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ABSTRACT

Globalization is rapidly changing the overall structure of the international division of labor with the shift of services and manufacturing from the old industrialized economies to the new emerging giants - the global office platform in India and the global factory floor in China. This dislocation in production, services and manufacturing signifies a challenge which might be more important, but nevertheless part and parcel of the inherent imbalances in the world economy. Until recently there has been much academic and layman attention on over-production, growing inequalities, the increasing North-South gap, the roaring conflicts over energy and raw materials including oil and water, turbulence and crisis in the international financial system, and not least the fact that the present phase of capitalism has led to jobless growth in the established core economies in Europe and the United States. The question for the international political economy is where and how do countries like India and China fit in?¹

Keywords: Globalisation, Regionalism, Bilateralism, Diaspora, USA, China, Southeast Asia

Introduction

Globalization is rapidly changing the overall structure of the international division of labor with the shift of services and manufacturing from the old industrialized economies to the new emerging giants - the global office platform in India and the global factory floor in China. This dislocation in production, services and manufacturing signifies a challenge which might be more important, but nevertheless part and parcel of the inherent imbalances in the world economy. Until recently there has been much academic and layman attention on over-production, growing inequalities, the increasing North-South gap, the roaring conflicts over energy and raw materials including oil and water, turbulence and crisis in the international financial system, and not least the fact that the present phase of capitalism has led to jobless growth in the established core economies in Europe and the United States. The question for the international political economy is where and how do countries like India and China fit in?

One possible scenario is that we are entering a new phase of capitalism characterized by a changing production pattern with a shift of economic gravity to the East with corresponding consequences for labor markets, wage levels and living standards in the West; another scenario is related to the substance of the re-emergence of protectionism and a repeat of the all-out tariff battles that led to the Great Depression in the 1930s. In short, and very significantly, what are the responses of the old economies that are loosing out (Newsweek February 6, 2006)! The recent failed Chinese bid for a medium sized American oil company, UNOCAL, is a case in point and perhaps signal a movement towards the end of neo-liberal globalization.

In their seminal account "China Awakes" Kristof and Wudunn noted: 'Almost overnight China has changed' (1994: 9). Although their observations primarily focused on internal dynamics and social and political changes, this book revealed the contours of a new 'Asian miracle' based on the premises and earlier experiences of the developmental state as exemplified in the 'command capitalist' strategy in Japan, South Korea and Taiwan. The new literature on China has concentrated on the country's ability and success in attracting foreign investment and the accompanying high economic growth rates. China is rapidly ascending to the status of a new economic as well as political and military power both regionally and globally. The world's most populous nation of some 1.3 billion people is already the seventh largest economy in terms of GDP as well as the third-biggest trading nation after Germany and the US. China's booming economy attracted FDI worth more than \$60 billion in 2004, making it the world's biggest FDI recipient. China's sharply swelling exports also accumulated more than \$700 billion in foreign reserves, the second-largest amount in the world after Japan's nearly \$850 billion. In addition, total employment in China is estimated around 750 million, which is about one and a half times that of the whole of the OECD with enormous labor reserve in agriculture and the informal sector ready to migrate to the coastal areas if or rather when labor markets tighten.

Many of these issues are well covered in the academic literature, but what is really new is the fact that Chinese enterprises themselves are now investing worldwide and across a broad range of economic activities ranging from trading and banking, to manufacturing and natural resource exploitation. UNCTAD (2005) estimates that China's outward FDI amounted to almost 39 billion in 2004. The data from UNCTAD and that of other agencies indicate that China has become a global player with operations established in more than 160 countries. This has led many commentators to speculate about the impact of Chinese overseas involvement: "President Hu

Jintao spent more time in Latin America last year than President Bush. And China's vice president, Zeng Qinghong, spent more time in the region last month than his US counterpart, Vice President Dick Cheney, over the past four years”(Miami Herald February 2, 2005 cf Landau 2005).

While the Bush administration asked Congress to increase US indebtedness with an additional \$81 billion in order to keep forces in Afghanistan and Iraq, China offered more than \$50 billion in investment and credits to countries inside the traditional Monroe Doctrine's shield. That sum surpasses President Kennedy's well known \$20 billion package for the decade of the Alliance for Progress in the 1960s. In 1975, Chinese trade with the Latin America amounted to \$200 million; in 2004, it had reached over \$40 billion. China has become one of the foremost players in the era of globalization, which US leaders promoted without considering that China might avail itself of this opportunity to move into previously sacrosanct US spheres (Landau 2005). At the same time, China's very rapid capital accumulation has brought a spectacular rise in its share of world GDP, nearly tripling from 5 percent to 14 percent in a quarter of a century. China alone has made up for the collapsed output share of the ex-Soviet Union and Eastern Europe and much of the downward drift in the share of Europe and Japan (Glyn 2005: 8).

The evolution is similar in the arena of international political economy with China using 'soft power' remedies to nurture "alliances with many developing countries to solidify its position in the World Trade Organization, flex its muscles on the world stage and act as a counterbalance to US power" (Chicago Tribune December 20, 2004 cf Landau 2005). This is also the case in Sub-Saharan Africa, and the rest of Asia where governments and business welcome Chinese investment and cooperation as an alternative to American interests and Washington's overwhelming obsession with security and 'hard power' related issues.

It seems clear that the Chinese leadership attempts to increase its ability to attract and persuade the world community, regional groups and individual states. Whereas the present strategy of the Bush administration is an extension of its ability to coerce as a means of implementing US foreign

policy exclusively relying on military or economic might. Soft power arises from the attractiveness of a country's culture, political ideals, and policies. Hard power remains crucial in a world of states trying to guard their independence and of non-state groups willing to turn to violence. But according to Nye, the neo-conservatives who advise the president are making a major miscalculation: They focus too heavily on using America's military power to force other nations to do our will, and they pay too little heed to our soft power. It is soft power that will help prevent terrorists from recruiting supporters from among the moderate majority. And it is soft power that will help us deal with critical global issues that require multilateral cooperation among states. That is why it is so essential that America better understands and applies our soft power (Nye 2004a; 2004b; 2003).

Thanks to an overly narrow focus on terrorism and a tendency to place bilateral ties above multilateral relationships the United States is also losing its influence in Southeast Asia to China. China makes a point of dealing with Southeast Asia as a region with a very assertive ASEAN policy which also enhances its bilateral relationship with it.

US military policies following the September 11, 2001 terrorist attacks have played a significant role in its estrangement. However, the problem in fact goes back to the Asian financial crisis of 1997, when the Clinton administration used its influence on the IMF to impose US business-friendly solutions on the region.

China's decision not to revalue its currency helped stabilize the regional economic order. Shortly after that, China, Japan and South Korea began holding annual discussions with Southeast Asia under the ASEAN-plus-three formula. In 1999, after China's accession to the WTO, ASEAN governments began to worry about the impact of Sino-US trade relations. As a result, China proposed a free trade agreement (FTA) with Southeast Asia, the framework for which was signed in 2002.

Although there are different statistical contradictions it seems that China will soon become ASEAN's second-largest trading partner and bilateral trade could reach US\$200 billion by 2010. Road and dam building, consolidation of control over the South China Sea, trade and investment combined with overseas development aid and military assistance might eventually result in China's domination of Southeast Asia regardless of Chinese intentions.

The question is whether what we are seeing in the region is a Chinese replay of the Japanese Flying Geese scheme with the moving of production platforms and FDIs to the catching-up formation in a pattern similar to that of Japan and later East Asian NICs in the past decades. As a by-product of such a course, China will sooner or later replace the United States as the region's most important strategic partner.

The aim of this paper cannot do justice to all the issues raised above. Although the global contradictions and problems provide the overall context the purpose is devoted to provide insight into and investigate how these emerging tendencies in the region are spelled out in the triangular relationship between China and the United States in Southeast Asia (with India mentioned in passim only).

The approach of the paper relies on a critical comparative international political economy perspective (Evans & Stephens 1988a and 1988b; Cox 1990; Strange 1994 & 1996) which seeks to explain the interrelated variables, inconsistencies and disruptive effects of China's dramatic rise and insertion into the global political economy, and the concomitant increase of foreign debt in the United States and its obsession with terrorism, respectively. The focus then is broadened into one that not only takes the state alone into consideration but also realizes that: "Through conscious political decision, elements of the Chinese leadership have

chosen to integrate China – or at least, parts of China – into the global political economy. In the process, they have allowed Chinese sovereignty, in the economic sphere at least, to become ‘perforated’, and increased the number of actors in the policy sphere” (Breslin 2002: 34). However, any analysis of China’s present overseas economic expansion and foreign policy interests must focus on Chinese realpolitik and the underlying forces which shape these interests. Especially the fact, that the state and local government authorities play a significant role makes it imperative to focus on these factors which are unique to China. Therefore, this paper includes a security perspective on whether China’s reliance on soft power is only a temporary phase on its way to regional cum global hegemony (Nye 2006)! The critical comparative international political economy perspective is based on an eclectic approach East and Southeast Asian international relations, employing realism, liberalism and constructivism to analytically differentiate between the different dimensions of the system’s modus vivendi (Katzenstein and Okawara 2001/02: 167-185).

Based on this recognition the paper analyses the new geo-political and geo-economic strategic relationship between China and Southeast Asia. Is Chinese encroachment into Southeast Asia creating greater stability, does it jeopardize US interests and what is the impact on the regime-types, economic restructuring, and the state-civil society relationship?

The paper is divided into four parts. The first part explores the historical and especially the contemporary changes in China’s geo-economic bilateral relationship with Southeast Asia through its bilateral trade, the role of FDI, the role of the ethnic Chinese Diaspora, and other economic factors. The second focuses on China’s role in the new emerging geo-political relations on a multilateral scale through new regional security, military and politico-economic institutions. The third part contains a brief exposure of shifting US bilateral and multilateral interests in the region -

both geo-economic and geo-political; however the bulk of this section is devoted to a comparison of the differences and similarities of US and Chinese approaches in Southeast Asia. Finally some concluding remarks are offered.

From Fifth Column to Investor

China's strategic interest in Southeast Asia goes back centuries exerting suzerainty of the region. In more modern times such as during the Cold war the CCP supported insurgencies and communist governments across the region. After the US defeat in Indochina Beijing became perceived as a direct threat in Vietnam in 1979, when Chinese troops crossed the Sino-Vietnamese border to 'teach Vietnam a lesson' over its invasion and occupation of neighboring Cambodia.

During the wave of national liberation struggles in Southeast Asia, the pro-American ruling classes facing strong local communist parties, such as in Indonesia, revolutionary movements as in Thailand, Malaysia, Philippines and Burma, were receptive to the US policy which portrayed the communist regime in China as the source of the menace to these societies. Today, mutual perception and trust in Sino-ASEAN relations has become important for both sides (Twining 2005). This relationship has strengthened furthermore as a consequence "of the post-Mao leadership's acknowledgement of the ideological and political reliability of Singaporean-style authoritarianism as a worthwhile formula for its own reform process" (Hersh 1998:32).

Thus, the former hostilities have been turned into claims by Beijing that its growing influence in Asia threatens no one and is to the mutual benefit of all. "If China does not provide economic opportunities for the region, it will lose the opportunity for a peaceful rise," Zheng Bijan, dean of

the influential CCP School, told foreign businesspeople attending a forum in China in April 2005. "This is by no means a bid for hegemony" (cf Brookings 2005).

Some US based observers see China's bilateral engagement with Asia as more political than economic. In a testimony to Congress, Assistant Secretary of State James Kelly claimed that the bilateral agreements mean little in economic terms, "but they serve notice of how China is using its newly won economic power to expand its presence and political influence among its southern neighbors" (Economy 2005). Such statements are intriguing as they confirm a change in US policy towards China from a friendly competitor to a strategic rival.

China's renewed interest in bilateral engagement with Southeast Asia comes in several spates which will be touched upon in the following. First and foremost is the increase in development aid and trade volumes; second is the increase of FDI both inward and outward; third is related to China's need for oil, gas and other energy sources; and finally security, defence and diplomacy related matters which cannot be separated from the above. This strategy is embedded in a regional and multilateral umbrella which will be discussed in the second and third sections of the paper.

China's relation with ASEAN is affected by the way the state controls its insertion into the global division of labor and manages its growth and overseas expansion under a dual-trading regime of export promotion and import substitution (Low 2003: 72). Again this is a repetition of the so-called Japanese model which relied on a neo-mercantilist strategy of conquering markets for exports and at the same protecting infant industries and nurturing sunshine manufacturing into global players. One analysis of the impact of Chinese exports on its Asian competitors shows that countries producing consumer goods based on low wages are increasingly suffering

negative consequences as China's share of world trade grows. Not Thailand, nor Cambodia or Laos are able to compete with base wages as reported from Guangdong at about \$80 per month and working hours up to 80 per week. The harsh discipline imposed on the Chinese working class and the fact that no independent unions exist translating in appalling working conditions makes it almost impossible for others to compete (Glyn 2005: 12-13).

China's rapid strides in expanding its trade relations with Southeast Asia have been paralleled by the growth of its role as a source of regional investment. As it secures the resources necessary to fuel its growth, Chinese State-owned enterprises (SOEs) are investing heavily in mining, natural gas, and logging opportunities throughout the region. China has committed US\$100 million in aid and investment to Myanmar and is actively extracting Indonesian natural gas, investing in infrastructure development in the Philippines, establishing rail and highway links with Cambodia, Thailand and Singapore, and promising to dredge part of the Mekong River in Laos and Burma to make it suitable for commercial navigation (Economy: 2005: 6). Also private Chinese companies are rapidly joining the SOEs in their search for new investment opportunities.

China tries to reassure its neighbors by claiming that its growing regional importance is a win-win situation for all. Nonetheless, some countries are seeing the benefits moving largely one way. In Myanmar and Cambodia, newly signed deals with China are generating fears of economic dependence and political domination. A trade agreement with Thailand has benefited China's exporters. The first cries of complaint are being heard. 'China has found it relatively easy in recent years to build closer ties to its neighbors with rhetoric about nurturing an East Asian economic community', says David Shambaugh, an American China specialist. "But striking specific

deals in specific areas to China's benefit," he contends, "will drive a wedge into the diplomatic progress China has made"(cf Vatikiotis 2004A: A 12).

ASEAN-China trade totalled US\$ 39.5 billion and US\$ 41.6 billion respectively in 2000 and 2001. ASEAN's share in China's foreign merchandise trade has been continuously on the rise, increasing from 5.8 percent in 1994 to 8.3 percent in 2000. China is now the sixth biggest trading partner of ASEAN (Tongzon 2005: 191). The two-way trade between China and ASEAN has been growing at a much faster pace than that between Japan and ASEAN in recent years. China-ASEAN trade topped \$100 billion in 2004, and soared 25% in the first half of 2005 from a year earlier to nearly \$60 billion amid ongoing reductions in tariffs in comparison trade conducted between Japan and ASEAN amounted to about \$74 billion during the same period. ASEAN is now China's fourth-largest trading partner behind the 25-nation European Union, the US and Japan. China has already superseded the US as the biggest trading partner of Japan and South Korea. For ASEAN, the US and Japan are still the two biggest trading partners. But many experts say that it is just a matter of time before China will replace both as ASEAN's biggest trading partner (Masaki 2005).

China's export structure is similar in many respects to that of the ASEAN countries. More intense competition is, therefore, to be expected in third-country markets and ASEAN domestic markets with the establishment of a FTA. China has the lowest unit labor cost and thus a comparative wage advantage in relation to the original ASEAN-6. Even with regard to productivity increase China's output per worker grows faster than that achieved in the Philippines, Malaysia and Indonesia (Tongzon 2005: 208).

The PRC is also an export rival to its regional neighbors in a range of goods, ranging from labor-intensive products to those of greater

technological complexity. It is also a competitor in terms of its capacity to attract FDI which can only increase at the expense of others. Also in competitive export capacity the PRC is a threat to Thailand and other Southeast Asian economies' market shares in the EU, US and Japan (Holst and Weiss 2005).

As an economic, political and cultural power house, China has been adept at overtaking the US in what American political scientist Joseph Nye has dubbed the soft power approach in influencing foreign societies' public opinions, and achieve sympathy. Taking this into consideration it is not surprising that China has a desire for bilateral deals with trade the only item on the agenda. As China's economy grows, it needs more resources and becomes more nervous about supply lines. The danger is that when China does a deal such as the bilateral trade pact signed in 2003 with Thailand, China becomes an unequal partner. "Thai officials say they knew Thailand might initially come out on the short end of a straight deal on produce with China, but they were optimistic about the longer-term trade benefits. So far, though, they have seen little progress. Thailand wants China to consider an open- skies agreement to increase air-cargo traffic, and also seeks to streamline customs procedures. Beijing has agreed only to study the proposals" (Vatikiotis 2004A: A 12). Whether this has implications for the Thai population's view of China is difficult to discern but according to one poll in 2003, 76% of Thais said that China was Thailand's closest friend as opposed to 9% who named the United States (Vaughn 2005: 20).

In a trade related issue Thailand has asked for support from Beijing, which has promised to train more Thai Chinese language teachers, send native speakers to work in Thai schools, and provide free teaching materials. China is already supporting language training in dozens of countries and reportedly has set a target of raising the number of foreigners studying Mandarin around the world to 100 million by 2010. Currently, more than 30

million people worldwide are studying Mandarin, according to the Chinese news service Xinhua. Since 2004, China's Education Ministry has opened cultural language centers called Confucius Institutes in over 20 countries, including South Korea, Australia, Singapore, Sweden, and Kenya. In 2004, 110,844 foreigners from 178 countries were studying Mandarin in China, says Xinhua, up 43 percent on 2003. In Southeast Asia, private language schools in Malaysia and Indonesia report rising enrolment in Chinese classes, according to Knight Ridder (Montlake 2006). This will also have important spill-over effects on future trade.

In smaller countries like Myanmar, Laos and Cambodia, the economic imbalances in the two-way trade are even more apparent. Chinese exports to Myanmar in 2003 were valued to be as high as \$900 million, compared with \$170 million in exports from Myanmar into China. Laos absorbed Chinese goods valued at almost \$90 million in 2003, more than double the 2002 figure. Laotian exports to China meanwhile, amounted to \$8 million, a 15% increase (Vatikiotis 2004A: A 12). These figures imply that there is a clear strategic link between FDI, ODA and military support which again makes for a comparison with Japan's historical experience in the region.

In Cambodia, closer ties to Beijing are spawning economic, political and even military agreements that, some officials fear, ties their country too closely to China. In November 2003, China and Cambodia signed a military agreement under which Beijing provides funds for military training as well as equipment. Cambodia also has accepted aid to help build a railway linking China's Yunnan province to the Cambodian seashore, a strategic priority for Beijing. China has lent Cambodia more than \$45 million during the past two years, mostly on interest-free terms. For some Cambodians, China has gained a strategic foothold in the country at the expense of Cambodian

autonomy and is geo-politically using Cambodia as a buffer against its old foe, Vietnam.

The situation in Myanmar has clear similarities with Cambodia. China has supplied more than US\$1.6 billion in arms to the country and continues to train a significant number of its military. Senior General Tan Shwe, the current head of state and chairman of the military State Peace and Development council that controls the country, made an official visit to China together with General Khin Nyunt, who is in charge of intelligence and international affairs (Beng 2003). In March 2004, Chinese Vice Premier Wu Yi was in Yangon to sign 24 pacts on economic and technical cooperation. The Chinese also gave Myanmar \$200 million in low-interest loans. Myanmar's ties with China have become so close that some regional diplomats suspect that Beijing now has a big say in domestic politics. Diplomatic sources say that a common complaint is that China is also dumping cheap goods and demanding special privileges for Chinese companies (Vatikiotis 2004B: A 12). China has strengthened political and military as well as economic relations with Myanmar in defiance of US and European sanctions against the military-ruled country. China wants to secure stable oil and other energy supplies by land, as well as by sea.. Speculation is rife about the idea of building an oil pipeline running across Myanmar to Kunming at an estimated cost of \$2 billion (Masaki 2005). The evidence shows that Beijing has a strategic interest and motive behind its dealings with the military leaders as such "China has supplied about US\$ two billion for armaments that have made the Burmese military, the second largest in Southeast Asia after Vietnam, much more technically sophisticated. It has helped the construction of roads, railroads, airfields, ports, and dams throughout the country. In 2003, China provided Burma with US\$200 million in economic assistance. Equally important are unrecorded Chinese influences: Chinese investment – *probably the largest*

of any foreign country – is not found in international statistics” [Frost 2004: 334.italics added by S. Frost]

China has also funded the "North-South Corridor" project to build a highway linking Kunming and Bangkok via Laos. The highway is scheduled to be completely opened to traffic in 2007. Japan balked at funding the project, partly for fear of lending China a hand in increasing its influence southward on the Indochina peninsula. China also set up a special fund totalling \$20 million within the ADB for poverty alleviation of the region in 2004 (Masaki 2005). Some observers argue that, dynamic economic growth will propel overseas investment in the ASEAN countries, rather than divert FDI from the region. “China’s rapid growth will result in a shift in comparative advantage between the region and China....In the near future, China could well constitute the fourth wave of FDI for Southeast Asia...” (Wong and Chan 2003: 278-279). China will also become an important player in regional currency schemes (Economy: 2005: 12).

In a specific case, which illustrates these points, Chinese firms are reportedly aggressively grabbing local market shares for manufactured items like motorcycles and other consumer products. A Chinese semi-state-owned enterprise TCL invested \$ 10 million in Vietnam to manufacture colour TVs, and within three years edged out foreign rivals - Sony and Samsung - to grab a 15 percent share of the Vietnamese market (Wong and Chan 2003: 297).

Whether this will materialize or not remains to be seen, but currently the region hosts a relatively big share of Chinese outward investment in non-trading activities. Although there is substantial disagreement about the real figures, due to unreliable statistics, China is now either the third or fourth biggest investor and rapidly climbing to become number one (Frost 2004). Among the ASEAN countries, Thailand attracted the largest number of

Chinese projects and garners the greatest share of investment (Wong and Chan 2003: 286). This rapidly growing flow of outward direct investment from China is primarily state-owned capital but private Chinese companies have also started to see benefits of investing abroad.

With a Chinese domestic market of 1.3 billion people and plenty of low-cost labor, it might be surprising to find companies looking at investing offshore. Yet, as China grows and competition intensifies, some companies are searching for new markets and try to develop global brands. They may also aim to escape regulatory barriers and overcapacity at home and, in the most developed areas, higher land and labour costs. Besides with protectionism growing in the US and EU against Chinese exports, a foreign presence can be a clear advantage. Sluggish domestic demand and declining profit margins have in some cases forced manufacturers such as the consumer-goods giant Haier, and the electronics heavyweights Changhong and Konka to establish production bases outside China (Vatiokakis 2004).

Beijing openly shows its desire to promote Chinese overseas investment. Premier Wen Jiabao told a business audience at an ASEAN summit in Bali in October 2003: "The Chinese government will encourage more of its companies to make investment and establish their businesses in Asian countries" (Vatiokakis 2004). More than 100 Chinese business executives attended an investment forum held in conjunction with the Bali summit and another 40 companies went to an Asia Pacific Economic Forum investment conference in Bangkok the same month. As a consequence, Chinese investments in ASEAN have been surging sharply.

According to the Ministry of Commerce mainland Chinese companies invested \$2.7 billion abroad in 2002. By the end of 2002, the Export-Import Bank of China provided a cumulative total of nearly 300

billion renminbi (\$36 billion) in concessionary loans and guarantees for companies operating overseas, according to official figures. Among the top 12 Chinese TNCs, mainly SOEs, now control over US\$ 30 billion in foreign assets with over 20,000 employees and US\$ 33 billion in foreign sales (UNCTAD 2002: 61).

Despite Premier Wen Jiabao's encouragement, and China's accession to the WTO in late 2002, outward investment still requires official approval. Projects that exceed \$30 million must go to the State Council, China's cabinet. From Beijing's point of view, lifting all barriers to overseas investment could risk a stampede with capital-rich Chinese companies bidding against each other for foreign assets, something that has already happened in the oil industry (Vatikiotis 2004A).

In order to keep the value of the renminbi at a low competitive level, the government has given more leeway to Chinese companies to invest overseas. The State Administration of Foreign Exchange rose to 10 the number of domestic regions from which companies may invest outside China. Compared to the \$120 billion of foreign-exchange inflows accumulated by the People's Bank of China in 2003, however, the sums flowing out in the form of approved capital investments are modest. According to state media, the ceiling on outward investments for each approved region is just \$200 million. But even with such restrictions, Chinese companies are still looking abroad and their ventures are growing bolder (Vatikiotis 2004A).

Before the bulk of China's overseas investments went primarily to resource-based extraction like in oil and gas in Australia, Indonesia and Thailand. But now Chinese manufacturers are scouting the region for production platforms to penetrate new markets. Competition in some areas can be fierce and there are competitive reasons for companies to start

looking outside the domestic market. Chinese companies now supply Indonesia with electric-power plants and mobile-phone networks, and there are plans to build a 17-hectare China business centre in Jakarta. Chinese investors come to Thailand "to use the country as a gateway to the ASEAN market," says BOI Secretary-General Somphong Wanapha (Vatikiotis 2004A).

FDI flows also create other problems. While the growth of China hypothetically can be a boon to the rest of the world in the long run, it can also be a cause for concern to Southeast Asia in the short and middle terms. But the amount of global FDI is limited and even declining. Total global FDI reached \$1.1 trillion in 2000, but declined to \$800 billion in 2001 due to a slowdown in the US. About 70 percent of total FDI was bound to concentrate in the US, Japan and the EU where the profits were steadier and higher. Therefore, the developing world was left to battle for the remaining 30 percent of the FDI. When one considers the fact that China is now expected to capture 6.5 percent of the total FDI for the next five years, the fight for the leftovers is even more severe. "That is to say, 10 Southeast Asian countries have to compete for the remaining 23.5 percent of the FDI left by China - an average of little more than 2 percent for each country" (Beng 2002).

These features partly explain why FDI into Southeast Asia have been declining dramatically. In this context, it is easy to understand why ASEAN is now trying to develop a close relationship to China. In 2000, Southeast Asia received just \$10 billion of foreign capital, a 37 percent decline from the \$16 billion in 1999. The FDI figure was \$27 billion in 1996 and \$19 billion in 1998 (Beng 2002). It does not appear that this decrease is going to change in the near future. In a five year projection by the Economist Intelligence Unit, the biggest recipients of FDI for the years 2001-05 were forecast to be the US, the UK and Germany receiving a total of \$236.2

billion, \$82.5 billion and \$68.9 billion respectively. Next on the list to get a significant share of global FDIs were: China, France, the Netherlands, Belgium, Canada, Hong Kong and Brazil. Thus, of the 10 economies, only two were in Asia. Furthermore, given Hong Kong's role as the de facto entrepot of FDI flows into China, the possibility of a statistical double count is high. Hence, China is in effect the lone beneficiary of the global investment flows while Southeast Asia both on individual country by country basis and as a region has been excluded as a major recipient of global FDI flows (Beng 2002).

This situation means that the region found itself in a catch 22 situation in competing for a share of FDI. Globalization has now turned the world into a beauty contest where the most attractive country or region will stand to gain the most from the flows of funds (Beng 2002). In other words, the region has entered the race-to-the-bottom which implies a decrease in regulation levels of labor relations, as well as an irreversible process that seek to exert a downward pressure on welfare and social benefits that are presumed to 'inhibit' the incentive to work. The term 'race to the bottom' reflects the notion that global economic competition encourages deregulation. This causes the state to lose or weaken its redistribution role and its capacity to offer services to citizens, as taxation revenues would decline in order to cater to investors. In short, the governments with the lowest standards and income taxes would emerge as the winners; since they would be the ones attracting companies to set up operations in their territory (Schmidt 2006B).

Indeed, the political establishments of Southeast Asia have to satisfy the expectations of international investors in as many areas as possible. Most notably, they have to strengthen the region's business environment entrenching transparency, accountability and fair competition. Moreover, there has to be a concerted effort to address the issue of political violence

and terrorism too. Barring such efforts, FDI will continue to make its way into neighboring and other regions to the detriment of Southeast Asia. Capital goes to places where profits can be guaranteed. Right now, unless ASEAN makes Southeast Asia better and safer than China, the flows of future FDI will continue to go north.

It is interesting in passim to note with Callahan that “it is common to assume that Western multinational corporations (MNCs) are the main investors in China. But diasporic Chinese (including Taiwan and Hong Kong) account for around 80 percent of foreign direct investment in the PRC” and “Thailand’s CP Group is the largest foreign investor in China” (Callahan 2003: 491/500). This is important because although the bulk of outward investment from China remains state-driven it is indeed plausible that some capital is recycled back through formal and informal diasporic networks.

Moving now to the pertinent issue of energy it has become clear that since 1993 China has become a net importer of crude oil and since then sharply increased oil. It is now the world's second-largest oil consumer, after the US. PRC already depends on imports for as much as 40% of its oil needs, nearly half of which comes from the Middle East. About 80% of Chinese oil import is shipped through the Malacca Strait, a waterway notorious for rampant piracies. There are also growing concerns after September 11 that tankers and other ships sailing through that waterway might be become a target for terrorism (Masaki 2005). Chinese investments in Indonesian oil, gas and power plants will certainly increase further under the Susilo Bambang Yudhyono administration. Jakarta needs FDIs urgently and Beijing is promising to deliver. Sino-Indonesian ties have undeniably improved since the 1990 normalisation of relations. Resource and oil rich Indonesia is the most important state in the region for energy-deficient China (Low 2003: 73). The recent signing of the Strategic Partnership

Agreement between the two countries in Jakarta on April 24, 2005 is certainly a historical milestone in Sino-Indonesian relations

Former President Megawati focused on closer economic relations with China. A Memorandum of Understanding was signed in 2002 that established an Indonesia-China Energy Forum. This was followed by PetroChina's moves to secure oil fields in Indonesia. China's National Offshore Oil Corporation has also invested in Indonesia's energy sector. In 2002, Indonesia won a contract to supply liquid natural gas to China's Fujian Province. From 1992 to 2002 bilateral trade between Indonesia and China increased from \$2 billion to \$ 8 billion while Chinese investment in Indonesia has grown from \$282 million in 1999 to \$6.8 billion in 2003. Despite growing economic ties, some analysts see Indonesia's desire to play a leading role within Southeast Asia as potentially creating a geo-political rivalry with China (Vaughn 2005: 27) There is also the potential that the developing economic relationship between Indonesia and China may not deliver the benefits to Indonesia that some have come to expect. In fact, "most analysts agree that China's changing export profile represents a serious threat to the future export competitiveness of most Southeast Asian countries. According to Chia Siow Yue, senior research fellow at the Singapore Institute of International Affairs, the export overlap between China and Indonesia is 83 percent and the overlap between China and Singapore is 38 percent" (Hart-Landsberg and Burkett: 88).

China's increasing dependency on oil and gas providers that are not based in unstable Middle East are crucial for the Chinese economy. This was demonstrated by the recent signing of a MOU between China and Iran for the purchase of 10 million tons of liquefied natural gas per year over the next 25 years. Conversely, the rapid rise in oil consumption by Asia, which is projected to grow by 80% from 2001 to 2025, could lead to increasing competition. Energy is a key resource for economic growth which in turn

has been a key source of political legitimacy for the CCP and government (Vaughn 2005: 30).

Beijing seems intent in pursuing a more active diplomacy around its southern periphery in Southeast Asia, including using “renminbi diplomacy” and defence co-operation. China’s US\$400 million loan to the Philippines announced during President Gloria Macapagal Arroyo’s Beijing visit in September 2004 and confirmed during Hu’s later visit to the Philippines for a rail link between Manila and the former US airbase Clark was a carrot for Manila to conclude a defence co-operation agreement with China, although the Philippines remains an important ally of the United States. Manila has since signed an agreement to co-operate in joint oil and gas exploration in the disputed Spratley Islands in the South China Sea. Indeed, in March 2005, the three countries took a step toward peacefully resolving the conflict when state-owned oil companies from China, Vietnam, and the Philippines signed a three-year deal to jointly search for oil and gas in the disputed area (Economy: 2005: 8).

During the bilateral quarrel between China and Singapore in 2004, there were rumours that the People’s Liberation Army (PLA) had offered to sell Chinese missiles to Malaysia, so as to calm the Malay majority’s suspicions of China. Defence co-operation between Jakarta and Beijing has been touted recently too. Beijing has also managed to convince Vietnam to delay its “tourist excursions” to the disputed Spratley Islands, after discreet intervention by the CPC with its Vietnamese counterpart “via the back door”. Vietnam has also signed a similar joint development agreement with China for the Spratleys. In concrete terms, China has established a listening post in Burma; and in 2002, China signed its first ever border agreement with Vietnam. The two countries also conducted a joint campaign to clear all the landmines along their border, resulting in an increase of border trade to \$4 billion yuan (Economy: 2005: 7).

Between 1999 and 2000, China has succeeded in signing bilateral political agreements with all ASEAN countries that are aimed at boosting bilateral long-term cooperation in the new century. Moreover, Chinese leaders have made full use of their attendance at almost all multilateral forums to conduct bilateral meetings with their ASEAN counterparts. For China, the relationship between multilateralism and bilateralism, thus, is a reciprocal one (Cheng-Chwee 2005). In all cases, Beijing has shown real panache and sophistication in dealing diplomatically with individual ASEAN countries, while promoting the much-touted ASEAN-China FTA (to be in effect by 2010). It has even managed to implement a foreign policy relying on 'divided to rule' within ASEAN, as illustrated by the recent Sino-Singaporean spat in which Beijing openly favoured and courted Singapore's ASEAN partners, who seemed just as keen to be courted by the Chinese panda (Teo 2005).

Rivals in Regionalism - The New East Asian Community

Few major international relationships have changed so rapidly as the Chinese-ASEAN rapprochement. Today, all countries of the region embrace and acknowledge publicly the "one-China" policy. This is to high degree a consequence of "better Sino-ASEAN economic ties also mean that Taipei will be left with little room to carry out economic diplomacy with Southeast Asia" (Cheng-Chwee 2005:113). China has shown a definite readiness to use its growing soft power notably economic leverage and national image and the benefits that accrue from non-material, ideational and cultural influences - as a persuasive means to translate its influence into concrete policy interests.

This also implies that ASEAN has witnessed a major conceptual change of its Northern neighbor, from what was termed a "China threat" to one of a "benign" China with opportunities. Three factors encouraged this

evolution: 1) China's pragmatic policy of political stabilisation denotes a radical political shift in terms of appeasement; 2) the real catalyst was an outcome of the financial crisis with the Chinese leadership's decision not to devalue the renminbi and the later bonus of surplus trade, accorded to ASEAN countries by Beijing; and 3) The shift - or reduced threat-perception is also due to Beijing's new, active foreign policy and sophisticated diplomacy, based on the smooth internal transitions from Deng Xiaoping to the Jiang Zemin-Zhu Rongji team, and then to the present Hu Jintao-Wen Jiabao team. Four areas of Beijing's present foreign policy sophistication would include a less pompous, but more pragmatic foreign policy; a growing economic diplomacy; its thrust towards international integration and finally, a struggle for multi-polarity in the world (Teo 2005).

Official relations between China and ASEAN began in July 1991 when Beijing started attending the ASEAN Post-Ministerial Conference. In November 2002, at the eighth ASEAN Summit in Phnom Penh, China signed various cooperation and partnership agreements with ASEAN, including one on Comprehensive Economic Cooperation, one on the South China Sea, and another on Non-Traditional Security Issues (Beng 2003). Since July 1994, China has also become a full dialogue partner of ASEAN and a member of the ASEAN Regional Forum (ARF).

All these diplomatic partnership agreements help to assure the ASEAN-countries of a more benign China in its outlook and national strategy, and have reduced the previous perception of a China threat. China is increasingly being recognized not only as a benign power, but also as a responsible actor on the world stage. The key to this policy change has been Beijing's move towards pragmatism, which can be observed in both China's domestic policies and external relations.

Southeast Asia appreciates the normalisation of China's new approach. This is encompassed in a greater sophistication of its foreign policy, and Beijing has deliberately redesigned its overall strategic engagement with the region. It does not only imply a shift from support for communist insurgencies but also an active policy of strategic friendship with ASEAN countries. Ideology has been abandoned both domestically and externally, as the vehicle of relations with its neighbors, and this has greatly assuaged the fears and concerns of Southeast Asian countries.

ASEAN governments and elites are probably impressed by the Chinese leaders' high pragmatism in governance, as Beijing attempts to create stability and equilibrium for its own economic and political development. The typical slogan of 'stability, development, reform' is creating a sense of assurance with Southeast Asian leaders, as well as Beijing's stress on the symbiotic relationship between internal and external stability.

Beijing's new security concept can also be interpreted as aiming at undermining US influence in Southeast Asia and loosen its alliances with Thailand and the Philippines. For example, in a speech in Bangkok in September 1999, Chinese President Jiang Zemin warned ASEAN states against 'hegemonism and power politics' and 'gunboat diplomacy,' code words for the United States. China is not adverse to playing power politics itself. Chinese inroads in Burma, Laos, and Cambodia, through economic aid and military assistance, have become a cause of geo-strategic concern in Vietnam and India, which viewed China's presence in these countries as creating levers of influence (2004 Thayer: 181).

Related to the soft power engagement in the region, China has taken a more active role in the Asian Development Bank and was the prime mover in the establishment of the Boao Forum, the Asian version of Davos.

All of these initiatives can be grouped under the rubric of China's - new soft power security concept, "which emphasizes cooperative (win-win) security, confidence building, and multilateral engagement. The popularity China has garnered from these activities is no doubt also enhanced by the economic opportunities it presents to regional states. Over the past five years, Chinese trade has grown by an annual average of 27 percent. In the past two years, Japan and South Korea have reached symbolic crossover points: for each, trade with China now exceeds trade with the United States. China's trade with ASEAN is on course to do the same over the next year or two. Yet, without China's active engagement of multilateral institutions, its growing bulk might provoke more fear than admiration, much as it did during the early and mid-1990s. Beijing's multilateral engagement has enabled it to improve its material position and its image simultaneously. The fact that this engagement furthers Chinese interests does not make it any less welcome in the region' (Heginbotham and Twomey 2005: 246).

The smooth transition from Jiang-Zhu to Hu-Wen - despite the western critique of China's lack of human rights and democracy is considered as another plus by the ASEAN elites. The common impression in the region is that the new generation of Chinese leaders is taking a more business like and pragmatic approach to foreign affairs.

Chinese assertive regional policies in the beginning of the 1990s towards Taiwan and the South China Sea caused serious anxiety. In 1996, the Chinese leadership engaged a new security concept as an attempt to develop mutual trust and ties of common interest to promote genuine security and create regional calm. In the aftermath of the Asian financial crisis Beijing offered economic assistance to the worst hit economies and avoided a devaluation of its currency. In fact, the financial crisis contributed to a major foreign policy change towards a more active Chinese

engagement with Asian multilateral security and regional organizations (Foot 2006: 85).

Moreover the crisis changed the regional perception of the US and EU's intentions. "In this context, the Chinese prime minister Zhu Rongji declared in November 2000 that China stood 'ready to work with other East Asian countries for the reform of the current international financial architecture', and was 'open to all ideas' about financial cooperation in the region" (Sohn 2005: 495).

China not only refrained from devaluing the renminbi but also provided a US\$1 billion loan bailout of Thailand. Despite objections by the IMF and Washington, in June, 2003, "China and 10 other Asia-Pacific countries, including five ASEAN members, agreed to establish an Asian Bond Fund worth more than \$1 billion to help bail out economies in crisis" (Economy: 2005: 6). Soon after in December 2004 China implemented a second bond fund for another \$2 billion to be invested in Asian currency-denominated government bonds. Indeed it is possible to argue that "The region – policy elite and wider community alike – perceived IMF policy throughout the late 1990s as humiliating and wrong. In the summer of 1997 the IMF (and the US government) impeded the Japanese initiative to create an Asian liquidity fund. The Asian Monetary Fund (AMF as it would have been called) was explicitly to apply softer conditions than those of the IMF. The AMF's concept corresponded more to that of a 'lender of last resort' than the IMF. Essentially, the AMF idea was about providing unconditional loans to overcome liquidity crises" (Dieter & Higgott 2003: 442).

These initiatives on financial matters were taken in parallel with several moves on the diplomatic front towards ASEAN. In November 2002 China signed two documents: a framework trade agreement designed to establish an ASEAN-China FTA by 2010; and also with ASEAN members, a

Declaration on the Conduct of Parties in the South China Sea, renouncing violent means of dealing with disputed sovereignty claims in these waters. In October 2003 it became the first major Asian state outside ASEAN to sign up to the association's Treaty of Amity and Cooperation, the provisions of which likewise rule out the use of force for settling issues in dispute (Foot 2006: 85-86).

Correspondingly, Mely Caballerro-Anthony of the Institute of Defence and Analysis in Singapore said: "China has expressed ... to work towards signing the Southeast Asia Nuclear Weapons-free Zone." The agreement underscores the willingness of China to refrain from the use of force as an instrument of policy (Beng 2003).

As Dieter and Higgott note that 'what we are seeing is the contours of a new regionalism in Asia that exhibits three overlapping and complex trends':

1. An interest in monetary regionalism arising from the desire that has emerged, since the financial crises of the late 1990s, to combat financial volatility.
2. An interest in bilateral trade initiatives within the context of the wider multilateral system, largely at the expense of the US endorsed Asia Pacific Economic Cooperation (APEC) style of open regionalism of the 1990s.
3. The emergence of a regional *voice* beyond that of the sub-regions Southeast and Northeast Asia but more restricted than that of the Pacific as a mega region. The voice of region in the global political economy that is emerging is a new one, an "East Asian" one (Dieter & Higgott 2003: 446).

As a consequence it is of interest to ask whether China is able to keep up its warm ties with ASEAN and other regional partners. The

following argues that this is actually what tries and the main objective is to free itself from the encirclement of the United States. If China's history of foreign relations is taken into further account, Beijing's words can indeed be taken at face value (Beng 2003). Yet the outreach to Southeast Asia is not entirely altruistic. It has been worked into the grand Chinese strategic calculation of how to cultivate a multipolar world in which the US, the current hegemonic power, would loose its dominance. Similarly, China's diplomatic overtures to ASEAN can be interpreted as an attempt to preempt member-states from increasing their bilateral security cooperation with the US. It is also a foreign policy goal to prevent Indonesia and Australia from further enhancing their military relationship after the signing of a security pact in 1995. "To be sure, Beijing is trying to forge a diplomatic strategy to prevent other countries from "uniting" against China by virtue of a perceived fear of a "China threat", economic or otherwise. That said, the principal focus has been on countering the lengthening shadow of the United States on the region" (Beng 2003). But there are also serious hindrances and problems involved. In late 2000, China adopted its 10th Five-year Plan starting in 2001. Under that strategy, the Mekong region's development became a top-priority project. In November 2002, the six members of the ADB-sponsored Greater Mekong Sub region (GMS) Economic Cooperation program held their first summit in Phnom Penh. On that occasion Chinese premier Zhu Rongji unveiled a package of financial and other assistance programs for the development of the GMS. In a surprise announcement, Zhu also told Cambodian Prime Minister Hun Sen that China would forgive an estimated more than \$1 billion in debts owed by Phnom Penh to Beijing. The Chinese decision was apparently aimed at improving bilateral ties, which had been uneasy because China had supported the Khmer Rouge regime, but probably also an attempt to avoid criticism of its dam-building which have grave consequences for ASEAN (Masaki 2005).

For Southeast Asia, correcting the so-called "ASEAN divide" - the huge gap in wealth between rich and poor members - has a high priority if it is going to fulfil its goal of creating a fully integrated "ASEAN Economic Community" by 2020. Per-capita income of Myanmar, for example, is less than one-hundredth that of Singapore. For countries outside ASEAN, like Japan and China, assistance in the development of the poorer ASEAN nations is becoming a very important avenue to strengthened ties with the entire ASEAN. In early July 2005, the second GMS summit was held in Kunming, capital of China's Yunnan province. Chinese Premier Wen Jiabao announced that China would individually expand the range of products eligible for preferential tariffs from Cambodia, Laos and Myanmar as of January 1 2006 (Masaki 2005).

This is indeed one issue that may provide insight into China's foreign policy towards Southeast Asia. The building of dams on the Mekong in Yunnan without taking any notice of the impact on its downstream neighbors has created a climate of suspicion. Two hydroelectric dams have been completed with an additional two under construction while four more are planned. These dams are part of China's attempt to meet its expanding energy needs and develop the Western interior. Problems associated with these dams have angered some downstream countries, as fish habitat is reportedly being degraded. Dam construction also limits the flow of silt, which is needed to replenish the fertility of downstream agriculture on Mekong flood plains. Some have called for the issue of water resource management to be made part of the ASEAN-China agenda, which China so far has denied (Vaughn 2005: 26).

Beijing's response has relied on a mixture of bilateral and multilateral initiatives. For instance, in 2002 China cut or exempted tariffs for 600 products from the three underdeveloped ASEAN nations since 2003. China also signed a number of documents with the other five GMS countries to

enhance cooperation in areas such as transportation, animal epidemics prevention, information superhighway construction, power trade, tourism and environmental protection. Geography is on China's side. Wen himself stated that all GMS countries are close neighbors of China and that the peoples in the region, nourished by the same river, have fostered long-standing friendship. "A close neighbor is more helpful than a distant relative," the Chinese leader said (Masaki 2005). "I firmly believe that China's development not only benefits its more than one billion people, but also presents development opportunities to other countries, its neighbors in particular, thus contributing to prosperity and stability of the region and the world at large," Wen said, concluding, "May our friendship and cooperation run as long and deep as the Lancang-Mekong River" (Masaki 2005).

Despite all the initiatives aimed at improving regional cooperation, Beijing remains only an observer of the Mekong River Commission, one of the oldest regional bodies in Asia, even as China builds dams in the river's upper reaches that are starting to affect water levels downstream of one of Southeast Asia's most important waterways. While some Thai nongovernmental organizations have expressed worries, diplomats in the region say the issue hasn't been raised officially because governments are afraid to upset China (Vatikiotis 2004B: A 12). China's ambitious program for harnessing and exploiting the Mekong River will have an important side effect, intended or otherwise: Downstream states, like Laos, Cambodia, and Vietnam, will be hostage to Chinese decisions concerning water flow. "The Mekong is as much the economic life-blood for these nations as the Nile is for Egypt" (Ott 2004).

This might have serious consequences for the creation of a new regional entity and not least on the Chinese rivalry with Japan for a leadership role of the region. Although a lot of discussions and energy has been devoted to whether the East Asian Community (EAC) should be seen

as an alternative to the US-led APEC or be more inclusive towards Canberra and Washington, Japan and China have been in constant rivalry about who should head the process. This has placed ASEAN in the middle as the two nations have competed for increasing ties with ASEAN. Taken alone as individual countries, the 10 ASEAN members are much smaller than Japan and China, but they wield a strong voice in East Asia when acting as a collective (Masaki 2005).

During this competitive process China has had the upper hand by taking a number of early concrete initiatives. In a geo-economic perspective, China and ASEAN signed the Framework Agreement for Overall Economic Cooperation in November 2002, kicking off the process of creating the world's biggest free trade zone with more than 1.8 billion people. Under that agreement, China and the old ASEAN members will put zero tariffs on most basic products by 2010. China and Cambodia, Laos, Myanmar and Vietnam will do the same by 2015. A year after the China-ASEAN framework agreement, Japan and ASEAN signed the similar Framework for Comprehensive Economic Partnership in October 2003, starting the process of creating a free trade zone by 2012. Japan has already concluded a FTA with Singapore and reached basic FTA agreements separately with the Philippines, Malaysia and Thailand. Japan's FTA negotiations with Indonesia and the whole of ASEAN got under way in 2005 (Masaki 2005).

In a geo-political perspective, China has taken a number of diplomatic initiatives as well. China signed ASEAN's 1976 Treaty of Amity and Cooperation, in October 2003, a few months before Japan did. Out of political consideration to its most important ally in Tokyo, the US initially refused to sign the treaty, which urges for peaceful settlement of conflicts and non-interference in internal affairs. Besides the 2001 "Declaration of Conduct" regarding the South China Sea a new March 2005 agreement

was signed between China, Vietnam and the Philippines to explore for oil in the South China Sea. "These assertive and at times conflicting Chinese policies apparently reflect a desire to assuage the perception of China among some in ASEAN as the most serious security threat to their countries and thereby to forge closer ties with the grouping. Cementing ties with ASEAN in general - and the joint oil-exploration agreement with Vietnam and the Philippines in particular - is also seen by some as part of efforts to pre-empt a possible US-led containment of China" (Masaki 2005).

This illuminates the fact that geo-political concerns have important impacts on geo-economic problems such as the creation of an Asian Monetary Fund (AMF) and/or the EAC. At this moment, however, the proposed EAC appears very likely to develop in several stages, with the first significant step coming with the formation of a region-wide FTA in the years ahead. Although there is no specific agreement yet on forming a region-wide FTA, a web of bilateral FTAs is now in the pipeline. Whatever the final shape of the proposed EAC, the development of the impoverished Mekong region as a means of rectifying the wide wealth gap among regional countries is widely deemed an essential building block for any such community. The manner the tug-of-war between Japan and China over the development of the Mekong region will be played out could have ramifications for the future political and economic landscape of the entire East Asia (Masaki 2005).

In a speech made in Singapore in January 2002 the Japanese Premier Minister Koizumi stressed the assistance Japan had offered to the region during the financial crises in 1997. Japan had extended a total of \$80 billion in financial assistance, including \$30 billion under the so-called New Miyazawa Initiative. Koizumi also said that in the 21st century, as sincere and open partners, Japan and ASEAN should strengthen their cooperation under the basic concept of "acting together - advancing together". For the

10 ASEAN members, the two sayings Wen and Koizumi cited - "A close neighbor is more helpful than a distant relative" and "A friend in need is a friend in deed" - may both be sincere. The ASEAN members will not play the devil's advocate to Koizumi's call for them to act together and advance together. But perhaps they want to do so, not only with Japan, but also with China as well (Masaki 2005).

Beijing's new soft diplomacy, especially with regard to its Asian neighbors, has evolved into a sophisticated and active soft power policy, and it has to be recognized that China is seeking or at least searching for a hegemonic role regionally, internationally, strategically and diplomatically. Now Beijing's Asian neighbors are accommodating their Chinese bed mate, but their dreams may turn out to be different.

Comparing China and the United States in Southeast Asia

ASEAN has sought to restrain Chinese power by enmeshing it in regional institutions. But whereas ASEAN is engaging China to tame the aggressive realpolitik that has characterised Chinese foreign relations, Beijing views the same institutions as a way to extend its regional influence and has sought to exclude the US. In planning for the first EAC summit, which was held in Malaysia, China tried to exclude India, Australia and New Zealand, but was overruled by Japan and ASEAN members. As China's regional influence grows, most ASEAN members are working to hedge against or balance Chinese power. While deepening trade and diplomatic co-operation with Beijing, many members, US allies such as Thailand and the Philippines, key swing states such as Singapore and emerging regional powers such as Indonesia, have also increased security ties with Washington (Twining 2005).

The question is why the US has changed its policy in the region from a benign power to one almost squarely focusing on hard power balance issues including terrorism as the overall obsession! For Southeast Asia, long under the United States' political and economic influence times are rapidly moving in a new direction. A decade ago about three-quarters of US investment in East Asia went to Southeast Asia. That figure has now fallen to 10 percent. Approximately 80 percent of US investment in East Asia now goes to China (Thayer 2004: 178).

During the revolutionary wave in East Asia, strongly influenced and inspired by Chinese political and ideological support, American policy towards the area had been dominated by the strategy of fostering economic growth in the region in order to neutralize the socialist threat and marginalize China. Taking advantage of the Sino-Soviet conflict, US China policy became more nuanced following President Richard Nixon's breakthrough 1972 diplomatic trip to Beijing. It is interesting to note that in a historical perspective, immediately after the foundation of the People's Republic of China in autumn 1949, the US articulated, in National Security Council Document (NSC 48/1), a policy of assisting the nations of East Asia to grow and challenge China. The Korean War, as well as the war in Indochina was part of the strategy to contain China!

During the anti-China period, US Asia strategy was developed through the prism of confrontation. For example, the allegations that China was seeking footholds in Laos, northern Thailand and Myanmar. US, British and Australian encouragement for the 1965 massacre of up to half a million leftwing supporters of the PRI in Indonesia was also justified as needed to prevent China from gaining a foothold there (Council on Foreign Relations, 2001: 2).

The economic and security significance of Southeast Asia to the United States is well established. As the Council on Foreign Relations task force report pointed out in 2001, "Southeast Asia's importance should be evident: it is home to almost 525 million people, commands a gross national product (GNP) of greater than \$700 billion, is our fifth-largest trading partner, holds a position of great geo-strategic consequence sitting aside some of the world's most critical sea-lanes (the Strait of Malacca, through which nearly half of the world's trade passes), and features a growing number of emerging democracies" (2001: 1-2). Perhaps most important in the current political context, is the fact that US leaders view Southeast Asia as a fertile breeding ground for terrorist activities.

The United States remains the region's single biggest destination for exports, and will be for some years to come. China's economy is still only about 10 per cent of the size of the U.S. economy. This is probably why the White House is on the defensive in terms of coming to grasp with the regional and multilateral setting in East and Southeast Asia. As one observer remarks: 'Relations between Southeast Asia and the United States are perhaps best described as "a policy without a strategy"' (Banloi 2003).

Asian leaders are organizing and building new regional institutions to avoid precisely the sort of power politics that America is practicing. Progress has been tenuous but real, and most regional leaders are cautiously optimistic about Asia's future. As long as this remains true, American emphasis on balance-of-power politics will continue to meet with only limited success. Indeed, this approach is likely to be undermined by regional players who are more interested in participating in economic integration and building regional communities than in divisive balancing behavior. Most troubling for the United States, it will also cede its leadership

role in Asia and limit Washington's ability to influence the future shape of regional institutions there (Heginbotham and Twomey 2005: 243-244).

The US approach is structured around bilateral relationships. In practice, American reluctance to engage actively with multilateral institutions and its narrow military focus ignore new opportunities and dangers in the Asian environment and, as a consequence, are self-defeating. Opposition to America's balance-of power approach to regional problems -and to the rise of China in particular - has limited US influence. Indeed, the American approach to Asia has created a leadership vacuum into which China can and has adroitly stepped in (Heginbotham and Twomey 2005: 246).

There is a strong opposition in the US against the formation of any formal regional association combining East and Southeast Asia. Some American experts see the emerging East Asian Community as the first step towards a regional trade bloc which could eventually exclude the US but also could under the domination of China reduce the currently unrivalled American position in the region. This would implicitly also mean the end of APEC. There are also some nationalist and pro-US critical voices in Japan who fear that China will take over the leadership of the region. The participation of India, Australia and New Zealand in the first East Asian Summit may in the first instance ease concerns in Japan and the US about possible Chinese domination of the proposed community but in the short-term perspective the situation is unclear. "Meanwhile, China is increasingly alarmed by the ongoing global "transformation" of the US military. The Bush administration insists that the transformation is aimed at ensuring stability in the "arc of instability", an area stretching from the Middle East to Northeast Asia via South Asia and Southeast Asia. There are deep suspicions in China, however, that the real motive for the transformation might be what some analysts call the soft containment of China" (Masaki 2005). These

mutual accusations and views of strategy are based on neo-realist perceptions deeply rooted in Cold War attitudes and it seems that the US strategy is changing towards a more “hard containment” utilizing the current sentiment on global terror.

In practice, US policy emphasizes cultivating partners to balance China, a country some American policy makers see as having parallels to Wilhelmine Germany. Ironically, it is Washington’s present *realpolitik* that is more Prussian in nature (Heginbotham and Twomey 2005: 243). The policy of encirclement, containment and balance-of-power politics of the present administration in the White House can lead to a revival of nationalism and revanchism in China. The official attitude of the US is based on the multilateralism of free trade APEC but in real politics it is based on exclusive bilateral dealings and constructed to contain China. The twin problem is that in order to avoid American power politics, Asian leaders try to establish cohesive regional organizations and at the same time the actual rise of nationalist segments in the region is a dangerous evolution.

China’s ultimate strategic purpose remains a subject of debate and speculation among analysts. Southeast Asia, in this respect, is the sole region adjacent to China in which Chinese influence can most easily expand. A benign interpretation would see China as simply cultivating the sort of stable, peaceful, and prosperous regional environment that is required for its own successful modernization. A more sceptical view sees China playing a long-term game designed to curtail American influence and weave a close-knit economic and security community with China at the center (Dalpino and Steinberg: 2003: 15).

Beijing is in fact using nationalism and the ‘glories of the Chinese civilisation’ to instil a sense of unity among Chinese nationals domestically and among the Chinese Diaspora in Southeast Asia. Although Beijing may

acknowledge that rampant nationalism could pose a danger to its own internal stability, it has astutely harnessed it to build a new Asian pride and identity, which it hopes could help establish a new Asian system of politics, economics, security and culture within the 'ASEAN+3' framework. The PRC ardently hopes this could be transformed ultimately into an East Asian Community under its leadership (Teo 2005). To realize its peaceful rise, China is using a sophisticated blend of trade, confidence building measures, and even development assistance to establish itself as an important regional cum global leader.

Of course the appeal of Confucianism offers Beijing a definite comparative advantage in its soft power approach! So does the cultivation and relationship China enjoys with the Chinese Diaspora in the region who dominate the economic and, in some countries like Thailand, increasingly the political scene. The immediate implications of such an approach are that it "...would be naive to believe that China is not interested in exerting a dominant influence over its regional hinterland; commercial and financial muscle will eventually be the levers of choice, perhaps spearheaded by a strong regional currency. As much as the Chinese may be more ethnically exclusive than Americans and some Europeans, they are every bit as eager to see Chinese culture and traditions adopted by others - as a mark of civilization. As more and more Chinese tourists visit the region and even begin to dominate the tourist trade, the service sector response will be to tailor to Chinese taste and custom. This will inevitably result in a revival of Chinese culture and language in local communities once believed to have assimilated. Already one of the fastest growing Chinese language media groups is based in Malaysia, where Chinese language education has an unbroken history of more than a century. Up to the present, businesses have catered to a culture that projects modernity and sophistication in a Western guise - this could change and have an impact on U.S. and European influence" (Vatikiotis 2003: 75). The use of culture as a tool of

diplomacy highlights the sense of theatre that China skilfully deploys to exaggerate kin, ethnic and national bonds between the Motherland and the Diaspora. It also “reflects an increased appreciation by the Chinese government of the importance of norms and soft power in diplomacy. Chinese print media, television, music, food, and popular culture are spreading around the region as never before. So, too, are Chinese tourists fanning out across the region, often filling the void left by American tourists staying home after 9/11, the Bali bombing, and tsunami; 800,000 Chinese toured both Thailand and Singapore in 2004” (Shambaugh 2005).

In this way it is safe to say that ethnic Chinese business communities scattered in Southeast Asia have facilitated “the rearticulation of mainland China into the global economy” not least through their reciprocal involvement in more than 100,000 joint ventures in China (Yeung 2000: 267; 271). It is also arguable that the Chinese Diaspora has been used not “just as a financial resource in China to fund revolutions in the past and economic reforms in the present; they have been an important symbolic resource in the construction of Chinese nationalism” (Callahan 2003: 483).

The combination of geo-political and geo-economic strategies and cultural expansion in the end begs an answer to the question: “what are the implications of China's policy of soft power for US influence in the region”? Elizabeth Economy notes the important point that, China's rise to date appears to be less about the “inevitable conflict of rising power” theory, popular in some circles, than about creeping power transition. Chinese thinkers, themselves, have recognized that the international community is concerned by the potential implications of China's rise and have taken pains to ensure that it will be perceived as non-threatening. This is well illustrated by Li Junru, Vice-President of the Central Party School at the Chinese Communist Party (CCP), who explicitly outlined the benefits to China's neighbors, stating, “China's rise will not damage the interests of other Asian

countries. That is because as China rises, it provides a huge market for its neighbors. At the same time, the achievements of China's development will allow it to support the progress of others in the region" (2005: 3-4).

In order to comprehend the motives and objectives of Chinese pragmatism it is important to put both bilateral and multilateral diplomatic initiatives and foreign policy into the overall trade and security context and understand the internal and external constraints for a Chinese expansive strategy in Southeast Asia. The region as a whole maintains a trade surplus with China of US\$8 billion annually, largely from its enormous exports of raw materials and precision machinery. China also agreed to an "Early Harvest Package" that is perceived by ASEAN as "largely a concession" to provide benefits through tariff reductions on 573 products including agricultural and manufactured goods. Individual Chinese entrepreneurs are also now expanding China's economic reach throughout Laos and Burma. In some areas, locals now use only the Yuan and speak Chinese (Economy: 2005: 4). The forays of Chinese companies fit in with a broader strategic push by Beijing to establish closer economic cooperation with and among Asian countries. Unofficial reports by ASEAN officials claim that the foreign policy aim is part of a broader thrust by China to deploy multilateralism against what it sees as US unilateralist hegemony in the region and the world. "This is a long-term game that China is playing," says a senior ASEAN official. "They want a situation in Southeast Asia that automatically takes into account China's interests. The whole objective of the policy is to avoid strategic encirclement by the U.S." (Vatikiotis and Hiebert 2003).

Critical voices note that ASEAN's trade with Japan of \$136 billion and that of the United States of more than \$136 billion in 2004 exceeds trade with China. At the same time, in both Indonesia and Malaysia, people complain that jobs are being lost to China. Not least because Chinese textile exports since January 2005 have increased, thus implying downward

competition for Cambodia and Vietnam. A growing mainland Chinese economic presence could also fuel latent resentment against the sizable ethnic Chinese economic elites in the region (Economy: 2005: 5). In fact, almost no research has so far been done to investigate the impact of China's FDI on labor markets, environment and social issues and the question is whether China is exporting its own poor labor practices (Frost 2004).

Factors inhibiting Chinese private investment and tourism are sensitivity to treatment of Chinese minorities in Southeast Asia and in particular in the Philippines and Indonesia. The Indonesian racial riots in the aftermath of the financial crisis in 1998 which targeted ethnic Chinese created long-term damage to the 'bamboo network' (Low 2003: 73). There are also cultural impediments when it comes to expansion as noted by a senior ASEAN official: "Unlike Americans, Chinese don't embrace foreigners - you cannot 'become Chinese'" (Vatikiotis 2003: 75).

Coming back then to the structural constraints some calculations made by the OECD suggest that China will surpass all other economies within a decade or so, but its vast population means that this would occur at less than one quarter of the US level of GDP per head. This is also indicated by a historical comparison between China and other Asian catch-up economies like Japan and South Korea. Thus after two decades, it is "still far behind, in relative terms, the positions from which their growth spurts were launched" (Glyn 2005: 10).

The US Department of Defence notes in its annual report that China's leaders have asserted that the United States seeks to maintain a dominant geo-strategic position by containing the growth of Chinese power, ultimately 'dividing' and 'Westernizing' China. Beijing has interpreted the

strengthening of the US-Japan security alliance together with efforts to expand NATO as manifestations of Washington's strategy (Marquardt 2003).

Despite strengthened military ties between the US and some regional actors, a strong reservoir of distrust and enmity exists toward Washington's economic and foreign policy in many of the region's public opinions. It is plausible that over time, China's message of non-interference, cooperative security, and the diminution of the role of the US that is implied by China's approach will gain in popularity, although the United States may yet again broaden its approach to security and regain territory it has lost (Economy: 2005: 9). In the meantime, officially sanctioned Chinese scholars identify US strategic intentions toward China as "encirclement" and "strangulation." They characterize US thinking about Southeast Asia as the weak link and this is where China can break through and defeat the American attempt at "containment". In private, Chinese diplomats have been known to use the Churchillian phrase "soft underbelly" to refer to Southeast Asia (Ott 2004).

Chinese official thinking indeed is quite ambitious. Yang Jian, political counsellor at the Chinese Washington embassy, told a seminar on Indonesia-China relations in November that Beijing's moves toward ASEAN are in line with the country's objective to bring East Asia together. "China sees its integration with Southeast Asia as part of the East Asia pact. If you look at the world today, you see Europe with its integration having grown for many years now. And you look at North America and NAFTA. Look at Southeast Asia, we still lack this" (Ott 2004).

China's approach has been subtle, using economic diplomacy to build a benign multilateral framework in the shape of a free-trade agreement with ASEAN. "China has shown a great deal of sensitivity," says Singapore Prime Minister Goh Chok Tong. "China realizes that it is a huge elephant,

and even if it treads softly, it can still shake the ground." One observer notes that "China is seen by some to be slowly filling the vacuum left behind by the United States in the political, economic and security spheres in the region. This implies that 'U.S. Influence in Asia under Bush is Waning'" (Agence France Presse, August 29, 2004.) and being replaced by China.

Chinese accession to the ASEAN code of conduct on disputes in the South China Sea, the shift in emphasis to ASEAN-plus-three (China, Japan and South Korea), in contraposition to the APEC framework which includes the United States, and movement towards an ASEAN-China FTA taken together mark a fundamental shift in relations between China and ASEAN (Vaughn 2005: 11).

ASEAN + 3 refer to the increasing linkages between ASEAN states and Japan, China, and South Korea envisaged serving as the basis for a new East Asian community. The ASEAN-plus-three concepts was preceded by former Malaysian Prime Minister Dr. Mahathir's notion of an East Asia Economic Group (EAEG), announced in December 1990, that sought to create an Asian economic grouping excluding the US, Australia and New Zealand. Consequently, the EAEG and ASEAN + 3 are based on an 'Asian' identity and differ from the 21-nation US dominated APEC. To some analysts, the ASEAN-China FTA, and indeed the whole ASEAN-plus-three approaches, is a way of addressing what ASEAN has viewed as an inadequate response by the United States, the IMF, and APEC to the Asian financial crisis of 1997/98. Some also view it as a Chinese attempt to assuage regional fears of China's growing economic power (Vaughn 2005: 14).

Meanwhile, despite the differences in attitudes towards China outlined above, other countries in the region have followed in Thailand's footsteps - largely out of economic self-interest. Singapore is in the forefront

with a policy of attracting Chinese companies to the island republic, offering favourable conditions for listing on the stock exchange, and help with accessing global export markets. Indonesia is banking on its long-term supply of energy to China, which now has controlling stakes in about 5 per cent of the country's oil and gas reserves. Even in Malaysia, then - Prime Minister Dr. Mahathir told Malaysian firms that they should "ally themselves with Chinese manufacturers in areas where the Chinese have technological advantages as this would help them penetrate the Chinese as well as regional and global markets" (Vatikiotis 2003: 72).

The next wave of outward investment from China will be led by larger home-grown conglomerates. In the ASEAN countries, salaries have decreased by 8 per cent, to US\$15,189 per year. While the average annual salary of engineers in Mainland China remains the lowest in the region at US\$8,136, they are earning US\$1,100 more than what they received twelve months before. Chinese financial institutions will follow, especially once the renminbi becomes a convertible currency, to help service Chinese corporations, just as Japanese banks did for Japanese companies in previous decades. This coming wave of FDI is embedded in a broader regional strategy encompassing all sectors and strategic goals and closely resembles the developmentalist and neo-mercantilist outward strategies of Japan and the NICS.

The ASEAN Chinese Free Trade Area (ACFTA plan), in particular, is instrumental to achieving many of China's foreign policy goals, in both the economic and political realms. In the former case, ACFTA is expected to further enhance the Sino-ASEAN trade. The FTA will increase China's exports to ASEAN by 55.1 per cent, and will increase Southeast Asian exports to China by 48 per cent. By creating a liberal and facilitative investment regime, the FTA is also likely to enhance Sino-ASEAN investment cooperation (Cheng-Chwee 2005: 110).

As mentioned above, Beijing has not only agreed to the "early harvest package" that will give ASEAN states earlier access to Chinese markets than other WTO members, it has also granted special treatment to Vietnam, Cambodia, Laos, and Myanmar. China obviously hopes that the short-term generosity in economic cooperation will lead to long-term political and economic gains. Similarly, China's active involvement in the ASEAN-plus-three is based on an anticipation that its diplomatic efforts will bring about favourable geo-political and economic outcomes (Cheng-Chwee 2005: 112).

Beijing has also stimulated the dynamics of regional cooperation in many other ways. An example is China's enthusiasm for developing the ASEAN-China dialogue into a vibrant web of multilevel and multi-sector cooperation. As noted above, the 1997 financial crisis was the main catalyst for the creation of a full-fledged diplomatic mechanism spanning summit, ministerial, and senior official levels. As Cheng-Chwee notes, the mechanism has stretched into various semi-state and civil society organizations that include research departments, media outlets, youth organizations, and the business sector. Also cooperation in agriculture, transport infrastructure, as well as energy have been included. Over time, these ties have interwoven into a web of interdependence between China and ASEAN. The PRC has also taken the initiative in pushing for the creation of the Network of East Asia Think-Tanks (NEAT) (2005: 115). These moves are not merely tactical but part of PRCs overall goal to utilize the ASEAN-plus-three as the main vehicle of East Asian cooperation and the creation of the hybrid East Asian Community. Although there are other factors at play, China has played a decisive role in pushing in that direction. "China's enthusiasm for East Asian cooperation is clearly driven by its aspiration to shape the direction of the existing regional institutions" (2005: 115-116).

Diplomatically China's goals and vision in Southeast Asia are clear as it rivals the US and Japan world-wide and regionally. Moreover it may be again considering ASEAN as its own Monroe sphere, as it was during the 400 years of the Chinese tributary system under the Ming-Qing Emperors. Southeast Asian countries appear to be accepting subordination as they seek to profit from the rising China.

One of the main short term dangers to Southeast Asia is not Chinese military aggression but the risk that the next axis of Cold War-type confrontation will be between the United States and China, and that the theatre in which this war is played out will be Southeast Asia. Some observers claim that growing strategic competition is likely to characterize Sino-American relations for most of the next decade. According to Dobb "the risk is higher than this: namely, that there will be a struggle for power between the United States and China, perhaps leading to military confrontation" (2001: 833). In this connection there are signs that Malaysia and Thailand are aligning towards China, as Burma has been doing for a much longer period.

Conclusion

This paper has provided a detailed desk study based on empirical evidence showing that China has a strategic interest in Southeast Asia. Beijing has engaged the region at all levels, bilaterally and multilaterally with individual states, and been at the forefront in the establishment of new regional institutions.

China has legitimate interests both geo-economic and geo-strategic not only in Southeast Asia, but also in East Asia in general. The Chinese leadership has shown a benevolent attitude in its dealing with regional organizations and the contrast between American power politics and

Chinese soft power bilateral and multilateral engagement has helped shift world and regional perceptions of both the United States and China. It is interesting to note that a new Asian assertiveness has been brought to the fore not least helped by active Chinese involvement.

China is also a global player and seen from the US point of view a potential disruptive element. The rising competition faced by US industry in the international political economy is creating a difficult situation in which the US will soon be facing very tough choices. Today, China operates a reverse Marshall Plan. To help sustain its massive exports to the United States, it recycles the resulting dollar inflow in the form of loans and asset purchases. China lends capital to the United States and in reality finances the overconsumption and current accounts deficit as well as the budget deficit of the White House. The twin deficits is inevitably leading to a declining US share of global GDP and loss of its world hegemony and when this is put into context with the US trade deficit with China it becomes an inherent contradiction. This situation is an unprecedented paradox. A communist party in power subsidizing the citadel of world capitalism!

From its independence in 1949 until the opening of China three decades later, China had sought security in alliances with superpowers; first with the Soviet Union, then with the United States. Neither alliance was altogether successful. With the Soviet Union, China failed to obtain Moscow's help in building a nuclear device. By 1969, China and the Soviet Union were already involved in a bitter border conflict that threatened to end in an open, and possibly nuclear, warfare between the two communist foes. When China warmed to the United States to offset the Soviet Union in 1972, its relationship lasted only until the end of the Cold War in 1989. Since then, the relationship between Beijing and Washington has been marked as much by cooperation as by mutual suspicion of each other's strategic designs. Now that China's power has gradually grown, it has become

imperative for Beijing to get up to cultivate good ties to Southeast Asia. Such a relationship is critical because when measured from the standpoint of gross domestic product, China's GDP is only one-quarter that of Japan and one-tenth that of the United States. However, if the current double-digit growth rate continues China will surpass both countries within a decade. The most important side-effect of China's growth is the attendant siphoning of critical FDI away from Southeast Asia. Under such conditions Beijing has to ensure that members of ASEAN remain closely bonded to China, not other stronger and richer powers. This is a sufficient reason for the Beijing to support mainland Chinese outward investment into the region and even relocation of production platforms and industries. The strategy of reassurance is indeed important in the context of China's impact on Southeast Asia. China's accumulated net FDI inflow totalled some \$309 billion for 1980-2000, of which 95 percent, or some \$284 billion, was attracted in 1993-2000. On the other hand, ASEAN's accumulated net FDI totalled only \$172 billion for 1980-2000. The danger does not lie here alone. China's manufacturing prowess is also displacing that of Southeast Asia, indeed, even Japan. This is another reason why Beijing is actively supporting and cultivating increased volumes of trade and providing much needed ODA to poorer Southeast Asian states. Given such figures, coupled with the possibility that China might dominate the entire mass manufacturing spectrum, hence leaving little room for Southeast Asia to innovate, it is little wonder that China is trying its best to ensure good ties with Southeast Asia. The forward looking and inclusive character of China's foreign policy is underlined through Beijing's active and repeated assurance that the relevance of the project is less important for China's own interest as it is for 'the sake of the creation of a region structure' (Dieter 2000: 22; Schmidt 2006A).

Many observers see the emerging relationship between China and Southeast Asia as having been transformed from one of suspicion and fear,

driven at first by ideological confrontation and then largely by ongoing territorial disputes, to one of increasing cooperation and collaboration, particularly in the area of trade. This change in the geo-political orientation of Southeast Asia is part of what some see as a larger shift in the international balance of power which puts the rise of Asia in general, and China in particular, on a scale equivalent to the rise of Western Europe in the 17th century or the rise of the United States at the beginning of the 20th century.

Beijing's relation to Asia is at this time also a function of the American geo-economic and geo-strategic current hegemony in world affairs. Having observed the relative facility of US military operations conducted in the Persian Gulf and especially in the Balkans and Iraq, it can be observed that neither prospective adversaries nor international organizations pose much of a constraint on the Washington and Pentagon's behavior. By cultivating ties with ASEAN, China can potentially put a check on US influence and accessibility to Southeast Asia. China has already started to build a network of infrastructure and pipelines running south through Southeast Asia to help connect Western China to the sea. Along the East-West axis there is a strong strategic desire to build pipelines so that oil and gas can be supplied to China and avoid passage through the Malacca Strait. China's leaders have said this is less a question of cost and more about enhancing the security of the country's energy supplies, notably from a possible US naval blockade (Vatikiotis 2004A).

Echoing the view of then - President Jiang Zemin at the 16th CCP Congress that neighboring countries be "treated with kindness". China's diplomacy is still largely devoted to rhetoric and to advocating the right of developing countries to pursue economic development rather than restricting development in favour of regulation. In certain aspects China can also be seen as a relative selfish player in regional diplomacy (Lang and Chan 2005: 28). However, it is extremely active in alleviating concerns of neighbors. In a speech at the University of Hong

Kong on January 10, Fu Ying, secretary general of Hong Kong's Ministry of Foreign Affairs' Asia Department, affirmed that China would commit itself to becoming a force for peace and stability in Southeast Asia and that it would not be a threat despite the magnitude of its growth. He also spoke of China's benevolent intent in handling various territorial, border and fishing disputes throughout the region. Strengthening ties with its neighbors has been the official diplomatic strategy of China since 1996, and increasing US and Japanese influence in Asia has given the strategy a new sense of importance and urgency (Beng 2003).

In a more systematic manner this contribution has shown that bilateral geo-strategic ties at the *formal* level have especially deepened in terms of substantial increases in development aid, likewise the trade volume between China and individual Southeast Asian countries will soon surpass trade with Japan, the NICs, the EU and the United States. The same can be said about Chinese FDIs pouring into the region's economies. Indeed China can be said to be following in the footsteps of Japan and later NICs in pursuing a diplomacy and economic policy based on soft power and a Listian neo-mercantilist strategy. In reality, China's diplomatic offensive started in the wake of the financial crisis in 1997 and has since then been based on a sophisticated strategy enhancing China's security and defence needs and can best be conceptualized as an attempt to break the US encirclement of mainland China. This also explains its rather successful push to create new regional institutions and its outright strategy of establishing a new Asian identity. It is probably only a matter of time before the AMF - an alternative institution to the IMF - will be formally initiated. The East Asian Community is still in an embryonic stage, but also in this case it will most probably emerge as a real alternative regional institution to the EU, NAFTA and other types of regional organizations. The myriad of Free trade areas, agreements and measures are, it seems, part of a grand design to create a new East Asian entity.

One possible backlash to official PRC policy towards Southeast Asia, which is beyond the scope of this paper, is the impact of *informal* Chinese encroachment into the region. Not least the fact that some commentators estimate unauthorized and thus illegal capital outflows from China between 1997 and 1999 totalled \$53 billion (Frost 2004: 327). This amount could be much higher today. Illegal migration, trafficking, prostitution, smuggling, drugs and the increasing power of triads and mafia type of activities can lead to opposition against the formal, official, multilateral policy of Beijing. Furthermore, SARS, bird's flu and other epidemic diseases can together with environmental hazards and transnational pollution bring China's official policy in jeopardy. However, informal regionalization in the form of regional production networks, ethnic Chinese business networks, and sub-regional economic zones can also be beneficial for integration (Peng 2002).

These formal initiatives and informal transformations have profound implications for the regime forms and state-society relationships in Southeast Asia and the current problems associated with institutionalized democracy in countries like Thailand and the Philippines can be seen in this light. The Asian (Chinese and Japanese) types of economic policy-making are not grounded in neo-classical or neo-liberal thinking – but utilized only when the individual economy can take advantage of these ideological devices. Otherwise, the 'East Asian way' is based on a pragmatic and state interventionist type of economic strategy which apparently does not need democracy.

In conclusion and seen from a historical perspective, the emergence of China as a prime mover in the regional and world political economy is not without precedent. Late developers within the international capitalist system have always brought forth tensions between the up-coming power and the established core nations. The realpolitik explanation of confrontations and strategies in the interstate system does not capture the essence of the

process at work. In contrast, the theoretical assumptions of critical international political economy, can better explicate the tensions created by China's rise by placing it in the context of the Japanese threat to US dominance in the Asiatic sphere prior to World War II. A worthwhile research agenda could be a comparative analysis of Japan's catching-up and its scheme of the Asiatic Co-prosperity Sphere with China's rise and challenge to the United States and Japanese positions in the region as a by-product of the Chinese attempt to create a regional community in Southeast Asia with China as its hub.

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