Future Role of China in Asia[1]

Justin Yifu Lin

Peking University
& Hong Kong University of Science and Technology

No. E2002004 August 15, 2002

[1]Paper prepared for "Asia 2015 Seminar" at Asian Development Bank Annual Meeting in Shanghai on May 10, 2002. I am grateful for Chen Yong's help in preparing this manuscript.

I. Introduction

To assess China's future role in Asia, it is necessary to have a short review of what China has achieved since the reform and open-door policy started in 1978. From the end of 1978 to 2001, the average annual Growth Rate of GDP in China reached 9.3% and that of trade 15.0%.[2] In other words, in the past 23 years, China's GDP and foreign trade have increased 8 and 25 times respectively. Now, China has become the seventh largest economy measured by official exchange rate and the second largest economy in terms of purchasing power. Because of this rapid growth, China has significantly reduced the number of people living below poverty line. China has not only developed its own economy, but also made many contributions to other Asian economies. For example, in the East Asian Financial crisis, China did not devalue its currency and thus helped to avoid the crisis-hit countries' competitive devaluation and contributed to their early recovery.

II. China's Growth Potential

In spite of the achievements after the reform China is still a very poor developing country. As is shown in Table 1, all the major development indicators in China today are very similar to that of Japan in the early 1960s.

Because China is still an underdeveloped country, just like Japan in the early1960s, and since Japan had maintained a high economic growth through the years from 1960s to 1980s, China also has the potential. This is because technological innovation is the most important determinant of economic growth. As a developing country, China's technological level lags far behind that of developed countries. Therefore, China can rely on technological borrowing from advanced countries to achieve technological innovation at lower cost and make technological borrowing as a driving force for its economic development, just as Japan and Asian Little Dragons did in the 1960s to 1990s. For this reason, I am confident that China has the potential to achieve a 7-8% annual GDP growth rate continuously in the coming two or even three decades.[3]

Table 1 Comparison of the Major Development Indicators between China and Japan

	China		Japan	
Life Expectancy (years)	Female 72	Male 68	Female 72.9	Male 67.7
	(1998)		(1965)	
Infant Mortality Rate (per thousand)	31 (1999)		30.7 (1960)	
Primary Sector as a Share of GDP (%)	15.9 (2000)		16.7 (1959)	
Engle's Coefficient in Urban Areas (%)	39.2 (2000)		38.8 (1960)	
Per Capita Electricity Consumption (kwh)	1071 (2000)		1236 (1960)	

[2] State Statistical Bureau, *China Statistical Abstract, 2002*, Beijing: China Statistical Press, 2002, p. 17 and p. 148.
[3] Justin Yifu Lin, "Prospect for Chian's Economy in the New Millennium" *Knowledge Economy and Entrepreneur,* 2000, No. 1(“展望新千年的中国经济”，《 知识经济与企业家》2000 年第 1 期).

Source: Kwan, C.H. "Overcoming Japan's China Syndrome," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002.

But this is only a potential. In order to bring this potential into full play, China needs to do a lot of things. It needs to complete the transition from a planned economy to a market economy; to strengthen its financial system; to harden SOEs' budget constraints so as to improve their corporate governance; to mitigate regional income disparities such as the disparities between urban and rural areas and those between the coastal and inland areas. It also needs to improve environmental sustainability, and maintain internal as well as external stability.[4]

In addition to all the things mentioned above, there is still one important and indispensable precondition for China to tap its growth potential. That is: it has to follow a right development strategy. [5] Although the technological potential had always been there, China had not benefited from this potential before 1978. Why? The reason is that China at that time adopted a wrong development strategy. The right strategy should be the one that promotes the industrial development according to China's comparative advantage, which lies in China's cheap and abundant labor force. In order to fully benefit from the technological gap between China and developed countries, China needs to focus on the labor-intensive industries and the labor-intensive segments of the capital/technological intensive industries.

At the same time, China also needs to integrate into the world economy so as to facilitate the borrowing of technology. China's entry into WTO will greatly accelerated this integration process. The spirit of WTO is to lower the tariff rates, to eliminate non-tariff barriers for trade, and to give foreign firms market access to domestic investments, commerce and profession services. That is, China's domestic economy will fully open to the foreign competition except for the remaining tariff rates. The accession will surely help China to complete its transition to a market economy. At the same time the government will have less means to support/protect domestic firms, which will accelerate China's reform of State-owned enterprise and ensure that China develops its economy in line with its comparative advantage.[6] In this way, it will accelerate China's integration into the world economy and speedup China's economic development.

III. The Impact of China's Future Growth on Asian Economies

In the years through 1980-2000, China's average annual growth rate of trade with all other countries was 12.6%, the average annual growth rate with the rest of Asia was 13.3%. In the past ten years, China's trade with other East Asian economies accounted for 55 - 60% of China's total trade.[7]

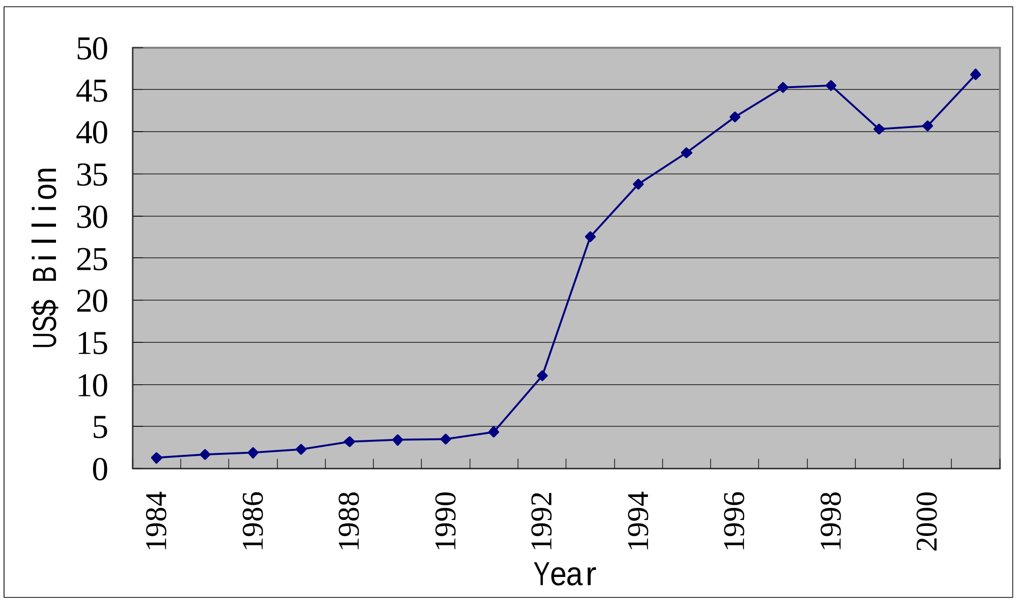
---

[4] Lin, Justin Yifu, Fang Cai, and Zhou Li, *The China Miracle: Development Strategy and Economic Reform*, Revised Edition, Shanghai People's Press and Sanlian Press, 2000.
[5] Lin, Justin Yifu, "Development Strategy, Viability, and Economic Convergence," *Economic Development and Cultural Change* (forthcoming).
[6] Lin, Justin Yifu, "WTO Accession and China's SOE Reform," in Lee, Kyung Tae, Justin Yifu Lin, and Si Joong Kim, eds., *China's Integration with the World Economy: Repercussions of China's Accession to the WTO*, Seoul: Korean Institute for International Economic Policy, 2001, pp. 55-79.
[7] State Statistical Bureau, *China Statistical Yearbook 1981 and 2001*, Beijing: China Statistical Press, 1981 and 2001.

Because of this rapid growth in China and its accelerating integration into the world economy, many people start to think of the implication of China's growth in the coming decades. Currently, there are two different views: some people in Japan, Korea and some other Asian countries regard China as a threat, while others view it as an engine of Asian growth. Let's look at the arguments for those who regard China as a threat. They have two major arguments. One is that labor cost in China is low, which will promote China's export of manufactured product and out-compete its ASEAN neighbors. Some people even argue that because of the development of IT technology, China may as well overtake Japan and NIEs. The other major argument is that China has such a large domestic market that China may absorb most foreign direct investment to developing countries, and deplete all the funds for other countries.[8]

Now let's look at what has really happened. First, let's take a look at the increase of FDI to China.

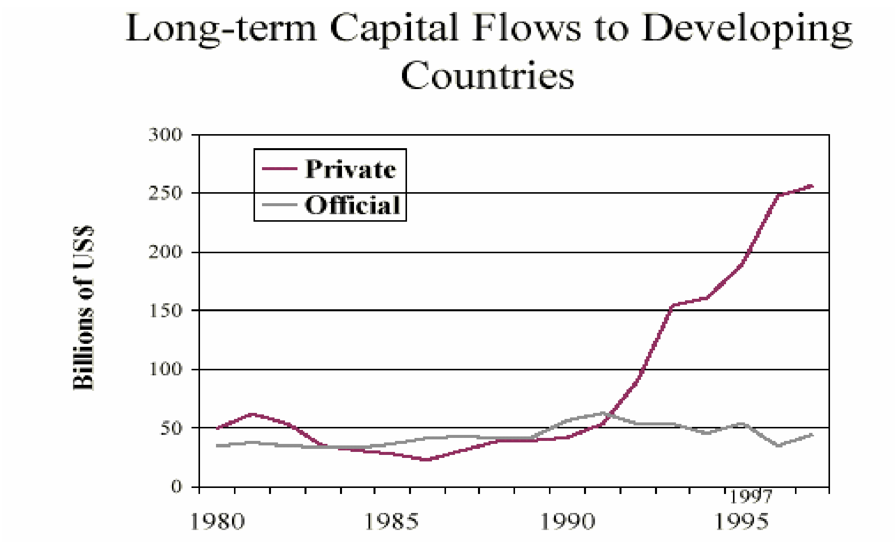
Figure 1: China's Foreign Direct Investment



Source: China Statistical Bureau, *China Statistical Abstract, 2002,* Beijing: China Statistical Press, 2002, p. 1545.

Figure 2:

[8] Kwan, C.H. "Overcoming Japan's China Syndrome," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002



OURCE: *Global Development Finance 1998*

In the 1980s, the FDI into China was only US$2-3billion per year. It started to surge in 1992 and in 1993 China became the largest FDI recipient country among all the developing countries. Currently, China attracts about US$45billion per year, the largest among developing countries and the second largest in the world, next only to the USA. In Figure 2, the red line represents the private capital flow into developing countries, and the black one at the bottom represents the official capital flow from the kind of organizations like ADB and the World Bank. There is no major change in the flow of international organizations, whereas the capital flow from the private sectors has increased strikingly since 1991, when the foreign investment in China began to increase dramatically. These two figures clearly demonstrate that the surge of China's FDI in the 1990s mainly comes from the surge of capital flow from the private sector. It is definitely not achieved at the expense of other Asian countries. Since 1993, China's share of FDI in Asia has been remarkably steady. That is to say, the more that foreign capital flows into China, the more it flows into other Asian countries. For another thing, most of China's FDI came from Hong Kong and Taiwan, whereas ASEAN countries, up to now, continue to receive more investments from both Japan and the US than China. All these facts show that China's development has not taken away the FDI of other countries.

Secondly, in term of China's labor cost, the wage level in China is very low. It is about 1/50 as much as that of Japan and US. However, China's labor productivity in manufacturing sector is extremely low, only about 1/25 of America's and 1/26 of Japans. Because of this low productivity, if we look into the composition of labor cost in manufacturing industry, the American wage level is only 1/3 higher than the Chinese level in terms of per dollar output value. Besides, the value added of China's manufacturing industry is comparatively low. In 2000, the average value-added in China was only 26%, which is much lower than that of the US and Japan, which are 49% and 43.6% respectively.[9]

[9] Chen Qingtai, "Promoting the Regional Economic Cooperation in Asia amidst Economic Globalization," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002

China’s industries depend mainly on borrowed foreign technology and do not have their own intellectual property rights. Most of China’s manufacturing factories and export came from the processing industries. Actually, 55% of China’s export came from processing industries. The implication is that when Chinese manufacturing sector grows, its export grows, and its import also grows correspondingly. On the average, for every US$ 100 worth of export, China needs to import US$ 50-70 worth of materials. That is to say, the more China exports, the more China imports. This kind of trade in effect benefits other Asian countries as well. Actually, in the past 20 years, on average, China’s annual import from Asia grew 2.5% faster than its export to Asia, as is shown in Table 2.

Table 2
China’s Annual Trade Growth Rate, 1980-2000

	Export	Import
Total	13.30%	11.80%
Asia	12.20%	14.70%
Asia (excluding Hong Kong)	12.40%	14.80%

Source: State Statistical Bureau, China Statistical Yearbook 1981 and 2001, Beijing: China Statistical Press, 1981 and 2001.

If we reexamine China’s trade with other Asian economies in the year 2000, we can see that most Asian economies except Japan and Hong Kong enjoy a large trade surplus with China (see Table 3). For example, in the year 2000, Korea has a surplus of US$12billion, Taiwan US$20billion and ASEAN countries US$5billion. As for Japan, China did not actually enjoy the entire surplus, because 42% of the export to Japan was from the Japanese joint ventures. Since Japan has relocated its non-competitive labor-intensive manufacturing operations into China and then imports the finished products from China, the actual trade benefits for China is much lower than the figure shown in the Table.

Table 3
China’s major Trading Partners in 2000 (US$ billion)

	Total Trade	China’s Export	China’s Import
Total	474.3	249.2	225.1
Japan	83.2	41.7	41.5
US	75.5	52.1	22.4
EU	69	38.2	30.9
HK	54	44.5	9.4
ASEAN	39.5	17.3	22.2
Korea	34.5	11.3	23.2
Taiwan	30.5	5	25.2

Sources: State Statistical Bureau, China Statistical Yearbook, 2001, Beijing: China Statistical Press, 2001, pp. 591-3.

In fact, more than 50% of China’s export in 2000 came from joint ventures, as a result of Japan’s and East Asian NIEs’ relocations of their non-competitive labor-intensive manufacturing factories to China. Table 4 presents the share of Taiwanese joint ventures in Mainland China's IT industry, which is a very dynamic industry in China in recent years. Last year, it contributed about 25% of China's total export. But a large part of this export was produced by Taiwanese firms. For example, in China, 90% power outlets, 85% scanners, and 72% CD-ROMs are provided by Taiwanese firms. Furthermore, most of these products are very intensive in labor. For more technology-intensive products like notebook, we see 0% in Table 4.

Table 4
The share of IT Products Manufactured in Mainland China
From Taiwanese Firms in 2000

Power outlets	90%
Scanners	85%
CD-ROMs	72%
Cabinets	71%
Monitors	56%
Motherboards	46%
Desktop PCs	45%
Digital Cameras	42%
Notebooks	0%

Source: Kwan, C.H. "Overcoming Japan's China Syndrome," paper presented at Asian Economic Integration: Current Status and Future Prospects" organized by Research Institute of Economy, Trade & Industry of Japan at Tokyo on April 22-3, 2002

IV. Concluding Remarks

In conclusion, since China has the determination to complete its transition from the planned economy to the market economy, China is likely to maintain a rapid economic growth in the coming decades. This economic growth will not at all become a threat to other Asian countries. In stead, it will bring them many benefits. Because if China can maintain a rapid economic growth, it will provide other Asian countries with a much larger market and at the same time provide them with a place to reallocate their non-competitive labor-intensive industries. Therefore, it is safe to say what is good for China is also good for other Asian countries. And as China maintains its rapid growth, it will serve as an engine for the Asian economy.