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Sino-Malaysia Trade Ties Remain Strong But Complex

*By John Lee**

EXECUTIVE SUMMARY

- Malaysia's export-orientated and open economy remains tied to the enormous consumer markets in North America and the European Union, and is less reliant on the Chinese consumer than is often believed.

- The complex and integrated nature of the ASEAN-6 and East Asian economies means that translating bilateral economic interactions with one country, into strategic leverage over that country is extremely difficult if not impossible.

- While China's economic rise and integration with the other ASEAN+3 economies have brought benefits to the region as a whole, weaknesses in the Malaysian economy combined with China's move up the manufacturing value-chain means that there are strong elements of competition between the two economies.

- Despite China's emergence as Malaysia's largest trading partner, the two economies are not intrinsically more tied to each other than to other major regional economies. This is clear from the extraordinarily low inward and outward FDI numbers between Malaysia and China as compared to Malaysia's investment relationship with a number of other regional and global economies.

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INTRODUCTION

In October 2013, Malaysia and China announced a bilateral trade target of RM511 billion (US$160 billion) for 2017,[1] having reached RM$180.61 billion in 2012, and RM$166.8 billion in 2011. This is on the back of China surpassing Singapore as Malaysia's largest trade partner in 2009, registering RM$128.38 billion in two-way trade.[2]

Behind the booming trade numbers are elements both of economic complementarity and of economic competition between the two countries. While China is one of several important partners for Malaysia in the region, it is far from being the *dominant* economic partner as is commonly presumed. Although China is emerging as a central hub of manufacturing assembly and production, economic opportunity (and resulting strategic and political leverage) in the region remains dispersed. As a result, contemporary economic developments and trends are not creating economic tools powerful enough for Beijing to seduce or else compel Kuala Lumpur to gradually bend to its strategic and political will.

SINO-MALAYSIAN TRADE RELATIONSHIP

In 2012, exports to China accounted for 12.6 per cent of Malaysian exports, second only to Singapore which accounted for 13.6 per cent. In the same year, China held its place as the leading import source country for Malaysia, at 15.1 per cent of imports, with Singapore second at 13.3 per cent.

Table 1: Leading sources of imports and destination of exports for Malaysia (by percentage)

	Share of total exports (2012)	Share of total imports (2012)	Share of total exports (2011)	Share of total imports (2011)
China	12.6	15.1	13.1	13.2
Singapore	13.6	13.3	12.7	12.8
Japan	11.8	10.3	11.5	11.4
U.S.	8.7	8.1	8.4	9.6
Thailand	5.4	6	5.1	6.1

Source: MITI and Department of Statistics Malaysia figures.

[1] Zuhrin Azam Ahmad, Yuen Meikeng, Cecelia Kwok and Isabella Lai, "Malaysia and China set trade target of RM511bil," *The Star*, October 5, 2013 <http://www.thestar.com.my/News/Nation/2013/10/05/Msia-and-China-set-trade-target-of-RM511bil-Xi-and-Najib-also-agree-to-form-strategic-partnership.aspx/> accessed January 14, 2014.

[2] Ministry of International Trade and Industry Malaysia (MITI) figures.

Let's look at what Malaysia exports to and imports from China. While commodities constituted over 85 per cent of the country's exports in the early 1960s, they now constitute less than one-fifth of exports.[3] More than 70 per cent of exports to China in 2012 were manufactured goods. The 'electrical and electronics' (E&E) sector accounted for 46 per cent of all exports to China, with semiconductor devices accounting for 64.4 per cent of these. Other important E&E exports to China were hybrid and electronic integrated circuits. For 2012, E&E products constituted 32.9 per cent of Malaysia's total exports. Indeed, China is the largest export market for Malaysia's E&E sector, receiving 17.6 per cent of all Malaysia's E&E exports, leading the U.S. which receives 14.2 per cent of Malaysian E&E exports and Singapore which receives 14 per cent.[4] Figures for 2011 and 2010 are similar to the 2012 figures.[5]

The structure of Chinese exports to Malaysia is remarkably similar. Manufactured parts and goods constituted 95.2 per cent of Malaysia's total imports from China, compared to manufactured goods from all countries constituting 78 per cent of all imports from all countries combined. This emphasises China's enhanced importance as an exporter of manufactured goods to Malaysia. In terms of Chinese manufactured goods exported to Malaysia, E&E products are the leading category at 37.8 per cent of all manufactured goods in 2012 and 40 per cent in 2011, followed by machinery, appliances and parts.[6] For Malaysian E&E imports, China was the leading supplier with 24 per cent of all such imports in 2012, followed by Singapore and the U.S. with 12.5 per cent each. In 2012 and 2011, China was also the leading import country of machinery and appliances parts into Malaysia, making up 20 per cent of imports in that sector in 2012 and 18.9 per cent in 2011.[7]

IMPLICATIONS OF SINO-MALAYSIAN TRADE STRUCTURE

The Sino-Malaysian trade relationship is dominated by exports and imports of manufacturing products and parts, especially in the E&E, machinery and appliances categories. Such a processing-dominant trade structure has a number of implications relevant to this paper.

First, it is clear that export-manufacturers view the ASEAN+3 economic region as a vast production chain with little discrimination as to where they locate production processes beyond commercial motivations of (capital and labour) cost and reliability. In this sense, one needs to understand the role ASEAN+3 economies continue to

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[3] Department of Statistics Malaysia figures.

[4] Department of Statistics Malaysia figures.

[5] Department of Statistics Malaysia and Malaysian External Trade Development Corporation figures.

[6] See "Trade Performance for the Year in 2012 and Month of December," Department of Statistics Malaysia <http://www.statistics.gov.my/portal/images/stories/files/LatestReleases/trade/bi/Dec12/Pre_External_Trade_Dec12BI.pdf> accessed January 15, 2014.

[7] Department of Statistics Malaysia figures.

play in export-manufacturing, with a large proportion of products destined for the vast and still dominant consumption markets in the U.S. and E.U. This is evident in figures showing that while ASEAN-China trade had grown in high double digit rates per annum for the previous ten years, trade between China and ASEAN immediately contracted by 7.8% in that year with the onset of the 2009 global financial crisis which plunged the Western markets into recession.[8] This is reflected in Sino-Malaysian trade which actually declined 1.7 per cent in 2009 from the previous year, having grown at a remarkable 21.7 per cent per annum (compounded) in the ten years before.[9]

Indeed, Sino-Malaysian trade only recovered to 'normal' boom-time levels when the economies especially of the U.S. and also the E.U. emerged out of recession. For example, from 2008-2009, Chinese exports to the U.S. declined by about US$41 billion or 12.2 percent – triggering significant decline in trading levels between the ASEAN+3 economies. From 2009-2010 and 2010-2011, Chinese exports to the U.S. increased by about US$69 billion or 23.3 per cent, and US$35 billion or 9.6 per cent respectively.[10] Over the same time period, two-way Sino-Malaysian trade increased by RM18.64 billion or 14.5 per cent (2009-2010), and RM20 billion or 13.7 per cent (2010-2011). Similarly, Malaysian trade with other ASEAN countries increased RM53 billion or 21 per cent (2009-2010) and RM25.3 billion or 8.3 per cent (2010-2011), having dramatically declined RM45.7 billion or 15.4 per cent from 2008-2009.[11]

This is compelling evidence that Western industrialised economies (rather than end consumer markets in China) have a greater role in driving trade between the ASEAN+3 countries, and between China and Malaysia in particular. After all, China's GDP still grew 8.7 per cent in 2009,[12] yet the dominant variable when it came to trade between ASEAN+3 countries was still the struggling economies of the U.S. and E.U.

Second, when it comes to sectors such as E&E and information communications technology (ICT) – which dominate Sino-Malaysian trade – foreign invested or owned firms account for more than 80 per cent of China's exports.[13] This is important because foreign invested and owned firms are far less likely to tolerate 'political interference' from Beijing, and any such attempt by Beijing would eventually cause foreign entities to divest out of China and/or resist using new capital to fund manufacturing plants in the country. Besides the resulting loss of jobs in an export

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[8] China Customs figures.

[9] Department of Statistics Malaysia figures.

[10] U.S. Census figures.

[11] Department of Statistics Malaysia figures.

[12] China National Bureau of Statistics figures.

[13] See Yuqing Xing, "China's High-tech Exports: Myth or Reality," *GRIPS Discussion Paper* 11-05, June 2011 <http://r-center.grips.ac.jp/gallery/docs/11-05.pdf> accessed January 14, 2014.

manufacturing sector that employs tens of millions of people,[14] a loss of interest in China by foreign entities would jeopardise China's capacity to 'import' innovation, and research and development (R&D) through attracting foreign capital and firms setting up export-manufacturing firms in the country.[15]

Third, while China's rise has offered benefits for regional economies, there are also strong elements of competition involved, which in important respects are deepening. On the one hand, China's economic rise and integration into ASEAN+3 production chains has made the whole ASEAN+3 region even more attractive to foreign firms and capital seeking manufacturing options. Additionally, although the size and ease with which regional firms can tap into a growing Chinese consumer market are often overstated, the Chinese domestic consumption market is nevertheless growing rapidly and will provide significant opportunities for regional economies.

Even so, all countries are jostling with each other to attract foreign direct investment (FDI) for setting up manufacturing hubs in their country, which will in turn offer benefits such as increased employment and technological transfers – major reasons why China chose the so-called 'East Asian export-manufacturing' route in the first place.

For a middle-income country like Malaysia, the dynamics are changing since China is itself moving up the value-chain in the production process, whilst holding its market share growth in the low-tech final assembly process at the same time.[16] The increased sophistication of its production base and processes is consistent with Beijing's hopes of capturing more value-add in the manufacturing process. This is reflected in a higher share of high-tech and sophisticated parts and products produced indigenously, rather than imported from middle- and high-income trading partners. Importantly, an increasing number of studies are finding that the sophistication of Chinese parts and products have become comparable to those produced in countries such as Malaysia and Thailand.[17] This is consistent with a number of earlier warnings that China was unlikely to stand still in the value chain and would increasingly challenge advantages that drew export manufacturers and brands to base production and processing operations in Malaysia.[18]

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[14] See Kai Guo and Papa N'Diaye, "Is China's Export Orientated Growth Sustainable?", *IMF Working Paper* WP/09/171, August 2009 < http://www.imf.org/external/pubs/ft/wp/2009/wp09172.pdf> accessed January 16, 2014.

[15] See Ling Feng, Zhiyuan Li and Deborah L. Swenson, "The Connection Between Imported Intermediate Inputs and Exports: Evidence from Chinese Firms," *National Bureau of Economic Research Working Paper 18260*, July 2012 <http://www.nber.org/papers/w18260.pdf?new_window=1>; Guillaume Gaulier, Francoise Lemoine and Deniz Unal-Kesenci, "China's Integration in East Asia: Production Sharing, FDI & High-Tech Trade," CEPII Working Paper 2005-09, June 2009 <http://cepii.com/PDF_PUB/wp/2005/wp2005-09.pdf> ; Hans Kundnani and Jonas Parello-Plesner, "China and Germany: Why the Emerging Special Relationship?", *European Council on Foreign Relations Policy Brief ECFR/55*, May 2012 <http://ecfr.eu/page/-/ECFR55_CHINA_GERMANY_BRIEF_AW.pdf> all accessed January 16, 2014.

[16] See Tze-Haw Chan, Hooi Hooi Lean and Chee-Wooi Hooy, "A Macro Assessment of China Effects on Malaysian Exports and Trade Balances," *MPRA Paper No. 48801*, August 2, 2013, pg. 20 < http://mpra.ub.uni-muenchen.de/48801/> accessed January 19, 2014.

[17] See "China's growth Through Technological Convergence and Innovation" in *China: 2030* (Washington DC: World Bank, March 2013) < http://www.worldbank.org/content/dam/Worldbank/document/SR2--161-228.pdf> accessed January 16, 2014, pp. 161-228.

[18] See R Jenkins, "Measuring the Competitive Threat from China," *UNU-WIDER Research Paper No. 2008/11*,

Although public official statements and many articles tend to emphasise the complementary nature of Sino-Malaysian trade there is strong evidence that some previous Malaysian export strengths have been eroded by China's rise. In looking at Malaysia's top 10 exports to its two most important industrialised markets (the U.S. and Japan) from 1991-2007, the author found that in two categories where Malaysia decreased its market share (integrated digital circuits and transmit receivers for radio and televisions,) China increased its market share vis-à-vis the two advanced economies. Even in categories where Malaysia increased its market share, these product categories were still considered 'partially threatened' as China increase in market share in those product categories (vis-à-vis the U.S. and Japan) was larger. More generally, and in the E&E sectors so important to Malaysian exporters, China had a growing if not larger market share of exports to the U.S. and Japan in all these categories.[19] While China was expanding market share for all technology products, the most rapid gains were being made in high-tech E&E products,[20] posing a direct threat to Malaysia's long-standing advantages in these categories.[21]

Using related reasoning, Malaysia's vulnerability is also heightened by the fact that the process and product innovation it once enjoyed in the manufacture of medium- and high-tech E&E parts and products was generally 'imported' into the country by foreign firms.[22] Even now, inputs for manufacturing are largely imported and not produced domestically. For sub-categories in the E&E sector where it continues to be successful in export, 'local' content and innovation are still relatively low.[23] Dependent on foreign firms for innovation and efficiency, Malaysia has become highly vulnerable to other countries that can offer similar manufacturing and assembly environments at better economic scale and cost.

Note that China cannot be held fully responsible for firms shifting higher value-add production and assembly to China, and away from ASEAN countries. Affiliated companies of multinational enterprises account for over 60 per cent of Malaysia's manufacturing output and over 80 per cent of manufacturing exports (or 65 per cent

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February 2008 <http://www.wider.unu.edu/publications/working-papers/research-papers/2008/en_GB/rp2008-11/_files/78941357991723260/default/rp2008-11.pdf> accessed January 16, 2014; D Greenway, A Mahabir and C Milner, "Has China displaced other Asian countries' exports?", *China Economic Review,* 19(2) June 2008, pp. 152-169.

[19] Shahid Yusuf and Kaoru Nabeshima, *Tiger Economies Under Threat: A Comparative Analysis of Malaysia's Industrial Prospects and Policy Options* (Washington DC: World Bank 2009), pp. 51-60.

[20] Above, pg. 60.

[21] Such an argument was considered several years ago by Jane T. Haltmaier, Shaghil Ahmed, Brahima Coulibaly, Ross Knippenberg, Sylvain Leduc, Mario Marazzi, and Beth Anne Wilson, "The Role of China in Asia: Engine, Conduit or Steamroller?", *Board of Governors of the Federal Reserve System International Finance Discussion Papers Number 904*, September 2007 <http://www.federalreserve.gov/pubs/ifdp/2007/904/ifdp904.pdf> accessed January 17, 2014.

[22] See Tze-Haw Chan and Chee-Wooi Hooy, "Malaysia-China Trade and Macroeconomic Linkages In The Globalization Era: A VECX Modelling".

[23] See M. Affendy Arip, Lau Sim Yee and Madono Satoru, "An Analysis of Intra-Industry Trade between Japan, Malaysia and China," *International Journal of Institutions and Economies* 3:1, April 2011, pp. 1-30 <http://ijie.um.edu.my/RePEc/umk/journl/v3i1/Fulltext1.pdf> accessed January 17, 2014.

of total exports.)[24] These foreign firms will make their own decisions on where to base manufacturing plants and processes according to commercial considerations. If Malaysia does not improve its indigenous capacity and business environment in these areas, then someone else will 'eat Malaysia's lunch' even if China does not.

But the point remains that the economic interests of the two countries are not always aligned despite burgeoning two-way trade numbers.[25]

CHINESE FDI IN MALAYSIA

The importance between attracting FDI to fund export-oriented operations on the one hand, and economic growth (and other positive spill-overs to the economy) on the other is clear from *Table 2*.

Table 2: Correlation between Export Volume, FDI and GDP Growth in Malaysia

	2007	2008	2009	2010	2011	2012
Exports in RM billions (% growth from previous year)	605.1 (2.74)	663.5 (9.65)	553.3 (-16.62)	639.43 (15.6)	694.55 (8.62)	702.19 (17.41)
FDI in RM billion (% growth from previous year)	29.07 (34.82)	24.1 (-17.1)	5.04 (-79.1)	29.32 (481.75)	32.93 (12.31)	27.13 (-17.41)
GDP Growth (%)	6.3	4.8	-1.5	7.4	5.1	5.6

Source: Malaysian External Trade Development Corporation; United Nations World Investment Report; World Bank Department of Statistics; Author's Calculations.

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[24] See Prema-chandra Athukorala and Swarnim Wagle, "Foreign Direct Investment in Southeast Asia: Is Malaysia Falling Behind?", *Journal of Southeast Asian Economies* 28:2 August 2011, pp. 115-133 at pg. 115 <http://muse.jhu.edu/journals/asean_economic_bulletin/v028/28.2.athukorala.html> accessed January 20, 2014.

[25] Note that Malaysia only de-pegged the ringgit from the U.S. dollar after China allowed the yuan to appreciate significantly against the U.S. dollar in July 2005. This is evidence that Malaysia sees itself in a somewhat competitive relationship with China in export-manufacturing, and was not prepared to allow an artificially low yuan undermine the attractiveness of Malaysia as an export-manufacturing economy. The same dynamic applies currently. Even though there is a debate as to the degree to which the yuan is undervalued against the U.S. dollar, the export-manufacturing industries of both Malaysia and China depend heavily on American domestic consumption. This means that China's managed currency peg against a U.S.-dominated 'basket of currencies' will continue to undermine the competitiveness of Malaysia's export-manufacturing sectors to some extent.

From 2007-2008 and 2008-2009 when FDI into Malaysia declined 17.1 per cent and 79.1 per cent respectively, Malaysia was forced to diversify its FDI sources and seek investment from firms based in countries such as China. In January 2010, State Grid Corporation of China and 1Malaysia Development Sdn signed a number of "multibillion dollar" agreements to develop the Sarawak Corridor of Renewable Energy, generating up to US$11 billion of economic value according to the 1Malaysia press release.[26] Another announcement was China Harbour Engineering Co investment in the RM4.5 billion Penang Bridge project, completed at the end of 2013.[27] A more recent announcement is the joint-establishment of the Malaysia-China Kuantan Industrial Park (and Qinzhou Industrial Park) to further boost bilateral trade and investment.[28]

Despite these high profile examples of Chinese investment particularly during difficult economic times, Malaysia is far from being overly reliant on Chinese FDI, with China not even counted amongst the top five investors from 2008-2012, as *Table 3* shows.

Table 3: Top 5 investors in Malaysia by country, 2008-2012

2012 - Top 5	Value of foreign investments (RM billions)*
Singapore	14.9
Japan	11.3
USA	9.5
Hong Kong	7.6
Netherlands	5.7
2011 - Top 5	**Value of foreign investments (RM billions)**
Japan	10.1
South Korea	5.2
USA	2.5
Singapore	2.5
Saudi Arabia	2.2

[26] See Hamisah Hamid, "1Malaysia, China giant pump billions into Sarawak corridor," *Business Times,* January 12, 2010 <http://www.1mdb.com.my/danabelia/news-1/1malaysia-china-giant-pump-billions-sarawak-corridor accessed January 23> 2014.

[27] See Josephine Jalleh, "All abuzz over Penang's new bridge," *The Star*, November 17, 2013 <http://www.thestar.com.my/News/Nation/2013/11/17/All-abuzz-over-Penangs-new-bridge.aspx/> accessed January 23, 2014.

[28] See Ahmad Fairuz Othman and M. Hamzah Jamaludin, "Malaysia-China jointly launch Kuantan Industrial Park," *New Straits Times*, February 5, 2013 <http://www.nst.com.my/latest/malaysia-china-jointly-launch-kuantan-industrial-park-1.213392> accessed January 24, 2014.

2010 - Top 5	Value of foreign investments (RM billions)
USA	11.7
Japan	4
Hong Kong	2.8
Singapore	2.1
Germany	1.9
2009 - Top 5	**Value of foreign investments (RM billions)**
Japan	7
Hong Kong	5.3
USA	2.3
Singapore	2
Taiwan	0.716
2008 - Top 5	**Value of foreign investments (RM billions)**
Australia	13.1
USA	8.7
Japan	6.5
Germany	4.4
Spain	4.2

Source: Malaysia Investment Development Authority; Bank Negara Malaysia; CIMB Research
**2012 Figures are based on CIMB estimates and are unconfirmed.*

As of the end of 2012, cumulative Chinese FDI in Malaysia stands at US$6.3 billion or RM20.05 billion, a mere 4.8 per cent of total Malaysian FDI stock.[29] Bank Negara figures in 2011 suggest that Chinese FDI stock in Malaysia was even lower, at RM1.126 billion, or 0.3 per cent of all FDI stock in the country – only the fourteenth largest investor country in Malaysia.[30] Even if we accept the higher figure, the stock of Chinese FDI in Malaysia as of the end of 2012 equates to about 11.5 per cent of all Malaysian FDI stock originating from Asia. To state the relative insignificance of Chinese FDI in Malaysia in another way, total Chinese FDI stock at the end of 2012 is a mere 1.24 per cent of total Chinese FDI stock for all countries at the end of 2012.[31] This indicates that Malaysia is not a major FDI player for China, suggesting that the political and strategic consequences of Chinese FDI in Malaysia are minimal. Even when we consider cross-border merges-and-acquisitions (M&A) involving Malaysian

[29] Figure of total Chinese FDI stock from Yuen Meikeng and Isabella Lai, "Najib hoping for more FDI from China for mutual benefit," The Star, October 4, 2013 <http://www.thestar.com.my/News/Nation/2013/10/04/China-more-FDI-najib.aspx/> accessed January 23, 2014. Total FDI stock in Malaysia figures from *UN World Investment Report* 2013: <http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=588> accessed January 23, 2014.

[30] Bank Negara Malaysia figures.

[31] Calculated from UN World Investment Report figures.

firms as targets (which sometimes do not show up in FDI figures, the M&A activity of Chinese firms in Malaysia do not even make the top ten rankings from 2001-11.[32]

In fact, the problem for Malaysia is its record of net FDI outflows since 2007, indicating a relative lack of confidence and/or opportunity for Malaysia-based firms in the country compared to other economies. This is shown in *Table 4* below. In such a competitive regional environment for capital, especially vis-à-vis the manufacturing sectors, such an unenviable record is unique amongst the ASEAN-6 economies. All this is further reaffirmation that while economic regionalism, and the deepening of regional production chains in particular, has been a boon for the Asia-Pacific, China's move up the manufacturing value chain is a competitive challenge to middle-income ASEAN countries such as Malaysia.

Table 4: Malaysian FDI inflows and outflows – 2006-12 (US$ billions)

	2006	2007	2008	2009	2010	2011	2012
FDI Inflows	6.08	8.695	7.172	1.453	9.06	12.198	10.074
FDI Outflows	6.021	11.314	14.965	7.784	13.399	15.249	17.115
Net FDI	0.059	-2.619	-7.793	-6.331	-4.339	-3.051	-7.041

Source: UN World Investment Reports

Moreover, in relative terms, China is far from being a dominant source of opportunity for Malaysia-based firms. From 2001-2011, China is ranked sixth in terms of cross-border M&A transactions involving Malaysian firms as acquirers, driven largely by Malaysian manufacturing firms seeking to acquire Chinese-based manufacturing firms to promote greater vertical integration of the manufacturing process.

Even then, Chinese firms acquired by Malaysian firms via M&As amounted to only US$3.213 billion, or 5.8 per cent of all such acquisitions in 2001-11. While the average size of an acquisition by a Malaysian firm through an M&A was US$40.5 million, the average size of a Malaysian M&A acquisition of a Chinese firm was only US$20.34 million. This suggests that such Malaysian acquisitions of Chinese firms tend to be smaller commercial plays, compared to the average size of an acquisition in advanced economies such as Singapore and the U.K. (ranked one and fourth respectively in terms of cross-border M&A transaction countries involving Malaysian

[32] See *OECD Investment Policy Reviews: Malaysia 2013* (Paris: OECD 2013), pg. 47 <http://www.oecd-ilibrary.org/docserver/download/2013031ec007.pdf?expires=1390527281&id=id&accname=ocid195150&checksum=25E7243F6B23ABFC4A4C9D203FE00605> accessed January 24, 2014.

firms as acquirers) which has an average acquisition size of US$53 million and US$105 million respectively.[33]

In terms of stock of Malaysian FDI abroad, China is not even ranked in the top ten countries.[34] China's Statistical Bulletin indicates that US$5.6 billion of cumulative FDI has entered from Malaysia as of the end of 2010, while Bank Negara Malaysia has a figure of US$1.9 billion worth of FDI stock entering China.[35] If we accept the Chinese Statistical Bulletin figure, this represented about 5.8 per cent of Malaysia's outward FDI stock at the end of 2010, while the Bank Negara figure represented 1.96 per cent of Malaysia's outward FDI stock in the same time period.[36]

In looking to the future, Malaysia's New Economic Model plan to become a 'high-income' country by 2020 includes looking beyond manufacturing with an emphasis on developing and exporting valued-added services to the region. Part of the plan is to position Malaysia as an attractive regional location for global firms to bring in FDI in order to base their operational headquarters and other aspects of the business in the country. There has been some success in attracting multinationals to the country in this context. But it is noteworthy that the vast majority of these firms are giants from advanced industrialised countries, rather than from China.

For example, a survey of the leading multinationals with significant operational bases in Malaysia are overwhelmingly from the U.S., U.K., Germany, Switzerland, France, Netherlands, Sweden and Norway.[37] The point is that firms and capital from advanced economies, rather than from China will be the more important contributors to the success of forward-looking plans such as the New Economic Model.

CONCLUSION

Using economics to extract political and strategic leverage and concessions is far more difficult than many commentators imagine.[38] In the case of Sino-Malaysian relations, this paper has argued that China's capacity to exploit the economic relationship to exercise meaningful or decisive influence over the political and strategic decisions of Malaysia is severely limited. Broadly speaking, this is the case for a number of reasons.

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[33] Figures from OECD.

[34] Bank Negara Malaysia figures.

[35] See Khor Yu Leng, "The Significance of China-Malaysia Industrial Parks," *ISEAS Perspective* #37, 2013, June 17, 2013 <http://www.iseas.edu.sg/documents/publication/iseas_perspective_2013_37_the_significance_of_china_malaysia_industrial_parks.pdf> accessed January 24, 2014.

[36] Author's calculations based on UN World Investment Report figures.

[37] See PwC, *Malaysia in Focus* 2012 <http://www.pwc.com.au/asia-practice/south-east/assets/publications/Malaysia-in-Focus-2012.pdf> accessed January 26, 2014.

[38] On a commentary that China can use its trade relationship to extract political concession vis-à-vis Australia, see Hugh White, "China will inflict pain if Abbott blunders on," *Sydney Morning Herald*, December 24, 2013 http://www.smh.com.au/comment/china-will-inflict-pain-if-abbott-blunders-on-20131223-2zueu.html accessed January 25, 2014.

First, while economic opportunities presented by China's rise are considerable now and will be more so in the future, such opportunities are neither large nor compelling enough to force Kuala Lumpur to abandon its long-standing strategic hedging strategy against Beijing. In fact, there is a strong case to be made that Malaysia's export-orientated and open economy remains tied to the enormous consumer markets in North America and the European Union, and is less reliant on the Chinese consumer than is often believed.

Second, the complex and integrated nature of the ASEAN-6 and East Asian economies means that translating bilateral economic interactions with one country, into strategic leverage over that country is extremely difficult if not impossible. Just as Malaysia's relatively open economy leaves it vulnerable to the ruthless forces of market completion, it also means that the Malaysian economy and Malaysian firms are not over-reliant on China for their current or future prosperity.

Third, while China's economic rise and integration with other ASEAN+3 economies has brought benefits to the region as a whole, weaknesses in the Malaysian economy combined with China's move up the manufacturing value-chain means that there are strong elements of competition between the two economies. This is expressed through the lowering of the relative competitiveness and attractiveness of Malaysia as a hub of higher value-add manufacturing and assembly, and as a destination for FDI. China's economic rise is not the straightforward win-win for Malaysia, despite the persistently positive diplomatic rhetoric between the two capitals.

Fourth, and despite China's emergence as Malaysia's largest trading partner, the two economies are not intrinsically more tied to each other than to other regional economies. This is evident in the extraordinarily low inward and outward FDI numbers between Malaysia and China compared to Malaysia's investment relationship with a number of other regional and global economies.

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