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Commission**

**“China’s Activities in Southeast Asia and Implications for U.S.
Interests”**

Summary

Commissioners, ladies and gentlemen, it is an honor to share my testimony on China’s role in Southeast Asia and implications for US interests in the region.

China’s Rise

China’s economic progress over the last two decades has been remarkable. As a major world power, recent history has not witnessed such an emergence since the United States began to engage the world after our Civil War.

To date, China’s entry on the world stage has been mostly peaceful and relatively benign. Given its rapid economic expansion – it has likely overtaken Japan as the world’s second largest economy already -- one could imagine less favorable scenarios than those we have witnessed. Predictably, the impact of China’s rise has been most notable in Asia, particularly in Southeast Asia.

While China has transformed itself over the last decade and half, the US role in Southeast Asia has remained relatively consistent – a major presence both economically and strategically, but unfocused. A fast growing China is a both an opportunity and a curse for Southeast Asia. It has brought money and markets without asking too much in return – yet. On the other hand, the fact that it China a focused strategy and has seen its leverage increase incrementally – worries the region’s leaders and heightens their fear of domination. Southeast Asia wants and needs the US must step up its game and articulate a strategy to advance its interests in the region. Only then will Southeast’s Asia atavistic hunger for balance be fed.

China Transforms its Perception in Southeast Asia

Over the last 15 years, China has transformed how it is perceived in Southeast Asia from that of a very large, awkwardly ideological, self-focused, security concern to the north to that of an engaged and interested neighbor providing significant benefits in trade, aid, tourism and the promise of increased investment and prosperity. Its size is even more relevant today than it was then – its economic and military muscles are there for all to see. Security concerns remain, and there is evidence that China's so called "charm offensive" toward its neighbors to the south is part of a strategy to build good will and leverage which will eventually allow it to assert itself in pursuit of its national security priorities including issues such as Taiwan, the South China Sea and energy and food security.

In soft power terms, China has made great gains attracting more Southeast Asian students and building on its cultural ties to Chinese communities throughout the region. China has made it easier for Southeast Asian students to travel and study in China and is providing scholarships at several levels, including masters and doctorate degrees. Chinese policies toward Southeast Asia over the last 15 years have transformed from ideological to opportunistic and pragmatic.

Chinese trade, investment, aid and foreign policy suggest a strong inclination to see the region as within its sphere of influence – covered by China's own version of the Monroe Doctrine. It is this Beijing perspective, not widely articulated but conveyed through posture, profile and persistence that causes concern among the Southeast Asian nations and warrants the constant attention and concern of US policy makers.

China's approach to Southeast Asia is clearly defined by its national security interests. Relative to other countries, and certainly to the United States, it takes a longer term view. As a result, Chinese policy has been practical and flexible on issues not vitally important to China. However, and tellingly for Southeast Asian analysts, when China's priority equities are involved, such as the in the case of the South China Sea or Uyghur refugees in Cambodia, it acts decisively and uses its leverage and muscle to achieve its goals. The region's leaders recognize these examples as the iron fist that flexes under the velvet glove of China's new diplomacy.

The US Role is More Consistent

Over the same time frame, the perception of the United States has been more consistent. A decade and a half ago, the US was the region's top trading partner and number one investor (when including energy investments with official foreign direct investment figures). Its military presence and forward deployment assured security in the Asia Pacific. The perception of the United States was generally positive. However, despite its significant commercial and military presence, Southeast Asian leaders felt that the US was not engaged enough, and was ceding economic opportunities and leadership to Japan. US soft power remained relatively strong, especially when compared with Japan, whose role as an aggressor in World War II was – and still is -- fixed in Southeast Asia's collective psyche.

Today, the US remains a major trading partner and arguably the top investor (when including energy investment to official figures which exclude energy). The US military continues to play the preeminent role in regional security and is the primary deliverer of “public goods” to the region, for instance in humanitarian assistance and disaster relief effort during the 2004 tsunami. However, over the same period, perceptions of US engagement and commitment dipped significantly, particularly during the Asian financial crisis and during the wars in Iraq and Afghanistan.

Southeast Asia’s Perspective – Balance

Southeast Asia’s primary concern, as it was 15 years ago, remains maintaining balance among the major powers. Today, that means balance between the United States and China.

In the 1980’s the ASEAN countries, at that time only numbering five (5) members, came to the US in the context of the ASEAN US Dialogue and urged America to re-engage, particularly economically. Japan had presented ASEAN with industrial development blueprints that regional leaders felt suggested virtual domination of their industrialization processes by the Japanese. Japanese aid supported the famous “Japan, Inc.” approach aggressively, as did Japanese diplomacy. Every year, the Prime Minister of Japan would make leader visits to every ASEAN capital, doling out aid and promoting policies that would augment Japanese trade and investment.

Today, China is the country making those leadership visits and getting the headlines. While the Japanese presence is still appreciated, China has been effective in promising the future: growth, markets, assistance and an Asian century.

So Southeast Asia is sending a similar message to the US. They are encouraging the US to step up its engagement, provide leadership on trade, address its own fiscal health, proactively pursue a central role in regional security architecture, increase investment and training, and work to expand on its leadership in areas such as education.

Southeast Asia’s leaders understand that China’s rise is economically beneficial, but they do not want to be dominated by China. Their strategy is to domination by enhancing regional integration through the ASEAN Charter¹, encouraging strong and sustained engagement by the United States and other dialogue partners, and solidifying ASEAN’s role as the core of regional security and trade architectures.

The Difference – A Strategy for Southeast Asia

Perhaps the most significant difference between China and the United States in Southeast Asia is that China has a clear strategy for the region, and the US does not.

China's Southeast Asia Strategy

China's policy for Southeast Asia is to become the dominant partner in East Asia, its perceived sphere of influence. China believes that strong ties and influence with the ASEAN countries ensures it cannot fall victim to any containment strategy. It also needs to secure access to long term food and energy supply as well as to protect existing logistics routes and develop new ones. Finally, tied aid creates new opportunities for Chinese companies and helps alleviate unemployment by allowing China to export labor.

Good examples are plentiful, but China's large and proactive aid program in Burma provides a case in point. Chinese aid dominates the Burmese economy. Chinese military sales support the ruling junta. Aid is directed at infrastructure projects that are built by Chinese contractors and laborers and designed to channel natural resources from Burma and the Andaman Sea to China. There is a new 6,000 mile pipeline under construction designed to pump oil and gas shipped from the Middle East and Africa overland through Burma and supply most of western China. Such new supply lines are coincident with the need for an increased security presence in the Indian Ocean along with port access and repair facilities. These facilities have been built in Burma and in offshore island and will likely lead to the development of the Chinese navy into a two ocean power in the future.

China ASEAN Free Trade Agreement

From 1993 to 2008, China increased its share of total ASEAN trade from 2 percent to 11 percent. The US share decreased from 18 to 11 percent over the same period. China over took the US this year as ASEAN's third largest trading partner behind Japan and the EU. However, Chinese investment in ASEAN remains relatively small compared to the U.S., estimated at less than one tenth of the \$173 billion the US had invested in 2008.

Trade is a good example of how an opportunistic and practical approach has benefited the perception of China in Southeast Asia. Instead of pursuing comprehensive, legally binding agreements such as the US pursues, China offered the ASEAN countries "free trade agreements" that had lower level commitments and were more economic cooperation agreements than FTA's. While the US spent years negotiating the US Singapore FTA, saw Trade Promotion Authority (TPA) languish and pass away, and left negotiations with Malaysia and Thailand on the table at the end of the Bush Administration, China forged ahead.

China, following the discipline of its focused strategy in ASEAN, took full advantage of the fact that ASEAN is the world's most trade dependent grouping of nations, with trade accounting for nearly 100 percent of aggregate gross domestic product in the ten member countries. China responded with a series of economic agreements it calls Free Trade Agreements and on January 1, 2010 the China ASEAN Free Trade Agreement (CAFTA) went into effect.

The ASEAN Secretariat now predicts China will become ASEAN's top trading partner within the next "few years" due to the CAFTAⁱⁱ. While the CAFTA is not an agreement that US trade negotiators would consider a true and substantive free trade agreement, it creates an economic region of 13 million square kilometers with 1.9 billion consumers, a regional GDP of about \$6 trillion and total trade estimated at \$4.5 trillion. It is also the biggest FTA in the world in terms of population size and the third largest in terms of economic value (after EU and NAFTA). CAFTA may not be comprehensive, but its impact is practical and it is clearly having a strong impact on the economic integration of China and ASEAN and East Asia generally.

It should be noted that US companies invested in China and or in ASEAN can, and in some in some cases among more sophisticated companies are, taking advantage of the CAFTA. American companies manufacturing in Thailand, for example, can use the provisions of CAFTA to more efficiently export their products within one of the world's largest and fastest growing regional markets.

CAFTA has also suffered from protectionist concerns among key ASEAN countries, most prominently Indonesia, who has asked for a one year delay in implementation and submitted a large list of over 200 industries it would like to be protected from the agreement.

Chinese Aid in Southeast Asia

Chinese aid to ASEAN countries has dual purposes of supporting diplomatic initiatives and creating new opportunities for Chinese companies. Major projects are built by or contracted to Chinese companies and built using labor exported from China. Not unlike the very commercially oriented Japanese aid programs in Southeast Asia in the 1990's, Chinese aid, though hard to quantify is growing fast and is a primary tactic in the implementation of China's Southeast Asia policy.

The best estimates to quantify Chinese aid in Southeast Asia have come from a Congressional Research Service Report which estimates that aid increased from \$36 million in 2002 to over \$6.7 billion in 2007. By comparison, the same source recorded US aid to Southeast Asian countries to be \$452 million in 2007. Of total Chinese aid for the region, CRS estimates 59% of this aid was tied to infrastructure projects, 38 percent to natural resources investments and the remaining 3% to humanitarian, military and high profile "gifts" such as sports arenas for regional games.

Over the same period, Chinese aid in ASEAN targeted maritime Southeast Asian nations. The Philippines, a US treaty ally, turned out to be quite open to Chinese "aid" after the Bush-Arroyo relationship started to flag as a result of President Arroyo pulling her country out of the "coalition of the willing" supporting the war in Iraq after a Philippine citizen was kidnapped and ransomed. China saw its opening to crack a traditionally hard nut. The Philippines had always been suspicious of Chinese intentions in the South China Sea, and had vocally rallied its ASEAN colleagues to stand together to face up to perceived Chinese provocation at Mischief Reef and other islands. However, after flooding Manila with aid for major projects such as the North Rail

and hosting a series of Presidential trips to China, relations warmed considerably. Perhaps coincidentally, in 2007 the Philippines unilaterally agreed to Chinese urging for a Joint Seismic Maritime Undertaking (JMSU) to explore energy resources in the South China Sea. Vietnam, which was informed that the other two partners had already signed, rightly felt it had been the victim of a *fait accompli*.

Indonesia was another major target. The fourth largest country in the world, third largest democracy and the country with the world's largest Muslim population, Indonesia had, until just a decade ago, banned documents written in Chinese – a vestige of Soeharto's anti-Communist campaigns. China could ill-afford an arm's distance relationship with Indonesia, the anchor of the ASEAN and one of the world's richest reservoirs of natural resources. Using the opening provided by the perceived harshness of the Western response to the Asian financial crisis, China stepped in to implement its strategy. Chinese assistance to Indonesia during the financial crisis was not exceeding large, but by Chinese standards it was, at the time, a major new level of commitment. Dividends were paid and Chinese aid clearly helped to mute or soften Indonesian concerns about Chinese motivations and helped establish long term supply contracts for coal and gas.

Chinese aid in ASEAN is generally directed through well placed politicians of the host country who have control or influence over projects that will serve Chinese interests such as roads to access natural resources or pipelines to access oil and gas.

Aid from China is provided for the most part in the form of low interest loans, but with repayment rates higher than the Japanese have employed. Funds are generally targeted on a project basis and infrastructure projects are a favorite target. According to ASEAN's Secretary General Dr. Surin Pitsuwan, Beijing is offering a \$10 billion infrastructure investment fund to improve roads, railways, airlines and information-telecommunication links between China and ASEAN and also providing a \$15 billion credit facility to promote regional integration and regional connectivity.

Projects are secured with business like memoranda of understanding that ensure Chinese equipment suppliers, contractors and even exported Chinese labor are the beneficiaries of project funds. In addition, there is ample evidence that in many of these projects, extra funds are available for politicians who help create and direct the opportunity. One of the most high profile cases in point is the infamous National Broadband Network (NBN) project in the Philippines. Chinese funds were reportedly expended through a Chinese university to help fund a nationwide initiative to increase broadband access ahead of Philippine Congressional elections in 2008. Major corrupt practices were alleged and brought the deal under public scrutiny, resulting in prosecutions and Congressional investigations and hearings.

The primary implications of China's aid in Southeast Asia are positive and negative. To the extent that Chinese aid projects build much needed infrastructure in Southeast Asia, all with interests in business and security and the well being of the region's 600 million people benefit. However, too often, Chinese funds are used to build unnecessary projects that serve political

rather than practical requirements. These projects support local politicians and Chinese contractors and labor, but not the indigenous population.

On the negative side, the mercantilist nature of some of China's aid may undercut reform-linked assistance offered by the US and other donors. Why take less funding to do achieve harder and less tangible goals?

In addition, American companies find themselves at a competitive disadvantage in the region when Chinese businesses, supported by non-conventional and targeted Chinese aid, compete for the same projects. While American firms abide by the provisions of the Foreign Corrupt Practices Act (FCPA), they lose major projects to competitors who use tactics that would violate the provisions of US law. This has become nearly endemic in the area of major public sector infrastructure projects. US firms, once preeminent leaders in the area of infrastructure in Asia, now play niche roles in supplying high end services or technical equipment to such projects instead of acting as prime contractors and major suppliers.

Due to the paucity of reliable data on Chinese aid in Southeast Asia, CSIS Southeast Asia is developing a proposal for a research project to assess where China's aid goes in Southeast Asia, how it is directed and channeled and its linkage to Chinese foreign policy and national security goals.

US: A Strong Presence but Not a Strategy

The United States has a strong presence and significant interests in Southeast Asia. The US has over \$173 billion invested in Southeast Asia, more than three times the amount invested in China and almost ten times US investment in India. The US has two treaty allies in ASEAN – the Philippines and Thailand, and a strategic relationship with Singapore that practically goes beyond most treaty relationships. In addition, the Obama Administration has indicated its interest in developing a new Comprehensive Partnership with Indonesia, which President Obama will help to advance when he visits the country next month. Concurrently, the US is rapidly developing strong ties with Vietnam, moving beyond political and economic linkages to expand strategic cooperation. To his credit, President Obama has joined hands with the ASEAN leaders and inaugurated the US ASEAN Summit last November in Singapore.

While it lacks a coherent trade strategy, the US Government has indicated it will join the negotiations for the Trans Pacific Partnership (TPP) starting in March in Australia. The concept is to create a very high level agreement among a coalition of 8 willing and motivated countries (Australia, Brunei, Chile, New Zealand, Peru, Singapore, the US and Vietnam) and then encourage other countries in the Asia Pacific region to join.

On the security architecture front, the US has indicated an interest in strengthening the ASEAN Regional Forum (ARF) and building on that structure to create a structure with ASEAN at its core.

The new US policy toward Burma is another important step in the right direction, particularly when thinking strategically about ASEAN. In the past, concerns about the political situation in Burma kept the US from engaging the ASEAN leaders. This gave other countries, most notably China, the policy equivalent of sanctuary. By adjusting the policy focus to employ both engagement and sanctions, US policy has the opportunity to be more effective on a bilateral basis in Burma and regionally with ASEAN.

The change in US policy on Burma takes away an inherent Chinese competitive advantage. By asserting support for the principle of non-intervention in the internal affairs of other nations, China was able to build up support among Asian countries that were (and are) working through difficult political transitions. As ASEAN countries' political models evolve, it is less clear that the Chinese approach will be as effective unless it adapts.

Conclusion

China has stepped onto the global stage in a relatively constructive manner during the last 15 years. Its presence in Southeast Asia has transformed and is now robust. It will continue to build on its position, but this development need not be at the expense of US interests.

Competition for markets and models between the US and China in Southeast Asia will remain strong. At the same time, the markets in Asia will continue to grow and be a source of exponential global growth.

The US has a very strong foundation in Southeast Asia. It maintains a commercial and security base that currently far exceeds that of China in the region.

The ASEAN countries will strive for balance, not only between the US and China, but also with other major and emerging powers. In that sense, ASEAN may prove to be a vital strategic fulcrum on which a sound and enduring US strategy for Asia can be built.

In this context, it is not so much Chinese initiatives and activities in Southeast Asia that impact US interests, but rather the need for the US to define its interests, focus on priorities and devise a strategy to ensure those interests are proactively and consistently advanced.

ⁱ The ASEAN Charter envisions the economic, political and cultural integration of the ten ASEAN countries by 2020.

ⁱⁱ ASEAN Secretariat.