

Testimony before the US-China Economic and Security Review Commission
Hearing on

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

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There is an extraordinary amount of literature out there on the objectives and modus operandi of China’s diplomacy in Southeast Asia. In the interest of full disclosure, I tend toward the more suspicious view of China’s ambition. I believe China is a strategic competitor of the United States, and that Southeast Asia is being warmly contested by it. But given the “peaceful development” counter-narrative so effectively pursued by China, and many well-respected alternative opinions, I thought my value-added today would lie less in proving one side of that debate than in looking at China’s economic diplomacy from where the ASEAN leaders sit.

The seminal year in China’s “Charm Offensive” was 2002. That year, China and ASEAN signed the “Declaration on the Conduct of Parties in the South China Sea (DOC)” and the “Framework Agreement on Comprehensive Economic Cooperation.”

As commissioners know, the territory comprising the South China Sea is disputed by China, Taiwan and four ASEAN members: Vietnam, the Philippines, Malaysia and Brunei. The DOC commits, in non-binding fashion, ASEAN and China to the peaceful resolution of conflicts over their claims. It is important to note that the DOC does not directly address those claims, nor does it necessarily provide a venue for addressing them. In fact, as the Chinese happily point out, the DOC explicitly calls for disputes to be addressed through “friendly consultations and negotiations by sovereign states directly concerned”.

In and of itself, the DOC is a very weak agreement. What it did essentially was to set aside conflicting territorial claims in the interest of developing the broader ASEAN—China relationship. In so doing, it removed a highly visible political barrier to closer economic ties. The DOC is in effect, if not provision, more an economic agreement than a security agreement.

The early to mid-1990’s were hard on China’s image in Southeast Asia. Its 1992 Territorial Sea Law, the highly visible dispute with the Philippines over the Spratlys, and the 1995-1996 missile crisis in the Taiwan Straits, all confirmed Southeast Asia’s worst expectations about China’s rise. Economic diplomacy began to turn things around for the Chinese in 1997 when they turned a predisposition for currency stability into a diplomatic coup. Chinese leaders claimed that as a contribution to recovery in the region, they would

not devalue the RMB. This contained the damage that the Asian crisis was inflicting on Southeast Asia by helping them keep their exports competitive. Token contributions to the IMF bailouts of Thailand and Indonesia also contributed to China's evolving "good neighbor" policy. President Obama held the first US-ASEAN Summit just last year. Then-Chinese-President Jiang Zemin held the first ASEAN-China Summit in 1997. It was at a summit meeting in 2000 that China proposed the idea of an ASEAN-China FTA, and at a 2001 summit that the two sides began to flesh out the idea. By 2002 the official Chinese image of "good neighborliness and mutual trust" had clearly won out and set in motion the profile in the region that China enjoys today.

The 2002 economic framework agreement became the centerpiece of China's economic engagement in Southeast Asia. It provided for the negotiation of an Agreement on Trade in Goods that came into full effect this January, a Trade in Services Agreement that came into effect in 2007 (July), and the ASEAN-China Investment Agreement signed in August of 2009 (effective date six months from signing). Emblematic of how far the U.S. is falling behind in its economic diplomacy in the region, much of the press has reported the trade in goods agreement as something new. In fact, it has been phasing in since January 1, 2004, first with tariff reductions on 600 agricultural products under an "Early Harvest" program, and then beginning on July 20, 2005 with additional phases for goods more generally, covering in total more than 7000 tariff lines. According to the ASEAN Secretariat, trade between ASEAN and China has maintained an average growth of 26 percent a year since 2003 – reaching almost \$200 billion in 2008.

Relatively speaking, goods are easy. Liberalization in services and investment – because of the nature and constituencies for non-tariff barriers – are much more difficult to realize. My judgment is that the ASEAN-China agreement on services will experience many of the same problems that ASEAN itself has experienced with its own ASEAN Framework on Services. That is, commitments will mostly represent window dressing on commitments made in the World Trade Organization, and not offer significant benefits beyond.

A similar dynamic is at play in the area of investment. The ASEAN-China agreement is based on the ASEAN Investment Area (now the ASEAN Comprehensive Investment Agreement). The limited number of sectors covered and exceptions have meant the concept is vastly underutilized. There is no reason to believe that agreements in these areas between China and ASEAN will fare better than ASEAN's own.¹

The impact of liberalization on trade in goods alone, however, is very powerful. China is now ASEAN's third largest trading partner behind the European Union and Japan, and is on pace to become number one very soon. And investments from China, whether driven by agreements or not, are continuing to grow. Chinese direct investment in ASEAN today is relatively small; ASEAN investment in China is much larger, \$6.1 billion compared to around \$50 billion.

¹ Walter Lohman and Anthony B. Kim, "Enabling ASEAN's Economic Vision" Heritage Foundation *Background* No.2101, January 29, 2008, at <http://www.heritage.org/Research/AsiaandthePacific/bg2101.cfm>.

There has long been a debate in Washington over whether China is “eating America’s lunch in Southeast Asia.” It depends on how you measure. The security types will mostly tell you “no.” There is simply nothing to match the military footprint and capacity of the U.S. in the Asia-Pacific. It is hands down the winner. The worriers have been looking at the other side of the equation: The economic trends and high-level, active Chinese economic diplomacy. The ASEAN states are playing a game whereby they take full advantage of near-term trends in China’s economic development while hedging against their longer-term security concerns. The question is whether in the long-term they might outwit themselves and be so deep on the economic side that their political choices are constrained. The less sanguine view of China’s intentions holds that this is the Chinese design.

This is important background because it demonstrates how well the Chinese have learned to play the game in Southeast Asia and, by contrast, how far the United States has fallen behind in its own game. The Chinese have sought to internalize ASEAN’s processes; they’ve learned to roll with the punches. They don’t spend much time complaining about the ASEAN “talk shop.” They have made investments in time and patience in the “ASEAN Way,” pushing hard when necessary, and easing off at others.

The 2002 economic framework is a prime example. Once the framework agreement was signed, the Chinese moved aggressively to implement it. They divided it into three agreements, separately covering goods, services, and investment, and agreed to each running on its own timeline. Negotiators did not wait for all three to be done before concluding each one.

The Chinese negotiated the “Early Harvest” program on what was widely perceived at the time as near-concessionary terms. It allowed for a two-tiered approach to liberalization that allowed more developed nations to come into compliance in 2010 and less-developed in 2015. In fact, when you consider the phasing in of the agreement on goods, it is actually multi-tiered, as it allowed almost a custom fit for compliance with the timetable. Like ASEAN’s own agreements, the ASEAN-China agreements also allow different treatment for “sensitive” and “highly sensitive” products and “general exceptions.”

The trick to engaging ASEAN is knowing when leaders are just talking and when there is something to it – and knowing that the difference is often determined by the energy and skill of an outside actor. The ASEAN-China FTA was more than just talk 10 years ago, but it was so because the Chinese made it so. Many of us underestimated the seriousness the Chinese would bring to the process – and the receptivity they would encounter on the ASEAN side.

My appeal today is that we not make the same mistake again. These economic trends are real, and Chinese diplomacy in the region is very effective. It is taking place across the board from financial markets cooperation to infrastructure development. They are down in the weeds consulting with ASEAN in forums barely on our radar screens. Let’s not

wake up five years from now – as we did on the Agreement on Trade in Goods – to discover a level of economic integration that has, in fact, been in the works for 15 years.

I have focused entirely on China's multilateral engagement in ASEAN because of the emphasis they have given it in their economic relations and for the sharp contrast it provides to the American approach. For the most part, the ASEAN states prefer the multilateral approach to China, obviously, because there is strength in numbers. But I also want to touch briefly on individual country dispositions toward China. The dynamic these various positions produce is critical to understanding the direction the organization takes in its relationship.

Everyone has his own version of ASEAN's sliding China disposition scale. My own goes like this (from most China friendly to least): Laos, Burma, Cambodia, Thailand, Malaysia, Singapore (midpoint), the Philippines, Indonesia, Vietnam.

To understand this scale and the political decision making process in Southeast Asia, I commend to you an excellent bit of scholarship by Kuik Cheng-Chwee at SAIS entitled "The Essence of Hedging: Malaysia and Singapore's Response to a Rising China."² Kuik proposes that to understand decision making in Southeast Asia, analysts have to get beyond the classic formulation of balancing vs. bandwagoning. Most the ASEAN states – and all the big ones – are "hedging" against China's rise. And the best way to understand their hedging strategies is by seeing them as "driven not so much by the growth of the Great Power's relative capabilities per se" but "by an internal process of regime legitimization in which the ruling elite evaluate – and then utilize – the opportunities and challenges of the rising power for their ultimate goal of consolidating their authority to govern at home."

You simply cannot understand ASEAN's decision making process the way we learned it in school, with countries strategically seeking to maximize advantages without consideration for the domestic (sometimes personal) demands on leaders. The Chinese approach to economic diplomacy accounts for this dynamic in a way that ours doesn't.

The U.S. cannot replicate the Chinese effort in Southeast Asia. Obviously, American officials are accountable to the American people in a way that the Chinese are not to their own. We cannot structure trade agreements in ways that chooses winners and losers by diplomatic or industrial policy imperative. Just getting agreements through Congress means that they must cover the range of sectors and issues. Hard to imagine telling the service industry that they're going to have to wait two years for their part of the agreement and still get their support on the Hill. The Chinese are also closer and have more diplomats to throw at ASEAN. We can do better than we are in covering ASEAN – establishment of the U.S. mission in Jakarta focused exclusively on ASEAN and headed by an Ambassador is a good start – but we cannot match the Chinese diplomat for diplomat, forum for forum.

² Kuik Cheng-Chwee, "The Essence of Hedging: Malaysia and Singapore's Response to a Rising China," *Contemporary Southeast Asia: A Journal of International and Strategic Affairs*, Vol. 30, No.2, Singapore Institute of Southeast Asian Studies (2008).

The other reality is China's own economic engagement. We can't stop it, and we shouldn't want to. Economic growth in ASEAN and China is a good thing and to the extent that cooperation benefits them both, that is good. Economic growth in Asia is lifting millions of people out of poverty and providing opportunities that many generations in the region have never enjoyed. We want to compete, but we never want to be in the position of begrudging China or ASEAN their economic success and improvement in welfare.

But we can step up our own game. Considerably. And we can learn valuable lessons from the developments in the region over the past 10 years.

First, the first three priorities for ASEAN are trade, trade, and trade. The U.S. cannot have an effective policy in Southeast Asia without a trade policy. Period. The Administration's effort to get more deeply engaged in ASEAN's processes, raise the American profile and stabilize participation in ASEAN activities is very well-advised, but it is empty gesture without a discernable free trade component. ASEAN's concerns about China are long-term. They are not so worried that the demonstration effect of American official visits alone is a sufficient advantage. We need substance, and the substance that counts is trade.

Second, we need to have a long-term vision: a Transpacific Partnership firmly rooted in the goal of an APEC-wide FTA, and an ASEAN-US FTA.

It is very encouraging that the Administration has picked up where the Bush Administration left off on the Transpacific Partnership. It will be interesting to see what they bring to the negotiations. The members of the TPP, including ASEAN states Singapore, Brunei, and Vietnam, understand that the U.S. is going to approach these discussions differently than the Chinese. Our tougher positions, they know, can actually enhance their competitiveness and access to quality goods and services in ways the China agreement cannot. They also expect issues like labor and environment to be on the table. But if the Administration plans to take any version of the proposals outlined by the House Trade Working Group, it would be better they just stay home until such time as they can fashion a trade agenda intended more to free trade than to constrain it. There are two sides to trade negotiations, and with China's economic clout in the region growing, we need every bit of leverage our market offers just to secure market access and the standards we have already set.

Third, take agreements with ASEAN seriously in concept, negotiation and subsequent implementation – just as China has. The fact that sometimes when left to its own ASEAN does not take its own agreements seriously is not important. The U.S. can be the catalyst. It is in this context that its investment in time is most important. It cannot be a catalyst if it demonstrates merely sporadic interest.

Fourth, be as flexible as possible. The U.S. can maintain its FTA gold standard. That is in the interest of both sides. But it can be flexible in other ways – and not necessarily in

the text of the agreements. The U.S. and ASEAN have a mutual interest, for instance, in helping small businesses compete. Financing for small and medium enterprises in ASEAN has long been a problem for which they have sought help with. Assistance with infrastructure development is another key area for ASEAN.

Fifth, integrate economic objectives with broader diplomatic ones. In the 1990s, China started out mostly with political liabilities and the promise of economic development not yet fulfilled. The U.S. starts with massive advantages, not the least of which are decades of positive engagement in the region, a global profile, military alliances in the region, partnerships, and USAID. The list of advantages the US has over China in this competition is long. The Bush Administration took some limited steps to integrate priorities under its ASEAN-US Enhanced Partnership, an agreement since endorsed by the Obama Administration; in the US-ASEAN TIFA process; and in its ADVANCE program (Development Vision to Advance National Cooperation and Economic Integration). The Obama Administration's Lower Mekong Initiative is an excellent start to expanding on this and gets directly at a geographical spot where the Chinese have a significant head start on the U.S.

Sixth, don't buck the current economic order, leverage it. If the Chinese want to invest in ASEAN's infrastructure, fine. The U.S. should have relationships in the region that help ASEAN determine its priorities and voice its concerns. If Chinese multinationals want to invest in ASEAN, great. Work to bring them into compliance with U.S.-friendly standards and integrate them into American supply chains. If there is to be more ASEAN-China trade, American companies ought to be invested in it on both sides of the border and integrated into markets back home. Fighting current economic trends undermines the credibility of our leadership.

In the end, if the U.S. is to continue leading in Asia, we have to prove that our concerns about security and our geopolitical competition with China are not going to upset ASEAN's economic apple cart, and that, in fact, we are a positive actor not a reactive, negative one. This will ensure that we stay at the table long into what remains in the larger scheme of things, a still uncertain future.

The Chinese are competing very effectively for influence in Southeast Asia. Worries in the region about their defense capabilities are rooted so distantly in the future that the U.S. role of security guarantor is not enough to substantiate an energetic engagement of the region. Neither is engagement without free trade leadership. There are many areas of potential economic cooperation, but without trade agreements, they are all small potatoes. The U.S. must be at the ASEAN table; it must also bring something tangible.