The Rise of China: Prospects of Regional Trade Policy

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Abstract: China now engages in multilateral trade liberalization as a new member of the WTO. Concurrently, the number of regional trade agreements is increasing worldwide. China and its trading partners would benefit from increased regional liberalization. Using a gravity equation for 23 Asia-Pacific countries between 1992 and 2000, we show that ASEAN and APEC currently have small effects on Asia-Pacific exports, which are mainly influenced by growth, trade barriers, and common language. However, we find that China's participation in regional agreements has large export potentials, not only with respect to ASEAN, but also in a broad agreement including South and East Asian countries. JEL no. F15, F17

Keywords: Economic integration; trade forecasting and simulation; gravity model; China

1 Introduction

In the past decades there has been a large expansion of trade in the Asia-Pacific region. Inspired by the East Asian tigers, other countries in the region have increasingly participated in trade. In order to boost international trade, most Asia-Pacific countries have pursued a policy of multilateral trade liberalization and have also entered into one or more regional trade agreements (RTAs). Given the increase in RTAs in other parts of the world, future multilateral liberalization may take place between trading blocs rather than between individual countries. Moreover, in response to difficulties in effecting multilateral trade negotiations, RTAs might demon-
strate larger dynamics in liberalizing trade. This may be the case especially in the Asia-Pacific region.

China's recent accession (2001) to the World Trade Organization (WTO) is a major step forward in the multilateral liberalization process. The opening of the large Chinese market will create new trade and investment opportunities for both China and its trading partners. But compared to its neighboring countries, China has to date been less active in joining RTAs in the Asia-Pacific Region. Nevertheless, China continues to further integrate with other Asian countries, as demonstrated by the recent talks between China and the Association of Southeast Asian Nations (ASEAN).\(^1\) This raises the question what regional trade policy is optimal for China and what the consequences are for the entire region. This paper focuses on the options for Chinese regionalism within the “regionalism versus multilateralism” debate.

In what follows, we estimate a gravity model for a set of 23 countries in Asia and the Pacific over a period of 9 years (1992–2000). In particular we try to answer three questions:

1. Which countries offer the largest openness to imports and exports and are hence good partners for regional trade liberalization?
2. Are the existing RTAs in the Asia-Pacific region trade-creating or trade-diverting with respect to members and nonmembers?
3. How large are the trade potentials for each country involved if China joins these RTAs?

We focus on three RTA scenarios. The first two involve RTAs with the Association of Southeast Asian Nations (ASEAN) and the Asia-Pacific Economic Cooperation (APEC) forum. The third is what we shall call the “Asian APEC,” consisting of a large group of Asian economies.

The gravity approach here is fine-tuned by some recent suggestions made in the literature. First, we pay particular attention to the distance variable and, secondly, we apply recent panel data econometrics throughout. Finally, we take into account new suggestions to measure trade creation and trade diversion effects.

The empirical findings point to limited effects from existing RTAs once we apply the appropriate methodology. Nevertheless several countries in the

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\(^1\) See Antkiewicz and Whalley (2004) for an overview of China’s recent RTA negotiations. See Section 2.3 and further on for an overview of the member countries of ASEAN and APEC.