

## China's 'Peaceful Development' and Southeast Asia: A Positive Sum Game?

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The economic growth underpinning China's 'Peaceful Development' has caused as much alarm among its Southeast Asian neighbors as has the growth of its military prowess. Politicians and academics alike in Southeast Asia have expressed concern that the sustained expansion of the Chinese economy will have a negative impact on ASEAN's economic prospects through diverting investment and through displacing Southeast Asian goods in foreign markets. Typical of such sentiments were the views of (then) Singaporean Deputy Prime Minister Lee Hsien Loong<sup>1</sup> who commented in November 2002 that

Southeast Asian countries are under intense competitive pressure, as their former activities, especially labor-intensive manufacturing, migrate to China. One indicator of this massive shift is the fact that Southeast Asia used to attract twice as much foreign direct investment as Northeast Asia, but the ratio is [now] reversed.<sup>1</sup>

Such populist expressions of potentially zero-sum competition between China and ASEAN for markets and for foreign investment, reminiscent of Ross Perot's predictions on the impact of NAFTA on the US economy, would not normally be expected to find resonance in the views of mainstream economics. A series of studies by the World Bank in the years leading up to China's accession to the WTO had concluded, however, that the lower-income ASEAN economies were the ones most likely to be adversely affected by China's WTO membership, particularly after the

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<sup>1</sup> *ChinaOnline*, 14 November 2002, quoted in Busakorn Chantasasawat et al, *International Competition for Foreign Direct Investment: The Case of China*, paper for the Hitotsubashi Conference on International Trade and FDI, December 2003.

country quotas associated with the Multi-Fibre Arrangement were removed at the end of 2004. Several other studies using a variety of methodologies reached similar conclusions about the potentially negative impact of China's export-oriented growth on ASEAN.<sup>2</sup>

What has been the actual impact on Southeast Asian economies of China's sustained economic growth? Has the surge of foreign direct investment (FDI) into China come at the expense of ASEAN? Has the improved access to foreign markets that Chinese exports have enjoyed since the country's WTO accession amplified the trend towards displacement of Southeast Asian goods? None of the studies listed in footnote two had data available to them for the period after China joined the WTO: their conclusions rested instead on projections drawn from computer modeling. Data on investment and trade have now been published for the first four years since China's accession to the WTO; these enable us for the first time to observe the impact that China's WTO membership has had on ASEAN. In this chapter, we use these data first to explore trends in FDI, and then the impact of China's growth on ASEAN's exports.

### **Foreign Direct Investment**

A dramatic increase in China's receipts of foreign direct investment (FDI) has seen it emerge as the largest single recipient of FDI in the global economy. The rapid growth in China's FDI receipts in the last years of the 20<sup>th</sup> Century occurred at a time when many Southeast Asian countries were experiencing a downturn in investment inflows. China now receives a substantial majority of the foreign investment that is recorded as flowing into East Asia as a whole, a fact that some commentators perceive as evidence that China is capturing a disproportionate share of such flows. The contrast in performance between ASEAN and China led some observers to assert that the growth of inflows into China came at the expense of Southeast Asian states. For

Wong and Chan, the experience suggested that “much of regional FDI [has been] diverted from ASEAN in favor of China.”<sup>2</sup>

While the fears that underlie such statements are entirely understandable, they reflect a number of logical fallacies. These include mistaking correlation for causation, a misrepresentation of foreign direct investment as constituting a fixed sum and a consequent fallacy that competition for foreign direct investment is inevitably a zero - sum game, and implicit unwarranted assumptions about what an “appropriate” level of FDI for China might be.

Alarm that China’s receipts of FDI have come at the expense of ASEAN is often based on a cursory review of data on FDI flows. Figure 8.1 shows the source of the concern: even though China was already receiving substantially larger inflows of FDI than ASEAN economies on average in the years 1992-97, the trends diverged spectacularly after 1999.<sup>3</sup> Whereas China’s FDI inflows increased to over \$50 billion per year, FDI inflows into ASEAN fell substantially (by 2002 they were half the level of 1999 although they did recover from 2002 to 2004, rising from \$13.1 billions to \$24.8 billions, not far below their pre-financial crisis peak). When viewed in terms of shares in all inflows to China, Hong Kong and ASEAN combined, the apparent “diversion” to China is even more graphic: whereas ASEAN gained an average of 40% of all inflows to the “region” in the years 1992-97, its share of FDI inflows from 2000 onwards was nearly halved to slightly over 20% (Figure 8.2).

Even if one accepts that these data suggest a strong negative correlation between FDI flows to ASEAN and those to China (and as we will see, this is a questionable conclusion to

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<sup>2</sup> John Wong and Sarah Chan, “China-ASEAN Free Trade Agreement: Shaping Future Economic Relations,” *Asian Survey* XLIII (2003): 523.

draw given various complications with the figures), correlation does not necessarily equate with causation. The reasons for Southeast Asia's relatively poor aggregate performance as a recipient of FDI around the turn of the new millennium have much to do with the aftermath of the financial crises in the region and subsequent political instability. Of particular note here is the failure of the Indonesian economy to make a rapid recovery from the shocks of 1997, and the response of Western investors to Malaysia's imposition of capital controls in 1998. Political uncertainty in these countries and in Thailand in the first years of the new century further weakened the investment climate. Indonesia experienced net *outflows* of FDI in every year between 1998 and 2003; for Malaysia, FDI inflows in 2004 were still one-third lower than in the peak year of 1996. Similarly, Thailand's annual inflows for the period 2002-4 were less than the average in the decade from 1985-95.

ASEAN's performance (with the exception of Singapore) in attracting new inflows of FDI has been poor. But can this be attributed to investment being diverted to China? A fundamental problem with the argument that increased FDI flows to China have come at the expense of ASEAN is the implicit assumption that the total amount of FDI in the global economy at any given time is fixed. Analysis that compares ASEAN and Chinese shares in FDI going to the ASEAN-China region as a whole (as presented in Figure 8.2) encourages a zero-sum perspective. Yet even a cursory glance at the variability in annual flows of FDI (even to this region yet alone globally) would point to the fallacy that underlies such perspectives.

Global FDI increased substantially in the last years of the 20<sup>th</sup> Century, a reflection of a massive increase in merger and acquisition activities (primarily among industrialized economies but with some substantial LDC participation as well) during the dot-com boom. FDI flows to developing economies rose from an annual average of \$118.6 billions over the years 1992-97 to

a peak of \$252.5 billions in 2000. The bursting of the dot-com bubble in combination with the events of September 11, 2001 led to a steep decline in global FDI flows. Inflows to developing economies declined to \$157.6 billions in 2002 but rebounded to \$233 billion in 2004, a 40% increase over the previous year. There is nothing in these figures to suggest that the overall amount of global FDI is in any way constant. An excellent example from the countries under consideration here is the bulge in FDI into Hong Kong in 2000 (when its share of total inflows to the ASEAN-China-Hong Kong “region” nearly doubled). A large part of this jump in inflows was due to a single acquisition—the \$12 billion purchase of Hong Kong Telecom by Pacific Century Cyberworks.

As Xiao argues persuasively, there is good reason to believe that a substantial portion of FDI is endogenously determined (that is, generated by investment opportunities and by the profits of firms already operating in the recipient economy).<sup>3</sup> He suggests that one way to interpret the recent surge in FDI into China is that it is a reflection of the capacity of the Chinese economy to create new profits and new capital. A portion of the new FDI inflow recorded by China is simply Chinese flight capital returning home or foreign investors reinvesting in China some of the profits that they have made there. Looked at from this perspective, the key challenge for less developed economies (especially China’s competitors in Southeast Asia) is to undertake the domestic reforms necessary to enhance their economies’ capacity to generate new investment opportunities and new capital. This is the principal arena for competition rather than over a fixed amount of global FDI flows.

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<sup>3</sup> Geng Xiao, *People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications*, (Manila: Asian Development Bank, ADB Institute Discussion Paper No. 7. July 2004).

To suggest that increased FDI flows to China have caused a loss of jobs in Southeast Asia is to make some heroic inferences from the data. Only careful, on-the-ground investigation can establish where a direct transfer of production from Southeast Asia to China has occurred (and some evidence of such transfers has been discovered in the closure of electronic plants in Penang and the transfer of their responsibilities to subsidiaries in China).<sup>4</sup> But correlations of (highly variable) aggregate FDI flows in themselves are not sufficient to establish such trends.

*Does China Receive a Disproportionate Share of FDI inflows?*

Some of the commentary on China's recent FDI inflows appears to assume that there is a "natural" level of FDI that is appropriate for an economy—hence China is somehow "supernatural" in the volume of flows that it has attracted. In reality, China, despite currently receiving the largest volume of FDI inflows in the world, is a small to medium recipient of FDI relative to the size of its population and to its GDP. What changed during the 1990s was that China went from punching grossly below its weight in foreign direct investment to a situation where it has become a medium-ranked player in terms of the inflows it receives relative to its GDP. This relationship is captured by UNCTAD's "Inward FDI Performance Index", calculated as the ratio of a country's share in global FDI flows to its share in global GDP. A ratio greater than one indicates the country attracts more GDP than one would anticipate from its economic size; a ratio of less than one indicates underperformance in terms of economic size.

**(Insert Table 8.1)**

China's performance on the FDI Index has improved substantially in the last fifteen years. But in a world in which openness to FDI has generally increased, its *rank* among 140

developing economies on this index in 2002–04 (45th) was essentially unchanged from 1988–90 (46th), suggesting that, despite the surge of foreign investment since the mid-1990s, China has not attracted FDI inflows disproportionate to its size, and that the increase in foreign investment has merely kept pace with the growth of the economy.<sup>5</sup>

The key contrast in the table comes not from an improvement in China's ranking but from a deterioration in those of the ASEAN economies. None of the ASEAN members is ranked higher in the 2002-4 period than it was in the years 1988-90 (Vietnam having advanced at the turn of the century has fallen back in the most recent ranking). Other ASEAN economies have slipped badly: Indonesia (already below China in 1988-90) is now in the bottom five performers of the 140 countries on the UNCTAD list. The Philippines, ranked above China in 1988-90, has also fallen badly. Perhaps more surprising is the poor performance of two of the ASEAN economies generally considered most open to foreign investment: Malaysia and Thailand. Malaysia has dropped from a top five ranking to close to the mid-way point on the UNCTAD table. And Thailand has performed particularly poorly, a substantial drop in its ratio of FDI share to global GDP share being reflected in a plunge in the UNCTAD rankings from the top twenty in 1988-90 to 106 in the most recent period. It now ranks substantially below Vietnam as well as China.

Only Singapore among the ASEAN economies has maintained its stellar FDI performance, although even Singapore's ratio and ranking slipped at the end of the 1990s. While these data suggest that China's performance is not extraordinary by international standards, in recent years it has surpassed that of any ASEAN country with the exception of Singapore. The UNCTAD data indicate that most ASEAN economies have not only done poorly since the mid-1990s in relation to China but also in comparison with many other developing countries. While

too much should not be read into data for individual years, the sustained trend recorded for ASEAN economies is not promising.

### *Flows vs. Stocks of FDI*

While the picture for most ASEAN countries in terms of FDI inflows is far from reassuring, analysis of FDI data from other perspectives is less gloomy and arguably provides the basis for a more accurate assessment of the relationship between the rise of China and the FDI record of ASEAN economies. First, consider data on FDI stocks rather than flows.

For many analysts of foreign investment, stocks data present a more accurate picture of trends in foreign ownership in an economy than do data on flows. The principal reason is that stocks data include investments these corporations make that are financed with locally raised funds and from reinvested earnings. When a subsidiary has been established for some time, the majority of its additional investments may be funded by local borrowings or reinvested earnings, rather than from money raised from the parent corporation. Data on FDI inflows (collected by host governments for balance of payments statistics) consequently may considerably understate the influence of foreign ownership in economies where the foreign presence is long established.<sup>6</sup> The data for the Philippines provide an excellent example of how these different measures can lead to alternative judgments on FDI performance. According to the U.S. Bureau of International Economic Analysis, in 2002 the Philippines incurred a net outflow of American FDI of \$669 million. But for the same year the bureau reported that stocks of American FDI in the Philippines rose by \$560 million.<sup>7</sup>

Looking at FDI stocks, the picture for ASEAN is less grim than that portrayed by data on flows. Although China's FDI inflows surpassed those to ASEAN economies after 1995, the



trend in FDI stocks in ASEAN continued upward even in the immediate aftermath of the financial crisis (see Figure 8.3). The stock data give no suggestion of a zero-sum relationship between China and ASEAN. Between 1995 and 2004, the value of FDI stocks in ASEAN more than doubled. Even in 2004, FDI stocks in ASEAN remained substantially (25%) above the level of those in China. A note of caution has to be sounded about the aggregation of the data, however. Singapore accounted for a large share (85%) of the growth in FDI stocks in the ASEAN region. Nonetheless, stocks of FDI also grew strongly in Thailand and Vietnam, presenting a very different picture from the data on flows or UNCTAD's flows-based performance index.

#### *Overstatement of China's FDI Inflows.*

Another reason why ASEAN's FDI performance vis-à-vis that of China may not be as bad as the data on flows seem to suggest is because China's total inflows of foreign capital may be considerably overstated. There are two principal factors underlying such over-statement: the manner in which China's inflows are calculated; and the significant proportion of inflows that may be "round-tripping" investment.

Most countries have adopted OECD standards for the measurement of FDI inflows: in essence, under the OECD guidelines, foreign investment is counted as part of FDI inflows only where investment by foreigners gives them control of at least 10% of the shares of a company. China does not apply this minimum limit. Any foreign investment is included in China's FDI inflow data, inevitably overstating China's receipts of FDI compared to home countries' data on outflows (and other recipients' data on inflows, too). Moreover, as Xiao notes, since local

government departments in charge of FDI promotion in China are responsible for collecting and reporting data on investment inflows, they have a powerful incentive to inflate these figures.<sup>4</sup>

A far more significant source of overstatement of China's FDI inflows, however, is that a large percentage of supposed foreign direct investment originates within China itself, a phenomenon known as "round-tripping". The principal reason why Chinese investors might seek to send their capital out of the country for ultimate re-investment in the mainland is to take advantage of benefits available only to "foreign-invested" enterprises. The People's Republic of China provides a variety of incentives to attract foreign capital including preferential tax treatment, preferential property rights particularly relating to land, and preferential access to financial services. Because of ongoing ambiguity over the status of property rights and their enforcement, private enterprises in the PRC often operate in an atmosphere of uncertainty. Property rights for foreign invested enterprises are somewhat better enforced and domestic investors certainly covet this preferential treatment. And they also seek the tax advantages afforded foreign investors.

The short life span of many "foreign-invested" enterprises in China itself reflects the desire of investors to exploit the tax benefits gained from an initial grant of this status. Xiao quotes data that suggest that at the end of 2002, 48% of the cumulative total of 424,196 foreign invested enterprises that had been registered in China had closed.<sup>5</sup> Many were wound up by their

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<sup>4</sup> Geng Xiao, *People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications* 17.

<sup>5</sup> Geng Xiao, *People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications*, 9.

owners so that they could start new foreign invested enterprises to take advantage once again of the preferential tax treatment that they would gain during the first five years of their operation.

Round-tripping is also encouraged by investors' worries about possible exchange rate realignments (an increasing concern in recent years). With intensified conjecture about the likelihood of a re-valuation of the renminbi, domestic investors have a powerful incentive to engage in speculative trans-border movement of their capital. Finally, round-tripping may be undertaken with the objective of taking advantage of the financial services expertise in Hong Kong and to list on Hong Kong's stock market.<sup>6</sup>

An initial indication that round-tripping is a significant issue in China's FDI inflows is seen in the country's sources of inward FDI. The big three players (the "Triad") in global FDI—the United States, the EU, and Japan—together account for only one quarter of China's FDI inflows (Table 8.2). In contrast, Hong Kong (43%) and offshore financial centers<sup>8</sup> (9%) account for more than one half of all PRC inflows. Considered together, inflows from the offshore financial centers exceed the flows of FDI from either the EU or Japan or the United States.<sup>9</sup>

Estimating the extent of round-tripping is inevitably complex, not least because the activity under investigation is illegal. Early work by the World Bank suggested that round-tripping might account for as much as one-quarter of all China's FDI inflows.<sup>10</sup> In its *Global Development Finance* report for 2002, the World Bank commented that the share of total flows that originated within the mainland had actually increased in the last years of the twentieth century.<sup>7</sup> Xiao provides the most comprehensive investigation of this issue to date.<sup>8</sup> Based on a

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<sup>6</sup> Geng Xiao, *People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications*, 11.

<sup>7</sup> World Bank, *Global Development Finance* (Washington: World Bank, 2002).

careful comparison of China's own data on FDI inflows with that of its major FDI partners on outflows to China, he estimates that "unverifiable" FDI, most likely round-tripping capital, constitutes as much as 46.5% of China's recorded inflows, with a range—allowing for possible statistical error equivalent to one standard deviation—of between 34.9% and 58.1%. To reduce the volume of inflows of FDI to China reflected in Figure 8.1 by 46% would present a dramatically different basis for comparison of China's recent performance with that of ASEAN—including China's relative standing on UNCTAD's FDI Performance Index.

**(Insert Table 8.2)**

Further evidence pointing to the likelihood that round-tripping capital constitutes a significant portion of China's recorded FDI inflows comes from estimations of capital flight from China. In a careful study of the various elements of capital flight, the most significant of which is trade mis-invoicing, Gunter estimates that capital flight from the PRC amounted to over \$100 billions a year between 1997 and 2000, and that a total of about \$900 billions had fled the PRC since 1984.<sup>9</sup> These sums are substantially in excess of China's annual FDI inflows: it is not unreasonable to assume that sizeable amounts of this capital returned to China in the form of round-tripping investment.

*Home Country Data*

Because China's data on inward FDI inflows are suspect, and because of the round-tripping phenomenon, it is important in attempting to evaluate the relative performance of China

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<sup>8</sup> Geng Xiao, *People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications*.

<sup>9</sup> Frank R Gunter, "Capital Flight from China: 1984-2001," *China Economic Review* 15 (2004).

in attracting FDI to seek alternative sources of data. The most obvious alternative is to examine national data from *source* countries. Figure 8.4 uses US data to calculate the shares of ASEAN, Hong Kong, and China in FDI outflows from the United States to this “region”. Here the picture is very different to that presented by UNCTAD data on FDI inflows (that usually are sourced from host country central banks). Although US investment into ASEAN slumped in the aftermath of the financial crisis, 1998 was the only year in which US FDI flows to China exceeded those to the ASEAN region.<sup>11</sup> By 2002, ASEAN countries were again receiving two-thirds of all US FDI into ASEAN, China and Hong Kong combined: China’s share of US FDI flows languished at less than 20%. Even allowing for the possibility that a portion of the flows to Hong Kong ended up in the mainland, the share of China in US outward FDI remained remarkably small.

The data from the EU for FDI flows to ASEAN, China and Hong Kong (Figure 8.5) show enormous volatility (the chart excludes data for 2000, which reflect a negative inflow [net outflow] of \$3.8 billions from Hong Kong, a spike which takes the percentage figures well beyond the limits of the graph). Despite the volatility in flows, there is only one year (1998) in which China’s share of EU FDI flows exceeds that of ASEAN. Again, the data from one of the world’s major foreign investing regions do not match those set for the inflows recorded by the Chinese authorities.

Data on shares in US FDI stocks in ASEAN, China, and Hong Kong (Figure 8.6) also do not suggest a precipitous drop in ASEAN shares of US FDI stocks in the region (which have actually remained remarkably constant over the ten year period). ASEAN’s share did fall from 1994 to 2005 but only from two-thirds to 60 percent of the US total. China’s share in US FDI stocks in the region remains at only slightly over 10%. Finally, equivalent data (Figure 8.7) for

the EU again show more volatility than those for the US. China's share of EU FDI stocks in the region was experiencing a steady upward trend at the same time that the ASEAN share was heading in the opposite direction in the years from 1994-2000 (at which point it matched the Hong Kong share). In 2000, however, largely as a result of a single merger and acquisition in the telecommunications industry in Hong Kong, the Hong Kong share in EU FDI stocks soared. The distortion caused by this single acquisition again points to the dangers of reading too much into short-term trends in foreign direct investment.

#### *FDI in ASEAN and China: A Zero-Sum or Positive Sum Game?*

The performance of most ASEAN countries since the mid-1990s in attracting new inflows of FDI has been poor (Singapore, the ASEAN economy facing the least competition from China, remains the notable exception). Even though the data on FDI stocks are more encouraging than those on flows, indicating that ASEAN economies have benefited from significant new investment by existing subsidiaries of foreign corporations, little in the analysis above will provide much comfort to governments of ASEAN countries. The decline in the relative attractiveness of Malaysia and Thailand as hosts to new foreign investment inflows is particularly notable. But whether this poor performance can be largely attributed to the new competition from the PRC for investment funds is questionable. The source of the relatively poor record is more likely to lie in domestic policies and performance.

In the years post-2000 when FDI flows to developing economies fell substantially, if a sizeable portion of inflows to China was in fact round-tripping capital (and thus to a considerable extent "captive"), China might reasonably have been expected to increase its share in overall flows to LDCs. There is no reason to believe that ASEAN countries were competing in any way

for such round-tripping funds. Even if one accepts that the recent record of ASEAN countries in attracting FDI is poor relative to that of China, this does not necessarily indicate a zero-sum competition over capital flows. The variability of FDI flows over the last decade suggests that no fixed sum of investment capital exists over which countries inevitably must compete.<sup>12</sup>

Moreover, several studies have suggested inflows of FDI into China have actually had a *positive* effect on ASEAN's FDI receipts. Using a panel regression approach, Chantasawat, Fung, Iizaka, and Siu in a series of papers estimate that a 10% increase in FDI inflows to China *raises* the level of FDI inflows to East and Southeast Asian countries by approximately 5 to 6%, depending on how the model is specified.<sup>13</sup> Zhou and Lall, using a similar methodology, report that FDI into China had a positive impact on investment flows into "Southeast Asia" after 1992.<sup>14</sup> And Eichengreen and Tong, using a gravity model, also find that FDI inflows into China are complementary with FDI flows to other Asian countries.<sup>10</sup>

While the variability in the data examined earlier in this paper and the problems involved in measuring FDI suggest that conclusions from such regression analysis should be treated with a great deal of caution, these studies cast further doubt on arguments that the increase in FDI into China has come at the expense of ASEAN. As Chantasawat *et al.* argue, the emergence of China as the "workshop of the world" can have both investment-diversion and investment-creation effects. Public discussion and much academic commentary has focused almost exclusively on potential investment diversion—the possibility that multinational companies will choose to locate in China rather than in other East Asian countries to take advantage not only of

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<sup>10</sup> Barry Eichengreen and Hui Tong, *Is China's FDI Coming at the Expense of Other Countries?*

(Cambridge, Ma.: National Bureau of Economic Research, Working Paper 11335, May 2005), <<http://www.nber.org/papers/w11335>>.

its relatively inexpensive unskilled and skilled labor but good infrastructure and huge domestic market.

On the other hand, China's stunning economic growth may also generate an investment creation effect. As China's industrialization proceeds apace, it develops a huge appetite for minerals and raw materials—spurring inflows of FDI into countries with the resource endowment to feed this appetite. Of greater interest to governments that have concerns that China will displace their manufactured exports in the global marketplace is another possible source of investment creation: the establishment of an increasingly sophisticated regional division of labor based on trans-border production networks that facilitate trade in components and their ultimate assembly. China's accession to the WTO, with the consequent removal of TRIMs (Trade-Related Investment Measures) such as local-content requirements, may facilitate multinationals' construction of such regional networks. In such circumstances, an increase in FDI in China for the purpose, for instance, of assembly of components, may stimulate complementary investments in manufacturing elsewhere in the region. It is to the new division of labor in the region that we now turn.

## **Trade**

Much of the conjecture about the negative impact on ASEAN of China's integration into the global economy rests on analysis of data for the period before China joined the WTO. Data are now available (from the UN's COMTRADE data base) that cover the first four years following China's WTO entry, which for the first time permits observation of the impact of China's WTO entry on ASEAN trade.



In this section of the chapter, I look at the evolution of ASEAN and China's position in the markets of Japan and the United States for five major categories of exports (aggregated at the two-digit level of SITC rev. 3): office machinery; electrical machinery; telecommunications and sound equipment; clothing; and footwear. The last two of these sectors feature relatively unsophisticated, labor-intensive manufactures. In both of these, China's share of the US and Japanese markets already exceeded that of ASEAN by 1995. The other three product sectors comprise relatively sophisticated manufactures. In all three of these in 1995, exports from ASEAN had a substantially larger share of the US and Japanese markets than did those from China. These five commodity groups combined accounted in 2003 for 71% of all ASEAN manufactured exports to the world (81% of all manufactured exports from ASEAN to the US; 62% of the total of ASEAN manufactured exports to Japan).

*Office Machinery (SITC 75):*

China's exports of office machinery (a category that includes computers) to the US market were less than one-fifth of the value of those from ASEAN in 1995 (Figure 8.8).<sup>15</sup> The value of China's exports expanded rapidly after China's access to the WTO in 2001, surpassing the value of those from ASEAN in 2003. China appears to account for much of the expansion in US imports in the last four years, testimony to its increasing competitiveness in higher value added goods. In contrast, not only have ASEAN countries lost market share but the absolute value of their exports of office machinery (a product category that accounts for nearly one-third of all ASEAN manufactured exports to the US) has also not matched the peaks reached at the end of the 1990s.

A similar pattern holds in the Japanese market although the decline in the ASEAN share and the increase in the Chinese share are even more pronounced (Figure 8.9). ASEAN accounted for one-third of all of Japan's imports of office machinery in 1995, its exports amounting to nearly six times the value of those of China. In 2002, the value of Japanese imports of office machinery from China exceeded that of imports from ASEAN: by 2005, China accounted for more than one half of Japan's imports of these products, the value of imports from China being substantially more than double those from ASEAN. Again, this is an instance where ASEAN countries not only lost market share but also the absolute value of their exports fell substantially from its peak in 2000.

#### *Electrical Machinery (SITC 77)*

This is the only sector (one that includes semiconductors, electrical switching machinery, cathode ray tubes and household electrical equipment) where ASEAN kept pace with China in the Japanese market (until the very last year in the period covered by this study). In the Japanese market, the value of imports from ASEAN in this sector rose substantially over the 1995-2003 period, probably testimony to the growing significance of "reverse exports" from Japanese subsidiaries in Southeast Asia. By 2004, the value of imports from ASEAN was more than three times that of 1995. Electrical machinery contributed one-third of the value of all ASEAN manufactured exports to Japan (Figure 8.10). In 2004, however, the growth trend tailed off so that by the following year, imports from China had overtaken those from ASEAN. The value of imports from China quadrupled over the period. China's share rose from 7.1% in 1995 to 25% in 2005. This is one of the few instances in the commodities investigated in this study where both

ASEAN and China over the decade after 1995 increased their shares in a significant export market.

In the US market, in contrast, imports from ASEAN peaked in 2000 (Figure 8.11). By 2003, imports from China exceeded those from ASEAN. Imports from ASEAN had fallen to less than their value in 1995, and by 2005 ASEAN's share of US imports of this product category fell to under 12%, a particularly poor performance in a product group that contributed close to a quarter of the value of all ASEAN exports to the US. The value of imports from China, in contrast, increased fivefold in the period 1995-2005 to capture a 19% share of all imports by the latter date.

#### *Telecommunications, Sound Recording Equipment (SITC 76)*

The value of US imports of telecommunications and sound recording equipment (TVs, radios, VCRs, DVD players) from ASEAN more than doubled over the years 1999-2005 (Figure 8.12). This growth, however, was insufficient to maintain ASEAN's share of US imports of this category (which accounts for 14% of all ASEAN manufactured exports to the US). ASEAN's share of the US market fell from 22% in 1995 to 15% by 2005. Imports from ASEAN were 75% above the value of those from China in 1995: in 1998, the value of imports from China exceeded those from ASEAN for the first time. By the end of the period, the value of imports from China was more than double those from ASEAN; China accounted for more than a third of the US market by 2005.

A similar situation prevailed in Japan where the value of imports in this sector from China surpassed those from ASEAN in 2002 (Figure 8.13). By 2004, the value of imports from ASEAN had recovered to be five percent higher than its previous peak in 2001. The value of

imports from China increased six-fold over the period 1995-2005: China's share in Japan's total imports in this sector rose from 14.4% to close to one half whereas ASEAN's share decreased from 35% to 24%.

In contrast to the three sectors considered above, clothing/apparel and footwear are two relatively labor-intensive sectors where China was already a major source of imports for Japan and the United States even before its accession to the WTO.

#### *Clothing and Apparel (SITC 84)*

This is the sector where new exports from China were expected to have the most negative impact on ASEAN economies taken together. The full impact of China's competitiveness in this sector would not be felt, however, until after the abolition of the MFA quota system from 1 January 2005, and the phasing out of the transitional arrangements that accompanied China's accession to the WTO. For the period for which data are available, country quotas continued to constrain access to the US market. Here we see the effects of quotas in operation, with similar market shares and similar increases in the value of imports from ASEAN and those from China occurring until 2001 (Figure 8.14). From 2001, however, when the US began to relax some quotas, imports from China began to expand at a more rapid pace than those from ASEAN.

The situation in the Japanese market was entirely different (Figure 8.15). The Japanese market was not subject to country quotas for clothing and textiles; it therefore provides a possible signpost to how world markets will look once industrialized countries completely remove the MFA restrictions. Whereas apparel and clothing constituted 13% of the total value of ASEAN's manufactured exports to the US in 2003, they contributed only 2% of such exports to Japan. By 1995, China was already by far the dominant player in Japan's market for apparel and

clothing, contributing 56% of the total value of Japan's imports in this sector. Between 1995 and 2005, the value of imports of clothing from China into the Japanese market increased by more than 80%, and China's share of overall Japanese imports of clothing grew to 80%. In contrast, the value of imports of clothing from ASEAN fell by nearly one half during the period. The share of ASEAN in Japan's imports of clothing fell from 6.5% to under 3.0%.

*Footwear (SITC 85):*

Footwear was the other labor-intensive sector where ASEAN countries were expected to experience significant difficulties because of the growth of exports from China. Data for the US show that China in 1995 was already a much more significant source of imports than was ASEAN, accounting for more than four times the value of imports from Southeast Asia (Figure 8.16). The gap between the two has widened considerably since then. Whereas imports from China have more than kept pace with the growth of global imports of this sector into the US, China's share of the US market rising from under one half to more than 70% from 1995-2005, ASEAN's market share has fallen from 12% to under 5% in the same period. The absolute value of imports from ASEAN has also fallen by fifty percent from its peak in 1997.

China was also a more significant source than ASEAN of imported footwear for Japan by 1995 (Figure 8.17). Again, the data show Japan's imports of footwear from China mirroring those from the world, with China's share of total Japanese imports in this sector rising from under one half to close to 70%. In contrast to the situation in the US market, ASEAN's share of the Japanese market after declining abruptly in the worst years of the financial crises had by 2002 come back to the level enjoyed in 1998. The absolute value of imports of footwear from ASEAN remains below its 1997 peak but by 2003 had climbed to 50% above its 1999 trough.

Table 8.3 provides a summary of the changes in the value and shares of imports from ASEAN into the Japanese and US markets. It makes for grim reading from the ASEAN perspective. In only one sector/country combination (electrical machinery in Japan) did both the value of imports and the share of ASEAN countries in total imports increase over the period 1995-2005 (and even here ASEAN's share of the market fell substantially in 2005). In only one other sector, telecommunications, did the value of imports from ASEAN increase in both the Japanese and US markets, even though ASEAN lost market share in both countries while that of China increased. For clothing, still governed in the US by the country quotas of the MFA, the value of ASEAN imports increased but its market share decreased. For all the other sector and country combinations, including the higher value-added sectors of office machinery in both the Japanese and US markets, and electrical machinery in the US market, ASEAN economies suffered not only an erosion of their share of the import market but an absolute decline in the value of their exports.

**(Insert Table 8.3)**

Care must be exercised in drawing any inferences from the descriptive data presented above. They are highly aggregated (at the SITC two digit level) and across all the major ASEAN economies, obscuring variance in performance across products and across countries. And, at best, they present a correlation between ASEAN loss of market share and simultaneous gains in that of China. The underlying factor behind such a correlation might not necessarily be the competitiveness of Chinese exports, however: the supply-side disruptions in the crisis-hit ASEAN economies in the period from 1997 onwards, for instance, may have been a factor underlying ASEAN economies' loss of market share. The data, however, do support the

conclusions of econometric work that has analyzed changing market shares in earlier periods.<sup>11 16</sup>  
The results from the ASEAN perspective, however, are even worse than those of studies that covered earlier periods. Holst and Weiss, for instance, reported rising absolute export values for ASEAN in the second half of the 1990s despite a substantial loss of its share in foreign markets.<sup>1217</sup>

*Integration into Regional Production Networks? ASEAN Trade with China*

While developments in its two principal export markets—Japan and the United States—in recent years appear to confirm fears about the damaging impact that China’s growth would have on ASEAN exports, to look only at competition in third country markets is to ignore

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<sup>11</sup> David Roland Holst, and John Weiss, “ASEAN and China: Export Rivals or Partners in Regional Growth?” *World Economy* 27 (2004): 1255-1274; More sophisticated methods used to examine the impact of China’s WTO accession on its neighbors have their own problems. Computable general equilibrium models make a variety of assumptions regarding elasticities of supply and demand, technological shifts, factor movements, etc., that may have little foundation in the real world, and have no way of factoring in the decisions that multinationals make on where to locate particular segments of a production chain. See, for instance, Sanjaya Lall and Manuel Albaladejo, “China’s Competitive Performance: A Threat to East Asian Manufactured Exports?” *World Development* 32 (2004): 1441-1466.

<sup>12</sup> David Roland Holst and John Weiss, “ASEAN and China: Export Rivals or Partners in Regional Growth?”

another potentially significant stimulus to ASEAN trade: growth in China itself and in China's exports of assembled products to the world.

The emergence of China as “workshop to the world” (or at least its assembly plant) has caused dramatic changes in the patterns and composition of trade within East Asia. The trade triangles that had developed in the late 1980s following the G7 Plaza Accord currency realignments, in which components were shipped from Northeast Asia for assembly in Southeast Asia for export to world markets, have been largely superseded by new trade triangles in which components from other East Asian economies are being shipped to China primarily for assembly and export to industrialized countries' markets. One consequence has been a significant growth in the overall importance of intraregional trade in East Asia. Although this still lags behind that of Europe, it now constitutes more than half of the total trade of countries in the region (Lincoln 2004). China has grown rapidly in significance as an export market for other East Asian states—not least Korea, for which it is now the single most important export market.

These new trade triangles reflect dramatic changes in the composition of intra-regional trade in East Asia and the Asia-Pacific region more generally. Economic complementarity in the Asia-Pacific has frequently been discussed in terms of patterns that characterized global trade before 1945—the exchange of raw materials for manufactures. Complementarity was seen, for instance, in the exchange of Australian and Indonesian raw materials for Japanese manufactures.<sup>13</sup> Such a static view of economic complementarity informs Wong and Chan's assessment of the potential for an ASEAN-China Free Trade Agreement:

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<sup>13</sup> Peter Drysdale, *International Economic Pluralism: Economic Policy in East Asia and the Pacific* (Sydney: Allen and Unwin, 1988)



...the lack of complementarity between the Chinese and ASEAN economies limits the capacity that each can absorb of the other's products. This obstructs to a certain degree the economic integration and interdependence of China and the ASEAN countries.... Mutually competitive, rather than complementary, structures of China and ASEAN prevented significant growth in trade, with the possible exception of China and Singapore.... In the area of traditional labor-intensive industries like textiles, clothing, and footwear, China's gains have come at the expense of ASEAN's.... China's emergence as a global manufacturing base has apparently also resulted in most ASEAN economies experiencing a severe hollowing out of their industries.<sup>14</sup>

Post-war trade, however, increasingly was dominated by intra-industry trade among the industrialized economies, a development that with FDI-driven globalization of production has spread rapidly to trade between industrialized and middle income developing economies, and increasingly among developing economies themselves. The growth of international production networks facilitated this intra-industry trade, a phenomenon that accelerated in the Asia-Pacific region following the currency realignments of the Plaza Accord.<sup>18</sup> Rather than static complementarities, the globalized economy is driven by a dynamic and rapidly-evolving division of labor. China's recent rapid economic growth in large part reflects its incorporation into this new division of labor through a further extension of production networks. Despite the growth of intra-regional trade in East Asia, the region as a whole remains dependent on extra-regional

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<sup>14</sup> John Wong and Sarah Chan, "China-ASEAN Free Trade Agreement: Shaping Future Economic Relations," *Asian Survey* XLIII (2003): 508, fn 4, 517, 519, 525.

markets for sales of finished manufactures. The difference over the past decade is that a larger percentage of finished goods exports to Europe and the United States are being sourced from China, displacing goods previously exported from Japan, Taiwan, Korea, and ASEAN.

Intra-industry trade has been a major source of the growth in East Asia's intra-regional trade in the last decade: Zebregs estimates that three-quarters of the growth of trade among East Asian economies in the period 1996-2000 was attributable to intra-industry trade.<sup>15</sup> As early as 1995, one-third of intra-regional trade was estimated to consist of intermediate goods that are further processed and then exported to countries outside the region.<sup>16</sup> The share has probably increased in the subsequent decade. Studies estimate that exports of processed components contribute between 60% and 80% of the value of all Chinese exports. In turn, components for processing constitute more than 50% of the total value of Chinese imports. Most of the components for processing in China come from Northeast Asian economies, however. Hong Kong, Japan, Korea, and Taiwan supply close to two-thirds of the inputs for China's processing activities—these components account for 40% of Japan's exports to China, and 60% of the exports of the other three economies.<sup>17</sup> To what extent have Southeast Asian economies also been integrated into these new trade triangles?

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<sup>15</sup> Harm Zebregs, "Intraregional Trade in Emerging Asia<" (Washington, D.C.: IMF policy Discussion Paper, PDP/04/1, April (2004), 9.

<sup>16</sup> Monetary Authority of Singapore, "Assessing the Support from Regional Domestic Demand," *Macroeconomic Review* II, 1 (January 2003): 60-70.

<sup>17</sup> Guillaume Gaulier, Francoise Lemoine and Deniz Ünal-Kesenci, *China's Integration In Asian Production Networks And Its Implications* (Tokyo: Research Institute of Economy, Trade

ASEAN and China have become more important economic partners for one another in the last decade. From 1995 to 2004, China's share in ASEAN's total exports increased more than threefold, from 2.6% to 7.5%. In line with a general trend of China drawing an increasing share of its overall imports from developing economies, ASEAN's share of China's market increased in the same period from 7% to nearly 11%. Some ASEAN economies have benefited significantly from China's need for raw materials imports to fuel its industrialization. But ultimately, given their emphasis on economic upgrading, most governments are going to be interested in the opportunities that China will offer for sale of their manufactures. Here, China's accession to the WTO has assisted them: China's average tariff level was halved to an average of 12.7 percent in the years from 1997 to 2002 and was scheduled to fall to 9.4% in 2005.

Table 8.4 examines the changing composition of ASEAN exports to China. It shows that (with the notable exception of Indonesia, whose exports continue to be dominated by energy products) a dramatic transformation in ASEAN exports to China occurred from the second half of the 1990s. The share of manufactures grew rapidly so that by 1998 they constituted more than half of the value of total exports. The share has continued to increase (in an era when the prices of some of ASEAN's commodity exports have risen substantially) so that by 2005, manufactures constituted more than two-thirds of the value of ASEAN's merchandise exports to China.

**(Insert Table 8.4)**

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and Industry, Discussion Paper 04033, 2004), 13.

<<http://www.rieti.go.jp/jp/publications/dp/04e033.pdf>>.

A more detailed breakdown of exchanges between ASEAN and China finds significant growth in intra-industry trade. The share of parts and components in Malaysia's exports of manufactures to China, for instance, rose from 6.4 percent in 1992 to 16.1 percent in 1996 to 50.6 percent in 2000; for Singapore the respective figures were 23.1 percent, 41.9 percent, and 50.3 percent; for Thailand 6.8 percent, 29.2 percent, and 54.0 percent.<sup>18</sup> ASEAN's share of China's burgeoning imports of components increased from 0.9% in 1992 to 19.3% in 2004.<sup>19</sup> China's rapid industrialization is fostering a new division of labor in East Asia, including the ASEAN economies, and a significant expansion of intra-industry trade.

While the composition of ASEAN exports has been transformed over the past decade because of the rapid growth of exports of manufactures, imports of manufactures from China have grown even more rapidly, generating a deteriorating trade balance in manufactures from the perspective of the ASEAN economies. This has been true for Indonesia, Malaysia, Singapore, Thailand, and Vietnam. The one exception has been the Philippines, which has tripled the value of its manufactured exports to China since 2001 (primarily electrical circuits), and has enjoyed a positive balance of trade in manufactures with China throughout the period. Only Indonesia because of its burgeoning exports of raw materials has consistently run balance of trade surpluses with China over the years 1995-2004 (Brunei has also done so in the years from 2000 onwards). For most other ASEAN economies, however, the balance of trade in non-manufactured

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<sup>18</sup> Prema-chandra Athukorala, "Product Fragmentation and Trade Patterns in East Asia,"

Division of Economics, Research School of Pacific and Asian Studies, Working Papers in Trade and Development 2003/21 (Canberra: Australian National University, 2003), Table A 2,p.48).

<sup>19</sup> Prema-chandra Athukorala, "Product Fragmentation and Trade Patterns in East Asia," 10.

merchandise has at least partially offset imbalances in manufactures trade. And these data do not include trade in services, which would be expected in at least the case of Singapore, to generate a healthy surplus. From the viewpoint of economic theory, bilateral trade balances are largely meaningless. But, as has been all-too-evident from the concerns of the US Congress over the years, economic and political logics do not always coincide. No doubt ASEAN governments will be looking at their bilateral trade balances with China as a litmus test of the commitment of China to a good neighborhood policy.

To what extent has the growth of the Chinese market offset the losses that ASEAN economies have suffered in the Japanese and US markets? A first point to note is that the aggregated position for ASEAN manufactured exports in the Japanese market is largely unchanged, losses in market shares in office machinery and telecommunications and sound equipment being offset by gains in the market share for electrical machinery. The question here then is reduced to asking to what extent gains in China have offset losses in the US market. If ASEAN had maintained its peak shares of US imports of the three categories of advanced manufactures included in this study—electrical machinery, office machinery, and telecommunications/sound equipment—its total exports of these products would have been worth approximately an additional \$21 billions in 2005 (a loss of about \$7 billions in each of the product categories). In the Chinese market, however, ASEAN countries have increased their sales of these products by approximately \$34 billions since 2000 (Table 8.5).

The principal gains have come in electrical machinery, where exports increased more than six fold from 2000 to 2005—primarily from Malaysia and the Philippines. Substantial increases also occurred in office machinery—with the value of exports up more than 300 percent—the single most important supplier for this product being Thailand. Again, one must

bear in mind various caveats in considering these data—the level of aggregation means that gains in one product sector and/or market may not necessarily offset losses in another for individual countries let alone individual companies. Significant adjustment costs may have been incurred as exports shifted primarily from finished products to the manufacture of components. But they do point to an emerging regional division of labor that is incorporating ASEAN states to a greater extent than some anticipated, to growing dynamic complementarities, and to the stimulus that China's growth has provided to some manufacturing sectors in some ASEAN economies.

**(Insert Table 8.5)**

*Conclusion*

China's rapid economic growth presents an enormous challenge to other economies, not least its neighbors in East Asia that have export structures similar to that of the mainland. How economies will fare in the face of the new competition will depend in large part on how successfully governments manage the process of domestic adjustment. This will involve, *inter alia*, investments for upgrading local skills, infrastructure, etc., and improvements in governance structures and in institutional performance.

The evidence presented in this chapter suggests that the pessimism of analysts who conceive of the China-ASEAN relationship primarily in zero-sum terms is misplaced. While ASEAN did not do well in attracting new inflows of foreign direct investment in the period from 1998 to 2003, there is little reason to believe that the primary cause of this relatively poor performance was competition from China. China's data overstate the magnitude of *foreign* investment inflows. Moreover, data on FDI stocks demonstrate that ASEAN remains a significant host of investment from the United States and the European Union. And the most recent data on FDI inflows to ASEAN, which shows a pickup in these in the years 2004-5,

suggest that much of the concern of ASEAN's leaders regarding the "China threat" may have been misplaced.

The picture for ASEAN countries' exports to their traditional markets of Japan and the United States at first sight seems to sustain alarmist scenarios regarding the "China threat". For the five major export sectors and two markets for which this chapter presents data, in only one sector in one market—electrical machinery in the Japanese market—did ASEAN countries increase both the value and their share of imports. In other products, ASEAN economies lost market shares in both Japan and the United States. The success in increasing exports of clothing to the US is likely to be short-lived unless Washington maintains administrative intervention in the market. And contrary to some expectations that ASEAN would at least be able to increase the overall *value* of its exports even if it lost market share to China, there was only one other product sector where this occurred—telecommunications and sound equipment.

Despite these findings, the recent data suggests that ASEAN economies are beginning to participate in a significant way in the new trade triangles that have accompanied China's rapid industrialization. Rather than a decline in ASEAN exports of manufactured goods to China, as the zero-sum scenarios would suggest, substantial increases in exports of components to China have occurred since its accession to the WTO. To a considerable extent, the increases in exports of components to China have offset losses in exports to the US market of products in the same SITC classifications, and have transformed the composition of ASEAN exports to China.<sup>19</sup>

What implications might these trends have for relations between ASEAN and China? The concerns that Southeast Asian countries voiced about the economic threat from China prior to China's accession to the WTO underscore the tactical brilliance of Beijing in proposing a free trade agreement to ASEAN, especially one that contained "early harvest" provisions for

immediate gains for its Southeast Asian neighbors (see Frost chapter in this volume). Regardless of the overall economic value of the China-ASEAN agreement—and, given that many of Southeast Asia's exports would enter the Chinese market duty free either because they are raw materials or components for assembly for export, the actual benefits from the agreement may be limited—it was a diplomatic masterstroke both for its effects in assuaging ASEAN concerns about China's 'peaceful rise' and in putting Tokyo on the back foot.

China, however, remains a far less significant market for ASEAN economies than it is for Japan, Korea, and Taiwan. Whereas China in 2004 absorbed close to 20 percent of Korea's and Taiwan's exports, and 13 percent of Japan's, for no ASEAN country did China account for more than 9 percent of total exports.<sup>20</sup> Despite the rapid growth in exports to China, it is nowhere close to becoming the largest single market for any of the Southeast Asian economies. Nonetheless, Southeast Asian states are worried about future dependence on China and potential economic as well as military vulnerability: they have no desire to place all their eggs in one basket. They can be expected, therefore, not only to maintain their commitment to their own preferential trade scheme, the ASEAN Free Trade Area, but to continue to seek preferential trade arrangements with countries from outside the region—hence the enthusiasm not just from Singapore but also from Thailand and Malaysia for negotiating a free trade agreement with Washington.



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<sup>1</sup> Mr Lee succeeded Goh Chok Tong as Singapore's Prime Minister in August 2004. China's "Peaceful Development" (中国和平发展; Zhongguo heping fazhan) has increasingly been preferred in China's official statements to the term "Peaceful Rise" (中国和平崛起; Zhongguo heping jueqi), whose use had the (presumably) unintended consequence of further unsettling rather than reassuring China's neighbors.

<sup>2</sup> The most recent calculations by Bank staff are included in Ianchovichina, Suthiwart-Narueput and Zhao (2004), and Ianchovichina and Walmsley (2003). Earlier work is reported in Martin and Ianchovichina (2001). For similar conclusions drawn from market share analysis rather than a computable general equilibrium approach see Weiss and Gao (2003), and Weiss (2004). Lall and Albaladejo (2004) present a less alarmist scenario. Eichengreen, Rhee and Tong (2004), using a gravity model, reach conclusions broadly similar to that of the World Bank, namely that China's growth will have a negative impact on low-income countries that export consumer goods but a positive impact on higher-income Asian exporters of capital goods.

<sup>3</sup> Data in this section are for the six largest ASEAN economies: Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam. Unless otherwise noted, data are from UNCTAD's *World Investment Report*.

<sup>4</sup> See Ernst (2002).

<sup>5</sup> See UNCTAD's annual *World Investment Report*.

<sup>6</sup> The International Monetary Fund (IMF) provides guidelines to member governments for the compilation of balance of payments and international investment position statistics. FDI,

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according to the IMF, consists of three components: equity capital; borrowings from the parent company; and reinvested earnings. These data therefore exclude investment funds that a subsidiary raises from sources other than the parent company, e.g., from borrowings from minority investors in the subsidiary, or from loans from local or international banks. Moreover, while reinvested earnings are part of the IMF's definition of FDI flows, a number of countries, including Thailand, do not include them as part of their reporting of investment data to the IMF. According to the ASEAN Secretariat, reinvested earnings constituted 37% of FDI flows to the ASEAN region between 1995 and 2002. "Seventh ASEAN Investment Area (AIA) Council Meeting, Joint Media Statement" (Jakarta, 2 September 2004), <<http://www.aseansec.org/16347.htm>>.

<sup>7</sup> Graham (1995: Chart 1) cites US government data that suggest foreign direct investment each year financed between one half and two-thirds of the capital expenditures by foreign subsidiaries of US companies in the period from 1973-92.

<sup>8</sup> The British Virgin Islands, Cayman Islands, Pacific Islands, Western Samoa, Mauritius, Bermuda, and Panama.

<sup>9</sup> Although of course some of this money may have originated in the Triad and reflects investments by Hong Kong-based subsidiaries of Triad MNCs.

<sup>10</sup> Harrold and Lall (1993: p. 24) cited in Lardy (1995) p. 1067.

<sup>11</sup> Before 2005, that is, when a huge outflow of US FDI from Singapore (in excess of \$10 billion) distorted the figures.

<sup>12</sup> The most recent data suggest another reason to discount the zero-sum perspective: flows to ASEAN are picking up again. As noted above, the inflows for 2004 were close to the pre-crisis level. Moreover, according to press reports that quoted Malaysia's Trade Minister, Rafidah Aziz,

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FDI inflows into the ten members of ASEAN reached \$38 billions in 2005. At the time of writing, UNCTAD had not yet released its 2005 data. If the ASEAN data are confirmed, the 2005 inflow will be a record level for ASEAN, surpassing the previous peak of \$32 billions in 1997. Eileen Ng, 'ASEAN Sees Foreign Investment Growing', *Associated Press* 21 August 2006.

<sup>13</sup> They note, however, that the 'China effect' is not the most important determinant of FDI flows to these other economies: of far greater significance are market size and policy and institutional variables including levels of corporate taxation, degrees of economic openness, and the extent of corruption. See Chantasawat, Busakorn et al, *International Competition for Foreign Direct Investment: The Case of China*, (Paper for the Hitotsubashi Conference on International Trade and FDI, December 2003); Chantasawat, Busakorn et al, *Foreign Direct Investment in China and East Asia* (Paper for the Third Annual Conference on China Economic Policy Reform, Stanford Center for International Development. November 12, 2004); Chantasawat, Busakorn et al, *Foreign Direct Investment in East Asia and Latin America: Is There a People's Republic of China Effect?* (Manila: Asian Development Bank, ADB Institute Discussion Paper 17. November 2004).

<sup>14</sup> They find no significant association before 1992 between FDI into China and that into Southeast Asia. Their study uses a most unorthodox definition of 'Southeast Asia', however, including both the Republic of Korea and Taiwan in their definition of this region. See Yuping Zhou and Sanjaya Lall, "The Impact of China's FDI Surge on FDI in South-East Asia: Panel Data Analysis for 1986-2001," *Transnational Corporations* 14 (2005): 41-65.

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<sup>15</sup> All of these graphs record data drawn from the UN's COMTRADE database. In all cases, the columns on the graph represent the absolute value of imports from ASEAN, China, and the World, with the value measured on the left vertical axis. The lines on the graph represent the shares of ASEAN and China in total imports, with the percentage share measured on the right vertical axis. For the purposes of the analysis of trade data, the ASEAN grouping is taken as the five original members: Indonesia, Malaysia, the Philippines, Singapore and Thailand.

<sup>16</sup> More sophisticated methods used to examine the impact of China's WTO accession on its neighbors have their own problems. Computable general equilibrium models make a variety of assumptions regarding elasticities of supply and demand, technological shifts, factor movements, etc., that may have little foundation in the real world, and have no way of factoring in the decisions that multinationals make on where to locate particular segments of a production chain. See, for instance, Lall and Albaladejo (2004).

<sup>17</sup> Compare Ahearne et al. (2003).

<sup>18</sup> Bernard and Ravenhill (1995), Borrus, Ernst and Haggard (2000), McKendrick, Doner and Haggard (2000). Recognition of the significance of such networks in the study of economics has come somewhat late. See, for instance, Arndt and Kierzkowski (2001), Ng and Yeats (1999).

<sup>19</sup> The most recent data provide a more positive picture than that portrayed by earlier analysis. Holst and Weiss (2004: 1263), for instance, estimate that the net gain to ASEAN from exports to China in the 1995-2000 period was equivalent to less than 20% of the value of the combined losses to China in the export markets of Japan and the United States in the same period. As we have seen, increases in the value of sales to the Chinese market have more than offset losses in the Japanese and US markets for the products reviewed in this chapter.



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<sup>20</sup> In 2004, Vietnam had the greatest dependence on the Chinese market, which accounted for 9.0% of its exports: the next highest dependence was that of Singapore at 8.6%.