Understanding China

Young-Chan Kim *Editor*

Chinese Global Production Networks in ASEAN

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The Department for International Trade and colleagues from the University of London served as the backbone of this project in that they introduced the initial concept and inspired our team to go beyond the boundaries of modern literature. Furthermore, the economic regionalism discussed in this book will serve as the basis for a twenty-first century neo-Asia, which I hope will stimulate those who are engrossed in this ongoing global conundrum, to anticipate the presence of a China-led regional integration. Thus, special thanks go to Ms. Johannes Glaeser from Springer, for her staunch support and invaluable editorial advice throughout the course of the entire project.

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Contents

Emerging China and Its Interaction with ASEAN Economies

Yuning Gao and Junyi Zhang

The emergence of China as the world's largest trader, second largest economy, and third largest outward direct investor has clearly had a major impact on all Association of Southeast Asian Nations (ASEAN) economies during the past decades. This chapter will first examine China's role in regional economic growth and its knock-on effects by analyzing the pattern and *co-movement* of various macroeconomic measures. The chapter then highlights China's integration with ASEAN economies within the global production network via the evolution of the sophistication and value added of merchandise trade. This integration is also closely connected to China's rising direct investment and the provision of commercial services, consisting mostly of construction contracts, to these economies. The free trade agreement between China and ASEAN, and the liquidity swap agreement between the Renminbi and the national currencies of ASEAN, will ensure this region becomes one of the most active economic zones in the world.

1 The Evolution of the Basic Economic Pattern

The evolution of the basic economic pattern can be divided into three stages. The first stage was that before the Asian financial crisis. During this stage, China and ASEAN were treated as major rising economies following the expected patterns of developing countries. Their relative economic scale, trade, capital flow, and credit were more stable at this time than in subsequent stages. The second stage was more of a transition period, while the third stage was characterized by China's accession to the WTO in 2001, after which China's economy was greatly boosted by its integration into the world economy, due to the capital inflow and also its domestic financial market.

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This constituted a dramatic change in the development patterns of China and the other ASEAN economies, as a comparison of the basic social and economic indicators shows. The ratio between the populations remained quite stable—in fact the relative gap even declined slightly from 2.37 to 2.22 times, indicating that the population growth in the ASEAN economies was a slightly faster than in China. However, comparing the economic scale, firstly the nominal GDP, we can see that China's nominal GDP more than quadrupled within this decade, while the overall GDP scale of the ASEAN economies tripled during this time. This demonstrates that the relative scale of China's GDP as compared with the ASEAN economies rose substantially from 2.27 times to 3.1 times. Given that this occurred over just 10 years, this constitutes a dramatic change.

This also greatly contributed to the booming of China's merchandise trade. In 2003, the overall scale of China's merchandise trade was still slightly less than that of the ten ASEAN economies. However, in 2012, the overall merchandise trade of China was 1.85 times that of the ASEAN economies. We took these two indicators as the measure of the overall economic scale. China, during this decade, rose very fast and became more dominant in the East Asian and Southeast Asian regions. This observation is also strongly supported by the primary energy use. China's economic growth model is more energy intensive, as the ratio of its primary energy use against that of the ASEAN economies is much higher than China's GDP against ASEAN's. The ratio also rose substantially from 3.67 times to 5.32 times, indicating that China's economic growth model is still energy intensive.

However, it is remarkable that the net FDI inflow for China rose only a little in comparison with the ASEAN economies. For both China and ASEAN, FDI inflow rose more than five times. Thus, while China maintained a slight advantage, international capital treated the whole region as a favored destination, spurring rapid growth in the ASEAN countries also.

The domestic financial market indicates the opposite, however. The ratio of China's stock market capitalization as against that of the ASEAN economies rose from 1.14 to 2.19, showing that China's stock market capitalization expanded and deepened much faster in comparison to the ASEAN economies. The domestic credit scale is the most significant indicator of China's economy, because domestic credit relies heavily on the booming of its credit market. In this respect, China's financial system is more similar to the continental European model that relies heavily on indirect finance, meaning that banks serve as key financial intermediaries. Therefore, China's total domestic credit is 1.5 times its GDP scale and four times the scale of the ASEAN economies. By 2012, China's domestic credit still kept at that high ratio against its GDP, while for ASEAN economies domestic credit was consistently lower than their nominal GDP. Thus, China and ASEAN have two completely different economic growth models. China's model is quite unusual for developing economies. If we measure the financial depth of its domestic credit against its GDP scale, we will find that China is more a credit-driven model and China's domestic credit market is in fact 6.46 times larger than that of the ASEAN economies (Table 1).

Table 1 The basic economic indicators of China and ASEAN

	2003			2012		
	China	ASEAN	Ratio	China	ASEAN	Ratio
Population total (million)	1288.4	543.2	2.37	1350.7	608.4	2.22
GDP (billion US$, current price)	1640.96	724.48[a]	2.27	8229.49	2281.02[a]	3.61
Primary energy use (million toe)	1245.3	339.3[b]	3.67	2731.1	513.5[b]	5.32
Merchandise trade (billion US$)	851.00	882.01	0.96	3867.86	2454.57	1.58
Net FDI inflow (billion US$)	49.46	21.39[c]	2.31	295.63	117.74[c]	2.51
Market capitalization (billion US$)	681.20	597.32	1.14	3389.1	1545.7	2.19
Domestic credit (billion US$)	2492.29	601.55[d]	4.14	12,762.29	1976.65[d]	6.46

[a]Myanmar not included
[b]Brunei, Cambodia, Lao, and Myanmar not included
[c]Brunei, Cambodia, Lao, and Myanmar not included
[d]Myanmar and Lao PDR not included
Source: Author's calculation based on World Bank (2014)

2 Macroeconomic Integration

Measurements indicating the level of actual economic integration between China and ASEAN provide more detailed information than broad comparisons between these two major economies. First of all, there is the basic indicator of macroeconomic *issue*, the GDP growth rate. The quarterly economic growth rate is indicated by data from the IMF international financial statistics database.

Observing the quarterly economic growth rate of China and the five main ASEAN economies—Indonesia, Malaysia, the Philippines, Singapore, and Thailand—it is very clear that two separate periods can be identified. Before the global financial crisis, the economic growth rate was more highly correlated between China and the ASEAN economies. For example, the correlation coefficient between China and the Philippines was 0.668 and 0.555 for Indonesia. For the other three—Malaysia, Singapore, and Thailand—the coefficients were nearly 0.3. Thus, at the macroeconomic level, before the global financial crisis, this region's economic growth was more integrated in terms of growth rate.

However, after the global financial crisis, with the exception of Malaysia which had an correlation coefficient of 0.431, the correlation coefficient of China's economic growth with the other four economies became much lower, especially for Singapore, which had a coefficient of −0.394. This dramatic change meant that after the global financial crisis, China's economic growth did not change that much compared with the precrisis period and remained quite stable. However, the ASEAN economies seem to have been damaged more severely by the global financial crisis. Thailand, for example, even witnessed negative growth from the fourth quarter of 2008 to the third quarter of 2009 and during the fourth quarter of

2011. Also, Singapore experienced four quarters of negative economic growth during the financial crisis—between the third quarter of 2007 and the second quarter of 2008. Thailand experienced a similar situation, and Malaysia likewise experienced negative growth. Thus, the economic growth rate greatly diverged between China and the ASEAN economies. This shows that the ASEAN economies were more driven by international capital inflow, which allowed their FDI inflow to keep pace with China's. The main difference between China and the ASEAN economies was thus that China's economy was mainly driven by domestic credit (Fig. 1 and Table 2).

Yet, interestingly, other indicators show a different pattern. For example, the correlation coefficient of consumption price index (CPI) change between China and the ASEAN economies seems opposite to that of GDP. Before the financial crisis, the correlation coefficients of the Philippines and Thailand were still quite high, but the respective correlation of the other three ASEAN economies with China was low

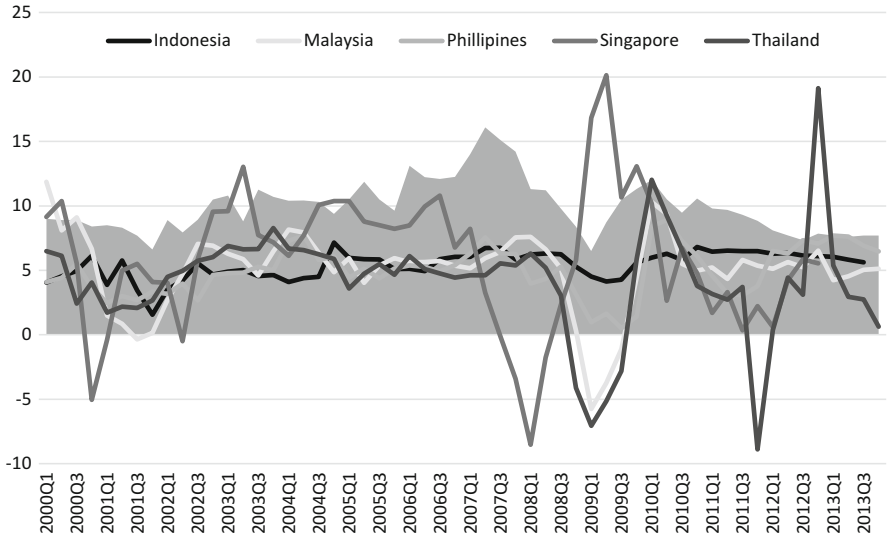

Fig. 1 GDP growth rate of China and five main ASEAN economies. *Source*: Author's calculation based on IMF (2014a)

Table 2 Correlation coefficients of GDP growth and CPI change

	Indonesia	Malaysia	Philippines	Singapore	Thailand
GDP growth correlation					
2000–2007	0.555	0.237	0.668	0.288	0.296
2008–2013	0.257	0.431	0.013	−0.394	0.299
CPI change correlation					
2000–2007	−0.287	0.030	0.725	0.269	0.634
2008–2013	0.293	0.527	0.817	0.862	0.650

Source: Author's calculation based on IMF (2014a)

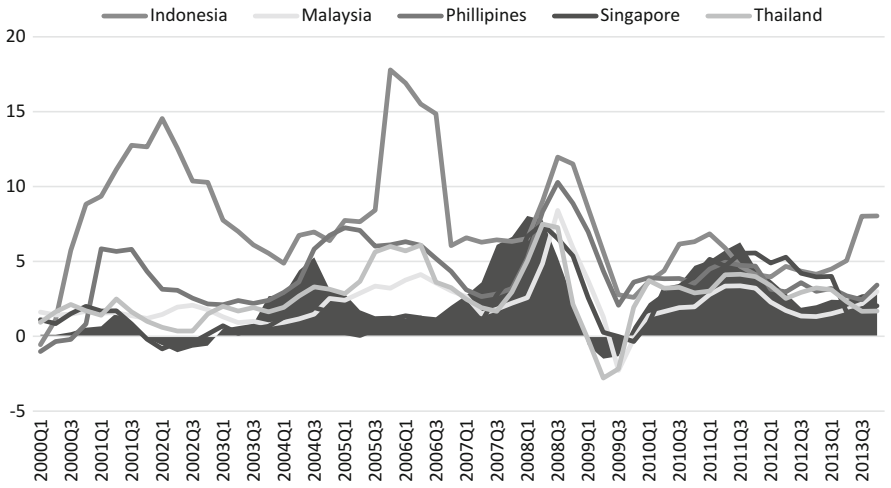

Fig. 2 CPI (quarterly) of China and five main ASEAN economies. *Source*: Author's calculation based on IMF (2014a)

or even negative. However, after the global financial crisis, the change of the price level showed that all of the ASEAN economies were positively correlated to that of China and, except for Indonesia, the other four had relatively high correlation coefficients. Thus, the change of price level (we use quarterly data here, also) was more closely correlated. Since the global prices were more determined by the liquidity provided by the global central banks, the price levels were increasingly affected not only by the commodity prices but also the global asset prices. This was not only a characteristic of China and ASEAN but was also a global pattern after the financial crisis beyond the convergence of all price level (Fig. 2).

These two different patterns show that China's economic growth is still isolated from the ASEAN economies. Because of international economic integration, especially global trade, outsourcing, etc., the price levels of China and the ASEAN economies are both heavily affected by the prices of tradable goods, mainly bulk commodities. This causes the price levels of China and the ASEAN economies to converge. When China and the ASEAN economies become more integrated, this typical phenomenon is reflected in the CPI. However, since China's economy is very large, its economic growth is still heavily determined by its domestic market, instead of the global market. In some ways this is a similar relationship to that of the United States and the global economy or Germany and Western Europe, that is, the growth engine of the region is a giant domestic-oriented economy whose economic growth is not heavily influenced by regional or global economic patterns. Instead, its price levels—not only the commodities but also assets—are even more affected by the crisis.

3 Merchandise Trade: Balance and Patterns

The relationship between China and the ASEAN economies with respect to merchandise trade is definitely the most crucial part of the region's economic integration. Both China and the main ASEAN economies are heavily blended into the global economy, especially in terms of the international division of labor, and serve as part of the international production network.

China is regarded as one of the largest trade surplus economies in the world, especially in comparison with the United States or the EU. If we observe the trade balance between China and the ASEAN economies, we may find that China is one of their main trade partners with a trade deficit. The peak of China's trade deficit with the ASEAN economies reached $40 billion in 2010 and 2011, although the trade deficit was turned into a surplus in 2013. Before 2013, Indonesia was always the largest source of China's trade deficit, and it alone contributed nearly $50 billion worth of trade deficit to China in 2013 alone. China turned the trade deficit into a surplus because Vietnam was one of the largest deficit economies, and, in 2013, the deficit tripled from that of 2012 ($14 billion), reaching $42 billion, making China a surplus economy in comparison with the ASEAN economies. Generally speaking, over the past decade starting from China's accession to the WTO, China has continually been a trade hub in the global economy. The ASEAN economies, together with Japan and South Korea, are the main source of China's deficit, and most of China's surplus must come from the United States and the EU. This is the basic pattern, apart from the anomalous case of 2013. Indonesia is always China's main source of imports, including metal and other raw materials (Fig. 3).

What should be highlighted is the importance of the reexport of merchandise from Mainland China through Hong Kong. When calculating the trade balance between Mainland China and all its trading partners, there appears a large gap between the export from China and the import of its trading partners, when Hong Kong is excluded, since Hong Kong serves as the trade hub in terms of merchandised trade for Mainland China. In Fig. 4, the dark area is the gap between China's own statistics regarding its exports and imports against the ASEAN economies, and that is surplus 1. From the import and export against China reported by all the ASEAN economies, we can calculate surplus 2. There is continually a large gap between surplus 1 and surplus 2. In some years, this gap could be as high as $40 billion, almost equaling the total trade surplus of the ASEAN economies against China in some years. This makes it necessary to take Hong Kong into account. If Hong Kong is included, then in some years—2009, 2012, or 2013, for example—the gap is almost zero. So if we calculate the reexport and the reimport of Mainland China through Hong Kong, then China definitely has a trade deficit against all the ASEAN economies. For example, according to the official statistics regarding Mainland China and the ASEAN economies only, China may become a surplus economy. Different data may produce different results and this is why we have to apply these adjustments.

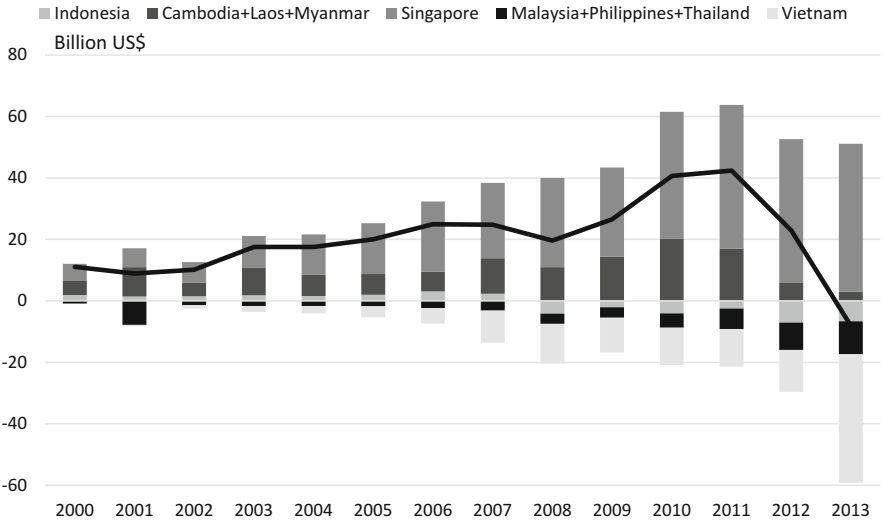

Fig. 3 ASEAN trade balance with China (Hong Kong included). *Source*: Author's calculation based on IMF (2014b)

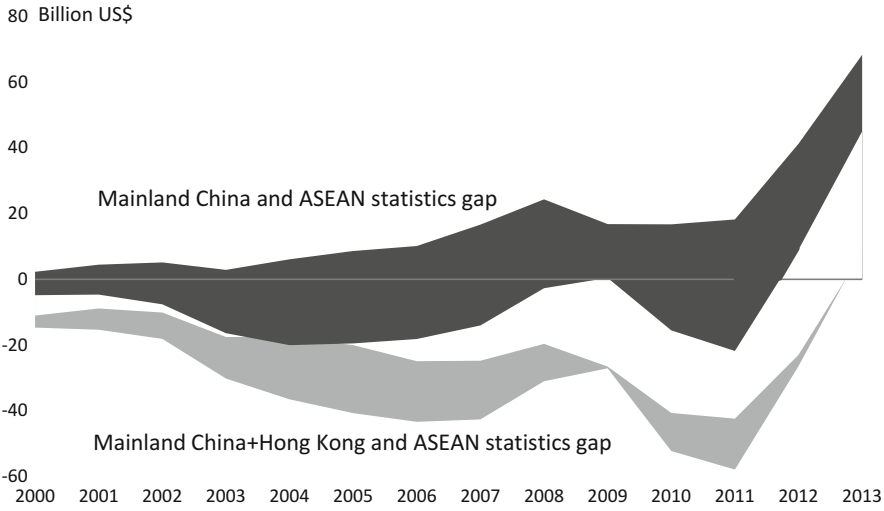

Fig. 4 Statistics gap trade balance between China and ASEAN. *Source*: Author's calculation based on IMF (2014b)

The pattern of merchandise trade between China and the ASEAN economies can be articulated when dividing all the merchandised trade into three categories according to Lall (2000) under the Standard International Trade Classification: primary products, raw material-based products, and manufactured goods.

The manufactured goods can also be divided into three subcategories: low-tech, medium-tech, and high-tech products.

The trade patterns of China and the ASEAN economies are very interesting. Within China's export to the ASEAN economies, the raw material-based products such as raw metals declined substantially from 21 % to just over 14 %. Furthermore, the high-tech trade in both directions between China and ASEAN declined. In 2005, high-tech products accounted for 62 % of China's imports from the ASEAN economies. However, by 2012, the figure had dropped to 46 %. Imports also declined from 49.6 % to just 41 %. Trade in medium-tech products rose, however, especially China's export of medium-tech products to all the ASEAN economies. Trade in low-tech products also rose substantially. This overall trade pattern here between China and the ASEAN economies is particularly notable. The high-tech products here mainly refer to the ICT goods. China and the ASEAN economies are on the same global value chain when it comes to the outsourcing of ICT products. Both are processing and assembling centers. Processing and assembling are part of intra-industry trade. Thus, as China and the ASEAN economies develop, the proportion of medium- and low-tech products, which are the real comparative advantage of China and ASEAN, rise. These products are truly made in China, made in Thailand, etc., whereas the high-tech products are actually only processed in these countries.

The trade pattern seems to have a decline of sophistication, but we would like to highlight that the real change is the decline of these processing and assembling activities and the rise of real economic activities or the real regional integration of medium-tech products such as machinery, general electronics, and other metal products. This trade pattern shows the rise of both China and ASEAN on the global value chain. They are trying to have more value added in their merchandise trade by importing and exporting more medium- and low-tech products. No doubt, the decline of raw material-based products in China's exports to the ASEAN economies indicates the rise of China's value added in its trade (Table 3).

If the same classification is used to observe the trade balance between China and the five main ASEAN economies, we can also identify the change of the trade pattern especially between China and Malaysia/Thailand. Their total trade balance grew a lot from 2005 to 2012, while China's import of high-tech products from Malaysia contributed the most to Malaysia's trade surplus against China. What is

Table 3 Trade pattern between China and ASEAN (unit: %)

	2005		2010		2012	
	Import	Export	Import	Export	Import	Export
Primary product	2.97	6.01	6.20	6.94	8.44	6.18
Raw material based	21.99	20.96	25.13	16.91	27.89	14.38
Low tech	0.89	10.58	1.35	14.16	1.75	18.98
Media tech	12.20	12.84	14.54	19.55	15.92	19.57
High tech	61.95	49.61	52.78	42.44	45.99	40.89

Source: Author's calculation based on UNSD (2014a)

remarkable is that China's import of raw material-based products from Malaysia also rose rapidly. At the same time, China's export to Malaysia of medium-tech productions—and low-tech products in particular—accounted for a much higher proportion in 2012. In the case of Thailand, it is mainly the medium-tech products that contributed to trade surplus against China in 2012. Interestingly, the high-tech products contributed the most to China's trade deficit against Thailand in 2005. That does not mean, however, the merchandise trade between China and Thailand has declined in sophistication, just as we have discussed. With Vietnam, in all the different categories of products, China has a trade surplus that mainly comes from low-tech products. The scale is similar to that of China's trade surplus against Malaysia in low-tech products. However, because of China's huge deficit against Malaysia, the overall balance is that China has a deficit against Malaysia. Singapore is similar to Vietnam. The only exception is Indonesia. China has a huge deficit in raw material-based products against Indonesia. China imports a lot of raw material-based products from Indonesia, but it also has a significant surplus of high-tech products with more than $9 billion in 2012. All these result in a pattern where China is in the upper stream compared with Indonesia and Vietnam, but in the downstream compared with Malaysia in the international division of labor. Singapore is different as it is similar to Hong Kong as a frequent reexport center (Fig. 5).

The problem of current statistics is that the traditional bilateral trade statistics usually base their trade balance calculations on gross trade. For example, when China exports an iPhone to the United States, the trade statistics only calculate the overall value of this iPhone as the trade surplus of China against the United States. This is the same with the ASEAN economies. For example, when Malaysia exports

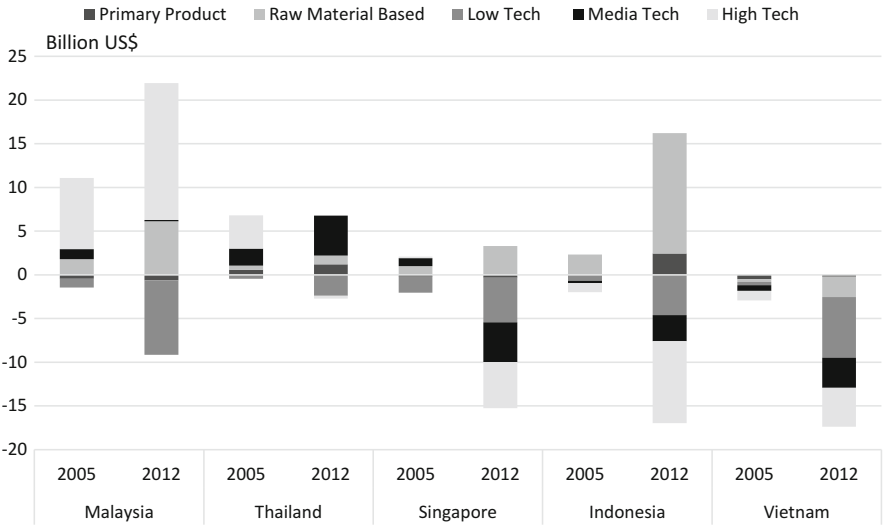

Fig. 5 Trade balance structure between China and ASEAN. *Source*: Author's calculation based on UNSD (2014a)

a hard drive or mainboard to China, the gross value of this product is recorded as the trade surplus of Malaysia against China. However, as is well known, with the international division of labor and international assembling activities, many of these economies, when they export the finished goods, especially the ICT goods, only get very little value added from the exported products. For example, China only gets 6 to 7 US dollars for each iPhone exported to the United States. This is also true with Malaysia when it exports a hard drive or mainboard to China for assembling.

The most recent development in statistics is that the OECD and WTO have introduced a new database called trade in value added. This database uses the input/output method to record the value-added part of trade activities. Under these new statistics, when an economy imports raw materials or components for assembling and processing, the calculation of reexport should only include the value-added part, not the gross value. Therefore, the overall trade balance using the value-added approach between China and the ASEAN economies in 2000 accounted for 2/3 of the traditional approach. In 2009 the trade balance with the value-added approach only accounted for a quarter of that calculated by the traditional approach. The main difference comes when calculating the trade balance between China and Malaysia, which is only 1/5 of the trade balance calculated using the traditional approach. The trade activities between China and Thailand show similar differences. For Indonesia, using the traditional calculation method, there is only a small trade deficit with China; however, with the value-added approach, China has $800 million worth of trade deficit against Indonesia. This means China's imports from Indonesia—mainly raw materials—have more value added, while China's exports to Indonesia, mainly parts and components, account for much less value added. Thus, the trade pattern changes completely from the traditional approach of gross value.

This provides a brand new picture of China's economic integration with the ASEAN economies, especially in merchandise trade. Both China and ASEAN are assembling centers and deeply involved in international trade, so their real value added in trade activities is much lower than their gross trade value. This is in part due to much overlapping of value of parts and components that are calculated twice, or even more, depending on their positions on the supply chain. If one country exports components to another country for assembling and then to the third country for final assembling, the value of the components may be calculated more than once. The value-added approach provides the real pattern—showing that although China is still downstream of the ASEAN economies, the extent of China's trade deficit against them is much less than the deficit calculated using the traditional approach. A lot of raw materials, like silicon and chips, are still imported mainly from Germany, Japan, and South Korea. The ASEAN economies make the raw materials into hard drives, mainboards, etc. and export them to China for final assembling. The value-added approach provides a more accurate map of the economic relationship between China and the ASEAN economies. This enables a reassessment of ASEAN's role in the international division of labor, and its position in the global value chain, which was hitherto overestimated (Table 4).

Table 4 Trade balance under gross and value-added approaches (unit: million $)

	2000		2005		2009	
	Gross	VA	Gross	VA	Gross	VA
Brunei	−98.0	−142.1	−188.7	−283.4	−217.2	−317
Cambodia	21.3	15.8	389.7	215.6	1021.4	477.9
Indonesia	−2167.3	−1941.5	−1657.9	−1485	36.1	−811.0
Malaysia	−3265.8	−1851.8	−8500.2	−1516.3	−15,017.2	−3398.8
Philippines	−622.4	−364.9	−7372.1	−643.2	−7106.6	−1154.6
Singapore	−2585.6	−1404.2	−7976.1	−2173.5	−7524.5	−2763.3
Thailand	−1840.4	−1008.2	−5257.2	−852.8	−10,933.6	−2742.0
Vietnam	86.7	6.1	2180.8	505.4	10,498.9	3990.7
ASEAN	−10,471.5	−6690.8	−28,381.7	−6233.2	−29,242.7	−6718.1

Source: Author's calculation based on OCED (2014)

4 Trade in Service and Contract Projects

Although China today has quite a high current account surplus because of its huge merchandise trade surplus, its rising deficit in the service trade has greatly lowered its current account balance, especially the trade balance in services with the ASEAN economies. For example, Singapore contributes the most to the trade balance, which is quite unique. When calculating the service trade balance between China and Singapore, China only has an advantage in certain services that are mainly labor intensive. In all the other four services of transport, insurance, finance, royalties, and licenses, Singapore enjoys a significant trade surplus against China, especially in transportation, since Singapore serves as one of the most important ports in the world. In the peak of 2010, China had $1.9 billion worth of deficit against Singapore. Although no Asian economies contributed very much to China's service trade balance, which is mainly between China and US/EU, Singapore nevertheless contributes substantially to China's service trade deficit in this region, mainly through transport (Fig. 6).

However, China has a comparative advantage in the construction service. According to China's official statistics, there is a class of construction projects categorized as contract projects. The overall scale of this category was $117 billion in 2012, which is even larger than China's outbound investment. In fact, China has a large amount of contract projects in all ASEAN economies, and in the ten ASEAN economies in 2012, these accounted for $19.3 billion, which is the majority of the total service trade. With the current service trade statistics, China has a huge deficit against Singapore, but if the vast amount of contract projects is included into the total bilateral flow of service, then China has a substantial surplus against all the ASEAN economies. This is an interesting case where China seems to be a large constructor doing work all over the world including in the ASEAN economies. The massive construction projects are driving China's own domestic economic growth and fuelling the global economy. The construction services that China provides to the main five ASEAN economies are quite close to each other—the top five each

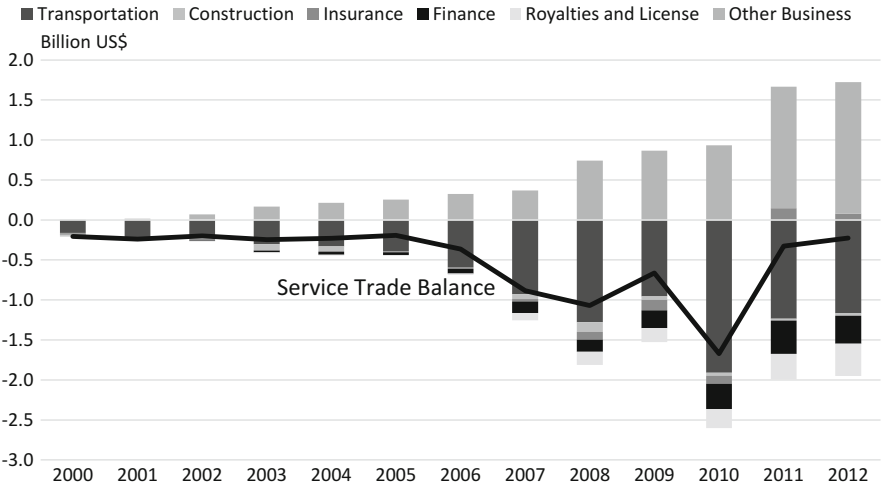

Fig. 6 Service trade balance between Singapore and China. *Source*: Author's calculation based on UNSD (2014b)

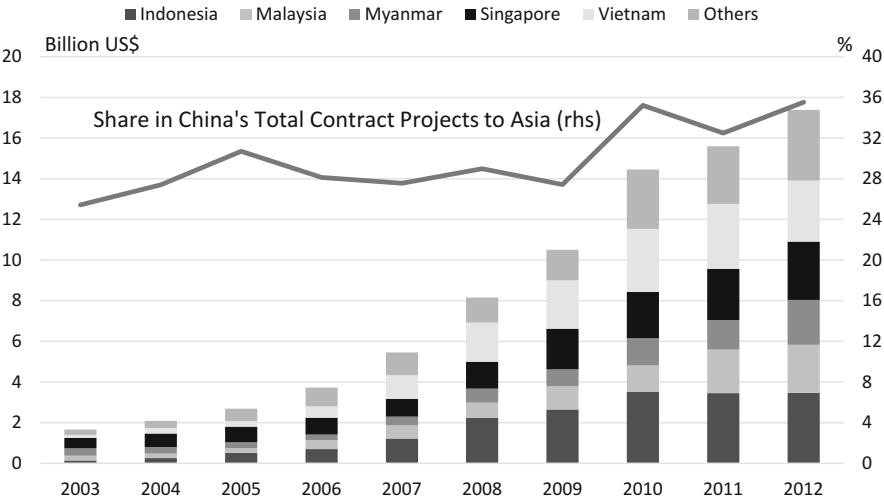

Fig. 7 China's contract projects with ASEAN. *Source*: Author's calculation based on NBS (various years)

has around $3 billion: for Indonesia, $3.5 billion and for Singapore, nearly $3 billion. The main difference is that the Philippines is not among the top five, replaced by Myanmar. This shows China's regional relation with the ASEAN economies aside from the merchandise trade. This is the pattern of China's bilateral service trade with the ASEAN economies (Fig. 7).

5 China's Capital to ASEAN and Its Impact

In 2013, China became the world's third largest outward direct investor, and in 2012 investment to ASEAN also rose from US$0.16 billion to around US$6 billion, constituting more than 7 % of China's total outward direct investment. Among the main destinations, Singapore has consistently had the largest share since 2006, peaking at 3.3 billion in 2011, which was even more than half of China's total direct investment to ASEAN. This is because China's direct investment to Singapore was more concentrated in the business service and financial sectors, which were closely related to imports from Singapore's service trade. The second largest destination was either Myanmar or Indonesia, and this consisted largely of direct investment to the utility and mining sectors (Fig. 8).

On the whole, the energy and mining sectors were the largest in terms of China's direct investment after 2008, apart from in 2009 when wholesale and retail trade contributed one third of the total. In 2012, investment in the mining sector alone reached US$1.7 billion, going mainly to Indonesia (the US$1.26 billion investment of China Nickel Resources to PT Jhonlin). The US$1 billion investment to the energy sector in 2011 was mainly backed by the US$2.5 billion contract of Sinopec to Brunei. Major investments to other sectors included a US$1.1 billion investment to the transportation sector in 2011 and a US$1.1 billion investment to the financial sector (Table 5).

However, the difficulty with calculating China's ODI to some financial service centers, such as Singapore, is that the official statistics cannot accurately record the final destination of the investment, but usually can only be classified as "leasing and

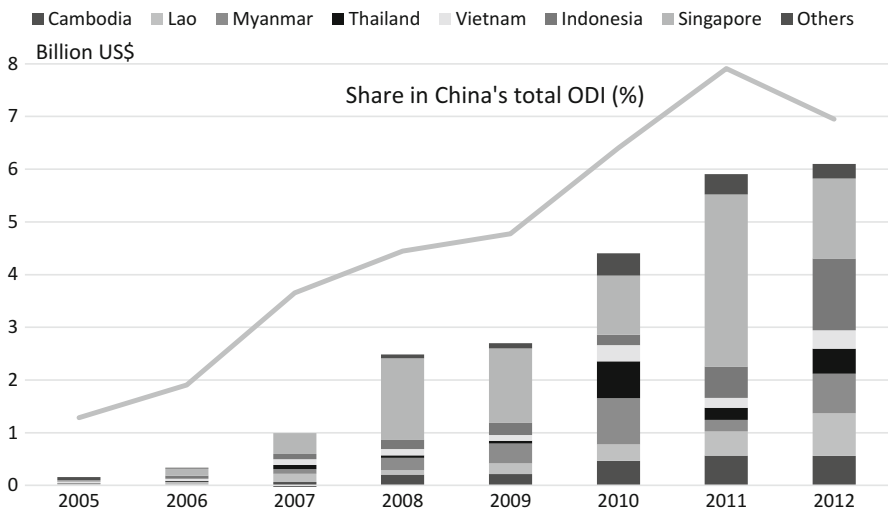

Fig. 8 Regional breakdown of China's ODI to ASEAN. *Source*: Author's calculation based on MOFCOM, NBS, and SAFE (various years)

Table 5 China's direct investment to ASEAN by sectors (unit: million US$)

	2007	2008	2009	2010	2011	2012
Energy	77.44	1175.71	349.32	791.3	1006.41	1081.79
Mining	96.80	241.75	465.54	898.17	446.09	1714.34
Manufacture	290.40	237.15	275.11	485.93	568.63	988.21
Wholesale and retail trade	119.00	92.07	909.95	171.02	752.53	682.88
Leasing and business service		161.32	152.07	155.98	566.74	440.41
Construction	77.44	162.86	181.95	346.06	442.73	600.94
Others		413.49	364.16	1556.18	2122.11	591.87
Total	968.00	2484.35	2698.10	4404.64	5905.24	6100.44

Source: Author's calculation based on MOFCOM, NBS, and SAFE (various years)

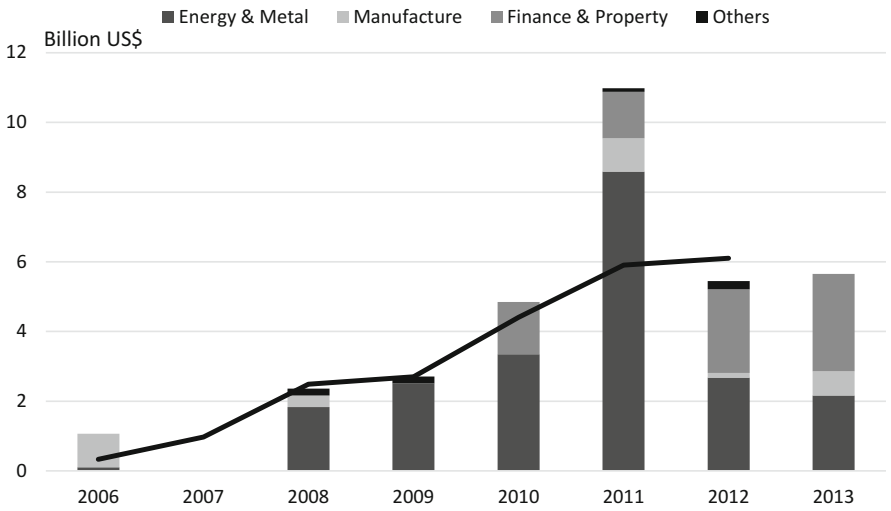

Fig. 9 Real destination China's ODI to ASEAN. *Source*: Author's calculation based on Heritage Foundation (2014)

business services" to those centers. Looking at the statistics of final destination for China's ODI, the China Investment Tracker Database, we may find that the regional and sectoral breakdowns are both quite different, and this can completely alter the overall pattern of Chinese ODI for the whole region. For example, the US$3.27 billion investment to Singapore, as well as some other investments, was not accurately recorded as direct investment in China's official statistics, and in fact the total Chinese ODI to ASEAN economies in 2011 was just a quarter of that shown in the official version (Fig. 9).

Table 6 Bilateral currency swap agreements between China and ASEAN economies

Agreement date	Counter party	Amount
2009.02.08	Malaysia	80 billion yuan/40 billion MYR[a]
2009.03.24	Indonesia	100 billion yuan/175 trillion IDR
2010.07.23	Singapore	150 billion yuan/30 billion SGD[a]
2011.12.22	Thailand	70 billion yuan/320 billion THB
2012.02.08	Malaysia (extended)	180 billion yuan/90 billion MYR
2013.03.07	Singapore (extended)	300 billion yuan/60 billion SGD
Total outstanding		550 billion yuan

[a]Expired when extended agreements become effective
Source: People's Bank of China (2014)

A bilateral currency swap agreement between monetary authorities, also known as a central bank liquidity swap, is a type of currency swap used by a country's central bank to provide liquidity in its currency to another country's central bank. The Chiang Mai Initiative (CMI) is a multilateral currency swap arrangement among the ten members of ASEAN, China (including Hong Kong), Japan, and South Korea. It launched on 24 March 2010 and draws from a foreign exchange reserve pool worth US$120 billion, which was increased to US$200 billion on 3 May 2012.

Since 2009 efforts to internationalize the Renminbi have also drawn on a series of bilateral currency swaps between the People's Bank of China (PBoC) and the main central banks of the world. By the end of 2013, the total outstanding of these swaps between China and ASEAN had reached 550 billion Yuan, more than half of which was between the PBoC and Singapore reserve bank. This also guaranteed the efficient liquidity of the Renminbi for ASEAN in trade, direct investment settlement, and other demands (Table 6).

The deepening of regional economic integration from trade to investment activity has greatly enhanced the degree of correlation of the exchange rate. Subramanian and Kessler (2012) find that the co-movement coefficients of the five main currencies of ASEAN are even higher with the Renminbi than with the US dollar since the financial crisis. In fact, even the lowest co-movement coefficient with the Renminbi, that of the Indonesian Rupiah at 0.456, is still higher than the highest one with the US dollar, that of the Philippine Peso at 0.427. The largest discrepancy was with the Singapore Dollar, which has the highest co-movement coefficient with the Renminbi (0.764), but the second lowest with the US dollar (0.160). The exchange rate movement of the Thai Baht and Malaysian Ringgit are also highly correlated with the Renminbi (Fig. 10).

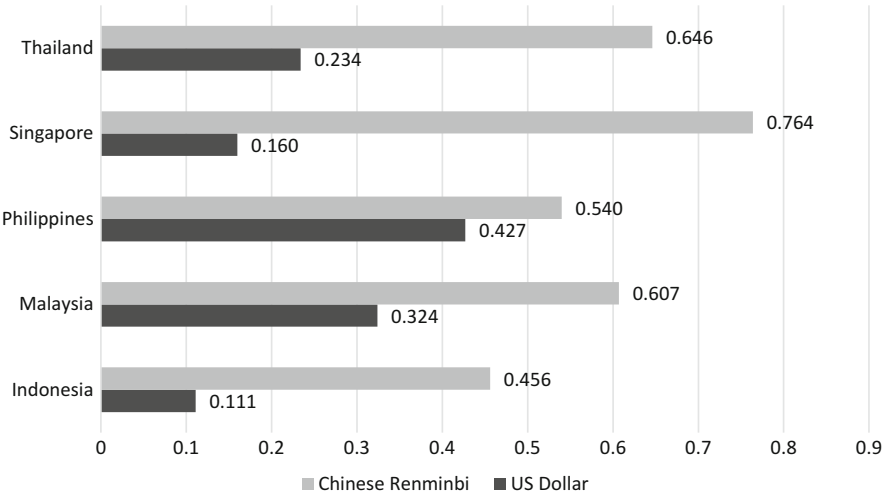

Fig. 10 Currency co-movement coefficients (2010–2012). *Source*: Subramanian and Kessler (2012)

6 Conclusions

In discussing the impact of emerging China on the ASEAN economies, the basic economic pattern is always the first thing that needs to be considered. The fundamentals of China and the ASEAN economies demonstrate that between these two economic blocks, there are a few similarities but more differences. They are both favorite destinations of FDI, but China relies much more on energy consumption and its domestic financial market. This is one of the main reasons that economic growth between China and ASEAN diverged after the global financial crisis. However, the rising correlation between their price changes indicates that they were both affected by the convergence of global asset prices after the crisis.

Furthermore, the deepening integration of trade activities between China and ASEAN progressed from a narrowing deficit to a surplus recently, driven by China's trade surplus against Vietnam. If divided by technological classification, China imported more raw material-based products, mainly from Indonesia, but exported more low-tech manufactured products, mainly to Vietnam. However, the dominance of high-tech products, mainly with Malaysia, within the bilateral trade was more a mismeasure of real value added of their trade balance. The trade in value added between China and ASEAN economies is just one fifth of the gross trade balance.

China's service trade with ASEAN experienced an expanded deficit with Singapore, mainly in the transportation service, but this later narrowed due to the boom in construction services provided by China to the other ASEAN economies. As a net direct investor to the nine developing ASEAN economies, China's capital

mainly went to the energy and metal sectors. Even the large amount of direct investment from Singapore to China may also be the result of round-tripping investment that fully utilized its financial service, which is reflected in the nonofficial statistics of China's ODI in finance and property.

Finally, the liquidity swaps under the Chiang Mai initiative and China's efforts to internationalize its currency both made the exchange rates of the five main ASEAN economies more closely correlated to the Renminbi than the US dollar following the financial crisis. We believe this is a sign that this regional economic integration labeled by their FTA in 2010 has already become deeper because of the tightening financial linkage.

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RCEP vs. TPP: The Pursuit of Eastern Dominance

Young-Chan Kim

1 Introduction

The notion of economic regionalism retains an amalgamation of meanings in geography, sociology, demographics and diplomatic relationships. According to Hettne (2005), regions are socially constructed, politically contested units that depend on the perspectives of political actors to 'exist'. This regional integration can be extended to the concept of different levels of interests, in relation to an individual country's multifarious demands.

Regardless of the elevated value of the Asian trading bloc, the focal point behind the construction of regional institutions has been disparate, as a result of conflicting economic objectives and prior social struggles. Thus, various attempts in implementing new rules and agreements have stalled or have been hindered due to contrasting interests and as a result of deep-rooted historical altercations.

Why are the Association of Southeast Asian Nations (ASEAN) economies integral on a global scale, and in what way are they indispensable for the development of both the US and Chinese economies? First and foremost, the regions are known to be strategically significant, partially due to the transport links that bridge Asia to the Middle East and Europe via its narrow waterways. It is further a viable flashpoint from a regional security perspective inter alia due to conflicting national ownership claims of the South China Sea. Nonetheless, despite its fragile setting, Southeast Asia possesses a vast history of remaining renitent in the face of domination, and it has further intricately manoeuvred her way among the great powers of Asia and the West.

Next, the ASEAN regional bloc is an emerging economic powerhouse. Its GDP exceeds US$2 trillion (3 % of world GDP) and is likely to grow at an average rate of 6 % for the forthcoming two decades (World Bank 2015). Furthermore, the bloc can

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be considered as being one of the most prominent outsourcing destinations for a plethora of nations ranging from the USA and the European Union (EU) to China and Japan.

Furthermore, economic ties with the rest of emerging Asia have heightened: China's share of the ASEAN trade market has almost tripled from 5 % in 2001 to 13 % in 2011, while the US and EU share has nearly halved, from 30 to 18 %, exemplifying the fact that Chinese influence has greatly intensified in recent years. Also, it is evident that manufactured exports now account for three-quarters of ASEAN exports, ranging from low-wage products in Cambodia and Vietnam to advanced electronics and textiles in Malaysia and Thailand and further leading financial service from Indonesia and Singapore.

These factors have resulted in the ASEAN regions becoming a sought-after partner in terms of both regional security and trade initiatives. In relation to the matter of trade, ASEAN has completed many free trade agreements (FTAs) with subsequent Asian partners, commencing with a path-breaking initiative with China in 2003, and it is now attempting to knit these together under the Regional Comprehensive Economic Partnership (RCEP) as one of the prominent members and the Trans-Pacific Partnership Agreement (TPP) as a partial member. Four ASEAN economies joined 12 countries from around the Pacific to negotiate the TPP. Both projects have critics: some perceive the RCEP as being too slow and too weak to make a difference, while others consider the TPP as being greatly intrusive for countries in the early stages of development.

This paper as a whole examines the notion of the Chinese integration effort within the ASEAN region focusing on the comparative analysis of the TPP and the RCEP and its further development into the Silk Road project. Furthermore, Sect. 2 illustrates the brief historical process for the development of the ASEAN bloc and the manner in which it has burgeoned continuously throughout the past years. Next, Sect. 3 presents the comparative analysis between the US-led TPP and the ASEAN-planned RCEP. The final section delineates various concluding comments and the limits and recommendations of the Chinese approach on both agreements are further exhibited.

2 A Historical Approach to the East Asian Regional Integration Effort

Since the Plaza agreement in 1985, the notion of international trade in the East Asian region was upheld by the Japanese and American trade ties. When contrasted to the intra-regional trade intensified European Union, which accounts for more than 60 % of their trade, the prominent source of internal trade in the Asian region depends largely on the action of extra-regional markets, such as those in the EU and the USA. Facets similar to technology innovated Japanese goods and a populous domestic market in the USA resulted in the majority of the Asian economies having

Table 1 Economic volume of ASEAN economies

Country/region	Growth year on year (%)	2013 (US$ billion)	2012 (US$ billion)
ASEAN	20.00	426.33	370.77
Brunei			1.63
Cambodia	26.71	3.7	2.92
Indonesia	1.46	67.2	66.23
Laos	59.30	2.74	1.72
Malaysia	11.89	106.07	94.8
Myanmar	31.33	10.15	6.97
Philippines	13.79	14.61	12.84
Singapore	31.95	91.4	69.27
Thailand	1.52	64.96	63.99
Vietnam	29.96	65.5	50.4

Source: China-briefing.com 2015

to rely upon the spillover impacts in relation to technology from Japan and cheap labour products from the USA; thus, the major trade-related countries had no need to adhere to any forms of regional integration (Table 1).

In addition, historical and ethical animus are subsequent problematic issues within the Asian region. In comparison to Germany in the early twentieth century, the notion of Japanese imperial policy and the impact of World War II are further sources of chagrin within the Asian region. Furthermore, these issues are to this day sources of intense conflict between Japan and subsequent nations similar to China and the Koreas. This sort of historical dilemma has been a persistent source of struggle during the last century.

Following the disappointing progress of the Uruguay Round Ministerial meeting in 1990, the Malaysian Prime Minister Mahathir Mohamad offered the formation of a regional trading bloc including members of ASEAN and China, Hong Kong, Japan and Korea, which was to be known as the East Asian Economic Group (EAEG). The prominent aim was to establish a regional trade arrangement for the group in response to the emergence of preferential regional trade arrangements elsewhere, such as that in North America. It was blocked from progressing further due to the US and Japanese objection of the proposal and increased pressure from the USA on her Asian allies to restrain from supporting the deeds of the EAEG. Thus, although the project was unable to proceed, it was deemed as being what many perceived as a signal of a re-ascendant East Asia and was further the seed of the ASEAN-Plus-Three project.

Since the early 1990s, East Asian countries have liberalised their financial systems and have further increased the provision of capital accounts. This has further resulted in an influx of long- and short-term capital investment and has dredged their market-orientated growth policy. However, the imminent vulnerabilities of the global financial market stimulated the Asian financial crisis in 1997, and it exposed the need for an abridged regional paradigm and a new wave of regional integration in Asia, which allows it to stand without the aid of external Western

partners. Furthermore, prior to the financial crisis, the USA dominated the trading market and was a lead importer in terms of internal trade with the members of the ASEAN. The national wealth of the member nations depleted due to the influence of Western financial institutions similar to hedge funds, and as a result, the members of the ASEAN started to search for a subsequent nation to enable the level of trade to sustain. The answer they found was China. This was greatly aided by the considerable number of Sino-businesses within the ASEAN region that enabled the integration process to proceed with greater ease.

The financial crisis in East Asia signalled for the emerging economies to embark on various feats to further the notion of economic regionalism in the areas of international trade and global finance. The crisis further stimulated the region's economies, which were in prior years progressively interdependent towards the US market, to acknowledge the value of the regional economic cooperation among themselves and to proceed to institutionalise such interdependence. Since November 2001, the notion of regional economic integration was initiated via the free trade agreement between the Chinese and the ASEAN nations, and from then on, more than 30 agreements were penned between subsequent members. Throughout the course of this period, the majority of the East Asian economies acknowledged the fact that unless they were to develop their own method of regional trade, they will undoubtedly be disadvantaged in the field of international trade and multilateral agreements. Also, after the financial crisis, certain nations similar to Thailand and Indonesia have identified the prominence of uniting themselves to reap the benefits of the bargaining power against the EU and the USA.

Government technocrats in East Asia, akin to China and Korea, were further made greatly aware of the need to amass a bigger market on a domestic scale, in order to exploit the scale of economics and dynamic efficiency gains. Thus, they perceived that the East Asian regional agreement could elevate both productivity and international competitiveness within their respective nations. Furthermore, it can make way for trade and investment and promote the notion of harmonisation when rule making and standard setting and various procedures in order to administer an efficient resolution. Thus, this would imminently bolster the calibre of the economy in that the service, labour mobility, investment, competition policy and intellectual property rights sectors would be increased in terms of their provision. Therefore, it is evident that this effort was essentially fundamental in developing the economy of the nations via the deepening of trade and investment integration.

The notion of an 'East Asian Community' was first proposed by the East Asian Vision Group in 2001 and sought to improve economic cooperation, financial cooperation, political and security cooperation, environmental cooperation, social and cultural cooperation and institutional cooperation. This eventually materialised in November 2004, when the East Asian Leaders proposed to form the East Asian Community and the idea of holding an East Asian Summit was further approved. Regardless of the fact that the prominent objectives were fairly expansive, the matter can be summarised within economic cooperation, ranging from the establishment of the East Asian free trade areas, expansion of the framework agreement on an ASEAN investment area to all of East Asia to promoting the notion of a

technological and knowledge-based economy. Further feats that were introduced ranged from various financial cooperation schemes including the finding of a self-aid regional facility for financial cooperation to the adoption of a better exchange rate coordination mechanism that was in tandem with both financial stability and economic development.

Amid the financial predicament of 2007 in the USA, China was a prominent economy which sought to achieve a monumental growth rate of over 10 %, and Beijing announced a pragmatic package for the ASEAN to surmount the global financial crisis. In April 2009, the then Prime Minister Wen Jiabao originally planned to make a three-point proposal at the abortive ASEAN summit in Pattaya, Thailand, to embrace the members of the ASEAN.

Wen proposed three focal points: first, put countering the financial crisis at the top of the East Asian cooperation agenda and focus on addressing the most pressing issues facing this regions; second, seize the opportunity of the crisis to make cooperation (sic) in all areas more substantive and robust and advance regional integration; and third, bear in mind common, long-term interests, unswervingly advance East Asian integration and promote regional peace and prosperity (Wang 2009).

There was even a direct financial support programme to strengthen the relations with the ASEAN nations; notably China–ASEAN investment cooperation fund totalling US$10 billion was initiated and sought to provide around US$39.7 million in special assistance to Cambodia, Laos and Myanmar to meet urgent needs and to offer, over the next 5 years, an extra 2000 government scholarships and 200 master's scholarships for public administration students from developing countries in the ASEAN (Ibid. 2009).

The notion of regional trade agreements has smeared the East Asian countries' development in that the multilateral trade system, which was the by-product of the US administration, has resulted in the increase in the division between the rich and the poor. International regulatory schemes, akin to those initiated by the WTO, have encountered difficulty in removing international trade barriers and have instead had a more detrimental impact on the nations' economies. Furthermore, there have been brewing credential issues towards the ASEAN regions from the US-planned financial scheme which was implemented by the World Bank and IMF.

Embracing similar goals of trade liberalisation and economic integration, the TPP and RCEP are two schemes of regional economic integration that have gained widespread attention in the Asia-Pacific region since 2010. It is somewhat outlandish that the China-supported RCEP does not include the USA, while the US-led TPP does not involve China at present, and what is more, the intrinsic notion of the latter scheme, will undoubtedly impede the Chinese administration from joining due to the hefty costs that a membership would bring about.

3 The Trans-Pacific Partnership Agreement and the Missing Role in China

In the latter stages of 2002, Chile, New Zealand and Singapore agreed to form a 'Common Economic Partnership' which was a forum that prioritised open trade, and when Brunei joined in subsequent years post the free trade negotiation, it was known as the 'Trans-Pacific Strategic Economic Partnership Agreement'. It was eventually renamed as the 'Trans-Pacific Partnership', as more countries proceeded to join. The agreement was both extensive and vast, and the ramifications it brought about were further expansive, affecting trades in manufacturing, environmental and employment legislations and intellectual property issues. In 2009, when the US President Obama formally entered the TPP negotiation, the membership at that time included Australia, Malaysia, Peru, Singapore and Vietnam, and in April 2013, Canada, Japan and Mexico followed through. All applicants were successful in obtaining a membership besides South Korea. Although there are solely 12 members in the scheme, the combined GDP of the TPP parties stands at US$27.7 trillion, comprising 40 % of global GDP and one-third of world trade.

The prime objectives of the TPP are to augment trade and investment among the TPP members, to promote innovation and economic growth and development, and to aid in the creation and retention of jobs to take the helm and to 'craft a high-standard, twenty-first-century agreement, which was proclaimed by the US Trade Representative. These objectives are set to be achieved via the construction of a free and open business environment through the establishment of a comprehensive, next-generation regional agreement and liberalising trade and investment. Furthermore, it is vital that the traditional trade issues and subsequent twenty-first-century challenges are embraced'.

3.1 TPP from the US Perspective

The main yardstick with which Washington measures Asian initiatives is how they affect its ability to be the dominant power in the region. The thrust of US foreign policy, in the words of the former US Secretary of State, James Baker, is always to avoid any institutional device that 'would draw a line down the middle of the Pacific and threaten to divide East Asia and North America' (Bergstern 1997). In relation to the US regional policy, there are two major pillars in terms of economic and diplomatic progress. The Trans-Atlantic Trade and Investment Partnership (TTIP) enables the USA to economically and politically integrate the European Union, and the TPP scheme further serves as the gateway for the USA to merge their value and ethics with the Pacific Rim countries. After more than a decade of minimal focus on the APEC, and with the Doha Round being discussed without much avail, due to the preference for bilateral trade agreements, the US government has now embraced the TPP negotiations in its place.

It is apparent that the Anglo-American financial crisis has mercilessly unveiled the perils of the USA's dependence on the international trade, and the gravity of the problem is being burdened with large trade and financial deficits and debts. Since the considerable trade deficit is the primary drive for America to resort to its debt-financed economy, increasing exports to reverse the trend and to reduce the trade deficit has become the key issue and objective in the Obama government's economic recovery plan. On his 2010 State of the Union address, Obama addressed to renew and revitalise efforts to promote American export. He promised 'to boost American exports, support American jobs, and level the playing field in the growing markets of Asia, we intend to complete negotiations on a TPP. And tonight, I am announcing that we will launch talks on a comprehensive Transatlantic Trade and Investment Partnership with the EU, because trade that is fair and free across the Atlantic supports millions of good-paying American jobs' (Union address 12 Feb. 2013). The agreement expected a double in the quantity of exports and it further forecasted the creation of two million employment opportunities by the year 2015. It was at almost the same time that the TPP talks started to unravel. The President's 2012 Trade Policy Agenda issued by the US Trade Representative pointed out that TPP is primarily engineered to create new opportunities for trade and cooperation in the Asia-Pacific region, in order to elevate the US economy and to stimulate employment. It is thus evident that it would have undoubtedly caused a fracas due to conflicting Chinese interests in the same regions.

The TPP is further regarded as a provisional arrangement or stepping stone towards a broader, all-encompassing Free Trade Area of the Asia-Pacific (FTAAP) that is viable within the forthcoming decade, as conceived by the Asia-Pacific Economic Cooperation (APEC) leaders in Bogor in November 1994 and advocated more recently by them in their meeting in Honolulu in November 2011. The TPP negotiations are not only contemplating the inclusion of further nations but are also preparing and constructing the trade protocol with an aim for further extensive collaborations with subsequent APEC members, including China.

From Washington's perspective, her economic policy has always been in tandem with the regional strategic policy. Thus, it is apparent that the TPP served as a viable route to bridge her economic relations with the ASEAN regions via the implementation of a newly reenergised strategic approach to East Asia. The 2007 crisis which sent a ripple through the Western financial world, however, was instrumental in disengaging the trade barriers and obstacles that impeded investment and was thus greatly influential in enabling the USA to ascend in the hierarchy of foreign policy via increased regional engagement with the East Asian nations.

Furthermore, the notion of the TPP synthesises with the idea of combatting heightening Chinese influence in the East Asian region. In a world of propagating FTAs, the US government is powerless to hinder East Asian governments from establishing agreements among themselves, and thus, the creation of a subsequent trade group that includes the USA serves as a beacon of US influence in contesting increasing Chinese prestige in these regions.

Next, regardless of the unceasing administration protestations, it is evident that the TPP serves as an efficient pressure point on China. The entry of the USA into the

TPP negotiations occurred in tandem with a period of erratic relations with the Chinese government, due to the elevating nationalistic and intrusive nature of Chinese domestic and foreign policies.

In addition, the fact that the TPP consists of an array of participants in the Asia-Pacific region serves as a great advantage. It is the common consensus among economists that the regional free trade areas are a more feasible route to reaping benefits that outweigh the trade diversion liability of this approach. However, the fact that the TPP allows a regional approach that averts from the problems encountered by the APEC in the late 1990s is more prevalent. The APEC provided the Obama administration with a scene at which they could push for the ideologies presented by the TPP, but the negotiations themselves were not an initial APEC objective.

En masse, the TPP is a reflection of the US pledge to markets with a sparse role for government in their economy. This American perception on the suitable role of a government in the market is also reflected in the ruminations of the WTO. The TPP, however, departs from the WTO commitment and instead adheres to the notion of multilateralism. The ongoing FTA negotiations between the USA and the EU are a subsequent exemplar of this trend in steering away from multilateralism. This exodus from multilateralism in international trade is an antiphon to the rise of China and the realisation that for the first time since the end of World War II, another nation possesses the economic capacity to exercise leadership in Asia, with conflicting views from the Western norm on how economies should burgeon.

Despite Washington's calls of affection, the mainstream US media have nevertheless continued to portray the TPP as being a ballast to impede the rise of China. According to *Forbes*, 'American trade policy is trying to contain China, notably through the mega-regional TPP, from which China is excluded'. Another report from the *Wall Street Journal* said, 'In the run-up to the APEC summit, people familiar with the matter say, the US blocked China's effort to begin negotiations on a regional free-trade agreement. The Free Trade Area of the Asia Pacific, because it conflicted with a Washington-backed alternative known as the TPP that excludes China'.

3.2 Japan and the TPP

In July 2013, Japan joined the TPP negotiations in July 2013 despite fervent opposition from the domestic agricultural lobbies in contrast to strong support from the corporations. In tandem with the concept of 'Abenomics', the TPP will strive to achieve economic prosperity post two decades of the 'missing' period and to restore sustained growth. Without growth, Japan will be powerless to solve the prominent areas of concern, similar to the matter of securing and increasing the provision of employment, sustaining a dependable social security system in an ageing society and reducing public debt to a level that is maintainable.

During his speech to the Centre for Strategic and International Studies on the 22nd of February 2013, Prime Minister Shinzo Abe stated that 'Firstly, when the Asia-Pacific or the Indo-Pacific region becomes more and more prosperous, Japan must remain a leading promoter of rules. By rule, I mean those for trade, investment, intellectual property, labour, environment and the like. Secondly, Japan must continue to be a guardian of the global commons, like the maritime commons, open enough to benefit everyone. Japan's aspirations being such. Thirdly, Japan must work even more closely with the US, Korea Australia and other like-minded democracies throughout the region'. (CSIS speech 2013)

The crux of Abenomics in line with the TPP agreement can boost foreign investment in Japan, which would in turn increase Japanese manufacturers' access to goods and services in the markets of member countries with whom Japan had no prior economic relations with, similar to the USA. This would further stimulate the confidence rates for Japanese MNEs investing in subsequent member countries through egalitarian treatment of foreign investment and intricate intellectual property rights protection in the host countries. It would further be greatly beneficial for small- and medium-sized firms to conduct business through simpler trade procedures. In addition, the TPP would undoubtedly intensify Japan–USA political relationships and make way for the diversification of Japanese trade, given the fear of overdependence on China and the perceived risk that increased relations with China entail.

Next, China has been playing an effective advocating role. Beijing has further exercised self-restraint over the East China Sea dispute (including the Diaoyu/Senkaku islands) with Japan, and the fracas that arose over territories in the South China Sea with several Southeast Asian regions were dealt with ease. Abe's repeated visits to the controversial Yasukuni Shrine, where some 2.5 million souls of Japan's war dead are honoured as patriotic heroes, catalysed the strained diplomatic relations with subsequent Asian nations similar to China and South Korea. This was due to the fact that many of those souls perturbed both Korean and Chinese citizens alike, and thus, Abe's act of respect merely stimulates aggravation. Furthermore, the fact that 14 Class-A war criminals convicted at the Tokyo tribunal, including war leader Tojo Hideki, are enshrined at Yasukuni further serves as a source of strife between the two nations. However, in recent years, Beijing and Tokyo have averted their perceptions to focus on the future rather than dwell on the past. The notion of being 'hot economically, cool politically' was penned to aid this cause. Nonetheless, Abe's continuous comments of respect and erratic behaviour on this matter greatly impede any forms of bilateral trade agreement and instead strain the relations further.

Geopolitically Japan is considered to be an Asian powerhouse, and that fact is unalterable. However, it is apparent that Japan's partners and competitors have long been in the West, and that fact remained constant post World War II. Moreover, having burgeoned under US tutelage and protection, post-war Japanese identity became disparate and progressively reliant upon the West. Furthermore, post the Cold War, the fact that Japan was the gateway to increased US influence in the East was acknowledged by China and Korea, and thus, this deteriorated relations

significantly in terms of trade. Thus, when Abe, a staunch supporter of Japan–USA relations, was re-elected in 2012, this galvanised the friction between Japan and her neighbouring nations.

3.3 China in the TPP as an Observer

Akin to Turkey and the EU membership, China was not greeted favourably. In Beijing's view of the TPP, joining the existing TPP with minimal opportunity for discussion on any of the existing provisions bestowed a multitude of predicaments at the domestic level. In May 2013, a spokesman for the Ministry of Commerce, Shen Danyang briefed that China will 'analyse the pros and cons of joining the TPP, based on careful research and according to the principles of equality and mutual benefit. We also hope to exchange information and materials with TPP members on the negotiations' (Reuters, 30 May 2013).

Despite frequent public announcements by the US leaders that the Washington welcomes a prosperous and strong China, Chinese technocrats possess an intrinsic suspicion of the real intentions of the USA. They are persistently vigilant of the possibility of a US-led coalition to deter China's continuous expansion in terms of her prestige and economic prowess. Chinese leaders further perceive that America always possesses the intention to politically 'Westernise' the mainland by prying on her domestic affairs and 'severing' the country by thwarting the reunification of Taiwan and meddling in Tibetan affairs.

In an article published in the *People's Daily*, the official newspaper of the Communist Party of China, it states that 'the US does not want to be squeezed out of the Asia-Pacific region by China . . . (the) TPP is superficially an economic agreement but contains an obvious political purpose to constrain China's rise (Ding 2011). In addition, Song Guoyou, Shanghai Fudan University notes that the current TPP member countries in negotiations are mainly military allies of the US, which demonstrates the fact that the US has followed its traditional pattern of choosing FTA partners—offering priorities to its military allies, and conclude the US collaboration with its military allies in East Asia will be strengthened through a closer trade relationship'. (Song 2011)

On a domestic scale, there are two prominent matters of consideration when adhering to the high standard of the TPP. China could, however, benefit from liberalisation in the manufacturing sectors, a high standard of protection and the promotion of investment, even from more rigorous anti-corruption rules; these issues are in tandem with the reform agenda of Xi's regime. As a result, Beijing became concerned with the possible economic adversities that were to arise due to rapid domestic alterations imposed by the new TPP regulation in domestic markets. Moreover, the high standards of the TPP may not be beneficial for Chinese standards, on matters similar to intellectual property rights.

From the Chinese perspective, the TPP, derived from the USA, is a gateway to obtaining indirect long-term economic and strategic benefits, including aiding

small–medium-sized American firms to exploit the free trade agreement environment, and ensuring that Washington's role as the rule-maker in regional trade regulations is sustained. Furthermore, the TPP was regarded as the US-dominated unified free trade association that benefits US firms rather than acting for the members' welfare. Li et al. (2014) assess the impacts of China being in or out of the TPP negotiations, via the use of a conventional static model with the two embellishments of trade costs in tariff form but with real resource use rather than revenue generation and endogenous trade imbalances. The report demonstrates that China loses in being astray from the TPP, but gains if inside a trade cost-targeted negotiation. Based on 2011 data, the effects are small (1–2 % GDP) and are much smaller and even negative for China in terms of their tariffs alone.

Beneath his shroud of suspicion, the US-led TPP is regarded as isolating Asia, as not all Asian members are entitled to a membership. In principle, the TPP is open to all ASEAN members who are willing and able to strive for a higher standard of rule, and the US strategy from the dawn was to commence negotiations with a minor association of economies with similar objectives to that of her own. As a result, it was met with a barrage of criticisms. For instance, it was met with great distaste by the Cambodian Prime Minister Hun Sen at the 24th World Economic Forum on East Asia in Jakarta, 'We should review it again . . . why did the TPP not include ten ASEAN members? . . . What is the purpose, real intention of establishing (the) TPP. . . that they include half of ASEAN to be partners. . . and leaving the other half of ASEAN outside' (The Diplomat April 2015).

According to Li, Wang and Whalley, 'China's strategy has been one of remaining flexible, in part, targeting each regional trade agreement to the preferences of China's partner. There is no "one size fits all" approach to regional trade agreements as has been the case more so with the EU and the US' (Li et al. 2014).

4 Regional Comprehensive Economic Partnership and Chinese Dominance

4.1 The Meaning of RCEP

In the midst of the WTO's declining credibility as a result of its inefficient ability to negotiate, the ASEAN and China led mega-regional trade deal, the RCEP due to be penned. The RCEP could create the world's largest economic trading bloc and could further bring about a multitude of ramifications for the world economy.

The prime objective of the RCEP is to attain a modern, comprehensive, high-quality and mutually beneficial economic partnership agreement among the ASEAN member states and ASEAN's free trade agreement partners. This would permit every nation in the agreement to contribute to sustain the economy of each country and to further strive for economic integration, equitable economic development and strengthening economic cooperation among the participants.

Table 2 Key features of the TPP and RCEP agreement (August 2014)

	TPP	RCEP
First mooted	December 2009	November 2011
Official negotiations	March 2010	May 2013
Intended completion	Late 2014	Late 2015
Negotiating rounds completed	19	5
Primary goal	Address quality issues through a new 'twenty-first-century' free trade agreement	ASEAN-plus-X model, accession yet to occur
Relation to regional architecture	Not tied to any existing organisation	Affirms principle of ASEAN centrality
Scope and coverage	"WTO-plus" aspirations—20 non-tariff issues targeted	"WTO consistent" only—mostly focused on tariffs
Major sponsor	US led	ASEAN led
Current members	Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, USA and Vietnam	ASEAN, Japan, South Korea, China, India, Australia and New Zealand
Significant 'absent' members	China, Indonesia and Korea	USA

Source: Wilson (2015)

It is the common consensus in China that the RCEP is a viable route for the promotion of the East Asian cooperation in a sui generis manner, via the combination of the 10 ASEAN members and their cohesive integration with their six major trading partners (Australia, China, India, Japan, New Zealand and South Korea). RCEP serves as the basis for the world's largest free trade bloc with 3.5 billion individuals alongside three major proponents of global market growth: China, India and the ASEAN. According to Basu Das (2013), RCEP will adhere to the rules and norms mostly attuned to ASEAN conventions and guidelines, built on a consensus. Flexible trade negotiation standards will make the RCEP attractive and would bring closer affinity at the institutional level connectivity and push further the much-needed people-to-people contacts at the regional level (Table 2).

As detailed by the figures above, it is evident that China and India, two of the prominent drivers of Asian economic growth, are absent from the TPP negotiations, while the USA, a subsequent powerhouse across the Pacific Ocean, is missing from the RCEP. As such, various government officials, technocrats and scholars from both nations (China and the USA) perceive that the TPP and the RCEP are conflicting in terms of their principles. This is as it is apparent that China and India are aiming to establish a regional framework that ostracises the USA, while the USA is adamant on establishing a regional bloc without the presence of China.

Table 3 exemplifies the fact that the RCEP countries are superior in terms of their population count at 3.4 billion than the TPP economies, which constitute for 0.8 billion of the global population. Nonetheless, the TPP members possess the higher GDP and PPP rates on average than their RCEP counterparts. All in all, the RCEP nations account for 48.3 % of world population, 29.2 % of world GDP and 28.3 % of world trade, in comparison to the TPP who account for 11.3 %, 38.8 % and 25.8 %, respectively. The data stated above coherently illustrates the fact that the TPP and the RCEP are prominent regional blocs in the world economy and that their respective coverage in the global economy as a whole is considerable. Furthermore, the data outlines the fact that the average GDP per capita is significantly larger for the TPP nations (US$32,751) when compared to the RCEP countries (US$18,879), echoing the fact that low income with the sino-ethnics diaspora countries primarily make up the RCEP.

The TPP, in particular, would reap a great deal of benefits for the ASEAN as a whole, especially if it were bolstered from the current four negotiators (Brunei, Malaysia, Singapore and Vietnam) to include Indonesia, the Philippines and Thailand. ASEAN's total acquisitions are perceived as being three times as great with the TPP, due to the presence of Western powerhouses similar to America, whereas under the RCEP, the majority of the nations, aside from China, are relatively mediocre in terms of their economic prowess. Furthermore, the TPP is perceived as being the gateway for a more profound integration and preferential access to greater new markets, while the RCEP overlaps in terms of its principles, as it is merely a network of FTAs between the ASEAN and its subsequent members.

The ASEAN policymakers should dismiss the belief that they must choose between the TPP and the RCEP, since both policies have proven to have their own merits. Moreover, it is apparent, however, that these perks are complementary. This can be deduced from the fact that the TPP predominantly focuses on greater synthesis with America, whereas the RCEP concentrates on continuing integration across the Asian markets, with China as the nucleus. The benefits of implementing and utilising both agreements simultaneously amount to approximately 90 % of the sum of the benefits derived from implementing each agreement alone; in other words, the agreements beget distinctive, interdependent gains. At the same time, however, nations who are members of both initiatives must ensure that they do not burgeon into alternate competing blocs (Table 4).

4.2 Implications of the TPP and the RCEP

In essence, the TPP is a US-led scheme and is widely regarded as being a 'WTO-plus approach' that yearns for cohesive economic integration and trade liberalisation to stimulate economic activity on a global scale. However, since the TPP scheme comprises of members from different echelons of economic development, it will be an arduous procedure in attempting to reach a common consensus on the optimum way forward. This is because of contrasting labour laws due to the

Table 3 Economic indicators of the TPP and RCEP members

	Population (million)	(%)	PPP (US$)	GDP (US$ billion)	(%)	GDP per capita (US$)	GDP growth (annual %)	Trade (US$ billion)	(%)
China	1350.7	19.2	10,920	8227.1	11.4	6091.0	7.7	3866.9	10.4
South Korea	50.0	0.7	32,350	1129.6	1.6	22,590.2	2.3	1067.5	2.9
India	1236.7	17.6	5000	1841.7	2.5	1489.2	5.1	782.6	2.1
Cambodia	14.9	0.2	2710	14.0	0.0	944.4	7.3	19.2	0.1
Indonesia	246.9	3.5	8750	878.0	1.2	3556.8	6.3	378.4	1.0
Laos	6.6	0.1	4170	9.4	0.0	1417.1	8.0	5.1	0.0
Myanmar	52.8	0.7	n/a	52.5	0.1	861.0	n/a	20.4	0.1
Philippines	96.7	1.4	7310	250.2	0.3	2587.0	6.8	117.4	0.3
Thailand	66.8	0.9	13,430	366.0	0.5	5479.8	7.7	477.1	1.3
Brunei Darussalam	0.4	0.0	n/a	17.0	0.0	41,126.6	0.9	17.0	0.0
Malaysia	29.2	0.4	21,460	305.0	0.4	10,432.1	5.6	424.0	1.1
Singapore	5.3	0.1	74,150	274.7	0.4	51,709.5	2.5	788.1	2.1
Vietnam	88.8	1.3	4800	155.8	0.2	1755.2	5.2	228.4	0.6
Japan	127.6	1.8	11,400	5959.7	8.2	46,720.4	1.8	1684.4	4.6
Australia	22.7	0.3	41,700	1532.4	2.1	67,555.8	3.7	517.8	1.4
New Zealand	4.4	0.1	30,970	167.3	0.2	37,749.4	2.5	75.6	0.2
USA	313.9	4.5	52,220	16,244.6	22.4	51,748.6	2.3	3882.7	10.5
Canada	34.9	0.5	41,270	1821.4	2.5	52,219.0	1.7	929.7	2.5
Mexico	120.8	1.7	16,030	1178.1	1.6	9748.9	4.0	751.4	2.0
Chile	17.5	0.2	20,270	269.9	0.4	15,452.2	5.4	158.1	0.4
Peru	30.0	0.4	10,390	203.8	0.3	6795.8	6.0	88.2	0.2
RCEP	3400.5	48.3	17,941	21,180.6	29.2	18,879.1	4.9	10,469.6	28.3
TPP	795.5	11.3	29,515	28,129.8	38.8	32,751.1	3.5	9545.2	25.8
World	7046.4	100	13,878	72,440.4	100.0	10,280.5		37,006.6	100

Source: databank.worldbank.org 2015

Table 4 Comparison of TPP and RCEP objectives

	TPP	RCEP
Market access for goods	• Elimination of tariff barriers with significant WTO + commitments • Elimination of non-tariff barriers • Negotiated market access and trade facilitation for textiles and apparel	• Progressive elimination of tariff and non-tariff barriers on substantially all trade-in goods • Comprehensive and high level of tariff liberalisation
Trade facilitation	• Predictable, transparent and expeditious customs procedures • Strong and common rules of origin • Build on WTO commitments on sanitary and phytosanitary measures and technical barriers to trade • Facilitate regional value chains	• Facilitate trade and investment • Enhance transparency in trade and investment • Facilitate regional and global value chains
Service	• Fair, open and transparent markets for service across borders while preserving the right to regulate • Open trade and investment in financial services, e-commerce and telecommunications • Negotiate on a negative list basis • Transparency and efficiency in temporary entry	• Substantially eliminate restrictions and discriminatory measures on trade-in services • Build on commitments made by RCEP members under WTO and ASEAN + 1 free trade agreements • Negotiate on all sectors and modes of supply
Investment	• Liberal access for investment and legal protection for investors • Expeditious, fair and transparent investor-state dispute settlement	• Liberal, facilitative, competitive investment regime • Negotiate on promotion, protection, facilitation and liberalisation
Competition	• Promote competitive business environment, protect consumers, ensure level playing field • Establishment and maintenance of competition laws and authorities, fairness, transparency, consumer protection, private rights	• Promote competition, economic efficiency, consumer welfare, curtailing anticompetitive practices • Recognise differences in capacity in RCEP on competition policy
Intellectual property	• Ensure effective and balanced intellectual property rights • Reinforce and extend WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) • Cover trademarks, geographical indications, copyrights, patents, trade secrets, data exclusivity • Cover intellectual property enforcement, genetic resources and traditional knowledge	• Reduce intellectual property-related barriers to trade and investment • Promote cooperation in utilisation, protection and enforcement of intellectual property rights
Dispute resolution	• Clear and effective rules for resolving disputes	• Effective, efficient and transparent process for consultation and dispute resolution
Cooperation	• Focus on needs of developing member economies in implementing high-standard provisions	• Build on cooperation agreement between ASEAN and dialogue partners

(continued)

Table 4 (continued)

	TPP	RCEP
	• Establishing institutional mechanism for cooperation and capacity building	• Focus on development gaps in RCEP and maximise the mutual benefits
Accession		• ASEAN free trade agreement partners may join negotiations as agreed by negotiating members • Accession clause to enable other ASEAN free trade agreement partners to join RCEP later
Environment	• Address trade and environment challenges • Discuss marine fisheries, conservation, biodiversity, invasive species, climate change, environmental goods and services	
Government procurement	• Ensure fair, transparent, non-discriminatory government procurement • Comparable coverage by all economies, transitional arrangements for developing economies	
Labour	• Address labour rights protection and ensure cooperation, coordination and dialogue	

Source: US Trade Representative (2011) for TPP and ASEAN (2012) for RCEP and requoted from Petri and Abdul-Raheem (2014)

difference in economic standards, which hinder unified and synchronised labour laws from being implemented. Also, intellectual property regulations may not strike the right balance between owners of the IP and the users.

The RCEP's history, however, is somewhat more varied than that of the TPP. It is considered to be a regional effort rather than a negotiation among 'like-minded' countries, and it is the by-product of nearly a decade of numerous attempts to initiate analogous discussions on the matter. Besides that, the RCEP synthesises with the ASEAN-Plus-One agreements between ASEAN and all the RCEP partners, and these have presumably already tested the curbs of regional liberalisation. Thus, it is apparent that the RCEP has a handful of prominent hurdles to surpass in order to elevate the status quo.

Nonetheless, the protocol for the RCEP adopted by ASEAN (2012) is somewhat audacious and envisages a modern, comprehensive agreement, covering many of the areas addressed by the TPP. However, the guidelines also take into consideration that 'the RCEP will include appropriate forms of flexibility including provision for special and differential treatment' (ASEAN 2012). Furthermore, multiple observers laud this commitment, but it is evident that it will be somewhat strenuous to transcend beyond existing agreements, due to the disparate nature of their

economies. So far, negotiators have impeded the implementation of special and differential treatment in the TPP.

In addition, one of the most focal areas of concern for the RCEP is to attain impartial economic development through the sino-ethnics oriented economic cooperation, notably within nations akin to Cambodia, Lao and Myanmar. In comparison to the RCEP, however, the TPP does not put a great deal of weight on the matter of economic cooperation. The members of the RCEP are closely knit to China economically as well as ethnically. They are all partners or plausible partners of China in its pursuit of the free trade agreements. Thus, the RCEP can be regarded being an idyllic podium for China to acknowledge its free trade aspirations and to push for regional economic integration and a tranquil development together with subsequent regional players.

4.3 Why Not Both?

The TPP and the RCEP are often regarded as being substitutes, but that is far from the case. Numerous ASEAN economies already participate in both negotiations—Brunei, Malaysia, Singapore and Vietnam—and one can acknowledge that there is no rationale to state that other middle-income countries should not do so as well. Regardless of the fact that certain ASEAN countries cannot liaise with the current phase of negotiations, the agreement is likely to anticipate enlargement and set the scene for accession. For countries who are inclined to adhere to both agreements, the idea of dual membership is compelling due to each scheme's merits.

However, the TPP and the RCEP offer benefits that are predominantly interdependent—one focuses on profound integration with the Americas, and the other on improved access to ASEAN markets, to stimulate increased economic activity. Coinciding memberships further aid to ensure that the two initiatives do not proliferate into competing regional blocs, which is the infamous drawback of regional FTAs. Countries involved in dual negotiations are most likely to align their provisions in order to simplify their internal policy adjustments and to synthesise with the requirements of both schemes. The similarity of the RCEP protocol and its TPP counterpart has been acknowledged already. This will not always be the case, but nonetheless, a significant overlap will make it more convenient to consolidate the agreements in the future or to proceed from shared provisions into subsequent global negotiations in future years.

The ultimatum for new members is the fact that the TPP template is likely to be more stringent and onerous than its RCEP counterpart and will, in part, mirror the interests of countries that are more advanced economically as well as politically (Perti and Plummer 2012). It is perceived that it will include greatly pressing provisions on services, intellectual property and competition policy, as well as permitting a fewer number of exceptions for sensitive sectors. Joining the TPP will require earlier and more difficult reforms than participation in the RCEP. At the same time, the benefits under the TPP template are predicted to be around twice as grand as those under the RCEP, on the basis that they are applied to the same group

of countries. Moreover, the necessary reformations with the ASEAN nations would in many cases emulate those required for the effective implementation of the AEC.

Furthermore, the fundamental difference is the fact that the TPP puts greater emphasis on a single and comprehensive form, whereas the RCEP pushes for a progressive and sequential approach, where different components are mediated and implemented under a different time table.

5 Conclusion

With the Obama administration at the helm, America has been readjusting her political and economic stance towards the Asia-Pacific and, in doing so, has exercised her power in curbing the rise of China in the East. Since Washington has taken the lead in advocating for the TPP, it has ceaselessly advocated for standards that Beijing cannot realistically adhere to in the near future and has, thus, effectively pursued a policy of isolationism on the Chinese. Wen emphasised that 'the main reason behind the Obama Administration's support for the TPP agenda is the US's desire to use the TPP as a tool to economically contain China's rise. . . . The TPP as superficially an economic agreement but contain an obvious political purpose to constrain China's rise' (Wen 2012). However, it is evident that this policy of isolationism has given way to the rise of the RCEP, a China-centred scheme that has efficaciously suppressed the American-led TPP scheme.

Furthermore, the fact that the majority of the middle class are Chinese ethnics in these regions has proven to be fundamental in bridging China's relations with her Asian counterparts. Thus, the contribution of the sino-ethnics has been integral in forming relations in trade and politics with these regions, which has resulted in the China-centred RCEP prevailing over her Western counterpart.

According to Fitriani in the Jakarta Post (13 August 2010), 'History teaches us that the reasons behind the absence of solid Asian regionalism and identity derive not only from domestic problems and inter-state distrust among Asian countries, but also from the presence of external powers like the US in the region'. In this way, one can acknowledge that regardless of the continuous endeavours of the Western world to permeate the Eastern region with their economic and political prestige, as displayed in America's pursuit of the TPP scheme, they are powerless to curb the influence of Eastern powerhouses who serve as the irrefutable nucleus of Asian development.

Under the current circumstances, China is voraciously engaging in subregional cooperation processes with many of her neighbours, ranging from the Greater Mekong Subregion Economic Cooperation to the implementation of China-led economic cooperation zones with the relevant ASEAN members. Further schemes such as the Maritime Silk Road initiative and the financial connected Asian Infrastructure Investment Bank have reignited the engine of regional growth which has ousted her American competitors, in terms of social, cultural and political integration.

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The Malaysia–China Economic Relationship at 40: Broadening Ties and Meeting the Challenges for Future Success

Hooi Hooi Lean and Russell Smyth

1 Introduction

Malaysia was the first country among ASEAN members to establish diplomatic ties with the People's Republic of China (hereafter China) when Malaysia's second Prime Minister, Abdul Razak, made his historical visit to China in 1974. Hence, 2014 marks the 40th Anniversary of Malaysia–China Diplomatic Relations. Over the course of the last four decades, economic cooperation between the two countries has exhibited strong growth. While Razak was responsible for the normalization of diplomatic relations between the two countries, the economic relationship showed the strongest evolution under Malaysia's fourth Prime Minister Mahathir Mohamad. Mahathir expanded trade and tourism between China and Malaysia and strengthened political ties (Barori 2012; Ko 2010; Lee 2012). Bilateral ties were further consolidated when Malaysia's sixth Prime Minister, Najib Razak, signed 16 MOUs with China in 2009 (Lee 2012). Most recently, the Malaysian and Chinese governments have established the Kuantan and Qinzhou industrial parks in an attempt to deepen bilateral economic and trade ties.

In this chapter, we discuss China's growing impact on Malaysia's economy through bilateral trade and foreign direct investment between the two nations, including the contributions of the Malaysian–Chinese business community in facilitating bilateral economic ties. Chinese tourists are one of the major sources of inbound tourism for Malaysia. Prior to the MH370 tragedy, Malaysia was expected to attract two million Chinese tourist arrivals in conjunction with Visit Malaysia Year 2014. On the other hand, China is one of the most popular destinations for outbound Malaysian tourists, especially among the Malaysian–Chinese

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community. We will also discuss the burgeoning tourist link between the two countries and how the MH370 tragedy and recent kidnappings of Chinese tourists in Sabah might impact on this relationship.

As the economic relationship between the two countries enters its fifth decade, some challenges are emerging. Perhaps chief among these for Malaysia is the growing importance of the Chinese economy, which threatens to shift the bilateral economic relationship in China's favour. As China moves up the value-added chain, there is the potential that Malaysia will lose its comparative advantage in the regional production network. We will conclude by discussing these economic challenges and how these challenges might be addressed in the future.

2 Trade and Investment

2.1 Trade

China is Malaysia's largest trading partner, while Malaysia is China's biggest trading partner in ASEAN, third in Asia and sixth in the world. The growth in bilateral trade between Malaysia and China has been remarkable. Figure 1 shows bilateral trade between the two countries. Bilateral trade increased from USD370 million in 1985 to USD6.26 billion in 2012. Bilateral trade took off after 2001 and 2002. The People's Bank of China reopened its Malaysia branch in 2001, which facilitated trade flows (Ko 2010). In 2002 the ASEAN–China Free Trade Agreement (FTA) was signed. This was the first FTA in the region and also Malaysia's first FTA. In the period since the ASEAN–China FTA was signed, total trade has grown at a compound annual growth rate of 48 %. Significantly, there has also been a changing pattern in trade between China and Malaysia, largely arising from the expanding Asian production network (with components sourced from all over East Asia with final assembly in Chinese factories), of which both China and the

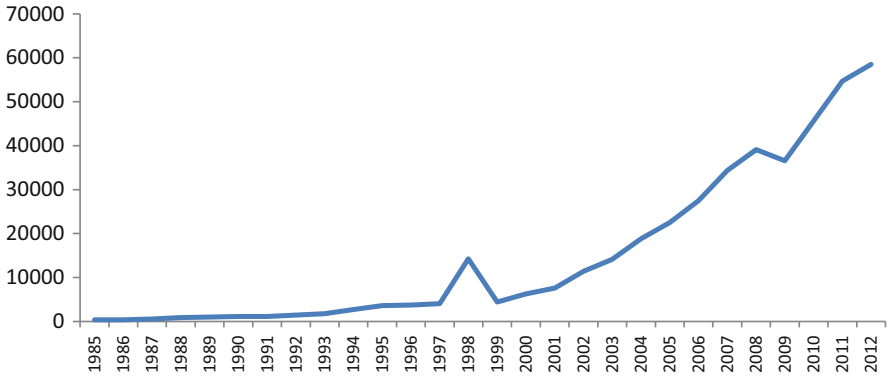

Fig. 1 Bilateral trade (million USD). *Source*: Asian Development Bank

ASEAN countries belong (Lee 2012). Within this production network of largely multinational corporations, there is considerable inter- and intra-regional trade. In 2012, electronics and electrical products were responsible for just under half (44 %) of China–Malaysia trade.

According to the Ministry of International Trade and Industry, the bilateral trade profile has witnessed a major shift in the past decade, in which commodities are no longer the major source of goods traded, but as much as 50 % of trade now comprises manufactured products and other higher value-added goods. In October 2013, both countries signed the Five-Year Programme for Economic and Trade Cooperation. This is a broad agreement that provides for bilateral cooperation in agriculture, energy and mineral resources; information and telecommunications; manufacturing, infrastructure and engineering; and tourism, logistics and retailing. This forms the basis of economic and trade cooperation for the next 5 years and provides the foundation of bilateral economic relations for decades to come.

2.2 Investment

Outward investment by both China (Zhang and Daly 2011) and Malaysia (Goh and Wong 2011) has increased rapidly since the 1990s. Reflecting this growth in both countries, mutual investments by Malaysia and China have increased, although growth has not been as rapid as growth in bilateral trade (Lee 2012). China was the sixth largest investor in Malaysia in 2010. Over the last decade, Chinese investment in Malaysia increased steadily to around USD470 million, coming off a base of less than 40 million in 2000 (Fig. 2). The Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM) hopes to further increase this number to

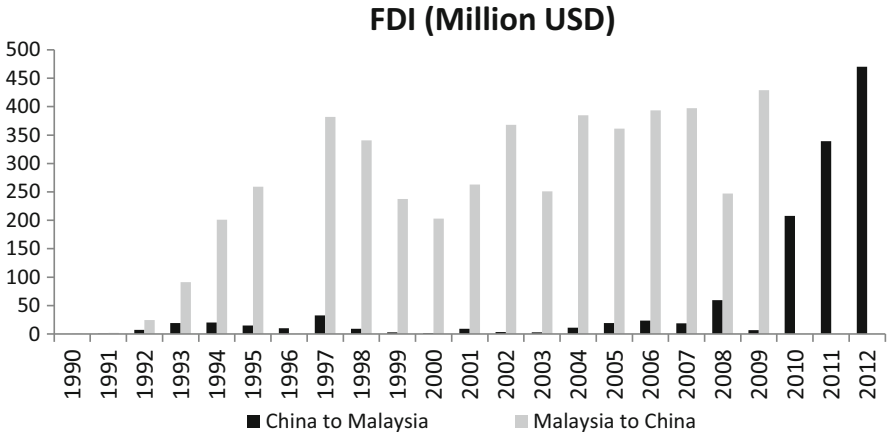

Fig. 2 FDI (million USD). *Source*: Asia Integration Center. *Notes*: Data for FDI from Malaysia to China is not available after 2009

USD500 million over a period of 3 years (The Star 2014a). Prominent Chinese companies, such as Huawei Technologies, the largest private company in China, have sizeable investments in Malaysia. Huawei Technologies has invested in information and communication technologies in Malaysia since 2001 and produces most of the broadband modems in Malaysia.

A key objective of the Najib government has been to attract more Chinese investment, while further strengthening the already strong bilateral trade ties between the two countries (Kuik 2013). The Najib government has put in place several measures to this effect. These include approval for a branch of China's largest bank, the Industrial and Commercial Bank of China, in Malaysia; simplifying visa requirements for Chinese nationals; establishment of a representative office of Bank Negara in China; and establishment of the Kuantan Industrial Park in Pahang.

Malaysia is the second largest investor in China among ASEAN countries with total investment of USD428 million in 2009. Malaysian investment in China increased sharply in the aftermath of the Asian financial crisis. Following the Asian financial crisis, then Prime Minister, Mahathir Mohamed, encouraged outward foreign direct investment. This period coincided with further marketization and opening up of the Chinese economy, following China's accession to the WTO in 2001. Malaysian investments in China are concentrated in the coastal cities with three-quarters in the cities of Shanghai, Guangzhou, Jiangsu, Beijing and Tianjin (Lee 2012). Malaysian investment in China has been boosted by the establishment of Qinzhou Industrial Park in Guangxi.

2.3 Kuantan and Qinzhou Industrial Parks

The Qinzhou Industrial Park was first put on the agenda during Premier Wen Jiabao's visit to Malaysia in 2011 and was launched in April 2012 by Najib Razak and Wen Jiabao. It is a 13,600 acre industrial park located near Qinzhou Free Park (150 km from Nanning). It will be completed in three phases over a 15-year period (Kuik 2013). Qinzhou is the third industrial park set up in China with a partner country, following the Suzhou Industrial Park and Tianjin Eco-City, which are set up as collaborative joint ventures between China and Singapore. Qinzhou is expected to be a regional hub for international logistics around China–ASEAN economic cooperation. Investors acquiring industrial land in the Qinzhou Industrial Park are expected to be offered attractive land prices, tax incentives and financial support.

The sister industrial park to Qinzhou is the Kuantan Industrial Park, which was selected because it is a deep-water port accessible from the South China Sea. Kuantan Industrial Park was first mooted at the launch of Qinzhou Industrial Park and was officially launched in February 2013. It is to be built on 1500 acres in Malaysia's eastern corridor. Thus, its size is just over one-tenth the size of Qinzhou. The Kuantan Industrial Park is costing USD 3.4 billion to build and will include steel and aluminium plants as well as a palm oil refinery. Kuantan Industrial Park is

expected to offer similar investment incentives to Qinzhou, such as 5 + 5 + 5-year pioneer tax-free status and capital allowances. The objective of the Kuantan Industrial Park, from Malaysia's perspective, is to boost Chinese investment in Malaysia. The hope is that it will draw in between 3 and USD10 billion in the next 5 years. It would also bring much needed jobs and investment to a region which is currently lagging more developed areas of Peninsular Malaysia. Initial Chinese investment in Kuantan Industrial Park, however, has been modest. One report, 12 months after it was launched, suggested that there was very little initial Chinese investment in Kuantan.

3 Tourism and Education

3.1 Tourism

Over the last decade, the number of tourists from China to Malaysia has doubled from 501,590 in 2000 to more than 1.5 million in 2012 (see Fig. 3). This figure further increased to 1.8 million in 2013 (Malaysian Insider 2014). There was a negative spike following the SARS outbreak. Salleh et al. (2011) found that the SARS outbreak had a statistically significant negative effect on Chinese tourism to Malaysia. China is the third largest source of visitors for Malaysia. This is significant given that tourism is the sixth biggest contributor to Malaysia's GDP and Malaysia's second largest source of foreign revenue (Salleh et al. 2011). One view is that Chinese tourists prefer Malaysia to Indonesia, the Philippines, Thailand and other ASEAN countries because Chinese language is widely used in Malaysia, making communication more convenient.

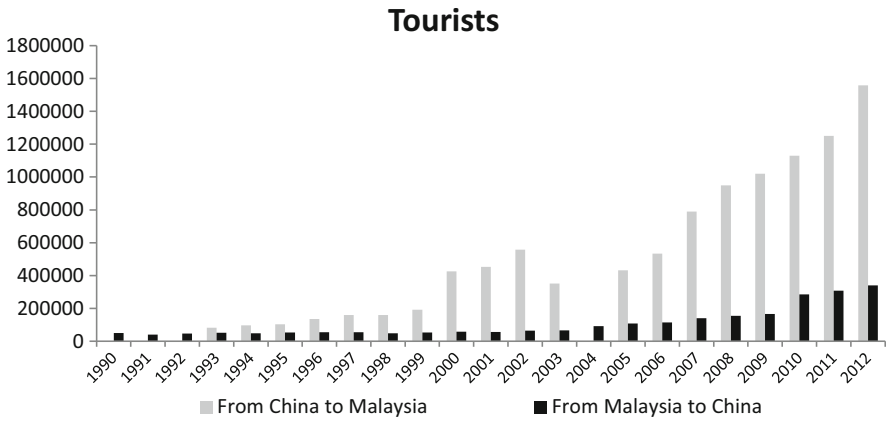

Fig. 3 Tourism between China and Malaysia. *Source*: China Statistical Year Book

While Malaysia was targeting two million Chinese tourists for Visit Malaysia Year 2014, the disappearance of Malaysia Airlines flight MH370 and a spate of kidnappings in Sabah are likely to hurt Malaysia's tourism industry until at least 2015. About two-thirds of passengers on board MH370 were Chinese nationals. The kidnappings in Sabah included a Chinese national, news of which was widely discussed on Sina Weibo, China's microblogging platform (The Star 2014b).

Malaysia's Tourism Minister Mohamed Nazri Abdul Aziz said that as of April 2014, more than 30,000 flight bookings were cancelled or delayed because of travellers' concerns about missing MH370. Following the disappearance of MH370, Malaysia suspended its Visit Malaysia Year 2014 campaign. The mainland travel agencies in China have also reported a sharp drop in the number of Chinese visitors to Malaysia. One report predicted Chinese arrivals in 2014 would drop by 20–40 % from 2013 levels, representing 400,000 to 800,000 tourists. If each tourist spends an average of 10,000 RMB during their stay, the total loss could amount to between four and eight billion RMB. Another report suggested that in March–April 2014, the number of tourists from northern China to Malaysia dropped by 50 % (Malaysian Insider 2014).

Tourism from Malaysia to China has also been considerable especially in recent years, reflecting China's opening up. The number of Malaysian visitors to China in 1990 numbered less than 50,000. However, since 2005 this number has doubled to reach around 400,000 in 2012. Indeed, Malaysian visitors now are the fifth largest source of tourists into China. In particular, The Chinese mainland attracts Malaysian Muslims who can now visit Islamic sites in China.

3.2 Education

Malaysia aspires to be a regional hub for the provision of education to international students (Knight and Morshidi 2011). To a large extent, this has been facilitated by Australian and UK universities setting up campuses in Malaysia and an assortment of twinning programmes between private colleges in Malaysia and foreign universities (Morshidi et al. 2011; Welch 2014). It is also assisted by Malaysia's cost structure and liberal visa requirements, relative to Australia, the UK and the USA. Nevertheless, Malaysia's aspirations to be a regional hub depend, to a large degree, on attracting international students from countries such as China (as well as Indonesia and South Asia), which otherwise might go to Australasia, Europe or the USA.

China has the largest number of international students studying in Malaysia, with 10,355 Chinese students studying in Malaysia at the end of 2008 (Lee 2012). The number of Chinese students studying in Malaysia at the end of 2013 was still around 10,000. This represents about 15 % of international students studying in Malaysia, although only a small proportion of the number of Chinese students studying abroad. At the end of 2013, there were 400,000 Chinese students studying abroad, so Malaysia attracts about 2.5 % of Chinese students studying overseas.

There are several factors which have had a positive effect on the number of Chinese students studying in Malaysia. The first was the signing of an MOU on educational exchange between China and Malaysia in 1997. The second is the large number of foreign campuses and twinning arrangements in Malaysia. The Malaysian campuses represent a cheaper option, which is often also regarded as a safer option, to studying in Australia, the USA or the UK. At the same time, it allows Chinese students to get a qualification from the Australian or UK institution. Malaysia is also viewed as an attractive destination for Chinese students because it allows them to improve their English, while still living in a Chinese community. In interviews Kell and Vogl (2012) conducted with Chinese nationals studying in Malaysia, one of the most attractive features of studying in Malaysia, besides the lower cost, was being able to communicate with Malaysian Chinese in Mandarin, which they felt helped them settle in better.

Third, in April 2011, China and Malaysia signed an MOU to recognize academic degrees and diplomas in both countries to facilitate student exchanges. Malaysia formally recognized 820 higher education institutions in China, while China recognized 71 higher education institutions in Malaysia (The Star 2014c). Education ties between China and Malaysia are expected to be strengthened by the establishment of a campus of Xiamen University in Malaysia. The campus will have a capacity for 10,000 students, of which one-third will be from China, one-third from Malaysia and one-third from other ASEAN countries (The Star 2014c). Shanghai Jiao Tong University is expected to open a campus in Kuching by 2018 (The Star 2014c).

The number of Malaysian students studying in China is smaller at about 6000. Almost all Malaysian students in China are ethnic Chinese students from Chinese independent school backgrounds. The Chinese government has generally not been very active in encouraging students from other races to study in China. There are particular specialties in which non-ethnic Chinese students are studying in China, such as Mandarin language training. This is a niche which could be considerably expanded. It has been argued that an expansion in Malaysian students studying in China would help to further facilitate trade and investment links between the two countries through increasing the awareness of China in Malaysia (The Star 2014c).

4 Role of the Malaysian–Chinese Business Community

Malaysian Chinese constitute about 24 % of the Malaysian population, but have traditionally been the major entrepreneurial class in Malaysia and have dominated business. The political economy of economic policy in Malaysia is very much about ethnicity and race. The New Economic Policy (NEP) in Malaysia has been described as a means to politicize ethnicity (Pepinsky 2013). The NEP, which was introduced following the 1969 race riots, was designed to reduce socioeconomic disparities between Malays and non-Malays (Malaysian Chinese and Malaysian Indians). The NEP had three specific objectives. The first aim was to raise the

income level of Malays to match those of non-Malays. The second aim was to increase the share of Malays in the high-earning professional and technical occupations. The third aim was to increase the proportion of Malays in business (see Lean and Smyth 2014). The New Economic Model (NEM), which was spelled out in two reports in 2009 and 2010, ostensibly rolls back some of the affirmative action policies inherent in the NEP. In particular, the NEM shifts the focus of raising the income level of Malays to raising the income level of the bottom 40 %, irrespective of ethnicity. However, the initial boldness in the NEM has been watered down in response to strong opposition from Malay nationalists, and the Malaysian government has been criticized for backtracking on commitments given in the NEM to discontinue affirmative action policies in favour of the Malays (see, e.g. Menon 2014; Woo 2011; World Bank 2011).

The role of the NEP in terms of promoting harmony between Malays and Malaysian Chinese in Malaysia has been controversial. Some observers have been complimentary. For example, Ramli et al. (2013) praise the NEM for ensuring ethnic and political stability over a long period and avoiding the racial problems that have had deleterious consequences for economic growth in some other Asia–Pacific countries, such as Fiji. The NEM has been responsible for relatively strong growth in Malaysia, which has helped to ease ethnic tensions (Pepinsky 2013).

Others, however, have pointed out that the NEP has contributed to ethnic tensions between the Malays and Malaysian Chinese (Aslam et al. 2012; Munusamy 2012). The NEP is widely regarded as promoting a rent-seeking culture among Malays, which has resulted in accusations of corruption and cronyism (Ramli et al. 2013). Overt discrimination against Malaysian Chinese under the NEP has resulted in capital flight and outward migration of skilled labour. In the period 2000–2010, Malaysia was in the top three countries in the world in terms of capital flight, and in 2010 Malaysia had the highest capital flight in the world in per capita terms (Woo 2014). According to the EPU (2011), a conservative estimate is that there are one million Malaysians living abroad. Singapore absorbs 57 % of the Malaysian diaspora, with most of the remainder in Australia, Brunei, the UK and the USA. The Malaysian diaspora is ethnically skewed with ethnic Chinese accounting for 90 % of the diaspora in Singapore and ethnic Chinese being overrepresented in other countries as well. Certainly, ethnic Chinese companies in Malaysia have had to be ingenious about adopting strategies that allow them to be successful in a pro-Malay business environment. This includes participating in so-called *Ali Baba* companies, which are joint ventures between Malays and financially well-endowed non-Malays, set up to access contracts to be allocated to Malays under the NEP (see, e.g. Chin 2010; Ramli et al. 2013).

The existence of a large Malaysian–Chinese community in Malaysia has been important for facilitating the economic relationship between China and Malaysia. The Malaysia–China Business Council (MCBC), which was officially registered as a non-profit organization in April 2012, has an important facilitative role. The MCBC provides information and advisory services to Malaysian entrepreneurs in China as well as Chinese entrepreneurs in Malaysia. It is seen as strategically important to the Malaysian government. Najib Razak appointed Ong Ka Ting,

who is a former senior Cabinet Minister and Prime Minister's Special Envoy to China, as the first Chairman of the MCBC.

Malaysia's approach to foreign relations with China has been influenced by the fact that it has a large Chinese ethnic community in Malaysia. As Kuik (2013) discusses, Malaysia's China policy in the post-Mahathir period can be attributed to an interplay of domestic and external factors. Domestically, the very positive approach which the Malaysian government adopts toward China is a reflection of its need to consolidate its mandate in an ethnically diverse country with, in particular, a nod to appeasing the large Malaysian–Chinese community at home. Underpinning this approach to China and Malaysian Chinese in Malaysia is the need to promote racial harmony within the broad parameters laid down by the economic policies of the NEP and NEM. In this sense, the role that the Malaysian–Chinese community plays in promoting Malaysia–China economic relations is twofold. At one level, the Malaysian–Chinese community plays a direct role through cultural and economic ties with China. However, at another level, their role is more subtle and operates through the political system. In a sense, this role is more powerful. It influences the attitude that the Malaysian government has toward China simply by representing a sizeable ethnic demographic in Malaysia which, in turn, provides it with some political clout.

5 Malaysia–China Diplomatic Relations at 40: Assessing the Relationship

The 40th Anniversary of Malaysia–China Diplomatic Relations provides a good opportunity to assess the economic relationship between the countries. Both countries have their own reasons for promoting the economic relationship and both gain from the relationship, albeit in different ways. Ko (2010) notes that the bilateral relationship between China and Malaysia is motivated by each country's political calculations with regard to other issues. In this respect, the economic relationship between China and Malaysia reflects the differential in economic size and political influence between the two countries. From Malaysia's perspective, maintaining a healthy relationship with China helps UMNO to attract votes from Malaysian Chinese in elections in Malaysia and provides an external assurance to domestic stability (Ko 2010). China recognizes Malaysia as an influential member of ASEAN and ASEAN forums, such as the ASEAN Regional Forum and the East Asian Summit, which consolidates Malaysia's position (Chan and Hooy 2012).

From China's perspective, promoting a strong economic and political relationship with Malaysia serves its political interests and assists China to counterbalance the influence of the USA in Asia. China and Malaysia have de facto worked together on various issues, such as advocating South–South cooperation and resolution of the South China Sea dispute. Malaysia has adopted a non-confrontational approach to resolving sovereignty disputes with China over the South China Sea,

which differs from Vietnam and the Philippines (Finkbeiner 2013). Najib's pragmatic approach to resolving disputes with China over sovereignty of the South China Sea has been to deflect the conflict to ASEAN channels for resolution, while stating that its bilateral relationship with China will be unaffected. This has been done primarily in order to promote its economic relationship with China and associated benefits flowing to Malaysia (Finkbeiner 2013). For its part, China sees nurturing its relationship with Malaysia on various issues as consistent with its own interests in promoting multipolarity, the creation of a new international order and China itself acting as a counterbalance for the USA in Asia (Ko 2010).

The Malaysia–China economic relationship can be expected to face several challenges. Foremost, among these from a Malaysian perspective is that it is becoming less competitive vis-à-vis China (Hew 2008; Lee 2012). A study by McKinsey consulting concluded that middle-level ASEAN countries, such as Malaysia, have lost their competitive advantage to China (Schwartz and Villinger 2004). The concern is that as China improves its innovative capacity, Malaysia risks losing its competitive advantage in the regional production network and ability to attract foreign direct investment (Lee 2012). This relates to a more general concern that Malaysia is stuck in the middle between being a labour-intensive low-income country and an innovation-intensive high-income country (Hill et al. 2012; Lean and Smyth 2014; Menon 2014; Woo 2011, 2014).

In the 1990s, GDP per capita growth in Malaysia was 4.6 %. Over the period 2000–2012, this figure fell to 2.8 % (World Bank 2013). Malaysia's critics point the finger at the NEP as a barrier to Malaysia graduating to a high-income country (Doraisami 2012; Menon 2014; Woo 2014). A standard production function suggests that output is being driven by labour, capital and total factor productivity growth (TFP). The critics of Malaysia's growth experience argue that the NEP has been responsible for capital flight (affecting capital) and outward migration of skilled labour (affecting labour). In the 1990s, Malaysian growth was relatively high *in spite of* the NEP, on the back of massive inward foreign direct investment. Since 2000, economic growth is lower because capital flight and outward migration have continued, while the bottom has largely fallen out of inward foreign direct investment (Woo 2014). This has occurred in large part because China joined the World Trade Organisation and attracted investment that had gone to Malaysia (Das 2007; Woo 2014). It is difficult for Malaysia to compete against the lower wage structure and larger market size in China in terms of attracting inward foreign direct investment (Goh and Wong 2011; Lee 2012; Woo 2014). The Third Industrial Malaysian Plan (2006–2020) identifies TFP as holding the key for promoting economic growth in Malaysia in the face of lower wage competition in China. However, TFP growth is relatively low in Malaysia. For example, Mahadevan (2011) found that TFP growth in manufacturing was less than 1.5 % over the period 1970 and 2002 and that technical efficiency was actually negative.

Another challenge to Malaysia, at least in the short term, is the potential economic slowdown in China, affecting Malaysian exports to China. China has a problem of over production, in which sectors such as iron and steel are producing a surplus (Beardson 2013; Krugman 2013; Naughton 2014). This is reducing the need

to import goods, which might impact on Malaysian exports to China. There are early signs this is occurring. Between February and March 2014, growth in Malaysian exports to China decreased from 25 to 1.8 %. However, overall it is expected that the effect of slowing growth in China on Malaysia should not be too drastic. The reason is that an important Malaysian export to China is palm oil. Irrespective of whether the Chinese economy slows, there still should be strong demand for palm oil for cooking.

A further potential threat is anti-Chinese sentiment in Malaysia. Domestically, there have been different points at which there has been anti-Chinese sentiment in Malaysia, dating back to the period before the establishment of diplomatic relations when Malaysia was suspicious of China for backing the Communist insurgency in Malaysia. It has, at times, erupted into violent riots, such as the race riots, which were the catalyst for the NEP. In Malaysia, the NEP has maintained ethnic stability, but the balance between Malays and Chinese has been fragile (Ko 2010).

Externally, as Lee (2011) notes, despite the blossoming diplomatic and economic relationship between the two countries, Malaysia has harboured a distrust of China. This, in part, reflects suspicion in Malaysia (and Southeast Asia more generally) of China's true intentions in Southeast Asia and the South China Seas (Cho and Park 2013). Malaysia uses the rhetoric of 'non-alignment' to adopt an issue avoidance stance with China on strategic matters, taking hard security matters and points of difference with China off the table (Lee 2011). Malaysia effectively puts this distrust to one side, because to do so enables it to benefit from the economic relationship with China. However, if China continues to squeeze Malaysia's economic competitiveness, Malaysia's economic rationale for its issue avoidance stance will be impeded, and this creates the environment for anti-Chinese sentiment in Malaysia to get a foothold.

Beyond the immediate effect of the MH370 disappearance on Chinese tourism to Malaysia, the MH370 incident potentially has broader implications for the Malaysia–China economic relationship. In the immediate aftermath of the disappearance, the Malaysian Airlines stock price declined 16 %, and the Malaysian Airlines stock price fell 40 % in the first 3 months of 2014. There has been widespread criticism in China of how the Malaysian government conducted the search for the plane. There has been speculation that the Chinese might boycott Malaysian exports. However, it is likely that any such boycott is only likely to have a short-term impact on bilateral trade. Some commentators have pointed out that there might be a boycott of the use of Malaysian Airlines in China in the short term, but this is unlikely to be significant, given that most trade uses sea transportation and there are alternative carriers for air transportation. The Wall Street Journal expressed the view that the MH370 incident might have a short-term psychological impact on Chinese investors, investing in Malaysian real estate resulting in less investment, but there is no hard evidence on this point.

6 Conclusion

The Malaysia–China economic relationship has been a beneficial one for both sides. China has used the relationship to further its political interests. Malaysia has benefitted from China's large size, while at the same time playing to the large Malaysian–Chinese community at home. This said, after four decades of diplomatic relations, the Malaysia–China relationship faces some challenges on the Malaysia side. Some of these, such as the MH370 incident, are likely to cause, at most, a temporary blip to trade and tourism between the countries. Others, such as the relative competitive position of the two economies, are more structural and potentially have more persistent implications for economic relations between the two countries.

As the Malaysia–China economic relationship enters its fifth decade, there is sufficient goodwill on both sides to expand investment and trade links. Bilateral trade is already strong. Trade ties could be strengthened via the Trans-Asian Railway Network Agreement, which will extend the Trans-Asian Railway. One avenue forward is strengthening of investment ties in manufacturing between the two countries through the two industrial parks, which are still in their formative stages. The other avenue forward is to focus on trade and investment in services, particularly education and tourism. Again, it is likely that Malaysia has the most to gain given the economic importance of China to Malaysia; however, Malaysia remains strategically important to China as it seeks to further its political interests in Asia more generally and ASEAN specifically.

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Indonesia–China Economic Relations in the Twenty-First Century: Opportunities and Challenges

Yuki Fukuoka and Kiki Verico

1 Introduction

Under the Suharto regime (1966–1998), which ruled Indonesia for more than three decades, Indonesia–China relations were characterised by mutual hostility and suspicion. Shortly after Suharto's assumption of power, formal diplomatic relations were declared 'frozen' in 1967. It took 23 years for Indonesia to resume ties with China, and this did not immediately translate into substantial changes in bilateral relations. It was only after the fall of Suharto in 1998 that one began to see significant improvements in Indonesia–China relations. Post-Suharto governments reversed the country's foreign policy and sought to re-engage with China. This re-engagement policy was initially driven by the imperative of economic recovery after the devastating 1997–1998 Asian economic crisis, which severely hit the Indonesian economy. Greater engagement with China, in particular in the economic arena, it was hoped, would facilitate the recovery process. More recently, as stability was restored to the Indonesian economy, particularly under the Susilo Bambang Yudhoyono (SBY) administration (2004–2014), bilateral relations have moved beyond economic cooperation, involving political and security cooperation as well. Thus, Indonesia and

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China established a 'strategic partnership' in 2005 which was subsequently upgraded to a 'strategic and comprehensive partnership' in 2013.

The growing ties with China, however, have brought not only opportunities but also unique challenges to Indonesia. In particular, increased economic competition with China has driven segments of the Indonesian business sector to demand greater protectionism, which has undermined the government's effort to strengthen its ties with China. It is argued that despite recent improvements, Indonesia–China relations have not entirely broken away from the difficult past as suspicions and sensitivity continue to characterise bilateral relations (Laksamana 2011; Novotny 2010; Sukma 2009a, b). In this context, the fear of China's aggressive penetration in the Indonesian market, if combined with the long-standing resentments of Indonesians concerning the economic role of the Chinese minority, could potentially destabilise the bilateral relationship. The implementation of the ASEAN–China Free Trade Agreement (ACFTA), for example, generated political backlash from Indonesian businesses which used the institutions of political party and parliament to demand greater protection for domestic industries from the government which responded by introducing a series of protective measures.

The aim of this chapter is to highlight the opportunities and challenges of Indonesia–China relations in the twenty-first century. The first section looks at the evolution of Indonesia–China relations from a historical perspective. Following Sukma (2009a, b), it emphasises the primacy of domestic politics, particularly the problem of the ethnic Chinese, in the shaping of Indonesia–China relations. The second section looks at the recent improvements in bilateral relations in the post-Suharto era with particular focus on trade and investment relations. Here it is emphasised that while the re-engagement with China has provided Indonesia with expanding economic opportunities from which Indonesian businesses have benefited, by facilitating China's increasing investment, it also generated the fear of China's aggressive penetration in the Indonesian market. The rise of the 'China threat' is further elaborated in the third section, which pays attention to the way in which Indonesian businesses, which are exposed to greater competition with Chinese products, provoked economic nationalism to preserve vested interests. As is highlighted with reference to the ACFTA, these business interests successfully influenced the political process to make the government implement protectionist measures. Finally, the last section sums up the main findings of the chapter.

2 Indonesia–China Relations from a Historical Perspective

As Sukma (2009b, p. 141) points out, managing relations with China has been 'one of the most difficult challenges to Indonesia's foreign policy'.[1] More strikingly, Sukma (ibid) argues that those relations were primarily subject to 'pressure stemming from Indonesia's domestic political arena'. For example, Indonesia's first

[1] The first three paragraphs of this section rely on Sukma (2009a, b).

president, Sukarno, had to maintain a delicate balance between two competing centres of political power, the Communist Party of Indonesia (PKI)—the largest communist party outside the former Soviet Union and China—and Indonesian armed forces (ABRI), to perpetuate his paramountcy. In this context, Indonesia's engagement with Beijing was motivated by Sukarno's desire to balance the military by strengthening the PKI, which received political and financial support from China. Strengthening diplomatic ties with Beijing also served Sukarno's policy of militant confrontation against 'Western imperialism'. The ABRI, on the other hand, were mostly anti-communist and had grown increasingly disturbed by Sukarno's alignment with China. Many in the ABRI leadership believed that Beijing sought to reorient the loyalty of Indonesian Chinese towards China while providing excessive protection for the PKI. Even after the dissipation of the PKI, the apprehension over China and the ethnic Chinese was to remain in the imagination of Indonesian elites and continued to shape Indonesia's relations with China as discussed below.

Indonesia's growing political alignment with China was brought to an abrupt end when an abortive military coup in October 1965 led to a regime change in Jakarta. Sukarno was forced out by Suharto, whose New Order regime charged the PKI as a perpetrator of the coup, allegedly with the assistance of Beijing and the ethnic Chinese in Indonesia, though the precise details of the event remain shrouded in mystery even today.[2] The Suharto regime, at least initially, staked its legitimacy on the claim that it saved the Indonesian state from a communist takeover, accusing China and Indonesian Chinese of complicity in the coup. Thus, in 1967, bilateral relations were declared 'frozen'. The Suharto regime assiduously maintained the presumed linkages between China, the ethnic Chinese and the communists in public memory as they were essential to preserve the basis for its hegemony. Three decades of institutionalised legal discrimination against the ethnic Chinese ensued, in which the racial dichotomy of pribumi (i.e. indigenous) and non-pribumi (non-indigenous) was rigidly maintained, with the intent continuously to objectify and essentialise the Chinese as 'the foreign Other' and prevent them from being accepted fully as 'Indonesians' says Hoon (2006, p. 152).

In this context, Sukma (2009a, pp. 593–4) argues, 'an early restoration of diplomatic ties with Communist China would undermine the legitimacy claim' of the New Order regime. The logic of the 'triangle threat' (China, the PKI and the ethnic Chinese) had continued to prevent Indonesia from restoring diplomatic ties with China for more than two decades (ibid). According to one survey, in the 1970s, two-thirds of the Indonesian elites considered China as a 'serious threat' to Indonesia and more than half pointed to China as 'the principal threat' (Weinstein 1976, p. 93). Positive changes in the regional and international environment from the mid-1970s onwards, especially in the nature of Beijing's relations with non-communist states, failed to alter Indonesia's perceptions and attitude towards China (see Weinstein 1976, pp. 111–125). The dynamics of Indonesia's domestic politics, which still required the employment of anti-communist ideology as the basis of regime

[2] For an excellent analysis of the 1965 coup, see Anderson and McVey (1971).

legitimacy, 'continued to underline the paramount importance of domestic political requirements over other considerations in Indonesia's foreign policy' (Sukma 2009b, p. 142). Even after China abandoned its revolutionary foreign policy and began to embark on a moderate and peaceful foreign policy of promoting 'four modernisations', Indonesian leaders remained largely sceptical of its intentions.

Yet, China's growing economic power and openness in the 1980s facilitated gradual improvements of bilateral relations, which eventually led to the resumption of direct trade relations in 1985. It should be noted here that by this time the Suharto regime had switched its claim to legitimacy. As Smith (2003, p. 3) points out, 'Suharto, dubbing himself the "Father of Development", now staked his reputation on economic progress'. 'Not only was the anti-communist theme no longer needed', Smith also argues, 'but China's economic potential was also attractive and potentially helpful to underscore the development basis of Suharto's new legitimacy'.[3] Restoring formal diplomatic ties with China, however, still remained subject to domestic political calculations. Although Indonesia began to recognise the importance of China, deep suspicion towards the ethnic Chinese continued to affect Indonesians' perception of China as well: Indonesia was still worried about the possible link between the People Republic of China (PRC) and the ethnic Chinese minority (Sukma 2009a).[4] Indeed, despite the resumption of trade relations, it was noted that 'trade and investment flows between China and Indonesia are expected to remain relatively low in the near future' (Atje and Gaduh 1999, p. 9).

Thus, it was only after 1998, when the Suharto regime collapsed in the aftermath of the 1997–1998 economic crisis, that one began to see significant improvements in Indonesia–China relations. Indonesia was severely hit by the crisis, and greater engagement with the Chinese economy became imperative for its own recovery. At the same time, eager to impress on the international community that Indonesia was now moving towards a greater democracy, post-Suharto governments, in particular under Abdurrahman Wahid (1999–2001), the country's first democratically elected president, removed discriminatory measures against the ethnic Chinese. Wahid also made China his first destination for a state visit. President Megawati Sukarnoputri (2001–2004), who replaced Wahid in July 2001, continued to improve ties with China. The policy of re-engaging China continued to occupy the foreign policy agenda of the next president, Susilo Bambang Yudhoyono (2004–2014). In this context, deep-rooted animosity towards the ethnic Chinese based on the triangle threat have slowly, though not completely, been eroded, and most Indonesians no longer see China as ideologically threatening.

Under the SBY administration, Indonesia and China deepened and broadened cooperation in the political and security realms as well. Indonesia signed an

[3] Novotny (2010, pp. 194–200) similarly argues that Suharto's growing confidence in Indonesia's stability prompted him to facilitate the 'defreezing' of Indonesia–China relations.

[4] It is worth recalling at this point that in preparing for the official restoration of diplomatic relations with China, the then Indonesian president, Suharto, still maintained that Indonesia 'must remain alert to the possibility of a PKI revival after the normalisation of ties with China' (*The Jakarta Post*, 27 February 1989).

agreement to establish a strategic partnership with China in 2005 (*The Jakarta Post*, 14 April 2005). In 2013, both countries agreed too on strategic and comprehensive partnerships in various fields that will benefit both countries (*The Jakarta Post*, 2 October 2013). Despite recent improvements in bilateral relations, it needs to be noted that Indonesia has not entirely broken away from the past. Indeed, many Indonesian elites still harbour age-old suspicions concerning China. Novotny (2010, p. 179), for example, argues that 'though the present Indonesian leaders tend to describe China as a challenge rather than a threat, the substance of their security concern vis-à-vis China has not undergone a significant change'. Wanandi (quoted in Smith 2003, p. 4) similarly notes that to mitigate the uncertainty over China's role in the region, 'it would be wise for East Asia to commit China to the web of rules and institutions in the region'. Such a sense of uncertainty regarding China could potentially destabilise the bilateral relationship, if fused with fear of losing out economically to China, which would exacerbate prejudice against ethnic Chinese.

In short, Indonesia–China relations improved significantly after the fall of the Suharto regime, which had portrayed China as a threat to national security. Post-Suharto governments reversed the country's foreign policy and sought to re-engage with China. This re-engagement policy was initially driven by the need to attract Chinese investment for economic recovery after the 1997–1998 Asian economic crisis. However, as stability was restored to the Indonesian economy, particularly under the SBY administration, bilateral relations have moved beyond economic cooperation, involving political and security cooperation as well. The establishment of 'strategic partnership' in 2005 and 'strategic and comprehensive partnership' in 2013 reflected such a shift. Yet, the fact remains that the most impressive improvement in Indonesia–China relations has taken place in the economic arena. Also economic opportunities provided by the rise of China will continue to be the primary driver of bilateral relations. The next section thus looks at the expansion of Indonesia's trade and investment relations with China.

3 Trade and Investment Relations

Indonesia's economic relations with China have improved significantly in the post-Suharto era, particularly under the SBY presidency. The most significant in this respect is the expansion of Indonesia's trade relations with China (see Table 1). In terms of Indonesia's export relations, for example, China has emerged as one of Indonesia's leading trading partners. From 1987 to 1997, Indonesia's average export value to China was USD1217 million, and China constituted Indonesia's fifth largest export trading partner (after Japan, the USA, Singapore and South Korea). After the fall of Suharto in 1998, however, Indonesia's export volume to China grew significantly. During the period of 1998–2007, Indonesia's average export volume expanded almost four times (USD4480 million) from the previous period. From 2008 to 2012, it reached USD16,685 million. China is now Indonesia's second largest export trading partner, only after Japan. A similar observation can be made in Indonesia's import relations. From 1987 to 1998,

Table 1 Indonesia's direction of trade (million USD) by top 10 trading partners last 25 years (1987–2012)

Direction of trade	Average 1987–1997	Rank	Average 1998–2007	Rank	Average 2008–2012	Rank
Exports, total						
1. Japan	10,631.23	1	15,196.33	1	27,190.04	1
2. USA	4780.30	2	8674.05	2	13,935.74	4
3. Singapore	3078.22	3	6659.30	3	14,485.38	3
4. Korea, Republic of	2027.07	4	4960.10	4	12,255.07	5
5. China, People's Republic of	**1217.33**	**5**	**4480.10**	**5**	**16,685.78**	**2**
6. Malaysia	577.13	8	2649.29	6	8976.56	7
7. Australia	715.43	7	2037.93	7	4421.51	9
8. Netherlands	1077.37	6	1871.02	9	4070.94	10
9. Thailand	551.85	9	1644.38	10	4798.69	8
10. India	213.23	10	2028.01	8	10,068.65	6
Imports, total						
1. Japan	6237.48	1	5096.03	2	16,828.63	3
2. Singapore	1842.55	3	5568.70	1	21,926.66	1
3. China, People's Republic of	**955.51**	**6**	**3653.69**	**3**	**21,054.98**	**2**
4. USA	3382.38	2	3429.87	4	9371.31	4
5. Australia	1445.56	5	2073.68	6	4403.02	9
6. Korea, Republic of	1550.66	4	2120.85	5	8868.24	6
7. Thailand	411.59	10	2025.19	7	8052.42	7
8. Malaysia	491.91	9	1897.96	8	9181.76	5
9. India	680.81	7	805.45	10	3407.44	10
10. Saudi Arabia	607.38	8	1843.62	9	4585.52	8

Bold values highlight that China is the important trading partner for Indonesia
Source: Own calculation using ADB Statistics

China was ranked sixth (after Japan, the USA, Singapore, South Korea and Australia) with the average import value of a mere USD955 million. In the subsequent period (1998–2007), it reached USD3653 million, and from 2008 to 2012 it reached USD21,054 million. China has emerged as the second largest partner after Singapore.

The recent increase in trade value could largely be attributed to the implementation of the ACFTA in 2010. Since 1 January 2010, the ACFTA has become fully effective in implementing zero tariffs on 6682 tariff posts in 17 sectors, including 12 in manufacturing and five in the agriculture, mining and maritime sectors. Bilateral trade value increased 42 % from USD25.5 billion in 2009 to USD36.1 billion in 2010. At the same time, however, it should be noted that China has benefited more from the expanding trade relations than Indonesia. This reflects the fact that China enjoys comparative advantage in a broader range of trading products (77 % of the trading products, most notably in manufactured products) than Indonesia (23 %, mostly in primary products) (Table 2). As a result of this,

Table 2 Product classification Indonesia–China of RCA and net export (2012)

HS2	Product (HS-2)	RCA Ina	RCA Chn	NX Ina Chn	Classification
03	Fish, crustaceans and aquatic invertebrates	2.56	0.98	−8,331,197	Not performed
05	Other products of animal origin	0.15	1.76	−9,167,004	Not performed
16	Edible preparations of meat, fish, crustaceans, molluscs or other aquatic invertebrates	1.54	1.52	−27,197,682	Not performed
20	Preparations of vegetables, fruit, nuts or other plant parts	0.34	1.07	−85,179,848	Not performed
21	Miscellaneous edible preparations	1.04	0.32	−85,894,020	Not performed
24	Tobacco and manufactured tobacco substitutes	1.76	0.26	−270,245,808	Not performed
36	**Explosives, pyrotechnic products, matches, pyrophoric alloys, certain combustible**	**0.33**	**1.65**	**−48,264,710**	**Not performed**
42	Leather articles, saddlery and harness, travel goods, handbags and similar articles	0.45	3.65	−373,428,249	Not performed
43	Furskins and artificial fur, manufactures thereof	0.02	2.28	−3,953,884	Not performed
46	Manufactures of straw, esparto or other plaiting materials; basketware and wickerwork	2.87	5.71	−10,165,150	Not performed
48	Paper and paperboard and articles thereof, paper pulp articles	1.89	0.61	−28,884,209	Not performed
50	Silk, including yarns and woven fabric thereof	0.00	4.42	−20,831,977	Not performed
51	Wool and animal hair, including yarn and woven fabric	0.01	1.48	−56,383,886	Not performed
52	Cotton, including yarn and woven fabric thereof	0.98	1.90	−467,483,252	Not Performed
53	Other vegetable textile fibres, paper yarn and woven fabrics of paper yarn	0.43	2.72	−16,935,728	Not performed
54	Man-made filaments, including yarns and woven fabrics	2.65	2.53	−575,682,385	Not performed
55	Man-made staple fibres, including yarns and woven fabrics	5.29	2.31	−302,544,753	Not performed
56	Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles	0.55	1.27	−102,075,650	Not performed
57	Carpets and other textile floor coverings	0.44	1.33	−32,346,231	Not performed

(continued)

Table 2 (continued)

HS2	Product (HS-2)	RCA Ina	RCA Chn	NX Ina Chn	Classification
58	Special woven fabrics, tufted textile fabrics, lace, tapestries, trimmings, embroidery	0.44	3.16	−122,172,858	Not performed
59	Impregnated, coated, covered or laminated textile fabrics; textile articles for industrial use	0.45	2.29	−350,333,161	Not performed
60	Knitted or crocheted fabrics	0.33	3.17	−509,883,155	Not performed
61	Apparel articles and accessories, knitted or crocheted	1.56	3.66	−1,049,498,147	Not performed
62	Apparel articles and accessories, not knitted or crocheted	1.89	2.87	−124,431,770	Not performed
63	Other textile articles, needlecraft sets, worn clothing and worn textile articles	0.60	3.49	−85,544,426	Not performed
64	Footwear, gaiters and the like and parts thereof	2.73	3.36	−192,649,029	Not performed
65	Headgear and parts thereof	0.33	4.27	−19,994,682	Not performed
66	Umbrellas, walking sticks, seat sticks, riding crops, whips and parts thereof	0.06	6.47	−80,475,877	Not performed
67	Prepared feathers, down and articles thereof; artificial flowers; articles of human hair	3.51	6.18	−13,559,114	Not Performed
68	Articles of stone, plaster, cement, asbestos, mica or similar materials	0.29	1.45	−112,651,597	Not performed
69	Ceramic products	0.63	2.84	−372,603,879	Not performed
70	Glass and glassware	0.52	1.73	−264,161,077	Not performed
73	Articles of iron or steel	0.58	1.48	−1,331,554,978	Not performed
81	Other base metals; cermets; articles thereof	0.09	1.56	−29,715,507	Not performed
82	Tools, implements, cutlery, spoons and forks of base metal and parts thereof	0.15	1.61	−215,381,236	Not performed
83	Miscellaneous articles of base metal	0.29	1.85	−343,408,540	Not performed
84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	0.27	1.52	−5,697,801,824	Not performed
85	***Electric machinery, equipment and parts; sound equipment; television equipment***	***0.49***	***2.06***	***−3,717,406,927***	***Not performed***

(continued)

Table 2 (continued)

HS2	Product (HS-2)	RCA Ina	RCA Chn	NX Ina Chn	Classification
86	Railway or tramway, locomotives, rolling stock, track fixtures and parts thereof	0.06	2.29	−72,074,141	Not performed
89	Ships, boats and floating structures	0.46	2.04	−723,068,758	Not performed
90	Optical, photographic, cinematographic, measuring, checking, precision, medical	0.12	1.09	−1,023,558,796	Not performed
94	Furniture; bedding, mattresses, cushions, etc.; other lamps and light fittings, illuminated signs, nameplates and the like; prefabricated buildings	0.78	2.97	−772,582,275	Not performed
95	Toys, games and sports equipment; parts and accessories	0.51	3.75	−161,456,641	Not performed
96	Miscellaneous manufactured articles	0.92	3.36	−248,190,824	Not performed
04	Dairy products, birds' eggs, honey and other edible animal products	0.24	0.05	−1,969,914	Not performed
06	Live trees, plants; bulbs, roots; cut flowers and ornamental foliage	0.12	0.10	−267,466	Not performed
07	Edible vegetables and certain roots and tubers	0.16	0.98	−390,933,442	Not performed
08	Edible fruit and nuts, citrus fruit or melon peel	0.39	0.34	−384,421,899	Not performed
10	Cereals	0.01	0.03	−10,792,479	Not performed
11	Milling products, malt, starch, inulin, wheat gluten	0.32	0.27	−27,849,904	Not performed
13	Lac, gums, resins and other vegetable saps and extracts	0.56	0.65	−34,822,079	Not performed
17	Sugars and sugar confectionery	0.34	0.20	−87,148,203	Not performed
22	Beverages, spirits and vinegar	0.11	0.10	−1,136,503	Not performed
23	***Food industry residues and waste, prepared animal feed***	***0.73***	***0.32***	***−23,649,895***	***Not performed***
25	Salt, sulphur, earth and stone, lime and cement plaster	0.22	0.62	−56,912,602	Not performed
28	Inorganic chemicals, organic or inorganic compounds of precious metals, of rare-earth metals, etc.	0.45	0.97	−495,288,875	Not performed
29	Organic chemicals	0.57	0.76	−272,348,581	Not performed
30	Pharmaceutical products	0.08	0.10	−25,494,194	Not performed

(continued)

Table 2 (continued)

HS2	Product (HS-2)	RCA Ina	RCA Chn	NX Ina Chn	Classification
31	Fertilisers	0.66	0.80	−442,480,785	Not performed
32	Tanning or dyeing extracts; tannins and derivatives; dyes, pigments and colouring matt	0.37	0.56	−275,396,912	Not performed
33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	0.50	0.26	−83,086,191	Not performed
35	Albuminoidal substances, modified starches, glues, enzymes	0.12	0.69	−66,506,374	Not performed
37	Photographic or cinematographic goods	0.00	0.56	−51,068,244	Not performed
39	Plastics and articles thereof	0.39	0.81	−642,136,636	Not performed
45	**Cork and articles of cork**	**0.02**	**0.07**	**−59,305**	**Not performed**
49	Printed books, newspapers, pictures and other products of printing industry; manuscripts	0.07	0.65	−20,440,403	Not performed
72	Iron and steel	0.18	0.69	−1,135,039,537	Not performed
76	Aluminium and articles thereof	0.44	0.97	−400,080,797	Not performed
78	Lead and articles thereof	0.10	0.07	−1,074,197	Not performed
79	Zinc and articles thereof	0.04	0.09	−7,037,337	Not performed
87	***Vehicles (not railway, tramway, rolling stock), parts and accessories***	***0.32***	***0.34***	***−891,847,508***	***Not performed***
88	Aircraft, spacecraft and parts thereof	0.11	0.07	−14,111,660	Not performed
91	Clocks and watches and parts thereof	0.02	0.96	−157,811,000	Not performed
97	Works of art, collectors' pieces and antiques	0.10	0.26	−1,994,172	Not performed
01	Live animals	0.26	0.21	209,511	Performed
02	Meat and edible meat offal	0.01	0.07	NA	Performed
09	Coffee, tea, mate and spices	3.89	0.34	20,576,283	Performed
12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit	0.20	0.22	96,977,949	Performed
14	Vegetable plaiting materials and other vegetable products	3.75	1.05	36,556,415	Performed

(continued)

Table 2 (continued)

HS2	Product (HS-2)	RCA Ina	RCA Chn	NX Ina Chn	Classification
15	Animal or vegetable fats and oils and their cleavage products, prepared edible fats	17.03	0.04	4,007,337,655	Performed
18	Cocoa and cocoa preparations	2.07	0.06	47,545,602	Performed
19	Preparations of cereals, flour, starch or milk; bakers' wares	0.85	0.21	30,900,613	Performed
26	***Ores, slag and ash***	***1.96***	***0.02***	***5,418,971,536***	***Performed***
27	***Mineral fuels, mineral oils and products of their distillation; bitumen substances***	***2.02***	***0.09***	***9,834,953,042***	***Performed***
34	Soap, waxes, polish, candles, modelling pastes, dental preparations with basis of waxes	1.59	0.42	78,578,713	Performed
38	Miscellaneous chemical products	1.88	0.50	360,408,956	Performed
40	***Rubber and articles thereof***	***4.13***	***0.81***	***1,490,048,470***	***Performed***
41	Raw hides and skins (other than furskins) and leather	0.40	0.12	10,905,671	Performed
44	Wood and articles of wood, wood charcoal	2.57	0.85	467,038,425	Performed
47	Pulp of wood or of other fibrous cellulosic material, waste and scrap of paper and paperboard	2.95	0.02	1,088,943,570	Performed
71	Natural or cultured pearls, precious or semiprecious stones, precious metals and metal clad	0.47	0.69	13,927,727	Performed
74	***Copper and articles thereof***	***1.16***	***0.35***	***199,389,856***	***Performed***
75	***Nickel and articles thereof***	***3.16***	***0.26***	***244,653,042***	***Performed***
80	***Tin and articles thereof***	***24.35***	***0.10***	***365,060,955***	***Performed***
92	Musical instruments, parts and accessories thereof	7.43	2.16	159,968	Performed
93	*Arms and ammunition, parts and accessories thereof*	*0.06*	*0.12*	*6,530*	*Performed*

Bold indicates China's export to Indonesia, products not imported from Indonesia
Italic indicates Indonesia's export to China, products not imported from China
Bold–italic indicates China invest FDI in Indonesia
Source: Own calculation using COMTRADE data

Indonesia has become increasingly reliant on natural-resource sectors for exports to China. Exports from the mining sector, for example, increased to USD5.82 billion or 41.4 % of the total export to China, in 2010, from merely 6.2 % in 2005. The contribution of the manufacturing sector, in contrast, has been in a continuous decline and fell to 56.9 % in 2010 from 91.4 % in 2005 (ICRA Indonesia 2011). This emerging pattern of vertical trade constitutes a major source of Indonesia's trade deficits, which reached an all-time high in 2012: USD7.7 billion (Table 3).

Table 3 Indonesia's direction of trade (million USD) from 1995 to 2012

Year	NX
1995	246.50
1996	459.91
1997	711.33
1998	925.74
1999	766.72
2000	745.74
2001	357.99
2002	475.58
2003	845.06
2004	503.40
2005	819.49
2006	1706.67
2007	1117.63
2008	−3612.70
2009	−2502.90
2010	−4731.60
2011	−3271.20
2012	−7727.60

Source: Own calculation using ADB Statistic

In terms of why Indonesia's manufacturing sector has been losing ground to its Chinese counterpart, it is worth recalling that the Indonesian manufacturing sector experienced a rapid growth from the 1980s, when it was suggested that Indonesia would eventually enter an advanced form of capitalism as witnessed in the 'East Asian Tigers'. East Asian developmental states had successfully nurtured so-called strategic industries to the point where they could compete in international markets. Unlike its East Asian counterparts, however, Indonesia has never been able to produce a competitive manufacturing sector. As Fukuoka (2012) highlights, this is largely because the pattern of state–business relations in Indonesia differed significantly from the East Asian model: firstly, the patrimonial state of Indonesia has been subject to the particularistic demands of predatory business elites able to influence policy-making through clientelistic connections. Secondly, the Indonesian state lacked a capable and coherent bureaucracy to ensure satisfactory policy implementation. In this context, state intervention in the market became an excuse to bestow patronage on politically powerful business groups.[5]

[5] For a concise discussion of East Asian developmental states, see Onis (1991). For example, in the case of preferential bank lending—a key instrument of state-led development in East Asia—while the Indonesian government prepared elaborate lists of priority categories, the Central Bank 'not only had little idea of the purposes to which cheap finance was actually put, but lacked even a clear picture of whether subsidised loans even reached the target groups' (MacIntyre 1994, p. 262).

Table 4 Proportion by sector (% of GDP) from 2003 to 2012

Sector	Agriculture and mining (%)	Manufacturing industry (%)	Utilities (electricity, gas and water) (%)	Services (construction, trade, transport and communication, finance and public administration, others) (%)
2003	23.5	28.3	1.0	47.3
2004	23.3	28.1	1.0	47.6
2005	24.3	27.4	1.0	47.4
2006	24.0	27.5	0.9	47.6
2007	24.9	27.0	0.9	47.2
2008	25.4	27.8	0.8	45.9
2009	25.9	26.4	0.8	47.0
2010	26.4	24.8	0.8	48.0
2011	26.6	24.3	0.8	48.3
2012	26.2	23.9	0.8	49.1

Source: Own calculation using ADB Statistic

Against this backdrop, Indonesian businesses had enjoyed a comfortable mentality as the state not only financially facilitated them but also protected them against competitors: their success and even survival has continued to depend on patrimonial plunder of state resources. Internationalisation in the sense of producing goods or services for exports was never high on the agendas of Indonesian manufacturers (Habir 1998). Even when the growth of manufactured exports took place, it was led by a relatively few products whose competitiveness was based on low wages and access to natural resources. By the 1990s it was suggested that Indonesia would be vulnerable to competition from countries like China with lower wage costs (Lall and Rao 1995). As Indonesia had failed to achieve the kind of industrial upgrading as observed in East Asia, it was expected that strengthening economic ties with China would 'do more harm than good' to local industries, in particular the manufacturing sector (*The Jakarta Post*, 6 November 2002).[6] Predictably, the implementation of the ACFTA has facilitated the process of de-industrialisation, the decline of the already uncompetitive manufacturing sector (Table 5).[7] Novotny (2010, p. 216) argues that the rapid growth of the Chinese economy, combined with the lacklustre performance of the Indonesian economy,

[6] In this respect, the experience of Indonesian footwear producers is indicative. An increasing number of Indonesian footwear firms have changed their businesses from manufacturing products to merely distributing manufactured goods imported from China. According to UN Comtrade, Indonesia was the world's fifth largest footwear exporter in 1996, with a global market share of around 5 %. It fell to 10th place in 2009, with a 2 % share. During the same period, footwear products from China entered the Indonesian market due to market liberalisation (Standard Chartered 2013).

[7] The industrial sector's share of Indonesia's total GDP has declined from 27.8 % in 2008 to 23.9 % in 2012 (Table 4).

Table 5 Proportion of FDI inflows to total ASEAN FDI inflows and proportion of FDI inflows to total country's FDI inflows (2011)

Home country	% of total intra FDI inflows in ASEAN	% of total extra FDI inflows in ASEAN	% FDI inflows from intra-ASEAN	% FDI inflows from extra-ASEAN	Total (%)
Brunei Darussalam	0	1	6	94	**100**
Cambodia	1	1	25	75	**100**
Indonesia	**47**	12	**43**	57	**100**
Lao PDR	0	0	18	82	**100**
Malaysia	15	10	22	78	**100**
Myanmar	1	2	10	90	**100**
Philippines	0	2	−4	104	**100**
Singapore	24	56	8	92	**100**
Thailand	3	9	6	94	**100**
Vietnam	8	7	20	80	**100**
Total	**100**	**100**			

Bold values highlight that Indonesia's share of intra-investment in ASEAN is the highest (47 %) and that it also constitutes a major source of intra-ASEAN investment (43 %)
Source: Own calculation using Table 25 ASEAN

could be translated into a dependency relationship between them. This development generated the perception of the 'China threat' and posed an obstacle to further enhancing bilateral relations.[8]

Still, it should be noted that if a Free Trade Agreement (FTA) succeeds in the creation of an efficient regional production network, it would then encourage more intra-regional investment as well.[9] Thus, to gain a complete picture of Indonesia–China economic relations, it is equally important to measure the extent to which Indonesia has benefited from China's investment.[10] Overall, China's FDI inflows in

[8] For example, in an article that appeared in the country's leading newspaper, *The Jakarta Post*, it was claimed that 'most people are of the opinion that Indonesia's agricultural products and manufacturing goods are extremely uncompetitive against China's'. The same article also suggested that 'instead of seeing the ACFTA as an instrument to strengthen the interdependence of the ASEAN region with China, many Indonesians see it as leading to cut-throat competition that will have negative impacts on the development of Indonesian economic capabilities in the long term' (*The Jakarta Post*, 27 October 2010).

[9] It is worth recalling at this point that previous studies found that in the context of ASEAN Free Trade Agreement (AFTA), trade creation (the replacement of expensive domestic production by cheaper imports from more efficient partner countries) is higher than trade diversion (the replacement of cheaper initial imports from lower-cost producers outside the union by imports from less efficient producers in member countries), thus facilitating increasing investment from more efficient member states to lower-cost members' affiliates as production bases transferred (Urata and Okabe 2007).

[10] This is particularly so given that Indonesia is now the most attractive destination of intra-ASEAN FDI, attracting around 47 % of the total intra-ASEAN FDI (Table 5). This indicates that Indonesia is well placed to attract further investment from China's increasing economic engagement with ASEAN.

Indonesia significantly increased, particularly in the last 5 years, from USD50.8 million in 2009 to USD296 million in 2013, though Indonesia is not yet among the top recipients of China's investment. A brief analysis of China's FDI inflows by sector (Table 6) reveals that China has invested most aggressively in the mining, metal, machinery and electronic, trade and repair, food and rubber and plastic industry sectors.[11] China is among the big ten investors in the fishery, wood, leather goods and footwear, rubber and plastic, non-metallic mineral, paper and printing, metal and machinery and electronic industries. Interestingly, China has also invested in the raw materials of the fishery and mining industries and both the utility sector (electricity, gas and water supply) and service sector of trade and repair, real estate, industrial estate and business activities and transport, storage and communication. It appears that China's investment has been comprehensive as it covers not only tradable sectors but also non-tradable sectors.

It is worth emphasising that China's long-term investment in Indonesia has been directed to Indonesia's comparatively disadvantaged sectors, namely, food, vehicles (not railway, tramway, rolling stock) and their parts and accessories, electrical machinery and equipment and parts, storage and paper and printing. It appears that China's investment in these sectors has largely been aimed at gaining access to Indonesia's large domestic market for these products. At the same time, China's increasing investment in these sectors could potentially enhance their international competitiveness, if such investment is pursued in ways which incorporate them into regional production networks. Another important aspect of investment relations is that China has displayed a strong interest in the fishery, wood and rubber sectors, each of which is identified as a 'priority integration sector' in the context of the ASEAN Economic Community. China's investment in these areas could help Indonesia develop new production bases which could then make an important contribution to the country's future economic growth. These observations suggest that the cost of trade borne by Indonesia has, at least to a certain extent, been compensated for by the benefit of attracting further investment from China.

To sum up, while Indonesia's economic relations with China have experienced a remarkable improvement in the post-Suharto era, the impact has been somewhat mixed. On the one hand, Indonesia has registered growing trade deficits with China, which enjoys comparative advantage in a wider range of products. Due to its failure to nurture a competitive manufacturing sector, Indonesia has become increasingly dependent on exporting primary products, as it deepens its trade relations with China; energy commodities are increasing their share of Indonesia's exports, while the share of non-energy-based manufactured products is declining. At the same time, however, such trade imbalance has, at least to a certain extent, been compensated for by China's investment, which could also help enhance the competitiveness of Indonesian industries. Despite such positive benefits, much of Indonesian public

[11] China's investment in Indonesia's mining sector is considered to be an important measure to secure a sustainable supply of raw materials required to support China's manufacturing sectors (Kian Wie 2010).

Table 6 China's FDI inflows in Indonesia (thousand USD) and China's rank among host countries from 2009 to 2013

Sector	2009	2010	2011	2012	2013	Rank among FDI home countries 2013
Fishery	–	–	–	–	1031	3
Wood industry	–	2000	50	–	1999	4
Leather goods and footwear industry	–	–	–	889	1199	5
Rubber and plastic industry	–	2000	10,008	450	35,135	5
Construction	–	–	1950	–	13,394	5
Non-metallic mineral industry	–	–	–	6198	32,233	6
Electricity, gas and water supply	–	3058	–	12,190	24,412	6
Trade and repair	10,510	11,564	17,656	14,394	29,302	6
Paper and printing industry	–	–	500	101	2097	7
Mining	4200	87,004	61,558	42,879	66,642	8
Other industry	–	–	–	–	2156	8
Metal, machinery and electronic industry	29,753	35,352	20,626	32,013	53,736	9
Real estate, ind. estate and business activities	–	–	–	–	3226	10
Transport, storage and communication	–	6072	150	2250	625	10
Food crops and plantation	–	40	3425	11,993	4523	11
Motor vehicles and other transport equip. industry	–	–	300	–	31	11
Textile industry	–	800	–	800	800	12
Food industry	5550	22,463	11,507	9654	12,309	13
Chemical and pharmaceutical industry	–	1484	–	7140	10,512	14
Other services	567	1810	500	–	1298	18
Hotel and restaurant	250	–	–	18	222	25
Total agriculture and mining sector	**4200**	**87,044**	**64,982**	**54,872**	**72,197**	
Total manufacturing industry sector	**35,303**	**64,098**	**42,991**	**57,246**	**152,207**	
Total service sector	**11,327**	**22,504**	**20,256**	**28,852**	**72,480**	
Total FDI inflows of China in Indonesia	**50,830**	**173,646**	**128,230**	**140,969**	**296,883**	

Bold values highlight total investment in three major sectors in the economy, which are agriculture and mining, manufacturing industry and service sector

Source: Own calculation using data of BKPM Indonesia http://www4.bkpm.go.id/contents/p16/statistics/17#.U5kGWM86Tug

discourse has focused on negative dimensions of Indonesia–China economic relations. In recent years, business elites and political elites alike have provoked the perception of the 'China threat', emphasising the negative implications of trade imbalance while conveniently ignoring the positive role China's investment could potentially play. As discussed below, these actors now constitute a significant obstacle to Indonesia's engagement with China.

4 Challenges of Managing Indonesia–China Economic Relations

The recent improvements in bilateral relations have brought unique challenges as well as expanded opportunities to Indonesia. In particular, increased competition with cheap Chinese products has driven segments of Indonesian businesses to demand greater protectionism, which has undermined the government's effort to further strengthen its ties with China. It should be noted at this point that despite recent improvements, Indonesia–China relations have not entirely broken away from the difficult past as suspicions and sensitivity continue to characterise the bilateral relationship (see Laksamana 2011; Sukma 2009a, b). As mentioned earlier, the fear of China's aggressive penetration in the Indonesian market, if combined with the long-standing resentments of Indonesians concerning the economic role of the Chinese minority, could potentially strain and even destabilise bilateral relations. Indeed, as Booth (2011, pp. 10–11) points out, a pessimistic view of the future suggests that discontent on the part of Indonesian manufacturers over 'unfair' Chinese competition could spill over into violence against the Chinese minority, 'especially if trading companies owned by Indonesians of Chinese origin are seen to be benefiting from sales of merchandise originating from China'.

A good example in this respect is the implementation of the ACFTA in 2010, which generated the perception of the 'China threat'. In particular, Indonesian manufacturers, who had been nurtured under state protection, ganged up on the ACFTA, provoking the fear that the elimination of trade tariffs would lead to the flooding of China's low-end manufactured products, resulting in the displacement of domestic industries.[12] The Indonesian Chamber of Commerce (Kamar Dagang dan Industri Indonesia: KADIN) was particularly vocal in demanding that the government protect local industries, calling for a renegotiation of the trade agreement (*Kompas*, 23 April 2011; *The Jakarta Post*, 23 April 2011).[13] However, then

[12] It was suggested that small and medium enterprises that employ 97 % of the total workforce and contribute to more than half of country's GDP were particularly hard pressed amidst the 'invasion' of Chinese products.

[13] To be sure, their concerns were not entirely without reason. For example, according to the Central Statistics Agency (Badan Pusat Statistik), non-oil-and-gas imports from China surged 55 % to USD2.79 billion within the first 2 months of the implementation of the ACFTA, a steep

Trade Minister Mari Pangestu repeatedly rejected such demands, emphasising instead that Indonesia would enjoy benefits under the agreement, such as increased access to the Chinese market, increased productivity and efficiency, lower prices for the domestic market and greater protection from adverse shocks to the global economy (*The Jakarta Post*, 13 April 2010). Indeed, recent studies conducted by one of the authors (Verico 2012, 2013a, b) identify positive impacts of the ACFTA, suggesting that the establishment of open and non-discriminative regionalism would provide favourable conditions for Indonesian manufacturers to take part in regional production networks while at the same time attracting further investment from outside.

However, as the opposition to the ACFTA intensified, Pangestu found herself increasingly marginalised in the policy-making process. The People's Representative Council (DPR) members flaunted 'national interests' as the reason for their opposition to economic liberalisation, often whipping up xenophobia, when their real interest lies in maintaining state protection to preserve vested interests. It is now 'fashionable for politicians of all parties to say that government's economic policies serve the interests of foreign capitalists rather than those of the Indonesian people' (Sukma 2009, p. 89). Also, Indonesian lawmakers are not even equipped with necessary knowledge on FTAs. This has made it increasingly difficult for post-Suharto governments to pursue economic liberalisation without being accused of selling the country to foreigners. The ACFTA was no exception to this as party politicians were vocal against its implementation. For example, a Golkar politician, Fahmi Idris, who also served as Minister of Industry, said 'we are not ready to participate in the ACFTA as we know that our products cannot compete with Chinese products', suggesting that the government postpone the implementation of the ACFTA (*The Jakarta Post*, 18 August 2009). Eddy Kuntadi, another Golkar politician who sat in DPR Commission VI overseeing industry and trade, similarly said 'we want a delay because it will create massive effects economically and socially' (*The Jakarta Post*, 21 January 2010).[14]

Thus, predatory interests, both inside and outside the DPR, began to mobilise against Mari Pangestu seeking for her removal. Some even made a racially provocative statement alleging that the minister, who is an ethnic Chinese, favoured her ancestors' interests in her policies. Though such a provocation did not result in the rise of anti-Chinese sentiments in Indonesian society, it was an acute reminder that economic grievance could still be expressed in ethnic terms.[15] In this context, Mari Pangestu began to lose the support of President Susilo Bambang Yudhoyono (SBY), who could no longer protect her without sacrificing the stability of his administration. In post-Suharto Indonesia, the president, though still powerful, has

rise from USD1.8 billion in the corresponding period the year before (*The Jakarta Post*, 3 April 2010).

[14] As Novotny's (2010, pp. 212–218) analysis highlights, such a perception of China's economic threat is widely shared by Indonesian foreign policy elites.

[15] Personal communication with local journalists

to remain attentive to a greater plurality of interests; any failure to do so is subject to serious repercussions (Slater 2004). SBY has proved to be particularly skilful in this regard. While claiming to address the pressing issues facing the country, such as structural reform of the economy, his government never pursued radical reforms that would have undermined the vested interests of the country's oligarchs. While some prominent technocrats committed to liberal economic reform, including Mari Pangestu, were appointed to strategic positions, they were invariably relegated when their reform threatened oligarchic interests (Fukuoka 2013).

In October 2011, SBY reshuffled his cabinet, relegating Mari Pangestu to the minor post of Culture and Tourism Minister. Mari Pangestu was replaced by Gita Wirjawan, who, upon assuming the post, promised a greater protection of local industries. Under Gita Wirjawan, Indonesian trade policy became increasingly protectionist. Responding to domestic pressure, the government has resorted to a distorted trade policy through quota and other non-tariff barriers, which are difficult to monitor and create rent-seeking opportunities for those who are closely politically connected (Nasution 2013). Such a protectionist tendency culminated in February 2014 when the DPR passed a new trade law (Law No. 7/2014), ostensibly aiming to protect local producers from foreign competition while developing higher-value industries. Significantly, this law provides authorities with a legal basis to implement quota policy to restrict exports and imports—a policy that theoretically and empirically has proved to be harmful to economic development as it tends to encourage rent-seeking activities. This law also requires the government to ask for the approval of the DPR for any FTA with extensive impact on the national economy.[16] This development is problematic given the tendency of the DPR to oppose greater economic openness. O'Rourke (2014), for example, argues that this law would 'inevitably create conflicts of interest among state officials, while benefiting vested interests with prowess in lobbying political parties'.[17]

To sum up, the experience of the ACFTA highlights significant obstacles that remain in Indonesia–China relations, by exposing structural weaknesses of the Indonesian economy. As well as exposing Indonesian industries to a greater competition, the ACFTA also provoked long-term fear that while China is striving towards becoming a manufacturing hub of the region, Indonesia is drifting further towards becoming a natural-resource-based economy. Trends in the economic relationship over the past years have reinforced these perceptions as the proportion

[16] Article 84 (1) of the law states that any trade arrangements (bilateral, regional and multilateral) need to be submitted to the DPR for approval within 90 working days after the signing. The word 'after' indicates that it has the potential to be rejected by the DPR. Indeed, Article 84 (3) states that the DPR decides whether or not a particular agreement requires parliamentary approval within 60 working days. Meanwhile, Article 84 (6) explicitly provides the DPR with the authority to 'reject' (*menolak*) the agreement if it could 'threaten national interests' (*dapat membahayakan kepentingan nasional*).

[17] It was also suggested that the turn towards protectionism was linked to the 2014 parliamentary and presidential elections—laissez-faire economics is unpopular in Indonesia.

of natural-resource-related exports has registered a discernible growth. Instead of addressing such weaknesses through institutional reform, Indonesia has opted for greater protection by stoking fears of China flooding Indonesia with cheap goods, while extracting raw materials. The trade structure is unlikely to shift significantly for some time. The greater political openness in the post-Suharto era has encouraged some politicians to embrace economic nationalism in its more extreme form, with strong anti-Chinese undertones. These elements could exploit resentments concerning the outcomes of the ACFTA, which could present even greater challenges to managing Indonesia–China economic relations.

5 Conclusion

Seen from a historical perspective, the recent improvement in Indonesia–China relations has been remarkable. Departing from the Cold War hostility, post-Suharto Indonesia has significantly strengthened its ties with China not only in the economic arena but also in the political and security arena. Looking at the evolution of economic relations, this chapter has highlighted that the growing ties with China have brought expanding opportunities for Indonesia, particularly in the form of China's investment, while at the same time exposing Indonesian manufacturers to greater economic competition. With reference to the ACFTA, it highlighted that increased economic competition with China has driven segments of the Indonesian business sector to demand greater protectionism, deliberately provoking the perception of the 'China threat'. In this respect, it was emphasised that despite recent improvements, Indonesia–China relations have not entirely broken away from the difficult past as suspicions and sensitivity continue to characterise these relations. In fact, the perception of China's aggressive penetration in the Indonesian market, if not managed well, could combine with the long-standing resentments concerning the economic role of the Chinese minority to potentially destabilise the bilateral relationship. Indeed political and business interests intent on preserving the status quo have managed to turn Indonesia in an increasingly protectionist direction, presenting an obstacle to the government's effort to further strengthen its relations with China.

Appendix

Based on calculations of RCA of Indonesia and RCA of China and net export of Indonesia and China, this article designs four classifications:

1. If RCA of Indonesia of a particular product is higher than 1 (one) and RCA of China of that product is higher than 1 (one) while Indonesia to China net export is positive, then the product is a *performed product of Indonesia*. If RCA of

Indonesia of a particular product is lower than 1 (one) and RCA of China of that product is lower than 1 (one) while Indonesia to China net export is positive, then the product is also classified as a *performed product of Indonesia* compared to China.

2. If RCA of Indonesia of a particular product is higher than 1 (one) and RCA of China of that product is lower than 1 (one) while Indonesia to China net export is positive, then the product is classified as a *performed product of Indonesia* which shows Indonesia's comparative advantage to China. If RCA of Indonesia of a particular product is lower than 1 (one) and RCA of China of that product is higher than 1 (one) while Indonesia to China net export is negative, then the opposite of the previous result is true, i.e. this product is classified as a *not performed product of Indonesia* which shows China's comparative advantage to Indonesia.
3. If RCA of Indonesia of a particular product is lower than 1 (one) and RCA of China of that product is higher than 1 (one) while Indonesia to China net export is negative, then the product is classified as a *not performed product of Indonesia* which shows Indonesia's comparative disadvantage to China. If RCA of Indonesia of a particular product is lower than 1 (one) and RCA of China of that product is higher than 1 (one) while Indonesia to China net export is positive, then the opposite of the previous result is true, i.e. this product is classified as a *performed product of Indonesia* compared to China.
4. If RCA of Indonesia of a particular product is higher than 1 (one) and RCA of China of that product is higher than 1 (one) while Indonesia to China net export is negative, then the product is classified as a *not performed product of Indonesia* which indicates that Indonesia needs to pay attention to the probability that her comparative advantage could turn into a disadvantage in the long run. If RCA of Indonesia of a particular product is lower than 1 (one) and RCA of China of that product is higher than 1 (one) while Indonesia to China net export is negative, then this product is classified as a *not performed product of Indonesia*. If RCA of Indonesia of a particular product is higher than 1 (one) and RCA of China of that product is lower than 1 (one) while Indonesia to China net export is negative, then this product is classified as a *not performed product of Indonesia* since this comparative advantage product could not achieve a positive net export to Indonesia.

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People's Republic of China (PRC): Thailand Economic Relationship After Signing of Free Trade Agreement in 2005

Ying Liu and Kankesu Jayanthakumaran

1 Background

People's Republic of China (PRC) is the third biggest nation globally situated in East Asia with the land area of 9.6 million km^2, population of 1.36 billion people and population density of 139 km^{-2}. PRC's capital is Beijing and comprises of 22 provinces, five autonomous regions, four municipalities and two special administrative regions. Special administrative regions are Hong Kong and Macao. Thailand is the world's 51st largest country situated in Southeast Asia with the land area of 513,000 km^2 and population of 67.1 million people. The population density of Thailand is around 131 km^{-2}. Thailand shares borders with four neighbours: Myanmar in the north, Laos People's Democratic Republic (LPDR) and Cambodia in the east, and Malaysian Peninsula and Malaysia in the south. Myanmar and LPDR are the borders of PRC.

PRC–Thailand bilateral relations in the form of commercial and cultural exchanges were a historical one during the Ming and Qing dynasties and lasted consistently with few interruptions over time.[1] After the Second World War, both countries strengthened their relationship by signing the Siam–PRC treaty. However, mutual suspicion prevailed for two reasons: one is the PRC involvement with

[1] For details, see Thailand China Economic Information—The Long-Stream Friendship, http://www.thailand-china.com/getdoc/3aab868f-0b9e-4b1d-bcf1-e93bb80ec7b8/The-Long-stream.aspx?lang=en-GB, accessed on September 16, 2014.

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Cambodia's conflicts and the other is PRC's support to the communist factions within the Thai political circle. In 1978, PRC offered support to Thailand in resolving Cambodia's internal conflict, and both countries signed the Thailand–China Joint Trade Committee (JTC) agreement. JTC is to promote bilateral trade volume goals and trade expansion. In 1985, both countries signed a contract on 'Promotion and Protection of Mutual Investment'. Since then trade and investment became the dominant theme in bilateral relations. Thailand supports the 'One PRC' Policy and maintains unofficial relations with Taiwan.[2]

PRC had a relatively closed economy prior to 1978; it initiated economic reforms since then and intensified them by joining the World Trade Organization (WTO) in 2002. The 1990s and 2000s perceived a speedy growth performance in the Chinese economy, reflected in reduced trade and investment barriers, improved trade, the quick technology transmission and greatly mobile factors of production such as capital and labour. Special economic zones (SPZs) were formed along the coastal line to invite foreign direct investment (FDI) and lift exports and imports of advance technology-based products. State-owned firms were permitted to function and adopt on free market-based principles, and private firms were promoted and legalised. Such arrangements facilitated Thai investments in China especially in the areas of papermaking, electricity, agroindustries, textiles and garments, auto parts, food beverage, hotels, banking and building materials.

The well-known Charoen Pokphand Group (CP Group) firm, originated in Thailand and owned by Thai Chinese, initiated the operation in PRC in the early 1980s and is currently involved with a range of products that include automotive, petrochemicals, retail distribution, agribusiness and agroindustries. In the early 1990s, more Thai companies such as the Cement Thai group, Saha-Union Group and M-Thai Group started operation in PRC. Other Thai companies operating in China are Thai Farmers Bank (Kasikorn Bank), Kaset Rungrueang Co. Ltd., Kratingdaeng (Red Gore) Group, Krungthai Bank, Bangkok Bank Co. Ltd. and Mitr Phol Group.

Thailand was isolationist and dependent on state-owned enterprises and agricultural exports such as rice, sugar cane and cassava prior to the 1970s. In the early 1980s, Thai economy slumped mainly due to the burden of high oil prices, debt crisis and decline in agricultural prices. This was addressed not only by using fiscal and monetary policies but also promoting exports by providing incentives such as exceptions and declines of tariffs and business taxes on imported intermediate inputs to all export projects. Free market policies steered to the intense development of an immense export-oriented, big-scale manufacturing sector, which in turn stimulated the economy linking the other extraordinary performance economies in Asia. Thailand's population comprised of around 14 % of ethnic Chinese. Thai Chinese are highly influential in Thai economy and control major part of the firms

[2] In 1998, the China–Thailand subcommittee on cooperation in trade, investment and tourism was created to strengthen the cooperation. This committee was terminated in 2001 after the change of governments from Democrats to the Thai Rak Thai Party.

registered on the stock market and the major part of market capitalisation. Thai Chinese entrepreneurs control majority of the sectors including agriculture, banking and finance, real estate and wholesale trade. Such cultural links facilitated Chinese investments in Thailand especially in the areas of agribusiness, textiles, electronics, rubber, chemicals, hotels, restaurants and real estate.

The Agreement on the Mutual Promotion and Protection of Investment was signed in 1985 to promote trade and investment. This agreement facilitated PRC's direct investment in Thailand. Investments prior to 1985 were mainly in the form of trading but not production. The time period fell into initial stage of opening the PRC economy to the rest of the world. PRC's political rationale towards inward FDI could be characterised as selective acceptance. PRC invited only selective investments and allowed big trading companies to go overseas. The Worldbest Group (textiles and garments), TCL Corporation (electronics) and Huawei Technology Corporation (wireless phone and networking equipment) are big investors in Thailand which originated from China right after signing the agreement.

Major breakthrough occurred with the signing of the PRC–ASEAN Free Trade Agreement (CAFTA) in 2002 and subsequent agreements of goods, services and investment within the decade. The bilateral trade and investment between PRC and Thailand have remarkably increased since signing of CAFTA. This shows that there are diversities in comparative advantage between two countries economically in the use of natural resources and the stage of economic development. The changing pattern of comparative advantages between two countries would shape the long-term sustainable economic relationship.

To capture the comparative advantage, the estimates of revealed comparative advantage (RCA) indices are widely applied to find changing pattern of bilateral comparative advantage (Utkulu and Seymen 2004). Such estimate is lacking in PRC–Thailand exports, and therefore, this chapter intends to fill the research gap to show the estimates of PRC's export competitiveness to Thailand. The chapter is structured as follows: the following section describes the bilateral trade agreements and performance between two economies. Section 3 explores the RCA indices. Empirical results of RCA indices and comparisons are presented in Sect. 4. The concluding section draws the findings.

2 Trade and Investment Dependence Between the Two Economies

Economic integration is viewed as an opportunity for more trade and investment. It contributes more jobs, greater demand for consumption and more economic growth. A successful economic integration can occur only if there is evidence of greater bilateral trade between the partner countries. The last decade witnessed massive expansion of PRC–Thailand bilateral trade and investment, and this reflects the existing complementarity of both economies. One can see that

PRC–Thailand economic relationship is successful mainly due to Thailand's greater participation in the Association of Southeast Asian Nations Free Trade Area (ASEANFTA). In 1997, ASEANFTA initiated the process of accommodating ASEAN plus China, Korea and Japan (ASEAN + 3). All these processes facilitated CAFTA formation.

Thailand is one of the prominent members of the ASEANFTA. Studies indicate that there was a significant macroeconomic compatibility among the founder members of ASEAN (Ong and Habibullah 2012).[3] ASEAN countries attempted to integrate PRC in November 2002. A rapid expansion of bilateral economic relations occurred right after signing China (PRC)–ASEAN Free Trade Area (CAFTA) in 2002 with the intension of forming a free trade area by 2010. The consistent steps have been taken by signing three agreements to integrate more: the Agreement on Trade in Goods in 2004, the Agreement on Trade in Services in 2007 and ASEAN–China Investment Agreement in 2009. CAFTA specifies that China and the ASEAN-6 (founders of ASEAN) eliminate tariffs on 90 % of their products by 2010 leaving ASEAN–CLMV (Cambodia, Laos, Myanmar and Vietnam) to achieve the same status by 2015. Tariffs on remaining 10 % of their products will be eliminated by 2018.

In 2012, Regional Comprehensive Economic Partnership (RCEP) was initiated by the ten member states of the ASEAN (Malaysia, the Philippines, Singapore, Thailand, Brunei, Vietnam, Myanmar, Cambodia, Indonesia, Laos) and the six other partners (Australia, China, India, Japan, South Korea and New Zealand). RCEP is not based on a predetermined membership but allows open accession which enables participation of any of the ASEANFTA partners at their convenience. External economic partners, such as Central Asian countries and remaining South Asian countries and Oceania, are also encouraged to join. All member states are expected to cover 28 % of the world's economy by 2015.

Ong and Habibullah (2012) find that ASEAN-5 and PRC integration have been more coordinated than just an ASEAN-5 macroeconomic compatibility using a cointegration analysis. Authors suggested more ASEAN–PRC coordination plan for further success. One should view PRC–Thailand FTA on this foundation of positive regional trade relationship. Under the umbrella of CAFTA, in 2003, the PRC–Thailand FTA attempted 'early harvest' agreement on farm trade enforcing a deal to bring zero tariffs for 188 types of fruits and vegetables. Both countries opened up their farm products before CAFTA came into force in 2010. Although there are few accusations (e.g. small farmers are not benefiting cheaper PRC's fruits in the Thai market) of 'early harvest' agreement, countries formed a joint working group to study the problems and obstacles. The bilateral trade relationship is

[3] In 1967, founder members—Malaysia, Indonesia, Thailand, the Philippines and Singapore—formed the ASEAN-5. By incorporating Brunei, the ASEAN-6 emerged in 1984. The ASEAN-10 countries include new members: Myanmar in 1997, Cambodia in 1999, Laos in 1997 and Vietnam in 1995.

positive and PRC became Thailand's second largest trade partner after Japan in 2011.

Shen (2013) argues that there are three positive factors in boosting the expansion of PRC–Thailand bilateral economic relations: Thailand is truly committed in the building of PRC and ASEAN FTA; PRC's 'Good Neighbour' diplomacy had wider implications for positive implications of the agreement; and there are existing close contacts of different levels of leadership since the signing up of agreement. Laurenceson (2003) pointed out that goods and services market reforms in PRC–ASEAN-5 countries can be complementary to greater levels of external financial liberalisation, such as regulatory reforms of financial institutions. Regulatory reforms should cater the risk management practices of financial institutions in order to safeguard from financial crisis. Such move has already been initiated by liberalising trade in services, but it is a long way to go to finish the agenda.

An important question is that how the CAFTA and PRC–Thailand FTA impacted the PRC and Thailand as mutual trading and investing partners. Trade between the PRC and Thailand has grown in volume continuously, and both countries remain as major export markets for each other since signing CAFTA. Figure 1 shows importance of PRC market for Thailand's exports and Thailand market for PRC's exports. Thai exports to the PRC increased from 5.2 % in 2002 to 11.9 % in 2013, while PRC's exports to Thailand increased from 15 to 17 % during this period. Figure 1 also shows a remarkable increase of export shares by both countries as soon as 'Investment' agreement is signed in 2009 under CAFTA.

Figure 2 shows the importance of PRC as a source of Thailand's imports and Thailand as a source of PRC's imports. Thai imports to the China increased from 7.6 to 15 % from 2002 to 2013, while PRC's imports to Thailand increased from 12 to 14 % during this period. Both countries benefited by increasing their importance for each other following the signing of CAFTA. Changes in Thai trade structure over the period reflect the impact of PRC's growing economic footprint.

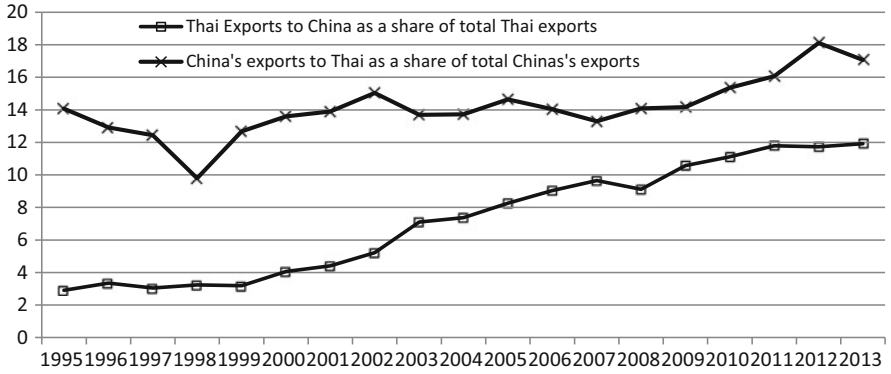

Fig. 1 Relative importance of China and Thailand as exports and imports markets (in %). *Source*: Bank of Thailand (2014)

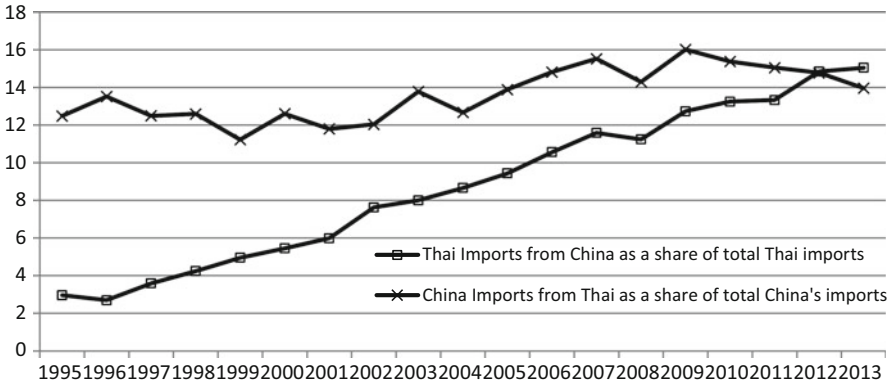

Fig. 2 Relative importance of China and Thailand as exports and imports markets (in %). *Source*: Bank of Thailand (2014)

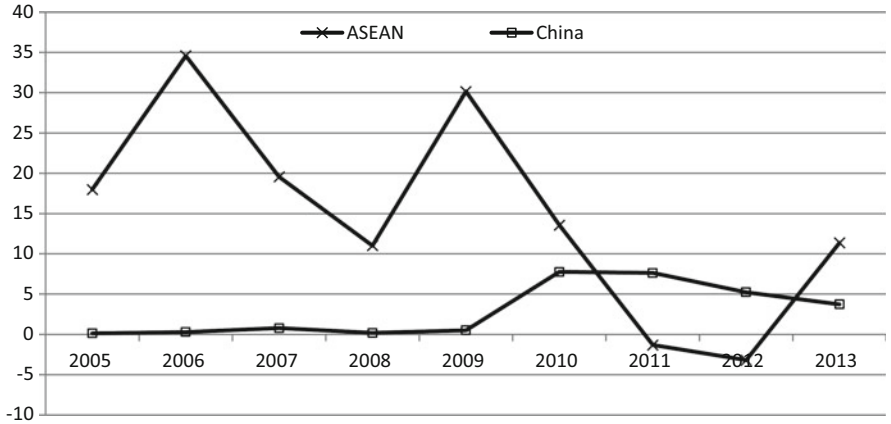

Fig. 3 FDI net flows to Thailand: from ASEAN and China (as a % of overall FDI). *Source*: Bank of Thailand (2014)

Figure 2 indicates a remarkable increase in import share by Thailand as soon as 'Investment' agreement is signed in 2009 under CAFTA.

In recent years, mutual investments between PRC and Thailand have increased considerably. Official net FDI flows from China to Thailand peaked at US$707 million in 2010 and have remained high since then (Fig. 3). FDI net flows as a percentage of overall FDI peaked 7.7 % in both 2010 and 2011 and have remained at a modest 5 %. ASEAN FDI flows to Thailand as a percentage of overall FDI became negative in 2011 and 2012. This shows that FDI from China to the Thailand remains attractive after signing 'PRC–Thailand Investment Agreement' in 2009.

PRC's exchange rate policy contains substantial intervention in the currency market to avert yuan's appreciation against the five major trading partners' currency

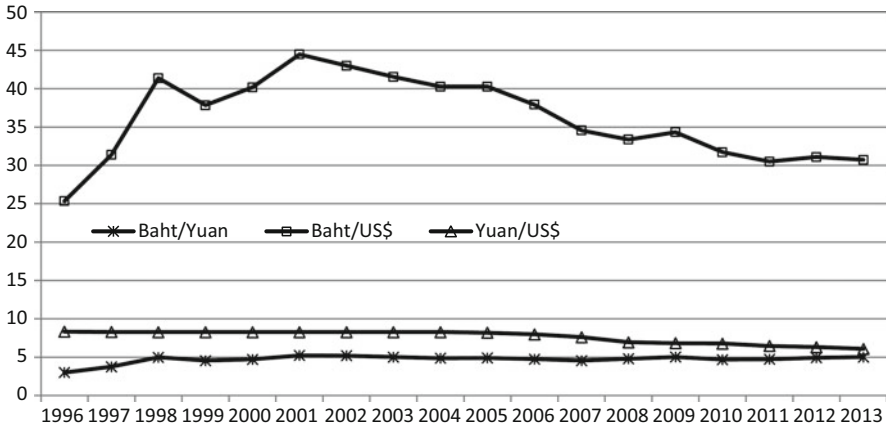

Fig. 4 Exchange rates. *Source*: Bank of Thailand (2014) and IMF (2014)

where Thailand involves with more managed floating regime. PRC's nominal currency rate relative to the US$ was smooth until 2005 (Fig. 4). In 2005, Chinese yuan was fixed with the basket of currencies (the euro, the US dollar, the Japanese yen and the Korean won) and allowed 2 % appreciation. The exchange rate band has remained 0.5 % above and below since mid-2007, when it was increased from 0.3 %. Thailand's nominal exchange rate relative to the Chinese yuan was also flat, while Thai baht against US dollar depreciates and appreciates after the Asian crisis. PRC's interventionist currency policy can encourage PRC's exports to Thailand but not imports. Thus, the Thai current account deficit hit US$10,488 million in 2013 which is −16 % of overall bilateral trade between Thailand and PRC.

The evidence shows that PRC's trade and investment relations with Thailand have remained robust after signing the CAFTA and a remarkable increase in trade and investment share since 2009. In recent years, more emphasis has been placed on trade in services, and with full opening there will be more service trade relationships.

3 Method of Estimating RCA

A nation which may generate or produce at lower relative cost than other nations can distribute more of its limited resources to the manufacture of that specific good.[4] In the wake of a progressively competitive international environment with accompanied liberalisation of trade and investment, it is appropriate to observe the

[4] Heckscher–Ohlin (H–O) model says that comparative advantage of a country lies on its relative factor scarcity. Balassa (1965) advocates that comparative advantage is revealed by observed trade patterns and reflects through pre-trade relative prices.

changing pattern of comparative advantage. Comparative advantages vary over-time. In this sense, it is dynamic. The estimates of changing pattern of comparative advantages are useful information for policy makers.

Balassa's (1965) measure of RCA is a widely known measure to capture the effect of factor supplies and technology on comparative advantage. This measure can be considered as a comprehensive one to pinpoint whether a country has an RCA rather than to decide the fundamental sources of comparative advantage. The index estimates normalised export shares, considering the same industry exports in a group of observed nations. The measure accommodates comparative advantage for a particular industry for the time period and number of countries and therefore allows comparison. Some research articles evaluate global level RCA (e.g. Vollrath 1991), and remaining others are at a sub-global/regional level or at bilateral trade between countries (e.g. Dimelis and Gatsios 1995; Balassa 1965).

The notion of RCA is well discussed in traditional trade theory. The RCA of a country is estimated by the comparative weight of a percentage of total exports of a particular industry in a country over the percentage of world exports in that industry and expressed as:

$$\text{RCA} = \frac{X_{ij}/X_{ig}}{X_{nj}/X_{ng}} = \frac{X_{ij}/X_{nj}}{X_{ig}/X_{ng}} \tag{1}$$

where X signifies exports, i reflects a nation, j reflects a industry, g shows a set of industries and n reveals a group of nations. It calculates a nation's exports of industries in relations to its overall exports and to the matching exports of a group of nations. If RCA > 1, a comparative advantage is shown; if RAC < 1, the nation is subject to a comparative disadvantage in that industry.

However, Greenaway and Milner (1993) argue that Balassa's RCA is biased due to the exclusion of imports. Based on this argument, another version of RCA can be derived by incorporating imports:

$$\text{RCA} = \frac{X_{ij}/X_{ig}}{M_{ij}/M_{ig}} = \frac{X_{ij}/M_{ij}}{X_{ig}/M_{ig}} \tag{2}$$

where X and M represent exports and imports, respectively, i represents a country, j represents a commodity and g represents a group of commodities (or industries). This RCA index can be measured either in global or bilateral levels.

Following the contributions of Balassa (1965) and Greenaway and Milner (1993), we will calculate the RCA index of PRC over Thailand [RCA_{ct}, Eq. (3)] and Thailand over PRC [RCA_{tc}, Eq. (4)]:

$$\text{RCA}_{ct} = \frac{X_{cjt}/X_{ct}}{M_{tjw}/M_{tw}} \tag{3}$$

$$\mathrm{RCA}_{tc} = \frac{X_{tjc}/X_{tc}}{M_{cjw}/M_{cw}} \tag{4}$$

where

X_{cjt} Total exports of jth commodity by China to Thailand
X_{ct} Total exports by China to Thailand
M_{tjw} Total imports of jth commodity of Thailand from world
M_{tw} Total imports of Thailand from world
X_{tjc} Total exports of jth commodity by Thailand to China
X_{tc} Total exports by Thailand to China
M_{cjw} Total imports of jth commodity of China from world
M_{cw} Total imports of China from world

Under the bilateral trade, if $\mathrm{RCA}_{ct} > \mathrm{RCA}_{tc}$, then China has advantage in that commodity in the market of Thailand; and if $\mathrm{RCA}_{ct} < \mathrm{RCA}_{tc}$, then China has disadvantage in that commodity in the market of Thailand.

In order to calculate the RCA of PRC with reference to Thailand, we use annual 2-digital SITC Revision 3 data covering PRC's exports and imports to Thailand and total imports from the world for the period 2000–2013 from the UN Comtrade database (2014).

4 Results

The aim is to explore the micro-level comparative advantages using RCA indices on exports at SITC-2 digit level between PRC and Thailand from the perspective of CAFTA in order to show that there is a catching up/diverging process between the two countries with the convergence towards a more competitive structure of RCA in exports. The analysis has been done by splitting the sample into 2000–2009 and 2010–2013 reflecting both the 'Investment' agreement in 2009 and subsequent increased in bilateral trade and investment. Presented is RCA of PRC with respect to Thailand. This is mainly to show that the shifting pattern of comparative advantage of PRC as PRC is the determining force as a big country.

Summary statistics (mean and coefficient of variation) are displayed in Table 1 (see Appendix Table 5 for annual detail). The industries for which China holds advantage reveal approximately the similar between the periods 2000–2009 and 2010–2013. In 2000–2009 China had advantage in 37 industries and in 2010–2013 in 39 industries. While 33 out of the 37 industries preserve their comparative advantage in 2010–2013, four industries drop their advantage: dairy products and birds' eggs (02), feeding stuff for animals (07), miscellaneous edible products (09) and chemical materials and products (59). Six new industries have gained comparative advantage in 2010–2013: pulp and waste paper (25); textile fibres and their wastes (26); metalliferous ores and metal scrap (28); cork and wood

Table 1 RCA of PRC with respect to Thailand (product group, 2000–2009 and 2010–2013)

		Mean		Coefficient of variation (%)	
		2000–2009	2010–2013	2000–2009	2010–2013
00	Live animals	−0.75	−0.18	−166	−32
01	Meat and meat preparations	0.18	0.02	208	51
02	Dairy products and bird's eggs	0.11	−0.01	181	−75
03	Fish crustaceans, molluscs	−1.06	−0.29	−147	−104
04	Cereals and cereal preparations	−8.95	−3.45	−36	−59
05	Vegetables and fruit	−8.89	−8.55	−28	−31
06	Sugars, sugar preparations and honey	−4.61	−1.20	−78	−391
07	Coffee, tea, cocoa, spices	0.10	0.68	777	17
08	Feeding stuff for animals	0.14	−0.68	536	−41
09	Miscellaneous edible products	0.12	−0.27	243	−139
11	Beverages	0.18	0.01	48	1105
12	Tobacco and tobacco manufactures	0.64	0.41	61	35
22	Oil seeds and oleaginous fruits	0.11	0.26	73	34
23	Crude rubber	−11.98	−14.13	−14	−18
24	Cork and wood	−1.54	−2.75	−23	−17
25	Pulp and waste paper	−0.33	0.02	−63	347
26	Textile fibres and their wastes	−0.25	0.08	−169	134
27	Crude fertilisers and crude minerals	1.96	1.59	31	6
28	Metalliferous ores and metal scrap	−0.03	0.09	−202	41
29	Crude animal and vegetable materials	2.05	2.18	30	12
33	Petroleum, petroleum products	−0.60	−0.44	−26	−40
34	Gas, natural and manufactured	n.a.	−0.16	n.a.	−67
41	Animal oils and fats	n.a.	n.a.	n.a.	n.a.
42	Fixed vegetable fats and oils	0.46	0.16	47	79
43	Animal or vegetable fats and oil, waxes	0.09	0.52	405	23
51	Organic chemicals	−0.04	−0.68	−1057	−63
52	Inorganic chemicals	3.84	2.84	25	6
53	Dyeing, tanning and colouring materials	0.91	0.44	13	35
54	Medicinal and pharmaceutical products	0.65	0.74	21	12
55	Essential oils, perfume materials, cosmetic	−0.19	−0.67	−107	−7
56	Fertilisers	1.00	0.82	38	33
57	Plastics in primary forms	−1.98	−2.02	−24	−17
58	Plastics in non-primary forms	0.22	0.72	135	29
59	Chemical materials and products	0.71	−0.11	35	−227

(continued)

Table 1 (continued)

		Mean		Coefficient of variation (%)	
		2000–2009	2010–2013	2000–2009	2010–2013
61	Leather and manufactures	−0.47	−1.50	−164	−13
62	Rubber manufactures	−3.83	−10.32	−43	−16
63	Cork and wood manufactures	−0.76	2.29	−129	38
64	Paper, paperboard and articles thereof	−0.32	0.70	−158	11
65	Textile yarn, fabrics, made-up articles	3.18	3.44	11	2
66	Nonmetallic mineral manufactures	−0.29	0.28	−117	187
67	Iron and steel	0.86	1.08	72	16
68	Non-ferrous metal	0.92	0.69	39	15
69	Manufactures of metals	0.44	0.55	22	16
71	Power-generating machinery and equipment	0.33	0.29	91	88
72	Machinery specialised for particular industries	0.93	1.29	27	12
73	Metalworking machinery	0.31	0.49	54	18
74	General industrial machinery and equipment	0.68	1.04	69	12
75	Office machinery and computers	−2.28	−4.40	−90	−13
76	Telecommunication, sound, TV, video	2.16	1.07	27	26
77	Electrical machinery, apparatus and appliances	−0.32	−0.01	−21	−1620
78	Road vehicles	0.43	0.64	43	21
79	Other transport equipment	0.46	0.30	147	72
81	Prefabricated buildings, sanitary, heating, lighting	5.10	4.46	22	50
82	Furniture and parts thereof, bedding, mattresses	2.79	9.19	105	29
83	Travel goods, handbags	2.50	3.91	19	13
84	Articles of apparel and clothing accessories	3.59	3.88	35	14
85	Footwear	3.70	6.92	30	23
87	Professional, scientific and controlling instruments	1.35	2.52	61	20
88	Photographic apparatus, equipment and supplies	0.22	0.27	226	21
89	Miscellaneous manufactured articles	0.72	0.76	29	61

Source: Authors' estimated using SITC Rev. 3 data (UN Comtrade Database, 2014)
Note: Revealed comparative advantages are shown if index is greater than 1

manufactures (63); paper, paperboard and articles thereof (64); and nonmetallic mineral manufactures (66). Four industries each gained or lost more than 10 ranks during this time as shown in Table 2.

Of the 10 greatest competitive sectors for PRC in 2000–2009, eight hold their advantage in 2010–2013 (Table 3). While industries like telecommunication, sound, TV, video (SITC-76) and crude fertilisers and crude minerals (SITC-27) fail to keep the top ten set, industries like professional, scientific and controlling instruments (SITC-87) and cork and wood manufactures (SITC-63) join as China's best competitive sectors in 2010–2013. Industries that revealed a loss of 10 or greater in their rank are chemical materials and products (from rank 19 to 43); dyeing, tanning and colouring materials (from rank 16 to 28); fixed vegetable fats and oils (from rank 23 to 35); and miscellaneous edible products (from rank 34 to 45). There are four industries which have shown an increase in their rank by 10 or more: animal or vegetable fats and oils move from 38 to 26; cork and wood manufactures from 50 to 10; paper, paperboard and articles thereof from 46 to 21; and nonmetallic mineral manufactures from 44 to 32 (Table 2).

Table 2 Inter-temporal shift of PRC's RCA in Thai market

Industries for which PRC holds advantage: 37 in 2000–2009, 39 in 2010–2013
Industries that have retained advantage: 33
Industries that have gained advantage: 6 (SITC Codes: 25, 26, 28, 63, 64 and 66)
Industries that cannot hold advantage: 4 (SITC Codes: 02, 07, 09 and 59)
Industries that have gained/lost more than 10 ranks
Industries that have gained: 4 (SITC Codes: 43, 63, 64 and 66)
Industries that have lost: 4 (SITC Codes: 09, 42, 53 and 59)

Note: SITC Codes details are as in Table 1

Table 3 PRC's top ten industries with a comparative advantage in Thai market

Rank	2000–2009	2010–2013
1	Prefabricated buildings, sanitary, heating, lighting (81)	Furniture and parts thereof, bedding, mattresses (82)
2	Inorganic chemicals (52)	Footwear (85)
3	Footwear (85)	Prefabricated buildings, sanitary, heating, lighting (81)
4	Articles of apparel and clothing accessories (84)	Travel goods, handbags (83)
5	Textile yarn, fabrics, made-up articles (65)	Articles of apparel and clothing accessories (84)
6	Furniture and parts thereof, bedding, mattresses (82)	Textile yarn, fabrics, made-up articles (65)
7	Travel goods, handbags (83)	Inorganic chemicals (52)
8	Telecommunication, sound, TV, video (76)	Professional, scientific and controlling instruments (87)
9	Crude animal and vegetable materials (29)	Cork and wood manufactures (63)
10	Crude fertilisers and crude minerals (27)	Crude animal and vegetable materials (29)

Note: SICT Codes in parentheses

Table 4 Stability of RCA

	Percentage share of product groups where			
2000–2009	RCA_{2000}	RCD_{2009}	RCD_{2000}	RCA_{2009}
	5.3	4.5	1.7	3.4
2010–2013	RCA_{2010}	RCD_{2013}	RCD_{2010}	RCA_{2013}
	3.3	2.1	10.6	11.4
2000–2013	RCA_{2000}	RCD_{2013}	RCD_{2000}	RCA_{2013}
	3.5	2.8	14.8	13.6

Source: Authors used SITC Rev. 3 data for calculations

5 Stability of RCA

Table 1 shows the mean and the coefficients of variation. The coefficients of variation which appeared in Table 1 advocate that the RCA is reasonably steady and stable over the periods 2000–2009 and 2010–2013, respectively. To examine this further, the relative importance of certain product group can be used as a simple indicator of stability (Hoekman and Djankov 1997; Fertö and Hubbard 2003; Utkulu and Seymen 2004). The set product group can indicate an RCA at time period t while a revealed comparative disadvantage (RCD) at time period $t+1$ or vice versa.

The set of products in which PRC ensures RCA in 2000 but turned to RCD in 2009 account for 5.3 % of the overall exports value to Thailand in 2000 and 4.5 % in 2009. A movement in the opposite ways occurred as follows, i.e. an RCD in 2000 but an RCA in 2009 accounted for 1.7 % in 2000 and 3.4 % in 2009 (Table 4). These results tend to give the assessment that the structure of PRC's RCA in Thailand market has not had substantial change during the period 2000–2009.

However, the set of product reveal slightly less stable pattern during the period 2010–2013. Even in those cases, China ensures an RCA in 2010, but an RCD in 2013 constitutes 3.3 % of the overall exports in 2010 and 2.1 % in 2013. The set of products for which there is a switch in opposite ways—an RCD in 2010 but an RCA in 2013—are more noticeable but only constitute 10.6 % in 2010 and 11.4 % in 2013 (Table 4). This would tend to support our argument that the structure of PRC's RCA in Thailand market has not changed radically from 2010 to 2013.

For the whole period 2000–2013, the test still supports that the structure of China's reveal comparative advantage in Thailand market does not change remarkably, although the product groups are slightly more prevalent.

6 Conclusions

Both PRC and Thailand experienced increased trade and investment after signing CAFTA. This paper intends to fill the research gap by finding the competitiveness and stability of PRC's exports to Thailand and vice versa. The findings of the competitiveness of PRC in relations to Thailand have been shown, based on the RCA, and computed for the period 2000–2013 splitting the sample into 2000–2009 and 2010–2013 reflecting both the 'Investment' agreement in 2009 and subsequent increase in bilateral trade and investment in the later period.

Our results show that China had an advantage in 39 industries in 2010–2013. While 33 out of the 37 industries preserve their comparative advantage in 2010–2013, four industries drop their advantage: dairy products and birds' eggs (02), feeding stuff for animals (07), miscellaneous edible products (09) and chemical materials and products (59). Six new industries have gained comparative advantage in 2010–2013: pulp and waste paper (25); textile fibres and their wastes (26); metalliferous ores and metal scrap (28); cork and wood manufactures (63); paper, paperboard and articles thereof (64); and nonmetallic mineral manufactures (66). This can be considered as shifting comparative advantage to Thailand. The structure of PRC's RCA in Thailand market has not changed remarkably during the whole period 2000–2013. Our findings of stability test confirm that results obtained are reasonably stable.

CAFTA is still in its infancy and can be considered as an 'unfinished agenda'. PRC's currency policy focuses more on its own economic stability, and this needs to be more flexible to enhance more trade integration. Our results on positive trade performances in the light of comparative advantages are an encouraging sign for further integration. PRC as a rising power will maintain stable, harmonious relations with its neighbouring countries including Thailand, and one would expect that PRC will commit deeper integration.

The RCA export performance indices are useful measure for policymakers if this is estimated over time to find the shift in comparative advantages. Our RCA export performance indices are purely calculated from observed trade data and are not accommodated potential effects of remaining government interventions and price distortions due to that. Factors like transport, storage, distribution, communication and quality are also not taken into account in this calculation. The above limitations will be taken into account in future studies.

CAFTA laid the foundation for initiating not only PRC and Thailand FTA but also wider RCEP agreement. Given that ASEAN-10 have the target of zero tariffs by 2018 (both 'Normal Track' and 'Sensitive Track'), negotiation should emphasise to reach a 'credible agreement' going beyond tariff reduction. The main stumbling block is that there are no FTAs among non-ASEAN partners to date, and this could delay credible negotiations. For example, China and India have no such pact regarding tariff reduction so far. Zero-tariff target of 2015 ('Normal Track') has not yet been met even among ASEAN-10. For example, Indonesia is still struggling to achieve a 65 % of around 10,000 tariff lines of goods target.[5] In the absence of proposed tariff reduction within the timeline, reaching 'credible agreement' on other issues may not happen soon. This provides some breathing space for ASEAN-10 to learn new knowledge to survive in a full-fledged wider RCEP in the future. In the interim, PRC–Thailand can also still use the bilateral FTA as a stepping stone to acquire new products with cost advantage and economies of scale to face the wider RCEP.

Appendix

[5] See Jakarta Post, March 09, 2015, for details (http://www.thejakartapost.com/news/2015/03/09/asia-pacific-strike-deal-year-end.html).

Table 5 Revealed comparative advantages of China with respect to Thailand, by-product group, 2000–2013

Code	Sector	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
00	Live animals	−7.26	−0.09	−0.18	−3.86	−0.13	−0.41	−1.42	−0.28	−0.17	−0.17	−0.19	−0.12	−0.15	−0.26
01	Meat and meat preparations	11.49	−0.58	−0.10	0.29	0.15	0.61	0.75	0.20	0.25	0.09	0.01	0.02	0.03	0.04
02	Dairy products and bird's eggs	0.04	0.00	0.00	0.02	0.01	0.05	0.02	0.59	0.27	0.02	0.00	−0.01	−0.01	−0.02
03	Fish crustaceans, molluscs	−1.31	−0.73	−0.11	−0.32	−0.53	−0.65	−0.60	−5.18	−0.82	−0.62	−0.74	−0.12	−0.19	−0.11
04	Cereals and cereal preparations	−6.05	−8.47	−7.63	−8.42	−4.75	−5.66	−13.28	−14.25	−10.30	−7.75	−5.55	−4.81	−1.38	−2.05
05	Vegetables and fruit	−3.29	−10.52	−9.20	−5.89	−12.30	−11.18	−10.23	−8.63	−5.00	−7.03	−6.99	−5.80	−9.84	−11.56
06	Sugars, sugar preparations and honey	−2.19	−11.96	−5.29	−5.60	−7.44	−3.13	−3.52	−3.60	0.24	−1.21	2.02	−1.01	−7.93	2.10
07	Coffee, tea, cocoa, spices	0.41	−0.26	−0.71	−0.96	−0.84	0.38	0.76	0.75	0.80	1.01	0.63	0.86	0.62	0.63
08	Feeding stuff for animals	1.16	1.04	1.06	0.52	0.45	−0.01	−0.41	−1.36	0.05	−0.08	−1.07	−0.47	−0.49	−0.69
09	Miscellaneous edible products	0.55	0.28	0.16	0.51	0.45	0.15	−0.04	−0.12	−0.40	0.06	−0.08	0.01	−0.19	−0.82
11	Beverages	0.16	0.29	0.35	0.13	0.18	0.15	0.17	0.12	0.14	0.09	0.11	0.08	0.09	−0.22
12	Tobacco and tobacco manufactures	−0.09	0.35	0.81	1.31	0.72	0.98	0.20	0.30	0.42	n.a.	0.51	n.a.	n.a.	0.31
22	Oil seeds and oleaginous fruits	0.06	0.03	0.03	0.06	0.05	0.08	0.16	0.15	0.15	0.28	0.39	0.19	0.22	0.26
23	Crude rubber	−15.50	−13.66	−14.14	−13.95	−12.83	−10.40	−10.14	−10.24	−12.12	−10.29	−11.01	−13.83	−14.40	−17.29
24	Cork and wood	−0.96	−1.04	−1.72	−1.65	−2.06	−1.68	−1.34	−1.22	−1.25	−1.94	−2.34	−2.33	−3.18	−3.14
25	Pulp and waste paper	−1.11	−0.79	−0.41	−0.44	−0.21	−0.17	−0.33	−0.38	−0.16	−0.11	−0.01	0.05	0.09	−0.06
26	Textile fibres and their wastes	0.77	−0.67	−0.46	0.48	−0.69	−0.68	−0.29	−0.09	0.10	0.09	0.04	−0.03	0.22	0.09
27	Crude fertilisers and crude minerals	2.77	3.34	2.16	1.97	1.81	1.76	1.85	2.00	1.75	1.03	1.52	1.55	1.53	1.74

(continued)

Table 5 (continued)

Code	Sector	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
28	Metalliferous ores and metal scrap	0.39	0.04	0.04	0.01	−0.03	−0.03	−0.06	−0.11	−0.12	0.00	0.07	0.10	0.05	0.13
29	Crude animal and vegetable materials	1.55	2.42	2.26	1.48	3.01	2.97	1.51	1.53	1.49	2.32	1.89	2.06	2.45	2.33
33	Petroleum, petroleum products	0.10	−0.42	−0.69	−0.86	−0.51	−0.47	−0.49	−0.72	−0.73	−0.48	−0.35	−0.25	−0.50	−0.66
34	Gas, natural and manufactured	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	−0.04	−0.23	−0.20
41	Animal oils and fats	0.00	0.06	0.00	0.01	−0.04	−0.07	0.00	−0.02	0.03	0.03	n.a.	n.a.	n.a.	n.a.
42	Fixed vegetable fats and oils	1.27	0.87	0.39	0.59	0.33	0.52	0.30	0.65	0.15	0.35	0.35	0.13	0.10	0.06
43	Animal or vegetable fats and oil, waxes	0.00	0.00	−0.37	−0.08	−0.10	−0.19	−0.03	0.44	0.64	0.39	0.36	0.53	0.65	0.53
51	Organic chemicals	0.43	0.64	0.11	−0.04	−0.02	−0.02	−0.90	−0.53	0.27	0.12	−0.17	−0.51	−0.90	−1.14
52	Inorganic chemicals	5.33	5.04	5.15	4.65	4.18	3.59	3.16	2.78	2.69	3.31	3.08	2.77	2.79	2.72
53	Dyeing, tanning and colouring materials	0.88	1.06	0.99	0.95	0.92	0.95	0.92	0.98	0.81	0.64	0.54	0.59	0.27	0.34
54	Medicinal and pharmaceutical products	1.05	0.91	0.79	0.57	0.53	0.50	0.59	0.56	0.71	0.73	0.76	0.85	0.67	0.67
55	Essential oils, perfume materials, cosmetic	−0.02	0.10	0.07	−0.24	−0.23	−0.13	−0.11	−0.22	−0.41	−0.53	−0.61	−0.68	−0.71	−0.68
56	Fertilisers	0.00	0.00	0.00	0.00	1.21	0.52	0.67	1.57	1.14	0.90	1.06	1.02	0.69	0.50
57	Plastics in primary forms	−2.60	−2.55	−2.62	−2.22	−2.23	−2.13	−1.88	−1.40	−1.52	−1.31	−1.62	−1.94	−2.08	−2.43
58	Plastics in non-primary forms	−0.40	0.05	−0.17	−0.16	−0.03	0.37	0.51	0.56	0.49	0.36	0.46	0.65	0.85	0.93
59	Chemical materials and products	0.49	0.95	0.86	0.94	0.64	0.81	0.77	0.63	0.59	0.16	−0.14	0.07	0.08	−0.47
61	Leather and manufactures	0.19	0.81	0.06	−0.30	−0.07	−0.26	−0.45	−0.88	−1.64	−1.47	−1.56	−1.30	−1.40	−1.73

62	Rubber manufactures	−2.20	−1.68	−2.19	−3.76	−3.94	−2.92	−4.88	−4.28	−5.58	−6.89	−8.67	−9.29	−10.89	−12.42
63	Cork and wood manufactures	−0.42	−1.78	−2.19	−1.91	−0.95	−1.13	0.34	0.57	0.04	−0.17	1.24	3.33	2.14	2.46
64	Paper, paperboard and articles thereof	−1.04	−0.85	−0.81	−0.52	−0.57	−0.35	0.22	0.27	0.02	0.37	0.61	0.69	0.72	0.80
65	Textile yarn, fabrics, made-up articles	3.21	3.26	2.69	3.18	2.67	3.03	3.14	3.25	3.54	3.84	3.51	3.51	3.36	3.40
66	Nonmetallic mineral manufactures	−0.39	−0.46	−0.89	−0.72	−0.43	−0.24	0.03	0.02	0.03	0.11	−0.11	−0.14	0.39	0.98
67	Iron and steel	0.73	0.19	0.03	0.01	1.43	1.44	1.67	1.05	1.30	0.71	0.86	1.21	1.23	1.03
68	Non-ferrous metal	0.41	0.55	0.57	1.20	1.49	1.30	1.01	0.96	1.05	0.68	0.67	0.55	0.74	0.79
69	Manufactures of metals	0.22	0.45	0.48	0.43	0.33	0.48	0.47	0.49	0.55	0.45	0.43	0.64	0.57	0.57
71	Power-generating machinery and equipment	0.31	0.08	−0.21	0.20	0.45	0.11	0.39	0.47	0.76	0.74	0.38	0.58	0.25	−0.04
72	Machinery specialised for particular industries	0.62	0.77	0.63	0.81	0.87	0.90	1.03	1.15	1.13	1.40	1.19	1.18	1.27	1.52
73	Metalworking machinery	0.18	0.16	0.21	0.28	0.15	0.24	0.30	0.45	0.55	0.63	0.53	0.47	0.38	0.58
74	General industrial machinery and equipment	−0.21	0.16	0.49	0.50	0.56	0.76	1.06	1.19	1.19	1.05	1.08	1.19	0.91	0.98
75	Office machinery and automatic data-processing machines	−0.66	−0.28	−0.14	−0.73	−1.64	−1.95	−2.35	−4.02	−5.73	−5.32	−4.31	−4.93	−4.73	−3.62
76	Telecommunication, sound, TV, video	1.68	2.65	2.77	2.28	1.90	2.26	2.69	2.56	1.98	0.87	0.66	1.14	1.17	1.32
77	Electrical machinery, apparatus and appliances	−0.47	−0.39	−0.29	−0.26	−0.30	−0.34	−0.29	−0.33	−0.27	−0.25	−0.29	−0.10	0.15	0.19
78	Road vehicles	0.29	0.26	0.25	0.37	0.18	0.48	0.56	0.62	0.74	0.58	0.48	0.66	0.63	0.81
79	Other transport equipment	2.08	0.43	1.13	0.01	0.02	0.04	0.03	0.10	0.20	0.54	0.60	0.14	0.31	0.15

(continued)

Table 5 (continued)

Code	Sector	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
81	Prefabricated buildings, sanitary, heating, lighting	7.22	6.31	5.13	4.23	4.68	5.76	3.89	3.55	5.27	4.98	3.28	2.96	3.84	7.78
82	Furniture and parts thereof, bedding, mattresses	0.56	0.47	1.01	1.60	1.65	1.86	2.00	3.65	4.89	10.20	22.61	9.67	6.24	8.23
83	Travel goods, handbags	2.48	2.24	2.37	3.11	2.53	2.07	2.10	1.97	3.39	2.76	3.17	4.29	4.08	4.11
84	Articles of apparel and clothing accessories	5.55	3.69	3.99	4.23	2.01	2.18	2.12	3.59	5.24	3.32	3.66	3.61	3.56	4.69
85	Footwear	4.31	4.84	4.87	4.40	2.54	1.90	2.56	3.26	3.56	4.74	6.78	5.84	5.83	9.24
87	Professional, scientific and controlling instruments	0.41	0.48	0.78	1.55	0.96	1.05	1.45	1.35	2.54	2.92	2.71	3.04	2.46	1.87
88	Photographic apparatus, equipment and supplies	0.88	1.14	0.47	−0.02	−0.34	0.02	−0.12	−0.26	0.00	0.43	0.23	0.25	0.25	0.36
89	Miscellaneous manufactured articles	0.55	0.62	0.42	0.50	0.64	0.74	0.86	1.04	0.89	0.94	0.90	0.98	1.09	0.08

Source: Authors' calculation based on SITC Rev. 3 data (UN Comtrade Database, 2014)
Note: Revealed comparative advantages are shown if index is greater than 1

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Is Urban Food Demand in the Philippines Different from China?

Tomoki Fujii

1 Introduction

Food is an essential good, and thus understanding its demand is important for the formulation of sound agricultural policies and developing sustainable agricultural business. A timely analysis of food demand is important because it can change over time not only because prices and incomes change but also because people's taste itself also change. However, even in countries where food accounts for a sizable share of expenditure or where the agricultural sector accounts for a large share of output, careful analysis of food demand is often not readily available.

In this study, we analyze the food demand in urban Philippines and compare it to the one in China. This comparison is interesting for two reasons. First, there are some similarities between Filipino and Chinese food cultures. This is not surprising, because Filipino cuisine has been significantly influenced by Chinese cuisine. The similarities are particularly pronounced in lower- and middle-class cuisine because the Chinese first came as traders, settlers, and merchants. For example, dishes like noodles, certain sausages, vegetables wrapped in a thin rice wrapper, and meat encased in dough come from the Chinese cuisine and have been widely absorbed in the Filipino cuisine and cooked in homes and eateries (see Fernandez 1986).

Second, the economic growth in China has been much faster than the Philippines in recent years. For example, according to the World Development Indicators published by the World Bank, China's GDP per capita in constant 2011 international dollars is $1554 in 1990 and $9230 in 2010. The corresponding figures for the Philippines are $4010 in 1990 and $5613 in 2010. Therefore, we may expect to see more pronounced changes in China than in the Philippines over the last two decades or so.

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There are, however, two important limitations to this argument. First, the Filipino food culture has also been heavily influenced by the Spanish food culture, but this is not applicable to the Chinese food culture. Therefore, the westernization of food culture has started much earlier in the Philippines. Second, the food culture in China is very diverse in itself. For historical reasons, the Chinese influence did not uniformly come from China. Most notable influences come from southern China, particularly around the current Fujian province. Despite these limitations, the structural changes in food demand China has experienced tell us some directions in which the structural changes in food demand are likely to take place in the Philippines. This is particularly true, if the Philippines were to catch up with China in GDP per capita in the future.

We analyze the food demand by estimating the Quadratic Almost Ideal Demand System (QUAIDS) proposed by Banks et al. (1997) with various rounds of the Family Income Expenditure Survey (FIES) using a variant of the iterated linear least-squares estimator developed by Blundell and Robin (1999). Besides the obvious empirical contributions, we improve on the existing method by estimating the QUAIDS for a relatively large number of goods in a reasonably efficient manner by using the conditional linearity of the estimation equations, by taking advantage of the variance–covariance matrix of the unobserved error term, and by directly imposing the restrictions on the parameters required by economic theory.

This paper is organized as follows. We first review relevant existing studies on food demand in the Philippines and China in the next section. In Sect. 3, we present the methodology used in this study. In Sect. 4, we describe the data followed by the results in Sect. 5. Section 6 offers some discussion including some policy and business implications.

2 Review of Existing Studies

To facilitate the discussion later, we provide a review of some of the important studies on food demand in China and the Philippines in this section.

2.1 China

There are an increasing number of studies on food demand in China, especially in urban China in recent years. This is not surprising because the changes in the food demand structure in China affect not only the food market in China but also the rest of the world. Here, we discuss a few studies that are most closely related to ours.

The study by Gould and Villarreal (2006) is one of the recent studies that adopt the QUAIDS. They use it to analyze the structure of food demand in four urban provinces in China. According to their estimates, beef, poultry, and grains other than rice are among the food categories with relatively high uncompensated

own-price elasticities. For most food items, the differences in expenditure elasticities and uncompensated own-price elasticities across different income groups were small. They also examined the importance of food at home and food away from home and found that the latter tends to increase with the household's income level.

Zheng and Henneberry (2010) estimate food demand only in the urban Jiangsu province. They find that there is no obvious difference in own-price elasticity across different income groups and that the income elasticity tends to be lower for wealthier households. Based on these estimates, they project the future food demand. They emphasize the importance of income distribution in demand projection as more equal distribution would imply higher food demand even when the average income remains the same. In a separate study, Zheng and Henneberry (2011) argue that the researchers should use the demand parameter that pertains to the relevant income group for the appropriate design of policies and marketing strategies for the population group of interest, because the constant elasticities of food demand among income groups are not supported in the urban Jiangsu province. These studies highlight the potential importance of addressing the heterogeneous elasticities across different income groups.

Another study that is closely related to ours is Dong and Fuller (2010). Using the Almost Ideal Demand System (AIDS) developed by Deaton and Muellbauer (1980), they analyze the shift in consumer demand in urban China between 1981 and 2004 with aggregate data. They find that changes in grain consumption can be largely explained by normal price and income effects. On the other hand, they find some evidence for structural change in the demand of meat, vegetables, fruits, and fish, which played a less important role in daily food consumption in traditional Chinese diets.

Similarly, Hovhannisyan and Gould (2014) use provincial-level data in urban China and test the structural change in food demand between 2002 and 2010. They find evidence that urban Chinese diet preferences have changed in their study period. Namely, they find that the magnitudes of uncompensated own-price elasticities in the seven food categories (meat, seafood, vegetables, fruits, grain, eggs, and fats) they used have decreased with an exception of eggs. These decreases are most apparent in the demand of fruits and meats, which points to their rising importance in the urban Chinese food diet.

Hovhannisyan and Gould (2011) also analyze the structural change in demand using household-level expenditure surveys for 1995 and 2003. Based on an independent test of equality, they find that uncompensated own-price elasticity has changed statistically significantly for all goods, except for beef and poultry, and became less elastic for seafood, vegetables, fruits, rice, and dairy products in their study period. Our approach is similar to Hovhannisyan and Gould (2011) in the sense that we use household-level data and a similar test for the presence of structural change.

The empirical evidence from these studies provides at least three important implications for our study. First, controlling for demographic characteristics of the household is potentially important. While this is not surprising, it is important in practice. Second, both price and budget elasticities, especially the latter, appear to

depend on whether the household is rich or poor to some extent. Therefore, we provide disaggregate results by the expenditure quintile. Third, while the estimated elasticities vary substantially across studies and their direct comparisons are difficult because of the differences in the geographic coverage, study periods, and methodologies used, they tend to find lower budget elasticities over time for most food items. On the other hand, the changes in price elasticities appear to be heterogeneous across food items. We will subsequently verify that this is also the case in the Philippines.

2.2 Philippines

There have been several studies on food demand in the Philippines to date. One of the earliest studies based on household surveys is Quisumbing et al. (1988). They use two household surveys conducted by the Food and Nutrition Research Institute in 1978 and 1982 to estimate food subsystem and the cross-tabulations taken from four rounds of FIES in 1961, 1965, 1971, and 1975 to estimate a translog expenditure system for five groups of goods.

Bouis (1990) proposes a demand system based upon a utility function that is additive in bulk, variety, and tastes of individual goods and applies it to the Philippines. His estimates show that meat tends to have high own-price elasticity and income elasticity whereas corn is estimated to have a negative income elasticity both in urban and rural areas. Similarly, Bouis et al. (1992) show that both caloric intake (computed from 24-h recall survey) and caloric availability (computed from food expenditure survey) tend to be higher for richer households for most food items, but this is not the case for corn.

Balisacan (1994) reviews earlier studies on food demand in the Philippines and estimates the AIDS using three rounds of the FIES data in 1985, 1988, and 1991. He finds that food items are generally income inelastic. In particular, rice, the major staple, has an income elasticity of 0.08. On the other hand, corn has a negative income elasticity, a pattern that is consistent with abovementioned studies.

A more recent estimate is provided by Mutuc et al. (2007). They use FIES data for year 2000 to estimate a QUAIDS with a detailed disaggregation of vegetables. They find significant difference between the expenditure elasticities of urban and rural households, whereas they did not find statistical difference between urban and rural households in own- and cross-price elasticities.

Our study is different from these earlier studies in several respects. First, many of the studies mentioned above, including those in China, either (1) assume separability between food and non-food items or (2) highly aggregate non-food items. However, the separability assumption is not a harmless assumption because the total budget for the food may be endogenous. Aggregation of non-food items may appear more innocuous, but the aggregability requires some (strong) assumptions on the utility function. When we lump a variety of non-food goods together, the

aggregability is less likely to hold even as an approximation. We avoid this issue by directly estimating a demand system with a relatively large number of goods.

Second, unlike the studies mentioned above, we use more recent rounds of FIES data. Therefore, our results provide an update on the elasticity estimates. Finally, we estimate elasticities over a long study period using a consistent methodology. This allows us to understand the changes in the structure of food demand. As far as we are aware, no study has investigated the changes in food demand structure in the Philippines using recent data.

3 Methodology

We estimate the demand system using the Quadratic Almost Ideal Demand System (QUAIDS) proposed by Banks et al. (1997), which has become a standard model of the analysis of demand systems. The QUAIDS model nests the AIDS model and retains its attraction of exact aggregability. The QUAIDS model has additional flexibility due to the quadratic logarithmic income term. As a result, some goods may be necessities at some income levels or luxuries at others in the QUAIDS model.

Both the AIDS and QUAIDS model can be in principle estimated by the standard estimation methods such as the maximum likelihood estimation (MLE). As is well known, the computational cost of MLE substantially increases as the number of parameters to be estimated goes up. Furthermore, the non-convergence issue is more likely to occur when the parameter space is high dimensional. These issues can be very serious, when the number of goods in the demand system is just moderately large, because the number of parameters to be estimated can inflate quickly. For example, without any additional regressors, the number of parameters to be estimated in the standard QUAIDS model is only 22, 72, and 247 when the number of goods in the system is 5, 10, and 20, respectively.

Therefore, applied researchers interested in the demand system of a particular set of disaggregate goods tended to deal with this issue (1) by focusing on a subset of the goods assuming some form of separability or (2) by aggregating the goods that are not of their main interest. The first approach is problematic when separability does not hold. The second approach is also problematic when the goods are not aggregable.

Blundell and Robin (1999) address this problem by estimating a large demand system without numerical maximization in the following manner: because QUAIDS model is conditionally linear, we can estimate the parameter by an ordinary least-squares (OLS) regression of the expenditure shares, taking some price indices as given. Then, these price indices are "updated" with the estimated coefficients. Using the updated price indices, we run an OLS regression again. This iteration continues until convergence is attained. The iterated linear least-squares (ILLS) estimator thus obtained is straightforward to implement and runs fast enough for practically large models as demonstrated by Blundell and Robin

(1999). In this study, we use a modified version of this estimator, which we refer to as the iterated generalized linear least-squares (IGLLS) estimation. As the name suggests, we run a (feasible) generalized least-squares (GLS) regression instead of an OLS regression in each iteration.

Our method runs comparably fast and yields more accurate estimates for two reasons. First, we impose the symmetry of the Slutsky matrix in the iterated regressions. This contrasts with the minimum chi-square estimator developed by Ferguson (1958), which is used to impose constraints after an unconstrained estimator is obtained. While the minimum chi-square estimator is asymptotically as efficient as the MLE under some restrictive assumptions (Rothenberg 1973), it is not generally so in a finite sample. This issue may be particularly severe when the variance–covariance matrix of the unrestricted estimator is not reliable. Second, we use the variance–covariance matrix of the residuals in the iterative procedure, so that the weights used in the regression are asymptotically optimal.

In this section, we first develop the IGLLS estimator. Because this is a straightforward extension of the ILLS estimator and their derivations are very similar, we shall keep this discussion short. We then discuss how the IGLLS estimator is used to estimate the QUAIDS.

3.1 *Definition and Asymptotic Properties of the IGLLS Estimator*

Let x_h and u_h be a real column M-vector of control variables and a real column K-vector of random error terms, respectively, for household $h \in \{1, \ldots, H\}$. We assume that the pair x_h, u_h is independently and identically distributed and that $E\left[u_h \middle| x_h\right] = \mathbf{0}_K$ holds for all h, where $\mathbf{0}_K$ is a column K-vector of zeros. The outcome variables of interest are a real column K-vector y_h, where y_h satisfies $y_h = g(x_h, \theta_0)$ $\theta_0 + u_h$ for some true parameter value $\theta_0 \in \Theta$ contained in the parameter set Θ, which is an open and convex set on $\mathbf{R}^D$. We further assume that $g : \mathbf{R}^M \times \Theta \rightarrow \mathbf{R}^{K \times D}$ is a twice continuously differentiable function with respect to $\theta\left(= \left[\theta^1, \ldots, \theta^D\right]^T\right)$, where we use a superscript to denote each vector component except that T is used as a transpose operator.

For the simplicity of notation, we define a few additional notations. First, we denote the non-singular finite weighting matrix by $W(\theta) \equiv E^{-1}$ $\left[(y_h - g(x_h, \theta)\theta)(y_h - g(x_h, \theta)\theta)^T\right]$ and also define $W_0 \equiv W(\theta_0) = E^{-1}\left[u_h u_h^T\right]$. Second, we use capital letters to denote stacked observations such that we have Y $\equiv \left[y_1^T, \ldots, y_H^T\right]^T$ and $U \equiv \left[u_1^T, \ldots, u_H^T\right]^T$. Finally, with a slight abuse of notation, we also define $G(\theta) \equiv \left[g^T(x_1, \theta), \ldots, g^T(x_H, \theta)\right]^T$. By definition, we have the following relationship:

$$Y = G(\theta_0)\theta_0 + U. \tag{1}$$

Notice that Eq. (1) is a standard linear equation once $G(\theta_0)$ is taken as given. The basic idea of the ILLS estimator is essentially built on this idea. That is, if we have an estimate $\hat{\theta}^{(p)}$ of θ in the pth iteration, then we can "update" the estimator by running the ordinary least-squares (OLS) estimation. However, this estimation is bound to be inefficient when u_h is correlated across h. This is indeed likely in the estimation of demand system because the error terms across goods are likely. Hence, instead of running OLS, we run a feasible generalized least-squares (FGLS) regression in each iteration to obtain a more efficient estimate.

To do so, we first estimate the weighting matrix $\hat{W}\left(\hat{\theta}^{(p)}\right)$ given $\hat{\theta}^{(p)}$ by the following equation:

$$\hat{W}\left(\hat{\theta}^{(p)}\right) \equiv \left[\frac{1}{H-1}\sum_{h}\left(y_h - g\left(x_h,\hat{\theta}^{(p)}\right)\hat{\theta}^{(p)}\right)\left(y_h - g\left(x_h,\hat{\theta}^{(p)}\right)\hat{\theta}^{(p)}\right)^T\right]^{-1}. \tag{2}$$

Then, we run an FGLS regression conditional on $G\left(\hat{\theta}^{(p)}\right)$ in Eq. (1) using $\hat{W}\left(\hat{\theta}^{(p)}\right)$ in Eq. (2) as a weighting matrix to obtain a new (updated) estimator in the following manner:

$$\hat{\theta}^{(p+1)} = \left[G^T\left(\hat{\theta}^{(p)}\right)\left(I_H \otimes \hat{W}\left(\hat{\theta}^{(p)}\right)\right)G\left(\hat{\theta}^{(p)}\right)\right]^{-1}\left[G^T\left(\hat{\theta}^{(p)}\right)\left(I_H \otimes \hat{W}\left(\hat{\theta}^{(p)}\right)\right)Y\right], \tag{3}$$

where I_H is an $H \times H$-identity matrix and $\otimes$ is the Kronecker-product operator.

Therefore, once we have an initial estimate $\hat{\theta}^{(0)}$, we obtain a sequence of estimates $\hat{\theta}^{(0)},\hat{\theta}^{(1)},\hat{\theta}^{(2)}, \ldots$ by continuing the iteration. We obtain our iterated generalized linear least squares (IGLLS) as a limit of this sequence. Notice that the only difference between the IGLLS and ILLS is the presence of weighting. Therefore, if we use I_K instead of $\hat{W}\left(\hat{\theta}^{(p)}\right)$ in Eq. (3), we obtain the ILLS estimator.

Because IGLLS is taken as a limit of the sequence, the IGLLS estimator $\hat{\theta}$ satisfies the following equation by construction:

$$\hat{\theta} = \left[G^T\left(\hat{\theta}\right)\left(I_H \otimes \hat{W}\left(\hat{\theta}\right)\right)G\left(\hat{\theta}\right)\right]^{-1}\left[G^T\left(\hat{\theta}\right)\left(I_H \otimes \hat{W}\left(\hat{\theta}\right)\right)Y\right]. \tag{4}$$

It can be shown that $\hat{\theta}$ is a consistent estimator of θ_0 and asymptotically normally distributed under suitable regularity conditions as shown in the following theorem:

Theorem 1 *Let* $\mathbf{e}_d$ *be a row* D*-vector whose dth component is one and all the other components are zero and define the following quantity:*

$$h(x_h, \theta_0) \equiv \sum_d \frac{\partial g(x_h, \theta_0)}{\partial \theta^d} \theta_0 \mathbf{e}_d,$$

whose dth column vector is the partial derivative of g with respect to the dth component of θ *multiplied by* θ_0*. Further define*

$$M_0 \equiv E\left[g^T(x_h, \theta_0) W_0 g(x_h, \theta_0)\right] \text{ and } Q_0 \equiv M_0 + E\left[g^T(x_h, \theta_0) W_0 h(x_h, \theta_0)\right].$$

Then, under suitable regularity conditions, $\hat{\theta}$ *given in* Eq. (4) *satisfies*

$$\hat{\theta} \xrightarrow{a.s.} \theta_0 \text{ and } \sqrt{H}\left(\hat{\theta} - \theta\right) \xrightarrow{d} N\left(0, Q_0^{-1} M_0 Q_0^{-T}\right).$$

The asymptotic variance can be estimated by replacing θ_0 with its estimate $\hat{\theta}$ in Q_0 and M_0 above.

3.2 Application of the IGLLS Estimator to the QUAIDS

We now apply the IGLLS estimator to the QUAIDS. Suppose that there are N goods in the economy, and denote the column N-vector of the logarithmic prices by $p \equiv [p^1, \ldots, p^N]^T$. We let the logarithmic expenditure be m. The QUAIDS proposed by Banks et al. (1997) follows from the following indirect utility function:

$$\ln v(m, p) = \left(\left[\frac{m - a(p)}{b(p)} \right]^{-1} + c(p) \right)^{-1}, \tag{5}$$

which is an extension of the price-independent generalized logarithmic (PIGLOG) indirect utility function used by Muellbauer (1976) and satisfies exact aggregability. The price indices $a(p)$, $b(p)$, and $c(p)$ are defined in the following manner:

$$a(p) \equiv a_0 + \alpha^T p + \tfrac{1}{2} p^T \Gamma p, b(p) \equiv \exp\left(\beta^T p\right), \text{and } c(p) \equiv \lambda^T p,$$

where $\alpha = (\alpha^1, \ldots, \alpha^N)^T$, $\beta = \left(\beta^1, \ldots, \beta^N\right)^T$, $\lambda = \left(\lambda^1, \ldots, \lambda^N\right)^T$, and $\Gamma = \left(\gamma^{n_1, n_2}\right)_{1 \le n_1, n_2 \le N}$. We set a_0 to be the observed minimum value of m following Deaton and Muellbauer (1980) and Banks et al. (1997). Applying these definitions and Roy's identity in Eq. (5), we have the following column N-vector of expenditure share functions $w = (w^1, \ldots, w^N)^T$:

$$w = \alpha + \beta(m - a(p)) + \frac{\lambda}{b(p)} (m - a(p))^2 + \Gamma p. \tag{6}$$

Because the expenditure shares add up to one when summed across all the goods,

w has to satisfy $w^T \mathbf{1}_N = 1$ for all p, where $\mathbf{1}_N$ is column N-vectors of ones. Therefore, this adding-up constraint requires the following restrictions on α, β, λ, and Γ:

$$\alpha^T 1_N = 1, \beta^T 1_N = \lambda^T 1_N = 0, \text{ and } \Gamma^T 1_N = 0_N.$$

Since all of these constraints are linear in the parameters, we can impose the constraints simply by eliminating the redundant parameters from the equations. That is, we can rewrite the adding-up constraints as follows:

$$\alpha^N = 1 - \sum_{n=1}^{N-1} \alpha^n, \beta^N = -\sum_{n=1}^{N-1} \beta^n, \lambda^N = -\sum_{n=1}^{N-1} \lambda^n, \text{ and } \gamma^{N,n} = -\sum_{m=1}^{N-1} \gamma^{m,n} \quad \text{for } n \in \{1, \ldots, N\}.$$

With these constraints, the Nth equation in Eq. (6) is trivially satisfied. Thus, we can simply drop the Nth equation to arrive at a system of $K(=N-1)$ estimation equations. Furthermore, note that symmetry of the Slutsky matrix requires $\Gamma = \Gamma^T$. Therefore, together with the adding-up constraint, we must have

$$\gamma^{n,N} = -\sum_{m=1}^{N-1} \gamma^{n,m} \text{ for } n \in \{1, \ldots, N\}.$$

Using this, we can rewrite the system of equations in Eq. (6) with the Nth component dropped. To this end, we denote w, α, β, λ, and γ with their Nth component dropped by $\widetilde{w}$, $\widetilde{\alpha}$, $\widetilde{\beta}$, $\widetilde{\lambda}$, and $\widetilde{\gamma}$. Similarly, we denote Γ with its last row and column dropped by $\widetilde{\Gamma}$. We further define $\widetilde{p}$ to be a K-vector of (normalized) prices, whose kth element is $p^k - p^N$, and also define $\widetilde{a}_0 \equiv a_0 + p^N$. Then, we can rewrite the system of estimation equations as follows:

$$\widetilde{w} = \widetilde{\alpha} + \widetilde{\beta}(m - \widetilde{a}(\widetilde{p})) + \frac{\widetilde{\lambda}}{\widetilde{b}(\widetilde{p})}(m - \widetilde{a}(\widetilde{p}))^2 + \widetilde{\Gamma}\widetilde{p},$$

where $\widetilde{a}(\widetilde{p})$ and $\widetilde{b}(\widetilde{p})$ are defined as follows:

$$\widetilde{a}(\widetilde{p}) \equiv \widetilde{a}_0 + \widetilde{\alpha}^T \widetilde{p} + \frac{1}{2}\widetilde{p}^T \widetilde{\Gamma} \widetilde{p} \text{ and } \widetilde{b}(\widetilde{p}) \equiv \exp\left(\widetilde{\beta}^T \widetilde{p}\right).$$

The symmetry constraint for the estimation of QUAIDS models is often not imposed when running regressions, as is the case with Blundell and Robin (1999), but by the minimum chi-square distance estimator. As Blundell (1988) and Browning and Meghir (1991) argue, this approach has an advantage that the resulting chi-squared statistic can be used to test the symmetry. However, the minimum

chi-square distance estimator requires accurate estimation of the variance–covariance matrix of the unrestricted estimator. This can be problematic in a finite sample when the number of goods in the economy is large. This is an important issue especially because the strength of the ILLS estimator is in its ability to estimate large demand systems.

Therefore, we directly impose the symmetry constraint by suitably transforming the problem. We note that the symmetry and adding-up constraints imply that there are $L \equiv K(K+1)/2$ free parameters in Γ. With a slight abuse of notation, we write these free parameters by $\gamma^l = \gamma^{k_1,k_2} \left(= \gamma^{k_2,k_1}\right)$ for $l = (k_1 - 1)k_1/2 + k_2$ with $1 \leq k_1 \leq k_2 \leq K$. It is also convenient to define the mapping from l to the corresponding pair of indices. That is, we have $\gamma^l = \gamma^{i_1(l),i_2(l)}$ for all l by defining

$$i_1(l) = \max_{i \in \mathbf{N}} \left\{ i \middle| \frac{(i-1)i}{2} < l \right\} \text{ and } i_2(l) = l - \frac{\left(i_1(l) - 1\right) i_1(l)}{2}.$$

To apply the IGLLS estimator in the estimation of a QUAIDS, it is useful to define a few matrices. Let us define

$$A_h^1 \equiv (m_h - \widetilde{a}(\widetilde{p}_h)) I_K \text{ and } A_h^2 \equiv \frac{(m_h - \widetilde{a}(\widetilde{p}_h))^2}{\widetilde{b}(\widetilde{p}_h)} I_K,$$

where I_K is a $K \times K$-identity matrix and the subscript h denotes a household. Furthermore, let us define a $K \times L$-matrix A_h^3, whose (k, l) element is $k = i_2(l)$ if $k = i_2(l)$, $\widetilde{p}_h^{i_2(l)}$ if $k = i_1(l)$, and zero otherwise. Using these notations, we can write the system of estimation equations as follows:

$$\widetilde{w}_h = g(x_h, \theta)\theta + u_h$$

where the set of parameters to estimate is $\theta = \left[\alpha^1, \ldots, \alpha^K, \beta^1, \ldots, \beta^K, \gamma^1, \ldots, \gamma^L\right]^T$, the observable characteristics are $x_h = (m_h, \widetilde{p}_h)$, and $g(x_h, \theta) = \left[I_K, A_h^1, A_h^2, A_h^3\right]$. Note that θ is unconstrained, because both the adding-up and symmetry constraints have already been internalized.

So far, we have ignored the potential heterogeneity in demand across different households with different demographic groups. To address this issue, we also include a few demographic variables such as the household size, the gender of the household head, and the educational attainment of the household head using the method adopted by Abdulai (2002), which adjusts the intercept term a_0 by the demographic characteristics of the household.

To estimate the variance–covariance matrix for the IGLLS estimator, it is necessary to find $h(x_h, \theta)$ defined in Theorem 1. To this end, we define π to be an L-vector of quadratic logarithmic prices whose ι-th element is $p^{i_1(l)} p^{i_2(l)}$ if $i_1(l) = i_2(l)$ and $2\, p^{i_1(l)} p^{i_2(l)}$ if $i_1(l) \neq i_2(l)$. Using this, it can be shown that $h(x_h, \theta)$ can be

written as $h(x_h, \theta) = \left[B_h^1, B_h^2, O_K, B_h^3\right]$, where O_K is a $K \times K$-matrix of zeros and B_h^1, B_h^2, and B_h^3 are defined as follows:

$$B_h^1 = -\left(\widetilde{\beta} + \frac{2(m-a)}{b}\widetilde{\lambda}\right)\widetilde{p}^T, B_h^2 = -\frac{(m-a)^2}{b}\widetilde{\lambda}\widetilde{p}^T, \text{and } B_h^3 = -\left(\frac{\widetilde{\beta}}{2} + \frac{(m-a)}{b}\widetilde{\lambda}\right)\pi^T.$$

It is convenient to present the results in terms of the elasticity. The budget elasticities ξ_h^k and uncompensated price elasticities $\rho_h^{k_1,k_2}$ for household h are given by the equations

$$\begin{cases} \xi_h^k = \dfrac{1}{w_h^k}\left(\beta^k + \dfrac{2\lambda^k(m_h - a(p_h))}{b(p_h)}\right) + 1 \\ \rho_h^{k_1,k_2} = \dfrac{1}{w_h^k}\left(\gamma^{k_1,k_2} - \dfrac{\lambda^{k_1}\beta^{k_2}(m_h - a(p_h))^2}{b(p_h)}\right) - \left(\xi^{k_1} - 1\right)\left(\alpha^{k_2} + \sum_n \gamma^{k_2,n} p^n\right) - \delta_{k_1 k_2}, \end{cases} \tag{7}$$

where $\delta_{k_1 k_2}$ is the Kronecker delta. We aggregate the elasticities found in this way by taking the weighted average with the weights being equal to the household's share of the total sample expenditure for the good of interest.

4 Data

For our empirical application, we combine FIES data with the annual Consumer Price Index (CPI) data, both of which are collected by the National Statistics Office (NSO) of the Philippines. The FIES contains detailed questions on consumption and expenditure as well as some other characteristics of the household. We focus on urban single-family households headed by a married working-age person with at least one child and no more than seven children to have reasonably homogeneous household composition. We use six rounds of the FIES data in 1998, 1991, 1994, 2000, 2003, and 2006 for this study, which contain 4584, 7577, 7262, 10270, 8652, and 7289 households, respectively.

The CPI data are based in year 2000 and available at the provincial level or lower for an overwhelming majority of the FIES households.[1] For a small fraction of FIES households where the CPI data are not available at the provincial level, we use the

[1] There are about 80 provinces in the Philippines during the study period, though the definitions of provinces change slightly over time. We use the finest geographic disaggregation that is possible in the data.

regional CPI data for the survey year. To use the differences in the price changes across provinces over time, we divide the data into pre-1997 period (i.e., 1988, 1991, and 1994) and post-1997 period (i.e., 2000, 2003, and 2006).

In this study, we only take the urban sample in the FIES data set. This choice is driven by two considerations. First, the CPI data are mainly collected in urban areas. Therefore, CPI may not capture very well the actual price system that rural households face. Second, most studies on food demand in China we are aware of are focused on urban areas. Therefore, to facilitate the cross-country comparisons between China and the Philippines, it is sensible to use only the urban data.

Because the definition of goods between the FIES and CPI are not the same, we have aggregated both data across goods so that the definitions of goods in the two data sets match.[2] As a result of this aggregation, we have the price and expenditure share for each household and for each of the 19 items of goods (expenditure categories), which include seven food items and 12 non-food items. Table 1 shows the definition of the 19 expenditure categories as well as their expenditure share in 1988 and 2006 disaggregated by the per capita expenditure quintile of the household, where Q1 represents the top (richest) quintile and Q5 the bottom (poorest) quintile. The reported figure in each cell is calculated as the average share for each item and quintile weighted by the product of the household's total expenditure and the household's sample weight.

As can be seen from Table 1, there are some consistent patterns that are observed over the study period. For example, the share of cereal (item #1) expenditure is lower for richer quintiles, a finding that is expected from previous studies. Table 1 also shows that there is some heterogeneity in the relationship between expenditure share for non-food items and total expenditure quintile. For example, richer households tend to allocate a higher share of expenditure on the rental of dwelling unit (item #11), transportation and recreation (item #16), communication (item #17), and household furnishing and equipment (item #18). However, there is no such relationship for fuel, light, and water (item #12), and only a weak relationship is observed for medical care (item #14) and personal care and household operation (item #15).

Table 1 is also consistent with the westernization of Filipino diet during the study period. While the expenditure shares for major food items have declined, the relative declines are different across food items. Therefore, the relative importance of dairy and eggs (item #2) and meat (item #5) within the food budget has increased over time. On the other hand, cereals (item #1), the most important food category in the traditional Filipino diet, have witnessed the largest absolute decline in the expenditure share during our study period.

[2] Apparently, Mutuc et al. (2007) have used FIES data for the year 2000, which contain the expenditure and quantity for each food item. However, the data we purchased from the NSO only contain the expenditure data, and thus we cannot derive the implicit prices households face from the FIES data. Furthermore, it would not be possible to obtain relevant quantities for non-food items. Therefore, we chose to aggregate goods instead in this study.

Table 1 Expenditure shares in percentage by expenditure items and per capita expenditure quintiles for 1988 and 2006

Item #	Description	1988						2006					
		Q1	Q2	Q3	Q4	Q5	Total	Q1	Q2	Q3	Q4	Q5	Total
1	Cereals	7.8	13.0	16.5	21.5	29.0	13.3	5.7	9.7	12.9	17.3	25.1	10.2
2	Dairy and eggs	4.3	5.0	4.7	4.3	3.3	4.4	3.6	4.2	3.9	3.7	3.2	3.7
3	Fish and seafood	4.7	7.0	8.6	10.3	11.4	6.9	3.3	5.1	6.2	7.5	9.5	5.0
4	Fruits and vegetables	4.9	6.1	6.3	6.1	6.7	5.6	3.4	4.5	5.1	5.6	6.2	4.3
5	Meat	9.1	8.6	7.7	5.7	4.6	8.1	6.7	8.4	8.5	7.6	5.9	7.4
6	Miscellaneous food	9.4	12.2	12.6	11.3	9.6	10.8	11.1	13.4	14.8	13.9	11.7	12.5
7	Beverages (incl. alcohol)	2.5	2.9	2.9	2.9	2.3	2.7	2.1	2.6	2.7	2.7	2.4	2.4
8	Tobacco	1.4	2.1	2.7	2.8	2.5	2.0	0.4	0.9	1.3	1.5	1.6	0.9
9	Clothes	4.4	4.4	4.2	4.3	3.7	4.3	2.9	2.6	2.3	2.2	2.0	2.6
10	Housing maintenance and repair	1.3	0.6	0.7	0.6	0.7	0.9	0.6	0.4	0.4	0.3	0.3	0.5
11	Rental of occupying dwelling	18.4	13.3	11.1	9.6	7.9	14.4	15.6	13.6	11.9	10.9	8.7	13.7
12	Fuel, light, and water	5.2	5.9	5.5	6.0	6.1	5.5	8.1	9.0	8.9	8.5	7.8	8.4
13	Education	4.3	2.9	2.3	1.9	1.5	3.2	7.0	4.1	2.3	2.0	1.8	4.8
14	Medical care	2.1	1.4	1.1	1.2	1.1	1.6	2.9	1.9	1.5	1.3	1.3	2.2
15	Personal care and HH operation	7.1	5.8	5.7	5.5	5.4	6.3	7.3	6.1	6.1	6.1	6.1	6.6
16	Recreation	0.8	0.5	0.4	0.3	0.2	0.6	0.9	0.4	0.3	0.2	0.2	0.6
17	Transportation and communication	6.7	4.3	4.0	3.3	2.4	5.1	11.1	8.4	7.6	5.9	4.3	9.0
18	HH furnishing and equipments	3.1	1.9	1.3	0.9	0.4	2.1	4.6	2.3	1.5	1.2	0.6	3.0
19	Other non-food items	2.4	2.1	1.8	1.4	1.1	2.0	2.7	2.3	1.9	1.5	1.2	2.3
Total		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Number of observations		1035	953	903	881	812	4584	1637	1528	1397	1369	1358	7289

Source: Author's calculation based on the FIES sample used in this study

Table 2 Household characteristics by per capita expenditure quintiles for 1988 and 2006

Variable	Description	1988						2006					
		Q1	Q2	Q3	Q4	Q5	Total	Q1	Q2	Q3	Q4	Q5	Total
HHSIZE	Household size	4.8	5.1	5.5	5.9	6.6	5.5	4.3	4.6	5.2	5.7	6.3	5.1
HHPRI	Head has at least some primary educ (%)	98.1	94.9	90.6	80.6	70.5	88.1	98.2	95.8	91.6	84.0	70.6	89.4
HHSEC	Head has at least some secondary educ (%)	86.5	67.0	50.0	35.7	24.7	55.2	91.2	77.7	62.1	45.7	26.8	63.8
HHCOL	Head has at least some college educ (%)	61.4	33.6	21.1	14.0	7.9	29.6	66.5	37.1	23.7	14.1	7.6	32.6
HHFEM	Female headed household (%)	12.7	6.1	3.3	2.6	2.3	5.8	18.0	7.2	3.5	2.9	2.1	7.5
HHAGE	Head's age	39.3	39.0	38.5	39.0	39.0	39.0	40.9	39.5	39.3	40.3	40.5	40.1

Source: Author's calculation based on FIES data

Table 2 describes the household characteristic variables used in this study. The reported figures are the mean within each quintile weighted by the sample weight. The first row (HHSIZE) shows that poor quintiles tend to have a larger household and that the household size has declined for all the quintiles over the study period. The second, third, and fourth rows show that the household heads in richer quintiles tend to be better educated than those in poorer quintiles. Note that those who have at least some secondary (college) education are automatically deemed to have at least some primary (secondary) education. Therefore, HHSEC (HHCOL) is by definition no larger than HHPRI (HHSEC) for all quintiles. The fourth row shows that the top quintile is disproportionately represented by female headed households. We find no obvious difference in head's age across different quintiles.

5 Results

We estimate the QUAIDS for the 19 items using the IGLLS estimator presented in Sect. 3 for 1988–1994 and 2000–2006 periods separately. In all the regressions, we control for the region and year. Table 3 reports the estimated coefficients on demographic shifters and their statistical significance. For example, it shows that the expenditure share for cereals tends to increase by 1.71 and 1.53 % points, respectively, for the periods of 1988–1994 and 2000–2006 when the household has one additional member, after controlling for a variety of other factors.

Table 3 also shows that better educated households tended to spend a higher share of expenditure on major protein sources including dairy and eggs (item #2), fish and seafood (item #3), and meat (item #5) for the 1988–1994 period, even after controlling for a variety of other factors including the total budget. While this pattern still exists for the 2000–2006 period, the gap between educated and non-educated households appear to have narrowed slightly.

Tables 4 and 5, respectively, present the total budget elasticities and uncompensated own-price elasticities for food items based on Eq. (7) as well as their changes over time and the statistical significance of the changes due to the independent test of equality. To obtain these estimates taking account of both the model and sampling errors, we randomly draw the parameters from a normal distribution with the estimated asymptotic mean and variance for 1000 rounds of simulation and impute the elasticities for each household for a bootstrapped sample in each round. We then aggregate over each quintile and obtain an estimate for each round. Taking the mean and standard deviation of these estimates over all the rounds, we have the estimated point estimates and their standard errors.

Table 4 shows that the budget elasticity is smaller for richer quintiles for all food items. The table also shows that the budget elasticity has generally declined over time. This is not surprising given the economic growth that has taken place over the study period. The only exception is cereals (item #1) for the top quintile, which is also not so surprising because households in the top quintile are already able to fully

Table 3 The estimated QUAIDS coefficients on demographic variables

	HHSIZE		HHPRI		HHSEC		HHCOL		HHFEM		HHAGE	
Item #	1988–1994	2000–2006	1988–1994	2000–2006	1988–1994	2000–2006	1988–1994	2000–2006	1988–1994	2000–2006	1988–1994	2000–2006
1	1.71***	1.53***	−1.03***	−1.09***	−1.03***	−0.62***	−0.38***	−0.28***	0.61***	0.32***	0.07***	0.05***
2	2.68***	0.86***	0.82***	0.48**	0.86***	0.22*	0.65***	0.46***	2.97***	1.93***	3.36***	3.16***
3	3.01***	1.32***	4.07***	4.07***	3.67***	2.73***	4.19***	2.85***	1.30***	1.56***	2.23***	3.52***
4	2.28***	1.18***	3.41***	4.63***	3.73***	3.48***	3.46***	3.08***	0.13	−1.59***	0.87***	−1.38***
5	−0.06***	−0.07***	0.39***	0.18***	0.25***	0.27***	0.30***	0.22***	−0.23**	−0.04	−0.09***	−0.09***
6	−0 49***	0.05	−0.19	−0.10	−0.01	0.17*	−0.16	−0.24***	−0.09	−0.04	−0.48***	−0.19*
7	−0.59***	0.01	−0.22	−0.13	−0.08	0.11	−0.16	0.31***	−0.57***	0.01	−0.42***	−0.02
8	−0.23	−0.11	−0.37**	−0.38***	−0.71***	0.09	−0.20	−0.43***	0.17	0.34***	−0.23	−0.07
9	0.16***	0.23***	−0.60***	−0.57***	−0.76***	−0.48***	−0.71***	−0.45***	−0.62***	−0.50***	−0.01**	0.01***
10	−0.52***	−0.51***	−1.06***	0.91***	−0.13	−0.25***	0.95***	0.03	3.38***	1.80***	1.68***	0.63***
11	2.89***	2.42***	3.81***	2.15***	2.33***	2.62***	0.90***	0.63***	1.59***	1.14***	0.46**	−0.37***
12	−1.66***	−0.13	1.13***	0.31**	3.44***	1.07***	0.99***	−0.24*	−0.04	−0.47***	0.08	−0.11
13	0.02	0.04***	−0.39***	−0.34***	−0.15**	−0.06	−0.15**	−0.24***	−0.15	−0.03	0.00	0.00
14	−0 44***	0.40***	1.50***	0.81***	−0.19**	−0.91***	−0.71***	−1.00***	−0.85***	−0.13	−1.64***	−1.12***
15	−148***	−1.62***	−0.85***	−1.20***	−0.30*	−0.49***	−0.50***	−1.27***	−0.03	−0.65***	0.05	−0.30***
16	1.21***	0.84***	−0.24	1.12***	−0.31**	−0.56***	−0.95***	−0.32***	0.21**	0.14**	−0.91***	−0.49***
17	−0.26***	−0.13***	0.42***	0.32***	0.34***	0.31***	0.12	−0.22***	0.22	−0.17	−0.02***	−0.03***
18	−1.47***	0.92***	0.08	0.95***	0.41***	0.53***	−0.49***	−0.16	−3.40***	−2.25***	−3.45***	−2.74***
19	−1.99***	−1.37***	−184***	−2.20***	−3.78***	−2.91***	−2.39***	−1.77***	−1.95***	−1.15***	−1.67***	−3.02***

Note: Author's calculation based on FIES and CPI data. Statistical significance at 10, 5, and 1 % levels is indicated by *, **, and ***, respectively. All coefficients are expressed in percentage

Table 4 Budget elasticities of demand for food items

Item #	Year	Q1		Q2		Q3		Q4		Q5		Total	
1	1988	0.040	(0.017)	0.189	(0.011)	0.293	(0.010)	0.407	(0.008)	0.514	(0.007)	0.259	(0.008)
	2006	0.085	(0.021)	0.132	(0.011)	0.253	(0.008)	0.374	(0.007)	0.497	(0.006)	0.245	(0.008)
	Diff	0.045		−0.057***		−0.040***		−0.033***		−0.017*		−0.013	
2	1988	0.856	(0.015)	1.062	(0.009)	1.140	(0.012)	1.225	(0.015)	1.376	(0.024)	1.020	(0.011)
	2006	0.716	(0.023)	0.940	(0.010)	1.009	(0.010)	1.087	(0.013)	1.225	(0.020)	0.885	(0.013)
	Diff	−0.140***		−0.123***		−0.131***		−0.138***		−0.151***		−0.135***	
3	1988	0.517	(0.019)	0.684	(0.011)	0.744	(0.010)	0.791	(0.010)	0.814	(0.010)	0.677	(0.010)
	2006	0.356	(0.025)	0.513	(0.011)	0.575	(0.009)	0.630	(0.009)	0.684	(0.009)	0.518	(0.011)
	Diff	−0.161***		−0.172***		−0.169***		−0.161***		−0.129***		−0.159***	
4	1988	0.727	(0.012)	0.802	(0.008)	0.814	(0.009)	0.817	(0.010)	0.841	(0.011)	0.781	(0.008)
	2006	0.551	(0.019)	0.682	(0.009)	0.721	(0.008)	0.754	(0.008)	0.785	(0.010)	0.661	(0.010)
	Diff	−0.176***		−0.121***		−0.093***		−0.063***		−0.056***		−0.119***	
5	1988	1.032	(0.010)	1.193	(0.008)	1.278	(0.011)	1.453	(0.018)	1.663	(0.029)	1.164	(0.009)
	2006	0.668	(0.018)	0.997	(0.007)	1.095	(0.007)	1.214	(0.010)	1.473	(0.018)	0.927	(0.010)
	Diff	−0.364***		−0.195***		−0.183***		−0.239***		−0.189***		−0.237***	
6	1988	0.868	(0.013)	1.032	(0.007)	1.078	(0.008)	1.139	(0.010)	1.238	(0.015)	1.002	(0.008)
	2006	0.764	(0.014)	0.920	(0.006)	0.967	(0.005)	1.007	(0.006)	1.081	(0.011)	0.885	(0.008)
	Diff	−0.105***		−0.112***		−0.111***		−0.132***		−0.157***		−0.116***	
7	1988	1.005	(0.017)	1.230	(0.013)	1.296	(0.014)	1.378	(0.019)	1.536	(0.026)	1.183	(0.013)
	2006	0.705	(0.024)	1.012	(0.010)	1.101	(0.010)	1.187	(0.011)	1.344	(0.019)	0.949	(0.013)
	Diff	−0.300***		−0.218***		−0.195***		−0.191***		−0.192***		−0.234***	

Note: Author's calculation based on FIES data. Standard errors are in parentheses. Statistical significance at 10, 5, and 1 % levels is indicated by *, **, and ***, respectively

Table 5 Uncompensated own-price elasticities of demand for food items

Item #	Year	Q1		Q2		Q3		Q4		Q5		Total	
1	1988	0.550	(0.094)	−0.158	(0.053)	−0.352	(0.041)	−0.510	(0.031)	−0.639	(0.023)	−0.146	(0.052)
	2006	0.736	(0.167)	−0.054	(0.096)	−0.296	(0.072)	−0.479	(0.053)	−0.637	(0.037)	−0.070	(0.092)
	Diff	0.186		0.104		0.056		0.032		0.002		0.076	
2	1988	−1.016	(0.091)	−1.048	(0.077)	−1.063	(0.082)	−1.078	(0.088)	−1.107	(0.106)	−1.043	(0.087)
	2006	−0.993	(0.143)	−1.016	(0.122)	−1.025	(0.130)	−1.035	(0.139)	−1.050	(0.156)	−1.011	(0.136)
	Diff	0.022		0.032		0.038		0.044		0.057		0.032	
3	1988	−1.177	(0.069)	−1.120	(0.046)	−1.099	(0.038)	−1.082	(0.031)	−1.074	(0.028)	−1.122	(0.047)
	2006	−1.238	(0.130)	−1.151	(0.083)	−1.124	(0.068)	−1.102	(0.057)	−1.079	(0.045)	−1.155	(0.085)
	Diff	−0.061		−0.031		−0.025		−0.020		−0.005		−0.033	
4	1988	−1.005	(0.039)	−1.005	(0.031)	−1.006	(0.030)	−1.006	(0.031)	−1.006	(0.028)	−1.005	(0.033)
	2006	−0.673	(0.076)	−0.755	(0.057)	−0.781	(0.051)	−0.802	(0.046)	−0.822	(0.042)	−0.743	(0.060)
	Diff	0.331***		0.250***		0.224***		0.204***		0.184***		0.262***	
5	1988	−0.838	(0.070)	−0.872	(0.074)	−0.872	(0.082)	−0.846	(0.108)	−0.836	(0.130)	−0.852	(0.078)
	2006	−1.233	(0.101)	−1.248	(0.081)	−1.266	(0.080)	−1.315	(0.090)	−1.432	(0.114)	−1.262	(0.092)
	Diff	−0.395***		−0.376***		−0.394***		−0.469***		−0.596***		−0.410***	
6	1988	−0.872	(0.059)	−0.944	(0.045)	−0.959	(0.043)	−0.966	(0.048)	−0.976	(0.057)	−0.923	(0.051)
	2006	−0.950	(0.066)	−0.983	(0.055)	−0.992	(0.050)	−0.999	(0.053)	−1.010	(0.063)	−0.975	(0.059)
	Diff	−0.078		−0.040		−0.034		−0.033		−0.034		−0.052	
7	1988	−1.321	(0.100)	−1.304	(0.086)	−1.295	(0.081)	−1.306	(0.083)	−1.359	(0.095)	−1.313	(0.091)
	2006	−0.627	(0.179)	−0.725	(0.142)	−0.740	(0.137)	−0.750	(0.135)	−0.734	(0.148)	−0.693	(0.155)
	Diff	0.694***		0.580***		0.555***		0.556***		0.625***		0.620***	

Note: Author's calculation based on FIES data. Standard errors are in parentheses. Statistical significance at 10, 5, and 1 % levels is indicated by *, **, and ***, respectively

satisfy their basic needs and cereals are, therefore, budget inelastic. This pattern did not change over time.

Table 5 shows that the uncompensated own-price elasticities are strikingly similar across quintiles for all the food items except for cereals (item #1). Cereals are clearly inferior goods for the top quintile, but it is a normal good for poorer quintiles. Table 5 also shows that there has been a statistically and economically significant decline in the magnitude of elasticity for fruits and vegetables (item #4) and beverages (item #7), whereas there has been a significant increase for meat (item #5). Both Tables 4 and 5 strongly indicate the presence of structural change between 1988 and 2006 as has been found in studies in China.

While our results cannot be directly compared with the studies on food demand in China because of the difference in the definition of food items, coverage of time periods, and the methodology used to derive elasticities, there are some common patterns observed in the changes in food demand between the two countries. First, increases in the magnitude of uncompensated own-price elasticity for meat have been observed in several studies in China. For example, Hovhannisyan and Gould (2014) report that the meat price elasticity has changed from −0.618 to −0.978 in their study period between 2002 and 2010. For earlier periods, Hovhannisyan and Gould (2011) estimate uncompensated own-price elasticities for beef, pork, and poultry for 1995 and 2003. The elasticities for pork and poultry have increased substantially, whereas that for beef slightly declined.

Second, as with our study, Hovhannisyan and Gould (2011) also find that the uncompensated own-price elasticities for vegetables and fruits have declined in their magnitudes between 1995 and 2003 (−0.520 to −0.457 for vegetables and −0.923 to −0.699 for fruits). For the period between 2002 and 2010, Hovhannisyan and Gould (2014) indicate that vegetables have become less elastic whereas fruits have become only slightly more elastic. Finally, Hovhannisyan and Gould (2011) find that the budget elasticity of demand has declined for a majority of food items they studied, which is similar to what we find.

6 Discussion

In this paper, we have estimated QUAIDS over a long period of time using a consistent methodology. While we have focused on the food demand, we chose to estimate the whole demand system to avoid assuming separability and excessively aggregating non-food items. However, this necessitates the estimation of a large demand system, which involves a large number of parameters. This issue becomes even more serious when some key demographic variables are included in the regression as they inflate the number of parameters to be estimated. To address these issues, we exploit the conditional linearity of the QUAIDS and developed and applied the IGLLS estimator.

Using six rounds of the FIES data, we have estimated a QUAIDS with 19 goods. We find that the urban Filipino diet is getting more westernized and that the food

demand in the Philippines has structurally changed during our study period between 1988 and 2006. In particular, the changes in demand for meat, vegetables, and fruits in the urban Philippines have been qualitatively similar to those observed in China.

The estimation results presented in this study have some policy implications. For example, as we have seen in the case of recent food inflation, the prices also affect poverty heterogeneously across households (Fujii 2013). Therefore, how food demand changes according to the changes in prices and incomes and how it varies across households are crucial for the assessment and formulation of economic policies, including agricultural subsidies, taxes, infrastructure investment, and social protection.

Our results also have some business implications. In general, if markets are segmented and people in different budget quintiles respond differently to price or total budget changes, then separate marketing and pricing strategies may be needed for different per capita expenditure quintiles. As we can see from Tables 4 and 5, there is a marked difference across quintiles for the demand of cereals (item #1). However, the price elasticities for other major food items including dairy and eggs (item #2), fish and seafood (item #3), fruits and vegetables (item #4), and meat (item #5) are rather similar across quintiles. Therefore, we do not have evidence to suggest that separate pricing strategies are needed for these items in the Philippines.

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Greater China, Cambodia, and the Garment Industry

Sophal Ear

1 Introduction

Representing 35 % of Cambodia's gross domestic product, the garment industry has been the single largest foreign exchange earner for Cambodia for at least a decade. How did this happen and what does this mean? This chapter explores the birth of the garment industry in Cambodia and its maturation right up to the global financial crisis, which has provided the most severe test of the industry's competitiveness. The garment industry is one of the few sectors—possibly the only sector—that has avoided complete capture by the authorities. This could be due to the remarkable influence of Greater China (Hong Kong, Macau, Mainland China, Singapore, and Malaysia) investors who claim 70 % of garment factories and 70 % of the executive committee that runs the country's trade association known as the Garment Manufacturers Association in Cambodia (GMAC). It could also be due to the industry's strength in numbers and their foreign nature (93 % non-Cambodian) resulting in too many firms to capture. Following this introduction, an analytical framework on governance and literature review are elaborated. The role of Greater China in garments is a natural segue to the dimensions of China proper's influence and interests in Cambodia, a small country of only 14 million people. The chapter ends with an examination of the

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hand-in-hand governance arrangements and labor successes, trials, and tribulations that may explain the rise of the garment industry, but also its present-day challenges.

Governance Analytical Framework and Literature Review[1] Billionaire George Soros has proffered that "The main cause of misery and poverty in the world is bad government."[2] Mr. Soros is by no means the only person to believe as much. Indeed, the idea of good *and* bad government has a long history, as long as there have been governments to rule nations.[3] At a Royal Institute of International Affairs dinner address on the governance of India on 26 April 1927, Sir Stanley remarked:

> Without using the language of hyperbole, it seems to me that we are confronted in India, and not only there, in Asia and Africa, with a problem of immense difficulty—the establishment of responsible government, and that based on democratic principles—for I know no other—in a country where, though it has produced individual men of genius in almost every field, the sense of discipline in every unit required for a lasting system of efficient democracy has not been developed to any considerable extent.[4]

Both Mr. Soros and Sir Stanley had similar normative notions of government in mind when they spoke, on the one hand, of "bad government" and, on the other hand, of "responsible government." Throughout this chapter the word governance will be used to denote "the traditions and institutions by which authority in a country is exercised."[5]

The Africanist and comparativist, Goran Hyden, defines governance as "the conscious management of regime structures, with a view to enhancing the public realm."[6] This is one of a series of definitions of governance collected by Joachim Ahrens and shown in Box 1.

- Governance capacity is defined "as the ability to co-ordinate the aggregation of diverging interests and thus promote policy that can be credibly taken to represent the public interest" (Frischtak 1994: 7).
- Governance is "an interactive process by which state and social actors reciprocally probe for a consensus on the rules of the political game" (Bratton and van de Walle 1992: 30).
- Governance is "the conscious management of regime structures, with a view to enhancing the public realm" (Hyden 1992: 7).
- Governance is the "capacity to establish and sustain workable relations between individuals and institutional actors in order to promote collective goals" (Chazan 1992).

[1] This section draws on earlier work by the author's doctoral dissertation, *The Political Economy of Aid, Governance, and Policy-Making: Cambodia in Global, National, and Sectoral Perspectives* (University of California, Berkeley, 2006).

[2] As quoted in Bank (2002).

[3] Indeed, even before the Treaty of Westphalia was signed in 1648 (giving birth to the modern-day nation-state), notions of governance reach as far back as Aristotle, Cicero, Machiavelli, and Montesquieu.

[4] Reed (1927: 315).

[5] Kaufmann et al. (1999: 1).

[6] Hyden (1992: 7).

- Governance signifies "the capacity to define and implement policies" (Kjaer 1996: 6, emphasis omitted).

Box 1: Definitions of Governance Source: Adapted from Ahrens (1999: 42)

Frischtak, Hyden, and Chazan are all explicit in their definitions that governance relates to the public or the collective good. In fact, they make a distinction between government (which might be wholly centered on the realm of private interests) and governance. Likewise Bratton and van de Walle's focus on social consensus also implies a collective aspect. Only Kjaer's definition is truly completely neutral about the content of policies.

The definitions collected by Ahrens demonstrate the "academic" picture, that is, before multilateral institutions like the World Bank and the Asian Development Bank (ADB) began to narrow the term's meaning to "the manner in which power is exercised in the management of a country's economic and social resources for development."[7] Subsequent development-oriented conceptualizations (ADB 1997; IMF 2001; OECD 2001; UNDP 1997; World Bank 1994) tend to circumscribe governance because of political limitations rooted in institutional charters (World Bank 1945; ADB 1965). The analytical framework used in this chapter is thus governance, while the industry is garments. Examination of the garment industry through the lens of governance provides an important clue as to how one sector has thrived despite of weak governance in Cambodia.

2 Garment Industry in Cambodia

2.1 Birth of the Garment Industry[8]

The garment industry is a relatively nascent one. In the 1990s, the Cambodian garment industry emerged and prospered in response to US trade preferences. In 1998–1999 specifically, success grew from the Clinton administration developing the US–Cambodian Trade Agreement on Textiles and Apparel (1999–2004), which linked market access (increasing quota) to labor standards. Cambodia is the only country where a trade–labor arrangement was agreed to and implemented.[9] This is not to say that labor

[7] World Bank (1992: 1) and ADB (1995). In fact, the phrase dates back to *Webster's New Universal Unabridged Dictionary*, as attributed in ADB (1995: 3).

[8] Material for this and the subsequent section draw from my earlier work for the World Bank, portions of which have appeared in a working paper for the Stanford Center of International Development; see Ear (2009b).

[9] So unprecedented was this linkage that a Harvard Business School case study on the US–Cambodia agreement was produced (HBS 2004). As with all HBS case studies, caution should be taken as these are not intended to be used as primary data.

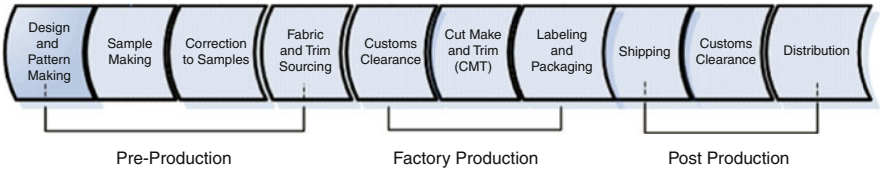

Fig. 1 Textile and garment value chain. *Source*: Adapted from Nathan Associates Inc. (2007: 11)

has not figured into every bilateral and regional trade agreement by the USA, but the difference is that such standards have not been enforced, while Cambodia's were, with rewards in the form of increased quotas for compliance.

The US trade preferences were made conditional on the observation of labor standards. Cambodia became the first and so far the only country in which the International Labour Organization (ILO) monitoring of labor standards was made mandatory.[10] Apart from benefiting workers, there appears to have been some economic payoff from this approach, as the Cambodian system appealed to buyers who increasingly based their brand on embracing ethical approaches to manufacturing through corporate social responsibility.

To date, Cambodia captures only a relatively limited share of the value chain and the value added in garment manufacturing, because it does not produce textile, nor buttons, nor even thread. Cambodia is only involved at the "cut, make, and trim" phase of the value chain (see Fig. 1). Almost all inputs for the industry are imported, and the country does not have a textile industry.

Direct contributions to the government budget have been limited since the industry enjoys import tax exemptions as well as generous tax holidays. Approximately 93 % of garment factories are foreign owned (GMAC 2010: 10), and a significant part of the profits are repatriated. In June 2006, 180 out of 270 firms then operating (specifically those firms which had applied for licenses before 14 March 2005) became eligible for an additional 2 years of tax holiday when the Council of Ministers acted to support the industry, in light of increasing competition from Vietnam and China (AP 2006).

Nonetheless, the economic benefits to Cambodia have been substantial in terms of direct and indirect job creation. Gross domestic product increased by an estimated 2 % annually since 1995 (EIC 2007: 12), although this effect has diminished with the global financial crisis. Garments account for approximately 80 % of recorded exports, 620,000 direct jobs (Xinhua 2014), and at least as many indirect jobs. The Cambodian garment industry has also benefited from diversification effects, i.e., garment buyers seeking to diversify their sources, and from regional effects, that is, being located in a region that is strongly engaged in textiles and garments.

Regarding industry dynamics, garment manufacturing in Cambodia took off between 1997 and 2001 with high rates of job growth and a rapid increase in the number of factories. Since 2001, job creation in the industry has slowed down. According to ILO (2011), employment peaked in 2008 (352,955) and shrunk in 2009 (296,800), before

[10] The ILO monitoring system is currently being rolled out on a voluntary basis to several other countries—Vietnam, Jordan, and Lesotho.

recovering in 2010 (319,383). Today, it stands at an all-time high of 620,000 and two million Cambodians benefit indirectly from the garment industry (Xinhua 2014). Contrary to some expectations, the industry did not experience a rapid decline after the end of MFA because China was restrained from exporting garments at will.

2.2 *Maturation of the Garment Industry*

The garment industry came under severe pressure in 2009, with garment exports declining 18.9 %, due to a sharp drop in demand in Europe and the USA (ILO 2010). Figure 2 shows levels of exports in 1995–2013, the sharp drop in 2009, and subsequent recovery driven primary by exports to Japan as US and EU markets slowed (Tuan 2012).

A combination of factors weigh on Cambodian competitiveness in garments: productivity is lower than in key competitor countries, while some costs are higher (mainly informal payments/bribes, transportation, electricity, and costs related to labor disputes), and its key US market underwent a recession (70+ % of garment exports are destined for the USA). The high cost and the unreliability of electricity is an issue for factories using the national grid as well as for those using their own diesel generators.

As mentioned, the Cambodian garment industry emerged in response to a big incentive provided by the USA and in the context of a strongly regulated regime at the international level (MFA). During 1999–2004, Cambodia enjoyed preferential access to US markets. There was a dual incentive for the government: "looking good" at the international level (particularly in its relations with the USA) and the fact that the quota regime offered considerable rents. The garment industry offers

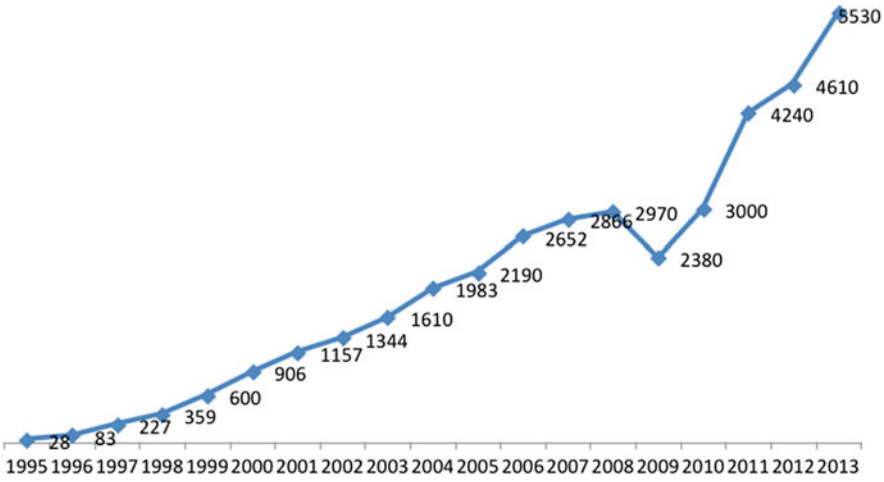

Fig. 2 Million US$ annual garment export in 1995–2013. *Source*: Ministry of Commerce, Generalized System of Preferences Department, as reported in GMAC (2010: 10) for 1995–2008; Xinhua (2011) for 2009 and 2010; Fibre2fashion (2013) for 2011 and 2012; Fibre2fashion (2014) for 2013

insights into Khan's theory of "how patron-client networks . . . have allowed some types of value enhancing economic transformations and prevented other types" (2006: 18). Allowing the garment industry to emerge was therefore a "win–win" situation for "white hat" as well as "black hat" interests in Cambodia.[11]

The garment industry's success could not have taken place without Cambodia's transformation in the 1990s. In the 1980s, the People's Republic of Kampuchea would not have permitted freedom of assembly. As a garment factory owner interviewed in 2008 underscored, "Before, you were not allowed to get together. Now it has become very popular. Idea has been accepted by government and private sector. What we need now is capacity and leadership." The owner's clear-cut recommendation was for donors like the World Bank to help fund secretariat functions for business associations. While GMAC has all it needs because of its strong capacity and resources, other associations are not as fortunate.

The sector has been able to generate some collective action by lobbying—enjoying better conditions for doing so than other business sectors in Cambodia. The sector is largely foreign, so key actors have fewer preexisting ties which would facilitate individual deals. It is also relatively more uniform than other sectors, in the sense that most players are of medium size and external[12] and face an international environment that is demanding in terms of quality standards and competitiveness. GMAC's formation has been inextricably linked with that of the apparel industry in Cambodia and with the Ministry of Commerce. GMAC's own narrative (on its website[13]) is particularly telling:

> After the reestablishment of the Kingdom of Cambodia in 1993, the first foreign investors to venture into this country are the garment manufacturers . . . With the granting of MFN/GSP [Most Favored Nation/Generalized System of Preferences] trade privileges to Cambodia in 1996 by both the USA and EU, the garment industry has maintained its pre-eminent position in the industrial landscape of Cambodia. Even the imposition of garment quotas by the USA in 1999 did not hamper this meteoric rise. *In retrospect, the quota issue spurred on more investments into the sector as the quotas imposed upon Cambodia by the USA were, on a per capita basis, the most generous among all countries subjected to this unilateral quantitative restraint regime due to Cambodia's commitment to uphold fundamental labor standards* . . . In mid 1996, most of the garment investors, *coming from such a diverse background as China, Hong Kong, Macau, Malaysia &*

[11] The terms "white hat" and "black hat" were introduced in research by Hughes and Un (2007: 1) and is said to be used and understood by senior government officials: "The 'white hat' system conforms to donor expectations, and can be found in small pockets throughout the state. The black hat system operates through personalist connections of kinship, cronyism, or patron-clientism, and is used to generate slush funds, through the seeking of rent through corruption, to buy the continued support of key players. This is the system that was used to end the war in the 1990s and it is the system which maintains Cambodia's high ratings for political stability." The terms have also been picked up by Craig and Porter in a paper presented at workshop on critical approaches to post-conflict policy sponsored by the Department of International Development, University of Oxford, 25–26 June 2008, in a paper entitled "Post-conflict institutional development: The perversities of Black Hat and White Hat governance in Cambodia."

[12] Between 300 and 500 garment factories are said to exist in Cambodia; the majority have between 1000 and 2000 workers, with a few companies having grown to several thousands of employees.

[13] See http://www.gmac-cambodia.org/.

> *Singapore, decided to form an ad hoc unit to represent them as a group instead of being singled out individually when dealing with officials from the … MoC*, which has been charged …by the RGC … to oversee the export of garments and the issuance of Certificates of Origin. In that same year, the RGC (MoC) working together with GMAC, were instrumental in the successful lobbying effort to persuade the U.S. to grant Cambodia its … MFN … status, in order that normal tariff applies to Cambodian garments imported into the USA. *Thus began a journey of symbiotic cooperation between the garment manufacturers and the RGC that has stood the test of time until today*. In 1999 GMAC was officially registered with the Ministry of Social Affairs, Labor, Veteran & Youth Affairs as a employers' organization in compliance with the Cambodian Labor Law 1997. Later on, it was incorporated as an association with the Ministry of Commerce … On the national level, the Ministry of Labor & Vocational Training invited representatives from the association to sit on the Labor Advisory Committee (LAC), the highest tripartite (RGC, employer & union) policy making body entrusted under the Cambodian Labor Law to recommend labor policies to the RGC. In fact, the Chairman of GMAC is designated a permanent Vice-Chairman post in the LAC [emphasis added]. (GMAC n.d.)

Why GMAC was not beholden to only two or three large investors is unclear. Created to represent disparate manufacturers from all over the world in order to prevent any particular manufacturer being singled out individually by the Ministry of Commerce, domination by two or three large investors could have defeated its purpose of industry representation. Since its inception, it has been led by Chairman Van Sou Ieng, a man of Cambodian nationality who could not deliver a speech in Khmer, with a Secretary-General named Ken Loo based in the Secretariat of GMAC. Both are ethnic Chinese. This has provided stability for GMAC through strong leadership, but could also pose a risk should Mr. Ieng cease to lead the organization.

Currently, membership in GMAC is mandatory for all garment factories in order to be able to export. It is arguably the country's most powerful business association. By acting collectively with respect to the export of garments, GMAC holds more power in dealing with authorities when it comes to keeping bribe taxes (unofficial payments) under control.

3 Dimensions of Chinese Influence

The most apparent effects of Chinese influence are in the promotion of an environment that generates growth. This growth environment encompasses not only the garment industry but also projects touching "telecommunications, fiber optics, pharmaceuticals, gold mining, agro-industry, and elastic bands." "Figures from the Cambodian Investment Board for the January to December 2007 period show that the Cambodian government approved 32 Chinese investment projects, amounting to almost US$481 million in registered capital and over US$2.6 billion in fixed assets" (Sullivan 2011: 51). From a regional context, this investment also aligns with China's view that "the development of the greater Mekong Sub-Region" is "a major regional priority" (Sullivan, 64). China's continued assistance to Cambodia and other nearby countries demonstrates promising development and progress that can possibly come.

A greater long-term effect of this Chinese investment is in the positive effects that stem from the technical expertise brought to the country to implement and sustain such

garment operations. Garment operations are more difficult to start and operate because Cambodia does not have an experienced pool of knowledge to draw this technical expertise from. This difficulty in starting up is further exacerbated because the Cambodian business and political elites are then unwilling to invest to obtain these resources and instead are rationally drawn to activities that enjoy the highest returns in the shortest amount of time and with the least amount of capital.

This barrier to start up factories in the garment industry has resulted in garments having a very international characteristic, which has prevented the industry from being captured entirely by Cambodian influence.[14] Surprisingly, this has had some positive effects, in that the industry is less easily persuaded or bought to engage in decisions that harm the industry. As noted, the sector is largely foreign, so key actors have fewer preexisting ties which would facilitate individual deals. It is also relatively more uniform than other sectors, in the sense that most players are of medium size and external[15] and face an international environment that is demanding in terms of quality standards and competitiveness. If nothing else, the ability for the industry to evade capture due to its international characteristic offers greater potential for social capital formation through horizontal associational links when compared to domestically based sectors according to a garment factory owner interviewed 2008.

3.1 Capture Avoidance Thanks to Greater China?

Institutions such as the Bar Association of the Kingdom of Cambodia, founded in 1995, were captured in 2004 when senior government officials, including the Prime Minister, became lawyers by virtue of their positions in government. What then explains GMAC's ability to *avoid* capture by different interests? GMAC currently represents 236 members as of 17 March 2010 (GMAC 2010: 10), making capture somewhat difficult. Figure 3 shows ownership by nationality.

[14] The identities of entrepreneurs, including Diaspora, matter since the garment industry is mainly foreign owned (although there are unavoidable links to local Cambodians in areas such as land, etc.). Both Western Diaspora and Chinese expatriates play significant roles across different sectors. Garment has a very strong Chinese element; ethnic Cambodians will send their children to Chinese-language schools so that they can work in middle management at garment factories doing accounting for example. Moreover, there is a strong Chinese ethnic component to business in Cambodia and more generally throughout Southeast Asia. Cambodians of Chinese ancestry include virtually the entire Phnom Penh Chamber of Commerce. For example, the modern rice mill operating in Cambodia is from a former Chinese-Cambodian businessman. Cham Prasidh is an ethnic Chinese Cambodian, as is the Minister of MAFF, Chan Sarun. Of course, while the manufacturers of garments are Asian, the "buyers" are Western.

[15] Between 300 and 500 garment factories are said to exist in Cambodia; the majority have between 1000 and 2000 workers, with a few companies having grown to several thousands of employees.

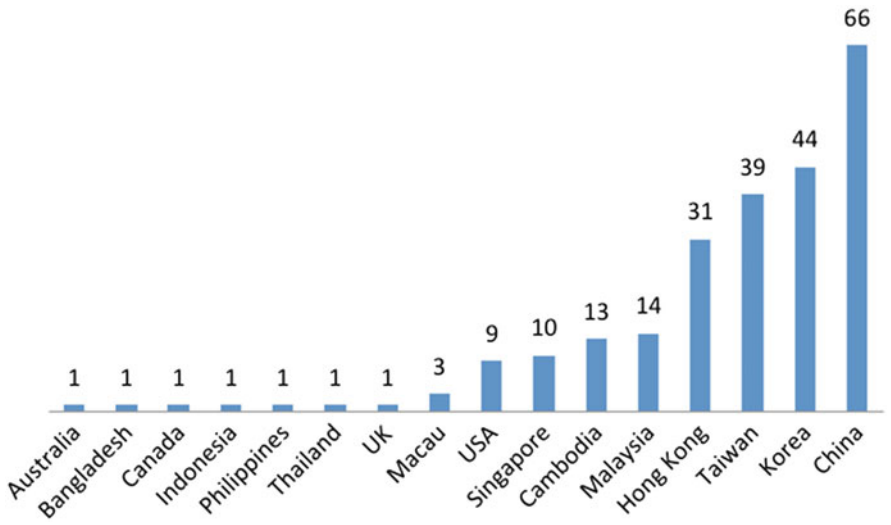

Fig. 3 GMAC garment factories in Cambodia by nationality of owner. *Source*: GMAC (2010: 10)

Greater China accounts for 163 out of 236 member factories, an impressive 70 % of GMAC's membership.

Based on GMAC (2010: 8–9) crosschecked against GMAC's membership nationality data (available on its website), GMAC's 27-owner strong Executive Council is comprised of three owners who hold Cambodian nationality (in actuality, two of the three owners in fact represent the same company, Evergreen Apparel). Figure 4 shows the breakdown in nationality for GMAC's Executive Committee. Again, Greater China claims nearly 70 % of the votes.

As noted earlier, GMAC's own website describes the "symbiotic cooperation between the garment manufacturers and the RGC that has stood the test of time until today" (GMAC n.d.), and in some ways, by requiring GMAC membership to export legally, it is unclear who captured whom.[16] Is GMAC an agent of the RGC and the RGC its principal, or is the government an agent of GMAC and GMAC its principal? What is crystal clear is that the sector has succeeded despite numerous challenges and is the leading contributor to Cambodia's growth. A turning point came on 13 March 2005 when Commerce Minister Cham Prasidh announced at GMAC's general meeting in Phnom Penh "If you do not see the reform at the end of

[16] GMAC (n.d.): "In 1999 GMAC was officially registered with the Ministry of Social Affairs, Labor, Veteran & Youth Affairs as a employers' organization in compliance with the Cambodian Labor Law 1997. Later on, it was incorporated as an association with the Ministry of Commerce. GMAC performs many roles. At the outset, it was a pressure group, making representations to MOC on issues that affect the general interests of its members. Later on, when external developments posed a threat to the well-being and survival of the Cambodian garment industry, GMAC was at the forefront lobbying the RGC to improve it trade facilitation efficiency and reducing fees and levies to keep the industry competitive in the world market."

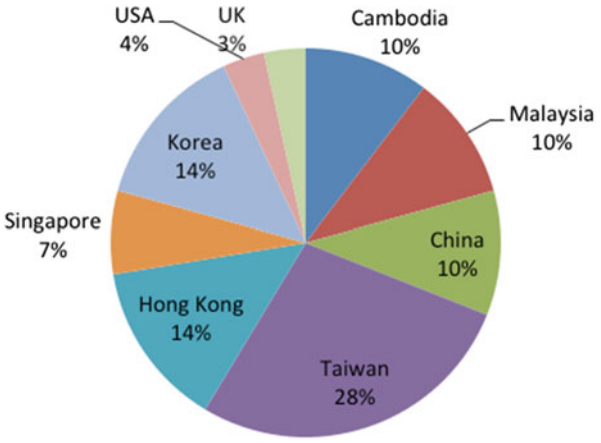

Fig. 4 GMAC Executive Committee by nationality. *Source*: GMAC (2010: 8–9) crosschecked against membership's nationality data

this year, you will not see Cham Prasidh as the Minister of Commerce again . . . In order to help the garment sector to survive, we must cut all the under-the-table costs" adding "How can I still be a commerce minister if the garment industry dissolves?" (as quoted in Prak 2005).

Since garment quotas no longer exist to generate economic rents per se, it is Cambodia's access through its WTO membership (to which it acceded on 13 October 2004), which allows Cambodia access to developed country markets. At that time, Vietnam was not yet a member of WTO, but China had already joined on 11 December 2001, albeit with strings attached to its membership, and Vietnam joined on 11 January 2007. Thus, whatever economic rents Cambodia enjoyed are slowly being eroded by increased competition. Moreover, rent-seeking by the economic police (Ministry of Interior) on the way to and from Sihanoukville port by customs officials (Ministry of Economy and Finance), by CamControl (MoC),[17] among other agencies of government, must carefully be negotiated and vigilantly monitored by GMAC lest they run amok.

Collective action via GMAC and the Government–Private Sector Forum (GPSF) has resulted in some improvements to the governance environment for the sector over time. In mid-November 2008, at the 14th GPSF following a request by Van Sou Ieng for a 30 % cut on Cambodian export fees to assist exporters, the Prime Minister announced a 10 % cut. Several years ago, GMAC agreed with the government that it

[17] According to CamControl's website (http://www.camcontrol.gov.kh/mission2.html): "Pursuant to article 14 of the Sub-Decree No. 54 AK September 22, 1997 on the organization and functioning the Ministry of Commerce, the Cambodia Import Export Inspection and Fraud Repression Department (CAMCONTROL) is responsible for:

1. Controlling and suppressing on fraudulent goods being marketed
2. Analyzing quality of food and consumption products
3. Supervising and certifying the compliance with nation standard on quality, safety and trademark of food and consumption products except medicine, medical equipment and cosmetic products
4. Inspecting goods exported and imported"

could negotiate informal fees with all government departments and accordingly inform its members. As a garment factory owner interviewed in 2008 explained:

> We negotiate with each government department. . .you take $10 for inspection instead of $35. . .we agree. We tell all members the cost negotiated at $10. If not accepting, I refer to GMAC, and GMAC refer to your boss. Some in private sector don't want their boss to know and cheat the boss.

According to a nongovernmental organization representative interviewed in 2008, the garment industry is paying 10 % in informal payments; given its $5.53 billion in export revenues (Fibre2fashion 2014), this is in excess of $550 million under the table, but only people with a position in the supply chain can touch this money. The garment industry has also been able to achieve some improvements in the operation of the transport and export–import processes. However, according to industry representatives, all these arrangements require constant monitoring and enforcement in order to avoid slippage. Often, what has been agreed upon at the ministerial level and with customs in Phnom Penh does not get telegraphed to the ground level where provincial authorities operate fiefdoms. Collective action by a single sector has nonetheless been insufficient to solve some major issues.

3.2 Hand-in-Hand Governance and Labor

The garment industry, the leading growth sector, offers useful lessons. It is an example demonstrating hand-in-hand governance, where the Cambodian government (in particular the Ministry of Commerce) with foreign investment capital and firms (coordinated by GMAC) worked together to create an environment that generated growth. The strategic vision developed by the RGC, with the US government, helped align expectations for investors. The link to export quotas and the supervision by the ILO helped to establish the credibility of these higher expectations. The rents for government of managing quotas (which ended in 2005 as the Multi-Fiber Agreement was dismantled) increased incentives. Subsequently, the existence of a strong and capable business association, GMAC, helped sustain support to the industry and to create a sense of security given GMAC's capacity to accomplish things with the RGC. This is evidenced in the capacity of this hand-in-hand relationship to reduce trade costs, at a time when these costs were still increasing for other industries.

Although hand-in-hand governance has brought positive change in the form of economic growth, there is concern "Within Cambodia's NGO community, and for western donors" as to the "lack of transparency and accountability surrounding investments, grants and loans" by China (Sullivan, 50). "There is a concern that Chinese investment, supported by China's foreign policy objectives in the region, may act as a disincentive for the Cambodian government to follow through on its commitment to democratic reform. Indeed, it may reinforce the power of Cambodia's political–economic elite, who preside over a notoriously unaccountable, opaque and inherently corrupt state system" (ibid).

Western donors have also played a great role in providing funding to the country, but these usually come with demands for reform and "It could be argued that by increasing the pressure to reform, or making aid conditional, Cambodia's traditional donors run the risk of pushing the government even closer to China" (Sullivan, 54). This has already happened in the donor space, but has also moved to trade as well. The Regional Comprehensive Economic Partnership (RCEP) negotiations were launched in Cambodia in 2012. Cambodia is one of the 16 countries, including China, that are a party to RCEP. Because the garment sector in Cambodia exports primarily to the USA and Europe, the impact of RCEP on Cambodia will be limited to garment inputs imported into Cambodia (fabric, thread, and buttons)—if at that—and not exports of garments from Cambodia to the USA and Europe. Since the USA and Europe are not parties to RCEP, and Cambodia is not a party to the Trans-Pacific Partnership (TPP) which the USA has spearheaded with Asia while excluding China, the impact of RCEP on Cambodia's garment sector will be limited. The concern will be Vietnam's membership in both RCEP and TPP, if the latter includes specific garment-related benefits. This, however, seems unlikely given that Bangladesh is Cambodia's biggest competitor (with much lower garment wages) and that Myanmar is the newest entrant in the global garment industry (with even lower wages).

Moreover, China's state policy of "noninterference" into the affairs of other states makes Chinese aid and investment particularly attractive to the poorer authoritarian and semi-authoritarian states like Laos, Myanmar, and Cambodia (Lum et al. 2008: 5). The situation is further pushed in China's favor because of the failed or stalled experiments with democracy through less than free and fair elections in the early to mid-1990s and the 1997 Asian financial crisis and its consequences for development in the region. The handling of the Iraq war in light of human rights abuses at Guantanamo Bay and Abu Ghraib detention centers has exposed the inconsistencies and contradictions of Western liberal democratic development models. "A Chinese approach therefore that appears not to promote a particular set of political and cultural values and norms may appear more attractive to some Southeast Asian states like Cambodia" (Sullivan, 55).

It is commonly held that growth without proper governance can only persist for so long. Growth depends on the functions of the state, which in Cambodia include peace and stability, private sector development through privatization and government–business relationship, and a patronage system mainly in rural areas. The country's ability to maintain growth will depend largely on keeping the gains made in political stability, but moving beyond these to quality of governance—and not just for the acts of commission, which are early and often, but for the acts of omission which are too often forgotten.

A great puzzle is how to explain such dazzling growth in Cambodia in junction with the presence of poor governance. Evidence suggests that two factors may help explain the garment sector's success despite poor governance: (a) the presence of a private sector organization—GMAC—which produced collective action to lobby authorities for negotiated industry-wide rent-seeking rates and (b) international drivers/incentives such as an overwhelmingly foreign presence in garments (93 % of garment factories are foreign owned) along with quota exports to the USA linked

with minimum labor standards that produced enough rents for all parties involved. The GMAC–Ministry of Commerce relationship is exceptional, embodying a governance focal monopoly. Establishing a garment industry in Cambodia proved a win–win proposition both for foreign investors and local stakeholders. What is clearly unique about the garment industry is the involvement of international players, the creation of new opportunities (as opposed to the dividing or displacement of preexisting rents), and the generation of social capital to fight long ingrained patron–client networks.

But again, despite the past successes, there are major challenges that the sector faces as it develops without proper governance and structure. One concern is labor disputes. Labor disputes are more frequent in Cambodia than in competitor garment countries.[18] Three reasons appear to account for this situation: (1) the international regime that was put in place in Cambodia has had unintended consequences, (2) highly fragmented labor unions, and (3) weaknesses in management of garment factories.[19] There are some signs that the three parties concerned including garment factories, labor, and government are now seeking to improve the situation.

Adherence to ILO labor standards is monitored in *Better Factories Cambodia*-supervised garment factories. While one might expect this to result in good labor relations, this has not in fact been the case. The number of labor unions has proliferated. Currently, more than 1000 unions are registered, although only around 440 are estimated to be active. This is still a large number considering that the formal sector employment is limited and given that few informal workers are unionized. According to a labor organization manager interviewed in 2008, 80 % of factories have active unions, averaging about 1.4 unions active per factory.

The large number of unions appears to result from a mixture of social and political factors. Organizational fragmentation is a common problem; most unions are affiliated with the CPP, some with SRP and other parties, while others are truly independent. As a Ministerial Prakas (Regulation) 305 is implemented, which refers to the "most representative union," this will eliminate the smaller unions, and indeed they are merging. The tendency for many people to set up their own union is shared by a number of developing and emerging market countries. While the ILO regime was intended to create free and strong trade unions, the formal rules

[18] According to estimates, one day per worker was lost due to strikes in 2006. This is in addition to a relatively large number of public holidays (26 days in 2011).

[19] A garment factory owner interviewed in 2008 said: "Strike happens when they say toilet is broken … etc. Why are they not eager to resolve without strike? Because management does not necessarily respond … they sometimes disregard because it is not important to the production … What we ask for is to give due process before striking. If management doesn't respond, you go to Ministry of Labor, and then to Arbitration Council. So give some time, but that does not happen. Some strikes, they don't even know what they want." According to the law, if there is a problem it should (1) be taken up in the factory, then (2) be referred to the Ministry of Labor—but that has weak capacity + expects payoffs to resolve issues, (3) the Arbitration Council. The AC's decisions, however, are not binding—a trade-off for its desire to be independent.

it helped put in place allowed an excessive flourishing of unions—and the resulting impossibility of collective bargaining has been an unintended consequence.[20]

There is some indication now that entirely self-serving unions are diminishing and that more comprehensive federations of unions emerge. The NUACC (National Union Alliance Chamber of Cambodia) founded in May 2007 claims to represent more than 200,000 workers (of which 75 % are from the garment industry, with the remainder being teachers and informal sector workers). It brings together 11 smaller "federations" and two individual unions. The NUACC claims to be politically unaffiliated, while its members have a range of political affiliations. A major union in the garment industry is the Free Trade Union (FTU) of Cambodia (claiming around 80,000 members). The government has not been very supportive of labor union consolidation—possibly out of concern that such consolidation could create alternative power centers. Such concerns are also evidenced by the fact that three leaders of the FTU have been killed in recent years (Chea Vichea in 2004, Ros Sovannarith in 2004, and Hy Vuthy in 2007, to cite but three).

Frequent strikes are at least in part also attributable to poor management. Reportedly, many factory managers have been unable to establish a communication regime which would resolve issues before they spill over into strikes. According to a garment factory owner interviewed in 2008, issues may be of a petty nature such as failure to repair broken toilets or failure to provide a shelter for bicycles and motorcycles with which workers commute to work. In most factories, even lower-level management is foreign rather than Cambodian which is perceived to contribute to poor communications.

In combination with poor infrastructure/costly utilities, strikes are an additional factor which contribute to constraining additional investment in the sector. There are ongoing efforts to change the regulatory framework with a view to smoothing labor relations. The main proposition is to establish a rule of the "most representative union" so that "collective bargaining" per factory would become possible (there is no discussion yet of sector-wide collective bargaining).

It is evident that political stability is a necessary but not entirely sufficient condition for success and that ultimately quality of governance will determine the future of garments and industry in general for Cambodia.

4 Conclusion

The garment industry highlights the importance of governance for growth and how governance can improve and support growth as well. The "good enough governance" that has kept the garment industry thriving itself is not a permanent

[20] Labor union leader interviewed in 2008 said: "According to Cambodian labor law, 8 workers are sufficient to establish a union." According to a Banker interviewed in 2008, "By law, you have to set up a staff association but most people don't associate."

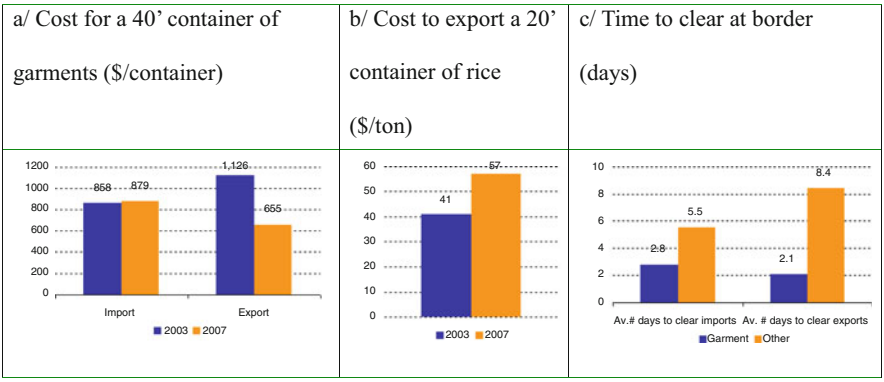

Fig. 5 Cost and timeliness of shipments: garments and other sectors. *Source*: JDI (2007). (**a**) Cost for a 40 ft. container of garments ($/container). (**b**) Cost to export a 20 ft. container of rice ($/ton). (**c**) Time to clear at border (days)

condition; it can go either way, and the key to policy is tipping it in the right direction. Potential factors for promoting growth include tackling the constraints observed in garments (lower productivity with higher costs) and other sectors. Of course, there are too many constraints for each to be binding per se. While garments and sectors like rice and livestock are all tradables, requiring transportation, electricity, or energy all faces similar unofficial payments. However, garments clearly had "good enough" governance through collective action and negotiation. Figure 5 highlights the stark difference in the cost of exporting a 20 ft. container of rice in 2003 versus 2007 and how garments today enjoy markedly superior treatment in terms of border clearance.

Despite these governance issues, it is apparent that Chinese investment in Cambodia has positively impacted the country in key areas: job creation and GDP growth. Other positive effects have been the technical knowledge that has been fostered and the global commercial relationships built. Yet, the topic of long-term effects is the most important issue to consider. Considering the geopolitical interests of China in Southeast Asia, Chinese investment does not come free; political and economic strings tie those who benefit to the influence of China. And this influence has most notably stirred concern among the international community on the status of Cambodian governance.

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Politics of Economic Relations Between China and Myanmar

Timo Kivimäki

1 Introduction

Economic relations between China and Myanmar are not just matters of the economy. Instead, economic considerations are ingrained in political realities. Firstly, when considering the economic relations between the two countries, it is evident that they need to consider the logic of voluntary political interaction in which countries are voluntarily choosing with whom to collaborate, interaction that is affected by power and persuasion, as well as political conflict where conditions are forced upon each other. On the level of voluntary cooperation, Sino–Myanmar interaction is a test of China's international "political competitiveness" after the ending of the Myanmar sanctions. During sanctions against Myanmar, China was in many economic types of interaction, the only choice for Myanmar. After the opening of Myanmar, China has had to compete with the rest of the world for Myanmar's collaboration. The prospect of a Regional Comprehensive Economic Partnership with Japan, South Korea, Australia, and New Zealand was on par within the same political arrangement; thus, the question of China's political competitiveness is undoubtedly going to be highlighted.

Secondly, the role of political power and persuasion is also relevant for the Sino–Myanmar economic relationship. It is important for Chinese foreign policy to use power in a way that serves its long-term global interests. On this level, the power relationship of Sino–Myanmar economic relations is a test of China's commitment to anti-hegemonism. China needs Myanmar's energy resources, yet an anti-hegemonic China cannot manipulate Myanmar's domestic decisions despite high stakes. How does one stay out of domestic affairs when Myanmar's internal power struggles matter so much to some core elements of China's economic and political rise is a question that China has had to ponder seriously?

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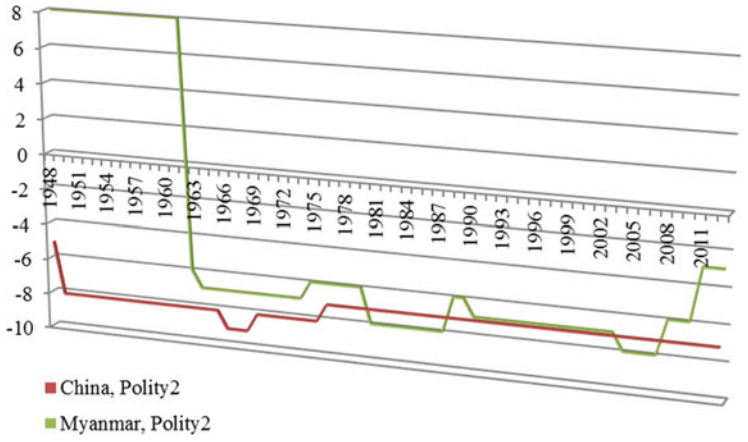
Finally, China's and Myanmar's economic relations are linked to force and conflicts through their connection to the internal conflicts of Myanmar. To a large extent China's economic interest in Myanmar is guaranteed only if Myanmar's domestic conflicts are ceased or at least mediated.

This chapter assesses the political ramifications of the development of the Myanmar–China economic relationship and focuses mostly on the three main challenges of competitiveness, anti-hegemonism, and conflict. With this objective, it is possible to draw broader generalizations on the development of China's approach to its neighborhood.

2 Historical Context of Myanmar–China Relations

Historically, Myanmar and China have considered the relationship between their people as intimate and sibling-like ("paukphaw"). Yet, political orientations of the two countries have occasionally made it difficult for the political elites of the two countries to work in tandem with one another. Neither country has subscribed to the Western model of democracy. This has been a common political orientation that has had a uniting potential (Graph 1). However, during the Cold War, the type of non-Western governance a country represented was crucial for the international identity of the country. A communist dictatorship and a Western-minded capitalist dictatorship could not identify with the same global mission. In the communist camp, pro-Western leaders were seen as being puppets of US imperialism, while in the West communist leaders were treated as external forces to the country, implanted either by the Soviet Union or by China. Thus, within the context of the



Graph 1 The level of democracy in China and Burma/Myanmar. *Source*: Polity IV data (Marshall and Jaggers 2000). Available from: www.bsos.umd.edu/cidcm/inscr/polity

Cold War, China and Myanmar's political differences from the Western concept of democracy did not play an important role.

Due to the fact that the Chinese are a considerable ethnic minority in Myanmar, the politics of ethnic relations occasionally alienated the two political elites and radical political groups. Sentiments against China as a state were often directed against innocent ethnic Chinese populations in Myanmar, and the Chinese state's aggressive reactions often further blurred the distinction between the People's Republic of China and the Chinese ethnicity (Quarterly Chronicle and Documentation 1967, pp. 217–219, 1968, pp. 190–191).

Once the Cold War had passed and states no longer necessarily sought their international alliances and identities on the basis of their political systems, it was possible for Myanmar and China to see commonness in their rejection of the Western concept of liberal democracy and the resistance of the Western hegemonic pressures against countries that did not adhere to the Western political formula of governance. This commonness was fostered by the continuing Western resistance against autocracies like China and Myanmar. China and Myanmar were both sanctioned by the West at the very transition to the post-Cold War order, China due to the suppression of anti-government protests in May–June 1989 and Myanmar due to the military coup and annulling of democratic elections in May 1990. This experience bound the two countries together in a way that affected the economic relations of the two countries. On the one hand, both countries felt that they were unfairly treated because of their refusal of Western liberal democracy. Their sovereignty was challenged by hegemonism and their security threatened by the inability of fully developed Western states to understand the need to develop states for the security of the nation. Both countries felt that in the name of international democracy and the principle of sovereignty and noninterference, the powerful Western countries should not punish developing countries for not adhering to the Western norms of governance. To some extent the Chinese and the Myanmar view emphasized international concepts of democracy at the expense of domestic democracy (Xinhua 2014b, c). On the other hand, sanctions meant the unavailability of a free access to international markets, especially for Myanmar, and thus pushed the countries together (Kivimäki et al. 2010).

The Chinese and Myanmar's common opposition to what China calls hegemonism of the West together with the restrictions especially Myanmar experienced from the West managed to bring the two countries together economically in the 1990s. The growth of economic ties can easily be seen in the statistics of trade in goods since Myanmar's independence (see Graph 2).

Western sanctions have also affected the content of trade relations between China and Myanmar. European sanctions (the European arms embargo from 1990 and the so-called Common Positions Common Position 1996/635/CFSP since 1996) prohibited trade in arms, involved visa restrictions on members of the regime and their allies and families, limited diplomatic contacts and froze officials' offshore accounts, and prohibited non-humanitarian aid or development programs. In August 2009, this list of sanctions was supplemented by adding the members of the judiciary responsible for the verdict extending Aung San Suu Kyi's house arrest to the existing list of persons and entities subject to a travel ban and to an asset freeze.

Graph 2 Myanmar trade with China. *Source*: IMF, http://elibrary-data.imf.org/ViewData.aspx?qb=52c9ce6fd5a8db6e942d7c26149ea7c7

US sanctions were even more extensive. Executive Order 13047 (1997) and Burmese Freedom and Democracy Act of 2003 and the somewhat more modern Jade Act 2008 and the Department of Treasury's Burmese Sanctions Regulations (BSR) of 2008 froze assets and property of Burmese officials, banned new investments in the country, banned almost all import from Burma, and prohibited financial services to and from the country. As a result, Myanmar was left without Western capital and sophisticated Western technologies. It is therefore no surprise that imports of such products and help in investments in the utilization of Myanmar's rich minerals and energy resources were the focal points of Myanmar–-China's economic relationship. In terms of trade, Myanmar offered raw materials (which were often extracted with the help of Chinese capital and technology) while importing high-tech products for its own production. Chinese investments complemented this economic profile by offering the capital needed for the production of energy, extraction of raw materials, and transportation of them to China. While in the beginning of the new economic relationship, up to one third of Myanmar imports from China were textiles and manufactures, the share of such products gave way to power-generating machinery and equipment, road vehicles and petroleum, petroleum products, and related articles (UN Comtrade Database).

Since the role of China in Myanmar's economy was largely related to compensating for the goods Myanmar could not get from the West due to the sanctions, it is understandable that the content of trade was problematic with a typical colonial division of labor. China offered machinery and high-tech products and participated in production by offering capital, while Myanmar could only offer raw materials (cork, wood, and food) for trade and the labor component in joint production (UN Comtrade Database). Chinese and Myanmar trade also became unbalanced as Myanmar had more needs to import than it had capacity to export. As a result, Myanmar–China economic relationship developed into a colonial pattern where the colonial subject (here Myanmar) was dependent on the colonial master (China) and focused in economic cooperation on tasks (manual labor and raw materials) that did not bring its economy forward. At the same time, the "colonial master" focused on tasks that developed its economy to higher levels of productivity and technological

excellence. This, despite the fact that the origin of such a structure of economic relationship was not in imperial or colonial designs of China, but simply in Western sanctions. While many of the smaller Chinese companies sometimes behaved in a way that reminded one of colonial domination, larger Chinese companies and especially state-owned enterprises were rather sensitive of the problematic structure of China–Myanmar's economic relationship and attempted to work against it within their fields (Yawnghwe 2014; CNPC undated).

3 Is China Competitive Enough?

With the increase in the political network, China now needs to compete more than before for Myanmar's business. On the one hand, bilateral cooperation with Myanmar will be competed for more intensively as before. On the other hand, with the rise of new multilateral arrangements, such as the Regional Comprehensive Economic Partnership, where East Asian and such pro-Western democracies as Australia, New Zealand, Japan, and South Korea participate in the context of an increased economic liberalization, China's political identity could become incompatible with the new/future democratic identity of Myanmar. This could be greatly problematic for China's large investments and energy cooperation with Myanmar.

When China's National Development and Reform Commission approved the plan to build two pipelines, one for gas and the other for oil linking the deepwater port of Kyaukphyu (east of the city of Sittwe, Rakhine State) in the Bay of Bengal with China's Yunnan Province in April 2007, Myanmar had just launched its seven steps to peace and democracy. At the time, very few believed that this plan could lead to anything resembling democracy. When China and Myanmar concluded and signed the agreements on the pipelines in November 2008 and in March 2009, Myanmar had just held its first National Convention with the main ethnic groups to advice the drafting of the new constitution. Generals were still in charge in Myanmar on October 31, 2009, when the construction work started. However, civilian government took over after the election of 2010, and the democratic opposition party National League for Democracy, NLD, took a landslide victory in the by-election of 2012. Soon after the by-elections in July 11, 2012, the USA eased its main instrument of investment-related sanctions (the Executive Order 13047, Clinton 1997), and the next year the USA eased its visa ban regime by modifying the Executive Order 13310 and the Presidential Proclamation 6912 (Clinton 1996). The European Union was even more radical in its policies by scrapping all sanction measures except the arms embargo of 1990 in one go by renewing the EU Common Position in April 2013 (Council of the European Union 2013). As a result, today the state-owned Myanma Oil and Gas Enterprise (MOGE) that regulates the usage and concession to its 30 offshore oil and gas blocks receives many international offers for exploration and utilization of Myanmar energy resources. Of the 61 competing oil companies, the biggest, Shell, ExxonMobil, France's Total, Norway's Statoil, Italy's Eni, Spain's Repsol, Anadarko Petroleum,

and Premier Oil, are all included. In the new situation, it has become possible that some of the Chinese infrastructure investments will benefit its competitors to gain access to Myanmar oil and gas (Competition escalates for Myanmar's offshore oil blocks n.d.; Zhao 2008).

While Myanmar's energy resources are now in open competition, oil and gas investments are a long-term business that requires also political considerations on both sides. An oil company will not invest close to $1 billion before even beginning to earn money from Myanmar oil unless it has made sure that the investment has some long-term security. Oil companies tend to cooperate closely with the governments of their home countries as well as with the host countries to make sure that their investment is safe. Sudden changes in terms between companies and the host countries could in extreme cases result in political turmoil where even completely independent oil companies might play clandestine roles as Prime Minister Mohammad Mosaddegh of Iran learned in 1953 after trying to nationalize the assets of a British oil company (now called BP) after a failed effort to renegotiate oil company's access. Considerations on who to give concessions are therefore not just economic. The question for China is therefore whether Chinese state-owned companies have the necessary political competitive edge to win contracts now that the Chinese "monopoly" is over.

The question of Chinese political competitiveness is partly a matter of identity. Governments form their profile by choosing their cooperation partners. The problem with Chinese economic relations with Myanmar is that China belongs to Myanmar's past, while politicians need to signal their preparedness for a change to survive their domestic political competition in the polls. Democratic commitment can be shown by collaborating with established democracies and by choosing different collaboration partners than the previous authoritarian government did. Furthermore, on the matter of national identity, China has not been very attractive: in opinion polls Chinese cultural presentations, TV arts, etc., have not been very popular, certainly not as popular as the Anglo-American signposts of identity (BBC World Service 2013; Kohut 2013).

Perhaps due to these profiles and factors regarding national identity, there are already pressures for the Myanmar government to disrespect some of the contracts by the previous government. The suspension of the building of the joint Chinese–Myanmar hydropower station in Myitsone in September 2011 after popular protest and after the prominent pro-democracy leader, Aung San Suu Kyi, had gone on the side of the protestors (Burma U-turn on controversial dam 2011) showed how democratic profiling of the government can harm Sino–Myanmar economic relations. Later in April 2013, over $2.5 billion worth of Sino–Myanmar double pipeline became a target of popular demonstrative action by farmers in Northern Shan State across the border to the Province of Yunnan as well as on the Maday Island, at the other end of the pipelines. Even a political party, the Rakhine Nationalities Development Party, *openly opposed the pipeline and advocated the closing of it*. The pipeline was a project of the previous government, and thus to some, it represented authoritarianism. However, despite continuing demonstrations,

the government did not yield into this pressure as the investments were simply too large to abandon for the sake of political profile.

The pressure to signal democratic identity by choosing to cooperative with the West rather than with China will probably not be a major threat to the economic cooperation of China and Myanmar during the presidency of Thein Sein. However, if the NLD wins the next general election, if the restrictions of the constitution for presidential candidates with foreign spouses are removed, and if Daw Aung San Suu Kyi becomes the next president of the country, such pressure may become very acute. The opposition leaders' intimate ties with the UK could, furthermore, weaken China's competitive edge in comparison to the Anglo-American world.

While the change to democracy pushes Myanmar government toward the West rather than toward China, a more long-term trend of proud independence-mindedness of Myanmar's leaders might eventually elevate China's political competitiveness. Many Chinese officials in energy business tend to see only dangers in the widening of Myanmar's contacts to the Western world. Yet, Myanmar officials have always considered dependence on China a problem. The fact that Myanmar's trade with China has developed into such an asymmetric direction has further aggravated the problem of dependence. Thus, it could be that the new options Myanmar has are actually helping the development of spontaneous relationship between China and Myanmar. When China is no longer the only option, Myanmar does not need to feel dependent on China, and this way a problem in the relationship between the two can be removed.

When it comes to energy investments, China does not have the arrogant reputation of its American and former colonial European counterparts. While British and American companies have actually been involved in the changing of regimes of host countries, the worst that has been said about China companies, i.e., the Chinese government, is that there is a rumor that one Chinese ambassador had encouraged Zambians against voting for an opposition party that had called for an investigation on the working conditions in Chinese-owned businesses in Zambia (Kurlantzick 2007). According to the Financial Times, Ambassador Li Baodong had suggested that China should cut diplomatic ties with the country, if the opposition candidate Michael Sata were to win the presidential vote (Reed and Correspondent 2006). However, the fact that cutting diplomatic ties is a threat and not a promise and that the threat reduced the opposition candidates' chances of getting elected already shows that even in Zambia, Chinese presence was welcomed. In comparison to the record of British and American interference, China could be a much less intrusive energy trading partner to Myanmar than its main competitors.

Myanmar's public opinions cannot yet be measured, and thus Myanmar has been out of the focus of the very important PEW and BBC opinion polls on popular sentiments on politics and trade with big powers. However, if Myanmar follows the same pattern as other nationalistically minded oil-producing countries, it seems clear that the power policies of the USA have played to the Chinese hands. China is perceived as an alternative, a "Not-USA," in the energy-exporting countries. Thus, whenever US drone attacks or invasions cause popular dissent among citizens of oil-producing countries, China's popularity tends to rise (BBC World Service 2013;

Kohut 2013). Since the USA has had to use its power in many of the oil-producing countries to protect its oil interests, oil-producing countries have developed popular opposition to the USA and thus positive sentiments toward China. While in general, in the world that is dominated by the Western media, China is viewed much less favorably than the USA, it is interesting to note that in oil-producing countries this is not the case. My earlier study on Chinese soft power revealed that while popular opinions in oil-importing countries have been clearly more positive to the USA with less than half of population viewed China favorably and over 60 % of people were favorable to the USA, in oil-exporting countries up to two thirds of people saw China favorably, while less than half of the population were favorable toward the USA (Kivimäki 2014). Up to 17 % more people in oil-exporting countries were favorable toward China than toward the USA.

Due to the high sensitivity of Myanmar people and its governments toward bullying from super powers, it seems likely that in Myanmar as in all oil-producing countries, the strong policies and low respect of sovereignty of oil-producing countries of the USA play into the hands of the "Not-US" China. Before it does, though, Myanmar has to realize that it is no longer monopolized in trade by China.

Finally, China's political attractiveness as a business partner could also be affected by geopolitics and geo-economics. China as a neighbor cannot disappear as did the USA from Southeast Asia once there was economic trouble as was the case during the Asian economic crisis in 1997–1998. Economic development and especially energy production require long-term investments, and a neighbor who can build material infrastructure such as pipelines (which the USA and Europe cannot do due to the distance) could be more attractive as a long-term partner in that sense.

Furthermore, China has developed a business model in which asymmetry that the neighboring position implies does not play against the sentiments of the weaker country. China is not seen as being domineering, and as a result, while Chinese culture, political system, and other Chinese qualities have not been popular, business with China has been supported in weak countries and oil-exporting countries more than business with the USA. While a clear majority of oil-producing countries see their economic relations with the USA as excessive, all Middle East countries, oil producers, and Asian countries with the exception of India and Japan had majorities of population that perceived the increasing Chinese economic influence as being something positive to their country (Kivimäki 2014; Kohut 2013).

With the democratization and internationalization of Myanmar, China has entered a competition for business with Myanmar. Even though factors relating to the notion of identity run against Chinese attractiveness, China has managed, partly under the heading of a "Not-USA," to capitalize on the negative sentiments toward the intrusive hegemonic approach of the USA. This, together with a continuing commitment to equality and anti-hegemonism, could be the explanation why, at least so far, Myanmar's opening has not reduced China's role in Myanmar's economy as Graph 2 indicates.

4 Anti-hegemonism Versus Necessities of National Security and Prosperity

Access to energy resources is one of the necessities of China's economic development. Zheng Bijian, a senior advisor to China's former President Hu Jintao, described the shortage of resources as the first of three fundamental challenges for China's peaceful rise (Zhao 2008, p. 211). Economic development, again, has been for the past four decades the first priority of Chinese state (Deng 1982). This reality pushes China to policies that intend to ensure access to the energy resources of Myanmar.

At the same time China has declared a policy approach that limits its capability to influence Myanmar's willingness to sell oil and gas to China. China identifies itself as an anti-hegemonic power, a country that considers other nations as equal and that respects everybody's sovereignty, territorial integrity, and the right to conduct their domestic policies without external interference. The Five Principles of Peaceful Coexistence from 1954 emphasized this (Five Principles of Peaceful Cooperation 1954), and since the Chinese Five Principles were developed together with Myanmar (and India), they tend to have an emphasized relevance in the Sino–Myanmar relationship. This seems clear at least on the level of declarations as the two countries declared their continuing commitment to the principles at the 60th anniversary of the launching of the principles (Xinhua 2014a, c). Since the Cultural Revolution, China has reaffirmed its commitment to the Five Principles and anti-hegemonism which, in official Chinese parlance, have meant refraining from imposing Chinese ideas relating to domestic administration on other countries (Deng 1982). Noninterference and equality between nations were elements of the doctrine of "peaceful rise" that was launched by the former Vice Principal of the Central Party School, Zheng Bijian, in 2003, and adopted by President Hu Jintao's administration (Choo 2009; Full Text: China's Peaceful Development 2011; Yue 2008). In 2004 former President Hu Jintao announced the "Four No's," one of which was a "No" to hegemonism (Arrighi 2008). President Xi Jinping's recent statements reveal that the Chinese respect for sovereignty and equality is crucial not only for the Chinese self-identity as an anti-hegemonic power but also for the goodwill that China needs from its neighbors for its economic and political development and peaceful rise (Xi 2012, 2013).

The material objective need for China to get access to energy resources of the neighboring countries if it intends to continue to develop economically could be seen in contradiction with the self-identity of China as an anti-hegemonic nation and with the requirements of goodwill China needs from its economic partners. History teaches us that oil businesses are difficult to conduct in the absence of some control over the safety of one's investments. However, for China this control will be perceived as being hegemonic. To some extent Myanmar serves as an exemplar of China's economic relationship as it is one of the oil-possessing neighbors and especially as it is one of the inventors of the Five Principles. Adjusting energy

needs with the idea of anti-hegemonism will therefore be one of the main political challenges China has in the political economy of its relationship with Myanmar.

According to one prediction, China will have to yield to its material needs. China's aid policies are designed to promote not just the interests of the recipient but also China itself. In July 1979, Deng Xiaoping told a Politburo working group: "we must ensure that both the donor and the recipient country can receive benefits" (cited in Reilly 2013, p. 145). According to James Reilly, the Chinese interest in aid is often to assist China's needs for raw materials. According to Ian Taylor, China's need for imported energy will be so pressing that it will make the country compromise its foreign policy principles of anti-hegemonism (Taylor 2009; Kreft 2006). The reason of such hegemonic influence is simply the pressure of China's own economic needs.

Another prediction is that China will impact domestic politics with its sheer size. According to Harry Verhoeven, China, with its size, already "interferes" into the domestic affairs of African oil-producing countries, and the doctrine of noninterference is reality only on the declaratory level (Verhoeven 2014). According to Joshua Kurlantzick, due to China's importance for Myanmar, Chinese cooperation with whichever political group will always play to the advantage of this group in domestic power battles. Thus, a powerful nation like China cannot really avoid domestic interference. Kurlantzick cites an activist who exemplified this by claiming that China will not enjoy the goodwill of the future democratic government as they are the people China helped keep in prison by collaborating with the previous autocratic government (Kurlantzick 2007, p. 224).

To assess how much hegemonism we can expect from the future Chinese approach to economic relations with Myanmar, we will first have to investigate how important Myanmar's economic contribution is to Chinese economic development. We have already established that China considers the facilitation of economic growth as the main function of the Chinese state. State is seen as an instrument of growth and this is what gives it its purpose and identity. Furthermore, we have established that China considers access to energy resources as the main bottleneck to China's economic development. Thus, we now only need to know how important Myanmar is in offering China the energy it needs.

By far the main energy-related cooperation project China and Myanmar have is the oil and gas pipelines that were finished in 2013 and became operational later that year. The value of the investment in the pipeline project is relatively high with the construction costs of the two pipelines alone reaching 16 billion RMB. The Chinese counterpart, the China National Petroleum Corporation, owns a 50.9 % stake and manages the 30-year-long project, and the Myanmar Oil and Gas Enterprise (MOGE) owns the rest. The total amount of natural gas projected from the Myanmar gas field at the end of the pipeline in Shwe field in A-1 offshore block off Rakhine State is 22 trillion cubic feet = 663 billion m^3, which is slightly less than China's natural gas consumption in 5 years. However, the share of gas consumption in the total consumption of energy is only about 3 % (Kreft 2006). If China manages to quadruple the share of its gas consumption as the total energy consumption, the reserves of Myanmar will not last for more than perhaps 1 year. The total depository

of oil at the end of the pipeline corresponds to the average Chinese consumption for about 4 months. This is actually surprisingly little, and if Myanmar is a showcase of China's anti-hegemonic economic relations, it might not justify that the bad PR China could get by bullying Myanmar over the pipeline project. Furthermore, if half of the value of the project is a great investment for China, the other half that is owned by Myanmar is of course vastly more substantial as an investment for Myanmar whose national economy is only a small fraction of that of China.

However, the pipeline will enable Chinese oil and natural gas from the Middle East and Africa to be shipped to Myanmar port in Rakhine State to be further transported through the pipelines to China. According to US Energy Information Administration, about two thirds of China's imported oil passes the Malacca Strait (U.S. Energy Information Administration (EIA) 2003). However, the capacity of the Myanmar pipeline is less than 1/30 of the traffic of Chinese oil through the Malacca Strait (U.S. Energy Information Administration (EIA) 2012). Thus, the role of the oil pipeline as a substitute to the traffic through the Malacca Strait is very limited. Much of China's oil transports would in any case need to pass through Sunda or Lombok straits if the Malacca Strait was blocked. Thus, also the strategic value of the Sino–Myanmar pipeline project is much smaller than it is portrayed in the media and much of the scholarship. It may not be a sufficient incentive for China to deteriorate its goodwill in its regional economic relations.

Furthermore, it may be that China could optimize Myanmar's willingness to grant it access to its energy resources exactly if China stays out of Myanmar's domestic affairs. In some case as in Iran in 1953, the USA was able to bully concessions and secure its energy investments by exerting pressure to domestic decisions and governance. However, on the long run, the lack of popularity of the USA in energy-exporting countries has shown that this strategy has not been very successful. Whether China will follow the American example remains to be seen. The future in this respect cannot be predicted; it will have to be made.

If energy trade with Myanmar could not justify hegemonism for China, perhaps the general overall need to access Myanmar's natural resources could. After all, Reilly claims that China's aid policies already aim at ensuring such access (Reilly 2013, p. 145). However, there might be a logical conceptual problem with jumping from this to the interpretation that this is hegemonism. Such an interpretation assumes that aid relationship should consider the well-being of the recipient country instead of being egoistic. However, altruism may not be desirable or anti-hegemonic in the Chinese understanding. Altruistic aid assumes that it is up to the donor to consider what will be of benefit for the recipient. Chinese principles of aid (and commercial relations), however, suggest that aid relationship is between equal nations who both have control over the definition of what can be defined as "good" for them. Economic relationship should be voluntary and aim at mutual benefit where both define their own goals, and thus China, as a donor, is supposed to think of its own benefits instead of paternalistically defining what is good for the recipient. The fact that both parties are equal and the relationship is voluntary makes it possible for both to consider their own benefits in the process that aims at making the economic relationship mutually beneficial (Enlai 1964). Thus, if

Chinese aid in Myanmar benefits Chinese access to raw materials, it is not against the Chinese rule of anti-hegemonism. On the contrary, it is an example of such thinking.

To expect China to understand aid in the same paternalistic manner as much of Western thinking understands aid is, however, very common. PEW report measures whether people of developing countries consider China and the USA "taking care of the interests of your country." The fact that the USA scores higher in this is then assumed a partial proof of the greater popularity of the USA in comparison to China (Kohut 2011). But for China it is important that people in developing countries appreciate the Chinese way of doing business and that they consider doing business with China positive. The countries may themselves consider and take care of their interests; China only needs to be useful for their interests and the relationship has to be voluntary, based on equality and mutually beneficial, to be in line with the Chinese anti-hegemonic principle.

Tiejun Zhang has theorized the difference of Western and Chinese thinking behind aid and economic relations by distinguishing between the Western objective of helping "good governance" in developing countries and the Chinese objective of helping "efficient governance." While the objective of "good governance" paternalistically defines what is good for the developing country, the objective of "efficient governance" gives the definition of what "good" is to the developing country. China tends to support efficiency of Myanmar governance only in such collaborative ventures where the "good" that Myanmar defines in its governance also serves Chinese benefit (the principles of mutual benefit). Yet, unlike hegemons who interfere in the domestic definition of values, Chinese concept respects Myanmar's own right to define what the government wants to define as good governance (Zhang 2009). Thus, what Reilly notices of the Chinese aid relationship with Myanmar does not need to be a proof of neocolonial or hegemonic ambitions of China. Of course Chinese aid relationship with Myanmar can develop into a direction where the shear strength of China and the asymmetry of the relationship could become to mean that the mutuality of benefits becomes asymmetric, too, and the share of benefits China gets from the relationship becomes disproportional. However, the fact that China only defines its own objectives in economic interaction does not prove hegemonism.

5 Conflict in Myanmar and the Sino–Myanmar Economic Relationship

Political conflict and interaction where conditions are forced upon each other is relevant for Sino–Myanmar economic relations. This does not mean that economic interaction between the two as such would be forced or that there was a risk of such a conflicting relationship between the countries. On the contrary, conflicts affect the

relationship when they occasionally involve ethnic Chinese and especially when they seriously affect the safety of Chinese economic investments in Myanmar.

Ethnic relations affected Sino–Myanmar interaction during the Chinese Civil War due to the fact that some of the Kuomintang forces sought refuge from the northern part of Myanmar in Kachin State and then conducted military operations from the Myanmar territory. Myanmar was naturally not in a position to prevent the penetration of the Chinese nationalist forces, while fighting between the nationalists and the communists in China could not always be limited within the Chinese border even if neither the nationalists nor the communists wanted to disrespect the territorial integrity of Myanmar. The ending of the Chinese Civil War in 1949 and the stabilization of the relations between the nationalists on Taiwan and the People's Republic calmed down the Kachin border areas. Yet, the sub-ethnicities in Kachin and Northern Shan State remain ethnically close to the Chinese, and this occasionally complicates the relationship of these groups with the central government and other ethnicities who might claim these sub-ethnicities as nonnative Chinese ethnicities. At the same time they complicate the relationship in the border areas between China and Myanmar. The incident of Myanmar Air Force bombing on the Chinese side in its pursuit of Kokang rebels in March 2015 and the killing of five Chinese citizens, as well as the Myanmar claim that local Chinese officials were helping Kokang rebels, exemplify these complications (Beech 2015).

There have been suspicions that China has ethnically based preferences in economic cooperation in favor of the sub-ethnicities that are genealogically close to the Chinese population. During the Cultural Revolution, it was clear that Chinese policies occasionally defended ethnic Chinese across borders, and there were major difficulties between the two countries due to the Chinese interference into the Myanmar ethnic relations (Quarterly Chronicle and Documentation 1967, 1968). At one stage, for example, the Central Committee of the Communist Party of China communicated to the Central Committee of the Communist Party of Burma that "It is the firm belief of the Communist Party of China that, having integrated all-conquering Marxism–Leninism with the conditions of Burma, the Communist Party of Burma will surely be able to lead the various nationalities of Burma to defeat U.S. imperialism and its agent in Burma—the reactionary Ne Win clique—as well as the accomplice of U.S. imperialism, Soviet modern revisionism, and carry the revolutionary armed struggle to final victory" (*Peking Review* 1968, 11 (14): 27).

During the past decades, though, suspicions of Chinese favoritism in favor of ethnic Chinese of Myanmar could be unfounded. China is committed to anti-hegemonism, and this should prevent it from interfering into Myanmar's ethnic relations. Yet suspicion of favoritism sometimes exists (several anonymous interviews by the author in special regions of Myanmar's Northern Shan in 2007 and 2008) on the level of individual businessmen. However, this is not sanctioned by the Chinese state. Yet, it sometimes affects the calculations in interethnic relations of Myanmar people across the Chinese border.

Chinese companies are also sometimes associated with the state of China, and when behaving in an exploitative manner, they might cause strain to the economic

relationship between the countries. According to a prominent mediator in Myanmar's interethnic peace process, small Chinese companies occasionally harm the interests of huge Chinese state-owned enterprises as exploitative and illegal business activities by smaller Chinese companies tarnish the image of all Chinese companies, even if bigger companies have a tighter official Chinese control over their deeds in Myanmar and thus even if they did not participate in anything illegal or exploitative. According to a major Myanmar mediator, Chinese state enterprises would benefit a lot of goodwill and safety in Myanmar's poorly controlled Northern Shan areas if they managed to control their small companies better and if they could prevent the illegal Chinese businesses from tarnishing the image of all Chinese business in the border areas (anonymous interview, April 2014).

Finally, the aid relationship with areas controlled by ethnic Chinese militias especially in Northern Shan is sometimes confusing from the point of view of sovereignty and territorial noninterference. In Wa areas (Northern Shan State, Special Region 2), for example, Myanmar's control over the Internet and mobile phone networks has not worked in several years, due to the Chinese investments in the local ICT network. Chinese mobile phone network has worked in the areas, while the restrictions imposed by the Myanmar government have not managed to prevent the relatively free use of the Internet and mobile phones in the area. Furthermore, due to the volume of economic interaction, Chinese currency replaced Myanmar kyat in Wa areas and areas of some other ethnicities close to the Chinese ethnicity. Also the local language in these areas is much closer to the Chinese language than to any of the other Myanmar languages.

People in the Wa areas, and the other ethnicities that are culturally close to the Chinese, are officially recognized by the Myanmar state as indigenous Myanmar races even though many Myanmar people consider them Chinese rather than Myanmar race. Yet, unlike Rohingya Muslims, ethnic Chinese are generally tolerated in Myanmar. "Even though the Chinese are sometimes resented and envied, they are not rejected, they are accepted" (Yawnghwe 2010).

While China has no claim over the territories that these ethnic Chinese occupy, the de facto reality is that these areas are more Chinese than Myanmar. Many of the ethnic Chinese areas also behave as if their status was somehow ambiguous. This is not so much because of their ethnicity as it is because of their long history as rebellious territories. The author of this chapter has witnessed in 2006 a meeting of the Wa leadership and several senior Myanmar officials. In the meeting the senior Myanmar officials addressed the leadership as "Mr. Prime Minister," "Mr. Defense Minister," "Mr. Foreign Minister," etc., and the "Prime Minister" spoke gratefully about "aid from Yangoon and Beijing" as if the two capitals were in equal footing in relation to the special Wa region. While this ambiguity has not been related to the Chinese ethnicity of the Wa, but rather to the fact that Wa people with their 30,000 troops live in a mountainous areas that the Myanmar army has not managed to control. Yet in economic relations, the ambiguous setting and the geographic location between China and Myanmar create sensitivities that China needs to be wary of.

In addition to conflicts between ethnic Chinese and the Myanmar government in Myanmar, Sino–Myanmar relations are also challenged by the conflicts that threaten the safety of Chinese investments in Myanmar. Some of these conflicts have been related to the difficult process of democratization of Myanmar with occasional fighting between democratic groups and the totalitarian governments of the past. During the past 20 years, China has taken a consistent line of noninterference in this battle. China has tried to avoid upsetting the government and the potential future democratic government partly for the sake of China's economic interests. For good economic relations, one does not want to make political obstacles by siding with one side in a power battle that can end up in either's benefit. However, China has naturally needed to make contracts with the existing government, and not with any opposition forces, and this has occasionally upset the democratic forces and strengthened the association of some of China's ongoing economic contracts with Myanmar with the authoritarian past of Myanmar. Yet, the democratic opposition, which is also very nationalistic, naturally appreciates China's willingness to stay outside the domestic battles and deal with the legal government rather than with their self-nominated "representatives" (confidential interview material). According to some diplomatic sources, China has also for at least since year 2006 communicated with the National League for Democracy in addition to dealing with the government, and by doing this it has created options for its economic relations in an NLD-controlled Myanmar of the future (confidential interview material).

The main conflict-related challenge for the Chinese economic investments in Myanmar has been the war between ethnic armies and the Myanmar government. Due to the joint Sino–Myanmar ownership of most of the large-scale economic investments in Myanmar, many groups that fight the Myanmar government consider the joint investments also as enemy assets and thus as legitimate targets. For at least some of the Kachin Independence Army, KIA, soldiers, the Sino–Myanmar oil/gas pipeline represents a target against the Myanmar government. The New York Times cited a senior commander, Lt. General Gam Shawng, of the KIA saying that "The pipeline will be a tool and an opportunity for the SPDC (the previous military leadership of Myanmar) to eliminate the armed groups" (Fuller 2009). The KIO/KIA has since then lost control over some of the pipeline areas and this has made the Chinese situation easier (Gawlu La Awng 2014). Their investments are no longer in an area controlled by armies that consider them as enemy assets. The Myitsone electricity projects that also got local opposition are another example of similar conflict–threat to China's economic investments (Burma U-turn on controversial dam 2011). There is no guarantee that similar cases of joint development projects could not rise in the future, too. In general, the fact that in large infrastructure and energy investments, Myanmar, like many other countries, likes to retain its control over the developments by insisting on joint development schemes makes joint investments unsafe for China due to the conflict–reality where its government collaborators are occasionally seen as enemies by some local ethnic armies.

While the Chinese principle of noninterference makes it very difficult for China to tackle the problems related to safety of their infrastructure and energy investments in Myanmar, Beijing has not remained totally idle about the safety issue either. In the absence of world media attention, China has taken a very central role in the facilitation of one of the peace processes that most threatened its energy investments, namely, the negotiation process between KIO/KIA and the Myanmar government (Joint Statement, Riuli Peace Talk, KIO-Government, March 11–12.2013 n.d.). For 18 months these negotiations were even held in China's Yunnan Province, in a city close to the Myanmar boarder and the stronghold of the KIO/KIA fighters. According to some, the Chinese involvement was at least in the beginning felt as intrusive (Anonymous 2013), while the Chinese approach was at times too strong. At some stage when the KIO was not willing to make a specific compromise, Chinese facilitating delegation was believed to have closed down the air conditioning of the building in which the stubborn rebel team needed to conduct their struggle for favorable negotiation results (discussion with a KIA negotiator, April 2014). However, soon, China's strategies softened, and it was easier for both sides to appreciate Chinese assistance for the settlement of the main conflict that threatened the greatest Chinese economic asset in Myanmar, the double pipeline.

In general, it is interesting to see how in Myanmar, China has had to take up new roles as a peace facilitator for the protection of its economic assets and economic relationship with Myanmar. Here, too, China does it differently to the way in which most Western countries are helping peace in the world. While in Myanmar Western powers have flashed a lot of money and built a lot of organizations that coordinate, help, and even try to monopolize dialogue between conflicting parties, and while sometimes it even seems that the Western aid is creating "representatives" of various conflicting parties, China has involved the actual fighters and tried to avoid institutionalizing anything around the negotiation process. This way, China has been less manipulative in its efforts to help peace.

At the same time, China has never tried to hide its economic interests behind its work for peace in the Kachin and Northern Shan states. China has investments it needs to protect, and much of the effort to facilitate peace dialogue between conflicting parties in the areas of the double pipeline has been actually initiated and sponsored by the China National Petroleum Corporation. China is there for its own benefit rather than "taking care of the interests of Myanmar." With voluntary cooperation from the Myanmar side, Myanmar's own interests will be taken care of by Myanmar people themselves, and the Chinese facilitation of the peace process proceeds along the lines both parties set for mutual benefit.

6 Conclusions

Sino–Myanmar economic relations are conditioned by the massive political changes that are on the way in Myanmar and in China as well as in the regional and global power balance. For China, Myanmar is not only one of the neighboring

countries, it is also a method of showcasing their prestige to other nations that China wishes to collaborate with. While for the "Chinese peaceful rise" Myanmar's collaboration will be essential, China's treatment of Myanmar will also be important as an exemplar to other countries China desires to collaborate with. By following the Sino–Myanmar relationship, other countries can acknowledge what to expect from China. This balance sets the interplay of economic and political considerations in China's relations with Myanmar. While in many ways, Myanmar illustrates one of the ways in which China has implemented her big power policies, the Sino–Myanmar relationship will also be indicative of the style of China's great power policies.

It is not feasible to predict the future of China–Myanmar's economic relationship because that relationship is in the hands of the free-willed Chinese and Myanmar leaders. Yet, it is possible to highlight the main considerations that this relationship needs to take into account. This has been the focal point of this chapter. By showing the political constraints the Myanmar–China relationship has to deal with, this chapter has also shown the relevance of this relationship for the overall Chinese big power approach. If China manages to sustain its political competition in Myanmar, similar competition will be easier for China in those countries that refer to Myanmar as another democratic country with good relations with China. Similarly, if China earns a reputation as an anti-hegemonic power in Myanmar, it will be easier to avoid suspicion of hegemonism that other countries could have against economic relations with China. Finally, if China manages to develop a way to deal with conflicts that threaten its economic assets in Myanmar, it will have a blueprint it can use elsewhere. This is why the nature of politics of the Sino–Myanmar economic relations is a prominent area of concern for China and for the region itself.

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A Study of Singapore as a Developmental State

Kalim Siddiqui

1 Introduction

Singapore has witnessed a rapid transformation in the last five decades from an entrepot predominant towards trade, commerce and services in the mid-1960s into an economy, which at present specialises in high-value manufacturing activities, and regional financial hub for business services in East Asia. The country is also rapidly expanding financial centre served by most of the international commercial and merchant banks (Richardson 1994). Singapore is a highly competitive economy and according to Swiss International Institute for Management Development between 1995 and 2012, the country ranked second in national competitiveness. By 2000, the production of hard disc drive (HDD) in the country reached US$10 billion and accounted for nearly 70 % of the world's total production of HDD. This is a highly standardised and easily transportable product. The Multinational Corporations (MNCs) have invested in the HDD manufacturing in Singapore as the gateway for Asian and global markets (World Bank 2009).

Singapore became independent in 1965 and its economy changed dramatically within less than three decades from a traditional fishing village to modern manufacturing and financial centre in Asia. By 1995 Singapore became the second country in Asia after Japan to be classified by the OECD as a 'developed economy'. Scholars have reviewed Singapore's rapid growth from a resource dependency perspective to Chinese business cultural practices. Since the majority of the population in Singapore are Chinese, therefore it was said that Chinese network approach has played an important role in building interfirm relations in Southeast Asia including Singapore. It was said that Chinese business management is different from Western companies. Chinese businesses faced a difficult environment when they migrated to other Southeast Asian countries. It was thus considered

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necessary to build cooperation in order to interact smoothly. Under such circumstances personal relationships were seen as important to enhance business interests. The businesses were kept under family control and relied on networks of trust to do business. Chinese business behaviour in Southeast Asia is seen to have been influenced by Chinese traditions and business practices. However, such scholars ignore the role of Western imperial domination in the region and how it undermined the independent development of industries in the region and at the same time created favourable conditions for Western capital and investors.

The study intends to examine critically the role of the state, international economic situations and the Cold War tension in the region and how these factors have played crucial role in achieving rapid growth rates. The aim of this paper is to critically evaluate various factors which have contributed towards achieving rapid economic development and prosperity, which has been ignored by the mainstream (also known as neoclassical) economists (Krueger 1980; Gopinathan 2007).

It seems that the explanations presented by the international financial institutions are inadequate because of its underestimation of the state involvement in the promotion of the foreign investment (IMF 2009; World Bank 1993). A weak domestic bourgeoisie invited foreign capital to assist its industrialisation and modernisation processes (Siddiqui 2010). The government has shown its total commitment towards the policy of active 'export promotion' and openness towards foreign businesses (World Bank 2009; Shin 2005). There are existing literatures about the role of MNCs in the transformation of Singapore's economy. However, it seems that they are insufficient. Some studies have criticised the role of MNCs as counterproductive (Mirza 1986), while others either have overlooked or saw it as positive contribution (Clifford et al. 1999).

During the 1980s and 1990s, the East Asian economies were increasingly debated among the international financial institutions and academics. The failures in economic strategies in other developing countries were also discussed, especially Latin America (Siddiqui 1998), Africa and South Asia, which had followed what was known as the 'Import Substitution Strategy' (Krugman 1994; Bhagwati 1987; Siddiqui 2012b). The setbacks during the 1980s in the economic growth led to the change in strategies and gave way to the 'neoclassical', i.e. pro-market, policies which heavily relies on 'market forces' and international companies for investments and resources (Siddiqui 2015a). It was claimed that East Asian economic growth success was mainly due to export-oriented strategies. The proponent of free market argues that export-led policies kept private incentives and entrepreneurship in line with those of the global businesses. As a result, higher levels of competition will ensure efficient resource allocations and higher productivity (World Bank 1993; Bhagwati 1987). The proponents of free-market policies are based on the presumed universal efficiency of the free market, which is expected to ensure economic growth in any country (Krueger 1980).

On the other hand, the critics said that the state played a crucial role in the early years of East Asian economic developmental experience of 'getting the prices wrong' instead of 'getting the prices right' which was responsible for achieving dramatic growth rates. Critics found evidence of clear state intervention in these

economies. For instance, South Korea's successful establishment of selective intervention in heavy industries led to enormous structural changes during the 1980s in its industrial structures and exports (Chang 1994; Wade 1990; Amsden 1989).

This paper is not aimed to present Singapore's growth success as a role model for other developing countries with large rural population, but to examine other important factors like favourable international environment, Cold War and the role of the state (Siddiqui 2012a). All these factors have contributed to achieve rapid economic development of the country. It appears to have been overlooked by previous researchers (Huff 1995). Moreover, the changing international environment and the end of Cold War and recent upsurge in globalisation of production most likely would impact on Singapore's economy. Singapore is a city state without a rural population; therefore the relationship between urban and rural and between the primary and secondary sector, which is so central to the problem of economic development, was just not there.

The study will emphasise the historical factors that seem to be important in determining a country's developmental strategies. The decline of Portuguese influence coincided with the rise of British influence in East Asia in the early nineteenth century. In 1819, Singapore was given to Britain as a reward for their help to the Sultan of Johor against his brother in local power struggle. The British East India Company managed to establish a post for spice trading. It attracted a vast number of migrants from the neighbouring countries, especially from China and India. This was mainly due to the political upheavals in their countries (Siddiqui 2009c).

Singapore started as a distribution centre that promotes the imperial interests in the region. British interest during the nineteenth and twentieth centuries was to see the free flow of goods and unhindered international trade and investment. Hence, it relied on foreign businesses and liberal trade policies. Being dependent on the West is not a new phenomenon for the country; since 1862 the island had been an important strategic harbour and entrepot trade, linking resource-rich south East Asian countries with European colonial powers who were then carrying out their own expansion of modern industrialisation and supply of crucial raw materials which were the important factor for the success of this project (Mirza 1986).

This study will also argue that the role of the state becomes more important due to increased processes of globalisation. It seems that Singapore's developmental state, unlike other states in East Asia, has shown no signs of devolving but instead appears to be strengthening by embarking on several post-industrial economic programmes also known as regional economic integration. The study also focuses on the changes in investment policy from regulation to promotion of foreign capital. Since the 1998 East Asian crisis, the government began to deregulate the financial and telecommunication sectors, and also in banking, the government removed the 40 % foreign shareholding limit for local banks, which allowed foreign banks to compete freely with domestic banks (Clifford et al. 1999; Siddiqui 1995).

The question arises why Singapore succeeded. It could be due to the country's strategic location and natural harbour. Singapore is located at the mouth of the Malacca strait which is the world's busiest maritime trade route, and more than

40 % of the world's trade is carried out through this. The country is located on the very strategic trade route and also it is one of the fastest and most dynamic regions of the world.

The article is divided into various sections: the 'Introduction' section briefly discusses an overview of Singapore. In the third and fourth sections, macroeconomic indicators and growth strategy are discussed. In the fifth section, the role of state is analysed in the context of promotion of economic policies crucial to the industrialisation and modernisation process of the country. In the sixth section, Singapore's recent policy of regional economic integration is analysed, and finally, in 'Conclusion', a summary is presented.

The methodology is derived from the aims of the study. This engages an understanding of the issues in the research project. The research requires international comparisons statistics and provides the main source to answer the research questions and address the objectives of this paper. Analysing the secondary data which has already been presented is the only possible way to get macroeconomic data. The secondary data sets together provide quantifiable information and statistics published by the governments for their country. Country-based multiple source data sets are also available from governments' publication and international organisations. These include data such as IMF, World Bank and OECD statistical data collected for member countries.

2 Early Post-Independence Policy

During the British colonial period, entrepot trade was the main source of income and trade alone accounted for more than one-third of the GDP in Singapore. From 1965 onwards, the People's Action Party (PAP) showed its commitment to develop industries as a key priority for the country. When Singapore became independent, its prospects were not very good. It had no natural resources and the population has very diverse ethnic backgrounds, with largely immigrants from very dissimilar history and ethnicity. The country's first Prime Minister Lee Kuan Yew had played very crucial role in transferring its economy. On economic front, prior to 1965 most of the foreign capital was from the UK and was invested largely in trading activities. The UK was the largest investor due to historical and colonial ties. The most foreign investment was in food, beverages, rubber processing and petroleum industries (Low 1998; Mirza 1986).

After independence, the government also continuously identified opportunities in US and European markets and then encouraged local investors to collaborate. The government claimed that external economic expansion could contribute to domestic businesses in two ways. First, it would create demand for local products, and second, it would allow Singapore companies to benefit from rapid economic growth in the region, which would mean less dependence on the Western markets for its exports (Ministry of Finance 1993). The state also promoted and encouraged the local businesses to exploit the opportunities in international economy. Similar

patterns were observed in some other East Asian countries. Subsidies were provided to investors in the selected sectors. The government created an environment to improve credibility and reputation and was seen as the basis upon which overseas investors may act (Shin 2005). With credibility and reciprocity among business partners and between government and foreign investors, trust would develop. With high levels of trust and the existence of a supportive environment, the businesses were able to take greater risks and long-term commitment. East Asian government-business relations—which were earlier seen as healthy as synergistic social capital—have since the 1998 crisis been denounced as 'crony capitalism', largely responsible for crisis. Moreover, the advent of neoliberal globalisation has also greatly reduced the scope for selective government interventions.

During the 1960s, the government lacked sufficient capital to invest in the economy and infrastructure; therefore, it was considered prudent to invite foreign capital to fill this gap. A clear plan was enacted to provide generous incentive to foreign companies, and also Jurong Town Corporation (JTC) was created in 1968 along with Economic Expansion Act to create low production costs sites for foreign investors. From the late 1960s onwards, Singapore took a significant initiative to export manufactured goods, which were relatively labour intensive. The question arises why MNCs have opted to invest in Singapore's economy. It seems that the institutional features of the host country are important determinant of FDI, including political stability, the existence of property rights, the tax system, availability of adequate infrastructure, etc. (Low 1984). In recent years changes have been made in Singapore's investment policy from regulation to promotion needs to make changes in country's institutions and organisational cultures. It means new policies involved building up new supportive government officials to understand and cater for the requirements of the foreign investors. Moreover, the PAP has ruled the country since 1965 and has played a crucial role in the formation of policies to assign the dominant role for foreign investors. Singapore has been shown to be actively pro-FDI by allowing wholly foreign-owned companies to operate in export-oriented manufacturing sectors with minimal restriction (Siddiqui 2015a; Koh 1987).

Singapore lacks adequate manpower for its growing industrial sector. This led to a constant need to import workforce from overseas in areas like constructions, IT, biotechnology, etc. Foreign workers are seen as very crucial for the advancement and for the successful economic diversification strategy. Prime Minister Lee Hsien Loong clearly said in a public meeting that "welcoming foreign talent" is crucial for our economic development and prosperity and also to ensuring the vitality of the country's economy' (Liow 2011: 254).

During the aftermath of the 2008 financial crisis, there has been recognition to reorganise the economy. This entails putting forth and promoting an alternative discourse based on more equitable distribution of assets and resources across Singapore society. Neoliberal policies commonly are associated with the rollback of the state and primacy of the market, i.e. privatisation of the state enterprises, deregulation and further integration with the international markets. Such policies have full support among the international institutions like World Bank, IMF and

WTO. 'The belief the economy is independent of and separate from politics among others were emphasised upon. It was the rationality that came to infuse, a whole variety of practices and assemblages for regulating economic life…' (Liow 2011: 244). It also involves extending and disseminating market values to all institutions and social action (Siddiqui 2014). The country seems to be moving away from a developmental state to a neoliberal one. In recent years the government had taken a number of measures in favour of free-market policies, as it is trying to bring closer to the international financial institutions and closer integration with the global economy. For instance, the privatisation of the Development Bank of Singapore (DBS) and liberalisation of the banking sector give us clear government policy direction. However, implementation of certain neoliberal policies does not mean doing away with all characteristics of the developmental state.

Neoliberal policies aim to re-establish the conditions for capital accumulation and to restore the power of ruling elites. Educational institutions were the sites of the preparation for social participation and for political formations of young minds. Education was not only the instrument in the country's 'miraculous economic development but equally as a vehicle for promoting a cohesive civic identity, based on the ideological tripod of multiculturalism, multilingualism and meritocracy' (Green 1997: 147). Furthermore, 'a greater emphasis on science and technology in the curriculum and expansion of vocational and polytechnic education, these states were able to achieve a tight coupling of education and training systems with state determined economic policies. These developmental states created centrally planned, universally available, standardised, and state driven education systems, which created the national subjectivities necessary for affiliation to the states' modernisation project' (Gopinathan (2007: 57).

However, with the globalisation and increased levels of economic integration, early prediction was made about the demise of the nation state, which is now seen to be farfetched. It seems that the role of the state has changed rather than been eliminated. State is still needed to carry out market reforms and curtail the role of public sector and to manage uncertainties and risks. Globalisation can be defined as a process associated with increasing economic openness, glowing economic interdependence and deepening economic integration into the world economy. If a country wants to stay its national sovereign economic policies, then it cannot have deep international economic integration. It means that a country cannot combine globalisation with national policies and has to sacrifice democratic politics and sovereign policies. It simply means that a country cannot simultaneously follow sovereign economic policies and economic globalisation.

During the golden age of capitalism, i.e. from the late 1940s to mid-1970s, it was possible to combine national policies and limit the degree of international economic integration. However, later on between 1976 and 1991, such possibilities were reduced and globally capital was on offensive and foreign capital investments and markets were seen as a way forward. However, in the post-1990s, pro-market and globalisation policies further reduced any national policies in favour of greater economic integration. Hence, in recent years the increased global economic integration meant to seek to harmonise policies, institutions and laws across the

countries, which made it difficult to pursue national economic interest. The golden age of capitalism witnessed liberalisation of trade and investment to provide foundation for economic expansion and earn the confidence of MNCs and international markets. International financial system is constrained in using autonomous Keynesian management demand to maintain levels of output and employment. Expansionary fiscal and monetary policies such as large government deficits to stimulate aggregate demand or low interest rates to encourage domestic investment can no longer be used by the national government because of fear that such measures could lead to speculative capital flight and also lose the confidence of international finance (Liow 2011).

Some researchers have characterised Singapore economy as predominantly laissez faire, which according to them is based on free-market policies (Rodan 1997), while others describe it as an economy under excessive state regulation and control (Perry et al. 1997). Perry et al. (1997: 126) argue that 'Key components of the domestic economy are in full or partial ownership and subject to government direction, as are the conditions of employment for the domestic workforce and a high share of personal incomes'.

It could be due to the lack of indigenous capitalist class and undeveloped institutions in the past. There seems to be close coordination among the senior ministers and civil servants and widespread intervention is prevalent. A number of agencies were set up with the aim to coordinate with government ministers and to speed up the process of modernising and meeting government set targets. Among the more prominent of these agencies are the following: Economic Development Board (EDB), International Enterprise and Productivity and Standard Board. The country also has domestically owned enterprises in the form of government-linked companies (GLCs) and these are administered through holding companies, i.e. Temasek, Singapore Technology and Health Corporation Holdings. The government also closely monitors labour market through Council on Professional and Technical Education (CPTE). It appears that the government intervention policies have resulted in achieving successful entrepreneur, where the government assigned agencies to be responsible for carrying out policy implementation. In recent years innovation financing policies have played an important role in contributing to the entrepreneurship in the country. On the issue of innovation and financing in modern sector in Singapore and Taiwan, Wonglimpiyarat (2013) finds that 'The innovation policies in both countries have increased emphasis on promoting R&D, technology commercialization and support for high-tech start-ups. In the case of Singapore, the government has played an important role in structuring. . .and in fostering technological innovation. The government has developed comprehensive schemes to finance firms in all stages of product life cycle from start-up to mature phases' (Wonglimpiyarat 2013: 115–116). The study concludes that 'the innovation financing policies to support entrepreneurial development in . . . Singapore and Taiwan. The results have shown an important role of the government in guiding policies to build up the national innovative capabilities. Singapore and Taiwan have effective financial schemes in place to encourage innovation development' (Wonglimpiyarat 2013: 116).

Singapore has a land area of only 648 km^2 and it is among the few countries in the world where housing sector is fully under government control. Since the 1960s the housing policies have been formulated under strict state control with an aim to advance social and economic growth (Phang 2001). It seems that government prioritised housing sector as it was considered to influence the macroeconomic factors, i.e. inflation and GDP growth, and as a consequence well-being of its inhabitants. The Housing Development Board (HDB) was created in 1960 to assist government long-term goals. As stated here 'providing decent homes equipped with modern amenities for all those who needed them' (Phang 2001: 44). As a result, housing sector received an average of 9 % of the GDP per annum from 1976 to 1997, while comparative figures for the UK and USA are less than 4 % for the same period (Phang 2001).

Despite various policy measures towards privatisation and pro-market policies since the East Asian crisis of 1997, the housing sector still is dominated by the public sector, where dwellings are sold on a 99-year lease to eligible households. The government acquired most of the land below the market prices under the Land Acquisition Act of 1966. Then the land was made available for public housing, industrial estates and other purposes. Central Provident Fund (CPF) was used as an instrument to finance housing. Forced savings of the workers were 'locked up' in the CPF, which could only be used for housing mortgage purposes. The HDB provided mortgage loans to buy flats and the interest rates charged are usually below the commercial bank rates. The fund is essentially a fully funded pay-as-you-go social security scheme which requires mandatory contributions where certain percentage of workers' monthly was deducted from their account for the fund. Contribution amount was between 20 and 25 % of wages for workers (Phang 2001). The state thus deals with the constraints on both the supply and demand side of the housing market, which has proved in the past to be very effective in providing resources to the housing sector and also reducing the risk. As Phang concludes that 'The structure of the housing loans market has allowed the CPF contribution rate to be more effectively used as a discretionary instrument to affect labour cost. The integral comprehensiveness of economic, housing, and housing finance policies thus also serves a useful purpose of providing policy-makers with the flexibility to steer housing policy to achieve desired (Short as well as longer term) economic objectives' (Phang 2001: 457).

From the beginning the government led by People's Action Party (PAP) has put as top priority and as an important policy aim the achievement of good governance. When the country attained independence in 1959, poverty was widespread; afflicted with serious housing shortages, half of the population was living in huts and the official unemployment rate was 14 %, with frequent labour unrest, corruption and high crime rate (Quah 2013). Corruption was widely prevalent during the colonial period. Soon after independence, to minimise corruption among the civil servants, the government formed Central Complaint Bureau in 1961 to reform bureaucracy. As former Prime Minister Lee Kuan Yew wrote in his memoirs regarding his determination to free the country from corruption, 'We were sickened by the greed, corruption and decadence of many Asian leaders [. . .] we had a deep sense

of mission to establish a clean and effective government. When we took the oath of office [. . .] in June 1959, we all wore white shirts and white slacks to symbolize purity and honesty in our personal behaviour and our public life. [. . .] we made sure that every dollar in revenue would be properly accounted for and would reach the beneficiaries at the grass roots as one dollar, without being siphoned off along the way. . .we gave special attention to the areas where discretionary powers had been exploited for personal gains and sharpened the instruments that could prevent, detect or deter such practices' (Lee 2000: 182–184).

Singapore has always been on the World Bank's governance indicators very honest with good and effective governance. The bank's data on *Doing Business Surveys* show that Singapore is ranked first among 183 economies included from 2007 to 2012 (World Bank 2012). The bureaucrats of the country are known as most efficient and honest in the region. As economist notes on Singapore's success, 'it has harsh judicial punishment, a tame press and illiberal social policies . . . Protests demonstrations are rarely permitted. . . Mr. Lee saw his authoritarian style government as an essential ingredient in Singapore's success' (The Economist 2015). Furthermore, as Quah concludes that 'Singapore's success in ensuring good governance is the combined influence of the political will of the PAP government was to solve the problems facing the country for the past 53 years and its favourable policy context, it will be difficult to transfer Singapore's experience in toto to other Asian countries because of lack of political will with unfavourable policy contexts in many Asian countries' (Quah 2013: 415).

3 Macroeconomic Indicators

Since independence, Singapore's economy has had an experience which was not common among other former colonies such as sustained economic growth, reliance on foreign companies, low inflation and high savings rates. Singapore's GNP increased to more than 13-fold between 1960 and 2000, and also the country witnessed sharp decline in both the number of people in poverty and in infant mortality. The annual real GDP growth rates averaged around 8 % between 1965 and 2009; except during the 1980s, it fell to 6.7 % mainly due to global recession (see Table 1 and also see Fig. 1).

In 2008–2009 the average growth rates again declined sharply due to the global financial crisis and uncertainty in export demands. There have been low levels of inflation, i.e. around 2 % annually during the nearly five decades, except in the 1970s when it rose to 5.8 % annually, mainly due to oil crisis and inflationary trends in the Western economies. The macroeconomic environment with low inflation has created a positive environment for a long-term business perspective in the planning and investment decisions and provided a good return on their investments (see Table 1).

Rising levels of incomes (see Fig. 2) and productivity enabled the government to appropriate a high level of domestic savings (Wong 1986). These savings were

Table 1 Macroeconomic indicator, 1960–2010 (%)

	1960–1969	1970–1979	1980–1992	1990–1997	2001–2010
Annual real GDP growth rate	8.0	8.3	6.7	8.7	1.2
Annual inflation rate 1	1.1	5.8	2.4	2.6	2.1

Notes: (1) GDP deflator
Source: Department of Statistics, 2012, Singapore: Ministry of Trade and Industry; also *The Economist*, 26th January–1st February, 2002; www.singstat.gov.sg

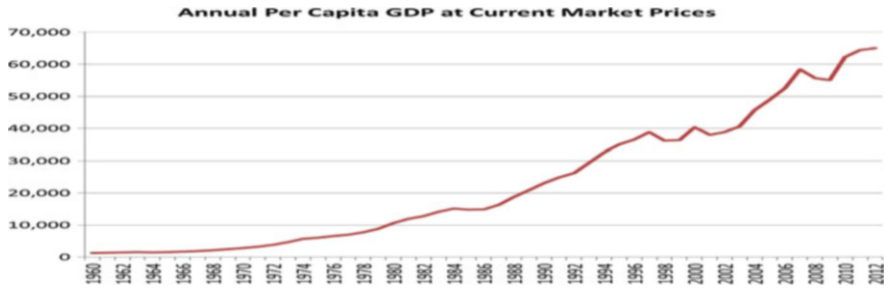

Fig. 1 Annual per capita GDP at current market prices. *Source*: Singapore Department of Statistics

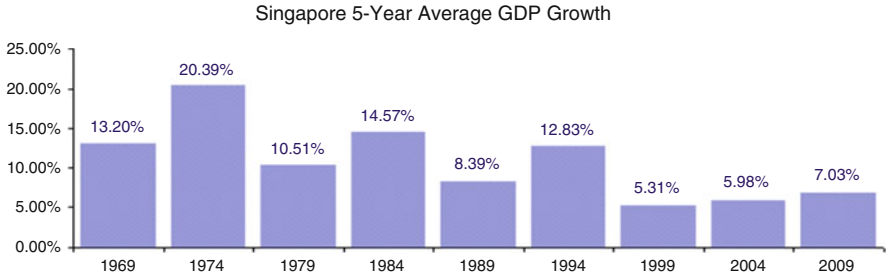

Fig. 2 Singapore's 5-year average GDP growth

invested in infrastructure and educational sectors (World Bank 2009). Per capita income grew rapidly between 1990 and 1997, and the country experienced negative growth during the East Asian crisis of 1998 and 1999. However, after 2001, the economy once again began to grow at higher rates (see Table 2).

Another crucial macroeconomic indicator is the rate of domestic savings. The savings could be invested, which would mean less reliance on overseas borrowings. Singapore's savings rates are among the highest in the world. The mobilisation of domestic resources appears to have played a very important role, along with foreign capital and technology in the economic development of the country. High savings and investment had been key ingredients of its developmental policy strategies. Since independence the gross national savings has steadily increased. As shown in

Table 2 Asia: real GDP (year over year per cent change)

	Actual data and latest projections					Difference from October 2014 WEO		
	2012	2013	2014	2015	2016	2014	2015	2016
Australia	3.6	2.1	2.7	2.8	3.2	−0.1	−0.1	0.1
Japan	1.8	1.6	−0.1	1.0	1.2	−1.0	0.2	0.3
New Zealand	2.4	2.2	3.2	2.9	2.7	−0.4	0.1	0.3
East Asia	6.8	6.9	6.7	6.3	5.9	−0.1	0.3	−0.5
China	7.8	7.8	7.4	6.8	6.3	0.0	−0.3	−0.5
Hong Kong SAR	1.7	2.9	2.3	2.8	3.1	−0.7	−0.4	−0.4
Korea	2.3	3.0	3.3	3.3	3.5	−0.4	−0.7	−0.5
Taiwan Province of China	2.1	2.2	3.7	3.8	4.1	0.3	0.0	−0.1
South Asia	5.2	6.9	7.1	7.4	7.4	1.4	1.0	0.9
Bangladesh	6.3	6.1	6.1	6.3	6.8	−0.1	−0.1	0.0
India[a]	5.1	6.9	7.2	7.5	7.5	1.5	1.1	1.0
Sri Lanka	6.3	7.3	7.4	6.5	6.5	0.4	0.0	0.0
ASEAN	5.9	5.20	4.6	5.1	5.3	−0.1	−0.2	−0.1
Brunei Darussalam	0.9	−1.8	−0.7	−0.5	2.8	−6.0	−3.5	−0.6
Cambodia	7.3	7.4	7.0	7.2	7.2	−0.2	−0.1	−0.1
Indonesia	6.0	5.6	5.0	5.2	5.5	−0.1	−0.3	−0.3
Lao People's Democratic Republic	7.9	8.0	7.4	7.3	7.8	0.0	0.1	0.2
Malaysia	5.6	4.7	6.0	4.8	4.9	0.1	−0.4	−0.1
Myanmar	7.3	8.3	7.7	8.3	8.5	−0.8	−0.2	0.3
Philippines	6.8	7.2	6.1	6.7	6.3	−0.1	0.4	0.3
Singapore	3.4	4.4	2.9	3.0	3.0	0.0	0.0	0.1
Thailand	6.5	2.9	0.7	3.7	4.0	−0.3	−0.9	−0.4
Vietnam	5.2	5.4	6.0	6.0	5.8	0.5	0.4	0.1
Pacific Island countries and other small states[b]	3.3	2.2	3.6	4.0	3.4	0.4	−0.5	0.2
Emerging Asia[c]	6.8	7.1	6.8	6.6	6.4	0.3	0.0	−0.1
Asia	5.6	5.9	5.6	5.6	5.5	0.1	0.0	−0.1

Sources: IMF, World Economic Outlook (WEO) database; and IMF staff calculations
Note: ASEAN = Association of Southeast Asian Nations
[a]For India, data and forecasts are presented on a fiscal year basis and output growth is based on GDP at market prices
[b]Simple average for Pacific island countries and other small states which comprise Bhutan, Fiji, Kiribati, Maldives, the Marshall Islands, Micronesia, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu and Vanuatu
[c]Emerging Asia comprises China, India, Indonesia, Malaysia, the Philippines, Thailand and Vietnam
Source: www.cebuictandbpm.com/. . ./2014/. . ./ASEAN-Global-Competitiveness-2 (Assessed on 2 June 2015)

Fig. 3, the savings rates rose from minus 3 % in 1965 to an average of 28 % in 1975 and further rose to 41 % in 1985 and reached 45 % by 2001. The deficit between savings and investments during the period of 1965–1985 is due to a rise in

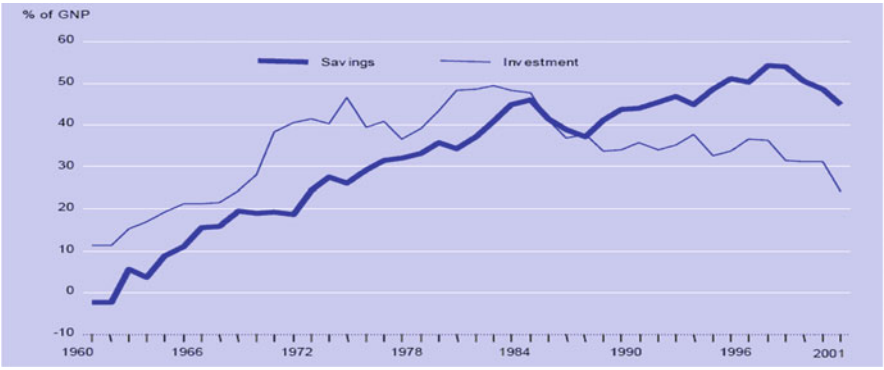

Fig. 3 Savings and investment trends in Singapore, 1965–2001. *Source*: www.singstat.gov.sg (Accessed on 10 July 2010)

investment rather than a decline in savings, which coincided with rapid industrialisation and expanding industries (Phang 2001).

Within the decade after the independence, the government was able to bring down the unemployment rates at very low levels and kept it at very low levels. Unlike the Phillips Curve model, Singapore observed a steady decline in unemployment without fuelling the inflationary pressures. Singapore succeeded in keeping under control macroeconomic variables and coordinated public sector investment decisions and thus was able to maintain largely stable economy; as a result the foreign companies found it a very attractive country to invest.

Moreover, the public sector savings contribution dominated among the sources of domestic savings. Its share rose from less than 25 % of the national savings in 1975 to 60 % in 1985. Public sector savings included the government budget surplus and surpluses realised by statutory boards. The private sector's contribution was also high mainly due to the government policy of forced savings through social security schemes, i.e. the CPF. It was estimated that from 1967 to 1990, the country's overall savings rates rose by 3.8 % (Huff 1995: 744). CPFs consisted of past contributions made by individuals during their employment period and such contribution was divided equally between employees and employers. The savings of the provident funds provided government cheap money available to invest in infrastructure and housing sector. The savings invested in infrastructure which made possible the expansion of mass rapid transit system, roads, airports, seaports and telecommunications in the country. In fact, it subsidised and made it attractive for foreign companies to invest in Singapore. The government infrastructure investment policy also has had wider 'crowding-in' impact, which means government expenditure was seen as complementary to the private investment, which played an important role in raising the economy's absorptive capacity and investor confidence (Toh 1997).

The World Bank (1993) study claims that public savings was about 44 % of the GDP on average in the periods between 1981 and 1990 (World Bank 1993). Toh

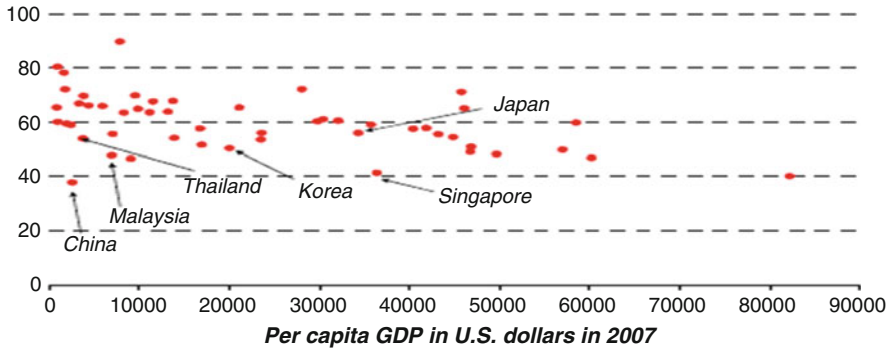

Fig. 4 Real private consumption in % of GDP for 2003–2007. *Source*: Asian Context, IMF, 2009, Washington D.C., p. 27 (Accessed on 5 August 2010)

(1997) agrees with the importance of public savings, but his estimation of public savings was higher, i.e. average about 53 % during the same period. And the significance of public savings was described as 'Public sector saving has consistently played a significance role in the contribution to the national saving' (Toh 1997: 9).

Figure 4 indicates that private consumption in Singapore is much lower than in Korea and Japan, although its average per capita income is nearly of the same level as Korea (Siddiqui 2009a). Therefore, on private consumption Singapore may need to focus more on its domestic economy as an engine of growth especially in the wake of the recent global economic crisis (IMF 2009).

Due to 2008 global financial crisis, consumers in export markets have reduced their consumption of imported goods. Therefore, Singapore needs to rebuild towards domestic demands in order to return to stable economic growth. It would be feasible to increase spending in social sectors and to build social safety nets because a stronger social protection system will reduce the need for precautionary savings to meet the need for education, health and old age care. As incomes and living conditions of working people rise further, it leads towards the expansion of home markets, which made further profitable to reinvest locally.

Social inequality has been rising since East Asian crisis, although it fell slightly in 2009, but rose again in 2010. The GINI Index for Singapore is at 0.48. This is an increase from 0.478 in 2009, after falling slightly in 2008 from 0.481. The GINI Index for Singapore remains one of the highest among the developed countries (Department of Statistics 2010). But, the government institutions have greatly depoliticised the people as a result to the economic crisis, and rising unemployment is seen as personal failures rather than structural reasons or government policy failures. It seems that depoliticisation has taken roots and the issue of unemployment is individualised.

4 The Growth Strategy

Singapore's vibrant economy is considered a sort of a miracle. Despite many obstacles, it managed to attain prosperity within a short period. However, in mid-1960s, Singapore had a large pool of unskilled workforce, high levels of unemployment and poverty, along with non-availability of natural resources, which meant that the country had limited developmental options (Shin 2005). The structural transformation took place, i.e. a shift towards manufacturing sector, and its share in GDP grew from 16.6 % in 1965 to nearly 30 % in 1980, and in 1993 manufacturing contributed to about 28 % of the total GDP and accounted for nearly 28 % of employment. The economy also witnessed the growing importance of a service sector, which included transports, communications, businesses and financial services. Since the early 1980s the country moved towards becoming an international financial centre which became increasingly vital for the economic growth in recent decades. And in 1993, services provided about 27 % of the GDP with 11 % of the total employment (Mookerjee and Yu 1997).

In the early 1980s, large companies invested in computer manufacturing due to availability of female educated workers at a fraction of wages paid in the developed countries. For example, nearly 72 % of those employed in the electronic production were female compared to nearly 43 % in the rest of the manufacturing sector in Singapore. Moreover, the wages in the electronic industry were lower than average manufacturing wages during the 1993.

However, Singapore is not an independent capitalist economy. Singapore's lack of indigenous capitalists marks its inability to chalk out a path of independent development. High-tech and new products are developed and designed overseas in order to have full control core competencies of the business. Since mid-1960s multinational companies have moved to Singapore, compelled by the higher wages, increased competitor and saturated domestic markets at home, resulting in one of the few truly international economies (Mirza 1986). This overwhelming level of foreign companies' involvement, not seen somewhere else, has been achieved just within one generation, largely due to massive capital inflows (Mirza 1986). By the end of 1980s, the country received foreign capital up to 4.6 % of the world and nearly 14.6 % of the total FDI destined to the developing countries in 1988.

The government's policy aimed to promote export-led growth and attract foreign investors by making the country one of the most secure and profitable countries to invest. Moreover, this policy decision coincided with the restructuring of the production system in developed countries, where rising trade union activities, production costs, high taxes and increased competition were the corporate sectors being found more profitable to relocate production in low-cost countries. Thus, Singapore has benefitted from the specific international circumstances and the MNCs found it more attractive to invest in the city state.

Moreover, overseas Chinese subsidiaries have played a prominent role to maintain a large-scale investment in Singapore. The country is surrounded by Chinese

overseas population in Malaysia, Indonesia, Hong Kong and also North America and Western Europe. Sector-wise, foreign investment in the country is a highly diversified. For example, inflows of funds from the UK and USA are concentrated in service sector. This most likely reflects their comparative advantage in invisible trade, while Japan and other EU countries have largely invested in the manufacturing sector because of the availability of good quality infrastructure, good governance and highly skilled labour force.

Singapore's comparative advantage is reflected on the strategic location on the main east-west communication networks; along with the presence of international financial institutions and the availability of excellent infrastructure, it proved to be the best possible destination for the foreign investors, especially in financial sector. Singapore managed to build a cluster of financial services, which further created opportunities for specialisation and economies of scale in this sector.

The key task of the EDB during the late 1960s was to achieve industrialisation and modernisation of the economy. This was based on the plans made by Dutch economist Albert Winsemius. But a shift happened during the 1990s. The Strategic Economic Plan (SEP) in 1991 was more bent on pursuing education and human resource development in order to encourage export of high-value goods. The EDB has focused on how to achieve steady growth of business sector in Singapore (SEDB 1995).

When global recession hit in 1985–1986, the government turned its attention to make Singapore a manufacturing and communications hub for foreign companies. As a result, between 1965 and 1980, export of manufactured products became important for the country's rapid economic growth. The proportion of direct manufactured exports to GDP increased from 12.7 % in 1965 to nearly 50 % in 1980 and further to 60 % by 1992. The importance of export could be seen from this that the export of manufactured products grew faster than manufactured output in Singapore between these periods.

The manufacturing sector consists of industries like electronics, engineering and chemicals. Petroleum refinery began in the country as early as in the 1960s, which has been developed with the government support. Petroleum refinery plays less important role now than three to four decades ago. In terms of employment, manufacturing employment accounted for 21 % of the labour, while in construction 13 % in 2000. It appears that the manufacturing sector has been built attracting multinational companies into sectors chosen by the government.

The Singapore economy is heavily dependent on exports, which did contribute US$268.9 billion to the nation's net earnings in 2009. Key export commodity includes consumer electronics, information technology products, petroleum products, pharmaceuticals and chemicals. There was a rapid increase in the exports of disc drive, printers and PCs during the periods 1986–1997, and in 2000 semiconductors, a higher-value-added product, became an important export item. Singapore's export by markets (% of domestic export) has changed during the last 25 years. For example, its exports to ASEAN countries increased from 17.5 to 21 % in 2001 and for China from 1.2 % to nearly 4 %, while for developed countries

(i.e. the USA, EU and Japan), it declined from 49.6 to 12 % over the same period (Siddiqui 2015b).

The destination of Singapore's exports has changed since the mid-1980s. For instance, the developed countries are still important, but their shares have been declining. China in the past has not been Singapore's export competitor, but it is now, particularly since the early 1990s, primarily due to huge increase in FDI associated with low-cost production and expectations of higher profits. The manufacturing sector in China has expanded rapidly during the last two decades towards higher-value export products. For instance, China is the third largest producer of electronic products in the world (Siddiqui 2015b). Singapore's principal imports are crude oil, electronic components, industrial machinery, motor vehicles, food and beverages and iron and steel.

Figure 5 shows the economic and sectoral changes between 1997 and 2009. The figure indicates that after the post-East Asian crisis, i.e. since 2000, the financial sector has grown more rapidly than manufacturing, while earlier the situation was the other way round.

The country has got large inflows of foreign capital, has the world's highest investment ratio for over 40 years and hosts about 5000 MNEs. By the beginning of 2001, MNEs accounted for three quarters of manufactured output and 85.3 % of Singapore's direct (produced in Singapore) manufactured exports (Siddiqui 2015a). The government of Singapore subsidises private investors through its active policies such as investment incentives, high-quality infrastructure provisions, and through education and training. Moreover, subsidies were mainly concentrated on strategic industrial clusters and were targeted by the government to persuade foreign investors.

The industrial upgrading in 1980–1990 was an attempt to further collaborate with the MNEs towards upgrading industries and technologies, i.e. high-technology

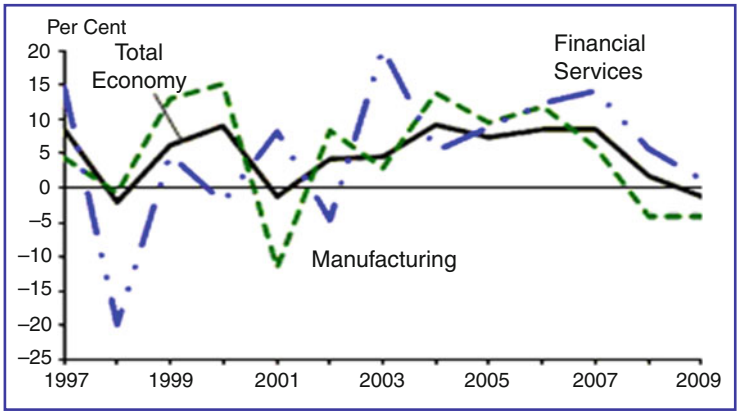

Fig. 5 Growth and sectoral trends between 1997 and 2009. *Source*: http://www.economywatch.com/world_economy/singapore/; www.singstat.gov.sg; www.singstat.gov.sg (Accessed on 10 July 2010)

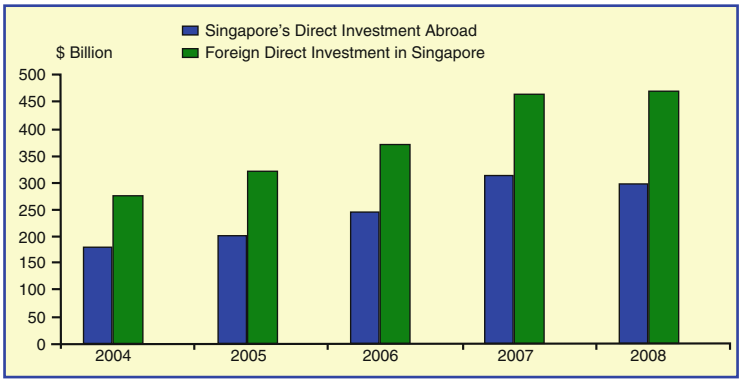

Fig. 6 Singapore's foreign direct investment inward and outward between 2004 and 2008. *Source*: http://www.economywatch.com/world_economy/singapore/; www.singstat.gov.sg; www.singstat.gov.sg (Accessed on 4 September 2010)

and high-value-added manufacturing, for example, an offer of larger tax concessions and breaks to foreign investors who are planning to invest in high-tech and high-value-added manufacturing products (Bello and Rosenfeld 1990). The government also made resources available to Nanyang Technological University and also huge funds were made available to the existing university, i.e. National University of Singapore, to enhance its computing and engineering, particularly R&D activities. The government of Singapore played an important role in regularly upgrading its economy by attracting MNE investment into targeted sectors.

As shown in Fig. 6, Singapore's outward investment has steadily grown, i.e. from nearly $180 billion in 2004 to $300 billion in 2008. However, it has suffered slight setback from $320 billion in 2007 to $300 billion in 2008. Inward investment in Singapore has increased from $180 billion in 2004 to $450 billion 2008. It clearly indicates that the FDI inward investment has been very important for the economy of the country. Singapore's outward investment was limited before 1990. By 1994 Singapore-based companies investments had increased by 29 %. This trend continued and in 1997 the amount invested abroad by Singapore domestic businesses tripled since 1990. Nearly two thirds were invested in Asian countries, 10 % in Europe and 5.5 % in North America.

Singapore took a keen interest in inviting foreign companies by providing them with complementary assets like infrastructure, a highly skilled labour force, fiscal incentives, etc. The workers' skills were upgraded continuously to maintain the country's competitive advantage position, and the EDB was given the primary task of attracting overseas investors. However, immediately after independence the government aimed to exploit the global geopolitical situation and its relationship with the industrialised countries to provide maximum benefit to foreign investors rather than to establish local industries who might be potential competitors with them (Huff 1995; Mirza 1986).

Krugman (1994) argues that East Asian economic growth is not sustainable because it relies mainly on factor accumulation, which is subject to diminishing returns, rather than productivity growth. The mainstream economists saw the East Asian crisis in 1998 as vindication of Krugman's findings. Krugman (1994) emphasised that productivity growth has played no role in the rapid growth rates in the country and the total amount of output growth could be explained by the increase in the quantities of inputs of especially capital and labour alone. He added that any further improvement in the efficiency and skills of the labour force was limited and there was no scope for increasing the participation rate (Krugman 1994).

Singapore at present is trying to develop as a service centre for linking key electronic manufacturing activities within the region. Thus it appears that Singapore has shifted from a key centre of manufacturing to regional headquarters to MNEs, while reallocating manufacturing centres across the region. The government is also building clusters to create a favourable domestic environment for pharmaceuticals and the biomedical industry.

The economic crisis of 1998 has led to significant changes in economic policy in the region. Short-term considerations such as IMF emergency credits to restore market confidence have shaped many economic reforms of the last two decades of the East Asian countries. Moreover, investment policy goals also changed in the region. Foreign ownership limits and domestic participation requirements have been phased out in most sectors, although some differences remain among countries in the region. During the post-economic reforms, IMF insisted on higher interest rates.

The Asian crisis began with Thailand's currency the *Bhat* value which declined sharply (15 %) in July 1997. But soon the crisis spread to South Korea, Malaysia and the Philippines and to a lesser degree to Hong Kong and Singapore. Moreover, after the Plaza Accord of 1985 being signed between the USA and Japan, as a consequence the US dollar was devalued by 50 % against the Japanese yen. Due to the overvaluation of the *yen*, it became more profitable for Japanese businesses to invest abroad including in Singapore. Hence, Japanese investors found cheaper to produce in other East Asian countries rather than domestically and the FDI from Japan witnessed a dramatic surge in East Asian region (Siddiqui 2009a). The recent financial crisis of 2008 did affect Singapore adversely and its economy contracted by 0.5 % in the third quarter of 2008 compared to the same period last year. Sharp decline was witnessed in biomedical sciences, the manufacturing sector, construction and tourism.

It seems true that investment in services is sensitive to changes in skill differences, while manufacturing investment is perhaps less sensitive to such things. Singapore is able to attract both high- and low-end manufacturing investments; the low-end investment passed towards neighbouring countries, while high-end manufacturing stays in the country. Since the 1990s, Singapore's skill share rose at much higher levels in relation to those of its neighbour. As a result, a tendency for a rapid rise in vertical orientation in outward investment for both manufacturing and services from Singapore to other ASEAN countries was observed (Siddiqui

2009b). Furthermore, many MNEs also use Singapore as a base to launch investment in neighbouring countries.

Since the East Asian economic crisis in 1998, the government of Singapore has adopted an increased degree of neoliberal economic policies to increase integration with global markets and gain the confidence of MNEs, but it also further exposed the domestic producers to international competitive pressures. This will have an impact on the local workforce, and the long-term social contract between people and government based on full employment was seen as a reward for adopting 'market-friendly' policies under strain.

However, unlike Japan and South Korea, Singapore largely depended on MNEs rather than indigenous companies for modern technology. As it was stated above, nearly 75 % of the country's manufacturing output was contributed by MNEs, and also foreign capital provided nearly two thirds of the equity capital of its manufacturing firms. Therefore, it is clear that in the case of Singapore, MNEs played a major role in the technological transfer from the corporations' headquarters to subsidiaries.

The recent arrival of globalisation is widely discussed among the researchers. Its main aspect is the less control over cross-border flows of goods and services. Since the 1998 Asian crisis and especially with the adamant of the free-market policies, the MNEs became the dominant forces in the global economy (Siddiqui 2009b). Singapore also witnessed a slowdown in growth and also a rise in unemployment, but by 2000 the GDP growth rate increased and FDI inflows started to rise again.

5 The Role of the State

In this section the role of the state vs. the market in economic policies will be discussed. The role of the state in economic affairs has been problematic. On this issue two views could be seen widely, namely, (1) the neoclassical explanation and (2) the radical view. The neoclassical (also known as mainstream) economists are concerned with the existence of market failures, which exist when the market mechanism fails to perform its role as the 'invisible hand' in the allocation of resources (Krueger 1980). The radical theorists view the state as the supporter and promoter of the interests of the capitalist class (Pitelis 1991). The internationalisation of capital itself via MNEs to accumulate further and dominate markets, however, needs a system of nation states to defend its global interest. As Pitelis (1991) argues, 'all translational capital, state functionaries and labour have some interest in the persistence of the nation state' (Pitelis 1991: 144).

Developmental state is a notion that an economic policy launched with the aim to promote industrialisation in the country. In Singapore such tasks were given to groups of technocrats who enjoy substantial political support to carry out long-term policies to promote industrialisation. It is evident in state direct regulation and participation in order to get such specific outcomes. In Singapore there is clear evidence of large government intervention in the economy through planning and

facilitating the expansion of industries. By actively providing logistical and infrastructural support to foreign companies, while at the same time investing in education and housing, was seen key to promote industrialisation and exports. Moreover, the government appeased foreign companies' labour-unfriendly measure and trade union rights were curtailed. A bill was introduced rendering strikes as illegal, and annual and medical leaves were reduced to increase the capital accumulation process. The government was able to clearly side with the capital, while the dissent was not tolerated and government deployed all necessary measures, repressive state apparatus if necessary, to ensure smooth process of accumulation and profits. 'Many have internalised the belief that economic success requires social and political stability and these necessarily come at the expense of sacrificing some political and constitutional rights. If economic growth represented the "pragmatic" goal of the Singapore state, it was reproduced at the level of everyday life in a culture of mass consumption. The ideology of pragmatism thus grounded the legitimacy of the PAP in the fulfilling of this criterion of growth' (Liow 2011: 247).

The role of the state becomes increasingly important as globalisation accelerates, contrary to mainstream economists which claim that increased role of market forces would lead towards a reduced role of the state (Stiglitz 1989). Singapore has heavily relied on government intervention. For instance, the government regulates land, labour and capital resources and their allocation. It sets prices on these very resources on which private investors largely rely on their future business calculations and investment decisions.

Moreover, in the 1980s international financial institutions propagated the virtues of free-market policies as the way to achieve rapid economic growth and prosperity for the developing countries. This nineteenth-century ideology is based on notions such as this 'invisible hand' as the means to allocate resources and unbridled competition as the means to efficient production (Siddiqui 2012a; Chang 1994). Government intervention in the economy was criticised as inefficient, a waste of resources and a threat to the personal liberties of the individual. Singapore was taken as the best example of the success of the free-market model (World Bank 1993). Contrary to this claim, Singapore's success is not due to free-market policies, which could be emulated by other developing countries.

The history of modern Singapore is intertwined with the former Prime Minister Lee Kuan Yew and his PAP. The PAP has ruled the country since it became independent. And in the name of development, the PAP established an authoritarian state which disregarded human rights and state force was used to crush any genuine critique of the government policies. The government used dictatorial means to make the way for the so-called 'free-market' model. Wages were kept down to make it internationally competitive. It seems that the government directives and interventions did manage to successfully achieve high levels of competitiveness. These government directives were observed in key areas such as labour markets, state-owned enterprises (SOEs) and forced savings (Toh 1997). Singapore's experience indicates that democracy and a free press are not essential factors for economic development. It has been argued that 'authoritarianism' and 'discipline' are better and necessary to achieve higher growth rates.

After the global economic crisis in the mid-1980s, the government began establishing government-linked corporations (GLCs); they were either owned by the government or via state-controlled entity in vital areas of the economy such as telecommunications, airlines, electronics and shipbuilding. The chairman of these GLCs came from PAP senior officials. The state through GLCs dominates the domestic economy—ranging from financial sector such as Developmental Bank of Singapore to utilities to land and property development to manufacturing. In recent years, following the economic diversification strategies, the government has invested overseas more than S$100 billion of the taxpayers' money. The government of Singapore's corporation, Temasek Holdings, presides more than S$70 billion in 2006; most of it is invested in 40 large businesses, which accounts for nearly a quarter of the country's stock market. The company performance and portfolio have not been fully disclosed or open to external regulations. Dhanabalan, the chairman of the Temasek, says: 'As long we are not asking outsiders to put money in, there is no reason to tell them our financials'.

In the capital markets, the government also plays a major role. For instance, its CPF and Post Office Savings Bank hold a majority of national savings. The Monetary Authority is responsible for monetary policies and acts as a country's central bank. The Banking Act of the 1970 had directed the banks and insurance companies to seek the Monetary Authority's approval for the appointment of their chief executive officers. This has been explicitly revealed by Wee Ee Cheong, former deputy chairman of the United Overseas Bank: 'A few years ago, the major shareholders of small bank proposed to appoint two of his family members as Directors but this was rejected by the Authority (Monetary Authority of Singapore)' (Tsui-Auch and Lee 2003).

In the mid-1960s, the housing situation was in deep crisis and the government has made housing sector as a priority area of policy concern. The HDB was set up to provide housing to the inhabitants (Miles 1994). Since then the share of residential construction in gross national investment and in GDP averages around 9 % of the GDP annually which was spent on housing construction and was more than double the amount spent by developed countries like the USA and UK (Miles 1994). The housing sector is dominated by the public sector, which then sells on a 99-year leasehold basis to the private households. The construction is carried out by private contractors through open tenders system. In 1966 the government owned about 40 % of the total land, which at present has doubled, i.e. 80 %. At the same time, the home ownership has also risen from 29 % in 1970 to more than 90 % in 2009. The CPF has played a key role to boost housing demands (Miles 1994; Low 1984).

It is useful to examine the sources of financing for the housing sector. Between 1960 and 1980, the forced savings was 'locked up' in CPF and could only be withdrawn for housing (Koh 1987). This still explains the existence of public debt despite annual budget surpluses. The Housing and Development Board provides mortgage loans to buy flats. The interest rate charged by the Housing and Development Board is below that rate of commercial banks. The government claimed to redistribute income through the housing policies. And indeed most households in the country have benefitted from access to houses. The government's Housing and

Development Board assists housing to nearly three quarters of the population in public housing estates. With the exception of the lowest-income public housing, they are profit-making and not subsidised. This is achieved by a combination of cost efficiency and charging the occupants at full costs. The government is the key player in the land market, where it holds about three quarters of all land in the country (Peebles and Wilson 2002; Phang 2001; Miles 1994).

Moreover, the government was able to control labour mainly due to the following: immediately after the independence, the government nationalised all labour unions in order to register with the National Trade Union Congress (NTUC). The PAP normally appoints the general secretary of the NTUC. Going on strikes by workers meant losing their jobs. The government always highlighted that the tiny city state with almost no natural resources and lack of workers' cooperation would mean withdrawal of developmental activities. It was said compliance and obedience were the only guarantee for growth and prosperity, while at the same time all these helped the government to keep wages low to make the country attractive for foreign businesses. The government established a Workforce Development Agency (WDA) in 2003 with the task of retraining workers who have been made redundant to find work especially in the service sector. The policy of total collaboration with the MNEs has led to undermine the growth of the domestic capitalist class in the country.

The government established the National Science and Technology Board (NSTB) in 1991 to promote R&D. The government created National Computer Board and also provided incentives to attract FDI into the electronic sector. In addition to this, the government is currently building two large projects, namely, the Tuas Biomedical Park and Biopolis, which are designed to support the growth of pharmaceutical and biopharmaceutical manufacturing.

The government's new economic strategy, i.e. biomedical sciences, retraining scheme and setting up industrial parks abroad, has aimed to diversify economy to continue steady economic growth. In Singapore, still the government remains the dominant agent for change acting through a series of interventionist measures, while the domestic capitalist class still remains absent and the working class remains relatively disempowered. The overseas investors knew that they 'could trust Singapore because other MNEs always said Singapore lived up to its commitments'. For example, according to the Chairman of DuPont: 'In other countries things would constantly come unglued, whereas in Singapore, once they said something, they stuck to it' (Schein 1996: 125).

The government policies were in three phases: the setting up of manufacturing during 1965–1980, the industrial upgrading of 1980–1990, and finally, regionalisation programme of 1990–2010. The country had a purposive economic strategy to encourage MNEs to collaborate and fully participate in the country's industrialisation process. The government also realised that foreign investors would choose to invest if they are confident of higher returns from their operations. Therefore, the state promised to provide best possible environment for businesses, for instance, the policy of making it a duty-free export processing zone and tax breaks for foreign investors. Between 1974 and 1984, the average rate of return of

US companies in Singapore averaged 35.4 %, compared to 16.9 % in Hong Kong, 18.4 % in Taiwan and 15.2 % in South Korea (Pereira 2000; Siddiqui 2013a).

The government also promoted sectoral diversification and since mid-1980s promoted the increased investment in high-value-added products and service sectors (Stiglitz 1989; Wade 1990). The country has promoted tourism as part of its diversified economy since the 1980. Over the years from 2.6 million tourists in 1980 to 6.2 in 1998 visit Singapore. Also in response to the 1985 recession, to diversify its economy and sources of income, Singapore encourages its own domestic capital to expand in other developing economies. In the mid-1990s the government took initiative to restructure and diversify the economy by shifting its heavy reliance on manufacturing exports towards service sector and aimed to create the country as international centre for services. For instance, in 1999 Prime Minister Goh Tong stressed the country's commitment towards further integration with the global economies in order to build 'world-class Singapore' as he said: 'we should now go global by forming strategic alliances or mergers with other major players. Indeed, we have no choice—where the industries are consolidating worldwide, we are either become major players, or we are nothing' (Goh Tong, 22nd August, 1999, www.web3.asia1.com.sg/archive/sg/1/one/one1a.html).

In recent years, there have been massive shifts of job relocation by foreign businesses towards other neighbouring countries. To prepare for this changing business environment, Singapore has been focusing on more capital-intensive skilled oriented sectors such as biotechnology sector. The government plans to shift workers from manufacturing towards service sectors; however, it would be difficult to upgrade manufacturing workers to become biotech researchers. In recent years the government EDB has taken initiative to boost the sectors such as pharmaceuticals, biomedical technology and health-care services. The government aims biomedical science sector to generate US$18 billion and create 15,000 new jobs by 2015. Singapore's biomedical policies are not designed to assist local companies, as other countries might do, but to invite MNEs who are linked to the biomedical sector and offer subsidies to those international companies to invest in Singapore (Pereira 2006). Moreover, in order to ensure adequate supply of highly skilled workforce, the government invested heavily in biomedical training and education including awarding a large number of scholarships to overseas and local students to take research in this sector. And also the government amended immigration laws to allow 'foreign talent' in biomedical sector to be employed by the MNEs.

To highlight the key role played by the country manufacture sector, only 25 % of manufacturing enterprises were foreign owned, employed 25 % of workforce and contributed to almost 72 % of the total country's exports in 1982. Foreign companies are attracted by cheap and disciplined labour and rapidly growing regional markets. The production carried out by MNEs can take the form of exports to the source country or to other countries or could be used as inputs into export-oriented industries in host country. All these three types of activities can be found in Singapore such as interindustry textiles exported in return for high-tech products. The intra-trade activities also prevailed, where subsidiaries of MNEs are involved in part of a global production process. Thus, due to this the development is far from

independent and rather peripheral, which is heavily dependent on developed economies and foreign companies.

Singapore's export-led development coincided with the search by the MNEs to reduce costs of production through cheap labour and raw materials in the 1970s. The government of Singapore intervention influenced market clearing levels largely due to measures such as the Employment and Industrial Relations Act of 1968. As suggested by findings of Lim and Pang: 'de-politicised the labour movement, established de facto government control over unions [and] transferred bargaining power from workers to employers' (Lim and Pang 1986: 11). Despite the attractiveness to production location due to the excellent infrastructure, the presence of cluster of complementary firms and shortages of labour in the 1980s, the government suppressed wages to make it attractive for foreign investors.

Singapore relatively witnessed fewer difficulties from the increasing instability of global financial markets. Since the country relied on MNEs for capital, technologies and management, the availability of domestic savings, thus, had little need for reliance on foreign debts.

The country has become a hub of foreign investment because of its strategic location and favourable government policies. The government of Singapore enforces a pro-foreign investment and export-oriented economic policy, helping the nation attract large-scale foreign investments despite its relatively costly operating environment. The USA is the leading foreign investor in Singapore, accounting for about $106.5 billion worth assets in the manufacturing and service sectors.

The government also employed other various measures and depoliticised and disciplined workers to make the country more attractive for foreign investors. For instance, the government regulated the labour market in the 1960s by disciplining the workers with the Trade Union Bill, Employment Act in 1968 and the Industrial Amendment Act (Rodan 1989: 48). The government also invested heavily to expand infrastructure through major government-owned industries. Rodan (1989) argues that 'the government's thinking that the question of industrial structure should not be left solely to the market—especially given the absence of domestic industrial bourgeoisie of any consequence' (Rodan 1989: 77).

As living conditions and availability of medical facilities improved, the participation rates increased. For example, the participation rate of the population has risen from 58 % in 1975 to 63 % in 1985 and 65 % in 1996. It was largely due to an increase in female participation rate. The male participation rate between 1985 and 2000 has varied around 78–79 %. It seems that the dramatic increase in female participation was due to spread of education among females. For example, by 2000 the proportion of female students was about 43.5 % in two public universities and also the female teacher ratio was still lower, i.e. only 21 % of teaching staff were females (Peebles and Wilson 2002).

The financial sector has been developed in the way of offering tax breaks for foreign firms and the government of Singapore has taken advantage of its location which meant it could fill a time gap that then existed. Many of the foreign financial institutions operating in Singapore are not concerned with the domestic economy because it is so small. They use it for regional and global operations. In 1997, the

government introduced reforms in financial sector on the suggestions of IMF. The main aim was to introduce more competition, transparency, etc. It also meant the banks to disclosure hidden assets that they did not report on their balance sheets.

6 Regional Economic Integration

In 1985, the government launched a policy to promote the country as a regional hub. It undertook two key policies, namely, to develop highly specialised niches and upgrade the productivity in the domestic sector. It is also known as cluster strategy of promoting key industries in telecommunications, electronics and pharmaceuticals. During the last two decades, the country has shifted from low-value manufacturing products to high-value products such as innovation, insurance, banking and financial services.

Since 1992 the government has been encouraging the businesses to expand into ASEAN countries and also in China. This was seen very crucial for the continuous growth of the country's economy in the twenty-first century. As Dr. Yuan, an MP and also the director of the Institute for Policy Studies, has said, 'One of the Singapore's options is to diversify from excessive dependence on a slow-growing South-East Asia and focus more on opportunities elsewhere, such as China, South Asia etc. .... The crisis has taught us that putting all our eggs into the regional basket has its pitfalls, and that it is more prudent to aim at greater diversification' (The Straits Times, January 24th, 1999).

Singapore is promoting a technical hub and regional knowledge centre and the government is doing every possible effort to develop higher-end capabilities. The existence of higher-tier suppliers becomes increasingly crucial in attracting MNEs' higher-end investments. Recently Singapore has increased its economic relations with its neighbour, particularly with Malaysia in electronics. For instance, total trade with Malaysia exceeded that of the USA due to the increase in FDI in Malaysia by Singapore-based firms. In early 1960s Singapore was producing labour-intensive goods such as textiles, household electric goods and petroleum refinery, while in 1980s and 1990s capital and skill-intensive electronic goods and financial services.

The global recession in the mid-1980s hit Singapore severely and the government realised the existence of small domestic markets and the absence of local entrepreneurship thanks to the large presence of foreign companies. The country took a major initiative in early 1990s towards regionalisation and created favourable conditions by ensuring its success. The regionalisation process was seen to encourage local private and state companies to regionalise their activities. The government also saw this as a countermeasure against future recession. Through the policy of regionalisation, the government provided various incentive schemes to invest in neighbouring countries. The state took active role in promoting outward investment of its domestic companies. It seems that this was only possible when the domestic economy has been saturated and seen as a bit safe to invest

abroad. Nearly three quarters of Singapore's FDI was in Asian countries such as Malaysia, which alone absorbed 60 % in 1990.

In 2000, Singapore has initiated eight large-scale industrial parks in neighbouring countries such as China, India, Indonesia and Vietnam. These overseas projects are positioned in premier location for Singapore's potential investors. The country is increasingly dependent on production and exports of value added that its highly skilled workforce could produce.

Singapore's regionalisation development programme of 1990–2010 coincided with a number of other regional factors such as appreciation of Japanese yen since the Plaza Accord was signed between the USA and Japan in 1985, which resulted in the rising of cost of production, especially in manufacturing sector in Japan. This certainly provided an opportunity for the government Singapore to attract Japanese investors, who are trying to find other locations for their production due to rising costs domestically. Factors such as stable macroeconomic environment and attractive government incentives contributed to making the country a favourable place for investors. The government also realised that because of the Special Economic Zones in south China with relatively cheap labour (Siddiqui 2009b), the MNEs might transfer their lower-value-added operations from Singapore. Therefore, it was rather seen as a survival strategy by the government to rapidly move towards higher-value-added activities, and government formulation of the 'Regionalisation 2000' Project was aimed specially to meet these specific challenges: 'The strategic intent of regionalization programme is to build an external economy that is closely linked to and which enhances the domestic economy by participating in the growth of Asia. This programme seeks to form a network of strategic zones in key markets with emphasis on building good linkages between our regional projects and domestic clusters' (SEDB 1995: 8).

Singapore in the 1990s invested in national developmental projects also knows as 'regionalisation strategy', where the government and GLCs invested in industrial park programmes. Singapore invested in several cities in industrial parks in the neighbouring countries. It was claimed that these industrial parks would be able to earn considerable profits, which would supplement the country's domestic economy. The government's 'regionalisation policy' strategy aimed at local businesses to locate production in industrial parks developed by Singapore and some countries in East Asia. It appears that these industrial parks did manage to encourage local businesses to invest in these overseas parks, but failed to generate enough profits to provide a substitute of the domestic economy (Pereira 2006).

In the early 1990s, the government realised globalisation was making Singapore less economically competitive. Although earlier international integration with the global capital benefited Singapore with influx of FDI, since 1990s capital began to move at much larger scale into other East Asian countries such as China, Malaysia, Thailand and Vietnam because of lower costs of production. Globalisation also includes global production networks, which is formed when big corporations disperse their production across different locations across the world. The motive for this dispersion could vary, but mainly to seek higher profits. As summarised by Ross and Trachte (1990), 'Its [MNEs] ability to scan the globe for investment

possibilities makes possible a rationale assignment of resources and ruthless pursuit of the exact combination of local policies, labour conditions, transport considerations, and so forth for any commodity or part' (Ross and Trachte 1990: 66).

It seems that MNEs have two prime motives, which are factors and markets. First one refers to factors of production necessary to carryout production of goods and services. It not only includes primary factors, e.g. labour, capital, raw materials, etc., but also secondary factors, e.g. supplementary elements which make it possible that production processes take place smoothly such as availability of infrastructures, educated workers, fiscal incentives, tariffs, etc. The second refers to domestic or regional markets for the products. Based on these two factors, the MNEs will look for optimal locations for production. Given that, many big corporations disperse the production, i.e. create a chain of production sites, often across national boundaries, in order to seek optimal location for production to maximise profits. It is said that global production networks could be potential source of economic growth for the developing economies because such networks could possibly generate employment, earn foreign exchange and transfer new technology and management to the host country (Lall 1996).

7 The East Asian Experience

The existing literature on political economy has pointed out that the policies and institutional mechanisms of the states in East Asian countries including Singapore have shaped the business strategies of the private businesses (Wade 1990; Amsden 1989; Johnson 1982). The government institutions were normally given tasks of economic and industrial policies in shaping the business decisions. The government assumed the role of 'developmental state' to modernise the economies and consistently provided guidance to the market. And also other Southeast Asian economies like Taiwan heavily regulated the FDI to help and build domestic industrialisation (Shin 2005; Cotton 1995).

The East Asian countries, such as Japan, had broken all previous historical records in rapid increase GDP growth rates, from the 1950s onwards in comparison to West Europe and the USA. Japan's spectacular economic recovery of a country was destroyed in the Second World War; the development of a very competitive manufacturing sector and fully modernised society with rising living standards was seen no less than a miracle until the 1990 (Siddiqui 2009a). It was soon followed by South Korea under Park Chung Hee in the late 1970s and also Taiwan was not far behind in catching up in the process of industrialisation and modernisation. Moreover, Japan, South Korea and Taiwan were creatures of US occupation and certainly the Cold War did play a crucial role during this period. But due to the Cold War, these countries have had some freedom to protect their businesses against MNEs. For instance, despite the lack of military autonomy, Park Chung Hee regime did manage to keep foreign capital at bay while promoting domestic corporations (Wade 1990; Amsden 1989).

The economies of South Korea and Taiwan grew fast during the 1970s and able to rapidly increase their exports. Their developmental policy model is known as 'outward orientation' (i.e. export led), which was heralded as successes compared to slow growth in the developing countries of Africa and Latin America. Both South Korea and Taiwan were able to successfully develop domestically owned businesses, largely in the private sector. Both countries developed their manufacturing production towards overseas markets, while at the same time protected their domestic markets. The government provided direction to achieve stated goals. And in South Korea, the government managed the industries through its control of banks. With control of credits the government made access to low-cost financing conditional on investment in new technologies and industries on meeting export targets. This method promoted and developed a handful of favoured borrowers, who emerged as chaebol, i.e. family-owned big corporate groups. In Taiwan the state also promoted new technologies, but through public investment in few selected state-owned industries. Both countries welcomed foreign investors towards strategically selected low-wage export processing sectors but also required them to share technologies with local firms.

However, there are local differences, for instance, the economic policies in South Korea and Taiwan (both are ex-Japanese colony) are conditioned by their background. Despite their heavily reliance of export-led growth, they undertook the policies of inward-looking Japanese model. As a consequence, Taiwan and South Korean indigenous companies are larger and more powerful and less dependent on foreign technology than those of Singapore.

8 Conclusion

Since mid-1960s, Singapore had sustained very high economic growth rate, with relative price stability, full employment and the inflation rate below world's averages (Nolan 1990). During this period the economy was diversified from entrepot trade and British military services to manufacturing, transport, financial and business services. The country has accumulated huge foreign exchange reserves in which the government is investing in assets abroad. There is no doubt that poverty, illiteracy and housing shortages have been removed from this island, but these benefits have been brought at considerable costs in terms of, for instance, independent development, human rights, freedom and workers' rights.

My findings about the Singapore developmental strategy of the last 50 years contradicts neoclassical also known as free-market theory and resembles more on state intervention. The government also controlled trade unions and wages. The government completely accepted the dominance of foreign corporations in export sectors. Rapidly expanding manufactured sector greatly helped to reduce unemployment. However, the country's workers were kept firmly under government control.

The study also finds that Singapore differs from the experiences of the other East Asian countries in many aspects. For instance, the country closely collaborated with MNEs and ensured that local bourgeoisie does not develop to an autonomous force. The reasons for such decision appear to be mainly due to lack of domestic capitalist class and also during the colonial period, these local merchants and capitalists were quite comfortable and used to deal with the metropolitan capital without any major conflicts. Therefore, despite some difficulties, it was easier for PAP to collaborate with foreign capital as they have done in the recent past.

However, Singapore like Korea and Taiwan undertook keen interest in expanding the role of the state in the economy and the developmental process and did not hesitate to move into the areas seen as crucial to expanding technology and export capacity such as manufacturing and steel and ship building sectors. The growth miracles of other East Asian countries like South Korea and Taiwan were not of blanket integration in the world market. But these countries had witnessed consistently state intervention and direction, along with favourable international Cold War policies in the region. As a result they were given access to Western markets and capital on a scale no other developing countries had experienced. With the end of the Cold War, the recent stagnation and increased power of the financial sector in metropolitan countries have ended the hopes for a project of national capitalist development. As Patnaik notes, 'This new phase also entails the end of bourgeois economic nationalism as a practical project in the Third World, i.e. of the attempt of the Third World bourgeoisie to carve out a space for itself and build a capitalism that is relatively autonomous of imperialism' (Patnaik 1999: 67). With the recent globalisation and the neighbouring countries' ambitious plan to invest in the development of seaport, Singapore will face increased competition in the overseas markets.

The policy options towards the adoption of neoliberal policies may provide some short-term boost to economic growth, but it heavily relies on privatisation, deregulation and trade liberalisation and acceleration of the growth of financial sector (Siddiqui 2013b). The finance and banks grow much faster than the real economy and at the same time the trade liberalisation has distributed manufacturing production globally. However, the vulnerability lies with such development as the Singapore model is obvious because of its overdependence of foreign capital and lack of indigenous capitalist class.

The East Asian crisis in 1998 led to the change in strategies and given way to the 'neoclassical' model, which relies on 'market forces' and 'international financial institutions' for investment and resources. For them, resource allocation is the key to higher growth rates for these countries. The proponent of free market argues that export-led policies will keep private incentives and entrepreneurship in line with those of the global businesses. As a consequence, higher levels of competition will ensure efficient resource allocations and higher productivity and higher growth rates.

The paper finds that the national economic policies do matter, as it could potentially influence the investment decision of MNEs, and also in Singapore the government policies were often seen as response to changing market and

international business environment. For long-term solutions, the government should take initiative to expand domestic markets by increasing the income of working people, and at the same time further efforts should be made to diversify the economy and control over the MNEs. Singapore needs to focus more towards increasing domestic demand in order to return to stable economic growth. It would be feasible to increase spending in social sectors and building social safety nets because a stronger social protection system will reduce the need for precautionary savings to meet the need for education, health and old age care.

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Vietnam–China Economic Relations and Recommendations for ASEAN–China Cooperation

Nguyen Thi Bich Ngoc

1 Introduction

Historical and geographical proximity has had great impacts on Sino–Vietnamese economic relations. Having a long history of trade and cultural exchanges, Vietnamese and Chinese bilateral economic cooperation is among the most durable, sustainable, and intensive of relations between China and Southeast Asia. Despite many "ups" and "downs" in the history of their bilateral relations, exchanges among Chinese and Vietnamese business communities have been carried out nonetheless for many centuries. From geographical perspectives, Vietnam is the only country in Southeast Asia bordering China on both land and at sea. Geography created favorable conditions for boosting socioeconomic relations, but also caused many difficulties, especially those related to territorial disputes. As a result, bilateral relations between Vietnam and China can be perceived as being alike to a portrait with adverse segments: one is a deep mutual understanding, with the partaking of values and ethics, while the other is of long-lasting skepticism and mistrust.

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2 Economic Relations Between Vietnam and China Since Normalization

2.1 In the 1990s

Since the normalization of diplomatic relations between Vietnam and China in 1991, bilateral economic cooperation has improved tremendously along with a considerable increase in the value of trade and investment. Shortly after the normalization process, a set of agreements were signed by the two governments in order to provide a legal foundation for bilateral trade and investment collaboration. The most important agreement reached by both sides in those years was the most-favored-nation treatment and various preferential custom tariffs granted by provisions of the trade agreement signed in November 1991.

In the early 1990s, Vietnam and China achieved impressive annual percentage changes in bilateral trade, with values that varied from 120 % to greater than 450 % annually (see Table 1). However, the great surge in the levels of trade could only be maintained in the commencing period when the notion of commercial exchange had only just been restored. During the second half of the 1990s, annual percentage changes in bilateral trade began to progressively decrease and even fell below zero in 1998 and 1999 due to the ramifications of the financial crisis.

Vietnam and China's trade relations in the first decade post-normalization also illustrated the fact that there were various emerging issues that were in need of addressing.

First, Sino–Vietnamese trade relations in the 1990s still comprised a low percentage of foreign trade for each of the respective nations, it constituted for just 0.4 % of China's and 7 % of Vietnam's total foreign trade on average. Moreover, considerable fluctuations in the annual percentage alterations indicated that there were low levels of connection between these respective markets. This was

Table 1 Trade values and annual percentage changes of Sino–Vietnamese trade in the 1990s

Year	Trade values (in US$ million)	Annual percentage change (%)
1990	7.23	–
1991	32.23	345.8
1992	179.07	454.4
1993	398.64	122.6
994	532.82	34.1
1995	1052.19	97.4
1996	1150.63	9.3
1997	1435.64	24.6
1998	1245.67	−13.2
1999	1218.15	−2.2

Sources: International Studies (Diplomatic Academy of Vietnam), No. 31, 1999; China Statistical Yearbook 1999

Table 2 Trade balance between Vietnam and China in the 1990s

Year	Export from Vietnam to China (US$ million)	Export from China to Vietnam (US$ million)	Trade balance of Vietnam (US$ million)
1990	3.37	3.86	−0.51
1991	10.23	21.40	−11.17
1992	72.71	106.36	−33.65
1993	122.63	276.00	−144.37
1994	191.16	341.66	−150.50
1995	332.06	720.13	−388.07
1996	308.48	842.15	−533.67
1997	357.10	1078.54	−721.44
1998	217.36	1028.31	−810.95
1999	354.29	863.86	−509.57

Sources: International Studies (Diplomatic Academy of Vietnam), No. 31, 1999

due to the fact that Vietnam–China's economic ties at that time were still unstable and vulnerable as a result of the financial crisis.

Second, Vietnam was facing increasing trade deficits with China which were progressively increasing each year. Between 1991 and 1995, China's export to Vietnam was around twice that of Vietnam's export. But in subsequent years (1996–1999), China's export to Vietnam was estimated to surpass that of Vietnam's by a considerable margin, around 2.5 times to fourfold of Vietnam's total export value (see Table 2). This circumstance can be explained by the trading structure in which almost all goods and commodities exported by Vietnam were raw materials or primary agricultural products with relatively low added value. The main goods supplied by Vietnam were rice, coconut oil, coffee, cashews, seafood, oil, coal, rubber, and metal ore. Meanwhile, China supplied to her counterpart produce that was predominantly agricultural utensils, machinery for the light industry, small hydropower stations, transport vehicles, garments, and fruits. Further reasoning may be due to the quota imposed by China on the trade of rice and rubber which were among Vietnam's key exported items.

Third, the expansion of the Sino–Vietnamese trade relations after normalization resulted in a plethora of difficulties for Vietnamese producers who faced fierce competition from Chinese companies. Chinese goods, having the upper hand in terms of price and diversity, managed to increase their market share greatly in Vietnam, especially among low-income consumers. Vietnamese enterprises were greatly disadvantaged due to the fact that the inputs for the manufacturing industries such as machinery, equipment, and raw materials were mainly sourced from China.

In addition, trade between Vietnam and China's border provinces constituted for a substantial part of bilateral trade within these respective nations. Border trade among the Vietnamese Northern provinces and the Chinese provinces of Guangxi and Yunnan in the 1990s was estimated to be around US$ 300–350 million per annum. Such value comprised up to 50 % of the total border trade in China which

made Vietnam a prominent ASEAN border trade partner of China (in comparison to Laos and Myanmar). Expansion of commercial exchange across the border provinces contributed significantly to the increase in GDP of these provinces and a stark increase in living conditions for those who were of local origin. Nevertheless, multiple transnational crimes, including smuggling, gambling, prostitution, trafficking in women and children, and drug trading and addiction, emerged as consequences of commercial activities in these boundary regions and posed huge challenges and potential risks to both sides. Therefore, efficient monitoring of the transition of trans-boundary goods and migrant flows was imperative for the two governments from both economic and security perspectives. Thus, in order to strive for an enhanced future, a temporary agreement on regulations of border administration was signed by both Vietnam and China in 1991. The focal point of this agreement was related to the notion of legalization of border trade and the reopening and monitoring of border gates. In 1992–1993, both Vietnam and China's governments adopted domestic laws providing preferential policies in order to increase the provision of economic activity in these provinces. Development of the border provinces was of mutual interests of both Vietnam and China in improving the quality of life for local communities, reduction of the development gap among regions, as well as coping with domestic and transnational crimes.

In terms of investment, FDI from China to Vietnam in the 1990s constituted for a small proportion of Vietnam's FDI inflow: about 3 % of the total value and around 2 % of the total quantity of projects were funded from Chinese investment. China invested mainly in the construction of small- and medium-sized infrastructure, in tourism and restaurants. Aside from the two projects that concentrated on the development of industrial zones in Ho Chi Minh City and Hai Phong that were fulfilled with a US$14 million and US$15.5 million investment, respectively, up to 60 % of projects that Chinese firms invested in were valued at less than US$1 million. The majority of these projects were of small and medium volume with an average capital of around US$2 million (see Table 3). This was much less than the average value of the projects that were funded by the ASEAN companies (approximately US$10 million), let alone investment from developed countries. There were three prominent reasons behind this situation:

Table 3 FDI from China to Vietnam and quantity of projects in the 1990s

Year	Value of China's FDI to Vietnam (US$ million)	Quantity of projects
1991	0.2	1
1992	3	10
1994	24	22
1995	60	33
1998	120	61
1999	130	76

Source: Proceedings of the conference "Vietnam–China relations: achievements after a decade and prospects" (Hanoi, November 2001, p. 323)

- Although the Vietnamese government made a considerable effort to improve conditions for foreign investment since 1988, there was a lack of an adequate legal system, and the standards and infrastructure at that time inevitably made Vietnam less competitive than China and her subsequent ASEAN counterparts.
- In the 1990s, after more than a decade of economic reform, China itself was among the most attractive destinations for FDI. Chinese large-scale investment projects were primarily focused on the burgeoning domestic market or the developed markets that were deemed to make a profit.
- In those years, almost all Chinese investors did not have long-term business plans in Vietnam. They preferred small-scale projects in order to recoup in close proximity. In case the project failed to reap the expected profit, Chinese investors tended to withdraw their capital shortly after and move on to another market.

In general, normalization of political and diplomatic relations between Vietnam and China in 1991 was an indispensable precondition for the restoration of bilateral economic cooperation. The most important achievements in the realm of Sino–Vietnamese cooperation in that period included (1) facilitation for collaboration among Vietnamese and Chinese business communities, such as increased access to goods and investment for both sides; (2) improvement of people's quality of life and infrastructure, especially in the border provinces; and (3) contribution to economic growth and reform in each country. As mentioned above, parallel to the benefits derived from boosting economic cooperation with China, Vietnam encountered various challenges ranging from an increasing trade deficit to inefficiency of investment, and there were also various security issues. Alongside the great difficulties that were caused by the financial crisis of 1997–1998, these challenges required new initiatives from both Vietnam and China to resolve in order to intensify bilateral cooperation. As for Vietnam, the government understood the needs of making relevant legal and political amendments, together with other measures aimed at improving the competitiveness of Vietnamese enterprises.

2.2 Between 2000 and 2009

During the course of the second decade after normalization, Vietnam and China had mutual interests in deepening bilateral relations and fostering cooperation in many areas. The bilateral, domestic, and regional context in this decade brought about favorable conditions for upgrading relations between the two countries.

First, at the turn of the century, Vietnam and China managed to resolve two important issues related to their land borders and in the Gulf of Tonkin (Beibu Gulf). Conclusion of the agreement on the demarcation of the land border between Vietnam and China dated 31 December 1999 and the agreement on the matter of delimitation of territorial waters, the exclusive economic zone, and the continental shelf of the Gulf of Tonkin (Beibu Gulf) on 25 December 2000 helped start a new phase in bilateral relations in the post-normalization period. Resolution of territorial disputes

regarding land borders and in the Gulf of Tonkin brought about a huge improvement in political relations between two parties and between two governments. Today there is an area called "Entrance of Gulf of Tonkin" which is still under negotiation.

Second, from the regional perspectives, this decade marked the starting point of ASEAN-10 which included all of the Southeast Asian states. Member states committed to accelerate regional integration and foster a bigger role of the association in East Asia. In order to fulfill a vast array of initiatives agreed among the members, ASEAN countries took into account the importance of cooperation with Northeast Asian partners. At the same time, the financial crisis of 1997–1998 also highlighted the importance of new cooperative mechanisms like ASEAN + 1 and ASEAN + 3. Tendencies of regional integration gave additional impetus to bilateral cooperation between Vietnam and China.

Third, from the angle of domestic reforms, both countries had mutual interests in maintaining stability for economic development. The reformation policy that both Vietnam and China adhered to had a similar approach and motive: to advance economic growth by means of increased exports and FDI. Since the end of the 1990s, leaders of the Vietnamese and Chinese governments began to set up clear targets for bilateral trade. For instance, during the visit of the Vietnamese Prime Minister Phan Van Khai to China in 1998, the two governments agreed to work together in order to achieve the bilateral trade target that was placed at US$2 billion in 2000. After that, the target for the years 2005 and 2010 was decided upon as being US$5 billion and US$10 billion, respectively. However, all these trade values were achieved earlier than the expected date; therefore, in 2005, the target for 2010 was raised to US$15 billion. Nonetheless, it took solely 2 years to acknowledge and surpass this goal, and in 2007, the total trade value between Vietnam and China was estimated to be greater than the US$16 billion motive.

2.2.1 Trade

2000–2009 has proven to be the most vibrant decade in Sino–Vietnamese economic relations in the post-normalization period. As indicated in Table 4, the total value of trade between the two neighbors has been increasing gradually. The annual percentage change in 2000 showed the recovery of bilateral trade after the financial crisis of 1997–1998. Although the annual percentage change was not as impressive as in the early 1990s, the increase in value was considerable. In 2009, the value of Sino–Vietnamese trade was elevated to almost US$18 billion in comparison to the 2000 objective, a considerable growth that further signaled the start of greater cooperation. At the same time, another financial crisis that occurred in 2008–2009 did not affect the levels of bilateral trade as greatly as the prior one of 1997–1998.

In comparison to the 1990s, this decade signaled the beginning of a new clear trend in that Vietnam and China tried to improve their coordination in fostering bilateral and regional trade initiatives. In 2001, Vietnam together with China took initiatives in accelerating the formation of ASEAN–China FTA (ACFTA) through the "Early Harvest" program. Each party committed to reduce import tariffs and to abolish

Table 4 Trade value between Vietnam and China in 2000–2009

Year	Total trade values (in US$ billion)	Annual percentage change (%)	Export from Vietnam to China (US$ billion)	Balance of trade of Vietnam (US$ billion)
2000	2.937	141	1.536	0.135
2001	3.024	2.96	1.417	−0.19
2002	3.677	21.6	1.518	−0.64
2003	5.022	36.6	1.883	−1.255
2004	7.494	49.2	2.899	−1.696
2005	9.146	22.04	3.246	−2.653
2006	10.634	16.26	3.243	−4.148
2007	16.356	53.8	3.646	−9.064
2008	20.824	27.3	4.850	−11.123
2009	20.814	−0.04	5.403	−10.008

Source: Statistics of Ministry of Industry and Trade (Vietnam) http://www.moit.gov.vn/vn/Pages/Thongke.aspx?Machuyende=TK&ChudeID=16. Accessed on 28 Feb 2015

them completely by 2008, i.e., 3 years earlier than the deadline agreed previously by ASEAN countries and China. However, by 2008, China and Vietnam had reduced the tariffs on the 536 and 484 categories, respectively, under the "Early Harvest" program. Despite the fact that 24 categories were not included in this program, Vietnam's active role helped Chinese enterprises to expand their market share not only in Vietnam but also in other ASEAN countries. ACFTA was considered as a gateway for China to tighten its economic and political linkages with Southeast Asian countries. In turn, Vietnam obtained China's support in encouraging Vietnam's accession to the WTO. In the Vietnam–China Joint Declaration that was signed in 2001 (shortly after China's admission to the WTO), China confirmed its support to Vietnam's entry into the organization (Joint Declaration between Socialist Republic of Vietnam and People's Republic of China in 2001). Three years later, this position was reiterated in the Vietnam–China Joint Communiqué signed in October 2004, together with the mutual recognition of the two sides as being a "market economy." The two parties also agreed to complete their bilateral negotiations as soon as possible, a feat which actually occurred solely a year later (Joint Communiqué between Socialist Republic of Vietnam and People's Republic of China in 2004).

Another way to promote trade cooperation and increase coordination between the two governments was to develop new bilateral initiatives. The most outstanding one was the initiative of "two corridors, one belt," which was initiated in 2004. Vietnamese and Chinese experts considered developing infrastructure that would serve as a Western corridor linking five cities, Kunming–Lao Cai–Hanoi–Hai Phong–Quang Ninh, and an Eastern one, linking five subsequent cities, Nanning–Lang Son–Hanoi–Hai Phong–Quang Ninh, together with the belt, which was called "the belt of Beibu Gulf." The memorandum of the implementation of the initiative of "two corridors, one belt" was signed in November 2006. After that, China wanted to make this area become the trade hub for Chinese goods and commodities that were going into the ASEAN market. Therefore, in July 2006, the government

of the Guangxi Zhuang Autonomous Region proposed to upgrade it into "one axis, two wings." "One axis" referred to the Pan-Beibu Gulf Economic Cooperation, while the "two wings" illustrated the Greater Mekong Subregion (GMS) and the Nanning–Singapore Economic corridor. Other bilateral initiatives were the agreement on fishery cooperation in the Gulf of Tonkin that was ratified in 2004, the framework agreement on oil cooperation within the agreed area in the Gulf of Tonkin, and the agreement on the expansion and deepening of bilateral trade and economic cooperation that was signed in 2008. Up till now, Vietnam and China have maritime cooperative mechanisms only in the Gulf of Tonkin.

2.2.2 Problems

Contrary to the positive trends of the total trade value, statistics showed the negative ramifications of the balance of trade for Vietnam, especially in the second half of the decade. From 2004 onward, Vietnam's trade deficit with China progressively began to increase each year, even when the annual percentage alterations declined (see Table 4). In comparison with other substantial trade partners, Vietnam also had multiple trade deficits with Taiwan and South Korea, which were also augmenting continuously each year between 2000 and 2009, but the deficits with these partners were considerably less than that with China. Meanwhile, Vietnam regularly experienced trade surpluses with subsequent prominent partners in the Western Hemisphere, alike to the USA and the EU. However, the value of the deficit with China was greatly considerable that the surpluses with other partners could not remunerate for the overall deficit of Vietnam's foreign trade.

Regarding the structure of goods and commodities, there was no major change in Vietnam's export to China. The main categories remained similar to the previous period including fishery products, rubber, crude oil, coal, rice, cashew nuts, sugar, and wood. Meanwhile, the vast proportion of imported goods from China consisted of machinery and materials for both industrial and agricultural purposes in Vietnam. For their industry, Vietnam imported refined petroleum and oil, iron and steel, machinery, apparatus and parts for telecommunications, textile fabric, and auxiliary materials for footwear, for sewing, for cigarettes, for paperboard, and for the plastic industry. For their agriculture, Vietnam bought from China chemical fertilizers, insecticides, herbicides, and also plant varieties. This structure of bilateral trade led to several problems for Vietnam:

- Lack of optimization in terms of their export–import structure with China was the direct reason for the heightening of Vietnam's trade deficit. This situation also indicated the difficulties of Vietnamese producers in diversifying export structures and developing new kinds of products in the Chinese market.
- Structure of their imports proved that Vietnam's manufacturing industry and agriculture depended heavily on Chinese input materials and equipments. The greater the manufacturing sector of Vietnam became, the greater the trade deficit that Vietnam had to endure (versus China).

Table 5 ASEAN–China trade in 2001–2009 (Unit: US $ billion)

Year	Trade value	China's balance of trade
2001	41.6	−4.8
2002	54.8	−7.6
2003	78.3	−16.4
2004	105.9	−20.1
2005	130.4	−19.6
2006	160.8	−18.2
2007	202.6	−14.2
2008	231.1	−2.8
2009	213.0	−0.4

Source: Wang Yuzhu, Sarah Y Tong. China–ASEAN FTA changes ASEAN's perspective on China. East Asia Policy, Vol.2, No.2, Apr/Jun 2010 via http://www.eai.nus.edu.sg/Vol2No2_WangYuzhu&SarahYTong.pdf

- In addition to the economic problems, there were sanitary and environmental issues related to Chinese goods. Using food and chemicals imported from China was often considered by Vietnamese consumers as being harmful to one's health and unfriendly to the environment.

From the perspective of the ASEAN–China cooperation, acceleration of bilateral and regional initiatives with China had dual impacts on Vietnam. On the one hand, this was a necessary measure to deepen Vietnam's engagement in regional integration and to increase connectivity among Vietnam's market and their East Asian counterparts. On the other hand, participation in regional commitments made the competition among ASEAN economies become tougher for Vietnam. Between 2001 and 2009, the Vietnam–China bilateral trade value constituted for around 7.5 % of the total ASEAN–China trade on average (see Table 5). Vietnam belonged to the group of China's major trade partners in Southeast Asia, however, with the most unfavorable balance of trade. For example, in 2009, Vietnam had the highest ratio of trade deficit to total bilateral trade (about 54.9 %) among China's major ASEAN trade partners (see Table 6). Given the gap in capacity between the Vietnamese producers and ASEAN-5's enterprises, it would be difficult for Vietnam to improve their balance of trade without increasing value-added content to its products.

2.2.3 Investment

In terms of investment between 2000 and 2009, there was a growth in both value and quantity of projects invested by China, mainly in the second half of the decade. The average scale of the projects increased to US$4.39 million per project in 2005–2009, which was consistent with the common trend of FDI projects in Vietnam during these years. Nevertheless, the percentage of FDI from China in relation to the total FDI inflow to Vietnam was still fairly modest (around 2 % of

Table 6 ASEAN–China trade statistics in 2009 by country (unit: US$100 million)

Country	Trade value	China's balance of trade
ASEAN	2130.11	−4.17
Brunei	4.23	−1.42
Burma	29.07	16.15
Cambodia	9.44	8.7
Indonesia	283.84	10.57
Malaysia	519.63	−126.99
Philippines	205.31	−33.62
Singapore	478.63	122.7
Thailand	382.04	−115.9
Vietnam	210.48	115.54
Laos	7.44	0.09

Source: Ministry of Commerce of People's Republic of China at http://english.mofcom.gov.cn/article/statistic/lanmubb/ASEAN/201002/20100206776202.shtml

Table 7 China's investment to Vietnam in 2001–2009 (excl. Hong Kong)

Year	Value of China's FDI to Vietnam (US$ million)	Quantity of projects
2000	148	92
2001	221	110
2002	74.8	58
2003	328.6	83
2004	774.9	391
2005	120.7	46
2006	401.3	77
2007	572.5	130
2008	373.5	73
2009	380	76

Source: Statistical Yearbooks from 2005 to 2009 (published by General Statistics Office of Vietnam) via www.gso.gov.vn; Do Tien Sam and Ha Thi Hong Van 2009, Vietnam–China trade, FDI and ODA relations (1998–2008) and the impacts upon Vietnam

total FDI annually), and investment value was further unsustainable. Due to the financial crisis of 2008–2009, FDI from China to Vietnam slowed down again and constituted only 0.58 % and 1.64 % of total FDI inflow in 2008 and 2009, respectively, causing China's rank to drop among Vietnam's foreign investors (see Tables 7 and 8).

In these years, an overwhelming part of China's FDI to Vietnam was invested in the manufacturing industry and construction sector, which covered more than 70 % of the total investment value and 70 % of the quantity of projects that were undertaken. The rest went to other sectors such as agriculture, forestry, and services. There was also a change in investment schemes in comparison to the 1990s. Chinese investors preferred to establish foreign-owned companies rather than joint-venture companies or business cooperation contracts for project management. In

Table 8 Percentage of China's FDI in total FDI inflow to Vietnam and ranks of China among countries of origin in 2005–2009

Year	Percentage of China's FDI to Vietnam (%)	Rank of China
2005	1.76	13
2006	3.34	9
2007	2.68	7
2008	0.58	16
2009	1.64	10

Source: Author (calculated from data published in the Statistical Yearbooks from 2005 to 2009—General Statistics Office of Vietnam)

other words, Chinese investors desired to possess ultimate control over their investments.

Furthermore, a subsequent form of investment from China to Vietnam was carried out through ODA projects. ODA was provided in various forms including nonpayment assistance, noninterest loans, and preferential loans. Two ODA projects were initiated in 1997 and 1998, but the majority of China's ODA destined for Vietnam came in the 2000s and was investment mainly in the energy, transportation, mining, construction, and chemical sectors. Nonpayment assistance and noninterest loans were provided to projects with "historical and political meanings" such as the extension of the Thai Nguyen Iron and Steel Corporation, upgrading the Bac Giang Fertilizer and Chemical Factory, and construction of the Vietnam–China Friendship Palace, with training programs for Vietnamese officials. Other projects were further fuelled via loans of considerable value; for instance, investment in thermoelectric factories in various provinces was calculated to several billion US$ (US$710 million in Cao Ngan, US$280 million in Cam Pha, US$173 million in Bac Giang). China also provided loans of US$340 million to the Hanoi-Ha Dong railway project and another loan of US$40.5 million to Vietnam's largest metal project at that time in the Sinh Quyen copper mine.

Investment from China (including FDI and ODA) was a necessary resource for Vietnam's development. At the same time, there were various consequences emerging from the implementation of projects that were fuelled by Chinese investment. *First*, Chinese investment to Vietnam was aimed at the realization of China's strategy to exploit energy and natural resources of other countries for China's industries. Therefore, China's FDI and ODA were concentrated on the fields of energy and were fixated on the extraction of natural resources. These projects require considerably low levels of technology exchange but nonetheless bring about negative ramifications on the environment and have a detrimental impact on the health of local communities. Alongside the trade structure (as mentioned above), this trend of Chinese investment could turn Vietnam into a source of raw materials and energy rather than an economic and technological partner as per expected.

Second, regulations imposed on China's ODA meant that all the ODA projects should be implemented by Chinese contractors. In reality, Chinese contractors often

took advantage in terms of bidding but carried out projects at a significantly low quality and with prolonged duration.

Third, a vast quantity of Chinese employees working in mining and construction projects indicated that Chinese investment could not foster job creation for Vietnamese labor but also led to the concern of multiple observers over security issues in local provinces, particularly in the strategically important areas like the Tay Nguyen highland.

The dynamics of the Vietnam–China economic relations in 2000–2009 indicated that the bilateral political relations between the two countries were progressively improving, which was especially due to the resolution of the territorial issues on the land borders and in the Gulf of Tonkin. This gave momentum for advancing economic cooperation between the two sides. Coordination and cooperation between the two governments in many initiatives, as well as increasing exchanges among Vietnamese and Chinese business communities, helped expand collaborations and promote mutual interests. Nevertheless, analysis of the patterns of the Vietnam–China economic relations proved that the benefits derived from these relations were necessary for Vietnam in the short term but brought about multiple negative ramifications in the long term.

2.3 Since 2010

During the last 5 years, Sino–Vietnamese economic relations were driven by a number of new factors. Since 2010, notwithstanding the impacts of the financial crisis in 2008–2009, China's GDP has continued to grow at more than 7 % per year and reached the first rank in terms of GDP based on the PPP rankings in 2014. Parallel to the immense economic growth, China's defense budget has also been increasing rapidly. A sharp rise in economic and military power led to changes in China's patterns of behaviors and policies which were implemented first in its periphery on land and at sea. Beijing took a range of measures to expand its political and economic influence, as well as increase their yield of soft power, in Central Asia and Southeast Asia. China took steps to change the status quo in the disputed areas in the South China Sea, which was a stark contrast to the DOC agreement among China and the ASEAN members in 2002. While the intention of China was to expand its control over the East China Sea by a self-declared ADIZ and to engage more actively in the dealings of other seas, China's motives raised concerns not only from the claimants but also from other major powers. Opportunities and challenges caused by China's rise, together with the attractive growth dynamics of the Asia Pacific, led to a shift of power gravity to this region. The rebalancing strategy launched by the USA in 2011 was followed by an adjustment in the policy of other big regional players such as India, Japan, Australia, and South Korea who, having gone through their own versions of rebalancing, reshaped the policies in a more restorative and progressive manner.

Meanwhile, a string of incidents in the South China Sea caused by China's aggressive and illegal moves raised an alarm over maritime security issues in East Asia, which related directly to the notion of sovereignty of the neighboring countries and the stability of global seaborne trade. Having both land and sea borders with China, Vietnam is among the countries who are destined to absorb the greatest impacts from these alterations. Since the 11th Party Congress in early 2011, Vietnam began to implement the "comprehensive integration" policy aimed at the mobilization of internal and external resources for fulfilling development strategies and for the transformation of the growth model. While Vietnam's integration within the realms of the regional and global economy has intensified through many new economic commitments, the stability of the security environment is an imperative facet for Vietnam. In this context, Vietnam needs stable and constructive relationships with neighboring countries, above all with China as the biggest neighbor, in order to stimulate greater economic activity. However, it seems to be difficult for Vietnam to achieve this because of the increasing assertiveness in China's policy in South China Sea. After the XVIII Congress of the PRC's Communist Party in 2012, the key concepts announced by the new generation of Chinese leadership which was known as the "Chinese Dream" and the "Sea Power Strategy" provided the platform for China's accelerating exploration of marine resources and land reclamation in the South China Sea. The oil drilling rig Haiyang Shiyou 981 (HD-981) placed in Vietnam's EEZ from May to July of 2014 was an obvious violation of Vietnam's sovereignty, bilateral and regional agreements, as well as international laws. Meanwhile, reclamation carried out by China in the Spratly Island could possibly serve as the gateway for the so-called 9-dash line which can give Beijing illegal control over almost 80 % of the South China Sea with all its resources and sea lanes that are imperative for communication. Protest in Vietnam in various industrial parks was a spontaneous reaction to China's provocative actions, while the long-term consequence of Beijing's aggressive policy will inevitably be the deterioration of bilateral political relations. The latter has had direct impacts on Vietnam–China economic relations in recent times.

Judging from the value of trade and investment, it seems that economic cooperation between Vietnam and China has not been greatly affected by the territorial disputes. According to the statistics in Table 9, the value of bilateral trade has been increasing with considerable year-on-year percentage changes. Even in 2014, despite the tensions over the HD-981 incident, bilateral trade has continued to rise at 17.16 % and has reached more than US$58 billion, a feat which has made China the biggest trading partner of Vietnam, for many consecutive years. For the first time, Vietnam has become the second largest trading partner of China in the ASEAN (after Malaysia). At first glance, Sino–Vietnamese trade seemed to be sustainable, but in real terms, it is evident that economic relations between the two neighbors have burgeoned under increased pressure. *First*, there is the pressure of unresolved economic issues accumulated from previous years. Trade deficits that have accumulated as a result of increased relations with China have continued to be a source of a great concern for the Vietnamese government, since the total value of Chinese exports to Vietnam has continuously increased (see Table 9).

Table 9 Trade value between Vietnam and China in 2010–2014 (in US$ billion)

Year	Trade value	Annual change of trade (%)	Export from Vietnam to China	Import from China to Vietnam	Percentage of import from China in total Vietnam's import (%)	Trade deficit for Vietnam
2010	27.947	34.3	7.743	20.204	23.8	12.461
2011	36.478	30.5	11.612	24.866	23.3	13.254
2012	41.173	12.87	12.388	28.785	25.3	16.397
2013	50.171	21.85	13.233	36.938	28	23.705
2014	58.78	17.16	14.91	43.87	29.6	28.96

Source: Statistical Yearbooks published by Vietnam Customs annually from 2010 to 2013. Statistic in 2014 was published on the website of Vietnam Customs via http://www.customs.gov.vn/Lists/EnglishStatistics/ViewDetails.aspx?ID=471&Category=News%20flash&Group=Trade%20news%20%26%20Analysis&language=en-US

Table 10 FDI from China to Vietnam in 2010–2014

Year	Value of FDI (US $ million)	Percentage of China's FDI in total FDI received by Vietnam (%)	Quantity of projects	Rank of China
2010	685	3.44	105	8
2011	757.7	4.86	85	5
2012	371.2	2.27	76	9
2013	2338.6	10.46	110	4
2014	432.7	2.33	110	9

Source: Statistical Yearbooks from 2010 to 2014 (published by General Statistics Office of Vietnam) via www.gso.gov.vn.

The main problem is that the composition of bilateral trade remains unchanged. In 2010–2015, China was the biggest supplier of key inputs and manufacturing resources, for Vietnam's manufacturing sector. China also stood regularly among the top three suppliers of petroleum products, iron, and steel for Vietnamese firms and corporations. Meanwhile, China continues to be one of the largest markets for Vietnamese rice, crude oil, wood and wooden products, rubber, footwears, and other raw materials. Unchanged trade structures forecast an increase, both in terms of Vietnam's trade deficit and the dependence of Vietnam's production services on Chinese inputs.

In terms of investment, there was a slight improvement in the FDI flow from China to Vietnam in 2010 and 2011. But the scale of the projects were still fairly diminutive, aside from the BOT project, regarding the funding of a thermal electric factory, Vinh Tan 1, which has registered capital at a value of US$2.018 billion. Statistics in Table 10 indicate that the FDI inflow from China to Vietnam was unsustainable. The project Vinh Tan 1 created a sharp rise in FDI from China, in

2013, but this exceptional case could not maintain a positive trend of Chinese investment in Vietnam. In terms of the BOT (build–operation–trade) projects, Chinese investors can maximize their profits by exercising their control over all the supply chains, while the Vietnamese consumers have to pay a higher price for the products that are supplied from Vietnam's natural resources. In recent years, there has been another trend in that Chinese investment has skyrocketed in projects involving industrial parks and garment factories. This is an adroit way to seize opportunities from the TPP in advance, i.e., to export Chinese products from Vietnam to a plethora of markets (especially the USA) at preferential tariffs as the TPP enters into full force. In this case, Vietnamese enterprises will encounter fiercer competition in their own markets, while a large proportion of benefits from the TPP will fall into the pockets of the Chinese investors (Doan Cong Khanh 2014).

Second, the pressure came from considerable asymmetry in terms of the economic capacity between Vietnam and China. The comparison in Table 11 indicates an increasing gap between Vietnam and China before and after the financial crisis of 2008–2009. Asymmetry between the two economies together with China's policy gradually turned Vietnam into a supplier of raw materials and energy for China's manufacturing service and a receiver of China's out-of-date technology. For that reason, Vietnam has been lagging behind in terms of development and modernization. Although Vietnam's Doi Moi policy commenced only 8 years after China's economic reforms, the gap has continued to increase nonetheless. In addition, bilateral trade constituted for only 1.2 % of China's trade, while it exceeded 19 % of Vietnam's foreign trade in 2013, which exemplifies the increasing dependence of Vietnam on China's market and its supplies. Vietnamese enterprises have been facing not only competition with Chinese producers but also a greater potential risk incurred by plausible instability in terms of their bilateral relations.

Table 11 Comparison of key economic indicators of Vietnam and China (in 2008 and 2013)

Indicator	Vietnam	China
Year 2008		
Population	85.1 million	1.324 billion
GDP	US$99.13 billion	US$4522 billion
GDP per capita	US$1164	US$3413
Foreign-exchange reserves	US$23.89 billion	US$1966 billion
Total trade	US$142 billion	US$2550 billion
Ratio bilateral trade/total trade (%)	14.66	0.82
Year 2013		
Population	89.7 million	1.357 billion
GDP	US$176 billion	US$9400 billion
GDP per capita	US$1910	US$6807
Foreign-exchange reserves	US$35 billion	US$3800 billion
Total trade	US$260 billion	US$4160 billion
Ratio bilateral trade/total trade (%)	19.3	1.2

Source: Database of World Bank via data.worldbank.org

Another pressure is related to territorial disputes in the South China Sea. As mentioned above, tensions in the South China Sea which were escalated by the provocative and illegal actions of China led to instability in terms of their day-to-day economic activities in some Vietnamese provinces. In more than 2 months, the giant oil rig HD-981 was placed in Vietnam's EEZ, together with a plethora of military aircrafts and vessels ramming Vietnam's fishing boats and coastguard ships. Tensions over oil rig incidents led to several negative moves from both sides, for example, China tightened control over cross-border imports of rice from Vietnam, while a cluster of Vietnamese consumers boycotted Chinese goods or canceled their tours to China. The most regrettable consequence was the riots that broke out in industrial parks in the Binh Duong and Ha Tinh provinces as a result of this misunderstanding. In order to restore the trust of foreign investors, the Vietnamese government had to pay compensation to the owners of the inflicted companies and assured them that similar situations would not happen again. In the long term, the assertive policy of China in the South China Sea alongside the plausible ramifications of this policy can bring about a multitude of negative impacts on the business environment of Vietnam.

China's policy in terms of its economic relations with Vietnam, and especially in the South China Sea disputes, raised concern among the Vietnamese citizens about the need for mitigation of dependence and the risks related to difficulties in bilateral relations. Although political dialogue between the two sides has often been restored and stabilized after incidents, there have been heated debates on how one can diversify the supply for Vietnam's manufacturing sector and also on the manner in which one can improve its capacity in preventing and managing risks, in various cases such as that of the HD-981.

Overall, Sino–Vietnamese economic cooperation in 2010–2014 made great contributions to economic growth and the development of the manufacturing sector of Vietnam. However, there have been quantitative growths, on most parts, in terms of the bilateral economic relations, while there has been a lack of qualitative development. Without an adjustment in the trade and investment structure with China, it will be greatly arduous for Vietnam to advance into the higher echelons of the product market and to foster sustainable development as a new growth model. In the meanwhile, the territorial disputes in the South China Sea will continue to be a much considered factor when they undergo the policy-making process and when the Vietnamese enterprises go about planning their future ventures.

3 China's Economic Policy in Southeast Asia: Implications for ASEAN and Vietnam

Due to the geographical proximity and long history of exchanges between China and Southeast Asia, China–ASEAN official relations have been established and have gradually institutionalized post the Cold War era. After the first attendance of

China's representatives at the 24th ASEAN Ministerial Meeting in 1991, China was awarded the full Dialogue Partner status 5 years later. However, China–ASEAN relations have developed in a rapid manner in comparison to subsequent external partnerships of the Association. China was the first external partner who elevated the relations with ASEAN to that of a Strategic Partnership for peace and prosperity in October 2003. In the 2000s, China began to accelerate its grand strategy aimed at obtaining global leadership, involving itself more proactively in many regions, including Central Asia, Africa, and Latin America. At the same time, Southeast Asia remains a gateway for China for its maritime routes and oceans. Utilization and control over world oceans became one of the key components in China's Grand Strategy and the "Sea Power Strategy" which had been advocated by China's top leaders since 2012. The role of Southeast Asia could be seen in the implementation of China's neighborly diplomacy and in the initiation of the "Maritime Silk Route of the twenty-first century" which embraced a vision of connection among the Pacific and Indian Oceans and other seas in the world.

Over the next 5–10 years, China's policy toward ASEAN will serve as a prominent factor when determining the future prospects of the ASEAN–China relations. From an economic perspective, China has implemented different policies toward alternate ASEAN countries belonging to each group: the ASEAN-6 (who are countries that are in the higher echelons in terms of their economic development) and the CLMV (nations with lower level). In each group, the claimants in the South China Sea disputes like Vietnam and the Philippines have been faced with separate economic policies from Beijing. Therefore, in the CLMV group, Vietnam presents a special case, in that they have been encountering various obstacles in economic cooperation with China while sharing traditional values and philosophies. When compared to other CLMV countries, Vietnam has had the most considerable bilateral trade values with China, but the smallest investment flow that is constantly decreasing in recent years. For example, in 2013, the cumulative investment values from China to Cambodia, Laos, and Myanmar were estimated to be a hefty US$9.6 billion, US$5.085 billion, and more than US$20 billion, respectively. In terms of the percentages, Cambodia received 9.8 % of China's FDI to the ASEAN, 9.2 % was issued to Laos, Myanmar received 8.8 %, while the proportion given to Vietnam constituted for only 6.2 %. Given Vietnam's advantage in the market scale and the fact that they possess greater potential than Cambodia, Laos, and Myanmar, such policies of China indicated a lack of interest in supporting Vietnam's development. Becoming the biggest investor in CLM, China also has had various opportunities to expand its economic and political influence over the host countries. Moreover, China's investment in the construction of multiple dams on the upstream of the Mekong River without considering the negative impacts on the ecosystem and the quality of life of local communities on the downstream exerted additional pressures on the Vietnamese economy. In the long term, dam construction together with climate change can severely damage the biggest rice farming area in the nation, and other economic activities in Southern Vietnam are at risk of depletion.

The trade and investment structures of China in the CLMV countries are different from those within the ASEAN-6. Raw materials, natural resources, and daily consumed goods constitute a major part of China's trade with CLMV, while the ASEAN-6 nations have a more optimized goods composition with China, including oil products, electronic products, automobiles and spare parts, etc. In the CLMV countries, China has heavily invested in mining, thermal and hydropower, and infrastructure construction, while the main sectors for Chinese investment in the ASEAN-6 are real estate, the automobile industry, agricultural processing, and garment making. As a result, the CLMV countries are left to dwell on the lower echelons of the supply chain that reap less profit. Whether it is intentional or not, these differences have increased the disadvantages of the CLMV and have further widened the development gap between the two groups. This gap has also been an obstacle to the ASEAN, as it has inevitably impeded its rise to a fully established and efficient Economic Community.

Another facet of the Chinese economic policy that has materialized post-2012 was a vast array of initiatives that were launched by the Chinese government. Alongside the RCEP, which was considered to be a direct counterbalance to the USA's TPP, China took steps to acknowledge the presence of various economic corridors in Southeast Asia that had been proposed to upgrade the ASEAN–China Free Trade Agreement (ACFTA) and proactively put forward the "Maritime Silk Route in twenty-first century" coupled with the Asian Investment and Infrastructure Bank (AIIB). These initiatives were married into the "2 + 7 cooperation framework" for the future development of the Sino–ASEAN relationship which was announced by the Chinese Premier Li Keqiang in October 2013. This framework included two political consensuses and seven key cooperation proposals. Two political consensuses referred to deepening strategic trust and expanding good-neighborly relationship and focusing on economic development and enlarging mutual benefits. The seven cooperation proposals consisted of (1) conclusion of a treaty on good-neighborliness, (2) upgrading the ACFTA, (3) participation in AIIB, (4) agreement on currency exchange, (5) establishment of ASEAN–China maritime cooperation partnership, (6) upgrading ASEAN–China Defense Ministerial Meeting, and (7) enhancing cultural exchanges. The huge potential and the benefits which are to be derived from these initiatives can hardly be denied. Improvement of existing mechanisms and launching progressive ideas are imperative for adapting and synthesizing with the trend of establishing a new generation of FTAs.

However, in a wider sense, the "2 + 7 cooperation framework" is an instrument of the Chinese government to realize and attain its economic and political goals. In terms of economy, these initiatives will aid China in resolving the overcapacity of domestic industries and will stimulate the creation of more preferential provisions to bolster the caliber of Chinese products in the ASEAN market and utilize China's financial resources. In terms of politics and strategy, this framework highlighted China's principles and measures of building relations with ASEAN in the "diamond decade." Through these mechanisms, China desired to achieve the status of a global currency for the renminbi and its own global financial institution, the AIIB, in competition with other "giants" like the World Bank, IMF, or ADB. Offering

attractive economic incentives for its Southeast Asian neighbors, China wanted to divert their attention from its accelerated land reclamation and other moves to alter their status quo in the South China Sea. After all, Beijing has been making continuous efforts to obtain ASEAN's recognition for China's role in the region and to legalize China's steps to domination. Aimed at attaining economic goals in the short term and strategic ones in the long run, the "2 + 7 cooperation framework" was promoted to be parallel to many other initiatives of China, in various regions to generate and implement China's set of rules and to challenge the existing world order.

Among China's initiatives, the Regional Comprehensive Economic Partnership (RCEP) is the most visible one which is expected to be concluded by November 2015. RCEP (or ASEAN + 6 FTA) has been considered as being an amalgamation of six bilateral FTAs among the ASEAN and her external partners. Meanwhile, many observers perceive the RCEP as being the direct counterbalance to the US-led Trans-Pacific Partnership (TPP). From Vietnam's perspectives, their participation in a number of FTAs is a measure to implement the policy of "comprehensive integration" that has been around since 2011. FTAs are the route that enables Vietnamese enterprises to receive greater opportunities to increase their export value in markets of the ASEAN members. Vietnam's approach to the RCEP is to put it into a nexus of regional and interregional commitments, including the ASEAN Economic Community (AEC). The TPP, alongside the ACFTA and many other protocols, is the gateway for Vietnamese companies to optimize their businesses. Both the TPP and the RCEP have their own strengths and setbacks. The TPP is known as a high-standard FTA in the twenty-first century which can deal with behind-the-border barriers, but it could only attract four out of the ten ASEAN members (Malaysia, Singapore, Brunei, and Vietnam). The RCEP, however, cannot be compared with the TPP in terms of its standard, rules, and its level of liberalization, but it has managed to include all of the ASEAN countries, which gives the impression that it possesses the interests of all its members and that the ASEAN is the nucleus of the project. In fact, the role of China is overwhelming in this model of trade liberalization. There is another argument for RCEP that the level of commitment is suitable for ASEAN economies and that it is easy to achieve, as it includes all three of the biggest national markets in Asia, i.e., China, India, and Indonesia. With all their strengths and weaknesses, the TPP as well as the RCEP can serve as the gateway out of the stagnation of the Doha Round and the difficulties that were encountered by the WTO system.

From the angle of the Sino–Vietnamese economic relations, many experts assessed the RCEP's impacts on Vietnamese companies as being both positive and negative. On the one hand, the RCEP focuses on East Asia, which includes the largest export and import markets of Vietnam. The RCEP is expected to create an easier route for Vietnamese companies to export, and the expansive market of the ASEAN and her partners will further enable Vietnamese firms to source cheaper materials of a higher quality for use in their manufacturing and service sectors. Vietnamese companies will be able to engage with greater ease in the regional value chain and have increased influence in the production network thanks to the

harmonization of existing rules. There are also chances to attract more FDI and to enhance technical cooperation among Vietnam and her partners. On the other hand, implementation of the RCEP may pose challenges to the economy in both regional and domestic markets. With a trading structure similar to those of neighboring countries, with products of a fairly modest quality and where the value-added content of most products is still meager, Vietnamese exporters will encounter more intense competition, especially with Chinese manufacturers. Besides, Vietnam already signed the bilateral FTAs with Japan and Korea giving Vietnamese goods preferential tariffs, but as soon as the RCEP enters into force, the advantage gained from these bilateral commitments will most likely be minimized (Assessing the Impacts of Regional Comprehensive Economic Partnership in Vietnam's Economy 2014).

It is evident that the real impacts will become clearer only after the members begin to implement the RCEP. In Vietnam's case, the impacts will depend on the level of FTA usage by Vietnamese companies. According to a research done by the Economist Intelligence Unit in 2014, utilization of FTAs by Vietnamese companies is still relatively low. Average FTA usage rate in Vietnam is about 37 % which is low considering that exports have grown to 80 % of GDP in 2012. Vietnam's usage rates for ASEAN FTA and FTA with China are higher, 65 % and 46 %, respectively, but are still irrelevant to trade values among Vietnam and its two key partners (FTAs in Southeast Asia: Towards the Next Generation 2014). The main reasons for not using FTAs are due to the complexity of the agreement terms, the fact that it gives no substantial new market access, it lacks the internal expertise, and because the benefits do not compensate for the difficulties. It is noteworthy that the statistics of Vietnam are still higher than those of Indonesia, Singapore, and Malaysia. Therefore, in addition to efficient reform policies, ASEAN countries will need to take measures to share information and experience for the benefit of the companies. It is important to help producers utilize the FTAs in a more profitable way, in order to improve their competitiveness and mitigate the risks or challenges related to these commitments. Otherwise, the FTAs will merely become instruments for exerting one's political influence over the less powerful nations, rather than fulfilling its purpose of being a beneficial protocol for all its members.

4 Recommendations for ASEAN–China Cooperation

Apart from China's policy, regional dynamism is also a crucial factor when determining the future directions of ASEAN–China relations. Official establishment of the ASEAN Community in December 2015 will most likely be a technical event rather than a turning point for the region. The level of intra-ASEAN connectivity is still to be improved, and many observers consider it as a community for the elite and middle class, rather than for people with low incomes. For that reason, the most important objective of the ASEAN Community is to be a "people-centered" scheme, a fundamental goal that they must achieve in order to appeal to the global audience. It will take time for the Southeast Asian nations, especially those who

belong to the CLMV group, to experience the real benefits that the community brings about.

Currently, although the ASEAN Community is going to be established shortly, Southeast Asia is still in a transforming period. Domestic political processes in ASEAN member states are evolving in different directions and will continue to shape the regional political landscape in the next 5–10 years. In recent years, new political forces in Myanmar and Cambodia have won their seats in national parliaments while there have been changes in political leadership in some other countries, for example, in Indonesia after the presidential election and in Thailand as a result of the military coup. The region is still waiting for the outcomes of Myanmar's election in 2015 and the 12th Party Congress in Vietnam in early 2016. On the one hand, the new political leaders need to concentrate more on domestic policy in order to consolidate power and maintain internal stability. On the other hand, there might be a gap in their vision regarding the ASEAN Community between the old generation of political leaders and the new ones who resumed power in recent years.

Today, while en route to a fully operated Community, the ASEAN will need to overcome various obstacles. *First*, awareness and synthesis among the nations are still irrelevant to the level of commitments among the ASEAN governments. *Second*, the CLMV countries are lagging behind in terms of infrastructure and their institutional and legal system and, thus, are not well-prepared to join the common market and synthesize with the free movement of goods, investment, and the labor force. *Third*, the ASEAN Community is ineligible to make any real progress, if the member states keep "talking regionally, but thinking nationally." ASEAN's failure in issuing a joint communiqué at the AMM 45 during Cambodia's chairmanship in 2012 indicates how the ASEAN will be divided when a member state puts national interests above that of the ASEAN's and even lets itself be driven by the motives of an external force. From another angle, the lesson that one can learn from AMM 45 is crucial for the development of the ASEAN in managing its relations with external partners, including China. *Fourth*, a power shift to the Asia Pacific in recent years has made ASEAN more attractive and more complex than ever before. Having received multiple proposals and offers from external partners, the ASEAN can barely give rational and timely responses, given its lack of resources and consensus. In terms of its relations with China, the ASEAN is facing a dilemma between attractive opportunities of cooperation and real threats from China's assertiveness and unilateralism in the South China Sea.

In this context, the ASEAN will likely be divided because of a failure in defining a joint position of member states toward China's initiatives. The ASEAN will also face a widened gap between the CLMV and the ASEAN-6 and a common market overflowing with Chinese products. China's initiatives are aimed at expanding their economic and political leverage and fostering their centrality in the Asia Pacific. Therefore, the ASEAN's participation in these initiatives without adequate policies can undermine the two most important visions of the ASEAN: unity and centrality in terms of regional architecture.

In order to foster efficient ASEAN–China cooperation, the parties need to take a balanced and comprehensive approach to their relations. Such an approach helps

them work out both the short-term and long-term visions for cooperation and consider economic growth and sustainable development, as well as being able to harmonize their economic and security interests. The following are several recommendations to be taken into consideration by policy-makers:

- Both the ASEAN and China need to adopt a common long-term vision on the ASEAN–China relations and to define the priorities and the principles of cooperation. It is important to achieve a common awareness for both sides that long-term stability and mutual benefits are key principles in building the ASEAN–-China relations. China can benefit from a peaceful, stable, and prosperous Southeast Asia and vice versa.
- Today, the principal way in which to overcome difficulties in the ASEAN–China relations is to improve mutual trust. The latter can be provided with a consistency in terms of the words and actions of the parties. China's initiatives can bring about peace and prosperity for East Asia if they are carried out without the concomitant of actions breaching sovereignty and stability of the Southeast Asian countries. Without improving the levels of confidence building, crisis management mechanisms joint projects will fail to be fulfilled adequately.
- ASEAN countries need to adopt a rational approach to China's initiatives which can be described as "cautious pragmatism." They can involve themselves proactively in the process of working out content for each initiative while bearing in mind potential threats. Otherwise, Southeast Asia might become an outsider and miss chances to integrate with other regions and their partners. At the same time, the ASEAN member states should carry out prior consultation and reach a common consensus on the principles of cooperation with China in order to avoid contradiction in their position.
- For China, it is necessary to understand that unilateralism is contrary to the concepts of integration and regionalism; thus, it is not suitable for multilateral megaprojects alike to the Maritime Silk Route or the AIIB. Components of each initiative as well as the mechanism of implementation should be worked out collectively, taking into account the interests of all parties. Negotiations among parties need to be conducted equally, thoroughly, step by step, and responsibly.
- An indispensable criterion for ASEAN–China cooperation in the context of the ASEAN Community is the compliance with international law. Only a rule-based approach can provide fulfillment of agreements reached among the parties and nurture sustainable relations. Role of regulations and international law needs to be emphasized upon when economic cooperation becomes more open and liberalized.
- Today, both the RCEP and the upgraded ACFTA are yet to be concluded. These commitments will be able to bring about real benefits if they help optimize the regional production network and enhance the supply chains. As mentioned afore, the possible consequences of the FTAs, in particular the increasing trade deficit in China's favor and the widening development gap between the ASEAN-6 and the CLMV group, need to be addressed in close proximity.

5 Conclusion

Given the complex security issues between Vietnam and China, their bilateral economic relations present a specific case of cooperation between China and the Southeast Asian countries. At the same time, this case helps reveal the challenges encountered by China and ASEAN in fostering mutual benefit cooperation (Chinese officials often call it the "win–win cooperation"). The biggest issues that require addressing include the matter of the trade deficit, the consequences of the FTAs, and the geopolitical impacts of China's initiatives on the ASEAN Community building process. The case of the Vietnam–China economic relations indicated that enhancing technology, increasing the value-added content of products, and diversifying sources of inputs for industries would be key elements of domestic reform for the CLMV countries. Domestic reforms are crucial for gaining a better place in the regional production network and supply chain by means of upcoming FTAs. From the ASEAN perspective, considering that China is decisively elevating its prestige in both economic and political terms, there are two things that the member states need to achieve: (1) a candid and efficient ASEAN Community and (2) ASEAN's independence in launching its own new initiatives and in making decisions.

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Tai-shang (Taiwan Business) in Southeast Asia: Profile and Issues

Alan Hao Yang and Hsin-Huang Michael Hsiao

1 Introduction

The rise of global capitalism has altered the geopolitical and geo-economic landscapes of nation-states by reshaping the role of transnational actors and enhancing their functions. Much has been discussed on the emerging international connectedness endorsed by the transnational actors and their networks. For example, the making of *transnational network of advocacy* highlights the global concerns of human rights, social equality, and environmental sustainability endorsed by global civil societies and international nongovernmental groups (Rodrigues and Moog 2004; Avant et al. 2010). The *transnational network of mobility* nourished by immigrants enriches the people-centered connectedness between their mother countries and host societies (Geiger and Pécoud 2013; Biao et al. 2013). Nevertheless, this chapter is more interested in a third type of network, *the transnational network of profit*, shaped by private sectors. It is a transnational economic cluster intensifying the distribution of labor in global production network, fulfilling the needs of global commodity supply chain, and accumulating the transnational capitals of private sectors in terms of political and economic influence.

By discussing the *transnational network of profit* with a specific focus on the role of the overseas Taiwan business in Southeast Asia, it argues that the global rise of overseas Taiwan business, also known by the name *Tai-shang*, has at least three contributions in the invested countries, that is, the industrial internationalization, capital trans-nationalization, and the facilitation of business and investment

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networks at localities. In effect, *Tai-shang*'s rising in Southeast Asia is specifically embedded in the intertwined effect from the abovementioned contributions. They cast both economic and political influences in Southeast Asian countries.

First, in respect of industrial internationalization, any domestic industrial sector can no longer maintain autarkic when facing the acceleration of globalization and of regional integration. Consequently, it is "embedded in" the supply chain of global production network. For specific labor-intensive industries such as manufacturing and textiles products, the practice of "internationalization" is a way to maintain competitiveness among others. It is aimed at reducing the cost of production through seeking low cost of raw materials and overseas production bases featured with abundant resources or low-salary employment (McBeath 1999: 106). In this regard, overseas businessmen hence serve as media to push domestic industries outside their home countries.

Second, as for capital trans-nationalization, overseas business communities facilitate the development of bilateral/multilateral trade and investment, bringing external resources to domestic industries. This process implies two flows: to the investing countries, the exploration of overseas business network diversifies the international market while reducing the costs of raw materials and labors for their domestic headquarters; to the invested countries, foreign investors may inject international capitals, encourages new technological incorporation, creat employment opporunities and human capitals—those imported fiscal and human capitals as well as technological spillovers, moreover, contribute to local economic growth (Kotrajaras et al. 2011: 184).

Third, with the investment from overseas businessmen, it is plausible to help connect transnational business network bilaterally and regionally. By creating new production supply chain, ethnic business unions, and even the political-business ties, these transnational economic actors do not only operate lucrative activities but also act as interest groups to generate socioeconomic capacity to influence the government of host countries. Take China for example. Over the past years, China's outbound investment has hit the record high, ranking as the third leading investor throughout the world (Pitlo 2015). Its state-owned enterprises (SOEs) *per se* as major contributors to critical infrastructures and public construction projects are not only seeking for economic benefits but working as the government outreach indirectly engaging in promoting bilateral political relations. Even those local SOEs with abundant resources enjoy more flexibility in pursuing international venturing with local companies and firms (Li et al. 2014: 996). Unlike these SOEs, small and medium enterprises (SMEs), though not directly supported by the government from mother countries, mostly have profound influence over the general public of the host countries.

For decades, the economic development in Southeast Asia has been shaped by enterprises from its Northeast Asian counterparts (Machado 2003; Harwit 2013). Up to the present, China's business seems to exercise preponderant influence in Southeast Asia (Suryadinata 2006, 2007; Lee 2014). China dispatches its SOEs to Southeast Asia, allowing these economic outreaches to execute its "Going Out Strategy" in deepening business networks at localities. For years, these Chinese enterprises have intensively collaborated with Southeast Asian governments by investing in critical

infrastructure such as railroads, highways, dams, and hydropower plants. In additions, these government-supported business groups actively interact with local overseas Chinese for the purpose of amplifying the profits.

Prior to the rise of Chinese SOEs in the region, the overseas Taiwan business (*Tai-shang*) appeared in Southeast Asia during the 1970s and 1980s, as the Taiwanese economy grew with fast speed, spilling its economic influence over neighborhood countries. People often attribute overseas Taiwan business in the same category of those from China; nevertheless, we argue that the two groups have a distinct culture, identity, acumen, and strategy.

Tai-shang earned full international attention during the anti-China demonstration in Vietnam on May 13, 2014 (known as the 513 incident). Under the authoritarian regime, organizing large-scale riot against foreign enterprises is rare in Vietnam. During the 513 incident, *Tai-shang* became a target of Vietnamese mobs; according to some international news reports, the Vietnamese demonstrators confused the Taiwanese enterprises with the Chinese ones, as both of their brands are marked in Chinese (Yu 2014). However, this explanation is not pertinent for the Vietnamese society has been acquainted with *Tai-shang* for decades. We argue that *Tai-shang* were served as scapegoats during the 513 anti-China riot due to the evasion of the Vietnamese government to directly challenge Beijing. Consequently, this incident again gave rise to the international concern on the contribution of *Tai-shang* in the region as well as its distinction from China.

Accordingly, this chapter sheds light on the presence of *Tai-shang* in Southeast Asia via four parts. The first part distinguishes China business and Taiwan business. The second part deals with incentives of Taiwanese investment in Southeast Asia. Then, this chapter will discuss the role of *Tai-shang* in regional integration of Southeast Asia. It proceeds to the survey of national profiles of Taiwan business in the region. Finally, the conclusion sums up the discussions by evaluating the contributions of and challenges facing Taiwan business in the region.

2 Comparing China and Taiwan Business in Southeast Asia

Historically, the ethnic Chinese businessmen have long been regarded as the leading player in shaping Asia's internal economic networks and trade links (Ptak 1999, 2004; Souza 2014). Even today, overseas Chinese are still dominant in economic and development agenda in most Southeast Asian countries based upon the individual family-based enterprises and related Chinese business networks (Folk and Jomo 2003: 3). The People's Republic of China's rising further consolidates this phenomenon as there are more and more businesses dispatching from China to Southeast Asia. Increasing amount of Sino–Southeast Asian trade from USD20 billion of 1995 to USD480.39 billion of 2013 justifies the upgrading relation from "the golden decade" (黃金十年) to "the diamond decade" (鑽石十年), a term invented by the Chinese Premier Li Keqiang in 2013 (ASEAN-China Center 2015).

Table 1 Chinese FDI in ASEAN countries: a comparison (USD millions)

	2003	2013
Brunei	0.1	72
Cambodia	59	2849
Indonesia	54	4657
Malaysia	101	1668
Myanmar	10	3570
Laos	9	2771
Singapore	165	14751
Thailand	151	2472
The Philippines	9	692
Vietnam	29	1267
Total	587.1	34769

Source: Salidjanova et al. (2015: 7)

Such an acceleration can be regarded as the fast-growing influence of the Chinese government and its business in the region.

In 2014, China's foreign exchange reserve has reached USD4.06 trillion, which puts China on the top of the world ranking. Meanwhile, China's business continues to seek collaborations worldwide by promoting its state capitalism overseas. One may find the domestic configuration of state capitalism, known as a solid alliance between the Chinese government and its SOEs, operating in line with rent-seeking modalities. The foreign investment pattern of China is also duplicating this "China Model" (中國模式) to consolidate the alliance between the Chinese government and its overseas business groups shown as the complex of wealth and power (Callahan 2013: 66–97). Moreover, China's businesses, most of which are SOEs, are the overseas outreaches of Beijing's "Going Out Strategy" by dedicating themselves in investing in its neighbors and beyond (Shambaugh 2013: 174–175). In 2003, the amount of Chinese FDI in ASEAN countries is USD587.1 million, while in 2013, the amount had exceeded to USD34 billion (Table 1).

Beijing has been actively engaging in global merger and acquisition (M&A) for years, targeting at grasping natural resources and technology-intensive industries (Pitlo 2015). For instance, China business exerts political and economic influences in Southeast Asian countries by purchasing or merging companies, allying with local governments, or by monopolizing scarce resources such as potassium salt mine in Thailand and copper in Myanmar. In other words, China's businessmen do not only pursue economic profits but also undertake strategic mission on behalf of their government. They become policy instruments to either strengthen national competitiveness or secure significant resources overseas (Li et al. 2014: 989).

Different to overseas China business, the overseas Taiwan business (*Tai-shang*) manifests very different dynamics. *Tai-shang* went abroad for investment in the early 1970s and 1980s, most of which were original equipment manufacturer (OEM). Being the ruling regime of Taiwan, Kuomintang (KMT) inherited monopolistic industries from Japanese colonialism. Those colonial legacies, including finance, energy, communication, and transportation sectors, were mostly transfused to KMT-led SOEs. *Tai-shang* were pressed by the expensive costs of production

following the government's lift of control over foreign exchange and the country's fast-growing economy. They were also pushed by the rising domestic wage rate due to a significant appreciation of the New Taiwan Dollar (NTD) (McBeath 1999: 107). Those first to move outside the country were "declining industries" (夕陽產業) since they encountered the most challenges brought about by domestic social economic structure centralized by KMT.

Consequently, cheap costs of production and low wage in Southeast Asia caught the attention of *Tai-shang*. Once settled, Taiwan business invested and manufactured products made of textile, timber, metal, and electrics before exporting the products to the West and other countries. In the 1970s and 1980s, these SMEs did not benefit financial support from the Taiwanese government, nor did they have well-structured institution and fiscal capacity as large corporations. However, it was common to see some Taiwan business setting up branches illegally in Southeast Asia without the Taiwanese government's permission (Interview 2015a). By all means, these Taiwanese SMEs were so mobile and independent that they succeeded to adapt themselves in Southeast Asia and generally entertain good ties with the local governments (Interview 2012).

The "Go South Policy" (南向政策) was implemented by KMT regime under President Lee Teng-hui in 1994. It was a policy aiming to counterbalance Taiwan over investment in China. Since its "reform and opening" (改革開放) policy of 1978, China has been pushing for economic growth, making its market attractive to foreign investment. Initially, *Tai-shang* followed this trend and has enjoyed the advantages of culture and language affinity comparing to other foreign investors. However, the political tension between Taiwan and China also perpetuated. President Lee Teng-hui hence exhorted *Tai-shang* to shift their attentions and interest to Southeast Asia in order to neutralize the "magnet effect" (磁吸效應) of the Chinese economy to avoid over economic dependence of Taiwan.

It is also true that this "Go South Policy" was embedded with political implication—boosting Taiwan–Southeast Asian relations in order to break through Taiwan's diplomatic deadlock. Therefore, the Policy was regarded as the government push for KMT-led SOEs and private business to seek investment projects in Southeast Asia, for example, Taiwan Salt Corporation, known as Taiyen, was pushed by the Ministry of Economic Affairs to collaborate with Indonesian counterparts and CPC Corporation to explore oil and gas projects in Indonesia, while Taiwan Sugar Corporation was persuaded to facilitate bilateral cooperation on sugar production in Vietnam (Hsiao and Kung 2002: 18). These governmental facilitations are rather strategic and political oriented, resulting in thousands of Taiwan business, most of which are SMEs, to invest in Southeast Asia.

3 Why Investing Southeast Asia?

From the perspective of geopolitics and geo-economics, the rise of *Tai-shang* in Southeast Asia reflects its strategic preferences. First, in terms of geography, Taiwan is relatively close to Southeast Asia, or we should say, located in Southeast

Asia. This geographical advantage facilitates the mobility of people between two sides. It takes less than 5 hours for *Tai-shang* to fly to any capital cities in Southeast Asian countries from Taipei and then access to specific economic zone nearby. Moreover, it takes only a few hours for *Tai-shang* in Southeast Asia to connect to neighboring countries, including China.

In terms of culture, Southeast Asian countries such as Thailand, Vietnam, and Singapore have long been influenced by Confucianism. This cultural affinity may reduce the gap between Taiwan business and Southeast Asian counterparts. It is easy for *Tai-shang* in Southeast Asia to adapt to local societies than those in Latin America and the United States. Even to Muslim countries such as Indonesia and Malaysia, local societies are familiar with Chinese culture thanks to the presence of early ethnic Chinese immigrants and overseas Chinese businessmen, as "intermediaries" (McBeath 1999: 123), providing a rather friendly environment for *Tai-shang*.

In effect, the key reason for private entrepreneurs of choosing Southeast Asia as destination of investment is still economic. Taiwan business was attracted by rich resources and abundant young labors with low salaries in Indonesia, Malaysia, and Thailand. Since most of SMEs in Taiwan were labor-intensive and export-oriented industries, Southeast Asia was of specific incentive for *Tai-shang*.

Finally, all Southeast Asian countries have experienced state-building processes. While striving for independence and national development, most of the new regimes were in need of foreign investments and economic inputs from major economies for the purpose of boosting economic growth and legitimizing their ruling. As a result, central and local elites in Southeast Asian countries mostly supported *Tai-shang*'s presence in their national economic agenda (Interview 2012; 2015a). This enabled Taiwan to surpass NIEs, such as Hong Kong, South Korea, Singapore, when it comes to foreign investment in Southeast Asia.

All of the above reasons had stimulated many Taiwan businesses, the SMEs, to strategically move to Southeast Asia as early as the 1970s. To cope with regional and national dynamics in Southeast Asia, there was a second wave of investment in Southeast Asia. The SOEs and KMT-led corporation adopted new strategies that have paid more attention to local and regional markets, instead of emphasizing purely on export. Indeed, the integration progress of Association of Southeast Asian Nations (ASEAN) was equivalent to a market of 560 million people, providing more incentives for *Tai-shang*.

4 The Rise of *Tai-shang* in ASEAN Economic Integration

The rise of *Tai-shang* corresponds to the process of economic integration in contemporary Southeast Asia. As ASEAN was established in 1967, this intergovernmental organization was aimed at promoting multilateral collaboration in economic development and sociocultural exchanges. Nonetheless, the lack of mutual trust hindered its member states from implementing joint economic undertakings (Ba 2009). Until the 1970s, as ASEAN members agreed upon ASEAN Industrial Project (1976) and ASEAN Preferential Trading Arrangement (1977), a gradual

progress of economic integration had begun to commence. The presence of *Tai-shang* in ASEAN industries was mostly investing in food manufacturing and textile mills with specific focus on raw materials at localities.

In 1981, the ASEAN Industrial Complementation Scheme was declared. The industrial development became the key to economic growth to the region. The 1980s had also marked an era of domestic economic reforms among major Southeast Asian countries. Policy reforms and industrial projects promoted by governments in Malaysia, Indonesia, Singapore, Thailand, and Vietnam were targeting at attracting more foreign direct investments (FDIs), further triggering domestic and regional growth. Meanwhile, the rise of environmental awareness as well as the increase of wage in Taiwan became the domestic push for *Tai-shang* to seek overseas production bases in the region. Increasing number of Taiwanese SMEs moved to Southeast Asia, mostly in Indonesia, Malaysia, Thailand, and the Philippines.

It was the promotion of free trade agenda, such as Common Effective Preferential Tariffs (CEPT) and the making of ASEAN Free Trade Agreement (AFTA), which speeded up ASEAN economic integration in the 1990s. As clearly stated in ASEAN Vision 2020, ASEAN countries determined to (1) fully implement the AFTA and accelerate liberalization of trade in services, (2) realize the ASEAN Investment Area (AIA) and promote free investment flows, (3) intensify and expand subregional cooperation in existing and new subregional growth areas, (4) further consolidate and expand extra-ASEAN regional linkages for mutual benefit and cooperate to strengthen the multilateral trading system, and (5) reinforce the role of the business sector as the engine of growth (ASEAN 1997). The new roadmap of Southeast Asian integration revealed an urgent need for external supports in terms of economic and investment inputs.

Against the backdrop, the KMT government in Taiwan began to advocate "Go South Policy" in the beginning of the 1990s. The Policy encouraged *Tai-shang* to invest in Southeast Asia, the political purpose of which was to counterbalance the increasing investment flows toward China. The first term of "Go South Policy" was drafted as "the Guideline on Enhancing Economic and Trade Relations with Southeast Asia" (加強對東南亞地區經貿工作綱領) which commenced in March 1994 and ended in December 1996. Brunei Darussalam, Indonesia, Malaysia, Singapore, Thailand, the Philippines, and Vietnam were the geographic foci. An expanded version had been advocated later in 1997 as "the Guideline on Enhancing Economic and Trade Relations with Southeast Asia, Australia, and New Zealand" (加強對東南亞及紐澳地區經貿工作綱領) with the full coverage of all Southeast Asian countries. As Asian financial crisis hit the region, Taiwan immediately supported a sub-regional proposal initiated by the Asian Development Bank and regional countries such as Japan and Singapore to provide necessary short-term currency and exchange assistance to Southeast Asian countries (McBeath 1999: 124). In 1998, Taipei announced a follow-up policy of "Concrete Measures on Plan of Action of Enhancing Southeast Asian Economic and Trade Cooperation" (加強推動東南亞經貿行動方案具體措施), showing its political will to engage AFTA as well as the contenious governmental support to *Tai-shang* in Southeast Asia. During 1993–2000, Taiwan business investment in Southeast Asia has exceeded USD44.8 billion with the average annual growth rate of 53.5 % (Ministry of Economic Affairs 2001: 4).

When it came to 2003, the proposal of ASEAN Community envisaged by the Bali Concord II was adopted. A new vision of ASEAN Economic Community (AEC) aimed to transform Southeast Asia into a single market and integrated production base. The construction of AEC, for sure, is simultaneously embedded in the global free trade networks as well as in the regional dependency politics on China's rising. China–ASEAN Free Trade Area (CAFTA), Regional Comprehensive Economic Partnership (RCEP), and the gradual realization of the Master Plan of ASEAN Connectivity later in 2010 facilitate a further constructed and interconnected Southeast Asia.

However, it is also true that Taiwan has been excluded from these active promotion of regional and bilateral FTA by ASEAN and regional powers such as China, Japan, and Korea. These intricate FTA network and business links will seriously disadvantage and challenge Tai-Shang due to higher import tariffs and market barriers (Zhao 2011: 48). In this regard, Taipei turns to enhance its policy to seek for opportunities of signing economic cooperation agreement (ECA) with neighboring countries by activating joint feasibility studies with ASEAN counterparts such as Indonesia, Malaysia, Thailand, the Philippines, and Vietnam. "Agreement between Singapore and the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu on Economic Partnership (ASTEP)" signed in November 2013 is one of the achievement between Taiwan and Singapore. It is believed that by pushing bilateral ECA with Southeast Asian counterparts, *Tai-shang* would be expecting to accelerate its integration in line with AEC and regional FTA networks.

5 *Tai-shang* in Southeast Asia: National Profiles

During the past decades, Taiwan business pays much attention to Indonesia, Malaysia, Singapore, and Thailand, but less focus on those Indochinese countries such as Cambodia, Laos, and Myanmar due to their domestic political instability. The general investment pattern of *Tai-shang* is to establish production base at Southeast Asian countries, import machine components from Taiwan to the invested countries, and manufacture final products at localities, and then export to the United States, European countries as well as Taiwan (Yeh and Huang 2015: 313). As ASEAN is rising as a single market, local Taiwanese investment has been shifted from export orientation to fulfill the domestic market and intra-regional needs.

There is no official statistics on the number of Taiwan business in Southeast Asian countries due to some enterprises are registered as local companies but owned by Tai-shang. According to various sources of Taiwan's Ministry of Economic Affairs and our fieldworks and interviews with Taiwanese business groups in Vietnam (Interview 2015b), Malaysia (Interview 2015a), Laos (Interview 2013), Cambodia (Interview 2012), and Thailand (Interview 2015c), it is estimated that there are 5000 Taiwan companies in Thailand, 4000 in Vietnam, 2000 in Indonesia, and 1800 in Malaysia, while there are only 20 in Brunei (Table 2).

Table 2 *Tai-shang* in key ASEAN countries

	Numbers
Brunei	20
Cambodia	300
Indonesia	2000
Laos	100
Malaysia	1800
Singapore	200
Thailand	5000
The Philippines	300
Vietnam	4000
Myanmar	200

Source: various sources

Table 3 Taiwanese FDI in ASEAN countries (1952–2013) (USD billions)

	Amount	Percentage
Cambodia	10.2	1.2
Indonesia	153.6	18.9
Malaysia	116.1	14.2
Singapore	106.1	13
Thailand	134.5	16.5
The Philippines	20.9	2.5
Vietnam	272.5	33.5

Source: Ministry of Economic Affairs (R.O.C.) (2014: 3)

Regarding the investment volume, Table 3 shows from 1952 to 2013, Vietnam prioritized No. 1 in Taiwan's FDI in Southeast Asia with the amount of USD272.5 billion as 33.5 % of Taiwan's investment in Southeast Asia. Indonesia came the second with the amount of USD153.6 billion as 18.9 %. Then, Thailand was in the third place with USD134.5 billion as 16.5 % (Table 3).

The year of 2000 witnessed domestic regime change in Taiwan as KMT government was replaced by the Democratic Progressive Party (DPP). As President Chen Shui-bian came into power, strategic focus of "Go South Policy" had been directed to tackle with challenges of Taiwanese investment in Southeast Asia with special focus on ICT and textile mill industries. DPP government re-announced Indonesia, Malaysia, Singapore, the Philippines, and Vietnam as key countries for Taiwan's investment. Clearly, the new waves of "Go South Policy" was designed to counterbalance Taiwanese increasing investment in China. By pushing China Steel, Formosa Plastics Group, Uni-President and Pou Chen Group to Vietnam, Taiwanese government desired to constructively engage Southeast Asian markets and governments. While KMT reclaimed power in 2008, Southeast Asia was still of strategic interest to Taiwan, with more focus on promoting ECA with regional counterparts. Since 2000, *Tai-shang* significantly modified its investment strategies; Vietnam became the most favored investment destination of Taiwan business, followed by Singapore and Thailand. Also, there are increasing investment projects in Indochinese countries, especially Myanmar. The following discussion surveys national profiles of *Tai-shang* in Indonesia, Thailand, Malaysia, Vietnam, the

Philippines, Singapore, Cambodia, and Myanmar, based on trade and investment statistics of Taiwan's Ministry of Economic Affairs and the authors' interviews.

5.1 Indonesia

Interestingly, the year of 2000 can be regarded as a watershed in the development of Taiwan business in Southeast Asia. Before 2000, *Tai-shang* invested the most in Indonesia with 855 projects worth of USD12.77 billion (Table 4). This was because Indonesia was rich of natural and human resources. Accordingly, factories set up by *Tai-shang* were mostly labor-intensive and resource-oriented industries such as pulp and paper, textile, and mining. For example, Taiwan helped establish industrial park in Batam Island in 1990. In 1996, Taiwan's leading SOE, China Petroleum, also invested in energy exploration and development, In 1997 and 1998, Taiwanese outbound investment in Indonesia reached USD3.4 billions and USD2.2 billions respectively (McBeath 1999: 121–122). As the Indonesian government continues encouraging foreign investment in local infrastructure and labor-intensive industries, it is still popular to Taiwan business during 2001–2014. *Tai-shang* continuously contributes 770 projects (No. 2) as USD3.9 billion (No. 3) in Indonesia (Table 5).

Table 4 Taiwanese investment in key ASEAN countries (1948–2000) (USD millions)

	Project/rank	Amount/rank
Cambodia	168 (**7**)	427.52 (**7**)
Indonesia	855 (**3**)	12,774.15 (**1**)
Malaysia	1786 (**1**)	9225.66 (**3**)
Singapore	316 (**6**)	1391 (**5**)
Thailand	1553 (**2**)	10,351 (**2**)
The Philippines	824 (**4**)	982.08 (**6**)
Vietnam	524 (**5**)	5202.48 (**4**)

Source: compiled by the authors with reference to BOI (Thailand), MIDA (Malaysia), NSCB (the Philippines), BKPM (Indonesia), MPI (Vietnam), CIB (Cambodia), and MOEA (Taiwan)

Table 5 Taiwanese investment in key ASEAN countries (2001–2014.6) (USD millions)

	Project/rank	Amount/rank
Cambodia	318 (**5**)	610.12 (**7**)
Indonesia	770 (**2**)	3910.79 (**3**)
Malaysia	644 (**4**)	2539.48 (**5**)
Singapore	206 (**7**)	9537.26 (**2**)
Thailand	648 (**3**)	3146.72 (**4**)
The Philippines	232 (**6**)	1124.2 (**6**)
Vietnam	2320 (**1**)	22,408.61 (**1**)

Source: compiled by the authors with reference to BOI (Thailand), MIDA (Malaysia), NSCB (the Philippines), BKPM (Indonesia), MPI (Vietnam), CIB (Cambodia), and MOEA (Taiwan)

In recent years, in addition to Foxconn's great interest in telecommunication sectors, *Tai-shang* has also paid more attention to Indonesian domestic market as this emerging economy is rising.

5.2 Thailand

Thailand was the second investment destination of *Tai-shang* before 2000. However, being suffered by Asian financial crisis, Taiwanese outbound investment in Thailand decreased in the late 1990s. Among 1553 projects in operation, *Tai-shang* had invested USD10.35 billion in Thailand. Cultural similarity and societal hospitality constitute two important factors for *Tai-shang* to invest in Thailand. Up to 2015, it is estimated that there are at least 5000 *Tai-shang* stationing in Thailand, some of them are operating by their second generation, conducting a more localized strategy (Interview 2015c). Taiwan business considered Thailand as the base for developing a variety of businesses ranging from basic iron and steel manufacturing to SMEs as human resources, chemistry, electronics, textile mills, food manufacturing, and service industries. New domestic needs concentrate on service industries which attract new type of *Tai-shang* to Thailand. During 2001–2014, Taiwan business launched 648 projects (No. 3) worth of USD3.1 billion (No. 4) in Thailand. While Myanmar is lifting domestic regulation to foreign investment, along with the rise of wage and political instability in Thailand, increasing number of Tai-shang considers to invest in Myanmar. Nevertheless, as Thailand enjoys various FTA with major economies in Asia-Pacific and beyond, the overall investment environment it is still attractive and favored by Taiwan business.

5.3 Malaysia

Tai-shang had invested the most projects in number in Malaysia (1786 projects as USD9.22 billion), making Malaysia as the third investment destination in Southeast Asia before 2000. Well-developed infrastructure and clearly defined regulations for foreign investment were advantages of Malaysia. In addition, the *Tai-shang* were attracted by abundant natural resources and a stable political situation in Malaysia. Therefore, increasing investments were contributing to machinery and equipment manufacturing, electronic parts and components manufacturing, textile mills, and banking and insurance since 1988. However, the lack of labor force in 1994 and the Asian financial crisis in 1997 diversified Taiwanese investments from Malaysia to Vietnam and China. The changing focus of Taiwanese investment in Malaysia also highlights a shift from textile mills and manufacturing sectors to financial service one. According to Taiwan's Ministry of Economic Affairs, more than 70 % of Taiwanese FDI are targeting at domestic financial service sector (Yeh and Huang 2015: 317). Currently, *Tai-shang* reinforces investments in service sector and

catering industry as a result of the government policy on promoting service industries (Interview 2015a). From 2001 to 2014, Tai-shang contribute 644 projects (No. 4) as USD2.5 billion in Malaysia, with a specific focus on basic metal manufacturing.

5.4 Vietnam

Before 2000, Vietnam only attracted 524 investment projects (No. 4) with the amount of USD5.2 billion (No. 5) from Taiwan. Since the 1980s, Vietnamese government welcomed Taiwanese investment and its first economic and cultural office, known as informal embassy, was installed in Hanoi in 1992 (Leifer 2001: 181). With the continuous support of "Go South Policy," Vietnam became No. 1 investment destination for Taiwan business in Southeast Asia in the 2000s. During 2001–2014, there were 2320 projects (No. 1) and USD22 billion instilling in Vietnam. A variety of SMEs, such as wearing apparel and clothing accessories manufacturing, electronic parts and components manufacturing, furniture, tourism, as well as banking and financing, are stationing in Vietnam for decades. Up to 2015, Taiwan ranks as No.4 foreign investor in Vietnam. Tai-shang are mostly stationing in the South surrounding Ho Chi Minh city. After 513 accident happened in 2014, Vietnamese government scrutinized foreign investment regulation and policy, providing more business incentive and favors for locla *Tai-shang*. The purpose is to keep Taiwanese investment at localities. Other than SMEs, ICT industries, such as Formosa Ha Tinh Steel Corporation (FHS) also invests new plant at Vung Ang Economic Industrial Zone in Ha Tinh.

5.5 The Philippines

Taiwan business invested 824 projects as USD982 million in the Philippines before 2000, focusing on manufacturing, textile mills, electronic parts and components manufacturing, and computer, electronic, and optical products manufacturing. Recent trend shows increasing investment has been contributed in fabricated metal products manufacturing. In 2006, as Taiwan and the Philippines signed a memorandum of understanding (MOU) with regard to the construction of economic corridor by the Subic Bay Metropolitan Authority (SBMA) and the Clark Development Corp. (CDC) of the Philippines and the Export Processing Zone Administration of Taiwan (Go 2006), a wider range of industries had been invested in the bay area such as motor vehicles and parts manufacturing, electronic parts and components manufacturing, chemical material manufacturing, food processing, banking and insurance, and shipping industry. From 2001 to 2014, Tai-shang has contributed 232 projects (No. 6) worth of USD1.1 billion in the Philippines.

5.6 Singapore

Singapore is of strategic interest to *Tai-shang* in terms of geo-economic consideration and skilled labor. In terms of geography, Singapore is acting as a Asia-Pacific financial and economic center, attracting various headquarters of multinational corporations to station in. Taiwanese companies such as China Airline and Eva Air, for example, consider Singapore as their regional hubs. With regard to skilled labor, Taiwan's leading semiconductor foundries, TSMC and UMC, had established plants in Singapore. Before 2000, there were 316 projects as USD1.3 billion invested by Taiwan business in Singapore, including manufacturing, electronic parts and components manufacturing, and banking and insurance. In recent years, domestic banks in Taiwan also set up branches in Singapore, such as the Bank of Taiwan, First Bank, CTBC Bank, Mega Bank, E. Sun Bank and etc. During 2001–2014, Singapore attracted 206 investment projects (No. 7) from Taiwan with the amount of USD9.5 billion (No. 2). The signing of ASTEP in 2013 further enhances Taiwan-Singapore economic and trade cooperation. ASTEP has been regarded as a cornerstone for Taiwan's forthcoming engaging in the Trans-Pacific Partnership (TPP) led by the United States and the Regional Comprehensive Economic Partnership (RCEP) led by ASEAN.

5.7 Cambodia

Taiwan had 168 investment projects worth of USD427 million in Cambodia before 2000. These projects specifically focused on textile products manufacturing and shoemaking industry. During 2001–2014, 318 projects (No. 5) as USD610 million (No. 7) were invested by Taiwan business. A special initiative is the Manhattan Special Economic Zone (MSEZ) located at the borderland between Cambodia and Vietnam. MSEZ was the first special economic zone in Cambodia, initiated and operated by *Tai-shang*, the Manhattan International Co., Ltd. (MIC). More than 50 % of enterprises in MSEZ are from Taiwan, including SHEICO, Towa, and Kingmaker Footwear. In addition to the development of special economic zone, real estate has recently been of specific interest of local *Tai-shang* competing with China, Korea, and Japan, as the Cambodian government is promoting urbanization and market liberalization in Phnom Penh (Interview 2012).

5.8 Myanmar

Due to political constraints and the Burmese government's "One China Policy," Taiwan business was not allowed to invest in Myanmar. Most of *Tai-shang*, therefore, were from Cambodia and Vietnam to invest in manufacturing,

agriculture, shoemaking, banking and financing, and joint venture in industrial park (Interview 2013). However, Taiwanese government began to promote investment in Myanmar since 2012, regarding Myanmar as a new frontier of *Tai-shang*. In 2013, the DICA of Myanmar government has approved the investment status of Taiwan business. Accordingly, an overseas office of the Taiwan External Trade Development Council has been installed in Yangon for the purpose of promoting FDI in the country. A recent project has been developed by the Taiwan Electrical and Electronic Manufacturers' Association (TEEMA), with specific focus on the proposal of building an industrial park in Southern Myanmar. Although Myanmar has been regarded as a rising economy and emerging market, its domestical political instability, the poor quality of infrastructure, and its closer relationship with China are the main concerns hindering Taiwanese investment. Up to 2015, Taiwan business such as Taiwan Hon Chuan Group, Pou Chen Group, and Asia Optical kick off the investment project and new producion line. In order to attract more Taiwanese foreign investment, Myanmar Trade Office has been installed in Taipei in June 2015.

6 Conclusion: *Tai-Shang*'s Contributions and Challenges

As one of the earliest foreign investors in Southeast Asia, Taiwan business has at least made five contributions to Southeast Asian countries and to Taiwan as well. First, in terms of economic growth, the investment from *Tai-shang* has helped increase GDP of many host countries. For example, the contribution of FDI to Vietnam's GDP increased from 2.1 % in 1989 to 18.7 % in 2008. Moreover, the contribution of Taiwan business in developing countries in Southeast Asia also met the strategic goal of narrowing the developmental gap among ASEAN states.

Second, in terms of regional production network, the active presence of *Tai-shang* in Southeast Asia has facilitated the global–regional–local nexus of production chain, especially in textiles, ICT, and electronics manufacturing.

Third, the increasing volume of Taiwanese investments also promoted bilateral trade between Taiwan and Southeast Asian countries. More open international markets have been favorable for both Taiwan and its Southeast Asian counterparts. The even closer economic ties between Taiwan and Southeast Asia facilitated by *Tai-shang* would definitely contribute to Taiwan's further engagement in regional grouping and trade integration despite of its political predicament set by China.

Fourth, in terms of labor market, ten thousands of *Tai-shang* stationing physically in Southeast Asia are mostly SMEs. They have been providing millions of job opportunities for local people, training them become skilled labors.

Most importantly, *Tai-shang* has facilitated political interconnectedness between Taiwan and Southeast Asia. The economic corridor between Taiwan and the Philippines and the Taiwan Industrial Park in Hanoi are showcasing positive relationships between Taiwan and Southeast Asian governments. Economic

projects are maneuvered as the only means of engaging ASEAN under the political constraint of "One China Policy" partially upheld by China.

During the past decades, structural changes in Southeast Asia brought new challenges to Taiwan business, such as Asian financial crisis, anti-Chinese movements, underdeveloped infrastructure at localities, rising environmental concerns, and the difficult labor management issues. These setbacks once discouraged Taiwanese investors to engage in Southeast Asia. However, as ASEAN Community is in the making and the domestic legalization of employment contract law in China has been implemented, quite a number of *Tai-shang* have begun either to shift their branches to Southeast Asia or even moved to Southeast Asian countries all together.

Meanwhile, as Southeast Asia is of importance politically and economically, new challenges faced by *Tai-shang* are also the challenges to Taiwan. First, a more sophisticated investment arrangement should be taken into account in line with ASEAN economic integration and its regional trade agreement (RTA) initiatives. It is imperative for the new generation of *Tai-shang* to incorporate the benefits of AEC into its roadmap of internationalization.

Second, an enhanced public–private partnership (PPP) between the Taiwanese government and Taiwan business should be practiced in implementing "Go South Policy." The lack of cross-sectorial coordination mechanism as the setback for *Tai-shang* should also be avoided. In September 2015, as the DPP Chairperson Tsai Ing-wen announces her "New Go South Policy" (新南向政策), it has been regarded as a multi-faceted impetus to Taiwan's further regionalization and globalization. Also, the emerging policy initiatives and discourses showcase Taiwan's concerns for being a part of regional grouping. New elements will be added based upon an enhanced PPP to further integrate Taiwan into Southeast Asian localities where *Tai-shang* will be the key intermediators to facilitate Taiwan's integration into the region.

Third, a higher standard of investment should be considered. The rise of environmental concerns and social justice for labor rights have long been ignored in *Tai-shang* in Southeast Asia. It is necessary for *Tai-shang* to respond and adapt to new standard and regulations of host societies.

Fourth, industrial upgradation is inevitable. Taiwan's long-term benefits gained from OEM and ODM in global production network have been undermined due to its shirking interest. Facing this challenge, Taiwan business should emphasize its Taiwanese branding and localize in ASEAN market.

Finally, moving from *Tai-shang* 1.0 toward *Tai-shang* 2.0 needs more strategic alliance and international collaboration. As proposed by Japanese and Korean enterprises and their governments in Southeast Asia, a new generation of *Tai-shang* should seek for long-term cooperations with other foreign investors so as to consolidate the production network and to work closely to improve investment environment of host countries.

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India and China: "Awakening Giants" Towards a Win–Win Future?

Manjira Dasgupta

> . . . "Two of the oldest and still extant civilizations, (India and China were), for Europeans, legendary seats of immense wealth and wisdom right up to the eighteenth century. . . . Somewhere between the mid-eighteenth century and early nineteenth centuries, both these countries became, in the European eyes, bywords for stagnant, archaic, weak nations . . . . . By 1960s . . . they were independent republics supposedly launched on their path of development, but both suffered devastating famines. . . . . These two countries were "basket cases" in the then fashionable terms of international diplomacy".
> . . . "Within the following forty years we are discussing China and India not as failures nor for their ancient wisdoms, but as dynamic modern economies. The Economist has to write editorials to tell the world not to be afraid of China's economic power. American legislators pass laws to prevent their businesses outsourcing work to India's software and telecommunication services. China ranks as the second largest economy in terms of GDP in PPP dollars. Together the two countries account for 19.2 % of world GDP—China 11.5 % and India 7.7 %".
>
> —Lord Meghnad Desai (2003)

> . . . "China and India have now become poster children for market reform and globalization in parts of the financial press, even though in matters of economic policy toward privatisation, property rights, and deregulation and lingering bureaucratic rigidities both countries have demonstrably departed from the economic orthodoxy in many ways. This has not escaped the attention of the Heritage Foundation . . . . . both are relegated to the group described as "mostly unfree" . . . Of course, not many have pointed out that the economic (particularly growth) performance of these two "mostly unfree" countries in terms of economic freedom seem to have been much better than that of most others".
>
> —Pranab Bardhan (2014, pp. 7–8)

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1 Introduction: Context of Study

At the time of writing this chapter, India and China, the two major emerging players in today's global shifting scenario who have always shared a unique and highly complex economic and strategic relationship, are looking ahead and preparing for their crucial next meeting over the Regional Comprehensive Economic Partnership (RCEP) negotiations later this year. India and China, two of the most keenly observed emerging players in the post-global-crisis scenario and followed closely with avid scrutiny (and specially in case of China, with somewhat apprehensive concerns), have all along shared an extremely intriguing mutual relationship. An altogether new era, however, has been marked between the current liberalized and post-reforms globalizing nations, as clearly evidenced by the recent series of cordial and meaningful meetings between the heads of the Chinese and the Indian nation.

The present chapter is being written at a time when, post the vagaries of the global crisis, emerging economies have weathered the storm and started emphatically on the path to recovery, rallying much faster than their developed counterparts. The backdrop is provided by the recent emphatic revival of "South–South" economic relations and cooperation in a massive post-crisis shifting away of global economic power from the advanced "North" to the developing "South" in standard trade parlance. The supremacy of China is an uncontested fact today, in driving the burgeoning South–South economic flows by dint of its ability to deploy an unorthodox growth model with investment as the crucial cornerstone in its ambition to climb up the industrial value chain (UNCTAD 2015). The imminent "seismic" shift in global power has profound implications for paths of industrial progress in the developing world and areas of strategic developmental cooperation (ibid). The outlook for these economies continues to be optimistic, in spite of challenges. Among emerging economies, India today stands on nearly equal footing with the formidable China in the global economic order. The present chapter undertakes a look at some salient aspects of the Chinese and Indian economies. The treatment here involves not only an examination of the production, industrial and trade aspects but looks into more depth at myriad dimensions the mutual relationships between the two "awakening giants"[1]—primarily emphasizing the economic aspect, but not completely excluding political and strategic ties that have had such marked impact on the respective economies—defining and shaping to a large extent crucial policies relating to national and international arena.

On a very brief historical note, China and India, both ancient nations, had shared a common historical legacy, with shared historical, commercial and cultural ties with their prosperous neighbour before its colonial subjugation. Till now, both share an extremely complex economic, political and strategic relationship that offers a fascinating study to the observer and analyst. However, attempts to highlight the fascinating mutual relationships between the two present some formidable challenges, and what is more, dwelling at length on purely political and

[1] Inspired by the elegantly titled treatise by Bardhan (2014).

strategic issues and even areas of frequent conflicts of interest would obviously be somewhat inappropriate and uncalled for when contributing to a volume that primarily focuses on the theme of mainly Chinese production networks, production clusters and business models.

And yet, in undertaking an intercountry analysis between mutually strategic and strong partners like India and China, too well known to be a relationship that has evolved over long decades and one that offers the analyst a fascinating study in diplomacy and mutual overtures under frequently extremely trying conditions, refraining completely from their mutual perceptions and engagements with each other would offer a very much incomplete treatment. Being aware, however, of the main aims and focus of the present collection, we have consciously attempted to strike a delicate balance, avoiding the quagmire of the all too real but complex details of mutually critical political and strategic issues that have so often shaped the whole nation's policies and institutions, including industry, trade and development.

We begin our discussion by noting with interest that in its Outlook for Emerging Asia for the current year, that is, 2015, the OECD, which had used the phrase "Beyond the Middle-Income Trap" in the extended title of its 2014 Outlook, explicitly emphasizes "Building Institutional Capacity" in its 2015 Outlook for the same, showcasing the vital and critical need of putting proper institutional structures in place as a prerequisite of development (OECD 2015). In the present context, this suggests that not only growth in economic terms but institutional policies and frameworks, too, are fundamental to the production system, networks and clusters that we have concerned ourselves with in the present volume.

1.1 India and China: Economic Performance and Respective Growth Experiences

Figure 1 presents a brief highlight of the recent growth performances of countries/groups thereof that have been showing the fastest growth for some time.

As shown in Fig. 1, between 2001 and 2013, China posted the fastest GDP growth in the world, followed by Australia and the ASEAN. ASEAN, the second fastest-growing economy in Asia, also exceeded India's overall GDP growth of 257 % over the period 2001–2013.

Finally, China's phenomenal overall GDP growth over the period 2001–2013, particularly its somewhat puzzling unhampered growth post-2008 given its high degree of connectedness with the global economy, far outstripped others, in striking contrast to the rather lacklustre performances by the EU, the United States and other Asian Tigers like Japan and Taiwan.

In its 2014 Economic Outlook for Southeast Asia, China and India, the OECD (2014) had predicted "robust" economic outlook over the medium term for emerging Asia, consisting of Southeast Asia, China and India, bolstered principally by

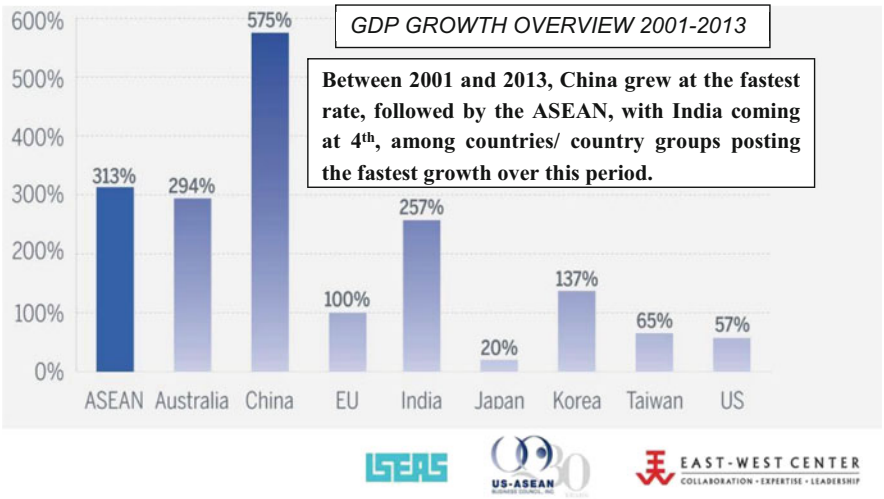

Fig. 1 GDP growth: overview of selected major countries (groups) 2001–2013. Based on the *Source* http://www.asiamattersforamerica.org/asean/data

"steadily increasing domestic demand". For 2015, growth prospects continued to remain "favourable in the medium term" (OECD 2015). Emerging Asia continues to face challenges and an eventual "gradual moderation," due to an apprehended slowdown in Chinese growth rate.

While projections for ASEAN remain optimistic for 2015–2019, China is expected to experience slowdown—various external risks being posed by the US monetary policy of quantitative easing (QE), structural reforms in Japan as well as uncertainties in the euro area (OECD 2015).

Table 1 presents a summary overview of the growth projected for emerging Asia over the medium term by the OECD (2015).

Overall, the projected rate of growth of 6.5 % per annum for emerging Asia over 2015–2019 is a healthy one, although markedly lower than the 9.5 % growth the region enjoyed just before the global financial crisis set in. This decline is predominantly consequent upon a slowing down in the erstwhile fast-growing and dominant economy of China (OECD 2015), although India, the other large economy in East Asia, seems to have managed to escape similar slowdown. For Southeast Asia, however, the medium-term outlook for growth remains at per with the pre-crisis level, with a projected real GDP growth rate of 5.4 % (annual average) over 2014–2018 as compared to 5.5 % in the period 2000–2007 (OECD 2015 and Table 1).

Table 2 presents data on real GDP growth rates for China and India over the time span 1984–2013, from available data on a continuous time series basis (World Bank 2015). The same data, presented in Fig. 2, affords a visually convenient idea about the respective trends.

Table 1 Projected real GDP growth in Southeast Asia, China and India (annual percentage change)

Country	2013	2019	2003–2007[a]	2011–2013	2015–2019
ASEAN, 10 countries					
ASEAN, 5 countries					
Indonesia	5.8	6.3	5.5	6.2	6.0
Malaysia	4.7	5.6	6.0	5.2	5.6
Philippines	7.2	6.3	5.7	5.9	6.2
Thailand	2.9	4.6	5.6	3.2	4.1
Vietnam	5.4	5.8	7.2	5.6	5.7
Brunei Darussalam	−1.8	1.9	1.7	0.9	1.6
Cambodia	7.5	7.3	10.6	7.3	7.1
Lao PDR	8.0	7.7	7.1	8.1	7.6
Myanmar	7.5	7.8	–	6.9	7.8
Singapore	3.9	3.6	7.9	4.1	3.5
Average of ASEAN 10	5.2	5.8	5.9[a]	5.4	5.6
Two large economies in emerging Asia					
China	7.7	6.6	11.7	8.2	6.8
India	5.0	6.8	8.8	5.5	6.7
Average of emerging Asia	6.5	6.5	9.5	7.0	6.5

Notes: Emerging Asia includes ASEAN 10 countries plus China and India
[a]Excluding Myanmar
Source: OECD (2015)

Table 2 and Fig. 2 show striking patterns of the respective growth of the Chinese and the Indian economy over the long time span. China, having begun its economic reforms at a much earlier point in time than India, was growing at a phenomenal annual average rate exceeding 15 % around 1984 and gradually experienced a decline around 1989–1990, falling lower than 4 %. India, on the other hand, had just begun to shake off its bureaucratic shackles around 1984, at last getting out of the famous "Hindu rate of growth" of 3.5 %, and saw one of its fastest rises in GDP growth over 1984–1990, led principally by fast escalating and unprecedented levels of government expenditure, until by 1990–1991 the country fell into one of its worst economic crises stemming from mounting external and internal imbalances and a severe balance of payments crisis eventually triggered by the Gulf War of 1989–1990. Widespread economic reforms followed, with macroeconomic stabilization and sweeping structural reforms on policy fronts including trade, industry, monetary and financial sectors.

Interestingly enough, the motivation behind China's own economic reforms originated within the national economy itself, with the government taking a proactive role at market-oriented reforms much earlier. India, on the other hand, had only tentatively begun sporadic liberalization efforts around mid-1980s, apparently needing the ultimate external trigger of the Gulf War and loss of credibility in the global market to initiate a full-fledged reform process— which came tied with loans from the IMF and World Bank with stringent conditionalities attached.

Table 2 Respective real GDP growth: China and India (average annual growth rate)—1984 to 2013

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
China	15.18	13.47	8.85	11.58	11.28	4.06	3.84	9.18	14.24	13.96	13.08	10.92	10.01	9.30	7.83	7.62
India	3.82	5.25	4.78	3.97	9.63	5.95	5.53	1.06	5.48	4.75	6.66	7.57	7.55	4.05	6.18	8.85

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
China	8.43	8.30	9.08	10.03	10.09	11.31	12.68	14.16	9.63	9.21	10.45	9.30	7.65	7.67	n.a.
India	3.84	4.82	3.80	7.86	7.92	9.28	9.26	9.80	3.89	8.48	10.26	6.64	5.08	6.90	n.a.

Source: World Development Indicators Series, World Bank (2015)

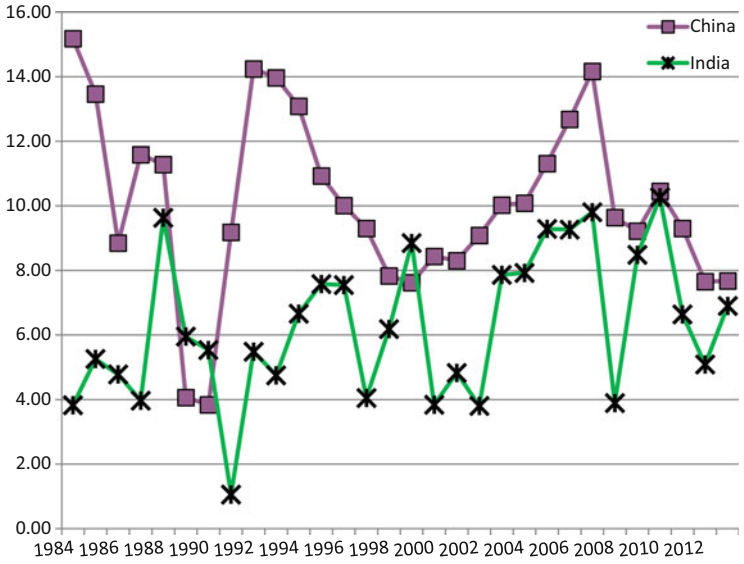

Fig. 2 Respective real GDP growth: China and India 1984–2013 (average annual growth rate). *Source*: Based on Table 2

The rapid growth of major East Asian countries, led principally by export-oriented and market-friendly domestic policies, suffered a rude jolt in 1998 with the Asian Financial Crisis. According to experts, however, China was relatively protected from the extreme growth shock principally owing to a pegged currency and comparative immunity on the financial front, although the Chinese growth rate did suffer from a lagged setback showing somewhat delayed reaction to the interconnected financial repercussions.

Many commentators have pointed to the "underlying similarity" between the global financial crisis that reached its severest point around 2008 and the Asian crisis of 1997–1998, ascribing both the events to poor financial and banking sector management coupled with flawed monetary policy (Basu Das 2012). However, the Asian banking system in general turned out to have relatively greater resilience compared to the advanced West, where the chronic introduction of increasingly complex and little understood instruments into the financial system, as well as insufficient risk assessment, gave rise to the financial turmoil and instability in the first place. India, on its part, was saved from the intense repercussions of the global financial crisis precisely because of its long chastised relative conservatism in its financial and monetary policy approach.

Between 2000 and 2007, both Chinese and Indian economies were continuing on the path of rapid economic growth, with China again achieving a growth rate in excess of 14 % and India its pre-1990 level of close to 10 %. Can one safely conjecture that the remarkable double-digit growth would have continued had it not been for the striking of the global financial crisis that had been building up for a

while in the US housing subprime market and reached its ultimate conclusion in 2008? The global crisis has given rise to intensive research into the question "whether or not the Asian region had "decoupled" from the United States sufficiently to allow it to weather the downward shocks the region was expected to suffer from the decreased US demand for its exports as that nation fell into recession … Over time, however, the depth of the crisis demonstrated that a sufficiently large adverse shock to demand from the rest of the world could also draw Asia into recession" (Leduc and Spiegel 2013, p. 1).

A further interesting finding by Leduc and Spiegel (2013) is the result that business cycle correlations between the US and Asian economies have in fact declined, the decline being steeper during the recovery from the global financial crisis than it has been in past recoveries. A potentially strong explanation is offered by the fact of monetary policy being constrained by the zero lower bound in the United States "while monetary policy in much of Asia was unconstrained", leading to "heterogeneity in monetary policy responses to the European crisis, and thereby decreased business cycle correlations" (Leduc and Spiegel 2013, pp. 23–24). Despite finding support for this hypothesis, however, the authors concede that this explanation is rather simplistic given that US monetary policy often bypassed the zero-bound constraint and that there were considerable variations in monetary policy across Asian economies themselves, so that more research into the issue is needed.

There is, as yet, some doubt over the empirical plausibility of the "decoupling" premise, given that the United States still acted as the destination for around 20 % of East Asian exports around 2012. Slowdown in US consumer spending did therefore have considerable adverse impact on economies that were export oriented, a fact reflected in the declining Chinese economic growth rate, in the neighbourhood of 9.8 % by 2009. India, in turn, experienced at the same time a plummeting in real growth down to 4 %, the severe setback reflecting a sudden contraction in demand.

By 2010, both economies, however, had accelerated growth due to proactive government stimulus programmes, followed by a renewed need for consolidation. By 2013, India seemed all poised to in fact catch up with the gradually slowing down China. The OECD medium-term projections (OECD 2015) indeed envisage China facing challenges that could slow down the growth of the economy.

India, in its turn, although experiencing slowdown, could maintain optimistic growth projections. However, as has been noted earlier on in the introduction, both China and India have proved much more resilient experiencing faster revival back to the long-term growth path compared to most advanced economies.

2 Production Clusters and China's Industrial Development: Lessons for India

Given the broad overview of respective growth experiences above, one is naturally led to the question as to what factor(s) explains China's incredible success in securing double-digit growth consistently, particularly when compared to India, its other significant peer economy in the region. Specifically, we are referring to the fundamental production framework characterizing the Chinese manufacturing sector, viz. the existence of a large number of "production clusters".

As a 2009 Wharton Report puts it,

> Over the past 30 years, most economists have come to believe that advanced economies are less likely to be driven by strong, lone companies than by complex ecosystems, or clusters, centered in a particular industrial sector. The evidence shows that outsized economic growth often requires an outsized pool of talent and specialized capital in a single geographical region . . . In China, a recent study by the National Science Foundation (. . .) found that the presence of many firms in a single area helped encourage innovation, diffusion of new ideas, flexibility and specialization. (Wharton and BCG 2009)

The 2009 Special Report, jointly developed by analysts at the Wharton School and the Boston Consulting Group (BCG), addressed the challenges faced by the manufacturing sector in China, coming specifically at a time when Chinese exports were facing a severe demand shortage in both global and domestic markets, and large-scale retrenchment stared Chinese factory workers in the face, coupled with falling wages.

Production clusters are indeed the backbone in many of the economies that have rapidly industrialized, including China, Japan, Korea as well as Brazil. In the Chinese case, Fig. 3 shows a remarkable example of the leap in manufacturing productivity that can result from a proper planning of industrial clusters.

Manufacturing Productivity in India Vs. China

	India	China	*China / India*
Nominal GDP (CY13)	$1.9 trillion	$9.2 trillion	*4.9x*
Industrial Sector (CY13)	$293mn	$4,159mn	*14.2x*
% of GDP	*16%*	*45%*	
Total Labour Force	484mn	788mn	*1.6x*
Manufacturing Workers	97mn	239mn	*2.5x*
Share of Total	*20%*	*30%*	
Industrial Output per Worker	$3,029	$17,428	*5.8x*
Annual Industrial Wages	$1,700	$7,638	*4.5x*
Industrial Output per US$1 of Wages	$1.8	$2.3	*1.3x*
Wages as a % of Output	56%	44%	
Total Logistics Spending	$253bn	$1,653bn	6.5x
% of GDP	13.5%	18.0%	1.3x
% of Industrial GDP	79%	40%	0.5x

Sources: National Accounts, World Bank, CIA World Factbook

Fig. 3 Comparative industrial productivity 2013. *Source Courtesy*: http://greaterpacificcapital.com/

Indian manufacturing rests on a vast percentage of informal sector employment (by a 2012 estimate India's informal or organized sector manufacturing vs. the formal or organized sector stood at a staggering 93:7). India's scattered and "chaotic" urban centres need urgently to be modelled on "Smart Manufacturing Clusters" (http://greaterpacificcapital.com/, 2013). According to the Greater Pacific (2013) Report, "India's metros and urban centres are dominated by slums which are hotbeds of economic activity however operating far below their potential. ... Various cities in China, Japan, Dubai and the US have experimented with creating smart cities and industrial clusters geared around innovation—with varying measures of success. Developing an industrial model for its cities which leverages the economic potential of slums would ensure India's cities become highly productive and also plan for urbanisation ... On this front there are important lesson from China's industrial experience" (ibid.)

India's Planning Commission, in its 2012 Report (Planning Commission 2012), outlines a "Cluster Strategy for India". It observes the remarkable success of many countries, including China, in having "...deliberately nurtured and developed Clusters to become productive units that contribute significantly in volume (GDP) and value (jobs, innovation) to the country's economy" (Planning Commission 2012, p. 15).

The Commission indicates two major lessons that India should learn from the experience of such countries:

1. Data collection and cluster mapping: whereby, first and foremost, the private and public sectors have to be engaged to produce a country-wide map locating clusters and their linkages with the national economy. "The aim is to understand actual cluster behavior and performance. In developed countries where data is available at the cluster, sub-cluster and firm levels, actual linkages within and between clusters are tracked through detailed analyses of their sourcing and selling behaviors as well as their business alliances. This analysis then allows the mapping of clusters across geographies, indicating the locations and perimeters of the given clusters" (Planning Commission 2012, pp. 15–16).
2. Knowledge sharing and collaboration: whereby collaboration between cluster enterprises, universities, research institutes and foreign cluster bodies should be strongly emphasized "in order to spur innovation and growth". In all this, the national government must proactively act to facilitate collaboration and produce the requisite funding and incentives.

As the Commission also notes, however, "... adopting the international models in India presents certain challenges. These include the lack of theoretical research on the discipline of cluster management in the Indian context, relatively less participation by academic institutions in cluster development research, low degree of maturity of a majority of Cluster Management Associations, low penetration of ICT (Information Communication Technologies) amongst cluster management organizations, and the relatively large number of agencies/institutions across industries and geographies which are working in the area of cluster management" (ibid., p. 16).

Recognizing the problems, the Commission has proposed a holistic solution for the management and effective functioning of manufacturing clusters in India on the basis of a three-pronged strategy of

1. Setting up a Cluster Stimulation Cell
2. "FACTS Framework" of cluster performance measurement
3. Cluster Competitiveness Index (Planning Commission 2012)

Finally, one necessary observation that needs to be made is India's comparative advantage in the area of skill-based services sector, rather than the manufacturing sector, where China has an uncontested edge. In India, on the other hand, "knowledge clusters", based on the services and knowledge-intensive sectors, are becoming increasingly significant, as a case study on Bangalore (India) in Ohara and Kimura (2009) conclusively establishes.

3 "Globalization", "Regionalism" and "Nationalism"

From the domestic production sphere, we now turn to take a look at the external trade scenario for our countries. We begin by noting that by definition, globalization refers to the integration of the domestic nation, or region, with the world economy. The concept of nationalism, to all intents and purposes a somewhat antithetic one to the former, has evolved considerably throughout history. The forces of globalization on one hand, and nationalism on the other, are apparently conflicting tendencies for any nation or conglomeration of nations. Given this apparent contradiction, the simultaneous coexistence of various regional blocs like the ASEAN has generated widespread debate as to the sustainability of such regional (most often trading) arrangements. The debate has further been enriched by authors like Sridharan and Srinivasa-Raghavan (2007) who have remarked on the "unspoken but widely acknowledged view … that it is better to have regionalized and faltered than never to have regionalized at all!" (Sridharan et al. 2007). Noting the simultaneously "pervasive and amorphous" nature of regionalism, the authors argue that "regionalism is here to stay", although requiring a good deal of "imitation and innovation" to sustain the process.

3.1 Indo–China Trade Relations

India and China have had a long history of mutual trade relations, and barring the few years of war, today the partners share bilateral commerce totalling US$71 billion. A brief look at the global trading patterns of the Chinese and the Indian economy, in terms of their major trading partners over the world, shows, however, that while China has always been a major partner for India's external trade, the latter has almost never figured in the top ten list of trade partners for China. Figures 4 and 5 will help bring home this fact.

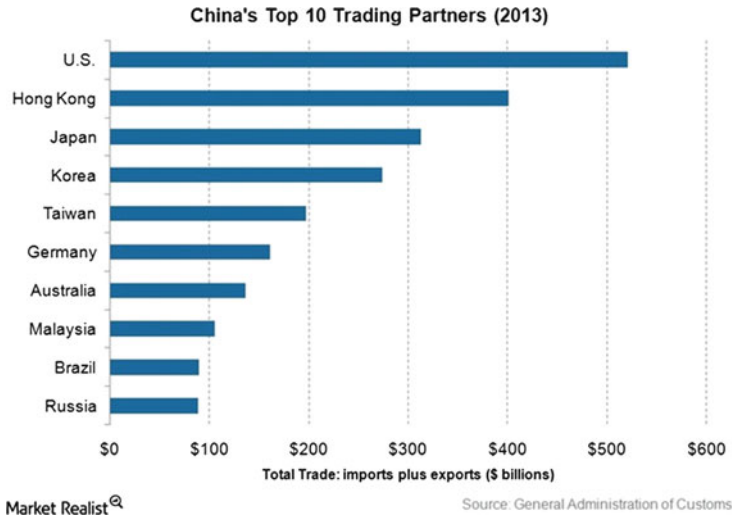

Fig. 4 Top ten trading partners of China (US$ billions). *Source Courtesy*: http://www.globalresearch.ca/

Fig. 5 India's top ten trading partners (US$ billions). *Source Courtesy*: Ministry of Commerce and Industry, GOI, and Jain (2013)

As Fig. 4 shows, by 2013, the countries that were the top trading partners for China ranged from the United States, its largest partner with total trade in excess of US$500 billion, followed by Hong Kong, Japan and Korea, in that order. Brazil and Russia comprise the last two among the "top ten" list.

For India, however, as Fig. 5 shows, China has dominated bilateral trade, holding the top spot in India's imports and the fourth (4th) rank in India's export destinations. Clearly, so far as global and bilateral trade is concerned, one could surmise a discernible asymmetry between the respective trading situations of the two partners, where China has a much more aggressive and proactive policy approach compared to its Indian counterpart.

We proceed next to an overview of the trend in bilateral trade relations between India and China over time, followed by a look at the various regional alignments and trading arrangements involving the two economies. The database that we have employed is as per the UN Comtrade Database on BEC (Broad Economic Category) basis[2], for comprehensive and consistent trade data allowing a comparative time series analysis between our two economies under study.

In the context of China and India (as indeed for any pair of countries/groups thereof), the UN Comtrade data is available separately for the respective source and destinations of trade. Accordingly, Table 3 and the chart in Fig. 6 represent the trade originating from India, that is, India's imports from, and exports to, China, over the period 1997–2014. Conversely, the corresponding data for trade originating from China to India is presented in Table 4 and Fig. 7 further on.

The first and foremost salient feature emerging from the summary presentation of the data is the continual, ever-widening trade surplus China has continued to enjoy against its Indian counterpart. In other words, India has consistently experienced a trade deficit with its leading trade partner, China, causing concerns at the domestic sphere.

Clearly, as far as trade originating from India to China is concerned, imports from China have consistently outpaced India's exports to the former over the period 1997–2014—resulting in a widening trade deficit that, after showing a temporary possibility of narrowing down around 2009–2010, has gone on widening even further as India's exports to China have taken a downturn.

Trade with India originating in China, as shown in Table 4, reinforces the conclusion, stated earlier, of China's continued comfortable position of a trade surplus in its favour. Barring the years 2003–2005, Chinese exports to India have consistently exceeded its own imports from the latter by a substantial margin, and by 2013–2014, China's trade surplus exceeded US$37,000 million.

[2] The UN Comtrade International Trade Database reports trade data as per three (3) distinct classifications: the Standard International Trade Classification (SITC), Harmonized Commodity Description and Coding System (HS) and Broad Economic Categories (BEC). For a fully explanatory discussion on these three alternative classification systems, see http://ec.europa.eu/eurostat/ramon/other_documents/bec/BEC_Rev_4.pdf. Also see the UN Comtrade site.

Table 3 India to China trade 1997–2014 [UN Comtrade BEC Classification (US$ Mn)]

Trade data between India ("reporter") and China ("partner"): as per UN BEC classification		
Year	Imports (US$ Mn)	Exports (US$ Mn)
1997	1110.56	718.14
1998	1097.69	427.75
1999	1294.88	542.01
2000	1477.58	734.89
2001	1827.55	922.54
2002	2619.85	1531.60
2003	3615.13	2567.16
2004	6051.26	4098.51
2005	10167.06	7183.79
2006	15639.06	7829.17
2007	24575.77	9491.98
2008	31586.02	10093.93
2009	30613.37	10370.05
2010	41249.12	17439.99
2011	55483.03	16717.79
2012	54140.46	14729.32
2013	51635.44	16416.83
2014	58230.55	13434.25

Source: Computed by author based on UN/Comtrade Database (2015). http://comtrade.un.org/data/

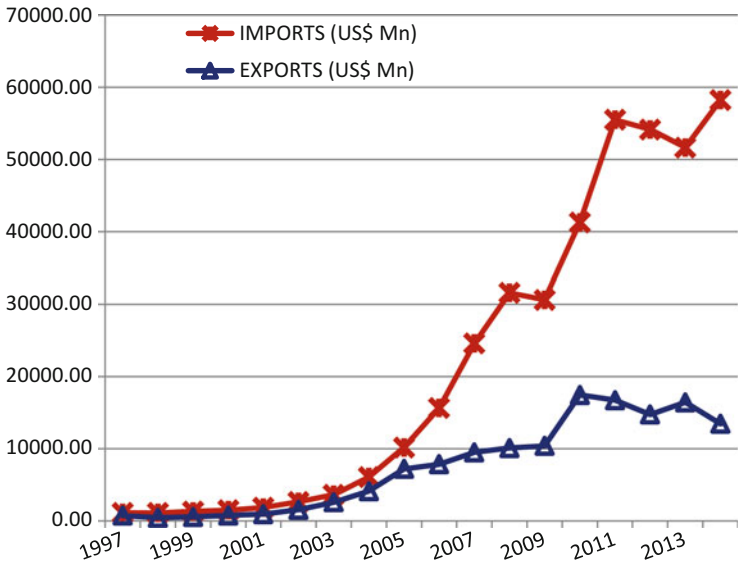

Fig. 6 India's trade with China 1997–2014 (US$ Mn). *Source*: Based on Table 3

Table 4 China to India trade 1998–2014 UN [Comtrade BEC Classification (US$ Mn)]

Year	Exports (US$ Mn)	Imports (US$ Mn)
1998	1016.67	905.71
1999	1161.93	825.75
2000	1560.74	1353.48
2001	1895.83	1699.09
2002	2671.16	2273.87
2003	3343.23	4251.38
2004	5936.01	7678.03
2005	8934.28	9766.22
2006	14581.30	10277.45
2007	24051.38	14617.16
2008	31585.38	20258.89
2009	29666.56	13714.29
2010	40913.96	20846.31
2011	50536.42	23372.28
2012	47677.45	18797.19
2013	48432.41	16970.27
2014	54220.38	16358.78

Source: Computed by author based on UN/Comtrade Database (2015)

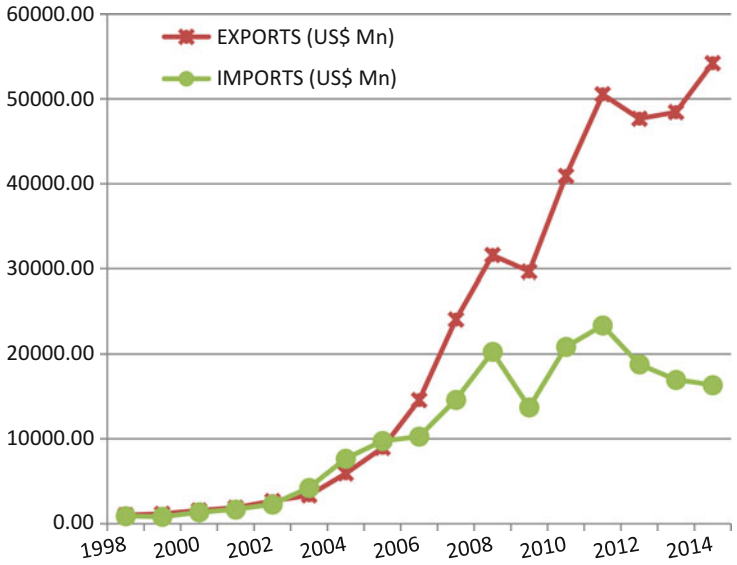

Fig. 7 China's trade with India 1998–2014 (US$ Mn). *Source*: Based on Table 4

The same summary conclusions are shown in Fig. 7, pointing to the urgent necessity on India's part to make its exports more competitive and for government to adopt a more proactive policy approach.

On a policy front, however, Indio–Chinese trade relations are set to receive a new fillip as a close monitoring of the recent mutual cordial overtures would suggest. The recent mutual visits by the Chinese and the Indian Premiere to their strategic neighbouring partners have seen a soaring of bilateral commercial agreements. Chinese investors have been taking active interest in India's bid to modernize its infrastructure framework including the railroad system, airports, roads and harbours. India and China have signed numerous deals in areas including renewable energy, ports, financing, telecommunications and film, and the eventually signed trade agreement in May 2015 was worth more than US$22 billion (Reuters and Deutsche-Welle 2015).

3.1.1 Regional and Subregional Alignments: FTAs, TTP and RCEP

As the financial turmoil in the arena of global trade has continued with the world market seeing unprecedented upheaval, various free trade agreements across major global players have however continued to be floated and given actual shape. A brief overview is in order of the relevant partnerships taking shape within the ever-active dynamics of today's global trading arena.

The year 2011 saw the nine Trans-Pacific Partnership countries—Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam and the United States—come together to announce an overall framework for a twenty-first-century Trans-Pacific Partnership (TPP) agreement, aiming to present "an ambitious, next-generation, Asia-Pacific trade agreement that reflects US economic priorities and values" (Lavelle 2013, p. 1). Plans were also being mulled for some time for a free trade zone between the United States and the EU, both having been badly impacted by the global crisis.

Analysts like Lavelle (2013) have discerned an obvious "political calculus" behind the purposeful exclusion of BRICS countries from the proposed US–EU free trade zones and TPP (the Washington-based Trans-Pacific Partnership) forums:

> *. . . "without the constructive participation of the BRICS and other emerging economies there is little prospect the west will continue to be able to drive global trade flows. The BRICS today have the wealth, consumption power, geopolitical position, expertise and the political will to influence and re-arrange the global system to their net advantage. And there is the obvious unintended consequence: targeted by the US–EU deal and excluded from Trans-Pacific Partnership will only push the BRICS world closer together."* (Lavelle 2013, pp. 3)

However, in a parallel and no less significant turn of events, the Regional Comprehensive Economic Partnership (RCEP), led principally by China, has sought to forge an equally formidable link across 16 Asia-Pacific countries (the 10 ASEAN nations, along with FTA partners, China, India, Japan, Korea, Australia and New Zealand) conspicuously leaving out the United States.

As Dhar (2012, p. 2) puts it,

> *RCEP is aimed at establishing the centrality of ASEAN in the economic dynamics of Asia. For more than 15 years, since the decision by ASEAN member states to create an FTA, the*

grouping has sought to position itself as the hub in the Asian region. In order to realize this objective, the grouping adopted a carefully crafted two-pronged strategy. The first was to engage in a process of regional economic integration, the culmination of which will be the formation of FTAs with all the countries in its immediate neighbourhood; India, Japan, China, Korea, Australia and New Zealand. In a way, the grouping had succeeded in forming the hub and spoke structure by reaching out to all its major partner countries. There was, however, one major weakness in this structure—the level of economic integration was not even. While with China, Korea, Australia and New Zealand, integration was fairly deep for it included not only the goods sector, but services and investment as well. With India and Japan, the integration was rather shallow: very little progress beyond a FTA in goods has been achieved.

Further … "For RCEP to materialize, several challenges will have to be overcome. The most significant being the proposed trilateral free trade agreement between China, Japan and Korea (CJK-FTA). The CJK-FTA will be the third largest FTA next to only the North American Free Trade Agreement (NAFTA) and the European Union (EU), and which according to some estimates, would cover a population of 1.5 billion and would represent 70 % of the Asian economic aggregate". (ibid)

So far as India's own participation in the RCEP is concerned, some analysts are worried about the even further widening of India's trade deficit that could result from its joining the RCEP. India's attempts to seek "differential schedules" with particularly ASEAN nations have found support from China and South Korea. The difficulty is the potential challenges and obstacles such factors could pose towards a successful and timely conclusion of the eagerly awaited RCEP negotiations around December 2015.

4 Development and Institutions

A distinctive feature that we discuss in this chapter is the aspect of freedom in economic life, traditionally less discussed but of late finding increasingly keen attention in current research at the international level (Bardhan 2014; Cebula et al. 2012; Dasgupta 2013; among others). A multidimensional concept defined and developed by the WSJ- Heritage Foundation (2015) and widely employed in international research, this aspect is nonetheless as yet somewhat under-represented in the literature pertaining to middle- or low-income countries. And yet, commentators have often discussed the challenges posed by the long-standing institutional problems of India—especially corruption and a "bloated bureaucracy" as potentially formidable obstacles, a factor that is indispensably linked with the concept of economic freedom.

What is the relevance of the concept in the context of the present chapter? There is, in fact, more than one sound justification for including the idea here, although the limited scope of this chapter rules out the detailed treatment that the analysis deserves. Restricting ourselves to a general overview and some essential overall

conclusions, we first explain our decision to discuss the concept of freedom in economic life:

1. The first justification, in our opinion, is provided by the explicit recognition of the index by the leading economist Bardhan (2014) in his truly authoritative treatise on the Chinese and the Indian economies. Since we too are discussing the complex interaction of the same two economies, reference to this aspect appears eminently pertinent.
2. As the very notion of development is continuing to acquire ever newer dimensions, the emphasis by OECD, from its last year's key theme (2014) of "Beyond the Middle-Income Trap" to the institutional aspect this year (2015), marks the utter indispensability of institutional arrangements and policy with which, again, the very basics of economic freedom are innately linked.

In the limited space of the present chapter, all we do is briefly indicate the concept and then go on to look at the overall evidence on freedom and its selected aspects deemed sufficiently important.

4.1 Indicators of Freedom in Economic Life: A Brief Overview[3]

The WSJ-Heritage Foundation (2015) defines and enumerates an array of "Freedom Indices", employed to categorize countries into varying degrees of "freedom" encompassing specific aspects of economic life. The Index of Economic Freedom is constructed on the basis of ten specific components of economic freedom, which, in turn, are based on the following four key categories:

- The "rule of law" aspect: comprising property rights and freedom from corruption
- "Limited government", represented through "fiscal freedom" (as given by relatively lower presence of government in the economy), and "freedom from government spending"
- "Regulatory efficiency", comprising business freedom ("a quantitative measure of the ability to start, operate and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process", Heritage 2015), labour freedom and monetary freedom
- Finally, the degree of openness of markets: as depicted by trade freedom ("a composite measure of the absence of tariff and non-tariff barriers", Heritage 2015), investment freedom and financial freedom

[3] The general conceptual background in this section is mainly based on Heritage Foundation (2015) and Dasgupta (2013).

Table 5 Range of freedom index and country diagnosis

Index range	Country location on the freedom scale
$\varphi < 50$	"Repressed"
$50 \leq \varphi < 60$	"Mostly unfree"
$60 \leq \varphi < 70$	"Moderately free"
$70 \leq \varphi < 80$	"Mostly free"
$80 \leq \varphi \leq 100$	"Free"

Source: Dasgupta (2013)

A weighted average of the ten components enumerated above is used to arrive at an overall economic freedom score for each economy, where each of the ten components of economic freedom can take a value between 0 and 100. Based on the value of the overall index (φ), the range of positions for an economy on the "freedom scale" can be located as in Table 5.

As Table 5 indicates, for any country (or country group), the score for each of the ten individual freedom indicators has been computed, according to which countries can be assigned their place in the appropriate "freedom range". Over the time period in question (1995–2014), for instance, Hong Kong and Singapore have consistently ranked at the top of the world with scores in the range of 90 and above, making them the two freest nations (see Heritage 2015).

Overall freedom indicators specifically for China and India are given in Table 6. The same information, presented in Fig. 7, brings out the essential trends in a visually obvious and instantly graspable manner.

Of the range of ten (10) individual components of economic freedom as outlined in page 30, we focus here on "overall freedom" for an understanding of the relevant basic issues. As Table 6 and Fig. 8 clearly show, so far as index of overall freedom is concerned, China has, throughout the study period of 1995–2014, remained firmly in the "mostly unfree" zone and experienced a gradual overall decline in its freedom score and ranking over the span of years. India, on the other hand, after starting from the "repressed" category in 1995, has eventually climbed up to the "mostly unfree" zone and overtaken China. Both countries, however, have all along stayed below the world average, the latter being a weighted average of all countries (for which data could be available) ranging from the "free" and "mostly free" to "repressed" on the other end of the scale.

China, having begun in 1995 at a higher score (52) and rank (71) than India (score 45.1 and rank 87), continued to outpace the latter till 2000 when the score and rank divergence between the two was the largest, after which India, in its turn, showed a gradual increase in its freedom score from below 50 ("repressed" region) to move up towards the "60" mark by 2014.

The above empirical findings, however brief, do throw some interesting light on our economies of concern. The rather low freedom scores, perhaps not very unexpected so far as China is concerned, are probably rather more surprising in case of India—which has long prided itself on its legacy of democratic polity and widely known as having emphatically started on the path to market reforms and globalization. Indeed, both China and India present interesting cases in point, as,

Table 6 Index of "overall economic freedom": 1995–2014 (China, India and the world average)

	China		India		
Year	Score	Rank	Score	Rank	World average
1995	52.0	71	45.1	87	57.6
1996	51.3	97	47.4	112	57.1
1997	51.7	107	49.7	112	57.3
1998	53.1	105	49.7	116	57.2
1999	54.8	103	50.2	120	57.6
2000	56.4	97	47.4	130	58.1
2001	52.6	114	49.0	127	59.2
2002	52.8	116	51.2	123	59.2
2003	52.6	120	51.2	127	59.6
2004	52.5	124	51.5	127	59.6
2005	53.7	113	54.2	108	59.6
2006	53.6	117	52.2	130	59.9
2007	52.0	133	53.9	119	60.1
2008	53.0	123	54.0	116	60.2
2009	53.2	132	54.3	123	59.5
2010	51.0	139	53.8	124	59.4
2011	52.0	135	54.6	124	59.7
2012	51.2	138	54.6	123	59.5
2013	51.9	136	55.2	119	59.6
2014	52.5	137	55.7	119	60.3

Source: Computed by author based on Heritage Foundation (2015)

despite being anointed jointly as the new "poster children for market reform and globalization" (Bardhan 2014), the two economies have nevertheless managed to bypass many of the reforms relating to privatization and deregulation prescribed by mainstream policy—a fact that is amply demonstrated by the rather low scores on the economic freedom front these two economies command and their placement in the "mostly unfree" category among the world.

As for the individual components that are used together to compute this "overall freedom" index, the reader is urged to refer to http://www.heritage.org/index/visualize for a fuller and comprehensive understanding of how various separate indicators have moved over time for each of the countries under study. Supplementing this brief overview with a more detailed look into the individual components of economic freedom, preferably over some length of time, would be beyond the scope of the present chapter and is reserved for future research. The reader may be referred to Dasgupta (2013) for an in-depth comparative assessment of the various freedom indicators of Singapore and India using time series data over 1995–2013.

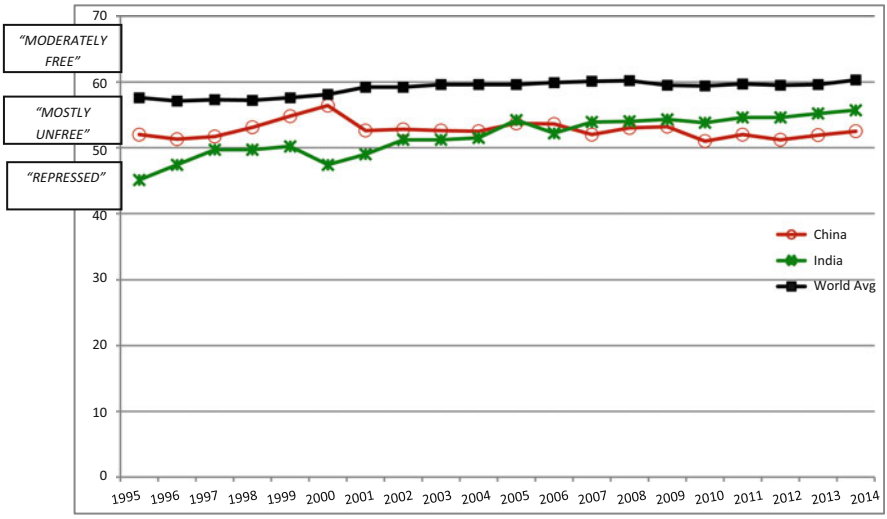

Fig. 8 Index of overall economic freedom: China and India (1995–2014). *Source*: Based on Table

5 Economic Freedom and Economic Performance

A natural and legitimate question at this point would be what, if any, is the relationship between performance on the freedom front and that on the economic front? Unfortunately, the answer is not quite straightforward. While Cebula et al. (2012) have found support for the hypothesis that higher economic growth tends to correlate with better freedom scores, this is neither always obvious nor applicable to all country groups. Reference has already been made to the observation by Bardhan (2014) as to how, in spite of being diagnosed as "mostly unfree", economic performance, in particular growth record of both China and India, has been much ahead compared to most relatively freer economies, so that drawing any overall conclusion would be difficult and one has to proceed on a case-by-case manner. The suggested analysis here calls for detailed time series analysis, possibly using panel data and cointegration and ECM techniques.

6 Concluding Remarks: A New Era in India–China Relationship?

As we conclude this discussion, India and China, the two major emerging players in today's global shifting scenario who have always shared a unique and highly complex economic and strategic relationship, are looking ahead and preparing for

their crucial next meeting over the RCEP negotiations later this year. India and China, two of the most keenly observed emerging players in the post-global-crisis scenario and followed closely with avid scrutiny (and specially in case of China, rather apprehensive portents) by erstwhile "super-powers" like the United States who have a clear stake in power and strategic issues, have all along shared an extremely intriguing mutual relationship. An altogether new era, however, has been marked between the current liberalized and post-reforms globalizing nations, as clearly evidenced by the recent series of cordial and meaningful meetings between the heads of the Chinese and the Indian nation.

With both the Chinese and Indian Premieres proactively participating in constructive and mutual concern areas and visiting each other's countries for meaningful and effective deliberations, conscientious attempts at resolving long-standing disputes that have so long provided ammunition to the speculations by global watchdogs can indeed be expected, though such an optimistic scenario is not without its own formidable challenges. Both nations are now, however, conscious more than ever before of presenting a concerted front before their Western counterparts, to recognize areas of mutual symbiotic cooperation.

The Chinese Premier's visit to India, followed by Indian Prime Minister Narendra Modi's May 2015 visit to China, has been fruitful in building mutual cordial understanding, as also in securing billions in trade deals (Reuters and Deutsche Welle 2015). The two premiers were also candid and forthcoming enough in discussing old border disputes, "a long legacy that always posed obstacles in the path of bilateral ties" (ibid), and "as the two Asian powerhouses sought to strengthen economic ties following decades of animosity.... The move signals that the world's two most populous nations may finally set aside mistrust over a long-festering border dispute to sign trade deals worth billions" (Reuters 2015). Chinese investors have been taking active interest in India's bid to modernize its infrastructure framework including the railroad system, airports, roads and harbours. India and China have signed numerous deals in areas including renewable energy, ports, financing, telecommunications and film, and the eventually signed trade agreement in May 2015 was worth more than US$22 billion.

Thus, the already existing historical connection that India had shared with its East Asian counterpart, reflected in shared history, culture and values but interrupted by a series of unfortunate disputes and war, is now being sought to be bolstered by realism and a set of mutually reciprocal concerns. Current developments all around are only underscoring the vital need for economies in the Asian and Asia-Pacific region to come together closer than ever before and forge stronger mutual alliances that can stand up to the challenges of the Western world besieged by its own post-crisis problems. China's support for India in the RCEP negotiations, one feels, is an auspicious beginning for further mutually beneficial understanding and increasingly more proactive policy approach to strengthen Sino–Indian ties.

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Economic Cooperation and Interdependence Between China and ASEAN: Two to Tango?

Fengming Qin, Tao Xu, and Zhaoyong Zhang

1 Introduction

The Association of Southeast Asian Nations (ASEAN) was founded in August 1967 at the leaders' meeting in Bangkok, with Indonesia, Malaysia, the Philippines, Singapore and Thailand being the founding nations and Brunei becoming the sixth member in 1984. ASEAN has since expanded into ten member states when it was joined by Vietnam in 1995, Lao PDR and Myanmar in 1997 and Cambodia in 1999. The basic objectives of ASEAN are to promote regional cooperation in security and politics as well as closer economic integration, social progress and cultural development of the region. With the implementation of ASEAN Free Trade Agreement (AFTA) since 1993, especially the ambitious target of creating an ASEAN Economic Community (AEC) allowing goods, services, capital and skilled labour to move freely across borders by 2015, ASEAN will be the largest regional integration in the developing world.

China's trade and economic relations with the countries of ASEAN have been long-standing, especially since the early 1990s when China established diplomatic relations with all the remaining ASEAN states and formal ties were established between China and ASEAN. At the Fifth China–ASEAN Summit in Brunei in November 2001, China proposed the establishment of a China–ASEAN Free Trade Area (CAFTA) to promote intra-regional free trade and investment, which was regarded as an important pillar to deepen economic relations and integration between ASEAN and China. This agreement was signed off in 2002 and aimed to

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establish a free trade area by 2010 between China and the six original ASEAN member states, including Brunei, Indonesia, the Philippines, Malaysia, Thailand and Singapore, and eventually to include the remaining ASEAN states of the Laos, Cambodia, Myanmar and Vietnam by 2015. With the implementation of the CAFTA in 2010, the average tariff rate on Chinese goods exported to ASEAN fell from 12.8 to 0.6 %, while the tariff rate on ASEAN goods exported to China also fell from 9.8 to 0.1 %. By 2015 when the free trade agreement is fully implemented, it is expected that the CAFTA will not only shape the trade relations between China and ASEAN but also the existing regional production networks and economic integration in the region.

The rise of China as a large trading nation in recent years creates both challenges and opportunities to ASEAN. In recent years, driven by the rapidly growing Chinese economy, East Asia has been forging closer economic ties than ever before, led to a new form of international specialisation in the region, characterised by its intricate global production sharing and intra-regional network trade. These networks have allowed firms to exploit comparative advantage by slicing up long production processes and allocating the production blocks throughout the East Asian region, with China being the manufacturing centre mainly for assembly by lower-skilled workers and exports of finished products throughout the world (Kimura and Ando 2005; Athukorala 2010; Thorbecke and Smith 2010; De Grauwe and Zhang 2012). Within this context, it is essential to reassess the dynamic relations of trade and investment between China and ASEAN and examine the impacts of the CAFTA on both economies. The purpose of this paper is to examine the economic cooperation and interdependence between China and ASEAN through trade and flows of investment in the context of increasing significance of regional production fragmentation. In particular, we assess the dynamic development of China–ASEAN economic relations and examine the changes in bilateral trade flows and trade patterns between China and ASEAN. The paper further investigates more closely how the China–ASEAN Free Trade Agreement will eventually reshape production and trade relationships between China and the ASEAN member countries. It also sheds light on the opportunities and challenges brought forth to both parties for further development of economic relations and cooperation due to their structural similarity in trade and lack of economic complementarity.

The remainder of this paper is organised as follows. In Sect. 2, we review the trade relations and discuss the trade pattern and the economic interdependence between China and the ASEAN countries. Section 3 assesses the structures of the ASEAN–China trade and examines their revealed comparative advantage at industrial level, followed by an analysis of the recent development of cross-border direct investment. The final section contains some concluding remarks and implications for the future development of ASEAN–China economic interdependence.

2 Economic Relations and Interdependence Between China and ASEAN

Whether the economies of ASEAN and China compete or complement each other has been hotly debated, especially since China regained its WTO membership and officially proposed to set up the CAFTA in 2001, but yet conclusive (see, for instance, Zhang and Ow 1996, Ravenhill 2006, Park et al. 2008, Greenaway et al. 2008 and Aslam 2012). Most of the studies tend to agree that ASEAN–China economic and trade relations are dynamic and diversified and the benefits derived from closer economic integration between ASEAN and China hinges on the evolving dynamic economic relationship and what implications to individual countries. A closer look at their economic performance reveals that ASEAN and China are arguably the most dynamic economies in the world today, and both have experienced phenomenal growth in recent decades. As presented in Fig. 1, China has enjoyed an average growth rate of about 10 % over the past two decades, a rate which has never been achieved by any other economy in the world and almost doubled the average rate of ASEAN during the same period. It is also noted that both the East Asian financial crisis in 1997 and the global financial crisis (GFC) in 2008 have had a much profound impact on the ASEAN economies, which have caused the cyclical fluctuations of growth and led most of the ASEAN countries to recession. Despite of the debate over the complementary and competitive economic relations, one may have to agree that China's openness to the outside world and rapid economic expansion provide the world, especially ASEAN countries, with certain opportunities for expanded trade and greater outlets for their direct investment. The high degree of integration through the flows of trade and capital between ASEAN and China will further reshape the economic structure of each individual economy and contribute to the business cycle synchronisation and co-movements of real output. A number of recent studies have confirmed that China's growth

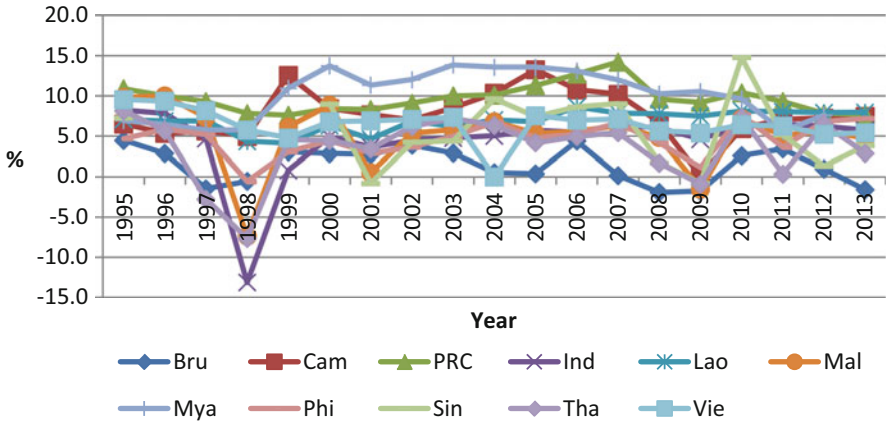

Fig. 1 Real GDP growth in ASEAN and China, 1995–2013

shocks have sizeable international spillovers and China's output co-movements with its East Asian neighbours have increased in recent years (see Sato and Zhang 2006, Sato et al. 2011 and Duval et al. 2014).

The economies of ASEAN and China differ markedly in economic size, system and development strategy at country level, and these differences have been acting both as a "pushing" force to stimulating the development of bilateral trade relations between ASEAN and China and also as a "resisting" force to limiting the trade expansion (Zhang and Ow 1996). Although ASEAN is a diverse group of economies, it has an aggregate economic size of US$2.3 trillion with an estimated GDP per capita of US$3745 and a combined population of 616 million in 2012. Geographically ASEAN is located at the heart of the Asia-Pacific region and situated across major trade routes with over US$5.3 trillion of global trade passes through its waterways each year. These are the strong pulling factors for goods and capital from China.

One most notable feature in the economic development of both ASEAN and China is the significant role played by foreign trade in driving their economic growth. Most of the ASEAN economies have traditionally been open and outward-looking, with foreign trade, technology and direct investment playing a crucial role in their economic growth. Singapore is arguably one of the most open economies in the world, with a trade/GDP ratio ranging from 311 to 440 % in 1990–2013. The trade/GDP ratios of other founding ASEAN countries are all above 100 % except Indonesia. Although the Chinese economy was traditionally closed and inward looking, China's over three-decade-long economic reforms have successfully transformed itself into an important trading nation and manufacturing centre in the world. China's trade/GDP ratio has gone up rapidly since its accession of WTO membership in 2001, peaked at about 70 % prior to the GFC. In 2009 China surpassed Germany and became the world's number one exporter and further surpassed the USA and became the world's biggest goods trading nation amounting to US$4.16 trillion in 2013. According to WTO, as the world's leading merchandise exporter since 2009, China's share of world exports climbed to over 11.74 % and its imports accounted for 10.32 % of the world total in 2013.

We report in Table 1 the changes of the trade pattern of ASEAN-6 and China in selected years from 1990 to 2013. Due to incomplete data and space limitation, we have excluded the four new member countries of ASEAN in the table. As it can be seen in Table 1, Both ASEAN and China have a very similar market structure of foreign trade. Traditionally the ASEAN countries were heavily dependent on the US, Japan and EU markets as an outlet for their imports and exports, and the emerging and developing countries, especially China, were relatively not so important to ASEAN. Since the late 1990s, especially since China's accession to WTO, there has been a dramatic change in their trade pattern, both ASEAN and China showing a steady decline in the shares of their imports from and exports going to the advanced countries but a steady rise in their trade share with the emerging developing countries, in particular, in terms of both intra-ASEAN and bilateral trade between ASEAN and China. It is interesting to note from Table 1 that, among the advanced economies, the Japanese market is particularly important for those

Table 1 ASEAN and China: percentage distribution of trade by major destination

		Advanced economies				Less developed economies		
		Total	USA	EU	Japan	EDCs	ASEAN	China
Exports								
Brunei	1990	75.47	3.41	0.24	58.10	14.06	20.93	0.14
	2000	74.46	11.96	3.62	40.67	17.99	23.16	1.76
	2010	79.33	0.15	0.09	45.21	19.23	10.53	7.04
	2013	72.74	0.15	0.10	42.15	21.21	19.29	2.71
Indonesia	1990	80.53	15.84	11.12	42.17	10.72	11.18	2.44
	2000	67.77	13.66	14.41	23.20	21.60	17.52	4.46
	2010	57.12	9.06	10.90	16.34	39.12	21.14	9.95
	2013	46.50	8.62	9.21	14.84	44.35	22.26	12.38
Malaysia	1990	60.56	16.95	15.52	15.31	16.47	29.45	2.10
	2000	62.88	20.54	14.01	13.02	18.70	26.56	3.09
	2010	47.39	9.55	10.78	10.46	39.21	25.37	12.53
	2013	43.98	8.09	9.08	11.09	42.01	28.05	13.45
Philippines	1990	88.64	37.87	18.54	19.79	8.39	7.27	0.75
	2000	80.04	29.85	18.11	14.68	11.78	15.65	1.74
	2010	61.80	14.71	14.42	15.22	23.94	22.47	11.09
	2013	67.37	14.51	11.44	21.16	25.14	15.96	12.19
Singapore	1990	62.26	21.25	15.64	8.75	37.68	22.35	1.51
	2000	59.66	17.31	14.00	7.54	40.18	27.36	3.90
	2010	45.37	6.53	10.01	4.66	54.62	30.26	10.36
	2013	42.29	5.84	7.86	4.29	57.69	31.38	11.78
Thailand	1990	75.13	22.72	23.38	17.21	16.78	11.92	1.17
	2000	67.69	21.32	16.30	14.74	22.92	19.34	4.07
	2010	49.56	10.47	11.18	10.51	45.45	22.93	11.11
	2013	45.00	10.07	9.71	9.73	49.35	25.95	11.92
China	1990	79.57	8.47	10.58	14.68	15.48	6.61	–
	2000	81.31	20.93	16.51	16.71	16.10	6.96	–
	2010	68.08	17.97	19.82	7.62	29.55	8.76	–
	2013	64.89	16.69	15.35	6.78	32.77	11.03	–
Imports								
Brunei	1990	53.27	15.28	18.09	14.57	2.70	62.57	2.70
	2000	35.10	10.78	15.78	4.72	1.18	57.64	1.18
	2010	30.27	4.36	13.84	5.25	12.89	56.35	12.89
	2013	33.45	7.24	21.12	1.97	22.08	43.36	22.08
Indonesia	1990	77.62	11.45	20.71	24.79	15.94	8.44	2.97
	2000	58.07	10.12	12.59	16.10	29.73	19.35	6.03
	2010	40.91	6.94	7.28	12.51	44.07	28.68	15.05
	2013	36.84	4.87	7.35	10.33	49.35	28.85	15.99
Malaysia	1990	73.65	16.95	16.07	24.18	11.37	19.07	1.92
	2000	65.42	16.63	11.04	21.08	18.40	24.02	3.94
	2010	49.22	10.64	10.24	12.58	38.84	27.10	12.55
	2013	42.86	7.85	10.86	8.68	43.99	26.64	16.37

(continued)

Table 1 (continued)

		Advanced economies				Less developed economies		
		Total	USA	EU	Japan	EDCs	ASEAN	China
Philippines	1990	70.87	19.54	12.14	18.44	25.14	10.57	1.40
	2000	70.33	18.59	9.17	18.88	22.92	15.55	2.28
	2010	50.60	10.72	7.27	12.33	39.92	28.04	8.42
	2013	50.77	10.82	10.12	8.44	42.39	21.75	12.99
Singapore	1990	64.73	16.08	14.03	20.12	35.26	17.12	3.44
	2000	58.97	15.06	11.97	17.22	40.59	24.72	5.29
	2010	47.63	11.46	12.34	7.87	52.37	24.00	10.83
	2013	46.42	10.42	12.36	5.47	53.57	20.88	11.71
Thailand	1990	72.50	10.78	16.72	30.36	19.20	13.08	3.31
	2000	60.92	11.77	10.48	24.73	31.58	16.66	5.45
	2010	50.29	5.88	7.56	20.70	44.98	16.60	13.25
	2013	45.11	5.87	8.76	16.41	50.54	16.68	15.06
China	1990	81.76	12.25	18.27	14.23	15.02	5.82	–
	2000	73.00	9.94	13.70	18.44	21.51	9.85	–
	2010	57.21	7.31	12.09	12.65	31.87	11.07	–
	2013	54.58	7.54	11.27	8.32	34.55	10.20	–

Sources: IMF Direction of Trade, CEIC, with authors' calculations

countries, such as Brunei, Indonesia and the Philippines, endowed with rich natural resources, but has seen a steady falling share for the leading exporters of manufactured goods in ASEAN, such as Singapore, Malaysia and Thailand. The market share of Japan in China's total exports showed a steady increase in the 1990s, reached about 17 % in 2000, and since then experienced a rapid fall eventually to 6.78 % of China's total exports by 2013. In contrast, both the EU and the USA have seen a steady rise in the share of China's exports, almost doubled in 1990–2010, which explains to a certain extent the competition between ASEAN and China in the third market. The import pattern of both ASEAN and China appeared symmetrically to their export pattern during the period, with a declining trend of dependence on the advanced economies and increasingly on the emerging developing economies.

In contrast to the declining trend of trade relations with the advanced countries, intra-regional trade and economic ties between ASEAN and China have been strengthened and substantially deepened since the 1990s, thanks to the rising East Asian economic integration and rapid urbanisation and economic growth in China.

As seen in Table 1, the Chinese market is more important as a source of imports than as an outlet of exports to most of the ASEAN countries. The market share of China in their total exports showed a sharp increase in the 2000s, all reached about 12 % in 2013 with the exception of Brunei from around one per cent in 1990. As an important source of imports, China accounted for over 22 % of Brunei's global imports in 2013, rising from only about 2 % in the 1990s and similarly over 15 %

for Indonesia, Malaysia and Thailand and around 12 % for the Philippines and Singapore in 2013. ASEAN trade with China has in general been underestimated as the figures did not capture the volume of trade diverted to and transacted via third countries, especially through Hong Kong, as well as cross-border trade between China and its ASEAN neighbours such as Myanmar, the Laos and Vietnam.

Overall, since 1990, two-way trade between China and ASEAN-10 has grown at an annual average of close to 20 %, amounting to about US$443 billion in 2013. China has been ASEAN's largest trading partner since 2009, with more than 16 % of imports coming from China in 2013, while ASEAN continues to be China's third-largest trading partner since 2010. With CAFTA and further economic integration, bilateral trade between the two economic entities is expected to achieve US $500 billion by 2015 and $1 trillion by 2020.

To further assess the trade interdependence between ASEAN and China, we report in Table 2 the relative importance of bilateral trade in each other's total imports and exports. As seen in Table 2, trade and economic interdependence between ASEAN and China is rapidly increasing since 2000, especially after CAFTA was proposed and implemented, relative to their earlier trade with each other. Some recent empirical study also confirms that CAFTA leads to substantial and significant trade creation, especially in agricultural and manufactured goods, including chemical products and machinery and transport equipment (Yang and Zarzoso 2014). One can note from Table 2 that China has become increasingly an important economic partner for ASEAN, and China is much more important as a source of supply for imports of the ASEAN countries rather than as an outlet for ASEAN's exports. ASEAN as a whole shipped over 10–12 % of its total exports to China in 2010–2013, while it imported back about 14–16 % of its total imports from the Chinese market in the same period. This contrasts to an average 2 % of exporting to China and 2.8 % of imports from China during the early 1990s (Zhang and Ow 1996). China's dependence on the ASEAN market as the source of import supply has steadily increased from about 5 % in 1990 to about 8 % by 2013, while as an outlet for China's exports, ASEAN's share has increased to 9.3 % by 2013 from 7.6 % in 1990.

The process of asymmetric trade interdependence between ASEAN and China is even more radical at the country level. Without considering the size effect, one can note in Table 2 that almost all ASEAN member countries have experienced a dramatic increase in their dependence on the Chinese market as both an outlet for their exports and a source of imports, a result confirming how ASEAN can benefit from the closer integration with China, but China's relative dependence on ASEAN market is more or less staying the same. China has become the most important trading partner of almost every country. Malaysia, the Philippines, Singapore and Thailand each shipped only about 1–2 % of their exports to China in 1990, but by 2013 their shares of exports going to China climbed up to around 12 %. Market shares of these countries for China's exports have increased steadily, up from 1.3–3.4 % in 1990 to 16.4 % for Malaysia and 12 % in Singapore in 2013. The new ASEAN member countries are even becoming more dependent on the Chinese market. The proportion of Myanmar's exports to China increased sharply to about

Table 2 Relative trade interdependence between ASEAN and China (in percentage)

	1990	2000	2010	2011	2012	2013	1990	2000	2010	2011	2012	2013
	Exports to China as % of total Chinese imports						Exports to China as % of the exporting country's total exports					
ASEAN	4.893	7.273	8.151	8.141	7.823	7.815	1.824	3.836	10.863	11.501	11.377	12.066
Brunei	0.006	0.025	0.042	0.029	0.018	0.004	0.145	1.762	7.040	4.446	2.714	0.766
Indonesia	1.551	1.229	1.126	1.317	1.192	1.159	3.249	4.455	9.946	11.273	11.398	12.381
Malaysia	1.151	1.345	1.787	1.720	1.584	1.575	2.105	3.085	12.534	13.121	12.637	13.447
Philippines	0.115	0.295	0.409	0.350	0.339	0.338	0.754	1.736	11.086	12.702	11.846	12.195
Singapore	1.484	2.388	2.618	2.456	2.425	2.490	1.513	3.895	10.360	10.427	10.757	11.776
Thailand	0.499	1.246	1.541	1.491	1.469	1.375	1.165	4.069	11.108	11.792	11.717	11.921
Cambodia	0.000	0.011	0.005	0.009	0.010	0.014	0.386	1.738	1.163	2.306	2.333	3.033
Laos	0.011	0.003	0.037	0.042	0.039	0.048	9.083	1.492	23.267	23.360	21.455	23.280
Myanmar	0.062	0.050	0.063	0.088	0.065	0.131	8.144	5.730	13.536	18.335	14.288	24.484
Vietnam	0.014	0.682	0.524	0.639	0.682	0.680	0.308	10.608	10.468	11.978	11.181	10.469
	Imports from China as % of total Chinese exports						Imports from China as % of the importing country's total imports					
ASEAN	7.625	7.485	8.257	8.381	8.907	9.296	2.931	5.055	13.555	13.701	14.771	16.338
Brunei	0.043	0.007	0.026	0.043	0.067	0.085	2.702	1.184	12.893	12.784	21.337	22.081
Indonesia	1.040	0.811	1.294	1.380	1.433	1.350	2.967	6.033	15.055	14.773	15.330	15.994
Malaysia	0.894	1.299	1.310	1.303	1.452	1.526	1.922	3.938	12.555	13.189	15.139	16.369
Philippines	0.289	0.315	0.321	0.351	0.358	0.400	1.398	2.279	8.422	10.075	10.797	12.992
Singapore	3.338	2.855	2.133	2.002	1.912	1.976	3.436	5.286	10.829	10.386	10.315	11.709
Thailand	1.764	1.355	1.554	1.609	1.821	1.701	3.313	5.453	13.249	13.334	14.844	15.059
Cambodia	0.005	0.045	0.075	0.092	0.105	0.136	5.911	7.992	24.197	28.306	30.609	32.577
Laos	0.025	0.015	0.033	0.027	0.050	0.086	10.717	5.489	14.663	11.203	16.211	25.979
Myanmar	0.219	0.219	0.243	0.279	0.304	0.366	20.620	17.962	38.507	38.758	36.645	39.563
Vietnam	0.007	0.562	1.268	1.295	1.404	1.672	0.162	8.961	24.014	23.533	25.785	28.646

Sources: IMF Direction of Trade, CEIC, with authors' calculations

25 % in 2013 from 8 % in 1990, while its imports from China peaked at 40 % in 2013 from 20 % in 1990. A similar pattern can be noted for Cambodia, the Laos and Vietnam. In 1990, market share of Vietnam for China's exports was almost zero largely due to the border tension with China, but it has changed dramatically from 2000 onwards, reached about 29 % by 2013. These drastic changes in trade dependence of ASEAN countries on the Chinese market reflect both China's close engagement with the process of regional economic integration and industrial restructuring in the region, characterised by its intricate global production sharing and intra-regional network trade and the rapid rate of urbanisation and structural changes in China. Under the new international fragmentation of production and intra-regional networks, firms can exploit their comparative advantage by slicing up long production processes and allocating the production blocks throughout the region, with China being the manufacturing centre mainly for assembly by lower-skilled workers and exports of finished products throughout the world (Thorbecke and Smith 2010; De Grauwe and Zhang 2012). This conclusion is lent further support by looking at the result generated from the analysis of changes in comparative advantage and the flows of cross-border investment between ASEAN and China in the subsequent sections.

Studies in the past report that, besides the political and institutional factors (Yong 2013; Amrita 2013), similarity of trade structures between ASEAN and China is another crucial variable that limits the absorptive capacity of each other's products and obstructs to a certain degree the development of bilateral trade relations. We report in Tables 3 and 4 the export and import structures of ASEAN countries and China for selected years in 1995–2013 at the SITC two-digit level. With the exception of Brunei and also the new ASEAN members, it seems to be true that the other original ASEAN members within the broad trade structure of the classification all exhibit a high level of trade similarity with China, but a different pattern is rendered in their trade structure if one looks at the trade pattern at bilateral level (Tables 5 and 6). Traditionally most ASEAN countries were seen to export largely primary products in the 1970s and 1980s, ranging from 94 % in Malaysia and the Philippines to about 99–100 % in Indonesia and Brunei (Zhang and Ow 1996). As seen in Table 3, this export pattern has been changed remarkably since the 1990s, and exports of manufactured goods have grown rapidly in these countries, thanks to a series of macroeconomic policy adjustment adopted in these countries in favour of diversifying the composition of their exports. The export shares of manufactured goods peaked at 80.3 % in 1999 for Malaysia, about 92 % in 2002 for the Philippines, about 86 % in 1999 for Singapore and 76 % in 2005 for Thailand and began to fall thereafter. It is interesting to note that Brunei has diversified its sole export goods—fuels—to a share of about 12 % of manufactured exports in 2001, even though this share has declined continuously to 2 % in 2013. Of the manufactured exports, the traditional labour-intensive products and resource-based manufactures such as iron and steel (SITC 67) and textile fibres, yarn, fabrics and clothing (SITC 26 + 65 + 84) still account for a predominant share but with a declining trend in all countries (with the exception of Singapore, the Philippines and Malaysia) and some advances in machinery and

Table 3 Export structures of ASEAN and China (in percentage)

	All food items	Agricultural raw materials	Ores and metals	Fuels	Manufactured goods	Of which		
						Chemi. prod.	Machi. and trans.	Other machi.
SITC	(0 + 1 + 22 + 4)	[2 − (22 + 27 + 28)]	(3)	(27 + 28 + 68)	[(5 to 8) − (667 − 68)]	(5)	(7)	[6 + 8 − (667 + 68)]
Brunei								
1995	0.06	0.01	0.05	91.11	8.23	0.11	4.52	3.60
2000	0.04	0.01	0.03	89.34	10.45	0.05	4.00	6.40
2005	0.07	0.06	0.31	92.52	6.95	0.03	0.95	5.97
2010	0.10	0.05	0.18	97.71	1.82	0.03	0.65	1.14
2013	0.12	0.02	0.11	97.36	2.04	0.81	0.51	0.71
Cambodia								
1995	4.14	73.39	0.25	0.00	21.67	0.31	0.74	20.62
2000	1.34	4.32	0.23	0.00	93.50	0.05	0.49	92.96
2005	2.30	3.71	0.26	0.00	92.55	0.11	0.50	91.93
2010	3.33	3.96	1.83	0.00	89.61	0.25	3.71	85.65
2013	6.56	4.25	1.00	0.00	88.04	0.29	6.90	80.85
China								
1995	8.27	1.81	2.07	3.58	83.58	6.07	21.08	56.43
2000	5.44	1.13	1.84	3.15	87.98	4.85	33.15	49.98
2005	3.23	0.53	1.79	2.31	91.70	4.69	46.23	40.78
2010	2.80	0.47	1.36	1.69	93.44	5.55	49.51	38.39
2013	2.72	0.46	1.18	1.53	93.87	5.41	47.06	41.40
Indonesia								
1995	11.38	6.67	5.96	25.32	50.52	3.36	8.44	38.71
2000	8.89	3.60	4.90	25.26	56.68	5.10	17.33	34.25
2005	11.66	5.06	8.45	27.69	46.89	5.25	15.88	25.76

2010	16.24	6.55	9.79	29.64	37.01	5.17	12.44	19.40
2013	17.50	5.86	7.03	31.44	37.17	6.01	12.13	19.03
Laos								
1995	11.11	11.11	42.28	5.31	40.72	1.61	0.34	38.78
2000	7.64	7.64	31.71	1.36	56.88	0.20	17.49	39.19
2005	6.56	6.56	28.02	4.56	35.74	0.32	1.47	33.95
2010	7.38	17.04	44.09	13.85	17.58	1.24	2.22	14.13
2013	7.77	19.62	36.49	19.52	14.17	2.06	1.48	10.63
Malaysia								
1995	9.50	6.18	1.35	6.99	74.53	3.04	55.14	16.35
2000	5.54	2.62	1.04	9.62	80.32	3.83	62.52	13.97
2005	6.94	2.48	1.12	13.41	74.53	5.80	54.00	14.73
2010	11.88	2.65	1.95	15.85	66.99	6.37	43.93	16.68
2013	11.00	2.17	3.29	22.22	60.64	6.66	38.07	15.90
Myanmar								
1995	41.86	38.54	2.25	0.17	11.93	1.04	0.93	9.96
2000	20.04	22.19	3.31	6.05	46.75	0.49	1.32	44.93
2005	20.21	19.42	3.09	33.34	22.86	0.20	0.70	21.95
2010	17.28	9.35	0.79	33.90	4.83	0.02	0.05	4.77
2013	19.57	13.17	1.93	39.33	9.02	0.24	0.48	8.30
Philippines								
1995	12.83	1.25	4.27	1.51	40.81	1.96	2.18	16.67
2000	4.77	0.56	1.62	1.33	91.28	0.89	76.13	14.26
2005	6.07	0.54	2.27	1.88	89.04	1.34	74.39	13.31
2010	7.32	0.70	3.91	2.05	56.28	3.02	44.28	8.98
2013	10.82	1.08	6.38	3.94	77.18	4.57	54.59	18.01

(continued)

Table 3 (continued)

	All food items	Agricultural raw materials	Ores and metals	Fuels	Manufactured goods	Of which		
						Chemi. prod.	Machi. and trans.	Other machi.
SITC	(0 + 1 + 22 + 4)	[2 − (22 + 27 + 28)]	(3)	(27 + 28 + 68)	[(5 to 8) − (667 − 68)]	(5)	(7)	[6 + 8 − (667 + 68)]
Singapore								
1995	3.95	1.08	1.97	6.84	83.62	6.00	65.62	12.01
2000	2.24	0.46	1.12	7.36	85.26	6.96	67.41	10.88
2005	1.65	0.33	1.06	12.19	79.91	11.38	58.73	9.80
2010	1.95	0.29	1.18	16.12	72.10	11.29	51.05	9.76
2013	2.35	0.30	1.21	17.40	69.96	12.21	46.39	11.36
Thailand								
1995	19.26	5.38	0.62	0.72	70.93	4.41	33.66	32.86
2000	14.42	3.34	1.16	3.21	74.23	5.93	43.59	24.71
2005	11.64	4.54	1.24	4.33	75.69	8.09	44.68	22.92
2010	12.80	5.19	1.27	4.94	71.61	8.67	42.19	20.75
2013	12.85	4.81	1.29	6.26	72.20	10.66	41.74	19.80
Vietnam								
1995	30.22	3.13	0.47	17.96	43.68	1.06	7.03	35.58
2000	25.31	1.99	0.44	26.41	42.40	0.96	8.65	32.80
2005	20.24	3.12	0.57	25.76	49.79	1.64	9.65	38.50
2010	19.25	4.05	1.02	11.05	63.95	2.60	15.89	45.47
2013	16.83	3.39	0.80	11.14	67.75	3.22	22.78	41.75

Source: UNCTAD, with authors' calculations

Table 4 Import structures of ASEAN and China (in percentage)

							Of which	
	All food items	Agricultural raw materials	Ores and metals	Fuels	Manufactured goods	Chemi. prod.	Machi. and trans.	Other machi.
SITC	(0 + 1 + 22 + 4)	[2 − (22+27 + 28)]	(3)	(27 + 28 + 68)	[(5 to 8) − 667 − 68]	(5)	(7)	[6 + 8 − (667 + 68)]
Brunei								
1995	13.57	0.61	3.30	0.18	81.84	6.36	38.98	36.50
2000	17.87	0.26	1.20	0.21	80.28	7.72	30.81	41.76
2005	19.91	0.32	1.57	1.24	76.81	9.35	29.40	38.06
2010	18.71	0.29	1.42	1.62	77.26	10.08	29.33	37.84
2013	15.02	0.20	1.38	7.50	75.07	7.98	36.68	30.42
Cambodia								
1995	23.82	1.62	7.65	8.96	56.32	5.87	34.22	16.24
2000	11.42	2.47	0.27	17.27	66.21	6.14	15.26	44.81
2005	10.09	1.43	0.38	10.75	75.77	6.94	16.42	52.41
2010	11.38	0.88	0.51	12.52	60.96	5.79	16.71	38.46
2013	12.43	0.59	0.83	17.25	66.73	7.10	19.78	39.86
China								
1995	6.99	5.20	4.44	3.88	78.11	12.90	39.80	25.40
2000	4.02	4.67	5.91	9.17	75.13	13.42	40.84	20.86
2005	3.26	3.58	8.43	9.69	74.40	11.78	44.01	18.61
2010	4.27	3.49	13.33	13.54	63.74	10.70	39.38	13.66
2013	5.06	3.43	11.75	16.16	57.66	9.72	36.45	11.49
Indonesia								
1995	8.41	5.35	3.56	6.15	75.32	14.08	42.00	19.25
2000	8.08	5.91	3.02	14.01	66.02	14.43	32.83	18.77
2005	6.55	2.92	2.84	23.45	61.54	12.38	32.76	16.40

(continued)

Table 4 (continued)

	All food items	Agricultural raw materials	Ores and metals	Fuels	Manufactured goods	Of which		
						Chemi. prod.	Machi. and trans.	Other machi.
SITC	(0 + 1 + 22 + 4)	[2 − (22+27 + 28)]	(3)	(27 + 28 + 68)	[(5 to 8) − 667 − 68]	(5)	(7)	[6 + 8 − (667 + 68)]
2010	8.36	2.86	3.15	19.86	63.43	11.74	34.64	17.05
2013	8.31	2.54	2.90	23.33	61.09	11.96	30.78	18.35
Laos								
1995	17.62	0.20	0.78	7.72	69.09	6.74	35.07	27.28
2000	15.79	0.65	1.02	11.59	68.82	6.34	35.35	27.13
2005	14.12	0.56	0.57	18.33	62.32	7.51	30.00	24.80
2010	10.95	0.43	0.75	19.52	67.20	6.28	33.80	27.12
2013	10.89	0.35	0.46	17.00	70.27	5.35	47.23	17.69
Malaysia								
1995	4.78	1.23	3.20	2.25	83.38	7.12	59.95	16.30
2000	4.34	1.33	3.00	4.85	83.74	7.23	62.64	13.86
2005	5.13	1.19	3.63	8.07	78.97	7.83	57.49	13.65
2010	7.77	1.99	5.18	9.97	73.21	9.10	49.50	14.61
2013	7.58	2.11	5.99	16.19	65.81	9.04	42.66	14.10
Myanmar								
1995	21.69	0.66	0.54	3.97	71.03	9.51	32.81	28.70
2000	11.60	0.43	0.66	15.00	71.60	11.59	27.13	32.88
2005	10.89	0.58	0.98	19.20	68.30	11.59	27.60	29.11
2010	7.27	0.38	0.78	19.63	59.43	10.01	24.01	25.42
2013	10.91	0.66	0.87	24.65	62.86	10.49	23.57	28.80

Philippines								
1995	8.35	2.16	3.23	9.21	57.83	9.18	32.49	16.15
2000	7.02	1.37	2.47	11.07	77.91	8.04	56.53	13.33
2005	6.93	0.87	2.35	13.21	76.40	7.30	57.81	11.30
2010	11.03	0.64	3.79	16.94	66.80	9.55	47.07	10.18
2013	10.33	0.67	2.97	20.76	64.94	9.97	42.78	12.19
Singapore								
1995	4.58	0.89	2.27	8.06	82.60	6.45	57.87	18.28
2000	3.24	0.40	1.57	12.05	81.30	5.73	60.73	14.83
2005	2.82	0.38	1.59	17.74	75.13	6.23	55.79	13.12
2010	3.15	0.34	1.52	26.11	64.71	6.67	46.31	11.74
2013	3.47	0.37	1.54	31.34	60.88	6.76	41.60	12.52
Thailand								
1995	3.76	4.12	3.24	6.75	78.75	10.47	47.54	20.74
2000	4.32	2.92	3.05	12.19	74.36	11.02	45.01	18.34
2005	3.98	2.05	3.91	17.72	68.23	10.16	38.04	20.04
2010	4.71	1.86	4.67	17.36	66.47	10.91	35.25	20.31
2013	5.13	1.51	3.49	20.81	62.37	9.41	34.47	18.48
Vietnam								
1995	4.95	2.40	1.98	10.30	75.88	16.68	28.31	30.89
2000	5.21	2.91	2.28	13.51	72.54	15.30	30.01	27.23
2005	6.29	3.68	2.99	14.60	69.67	14.39	25.07	30.20
2010	8.59	3.52	4.79	9.60	71.94	14.70	29.19	28.05
2013	7.80	2.55	3.31	12.10	73.48	14.32	30.34	28.82

Source: UNCTAD, with authors' calculations

Table 5 Structures of ASEAN's exports to China (in percentage)

SITC	Primary commodities					Manufactured goods					Other manufactured goods		
	Total (0 + 1 + 2 + 3 + 4 + 68)	All food items (0 + 1 + 22 + 4)	Agri. raw materials (2 – 22 – 27 – 28)	Ores and metals (27 + 28 + 68)	Fuels (3)	Total [5 to 8 – (667 + 68)]	Chemical prod. (5)	Machi. and transp. equip. (7)	Electron excl. parts and components (751 + 752 + 761 + 762 + 763 + 775)	Parts and components for electrical and electronic goods (759 + 764 + 772 + 776)	Total [6 + 8 – (667 + 68)]	Iron and steel (67)	Textile fibres, yarn, fabrics and clothing (26 + 65 + 84)
Brunei													
1995	1.09	1.09	–	–	–	28.26	1.09	–	–	–	27.17	–	2.17
2000	99.56	–	0.08	0.07	99.41	0.43	–	0.02	–	–	0.41	0.01	0.02
2005	99.94	0.00	0.00	0.00	99.93	0.06	0.00	0.04	0.00	0.01	0.02	0.00	0.01
2010	99.86	0.65	0.03	0.07	99.10	0.14	0.00	0.07	0.00	0.01	0.07	0.00	0.03
2013	88.29	0.32	1.35	0.00	86.62	11.57	11.38	0.03	0.00	0.02	0.16	–	0.02
Cambodia													
1995	46.46	6.27	40.19	–	–	53.54	–	–	–	–	53.54	–	–
2000	13.59	2.49	11.10	0.01	–	86.41	0.01	0.07	–	–	86.33	–	4.00
2005	42.71	4.20	38.48	0.03	–	57.28	3.78	1.47	–	0.37	52.03	0.04	41.61
2010	68.53	2.64	64.81	1.07	–	31.06	1.07	1.59	0.01	0.08	28.40	–	27.68
2013	52.37	10.42	40.91	1.04	0.00	47.51	1.28	5.93	0.00	0.55	40.31	0.00	36.50
Indonesia													
1995	64.63	11.03	7.07	2.60	43.93	35.37	5.84	1.66	–	0.02	27.87	0.34	3.06
2000	62.10	7.85	16.35	0.76	37.14	37.90	12.36	2.88	0.24	1.64	22.66	0.27	4.58
2005	73.59	12.29	12.94	6.89	41.47	26.41	11.51	5.16	1.72	1.25	9.74	1.16	2.07
2010	82.21	17.93	14.64	11.26	38.38	17.79	8.08	3.97	1.26	1.13	5.74	0.14	1.97
2013	82.64	15.03	13.04	18.12	36.44	17.36	7.57	2.54	0.31	0.85	7.25	0.07	2.54

Laos													
1995	93.32	57.48	34.87	0.97	–	6.57	0.05	4.21	_	_	2.31	2.18	–
2000	98.56	24.19	73.89	0.48	–	1.44	_	_	_	_	1.44	–	0.04
2005	94.33	5.76	61.62	26.95	–	3.59	0.15	_	_	_	3.44	–	0.97
2010	99.25	4.29	20.45	74.08	0.43	0.75	0.44	0.05	_	0.04	0.26	0.00	0.12
2013	99.02	5.08	51.15	42.50	0.29	0.98	0.28	0.18	_	0.13	0.52	–	0.11
Malaysia													
1995	54.92	39.91	9.25	0.90	4.87	44.47	3.24	13.35	0.82	3.82	27.88	0.37	2.25
2000	34.05	12.00	8.80	2.28	10.97	65.05	9.16	43.20	3.97	34.12	12.69	1.39	2.30
2005	28.27	13.88	8.62	1.39	4.38	70.54	12.20	47.45	4.98	35.88	10.89	1.69	1.40
2010	28.02	14.13	5.38	1.94	6.56	71.70	8.40	53.11	9.68	39.61	10.19	0.53	0.85
2013	35.82	11.78	4.49	8.99	10.57	63.86	10.63	43.99	6.30	33.62	9.24	0.31	1.11
Myanmar													
1995	66.99	9.44	50.57	6.99	0.00	2.23	0.58	0.36	0.06	0.01	1.29	0.01	0.49
2000	91.02	14.96	67.27	8.79	_	2.28	0.06	1.76	_	1.67	0.46	–	0.10
2005	93.87	10.48	69.87	13.40	0.12	3.54	0.39	0.60	0.00	0.49	2.55	0.06	0.71
2010	60.76	27.41	26.61	6.75	_	1.38	_	0.02	_	_	1.36	–	1.14
2013	74.15	23.45	40.08	10.51	0.11	4.24	0.45	0.45	0.00	0.37	3.35	0.06	1.47
Philippines													
1995	85.86	16.28	1.73	20.86	46.99	9.70	3.15	4.39	0.07	1.29	2.16	0.10	0.88
2000	36.87	9.89	1.29	14.77	10.92	63.11	3.16	55.85	1.37	50.64	4.10		0.83
2005	9.39	1.30	0.49	4.28	3.32	90.59	0.78	87.87	15.35	67.59	1.95		0.45
2010	17.57	3.28	0.70	10.28	3.31	55.04	4.11	49.47	21.09	23.79	1.46		0.46
2013	34.92	7.89	1.49	21.55	3.98	64.97	4.05	55.80	17.00	20.54	5.12	0.11	0.74
Singapore													
1995	33.05	4.69	2.09	8.00	18.27	62.64	13.07	40.07	5.16	15.09	9.50	1.08	0.85
2000	16.15	0.96	1.36	2.03	11.80	81.52	14.66	57.57	10.32	34.95	9.29	0.33	0.77

(continued)

Table 5 (continued)

	Primary commodities					Manufactured goods					Other manufactured goods		
SITC	Total (0 + 1 + 2 + 3 + 4 + 68)	All food items (0 + 1 + 22 + 4)	Agri. raw materials (2 − 22 − 27 − 28)	Ores and metals (27 + 28 + 68)	Fuels (3)	Total [5 to 8 − (667 + 68)]	Chemical prod. (5)	Machi. and transp. equip. (7)	Electron excl. parts and components (751 + 752 + 761 + 762 + 763 + 775)	Parts and components for electrical and electronic goods (759 + 764 + 772 + 776)	Total [6 + 8 − (667 + 68)]	Iron and steel (67)	Textile fibres, yarn, fabrics and clothing (26 + 65 + 84)
2005	10.59	0.97	0.70	1.16	7.76	88.23	14.97	65.45	10.99	45.35	7.81	0.26	0.30
2010	18.91	1.92	0.57	1.43	14.99	79.45	16.62	54.61	3.22	42.12	8.23	0.23	0.15
2013	15.16	1.78	0.69	1.12	11.57	82.22	18.59	54.57	2.70	42.24	9.07	0.25	0.17
Thailand													
1995	76.55	58.31	16.98	0.55	0.71	23.30	7.45	7.38	2.01	1.88	8.48	1.39	6.89
2000	40.90	9.63	14.81	1.14	15.32	58.27	11.88	35.16	0.98	26.11	11.23	2.04	3.95
2005	31.11	8.04	12.68	1.46	8.93	68.44	15.32	42.58	19.81	14.96	10.53	2.37	3.08
2010	30.13	7.40	15.21	1.03	6.48	69.80	18.26	38.79	19.92	11.44	12.75	0.54	1.86
2013	38.19	9.64	18.72	1.15	8.69	61.65	25.61	22.00	8.06	7.05	14.04	0.07	1.92
Vietnam													
1995	91.40	42.18	24.48	2.25	22.49	8.52	5.52	0.94	0.01	0.02	2.07	0.28	2.00
2000	94.37	31.79	7.32	1.47	53.79	3.57	1.58	0.52	–	0.36	1.47	0.01	0.73
2005	83.74	13.63	17.00	2.40	50.72	12.74	2.50	5.05	1.10	1.35	5.19	0.03	1.54
2010	57.97	12.52	20.47	2.65	22.33	37.16	6.26	13.65	4.10	5.84	17.25	1.21	6.38
2013	57.26	18.35	15.18	1.60	22.13	42.74	7.91	17.15	3.47	10.12	17.68	0.64	8.08

Source: UNCTAD, with authors' calculations

Table 6 Structures of ASEAN's imports from China (in percentage)

	Primary commodities					Manufactured goods					Other manufactured goods		
SITC	Total (0 + 1 + 2 + 3 + 4 + 68)	All food items (0 + 1 + 22 + 4)	Agri. raw materials (2 − 22 − 27 − 28)	Ores and metals (27 + 28 + 68)	Fuels (3)	Total [5 to 8 − (667 + 68)]	Chemical prod. (5)	Machi. and transp. equip (7)	Electron excl. parts and components (751 + 752 + 761 + 762 + 763 + 775)	Parts and components for electrical and electronic goods (759 + 764 + 772 + 776)	Total [6 + 8 − (667 + 68)]	Iron and steel (67)	Textile fibres, yarn, fabrics and clothing (26 + 65 + 84)
Brunei													
1995	23.97	15.91	0.21	7.85	0.00	76.02	1.84	6.65	0.73	2.28	67.53	13.59	4.83
2000	20.16	17.60	0.25	2.29	0.02	79.84	2.09	7.14	2.73	0.66	70.61	6.29	37.01
2005	13.10	11.53	0.30	1.21	0.06	86.84	2.65	11.31	4.32	2.24	72.89	8.21	37.17
2010	13.07	10.66	0.23	2.10	0.08	86.92	4.17	13.43	4.80	3.32	69.33	13.29	30.11
2013	5.74	4.70	0.20	0.69	0.15	94.26	4.01	34.78	7.75	10.46	55.47	13.00	6.85
Cambodia													
1995	25.47	24.48	0.38	0.36	0.25	73.88	7.30	29.91	1.62	0.43	36.68	6.42	9.69
2000	5.64	5.15	0.11	0.17	0.21	94.27	2.97	17.30	4.47	1.70	74.00	8.31	50.54
2005	5.04	3.98	0.03	0.41	0.62	94.92	2.17	11.27	0.64	1.98	81.48	1.99	69.16
2010	2.54	1.41	0.28	0.35	0.50	97.45	2.04	20.62	0.39	6.19	74.79	2.06	60.25
2013	2.22	1.43	0.27	0.15	0.37	97.78	1.91	27.43	0.88	3.79	68.44	1.48	53.52
Indonesia													
1995	29.76	18.25	1.76	3.76	5.99	70.24	15.50	25.47	1.89	3.47	29.27	12.31	5.56
2000	27.80	12.27	3.62	1.76	10.15	72.18	11.14	36.01	7.12	5.36	25.03	4.39	10.14
2005	28.16	4.95	0.57	2.25	20.39	71.83	11.45	30.21	3.15	6.98	30.18	9.64	7.15
2010	15.77	6.83	0.68	1.85	6.42	84.21	10.27	45.25	7.63	11.98	28.69	4.67	9.65
2013	11.51	4.60	0.78	1.67	4.45	88.48	11.54	43.87	6.21	10.84	33.08	5.59	10.58

(continued)

Table 6 (continued)

SITC	Primary commodities					Manufactured goods					Other manufactured goods		
	Total (0 + 1 + 2 + 3 + 4 + 68)	All food items (0 + 1 + 22 + 4)	Agri. raw materials (2 − 22 − 27 − 28)	Ores and metals (27 + 28 + 68)	Fuels (3)	Total [5 to 8 − (667 + 68)]	Chemical prod. (5)	Machi. and transp. equip (7)	Electron excl. parts and components (751 + 752 + 761 + 762 + 763 + 775)	Parts and components for electrical and electronic goods (759 + 764 + 772 + 776)	Total [6 + 8 − (667 + 68)]	Iron and steel (67)	Textile fibres, yarn, fabrics and clothing (26 + 65 + 84)
Laos													
1995	32.28	31.34	0.11	0.41	0.42	67.70	2.18	50.42	0.34	3.02	15.10	0.21	5.78
2000	6.77	5.55	0.33	0.28	0.61	92.82	3.86	55.83	0.95	10.28	33.14	2.07	17.22
2005	2.32	1.45	0.17	0.44	0.25	97.68	2.44	72.38	0.97	18.99	22.87	4.59	6.43
2010	5.17	3.03	0.07	0.75	1.32	93.69	2.37	41.13	1.10	10.60	50.20	3.03	29.48
2013	2.49	1.38	0.04	0.16	0.91	97.51	2.01	79.93	0.91	32.73	15.58	2.18	1.16
Malaysia													
1995	19.61	12.25	2.11	4.62	0.63	77.56	8.34	27.90	1.99	10.85	41.32	10.96	14.38
2000	20.56	15.05	2.00	2.68	0.84	77.72	6.34	51.40	2.35	34.53	19.98	2.47	6.26
2005	7.94	4.40	0.44	1.29	1.81	89.94	4.35	69.81	9.33	44.23	15.78	3.54	3.02
2010	9.70	5.54	0.69	2.75	0.72	89.59	8.38	60.00	8.68	32.09	21.22	4.25	2.87
2013	12.62	4.10	0.53	6.00	2.00	86.86	7.77	58.48	6.70	30.57	20.61	4.81	2.75
Myanmar													
1995	16.95	13.69	0.29	0.07	2.91	82.11	8.47	40.46	1.26	0.98	33.18	5.47	16.97
2000	11.17	5.65	0.44	0.13	4.95	88.24	10.54	34.98	3.59	1.91	42.72	6.13	24.18
2005	15.40	6.36	0.24	0.40	8.41	84.60	8.45	39.50	1.22	4.79	36.66	7.30	16.75
2010	2.88	1.07	0.25	0.29	1.28	97.12	4.78	39.03	2.34	3.07	53.32	15.62	16.33
2013	14.34	6.45	0.32	0.30	7.28	85.66	8.01	32.74	1.24	3.30	44.91	11.69	17.17

Philippines													
1995	21.93	10.95	0.32	5.13	5.52	71.27	14.51	14.49	1.75	2.53	42.26	19.73	7.05
2000	25.49	16.71	0.98	3.05	4.75	74.50	11.58	24.70	3.66	11.08	38.22	3.86	13.94
2005	11.64	5.21	0.30	1.75	4.38	88.33	9.47	53.18	2.57	39.81	25.68	7.40	7.32
2010	13.70	6.25	0.40	2.59	4.45	86.30	13.25	46.11	4.54	27.16	26.93	6.12	4.64
2013	18.58	6.56	0.36	1.60	10.05	81.40	13.10	36.97	3.48	15.48	31.33	6.25	5.24
Singapore													
1995	24.38	11.64	1.35	6.03	5.36	75.19	4.01	39.99	10.62	13.48	31.20	2.92	11.30
2000	16.14	3.98	0.43	3.64	8.09	83.64	2.91	60.96	14.91	32.14	19.77	0.78	5.81
2005	10.61	2.06	0.21	1.84	6.51	89.04	2.53	69.27	12.03	44.18	17.24	2.39	4.27
2010	14.81	1.86	0.23	1.22	11.51	84.29	3.73	62.26	13.11	35.86	18.31	2.83	2.72
2013	12.84	2.03	0.23	1.15	9.42	86.46	4.03	61.99	10.57	37.49	20.44	4.90	2.53
Thailand													
1995	12.92	2.77	3.43	4.19	2.52	85.72	13.14	24.90	4.84	7.43	47.67	22.36	14.99
2000	11.29	3.74	2.48	2.45	2.62	88.11	9.28	48.29	4.97	26.78	30.53	4.87	14.29
2005	7.93	2.48	0.54	4.37	0.54	91.71	8.58	53.52	8.83	28.61	29.60	10.65	6.35
2010	8.25	3.04	0.62	3.73	0.87	91.62	10.94	53.19	9.03	23.81	27.49	5.13	5.62
2013	7.64	3.52	0.58	3.22	0.31	92.23	9.80	55.68	8.36	22.85	26.75	6.23	4.56
Vietnam													
1995	9.59	4.41	0.77	2.69	1.72	90.38	12.84	26.09	1.24	1.44	51.45	11.85	11.72
2000	19.90	5.49	1.27	3.34	9.80	78.00	15.90	43.21	1.41	1.03	18.89	6.22	6.07
2005	23.15	3.82	1.48	1.95	15.90	74.62	13.11	22.63	1.62	4.27	38.87	13.29	14.78
2010	13.86	2.39	0.96	1.93	8.57	85.15	11.60	39.59	4.62	13.73	33.96	8.43	14.32
2013	13.30	2.28	0.93	1.86	8.24	86.67	12.54	41.25	4.76	16.86	32.88	6.95	15.16

Source: UNCTAD, with authors' calculations

transport equipment (mainly in electrical machinery and other consumer engineering products). It is interesting to note that the new ASEAN member countries, especially Cambodia and Vietnam, show a rapidly increasing trend of exports in labour-intensive products and resource-based manufactures, while the original ASEAN members are the major exporters of parts and components and their reliance on exports of traditional labour-intensive products has significantly been reduced. Malaysia, the Philippines, Singapore and Thailand are playing an increasingly important role as exporters of parts and components (SITC 759 + 764 + 772 + 776) in the machinery and equipment industry though the share of these products in their total exports shows a steadily declining trend since the early 2000s.

In comparison, China possesses a quite similar commodity composition of its exports to that of ASEAN and has also experienced dramatic structural changes, from largely an exporter of primary products to increasingly an exporter of manufactured goods over the past two decades. As it can be seen in Table 3, there has been a very dramatic decline in the primary goods and food and agricultural goods in China's exports over the last two decades, falling respectively to less than 10 % and 3 % by 2013, while the share of manufactured goods increased to about 94 % of China's total exports, indicating China has emerged to be a manufacturing powerhouse and an important global growth engine. The most notable change in the composition of manufactured exports is the sharp increase in the exports of machinery and transport equipment (SITC 7), rising from 21 % of China's total exports in 1995 to more than 47 % in 2013. In particular, the share of parts and components exports rose from 5.7 % of the total in 1995 to 18 % in 2013. This further confirms that China has become the world's major manufacturing base as an assembler and producer of parts and components and may also imply that China is an export rival for ASEAN in these industries in third-country markets.

Overall the import structures of ASEAN countries show a cyclical trend of growing importance of fuels and metals as well as manufactured products, but mostly a steadily declining share of food and agricultural raw materials (Table 4). China has a quite similar picture in comparison with ASEAN's import pattern. The proportion of China's imports of ores, metals and fuels grew steadily over time from around 8 % in 1990 to about 28 % in 2013, and the share of food and agricultural raw materials declined steadily from, respectively, 7 % and 5.2 % in 1990 to 5 % and 3.4 % in 2013. Of the manufactured imports, machinery and transport equipment rose from 40 % in 1990 to about 47 % in 2003 and then declined steadily to about 36.5 % in 2013, and chemical products also declined from 13 % in 1990 to 9.7 % by 2013. This dynamic pattern of trade reflects China's emergence as a global manufacturing powerhouse on one hand and its efforts to move up the value chain in the high end while growing its businesses throughout the manufacturing value chain on the other hand. That also explains why the rise of the Chinese economy has been viewed as a rival or threat to ASEAN economies, especially in the world export markets of labour-intensive goods.

However, when we look at the trade pattern between ASEAN and China at bilateral level, some of the rivalry concerns are no longer so important. As it can be seen in Tables 5 and 6, with the exception of resource-rich countries such as Brunei

and Indonesia as well as the new ASEAN members where the patterns of trade with China are mostly complementary, the rest show an increasing importance of intra-industry trade with China predominantly in manufacturing, thanks to the rapid economic integration in the region which had led to the new form of international fragmentation of production in East Asia. Hence, the nature of international trade has been changed from trade in goods to trade in tasks. With advances in transportation and communications technology, components and unfinished goods can be moved quickly and cheaply, and firms can take advantage of factor cost disparities in different countries with "offshoring" of both manufacturing tasks and other business functions, which can generate shared gains for all domestic factors (Grossman and Rossi-Hansberg 2008; Baldwin and Robert-Nicoud 2014). As it is evidenced in Tables 5 and 6, the increasing fragmentation of value chains has led to a steady increase of trade flows in intermediate goods, especially in the manufacturing sector, between China and these ASEAN countries. Trade in intermediate goods, especially in parts, components and accessories (ISIC 759 + 764 + 772 + 776), is the most dynamic sector of international trade with China, rising from 3.8 % of Malaysia's total exports to China and about 11 % of its imports from China in 1995 to, respectively, about 34 % and 31 % in 2013, from about 1.3 % of the Philippines' exports and 2.5 % of its imports in 1995 to, respectively, 21 % and 15.5 % in 2013 and from 15 % of Singapore's exports and 13.5 % of its imports in 1995 to, respectively, 42 % and 37.5 % in 2013. For Thailand, exports of parts, components and accessories to China was less than 2 % in 1995 and peaked at 27 % in 2001 and then experienced a steady decline to 7 % by 2013, while its imports of parts, components and accessories from China shows a similar pattern, rising from 7 % in 1995 to about 30 % in 2003 before falling to 23 % in 2013. In contrast to the conventional trade theory, what one can observe is that, in an integrated region such as ASEAN and China, a country's comparative advantage of completing a specific task along the global value chain rather than the final goods determines its specialisation. Such increasing trade of intermediate goods and services due to the widespread emergence of offshoring promotes specialisation of each economy and leads to more trade in tasks with new value added along the production chain (see, for instance, Grossman and Rossi-Hansberg 2008 and Baldwin and Robert-Nicoud 2014 for the theoretical underpinnings). The fragmentation of production in East Asia is the major contributor to its economic integration through increasing intra-regional direct investment and trade, while China's recent shift to consumption-led growth will offer new opportunities to ASEAN and fuels further regional economic interdependence and closer regional integration.

3 Changes in Comparative Advantage

To further comprehend the analysis of the ASEAN–China economic relations and interdependence, we now turn to evaluating how their comparative advantage changes over time. The theory of comparative costs as a means of explaining the location of production has well been documented, but not much has been done to apply the theoretical concept of comparative advantage in empirical analyses, especially in analysing trade performance. This is largely due to the difficulties in empirically defining the autarkic variables in the notion of comparative advantage theory. Given that the relative prices under autarky are not observable, the Balassa Index of Revealed Comparative Advantage (RCA) proposed by Balassa (1965) has been widely used empirically to identify structural trade-related patterns across countries and to approximate countries' sectorial specialisation at both regional and global levels as well as bilateral level (see, for instance, Vollrath 1991, Dimelis and Gatsios 1995, Ferto and Hubbard 2003, Hinloopen and Van Marrewijk 2004 and Svaleryd and Vlachos 2005). Using X to denote exports, i a specific country, j a specific commodity or industry, t is the total exports of that commodity or industry and n the reference country (or countries), the Balassa Index can be written as

$$\mathrm{RCA}_{ij} = \left(X_{ij}/X_{it}\right)/\left(X_{nj}/X_{nt}\right) = \left(X_{ij}/X_{nj}\right)/\left(X_{it}/X_{nt}\right) \tag{1}$$

The Balassa Index basically measures a country's normalised export share of an industry with respect to the exports of the same industry in a group of reference countries. If RCA is larger than unity, it indicates that the country has a "revealed" comparative advantage in this commodity/industry, and if the index is less than unity, the country is said to have a comparative disadvantage. When the index is equal to unity, it is said that the country has a neutral comparative advantage. The Balassa Index has been under critique for its incomparability across time and space and bias due to the omission of imports, especially when country size is important. Vollrath (1991) proposed three alternative specifications of measuring a country's revealed comparative advantage, namely, the relative trade advantage (RTA), the logarithm of the relative export advantage (RXA) and revealed competitiveness (RC). Vollrath's RTA is defined as

$$\mathrm{RTA}_{ij} = \mathrm{RXA}_{ij} - \mathrm{RMA}_{ij} = \left(X_{ij}/X_{it}\right)/\left(X_{nj}/X_{nt}\right) - \left(M_{ij}/M_{it}\right)/\left(M_{nj}/M_{nt}\right) \tag{2}$$

where M represents imports, RXA is the equivalent to the original Balassa Index and RMA is its counterpart, the relative import advantage. The revealed competitiveness can be written as follows:

$$\mathrm{RC}_{ij} = \ln\mathrm{RXA}_{ij} - \ln\mathrm{RMA}_{it} \tag{3}$$

One may note that Vollrath's second and third measures of a country's revealed comparative advantage are both in logarithmic form. The advantage of expressing

these two indices in logarithmic form is that they become symmetric through the origin. Positive values of these indices reveal a country's comparative/competitive advantage and vice versa, and negative values indicate comparative/competitive disadvantage.

In this paper we apply the Balassa Index and Vollrath's three alternative measures of revealed comparative advantage to the analysis of economic relation between ASEAN and China. Since we are interested in the competitiveness of China in ASEAN, we calculate these indices on bilateral levels. Following Krause (1982), Tyers and Phillips (1984) and Zhang and Ow (1996), we divide commodities at SITC 3-digit level into five groups according to their intensities in the five factors, i.e. agricultural resources, mineral resources, labour, technology and human capital. This classification permits a more accurate investigation of the structure of ASEAN and Chinese exports, as both are primarily natural resource based, and the possible trends in economic interdependence. Although all products embody multiple factors in the production processes, each can be classified according to its dominant factor that used most intensively and/or that which determines the location of production.

Table 7 reports the mean and standard deviation for the four RCA indices computed for China's trade with selected ASEAN countries over the period 1993–2013 (with Vietnam from 2001 to 2013 and Myanmar from 2006 to 2013) depending on data availability. It is interesting to note that the Balassa Index and Vollrath's three alternative RCA measures present a similar pattern of revealed comparative advantage for some categories with some countries but inconsistently for others. As it can be seen in Table 7, all the four indices show that China has a revealed comparative advantage over Indonesia in the production of technology- and human capital-intensive goods, with Malaysia in agricultural resource-based and human capital-intensive products; with Myanmar in unskilled labour-intensive products; with the Philippines in agricultural resource-based, unskilled labour-intensive and human capital-intensive products; and with Thailand in the human capital-intensive goods. There is no a clearly predicted revealed comparative advantage over Singapore and Vietnam based on the four indices, though the Balassa Index indicates a revealed comparative advantage in natural resource- and technology-based goods over Singapore and in agricultural and natural resource-based as well as unskilled labour-intensive goods with Vietnam. The changes in comparative advantage over the past two decades indicate that commodity mix complementarity exists in certain goods categories and with individual countries. The revealed comparative advantage suggests a wide scope for the future expansion of ASEAN–China bilateral trade. This includes that China shall enlarge its imports of agricultural and mineral resource-intensive products from those resource-rich ASEAN economies while exporting in turn more labour-intensive and human capital-intensive goods. From this, it should not be surprising to observe a dynamic economic relationship between ASEAN and China, interacting both competitively and complementarily. This appears to accord with what the standard neo-factor proportion paradigm implies as a result of high economic development and structural changes. The evolution of the RCA indices over time and the

Table 7 Revealed comparative advantages of China with respect to selected ASEAN countries by commodity group, 1993–2013

	Indonesia		Malaysia		Myanmar		Philippines		Singapore		Thailand		Vietnam	
Commodity group	Mean	SD	Mean	SD	Mean	SD	Mean	SD	Mean	SD	Mean	SD	Mean	SD
(a) Agricultural resource intensive														
RCA	1.60	0.38	1.37	0.24	0.78	0.34	1.49	0.30	0.57	0.18	0.87	0.28	1.19	0.20
RTA	−0.74	0.75	0.01	0.65	−7.78	3.54	1.12	0.33	0.42	0.22	−0.29	0.41	−0.53	0.65
lnRXA	0.46	0.28	0.30	0.18	−0.32	0.37	0.38	0.23	−0.61	0.29	−0.19	0.33	0.16	0.17
RC	−0.47	0.32	0.09	0.46	−2.36	0.30	1.65	0.75	1.40	0.62	−0.31	0.41	−0.31	0.43
(b) Mineral resource intensive														
RCA	1.60	0.34	0.52	0.16	1.47	0.22	0.98	0.17	1.00	0.21	0.87	0.25	1.77	0.45
RTA	−0.28	0.67	0.04	0.25	−0.53	0.88	0.30	0.59	−0.22	0.26	0.39	0.40	−1.79	1.32
lnRXA	0.46	0.30	−0.70	0.30	0.37	0.14	−0.04	0.18	−0.02	0.21	−0.18	0.29	0.53	0.27
RC	−0.19	0.32	0.11	0.55	−0.23	0.50	0.62	0.78	−0.22	0.25	0.71	0.78	−0.54	0.47
(c) Technology-intensive goods														
RCA	1.04	0.15	1.07	0.08	0.93	0.10	0.90	0.09	1.05	0.08	1.09	0.09	0.75	0.08
RTA	0.76	0.24	−0.02	0.09	0.78	0.12	−0.18	0.27	−0.06	0.15	−0.14	0.30	0.37	0.24
lnRXA	0.03	0.15	0.07	0.07	−0.08	0.13	−0.12	0.10	0.04	0.08	0.09	0.08	−0.29	0.12
RC	1.37	0.45	−0.02	0.09	1.87	0.32	−0.14	0.32	−0.05	0.14	−0.10	0.20	0.93	0.67
(d) Unskilled labour intensive														
RCA	0.96	0.16	0.98	0.17	1.03	0.22	1.23	0.20	0.94	0.27	0.80	0.19	1.45	0.33
RTA	−0.66	0.57	0.14	0.57	0.11	0.87	0.81	0.36	0.71	0.23	−1.10	0.78	−3.19	2.26
lnRXA	−0.04	0.21	−0.04	0.17	0.01	0.19	0.19	0.17	−0.11	0.35	−0.25	0.23	0.34	0.26
RC	−0.63	0.25	0.35	0.74	0.35	0.83	1.27	0.65	1.42	0.30	−0.82	0.32	−0.96	0.60
(e) Human capital intensive														
RCA	1.36	0.33	1.15	0.24	0.78	0.35	1.33	0.28	0.88	0.20	1.13	0.38	0.65	0.21
RTA	0.69	0.54	0.40	0.52	0.14	0.71	0.48	0.80	−0.60	0.57	0.27	0.65	−2.12	1.11
lnRXA	0.30	0.34	0.12	0.20	−0.33	0.39	0.26	0.21	−0.15	0.21	0.07	0.31	−0.49	0.34
RC	0.82	0.58	0.52	0.62	1.37	1.53	0.79	0.95	−0.50	0.44	0.38	0.60	−1.42	0.57

Note: the mean and standard deviation of the RCA indices for Vietnam were calculated over the period 2001–2013 and for Myanmar over the period from 2006 to 2013. *SD* stands for standard deviation

relatively high standard variation for Vollrath's three alternative RCA measures also indicate that China is likely to follow the general industrialisation paradigm in shifting and composing its export structures.

4 Bilateral FDI Flows Between China and ASEAN

Since the reform and opening up in the end of the 1970s, especially after Deng's southern tour in the early 1990s, China has achieved remarkable success in attracting foreign direct investment (FDI) and become one of the top destinations in the world for FDI since 2003. According to UNCTAD World Investment Report 2004, FDI inflows to China in 2003 reached $53.5 billion making China the world's largest recipient of total FDI but the world's second-largest recipient when the US FDI figure was revised to US$56.8 billion in its World Investment Report 2005. By 2013, the utilised FDI in China has reached US$118.7 billion. The recent UNCTAD report shows that China became the top destination for inward FDI again in 2014, with an estimated amount of over US$128 billion of FDI received, despite concerns of China's economic slowdown. This has drastically changed the economic geography in the Asia-Pacific region and is often viewed as a threat to the ASEAN countries. There has been a serious concern about FDI diversion from these countries to China.

However, one notable feature observed in recent years is that foreign investment into China's traditional manufacturing has experienced a rapid decline but rising in the Chinese service sector. This change in sectorial distribution reflects largely the response of MNEs towards the slowing down of China's economic expansion and a transition of its economic structure. This implies that the main engine of the economy in China is no longer manufacturing but the service sector and domestic consumption. Due to the rapid increases in labour costs, China's traditional advantage in the manufacturing sector is decreasing, especially in comparison with some of the ASEAN countries. This has become one of the important factors explaining the decline of FDI inflow into the manufacturing and also the driving force behind the steadily increase in China's outward FDI in recent years.

In contrast to the strong trade links between ASEAN and China, investment flows between the two are relatively weak. Figure 2 presents the bilateral direct investment flows between ASEAN and China. China used to be a receiver of foreign direct investment rather than a source in the world, particularly in ASEAN in the 1980s and the 1990s. As it can be seen in Fig. 2, the role played by ASEAN as an important source of FDI to China has been steadily decreasing during the period 1997–2012, while increasingly ASEAN has become an important destination for China's outward investment. One may note that since 2005 the share of FDI flowing in from ASEAN to China has increased from 4.3 % in 2005 to 6.3 % in 2012, but still far below the share of 9.3 % in 1998. As it can be seen in Table 8, Singapore is the largest investor in China, followed by Malaysia, Brunei, Indonesia, the Philippines and Thailand. The new ASEAN members are not an important

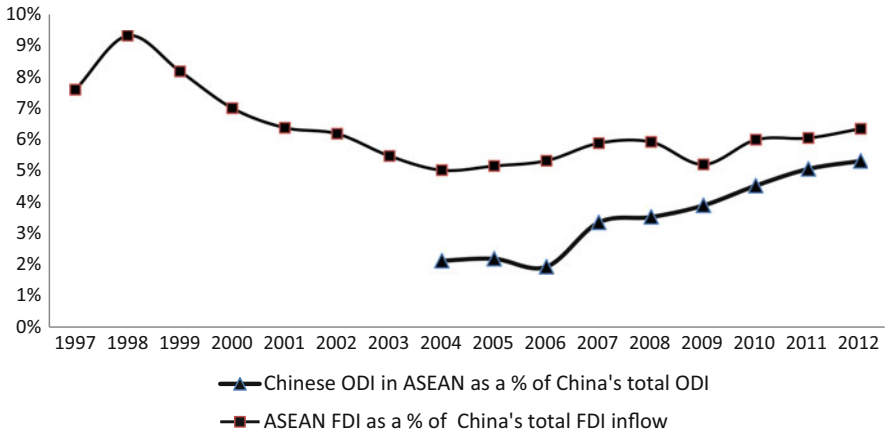

Fig. 2 Bilateral FDI flows between ASEAN and China, 2003–2012. *Source*: China's Ministry of Commerce, Statistical Bulletin of China's Outward Foreign Direct Investment 2007–2012 and the Chinese Financial Yearbook, with authors' own calculations

source of FDI to China. This finding is consistent with the conclusion of Cheong and Plummer (2009) that ASEAN countries increased their FDI stock in each other after the Asian financial crisis, and there was no evidence of FDI competition with China before 2006.

With China's rapidly integrating with the global economy, its outward FDI has picked up rapidly in recent decades, especially since China's WTO entry in 2001, to make overseas acquisitions to gain technology and market access and international experience. China has transformed into a major source country of FDI in the world and become the third-largest source of foreign direct investment after the USA and Japan since 2012. According to the recent UNCTAD report, China's annual FDI outflow amounted to US$87.8 billion in 2012 and US$101 billion in 2013. ASEAN has become the second-largest recipient of China's outward FDI in the recent years, especially since the ASEAN–China Investment Agreement was signed in 2009. China's cumulative FDI flows into ASEAN amounted to just $631 million dollars from 1995 to 2003, less than 0.2 % of the region's total global inflows. In 2012, ASEAN emerged to be the third-largest destination for China's outward investment, only after Hong Kong and European Union, and the third-largest source of FDI inflow in China. China's outward FDI in ASEAN grew at an average annual rate of 68 % in 2003–2012, and its outward FDI stock increased to US$28.2 billion in 2012 from US$587 million in 2003 (see Tables 9 and 10). As it can be seen in Table 10, Singapore has been the most popular destination for China's outward FDI in the region, followed by Indonesia, Myanmar, Cambodia, Thailand, the Laos, Vietnam, Malaysia, the Philippines and Brunei.

Table 11 and Fig. 3 report China's FDI flows and stocks in ASEAN by sector. In 2012, 45.8 % of China's FDI flows went into mining and energy-related business, over 22 % went into the services industries, 16.2 % went into manufacturing and

Table 8 ASEAN utilised FDI in China (in US$ millions)

	Brunei	Cambodia	Indonesia	Laos	Malaysia	Myanmar	Philippines	Singapore	Thailand	Vietnam
1995		1.31	111.63		259		105.78	1851.2	288.24	28.3
1996		7.44	93.54		459.95	0.58	55.51	2243.6	323.31	1.45
1997	0.09	5.45	79.98	0.39	381.83	2.68	155.63	2606.4	194	1.54
1998	1.83	2.9	68.97	1.12	340.49	5.11	179.27	3404	205.38	14.14
1999	0.18	2.48	129.17		237.71	11.01	117.28	2642.5	148.32	0.13
2000		1.94	146.94	3.07	202.88	2.3	111.12	2172.2	203.57	0.56
2001	0.1	9.3	159.64	1.04	262.98	2.26	209.39	2143.6	194.21	1.48
2002	17.36	13.74	121.64	5.15	367.86	16.76	186	2337.2	187.72	2.51
2003	52.6	12.52	150.13	0.4	251.03	3.51	220.01	2058.4	173.52	3.31
2004	96.05	20.69	104.52	4.25	385.04	8.78	233.24	2008.1	178.68	1.14
2005	160.39	2.76	86.76		361.39	3.74	188.9	2204.3	95.9	1.27
2006	294.21	2.12	100.68		393.48	7.36	134.34	2260.5	144.82	13.66
2007	376.88	6.34	134.41	3	397.25	3.26	195.32	3184.6	89.48	0.73
2008	340.42	2.92	167.25	6.7	246.96	3.3	126.87	4435.3	129.21	2.07
2009	348.12	13.37	111.72	2.43	428.74	3.39	111.01	3604.8	48.66	5.92
2010	309.56	10.35	76.84	9.45	294.33	3.52	138.06	5428.2	51.34	2.03
2011	255.82	17.37	46.07	5.88	358.28	10.21	111.85	6096.8	101.2	1.29
2012	151.09	16.6	63.78	2	317.51	3.84	132.21	6305.1	77.72	3.16
2013	133.19	22.51	126.23		280.53	5.85	67.26	7228.7	483.05	
2014					157.49		97.07	5826.7		

Sources: CEIC

Table 9 China's outward FDI, by region, 2012 (in US$ billions)

	Flows			Stock	
Economies	Amount	Growth rate (%)	Share (%)	Amount	Share (%)
Hong Kong	51.238	43.7	58.35	306.372	57.60
European Union	6.120	−19.1	6.97	31.538	5.93
ASEAN	6.100	3.3	6.95	28.238	5.31
USA	4.048	123.5	4.61	17.080	3.21
Australia	2.173	−31.3	2.47	13.873	2.61
Russian Federation	0.785	9.6	0.89	4.888	0.92
The rest of the world	17.340	28.6	19.75	129.952	24.43
The world	87.804	17.61	100	531.941	100.00

Source: China's Ministry of Commerce and UNCTAD, with authors' calculations

Table 10 China's outward FDI in ASEAN, 2003–2012 (in US$ millions)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Values of China's outward FDI flows										
ASEAN	*119*	*196*	*158*	*336*	*968*	*2484*	*2698*	*4405*	*5905*	*6100*
Brunei	–	–	2	–	1	2	6	17	20	1
Cambodia	22	30	5	10	64	205	216	467	566	560
Indonesia	27	62	12	57	99	174	226	201	592	1361
Laos	1	4	21	48	154	87	203	314	459	809
Malaysia	2	8	57	8	−33	34	54	164	95	199
Myanmar	–	4	12	13	92	233	377	876	218	749
Philippines	1	–	5	9	5	34	40	244	267	75
Singapore	−3	48	20	132	398	1551	1414	1119	3269	1519
Thailand	57	23	5	16	76	45	50	700	230	479
Vietnam	13	17	21	44	111	120	112	305	189	349
Values of China's outward FDI stocks										
ASEAN	*587*	*956*	*1256*	*1764*	*3954*	*6487*	*9579*	*14,358*	*21,469*	*28,245*
Brunei	–	–	2	2	4	7	17	46	66	66
Cambodia	59	90	77	104	168	391	633	1130	1757	2318
Indonesia	54	122	141	226	679	543	799	1150	1688	3098
Laos	9	15	33	96	302	305	536	846	1276	1928
Malaysia	101	123	187	197	275	361	480	709	798	1026
Myanmar	10	20	24	163	262	500	930	1947	2182	3094
Philippines	9	10	19	22	43	87	143	387	494	593
Singapore	165	233	325	468	1444	3335	4857	6069	10,603	12,383
Thailand	151	182	219	233	379	437	448	1080	1307	2127
Vietnam	29	160	229	254	397	522	729	987	1291	1604

Source: China's Ministry of Commerce and UNCTAD

about 10 % went into construction. Within the services sector, 11.2 % went into the wholesale and retail trade and 7.2 % into business services, while finance and transportation and storage each absorbed 1.5 % of China's FDI flows. The sectoral distribution of China's FDI stocks showed a similar pattern, except in the finance

Table 11 Industrial distribution of China's outward FDI to ASEAN, 2012 (in US$ millions)

Industries	Flows	Share (%)	Stock	Share (%)
Production and supply of electricity, gas and water	1081.79	17.7	5119.96	18.1
Mining	1714.34	28.1	4033.28	14.3
Wholesale and retail trade	682.88	11.2	3558.30	12.6
Leasing and business service	440.41	7.2	3387.69	12.0
Manufacturing	988.21	16.2	3347.56	11.9
Finance	93.99	1.5	2577.48	9.1
Construction	600.94	9.9	2216.39	7.9
Transport, storage and post	93.19	1.5	2098.15	7.4
Agriculture, forestry, husbandry and fishing	299.71	4.9	996.67	3.5
Scientific research and technical service	24.64	0.4	452.41	1.6
Real estate	44.53	0.7	182.06	0.6
Information transmission, computer services and software	6.28	0.1	120.03	0.4
Resident service, repair and other services	12.02	0.2	74.78	0.3
Lodging and catering services	12.41	0.2	29.30	0.1
Culture, sports and entertainment	3.08	0.1	17.84	0.1
Others	2.02	0.1	25.64	0.1
Total	6100.44	100.0	28237.54	100.0

Source: Ministry of Commerce of People's Republic of China, "2012 Statistical Bulletin of China's Outward Foreign Direct Investment"

sector and transportation and storage sector where the former accounted for 9.1 % of the FDI stocks and the latter for 7.4 %. It is also interesting to note from Fig. 3 that the investment pattern and sectoral distribution of China's outward FDI do not change substantially over time, reflecting largely the underlying motives of Chinese MNEs, namely, seeking market to expand/defend its overseas trade market, securing resources such as oil and minerals, securing advanced technologies and knowledge as well as strategic distribution channels and securing efficiency and competitiveness through production relocation to cheaper resources and input. The diversity in developmental stages of the ASEAN economies and complementarity of the regional production system provides Chinese firms with promising economic opportunities for trade and investment and fosters a new form of regional division of labour and specialisation with the rapid increases of trade in tasks between ASEAN and China. This provides further empirical support to our early discussion that increasingly it is a country's comparative advantage of completing a specific task along the regional value chain that determines the patterns of its trade and specialisation.

Closer economic ties between ASEAN and China will create new business opportunities for both economies. ASEAN offers a great diversity of consumer markets and investment opportunities for the Chinese firms, especially in the areas of natural resources, agriculture, electronics, large consumer markets and rapidly

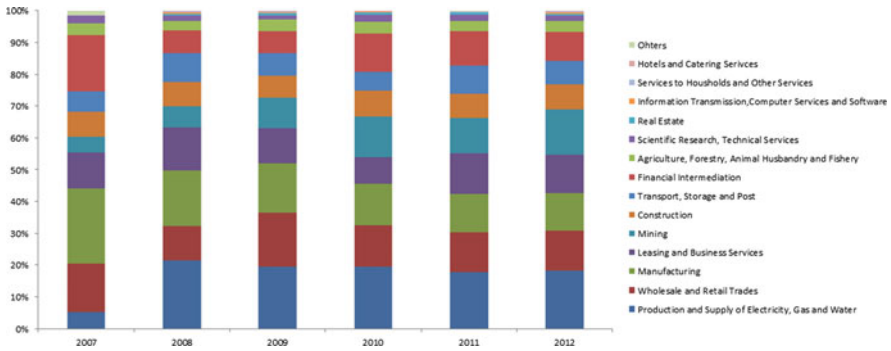

Fig. 3 China direct investment flow in ASEAN by sector (in percentage). *Source*: Ministry of Commerce of People's Republic of China, Statistical Bulletin of China's Outward Foreign Direct Investment 2007–2012, with authors' calculations

developing infrastructure projects. China's rapid urbanisation and shifts from export-led growth to domestic consumption-led growth based on technology innovation have also resulted in strong demand for both consumer goods and commodities and capital goods from the world. As we have early analysed, ASEAN economies have benefited from China's strong domestic demand since the recent global recession, in particular for commodities and capital goods. Rapid urbanisation and the rise of middle-class families in China will change consumer lifestyles and have sizeable implications for imports of quality and luxury products and services. ASEAN could still benefit from China's urbanisation process and shifts towards consumption-led growth by integrating themselves along the regionally integrated production chain or supply chain centred in China.

Recently China has proposed the "Belt and Road" initiative for the purpose of promoting and enhancing highly efficient allocation of resources and deep integration of markets, regional policy coordination, financial integration and trade liberalisation across countries along the Belt and Road. The "Twenty-First Century Maritime Silk Route Economic Belt" (also called "the Maritime Silk Road") is a complementary initiative aimed at investing and fostering collaboration in Southeast Asia, Oceania and North Africa. Partly to complement and support the Belt and Road's development, two regional institutions, Asian Infrastructure Investment Bank (AIIB) and New Silk Road Fund (NSRF), are to be established. The implementation of this initiative will offer opportunities for new complementarities and further reshape the patterns of trade, investment and infrastructure development in the region.

5 Concluding Remarks

China's trade and economic relations with the countries of ASEAN have been long-standing, despite the debate over the complementary and competitive economic relations between them. In this paper, we have examined the economic cooperation

and interdependence between China and ASEAN through trade and flows of investment in the context of the increasing significance of regional production fragmentation. It has been shown that China has become increasingly an important economic partner for ASEAN and is much more important as a source of supply for imports of the ASEAN countries rather than as an outlet for ASEAN's exports. China has been ASEAN's largest trading partner since 2009, with more than 16 % of ASEAN's imports coming from China in 2013, while ASEAN continues to be China's third-largest trading partner since 2010 with the implementation of the CAFTA. The process of asymmetric trade interdependence between ASEAN and China is even more radical on the country level, especially for the new ASEAN member countries. Trade in intermediate goods, especially in parts, components and accessories, has become the most dynamic sector of ASEAN's international trade with China. This lends supports to the proposition that the nature of international trade in this region has been changed from trade in goods to trade in tasks. Driven by the rapidly growing Chinese economy, the region has formed a new format of international specialisation, characterised by its intricate global production sharing and intra-regional network trade. It is therefore a country's comparative advantage of completing a specific task along the global value chain, rather than the final goods, that determines its specialisation. The increasing fragmentation of value chains has led to a steady increase of trade flows in intermediate goods, especially in the manufacturing sector, between China and these ASEAN countries. The changes in revealed comparative advantage over the past two decades suggest a wide scope for the future expansion of ASEAN–China bilateral trade, which further confirms that commodity mix complementarity exists in certain goods categories and on the country level.

It has also been shown that in the past decades China has transformed from one of the largest FDI recipients into a major source country of FDI in the world to gain technology and market access and international experience. ASEAN has become the second-largest recipient of China's outward FDI in the recent years, with Singapore being the most popular destination for China's outward FDI in the region. It is found that China's outward FDI flows into ASEAN are largely focused on mining and energy-related sectors, services industries and manufacturing and construction. With the rising labour costs, Chinese outward FDI increasingly moved into offshoring production into the new ASEAN members. It is believed that China's rapid urbanisation and recent shifts towards consumption-led growth as well as the "Belt and Road" initiative will offer opportunities for new complementarities and further reshape the patterns of trade, investment and infrastructure development in the region.

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