

# **China, the World Trade Organization, and Regional Economic Cooperation**

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## 1. Introduction

Compared with its predecessor, the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO) is more comprehensive in terms of coverage of agreements and more powerful embodying a much-stronger dispute settlement mechanism. However the absence of China from the WTO has constituted a serious limit. Without China in the world trading system, it is fair to say that the WTO is not truly the 'world' trade organisation, and that having not been a member of the WTO, China has not been fully incorporated with the world economy.

At the time of writing this chapter (November 1999), China and the United States finally agreed on the conditions of China's entry into the WTO. Chinese authorities have thought that the United States was the leading member blocking China's accession. Thus the biggest hurdle is removed and China is finally about to be brought into the rule-based world trading system. On the other hand, not only globalism and multilateralism, but also regionalism is flourishing in the world. Given the current tide of regionalism, China also joined Asia Pacific Economic Cooperation (APEC) in 1991 while trying to accede to the WTO. Since then China has been an active member of APEC. More recently countries in Northeast Asia, which include China, have been discussing the possibility of forming a preferential trade arrangement in the region. The Asian financial crisis was obviously a momentum.

There are significant differences in the nature of the institutions of the WTO, APEC and the so-called Northeast Asian Economic Cooperation (NEAEC). While the WTO includes about 140 member economies in the world and has binding rules for its members, APEC covers only 21 economies in the Asia-Pacific region and relies largely on consensus and peer group pressure. NEAEC, if formed, would include only countries in Northeast Asia and would be a preferential rules-based arrangement. They have commonality, however, in the sense that they all serve as stimuli to trade liberalisation and reform in China.

This chapter consists of three sub-themes. In section 2, it first aims to evaluate the meaning of China's accession to the WTO. Then it discusses matters regarding China's relations with APEC in section 3. Section 4 summarises China's economic relations with its neighbouring countries in Northeast Asia and discusses the possibility of forming a preferential trade arrangement in the area. Finally section 5 concludes.

## 2. China and the World Trade Organisation

In his address to Beijing University in 1997, Renato Ruggiero, the then WTO Director-General, said, “China increasingly needs the opportunities and security of the WTO system to fulfil its huge potential for growth and development.” He further remarked, “the WTO increasingly needs China as a full and active member to be a truly universal system.” (21 April 1997, Address to Beijing University, China. <http://www.wto.org/speeches/china.htm>) This section evaluates his remarks.

### *Importance of China in the World Economy*

Before China launched its so-called ‘reform and open-door policy’ in the late 1970s, it was an insignificant participant in the international economy. In 1977 its total trade was less than US\$15 billion, its share of world trade was only 0.6 per cent, and it was only the 30<sup>th</sup> largest exporting country in the world. In the late 1970s China was also a negligible participant in world capital markets. China was not a borrower either in international commercial markets or from international financial organisations such as the International Monetary Fund (IMF) and the World Bank. It also did not receive private foreign direct investment and did not invest abroad. Thus China was largely isolated from the world economy.

In the 1990s China’s role in the international economy are totally different. In 1998 China’s total trade recorded US\$ 324 billion, accounting for 3 per cent of world trade. China is now the world’s 10<sup>th</sup> largest trading country.<sup>1</sup> China is the largest emerging trading nation with one fifth of the population of the world. China also is a significant borrower in international capital markets. In 1998 foreign capital actually utilised in China reached US\$58.9 billion. In particular, the total amount of foreign direct investment reached US\$45.6 billion, far larger than any other developing country, ranking second in the world behind only the United States. Thus China already plays a major role in the world economy.

The International Monetary Fund (IMF) found that on a purchasing power basis the Chinese economy in 1990 accounted for just over 6 per cent of world output, ranking third behind only the United States and Japan (IMF, 1993). A more recent research by the World Bank suggests that based on purchasing power parity China ranked the second largest economy in the world, only behind the United States. (World Bank, 1997a) In

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<sup>1</sup> In 1998 the value of China’s exports was US\$ 183.8 billion and its imports recorded US\$ 140.2 billion. China is the world’s 9<sup>th</sup> largest exporter and 11<sup>th</sup> largest importer. In 1998 Chinese exports of services totalled US\$ 23 billion and its imports totalled US\$ 28.6 billion, making China the world’s 15<sup>th</sup> largest services exporter and 11<sup>th</sup> largest importer.

addition, the World Bank projects that China's share of world trade will be around 10 per cent by 2020, making it the world's second largest trader (World Bank, 1997b).

China is one of the five permanent members in the United Nation's Security Council and is a member of the IMF. However, China is still not a member of the WTO. As noted in Introduction, the absence of China from the WTO constitutes a serious limit even though it is in a far stronger position than the GATT. Without China in the world trading system, the WTO is not truly the 'world' trade organisation. Alternatively, without WTO membership, China's integration with the world economy is incomplete. Only when China is acceded as a member of the WTO, will the WTO be truly the 'world' trade organisation and will China be finally brought into the world economy.

### *The Process of China's Accession to the WTO*

China was one of the original 23 contracting parties of the GATT, the predecessor of the WTO. After China's revolution in 1949, the Nationalist Government in Taiwan formally withdrew in 1950 China's membership from the GATT. In 1984 China requested and received permanent observer status. And in 1986 China formally applied to become a GATT contracting party. A working party to examine China's status was established in March 1987 and met for the first time in October 1987.<sup>2</sup>

By the Spring of 1989 the fact-finding phase was completed and many thought that the working party could move into relatively advanced stages of the negotiations. However, following the advent of the Tiananmen incident in June 1989, the negotiations were at halt for more than two and a half years. Only in October 1992, active negotiations were resumed (Gertler, 1998; Wong, 1996). During the Uruguay Round negotiations, China wanted to become a founding member of the WTO. After having had failed to meet the 1994 deadline to become a founding member of the WTO, interest in accession waned for a while in China and the Chinese authorities seemed to be reluctant to make substantial progress. However, China soon renewed its negotiations to join the WTO.

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<sup>2</sup> Taiwan was granted observer status in 1965. In 1971, however, this status was removed, following a decision by the UN General Assembly that recognised the People's Republic as the only legitimate government of China. In 1992 a working party was established to examine the request for accession of the Separate Customs Territory of Chinese Taipei. It has been agreed between China and many contracting parties of the WTO that Chinese Taipei, as a separate customs territory, should not be acceded to the GATT/WTO before the People's Republic. On the other hand, Hong Kong became a contracting party in 1986. Subsequently Hong Kong, as a contracting party of GATT, was a full participant in the Uruguay Round and became an original member of the WTO in 1995. Since July 1997, when it became a Special Administrative Region of China, Hong Kong has retained the status of a separate customs territory and continued to be a WTO member, using the name of 'Hong Kong, China'. (WTO, 1999)

As in other WTO accession processes, China and each of WTO members have negotiated market access commitments in the Chinese market. And it is normal in the accession negotiations for WTO members to seek substantial concessions from an acceding country. In particular the United States, the European Union and Japan, the dominant contracting members of the WTO have played key roles in bilateral trade negotiations concerning China's accession. Chinese authorities have thought that the United States was the leading member blocking its WTO accession (Wei, 1998). Having experienced ups and downs of the negotiations, China and the United States finally agreed in November 1999 on the conditions of China's entry into the WTO. Thus China is now about to join the WTO, 13 years after it formally applied to become a member.

China's accession negotiations have come a long way for several reasons. China's economic system has been thus far by and large not compatible with the disciplines of the WTO. The peculiarity of China's economic system complicated the process of bringing China into conformity with WTO rules (Van der Geest, 1998). For instance, trading rights, traditionally monopolised by the State, have long represented one of the biggest obstacles to China satisfying WTO entry requirements. The size of China mattered, as well. China's large share in world market for some products in such industries as light manufactures ensured competitors in the rest of the world worry about China's accession to the WTO. Several members argued that China was not an ordinary developing country because of its large size and its importance in world trade and thus China could not be admitted to the WTO with developing country status (Yang, 1999). On the other hand, China insisted that it be allowed to join the WTO with developing country status.<sup>3</sup>

The negotiations on the accession of China to the WTO were also dragged for a long time, because they were determined not only by economic factors but also by political factors, both within China as well as internationally (Van der Geest, 1998). For example, the political unrest of China in 1989 made the West reluctant in negotiations. The United States and others in the West wanted to see an improvement in human rights in China as a precondition (Hilf and Feddersen, 1998). More recently NATO's bombing of China's embassy in Belgrade in early 1999 during the Kosovo war resulted in suspension of the talks.

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<sup>3</sup> If allowed, the developing country status would allow China for longer transition periods both for meeting WTO accession demands and for complying with on-going liberalisation commitments under the Uruguay Round. It also would provide China with access to the many other 'Special and Differential' provisions in the GATT/WTO agreements. In particular, as provided in GATT Articles XII and XVIII China as a developing country would be allowed to restrict imports when it faces difficulties in its balance of payments or seek to retain protection for a particular infant industry. And China would be eligible to receive more favourable tariff treatment under the so-called 'enabling clause' which authorises the operation of the Generalised System of Preferences (GSP). (Anderson, 1997; Abbot, 1998)

## *Effects of China's Accession to the WTO*

As the negotiations on China's WTO accession have not finished and hence the Protocol on China's WTO Accession has not been finalised, the exact conditions of China's membership are not known. Generally speaking, China will be entitled to export its products and services to other WTO members at the rates of duty and levels of commitment negotiated in the GATT and the Uruguay Round, and in return it will accept the WTO agreement and related MTAs. During the years of its accession negotiations to the WTO, China has made many concessions and offers to liberalise its import regime of both goods and services. Specifically,

- At the APEC meeting in Osaka in November 1995, China announced its new programme of tariff reduction and liberalisation of non-tariff measures.
- The simple average tariff rate (not including agricultural products) has been reduced from 42.7 per cent in 1992 to 16.7 per cent in 1999. In addition, China committed to reducing its average tariff rate to around 15 per cent by 2000 and to around 10 per cent by 2005.
- Non-tariff measures (NTMs) have been reduced from 1,247 in 1992 to less than 400 (about 5 per cent of the total import tariff lines) in 1998. China agreed to eliminate all WTO inconsistent NTMs by 2010.
- China has agreed to ensure that import purchasing procedures of state trading enterprises are fully transparent and in compliance with the WTO.
- China has agreed that import and export licensing should be in full compliance with WTO rules, and sanitary and phytosanitary measures will be notified in accordance with the WTO SPS agreement.
- China has agreed to grant full trading rights for Chinese and foreign companies within 3 years of accession.
- China has committed to national treatment for foreign firms in pricing and procurement of goods and services for production and distribution of goods in the domestic market.
- China has agreed to implement the WTO TRIPS Agreement upon its accession to the WTO.

In bilateral market access negotiations between China and the United States, the crucial services sectors such as telecommunications, banking, insurance, distribution, consulting, tourism and agriculture, among others were also resolved. Specifically, in the trade accord reached between China and the United States in November 1999, provisions cover the following, among others (Washington Post, 15 November 1999):

- Foreign firms will be able to buy up to 49 per cent of telecommunications firms, effectively immediately, and up to 50 per cent within two years.
- Foreign banks will be able to do transactions in Chinese currency with Chinese companies in two years and with Chinese individuals in five years. In five years all geographical restrictions on foreign banks operating in China will be lifted.
- Foreign insurance companies will be able to own 50 per cent of joint ventures immediately, and all geographical restrictions on the ability of foreign firms to sell insurance will be lifted by 2003.
- Foreign automobile firms will be able to supply financing for new car purchases. Tariffs on auto imports will also be reduced from 80 to 100 per cent to 25 per cent by 1 July 2006.
- The number of foreign motion pictures allowed in China would increase from 10 to 20 a year.
- China will cut tariffs on a wide range of agricultural products.

What will be the effects of China's WTO accession? Some simulation-based studies have suggested that both China and the rest of the world potentially have a great deal to gain from China's WTO accession. Using a standard global computable general equilibrium model known as GTAP, Anderson et al (1997) provide projected estimates of the effects by 2005 of Uruguay Round implementation without and then with accession of China and Taiwan to the WTO. They show that accession of these two economies to the WTO would accentuate many of the beneficial effects of the Uruguay Round. Specifically, the Uruguay Round will boost global world trade growth in aggregate by 10 per cent without China and Taiwan participating, and by 15 per cent with China and Taiwan participating. The inclusion of China and Taiwan also increases the global welfare gain from the Round by 40 per cent. More than a third of that extra gain goes to China. In their study degree of liberalisation by China is based on what China had on offer in 1994. Because that was less than is eventually agreed to, the results are underestimated. Their results are also underestimated because their general equilibrium model is not a dynamic model with endogenous growth built in, and hence does not take the additional growth effects of liberalisation on investments. The study by Anderson et al. (1997) also reports projected changes in the composition of production in China. In particular, China's accession to the WTO will ensure that in China more resource will be moved from agriculture to the non-primary sectors such as light manufactures, where China has its strongest comparative advantage. As a result the GDP share for light manufactures is projected to grow by 42% instead of 8% between 1992 and 2005.

There are other less-easily quantified but nonetheless important effects of China's accession to the WTO. Let us consider these effects on China, WTO members and the WTO itself, respectively.



#### Effects on China:

- China should be safeguarded from discriminatory treatment in trade and hence will not be subject to ad hoc decisions by foreign governments about whether it will continue to enjoy trade privileges.
- If its rights are impaired by other WTO members, China will have access to the formal dispute settlement procedures of the WTO. China, as a member, will fully participate in the Millennium Round of multilateral trade negotiations.
- The market-opening measures and legal changes required to become a WTO member will cement China on a path toward a market system and the rule of law.
- This will reduce policy uncertainty in China and hence bring consistent economic reform and opening of the Chinese economy in the longer term. This will also attract foreign investment, boost China's economic reforms and encourage economic growth in China and its trade.
- On the contrary, many sectors, especially those dominated by state-owned enterprises, will be subject to increasing pressure for adjustment. Unemployment may get worse in the short run before it improves in the longer term. Without a legitimate social security system in place, social unrest may rise.

#### Effects on WTO members:

- As China will open its huge domestic market to foreign goods and services, and as it will be bounded by the rule of law in the conduct of its trade relations, foreign firms will have better access to China's highly protected market of 1.3 billion people.
- As China will have better access to the world market, some countries will have to face harsher competition in both domestic and foreign markets.
- As China will be anchored in the global economy, stability in external security relations will be encouraged in Northeast Asia and more broadly in Asia-Pacific area. In particular, military-security relations will be translated into economic relations in the region.

#### Effects on the WTO:

- Because, as a very large economy, China's influence is likely to be great, China's entry into the WTO may affect the general governance climate of the organisation.
- In particular, China may affect the overall balance between industrialised and developing members in the WTO. China could conceivably lead developing members toward a stalemate with industrialised members on new agenda items. Thus industrialised members would have a very difficult time overcoming entrenched resistance from a large block of developing members. Such resistance would certainly undermine the effectiveness of the WTO (Abbot, 1999). But it

would certainly increase the equity of the WTO, at least from the point of view of developing members.

Overall, China's WTO accession will be beneficial for the WTO and its members, as well as China. At the same time China's entry represents perhaps the biggest challenge to the future of the WTO and its members, as well as to China. But nothing can be accomplished without some element of risk. And this risk should be welcomed because isolating the major economic power, whose transition to market economy may otherwise contribute very positively to the international community, would constitute a greater risk.

### **3. China and APEC**

China, while it was seeking a WTO membership, joined Asia-Pacific Economic Cooperation (APEC) in 1991. Since then China has actively participated in the APEC trade liberalisation process. Hence this section discusses issues regarding China's relations with APEC.

#### ***The WTO and Preferential Trade Agreements***

The Most Favoured Nation (MFN) clause in Article I of the original GATT, signed in 1947, forbids members from pursuing discriminatory trade policies against one another. However Article XXIV allows members to form Preferential Trade Arrangements (PTAs), provided they eliminate, rather than just lower, within-union trade barriers on 'substantially all trade', and provided that they do not raise trade barriers on goods produced outside the union. (Panagariya, 1999).

Consequently many different PTAs have been created since the formation of the GATT. Most notably in Europe, the European Community (EC), which had formed a single integrated market in 1992, has recently organised the European Union (EU) which not only utilise a common currency but also pursue common diplomatic and security policies. In the meantime, the United States, Canada, and Mexico established the North American Free Trade Area (NAFTA) in 1994. It is highly possible that NAFTA eventually will be expanded to include the Latin American countries. The Enabling Clause of GATT, which was written in 1979, also, permits developing countries to exchange two-way partial tariff preferences. Under this provision, the bulk of PTAs consisting exclusively of developing countries, such as the ASEAN Free Trade Area (AFTA) and the Southern Cone Common Market (MERCOSUR), have been concluded.

As of April 19, 1999, out of 82 regional trade agreements notified to the GATT/WTO under GATT Article XXIV, 61 were formed in the 1990s. PTAs are certainly in fashion. Given the current tide of regionalism and the proliferation of PTAs, it is not surprising that many economies are seeking to join preferential arrangements while trying to accede to the WTO.

Some authors such as Panagariya (1999) view PTAs as a stumbling block to global free trade, and a source of fragmentation of the global trading system rather than a unifying force. Some others including Dutta (1999), however, express their view that PTAs can serve as a building block to global free trade, provided they are open and non-discriminatory in their liberalisation processes. Certainly APEC has been a good example.<sup>4</sup>

### *China, APEC and the WTO*

APEC was born in 1989 out of deep concern among East Asian and Western Pacific economies about the fate of the global, multilateral trade regime and the slow progress of multilateral trade negotiations in the Uruguay Round (Drysdale, 1998). Along with Hong Kong and Taiwan, China was admitted as a member at the third meeting of APEC in Seoul in 1991. Throughout the 1990s China has been increasingly incorporated into APEC. For instance, China's exports to the APEC member economies increased from US\$111.4 billion in 1992 to US\$240.3 in 1997. The annualised growth rate during this period is 16.8%. China's imports from the APEC member economies also recorded a high annual growth rate of 16.9 per cent, increasing from US\$68.7 billion in 1992 to US\$137.6 billion. The APEC region accounts for more than 60 per cent of China's trade, and a much higher percentage of its foreign capital inflows (Yang and Huang 1999). Most of APEC member economies are China's most significant partners in trade and investment.

There are two main characteristics of APEC: 'open regionalism', and 'voluntarism'. The concept of open regionalism is still not clear even among the proponents. It is generally understood that liberalisation undertaken within APEC is not to be preferential, but rather extended to economic transaction with all WTO members. Since it has not created any trade preferences, it is not a PTA and thus does not constitute of a breach of most-favoured-nation (MFN) treatment and needs not be notified to the WTO (Panagariya, 1999).

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<sup>4</sup> Read also WTO (1995) and OECD (1995) for analysis on the impact of regional arrangements on the multilateral system.

Concept of voluntarism is rather clear. APEC agreements are not binding and therefore not enforceable legally. Therefore the process of APEC's liberalisation is opted for peer-group pressure and sometimes described as a process of 'concerted unilateral liberalisation'. This of course creates loopholes and free riders, and is criticised as a major drawback of APEC as a regional arrangement.

APEC members are committed to achieving free trade and investment within the region by 2010 for developed economies and 2020 for developing economies. Employing a GTAP model, Yang and Huang (1999) evaluate the impact of APEC trade liberalisation on China by 2020. If all border barriers to trade in the APEC economies, including those to agricultural trade, are eliminated on a MFN basis, China's real GDP is projected to increase by 2.9 per cent. Both exports and imports expand by 42 per cent and 70 per cent, respectively, leading a US\$20 billion reduction in China's trade surplus in 2020.

Like WTO accession, the APEC process may help China's domestic reform. But the APEC process has been very slow and limited. So far, therefore, it is fair to say that China has not given its APEC membership much importance in helping domestic reform or has not felt APEC as much external pressure for economic reform. But the APEC process seems to have served as a stimulus to trade liberalisation in China.

For instance, at the Osaka APEC Summit in 1995 China announced a tariff reduction plan, and, in conforming to the commitments, lowered its tariff rate for over 4,900 items in April 1996 and hence lowered its simple average tariff rate to 23 per cent. In 1997 China further lowered its average tariff rate to 17 per cent and eliminated non-tariff measures on 17 items of products. In its Individual Action Plan submitted to APEC in October 1997, China made commitments to further lower the average tariff rate to 15 per cent by 2000 and to increase progressively the number of operational subsidiaries of foreign banks, etc. In conforming to the commitments, in January 1999, China lowered the average tariff rate to 16.7 per cent, by reducing the tariff rates for 1014 items.

In fact, APEC has been an important international economic forum for China in addressing trade issues with its major economic partners, given that China was not a member of the WTO. It has also been advantageous for China being an APEC member in the negotiations of its accession to the WTO. Before China became a member of the WTO, APEC was a forum for China to demonstrate its commitment to WTO rules. And by showing its commitment to APEC, China has been able to build support from APEC members for its WTO membership. In particular, the President of China met the President of the United States for the first time at the APEC meeting in 1993 and began discussing the parameters of Chinese entry into the GATT/WTO.

In addition, APEC has served as the only major forum at which representatives of the governments of China and Taiwan sit around the same table and debate regional economic issues. Through APEC, China and Taiwan have participated in APEC's trade liberalisation process and demonstrated a cooperative approach on economic issues. This will have a positive effect in the future when these two economies become WTO Members. In the case of China, the annual Leaders' meeting has meant that the concept, process and benefits of trade liberalisation are brought annually to the attention of the President of China. (Fried, 1998) Thus APEC's contribution has been to establish an international intellectual and policy framework within which China can pursue this integration without yet being a member of the WTO (Fried, 1998).

Thus APEC has played a constructive role in addressing China's integration into the world economy and hence China's entry into the WTO. With China's accession to the WTO, it is an open question what APEC will mean to China. It will be of course in China's interests to continue to participate in APEC. APEC has not competed with the WTO, but it has complemented it. Hence the APEC process will continuously help China's reform and its integration with the world economy China's reform.

#### **4. China and Northeast Asian Economic Cooperation**

Within APEC, there are three sub-regional PTAs – NAFTA, AFTA and CER. These sub-regional arrangements involve 12 of 18 members. China, Hong Kong, Japan and South Korea, which are all located in Northeast Asia, are key APEC economies and are not members of any sub-regional arrangements. As a matter of fact, with China's WTO accession, all but four WTO members (China, Hong Kong, Japan and Korea) are parties to at least one regional agreement. Thus the only region which has so far remained committed to the MFN approach to liberalisation is Northeast Asia (Panagariya, 1999).

However, there have recently been increasing interests in economic cooperation among the Northeast Asian countries. China has also pursued a very active role with regard to economic cooperation in this region. And more recently, there have been discussions on forming a free trade area among China, South Korea and Japan. Accordingly, this section will discuss the current status of and prospects for economic cooperation in Northeast Asia, and its implication for China.

##### ***Current State of Northeast Asian Economic Cooperation***

Although there are numerous geographical definitions of Northeast Asia, it is in

general understood to include China, Japan, South Korea, North Korea, Mongolia and the Far East of Russia. In some studies Hong Kong and Taiwan are also considered to be part of Northeast Asia. In terms of GDP and total trade, Northeast Asia is a little bit smaller than EU and NAFTA. In terms of population, however, it is about four times larger than EU or NAFTA. Japan takes the lion's share of GDP and China is the biggest country in terms of population and the area of land in Northeast Asia.

Potential of Northeast Asian Economic Cooperation is based on substantial economic complementarity and the dynamic nature of the countries in this region. As summarised in Table 1, the countries in this region have a highly complementary relationship in terms of the industrial structure and factor endowments. Japan, as a developed country, has plenty of capital and advanced technology, and its capital and technology-intensive enterprises are now playing a dominant role in the world manufacturing industries. However, it is poor in natural resources, and its labour costs are high. South Korea has fairly rich capital, development experience (know-how) and technology-based industries. However, it also suffers from lack of resources and labour. China, while not so modern compared with Japan and South Korea, is very rich in labour with low costs and fairly abundant resources. The Russian Far East is very rich in natural resources but suffers from lack of labour and capital. North Korea and Mongolia are similar in that their labour costs are low, and they have a certain amount of natural resources but need capital and technology. This complementarity of the Northeast Asian economies provides a good material basis for developing economic cooperation in the region.

Table 1. Complementarity of Northeast Asian Countries

Country	Labour	Resource	Capital	Technology	Business Know-how
China	++	+	-	-	-
Japan	--	-	++	++	++
South Korea	--	-	+	+	+
North Korea	+	+	--	-	--
Mongolia	-	+	--	-	--
Russian Far East	-	++	--	-	-

Note: ++ very abundant, + abundant, - scarce, -- very scarce.

Second, Northeast Asia is considered as economically the most dynamic region in the world. Especially in the 1970s and 1980s, China, Japan and Korea have recorded

much higher economic growth rates than the world average. China and Korea are expected to continue to grow faster than the world economy. Also the Japanese and South Korean economies are well known for their dependency on foreign markets. Since 1978, China's foreign trade has also increased very rapidly. Accordingly, China, whose total trade was smaller than that of South Korea until 1991, has become the second largest trading country after Japan in Northeast Asia.

The Northeast Asian Economic Cooperation began to be realised when China originally proposed the idea of developing the so-called golden delta of Tumen River in "The First International Conference on Economic and Technological Development in Northeast Asia" held in Changchun, China in July 1990. The idea was taken in 1991 by the United Nations Development Plan (UNDP) as the Tumen River Area Development Program (TRADP) and North Korea, China, Russia, South Korea and Mongolia participated in the program. The TRADP has entered the second phase following the sixth Program Management Committee (PMC) held in New York in December, 1995, which agreed on the formation of intergovernmental bodies including the "Tumen River Area Development Coordination committee" and the "Consultative Commission for the Development of Tumen River Economic Development Area and Northeast Asia Commission".

The intra-regional Foreign Direct Investment (FDI) in this area has recently increased, even though it is still in a beginning stage. The main suppliers of the FDI in the region are Japan and South Korea, and the main recipients are China and the Russian Far East. The FDI is expected to increase in this region since special free trade zones have recently been established in China's northeastern provinces, the Russian Far East, North Korea and Mongolia. China established the Hunchun Border Economic Cooperation Zone and Russia set aside Nakhodka, Vladivostok, and the Sakhalin island areas as a free economic region. North Korea also established the Rajin-Sonbong Free Economic Trade Zone in 1991, and Mongolia established a special economic zone in Dornod province and a free trade zone at a Mongolia-Russia border area in 1993.

Despite these recent developments, however, Northeast Asian Economic Cooperation was seen mainly as embodying local integration and thus economic cooperation between nearby localities across national boundaries has been regarded as the most probable type in which central governments play a very limited role (Lee, 1999). Especially local governments of Northeast China, the Russian Far East, the Japan Sea coastal area of Japan and Korea's East Sea coastal area have pursued actively economic cooperation with other local governments in Northeast Asia. However, lack of coordination at three levels – locally in each country, between localities and the national level in each country, and among localities across national borders- has complicated

regionalism in this region (Rozman, 1997, p.27).

### ***Prospects for Northeast Asian Economic Cooperation***

There are many obstacles that must be overcome to strengthen the economic cooperation in Northeast Asia. First, different economic systems coexist in Northeast Asia. North Korea still has a basically autarchic socialist economic system, while China and Russia are in the process of adopting a market system. Second, Northeast Asia, as a region, is too unbalanced. Northeast Asian countries differ not only in the level of economic development, but also in the size of their economies. Third, this region has a history of Japan's invasion and the unfortunate aspects of past history still linger in most parts of the region. Fourth, only some regions of China and Russia are often considered as part of Northeast Asia, while North and South Korea as well as Japan are included in their entirety. Fifth, the United States, which has remained as an influential presence in Northeast Asia, does not want to see an economic bloc of Northeast Asian countries.<sup>5</sup> Finally, Northeast Asia was previously the world's coldest area during the cold war, and there still exist some unresolved regional conflicts and lingering tensions. In particular, South and North Korea are still under a quasi-war state of truce; Japan and Russia are quarrelling over the Northern islands issue.

Given these various obstacles, no serious attempt has been made to consider Northeast Asian Economic Cooperation as being a case of economic integration similar to the EU or NAFTA. (Lee, 1999). And a formal form of regional economic integration including all countries in Northeast Asia does not seem to be possible in the foreseeable future. However, the need for economic cooperation among Northeast Asian countries has been re-emphasised after the East Asian financial crisis. (Lee, 1999) China's trade liberalisation process in an attempt to the WTO has also increased the possibility of establishing Northeast Asian Economic Cooperation. (Luo, 1999)

In particular, there have recently been discussions focusing on a trilateral cooperation among the three major countries in the region - China, Japan and South Korea. In November 1999, China, Japan and Korea held a tripartite summit on the sidelines of the formal summit of ASEAN Plus Three in Manila. It was the first time that leaders of the three nations get together after decades of feuds and distrust caused by the Cold War. They agreed to conduct a joint research to seek ways of institutionalising economic cooperation among the three Northeast Asian countries (Korea Times, 28 November 1999. According to the report, the three countries will commission their research institutes to identify 10 areas, including commerce, customs, maritime,

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<sup>5</sup> For China, Japan and South Korea, the United States is the largest export market and the biggest source of technology and capital. Also Japan and South Korea have military treaties with United States.



environmental and fisheries sectors as the target sectors of trilateral economic cooperation.

It is not certain at this point in time whether these three countries will launch a formal PTA in the foreseeable future. But it is fair to say that it will be a possibility, as after the Asian financial crisis Japan and South Korea seem to realise the necessity of a formal PTA in Northeast Asia. For instance in August 1998 the then Japanese foreign minister first proposed the idea of Northeast Asian Free Trade Agreement (NEAFTA) and in September the Japanese ambassador to Korea proposed a feasibility study on a Korea-Japan free trade area (FTA). A feasibility study on a FTA among China, Japan and Korea was also suggested in the ministerial meeting between Korea and Japan in November 1998. Since then Japan and Korea have been carefully exploring the possibility of such a sub-regional arrangement in the Asia-Pacific Rim. Recently a conference was organised by the Korea Institute for International Economic Policy (KIEP), which is the Korean counterpart of joint research with Japan. In the conference, Cheong (1999), a research fellow of KIEP, argues that the most desirable form of economic cooperation among Korea, Japan and China would be to create a preferential trading block, so-called 'Northeast Asian Free Trade Area', among member countries eliminating tariff and non-tariff barriers.

China shares with Japan and Korea the view that economic cooperation among China, Japan and South Korea is particularly important. In particular, China proposes that the three countries establish a growth triangle and encourage direct investment in the region. Yet China, who is still sceptical over its framework and suspicious of Japan's supremacy over the Asian economy, prefers to start from non-institutional cooperation among the three countries and move to institutional cooperation stage in the long run. (Luo, 1999) In the following subsection, let us see how China has been closely related with Japan and South Korea in terms of trade and investment, and discuss how a free trade arrangement among the three countries will affect China's trade with Japan and South Korea.

### ***China's Trade and Investment with Japan and Korea***

China, Japan and South Korea have many things in common, such as the usage of Chinese characters. As seen in Table 2 these three countries are also similar in that they have enjoyed dynamic growth for almost three decades, and averaged far over the world rate growth. As a result, these three countries take lion's shares of Northeast Asia's GDP and total trade. In 1997 these three economies represented 19.1 per cent of the world income and 15.7 per cent of world trade. Even though Japan's share in world is expected

to decline in the coming years, China and South Korea are expected to remain dynamic economies and hence their shares are expected to keep increasing (Table 3).

Table 2. Growth Rates of China, Japan and South Korea

(Unit: %)

	1970-79	1980-89	1990-99
China	5.6	10.0	10.2
Japan	4.6	3.9	1.0
South Korea	8.8	9.0	5.4
World	3.9	3.0	2.3

Source: Standard & Poor's DRI, *World Economic Outlook*, Third Quarter, 1999.

Table 3. Share of World Income

(Unit: %)

	1997	2000	2005	2006-20
China	3.2	3.6	4.4	5.8
Japan	14.3	12.7	11.8	10.9
South Korea	1.6	1.6	1.8	2.2
Total	19.1	17.9	18.0	20.9

Source: Standard & Poor's DRI, *World Economic Outlook*, Third Quarter, 1999.

Meanwhile, Japan and Korea are China's major trade partners. Table 4 summarises the trend of China's trade with Japan and Korea. China's trade with Japan, which had recorded US\$ 22.8 billion in 1991, increased rapidly since then and recorded US\$63.8 billion in 1997. Due to the Asian crisis in 1997, it declined in 1998 and recorded US\$57.8 billion. In 1998 the bilateral trade represented 8.7 per cent in Japan's trade and 18.0 per cent in China's trade. Chinese exports to Japan tripled between 1991 and 1997, while imports from Japan merely doubled for the same period. And thus China has enjoyed huge trade surpluses with Japan throughout the 1990s. China is the second largest exporter to Japan, next to the United States.

By comparison, China-South Korea trade, which was merely less than 20 per cent of China-Japan trade in 1991, ever since has shown a remarkable growth and recorded US\$ 23.6 billion in 1997, which was about 37 per cent of China-Japan trade. Because of the financial crisis in Korea, it declined for the first time in 1998 and recorded US\$ 18.4 billion. In 1998 China-Korea trade represented 6.5 per cent and 8.2 per cent of total trade

of China and South Korea, respectively. Contrary to China-Japan trade, China's trade with South Korea has recorded trade deficits since 1993. It goes without saying that Japan-South Korea trade has also been large. Thus the share of intra-regional trade among the three countries has consistently increased: from 12.4 per cent in 1990 to 18.7 per cent in 1997.

Table 4. China's Trade with Japan and Korea

(Unit: Billions of US\$)

Year	Total Trade with		Exports to		Imports from		Trade Balance	
	Japan	Korea	Japan	Korea	Japan	Korea	Japan	Korea
1991	22.8	4.4	14.2	3.4	8.6	1.0	5.6	2.4
1992	28.9	6.4	17.1	3.7	12.0	2.7	5.0	1.1
1993	37.8	9.1	20.6	3.9	17.3	5.2	3.3	-1.2
1994	46.3	11.7	27.6	5.5	18.7	6.2	8.9	-0.7
1995	57.9	16.5	35.9	7.4	21.9	9.1	14.0	-1.7
1996	62.4	19.9	40.5	8.5	21.9	11.4	18.7	-2.8
1997	63.8	23.6	42.0	10.1	21.8	13.6	20.3	-3.5
1998	57.8	18.4	37.1	6.5	20.7	11.9	16.4	-5.5

Source: Lee (1999).

China is also a destination for investment by Japanese and Korean firms in the 1990s (Table 5). Japan's FDI in China peaked in 1995, amounting US\$4,473 million, and cumulative Japanese investment in China exceeded that of the United States for the first time, making Japan the largest investor in China after Hong Kong and Taiwan. Since 1996, however, its FDI in China has declined sharply. The share of Japan's FDI in China (in Japan's overall overseas investment) has also decreased recently: from 8.8 per cent in 1995 to 2.6 per cent in 1998. Korea's FDI in China shows a similar path to that of Japan in 1990s. It had risen sharply by 1996 and thereafter has fallen due to the financial crisis in Korea. As a consequence, the share of Japanese and Korean investments in China's total FDI has shrunk from 12.3 per cent in 1996 to 8.4 per cent in 1998. Thus, Japan and Korea are not as important investing partners of China as its trade partners.

What would be the impact of concluding a PTA on these three countries? According to Cheong (1999), removal of all tariffs in these three countries increases the intra-regional trade by US\$ 107.3 billion in the first year (Table 6). Exports of China, Japan and South Korea to the other two countries increase by US\$24.0 billion, US\$60.6

billion and US\$22.7 billion respectively, while imports of China, Japan and South Korea increase by US\$74.5 billion, US\$19.6 billion and US\$13.2 billion respectively. Thus, the intra-regional trade balances of Korea and Japan are expected to improve, that of China is expected to deteriorate. China's trade balance will deteriorate by US\$ 32.8 billion with Japan and by US\$ 17.7 billion with Korea. (Table 7) Korea's trade balance with Japan will also deteriorate, while that with China will improve. Thus Japan is expected to get the largest benefit of forming a FTA, while China is expected to be in the least advantageous position.

Table 5. Foreign Direct Investment of Japan and South Korea in China

(Unit: Millions of US\$, %)

	1993	1994	1995	1996	1997	1998
Japanese Investment in China						
Amount	1,691	2,565	4,473	2,510	1,987	1,065
(Share of China's FDI)	(4.7)	(6.2)	(8.8)	(5.2)	(3.7)	(2.6)
Korean Investment						
Amount	264	632	822	824	628	630
(Share of China's FDI)	(20.9)	(27.5)	(26.8)	(19.5)	(19.5)	(16.2)

Source: Lee (1999).

Table 6. The Impact of Tariff Removal on Intra-Regional Export in Northeast Asia

(Unit: Billions of US\$)

Origin\Destination	China	Japan	South Korea	Total
China		+19.3	+4.7	+24.0
Japan	+52.1		+8.5	+60.6
Korea	+22.4	+0.3		+22.7
Total	+74.5	+19.6	+13.2	+107.3

Source: Cheong (1999).

Table 7. The Impact of Tariff Removal on Trade Balances in Northeast Asia

(Unit: Billions of US\$)

	China	Japan	South Korea	Total
China	-	-32.8	-17.7	-50.5
Japan	+32.8	-	+8.2	+41.0
Korea	+17.7	-8.2	-	+9.5

Source: Cheong (1999).

This raises some sceptical arguments against forming a FTA of complete elimination of tariffs. Thus Cheong (1999) suggests a 'asymmetric' trade liberalisation, which would allow China and Korea to have a longer implementation period for tariff reductions. On the other hand, Tanaka (1999) suggests, as a first step, an arrangement similar to the European Coal and Steel Community (ECSC), the forerunner organisation of the European Economic Community (EEC), could be set up. Also a possible scheme would be the linkage of trade liberalisation and investment, which would arrange for specific Japanese investments into those sectors in China (and in Korea in some cases) which would be most seriously affected by a worsening sectoral trade balance.

Lastly, it is to note that regional trade arrangements among the WTO members are nested (or subordinated) within the world trading system. Also, sub-regional trade arrangements at lower levels are nested within regional arrangements at higher levels. Thus the appropriate relationship of the different levels to each other as well as to the WTO is of importance. That is, whatever the form Northeast Asian Economic Cooperation may take, it must ensure that it complements and converges both with the WTO and APEC within which they are nested.

## **5. Concluding Remarks**

China's entry into the WTO is one of the most significant steps in the nation's 20 year old 'economic reform and open-door policy'. It will mark as a major success and challenge for Chinese reform, as it will be forced to open its domestic market to foreign products and companies on a scale unprecedented in 50 years of communist rule. China's WTO entry will fundamentally alter its economic relations with the rest of the world. China will have better access to the world market of goods and services; and the security of its access to foreign capital markets and foreign direct investment will be enhanced.

Joining the WTO will also ultimately have a huge effect in China on how business is done, how people work and how trade is conducted. Turning its state-owned factories and banks into market-based operations will cause huge unemployment at least in the short term, and possibly social unrest. But the only way to get to a successful economy for the long term is to work their way through these problems.

On the other hand China's WTO accession will help strengthen China's relations with its neighbours and will help stabilise the economic situation and the security relations in Northeast Asia and in Asia-Pacific region. APEC has played a constructive role in addressing China's integration into the world economy and hence China's entry

into the WTO. Along with the rules of the WTO, the harmonisation process of APEC will continuously help China's reform and its integration with the world economy.

Lastly, Northeast Asia, which has remained 'blank' without any institutionalised linkages to each other in the region, is now moving toward regionalism. Obviously, this poses another opportunity and challenge for China, and for the countries in the region.

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