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Strategic Policy Implications for Southeast Asia

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Ng Beoy Kui

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The Economic Emergence of China: Strategic Policy Implications for Southeast Asia

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ABSTRACT

The purpose of this paper is to analyze strategic policy implications arising from possible threats and opportunities in the face of the emergence of China as an economic powerhouse. The focus of the paper is not on the regional approach through mainly regional co-operations but more on policy strategies and responses at the national level. Depending on their degree of national economic development, economic structure and comparative advantage, eight strategic positionings have been identified. Of these eight positionings, direct competition is considered as an unwise move, considering China being endowed with relatively cheap labour resources. Together with its huge domestic market which can serve as a magnet for direct foreign investment, competition in attracting FDI can be a daunting task for most to the Southeast Asian countries. Instead, competition based on niche areas through branding, for instance provides a feasible alternative. The other alternative is to avoid direct competition by upgrading its economy, venturing into those areas where China has no comparative advantage as well as looking inward for sources of growth. Others may adopt 'connecting' strategies such as complementing or supplementing the Chinese economy by meeting China's increasing demand for natural resources or exploiting its huge domestic market. Still others may explore the possibilities of forging strategic alliance with China in the global market or playing the role of a middleman between China the West.

Keywords*: China, Southeast Asia, ASEAN, foreign direct investment, outbound investment, international trade, comparative advantage, tourism*

Introduction

When China adopted an open door policy in 1978, there was not much of a concern to the Asian countries, as political uncertainties within China still were unsettled[1]. After Deng's visit to the Southern China in 1992, political atmosphere in favour of drastic economic reform emerged in earnest. Foreign direct investment (FDI) started to pour in and reached a peak in 2005. Initial focus in manufacturing activities was directed at light manufacturing such as textiles, clothing, apparels, spot goods and toys. As multinational corporations (MNCs) from Taiwan, Hong Kong, Korea and Japan began to reallocate their electronics plants to China, China switched its focus to manufacturing of electrical, electronics and telecommunication products and was subsequently integrated into the Asian production networks.[2] The rapid expansion of manufacturing exports from China has raised the concern among Southeast Asian countries that their exports might be crowded out by Chinese exports in the third country markets, in particular the US market. This is because Chinese main comparative advantage in relatively cheap labour may wipe out Southeast Asian labour-intensive industries. The concern is further aggravated by the accentuation of China serving as a magnet for attracting massive of FDI at the expense of Southeast Asia as a region. With the accession of China into the World Trade Organization (WTO) in 2001, such fear of 'China threat' has caused much anxiety within the region and various policy proposals were adopted in response to the emergence of China as an economic powerhouse.

China, on its part also attempts to allay the fear by showing its willingness to join the ASEAN's free trade zone as early as in December 2000 with the objective of establishing the ASEAN-China free trade zone by year 2010. China also participated in other regional co-operation efforts such as the 'Early Harvest Programme' in October 2003 and Chiang Mai Initiative (CMI) for financial cooperation in 2000. All these economic co-operations were well documented and updated by a recent book edited by Saw (2007). While regional approach towards the rise of China is well documented in the literature, individual national policy responses are not much recorded, however. The purpose of this paper is to assess various policy implications and also evaluate some of the policy responses adopted by the Southeast Asian countries.

The paper is divided into four sections. After this Introduction, the paper, in its second section, attempts to ascertain the seriousness of China threat in trade and investment. The third section intends to assess various policy implications for the Southeast Asian countries from a national strategic perspective. The final section gives an overview of these policy implications and raises some of the issues and concerns for future discussion and research.

Does China Pose a Threat?[3]

With the opening of China, its merchandise trade has increased tremendously over the last three decades. In particular, Chinese exports which totaled 1% of the total world exports in 1978, had increased significantly to 13% in 2005.

Consequently, China is the third largest trading nation after the United States and Germany in 2006. China's trade structure has in the meantime, undergone a profound transformation since its opening in late 1970s. Firstly, manufactures exports as a percentage share of total merchandise exports rose from less than 40% in late 1970s to 92.4% in 2006, with the rest accounted by agricultural and mineral products. Secondly, there was also a structural change within the manufacturing export sector. In the first and half decade after its opening, manufacturing exports comprised mainly labour intensive products such as apparel, footwear, toys and sport goods. These manufactures goods accounted for a half of the total merchandise exports and two-thirds of manufacturing exports by mid-1990s (Athukorala, 2007: 5). However, the composition of export trade shifted towards more sophisticated manufactures, such as electronics and telecommunications products as well as transport equipments and machinery. While sophisticated manufacturing exports recorded a dramatic increase from 17% to 44% between 1993 and 2005, light manufacturing exports, however, showed a secular decline from 49% in 1993 to 31% in 2005. Notwithstanding with such dramatic shift, the degree of sophistication in these Chinese manufacturing exports is debatable, however.

Does China Increase Its Market Share at the Expense of Southeast Asia?

In mid-1990s, Southeast Asian countries' market share in US and Japan's imports already showed signs of retreating, in the face of increasing China's competition. For instance, China's share of US imports has increased from 0.7%

in 1987 to 9.2% in 2004 while the share of ASEAN-5 (Indonesia, Malaysia, the Philippines, Singapore and Thailand) in the same market increased from 4.5% in 1987 to 6.7% in 2000 and then declined to 3.8% in 2004. As Revenhill (2006) observes, China's exports of office machinery, electrical machinery and telecommunications products which were insignificant in 1995 in US and Japanese markets started to exceed that of ASEAN-5 by around 2002. For clothing, apparel and footwear, the negative impact from China in these two markets was even more damaging. For instance, imports of clothing from China by Japan rose by more than 70% between 1995 and 2004 and, the share of this market reached 80%. In contrast, ASEAN's share dwindled to 3% from 6.5% in the same period. This "trade competition" paradigm is well supported by empirical evidence provided by Bhattacharya A. S. Ghosh and W. J. Jansen (2001). Eichengreen, Rhee and Tong (2004) also concur that China's exports to third markets tend to crowd out the exports of other Asian countries. Study by McKibbin and Woo (2003) also show pessimistic results that Southeast Asian industrial exports were facing intense competition from Chinese industrial exports.

In the same vein, study by Lall and Albaladejo (2004) also shows the extent of competition from China. The authors use correlation analysis between Chinese and regional export structures as indicator of China's competitive threat (see Table 1). Between the period 1990 and 2000, they conclude that Chinese export structure was becoming similar to that of its neighbours. For instance, export structure of Singapore was hardly similar to that of China in 1990. However, by year 2000, the correlation coefficient went up from 0.1 to 0.41. Other Southeast Asian countries also show similar trends. Chia and Sussangkarn (2006:109) calculate Spearman's rank correlations on global exports of ASEAN and China for 2003 which shows R^2= 0.6149 for the region. Individual countries show correlation between 0.4733 (Singapore) and 0.6663 (Thailand).

Lall and Albaladejo (2004) also compute technological structure of China and ASEAN-5 (Table 2). All countries show an upgrading in their exports' technological structure. China started with high share of resource-based and low technology exports. Within one decade, China had improved significantly on exports of high technology products. ASEAN-5 also displayed similar trends of varying degrees. The authors also use changes in world market shares as indicators of China's threat. ASEAN-5 is considered as facing 'direct threat' from China if its market shares declines while that of China rises. Similarly, if both entities gain their market shares and that situation is considered as 'no threat' from China. However, if both entities gain market shares at the same time but China's gain is faster, then it is noted as 'partial threat.' From Table 3, all ASEAN-5 face increasingly 'partial threat' from China but 'direct threat' has gone down significantly. Except for Malaysia, 'direct threat' for other ASEAN countries show significant declines. The number for 'no threat' from China also increased for all ASEAN-5 except Malaysia. There are two main reasons for such scenario. One is that ASEAN-5 exports a significant amount of machinery and electronic parts and components to China which later serves as an export platform for these products after their processing or assembly there. That explains the increasing ‘partial threat’ from China and this is misleading. Secondly, ‘no threat’ from China increases because China imports large quantities of primary products and resource-based manufactures as well as capital and intermediate goods to meet its needs in domestic-oriented production. She also imports sophisticated consumer goods to meet increasing domestic dmand (Lall and Albaladejo, 2004: 1457). Study by Ahearne and others (2003) also observe that there was a co-movement of export growth between China and other Asian economies in the period between 1979 and 2001. Common factors such as economic growth in advanced economies, movements in the world prices of key exports and movements in the yen-dollar exchange rates exerted far more impact on all Asian exports. The implications from their analysis are that competition from China has negligible effects on Southeast Asian export performance.

Revenhill (2006) also observes that shares of manufactures in China’s imports from ASEAN increased from a weighted average of 31% in 1990 to 56% in 2004 (see Table 4). This confirms the view that China is deeply involved in the triangular trade of the Asian production networks (Gaulier, Lemone and Unal-Kesend, 2005; Haddad and Easpr, March 2007; Athukorala, Prema-Chandra. 2006; IMF, 2007)). In this trade, the newly industrialized economies comprising Hong Kong, Korea, Singapore and Taiwan as well as ASEAN-5 imported parts and components from US and Japan and processed them into intermediate inputs. These inputs are then exported to China for final assembly as this last stage of processing is the most labour intensive. Finally, China exports these final products back to US and Japan.

Does China Divert Away Foreign Direct Investment?

Another Southeast Asian concern is the diversion of FDI away from the region in the face of massive FDI flows into China. Such diversion became evident when Southeast Asia was still licking its wounds after the Asian financial crisis in 1997. In fact, the region's share of total FDI declined from over 30% in mid-1990s to 10% in 2000. With the global IT recession in 2001 and the outbreak of SARs (Severe acute respiratory syndrome) in 2003, FDI inflows of Southeast Asia still hovered around US$20 billion on average between 2000 and 2003 while that of China was more than double the inflows of Southeast Asia, recording almost US$50 billion on average (see Table 5). In 2006, FDI flow to China recorded US$69.5 billion and that of Southeast Asia recovered strongly to reach US$51.5 billion. This trend shows that the issue of FDI diversion to China is uncalled for. In fact, FDI flows between the two entities grew concurrently with a rapid pace, indicating that FDI flows is not a zero sum game. The so-called diversion was mainly due to the uncertainties arising from the aftermath of the Asian financial crisis (Wu, et al, 2002), the global IT recession and the outbreak of SARs. According to Mercereau (2005) there is very little evidence to indicate that China's success in attracting FDI has been at the expense of other countries in the region, with the exception of Singapore and Myanmar. Singapore suffered a decline in FDI was due to the global IT recession in 2001 and the outbreak of

SARs in 2003. Myanmar suffered a decline in FDI because Singapore, one of its main investing countries, has switched its investment focus to China. Kit, Ong and Kwang (December 2005) believed that East Asian economies of Korea, Taiwan, Singapore, Malaysia, Indonesia and Thailand will continue to draw FDI flows, notwithstanding China's magnet for FDI. Their conclusion is based on the notion that MNCs need to diversify their risks in investment among East Asian countries, and also that the lack of intellectual property protection in China may deter some MNCs from investing in China.

Secondly, the need for division of labour in the Asian production networks arising from intra-industrial specialization among affiliates of MNCs and supply chain complementarities would lead to concurrent investment in both China and Southeast Asian region (Giroud, 2004; Ravenhill, 2006). Chantasasawat, Fung, Izaka, and Siu (2004) estimate that for a 10% increase in the China FDI, East and Southeast Asian countries are able to attract 5% to 6% in FDI. The correlation partly explains the complementary aspect of FDI between China and other parts of East Asia. This is especially so when China is already deeply involved in vertical specialization in electronics and telecommunication industry. According to Dean, Fung and Wang (January 2007), 35 per cent of the value of China's exports to the world is attributed to imported inputs. In some sectors the percentage share is more than 50%.

China's Emergence and Policy Implications

The above discussion is at the aggregate level. Much insight will be shown if one goes deeper at industry or product level. Economic Analytical Unit (2003) uses Michaely index[4] to show China and East Asian countries' major areas of comparative advantage and disadvantage. From the analysis (Table 6), China's major comparative advantage is still in the areas of labour intensive manufactures. Its major comparative disadvantage is still confined to primary commodities such as crude oil and mineral products. However, China is rapidly moving up the value added chain, as shown in Table 7. China is gaining its comparative advantage in electronics and telecommunications products while loosing its advantage in light manufacturing products such as clothing and footwear as well as prepared foodstuff.

Resource-based Industry and Policy Responses

For the Southeast Asian region as a whole, the region has comparative advantage in resource-based products, such as timber (Malaysia, Indonesia and Myanmar); crude oil (Indonesia and Malaysia); palm oil (Indonesia and Malaysia); and other food products (Thailand and Vietnam). In this respect, exports of these commodities to China are that of complementary relationships. With an average GDP growth rate of about 9-10% a year since 1978, China has an insatiable appetite for raw materials to the extent that it has been labeled as a "hungry dragon" (Economist, 2nd October 2004). Its demand for primary commodities, especially energy, metal and food products has increased rapidly. China is now the second largest consumer of oil after the United States. In this case, Southeast Asia's exports of commodities and foodstuff to China are considered as complementary in nature. However, some Southeast Asian countries are concerned that the higher demand for such products by China and the concurrent decline in manufacturing exports may lead eventually to their 'de-industrialization.'[5] The term has a negative connotation of 'exploitation' and 'old colonial division of labour' (Bello, December 2006) of primary commodity producing countries[6]. The concern was especially widespread among Asian late-comers such as Vietnam, Myanmar, Laos, and Cambodia, and to a lesser extent, Thailand and the Philippines (Bello, December 2006; Cao, 2006; Tran, March 2006).

The complementary economic relationship between China and Southeast Asia would inevitably benefit Southeast Asia as a whole. This will contribute to the region's GDP and thereby economic development of the region. As noted by Humphrey and Schmitz (April 2006), China has a substantial economic impact on Asia through its increasing demand for oil. Energy consumption has been driven by China's rapid economic growth, accompanying by its industrialization, urbanization, and increased motorization. This has raised oil prices, contributing huge amount of oil revenue to the coffers of oil-exporting countries such as Indonesia, Malaysia and Vietnam. However, oil-importing countries especially the late-comers will suffer greatly as oil import bills will rise substantially. In addition, rising oil prices will raise inflationary expectations among countries which can be intractable macroeconomic problems for all nations. The increasing exports of other raw materials and foodstuff to China also help Southeast Asian development. As to the issue of de-industrialization, it is up to each of the Southeast Asian countries to undertake policy measures to avoid such process. Export proceeds earned from resource-based industries could be diverted to the effort of restructuring and upgrading their economies. The issues of 'exploitation' and 'old colonial division of labour'[7] would not be repeated as Southeast Asian countries also export manufactures and not just primary commodities in a globalized world. The policy issue here is how to exploit one country's comparative advantage and at the same time to restructure the economy so as to be more competitive in the global market.

Labour-intensive Manufacturing and Policy Implications

A study by the Asian Development Bank (2007) concludes that "Southeast Asia competes in world markets with the PRC in labor-intensive manufacturing but the PRC is largely complementary in natural-based products and human capital- and technology-intensive manufactures." According to IMF (October 2007: 47), "While there remains a clear division of labour among Asian sub-regions, the complementary relationship shows some signs of evolving into a more competitive one." In particular, ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand and Vietnam) is experiencing rising competition from China. As Rahardja (August 2007) noted, these countries now feel competitive pressure from China in the third markets as well as in their own backyards. For instance, China’s exports of machinery to the world in 1993 were at the same level as that of Malaysia. However, by 2004, China’s exports of the products were four times more than that of Malaysia. Tham (December 2001) concludes that for high-technology products, Malaysia still has comparative advantage vis-à-vis that of China. Its resource-based products such as wood and wood products, crude oil and palm oil are making significant inroad into the Chinese market. However, Malaysia lost out in terms of export share of labour intensive products such as clothing and apparel. As for home markets, manufacturers of motorcycles in Indonesia (Rahardja, August 2007), Thailand and Vietnam (Intarakumnerd and Fujita, 2006) are under severe competition from imported Chinese motorcycles. However, ASEAN increased its market share (value term) in the US apparel market from 17.3% in 2005 to 19.3% in 2006 (ADB, 2007: 95). In particular, Cambodia, Indonesia and Laos have gained significant market share in the US clothing market.

From the above analysis, it is difficult to ascertain whether China poses a threat to the Southeast Asian countries. In the exports of machinery and electronics products, there seems to be more of complementary nature. The only concern is that as China upgrades along its technological ladder, other Southeast Asian countries will also need to upgrade themselves to sustain its complementary relationship in the Asian production networks. In fact, the main threat comes from the southern provinces of China which are equally, if not more competitive than many Southeast Asian countries. In the face of increased competition not only between China and the region but also among Southeast Asian countries themselves, each country will have to play a role in the “catching up” process through technology transfers from more advanced economies to less advanced to latecomers (IMF, 2007). This is the familiar “flying-geese model” as expounded by Akamatsu (1962). However, one main concern is that unlike NIEs, where they possess relatively strong indigenous technological base, Southeast Asian countries including Singapore still rely very much on MNCs for technology transfers. Unless MNCs are prepared to help upgrade host country’s technological levels, the question of technological upgrading especially among latecomers will become very remote. At the same time, host countries must also facilitate such technology transfers by raising educational standards, widespread use of English and enhance their research capabilities.

As other labour intensive and light manufacturing in the third markets and home markets, competition from China is expected to be more severe. Singapore which is constantly facing labour shortage has reallocated such industries to other parts of Southeast Asia in the 1980s. Malaysia also shifts away from labour-intensive industries as it started to be under labour shortage pressure in the mid-1990s. With the rise of China, labour-intensive industries in Southeast Asian countries with the exception of Singapore and Malaysia are now facing increasingly competitive pressure from China. One way is to avert direct competition from China by focusing on those labour-intensive industries which are also resource-based such as oleo chemical products, rubber products and processed foodstuff. As for footwear, apparels and clothing, Southeast Asian countries need to establish a niche market with solid branding. Such a strategy will be able to establish a strong foothold in the third markets. The other alternative is to exploit markets that China is still not able to penetrate much. For instance, Singapore, Malaysia and Indonesia can establish hubs for *halal* food for Middle East countries and even China market itself.

Policy Implications for Attracting Foreign Direct Investment

Kit, Ong and Kwan, (December 2005) argue that East Asia-7 (Korea, Taiwan, Singapore, Malaysia, Indonesia, the Philippines and Thailand) will continue to draw FDI, despite that the fact that China has attracted a substantial amount of FDI inflows since 2003. Firstly, MNCs would like to diversify their risks as China while politically stable, may encounter various problems such as power outages, pollution and supply bottlenecks. The so-called “China plus one” strategy[8] is to ensure that supply chain in the Asian production network would not be disrupted at any point of time. Secondly, manufacturers in EA-7 have moved up the value chain and already establish a niche in high-end products which are complement to the manufacturing and assembly of lower-end products. Thirdly, investment in China does not necessary mean profitable ventures. China is still at a very early stage of developing private property rights, general respects for intellectual property and high hygienic standards. Wages and office rentals in coastal provinces and cities are also increasing at a rapid rate that may also wide out their profit margins. However, Cross and Tan (2004) conclude that the greatest competitive pressure will come from China for higher value-added market-oriented FDI from Triad countries[9].

The policy implications from the above analysis are three folds. One is that if Southeast Asian countries were to stay relevant in the Asian production networks, the region has to be always stay ahead of China in a “flying-geese” pattern (ADB, 2007:96). If China were to move up the value chain, Southeast Asia has to move up as well and must be always way ahead of China. Then their complementary relationships would be sustainable. In this manner, FDI flows to China will be accompanied by FDI flows to the region. Should any Southeast Asian country fails to keep up the pace, it would eventually fall behind China. Such competitive pressure from China is considered as ‘healthy’ in a globalized world as this will sustain increasing total productivity gains in the region.

Secondly, for MNCs to consider as the next best alternative after China for risk diversification purpose, investment climate in the region has to be improved further “through increased legal certainty and strengthened governance to enforce contracts, to protect intellectual property, and to ensure that product standards are met.”[10] Specifically, there is a need to introduce custom reforms and improve infrastructure and logistics services to reduce trade cost. In addition, ownership restrictions which are averse to MNCs should be reduced to a bare minimum. For instance, the “New Economic Policy” as implemented by Malaysia will do more harm than necessary in attracting FDI, not only because of its ownership restrictions but also of its adverse effect on productivity growth (Ng, 1998). Apart from micro level policies, macroeconomic stability and potential for growth are also important attractions for FDI flows.

The third strategic step is to avert direct competition with China by exploiting its comparative disadvantage. These disadvantages include relatively low protection of intellectual property right, private property right and general disregard for high hygienic standard and environment protection. In this respect, investment policy should be directed at providing a conducive environment for those industries that require stringent rules and regulations on intellectual property rights and hygienic standards, and their enforcement of these rules. The other areas of great potentials are those based on technological innovations as well as innovative ideas. Singapore, for instance, has adopted this strategy by attracting FDIs which require patent right and intellectual property right protection such as pharmaceutical and multi-media industries.

Huge Chinese Market as Investment Opportunities

Investment in China to exploit its huge market requires certain core competencies, especially those based on indigenous technology in addition to investible fund. Among Southeast Asian countries, only Singapore, Malaysia and Thailand did make a stride in investing in China. One main barrier is that local enterprises in the region are not well-capitalized MNCs which should have established their own niche areas or branded products. To overcome this barrier is to follow the Singapore model by developing its own government-linked corporations (GLCs) into MNCs. The other alternative is to develop its own local enterprises into MNCs as Japan and Korea have undertaken in the past decades. Moreover, the government can also encourage local enterprises to join MNCs in investing in China. To get involved in this type of joint-ventures in China, local enterprises must have certain niche either in terms of indigenous technology or in terms of local expertise in certain areas. Finally, GLCs can also take the lead in a business group comprising local private enterprises in investing in China, as Taiwan has pursued such a model for the last two decades.

Services sector in China represents an enormous potential market for foreign investment. As China is taking step to liberalize its services sector, Southeast Asian investors should take advantage of its services liberalization. China's services sector grew strongly in the 1990s as per capita income rises. However, the development of the services sector in China has been constrained by the country's focus on manufacturing exports. At the same time, barriers were imposed on trade and investment in the services sector. Moreover, the services sector is dominated by many state monopolies such as the banking, insurance, telecommunication, and transport sector. With the accession to WTO in 2001, China has decided to speed up the development of its services sector. Steps have been taken to increase foreign participation to promote competition and improve efficiency. For instance, the Chinese government announced on in November 2007 that plans to encourage foreign investors to expand into outsourcing services in China have been put in place. Ten cities including Beijing and Shanghai have also been assigned to house centres for outsourcing services. In this regards, China will gradually scrap restrictions on the destination, ownership and business scope of foreign investment in the services sector. With rapid urbanization and industrial development, services sector in China is expected to expand by leaps and bounds.

Outbound tourism in China is another potential area for opportunities exploitation to investors in Southeast Asia. Outbound tourism of China officially started in 1990 and it has gone from the phase of travel to Hong Kong and Macao, travel to the border regions to the phase of travel to other distant foreign countries (World Tourism Organization, 2006). Subsequently, outbound travel by private Chinese citizens has been increasing rapidly. From 1994 to 2000, the number of outbound travelers has experienced an increase of one million a year to reach 10 million in 2000. After 2000, the rate of increase was about 3-4 million a year. By 2005, outbound numbers reached more than 31 million, as compared with 3.74 million in 1993. It is estimated that there are more than 200 million Chinese who are financially able to travel overseas. According to a forecast from the World Tourism Organization (2006), China will have 100 million outbound travelers and become the fourth largest source of outbound travel in the world by 2020. To support outbound tourism, nearly 700 licensed outbound travel agencies have been set up in China. In addition, more than 90 countries have been given ADS (Approved Destination Status), and this figure is expected to increase further. In this context, China represents the single greatest growth opportunity in the world for Southeast Asian travel destinations and tourism companies, as 91% of outbound Chinese tourists traveled in the Asia-Pacific region in 2006. Of these, about 3 million arrived ASEAN countries in 2005. Singapore, Thailand, Vietnam and Malaysia received larger portion of the pie[11] (See Table 8). Together with the emergence of low cost airlines, inbound tourism presents vast potential opportunities to Southeast Asian countries. In response to this great potential, Singapore in April 2005 announced its plan to set up two integrated resorts (IR) as a major step towards this direction. According to its Ministry of Trade and Industry, the objective of the integrated resorts is “to broaden our leisure and entertainment options to enhance Singapore's reputation as a premium "must-visit" destination for leisure and business visitors”[12] Singapore has to act fast as many countries in the region are moving quickly to develop their tourist attractions to entice, among others, the large number Chinese outbound tourists. In addition, Singapore is also trying to attract health care tourism, not only from the ASEAN region but also from China.

Strategic Partners in Outward Investment from China

In 2001, the then Chinese premier, Mr. Zhu Rongji announced the adoption of ‘Going Global’, i.e. encouraging Chinese companies to invest abroad. In March 2006, the Chinese government reiterated its commitment to invest abroad. The agenda behind this drive is for energy security, geopolitical positioning and promotion of national competitiveness (Lunding, 2006). China’s outward investment grew at an average of 65.6% per annum from 2000 to 2005. In 2006, outward investment during 2006 amounted to US$16.1 billion, as compared with US$2.9 billion in 2003. As at end of 2006, total stock of outward investment from China totaled US$73 billion, as against US$15.8 billion in 1995. The Chinese government estimates that by year 2010, the total stock of outward investment will go up to US$120 billion. There are more than 30,000 Chinese companies investing in 160 countries. However, there is a changing focus on these outward investments away from developed countries in North America and Europe towards Asia. About 60% of these Chinese overseas direct equity investments went to Asia. However, Southeast Asia received only an insignificant amount of these outward investments (Chia and Sussangkarn, 2006:118). The main recipients were Thailand, Singapore, Indonesia and Cambodia. China's outward investment is a "win-win" strategy for both China and Southeast Asia. Such capital flows not only create jobs at the investment destinations and boost the local economy, but also help Chinese firms to diversify export origins of their products and thus avoid any controversial trade disputes and conflicts with its trading partners, especially US and Europe. The main issue is how to attract these Chinese investments to the region, considering the fact that China is expected to amass a total of US$1.4 trillion in foreign exchange reserves in 2007. Alternatively, Southeast Asian countries should also seriously consider to treat China as a strategic partner in investment and trade in Europe, US, India and the Middle East by exploiting their traditional colonial links, as well as cultural and ethnic affinity to these regions. For instance, their Muslim, Chinese and Indian communities can be empowered to be valuable resources for such strategic alliance in the venture.

Concluding Remarks

From the above analysis, one can safely conclude that China's emergence as an economic powerhouse has benefited most of the Southeast Asian countries. In the Asian production networks, the complementary aspect of the production has given rise to a booming intra-regional and intra-industry trade. The triangular trade among the US, Japan, NIEs and Southeast Asian countries has resulted a certain degree of payment imbalances in favour of both China and the Asian region. However, there are concerns that as China moves up its technological ladder, some of the Southeast Asian countries fail to catch up in the process, to the extent that such complementary relationships may break down in the future. China's emergence also benefits Southeast Asian countries in another way. With its rapid growth in the past three decades, China's increasing demand for raw materials benefits a number of Southeast Asian countries, although some of them raise their concern of de-industrialization and a repeat of old colonial division of labour. Moreover, the labour-intensive industries in Southeast Asia may face the crowding-out effect from China.

However, the huge domestic market of China presents great potentials for investment opportunities to the Southeast Asian countries. This is particularly so in the services sector, including outbound tourism from China. Equally important is the outward investment by China which can supplement domestic capital for economic development and employment creation. The main beneficiaries are Southeast Asian latecomers such as Vietnam, Cambodia and Laos.

The paper also explores various policy implications arising from China's economic emergence. Depending on their respective degrees of economic development, economic structure and comparative advantage, eight strategic positionings have been identified. Of these eight positionings, direct competition is considered as an unwise move, considering China being richly endowed with relatively cheap labour resources and possesses a huge domestic market which can serve as a magnet for direct foreign investment. Instead, competition based on niche areas through indigenous technology and branding, for instance, provide a viable alternative. The other alternative is to upgrade and restructure its economy, venturing into those areas where China has no comparative advantage. Others may adopt 'connecting' strategies such as complementing or supplementing the Chinese economy by meeting China's increasing demand for natural resources or exploiting its huge domestic market. Still others may explore the possibilities of forging strategic alliance in the global market or playing the role of a middleman between China and the West.

On the whole, Southeast Asian countries need constantly upgrade and restructure their respective economies as an effective policy response towards threats from China. They must be able to turn these threats into opportunities.

For instance, stiff competition from China's labour-intensive industries should alert the local counterparts in Southeast Asia not to be complacent and increase their productivity constantly. Such competition from China will also allow the region to look beyond exporting traditional products by establishing a niche in matured markets. They must also look beyond the usual traditional markets by exploring those of unexploited ones in the Middle East and Latin America.

Of no less importance is the need to Southeast Asian countries' domestic business and investment climate. This is crucial in three respects. One is to be more competitive than China in attracting FDI from the Triad countries, as well as from NIEs and other intra-regional FDIs. Secondly, Southeast Asian countries should also serve as the next best, if not the better alternative to China for MNCs to diversify their overall risk in Asian investment. Finally, the better business and investment climate should serve as key attractions to China' outward investment.

Southeast Asian countries have been adopting export-oriented strategy as the main thrust for economic growth since 1970s. In the face of economic threat from China, a two-track strategy suggested by 'Thaksinomics.'[13] seems to be a more balanced approach as a policy response to the rise of China. The strategy requires a country to continue with the export-oriented approach and at the same time, to look inward to its domestic market as a renewed source for sustaining their economic growth. This strategy is only relevant to those countries which have large population base in the agricultural sector. Countries like Indonesia, Thailand and Vietnam are possible candidates for such policy strategy. With this strategy, increase in government expenditure with a view to eradicate poverty and improve rural income will be the most effective way to ensure that the strategy is successful. However, the budgetary implications arising from such strategy could be enormous and the governance to avoid corrupt practices can be a challenging task to most of the Southeast Asian countries.

Table 1: Correlation Coefficients of Mainland China and Regional Export Structure
(3 digit SITC)

	Mainland China 1990	Mainland China 2000
Korea 1990	0.38	0.64
Korea 2000		0.43
Taiwan 1990	0.34	0.83
Taiwan 2000		0.53
Singapore 1990	0.10	0.42
Singapore 2000		0.41
Malaysia 1990	0.28	0.24
Malaysia 2000		0.44
Thailand 1990	0.30	0.52
Thailand 2000		0.51
Indonesia 1990	0.38	0.07
Indonesia 2000		0.33
Philippines 1990	0.23	0.38
Philippines 2000		0.33

Source: Lall and Albaladejo (2004) table 4.

Table 2: Technological Structure of Manufactured Exports 2000 (%)

	China		Singapore		Malaysia		Thailand		Indonesia		Philippines	
Resource-Based	14.3	9.5	27.8	14.9	31.9	13.1	24.2	18.4	54.2	33.7	37.6	6.5
Low Technology	51.9	44.9	9.6	6.5	14.8	9.6	40.1	21.5	32.6	31.3	33.7	11.9
Medium Technology	26.9	21.2	23.4	17.4	18.0	17.8	15.1	23.8	11.3	17.5	12.9	11.6
High Technology	6.9	24.4	39.1	61.2	35.3	59.4	20.6	36.3	1.9	17.4	15.8	70.0

Source: Lall and Albaladejo (2004) table 3.

Table 3: China's Threat to NIE in the World Market 2000 (% of Total Exports)

Category	Singapore		Malaysia		Thailand		Indonesia		Philippines	
	1990	2000	1990	2000	1990	2000	1990	2000	1990	2000
Partial Threat	33.6	40.4	47.7	56.5	41.8	61.6	22.8	48.3	30.7	44.0
No threat	12.8	32.0	12.6	5.0	7.5	15.9	5.7	10.7	7.2	44.3
Direct threat	49.0	23.5	10.8	28.7	40.1	15.1	37.1	19.9	34.4	5.8
Reverse threat	2.3	3.4	22.4	6.3	6.5	6.1	5.6	8.9	6.6	3.6
Mutual withdrawal	2.3	0.7	6.5	3.5	4.1	1.3	28.9	12.2	21.1	2.4

Source: Lall and Albaladejo (2004)

Table 4: Share of Manufactures in China's Imports from ASEAN (%)

	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Indonesia	54.4	29.2	22.5	23.5	34.1	29.0	25.3	27.0	25.0	22.4	22.3
Malaysia	11.9	41.0	48.3	40.9	41.9	49.4	54.5	62.1	54.5	50.8	50.2
Philippines	1.8	6.5	18.6	24.1	45.6	58.4	59.9	69.2	79.3	81.0	92.5
Singapore	28.6	48.5	48.2	50.9	60.5	68.1	66.5	67.1	66.0	66.6	68.4
Thailand	10.4	14.5	21.5	31.7	47.7	45.2	44.5	45.9	53.3	46.7	59.7
ASEAN-5 (weighted average)	31.1	34.9	36.5	39.1	49.2	52.2	51.7	56.0	56.1	54.1	55.5

Source: Revenhill (2006),Table 2. Calculated from U.N. COMTRADE data

Table 5: Foreign Direct Investment (FDI) by Country (US$ million)

	1980	1990	2000	2001	2002	2003	2004	2005	2006
China	57	3487	40715	46878	52743	53505	60630	72406	69468
Southeast Asia	2756	12821	23541	19582	15774	19920	35245	41071	51483
Brunei	-20	7	549	526	1035	3375	334	289	434
Cambodia	1	…	149	149	145	84	131	381	483
Indonesia	300	1092	-4550	-2978	145	-597	1896	8337	5556
Lao	…	6	34	24	25	19	17	28	187
Malaysia	934	2611	3788	554	3203	2473	4624	3965	6060
Myanmar	0	225	208	192	191	291	251	236	143
Philippines	114	550	2240	195	1542	491	688	1854	2345
Singapore	1236	5575	16484	15649	7338	10376	19828	15004	24207
Thailand	189	2575	3350	3886	947	1952	5862	8957	9751
Timor-Leste	0	0	0	84	1	5	3	…	3
Vietnam	2	180	1289	1300	1200	1450	1610	2021	2315

Source: United Nations Conference on Trade and Development, World Investment Report 2007

Table 6: China's Major Areas of Comparative Advantage and Disadvantage

Top 10 Comparative Advantage Groupings	Top 10 Comparative Disadvantage Groupings
Clothing	Non-office machines
Office machines and parts	Electronic integrated circuits and micro assemblies
Footwear	Plastic in primary forms
Toys and sporting goods	Crude oil
Furniture	Chemical products
Leather articles	Steel
Plastic articles	Instruments (not timekeeping or musical)
Iron and steel articles	Copper and copper articles
Prepared foodstuffs	Mineral ores
Video and digital cameras	Aircraft
Mobile phones	

Source: Economic Analytical Unit (2003) Table 2.1.

Table 7: China's Changing Revealed Comparative Advantage

Top 5 Areas of Strengthening Advantage	Top 5 Areas of Improving Disadvantage
Office machines and parts	Non-office machines
Video and digital cameras; mobile phones	Non-rail vehicles
Iron and steel articles	Steel
Video recorders	Fertilizers
Furniture	Synthetic fibres and fabrics
Top 5 Areas of Declining Advantage	**Top 5 Areas of Worsening Disadvantage**
Clothing	Electronic integrated circuits and micro-assemblies
Vegetables products	Crude oil
Animals and animal products	Organic chemicals
Footwear	Oilseeds
Prepared foodstuffs	Diodes, transistors and semiconductors

Source: Economic Analytical Unit (2003) Table 2.2.

Table 8: Visitor Arrivals from China to ASEAN Countries

Country	1995		2005		1995-2005	
	No. 000	Share of China (%)		Share of China (%)		Share of China (%)
Brunei	0	0.00	4	0.1	38	0.6
Indonesia	39	0.90	53	1.8	264	0.5
Malaysia	103	1.38	352	11.7	3437	3.0
Philippines	9	0.51	107	3.6	327	1.5
Singapore	202	2.83	858	25.5	5238	6.5
Thailand	376	5.49	762	25.3	6948	6.8
Cambodia	23	10.45	50	2.0	341	5.5
Laos	4	1.16	39	1.3	259	3.6
Myanmar	0	0.00	20	0.7	131	3.8
Vietnam	63	4.66	753	25.0	5999	25.1
ASEAN	818	2.76	3007	5.9	22984	5.5

Source: ASEAN Secretariat. Available at URL: http://www.aseansec.org

[1] There were factions in China then. One led by reformist, Deng Xiao Peng and the other by Chen Yun, a conservative. The two factions fought over the extent and the pace over economic reforms for China. It is the ultimate victory for Deng that he decided to accelerate the pace of economic reform in 1992 (Yang, 2004).

[2] There are three major regional production networks in the world. One is based in Northern America with its base in Silicon Valley. The others are the Asian production networks and the European production networks.

[3] For detailed discussion on China's economic rise as threats and opportunities, please refer to Ng (December 2007.)

[4] The index measures a product's share of exports minus its share of imports. If the index is positive, it indicates that the country is a net exporter. Otherwise it is a net importer. The index is therefore a revealed comparative advantage (disadvantage) of a country.

[5] It is also known as 'Dutch disease' arising from re-allocation of resources from traditional industrial sector to the booming sector such that output share from the traditional industrial sector falls as a consequence.

[6] This same view was also expressed by a New York Times article (29 June 2002) that "China is grabbing much of the new foreign investment in Asia, leaving its once-glittering neighbors – Thailand, South Korea, Singapore – with crumbs… Some Asian officials say they fear that Southeast Asia will be relegated to the role of supplier of food and raw materials to China in exchange for cheap manufactured goods…"

[7] In this division of labour, developed countries which were also the colonial masters, imported primary commodities from their colonies at lower prices. They then processed these primary commodities into manufactured goods and exported back to their colonies at much higher prices.

[8] This is an MNC strategy in diversifying their risk in investment in China and other Asian region. If a plant is built in China, another plant will also be set up in other parts of Asia.

[9] Triad countries refer to the United States, Japan and Europe.

[10] Asian Development Bank Outlook, 2007b, p. 74.

[11] The growth of the Asia Pacific tourism market is further fuelled by the growing middle class in India, the Middle East and ASEAN region.

[12] Ministry of Trade and Industry, http://app.mti.gov.sg/default.asp?id=585.

[13] According to Thaksinomics (proposed by the former Thai prime minister, Mr. Thaksin Shinawatra), it is an eclectic strategy comprising two tracks. The first tract is the usual export-oriented strategy in

manufacturing spearheaded by multinational corporations (MNCs). The second track provides strong support to local enterprises leveraging on indigenous skills and resources. In the short run, the government strategy is to stimulate domestic demand through its expenditure on rural and agricultural sector. In the meantime, the second track also seeks to develop new local industries as part of the diversification away from export-oriented activities. In addition, the track also attempt to implement measures to assist business to move up the value added chain, thus keeping ahead of direct Chinese competition (http://www.thaksinomics.com/).

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