

## Testimony before the U.S.-China Economic and Security Review Commission

### HEARING ON CHINA'S RELATIONS WITH SOUTHEAST ASIA

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#### Written Statement

My answers to the specific questions asked by the Commission regarding Malaysia's relations with China, and the impact of that relationship on Malaysia's interactions with the Association of Southeast Asian Nations (ASEAN) and the United States are drawn from the paper's analysis of the development of Malaysia-China relations within the wider context of Malaysia-China-ASEAN and Malaysia-United States relations covering the period from Malaysia's attainment of independence in 1957 until the present. The paper concludes with policy recommendations addressed to Malaysia-China, Malaysia-U.S., and Malaysia-ASEAN relations.

#### Driving Principles of Malaysia's Foreign Policy

A medium-sized nation, covering an area slightly larger than New Mexico and inhabited by a multi-ethnic population estimated at 30 million in 2010,<sup>1</sup> Malaysia's foreign policy has consistently manifested roughly the same mix of objectives focused on promoting domestic stability, fostering economic growth, maintaining regime legitimacy, safeguarding national sovereignty, and taking steps aimed at ensuring an external environment conducive to regional stability and economic prosperity. Over the years since its independence in 1957 the leaders of first Malaya and then (since 1963) Malaysia have closely associated themselves with the political and economic values espoused by Western democracies, while at the same time keeping a wary eye on developments in the People's Republic of China, the nation they have long expected they would one day have to reckon with as the region's dominant player. During this same period these leaders have also given priority to maintaining strong relations with the United States, partly because of direct bilateral benefits to be gained and partly because they recognize that U.S. power makes it the only viable counterweight to Chinese assertive expansionism. With such considerations in mind, Malaysia has since the end of the Vietnam War essentially pursued a hedging posture, one that seeks to safeguard national security while deriving maximum economic benefits from expanding trade and investment ties with

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<sup>1</sup> The population is broken down into: Malay 50.1%, Chinese 22.6%, indigenous 11.8%, Indian 6.7%, other 0.7%, non-citizens 8.2%. *CIA World Factbook: Malaysia*, 2010.

both the United States and China. This foreign policy stance has been variously described by scholars as one that seeks to maintain “equidistance” between U.S. and China,<sup>2</sup> as one that strives to avoid dominance by either power while embracing engagement with both,<sup>3</sup> and as one that relies on a strategy of “middlepowermanship” to enable the country to “balance, hedge, and countervail the foreign policies of major powers.”<sup>4</sup>

Six Malaysian Prime Ministers have steered the course of Malaysia-China ties since 1957: Tunku Abdul Rahman Putra Al Haj (1957-1970), Tun Abdul Razak Hussein (1970-1976), Tun Hussein Onn (1976-1981), Tun Dr. Mahathir Mohamad (1981-2003), Tun Abdullah Ahmad Badawi (2003-2009) and Datuk Najib Abdul Razak (2009-present). In the political and economic realms, Malaysian foreign policy goals have consistently revolved around forging racial harmony among the country’s majority Malay Muslim and minority non-Muslim Chinese and Indian communities; promoting economic development while redistributing national wealth in an equitable manner between Malays and non-Malays through Malay (*bumiputera*) affirmative action; and enhancing the legitimacy of the United Malays National Organization (UMNO)-dominated National Front (*Barisan Nasional*) government coalition that has held power since 1957.

### **Malaysia-China Relations, 1957-present**

When Malaysia attained independence from Britain in 1957, it was still traumatized by the Chinese Communist Party’s (CCP) backing of the Malayan Communist Party (MCP) insurrection in 1948 that sought to establish a People’s Republic of Malaya. The UMNO leadership continued to view China as one of Malaysia’s greatest security threat, even when China was undergoing massive economic, social and political upheavals under Mao Zedong’s Great Leap Forward and Cultural Revolution campaigns from 1960 to the mid 1970s. Such a perception stemmed from the support the MCP received from the Chinese-educated working class, who formed the majority of the immigrant Chinese community (which constituted 38% of the population in 1957), and whose loyalty was considered by the Malay leadership to be primarily China-centric.<sup>5</sup> Although the insurrection was effectively quelled by the late 1950’s, Beijing patronage of the MCP accounted for Malaysia’s firmly pro-West foreign policy during the major part of the Cold War. Strong relations with London were viewed as paramount to the new nation’s security and political development, while Washington was considered an important potential partner for expanding and diversifying economic ties.

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<sup>2</sup> Kuik Cheng Chwee, “Malaysia-China Relations: Three Enduring Themes,” Meredith Weiss, ed., *Routledge Handbook of Contemporary Malaysia*, 2014: 417-427.

<sup>3</sup> Helen Nesadurai, “Malaysia and the United States: Rejecting Dominance, Embracing Engagement,” RSIS Working Paper no.72/04, RSIS, Singapore, 2004.

<sup>4</sup> Johan Saravanmuttu, *Malaysia’s Foreign Policy: The First Fifty Years: Alignment, Neutralism, Islamism*, Institute of Southeast Asian Studies, 2010: 330.

<sup>5</sup> Heng Pek Koon, *Chinese Politics in Malaysia: A History of the Malaysian Chinese Association*. Oxford University Press, 1988.

It was not until 1974 that Malaysia, under Prime Minister Abdul Razak, established diplomatic ties with China. It was the first country in Southeast Asia to do so. Malaysia's overture to China was a carefully calibrated response to the changing regional security and economic landscape that emerged after 1970 in the wake of President Richard Nixon's "One China" policy, the U.S. military disengagement and withdrawal from Vietnam, and China's transition to a state-guided, market-driven economy under Deng Xiaoping's "Opening and Reform" policy.

The transformation in Malaysia's China policy from hostility to rapprochement and strong friendship resulted from five key developments: (1) severance of party-to-party ties in 1978 between the CCP and the MCP; (2) promulgation of China's new citizenship laws in 1989, which ceased to recognize "Overseas Chinese" as nationals of China; (3) introduction of Prime Minister Mahathir's "Look East" policy in 1981 which sought to increase trade and economic ties first with Japan and subsequently with a rapidly modernizing China that had become more receptive than Japan to foreign investments; (4) China's support of Mahathir's proposal in 1991 of an East Asia Economic Grouping (EAEG), an Asia-only economic integration framework; and (5) China's decision not to devalue its currency in the wake of the Asian Financial Crisis, a decision that positively benefited Malaysia by allowing its exports to remain competitive in the U.S. and European markets.<sup>6</sup> Malaysia's diplomatic breakthrough with Beijing paved the way for the normalization of ties by other Southeast Asia countries that had also been unhappy with Beijing's support of their domestic communist movements. Thailand and the Philippines established ties in 1975, though Indonesia and Singapore did not do so until 1990.

### **The Economic Dimension of Malaysia- China Relations and Enhanced Cooperation under the Comprehensive Strategic Partnership**

In October 2013 Prime Minister Najib Razak and President Xi Jinping upgraded the "special relationship" of their two countries to a "Comprehensive Strategic Partnership." While the new partnership envisaged enhancing ties across a broad spectrum of cooperative activities, the major focus is economic cooperation, the strongest pillar of the bilateral relationship. Since 2008, Malaysia has been China's largest trading partner in ASEAN as well as its third-largest in Asia after Japan and South Korea, a notable achievement given Malaysia's modest-sized 30 million population. China surpassed Singapore in 2010 to become Malaysia's top trading partner. Bilateral trade reached \$106 billion in 2014 and both sides pledged to increase trade volume to \$160 billion by 2017.<sup>7</sup> (In comparison to Malaysia-China trade that amounted to MR203.2 billion in 2013, the figure for Malaysia-US trade was MR109.0)<sup>8</sup>

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<sup>6</sup> See, e.g., Kuik, "Malaysia-China Relations: Three Enduring Themes."

<sup>7</sup> Ernest Bower & Phuong Nguyen, "Will China-Malaysia Relations Remain a Model for Asia?" CSIS. February 18, 2014. <http://cogitasia.com/will-china-malaysia-relations-remain-a-model-for-asia/>.

<sup>8</sup> Malaysian Ministry of International Trade and Industry 2013 Report. The exchange rate is roughly MR3 to \$1.

Malaysian Chinese entrepreneurs were among the first generation of foreign investors to finance the initial low-capital, labor-intensive phase of China's capitalist opening under Deng Xiaoping. Led by businessmen such as Robert Kuok (whose investments in China include high profile real estate holdings such as the Shangri-La Hotel chain and a 87.5% stake of Coca-Cola's bottling venture as of 2012)<sup>9</sup> and William Cheng (whose Lion Group owns real estate, department stores and breweries in China), the entry of these Malaysian Chinese business pioneers into the new China market was facilitated by cultural, linguistic and familial bonds that ethnic Chinese in Malaysia drew from their ancestral home country. The business know-how, Chinese language and cross-cultural skills of Malaysian Chinese entrepreneurs have enabled and leveraged the second wave of Malaysian foreign direct investment (FDI) in China that went in after the 1997 Asian Financial Crisis. This latter wave comprises an increasing component of Malaysian government-linked companies (GLCs), in which Khazanah Nasional, the country's sovereign wealth fund, holds substantial stakes. With access to seemingly unlimited public sector funding and political patronage, the investments made by Khazanah and other GLCs, such as Sime Darby, the world's largest palm oil plantations owner, are significantly larger, and are more capital and technology intensive than the pioneer wave of private sector Malaysian Chinese FDI.<sup>10</sup>

The stock of Malaysian FDI in China reached \$7 billion in 2013, an amount that dwarfed Chinese FDI in Malaysia, which amounted to \$1 billion.<sup>11</sup> However, China is set to dramatically increase its Malaysia-bound investments under the Comprehensive Strategic Partnership. It will co-fund the China-Malaysia Qinzhou Industrial Park in Guangxi Province, the Malaysia-China Kuantan Industrial Park in Prime Minister Najib's home state of Pahang, and a significant upgrading of the Malaysian port of Kuantan. To maximize the synergies in their economies, the industrial park in China will specialize in food processing, biotechnology, and information technology, and the Kuantan site will host businesses in steel manufacturing, aluminum processing, and palm oil refinery. The two countries also pledged to undertake cooperation in telecommunication, remote sensing satellite and biological technology.<sup>12</sup> Economic cooperation recently expanded into the financial sector, with the two countries' central banks agreeing to establish a yuan clearing bank in Kuala Lumpur as part of China's quest to internationalize the renminbi. Malaysia was the first country outside China to use the renminbi for trade

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<sup>9</sup> "The world's shrewdest businessman – Founder of Shangri-La Mr. Kuok." April 1, 2012. <https://stulanglaut.wordpress.com/2012/01/04/the-worlds-shrewdest-businessman-founder-of-shangri-la-mr-kuok/>.

<sup>10</sup> See, e.g., <http://www.thestar.com.my/Business/Business-News/2013/10/04/Khazanah-Nasional-invests-RM486m-in-exposure-to-China-environ-sector/?style=biz>; and [http://www.khazanah.com.my/docs/Media%20Statement\\_Khazanah%20and%20Beijing%20Enterprises%20Group%20forge%20partnerships%20in%20environmental%20related%20sectors\\_4Oct2013.pdf](http://www.khazanah.com.my/docs/Media%20Statement_Khazanah%20and%20Beijing%20Enterprises%20Group%20forge%20partnerships%20in%20environmental%20related%20sectors_4Oct2013.pdf).

<sup>11</sup> "MCCC: Malaysia to see influx of China FDI." *The Edge*, December 16, 2014. <http://www.msn.com/en-my/money/topstories/mccc-malaysia-to-see-influx-of-china-fdi/ar-BBgRMIt>.

<sup>12</sup> "Malaysia, China Agrees to Lift Ties To Comprehensive Strategic Partnership." October 4, 2013. [http://news.xinhuanet.com/english/china/2013-10/04/c\\_132772213.htm](http://news.xinhuanet.com/english/china/2013-10/04/c_132772213.htm).

settlement and has grown to become one of the world's top 10 offshore yuan centers and the second country in Southeast Asia, after Singapore, to host a yuan clearing bank.<sup>13</sup>

### **Expanding Economic Cooperation under China's Maritime Silk Road Initiative and Asian Infrastructure Investment Bank**

President Xi Jinping's announcement of the 21<sup>st</sup> Century Maritime Silk Road (MRI) initiative in October 2013 and establishment of the Asian Infrastructure Investment Bank (AIIB) in April 2015 to fund MRI-related projects will further deepen Malaysia-China economic cooperation. Buttressed by the proposed overland Silk Road Economic Belt (SREB), the Maritime Silk Road (MSR) will build up port and maritime connectivity to broaden China's trade channels with the maritime regions of Southeast Asia, South Asia, the Middle East and East Africa. That geographic footprint harks back to Imperial China's historic maritime tribute trade routes, which reached their apogee during the Ming Dynasty (1368-1644). Together with the overland routes for land transportation corridors that connect China to Europe as well as all other major Asian sub-regions, including Indochina, Southwest and Central Asia, the Silk Road Economic Belt and Maritime Silk Road (termed "One Belt one Road," or OBOR) are intended to lay the foundations of a Sino-centric new world economic order. Through muscular trade diplomacy and infrastructure diplomacy, Xi Jinping envisages a resurgent Chinese Middle Kingdom superpower at the apex of a new order spanning Asia, Africa and Europe.

Apart from providing \$50 billion toward the \$100 billion initial capital for the AIIB, China has set aside another \$40 billion for MRI projects. Responding positively to the opportunity to fund its "infrastructure investment gap" (an Asian Development Bank study in 2009 predicted that Malaysia will need \$188 billion to finance planned infrastructure projects between 2010 and 2010), Malaysia was one of AIIB's 35 Prospective Founding Members (PFMs), and another 23 countries have applied for this status.<sup>14</sup> Malaysia's priority projects include a high-speed rail connection between Kuala Lumpur and Singapore, the first of its kind in Southeast Asia, which has drawn interest from the China Railway Construction Corporation as well as companies from Japan, Germany and France.<sup>15</sup> Due to Malaysia's support for the AIIB, the chief economist of the country's leading bank, Maybank, has proposed that Beijing set up an AIIB ASEAN Office in Kuala Lumpur to coordinate its ASEAN activities.<sup>16</sup>

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<sup>13</sup> "Malaysia, China to take ASEAN-China FTA to next level," *The Sun Daily*, May 31, 2014. <http://www.thesundaily.my/news/1064215>.

<sup>14</sup> Larkin, Stuart, *The Conflicted Role of the AIIB in Southeast Asia*, ISEAS Perspective #23, May 8, 2015: 3.

<sup>15</sup> "Chinese firms have leg up in deal for Kuala Lumpur-Singapore rail line." March 11, 2015. <http://english.caixin.com/2015-03-11/100790345.html>.

<sup>16</sup> "AIIB to provide new infrastructure funding avenue, promote China-ASEAN connectivity: Malaysian economist." April 27, 2015. [http://www.asean-china-center.org/english/2015-04/27/c\\_134187284.htm](http://www.asean-china-center.org/english/2015-04/27/c_134187284.htm).

The robust economic foundations of the bilateral relationship served Kuala Lumpur well during the MH370 tragedy that resulted in the loss of 154 Chinese lives in March 2014, when the ill-fated Malaysian Airlines carrier disappeared without a trace in the Indian Ocean.<sup>17</sup> That tragedy occurred soon after the two countries launched the “Malaysia-China Friendship Year” to celebrate the 40<sup>th</sup> anniversary of diplomatic ties. Beijing criticism of Malaysia’s handling of the missing airplane was notably tempered and has not cost damage to the relationship. Unlike the outraged protests outside the U.S. Embassy following the U.S. bombing of the Chinese Embassy in Belgrade in 1999, Beijing only permitted peaceful rallies outside the Malaysian Embassy in Beijing.<sup>18</sup> Not seeing Malaysia as having any ulterior motive behind the loss of its nationals, Beijing’s measured reaction has allowed the two countries to maintain strong ties, and the two countries continue to cooperate in joint search operations in the Indian Ocean, aided by Australia.

### **The Political-Security Dimension of Malaysia-China Relations**

While the political relationship between Malaysia and China was not affected by the MH370 tragedy, the resurgence of Chinese assertiveness in the South China Sea may prove much more difficult to handle. Although to date China has not directed any of its coercive maritime tactics toward Malaysia, unlike its hostile treatment of territories claimed by Vietnam and the Philippines, recent Chinese naval incursions into territorial waters claimed by Malaysia have caused serious concern among Malaysia’s strategic thinkers.

Unlike Malaysia-U.S. security relations that have broadened and strengthened over the past four decades (discussed further on), Malaysia’s security cooperation with China is recent and quite limited. After signing their initial defense MOU in 2005, the first formal security consultation between Malaysian and Chinese senior defense officials to increase exchanges between the two militaries, deepen law enforcement, and strengthen counter-terrorism and transnational crime cooperation was held only in 2012. It was not until 2014 that the two countries conducted their first bilateral military exercise.<sup>19</sup>

### **Renewed Tensions in the South China Sea**

China’s charm offensive and good neighbor policy in South East Asia, exemplified by its accession to the ASEAN-sponsored Declaration of the Code of Conduct in the South China Sea in 2002 effectively ended in April 2010, when Beijing reasserted its “indisputable claim” by declaring that the South China Sea was a “core interest” of China’s on a par with its claims to Taiwan, Tibet and Xinjiang.<sup>20</sup> Chinese reassertion of

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<sup>17</sup> “MH370 search area will be expanded if no discovery made by May: Liow,” *New Straits Times*, April 16, 2015. <http://www.nst.com.my/node/80716>.

<sup>18</sup> “Why MH370 will not change Chinese/Malaysia Relations,” *Huffington Post*, May 20, 2014.

<sup>19</sup> Prashanth Parameswaran, “Malaysia, China Begin First Joint Military Exercise,” *The Diplomat*, December 24, 2014.

<sup>20</sup> M. Landler, “Offering to Aid Talks, U.S. Challenges China on Disputed Islands”, *New York Times*, 24 July, 2010.

its maritime claims has been viewed by some observers as a proactive response to the moves of other claimant states to solidify their claims vis-à-vis Beijing.<sup>21</sup> Malaysia and Vietnam's joint submission to the UN Commission on the Limits of the Continental Shelf in May 2009, requesting information pertaining to their respective extended continental shelf claims, triggered off the current round of renewed tensions. Chinese analysts argue that the US pivot to Asia had emboldened ASEAN claimants to advance their claims at a time when political succession in China made it "impossible for the leadership to continue its passivity toward sovereignty issues."<sup>22</sup> President Xi Jinping established and personally headed a central "crisis response leadership group" to coordinate the policies and actions of all government agencies, including the People's Liberation Army Navy, to implement China's new coercive diplomacy in the East and South China Sea. Beijing's recent spate of reclamation operations in disputed waters in the South China Sea, including the building of an airstrip suitable for military use in the Spratly Islands in waters that are also claimed by the Philippines, has made the South China Sea Southeast Asia's biggest potential military flashpoint.

Although China acceded to the United Nations Convention on the Law of the Sea (UNCLOS) in 1996, it continues to use the "nine-dash line" delimitation to assert its claim over its "historical" maritime domain, with the apparent aim to control the fisheries, minerals and other maritime resources as well as the potentially vast oil and gas deposits to be found there. Articulating the official line, a Chinese analyst at a state-sponsored think tank stated: "UNCLOS, which came into force in 1994, cannot deny China's 'U-shape line' published almost half a century ago"<sup>23</sup> China's claims are challenged by Malaysia and other three ASEAN states: Brunei, Philippines and Vietnam, which are also signatories of UNCLOS. Claimant states seek jurisdiction over land features and exploitation rights over marine and seabed resources in their Exclusive Economic Zones (EEZ), which extend up to 370 kilometers (220 nautical miles) from their respective coastlines.

While China occupied the Paracel Islands and Mischief Reef in the Spratly Islands after winning naval skirmishes against Vietnam in 1974 and 1988, and the Philippines in 1995 and 1998, it has not acted against Malaysia's occupation of disputed features that fall within the nine-dash line in the southern-most part of the South China Sea. That demarcation appears to go as close to 55 kilometers (34.2 miles) off the coast of Malaysia's Sarawak state. Malaysia currently occupies eight features in the Spratlys, compared to 22 by Vietnam, nine by the Philippines, one by Taiwan and seven by China following its latest round of reclamation, which includes the military airstrip and other defense installations.<sup>24</sup> Malaysia occupied Swallow Reef (Layang Layang) in 1983, and

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<sup>21</sup> You Ji, "Deciphering Beijing's Maritime Security policy and Strategy in Managing Sovereignty Disputes in the South China Seas," *RSIS Policy Brief*, Singapore, October 2010.

<sup>22</sup> *ibid*: 4.

<sup>23</sup> Q. Cao, "A Sea of False Accusations: The Philippines' legal challenge over South China Sea disputes is untenable," China Institute of International Studies, 22 April, 2014.

<sup>24</sup> Mary Fides Quintos, "Artificial Islands in the South China Sea and Their Impact on Regional (In)Security," *FSI Insight*, vol. II, no. 2, March 2015.

subsequently built up the reef into an artificial island covering six hectares to support naval personnel, a 500-meter airstrip, and a 90-room dive resort.<sup>25</sup>

In sharp contrast to its belligerent confrontation of Vietnamese and Philippine activities inside its claimed waters – when Chinese coast guard and fishing vessels faced off Vietnamese and Philippines vessels over the deployment of a Chinese oil rig in the first instance, and over access to Scarborough Shoal in the second – Beijing has not publicly objected to Malaysia’s extensive oil and gas explorations, nor has it complained about Malaysia’s recent announcement of a discovery of oil and gas deposits 90 miles off Sarawak. At least nine gas and oil blocks are currently under development and are expected to go online in 2016. Investors include U.S.-based Murphy Oil Corp and Conoco Phillips, in a joint venture with Malaysia’s state-run Petronas.<sup>26</sup>

Underlining China’s tolerance of Malaysia’s reclamation and exploration activities in its claimed waters, a Chinese Foreign Ministry statement issued in June 2014 acknowledged that while China and Malaysia have disputes, “the two sides share broad consensus on appropriately handling the disputed areas.”<sup>27</sup> A Malaysian strategic analyst stated that both Malaysia and China have implicitly agreed to pay heed to each other’s legitimate interests and “to go to extra lengths to avoid playing out their disputes through the media.”<sup>28</sup>

China’s soft approach toward Malaysia might be due to the fact that Beijing currently has its hands full dealing with both Vietnam and Philippines, whose claims lie in waters closer to the Chinese mainland than Malaysia’s more distant activities. In addition, unlike Vietnam and the Philippines, Malaysia and China have deep energy ties: Malaysia is China’s third largest supplier of liquefied natural gas (LNG), and the state-owned China Petroleum & Chemical Corporation (Sinopec) is a minority partner in a Petronas-led project in Canada’s Pacific Northwest LNG.<sup>29</sup> Finally, China needs good relations with Malaysia in light of America’s rebalance which it perceives as a neo-containment policy despite Washington’s assurances to the contrary. Thus, Beijing is likely to refrain from taking actions that could alienate Malaysia, particularly given Washington’s warm ties with Prime Minister Najib, that would benefit U.S. strategic interests.

However, recent unprecedented appearances of Chinese naval vessels close to Malaysia’s coast have unnerved Kuala Lumpur. In March 2013, four Chinese vessels conducted exercises just 50.3 miles away from Sarawak. They were followed by a second exercise in early 2014 when another flotilla carrying PLA-Navy personnel pledged to defend

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<sup>25</sup> *ibid.*

<sup>26</sup> “Malaysia, China Keep Low Profile on Conflicting Sea Claims,” *Wall Street Journal*, June 24, 2014.

<sup>27</sup> *ibid.*

<sup>28</sup> Shahrman Lockman, “Why Isn’t Malaysia Afraid of China (For Now),” *The Strategist*, April 24, 2013.

<sup>29</sup> “Malaysia, China keeps low profile on conflicting sea claims,” *Wall Street Journal*, June 24, 2014.



Chinese sovereignty in an oath-taking ceremony.<sup>30</sup> While Malaysia made no public protest, choosing instead to convey its concern quietly through standard diplomatic channels, those incidents have caused some Malaysian political strategists to warn that Malaysia needs to heed what they describe as a “wake-up call that it could happen to us and it is happening to us.”<sup>31</sup> At the same time, a retired senior Foreign Minister official counseled prudence, observing that, as Malaysia’s neighbor, “China is here to stay for ever, and it will assume superpower status sooner or later...[so] the correct approach towards China is not to isolate China but to engage China. This is the best way for Malaysia to maintain its non-aligned posture and sustain its independence in the international arena.”<sup>32</sup>

### **Malaysia-China Cooperation on Transnational and Nontraditional Security Issues**

Malaysia’s cooperation with China on transitional and non-traditional security (NTS) challenges is limited and insignificant compared to the robust partnership it has with the U.S. on this range of issues. Due to stronger shared mutual concerns across a wide spectrum, Malaysia has chosen to work with Washington instead of Beijing in addressing major transnational challenges posed by illegal migrant workers, refugees, trafficking in people, drugs and arms trafficking, terrorism, maritime piracy, money laundering and natural disasters. Unlike the U.S., which has provided valuable assistance to Malaysia and other ASEAN countries through programs such as the USAID and State Department co-funded ASEAN Development Vision to Advance National Cooperation and Economic Integration (ADVANCE), China has lagged behind the U.S. in proffering such “public goods” in countries other than those of particular strategic interests to it, notably Laos and Cambodia.

The NTS threats for which Malaysia has cooperated with China, both bilaterally and as a member of ASEAN, have included actions to contain the SARS (severe acute respiratory syndrome) outbreak in 2003, prevent Avian Flu pandemics, build law enforcement capacity to counter cross-border human and drug trafficking between China and its bordering countries (particularly, Laos and Burma/Myanmar), combat piracy, and undertake humanitarian assistance and disaster relief (HADR) joint exercises.<sup>33</sup> On a bilateral basis, Malaysia cooperates with China in promoting people-to-people education and cultural exchanges, especially in expediting flows of students and tourists between the two countries. After signing an agreement in 2011 to promote educational exchanges, some 4,000 (predominantly Malaysian Chinese) Malaysians were enrolled in 820 Malaysia-recognized Chinese institutions, and some 10,000 Chinese students studied in 71 China-recognized Malaysian private and public English-medium colleges as of January 2013. In 2015, Xiamen University (originally endowed by a rags-to-riches

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<sup>30</sup> Kuik Cheng Chwee, “Malaysia-China Relations After MH370: Policy Change or Business as Usual,” *The Asan Forum*, October 15, 2014.

<sup>31</sup> Tang Siew Mun, “China’s assertiveness hardens Malaysian stance in sea dispute,” *Insight*, February 26, 2014.

<sup>32</sup> Cited in Kuik, “Malaysia-China Relations: Three Enduring Themes,” 2014.

<sup>33</sup> David Arase, “Non-traditional Security in China-ASEAN Cooperation,” *Asian Survey*, Vol. 50, No. 4, July/August 2010.

Chinese Fujian migrant to Malaysia, Tan Kah Kee) will be the first China university to open an overseas campus in Malaysia, with all courses taught in English.<sup>34</sup> By comparison, 6,822 Malaysian students were enrolled in the U.S. during the 2013/2014 academic year.<sup>35</sup> With regard to tourism, some 1,558,785 Chinese tourists visited Malaysia in 2013,<sup>36</sup> a figure that dwarfs the flows of American tourists to Malaysia.

### **Leveraging Malaysia-China Relations in ASEAN**

China's special relationship with Malaysia also stems from Beijing's appreciation of the benefits gained from Kuala Lumpur's successful efforts to integrate China into the ASEAN-led regional economic order. As a founding member of ASEAN in 1967 that normalized ties with China in 1974, Malaysia effectively opened the door for Chinese participation as a full dialogue partner of ASEAN in 1995, after Indonesian and Singapore established ties with Beijing. It was Prime Minister Mahathir who proposed Chinese membership, together with Japan and South Korea, in the East Asia Economic Grouping, an Asia-only organization that was opposed by Washington. However, that concept subsequently evolved to become the ASEAN plus Three (APT) grouping after the Asian Finance Crisis, when the U.S. no longer objected to Japan and South Korea joining it. Malaysia and China subsequently worked together in 2005, when Malaysia was ASEAN chair, to upgrade the APT into a Leaders Summit. The establishment of the East Asia Summit, comprising the ten ASEAN countries, China, Japan and South Korea, would have given material shape to Mahathir's initial vision of an "Asia for Asians" regional institution. However, a notable difference between the EAEG concept of 1991 and its EAS avatar in 2005 was that China had by then emerged as the grouping's strongest political and economic force instead of Japan, which had been weakened by long-term economic stagnation and domestic political travails. However, concerns raised primarily by Indonesia and Singapore about China's prominent role in an organization of asymmetrical power relations between Beijing and its 10 weaker ASEAN neighbors scuttled the EAS' original Asia-only composition. When finally established in December 2005, India, Australia and New Zealand were added to balance China by expanding the EAS' democratic make-up.<sup>37</sup> The U.S. and Russia became members in 2011.

While the opportunity offered by Malaysia for China to play a leading role in the EAS did not materialize, participation in ASEAN-led institutions worked to China's advantage in several ways. Positioning itself to benefit from the eventual integration of a 600-million strong ASEAN market and production base, China was the first country to establish a free trade agreement with ASEAN, the China-ASEAN Free Trade Agreement (CAFTA) in 2002. Although limited in scope and low quality in standards compared to

<sup>34</sup> "China-Malaysia Recognition Increases Mobility," *The PIE News*, January 21, 2013. <http://thepienews.com/news/china-malaysia-mutual-recognition-increases-mobility/>.

<sup>35</sup> "Open Door Factsheet: Malaysia 2013," [www.iie.org](http://www.iie.org).

<sup>36</sup> "Malaysia to meet target of 1.7mil Chinese tourists arrivals in 2013," *The Star*, July 19, 2013. <http://www.thestar.com.my/news/nation/2013/07/19/malaysia-to-meet-target-chinese-tourists-arrivals-in-2013/>.

<sup>37</sup> Michael Green & Gill Bates, eds., *Cooperation, Competition, and the Search for Community: Asia's New Multilateralism*, Columbia University Press, 2009.

free trade agreements negotiated between the U.S. and its trading partners, the lowering of tariff barriers under CAFTA enabled China to more closely integrate Southeast Asia's supply chain and production networks that feed intermediate goods from the region to China's "Factory Asia" hub, which turned these intermediate goods into finished exports for the U.S. and European market.<sup>38</sup> The establishment of the ASEAN Economic Community and realization of the ASEAN-led Regional Comprehensive Economic Partnership (RCEP), comprising ASEAN and its free trade partners of China, Japan, South Korea, Australia, New Zealand and India, will further fuel China's economic growth at a time when its fast-paced growth rates are finally slowing down. Malaysia, for its part, hopes to serve as a clearing house for Chinese yuan flows, and as a gateway for goods produced in sites such as the China-Malaysia Qinzhou Industrial Park, to the larger ASEAN Economic Community.<sup>39</sup>

### **Malaysia's China Hedging Policy – Strengthening the Malaysia-US Relationship**

While trade and investments between Malaysia and China, and Chinese initiatives such as the AIIB and Maritime Silk Road will inevitably draw both Malaysia and ASEAN closer into China's economic orbit to form what Xi Jinping calls a "community of shared destiny," that process has geostrategic and security connotations that could work against the national interests of Malaysia.<sup>40</sup> Due to its unhappy experience with China's support of the Malaysian Communist Party-led insurrection, the Malay leadership is understandably wary that a politically dominant and military powerful China could once again threaten its national interests domestically and externally. Although Malaysia's Chinese have long since divested themselves of China-centered political sentiments, they have also largely abandoned the UMNO-led governing coalition in the general election of 2008 and 2013. Their opposition to the government stem from grievances over Malay affirmative action policies, lack of transparency and accountability in governance, and rising racial and religious polarization between Malay Muslims on the one hand, and non-Malays and non-Muslims on the other. At the same time, Chinese claims over energy resources and fisheries in the South China Sea, construction of defense installations in the southern Spratlys, and intrusion into waters claimed by Malaysia pose a serious existential threat to Malaysia's national security and strategic interests.

China's rise to be the dominant Asian power would also challenge Malaysia's and other member countries' concept of ASEAN centrality. Beijing's vision of an asymmetrical, core-periphery power structure under a new Sino-centric regional order would be quite different from ASEAN's current promotion of an ASEAN-based multilateral regional integration. In 2012 China effectively carried out a "divide and rule" strategy when it put pressure on Cambodia, the then ASEAN chair, to prevent the release of a joint ASEAN Ministers Meeting statement, against the desire of Vietnam and the Philippines to have

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<sup>38</sup> Claudia Canals, "China, at the heart of 'Factory Asia,'" June 5, 2014.

[http://www.lacaixaresearch.com/en/web/guest/detail-news?lastnewsportal\\_articleData=413233,10180,1.9](http://www.lacaixaresearch.com/en/web/guest/detail-news?lastnewsportal_articleData=413233,10180,1.9).

<sup>39</sup> "Malaysia-China Relations Blossoming Beyond Expectations," *Bernama*, November 15, 2014.

<sup>40</sup> Larkin, 2015: 10.

that document refer to China's behavior in the South China Sea.<sup>41</sup> ASEAN was momentarily and publicly in disarray before it finally joined ranks again under Indonesia's leadership.<sup>42</sup> Fear of China's ability to marginalize and divide ASEAN led Malaysian Deputy Foreign Minister Hamzah Zainuddin in March 2015 to describe China "as an aggressive nation in the South China Sea," and he called for ASEAN to be united against that source of aggression.<sup>43</sup> When Malaysia chaired the 26<sup>th</sup> ASEAN Summit in April, 2015, Prime Minister Najib's Chairman Statement declared that ASEAN leaders shared serious concerns that land reclamation being undertaken in the South China Sea has eroded "trust and confidence and may undermine peace, security and stability in the South China Sea." The statement also affirmed freedom of navigation in and over the South China Sea, emphasized the need for all parties to ensure full and effective implementation of the Declaration of the Code of Conduct to exercise self-restraint and not resort to threat or use of force and resolve all differences and disputes through peaceful means in accordance with international law, including the 1982 UNCLOS, and to work to ensure the expeditious establishment of an effective and binding Code of Conduct for the South China Sea.<sup>44</sup>

In order to deter China from exerting unwanted pressure on Malaysia, the UMNO leadership has adopted a policy of "soft balancing," primarily through strengthening bilateral ties with the U.S. on all fronts: economic, political, defense, and social. Malaysia-U.S cooperation has never been stronger than under the current Najib and Obama Administration.<sup>45</sup> Warmly embracing Obama's pivot or rebalance to Asia, which has actively courted Malaysia, together with Indonesia and Vietnam, as Washington's new partners in the region, Najib has ramped up military cooperation, including increasing the numbers of U.S. naval ship visits to Malaysian ports, upgrading Malaysia's status in the US-led Cobra Gold military exercises from observer to participant status, drawing on the U.S. to build up Malaysia's Marine Corps, and holding the first exercise with the U.S. Marine Corps in August 2014. While that exercise was conducted in Sabah, close to waters visited by the PLA-Navy flotilla, Malaysia was careful publicly to reassure China that its recent defense capacity-building measures in East Malaysia were aimed at the threat posed by Sulu insurgents of the self-styled "Royal Army of the Sultanate of Sulu," who invaded Lahad Datu in 2013 in an abortive attempt to reclaim the territory for the defunct Sulu Sultanate.<sup>46</sup>

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<sup>41</sup> Carl Thayer, "ASEAN'S Code of Conduct in the South China Sea: A Litmus Test for Community-Building?" *The Asia-Pacific Journal*, 10 (34), 4, 20 August 2012.

<sup>42</sup> Carl Thayer, "South China Sea in Regional Politics: Indonesia's Efforts to Forge ASEAN Unity on a Code of Conduct," Paper presented to 3<sup>rd</sup> Annual Conference on managing Tensions in the South China Sea, Center for Strategic and International Studies, Washington DC, June 5-6.

<sup>43</sup> "Malaysia to push drafting Code of Conduct to settle dispute with China," *The Star*, March 12, 2015. <http://www.thestar.com.my/News/Nation/2015/03/12/Parliament-CoC-Malaysia-China/>

<sup>44</sup> "China maritime tensions dominate Southeast Asia summit," *Reuters*, April 27, 2015..

<sup>45</sup> Heng Pek Koon, "Malaysia and the United States: A Maturing Partnership," Meredith Weiss, ed., *Routledge Handbook of Contemporary Malaysia* 2014.

<sup>46</sup> Zachary Keck, "Malaysia to Establish Marine Corps and South China Sea Naval Base," *The Diplomat*, October 19, 2013.

On the economic front, Malaysia is one of the four negotiating partners from ASEAN in the U.S.-led Trans-Pacific Partnership talks. The U.S. is Malaysia's fourth-largest trading partner, and the largest holder of cumulative FDI (totaling \$15 billion in 2012, an increase of 21.1% from 2011),<sup>47</sup> while Malaysia is the U.S. second largest trading partner in ASEAN. Najib remains committed to bringing the TPP talks to a successful conclusion in the face of stiff domestic opposition, led by former Prime Minister Mahathir.<sup>48</sup> Thus, while Malaysia's economic engagement with China is set to expand bilaterally and multilaterally through participation in the AIIB, and trade liberalization in the ASEAN Economic Community and the Regional Comprehensive Economic Partnership, Najib looks steadfastly to technology-rich America and the 12-TPP member markets to fulfill his long-held desire for Malaysia to become an advanced economy by 2020.

When Malaysia-U.S. bilateral relations were upgraded to a Comprehensive Partnership in 2014, the bilateral cooperation became significantly more vibrant than that with China. With Washington's renewed focus on militant Islam in Iraq and Syria, Malaysia has pledged to work pro-actively with the U.S. to prevent the Islamic State (ISIS/ISIL) from recruiting jihadists from within its borders. In April 2014, Malaysia passed the Prevention of Terror Act, which allows for imprisonment of terror suspects for two years, with multiple extensions, or restriction of their movements for five years.<sup>49</sup>

Apart from security and economic cooperation, other areas of cooperative activity focus on education, exchanges, and cultural heritage preservation. The U.S. Fulbright English Teaching Assistant program in Malaysia is among the largest in the world, helping improve the English language skills of thousands of Malaysian secondary school students. In 2014 during his state visit to Kuala Lumpur (the second by a U.S. president since President Johnson in 1966), President Obama launched the Young Southeast Asian Young Leaders Initiative (YSEALI) that provided additional exchange programs, grant opportunities and fellowships for Malaysian and other ASEAN youth between the ages of 18 and 35.<sup>50</sup>

### **Policy Recommendations: Malaysia-U.S., Malaysia-China, and Malaysia-ASEAN Relations**

The following policy recommendations address the organizing principles that determine Malaysia's relations with both China and U.S. These are: that Malaysia desires to maintain an "equidistant" foreign policy with both major powers; that it seeks productive

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<sup>47</sup> Office of the United States Trade Representative: Malaysia, April 30, 2014.

<https://ustr.gov/countries-regions/southeast-asia-pacific/malaysia>.

<sup>48</sup> Heng Pek Koon, "The Trans-Pacific Partnership Negotiations: Challenges and Prospects for Malaysia," *International Law Journal*, Shanghai University of International Business and Economics, 2014 (12): 82-98.

<sup>49</sup> "Lurch to illiberalism," *The Economist*, April 11, 2015.

<sup>50</sup> U.S. Department of State: Fact sheet, Malaysia. Jan 23, 2015.

<http://www.state.gov/r/pa/ei/bgn/2777.htm>.

and positive relations with each; that it continues to be “non-partisan” and “even-handed” in not having to “take side” with either power; and that it wishes to minimize the potential for interference by either power in its domestic handling of Malay affirmative action policies amidst rising racial and religious tensions between Malay Muslims and non-Malay Muslims in the country. After the occasionally scratchy bilateral relationship under Mahathir, Malaysia has become a reliable and steadfast partner under Najib. Fuelled by growing unease over China’s strident assertiveness and reclamation activities in the South China Sea, Kuala Lumpur is likely to forge even closer security ties with Washington. As the chair of ASEAN in 2015, and a non-permanent member of the United Nations Security Council in 2015-2016, Malaysia is, in turn, well positioned to support U.S. interests both regionally in ASEAN and globally in the UN.

### **Policy recommendations to the USCC:**

1. Implement the Malaysia-U.S. Comprehensive Partnership by establishing Working Committees to strengthen bilateral cooperation in trade and investment, defense and security, education and people-to-people exchanges, science and technology, energy, environment and climate change, health and pandemics, and democracy and civil society promotion.
2. Sustain the Obama Administration’s Asia rebalance policy and continue to engage Malaysia as a key partner and stakeholder of the pivot. Give full support to Malaysia as the ASEAN chair. Ensure President Obama’s attendance at the US-ASEAN Leaders Summit and the EAS Leaders Meetings in Kuala Lumpur in November later this year.
3. Maintain a high level of bi-partisan Congressional support that includes sufficient funding for the diplomatic, defense and economic resources needed to sustain effective U.S. engagement in the region. Obama’s successor in the 2016 presidential race should be encouraged to pursue the key actions and policies of the pivot, as well as to manage expectations and perceptions regarding mutually shared U.S.-Malaysia-ASEAN objectives and concerns in the region.
4. Pass the Trade Promotion Authority (TPA) and bring the Trans-Pacific Partnership (TPP) negotiations to a timely conclusion. Failure to do so would harm U.S. reputational, political and economic standing in the region, while allowing the China-led AIIB, Silk Road Economic Belt and Maritime Silk Road initiatives to gain momentum toward the establishment of a 21<sup>st</sup> Century Sino-centric regional order.
5. Promote U.S. private sector investment in Malaysia through the American Chamber of Commerce (AMCHAM) and work with the US-ASEAN Business Council to deepen economic cooperation and trade liberalization in ASEAN in the U.S.-ASEAN Expanded Economic Engagement (E3). Encourage U.S. public-private funding to help Malaysia and ASEAN member countries address their “infrastructure investment gap.”
6. Join the AIIB. Rather than opposing this lavishly-funded Chinese initiative that has been heartily welcomed by all the counties of South East Asia, it would be much more

preferable for the U.S. to join its European allies in order exert influence from the inside to set high standards of diligence, transparency and accountability in the new bank's decision-making processes.

7. Support "ASEAN centrality" by participating in and building institutional capacity of ASEAN and ASEAN-led groupings such as the East Asia Summit (EAS), ASEAN Defense Ministers Meeting Plus (ADMM+) and the ASEAN Regional Forum (ARF). Continued U.S. backing for ASEAN would prevent it from being divided and marginalized by China's coercive diplomacy in the South China Sea.

8. Join UNCLOS as a means of supporting Malaysia's and ASEAN's commitment to upholding international laws governing freedom and right of passage in and over waters such as the South China Sea and thus provide the legal bedrock for a binding ASEAN-China Code of Conduct in the South China Sea. This issue has been one of considerable urgency, because by building up land features to support military installations in the Spratly Islands, Beijing is rapidly creating a de facto "Air Defense Identification Zone" (ADIZ) in the South China Sea, like the one it formally established in the East China Sea.

9. Work with Malaysia and other claimant ASEAN states in establishing an ASEAN-based conflict prevention and rapid response mechanism to deal with localized incidents in the South China Sea before they break out into open conflict. ASEAN may be viewed by some in Washington as nothing more than a talk shop, but absent a U.S. willingness to directly confront China in the South China Sea, ASEAN remains America's best multilateral instrumentality for helping advance its maritime and other geo-political and strategic interests in the region.