

Friend or Foe: China's accession to the World Trade Organization and Its Impact on ASEAN countries

I. Introduction

Visit the Vietnam frontier with China for a glimpse of the future. Almost every conceivable Chinese item pours across the border, better made and cheaper than it can be produced in Vietnam: furniture, electrical appliances, machinery, clothes – including jeans of mediocre quality, but still a good buy at US\$2 a pair – shoes, even ornamental Buddhas. Pirated compact disks of the latest Hollywood blockbuster movie, released only a few weeks earlier in the U.S., go for a quarter of the cost of a local CD. Motorbikes, the basic mode of transport in Vietnam, is a clear case of what impact this deluge of bargain imports is having on an entire country. The price of a 90cc Honda Dream 2, assembled under license in Hanoi, has tumbled to \$1,800 from \$4,500, under the onslaught of Chinese models selling for as little as \$500, including one audaciously branded “Hongda.” To add insult to Japanese injury, nimble-fingered Vietnamese mechanics fit Honda replacement parts into the Chinese machines.

There is no doubt China's looming presence – prompted by its rapid economic liberalization and its accession in late 2001 to the World Trade Organization, the chief regulatory body for international trade – worries its Southeast Asian neighbors. For the most part, the international community, Asia included, welcomes the prospect of Beijing's entry into the WTO, the end-result of years of arduous negotiations. China's admission to the WTO is further evidence that it plans to take its place in the global system and abide by existing global rules, rather than challenge the established order as the country advances toward what some call “superpowerdom.” While it remains to be seen what role China plays in the world trade body, its inclusion, most believe, will contribute to a more stable and secure region. But as Southeast Asia has quickly discovered, the rise of an economic powerhouse that historically expects neighbors to pay it tribute is bound to be discomfiting. With a population of well over 1.2 billion and bordering 13 other countries, China is hard to stop – and it will undoubtedly become as much of an economic rival as an ally, as it is already beginning to do so. For countries in

the shadow of this looming giant, the burning question is: How high a price will they have to pay for China's ascendancy? As the global economy continues to suffer from a prolonged slowdown, this worrisome question is finding answers that do not necessarily please the Southeast Asian nations, at least in the short to medium term. In his annual report in 2000, a year before China entered the WTO, Rodolfo Severino, secretary-general of the Association of Southeast Asian Nations, or ASEAN for short, warned that China was already sucking in vast amounts of foreign investment at ASEAN's expense, and to be sure, Severino's warning is gradually becoming reality. Already, there has been a noticeable diversion of foreign direct investment flows to China at the expense of other Asian countries, particularly within ASEAN. Certainly, these economies' structural weaknesses, as revealed by the Asian financial crisis of 1997-1998, are partly to blame. The crisis exposed shaky financial infrastructures and bad debt in countries such as Indonesia and Thailand, driving foreign investors away, and encouraging them to flock to Chinese free trade zones where taxes and other financial incentives are attractive, and where companies are free from the political instability and civil unrest that plagued many Southeast Asian countries during the economic typhoon of the late 1990s.

Even so, while China may be taking the lion's share of investment dollars from ASEAN, these countries have not dropped out of investors' list altogether. In fact, even within ASEAN, the newly industrialized economies are likely to gain much from China's WTO accession in the long run, and that will be the general conclusion that I plan to reach for this paper. Three points in support of this conclusion: first, the Southeast Asian cluster did not enter this new era of Chinese superpowerdom without any defense or preparation. Regional trade blocs in ASEAN and the realignment of industrial focuses within each of the countries have helped prepare them to survive under the shadow of the looming Chinese giant. But we have to also analyze the effectiveness of these trade blocs, some of which have been criticized for being executed half-heartedly. Finally, we can turn to the case study of Singapore to witness how ASEAN countries are struggling to preserve their positions in the economic hierarchy.

But before we begin to dissect the ASEAN quagmire, let us not presume that the picture is entirely rosy for China either. The country still faces major obstacles – both domestically and internationally - that will test whether the country could indeed preserve its newly acquired status as the Asian region’s new economic, or go the way of former superpowers such as Russia, which cannot resolve its economic liberalization with the growing pains that have created great divides between the poor and the rich. On the domestic front, the challenges are clear – preventing resentment that is deriving from the income and economic gap between the rich and the poor, the rural and the urban. The Chinese government realizes that it needs to speed up the urbanization of the country. Go 30 minutes outside Shanghai city, the so-called new “pearl of the orient,” visitors are greeted by rice paddy fields, poverty, poor sanitation and infrastructure. On the international front, China is keenly aware that it will win few friends if its manufacturing operations put the opposition in Southeast Asia out of business completely.

All that being said, Southeast Asian countries cannot be nonchalant about their neighbor. Survival is of the utmost; ASEAN nations need to continue discovering new means of economic survival ahead of China’s growth, moving up the production ladder to avoid direct competition with China in areas such as low value-added manufacturing. They will also need to move up if they are to take advantage of the opening of the Chinese market in autos, telecommunications, aviation, pharmaceuticals, financial services and other sectors. It is as Singapore Senior Minister Lee Kuan Yew described in early 2001 at the end of his trip to China: “You imagine Taiwan – 23 million – times 50. We’ll have to find niche areas where we have an advantage, using our present lead in these fields. If we just stay put, we’ll be overtaken in every field.”

II. Pre-WTO – Comparing China and ASEAN Countries

To understand Southeast Asia’s current predicament, we must first travel back to the 1990s, a decade that marked both Southeast Asia’s economic peak and bottom. The earlier part of the decade belonged to Southeast Asia. The cluster of Singapore, Malaysia, Thailand, Indonesia and the Philippines earned the title, “Asia’s mini-Tigers.” ASEAN economies were surging, their political systems were stable, and cheap labor and falling

trade barriers were creating an economic bubble in the sub-region. It was around this time when many foreign fund managers began to discover Asian stocks - or so it seemed when a tidal wave of foreign investors swept through Asian in late 1993, sending Asian-Pacific stock indices smashing through records almost daily. Indexes in Manila, Jakarta, and Hong Kong doubled during the year. Stock indices in Kuala Lumpur, Taipei and Bangkok shot up more than 80%. Analysts at the time explained the extraordinary rallies by harping on the region's great potential for growth at a time when the U.S., Japan and Europe were experiencing somewhat of an economic recession. U.S. investors, in particular, were tired of the paltry interest rates prevailing at home, and were easily convinced to pile their dollars into Asian equities.

Boosted by foreign investors' confidence in the region, Southeast Asia gained quickly on its richer or bigger northern neighbors in Hong Kong, Taiwan and South Korea, attracting the bulk of foreign investments in Asia. According to the ASEAN secretariat, in 1996, on the eve of an economic typhoon that would reap disaster in the region, Indonesia, Malaysia, Thailand, Singapore and the Philippines combined lured more than \$16 billion in foreign direct investment – four times that of South Korea, Taiwan and Hong Kong combined, which themselves were experiencing unexpected boom. For much of the 1990s, the economies of both North and South Asia grew by 7% to 8% a year (with notable exception of Japan). In each country, economic liberalization was taking place to pace itself with the growth in the region. The Malaysian government's New Economic Policy, introduced in the 1970s, though racially controversial, started to see its effects, creating and empowering a new Malay middle class, lifting a large population of the country out of poverty. In the Philippines, the reforms installed by President Fidel Ramos since 1992, also helped rebuild an economy plagued by a corrupt legacy. Using a formula of export-led growth, tight monetary and fiscal policies, liberalization of trade, deregulation and shrinking of the public sector's role in the economy, the Ramos administration managed to generate stable – if not highly impressive – growth. Ramos also attempted to restructure the country's economy away from domination by a few protected conglomerates, toward a free market regulated by laws and open to world trade.

Coupled with Southeast Asia's export-based economic success, the ASEAN nations began to accept a new economic mantra: that prosperity can be based on free trade, rather than protectionism. It was actually a concept that when first introduced by then-Australian Prime Minister Bob Hawke in 1989, was met with lukewarm responses from Southeast Asian diplomats. Hawke wanted to create a forum for Asian-Pacific economic cooperation that would further solidify the already-extraordinary regional growth. Despite fears that the new grouping would be dominated by the U.S and Japan, Howard convinced delegates from 12 Pacific Rim nations to meet in Canberra, Australia in November that year to launch the Asia Pacific Economic Cooperation forum, now known commonly as APEC. From conception, the emphasis of the forum, as the name implied, was on cooperation, not a protectionist trade bloc. But in fact, the new group mostly meant just talk until a November 1993 summit called by then-U.S. President Bill Clinton in Seattle. There, leaders of the then-15 APEC members gave the group a clearer purpose, announcing several new initiatives and pledging to increase economic cooperation in areas such as trade, education and the environment. By 1994, APEC was on a roll. In November that year, in Bogor, Indonesia, the by-now-18 APEC nations agreed to remove trade and investment barriers by 2010 for industrialized nations and by 2020 for developing economies. One year later, at a summit in Osaka, Japan, in symbolic "down payments" on promises made in Bogor, many APEC nations trumpeted deregulation and tariff-reduction measures they were implementing. The nations also endorsed a slightly more specific game plan to help remove trade barriers in the region by 2020.

Inspired by this new cooperative spirit, ASEAN itself also took steps toward economic integration, forming for the first time in 25 years a free-trade zone in January 1992 that would drop trade barriers among the member nations by the year 2008. While some exemptions were granted to developing nations, particularly in the area of agricultural products, the general drive to speed up the pace of economic integration was a clear pre-emptive protection against what would be seen as the China threat. The increasingly globalizing economy in the 1990s was creating strong new competitors for trade and investment, and China was already embarking on its slow economic

liberalization program. ASEAN nations realized even then that they had to take collective action to maintain their economies' growth rates.

A quick glance at the statistics of foreign investment flows into China and the ASEAN at the time already indicates the inklings of China's economic miracle. According to the 2002 ASEAN yearbook on foreign investments, the Southeast Asian trade bloc received its biggest leap of foreign investment flow between 1994 and 1995, the height of the region's economic boom, from \$13.9 billion in 1994 to \$25.4 billion the following year, almost doubling the dollars. The upward trend continued in 1996, peaking at \$30.4 billion in 1997, on the eve of the financial crisis that cut ASEAN's investment flow by almost half to \$18.5 billion in 1998. In that same period of time, China was also not-so-quietly growing. The year 1994 reported only \$13.9 billion in investment dollars to China, but the following year, the "middle kingdom" drew more than \$35 billion, surpassing the ASEAN bloc in investment dollars. With these statistics, perceptions were beginning to shift about the motives and ambitions of China. Once seen as the poor, large and introverted cousin of the smaller, export-driven dynamos, China's quiet but definite economic growth beginning in the mid-1990s was already worrying the ASEAN trade bloc. Mahathir Mohamad, Malaysia's prime minister said as early as 1996 that "we are told all the time that China is a threat, a future enemy. ... I have always maintained that if you say a country is your future enemy, it is your present enemy."¹ Even so, the sporadic voices raising concerns about China's imminent rise to economic power were largely suppressed by the comfort of knowing that there were enough foreign dollars to go around for most every country. Times were good in Asia in general, so no one felt the particular need to worry too much about what might come with China's increasing economic ammunition.

But as the statistics in the ASEAN yearbook indicated, the boom in the region largely covered up what would be inevitable – the eventual economic bust. After three straight years of growth in excess of 8%, the economies of Southeast Asia finally began to fizzle out toward the middle of 1996, with economists fretting over the implications of overheated economies, such as inflation, labor shortages and deficits on the current

account brought about by an insatiable appetite for imports. Economists, at the time, attributed part of the slowdown ironically to a growing dependency in Southeast Asia on intraregional trade, which had in fact been a major reason for Asia's economic success to start with since it relied less on the ups and downs of the developed world. But as the region's economies cooled down, that trend proved to be a double-edged sword. By 1997, Thailand was showing worrisome signs of political instability; the revolving-door democracy made it difficult for any government there to carry out consistent economic policies. Corruption and cronyism abound, and became to typify a major reason for the collapse of many Southeast Asian economies. "That kind of political uncertainty doesn't augur well ... for addressing sluggish demand," said Song Seng Wun, regional economist at HG Asia Securities (Singapore) Pte. Ltd. at the time. ²

Indonesia's shaky economic and political infrastructure, in particular, raised a red flag amidst the euphoric economic boom. Even with its booming economy, Indonesia was still receiving annual foreign soft loans and aid worth 15% of government revenues and 2% of GDP, one of the highest proportions in the developing world and comparable with Africa. Foreign aid is a poor catalyst for economic change, and as Africa's soft-financing addiction showed, it probably postponed rather than promoted economic reform in Indonesia. Additionally, around two-thirds of Indonesia's foreign borrowing came from official creditors rather than the private sector, while over 80% of capital inflows to East Asia were private. Indonesia's financial system, the mechanism that delivered savings to productive investment, was also flawed. Its banks were among the weakest in noncommunist Asia because of constant political interference over who got access to domestic and foreign capital. The result was an overdependence on foreign capital to satisfy domestic demand growth and high foreign indebtedness (47% of GDP compared to East Asia's 27%, and a debt service ratio of 28% compared to East Asia's 8%.) (As it turns out, Indonesia is one of the few countries that is still mired in economic disarray and hasn't fully bounced back from the Asian crisis.)

Also problematic was the growing trade deficits in countries such as South Korea and Thailand. To control the deficits, governments raised interest rates to attract short-term

foreign currency inflows to finance family conglomerates and sustain the economic flow. But higher interest rates, in turn made it more difficult to spur growth; and that led to depressed corporate-earnings prospects, which then caused portfolio institutional investors to pull their money out of equity markets. Combined with political systems that were beginning to fray at the fringes, the prospects of continued economic prosperity began to wane in the region. The Chinese takeover of Hong Kong on July 1, 1997, along with lingering tensions across the Taiwan Straits around the same time, both created some jitters among foreign investors in the region. The Indonesian riots that killed five and injured dozens also rattled foreign investors, and marked the beginning of now-close to five years of political instability in the archipelago nation.

Leading up to the Asian financial crisis, the problems revealed the need within Southeast Asia to invest in infrastructure, an area that, despite all the growth in the region, had largely been neglected by Asian economies during the euphoric economic years -- with the exception of Singapore. "However essential infrastructure investments are in supporting the framework for a modern economy, they simply don't yield the same fast returns that investing in a factory that makes textiles, toys or semiconductors for export will do," said Jim Rohwer, chief economist for Asia with CS First Boston and the author of *Asia Rising*. He argued that this would ultimately contribute to a slowing in Asia's overall growth rates starting in 2000. He was right for the most part -- except for the timing. The slowdown came three years before his prediction.³

The economic typhoon in 1997 hit Southeast Asia far harder than Northeast Asia, and was undeniably one of the worst economic catastrophes since the 1930s. Thailand's expected growth, for example, went from 7% in 1997 to a negative 2%, and other Southeast Asian nations also suffered the same fate. Criticisms from the International Monetary Fund and other global financial bodies began to fly about Southeast Asia nations of misallocating investment dollars, which essentially amounted to an accusation of local governments using government-controlled banks to funnel foreign investments to friends, family or chosen entrepreneurs who then returned the favor by kicking back campaign contributions or personal gratuities.⁴ Politicians used taxpayers' money to build

huge public-works monuments to themselves. Businessmen speculated in property and constructed enormous overcapacity in cars, chips, steel, textiles, and electronics. Cheap capital from the U.S. and elsewhere, chasing Asia's image of itself as the growth machine of the 21st century, overheated the region's economic growth. Asia's high savings rates, inexpensive labor and strong exports would have supported these growth rates, but throw billions of extra bucks into a corrupt crony-capitalist system that is immune to market discipline, and the result was economies run amok.

In the aftermath of the financial crisis, the Southeast Asian nations scrambled to recover both lost time and lost capital, which the region hasn't been able to entirely recover even today. Talks of regional cooperation were pushed by the wayside. Some of the Southeast Asian countries, such as Malaysia, retreated into isolation and acquired somewhat of a distaste for foreign investors. Malaysian Prime Minister Mahathir's angry attacks on foreign speculators and his currency controls were an obvious example. The years 1998 and 1999 saw investment dollars almost half of what the ASEAN region saw in its heyday - \$18.5 billion and 19.7 billion respectively. 2000 was also a bad year, with only \$11.1 billion of foreign investments flowing into the region. The stumbling block for ASEAN truthfully was not so much that the region was doomed by the economic prosperity of China and an economic revival in the U.S. and Japan. Rather, it was because Southeast Asian nations were slow on their feet to remedy the problems that created the crisis in the first place. Few companies in Southeast Asia bothered to restructure their operations, and fewer went bankrupt as a result of poor management and bad accounting. In Thailand, for example, where the crisis had burned the longest, none of the 353 companies identified for a debt-restructuring program reached an agreement with their creditors for the months to follow the crisis. Indonesia's political turmoil deepened post-financial crisis as ousted former President Suharto's cronies continued to control the country's largest conglomerates and hold influential positions within the government. Suharto's immediate successor failed to bring about reforms necessary to revive the fallen economy of the archipelago state, and his successor Megawati, has produced a mixed report card on pushing forward financial reforms needed to restore investor confidence in the country.

The economic vacuum suddenly created by the financial crisis and foreign investors' disinterest in Southeast Asia created a window of opportunity for China to solidify itself as a regional power. Although China was inevitably hurt by the Asian financial crisis – foreign investments into the country dropped slightly in the years 1998-2000 to a low of \$40.3 billion – it was quick to rebound with close to \$47 billion in foreign capital flow into the country by 2001. No economy ever before has grown so fast, so long as China did in the 1990s. Indeed the country and its 1.2 billion have emerged as a key regional growth engine – source of both cheap labor and assembly lines, and a market for many consumer goods. Undeterred by the financial crisis, the Chinese government aggressively pushed for economic liberalization within the country, dubbing the reform a “market economy with socialist characteristics.” Under directives that began in the 1990s, China's bureaucracy has become relatively more streamlined and approvals are just as easy (or no harder to come by) as in rival countries in Southeast Asia.

As Southeast Asia struggled to heal in the late 1990s, China began to take over some of the primary business functions, offering itself as even cheaper labor and more importantly, a stable (even if dictatorial) government. First to move were the manufacturers of shoes, clothing, bicycles and toys from Indonesia, Thailand and Malaysia to China's free trade zones. Then, electronics companies followed suit, moving some of their assembly line, low-end factory work north as well. China's abundant pool of young, high-school educated workers is hard to compete with. Its universities and institutes also churn out thousands of well-trained yet relatively low-paid engineers. The cost of industrial land is among the cheapest in the world – about \$25 per square meter in Shanghai, half the price of Kuala Lumpur and Bangkok, and 60 times cheaper than Yokohama, Japan.⁵ Phone service, ports, electrical power, and other infrastructure in China's key coastal cities are among the best in the developing world. By 2000, ASEAN's share of foreign direct investments had fallen to only 10% in developing Asia from 30% in the early 1990s, whereas China leapt to 30% from 18% in the same period of time.

It soon became clear to the ASEAN countries that their decade was over. A new era had been ushered in, and they needed to survive it.

III. ASEAN and the WTO: Learning to cope with China's Superpowerdom

These days, rarely does a day go by without another announcement of millions of foreign-investment dollars being pumped into China. The mainland, Hong Kong included, takes close to 70% of all foreign direct investment in the region, and that percentage is not likely to come down with China's entry into the WTO. There are very real fears that that the "sucking sound" of investment being drawn into China will accelerate, and very possibly marginalize economies in the rest of the region. The reality is also this: Asian economies simply can't compete with China's vast pool of cheap, skilled and semi-skilled labor and its immense market. China's eastern seaboard alone is home to a 400 million to 500 million strong urban middle class with an appetite and ability to pay for everything from mobile phones to computers. "What attracts production relocation to China is its domestic demand," said Dong Tao, senior regional economist at Credit Suisse First Boston in Hong Kong. "Unfortunately no other Asian countries have that."⁶

All these statistics and reality point to China as a threat. Southeast Asia has really little choice but to "get its act together" as some economists in the region point out bluntly. That being said, the differentiating factor is just how big the China threat is to Southeast Asia's economic well-being -- and the answer: it largely depends on Southeast Asia itself.

Contrary to the beliefs of some fatalists, Southeast Asia has not become irrelevant because of China's rise, and realistically, it will not likely become such. Certainly, a slip in investment figures or a slide in export volumes could send some to speculate and play out scenarios of doom, but sometimes these conventional doom-and-gloom scenarios need to be turned on their heads – or at least examined more closely. Increasing investment into China is not a zero-sum game. Economic ties between China and the rest of the region are already enhancing trade and investment flows. In the longer term, the rise of China could actually benefit the rest of Asia. With its vast economy and growing

per-capita income, China will become a source of demand for goods produced elsewhere in Asia and a destination for investment. The region is by no means there yet, most economists in the region say, but they do predict that China will likely replace the United States as the top market for Asian exports and will eventually become a significant investor in the rest of Asia. China's boosters claim the mainland economy has the potential in the next fifteen to twenty years to become as big as the U.S. economy is today. And if that prediction holds true, there will be beneficiaries all round in the region.

A quick glance at the world's Fortune 500 multinationals is strong evidence that most of them have not entirely fled Southeast Asia for China, though some have indeed stripped their Southeast Asian operations to bare bones since the Asian financial crisis. Motorola Inc., for instance, says its investments in each Asian-Pacific country is primarily to serve the local market; the company has production, design, research and development facilities in both Malaysia and Singapore, and in 2000, beefed up its China operations by investing US\$1.9 billion in a new semi-conductor wafer fabrication facility. Contrary to common perceptions, strong foreign direct investment flows into China have been accompanied by strong flows to the rest of Asia. FDI flows into emerging Asia have increased robustly in recent years post-financial crisis. As a share of gross domestic product (GDP), investment flows have been greatest in Singapore and Hong Kong, reflecting the openness of their economies. Malaysia's foreign direct investment flows rebounded from \$2 billion in 1998 to nearly \$4 billion in 1999-2000 as foreign investors began to regain some of their lost confidence in Southeast Asia. All these indications debunk the popular belief that China's growth stifles foreign investment flows elsewhere in Asia.

China's growth will in fact create complementarity rather than outright competition in the region. Why? This could basically be explained by the simple concept that Asia contains a range of countries, all at different development stages, meaning that they would tend to specialize in producing different types of goods. As a result, foreign direct investment may be drawn to comparative advantages within the region: some to abundant labor, some to technological know-how. A good example of tracking the stages of

economic development would be to point to the evolution of Taiwan's domestic economy. Initially a hub for the cheap manufacturing factories that its Southeast Asian cousins eventually inherited to make toys, shoes and clothes, Taiwan's industries and economic infrastructure grew sophisticated throughout the 1970s and 1980s and eventually became a prized center for technology production such as chips and liquid crystal display computer monitors. In addition to the varying stages of economic development, another important reason for complementarity is the fact that movement of capital along the global production chain often appears motivated by a multinational's desire to be closer to ultimate customers and to other partners in the production process. As a result, there are greater incentives to diversify foreign direct investment placement if the marketplace in Asia is also dispersed. A good example of that is Nissan of Japan. The automotive giant manufactures pick-up trucks and passenger cars in China. But it is also beefing up its presence in ASEAN. In March 2001, Nissan increased its stakes in all of its three Thai affiliates from 25% to 74.9%. In July, Nissan said it would raise its equity stake in local assembly partner PT Ismac Nissan Manufacturing in Indonesia to 75% from 35%.⁷

Confidence among foreign direct investors in Thailand, Singapore and Malaysia has certainly held up ASEAN's medium-term prospects against China, especially in the period leading up to this year's introduction of the ASEAN Free Trade Area (AFTA). FDI approvals in Thailand were up 50% in 2000, while Malaysia witnessed its strongest-ever period of FDI approvals in the 12 months to May 2001. Analyzing FDI data from source countries rather than destination countries (which all use different definitions of foreign direct investments), ASEAN is not in fact devastated by the China allure. Despite moribund investment in Indonesia, where political instability is largely to be blamed, four ASEAN members – Malaysia, Thailand, Indonesia and the Philippines – received \$2.6 billion of net foreign direct investment inflows from the U.S. in the 12 months ending March 2001 – more than five times the \$517 million in U.S. direct investment flowing to China over the same period. Japanese foreign direct investment to the ASEAN four also exceeded that to China in 12 of the past 13 years. If Singapore is included, the five ASEAN economies received larger foreign direct investment inflows from Japan than China in each of the past 14 years. Economists are also quick to remind that the accuracy

of China's investment figures have often times been dubious. At more than \$40 billion annually, China's foreign direct investment figures look impressive, but this figure often includes investment from Taiwan and Hong Kong, and at least some of which represents the round-tripping of mainland investment disguised as foreign direct investment. According to Prasenjit Basu, chief economist for Southeast Asia at Credit Suisse First Boston in Singapore, errors and omissions in China's balance of payments in 2000 amounted to almost \$12 billion. A simulation exercise done by the ASEAN secretariat last year also bolsters Basu's positive outlook for ASEAN. Analyzing by trade values, rather than volumes, the ASEAN secretariat believes that half of the region's 10 members are expected to gain long-term from Beijing's WTO membership. Specifically, the five former tigers would experience an increase in exports to China, though all members would experience a decline in exports to the rest of the world. The bottom line: a net export gain for Malaysia of \$35.6 million, Thailand \$16.1 million, Singapore \$14.1 million, the Philippines \$2.9 million and Indonesia, \$277,000.

Still, even with mounting statistics and projections easing the qualms within Southeast Asia, the country that these Southeast Asian tigers had long been suspicious of politically and condescended economically will undoubtedly bring about rather unwelcome changes to their well-being. Its accession to the WTO, and with that, newly gained economic powers have all given China more confidence to assert itself militarily and politically in the region, raising concerns about regional security. The dispute over the Spratly Islands in the South China Sea is a good example. China has long claimed the territory wholly as its own. Yet, Malaysia, the Philippines and Vietnam also claim part or all of the 800-kilometer long chain, which may hold large undersea oil and gas deposits. China has battled Vietnamese troops in the area and prompted howls of protest from the Philippines after building concrete structures on one of the islands. It has refused to negotiate with ASEAN over the islands' status, all of which have raised red flags about what kind of role China might come to play in regional security in Asia. (Certainly, the U.S. is serving as a counterbalance to China's power ambitions, but to what extent is an uncertainty.)

Despite the positive longer term outlook, the short-term economic blow by China's entry into the WTO is clear and pressing. Entering the WTO has noticeably increased China's efficiency, boosting exports of textile and apparel goods, footwear and various agricultural products, and created some semblance of a legal system that gives foreign investors some confidence about the rule of law within the country. Immediately impacted by this newly reformed China were India and a few of the developing Southeast Asian countries such as Malaysia, Indonesia and Thailand. Beyond mere investment dollars, the increased competition from China in export markets, on which these economies heavily rely, will be the most prominent impact, and they will have to find ways to move up the production ladder so as not to be directly in competition with China.

Malaysia's electronics and shoe manufacturing industries offer a quick and sensible glance at how developing economies can adjust in the face of China's cheaper and more abundant labor and land. Some of its more successful and resilient shoemakers now use computer-aided design and put in a lot of efforts to design and brand their products. Elid, another Malaysian electronics company, began to transfer some of its lower-end manufacturing processes to China, especially the Pearl River Delta, which is fast becoming an electronics hub with its inexhaustible supply of labor and where electronics components are easily available. But the company's main control center and research and development activities remain in Malaysia.

China's immediate impact on ASEAN economies introduced a fresh urgency behind decade-old plans to create a free-trade zone in the region by 2003, a move that would slash import tariffs on goods made in Thailand, Malaysia, Singapore, the Philippines, Indonesia and Brunei. An integrated ASEAN bloc could position itself as an alternative manufacturing base to China. ASEAN secretary-general Roldofo Severino argues that an ASEAN Free Trade area (AFTA) is "substantially now a reality," but Southeast Asia is nevertheless being shunned by investors. Apart from the lure of China, they are deterred by political uncertainty in leading states, particularly Indonesia, which gives Southeast Asia an image of instability and threatens to marginalize it, particularly since the Bali bombings in late 2001, linked to the terrorism that has been unleashed since the

September 11 attacks in the United States. China, meanwhile, is pouring resources into education, building infrastructure and adopting the practices that will give it a chance to match the West in the decades ahead. Investors have to give the AFTA time to work out its kinks, Severino says in defense of ASEAN.

Despite solid progress since the launch of the AFTA in 1994, the shaky reputation that precedes the agreement implies that efforts to open the 10 member countries to the unimpeded flow of goods and services among themselves are faltering, and that the whole exercise is a waste of time and diplomatic effort. “AFTA hasn’t gotten a fair shake,” says Robert Teh, director of the Bureau of Trade, Industry and Services at the ASEAN secretariat in Jakarta, Indonesia, although analysts say the responsibility of bad publicity lies with the member governments, many of whom haven’t always demonstrated an unwavering commitment to their declared regional aims.

Although much more limited in scope than the North American Free Trade Agreement or the European Union, AFTA wants to make Southeast Asia more attractive for foreign investment. The sub-region must enhance its appeal as a production and export platform. It became apparent since the regional economic crisis struck in 1997 that ASEAN is in danger of being left in the dust, as investors stampeded into China, a trend that has only accelerated since Beijing joined the WTO.

While increasing intra-ASEAN trade is a natural consequence of lowering barriers, that is not the ultimate objective. The AFTA framework needs to be expanded to sharpen the region’s competitive advantages. So ASEAN has addressed trade facilitation, harmonizing tariff nomenclature and customs procedures among other things. It has also moved to liberalize investment and services, since they, too, are vital to an integrated market. ASEAN’s difficult task of absorbing its four newest and least developed members – Vietnam, Laos, Myanmar and Cambodia – is eased by their gradual compliance with AFTA, which encourages the acceptance of trading norms and practices. For all ASEAN members, AFTA can be considered what Indonesian economist Hadi Soesastro calls a training ground, or an intermediate phase, on the way of integrating

themselves more fully into the world economy. Each time individual ASEAN countries extend their AFTA concessions to outsiders, he says, “they are moving further away from the AFTA playground to step into the global arena.”

The free-trade area that was to have been created by 2008 covers all types of products, where only manufactured goods and processed agricultural items were included originally, though some sensitive farm produce will remain protected a while longer. Products that were on a temporary exclusion list are also being included, with the notable exception of Malaysia’s auto industry, which has been permitted to shield itself against imported vehicles for the time being. In the case of the initial signatories – Indonesia, Malaysia, Singapore, the Philippines, Thailand and Brunei – tariffs on these products should be reduced to 5% or less by next year, while quantitative restrictions and other non-tariff barriers must be eliminated. Vietnam, Laos, Myanmar and Cambodia have until between 2006 and 2010 to comply. On top of that, ASEAN leaders set in 1999 targets for the eventual removal of all duties.

Although analysts have detected a little trade diversion, AFTA has certainly expanded trade as average tariff rates on covered products fell to 4.43% last year from 12.76% in 1993.⁸ Intra-ASEAN exports climbed to \$85.4 billion in 1997 from \$44.2 billion in 1993, before being hammered for two years by the economic typhoon. By contrast, negotiations to liberalize trade in services have made little headway. Still, there have been hiccups along the way that have given the AFTA much negative publicity. Kuala Lumpur’s insistence on protecting its national car, the Proton, for example, until 2005, generated concern that others would follow and seriously undermine AFTA. Thailand, which has become a regional hub for car makers from the U.S., Japan and Europe talked of retaliating against Malaysian palm oil. Indonesian businessmen suggested their fledgling car operations could also do with temporary help, if relatively prosperous Malaysia was experiencing “real difficulties.” In the event, fortunately, none of these fears have been realized, though the Philippines was under pressure to protect a proposed petrochemical plant. Still ASEAN faces a daunting challenge in trying to sell the AFTA concept. Few governments, companies or prominent individuals – even those who are happily still

operating in the sub-region – believe that Southeast Asia will be a free-trade area by 2010, despite the fact that the completion date was advanced twice in the face of adversity.

There is a saying that you keep your friends close, and your enemies even closer. ASEAN's negotiations for a broader free trade area with China could certainly help gain some confidence in the region's attempts at revival. It is a deal that both parties – the Southeast Asian nations and China – will benefit from. From China's perspective, the idea is to give its Southeast Asian neighbors a leg up in exporting into the Chinese market, by offering them even greater trade liberalization than China agreed to as part of its WTO accession agreement. China also will benefit internally from a joint FTA; it would be both a way to solidify its economic influence in the region, and to open up more venues for attracting foreign investments to its rapidly liberalizing market. For ASEAN, this could mean better access than others to the world's most dynamic economy. A link-up between China and ASEAN makes sense: ASEAN's population is 500 million, as against China's 1.3 billion population. But ASEAN's combined GDP is almost the same size as China's. Combining them would give birth to a market of 1.8 billion consumers, or almost a third of the world population. The wide variety of traditional strengths, talents, and natural resources of the two areas would have great power to shape the contours of this giant consumer market.⁹

The proposed China-ASEAN FTA, a Chinese initiative endorsed by both sides in November 2001, is set to take shape within a decade. As part of the free trade area, there will bound to be much lower tariff rates, and, especially in the agricultural trade, less barriers than even the WTO's boundaries, because largely temperate China and tropical ASEAN see themselves as having complementary agricultural sectors. Among those set to benefit the most are the least-developed members of ASEAN, which have been hurt the most by China's WTO accession. These countries include Burma, Cambodia, Laos and to a lesser extent, Vietnam, as China has promised to extend to them the same most-favored nation trading status that it grants to WTO members.

At present, the trade and investment flows between China and ASEAN are already significant. From 1999 to 2000, the share of East Asia's exports going to China almost doubled, from 5.2% to 10.2%. Measuring in terms of trade volume, between January and September, 2002, it reached \$38.55 billion, surging more than 27 percent compared to the same period last year.¹⁰ Since 1995, the annual trade volume between China and ASEAN has increased by an annual average rate of over 15 percent. ASEAN has become China's fifth largest trade partner, while China is ASEAN's sixth largest. Malaysia, for example will surely benefit from increased access to China's market. According to Malaysian government statistics, the country's current export volume to China has increased seven-fold from 1991, while import volume has increased six-fold. Half of the commodities traded were electronic, electrical, chemical, machinery and textile products, and edible oils and grains.

Already, Chinese and ASEAN corporations have taken initiative to start collaborating now. CNOOC Ltd., China's third largest oil company, spent \$585 million to buy the Indonesia oil and gas properties of Spanish energy group Repsol-YPF SA. Chartered Semiconductor Manufacturing Ltd., of Singapore, said it will provide a technology process to Shanghai Tsinghua Chip Crystal Microelectronics Co., and the Government of Singapore Investment Corp. announced its largest China investment to date, paying \$42 million for a Shanghai site on which it will build an office complex. On a macro level, a China-ASEAN FTA will only make intra-regional trading even more attractive, both for the domestic companies of the member countries and for foreign businesses with operations in both North and South Asia.

To ease its Southeast neighbors into a joint free trade area and solidify its influence over the Asian region, Chinese officials have made generous gestures to show that the country will step up as a responsible and benevolent leader in the region. Take its relationship with Cambodia for example. While there are concerns about Chinese dams in the Mekong River, which affects flows to Cambodia, Vietnam, Laos, Thailand and Myanmar, China has also been generous in offering many of these countries economic aid. China is a big donor to Cambodia. It provides water wells in the countryside and

built a major annex to the National Assembly compound. Traffic lights around Phnom Penh, Cambodia's capital, were funded by loans from Beijing, and Cambodia's King Sihanouk flies to China for regular medical checkups while maintaining a palace there, all provided at no charge.

Still, fear remains that ASEAN countries will become mainly low-end suppliers to China's market, providing agricultural products and natural resources such as oil, minerals and timber. Some statistics do seem to point to this as a worrisome trend. In 1993, ASEAN imported \$430 million worth of plastics and rubber and \$330 million worth of fats and oils. In 2000, for example, plastics and rubber imports jumped five times to \$2.27 billion. And some ASEAN countries— particularly Indonesia, which is the biggest — have not done enough to restructure their economies or fix their battered banking systems, which concerns analysts who believe that these economies might become the undesirable step cousins to China's economic boom. And there are the worries over terrorism post-9/11, coupled with the tragedy resulting from the Bali bombing in October 2002. "Southeast Asia is back on the radar screen, but for some of the wrong reasons," says Simon Tay of the private Singapore Institute of International Affairs.

A framework is in place for tighter cooperation between China and Southeast Asia, but only time can tell how this framework, including reducing tariffs and opening up industry sectors to ASEAN quicker than WTO requires, will be realized and accepted by both foreign investors and member countries.

IV. A Case Study in Singapore

Among the Southeast Asian nations, Singapore emerged from the Asian financial crisis of the late 1990s the least scarred. Part of the credit is due to its government's diligence in building an economy with a solid infrastructure and a legal and political system that, though criticized as iron-fisted, is solidly stable. When the economic typhoon swept through Southeast Asia, and destroyed along with economic prosperity, civil and political stability in the region, Singapore was among the few that retained order.

Nevertheless, as a neighbor to countries plagued by civil unrest, the tiny island republic of Singapore suffered along as well. On the eve of the financial crisis, Singapore was drawing more than \$10.7 billion in foreign direct investments, according to the ASEAN statistics. That figure dropped 41 percent to \$6.3 billion. The rebound from that low has leveled at \$8.6 billion in 2001, but still, the eagerness of foreign investments into Singapore has certainly waned since the early 1990s, and especially with China's growing presence in the region.

An island of four million, Singapore has always been forced to change constantly to adapt to the economic development and advancements of its larger and sometimes hostile neighbors. When cheaper-waged neighbors started to take over low-wage manufacturing in the 1980s, Singapore began its gradual shift to sophisticated technology manufacturing, and developing a homegrown hi-tech industry with companies such as Creative Technologies which specializes in digital entertainment software. Still, Singapore also finds itself caught in an odd spot – a developed and sophisticated nation trapped in a region of Asia that foreign investors were shunning. In the aftermath of the Asian financial crisis of the late 1990s, Singapore became a safe haven for foreign companies operating in Southeast Asia. The government tried to leverage that unique position, taking advantage of Hong Kong's struggle to reboot after the crisis to propose itself as the new post-crisis financial services hub; but the island republic's own protectionist measures in the financial services industry essentially destined that campaign to fail.

As Hong Kong slowly merged itself into the Chinese economy post-1997, Singapore started to fret more over its relevancy in Asia's developed world, and found no place for itself in the developing world either. China's emergence as an economic power and the Internet boom that revived Northeast Asia have also created a split between the northern and southern economies, further isolating Singapore, a lonely developed nation trapped in a developing region that is struggling to right past wrongs. Singapore, the south's economic capital, and Hong Kong, the north's capital, have always been considered as the most desirable Asian locales because of their locations and their sophisticated domestic economies. But the pendulum has always swung one way or the other,

depending on their economic and political health; China's entry into the WTO certainly has made many question Singapore's significance, but the island republic's alert and agile responses to the needs of foreign investors – offering new incentives, lower tariffs and better tax breaks among other quick-fix measures – has kept it an important outpost in the Asian Pacific region.

Take the example of American packaging company, United Parcel Services for example. Charles Adams, president of its Asia division, says he gets badgered by the same question every year: Shouldn't our company move its Asian operations to Hong Kong so we're closer to mainland China? And Adams always gives them the same answer. No, his division of the package delivery company should stay put. "We are in Asia to do business with the whole region, not just with China. There's no doubt China is an important market, but that doesn't mean we have to be based there," Adams says. "Our U.S. headquarters is in Georgia. Is that the most important state? No, California is [the biggest state] for our business."¹¹ In Adams' eight years with the Asian division of the shipping giant, he has commissioned numerous studies that considered the costs and benefits of locating the company in any one of half a dozen Asian cities including Hong Kong and Shanghai. The research showed that for United Parcel Service, Inc., Singapore's strategic position as a transshipment hub, its orderly and politically stable government, and its Westernized society set it apart from competing places such as Sydney and Hong Kong.

Now that the honeymoon period is over for China's WTO entry, Singapore hopes that with tax breaks, quality-of-life perks for expatriates, and a new trade agreement with the United States among other bilateral agreements with developed nations, it can lure even more multinationals to its shores. China without a doubt is a formidable competitor to the tiny island republic of Singapore. Many American businesses ranging from construction companies to pharmaceutical concerns that used to be in Singapore have relocated to Hong Kong so as to be closer to China. American pharmaceutical leader Eli Lilly and Company, for example, moved to Hong Kong from Singapore in late 2001 because its business was moving north. More than 60 percent of Eli Lilly's business comes from

China, Taiwan and Korea, so Eli Lilly said it seemed natural to move corporate functions closer to the company's first-tier markets.¹²

This is the very kind of talk that is making Singapore nervous. American businesses have long been the island nation's top investors, contributing 17 percent of the country's total foreign direct investments in 2000, according to Singapore's Ministry of Trade and Industry. But even though WTO requires have loosened the trade barriers in China, most of the 700 American companies in Singapore have chosen to keep their regional operations on the island republic, claims the Singapore Economic Development Board (EDB), the government agency charged with promoting Singapore's pro-business environment. The EDB and the Singapore chapter of the American Chamber of Commerce, a nonprofit lobbying group that works with local governments and U.S. businesses around the world, say, although they have no hard statistics, they haven't seen any anecdotal evidence that U.S. companies are in a hurry to leave Singapore for China.

One reason for this staying power is that for the past five years, and especially over the past several months, Singapore's government has gone to extensive lengths to court multinational companies. In public speeches, Singapore's leaders have urged their citizens to welcome foreign businesses to the republic. It's not just talk; in early 2002, Singapore's deputy prime minister Lee Hsien Loong slashed corporate tax rates to 22 percent from 25 percent to bring his country's rates closer to the lower taxes of Hong Kong and Shanghai. With only four million people – a quarter of whom are foreigners – Singapore has also aggressively courted foreign executives, not just the corporations for which they work. In 1997, the government launched a campaign to recruit foreign professionals. The program was created, government officials say, in part because of the intense battle for qualified workers in Asia. At the same time, many multinationals were beginning to tighten their belts on expensive expatriate packages. Many foreign professionals no longer had their housing allowances, living expenses, and children's tuition paid for when they came to Singapore and other countries, making overseas assignments less attractive. So Singapore's government decided to offer employees tax rebates to cover relocation and recruitment costs for hiring foreign executives, hopefully

an incentive in turn to keep the foreign companies rooted in the island republic. Currently more than 90,000 foreign executives work in Singapore; about 10,000 of them have received employment passes since the foreign talent campaign began. (And the Minister of Manpower recently shortened the application processing time for “top foreign talents” so they can receive their employment passes within one week.)

The EDB has also set up a Training and Attachment Program, TAP, which places young Singaporean graduates with multinational companies. U.S. computer networking heavyweight Cisco Systems, Inc. sponsors internships for a few Singaporeans a year in its offices in the U.S. and around Asia, where the interns receive training in computer networking skills. Some TAP graduates have gone on to work for the San Jose-based company. “In our business, the most important thing is finding and hiring the right talent,” says Joseph Puthussery, Cisco’s Asia Pacific marketing director. “Nowhere else is the government as willing to help us develop talent in IT as the government in Singapore is.”¹³ The island nation also presents itself to blue-chip corporations as a safe haven of law and order. Political unrest in Indonesia, Thailand and neighboring countries drew many businesses to the republic over the past five years, largely in the aftermath of the Asian economic typhoon. From Singapore, most of Southeast Asia is no more than a three-hour non-stop flight. Both Jakarta and Bangkok, two of the busiest centers of corporate restructuring, are less than two hours away.

Perhaps Singapore’s small size is not all disadvantages for the island republic. Policy changes under the one-party political system come quicker than in its neighboring Southeast Asian nations where political bickering and corruption make the push for sensible economic policies to cope with China’s competition come extremely slowly. Realizing its smallness in size, Singapore has turned that disadvantage on its head and tried to market Singapore as a launch pad to the rest of the region. Its focus is on attracting high-end industries such as biotechnology, financial services and professional services such as recruitment firms and consultants. Under the “Headquarter Singapore Program,” the EDB has managed to attract close to 30 global companies to base their Asian regional operations in Singapore, including UPS, General Electrics, Nokia, Caltex,

Philips Electronics, among others. To further incentivize multinationals to use Singapore as a launch pad, the government introduced the “Regional Headquarters Award,” which offers companies that satisfy all the requirements under the headquarters program a 15 percent tax break for the first three years they base their operations in Singapore. In the biotech arena, international pharmaceutical company Merck & Co. signed a tie-up agreement with the National University of Singapore to set up a research and development center to focus on developing drugs specifically catered to the needs of Asian countries, the first Merck R&D facility outside its United States home base. Services companies such as Korn/Ferry International, the largest global recruiter, and Bain Consulting, have a significant chunk of their regional operations in Singapore, including their presidents of Asia-Pacific. To compliment its focus on services and biotech, Singapore at the height of the Internet boom from 1999 to 2000 pushed aggressively to attract venture capitalists to the tiny island republic, urging them to use it as a launch pad for investing in Asia. This initiative has received mixed success as the dot-com bust that soon followed in 2001 dried up investment opportunities in Asia. Still the Singapore venture capital industry has been able to cumulatively raise \$11.5 billion, of which \$8.5 billion has been committed to 2000 projects worldwide.¹⁴

Singapore markets its strengths not just in the business arena. As a former British colony, Singapore’s government boasts the country as the only nation outside Hong Kong’s Special Administrative Region, where English is the official language of business and where all of its citizens are for the most part entirely fluent in English. The Westernized society of Singapore is one point that the EDB relentlessly markets. In mid-2001, the Singapore government ran a series of commercials on cable television stations CNN and CNBC featuring expatriates telling stories about their lives in Singapore; the main message was “It’s just like home.” True to those testimonies, gastronomic and other reminders of American life can easily be spotted around the island: Skippy chunky peanut butter, Oreo cookies, Kellogg’s corn flakes, Swensen’s ice cream. The Singapore American School is modeled after the U.S. school system, offering advanced placement classes and SAT prep courses to prepare students bound for U.S. colleges. The American

Club holds Passover seders, Easter brunches, and Christmas dinners for those who can't go home for the holidays.

But the ad campaigns, the American goods and all the tax perks cannot paper over the downside of doing business in Singapore. The economy has started to slip: economic growth of 10.3 percent in 2000 gave way to a recession in 2001. In the last three years, the pillars of Singapore's economy – high-end electronics, shipping, chemicals and financial services – have suffered as cheaper competitors in China and long-time rivals in Hong Kong and Taiwan fight for the same pot of foreign capital. In Singapore's backyard, Malaysia is trying to assume the role of regional transport hub by wooing shippers and airlines with cut-rate fees. There are other drawbacks for American companies in Singapore. Foreign retail banks, for example, can operate only a limited number of ATM machines and branches there. Foreign mutual funds are also shut out of a lucrative source of business. The state-run Central Provident Fund – similar to the U.S.'s Social Security program – is a pot of more than \$50 billion that comes out of paychecks of all citizens and permanent residents every month. Singaporeans can choose to invest the money in mutual funds or leave it in regular savings accounts. But only a few foreign mutual fund houses are permitted to offer funds for these retirement monies. Moreover, the Singapore Stock Exchange has imposed strict financial disclosure and corporate governance rules on listed companies. New York-headquartered investment banks such as Goldman Sachs & Company, Merrill Lynch & Co., Inc., and Morgan Stanley have a presence in Singapore, but all have chosen to base their regional operations in Hong Kong. China's more laissez-faire attitude toward the financial market allows more flexibility for these corporate banks.

To shield itself from certain impact after China enters the WTO, Singapore has aggressively sought bilateral trade agreements with other countries to secure a share of its market access in countries where it competes with China. To draw on one clear example, the Singapore FTA with Japan tore down the first trade barriers to doing business between North and South Asia. The agreement, which Singapore and Japan signed in January 2002, would take both countries beyond their current commitments to the WTO.

Their WTO commitments cover about 65 percent of current Japan-Singapore trade. Under the FTA, Singapore will grant all Japanese products duty-free entry, while Japan has increased its zero-tariff commitments from the current 34 percent (under WTO) to 77 percent of total tariff lines. Some 94 percent of Singapore's exports to Japan will enter free of duty. The two countries have agreed that electronics, pharmaceuticals, instrumentation equipment, transport equipment and fabricated metal products will be tariff free. Singapore estimates that the potential cost savings from the concessions could grow from \$36 million to \$198 million within five years. Significantly, the FTA is not exclusive of third countries, because Singapore has seen to it that foreign subsidiaries based in Singapore will be treated in the same manner as indigenous Singapore companies. This is not an altruistic move; rather, it is to enhance Singapore's claim as the most attractive destination for multinational companies to establish Asian regional headquarters. The effect Singapore hopes to get from this is that foreign companies will flock to Singapore if they are seeking an indirect route to the Japanese market. This applies especially to Japan's tightly-held services sector, for example, medical and dental services and education.

Singapore's FTA initiatives with the US, Japan and others have also indirectly contributed to catalyzing wider economic linkages and cooperation with these more advanced economies and help anchor them to Southeast Asia. With increasing diversion of investment elsewhere, FTAs, even bilateral ones between individual countries, help catalyze greater trade and investment flows for all ASEAN members, thereby supporting economic growth and job creation. In fact, WTO Director-General Supachai Panitchpakdi has supported Singapore's efforts, pointing out that Singapore could become a linchpin linking ASEAN and the rest of the world. "We need linkages between the region and NAFTA [North American Free Trade Agreement]. Whatever Singapore does, it can generate spin-offs for ASEAN."¹⁵ Far from undermining ASEAN economies, Singapore's FTAs bring about the sharing of benefits. For example, during his visit in early 2002 to Batam and Bintan, two tiny Indonesian islands forty-five minutes by boat from Singapore, U.S. Trade Representative Bob Zoellick announced the Integrated

Sourcing Initiative (ISI) which extended Singapore's FTA with the US to Indonesia for IT products.

V. Conclusion

Any which way the analysis goes, it is obvious that those economies that enter China's orbit will prosper. Those that cannot – or rather, will not – are likely to suffer and decline. China's massive population size and its ability to offer both skilled and unskilled labor to satisfy the whole gamut of industries, from low-end manufacturing to sophisticated computer chip production, will continue to pose a threat to its neighbors. At the low end, where even cheap Thai and Filipino workers cannot match China's rock-bottom wage scales, competition from the mainland is almost guaranteed to decimate certain local industries such as textiles and toys. (Less developed – and cheaper – countries like Vietnam and Indonesia may still be able to hold onto some market share for now, but for Indonesia, the litmus test is political stability.) To survive, these countries will need to focus on sectors like agriculture – where mainland tariffs and farm subsidies are both set to drop – and on the wealthy Chinese middle class, who could boost tourism revenues. At the high end, economies such as Singapore, Hong Kong and Taiwan will have to be flexible and nimble in finding the niches where China is still ill-prepared to satisfy the needs of foreign investors. Singapore's efforts to transition its economy entirely away from manufacturing into services industries and high-end tech sectors such as biotech and computer chip design, are smart solutions to bracing for the China "threat."

Still, the so-called China threat is perhaps only an exaggerated perspective. China is entering only its second year as a member of the WTO; many of the commitments and promises it made to the world, and Southeast Asia, to open up its borders are still in progress, or have not even started. Perhaps it is difficult at present to visualize what a developed China might look like, but as China continues to grow stronger, its very success will not just burden the region. On the contrary, it will be more of a benefit. The "China threat" will spur Asian governments to further their own reform efforts in a phenomenon that some have called "China envy." Governments can no longer stand to

ignore reforms of their financial systems and adaptations of corporate governance, especially when China pushes ahead with much-needed and much-expected change. As Beijing further liberalizes and opens its economy as part of WTO-entry requirements, other countries, so the logic goes, will be forced to follow suit.

Beyond market access, China has come a long way in opening up its economy, but some of the most difficult adjustments still lie ahead, especially in the highly protected industries, where state-owned enterprises tend to be concentrated, and in the services sector. It will inevitably experience some difficulties in implementing its commitments as interest groups try to delay reforms and capacity constraints emerge. China must now step up its institution building and rebuilding – including dismantling remaining central planning institutions, formulating policies consistent with WTO agreements, amending laws inconsistent with WTO rules, and imposing uniform rules throughout the country. It also needs to strengthen social safety nets and narrow economic and social disparities between regions, which will require huge fiscal resources. And without question, it will have to increasingly adhere to the rule of law.

Aware of the unease that is spreading in the region, China has taken every opportunity to stress the economic complementarity that might grow deeper with its economic strength. The government also seems to be acutely aware of the need to temper economic success with diplomatic reality, as China seeks to settle accounts with history and assume a leadership role in the region and the wider world. With examples of generous aid and investment packages in Cambodia, Myanmar and Vietnam, it can be seen that Beijing appreciates that profit must sometimes give way to politics. As Southeast Asian countries try to identify their competitive advantages, they can take heart from the priority that Beijing is giving to the development of its domestic economy. If the new leaders of China hold true to their course, China will not simply follow the Japanese model and emphasize exports above all.

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⁷ Saywell

⁸ ASEAN Secretariat

⁹ May 2002 Speech by Philippine President Gloria Macapagal-Arroyo.

¹⁰ Statistics from the First Macro-Economic Forum on China and the Association of Southeast Asian Nations (ASEAN), October 26, 2002, Kunming, China.

¹¹ Interview with Charles Adams, president of United Parcel Services Asia, Inc., May 2002.

¹² Interview with Daniel Brindle, Eli Lilly's corporate and government affairs spokesman, June 2002.

¹³ Interview with Joseph Puthussery, Cisco Systems, Inc.'s Asia Pacific marketing director, May 2002.

¹⁴ From the Economic Development Board of Singapore website: www.edb.gov.sg

¹⁵ Interview with Supachai Panitchpakdi, director-general of the WTO, in August 2002.