DEVELOPMENT AND RESTRUCTURING: PROMOTING COMMON PROSPERITY IN THE REGIONAL ECONOMIC INTEGRATION IN EAST ASIA

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I. THE CURRENT SITUATION AND GOALS OF ECONOMIC GROWTH IN CHINA

In the past 25 years, the whole world has witnessed China's rapid economic growth along with the process of its reform and opening up. China's GDP rose from 362.41 billion yuan in the pre-reform 1978 to 10.398 trillion yuan in 2002, a 28-fold growth. Meanwhile, foreign trade grew at an average annual rate even higher than that of the national economy. Total import and export increased from $20.64 billion in 1978 to $620.77 billion in 2002, a 30-fold rise. Foreign exchange reserves also increased from $840 million in 1979 to $286.41 billion in 2002.

The year 2003 was characterized by a complex and changeable international situation, a sudden SARS epidemic, and a rash of natural disasters. In such a situation, China's national economy still maintained a fairly fast growth, and achieved a remarkable performance. In the first quarter, economic growth was as high as 9.9%, the highest first-quarter rate since 1997. In the second quarter, however, the SARS epidemic, natural disasters, and other unfavorable factors reduced economic growth to 6.7%. But in the third quarter, the Chinese economy rebounded to the pre-SARS growth level, at 9.1% over the same period of the previous year. Initial accounting and evaluation by the State Statistical Bureau indicate that China's GDP growth for the whole year will reach 9.1%, reaching 11.6694 trillion yuan, the fastest annual growth since 1997. At the current exchange rate, China's total GDP would be equivalent to $1.4 trillion, with a per capita average of $1,090. In addition, the preliminary customs statistics indicate that the import and export for the whole year will total $851.21 billion, a 37.1% growth over the previous year. That would be the fastest-growing year since 1990, and make China the world's fourth largest trading country. In particular, imports totaled $412.84 billion, which was 39.9% higher than in the previous year or 5.3% higher than export growth. In 2003, China approved a total of 41,081 foreign-invested enterprises (a 20.22% increase over the previous year), with a total contract foreign capital value of $115.07 billion (a 39.03% increase) and a paid-in value of $53.505 billion. The foreign exchange reserve totaled $400 billion, personal savings rose to more than 10 trillion yuan, and tax revenue reached 2 trillion yuan.

These facts prove that the principle of expanding domestic demand, the proactive fiscal policy, and the sound monetary policy the Chinese government continued to follow after WTO accession were still having positive effects. The impact of the SARS epidemic in the first half of the year on the Chinese economy was also partial, temporary, and limited. It did not reduce the momentum of rapid economic growth. It is a prevailing view that the upgrading of consumption structure and the rapid development of the emerging industries, such as real estate, automobiles and telecom, as well as the related steel, petrochemical, and electromechanical sectors, played a visible role in the year's economic growth, and the characteristics of a heavy and chemical industrialization are beginning to emerge. Meanwhile, the fact that China's per capita GDP exceed $1,000 in 2003 also indicates that China will enter an important new period of economic growth.

But the Chinese economy also encountered some notable problems in 2003. They were primarily the unduly large scale of investment, the blind expansion in some industrial sectors, and the failure to effectively contain the low level and redundant construction projects. In addition, contradictions also existed in the transport, supply and demand of coal, power and oil in some regions. In light of these problems, five measures were put forward at a State Council executive meeting presided over by Premier Wen Jiabao in December 2003. They included control over the scale of investment in fixed assets and stronger regulation over some blind investment projects and low-level expansionary sectors. In addition, economic and legal means would be used as the primary tool to tighten market access, tighten control over land use, and tighten project examination and lending.

To achieve its strategic goal of building a well-off society for all, China aims for its GDP to reach four times the 2000 level in 2020, with an average annual growth rate of 7.2%. In other words, its GDP in 2020 will be close to 36 trillion yuan at comparable prices. At the current exchange rate, the GDP will be more than $4 trillion and the per capita GDP will be about $3,000. That will be equivalent to the average level of middle-income countries.

II. THE POSITIVE IMPACT OF THE SUSTAINED RAPID GROWTH OF CHINA'S ECONOMY ON THE ECONOMIES IN ASIA AND THE REST OF THE WORLD

Currently, there are various discussions on the rise of the Chinese economy. Facts have proven and will continue to prove that the sustained and rapid growth of the Chinese economy will bring benefits to the economies in Asia and the rest of the world and it is already making ever-greater contributions to the recovery and development of the world economy.

1. As China becomes the 'factory of the world', it will also become the world's largest product and service market.

As the world's most populous country, China has a huge domestic market capacity unrivalled by most other countries. In addition, its national economy is in a stage of rapid growth and has the largest growth potential in the world in terms of demand for products and services. On this basis, even if the popularity of a product is not very high, demand for it could be among the highest in the world. With the economy growing, incomes increasing, and the market size expanding, the potential market demand will constantly turn into real demand, which will inevitably lead to a continuous rise in import capacity and an expansion of import scale and will bring real benefits to trading partners. One proof of this trend is that China's import growth has always been higher than that of export in recent years, with the narrowing annual trade surplus. The following data show how the neighboring countries in East Asia have benefited from their trade with China.

Exports from the main ASEAN countries to China for the period of 1990-2000 grew more than 100%.

In trade with China in 2000, Korea reaped a surplus of $12 billion, and ASEAN as a whole posted a surplus of $5 billion. The trade surplus of China's Taiwan Province with China's mainland was even higher, at $20 billion. In 2002, China's imports from Japan, Korea, and ASEAN were respectively 25%, 22.2% and 24.4% higher than in the previous year. China's trade deficit with them was $5.03 billion, $7.63 billion and $13.07 billion, respectively. In the first 10 months of 2003, China's import from the above three regions were respectively $60.2 billion, $34.6 billion and $38.1 billion, up 39.2%, 53% and 54.4% respectively over the same period of the previous year. These growth rates were all significant. For other Asian countries, their exports will also grow drastically thanks to the increase in China's imports. Very soon, China will become the primary export destination for Japan, Singapore, Malaysia, and the Philippines. From table 1, it can be seen that, among the top 10 sources of China's trade deficit in the first 11 months of 2003, 6 were East Asian countries and regions.

Table 1. The Top 10 Sources of China's Trade Deficit in the First 11 Months of 2003

$100 million

Rank	Country（Region）	Jan.- Nov. 2003 $100 million	Jan. – Nov. 2002 $100 million	Growth %
1	Taiwan Province of China	-364.1	-284.7	27.9
2	Korea	-209.8	-116.7	79.8
3	Japan	-133.9	-45.5	194.3
4	Malaysia	-71.0	38.6	84.1
5	Germany	-62.5	-47.4	31.8
6	Thailand	-44.7	23.4	90.8
7	Russia	-35.6	-44.7	-20.3
8	Brazil	-34.0	-14.0	143.6
9	Philippines	-28.3	-10.1	180.1
10	Saudi Arabia	-27.7	-15.7	75.9

Note: Ranked according to the amount of deficit.
Source: Statistics of Chinese Customs

China's fast-expanding imports have helped spur a slow recovery of the world economy. At present, China is already the world's largest consumer market for at least 100 products, including iron and steel, cement, and mobile phones. And with the development of the Chinese economy, increasing incomes, and the upgrading of consumption structure, China's import demand will be increasingly diverse, and the quantity and variety of imports will quickly grow. This will further encourage China to conduct mutually complementary, beneficial trade and economic cooperation on a wider scale with its trading partners.

Some competent authorities forecast that in the coming three years, China's goods import will reach $1 trillion. Even if foreign trade grows at the same pace as the economy, China's annual import after 2020 will well exceed $1 trillion. This will undoubtedly bring even more opportunities to its trading partners.

From 1990 to 2001, while the average growth rates of global export and import were respectively 6.3% and 6.5%, those of China were 14.9% and 15.5%. China's growth rates were visibly higher than the global average levels. China's export commodities have benefited numerous consumers around the world. U.S. consumers alone saved nearly $15 billion each year in their spending. This has also helped the foreign companies that make procurements in China reduce their costs of production and increase the international competitiveness of their products. China's fast-growing imports have created countless job opportunities around the world. The vigorous development of China's foreign trade has to a certain extent pushed forward global free movement of resources and the optimization of their allocation.

Even among China's export, more than half are products made by foreign-invested enterprises. In the first 11 months of 2003, for example, the foreign-invested enterprises accounted for $213.52 billion or 54.7% of China's total export. This means that other countries shared a significant portion of China's export earnings. Currently, there is an allegation that China's export growth has resulted in worldwide deflation. This is groundless, China's products, noted for high quality and competitive prices, are welcomed by consumers in all countries and do help to pull down certain prices in the importing countries. But it is farfetched to say that the deflation in these countries has been caused by merely importing some Chinese products. China accounts for less than 4% of the world's economic aggregates and its export accounts for only about 5% of the world's total export. Therefore, the impact of China's growing export on the world economy and global trade is limited. For example, China's export products account for only 2% of Japan's GDP and a little over 1% of U.S. GDP. Furthermore, most products exported by China are low-end consumer goods and labor-intensive products, which cannot have any significant impact on the overall price levels in those countries. In fact, China itself also faces the problem of deflation, which to a certain extent is due to falling prices of import products arising from the lowering of tariffs after the WTO accession. Global deflation has diverse and profound causes, such as overproduction in the world's leading economies, the economic downturn, and the lower costs arising from the wide application of new technologies. Every country, without exception, should focus more on the defects of its own economy when trying to pinpoint the root cause of deflation, and should carry out necessary policy and structural adjustments in a timely manner. Reform is indispensable for all countries.

2. China's economic growth will create more opportunities and a better environment for foreign investment.

Over the past 25 years, the amount of foreign direct investment attracted by China has grown drastically. In 2002, China attracted $55.011 billion in foreign direct investment (a paid-in value), ranking the first in the world. By the end of December 2003, China had approved a total of 465,277 foreign-invested enterprises, involving a total contract value of $943.1 billion and a paid-in value of foreign capital of $501.5 billion.

China is not only the main source of trade surplus for East Asian countries and regions but also the major destination of their overseas investment. In 2002, for example, China replaced the United States to become the largest destination for Korean and Japanese overseas investment.

China's comparative advantage in the international division of labor has been the main reason for the rapid growth of the foreign investment it has attracted. (1) China's labor is enormous in quantity, high in quality, and low in cost. (2) In terms of non-labor factors, China has a comprehensive industrial system and a solid manufacturing base. This advantage has been an important factor for attracting foreign investors and multinational companies to invest in China and realize their industrial transfer. (3) China has the world's largest potential market, which will be even more appealing with the liberalization of market access and the elimination of the proportional restrictions on the marketing in China of the products made by foreign-invested enterprises. (4) Thanks to over 20 years of reform, opening up, and rapid economic growth, China is politically stable and economically prosperous and is advancing fast in infrastructure construction, which together constitutes an excellent environment for investment. Besides, after being admitted into the World Trade Organization, China has been making corresponding adjustments of its policies and related laws and regulations on foreign trade and foreign investment according to the WTO rules and China's relevant commitments including granting national treatment to foreign-invested enterprises. Therefore, the policy and institutional environment will improve further.

Currently, China is continuing to carry out large-scale economic construction in order to build a truly affluent society by the year 2020. The infrastructure construction now going on in various parts of the country, the implementation of strategies such as the development of the western region and the rejuvenation of the old industrial bases in the northeast and elsewhere of the country, the execution of key national projects such as transmitting natural gas and electricity from the west to the east, diverting water from the south to the north, the Qinghai-Tibet railway now under construction and the proposed Beijing-Shanghai high-speed railway will all provide new growth points for the Chinese economy. At the same time, they will also provide historic opportunities to foreign investors.

At present, many developed countries and some newly industrialized countries are transferring their industries to the developing countries where labor cost is low. This is because labor cost in their native countries is too high. And China, with the above-said comparative advantage, is becoming the first destination chosen by many countries for such an industrial transfer. As a result, some people begin to complain, alleging that this industrial transfer, while turning China to the world's factory, is hollowing out the industries in their native places and constitutes a threat to their local economies. First of all, China has not yet become a world factory in any real sense. In 1999, the United States accounted for 20% of the world's manufacturing industry, and Japan accounted for 15%. China's share was only 5%, and its exports were far lower than that of the United States, Germany, Japan or other countries. Most of the products exported by China were labor-intensive. They were not only limited in variety but also low in grade. Besides, more than half of them were products of processing trade. In this sense, China in fact is only a processing and assembly workshop of the world factory.

Furthermore, the industrial transfer from developed countries to developing countries is an inevitable outcome of industrial upgrading and profit maximization. Moreover it conforms to the general economic law that under the conditions of a market economy, capital flows to the sectors and regions where cost is low and efficiency and returns are high. In fact, most of those transferred are the labor-intensive assembly and processing industries that no longer enjoy comparative advantage and international competitiveness in their native countries. Even if these industries can manage to operate in their native countries, they cannot survive fierce international competition, let alone achieve full efficiency of their capital. Therefore, this industrial transfer is bringing more benefit than harm, if not only benefit without harm, to these countries.

In fact, this industrial transfer helps realize advantage complementarity between developed and developing countries. Take China and Japan for example. China enjoys a comparative advantage in labor-intensive industries, whose products are mostly low value-added and low-tech. On the other hand, Japan enjoys a significant advantage in the capital- and technology-intensive industries, whose products are mostly high value-added and hi-tech. In the area of mid-tech products, such as household appliances, China and Japan are in competition to a certain extent. But Japan at least still enjoys an advantage in high-end household appliances. Overall, Japan is far stronger than China in high technology and product R&D as well as in finance and other service industries, which are precisely what China lacks right now. Therefore, the Chinese and Japanese economies are highly complementary and their cooperation outweighs competition.

III. DEVELOPMENT AND RESTRUCTURING: KEY TO CHINA'S ECONOMIC SUCCESS

While China's economic development in the past 25 years has been robust with an average annual growth rate of more than 9%, it still faces many problems and challenges. Some of the institutional and structural problems associated with economic transition have yet to be fully solved. Just as pointed out by the third plenary session of the 16^{th} CPC Central Committee, the Chinese economy still faces problems with economic structure, income distribution, slow growth in peasant income, employment problems, increased pressure on resources and the environment, and the weak competitiveness of the economy as a whole. The following discussion will concentrate on some prominent problems.

1. Population and employment pressure.

China is a big country with a population of over 1.3 billion. Therefore, population and employment becomes the most difficult issue confronting China. It is forecast that before 2010, the working-age population will increase by 10 million a year on average. In 2002, the registered urban unemployment rate was 3.9%. If the laid-off workers and other forms of unemployment were included, the total rate could be about 8-10%. This problem is most serious in the rural areas. The rural labor force now totals 480 million people, of whom 160 million are engaged in local rural enterprises and other non-farming occupations. The remaining 320 million people are in agriculture. If calculated at the current reasonable labor productivity, agriculture actually needs only 170 million people. Therefore, the surplus rural labor is about 150 million people. And this figure is swelling each year by more than 6 million. Of the 90 million cross-regional peasant workers, a significant portion has no stable work or residence and accordingly the likelihood that they return to their native places is very high. Providing employment for the migrant rural labor is a formidable task. When too much rural labor concentrates on limited farmland, agricultural labor productivity will fail to rise. This explains why peasant income is low and lacks the dynamics for growth. In some places, peasant income stagnates and even declines. As a result, the income gap between the urban and rural areas continues to widen. The income ratio for urban and rural residents was 2.51:1 in 1978, and rose to 3.11:1 in 2002.

While this problem constitutes great challenge to China’s industrialization and urbanization efforts, it implies two related issues of significance. On one hand, the massive surplus of rural labor has become an important reason for the nearly infinite supply of low-cost labor for China’s labor-intensive industries. Therefore, China will maintain its comparative advantage in labor-intensive industries for a long time to come, which is also one of the directions China must stick to in its industrial development. On the other hand, when we say China is a potential huge market, we mean that the rural population, which accounts for more than 70% of the country’s total, is one of the main potential market capacities that are yet to be developed. As progress is gradually made in shifting and employing surplus rural labor and as peasant income rises, China’s vast market potentials will gradually turn into real market capacities. This will be a blessing not only for China, which is making great efforts to expand domestic demand, but also for its trading and investment partners. But this is obviously a long-term and arduous task, and China’s industrialization, urbanization and modernization still have a long way to go. China is now making unrelenting efforts in this direction. For example, it has gradually removed various restrictions on peasants working in the urban areas. To improve the quality of peasant workers and their ability to find jobs, the government has worked out the 2003-2010 National Training Program for Peasant Workers. The goal is to offer pre-job introductory training in 2003-2005 for 10 million peasants who plan to flow to non-farm occupations or to the urban areas and offer occupational training for 5 million of them. In addition, on-job training will be offered to the 50 million peasant workers who have already entered into non-farm occupations. From 2006 to 2010, introductory training will be offered to another 50 million peasants who plan to flow to non-farm occupations or to the urban areas and occupational training will be offered to 30 million of them. In the meantime, on-job training will be offered to over 200 million peasant workers who have already entered non-farm occupations.

The fundamental way out to solve this problem is to break up the dualist system structure that separates the urban and rural areas from each other, and to create a new pattern in which labor flow is reasonable and urban and rural development is coordinated.

2. Unevenness in regional development.

The unevenness in China's regional development is a well-known problem. For example, the western region accounts for 71.4% of China's total territory and 28.1% of the country's total population. However, it accounts for only 17.2% of China's GDP. In addition, the western region is noted for vast expanse, backward and uneven distribution of infrastructures, scarce and highly uneven water resources, different degrees of intra-regional economic and social development, serious market constraint to resource development and industrial development, and lagging process of reform and opening up.

The Chinese government has paid great attention to the unevenness in regional economic development and has taken a series of important measures to solve this problem. Statistics indicate that from 1999 when the strategy for Western development began to be implemented to 2002, state investment in the western region, including national debt investment and capital construction fund within the central financial budget, totaled 600 billion yuan, far exceeding the amount invested there in any previous period.

Meanwhile, the state also offered a series of preferential policies on tax and other factors in the western region and introduced special policies to encourage foreign investors to participate in the infrastructure construction and resource development in agriculture, water control, ecology, transport, energy, municipal construction, environmental protection, mining and tourism and in the establishment of research and development centers. Although the gap between the eastern, central and western regions is still widening, this widening is gradually slowing down. Solving unevenness in regional development will take great effort over a long time, and require the unremitting efforts of generations before tangible results can be achieved. The Chinese government's principle on regional development is to strengthen the coordination and guidance over regional development, actively push forward the development of the western region, effectively tap the overall advantages of the central region, support the central and western regions to accelerate reform and development, rejuvenate the old industrial bases in the northeast and other parts of the country, and encourage the eastern region to realize basic modernization first where conditions permit. Facts prove that the development in the eastern region has given a strong push to the accelerated development in the western region. With rich resources, the western region has an immense space for development. After persistent efforts, the region can nurture new growth points for the Chinese economy. In the meantime, the western region also provides large amounts of cheap labor and backup resources and development space for the eastern region. With the increase in the eastern region's ability to proliferate its economic achievements and the improvement in the western region's investment climate, a situation could emerge, in which the east and western regions interact with each other.

3. The reform of state-owned enterprises and the development of private enterprises.

The reform of China's state-owned enterprises has evolved from decentralization and concession and the contract responsibility system to changing operating mechanisms and to establishing modern corporate systems. This evolution reflects a continuously deepened understanding of the market economy. Reform has come a long way, with the industrial structure being optimized, the scale of assets being continuously expanded and the quality of assets being improved. Statistics indicate that by 2002 the net value of all state-owned assets had reached 11.83 trillion yuan, of which the net state-owned assets in operation totaled 7.69 trillion yuan. The state-owned sector is playing an important role in the economic and social development. However, as the reform of state-owned enterprises enters a crucial period, some problems also emerge. For example, the state-owned assets are managed through diverse channels, government functions are not separated from enterprise management, the capital contributors of state-owned assets are absent, and insiders are controlling enterprises.

In order to solve these profound contradictions and problems, the 16th National Congress of the Communist Party of China proposed the establishment of a state-owned asset management system, under which the central and regional government respectively would perform the capital contributor's duties and enjoy the owner's rights and interests on behalf of the state. The rights, obligations and responsibilities are integrated, and the management of assets is integrated with the management of personnel and business. This a new idea for reform. Currently, the reform of China's state-owned enterprises proceeds mainly in the following four directions:

First, improve the state-owned asset management system and materialize the presence of capital contributors. The issue of capital contributors represents a key to the reform of state-owned enterprises. China has already established a body, the State-Owned Assets Supervision and Administration Commission under the State Council, to perform the capital contributor's duties for the state-owned assets on behalf of the central government. It also promulgated the Provisional Regulations on the Supervision and Management of Enterprises' State-Owned Assets. Regional state-owned assets supervision and administration commissions have also been established. In addition, a budgetary system for the operation of state-owned capital and a system for the evaluation of the operating performance of enterprises will also be established. As a result, a framework for the state-owned assets management system is taking shape.

Second, deepen the reform of the property rights system. So far, the orientation of the reform aimed to establish modern property rights system has been chartered, which calls for clearly-defined jurisdictions, well-defined rights and responsibilities, strict protection and smooth transition. In addition, measures to protect property rights are becoming increasingly sound and a property rights exchange market is largely in place.

Third, improve the corporate governance. Most listed companies have established standardized structure for corporate governance. China Securities Regulatory Commission has promulgated the Rules for the Governance of Listed Companies and a series of other regulations. An effective supervision and control mechanism for the state-owned enterprises has been primarily in place.

Fourth, expedite the readjustment in the layout and structures of the state-owned economy and promote the reform of the monopoly industries. The basic direction of such a reform is to encourage the state-owned capital to invest more in the important industries and key sectors that are vital to state security and the national economy so as to increase the controlling power of the state-owned economy. In addition, other state-owned enterprises should participate in market competition through asset reorganization and structural adjustment. Market access should be relaxed for monopoly industries, where competition mechanisms should be introduced, and investors should be actively diversified if conditions permit. Currently, progress has been made in restructuring the telecom, electricity, civil aviation and other monopoly industries, and the reform of the railways, postal service and municipal public undertakings is gaining momentum.

Because of the socialist nature of the Chinese state, the issues of ownership system and property rights have all along been the core content of the reform of state-owned enterprises and also a focal point of debates. It is particularly worth noting that the decision of the 3rd plenary session of the 16th CPC Central Committee explicitly stated that the economy of mixed ownership participation by state-owned capital, collective capital, and non-public capital should be developed on a large-scale so as to diversify equity investors and enable the stockholding system to become the main form of public ownership manifestation. This is an important theoretical breakthrough on the ownership issue of state-owned enterprises. It represents a complete breakaway from the conventional understanding of public ownership under the conditions of the planned economy and will inevitably push forward the diversification of the stock rights of state-owned enterprises in a powerful way.

At the end of 2001, China had a total of 2,028,500 private enterprises, with a total registered capital of 1,821.2 billion yuan. Employing 27,138,600 people, these enterprises had an output value of 1,231.7 billion yuan. They have become a major force in supporting the sustained and rapid growth of the Chinese economy.

The development of China's private enterprises has experienced a tortuous course. It was only after the 15th Party Congress in 1997 that the private economy began to truly integrate with the Chinese economy, became an important component of the socialist market economy, and scored vigorous growth. But there are still some problems that are seriously restraining the development of private enterprises. They include limited fund-raising channels, weak operating management, lack of staying power for development, and other institutional obstacles hindering the development of the private sectors.

In 2002, the 16th Congress of the Communist Party of China explicitly stated that it was necessary to unswervingly encourage, support and guide the development of the non-public economy. In addition, major progress was also made in liberalizing market access and protecting private property rights, which created a broad space for the development of private enterprises. At present, the main directions in developing private enterprises are the following:

First, efforts are made to remove barriers to the development of private enterprises. The main measures include the overhauling and revision of the laws, regulations, and policies that restrict the development of the non-public economy; the easing of market access so as to allow the non-public capital to enter the infrastructure facilities, public undertakings, and other industries and sectors where such an entry was not prohibited by law; the offering of equal treatment in investment, fund raising, tax, land use, and foreign trade that have been enjoyed by other enterprises.

Second, protection of private property rights is more clearly advocated and this topic has been included in the agenda of constitutional amendment.

Third, multi-layer and diverse capital market systems are being established to provide more fund raising channels for private enterprises. At present, the credit guarantee system for small and medium-sized enterprises has been gradually established to provide credit and fund-raising support for small and medium-sized private enterprises. The stock market threshold for the listing of private enterprises has been lowered, and in 2002 alone 10 private enterprises were listed to raise funds. The establishment of a second stock exchange is actively studied and promoted to encourage the development of small and medium-sized private high-tech enterprises.

Fourth, the investment and service environment for the private economy is being improved to guide and supervise the operation of private enterprises. In the course of their development, private enterprises may demonstrate some symptoms of an early market economy, such as blind investment and lack of market credit. The state will guide the rational development of private enterprises through the regulation of industrial policies and tax policies and encourage private enterprises to participate in international competition. At the same time, tools such as standardizing the order of the market economy, establishing corporate credit systems and improving laws and regulations will be employed to regulate the development of private enterprises.

4. The problems and reform of the financial sector.

Financial reform is now a major challenge confronting China. The hardest nut to crack is how to solve the large amounts of bad assets of banks, especially the four leading state-owned commercial banks. The speed and quality of such a solution are not only crucial to the whole process of financial reform, but also vital to the healthy development of China's national economy.

The seriousness of the bad assets of the Chinese banking industry is no secret. In recent years, the government has taken two major measures. One is that the Ministry of Finance issued a 270-billion-yuan special national bond in 1998 to replenish the equity funds of the four leading state-owned commercial banks. The other is that the state set up four asset management companies in 1999, namely Huarong, Dongfang, Changcheng, and Xinda, to respectively take over a total of 1,400-billion-yuan bad assets from the four leading state-owned commercial banks for centralized treatment. At the end of June 2003, the total amount of non-performing loans of the financial institutions, calculated according to the five-grade classification method, was 2.54 trillion yuan, equivalent to about $310 billion. The ratio of non-performing loans was 18.74%. Of all the non-performing loans, the balance of the non-performing loans of the wholly state-owned commercial banks was 2.007 trillion yuan, accounting for 80% of the non-performing loans of all financial institutions. The non-performing loan ratio was 21.38%.

The main measures to deepen the reform of the financial industry are as follows: The 3rd plenary session of the 16th Central Committee of the Communist Party of China set the strategic goal of deepening the reform of the financial system and improving the financial regulatory mechanism and system. To achieve this goal, the Chinese government recently took two major steps:

One is the adoption of the Law of the People's Republic of China on the Supervision of the Banking Industry on December 27, 2003 by the sixth meeting of the Standing Committee of the National People's Congress. The law entered into force on February 1, 2004. The meeting also approved two decisions on the revision of the Law on the People's Bank of China and the Commercial Bank Law of the People's Republic of China. The three laws constitute the legal guarantee for the realization of the strategic goal set by the 3rd plenary session of the 16th Party Central Committee. The enactment and amendment of the three bank laws are of vital importance to the improvement of the financial regulatory system, the strengthening of the financial regulatory tools, the intensification of regulation and the improvement of financial regulation.

Secondly, the State Council recently decided to conduct trials of shareholding transformation of the Bank of China and the China Construction Bank. This is a major policy decision designed to expedite financial reform and promoting the healthy development of the financial industry. As there are flaws in the corporate governance and operating mechanism of the wholly state-owned commercial banks in addition to other historical reasons, these banks are still plagued by high bad asset ratio and low capital adequacy ratio. In light of the existing financial conditions of the two banks, the State Council decided to use $45 billion of state foreign exchange reserve to replenish their equity funds. Each of the two banks received a capital injection of $22.5 billion, which will raise their core capital adequacy ratio by more than 4 percentage points. The shareholding transformation of the two banks will help form standard corporate governance and a strictly defined internal right and responsibility system so that they will speed up the disposal of bad assets, replenish equity funds, and establish sound financial control and internal risk prevention mechanisms. By so doing, they will truly change their operating mechanisms and create conditions for listing so that these state-owned banks would be turned into true commercial banks.

The problems emerging in the course of reform and development can only be solved through persistent reform and development. One thing is clear: China will stick to the principle of economic construction, continuing reform, and opening up. As a developing country that still has to combat poverty and backwardness, China will always take development as the top priority for invigorating the nation. The Third Plenary Session of 16th CPC Central Committee advocated the people-oriented thinking and establishing the concept of comprehensive, coordinated and sustainable development. Under this concept, overall considerations should be given to urban and rural development, to regional development, to economic and social development, to harmonious development of people and nature, as well as to domestic development and opening up, in order to realize all-round socio-economic and human development. China's peaceful rise with the theme of reform, openness, and development will bring benefits to its own people. At the same time, it will also benefit the economies around the world and lay a solid domestic groundwork for China to participate in international economic cooperation and regional economic integration. Therefore, China's reform and development needs world support.

IV. CHINA'S STRATEGY FOR REGIONAL ECONOMIC INTEGRATION: ACTIVELY PARTICIPATING IN INTERNATIONAL COOPERATION AND PROMOTING COMMON PROSPERITY

1. The new trend in developing free trade relations in East Asia

(1) Regionalism against the background of economic globalization.

In the 1990s, regional economic integration became a global trend. By the end of 2002, there had been 250 regional trade agreements (RTA) formally reported to the World Trade Organization. Most WTO members joined one or more RTAs, and the trade between RTA members accounted for 43% of global trade in 2001. RTAs have many forms, and more and more countries have adopted the FTA-based system. Countries often establish trade blocs through free trade agreements out of political considerations. For example, economic integration is used to prevent possible military conflicts or to safeguard regional security. But against the background of economic globalization establishing free trade areas to expand internal markets, attract outside investment and increase international competitiveness has become a new driving force for regionalism. At the end of the 1980s, the European Union began to establish a single market, putting great pressure on the United States. The latter immediately quickened its steps to establish a North American Free Trade Area. Driven by the European and American trade blocs, many countries began seeking regional cooperation partners in order to acquire benefits and avoid harms. Hence producing a worldwide domino effect of regionalism.

At that time, some countries also proposed the establishment of an East Asian Regional Cooperation Organization. But the proposal received little response, and was shortly replaced by the Asia-Pacific Economic Cooperation Forum (APEC). In 1992, ASEAN countries reached agreement on establishing a free trade area (AFTA) in 15 years. But AFTA's authorization clause adopts the "consensus" principle. Later on, ASEAN introduced this principle into APEC and advocated for "open regionalism". The trade liberalization scenario of APEC adopted the "principle of unilateral voluntaries" without binding force to its members. As a result, before the Asian financial crisis, the countries in East Asia were primarily following a unilateral liberalization policy based on the most-favored-nation treatment (MFN), which was an important force in supporting a multilateral trade system. The economic links between these countries were primarily based on market forces instead of institutional arrangements between governments.

The 1997 Asian financial crisis changed the policy orientation of the East Asian countries. As a result, regional economic integration embarked upon a fast track of institutional arrangements. Strengthening regional economic cooperation and jointly resisting the impacts of economic globalization have become a consensus among these countries. The 10 ASEAN countries established a regular leadership meeting system with China, Japan and South Korea (10 + 3), which formed a framework for regional cooperation in East Asia.

(2) China's proactive position injected new vigor into the development of free trade relations in East Asia.

Great difference in the development levels of the economies in East Asia and the complex political relations have always been an impediment to the establishment of regional free trade relationships. As a result, progress has been slow in the study of and negotiation on various bilateral and multilateral FTA proposals. China's development needs a neighboring environment characterized with relative political and economic stability. In order to eliminate the misgivings of other East Asian countries about China's economic rise after its WTO accession and to create a new situation in which China and other East Asian countries can develop a free trade relationship, Premier Zhu Rongji took the initiative at the ASEAN-China summit in Singapore in November 2000 by proposing studying the feasibility of establishing a free trade area between ASEAN and China. At the ASEAN-China summit in Brunei on November 6, 2001, the leaders accepted the proposal of an expert group and reached consensus on beginning FTA negotiations. At the ASEAN-China summit in the Cambodian capital of Phnom Penh on November 4, 2002, the ASEAN-China Framework Agreement on All-Round Economic Cooperation was signed. China's proactive position on developing regional free trade relations promoted the process of establishing intra-regional and inter-regional FTAs between the East Asian countries. In January 2002, Japan and Singapore signed the Economic Partnership Agreement for the New Era (JSEPA) and issued a joint statement on establishing a comprehensive economic partnership with ASEAN and on bilateral FTA negotiations. Korea and Chile also signed a bilateral FTA agreement in October 2002 after four years of negotiations. Among the ASEAN countries, Singapore adopted the most active FTA strategy, and has signed bilateral free trade agreements with Australia, New Zealand, Japan, the European Union and the United States. Currently, it is promoting bilateral FTA negotiations with Canada, Mexico and Republic of Korea.

(3) The contradiction between the expansion of supply capacity and the slow development of internal market in East Asia has become increasingly prominent.

Before the mid-1980s, while East Asia's share of global trade continued to increase, its intra-regional trade development was relatively slow, with its share in the region's total trade volume declining. In the 1990s, however, things changed visibly. East Asia's intra-regional export in the region's total export rose from 40.1% in 1990 to 49.3% in 1995. Later on, this ratio dropped to 45% in 1999 because of the impact of the Asian financial crisis. Unlike the EU single market and the U.S.-centered North American Free Trade Area, the expansion of East Asia's intra-regional trade was primarily a result of the extension of the production chains and value chains arising from industrial transfers. For long, Japan and Asia's "four little dragons" have relied heavily on the European and American markets for export. With the transfer of the comparative cost advantage, they transferred the uncompetitive industries and production links to other countries in East Asia and hence expanded the mutual trade among East Asian countries. However, as Japan in fact only turned part of its export and trade surplus from the European and American markets into its exports and trade surplus with East Asian economies and into the trade surplus of East Asian economies against the European and American markets, the export dependence of the East Asian economies on Japan did not increase tangibly. Therefore, although the proportion of East Asia's intra-regional trade rose slightly in the 1990s, the intra-regional markets are not so open and their consumer demand growth has been relatively slow. For this reason, there have been no fundamental changes in their heavy export dependence on external markets and in the drastic increase of their foreign exchange reserve.

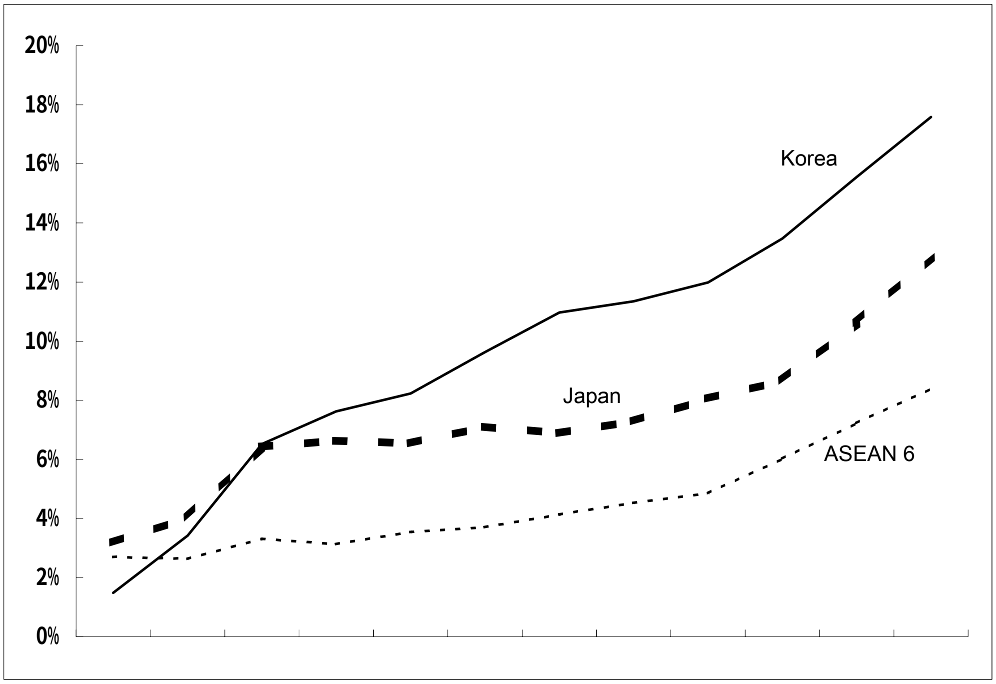
The formation of the two major trade blocs in Europe and North America and the continuous extension of the two blocs to the neighboring regions have begun producing a trade transfer effect on East Asia. Some countries saw their shares in the European and American markets being squeezed by the members of the two blocs and diminishing gradually. From 1993 to 2001, East Asia's share in the import of North America dropped from 33.5% to 28.5%. In order to increase competitiveness, many countries began to transfer more and more commodities to China for export processing, which swelled China's trade surplus against the United States and aggravated trade frictions.

Most East Asian economies have a small domestic market and lack the capacity to upgrade industries by themselves. Because technological renewal today is faster and product life cycle is shorter, these countries are also in an unfavorable position to accept international industrial transfer. The result is that their industrial structures tend to be similar and their mutual competition tends to be crueler. One of the reasons behind the Asian financial crisis was the decline in the export earnings of the East Asian countries and the deterioration of their balance of payments arising from the fall in the prices of electronic products in 1996.

(4) China and Japan could provide a vast and stable intra-regional market for the growth of the East Asian economies.

Thanks to the rapid growth of the Chinese economy, China has been gradually demonstrating its great advantage in market scale. In 2001, the per capita GDP in China's coastal region, which had a population of nearly 480 million, reached $1,550. Chart 1 indicates that the export dependence of all East Asian countries on China has been tangibly higher in recent years. Of the newly added exports of the East Asian countries in 2002, 56% was destined for China. This is partly because industrial transfer expedited the growth of trade in intermediate products, but undoubtedly, it also reflected the rapid expansion of China's domestic demand. The Asian Development Bank noted in a report in early 2003 that China would overtake Japan in 2005 to become Asia's largest importer. In 2002, China's GDP already reached $1.2 trillion. As long as China can maintain a 7% growth rate, the overall scale of the Chinese economy will exceed $2 trillion in 2010 and will no doubt provide an even wider export market for the East Asian countries.

Chart 1. Export Dependence of East Asian Countries on China



Note: The six ASEAN countries are Singapore, Malaysia, Indonesia, Thailand, the Philippines and Brunei. Their export to China's Hong Kong is not included.
Source: Calculated on the basis of the statistics of the WTO and China's Ministry of Foreign Trade and Economic Cooperation.

As the world's second largest economy, Japan's GDP reached $3.75 trillion in 2002. Its domestic market is equally huge. Cultural, commercial, and other reasons have made it difficult for foreign products to enter this market. However, in a situation characterized by rapidly deepening economic globalization, the low efficiency and high cost of Japan's domestic economic sectors have seriously impeded further growth of the Japanese economy. The Japanese government has realized this problem and is working hard to promote reforms. Its citizens are also gradually changing their attitude toward outside commodities and culture. Once earnest domestic restructuring can be carried out and once its market opens to the outside world, Japan along with China will become the new powerhouse for the economic growth in East Asia.

In fact, the overall economic size of the 13 countries including ASEAN, China, Japan and South Korea can be comparable with that of Europe or North America. It is entirely possible for the 13 countries to form an intra-regional market that can match the North American Free Trade Area or the European Union. If that happens, their over-dependence on the European and American markets for economic growth will change. Calculated on purchasing power parity (PPP), the combined GDP of China and Japan in 2001 accounted for 19.3% of the global total. If South Korea, Singapore and four other ASEAN countries were included, the combined GDP share in the global total would be 24.8%, which was higher than the 21.3% for the United States and the 19.8% for the European Union.

(5) The disparity in the levels of economic development is not necessarily an insurmountable barrier to the establishment of a regional free trade relationship.

One must recognize that the disparity in the economic development levels of the East Asian countries is still very prominent. The IMF data indicate that, among the 13 countries of ASEAN members, China, Japan and South Korea, the per capita GDP in 2001 of the richest Japan was 197 times that of the poorest Myanmar. On the other hand, in 2002 when the European Union decided to admit 10 new members, the per capita GDP of the richest Luxemburg was only 12 times that of the poorest Lithuania. And in 1991 when the negotiations on the North American Free Trade Area were launched, the per capita GDP of the United States was only six times that of Mexico.

But the new tide of regional economic integration in the past 10 years indicates that the FTA framework is no longer limited to the countries that are geographically close and are at similar levels of economic development. The Japan-Mexico FTA, the Korea-Chile FTA and the Australia-Thailand FTA are all typical examples of cross-continental alliances between developed and developing countries. The European Union has decided to admit 10 new members in 2004, and the North American Free Trade Area is also actively expanding to South America. Therefore, the difference in economic development levels may make it more difficult for all participants to harmonize their interests and prolong the time of FTA negotiations. But it is not an insurmountable barrier to FTA establishment. We should also see that the per capita GDP gap between Japan and China, the most important two of the 13 countries, had narrowed from 79-fold in 1991 to 35-fold in 2001.

According to the measurement model analysis conducted by DRC’s Research Department of Foreign Economic Relations, the establishment of FTA among ASEAN, China, Japan and South Korea will bring tangible economic benefit to all the participating parties. As there is shortage of data about the four countries of Brunei, Myanmar, Laos, and Cambodia and as the scales of the four economies are relatively small, they are not included in the analysis. In other words, the ASEAN here refers only to Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam, and the analysis is in fact a modeling of the FTA formula that comprises nine countries of ASEAN members, China, Japan and South Korea. The analysis envisages two scenarios. Scenario one does not consider the impact of the two factors of China lowering import tariffs after its WTO accession and the six ASEAN members mutual elimination of import tariffs, while scenario two takes the two factors into account.

Scenario one indicates that all the nine FTA members will achieve certain GDP growth, with China's GDP growth rate being 3.4% or roughly at the middle level when compared with other members (table 1).

If only GDP is taken into account, Vietnam will be the country that enjoys the greatest benefit, with its GDP growth rate being as high as 14.85%. This rate is far higher than the country's average GDP growth rate (6.78%) during the 1990-2001 period. Singapore will post the smallest GDP growth rate, which is only 0.26% and far lower than the country's average GDP growth rate (7.18%) in the past 12 years. Although Japan's GDP growth rate will be only 0.78%, this growth rate is still meaningful if its long economic stagnation is taken into consideration. Except Singapore, all other countries will see some improvement in their trade balance. China's export and import will respectively rise 81% and 88%, with a net export increase of $19.9 billion.

In the area of economic welfare, all countries except the Philippines and Singapore will benefit. As the indicator that measures economic welfare includes consumers' and producers' surplus, the members that have higher income levels or have larger scales of demand will be more impacted in the course of regional economic integration. Although the GDP growth rates for China, Japan and Korea will not be high, their economic welfare will respectively increase by $54.7 billion, $118.8 billion and $34.7 billion, which are visibly higher than other members.

Table 2. Simulation Results: Scenario One

Country (region)	GDP %	Exports %	Imports %	Trade Balance US$100 million	Terms of Trade %	Economic Welfare US$100 million
Indonesia	1.64	51.02	62.95	61.56	15.78	204.18
Malaysia	8.12	105.84	119.17	96.44	9.21	219.69
Philippines	5.78	150.76	105.33	17.10	-12.87	-20.02
Singapore	0.26	139.89	133.29	-16.69	-4.04	-47.92
Thailand	4.79	56.31	59.80	106.90	4.25	137.01
Vietnam	14.85	104.53	87.75	4.83	15.67	55.03
China	3.40	81.19	88.41	199.13	5.23	547.27
Japan	0.78	51.47	70.59	58.16	7.39	1188.44
Korea	3.42	74.70	77.16	105.92	6.99	347.44
Taiwan Province of China	-0.62	-12.98	-22.66	-98.11	-11.24	-224.28
USA	-0.05	-8.37	-7.99	-154.21	-3.13	-554.98
EU	-0.01	-2.45	-2.78	-184.14	-1.26	-409.43
Other countries	-0.15	-3.25	-3.65	-196.90	-1.81	-565.98

Source: CGE model simulation results of research topics group.

In scenario two, all members in the region except China will see their macro indicators change in a way similar to that described in scenario one. This is primarily because once the nine-nation FTA is established, it will in fact include the mutual elimination of import tariffs among the six ASEAN countries. Also China's accession to the WTO has a noticeable impact on only China itself (table 2).

China's GDP growth will rise to 4.27%, mainly because the positive impact of WTO accession on China's economic growth will be larger than the negative impact of the FTA established by the six ASEAN countries on the Chinese economy. As opening domestic market to all WTO members can worsen trade terms in a certain degree, the margin of the improvement of China's trade terms dropped to 1.62%. Accordingly, its economic welfare will also increase by a visibly smaller margin, or by $45.2 billion, when compared with scenario one.

Table 3 Simulation Results: Scenario Two

Country (region)	GDP %	Exports %	Imports %	Trade Balance US$100 million	Terms of Trade %	Economic Welfare US$100 million
Indonesia	1.64	75.24	64.46	61.02	15.53	201.55
Malaysia	8.11	115.08	116.33	95.32	9.03	217.17
Philippines	5.77	140.44	105.66	16.92	-12.87	-19.99
Singapore	0.25	134.75	132.09	-16.93	-4.05	-48.08
Thailand	4.79	72.06	59.56	106.03	3.98	133.98
Vietnam	14.84	123.72	89.33	4.81	15.61	54.91
China	4.27	102.76	106.64	186.35	1.62	452.02
Japan	0.76	58.26	69.37	47.97	6.91	1,127.25
South Korea	3.41	81.01	76.67	101.18	6.24	326.75
Chinese Taiwan	-0.47	-20.00	-17.94	-77.22	-8.58	-170.90
USA	-0.04	-11.66	-8.42	-156.51	-2.72	-482.67
EU	0.00	-4.74	-4.12	-175.47	-1.07	-338.06
Other countries	-0.13	-5.60	-4.32	-193.46	-1.52	-474.61

Source: CGE model simulation results of the DRC Research Team.

2. China's strategy for regional economic integration

China's arrangement for regional trade liberalization experienced two phases. With the Asian financial crisis as the turning point, China moved from favoring APEC-advocated regional free trade to paying equal attention to developing institutionalized economic cooperation with neighboring countries.

(1) The position on regional trade liberalization before the Asian financial crisis.

Before the Asian financial crisis, APEC was one of the most important regional economic cooperation organizations China had joined. The statements made by Chinese leaders at APEC meetings indicated China's basic position on regional trade liberalization.

Long-term goal. China supported the Bogor Declaration, under which trade and investment liberalization would be as a long-term goal and an appropriate timetable would be worked out to achieve this goal. But China also held that consideration should be given to the interests of the members with different levels of economic development and the members should be allowed some flexibility, on an independent and voluntary basis, in trade and investment liberalization.

Consensus principle. China held that the members that were at different stages of economic development and practiced different social systems should respect each other and that decisions on the major issues such as the direction, emphasis and schedule of regional economic cooperation should be made on the basis of consensus through consultation.

Open regionalism. China held that APEC should be an open, flexible and practical economic cooperation forum and consultation body, instead of a closed and institutionalized economic bloc. Trade liberalization should be based on the non-discrimination principle and be open to each other. Regional members should actively expand extra-regional exchanges and cooperation while deepening intra-regional economic cooperation.

The principle of being independent and voluntary. China held that when working out targets for economic development cooperation, the right of the members to independence in developing their economies should be respected and their initiative and creativeness should be brought into full play. When collective actions were taken, the principle of the members being independent and voluntary should be respected and should become the cornerstone of forging economic cooperation in the Asia-Pacific region. China also held that it would be unrealistic and run counter to the spirit of fair competition to request all members to promote liberalization simultaneously in all sectors in disregard of development levels and practical conditions.

(2) The position on regional trade liberalization within the “10+3” framework.

The 1997 the Asian financial crisis changed the course of regional economic integration in East Asia. Strengthening regional cooperation and jointly resisting the pressures arising from economic globalization became a common understanding of all East Asian countries. The 10 ASEAN countries, China, Japan, and Korea established a regular leadership conference system (called 10+3), which became the framework for East Asian regional cooperation. China highly valued the roles of this mechanism in resisting outside shocks and in strengthening regional cooperation in East Asia. It believed that the “10+3” mechanism could develop into a principal channel for East Asian regional cooperation so as to gradually establish a framework for regional financial, trade and investment cooperation and to realize a greater integration of the economies in the region.

Speaking at the seventh leadership meeting of the ASEAN, China, Japan and Korea in October 2003, Premier Wen Jiabao held that as there existed great disparity in the East Asian region, deepening the “10+3” cooperation needed to observe the following principles:

- *Equality and consultation.* The countries should seek agreement through consultation and play their roles on the basis of equality so that the “10+3” cooperation can meet the common need and interests of all the parties.
- *Mutual benefit and a win-win result.* Efforts should be made to narrow the development disparity confronting the relatively backward countries in East Asia so that these countries can benefit more. Only by doing so can the “10+3” cooperation has a more solid foundation.
- *Advance step by step.* Regional cooperation is still in its preliminary stage. We should both actively seek progress and give consideration to the practical conditions of different parties so as to promote the process of cooperation step by step and in a down-to-earth manner.
- *Opening and accommodating.* The development in East Asia can not advance without the world. So we cannot isolate ourselves or form exclusive blocs. Instead, we should strengthen cooperation with other regions and countries while deepening cooperation in our own region.

In accordance with the above principles, China is currently promoting regional economic integration in the following key areas:

Actively promote the China-ASEAN FTA. In accordance with the ASEAN-China Framework Agreement on All-Round Economic Cooperation jointly signed in November 2002 by Chinese and ASEAN leaders, the two sides will establish a free trade area in 2010. In order to realize this goal, China is actively promoting trade negotiations with the ASEAN countries.

Actively promote the feasibility study on establishing the China-Japan-Korea FTA. The joint study on the feasibility of establishing a China-Japan-Korea Free Trade Area was formally launched in 2002. This is a step of positive significance to promoting the economic and trade cooperation between the three countries and to realizing a greater economic integration in East Asia. China supports the research institutions of the three countries to launch the next-step research on the impact that the three-nation free trade area may have on industries.

Study the feasibility of establishing the East Asian Free Trade Area. Positive results have been achieved in establishing the China-ASEAN Free Trade Area. Japan has also reached agreement with ASEAN on establishing closer economic and trade partnership. Meanwhile, Korea began considering establishing a free trade area with ASEAN, and ASEAN has taken the establishment of an “economic community" as its next development direction. All these developments will create favorable conditions for eventually forming the East Asian Free Trade Area. The quantitative simulation analysis By DRC's Research Department of Foreign Economic Relations indicates that, among all possible FTA formulas for the East Asian region, the "10+3" formula can bring the maximum economic benefits to all parties and should therefore be considered in the research as a long-term goal for the regional economic integration in East Asia.

In short, the Chinese government's basic stand on the regional economic integration in East Asia is to actively participate in and promote this regional economic cooperation. This is because it conforms to the fundamental interests of the people of all countries in East Asia, including China, and will promote regional peace and prosperity. For this reason, China will work with all countries in East Asia to make its due contribution to the realization of this historic goal.