

Heritage Lectures

No. 1149

Delivered February 3, 2010



Published by The Heritage Foundation

February 24, 2010

More Charm than Harm: Lessons from China's Economic Offensive in Southeast Asia

Walter Lohman

Abstract: *The Chinese are competing very effectively for influence in Southeast Asia. To continue leading in Asia, the United States must demonstrate that its concerns about security and geopolitical competition with China are not going to upset ASEAN's economic appletart. Concerns in the region about China's defense capabilities are rooted so distantly in the future that the U.S. role of security guarantor is not enough to substantiate an energetic engagement. What is needed is American free trade leadership. The U.S. must be at the ASEAN table, but it must also bring something tangible.*

The year 2002 was the seminal year in what is now called China's "charm offensive"¹ in Southeast Asia. That year, China and the Association of Southeast Asian Nations (ASEAN) signed the Declaration on the Conduct of Parties in the South China Sea (DOC) and the Framework Agreement on Comprehensive Economic Cooperation. These two agreements laid the groundwork for sustained Chinese competition for influence in Southeast Asia, an area of the world with critical economic, security, and geopolitical importance to the United States.

The territory comprising the South China Sea is disputed by China, Taiwan, and four ASEAN members: Vietnam, the Philippines, Malaysia, and Brunei. The 2002 DOC commits, in non-binding fashion, ASEAN and China to the peaceful resolution of conflicts over their claims.

Talking Points

- The biggest priority for ASEAN is trade. The U.S. cannot have an effective policy in Southeast Asia without a trade policy.
- The U.S. needs a long-term economic vision: a Transpacific Partnership firmly rooted in the goal of an APEC-wide free trade agreement and an ASEAN-U.S. FTA.
- The Chinese are competing very effectively for influence in Southeast Asia. Worries about their defense capabilities are rooted so distantly in the future that the U.S. role of security guarantor is not enough to substantiate energetic engagement.
- Economic growth in ASEAN and China is a good thing. The U.S. should never be in the position of begrudging China or ASEAN their economic success and improvement in their people's welfare.
- One simply cannot understand the ASEAN response to China without considering the nature of its governments.

This paper, in its entirety, can be found at:
www.heritage.org/Research/AsiaandthePacific/hl1149.cfm

Produced by the Asian Studies Center

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002-4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

It is important to note that the DOC does not directly address those claims; nor does it necessarily provide a venue for addressing them. In fact, as the Chinese happily point out, the DOC explicitly calls for disputes to be addressed through “friendly consultations and negotiations by sovereign states directly concerned.”²

In and of itself, the DOC is a very weak agreement, but it accomplished something very important for the Chinese. It essentially set aside conflicting territorial claims in the interest of developing the broader ASEAN–China relationship. In so doing, it removed a highly visible political barrier to closer economic ties, including the possibility of joint resource development in the sea itself. The DOC is, in this way, more an economic agreement than a security agreement.

The early to mid-1990s were hard on China’s image in Southeast Asia. China’s 1992 Territorial Sea Law, its highly visible dispute with the Philippines over the Spratlys, and the 1995–1996 missile crisis in the Taiwan Strait all confirmed Southeast Asia’s worst expectations about China’s rise.

Economic diplomacy began to turn things around for the Chinese in 1997 when they turned a predisposition for currency stability into a diplomatic coup. Chinese leaders claimed that, as a con-

Economic diplomacy began to turn things around for the Chinese in 1997 when they turned a predisposition for currency stability into a diplomatic coup.

tribution to recovery in the region, they would not devalue their currency, the RMB. This contained the damage that the Asian crisis was inflicting on Southeast Asia by helping them to keep their exports competitive. Token contributions to the International Monetary Fund’s bailouts of Thailand and

Indonesia also contributed to China’s evolving “good neighbor” policy.

China’s Growing Engagement in Southeast Asia

President Barack Obama held the first U.S.–ASEAN leaders summit just last year; then-Chinese President Jiang Zemin held the first ASEAN–China Summit in 1997. It was at a summit meeting in 2000 that China proposed the idea of an ASEAN–China free trade agreement (FTA) and at a 2001 summit that the two sides began to flesh out the idea. By 2002, the official Chinese image of “good neighborliness and mutual trust” had clearly won out and set in motion the relatively benign profile in the region that China enjoys today.

The 2002 economic framework agreement became the centerpiece of China’s economic engagement in Southeast Asia. It provided for the negotiation of an Agreement on Trade in Goods that came into full effect in January 2010, a Trade in Services Agreement that came into effect in July 2007, and the ASEAN–China Investment Agreement signed in August 2009 (effective date six months from signing).

Emblematic of how far the U.S. is falling behind in its economic diplomacy in the region, much of the press has reported the Agreement on Trade in Goods as something new. In fact, it has been phasing in since January 1, 2004, first with tariff reductions on 600 agricultural products under an “Early Harvest” program and then, beginning on July 20, 2005, with additional phases for goods more generally, covering in total more than 7,000 tariff lines. According to the ASEAN Secretariat, trade between ASEAN and China has maintained an average growth of 26 percent a year since 2003, reaching almost \$200 billion in 2008.³

Relatively speaking, goods are easy. Liberalization in services and investment, because of the

-
1. Joshua Kurlantzick, *Charm Offensive: How China’s Softpower Is Transforming the World* (New Haven, Conn.: Yale University Press, 2007).
 2. Association of Southeast Asian Nations Secretariat, “Declaration of Parties in the South China Sea,” November 4, 2002, at <http://www.aseansec.org/13163.htm> (February 4, 2010).
 3. Association of Southeast Asian Nations Secretariat, “ASEAN–China Free Trade Area: Not a Zero-Sum Game,” press release, January 7, 2010, at <http://www.aseansec.org/24161.htm> (February 4, 2010).

nature and constituencies for non-tariff barriers, are much more difficult to realize. The ASEAN–China agreement on services will probably experience many of the same problems that ASEAN has experi-

The impact of liberalization on trade in goods... is very powerful. China has now surpassed the United States as ASEAN's third largest trading partner...and is on pace to become number one very soon.

enced with its own ASEAN Framework on Services. That is, commitments will mostly represent window dressing on commitments made in the World Trade Organization and not offer significant benefits beyond that.

A similar dynamic is at play in the area of investment. The ASEAN–China agreement is based on the ASEAN Investment Area, now the ASEAN Comprehensive Investment Agreement. The limited number of sectors covered and exceptions has meant that the concept is vastly underutilized. There is no reason to believe that agreements in these areas between China and ASEAN will fare better than ASEAN's own.⁴

The impact of liberalization on trade in goods alone, however, is very powerful. China has now surpassed the United States as ASEAN's third largest trading partner, behind the European Union and Japan, and is on pace to become number one very soon. And investments from China, whether driven by agreements or not, are continuing to grow. Chinese direct investment in ASEAN today is relatively small; ASEAN investment in China is much larger: \$6.1 billion⁵ compared to around \$50 billion. American investment in ASEAN remains much larger than Chinese investment, at \$153 billion.⁶

There has long been a debate in Washington over whether China is “eating America's lunch in Southeast Asia.” It depends on how you measure. Those who are most concerned with military and security affairs say this overstates the situation. There is simply nothing to match the military footprint and capacity of the U.S. in the Asia–Pacific. It is, hands down, the winner. The worriers have been looking mostly at the other side of the equation: the economic trends and high-level, active Chinese economic diplomacy.

The ASEAN states are playing a game whereby they take full advantage of near-term trends in China's economic development while hedging against their longer-term security concerns. The question is whether, in the long term, they might outwit themselves and be so deep on the economic side that their political choices are constrained.

Learning to Play the Game

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

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

-
4. Walter Lohman and Anthony B. Kim, “Enabling ASEAN's Economic Vision,” Heritage Foundation *Backgrounder* No. 2101, January 29, 2008, at <http://www.heritage.org/Research/AsiaandthePacific/bg2101.cfm>.
 5. Association of Southeast Asian Nations Secretariat, “ASEAN–China Investment Agreement,” Fact Sheet, August 15, 2009, at <http://www.aseansec.org/Fact%20Sheet/AEC/2009-AEC-031.pdf> (February 4, 2010).
 6. U.S. Department of Commerce, Bureau of Economic Analysis, “U.S. Direct Investment Position Abroad on a Historical Cost Basis: Country Detail by Industry, 2008,” at http://www.bea.gov/international/xls/pos_long_08.xls (February 4, 2010). Singapore accounts for \$106.5 billion of \$153.2 billion U.S. investment in ASEAN.

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

The trick to engaging ASEAN is knowing when leaders are just talking and when there is something to it—and knowing that the difference is often determined by the energy and skill of an outside actor. The ASEAN–China FTA was more than just talk 10 years ago, but it was so because the Chinese made it so.

The trick to engaging ASEAN is knowing when leaders are just talking and when there is something to it—and knowing that the difference is often determined by the energy and skill of an outside actor.

The U.S. cannot underestimate the seriousness of Chinese engagement in the region. These economic trends are real, and Chinese diplomacy in the region is very effective. It is taking place across the board from cooperation on financial markets to infrastructure development. They are down in the weeds consulting with ASEAN in forums barely on American radar screens. The U.S. cannot afford to wake up five years from now, as many in the press did on the Agreement on Trade in Goods, to discover a level of economic integration that has, in fact, been in the works for 15 years.

ASEAN Country Dispositions Toward China

China’s focus on multilateral engagement contrasts sharply with the traditional American approach. For the most part, the ASEAN states

The less free a country is, the more likely it is to have close relations with China.

themselves obviously prefer the multilateral approach to China because there is strength in numbers. But it is important also to touch on individual Southeast Asia country dispositions toward China. The dynamic that their positions produce is a critical part of understanding the direction the organization takes and how it responds to China.

ASEAN’s sliding China disposition scale can be summarized as follows, from most to least China-friendly: Laos, Burma, Cambodia, Thailand, Malaysia, Singapore (midpoint), the Philippines, Indonesia, and Vietnam. It is no accident that the countries closest to China, with the exception of Vietnam, are the most friendly. They have the most to gain or lose and, in the case of Burma, require a member of the U.N. Security Council to protect them from punishment for the deplorable way the regime treats the country’s citizens.

China provides this service in exchange for a number of strategic advantages, including Southern ports and access to resources. Maritime Southeast Asia is more wary of China’s long-term intentions, and Vietnam has had a centuries-long rivalry with China, including most recently a border war in 1979 and a 1988 clash in the South China Sea. In ASEAN, each of the 10 members has an equal voice in the direction the organization takes, however small it may be.

The other sliding scale to keep in mind when considering the ASEAN decision-making process is the democratic accountability scale. Using Freedom House scores for political and civil freedom, the countries can be ranked from “not free” to “free” as follows: Burma, Laos, Vietnam, Cambodia, Thailand, Singapore, Malaysia, the Philippines, and Indonesia. The first four countries on this list (and Brunei) are rated “not free”; the next four are rated “partly free”; and Indonesia is the only country in ASEAN rated “free.”⁷

7. Freedom House, “Freedom in the World 2009: Selected Data from Freedom House’s Annual Global Survey of Political Rights and Civil Liberties,” at <http://www.freedomhouse.org/template.cfm?page=363&year=2009> (February 4, 2010).

These two scales combine in interesting ways. The less free a country is, the more likely it is to have close relations with China. (China's freedom score is the same as Laos in the Freedom House report.) Admittedly, there are many other variables to consider, not least of which is proximity. Yet it would be a mistake to dismiss the correlation in governance between China and its closest allies in ASEAN.

"Hedging" Against a Rising China

Kuik Cheng-Chwee, a Ph.D. candidate at the Paul H. Nitze School of Advanced International Studies in Washington, D.C., makes excellent sense of ASEAN's decision-making in an article entitled "The Essence of Hedging: Malaysia and Singapore's Response to a Rising China."⁸ Kuik proposes that to understand Southeast Asia's response to China, one must get beyond the classic political science formulation of balancing vs. bandwagoning. Most of the ASEAN states—and all of the big ones—are "hedging" against China's rise. They seek maximum economic benefit from China's rise while guarding against the possibility that it will ultimately seek to dominate the region.

The U.S. is essentially approaching China in the same way, but the ASEAN states are "driven not so much by the growth of the Great Power's (China) relative capabilities" as they are "by an internal process of regime legitimization in which the ruling elite evaluate—and then utilize—the opportunities and challenges of the rising power for their ultimate goal of consolidating their authority to govern at home."

You simply cannot understand the ASEAN countries' response to China without considering the domestic demands on their leaders and the nature of their governance. The Chinese approach to economic diplomacy accounts for this dynamic in a way that America's does not.

The U.S. cannot replicate the Chinese effort in Southeast Asia. Obviously, American officials are accountable to the American people in a way that the Chinese are not accountable to their own. We cannot structure trade agreements in ways that

The biggest priority for ASEAN is trade. The U.S. cannot have an effective policy in Southeast Asia without a trade policy.

choose winners and losers by diplomatic or industrial policy imperative. Just getting agreements through Congress means that they must cover the range of sectors and issues: Hard to imagine telling the service industry, for instance, that they have to wait two years for their part of a free trade agreement and still get the required industry support for passage.

The Chinese are also closer and have more diplomats to throw at ASEAN. The U.S. can do better than it is in covering ASEAN—establishment of the U.S. mission in Jakarta focused exclusively on ASEAN and headed by an ambassador is a good start—but we cannot match the Chinese diplomat for diplomat, forum for forum.

The other reality is China's own economic engagement. The U.S. cannot stop it, and it should not want to. Economic growth in ASEAN and China is a good thing, and to the extent that cooperation benefits them both, that is good. Economic growth in Asia is lifting millions of people out of poverty and providing opportunities that many generations in the region have never enjoyed. We want to compete, but we never want to be in the position of begrudging China or ASEAN their economic success and improvement in their people's welfare. Whatever the U.S. could possibly gain in limiting China's comprehensive power it would more than lose in public image and regard among our allies and friends.

What Needs to be Done

But the U.S. can step up its own game considerably, and it can learn valuable lessons from the developments in the region over the past 10 years.

First, the biggest priority for ASEAN is trade. The U.S. cannot have an effective policy in Southeast Asia without a trade policy.

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

The Administration's effort to get more deeply engaged in ASEAN's processes, raise the American profile, and stabilize participation in ASEAN activities is very well advised, but it is an empty gesture without a discernible free trade component. ASEAN's concerns about China are long-term. ASEAN countries are not so worried that the demonstration effect of American official visits alone is a sufficient advantage. The U.S. needs substance, and the substance that counts is trade.

Second, the U.S. needs a long-term vision: a Transpacific Partnership firmly rooted in the goal of an APEC-wide FTA and an ASEAN–U.S. FTA. It is very encouraging that the Administration has picked up where the Bush Administration left off on the Transpacific Partnership. It will be interesting to see what they bring to the negotiations.

The members of the TPP negotiations, including ASEAN states Singapore, Brunei, and Vietnam, understand that the U.S. is going to approach these discussions differently than the Chinese. The tougher positions, they know, can actually enhance their competitiveness and access to quality goods and services in ways the China agreement cannot. They also expect issues like labor and environment to be on the table.

But if the Administration plans to take any version of the proposals outlined by the House Trade Working Group,⁹ it would be better that they just stay home until such time as they can fashion a trade agenda intended more to free trade than to constrain it. There are two sides to trade negotiations, and with China's economic clout in the region growing, the U.S. needs every bit of leverage that our market offers just to secure access and the standards we have already set.

Third, take agreements with ASEAN seriously in concept, negotiation, and subsequent implementation—just as China has. The fact that sometimes, when left to its own, ASEAN does not take its own agreements seriously is not important. The U.S. can

be the catalyst. It is in this context that its investment in time is most important. It cannot be a catalyst if it demonstrates merely sporadic interest.

Fourth, be as flexible as possible. The U.S. can maintain its FTA gold standard. That is in the interest of both sides. But it can be flexible in other ways—and not necessarily in the text of the agreements. The U.S. and ASEAN have a mutual interest, for instance, in helping small businesses compete. Financing for small and medium enterprises in ASEAN has long been a problem for which they have sought help. Assistance with infrastructure development is another key area for ASEAN.

Fifth, integrate economic objectives with broader diplomatic ones. In the 1990s, China started out mostly with political liabilities and the promise of economic development not yet fulfilled. The U.S. starts with massive advantages, not the least of which are decades of positive engagement in the region, world-class investment and business practices, a global profile, military alliances in the region, partnerships, and foreign assistance.

The list of advantages the U.S. has over China in this competition is long. The Bush Administration took some limited steps to integrate priorities under its ASEAN–U.S. Enhanced Partnership, an agreement since endorsed by the Obama Administration; in the U.S.–ASEAN Trade and Investment Framework Arrangement process; and in its ADVANCE program (ASEAN Development Vision to Advance National Cooperation and Economic Integration). The Obama Administration's Lower Mekong Initiative is an excellent start to expanding on this and gets directly at a geographical spot where the Chinese have a significant head start on the U.S.

Sixth, don't buck the current economic order; leverage it. If the Chinese want to invest in ASEAN's infrastructure, fine. The U.S. should

9. On January 20, 2010, the House Trade Working Group sent a letter to United States Trade Representative Ron Kirk that, among other things, endorses labor and environmental standards that are stronger than those in previous agreements, as well as a democracy clause and the TRADE Act. The text of the letter can be found at http://www.michaud.house.gov/index.php?option=com_content&task=view&id=908&Itemid=76. For commentary on the TRADE Act, see Daniella Markheim, "An Act to End Trade," Heritage Foundation *WebMemo* No. 2524, July 6, 2009, at <http://www.heritage.org/Research/TradeandEconomicFreedom/wm2524.cfm>.

have relationships in the region that help ASEAN determine its priorities and voice its concerns. If Chinese multinationals want to invest in ASEAN, great. Work to bring them into compliance with U.S.-friendly standards and integrate them into American supply chains.

If there is to be more ASEAN–China trade, American companies ought to be invested in it on both sides of the border and integrated into markets back home. Fighting current economic trends undermines the credibility of our leadership.

If there is to be more ASEAN–China trade, American companies ought to be invested in it...and integrated into markets back home.

Seventh, continue to deepen and broaden American involvement in ASEAN and other forums in the region. President Obama should commit to making the U.S.–ASEAN leaders summit an annual event beginning in 2010 in Vietnam.

Conclusion

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

The Chinese are competing very effectively for influence in Southeast Asia. Worries in the region about their defense capabilities are rooted so distantly in the future that the U.S. role of security guarantor is not enough to substantiate an energetic engagement of the region.

Neither is engagement without free trade leadership. There are many areas of potential economic cooperation, but without trade agreements, they are all small potatoes. The U.S. must be at the ASEAN table, but it must also bring something tangible.

—Walter Lohman is Director of the Asian Studies Center at The Heritage Foundation.