

China's Economic Rise, the Regional Economy and Hong Kong's Place

(Main Points)

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I. Impact of China's Economic Rise

1. In today's world economy, the most striking story is China's economic rise. Based on its success of the policy of reform and opening o the outside world, Chinese economy has keeping for high growth for almost three decades. As a result China's share in world economy, both in trade and GDP term has been risen significantly, the third largest in both areas (foreign trade from 2005, GDP from 2007). In the Asia-Pacific region, the first country that changed the regional economic pattern after the Second World War is Japan, and the now it is China. Especially in the trade and FDI terms, China has changed the region more than Japan since China is more regional oriented.
2. What China has changed?
 - ※ The first change is the direction of FDI flow. China becomes the second largest country after the United States and the first largest in developing countries in absorbing FDI flow.
 - ※ The second change is the pattern of the regional trade. China replaces Japan to become the largest trade deficit of the US. China becomes the No.1, or No.2 market for most of its neighbors.
 - ※ China becomes a hub for regional industrial restructuring. The production network in the Asia-Pacific based on FDI flow has been

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developed quickly.

3. China-US economic relations become a key factor in the Asia-Pacific region. The two economies are highly interdependent in nature. The problem is that due to China's special place and role in the regional production network, the trade deficit of the US with China has been rising sharply. According the US statistics, the trade deficit with China accounts for 27.8% of the total, 5% more than in 2002, while according to China's statistics, 17.3%, 9% more than in 2002.² The trade dispute between the two countries are tensing, which may hurt the growth of the regional economy if it becomes worse. Because of its special nature, the simple restriction, anti-dumping action will not help to solve the problem since the imbalance comes both from US internal problem and the regional structure. China runs big trade deficit with its neighbors in Asia in balancing the surplus with US and EU.
4. The Asia-Pacific region has benefited from the trend of globalization and regionalization. The development of the regional production network relating to trade, investment, service has provided an important foundation to the growth of the regional economies. FDI flows to China and relating imports from China help the industrial restructuring of Japan and 'four dragons', which is a key factor to help Japan out of the stagnation. China becomes a principle market for US export, with higher export rate to China than to other economies. Actually, the current trade imbalance between China and the US reflects the reshaped structure of the economic relations between the US and East Asian economies. East Asia accounts for 84% of China's trade deficit in 2006. According to a study, even until 2020, China's trade balance will still rely on the large trade surplus with the US and trade deficit with NIEs in East Asia.³ In recent two years, China's exports to the US market have continued to increase although increasing restrictions

² Figure from US Census Bureau, Foreign Trade Statistics, China Ministry of Commerce, Statistics.

³ David Roland Holst, Iwan Aziz, Ligang Liu: Regionalism and globalism: East And Southeast Asian trade relations in wake of China's WTO accession, ADB Institute Research paper series, No.XX, 2003,p16, 19.

done by the US side and the fast appreciation of RMB. It seems that this trend will continue even China takes more actions to readjust its export policy (e.g. highly reducing export refund tax, trade promotion to other markets etc.) for some time since it is a problem of the region, rather than just of China. If Chinese economy goes slow down due to the hard policy of the US, the whole regional economy will be negatively affected.

5. However, China is facing serious pressure to restructure its economic growth model. China has followed the traditional path of industrialization by receiving the FDI inflow from the industrial and NIEs economies. On the one hand, China's problem is the result of the industrial accumulation, and on the other hand, due to its size and fast emerging, it accelerates the imbalance of the regional as well as the global economy. The growth of Chinese economy has facing three challenges:

- ※ From export led growth to domestic demand led growth. Due to the structure of the FDI led export;⁴

- ※ From tech-absorbing to tech-innovating-changing the structure of mass manufacturing to a more balanced economic structure;

- ※ From a polluted economy to a clean economy-developing energy saving, environment friendly economy;

- ※ From growth oriented to eco-social balanced development;⁵

To deal with the above challenges, China needs great effort and time, not just by itself, but also by the cooperation of the regional and world community.

II. Trend of Regional Cooperation

⁴ Although 80% of China's economic growth comes from domestic demand, export plays a dynamic role in keeping the economy on high speed. About 60% of China's export done by FDI, more than 1/2 of China's exports are processed products with low value added. This is one of the reasons why China has to import large amount of raw materials and energy.

⁵ The 17th Chinese Communist party congress emphasized to adopt a "new development model", differing from the past term of "new growth model" and to follow the people oriented development.

1. In the Asia-Pacific region, the economic integration, i.e. economic regionalization has developed mostly by the two forces: government trade and FDI friendly policy and active business activities. The regional cooperation partly as the internal demand, partly as a reflection to the movement in the other region, mainly in Europe, started only from the initiative of APEC in the Asia-Pacific region, NAFTA in North America, AFTA in Southeast Asia in early 1990s. In East Asia, the regional cooperation movement only started after 1997 for an immediate demand of dealing with the financial crisis. The progress of APEC seems not significant as it was expected, for example, it is considered that the Bogor goal seems no longer as a reliable target of APEC in facing a multi-layered FTAs in the region. The new FTAAP initiative by the US intends to change the nature of APEC and lead to a negotiated FTA. The wide suspicion on the feasibility of FTAAP exists among the members of the region since the great diversity and sub-region focused efforts make it less on the priority.
2. Economic cooperation in East Asia started with a structure of "10+3" dialogue and "10+1" FTAs. Based on the increasing shared interest in the region, East Asian regionalism emerges by calling on establishing East Asian community. East Asian economic integration has been based on the market force supported by the unilateral liberalization of the developing economies. East Asia regional based FTA movements encouraged by China-ASEAN FTA initiative that is called as a competitive process. Although several "10+1" FTAs have been concluded, it seems difficulty exists if the region turns to convergent FTA from the current multi-layered to an integrated framework. The Joint Expert Group on feasibility study on EAFTA concluded its report in 2006 by calling an early negotiation of EAFTA starting from "10+3" framework. But Japan proposed CEPEA starting from EAS for which the study group is conducting the feasibility study. By calling an EAS based CEPEA, it is considered that Japan intends

to break a China centered East Asia regionalism.⁶ It seems that in the mid-term future, there will two parallel movements: the unilateral and bilateral driven and the regional driven, the former stronger than the later. However, although the East Asian political convergence will be a complex process, the economic convergence will continue to be promoted.

3. The regional cooperation processes in the Asia-Pacific and the East Asia are not conflicted each other. There are many interactive arrangements among different initiatives. The US concern on East Asian initiative comes from politics, rather than the economics. The business concerns are real since the ‘noodle bow’ effects make the business transactions in the regional and global levels more complex and costly under the current multi-layered framework of FTAs. If the East Asian FTA or an Asia-Pacific FTA will not be possible in the short time, it is desirable to initiate the facilitation program, for example, an integrated ROO in the Asia-Pacific through APEC framework.

III. Hong Kong’s Place and Role

1. Hong Kong economy has experienced significant change and restructuring, especially in its relations to the Mainland China. There are at least four fundamental changes:

- ※ Hong Kong used to be the major FDI resource to Mainland, but now it no longer though it continues to play an important role;
- ※ Hong Kong used to be the major trade center for Mainland China’s export, but now it is no longer;
- ※ Hong Kong used to be the main financing center for the Mainland companies, it is now just one of the centers;
- ※ Hong Kong used to be an independent economy, but now it is highly

⁶ Shaun Breslin: Supplying demand or demand supply? A alternative look at the forces driving East Asia community building, Policy Analysis Brief, The Stanley Foundation, Nov. 2007.

integrated with the Mainland, especially with South China area under the framework of CEPA.

This does not mean that Hong Kong has lost its position and role in the regional economy. Hong Kong has its own competitive advantage in the regional economy. Hong Kong has recovered from the financial crisis and structural transformation.

2. Economic integration with the Mainland Chinese economy has provided a dynamic foundation for Hong Kong's economic growth since the Mainland has a great potential for future economic development. In this point, the future Hong Kong's economy will rely how to best use its special position with the Mainland. Hong Kong should make itself as the following three centers:

※ As a center supporting and financing the innovation through its efficient management and marketing. China determines to become an innovative country in the next 15-20 years with the aim of changing the current low value added manufacturing and assembling.

※ As a financial and service center for the regional economy, especially in the newly emerged Asian region. Hong Kong's position as a financial center will not be replaced by other centers. According to ADB recent survey, Hong Kong banks are the most efficient among 300 top Asian banks, with 5.5% assets of them, but 12.2% profit.⁷ With the further economic integration, Hong Kong can play a more active role in providing financing, management, research and logistics network to Asia and also to the Asia-Pacific region.

※ Hong Kong should be encouraged to engage in the regional cooperation and selectively participate the regional institutions, for example, the regional financial cooperation framework, like the Chang Mai Initiative, and ministers' meetings.

⁷ See China-ASEAN Exposition, October, 2007, p.82.