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## **China's Influence in Southeast Asia**

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## Executive Summary

1. China's clout in Southeast Asia is less than that portrayed in the mainstream media. In terms of investment in ASEAN, China contributes less than the EU, the U.S. and Japan. Chinese economic aid to ASEAN countries is also dwarfed by those from Japan and the U.S.
2. Most prominent in the China-ASEAN economic relations is not investment and economic aid but the rapid growth of bilateral trade. In 2003, it reached US\$78.3 billion, an increase of 42.9 per cent from the previous year. In 2004, it was over US\$109.9 billion with a growth rate of nearly 40 per cent, with ASEAN becoming China's fourth biggest trade partner, and China the fifth biggest partner of the ASEAN.
3. Nonetheless, these trade figures can be deceiving. For example, one study showed that while China produces 75 per cent of the toys in the world, it only retains 1/70 of the total profit. The *New York Times* in 2006 reported that "the biggest beneficiary" of China's increased export is not China. "A Barbie doll (made in China, exported to the U.S.) costs US\$20, but China only gets about 35 cents of that." "Because so many different hands in different places touch a particular product, you might as well throw away the trade figures (of China's export)."
4. This anomaly also applies to China's trade with ASEAN. Foreign companies based in China accounted for 60.6 per cent of China-ASEAN trade in 2005. Much of this comes from intra-industry trade within and between the foreign companies in China and Southeast Asia, and entrepot trade. In this regard, double counting can be serious as many products, especially electronic products, may cross borders twice or more, therefore grossly inflating the two-way trade figure. This double counting is estimated as high as 30 per cent of the total trade between China and ASEAN.
5. Furthermore, Chinese companies may find it difficult to compete in ASEAN markets. First, they are mainly small and medium companies that lack huge resources to compete effectively with foreign companies that are already firmly established in ASEAN markets. Secondly, they are not coordinated amongst themselves and not well integrated into ASEAN markets. Most of them lack sufficient knowledge of and research into ASEAN markets. Thirdly, even the better-developed coastal provinces still focus on Western markets and see the ASEAN market only as an alternative when they cannot expand further in Western markets.
6. On the diplomatic level, China's diplomatic success with ASEAN is often by chance. This success has much to do with the U.S. obsession with terrorism and its relative neglect of the region. It also has a lot to do with the 1997 financial crisis and consequently ASEAN's desire not to be taken for granted

and its initiatives to engage China in a constructive balance of power in the region. Very often, people only see Chinese “pushes” into the region without seeing ASEAN’s “pulls”. Without such “pulls”, China’s “pushes” will not go far and may even backfire.

7. The strategic basis for China to accelerate its push into Southeast Asia is even weaker than the economic basis. Though there is now less public talk of the “China threat”, the suspicion and distrust of China remains deep-rooted and may grow if the rising China rushes deeper into Southeast Asia. As it is, ASEAN countries are not jumping on the China bandwagon, but “hedging” against it, while developing robust ties with other extra-regional powers to balance China.
8. Beijing has evidently read the message and readjusted its approach towards ASEAN. Beijing will shift its focus from East Asian integration to its bilateral relations with ASEAN, i.e. China-ASEAN FTA, and with individual ASEAN countries. It will continue to stress on economic relations and a low profile but substantive diplomacy. The best diplomacy is to arouse enthusiasm among countries by dealing with them in a way that makes them feel important and appreciated and engaging them without making them feel manipulated. China is on the learning curve now.

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## **CHINA'S INFLUENCE IN SOUTHEAST ASIA**

While China has gained influence in Southeast Asia in recent years, it will face more challenges down the road. China does not have a strong economic, social and strategic basis in Southeast Asia to support a plan for a smooth and deep penetration that would tilt the current regional strategic balance in its favour. This essay explores these challenges and new trends in China's ASEAN policy after the East Asia Summit in December 2005.

### **Weak Economic Basis**

China's clout in Southeast Asia is less than it is described to be by the mainstream media. In terms of investment, by November 2004, the officially registered Chinese accumulated investment in ASEAN was only US\$1.165 billion (compared with US\$38.22 billion of ASEAN investment in China), which comprised only 7.7 per cent of total Chinese overseas investment. U.S. investment in Southeast Asia stood at US\$85.4 billion. From 1995 to 2003, China's investment in ASEAN comprised 0.29 per cent of the total foreign investment in ASEAN, in sharp comparison with 28.83 per cent for EU, 16.47 for the U.S. and 12.9 per cent for Japan. Chinese economic aid to ASEAN countries is also dwarfed by those from Japan and the U.S. as well.

With so little investment and economic aid, China's real influence should not be over-exaggerated. Its investment and aid will increase. However, given the reality of the Chinese economy, it is unrealistic to expect its investment and aid to match those of the U.S. and Japan in the near future.

What features prominently in the China-ASEAN economic relations is not investment and economic aid but the rapid growth of their bilateral trade, at an annual rate of 20.8 per cent from 1990 to 2003, and over 30 per cent from 2001. In 2003, it reached US\$78.3 billion, an increase of 42.9 per cent to the previous year. In 2004, it was over US\$109.9 billion with a growth rate of nearly 40 per cent, with ASEAN becoming China's fourth biggest trade partner, and China the fifth biggest partner of the ASEAN.

But these trade figures can be deceiving. The devil is in the details. First, process industries by foreign companies (referring to foreign-owned and foreign-invested companies) in China accounted for 55 per cent of China's total export in 2004. In 2000-2004, the export by foreign companies in China increased from US\$119.4 billion to US\$338.6 billion, i.e. an increase from 47.9 per cent to 57.1 per cent in China's total export. Their import increased from US\$117.3 billion in 2000 to US\$324.6 billion in 2004, an increase of 52.1 per cent to 57.8 per cent in China's total import. Their total import/export during the period increased from US\$236.7 billion to US\$663.2 billion, an increase of 49.9 per cent to 57.4 per cent. They have made up 77 per cent of the top 200 exporters in China, 62 per cent of the top 500 importers. Heavy double counting has been evident as China processes only a fraction of the finished products. One American report in the 1990s put the profit rate for China at 17 cents for every U.S. dollar China exported. One 2003 study shows that China produces 75 per cent of the toys in the world, but only retains 1/70 of the total profit. *The New York Times* in 2006 reported that "the biggest beneficiary" of China's increased export is not China. "A Barbie doll (China exported to the United States) costs US\$20, but China only gets about 35 cents of that." "Because so many different hands in different places touch a particular product, you might as well throw away the trade figures (of China's export)."

This also in one way or another applies to China's trade with ASEAN, most of which is by foreign companies in China. They accounted for 60.6 per cent of China's trade with ASEAN in 2005. For the ASEAN side, the figure is even higher. Much of this percentage is from the intra-industrial trade within and between the foreign companies in China and Southeast Asia and entrepot trade. In this regard, double

counting can be serious as many products, especially electronic products, may cross borders twice or more, therefore grossly inflating the two-way trade figure. This double counting is estimated as high as 30 per cent of the total trade between China and ASEAN. In the China-Singapore trade, which makes up the lion's share of the China-ASEAN trade, entrepot trade accounts for 46 per cent of China's export to Singapore, 40 per cent of Singapore's export to China.

Chinese companies find it difficult to compete in ASEAN markets. First, they are mainly small and medium companies that lack huge resources to compete effectively with foreign companies that are already firmly established in ASEAN markets.

Secondly, they are not coordinated amongst themselves and not integrated well into the ASEAN market. Most of them operate alone without much cooperation in Southeast Asia. Most of them lack sufficient knowledge and research into the ASEAN market.

Thirdly, it is China's Yunnan Province and Guangxi Autonomous Region that show the strongest enthusiasm for pushing into the ASEAN market. These better-developed coastal provinces still focus on Western markets and see the ASEAN market only as an alternative when they cannot expand further into Western markets. Take 2001, for example, when trade with ASEAN countries comprised the largest portion of the total foreign trade of Guangxi and Yunnan (35.6 per cent), but only a combined US\$1.6 billion, which made up only 3.8 per cent of China's total trade with ASEAN (US\$41.6 billion). China's Guangdong Province traded US\$15.4 billion with ASEAN countries, which made up 37 per cent of China's total trade with ASEAN of that year. However, to Guangdong Province, China's top exporter, this was only 8.47 per cent its total foreign trade. Its trade focus was on the U.S., Japan and other Western markets. It is the same case for other developed Chinese provinces and cities, such as Shanghai, whose trade with ASEAN comprised only 8 per cent of its total foreign trade of the same year.

This shows that those competitive big Chinese companies still do not take ASEAN as its main market and essential trade partners. China also lacks in-depth research, close watch and rich information of developments in the ASEAN market,



with the exception of a few ASEAN countries. A successful and large-scale penetration by Chinese companies into Southeast Asia is difficult at the moment.

This point is also borne out with a closer look of the bilateral trade growth, which in absolute term appears very impressive, but not so if viewed as a proportion of the total trade. For example, from 2000-2005, China's trade with ASEAN grew at an annual rate of well over 30 per cent. However, China's total foreign trade also increased at an annual rate of over 30 per cent over the same period (a bit lower than its trade with ASEAN). In other words, this growth in China-ASEAN trade can well be said to be a normal, or perhaps a bit higher than normal, especially when one considers that this bilateral trade started from a low base and that foreign companies in China accounted, for example, for 60.6 per cent of China's trade with ASEAN in 2005. This trade comprises 8.3 per cent of China's total foreign trade in 2000, 8.2 per cent for 2001, 8.8 per cent for 2002, 9.1 per cent for 2003, and 10.5 per cent for 2004, but comes down to 9.14 per cent for 2005. So, there is growth, but not spectacular growth, especially if we consider China's total trade with Asian countries reached US\$664.9 billion in 2004 (Its trade with ASEAN was US\$109.9 billion in 2004). This increased by 34.2 per cent compared to the previous year and comprised 57.6 per cent of China's total foreign trade while trade with ASEAN comprised 10.5 per cent. The year 2005 witnessed a sharp reduction of the growth in China-ASEAN trade. It only grew by 23.1 per cent to US\$130.37 billion, in sharp comparison with its previous high growth rate (42.9 per cent for 2003 and 40 per cent for 2004). In the same year, China's trade with India grew by 38 per cent and its trade with Russia grew by 37.1 per cent.

If we view this from the ASEAN side, the same situation still exists. Take China's largest ASEAN trade partner, Singapore, for example. In 2005, it had recorded its highest trade with China at S\$67.1 billion, which dwarfed many other ASEAN countries (Total China-ASEAN trade in 2004 was US\$109.9 billion). Nevertheless this figure would not appear so overwhelming if we consider that Singapore's total foreign trade of the same year stood as high as S\$716 billion.

The author does not deny the fast growth of trade and its positive impact on China-ASEAN relations, of which the author is fully aware, but would like to alert

readers to the danger of accepting trade figures without proper perspective. There has also been exaggeration of the economic significance of the China-ASEAN FTA and excitement over it on the part of the Chinese side. This FTA is the first one for China, but not for some ASEAN countries, which have far more extensive economic ties with the U.S., Japan and EU than China. Their trade with Japan over the past years is normally twice as much as that with China.

### **ASEAN “Pulls” vs. China “Pushes”**

China’s diplomatic success with ASEAN is often by chance, notwithstanding its diplomatic skills. For example, this success has much to do with the U.S. obsession with terrorism and its relative negligence of the region. It also has a lot to do with the 1997 financial crisis and consequently ASEAN’s intention not to be taken for granted, and its initiatives to engage China in a constructive balance of power in the region. Very often, people only see Chinese “pushes” into the region without seeing ASEAN’s “pulls”. Without such “pulls”, China’s “pushes” will not go far and may backfire. Take the warming of China-Indonesia relations for example. They recently declared each other “strategic partners”. This may have a lot to do with the Indonesian government’s frustration with excessive U.S. pressure on it in the fight against terrorism and consequently its intention to use China to balance the U.S. pressure. Its overture to build defence ties with China and to buy Chinese weapons can be interpreted as leverage for the U.S. to lift its arms embargo on Indonesia.

For Myanmar and Cambodia, who have close relations with China, it is largely because, in the case of Myanmar, the U.S. chose not to engage with its government and not to trade with and invest in Myanmar. U.S. trade sanction and embargo against Myanmar still stands. In the case of Cambodia, China is the top investor and trade partner. The U.S., because of political considerations, did not, and still does not, trade massively with and invest in Cambodia. If the U.S. changes its policy and puts sufficient resources into wooing these two countries, the situation there can be different. We have not seen a single case in which the U.S. lost out to China over a Southeast Asian country when it chooses to go all out to win it over. If Washington is

willing to compromise somehow on its other concerns, such as human rights and democracy, and give massive economic support, its relations with Myanmar and Cambodia will improve and China may not be able to keep its primacy in these two countries. China's direct influence over the central government of Myanmar is rather limited, as shown in the case of the home arrest of former Myanmar Prime Minister Khin Nyunt. China had no information before his arrest and little influence over the government re-shaping afterwards. Its influence lies more in Myanmar's northern border areas than with the Central government, which has been trying to keep China at a respectful distance and balance it off with overtures to India and Thailand. Beijing often feels unsure of what Yangon has mind. Myanmar leaders often keep silent to conceal their differences with China and keep a distance from Beijing (while leaders of North Korea often choose to argue with Beijing over their differences). The visit by Myanmar Prime Minister Soe Win to China in February 2006 and its agreement to sell trillions of cubic feet of gas to China through future pipelines mark a boost in bilateral relations. But this has more to do with Yangon's severe sense of insecurity (such as its obsession with both regime stability and possible U.S. military attacks) than China's influence. In other words, this boost is built more on U.S. "pushes" than on China's "pulls".

As for Singapore, Beijing feels that it inclines more towards the U.S. than being neutral and may occasionally give Beijing some unpleasant surprises on the issue of Taiwan, U.S. military presence in Southeast Asia and East Asia integration. Thailand appears to have good relations with Beijing. But Beijing is aware that it also has good relations with other big powers including its alliance with the U.S. Beijing very often feels unsure of Bangkok's intentions under strong U.S. influence. On the issue of joint naval exercises between the two countries, Bangkok resisted and hesitated for a long time and only agreed, at the last moment, to have a very limited, low-profile and symbolic one in late 2005 with a PLA naval fleet that was passing (not special visit) Thailand on its way back from its joint naval exercises with Pakistan and India. China's relations with Vietnam have improved with many interactions taking place on all the levels. But with the territorial disputes in the South China Sea still unresolved and with historical baggage, Vietnam is deeply wary

of a rising China. It may cooperate with China on minor issues and areas, but always holds its own firmly on important issues, especially on its relations with the U.S., which has always been a concern to Beijing.

As for China's good relations with Malaysia, the two countries have similar views on many international and regional issues (e.g. East Asia integration). But this does not mean that Malaysia is under China's influence. The fact that the leaders of the two countries hold similar views does not mean they do so out of the same interests. Malaysia, out of its own interest, intends to engage more closely with China for economic benefits, higher international profile and a favourable regional balance of power vis-à-vis other powers. In other words, it is not China that calls the shots. A closer look shows that in many ASEAN countries, the drive for better relations with China is still narrowly based. For example, in Malaysia and Indonesia, this drive comes mainly from certain sectors of the business circle. In the Philippines, even the business circle, including many Filipino-Chinese small and medium businessmen, hold strong reservations over Chinese economic competition, let alone other more influential sectors of the society, such as military, church, intellectuals and police etc. This is in sharp contrast to the U.S. relationship with the Philippines (and with some other ASEAN countries) where relations are not only long-established but also rest on wide and substantive social bases with solid political, economic, military and social bonds. This relationship is not only built on the government level but also on extensive private sector and non-governmental levels, such as among their NGOs. On the contrary, China's relationship with many ASEAN countries remains mainly on the high governmental level (such as frequent visits by Chinese leaders) and has not yet gone down deep and substantively to the middle and lower levels of the societies.

### **“Leaders’ Diplomacy”**

This “leaders’ diplomacy” carries prominent media value and exposure, but lacks sufficient substance if this “media friendship” among the leaders does not deepen and broaden to the middle and lower levels of ASEAN societies.

On the ground, many economic, social, and even ethnic and religious problems will erupt, for which neither Beijing nor ASEAN states seem to be fully prepared. The Chinese companies penetrating ASEAN markets will face more of such troubles than American and Japanese companies. This is not only because the former is a newcomer and the latter have been firmly rooted locally for years with a lot of experience with local public relations, but also because Chinese exports generally compete against the local economy while American and Japanese exports are more complementary. Exports of China and ASEAN are very similar. A study of 2002 showed that China's export overlapped Indonesia by 83.5 per cent, Thailand by 76.1 per cent, Philippines by 57 per cent, Malaysia by 54.5 per cent, and Singapore by 44.2 per cent.

With this awareness, China is now making effort to avoid the areas where they compete with local companies and choose to invest and trade more in areas that are mutually complementary such as raw materials, energy resources and infrastructure. However, this is also a limit since Chinese companies have to, sooner or later, expand into other areas competitively, thus heightening the fear of the Chinese economic threat. Managing this competition without affecting state-to-state relations will be a difficult challenge to both sides.

Without a strong and harmonious economic basis, the relations between China and ASEAN will experience many humps on the road ahead. More Chinese companies in Southeast Asia will also bring more Chinese migrants, including more illegal ones. This, if not handled well, may cause alarm among local people and worsen ethnic tensions.

### **China's Lure**

China's attractiveness to ASEAN still lies heavily, however, in its booming market. For example, from December 2001 to September 2005, China's annual imports stood at an average US\$500 billion and created about 10 million employment opportunities for other countries and regions. From 2006, China's imports will increase hugely and is expected to reach US\$1 trillion by 2010. China-ASEAN trade can reach over

US\$200 billion by 2010. This huge import demand from the Chinese market provides a strong incentive for (at least some) ASEAN countries to have a fairly good relationship with China in order to secure a better niche in the booming Chinese market. Such a good political relationship may transform into immediate economic and trade benefits. For instance, China may be more willing to share benefits with countries it has good relations with than it is with other countries. ASEAN, for the past years, have benefited from huge trade surplus with China, which stood around nearly US\$20 billion. This is not purely market-driven, but also strongly politically motivated through policy setting: Beijing is willing to keep such a huge trade deficit in order to have good relations with ASEAN. For some ASEAN countries, that sounds strange but it is true. China does not mind its exports overlapping with the ASEAN countries that it has good political relations with. This is because this good political relationship can lead to favourable economic deals and trade arrangements where China can show more understanding of how their exports compete with the others and may therefore make compensation, either in the same areas where their exports compete with each other or in other areas where the ASEAN countries enjoy trade competitiveness. For example, in negotiating the China-ASEAN FTA, to persuade certain ASEAN countries that were unwilling to conclude the Framework Agreement and the Early Harvest Programme (despite the benefits it brings, some of its clauses may still subject certain ASEAN products, but not all, to Chinese competition), China expressed its willingness to sign separate bilateral agreements in other trade areas with those ASEAN countries to more than offset their potential losses that may occur from signing these documents.

### **Strategic and Political Basis**

The strategic basis for China to accelerate its push into Southeast Asia is even weaker than the economic basis. Though there is now less public talk of the “China threat”, the suspicion and distrust of China remains deep-rooted and may grow if the rising China rushes deeper into Southeast Asia. As both Chinese and international scholars point out, ASEAN countries are not jumping on the China bandwagon, but “hedging”

against it, while developing robust ties with other extra-regional powers to balance China.

The Chinese “pushes” have already alerted other major powers, especially Japan, into stronger response to offset Chinese advances in the region. Furthermore, these pushes, even though not through any evil design, may have already made ASEAN countries feel that their standing as the driving force may be compromised. With serious internal challenges, such as uneven economic and political developments among the member states (for example the growing “two tiers” of ASEAN) and the complexity of ASEAN integration (ASEAN Community), ASEAN needs “breathing space” to pull itself together to consolidate itself as the driver in regional affairs. China, if being pro-active with too many initiatives, may make ASEAN feel that it is more difficult to maintain the leadership. What is worse, these pro-active initiatives may make some ASEAN countries feel that the regional strategic balance could be tipped.

### **Trends**

Beijing has evidently read the message and readjusted its approach towards ASEAN. Beijing is expected to be more attentive, more cautious and subtle. It will shift its focus from East Asian integration to its bilateral relations with ASEAN, i.e., China-ASEAN FTA, and with individual ASEAN countries. It will continue to stress on economic relations and low profile but substantive diplomacy. It does not intend to “walk fast” but “walk stable”, emphasising on consolidating what it already has as the basis for further development. It will also seek to broaden the social basis in ASEAN countries for a stable bilateral relationship as shown in the recent visits by Chinese Premier Wen Jiabao to Cambodia and Chinese leader Jia Qinglin to Vietnam.

Historically, a sensible strategy for a big power is to build a long-term and solid moral and economic basis and wait to be invited in, like the U.S. was invited into West Europe following the end of the WWII , rather than to force its way through. The best diplomacy is to arouse enthusiasm among countries by dealing with them in a way that makes them feel important and appreciated and engaging them without making them feel manipulated, making them aware of the success of

their own initiatives and complement their interests, winning them over to your way of thinking without causing offence. China is on the learning curve now.



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