

# PERSPECTIVE

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## China's Economic Statecraft in Southeast Asia

*Vannarith Chheang\**

### EXECUTIVE SUMMARY

- Economic statecraft (the use of economic might for strategic objectives), and institutional statecraft (the development of China-led multilateral mechanisms to serve its grand strategy) are major components of Chinese economic diplomacy.
- The Belt and Road Initiative (BRI) and Lancang-Mekong Cooperation (LMC) are China's two main institutions to exercise its economic diplomacy in Southeast Asia. LMC also serves as a sub-regional mechanism for BRI projects in the Mekong region.
- Southeast Asian countries are generally supportive, albeit to varying degrees, of China's economic diplomacy. China is their main trading partner and a major foreign investor.
- Southeast Asian states are concerned that the power asymmetry and economic overdependence on China may limit their foreign policy options and strategic maneuverability.

*\* Vannarith Chheang is Visiting Fellow at ISEAS - Yusof Ishak Institute. The author would like to express his gratitude to Daljit Singh and Lye Liang Fook for their comments.*

## **INTRODUCTION**

China, the world's top trader and manufacturer, is an emerging predominant global economic power, especially following the global economic crisis of 2008. Moreover, the country is taking a leadership role in defending the international liberal order (especially the economic aspects of it). Some analysts opine that "the future of the global order is in a state of flux. China has a clear script for the future,"<sup>1</sup> and Asia in which China is poised to the transition into "a different type of world order"<sup>2</sup>. The key challenge for Southeast Asian countries is therefore about how they are to respond and adapt to the power transitions.

China's economic power in the region derives from four interconnected elements, namely the use of commercial actors (in the form of state-owned enterprises) for strategic objectives, transnational Chinese entrepreneurs (in the form of private-owned enterprises), the overseas ethnic Chinese communities, and the dynamics of economic regionalism.<sup>3</sup> However, the power asymmetry and overdependence on China have caused a certain degree of concern in Southeast Asia. Structurally, the power asymmetry limits the foreign policy options and strategic maneuverability of weaker states.

The Belt and Road Initiative (BRI) and Lancang-Mekong Cooperation (LMC) are used here to illustrate China's evolving regional economic diplomacy. This diplomacy refers to the art of transforming the external environment into sources of national growth and deploying economic leverage for strategic benefits through the combination of trade, investment and development assistance. Economic statecraft and institutional statecraft are the two main economic strategies employed by China.

## **CHINA'S ECONOMIC STATECRAFT**

China has used of economic statecraft in Southeast Asia effectively. This has been done through a combination of economic inducement (the use of economic incentives to win political support) and economic coercion (the use of economic punitive measures to pressure other weaker states). Commercial actors have strategic relevance and China has effectively aligned its strategic goals to the ambitions of these actors.<sup>4</sup>

During the 1997 Asian financial crisis, China refrained from devaluing its currency and offered US\$4 billion in support to Thailand and other regional countries. China also encouraged regional countries to step up regional cooperation and international financial reforms. In addition, China's bilateral economic ties with ASEAN have strengthened considerably since 1990s. China is the largest trading partner and third biggest foreign investor of ASEAN. In 1990, the bilateral trade volume between China and ASEAN was only US\$7.9 billion. In 2017, this had multiplied 65 times and reached US\$514 billion, (with China enjoying a trade surplus of US\$43.4 billion).

Beginning with modest investments in the 1990s, China is now one of the main sources of foreign investment in ASEAN (after Japan and the US), accounting for more than US\$9.2 billion in 2016 (of which about US\$6 billion went to mainland Southeast Asia-Cambodia, Laos, Myanmar, Thailand and Vietnam). China is also emerging as the top donor in the region. In early 2018, it offered concessional loans of US\$1.1 billion to mainland Southeast Asia.

Apart from economic inducements, China has applied economic coercion against regional countries deemed to have acted against China's core national interests. An oft cited example is the economic friction between China and the Philippines arising from the 2012 faceoff between the two countries over the Scarborough Shoal in the South China Sea. China tightened quality controls on Philippine fruits and reduced the number of Chinese tourists to the Philippines to demonstrate its displeasure.

Separately, China halted rare earth exports to Japan in 2010 over Japan's arrest of a Chinese trawler captain near the disputed islands, Senkaku/Diaoyutai. Most recently, China introduced a slew of socio-economic and diplomatic measures against South Korea over its controversial deployment of THAAD in 2016. China has also converted unpaid debt incurred by other countries into assets which it now controls such as the Hambantota Port in Sri Lanka.<sup>5</sup> In the view of one analyst, "Beijing seems certain to continue using economic leverage for political and strategic ends [...] As China develops a heftier role in the world economy, it will have greater capacity—and thus a greater temptation—to do just that".<sup>6</sup>

## **CHINA'S INSTITUTIONAL STATECRAFT**

China has proactively implemented institutional statecraft by promoting China-led multilateral mechanisms, while upholding the existing norms and rules of existing multilateral institutions deemed to serve China's interests. China's approach towards multilateral institutions, although wide ranging, can be understood as a combination of engagement and integration into existing regional and global institutions as well as opposing or revising certain aspects of the institutional frameworks that do not serve its interests.<sup>7</sup> The Chinese way of institutional statecraft can be characterized as being based on functionalism and pragmatism rather than on rules-based institutionalism.

After its accession to the World Trade Organization (WTO) in 2001, China's opening up policy has gained new momentum and provided a higher degree of liberalization particularly in trade and investment. Since the early 2000s, China has also been actively involved in regional institutions such as the Greater Mekong Subregion (GMS) and ASEAN. In 2002, the ASEAN-China FTA was signed – it was subsequently and gradually upgraded with the Agreement on Trade in Goods in 2005, Agreement on Trade in Services in 2007, Agreement on Investment in 2009, and the upgraded FTA signed in 2015. In 2003, China became a strategic partner to ASEAN. Through its engagement with the ASEAN-led multilateral institutions, China's perception and approach towards multilateralism have changed from "caution and suspicion" to "optimism and enthusiasm". In China's view, multilateralism complements, and does not supplement, bilateralism.<sup>8</sup>

Essentially, China has shown strong interest in building synergies between sub-regional and regional mechanisms with China's grand strategic initiative such as BRI. For instance, at the 6<sup>th</sup> GMS Summit in Hanoi held in March 2018, Chinese Foreign Minister Wang Yi asserted that regional countries are "natural partners" and "primary beneficiaries" of BRI. Promoting the alignment of GMS cooperation with the BRI is pertinent to China's regional economic diplomacy. He added that "we should make the policy alignment a reality, tap the full potential of the economic corridors, strengthen economic and trade links and deepen people-to-people

bonds, so as to build a more close-knit community of shared destiny in the sub-region and open up a brighter future for the development of the sub-region”.<sup>9</sup>

## **LANCANG-MEKONG COOPERATION (LMC)**

In 2015, China proposed its own version of sub-regional cooperation mechanism called Lancang-Mekong Cooperation (LMC), which aim to promote cooperation under three pillars similar to those in the ASEAN Community Blueprints: political security cooperation, economic cooperation, and social and cultural cooperation. In terms of institutional statecraft, LMC serves as one of the important arms of BRI in connecting China with mainland Southeast Asia. The 26-point Sanya Declaration from 2016 illustrates the importance of building synergy between BRI and LMC, as well as relevant development programmes in the Mekong region, including the Master Plan on ASEAN Connectivity (MPAC). At the second LMC Summit in Phnom Penh held in January 2018, the leaders adopted a five-year action plan from 2018 to 2023 to build a community of shared future of peace and prosperity, harmonize BRI, ASEAN Community Vision 2025 and other sub-regional cooperation mechanisms.

There are four levels of working mechanism involved, namely sectoral working group meeting, senior officials’ meeting, foreign ministers’ meeting, and leaders’ meeting (the leaders’ meeting is the top decision-making body). China also supports the creation of a coordinating body at both the national and regional levels to facilitate LMC-related projects, and fund the global centre for Mekong studies to promote think tank collaboration in the region. The LMC members have established their national secretariat and are holding consultations on the possibility of establishing a regional secretariat to manage LMC projects and activities.

Where economic statecraft is concerned, LMC serves as a springboard for China to expand its economic footprint and play a preponderant economic role in the Mekong region. China is now the largest trading partner to Cambodia, Myanmar, Thailand and Vietnam and the second largest to Laos. China’s trade with these countries in 2017 exceeded US\$220 billion. China’s investment topped US\$42 billion in cumulative terms and rose by more than 20% in 2017. Under the LMC framework, China has pledged to provide concessional loans of up to US\$1.6 billion and credit loans totaling another US\$1.6 billion to promote industrial capacity cooperation and infrastructure construction within the region. Additionally, China has committed another US\$200 million to fund South-South cooperation, and to set up an LMC special fund to provide US\$300 million in five years to support small- and medium-sized cooperation projects within the region.

Geopolitically, LMC and economic interdependency are instrumental in shoring up China’s leadership role and geostrategic leverage in the Mekong region. China’s economic and political influences in mainland Southeast Asia is stronger than in maritime Southeast Asia. ASEAN’s unity and centrality can be at risk if there is a widening strategic division between the mainland and maritime Southeast Asia.<sup>10</sup> There are some concerns that China might divide and weaken ASEAN if this regional grouping poses certain challenges or threats to China’s regional interests. For instance, the failure of the ASEAN foreign ministers to come up with a joint communique in 2012, due to deep differences over the South China Sea issue, was allegedly due to China’s “divide and rule tactics” in ASEAN.<sup>11</sup>

## **BELT AND ROAD INITIATIVE (BRI)**

At a higher level of regional diplomacy, China proposed Belt and Road Initiative (BRI) in 2013 to realize the “China Dream” and “national rejuvenation”. It is a grand vision with a strategic ambition, and it requires huge resources. Some analysts consider BRI to be “China’s emerging grand strategy of connective leadership”.<sup>12</sup> However it is hard to comprehend. BRI is not yet a strategy. It is an inter-continental cooperation platform with a focus on economic and cultural cooperation. BRI, the core of Xi Jinping’s institutional and economic statecraft, is characterized by functional cooperation, without clear rules and regulations.

BRI serves as a springboard for China to strengthen its geo-economic power and exert its geostrategic influence. From the Chinese perspective, the BRI International Cooperation Forum, a biannual summit launched in May 2017, is a top decision-making body, while other regional mechanisms such as LMC, China-ASEAN partnership, Greater Mekong Subregion (GMS), and Boao Forum for Asia serve as platforms for policy consultation and joint project implementation. And bilateral cooperation, normally under bilateral MOUs and agreements, is the most important mechanism in concretizing the BRI projects.

BRI provides an important alternative for countries to diversify their sources of growth. Ideally, BRI is also being portrayed as the defender of an open global system and a liberal global economic order. Some Chinese scholars argue BRI encourages “a possible new globalization path” including the exploration of “inclusive globalization” which may consist of five elements such as inclusive growth, inclusive infrastructure development, inclusive development paths, inclusive participation in globalization, and cultural inclusiveness.<sup>13</sup> However, there are some concerns with regards to the quality, bankability and economic feasibility of some BRI projects. For instance, the new Malaysian government under Mahathir Mohamad is reviewing BRI projects that were signed between China and the previous government<sup>14</sup> and Vietnam has some reservations in lending full support to BRI.<sup>15</sup>

Some of the key connectivity projects under BRI in Southeast Asia include the China-Laos rail project, the China-Thailand rail project, the Jakarta-Bandung high-speed rail project, and road projects connecting Kunming and Bangkok, Kunming and Hanoi, Kunming and Kyaukpju, and Phnom Penh and Sihanoukville in Cambodia. Additionally, some economic or industrial zones have been designated as BRI projects such as the Thai-China Industrial Park in Rayong (Thailand), Sihanoukville Economic Zone (Cambodia), Long Giang Industrial Park (Vietnam), China-Indonesia Economic and Trade Cooperation Zone (Indonesia), Vientiane Saysettha Development Zone (Laos), China-Indonesia Julong Agricultural Industry Cooperation Zone (Indonesia), Indonesia Morowali Industrial Park, and Malaysia-China Kuantan Industrial Park (Malaysia). However, some of these projects were implemented before the launching of BRI and some countries are reluctant to regard infrastructure projects decided before 2013 as BRI projects. For instance, Indonesia only registers those infrastructure projects and economic interactions under President Xi Jinping’s administration to be such.<sup>16</sup>

## **PUSH AND PULL FACTORS**

China’s economic reasons for pushing LMC and BRI are: firstly, these initiatives encourage and enable Chinese companies to “venture out” by expanding their market access and business

networks; secondly, these help relieve overcapacity in major industrial sectors in China; and thirdly, the initiatives exert international influence and authority and enhance China's international status and leadership role. These two initiatives are the institutional and economic means to advance China's strategic and diplomatic leverage.

BRI and LMC are not only the result of China's push, but also Southeast Asia's pull. Domestic politics greatly affect the implementation of the two initiatives. The ruling elite across Southeast Asia perceive that performance bestows legitimacy and defines the survival of their regimes (especially amidst the rising trend of authoritarianism in many countries in Southeast Asia). Complex political-business ties between Chinese entrepreneurs and local politicians partially explain the responses of the ruling elite towards BRI and LMC.

However, there are some internal factors that may constrain the realization of China's regional projects such as the opposition movements against the established governments which label China as a threat to national economic sovereignty, democracy and human rights, and good governance. Coupled with the lack of transparency, grassroots movement and local opposition groups are organising to challenge China's growing economic presence.

## **PROSPECTS**

BRI and LMC are the nucleus of China's evolving regional economic diplomacy. These mechanisms serve as the catalysts in boosting China's economic footprint in Southeast Asia and over the long term, to realize a Sino-centric regional order. Countries in mainland Southeast Asia are going to come under China's stronger influence compared to countries in maritime Southeast Asia due to geographic proximity with land connectivity and the intensity of sub-regional cooperation, particularly through LMC. China regards the Mekong region as its strategic backyard.

However, China needs to work closely with regional countries to address concerns such as political anxiety caused by the power asymmetry and the overdependence on China, trade imbalance, anti-China sentiments (mainly due to malpractices by some Chinese enterprises and overexploitation of natural resources), questions relating to transparency and quality of mega infrastructure projects, lack of people's participation and fair distribution of benefits, and a lack of social and environmental safeguards and standards. China needs to understand the local dynamics and be more sensitive to local concerns and grievances.

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- <sup>2</sup> Amitav Acharya (2018) Asia after the liberal international order. East Asia Forum, 10 July 2018, <http://www.eastasiaforum.org/2018/07/10/asia-after-the-liberal-international-order/>
- <sup>3</sup> Yos Santasombath (2018) Chinese capitalism and economic integration in Southeast Asia. *Trends in Southeast Asia No. 7*. Singapore: ISEAS-Yusof Ishak Institute.
- <sup>4</sup> William J Norris (2016) *Chinese Economic Statecraft: Commercial Actors, Grand Strategy and State Control*. Cornell University Press.
- <sup>5</sup> Sri Lanka handed over its US\$1.3 billion Hambantota seaport to China on a 99-year lease in 2017 after it faced losses and difficulties in repaying the debt. Some has called the situation a “debt trap” which China used to yield its political leverage and geopolitical influence. Financial Times, 11 December 2017, <https://www.ft.com/content/e150ef0c-de37-11e7-a8a4-0a1e63a52f9c>
- <sup>6</sup> Evan Feigenbaum (2017) Is coercion the new normal in China's economic statecraft? Carnegie Endowment for International Peace. <http://carnegieendowment.org/2017/07/25/is-coercion-new-normal-in-china-s-economic-statecraft-pub-72632>
- <sup>7</sup> John Ikenberry and Darren Lim (2017) China's emerging institutional statecraft: The Asian Infrastructure Investment Bank and the prospect for counter-hegemony. Brookings Institution. <https://www.brookings.edu/wp-content/uploads/2017/04/chinas-emerging-institutional-statecraft.pdf>
- <sup>8</sup> Kuik Cheng-Chwee (2005) Multilateralism in China's ASEAN Policy: Its Evolution, Characteristics, and Aspiration. *Contemporary Southeast Asia*, Vol. 27, No. 1, pp. 102-122.
- <sup>9</sup> Ministry of Foreign Affairs of the People's Republic of China, [http://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/t1547620.shtml](http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1547620.shtml)
- <sup>10</sup> Pongphisoot Busbarat (2018) Grabbing the *forgotten*: China's Leadership Consolidation in Mainland Southeast Asia Through the Lancang-Mekong Cooperation, ISEAS Perspective No. 7, 2018, [https://www.iseas.edu.sg/images/pdf/ISEAS\\_Perspective\\_2018\\_7@50.pdf](https://www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2018_7@50.pdf)
- <sup>11</sup> Tang Siew Mun (2016) China shoots itself into the foot with divide and rule tactics in Asean. Today, 17 June 2016, <https://www.todayonline.com/commentary/china-shoots-itself-foot-divide-and-rule-tactics-asean>
- <sup>12</sup> Giovanni B. Andornino (2017) The Belt and Road Initiative in China's Emerging Grand Strategy of Connective Leadership. *China and World Economy*, Vol. 25, No.5, pp.4-22.
- <sup>13</sup> Liu, W., Dunford, M., and Gao, B. (2018) A discursive construction of the Belt and Road Initiative: From neo-liberal to inclusive globalization. *Journal of Geographical Sciences*, 28(9): 1-17.
- <sup>14</sup> Tang Siew Mun (2018) China's infrastructure strategy under review in Malaysia, ISEAS Commentary, 8 June 2018.
- <sup>15</sup> Le Hong Hiep (2018) The Belt and Road Initiative in Vietnam: Challenges and Prospects. ISEAS Perspective No. 18, Issue 2018. Singapore: ISEAS-Yusof Ishak Institute. [https://www.iseas.edu.sg/images/pdf/ISEAS\\_Perspective\\_2018\\_18@50.pdf](https://www.iseas.edu.sg/images/pdf/ISEAS_Perspective_2018_18@50.pdf)
- <sup>16</sup> Siwage Dharma Negara and Leo Suryadinata (2018) Indonesia and China's Belt and Road Initiatives: Perspectives, Issues and Prospects. *Trends in Southeast Asia No. 11*, 2018. Singapore: ISEAS-Yusof Ishak Institute.

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