



## Original Article

# The Role of China in Asia's Evolution to Global Economic Prominence

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### Abstract

*The objective of this article is to show how China's rapid growth was instrumental in integrating Asian economies with each other and mutually supporting rise of a dynamic Asia. It demonstrates the thorough structural transformations that the Chinese and Asian economies underwent over the last three decades. In a short span of three decades Chinese economy made a sizeable regional and global niche for itself. China's vertiginous growth became instrumental in integrating the real economies in the region. China and the neighbouring Asian economies influenced and shaped each other's economic evolution. Trade, foreign direct investment (FDI) and vertically integrated production networks were the principal channels of market-led integration. China's rise as a regional economic power, before becoming a global one, was a substantially significant economic event. A defining moment in China's economic relationship with its Asian neighbours was the outbreak of the regional financial crisis in 1997–98. Similarly when the global financial crisis (2007–09) struck, China's macroeconomic fundamentals were strong, and it helped propel regional growth. In several other important ways, China sways not only the regional economies but also the global economy.*

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### 1. Introduction

The broad objective of this article is to show how China's rapid growth was instrumental in integrating Asian economies with each other and mutually supporting rise of a dynamic Asia. It examines how the relationship between China and the neighbouring Asia evolved into a market-led symbiosis. Two relevant and interrelated economic realities are: first, the People's Republic of China (hereafter 'China') in 2012 is a large economy in both absolute and relative terms. Over three decades of macroeconomic reforms and the resulting dynamism turned it into the largest regional economy in mid-2010. In a short period of time, China has established a noteworthy niche in both the regional and global economies (Das 2008a, 2008b). Second, the recent economic transformations in China and the surrounding rapidly growing Asian economies have been thorough, comprehensive and methodical. This group of Asian economies has turned into the most dynamic in the global economy.

The two realities are correlated because China's relatively belated economic ascent has had an appreciable effect over the neighbouring Asian economies, and it became the driver of wide-ranging transformations in them through inter-linkages and interdependencies. China is a defining factor behind rapidly transforming Asian economy. Its role

in the Asian economy grew monotonically and is now pivotal. Its soft power has been on the rise, which is not to denigrate its hard power. Although it is an emerging-market economy (EME) by definition, it surpassed Japan, a matured industrial economy, as Asia's leader in many dimensions. China's resurrection to its previous economic role in the regional and global economies as a major economic power is 'not only the best news for global human welfare in a generation, but promises to raise a variety of geopolitical challenges, which as yet remain unpredictable' (Findlay & O'Rourke 2007, p. 545).

## 2. Emergence of Asia and Integration of China

Between 1950s and 1990s, four countries or country groups in Asia recorded ebullient gross domestic product (GDP) growth and displayed superlative economic performance. It began with the post-War reconstruction, recovery and brisk growth of Japan, followed by equally brilliant performance of the four newly industrialised economies (NIEs). As alluded to above, the Association of Southeast Asian Nations (ASEAN)-4<sup>1</sup> were the next to pick up the baton. China was to join these high achievers last. Its brisk growth provided a veritable impetus to the process of regional integration. As they adopted an outward-oriented growth strategy, the leading and following country or country-group influenced each other's growth. These high performers mutually shaped each other's economic evolution as well as economic structure and growth trajectory. Together, they are responsible for modernising, industrialising and revolutionising the Asian economy in a remarkably short time span. China's regional and global integration caused a regional and global reallocation of economic activities. It also resulted in generating several globally significant externalities.

Until the early-1990s, Chinese political leadership did not display enthusiasm for cultivating close relationship with the region, or for

economically integrating into the neighbouring Asian economies (Shambaugh 2005; Ye 2010). That said, it did remain interested in bilateral relationship with the regional economies. If it is open, a large and rapidly growing economy does impact its neighbours' growth performance. It can create complementarities and growth opportunities for its neighbouring economies, and also intensify competition for them. Additionally, an important impact of China's integration with the Asian economies was deepening of production fragmentation in the region. China has been influencing the pace of economic growth in the rest of Asia for close to two decades. As the twenty-first century dawned, China began to appear a major driver of regional economic growth.

In 1980, intra-regional trade in Asia was not very high, only 37 per cent. With increasing trade in parts, components and intermediate products, it began expanding rapidly. During 2000–09, trade performance in Asia grew increasingly intra-regional. China had a role to play in the strengthening of intra-trade trend because it evolved as the largest destination for regional exports. In 2009, China accounted for more than 50 per cent of total regional trade. Exports of Asian economies to the rest of the world nearly doubled during this period, but intra-regional exports increased by two-and-a-half times. Intra-regional exports were 49 per cent of the total in 2000. They increased to 51.6 per cent in 2009 (World Trade Organization (WTO) 2011). Thus, Asia became its own most important trade partner. China absorbed 12.3 per cent of intra-regional exports in 2009. In 2000, this proportion was only 7.6 per cent. China also absorbed almost 50 per cent of intra-regional exports of the developing economies of the region.

Over the same period, the role of Japan and the NIEs as major export destinations for the regional exporters declined. Their intra-regional imports fell. In case of Japan, this decline was 2.1 per cent and NIEs 3.3 per cent. The NIEs recorded the largest (10.8 per cent) increase in their exports to China during the period under consideration. In 2009, 24.2 per cent of their total exports were headed to China. At the same time, NIEs' exports to

1. The ASEAN-4 economies comprise Indonesia, Malaysia, the Philippines and Thailand.

Japan declined significantly (4.2 per cent). In 2009, Japan was the destination of merely 5.8 per cent of their exports. The ASEAN economies were minor trading partners of China in 2000, exporting only 3.9 per cent of their regional exports to it. In 2009, China grew an important trade destination, absorbing 10.4 per cent of their total intra-regional exports (United Nations Economic and Social Commission for Asia and Pacific (UNESCAP) 2011).<sup>2</sup> These statistics demonstrate the increasing centrality of China in Asia's trade flows.

During and after the global financial crisis (2007–09), the Asian economy proved to be a compelling and credible force in the global economy. For structural and policy reasons, it not only led the global economic recovery from what is being termed the Great Recession but also contributed meaningfully to it (Das 2011a). According to Shinohara (2010), it provided an appreciable pull force to the global recovery. Asia emerged from the global financial crisis as a growth driver and an anchor of stability for the global economy. It emerged from what was being referred to as the Great Recession with its standing in the world economy strengthened. Well integrated regionally and with the global economy, Asian economy promises to be the largest economy in the world in the foreseeable future.

Over the preceding three decades, the mutual relationship between China and surrounding Asia has evolved in a pragmatic, productive and constructive manner. This article investigates their evolving process of mutual acceptance and progressive economic interaction. The objective is to examine how China is influencing its neighbouring Asian economies and to see whether their economic relationship developed into a market and institution-led symbiosis. Unquestionably, there were apprehensions in some quarters regarding rapidly growing China having a damaging and deleterious economic impact over the neighbouring

Asia. The bottom line is to explore whether the Asian economies have gained or lost from China's recent rapid growth.

During the reform process, the Chinese economy liberalised both domestically and externally, which enabled its market-led integration with the regional economy. The principal channels of China's market-led regional integration were trade and foreign investment as well as production networks and the so-called processing trade. A defining economic occurrence of the last quarter century for Asia is China's resurgence as a manufacturing powerhouse. China's economic importance not only grew enormously for the regional economies, but it has also been economically influential in a significant manner on an unremitting basis. It has been having a constant and decisive impact over regional institutions and economic structure.

Economic events in China have a large bearing on Asia. What cannot be ignored is that the reverse is equally true. China's vertiginous growth, on the one hand, and its rapid trade expansion and increased inflows of foreign direct investment (FDI) on the other, have influenced the Asian economy massively. There is little element of surprise in it. Trade and FDI were also responsible for market-led integration of the regional economy. Likewise, regional production chains or production networks became a mechanism by which Asian economies tangibly influenced each other as well as integrated in a market-led manner. As barriers to the movement of goods, services and factors of production are dropped further, Asian economies would integrate more with each other as well as with the global economy. It would enable higher degree of specialisation and facilitate exploitation of scale and scope economies. Indubitably, both deepening regional integration of China in Asia as well as intensifying regional integration per se is sure to stimulate regional growth. Industries and businesses will have more opportunities than they have had so far. In the post global financial crisis period, this boost could not be timelier because the advanced industrial economies have been recovering at a tepid pace. The economic challenges in the European Union (EU)

2. See Table 5, p. 9 of United Nations Economic and Social Commission for Asia and Pacific (UNESCAP) (2011).

and the United States may well keep their medium-term growth below potential.

China's rise as a regional economic power, before becoming a global one, was a significant, if a trifle sensitive, economic issue. Its policies towards Asia underwent distinct and striking transformation. In the pre-1978 era, China was not trusted by its neighbouring Asian economies. In turn, for quite some time, China also regarded its Asian neighbours with mistrust and suspicion. It perceived them as an instrument of US foreign policy, bent on thwarting China's progress and economic ascent. Early during the reform period (post-1978), this mindset and posture of the policy-making establishment in China changed. It dawned on them that China's economic interest lay in engaging and cooperating with the surrounding regional economies. This could be achieved by developing close bilateral economic relationships as well as through multi-lateral engagement, including proactive promotion of formal regional institutions.

In regional policy-making, the Chinese government adhered to Deng Xiaoping's policy guidelines of remaining passive in exerting regional influence and not being anxious to assume or assert leadership in regional affairs. Not accepting a large regional or global role or responsibility that the society and country might later on find burdensome was another similar policy guideline. These ideas were embodied in Deng's *buyao dangtou* or 'not seeking leadership' principle. In his post-1990 public speeches, Deng repeated them on numerous occasions. Deng's penchant for exercising self-restraint in regional and international affairs and avoiding being seen as obtrusive and meddlesome by other countries was strong. He implored his country to do likewise. Hindsight demonstrates that Deng was a far-sighted political leader, and his strategies served China well.

### 3. The Asian Crisis and China's Strategic Policy Shift

China was less fully engaged in Asia until the mid-1990s and was even somewhat aloof. A

defining moment in China's expression of its policy stance towards its Asian neighbours came at the time of the outbreak of the Asian financial crisis of 1997–98. Until then, economic growth and national security had been regarded as two separate logical policy spheres rather than a single policy domain in China. Economic reform-led growth was given higher priority on the domestic policy agenda. When the Asian crisis (1997–98) struck, it became clear to the policy mandarins that China's economic fortunes and domestic economic stability were impossible to disentangle from what was happening in the rest of the Asian economy (Zhengyi 2004). This realisation led to a significant conceptual and policy transformation. The Asian crisis made Chinese policy-makers rethink the link between domestic and regional, including international, economic policy. Their understanding regarding the value and consequences of engagement with the regional economies grew.

Realising the importance of interdependence, the Chinese policy mandarins came to conclude that regional economic engagement would eventually be in China's national economic self-interest. After the Asian crisis, China began taking its regional role far more seriously than ever before. They also realised that joining and actively participating in the region and global economy had two realistic sides to it: shouldering responsibilities and benefiting from the arrangement. The term *fuzeren de daguo*, or 'responsible great power', became endemic in official communications after the Asian crisis.

It was recognised that a regional environment of conflict, stress and tense relationships with small and less powerful neighbours would align them against China. This could be their first reaction. In addition, it may have served US interests vicariously. The United States would get an opportunity to become more active and important in Asia as a counterbalancing power against China. Therefore, maintaining amicable relations with its regional neighbours became vitally important for China. It made strenuous efforts to improve economic and political ties with other Asian countries, and even made strong

concessions to achieve improvement in bilateral relations.

### 3.1 Emergence of a Post-crisis Policy Stance

Based on policy advice proffered by the International Monetary Fund (IMF) and the World Bank, many rapidly growing Asian economies had followed a three-pronged strategy of attracting capital from the global financial markets. It included liberalisation of domestic financial sector, maintaining a high domestic interest rate to attract capital and pegging the national currency to the dollar so that foreign investors feel reassured against currency risk. An excessive amount of short-term capital—notorious for its volatility—found its way to the Asian economies. Indonesia, Korea, Malaysia, the Philippines and Thailand found themselves in dire straits. Transmission mechanism of the Asian crisis worked its way through economic fundamental and financial and trade channels. The crisis-affected Asian economies and the regional economy suffered credit contractions, recessions, stock price bursts, depletion in forex reserves and steep currency depreciations. The real economy pummeled, leading to serious deterioration in economic fundamentals. The costly bailout packages devised for the crisis affected Asian economies by the IMF during the 1997–98 crisis were perceived by the Asian governments as humiliating. The macro-economic and structural conditionality associated with the IMF's assistance programs that were negotiated with Thailand (August 1997), Indonesia (November 1997 and August 1998) and Korea (December 1997) was seen as overly harsh and intrusive. Disillusionment and disaffection of the Asian governments with the IMF, and in general with the international financial institutions (IFIs), over the handling of the Asian crisis is well documented.

Although the Chinese economy was not badly damaged by the Asian crisis, it saw this regional ambience as an opportunity for partnership and collaboration with neighbouring economies in designing regional public goods such as the Chiang Mai Initiative, the Asian Monetary Fund and the development of Asian currency-denominated long-term Asian bond

markets. It was envisaged that these institutions, if successfully created, would help the regional economy in fending off any future regional crises, which in turn would lead to a vibrant Asian economy in the future. Development of the Asian bond market would not only help channel huge amounts of Asian savings into long-term investments in Asian currency-denominated instruments in the region but also remedy their financial systems' excessive reliance on foreign banks. During the Asian crisis, China made a decisive contribution to stabilising regional markets.

### 3.2 Compelling Surge in China's Economic Role in the Region

In the post-Asian crisis period, China's standing in the regional neighbouring economies increased markedly. China's celebrated rise to the status of the second largest global economy, largest exporter, second largest importer and the hub of regional production networks has meaningful ramifications for the Asian economy.<sup>3</sup> By the 2020s, it is projected to be the largest economy in the world at current prices and market exchange rates. Growing status of the Chinese economy is sure to create further opportunities for the neighbouring Asian economies to upgrade their pattern of growth as well as move up the economic ladder and value chain. As for the recent past, when the global financial crisis (2007–09) struck, China's macroeconomic fundamental were strong. It enjoyed a current account surplus and a sizeable accumulation of forex reserves. In addition, its public and external debts were low. China's economic dynamism and fast expanding business firms favourably influenced the regional economies and businesses. It became a driver of growth for them.

China became, and helped Asian economy become, the factory of the world. Electronics and light manufactures are two of the

3. See Das (2008a), Das (2011b) and Vincelette et al. (2011) for a current account of China's pre-crisis growth.

important lines of China's exports, which are split almost equally between processing and non-processing trade. China has evolved into the centre of regional and global production chains. This has increased China's importance for the regional economy immensely and significantly affected the structure of manufacturing industries in Asia. This applied *a fortiori* to the high-technology manufactured products. It has enabled them to benefit from China's dynamism.

In the post-global financial crisis period, China appears well placed to enhance its significance in the regional and global production chains, which are likely to be further consolidated in the future. This would be largely due to the fact that China's manufacturing base is large, diversified, and it is expanding fast. A progressive number of large domestic firms with skilled labour force and R&D capabilities would support such an expansion. Along with that regional and global supply chains will also expand.

Although the United States and Japan are the global leaders in innovation, a range of measures indicate that new nucleuses of global innovation are emerging. China is the most conspicuous among them. This trend is driven first by strong growth in R&D investment in Asia in general and China in particular.<sup>4</sup> Since 2000, China's annual investment in R&D has expanded rapidly. In 2009, it was 580.2 billion RMB yuan. China also has the benefit of the largest R&D workforce in the world. According to Park (2011), 20 per cent of world's total R&D brain power resides in China. Both quality and quantity of innovation in China are

approaching world-class levels. Recent R&D investment has increasingly been financed by private sector. The second driving factor is the globalisation of higher education. China also had medium and long-term National Plan for Science and Technology Development. The objective of these plans was to enhance the indigenous innovation capabilities, so that the next stage of economic transformation may entail entering capital and technology-intensive industries.

China's large and diverse imports also materially influence the regional economy. Between 2000 and 2010, China's import volumes increased 4.4 fold. In 2010, its merchandise imports were \$1,395 billion and services imports \$192 billion (WTO 2011). During the global financial crisis, China devised and implemented a sizable fiscal and monetary stimulus, which supported China's import growth, in the process buttressed regional and global recovery efforts. China is an important trading partner of all the regional economies. As a large trader, it has been influencing the regional economy inordinately, and it will continue to do so in the medium term. Although China's multilateral trade volumes are likely to grow slowly during the post-crisis period, it is sure to provide a strong impetus to intra-regional trade. As China's macroeconomic rebalancing endeavours continue, China's import composition is likely to change. Imports of intermediate inputs may decline, while more consumer goods may become items of large import, which in turn may well benefit the regional trading partners.

China also sways both the regional and global economies as a large net saving and high-investing economy. At 35.1 per cent of GDP its rate of investment was high in 2000. In 2010, it was exceedingly high at 48.6 per cent. The rate of gross national saving was even higher. It increased from 36.8 per cent of GDP to 54.2 per cent over the same period. Consequently, China current account surplus rose from \$20.5 billion to \$300 billion during the period under consideration. China and some Asian economies have established themselves as the largest capital exporters in the world (World Bank (WB) 2011).

4. Global innovation landscape is changing. The US and Japan are still the leaders in innovation in science and technology, but competition from Asian economies has been on the rise. China is the leading competitor. According to a study by Goldman Sachs, R&D spending in Asia exceeds EU levels and is likely to overtake the US levels by 2015. China is the most important player in this area. At \$100 billion R&D investment, China is the third leading R&D investor in the world. Both the US (at \$325 billion) and Japan (at \$123) made higher investments than China. The Chinese government's target of 2.5 per cent of GDP on R&D by 2010 would triple China's R&D investment, reaching \$300 billion by 2010 (Gilman 2010).

**Table 1 Chinese Outward FDI Flows to Asia (2003–2010) (In millions of \$)**

Year	Asia	Annual increase (%)	Proportion of total OFDI (%)
2003	1,505.03		52.72
2004	3,013.99	100.26	54.82
2005	4,484.17	48.78	36.57
2006	7,663.25	70.90	43.46
2007	16,593.15	116.53	62.60
2008	43,547.50	162.44	77.89
2009	40,407.59	-7.21	71.48
2010	44,890.46	11.09	65.24

Source: MOFCOM, 2010 Statistical Bulletin of China's Outward Foreign Direct Investment (Posted in 16 September 2011).

### 3.3 China's Outward Foreign Direct Investment in Asia

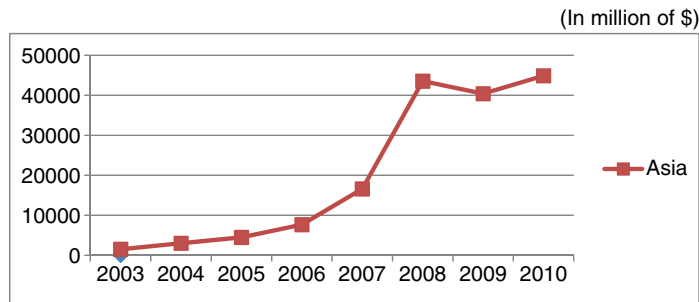
In the post-Asian crisis period, China emerged an increasing source of FDI, which became the latest element in China's integration in the Asian economic system. The government has an overwhelmingly high influence over the direction of China's outward foreign direct investment (OFDI). Consistent OFDI data are available from the Ministry of Commerce for the 2003–10 period. They demonstrate that in the post-Asian crisis period, there was a dramatic increase in China's OFDI in the surrounding Asian economies, from \$1,505 billion to \$44,890 billion. There were large year to year increases in China's investments in the regional economies. They remained the largest recipients of the Chinese OFDI. There were years when OFDI doubled or more than doubled from 1 year to the next (Table 1, Figure 1). This helped integrate the Chinese economies with the region. It was evident that for the investing Chinese firms surrounding Asian economies were the most important. A large proportion of their total OFDI went to them. China had a unambiguous bias towards Asian economies. In 2008 and 2009, Asia accounted for close to three fourths of the total OFDI flows. As 2009 was a global financial crisis year, OFDI flowing to Asia recorded a minor decline. However, in 2010 the old increasing trend returned and Asian economies again received almost two thirds of the total OFDI.

## 4. Essentials of China's Regional Economic Strategy

The Chinese policy-making elite paid attention to developing their economic strategy with its dynamic regional neighbours in mind. It regarded methodical expansion and deepening economic ties with its regional neighbours as a positive means of winning their trust. Developing a symbiotic relationship with the regional economies was another certain advantage. Both of these objectives were paid copious attention by the Chinese policy-makers. To them, this appeared to be a distinct win-win regional strategy. It could lead to creation of ties that bind Chinese economy with its dynamic Asian neighbours, and these relationships could be innovatively nurtured and strengthened in the future. This is not to deny the occasional flare-ups and verbal spats on the prickly Taiwan issue, of course.

An eminent characteristic of the Chinese economy is liberalisation. Openness or trade orientation of an economy is measured by trade (exports plus imports) as a percentage of GDP. As seen in Table 2, by 1990 openness of the Chinese economy had reached 29 per cent and 44 per cent by 2000. The opening up process was accelerated after 2000, particularly after China's WTO accession. Between 2000 and 2005, it dramatically increased from 44 per cent to 69 per cent. China became a proponent of regional trade liberalisation. It supported and initiated several regional trade liberalisation endeavours. This confirmed China's support to the tenet of free trade and belief in the classical economic principle of gains from trade, rather than in narrow code of mercantilists.

In 2006, China's openness was 70 per cent, implying that it was a trade-orientated economy. However, when the global economic crisis began in 2007, it declined somewhat to 68 per cent (Table 2). As the global financial crisis worsened, it declined further to 62 per cent (in 2008) and 49 per cent (in 2009) (World Bank (WB) 2011). Trade became one of the prominent channels of integration with the regional economy for China and in turn led to regional economic interdependence in an effective manner.

**Figure 1 Chinese Outward FDI Flows to Asia (2003–10) (In million of \$)**

Sources: Same as Table 1.

**Table 2 Openness of the Chinese Economy (1990–2009) (in Per cent)**

Exports as percentage of GDP	Imports as percentage of GDP	Total (%)	
1990	16	13	29
1995	29	19	39
2000	23	21	44
2005	37	32	69
2006	39	31	70
2007	38	30	68
2008	35	27	62
2009	27	22	49

Source: World Bank (WB) (2010).

**Table 3 Openness of the other Asian Economies (2009)**

	Imports of goods and services (% of GDP)	Exports of goods and services (% of GDP)	Total (% of GDP)
Japan	12	13	25
Hong Kong, SAR	187	194	381
Singapore	203	221	424
Korea	46	50	96
Taiwan	46	53	99
Indonesia	21	24	45
Malaysia	75	96	171
Philippines	31	32	63
Thailand	58	68	126
Vietnam	79	68	147

Sources: (a) World Bank (WB) (2010). *World Development Indicator Online Database*. Washington, DC.

(b) National Statistics Republic of China (Taiwan) (2010). *Key Economic and Social Indicators*. Taipei City, Taiwan.

As the statistics in Table 3 show, the other Asian economies also have an open trade regime, with Singapore and Hong Kong SAR coming at the top due to their huge *entrepôt* trade. Malaysia, Vietnam and Thailand are also highly trade-oriented economies. The trade volume of Taiwan and the Republic of Korea (hereinafter Korea) are also close to the size of their respective GDPs. This should facilitate regional integration for these economies and China. Indonesia is the least open economy in this group, with trade to GDP ratio at 45 per cent. Japan, the only matured industrial economy in the group, is not as open as it was in the past. Its openness indicator is merely 25 per cent.

Declining tariff rates are another important indicator that portend to the opening up of an economy. Over the recent decades, China's tariff barriers continuously declined. In 1980–84, they were high at 49.5 per cent. In 1985–

89, they fell to 39.3 per cent. They did not show a fall in 1990–94 and remained almost stationary (40.0 per cent). However, in preparation to the WTO accession, a precipitous fall occurred in 1995–99 to 18.8 per cent and further down to 12.8 per cent in 2000–05 (Nicita & Olarreaga 2006). Non-tariff barriers were also reduced or eliminated. Although an open economy is a necessary condition, it is not sufficient to make an economy a successful trader. It needs to be supported by complementary policy inputs like efficient infrastructure for production and well-organised logistics that enable firms to connect to international networks of producers and suppliers.

China, like the United States, had adopted a strategy of keeping its economy open to

promote global economic interdependence. By keeping its markets open, China has managed to provide growth opportunities to the regional economies and to be a welcoming economic partner to them. In the second decade of the twenty-first century, regional economies accept China much more than they did in the past. For the most part, Asian economies began to perceive China as an economy that will provide them with growth opportunities. The likelihood of seeing China as an overbearing menace has been erased. Thus, openness of the economy indubitably was a logical and pragmatic strategy. By following this strategy and by opening its markets for exports from the regional neighbours and targeting their markets for its own export, China could become a veritable locomotive of regional growth. Tang and Zhang (2006, p. 53) succinctly describe the Chinese strategy as, 'participate actively, demonstrate restraint, offer reassurance, open markets, foster interdependence, create common interests, and reduce conflict'.

With the exception of Japan, the regional economies are much smaller than China in terms of the size of GDP. Adoption of outward-oriented strategy had also helped in integrating the NIEs of Asia as well as the members of the ASEAN<sup>5</sup> into the Chinese economy. This process received an impetus from China's bilateral economic agreements, which drew the neighbouring Asian economies closer to the Chinese domestic markets. China has bilateral agreements with Singapore and Thailand, a Taiwan Economic Cooperation Framework Agreement with Taiwan and a Closer Economic Partnership Agreement with Hong Kong. In 2002, China also entered into a comprehensive framework agreement with ASEAN; its objective was to reach an agreement on an ASEAN–China free-trade agreement (FTA) by 2010. Also, emerging multilateral structures were utilised by China

for pursuing the objective of coming closer to the regional economies. Being in the multilateral frameworks would enable China to compete for influence with the erstwhile regional powers like Japan and the United States.

As a regional strategy, China also encompassed the political and security dimensions in its relationship with its Asian neighbours. A fully fledged cooperation and partnership relationship with the regional states was not possible without the inclusion of these dimensions. For instance, China began its interaction with the ASEAN economies through the ASEAN Regional Forum, which was created during the 1992 ASEAN Summit in Singapore after the collapse of the Soviet Union, withdrawal of the United States from its bases in the Philippines in 1991, and the visit of Indonesian President Suharto to China. China elevated its relationship with ASEAN further by strengthening economic and political relationship through the ASEAN–China Free Trade Area (ACFTA). The initial ACFTA agreement was signed in 2002 in Phnom Penh, Cambodia, with the intent to establishing a FTA in 2010. In addition, the Treaty of Amity and Cooperation in Southeast Asia (TAC-SEA) was signed in 1976 by the ASEAN members, which China joined in 2003. Later on a good number of other states also joined the TAC-SEA. The United States became a member late, not until 2009. Thus, developing close relations with the regional neighbours remained an important policy objective for China, and it deployed different channels for developing them.

With its north-eastern neighbour, Korea, China began its relationship directly on an economic level. Subsequently, it grew closer and more cordial and flourished in political and security domains as well. There have been favourable results in terms of China's efforts to improve relationships with East and Southeast Asia. Despite constantly improving the regional economic and political relationships and succeeding in developing strong economic ties, China's relationship with India and Taiwan cannot be called amicable and satisfactory. There have been occasions when it flared

5. The Association of Southeast Asian Nations (ASEAN) was founded by five Southeast Asian economies, namely, Indonesia, Malaysia, the Philippines, Singapore and Thailand in August 1967. Since then its membership has expanded to include Brunei, Myanmar, Cambodia, Laos and Vietnam.

into wars of words and stinging public statements in the media. The old regional rivalry between China and Japan is no longer as intense as it was in the past. China has promoted the ideas of a free trade area between China, Japan and Korea as well as an ASEAN-Plus-Three (APT). These initiatives reflect China's inclination to ignore the historic bitterness and form a constructive relationship between the two regional economic giants. This bilateral relationship between the largest and second largest regional economies is a significant one for Asia and will always influence the regional economy.

### **5. China and the Evolving Pattern of Economic Integration in Asia**

Trade, FDI and regional and global production networks are the principal channels through which the Chinese economy has integrated with the neighbouring Asian economies in a market-driven manner. In the 1970 and early 1980s, Japan overwhelmingly dominated Asian trade. It accounted for almost 60 per cent of the regional exports and imports. This scenario morphed as the other Asian economies began liberalising and improving their trade performance. For successful integration of China with the Asian economies, it is a necessary condition that they liberalise their external sector as well. Significant trade and investment liberalisation took place in Indonesia, Korea, Malaysia, the Philippines, Taiwan and Thailand in the mid-1980s. Vietnam embarked on reforms belatedly in the early 1990s. These economies took initiatives in unilateral trade liberalisation, which was carried out in a non-discriminatory manner. They also were full participants in the multilateral liberalisation measures initiated first by the General Agreement on Tariffs and Trade, and since 1995 the WTO.

Intra-developing economies FDI, which largely included large developing economies and the EMEs, was not given a great deal of significance until early twenty-first century. After it was the focus of the World Investment Report (WIR) 2006, other studies on this important issue were launched. Its relevance

and significance was also seen in the context of FDI flows from the surrounding Asian economies to China. Since 2004, intra-developing country FDI increased rapidly. In 2008, its volume reached 16 per cent of the total FDI outward stock. Although global FDI flows contracted due to the global financial and economic crisis in 2009, FDI flows originating from the developing economies were affected less adversely. Intra-Asia increase in FDI is a relatively recent phenomenon, which has effectively worked towards integrating the region. This trend successfully advanced China's regional integration with its neighbours as well as general Asian integration.

A significant part of FDI in the Asian economies comes from other Asian economies (Lipsey & Sjöholm 2011). Although there are data gaps, the WIR of 2006 found that approximately half of the FDI inflows in the Asian economies were from the other regional economies, largely from the regional EMEs. According to this source, around 65 per cent of inward stock of FDI in 2004 in Asia was from the other Asian economies. The same source estimated that between 2000 and 2004, average annual intra-Asian FDI flows amounted to \$48 billion. The WIR of 2010 estimated that of the \$875 billion FDI received intra-regionally by Asian economies in 2008, China was the source economy of \$307 billion. Furthermore, the four NIEs of Asia, that were a lucrative source, accounted for \$512 billion. China received a great deal of FDI—as much as 65 per cent of total receipt—from the NIEs. Due to increasing labour cost, firms in the NIEs are motivated to invest in China and other Asian economies (Gao 2005; Kittilaksanawong 2011). The rapid and persistent increase in wages in China will further facilitate the process of regional integration because manufacturing activity from China will move to the Southeast Asian economies.

Taking a balance-of-payments approach, Hattari and Rajan (2009) estimated that 35 per cent of FDI flows into the developing Asia during the 1990–2005 period originated intra-regionally. China and Hong Kong SAR dominated both as hosts and sources. After WTO accession, China became a significant source

country investing not only in the region but also outside Asia. China's role in outward FDI flows strengthened after 2004; in 2010 its share amounted for 8.5 per cent of the total FDI stemming from the developing countries (Aleksynska & Havrylchuk 2011). Intra-regional FDI made by Hong Kong SAR and Singapore is obscured by the fact that it is often made by business firms from other countries, which are both based in Asia and outside. One general characteristic of intra-Asian FDI is that investing firms tend to prefer locating their affiliate operations in more labour-intensive industries.

Trade among the East and Southeast Asian economies, which includes China, began expanding from the 1980s. It was paltry, less than 1 per cent of their total trade, in 1975. It began increasing and reached 10 per cent of their total trade in 2001 and 13 per cent in 2004.<sup>6</sup> During this period, China produced almost half of the regional GDP and a third of total exports. High and sustained GDP growth of the Chinese economy in the decade of the 1980s was the principal driver of intra-regional trade. The Chinese economy had established itself as an outward-oriented economy and by the time it acceded to the WTO it had become trade dependent. The obvious benefit of WTO accession was improvement in access to export markets and reduction in import cost of raw materials and intermediate products. The latter helped China in its production and exports of manufactures. This made Chinese products more competitive in the world markets *vis-à-vis* exports from the other regions of Asia.

Developments in the early 1990s were important in this regard. China began improving its complicated and restrictive trade regime after 1990 and also its export structure began to diversify towards capital and skill-intensive products. This was the time when China began to emerge as a major player in the global economy. The 1990s were a turning point in that during this period, liberalisation of trade and FDI accelerated in China and the ASEAN economies. The liberalising of these two important policy areas together created obvious

synergy in the regional economy. In the early 1990s, exports of the ASEAN economies to China began picking up in value terms. A significant amount of new ASEAN exports to China were in the category of medium-technology manufactures. More technologically advanced ASEAN economies, like Malaysia, the Philippines, Singapore and Thailand, exported semiconductors and computer components. The other ASEAN economies exported natural resources to China. However, ASEAN-4 essentially exported durable goods to Japan and the NIEs.

In 1995, exports from Japan and the four NIEs to China accounted for 10.6 per cent of all exports. This group of five economies is resource poor. In case of ASEAN-4 economies, this proportion was a mere 3.5 per cent (Robertson & Xu 2010). Therefore, in relative terms, the larger ASEAN economies were less integrated with the Chinese economy in 1995 than Japan and the NIEs. As for China's exports to these two groups of Asian economies, Japan and the NIEs accounted for 31 per cent of the total exports to the region, while the ASEAN-4 for only 4.2 per cent in 1995. China's exports as a fraction of its total multilateral exports were again much higher to Japan and the NIEs (8.4 per cent) than to the ASEAN-4 (3.9 per cent) economies. These statistics show that in 1995, Japan and the NIEs were far more closely integrated with the Chinese economy than the ASEAN-4 economies. What is noteworthy is that the trade structures of China and the ASEAN-4 economies were identical at this juncture. This state of affairs had changed by the middle of the decade of the 2000s. China, with a market of 1.3 billion consumers, had become the principal engine of growth not only within the region but also for the global economy as a whole (Garnaut & Song 2006).

By 2006, China had become the fifth largest export market of the ASEAN economies and the third largest source of imports. A direct influence of China on ASEAN economies was giving an impetus to their exports to its large domestic market. In fact as imports and exports of the ASEAN economies are increasingly becoming more China centric, some

6. The source of these statistical data is Coxhead (2007).

scholars have questioned the relevance of ASEAN grouping (Tambunan 2005, 2006). Members of ASEAN have larger trade with China than they have with each other. A quantitative examination using highly disaggregated trade data revealed that a lot of changes occurred in intra-industry trade over the 2000–05 period between China and the ASEAN-5 economies. These were the five founding economies of ASEAN for which disaggregated data were available. This demonstrated the unique importance of China for the ASEAN economies, both as a market for exports and source for imports. This empirical study concluded that there was no crowding out of bilateral trade among the five members of ASEAN due to their increasing trade with China. If anything, increased integration with the Chinese economy resulted in an increase in the intra-ASEAN-5 trade. Thus, while China has influenced trade flows within the ASEAN region, it has not ‘significantly reorganised trade flows away from intra-ASEAN-5 to that of ASEAN-5-China. There are grounds for suggesting that the ASEAN-5-China trade interaction can be considered an important driver for intra-ASEAN-5 export expansion’ (Devadason 2011, p. 143).

The statistical data presented above indicate that since the mid-1990s, trade with China in goods has been increasing for most regional economies. China’s trade in goods with the regional economies has increased at a faster rate than that with the rest of the world. However, intra-regional trade in services failed to show comparable dynamism. For deeper regional integration, a similar market-driven increase in trade in services, which includes financial services, is needed. Increased trade in components is partially achieving this objective. Many Asian economies have a high-value-added services sector, which has so far lagged behind manufacturing sector in regional trade. Increased intra-regional trade in services will prove to be beneficial for other sectors domestically and abroad. As barriers to trade and movement of factors of production come down further and the regional integration advances further, regional economies will be able to have

stronger links with China and benefit from its dynamism.

The ongoing wave of globalisation became another instrument of regional integration in Asia. Globalisation enabled latecomer economies like China to regionally and globally integrate through expansion of production networks. They developed fast over the decade of the 1990s and became extensive in Asia, *a fortiori* in East Asia. They involved Asian business firms as well as multinational from the EU and the United States. These multinationals changed their operational strategy from exporting to international production. Their newly structured and reorganised businesses in different parts of the global economy enabled them to reduce costs and improve their ability to react to technological advancements. They could meet requirements of their global markets more swiftly by way of globally integrated production and distribution networks. Many Asian economies, including China, were their preferred locations for setting up such cross-border networks. They were initially intra-firm but increasingly grew arm’s-length inter-firm networks. They made invaluable contribution to integration of Asian economies.

The impact of the spread of regional production networks was rapid expansion and increase in both FDI and trade between the Asian economies. An influential empirical study concluded that production networks in the region accounted for a large proportion trade flows of most member countries. They entailed both intra-firm and arm’s-length trade (Ando & Kimura 2005). The Asian production and distribution networks are idiosyncratic in following three traits: First, they are enormously significant for the regional economies. Second, they tend to cover a large part of the region and number of countries. Third, over the years they have grown exceedingly sophisticated in terms covering intra- and inter-firm transactions of regional manufacturing firms. No doubt, other parts of the global economy also successfully developed such production and distribution networks. The most salient examples are the Mexico–United States networks and Western-Central-Eastern Europe corridor. They are yet to reach the level of

sophistication that Asia has been able to achieve (Kimura 2006).

## 6. Summary and Conclusions

This article examines how the relationship between China and the neighbouring Asia evolved into a market-led symbiosis. Asian and Chinese economies have undergone a thorough structural transformation. In a short span of three decades, Chinese economy made a regional and global niche for itself. These two facts are correlated. Due to close inter-linkages and inter-dependencies China's rapid economic ascent has had a discernable effect over the neighbouring Asian economies. China's brisk growth provided a veritable impetus to the process of integration of the real economies. These high-performing Asian economies influenced and shaped each other's economic evolution. Intra-regional trade increased rapidly from a low level, and Asia has now become its most important trading partner. With that, China became an important trading partner of most Asian economies. During its reform and restructuring period, the Chinese economy liberalised both domestically and externally, which impelled its market-led regional integration with the neighbouring Asian economies. FDI and vertically integrated production networks functioned as the other channels of market-led economic integration. China's rise as a regional economic power, before becoming a global one, was a substantially significant economic event.

A defining moment in China's economic relationship with its Asian neighbours was the outbreak of the regional financial crisis in 1997–98. In the post-Asian crisis period, China's standing among the regional economies increased markedly. China's celebrated rise to the status of the second largest global economy, the largest exporter, the second largest importer and the hub of regional production networks has had meaningful ramifications for the Asian economy. Similarly, when the global financial crisis (2007–09) struck, China's macroeconomic fundamentals were strong and it propelled regional growth.

China sways both regional and global economies as a large saving and high-investing economy. Also, in the post-Asian crisis period, China emerged an increasing source of FDI, which had an Asian bias. It became the latest element in China's integration in the Asian economic system. An eminent characteristic of the Chinese economy was its liberalisation and openness. This trait helped in trade becoming one of the prominent channels of integration with the regional economy for China. In turn, it led to increasing regional economic interdependence in an effective manner. With growing economic weight, China's importance for its neighbouring regional economies continued to increase.

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