

China and Economic Cooperation in the Asia-Pacific Region

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China has become a major economic actor in the Asia-Pacific region. Since Deng Xiaoping's comprehensive reforms were initiated in 1978, the country's external economic relations have become more extensive, with the regional economies as the primary benefactors. China's total two-way trade grew from less than US\$15 billion in 1976 to over US\$128 billion in 1990. The Asia-Pacific region accounts for about 70 percent of this trade, half of which is conducted with Hong Kong and Macau alone, and more than a quarter of Hong Kong's exports are destined for the Chinese market. The composition of China's exports has also shifted significantly as a result of reforms and the country's open-door policy. Primary products, which made up over half of China's merchandise exports in 1980, accounted for only 28.6 percent in 1989. Conversely, manufactured goods have risen from less than 50 percent of total merchandise exports in 1980 to over 71 percent in 1989.

Foreign direct investment (FDI) has contributed significantly to the development of services, oil exploration and export-oriented manufacturing industries in China. Pledged foreign investment—most of which originated in the Asia-Pacific region—grew from US\$9 billion in 1984 to nearly US\$34 billion in 1989. The unique position of Hong Kong and Macau, in proximity, language, and family ties, has contributed to the fact that these countries account for over 60 percent of total FDI in China. Hong Kong has also acted as a conduit for Taiwan investment, most of which is focused primarily in Guangdong and Fujian provinces. Efforts by the government in Taipei to encourage investments in Vietnam and elsewhere in Southeast Asia to avoid overdependence on the Chinese market suggests the importance of China for Taiwanese investors.¹ Similarly, the fact that there has been no real shift of Hong Kong investment away from China since June 1989 suggests that China remains a favorite market for Hong Kong investors.

Although Sino-Thai security relations have been extremely close over the past decade and a half, economic relations have remained insignificant. Thailand accounts for less than one percent of China's total trade, and exports to China account for less than 1.5 percent of Thailand's total. Aside from several investments in agro-industries, Thailand's investments in China are nothing to speak of. Similarly, the most significant Chinese investments in Thailand come not from China, but from Taiwan—the fourth-largest investor in Thailand in 1991. Chinese manufacturers do compete with Thai firms for export markets and for direct foreign investment since both countries have an abundance of low-wage labor. Nevertheless, given its growing economic integration into the Asia-Pacific region, China remains important to Thailand for political and security as well as indirect economic reasons.

This article assesses the present status of the Chinese reform process and how it shapes China's role in Asia-Pacific economic cooperation. Since China, Taiwan, and Hong Kong all became full members of the Asia-Pacific Economic Cooperation (APEC) conference at the ministers' meeting in Seoul in November 1991, the durability and progress of China's economic reforms have taken on greater significance for the region. The degree to which economic cooperation in APEC can proceed now depends largely on the extent of reforms in China. As Lardy observed, "further reforms of China's foreign trade regime, as well as related domestic economic reforms, are a prerequisite for making significant progress toward regional economic cooperation."² In discussing China's interests in participating in a regional institutional framework for cooperation, the Beijing-Taipei relationship is also considered for its impact on the viability of the APEC grouping which includes the two adversaries on equal terms.

ECONOMIC POLICY

Although certainly influenced by a shift in the precarious balance between reformers and conservatives within the Communist Party of China (CPC), the retrenchment policies imposed by the Beijing leadership in the latter half of 1988 are hardly an aberration from the cyclical nature of the Chinese economic policies. Since 1978, China has experienced three reform cycles, in which rapid rates of GDP growth were accompanied by high rates of inflation (see [Figure 1](#)). During these periods—1978/79, 1984/85, and 1987/88—reform efforts and the relaxation of credit resulted in surges in investment, growth rates, and imports. Overheating of the economy followed, as China's underdeveloped infrastructure and lack of financial discipline contributed to inflation, resource imbalances, and trade and current account deficits. Each of these three reform cycles forced the Chinese leadership to adopt stringent stabilization measures.

Due to the political dimensions of economic decision-making in China, macroeconomic policy responses to overheating were not—and are still not—prompt. Decentralization of administrative authority has sapped control over the economy from the center and given it to the provinces, which have competing interests. Not only rivalries at the central levels, but also contention for control between Beijing and the provinces, mean that unpopular retrenchment policies have consistently been put off until the situations become serious enough that stability is threatened. This was the case in 1988 when inflation reached 18.5 percent,³ and the central and regional administrative authorities reached a commitment to guarantee that credit expansion would be curtailed, investments slowed, wage demands moderated, and fiscal contracts honored.⁴

The World Bank has estimated that, given severe bottlenecks in such critical subsectors as energy, transportation and industrial raw materials, the highest sustainable rate of national economic growth is somewhere between 6 and 7 percent.⁵ As has been witnessed during the reform cycles, rapid rates of growth above this level have led to overheating and popular dissatisfaction. The perception among the hardline faction of the CPC leadership, thus, has been that reforms and the ambitious goals set by the reformers have overextended the economy's absorptive capacity. Excessive inflation, in times of economic upswings, has made this faction more wary of the consequences of reforms and has galvanized its reluctance to remove the causes of inflation.

Several factors have contributed to the limited capacity of the Chinese government to stimulate growth without overheating the economy. First, the state of China's physical infrastructure, a manifestation of Mao-era policies emphasizing provincial self-sufficiency, has constrained China's growth potential. The lack of a comprehensive national transportation network has severely limited intra-provincial as well as international trade. Similarly, despite the impressive development of capacity, the country is destined to continue suffering from an undersupply of energy for the near future. China's energy planners have set targets of 7 percent annual rises in electrical output up to 1995. This, however, is unlikely to keep pace with the growth of industrial output which grew by 17 percent during the first quarter of 1992 alone.⁶ While more rational energy prices could help to improve energy efficiency, the state needs to further develop realistic sources of energy.

Second, state enterprises continue to account for over half of China's industrial output, and yet at least 40 percent of these firms are unprofitable. In 1991, the government was forced to spend 31 billion renminbi (US\$5.7 billion) to prop them up.⁷ Despite a bankruptcy law promulgated in 1991, the Communist Party is hesitant to allow state enterprises to fold for fear of social unrest. These firms constitute the only welfare system available in the country and, if they were to close, the destitute unemployed could become disruptive. Thus, instead of forcing state enterprises to be responsible for their losses, the government has allowed firms chronically in the red to continue producing inefficiently with the full knowledge that, as their budget constraints are not hard, they need not be concerned with profitability. The consequence of this situation for the economy is that there is inflation causing excess demand for investment in unproductive projects in the state sector. During times of retrenchment, the dynamic private sector is crowded out as scarce capital is administratively allocated to these state enterprises.

Furthermore, the "double guarantee" system—in which state enterprises receive preferential access to inputs, transportation, and credit in return for guaranteed tax and profit remittances—has exacerbated the situation. Part of the 22 percent increase in domestic lending in 1990 was to cover state firms' remittance obligations to prevent them from losing these privileges.⁸

Finally, decentralization has weakened the central government's control over monetary policy and has also led to competition between provinces. Beijing's ability to instill financial discipline has been drained by provincial influences over local branches of the People's Bank of China and other financial institutions. During expansionary phases of the reform cycle, central bank targets for monetary expansion have repeatedly been exceeded as the individual provinces attempt to outdo each other. As mentioned earlier, the central government's inability to control the provinces has weakened its capacity to carry out macroeconomic adjustment policies in the early stages of inflation, forcing it instead to reach a national party consensus before taking more drastic measures. Similarly, the greater authority delegated to the provincial parties has resulted in local protectionism limiting inter-provincial trade. In 1990, for example, Guangdong officials complained of local officials in Hunan and Guangxi provinces blocking the movement of foodstuffs from their provinces to the higher priced markets in Guangdong.⁹ Such forms of protectionism, as well as provincial industrialization strategies which ignore complementarities with neighboring provinces, have constrained national welfare and economic growth.

STATUS OF ECONOMIC REFORMS

During transitory retrenchment periods, it is relatively easy for the reformist and hardline factions of the CPC to agree on a common cause. Following the crackdown on demonstrators at Tiananmen Square in June 1989, this was even more so the case as opposition to one-party rule forced greater cohesiveness in the CPC. However, given that the "economic rectification" policy has brought inflation back in line and has shifted the current and trade accounts toward surplus, the tide is changing. The reformers are taking greater control over economic policy with the support of Deng Xiaoping.

Since his trip to the Shenzhen and Zhuhai Special Economic Zones (SEZs) in Guangdong province from January 19 to 23, 1992, Deng has thrown his political weight behind accelerated reforms. That he had to resort to the use of the media to get his message across, however, suggests that firm support for reforms did not initially exist within the CPC Politburo and that he had no recourse through official mechanisms. Nevertheless, reformers appear to have gained the upper hand in the Politburo, which issued a statement prior to the National Peoples' Congress (NPC), in line with Deng's SEZ pronouncements. At the national level, time appears to be on the side of the reformers as old age is taking a greater toll on the conservatives than the liberals. The passing away of Long Marchers like Li Xiannian, Deng Yingchao, and Hu Qiaomu, and the ill health of such figures as Vice-President Wang Zhen, 84, and former Beijing mayor Peng Zhen, 90, are weakening the resolve of conservatives in a system reliant on patron-client relations. As a China-based diplomat relates, these elder statesmen—often referred to as "Immortals"—should be viewed "not so much as political actors in their own right, but rather as features of the landscape; giant trees or thickets that provide cover for the combatants. And, if the landscape gets defoliated in coming months, the fighting could very well heat up."¹⁰

Support for reform from the provincial political figures was also evident at the NPC convened in March, and resulted in a surprisingly exciting meeting in which the delegates pressured Premier Li Peng to backtrack on his annual policy statement. Li's address, given at the opening session was significant more for its omissions than for what was actually said. First, he failed to assert, as the Politburo had already done, that "Left deviationism" is a greater threat to China than that of the Right. If such a statement were made, it could have easily been interpreted as an affirmation of Li's own "mistakes." Second, he promised to "make China a powerful, socialist country standing firm as a rock in the East," but avoided Deng's commitment to "a hundred years" of reform. Finally, he did not endorse the 10 percent growth rate target endorsed by Deng,¹¹ and instead called for a more moderate 6 percent growth per annum. Li's obstinacy caused a stir among the delegates and the national press—known for towing the party line—duly printed their criticisms of the Premier's address.¹²

The reforms espoused at the NPC are extensions of those which took place under former party chief Zhao Ziyang, but are likely to be less radical given the greater influence of the conservatives in economic decision-making. The reforms are characterized by an emphasis on market forces and greater autonomy for local authorities. Differing agendas emerging from the ministries, provinces, and individuals, however, betray a lack of coordination among the reformers.¹³ The result has been an eclectic set of reform measures announced in the first half of 1992. First, price controls on most agricultural commodities, including staple grains, are to be lifted. Second, steps are being taken to make state enterprises responsible for their performance and losses. Given that the budget deficit grew to an estimated 9 billion renminbi (US\$1.6 billion) in 1990, the party leadership finds itself in a catch-22 situation. On the one hand, policies of propping up inefficient state firms are unsustainable, while on the other hand, instability like that seen in the spring of 1989 is sure to surface if these firms are allowed to collapse. The elimination of soft budget constraints is sure to proceed slowly. Third, China's currency, the renminbi, which has been devalued several times since the 21 percent devaluation against the dollar in December 1989,¹⁴ is being brought more in line with the unofficial exchange rate. The further opening of the foreign exchange adjustment centers (FEACs)—also known as swap markets—to sectors within the Chinese economy, which are not already qualified for participation, is one means of achieving the ultimate goal of convertibility. Fourth, local authorities are being offered greater autonomy from the central government as an incentive to attract more foreign investment on their own. Finally, stock exchanges are receiving the support of the reformers. The success of the experimental bourses in Shenzhen and Shanghai have given life to new stock markets in Guangzhou, Xiamen, and Hainan Island.¹⁵ The nascent exchanges are envisioned not only as a mechanism for privatizing state enterprises, but also as an arena for floating government bonds to help Beijing overcome its reliance on the printing presses and forced savings to finance budget deficits.

The collapse of the Soviet Union and the socialist governments in Eastern Europe has taught the Beijing government a valuable lesson: without economic growth a communist government's political stability cannot be guaranteed. As one regional scholar commented, "In the next decade or so, policy-makers in Beijing will confront an inescapable reality: Support for reforms is rooted in the demonstrable shortcomings of the past economic and political system, the lack of a discernible alternative approach to economic development, and the clear benefit the reform and open policy has brought about. Thus, regardless of any ideological or political objections to its content, the reform program is not likely to be removed from its central place on the Chinese agenda."¹⁶ This was made clear when, at the Fourteenth Party Congress in October 1992, the CPC pronounced its commitment to developing a "socialist market economy." Although the ambiguity of this term leaves much room for interpretation, it is the first time that the term "market" has been etched into official party doctrine and is an indication that the CPC recognizes the irreversibility of economic reform.

REFORM AND FOREIGN ECONOMIC RELATIONS

*China is the greatest investment story in the world right now,...everyone's looking for a piece of the action.*¹⁷

China is beginning to emerge from the pariah status it earned following the June 1989 crackdown on the students assembled at Tiananmen Square. A renewed atmosphere of reform has instilled a sense of cautious optimism among foreigners doing business there. Obstacles to investment continue to exist, however. Time-consuming negotiations, an incomplete legislative framework, a backward infrastructure, and insufficient local sources of finance have all slowed the inflow of FDI. Nevertheless, such advances as the new stock markets, initiation of long-term land leases (up to 70 years in open cities and SEZs), and the Amendment to the Law on Joint Ventures Using Chinese and Foreign Investment have helped to improve the investment environment. The latter allows foreign partners to play a greater role in the management of joint ventures, and protects equity joint ventures from expropriation by the Chinese government.

The pace of reform will undoubtedly affect China's trade and investment relations in the near future and thus dictate its capability of cooperating with other regional economies. Three components of reform are of particular relevance to China's external accounts.

First, although already mentioned, it is worth elaborating further on the relation between the domestic price structure and China's external economic relations and trade. Due to government controls over prices of many raw materials, intermediate inputs, and final goods, domestic prices tend not to reflect costs of production. With such distorted prices, the central government must rely on export subsidies to encourage the sale of overpriced domestic goods in the international market. Similarly, quantitative restrictions are employed to protect the domestic production of goods in which China has a comparative advantage, but are overpriced due to price controls.¹⁸ The Chinese adopted a two-tier price system to introduce market prices to the overall structure. By allowing prices for items outside of the state plan to float, the party provides private entrepreneurs with access to necessary inputs at domestic market prices. This system, however, is fraught with incentives for corruption. Party cadres with access to, and control over, underpriced goods attained through the state supply system have been known to sell these on the open market and pocket the difference. Conservative and reformist party members understand the problems, but disagree over the means of alleviating them. The conservatives believe that the two-tier price system should be eliminated by allowing the central authorities to reclaim greater control over prices. The reformers, however, prefer a gradual reduction in price controls so that eventually a single market-driven price system will emerge. This is one issue, along with the convertibility of the renminbi, which will have to be addressed in the near future if China is to incorporate its economy into the regional community.

Second, while the growth of China's foreign trade corporations (FTCs) has acted as a stimulus to trade under the present system, several problems associated with them have appeared. The FTCs maintain monopolistic control over certain commodities and control trading rights of most goods. Relatively few production enterprises have the right to trade directly with international purchasers; most must use the FTCs as intermediaries. As they frequently are set up at the initiative of the provincial governments and have specific import and export targets to meet, and as the losses incurred meeting these targets are covered by the state, the FTCs are not sensitive to relative prices. Furthermore, because the establishment of new FTCs tends to occur in spurts during periods of decentralization, it has been difficult to find experienced and qualified personnel to staff them. The common reaction of the central government to this weakness, as occurred during the latest retrenchment period, has been to place arbitrary limits on the growth of FTCs, to recentralize the authority to grant trade rights, and to close new FTCs.¹⁹

Finally, China's trade regime maintains a relatively high degree of protection. Tariffs, which range as high as 200 percent, discourage the import of many needed intermediate goods, leaving the economy with an inherent anti-export bias. A wide range of non-tariff barriers, the most obvious of which is import and export licensing, affect the competitiveness of a significant number of goods not included in the state plan. The impressive turnaround in the trade balance, from a deficit of US\$5.6 billion in 1989 to a surplus of US\$7.5 billion in 1990,²⁰ was not only a result of the belt-tightening policies, but also of greater control over imports and exports.

For China to genuinely participate in economic cooperation in the Asia-Pacific region, its economy must become more transparent. Progress made in rationalizing these three areas—domestic prices, the FTCs, and the management of trade—will be an important determinant of the degree to which the Chinese economy interacts equitably with the regional economies. China's membership in GATT, after all, is not being held up for political reasons. Until the government redresses the effects of its excessive intervention in the economy, questions over the equitable nature of China's economic relations will not subside.

POLICY ON ASIA-PACIFIC ECONOMIC COOPERATION

Beijing's policy toward regional economic cooperation has not been explicitly pronounced in the form of policy statements. Yet, through an examination of China's domestic and international interests, and through reports in publications which act as government mouthpieces, it is possible to speculate about the gains the Chinese expect to receive from their membership in APEC, and possibly from greater cooperation with only the East Asian economies.

Since it is faced with growing protectionism in the EC and the United States—each year China's most

avored nation (MFN) trading status must be renewed by Washington and this is becoming increasingly difficult due to human rights abuses in China—there is a necessity for China to diversify its economic interests and to establish market niches in the dynamic Asian economies (DAEs). This partially accounts for the improved economic relations between China and Taiwan, and South Korea.

China's vision for the structure of APEC has its limits. As a *Beijing Review* article asserts, "the actual conditions that exist in the Asia and Pacific region will strongly impede, in the remaining years of this century, the formation of contract-like economic cooperation that is being practiced in Western Europe and North America."²¹ Thus, Beijing's model of economic cooperation eschews any notion of market sharing in the form of a trade union. Similarly, the supranational characteristics of an economic community are anathema to the Chinese, who consistently find themselves defending their domestic policies against the interference of others. Yet, because they are faced with greater protectionism in the European Community and the United States, the Chinese are more willing to harmonize economic and trade policies provided that the sovereignty of each individual government is not violated.²²

Lardy attributes this apparent desire to be instrumental in shaping the Asia-Pacific economic environment, while remaining ambivalent toward institutionalizing the economic cooperation process further, to several factors.²³ First, China fears that Japan will become the dominant power in any regional cooperation mechanism. Apprehensions, based on Japan's historical aggression in China, have not been alleviated by the ease with which Japanese textbooks have rewritten the atrocities inflicted by the Japanese on the Chinese, nor by the passage of a law legalizing the stationing of peacekeeping troops abroad. While the Japanese represent a significant threat, the Chinese value Japan's role as an important economic leader. By forming a strictly economic forum for economic cooperation, Beijing hopes to reap the benefits of closer economic relations while avoiding any threat to its security and sovereignty.

Second, China has not abandoned the North-South framework of international relations, and believes that the North still has obligations to the South. Economic assistance is welcomed and the structure of regional cooperation should take on a form which can integrate formal equality among its members with the extension of aid and mixed credits—especially from Japan—to its developing economies in the South.

Finally, reforms have not progressed to the extent that the Chinese economy can be more fully opened to the regional market. China remains a socialist, semi-planned economy in which many components of trade are under the influence of the central and provincial governments. Until reforms of China's trade regime and other relevant domestic economic reforms—such as loosening controls over prices—proceed further, the country's trade regime will continue to differ significantly from those of regional partners, making formal cooperation impossible.

TAIWAN-CHINA RELATIONS AND REGIONAL ECONOMIC COOPERATION

The dynamics of Beijing-Taipei relations is a factor which will inevitably influence APEC and other regional cooperation proceedings. Given that direct shipping, aviation, and communications between the two sides of the straits are restricted, it would be unrealistic to envision comprehensive economic integration within the region. Nevertheless, the mere fact that China, Taiwan, and Hong Kong all became members of APEC at the same time²⁴ at the Seoul summit in November 1991 is indicative of the direction of relations between the two former adversaries, and how they relate to the region.

Although direct trade and investment in China by Taiwan residents have technically been illegal—and thus official statistics are difficult to come by—economic relations between the two have become significantly extensive. China's two-way trade with Hong Kong—the conduit for Taiwan-China trade—grew significantly in the 1980s, from US\$9.4 billion in 1984 to just over US\$44.2 billion in 1990. Similarly, Taiwan's total trade with Hong Kong grew from US\$3 billion to US\$11 billion during the same period. Growth in consumer spending among Hong Kong's 6 million people has certainly not accounted for this growth. Taiwan investment in China has been funnelled through Hong Kong toward Guangdong and Fujian provinces in particular, where the effects have been seen in double-digit growth rates since 1987. In April 1991, when it

became legal, more than 2,500 Taiwan companies registered their investments in China, with a declared total value exceeding US\$660 million.²⁵

Taiwan has also become important to other economies in the region. This has especially been the case since the latter half of the 1980s, when various factors—including rising wage rates, a depreciating NT dollar, and large foreign exchange reserves—encouraged the outflow of capital directed mostly toward China and Southeast Asia.

As shown in [Table 1](#), approved Taiwan FDI to the ASEAN-4 countries has grown significantly since the mid-1980s. Between 1986 and 1989, Taiwan FDI to the region grew over 20 times from US\$92 million to just under US\$2 billion. In the following year, it doubled to US\$3.9 billion. These investments—made in relatively labor-intensive industries²⁶—have enhanced the relevance of Taiwan to Thailand and its ASEAN neighbors, and have thus made the Taipei-Beijing relationship more of a concern in the region.

The direction of relations between China and Taiwan have indeed been encouraging. The two capitals have floated their own proposals for unification, ranging from Beijing's "one country, two systems" model to Taipei's "one country, two governments" model. While in each case these proposals have been non-starters, the lifting of restrictions and the growing commerce across the straits are integrating the two in a de facto, if not de jure, manner. In May 1991, President Lee Teng-hui formally lifted the "period of communist rebellion," and declared the state of war with "Red China" to be over. The Taiwan legislature is also considering an omnibus bilateral-relations bill which will officially endorse the relaxation of restrictions on relations with China, and will likely allow the executive greater powers to improve these relations.²⁷

Formal unification, however, is unlikely to be witnessed in this century because the standards of living in China and Taiwan are so divergent that, until China's economy grows significantly, the Chinese in Taiwan will continue to be unwilling to sacrifice their way of life. The handing over of Hong Kong to China in 1997 will also act as a barometer for the Taipei government. Depending on how Beijing treats Hong Kong, and if it permits the soon-to-be former colony to maintain its system of government and market economy for 40 years, as agreed upon in the Basic Law, Taiwan's leadership will proceed accordingly on the issue of national unification. One point of concern for China and for many in Taiwan—as was made evident by the overwhelming electoral victory by the Nationalist Party in the 1992 elections—is the growing pressure from the Taiwanese population for independence. Although Taiwan is a de facto sovereign state, both the Beijing and Taipei regimes refuse to recognize it as such. While its means of doing so are in question, the government in China has threatened to use force to invade Taiwan if it declares itself an independent state. This has instilled a sense of caution in the Taiwan government, the result being that such an outcome is unlikely to occur.

Nevertheless, China and Taiwan are learning not only to coexist peacefully, but also to interact within fora such as APEC. Such implicit two-way recognition is further verified by the establishment of diplomatic relations between Taiwan and Grenada in 1991. Because both Taipei and Beijing reject a "two China" policy, if one of the two officially recognizes a third country, the other automatically severs its ties with the third country. This has been the case for all countries except Grenada. When Taiwan established relations with the Caribbean state, China continued to maintain official ties. Granted Grenada is not a very significant country in the eyes of the Chinese on either side of the straits, yet the significance of this dual recognition should not be overlooked. Taipei and Beijing appear to be developing a modus operandi—as is demonstrated by the Grenada recognition and the simultaneous accession to APEC—which will facilitate the contribution of these two important Chinese states to the regional economy.

REGIONAL RELATIONS

While the tenuous relationship between China and Taiwan appears to be improving, the state of Beijing's interaction with other states in the Asia-Pacific region is becoming less certain. Although the end of the Cold War has brought Chinese complicity in resolving the Cambodia conflict, and the establishment of diplomatic ties between Beijing and Hanoi, which was preceded by a rapprochement between China and

both Indonesia and Singapore, there are indicators that the relations are not eminently intimate.

The islands in the South China Sea, especially the Spratlys, have become a possible regional flash-point which could embroil China in conflicts with its Southeast Asian neighbors and Taiwan. Conflicting claims to sovereignty over the Spratlys by China, Brunei, Malaysia, the Philippines, Vietnam, and Taiwan have resulted in a standoff which has turned violent in the past. In 1988, the Chinese sank three Vietnamese naval vessels and killed 73 Vietnamese sailors in a clash over the islands. In its official 1983 map, the Chinese government claims to control three million square kilometers of the total 3.5 million square kilometers in the South China Sea. Efforts by the Indonesians to foster a peaceful agreement have had some success by eliciting unofficial assurances from the six players to cooperate. The Vietnamese even claim that they have turned down requests by foreign companies to negotiate oil exploration rights in the Spratly Island because claims to sovereignty have not been resolved.²⁸ Nevertheless, in May 1992, China signed an agreement with a United States company, Crestone Energy Corporation, to explore for oil between the Spratly Islands and Vietnam's southeast coastline. This action—possibly calculated to disrupt the rapprochement between Washington and Hanoi, or to gain territory in the vacuum emerging following the closing of United States bases in the Philippines—has caused a flurry of verbal exchanges, as the remaining five claimants resent China's expansionism.

Two issues are at stake. First, despite most of the islands being uninhabitable, their value derives from the potential of large mineral resources, and oil and gas deposits laying beneath the surface. It is estimated that there are oil reserves of between 13 billion and 17 billion tonnes in the 310,000 square kilometers surrounding the James Shoal island alone.²⁹ Although Li Peng intimated in August 1990 that China might be willing to pursue joint development of the Spratlys, it appears that the changing strategic situation in Asia has made them more bold in securing their interests. Second, the islands occupy strategic sea lanes from the Indian to the Pacific Ocean. Southeast Asian states wary of Chinese intentions fear that Chinese control over these sea routes would give excessive power to China.

Commercial relations with the United States are of particular concern to China. According to the Jackson-Vanick amendment of the United States trade law, every year Washington must extend China's MFN trade status, based on China's emigration policy. Until June 1989, the extensions were routine business. Following the crackdown on the demonstrators at Tiananmen Square, however, Democrats in Congress have seized the issue and made the extension of China's MFN status a yearly battle. President George Bush has been adamant about extending MFN to China and has received the necessary support needed in the Senate³⁰ to maintain his vetoes of bills attaching further conditions to the trade relationship.

The new administration under Bill Clinton, however, could be less congenial to Beijing. Although Clinton argues that China should not be isolated—after all, that is nearly impossible—he and the Democratic Congress are willing to place human rights conditions on the United States' trade policy toward China. Whether this means that China will lose its MFN trade status with the United States remains uncertain. The interpretation of whether human rights are being violated in China will rest on the president, who must take into account the additional side-effects of disrupting trade relations between the two economies. First, an estimated 100,000 American jobs will be lost as China retaliates by raising tariffs on American goods, for which there are substitute suppliers. Second, Hong Kong—a center for entrepôt trade between China and the United States—will be significantly hurt. The uncertainty about China's MFN status has already helped to undermine confidence in the colony in the lead-up to its reversion to China in 1997. Third, the dynamic private sector—that section of Chinese society which the United States proclaims it wants to support—will be the hardest hit. Not only will state enterprises receive discriminate support from the Chinese government in light of diminished exports, but the exposure of local entrepreneurs to foreign managers and their expertise will be diminished. Finally, such interference in China's internal affairs will play into the hands of the hardliners, who can use the United States' policy as justification for their xenophobic ambitions. The outcome of this policy debate will clearly have an impact on economic cooperation at the APEC-level.

Finally, China's relationship with ASEAN is of particular concern to Thailand. Singapore's efforts to improve

relations between ASEAN and China is being countered by resistance from Indonesia, whose suspicions of China have grown as a result of China's aggressive posturing in the South China Sea. Although trade with China makes up less than 2.5 percent of Thailand's total trade, it would be prudent for Thailand to cautiously encourage a regular dialogue between ASEAN and China, while reassuring Indonesia that its interests are not being ignored.

Thailand's relations with the Peoples' Republic of China have been close since 1975 and the fall of Saigon. Common interests in containing Vietnamese hegemonic aspirations allowed for a marriage of convenience between the two erstwhile adversaries. Although the nascent peace in Cambodia and rapprochement between Bangkok and Hanoi have weakened this common denominator, the relationship remains intact. As Wong warns, however, "... if there should be a fundamental change in the power equation in Indochina, it is not inconceivable that Thailand could change its bets and the resultant Sino-Thai relations would suffer."³¹ Indeed, members of the Thai military are wary of China and its sales of obsolete military equipment to Thailand at "friendship prices." Economic interaction and competition for third markets, however, are taking on greater significance in the Sino-Thai relationship and could become a central component of it. Greater dialogue, not only at the bilateral level, but also at the Asia-Pacific level can help to assure that Thailand gains the most it can from its mutually beneficial relationship with China and its reforming economy.

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