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China's Role in the World: Is China a Responsible Stakeholder?

When we look at China we tend to concentrate on the most recent headlines or at least the latest major event, be it the East Asia Summit, China's accession to ASEAN's basic founding document, or China's occupation of Mischief Reef off the Philippines. Likewise, when we appraise U.S. policy effectiveness we tend to do it with an emphasis on short-term failings and ways in which U.S. policy might have been optimized, particularly if informed by the omniscience of hindsight.

This morning I would like to begin by appraising where we are today in Southeast Asia from the vantage point of four decades before discussing China's past, present, and future role in the hopefully peaceful evolution of Southeast Asia.

In the 1960s Southeast Asia was characterized as "the Balkans of Asia." Indonesia, under President Soekarno, was following an expansionist and nationalist foreign policy, intermittently attacking the US and engaging in actual warfare to prevent the formation of Malaysia, 1963-66. At one point in 1965 the U.S. Department of State thought it inevitable that Indonesia, the largest nation in Southeast Asia, would become a communist people's republic in close alliance with China.

As late as 1962 Singapore was thought to be a likely candidate for communist takeover. At that time Thailand was a poor country, ruled by a hard-nosed military clique that specifically eschewed any association with democracy, even as a distant goal. From the mid 1960s to the late 1980s, the Philippines was ruled by President Marcos, who began as a popular democrat but ended as a remarkably corrupt and violent autocrat. In the midst of these chronically weak societies and governments, China under Mao played a major destructive role in Southeast Asia, intentionally destabilizing as many non-communist governments as possible. Most Southeast Asian governments were profoundly distrustful of China because of its manifest willingness to provide money and guns to rebel groups seeking to bring down central governments. China's greatest success (before it turned into a failure) was its support to North Vietnam and its southern confederates in their externally supported internal war against the South Vietnam and the

United States. Ultimately that conflict cost a million Vietnamese their lives as well as more than 50,000 Americans from my generation. Less than four years after China had backed the winning side in Vietnam, it found itself at war with a united Vietnam in retaliation for Vietnam's occupation of Pol Pot's Cambodia.

What a difference four decades can make for the role of the U.S. and for the role of China in Southeast Asia. Indonesia since the late 1960s moved from GDP/capita of approximately \$100 to in excess of \$1,000 per annum, in spite of the economic crisis of the late 1990s. After having no diplomatic relations whatsoever with China from 1967-1990, Indonesia and China now have relations that are normal and cordial in all respects. Furthermore, effective but authoritarian rule under President Suharto has been replaced, under President Susilo Bambang Yudohyono, by what appears to be the first government in fifty years that is both democratic and effective. From the vantage point of American interests, the prospect of a radical people's democracy, after considerable bloodshed and instability, has been replaced by the largest Islamic democracy in the world and one that by and large adopts a moderate line in both its foreign and domestic policies. Conditions in Indonesia have obviously improved over the long term and the U.S. policy of patient and professional long-term involvement and commitment have paid a clear dividend to the American people.

Singapore has gone from being a dusty, radicalized port city of the British empire to being stable and more wealthy than its former colonial ruler. Even though the system of government is at best semi-democratic, Singapore has obviously made great strides for its people and has consistently been a dependable partner for the United States in the region. Malaysia came into being in 1963 and was immediately confronted with an armed assault from Indonesia. Having survived this onslaught with the assistance of the Great Britain, New Zealand, and Australia, Malaysia in the intervening four decades built a strong and open economy that has posted consistently high growth rates. Although the openness of its democratic life was constrained by the domination of Prime Minister Mahthir (1969-2003), as a nation Malaysia has been an obvious success and has maintained good relations with the United States.

The Philippines presents a more mixed picture. It emerged from the Second World War as democratic, English-speaking, and the second most developed country in Asia, following only Japan. Although the Philippines is a wealthier country today than it was forty years ago, it has consistently lagged behind the region in its growth trajectory. Furthermore, it has displayed serious problems with governance under both democratic and non-democratic regimes. Even though democratic elections have been a constant in Philippine political life for a hundred years, the same old elite families continue to dominate governments and rural alienation from oft rapacious elite activities has led repeatedly to social unrest and violence (the Huk Rebellion, New People's Army (NPA) and the Islamic rebellions in the South). At the end of the Cold War, the democratically elected Philippine Senate declined to renew U.S. access to the military bases at Clark Field and Subic Bay. In 1993 this led to a withdrawal of U.S. armed forces and what was perhaps a necessary downward readjustment in the bilateral security relationship. Two events subsequently resuscitated the U.S.-R.O.P security relationship: China's occupation

of Mischief Reef in 1995 and the Philippine reaction to the 9/11 attack on the World Trade Center. President Arroyo immediately offered any assistance the Philippines could render, including access to the former bases. Although neither option proved necessary, the gesture of alliance solidarity was greatly appreciated. The Philippines is a major Non-NATO Ally of the United States but its internal social and political weaknesses continue to constrain its democratic stability and its economic prosperity.

Like the Philippines, Thailand has continued to be a mutual security ally of the United States. With a per capita income of nearly \$3,000 per annum it is roughly twice as well off as the Philippines. Likewise, Thailand's political system has evolved into a full democracy, with a series of democratically elected parliaments. With thirty years of experience with export-led growth and with its large Sino-Thai minority, it plunged into trade and investment in China almost as soon as China opened its doors to the outside world. Before the Asian financial crisis in 1997, one Thai conglomerate, the C P Group was the largest single foreign investor in China. In spite of the close security relationships with the U.S. (that led it to send Thai troops to both Afghanistan and Iraq), Thailand is generally recognized as having the closest relationship to China among the Southeast Asian nations. By any long-term standards the Thailand story is a great success although the political system remains vitally dependent on the authority of its highly respected but aging monarch.

For Vietnam, the second half of the twentieth century was dominated by warfare: 1948-54 against the French; the subsequent war with the United States until 1972; the triumph over South Vietnam, 1972-75; the unsuccessful invasion and occupation of Cambodia, 1978-90, and a six week border war and an extended period of low level conflict with China that continued for ten years after 1979. In combination with a quite substantial post revolutionary out-migration (1975-1985), ill-considered economic policies brought the country to a decision point in 1986 when it adopted doi moi, a set of economic reforms that have led to substantial a rapid growth over the past twenty years. By 1990, Vietnam had withdrawn its troops from neighboring Cambodia, whose occupation had completely isolated Vietnam diplomatically from 1978-91. The Paris Peace Agreement of 1991 and the subsequent U.N. supervised elections in Cambodia in 1993 led to the re-emergence of Vietnam as a normal nation, a country that could expect to trade and interact with everyone including former adversaries such as the U.S. and China.

The conclusion to be drawn from this brief circuit of Southeast Asia is that U.S. interests over the past 40 years have fared remarkably well in Indonesia, Singapore, Malaysia and Thailand and less well, but not disastrously, in the Philippines. Even in Vietnam there has been a recent flowering of relations between former enemies. All of the Southeast Asian states, with the exception of Burma, are stronger states and more capable of governing their territories and delivering services to their people. The remarkable thing is that many of these successes were accomplished in spite of the direct opposition of China in the early years and this leads me to be optimistic that American interests, as well as the interests of the more open societies of Southeast Asia, can be protected quite adequately now that China has become a more positive and more powerful competitive force, strategically, economically, and diplomatically.

Southeast Asia and the China Market

The growth of intra-Asian trade in the 1980s and mid 1990s resulted from the rapid rise of China and ASEAN, the continuing expansion of Korea, and Japan's stature as the world second largest economy. China continued its rapid economic ascent in the 1990s while Japan entered a 15-year-long recession in 1990 and the remaining Asian economies were caught up in the Asian financial crisis of 1997-98. China's continuing advance in world trade has meant that trade with Southeast Asia rapidly expanded, albeit from a low base, in the opening decade of the new century.

Does this mean that China has become as important for the ASEAN countries as it has for Korea and Japan? In 2004 Japan was China's largest source of imports, and China was the largest market for Korean exports. Nothing like comparable statistics exist in Southeast Asia, even though trade with China is growing rapidly. According to WTO statistics Indonesia, Malaysia, Singapore, the Philippines, and Thailand all have substantially greater trade interdependence with the U.S. than they do with China. In many ways Thailand under Prime Minister Thaksin has been the most vocal advocate of increasing trade relations with China but in 2004 China was only the fifth largest market for Thailand's exports while China was the fourth largest source of Thailand's imports. Vietnam differs from the rest of ASEAN. Having a common border, China is the largest source of Vietnam's imports and the fourth largest destination for Vietnamese exports.

One of the downsides of the rise of China and the Asian Financial crisis of 1997-98 is that China continues to peg the RMB in a narrow band that makes investing in China very cheap for American firms and makes China's exports quite competitive. In contrast, the ASEAN countries by and large have floated their currencies in 1997-98, allowing values to be determined by supply and demand rather than by government fiat. This policy change on the part of Southeast Asia has made their exports less competitive in relationship to China and made China a more favorable destination for foreign direct investment, especially in manufacturing. In the ASEAN countries, the pegged exchange rates of the 1980s and 1990s had led to a vast misallocation of investments, supplying the structural cause of the crash of '97. No one in ASEAN wants to repeat this experience. The \$64,000 question of Asian economics is, "How long can China maintain its current peg and closed capital account?" In my opinion, China will not loosen the peg significantly or open its capital account until it is forced to by domestic economic developments.

ASEAN Diplomacy: Hedging Strategy in an Uncertain Region

During the forty-year period from the late 1960s to the present, the countries of Southeast Asia developed a regional association that has been remarkably effective in some ways and utterly impotent in others. When it was founded in 1967 it was supposed to foster social and economic integration. In its first years it did little more than increase the interaction among formerly separate and potentially hostile post-colonial elites. As a

trading organization it remained ineffective. Its single greatest achievement was the agreement among its founding members to forgo the use of force among member states and to cease interfering in the internal affairs of the associated states. In effect, this froze the borders among members and brought to an end the possibility of open conflict among members.

When Vietnam invaded Cambodia in late 1978, ASEAN began to act like a security community, that is, the association banded together to oppose Vietnam's occupation of Cambodia. China provided military supplies; ASEAN organized the opposition in the U.N.; Thailand acted as a conduit for Chinese weapons, and the U.S. provided basic diplomatic and political support. At the time many academics said time was on the side of Vietnam in Cambodia and that Vietnam would never be forced to leave, but the persistence of the ASEAN organized opposition and the collapse of the Soviet Union made possible the historic turn-about that was then memorialized in the Paris Peace Agreements of 1991.

After having forced Vietnam out, ASEAN almost immediately expanded to include its former adversaries. This action tells a great deal about the ASEAN's unspoken *modus operandi* with regard to past and potential opponents. By drawing former adversaries into ASEAN, the founding members assumed that membership would resolve fundamental security problems. Until the original five countries formed ASEAN, there were serious security problems among them. ASEAN in fact became the gilded cage by which Indonesian expansionism was contained. Admitting Vietnam, and later Laos, Cambodia, and Burma, was costly to organizational effectiveness. Expansion meant genuine dilution of the capacity to act on matters such as the environmental haze, the financial crisis, and Timor. Why was ASEAN willing to expand and court therefore what was almost organizational dysfunctionality? First, creating the ASEAN 10 ended the security problems of the mainland Southeast Asian countries. All members, particularly Vietnam, are now committed to non-use of force and non-interference in the internal affairs of other members. This is a far cry from the period immediately after April 1975 when cocktail party chatter concentrated on just how long it would take the Vietnamese with 1,200 tanks to reach the outskirts of Bangkok. ASEAN assumes that it has relegated such grim scenarios to the dustbin of history and that under foreseeable circumstances ASEAN has brought an end to international war at least among the member nations. Second, expanding ASEAN to 10 members created a diplomatic barrier to any potential aggressive moves by China in SEA. Obviously ASEAN cannot stop China militarily; instead ASEAN assumes that if there is a blatant act of aggression, the ten countries can band together to oppose it in the way they successfully opposed Vietnamese expansionism in Cambodia.

One of the most important functions of ASEAN is always unstated, its security motivations. At the height of ASEAN's orchestration of the guerrilla war to force Vietnam to withdraw from Cambodia, its foreign ministries routinely refused to confirm the obvious facts of their interference inside Cambodia. For similar reasons, no one should expect ASEAN today to articulate its three-way hedge with regard to China. All ASEAN foreign ministries continually state they are positive the relationship with China

will be peaceful in the 21st century (precisely what it was not in the 1950s, 1960s, 1970s, and 1980s.) However, ASEAN expanded to ten members as a long-term hedge to reduce its risks, on the off-chance that China again became aggressive toward Southeast Asia. In a second hedge, ASEAN welcomed China's willingness to sign the Treaty of Amity and Concord, even though it does not guarantee non-aggression by China and leaves unresolved territorial disputes in the South China Sea. In a third hedge, ASEAN members have continued to urge the U.S. to remain economically, militarily, and politically involved in Southeast Asia. The unarticulated assumption followed by ASEAN diplomats is that no single bi-lateral relationship can ensure security but that multiple relations, including partially contradictory ones, will build a sufficiently dense diplomatic web to ensure ASEAN security in the event that a) China turns out to be a responsible stakeholder or b) that China turns aggressive. Hedging involves making astute future investments to reduce risks in the face of unpredictable eventualities, and the Southeast Asian nations have played this game exceedingly well for forty years.

The East Asian summit of 2005 provides an interesting window on ASEAN's hedging behavior toward China. The idea of an exclusively Asian summit (excluding Australia, New Zealand, and the United States) was first broached in 1991 by Prime Minister Mahathir. The combined opposition of the U.S. and Japan, as well as China's reluctance at that time to participate in multilateral undertakings, led to the demise of the East Asia Economic Caucus. In the wake of the Asian financial crisis and changes in China's willingness to participate in multilateral diplomacy, ASEAN+3 was established including currency swap arrangements, called the Chiang Mai Initiative.

Whether the Chiang Mai Initiative would be effective in a new currency crisis was far less important than the fact that for practically the first time Asian countries were working together to create concrete economic agreements without the involvement of the U.S., Australia, or New Zealand. ASEAN+3 decided in 2004 to hold an East Asia Summit in 2005, and China and Malaysia took the lead in putting forward this unique arrangement. In the run up to the Kuala Lumpur EAS, it became clear that Indonesia, the Philippines and Singapore realized that such an organization would showcase the influence of China and decrease substantially the influence of ASEAN. Behind the scenes negotiation resulted in widening the EAS to include India, Australia, and New Zealand (to the consternation of former Prime Minister Mahathir) and over the muted objections of China.

The December 2005 Kuala Lumpur meeting of EAS was marked as much by discord as amity, particularly between Japan and China, and the non-participation of the United States appeared to be less important than the growing tensions between China and Japan and the unwillingness of important elements of ASEAN to follow Beijing's lead. Thus a story designed to illustrate the rise of China ended up underlining the ability of ASEAN to utilize outside powers (India, New Zealand, and Australia) to frustrate Beijing. Rather than proving China's predominance, the EAS provided another example of ASEAN hedging behavior.

American Policy and the Future of Southeast Asia

It is clear that Southeast Asia has thus far accommodated the rise of China quite well, and rather than being drawn totally into China's economic and security orbit, Southeast Asian nations continue to maintain balanced economic relationships with non-Chinese markets while continuing to play a sophisticated diplomatic game that hedges the rise of China with the continued presence of the United States, the on-going importance of Japan, and the rise of India. Although the future remains uncertain, the current status quo (if it could be maintained) is quite comfortable for the United States.

The problem is that this is "not your father's China." China, for the first time in several hundred years is conducting its diplomacy in a highly sophisticated manner. Expectations had been so low for so long, that when China responded positively to the Thai currency crisis it reaped nearly infinite accolades (while never being required to deliver on its promised \$1 billion in financial support). Japan and the United States are expected to respond rapidly and responsibly and sometimes are given scant credit when they do. In the context of Asian financial crisis Japan supplied over \$70 billion in financial backing, the US effort amounted approximated \$15 billion, and China offered \$1 billion. Who got the credit? Answer: China. Expectations rule, in international as well as domestic politics!

Until the last 5-10 years China's leaders and diplomats appeared to Southeast Asians to laud the superiority of the Middle Kingdom. Furthermore China had a long past to live down concerning armed intervention on the side of insurgents. Today, the U.S. faces a much more skilled and competitive Chinese diplomatic corps, and yet the U.S. is perceived as giving short shrift to Asia (with the exception of North Korea). China today is no longer perceived as part of the problem; in fact, China is perceived as part of the solution for Asia's economic challenges in the 21st century.

China has begun to treat Southeast Asia seriously. In contrast, ever since 1975 Southeast Asia has been treated as an after thought. With the exception of the Vietnam War, most of Washington's policy attention, during and after the Cold War, has focused on Northeast Asia. This has been true in Republican as well as Democratic administrations. The question is whether this tendency to ignore Southeast Asia remains a sustainable strategy? China's relative military and economic importance to Southeast Asia is rapidly growing, and a healthy U.S. policy should adjust itself to increased competition. This can and should be done without antagonizing China.

What concrete steps might be taken?

- High-level U.S. officials should travel more frequently to Southeast Asia. If the Secretary of State cannot go to the ASEAN meeting in a given year, the Secretary of the Treasury should. However, ASEAN must play its part. For too long ASEAN Post Ministerial Meetings have been known primarily for funny shirts and silly songs. Focusing Post Ministerial Meeting on FTAs and on touchy

subjects, from Timor to terrorism, would help to rekindle Washington's attention. ASEAN must alter the quality of its dialogue if it wants to be taken seriously.

- Middle level U.S. officials from State, DoD, and Treasury should travel more constantly to South and to Southeast Asia rather than just to Northeast Asia. Personal relationships remain the coin of the diplomatic realm in Asia. Time invested in frequent and regular consultations in Asia can become invaluable in time of crisis.
- More emphasis should be placed on soft power. Since the end of the Cold War there has been a precipitous decline in U.S. government support for training Southeast Asian students at the advanced level in the U.S. In contrast the number of opportunities for Southeast Asians to train in China has greatly increased. This is the kind of peaceful competition to which the United States should return, if it is serious about maintaining its position in Southeast Asia.
- Major reversals to the stability and prosperity of Asia and the Pacific become probable in the event of armed conflict over Taiwan or an uncontrolled legitimacy crisis within China itself. Judicious and balanced firmness toward the authorities in both Taipei and Beijing should be sufficient to preclude miscalculation by either party.
- In contrast, a legitimacy crisis on the Mainland could be precipitated by a system wide banking crisis. In the last several decades Sweden, the U.S., Japan, Korea, Indonesia, Thailand, Malaysia, and the Philippines have all faced system threatening banking crises. At present the Chinese banking system probably contains a greater proportion of bad loans than any banking system has ever successfully contained. The laws of financial gravity will eventually apply to China. Officials of the Federal Reserve and Treasury should provide their best offices to the Central Bank and other financial officials in China because it is in the interests of everyone to avoid 'the mother of all banking crises.' Means should be found to train an extensive number of Chinese officials in U.S. banks, at the Fed, in the Treasury, and at the IMF before the crisis becomes acute.

Not one of the above policy suggestions involves a major increase in annual expenditures. What they require are qualities far more rare than gold: the ability to anticipate crises and a willingness to invest time and resources wisely before a crisis begins.

