

The Economic Rise of China: Threats and Opportunities from the Perspective of Southeast Asia

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Abstract

The purpose of the paper is to examine the economic impact of China on Southeast Asian countries, mainly in terms of trade and investment. The paper attempts to examine whether the rise of China poses a threat to Southeast Asia as a region in the area of international trade, especially competition in third country markets, and asks, can they be friends and allies rather than competitors in international market? Secondly, the paper also questions if the concentration of foreign direct investment (FDI) in China is resulting in a diversion of FDI away from the region. Do FDI in China and Southeast Asia complement one another when it comes to the international division of labour? On the other hand, the increasing role of China as an international trader and global investor provides an opportunity for Southeast Asia countries to integrate with the Chinese economy. The huge domestic market of China also provides vast opportunities for investment, especially through connections with their respective ethnic Chinese businesses in the region. The overall assessment is that the rise of China will benefit Southeast Asian countries, especially in terms of China's role in the Asian production network, destination for investment, its outward investment and more importantly, its huge and growing domestic market. All these turn China into another driver for economic growth in Asia.

Keywords: China, FDI flows, Southeast Asia, trade, investment, Asia production networks.

Introduction

The emergence of China as an economic powerhouse has been causing a stir in the international political and economic arena since the early years of this century. A number of countries express great fear of this trend, while others greet it with much admiration. Those who are fearful of the rise express their concern that cheap labour costs in China will inevitably wipe out their industries and reduce their market shares in the international market. Those who welcome its rise emphasize the

sheer size of China's domestic market as offering ample opportunity for them to exploit, and its potential role as another driver of economic growth in the region after Japan.

Since the opening up of China in 1978, China has achieved a spectacular and unprecedented economic growth. On average, a growth of 9.7 percent in real GDP was recorded over the period between 1979 and 2005, as compared with a growth of 5.3 percent between 1949 and 1977. Per capita income also grew strongly from US\$205 in 1980 to US\$1,100 in 2005. According to the announcement made on 20 December 2005, its GDP estimates had been revised upward by 16.8 percent on average, so that China now ranks the fourth largest economy in the world, replacing the United Kingdom. If GDP is measured based on purchasing power parity (PPP), then China ranks second after the United States.

At the micro level, China is the largest producer in the world of steel, cement, coal, mobile phones, digital cameras, colour televisions, DVD players, and pharmaceutical ingredients (Hanscomb Means Report Jul. / Aug. 2004). It ranks second in the production of electricity and third in semiconductor chips. As a consumer, China is the largest purchaser of steel, cement, copper, tin, platinum, zinc, coal, 'fine' chemicals and mobile phones. It ranks second in the consumption of oil, aluminum, lead and electricity. All these statistics indicates that China is an important producer and also a large consumer, a fact that Southeast Asia cannot afford to ignore.

Some economists consider the economic rise of China as an 'economic miracle.' It took four centuries for Europe to achieve the current level that China has achieved. The United States, on the other hand, took almost a century to reach the same level. However, China took only about three decades to achieve just that. The basic strengths of such a 'miracle' lie in its having relatively cheap and quality labour (cost reduction), huge size of its domestic market (market access), good infrastructures (access to communication and other networks) and preferential tax treatments for foreign investment (policy environment). The economic growth has been sustainable because, firstly, it has many growth drivers (Anderson 2005). Secondly, these drivers emerge sequentially, one after another, rather than appearing all at the same time. In addition, each driver is normally sustained for a long period.

The rise of China has exerted a great impact on the world economy. First of all, China has emerged as an important trading nation. It ranks as the third largest leading exporter and importer in the world after European Union (EU) and the United States. If the EU is not treated as

an integrated economy and thereby excluded, then China ranks second as a leading exporter and importer. With its strong presence in international trade, China has been enjoying current account surplus since the late 1970s. At the same time, it also attracts massive volumes of foreign direct investment (FDI) amounting to US\$60 billion in 2004, overtaking the United States as the largest destination of FDI since 2002. Both current account surplus and capital inflows over the past decades have contributed to its large pool of external reserves. At the end of February 2006, external reserves of China recorded US\$853.7 billion, overtaking Japan (US\$850.1 billion) as the world's largest holder of foreign exchange reserves (Bradsher, 29 March 2006). Thus, it has been recognized that with the sheer size of China's economy and its rapid expansion, China is beginning to serve as an engine of growth not only in Asia, but even globally (Lardy 2003).

Nevertheless, China's economy is just one seventh of the size of the United States, and only one third the size of Japan. In addition, it will take another 45 years, before it can be called a modernized, medium-level developed country. Moreover, China has a long way to go in its economic reforms, especially the reforms of its financial sector and state-owned enterprises. Other weaknesses of the Chinese economy include disparities between rural and urban areas, regional disparity between coastal provinces and provinces in other parts of China, and the insurmountable problems of the agricultural sector, rural villages and poor farmers (locally known as problems of 'san nong'). In addition, of no less importance are negative effects on the environment, social security issues, fragmented markets, corruption and generally poor governance in corporate and banking sector.

The purpose of this paper is to analyze any possible threats and opportunities posed by the economic rise of China on trade and investment in Southeast Asia. The paper is divided into five sections. The next section attempts to examine the controversial issue on the diversion of FDI away from Southeast Asia since the Asian Financial Crisis in 1997. China has been accused as the culprit for pulling in most of FDI at the expense of the region. A number of studies have shown that there is a co-movement between FDI in China and that of Southeast Asia, probably arising from the emergence of the Asian production networks with vertical fragmentation of supply chain. The third section tries to answer another controversial issue: that China, with its cheap labour costs, might wipe out the Southeast Asian 'tigers' in international trade, especially after China's accession to the World Trade Organization (WTO). Notwithstanding

the accusation that China poses a threat to trade and investment, it has, with its large domestic market and huge external reserves. the potential to offer windows of opportunities for further exploitation, to Southeast Asia. The concluding section attempts to raise other related issues and concerns from the perspective of Southeast Asia.

How Serious Is the Threat?

China has been attracting large amounts of FDI since the early 1990s. The Southeast Asian economy was then in an era of economic boom, and the phenomenal growth of FDI to China went unnoticed. However, with the outbreak of the Asian Financial Crisis in 1997, Southeast Asia began to feel the pinch that FDI was being diverted away from the region and invested in China (See Table 1). To make matters worse, some free acting industries were also moving to the north, presumably taking advantage of cheap and quality labour there. The share of FDI also showed a significant decline for Southeast Asia vis-à-vis that of China. In the early 1990s, ASEAN accounted for about 30 percent of FDI flowing to developing Asia, while China's accounted for only 18 percent (Yang 2003). Around a decade later, ASEAN's share had fallen to only 10 percent in 2000, while that of China had increased to 30 percent. It is therefore not surprising that when Malaysia's FDI fell in 2002, the then Prime Minister, Dr. Mahathir remarked, 'everyone is feeling the pinch because of the amount of FDI's has shrunk and then, a lot of that is going to China...' (Straits Times 21, September 2002). Panitchpakdi (2000) also expressed the same feeling and states: 'we seem to be suffering somewhat from the diversion of investment away from ASEAN [towards China].' All these lead to the fear of 'the giant sucking sound' (Fung and others 2005), not only in terms of withdrawal of existing FDI to China ('hollowing-out' effect), but also the receipt of new FDI.

The impression of "the giant sucking sound" is understandable. This was especially noticeable immediately after the Asian Financial Crisis. There were many movements of capital during the crisis, arising from macroeconomic vulnerability and political uncertainty in the region. For example, race riots in Indonesia caused a loss of confidence among ethnic Chinese businesses, both indigenous and foreign, to move away from Indonesia. There were also changes in political regimes and heads of central banks and monetary authorities in the region, causing more uncertainty in economic policies. Even with a V-shape economic recovery within a short span of time after the crisis, it did not help a great

TABLE 1: FDI inflow of China and ASEAN-5 in past 11 years, US\$ billion

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
China	27.5	33.7	35.8	40.1	44.2	43.7	38.7	38.3	44.2	49.3	53.5
Indonesia	2.0	2.1	4.3	6.1	4.6	-0.3	-2.7	-4.5	-3.2	-1.5	-0.5
Malaysia	5.0	4.3	4.1	5.0	5.1	2.1	3.8	3.7	0.5	3.2	2.4
Philippines	1.2	1.5	1.4	1.5	1.2	2.2	1.7	1.3	0.9	1.7	0.3
Singapore	4.6	8.5	11.5	9.3	13.5	7.5	13.2	12.4	10.9	7.6	5.5
Thailand	1.8	1.3	2.0	2.3	3.8	7.3	6.1	3.3	3.8	0.9	1.9
ASEAN-5	14.7	17.9	23.5	24.4	28.4	19.0	22.2	16.4	13.1	12.0	96.7
China and ASEAN-5 Total	42.2	51.7	59.4	64.6	72.7	62.7	60.9	54.8	57.3	61.3	63.1
ASEAN-5/Total	35	35	40	38	39	30	36	30	23	20	15
China/ Total	65	65	60	62	61	70	64	70	77	80	85

Source: Asian Development Bank, 2005.

deal, as severe damage had already been done. Secondly, 'the hollowing-out' effect arising from the prominence of China as a cheaper place for investment had become all too obvious. This was further evidenced by a significant shrinking of Southeast Asia's share of FDI vis-à-vis that of China, especially after its accession to WTO in 2001.

China as a Magnet for Investment

From the perspective of multinational corporations (MNCs), making an investment decision, as well as relying on political stability and a conducive business environment, depends critically on getting access to the market for their products and services, the comparative cost of business and production, and access to the communication and transportation infrastructure. China, in many respects fits nicely into this framework and has been attracting FDI which are 'market orientated, cost orientated and input orientated' (Buckley 2004). Following Buckley's analysis, China is a magnet for FDI because of the following factors:

- Large domestic market (market access)
- Cheap and skilled labour (cost reduction, access to immobile inputs)
- Fixed exchange rate (risk reduction)
- Investment incentives (cost reduction)
- Good infrastructures (access to immobile inputs)

FDI from 'Western' MNCs (including those from Japan) in China are often aimed at penetrating the host country's market, thus evading

import barriers and licensing imposed on their exports to China. This is in contrast to FDI from the newly industrial economies (NIEs) such as Korea, Taiwan and Hong Kong which are more concerned with cost reduction, especially labour cost. In the early phase of FDI flows since 1978, most of the FDI to China mainly came from newly industrialized economies (NIEs) such as Korea, Hong Kong and Taiwan. These investments were export oriented (Cross and Tan 2004). Instead of producing and exporting from home bases, these FDI's used China as an export platform for exporting their manufactured products to the United States, European Union and Japan. As a result, their production bases concentrated at coastal provinces, such as Guangdong, Fujian, Shanghai and Jiangsu. With rapid development in computer and telecommunication technology, vertical fragmentation of production process and supply chain across borders based on each country's or region's comparative advantage have displaced the importance of agglomeration economies as a key in the global strategy of MNCs. FDI from NIEs thus fully exploit these comparative advantages by integrating China as part of their vertical supply chain. Consequently, those labour intensive processing and assembling operations were relocated from their homelands or Southeast Asia to China's coastal provinces. The flows of this type of FDI into China accelerated in the late 1990s and in the past 5 years when political and economic uncertainty in the region became more marked.

Southeast Asia has no lack of cheap labour. Countries like Indonesia, the Philippines, Vietnam, and Myanmar are all excellent examples. Their failures to attract this type of FDI indicate that factors other than cheap labour do matter to the Asian MNCs. Some attribute this to cultural affinity and 'guangxi' between ethnic Chinese businesses in Taiwan, Hong Kong and Singapore, and mainland Chinese in China as one significant determinant in their investment decision. According to Crawford (2000),

Ethnic Chinese firms and their unique social capital are at the centre of the business networks that define coastal China's political economy and its intensified integration with the global economy. FDI and trade flows to and from the Southern provinces of Guangdong and Fujian, and to overseas Chinese communities, constitute major sources of synergy between the economies of Hong Kong, Taiwan and China. Each plays a complementary role in 'Greater China' and are connected via a series of private socioeconomic linkages that transcend political boundaries...

To validate the existence of such cultural factors, Gao (August 2001) conducted an empirical study on the determinants of FDI in China, and included the share of ethnic Chinese population in each of the source

countries as a tool to measure the cultural factor. The estimation results of various equations show positive relationships with 95 percent confidence level. He therefore concludes that 'a one percentage point increase in the ethnic Chinese population share leads to a 3.8 percent or higher increase in cumulative FDI in China.' This conclusion is totally absurd and the positive relationships may be considered as spurious. Firstly, using share of ethnic Chinese population as a tool for measuring cultural factor is misleading. It implies that the larger the percentage of ethnic Chinese in an area, the stronger the cultural links. Singapore has the largest share of ethnic Chinese population among Southeast Asian nations, and yet its business culture is the most westernized and has the least use of cultural affinity and 'guanxi' in business dealings (Chan and Ng 2000; Ng 2001). Secondly, the share of Chinese population and accumulative stock of FDI have theoretically no causal relationships and, more important still, both are somewhat influenced by trends over time. The positive relationships in Gao's study are therefore spurious.

Apart from cheap and quality labour, political stability, liberal economic policy, and market access, are important factors in determining FDI flows to China. Cultural factors, perhaps, are of secondary importance.

FDI Diversion and 'Round-tripping'

China has been the largest recipient of FDI since 2002. Of all the investors, Hong Kong has by far been the largest investor in China since 1978, accounting for about 45 percent of the total FDI. However, it has been estimated that a significant portion of FDI from Hong Kong actually originated from China itself. The World Bank (2002) estimated that such type of the 'round tripping' of funds accounts for 20 percent to 30 percent of FDI in China. Xiao (2004) finds that the 'round tripping' has been underestimated and the figure may be as high as 40 percent of the total FDI in China. Gunter (2004) estimates that about one quarter of flight capital later returns to China when opportunities arise. These capital movements are normally channeled through under invoicing for exports and over invoicing for imports. The main motive of such 'round tripping' is to evade or avoid trade barriers, or gain access to investment incentives available only to foreign investors (for instance, 15 percent corporate tax for foreign investors compared to 33 percent for domestic firms), and also better investor protection offered in China to foreign investors (Chantasasawat and others 2004; Erskine 2004).

Another motive for the 'round-tripping' through offshore financial centres such as Virgin Island and Western Samoa, is to evade taxes from source countries (Prasad and Wei 2005). Most of these investors came from Japan, Taiwan and the United States. Consequently, the Virgin Islands for apparently no clear reason, accounted for slightly about 10 percent of the total FDI flows to China since 1998, while the share of Western Samoa rose from 0.3 percent in 1998 to 2 percent in 2004. The above two types of 'round-tripping' tend to overstate the FDI flows to China and at the same time give rise to the impression that China has been sucking away investment from the Southeast Asian region.

Another type of 'round-tripping' was due to the earlier prohibition of Taiwanese investment in mainland China by the Taiwanese authorities (Prasad and Wei 2005; Mercereau 2005). To evade such restrictions, significant portions of the Taiwanese investment flowed through Hong Kong, Singapore, Virgin Islands and Western Samoa and were then re-directed to China eventually. When these restrictions were progressively removed, there was a significant diversion of these investments from Southeast Asia, notably Singapore towards China directly. In his study, Mercereau (2005) attributes this factor to the inverse relationships between FDI in China and FDI in Singapore. Therefore, Singapore's decline in FDI does not imply a diversion of new FDI away from the island country toward China. This is especially so because the two countries' basically attract different types of FDI: one concentrates on labour intensive and market access type of FDI while the other prefers export oriented high-tech investment.

FDI Augmenting in Export oriented Industries

Cross and Tan (2004) assess the impact of China in attracting FDI on Southeast Asia and the impact differed depending on the type of FDI. According to their findings, Southeast Asian countries such as Brunei, Myanmar and Indonesia tend to attract FDI which are mostly natural resource oriented, notably in oil and gas extraction and associated support industries. In this case China is not able to attract these FDI as China lacks such natural resources. China will divert away market-seeking FDI, as countries like Brunei, Lao and Singapore will be able to compete with China, because of their relatively small populations. Likewise, Myanmar and Vietnam will be adversely affected because of their lack of purchasing power. At the moment, only Malaysia, the Philippines, Singapore and Thailand are still able to compete with China for attract-

ing FDI which are of capital or technology intensive types. As Singapore invests increasingly more in China, countries such as Cambodia, Laos, Myanmar and Vietnam will receive less investment from Singapore. However, the fall in investment by Singapore will be more than offset by investment by China. Indonesia also benefits from increasing investment from China in its energy sector, despite a significant decline in FDI from other traditional sources, such as Singapore and Taiwan.

Anderson (2004) argues that FDI to developing countries is not a zero sum game. Firstly, resource-seeking FDI, especially those of oil and gas extraction may not come to China, as noted by Cross and Tan (2004). Secondly, most of the FDI going to China are of market seeking type (about 75 percent) with the rest meant for export-oriented types. Even if the FDI are of export-oriented category, China may not stop this type of FDI from Southeast Asian countries. On the contrary, the increase in FDI in China may also encourage additional FDI in other countries. For instance, to reap the full benefits of building assembly plants in China, MNCs may also need to invest components production in Singapore and Malaysia. With the advancement of computer and telecommunication technology, the supply chain can be fragmented vertically, so that the comparative advantage of each host country can be exploited optimally. Since each country is endowed with different competitive advantages, MNCs will allocate the type of sub-components of the supply chain most suitable to that particular country. For instance, the labour intensive assembly and operations will be allocated to China as its labour force is cheap and also comparatively efficient (compared to Indonesia and Myanmar). As for those requiring higher level of skills or more capital intensive, MNCs will allocate this type of plants to those countries which have such a competitive advantage. In this case countries like Singapore and Malaysia fit well into the integrated Asian production system.

Such international division of labour in Asia, has resulted in high volume of intra-firm and intra-industry trade in the region. In the transition period, it has been observed that there was a speeding up of withdrawal of the most advanced Asian economies (Hong Kong, Korea, Taiwan and Singapore) from the production and exports of labour intensive products and enlarging of intra-regional trade in sophisticated intermediate components and manufactured goods. In this sense, China serves as an export platform while the other Southeast Asian countries specialize in a more sophisticated production process. As Zebregs (2004: 12) observes,

The reorganization of production process across borders has contributed to more intraregional trade and FDI as well as a growing share of Chinese

exports in international markets. It has also resulted in a high correlation of 0.8 of intraregional exports to China and China's exports to the EU, Japan, and the United States over the past ten years.

In analyzing the impact of China on Southeast Asia in attracting FDI, Mercereau (2005) uses data for 14 countries spanning the period 1984-2002. His paper does not find much evidence 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 was affected because of the lifting of investment restrictions on China by Taiwanese authorities. Previously, Taiwanese investors tried to circumvent such restrictions by investing in Hong Kong and Singapore. After the lifting of these restrictions, total Taiwanese FDI to China increased, while Taiwanese FDI to Singapore decreased. In the case of Myanmar, Singapore which was previously the second largest investor in Myanmar now turns to China and HK and thereby reduces its flows to Myanmar. However, the majority of Southeast Asian countries were not greatly affected.

Moreover, Chantasawat, Fung, Iizaka and Siu (2004) find that China's FDI receipts and other Asian countries' receipts are positively correlated. This evidence, together with increasing intra-regional trade, confirms the every existence of an integrated production system in Asia, based on international division of labour. In the same vein, Eichengreen and Tong (2005) also report that the increasing amount of FDI flowing into China simultaneously induces greater investment in other countries. To the extent that they are part of the same interconnected global production network, the authors find that this complementary relationship is particularly evident in Asia, where China's economic expansion provides impetus to foreign investors 'to support a regional supply chain for feeding China's burgeoning and varied enterprises.'

Does the Dragon Wipe Out Tigers in International Trade?

It has been a concern to Southeast Asian nations that with the emergence of China as the third largest trading nation after the United States (US) and European Union (EU), China has posed a serious threat to these countries (see Table 2). First of all, China with its cheap labour, competes directly with Southeast Asian countries in the world market for manufacturing, especially light manufacturing and labour intensive products, and increasingly, higher value-added products, such as semi-conductors, and other technology items. Secondly, effective from January 2005, the United States and EU had abolished their quotas on

Chinese textiles and clothing exports under WTO rules. Hence, China will become a formidable competitor in these two markets as textiles and clothing are labour-intensive products. This 'trade competition' paradigm is well supported by empirical evidence conducted by Bhattacharya A. S. Ghosh and W. J. Jansen (2001). They conclude that '..., our findings constitute some preliminary support for the view that China's rapid export growth has hurt some Asian economies in their core export markets since 1994, notably Malaysia, Pakistan and Thailand' (Jansen 2001:221). Kit, Ong and Kwan (2005) using a dynamic shift-share analysis also come to a conclusion that all the East Asian 7 economies (EA-7) of Korea, Taiwan, Singapore, Malaysia, Indonesia, the Philippines and Thailand suffered negative net-shifts as China turns into a manufacturing powerhouse. Consequently, China has become a major competitor in exports of consumer goods, but also in low and mid-range capital and intermediate goods.

TABLE 2: US Imports from ASEAN-5 and China in Billions of US \$

	World Total of US	Indo- nesia	Malay- sia	Philip- pines	Singa- pore	Thai- land	ASE- AN-5	China
1987	424.4	4.0	3.1	2.5	7.3	2.3	19.2	3.1
1988	459.5	3.6	3.7	2.6	9.5	3.3	22.7	3.5
1989	492.9	4.3	4.9	3.3	10.7	4.5	27.7	4.7
1990	517.0	4.2	5.2	3.3	11.7	5.5	29.7	5.8
1991	508.4	4.2	6.0	3.3	11.9	6.3	31.7	6.8
1992	553.9	5.3	7.9	4.0	13.6	7.6	38.5	9.6
1993	603.4	6.1	10.2	4.6	15.1	8.3	44.3	18.4
1994	689.2	6.7	12.7	5.3	17.6	9.6	51.8	22.5
1995	770.9	7.5	15.7	6.4	21.2	10.3	61.0	26.0
1996	822.0	8.1	14.9	7.4	23.2	10.4	63.9	28.9
1997	899.0	8.5	15.2	9.2	23.1	11.8	67.8	35.4
1998	944.4	8.5	16.4	10.3	22.0	14.0	71.2	41.2
1999	1059.4	8.6	19.2	11.1	22.6	13.5	75.0	47.4
2000	1259.3	9.4	22.8	12.5	23.6	15.5	83.8	62.3
2001	1180.1	7.7	17.8	8.9	18.7	13.2	47.8	54.3
2002	1202.3	7.5	18.8	8.6	19.1	13.5	48.6	70.0
2003	1305.1	7.3	20.5	7.2	20.5	13.6	48.8	92.6
2004	1525.3	10.5	23.7	8.1	23.5	15.5	57.9	139.7

Source: 1. Asian Development Bank, 2005 for ASEAN and China. 2. <http://www.oecd.org/statisticsdata/> for United States imports total.

Eichengreen, Rhee and Tong (2004) also concur that China's exports to third markets tend to crowd out the exports of other Asian countries. However, they make a distinction between consumer goods and capital goods. For consumer goods which are produced mainly by less developed Asian countries, the crowding out effect is more serious. The effect on capital goods is much less. A rise in Chinese output therefore positively affects the exports of its high-income Asian neighbours but negatively affects the exports of less developed countries in the region. Lall and Albaladejo (2004) analyze the competitive effects of China's exports in terms of different levels of technology. For the NIEs and ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) they have been affected by China's expansion into low technology products. The competitive effect is not a loss of market share but rather a lower gain in market share in the third market. This constitutes the main threat to the ASEAN-4 which is technologically less advanced. China's threat in medium-technology products is also growing. It is a matter of time before China will mount a serious competitive challenge to all Asian countries in products like vehicles, machinery and simple electronics. However, in high technology products, a 'complementarity' between China and its Asian neighbours is more obvious.

Study by Ahearne and others (2003) give a different picture. They observe that there was a co-movement of export growth between China and other Asian economies in the period between 1979 and 2001. This suggests that common factors such as growth in advanced economies, particularly the United States, EU and Japan, and movements in the world prices of key exports and fluctuations in the yen-dollar exchange rates, all exerted far more impact on all Asian exports. Competition from China has negligible effects. Of no less importance is the vertical integration of many products in Asia which contributes significantly to such co-movement. The evidence suggests a 'flying geese' trade pattern in which China and ASEAN-4 move into the product space vacated by NIEs. Kwan (2002) notes that the trade structures among the Asian nations are broadly consistent with their respective levels of economic development. The 'flying-geese' formation has not been disrupted by the emergence of China.

In the same spirit, Joseph (2006) also observes a distinct division of labour in Asia and the tendencies for regional integration, evidenced by a rising intra-Asian trade. In this instance, China is playing an increasingly important role in the so-called Asian production networks (Gaulier and others, 2004), that produce for the world market. MNCs from Japan,

South Korea, Taiwan and Hong Kong invest heavily in China in the form of joint ventures which serve as manufacturing or processing arms of the MNCs. The joint-venture companies import primary products or intermediate inputs from East Asian countries for further processing and final assembly in China. The end products are then exported to the United States, Europe and Japan. This 'triangular trade' has resulted in three consequences. Firstly, China is having huge trade deficits in its bilateral trade with its northeast Asian neighbours while turning in large trade surpluses with the United States and Europe. For Southeast Asia, China's trade surpluses with these countries are becoming smaller (Table 3) Secondly, trade between Japan and South Korea on the one hand and the United States and Europe on the other have remained the same for many years (Joseph 2006:27). Finally, China has been integrated with the Asian economy and in fact, it is now a driving force for economic growth in East Asia.

The above literature survey shows conflicting conclusions: one group reveals strong trade competition between China and its neighbours, while the other observes a 'flying-geese' pattern in a 'triangular trade', in which China plays a pivotal role. Empirical evidence from studies by the first group ('trade competition' paradigm) shows that China is a

TABLE 3: ASEAN's Trade with China, 1995-2004, US\$, million

Country/ Item	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	1995-2004, average %
Indonesia											
Exports	1741	2057	2229	1832	2008	2767	2200	2903	3802	5870	14.5
Imports	1495	1597	1518	906	1242	2022	1842	2427	2957	5693	16.0
Malaysia											
Exports	1889	1882	1852	1994	2318	3028	3821	5253	6810	8460	18.1
Imports	1709	1876	2232	1849	2139	3237	3804	6157	7300	10339	22.1
Philippines											
Exports	209	328	244	344	575	663	793	1356	2145	5342	43.3
Imports	660	653	972	1199	1040	786	975	1252	1798	3539	20.5
Singapore											
Exports	2759	3395	4053	4065	3920	5377	5329	6863	10134	15392	21.0
Imports	4042	4439	5668	4851	5697	7116	7195	8869	11073	16211	16.7
Thailand											
Exports	1642	1868	1744	1769	1861	2806	2863	3553	5707	7103	17.6
Imports	2096	1953	2260	1822	2495	3377	3711	4928	6067	8185	16.3

Source: Asian Development Bank, 2005.

competitor rather than a comrade. This is because most of these studies apply various forms of market share analysis or correlation analysis. The first type, suffers from the implicit assumption of a zero-sum game. In particular, a loss of market share in the third market may imply a reallocation of labour-intensive or low technology products to China to take advantage of low labour costs and does not necessarily mean a loss of competitiveness. Correlation analysis has its caveat too. The analysis would definitely show positive correlations if product classification in aggregate data for empirical studies is too broadly defined. Secondly, both types of analyses have not taken into account the investment and trade patterns in the region which may throw some light on the integrated patterns in the whole range of supply chains within the Asian region. Such Asian production networks are becoming more pervasive in the region, where logistic management and management controls through advances in computer and telecommunication technology, facilitate the exploitation of comparative advantage of each country by MNCs.

Window of Opportunities for Southeast Asia

China provides ample opportunities for Southeast Asia in two respects. With its huge size of domestic market and cheap labour costs, China represents an attractive investment destination, especially with its attractive preferential tax treatment for foreign investors. In fact, ethnic Chinese businesses from Southeast Asia were pioneer investors investing in China when China opened its doors in 1978. One of the main reasons for investing in China was due to affirmative actions undertaken by some of the Southeast Asian governments. This took the form of a kind of 'racial discrimination' that forced ethnic Chinese enterprises to invest abroad (Ng 1998). China, represents vast investment opportunities for these ethnic businesses to evade domestic discrimination. On the other hand, their close cultural affinity and the low language barriers with mainland China have enhanced their competitive advantage vis-à-vis that of business corporations from other parts of the world (Ng 2006). To China, these overseas Chinese capitalists were, in fact, its target in attracting FDI during the Experimental Period (1979-83). When the Asian Financial Crisis broke out, China again represented a more viable investment destination as compared with other countries in the region which were adversely affected by political and economic uncertainty

Within the region, Singapore seems to benefit the most from the rise of China. Unlike other countries in the region, the Singapore government

took the initiative in promoting Singaporean investment into China, as part of its regionalization drive in 1993. With its 'political entrepreneurship' and reputation in 'honesty and straightforwardness' in business dealings (Bolt 2000), the Singapore government through its government-linked corporation (GLCs) has set up the Suzhou Industrial Park (SIP) in Jiangsu Province with co-operation from the Chinese counterpart. As a result, Singapore is one of the leading investors in China.

With the on-going liberalization in China's service sectors, following its commitments under the WTO accession, Southeast Asia would also benefit from such liberalization. Under WTO rules, China will have to fully open all of its markets to foreign service providers in a number of key services areas over a span of five years, from between 2002 to 2006 (Whalley 2003). Such areas include distribution, financial services, telecommunications, professional business and computer services, the film industry, environmental services, accounting, law, architecture, construction, and travel and tourism. China is also planning to liberalize restrictions on foreign ownership and geographical coverage of licenses in the services sector. Such liberalization represents ample opportunities for ethnic Chinese businesses in the region for direct investment. Of equal significance, is the recent strategic move by Temasek Holdings of Singapore to serve as a strategic investor in the reform of four state-owned banks. Temasek has invested US\$3.1 billion or 3.1 percent of share capital in Bank of China and US\$1.4 billion or 5.1 percent of share capital of China Construction Bank.

Apart from provision of investment opportunities, China is now one of the largest global investors in the world, and that role alone will represent another opportunity for Southeast Asian countries to attract Chinese investment in the region (Wong and Chan, 2003; Frost, 2004). According to data from China's Ministry of Commerce, as at end of 2003, there were 7,470 Chinese enterprises investing overseas, as compared with 1,882 in 1995. Out of the total number of these enterprises, a disproportionately large number of these enterprises were located in Hong Kong (2,336 companies), most of which were suspected of 'round-tripping'. Central and Eastern Europe (865) ranked second while ASEAN countries ranked third (857 companies). In terms of cumulative value of Chinese investment over the period 1979-2001, most of these investments were directed to European Union (15.3 percent), ASEAN (13.2 percent), the United States (12.6 percent), and Hong Kong (12 percent).

Chinese investments in developed countries such as European Union and the United States, were largely meant for acquiring latest technol-

ogy, managerial know-how, international brand names and distribution networks (Lunding 2006). The motives of Chinese investment in the ASEAN region differ from country to country. Chinese investment in low-income ASEAN countries (Laos, Myanmar and Vietnam) concentrated on infrastructure development and manufacturing activities, especially in textiles, clothing, home appliances, and consumer electronics industries. This is because these industries were facing severe competition at home in China, resulting in thinning of profit margins and overcapacity in domestic production. Chinese investment in Indonesia, Malaysia and Thailand are more for resource-seeking types, especially in petroleum and commodities sector.

In the case of investment in Singapore by Chinese companies, the main motive is to make use of Singapore's well-established networks in regional markets for Chinese enterprises sourcing for raw materials and intermediate goods in Southeast Asia (Wu and Yeo 2002). Singapore can also serve these same Chinese enterprises as a regional marketing and distribution base in the ASEAN region. Moreover, Chinese companies are able to exploit Singapore's comparative advantage in the provision of managerial talent, brand building expertise, legal and human resources services to globalize their operations. In particular, Singapore with its strategic location can serve as a bridge between China and India, as well as between China and Middle East countries.

Concluding Remarks

China with its huge size and rapid economic growth since 1979 is both a competitor and ally within the Southeast Asian region. It is a competitor because of its low labour costs and abundant supply of quality labour. It is also a competitor to Southeast Asia in attracting FDI. Southeast Asian countries such as Indonesia and Vietnam are not lacking in cheap labour, but the quality of labour and investment climate have yet to be improved so as to be more competitive compared to that of China.

However, China also provides ample opportunities for Southeast Asia to be a partner in economic growth. Firstly, Southeast Asia is richly endowed with natural resources in which China is lacking. With its rapid economic growth, China's demand for natural resources, especially energy, has been on the rise and in this respect, Southeast Asia plays a complementary role to the economic development of China. In the manufacturing sector, Southeast Asia is already integrated in the Asian production networks in which China plays a pivotal role. This

can be seen by the increasing 'triangular trade' among the developed countries, China and other Asian countries. Intra-firm and intra-industry trades in the east Asian region are pervasive and have shown signs of strengthening and becoming much embedded. With its huge economy, China presents opportunities for investment especially those market-seeking types of MNCs in the region. Singapore and Malaysia took the lead in this investment drives in China since early 1990s especially in light manufacturing, property and hotel industry. In fact, the economic rise of China has well placed itself in a 'flying geese' pattern of economic development in East Asia. With the turn of the new century, China, with its huge foreign exchange reserves is actively investing abroad. Southeast Asia countries such as Singapore, Thailand, and Laos also benefit somewhat from this investment flows. Moreover, Southeast Asian countries, through their respective ethnic groups such as Indian, Muslim and Western educated communities can also play the middleman role between China and the West, between China and India as well as between China and the Middle East. All in all, China has replaced Japan as a new engine of economic growth in the East Asian region including Southeast Asia since early 1990s, when Japan entered a period of 'Lost Decade'.

A cursory survey of literature in this area shows mixed opinions. To some, China is a competitor, especially in areas connected with technology development. To others, China's emergence has given rise to opportunities whereby Southeast Asia, with its proximity and cultural affinity through its ethnic Chinese population, is able to exploit this fact for its own economic gains. The overall assessment is that the rise of China will benefit Southeast Asian countries, especially in terms of China's role in the Asian production networks, destination for investment, its outward investment and more importantly, its huge and growing domestic market. All these turn China into another driver for economic growth in Asia. Even then, Southeast Asia will still face challenges from China in the future. The most immediate task ahead is how to avert direct competition from China in labour intensive and low technology sectors. In the long run, Southeast Asian countries need to consider how to keep ahead in terms of technology development and yet at the same time complementing the growing Chinese economy.

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