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The Economic Rise of China: Its Threats and Opportunities from the Perspective of Southeast Asia[1]

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ABSTRACT

The purpose of the paper is to examine the economic impact of China on the 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 the third markets. Can they be comrades rather than competitors in international market? Secondly, the paper also questions the concentration of foreign direct investment (FDI) in China implies a diversion of FDI away from the region. Are the FDI in China and Southeast Asian region complement each other in 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 of their respective ethnic Chinese businesses in the region. In return, Southeast Asian countries, through their respective ethnic groups can also play a middleman role between China and the West, as well as between China and India together with the Middle East.

Keywords: *international trade, direct foreign investment, outward investment, China, ASEAN, economic integration, regional economic co-operation, World Trade Organization*

Introduction

The sudden emergence of China as an economic powerhouse has caused a stir in the international political and economic arena since early 2000s. A number of countries express awful fear of the emergence while others greet with much admiration. Those who are fearful of the rise express their concern that cheap labour cost in China will inevitably wipe out their industries and reduce their market shares in the international market. Those who welcome its rise emphasize China's sheer size of domestic market as ample opportunities for their exploitation and its potential role as another engine of economic growth in the region after Japan.

Since the opening of China in 1978, China achieved a spectacular and unprecedented economic growth in the economic history of mankind. On average, real GDP growth recorded 9.7% over the span between 1979 and 2005, as compared with a growth of 5.3% 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% on average such that China now replaces Britain and ranks the fourth largest economy in the world. 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 in 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 in 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 a few decades to achieve just that. The basic strengths of such "miracle" lies in its endowment of relatively cheap and quality labour (cost reduction), huge size of its domestic market (market access), good infrastructures (access to immobile inputs) 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 appear all at the same time. In addition, each driver normally sustains 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 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 late 1970s. At the same time, it also attracts massive volume 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 had contributed to its large pool of external reserves. At 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 its sheer size of China's economy and its rapid expansion, China begins to serve as an engine of growth not only in Asia, but even globally (Lardy, 2003).

Nevertheless, China' economy is just one-seventh the size of the United States economy and only one third the size of Japan. Secondly, it will take another 45 years until 2050 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, 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"). Of no less importance are environmental deterioration, 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. After the Introduction, 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 sucking away most of FDI at the expense of the region. A number of studies has 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 the China with its cheap labour cost might have wide out Southeast Asian tigers in international trade, especially after China's accession to the World Trade Organization (WTO). Notwithstanding the accusation of China posing a threat in trade and investment, China with its large domestic market and huge external reserves provides windows of opportunities to Southeast Asia for further exploitation. The concluding section attempts to raise other related issues and concerns from the perspective of Southeast Asia.

How Serious Is the Giant Sucking Sound?

China has been attracting a huge amount of FDI since early 1990s. Southeast Asian economy was in economic boom then and the phenomenal growth of FDI in China went unnoticed. However, with the outbreak of the Asian Financial Crisis in 1997, Southeast Asia began to feel the pinch that FDI was diverting away from the region and invested in China (See Table 1). To make matter worse, some foot-loose industries were also moving upward 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% of FDI flowing to developing Asia, while China's accounted for only18% (Yang, 2003). About one decade later, ASEAN's share had fallen to only 10% in 2000, while that of China had increased to 30%. It is therefore not surprising that when Malaysia's FDI inflow fell in 2002, the then Prime Minister, Dr. Mahathir remarked, "Everyone is feeling the pinch because of the amount of FDIs 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 has this to say, "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.

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

Data source: Asian Development Bank, 2005.

The impression of "the giant sucking sound" is understandable. This was especially noticeable immediately after the Asian Financial Crisis. There were severe capital flights during the crisis arising from macroeconomic vulnerability and political uncertainty in the region. For instance, racial riots in Indonesia in the aftermath had caused a loss of confidence among ethnic Chinese business, be it indigenous or 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 much as damage had been done. Secondly, "the hollowing-out' effect arising from the prominence of China as a cheaper place for investment became too obvious by then. 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 multinational corporations' (MNCs) perspective, investment decision, besides political stability and conducive business environment, depends critically on market access for their products and services, comparative cost of business and production and access to immobile inputs. China, from many respects fits nicely in 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 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 came mainly from newly industrialized economies (NIEs) such as Korea, Hong Kong and Taiwan. These investments were exported-oriented (Cross and Tan, 2004). Instead of producing and exporting from home bases, these FDI 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 global strategy of MNCs. FDI from NIEs exploit thus fully 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 late 1990s and early 2000s when political and economic uncertainty in the region became more prevalent.

Southeast Asia is no lack of cheap labour. Countries like Indonesia, the Philippines, Vietnam, and Myanmar are 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 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 factor, Gao (August 2001) conducted an empirical study on the determinants of FDI in China and included share of ethnic Chinese population in each of the source country as a proxy for the cultural factor. The estimation results of various equations show positive relationships with 95% confidence level. He therefore concludes that "a one percentage point increase in the ethnic Chinese population share leads to a 3.8% 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 proxy for cultural factor is misleading. It implies that the larger the share the more cultural it is. Singapore has the largest share of ethnic Chinese population among Southeast Asian nations and yet its business culture is the most westernized and has least use of cultural affinity and 'guanxi' in business dealings (Chan and Ng, 2000; 2001). Secondly, share of Chinese population and accumulative stock of FDI have theoretically no causal relationships and, more important still, both are somewhat influenced by time trend. The positive relationships in Gao's study are therefore spurious.

Apart from cheap and quality labour, political stability, liberal economic policy, and market access as exemplified by China since its opening in 1978 are more important factors in determining FDI flows to China. Cultural factors, perhaps, are of secondary importance or least importance.

FDI Diversion and Round-tripping

China has been the largest recipient of FDI since 2002. Of the investors, Hong Kong has by far been the largest investor in China since 1978, accounting for about 45% of the total FDI. However, it has been estimated that a significant portion of these FDI from Hong Kong is actually originated from China itself. World Bank (2002) estimated that such type of the "round tripping" of funds accounts for 20% to 30% of FDI in China. Xiao (2004) finds that the "round tripping' has been underestimated and the figure may be as high as 40% 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 flights 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% corporate tax for foreign investors vis-à-vis 33% for domestic firms), and also better investor protection offered in China to foreign investors (Chantasasawat and others, Nov. 2004; Erskine, Aug. 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, Virgin Islands for no reason accounted for slightly about 10% of the total FDI flows to China since 1998 while the share of Western Samoa rose from 0.3% in 1998 to 2% 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 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. Mercereau (2005) attributes this factor in his empirical study for 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) categorize FDI into three types and assess the impact of China in attracting FDI on Southeast Asia. According to them, for countries like Brunei, Myanmar and Indonesia, FDI are mostly natural resource-oriented, notably in oil and gas extraction and support industries, China is not a threat. If China attracts huge amount of market seeking FDI, countries like Brunei, Lao and Singapore will be adversely affected because of small population; Myanmar and Vietnam will be affected because of lack of purchasing power. Malaysia, Thailand and the Philippines may not be affected much depending on whether FDI are of capital or technology-intensive. FDI stock of Southeast Asia used to exhibit strong source country affiliation. For instance Malaysia tends to attract British-owned FDI while American-owned FDI tend to flow to the Philippines and Thailand. If China is able to attract more FDI from these countries, there will be a diversion of FDI away from Southeast Asia, not to mention effect of ‘hollowing-out’ and offshore outsourcing and outprocessing.

Singapore will benefit by investing in China with their expertise in service-related areas, such as transport and logistics. Countries such as Cambodia, Laos, Myanmar and Vietnam will be adversely affected. Malaysia and Indonesia which are the two traditional Singapore FDI are somewhat affected

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%) with the rest meant for export-oriented. Even if the FDI are of export-oriented category, China may not crowd out 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, supply chain can be fragmented vertically such that comparative advantage of each host country can be exploited optimally. Since each country is endowed with different comparative advantage, MNCs will allocate the type of sub-component 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 require higher level of skills or more capital intensive, MNCs will allocate this type of plants to those countries which have such comparative 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, it is 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 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, total Taiwanese FDI to China increases, while Taiwanese FDI to Singapore decreases. 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, majority of Southeast Asian countries were not much affected.

Moreover, Chantasasawat, Fung, Iizaka and Siu (2004) find that China's FDI receipts and other Asian countries' receipts are positively correlated. This evidence together with an increasing intraregional 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 manufactures, especially light manufacturing and labour intensive products, and increasingly higher value added products, such as semi-conductors, and other technology products. Secondly, effective from January 2005, the United States and EU had abolished their quotas on Chinese textiles, garments and apparels exports under WTO rules. Hence, China will become a formidable competitor in these two markets as textiles, garments and apparels 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.” (2001:221) Kit, Ong and Kwan (2005) using a dynamic shift-share analysis also came 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. 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 dollars

	World Total of US	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN-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 which are exports of developed Asian countries 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) 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 threats 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 that China would mount a serious competitive challenge to all Asian countries in products like automobiles, machinery and simple electronics. However, in high technology products, complementarity between China and its Asian neighbours is more pervasive.

Study by Ahearne and others (2003) gives 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 advance economies, particularly United States, EU and Japan, movements in the world prices of key exports and movements in the yen-dollar exchange rates 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 also which contributes significantly to such co-movement. The evidence suggest 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 the 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 been flat for many years (Joseph, 2006:27). Finally, China has been integrated with the Asian economy and in fact it is now an engine of economic growth in East Asia.

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

Data source: Asian Development Bank, 2005.

The above literature survey shows conflicting conclusions; one group reveals severe 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) has the result that China is a 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 of the analyses 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 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 one of the pioneer investors investing in China when China opened its door in 1978. One of the main reasons for investing in China was due invariably to affirmative actions undertaken by some of the Southeast Asian governments with racial discrimination that forces these ethnic Chinese enterprises to invest abroad (Ng, 1998). China, with its open door policy, large domestic market and cheap labour represents vast investment opportunities for these ethnic businesses to evade domestic discrimination. On the other hand, their close cultural affinity and 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 that of other Asian region which was infected with political and economic uncertainty then.

Among the Southeast countries, Singapore seems to benefit the most with 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, indeed.

With the on-going liberalization in China's services sectors, following its commitments under the WTO accession, Southeast Asia would 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 2002 to 2007 (Whalley, 2003). Such areas include distribution, financial services, telecommunications, professional business and computer services, motion pictures, 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 to exploit through direct investment. Of significance is the recent strategic move by Temasek Holdings of Singapore to serves as a strategic investor in the reform of four state-owned banks. Temasek has invested US$3.1 billion or 3.1% of share capital in Bank of China and US$1.4 billion or 5.1% of share capital of China Construction Bank.

Apart from investment opportunities in China, 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 to be for "round-tripping" purpose. 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%), ASEAN (13.2%), the United States (12.6%), and Hong Kong (12%).

Chinese investments in the developed countries such as European Union and the United States were largely meant for acquiring latest technology, 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, garment industries, home appliances, and consumer electronics. 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 network in regional markets for Chinese enterprises sourcing for raw materials and intermediate goods in Southeast Asia (Wu and Yeo, 2002). Singapore can serve these same Chinese enterprises a regional marketing and distribution base in the ASEAN region. Moreover, Chinese companies are also 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 comrade to the Southeast Asian region. It is a competitor to the Southeast Asian countries especially in the third country markets such as the United States and European Union 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 lack of cheap labour but the quality of labour and investment climate have yet to be improved so as to be more competitive vis-à-vis 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 while 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 is evidenced 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, real estate and hotel industry. In fact, some economists argue that 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. Al 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 has shown mixed results. To some, China is a competitor especially when it also moves upward in the technological ladder. To others, China’s emergence has given rise to opportunities whereby Southeast Asia, with is its proximity and cultural affinity through its ethnic Chinese population is able to exploit for its own economic gains. At this juncture, there is no clear sign as to which argument is more appropriate. The following parable quoted by Ahearne, Fernald, Loungani and Schindler (2003) best described the current situation:

> “Two men sought a Buddhist monk’s help to resolve their dispute. The first man told his side of the story, and the monk

> said: 'You're right!' The second gave his side, and the monk said: 'You're right!' A third person who was listening to all this protested to the monk: 'These men have opposing views. How can you say they're right?' The monk thought for a bit and told him: 'You're right too'."

From the perspective of the Buddhist monk in the parable above, the two opposing views are not at all conflicting. It all depends on which perspective you are looking at. 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 and also how to move up the technological ladder and yet complementing to the Chinese economy. The worst scenario is to revert back to a primary commodities producing region as in the 1950s and 1960s. While complementing to the Chinese economic growth, the long term prospect as a primary commodities producing region is not a welcome scenario.

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