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# **Economic Statecraft: An Assessment of China's Search for Influence in Southeast Asia**

Xue Gong<sup>\*</sup>

## **Abstract**

In pursuit of bringing Southeast Asia into its supportive circuit, China has seen the potential of economic inducements to be a key instrument in securing its foreign policy and geopolitical goals. Nowhere is this more evident than in Southeast Asia where China's economic statecraft is reflected in its infrastructure investment. China's infrastructure for influence brings the unique pattern of China-Southeast Asia relations, yielding a degree of success as China has established its economic status in the region. However, China's offensive charm that aims to assuage the fears and anxiety of its southern neighbors is constrained by its capacity of mobilizing overseas ventures by SOEs into serving foreign policy goals.

**Keywords :** Economic statecraft, infrastructure for influence

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## 1. Introduction

China has a long history of resorting to economic statecraft in pursuing its foreign policy goals. Between the 1950s and 1970s when China's international trade relation was in its infancy, China's economic statecraft accented on ideational revolutions by grants and its long-term assistance to insurgency groups in Southeast Asian countries and other third world countries. This had caused severe damage to China's image abroad. This aspect of economic statecraft before the opening up displays the politics-first strategy. Such strategy usually disregards benefits and costs to China itself with less economic calculation. But this politics-first situation changed until China shifted its attention to economic priorities after Deng came into power<sup>1</sup>. 'Bringing in Foreign Direct Investment (FDI)' policy has been formulated with the primary purpose of supporting the imperatives of China's pragmatic commitment to its domestic modernisation. The end of the Cold War and the 1989 Tiananmen Incident forced China to look "south" for support. Conceived as a "good neighbor policy",<sup>2</sup> the first attempts towards confidence-building on mainly political and security issues were bolstered by economic cooperation in the 1990s. China's good neighbor policy was aimed at strengthening regional relations so as to surround itself with friendly states, which would allow China to focus on economic growth.<sup>3</sup>

Economic statecraft is the use of economic resources by political leaders to exert influence in pursuit of foreign policy objectives. What makes economic statecraft special is 'it is more concerned with value creation than value-claiming; it makes greater use of multilateral or plurilateral negotiations compared with the greater use of bilateralism in politics and security foreign policy diplomacy.'<sup>4</sup> Thus, what distinguishes economic diplomacy and economic statecraft is that the latter contains more connotation than the former in terms of influence exercise as well as diversified tools both in economic sanctions and inducements. Economic statecraft that designed for promoting tighter economic relations is seen as a means of building confidence and improving stability in a region or consolidating political ties with a strategic partner.

There are mainly three ways of China in promoting its economic statecraft<sup>5</sup>: free trade agreements (FTAs) to expand China's overseas market and acquire access to the natural resources. Foreign aids also constitute a critical aspect of China's economic diplomacy. China's foreign aid is characterised with an aid package program including financial loans, state-subsidised infrastructure investment, and technical assistance.<sup>6</sup> The final dimension of China's expanding diplomatic toolkit is China's financial diplomacy. The turning point of the relationship between China and Southeast Asia is China's generosity in the 1997-1998 Asia financial crisis where China denied devaluation of Chinese Renminbi in order to maintain regional stability. In contrast to the US and Japan's rejection to help, China generously participated in the International Monetary Fund (IMF)-initiated aid projects. After the crisis, the Chinese government continued supporting the economic stability by providing Thailand and other countries with over 4 billion US dollars in non-strings attached financial assis-

1 Baiyi, Wu, ed. *Diplomacy for Integration: The Economic Aspect of Chinese Foreign Policy*. edited by Kerr David and Liu Fei, The International Politics of Eu-China Relations. Oxford: Oxford University Press.

<sup>2</sup> Known as 睦邻外交, China has this concept since the 1950s, but before the opening up policy, China was unable to create a good connection with neighboring countries. After 1980s, China attempts to build a responsible image by establishing good relations with neighbors.

3 Ba, Alice. *Between China and America: Asean's Great Power Dilemmas*. China, the United States and Southeast Asia : Contending Perspectives on Politics, Security and Economics. edited by Evelyn Goh and Sheldon W. Simon London: Routledge, 2008.

4 Woolock, Stephen, ed. *Economic Diplomacy* edited by Pauline Kerr and Geoffrey Wiseman, *Diplomacy in a Globalizing World: Theories and Practices* New York: Oxford University Press 2013.

5 Medeiros, Evan S. *China's Expanding Diplomatic Toolkit*. *China's International Behavior: Activism, Opportunism and Diversification* RAND Corporation, 2009, p. 62.

6 These assistance and aid are often provided through the China Export-Import Bank (CEIB) or China Development Bank (CDB). China's foreign assistance is often accompanied by its foreign direct investment (FDI). According to statistics from China's Ministry of Commerce, the FDI in ASEAN jumped from \$ 0.12 billion to \$5.9 billion between 2003-2011. It was seen a rapid increased by 34.1% of FDI in 2011 compared to the year of 2000.

tance.<sup>7</sup> China proved itself committed to the development and stability under tremendous pressure with risks, thereby strengthening closer political ties with its southern neighbors.<sup>8</sup>

With more confidence in economic power, China seems not to shy away from international responsibilities. The fact that China has become proactive in multilateral institutions such as ARF (ASEAN Regional Forum) in the 2000s, offered to enter into free trade agreements with ASEAN for not just economic but also strategic intents.<sup>9</sup> China has sacrificed some economic benefits in exchange for the trust and shifted the reliance of Southeast Asia on the United States and Japan to China itself. For example, the agreement on China-ASEAN FTA Early Harvest Programmes, is believed to display more political motivation than economic one at the expense of China's domestic interests where Yunnan and Guangxi provinces suffer the most given similar agriculture products.<sup>10</sup> After the financial recession, China has also focused on its attention to regional financial stability by establishing the China-ASEAN FTA (CAFTA), China-ASEAN Investment Cooperation Fund. Contrary to asymmetry theory that big power tends to use economic coercion towards smaller counterparts for strategic and foreign policy purposes,<sup>11</sup> China has restrained itself from wielding coercive economic advantage to press its weaker neighbors. Instead, China adopts various forms of economic inducements as assurance mechanisms against suspicion of Chinese economic domination.<sup>12</sup>

China's efforts in guaranteeing the supply of energy and raw materials as well increasing its influence pay off. China replaced the US as ASEAN's (Association of Southeast Asian Nations) top trading partner in 2008 and trade is going to expand as the Sino-ASEAN Free Trade Area (FTA) came into 2010.<sup>13</sup> By promoting trade and investment relations with its neighbors, this strategy enables China to create more infrastructure deals for its SOEs (State-owned Enterprises) while bolstering its influence. China has witnessed active infrastructure investment in routes such as transnational railways and roads, hydropower dams, and oil and gas pipelines across its neighbors. These investments as inducements can secure China's access to strategic resources while meeting demands of recipient country for infrastructure investment. Following this logic, in recent years, China further promoted its economic inducement by launching currency swap agreements, 'One Belt, One Road' initiatives and Asian Infrastructure Investment Bank after Xi Jinping came into power.<sup>14</sup>

Due to the potentials of economic development in Southeast Asia, geographical proximity, similar culture convergence and a large population of the ethnic Chinese community, Southeast Asia is an easier region to expand China's influence by encouraging its enterprises, especially SOEs going overseas. With substantial financial and political support, SOEs has already carried out large-scale of infrastructure projects in upholding China's 'Good Neighbour' diplomacy. Because of their unique political status in the Chinese economy, China is reckoned to wield its business actors for geopolitical purposes. While China's accommodating foreign diploma-

7 "Pro-Active Policies by China in Response to Asian Financial Crisis." edited by Ministry of Foreign Affairs of the People's Republic of China, Nov 17 2000. See at <http://www.fmprc.gov.cn/eng/ziliao/3602/3604/t18037.htm>.

8 Alice D. Ba, China and ASEAN : renegotiating relations for a 21st century Asia, Asian Survey, Vol. 43(2003), pp. 622-647.

9 Segal, Adam, ed. *Chinese Economic Statecraft and the Political Economy of Asian Security*. edited by William W. Keller and Thomas, China's Rise and the Balance of Influence in Asia University of Pittsburgh Press, 2007:242.

10 Goh, Evelyn. "Limits of Chinese Power in Southeast Asia." East Asia Forum May 10 2011. <http://www.eastasiaforum.org/2011/05/10/the-limits-of-chinese-power-in-southeast-asia/>; Yang Jiang, "China's Free Trade Agreements and Implications for the WTO", drafted paper presented at ISA convention, March 2008, available at: [http://www.allacademic.com/meta/p\\_mla\\_apa\\_research\\_citation/2/5/0/8/6/pages250869-1.php](http://www.allacademic.com/meta/p_mla_apa_research_citation/2/5/0/8/6/pages250869-1.php), p. 10.

11 Although economic integration has created closer political relations, Southeast Asian countries still stay cautious because of the asymmetric power among China and Southeast Countries. According to Womack, normalcy between China and Southeast Asian relation indeed has created common interests but the politics and security concerns still matter. See Womack, Brantly. "China And Southeast Asia: Asymmetry, Leadership and Normalcy ". Pacific Affairs 76, no. 4 (Winter 2003-2004): 529-48.

12 Ravenhill, John, and Yang Jiang. "China's Move to Preferential Trading: A New Direction in China's Diplomacy." *Journal of Contemporary China* 18, no. 58 (2009).

13 Salidjanova, Nargiza, Jacob Koch-Weser, and Jason Klanderman. "China's Economic Ties with Asean: A Country-by-Country Analysis." In *U.S.-China Economic and Security Review Commission*, Staff Research Report, March 17 2015.

14 Similarly, at the financial forum of the 10th China-ASEAN Expo (CAEXPO), the deputy governor Yi Gang announced the bilateral local-currency swap agreements with Asian countries, valuing 1.4 trillion yuan (around 226 billion USD).

cy has advanced its relations with Southeast countries at the state level, transitional issues of overseas activities have been a continued source of angst among regional civil society. For example, the Myanmar government suspended the planned Myitsone Dam invested by China Power Investment Corporation (CPI).

*'...Our government, being elected by the people, has to take great consideration of public opinion. Accordingly, we have an obligation to respond to the public concern with seriousness. Therefore, we will suspend the Myitsone project during the term of our government...'*

Myanmar President Thein Sein in a letter to the Parliament<sup>15</sup>

Myitsone dam is just one example of China's investment that has attracted intense resistance-an unwelcome effect of a Chinese economic diplomacy. Table 1 illustrates significant controversial projects carried out by Chinese SOEs.

Table 1: China's major controversial projects in Southeast Asia (from 2007-2015)

Country	Project/Issues	Chinese Companies	Investment scale	Outcome
<b>Myanmar</b>	Letpadaung copper mining	Wanbao Mining (a subsidiary of The China North Industries Corporation ) and Union of Myanmar Economic Holdings	USD \$1.07 billion	Suspend
	Kyaukpyu-Kunming railway	China Railway Engineering	USD \$ 20 billion	Cancel
	Myitsone Dam	China Power International (CPI)	USD \$ 3.6 billion	Suspend
	Khaunglanphu Dam	CPI	unknown	Suspend
	Chibwe Dam	CPI	unknown	Suspend
	Lakin Dam	CPI	unknown	Suspend
<b>Vietnam</b>	Bauxite Mining	Chalco	unknown	Protest/Ongoing
<b>the Philippines</b>	Northrail Project	China National Machinery and Equipment Corporation (CNMEC)	USD \$900 million	Derail
	NBN/ZTE scandal	ZTE Corporation	USD\$329.5 million	Cancel
<b>Cambodia</b>	Chhay Areng dam	Sinohydro	USD\$400 million	Suspend

Source: author's own summary by data collection

Note: ZTE Corporation is a state-owned, private-operating company

The scholarship of international political economy with a focus on China's Southeast Asia has provided substantial perspectives on understanding China's economic activities in Southeast Asia. There are three main theoretical approaches to understand economic statecraft: system-centred, society centered and state centered.<sup>16</sup> Most analysis of economic statecraft begins with the influential work of Albert Hirschman who highlights the

<sup>15</sup> Kaung, Ba. "Burmese President Halts Myitsone Dam Project." *The Irrawaddy* (Sep 30 2011).

<sup>16</sup> Ikenberry, G. John, and David A. Lake. "Introduction: Approached to Explaining American Foreign Economic Policy." *International Organization* 42, no. 1 (Winter 1988): 1-14.

favorable political consequences by larger or richer economic powers dominating smaller counterparts through asymmetric interdependence. Realists like Krasner believe states pursue power and shape the economy to serve the former end. He argues structure of international trade is determined by the interests and power of states aiming to maximize national goals.<sup>17</sup> Strange argues due to accelerating rate of technology development, the mobility of capital and labor in the international economy, the relationship between the state and transnational firms has altered in the way that the latter drives a new form of diplomacy in the international affairs.<sup>18</sup> These powerful multinational corporations- MNCs are witnessed to influence the foreign policy by their initiatives and interests on the global basis. Then Tarzi examines bargaining powers between MNCs and the host country and finds bargaining advantage varies by studying expertise in managing overseas investment, the capacity of exercise power among ruling elites and ability of meeting demands from non state actors such as international NGOs and domestic civic society.<sup>19</sup> Drawing upon classical work from economic statecraft theories, there are a few outstanding narratives on China's case covering its tools, goals, intentions, and effectiveness in the context of a young learner of wielding economic statecraft. The extant literature tends to focus on China's foreign trade relations, its foreign aid programme, outbound direct investment as well other monetary and financial diplomacy.

Adam Segal and James Reilly recognize China's political use of economic statecraft in its pursuit of foreign policy objectives.<sup>20</sup> Hirschman deeply influences Segal's work; he points out China's potential economic prowess in achieving security issues such as territorial disputes. Reilly also finds China's increasing tendency to apply economic coercion to force target countries to change their policies in line with Chinese interests.<sup>21</sup> There is evidence that China adopts economic incentive tools such as trade and investment to influence strategic and political decisions of decision-makers in Southeast Asia.<sup>22</sup> With tensions rising in the South China Sea, China's use of its economic leverage over Southeast Asian countries has recently come into focus. Ravindra assesses the costs of economic sanction from China against Vietnam and the Philippine by comparing vulnerable trade sectors in each country and concludes the Vietnam is more vulnerable to coercion but political factors such nationalism offsets such coercion.<sup>23</sup> In terms of the economic and security relations, Drezner calls for studies on the domestic motivation of China's economic diplomacy and the efficacy. He further concludes China's economic coercion is for short-term considerations rather than a shrew or rational economic statecraft.<sup>24</sup>

China has a long history of foreign aid to the third world countries since its establishment. Predominant scholarly work focuses on this aspect of China's early economic statecraft behavior. One area focuses on the Cold-war period whether China tried to establish links between its foreign aid and foreign policy goals to strengthen its communist regime and compete with Taiwan for international recognition.<sup>25</sup> Meanwhile, there has been abundant research in studying Sino-Africa relations in the context of China's rising economic status. Trade ex-

<sup>17</sup> Krasner, Stephen D., ed. *State Power and the Structure of International Trade* edited by Jeffry A. Frieden and David A. Lake. 4th ed, International Political Economy: Perspectives on Global Power and Wealth. London and New York: Routledge, 2004.

<sup>18</sup> Strange, Susan, ed. *States, Firms, and Diplomacy*. edited by Frieden Jeffry A and David A. Lake. 4th ed, International Political Economy: Perspectives on Global Power and Wealth. London and New York: Routledge 2004.

<sup>19</sup> Tarzi, Shah M. ed. *Third world governments and multinational corporations: dynamics of host's bargaining power*. edited by Frieden Jeffry A and David A. Lake. 4th ed, International Political Economy: Perspectives on Global Power and Wealth. London and New York: Routledge 2004.

<sup>20</sup> Segal, Adam, ed. *Chinese Economic Statecraft and the Political Economy of Asian Security*. edited by William W. Keller and Thomas, China's Rise and the Balance of Influence in Asia University of Pittsburgh Press, 2007; Reilly, James. "China's Unilateral Sanctions." *The Washington Quarterly* 35, no. 4 (Fall 2012).

<sup>21</sup> China warns US over Taiwan arms sales, Sep 22, 2011

<http://www.telegraph.co.uk/news/worldnews/asia/china/8780672/China-warns-US-over-Taiwan-arms-sales.html>

<sup>22</sup> Lee, John. "China's Economic Influence in Thailand: Perception or Reality?". Singapore: Institute of Southeast Asian Studies 11 July 2013.

<sup>23</sup> Ravindran, Madhu Sudan. "China's Potential for Economic Coercion in the South China Sea Disputes: A Comparative Study of the Philippines and Vietnam". *Journal of Current Southeast Asian Affairs* 31, no. 3 (2012).

<sup>24</sup> Drezner, Daniel W. "Three Ways of Looking at Chinese Economic Statecraft." *Foreign Policy* (Oct 20, 2010).

<sup>25</sup> Lin, Teh-chang. *The Foreign Aid Policy of the People's Republic of China: A Theoretical Analysis* Northern Illinois University 1993; Brautigam, Deborah. *Chinese Aid and African Development: Exporting Green Revolution*. Palgrave Macmillan, 1998; Zhang, Shu Guang. *Beijing's Economic Statecraft During the Cold War, 1949-1991*. Washington, D.C.: Woodrow Wilson Center Press, 2014.



pansion and resource have been identified as the most likely motivations of its extensive economic activities. For example, Alves identifies the energy security of China as the driving force behind its relentless quest for oil in comparing cases of Angola and Brazil.<sup>26</sup> She argues the Chinese characteristic infrastructure for oil loans has made up the primary form of China's economic diplomacy in Africa and Latin America.<sup>27</sup>

However, the state-to-state or the society centered explanations are unable to address the uniqueness of China's state-business relationship that state dominates. There are also new perspectives in studying China's economic statecraft by introducing domestic actors, which provides a more empirical insight into micro-level economic interactions between China and its targets. Some recognize the importance of sub-state actors in China's economic statecraft. Li observes local liberalism can provide insights into understanding China's foreign relations with its neighbors. He finds the active initiative by the local governments which share borders with the mainland Southeast Asian countries has influenced the strategy-making of China-ASEAN economic relations in the central government. Although still constrained by the historical and strategic mistrust that exist among states, the proactive role taken by the local governments suggests sub-state actors are facilitating China's economic diplomacy.<sup>28</sup> Brautigam provides the study of overseas of economic activities of its companies in new overseas special economic zones. By studying the characteristics of different zones, the main findings are China go abroad to enhance its energy and resource security, promote its political influence, as well as boosting business opportunities for its firms especially SOEs.<sup>29</sup> Gill and Reilly recognizes the 'corporate engagement' as an agent in the strategy of states as principal to promote its geopolitical interests and soft power in addition to resources and business opportunities for its domestic growth demands.<sup>30</sup> Norris also recognizes the state-business relations in China's grand strategy because business activities carried out by the business actors generates security externalities that impact the outcome of its geopolitical objectives.<sup>31</sup>

The above literature on China's historical records and current economic activities patterns enables this paper to extract the insightful perspectives and analysis angles. However, this article aims to build further on literature and wish to provide a new angle from the inside-outside factors that influence its overseas performance. For example, the state-business actors: the capability of state control over the business actors paves the way of pondering on the puzzle that why the business actors in an authoritarian China sometimes were unable to fulfill the goals in China's foreign relations. Thus, a critique analysis is required.

China's SOEs has been used as tools venture overseas through specific policy incentives, political backing and financial support. It is important because China's state-business relationship affects its positive economic statecraft that has backfired its image building and influence projection. This paper finds pluralistic domestic challenges in state-business actor relations constrain its agility in economic statecraft maneuvering. The recognition of ramification of non-state actors helps provide new perspectives in understanding China's behavior and capa-

<sup>26</sup> Goldstein, Andrea, Nicolas Pinaud, Helmut Reisen, and Xiaobao Chen. "The Rise of China and India: What's in It for Africa ". OECD Development Center Studies Development Centre of the Organization for Economic Cooperation and Development 2006; Gill, Bates, and James Reilly. "The Tenuous Hold of China Inc. In Africa." *The Washington Quarterly* (Summer 2007); Monson, Jamie. *Africa's Freedom Railway: How a Chinese Development Project Changed Lives and Livelihoods in Tanzania*. Bloomington: Indiana University Press, 2009; Brautigam, Deborah. *The Dragon's Gift: The Real Story of China in Africa* Oxford University Press, 2010.

<sup>27</sup> Alves, Ana C. "China's Oil Diplomacy: Comparing Chinese Economic Statecraft in Angola and Brazil." PhD, London School of Economics, June 2011.

<sup>28</sup> Li, Mingjiang. "Local Liberalism: China's Provincial Approaches to Relations with Southeast Asia ". *Journal of Contemporary Asia* 23, no. 86 (2014): 275-93.

<sup>29</sup> Brautigam, Deborah, and Tang Xiaoyang. "Economic Statecraft in China's New Overseas Special Economic Zones : Soft Power, Business or Resource Security? ." *International Affairs* 88, no. 4 (July 2012).

<sup>30</sup> Gill, Bates, and James Reilly. "The Tenuous Hold of China Inc. In Africa." *The Washington Quarterly* (Summer 2007).

<sup>31</sup> Norris, William J. "Economic Statecraft with Chinese Characteristics : The Use of Commercial Actors in China's Grand Strategy." PhD, Massachusetts Institute of Technology, 2010.

bility. This paper aims to fill the scant research on China's economic statecraft as a key tool in its strategy towards Southeast Asia by focusing on China's infrastructure for influence in Southeast Asia.

## 2. Analytical Framework

In traditional diplomacy, the ministry of foreign affairs usually takes charge. However, in China's economic statecraft, regulatory bodies of different ministries and departments are involved even though some of their function overlap. The overlapping regulatory agencies from the domestic bureaucracy structure complicates consistent supervision over SOEs business activities abroad. Due to fragmented administration, constraints rise among coordination and practice norms, which makes monitoring China's SOEs overseas adventure in line with expected foreign policy goals more difficult.

### *Challenge of coordination and policy coherence*

In China, the State Council supervises every organ of ministerial levels. The Ministry of Commerce (MOFCOM) regulates foreign trade, approves and monitors SOEs in overseas activities and directs foreign aids. The National Development and Reform Commission (NDRC) is a central planner for China's economic development by setting industrial policy and creating regulations and standards for Chinese SOEs. The NDRC assesses overseas activities of SOEs to see whether they are in line with China's national interests. The State-Owned Asset Supervision and Administration Commission (SASAC) owns SOEs and also oversees activities of China's SOEs and has the authority to approve and remove personnel, approve mergers and acquisitions and drafts laws and regulations.<sup>32</sup> The Ministry of Finance (MOF) monitors government-related investments fundings by offering capitals into state banks to support SOEs. The Ministry of Foreign Affairs (MFA) provides advice to MOFCOM on the research of overseas markets for Chinese companies and foreign aid issues. Its main responsibility is to safeguard China's reputation overseas. Although Economic Counselor's Office that oversees China's overseas business is located in MFA foreign embassies, ECO is subordinate to MOFCOM and carry out what MOFCOM directs. China Export and Import Bank (EXIM) and China Development Bank (CDB) are both ministerial level entities. The former finances trade deals and provides subsidized loans for China's foreign aid projects while the CDB helps finance infrastructure and resource projects both at home and abroad.

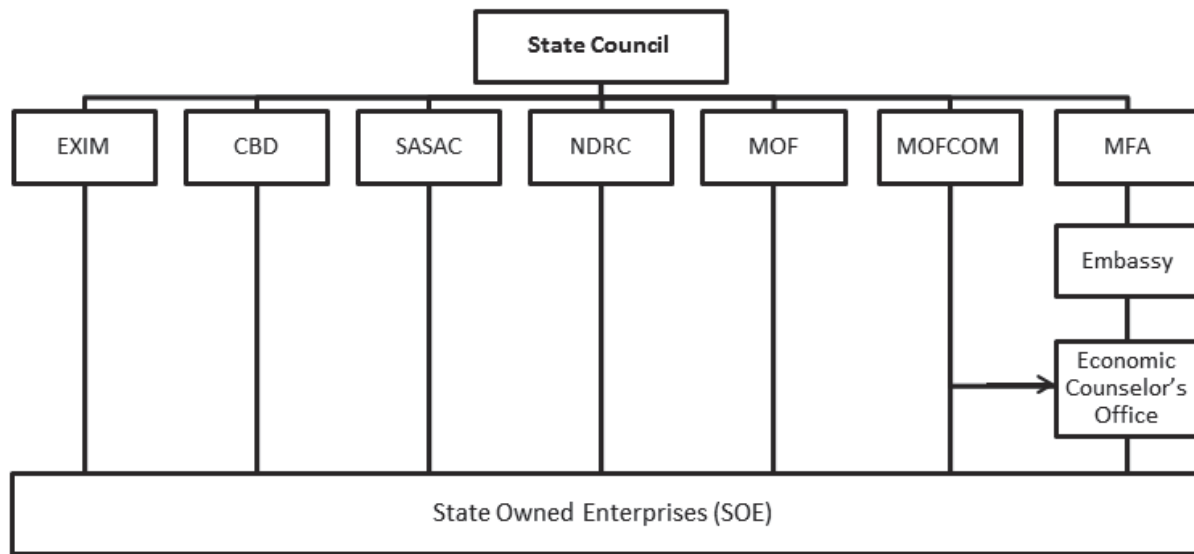
Different from most Western economic statecraft,<sup>33</sup> China encourages its government envoys to focus on one country or region so that Chinese diplomats would be able to forge an extensive contacts in the local business, political communities, paving the way for the Chinese SOEs to come to the target countries through connections with political and economic elite in the country. However, the embassy from MFA does not have regulatory authority over the illicit activity of China SOEs in the host country, which dwarfs China's diplomatic efforts.

<sup>32</sup> Naughton, Barry. "Sasac and Rising Corporate Power in China." In *China leadership Monitor*: Hoover Institution, Spring 2008.

<sup>33</sup> For example, the US Foreign Service Officer in the US Embassy in a particular country would be rotated within two or three period to other parts of the world to avoid 'clientitis' and bribery.



Figure 1. China regulatory entities for SOEs



Author's image based on reports and papers analysis <sup>34</sup>

On top of the ministerial level agencies, the subsidiaries of these ministries in provincial and city level complicate China's regulation over SOEs activities further. Diverse domestic actors proliferate in a complex web of ministries, military, SOEs, ect that all try to maximize their interests by influencing state policy making.<sup>35</sup>

The competitive nature of international political economy drives states to compete for the strategic natural resource, technological advantage, and decreasing costs for industrialization to ensure its national income growth, military power accumulation, and domestic society stability. The nature of market forces from globalization and technology development poses threats to state autonomy, where business actors engage in activities that may diverge from the goals of the governmental strategy. In an anarchic but competitive international system, states socialize and interact with one another spontaneously and inadvertently. Even though China's political system still has remained authoritarian, the growing synergies between the fast changing domestic market reforms and international contexts have led to China's changing behaviors. During the socialization process, the capability of political ruling elites to respond to external changes depends on the relations with its domestic actors, such as nationalism, ideology, military, influential interest groups.

While recognizing the significant role that the government plays in designing the foreign assistance policy as part of its economic statecraft, the state is limited in its capacity of transforming its economic power into desired foreign policy goals because of special state-SOEs relations. SOEs are able to exploit political relations through connections within the State to receive support. At first glance, it seems paradoxical given the assumed influence of the central government on domestic actors and tight control of the Party over the strategic issue. In fact, the top level SOEs CEOs, chair of the board of directors, and managers are all appointed and promoted by SASAC and Organization Department of Communist Party, not to mention a party secretary is also appointed within the SOEs. What's more, an SOE manager may simultaneously hold more than one of the positions within the com-

<sup>34</sup> Reilly, James. "China's Economic Statecraft: Turning Wealth into Power ". *Lowy Institute for International Policy* (November 2013); Backaler, Joel. *China Goes West: Everything You Need to Know About Chinese Companies Going Global*. New York Palgrave Macmillan, 2014;

<sup>35</sup> Jakobson, Linda, and Dean Knox. "New Foreign Policy Actors in China." In *SIPRI Policy Paper*: Stockholm International Peace Research Insititue, September 2010.

pany where political connections facilitates bribery and red-tape seeking.<sup>36</sup> They possess ranking equal to ministerial level and even some of them have authority on par with government agencies that supervise their company. Guanxi- connections also facilitates SOEs to wield deep personal networks they can leverage to influence state policies. The fact that quite a few SOEs leaders possess family or political connections with ruling elites makes SOEs more vulnerable to personal or clan gains.

According to Mastanduno, there are two aspects of positive economic statecraft: one aiming to produce immediate effects and the other to induce with long-term rewards.<sup>37</sup> However, targeting-setting management that affects political promotion lead to less sustainable plan for long-term foreign policy goals, especially in energy and resource sectors. SOEs managers are far from passive policy implementers. For one thing, political assessment for promotion is closely connected with the profits and scale of investment volumes. Often they are in the position of the company for five years, which means they are unlikely to undertake prospecting project which will take more sustainable years to effect into positive outcome. For another, to those with no prospect of political promotion, many executives are deeply attracted to personal gains. They take advantage of assets and preferential loans to invest overseas. If the investment performs well, the net profits will be their personal gains. Otherwise, the state will endure the investment loss. The central government expects Chinese SOEs to be on their best behavior for strategic foreign relations goals. China's MFA has made these expectations clear in public statements because the Chinese government does not wish to see China's reputation and soft power diminished by the unlawful activities of its business activities. However, the priority of speed over quality in investments is the main reason of incurring local resistance and concerns over China's infrastructure for influence inducement.

Within SOEs themselves, heavy corporate structures further complicate oversight of these companies. With a large size of subsidiaries across different provincial, city and overseas level, competition exists which creates ample space for misreporting and illicit activity for narrow interests. The Chinese saying: heaven is high and the emperor is far away, 天高皇帝远 is often used to describe the loose control on overseas practice of China's SOEs. In another word, SOEs can be quite autonomous in pursuing their own interests, as Liou convincingly develops in the case of two SOEs: CNPC and Sinopec competing in Sudan against the national strategy of energy security.<sup>38</sup>

The Chinese leadership has realized this negative impact, and therefore issued corporate social responsibility and amended regulations to monitor overseas business activities of the Chinese companies.<sup>39</sup> However, the Chinese government and companies are resistant to the imposition of Western standards and norms on investment projects. They uphold non-interference principle which is believed to be popular and pragmatic in dealing with developing countries by the Chinese leadership. Furthermore, because China offers assistance such as government buildings, infrastructure, and energy facilities funded by loans from the EXIM and built by Chinese companies without the conditions, it often receives appreciation. Because of this, many foreign aid experts, non-governmental organizations (NGOs), and local groups have criticized China for failing to promote democracy, widespread, sustainable development, and environmental conservation.<sup>40</sup>

<sup>36</sup> Leutert, Wendy. "Chinese State-Owned Companies under Scrutiny." Council on Foreign Relations Feb 26 2015.

<sup>37</sup> Masranduno, Michael, ed. *Economic Statecraft Revisited*. edited by Steve Smith, Amelia Hadfield and Tim Dunne, Foreign Policy: Theories, Actors, and Cases: Oxford University Press, 2008.

<sup>38</sup> Liou, Chih-shian. "Bureaucratic Politics and Overseas Investment by Chinese State-Owned Oil Companies: Illusory Champions ". *Asian Survey* 49, no. 4 (July/August 2009): 670-90.

<sup>39</sup> [http://www.zadek.net/wp-content/uploads/2011/04/Harvard\\_Responsible-Business-in-Africa\\_November2009.pdf](http://www.zadek.net/wp-content/uploads/2011/04/Harvard_Responsible-Business-in-Africa_November2009.pdf), <https://www.chinadialogue.net/article/show/single/en/1407-China-s-opportunity-to-embrace-responsible-competitiveness>

<sup>40</sup> Lum, Thomas, Wayne M. Morrison, and Bruce Vaughn. "China's 'Soft Power' in Southeast Asia." In CRS Report for Congress: Congressional Research Service, January 4 2008.

China itself fails to realize the reality of China as the great power; the non-interference increasingly become unfeasible. As its aid and development programmes grow, the convergence with the international expectations and standards may be unavoidable. At the same time, the Chinese government and companies have different perceptions of non-governmental organizations, labeling it as anti-China with bias. More generally, the Chinese react to Western criticism with a stronger sense of nationalism which derived from the memory of humiliation of last century. Therefore, they are unwilling to consult NGOs before or during the project, which isolates themselves from the locality.

### *Aiming Southeast Asia*

Encouraging SOEs to venture overseas fits China's economic statecraft in serving its own economic transformation. Firstly, Chinese state relies on SOE's balance sheets and resources to perform many strategic and policy-oriented functions.<sup>41</sup> Secondly, the rapid economic growth over the past two decades has depleted certain domestic natural resources such as oil and water while witnessing saturation of certain industries such as construction and steel. Overdevelopment in China means manufacturing and infrastructure investments are suffering from lack of domestic demand.<sup>42</sup> Meanwhile, due to the decades' economic growth, China is having a huge capital surplus, which explained the robust growth of foreign reserves at USD \$ 3.9 trillion. The fear that the value of foreign reserves might shrink in future signals significant capital flight from China to reduce its excessive levels of investment in the domestic market. Thirdly, SOEs carry historical burdens for taking care of its large workforces that they used to support in areas such as bonus, medical welfare, housing allowance. Market reform expects Chinese SOEs to be competitive in meeting annual targets set by SASAC, which is closely connected to the promotion of SOE managers into the political arena. Due to its special status in China's economy, SOEs expand overseas as a tool to boost China's foreign policy goals with preferential government policies. The eagerness for resources and market share has been driving China's prominent role in global investment activities.<sup>43</sup> Thereby, SOEs has become a strategic tool in China's market share expansion, production value chain upgrading and resource securing. But its locomotives tend to be mercantilist and driven by the concerns about the relative economic and military influence of other powers in the region, especially in Southeast Asia.

Southeast Asia is rich in natural resources, ranging from minerals, oil, natural gas to water, forest products and rich bio-diversity that has attracted an increasing influx of Chinese investments into this region. The convergence between China and mainland Southeast Asian countries is largely due to China's needs for natural resources to fuel its growing economy and low-cost labor force. The end of Cold War in the 1990s created a favorable environment for China to develop its economic inducements toward its southern neighbors. Since then, China has become an important source of investment financing in Southeast Asia. A significant part of China's investment converges with foreign aid in forms of concessional loans, interest-free loans, and grants for infrastructure projects, debt relief to high-indebted developing countries, as well as preferential tariff agreements. However, China's foreign aid has blurring definition because subsidies and loans are usually disbursed together by MOFOM, through China Export-Import bank (China EXIM). This type of financial support for infrastructure often mixes aid and commercial financial instruments. For example, the 193 MW Kamchay dam in Cambodia

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<sup>41</sup> "China State-Owned Enterprises: On a Bumpy Path Towards Market Reform." Fitch ratings June 9 2014.

<sup>42</sup> Hu, Jianlong. "China's Firms Battle Each Other in Africa." Chinadialogue (2014).

<sup>43</sup> Urban, F., and G. Mohan. Case for Support: China Goes Global. . Economics and Social Research Council Esrc. Swindon, 2011.

has received concessional loans and aid package committed of US\$600 million as well as part of profits earned by Sinohydro Group in an initial public offering (IPO).<sup>44</sup>

China's economic venture into Southeast Asia is turning into one of the most striking features of its emergence as a global economic player. The academic debate over China's growing engagement with developing countries has been either labeling China as neo-colonialism in search for raw materials or mercantilism in pursuit of seizing economic opportunities. Although China's quest for resources defines its engagement with Africa and Latin America,<sup>45</sup> there tends to display a more complicated pattern for China's economic engagement with Southeast Asia due to more direct geopolitical consideration.

According to ASEAN official report, the top ten sources of foreign direct investment inflows into ASEAN countries, the mainland of China, excluding Hong Kong and Taiwan ranks the fifth from 2013-2015, with a share of 6.8% in 2015 only. However, a lot of Hong Kong and Singapore registered Chinese companies, especially SOEs takes up the majority of overseas investment. And this trend is increasing due to more economic incentives policies encouraged by the central government.<sup>46</sup>

Table 2 Top FDI inflows to ASEAN from Year 2013-2015

Country/region	Value			Share to total inflows		
	2013	2014	2015	2013	2014	2015
ASEAN	19,562.2	22,134.5	22,232.2	15.7	17.0	18.4
European Union (EU)	24,511.3	24,989.9	20,127.6	19.6	19.2	16.7
Japan	24,750.2	15,705.4	17,559.4	19.8	12.1	14.5
USA	7,157.2	14,748.5	13,646.0	5.7	11.3	11.3
China	6,426.2	6,990.1	8,256.5	5.1	5.4	6.8
Republic of Korea	4,303.3	5,750.7	5,710.4	3.4	4.4	4.7
Australia	2,587.7	6,281.5	5,246.7	2.1	4.8	4.3
Hong Kong	5,251.2	9,813.2	4,542.9	4.2	7.5	3.8
Taiwan, Province of China	1,381.8	3,253.9	2,807.0	1.1	2.5	2.3
New Zealand	335.9	550.0	2,241.2	0.3	0.4	1.9
Total top ten sources	96,267.1	110,217.7	102,370.0	77.1	84.8	84.7
Others	28,597.4	19,777.4	18,448.8	22.9	15.2	15.3
Total FDI inflow to ASEAN	124,864.5	129,995.1	120,818.8	100.0	100.0	100.0

<sup>44</sup> "China Gives Cambodia \$600m in Aid ". BBC, April 8 2006, <http://news.bbc.co.uk/2/hi/asia-pacific/4890400.stm>; China IPO to benefit Kingdom, September 30 2011, <http://www.phnompenhpost.com/business/china-ipo-benefit-kingdom>.

<sup>45</sup> Gill, Bates, and James Reilly. "The Tenuous Hold of China Inc. In Africa." *The Washington Quarterly* (Summer 2007); Alves, Ana C. "China's Oil Diplomacy: Comparing Chinese Economic Statecraft in Angola and Brazil." *London School of Economics*, June 2011.

<sup>46</sup> ASEAN Foreign Direct Investment Statistics Database as of 31 December 2014 (Data is compiled from submission of ASEAN Central Banks and National Statistical Offices through the ASEAN Working Group on International Investment Statistics (WGIIS).

"Top Ten Sources of Foreign Direct Investment Inflows in Asean ". Association of Southeast Asian Nations, [http://www.asean.org/images/2015/January/foreign\\_direct\\_investment\\_statistic/Table%2027.pdf](http://www.asean.org/images/2015/January/foreign_direct_investment_statistic/Table%2027.pdf).

Source: Top Ten Sources Of Foreign Direct Investment Inflows in ASEAN<sup>47</sup>

However, there are four pillar issues blocking China's economic statecraft towards Southeast Asia: Firstly, the South China Sea disputes has barred further cooperation such as Vietnam's suspicion of China's railway system connecting China and Singapore. The maritime dispute claimers attempt to bring the framework of ASEAN into the dispute, which not only makes the unity of ASEAN under question but also challenge China's favorable bilateral solution. Nationalism in both China as well as other Southeast Asian countries have made the compromise on sovereignty more difficult. Secondly, the limitation existing in economic-security nexus has changed the strategy of Southeast Asian countries into economic engagement with China while security leaning on the United States. The promotion and upgrading of China-ASEAN relations have not necessarily been translated to the progress of political security relations. Instead, as the interdependence with China depends, some of the Southeast Asian countries have become even more suspicious of China's rise. Thirdly, China is not the only country that is eyeing mainland Southeast Asia for its energy potential. The United States, Japan, and other major players are all competing for the influence projection in this region. An obvious example is after Myanmar suspended China's dam investment, increasing Japanese investment returns to take the advantage. Lastly, China is quite a late comer in terms of overseas investment. Due to domestic demands, Chinese companies have been forced to develop highly risky projects in the crisis-prone or immature-market regions compared to the developed countries such as the United States, Japan, and Canada. Therefore, public frustration about China's energy extraction pattern has backlashed China's benign political will in several Southeast Asian countries.

### 3. Conclusion

The study of China's theoretical and practical economic statecraft in Southeast Asia can contribute to the understanding of how China will behave in the international system.<sup>48</sup> To realize its peaceful rise, China is using a mixture of trade, financial, investment measures, and development assistance to establish itself as an influential regional leader. Even it is far from replacing the United States in the region; it is steadily building connectivities with other countries and demonstrating a willingness to step into when there is a vacuum. Over the past decade, China has received much appreciation in the region for its economic approach towards Southeast Asia, and its ability and desire to understand the needs of regional countries.<sup>49</sup> However, many in the region remain suspicious and cautious of China's growing power, especially when the South China Sea disputes remain the greatest area of concern for most Southeast Asian states.

As the economic cooperation deepens, it is believed among some Chinese leaders and scholars that, the strengthening relationship may not lead to the satisfactory solutions of China's security concerns, but it will probably restrain the behaviors of parties involved due to common economic interests. In its bid to bring Southeast Asia into its supportive circuit, China has realized the potential of using economic inducements as a key instrument in securing its foreign policy and geopolitical goals. Findings in the paper suggest that China has tac-

<sup>47</sup> [http://asean.org/?static\\_post=foreign-direct-investment-statistics](http://asean.org/?static_post=foreign-direct-investment-statistics)

<sup>48</sup> For the heated discussion of China's reaction and behavior in international system, see, Johnston, Alastair Iain, and Robert S. Ross. *New Directions in the Study of China's Foreign Policy*. Calif: Stanford University Press, 2006; Goldstein, Avery. "Power Transitions, Institutions, and China's Rise in East Asia: Theoretical Expectations and Evidence." *Journal of Strategic Studies* 30, no. 4-5 (Aug-Oct 2007): 639-82; Ross, Robert S., and Feng Zhu. *China's Ascent: Power, Security, and the Future of International Politics*. Ithaca: Cornell University Press, 2008; Shambaugh, David. "China Engages Asia: Reshaping the Regional Order." *International Security* 29, no. 3 (Winter 2004/5): 64-99; Zhu, Zhiqun. *China's New Diplomacy: Rationale, Strategies and Significance*. Burlington, VT: Ashgate Publishing Co, 2010; Mingjiang, Li, ed. *China and the Changing Strategic Dynamics in Asia*. Four vols. Vol. I, China's International Relations in Asia New York: Routledge, 2010

<sup>49</sup> Economy, Elizabeth. *China's Rise in Southeast Asia: Implications for Japan and the United States*, Vol 3, Issue 10, 2005, The Asia-Pacific Journal, <http://apjif.org/-Elizabeth-Economy/1815/article.html>

itly changed its course of diplomacy from serving economic development to wielding economic power. It also sheds light on constraints from a state-business relationship that limit China's influence through economic inducements. In this regard, China has a long way to go in improving its economic statecraft to sever its foreign policy better.

Although China realizes that its influence from economic statecraft is rather limited, it is likely that China will continue to use economic incentives to reduce containment from its competitors and maritime dispute claimants, as it did before in isolating the international status of Taiwan. It is also likely that China will expand its diplomatic toolkit, using politics and military as a last resort to secure its interests. Whether China changes its course of economic diplomacy also hinges on the response from the United States and its alliance as well. With so many factors in play, economic diplomacy is not a straightforward approach for states to realize their foreign policy goals, but China will continue to utilize it as long as it fits its strategy.