

PERSPECTIVE

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Do the Economic Ties between ASEAN and China Affect Their Strategic Partnership?

*Sanchita Basu Das**

EXECUTIVE SUMMARY

- ASEAN-China economic engagement underpins their overall strategic partnership.
- Growing trade volumes since the 1990s were further facilitated by the ASEAN-China Free Trade Agreement (ACFTA). Chinese infrastructure financing in ASEAN countries boosted the already strong linkages between ASEAN and China.
- There are trust issues between the two. ASEAN countries worry that the growing trade deficit and the excessive dependence on China in trade and infrastructure financing will affect their domestic economy and foreign policy autonomy.
- As ASEAN and China mark 15 years of their strategic partnership this year, they need to find ways to improve mutual trust.

** Sanchita Basu Das is Lead Researcher for Economic Affairs at the ASEAN Studies Centre at ISEAS - Yusof Ishak Institute.*

INTRODUCTION

Economic linkages between ASEAN and China underpin their overall strategic partnership. Ties between them have flourished since the early 1990s when China undertook outward-oriented reforms and joined the World Trade Organisation (WTO). As the ‘factory of Asia’, China led in manufacturing exports and developed value chains with inputs from many ASEAN countries.

The ASEAN-China Free Trade Agreement (ACFTA), sought to reduce the cost of doing business along the regional value-chains. Besides tariff elimination, the agreement promised deeper integration covering services, foreign investment and measures incorporating trade facilitation. Indeed, today China is ASEAN’s largest—and ASEAN is China’s third largest—trading partner. Two-way investment has been growing, with ASEAN being China’s fourth-largest investment destination and its third-largest source of foreign direct investment (FDI).¹

This year, ASEAN and China are celebrating 15 years of their Strategic Partnership. They will outline their bilateral relationship through the ASEAN-China Strategic Partnership Vision 2030, which is expected to be announced during the Summit meetings in November 2018. The Vision intends upgrading the 2013 ASEAN-China cooperation framework from 2+7 to 3+X.² While ‘2+7’ referred to two-point political consensus – enhancing strategic trust and promoting economic cooperation – and seven cooperation fields, such as ACFTA, inter-connectivity, security exchanges, and others, ‘3+X’ is currently developed around three pillars, i.e. political-security, economy and people-to-people exchange, and a number of cooperation agendas yet to be determined.

Economic cooperation is a key thrust area of ASEAN-China’s vision on strategic partnership. Besides promoting two-way trade in goods and services, increasing attention is being paid to raising FDI and building infrastructure in ASEAN countries. This paper reviews the progress of ASEAN-China economic relations and discusses some concerns around such engagement. It concludes that while China’s increasing attention towards small ASEAN members is well appreciated, the ASEAN-China Strategic Partnership Vision 2030 should nevertheless be mindful of ASEAN members’ trade deficit concerns and of their fear of losing policy autonomy due to economic overdependence on China.

BILATERAL ECONOMIC RELATION STRENGTHENED BY ACFTA

Economic ties between ASEAN and China have been growing steadily since the mid-1990s. The bilateral merchandise trade went up from US\$13.3 billion in 1995 to US\$113.5 billion in 2005 and further to US\$368 billion in 2016. For the entire period, the growth rate was around 18% per annum, which is impressive compared to a growth rate of around 7% per annum for ASEAN’s trade with the world.

The importance of services trade for both parties has also grown in 2005-2016: for China, it increased from US\$161 billion to US\$657 billion³, whereas, for ASEAN, it rose from US\$252 billion to US\$643 billion⁴. In recent times, ASEAN enjoyed a trade surplus of US\$8 billion and China ran a trade deficit of US\$243 billion, implying that China imports more services from the world compared to ASEAN. Bilaterally, China exports engineering and labour services to ASEAN and imports transport, financial and construction services from ASEAN countries.⁵ Trade in tourism services is significant and has potential to rise further. In 2016, 20.3 million of Chinese tourists visited ASEAN countries (around 18% of the total), and 10.3 million of ASEAN tourists visited China (8% of the total).

The share of Chinese investment flows increased in the meantime from 3 to 10% (US\$2-US\$9.8 billion) in the region as ASEAN countries worked towards an economic community and experienced high volume of FDI inflows. The production network fostering closer integration raised Chinese investments especially in ASEAN's manufacturing sector. The reverse FDI flow from ASEAN to China is predominantly led by Singapore.

The growing economic relationship was further cemented by ACFTA. The parties signed the trade in goods agreement in 2004 that called for tariff reduction for a number of product lines between ASEAN-6 countries and China by 2010⁶ and between the CLMV countries⁷ and China by 2015. The countries adopted the 'Early Harvest Programme' (EHP) prior to the establishment of FTA, where China decided to give immediate tariff concessions to ASEAN members on a number of agriculture products.

The services trade agreement was signed in January 2007. Liberalization in the tourism sector was notable, given the common interest on both sides.⁸ Although commercial presence of multinational companies across borders was sensitive, ACFTA promised to encourage investment flows between parties in business services, construction, tourism, travel, transport and educational services. An investment agreement was signed in 2009, aiming to foster collaboration by raising transparency of regulations and protecting investors' interests. ACFTA was subsequently upgraded in 2016 with improvements in areas of rules-of-origin, trade facilitation, services liberalization and investment promotion.

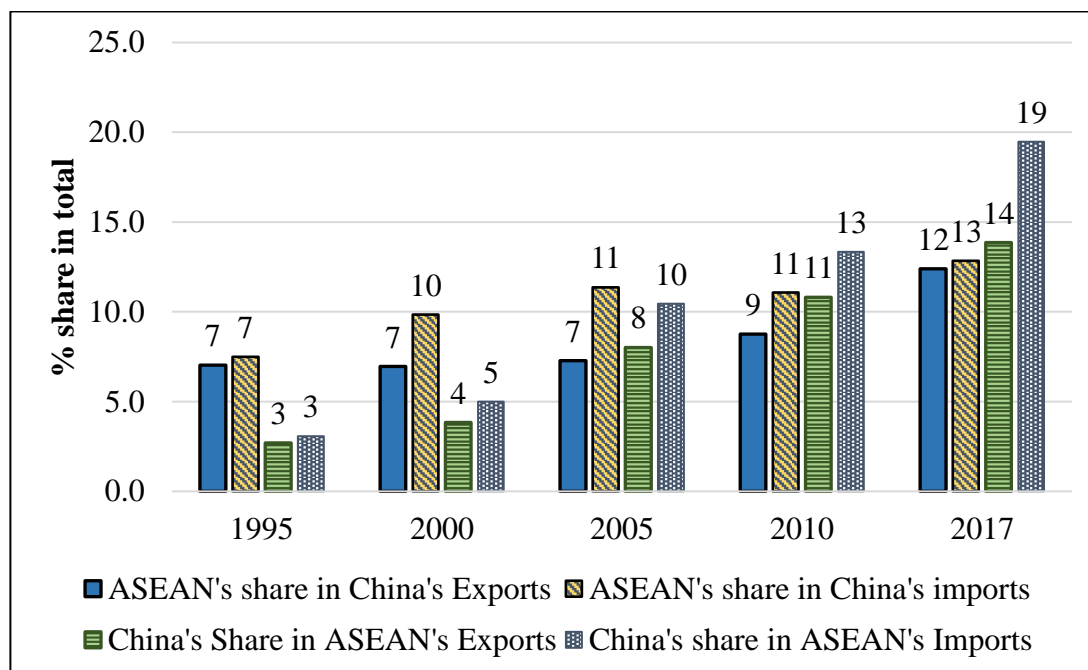
Thus, as market forces brought China and ASEAN economies closer to each other, institutional mechanisms under ACFTA worked to further strengthen these linkages. But despite such growing ties, there are pockets of anxieties.

MERCHANDISE TRADE DYNAMICS BETWEEN ASEAN AND CHINA

The main anxiety emerges from the relative presence of ASEAN and China in each others' market. According to Figure 1, ASEAN's presence in China's trading basket has increased over time, though the importance for exports is lower compared to imports. China's relative imports from ASEAN, after a jump from 7 to 11 percent in 1995-2005, did not improve markedly in the post-ACFTA period of 2010. However, China's presence in ASEAN's trading basket jumped 5-6 times between 1995 and 2017. In the post-ACFTA period, the

share China had in ASEAN’s imports saw a steep rise vis-à-vis exports. This implies that Chinese enterprises penetrated ASEAN’s market more efficiently than the other way round.

Figure 1: Presence of ASEAN and China in Each Other’s Markets



Source: estimated from CEIC database

The shares of individual ASEAN countries, in China’s exports and imports are relatively modest. Interestingly, Malaysia’s penetration in China’s market is the highest among ASEAN countries, owing to China’s oil imports, whereas Singapore’s share in China’s trading basket has gone down as its role as an entrepôt diminished. In contrast, China’s presence in all ASEAN countries went up during 2005-2017. In recent years, Chinese imports are most predominant in Cambodia, followed by Myanmar and Vietnam.

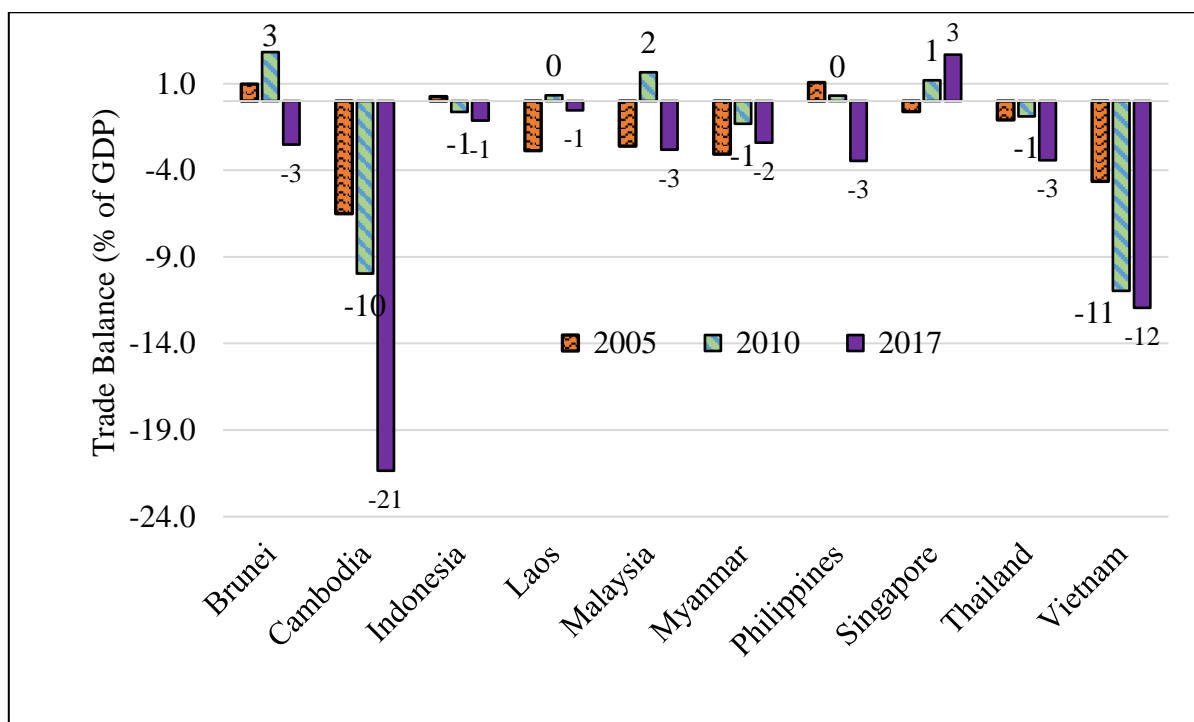
Table 1: % Share of ASEAN Countries in China’s Trading Basket and Vice Versa

	ASEAN's share in China's Exports		ASEAN's share in China's imports		China's Share in ASEAN's Exports		China's share in ASEAN's Imports	
	2005	2017	2005	2017	2005	2017	2005	2017
Brunei	0.0	0.0	0.0	0.0	2.4	4.7	8.2	19.6
Cambodia	0.1	0.2	0.0	0.1	0.5	6.9	16.6	34.2
Indonesia	1.1	1.5	1.3	1.6	7.8	13.7	10.1	21.5
Laos	0.0	0.1	0.0	0.1	4.3	28.6	9.3	21.5
Malaysia	1.4	1.9	3.0	3.0	6.6	13.4	11.6	18.4
Myanmar	0.1	0.4	0.0	0.2	3.9	36.5	21.2	31.4
Philippines	0.6	1.4	1.9	1.0	9.9	11.1	6.3	17.2
Singapore	2.2	2.0	2.5	1.8	8.6	14.7	10.3	13.9
Thailand	1.0	1.7	2.1	2.3	8.3	12.4	9.4	19.8
Vietnam	0.7	3.2	0.4	2.8	9.9	14.5	16.0	25.8

Source: estimated from CEIC database

The growing presence of Chinese goods in ASEAN markets is a serious concern as they not only raise the countries’ trade deficit with China but also increase the possibility of political stress. Figure 2 shows that apart from Singapore, all ASEAN countries had trade deficits with China in 2017. While Brunei, Indonesia and the Philippines enjoyed a trade surplus with China earlier, it turned into deficit more recently. Cambodia and Vietnam’s deficits increased consistently throughout the period of 2005-2017. These imply that Chinese exports to these countries, already dominant, intensified after ACFTA in 2010.

Figure 2: Trade Balance of ASEAN Countries with China (as % of GDP)



Source: estimated from the CEIC database

Indonesia, in particular, was worried about ACFTA from the beginning. Its deteriorating trade balance in manufacturing sector led to political stress in the country.⁹ Jakarta was unhappy that it was treated differently as, for instance, under *EHP*, Indonesia paid higher duties on Chinese processed cocoa imports compared to Malaysia and Singapore. Jakarta even considered renegotiating part of ACFTA, i.e. around 220 tariff lines across iron and steel, textiles, apparels and footwear industries, but failed to succeed. Subsequently, despite Beijing’s promises to invest in Indonesia’s infrastructure and increase imports from Indonesian manufacturers, concerns over job loss on account of Chinese low-cost imports led to public demonstrations in many Indonesian cities. A rift between the Ministry of Industry and the Ministry of Trade surfaced, leading to a cabinet reshuffle to pacify the public.¹⁰

Thus, although ASEAN and China’s economic partnership is generally considered to be positive, possibility of economic conflicts cannot be altogether disregarded because of the differences in size and development plans. This has repercussions for ASEAN-China’s overall strategic partnership going forward.

CHINA’S INFRASTRUCTURE INVESTMENT IN ASEAN TO SUPPORT ACFTA

Besides commerce, Chinese infrastructure investment in ASEAN countries has enhanced bilateral connectivity. The two sides embarked on a partnership of integrated transport development in 2003 as they recognised that ‘building an integrated transport network... is

a vital supporting infrastructure to an ASEAN-China free trade area'.¹¹ Both sides subsequently signed an MOU on Transport Cooperation in 2004. In 2016, the countries adopted a Strategic Plan for ASEAN-China Transport Cooperation and decided to explore ways to synergise common priorities between the Master Plan on ASEAN Connectivity 2025 (MPAC 2025) and the Belt and Road Initiative (BRI).¹² The countries agreed to promote cross-border projects like the Singapore Kunming Rail Link, navigation in Lancang-Mekong River, the Port Cities Cooperation Network and Logistics Information Cooperation.

At present, ASEAN countries and China have collaboration across power, transport and telecommunication projects (Table 2).¹³ Chinese multinational enterprises – both state-owned and private players – are actively participating in ASEAN's infrastructure landscape.¹⁴ Specifically in CLMV, Chinese companies are the largest investors in hydropower plants, dams, roads, bridges, seaports and railway networks.

The China-ASEAN Fund for Investment Cooperation, proposed by Chinese Premier Wen Jiabao in 2009, has also been investing in ASEAN since 2010. More recently, since January 2016, the Asian Infrastructure Investment Bank (AIIB) has started to provide infrastructure loans to ASEAN members. Indonesia tops the list in receiving such funds, followed by the Philippines and Myanmar (Table 3).¹⁵

Table 2: List of Selected Chinese Infrastructure Investment Projects in ASEAN

Power and Electricity	Transport	Telecommunication
3 hydropower dams on Nam Ma River (Laos)	Railway link, steel plant, seaport (Cambodia)	Telecom services to several ASEAN members
Nam Tha 1 hydropower dam (Laos)	Expansion of Luang Prabang International airport (Laos)	Developing 8.900 km ASEAN-Japan Cable system linking Brunei, China, Hong Kong, Japan, Singapore and Philippines
Tatay River hydropower dam (Cambodia)	Deep-seaport on Madae Island (Myanmar)	
Lower Stung Russei Chrum hydropower station (Cambodia)	Line 2A of Hanoi Metro (Vietnam)	
Phnom Penh-Sihanoukville transmission line and East Phnom Penh-Neakleung-Svay Rieng transmission line (Cambodia)	Kuantan port (Malaysia)	
120 MW Atai hydropower plant (Cambodia)	Penang 2nd Bridge (Malaysia)	
530 MW Hlawga power plant (Myanmar)	73 units of C951 three-car trains for the driverless Downtown MRT Line (Singapore)	
1200MW Vinh Tan 1 coal-fired power plant (Vietnam)	Tanjung Sauh Port, Batam (Indonesia)	
Power plant in Bali (Indonesia)	Supplying trains for Metro Rail Transit Line 3 (Philippines)	
Hydropower project in Kalimantan (Indonesia)	Fourth Friendship Bridge on the Mekong River across Laos and Thailand	
5MW ground-mounted solar photovoltaic project (Thailand)		

Source: ASEAN Secretariat 2015¹⁶

Table 3: List of Approved Project in ASEAN Countries with AIIB Financing

ASEAN Country	Project Name	AIIB Loan (US\$ million)
Indonesia	Dam Operational Improvement Project	125
	Regional Infrastructure Development Project	100
	National slum upgrading project	217
Philippines	Metro Manila Flood Management Project	207
Myanmar	Myingyan 225 MW Gas turbine power plant	20

Source: www.aiib.org

While these are positive developments, there are concerns that Chinese investment is hurting the domestic economies of receiving countries. China's assistance is often beyond financing and extends to project management, equipment supplies, construction material and workers. This creates anxieties in local economies. Cambodia, for instance, heard grievances from locals that new jobs from Chinese investments go to Chinese immigrants. Even small indigenous businesses are hurt as Chinese workers favour Chinese-owned shops to service their daily needs.¹⁷ Likewise in Indonesia, locals complain that Chinese firms regularly bring their 'own workers and machines, creating friction with locals'.¹⁸ China-funded projects are also seen as compromising the environmental conditions of the receiving countries. Recently, as Thailand decided to accelerate the project approval process, Chinese investment in a power plant was seen as going against the country's laws for environment protection.¹⁹

Chinese interest in investing in mega-projects like Forest City in Malaysia, Sihanoukville port city in Cambodia, Sino-Laos railway project, and the Kyaukpyu SEZ in Myanmar is regularly seen as detrimental for national debt of the recipient countries as it raises concerns over debt repayment and other strategic risks. For Cambodia and Laos, in particular, China holds approximately 50% of their total debt. This dependency has often forced Cambodia to take into account 'Chinese diplomatic and political interests at the expense of ASEAN counterparts'.²⁰ Going forward, as the debt burden becomes too much to bear, these countries may have to deploy state properties, like a deep-sea port or oil and gas field, as equity to pay the Chinese. This debt-trap possibility, through which Beijing may acquire strategic assets, often impels ASEAN countries to take a cautionary approach towards Chinese mega-investments.

Indeed, Chinese infrastructure investments in ASEAN countries are a means to increase trade among the ACFTA participants. But the anticipated anxiety from increasing economic engagement inhibits positive translation to overall ASEAN-China strategic partnership. A cautious approach will always be employed by the ASEAN members while dealing with Beijing's economic generosity.

DOES ACFTA ENHANCE ASEAN- CHINA STRATEGIC PARTNERSHIP?

ASEAN and China embarked on their ‘Strategic Partnership for Peace and Prosperity’ in 2003. Acknowledging the complexity and significant changes in global economy, the countries felt that such a partnership, covering areas of politics, security, economics and social affairs, was essential ‘to serve the immediate and long-term interests of both sides’.²¹ Particularly on economic cooperation, ASEAN and China agreed to accelerate their discussion on ACFTA to deepen cooperation in agriculture, human resource, investment and information-technology. But how far has the ACFTA and the resulting economic engagement contributed towards strengthening the strategic partnership?

ACFTA was first proposed in 2000 by Chinese Premier Zhu Rongji in view of multiple complexities in the region. Around that time, many ASEAN countries were suffering from the 1997-98 financial crisis and struggling with economic growth. Concurrently, the countries were feeling uneasy about China’s accession to WTO in 2001, as it was capable of drawing the lion’s share of FDI in the region. In order to ease such tension, ACFTA was thought to provide ASEAN countries and China access to each other’s markets, thereby helping the former in the face of the latter’s economic rise.²²

The wisdom of securing ACFTA became more obvious in the post-2008 economic crisis. As economic growth slowed down in the West, ACFTA became a means to strengthen economic cooperation among countries driving global growth.

Thus, in 2013, while commemorating 10 years of ASEAN-China Strategic Partnership, Chinese Premier Li Keqiang made a proposal of ‘2+7 cooperation framework’ for the following decade, where *two* referred to enhanced strategic trust and deeper economic cooperation and *seven* implied fields of cooperation that included ACFTA and better infrastructure.²³

The participating members agreed to upgrade ACFTA by ‘improving overall market access conditions and trade balance between both sides as well as expanding the scope and coverage of the Framework’. The participating countries set a target of increasing two-way trade and investment to US\$1 trillion and US\$150 billion respectively by 2020.²⁴

While ASEAN members welcomed China’s pronouncements, they remained wary on two fronts. First, ACFTA seemed to have benefitted China more than the ASEAN countries. Chinese businesses, being more competitive, penetrated ASEAN markets more effectively than vice-versa. This resulted in merchandise trade deficit uniformly across all ASEAN members (except Singapore), creating resentment against Chinese products and generating animosity between local businesses and governments in many ASEAN countries. Second, the small countries fear that excessive economic dependence on China will undermine their negotiating position in security issues. They may also lose their foreign policy autonomy to Beijing going forward. This was demonstrated in the past when Beijing used Phnom Penh to block a foreign ministers’ statement that was seen to oppose China’s claims in the South China Sea (SCS). Also, the Philippines protest against Chinese claims in SCS was

dampened during Duterte's presidency compared to Aquino's, as the former considered Chinese economic support far more important than claiming rights in the SCS.

Thus, while ACFTA and related infrastructure initiatives are important mechanisms to enhance trade and investment between ASEAN and China, they are yet to fully translate into a strong strategic partnership between the two. Since the late 1990s, China has been trying hard to deepen economic relations with ASEAN, but the growing trade deficit and the lack of mutual trust has dogged the relationship. It seems that 'the mutual trust between both sides on security issues has not been elevated as much as the volume of trade has'.²⁵

This is where China needs to make a tangible change going forward. To mark the 15 years of strategic partnership, Beijing has proposed upgrading the existing '2+7 cooperation framework' to '3+X'. It intends to draw the new framework around 3 pillars, i.e. political-security, economy and people-to-people exchange, in line with ASEAN Community. Since the number of cooperation agendas is yet to be determined, it should pay attention to ASEAN's concerns.

Going by the earlier proclamation of improving 'trade balance between both sides', Beijing must provide a time line and action plan on the way forward. The China-ASEAN Expo²⁶, instituted in 2004, is a useful forum for ASEAN manufacturers to showcase themselves in the Chinese market, but that is not sufficient to narrow the trade deficit that ASEAN members have with China.

Services trade needs to be strengthened. While China is a significant importer of transportation, travel and other commercial services,²⁷ Singapore, Thailand and Malaysia are leading exporters of these services. This creates immense trade potential between these countries.

ASEAN and China need to expand their scope of cooperation to new areas, including e-commerce. With Industrial Revolution 4.0, they should advance cooperation in areas of technological innovation and digital economy. As ASEAN embarks on regional cooperation on the Smart Cities Network in 2018, China has a big role to play in sharing their experience as they have more than 500 smart city projects in progress.²⁸

Finally, although synergies can be drawn between ASEAN's MPAC projects and China's BRI, these should be developed in a way where both parties can benefit. Beijing should not see investments in MPAC projects as an avenue for it to acquire strategic assets, and through which it can either advance its military influence or gain access to natural resources. MPAC investment from China should be a prerequisite for increased manufacturing activities, technology transfer and job creation in ASEAN countries. It should be for integrating ASEAN countries more strongly rather than for manipulating future geopolitical issues in the region.

CONCLUSION

Economic cooperation is a crucial aspect of the overall ASEAN-China Strategic Partnership. For years, trade and investment have been contributing to growing economic ties between the two parties. But there are pockets of worry among the ASEAN countries. Going forward, as China prepares to upgrade its current relationship with ASEAN to celebrate 15 years of strategic partnership, it should be mindful about member countries' concerns and look for concrete ways to build mutual trust. After all, economic engagement has to be beneficial for everyone before it can contribute positively to an enhanced institutionalized form of ASEAN-China Strategic Partnership Vision 2030.

¹ ASEAN Secretariat 2017 (http://asean.org/storage/2017/11/China-and-ASEAN-on-Cooperation-Connectivity-CN-ASEAN_adopted.pdf)

² http://www.chinadaily.com.cn/world/2017-11/13/content_34491398.htm

³ A rise in global share from 3.1 to 6.9% (WTO Trade Database and author's calculation)

⁴ A rise in global share from 4.9 to 6.8% (WTO Trade Database and author's calculation)

⁵ Yang, Chunmei. 2009. 'Analysis on the Service Trade between China and ASEAN', *International Journal of Economic and Finance*, Vol. 1, No. 1, 221–24.

⁶ In 2010, Chinese imports faced an average tariff rate of 0.6% (vis-à-vis 12.8% earlier) in ASEAN countries and ASEAN imports faced an average tariff rate of 0.1% in China (from 9.8% earlier).

⁷ CLMV countries are Cambodia, Laos, Myanmar and Vietnam

⁸ Ishido, Hikari. 2011. 'Liberalization of trade in services under ASEAN+n: A mapping exercise', *ERIA Discussion Paper, No. 2*.

⁹ Stephen V. Marks. 2015 'ASEAN-China Free Trade Agreement: Political Economy in Indonesia', *Bulletin of Indonesian Economic Studies*, Vol 51 (2): 287-306

¹⁰ Koon Peng Ooi. 2016. 'Examining the Impact of ASEAN-China Free Trade Agreement on Indonesian Manufacturing Employment', *CSAE Working Paper (WPS/ 2016-15)*, University of Oxford

¹¹ ASEAN Secretariat 2003 (<http://asean.org/joint-media-statement-of-the-2nd-asean-china-transport-ministers-meeting-yangon/>)

¹² ASEAN Secretariat 2016 (<http://asean.org/storage/2016/09/Joint-Statement-of-ASEAN-China-Commemorative-Summit-Final.pdf>)

¹³ ASEAN Secretariat and UNCTAD (2015), 'ASEAN Investment Report 2015: Infrastructure Investment and Connectivity'.

¹⁴ The Chinese investment through MNEs (such as Three Gorges Corporation, Guodian Corporation, Sinohydro Corporation) are often not reflected in the FDI numbers as many of these companies operate through subcontractors (NEMs).

¹⁵ Indonesia has received total assistance of around US\$442 million across three projects, accounting for 12 percent of total funds (US\$4 billion) disbursed by AIIB till now.

¹⁶ ASEAN Secretariat and UNCTAD (2015), 'ASEAN Investment Report 2015: Infrastructure Investment and Connectivity'.

¹⁷ <https://thediplomat.com/2018/02/what-does-chinese-investment-mean-for-cambodia/>

¹⁸ <http://www.reuters.com/article/us-indonesia-election-china/in-indonesia-labor-friction-and-politics-fan-anti-chinese-sentiment-idUSKBN17K0YG>

¹⁹ <http://www.scmp.com/week-asia/society/article/2102934/thailand-chases-chinese-money-what-cost>

²⁰ <https://globalriskinsights.com/2018/01/money-talks-chinas-belt-road-initiative-cambodia/>

²¹ http://asean.org/?static_post=external-relations-china-joint-declaration-of-the-heads-of-state-government-of-the-association-of-southeast-asian-nations-and-the-people-s-republic-of-china-on-strategic-partnership-for-peace-and-prosp

²² Yuzhu, Wang and Sarah Y. Tong. 2010. 'China–ASEAN FTA Changes ASEAN's Perspective on China', *East Asian Policy*, Vol. 2, No. 2, 47–54.

²³ Other cooperation agendas were - signing of a treaty on good-neighborliness, improving security exchanges, boosting financial cooperation, promoting maritime cooperation through 21st-century 'maritime Silk Road' and reviving exchanges in culture, technology and environment protection. (http://www.asean-china-center.org/english/2013-10/10/c_132785560.htm)

²⁴ <http://www.asean.org/storage/images/archive/23rdASEANSummit/7.%20joint%20statement%20of%20the%2016th%20asean-china%20summit%20final.pdf>

²⁵ Anuson Chinvano, (2015). 'ASEAN-China Relations: Prospects and Challenges', *RJSH Vol. 2, No. 1: 9-14*

²⁶ The China-ASEAN EXPO showcases products from ASEAN and China. It is organized and hosted by China on an annual basis since 2004. On the sidelines of CAEXPO, ASEAN-China

Business and Investment Summit (CABIS) was established to bring government and the private sector together to exchange views on matters of concern

²⁷ Other commercial services include communication services, construction, insurance, financial, ICT services and other business service (source: WTO Trade Statistics).

²⁸ <http://www.pmo.gov.sg/newsroom/people%E2%80%99s-daily-interview-pm-lee-hsien-loong>

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