

# **THE EMERGENCE OF CHINA: IMPACTS ON THAILAND AND ASEAN AND THE ROLE OF JAPAN**

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This paper focuses upon the impacts of the emergence of China. Impacts on ASEAN as well as the competitive challenges and opportunities for Thailand are discussed. It is suggested that ASEAN needs to revitalize its competitiveness by pushing ahead with deeper integration to make ASEAN into an integrated trading and production region. This will enable ASEAN to increase competitiveness by exploiting its fairly large size. The role of Japan in this process is particularly important. The large Japanese production presence in ASEAN through past foreign direct investment makes it mutually beneficial that ASEAN regains its competitiveness and dynamism.

## **1. EMERGENCE OF CHINA AND IMPACTS ON ASEAN**

The integration of China into the world economy over the last decade or so has had a major impact on the economies in the region and also globally. This is to be expected given the size of China; with a population of about 1.3 billion and a workforce of about 700 million. Integrating an economy this size into the world economy is bound to affect the world trade and investment regimes. Since 1990, China's exports and imports have increased by more than five-fold. China's exports amounted to about US\$325 billion in 2002 or about 5.1% of world exports compared to only 1.8% in 1990 (Table 1).

**Table 1: China's Exports and Imports, 1990-2002**  
(Million US\$)

	<b>Exports</b>	<b>Imports</b>	<b>% Share in World Exports</b>
1990	62,091	53,345	1.80
1991	71,910	63,791	2.05
1992	84,940	80,585	2.26
1993	91,744	103,959	2.43
1994	121,006	115,615	2.80
1995	148,780	132,084	2.88
1996	151,048	138,833	2.80
1997	182,792	142,370	3.28
1998	183,712	140,237	3.35
1999	194,931	165,699	3.42
2000	249,203	225,094	3.88
2001	266,098	243,553	4.31
2002	325,565	295,203	5.07

Source: World Trade Organization.

If one compares ASEAN exports with China, it can be seen that ASEAN's exports have also increased substantially between 1990-2002, from about US\$144 billion to US\$401 billion (Table 2). However, the relative pattern of export increases over time between ASEAN and China is illuminating. Between 1990-96 (prior to the financial crisis), ASEAN exports increased by about US\$200 billion while China's exports increased by about US\$90 billion. So the increase in ASEAN exports was about double that of China during that period. Since 1996, however, China's exports have increased by much more than ASEAN's, increasing by about US\$ 175 billion between 1996-2002 compared to an increase of only about US\$ 60 billion for ASEAN exports during the same period. Also, if one ignores intra-ASEAN exports, then China's exports are now larger than ASEAN's exports in absolute value.

**Table 2: ASEAN Exports, 1990-2002**  
(Million US\$)

	<b>Exports</b>	<b>Share in World Exports</b>	<b>Extra-ASEAN Exports</b>
1990	144,149	4.18	
1991	165,184	4.70	
1992	186,345	4.95	
1993	212,327	5.62	167,845
1994	262,142	6.06	202,094
1995	321,408	6.23	249,153
1996	340,733	6.32	258,935
1997	353,037	6.33	267,459
1998	329,674	6.00	258,360
1999	359,229	6.30	281,037
2000	427,515	6.65	331,051
2001	381,611	6.18	296,309
2002	401,264	6.25	

Note: ASEAN data refer to ASEAN-10.

Source: World Trade Organization and ASEAN Secretariat.

These data show that ASEAN is now finding it more and more difficult to compete with China in the world market. Thus far, the impacts of China's greater competitiveness on ASEAN exports may not have been fully felt. This is because ASEAN exports have still been increasing, although at a much slower rate compared to before the crisis. However, one needs to take account of the fact that as a result of the crisis ASEAN currencies have weakened considerably against the Yuan which has been virtually pegged to the U.S. dollar. Using export shares of ASEAN member countries as weights, the weighted real exchange rate index of ASEAN currencies relative to the Yuan has depreciated by about 27% between 1996 and 2002. This has helped to keep ASEAN export growing. However, even with the depreciation, ASEAN is finding it difficult to compete with China. And with ASEAN currencies entering a more stable phase over the last year or so, it is unlikely that ASEAN can rely on this source of increased competitiveness to boost its exports relative to China in the future.<sup>1</sup>

Recent export data also raise many questions about the future trend of ASEAN exports. Table 3 shows recent export growth figures for a number of East Asian countries, including major ASEAN countries. It can be seen that many ASEAN countries are having difficulties with exports. Exports from Thailand and Singapore appear to be recovering well in 2003. However, those from Indonesia, Malaysia, and the Philippines are experiencing low or negative growth. This is a source of concern for these countries. The question of whether these figures reflect transitory problems for these countries, for example from the impact of SARS or terrorism, or whether they reflect a trend for the region as a whole is unclear at present.

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1 Of course, if China is somehow pressured to revalue the Yuan, then this could provide a few more years of breathing room for ASEAN exports. However, the combined current account surplus of ASEAN countries is much larger than China's (about US\$40 billion for ASEAN in 2002 compared to about US\$23.4 billion for China) so that there are also likely to be pressures on ASEAN countries to appreciate their currencies as well.

**Table 3: Recent Export Growth for East Asian Countries**  
(Based on US\$ Value)

	2003 Year-on-Year Growth		
	%		
	Q1	Q2	Q3
China	33.6	34.3	28.9
Hong Kong	-10.4	-11.6	-5.5
Indonesia	17.9	4.7	1.3
Japan	5.1	2.7	7.1
Malaysia	8.0	6.0	-3.1
Philippines	4.9	-0.5	-2.6
Singapore	26.4	11.9	12.0
South Korea	23.5	14.5	19.9
Thailand	21.3	16.8	11.0

Note: China Q3 includes only July and August; Hong Kong and Singapore includes re-exports; Japan growth based on yen value.  
Source: Official sources in the various countries.

The greater competitiveness of China is also reflected in the huge amount of foreign direct investment that flows into China each year, amounting to about US\$40 billion per year over the past 6-7 years (table 4). At the same time this table 4 also shows the alarming decline in net FDI coming into ASEAN over the past couple of years. These developments in trade and investment flows resulting from the emergence of China should be matters of great concern for ASEAN as a group.

**Table 4: Net Inflow of Foreign Direct Investment to ASEAN and China, 1990-2001**  
(US\$)

	ASEAN	China
1990	10,181	2,657
1991	12,718	3,453
1992	10,515	7,156
1993	12,102	23,115
1994	13,292	31,787
1995	17,879	33,849
1996	18,197	38,066
1997	18,215	41,674
1998	18,813	41,117
1999	15,588	36,978
2000	3,847	37,483
2001	2,452	37,357

Source: World Bank

## 2. CHINA'S IMPACTS ON THAILAND: COMPETITION AND OPPORTUNITIES

A study by the Thailand Development Research Institute<sup>2</sup> analyzed Thailand's changing trade

<sup>2</sup> Apichat Pongsirirushakun et. al. (2002): "Thailand's International Trade, Investment and Competitiveness." Paper presented at the 2002 Year-End Conference on Meeting the Challenges from Globalization, Thailand Development Research Institute, December (in Thai). The comparison between Thailand and China was reported in Chalongsob Sussangkarn (2003): "Thailand and the China-ASEAN FTA." *TDRI Quarterly Review*, Vol. 18, No. 1, March.

competitiveness and trade structure. This also gave insights into the relationships between Thailand and China's trade patterns and competitiveness. The similarities of trade patterns between Thailand and other countries were studied by computing the Spearman's rank correlation between the Revealed Comparative Advantages (RCA) ranking of various product groups.<sup>3</sup> The data used was from PC-TAS for the year 2000 and covered about 100 product groups according to the Harmonized System (HS) of trade classification.<sup>4</sup> The rank correlations with Thailand were calculated for about 35 countries, and the results are shown in Figure 1.

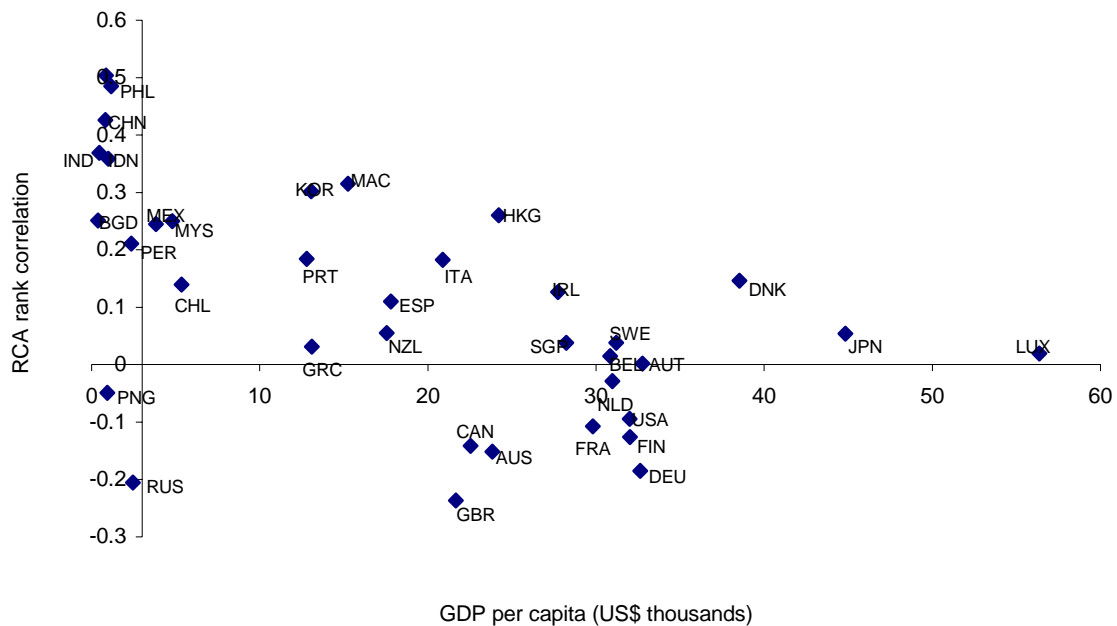
In Figure 1, the RCA rank coefficients are given along the vertical axis. The horizontal axis shows the per capita GDP of the various countries as an indicator of the relative cost of production. The vertical line toward the left of the figure indicates Thailand's level of per capita GDP. Countries with negative rank correlations or with a rank correlation not too far away from zero are those who do not compete directly with Thailand, and their demand structure may be complementary with the structure of Thailand's exports. Of such countries, those that have a higher per capita income compared to Thailand are good potential markets for Thai exports, as consumers in these countries will be relatively well off. In Figure 1, some of the more significant countries in this group include the United States, Canada, Australia, Germany, France, Japan, and Singapore, basically the developed economies.

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3 The Revealed Comparative Advantage RCA is computed as  $RCA = (XIK/\Sigma XK) / (XIW/\Sigma XW)$  where XIK is the value of sector I export of country K, and XIW is the total value of world export of product I.

4 PC-TAS is the Trade Analysis System for personal computers developed by the International Trade Center UNCTAD/WTO, the United Nations Statistic Division.

**Figure 1: Thailand's RCA Rank Correlation with various Countries**



Source: Computed from PC TAX. GDP percapita from World Bank.

Countries with fairly high (and positive) rank correlations have similar export structures to Thailand. These countries tend to be competitive with Thailand in export markets. Such countries that also have lower per capita GDP to Thailand are particularly strong competitors, as they are likely to have lower cost of production. These countries include the Philippines, China, Indonesia and India. Thus, China is certainly one country that is a strong competitor to Thailand given the similarities of trade structures and lower cost of production.

To look in more detail at the similarities of export structures between Thailand and China, the RCA rank correlations can be carried out within various product groupings. Table 5 shows the rank correlations of RCA's within various ISIC product categories, with the meanings of the ISIC codes shown in Table 6. Table 5 also shows the number of product items within each ISIC group and the value share of each group in Thailand's exports for 2000. The groups with relative high rank correlation coefficients and also significant shares in Thai exports include the following: ISIC1 (Agriculture, Hunting, Forestry and Fishing), ISIC31 (Manufacture of Food, Beverages and Tobacco), ISIC32 (Textile, Wearing Apparel and Leather Industries), and ISIC38 (Manufacture of Fabricated

Metal Products, Machinery and Equipment). These groups altogether account for about 75% of total Thai merchandise exports. Thus, the likely competition with China covers a very broad range of Thai exports.

**Table 5: Rank Correlation with China within Product Groups**

Product Group	Rank Correlation	No. of Product Items	Share in Thailand's Export (%)	Intra-Industry Trade Index (IIT)
ISIC1	0.32**	372	6.75	0.3
ISIC2	-0.02	112	1.45	0.6
ISIC31	0.43**	381	10.56	0.1
ISIC32	0.17**	863	10.48	0.9
ISIC33	0.65**	70	2.02	0.0
ISIC34	0.37**	151	1.26	0.1
ISIC35	-0.09**	1000	10.51	0.9
ISIC36	0.11	153	1.74	0.1
ISIC37	0.19**	358	2.19	0.2
ISIC38	0.33**	1317	46.91	18.9
ISIC39	0.18*	168	3.71	0.1

Note: \*\* denotes correlation is significant at the .01 level (2-tailed);\* denotes correlation is significant at the .05 level (2-tailed).

Source: Pongsirirushakun et. al., 2002. Calculated from data in PC-TAS, 2002.

**Table 6: International Standard Industrial Classification (ISIC Revision 2)**

1	Agriculture, Hunting, Forestry and Fishing
11	Agriculture and Hunting
12	Forestry and logging
13	Fishing
2	Mining and Quarrying
21	Coal Mining
22	Crude Petroleum and Natural Gas Production
23	Metal Ore Mining
29	Other Mining
3	Manufacturing
31	Manufacture of Food, Beverages and Tobacco
32	Textile, Wearing Apparel and Leather Industries
33	Manufacture of Wood and Wood Products, Including Furniture
34	Manufacture of Paper and Paper Products, Printing and Publishing
35	Manufacture of Chemicals and Chemical, Petroleum, Coal, Rubber and Plastic Products
36	Manufacture of Non-Metallic Mineral Products, except Products of Petroleum and Coal
37	Basic Metal Industries
38	Manufacture of Fabricated Metal Products, Machinery and Equipment
39	Other Manufacturing Industries

The above analysis shows that there are many similarities between the structure of Thai and Chinese exports. This suggests that the two countries are very competitive in the global export markets. An additional factor can be investigated further, and this is whether the two countries have a lot of mutual trade with each other in various product groups. Thus, while the export structures may be similar, if the two countries have a lot of intra-sector trading, then the similarity of export structures may indicate complementarities in trade as well as competitiveness. Thus, there could be a lot of intra-industry trading between the two countries. To check on this, one can look at the so-called Intra-

Industry Trade Index (IIT).<sup>5</sup> An IIT value close to 100 suggests a lot of intra-industry trading, and growth in one country's exports could lead to a lot of demand for the other country's exports; for example through demand for intermediate products.

The IIT values for various product groups between Thailand and China are given in the last column of Table 5. For most of the product groups, the IIT values between Thailand and China are fairly low, suggesting little complementarities between the export structures of the two countries. However, the IIT Index is reasonably high for the ISIC38 group (Manufacture of Fabricated Metal Products, Machinery and Equipment). As the products covered by this group are fairly diverse, there could be room for much bilateral trading of products in this group.

To be more specific about Thai products that are facing strong competition from China in various export markets, one can look at product groups in major Thai export markets where Thailand has recently suffered declines in market share and where China's market share has been increasing. The relevant product groups in the US, EU and Japanese markets are given in Table 7.

**Table 7: Sectors with Recent Declining Thai Shares and Increasing Chinese Shares by Market**

US Market	EU Market	Japanese Market
Shoes and Accessories	Garments	Animal Feed
Telecommunications Related	Textiles	Garments
Printed Circuits	Air Conditioners and Parts	Furniture
Electrical Appliances and Parts	Video and Audio Equipments	Plastic Products
	Television and Parts	Television and Parts
		Refrigerators and Parts

Source: From PC-TAS data, 2002.

As with the earlier analyses, Table 7 shows that the product groups that appear to be significantly affected by Chinese competition are very broad, ranging from food sectors to labor-intensive manufacturing to the more technologically intensive products. This suggests that China's range of competitive advantage over Thailand is rather broad, and the emergence of China into the world market has and will significantly affect Thailand.

Apart from the competitive impacts of China, however, there are also tremendous opportunities from China's economic emergence. First of all, the Chinese economy has been the fastest growing

5 The IIT Index is calculated as 
$$IIT = \left(1 - \left(\frac{|x_{ij} - m_{ij}|}{x_{ij} + m_{ij}}\right)\right) * 100$$
 where  $x_{ij}$  is the value of country  $i$ 's export of product  $j$  to the market under focus, and  $m_{ij}$  is the import value of in country of product  $j$  from the market under focus. See Felt and Pupphavesa (1995).



economy in the region for a number of years, and it is playing an increasingly significant role in absorbing some of the exports from ASEAN countries. While the average per capita income in China is still lower than all the original ASEAN-6 countries except for Indonesia, China's population is very large and its economy is diverse. The booming and well-off coastal areas in particular could be an important source of demand for relatively high quality products from ASEAN. Also, if China's economy continues to grow at 7-8% per year well into the future, the relative gap in per capita incomes between China and various ASEAN economies will likely narrow substantially.

Many goods and services produced by Thailand also have good potential in the Chinese market. High-end Thai rice already has an established market in China. Products in the ISIC38 group, where the IIT index is reasonably high should also benefit significantly from the high growth of China. For tourism, Chinese tourists are becoming more and more important to the Thai tourism industry, with about 800,000 arrivals in 2001 compared to about 450,000 arrivals in 1997. Thus, there are plenty of opportunities available.

In addition, some big Thai businesses should certainly benefit from the investment potential in China. Already Thailand has some big business groups that are major investors in China. In particular, the CP Group has been a major investor in China in many sectors, including chicken, animal feed, motorcycles, and wholesale and retail trades. Recently, the CP Group opened the largest shopping complex in China, the Super Brand Mall in Shanghai.

Recent trade data also show the growing importance of China for Thailand. Tables 8 and 9 show Thailand's exports and imports by country and region. Thai exports to China have been growing very rapidly. During the first 11 months of 2003, Thai exports to China grew by 61%. At the same time, exports to NAFTA, Thailand's largest export destination outside of ASEAN, hardly grew at all in 2003. This shows the tremendous opportunities of the Chinese market, and indicates that Thai exporters have been able to exploit these opportunities successfully. If this ability to exploit the Chinese market continues and China's economy continues to grow at close to the past high rates, then China will rapidly increase in importance as a destination for Thai exports.

**Table 8: Thai Exports by Destination , 2002 and 2003**

	2002				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jan-Nov
	<b>Million US\$</b>							
Total Exports	15,409	16,742	18,315	18,352	18,822	19,394	20,113	72,966
ASEAN	3,120	3,512	3,501	3,436	3,745	4,090	4,176	15,073
NAFTA	3,206	3,613	4,164	3,834	3,459	3,611	3,957	13,732
Japan	2,302	2,429	2,546	2,671	2,769	2,725	2,834	10,375
EU	2,386	2,480	2,597	2,754	2,952	2,792	2,840	10,697
Other E. Asia	1,583	1,756	1,828	1,889	1,987	2,068	2,007	7,600
China	703	753	929	1,170	1,326	1,314	1,382	5,100
Middle East	584	630	650	619	635	707	737	2,648
Australia	343	370	469	461	452	543	573	1,994
Others	1,182	1,199	1,631	1,518	1,497	1,544	1,607	5,747
	<b>Year-on-Year % Growth</b>							
Total Exports	-7.0	3.2	10.6	14.4	22.1	15.8	9.8	15.5
ASEAN	0.4	8.8	8.0	11.9	20.0	16.5	19.3	20.5
NAFTA	-9.2	3.3	6.6	7.7	7.9	-0.1	-5.0	0.3
Japan	-14.9	-1.2	4.5	11.0	20.3	12.2	11.3	13.4
EU	-17.4	-6.3	3.6	9.5	23.7	12.6	9.4	14.5
Other E. Asia	-2.0	7.4	13.9	16.8	25.5	17.8	9.8	18.2
China	3.7	9.8	24.4	53.5	88.6	74.5	48.8	61.0
Middle East	5.2	12.5	19.7	16.4	8.7	12.2	13.4	15.1
Australia	14.3	23.3	19.9	24.6	31.8	46.8	22.2	32.7
Others	-0.5	-0.4	37.9	26.2	26.6	28.8	-1.5	12.8

Source: Bank of Thailand.

**Table 9: Thai Imports by Origin, 2002 and 2003**

	2002				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Jan-Nov
	<b>Million US\$</b>							
Total Exports	14,628	15,763	17,151	16,714	17,416	17,591	19,096	67,691
ASEAN	2,458	2,677	2,913	2,770	2,757	2,737	3,463	11,337
NAFTA	1,738	1,645	1,649	1,648	1,872	1,719	1,701	6,738
Japan	3,085	3,558	4,118	4,043	4,072	4,313	4,638	16,331
EU	1,628	1,719	1,935	1,757	1,723	1,910	1,872	6,750
Other E.Asia	1,555	1,562	1,614	1,567	1,612	1,647	1,843	6,438
China	1,121	1,184	1,217	1,377	1,312	1,508	1,501	5,446
Middle East	1,232	1,463	1,463	1,514	2,076	1,571	1,812	6,699
Australia	349	312	423	410	334	373	416	1,453
Others	1,462	1,643	1,819	1,628	1,658	1,813	1,850	6,499
	<b>Year-on-Year % Growth</b>							
Total Exports	-11.5	4.5	9.6	14.6	19.1	11.6	11.3	14.4
ASEAN	-12.0	15.9	14.3	17.2	12.2	2.2	18.9	13.2
NAFTA	-27.1	-8.3	-11.5	3.5	7.7	4.5	3.2	10.0
Japan	-16.4	5.2	24.6	16.9	32.0	21.2	12.6	20.5
EU	-20.1	-8.7	4.9	-2.9	5.8	11.1	-3.3	3.8
Other E.Asia	11.7	13.1	18.2	16.5	3.7	5.4	14.2	10.6
China	33.5	30.5	28.5	37.0	17.0	27.4	23.3	22.2
Middle East	-20.9	-11.4	-10.8	35.9	68.5	7.4	23.9	26.7
Australia	15.2	-8.5	-3.0	39.0	-4.3	19.6	-1.7	6.8
Others	-4.3	16.4	6.5	3.4	13.4	10.3	1.7	7.2

Source: Bank of Thailand.

On the reverse side, Thai imports from China have also been growing at very high rates over the past couple of years or so. The rate of growth during the first 11 months of 2003 was about 22%. This

was much lower than the rate of growth of Thai exports to China during the same period. However, as was indicated earlier, the full impact of China's emergence on the growth of Chinese imports into Thailand (and ASEAN) may not yet be so evident at this time. In any case, the total value of Thai imports from China is still slightly larger than the total value of Thai exports to China at present.

### 3. THE CHINA-ASEAN FTA

The "Framework Agreement on Comprehensive Economic Cooperation between the Association of Southeast Asian Nations and the People's Republic of China" was signed on November 4, 2002 in Phnom Penh. This was only just slightly more than one year after the idea was introduced by China, and may appear rather surprising given the high competitiveness of the Chinese economy in a broad range of product groups. Clearly the high growth of the Chinese economy and the tremendous trade and investment opportunities in China, as earlier indicated, are important factors that led ASEAN leaders to quickly take up the idea of the China-ASEAN FTA. However, other aspects of the China-ASEAN FTA are also attractive to ASEAN.

The inclusion of the "Early Harvest Programme" in the China-ASEAN FTA appears very attractive to ASEAN. Many ASEAN economies have comparative advantages in some food and agriculture sectors included as part of the programme (table 10), and these economies (including Thailand) are therefore attracted to the benefits they could be gained in the relatively short-term. Some of the sectors are also complementary between tropical ASEAN and the more moderate climate China, such as fruits and vegetables.

**Table 10. Sectors in Early Harvest Programme**

HS Chapter	Description
01	Live Animals
02	Meat and Edible Meat Offals
03	Fish
04	Diary Produce
05	Other Animal Products
06	Live Trees
07	Edible Vegetables
08	Edible Fruits and Nuts

Source: China-ASEAN Framework Agreement.

By introducing the Early Harvest Programme, China also basically makes its economic cooperation framework proposal stand out from what could be matched by Japan (or South Korea), and in some sense took the leadership role away from Japan in the area of regional economic

cooperation. While Japan has concluded an Economic Agreement for a New Age Partnership with Singapore, the fact that Singapore has a negligible agricultural sector was critical to its ability to conclude the agreement. It is highly unlikely that Japan can offer anything similar to ASEAN countries, so the Chinese agreement will stand out from anything that may develop later between ASEAN and Japan or other countries in the region. So an important part of the reason for the FTA initiative from China is also to promote its own leadership role in the region.

Another important factor about the China-ASEAN FTA is that it should not be viewed purely from the perspective of the economic benefits that may result from the agreement, but also from geopolitical power play perspectives, in particular between China and Japan and even between China and the United States. The China-ASEAN agreement is attractive for ASEAN, as it provides an impetus for other major economic powers to attach more importance to developing further economic cooperation with ASEAN.

Japan had to respond quickly to the China-ASEAN initiative, and surely enough a “Joint Declaration of the Leaders of ASEAN and Japan on the Comprehensive Economic Partnership” was announced on 5 November 2002, in Phnom Penh just one day after the signing of the China-ASEAN economic cooperation framework agreement. Subsequently, the “Framework For Comprehensive Economic Partnership Between the Association of Southeast Asian Nations and Japan” (AJCEP) was agreed on 8 October 2003 in Bali on the sideline of the 9<sup>th</sup> ASEAN Summit. It seems clear that if the China-ASEAN FTA was not on the table, then it is unlikely that Japan would have moved as quickly to develop a framework for economic partnerships with ASEAN.

Apart from Japan, even the United States took notice of China’s initiative, and also introduced an Enterprise for ASEAN Initiative (EAI) that opened the window for possible bilateral FTAs between the United States and members of ASEAN along the lines of the Singapore-US FTA. The United States and Thailand have already announced their intention to begin a process that should lead to an FTA negotiation between the two countries starting in 2004. The China-ASEAN economic cooperation initiative therefore has implications beyond the direct impacts of the agreement because it became an impetus for other economic powers to take more seriously the development of concrete steps toward greater economic cooperation with ASEAN. This is of great indirect benefit to ASEAN.

For ASEAN, it appears to be of much greater benefit to develop an FTA with an economy that is at a more advanced stage of development compared to ASEAN than with a country that is still at a lower level of development on average compared to ASEAN. Because of geo-political considerations, while the agreement with China may be risky in competitive terms, if it can bring about indirect benefits through FTAs with countries such as Japan and the United States, the net benefits are likely to be significantly positive.

The China-ASEAN framework agreement has the goal to achieve zero tariffs for all products in the “normal” track, by 2010 between China and ASEAN-6, and by 2015 between China and the newer ASEAN member countries. Some products could also be put into the so-called “sensitive” track, and the parties will have to negotiate specific agreements for these products. At this point, it is hard to say whether the negotiations under this framework agreement will proceed smoothly. The experience within ASEAN in trying to establish AFTA shows that countries could try to exclude many sensitive sectors from the agreement, or delay the reduction of tariffs or non-tariff barriers on these sensitive sectors. The situation in the negotiations with China may develop in a similar fashion, especially since China is already highly competitive in many sectors even without a free trade agreement, and this will become clearer and clearer over the next few years or so.

#### **4. REVITALIZING ASEAN COMPETITIVENESS THROUGH DEEPER INTEGRATION**

While ASEAN countries can benefit substantially from the opportunities in China, the emergence of China and its impacts on world trade and investment flows should nevertheless be matters of great concern to ASEAN. To fully benefit from the China-ASEAN FTA as well as other regional FTAs (such as with Japan.) that may develop in the future, it is essential for ASEAN to revitalize its competitiveness. As was seen in section 1, ASEAN is no longer very dynamic, whether in terms of exports or direct investment, especially in comparison with China.

To become more competitive ASEAN countries will need to carry out domestic “upgrading” policies in many areas, particularly in technological upgrading and skill formation.<sup>6</sup> However, the

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<sup>6</sup> A recent study by ASEAN and Japan think tanks addressed many of the upgrading issues in the specific ASEAN countries. See Ippei Yamazawa and Daisuke Kiratsuka (eds.), *ASEAN-Japan Competitive Strategy*. Institute of Developing Economies, Japan External Trade Organization, 2003.

message from China's emergence is clear and strong; it is that size does matter, and that ASEAN will need to integrate a lot more and a lot quicker to reduce the costs of doing business in ASEAN, to make the region more competitive and more attractive for foreign investment. Unless ASEAN takes the challenges of China seriously and pushes ahead quickly with much deeper economic integration, there is a danger that each of the ASEAN economies will become marginalized. This would be a great pity, since ASEAN as a group is certainly not small. With a population of about 530 million and total GDP (current US\$) of about US\$560 billion, the region is about half the size of China and should be able to compete equally with China, whether in terms of exports or the ability to attract foreign direct investment.

ASEAN leaders are now paying more attention to the need for further integration of ASEAN beyond AFTA, eventually to some form of ASEAN Economic Community.<sup>7</sup> At the 8<sup>th</sup> Summit in Phnom Penh in November 2002, the "Leaders considered the idea of an ASEAN Economic Community as an end goal for the Roadmap for the Integration of ASEAN and Vision 2020 which ministers could study."<sup>8</sup> This was recently reaffirmed in the so-called "Declaration of ASEAN Concord II (Bali Concord II)" at the 9<sup>th</sup> Summit in Bali in October 2003. The year 2020 is, however, very far away, and unless ASEAN moves more quickly to integrate, it may lose so much competitiveness in the meantime that revitalizing ASEAN economies becomes almost impossible. Singapore and Thailand have tried to push for an earlier timetable for the formation of the ASEAN Economic Community. However, other member countries were not so enthusiastic and the latest declaration still sticks to the 2020 timetable. This suggests that continual additional efforts will be needed to push ASEAN economies more quickly along the path of integration.

Prior to the 1997 crisis, most ASEAN economies were doing well, growing at more than 5% per annum (except the Philippines), so the need for serious attention on further regional integration beyond the implementation of AFTA was not that strong.. With the crisis, the region was faced with

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7 There have been numerous suggestions in the past for further ASEAN economic integration beyond AFTA to make the region more competitive and attractive as an investment destination. Documents such as the Vision 2020, the Hanoi Plan of Action, and the report of the ASEAN Eminent Persons Group on Vision 2020 all contain elements that will move ASEAN forward along the path of deeper economic integration consistent with establishing some form of Economic Community for the region in the future.

8 Press statement by the Chairman of the 8th ASEAN summit, the 6th ASEAN+3 summit and the ASEAN-China summit. Phnom Penh, Cambodia, 4 November, 2002.

urgent problems that each country had to tackle. The crisis also substituted the necessity for deeper integration to increase ASEAN's competitiveness by the general depreciation of the regional currencies. However, competitive advantages from this source are now likely to be over, and with the emergence of China, ASEAN has seen its competitiveness and attractiveness as an investment destination dwindle. It is therefore appropriate for ASEAN to pay more attention to going beyond AFTA and push ahead with deeper regional integration at this time, particularly also given that tariff reductions under AFTA for the vast majority of items have already been carried out. This will make ASEAN a more integrated trading and production region and should increase competitiveness and attractiveness for investment.

In moving toward something like an ASEAN Economic Community, strong push factors will be needed. This is because there will also be resistance from those sectors and parties that prefer the status quo. Also, the benefits of deeper integration may not be so clearly perceived, as those who might emerge as real winners as a result of the integration are not so evident at the current time. In the case of Europe, conflicts between sovereign nations that led to the destruction of the two world wars provided important push factors that led to the Schuman Plan and the establishment of the European Coal and Steel Community that took away member states' sovereign roles in these sectors.<sup>9</sup>

In ASEAN, there is no comparable history that could push ASEAN integration along the same path as in Europe. However, there are other push factors that could provide the impetus for ASEAN countries to move more seriously toward deeper integration. The emergence of China is clearly one very important push factor. The development of various regional trade agreements is also important.<sup>10</sup> The role of Japan should also be highlighted. This is discussed in the next section.

## 5. THE ROLE OF JAPAN IN REVITALIZING ASEAN

The role of Japan in revitalizing ASEAN is particularly important. This is because there are very strong economic ties between Japan and ASEAN for many decades. Even though ASEAN's and Japan's economic links to other countries and regions, particularly to China, have increased

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9 See Richard Baldwin and Charles Wyplosz, *The Economics of European Integration*. Chapter 1. Forthcoming. Available on line at [http://heiwww.unige.ch/~baldwin/papers/BW/BW\\_May03.htm](http://heiwww.unige.ch/~baldwin/papers/BW/BW_May03.htm).

10 See Chalongphob Sussangkarn, Foundation and Prospects of the ASEAN Economic Community's Establishment. *TDR Quarterly Review*, Vol. 18, No. 3, September 2003.

significantly over the past ten years or so, the links between ASEAN and Japan are still very strong. This is the case whether one looks at trade, investment, or the presence of expatriate Japanese.

Table 11 gives data on ASEAN exports and imports by region.<sup>11</sup> For ASEAN, the most important source of trade is intra-ASEAN trade. This is true for both exports and imports. In 2001, the most important export destinations outside ASEAN were the US, the EU, Japan, and China in that order. Since the crisis in 1997, the share of exports going to the US has declined. The shares going to Japan and the EU have increased slightly. Exports to China have increased extremely rapidly over the past five years or so; the share of exports going to China jumped from 2.8% in 1997 to 8.5% in 2001. The increase has continued in the more recent period, such as in the case of Thailand previously discussed in section 2.

**Table 11: ASEAN Exports and Imports by Region**

	Exports			Imports		
	1993	1997	2001	1993	1997	2001
	<b>Amount (Million US\$)</b>					
World	206,637	342,670	366,835	223,311	355,972	312,912
ASEAN	43,681	85,352	83,464	38,763	64,621	65,229
Japan	30,952	42,009	48,214	55,703	71,264	52,929
China	5,071	9,656	31,234	4,336	13,483	23,234
S.Korea	6,126	10,668	14,711	7,148	14,857	13,057
ASEAN+3	85,830	147,684	177,622	105,951	164,226	154,450
USA	42,008	70,030	61,672	33,713	61,695	45,566
EU	31,392	46,087	56,139	31,822	51,010	39,558
	<b>Share (%)</b>					
World	100.0	100.0	100.0	100.0	100.0	100.0
ASEAN	21.1	24.9	22.8	17.4	18.2	20.8
Japan	15.0	12.3	13.1	24.9	20.0	16.9
China	2.5	2.8	8.5	1.9	3.8	7.4
S.Korea	3.0	3.1	4.0	3.2	4.2	4.2
ASEAN+3	41.5	43.1	48.4	47.4	46.1	49.4
USA	20.3	20.4	16.8	15.1	17.3	14.6
EU	15.2	13.4	15.3	14.3	14.3	12.6

Note: Data for ASEAN only includes original ASEAN-6 countries.

Source: ASEAN Secretariat.

For imports from outside ASEAN, Japan is the most important supplier for ASEAN, with a share of about 17%. Japan is followed by the US, the EU and China, in that order. The share of imports from Japan has been steadily falling since the early 1990s. The shares from the US and the EU

<sup>11</sup> ASEAN data in this table only include the original ASEAN6 countries (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand).



increased slightly between 1993 and 1997, and then fell between 1997 and 2001. As with exports, China's share in ASEAN imports has increased very rapidly, from 1.9% in 1993 to 3.8% in 1997 to 7.4% in 2001. The increasing trend has continued beyond 2001. Thai imports from China increased by about 32% in 2002 and by about 22% year-on-year during the first 11 months of 2003.

From these trade data, it can be seen that, in spite of the increasing importance of trade with China, total trade between ASEAN and Japan is still about twice as large as that between ASEAN and China. Thus, Japan is still very important for ASEAN.

From Japan's perspective, ASEAN is also an important trading partner. Table 12 gives the data on Japan's exports and imports by region. In terms of Japanese exports, the US market is the most important, with a share of about 28% in 2002. This is followed by the EU with about a 15% share. ASEAN is next with a share of about 10%, closely followed by China with a share of about 9.5%. China's share of Japan's exports has been increasing rapidly, however, so that China will overtake ASEAN as a destination for Japan's exports in the very near future. ASEAN's share was increasing quite quickly between 1990 and 1995, from 11.5% to 17.3%, but the share has declined as a result of the 1997 economic crisis which substantially reduced ASEAN's purchasing power.

**Table 12: Japan Exports and Imports by Region, 1985-2002**

	Exports					Imports				
	1985	1990	1995	2000	2002	1985	1990	1995	2000	2002
	Amount (billion yen)									
World	41,956	41,457	41,531	51,654	52,109	31,085	33,855	31,549	40,938	42,228
USA	15,583	13,057	11,333	15,356	14,873	6,213	7,586	7,076	7,779	7,237
EU	5,435	8,396	6,581	8,432	7,663	2,422	5,416	4,575	5,043	5,482
ASEAN6	2,701	4,754	7,195	5,643	5,300	4,847	4,208	4,374	6,119	6,125
China	2,991	884	2,062	3,274	4,980	1,552	1,730	3,381	5,941	7,728
	Share (%)									
World	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
USA	37.1	31.5	27.3	29.7	28.5	20.0	22.4	22.4	19.0	17.1
EU	13.0	20.3	15.8	16.3	14.7	7.8	16.0	14.5	12.3	13.0
ASEAN6	6.4	11.5	17.3	10.9	10.2	15.6	12.4	13.9	14.9	14.5
China	7.1	2.1	5.0	6.3	9.6	5.0	5.1	10.7	14.5	18.3

Source: Statistical Bureau, Ministry of Public Management, Home Affairs, Post and Telecommunications, Japan

As a source of imports into Japan, China ranks top, with a share of about 18%. The US is next with a share of about 17%, followed by ASEAN with a 14.5% share and the EU with a 13% share. China's share has also been increasing very rapidly, with the share increasing by almost four percentage points between 2000 and 2002, so China will very quickly become the most dominant

source of Japan's imports. However, ASEAN is still an important trading partner for Japan, with a share in total two-way trade of about 12%.

Apart from trade relations, Japanese investment has been very important for ASEAN's economic development. The Plaza Accord in 1985 led to a rapid appreciation of the yen with respect to the US dollar and this led to a large outflow of Japanese investment to ASEAN to take advantage of the lower production costs in the region. The inflow of Japanese investment into ASEAN was important in bringing about rapid industrialization and rapid growth in the recipient ASEAN economies. In Thailand, this significantly contributed to the acceleration in manufactured exports and economic growth starting about 1986.

The flows of foreign direct investment (FDI) from Japan to ASEAN countries and to China are shown in Table 13. In general, Japanese FDI flows into ASEAN countries have been larger than the flows into China. However, the figures for the flows to ASEAN after the crisis could be somewhat misleading. Some of these were due to a conversion of debt into equity, so there was really no new investment involved. In any case, one can see that the inflows into ASEAN have been declining after the crisis. The inflow into China is also on an increasing trend, and data for 2003 and beyond should indicate this more clearly.

**Table 13: Outward FDI from Japan by Destination, 1989-2002**

(Billion Yen)

	<b>Indonesia</b>	<b>Malaysia</b>	<b>Philippines</b>	<b>Singapore</b>	<b>Thailand</b>	<b>ASEAN 5</b>	<b>China</b>	<b>World</b>
1989	84.0	90.2	26.9	257.3	170.3	628.8	58.7	9,033.9
1990	161.5	106.7	38.3	123.2	169.6	599.2	51.1	8,352.7
1991	162.8	120.2	27.7	83.7	110.7	505.2	78.7	5,686.2
1992	214.2	91.9	21.0	87.5	84.9	499.4	138.1	4,431.3
1993	95.2	89.2	23.6	73.5	68.0	349.5	195.4	4,151.4
1994	180.8	77.2	68.3	110.1	74.9	511.3	268.3	4,280.8
1995	154.8	55.5	69.2	114.3	119.6	513.3	431.9	4,956.8
1996	272.0	64.4	63.0	125.6	158.1	683.0	282.8	5,409.5
1997	308.5	97.1	64.2	223.8	229.1	922.8	243.8	6,623.6
1998	139.8	66.8	48.8	83.2	176.0	514.5	137.7	5,241.3
1999	102.4	58.8	68.9	110.2	92.4	432.7	84.9	7,470.3
2000	46.4	25.6	51.4	50.5	103.0	276.9	111.2	5,385.4
2001	62.2	32.0	95.1	143.3	110.5	443.1	180.8	3,992.2
2002	50.9	9.8	50.0	91.5	61.4	263.6	215.2	4,417.5
Sum	2,035.6	985.2	716.5	1,677.6	1,728.4	7,143.3	2,478.6	79,432.8

Source: Ministry of Finance, Japan

Although Japanese FDI inflows into ASEAN may have declined compared to before the crisis, the stock of Japanese investment in the ASEAN countries is still fairly large, and still much larger than

the stock of Japanese investment in China. Table 14 gives the data on Japan's FDI assets for 1996 and 2002. For ASEAN<sup>12</sup>, this amounted to about ¥3.5 trillion in 2002. This was about 2.4 times larger than the stock of Japan's investment assets in China. These figures could also underestimate the actual stock of Japanese productive assets in ASEAN as the valuation depends to some extent on the local currency exchange rates in the various countries, and ASEAN exchange rates have depreciated substantially. This is probably why Table 14 shows a substantial decline in the direct investment assets in ASEAN after the crisis.

**Table 14: Japan's Direct Investment Asset, 1996 and 2002**  
(Billion Yen)

	1996	2002
ASEAN 5	6,143	3,487
Indonesia	1,994	667
Malaysia	667	470
Philippines	332	355
Singapore	1,323	1,245
Thailand	1,827	750
China	939	1,481
World	29,999	36,478

Source: Ministry of Finance, Japan

The extent of Japanese businesses abroad is also reflected by the presence of Japanese nationals overseas. Table 15 shows that there are still a significant number of Japanese who are long-term and permanent residents in the ASEAN countries (about 80,000 persons). The number of such Japanese is still greater than that in China (about 53,400 persons).

**Table 15: Number of Japanese Nationals Overseas, 1981 and 2001**

	1981	2001
ASEAN 5	30,542	79,949
Indonesia	6,792	12,254
Malaysia	3,539	11,653
Philippines	4,365	10,137
Singapore	9,078	23,174
Thailand	6,768	22,731
China	6,601	53,357
World	445,372*	837,744

Note: Sum of long-term residents (more than 3 months) and permanent residents. \* denotes data for 198.

Source: Population Statistics of Japan 2003, compiled by National Institute of Population and Social Security Research, Tokyo, Japan.

All of the data referred to above show that the economic relationships between ASEAN and Japan are still very strong. This means that it is in the common interest of both Japan and ASEAN for

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<sup>12</sup> ASEAN-5 refers to ASEAN6 excluding Brunei.

each party to recover from the economic difficulties that each has been through: for Japan to recover from its decade long stagnation; and for ASEAN to fully recover from the economic crisis and regain its competitive edge that was a key factor behind the so-called “East Asian Economic Miracle.”<sup>13</sup> Without a vibrant ASEAN, Japanese investments and business networks in ASEAN that have been built up over the last couple of decades would decline substantially in value.

While the agreement between ASEAN and Japan to initiate negotiations for the AJCEP has taken much longer to realize than the framework for the China-ASEAN FTA, the AJCEP should be more significant in bringing about a more integrated ASEAN that could lay the foundation for a revitalization of ASEAN’s competitiveness. The AJCEP is a broad framework covering liberalization, facilitation, and co-operation activities, along a similar line to the previously concluded Japan-Singapore Agreement for a New-Age Economic Partnership. Facilitation and cooperation will cover a number of areas, such as trade related procedures, business environment, intellectual property rights, and other areas including human resources development, energy, transportation and SME. Liberalization will include trade in goods, trade in services and investment. Consultations in these areas to develop implementation programs will begin in 2004.

An important difference between the China-ASEAN FTA and the AJCEP is that Japan has a very large production presence in ASEAN while China does not. So, implicit behind the AJCEP is the need for further ASEAN integration to become an integrated trading and production region.<sup>14</sup> The various facilitation and cooperation areas in the framework agreement, as well as liberalization measures, can help to accelerate the ASEAN integration process. This is particularly important from the Japanese perspective. Because Japan has a large production base in ASEAN, it is important for Japanese companies to maximize the effectiveness of these investment, particularly given the challenges posed by the emergence of China. This involves exploiting scale economies by changing investment and production strategies from mainly country-based as in the past to regional-based strategies. This will only be effective if ASEAN can push ahead and integrate further to something like an ASEAN Economic Community.

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13 World Bank (1993): *The East Asian Miracle: Economic Growth and Public Policy*. Oxford University Press, New York.

14 With some special and differential treatments for the newer ASEAN member countries.

While most intra-ASEAN trades now face 0-5% tariff (in ASEAN6), there are important sensitive products that various countries are still protecting. In the case of automobiles, for example, because Malaysia is delaying its tariff reductions, in reciprocal fashion Thailand's tariffs on automobile related products from Malaysia remain high. Automobile parts shipped from Malaysia to Thailand still face a tariff of between 30-42%. This causes a lot of problems for some Japanese producers who have plants producing automobile parts in Malaysia and want to transport them to Thailand for final assembly. Apart from inefficiencies arising from various sensitive products, there are also many other implicit barriers that add to the cost of sourcing for parts and supplies among ASEAN countries, such as customs, standards and other trade facilitation related measures.

A recent joint report on the AJCEP by 10 research institutes in ASEAN and IDE/JETRO from Japan<sup>15</sup> recommended a number of tasks to be pursued in achieving the AJCEP. These also include the need to complete the single ASEAN market, further structural reforms in ASEAN economies emphasizing competitiveness-enhancing policies, and reductions in barriers to trade, services, and investments. The goal for ASEAN should be to make the region as integrated and competitive as possible. This is also a common goal for Japan, particularly from the perspective of Japanese multinational companies that have significant presence in ASEAN. These companies are certainly influential with ASEAN governments. So they should play some significant role in persuading ASEAN governments to move ahead more quickly with ASEAN integration. With such integration, ASEAN will be able to take full advantage of the current situation where ASEAN seems to be a hub of interest for FTA agreements by key countries.

A successful outcome of the AJCEP will require adjustments on both sides. For ASEAN countries, domestic adjustments to increase efficiency and competitiveness will be required. Countries will also need to make domestic adjustments to achieve deeper ASEAN economic integration. Countries need to give a bigger weight to a regional perspective on ASEAN development rather

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15 See "Joint Study Report: ASEAN-Japan Comprehensive Economic Partnership: Vision and Task Ahead" in Ippei Yamazawa and Daisuke Hiratsuka (eds.): *Toward ASEAN-Japan Comprehensive Economic Partnership*. Institute of Developing Economies, Japan External Trade Organization, 2003. For some quantitative assessments of the impacts of an FTA between Japan and ASEAN using a CGE model, see Kazuhiko Oyamada: "What Effect will Trade Liberalization between Japan and ASEAN Members Have over Time?" in the volume referred to above.

retaining mainly a domestic, national perspective. For Japan, agriculture has always been a difficult issue. However, the sector should be examined in detail on a commodity by commodity basis. A study comparing the agricultural composition of ASEAN and Japan found that in general the agricultural structures of ASEAN and Japan are not so competitive with each other.<sup>16</sup> The AJCEP is likely to lead to increases in exports of agricultural products from both sides. Of course, some products are particularly sensitive for Japan, and negotiations and domestic adjustments to deal with these areas will be necessary.

In spite of these adjustment problems, it is very important that both sides try seriously to find an acceptable agreement to push ahead with the AJCEP. The agreement should serve to further deepen ASEAN-Japan economic relations and could significantly contribute to the revitalization of ASEAN competitiveness. This is crucial for exploiting the full economic potential of ASEAN and also for increasing the value of the already substantial Japanese presence in ASEAN.

For ASEAN, it is critical to be able to retain the foreign partners and investors that have helped to develop the region over the past couple of decades. In the case of Thailand, the country has relied on partnerships with all countries to attract FDI and develop the domestic industrial capabilities. Thailand's partnership with Japan in particular has been very close, and Japanese investment in numerous sectors in Thailand, and Japan's assistance throughout the period of the financial crisis, have been highly appreciated in Thailand.

The need for ASEAN countries to deepen their economic integration is also driven by the movement in East Asia toward greater regional economic and financial cooperation. As a group of 10 countries in an East Asian region, ASEAN is dominated economically, technologically and in terms of size by Japan and China. Only by integrating more closely to become a single trading and production region will ASEAN have sufficient clout to take full advantage of East Asian integration.

## 6. CONCLUSIONS

The emergence of China has been very significant for the world economic system in general and for ASEAN and East Asia in particular. While there are many economic opportunities for ASEAN from

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16 See Nipon Poapongsakorn: "Agriculture: A Viewpoint from ASEAN", in Yamazawa and Hiratsuka (eds.): *Toward ASEAN-Japan Comprehensive Economic Partnership*. Op. Cit.

the emergence of China into a major economic force, the competitive challenges from China are also very real. To revitalize its competitiveness, ASEAN needs to integrate much more deeply to develop the region into a single trading and production region. To achieve this, the role of Japan is particularly important. Japan has a very large economic presence in ASEAN, particularly in production assets. A more competitive ASEAN would enhance not only each ASEAN country's economic potential, but also the value of the large Japanese production assets within ASEAN. Given the importance of Japan to ASEAN, particularly the influence that large Japanese multi-national companies have with ASEAN governments, Japan can provide a crucial impetus for ASEAN countries to overcome domestic resistance and move more quickly toward a fully integrated economic region.