

Chinese FTA Strategy & Regionalism Promotion

By Ke LONG



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COMPARING the impact of current Chinese economic development on East Asia with one or two decades ago, China increased its power driving regional economic development dramatically in the past five years. Recently China is changing from a regional manufacturing center for the regional market to a key country leading regional cooperation. When we take a look at economic development and institutional reform historically, we find that China was still an extremely low-income economy three decades ago. Now, China has developed into a semi-developed country. Although its per capita GDP was only around \$2,000 in 2007, coastal provinces and big cities such as Jiangsu, Guangdong, Shandong, Zhejiang, Beijing and Shanghai have developed to the middle-income level. The economic structure has been industrialized. Per capita GDP in these provinces and big cities has been more than \$10,000.

Because of its strong economic performance, China decided to pursue entry into the World Trade Organization (WTO) at the end of the 1990s, and succeeded in entering the WTO in 2001. China promised to open its markets to foreign businesses as a commitment to entering the WTO. Meanwhile, the Chinese economy has been globalized since then. These efforts not only provide benefits to foreign companies, but also contribute to Chinese economic development itself.

1. Lessons from Currency Crisis

Asian countries experienced a currency crisis that started with the Thai baht's depreciation in 1997. During the crisis, Asian currencies, including the Japanese yen but excluding the Chinese yuan, depreciated 30% to 70%. Of course the Chinese economy was also damaged by the crisis. The domestic market turned towards deflation, and the government had

to relax financial policy to encourage fixed-asset investment. Meanwhile, the Ministry of Finance issued more treasury bonds to expand construction of infrastructure such as highways, airports, power stations, etc. However, as a result the fiscal deficit ratio against GDP reached 3% at the time (see the *chart*), and 3% is a defense line for governments to hold fiscal deficits, according to an OECD standard. That means the Chinese government needs to lower the fiscal deficit ratio against GDP to sustain economic development.

Meanwhile, China faced strong pressure to depreciate its currency as its neighbors had. If China, however, had depreciated the yuan under the crisis situation, Asian countries would have started a depreciation race that could have led many Asian emerging economies into another crisis. Recovery from damage inflicted by such a crisis would take a long time.

At the end of 1997, China's then Premier Zhu Rong-ji announced that China would not depreciate the yuan, and emphasized China would pour more effort into stabilizing the currency and encouraging investment to overcome the

difficult situation.

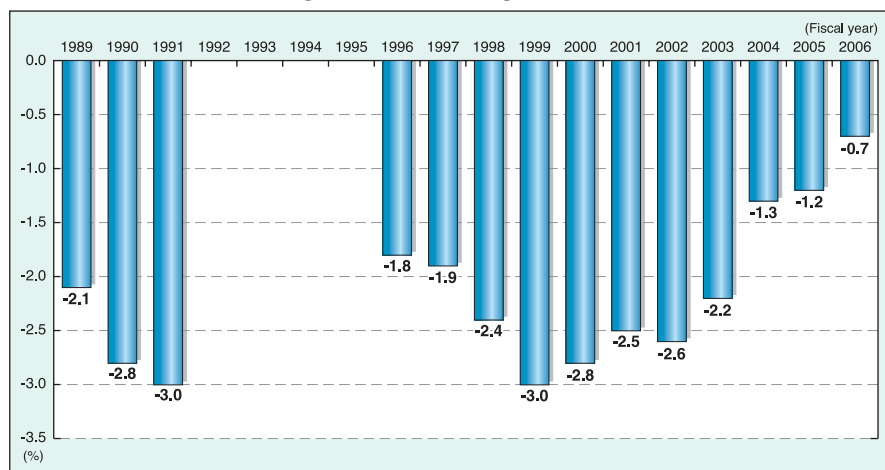
The announcement clearly gave Asian countries confidence and contributed to stopping the outflow of foreign capital. In 1999, Asian countries succeeded in recovering from the crisis, and their economies restarted to develop continuously, like the letter "V".

It must be noted here that there are many lessons we can learn from the crisis. One is our Asian economies were too reliant on exports to the United States. If Asia wants to sustain economic development, it must do more to create a regional common market to encourage interregional trade and investment. For Asian countries, it is definitely important currently to create a network of multilateral FTAs and EPAs.

2. China's FTA Strategy

Since three decades ago, China has succeeded in rebuilding its infrastructure system and gradually its economic development has come to contribute to global economic activity as a main engine. China is now playing an important role

Chart Overall government budget deficit ratio to GDP



Source : Key Indicators 2007, Asian Development Bank

in the global economy as a center of world manufacturing industries, and is considered a potential market as well.

Although China was able to enter the WTO in 2001, it still faces difficulties with how to get confidence from its neighbors in leading the way to creating a common market with its fellow Asian countries. At the end of 2001, Zhu Rong-ji approached ASEAN countries and promised that China would open its agricultural market to secure the confidence of ASEAN countries to create an FTA by 2010. The ASEAN countries responded to Zhu's proposal positively. This is a very important turning point for Asian regional economic cooperation.

It is a pity, however, that China, Japan and South Korea have not started to develop economic integration yet. They have faced some difficulties concerning history, in particular the Yasukuni war shrine issue. As a result of the lack of official dialog under the Junichiro Koizumi administration, China and Japan approached ASEAN countries individually. But it is common knowledge that it is too inefficient for Asia to work under the framework of "ASEAN+1." We are now fortunate to see that the Shinzo Abe administration made a strategy change in favor of engaging China to work together. In addition, China's Hu Jintao administration also changed policy to cooperate with Japan, putting historic problems aside.

The Abe administration suggested to the Hu administration to promote a win-win relationship strategically, and China accepted Japan's suggestion. The two countries restarted visits by their leaders to each other.

3. Japan's FTA Strategy

Japan changed its policy not only to maintain its alliance with the United States, but also to strengthen dialog with Asian countries to improve regional economic cooperation, which also definitely contributes to security in Asia. To avoid a considerable crisis like what happened in 1997, China and Japan need to work together to lead Asian countries towards regional cooperation, as seen in the "ASEAN+3" approach.

There are also some differences between Japan and China regarding the consideration and organization of regional cooperation. Generally a multilateral FTA or EPA framework must be feasible. Japan wants to promote a new framework called "ASEAN+6" including Australia, New Zealand and India. Basically ASEAN+3 and ASEAN+6 are not alternatives to each other: the important thing is to take the first step.

Here we must make it clear that for the Japanese government it is not easy to sign an FTA, whether it is multilateral or bilateral. Most Asian countries request that Japan open its agricultural market, but it seems that the Japanese government and some politicians cannot accept such requests and refuse to open its agricultural market to foreign produce even though the ratio of agricultural output against GDP in Japan is very small.

Here the most important problem is what you want to get, and what you can give. We cannot expect to only get but not give. As a major economy in Asia, Japan could and should take a leadership role to improve regional cooperation. Whatever Japan or other Asian countries do, it will be beneficial to work together. So there is no reason to refuse to create a regional FTA or EPA.

4. New Framework to Improve Asian Regional Economic Cooperation

It is clear that few countries in the Asian region refuse to create an economic cooperation framework like an FTA or EPA in this region. Since experiencing the currency crisis in 1997, all members in the region have come to recognize the importance of regional economic cooperation. Fortunately we have strong leadership to drive us towards cooperation: Japan and China have turned to be much more positive and active to work together to create an FTA or EPA in East Asia.

Actually, both Japan and China need to change their economic structures, not only concerning their reliance on exports to the United States, but also in terms of encouraging intraregional transactions. Over the past three decades, the FDI of Japanese companies in Asia has played a

very important role in industrial division regionally. Although regional economic integration has not yet been realized, interdependence within Asia has been strengthened in the process of FDI.

Since the 1990s, China has supplied a marketplace to integrate regional manufacturing and market transactions. Guangdong Province in Southeast China has become a center of machinery assembly industries. The free economic development zone there has attracted many foreign companies, including those from Japan, NIEs and ASEAN. To shift their assembly functions to southeast China. Actually, it is against this background that China could realize a large surplus of international trade with the United States. However, it is considered that the trade imbalance with the United States is not sustainable and stable. It is important to create a regional FTA to improve interdependence as soon as possible.

The problem is how to realize regional economic integration. First, it is necessary for all members, especially Japan and China, to endeavor to open their domestic markets. Second, it is important to realize a consensus to create a rule of law to overcome differences in values and cultures in the region. Third, it is realistic to begin establishing the framework with core members in the region, and expand gradually.

Here we should not forget the reasons for creating an FTA/EPA. The aim is to lower regional trade transaction costs at first, and improve the efficiency of regional industries. Such economic cooperation could strengthen regional industrial competitiveness, and also stabilize regional economic development.

Although the merits for the members in the region are clear, of course it is not easy to realize. The negotiation process could be very difficult. Governments in democratic states such as Japan and South Korea need to do more to persuade parliament, and also need to disclose all information to citizens. But it is also clear that we don't have any other option besides cooperation. **JS**

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