

Research Series on the Chinese Dream
and China's Development Path

Jianglin Zhao
Yuzhu Wang
Xiaobing Zhou
Zhongyuan Zhang

China's Rise and the Development of Asian Regional Integration



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Preface

This book is the result of the Chinese Academy of Social Sciences (CASS) 2011 research project entitled “China and the New Asian Market”, led by research fellow Jianglin Zhao.

China’s rise has become an indisputable fact in recent years. The significance of this fact to the whole region has never been fully explored, though it will influence China’s future development and its relationship with Asia. This book is based on the study of this relationship from the standpoint of the region.

After many years of development, Asia has crossed the threshold of a new development stage and became the manufacturing center of the world. With China as the place of final product assembly and the developed world as its market, Asia has had an export strategy which has created one economic miracle after another. But the financial crisis of 2008 has changed the economic picture of the world. The developed economies, mired in the subprime loan debacle and overburdened with debts, are unlikely to return to the limelight in the short term, forcing Asian countries to change their economic strategy and leverage their markets for future growth. Moreover, with the continued rise in per capita income, Asian economies seem ready for the next step in their economic development.

From the market standpoint, Asian economies are at the crossroads of two transformative trends. One is the change of growth model from export-based to domestic demand-based, while the other is a consolidation of regional markets to satisfy the requirements of future economic growth. This book will focus on the latter trend. If the expanded domestic demand is unable to compensate for the reduced demand from the developed world, Asia’s industrialization will slow down, especially since this industrialization is of a collective nature.

China seems poised to be the major participant if not the creator of the consolidated Asian market. Having adopted the policy of reform and opening up more than 30 years ago, China has become a major Asian and world power. In 2010, it overtook Japan as the second largest economy of the world and the largest Asian economy in terms of GDP. This fact has transformed China’s economic relations with other countries in the region and endowed it with the ability to lead Asia on a path of autonomous development.

China's strategic interest in a consolidated regional market is threefold. First, a regional market can extend China's window of opportunity in terms of economic development. As demand from the developed markets continues to be weak and the domestic market not fully developed, a regional market can have stabilizing effects on economic growth and industrialization. Second, a regional market protects the common interests of China and other Asian economies. After the financial crisis of 2008, it has become increasingly clear that China is the final consumer of regional products; in other words, China's significance as a market has been made clear. China's relationship with other Asian economies used to be focused on production; now it is focused on market. This change is favorable to the establishment of an Asian economic community. Third, a regional market is a theater in which China can implement its strategy. As an influential world power, China needs a regional market to facilitate the rise of the Asian region.

This book explores the market issues in Asia's industrialization and the possibility and continuity of China's adjustment of its relationship with the Asian region in the next 5 to 10 years from a regional standpoint. It also tries to quantify the effects of China's rise on the regional market.

Major conclusions are the following. First, Asian industrialization, including China, has regional characteristics. Considering the constraints of individual markets, Asian economies share a collective desire for a regional market. Second, a consolidated regional market concerns not only the stability of China's industrialization and economic development but also the implementation of China's overall strategy. Third, due to the limitation of its economic capabilities, China is not yet the leader but a major participant in a regional market. So a consolidated regional market is still a goal, not a fact.

This book is divided into nine chapters. Its authors are all researchers at the National Institute of International Strategy at CASS. I am the author of Chaps. 1, 2, 4, and 6, and the first and second sections of Chap. 9. Xiaobing Zhou is the author of Chap. 3, and Yuzhu Wang is the author of Chaps. 5 and 8 and the third section of Chap. 9. Chapter 7 is written by assistant research fellow Zhongyuan Zhang.

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December 2013

Jianglin Zhao

Contents

1	Introduction	1
1.1	Background and Significance	1
1.1.1	Background	1
1.1.2	Significance	3
1.2	The Problem	4
1.2.1	Studies in China	5
1.2.2	Studies in Other Countries	7
1.3	Research Design, Methodology, and Conclusions	9
1.3.1	Research Design	9
1.3.2	Methodology	10
1.3.3	Structure and Conclusions	10
	References	14
2	External Market and Regional Industrialization	17
2.1	The Relationship Between External Market and Regional Industrialization	17
2.1.1	The Relationship Between External Market and a Big Country's Industrialization	18
2.1.2	The Relationship Between External Market and Regional Industrialization	20
2.2	China's Industrialization Under Restrictive Market Conditions	25
2.2.1	China's Industrialization Under Open Conditions	25
2.2.2	What Further Industrialization Requires of External Markets	27
	References	30
3	Structural Characteristics of Major Regional Markets	31
3.1	Characteristics of the World Market	31
3.1.1	Trends in the World Market	31
3.1.2	Regional Changes in World Trade	35
3.1.3	Changes in Merchandise on the Global Market	39

3.2	Structures of Major Regional Markets	43
3.2.1	The North American Market	43
3.2.2	The EU Market	45
3.2.3	The Latin American Market	50
3.3	Economic Systems in Major Regions of the World	56
3.3.1	Europe	56
3.3.2	North America	60
3.3.3	Latin America	63
	References	64
4	Evolution of the Asian Market Structure	65
4.1	Size of the Asian Market	65
4.2	Changes in Regional Demand in 2008	69
4.2.1	Changes in Asian Demand	69
4.2.2	Trends in Asian Demand	76
4.3	Import in the Asian Market and Structural Changes	78
4.3.1	Changes in Intra-regional Import	78
4.3.2	Structure of Intra-regional Import	80
4.3.3	Assessment of Intra-regional Import	84
5	Cooperation and Development in Asia	89
5.1	Three Major Negotiation Processes	89
5.1.1	The China-Japan-South Korea Free Trade Area	89
5.1.2	The Trans-Pacific Partnership (TPP)	90
5.1.3	The Regional Comprehensive Economic Partnership (RCEP)	93
5.2	Development Trends in Asia-Pacific Cooperation	97
5.2.1	Asia-Pacific Cooperation to See a Period of Framework Ambiguity	98
5.2.2	East Asia Cooperation Undergoing Framework Reshaping and RCEP Emerging as a New Platform for Regional Cooperation	100
5.2.3	East Asia Cooperation Within the Frameworks of CJSKFTA, TPP and RCEP	102
	References	104
6	Changes in China's Economic Relations in Asia	105
6.1	Main Characteristics of Changes in China's Economic Relations with Other Asian Countries	105
6.1.1	Changes in China's Trade Relations with Other Asian Countries	105
6.1.2	Capital Flows Between China and Other Asian Countries	110

6.2	Economic Interactions Between China and the Rest of Asia	114
6.2.1	Significance of Changes to Development Strategies in Asia to the Chinese Economy	114
6.2.2	The Significance of China's Growth to Asia	119
6.3	Changes in China's Economic Relations with Other Asian Countries: Intertwined Markets	123
6.3.1	Expansion of Scale: China–ASEAN Trade Relations Prior to the 1997 Asian Financial Crisis	123
6.3.2	External Markets: The Basis for Developments in China–ASEAN Trade Relations Prior to the 2008 Global Financial Crisis	124
6.3.3	Intertwined Markets: New Developments in China– ASEAN Trade Relations in the Post-crisis Era	129
	References	133
7	Impact of China's Rise on the Regional Market	135
7.1	New Trends in Trade Development in East Asia	136
7.2	China's Position as Market for the Region	143
7.2.1	Trade Combination Degree (TCD) Between China and Other East Asian Countries	143
7.2.2	Trade Complementarity Between China and Other East Asian Countries	147
7.2.3	Trade Competitiveness Between China and Other East Asian Countries	149
7.2.4	China's Role in East Asia as a Market from the Angle of End Products	151
7.3	Interplay Between China and the U.S. in the Asian Export Market	151
7.4	Interplay Between China and the U.S. in the Consumer Goods Market	158
7.4.1	The Model and Calculation Methods	159
7.4.2	Results and Analysis	161
7.5	Main Conclusions	168
	References	169
8	China's Participation in Asian Cooperation	171
8.1	China's Participation in Regional Cooperation in Asia	171
8.1.1	“Upgrading” the ASEAN–China Free Trade Area (ACFTA)	171
8.1.2	East Asian Cooperation: Advancing the CJSKFTA	175
8.2	Impact of Major Asian Economies' Cooperation Strategies on China's Efforts to Establish a Regional Cooperation System . . .	177
8.2.1	Competition Between Major Players Driving Regional Cooperation in Asia–Pacific	178
8.2.2	RCEP and ASEAN's “Core Position”	181

8.3	The Challenge of Multilateral Framework Restructuring Facing China	186
8.3.1	Multilateral Partnerships to Stagnate in Next 5–10 Years, China to Turn to Regional Cooperation	186
8.3.2	APEC’s Weaker Role as Cooperation Platform for Asia–Pacific and East Asian Cooperation in Framework Restructuring	188
8.3.3	RCEP Expected to be Advanced to the Maximum	189
	References	190
9	Strategic Direction and Pathways for China’s Consolidation of the Asian Market	193
9.1	Challenges Facing China in Consolidating the Asian Market	193
9.1.1	Addressing Issues in the Chinese Economy in the Period of International Strategic Opportunities	193
9.1.2	Strategic Direction for China’s Consolidation of the Asian Market	196
9.2	Main Pathways for China’s Consolidation of the Asian Market	198
9.2.1	Strategic Significance of Building an Asian Market	198
9.2.2	Main Pathways for Building an Asian Market	200
9.3	China’s Cooperation Strategy for Asia	202
9.3.1	Competition in Regional Cooperation Framework in the Context of China’s Rise	203
9.3.2	Interdependence and the CJSKFTA	206
9.3.3	The TPP and China	212
9.3.4	RCEP and China’s Cooperation Strategies	214
9.3.5	China’s Strategic Choices for Regional Cooperation	216
	References	219

About the Author



Jianglin Zhao a Ph.D. in economics, is a Research Fellow and Director of the Office for Research of International Economic Relations at National Institute of International Strategy, Chinese Academy of Social Sciences (CASS) and was a Visiting Scholar at a number of Japanese and American universities and research organizations. She is the author of *East Asia's Technology, Intellectual Property Protection and Economic Growth* (Economic Science Press, 2007), Editor of *East Asian Growth Model: Transformation and Vision* (Social Sciences Academic Press, 2010), and *Post-Crisis Asian Growth and Strategic Adjustment* (Social Sciences Academic Press, 2013), and has published a number of research papers.

List of Figures

Fig. 2.1	A big country's standard industrialization process under closed conditions	18
Fig. 2.2	A big country's economic development under open conditions	20
Fig. 2.3	The relationship between market and industrialization in Asia	23
Fig. 2.4	Effects of domestic and external demand on regional economy	24
Fig. 2.5	Structural changes in Asia's demand. <i>Source</i> World Bank	24
Fig. 2.6	Poverty in China. <i>Note</i> Poverty definition: daily income USD1.25, or monthly USD38. <i>Source</i> World Bank, World Development Indicators (WDI), http://data.worldbank.org/indicator	26
Fig. 2.7	Foreign investment in China. <i>Source</i> World Investment Reports	27
Fig. 2.8	Structural changes in demand. <i>Source</i> 1978–1989 data from <i>China Statistical Yearbook</i> ; 1990–2012 data from ADB	29
Fig. 3.1	Growth in the world trade in goods. *Crude oil price is measured in USD/barrel of 2011. <i>Source</i> WTO databases; BP Statistical Review of World Energy	32
Fig. 3.2	Major regions' dependence on trade. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	34
Fig. 3.3	Changes in global export by region. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	35
Fig. 3.4	Changes in global import by region. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	36
Fig. 3.5	Global balance of trade. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	37
Fig. 3.6	Regional reliance on intra- and extra-regional import. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	38

Fig. 3.7	Intra- and extra-regional export dependency. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	39
Fig. 3.8	Changes in world Merchandise export. <i>Source</i> WTO. http://stat.wto.org/StatisticalProgram	40
Fig. 3.9	Changes in export of manufactures. * Office and telecommunications equipment falls under the category of machinery and transportation equipment. <i>Source</i> WTO. http://stat.wto.org/StatisticalProgram	40
Fig. 3.10	Changes in export of manufactures by region. <i>Source</i> WTO. http://stat.wto.org/StatisticalProgram	41
Fig. 3.11	Changes in export of fuels and mining products by region. <i>Source</i> WTO. http://stat.wto.org/StatisticalProgram	42
Fig. 3.12	Changes in export of agricultural products by region. <i>Source</i> WTO. http://stat.wto.org/StatisticalProgram	42
Fig. 3.13	Changes in global export by Merchandise and region. <i>Note</i> The data is the yearly distribution of the various categories of global export. <i>Source</i> WTO. http://stat.wto.org/statistic alprogram	43
Fig. 3.14	North American trade. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	44
Fig. 3.15	EU trade. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	48
Fig. 3.16	Composition of EU trade by country in 2012. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	52
Fig. 3.17	Volume and growth of Latin American trade. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	52
Fig. 3.18	Extra-regional trade by country in 2012. <i>Source</i> UNCTAD. http://unctadstat.unctad.org	53
Fig. 4.1	Asia's percentage of world GDP. <i>Note</i> Data for 2014–2017 are forecasts. <i>Source</i> World Bank and IMF	66
Fig. 4.2	Asian economies' shares of global GDP. <i>Note</i> Data for 2014–2017 are forecasts. <i>Source</i> World Bank and IMF	67
Fig. 4.3	Asia consumption versus world consumption. <i>Source</i> World Bank	68
Fig. 4.4	Asian investment versus world investment. <i>Note</i> Data for 2014–2017 are forecasts. <i>Source</i> World Bank	68
Fig. 4.5	Asia's balance of trade. <i>Source</i> World Bank	69
Fig. 4.6	Composition of Asia's GDP. <i>Source</i> ADB and IMF	70
Fig. 4.7	Change in Asian demand. <i>Source</i> ADB and IMF	71
Fig. 4.8	Consumption in Asia's developing countries. <i>Source</i> ADB and IMF	71
Fig. 4.9	GDP composition in Asia's developing countries. <i>Source</i> ADB and IMF	71
Fig. 4.10	Consumption of Asia's developing countries, Japan, EU and U.S. in 2012 (GDP = 100). <i>Source</i> ADB, IMF, EU website, and U.S. Bureau of Economic Analysis	73

Fig. 4.11	Asian countries' demand in 2012. <i>Source</i> ADB and IMF	73
Fig. 4.12	Per capita income and savings-investment model 2005–2012. <i>Source</i> ADB	76
Fig. 4.13	Structure of regional demand. <i>Source</i> ADB and IMF	76
Fig. 4.14	Structure of regional demand 2005–2012. <i>Note</i> Data represent the difference in consumption between 2005 and 2012. <i>Source</i> ADB and IMF	77
Fig. 4.15	Asia's share of global import. <i>Source</i> UN Comtrade Database	79
Fig. 4.16	Major asian economies' shares of global import. <i>Source</i> UN Comtrade Database	79
Fig. 4.17	Asia's intra- and extra-regional import of consumer goods. <i>Source</i> UN Comtrade Database	80
Fig. 6.1	Changes in China's trade position in East Asia. <i>Note</i> "East Asia" here includes China, Japan, South Korea, Taiwan (China), Singapore, Indonesia, Malaysia, Thailand, the Philippines, and Vietnam. <i>Source</i> UN Comtrade Database and the Asian Development Bank (ADB)	106
Fig. 6.2	U.S. imports from Asia against total imports. <i>Note</i> "Asia" here refers to China, Japan, the "Four Asian Dragons" and ASEAN. The "Four Asian Dragons" here only include Taiwan Province, South Korea and Singapore, while "ASEAN" only includes Indonesia, Thailand, Malaysia, the Philippines and Vietnam. <i>Source</i> UN Comtrade Database	107
Fig. 6.3	Capital inflows and outflows in Asia as of 2012. <i>Source</i> <i>World Investment Report 2013</i> by the United Nations	111
Fig. 6.4	Changes in the composition of Chinese exports to the rest of Asia. <i>Source</i> Calculated using UN Comtrade Database	115
Fig. 6.5	Changes in the composition of Chinese exports to the rest of Asia (all products to Asia at base of 100). <i>Source</i> Calculated using UN Comtrade Database	116
Fig. 6.6	Population, GDP, per capita income, and current account as proportion of GDP. <i>Source</i> ADB and the International Monetary Fund (IMF)	120
Fig. 6.7	Major Asian economies' deviation from the standard consumption model in 2009. <i>Source</i> ADB and IMF	121
Fig. 6.8	America's trade balance with China and Asia. <i>Source</i> UN Comtrade Database	122

Fig. 6.9	U.S. imports from East Asia against total imports. <i>Note</i> “Asia” here refers to China, Japan, the “Four Asian Dragons” and ASEAN. The “Four Asian Dragons” here only include Taiwan Province, South Korea and Singapore, while “ASEAN” only includes Indonesia, Thailand, Malaysia, the Philippines and Vietnam. <i>Source</i> Calculated using UN Comtrade Database	125
Fig. 6.10	Proportion of ASEAN exports to the U.S. and China as proportion of total exports	125
Fig. 6.11	Changes in per capita income in China and ASEAN. <i>Source</i> IMF	128
Fig. 6.12	Investments between China and ASEAN and their growth. <i>Source</i> Ministry of Commerce web site	132
Fig. 7.1	Consume goods imports by China and the U.S. as a proportion of world total. <i>Source</i> UN Comtrade Database	159
Fig. 7.2	Growth rates of consumer goods imports by China and the U.S. <i>Source</i> UN Comtrade Database	160
Fig. 7.3	IRFs for the <i>lnccch</i> , <i>lncgdp</i> , and <i>lncus</i> variables, 1998–2012 (second-order lag)	165
Fig. 9.1	TPP members’ contribution to the U.S. trade	213
Fig. 9.2	China–ASEAN trade since the establishment of dialogue. <i>Source</i> China customs	216

List of Tables

Table 1.1	Structure and conclusions	11
Table 3.1	U.S. Trade in the 21st century	44
Table 3.2	Changes in share of U.S. trade Merchandise by Region	46
Table 3.3	Composition of EU Trade ⁷⁷	47
Table 3.4	Composition of EU trade Merchandise by region	49
Table 3.5	EU balance of trade in 2012	50
Table 3.6	Trade balance of major EU countries in 2012 (in USD1 billion)	51
Table 3.7	Latin American trade by region	53
Table 3.8	Composition of Latin American trade Merchandise	54
Table 3.9	Latin American balance of trade in 2012 (in USD1 billion)	55
Table 3.10	LA4's balance of trade in 2012 (in USD1 billion)	56
Table 3.11	Evolution of European economic system	57
Table 4.1	GDP of major economies in the world	66
Table 4.2	Asian demand 2005–2012	75
Table 4.3	Structure of regional import (Total National Import = 100)	81
Table 4.4	Structure of regional import (Total Regional Import = 100)	83
Table 4.5	Developed world versus Asia in post-crisis import	85
Table 4.6	Asia versus developed world in post-crisis import structure	87
Table 5.1	Tariff reductions in the “10 + 1” free trade areas	103
Table 6.1	China's trade relations with Asia	108
Table 6.2	China's trade balances with Asia and the World	109
Table 6.3	Capital flows within the region as of 2012 (inventory)	112
Table 6.4	Industry breakdown for Chinese FDI as of 2010	113
Table 6.5	Changes in the technological content of exports from major Asian countries	118
Table 6.6	Impact of changes in Asian countries' economic development strategies on China	119
Table 6.7	Chinese tax cuts for ASEAN products by category	127
Table 6.8	Personal consumption in China, ASEAN and developed countries, 2005–2010	130

Table 6.9	Trade dependence between China and ASEAN	131
Table 7.1	Changes in east Asian exports to Japan	137
Table 7.2	Changes in east Asian exports to China	137
Table 7.3	Changes in east Asian exports to the U.S.	138
Table 7.4	Changes in exports by east Asian economies according to the BEC classification, 2000–2012	139
Table 7.5	Changes in east Asian exports to China by category, 2000–2012	142
Table 7.6	Changes in east Asian exports to Japan by category, 2000–2012	144
Table 7.7	Trade combination degree (TCD) between Japan and other east Asian countries	145
Table 7.8	Trade combination degree (TCD) between China and other east Asian countries	146
Table 7.9	Trade combination degree (TCD) between the U.S. and east Asian countries	146
Table 7.10	Trade complementarity between Chinese and other east Asian countries (1995–2012)	149
Table 7.11	Trade competitiveness between China and other east Asian countries (2000–2012)	150
Table 7.12	Changes in the proportion of consumer goods exported by east Asian economies to China, Japan and the U.S.	152
Table 7.13	Results of panel data unit-root test for variables	154
Table 7.14	Co-integration test results between the variables ex2ch, ex2us, and gdp	154
Table 7.15	Interplay between Asian exports to the U.S. and exports to China (PMG and MG estimates)	155
Table 7.16	Results of the Granger causality test on Asian exports to China and to the U.S.	157
Table 7.17	Impact of U.S. consumer goods imports from the rest of the world on chinese consumer goods imports (system GMM values)	162
Table 7.18	Variance decomposition	166
Table 9.1	Changes in GDP of major countries in the world, 1991– 2011	203
Table 9.2	Trade between China, Japan and South Korea	207

Chapter 1

Introduction



China's rise has been an indisputable fact in recent years, but the overall significance of this fact in the region has never been fully studied. This subject concerns China's future development and its relationship with the region. This book attempts to describe the new economic relationship China may entertain with the region from the standpoint of the region.

1.1 Background and Significance

1.1.1 Background

Background considerations for this book are the following:

First, history has shown that regions have become an important platform and focus for national (or regional) activities¹ as exemplified by the following phenomena: 1. The region is a major platform of economic activities by the economies within the region. For instance, 70% of EU's external trade happens within the block. This means that major EU economic activities happen among members and not with the outside world. 2. The region is the theater in which members implement their national strategies such as free trade agreement and financial integration. The matured regional markets are in Europe and North America where most of the developed countries, the highest GDPs, and the most sophisticated market systems can be found. In contrast, Latin America and Africa have lower economic development and lack regional market mechanisms while Asia has raised the level of economic development and market integration markedly.

Second, after many years of development, Asia entered into a new development stage and became the manufacturing center of the world. With China as the place of

¹ Katzenstein encourages further study of regions. Katzenstein (2007).

final product assembly and the developed world as its market, Asia has had an export strategy which has created one economic miracle after another. But the financial crisis of 2008 has changed the economic picture of the world. The developed economies, mired in the subprime loan debacle and overburdened with debts, are unlikely to return to the limelight in the short term, forcing Asian countries to change their economic strategy and leverage their markets for future growth. Moreover, the rise of an Asian economic community has propelled Asia to a new stage of economic development, and this is a big change resulting from the financial crisis. During the Asian financial crisis of 1997, Asian countries were unable to grow their economies by themselves and had to rely on the developed world to extricate themselves from the crisis. Today, with the steady increase in per capita income, Asian countries are able to decide on their own development paths; they can rely on their own and the region's strengths to achieve the next economic goal.² For this reason, a consolidated regional market has become the focus and goal for the Asian economies. Of course, the regional market is a mid- to long-term goal.

Third, due to its rise, China can become the major participant if not the creator of an Asian regional market. More than thirty years after first adopting the policy of reform and opening-up, China has become a major Asian and world power. In 2010, it overtook Japan to become the second largest economy of the world and the largest Asian economy in terms of GDP. This fact has transformed China's economic relations with other countries in the region and endowed it with the ability to lead Asia on a path of autonomous development.

China's strategic interest in a consolidated regional market is three-fold.

First, a regional market can extend China's window of opportunity in terms of economic development. This window of opportunity has changed to the extent that the external environment can no longer satisfy the requirements of China's industrialization and economic development. The economy grows as the external markets change. As demand from the developed markets continues to be weak and the domestic market not fully developed, a regional market can have stabilizing effects on economic growth and industrialization. China must adjust its strategic thinking and actively create a regional market to create more opportunities for itself.

Second, a regional market protects the common interests of China and other Asian economies. The growth of external markets and economic growth have not kept pace with the increase in Asia's production capacity, and the situation has reached a critical point. There are two ways of solving this problem: either the external markets have to expand further to absorb more Asian products or Asia must make adjustments to its economic structure. It seems that the latter is more likely to happen. As China's relationship with the other Asian economies has changed from production-focused to market-focused, China has to make some structural adjustments first and its neighbors will have to follow suit.

² Akyuz feels that it is impossible for Asia to return to the era of export-oriented high growth since the developed countries are experiencing low growth and high unemployment after the global financial crisis. What Asian countries need to do is to find a balance between domestic and external demand and restructure their industries to focus on domestic demand and regional trade. Akyuz (2011).

Third, China can implement its national strategy in a regional market. We have said that the region is an important platform for strategic and economic development. As an influential world power, China needs a unified regional market to further its strategic interests. The regional market can also serve as a natural showcase for the peaceful rise of China; it can help eliminate conflicts and bring about the rise of the Asian region.

1.1.2 Significance

This study differs from others in the following ways:

First, theoretical contribution. This book analyzes the relationship between market and industrialization from a regional standpoint. Existing research on industrialization has focused on individual countries and not on multi-national regions. Asia differs from other areas of the world in that it is undergoing regional industrialization.³ Economies at different levels of development are at different stages of industrialization; they may be transforming from agrarian to industrial, from labor- to technology-intensive, some highly developed economies in terms of GDP from technology—to knowledge-intensive, and from industrial to post-industrial. But common interests and challenges (e.g. how to overcome market restrictions during industrialization) unite Asian economies which are integrating at a faster speed as a result. The goal of this book is therefore to provide an analytical platform to discuss the future of the Asian economy and the strategy that China may adopt.

Second, academic value. That this book takes the regional approach is unique. Most of the existing research discusses China's economic transformation (changing of focus from export to internal demand) and extrapolates regional relationships from the Chinese perspective. This approach has some shortcomings: First, China is negatively impacted by the stagnating developed markets and has to rely on a prosperous and stable region to continue its industrialization. Second, since China is the largest Asian economy, any change in its strategic considerations will have reverberations in the region. China has to be mindful of the national interests of the other countries in the region. A focus on China is not sufficient to tease out the trends of regional relationships or turn in a credible regional strategy based on common interests.

Third, practical value. To wield its influence as a regional power, China has first of all to become the instigator of a regional market. This represents a historical opportunity as well as a crucial challenge for China. The developed markets had matured during the long process of industrialization and are accessible to the world in the post-industrial period. China is still in the process of industrialization; it did not have enough time to develop a mature market but is thrust prematurely into the role of providing a market for the region. Thus, for an indefinite period in the future, China will be a producer and, more importantly, a consumer of regional products.

³ Latin America has some similar features but these are not as prevalent as in Asia.

It can become a true regional power if it can successfully extend its market to the region.

This is an auspicious time for China. The relationship between the ascendant power and the region is changing. This is a time of economic development and transformation for China and its neighbors and China can contribute positively to regional transformation. The majority of Asian economies are small and have limited spillover effect to the regional market. But China, due to its size, has the natural conditions to be the contributor to the regional market. In reality, being the consumer of regional products is the prime reason that the relationship between China and the region is changing, but it has taken many years for China to come to this point, and this situation has only become apparent after the financial crisis of 2008. China could be the leader of the region if it can realize its potentials during this auspicious time of change. Of course, China is not as good a consumer as the U.S. and will still be a major producer in the region for the foreseeable future, but it can take advantage of the scope of its expanding market to lead Asian countries to limit and utilize the spillover effects of each market to construct a relatively autonomous regional market.

1.2 The Problem

This book reexamines the changes in regional relationships from the perspective of market demand and explores how China may change its relationship with the region in order to construct a regional strategy. A pressing issue for Asia now is how to construct a unified low-cost market big enough to satisfy the requirements of future growth. Some research⁴ suggests that the scope of the Asian market (including expanded national and regional demand) is insufficient to compensate for the reduced demand from the developed world. Asia's industrialization will slow down if increased Asian capacity is not matched with a suitably sized market. The market is especially important as Asia industrializes collectively, and integrating a regional market has become the precondition for future Asian growth.

The majority of existing research discusses regional relationships through the lens of production; the research includes theories on trade creation and industrial transformation such as the Flying Geese Pattern, and their point of departure is always production. Very few papers analyze the changes in economic relationships from the angle of a regional market and view the latter as a precondition for their research.

⁴ Even though emerging economies have increased the volume of import, Xiaosong Wang et al. argue that these economies are unable to weather a global crisis because the quantity of their final products is still small compared with the world's total. Longhua Zhao et al. hold that external demand for Chinese products will worsen because the expanded internal demand of the emerging economies is not sufficient to compensate for the reduced demand of the developed world. Jimenez et al. find that an emerging economy's export to the developed world is strongly related to economic growth and that South-South trade is unable to replace South-North trade. See Wang and Xie (2009), Zhao and Guo (2011), Jimenez and Razmi (2013).

In reality, many questions prompt us to reexamine regional economic relationships: What caused the call for global rebalancing? Is the path for future Asian industrialization and modernization sustainable? Will collective industrialization bring about contentious competition and conflict? Will cooperation solve the problem of market that Asia is grappling today?

We will examine existing studies and try to see if the changes in China's relationship with the region and a consolidated regional market are possible, workable, and sustainable.

1.2.1 *Studies in China*

Studies done inside China have a number of features in common:

First, a change in research direction. In the past, the focus was on how the region affected China; now the focus is on how China affects the region. The fast pace of China's economic development has made China more influential in the region, and Chinese experts are paying more attention to the Chinese factor in the structural changes that are happening in Asia. Some research suggests that a new Asian economic order is in the process of being formed and academia should focus on making this order more stable and defining the role China should play within it. Yunling Zhang⁵ thinks that China's rapid development adds a wild card in the transformative Asian region while Ruan Zongze⁶ documents the interaction between China and East Asia and analyses their common interests. Ning Huan⁷ believes that China can have a stabilizing effect if it cooperates with its East Asian neighbors while Feng Wang⁸ indicates that import is bigger than export in regional trade and that China imports more than Japan. Wei Zhao⁹ points out that China's vastly increased trade volume has changed the pattern of East Asian trade and a new China-centered triangular trade pattern is taking shape in which China will replace Japan as the prime instigator of a new East Asian industrial structure.

Second, a change of research focus from production to consumption. Although most research studies how China changes the structure of regional trade as a regional producer, some researchers are keener on viewing China as a consumer. They delineate a future in which China is the provider of market. Studies by Xiao Li et al.¹⁰ as well as Zhaoyang Zheng and Xin Zhou¹¹ point out that the strengthening China Factor is a trend of regional cooperation that should not be overlooked. After thirty years of development, the fast growing Chinese economy has changed the paradigm

⁵ Zhang (2007).

⁶ Ruan (2007).

⁷ Huan (2008).

⁸ Wang (2008).

⁹ Zhao (2009).

¹⁰ Li et al., (2005).

¹¹ Zheng and Zhou (2007).

of regional economic cooperation, from the old Flying Geese Pattern to the current “rhombus-shaped framework”, and many East Asian countries have grown more reliant on the Chinese market. The conclusion that Xiao Li and Jinghui Fu¹² draw from this is that China is playing the role of market provider and that this trend will strengthen as the Chinese economy grows and the RMB rises in value. However, China is not ready to replace the U.S. as the largest market for East Asian products. Yibing Ding et al.¹³ hold that the growing Chinese market is far from being on a par with the American and Japanese markets in terms of absorbing East Asian final products and that China needs to change the domestic economic structure to match the changing trade pattern. Dawei Li¹⁴ thinks the following about China’s import: it will increase faster than export, semi-processed products will continue to decline while technical and key parts will increase markedly, it will play a more important role in shaping some key industrial structures, commodities will still constitute an important part while consumer goods will increase appropriately, and the source of import will become more varied.

Third, China’s regional strategic preparedness. Youwen Zhang¹⁵ thinks that China’s economic status in the world has risen after the financial crisis of 2008 and that China is poised to become an economic powerhouse. Jiayi Zou¹⁶ argues that under this new set of conditions, China needs more balanced economic relations with the world, including dynamic and balanced trade relations, bidirectional and controllable investment relations, diverse and independent currency relations, comprehensive and open geopolitical relations, and proactive and effective development relations. These balanced relationships will promote a virtuous cycle between China’s and the world’s development.

Even though Chinese research has yielded fruitful results, it does not have a sufficient grasp on the realities of regional relationships and is not able to describe clearly the effects of Chinese influence on the region. These issues are precisely what this book wants to explore. Many studies think that China ought to turn to domestic demand in a restrictive external environment and make structural adjustments to respond to changes in the outside world. To rely less on external demand, Yongding Yu¹⁷ notes, structural changes are necessary even if export to the U.S. improves. Due to China’s lack of real strength, some researchers suggest that China should invite other countries to create a regional market together. Hualin Jin et al.¹⁸ hold that it is difficult for individual countries to expand domestic demand, and even China and Japan are unable to become a provider of market by themselves alone. It is more reasonable to create a regional economic model in which member states try to expand export and investment based on domestic demand. Positive interaction with

¹² Li and Fu (2010).

¹³ Ding et al. (2013).

¹⁴ Li (2011).

¹⁵ Zhang (2012a).

¹⁶ Zou (2011).

¹⁷ Yu (2010).

¹⁸ Jin and Jin (2009).