

China's new found love: The GMS¹

Nilanjan Banik²

¹The author would like to thank Dr Pradeep Srivastava, Professor T. N. Srinivasan, Professor Rangarajan Sundaram, and Professor Viswanath Pingali for useful comments on the earlier drafts of this paper. Research assistantship provided by Mr Jyoti Prasad Mukhopadhyay is also acknowledged.

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Nilanjan Banik²

Abstract: The objective of this paper is to understand 'why' the Chinese firms are investing outside China, and 'how' China stands to gain from this decision. For our analysis, we consider the case of China's trade, and investment relation in the Greater Mekong Sub-region (GMS). We find that a reason for the Chinese firms to invest in the GMS has to do with higher domestic input cost, as well as, to evade protectionist measures in the US and the EU. As to, 'how' China stands to gain, it is largely explained through elements of complementarities in trading and investment relationship.

Key Words: China, GMS, Trade, Investment

JEL Classification: F13, F14, F15

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I. Introduction

In recent times shopping spree by major Chinese state-owned firms has been grabbing media headlines. China is investing everywhere, and in every possible sector, such as oil and natural gas, energy, mining, computers, automobiles, telecommunication, and home appliances.³ In this paper we make an attempt to look at the macro factors that are motivating Chinese investment, and trading relation with respect to the Greater Mekong Sub-region (GMS). The GMS comprises of Yunnan and Guangxi province of Peoples Republic of China (PRC), Myanmar, Lao PDR (Laos), Thailand, Cambodia, and Viet Nam. For this analysis, GMS comes as a natural choice. GMS comprises of both emerging technology advanced economies such as China, Thailand, and Viet Nam, as well as, relatively poor rural based economies such as Laos, Cambodia, and Myanmar. Analyzing investment and trading relation of China in this economically diverse landscape, in some way will capture its investment, and trading relation elsewhere in the world. To our knowledge this article is the first of its kind which makes an attempt to understand, ‘why’, and ‘how’ China stands to gain from developing its trading relation with the GMS.

Measured in terms of growth rate of real Gross Domestic Product (GDP), the GMS is one of the fastest growing regions in the world. This region has been growing at an annual average rate of 7 per cent during recent years.⁴ Unlike an institutional arrangement – where countries are bounded by legal agreement, and operate under regional trading agreements – GMS is a project driven flexible organizational structure which was created with the help of Asian Development Bank in 1992. Few other regional characteristics are worth mentioning. The GMS is relatively much less affected by global economic downturn.⁵ Consequently, one finds minimal use of protectionist measures targeted at each other’s exports. The GMS has diverse energy resources in the form of hydropower, natural gas, and coal. Factor input costs – primarily, land, labor and real estate costs – are much cheaper in the GMS when compared to coastal China.

Table 1: Economic Indicators for the GMS, 2009

Regions	Population Million	Population Density People/sq km	Rural Population share (% of total population)	GDP Current US \$ (billion)	GDP per capita Current US \$
China	1334.74	142	56	4985	3744
Yunnan	45.1	115	68	60.9	1349
Guangxi	47.7	201	64	76.5	1605
Cambodia	14.21	82	78	10.02	677
Lao PDR	6.12	27	69.12	5.93	940
Myanmar	59.27	76	66.76	34.26	571

³ A recent search on the Google about Chinese buyout activities yielded close to 3.4 million hits. A nice summary article is available at: <http://www.economist.com/node/17463473>.

⁴ Between 2000-2007, annual average growth rate of GDP in China, Cambodia, Thailand, Laos, and Viet Nam, are 10.2 per cent, 9.8 per cent, 5.4 per cent, 6.6 per cent, and 7.8 per cent, respectively (World Development Report 2009, p. 356-357).

⁵ This becomes evident from the growth rate of GDP for the countries in the GMS.

Thailand	66.90	132	66.34	264	3940
Vietnam	86.02	278	71.68	91.85	1052

Source: World Development Indicators, World Bank, and Statistical Communiqué of the PRC. Figures marked in bold are 2008 figures. For Yunnan and Guangxi, these are 2007 figures.

The rest of this article is organized as follows. Section II analyzed how global economic slowdown has affected China's macroeconomic fundamentals. The impact of such global slowdown in influencing Chinese trade, and investment decision in the GMS are discussed in section III. In section IV we document direction of trade flow between China, and other countries in the GMS. The main findings of this study are elaborated in section V. Finally, we conclude in section VI.

II. Global economic slowdown and China

The financial crisis of 2007 has seriously affected world trade and world income. This is especially true for countries with a higher trade dependency ratio (that is, ratio of the sum of exports and imports to gross domestic product). The slump in global demand has made countries around the world cautious about opening up markets further, and some governments are resorting to protectionist measures. The Organisation of Economic Co-operation and Development (OECD) in its *G20 Report on Trade and Investment Measures 2009* states: "The main risk is that G20 members will continue to cede ground to protectionist pressures, even if only gradually, particularly as unemployment continues to rise" (OECD Report on G20 Trade and Investment Measures, p.6). G-20 nations have accounted for 70 per cent of all protectionist measures since the start of economic crisis of 2007.⁶

Protectionism is not just confined to any one group of countries or trade policy instruments. Indeed, protectionism is becoming evident in terms of higher tariffs and non-tariff barriers (NTBs), mainly in the form of antidumping measures, sanitary and phytosanitary sanctions, and even through the provisions granting subsidies to domestic producers. It is to be noted that much of this discrimination against foreign commercial interests does not break any World Trade Organization (WTO) rules. For example, some countries are increasing their applied tariffs while keeping them below the rates they bound at the WTO.

This short prelude is important as trade explains most of China's income, and labor productivity growth. The trade dependency ratio for China is around 70 per cent. This means a fall in exports can seriously harm the Chinese economy. Because of global financial crisis, and China being a large economy in the world trade arena⁷, it is not surprising that its exports were affected. During 2008, Chinese exports to the EU and the US fell by 19.4 per cent and 12.5 per cent, respectively. After maintaining a

⁶ See entries in the Global Trade Alert database. Available at: <http://www.globaltradealert.org/site-statistics>.

⁷ For the year 2008 and 2009, Chinese exports value ranked highest in the world, followed by Germany and the USA. Source: World Trade Organization Database. Available at: <http://stat.wto.org/StatisticalProgram/WSDDBStatProgramSeries.aspx?Language=E>.

double digits growth rate starting from 2003 until 2007, Chinese GDP growth rate fell to 9 per cent during 2008, and further to 8.7 per cent during 2009.⁸

Global Trade Alert database has indicated that as many as 659 measures have been initiated by China's trading partners against the Chinese exports. Most of these measures (numbers of measures initiated are indicated in parenthesis) have originated from – Russia (31), Germany (18), France (16), United Kingdom (17), Spain (16), Italy (15), Netherlands (15), Sweden (13), Austria (13), Belgium (13), Finland (13), in Europe, and USA (9).⁹ China's trade surplus fell from US\$ 298.12 billion in 2008 to US\$ 195.84 billion in 2009.¹⁰ China did retaliate with some measures on its own, but they are only 49 in numbers. Some of those measures include, ban on imports of Irish pork, Belgian chocolate, Italian brandy, British sauces, Dutch eggs, and Spanish dairy products.

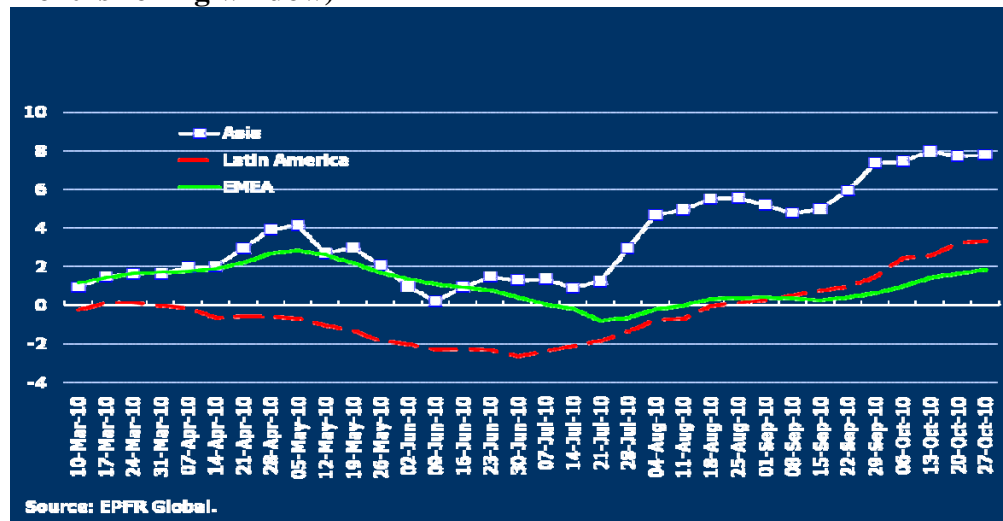
On one side when global recession is hurting the Chinese exports, it has benefitted the Chinese economy in some other ways. Recession in Europe and in the US means fund managers are more interested to invest in emerging market such as China. Foreign fund managers has injected a total US\$ 1.04 billion into China equity funds in the two weeks ending November 24, 2010 significantly more than injections to all other Brazil-Russia-India-China (BRIC) equity funds (Financial Times, 2010b). China has been able to attract huge amount of foreign exchange because of its economic superpower status. In addition, expectation about future appreciation of Chinese Renminbi has also been an influential factor explaining inflow of foreign funds. Starting July 2005 – the year when China adopted the managed float replacing fixed peg to the US dollar – its currency has appreciated by about 20 per cent over the three subsequent years (Straub and Thimann, 2010). China has been actively intervening in its foreign exchange market (that is, using Chinese Renminbi to buy US Dollars), and continued accumulating foreign reserves (Cline and Williamson, 2010). As of June 2010, China has a reserve of US\$ 2.45 trillion.

⁸ Source: Statistical Communiqué of the PRC, 2010. Available at: http://www.stats.gov.cn/english/newsandcomingevents/t20100226_402623115.htm.

⁹ For detail regarding measures initiated against China's exports, see: http://www.globaltradealert.org/sites/default/files/GTA8_country-by-country.pdf.

¹⁰ Source: World Trade Organization Database.

Figure 1: Emerging Market Equity Funds Flow (Billions of US Dollars; 12 months rolling window)

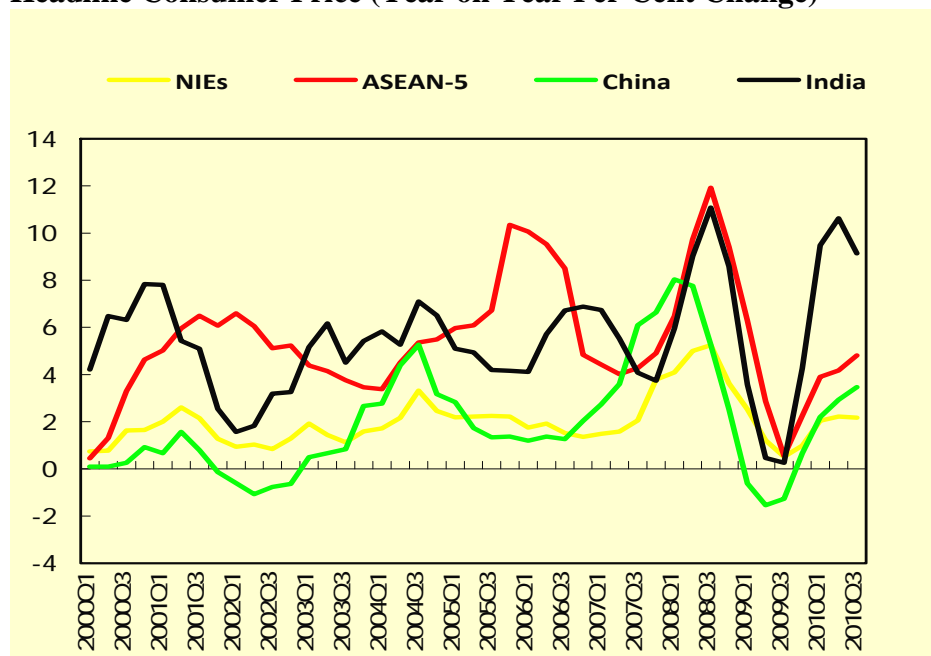


However, such active intervention in the foreign exchange market, and increase in income in China, have resulted the economy to heat-up. Wages of migrant workers, land, property rents, and power prices, have all registered an increase. Measured as year on year basis as of November 2010, labor costs have gone up by 21 per cent, and the home prices across 70 cities in China have gone up by 7.7 per cent. Recent 2010 estimates suggest minimum annual wage rates for Cambodia, Laos and Viet Nam are US\$ 600, US\$ 434, and between US\$ 1200-1500, respectively. If one were to add the mandatory welfare allowances to the minimum annual wage rates, then the Chinese labor costs are at least double compared to laborers in other regions in the GMS (Devonshire-Ellis, 2010). Property prices are also on the rise. What is worrisome is that property prices are rising despite the government having ownership right for land – indicating possible real estate bubble. China has also imposed stricter pollution control norms on its industries, raising the marginal cost of producing goods in China, further.

The fact that the Chinese input costs are rising is evident from multinationals shifting their manufacturing base from China to India. Auto giants, like, Ford and Hyundai have shifted their production bases to India. Between January – July 2010, India exported 230000 cars, vans, sport utility vehicles, and trucks – a growth of 18 per cent, whereas, Chinese exports tumbled 60 per cent to 165000 units. Perhaps due to the same reasons, Nokia exports mobile handsets to some 70 countries from its manufacturing bases located in India.¹¹

¹¹ See, John et al. (2010).

**Figure 2: Inflation in Asia (Excluding Japan):
Headline Consumer Price (Year on Year Per Cent Change)**



Source: International Monetary Fund (IMF) Regional Economic Outlook, October 2010.

As we will see in the next section China’s investment decision in the GMS is in many ways guided to counter its rising domestic input costs, and its exports being targeted with foreign protectionist measures.

III. China and the GMS

High saving rates in China (which is around 50 per cent of GDP), coupled with its fast rising income, and ever rising foreign exchange reserves, means that Chinese have funds to invest elsewhere. Before the economic crisis started, China has invested a major portion of their trade surplus in US Dollar and Euro-denominated assets, value of which is now falling.¹² Between July-October 2010, US Dollar has depreciated by 12 per cent against Euro.¹³ Federal Reserve is printing too much money making the US Dollars lose value further. In fact, USA is investing in assets in China, and other emerging economies in Asia through foreign direct investment (FDI) route, thereby exporting inflation.

Under these circumstance, the GMS can be a natural choice for Chinese FDI primarily because of three factors. First is by shifting production base into the GMS,

¹² The exact makeup of China's roughly US \$2.45 trillion in foreign exchange reserves is a state secret, but most analysts estimate it holds about two-thirds in Dollar-denominated assets and the rest primarily in Euros, Japanese Yen, and British pounds.

¹³ Currency Thoughts. Available at: <http://currencythoughts.com/2010/09/24/a-fed-policy-to-promote-Dollar-depreciation/>.

the Chinese firms can evade foreign NTBs. Secondly, in the GMS, goods can be produced at a cheaper cost relative to coastal China. And finally, as Chinese currency has been appreciating since 2005 and with an expectation about future appreciation, there is a feeling that price of Chinese exports will become costlier. Chinese firms can gain by importing raw material (as imports become cheaper when currency appreciate), and use this imported raw material to produce finished goods outside China.

Proposition 1: Continuous price rise in China such as labor costs, energy price and land rents; the protectionist measures in the US and the EU; as well as the appreciating value of Chinese Renminbi, are motivating the Chinese firms to move into neighboring ASEAN region.

This proposition is supported well by the fact that presently China explains more than 75 per cent of the trade (exports plus imports) happening in the GMS region. As is evident from Table 2, China's share in the GMS trade has increased from 74 per cent during 2000 to 79.6 per cent in 2009 (Also see, Figures 3a, and 3b). China's exports share has increased more relative to its imports share. China's exports contribution to the GMS trade has increased from 36.9 per cent in 2000 to 47.9 per cent in 2009, whereas its share of imports has decreased from 37.1 per cent in 2000 to 31.7 per cent in 2009. In fact, exports by China to GMS 5 (that is, Cambodia, Laos, Myanmar, Thailand and Viet Nam) is growing at an annual average rate of 24.9 per cent, faster than its exports growth to Rest of the World (ROW) growing at 19 per cent annually, in 2000-2009. Intra-GMS 5 exports among themselves is growing at an annual average rate of 18.2 per cent which is less than their annual average exports growth to China, growing at 19.2 per cent annually in 2000-2009. Intra-GMS 5 exports to ROW (without China) has increased from US\$ 82.5 billion in 2000 to US\$ 200.5 billion in 2009, representing an annual average growth rate of 10.4 per cent. This figure is again less than intra-GMS 5 exports growth of 19.2 per cent to China. In 2009, the share of intra-GMS 5 trade without China was around 20 per cent. China is the driving factor behind expansion of trade in the GMS.

Figure 3a: Intra-GMS trade, and China's exports to GMS 5 2000-2009 (US\$ billion)

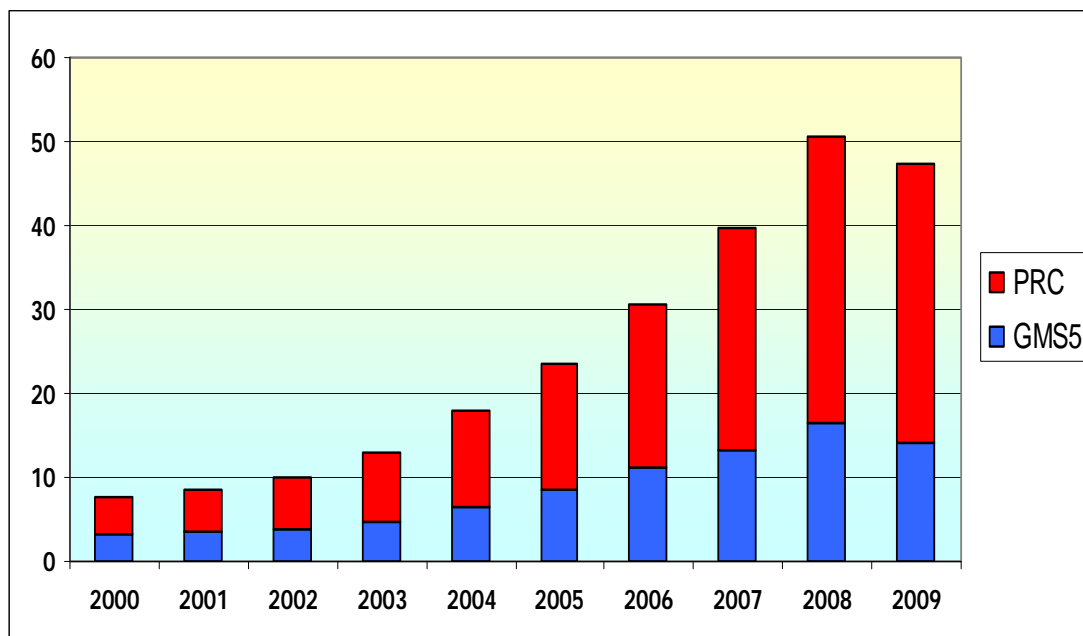


Table2 Examining the Trade Dynamics: China and the GMS 5^a (Figures are in billions of USD)

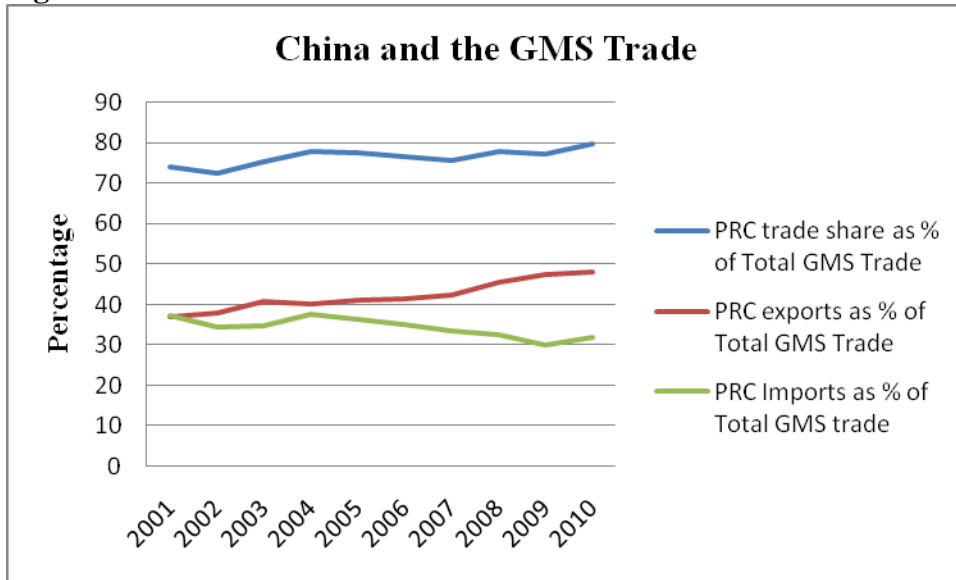
Year	Exports by PRC ^b to GMS 5	Exports by PRC to ROW excluding GMS 5	Exports by GMS 5 to PRC	Exports by GMS 5 to ROW (without PRC)	PRC's trade within GMS	Intra-GMS 5 Total Exports Among themselves (Excluding PRC)	Intra-GMS 5 Exports among themselves plus PRC Exports to GMS 5	Intra-GMS 5 Exports among themselves plus PRC Exports to GMS 5 plus PRC Imports from GMS 5 = Total GMS Trade	PRC trade share as % of Total GMS Trade	PRC Imports as % of Total GMS trade	PRC exports as % of Total GMS Trade
	Xab	Xc	Mab (=Xba)	Xbc	Xab+Xba	Xb	Xab+Xb	Xab+Xb+Mab	(Xab+Xba)/(Xab+Xb+Mab)	(Xba)/(Xab+Xb+Mab)	(Xab)/(Xab+Xb+Mab)
2000	4.5	244.7	4.5	82.5	9.0	3.2	7.6	12.2	74.0	37.1	36.9
2001	4.9	261.2	4.4	79.9	9.3	3.6	8.5	12.9	72.4	34.4	37.9
2002	6.1	319.5	5.2	84.8	11.4	3.8	9.9	15.2	75.1	34.5	40.5
2003	8.3	429.9	7.8	97.5	16.1	4.7	13.0	20.7	77.6	37.5	40.1
2004	11.6	581.8	10.2	118.6	21.8	6.4	17.9	28.2	77.3	36.3	41.0
2005	15.0	746.9	12.7	136.9	27.7	8.6	23.6	36.3	76.3	35.0	41.4
2006	19.3	949.6	15.4	164.8	34.7	11.2	30.5	45.8	75.6	33.5	42.1
2007	26.7	1193.4	19.0	194.5	45.7	13.1	39.8	58.8	77.7	32.4	45.4
2008	34.1	1396.6	21.6	229.3	55.7	16.6	50.7	72.3	77.1	29.9	47.1
2009	33.2	1168.5	21.9	200.5	55.1	14.2	47.3	69.2	79.6	31.7	47.9
Annual Average Growth Rate in 2000-2009	24.9	19.0	19.2	10.4	22.3	18.2	22.5	21.3	0.8	-1.8	2.9

Note: ^a GMS 5 comprises of Cambodia, Laos, Myanmar, Thailand and Viet Nam.

^b PRC is People's Republic of China.

Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/mr/daCommoditiesResults.aspx?px=H3&cc=TOTAL>

Figure 3b: China and the GMS Trade



Other factors influencing Chinese investment decision in the GMS

In addition to proposition 1, China stands to gain from greater economic activities in the GMS in terms of: (1) getting access to a bigger market, (2) bringing a more balanced regional growth within China, (3) investing in regions and markets, that can be used as captive resources, especially, mineral and energy, and (4) political dominance in the South China Sea involving the Spratly Islands.

Access to a bigger market: Trade and investment measures undertaken in the GMS are non-discriminatory and complementary in nature. These nations are increasingly driving down differences among each other in the form of tariff barriers and other border costs. Most of the items are traded at zero tariffs among the member countries. Thailand, Laos, Cambodia, Viet Nam, and Myanmar are all part of ASEAN. As on 1 January 2010 duties on 99.65 per cent of all tariff lines under the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area have been eliminated. For the newer ASEAN Member States – Cambodia, Laos, Myanmar and Viet Nam – 98.96 per cent of total tariff lines are within the tariff of 0 to 5 per cent range.¹⁴ Since October 2003, China and Thailand have taken lead in implementing zero tariffs on agricultural products, covering 200 types of fruit and vegetables. China has also granted zero tariffs treatment to Cambodia (83 products), Laos (91 products) and Myanmar (87 products). In fact, during August 2009, China has signed the China-ASEAN Free Trade Investment Agreement (CAFTA), in addition to signing free trade pact on goods, and services earlier. China-ASEAN Free Trade Area has come into effect from 1st January 2010. Free market access for Chinese exports to the GMS means a larger market for their manufacturers.

¹⁴ Association of Southeast Asian Nations. Available at: <http://www.aseansec.org/25084.htm>.

Balanced regional growth within China: When compared with the other provinces, like, Shandong, Guangdong, Hainan, Jiangsu, Beijing, Shenzhen, and Tianjin,¹⁵ the provinces of Yunnan and the Guangxi, are relatively underdeveloped. Given their geographical proximity to South Asia and the ASEAN markets, China can gain substantially by developing these two regions. Yunnan province shares border with Myanmar in the West, Laos, and Viet Nam in the South. A direct access from Kunming (capital city of Yunnan) to the sea ports of Myanmar would mean China can export products directly to South Asia, Middle East and Europe without going all the way through Malacca Strait, resulting in savings on transport costs and time. Guangxi is located adjacent to the economically developed pan-Pearl River Delta, Hong Kong and Macao. Guangxi also neighbors Viet Nam, which means Chinese factories can set up base there, and still continue to get access to the ports at Hong Kong in the North, and Singapore in the South.

Captive source of resources: Talking about captive resources within the GMS, since 1996, the Chinese firms have constructed six hydro-power plants and one thermal power station in Myanmar (Ebashi, 2006). China has also invested in power transmission, and copper processing activities in Viet Nam. Dongfang Electric of China has won a contract to construct coal fired thermal plant at Hai Phong, Viet Nam (Financial Times, 2010a).

Political dominance in the South China Sea: There has been ownership issue over the Spratly Islands, and the Paracel Islands in the South China Sea. Brunei, China, Indonesia, Philippines, Malaysia, and Viet Nam, each has notified United Nations about their share of claim. The sea around Spratlys archipelago is believed to be extremely rich in natural resources such as hydrocarbons, and fisheries. For reason understandable, the US wanted to mediate using the ASEAN forum which China has been opposing. China's inroad to the GMS can be seen as a strategic move to dominate the politics of South China Sea.¹⁶

So there are reasons for China taking interest in the GMS region.

IV. Direction of Trade flows in the GMS

Below we analyze the direction of Chinese trade flow with respect to individual country within the GMS. While analyzing, we have concentrated on major commodities with a combined exports share of at least 45 per cent.

¹⁵ These regions form the backbone of China's coastal trade.

¹⁶ For more about this refer: http://www.economist.com/blogs/banyan/2011/02/south_china_sea.

*China-Thailand:*¹⁷

Exports of China going to Thailand has increased from US\$ 2243.2 million in 2000 to US\$ 13307.1 million in 2009, representing an annual average growth rate of 22 per cent. The six major exports from China to Thailand include office machines and automatic data processing machines (such as computers, calculators, magnetic and optical reader, and parts and accessories of these machines), general industrial machines (such as air conditioners, refrigerators, pumps, and parts and accessories of these machines), telecom and sound equipment (such as telecommunications equipment and parts and accessories like, telephone lines, microphones, amplifiers, etc.), electrical machinery and apparatus (such as electric bulbs, batteries, switch board, etc.), iron and steel (such as pig iron, iron pellets, iron and steel bars), and textile yarn fabrics (such as cotton fabrics, and textile yarn). In 2000-2009, these six export items on average accounted for around 55 per cent of total China's exports to Thailand. Out of these six items, the three largest export items such as office machines and automatic data processing machines, telecom and sound equipment, and electrical machinery and apparatus, accounted for more than 30 per cent of total China's exports to Thailand. In 2000-2009, the largest export item was office machines and automatic data processing machines, with an average share of 14 per cent in total exports. Telecom and sound equipment, and electrical machinery and apparatus, are the two other important export items, with an average share of 10 per cent each in total exports in 2000-2009. General industrial machine is the fastest growing export item with an annual average growth of 34 per cent in 2000-2009. On an average this item had a share of 5 per cent in total exports in 2000-2009. The shares of textile yarn fabrics, and iron and steel, in total exports are falling. Export share of textile yarn fabrics as a percentage of total exports has fallen from 9.4 per cent in 2000 to 6.5 per cent in 2009. The corresponding figures for iron and steel are 6.5 per cent in 2000, and 4.5 per cent in 2009.

*Thailand-China*¹⁸:

Within the GMS, China is the largest destination for exports from Thailand. Exports of Thailand going to China has increased from US\$ 2816.3 million in 2000 to US\$ 16123.8 million in 2009, representing an annual average growth rate of 21 per cent. The five major exports from Thailand to China include petroleum and petrol products (such as petroleum oils and oils obtained from bituminous minerals other than crude, like, kerosene, light oil, etc.), plastic in primary form (such as polymers of ethylene, and vinyl chloride), crude rubber (such as natural rubber, and synthetic rubber), office machines and apparatus (such as parts and accessories of automatic data processing machines like computer, calculators, etc.), and electrical machineries and apparatus

¹⁷ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,2009&p=764&rg=2&so=9999&qt=n>.

¹⁸ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=764&y=2000,%202009&p=156,%20344,%20446&rg=2&so=9999&qt=n>

(such as equipment for distributing electricity, electric switch board, photo-cathode valves, and tubes, bulbs, batteries, etc.). In 2000-2009, these five items on average accounted for around 60 per cent of total Thailand's exports to China. The largest export is office machines and apparatus (22 per cent), followed by crude rubber (11 per cent), electrical machineries and apparatus (11 per cent), petroleum and petrol products (8 per cent) and plastic in primary form (7 per cent), with numbers in the parentheses indicating average share of respective items in total exports in 2000-2009. Among these items, office machines and apparatus, and electrical machineries and apparatus, are the two fastest growing export items – registering an annual average growth rates of 24.7 per cent, and 19.7 per cent, respectively, in 2000-2009. The other main exports from Thailand to China include, cereal and cereal products (rice), although its contribution in total exports is falling – 4.5 per cent in 2000 to 1.4 per cent in 2009.

*China-Viet Nam:*¹⁹

Exports of China going to Viet Nam has increased from US\$ 1537.2 million in 2000 to US\$ 16300.9 million in 2009, representing an annual average growth rate of 30 per cent. Within the GMS, Viet Nam has become the largest destination for Chinese exports. The four major exports from China to Viet Nam include textile yarn fabrics (such as cotton fabrics, and textile yarn), petroleum and petrol products (such as petroleum oils and oils obtained from bituminous minerals other than crude, like, kerosene, light oil, etc.), iron and steel (such as pig iron, iron pellets, iron and steel bars), and road vehicles (such as motor cycles, moped, motor vehicles for transport of goods, and parts of motor vehicles). In 2000-2009, these four exports items on average accounted for around 45 per cent of total China's exports to Viet Nam. Out of these four items, the three largest export items such as textile yarn fabrics, petroleum and petrol products, and iron and steel accounted for more than 30 per cent of total China's exports to Viet Nam. In 2000-2009, the average share of these items in the total export basket were 12 per cent for petroleum and petrol products, 11.5 per cent for textile yarn fabrics, and 11 per cent for iron and steel. Telecom and sound equipment, and electrical machinery and apparatus, are the two fastest growing export items. The share of telecom and sound equipment in total exports has increased from 0.88 per cent in 2000 to 8.93 per cent in 2009. The corresponding figures for electrical machinery and apparatus are 1.47 per cent in 2000, and 5.28 per cent in 2009. Although a major export, share of road vehicles in total exports has fallen from 28.9 per cent in 2000 to around 4 per cent in 2009.

¹⁹ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,2009&p=704,%20704&rg=2&so=9999&qt=n>

*Viet Nam-China:*²⁰

Exports of Viet Nam going to China has increased from US\$ 1536.4 million in 2000 to US\$ 4746.7 million in 2009, representing an annual average growth rate of 13 per cent. The eight major exports from Viet Nam to China include crude rubber, fruits and vegetables (such as cassava, cashew nuts, etc.), petroleum and petrol products (such as petroleum oils and oils obtained from bituminous minerals other than crude, like, kerosene, light oil, etc.), cork and wood, metaliferous ores and metal scraps (such as iron ores, and concentrates), coal coke and briquettes, fish crustaceans and mollusk, and footwear. In 2004-2009, these eight exports items on average accounted for more than 72 per cent of total Viet Nam's exports to China. The three largest export items such as coal coke and briquettes, petroleum and petrol products, and crude rubber, accounted for more than 50 per cent of total Viet Nam's exports to China. Exports of coal coke and briquettes, and crude rubber have registered an annual average growth rate of 76.9 per cent, and 41.0 per cent, respectively in 2000-2009. Their shares in total exports have also increased: from 0.50 per cent in 2000 to 27.24 per cent in 2009 for coal coke and briquettes, and from 4.33 per cent in 2000 to 21.41 per cent in 2008 for crude rubber. Although still a major component of exports, share of petroleum and petrol products has fallen from 53.29 per cent in 2000 to 9.77 per cent in 2009. In 2000-2009, this item has registered an annual average growth of -3.3 per cent, indicating toward its losing importance in the overall exports basket. The other export item that has experienced a fall in export share is fish crustaceans and mollusk – 15.42 per cent in 2000 to 0.59 per cent in 2009. Share of fruits and vegetables in total exports have remained more or less constant at around 9 per cent in 2000-2009.

*China-Cambodia:*²¹

Exports of China going to Cambodia has increased from US\$ 164.06 million in 2000 to US\$ 907.06 million in 2009, representing an annual average growth rate of 21 per cent. The single most important export from China to Cambodia is textile yarn fabrics (such as cotton fabrics, and textile yarn) with an average export share of 58 per cent in total exports in 2000-2009. This item is also growing the fastest. The annual average growth rate for textile yarn fabrics in 2000-2009 was 23.2 per cent. Two other important export items are telecom and sound equipment (such as telecommunications equipment and parts and accessories like, telephone lines, microphones, amplifiers, etc.), and iron and steel (such as pig iron, iron pellets, iron and steel bars). Each has registered an average export share of around 4 per cent in total exports in 2000-2009.

²⁰ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,%202009&p=516,%20704&rg=1&so=9999&qt=n>

²¹ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,2009&p=116&rg=2&so=9999&qt=n>

*Cambodia-China:*²²

Exports of Cambodia going to China has increased from US\$ 24.1 million in 2000 to US\$ 36.9 million in 2009, representing an annual average growth rate of 4.82 per cent. The five major exports from Cambodia to China include cork and wood (such as wood blocks), cork and wood manufactures (such as wooden doors, windows, and their frames), crude rubber (such as natural rubber, and similar natural gum in primary forms), textile fabrics (such as worn clothing, and textile rags), and clothing accessories (such as men, women, boys' and girls' trousers, shorts, dresses, and skirts). In 2000-2009, these five items on average accounted for around 85 per cent of total Cambodia's exports to China. The largest export is cork wood, and cork wood manufactures (38 per cent) followed by textile fabrics and clothing accessories (33 per cent), and crude rubber (14 per cent), with numbers in the parentheses indicating average share of respective items in total exports in 2000-2009. Exports of clothing accessories and crude rubber are growing the fastest. While clothing accessories has registered an annual average growth rate of 261.2 per cent in 2000-2008, crude rubber has registered an annual average growth rate of 47.8 per cent. There has been a huge fall in share of cork and wood manufactures (SITC code 63) in total exports: from 85 per cent in 2000 to less than 1 per cent in 2009. However, share of cork and wood (SITC code 23) in total exports has shown a steady increase: from 4.6 per cent in 2000 to 23 per cent in 2009. The reason for these two items still managing to be on average the largest export items in 2000-2009 is because of their higher share in total exports during 2000-2005.

*China-Laos:*²³

Exports of China going to Laos has increased from US\$ 34.4 million in 2000 to US\$ 376.6 million in 2009, representing an annual average growth rate of 30 per cent. The five major exports from China to Laos include road vehicles (such as motor cycles, moped, motor vehicles for transport of goods, and parts of motor vehicles), telecom and sound equipment (such as telecommunication equipments, and parts and accessories like, telephone lines, microphones, amplifiers, etc.), electrical machinery and apparatus (such as electric bulbs, batteries, switch board, etc.), general and special industrial machines (such as air conditioners, refrigerators, pumps, and parts and accessories of these machines), and power generating machines (such as internal combustion piston engines, rotating electrical plant, and their parts thereof). In 2000-2009, these five exports items on average accounted for around 65 per cent of total China's exports to Laos. The two largest export items are road vehicles, and telecom and sound equipment, with an average share of 18 per cent each in total exports in 2000-2009. Three other important export items, namely, special and general industrial

²² Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=116&y=2000,%202009&p=156,%20344,%20446&rg=2&so=9999&qt=n>

²³ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,2009&p=418&rg=2&so=9999&qt=n>

machines, electrical machinery and apparatus, and power generating machines, had an average share of 11 per cent, 10 per cent, and 7 per cent, respectively, in total exports in 2000-2009. The fastest growing export item is power generating machines, having registered an annual average export growth of 57 per cent in 2000-2009.

*Laos-China:*²⁴

Exports of Laos going to China has increased from US\$ 6.4 million in 2000 to US\$ 367.31 million in 2009, representing an annual average growth rate of 57 per cent. The four largest export items such as, fruits and vegetables (such as cassava, jatropa, palm, roots, and other edible vegetable products), cork and wood (such as wood blocks, and railway sleepers of wood), non-ferrous metals (such as copper, gold and gypsum), and metaliferous ores and metal scraps (such as copper ores and concentrates), accounted for more than 80 per cent of total exports. Although, exports of fruits and vegetables, and cork and wood have registered an annual average growth rate of 15.7 per cent, and 27.1 per cent, respectively between 2000-2009, their share in total exports have fallen. For fruits and vegetables, their share in total exports has fallen from 23.65 per cent in 2000 to 1.53 per cent in 2009, whereas for cork and woods, the figures are 62.21 per cent in 2000, and 9.44 per cent in 2009. For non-ferrous metals, their share in total exports has fallen from 24.47 per cent in 2005 to 10.06 per cent in 2009. Metaliferous ores and metal scraps has emerged as the most important export item, with its share in total exports increasing from 2.46 per cent in 2005 to 67.74 per cent in 2009, and recording an annual average growth rate of 346.2 per cent during the same period.

*China-Myanmar:*²⁵

Exports of China going to Myanmar has increased from US\$ 496.4 million in 2000 to US\$ 2261.2 million in 2009, representing an annual average growth rate of 18 per cent. The five major exports from China to Myanmar include textile yarn fabrics (such as cotton fabrics, and textile yarn), road vehicles (such as motor cycles, moped, motor vehicles for transport of goods, and parts of motor vehicles), general and special industrial machines (such as air conditioners, refrigerators, pumps, and parts and accessories of these machines), iron and steel (such as pig iron, iron pellets, iron and steel bars), and power generating machines (such as internal combustion piston engines, rotating electrical plant, and their parts thereof). In 2000-2009, these five export items on average accounted for around 51 per cent of total China's exports to Myanmar. The largest export item from China to Cambodia is textile yarn fabrics with an average export share of 16 per cent in total exports in 2000-2009. The annual average growth rate for textile yarn fabrics in 2000-2009 was 11 per cent. Four other

²⁴ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,2009&p=418&rg=1&so=9999&qt=n>

²⁵ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2000,2009&p=104&rg=2&so=9999&qt=n>

important export items, namely, general and special industrial machines, road vehicles, iron and steel, and power generating machines, had an average share of 11 per cent, 8 per cent, 8 per cent, and 7 per cent, respectively, in total exports in 2000-2009. The fastest growing export item is power generating machines, having registered an annual average export growth of 24 per cent in 2000-2009.

*Myanmar-China:*²⁶

Exports from Myanmar going to China has increased from US\$ 124.8 million in 2000 to US\$ 646.1 million in 2009, representing an annual average growth rate of 20 per cent. The largest export item is cork and wood (such as log of wood, railway sleepers, etc.). In 2000-2009, this item on average has accounted for around 58 per cent of total Myanmar's exports to China. In addition, there are three other important export items, namely, non-metal mineral products (such as pearls and precious stones), fruits and vegetables (such as chili, pineapple, papaya, asparagus, etc.), and fish, crustaceans and mollusk. In 2009, the shares of these items in total exports were 11 per cent, 8 per cent, and 9 per cent, respectively.

V. Understanding the Trade Dynamics

From section IV, it is evident that there exist complementarities in trading and investment relation between China, and other nations in the GMS. Complementarities exist in terms of trade in energy, consumer durables, and food items. The energy source, particularly hydroelectric power generation on the Mekong river, can be of use to the booming and fuel hungry economy of China. In 2009, China accounted for 46 per cent of global coal consumption, and consume similar amount of aluminum and zinc.²⁷ China is looking at alternative additional sources for energy. Laos has been supplying hydroelectric power to Thailand. Viet Nam has been supplying petroleum and petrol products to Thailand, China, Laos, and Cambodia. China has invested in hydroelectric power project in Cambodia. In the future, Cambodia with a potential of an estimated 8000 megawatt of hydropower can also be a major supplier for energy. There are about 30000 million tones of coal reserves in Yunnan, with a potential to generate 125000 megawatt of electricity over a 30 years period.

A rise in income in China has also resulted in increase demand for food, meat, and clothing – something which are supplied particularly by, Myanmar, Laos, Cambodia, and Viet Nam. In return, China is increasingly exporting raw materials, and electronic items into the GMS region. For instance, textile yarn is one of China's biggest exports. China has been investing in garment manufacturing activities in Myanmar, and Cambodia. Textile yarn is used as an input for manufacturing garments in these two countries. Cambodia has now emerged as a one of the major exporters of clothing and accessories. For Myanmar, garment is one of its major exports item.

²⁶ Data Source: United Nations Commodity Trade Statistics Database. Available at: <http://comtrade.un.org/db/dqBasicQueryResults.aspx?cc=AG0&px=S3&r=156,%20344,%20446&y=2008,2009&p=104&rg=1&so=9999>

²⁷ For more about this refer: <http://www.economist.com/node/17363625>

We find evidence about intra-industry trade. Most of the trade happening between China-Thailand, and China-Viet Nam, relates to items in the capital goods sector, such as, office machines, electric machines, road vehicles, etc. Thailand, Viet Nam, and Cambodia, has become manufacturing hub for white goods (namely, consumer durables, like, mobile phones, air conditioner, refrigerators, computers, etc.) and other electronic items. Most of the office machines, and electrical machineries that Thailand exports; most of the fertilizers and motor cycles that Viet Nam sell, are made with Chinese machinery inputs, and with the help of Chinese investment. Accordingly, we find inputs used for manufacturing office machines, automatic data processing machines, general industrial machines, and power generating, forming bulk of Chinese exports to these three countries.

For, Myanmar and Laos, bulk of China's exports comprise of finished electronic items, road vehicles, electrical equipments, telecommunication and sound equipments, and iron and steel. China is investing in Myanmar with money and technical expertise to build infrastructure, such as, building container dock and coastal ships, power stations, and cement factories. Similarly, major exports items of China to Laos, include, electrical equipments, road vehicles, telecommunication and sound equipments, clothing and accessories and manufactured commodities. China's strategy for these two countries seems to involve building technical and commercial expertise with an eye to venture into the services sector. For example, China has laid down optical fiber cables in the Yunnan-Laos-Thailand sector, and Yunnan-Laos sector. It is also assisting Cambodia to lay their telecommunication network.

This element of trade, and investment complementarities, are facilitated by two other related issues: (1) Agglomeration effect, and (2) A fall in trade costs.

Agglomeration Effect: Agglomeration effect in economics is associated with economies of scale, and show how scale economies in production, movement of labor and capital, and falling transport costs interact to produce rapid economic growth in cities, town and region. To sustain rapid growth of trade, it is necessary to have a well-functioning infrastructure – including road and rail connectivity, efficient ports and airports, electric power, telecommunications, and banks.

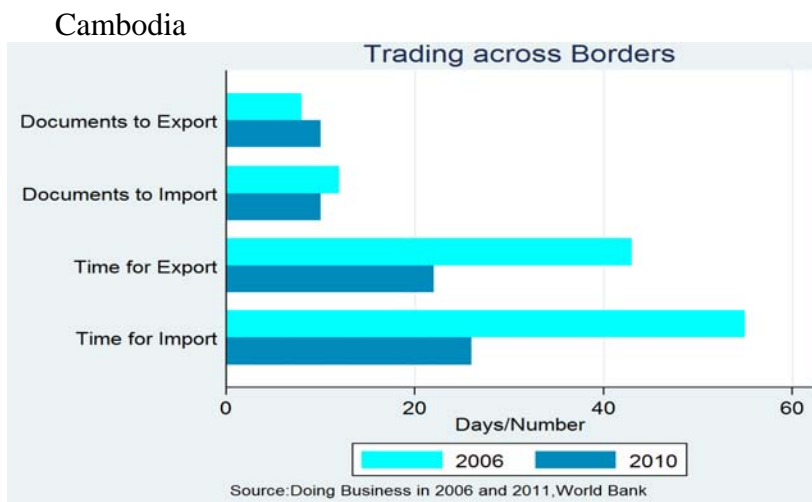
In the GMS, the attempt has been made to integrate the region primarily by building network of roads. The backbone of transport system essentially comprises three large networks of roads – the North-South economic corridor, East-West economic corridor, and the Southern economic corridor. Laos and Yunnan province are landlocked and have mountainous terrain. Myanmar also has considerable portion of hilly terrain. Adverse physical geographic conditions increase economic distance; reduce trade of goods and services; and flow of labor, capital, and information. Connecting these spatially separated regions is important from the perspective of overall regional development. These economic corridors can connect landlocked regions in the GMS with the seaports.

The North-South economic corridor connects Yunnan province of China with Thailand, via Laos and Myanmar. The East-West corridor connects Myanmar, Thailand, Laos and Viet Nam. And, the Southern economic corridor connects Thailand, Cambodia with Viet Nam.²⁸

Trade Costs: Trade cost is any cost that is incurred in moving the good to the final consumers other than the marginal cost of producing the good. There can be many types of trade cost. These include: transportation costs - both freight costs and time costs; information costs; contract enforcement costs; costs associated with trading in different currencies; lack of trade facilitation measures, such as, inadequate logistics of moving goods through ports, inefficient handling of custom documentation, lack of harmonization of regulation standards, etc.; language barriers; and local distribution costs, both, wholesale and retail.

World Bank has a way of tracking trade costs. In their document titled, “Doing Business Report”, it provides information about four leading indicators, namely: number of documents required for exports; number of documents required for imports; time taken for exports; and time taken for imports. Tracking these indicators over time can generate some idea about trade costs. As Figure 4 shows, for the GMS countries, there is an indication about a fall in trade costs between 2006 and 2010. On the basis of these four aforementioned indicators, available data suggest that trade costs is least for China, followed by Thailand, Viet Nam, Cambodia, and Laos.

Figure 4: Trading across border costs

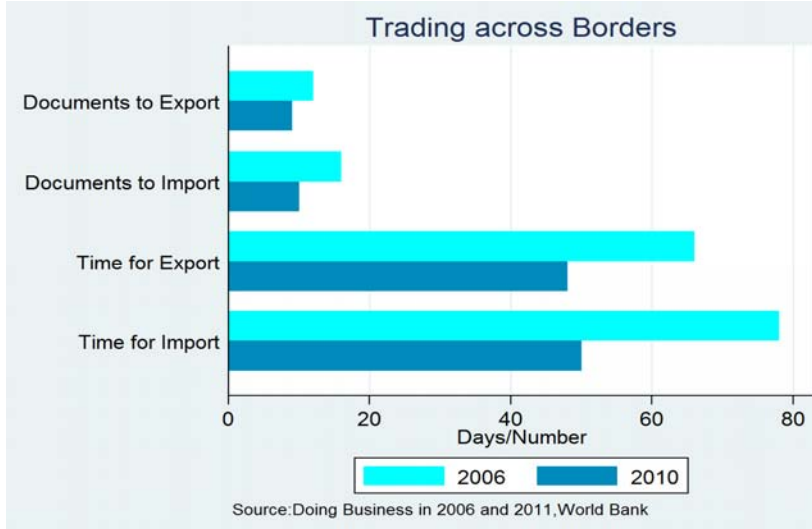


²⁸ These corridors are part of the ASEAN-China transport corridors which plans to connect: i) China-Myanmar-Andaman Sea; ii) China-Lao PDR-Myanmar-Thailand- Malaysia-Singapore; iii) China-Viet Nam-Laos-Cambodia; iv) Viet Nam-Cambodia- Thailand-Myanmar; and v) Viet Nam-China-Myanmar-India. For more about China-ASEAN infrastructure initiative, see: <http://www.aseansec.org/25587.htm>.

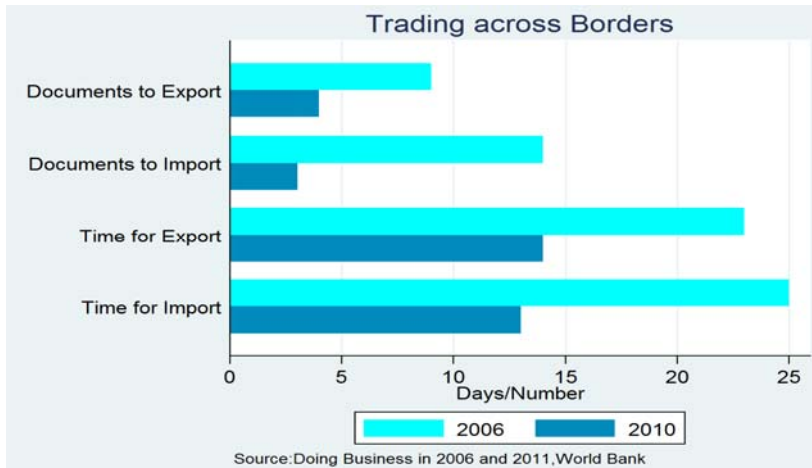
China



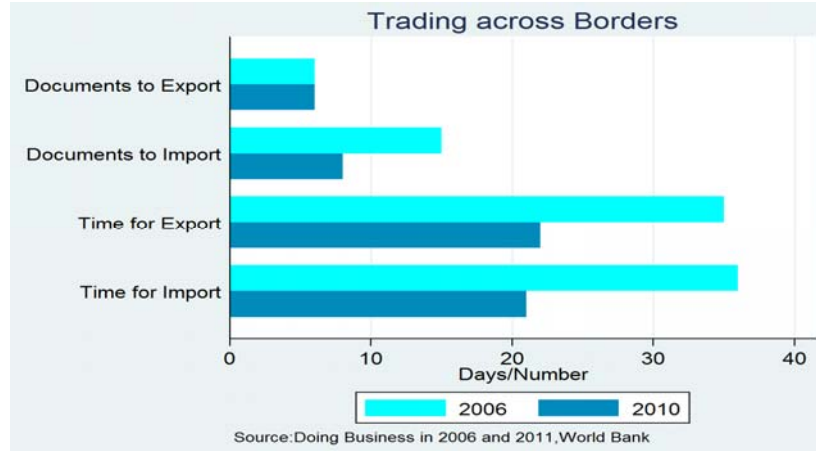
Lao PDR



Thailand



Vietnam



Proposition 2: A fall in trade costs, complementarities in trade and investment relation, along with the factors mentioned in Proposition 1, have resulted in greater synergy in trade and investment relation between China, and other countries in the GMS.

VI. Conclusion

In this paper we attempt to understand ‘why’ the Chinese firms are investing outside China, and ‘how’ China stands to gain from this decision. We consider the case of GMS because this region comprises of both emerging technology advanced economies such as China, Thailand, and Viet Nam, as well as, relatively poor rural based economies such as Laos, Cambodia, and Myanmar. Analyzing investment and trading relation of China in this economically diverse landscape, in some way will capture its investment, and trading relation elsewhere in the world.

A reason for the Chinese firms to invest in the GMS has to do with continuous price rise in China such as increase in labor costs, energy price and land rents, as well as, the protectionist measures in the US and the EU targeting its exports. Under these circumstances, China stands to gain by investing in the GMS.

As to, ‘how’ China stands to gain is largely explained through the elements of complementarities in its trading and investment relationship with other countries in the GMS. Complementarities exist in terms of trade in energy, consumer durables and food items. China is a major buyer of energy and food items from this region. Laos has been supplying hydroelectric power to China, and Thailand. Viet Nam has been supplying petroleum and petrol products to Thailand, China, Laos, and Cambodia. A rise in income within the GMS has also resulted in increase demand for food, meat, and clothing – things which are supplied particularly by, Myanmar, Laos, Cambodia, and Viet Nam. As labor is relatively cheaper in Cambodia, and Myanmar, China has

been investing in garment industries there. A fall in trade costs, emergence of better infrastructure connectivity because of economic corridors, and reduction in tariff barriers because of trade reforms, have all resulted in greater synergy in trade and investment relation in the GMS region.

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