges (Palanca 1999). At the same time, niche products are being explored and identified for more exchanges. Diversity of manufactured products in aspects of designs, etc. makes trade possible despite similar export profiles and seeming competitive nature of trade structures.

Besides trade, direct foreign investment is also an active component of ASEAN-China economic relations. Foreign investments of the ASEAN-5 in China increased from US$37 million in 1987 to US$3,185 million in 1996. These levels represent 1.4 percent and 7.5 percent, respectively, of total direct foreign investments in China. China's investments in these countries for the period 1979-1996 is only US$134 million making up 6.2 percent of total China's direct investments abroad.

How were the ASEAN countries affected by the tremendous surge of direct foreign investment in China in the 1990s? Tan's study (1999) shows that the dramatic increase in China's direct foreign investments has had no negative effect on the ASEAN but instead presented the emerging economies investment opportunities (Tan 1999). The much-improved share of China in the global supply of DFI has not been accompanied by reductions in the shares of the ASEAN-4 nor of all developing countries as a group. There is no indications that DFIs in China have crowded-out DFIs in the ASEAN. Rather, ASEAN countries, particularly Thailand and Singapore, join the world bandwagon and also invested substantially in China. They see opportunities in the growth of China's economy opportunities for their foreign investments. Such foreign investments have been observed to stimulate exports of the investing countries to the host country.

Bilateral Relations with Singapore, Thailand, Malaysia, and Indonesia

This section discusses the bilateral economic cooperation between China and Singapore, Malaysia, Thailand, and Indonesia given the bilateral political relations. A discussion of the Philippines' bilateral relations with China is presented in the next section.

For both China and the ASEAN countries, bilateral trade is not just based on economic interests but on political and security interests as well. From China's perspective, individually as well as collectively, the ASEAN member states help China realize its vision of a multi-polar order. On the other hand, these ASEAN countries accept China's interests in the region although they are also generally apprehensive of the effect of China's increasing military and economic power in the region. Most of them, however, believe in befriending China, engaging it politically as well as economically.

Structural development in China and the ASEAN countries has affected their bilateral trade commodity structure, which has evolved from exchange of primary products such as food and crude materials to trade of manufactured goods as well as machines and equipment from 1980 to 1996.

Singapore

Among the ASEAN countries, Singapore has the highest share in trade with China, accounting for approximately two-fifths share in total ASEAN-5's trade with China since 1980. Trade volume grew from US$728 million in 1980 to US$7147 million in 1996, increasing more than nine-fold. Initially Singapore traded machines and equipment for China's primary products. Among the ASEAN countries, only Singapore has revealed comparative advantage indices that are not significantly correlated with those of China. However, comparing 1987 and 1995 data, the correlation coefficient increased in value. By 1996, as it is the case with China's bilateral trade with other countries, machines and equipment dominated the exports and imports of Singapore to and from China.

With respect to foreign investments in China, Singapore also greatly exceeds the ASEAN-4. For the last 13 years the amount of Singapore's investments in China is more than twice that of all the ASEAN-4 combined. The increase has also been rapid—from US$37 million in 1987 to US$53 million in 1990 to US$492 million in 1993 to US$2247 million in 1996. In contrast, China's investments in Singapore are very small. They amounted to only US$15 million for the period 1979-1996.

The spectacular growth in the levels of Singapore's trade and investment ties with China can be attributed to Singapore's large total trade volume and investment capability as well as the high degree of complementation between exports of the two countries. Much of it, however, can also be said to be due to Singapore's conscious effort to engage China economically, reflecting its recognition of China's huge economic potential and power status.

Politically, Singapore is a strong supporter of China, having similar political cultures based on Confucian authoritarianism. A common cultural and language affinity has also enabled Singaporeans to trade and invest heavily in China. However, despite its large ethnic Chinese base (or perhaps because of this), Singapore strives hard to be identified with the Southeast Asians rather than with the Chinese. Singapore considers establishing friendly relations with its Southeast Asian neighbors it feels is more important than with China. As a matter of fact, Singapore is the last among the ASEAN-5 countries to establish diplomatic ties with China. It was done in October 1990, two months after Indonesia established formal ties with China.

Malaysia

Malaysia-China trade has also been robust. From the early 1980s to mid-1990s, Malaysia's exports to China increased over 1127 percent, from an annual average of US$157 million for the period 1980-1984 to US$1926 million for the period 1994-96. These values correspond to share in total exports of around 1.2 percent and 2.8 percent respectively. Malaysia's import from China, which maintains about the same percentage share in its total imports for the whole 1980-1996 period, has not grown as fast. The growth from the early eighties to mid-nineties was about 573 percent, from an annual average of US$188 million for 1980-1985 to US$1258 million for 1993-1996.

Wood and rubber are among the top ten exports of Malaysia to China for the entire period 1980-1996. China's exports to Malaysia have progressed from basically food items (rice, meat, fruits, and spices) in the early 1980s to basic manufactures and chemicals in 1988. In the 1990s, intra-industry trade of machines--electrical and non-electrical, office machines, and telecommunication equipment—dominates trade between the two countries, although the crude materials, wood and rubber, remain important exports of Malaysia to China.

Until the mid-1990s, Malaysia's direct foreign investments in China were insignificant. From a value of US$1 million in 1990, they increased to US$91 million in 1993 and US$460 million in 1996. The spurts in exports to China for the mid-1990s period can probably be explained by the increase in investments during this period.

Among the ASEAN countries, Malaysia is most sensitive to China's dominant presence in the region. It has, since early on, been reacting with utmost pragmatism. Malaysian Prime Minister Mahathir Mohamed, in his visit to China in 1993, suggested that China and Malaysia should "seize the present opportunity to contribute to regional peace and stability and promote mutual development by actively boosting economic cooperation" (McDougall 1997). As has been shown, economic relations with China have increased very significantly since 1993. As a matter of fact, Malaysia, which has been criticized by the West for its authoritarian government, now sees relations with China as a leverage with these powerful countries (Baviera 1999).

Thailand

Like Malaysia, Thailand has had very strong economic relations with China since the eighties, maintaining relatively substantial trade shares and volumes with China. Also, similar to Malaysia, Thailand has reduced its trade balance with China since exports to China have been increasing at faster rates than imports from China. From the early eighties to mid-nineties, exports increased by 870 percent, from an annual average of US$181 million for the period 1980-1984 to US$1755 million for the period 1995-96. On the other hand, imports increased by just 552 percent, from an annual average of US$231 million for 1980-1984 to US$1505 million for 1995-1996.

Thailand is an exception among the ASEAN countries in that food products are still among the top exports in trade with China. Rice, which was Thailand's eighth top export to China in 1980, became the third in 1988 and the second in 1996. Sugar topped the list in 1988 and in 1996, occupied the fourth position. The decline in the revealed comparative advantage of agriculture-intensive exports has been stronger for China than for Thailand. Aside from trading different items of machines and basic manufactures with China, Thailand continues to export primary and basic products, i.e., rice, sugar, crude materials, and chemicals. In contrast, imports from China consist of mostly manufactured products.

Thailand-China economic relations are based on very pragmatic strategic considerations. Thailand considers China a dominant power and wants to align with it. China, on the other hand, sees Thailand's strategic importance in the Indochina politics. Trade balance has generally been in China's favor, but is getting even because of a rapid increase in Thailand's exports to China. This increase in exports may in part be explained by its capital outflow to China that started in the late 1980s, when Thailand invested heavily in the human capital intensive and technology intensive industries. A rapid increase in direct investments in China is seen for the 1990s. Utilized amount was US$234 million for 1993 and US$328 million for 1996.

Indonesia

Indonesia-China trade grew remarkably from very negligible levels starting 1985. In fact, Indonesia ranks first among the ASEAN countries in terms of the growth rate of the country's export to China for the period 1980-1996. In 1996, the share of its trade with China in the country's total export and total import is highest among the ASEAN-5. While trade has grown very rapidly, capital flows to and from China are still small.

Indonesia is strategically important to China due to its size and status in ASEAN as well as its strategic location in the Straits of Malacca. With the rise of China as a major power in world politics, Indonesia saw the importance of recognizing China in international diplomacy. Such formal relations became imperative when China and the United States improved their relationship in the 1980s. Indonesia finally normalized diplomatic ties with China in August 1990. Indonesian trade with China increased significantly since then with exports to China far exceeding imports from China. It can be surmised that "China was using trade to help consolidate newly restored political relations with a strategically important neighbor" (Baviera 1999). China also gained political points with Indonesia by offering a substantial assistance package when the latter suffered the Asian financial crisis in 1997. The assistance consisted of US$3M worth of medicine and materials, US$200M worth of export credits, and US$400M contribution for the IMF's Indonesian bailout package.

China's Bilateral Relations with the Philippines

Philippines-China economic relations dated as early as the 9th century when the Philippines, together with other Southeast Asian countries conducted trade under the "vassal tributary missions." Trade continued to prosper despite discriminatory policies during both the Spanish and American colonial rules. But with the establishment of the People's Republic of China under the Chinese Communist Party on October 1, 1949, trade between China and the Philippines was suspended. Instead, the Philippine government signed an agreement with Taiwan on trade relations and exchange of specialists and information.

Commercial ties with China were renewed only in 1971 and became vigorous when President Marcos established diplomatic relations with China in 1975. Trade volume rose from US$1.4 million in 1971 toUS$72.3 million in 1975 to US$250.7 million in 1980. Due to the positive political decisions deliberated by the leaders of both countries, trade volume grew significantly although the balance of trade had been in China's favor. Essentially, crude oil, at concessional prices, and high-grade coal were the Philippines' imports from China and coconut oil was its major export to China.

In the 1980s, however, when the Philippines was beset with political and economic crises, trade volume dropped markedly. The trade balance policy pursued in 1977, which attempted to balance trade with China, also contributed to the decline in trade. The Aquino government, which toppled the Marcos dictatorship in 1986, worsened the Philippines' relation with China by focusing attention on Taiwan, which was offering economic support to the Philippines. As a consequence, trade volume between the Philippines and Taiwan rose dramatically while trade volume between the Philippines and China plunged to a new low. With Taiwan's "money diplomacy," some Philippine legislators proposed "a review of the country's 'One-China Policy,' the passage of a Philippine-Taiwan Relations Act, and granting diplomatic status to Taiwan officials and businessmen in the Philippines" (B.Lim 1999).

The policy of the Aquino government to focus on Taiwan happened during the period when economic development in China was very rapid. Hence, unlike the other ASEAN countries whose economic growth was stimulated by China's dramatic economic growth, the Philippines did not benefit much from China's dramatic economic growth in that respect. On the other hand, sad to say, Taiwan's promises to help build the Philippine economy failed to materialize when Aquino stepped down as president.

Under the Ramos government (1992-1998), Taiwan remained a sensitive issue in the Philippines' diplomacy with China. In its first year, the issue was aggravated with the meeting Ramos had with Taiwan President Lee Teng-Hui in Subic in February 1993, which the Chinese considered a violation of the One-China policy. A state visit to China by Ramos in 1993 and a return visit by Jiang in 1996 softened the cold diplomatic situation. Notwithstanding these visits, the Spratlys issue provoked much national reaction from the Departments of Defense and Foreign Affairs of the Philippines. China's occupation of the Mischief Reef in 1995 and later the attempted occupation of the Scarborough shoal were considered by the Philippines as threats to Philippine security.

Despite the tense and cold diplomatic relations between the Philippines and China since the Spratlys issue in 1995, economic relations have been relatively vibrant in 1995 and 1996. Contrary to expectations, trade and investment activities between the Philippines and China increased sharply. The basis for such increase in economic relations can be traced to economic policies taken by both governments. These policies provided better trade and investment opportunities for business people. Traders and investors from both sides respond to market signals and government policies. The lifting of the trade balance policy by Ramos shortly after he took office in 1992 was a positive factor in stimulating Philippines-China trade. China, on the other hand, further adopted market liberalization program for its foreign trade system in 1994. Policies that increased investments include the liberalization of foreign exchange in the Philippines and China's improved incentive program for foreign investment. Attracted by the incentives, Filipinos, particularly the ethnic Chinese, responded by investing in China. However, the biggest Philippine investment in China has been by San Miguel Corporation, a non-ethnic Chinese business. The investments of the Philippine Chinese were mostly small and medium scale, low-tech enterprises in manufacturing, services, and real estate development.

It is obvious, therefore, that with market liberalization in China, its economic relations with other countries are affected not just by political relations but are also dictated by market forces and government policies. Increasingly, the trade and investment entities are no longer governments but individual corporations.

As it is the case with the other ASEAN countries, with regard to Philippine trade with China, there has also been a development towards horizontal division of labor over the years. While in the 1980s Philippines-China trade was in the area of agricultural products and basic material, in 1996 several commodity classifications under the "machines and equipment" category were among both the top Philippines' exports to China and China's exports to the Philippines. This kind of exchange reflects intra-industry trade relations between the two countries.

Effects of China's Growth on the ASEAN

China's economy has grown in leaps and bounds since it decided to open up and undertake a program of economic reform in late 1979. What are the impacts of this growth on the ASEAN countries, all of which have been striving to achieve "NIC-hood" even before China opened up? Being outward-looking market economies, China and the ASEAN-5 countries focus on exports as the engine of growth. China, however, has not been a competing force in the region but instead has been an impetus for greater growth.

For the period 1980-1988, China's external trade volume grew at an annual average of 13.2 percent. This growth rate was much more than that of any individual ASEAN-5 countries. Growth of the external trade of the ASEAN-5 countries as a whole was at an annual average of 5.9 percent, faster than the average of the world (4.8 percent). During this period, China, with its extraordinary growth, did not pose as a competing force to the ASEAN countries. This can be seen from the growth of the ASEAN countries in the years following. In 1988-1996, trade of all the ASEAN-5 grew at unprecedented high rates, with the annual average being 16.3 percent for total trade volume. China, still growing very fast, experienced an average growth rate of 13.8 percent for total trade volume. The average trade growth rate for the world was 8.5 percent, much lower than it was for the ASEAN-5 countries and China. Here, the synergy effect of China's growth in the region and in the world since it liberalized its economy is illustrated.

China's open economy has been an important market for the ASEAN countries. Bilateral trade between each of the ASEAN-5 countries and China has been such that the export of each of the association countries to China as a share in the country's total exports increases.

With respect to direct foreign investments, statistics show that massive flow into China did not have any crowding out effect on the ASEAN-4 (Tan 1999). Global supply of DFI increased significantly as a result of China's open door policy. Due to the synergy effect, East Asia, both Northeast and Southeast, became a region of focus for investors. The share of the developing countries in general and the ASEAN-4 in particular in global supply of DFI did not decrease even as China increased its share, indicating that the volume of DFI inflow to the developing countries actually increased. On bilateral terms, Thailand and Malaysia have been able to establish active two-way DFI flows with China.

These flows were based on the complementation with respect to raw materials, labor skills, and technology, aside from the rationale of easier access to China's enormous market.

Based on the ASEAN-5 cases, evidence of a positive correlation between export to China and investment in China was found. The data on ASEAN-China bilateral relations supports the likelihood that trade relations do improve through investment linkages.

These positive effects of China's growth on the ASEAN countries are contrary to expectations based on traditional trade theories. The ASEAN countries generally have similar factor endowment as China but cannot compete with China in the extent of labor abundance. China's large population increases its advantage of low labor cost and economies from larger scale of production. It also attracts foreign investments that may be diverted from the ASEAN countries. Therefore, based on a traditional trade theory that explains the existence of a country's comparative advantage by its factor endowments, China and the ASEAN countries would not have much to trade but instead would compete for markets. However, the synergy effect of China's economic growth has provided vigor and increased both trade and investment activities in the region.

The Heckscher-Ohlin-Samuelson trade model explains trade based on comparative advantage determined by factor and resource endowments. This principle explains traditional international trade, the basis of which has been trade of inter-industry products. It describes exchange of very different types of commodities, usually between countries of very different factor endowments, and generally different levels of development. An investigation of the top commodities being exchanged between China and the ASEAN countries shows that the bilateral trade structures have moved towards intra-industry trade. Due to the semblance of their resource endowment, the trade profile of China and the ASEAN countries -- except for Singapore and, to a certain extent, Malaysia, are similar.[6] Among the ASEAN-5, Thailand's and Indonesia's export commodity structures are most similar to China's. Despite this fact, the bilateral trade of Thailand and Indonesia with China has grown the fastest among the ASEAN-5 in the last two decades.

Manufactured products dominate trade between the ASEAN countries and China. As a result of the export industrialization program followed by these countries, their industrial structure has been changing and manufactured exports have been growing much faster than traditional primary exports. The manufacturing industry consists of a broad spectrum of goods, not only in terms of capital-labor ratio but also, due to the heterogeneity nature of the goods, the variety and forms each product can have. Because product differentiation characterizes manufactured products, the opportunities for intra-industry exchanges of manufactured goods are particularly plenty. Consequently, bilateral exchanges between China and the ASEAN countries are converging towards manufactured goods. Besides competition through price, non-price competition such as

[6] This is based on the strong correlation between their revealed comparative advantage indexes.

quality and style is now important in their bilateral trade and their trade with the developed countries.

It is evident therefore that for the ASEAN nations' trade with China, despite similar resource endowment and industrial structure, competition and specialization are possible through horizontal division of labor. Given this kind of trade structure, the level of competitiveness and identification of trade niches are key factors in determining trade volumes. This is well summarized by Ariff (1994): "International trade is too complex a phenomenon to be adequately explained in terms of factor and resource endowments. The new literature tells us that it is competitive advantage based on policies and strategies, not comparative advantage based on factor and resource endowments, that determines the trade pattern (Porter 1989). How else can one explain the creditable performance of Singapore which is resourceless and yet so resourceful."

Current Problems in China's Economy: Reform of the SOEs

Since opening up, the biggest economic problem China faces has been the state-owned enterprises. A series of reforms that aim to shed redundant labor and make the SOEs responsible for their performance has been undertaken since the early 1980s. Output share of state sector declined from 78 percent in 1978 to 55 percent in 1990 and 34 percent in 1995. However, reform of this sector is too slow to cope with the increasing competition from the non-state sector and imports. Over time, SOEs deteriorated in efficiency and financial performance. In 1996, half of these enterprises reported losses and the sector as a whole also made a loss. Most of these SOEs are plagued with redundant labor, estimated to be a third. The wages plus social benefits given to labor of the SOEs are very much above rates commensurate with productivity.

The SOE problem is of great concern to the Chinese government. How the problem is addressed will determine to a great extent the economic prospects of China. The sector, with its inefficiency, can also limit the further liberalization of the trade system and financial sector. It is also a fiscal burden. However, reforming the SOEs means massive lay off of workers and shedding of their welfare provision function. The unemployment and/or the lowering of living standards of SOE workers due to the reform can have consequences on social and political stability.[7] Because of this, the pressure on SOEs to become profitable or go out of business was eased despite the draft bankruptcy law being in place since 1986. Major banks continued to extend state-directed lending of working capital to money-losing state enterprises.

The economic slowdown due to the Asian crisis put more pressure on reforming the state-owned enterprises as well as the financial and fiscal sectors. In recent years, SOEs have been under stricter budget constraints, enjoying less subsidies and loans from the government. Laying off of workers for the enterprises that go bankrupt and those that try to streamline their personnel means transferring of social service obligation from the SOEs to the private sector and national and local governments.

[7] SOE workers are mostly in the urban sector, which is more politically sensitive than the rural areas.

The fiscal and financial sectors face constraints posed by reforms in SOEs. With increasing losses and deficits in the SOEs and reforms that allow profitable SOEs to retain part of their profits, the tax effort (tax revenue to GDP ratio) fell substantially from 28.4 percent in 1980 to 10.5 percent in 1997. On the other hand, government expenditures have increased due to the need to take over the provision of social safety nets and social insurance that used to be provided by the failed SOEs. Although government subsidies to SOEs are reduced, in the short run the government is still expected to raise large amounts of money to capitalize a very troubled financial sector, as the state-owned banks are saddled with non-performing loans.[8]

Recently, a solution to this huge problem was made by the creation of asset management corporations which, through debt-equity swaps, will help restructure many major enterprises. For example, Cinda Asset Management is to buy the non-performing loans from China Construction Bank, one of the four state-owned banks. State-owned enterprises with the bad loans are forced to restructure, layoff workers, and become more efficient in order to repay the bad loans. It is expected that the management companies will start the adoption of basic commercial and market-based banking practices for loan transactions to the corporate sector. It is also expected that the non-performing loans of the other commercial state-owned banks will be taken care of as well, thus helping the recapitalization of these banks.

With respect to ownership reform of state-owned assets, the Chinese government tries to retain its dominant control over enterprises in the upstream and strategic industries, those that involve economies of scale, externalities, and "learning by doing." There is evidence that the government has indeed been privatizing or closing small and medium SOEs involved in trade and the downstream industries and keeping firms in the upstream industries, industries important to the development of high technology and the industries of public utilities (Nolan and Wang 1999).

The government is also focusing on housing, education and health sectors. Housing supports the SOE and labor reforms and at the same time has strong repercussions for growth. It contributes to labor mobility and has significant multiplier effect on domestic demand and labor multiplier. Education and health for the general public are also critical sectors as they are important for social stability particularly if seen in the light of the unequal distributional effect of growth.

Prospects

China's economic growth has slowed down since the Asian crisis.[9] One important negative consequence of the crisis is the effect on China's exports, which declined due to the currency depreciation of countries affected by the crisis. Growth rate has gone down from 8 to 9 percent in 1997 to just 6 to 7 percent in 1999. The economy now faces structural changes in patterns of both domestic and international demand as well as a less

[8] Non-performing loans are estimated to be 24 percent of total loans in 1997.
[9] China was spared from the crisis because of its strong macrofundamentals, plus the fact that its capital market was not open, currency not convertible, and most of its foreign investments were direct investments.

favorable world environment. With such problems, the sense of urgency for reform is stronger than ever. The experiences of countries affected by the Asian crisis provide lessons for reform in China's financial institutions and regulations. Even the crackdown of corruption is believed to have been influenced by the economic crisis including the political developments in Indonesia.

China has been vigilant all throughout the crisis, keeping its economy as resilient as possible. The economy has bounced back quickly. The most recent statistics show that China's economy is again accelerating, after slower growth at 6 to 7 percent due the Asian financial crisis. China's GDP grew 8.1 percent in the first quarter of 2000 while the growth forecast for the whole year is between 7 and 8 percent (Brown 2000).

China's economic growth prospects, on which relies its political stability, depend strongly on its domestic and external economic environment. The re-absorption of displaced labor and viability of the state enterprises and financial institutions also depend on such an environment. Trade continues to be a strong stimulating factor in the growth process. The expected entry of China to the World Trade Organization will pressure it to further promote its trade volume and efficiency. Much depends on its SOE and financial reforms that can mean either more efficiency and profitability, or if unsuccessful, can mean financial turmoil as the system will have to conform to the regulations of global trade and finance. If the reforms are realized, we can expect that in the medium and long term, given a positive world environment, China will be heading towards real economic development.

What prospects lie ahead for ASEAN-China economic relations? China's increase in efficiency due to liberal policies as well as institutional changes and international exposure can gradually erode the competitive advantages that the ASEAN countries now have over China. The ASEAN nations will face stronger competition and will have to adopt policies and strategies in order to increase also their efficiency and competitive levels. Following the direction of intra-industry exchange in their trade with China, they will need to look more intensely for new niches and develop a new pattern of specialization. China is experiencing a downward trend in agricultural comparative advantage. With this trend, plus the strong focus on industrialization, it is expected that the import demand for food products and basic materials for China will increase. The demand for better quality and more variety in consumer goods, for both food and non-food items, is expected to rise with per capita income increasing. All these trade opportunities are expected to multiply following China's accession to the World Trade Organization. China's demand for imports will increase when it opens up its entire economy. So far only the coastal areas and some key cities are open up. With respect to industries, more will be open up for foreign investment. Premier Zhu has indicated that China "will take on an active role in economic globalization by gradually opening commerce, foreign trade, banking, insurance, securities, telecommunications, tourism and media services to foreign investors" (Brown 2000). Correspondingly, we can expect that China will increase its investment outflow as well.

In the past decades, the general political relations between China and the ASEAN nations set the conditions for bilateral economic cooperation. More recently, with China's economy becoming more market oriented, many trade and investment decisions of the Chinese and the ASEAN nationals have been based on the profit opportunities available to them. From 1993 to 1996 when China experienced a boom in direct foreign investments, business people in the Philippines joined the global bandwagon in investing and trading with China despite the political tension between the two countries created by the Spratly issue.

From a long-term perspective, it is important that "both ASEAN and China exert greater efforts to expand mutual trust and define the norms that will guide their political, security as well as economic relations" (Baviera 1999). For the Philippines, the long-term imperatives of its security require the maintenance of peace and stability in the regional environment, which means a friendly relationship with China, one of the major powers in the neighborhood.

Over the last couple of decades, all the ASEAN nations have developed favorable political relations that can boost future economic cooperation, both bilaterally and multilaterally. As a bloc, ASEAN and China can collectively move for a comprehensive multilateral trade negotiating strategy to promote their interests. With the current trend of regionalism, countries in East Asia have come to realize that they stand to lose market access and export demand if they do not develop multilateral trade negotiations and agreements. The experience of the recent financial crisis also shows that regionalism is important not only to address regional economic, political, and security issues, but also to safeguard against another regional crisis. It is hoped that the formation of ASEAN-Plus3 will increase the mutual economic dependence between the ASEAN nations and China even as these countries increase their integration with the global economy.[10]

[10] ASEAN Plus 3 refers to a new emerging framework for regional economic cooperation among the East Asian states of ASEAN, China, Japan, and Korea that was given impetus by the Asian crisis.

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