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# Introduction: Southeast Asia and China's Growth Deceleration

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**Abstract**

Because China has experienced unprecedented growth so high and for so long, its recent growth deceleration has become a subject of intense debate. This debate has pitted proponents of "China Collapse" against those who argue for the country's reversion to more balanced growth. For ASEAN member countries which have become increasingly integrated economically with China, the key question is not the above debate but how severe the impact of this slowdown on them will be. For each country this impact depends on the level of economic development and the precise nature of the bilateral economic relationship. Factors unrelated to China also impact these countries, so that blaming China for any adverse developments would not be fair. But untangling causes is not easy. Equally important to remember is that China's "New Normal" is multi-dimensional and a focus on growth deceleration alone is not helpful. The papers in this Special Issue explore these topics in greater detail.

***Keywords***: *Economic growth, new normal, China, Southeast Asia*

## 1. China's Growth Phenomenon and the New Normal

Since Deng Xiaoping liberalized the Chinese economy after three decades of central planning, the dominant story has been its economic growth. This growth has been unprecedented, both in terms of magnitude and longevity. Between 1982 and 2012, its GDP grew at and above 7% per annum,[1] an unbroken spell of 30 years. This performance has been built on trade – over the period 1980 to 2010, China's trade (exports plus imports) as a share of GDP had expanded from 12.4% of GDP to 48.9% before easing a little to 47.7% in 2014. Along the way, it overtook Germany to become the world's largest exporter in 2009 and the US as the world's largest trading nation by 2012 (Bloomberg, 2013).

This growth performance has also garnered much attention, especially in Western intellectual circles, because it is built upon an approach to economic transition – gradualism – that was not favoured by many scholars (e.g. Sachs, 1992), who put their weight behind the "Big Bang" approach of complete liberalization in a single step. Much to these scholars' embarrassment, China's economic performance stood in stark contrast to that of Russia and many eastern European countries, adopters of the "Big Bang" approach, which saw their economies collapse before recovery.

Yet the longer China's economy continued on its "miraculous"[2] growth path, the greater the consciousness that this growth cannot continue forever. This consciousness has been given substance since 2012, when China's growth rate fell from 9.5% a year earlier to 7.9% and further to 6.9% in 2015. The phenomenon itself acknowledged by the Chinese leadership in its reference to the "New Normal"[3], has generated active debate as to its causes. A "New Normal" refers to China's rebalanced economic growth featured by a slower but more sustainable economic development increasingly supported by technological innovation and industrial upgrading, instead of a miraculous double-digit growth rate largely supported by cheap and abundant labour and use of natural resources in the past decade (Rasiah et al., 2013; Zhang and Chen, 2017).

Growth deceleration has on the one hand been predicted by theories of convergence which hold that as economies develop, their rates of economic growth must inevitably decline, allowing economies further down the development ladder to catch-up (Kerr et al., 1973; Ramesh, 1976). More ominous is the argument based on empirical observation that many middle-income countries never progress beyond middle-income, instead falling into a "middle-income trap" (Gill and Kharas, 2007). This is a result of the country not being able to move up the production value-added ladder to compete with more advanced countries while simultaneously losing comparative advantage at the lower end of the value-added spectrum to countries lower down the development ladder.

An entirely different narrative, though reaching a similar but more extreme conclusion, is that of the eventual collapse of China under a system at variance with Western-style liberal democracy. Although couched under different guises ranging from political repression (Shambaugh, 2015), lack of people's voice (Anderlini, 2013), corruption and poor governance (Acemoglu and Robinson, 2012; Pei, 2015), China's slowdown, it has also been argued presages its eventual collapse.

Whatever the explanation for slowing growth, China's economy has grown so large that any change in its overall growth will impact other economies, with deceleration having likely adverse consequences for the latter as well. China's growth slowdown will mean lower imports from the rest of the world, especially in the form of resources imports. It will also mean that Chinese companies will seek to be more aggressively competitive in global markets even as the domestic market offers fewer opportunities for growth. Proponents of China collapse may yet see the realization of their prediction, but were this indeed to pass, it would prove to be an empty victory as their economies suffer adverse consequences of China's slowdown.

A change of such magnitude in China's economic growth will undoubtedly impact the rest of the world, including Southeast Asia, which is intensively involved in trade and investment with China in the past decades. What of Southeast Asia, all members of ASEAN is the focus of this special issue, for which almost all countries (Brunei being the exception) count China as the largest source of their imports and a top destination for their exports (Table 1). While the slowdown in trade will surely have an economic impact, the structure of economic relations between each Southeast Asian country and China varies. In addition to this structural factor, contextual factors can also be important. As discussed briefly in the next section, it is difficult to generalize for the whole of Southeast Asia.

## 2. China's Growth Slowdown and Implications

A number of reasons, both domestic and external, have been advanced regarding China's economic slowdown. Domestically, China's major challenges include the after effects of the massive stimulus of RMB4 trillion that, predicted Roubini (2011), led to China "eventually facing immense overcapacity and a staggering non-performing loan problem" and "… after 2013… suffer a hard landing". Another challenge is rising inequality, the

**Table 1** China's Importance in the Trade of ASEAN Countries, 2013

| *Country* | *China's Rank as Export Destination* | *China's Rank as Import Source* | *China's Rank as Trading Partner*$^{+}$ |
|---|---|---|---|
| Brunei | >5 | 4 | >5 |
| Cambodia | >5 | 1 | 2 |
| Indonesia | 2 | 1 | 1 |
| Laos | 1 | 2 | 2 |
| Malaysia | 2 | 1 | 1 |
| Myanmar | 2 | 1 | 1 |
| Philippines | 3 | 1 | 2 |
| Singapore | 2 | 1 | 1 |
| Thailand | 1 | 2 | 1 |
| Vietnam | 3 | 1 | 1 |

Note: $^{+}$ Trade refers to the sum of exports and imports.
Source: Salidjanova and Koch-Weser (2015).

result, according to the World Bank, of the realignment of economic activity away from agriculture and towards industry which rapid urbanization helped accelerate (Sharma et al., 2011, p. 3). Other challenges have also emerged, including "demographic challenges of a low fertility rate and rapid population ageing, income distribution, environmental degradation" and so on (Zhang and Chen, 2017, p. 1).

Of these domestic challenges, there is less of a dispute about their presence than about their severity. China collapse proponents argue that these challenges are so severe as to lead to the end of the present system (Kroeber, 2012).[4] Less extreme pessimists predict a "hard landing" that will see China experiencing a depression (Roubini, 2011). Some seasoned China observers (e.g. Lardy, 2015) are more optimistic, arguing that China's "economy can weather a long, slow fall" (Knowledge@Wharton, 2014).

Whatever the pessimists predict, the Chinese leadership (Tiezzi, 2015) for its part, saw the slowdown more as an opportunity to "rebalance" the economy. This rebalance would certainly include shifting away from heavy dependence on exports to domestic consumption as the growth driver, redressing income and asset inequality between the coastal and interior provinces, and between the rich and poor within each location. Economic restructuring would take the form of moving from low cost and low value-added manufacturing, for which China has become renowned, to higher value addition in manufacturing through the use of technology and a shift to services. As wages have been increasing, and as China ramps up its technological capability, this is already occurring. Efforts are also being made to nurture high value-added services, such as finance and insurance.

The external environment has also been none too certain. Of the major industrial powers, only the US has recovered from the Global Financial Crisis despite the Trump administration arguably leaving the nation's future uncertain. Europe continues to be mired in one scandal after another, and the latest, Britain's disengagement from the European Community, a decision taken in June 2016, will impact both for years to come. Japan is yet to find a way to recover from the lost decade that began after the 1986 Plaza Accord. China, of course, is not a bystander to reduced global growth; it has been a key driver of global growth for years.

For Southeast Asia, which has become increasingly trade-dependent on China (although the converse is not true)[5], the most direct consequences are in the area of trade. A slowdown in China's growth should see reduced demand by China for Southeast Asian exports, which will be hurt by both lower volumes and prices. Nevertheless, not all Southeast Asian exports are arms-length exports to which the previous statement applies. A substantial proportion of trade with China consists of process trade from global supply chains. What happens to these chains is difficult to predict. One possibility is to see process trade also shrink – after all, goods that are finally assembled in China, the end-point of many supply chains, are partly destined for the Chinese market. Another dimension of China-ASEAN economic integration is outflow investment from China. One of the ominous developments following the ever-growing Chinese investment, not necessarily related to the slowdown though, is the likelihood that as China's technological capability grows, it will progressively take over segments of these supply chains. Indeed, "onshoring" – the substitution of imported intermediate inputs with domestic production – is already occurring (Kang and Liao, 2016).

Also the level of economic development and the nature of economic relations between each ASEAN member country and China vary. For instance, while countries like Malaysia which has a trade surplus with China will see that surplus shrink, countries like Vietnam which has a trade deficit with China may see this deficit grow. At the same time, countries like Cambodia and Laos are recipients of Chinese economic aid which may not be severely affected by the China slowdown. For CLMV countries, there is hope that China's attempt to upgrade its industries may see a relocation of labour-intensive industries from China to these countries. There is no certainty for this development, however. First, China may opt, as part of its rebalancing, to move its industries westward away from the coastal region.[6] Second, China's increasing deployment of robotics in production may see jobs being eliminated in China without production relocating (Willliams-Grut, 2016).[7] The effect of factories in China replacing humans on the manufacturing line with robots in a new automation-driven industrial revolution is increasingly felt around the globe (Bland, 2016). Perhaps, as wages in China rise, whether for economic or policy reasons, other foreign invested enterprises that counted on China's cheap labour may shift their operations out of China. For example, Vietnam can potentially benefit from this development.

The discussion so far assumes that China's growth deceleration is the single major factor impacting Southeast Asia. This is of course not true. Other major developments, some attributable to China while others not, are clearly germane to what happens to Southeast Asian nations even as China's economy slows.

The first of these, in which China not only has a hand but plays a pivotal role, is the global economic initiative called "Belt and Road Initiative" (BRI). Launched in 2013[8], it consists of a land component – the "Belt", or the "Silk Road Economic Belt" – that involves the development of a number of corridors that link China to Central Asia and Eastern Europe, and the "Road", or the "21st-Century Maritime Silk Road" – that involves the development of ports as nodes to newly created shipping routes connecting Chinese ports to their European counterparts. The motives for this massive undertaking have been extensively commented upon, falling broadly into economic and geopolitical imperatives. Economic motives include fostering closer economic ties with Eurasia and countries along the Maritime Silk Road, securing continued access to energy sources, better use of the huge reserves China has built up than simply investing in low-yield US treasuries, and to absorb excess output of steel and construction materials that resulted from China's fiscal stimulus in response to the Global Financial Crisis of 2008. Geopolitical motives are said to include reduced vulnerability to disruptions to existing trade and supply routes to China, and challenging the existing world economic order orchestrated by the US in the Bretton Woods Agreement of 1946. To move from strategy to implementation, a Silk Route Fund of US$100 billion has been established to provide seed money for projects.

Whatever the motives, Southeast Asia stands to benefit from this global initiative. The ASEAN region is targeted by China as part of its Maritime Silk Road, with Chinese investments in logistics and transportation infrastructure expected. Many ASEAN-mooted plans, such as the ASEAN Master Plan for Connectivity (AMPC) 2025 and the Lancang-Mekong Cooperation Initiative, that seek to integrate the diverse region through networks of high-quality infrastructure could find a possible synergy in China's BRI.

ASEAN countries also stand to benefit from the separately established but BRI-related Asian Infrastructure Investment Bank (AIIB). This bank, established in October 2014 and capitalized at US$100 billion, intends to provide investment lending for infrastructural construction in Asian countries for which there is huge unmet demand. Its establishment is seen as reflecting China's dissatisfaction with what it perceived to be the inadequacy of World Bank reform that did not fully recognize the country's economic heft. It also sees infrastructure as a major investment gap with growing demand largely unmet by existing multilateral institutions like the World Bank and the Asian Development Bank. Thus Wolf (2015), in a commentary supporting Britain's decision to be a founding AIIB member, noted: "Developing countries in Asia are in desperate need of such (infrastructure) investment. Private funding of risky and long-term projects is often either expensive or non-existent. The resources of the World Bank and Asian Development Bank are grossly deficient, relative to the needs." Operating in parallel to the AIIB but also called upon to provide financial support to BRI is the China Development Bank (CDB) and the Silk Road Fund. Adding to it, bank alliances by China's traditional policy banks and state-owned commercial bank would also present an opportunity to the Southeast Asia countries to carry out their ambitious projects across the region.[9]

A third area, this time of tension, in which China plays a central role is its territorial claim over much of the South China Sea through its "nine-dash line" on its maps. While China stakes its claim on its reading of history, Vietnam disputes China's historical interpretation, citing its own historical records, while the Philippines contests China's claim on the geographical grounds that China claims waters too close to its shores (BBC, 2016). Other claimants are Brunei, Malaysia and Taiwan. While some countries would like ASEAN to mediate or an international tribunal to rule on China's claim, China is opposed to both, preferring bilateral negotiations. These contests are not helped by a partisan (Western) media insisting on "freedom of navigation", with the US sending warships through the area to challenge China's claim (see, for instance, Ku et al., 2016). The situation, although with no immediate settlement in sight, is dynamic. Despite the Philippines winning its case at the International Tribunal, its new President was prepared and did meet with his Chinese counterparts to downplay the dispute. Vietnam has likewise agreed to bilateral negotiations with China. The economic impact of this dispute appears not to have been large so far, since it has not spilled over into economic sanctions or other measures by the disputing parties, and, as indicated, the parties in greatest conflict have attempted to mend fences. Nevertheless, despite China's acquiescence to ASEAN leadership in its region (Kuo, 2016), ASEAN members are split on how the dispute is to be settled, hence posing a major challenge to ASEAN's touted centrality in the region.

Important as China is, Southeast Asian countries themselves are affected by other developments, both external and domestic. Examples of non-China developments external to Southeast Asia are the sharp fall in oil prices and softening of natural resource prices, the slowdown in global trade, leading some to ask if we have reached "peak globalization".[10] The former has hit natural resource producers hard, while the latter would have impacted countries dependent on trade. ASEAN countries themselves have domestic challenges that affect their economic growth. For example, Malaysia has been plagued by scandal around missing billions from the sovereign wealth fund called One Malaysia Development Bhd (1MDB) that has seen investigations in five countries outside Malaysia (the US, Singapore, Switzerland, the UK, and Australia) (Adam and Sam, 2016). Within Malaysia, civil society groups clamoring for accountability have been met by government crackdowns on civil liberties and incarceration of its critics (for a good summary, see Ramesh (2016)). These developments, unfolding since the Fund asked for an extension to file its annual report in 2013, have eroded investor confidence; foreign (portfolio) investment outflow has been significant and the Malaysian Ringgit has taken a beating the likes of which have not been seen since the 1997-98 Financial Crisis.

Another example is Thailand, where the death of King Bhumipol Adulyadej rendered a tense political standoff between the ruling junta which strongly supports the King and to an extent is aligned with Bangkok's middle-class elites against the rural population, which ex-Prime Minister Thaksin Shinawatra had leveraged to gain power in 2001. Thaksin was ousted in a military coup in 2006, his group making a return of sorts as his sister Yingluck became Prime Minister in 2011, but she was herself ousted by the military that continues to run the country today. This uncertainty has risen because some believe the Crown Prince who would succeed Bhumipol views the Thaksin group more favourably (*The Economist*, 2016). The consequences of this turmoil is summarized by Suthiwart-Narueput (Knowledge@Wharton, 2015) noting "Thailand's economy seesawing between lackluster and negative growth." "Weak exports, tepid public and private spending, falling prices in farm goods and falling domestic consumption" have dashed hopes of a return to pre-Asian Crisis growth.

These instances demonstrate the complexity of factors that impact Southeast Asian countries' performance. They render the task of distilling the impact of China's "New Normal" a most challenging one. And they call for, at a minimum, critical review at the country level. The papers assembled in this issue seek to do precisely this. Beginning life as conference papers under the theme "Great Fall or New Normal: China's Economic Restructuring and Its Impact on Southeast Asia" held at the Institute of China Studies, University of Malaya, Kuala Lumpur on 28 July 2016, they reflect the authors' thoughts on what China's "New Normal" means for their respective countries. Because they were left to develop their ideas freely under the broad theme, they have focused on a range of issue they believe to be important. Beyond editorial changes, no effort has been made to harmonize the papers' contents. We believe that in this instance, diversity serves the discussion of the topic better than uniformity of content structure.

## 3. Structure of this Issue

The papers in this Special Issue examine the issue of China's slowdown and its impact on ASEAN countries from both the Chinese and ASEAN countries' perspectives. Using research methodology that range from quantitative to qualitative, they explore this issue's many dimensions, reaching conclusions with major implications. Six papers appear in this Special Issue – three written from the China and regional perspectives and three from country perspectives.

The first paper by Li and Quan frames the issue from a China perspective, broadening the definition of China's "New Normal" to include major structural shifts the economy has been undergoing. They argue, correctly, that focusing exclusively on growth results is a myopic view that ignores other major developments. Arguing further that the growth slowdown has thrown up economic vulnerabilities that had been hidden by spectacular growth, they proposed several remedies.

The next paper by Tong and Kong deals with China-ASEAN trade, the most direct channel of transmission of China's slowdown. Instead of focusing on the negative impact, they adopted a long-term view of the evolution of China's trade as China adopts a more pro-active stance in outward economic ventures as well as regional economic cooperation. They argued optimistically that despite periodic tensions, bilateral economic ties will continue to improve. The authors also see that the more resource-abundant countries will likely benefit more than countries less well endowed. If economic integration is successful in producing a more prosperous region, it will be possible to envisage the evolution of a common development strategy.

The third paper by Zhang and Li takes a regional perspective of China's other major channel for economic ties with ASEAN – its outward foreign direct investment (OFDI) in Southeast Asia. Noting the growth of OFDI despite China's slowdown, the authors explained this apparent contradiction through China's geo-economic imperatives, the desire to secure natural resources to hedge against uncertainty and Chinese enterprises relocation of their production to lower labour cost Southeast Asia as Chinese wages rise. Increasingly too, they recognize ASEAN countries as growing markets that can provide higher returns for Chinese enterprises than they could secure at home.

With China as Malaysia's largest trading partner, any slowdown in China's growth reflected in diminished trade should be bad news for Malaysia. The first of the three country papers, contributed by Cheong and Wang, argues that this statement needs to be qualified. First, Malaysian exports of palm oil to China, the price and volume of which had shrunk, is not the most important export item, that honour belonging to intermediate goods in the process trade. Second, Chinese investment in Malaysia has surged even as FDI from other countries has diminished. And finally, Malaysia's woes, including problems created by the scandal surrounding the sovereign wealth fund 1MDB, the collapse in oil prices as a result of a supply glut, cannot be blamed on China. They conclude that Malaysia's "New Normal" of uneven growth is the consequence of a host of factors of which China's growth deceleration could be the least of Malaysia's worries.

Like Malaysia, the Philippines also experienced no more than a modest impact from China's slowdown. By the time China's slowdown began, the Philippines has already experienced poor export performance, made worse by the Global Financial Crisis of 2008. These reverses had enabled the Philippines to bolster domestic demand. That trade between China and the Philippines has not been substantial also helped cushion any shock from a China slowdown. Thanks to the efforts to normalize relations with China, the Philippines should see a future rise in Chinese FDI. However, Lim, who authored the Philippines paper, warns of the importance of governance given China's none too stellar record of investments there.

The last of three country papers is that of Laos by Kyophilavong and his colleagues. Employing a computable general equilibrium model, they estimated the impact of Chinese investment on the Lao economy. The authors found the short-run impact not only positive for growth but also that it is beneficial for income distribution. However, because Chinese investment is in the resources sector, the downside is the negative long-run impact on the environment and on natural resource depletion. The simulations also show that the threat of "Dutch disease", which is believed to be harmful to the non-resource sector as a result of an appreciating exchange rate, is very real.

## 4. Conclusion

After decades-long miraculous growth, China's economic development, which was largely supported by cheap labour, exploitation of natural resource and low-cost investment in the past, has entered a period of "New Normal" with a slower but more sustainable growth of 6-7% since 2015. While the slow-down of the Chinese economy in no way signals a hard landing as China has, in many ways, demonstrated new momentum to sustain its economy, the magnitude of China's economic slow-down has undoubtedly impacted Southeast Asia which has engaged substantially in trade and investment with China. These uncertainties lead to several major questions on which this special issue attempts to shed some light. The questions the six papers in this issue address are: 1) Is China failing or adjusting to a new normal? 2) What are the economic implications of China's growth deceleration? And (3) what factors besides developments in China, are impacting and will impact countries in ASEAN?

What are the takeaways from the analyses emanating from the seven papers in this Special Issue? First, if we take a broad view of China's "New Normal", its arrival can have consequences for ASEAN economies that are increasingly integrated with it. Second, in terms of trade, a major transmission channel, while the short-run impact of China's "New Normal" is a reduction in bilateral trade, the longer-term impact – a change in the nature of China-ASEAN trade as China transits from trade-led to consumption-driven growth and from low to high value-added output – is likely to have greater significance for ASEAN countries. Third, Chinese OFDI, another key transmission channel, is driven as much by geo-strategic as by geo-economic imperatives. China's "New Normal" has not only not diminished Chinese OFDI but has also seen the opposite occur. With China's proposed BRI, activities of the AIIB and the "Going Out" policy gathering momentum, this trend should continue. Fourth, although Chinese OFDI is to be welcomed, care should be taken to ensure that projects reap immediate economic gains but do not damage the economy in the long-run. At the same time, governance of these projects needs to be carefully monitored, given the checkered history of Chinese projects in the Philippines. Finally, it is not easy to untangle the impact of other factors affecting ASEAN country economies from the impact of China.

As with most studies, this study has some limitations. A study based on a general discussion and three selected Southeast Asian countries cannot claim to speak to the overall impact of China's New Normal on the entire Southeast Asian region. The great socio-economic diversity among the Southeast Asian countries has made it extremely difficult to generalize or to give a uniform answer of such question. Nevertheless, this special issue represents an initial contribution that should lead to future explorations of this broad topic that is multi-dimensional and cross-disciplinary. Indeed, the dynamism that has characterized ASEAN-China relations will most certainly render further study mandatory.

## Notes


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1. Data from World Bank database: <http://data.worldbank.org/indicator>.
2. The World Bank's 1993 report *The East Asian Miracle* did not include China among its "miracle" economies, because by that year, China's growth had lasted no more than 15 years. China more than deserves this accolade because it has outgrown every single one of the countries in the report.
3. Chinese President Xi Jinping in a speech to 1,500 business leaders in the APEC CEO Summit in November 2014 referred to China's growth reduction as its "New Normal" to indicate that the people should no longer expect continued high growth (Xinhuanet, 2014).
4. Kroeber (2012) not only alleged that China's "political system is built on a principle of unfairness" but goes further to label Chinese society as "second rate".
5. In 2013, ASEAN as a whole accounted for 10.7% of China's trade while the EU accounted for 13.4% and the US 12.5%. China's trade with other Asian countries accounted for 32.1% of the country's total that year (Salidjanova and Koch-Weser, 2015: 6).
6. This has indeed been happening. The growth rates of China's western provinces have outstripped those of its eastern provinces since the onset of the Global Financial Crisis that began in 2008, thanks to China's massive RMB4 trillion stimulus (Ma and Summers, 2009: 7).

7. Citing a study by Michael Parker and Alberto Moel for the global manager firm Berstein, Williams-Grut noted: "China is not getting rid of the work. It is just getting rid of the workers."
8. The Silk Road Economic Belt concept was introduced by Chinese President Xi Jinping during his visit to Kazakhstan in September 2013. A month later, in a speech to the Indonesian Parliament, he proposed "building a close-knit China-ASEAN community and offered guidance on constructing a 21st Century Maritime Silk Road to promote maritime cooperation" (Xinhuanet, 2015).
9. According to ADB, ASEAN region requires US$60 billion in investment per year in road, rail, power, water and other critical infrastructure. However, the ASEAN Infrastructure Fund (AIF) has a total equity of only US$485.3 million, far below the necessary amount to make big loans each year.
10. Braga (2015) noted that the elasticity of trade with respect to world GDP (the % increase in trade with respect to a 1% change in world GDP) has fallen from a high of 2 in the 1990s.

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