Release No.: 19/Oct.

02-2/94/1/13

**SPEECH BY MR. LEE KUAN YEW, SENIOR MINISTER**

**AT THE EUROPE / EAST ASIAN ECONOMIC SUMMIT**

**AT SHANGRI-LA HOTEL**

**ON THURSDAY, 13 OCTOBER 1994 AT 5.00 PM**

# THE EAST ASIAN CHALLENGE AND ITS IMPACT ON EUROPE AND NORTH AMERICA

## Introduction

East Asia is projected to grow by five to six per cent on average over the next three decades, or seven per cent excluding Japan. By the year 2025, its combined Gross Domestic Product (GDP) will be twice as large as North America's, or almost equal to the GDP of North America and Europe combined. (See Table 1.)

National Archives of Singapore

The policies of the United States (US) and the European Union (EU) towards East Asia will have long-term strategic consequences for the future. However, neither has yet formulated a coherent, long-term strategy towards East Asia. The challenge of East Asia springs primarily from the colossal transformation that is taking place in China, a continent of 1,200 million people, able to do 50 times over what Hong Kong (six million) and Taiwan (20 million) together can do.

The other major and continuing challenge in East Asia is Japan. Japan already contributes 12.5 per cent of the United Nations (UN) budget - second to the US. It cannot indefinitely be denied a permanent seat on the UN Security Council. But it is China's giant size that poses the real challenge for Western strategy in the post-Cold War era.

National Archives of Singapore

As the nature of the challenge from Japan is well known, I will deal mainly with China. This is not because the rest of East Asia is unimportant. Korea. Taiwan, Hong Kong and the Association of the South East Asian Nations (ASEAN) are significant players in East Asia. But they cannot alter the balance of power in the world. China can.

China's GDP will be equal to that of North America in three decades. It will become a global player. How the West deals with China as it struggles to overcome its many economic, political and administrative weaknesses will determine whether China will be a constructive or a negative player.

The West can join in China's development and benefit from it. Or it can try to slow down China's growth through restricting its access to markets, capital and technology and so minimise its own restructuring which will become necessary as a result of China's enormous supply of skilled and unskilled workers.

Over the next three decades, China will need huge amounts of Western capital, technology and know-how. If the West engages in constructive collaboration with China, China will be more likely to become a cooperative global player.

National Archives of Singapore

**Integrating East Asia or Isolating It: The West's Strategic Choice**

The World Bank estimates that between one-third and one-half of the global increase in imports from now until the year 2000 will be accounted for by East Asia. Its rising incomes have increased demand for sophisticated consumer goods and infrastructure development, which Western firms are well-placed to provide.

**Is East Asia a Threat or an Opportunity?**

These opportunities have not been favourably articulated in the West. The Western media, with a few exceptions, have portrayed East Asia's rapid growth, especially China's rapid growth as being at the expense of the West, displacing lower-skilled Western workers from their jobs.

National Archives of Singapore

The conventional wisdom is that exports from East Asia displace domestic production in the West, thus increasing domestic unemployment and contributing to economic stagnation. Some Western politicians and media claim that East Asian exports are competitive because they rely on "exploited, underpaid" labour, and on labour practices which could not be tolerated in the West.

In reality, exports from developing Asian countries form only a tiny fraction (less than 4 per cent) of total consumption of manufactured goods in the developed countries[1]. Technological change, not competition from poorer countries, is the basic cause of US and EU unemployment. Because European wages and social costs are high, managements avoid hiring more workers by increasing automation, computerisation and robotics. So, their demand for highly educated labour is increasing, but their demand for unskilled labour is falling.

The western media portrays investments in the emerging economies as being at the expense of investments in the industrial countries. The flow of capital from all advanced nations to newly industrialising countries reached a new peak of US$100 billion in 1993. But this represents only three per cent of investment in developed nations[2].

National Archives of Singapore

1 Imports from developing countries as a percentage of manufactured consumption in the developed economies were 3.36 per cent for 1989-90 (Handbook of International Trade and Development Statistics 1992, UN Conference on Trade and Development, Geneva, pp. 534).
In 1992, the US and European Community (EC) 12 countries spent 3.0 per cent of their combined GDPs on imports of manufactured goods (SITC 5 to 8) from East Asia (including Japan), or 1.3 per cent if Japan is excluded.

2 It would have reduced growth in their capital stock by less than 0.2 per cent (Paul Krugman, "Does Third World Growth Hurt First World Prosperity?" in Harvard Business Review, July-August 1994, pp. 113-121).

Far from diverting investments from the West, the increase in demand for goods and services created by East Asia's emergence will stimulate investments in the West to meet this demand.

In the US, advocates of managed trade say that East Asia's bilateral surpluses are proof of unfair competition. America's largest deficit is with Japan[3]. It is caused by macroeconomic fundamentals. As long as Americans save too little of their income, they will be running deficits, with Japan or with other countries.

The increase in the US trade deficit with China is because Hong Kong and Taiwanese industries have moved to China. America's trade deficit with China increased while its deficits with Hong Kong and Taiwan have declined. But the overall American trade balance with China, Taiwan and Hong Kong together has not changed.

National Archives of Singapore

[3] In 1993, the US calculated its trade deficit with Japan at US$72.5 billion, and that with China at US$23.7 billion (as reported in IMF Direction of Trade Statistics, June 1994.) The OECD Monthly Statistics of Foreign Trade, August 1994, gives the US - Japan bilateral trade deficit in 1993 as US$59.3 billion.

The combined current account deficit of East Asia (excluding Japan) will get larger in the next decade, as massive infrastructural investments flow into China and the rest of East Asia[4]. The West has huge opportunities to export its goods and services to the region, and build infrastructure needed for its growth.

**How the West can Benefit**

East Asia has already helped to spur economic recovery in certain sectors in the West. For example, the aviation industry, airlines in US and Europe face severe financial problems due to the economic recession and airfare wars. Western airlines have drastically cut orders for new aircraft. On the other hand, Asian demand for aircraft has remained strong. Airbus Industry expects air traffic to grow at an average of eight per cent in Asia though to the year 2006, compared to five per cent in Europe and four per cent in the US. China will lead this demand with a 14 per cent per annum growth in passenger traffic[5].

National Archives of Singapore

Estimates of China's demand in energy, information technology (IT) and telecommunications are overwhelming. Western firms are strong in these sectors. China's electricity consumption will more than triple over the next two

[4] East Asia excluding Japan should have a combined current account deficit of about US$50 billion (in 1993 dollars) by the year 2000.

[5] "Asia likely to lead growth in air travel industry, says Airbus" in Business Times 25/2/94, pg. 2.

decades. China's IT market is expected to more than double to US$48 billion by 1997[6]. China aims to increase the number of main telephone lines per 100 inhabitants from two at present to 10 by the year 2000. If they reach even half of this target (five lines per 100 inhabitants), it will be 20 per cent of the world demand for telecommunications equipment in the year 2000[7].

Annual per capita income for the top 10 per cent of Chinese households, at market exchange rates, is about US$1000[8]. That's more than 100 million consumers. Higher income households have fuelled much of the consumption boom over the last few years. The demand for big-ticket items is especially strong. Private consumption tripled between 1978 and 1992: Sales of refrigerators rose 24 times. The Chinese people have purchased about 13 million television sets in 1990 - about 11.5 per 1000 population.

National Archives of Singapore

Another example is biotechnology. Many biotechnology firms are setting up new offices in China. Amgen Inc., for example, has opened offices in Beijing and Guangzhou. American Biogenetic Sciences has established a cooperative

[6] Report by San Jose based market research firm Dataquest Inc., quoted in "Demand will double size of IT market in China, says report" in Business Times 30/3/94, pg. 4.

[7] "Hanging on a China line" in The Economist 27/8/94, pg. 50 and "Alcatel in China: The biggest prize" in The Economist 16/1/93, pp. 68-69.

[8] Data in this paragraph from "China's consumer market", DRI/McGraw-Hill and the China Statistical Information and Consultancy Service Centre, Fourth Quarter 1993.

agreement with the Chinese Academy of Medical Sciences in Beijing, while United Biomedical Inc. has received approval from the Chinese government to test its new AIDS vaccine in Yunnan[9].

In the past, western firms invested in East Asia to take advantage of lower production costs. Some western firms now produce the bulk of their global output in Asia. Texas Instruments hires more than 15,000 workers in Asia, including production operators, software engineers and even research and development (R & D) specialists[10].

Now they can take advantage of East Asia's growing consumer market. General Motors is entering the automobile market in Southeast Asia. But the Japanese had earlier set up a network of local assembly plants in the region[11], and they are overwhelmingly dominant.

National Archives of Singapore

[9] "Genes for the masses" in China Trade Report, March 1994, pg. 5.

[10] "A new frontier: US electronics firm expands in Asia" in Far Eastern Economic Review, 17/9/92, pp. 62-63.

[11] "GM Finally Discovers Asia" in Business Week, 24/8/92, pp. 42-43.

The growth in Asia's demand for goods is matched by its greater need for services from the West. Asia already runs large trade deficits in services, from US$17.6 billion in 1987 to US$57.1 billion in 1992[12]. By 1992, Asia had overtaken Europe as the biggest buyer of US services[13].

China will not import simple manufactures goods like television sets and radios which they can easily manufacture. But it needs sophisticated equipment for production. It needs expertise and technology in financial services, telecommunications, transportation, health care and education. The US and Europe have the comparative advantage in these service sectors.

The US and Europe will benefit from these developments in East Asia. But they have to tackle their own problems of low savings, high budget deficits due to extensive welfare provisions, and structural rigidities in the labour markets.

National Archives of Singapore

Japan also will have to adjust. Its comparative advantage is shifting. If it does not relocate the production of goods to East Asia, it will become uncompetitive and unable to free resources for higher value-added sectors. Compared to German or American firms, the Japanese still produce a much

[12] "Invisible imbalance: Asia's services trade deficit" in Business Asia 11/4/94, pp. 12.

smaller fraction of their output in subsidiaries outside of Japan (six per cent). Over the next decade, they have to relocate many lower value-added industries.

National Archives of Singapore

[13] US Department of Commerce, as cited in Business Times 20-21/11/93, pg. 1.

**Integrating China in a Multilateral Framework**

Integrating China in a multilateral framework is really the first item on the agenda of developed countries. President Clinton's renewal of China's most favoured nation (MFN) status and his commerce secretary's recent China visit show that Americans recognise what is at stake. Lobbying by human rights interest groups could not overcome the need to get US industries into China. In 1993, the US had over 2000 investments worth US$6 billion in China. But more important than the economic are the strategic interests. The US needs to encourage China to be a cooperative and constructive global player.

China's relations with the industrial world should be multilateral, not bilateral. Closer ties between China and the US should be matched by similar ties between China and Japan, China and EU, in a multilateral framework of cooperation -- in trade, intellectual property rights (IPRs) and also international security.

National Archives of Singapore

China's early accession to General Agreement on Tariffs and Trade (GATT) is important for the world. GATT membership will push China to move more rapidly in removing its import barriers. All GATT members can hold China to the terms of the agreement. It would have to play by the rules and abide by its

promises[14]. China has already gained from the Uruguay Round, but through separately negotiated bilateral agreements[15]. As a GATT member, China's concessions will be multilateral, not confined to the stronger countries that can extract concessions by bilateral agreements.

China should also be integrated into a multilateral regime for the protection of intellectual property rights (IPRs). American software makers estimate that 94 per cent of software in use in China is pirated, causing them estimated losses of US$322 million per annum[16].

[14] China has already signalled its willingness to join GATT, by instituting reductions in tariffs and quotas and making certain concessions to the West. For example, the US and EU wants safeguards written in to the protocol governing China's accession, so as to protect their economies against surges of Chinese imports. After initial opposition, China has indicated its willingness to make concessions on the safeguards issue (Far Eastern Economic Review 17/3/94, pp. 42-43).

National Archives of Singapore

[15] GATT reforms are expected to boost China's exports by 38 per cent over the next 10 years - double the average benefit for developing countries - and to increase its GDP by 1.8 per cent - 2.5 per cent by the year 2002 (Business China 7/3/94, pg. 4, quoting World Bank and OECD estimates). China enjoys large gains because its main exports are now manufactures goods, which are subject to relatively high tariffs, rather than primary products, which face lower tariffs. Moreover, the Uruguay Round agreement to phase out the Multi - Fibre Agreement in 10 years would also boost Chinese textiles exports significantly.

[16] Estimates by Business Software Alliance, which represents eight US software makers. These losses may be underestimated, because China cannot be hermetically sealed off from the rest of the world. The International Federation of Phonographic Industry estimates that China has 26 plants producing 75 million compact discs (CDs) annually, while its annual domestic demand is only 5 million per annum. Therefore, the pirated CDs are actually being made for export. If China is not integrated into the world IPR regime, such illegal exports have the potential to undermine IPRs in other countries. ("Fakes under Fire" in China Trade Report July, 1994, pp. 2-3.)

For the world's stability and security, integrating China into an international framework is not a question of choice, but of necessity. The world does not need another Cold War. The ASEAN Regional Forum (ARF)[17], which involved all five Security Council members of the United Nations, is a good example of multinational cooperation to ensure stability in the region.

**The Costs of Isolating China**

China's emergence as a major global economic player over the next two to three decades can be slowed, but not stopped. If the West seeks to block China's development by imposing trade restrictions and withholding technology, China's growth will undoubtedly slow down. China may take at least twice as long to become industrialised. At slower growth of about 4 per cent per annum from 2000 onwards, China will reach a GDP level in 50 years (2045). That is equal to what it can reach in 30 years (2025) if it grows at seven per cent per annum. But it will eventually get there, and what is more troubling, it will have to build up its own sphere of influence as part of the process.

National Archives of Singapore

I believe that the US and EU will lose in strategic terms if China operates outside GATT and goes it alone. For it will mean that China need not pay

[17] Eighteen countries: ASEAN, US, Japan, Canada, the EC, South Korea, Australia, New Zealand, Russia,

copyright royalties or observe patent rights and that the US and EU will give up exports and investments in the largest growing economy in the post-Cold War world.

Blocking China only encourage China to go for DIY (do-it-yourself) solutions. China will pirate copyrights, ignore patents, do reverse engineering and make the grade as Japan did before World War II. Whatever relief the West will gain from China's, and as a result East Asia's, slower growth, will have to be paid for in terms of heightened world tensions and increased military spending. The price will be a world poisoned by enmity and suspicions.

Finally, what happens in East Asia, which means in the main, what happens in China and Japan and how their relationship develops, will decide the kind of world we live in year 2020. It will be short-sighted to repeat the errors of protectionism, imperial preferences, and currency devaluations that led to World War II. The world has become too integrated by science and technology to be kept apart by policies based on ideology, religion, culture or race. For better or for worse, we have become one interdependent and mutually destructible world.

National Archives of Singapore

---

China, Vietnam, Laos and Papua New Guinea.

Table 1
GDP Projections at Purchasing Power Parity

| | Real Growth (% pa) | | | | | GDP at PPP's and Price Levels of 1990 (US$8m) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1956-90 | 1991-2025 | 1991-2000 | 2001-2010 | 2011-2025 | 1990* | 2000 | 2010 | 2015 | 2020 | 2025 |
| North America | 2.9 | 2.7 | 2.7 | 2.8 | 2.7 | 8560 | 8642 | 11069 | 12601 | 14420 | 16800 |
| US | 2.8 | 2.1 | 2.5 | 2.0 | 2.0 | 5522 | 7069 | 8617 | 9513 | 10504 | 11597 |
| Canada | 3.9 | 2.2 | 2.2 | 2.5 | 2.0 | 523 | 650 | 832 | 918 | 1014 | 1119 |
| Mexico | 4.4 | 5.9 | 4.8 | 7.0 | 6.0 | 516 | 824 | 1621 | 2169 | 2902 | 3884 |
| LA & Caribbean (ex Mexico) | 3.7 | 5.0 | 5.0 | 5.0 | 5.0 | 811 | 1321 | 2152 | 2746 | 3505 | 4473 |
| Europe | 2.2 | 2.9 | 2.3 | 3.1 | 3.1 | 6354 | 7997 | 10859 | 12506 | 14563 | 17162 |
| FC-12 | 3.1 | 1.9 | 2.3 | 2.2 | 1.5 | 4626 | 5307 | 7219 | 7777 | 8378 | 9026 |
| FFTA | 2.7 | 1.9 | 1.6 | 2.0 | 2.0 | 653 | 648 | 790 | 872 | 963 | 1063 |
| East Germany | 2.3 | 7.4 | 8.0 | 7.5 | 7.0 | 151 @ | 326 | 672 | 943 | 1323 | 1853 |
| Eastern Europe | 1.5 | 5.1 | 3.0 | 6.0 | 6.0 | 512 | 688 | 1231 | 1648 | 2205 | 2951 |
| FSU | 1.3 | 4.3 | 0.3 | 6.0 | 6.0 | 513 @ | 528 | 946 | 1268 | 1694 | 2287 |
| East Asia= NE Asia + SE Asia | 7.3 | 5.5 | 5.6 | 5.6 | 5.4 | 4982 | 8697 | 14882 | 19237 | 25086 | 32978 |
| East Asia (ex. jpn) | | 6.7 | 7.5 | 6.8 | 6.2 | 2889 | 5927 | 11485 | 15487 | 20946 | 28407 |
| North East Asia | 6.2 | 5.3 | 5.3 | 5.3 | 5.3 | 3975 | 6639 | 11206 | 14338 | 18547 | 24239 |
| Japan | 5.6 | 2.3 | 2.5 | 2.4 | 2.0 | 2093 | 2680 | 3397 | 3750 | 4141 | 4572 |
| China | 7.5 | 7.6 | 8.5 | 7.5 | 7.0 | 1268 | 2843 | 6861 | 8220 | 11528 | 18189 |
| China & HK | | 7.4 | 8.3 | 7.3 | 6.9 | 1350 | 2894 | 6079 | 8473 | 11823 | 18510 |
| NIEs - 3 | 8.8 | 5.1 | 8.6 | 5.3 | 4.0 | 603 | 1139 | 1910 | 2321 | 2820 | 3428 |
| Hong Kong | 8.1 | 3.8 | 5.0 | 3.8 | 3.0 | 93 | 151 | 219 | 264 | 294 | 341 |
| South Korea | 9.1 | 5.4 | 6.9 | 5.8 | 4.2 | 309 | 63 | 1041 | 1277 | 1567 | 1923 |
| Taiwan | 9.0 | 5.1 | 6.7 | 5.4 | 4.0 | 202 | 386 | 651 | 790 | 959 | 1181 |
| North Korea | na | 3.4 | 2. | 4.0 | 4.0 | 22 | 26 | 39 | 47 | 57 | 70 |
| South East Asia | 6.2 | 6.4 | 6.7 | 6.7 | 5.9 | 1007 | 1918 | 3676 | 4899 | 6539 | 8730 |
| ASEAN-5 | | 6.4 | 6.7 | 6.7 | 5.9 | 981 | 1871 | 3577 | 4782 | 6347 | 8470 |
| Singapore | 9.0 | 4.6 | 6.8 | 4.5 | 3.0 | 40 | 78 | 121 | 140 | 163 | 180 |
| ASEAN-4 | 6.3 | 6.4 | 6.7 | 6.8 | 6.0 | 941 | 1793 | 3456 | 4622 | 6185 | 8282 |
| Indonesia | 6.5 | 6.2 | 6.5 | 8.5 | 5.6 | 429 | 806 | 1619 | 2005 | 2658 | 3524 |
| Malaysia | 6.8 | 6.5 | 8.0 | 7.1 | 5.2 | 105 | 228 | 452 | 582 | 750 | 967 |
| Philippines | 4.1 | 5.7 | 2.9 | 6.0 | 7.4 | 143 | 190 | 340 | 486 | 694 | 982 |
| Thailand | 7.6 | 7.0 | 8.0 | 7.3 | 6.1 | 264 | 569 | 1152 | 1549 | 2082 | 2789 |
| Vietnam | na | 7.9 | 8.0 | 8.5 | 7.5 | 8 @ | 17 | 39 | 56 | 30 | 115 |
| Myanmar | na | 7.0 | 6.0 | 7.8 | 7.1 | 8 @ | 14 | 30 | 42 | 60 | 84 |
| Others # | 2.2 | 5.9 | 6.5 | 6.0 | 6.0 | 10 @ | 16 | 29 | 39 | 52 | 70 |
| Australia & NZ | 3.5 | 2.9 | 3.5 | 3.1 | 2.5 | 319 | 450 | 610 | 690 | 779 | 881 |
| South Asia | 4.3 | 5.9 | 5.5 | 6.0 | 6.0 | 338 @ | 577 | 1034 | 1384 | 1852 | 2478 |
| Others | 4.3 | 4.7 | 4.4 | 4.8 | 4.9 | 1211 @ | 1859 | 2983 | 3781 | 4793 | 6078 |
| Africa | 3.0 | 3.3 | 1.7 | 4.0 | 4.0 | 255 @ | 302 | 302 | 544 | 681 | 805 |
| Middle East | 5.3 | 5.0 | 5.0 | 5.0 | 5.0 | 956 @ | 1557 | 1557 | 3237 | 4132 | 5273 |
| World | 3.1 | 4.0 | 3.6 | 4.0 | 4.2 | 20575 | 29353 | 43589 | 52944 | 64998 | 80651 |

Brunei, Cambodia and Laos
International Financial Statistics. World Bank World Development Report 1992: Asia Yearbook, 1992; National Publications.

National Archives of Singapore