Beijing's prowess spurs innovation in Southeast Asia

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Last year, Sunningdale Tech, an injecting molding and precision assembly company in Singapore, bid to provide printer casings for a multinational computer company. The contract went to a Chinese competitor, which surprised Paul Ow, Sunningdale's vice president, less than the margin — 25 percent — by which Sunningdale was outbid.

"The China impact is something we face every day," Ow said. "You can't get around it. The only thing we can do is look to do things they can't."

For many in Southeast Asia, that has meant scrambling to find niches with higher added value, rather than competing head-on with China, whose large and cheap labor pool and massive injections of foreign investment — $72.4 billion last year, according to a U.S. congressional research report — have helped transform it into the world's biggest manufacturer of low-cost goods.

India, too, is starting to pose a challenge to the long-term health of Southeast Asian economies, particularly in the service sector.

The difference, however, is that China has a $2 trillion economy, compared with India's $700 billion. China's exports are worth $600 billion a year, while India's are $60 billion. China receives about $50 billion in foreign direct investment a year, versus India's $5 billion. It is China that Southeast Asian nations need most to adapt to, and that is driving them, faster than they might otherwise, to diversify their economies.

No nation in the region epitomizes this more vividly than Singapore, which has struggled to secure electronic contracts recently against China and other Asian neighbors but has determinedly pushed ahead in other areas.

Last year Singapore announced plans to open its first casino to expand its tourism sector.

Two years ago it started a banking degree program at Singapore Management University, with the aim of turning itself into a private banking hub, and changed its tax laws to attract more foreign capital. The changes seem to be paying off. In 2005, total assets managed by financial institutions based in Singapore rose 26 percent to 720 billion Singapore dollars, or $457 billion.

Meanwhile it has poured billions of dollars into biotechnology research since 2000 and is now home to nearly 1,000 foreign-trained postdoctoral researchers, according to media reports. The government said last year that it planned to spend $7.5 billion on medical sciences over the next five years, up from nearly $4 billion in the past five, according to a Cox News Service report in June.

Malaysia is now adopting a similar strategy. In the past 30 years it has evolved from a tin, rubber and palm oil producer into a major assembler of electronics, which now account for 80 percent of its exports and have made it the 10th-largest trading partner of the United States. Increasingly, however, multinationals appear to be passing it by. That is partly because of its sometimes burdensome restrictions on foreign workers and investment and partly because greater efficiency, higher levels of innovation and lower wages can be found elsewhere in Asia, said several economists, including Rajah Rasiah, a professor of technology and innovation policy at the Asia Europe Institute in Kuala Lumpur.

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Cyberjaya, a high-technology industrial suburb of Kuala Lumpur that opened in 1999 as Malaysia's answer to Silicon Valley, is now home to a number of vacant buildings. Although Malaysia intends to continue to invest in value-added manufacturing, the government aims to reduce manufacturing to a 28.5 percent share of the economy by 2020 from 30 percent now while raising the share of services to nearly 60 percent.

A 2005 study of offshore locations for shared services and outsourcing by the business consultancy A.T. Kearney put Malaysia among the top three countries in the world in terms of people skills and availability, business environment and financial structures.

Tourism is another plank of the plan. In May the government started talks with Walt Disney to open a theme park in the southern state of Johor, to compete for tourist dollars with the casinos planned in Singapore.

The Malaysian government is also looking to biotechnology, communication technology and health care as growth niches — a spread that worries some analysts.

"Malaysia's strategy is eclectic and the worry is that it's not driving in a particular direction," Rasiah, the technology professor, said.

Neighboring Indonesia, Thailand and the Philippines, meanwhile, have gone less far down the diversification road.

Thai textile production on the whole has survived the onslaught of Chinese competition with factories shifting to higher value-added materials like spandex and wrinkle-free garments, said Chayawadee, a senior economist with the Bank of Thailand. But a number of leather factories have shut their doors, and some analysts say it is just a matter of time before China catches up in other areas.

Productivity and diversification in Thailand are impaired by excessive regulation and shortages of skilled labor, infrastructure and educated graduates, a recent World Bank survey said.

In Indonesia, legal uncertainties and weak labor markets, infrastructure and tax collection are also holding back economic growth and diversification, said Stephen Schwartz, the International Monetary Fund's senior resident representative there.

Indonesian textile makers have lost business to China, and Indonesia is poorly linked into the high-tech sector, which "explains why foreign direct investment is less than optimal," he said.

Still, Indonesia is exporting oil, gas, timber, coal, palm oil and other commodities to fuel surging Chinese industrial growth, which helped its economy to grow 5.6 percent last year. Its well-being may not be served best by trying to rise up the value-added chain, Schwartz said. "Indonesia's already a pretty diverse economy," he said.

In the Philippines, too, moving up the value-added chain may matter less than elsewhere.

With demand for raw materials booming, the government has adopted a pro-mining policy that is expected to raise mineral revenue by 50 percent this year from last year's $1.8 billion.

The Philippines also reaps huge remittances from overseas workers, estimated by the central bank to be heading for $12 billion this year, while outsourcing, in a country where 82 percent of the population speaks English, is a $2.6 billion-a-year industry employing 179,000 people.

Still, economic growth of barely 5 percent last year was sluggish by regional standards, and Manila, like other capitals in the region, is looking to enrich the mix. One target niche is medical tourism, with a goal of earning $2 billion in annual revenue within five years — equivalent to the country's total tourism revenue last year.

China's rise "puts a premium on absorbing technology, skilled labor and education," said Homi Kharas, the World Bank's chief economist for the East Asia Pacific region.

Open markets and more efficient infrastructure are also important. "Most cities in the region are not efficient," Kharas said. "People should be concerned about that. You need to keep innovating."

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