

CHINA'S RELATIONS WITH SOUTHEAST ASIA

HEARING
BEFORE THE
U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

ONE HUNDRED FOURTEENTH CONGRESS
FIRST SESSION

WEDNESDAY, MAY 13, 2015

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COMMISSION

WASHINGTON: 2015

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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The Commission was created on October 30, 2000 by the Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Public Law No. 106-398, 114 STAT. 1654A-334 (2000) (codified at 22 U.S.C. § 7002 (2001), as amended by the Treasury and General Government Appropriations Act for 2002 § 645 (regarding employment status of staff) & § 648 (regarding changing annual report due date from March to June), Public Law No. 107-67, 115 STAT. 514 (Nov. 12, 2001); as amended by Division P of the “Consolidated Appropriations Resolution, 2003,” Pub L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of the Commission); as amended by Public Law No. 109-108 (H.R. 2862) (Nov. 22, 2005) (regarding responsibilities of Commission and applicability of FACA); as amended by Division J of the “Consolidated Appropriations Act, 2008,” Public Law No. 110-161 (December 26, 2007) (regarding responsibilities of the Commission, and changing the Annual Report due date from June to December); as amended by the Carl Levin and Howard P. “Buck” McKeon National Defense Authorization Act for Fiscal Year 2015, P.L. 113-291 (December 19, 2014) (regarding responsibilities of the Commission).

The Commission’s full charter is available at www.uscc.gov.

July 21, 2015

The Honorable Orrin Hatch
President Pro Tempore of the Senate, Washington, D.C. 20510
The Honorable John A. Boehner
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR HATCH AND SPEAKER BOEHNER:

We are pleased to notify you of the Commission's May 13, 2015 public hearing on "China's Relations with Southeast Asia." The Floyd D. Spence National Defense Authorization Act (amended by Pub. L. No. 109-108, section 635(a) and amended by Pub. L. No. 113-291, Section 1259 B) provides the basis for this hearing.

At the hearing, the Commissioners received testimony from the following witnesses: Bonnie Glaser, Senior Adviser for Asia, Freeman Chair in China Studies and Senior Associate, Pacific Forum, Center for Strategic and International Studies; Rapp Hooper, Fellow, Asia Program, and Director, Asia Maritime Transparency Initiative, Center for Strategic and International Studies; Patrick Cronin, Senior Advisor and Senior Director, Asia-Pacific Security Program, Center for a New American Security; Chin-Hao Huang, Assistant Professor of Political Science, Yale-NUS College (Written Testimony Only); Peter Chalk, Adjunct Senior Analyst, RAND Corporation (Written Testimony Only); Robert Sutter, Professor of Practice of International Affairs, Elliott School of International Affairs, George Washington University; Meredith Miller, Senior Vice President of Trade, Economic, and Energy Affairs and Director of the Washington, D.C. office, National Bureau of Asian Research; David Dapice, Economist, Vietnam Program, Ash Center for Democratic Governance and Innovation, John F. Kennedy School of Government, Harvard University; Priscilla Clapp, Senior Advisor, U.S. Institute of Peace and the Asia Society; Pek Koon Heng, Director of the ASEAN Studies Initiative and Assistant Professor, School of International Service, American University; and Hiebert, Deputy Director and Senior Fellow, Sumitro Chair for Southeast Asia Studies, Center for Strategic and International Studies.

The hearing focused on key developments in the security, diplomatic, and economic spheres of China's relations with countries in Southeast Asia and with the Association of Southeast Asian Nations (ASEAN). It sought to understand how China's relations with the region may be changing and assessed the implications of developments in China-Southeast Asia relations for the United States.

We note that prepared statements for the hearing, the hearing transcript, and supporting documents submitted by the witnesses are available on the Commission's website at www.USCC.gov. Members and the staff of the Commission are available to provide more detailed briefings. We hope these materials will be helpful to the Congress as it continues its assessment of U.S.-China relations and their impact on U.S. security.

The Commission will examine in greater depth these issues, and the other issues enumerated in its statutory mandate, in its 2015 Annual Report that will be submitted to Congress in November 2015. Should you have any questions regarding this hearing or any other issue related to China, please do not hesitate to have your staff contact our Interim Congressional Liaison, Nicholas Armstrong, at (202) 624-1481 or via email at narmstrong@uscc.gov.

Sincerely yours,



Hon. William A. Reinsch
Chairman



Hon. Dennis C. Shea
Vice Chairman

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CHINA'S RELATIONS WITH SOUTHEAST ASIA

WEDNESDAY, MAY 13, 2015

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, D.C.

The Commission met in Room 608 in the Dirksen Senate Office Building in Washington, DC at 9:00 a.m. Commissioners Carolyn Bartholomew and Daniel M. Slane (Hearing Co-Chairs), presiding.

OPENING STATEMENT OF COMMISSIONER CAROLYN BARTHOLOMEW HEARING CO-CHAIR

HEARING CO-CHAIR BARTHOLOMEW: Good morning, everyone. Welcome to the sixth hearing of the U.S.-China Economic and Security Review Commission's 2015 Annual Report cycle. Thank you all for joining us today.

Today's hearing will focus on key developments in the security, diplomatic and economic spheres of China's relations with countries in Southeast Asia and with the Association of Southeast Asian Nations, or ASEAN.

It will seek to understand how China's relations with the region may be changing and the implications of developments in China-Southeast Asia relations for the United States.

Among the security and geopolitical challenges in Southeast Asia, the South China Sea disputes are some of the most contentious. In recent years, China has taken a more assertive, some would say aggressive, approach to its territorial claims in the South China Sea. Beijing has sought to advance these claims through deploying various civilian and military maritime actors and through land reclamation and construction on the land features that it controls, among other means.

China's actions are causing countries in the region and the United States to question whether China will be a peaceful and cooperative regional and global partner and are increasing the risk of regional instability and even an armed conflict, which could involve the United States.

Since 2014, China has dramatically increased its land reclamation and construction activities in the Spratly Islands. Just last week, the Pentagon revealed China had added 1,500 acres to its South China Sea outposts since last December. These land reclamation and associated infrastructure improvement projects pose challenges to international law and global norms, and I would note that just yesterday, of course, the Wall Street Journal reported that the U.S. military is proposing challenges to China's sea claims. The Chinese are also enhancing their ability to sustain military and maritime law enforcement presence in the South China Sea.

These developments underscore the importance of a robust U.S. military presence in the Asia Pacific and of U.S. efforts to partner with regional countries to enhance their capacity in areas such as maritime domain awareness.

To help us understand China's approach to the South China Sea disputes and other key

aspects of China's relations with Southeast Asia, we have invited a distinguished group of witnesses to participate in this hearing.

Before I turn the floor over to my co-chair for this hearing, Commissioner Dan Slane, for his opening comments, I would like to thank Chairman Enzi and the staff of the Senate Budget Committee for securing this room for us today, and I'll just remind all of our witnesses to please make sure that you--and my colleagues--that your microphones are on when you speak so that our transcriptionist is able to capture your comments.

Commissioner Slane.

**PREPARED STATEMENT OF COMMISSIONER CAROLYN BARTHOLOMEW
HEARING CO-CHAIR**

Hearing on “China’s Relations with Southeast Asia”
Opening Statement of Commissioner Carolyn Bartholomew
May 13, 2015
Washington, DC

Good morning, and welcome to the sixth hearing of the U.S.-China Economic and Security Review Commission’s 2015 Annual Report cycle. I want to thank you all for joining us today.

This hearing will focus on key developments in the security, diplomatic, and economic spheres of China’s relations with countries in Southeast Asia and with the Association of Southeast Asian Nations or ASEAN. It will seek to understand how China’s relations with the region may be changing and the implications of developments in China-Southeast Asia relations for the United States.

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To help us understand China’s approach to the South China Sea disputes and other key aspects of China’s relations with Southeast Asia, we have invited a distinguished group of witnesses to participate in this hearing.

Before I turn the floor over to my co-chair for this hearing, Commissioner Daniel Slane, I would like to thank Chairman Enzi and the staff of the Senate Budget Committee for securing this room for us today.

**OPENING STATEMENT OF COMMISSIONER DANIEL M. SLANE
HEARING CO-CHAIR**

HEARING CO-CHAIR SLANE: Thank you, Commissioner Bartholomew, and welcome everyone.

China views economic integration with Southeast Asia as key to its own economic growth and has established several diplomatic initiatives, including the 21st Century Maritime Silk Road and the Asian Infrastructure Investment Bank, to support these integrations. China's engagement with Southeast Asia in areas such as international trade, finance, and infrastructure development has the potential to complement U.S. engagement in the area.

However, concerns exist that China's strategy may be to supplement existing international economic institutions in favor of economic architecture under its own leadership that falls short of global standards, transparency, labor rights, and environmental protection. We hope that China's efforts to integrate with Southeast Asia economically will be built on such high standards and not undermine the integrity of existing economic institutions.

Despite efforts at multilateral cooperation in the region, China's bilateral engagement with Southeast Asian countries remains a pivotal component of its regional foreign policy. While China has expressed an interest in serving as a more responsible stakeholder in the global forums, it also worries that multilateralism will limit its leverage to fulfil its own national interest.

Through bilateral engagement in Southeast Asia, China is attempting to create a regional landscape in which it plays an increasingly dominant role where its interests may be served more directly.

Given the importance of bilateral engagement in China's Southeast Asian policy, we will be looking closely at its relationship with three key nations--Burma, Malaysia and Vietnam--later in our hearing today.

I'd like to remind the members of our audience that today's hearings will be webcast on the Commission's Web site, where all the written statements submitted for the record are also available. A transcript of today's hearing will be published on our Web site at later date.

**PREPARED STATEMENT OF COMMISSIONER DANIEL M. SLANE
HEARING CO-CHAIR**

Thank you, Commissioner Bartholomew, and welcome everyone.

China views economic integration with Southeast Asia as key to its own continued economic growth, and has established several diplomatic initiatives, including the 21st Century Maritime Silk Road and the Asian Infrastructure Investment Bank, to support this integration. China's engagement with Southeast Asia in areas such as international trade, finance, and infrastructure development has the potential to complement U.S. engagement in the region.

However, concerns exist that China's strategy may be to supplant existing international economic institutions in favor of economic architecture under its own leadership that falls short of global standards in governance, transparency, labor rights, and environmental protection. We hope that China's efforts to integrate with Southeast Asia economically will be built on such high standards and not undermine the integrity of existing economic institutions.

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PANEL I INTRODUCTION BY COMMISSIONER DANIEL M. SLANE

HEARING CO-CHAIR SLANE: We'll start with our first panel. Our first panel of today's hearing will focus on the security dimensions of China's relationship with Southeast Asia. The panel will examine China's approach to the South China Sea disputes, the responses of Southeast Asian countries to China's actions in the South China Sea and the responses to Chinese military modernization and security cooperation between China and countries in Southeast Asia.

First, we'll hear from Bonnie Glaser, Senior Advisor for Asia in the Freeman Chair at the China Studies and Senior Associate in the Pacific Forum at the Center for Strategic and International Studies.

Ms. Glaser's work focuses on issues related to Chinese foreign and security policy. In addition to her work at CSIS, she is also a consultant for the U.S. government on East Asia. From 2003 to mid-2008, Ms. Glaser was a Senior Associate at the CSIS International Security Program. Prior to joining CSIS, she served as a consultant for various U.S. government offices, including the Department of Defense and State.

Ms. Glaser has written extensively on topics, including Chinese threat perceptions and the views of the strategic environment, China's foreign policy, Sino-U.S. relations, U.S.-China military ties, and Chinese perspectives on multilateral security in Asia.

Next will be Mira Rapp-Hooper, a Fellow at the Asia Program and Director of the Asia Maritime Transparency Institute at CSIS. Dr. Rapp-Hooper's expertise includes Asian security issues, deterrence, nuclear strategy and policy, and alliance politics.

She was previously a Stanton Nuclear Security Fellow at the Council on Foreign Relations. Her Ph.D. dissertation, "Absolute Alliance: Extended Deterrence in International Politics," is a study of the formation and management of so-called nuclear umbrella alliances.

Dr. Rapp-Hooper's academic and policy writings have appeared in *Political Science Quarterly*, *Security Studies*, the *National Interest*, and *Foreign Affairs*, and she has a forthcoming article in the *Washington Quarterly*.

Finally, we have Patrick Cronin, Senior Advisor and Senior Director of the Asia-Pacific Security Program at the Center for a New American Security. Prior to joining the Center for a New American Security, Dr. Cronin was the Senior Director of the Institute for National Strategic Studies at the National Defense University, where he simultaneously oversaw the Center for the Study of Chinese Military Affairs.

During his career, Dr. Cronin has also served as the Director of Studies at the London-based International Institute for Strategic Studies, Senior Vice President and Director of Research at CSIS, Director of Research at the U.S. Institute of Peace, a senior analyst at the Center for Naval Analyses, and a U.S. Naval Reserve Intelligence officer.

Thank you for coming. Please keep your opening remarks to seven minutes. Ms. Glaser, we'll start with you.

OPENING STATEMENT OF BONNIE GLASER
SENIOR ADVISER FOR ASIA, FREEMAN CHAIR IN CHINA STUDIES AND SENIOR
ASSOCIATE, PACIFIC FORUM
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

MS. GLASER: Good morning. Thank you, Co-chairs Bartholomew and Slane, Commissioners and staff. I'm grateful for the opportunity to testify today and for all the work you do to increase understanding of China.

China views the status quo in the South China Sea as unacceptable and is seeking to create conditions more favorable to Chinese interests. China's ultimate strategic objective in the South China Sea is a matter of speculation. However, it seems increasingly likely than Beijing seeks to eventually assert sovereignty over as much of the South China Sea as possible.

Beijing's strategy to change the status quo in its favor does not rely on use of force. Instead, China is engaged in "salami slicing," using small incremental actions, none of which by itself is a casus belli. These include coercive actions against foreign ships, interference with energy exploration, disruption of foreign supply operations, unilateral energy exploration in disputed waters, and warnings to foreign aircraft in international airspace.

Since March 2014, China has conducted land reclamation on seven reefs in the Spratly Archipelago adding a total of 2,000 acres. This has posed new risks to regional security that my colleague Mira Rapp-Hooper will discuss in detail.

A crucial element in China's strategy to force fellow claimants to accept the reality of China's control is the use of economic inducements. With the introduction of the Asian Infrastructure Investment Bank, the One Belt, One Road project, the Silk Road Fund, Beijing seeks to bind its neighbors more closely to China and increase Chinese leverage over them.

China expects these neighbors over time to accommodate Chinese interests, including on territorial disputes, in return for providing those economic benefits.

In my written testimony, I summarize the reactions of ASEAN as well as key individual countries, Malaysia, the Philippines, Vietnam and Indonesia, to China's actions in the South China Sea.

Since another panel later today will focus on this issue, and my time is limited, I will simply say a few words about ASEAN. How to manage disputes over a maritime sovereignty in the South China Sea has been one of the most divisive issues facing ASEAN in recent years. As a grouping, ASEAN remains reluctant to antagonize China.

Nevertheless, anxiety about rising tensions in the South China Sea and the role played by China in precipitating tensions has increased significantly among virtually all its members, prompting ASEAN to speak out more forcefully on the issue.

ASEAN's role in managing the ongoing disputes will remain important but limited. Destabilizing behavior by China will likely be met with tougher ASEAN rhetoric but little more. Collective action beyond the adoption of harsher language is improbable.

ASEAN will unquestionably continue to press China to negotiate a Code of Conduct, but Chinese dissatisfaction with the status quo in the South China Sea makes it unlikely that Beijing will support finalizing a CoC in the near-term. It's possible that upon completion of its land reclamation activities and after its military outposts are operational that China may opt to conclude a CoC from a more advantageous position.

However, China might still resist agreeing to make it legally binding and to include a dispute settlement mechanism, and without these elements, a Code of Conduct would be no more

effective in preserving peace and stability in the South China Sea than the voluntary 2002 Declaration of the Conduct of Parties has been.

It is unlikely that any single cost imposition step will successfully persuade China to alter its present course of action. However, it is possible that a multifaceted strategy that is coordinated with like-minded countries can deter China's use of coercion and convince Beijing to adopt a less confrontational strategy toward its neighbors.

The Obama administration strategy so far has included multiple elements aimed at raising the cost to China for its destabilizing actions, and these policies have created some penalties for China but have not yet been sufficient to change Beijing's overall cost/benefit calculus, and therefore more steps need to be taken.

So I have outlined six additional steps that should be considered as part of the U.S. cost imposition strategy.

First, encourage ASEAN to develop its own legally binding Code of Conduct that would contain risk reduction measures and a dispute resolution mechanism. Only by reaching a consensus on a draft CoC can ASEAN hope to make progress in negotiating a China-ASEAN CoC.

An alternative is for ASEAN to adopt a treaty that would be similar to the Treaty of Amity and Cooperation that would be open to accession by all of ASEAN's dialogue partners. Quick accession by the United States, Australia, Japan and others would put pressure on China to accede to that treaty and abide by its provisions.

Second, conduct freedom of navigation operations in the sea and air around China's artificial islands. This is in the news today, as you mentioned, in the Wall Street Journal, and this is something that I think is important. The U.S. has carried out the FON program to protect maritime rights throughout the world for decades since 1979.

Third, respond to future Chinese coercive acts, including using U.S. naval forces to deter China's use of white-hulled vessels. By relying on coast guard and paramilitary ships, China appears to believe it can conduct coercive actions without incurring significant risk. This has provided China with an opportunity to change the status quo. A successful counter-coercion strategy should entail consideration of a greater acceptance of risk by demonstrating U.S. willingness to employ Navy ships in response to China's provocations.

Fourth, withhold invitation to RIMPAC 2016 for China if it coerces its neighbors. RIMPAC should be open to participation by nations that are contributing to peace and stability in the Asia-Pacific region. So if China is using its newly built outposts to coerce other claimants, then I think that that invitation should be withheld.

Fifth is to encourage Taiwan to clarify the meaning of its original 1947 11-dashed line and its territorial claim in the South China Sea. China's claim is, of course, based on Taiwan's original claim, and the ambiguity of that claim is a major source of tension in the South China Sea. A decision by Taiwan to clarify its claim would put pressure on Beijing to do the same.

And finally, we must continue to help the Philippines and Vietnam enhance their maritime policing and defense capabilities.

There is much for Congress to do in this regard. It can publicize China's destabilizing activities and promote a more effective U.S. policy toward the South China Sea. Timely letters from Congress to senior officials in the executive branch expressing concern and advocating specific courses of action are one important tool. Of course, there's also congressional resolutions that can send powerful signals of American concern, not only to our executive branch but to the region and the rest of the world.

And last, but not least, the Congress could require the Defense Department to include a section on Chinese activities in the South China Sea in its Annual Report to Congress on Military and Security Developments Involving the PRC. And, in addition, Congress could require that the commander of U.S. Pacific Command report on China's South China Sea activities in its annual posture statement to the respective Armed Service Committees of the House and the Senate.

Thank you again for the opportunity to testify today.

**PREPARED STATEMENT OF BONNIE GLASER
SENIOR ADVISER FOR ASIA, FREEMAN CHAIR IN CHINA STUDIES AND SENIOR
ASSOCIATE, PACIFIC FORUM
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES**

Prepared Statement of
Bonnie S. Glaser
Senior Adviser for Asia
Center for Strategic and International Studies

Testimony before the U.S.-China Economic and Security Review Commission
Hearing on China's Relations with Southeast Asia
May 15, 2015

Thank you Co-Chairs Commissioners Carolyn Bartholomew and Daniel Slane, members of the Commission, and staff. I am grateful for the opportunity to testify today and for all the work you do to increase understanding of China.

China's Strategy toward the South China

- What is China's strategy regarding the South China Sea maritime and territorial disputes? What are China's near-term and long-term objectives? What tactics does China employ to advance its interests in the South China Sea? How does China assess the progress it is making?

From Beijing's perspective, China has "indisputable sovereignty over the islands in the South China Sea and the adjacent waters, and enjoys sovereign rights and jurisdiction over the relevant waters as well as the seabed and subsoil thereof."¹ Beyond that statement, China has deliberately remained ambiguous about the extent of its claim in the South China Sea. Although China submitted its nine-dashed line map in a Note Verbale to the UN Secretary General in May 2009, it has never clarified the nature of its claim associated with that map.

China views the status quo in the South China Sea as unacceptable and is seeking to create circumstances more favorable to Chinese interests. The development of more advanced capabilities in recent years has enabled the Chinese to exert greater control over the disputed water and airspace in the South China Sea.

China sees itself as a relative latecomer in the scramble to assert sovereignty over land features in the South China Sea. In 1974, China seized the Crescent Group in the western Paracel Islands from Vietnam in a bloody naval firefight. Beijing had no foothold in the Spratly Archipelago until it snatched Johnson South Reef in another naval skirmish with Vietnam in 1988. Later China occupied another seven submerged or partially submerged features in the Spratlys. By

¹ Permanent Mission of the People's Republic of China, Notes Verbales CML/17/2009 and CML/18/2009, May 7, 2009, available from the UN Division for Ocean Affairs and the Law of the Sea (DOALOS) at: http://www.un.org/Depts/los/clcs_new/submissions_files/mysvnm33_09/chn_2009re_mys_vnm_e.pdf and http://www.un.org/Depts/los/clcs_new/submissions_files/vnm37_09/chn_2009re_vnm.pdf. See also Chinese Ministry of Foreign Affairs: Position Paper on the Matter of Jurisdiction in the South China Sea Arbitration, December 7, 2014, <http://www.cfr.org/territorial-disputes/chinese-ministry-foreign-affairs-position-paper-matter-jurisdiction-south-china-sea-arbitration/p33978>.

comparison, Vietnam occupies approximately 26 land features; the Philippines has eight features under its control; Malaysia occupies another three; and Taiwan occupies one. Every claimant other than China, with the exception of Brunei and Malaysia, has at least one naturally formed island under its control. Most of the other claimants also have extracted hydrocarbons in the Spratlys.

Chinese officials say that the government has been under pressure to defend the nation's sovereignty and territorial integrity, including in the South China Sea. The People's Liberation Army, the security and intelligence apparatus, maritime agencies, state-owned energy companies and the general public support a vigorous defense of Chinese interests, especially territorial integrity and sovereignty. Deng Xiaoping's policy of "shelving sovereignty and pursuing joint development" has apparently been judged a failure in recent years.² Chinese analysts maintain that other claimants took advantage of Deng's moderate approach and China's restraint to pursue unilateral development of energy resources.

Possibly in response to this pressure, but more likely reflecting his personal proclivities, Chinese President Xi Jinping has adopted an unbending stance on sovereignty issues. In January 2013, just two months after becoming secretary general of the Chinese Communist party, Xi told members of the Politburo Standing Committee that China would never sacrifice its legitimate rights or basic interests No foreign country should expect us to make a deal on our core interests and hope we will swallow the bitter pill that will damage our sovereignty, security and development interests."³ At key meetings since then, Xi has reiterated this position, including at the Foreign Affairs Work Conference held in November 2014.⁴

Beijing's strategy to change the status quo in its favor does not rely on the use of force. Instead, China is engaged in "salami-slicing"—using small, incremental actions, none of which by itself is a *casus belli*.⁵ These include coercive actions against foreign ships, interference with energy exploration, disrupting foreign supply operations, unilateral energy exploration in disputed waters, warnings to foreign aircraft, and subsidizing Chinese fishing boats to fish in disputed waters. For example, in the energy realm, Chinese law enforcement vessels have obstructed seismic surveys in the 200 nm Exclusive Economic Zones (EEZ) of Vietnam and the Philippines. Beijing also imposes pressure on international oil firms that have signed oil exploration deals with other claimant countries in the South China Sea. Both ExxonMobil and IndianOil, India's state owned oil company, have been threatened to abandon deals with Vietnam or face consequences against its businesses in China.⁶

Chinese vessels patrol the waters adjacent to the Paracel Islands, driving away Vietnamese fishing boats. Law-enforcement ships use coercive tactics to enforce a unilaterally imposed

² Comment by senior Chinese official at a closed-door meeting in Boao, China, April 2015.

³ "No Compromises over China's sovereignty: Xi," Xinhua, January 30, 2013, <http://english.sina.com/china/2013/0129/555233.html>.

⁴ "Xi eyes more enabling international environment for China's peaceful development," Xinhua, November 30, 2012, http://news.xinhuanet.com/english/china/2014-11/30/c_133822694.htm.

⁵ Bonnie Glaser, "Statement before the U.S. House Armed Services Subcommittee on Seapower and Projection Forces and the House Foreign Affairs Subcommittee on the Asia Pacific," Hearing on People's Republic of China Maritime Disputes, January 14, 2014, http://csis.org/files/attachments/ts140114_glaser.pdf.

⁶ Greg Torode, "Beijing pressure intense in South China Sea row," *South China Morning Post*, September 23, 2011, <http://www.scmp.com/article/979876/beijing-pressure-intense-south-china-sea-row>.

annual ban on commercial fishing in certain areas of the South China Sea, including aggressive maneuvering, use of water cannons and floodlights, and ramming. Foreign fishermen who violate the ban can be charged with punishments such as fines, license revocations, confiscations, and possible criminal charges.⁷ In the waters around Scarborough Shoal, Chinese white-hulled ships ram Philippines fishing vessels when they refuse to leave the area.⁸

The Chinese government also encourages Chinese fishermen to fish in disputed areas far from China's shores.⁹ The government pays for fuel and provides subsidized Beidou satellite navigation systems that link a fishing vessel's location to the Chinese coast guard in case of run-ins with Philippine or Vietnamese ships. Chinese media reported that at the end of 2013, more than 50,000 Chinese fishing vessels had installed the navigation equipment.¹⁰ Fishing boats are also tasked to help defend Chinese sovereignty. When the Chinese Haiyang Shiyou-981 oil rig was placed in disputed waters off the coast of the Paracels and inside Vietnam's EEZ in May 2014, Chinese fishing boats played a role in protecting the oil rig and ramming Vietnamese fishing boats.

In recent months, China has started applying coercion in portions of the airspace in the South China Sea. In an especially dangerous move, a Chinese warship stationed near Subi Reef, a formerly submerged feature that is now a reclaimed island, aimed a powerful light at a Philippines military plane on maritime patrol at the end of April.¹¹

Since March 2014, China has conducted land reclamation on seven reefs in the Spratly Archipelago, adding a total of 2,000 acres.¹² These ongoing dredging and construction activities prospectively serve purposes beyond consolidating Chinese presence on land features. China has emphasized that the artificial islands will improve the working and living conditions of people stationed on them as well as enable China to provide more effective maritime search and rescue, disaster prevention and mitigation, marine scientific research, weather observation, environmental protection, navigational safety, fishery production services, and other such public goods, while also acknowledging that they will satisfy "the need of necessary military defense."¹³ Observers believe that the artificial islands will serve as forward operating bases for Chinese commercial interests, such as fisheries and hydrocarbons, as well as for various Chinese maritime law enforcement agencies. They will also likely be used for military purposes, including as bases for intelligence, surveillance, and reconnaissance activities, as well as ports for Chinese submarines and navy surface vessels. As a bastion for Chinese submarines, the South China Sea could be used to counter enemy antisubmarine operations and enhance China's anti-

⁷ "Fishing Ban starts in the South China Sea," Xinhua, May 17, 2012, http://news.xinhuanet.com/english/china/2012-05/17/c_131592412.htm.

⁸ Cecelia Yap, "Philippines Says China Rammed boats in South China Sea, Bloomberg, February 4, 2015, <http://www.bloomberg.com/news/articles/2015-02-04/philippines-issues-protest-over-china-ramming-illegal-fishing>.

⁹ Harry Kazianis, "China's 50,000 Secret Weapons in the South China Sea," *The National Interest*, July 30, 2014, <http://nationalinterest.org/feature/china%E2%80%99s-50000-secret-weapons-the-south-china-sea-10973>.

¹⁰ John Ruwitch, "Satellites and seafood: China keeps fishing fleet connected in disputed waters," Reuters, July 27, 2014, <http://www.reuters.com/article/2014/07/28/us-southchinasea-china-fishing-insight-idUSKBN0FW0QP20140728>.

¹¹ Franz Kendrick, "Chinese Aims a 'Powerful Light' at PHL Military Plane in Disputed Sea," *Philippine News*, April 24, 2015, <http://philnews.ph/2015/04/24/chinese-aims-a-powerful-light-at-phl-military-plane-in-disputed-sea/>.

¹² Lolita C. Baldor, "US Official: China Island Building Now Totals 2,000 Acres, AP, May 8, 2015, http://hosted.ap.org/dynamic/stories/U/US_UNITED_STATES_CHINA_MILITARY?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT&CTIME=2015-05-08-16-58-36.

¹³ Foreign Ministry Spokesperson Hua Chunying's Regular Press Conference on April 9, 2015, Ministry of Foreign Affairs of the People's Republic of China, http://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/t1253488.shtml.

access/area-denial capabilities.¹⁴

Within the next few years, China is likely to establish an Air Defense Identification Zone (ADIZ) in the South China Sea. An ADIZ would obligate aircraft flying through the zone to accommodate Chinese-imposed rules, including the identification of flight plans, the presence of any transponders, and two-way radio communication with Chinese authorities.¹⁵ After China announced an ADIZ in the East China Sea in November 2013, senior PLA officers privately indicated that plans have long been in place to set up such zones in all of China's near seas, which include the East China Sea, the South China Sea, and Yellow Sea. Chinese officials have subsequently said that the security situation in the South China Sea does not warrant the establishment of an ADIZ, although China retains the right to impose an ADIZ in its sovereign territory if and when it chooses.¹⁶ To have the ability to enforce an ADIZ, China needs several airstrips. It currently has one two-kilometer-long airstrip on Woody Island in the Paracels, which has recently been upgraded. A 3,000 meter long airstrip is under construction on Fiery Cross Reef, a reclaimed island in the Spratlys. Satellite images suggest that another airstrip may be built on Subi Reef.¹⁷

China has recently taken the step of advancing what amounts to a legal defense for its South China Sea claim. In December 2014, China published a position paper defending its claim even though it did not agree to take the case to an international arbitration panel as requested by the Philippines.¹⁸ Though the position paper rejects the formal arbitration procedure, it serves to temper the perception of China as a bully in the region. China has also created a body of domestic legislation protecting its vast maritime claims. In June 2011, Beijing declared a new South China Sea prefecture with its own government structure based on Woody Island in the Paracels.

Diplomatically, China has tried to impose its "dual-track approach" to the South China Sea on both claimants and non-claimants. This policy, formulated in August 2014, advocates that territorial and maritime disputes be addressed by countries directly concerned through friendly consultations and negotiations in a peaceful way, while peace and stability in the South China Sea be jointly maintained by China and ASEAN countries.¹⁹ Beijing continues to favor managing the South China Sea disputes bilaterally, where it has substantial leverage over smaller claimants, most of which are highly dependent on China economically. Chinese officials work tirelessly to keep the territorial disputes off the agendas of multilateral organizations such as ASEAN, the ASEAN Regional Forum, and the East Asia Summit, although they are having less

¹⁴ Tetsuo Kotani, "Why China Wants South China Sea," *The Diplomat*, July 18, 2011, <http://thediplomat.com/2011/07/why-china-wants-the-south-china-sea/>.

¹⁵ J. Berkshire Mileer, "China takes steps to control South China sea," AlJazeera, April 23, 2015, <http://america.aljazeera.com/opinions/2015/4/china-takes-steps-to-control-south-china-sea.html>.

¹⁶ "China dismisses ADIZ reports, optimistic about South China Sea Situation," Xinhua, February 2, 2014, http://news.xinhuanet.com/english/china/2014-02/02/c_126085456.htm.

¹⁷ Victor Robert Lee, "South China Sea: China's Unprecedented Spratlys Building Program," *The Diplomat*, April 25, 2015, <http://thediplomat.com/2015/04/south-china-sea-chinas-unprecedented-spratlys-building-program/>.

¹⁸ "Position Paper of the Government of the People's Republic of China on the Matter of Jurisdiction in the South China Sea Arbitration Initiated by the Republic of the Philippines," Ministry of Foreign Affairs of the People's Republic of China, December 7, 2014, http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1217147.shtml.

¹⁹ "China supports 'dual-track' approach to resolve South China Sea issue: Chinese FM," Xinhua, August 10, 2014, http://news.xinhuanet.com/english/china/2014-08/10/c_133544827.htm.

success as China's activities in the South China Sea become more worrisome to its neighbors.

China's ultimate strategic objective in the South China Sea is a matter of speculation. However, it increasingly seems likely that Beijing seeks to eventually assert sovereignty and control over as much of the South China Sea as possible. By exercising control over the waters and air space of the South China Sea, China will be better positioned to defend its sea lines of communication and raise the costs to foreign navies, especially the United States, of operating in a semi-enclosed sea.²⁰

Although China has a long way to go to consolidate its sovereignty claim and exert control over the South China Sea, it is nevertheless pleased with the progress it has made so far. Relying on white-hulled vessels to advance Chinese interests has created an advantageous space for China to advance its maritime interests. The seizure of Scarborough Shoal after a prolonged stand-off with the Philippines in 2012 was deemed a major victory that has since been applied to the disputed Senkaku/Diaoyu Islands in the East China Sea and Second Thomas Shoal in the Spratlys where a contingent of Philippines Marines stand watch on a rusted-out ship that was beached there in 1999. Thus far, China has incurred only a limited cost for its extensive land reclamation and construction activities.

A crucial tool in China's strategy to force fellow claimants to accept the reality of Chinese control is the use of economic inducements. With the introduction of the Asian Infrastructure Investment Bank, One Belt, One Road project, and its Maritime Silk Road Fund, Beijing is building a framework for deep economic cooperation with countries on its periphery. China expects these neighbors over time to accommodate Chinese interests, including on territorial disputes, in return for providing those economic benefits.

Southeast Asia's Response to China's Actions in the South China Sea

- How are Southeast Asian countries responding to China's actions in the South China Sea? What are the opportunities and limits in addressing the disputes in the South China Sea through ASEAN? What is the potential for reaching a Code of Conduct?

ASEAN

ASEAN is an organization composed of ten countries with divergent cultures, political systems and strategic priorities. Decision making is based on consensus, which means the lowest common denominator prevails. How to manage disputes over maritime sovereignty in the South China Sea has been one of the most divisive issues facing ASEAN in recent years. Only four members of ASEAN—Vietnam, the Philippines, Malaysia, and Brunei—are claimants in the South China Sea, and of those, only the Philippines has adopted a directly confrontational approach to China. ASEAN as a grouping remains reluctant to antagonize China. Nevertheless, anxiety about rising tensions in the South China Sea and the role played by China in precipitating

²⁰ Carl A. Thayer, "South China Sea: Assessing China's Land Reclamation Activities," Chennai Centre for China Studies, March 16, 2015, <http://www.c3sindia.org/china/4880>.

tensions has increased significantly among virtually all its members, prompting ASEAN to speak out more forcefully on the issue.

One week after China's May 2, 2014 deployment of the massive state-owned oil rig HD-981 off the coast of the Paracel Islands and inside Vietnam's EEZ, ASEAN Foreign Ministers issued a stand-alone statement expressing "their serious concerns over the on-going developments in the South China Sea, which increased tensions in the area." The statement urged the parties concerned to act in accord with international law, including the United Nations Convention on the Law of the sea, to exercise self-restraint, avoid actions that could undermine peace and stability, and to resolve disputes by peaceful means without resorting to the threat or use of force.²¹ The joint statement released following the ASEAN summit in Malaysia in April 2015 voiced concerns about land reclamation activities that members agreed have "eroded trust and confidence and may undermine peace, security and stability in the South China Sea."²² To address the matter, ASEAN leaders called for more dialogue.

ASEAN's role in managing the ongoing disputes in the South China Sea will remain important, but limited. Destabilizing behavior by China will likely be met with tougher ASEAN rhetoric, but little more. Collective action beyond the adoption of harsher language is improbable. ASEAN will unquestionably continue to press Beijing to negotiate a Code of Conduct (CoC), which its members and China agreed to in the 2002 Declaration of Conduct of Parties on the South China Sea (DoC). Although China began to discuss a CoC with ASEAN in July 2013, virtually no progress toward an agreement has been made. A draft Code circulated by Indonesia that reportedly called for an end to military exercises in disputed waters, reaffirmed freedom of navigation, and set out rules to prevent accidents at sea has not gained traction.²³

Chinese dissatisfaction with the status quo in the South China Sea makes it unlikely that Beijing will support finalizing a CoC in the near term. It is possible that upon completion of its land reclamation activities and after its military outposts are operational, China may opt to conclude a CoC from a more advantageous position. However, China might still resist agreeing to make the CoC legally binding or to include a dispute settlement mechanism. If a CoC is not legally binding and has no agreed-upon mechanism to resolve disputes as they arise, it is likely to be no more effective in preserving peace and stability in the South China Sea than the voluntary DoC has been.

Malaysia

Malaysia's concerns about China's behavior in the South China Sea have surged in the past few years, but its leader, Prime Minister Najib Razak, remains determined to not allow the territorial dispute to dominate Sino-Malaysian ties. In March 2013 and January 2014, Chinese ships conducted naval exercises around James Shoal, a submerged reef that lies inside Malaysia's 200

²¹ ASEAN Foreign Ministers' Statement on the Current Developments in the South China Sea, May 10, 2014, <http://www.asean.org/news/asean-statement-communicues/item/asean-foreign-ministers-statement-on-the-current-developments-in-the-south-china-sea>.

²² Chairman's Statement of the 26th ASEAN Summit, April 27, 2015, http://www.asean.org/news/asean-statement-communicues/item/chairman-s-statement-of-the-26th-asean-summit?category_id=26.

²³ Shannon Tiezzi, "Why China Isn't Interested in a South China Sea Code of Conduct," *The Diplomat*, February 26, 2014, <http://thediplomat.com/2014/02/why-china-isnt-interested-in-a-south-china-sea-code-of-conduct/>.

nautical mile EEZ and 1,800 km. from Mainland China. After the second provocation, Malaysia quietly launched a dialogue with the Philippines and Vietnam to coordinate policy toward China.²⁴

Malaysia openly rejects China's expansive nine-dashed line claim. In May 2009, Malaysia made a joint submission to the UN with Vietnam which claimed a continental shelf in the southern part of the South China Sea. A joint statement signed during President Obama's visit to Malaysia in April 2014 contained a lengthy paragraph on the South China Sea that affirmed the importance of safeguarding maritime security, ensuring freedom of navigation and overflight throughout the region, avoiding the use of force, intimidation or coercion, and exercising self-restraint in the conduct of activities. It also emphasized the importance of resolving territorial and maritime dispute in accordance with UNCLOS.²⁵

As holder of the rotational chair of ASEAN this year, Malaysia has tried to strike a difficult balance: allowing constructive and positive discussion of the South China Sea among ASEAN members and pushing for progress on a CoC, while avoiding a confrontation with China. At a press conference following the April ASEAN leaders' meeting, Najib struck a moderate tone, saying that ASEAN will "continue to engage China in a constructive way," We hope to be able to influence China."²⁶

China's encroachments on Malaysia's waters was likely a factor in Kuala Lumpur's decision to upgrade bilateral relations with the U.S. to the level of "comprehensive partnership," including strengthening military ties. Malaysia reportedly offered to host U.S. Navy P-8A Poseidon aircraft, although only on a case-by-case basis, which means that this understanding has greater political than military significance.²⁷

One of Malaysia's primary interests is to protect its oil and gas reserves in the region. So far, China has refrained from disrupting Malaysia's drilling activities. Rajib announced that the defense budget in 2015 will increase by 10 percent to \$5.4 billion. In 2013 Malaysia revealed plans to build a navy base in Bintulu on Sarawak, the closest major town to James Shoal, where it will station a new Marine Corps.²⁸

The Philippines

Of all the claimants, the Philippines has adopted the most confrontational strategy toward China on South China Sea matters in recent years and consequently has borne the brunt of China's ire. Manila decided to take China to court after years of unsuccessful bilateral diplomacy and

²⁴ Richard Javad Hevdarian, "Philippines and Vietnam in the South China Sea: A Burgeoning Alliance," *The World Post*, May 26, 2014, http://www.huffingtonpost.com/richard-javad-hevdarian/philippines-and-vietnam-i_b_5392321.html.

²⁵ Joint Statement by President Obama and Prime Minister Najib of Malaysia, April 27, 2014, <https://www.whitehouse.gov/the-press-office/2014/04/27/joint-statement-president-obama-and-prime-minister-najib-malaysia-0>.

²⁶ Manirajan Ramasamy and Pooi Koon Chong, ASEAN to Keep Non-Confrontational Approach on South China Sea, Bloomberg, April 27, 2015, <http://www.bloomberg.com/news/articles/2015-04-27/look-to-global-law-for-south-china-sea-engagement-najib-says>.

²⁷ Dzirhan Mahadzir, "Base for the P-8? The View from Malaysia," Center for International Maritime Security, <http://cimsec.org/base-u-s-p-8s-view-malaysia/13047>.

²⁸ Stuart Grudgings, "China's assertiveness hardens Malaysian stance in sea dispute," Reuters, February 26, 2014, <http://uk.reuters.com/article/2014/02/26/uk-malaysia-china-maritime-insight-idUKBREA1P1Z020140226>.

unrelenting pressure. In 2012, a confrontation ensued between China and the Philippines at Scarborough Shoal after a Philippine naval frigate attempted to arrest Chinese fishermen poaching protected shellfish. A U.S. attempt to mediate failed. After both sides withdrew their vessels, Chinese naval, civil, and civilian maritime forces returned, forming concentric circles of control that Chinese experts have called a cabbage strategy and roped off the mouth of lagoon.²⁹ To date, the Chinese control the waters around the Shoal and will not permit Philippines fishing boats in the area. Chinese pressure on the Philippines during the incident included quarantining imports of tropical fruits and restrictions imposed on Chinese tourists to the Philippines.

Another episode that persuaded Manila to initiate arbitration proceedings at the International Tribunal for the Law of the Sea was China's interference with a Filipino vessel conducting seismic studies at Reed Bank, which is inside the Philippines EEZ.³⁰ Plans to drill in the waters around Reed Bank have been suspended.³¹ The case that is now pending at The Hague asks that China's maritime claims based on the nine-dashed line be declared "contrary to UNCLOS and invalid."

The Philippines is alarmed about China's dredging activities, some of which are taking place on land features claimed by Manila, including on Mischief Reef, located inside the Philippines EEZ. Once China's outposts are complete, Manila fears that a permanent Chinese presence in the Spratlys will enable China to easily disrupt the delivery of supplies to its outposts, and therefore make it impossible for the Philippines to sustain its presence on some of the smaller reefs that it occupies. China has already demonstrated this intention at Second Thomas Shoal. Manila is also worried that China will establish an ADIZ over the South China Sea. In early May, China apparently challenged Filipino aircraft landing and departing from Pagasa Island and warned Filipino patrol planes to stay out of Chinese airspace around Subi Reef where extensive land reclamation is taking place.³²

In the face of growing Chinese pressure, Manila has begun to shift its attention away from internal security threats to the maritime domain. The Philippine Coast Guard is undergoing a modernization program, including acquisition of new aircraft, patrol vessels, installation of coastal surveillance and communication systems, and other assets. Among those in the pipeline are one 80-meter Offshore Patrol Vessel, four 24-meter Inshore Patrol Boats from France, and ten new 40-meter Multi-Role Response Vessels from Japan.³³ The Philippine Navy is being modernized as well, albeit from a very low base, with the planned purchase of three guided missile fast attack craft, two guided missile stealth frigates, and two anti-submarine helicopters.

²⁹ Ely Ratner, "Learning the Lessons of Scarborough Reef," *The National Interest*, November 21, 2013, <http://nationalinterest.org/commentary/learning-the-lessons-scarborough-reef-9442>.

³⁰ *Stirring up the South China Sea (III): A Fleeting Opportunity for Calm*, International Crisis Group, Asia Report no. 267, May 7, 2015, <http://www.crisisgroup.org/en/regions/asia/north-east-asia/china/267-stirring-up-the-south-china-sea-III-a-fleeting-opportunity-for-calm.aspx>.

³¹ "PHL stops oil and gas drilling in Reed Bank, cites dispute with China, GMA News, March 3, 2015, <http://www.gmanetwork.com/news/story/445665/economy/companies/phl-stops-oil-and-gas-drilling-in-reed-bank-cites-dispute-with-china>.

³² "Philippines alarmed over China aircraft challenges in disputed sea," Channel News Asia, May 7, 2015, <http://www.channelnewsasia.com/news/world/philippines-alarmed-over/1831716.html>.

³³ Philippine Coast Guard – Focusing on the Modernization of its Naval and Air Assets, MaxDefense, November 7, 2014, http://maxdefense.blogspot.com/2014_11_01_archive.html.

Vietnam

Growing tensions with China in the South China Sea have challenged Hanoi's efforts to maintain a stable and constructive relationship with its much larger neighbor. Vietnam has steadfastly opposed Chinese intimidation tactics ranging from severing cables of Petro Vietnam ships engaged in seismic surveys in 2011 and 2012 to the positioning of the giant oil rig in Vietnam's EEZ in May 2014. Vietnam and Malaysia jointly submitted a notification of the two nations' extended continental shelf claims to the UN Commission on the Limits of the Continental Shelf in May 2009. Although Hanoi has not joined Manila in its arbitration case, it lodged a submission in December 2014 which rejected China's nine-dashed line as "without legal basis," and requested that the court give "due regard" to Vietnam's own legal rights and interests in the Spratlys, Paracels, and in its EEZ and continental shelf while deliberating the case.³⁴

Hanoi has forcefully opposed China's construction and expansion of reefs in the South China Sea that it claims rightfully belong to Vietnam. It has repeatedly called on China to end its activities and strictly comply with international law, including UNCLOS, and the DOC, which contains the following provision: "The Parties undertake to exercise self-restraint in the conduct of activities that would complicate or escalate disputes and affect peace and stability including, among others, refraining from action of inhabiting on the presently uninhabited islands, reefs, shoals, cays, and other features and to handle their differences in a constructive manner. Vietnam and China are engaged in a diplomatic tussle at the UN, with both sides sending diplomatic notes to other countries' permanent missions to the UN asserting sovereignty and condemning the other's land reclamation activities."³⁵

To counter Chinese pressure in the South China Sea, Vietnam is enhancing cooperation with many of its neighbors, both small and large, near and far. Hanoi and Manila are strengthening military cooperation, including training, visits, defense industry collaboration, and handling of maritime violations.³⁶ The strategic partnership with India, established in 2007, is expanding in a number of fields, including energy, trade, defense, and space.³⁷ Political and military ties with the US are developing steadily. The partial lifting in 2014 of the ban on the sale of lethal weapons by the U.S. to Vietnam has begun to lay the foundation for a bilateral defense procurement relationship. Nevertheless, Vietnam can be expected to maintain a balance in its foreign policy, especially between the U.S. and China.

In the face of the growing threat from China in the South China Sea, Vietnam is modernizing its navy. All six Kilo class diesel submarines will be delivered by Russia before 2016. Other platforms being procured include four Gepard class frigates from Russia, four Sigma-class

³⁴ Prashanth Parameswaran, "Vietnam Launches Legal Challenge Against China's South China Sea Claims," *The Diplomat*, December 12, 2014, <http://thediplomat.com/2014/12/vietnam-launches-legal-challenge-against-chinas-south-china-sea-claims/>.

³⁵ "China must stop violating Vietnam's sovereignty in East Sea: foreign ministry," Tuoi Tre News, May 9, 2015, http://tuoitrenews.vn/politics/27957/china-must-stop-violating-vietnams-sovereignty-in-east-sea-foreign-ministry?utm_content=buffer76f0c&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer.

³⁶ Vu Trong Khanh, "Philippines, Vietnam to Deepen Military Cooperation," *The Wall Street Journal*, June 25, 2014, <http://www.wsj.com/articles/philippines-vietnam-to-deepen-military-cooperation-1403699495>.

³⁷ Carl Thayer, "India and Vietnam Advance Their Strategic Partnership," *The Diplomat*, December 11, 2014, <http://thediplomat.com/2014/12/india-and-vietnam-advance-their-strategic-partnership/>.

corvettes from the Netherlands, and new missile boats.³⁸ Vietnam's Coast Guard is also being upgraded.

Indonesia

Indonesia is not a claimant in the South China Sea disputes, but its Natuna Islands are located where China's nine-dashed line claim and Indonesia's EEZ off the coast of Natuna overlap. When China submitted its nine-dashed line map to the United Nations Commission on the Limits of the Continental Shelf in May 2009, Indonesia officially protested. Indonesian President Joko Widodo reiterated this position in an interview with the *Yomiuri* newspaper during his visit to Japan in March 2015. Jokowi reportedly stated: China's "nine-dashed line that China says marks its maritime border has no basis in any international law."³⁹

In recent years, Indonesia has been more vocal in expressing its concerns about Chinese activities in and possible Chinese claims to the waters around the Natuna Islands. For example, after China issued a new passport with a map of the Chinese nation in 2014 that included a part of the Natuna waters, a senior Indonesian official dubbed China's claim "arbitrary."⁴⁰ In an article published in the *Wall Street Journal* later that year, General Moeldoko, chief of the Indonesian armed forces, said that his nation "is dismayed . . . that China has included parts of the Natuna Islands within the province as its territory."⁴¹ When announcing multilateral military drills that took place around the Natuna Islands in 2014, a senior Indonesia National Defense Forces (TNI) official warned that attention would be paid to "the aggressive stance of the Chinese government by entering the Natuna area."⁴² Indonesia has recently embarked on a plan to modestly bolster its naval, air, and army forces on and around the Natuna Islands as a preemptive measure against instability in the South China Sea.⁴³

Jakarta has employed a mix of diplomatic, legal, and military measures aimed at opposing China's vast claims in the South China Sea, while maintaining its status as a non-claimant. At the same time, the Indonesian government has worked assiduously to promote progress toward a CoC and the implementation of confidence-building measures in the region. Earlier this year, Jokowi reaffirmed his country's willingness to play the role of an "honest broker" in the territorial disputes. Indonesia's goals are to defend its rights in its EEZ, ensure peace and stability in the South China Sea, while continuing to strengthen relations with China.

³⁸ Vietnamese People's Navy – Modernization, Global Security.org, <http://www.globalsecurity.org/military/world/vietnam/navy-modernization.htm>.

³⁹ "Indonesia's leader rejects China's South China Sea claims," Aljazeera, March 23, 2015, <http://www.aljazeera.com/news/2015/03/indonesia-leader-rejects-china-south-china-sea-claims-150323045523097.html>.

⁴⁰ Berni Moestafa and Sharon Chen, "Indonesia flags military build-up to protect presence in South China Sea," *Sydney Morning Herald*, May 30, 2014, <http://www.smh.com.au/world/indonesia-flags-military-buildup-to-protect-presence-in-south-china-sea-20140529-zrsgr.html>.

⁴¹ Moeldoko, "China's Dismaying New Claims in the South China Sea," *Wall Street Journal*, Apr. 24, 2014, <http://www.wsj.com/articles/SB10001424052702304279904579515692835172248>.

⁴² Zachary Keck, "China's Newest Maritime Dispute," *The Diplomat*, March 20, 2014, <http://thediplomat.com/2014/03/chinas-newest-maritime-dispute/>.

⁴³ *Ibid.*

Developing a Cost Imposition Strategy

- Is US strategy achieving any success in persuading China to not use coercion against its neighbors, to settle disputes peacefully and to abide by international law? What additional steps could the US take, including congressional action?

It is unlikely that any single cost imposition step will successfully persuade China to alter its present course of action. However, it is possible that a multifaceted strategy that is coordinated with like-minded countries can deter China's use of coercion and convince Beijing to adopt a less confrontational policy toward its neighbors in the South China Sea. The Obama administration's strategy so far has included the following elements: 1) explicitly criticizing China for taking destabilizing actions; 2) actively mobilizing support for use of legal dispute mechanisms; 3) bolstering U.S. military presence and capabilities; 4) enhancing capabilities of allies and partners through military drills and provision of equipment; 5) encouraging Southeast Asian claimants to work together and push China to conclude a legally binding CoC; 6) backing multilateral frameworks for cooperation, risk reduction, and dispute resolution; 7)) putting forward specific suggestions aimed at reducing tensions, such as a voluntary freeze on destabilizing activities; 8) strengthening regional security and economic architecture; and 9) reinforcing ASEAN and U.S.-ASEAN Ties, and promoting ASEAN unity and centrality.⁴⁴ These policies have created some costs for China, but have not yet been sufficient to change Beijing's overall cost/benefit calculus. Therefore, more steps need to be taken.

The following additional steps should be considered as part of the U.S. cost imposition strategy.

1. **Encourage ASEAN to develop its own Code of Conduct** containing risk-reduction measures and a dispute-resolution mechanism. Only by reaching a consensus on a draft CoC can ASEAN hope to make progress in negotiating a China-ASEAN CoC. An alternative is for ASEAN to adopt a Treaty of Amity and Cooperation in Southeast Asia's Maritime Domain that would bind all ASEAN members to bring their maritime boundaries and claims into line with international law, including UNCLOS and commit all signatories to renounce the threat of and use of force to settle disputes and to uphold good order at sea, including safety of navigation and overflight. The Treaty would be open to accession by all of ASEAN's dialogue partners. Quick accession by other ASEAN dialogue partners would put pressure on China to accede to the Treaty.⁴⁵
2. **Conduct freedom of navigation (FON) operations around China's artificial islands.** UNCLOS provides that artificial islands do not qualify as "islands" under the Convention because they are not naturally formed areas of land surrounded by and above water at high tide. Therefore, artificial islands are not entitled to any maritime zones.⁴⁶ Since

⁴⁴ Bonnie S. Glaser, "U.S. Strategy Seeks to Calm the Roiled Waters of the South China Sea," Paper for the Fourth CSIS annual conference on the South China Sea, July 2014,

http://csis.org/files/publication/140930_Hiebert_PerspectivesSouthChinaSea_Web.pdf.

⁴⁵ This proposal was put forward by Carlyle A. Thayer, *Indirect Cost Imposition Strategies in the South China Sea: U.S. Leadership and ASEAN Centrality*, Maritime Strategy Series, Washington, D.C.: Center for New American Security, April 2015, <http://www.cnas.org/sites/default/files/publications-pdf/CNAS%20Maritime%208%20Thayer.pdf>.

⁴⁶ Robert Beckman, "International Law and China's Reclamation Works in the South China Sea," 2nd Conference on South China Sea, Lee Kuan Yew School of Public Policy, National University of Singapore, <http://cil.nus.edu.sg/wp/wp-content/uploads/2015/04/Beckman-Nanjing-Draft-17-April-2015.pdf>.

1979, the US has carried out the FON program to protect maritime rights throughout the world.

3. **Respond to future Chinese coercive acts, including by using U.S. naval forces** to deter China's continuing use of "white hulled" paramilitary vessels. By relying on paramilitary ships, China appears to believe that it can conduct coercive actions without incurring significant risk. This has provided China with an opportunity to change the status quo. A successful counter-coercion strategy should entail consideration of a greater acceptance of risk by demonstrating US willingness to employ navy ships in response to Chinese provocations.
4. **Withhold invitation to RIMPAC 2016 if China coerces its neighbors.** RIMPAC should be open to participation by nations that are contributing to peace and stability in the Asia-Pacific region. If China uses its newly-built outposts to coerce the other claimants, for example by establishing an Air Defense Identification Zone over the South China Sea, China should not be invited to participate in the next RIMPAC exercises in 2016.
5. **Encourage Taiwan to clarify the meaning of its original 1947 11-dashed line and its territorial claim in the South China Sea.** Since China's nine-dashed line claim is based on Taiwan's original claim, a decision by Taiwan to clarify its claim would put pressure on Beijing to do the same. UNCLOS requires that maritime claims be derived from land features. It does not recognize "historical rights" as a basis for claiming EEZs or Extended Continental Shelves. Taiwan has called on regional nations to respect UNCLOS, but it has not defined its claim in the South China Sea.⁴⁷
6. **Continue to help the Philippines and Vietnam enhance their maritime policing and defense capabilities** so they can deter and respond to China entering the water and airspace in their EEZs with impunity. Similar assistance should be extended to Malaysia and Indonesia if requested. For example, the U.S. should encourage regional states to acquire land-based intelligence, surveillance, and reconnaissance (ISR) aircraft and anti-ship cruise missiles. The U.S. should coordinate with Japan, Australia and other like-minded nations in these efforts to enhance the effectiveness of such assistance.

Role of Congress

Congress can play an important role in promoting a more effective U.S. policy toward the South China Sea. Timely letters from Congress to senior U.S. officials expressing concerns and advocating specific courses of action are one important tool. The March 19, 2015 letter from the Chairmen and ranking members of the U.S. Senate Foreign Relations and Armed Services committees to Secretary of Defense Ashton Carter and Secretary of State John Kerry calling for a comprehensive U.S. strategy to address Chinese actions in the East and South China Seas is a case in point.

⁴⁷ Lynn Kuok, *Tides of change: Taiwan's evolving position in the South China Sea*, The Brookings Institution, May 2015, <http://www.brookings.edu/research/papers/2015/05/taiwan-south-china-sea-kuok>.

Congress could also take steps to publicize China's destabilizing activities in the South China Sea. For example, Congress could require the Defense Department to include a section on Chinese activities in the South China Sea in its Annual Report to Congress on Military and Security Developments Involving the People's Republic of China. In addition, Congress could require that the Commander of the U.S. Pacific Command report on China's South China Sea activities in his or her annual posture statement to the respective Armed Services Committees of the House and Senate.

Congressional resolutions can send powerful signals of American concerns to the executive branch, the region, and the rest of the world. One such example, S.Res.412, which passed in July 2014, called on China to withdraw its massive drilling rig and associate maritime forces from the area near the Paracels and condemned coercive actions to alter the status quo or to destabilize the Asia-Pacific region.

**OPENING STATEMENT OF MIRA RAPP HOOPER
FELLOW, ASIA PROGRAM, AND DIRECTOR, ASIA MARITIME TRANSPARENCY
INITIATIVE, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES**

DR. RAPP-HOOPER: I'd like to begin my remarks today by thanking the Commission for inviting me to testify. It's an honor to appear before this distinguished panel of Commissioners.

My testimony today will focus on China's recent land reclamation and construction activities in the South China Sea and their broader implications.

Since early 2014, China has undertaken widespread land reclamation and construction in the Spratly Islands at seven known locations. These are the seven of the yellow dots on the map in front of you. This work has converted several rocks and formerly submerged reefs into artificial islands. Each of these facilities is disputed between China and at least one other South China sea claimant.

China's land reclamation efforts follow a four-step process. They begin when China sends in dredging ships to expand channels around a given land feature. Vessels dredge up sand from the seabed and deposit it to create terrain above the water line. They use concrete to construct sea walls and prepare the surface of the new land mass for construction. China then begins to construct new facilities on these islands.

China argues that it holds sovereignty over each of the features on which it has been building and that it is therefore acting legally.

Beijing likely has multiple motivations for its reclamation activities in the Spratly Islands.

The first set of motivations are military and strategic. Satellite imagery indicates that China has already installed some military hardware on its artificial islands, including anti-air and anti-surface guns, radar and communications equipment, helipads, piers and docks.

Fiery Cross Reef, which is shown on the second page of your handout, will host a 3,000 meter runway that will allow China to land any aircraft it possesses, and it may also include a harbor large enough to dock major surface combatants.

China's new military installations will improve its ability to maintain a regular presence in the Spratlys and allow it to carry out frequent patrols by air and sea. China's claims in the South China Sea stretch a thousand miles or more from its shores as represented by its Nine-Dash Line.

China's limited refueling and resupply capability has meant that Beijing cannot easily press its claims in the southern parts of these waters. With these outposts complete, however, China will be able to allow its vessels and aircraft to rest and resupply. With additional radar and communications equipment, China will have much improved maritime domain awareness over near-by waters and airspace.

This could eventually allow it to declare an Air Defense Identification Zone over the South China Sea. These island facilities will likely be used to allow China to assert its South China Sea claims and to discourage other claimants from challenging them.

There are some notable legal implications of China's construction activities. The seven features China is reclaiming are all part of an ongoing South China Sea arbitration case that has been brought by the Philippines against China before the Hague.

In part of its argument, the Philippines states that several of the Spratly features that China occupies are rocks or reefs and therefore entitled to only a 12-nautical mile territorial sea

at most and not an EEZ or a continental shelf.

China's building activities have been taking place only since this case has been active. While China will surely not convince the court that these artificial features deserve to be treated as full-fledged islands under UNCLOS, its rapid-fire building may be an attempt to make it more difficult for the tribunal to rule on the previous status of these features.

In official statements, Chinese leaders have acknowledged the military utility of these new bases and also proffered other explanations. These include maritime search and rescue operations, disaster prevention and mitigation, marine research, meteorological observation, protection of the ecological environment, and the facilitation of fishing activities.

For other South China Sea claimants, the implications of China's island building lie in its ability to maintain regular sea and air patrols and to monitor the area, to apply significant pressure to other claimants, and to advance its own maritime and territorial claims.

China's artificial islands may also have implications for conflict escalation. Several of the features are in close proximity to islands that are already held by the Philippines and the Vietnam. If China increases the flow of vessels and aircraft through these outposts, this would in turn increase the risk of accidental or inadvertent escalation between the claimants and the potential for an armed clash.

For the United States, China's island building could imperil several of its articulated interests in the South China Sea. These include its interests in the peaceful resolution of disputes and international law and in freedom of navigation. These activities may also have implications for the United States Mutual Defense Treaty with the Philippines.

There are a few measures that U.S. policymakers can take to mitigate the risks that China's artificial islands are used to coerce other claimants. Washington should hold Beijing to its word, that its new islands are for civilian purposes. It should accept China's invitation to use them for search and rescue exercises. U.S. officials should also repeat to Chinese counterparts that the United States will actively contest a South China Sea Air Defense Identification Zone if China announces one.

The United States and China have made important progress in their military ties this year, but the U.S. should convey that this progress could be jeopardized if China continues to militarize its new outposts. Policymakers must consider what specific military moves by China, for example, installing missile systems or basing fighters, would make further military cooperation with China inappropriate.

Destabilizing Chinese actions may be met with a decision to disinvite China from exercises, as my colleague Bonnie Glaser suggested, or to pause negotiations on additional confidence-building measures. These stakes should be communicated to China in advance and implemented on a tit-for-tat reciprocal basis.

The United States must also augment its investment in ally and partner maritime domain awareness capabilities. Foreign military financing to the PACOM area of responsibility represents just one percent of the total. Vietnam and the Philippines will never have the naval or coast guard capabilities to match China's, but their ability to monitor the South China Sea can be substantially improved.

If it does increase the dollar value of its aid to partners, however, Washington should make clear that this is contingent on a freeze of activities that could be construed as destabilizing. It should in turn tell China that it is conditioning new partner aid on restraints, but that this will only be possible if China itself does not militarize its outposts.

The United States should also encourage multilateral cooperation and maritime domain

awareness and maritime patrols amongst the ASEAN states.

I would also endorse Bonnie Glaser's call for ASEAN to develop its own Code of Conduct in wake of the fact that the Code of Conduct between ASEAN and China has been stalled recently.

The United States must also consider how to mitigate risk in its alliance with the Philippines. The alliance has been reinvigorated in its recent years, but it does not have nearly as many standing security dialogues as other U.S. partnerships in the region, and these contribute significantly to allied assurance as well as to deterrence.

Washington should consider establishing a standing crisis dialogue with the Philippines through which both countries can communicate regularly on the evolving situation in the South China Sea.

With land reclamation efforts in the Spratly Islands substantially complete, Washington must focus its efforts on ensuring that these new artificial islands do not become heavily armed outposts used to coerce friends and partners, to derail peaceful resolution of disputes, or to disrupt freedom of navigation and overflight. The risk of escalation in the South China Sea is rising, and this places core U.S. interests in peril.

Thank you very much.

**PREPARED STATEMENT OF MIRA RAPP HOOPER
FELLOW, ASIA PROGRAM, AND DIRECTOR, ASIA MARITIME TRANSPARENCY
INITIATIVE, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES**

Statement before the U.S. – China Economic and Security Commission

“SECURITY DIMENSIONS OF CHINA’S RELATIONS WITH SOUTHEAST ASIA”

A Statement by:

Dr. Mira Rapp-Hooper

Director, Asia Maritime Transparency Initiative and
Fellow, Asia Program
Center for Strategic and International Studies (CSIS);

May 13, 2015

Room 608, Dirksen Senate Office Building

Island Construction in China’s South China Sea Strategy

I would like to begin my remarks today by thanking the Commission for inviting me to testify. It is an honor to appear with this group of experts and before this distinguished panel to discuss the security dimensions of China’s relationships in Southeast Asia. My testimony will focus on China’s recent land reclamation and construction activities in the South China Sea and their broader implications.

Countless analysts have argued that China is advancing its territorial and maritime interests in its periphery using so-called “salami tactics”—efforts to further its aims opportunistically, without activating U.S. security commitments or provoking a full-blown conflict. Examples include China’s efforts to challenge Japan’s administration of the Senkakus through maritime and aerial patrols, its declaration of an East China Sea Air Defense Identification Zone, its seizure of Scarborough Shoal from the Philippines, and its placement of an oil rig in Vietnam’s waters. Recent land reclamation and construction efforts in the South China Sea must be considered in light of these broader trends.

Since early 2014, China has undertaken widespread land reclamation and construction in the Spratly Islands at seven known locations. This work has converted several formerly submerged reefs into artificial islands, and increased the size of other features many times over. Each of China’s new artificial islands is disputed between China and at least one other South China Sea claimant. At least three of these artificial islands— Hughes Reef, Johnson South Reef, and Mischief Reef – are within the 200 nautical mile Exclusive Economic Zone (EEZ) that the Philippines claims from its nearest primary landmass, the island of Palawan.

China’s land reclamation efforts appear to follow a four-step process. They begin when China sends in dredging ships to expand the channels around a given land feature; they then dredge up

sand from the sea bed and deposit it on the reef or rock to create terrain above the water line; they use concrete to construct sea walls and prepare the surface of the new landmass for construction; they begin to construct military and civilian facilities on the island.

China argues that it holds sovereignty over each of the features on which it has been building, and that it is therefore acting legally. Other claimants and U.S. officials, however, have argued that the speed and scale of China's activities raise serious questions about its long-term aims, and serve to escalate tensions in these already-heavily contested waters.

Utility of China's Island Building

China likely has multiple motivations for its building activities in the Spratly Islands. Chinese officials have acknowledged that the artificial islands have military value, but have insisted that the outposts are "mainly for civilian purposes," including search and rescue, environmental study, and fishing. There may also be a legal rationale for these recent projects.

Military and Strategic Utility

Satellite imagery indicates that China has already installed some military hardware on its artificial islands. This includes: troop garrisons; anti-air and anti-surface guns; radars; communications equipment; helipads; piers and docks. Fiery Cross Reef will host a 3,000-meter runway that will allow China to land any aircraft it possesses, and it may also include a harbor large enough to dock major surface combatants. Analysts have also speculated that China may build a second airstrip on Subi Reef, which it has only begun to reclaim recently.

China's new military installations will likely improve its ability to maintain a regular presence in the Spratlys and allow it to carry out frequent patrols by air and sea. China's claims in the South China Sea stretch 1,000 miles or more from its shores, as represented by its Nine-Dash Line. China's limited refueling and resupply capability has meant that Beijing cannot necessarily press its claims in the southern part of the South China Sea. By constructing airstrips, port facilities, and helipads on these new islands, however, China may be able to allow PLA Navy and Coast Guard vessels and military aircraft to rest and resupply. By installing radar and communications equipment, China will have much-improved maritime domain awareness (MDA) over nearby waters and airspace. China could also operate maritime patrol or Airborne Warning (AWACS) aircraft, which would further improve MDA and ISR. This augmented monitoring capability could eventually allow China to declare an air defense identification zone (ADIZ) over the South China Sea, as it did in the East China Sea in 2013. In peacetime, these island facilities will likely be used to allow China to assert its South China Sea claims, and to discourage other claimants from challenging them.

Where combat operations are concerned, China could use artificial islands to house some of the systems that are associated with anti-access/area denial strategies (A2/AD), including radars, anti-ship cruise missiles, and surface-to-air missiles. It could also station vessels and aircraft on the islands on a rotational basis. In a conflict scenario, these tiny bases would be quite vulnerable to attack, but the need to account for them could divert U.S. assets from other missions.

Legal Implications

The UN Convention on the Law of the Sea is the core international maritime legal regime. China is a party to UNCLOS, although it has opted out of many of the treaty's dispute resolution mechanisms. The other South China Sea claimants are also UNCLOS parties. The United States is not a signatory, but observes its provisions as customary international law.

Under the UN Convention on the Law of the Sea, land reclamation is not illegal if it takes place on the high seas. It may be illegal, however, if it takes place in the Exclusive Economic Zone of another state, and three of the features China is developing-- Hughes Reef, Johnson South Reef, and Mischief Reef-- lie in the Philippines' EEZ. China could conceivably argue, however, that it is developing features that also lie in its own EEZ based on its claims to other islands.

Legality of reclamation activities aside, China cannot claim under international law any additional maritime entitlements based on its new artificial islands. A reclaimed land mass is not entitled to a 200 nautical mile EEZ or to a continental shelf of its own. If an artificial island was formerly a rock, it is entitled to a 12 nautical mile territorial water. If it was formerly a submerged reef, a state should not be able to claim more than a 500-meter safety zone around it. Thus far, China has not asserted new legal claims to waters based on these artificial islands.

Where legal motivations are concerned, it is notable that the seven features being reclaimed are all part of an ongoing South China Sea arbitration case that has brought by the Philippines against China. The case is currently being considered by the International Tribunal on the Law of the Sea at The Hague. China is not participating in the case and has stated that it will not be bound by the ruling. In its case, the Philippines argues that China's claims and activities in the South China Sea are illegal under UNCLOS. In one portion of its argument, the Philippines states that several of the Spratly features that China occupies are rocks, and therefore entitled to only a 12 nm territorial water, and not an EEZ or a continental shelf. In another portion, the Philippines argues that several of China's Spratly features are low-tide elevations, meaning they are completely submerged under water. Submerged features are not subject to any sovereignty claims at all and do not generate any maritime entitlements.

China's building activities have been taking place only since this case has been active. While China will surely not convince the court that these artificial features deserve to be treated as full-fledged islands under UNCLOS, its rapid-fire building may make it more difficult for the tribunal to rule on their previous status. The court's judgment is expected in early 2016, and China's reclamation efforts will likely be complete well before that date.

Other Explanations

In official statements, Chinese leaders have acknowledged the military utility of these new bases,

but also proffered several other explanations for them. These include maritime search and rescue operations, disaster prevention and mitigation, marine research, meteorological observation, protection of the ecological environment, and the facilitation of fishing activities. There is little doubt that these artificial islands could allow Chinese fisherman to rest and resupply, and therefore maintain a more sustained presence in the area. They could also be used to explore for oil and gas. In late April, 2015, PLA Navy chief Admiral Wu Shengli told U.S. Chief of Naval Operations Admiral Jonathan Greenert that the United States would be welcome to use its South China Sea facilities for weather monitoring and search and rescue operations “when the time is right.”

Implications for Other Countries

For other South China Sea claimants, the implications of China’s island building lie in its ability to maintain regular sea and air patrols and to monitor the area. If China can maintain PLA Navy ships, China Coast Guard vessels, and PLA Air Force aircraft in the waters and airspace around the Spratlys, it will be able apply significant pressure to other claimants, and to advance its own maritime and territorial claims. The Philippines and Vietnam have scant naval and coast guard capabilities compared to China’s. Both of these U.S. partners occupy features of their own in the Spratly Islands. Vietnam occupies 21-25 features, and the Philippines occupies approximately nine. If China can closely monitor the area and project power within it, it may be able to put significant pressure on these positions. This could, in turn, allow China to wrest from other claimants additional land features in the Spratlys, as it did the Scarborough Shoal from the Philippines in 2012.

In addition to its implications for lower-level coercion in the area, China’s artificial islands may have implications for conflict escalation. China’s new island at Johnson South Reef is only 6.2 km away from Collins Reef, and its outpost at Hughes Reef is just 14 km away from Sin Cowe Island. Sin Cowe and Collins are both held by Vietnam. China’s artificial island at Subi Reef, which may eventually house an airstrip, is just 26 km from Thitu Island, which is home to the Philippines’ only airstrip in the Spratlys. Given these short distances, moves by China to significantly augment the flow of vessels and aircraft through these outposts would increase the risk of accidental or inadvertent escalation between the claimants, which could in turn result in armed conflict.

For the United States, China’s island building could imperil several of its articulated interests in the South China Sea. These include its interest in the peaceful resolution of disputes, in international law, and in freedom of navigation. These activities also have implications for the United States’ mutual defense treaty with the Philippines.

Secretary of Defense Carter has already objected publicly to China’s “militarization” of the islands. There can be little doubt that these building projects make peaceful dispute resolution less likely, as they erode trust and confidence among other claimants. These reclamation efforts may also do serious harm to the UNCLOS regime if they compromise the Hague Tribunal’s ability to rule on the Philippines vs. China case.

The United States must also consider the implications of China’s building for freedom of

navigation and freedom of overflight in the area. Chinese officials have stated that neither of these principles is in jeopardy in the South China Sea. Recent reports indicate, however, that in just the last three months, China has warned Philippines' air force and navy aircraft not to enter disputed airspace on at least six occasions. If China declares an ADIZ in the South China Sea, this could certainly threaten freedom of overflight. Where freedom of navigation is concerned, one-third of the world's commercial shipping passes through the South China Sea. Beijing has little incentive to see this seriously disrupted, but the Philippines already asserts that China regularly interferes with its ability operate freely in its own exclusive economic zone.

Washington must also consider its treaty obligations to Manila. Unlike the position that the United States has articulated with respect to the role of the Senkakus in the U.S.-Japan alliance, Washington has not committed to intervening in a conflict on the Philippines' behalf over an island in the South China Sea. Rising Spratly tensions, however, make it more likely that a Philippines vessel or aircraft could be attacked and that Philippines soldiers could be killed. This could have grave consequences for the alliance.

The Role of China's Actors in South China Sea Construction

Numerous Chinese actors have been involved in its island construction projects, including state-owned enterprises, maritime militias, and the Coast Guard and PLA Navy. The China Communications Construction Company owns and operates many of the dredgers that have been used for reclamation. Many of the same dredgers that have created China's new islands in the Spratlys have also done work on its outposts in the Paracels. The Tanmen Village Maritime Militia Company delivers supplies to China's Spratly features.

Analysts have recently begun to study China's maritime militia units. These are small, tactical groups whose members function interchangeably as fishermen and soldiers. They serve as offshore militias using specially-registered fishing vessels and are organized by local military and government officials.

China's Coast Guard was formerly divided into five different maritime law enforcement agencies but is being consolidated into a single organization. Where the number of coast guard vessels is concerned, the Chinese Coast Guard already outnumbers Japan, Vietnam, Indonesia, Malaysia, and the Philippines combined, and is projected to keep growing. Two new 10,000 ton Chinese coast guard cutters are currently under construction and are likely to be deployed in the PLA's South Sea fleet. The direct role of both the coast guard and navy in land reclamation is unclear, however: both services' vessels may have been deployed to monitor dredging activities.

Southeast Asia's Response

Among Southeast Asian countries, the Philippines has been the most vocal in its objections to China's recent actions, but ASEAN has been surprisingly unified and firm on the matter too. Prior to the April 26-27 ASEAN Summit, Philippine President Benigno Aquino called for a robust response to China's reclamation activities. The final ASEAN chairman's statement expressed "serious concern" and said that China's activities "eroded trust and confidence and may even undermine peace, security, and stability in the South China Sea." The statement noted worries about freedom navigation and freedom of overflight in the South China Sea, suggesting that ASEAN is concerned about a possible ADIZ declaration in the future. The same chairman's statement noted that ASEAN members would address the reclamation issue through ASEAN frameworks, and this may include the ASEAN Ministerial Meeting and the ASEAN Regional Forum this summer.

The April ASEAN statement called for urgent consultations towards a binding and effective Code of Conduct between China and ASEAN. Several claimants have argued, however, that China's current building activities violate the spirit of the 2002 Declaration on Conduct—the non-binding precursor document—and many reports suggest that China may be stalling in negotiations on a binding code. Recent events therefore suggest that under Malaysia's leadership, ASEAN may be more unified than expected in responding to China's activities, but that the long sought, "rules-of-the-road" agreement between China and ASEAN is unlikely to be reached soon.

Other South China Sea Construction Projects

As concerns over China's activities have grown, officials in Beijing have taken care to highlight that they are not the only claimants to have pursued major construction projects in the South China Sea. Strictly speaking, they are correct, but China's building projects still dwarf those of other claimants in scope, speed, and scale.

Last week, the Asia Maritime Transparency Initiative made public satellite images that demonstrate that Vietnam has done reclamation work on two land features in recent years. It has added approximately 21,000 square meters of new land to Sand Cay, and 65,000 square meters of new land to West Reef. It has also added new military facilities to Sand Cay. By way of comparison, China created 900,000 square meters of new land at Fiery Cross Reef alone, and this is just one of seven features it has developed. Additionally, nearly all of China's activity has taken place over the course of one year, while Vietnam's projects occurred over two or three years.

In response to revelations about China's reclamation work, the Philippines has lifted a self-imposed freeze on Spratly construction. It has resumed repairs and maintenance work, and this is believed to be modest. Taiwan, for its part, has also been upgrading Itu Aba, the single island that it controls in the Spratlys. This includes a \$100 million dollar port renovation and significant improvements to its airstrip. There is no evidence that Malaysia has been doing construction work on the features that it occupies.

Policy Recommendations

There are few good options when it comes to direct U.S. intervention in land reclamation in the South China Sea. There are, however, a few measures that it can take to mitigate the risk that these new islands are used for coercive purposes.

With respect to China, Washington should hold Beijing to its word that its new islands are for civilian purposes. It should accept its invitation to use them for weather monitoring, and for search and rescue exercises. U.S. officials should also repeat to Chinese counterparts that the United States will actively contest a South China Sea ADIZ if China announces one. Additionally, the United States and China have made important progress in their military-to-military ties this year, negotiating two confidence-building agreements and holding several joint exercises. U.S. officials may want to convey to China that this progress could be jeopardized if China continues to militarize its new artificial islands. They should consider what specific actions by China (e.g. missile emplacements, the garrisoning of additional troops, the basing of fighters) would make further military cooperation with China inappropriate. Destabilizing Chinese actions may be met with decisions to disinvite Chinese participation in exercises, or to discontinue negotiations on additional confidence-building measures.

The United States must also augment its investments in ally and partner maritime domain awareness capabilities. Washington has already begun to do so, but Foreign Military Financing to the PACOM area of responsibility is just one percent of the total. Vietnam and the Philippines will never have the naval or coast guard capabilities to match up to China's, but their ability to monitor the South China Sea can be substantially improved. The United States should also encourage multilateral cooperation in MDA, ISR, and even maritime patrols among ASEAN states. If it does increase the dollar value of its aid to partners, however, Washington should make clear that this is contingent on a complete freeze of activities that could be construed as destabilization (major land reclamation, the installation of new military-related facilities, the occupation of new features). It should in turn tell China that it is conditioning partner aid on a freeze, but that this will only be feasible if China keeps to its word and uses its islands for humanitarian and research purposes.

With prospects for a binding ASEAN-China code of conduct stalled, Washington may want to support the development of "rules-of-the-road" by other means. ASEAN itself could negotiate and draft a binding Code, and then offer China the opportunity to sign it. If pursued, this process should be led by the ASEAN maritime states.

The United States must also consider how to mitigate risk in its alliance with the Philippines. The U.S.-Philippines alliance has been reinvigorated in recent years, as evinced by the Enhanced Defense Cooperation Agreement, but cooperation between the two countries was stalled for two decades. As a result, the alliance does not have nearly as many standing security dialogues as other U.S. partnerships in the region, such as those with Japan and South Korea. Washington should consider establishing a standing crisis dialogue with the Philippines, through which both countries can communicate regularly on the evolving situation in the South China Sea. This would also be an appropriate forum for contingency planning and exercises.

With land reclamation efforts in the Spratlys substantially complete, Washington must focus its efforts on ensuring that these new artificial islands do not become heavily armed outposts used to coerce friends and partners, to derail peaceful resolution of disputes, or to disrupt freedom of navigation and overflight. The risk of escalation in the South China Sea is rising, and this places core U.S. interests in peril.

**OPENING STATEMENT OF PATRICK CRONIN
SENIOR ADVISOR AND SENIOR DIRECTOR, ASIA-PACIFIC SECURITY
PROGRAM, CENTER FOR A NEW AMERICAN SECURITY**

DR. CRONIN: Co-chairs Bartholomew and Slane and other distinguished members of the Commission, thank you very much for this high honor to participate in today's hearing.

I've written extensive testimony. I will try to briefly touch upon different aspects of it before focusing on a U.S. strategy perhaps to counter coercion in the South China Sea.

My first judgment is that we're in the midst of an intensifying competition that's mainly driven by a more powerful China determined to set the rules of engagement around its vast periphery. This is something that I've come to see over a series of projects we've directed at the Center for a New American Security during the past five years.

The first of these focused on the South China Sea and the growing tensions there. Far from responding to U.S. policy, China's behavior and the concern it evoked among its neighbors catalyzed the U.S. policy of enhanced comprehensive engagement known as the rebalance to Asia. The rising clamor for the United States to step up its presence and participation created new obstacles for a China eager to test its newfound power. The proving grounds became expansive claims to the lion's share of the South China Sea based on antiquated and vague historical rights, but in reality these trends are driven by deeper forces at work in Chinese society. That was the gist of our first study five years ago.

Our second related research project looked at the growing web of intra-Asian security ties that have developed as a result of China's assertiveness. China has consistently disparaged and opposed the development of minimally effective defenses among its neighbors while unapologetically accelerating the modernization of its defense and security forces.

A third project that I worked on and directed looked at a pattern of behavior that I've now come to call "tailored coercion." To circumvent the latent power imbedded in America's rebalance policy and the maturation of these intra-Asian security ties, China has resorted to an amalgam of stratagems rooted in classical Chinese thought.

By intermingling soft and hard power instruments of policy and dialing them up or down depending on the circumstances, China hopes to expand control over these "gray zone" situations in acting beneath a threshold of action that might trigger a direct military response. While China has met a robust and strengthened U.S.-Japan alliance in the East China Sea, it has found relatively open running room in the South China Sea.

A fourth major project I've directed and just finished looks at cost imposition strategies, and I'll touch upon this when I talk about U.S. recommendations.

I talk more about China's sophisticated strategy and the nuanced strategy, which is critical to developing a counter-strategy. We have to understand more about what China is doing, what is sometimes captured in the phrase "two steps forward/one back."

I look at China's land reclamation, and as Mira highlighted, the many uses of the land reclamation, especially for military strategic purposes, should not be lost amidst all the diplomacy that masks what China is really up to there, including preventing the United States from resupply and supporting Taiwan in another Taiwan contingency, including making sure that China can project power out from the South China Sea, deny the U.S. access to the South China Sea, including letting China build a SSBN ballistic missile submarine bastion in the South China Sea.

Southeast Asia's response has been basically threefold, and I think both previous

testimonies speak to this, three phrases that I would characterize what all ten nations essentially are doing. They're following their very well- practiced risk aversion approach to not wanting to look for confrontation with China. That's in everybody's interests. Even the United States tries to avoid confrontation. Nobody is looking for that.

Secondly, the one thing that unifies a disunified ASEAN is major power meddling and the perception of major power meddling. So this coercive diplomacy from China is what is occasionally leading to the unified rhetoric that Bonnie Glaser referred to, but not necessarily and not likely unified action.

If the United States takes too much assertive action, we'll be the force against which ASEAN will bizarrely unify because we'll look like we'll be destabilizing the region and China will be there to push the narrative that we are destabilizing the region. And we see that in the rhetoric right now in response to the potential for military patrols in the South China Sea. China is basically saying, look, the United States is destabilizing the region or the Philippines is destabilizing the region rather than the Chinese actions.

The third phrase is accelerated hedging. Despite the rhetoric and despite the inaction on ASEAN, they're all actually taking action to accelerate their hedging, both by building up their national capabilities, the intra-Asian security ties and looking more for U.S. security support and help. as well as for help outside of the region from other countries from Japan, Australia, India and others.

Now let me just say in policy recommendations, my main recommendation is to help the United States work with allies and partners in Southeast Asia and beyond to achieve our desired strategic outcomes and not simply short-term tactical responses. So ultimately this needs to be orchestrated at the most senior levels of the executive branch of government, but there are ways obviously for Congress to help as well.

When China exercises bad judgment and violates expected norms of behavior, the United States should find ways to impose appropriate costs. There are consequences to our inaction and failing to act now to establish what constitutes good neighborly relations may raise the risk of trying to oppose coercion in the future.

There will be a predictable chorus of opinion agonizing over America's own shortcomings with respect to international behavior. We need to be humble yet resolute, determined to work with others for fair-minded, rules-based order.

Now the least painful way to impose costs will remain mostly indirect approaches, especially diplomatic and legal. Also information can be harnessed as a much greater policy instrument as has already been suggested.

Some of the recommendations I make: require the executive branch to keep persistent, precise and public details of China's military, diplomatic, legal, informational and other relevant activities in the South China Sea.

Second, support the creation of a region-wide information-sharing center. This creation of a common operating picture, if you will, for the region ideally might be ASEAN-based or U.S.-led, but regardless should be open to providing information for all international actors transiting international waters, including obviously the 18 members of the ASEAN Defense Ministers-Plus and East Asia Summit processes.

Thirdly, encourage the United States to forge a coalition of maritime countries willing to voluntarily promote a binding Code of Conduct like the one we hope China will one day accept. And I like the idea of the other two testimonies here about building, helping support an ASEAN consensus on a Code of Conduct as well.

And in addition to these indirect ways to impose costs on bad behavior, the United States should create a more propitious environment for occasional, more direct responses to tailored coercion or other unilateral changes to the status quo.

Timely and geographically meaningful exercises not unlike the recent U.S.-Philippine amphibious exercise near Scarborough Shoal should be conducted periodically so as to convey both concerns and capabilities. Likewise, the United States should give careful consideration to the right time to conduct freedom of navigation operations, including one perhaps to illustrate that submerged land features, even when they've been built up into artificial islands, are no claim to territorial waters or airspace.

**PREPARED STATEMENT OF PATRICK CRONIN
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May 13, 2015

**Testimony before the U.S.-China Economic and Security Review Commission
“China’s Relations with Southeast Asia”**

*Prepared Statement of Dr. Patrick Cronin
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Co-Chairs Bartholomew and Slane, and other distinguished members of the Commission, thank you for the opportunity to participate in today’s hearing. It is a high honor to testify here on matters that are important to the United States and the future stability and prosperity of the Asia-Pacific region. I will address China’s strategy in and around the South China Sea, including with respect to its controversial land reclamation activities. Then I will briefly examine perspectives and reactions of Southeast Asian countries. Finally, I will offer policy recommendations about some of the steps that might be considered to counter China’s increasing pressure on Southeast Asia.

Introduction

We are in the midst of an intensifying competition in Asia. The main driver of this competition is an ever-more powerful China determined to set the rules of engagement around its vast periphery. The South China Sea is the locus of rivalry. In seeking to expand its influence in Southeast Asia, China may well believe it is simply reclaiming its historic position as the dominant regional power. It may also think that its actions are defensive, designed to protect its security, access to resources, and vital sea lines of communication. But it realizes that the post-World War II order largely built by the United States still obstructs this objective. Thus, many Chinese hope to displace the United States while gradually dominating its neighbors in a manner unlikely to trigger any decisive or timely response. This is effectively Chinese regional hegemony in slow motion. In Washington, too often the urgent crowds out the important. If we wait for the important changes presently underway in Southeast Asia to develop on their current trajectory, the United States and its allies and partners will soon not only lose substantial leverage over the rules and norms of behavior in this region but also may well face larger security risks in the future.

I do not arrive at these judgments suddenly. For the past several years at the bipartisan Center for a New American Security (CNAS), I have directed a series of projects that have analyzed evolving regional trends, particularly in maritime Asia. The [first project](#) dissected China’s more aggressive posture in the South China Sea.⁴⁸ Far from responding to U.S. policy, China’s behavior and the concern it evoked among its neighbors catalyzed the U.S. policy of enhanced

⁴⁸ Patrick M. Cronin, ed., “Cooperation from Strength: The United States, China and the South China Sea,” (Center for a New American Security, January 2012).

comprehensive engagement known as the pivot or rebalance to Asia. The rising clamor for the United States to step up its presence and participation created new obstacles for a China eager to test its newfound power. The proving grounds became expansive claims to the lion's share of the South China Sea based on antiquated and vague historical rights, but in reality these trends are driven by deeper forces at work in Beijing and Chinese society.

Our [second related research project](#) highlighted the organic development of intra-Asian security ties that were rapidly developing as a consequence of China's assertiveness and America's uncertain staying power.⁴⁹ China has consistently disparaged and opposed the development of minimally effective defenses among its neighbors while unapologetically accelerating the modernization of its defense and security forces. This report called attention to the fact that China is not the only rising Asian power and others will adjust their policies as necessary to hedge against an uncertain future security environment.

A [third project](#) critical to my current understanding of China's strategy identified a pattern of behavior I labeled "tailored coercion."⁵⁰ To circumvent the latent power embedded in America's rebalance policy and the maturation of intra-Asian security cooperation, China has resorted to an amalgam of stratagems rooted in classical Chinese thought. By intermingling soft and hard power instruments of policy, and dialing them up or down depending on the circumstances, China hopes to expand control over these "gray zone" situations beneath a threshold of action that might trigger a direct military response. While China has met a robust and strengthened U.S.-Japan alliance in the East China Sea, it has found relatively open running room in the South China Sea.

A fourth major project, the full compilation of which will appear shortly as a single volume, addresses how the United States, together with allies and partners, can impose costs on tailored coercion and other bad behavior in the East and South China Seas. To quote from the [concluding capstone paper](#) in this series of essays on cost-imposition strategy:

...between war and peace there is an ever-widening no man's land of assertiveness, coercion, and distrust. Especially within the gray zones of maritime Asia there is increasing competition over the rules, rule-making, and rule enforcement. The United States ... appears to be experiencing a slow erosion of credibility. A re-emerged China is recasting itself as a maritime power, calling at times for an exclusionary "Asia for Asians" architecture, and using its comprehensive instruments of power to unilaterally change facts on the ground, in the sea, and in the air. Left unchecked, rising maritime tensions will further undermine American influence, jeopardize the sovereignty of neighboring states, and sink the general postwar regional order.⁵¹

This cumulative body of research activity, supplemented by regular travel throughout the region and to scores of international conferences and workshops on related issues, as well as

⁴⁹ Patrick M. Cronin, Richard Fontaine, Zachary M. Hosford, Oriana Skylar Mastro, Ely Ratner and Alexander Sullivan, "The Emerging Asia Power Web: The Rise of Bilateral Intra-Asian Security Ties," (Center for a New American Security, June 2013).

⁵⁰ Patrick M. Cronin, Ely Ratner, Elbridge Colby, Zachary M. Hosford and Alexander Sullivan, "Tailored Coercion: Competition and Risk in Maritime Asia," (Center for a New American Security, March 2014).

⁵¹ Patrick M. Cronin and Alexander Sullivan, "Preserving the Rules: Countering Coercion in Maritime Asia," (Center for a New American Security, March 2015).

innumerable discussions with U.S. and regional officials, is the solid foundation on which I base my judgments. It is this same corpus of works from which I now distill some insights about China's current strategy and tactics in the South China Sea.

China's Strategy

While China wishes to assert greater control over its periphery, it is not an adversary of the United States. It seeks not to invite war but rather to set the conditions of and exert influence over a contested peace. Its first objectives are rooted in economic-political stability: the preservation of economic growth and of the ruling Communist Party of China. Both of those pillars of China are increasingly under stress, the former as the rate of economic growth declines and the latter as a rising middle class seeks to alter the social compact with Beijing. In President Xi Jinping's tenure Chinese power and confidence have risen to the point that China's desire for a larger de facto sphere of influence is undermining the preexisting regional order. Propelled by the irrational forces of nationalism and the rational forces of sober security calculation, China has accelerated an effort that effectively displaces, blocks, and denies U.S. power. China seeks to neutralize America's still considerable conventional military capability, while it preempts attempts to coalesce Southeast Asia against Chinese power.

So while China is not an enemy, it is very clearly a fierce competitor. Tapping into global trends, China is able to make common cause with Russia and others to foster the natural forces of multipolarity that in turn promise to give China greater latitude over how to deal with its neighbors.⁵² Leveraging its growing position as the number one economic partner with virtually all countries in Southeast Asia, China is able to portray America's military power as a potential liability and source of confrontation. Relying on a full complement of policy tools, China is able to promote initiatives—often no more than slogans thrown out at rapid speed to find out what if anything sticks—to advance its ascending power at the expense of others. China is, simply put, out-maneuvering the United States. In recent months, Beijing has sought to alter the dominant perception that China is being exclusionary and seeking its own set of rules; and it has partially succeeded in portraying the United States and its allies in that unfavorable light. Thus, Chinese interlocutors currently have among their talking points the notion that the Asian Infrastructure Investment Bank is inclusive and good, while the Trans-Pacific Partnership trade pact is exclusionary and bad. This is nonsensical, but the United States is partly to blame for allowing such a false narrative to develop.

Chinese strategy is not simply to win without fighting but to put itself into the more favorable position to control its destiny and shape its environment. This is largely a strategy built on direct assault through information, legal, and psychological campaigns (the so-called “three warfares”), but decidedly an indirect approach when it comes to military defenses. Its military modernization is sufficiently public and robust as to alter the perceptions of its smaller neighbors, especially when they harbor doubts about the future strength and political will of the United States to come to their defense or maintain a regional balance of power. The

⁵² See, for instance, Mathew Burrows, *The Future, Declassified: Megatrends That Will Undo the World Unless We Take Action* (New York: Palgrave Macmillan, 2014), especially Chapter 2, “A Splintered World,” pages 43-63. Significantly, regarding the general trend toward the diffusion of global power, Burrows identifies individual empowerment, manifested in such developments as a mushrooming middle class in Asia, as more salient than shifts in power among states.

development of the People's Liberation Army is also sufficiently rapid and advanced to severely complicate America's future ability to project power forward into East Asia to protect U.S. and allied interests. But it is not so advanced as to spoil for a fair fight. Indeed, the revitalized U.S.-Japan alliance, including both a more proactive Japanese leadership determined to defend its Southwest Island Chain and a far more integrated alliance capability as articulated in new defense guidelines, have deflected some of China's assertiveness toward the South China Sea, where there is no clear Article V commitment and a multitude of actors and disputed claims to keep the region out of balance.

A thread running through the approaches of all Chinese leaders from Mao to Xi is China's remarkable literature on classical strategic thought. At the heart of this literature, including Sun Tzu's famous *The Art of War*, is the wisdom of an indirect approach to produce a favorable balance rather than direct force to achieve a decisive outcome. The idea is not to defeat your foe in head-to-head combat, but rather to out-position him; not to produce a decisive battle but to ensure that your position is more favorable than that of your opponent.⁵³ Yet American strategic thinking, as well as the American approach to war and conflict, leads us to want to resolve forces in tension rather than to balance them. But President Xi knows that when one meets an immovable object, it is preferable to use an indirect approach. As Sun Tzu wrote, even the soft substance of water eventually can wear down the hardest stone. Minus an immovable object, of course, one can become far more willing to probe opportunities until there are obstacles or costs.

An indirect approach puts a premium on what we like to call "smart power." For the Chinese this involves building a diverse arsenal of soft and hard power policy tools, and intermingling them at varying levels of intensity to achieve a favorable balance, both at the moment and in the future. Thus, even benign moves, such as a sudden embrace of confidence-building measures and infrastructure development in the form of "one belt, one road," can both deflect momentary pushback and, if brought to fruition, deny a competitor the ability to implement future moves. This constant calibration and recalibration among a variety of policy instruments is captured by the phrase "two steps forward, one back." China is on a constant vigil over how to advance its regional power, brazenly accelerating when opportunities arise and shifting messages and course as necessary to adapt to rising costs and obstacles. This is not to say that the Chinese perfectly execute classical Chinese strategy. I have attended many conferences where the same Chinese official or expert simultaneously declares that no one can stop China's actions and that China is being bullied by one of its smaller neighbors. Victimhood alternates with brazen claims amounting to spheres of influence appropriate to nineteenth-century realpolitik in which big powers are meant to dictate to small powers. The mixed messaging is not always received as intended, although often China's goal is not the intellectual purity of an argument. It is sometimes more convenient to deploy a multitude of arguments, however contradictory.

Chinese strategy is also attentive to the time factor in political developments. Broadly speaking, China seeks to engender certainty of its future power, with the corollary that crossing China now would be an imprudent course of action. In the short term, it is sometimes simply a matter of playing out the clock on various political milestones such as elections or rotating regional chairs within institutions such as the Association of Southeast Asian Nations (ASEAN). Other times,

⁵³ The best recent book on Chinese strategy to help bridge the gap between Chinese and Western thought is that written by Derek M. C. Yuen, *Deciphering Sun Tzu: How to Read The Art of War* (Oxford and New York: Oxford University Press, 2014).

China's intent is to delay collective action by shifting the blame for potential instability onto the perceived weakest link within the context of regional politics. That is, if the Philippines or Vietnam is pushing back too hard on China's assertiveness, then China seeks to convince other ASEAN members that a single country is upsetting the entire regional order.

Another tactic is for China to play the history card, or, in the case of the South China Sea, the historical rights card. Offering up an artificial island for regional cooperation—an island that under international law is not clearly China's and which would also not engender even a territorial claim if it were originally a submerged land feature—is a way for China to take one more wild stab at buying acceptance of its vague claims of historical rights. But as Bill Hayton has shown in his exemplary volume on the history of the South China Sea, the concept of sovereignty is relatively new, historical contact is not the same thing as modern sovereignty, and contemporary international law under the United Nations Convention on the Law of the Sea established a different basis for determining sovereignty.⁵⁴

To recap my general insights regarding Chinese strategy, it is, classically speaking, more a game of position than of brute force, more a constant campaign rather than a series of decisive battles. I have little doubt that classical strategic thought has had a heavy influence on Xi Jinping, as well as his predecessors. But added to this predisposition is the exigency of preserving one-party rule in the face of mounting tensions as the rate of economic growth slows. China thus far is substituting more ideology and nationalism to compensate for the likely falloff in delivering economic goods as part of an unwritten social compact. Nationalism has been a sleeping dragon that, once awakened may come back to haunt China and the region.

Despite the foregoing characterization of Chinese strategy, we should not assume that the current leadership in Beijing has a detailed blueprint for action. If that were true, then hoary phrases such as the “Great Rejuvenation” and the “China Dream” would be accompanied by far more detailed objectives. Indeed, there have been important research efforts to demonstrate the challenges Xi faces in governing a modern, diverse, and ultimately fragile China. Bearing in mind China's sources of insecurity and its vulnerabilities will be critical in fashioning an effective posture to dissuade China from a course that relies more on unilateral coercion in favor of a course more rooted in multilateral cooperation.

China's Land Reclamation

Because the United States and others throughout the region seek to maximize cooperation with a reemerging China while minimizing conflict, we are caught between a rock and hard place as to how to handle brash acts of forcefulness such as the creation of artificial islands in the South China Sea. China is well on its way to doubling the preexisting land mass in that sea, seeking to make its ambiguous nine-dash-line claim to most of the South China Sea—which, in its most expansive forms, the U.S. government has stated has no basis in international law⁵⁵—a de facto reality. It also refuses to participate in the current case lodged by the Philippines before the

⁵⁴ Bill Hayton, *The South China Sea: The Struggle for Power in Asia* (New Haven, CT: Yale University Press, 2014).

⁵⁵ United States Department of State Bureau of Oceans and International Environmental and Scientific Affairs, *China: Maritime Claims in the South China Sea*, Limits in the Seas No. 143 (December 5, 2014), <http://www.state.gov/documents/organization/234936.pdf>.

International Tribunal on the Law of the Sea, thereby calling into question China's interest in abiding by international law. Australian academic Alan Dupont describes what China is trying to do as terraforming its way to control over the South China Sea.⁵⁶ China's strategic intent may be as simple as a desire to exercise greater capability over its near seas, consistent with its growing power, capability, and confidence and infused by a sense of historical injustice, nationalism, and political exigency.

It is interesting to listen to Chinese officials struggle to explain their assertive actions. One line of argument is that China is building up submerged land features to sustain ports and runways as a global public good; indeed, said Admiral Wu Shengli, China would be happy to open up the artificial islands for international cooperation, such as for humanitarian assistance and search and rescue, "when the conditions are right."⁵⁷ Yet another line of argument is that the previous actions undertaken by Vietnam and the Philippines requires China to build up their own facilities, even though the scale of what China has done is an order of magnitude beyond what other neighbors have done. Moreover, in keeping with China's desire to issue ambiguous and plausibly denial threats, at least one Chinese official has said that the facilities on these submerged features and rocks were essential to help maintain "the quality of life for soldiers"—i.e., hinting to U.S. officials that they intend to build up radars, runways, docking facilities and military garrisons on these outposts.⁵⁸

One does not have to gain access to classified PLA plans to understand the potential purpose of such island fortifications: they extend Chinese power projection capability and they erode American power projection capability. In the event of Mainland attempts to coerce Taiwan, for instance, the United States will have a far more difficult time demonstrating support for Taiwan than it did when it was able to dispatch two aircraft carriers through the Taiwan Strait during the 1995-1996 crisis. Moreover, the potential runways and other facilities in the Spratlys and Paracels create the infrastructure that will give China a genuine ability to try to impose air and sea control, not to mention an Air Defense Identification Zone (ADIZ). When China suddenly declared an ADIZ in the East China Sea in November 2013, it was not long before it was obvious

China could not enforce such a declared area.⁵⁹ Through land reclamation, the PLA will be more able to create vital control over who can go where in the South China Sea, thereby raising future costs on U.S. attempts to patrol in international waters within China's Exclusive Economic Zone (EEZ). Significantly, China will be better poised to create a ballistic missile submarine (SSBN) sanctuary, something it may wish to establish as part of an enhanced nuclear posture. An SSBN bastion strategy would provide a more survivable, mobile nuclear deterrent force capable of threatening the United States with an assured second-strike capability. Although the aim is not to use nuclear weapons, the main effect could be to undermine America's nuclear umbrella over regional allies, thereby hastening the pace of Chinese dominance over the region. Here in Asia,

⁵⁶ Peter Harcher, "World Reluctant to Point Finger at China's Encroachment on Strategic Islands," *The Sydney Morning Herald*, May 5, 2015.

⁵⁷ Jeremy Page, "China Puts Conciliatory Slant on Land Reclamation," *Wall Street Journal*, May 1, 2015.

⁵⁸ These are the words of Major General Luo Yuan with respect to Fiery Cross Reef. See "China Builds Island in the South China Sea," (The U.S.-China Policy Foundation, Washington, D.C., November 26, 2014).

⁵⁹ Craig Whitlock, "U.S. Flies Two Warplanes over East China Sea, Ignoring New Chinese Air Defense Zone," *The Washington Post*, November 27, 2013.

as elsewhere, perceptions often matter as much or more than reality.

A few former U.S. officials and noted experts contend that the United States must not let the South China Sea hijack our relations with China. I agree. The question is not whether or not to accommodate a rising China but whether and how to draw the line on certain types of bad behavior.⁶⁰ But the risk of a catastrophic fissure is small, not least because China does not want that to happen. Instead, my esteemed colleagues should instead consider the consequences of not standing up for allies and partners. If misdeeds and bad behavior incur no penalties, if actions have no consequences, then there is very little incentive for any power to bother with standards, codes of conduct, and international law. In short, the challenge is not the risk of war (as opposed to inadvertent incidents, which remain all too real a problem), but instead how to embrace the contradiction of mostly supporting U.S.-China cooperation but sometimes lowering the boom when it comes to clarifying what constitutes violations of regional norms. The real risk is that an unchecked China will realize domination of its near seas for all the irrational and rational reasons suggested above. After all, China managed to exercise what some consider a case of textbook extended coercion on the United States during the 2012 crisis over Scarborough Shoal. In that crisis, Washington walked its ally in Manila down and convinced it to de-escalate but did nothing to prevent China from moving in to exercise permanent control over the disputed shoal, which lies well within the EEZ of the Philippines. From this vantage point, we appear ready to let China hijack the South China Sea out of the untested fear that Beijing will forfeit its interest in cooperation with the United States and other regional states.

Southeast Asia's Response

As China has re-emerged in the world, Southeast Asia has risen, too. Anxieties of rising Southeast Asian countries were largely what prompted a more active U.S. policy known as the pivot or rebalance. The further idea of a “rebalance to the rebalance” acknowledges the need for greater engagement with traditional and new partners in Southeast Asia, given our longstanding presence in Northeast Asia. There are both opportunities and risks for the United States to further engage Southeast Asia, but first let me touch upon China's relations with the region. Three salient aspects of Southeast Asia's response to China's assertiveness in the South China Sea, including land reclamation activities, are risk aversion, unity in the face of major power meddling, and accelerated hedging.

ASEAN is a successful political body, providing important and myriad venues for diplomacy. But ASEAN is notoriously risk-averse when it comes to confronting serious challenges. It is a consensus-driven body and not likely to become an action-oriented institution anytime soon. China relies on this risk-averse nature, and resorts to divide-and-conquer tactics anytime the 10 Southeast Asian countries appear to be uniting on anything, even a broad statement, that might be construed as antithetical to China's interests. Because Southeast Asian countries have such diverse interests from one another, not least between claimant and non-claimant countries in the

⁶⁰ As my distinguished colleague Robert D. Kaplan has written, U.S. officials “must be prepared to allow, *in some measure (italics added)*, for a rising Chinese navy to assume its rightful position as the representative of the region's largest indigenous power. True, America must safeguard a maritime system of international norms, buttressed by a favorable balance of power regimen. But the age of simple American dominance, as it existed through all of the Cold War decades and immediately beyond, will likely have to pass.” See Robert D. Kaplan, *Asia's Cauldron: The South China Sea and the End of a Stable Pacific* (New York: Random House, 2014), 182-183.

South China Sea, China is able to find numerous seams to pull apart. In addition, because all of China's neighbors in the region enjoy major trading relations with China, Beijing is able to offer incentives (or to threaten to withhold incentives) in exchange for cooperation. This helps to explain why in 2012, for the first time in the body's 45-year history, ASEAN foreign ministers failed to issue a joint communiqué when Cambodia chaired the meeting in Phnom Penh due to disagreements over whether to include the South China Sea as a security issue of concern.⁶¹

Yet even ultra-cautious Malaysia, which enjoys the largest trading relationship with China among any ASEAN member state, managed a show of unity in April of this year, declaring that reclamations in disputed waters in the South China Sea had "eroded trust and confidence and may undermine peace, security and stability."⁶² This recent declaration is a reminder what unites ASEAN members: namely, the fear of meddling by outside powers. For the past several years, China has been the main concern. The Philippines and Vietnam have been on the frontiers of China's assertiveness in the South China Sea. Even so, attempts by the United States to provide military reassurance and presence, or to offer assurances to particular members such as the Philippines, incur a predictable backlash out of fear that America's stabilization efforts may also roil the region. That is why it is incumbent on U.S. officials to calibrate efforts to strengthen our access and security cooperation in Southeast Asia with a sharp understanding of how far the region will go based on the balance of political forces. In 2010, Southeast Asian states turned to the United States to provide a clear counterweight to Chinese assertiveness; but most of those official entreaties were behind closed doors and seldom to their own publics.

The third element of ASEAN's response is a general trend toward accelerated security hedging. Partly this involves seeking closer relations with the United States. But in large measure it is also seeking stronger intra-Asian relations, including with other Indo-Asia-Pacific military partners, including Japan, Australia, the Republic of Korea, and Australia, as well as Britain and France. What this latter network development suggests is the potential for forging wider ties with maritime countries and strengthening more inclusive regional institutions such as the East Asia Summit process and the ASEAN Defense Ministers' Meeting Plus process, each of which includes 18 members.⁶³

In short, Southeast Asian responses to China's activities have been to double down on their own variations of engage-and-hedge strategies to bind and balance a more powerful China. The flip side of China's divide-and-conquer tactics vis-à-vis ASEAN is Beijing's efforts to deploy protracted trust-building diplomacy not aimed at concluding agreements, especially binding ones, but rather to forestall doing so. Engaging in talks for the sake of talks buys China more valuable time and softens transaction costs while it simultaneously asserts its growing influence in other ways. Such tactics are not lost on most ASEAN member states, some of whom advise the United States to do what most regional diplomats practice without being told: *viz.*, to use a bit of guile, to demonstrate an ability to stake out seemingly contradictory arguments, knowing that

⁶¹ Ernest Z. Bower, "China Reveals Its Hand on ASEAN in Phnom Penh," *East Asia Forum*, July 28, 2012.

⁶² Manuel Mogato and Praveen Menon, "China Maritime Tensions Dominate Southeast Asia Summit," Reuters, April 27, 2015, <http://www.reuters.com/article/2015/04/27/us-asean-summit-southchinasea-idUSKBN0NI0BH20150427>.

⁶³ The East Asia Summit and ADMM-Plus countries each include the ten ASEAN member states (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam), and eight non-Southeast Asian countries (Australia, China, India, Japan, New Zealand, the Republic of Korea, Russia, and the United States).

expressing the whole truth in public all the time is not necessarily the most advantageous course of action in the competitive arena of international affairs.

The majority of ASEAN members, particularly its maritime members, are at least quietly advocating that the United States remains firmly footed in the region, while simultaneously building out a wider network of security partners. On the other side, almost all ASEAN countries prefer non-confrontational ways to deal with China. United in both is the consensus fear that larger outside powers will run roughshod over Southeast Asian interests. China's flirtation with tailored coercion over the past several years has yielded a number of united front statements, including the April response to the Great Wall of Sand reclamation efforts of China. But ASEAN unity can also be aimed at the United States, should we allow China to maneuver us into over-reacting or losing the battle of narratives over the best approach for defining and address the problems.

U.S. Policy Recommendations

My main policy recommendation is to help the United States work with allies and partners to achieve our desired strategic outcomes and not simply short-term tactical responses. Ultimately this needs to be orchestrated at senior levels of the executive branch of government, but there are many ways the legislative branch of government can support a multi-faceted, nuanced mixture of cost-imposition, capacity building, and comprehensive engagement.

When China exercises bad judgment and violates expected norms of behavior, the United States should find ways to impose appropriate costs. There are consequences to our inaction, and failing to act now to establish what constitutes good neighborly relations may raise the risks of trying to oppose coercion in the future. There will be a predictable chorus of opinion agonizing over America's own shortcomings with respect to international behavior; we need to be humble yet resolute, determined to work with others for fair-minded, rules-based order.

The least painful way to impose costs will remain mostly indirect approaches, especially diplomatic and legal. Information should also be harnessed as a policy instrument, given that transparency and information technology are both areas that play to America's strengths. Here are several ways we could do a better job at imposing indirect costs, while accruing other benefits as well:

- *Require the executive branch to keep persistent, precise, and public details of China's military, diplomatic, legal, informational, and other relevant activities in the South China Sea.* It is the administration's job to keep these activities in the forefront of regional diplomats at forums such as the East Asia Summit, the ASEAN Regional Forum, and the ADMM-Plus. But Congress can assist, not only by passing timely "Sense of Congress" bills enumerating U.S. interests and concerns, but also by ensuring a more public and empirical approach is widely available. Congress should direct the Department of Defense, in cooperation with the Department of State, to establish an authoritative information source not unlike a blog. It could also be supplemented by or made part of an annual report of activities in maritime Asia. This would not require a new institution but instead could be delegated to an existing research institution, either the Center for

Maritime Studies Institute at the U.S. Naval War College or the Center for Naval Analyses. The key here would be to ensure these analyses are more authoritative than those that can be produced by completely non-governmental institutions.

- *Support the creation of a region-wide information-sharing center.* There are various opportunities for integrating and improving upon existing embryonic attempts at this notion. For instance, perhaps it could be centered at Singapore's existing Information Fusion Centre, which was established at the Changi Command and Control Centre in 2009 to provide maritime domain awareness to deal with pervasive problems such as piracy, maritime safety, border disputes, and disaster relief. Ideally, this center might be ASEAN-based or U.S.-led, but regardless should be open to providing information for all international actors transiting international waters, including obviously the 18 members of the ADMM-Plus and East Asia Summit processes.
- Today's unprecedented degree of imagery and data should be more readily available as a regional public good. Indeed, the U.S. Pacific Command is already working with ASEAN members on improving a common operating picture to deal with universal challenges such as humanitarian assistance and disaster relief and search and rescue operations. Furthermore, a general information exchange would complement higher-end cooperation between the United States and key allies and partners.
- *Encourage the United States to forge a coalition of maritime countries willing to voluntarily promote a binding code of conduct like the one we hope China will one day accept.* This may help reinforce those within ASEAN to keep pushing ahead on a binding Code of Conduct, exact a price on China for foot-dragging and refusing to accept binding rules, and create a wider network of cooperation among maritime powers. While this coalition would not have enforcement authority, it could well provide a wellspring for enforcement-type activity, such as the conduct of periodic patrols to maintain freedom of the seas and an open global commons. But this would not and should not be an alliance. Interests are too diverse to support an alliance in Asia and it would only create the kind of polarization of Asia we seek to avoid.
- *Strengthen America's capacity for understanding, analyzing, interpreting, disseminating, and discussing international law and diplomacy regarding maritime security, especially in the South China Sea.* Not only should the State Department continue regularly publishing authoritative documents on international maritime law, but Congress should support adding international legal experts to key regional policy offices at the State Department, the Department of Defense, and U.S. Pacific Command. This will be critical as we seek to support the Philippines in its efforts to address disputes through legal means and international law rather than coercion. The forthcoming judgment from the arbitral panel will only be important if we make the case that international law matters and remains a far better way to deal with disputes in the South China Sea than China's forthcoming fortifications.
- *Ratify the United Nations Law of the Sea Treaty.* Administrations abide by it. The failure of Congress to ratify it only undermines our diplomatic efforts to mobilize support

for a rules-based approach, while abetting disinformation campaigns aimed at undermining our credibility. As we inevitably accommodate shifts in global power, it is increasingly to our advantage to shape a common rule set in which they occur.

In addition to these indirect ways to impose costs on bad behavior, the United States should create a more propitious environment for occasional, more direct responses to tailored coercion or other unilateral changes to the status quo. Timely and geographically meaningful exercises, not unlike the recent U.S.-Philippines amphibious exercise near Scarborough Shoal, should be conducted periodically so as to convey both concerns and capability. Likewise, the United States should give careful consideration to the right time to conduct freedom of navigation operations (FONOPs), including one perhaps to illustrate that submerged land features—even when they have been built up into artificial islands—earn no claim to territorial waters or airspace. This type of activity—a punch in the nose against aggression—must be emplaced in a careful diplomatic framework in which the United States is poised to emphasize both its engagement and hedging dimensions of policy.

The second way to counter China's provocative moves in the South China Sea is to deny China the benefits of salami slicing tactics and coercion. The principal and easiest way to do this is by building greater capacity, both a minimal coastal defense and defense capacity, among the region's maritime powers. A putative common operating picture for the region as a whole can be augmented by advancing bilateral cooperation on maritime domain awareness. Most of this cooperation will happen on a bilateral basis, although in some cases countries can derive benefit by working with U.S. allies (e.g., on coast guard capacity) or through mini-lateral exercises among three or more countries. Some specific steps that Congress might take to foster capacity building and otherwise help deny China political gains from maritime coercion are as follows:

Congress should request from the Department of Defense a clear long-term capacity-building plan for Southeast Asian maritime countries. This should encompass plans for building capacity, bilaterally and multilaterally, including ways to leverage the natural development of an Asian power web—a loose network of intra-Asian relations. Among the highlights of any bilateral plans ought to be a clear blueprint for how to move forward with the Enhanced Cooperation Defense Agreement with the Philippines. Here we should consider not just rotational forces but human capacity building, literally supporting the Philippines as it seeks to develop future strategic concepts. We undertook a similar program in the early 1990s with Japan, and today Japan's Ministry of Defense is awash with strategic depth. Similar plans of action with Vietnam should be spelled out, particularly as the United States builds on a strong foundation of strategic dialogue. Indonesia remains a looming opportunity, and President Joko "Jokowi" Widodo's maritime fulcrum should be seized as an open door for expanded maritime cooperation. In all these cases, as well as with others, we must be mindful to approach cooperation in ways that can be absorbed and sustained. Bear in mind there will be political pressure on these capitals to dilute cooperation with the United States in order to balance national interests with China.

The final leg of the policy response should focus on engagement and, more broadly, doubling down on serious implementation of a comprehensive policy of rebalancing to Asia. This must begin with economic and diplomatic approaches and be undergirded by a quiet and sustained strength. Economically, this means the completion of the Trans-Pacific Partnership and Trade

Promotion Authority, which are essential for our future prosperity and security. But it also means going back to the drawing board to think through a long-term development initiative that gives the United States a more effective and positive approach to development rather than being portrayed as an obstacle to development. Any objective analyst standing back and looking at recent U.S. development initiatives—such as the Lower Mekong Initiative and the attempt at building energy plants in Pakistan—and comparing them with the major promises of China and the Asian Infrastructure Investment Bank, would be forced to conclude that China is the rising power and America is in steep decline. But our failure of imagination, our failure of bipartisanship, and our failure of execution should now give way to a creative, serious, long-term way to demonstrate anew why the United States and its allies and partners have so much to contribute to problem-solving, human development, and regional integration. It takes nothing away from China but rather emphasizes our soft power offense.

Diplomatically, doubling down on the rebalance means not only showing up, but taking up selective yet meaningful roles in the most important regional institutions, including ADMM-Plus and the East Asia Summit. It means working with allies and partners to keep China's actions in the South China Sea in the limelight of other diplomatic arenas, too. It means letting our officials participate in selected but important Track Two events, where the Chinese never fail to send delegations to make their points; rather than simply respond to these points, we can make use of such meetings to remind the region that the United States has a positive vision for an inclusive, rules-based architecture. It remains determined to preserve the global commons, uphold

freedom of the seas, and protect allies and partners from aggression and coercion; but it intends to do so by taking the high road and insisting on fair-minded rules while imposing appropriate costs on misdeeds.

Rebalancing on the military and security front requires preserving the United States military capability to retain sufficient and credible forces forward deployed, prepared to undertake a wide array of missions, not least in situations short of war. The presence in Singapore is extremely helpful and must be closely nurtured. The presence in Australia is crucial and should expand over time. The presence in the Philippines should also grow, once the Supreme Court of the Philippines validates the legality of rotational presence. But another significant aspect of a serious presence as a permanent Pacific power means following through on U.S. territory in the Marianas, including the build up of Marine presence and exercise ranges to engage regional allies and partners. For the longer-term, we need to embrace the kind of thinking started by Deputy Secretary Robert Work, as he analyzes how to invest in a “third offset” strategy to compensate for growing anti-access and area denial capabilities in the region.⁶⁴

Meanwhile, our engagement with China, including military-to-military engagement, should be institutionalized, continuous, regardless of friction—especially because such friction is likely to persist for some time. But this does not mean just pursuing any and all engagement. Congress is right to want to inventory the bilateral defense relationship to ensure it is balanced. Engagement of China, including pushing for effective confidence-building measures (CBMs), should be an

⁶⁴ Robert O. Work, “The Third U.S. Offset Strategy and its Implications for Partners and Allies,” (Willard Hotel, Washington, D.C., January 28, 2015), <http://www.defense.gov/Speeches/Speech.aspx?SpeechID=1909>.

essential part of this comprehensive policy. While some want to rush to exclude China from military-to-military activities, I favor focusing on the quality of the military-to-military engagements we have. The biennial Rim of the Pacific (RIMPAC) exercise, for instance, seems to me an appropriate way for the United States to showcase how its military presence and capability is oriented toward a region-wide public good of stability and effective responses to common challenges, from HA/DR to search and rescue and illicit trafficking. But CBMs should be meaningful, pragmatic, and not excuses for helping China to offset its more belligerent behavior in the eyes of Washington and the region. Previously I have suggested other CBMs as well.⁶⁵

Concluding Thoughts

Our aim should be not to over-militarize the problem but to seek to win the peace through a concerted, long-term strategy of cost-imposition, capacity building, and engagement. Partly this

means resisting our national proclivity for rushing to resolution and instead seeking to manage disputes through a careful policy that balances ends and means not just for the United States but also within the context of Southeast Asia. Living with some level of tension, and even some contradiction between our vision and today's reality, is for the foreseeable future the best we can do. We can neither afford to discard nor to go beyond a strategy in which engagement and hedging are the yin and yang of our regional strategy. But we can improve upon the dimensions of this dialectical approach, beginning by doubling down on a policy of comprehensive rebalance to Asia.

Countering bad behavior is not the same thing as containment; neither is using a mixture of hard and soft power instruments to impose costs on bad behavior going to prompt the South China Sea to hijack U.S.-China relations. Only China can contain China and only China can derail U.S.-China relations by underestimating our resolve to ensure that stability and prosperity are not undermined by unilateral changes to the status quo through coercion or force. Some highly respected colleagues have called to halt activities that perpetuate the continued emergence of China; I would modify that call to more narrowly circumscribe what is within our power: namely, to preserve our interests by seeking cooperation through strength, putting forth a positive vision that continues to appeal to and mobilize most of the region, and yet, in seeming contradiction, being willing to impose costs on behavior that falls outside of rules, norms and standards.

Living with contradiction requires a constant recalibration to retain the proper balance depending on the circumstances. It means continuing to seek to grow positive engagement with China even when this seems unlikely to make a major difference. First, it may achieve practical ways to avoid unintended consequences. Second, it messages to the rest of the region our positive, inclusive, rules-based vision for the region. Some will be uncomfortable with that, but I would suggest that their alternatives are imprudent—either too bellicose or too accommodating. The dynamic tension between engagement and hedging will not always yield least confrontational way to pursue our goals; but it remains the most realistic means of protecting regional order and our interests, and is far preferable to tilting so far toward one-sided accommodation that the order

⁶⁵ Patrick M. Cronin, "The United States, China, and Cooperation in the South China Sea," in *Territorial Disputes in the South China Sea: Navigating Rough Waters*, eds. Jing Huang and Andrew Billo (New York: Palgrave Macmillan, 2015), 149-163.

we are purported to be upholding is hollowed out from the inside.

But cost-imposition and bigger muscle moves must be emplaced within a larger diplomatic framework of comprehensive policy in which each move is designed to support a larger political objective. That objective relates to America's long-term interest in being integrated into the most dynamic region in the world. The Indo-Asia-Pacific region will be the locus of economic and military power in this century. We can ride with this trend or put our heads in the sand. We can build on our historic post-World War II role in erecting a system by which most, including China have thrived or we can accept the gradual diminution of our considerable influence and position and accommodate ourselves to a reduced role and stature in the world, ceding at the same time our ability to respond to external events.

The main reason we can cooperate through strength is because the pursuit of an open, rules-based system does not genuinely threaten China but in fact continues to support it. We have convergent and divergent interests. We should never stop trying to maximize convergent interests. But when we have divergent interests, we should not pretend that they do not exist. China will not stop pressing its favorable narrative and points, many of which will be contradictory and based on half-truths; neither should the United States let up in pressing its interests, and vision, all the while ensuring that we have the capabilities to back them up. The aim, once again, is to "win the peace," not catalyze a war. But preserving prosperity and stability does not mean always averting confrontation.

It is not thinkable to contain China and to pretend that we can only erodes our position. Conversely, fearing the need to confront bad behavior for fear of upsetting our vital relations with China fails to grasp the larger stakes at play over the future regional order. It also succumbs to a curious belief that China will reward weakness. The reason I believe a strategy of cooperation through strength, including cost-imposition measures, will work is because it is, or at least can be if embedded in a larger foreign policy framework, predicated on powerful common interests. Chinese propaganda and distrust notwithstanding, America truly does seek an inclusive system in which rules are equitably worked out among all. Rules such as those calling for settling disputes peacefully and not using force or coercion to alter the status quo ultimately benefit all, including China. They are rules we can all live by.

PANEL I QUESTION AND ANSWER

COMMISSIONER FIEDLER: Thank you. Excuse my allergy response.

Why now? Why has China decided to sort of confront the issue now? I know that's speculative.

MS. GLASER: Thank you, Commissioner Fiedler. Very important question. I think the China strategy really began to change in approximately 2009-2010. It is motivated, I think, or really driven by a combination of factors. One is capabilities. China now has capabilities to impose a price to bully its neighbors that it did not have in the past, and we see this in the East China Sea as well as in the South China Sea.

There is also a perception in China, which really began in 2009, the onset, of course, of the global financial crisis, that the United States was at least in relative decline, that the situation in terms of the comprehensive balance of forces, if you will, was really shifting in China's favor.

And I think, thirdly, we have a new leader in China so although this began before Xi Jinping came to power, frankly, he has spoken out quite clearly that China should never compromise on its sovereignty or territorial integrity. At the same time, that it should build good relations with its neighbors. And if you look back over the history of how China dealt with its land borders with its neighbors, the approach was really quite different.

China actually gave occasionally some territory in order to get peace and to sign treaties to resolve these land borders with many of its neighbors, and its approach was a different principle than it has today. It was we should have mutual compromise, mutual understanding.

Xi Jinping, I believe, driven in part by nationalism, a desire to consolidate his own power, he is looking at economic reform, anti-corruption campaign, trying to build a much more powerful China in support of his China Dream that he has so clearly articulated.

COMMISSIONER FIEDLER: So why shouldn't we look at this as a direct test of wills between China and the United States? I mean this is clearly not a test of wills with, excuse the term, minor states like the Philippines and Vietnam and others vis-a-vis China minor. Why should we not perceive this as a direct test of our will?

DR. CRONIN: Well, I believe it is a direct test of our will, and I think the test, though, is not simply our strength; it's our balance. How do we maintain our balance in this very diverse important dynamic region? China thinks it has an opportunity to expand its power and influence over this region because it thinks it can keep its balance better. Why? It has more economic leverage. It has more capability that Bonnie Glaser talked about.

Yes, sir?

COMMISSIONER FIEDLER: Which is why I'm wondering why, as their capability develops, their capability is not yet equal, therefore, one would assume that it is a more opportune time for us to confront that power in a test of wills now rather than later. And that appears to be some folks in the U.S. government have that view because we're getting slightly more aggressive in the last few days in freedom of navigation exercises.

It also occurs to me that the definition--I mean that the definition of sovereignty by the Chinese is a new one that should not necessarily be honored by anyone, much less us, i.e., it's a spongy issue, just a claim of sovereignty with no real legal basis. Why shouldn't we confront this very dramatically now? And because most of these suggestions that I'm hearing are very diplomatic, very incremental, and the Chinese have decided to not be very incremental.

DR. CRONIN: Well, Commissioner, my own view is that while we have to be strong and should not be afraid of being strong, even punching China in the nose, it has to still be

placed in the diplomatic framework.

COMMISSIONER FIEDLER: No, I get it.

DR. CRONIN: And so what we're trying to do is we're trying to win the long peace and we're not trying to start a war. China is not trying to start a war either. It's actually trying to use its opportunity and capacity, and driven by those nationalistic and domestic forces inside China is being encouraged to expand its own influence, its sphere of influence and control for its own security, for its own political security.

So we have to occasionally take them on head on because we do have that capability. So in the East China Sea in November 2013, four days after they announced an Air Defense Identification Zone they could not enforce, we flew planes through it.

Well, I think we're going to put ships right up to these artificial lines. I think that's the right thing to do at the right time, but then we need diplomatic moves afterward to engage the region and let them know, hey, we're not destabilizing the region, we're powerful, but we're not here to bring just guns to this party, we're here to bring the Trans-Pacific Partnership and trade and development, and it's not just China that's bringing these things through the Asian Investment Bank.

You know, we're here to bring them as well, but Bonnie, I'm sure, and Mira have a lot more to say about this.

COMMISSIONER FIEDLER: My time has expired. I don't want to take anybody else's time. I'll have another round.

HEARING CO-CHAIR SLANE: Commissioner Wessel.

COMMISSIONER WESSEL: Thank you all for being here.

I was constantly writing various phrases of each of the witnesses including "win the long peace," a comment, Mr. Cronin, you just said, and I don't mean this about your approach but rather the overall U.S. approach, which appears to be somewhat naive and hopeful rather than recognizing, I think, as you said, Dr. Glaser, that as each of you has said, that China has very definitive plans for the region. It doesn't plan on backing away. It's patient. It has a longer time horizon.

I don't think there was any question that the overheads that you provided that couldn't have been foreseen last year that, you know, this was going to happen. Just we finally got the imagery to show catch-up with what we knew they were going to do.

Why do you think that the actions we have taken or are prepared to take will have any measurable impact on China's long-term plans and potentially success? And for each of the witnesses, please.

Dr. Glaser, do you want to start?

MS. GLASER: Thank you very much and a very important question.

I believe that there is an opportunity to influence and shape China's choices. As Patrick Cronin said, the Chinese do not want a confrontation with the United States. In the absence of a favorable international environment, China cannot really continue to develop and to achieve this goal of reemerging as a great power, and this is a long-term strategy.

So China will test the United States and other nations, such as Japan, but if it assesses that the costs are too high, then I think it will recalibrate. We saw, for example, when China deployed the oil rig in Vietnam's EEZ last year and the Chinese instigated a response in Vietnam that I believe really alarmed them, and so they were, I think, ultimately forced to pull back and to try and reconcile with Vietnam.

The Chinese last, also in 2014, Xi Jinping put forward a new idea for a strategic

architecture, security architecture, in the region that would essentially exclude the United States. That's not supported by the region. So if we have an effective and cogent diplomatic military security strategy, and it must be with the region, it certainly cannot be unilateral, then I think we can shape China's choices.

We can certainly deter any very confrontational behavior, but it's this gray zone that's really very, very challenging because they are using these white-hulled ships, and until very recently we've refrained from using naval ships in any real capacity directly against these provocations.

COMMISSIONER WESSEL: So how would you grade our response right now in terms of China? And understanding what you said about Vietnam's oil rig and other activities, it seems that, one of you said, I think, "two steps forward, one step back," but, you know, two steps forward, one step back means you're a step ahead each time you do something. And you mentioned RIMPAC and six, as I recall, six steps all together.

Is what we're doing enough right now? Are those six steps enough as additive measures and has the pivot been evident enough and real enough to have a measurable impact?

MS. GLASER: So I would just say briefly that I do think that the United States has underestimated Xi Jinping's willingness to have tensions with all of its neighbors at the same time and to stand up to the United States so I think we're playing a little bit of catch-up, but I do think the administration has a strategy. In my longer submitted testimony, I did write in detail what that is.

I just think we need to do more, and we have to continuously be sending a clear and consistent signal to China. Then we have to observe how China reacts, and we have to be constantly trying to create that right mix. We must have some reassurance to China as well. That's the other side of the coin of deterrence. But we must work harder to be more effective so that we can truly convince the Chinese to change their calculus and change their behavior.

Thank you.

MS. RAPP-HOOPER: I'll just add to that the fact that, as my colleague Bonnie Glaser already mentioned, we do understand China's strategy to be one of salami slicing, and this is specifically designed not to trip U.S. reactions, U.S. security commitments, or provoke a conflict.

So to effectively and sufficiently dissuade and deter this type of behavior, the United States needs to formulate and execute a response that is specific and reciprocal, meaning identifying the actions it's willing to take if China takes a specific action itself and then implementing that strategy accordingly.

Obviously, the United States has identified many of its core interests in the South China Sea already, but whether it's undertaking a freedom of navigation exercise, as has been rumored just in the past 24 hours, or some other form of more assertive communication of our interests in the South China Sea, it will require Washington to have something of a risk tolerance when it comes to both its position in the South China Sea and its relationship with Beijing.

DR. CRONIN: Commissioner, we're being outmaneuvered. We need three elements to our approach. The first one is the one you suggest, which is strength, and I didn't mean to undersell the need for strength. It's actually imbedded in my own sort of lengthy testimony.

That strength includes not only the strength for fighting wars, though, but also for presence and reassurance, and we need to be there from the Marianas to doubling down on where we're going to be in the Philippines, to continuing to be in East Asia and Australia and elsewhere. We need sufficient number of ships and aircraft, but we also need to think long-term how do we preserve our power projection, and issues like the third offset strategy that Robert

Work, the Deputy Secretary, has talked about speaks to some of the ways we need to increase our long-term advantage on power projection.

Second, we need to cooperate at the same time. Southeast Asia, in particular, does not want the United States to exclude their largest trading partner. So trying to avoid making choices is one reason why we need a third element. We need some guile, I mean for lack of a better word. We need to be able to speak out of both sides of our mouth at the same time and have a complex agenda. That is the heart of my strategy. We do it with domestic politics all the time.

How well do we do it on international affairs? This is advice to me from a central Malaysian. All right. Malaysians are the most risk averse of the maritime claimant states, except for Brunei, compared to the Philippines and Vietnam, and they said, look, you Americans need to learn to speak out of both of your sides of your mouth at the same time. That's what we're doing when we don't criticize the Chinese, but we are worried about the Chinese.

So we need some sophistication here. That's all I'm arguing. I'm not saying for being soft, but making sure that we've got a long-term strategy that this is imbedded in, and bear in mind China's sophisticated strategy, which is about outmaneuvering us. It's about being in the right position for leverage. It's not about confrontation either.

Thank you.

COMMISSIONER WESSEL: Thank you.

HEARING CO-CHAIR SLANE: Vice Chairman Shea.

VICE CHAIRMAN SHEA: Thank you very much for your testimony.

Ms. Glaser, I think the six points you've outlined are really good additional steps, and I hope the administration reads your testimony and implements them post haste. And I like what you had, the other two witnesses, had to say.

Let me, help us sort of frame this issue, why should the American people care? I think this issue of the Spratly Islands, the Paracels, South China Sea, it's sort of seeping into the press, but I think the average American, it's sort of a bit of a mystery, but, let me ask you this question. What would the world look like if China achieved its goals in the South China Sea, if China fully achieved those goals, which I assume are exercising control over this region, continuing its land reclamation projects, militarizing many of these newly created features, and maybe ultimately declaring ADIZ in the South China Sea?

So what would the world look like? How would that affect American interests? Why should the American people care?

DR. CRONIN: Well, the long-term trends over the next 35 years have been spelled out by a number of studies, including one by Mathew Burrows, formerly of the National Intelligence Council, in his book, A World Declassified. And we don't know what the future looks like, but we can still forecast these trends, and right now China is heading toward not only being the largest economy but having really the largest regional military power.

Based on their domestic constructs right now and the preservation of the Communist Party of China, that doesn't look pretty for how you treat your neighbors. When you want to censor your Chinese and incarcerate them for human rights and for freedom of information, you're going to treat your neighbors even less well than that. So there are huge concerns about what rules China will follow.

So the rules of behavior, the rules setting, the rule enforcement are in question here. Many Chinese want a much better future. Many want to be part of this global community. We don't know whether this will work or not. There's a book called China Mirage saying it won't

work and we've failed over time. Nobody really knows though. China experts disagree on this issue.

So we have to hedge our own bets. We should not forfeit the ability and the leadership that we've exercised, especially since the end of World War II--a system that we've helped build up that is rules-based, that is inclusive, that has helped China, that's helped human development, we should be part of that. And so if we're going to be concerned about rules, as well as our allies and partners and the relationships we've built up for this system, as well as freedom of navigation for trade and commerce and ideas, as well as the global commons that include cyberspace and outerspace, if there are going to be rules that we can all live by, we need to have a bigger say.

If we let China say, based on what they're doing with the land reclamation in the South China Sea, our voice will be minimal, and that will not be a better world.

VICE CHAIRMAN SHEA: Well, I agree with you, but I'm trying--I agree with you entirely, but the question is let's talk to the American people to sort of get into their heads and try to be persuasive here.

MS. GLASER: A vital interest, certainly, that the United States has in the region is really peace and stability for transit of goods, particularly, of course, energy, merchant shipping. I think it's over 50 percent of trade that goes through these waters. Our ally, Japan, relies on virtually all, of course, of its oil going through those waters as well. Australia, it is very dependent on trade.

So maintaining peace and stability is very critical, and if there is any kind of conflict in that, in that region, then that will, I think, certainly bode poorly for everybody's interests in the region.

There's also, I think, secondly, this issue of credibility of the United States as an ally and as a guarantor of peace and stability, and I recall in 1996 when China, of course, at that time was using force, firing missiles directed at Taiwan, the United States sent two aircraft carriers toward the region, and that was, in part, to let the region know that we were going to continue to stand up for peace and stability. We want nations to be assured of that.

Our extended deterrence credibility relies on that, particularly with Japan. So the United States, I think, must continue to reassure the nations in the region that we will be present and that we will try to enforce rules of the road and international law. Most of them are unable to do it themselves. I think they will all be forced potentially, if we are seen as too weak or unwilling, then they will all accommodate to China, who will then set potentially very different rules in the region and even globally because this is really a litmus test of how China will deal with its differences in the future.

Thank you.

VICE CHAIRMAN SHEA: Okay. Thank you.

HEARING CO-CHAIR SLANE: Commissioner Bartholomew.

HEARING CO-CHAIR BARTHOLOMEW: Thank you. And I really appreciate all of you coming. We get the benefit of all of your expertise, which is helpful.

I have three sets of questions, which I think I'm going to put all of them out there, and you can sort of pick which one, and if we have a second round, we can go back to them.

Ms. Glaser, in particular, I'd like you to dig into a little bit your suggestion about Taiwan clarifying its 11-dashed line. What would that look like? What should that look like? And how can Taiwan do that given the discussions that are going on between Taiwan and the mainland about the future of Taiwan? I mean are they free to be able to do that? So I think there are costs to doing it, but I'm quite curious about that.

While we asked all of you to talk about sort of the security issues vis-a-vis ASEAN, I wondered given all of your expertise if you would talk a little bit about what does the militarization of these outposts mean for U.S. security, too? I mean for--what does it mean? What does it mean for us operating in the region if the Chinese have moved to militarize geographically in a way that they haven't before? What kind of risks and costs does it have for us?

And, then, Dr. Cronin, I'm really interested in this, what you were talking about, about the perception that the U.S. can't be seen as destabilizing the region. To me, that's an argument that maybe three years ago we would have to had to worry about, but with China building military facilities out in the South China Sea, why would anybody but the Chinese perceive that a U.S. response or action would be seen as destabilizing when to me it's pretty clear that the destabilization is coming from China's action?

So there I guess I would add to that, that the issue that, again, even a few years ago, people's uncertainty, the countries' in the region uncertainty, they were hedging in their uncertainty about what was the U.S. commitment to being in the region and staying in the region, has that dynamic shifted a little bit? Are people more confident in a U.S. presence and what does that mean?

So, Bonnie, let's start with you on Taiwan.

MS. GLASER: Thank you, Commissioner Bartholomew.

I think this is really quite important because the only claimant that can really put this kind of pressure on China in terms of forcing it to clarify its own claim really is Taiwan. So you take the 11-dashed line, I believe that Taiwan has looked into its archives and that they understand the origins of this line and are reluctant to really say so publicly.

But having said that, Taiwan has said more in recent days. In fact, issued a statement, I believe it was April 29, in which it did mention the U.N. Convention on the Law of the Sea and its own claim being in accordance with that. So everyone of the claimants, including Taiwan, really, of course, needs to clarify its claims and its baselines and bring them in accordance with the Law of the Sea, but Taiwan really, I believe, needs to clarify this original 11-dashed line.

Now some people might say that this might create great tensions with the mainland. I believe that there is a window of opportunity in between now and the elections in January where Beijing is very concerned about the DPP coming back to power, very willing to work with the KMT to do whatever it can to keep it in power. So I don't think this is a moment where we're going to see China try to impose penalties on Taiwan for doing something that is obviously opposed by China.

If this step is taken by a DPP government in the future, then, frankly, I think it could be very worrisome because the reaction of Beijing might be much stronger. So I think that we should continue to encourage Taiwan, and I know the administration has done so, to clarify what the original reason was that this line was created, what its claim is, and to therefore use that to put pressure on Beijing to do the same.

HEARING CO-CHAIR BARTHOLOMEW: So we're going to have to go back to my other questions in a second round, but, Bonnie, for people who might be listening to this who don't know or understand what that clarification means, can you articulate? I mean it sounds like you are saying that the clarification would indicate that China does not have the historical claim to this territory in the South China Sea. Can you articulate that one way or another?

MS. GLASER: I would ultimately say that in the absence of the willingness of all the claimants to go to the International Court of Justice, we will never know which claimant has the

strongest claim, and I believe that ultimately that should be a course of action that is taken. But this original line that Taiwan created was when Japan was withdrawing after the end of World War II and Taiwan wanted to patrol this area of the South China Sea.

One possibility that I have heard from officials is that it was, indeed, just a line of patrol rather than a claim to all of the water within the line, and so if Taiwan were to say we claim the following land features, which would probably be all of them within the dashed line, with appropriate adjacent waters, whether that's 12 territorial miles for a rock or 200 nautical miles for an island, as defined under UNCLOS, it would not include all of the waters. It would not provide jurisdiction over all of the energy exploitation or all of the fishing, for example.

So it would begin to define and restrict where the capabilities are that could then be applied by China to these waters, and there are areas within this nine-dashed line that would then be seen as international waters rather than associated with land features that would belong to either one of the claimants or the other.

But a resolution of the dispute itself, who owns what, ultimately, I think that decision should be made by the courts.

HEARING CO-CHAIR BARTHOLOMEW: Okay.

Mr. Chairman, I'm going to defer my next round, my other questions, to a second around. So thank you.

HEARING CO-CHAIR SLANE: My question to the panel is do you anticipate additional claims coming from China on other territories in the area?

DR. CRONIN: Well, additional to the Nine-Dash Line, they're going to put pressure on the Philippines next almost surely, probably after the summit, the U.S.-China summit, sometime by next spring, I would guess. We saw this earlier when they tried to stop the resupply of the Sierra Madre, the wrecked shippage that the Philippines was resupplying and trying to sustain.

There are places, as they move, these reclamations, their position moves toward the south of the South China Sea, and so they're going to keep putting pressure in this area because they want to move two steps forward and one back. They want to, yes, keep moving forward inexorably to control this area, and if I can just go back to the previous question of doesn't the region understand that, they do, and they do want a response, but then think of this as a campaign, the response to the response to the response to the response, and that's what I'm talking about, making sure that our strength is not then used against us because the Chinese are already trying to preempt us from even being strong, but then they'll do this.

So China will be continuing to exercise what they think are their historical rights. Going back to the Taiwan question, this is why it's so important to try to enlist someone like Ma Ying-jeou, while he's still in power for another few months and an expert on these issues, to stake it, realize that the cross-Strait relations are frozen anyhow. They're not going to have any more economic deals. He's done what he can. And he needs to say, look, we didn't mean to claim sovereignty over all these waters, and he can do that.

If he doesn't do it, then China right now again has a green light to just keep spreading and that's what it's going to keep doing. Until it runs into an immovable object, it will keep moving. Why? Because they have capability, it's in their interest, they have a general sense of historical rights that, by the way, latest archeology shows, wasn't necessarily Chinese. We need to build on that history.

MS. GLASER: If I could just add one sentence, and that is that I do not view China as an expansionist power. China has had a very consistent claim, set of claims, sovereignty disputes with neighbors. They are with Japan. They are with these claimants in the South China Sea.

Obviously, still with some of its land neighbors, such as India. But I do not think that we are going to see an expansionist definition of Chinese sovereignty.

HEARING CO-CHAIR SLANE: Chairman Reinsch.

CHAIRMAN REINSCH: Thank you.

I've got two short questions for Dr. Hooper and then a longer one for everybody. First, Dr. Hooper, on the reclamation issue, are these geologically stable structures that they're developing? What happens with the next tropical storm?

MS. RAPP-HOOPER: That's a good question and one that's very difficult to answer since obviously no one to whom we have access has actually been on these artificial islands themselves. They are built on former reefs for the most part, reefs or rocks. There's no question that they've done significant damage to the ecological environment beneath already. Whether or not the islands themselves are sound in perpetuity, I can't say, but it is definitely the case that they would be vulnerable in the case of a major typhoon.

Certainly, any major surface combatants that were ported at these artificial islands would be vulnerable in the case of a major typhoon so that's certainly something the Chinese will have considered.

CHAIRMAN REINSCH: I'm glad you mentioned ecological damage. I think that was something that's important to be brought out.

Second, you said at one point that one of the things we should do--I think it was you--said that one of the things that we should do is take them up on their invitation to use these facilities for search and rescue missions or whatever.

I can see why there might be an intel interest in doing that because we'd probably learn, but wouldn't doing that also at least implicitly recognize the legitimacy of their claims?

MS. RAPP-HOOPER: Potentially it could. I think that's an important point. The reason I suggest this, however, was, as you said, there would be certainly an intelligence benefit to doing so, and if some sort of multilateral exercise was possible from these islands, we could try to hold China to their word that these were for civilian purposes, predominantly or only. But, again, an important point that you bring up.

CHAIRMAN REINSCH: Yeah. So for all of you or any of you that wants to respond, let me go back to the immovable object point that Dr. Cronin made. Supposing--I mean I agree with the salami slicing tactic; I think that's well established--supposing the point is reached where the United States plays the role of immovable object, and a confrontation ensues. We don't back down. They don't back down.

How does that play out? I mean how does that play out militarily? What would happen? Are we equipped to sustain an effort in this region? Fantasize for a moment. Any of you.

DR. CRONIN: We need to do more to strengthen our long-term position in the region. I'm a big supporter of whatever we call the pivot, the rebalance, of long-term engagement with the Indo-Asia Pacific. This is the locus of economic, technological, military power in the 21st century. We're either there or we're lost.

CHAIRMAN REINSCH: So your view is that we're not sufficiently prepared for that kind of confrontation right now?

DR. CRONIN: We are prepared for a short-term confrontation, but what basing do we have in the South China Sea? We have a couple of littoral combat ships going up to four in Singapore with the Singapore government very friendly, not wanting us to use them for confrontational purposes.

We still are waiting for the Supreme Court of the Philippines to determine whether we

can have long-term rotational forces in places like Palawan and elsewhere. But we don't have any presence in Vietnam, another big claimant, or Malaysia or Indonesia. We need to start building up the security ties with those countries in a way that is still compatible with regional growth and development, including their interests with trade with China, so that we're in a stronger position.

We need to double down on the Marianas. We haven't yet finished our presence there, not just our military presence, but to engage the region outside of the South China Sea where it's contested into an area that's less contested. We need to keep in Northeast Asia and we need to build up in Australia, and we need to make sure we're oriented toward the West Coast. Those are parts of the rebalance that are the military aspects, and we haven't followed through with the financing or the resourcing.

CHAIRMAN REINSCH: One would think that those things would come first before confrontation. But do the other two of you want to comment? Do you agree with Dr. Cronin?

MS. RAPP-HOOPER: I do agree with Dr. Cronin. I think our presence in the South China Sea is certainly not remotely comparable to our presence in Northeast Asia, and certainly that comes, that is the case when it comes to the potential for a conflict.

MS. GLASER: I think you have a very like-minded panel. I also--

CHAIRMAN REINSCH: That's all right.

MS. GLASER: I also agree with Dr. Cronin. We do need to put more resources into the Pacific. If we're going to have partner exercises and build this maritime domain awareness capacity, we're just going to have to be able to resource it.

CHAIRMAN REINSCH: Okay. I'm interested in the remaining 12 seconds in the concept of guile, which I know Dr. Cronin mentioned. I once was in a meeting with a senator, who's no longer in the Senate, who made the point in passing or asked about the particular political troubles his party was having at the moment, and he said, you know, the real problem is the other party lies better than we do, and I won't indicate which party was which.

[Laughter.]

CHAIRMAN REINSCH: I suppose you could say it about either party. Are you really saying that we don't lie well enough? Is that your point?

DR. CRONIN: I'm saying I just came back from an international conference. We all attend international conferences. I mean too many international conferences. And I can't tell you, I mean I was there beside four PLA officers, and they were all lying, yes, sir, they were all lying. There were truths amidst the lies. There was fiction amidst the non-fiction, but I was actually sticking to facts and objectivity, and then I realized maybe we just need to make a bigger point here that is not we know the history. They use historical rights, for instance, like its historical claim of sovereignty is really indisputable.

Well, that's not the case so they can't just be allowed to say that without being responded to. We need to be, at least carry nuance, two thoughts at the same time, because we have different audiences in this region. That's what I'm saying. So we need to be strong and make sure that nobody--we shouldn't have to talk about our strength. It's a shame that we have to talk about our strength. I mean we should be speaking softly and carrying a big stick and then very engaged in this region, and the two immovable objects, when the Chinese don't back off, they will back off.

Why will they back off? Because they don't want a confrontation. They're using risk because nobody is stopping them right now. But then we need a move after that that says, by the way, we're not actually trying to grow confrontation. We're actually trying to grow cooperation

around rules that we can all live by, and, in fact, the reason my strategy, I think, works, as I stated in my testimony, is that I believe that it's based on the self-interest of China.

It is in China's enlightened self-interest that we don't always see exercised to actually create rules that we can all live by and grow by. If we let them have their own rules, they'll take them. Why not?

CHAIRMAN REINSCH: Thank you.

HEARING CO-CHAIR SLANE: Commissioner Tobin.

COMMISSIONER TOBIN: Thank you all.

And Commissioner Bartholomew, you asked the question I was going to dig further in in terms of Taiwan. So my question for Dr. Hooper relates to the arbitration that's going on vis-a-vis the Philippines. And if you could give us and those watching a sense of the time frame and the extent to which other such tribunals have ever made a comparable decision. So if you could shed some light on the tribunal process and how hopeful or likely it will be a fair, legal process.

And then I have a question, too, about the guile. So I'll start with that.

Dr. Hooper.

MS. RAPP-HOOPER: I should start out by noting that I'm not an international lawyer, but I will answer this question to the best of my ability.

The tribunal process has been ongoing since 2013. The case is very much underway. China is not participating in the case itself, but under the U.N. Convention on the Law of the Sea, the trial can go forward without China as an active participant.

The Philippines has filed a vast memorial statement of its case and also filed with the court several supplementary documents. China has itself filed or rather publicized a brief, which was intended to explicate its non-participation in the case, and it released that brief in December of this past year.

The tribunal is currently considering whether it has jurisdiction over this, the claims that the Philippines have made in its case, and it is expected to rule on the jurisdictional issue at some point in the next several months. It is expected to give a final ruling in the arbitration early in 2016.

So there is no question that the tribunal at the Hague, the International Tribunal on the Law of the Sea, is undertaking every effort to ensure that the Philippines has its day in court. This is a thoroughly unprecedented case in its importance on the international stage, and in the documents that we understand the Philippines to have submitted, I think that many of us remain very hopeful that this will produce some positive outcome in terms of clarifying international law.

COMMISSIONER TOBIN: Do you have any knowledge on the court itself? What kind of, you know, are they considering whether they have jurisdiction? What kind of legal expertise do members have?

MS. RAPP-HOOPER: Oh, they have superb legal expertise.

COMMISSIONER TOBIN: Okay. Good.

MS. RAPP-HOOPER: The basic elements of the Philippines case are, number one, the fact that they argue that China's Nine-Dash Line is illegal; number two, that they argue that several of the features that China occupies in the Spratly Islands are reefs or rocks as opposed to full-fledged islands; and then, lastly, that they have been prevented from operating normally in their own Exclusive Economic Zone.

The court is very well equipped to evaluate all of those issues and has been doing so methodically and with just copious documentation over the course of the last year plus.

COMMISSIONER TOBIN: So it would be great if we could combine the Taiwan and this court proceeding.

Dr. Cronin, if you were advising and with this guile concept in mind, if you were advising the head of PACOM, what kind of exercises, what kind of drills, what would you recommend, and beyond drills and exercises, what other advice would you give?

DR. CRONIN: Commissioner, thank you.

If I may, just one line on the tribunal.

COMMISSIONER TOBIN: Yes.

DR. CRONIN: The reclamation projects are in many ways China's physical attempt to outmaneuver the coming sort of decision and judgment of this panel, which is very interesting. That's one way they use guile, that rather than directly say, look, we're going to participate in international law and try to go along with it, no, they'll just create the facts in a different way, and then when there's a judgment, no matter which way the judgment goes, well, possession is nine-tenths of the law, they're there, they built it up, very clever. Who wins that fight?

COMMISSIONER TOBIN: Right.

DR. CRONIN: So we need to make sure. In my testimony, I talk about the three warfares of China--using information; using law fare; and using psychological effect--something that's very classically Chinese. I'm not saying they do this all brilliantly, and it's all well executed, but because they do it, and we basically fail to do it anymore, we did it during the Cold War, but we're not in a new Cold War. We're in a different kind of competition, a long-term competition for the peace, as I've suggested.

But we need to use information. I just came from PACOM. I was just there briefing the J-5, the Deputy J-5. They need not just the Tiger Team they've put together, and with Admiral Harris, very capable commander coming in, hopefully on the 27th of May, and Admiral Swift, as well, at PACFLT, very able professional military officers. They understand these concepts very well.

And they understand the Southeast Asia and the East Asian context they're working within. So they need to be able to use information more freely, and that includes drawing on imagery and declassifying this imagery, which is why I don't want to accept the Chinese illicitly-built artificial island as a basis for international cooperation. No, I will not do that. I would not recommend doing that.

I would say, China, we're inviting you into the East Asia Summit oriented all-inclusive common operating picture for humanitarian assistance but also so we can see what's happening. What is that you're building on this island? Let's take a look at it here.

And I want to put them on our terms, not their terms. I don't want to give them the legitimacy of saying that this is theirs. It's not. This is disputed territory that we're talking about, disputed waters that they're building territory on.

So I want to see freedom of navigation operation in the short-term that essentially does what we did with the ADIZ in the East China Sea. It reveals that the Chinese can claim it, but they don't really own it. They don't possess it in any sense, legally, physically, in any sense. And we can do that. We do indeed have this capability to do this.

But we have to think about the next stages well beyond these individual operations. We've been reluctant to do many FONOPS, freedom of navigation exercises, in this region. The Chinese in the next administration in 2017, one of the next crises beyond the Taiwan crisis that I think Bonnie Glaser rightly pointed could be coming in 2016, beside the Philippine crisis that could be coming in 2016 as well, we're going to also see potentially a crisis again to challenge

America's surveillance within the 200 nautical mile Exclusive Economic Zone.

This reclamation, not just around sort of defending the submarine bases, but also gives China much bigger air and sea capacity to push back on future surveillance, which we think is lawful because it's about transparency for the global commons. It's not intruding in the territorial waters and airspace of China.

COMMISSIONER TOBIN: Right.

DR. CRONIN: And we let the Soviet Union do this within our airspace, even in a shorter EEZ defined airspace back in the Cold War. So it's about keeping transparency for the global good. That's how we should see it. We know the Chinese won't accept that just if we ask them to. So we're going to have to enforce that because we're going to mobilize others around it.

That takes not just guile. It takes, it takes a determination to defend your interests, to define your interests. The Chinese do this all the time. And why shouldn't we stand up and define our interest, defend our interests, explain our interests, mobilize people around our interests, and recognize that, by the way, we want to do this for their good, too, to cooperate, and that's what I mean.

COMMISSIONER TOBIN: It takes will and intention, too, doesn't it? Thank you.

HEARING CO-CHAIR SLANE: Senator Goodwin.

COMMISSIONER GOODWIN: Thank you, Mr. Chair.

I'd like the panel's thoughts on the effect that the failure of the United States to ratify the Law of the Sea Treaty has on our ability to engage on these issues in the region and, perhaps more pointedly, would China feel more pressure, both from us and from the international community, to participate in this Philippines arbitration if we had ratified that treaty?

MS. GLASER: I think that the Chinese benefit from portraying the United States as hypocritical, insisting that China abide by UNCLOS when we ourselves have not ratified it, even though, of course, the United States correctly says that we act in accordance with UNCLOS, but the Chinese can use this again to their advantage.

Having said that, if we were to ratify, I don't think that that would have made the Chinese agree to this arbitration case. I actually think that the Chinese believe that they will not pay much of a cost even if the arbitral tribunal rules against them, and under Xi Jinping, there is a greater willingness to incur particularly reputational costs than there has been in the past, and a rising China with so many countries dependent on China economically, the Chinese are more confident that they can ride this out.

So I think, as I said earlier, we really do need a multi-faceted strategy. I think that ratifying UNCLOS is a very important part of that strategy, but, in and of itself, I don't think that it would be decisive.

MS. RAPP-HOOPER: I'll just add on to my colleague's comments with which I agree. I agree that the failure to ratify UNCLOS is regrettable. The main difference between the U.S. and China when it comes to the U.N. Convention on the Law of the Sea that we have seen emerge time and again over the last several years is the difference in interpretation of the activities that are permissible in the Exclusive Economic Zone, whether or not military exercises and the like are permissible in another country's Exclusive Economic Zone, and that difference of interpretation would remain even if the United States had ratified UNCLOS.

DR. CRONIN: I actually agree so we're three of a kind here. But one thing that I would add is that, and it reflects Bonnie Glaser's call for imbedding this in a larger strategy, is we can make much better use of international law and of understanding the law. We have a lot of lawyers, and we need to have more maritime lawyers and we need to make use of people like

Peter Dutton up at the Naval War College much more effectively.

So not only does the State Department need to weigh in on the illegality and our own legal views about what China is up to so we can make statements and use the law to our advantage and use the law to our benefit. But UNCLOS for all of my conservative friends who still oppose it, I just say, look, we already follow it as a matter of practice, both administrations, both parties. We're only losing points in this region.

It makes still for a stronger legitimizing presence to engage the rest of the region. Don't just think about China. We're not necessarily here to think that we can shape China's views overnight, but we can definitely build our credibility within Southeast Asia and the region.

COMMISSIONER GOODWIN: How about some engaging in some blatant speculation as to how this tribunal might rule and the response that the parties would have? If they would rule in the Philippines favor, what does China do in response? And conversely, if they would decline to exercise jurisdiction and even hear the case, what options are left for the Philippines? Simply the bilateral negotiations that China has been insisting upon. And if that's the case, what role can the U.S. play?

MS. GLASER: Well, let me just comment on the first part of your question, which is my sense from talking with experts and officials in China, is that they are prepared to ignore any ruling that is issued by the tribunal. They do not think that they are going to pay a very high cost for doing so.

I think the implications for the United States and really worldwide are really profound because if China is essentially permitted to act against this tribunal award if it is indeed in the Philippines favor, finds the Nine-Dash Line illegal, then that will create opportunities for other countries like Russia to also violate UNCLOS. It will really undermine the treaty itself, which I think will just really have very, very negative consequences.

I do think that the Philippines would ultimately feel that it does have to perhaps reconsider some kind of bilateral negotiations with China, and with an election coming up in the Philippines, we may have a leader coming in that is a little bit more inclined to take some economic benefits from China and put aside some of these issues as well.

And as you know, when you have new administrations come in, sometimes they start pursuing different strategies so there's a lot of moving parts.

COMMISSIONER GOODWIN: Thank you.

MS. RAPP-HOOPER: I will note that I am hopeful that the court will find that it has jurisdiction in this case and will rule at least in part in the Philippines favor. My wild speculation will be that the Philippines will not get every little thing that it has asked for, but as my colleague has mentioned, China has already stated that it will not comply with the ruling.

So when the court does release its decision, this will be a particularly important time for the United States to mobilize international opinion behind both the Philippines and behind the rule of law and instruments of international law.

And as Patrick mentioned, U.S. lawyers are very well equipped to do that effort such as the recent State Department Limits in the Sea paper which examined China's Nine-Dash Line as just one example of what U.S. government lawyers can do if they decide to rally behind the cause of international law.

DR. CRONIN: Best case is that there is some ruling over the legitimacy of the Nine-Dash Line claim, and that it has to be based on UNCLOS, and therefore land features can't be the waters just entirely enclosed in that Nine-Dash Line map.

As a result of that, China would not, as I think Bonnie suggested, essentially roll over and

sort of abide by that, but they might be in the right political context willing to essentially live by it. They might be willing to say, at least, that they're living by it and allow some ambiguity, and that may be the best case right now just based on that legal ruling.

But we should be building up the case law and building up the mobilization of the region to support other laws that will restrict China's future arbitrary use of power, including reclamation.

COMMISSIONER GOODWIN: Thank you.

HEARING CO-CHAIR SLANE: Senator Talent.

COMMISSIONER TALENT: Thank you, Mr. Chairman.

This has been a great panel. I think one of the best we've had. And Ms. Glaser, you get the gold star because I've been waiting for somebody in one of these panels to say the word "balance of power," and you did in response to Mr. Fiedler's question.

The thing that changed, that is changing, the fundamental it seems to me that affects everything else, is that the balance of power in the Western Pacific is shifting. We're actually--I know you're frustrated with our diplomacy and our lack of guile. We're doing that a lot better than we used to. I mean we didn't do it at all five or six years ago, and they weren't doing these things, and the thing that's changed is the balance of power.

I do have a question here, but I'm setting this up.

[Laughter.]

COMMISSIONER TALENT: I think the rebalance policy is a great policy. I think it's failing for want of power, and I think the Chinese can see it just as we can see it. When we have a president who says correctly we're going to shift 60 percent of the Navy to the Western Pacific, and the Pentagon says, okay, we can do that maybe by 2020, and by the way, by the time we do it, it will be no more ships than we have now because the Navy is shrinking.

So here's my question. Given that we're living in this sequester world where we cut a trillion dollars out of the budgets, and they see that, my concern is this: if we do everything that you're saying we should do, we act effectively, we compete effectively with them in the other areas, you know, the propaganda, the diplomacy, TPP and all that stuff, and the balance of power continues to shift, then what I'm afraid we'll be doing is provoking them rather than deterring them, presenting ourselves as the obstacle to their ambitions in the region, but at the same time as we are divesting ourselves of the power necessary to deter them.

Now that happened one other time in modern history, in the late 1930s. I'm not saying that they're like the Japanese. Nobody expected the Japanese to do what they did either. And this is a real concern I have. And so I'd like you to address that, and also to address if we're going to allow the balance of power to continue to shift, I'm talking about hard power in the region in their direction, would it make some sense for us to negotiate the best deal we can get with them and then otherwise get out of their way?

MS. GLASER: That's a very provocative question, Commissioner, and important to consider.

COMMISSIONER TALENT: I'm provoking you but not deterring you.

[Laughter.]

MS. GLASER: Good. I think that where Chinese interests are expressed reasonably, China's rise does demand that in some ways the Chinese be accommodated. The United States cannot stand, I think, and other countries against everything that China wants, and we have seen this with the Asian Investment Infrastructure Bank, where China has capabilities to bring to the table, and many countries, of course, have joined because they want to use this opportunity to

benefit from China's economic largesse but also encourage China to adopt the international norms and laws.

I do not think that the way to deal with this is to sit down and negotiate some sphere of its--respective spheres of influence, for example, or to negotiate with China how we are going to allow them to protect their interests and what belongs to us, what belongs to them.

I think this would actually be quite opposed by the region. The balance of a hard power I think very much remains to the advantage of the United States still. I don't think that the Chinese believe that they have caught up with U.S. capabilities in hard power. But importantly we need to look at that balance of power very comprehensively. It's economic; it's political.

If the Chinese act in ways where they essentially alienate all of their neighbors, they are going to result in a coalition that will be against them and all of these countries are already reaching out to the United States to work very closely with them to help balance China. They want to hedge, too. They want to have good relations with China, and they want the United States to get along with China.

I don't think sitting down and having a negotiation with China is the way to go. The first thing to do is to ensure we have a common set of rules and norms, as Patrick has talked about. We have to bring China more into the prevailing international system, but we definitely have to find ways to work with China, accommodate some of its interests as it rises. Otherwise, yes, we will provoke a very negative backlash from China.

MS. RAPP-HOOPER: Senator, while you are certainly correct that the U.S. Navy is not necessarily growing while China's continues to do so by leaps and bounds, I would just point out one thing that is true when it comes to U.S. power in the region now that was certainly not true in the 1930s, and that is the existence of its many standing alliances, and the fact that these play a role as force multipliers in the region.

Balance of power calculations must absolutely include not only the United States' current alliances and partnerships but potential alliances and partnerships that may be in place by 2020. So obviously, the U.S.-Japan alliance has been extant for many years, but we've seen marked changes in that alliance just in the last few years that may allow Japan to play a much different and very important role in the region, including in the South China Sea.

As discussed, the U.S.-Philippines alliance has been reinvigorated, and while the status of the enhanced Defense Cooperation Agreement remains suspended in the Philippines Supreme Court, that is another important agreement that could result in force multiplication in the South China Sea.

We should also continue to explore possibilities of basing additional U.S. forces in Australia and should continue to explore the possibility of partnerships with India. Obviously, Prime Minister Modi has expressed a great interest in looking and acting East and is himself very concerned about freedom of navigation in the South China Sea.

COMMISSIONER TALENT: All right. Let me just--because you talk about basing additional forces in Australia, the Navy is struggling to deploy 95 ships globally. Now we are not going to stop maintaining a presence in the Persian Gulf. We need ships in the eastern Mediterranean. The plan calls, last time I looked, to base 67 ships in the Western Pacific. That would leave 28 ships for the rest of the world. I mean it's math that does not add up.

You talk about allies. I certainly agree the Japanese-American allies, I think that's the best development in the region that I've seen. You can't just add though the ships of others because we don't have the kind of working cooperative relationship with them that we do with the Japanese. Australia, we do.

And I think you're underestimating the extent to which they are shifting the balance of hard power in that region and the implications for policy. I jumped in. Go ahead and comment and then I know Dr. Cronin wants to say something.

DR. CRONIN: Senator, I agree with your concerns. We need to build more ships, sir. It's not the only aspect of our power, but without it, we lack serious credibility that should be undergirding our diplomacy and our trade and expanded business ties throughout these regions.

And you're right. We do have global responsibilities so we can't just look at the Asia-Pacific. The reason though to base in a place like HMAS Stirling near Perth, potentially at least rotate ships through there, is because it gives us closer presence to both the South China Sea and yet access to the Indian Ocean where we also have so many strong interests in the Persian Gulf region.

So there are things we can do to leverage those things, but you're right, they don't compensate for numbers. Numbers matter when it comes to your inventory.

I agree with the previous witnesses here on this point. We are not trying to provoke them for unlimited ends. We're trying to provoke them on bad behavior, and that's a very important issue, which is to say we're actually trying to cooperate with China, but we're not going to cooperate with them without any concern for the rules. We're going to have to say, look, this really is harassment and reckless endangerment of another vessel or ship.

This really is provocative reclamation of disputed territory that is threatening your neighbors, and we can do something about that. That doesn't stop their ambitions. That doesn't stop the rise of the Chinese middle class. We support that. So we can distinguish between those two.

Finally, there's a myth of power transition. Nobody knows what the future holds, but the Chinese in any international conference I go to the first thing will say the long-term trend, understand, it's the great power transition, it's the reemergence of China, and it's the decline of the United States. Well, in 2008, it was more credible than it is in 2015. I don't know what it will be in 2025 or 2030. I don't know what the situation will be in China, and the Chinese don't know either, and they're hurrying up in the meantime while they can.

HEARING CO-CHAIR SLANE: Thank you.

We'll go for a second round.

COMMISSIONER FIEDLER: Just one quick comment on what you just said. The capital flight from China is coming to the United States as a principal difference from 2008.

One, I have a concern, and it's not just with how you said it, Dr. Cronin. We hear it all the time, that it's not in the Chinese self-interests. I think they're fully capable of determining their self-interests. I think they have determined their self-interests. And that it is action by someone else that changes the equation that determines their self-interests. Okay.

And, Dr. Glaser, I mean Ms. Glaser, you talked about prevailing international system. The trend is that they don't want to be in the prevailing international system. The international order as it existed prior to their rise, they don't believe accommodates their rise.

I mean, right? We're getting a lot of conflicting views about whether or not they accept the international system. They didn't have anything to say about the rules, and now they're saying I think I'll determine the rules. I got some power now. And that's in their self-interests, by the way.

MS. GLASER: So with all due respect, I would say that the Chinese recognize that they have been able to rise under the international system that has prevailed since World War II.

They recognize that it is fundamentally in their interests. The Chinese long called for

adjustments in that order, not upending, not supplanting it, but adjustments. You look at the United Nations, the Chinese have embraced the United Nations.

COMMISSIONER FIEDLER: Like sovereignty--

MS. GLASER: The last thing that they want is to really allow--

COMMISSIONER FIEDLER: --such as in the South China Sea?

MS. GLASER: They embrace sovereignty. This is not something that they are looking to change the definition of, but there are aspects where they are asserting their rights because, as I said earlier, they have the capabilities to. We see in the international financial system where they have capabilities, and they are trying to introduce by the new BRICS Bank and the AIIB their own contribution to potentially change some of the ways in which donor--

COMMISSIONER FIEDLER: Because the international system as it exists doesn't accommodate them.

MS. GLASER: I believe not the fundamental international system. I think there's a difference between adjusting and throwing out the baby with the bath water.

COMMISSIONER FIEDLER: So what is more important to us, stability in China, as defined by Xi Jinping, or actually as defined by ourselves, or freedom of navigation in the most important trade routes in the world? I mean isn't that the choice we're sort of heading towards? That if Xi--can Xi lose when he slices the salami, and I don't know about you guys, but I buy salami every now and then, and then sort of slice it and they hold it up and say is that good or do you want more or less; right?

Slicing salami seems to be getting in bigger chunks. Can he lose? Can he afford to lose without it affecting his own domestic power base?

MS. GLASER: Ultimately the most important thing for Xi Jinping is to keep the Communist Party--

COMMISSIONER FIEDLER: Party in power.

MS. GLASER: --in power. And there is enormous support from all of the various maritime actors and constituencies in China for a more aggressive foreign policy.

COMMISSIONER FIEDLER: So this makes this situation more dangerous than it even appears.

MS. GLASER: I would agree with that. But loss and victory, the terms, can change. China can redefine tomorrow what victory is or what losing is. I don't think that the Chinese have defined that so narrowly that they've already backed themselves into a corner and therefore if they give up every drop of water within the Nine-Dash Line, that the Communist Party will fall from power. They have been very ambiguous about it.

COMMISSIONER FIEDLER: But if our naval exercises in support of freedom of navigation get as aggressive as we're talking about this morning, it creates a loss situation for him too; does it not? We're talking some serious risk here.

DR. CRONIN: Commissioner, that's why we need to couple strength with diplomacy. I mean that's precisely why because we need to also give the face-saving way out. When I say that China will base this on their interest, yes, we need to help define interest in ways that we want to cooperate with. They did this in 2012. So when Scarborough Shoal, when they convinced our diplomats to move the Philippine ally out of the way of Scarborough Shoal, we let them win.

COMMISSIONER FIEDLER: I agree with you except that there's been a consolidation of power inside China by Xi Jinping in the last couple, I mean from 2012 to 2015, that is very significant and different than any previous, the two previous regimes, if you will.

That's why I think this, I ask the serious question about is in our calculation, is stability

more important, in our own internal calculations, more important in China? Do we actually support the survival of the Communist Party in a way that we're hesitating in our own actions vis-a-vis them in the South China Sea because we're worried about destabilizing Xi? I don't think that's crazy. Okay.

DR. CRONIN: I think if you're not looking at the legitimacy of, I mean the control of the Party and survival of the Party at a lower level, we're worried about instability in the economy, and that could happen very quickly and swiftly if Xi did not succeed at certain reforms and certain movement. So I think there's concern. I don't think we're at the level of thinking that the Communist Party is, as David Shambaugh has written, going to disappear within the next five years. It may, but we don't know that.

So the domestic affairs of China are very complex. Our ability to control them are very limited. We have more control over the international environment where we can maintain stability.

COMMISSIONER FIEDLER: Well, I think we're only disagreeing about how much the domestic politics of China drive what's going on in the South China Sea and therefore what we must take into consideration as we do that.

That's all I'm saying. I think it's a very dangerous situation. I don't think it's as easy as some people do.

DR. CRONIN: Commissioner, I mean I just want to emphasize, I agree with your basic point. That's why the stakes are very high indeed. That's why we need to take this area more seriously. We need to be more engaged. We need to be more nuanced and concerned about it. But we shouldn't necessarily shy away from all confrontation over rules even while we have to understand how will it react, what will it lead to inside Beijing?

COMMISSIONER FIEDLER: Thank you very much.

HEARING CO-CHAIR SLANE: Thank you, panel. Our time has come to an end. The testimony has been great. We really appreciate all of your time, and we will stand down for ten minutes and reconvene as 10:50.

[Whereupon, a short break was taken.]

PANEL II INTRODUCTION BY COMMISSIONER CAROLYN BARTHOLOMEW

HEARING CO-CHAIR BARTHOLOMEW: Okay. If we could ask our witnesses to take your seats, please. Clearly, we had a lot of interesting issues raised in the first panel, and we really look forward to hearing from our experts in the second panel who can cast some more light on some different aspects of this.

Our next panel will explore diplomatic and economic issues in China's relations with Southeast Asia. Our panelists will examine developments in China's diplomatic engagement with Southeast Asian countries and ASEAN and key economic trends in China's relations with Southeast Asia, focusing specifically on trade, finance and development.

First up is Robert Sutter, Professor of Practice of International Affairs at George Washington University's Elliott School of International Affairs. Dr. Sutter has had a long and distinguished government career, serving among other things as the Senior Specialist and Director of the Foreign Affairs and National Defense Division at the Congressional Research Service, the National Intelligence Officer for East Asia and the Pacific at the National Intelligence Council, the China Division Director at the Department of State's Bureau of Intelligence and Research, and a professional staff member of the Senate Foreign Relations Committee.

The third edition of Dr. Sutter's award-winning survey, *Chinese Foreign Relations: Power and Policy Since the Cold War*, was published in 2012, and his new book, *The U.S. and Asia*, will be published in August 2015.

Next we'll hear from Meredith Miller, Senior Vice President of Trade, Economic and Energy Affairs at the National Bureau of Asian Research, NBR. She's also Director of NBR's Washington, D.C. office. Ms. Miller has published extensively on the economics of Southeast Asia, including most recently about Burma's emerging role in the regional economy.

Prior to joining NBR, Ms. Miller served at the Department of State as the Deputy Director for the Office of Economic Policy in the Bureau of East Asia and Pacific Affairs--long to get on a business card--and as an analyst in the Bureau of Intelligence and Research. Ms. Miller has also worked at the U.S.-Vietnam Trade Council.

Finally, we have Dr. David Dapice--is that how it's pronounced--okay--Chief Economist and Director of the Vietnam Program of the Harvard Kennedy School's Ash Center for Democratic Governance and Innovation.

Dr. Dapice is a development economist with a focus on Southeast Asian economies. He has been working with the Vietnam Program at Harvard's Kennedy School since 1990 and has conducted field research in Indonesia, Vietnam, Burma, Cambodia and Thailand. He's also done work in Southeast Asia for the World Bank and the Rockefeller Foundation.

In addition to his position at Harvard, Dr. Dapice is an Associate Professor of Economics at Tufts University.

I remind our witnesses to please keep your opening remarks to seven minutes. As you can tell, we're not shy about asking questions. Dr. Sutter, we'll start with you.

**OPENING STATEMENT OF ROBERT SUTTER
PROFESSOR OF PRACTICE OF INTERNATIONAL AFFAIRS, ELLIOTT SCHOOL
OF INTERNATIONAL AFFAIRS GEORGE WASHINGTON UNIVERSITY**

DR. SUTTER: Thanks very much. It's a great pleasure to testify before the Commission. I welcome this opportunity greatly.

I have answered the questions asked by the Commission in my longer prepared statement. I will highlight here four general findings and three recommendations.

The findings. First, the behavior of the PRC shows no coherent strategy in dealing with Southeast Asia. Broader foreign policy concerns drove Chinese behavior to change repeatedly in often violent ways during the Cold War. Recent decades have seen changes in Chinese behavior driven by competing goals in international affairs.

In particular, China seeks regional stability and smooth economic growth in support of continued Communist rule. This goal is at odds, however, with Beijing's nationalist ambitions to control disputed territory at the expense of its neighbors.

Thus, the record shows that Southeast Asia is an important area where broader Chinese goals are sought. Fostering close and cooperative Chinese-Southeast Asian relations for their own sake definitely has been a secondary priority.

Second finding. Recent Chinese behavior shows Beijing using what I call a "double game" in seeking its contradictory goals in Southeast Asia.

On the one hand, governments in Southeast Asia which oppose China's advancing territorial expansion in disputed territory face strong and intimidating Chinese pressures.

On the other hand, Beijing appeals throughout Southeast Asia stress Chinese economic power and alleged largess. They emphasize that regional governments will gain enormously through closer economic ties with rising China.

Beijing plays a similar double game with ASEAN. It works cooperatively with the organization and its various bodies, using these venues to advertise China's largess. But it intervenes strongly to the detriment of ASEAN unity when Chinese sovereignty claims are involved.

Xi Jinping has more strongly emphasized both sides of China's double game. He and his government are tougher on territorial issues. Xi's actions receive much stronger propaganda treatment in China, greater than any Chinese leader since Mao Zedong. His pronouncements highlight vague but disturbing rhetoric of a "China dream" with China restored territorially and advancing sway through "common destiny" with neighbors. Offers of Chinese economic largess promote the common destiny with neighbors.

Third finding. The United States and the Obama government rebalance policy figure prominently in Xi's double game in Southeast Asia. ASEAN and individual Southeast Asian governments are in no position to confront Beijing's territorial advances without support from the United States.

Xi's approach to the U.S. also involves what I see as a double game for America. Xi emphasizes common ground and managing differences while he pursues territorial expansion, economic practices, military build-up and other initiatives that undermine American influence, especially in Asia.

The fourth finding. The purported Chinese economic dominance in Asia is not true, in my view. And the evidence that Asian governments are bandwagoning with China because of China's alleged economic dominance is weak. Hedging continues throughout the region; the

rebalance enables such hedging against rising China.

China has a mixed and arguably mediocre record in various campaigns over the past 20 years to advance infrastructure and investment in Southeast Asia and in other developing regions. And Chinese experts are warning against over-optimism as Beijing confronts major difficulties in carrying out its current visionary plans.

Regarding the three recommendations. First, since the United States is negatively affected by China's territorial advances, and it is the only power with strong ability to deter Chinese advances, I strongly support congressional calls for the administration to develop a strategy to deter the Chinese advances.

Second, U.S. policy in response to Chinese economic initiatives in Asia should not be based on propaganda and punditry. The Congress, media, and public opinion need a comprehensive assessment of the achievements and failures of ambitious Chinese schemes for investment and assistance in developing countries over the past 15 to 20 years. That assessment will provide lessons for Americans on how best to respond to current Chinese initiatives.

Third, Beijing continues past practice in seeking economic support of developed countries and international financial institutions even as it undermines them with China-centered economic initiatives. Many Chinese infrastructure projects in developing countries have been underwritten by U.S.-backed international financial institutions.

Available evidence shows Beijing will continue to seek developed country support in order to offset the risk for China in Chinese proposed investments in developing countries. Congress should require the administration to explain how it will deal with China's efforts to get the United States and U.S.-backed international financial institutions to pay for infrastructure, investment and other Chinese plans that undermine the interests of the United States and those institutions.

Thank you very much for this opportunity.

**PREPARED STATEMENT OF ROBERT SUTTER
PROFESSOR OF PRACTICE OF INTERNATIONAL AFFAIRS, ELLIOTT SCHOOL
OF INTERNATIONAL AFFAIRS GEORGE WASHINGTON UNIVERSITY**

Date: May 13, 2015

Panelist: Robert Sutter, Professor of Practice of International Affairs, Elliott School of
International Affairs, George Washington University

Testimony before the U.S.-China Economic and Security Review Commission

Title of Hearing: "China's Relations with Southeast Asia."

Written Statement

Purpose and scope

This written testimony is divided into four sections responding to the specific questions asked to me by the Commission.

SECTION 1.

What strategy does China apply to its relations with countries in Southeast Asia and with ASEAN? What importance does China accord to Southeast Asia in its foreign policy? What changes have occurred in China's policy toward Southeast Asia since Xi Jinping assumed power?

This observer discerns no coherent Chinese strategy in the course of 65 years of People's Republic of China (PRC) interaction with Southeast Asia. The record shows repeated and often dramatic changes in the Chinese approach to Southeast Asia caused by sharp shifts in China's overall foreign policy priorities. As a rule, Southeast Asia has been an important arena where Beijing has pursued broader but often changing foreign policy goals. In that context, China has given decidedly secondary priority to fostering close and cooperative Chinese-Southeast Asian relations for their own sake.

Below please find a brief discussion of each of the remarkable twists and turns in China's approach to Southeast Asian nations since the founding of the PRC in 1949. ASEAN was founded in 1967 but did not figure very much in Chinese foreign policy calculations until the protracted crisis caused by armed struggle against the Vietnamese military occupation of Cambodia, 1979-1989. China's changing approach to ASEAN since that time is highlighted various subsections noted as *China and ASEAN*, below. Meanwhile, the final pages of this section deal with changes in Chinese policy under Xi Jinping

Cold War Developments

During the 40 years of the Cold War, the changing Chinese approaches went through dramatic shifts that repeatedly featured ruthless, violent and very disruptive Chinese behavior at the expense of its Southeast Asian neighbors.

- The PRC's initial revolutionary emphasis on resisting U.S.-led imperialism saw close Chinese collaboration with and strong logistical and military support for Vietnamese Communist armies in the defeat of U.S.-backed French forces in Indochina.
- China followed the post-Stalin (d. 1953) Soviet leadership in seeking an interlude of reduced tensions during a few years of so-called peaceful coexistence in the 1950s.
- That phase ended in 1958 with renewed Chinese militancy—e.g. confronting America in the Taiwan Strait, supporting Vietnamese Communist armed struggle against U.S.-backed South Vietnam, and breaking with the USSR because of among other things the latter's perceived overly accommodating posture to America and its allies, notably in Asia. Supporting armed resistance against its enemies, China provided large amounts of military supplies, training, financial assistance and political support to indigenous Communist Party led-insurgencies against Western leaning governments in Thailand, Malaysia, and the Philippines. Chinese clandestine support for the Communist Party of Indonesia (PKI), then the largest non-ruling Communist Party in the world, went hand in hand with China's active wooing of the radical militancy of the Indonesian regime of President Sukarno. A coup attempt in 1965 against the leadership of the Indonesian Armed forces led to an enormous backlash that saw one-half million deaths, including many thousands of ethnic Chinese, and that destroyed the PKI and Chinese influence in the country.
- China's Cultural Revolution begun in 1966 radicalized Chinese opposition to opponents world-wide, including in Southeast Asia. Support for armed insurgencies now also targeted Indonesia. Neutral Burma reacted violently against Chinese Maoist demonstrations in 1969, causing China to create, fully support and direct a fighting force of over 20,000 armed insurgents under the rubric of the Burmese Communist Party that represented the most serious security threat to Burma for the next 20 years. Strident anti-Soviet Red Guards disrupted the shipments of Soviet arms passing by rail through China to support the Vietnamese Communists against America, seriously alienating Vietnam.
- Mao Zedong's China came under heavy Soviet military pressure and saw the wisdom of a breakthrough with President Richard Nixon who sought rapprochement with Beijing for strategic reasons including seeking leverage against the increasingly powerful USSR. Chinese support for the Vietnamese Communists and the various insurgencies in Southeast Asia continued, but Hanoi became very suspicious of China's new direction with America and sought to rely more on the USSR. The latter move deepened Chinese suspicions of Vietnam.
- Soviet-backed Hanoi's victory over U.S.-supported South Vietnam in 1975 opened the path to 15 years of ruthless armed struggle between China and Vietnam. China solidified its longstanding clandestine support for the radical Khmer Rouge regime that defeated the U.S.-backed military regime in Cambodia in 1975. China sustained strong material and political support for the regime as it carried out its catastrophic consolidation of power (resulting in the deaths of 20 percent of the population of the country) and pursued armed challenges to Vietnam over territorial and other issues. As the Vietnamese prepared to invade Cambodia and topple the regime, it tried to purge Vietnam of ethnic Chinese, resulting in a massive exodus of hundreds of thousands of ethnic Chinese to China and neighboring countries.
- The Vietnamese invasion of December 1978 destroyed the Khmer Rouge government but China insured that strong armed resistance by the guerrillas continued in Cambodia.

Beijing worked with the United States and its allies and with ASEAN in opposition to the Vietnamese installed regime and the Vietnamese military occupation. Hundreds of thousands of Chinese forces invaded northern areas of Vietnam for several weeks in 1979 and Chinese forces fired artillery barrages and carried out other violent military operations along the Sino-Vietnamese border for the next ten years.

- The violence focused on Cambodia didn't end until the end of the Cold War. The weakened Soviet Union curbed support to Vietnam which in turn saw the need to end its military occupation and seek peace. The Chinese were eventually persuaded to pull back support for the Khmer Rouge, allowing a peace agreement to be reached in 1991.
 - *China and ASEAN.* The Cambodian struggle saw China's first substantial interaction with ASEAN. Heretofore, Beijing had been suspicious of ASEAN's pro-western leanings. China also was well aware that Indonesia and to a lesser degree Malaysia had grave reservations about how struggling against and weakening Vietnam would open the way to what Jakarta and Kuala Lumpur feared would be Chinese expansion in Southeast Asia at odds with their interests.

Post Cold War Developments

The collapse of the Soviet threat with the demise of the USSR in 1991 at the end of the Cold War greatly relieved the PRC's security concerns around its periphery including Southeast Asia. For this and other reasons, China has been less prone than during the Cold War to resort to armed struggle and gross violence. However, in reaction to the Tiananmen crackdown of 1989, the United States led efforts to isolate and pressure China, looming as a serious threat to continued communist rule in the country.

From this period up to the present, the PRC leadership has focused on important foreign policy priorities that are designed to sustain Communist rule, support Chinese economic and military development, enhance Chinese security and advance Chinese nationalistic sovereignty claims. As shown below, these goals often lead to conflicting Chinese policies and practices in Southeast Asia and elsewhere. Up to this point, Chinese foreign relations with Southeast Asian neighbors have gone through three distinct phases and seem to be entering a fourth phase under President Xi Jinping.. The shifts from one phase to the next have seen Chinese leaders reverse or revise policy actions and goals seen as having failed or otherwise become counterproductive for Chinese interests, and to add policy actions and goals better suited to advancing Chinese interests. Against this background, it seems prudent to expect continued shifting in China's policies and practices in Southeast Asia depending on circumstances in the region and on other broader influences in Chinese foreign policy making.

1989-1996. The first phase witnessed strong Chinese efforts to break out of the post Tiananmen isolation and pressure imposed by the United States and western aligned countries by means of more active Chinese diplomacy. Chinese diplomacy focused on neighboring countries and other developing states which were more inclined to deal with China pragmatically and without pressure regarding China's political system or other internal affairs.

- *China-ASEAN relations.* China in this period viewed positive interaction with ASEAN as increasingly important. It engaged actively with ASEAN in order to improve political relations, build collaborative mechanisms, and curb the ability of the United States to pressure China over human rights and other sensitive issues.

At the same time, however, China's imperative to protect and advance nationalistic sovereignty claims saw China pass a territorial law in 1992 asserting strongly claims to disputed territories, especially along China's eastern and southern maritime borders. The Chinese military and civilian security forces backed efforts by Chinese oil companies, fishing enterprises and others to advance Chinese claims in the Spratly Islands of the South China Sea against the expansion of such activities by Vietnam, the Philippines, Malaysia and other claimants.

- *China and ASEAN.* A major incident in 1995 saw the leading states of ASEAN stand against Chinese territorial expansion and the United States also publicly weighed-in in support peaceful resolution of regional disputes.

The nine months of off-and-on large-scale Chinese military exercises against Taiwan in 1995-1996 saw few of China's neighbors explicitly side with China or the United States. But many were seriously concerned with the implications for their interests of China's assertiveness and ambitions.

1996-2001. Trying to reduce regional fear of the "China threat," Chinese leaders in this period played down military actions and assertive commentary as they demonstrated more concern to reassure neighbors in Southeast Asia and other countries of Chinese peaceful intentions. They propounded principles related to a "new security concept" that built on the moderate approach China had adopted at times in the past regarding the so-called five principles of peaceful coexistence in international affairs. Chinese diplomacy was very active in bilateral relations, establishing various types of special partnerships and fostering good neighbor policies.

- *China and ASEAN.* China also increased positive interaction with ASEAN, the ASEAN Regional Forum, and other Asian regional organizations.

Chinese trade relations with neighboring countries generally grew at twice the rate of China's rapidly growing economy. The Chinese economy remained stable amid the Asian economic crisis of 1997-1998. China did not devalue its currency, it sustained economic growth, and it supported some international efforts to assist failing regional economies—developments that boosted China's stature in the region.

Seeming at odds with China's reassurance of its neighbors was the concurrent strong public opposition to perceived U.S. efforts to pressure and weaken China and strong public opposition to U.S. domination and "hegemonism" in various world areas, notably including Southeast Asia. Beijing told neighboring states that its "new security concept" opposed the archaic "cold war thinking" seen in U.S. efforts to sustain and strengthen alliance relations, including U.S. alliance relations or closer military relations in Asia, notably with Japan, South Korea, Australia, and some Southeast Asian nations. Beijing indicated that these states would be wise to follow China's approach and to eschew closer alliance and military ties with the United States.

2001-2012. The coming to power of the George W. Bush administration coincided with another shift in China's policy in Asia and elsewhere. The initially tough Bush administration approach to China involved supporting Taiwan, opposing China's military buildup and Chinese proliferation practices, strengthening U.S.-Japan alliance relations and developing ballistic missile defenses in Asia. These steps did not elicit strident criticism by Chinese officials and in official Chinese media, whereas in the recent past, even less serious U.S. steps against Chinese interests were routinely denounced as perceived manifestations of US hegemonism and cold war thinking.

Over time, it became clear that China was endeavoring to broaden the scope of its ongoing efforts to reassure its neighbors that China was not a threat. The broadened efforts now included and focused on the United States. The previous Chinese efforts attacking U.S. policies and alliance structures in order to get Asian governments to choose between closer relations with China's under the rubric of China's new security concept and closer relations with the United States had failed and were put aside. In their place emerged a new and evolving Chinese emphasis focused on Washington as well as on Asian and other powers that China's "rise" would be a peaceful one that represented many opportunities and no threat to concerned powers. China's initial emphasis on "peaceful rise" eventually evolved into the even more moderate rubrics focused on "peaceful development" and seeking "harmony" in relations with all powers.

- *China and ASEAN.* The shift in China's approach reinforced the positive momentum in China's relations with Asian neighbors, notably in Southeast Asia and ASEAN. The webs of agreements China established with ASEAN and its member states grew rapidly. China initiated in 2002 an ASEAN-China Free Trade Agreement (ACFTA) that Japan, India, South Korea and other trading powers endeavored to duplicate in later years. It agreed that year in negotiations with ASEAN to the Declaration on the Conduct of the Parties in the South China Sea which set guidelines on how territorial disputes should be managed. China also prompted other powers to follow its lead in being the first to sign ASEAN's Treaty of Amity and Cooperation (TAC) in 2003. It played an active role in ASEAN-convened international groups, with China's preference at the time being ASEAN Plus Three (China, Japan and South Korea), which notably excluded the United States. China worked closely with Malaysia in influencing the creation of the ASEAN convened East Asian Summit during Malaysia's tenure as ASEAN's annual chair in 2005. The plan was for China to host the 2006 meeting and for membership to be restricted to ASEAN Plus Three. The plan was thwarted because of opposition by Japan, Indonesia, Singapore and others, fearing Chinese dominance in the group. ASEAN's chair remained the host of the East Asia Summit and membership was opened to India, Australia and New Zealand, with Russia and the United States joining later.

Trade continued to grow rapidly and investment by Southeast Asian countries into China was substantial, while Chinese investment in those countries remained comparatively much smaller. China actively developed closer road, rail, river, pipeline, electric grid and other connections with bordering Southeast Asian countries.

- *China and ASEAN.* After the setback in seeking Chinese leadership in the East Asia Summit, China's attention to Southeast Asia and ASEAN appeared to decline. Although

Chinese officials continued to talk about ASEAN taking the lead in Asian multilateralism, they also privately and sometimes publicly showed impatience with the slow pace of progress under the leadership of ASEAN governments, many of which were beset with fundamental problems of political unrest and instability. China's ability to advance relations with ASEAN and the region were postponed when Thailand had to cancel and reschedule the annual ASEAN summit and related meetings in late 2008 because of political turmoil in Bangkok that closed the airports in the city. The Chinese efforts faced an added setback when the rescheduled meeting in Thailand in April 2009 was canceled and foreign delegates evacuated as hostile demonstrators invaded the meeting site. In this period, China found itself following the United States and others rather than leading the foreign powers in interaction with ASEAN. Notably, China delayed as the United States considered and finally made the appointment of an ambassador to ASEAN. As a result, China's later appointment of an ambassador to ASEAN seemed to be following the U.S. lead rather than setting the pace as China did earlier in the decade in dealing with the ACFTA and signing the Treaty of Amity and Cooperation. China also followed the U.S. lead in setting up a representational office with the ASEAN headquarters in Jakarta.

Changes under Xi Jinping (2012-present)

Beginning in 2009-2010, China adopted what many outside of China and some in China assessed as "assertive" practices particularly regarding territorial claims with its Southeast Asian and other neighbors and the United States. For a time, the Chinese actions were mixed with strong reaffirmations of reassurance and peaceful intent, creating a muddled situation regarding China's overall intent toward Southeast Asia.

In the lead up to and under the leadership of Xi Jinping since 2012, Chinese intentions in the South China Sea and other territorial disputes have become clearer. In effect, Beijing is playing a double game.

On the one hand, Chinese policy and practice is driven by domestic nationalism and demands for a less deferential and more activist Chinese foreign policy. Against this background, the Xi government is carrying out widely publicized policies that advance Chinese South China Sea claims at the expense of China's neighbors and in ways that seriously challenge and undermine America's position as a security stabilizer in the region. Rapidly expanding Chinese military and para-military capabilities along with impressive oil rigs, fishing fleets, dredging machines and construction abilities allow and probably prompt China's leaders to expand in areas that have long been claimed by China and have been seen as unjustly infringed upon by other claimants. Probably also driving the Chinese advance is reaction to the Obama government's rebalance policy which has seen the United States expand military, economic and diplomatic relations throughout the broad Asia-Pacific region in ways seen at odds with Chinese ambitions.

On the other hand, Xi's China has married its tough policy on South China disputes with visionary publicity surrounding China's proposed Silk Road Belt, Maritime Silk Road, and related proposals such as the still forming Asian Infrastructure Investment Bank (AIIB) and related economic initiatives. In effect, China has set forth a choice for the Philippines, Vietnam,

other Southeast Asian disputants of China's South China Sea claims, ASEAN, and other governments and organizations with an interest in the South China Sea, notably the United States. It now seems clear that pursuit of policies and actions at odds with Chinese claims in the South China Sea will meet with more of the demonstrations of Chinese power seen in China's takeover of Scarborough Shoal from the Philippines in 2012, its deployment of an oil rig and a massive armada of defending ships near islands very sensitive to Vietnam in 2014, and its recent massive land reclamation for force projection in the far reaches of the South China Sea. At the same time, Southeast Asian and other neighbors' moderation and/or acquiescence regarding Chinese South China Sea claims would result in mutually beneficial development depicted in the massive publicity avowing Chinese economic largess.

- *China and ASEAN.* The lessons of the recent Chinese priorities and practice for ASEAN are that the now stronger Chinese territorial ambitions trump past emphasis on accommodation and reassurance. Notably, China manipulated Cambodia, the ASEAN chair in 2012, in a temporarily successful effort to keep the South China Sea disputes off the agenda of ASEAN and ASEAN-convened meetings like the ASEAN Regional Forum and the East Asia Summit. The manipulation resulted in an unprecedented public split in ASEAN unity. The manipulation along with the tough Chinese behavior on territorial disputes lays bear the reality that China's nationalistic ambitions to secure its territorial claims override China's concerns for cooperative relations with ASEAN and Southeast Asian governments. The latter concern is clearly secondary to the former.

An overall implication of the current Chinese double game in Southeast Asia and with ASEAN is that Beijing judges regional circumstances will require acceptance of China's new assertiveness. The Southeast Asian countries and ASEAN on their own are too weak to resist.

SECTION 2

What does China seek to achieve through its relationship with ASEAN? How constructive is China's role in the various ASEAN forums in which it participates and the East Asia Summit? How is China responding to increased U.S. engagement with Southeast Asia as part of the rebalance to Asia policy?

For now, the Chinese seem intent on pursuing existing and promised positive interchange with Southeast Asian governments and in ASEAN and ASEAN-led groups like the East Asian Summit provided they avoid challenging China on sensitive issues. The sensitive Chinese issues used to be limited to subjects like communist rule in China, Tibet, and Taiwan. As shown above, they have broadened recently to include territorial disputes in the South and East China Seas. Presumably, circumstances could cause China to broaden the list further to include close security cooperation with the United States and its allies, as China attempted to do in the late 1990s.

At one level of analysis, China has been successful in managing Southeast Asian affairs in pursuing its determination to advance territorial control in disputed areas and showing greater power and activism in foreign affairs. With the exception of the current Philippines government and to a degree Vietnam, Southeast Asian nations and ASEAN have been reluctant to publicly stand against China on South China Sea disputes. Vietnam's large-scale anti-China riots last year

came as an unwelcomed surprise to Beijing and appear to have caused China to reassess and moderate to some degree its expansionism in the South China Sea. But as noted above, Beijing seems to judge that Southeast Asia overall is weak and divided and not prepared to resist China's recently stronger ambitions.

On the other hand, few if any Southeast Asian governments appear to be bandwagoning with China. Media used to characterize the Myanmar Junta as completely under China's sway, ignoring the generals' personal and protracted experience fighting the Chinese-created Burmese Communist Party insurgency. For these and other reasons, the generals more recently stopped big Chinese projects and moved to expand Myanmar's international options at China's expense. Cambodian leader Hun Sen maneuvers for advantage in relations with China, but this successful strongman almost certainly recalls that China deemed him enemy #1 for over a decade when he led the Vietnamese-backed regime in Phnom Penh while China strongly supported the Khmer Rouge guerrillas.

A prevailing pattern involves Southeast Asian government hedging their bets in dealing with a rising China that is adopting coercive measures and an increasing list of demands for its neighbors. In this context, the governments generally support the Obama government's stronger military, economic and military engagement in the area under the rubric of the rebalance policy toward the broad Asia-Pacific region. The more active U.S. policies and practices are the main deterrent to more aggressive Chinese behavior in Southeast Asia. China sharply criticizes the U.S. policy; China rightly sees American support as strengthening the resolve of Southeast Asian states to maneuver in order to avoid falling under China's sway as they try to sustain their national interests even when at odds with China over the South China Sea or other issues.

At bottom, regional wariness of rising China will continue. The United States and its ally Japan seem best positioned to take steps on their own and with others including Australia and India to deter Chinese expansion and show China costs for its recent expansionist actions. And these steps can build on closer security cooperation with the United States sought not only by the Philippines and Singapore, but also Indonesia, Malaysia and Vietnam among others. Such demonstrations may cause China to recalibrate the strengths and weaknesses of its current policy and shift to a less challenging stance, as it did in 2001.

SECTION 3

How do individual Southeast Asian countries view China's growing trade and economic dominance in the region? What is your assessment of China's regional economic initiatives, such as the Asian Infrastructure Investment Bank (AIIB)?

While it's probably too early to give a definitive assessment of the impact of Xi Jinping's varied economic initiatives on Chinese relations with Southeast Asian states, the assessment provided below which is based heavily on the reservations of Chinese specialists and officials,⁶⁶ argues that it would be incorrect to assume that China is in a dominant economic position in Southeast Asia. The facts argue otherwise. Despite repeated Chinese pledges over the past decade to enhance investment in Southeast Asia with a \$10 billion fund, a \$3 billion fund and other

⁶⁶ See the review in "China-Southeast Asia Relations," *Comparative Connections* (May 2015) www.csis.org/pacfor

initiatives, Chinese investment (including from Hong Kong) in ASEAN countries remains at modest levels—about 10 percent of foreign investment there according to ASEAN data. Investment by Japan and the European Union are much higher. A recent USCC study had the Chinese investment figure even lower than ASEAN figures. Chinese trade (including Hong Kong) is more important—close to 20 percent of ASEAN trade but again far from dominant, especially if once considers the following: More than half of Chinese foreign trade is controlled by foreign invested enterprises in China; China-ASEAN trade is active processing trade and eventual production of manufactured goods; only 22 percent of those goods are used in China or ASEAN countries; 60 percent of those goods are exports to and dependant on sales in other markets, mainly to the United States and Europe.

Available information and results of schemes in Chinese investment and economic interchange abroad in the last 15 years that are similar to Xi Jinping's current economic initiatives show a pattern of grandiose visions running up against difficult realities. The problem is exacerbated under Xi Jinping as his leadership puts stronger emphasis than previous Chinese governments on projecting an image of greater Chinese activism in world affairs. The assessment below argues that the very loud drumbeat from China's massive propaganda enterprise of purported Chinese beneficence and largess moving Southeast Asians to forget their differences and bandwagon with China is misleading and far from reality.

Assessing AIIB, Silk Road Fund, and China-Southeast Asian Relations

The China-initiated AIIB represents a work in progress. Chinese officials reportedly were surprised by the number of states seeking to join, despite reports of opposition by the United States. The Chinese Ministry of Finance announced on April 15 that 57 nations were approved as founding-members of the AIIB; they included all members of ASEAN. Official Chinese media reported China's commitment of \$50 billion to the bank, but the commitments of other nations, the rules and regulations of the body and a host of other issues are in the process of being resolved. Deliberations to decide on the distribution of each country's respective share of decision making power in the bank and the selection of leading bank officials reportedly are expected in meetings of representatives of the founding members later this year.

By contrast, the \$40 billion China Silk Road Fund is under direct Chinese control and has registered more concrete progress than the AIIB. The Fund was established on December 29, 2014 and began operation on February 16, 2015. The scope of the Fund's activities involves both the countries included in China's Silk Road Economic Belt (mainly countries West of China going overland as far as Europe) and countries included in China's 21st Century Maritime Silk Road Initiative (mainly countries along the sea routes from China through Southeast Asia and the Middle East to Europe). A map publicized by official Chinese television and print media on April 15 showed that the scope of the Silk Road Economic Belt and the 21st Century Maritime Silk Road involves all of the Southeast Asian countries as well as neighboring countries of the South Pacific.

Coincident with the Boao Forum on Asia Annual Conference and Xi Jinping's keynote address there emphasizing China's "common destiny" with Southeast Asian and other neighbors, Chinese authorities released on March 28 a new action plan suggesting steps to be taken under

the rubrics of the Silk Road Economic Belt and the 21st Century Maritime Silk Road initiatives. The plan was created by the National Development and Reform Commission, the Ministry of Foreign Affairs and the Ministry of Commerce and was endorsed by the State Council. It was as much a vision statement as it was a plan for action. The main substance of the plan is in sections dealing with “framework” and “cooperation priorities” that detailed a very wide range of proposed or possible policies and practices. The details showed that while China has a focus on developing infrastructure projects connecting China more closely with its neighbors, Beijing is open to pursuing a broadly defined range of actions favored by China and neighboring states involving promoting enhanced policy coordination across the Asian continent, financial integration, trade liberalization and people-to-people connections.

Providing some clarity on what Southeast Asian and other neighbors can expect from Silk Road Fund, official Chinese media announced the first project supported by the Fund during President Xi Jinping’s visit to Pakistan on April 20. The project involves providing capital to build the Karot Hydropower project in northeastern Pakistan. That project is valued at \$1.65 billion. It is part of a very ambitious Chinese plan to build a \$46 billion 3,000 kilometer China-Pakistan Economic Corridor from China’s Xinjiang Uyghur Autonomous Region through the Khunjerab pass (elevation 15,397 feet) in the Karakorum Mountain range into Pakistan’s Baluchistan region to the Chinese built Gwadar Port on the far western Pakistan coast, thereby connecting China, Pakistan and the Arabian Sea. It remains very difficult at this early stage to determine how and if the \$46 billion Chinese plan will be implemented and paid for, but the overall figure is staggering. By comparison, the United States was the main provider of assistance to Pakistan during the long U.S. led war in Afghanistan since 2001. The total amount of U.S. assistance is about \$31 billion and the American assistance is forecast to decline sharply with the U.S. military pullback from Afghanistan.

According to official Chinese media, the hydropower project is emblematic of the kinds of medium to long term projects that will be supported by the Fund in Southeast Asia and elsewhere within the broad scope of the Fund. Specific information on the Pakistan project says that construction of the proposed power station will start at the end of 2015 and the station will be in operation by 2020. The station will be operated by a Chinese company for 30 years and then it will be transferred to the Pakistan government.

Chinese media reporting shows a diffusion of Chinese funding mechanisms both supporting the Pakistan power project and supporting the broad Silk Road Fund. The media reporting does not provide a clear figure on how much of the \$1.65 billion cost of the power project actually will be paid by the Fund. What it says is that the Fund will join “a consortium led by the Export-Import Bank of China” that is supplying the funding for the power station, according to a *China Daily* report of April 20. Meanwhile, the *China Daily* report also disclosed that the initial capital of the China Silk Road Fund amounts to \$10 billion coming from a variety of sources including \$6.5 billion from foreign exchange reserves; \$1.5 billion from the sovereign wealth fund, China Investment Corporation; \$1.5 billion from the Export-Import Bank of China; and \$500 million from the China Development Bank.

Motives, Risks and Implications for China-Southeast Asian Relations

Publicity surrounding the Boao Forum and President Xi's speech there and speeches on other recent occasions underlined Chinese motives seeking mutual benefit, peace, development and ever greater cooperation and integration with Southeast Asian and other neighbors. Chinese leaders and commentary also repeatedly disavowed seeking advantage in competition for influence with the United States, Japan and others.

Nevertheless, the surge of Chinese commentary also contained remarks by Chinese leaders and lower-level officials and commentators showing specific benefits China seeks from the Silk Road Fund, the AIIB and related efforts in dealing with Southeast Asian and other neighboring countries. There are economic benefits and strategic benefits.

The perceived economic benefits are:

- China's massive foreign exchange reserves are said to be better employed in infrastructure development and investments abroad in Asia than being employed in U.S. government securities and such other low-paying investments abroad.
- Asia's massive need for infrastructure meshes well with China's massive overcapacity to build infrastructure after 30 years of rebuilding China. Meshing the two will allow competitive Chinese construction companies to continue productive growth in building Chinese-funded infrastructure in neighboring countries.
- Connecting remote western and southern regions of China with neighbors through modern infrastructure in Asia will serve to develop these backward Chinese regions more rapidly and thereby help to bridge the wide economic development gap between interior and coastal provinces in China.
- The Chinese-supported infrastructure will allow many Chinese industries with excess capacity or facing higher wage demands or more stringent environmental restrictions in China to relocate to nearby Asian countries and continue to prosper and develop.
- The Chinese funded connection with neighbors will facilitate trade and the increased use of the Chinese currency in international transactions.
- Developing trade routes including road, rail and pipeline connections to China from the Arabian Sea through Pakistan, from the Bay of Bengal through Myanmar, and overland through Central Asian states and Russia is said to reduce China's vulnerability to possible foreign interdiction of sea borne shipments of oil and other needed goods to China. In particular, Chinese strategists worry about such vulnerability of Chinese imports and exports passing through the Indian Ocean and the Strait of Malacca.

The perceived strategic benefits are:

- Disputes over South China Sea territorial disputes and Chinese intimidation and divisive tactics in dealing with ASEAN and its member states have led to what some Chinese commentators see as "negativity" in recent China-Southeast Asian relations. The Silk Road Fund and related initiatives act to change the subject in China-Southeast Asian relations in ways that improve Chinese influence and image.

- The Chinese initiatives are seen as an effective way to use China's geographic location and large foreign exchange reserves in crafting policies and practices that off-set American efforts to advance U.S. regional influence and standing through the Obama government's rebalance policy in Asia.

While generally emphasizing the positive, the surge of Chinese commentary also contains statements by Chinese officials and commentators showing reservations about the Silk Road Fund and related initiatives, seeing notable risks. They involve economic risks and political risks.

The perceived economic risks are:

- Since the more viable investment opportunities in Asia have already been taken, China will be focused on less secure investment opportunities. Given this reality, some commentators warn against repeating the shortcomings seen in China's "going out" efforts using Export Import Bank and China Development Bank funding to seek energy and resources over the past decade. Those efforts had a mixed record, with responsible officials saying that over half of Chinese overseas investment projects are unprofitable and 80 percent of Chinese mining deals have failed.
- Beijing continues to emphasize it is a "developing" country with major internal needs. Thus, the win-win formula governing Chinese funding abroad usually requires assurance that the funding will be paid back in some way. The long term commitment to infrastructure development in less than secure countries heightens the chance for changes and unrest that have destroyed or undercut massive Chinese investments carried out or planned in places like Iraq before 2003, Libya, the Philippines, Nigeria, Myanmar, Mexico, Sri Lanka and Greece among many others. Chinese commentary also notes that longer term investment is more prone to loss due to corruption in such less than stable countries. All of the above undercut the likelihood of Chinese outlays being paid back.

The perceived political risks are:

- China's Asian neighbors are seen as wary of coming under China's sway as a result of the closer economic connections called for in the Silk Road Fund and related plans. Chinese commentators have warned Beijing against appearing like Japan did in the late 1980s as Tokyo prompted regional fears as it bought resources and deepened investment using its highly valued currency and other economic advantages.
- China also has a mixed reputation in its support for labor standards, environmental protection, the quality of work and sustaining large Chinese built infrastructure projects. Backlash has come in African and Latin American countries and is seen in changing attitudes working against China among rulers in Asian countries including Myanmar, the Philippines, Sri Lanka and others.

Meanwhile, data and assessments provided by ASEAN, *The Economist*, and the *China-Latin America Economic Bulletin* show that the Chinese record of actual investment abroad has amounted to much less than anticipated by Chinese and foreign media highlighting for many years a variety of multi-billion dollar Chinese investment schemes similar to the Silk Road Fund. The data and assessments show that China's actual investment in Southeast Asia, Africa and

Latin America has amounted to a significant but still modest amount for these areas ranging from about 10 percent for ASEAN to around 5 percent each for Africa and Latin America. Even when one takes into account underreporting by the Chinese government of investment abroad, China's low percentage of investment after many years of pledges and plans to increase investment is a notable finding.

Against the background of the above realities, prominent Asia-Pacific economic and political expert, Zhang Yunling of China's Academy of Social Sciences advised *China Daily* on March 9 that the new Chinese investment plans may take a long time "20 years, 50 years, or even 100 years to accomplish." He warned that the potential risks include "political instability in some countries, terrorism, global competition and concerns about China's growing presence in some regions."

Taken as a whole, the above assessment shows that despite China's disavowals of seeking advantage at others' expense, China does seek a number of advantages in using recent economic initiatives to advance its relations and influence in Southeast Asia at the expense of the United States, Japan and their allies and associates. At the same time, knowledgeable Chinese officials and specialists appear realistic about the risks involved in these economic initiatives. And, specialists in China and abroad argue on the basis of Chinese experience over the past decade that the actual Chinese impact of the recent investment initiatives may remain limited and far from dominant for some time to come.

An implication for the United States is that basing judgments on Chinese visions in action plans and pervasive publicity regarding Chinese largess has been off-target in the recent past and in view of prevailing realities would be off-target today.

SECTION 4.

Recommendations

- The evidence above of China's "double game" in promising largess while taking territory in Southeast Asia seems to reinforce rising American criticism of China playing a similar double game toward America. Beijing seeks summitry and dialogues publicly fostering cooperative ties while actively exploiting and undermining American influence in Asia, in international economics and other sensitive areas. In particular, the Chinese behavior reinforces this observer's support for calls in Congress for the articulation of an administration strategy to deal with Chinese territorial advances in Asia even as Beijing propounds its alleged intention of seeking a new type of cooperative great power relationship with the United States. The weakness of Southeast Asian countries and ASEAN relative to China and the close Chinese attention to U.S. regional moves shows that under current circumstances the United States, with the support of Japan and some others, determines whether or not China will be deterred from continued expansion at neighbor's expense.
- A major challenge facing U.S. policy makers involves dealing realistically with the widely publicized Chinese visions and plans for investment and assistance abroad. To do so U.S. policy makers need
 - An assessment of the achievements and failures of similarly ambitious Chinese schemes for investment and assistance in developing countries seen over the past 15-20 years. How many of these schemes announced with great fanfare in the past have failed to be implemented? What caused the failures? Do conditions prompting failures in the past persist up to the present? What is the basis for Chinese officials saying that over half of Chinese investments abroad are unprofitable? Optimally, such a study should be done by the U.S. intelligence community, if necessary using classified information but also allowing for an unclassified version to be shared openly with the Congress, American opinion leaders and media. The study also could be done by organizations capable of conducting what appears to be a large scale research and analysis enterprise such as the Government Accountability Office, The RAND Corporation and others.
 - An assessment of the significance of various shortcomings and risks seen by Chinese and international specialists regarding the major recent investment and assistance initiatives of the Xi Jinping government. How significant are these obstacles and how are they likely to affect the implementation of the Chinese development schemes? This study also seems to require the type of large scale research and analysis noted above and to require at least U.S. government involvement to be sure that relevant classified information is used effectively.
 - Given China's ongoing practice of continuing to receive foreign assistance from Western countries and from Western-backed international economic institutions like the World Bank and the Asian Development Bank, how and to what degree will China seek such international support for China's ambitious international investment and assistance plans under the AIIB, The Silk Road Fund, The New

Development Bank of the so-called BRICS countries (Brazil, Russian India, China, and South Africa), the \$46 billion China-Pakistan Economic Corridor, and other such plans? What will be the impact of the Chinese plans on longstanding U.S. efforts in international assistance to foster sustainable development through good governance and avoiding unsupportable over extension of economic commitments? If as anticipated China seeks the support of World Bank, Asian Development Bank and other international economic institutions for investment and assistance plans that clearly benefit China at the expense of U.S. policy goals, Congress should press the Administration for a strategy that would deal effectively with this aspect of what is seen by critics as part of China's "double-game" toward America.

**OPENING STATEMENT OF MEREDITH MILLER
SENIOR VICE PRESIDENT OF TRADE, ECONOMIC, AND ENERGY AFFAIRS AND
DIRECTOR OF THE WASHINGTON, D.C. OFFICE
NATIONAL BUREAU OF ASIAN RESEARCH**

MS. MILLER: Co-chairs Bartholomew and Slane, honorable members of the Commission, thank you so much for inviting me here today to share my perspective with you.

You have a lot of great expertise on the panels today, and I'm going to focus my remarks particularly on the strategies that Southeast Asian countries are employing to manage both the cooperative and competitive elements of their economic and trade relations with China, and what the U.S. can do to help support these strategies.

First, I also want to say how timely today's hearing topic is. This is a very critical year for Southeast Asia's trade diplomacy and the trajectory of its future economic relationship with China. There are four major trade initiatives targeted for completion this year that will greatly affect regional trade flows:

First, the ASEAN economic community; secondly, the upgrading of ASEAN's FTA with China; third, the completion of two mega free trade agreements, the Regional Comprehensive Economic Partnership agreement and the Trans-Pacific Partnership agreement.

China's increasing weight in Southeast Asia is a major factor behind Southeast Asian countries pursuit of all four of these initiatives.

There is a tremendous amount of diversity among economies of Southeast Asia, but all ten are acutely focused on the importance of healthy economic relations with China, the formidable competition that China poses to their own economic growth, the potential liabilities of overdependence, and then, as you were discussing earlier this morning, the need to safeguard against economic ties potentially being leveraged by China for political or strategic gain.

I want to now briefly touch on some of the strategies that ASEAN is employing. First, ASEAN is very focused on forming its own cohesive economic unit. So I mentioned the ASEAN Economic Community. The ten members of ASEAN are striving to build a free trade area that will allow for the free movement of capital, labor and goods, and allow them to build efficiencies, increase productivity, and compete with China as a destination for FDI.

The grouping is already focused on what their commitments are going to be in the next round of integration post-2015, and ASEAN has also continued to solidify its efforts and position itself as the leader of regional integration in Asia more broadly. The flagship economic initiative in this regard is the Regional Comprehensive Economic Partnership, which will knit together ASEAN's FTAs with six external partners, including China, into an agreement that will cover 28 percent of world GDP.

The RCEP is not envisioned to have the scope, depth or coverage of the TPP, but it has been put forward as a model for future regional economic integration and the platform for a free trade area of the Asia-Pacific.

For ASEAN, RCEP is important not only in terms of the potential economic gains and engagement with China, but also because, as I said, it helps to solidify their position as the organizer of broader regional cooperation.

Second, ASEAN is working to increase ties with China through the upgrading of their bilateral free trade agreement which will allow ASEAN greater access to China's markets and potentially make ASEAN more attractive as a manufacturing location for companies that want to export into the Chinese market where labor costs are rising.

Third, and very importantly, ASEAN has employed a strategy of diversification. They very actively pursued FTAs with many other countries, and they are looking for closer relations with the U.S. This is a major impetus behind the participation of Brunei, Malaysia, Singapore, and Vietnam in the TPP negotiations.

TPP is the most significant trade initiative underway for the U.S. in Asia. If completed, it will cover approximately one-third of world trade and 21st century issues that are critical for the U.S. economy.

This year is a critical juncture for TPP. Negotiators are trying to wrap up the agreement. Here on Capitol Hill, there's a very lively debate about trade promotion authority and whether or not to grant that to President Obama. The timing and the conclusion of TPP are important for the economic benefits that will accrue to the members, but also in this broader context of regional economic integration in terms of RCEP and the ASEAN economic community.

It's very important at this juncture for the U.S. to continue to support ASEAN's diversification strategy. We should work quickly to complete the TPP, and hopefully Congress will soon grant TPA.

We also need to more clearly articulate a road map for the inclusion of all of ASEAN in the future. Without that, the default I think for ASEAN going forward for a free trade area of the Asia-Pacific will naturally fall to the Regional Comprehensive Economic Partnership, which they feel a strong amount of ownership and leadership of that initiative.

It's also very important for the United States to support ASEAN's goal of closer economic integration within Southeast Asia, and there's a really, I think, wonderful window of opportunity for the U.S. government and U.S. industry to play in helping to set a high level of ambition for the next tranche of commitments that that body is looking at making post-2015.

The U.S. should also continue to work bilaterally with our partners in the region to help them to continue to put measures in place that will increase domestic demand and productivity and help to alleviate dependence on China's economy.

I would say overall the efforts of Southeast Asia to diversify their economic relationships have yielded positive results. Despite the current economic slowdown in China, the outlook for Southeast China is fairly rosy, according to the most recent Asian Development Bank projections. That's due to an increase among intra-ASEAN trade, an uptick in U.S. demand, low oil prices, and a number of factors that have helped so far to insulate them from some of the impacts of China's downturn.

I think it's also important to mention that for the United States, we have a role to play not only as an economic partner but as a strategic partner. There is a strong undercurrent of concern in the region that in the future economic ties, as I said earlier, might be leveraged in political strategic context. This is a very strong concern in countries such as the Philippines and Vietnam that are currently embroiled in territorial disputes with China, but it is also present in other capitals in the region.

I'll close there. Thank you very much.

**PREPARED STATEMENT OF MEREDITH MILLER
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NATIONAL BUREAU OF ASIAN RESEARCH**

China's Relations with Southeast Asia

Testimony for the U.S.-China Economic and Security Review Commission

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Introduction

Chairman Reinsch, Vice Chairman Shea, and Honorable Members of the Commission, thank you for inviting me to share my perspective with you on China's growing economic ties with Southeast Asia. It is an honor to participate in this timely hearing. Southeast Asia is a central focus of the Obama administration's "rebalance to Asia" and a region of growing economic and strategic importance. This year is critical for Southeast Asia's trade diplomacy and future economic relationship with China given that four major trade initiatives are underway that will have a significant impact on the region's trade flows. The establishment of the ASEAN Economic Community (AEC), the upgrading of the ASEAN-China Free Trade Area (ACFTA), and completion of the Regional Comprehensive Partnership (RCEP) and Trans-Pacific Partnership (TPP) negotiations are all targeted for this year. China's increasing economic weight is a major consideration for ASEAN members in pursuit of all these initiatives as they seek to carefully manage economic relations with China.

Background

For Southeast Asian countries, China is both an important trading partner and a formidable competitor for market share, manufacturing, and foreign direct investment (FDI). China surpassed the United States, Japan, and other economies to become ASEAN's largest and most important external trade partner in 2009, while ASEAN has been China's third-largest trading partner since 2011.⁶⁷ According to the grouping's external trade statistics for 2013, China ranked first out of the regional bloc's top ten trade partners, making up 14.0% of total trade. ASEAN's next largest trading partner, the European Union (EU), made up 9.8% of the bloc's total trade in 2013. While the degree and nature of China's economic importance varies among individual ASEAN members, China is a critically important economic partner for all ten. It is the most

⁶⁷ "ASEAN Eyes Greater Investment from China," Xinhua, January 14, 2014, http://news.xinhuanet.com/english/china/2014-01/14/c_133044481.htm.

important export market for Malaysia, Singapore, Laos, and Cambodia and the largest foreign investor in Cambodia, Laos, and Myanmar.⁶⁸

Recognition of the importance of healthy economic relations with China is deeply understood in ASEAN capitals. The importance of China to the region's economic prospects was clear in the aftermath of the 2008 global financial crisis. Southeast Asia weathered the crisis fairly well, continuing to post favorable growth rates of 5.4% on average despite recessions in key export destinations such as the EU, Japan, and the United States.⁶⁹ Growing domestic demand, supported by favorable demographic profiles in key economies such as Indonesia and the Philippines, was a contributing factor along with rising trade within ASEAN and with broader Asia, particularly China.⁷⁰ Approximately 26% of Southeast Asia's exports go to other ASEAN members.⁷¹ The total value is expected to continue to climb as regional supply chains mature, providing an increasingly important ballast as China's economy slows.

As a result, Southeast Asian policymakers increasingly see their countries' economic fortunes tied together as well as to China. This has spurred vigorous trade diplomacy from ASEAN members targeting three goals: (1) increased ASEAN integration, (2) closer ties with Asia's economic powerhouses China and India, and (3) closer ties with the United States, the EU, and Japan to gain market access and maintain balance in their economic portfolios. The United States has a strong interest both in fostering an ASEAN that forms a cohesive, independent, and prosperous economic community and in ensuring that ASEAN's trade ties with China are balanced.

ASEAN Centrality and Regional Integration

The ten members of ASEAN have committed to strengthening ASEAN's regional economic integration as well as its role in coordinating approaches to external partners and driving the development of regional architecture through the principle of "ASEAN centrality."

For ASEAN's goal of closer economic integration, efforts have focused on the formation of the AEC. The AEC aims to transform ASEAN into a union with free movement of goods, services, investment, skilled labor, and capital in order to realize efficiencies, build economies of scale, and compete with neighboring China and India as a destination for FDI. ASEAN is in the final months of fulfilling the requirements for the AEC Blueprint to meet the deadline of December 2015. According to ASEAN officials, approximately 90% of these requirements have been met.⁷² The final commitments—in areas such as investment, financial services, and labor flows—are the most challenging, however, and many observers have expressed skepticism that these will all be fulfilled this year. Under Malaysia's 2015 ASEAN chairmanship, the grouping is already working on developing a new ten-year strategic plan and targets for deeper integration

⁶⁸ Vinayak HV, Fraser Thompson, and Oliver Tonby, "Understanding ASEAN: Seven Things You Need to Know," McKinsey & Company, May 2014,

http://www.mckinsey.com/insights/public_sector/understanding_asean_seven_things_you_need_to_know.

⁶⁹ Asia Development Bank, *Asia Development Outlook 2014: Fiscal Policy for Inclusive Growth* (Mandaluyong City, Philippines: Asian Development Bank, 2014).

⁷⁰ Asia Development Bank, *Asia Development Outlook 2014*.

⁷¹ "External Trade Statistics," ASEAN, July 24, 2014, <http://www.asean.org/news/item/external-trade-statistics-3>.

⁷² Ming Tian, "Regional Integration, Cooperation Top Priorities of ASEAN Summit," CCTV, April 24, 2014, <http://english.cntv.cn/2015/04/24/VIDE1429864084814390.shtml>.

post 2015.⁷³

As part of its push for greater integration, ASEAN has also actively pursued free trade agreements (FTA) with external partners to achieve the policy goal of “a coherent approach towards external economic relations” among members and to reinforce the principle of ASEAN centrality in broader regional integration efforts with North and South Asia.⁷⁴

The first and perhaps the most significant FTA that ASEAN has negotiated to date is with China. Entering into full effect in 2010, ACFTA is the world’s largest free trade area covering 1.9 billion people and third-largest in terms of nominal GDP after the EU and North American Free Trade Agreement (NAFTA). The first tranche of commitments reduced tariffs on nearly 8,000 product categories, or 90% of imported goods, to zero for China and the six founding members of ASEAN. More recent and less developed members (Cambodia, Laos, Myanmar, and Vietnam) were given a five-year phase-in period and are committed to implement these terms this year.⁷⁵

Under ACFTA the average tariff rate on Chinese goods exported to ASEAN dropped to just 0.6%, down from 12.8%. The tariff rate on ASEAN goods exported to China also fell from 9.8% to 0.1%.⁷⁶ Since the implementation of ACFTA, two-way trade has grown and resulted in trade deficits for most ASEAN members.⁷⁷ The agreement also has the potential to further influence how manufacturing develops in the region. As labor costs in China rise, ACFTA becomes a potentially attractive option for Chinese and multinational companies to move manufacturing to lower-cost areas of Southeast Asia while continuing to service the Chinese market.⁷⁸ For example, with Vietnamese wages currently at about a third of those in South China, manufacturing capacity for products ultimately destined for the Chinese market is increasingly finding its way to Vietnam. Vietnam’s full implementation of ACFTA commitments this year could lead to an uptick in employment and help ameliorate the country’s trade deficit with China.

In 2013, Chinese premier Li Keqiang called for an “upgraded version” of ACFTA, pledging economic and trade cooperation of “a greater scope and higher quality.”⁷⁹ China proposed including better measures on trade facilitation, lowering tariffs, cutting non-tariff measures, holding talks on a new round of service trade commitments, and promoting openness in the area of investment. This proposal was well received by ASEAN and the two sides have set a goal for two-way trade of \$500 billion by 2015 and \$1 trillion by 2020 as well as achieving two-way investment of \$150 billion by 2020.⁸⁰

ASEAN has also continued efforts to solidify ASEAN centrality, which positions the grouping as the driver of broader multilateral cooperation in the region through its leadership of the East Asia Summit (EAS) and ASEAN Defense Ministers’ Meeting and trade diplomacy with external

⁷³ “ASEAN on Track to Deliver Measures under AEC, Says ASEAN Deputy Sec-Gen,” *Malay Mail*, April 25, 2015,

<http://www.themalaymailonline.com/money/article/asean-on-track-to-deliver-measures-under-aec-says-asean-deputy-sec-gen>.

⁷⁴ Yoshifumi Fukunaga & Ikumo Isono, “Taking ASEAN+1 FTAs towards the RCEP: A Mapping Study, ERIA Discussion Paper Series, January 2013.

⁷⁵ Chris Devonshire-Ellis, “Understanding China’s Free Trade Agreements,” China Briefing, February 10, 2014,

<http://www.china-briefing.com/news/2014/02/10/understanding-chinas-free-trade-agreements.html>.

⁷⁶ “Upgraded Version of ASEAN-China FTA,” *China Daily*, November 13, 2014,

http://www.chinadaily.com.cn/world/2014liattendealm/2014-11/13/content_18910660.htm.

⁷⁷ Nargiza Salidjanova and Iacob Koch-Weser, U.S.-China Economic and Security Review Commission Staff Research Report, “*China’s Economic Ties with ASEAN: A Country by Country Analysis*”. March 17, 2015

⁷⁸ Devonshire-Ellis, “Understanding China’s Free Trade Agreements.”

⁷⁹ “Upgraded Version of ASEAN-China FTA.”

⁸⁰ ASEAN-China Statement, 2014.

partners. The flagship economic initiative for ASEAN centrality is the RCEP between ASEAN members and six dialogue partners (Australia, China, India, South Korea, Japan, and New Zealand). This comprehensive partnership would knit together ASEAN's existing FTAs with these countries. When completed, RCEP would create an integrated market with a combined population of over 3 billion people, representing 49% of the world's population, and with a combined GDP of about \$20 trillion, or 28% of the world's GDP based on 2011 figures. As currently envisioned, RCEP does not have the depth or scope of the TPP, though it could provide a model and alternative vision for a Free Trade Area of the Asia-Pacific (FTAAP). For ASEAN, RCEP is important not only for its trade and economic benefits but for the role it plays in strengthening the strategic imperative for ASEAN's continued engagement in regional integration.⁸¹

Diversification Strategies

ASEAN members have also employed strategies as a group and individually to buffer against overdependence on China's economic growth. Central to these strategies is diversification of economic partners and export markets. This is part of the impetus behind the many bilateral FTAs that ASEAN has negotiated as well as the participation of Brunei, Malaysia, Singapore, and Vietnam in TPP negotiations. Both ASEAN and the United States are also committed to deepening economic ties across the Pacific.

The TPP is the most significant trade negotiation underway in Asia for the United States. The TPP is an FTA that would knit together twelve Asia-Pacific Economic Cooperation (APEC) economies, including four from ASEAN (Brunei, Malaysia, Singapore, and Vietnam), into an arrangement that liberalizes approximately one-third of world trade and covers new "21st century" issues such as e-commerce, cross-border investment, and intellectual property rights. The TPP also includes an open accession clause and is intended to be a building block toward an eventual FTAAP. Formation of the FTAAP is a goal endorsed by the 21 member economies of the APEC forum, which include 7 ASEAN members, the United States, and China. This year is also a critical juncture for the TPP as negotiators are striving to conclude the agreement as soon as possible. Critical to the eventual outcome of TPP negotiations will be congressional approval of trade promotion authority (TPA), allowing for a congressional up-or-down vote on trade pacts without amendment.

The timing of the conclusion of the TPP and granting of TPA is important not only in terms of the economic benefits that will be accrued by the United States and other TPP partners but also in the context of the wider push toward economic integration in Asia through the AEC, RCEP, and vision of an FTAAP. How the TPP, RCEP, and other existing FTAs in the region relate to the FTAAP is an open question for many regional economies. It is in the long-term interests of the United States and Asia for the TPP to be the accepted model for future economic integration.

Successful conclusion of the agreement this year would strengthen the credibility of the TPP as the vehicle for the FTAAP and would provide a high-standard template for future regional economic integration. In the meantime, it is critical for the United States to continue to work closely with ASEAN to ensure that more developed ASEAN members such as Indonesia,

⁸¹ "Factsheet: What you need to know about Regional Comprehensive Economic Partnership (RCEP)," Ministry of Trade and Industry (Singapore), June 18, 2014, <http://www.mti.gov.sg/MTIInsights/Pages/FACTSHEET-WHAT-YOU-NEED-TO-KNOW-ABOUT.aspx>.

Thailand, and the Philippines are prepared to enter the TPP in the near term and to flesh out a roadmap for eventually including all the ASEAN members.

Overall, the efforts of Southeast Asian countries to diversify economic relationships and deepen ASEAN ties have yielded positive results. The impact of China's current economic slowdown has been variable, depending on individual countries' export portfolios, with those that are more heavily dependent on commodity exports, such as Cambodia and Indonesia, feeling the impact more strongly. On balance, according to the most recent outlook from the Asian Development Bank (ADB), Southeast Asia's growth projections are fairly rosy, boosted by continued growth in domestic demand, stronger growth in the United States, and lower oil prices.⁸²

In addition to not wanting to tie their economic fortunes too closely to China's, many Southeast Asian countries have deeper concerns that Beijing may seek to leverage economic ties in order to coerce political and strategic policy decisions in China's favor. There is good precedent for this concern and several high-profile examples. In 2010, ties between Norway and China plummeted after the Nobel Peace Prize was awarded to Chinese dissident Liu Xiaobo. Five years later, Beijing continues to impose tight restrictions on Norway's imports of salmon.⁸³ Likewise, headlines about Beijing's unofficial halting of rare earth exports to Tokyo in 2010 at the height of Sino-Japanese tensions in the East China Sea were closely followed throughout the region.

Concerns over China's economic influence yielding political leverage are particularly strong in the Philippines and Vietnam, which are both embroiled in territorial disputes with China. For the Philippines, an April 2012 flare-up with China over the contested Scarborough Shoal in the South China Sea triggered a Chinese quarantine of produce from the country. Chinese officials blocked hundreds of containers of bananas and slowed inspections of papaya, mango, coconuts, and pineapples.⁸⁴ Mainland tourist agencies also warned Chinese tour groups to delay or cancel trips to the Philippines due to "safety concerns." In the case of Cambodia, Phnom Penh's chairmanship of ASEAN in 2012 left the grouping unable to agree on a joint communiqué for the first time in ten years due to the strong pressure that Beijing put on Cambodia to omit any mention of the South China Sea from the final statement.

Concerns also stem from public perceptions in many Southeast Asian countries that economic ties are unbalanced and weighted in China's favor. In Myanmar, the desire to balance overwhelming dependence on China is frequently cited as a strong impetus for the political and economic opening in 2011 and Myanmar's efforts to establish positive economic relationships with the EU, Japan, and the United States. Since 2011, several high-profile Chinese infrastructure projects within Myanmar have been put on hold due to protests over the environmental impacts and concerns that the deals were negotiated to China's rather than Myanmar's benefit.

In Vietnam, popular anger over China's large economic role, coupled with a strongly nationalistic response to maritime disputes with China, has cast a large shadow over the economic relationship. China is Vietnam's largest trading partner, and Hanoi has faced a

⁸² Asian Development Outlook 2015.

⁸³ "Norway, China Agree on Salmon Trade Deal," Undercurrent News, April 17, 2015, <http://www.undercurrentnews.com/2015/04/17/norway-china-agree-on-salmon-trade-deal>.

⁸⁴ Bonnie Glaser, "China's Coercive Economic Diplomacy," *Diplomat*, July 25, 2012, <http://thediplomat.com/2012/07/chinas-coercive-economic-diplomacy/>.

growing trade deficit, which now equals nearly \$24 billion.⁸⁵ Vietnam is closely integrated into regional supply chains, and many of its factories depend on inputs from China. Additionally, China supplies Vietnam with more than 50% of its textile material, a key export for the growing Vietnamese economy.⁸⁶ Vietnam's leadership is acutely aware of deep public mistrust and antipathy toward China and that safeguarding Vietnam's interests in the South China Sea is critical to the government's legitimacy. The leadership thus must walk a narrow tightrope between public opinion about China and hotly contested territorial disputes and the close intermingling of Vietnam's economic fortunes with China's.

A View from China

For China, Southeast Asia is an increasingly important market, a source of critical commodities, and a neighboring region central to its long-term strategic and economic great-power ambitions. China has generally made diplomatic and economic overtures to ASEAN from a platform of shared mutual interests. Its active participation in RCEP and proposal to upgrade ACFTA are examples of this approach. Recognizing the strategic mistrust between China and many Southeast Asian countries, Beijing has also tried to integrate its political and economic approaches, though with limited success.

At a special foreign ministers' meeting in 2013 to mark the occasion of the tenth anniversary of the ASEAN-China strategic partnership, China shared a new vision for the development of its relations with ASEAN. This vision was supported by the "2+7 Cooperation Framework" proposed by President Xi Jinping at the October 2013 APEC Economic Leaders' Meeting in Bali and by Premier Li Keqiang at the 16th ASEAN-China Summit in Brunei a few days later.⁸⁷ The new 2+7 framework for Southeast Asia-China relations consists of a two-point political consensus and seven proposals for cooperation. Li outlined four pillars for this vision, including upgraded trade relationships through RCEP, an upgraded ACFTA, and ultimately the FTAAP. He also pledged that China would continue to adhere to the Treaty of Amity and Cooperation (TAC) and proposed a new treaty of good-neighborliness, continued negotiations on a code of conduct in the South China Sea, and develop a joint security structure in the Asia-Pacific.⁸⁸ Thus far, most of the advancements of this vision have come in the economic sphere, which continues to provide the foundation for China's relations with ASEAN.

Southeast Asia is also central to China's broader great-power ambitions. In 2013, Xi announced plans for a new Silk Road and 21st century maritime Silk Road, which would construct massive new networks connecting East Asia with Europe, which would position China as the world's economic center of gravity. In rolling out these initiatives, Chinese leaders pledged significant amounts of financing for infrastructure development and the founding of the Asian Investment and Infrastructure Bank (AIIB), which appealed directly to Southeast Asian countries need for infrastructure financing and ASEAN's Master Plan for Connectivity. Greater connectivity is essential for ASEAN to reach its economic integration goals and maintain its role as the hub of

⁸⁵ "Vietnam and China: Through a Border Darkly," *Economist*, August 16, 2014, <http://www.economist.com/news/asia/21612234-relations-between-two-communist-neighbours-are-their-lowest-point-decades-through-border>.

⁸⁶ fiber2fashion, "Vietnam Sources 50% of raw textile material from China", October 30th, 2013

⁸⁷ Bilahari Kausikan, "ASEAN-China Relations: Building a Common Destiny?" *American Interest*, September 23, 2014, <http://www.the-american-interest.com/2014/09/23/asean-china-relations-building-a-common-destiny/>.

⁸⁸ Zhai Kun, "Chinese Diplomacy Towards Southeast Asia in 2014", *China US Focus*, January 16, 2014

Asia, while high logistics costs continue to be an impediment to overall FDI. The ADB estimates the infrastructure needs of developing Asia and the Pacific at \$8 trillion for ten years, or \$800 billion per year.

In announcing the maritime Silk Road initiative in Jakarta, Xi not only indicated Indonesia's important anchoring role in the initiative, but also enmeshed it with new president Joko Widodo's ambition to restore Indonesia as a maritime power.⁸⁹ Yet the current levels of mistrust over China's long-term strategic ambitions could limit the realization of Xi's vision for "one belt, two roads" if Southeast Asian countries fear that these new connections and higher levels of infrastructure investment from China could be used to their strategic disadvantage.⁹⁰

Monetary Policy

China's direct influence over monetary policy in Southeast Asia has lagged behind its overall economic weight in the region. Within the International Monetary Fund (IMF), China has less voting power than the United States and Japan in the absence of reforms to the quota system that are needed to allow China a role commensurate with its global economic stature. This limited role for China and other developing Asian states in the IMF has been a catalyst for the development of regional institutions to serve as a counterweight to U.S. led global institutions.⁹¹ While ASEAN has led the development of these mechanisms, China has played a critical supporting role and much needed financing. The Chiang Mai Initiative (CMI), established in the wake of the 1997 currency crisis that created widespread distrust of the IMF, was intended to provide for a regional currency swap system, but it has not been used to date, even during the 2008 currency crisis.

ASEAN +3 finance ministers agreed in 2009 to set up the CMI Multilateralization (CMIM). The CMIM is a \$240 billion reserve pooling arrangement that enables participating states to borrow at pre-negotiated rates, and 30% of the funds may be drawn without an IMF program in place. The new CMIM provides hard currency support for members facing possible liquidity crises by making available U.S. dollars that borrowers can exchange for local currencies before later reversing the transaction and paying interest⁹². The volume of reserves that regional banks have pledged give the CMIM the potential to play a meaningful role in emergency finance in Asia. Yet the negative perceptions and stigma associated with the IMF and crisis financing linger, and it is an open question if this mechanism will be utilized.

China has moved forward with steps to internationalize the renminbi (RMB) by developing currency swaps with friendly countries such as South Korea, Singapore, Malaysia, and Thailand. The RMB is still not convertible and has not emerged as a significant reserve currency, though Beijing is working slowly toward that status. Fluctuations in the RMB do affect the monetary policy of Southeast Asian countries, particularly those competing most closely with China for export markets around the world. When the RMB depreciates, key competitors are motivated to cut rates, and when it appreciates, they can more comfortably allow their own currencies to

⁸⁹ Zhao Hong, *Trends in Southeast Asia: China's New Maritime Silk Road: Implications and Opportunities for Southeast Asia* (Singapore: ISEAS Publishing, 2015), http://www.iseas.edu.sg/documents/publication/TRS3_15.pdf.

⁹⁰ Hong, *Trends in Southeast Asia*.

⁹¹ John D. Ciorciari, "China's Influence on Monetary Policy in Developing Asia" Paper for the 2013 ISA Annual Meeting, Panel on "China's Influence in Developing Asia" San Francisco, CA, April 5, 2013

⁹² Ibid

increase in value without fearing a loss in market share. Highly export-dependent countries like Singapore, Malaysia, Vietnam, and Thailand track very closely with the RMB, and the relative weight of the RMB in the currency baskets of Malaysia, Singapore, Thailand, and the Philippines has risen while the U.S. dollar's weight has decreased.⁹³

China is also lobbying for inclusion in the IMF's special drawing rights (SDR) basket as part of a strategy to further internationalize its currency. The SDR, an international reserve asset, currently comprises dollars, yen, pounds, and euros. The basket is up for review in May, and Chinese premier Li Keqiang was reported by state news agency Xinhua as saying in April that he had asked the IMF to include the RMB in the SDR.⁹⁴ This, along with AIIB and bilateral currency swaps, is an important step in China's efforts to internationalize the RMB.

Policy Considerations for the United States

The United States continues to play an essential role as an important economic partner for ASEAN and a leader in setting norms and rules for global commerce. The United States should continue to support ASEAN's efforts to form a cohesive economic area and to diversify trade and economic relationships. First, there is an important role for U.S. industry and government to play in providing input and encouragement for a high level of ambition in ASEAN's post-2015 goals and in strengthening the grouping's cohesion in addressing tough issues with China, such as the South China Sea disputes. Second, the United States should complete the TPP as soon as possible and work on a roadmap for including more ASEAN members in the next round of negotiations. The TPP is viewed by many in the region as an important indication of the U.S. commitment to Asia. Without a path toward full ASEAN participation in the TPP, the grouping will naturally look to RCEP as the model for regional economic integration. Third, the United States should encourage individual Southeast Asian countries to continue to put in place measures to increase domestic demand and productivity in order to safeguard against a potentially protracted slowdown in China.

⁹³Arvind Subramanian and Martin Kessler, "*The Renminbi Bloc is Here: Asia Down, Rest of the World to Go?*", Working Paper Series, Peterson Institute, Revised August 2013

⁹⁴"China Clings to Strong Yuan despite Export Slowdown," *Malay Mail*, April 14, 2015, <http://www.themalaymailonline.com/money/article/china-clings-to-strong-yuan-despite-export-slowdown#sthash.xsMaTHtO.dpuf>.

**OPENING STATEMENT OF DAVID DAPICE
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DR. DAPICE: I'd like also to thank all of the Commissioners for inviting me and I will try to be brief.

You asked me about trade. My paper shows Chinese share of ASEAN trade going from four to 14 percent in the last 13 years. The U.S. has gone from 16 to 8 percent so that really is a changing of places. This will not continue. I mean this trend will not continue. China will continue to gain some, but some of the labor-intensive exports that are now coming from China will go to ASEAN, and that will offset some of the lower commodity prices caused by China's slower growth, and those lower commodity prices and China's lower growth will not accelerate the Chinese share of trade with ASEAN.

It's important to realize that China only takes about one-eighth of ASEAN's exports, that they are well diversified, as Meredith said. And I don't anticipate a major problem from the slowing Chinese growth assuming it's in the four to six percent range in the next several years.

I think there will be rising demand from South Asia and growing demand within ASEAN itself. So I think bottom line that part of Chinese slowdown is not a severe problem. That's not talking about a collapse of the Chinese economy, which I do not foresee but is possible.

In investment, FDI, China is not that big a factor--six or seven percent only. It's, of course, larger if you include real estate and land investment, part of the Chinese credit bubble sort of spilling over into Southeast Asia as well where they buy land and buildings and so on, and that, of course, is not very well recorded so it's hard to say much about it except that it exists, and it's not unimportant.

In infrastructure, we can talk about the Infrastructure Bank, the AIIB, if you wish, but I'll just say that ASEAN needs to invest about \$100 billion a year in infrastructure. All the emerging markets need about a trillion dollars a year in infrastructure, and the World Bank and the ADB lend about \$20 billion a year for infrastructure.

So more is needed although frankly it's not really a shortage of capital in my view. It's a shortage of bankable projects. There's been a lot of trouble getting good projects that are bankable that people will want to invest in, sensible people for non-political reasons.

And I think a lot of ASEAN countries have trouble setting up these projects, and there are obvious problems there long-term. They're illiquid. You borrow in foreign currencies. The revenues are usually in domestic currencies. So they're problematic for a number of reasons beyond availability of capital.

Tourism. I'll just say very briefly Chinese tourism tripled, tripled, between 2009 and 2013. They're about 25 percent of non-intra-ASEAN tourism, and that will certainly continue to rise with the rising Chinese middle class. On the one hand, more people will learn Mandarin. On the other hand, the Chinese sometimes don't behave very well, and I'm not sure where you come out on that.

I've tried to save a little bit of time for the Mekong basin, which is a whole other issue, almost worth seven minutes by itself. But China's dams are a concern. They've already been built largely. They affect about one-fifth of the flow in sediment of the entire Mekong basin.

How those dams are managed in terms of when the water is released and whether they wash the sediment out from behind the dams will in large part determine China's contribution to

either stabilizing or aggravating dry season shortages and so on.

If China diverted water from the Mekong in the south to north water projects, which are huge, you know, 50 billion plus infrastructure projects, in three phases, and the Mekong would be the third, and they have not yet begun this, but if they did, that would be a severe impact, but as of now, the major impact is the Lower Mekong development, both tributaries and the main river itself, and this is largely being done within the auspices of Thailand, Cambodia and Laos, especially, and even Vietnam is investing in some dams in Laos that would affect the Mekong Delta.

You know, it's like the left and right hands don't know what they're doing--affect in a bad way. And in the Mekong Delta themselves, they're overpumping water and not managing the resources very well. The Tonle Sap is under a lot of stress. It's being overfished, and certainly if wet season flows were reduced, you would have problems recharging the Tonle Sap when it reverses the flow during the flood season.

I think we can talk more about that. I'm sure there will be more questions, but I think my bottom line is Vietnam could probably manage the problems. With some difficulty, Cambodia would have a harder time, and I'll leave it at that.

Overall, China is a major economic partner. Its influence will grow but more slowly. It will not dominate, I don't think--there are too many other players--in investment. The EU and Japan are very important. It's hard to say exactly what the U.S. is because its direct share is not properly--some of it comes from Singapore so it shows up as intra-ASEAN and so on.

But anyway I think China's slower growth will not be so severe, but how the entire Mekong basin is managed will determine whether or not Cambodia and Vietnam have a hard time or just sort of manageable problem to deal with going forward.

Thank you.

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China's Relations with ASEAN Economies
Short essay prepared for the U.S.-China Economic and Security Review Commission
April 21, 2015

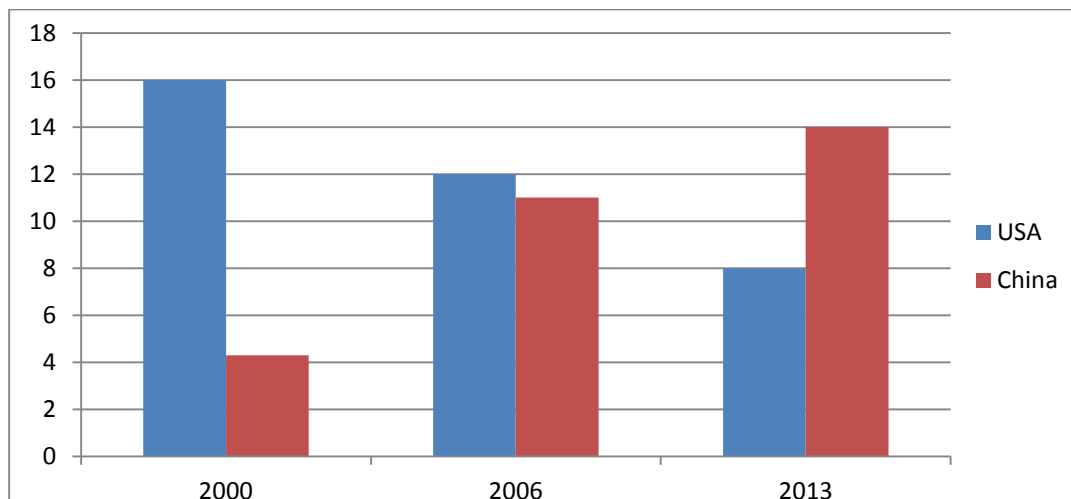
I. Introduction

China is intensively involved in Southeast Asia (SEA) as a major importer, exporter, aid provider and investor. Many Chinese citizens work, live and visit in SEA and China is a major diplomatic presence. This situation has both positive and negative aspects which most of the nations are trying to manage in different ways. These comments will not focus on the “China Sea” issues, which primarily involve the Philippines and Vietnam as they are more military and diplomatic than economic – though some resource issues are involved. Instead, these remarks will focus on the implications of Chinese economic engagement with the region.

II. Trade

China's trade with SEA has grown rapidly. If we take the period since 2000, Graph 1 shows the share of China and the US for combined imports and exports. Most ASEAN exports are of raw materials, though some nations export components for electronics. Most ASEAN imports are of manufactured goods, either for consumer goods or machinery. For all of ASEAN in 2013, China bought 12% of their exports (compared to 3.5% in 2000) and supplied 16% of their imports by value (it was 5.2% in 2000), or 14% of total 2013 trade. This increasing share may slow or stabilize in the future as China's growth slows down.

Graph 1: China and US – Share of ASEAN Trade



Source: “China's “Soft Power” in Southeast Asia”, 1/4/2008, CRS RL 34310; and ASEAN data base for 2013

The trend since 2000 is of a rising share of trade with China and a falling share from the US – indeed, the US share has fallen in half since 2000. The current US share is slightly more than half of China’s share and likely to fall further. However, the US tends to import more manufactured products from ASEAN in comparison to China. These products are labor-intensive and often have low domestic value added in the exporting (assembly operation) country. China’s exports tend to have more domestic value added. The migration of labor intensive exports from China to ASEAN might slow the decline in the US share.

It is likely that China’s GDP growth will slow in this decade, perhaps to 5-6%⁹⁵. More significantly, the composition of their growth will skew away from exports and investment to domestic consumption and services. These will be less material intensive and so products such as coal, copper and iron ore will drop in price, a process already underway. However, the major exports of ASEAN by value are food and fuel, not hard minerals. Fuel consumption will move from coal⁹⁶ to gas and, to a lesser extent, oil. Oil is not a major ASEAN net export but gas is. US export policy towards its own natural gas will certainly influence the price of LNG in Asia, perhaps as much as China’s growth slowdown.

Food imports are harder to predict, since they depend not only on China’s policies towards self-sufficiency but also Chinese attitudes towards food quality. Water shortages, soil pollution and an aging farm work force will tend to depress China’s food production. Overall population growth in China is slowing with a rising share of elderly. Incomes are rising, leading to less direct grain consumption and more meat, poultry, fish and dairy. Fresh vegetables and fruits are likely to take more of the food budget. ASEAN is well placed to supply a portion of this rising demand, though less so in dairy and meat than others.

If raw material prices (including rubber, coffee, and so on) do soften further, this will push ASEAN to accelerate the growth of its non-farm sectors. These had been growing faster before the Asian crisis but slowed during the Crisis and this slower rate continued as China’s demand for commodities led to a greater focus on raw materials. The migration of labor-intensive exports from China gives ASEAN, especially the lower-income portion, a clear path forward. In any case, agriculture normally declines as growth progresses and productivity and incomes in the rural sector are much below those of cities. It would be natural and desirable to move labor from lower productivity rural areas to higher productivity sectors. However, this process is already underway among younger workers and most farmers are aging. They may be less able to shift advantageously to urban jobs.

⁹⁵ Japan is not covered in this paper. It is a major investor and trading partner but with high debt and a shrinking population, it will be a receding factor going forward.

⁹⁶ Indonesia is the world’s largest thermal coal exporter, with exports of about \$25 billion, or 12-15% of total exports by value. While Chinese coal imports can be expected to fall, India and other nations may pick up much of the slack. Domestic policy is also restricting some illegal exports and there has been little growth in recent years.

III. Investment

ASEAN had \$334 billion of FDI in 2011-2013. The “big three” sources were the EU, Japan, and intra-ASEAN investment, which together accounted for 56% of total FDI coming into ASEAN. China’s three year total for FDI was \$21.9 billion or 6.5% of the total – if Taiwan (1.8%) and Hong Kong (4.1%) are added, the total was 12.4%. The US directly invested \$24 billion in the three year period or 7.2% of the total, though some US multinational investment is counted as coming from Singapore or other places. Thus, China is an important but not dominant investor.

It may be that Chinese are buying land and real estate in significant amounts and some of their purchases may not be captured in the normal FDI statistical net. It is hard to evaluate this channel in terms of value or trend. If overall Chinese credit grows more slowly, it is likely to slow as well. China now has a credit to GDP ratio of 200% to 250% and credit cannot safely grow rapidly as the economy slows. While the Chinese authorities realize this, they have very recently cut reserve requirements and interest rates as expansionary measures. It remains to be seen if this creates bubbles not only in China’s but also ASEAN’s stock and real estate/land markets. Such bubbles eventually collapse and slow future growth.

IV. Chinese Aid

It is sometimes difficult to distinguish aid from investment coming from China due to the intertwined nature of Chinese state enterprises and the government. For example, in Afghanistan, China won a contract to exploit a large copper deposit with the help of major infrastructure which was financed with Chinese government loans. Funds to Chinese companies to invest in “drug substitution” programs in Myanmar have resulted in large land grants for rubber and other tree crops. Because of Myanmar practices, these land grants often come at the expense of ethnic farmers and complicate peaceful resolution of ethnic conflicts. The “New Silk Road” initiative will lend many billions of dollars for infrastructure in ASEAN. (The recent trip of Xi Jinping to Pakistan produced promises of \$45 billion of infrastructure investments.) The loans for these projects will be at or close to commercial rates, say 5-6%.

China has nearly \$4000 billion in foreign exchange reserves, much of it earning essentially nothing if held in Treasury bills. It also has excess capacity in steel, cement, and companies making high-speed trains or in construction. It certainly makes internal sense for them to finance roads, trains, ports, dams and other projects desired by the borrowing countries. They get a higher return on their funds, employ Chinese people and physical capital that would otherwise be idle and extend their influence as well.

Cambodia has been a special focus of aid, receiving billions of dollars over the years.⁹⁷ Laos and Myanmar are also recipients, while Vietnam and Thailand have gotten some loans in the past five years. The interest of China in having Cambodia stall ASEAN resolutions on the South China Sea or other issues is obvious and there is likely a linkage. The other nations do not show any clear correlation between Chinese influence and aid levels. Thailand, for example, is more

⁹⁷ See: <http://www.eastasiaforum.org/2013/07/16/chinese-investment-and-aid-in-cambodia-a-controversial-affair/> and <http://www.channelnewsasia.com/news/asiapacific/chinese-influence-in/1763310.html>

open to China than Vietnam in many ways but gets relatively little in aid from them.⁹⁸ I am not a political scientist or diplomatic observer⁹⁹, but it would be mistaken to take aid, investment or trade flows as a determinant of attitudes towards China though they obviously are a factor for the relevant country to weigh. In Thailand's case, the authoritarian military government is not a concern for China but is to the US, so it is easier for China's influence to grow because they do not try to or want to change the type of government.

An active discussion has grown up around the Chinese Asian Infrastructure Investment Bank, which the US has opposed on the grounds that it will ignore environmental and other safeguards. If this is the real concern, it would make more sense to be inside and learn of its procedures and perhaps modify some of them rather than being on the outside. This is the inclusive position being taken by most of Europe and Asia. The US, with Japan, is isolated and has diminished influence. Many Chinese suspect the opposition is less principled and reflects a reluctance to allow China to play a growing role.

However confused the US may be on that issue, its own internal disputes have not escaped notice and are more significant. The possible cessation of the Export-Import Bank is one example – it makes no sense to disarm unilaterally in finance and trade any more than it does in military contests. Every other major country has a similar bank to provide credit. China has one that is more active than ours and just got a new \$30 billion injection. Whatever waste or favoritism is in the Export-Import Bank, the better response would be to fix its procedures and the US corporate tax code rather than hand huge amounts of trade to other nations. Other examples are the failure of the US to fix up even its existing infrastructure (bridges falling; gas pipelines exploding; water mains erupting, trains derailing, etc.) at a time of low interest rates and high corporate cash balances. It appears there is an ideological divide that prevents obvious solutions – again, the periodic shutdowns of the government or the shifting of cash balances and forced government worker holidays are watched with a mixture of consternation and bemusement.

With a falling share of trade; a secondary role in investment; a small amount of bilateral aid and a dysfunctional political system, the US has ceded much of its leadership role. While it remains a major buyer of many ASEAN exports, and its military power is useful and crucial for ASEAN to balance China, few nations are in a position to choose one nation over the other. China is seen as expansionist, aggressive, unreliable, big and close. The US is seen as distant, distracted, and (relatively) diminishing.

V. Tourism, Migrants and the Ethnic Chinese

Tourism is an important industry for many ASEAN economies and tourist arrival numbers grew by 50% from 2008 to 2013. There were 98 million tourist arrivals in ASEAN in 2013, of which 43.2 million were from other ASEAN neighbors. Of the remaining 54.8 million tourists, 12.6

⁹⁸ A Chinese Harvard fellow was very interested in attitudes towards China in Vietnam and Myanmar. I observed that he had not asked me about Cambodia or Thailand. "No", he said with a smile, "It is not necessary."

⁹⁹ I did review a book by Ian Storey, *Southeast Asia and the Rise of China: The Search for Security*, Routledge, 2011 (hard cover) and 2013 (paperback). He is the one to ask about diplomatic issues.

million (23% of non-ASEAN) came from China and 3.2 million (5.8%) were from the US. China's numbers tripled from 2009 while the US grew just 20% in the same period. This does not account for differences in spending (or behavior!) but the gap in numbers and trend in growth is marked. A growing Chinese middle class is likely to travel even more in the future and further widen the gap. This growing market will mean more learning of Mandarin and increasing overall influence.

In addition to “normal” tourism, some Chinese effectively migrate to some ASEAN countries. In Myanmar, it has been estimated that 1-2 million Chinese, mainly from Yunnan, have moved to Myanmar and purchased citizenship cards.¹⁰⁰ It is likely that additional numbers have moved into Laos and there is visa-free travel into Cambodia as well. It is likely that these movements are individually motivated rather than state-sponsored but they do constitute an important factor it would be foolish to ignore. Those that move typically have access to some capital, marketing contacts, and business savvy. They end up controlling much retail and wholesale trade and often buy up urban land and real estate.

There are also people who have lived much longer in ASEAN but who are ethnically Chinese. In many cases, their ancestors came many generations ago. Most of these people consider themselves citizens of the country they were born in and are in no sense a “fifth column” although anti-Chinese pogroms, such as those orchestrated by Prabowo during the Asian crisis, do little to encourage patriotism! What is relevant is Chinese-linked ethnic groups such as the Wa, who are semi-independent within Myanmar and who rely on Chinese arms and support.¹⁰¹ Ethnic Chinese-ancestry business people are hugely important in Southeast Asia, but most of them reflect the crony capitalist economic structure in which they operate. They are often good at getting favorable treatment, but not always at competing in world markets. This may be one reason why so many ASEAN economies seem to have slowed down to 4-6% growth when still at moderate income levels – a “middle income trap” caused by inadequate structural reform. It would not be fair to blame business people for operating according to the rules of where they live and work, but the semi-separate ethnic status may slow the political coalitions that would otherwise lobby for efficiency-increasing and corruption-reducing measures.

VI. Lower Mekong Issues

The Mekong River is important to tens of millions of farmers and fishermen and is being affected by a large number of dams already built and planned or being built either on its tributaries or the main river itself. China is not a member of the Mekong River Commission and has built several upstream dams. The impact of these dams will in large part depend on how they are managed. It is likely that they will have some impact in lowering flood season flows and increasing dry season flows and will probably influence silt transport to some degree, depending on if or when the dams are flushed of their accumulated sediment. There are already moderate

¹⁰⁰ This range of recent migration has been mentioned to me but is hard to document. It is illegal to purchase citizenship cards and no registry is kept.

¹⁰¹ <http://alfredmeier.me/2014/03/18/myanmars-northeast-chinas-version-of-crimea/>

impacts from these dams, including on sediment and water flows and fish. If China were to transport water to its ambitious multi-stage south-to-north water channels and canals, it would have a much larger impact.

While Chinese dam construction is rightly scrutinized, it is likely to be less important than what is being done or planned by Thailand, Laos and Cambodia. These nations account for about four-fifths of the water flow and sediment. Even Vietnam is investing in dams in some of these nations, even though it may adversely influence its own Mekong Delta! The concern for the Mekong, and especially for the Mekong Delta and Tonle Sap Lake, are related to Chinese plans (barring major northward water diversions) in a minor way. A Thai high-level water diversion project could have a major negative downstream impact.¹⁰² It is unclear if it will be implemented, in spite of its poor returns.

The Mekong Delta is itself troubled by its own mining of groundwater, which lowers the ground level itself and makes low lying (most) land vulnerable to rising sea levels. It also leads to water quality problems. Managing underground and surface water resources is of much more immediate importance than controlling Chinese dams. The Tonle Sap has been overfished and is getting silted. Uncontrolled dumping of human and industrial waste into the Mekong from Phnom Penh and parts of the Delta in Vietnam also contribute to pollution problems. When the downstream nations are mismanaging their own resources so badly, it is harder to chastise the Chinese.

The Mekong has historically been a difficult river to navigate due to its rapids. These also provide a habitat for fish. When shallow, rocky areas are blasted to provide navigation channels, this has a deleterious impact on fish and those who rely upon them. Dams, even with fish ladders, also interfere with spawning, much as salmon are harmed in the US. This becomes a distributional issue within and between nations on the Mekong. If fishermen (and women) can find other sources of livelihood and protein, the cost of the reduced fish populations may be tolerable to them. If not, then some suffer to benefit others. Aside from financing studies and projects to help those displaced, the US has only a limited ability to influence the choice and pace of these projects, especially now that the Chinese are likely to support construction of Mekong dams if they are approved by the ASEAN government that controls that section of the river. The Mekong River Commission signatories do have certain obligations to downstream nations, but it is unclear if this will effectively constrain them.

The impact of these Mekong investments will be felt primarily in Cambodia and Vietnam. If Vietnam continues (or regains) its relatively rapid industrial growth, it is likely to be able to absorb many of the displaced. Agriculture is less than 20% of GDP but is still nearly half of the employed workforce in Vietnam, and even higher than that in the Mekong Delta. A growing productivity disparity between a largely unchanged (in number) agricultural labor force and a

¹⁰²http://www.academia.edu/898934/Water_Poverty_and_the_Governance_of_Megaprojects_The_Thai_Water_Grid_ is a critical summary of the proposed "Water Grid" which involves large diversions of Mekong water.

growing nonfarm labor force will in any case tend to push more workers out of agriculture over time. The main question is how quickly and where else these aging and poorly educated workers can be absorbed. There would certainly be strains and perhaps some reversal of the considerable reductions in poverty, which had measured about 1/3rd of households in 1998 in the Delta and now is said (with a somewhat different poverty level) to be less than 10%. It is possible that some of the fish raising would replace rice growing and adjust to less fresh water. This would not be equally true though for shrimp farming which needs fresh water. Overall, it would be a blow but a blow which could be absorbed at some cost.

The situation in Cambodia is less clear although the economy is more agricultural (51% of workers; a third of GDP) and has less industrial development. It is likely that the possible death (from increased siltation and no flood season flow reversal) of the Tonle Sap would have a relatively large impact on livelihoods which would be harder to offset by gains in industry and services. It is not clear if the reverberations would increase instability. Certainly the governance indicators for Cambodia are not very high¹⁰³ and the ability or willingness of the government to respond may not be satisfactory. However, the current trends point in the same direction, even without further Mekong investments.

VII. Conclusions

China's size, proximity, policies and recent growth have been both an opportunity and a problem for ASEAN. China's rising demand for commodities has probably slowed the industrial development of some ASEAN economies and resulted in a focus on producing raw materials. The production of commodities does not usually accelerate overall growth or necessarily help income distribution. On the other hand, ASEAN has been capable of responding to a market opportunity and earned foreign exchange. Economies have grown 4-6% a year since 2000 for the most part and sometimes faster in the poorer nations. Chinese investment and aid tends to promote Chinese interests, but these partly overlap with ASEAN government interests.

A slower growing China will be partly offset by more domestic demand growth within ASEAN and by demand from South Asia and other regions. A tilt towards more industrial development in ASEAN, partly driven by migration of some export industries from China, will offset some of the losses from less agricultural growth. The environment may also feel less pressure to displace forests with palm oil and rubber plantations. China only bought about an eighth of ASEAN exports in 2013, so they are pretty well diversified. Sluggish growth in the EU and Japan is also a challenge, perhaps greater than a 5% Chinese GDP growth focused more on services and consumption.

ASEAN will likely split with "island" Southeast Asia – non-contiguous to China might be a better term – having more room for balancing the influence of China with other partners; and

¹⁰³ The World Bank rates most nations on six dimensions of governance. Cambodia is in the bottom fifth for voice and accountability, government effectiveness, rule of law and control of corruption. While voice is also low in Vietnam, the other variables are close to the 40th percentile – that is below the median, but well above Cambodia.

contiguous nations having to bend more or less directly to China's will. Indonesia – an important nation in its own right – is part of the “island” group, as is the Philippines. It should be noted that President “Jokowi” said the nine dash line had no basis in law. Malaysia and Singapore are also able to have foreign policies which consider China but are not dominated by it. Thailand, Laos, Cambodia and – probably – Myanmar fall into the contiguous group. This is true in spite of considerable anti-Chinese feeling in Myanmar.¹⁰⁴ Only Vietnam stands out as a nation that touches China but wants to keep a degree of independence. They will not join an anti-China alliance but will try not to be dominated.

The Mekong basin is being impacted by dams and irrigation schemes in both China and, especially, downstream nations. Poor resource management is widespread in the region and more attention to economic returns on investments and proper water management would do wonders for mitigating the impact of such projects as do go forward. If many of these projects do go forward, the Mekong Delta will have to make large and painful adjustments, but will probably manage with some outflow of workers. In Cambodia, there are fewer alternatives and the impact on poverty is likely to be greater.

The ability of the US to control these outcomes is limited. Most governments are authoritarian and not inclined to listen to a country that lectures them, does not often pay attention, and is far away and less important than its giant neighbor. The TPP, if it passes, would help to some extent and keep the US in the game. *Not passing TPP would kill the pivot and all but announce a new period of isolationism.* The US still has soft power – its education is admired and its society is seen as open and more equal and meritocratic than most in the region. Its multinational companies are seen as good places to get a job, though few can even dream of such. US technology remains impressive. On balance, the US position that makes sense is to encourage ASEAN to remain open economically and to information flows and to gently urge it to trend towards more democracy. They do not want to choose between China and America. America being there means they are not forced to choose.

Note on the Author

Professor David Dapice began working in Indonesia as an economic adviser with the Harvard Development Advisory Service in 1971. He became a professor of economics at Tufts University in 1973 where he still teaches and has continued working with Harvard University, engaging in development work on the ground in Indonesia, Vietnam, Myanmar, Thailand and Cambodia. He has been the chief economist of the Vietnam Program in Harvard's Kennedy School since 1990 and worked extensively in Myanmar in the 1990's and since 2009.

¹⁰⁴ Myanmar is worth a paper in itself. It may become a virtual Chinese protectorate with military bases and a limited degree of maneuver. It is so divided and poorly run that its time to reform is limited.

PANEL II QUESTION AND ANSWER

HEARING CO-CHAIR BARTHOLOMEW: Thank you very much to all of our witnesses. We'll start our questions with Chairman Reinsch.

CHAIRMAN REINSCH: I'd like to pursue a little bit more about the questions that Ms. Miller raised about RCEP and TPP and the way they interact, and particularly maybe you as well as the others could comment on not only the--really the readiness of ASEAN countries that are not currently part of TPP--Laos, Cambodia, Burma, Thailand, in particular, and also the Philippines--to join. I mean some of them have expressed interest. Some of them have said nothing. But interest and preparation and readiness are very different things.

For example, are they all WTO members to begin with? Or if not, should that come first? I think the United States has said from time to time that it's probably in our interest to have this be bigger rather than smaller--TPP--bigger rather than smaller, which I agree with, but one of the questions that I think we ought to spend some time reflecting about is whether these are new entrants that are viable? Can you comment on that?

MS. MILLER: Absolutely. Thank you.

You hit exactly on the most challenging issue in thinking about what will be the platform for future comprehensive economic integration in Asia, which is that the TPP and all U.S. FTAs are to a very high standard and one that would be very difficult for some of the Southeast Asian economies to consider meeting at this particular stage.

There have been expressions of interest from the Philippines, from Thailand, from Indonesia. I think if those countries were properly motivated, they could make those commitments. Vietnam is one of the less developed countries in the region, and for a variety of strategic and economic decisions, they are moving ahead with the TPP negotiations despite challenges on issues such as state-owned enterprises and government procurement.

So I think if those countries were to make the political commitment, they certainly could move forward. Would they make the political commitment is another question? Thailand, as you know, is in the midst of political upheaval.

President "Jokowi" of Indonesia has just come into office and has expressed some reluctance to take on new economic liberalization commitments even in the context of ASEAN's own economic integration.

And the Philippines I think is a country that we should work with. We should work with all three, but it's certainly a challenging issue, and it's one where I think the U.S. needs to have an extended timeline and an incremental approach.

CHAIRMAN REINSCH: And you've committed a sin of omission here. You left the other ones out. Does that mean--

[Laughter.]

CHAIRMAN REINSCH: --you don't regard them as short-term candidates?

MS. MILLER: I think, you know, as I said in my testimony, I think the TPP would be the most beneficial platform for long-term integration in the region.

CHAIRMAN REINSCH: Well, it's a "give more, get more" philosophy.

MS. MILLER: Yeah. Which means that ASEAN has to be a part of it. I do think the timeline would be even more extended for countries like Laos, Cambodia and Myanmar, which is why I committed the sin of omission.

CHAIRMAN REINSCH: What are the implications for ASEAN if they effectively divide and half of them join TPP and half of them don't over four or five years?

MS. MILLER: Within ASEAN, I think that does pose some challenges. There's potentially some benefits that I'm sure David could speak to in terms of the overall trade flows into the region. As they work on their economic integration, the more countries within ASEAN that are party to the TPP, the more likely there is a spillover benefit to the others.

On the other hand, there's also some risk of trade diversion that has some countries in the region very concerned. Cambodia's leader spoke out quite strongly at a recent meeting in Jakarta about the splitting nature of TPP, and that is a concern in the region. I think for the United States, if we put forward a vision, although a long-term vision, for how ASEAN members can join and put in place some programs to work with them on that more intensively--there are some now--but more intensively, that could help to ameliorate those concerns. But they are there.

CHAIRMAN REINSCH: Dr. Dapice, do you want to add something?

DR. DAPICE: Yeah. Just I would say within Vietnam there is a realization that if they don't move forward with the TPP, they will lose their ability to create some oxygen between China and the United States. They'll be sort of by their geography sucked into a one-sided relationship. They want to be neutral. I think they want to be Finland, you know, in terms of not allying with either but having the maneuver, and I think they're willing to make some sacrifices along the lines of TPP to do that.

Myanmar is in a whole other century. I've been doing a lot of work in Myanmar so I'll just say it's not at all ready.

CHAIRMAN REINSCH: Bob, do you want to say anything or are you?

DR. SUTTER: I agree fully with these comments.

CHAIRMAN REINSCH: Oh, playing it safe. Okay. Thank you, Madam Chairman.

[Laughter.]

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: Could you explain to me how China uses, could use economic coercion against Southeast Asian states that we're talking about? How would they coerce them?

MS. MILLER: I'm happy to take a crack at the answer. I think Bob has done a lot of work in this area, too.

First, there have been a number of examples that although not directed at Southeast Asian states were closely tracked in the region. You may remember in 2010 the Nobel prize was awarded to a Chinese dissident. Five years later Norway is still experiencing obstacles to their export of salmon to China. China's embargo on rare earths exports to Japan also garnered a lot of interest and attention in the region.

And the Philippines has experienced this directly. Following a flare-up in the South China Sea with China, China put a dramatic slowdown on produce exports into the Chinese market, which left a lot of bananas and papayas and pineapples rotting on the border. Mainland tourist agencies also advised Chinese tour groups that it was not safe at that time to travel to the Philippines.

As David mentioned, tourism has become an increasingly important source of revenue from China for many Southeast Asian economies, and this did have an impact on the Philippines. It didn't provoke them to change their policy, but it did add a dimension of members of the business community there going to the government and urging them to address the situation with China.

For other countries, I think this is something that lingers in the back of their calculations when they think about some of these harder strategic issues with Beijing.

DR. SUTTER: Yeah, I agree fully with that. I think the Chinese show that they're not bound by international norms when they do this sort of thing. And so the examples. They're ready to take on Japan, and they can do it in quiet ways that really are very difficult to resolve in the WTO. They can just cut off your market. They could do it to America.

So this is a reality--no, I'm not kidding. I mean--

COMMISSIONER FIEDLER: At some cost to themselves.

DR. SUTTER: Of course. Of course. But the point is they can do it, and so I think this is a lesson that all countries around China's rim understand quite well, that if they cross China, the capability of China to take egregious actions, egregious in the sense of contrary to all international norms, is quite large.

DR. DAPICE: Let me just, I completely agree with that. I mean Indonesia exports a lot of coal to China. China does not have to buy Indonesian coal. Myanmar exports a lot of rice. Sometimes those exports have been arbitrarily cut off for complicated reasons. I'm not saying it's--

COMMISSIONER FIEDLER: Well, let me, I understand--I mean, first of all, your example, two out of three were non-Southeast Asian, but I understand that episodically they can interrupt markets and have shown a willingness to do so.

The question is economic dependence. Okay. If Indonesia has got coal to sell, can it sell it somewhere else or are they dependent upon China for that and there is no other market? The same thing with rice. So the coercion works sometimes, may not work others, and works in varying degrees, and at what point can they develop a lesser dependence so that coercion is never a problem? I mean what's the tripping point here?

I mean if I'm running one of those governments, and they tend to be run by small groups of people, how do you plan for that? I mean I see U.S. companies living in fear of Chinese retaliation so I know that this exists, but if you're a state, you got to learn how to deal with that. I mean hedging is what we heard in the first panel on a security basis, so you hedge economically. Is that the best you can do?

DR. DAPICE: When you start developing a coal mine, you typically sign a 20 or 30-year agreement for sales. If you sell on the spot market, you can, of course, sell at a price, but the price might be a good deal lower if your main and normal buyer suddenly evaporates.

So the effects of these tactics, if you will, are to impose costs on people that do things they don't like, and likewise with rice. You know the rice traders who I talk to in Myanmar have invested capital bringing/trucking at high cost rice to the Chinese border, and then they start arresting Chinese traders that buy that rice, you know, so the rice price goes down, the traders suffer losses, the farmers don't get as much money.

COMMISSIONER FIEDLER: And then they go to their government to collapse on whatever issue that is motivating the Chinese at the moment?

DR. DAPICE: If Myanmar worked better, yes.

COMMISSIONER FIEDLER: I mean but that's the point, right? You only exercise coercion in order to get something?

DR. DAPICE: Or teach a lesson.

COMMISSIONER FIEDLER: Or teach a lesson. I'm having difficulty coming up with how much power, coercive power, they in fact have.

DR. SUTTER: If I could offer a suggestion. It's look at the record and see where the Chinese have actually done this and how much of an impact it's actually had. And I think you'll find it doesn't work that well, but it's there, and they can disrupt things, and it's very disruptive,

and most governments don't want that kind of disruption.

But the idea of coercing these governments to give up their sovereignty on the basis of some commercial interest is harder to see. What's the example that one would use, and I don't see any. The Chinese have been doing this practice for a long time. This is not new. And so look at the record. Where have the Chinese actually gotten a government to change its position on a certain issue because of these concerns about economics? And I don't think it's--I think there's a tendency to avoid trouble with China.

COMMISSIONER FIEDLER: The United States in 1994.

DR. SUTTER: Well, I'm not sure what you're referring to exactly.

COMMISSIONER FIEDLER: MFN on human rights--

DR. SUTTER: Yeah, that wasn't China. That was the U.S. business community, wasn't it?

COMMISSIONER FIEDLER: There was a threat to Boeing; right? Every time anybody--there was a hiccup in the relationship--

DR. SUTTER: We're getting far away from the topic.

COMMISSIONER FIEDLER: No, no, no. But it's coercive.

DR. SUTTER: Yeah, right.

COMMISSIONER FIEDLER: No, no, we're talking coercive.

DR. SUTTER: But the point is we can look for those kinds of examples with China in Southeast Asia, dig them up, find out, but my sense is it's not a big--it's a factor for making these countries cautious, not for making them give up everything because of China.

If I could, on the Cambodia example, Cambodia got benefits. The Chinese gave benefits to Hun Sen. Is Hun Sen in China's pocket? This is a very important issue, it seems to me. Hun Sen was enemy number one for China for 15 years. You need to look at the record of these people. I mean this guy is--I mean he was in charge of the regime in Cambodia that China was backing the Khmer Rouge to kill. And that went on for 15 years.

I don't think he personally has a lot of love lost for China. So would he do certain things for advantage? I think so, but is he in China's pocket? I find that very difficult to believe.

HEARING CO-CHAIR BARTHOLOMEW: So it's--I'm going to take my time--it's an interesting dynamic because I have to say that sort of building on Jeff's question, or as I understand his line of reasoning, I came into this thinking that because of the economic issues, China had more leverage or power vis-a-vis any number of these countries or sort of the region writ large, but listening to you all, I'm not even sure that the facts bear that out.

So if we just sort of go to a basic question of how important is the economic relationship between China and the individual Southeast Asian countries, perhaps it's not as important as I thought. So I'm just wondering if the coercion that Jeff is referring to, it's kind of sectoral but not a full government coercion. So I wondered, could you guys just give us a little bit more information/data on how important China is?

So we're not talking about Australia, but China's economic slowdown is having a significant impact on Australia's iron ore industry, for example. So is it that China is not as important economically to these countries as some of us might have presumed in the first place?

DR. DAPICE: Australia, of course, developed a very large and predominant, one might say, relationship with China on things like coal and iron ore. The closest you get is China, is Indonesia with coal. That's probably--and, of course, palm oil generally with Malaysia, Thailand, to some extent, and Indonesia.

But, you know, frankly, palm oil is more of an easily traded commodity. It can go lots of

places. India wants a lot of it. So outside of coal, which is not a major, I mean it's an important but not a huge Indonesian export, I would say that your intuition or your new intuition is correct, that this is not a super-important issue. It's an issue, and there will be some adjustments, but again India is growing, ASEAN is growing, the labor-intensive factories are coming into ASEAN, including Indonesia and Vietnam especially. So this is offsetting a lot of the commodity problem.

And if fewer forests are cut down for rubber and palm oil, it's not the worst thing. So I'm not saying there's no issue, but I am saying that frankly the Federal Reserve raising interest rates might be a bigger issue in the next year or two for Indonesia than China's slowdown.

HEARING CO-CHAIR BARTHOLOMEW: Ms. Miller.

MS. MILLER: Thank you.

That's an excellent question. I think that for many Southeast Asian countries, when you're thinking about the potential for coercion, that's most likely to be effective when it's an issue they don't care about very much.

So for something that's a core national interest, such as South China Sea, even though China, I think, especially short-term, particularly with Vietnam, which has a very close trading relationship with China, could exercise some punitive damage, it would be very unlikely to yield the results. If it was an issue that was farther afield, outside of Southeast Asia, then I think there is the potential for countries to make an interest calculation based on that past precedent and also the incentives that China offers.

You know we were talking about Cambodia earlier. That was, I would say, an example of inducement rather than coercion and encouraging the Cambodians to take a line along with China's on the South China Sea at the ASEAN meeting in Phnom Penh.

In terms of the economic interdependence, China is a very important trading partner, but as we've been discussing, the region has employed a pretty comprehensive hedging and diversification strategy.

HEARING CO-CHAIR BARTHOLOMEW: That's interesting.

MS. MILLER: The success of that varies among the membership so for a country like Cambodia, it's much more dependent on China than Indonesia or Thailand or the Philippines would be.

HEARING CO-CHAIR BARTHOLOMEW: Dr. Sutter, anything to add?

DR. SUTTER: I agree with the other panelists. I thought they were excellent comments. I'm struck by the interdependence of China's trade with this part of the world.

The Singapore ambassador to China said this about a year ago. He said that all the trade between China and ASEAN is very interdependent, and he said that ultimately it involves manufactured goods, production of manufactured goods. So you have more than half the Chinese--foreign trade in China is controlled by foreign-invested enterprises in China. And so there's a lot of processing trade.

And this person said, he said, okay, we have all this trade between ASEAN and China, and it produces goods. 60 percent of those goods go out of China and ASEAN. Only 22 percent stay in China-ASEAN. So China doesn't consume these goods. They go to other places like here and Europe and places like that. And so the nature of this interdependency I think is very important for China. They have to understand this and for the countries of Southeast Asia.

And so my point is that if you start looking at trade levels, you can get sort of an odd reading. I think the figures are accurate; in looking at ASEAN's trade, it's 14 percent from China, that's with China, which is pretty high, but it's not nearly as high as South Korea or

Australia or many others. And so what sort of influence does China have there? It has influence, but it's not dominant in any way. So I did react strongly to the idea of dominance, and I'm glad to hear the other speakers don't think it's a very good idea either. China is not dominant in Southeast Asia, in my view.

HEARING CO-CHAIR BARTHOLOMEW: Again, it's so interesting because for me it's a perception shift of walking in this door and then hearing what you're saying. But if we explore this interdependence issue a little bit more, the presumption there is that China has some dependence on some of these Southeast Asian economies?

DR. SUTTER: Well, they depend on foreign-invested enterprises, and so they're--

HEARING CO-CHAIR BARTHOLOMEW: So you're saying this is like Singapore's investment into--

DR. SUTTER: Or U.S. companies, U.S.-based companies, investing in China and bringing components from Southeast Asia into China to make products for export.

HEARING CO-CHAIR BARTHOLOMEW: Right.

DR. SUTTER: And this is widespread. Japan does this. South Korea does this. You know, Taiwan does this. All sorts of countries do this. So this leads to a very interdependent--you need the foreign investment in China. It leads to a great deal of interdependence. They need that, and they need the markets, and so that's--so Southeast Asia is part of this, but it's ultimately they have to behave in a way that keeps those markets open and keeps the investment coming in.

HEARING CO-CHAIR BARTHOLOMEW: Well, it doesn't seem, I mean if you were here for our earlier panel, of course, where we talked about the security issues, it doesn't seem that China seems all that concerned about how its Southeast Asian neighbors are going to react to the South China Sea, for example. It doesn't seem like that's defining or even having any impact on China's actions.

DR. SUTTER: I think you're right in that sense. We're in a new phase with Xi Jinping. He's very assertive, and he's very outwardly assertive, and he's grandiose, and he gets all this publicity. So he's sort of like Mao, you know, makes these broad things, and they have this vision of what's going to happen, but the vision, if you start parsing the vision, you find it's really full of holes, and it's very hard to implement.

And in Southeast Asia, we've seen this before. The Chinese have been talking about \$10 billion of investment funds for Southeast Asia for a decade, and the level of investment is low. It's, as was stated earlier, it's still low. It's less than ten percent if you count Hong Kong investment, too, and your Commission did an excellent study on this, showing this very well.

So this is the way China operates. It has this grand vision and moves forward with it and gets everybody excited about it, in China, at least, and a lot of people overseas, but actually what happens is a very mixed picture. I tried to lay this out in my testimony--in my written testimony--but if you look at what happened in Africa, you look at what happened in Latin America, they did the same thing. They've been doing this for 20 years. And it's limited. Sure, they're more important. The Economist had them as five percent of investment in Africa is from China.

Now that doesn't count all the infrastructure projects and so forth, but it does--it's still not--the Economist basically summed it last year and said they're one of many in Africa.

HEARING CO-CHAIR BARTHOLOMEW: Yeah, and that's off topic, but I would simply say that--

DR. SUTTER: It's the same deal in Southeast Asia, though, is the point I'm trying to make.

HEARING CO-CHAIR BARTHOLOMEW: Right, right, but a lot of Chinese

investment in Africa is enriching the people at the top of the government. So it's not as though you could, to me, that you could look at the economics of the investment without seeing why the people at the top are interested in continuing that investment coming in. I mean it's not going to have the same kind of return on investment that it might be if they were not enriching Robert Mugabe and people like that.

It's a separate topic--

DR. SUTTER: Yeah.

HEARING CO-CHAIR BARTHOLOMEW: --but I have a couple of other questions. But, Commissioner Tobin, we'll go to you.

COMMISSIONER TOBIN: Great. Thank you.

I think perfect lead-in to--my question is for Professor Sutter. You spoke eloquently in your testimony about the double game, which is somewhat of a term-of-art. Maybe I'll ask you to explain that, but I want to move from that concept of double game to your second recommendation and ask you to tell us a little bit more about it.

The second recommendation that you made: A major challenge facing U.S. policymakers involves dealing realistically with the widely publicized Chinese visions and plans for investment and assistance abroad--just what we were talking about. To do so, U.S. policymakers need an assessment of the achievements and the failures. How many of these schemes announced with great fanfare in the past have failed to be implemented?

And then you proceed to say that this would be something you might recommend being done on an unclassified level. So tell us what your whole concept is; what that would get to us if somebody like a RAND or equivalent were commissioned to do this?

DR. SUTTER: In my view--

COMMISSIONER TOBIN: I know you see something.

DR. SUTTER: Oh, yes. Well, if you took your study, the Commission's study on China's investment and economic interaction with Southeast Asia, and you did that with a very large organization with lots of resources and came up with this sort of a picture of what the Chinese have done, I think you'd find that it's a very mixed sort of picture.

What we see now is just the end part of this. We've seen all the promises of investment and so forth, and we see limited action, and the figures show it's not that great. What happened? And so I have a list. I have around 15 items that I have on my list, the big failures of the Chinese. I have a Chinese official that says most of our investments--the majority of our investments overseas are not making money. Now he said that. Okay. So why? What happened? Where did this come about? I think that would be very illuminating.

COMMISSIONER TOBIN: To kind of go through the process of the business process; right?

DR. SUTTER: No, not the business. Just do an evaluation, what happened? Where are the failures? We have excellent media coverage of the announcements, of the successes. We have almost no coverage of the failures.

COMMISSIONER TOBIN: Uh-huh. Uh-huh.

DR. SUTTER: And so we need that information, it seems, as a government, to make reasonable decisions in dealing at how big a challenge is China in these areas and how is this going to--the question for our hearing today--is this going to lead to dominance in Southeast Asia? But more broadly, it's a very powerful argument for China's power and how powerful is it? How successful has it been? And how successful is it likely to be?

I mean the comment on Chinese--Southeast Asian projects for the Chinese investment not

being bankable, this is a very telling comment.

COMMISSIONER TOBIN: Uh-huh.

DR. SUTTER: Because you're dealing with a country that still practices what they call the "win-win" principle, and they want to get paid back.

COMMISSIONER TOBIN: Uh-huh.

DR. SUTTER: They're not like the United States. They don't just provide money and don't forget about it. Or you want them--the Americans, they want you to do something. The Chinese want to get paid back. And they're very careful about this. And so where can they do this and get paid back? And so what you find is it's more limited as a result.

And so I think this kind of information would be very useful. We used to do this kind of thing in the intelligence community in the Cold War. We did this with the Soviet Union and China and other countries. I don't think it's that hard. It's hard to do, but you put a lot of people on it, and I think you can do a very good job of this.

COMMISSIONER TOBIN: Thank you. I'm intrigued by that.

HEARING CO-CHAIR BARTHOLOMEW: So I'm going to recognize one of the other Commissioners, but Dr. Sutter, I'm going to take the prerogative of the chair and push you just a little bit on this, this concept that they want to be paid back, because, again, I would argue that the Chinese have made a lot of these investments for not what we would consider a normal economic reason, that return on the investment, a financial return on investment has not been what's been driving it, and because so much of this money is state-owned enterprises or something like that, it's not what we would consider a free market calculation that's going into these investments.

So when you say that they expect to be paid back, do you mean expect to be paid back in a financial sense or that there's going to be a return on investment that might do with votes at the U.N. Human Rights Commission or supporting other things as China's role is growing in the world?

DR. SUTTER: Thank you very much.

That's a very good question. My sense in reading the literature on this subject is that in general the Chinese want to get paid back. Robert Mugabe is an exception, and if you look at how they handle him, they limit what they do for him. They're careful about this, and they look for avenues where--and they have a long payback period.

So what you'll find in the going-out strategy that China followed in the last 15 years in Africa and so forth, they were looking for resources, and so they worked with Angola, which is not seen as--you know, sometimes seen as a corrupt government, but they got paid back with oil.

HEARING CO-CHAIR BARTHOLOMEW: But again it's not a one-to-one, I invest in you, you give me a return on my investment with a percentage.

DR. SUTTER: It's not, no, no, no, it's not that kind of investment.

HEARING CO-CHAIR BARTHOLOMEW: I mean with resources maybe.

DR. SUTTER: But they want to get their money back. And being paid back means, okay, I put this much in, I want to get this much out. And that is--scholars like Deborah Brautigam and others who have looked at this, this is a very common way that the Chinese operate.

HEARING CO-CHAIR BARTHOLOMEW: I wonder if our other panelists have thoughts or comments or if they agree with this as sort of the filter that the Chinese use?

DR. DAPICE: I think the Chinese make small friendship investments where it is overtly political, and they don't really--it's either a gift or a virtual gift because of the very low interest

rates and very long time periods.

But I think the really large investments involving billions of dollars are more on Professor Sutter's lines where I mean right now they have hundreds of billions invested in Treasury bills that are paying zero and negative real rates. It would be astonishing if they didn't want to lend some of that out at five or six percent, and if they did a reasonably good job of lending it, they could probably earn a lot more and employ cement and steel industries that are underemployed and get the high-speed train factories revved up, which now have overcapacity.

So, you know, I think part of this AIIB is really a coincidence of interests. You know ASEAN needs infrastructure; China has capital and facilities and experience doing large projects like dams probably better than anyone else in the world frankly. And if you're not too concerned about the environment or displacing people or a few of those other things, they'll get the dams built, and they'll get them built more cheaply than Japan or someone else, or even Norway.

So I see this as primarily in many ways a way to reorient their resources in a way that helps them and also to some extent helps at least some groups in ASEAN. It's an important point. And it is business oriented. I mean I'll put it that way.

HEARING CO-CHAIR BARTHOLOMEW: Ms. Miller, anything to add?

MS. MILLER: I would agree with both those excellent comments. Thank you.

HEARING CO-CHAIR BARTHOLOMEW: All right. Thanks.

Commissioner Slane.

HEARING CO-CHAIR SLANE: Dr. Sutter, I was interested in your comment about the Chinese official who said to you that most of our overseas investments are not making any money. I assume you're referring to state-owned enterprises?

DR. SUTTER: This wasn't said to me. This is a report in the official Chinese media, and a Chinese official mentioned that over half of our foreign investment--over half of our invested enterprises overseas are not making money--are losing money, if I had the precise words.

HEARING CO-CHAIR SLANE: And was he referring to state-owned enterprises, do you think?

DR. SUTTER: I assume--I don't know what he was referring to, sir.

HEARING CO-CHAIR SLANE: Okay.

DR. SUTTER: But I assume it's the Chinese investments overseas. And so, but maybe he may have had a term, an area that he was talking about, but he made this broad statement.

HEARING CO-CHAIR SLANE: It's curious because the Chinese government has been pushing them to go abroad, but yet--and we were expecting--at least I was expecting to see a wave of investment here in the United States, and it just hasn't happened.

DR. SUTTER: Uh-huh.

HEARING CO-CHAIR SLANE: And I'm just wondering whether that's part of it. It seems contradictory.

DR. SUTTER: Well, I think you can make money more easily in the United States, I think, than in many other places where the Chinese are now active, but there is, I think it's important to keep in mind there is a reevaluation of the going-out approach. There are a number of reports on this. I've talked to some specialists about this.

In other words, the Chinese, it didn't work out so well in so many different places. They lost money. I have another quote from a Chinese official who says 80 percent of China's mining enterprise efforts have failed. Now, I talked to somebody who works in mining, and he said that often happens. I mean that's a figure that happens, but 80 percent is pretty high. So we have this notion that China is mining all over the place, and they're actually not working out.

So the impression still lives, but the reality is something that's different. So just to amplify my point here.

HEARING CO-CHAIR SLANE: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Senator Talent.

COMMISSIONER TALENT: Talk a little bit, if you will, about the commonalities that the countries within ASEAN perceive. How strong are they as a basis for common action? I mean I'm having trouble getting a handle on what those countries are willing to do as a group.

And then I'll go a little bit into the security field area, and I agree with you that the Chinese haven't been able to and I think they're beginning to realize they won't be able to dominate the region through economic leverage alone. Do you think that bears on the calculus regarding their military build-up and what they're doing with these islands? In other words, assuming they want to dominate the region and are reaching the conclusion they can't do it economically, will we see even more of that as a way to get their, achieve their goals with these countries?

DR. SUTTER: Commonalities among ASEAN I've found are hard, particularly on difficult questions. So I'm not sure I would talk about that, I can say much about that, as far as particularly facing off against China in any serious way. I think this is very difficult to ask ASEAN to do this. They're all hedging and maneuvering, but actually facing off against China, I don't think they're ready to do that very much at all.

The military build-up and China's expansion in Southeast Asia, as we see it, I think these are probes. They're probing. They look at the gain. If they don't meet a lot of resistance, then they go further. They're able to do this now. They have the capacity to do these kind of expanding things they're doing in the South China Sea islands.

And I don't think they have a lot of concern or really respect for ASEAN and the Southeast Asian countries. I think they think they're pretty weak. And so the problem for them, I think, is heavily the United States. And that's the problem. And so they, but right now they seem to be, they keep probing. They keep expanding in not big ways. I mean they look dramatic I guess in some ways, but they're not a military assault or anything like that, and so they're--and this is their territory from their point of view so they think they're right, and it has support at home because of the national feeling in China.

So they're moving in this direction, but I think if circumstances were to change somewhat, I think they would reconsider. I don't think they're ready to confront the United States because for many different reasons, but I think they feel one of the reasons is they're not in a particularly strong position in Asia. They really don't--the U.S. is in a much stronger position in Asia than China is in many different ways.

And so this is, so I think they have to be cautious, and I think they will be cautious if they're faced with costs. So I agree with the previous panel, particularly Mr. Cronin, and his emphasis on costs.

I think this is very important and it doesn't have to come in a direct confrontation in the South China Sea. The costs can come in lots of other places. You can do lots of other things all around the world that have complications for China that make it clear that this is part of the American reevaluation of China policy, that we want you to stop this, because I think this is very important for the United States and its interests in dealing with China.

I think we have a strong position in Asia, and China is eroding it, is undermining it, and this is serious. So I think I would favor a strong, a more coherent, and more active American approach in dealing with this issue.

DR. DAPICE: I think within ASEAN there are countries largely on the mainland but not entirely that are accommodationists, that are willing to kowtow isn't quite the right word, but, you know, make their peace with China by being somewhat deferential.

And I think there are those that are trying to balance more, like Vietnam, Philippines, Indonesia especially. I would say Thailand, Cambodia, Laos are definitely accommodationists; Malaysia by temperament if not by need. Myanmar, let's leave that open.

In fact, in Myanmar, a student of mine was trying to unpack what China means to Myanmar, and there's Beijing, there's the state enterprises, there's the Yunnan state investments, and then there's Yunnan people, probably one or two million could have come into Myanmar from China, bought citizenship cards, and are controlling quite a lot of the business there, but that's not part of a Chinese state thing. It's people with capital and marketing knowledge getting a better life for themselves.

So when you say China, what are you talking about in Myanmar? You need to unpack some of this, it seems to me. Anyway, I don't see ASEAN sticking together in the face of China. I think that is correct, and on the other hand, I think China does sort of think at least of the contiguous countries as its backyard to some extent and feels that it should have more influence, and to some extent, it does.

HEARING CO-CHAIR BARTHOLOMEW: Senator Goodwin.

COMMISSIONER GOODWIN: Thank you, Madam Chair.

Dr. Sutter, in your written testimony, you indicate that it's fairly likely that China will seek the support of the World Bank and other international economic institutions in pursuit of their investment plans, such as the pipeline through Pakistan and the Silk Road Fund and the BRICS Bank, for plans that, in your words, clearly benefit China at the expense of the United States, and your recommendation in response to which is that Congress should press the administration for a strategy that would deal effectively with this approach.

And my question is for the entire panel. What would that strategy include?

DR. SUTTER: I wish I knew more about how the U.S. deals with this now. The Chinese win contracts in Africa. These are funded by the different organizations, international, World Bank and other organizations. The World Bank still provides loans to China. This is to the tune of one to \$2 billion a year. The Asian Development Bank still provides loans to China, \$1.5 billion a year.

Most of the developed countries have foreign assistance programs of one sort or another dealing with China. All of these things are going on while the Chinese are doing this sort of stuff. And so in the previous panel, it was mentioned that China wants to keep the international system as it is. They do. They're milking it. It's very important for them.

And so this is, we need to understand this, and we need--and so I think, you know, so what do we do about it? That's a hard thing. I don't know exactly what to do. I think we need to be aware of this, but my sense is that the Chinese in their reaching out for investment, if you're going to put \$46 billion in Pakistan, this is very risky, and I don't think they want to bear all the cost themselves. They'd rather have others help them bear the costs and reliable partners like the World Bank and the Asian Development Bank.

And I think we have some voice in that, and we, the United States as a government, has some voice in that, and so my argument is, well, let's take a look at this carefully, and because otherwise we could get swept away in this wonderful thing that, oh, we're all going to invest in infrastructure that Asia needs but they can't pay for because it's not bankable, but therefore we'll provide the support for this, and the Chinese will be very careful in figuring out how they get

paid back. And so this is the pattern that I worry about.

And I've seen the Chinese look at, use these other funded mechanisms quite effectively in Africa and other places, and so I think that it's very likely that this would continue.

COMMISSIONER GOODWIN: On an individual basis with regard to a particular project, should the United States voice objections to China's eligibility to obtain funding from these international vehicles?

DR. SUTTER: I think it has to be done carefully, and I don't know what the practice is now because this doesn't get much publicity--the deliberations about these projects.

I notice the Japanese, the head of the Asian Development Bank is a Japanese individual. He said that we're going to keep high standards. So if they keep high standards, then they may turn down projects as not bankable.

But if there's a wave of enthusiasm because we have to develop Asian infrastructure and therefore modify your criteria so you be sure that this Asian infrastructure gets built, which has all the advantages for China that the previous panelists underlined very well, this is perfect for China. They're going to make lots of money on this, and they have all this capacity, and somebody else is paying for it. Wow. So much the better from their point of view.

COMMISSIONER GOODWIN: Anyone else on the panel?

MS. MILLER: That's a really important and difficult question to answer. I'll just add briefly to Bob's comments to say that I think this is a topic that the U.S. should be discussing and coordinating on more closely with other donors within those international institutions, like the World Bank and the ADB, but also on a bilateral basis going forward.

I think one thing that's going to be very important, particularly for Southeast Asia, when talking about these massive infrastructure projects that are planned is that they are set out in places that are going to benefit the capitals of the ASEAN region as well as China's ambitions for the New Silk Road and positioning itself as the economic center of gravity in the region.

COMMISSIONER TOBIN: Madam Chair, can I just ask a clarifying question?

HEARING CO-CHAIR BARTHOLOMEW: I think we have--

COMMISSIONER TOBIN: Okay.

HEARING CO-CHAIR BARTHOLOMEW: Dr. Dapice, did you have something that you wanted to add?

DR. DAPICE: Just very briefly, the billion or so lending that goes to China is like one three-thousandth of their investment so it's neither here nor there in terms of financial flows, it's so small.

If the World Bank continues its current policies of insisting on fairly strong environmental studies, displaced people, and so on, I think it would probably have some difficulty in participating very actively in at least some of the projects. I mean the whole AIIB value added from an ASEAN point of view is you won't have to jump through so many hoops, and I can see that from both sides. I think sometimes the procedures, I think for Nam Theun, which was a dam in Laos, it took about 20 years to get through all of the hoops. So sometimes the bureaucracy can get kind of overbearing.

On the other hand, in Myanmar where the Kachin were being displaced, it's not very pleasant for them. So I think China will bring a rougher approach, and there's no reason that others have to join in that. I think the reasons the Europeans did is they wanted some of the contracts. And that's what was going on there.

Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Tobin, question?

COMMISSIONER TOBIN: Just, yes, please. Professor Sutter, when you were speaking about the \$46 billion investment of China from the Asian Infrastructure Bank, and then you suggested, I think--let me just see if I'm hearing it correctly--that maybe they would go to the World Bank when it doesn't work out the way that they envision it. That wouldn't put us on the hook, would it? Is that what you were implying? It would be the World Bank on the hook perhaps to say yes or no. But how do you--can you clarify for me?

DR. SUTTER: We need to figure out what's going on. The AIIB doesn't exist yet.

COMMISSIONER TOBIN: Yes.

DR. SUTTER: So it has no funding at all. China has promised 50 billion to the AIIB. The \$46 billion for Pakistan, it's unclear where that money is going to come from. That's seen separate, in part, at least, from the Silk Road Fund. It's a very--so they have three or four big things going on at the same time here.

My point is only that there's a momentum that the Chinese are building, and the momentum is, oh, let's do this. Let's make it happen. And that's hard to stop. It's political. This is a political movement, not an economic movement.

COMMISSIONER TOBIN: Yeah.

DR. SUTTER: And you can see where investment would be supported in certain areas that wouldn't be supported under other circumstances. But the circumstances are changing. I don't mean to say that the World Bank and the ADB let politics influence their decisions, but I think they do.

And so I think this is what I'm getting at, and so, and what the role of the United States would be in this is that if the U.S. doesn't support this or is at odds with this, well, then these organizations will be using money that may not get paid back, may not--the return may not be--may come to this. So we'll lose that, and then the U.S. will be sort of in the position as the real negative outlier here, and so this is something to work on. So you need a strategy to deal with this. It is a very delicate political issue.

COMMISSIONER TOBIN: Yeah. Thank you.

HEARING CO-CHAIR BARTHOLOMEW: And actually I would add to my colleagues that there are some very specific things that could be done and need to be done. One would be confirmation of the U.S. Executive Director to the World Bank, and for the Obama administration to actually start paying attention to what's happening at the World Bank because there's a huge vacuum at the top in terms of our participation as everything is unfolding.

Dr. Dapice, I want to acknowledge particularly your emphasis, although you didn't use the word safeguards, but the environmental and human rights protections that are in there are important.

And also just mention--I've been focusing on this a lot lately elsewhere--that it's interesting that China uses some of the financial support that it gets from the international financial institutions to do things like invest in renewable energy projects, some of these things. It's another way that they're underwriting some of the costs of what they're doing. So anyway.

Commissioner Shea.

VICE CHAIRMAN SHEA: Thank you.

I was wondering if each of you could just briefly discuss a topic that's very broad, and that's the role of the Chinese ethnic communities in the ASEAN states? I know there's a long history of Chinese communities in these countries. Some of it has been very violent and unhappy, but in many of these countries, they play a prominent role in the economies.

I was just wondering if you could just sort of share your thoughts on the economic impact

of these Chinese communities in these countries and their prominence?

DR. DAPICE: Maybe I'll just start quickly. First of all, they're very important. Chinese ethnic groups who were born in these countries and whose great-great-grandfathers often came some great time ago are usually controlling quite a lot of the businesses. They almost define what we talk about in terms of crony capitalism, the "Ohnyas" in Cambodia, for example, are, you know, where they literally make contributions to become--they put it on their business card--"Ohnya."

I think that they're pretty good businessmen, but they respond to the environment they are in, and in that environment, you get more return from getting good conditions for your investment than in becoming super-efficient. So you don't get a lot of firms that are really good in global competitive terms, but you get firms that operate well within their markets.

Now, the ASEAN free trade area is breaking that up a little, but perhaps not as much as you might think. I think the main impact on Southeast Asia is it contributes to the middle income trap. Because these people are ethnically distinct, they have more trouble forming sort of political party or group that would lobby for efficiency-improving investments and policies.

And so I think one reason you're only growing at four to six percent in most of ASEAN instead of the seven or eight or nine percent that Taiwan and Korea did, I mean there are many reasons, but one of them is that the local business community is not as strong a force vis-a-vis other groups that are also entrenched.

So I think on the whole they're more or less patriotic. I don't view them as a fifth column or anything like that. I think they're good at business, but they're good at the business they're in, which is a more influence-based business, not unlike parts of Latin America frankly. And if they were better integrated politically, then I think the whole, those economies and societies would work better. I'll just stop there.

Thanks.

VICE CHAIRMAN SHEA: Thank you.

MS. MILLER: I'll just add to David's point to say that the integration of Chinese minority communities in Southeast Asia has been something that countries throughout the region have struggled with in various ways since the colonial era. It's a very diverse community in terms of people who have been living in Southeast Asia for hundreds of years and others who have immigrated in the last ten or 20.

Depending on the country, they play a very prominent role in the economy. And this is particularly true for Malaysia where Chinese language ability is quite strong and the ethnic Chinese community and the business-to-business ties are fairly robust with mainland China. Singapore, as you know, is a majority ethnic Chinese country, but interestingly has had some amount of debate in the recent election cycles about more recent immigrants from China and the impact that they're having on Singapore's economy overall.

In the Philippines and Thailand, they tend to be more closely integrated into the political and business elite.

VICE CHAIRMAN SHEA: President Aquino is from Fujian Province, his family.

MS. MILLER: Exactly.

VICE CHAIRMAN SHEA: Right.

MS. MILLER: So that's just a snapshot of a very complex picture. I think it does help to facilitate business-to-business ties, as David said. Struggles with integrating politically and culturally continue because of the legacy of both colonialism and China's association with some Communist uprisings in various countries in Southeast Asia.

DR. SUTTER: Just a couple of points to add to the complex picture that emerges in the region. The Chinese, of course, when they moved toward modernization and outreach, the first place they went to were the so-called "overseas Chinese" in Southeast Asia.

They appealed to the diaspora to invest in China, to come back, and help with the modernization. This effort in the Chinese government system is very strong. People that hold these positions that deal with liaisons, as liaisons to these communities, have a very high position, and so this is a big feature of Chinese. So they work very hard at this, having good relations with these communities in Southeast Asia and other places.

And so for the Chinese, they take this very seriously--the Chinese government takes this very seriously, it seems to me. I don't know about the attitudes. I was very impressed by the overseas, the Chinese community in the Philippines. Doing speaking there not too long--well, a few years ago, in a period of tense relations between China and the Philippines, I found that this community wasn't buying any of that. They wanted good business relations with China, and so the heck with these other things. They were concerned with that. And this was like 200 people in the audience, and they just felt this way.

So I think that the pragmatism of these folks in dealing with China, they were able to deal with China. They have advantages in lots of ways. This is I think an important force in many of these countries, and if you're looking at the Philippines and what's going to happen with the change in government in the Philippines in 2016, my working assumption is that this community, the overseas Chinese business community in the Philippines, wants to work for better relations with China. They don't want to be confronting China.

VICE CHAIRMAN SHEA: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: But we also can't forget the terrible legacy of discrimination against ethnic Chinese communities. I'm thinking particularly of the riots that happened against the Chinese in Indonesia in the 1990s. Yeah.

Commissioner Fiedler, I think you'll probably be our closing questions today.

COMMISSIONER FIEDLER: One, a comment. I'm not sure I care if the Chinese spend \$50 billion building better roads because they certainly don't have--even they don't have enough troops to guard them and control them so they'll benefit everybody. And I wouldn't mind them spending \$50 billion building roads in the United States.

[Laughter.]

COMMISSIONER FIEDLER: Since we can't get the U.S. Congress to do, to find a funding mechanism.

I wanted to raise the question of fisheries, South China Sea confrontation, sovereignty issues and their impact on Southeast Asian countries' fishing industries, which are critical industries.

DR. DAPICE: President Jokowi has outlined a maritime strategy for Indonesia, which basically says we're a maritime nation and we want to secure our oceans and resources in them, and he was aware that the Navy was quite corrupt under the previous SBY, and that something like ten to \$20 billion a year in fish were being illegally removed, and that was behind his decision to stop ships, inspect them; if they were not licensed, take the crew off and burn some of the ships.

They have satellite photos of the fishing fleets moving north because they did not wish to be burned. President Jokowi also said that the Nine-Dash Line has no basis in international law. He made that as a public statement. So I would say that, especially for Indonesia, this is something that they very much have their eye on and have spoken out publicly on and are doing

something about, and he's very popular at home.

It didn't much help relations with the people who own the ships, but that's one more example of how the ASEAN spirit only goes so far, and I'll stop there.

MS. MILLER: Let me just say first how glad I am that you raised this issue. So many of the headlines over confrontations in the South China Sea are about gas, in particular, you know, forecasts of oil resources, and while those are certainly commercially significant, when you look at the overall energy demand of the region, it's really just a drop in the bucket.

When you're talking about fish, it's absolutely critical to the food security of people all along the coastline in South China and Southeast Asia. And these disputes have provided a real obstacle to coordinating on fishery management, which is an area that it seems to me perhaps there's a way for China and Southeast Asia to creatively work together to think about ways that they could perhaps all unilaterally impose fishing bans at the same time or at least take a somewhat more coordinated approach.

But as David mentioned, for many countries in the region, some of the most tense standoffs have actually been over the arrest and detainment of fishermen. It's an issue that strikes close to the heart.

DR. SUTTER: I agree with the previous speakers. I would just add that Chinese capabilities in this area are really very large, and they're growing all the time, and their practice has been quite unilateral in dealing with this issue.

If you look at the Chinese assertiveness in the South China Sea, the leading edge was fishing, with imposing bans on fishing. They just imposed them. And Vietnam, in particular, was seriously affected by this. And so now that they have a very large coast guard, which grows all the time, they have large fleets with processing ships, and they're determined to do this, to expand, and so I wish Indonesia luck in confronting this situation. I think the Chinese want the fish, and they have, and increasingly they have the ability to get it.

And so I think that's the picture that's going to take hold. I'm not sure they're going to be cooperative in the sense of reaching agreements and so forth. Maybe that could happen, but their practice for the last ten years has been just steadily building up their capabilities so they can just force these others out.

In a way, Scarborough Shoal is an example of this kind of expansion. What happened to the Philippine fishermen in Scarborough Shoal is the kind of thing that I would expect to see more of.

COMMISSIONER FIEDLER: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: And, of course, without fisheries management, the stocks are going to get depleted, and the more the stocks are depleted, the greater the tensions are going to be with huge implications, both security-wise and on food security.

I want to thank all of our panelists. This has been very interesting, has I think forced us to reconsider some of the preconceptions we might have walked in, which is always a good thing, and I'll just announce to the group that we will break now for lunch and will reconvene at 1:30 this afternoon for our final panel.

Thank you very much.

[Whereupon, at 12:15 p.m., the hearing recessed, to reconvene at 1:29 p.m., this same day.]

PANEL III INTRODUCTION BY COMMISSIONER CAROLYN BARTHOLOMEW

HEARING CO-CHAIR BARTHOLOMEW: All right. We're going to set precedent here and start a few minutes early. Thank you to our witnesses for appearing today.

Our final panel is going to focus on China's relations with three Southeast Asian countries: Burma, Malaysia and Vietnam. Our panelists will examine the political, economic and security components of these three bilateral relationships.

Our first panelist will be Priscilla Clapp, a Senior Advisor to the Asia Society and the U.S. Institute of Peace. Ms. Clapp's work with these and other non-governmental organizations focuses on Burma. During her 30-year career with the U.S. government, she served as Chief of Mission and permanent Charge d'Affaires at the U.S. Embassy in Burma from 1999 to 2002, Deputy Chief of Mission in the U.S. Embassy in South Africa, Principal Deputy Assistant Secretary of State for Refugee Programs, Deputy Political Counselor at the U.S. Embassy in Moscow, and Chief of Political-Military Affairs in the U.S. Embassy in Japan.

She also worked on the State Department's Policy Planning Staff, in its East Asian, Political Military, and International Organizations Bureaus, and with the U.S. Arms Control and Disarmament Agency. She is the author of numerous publications on Burma and U.S. Burma policy.

Next we'll hear from Pek Koon Heng. Is that pronounced correctly?

DR. HENG: Heng.

HEARING CO-CHAIR BARTHOLOMEW: Heng. Director of the ASEAN Studies Initiative and Assistant Professor in the School of International Service at American University. Dr. Heng is a specialist in the international relations and international political economy of Southeast Asia.

She is also a Contract Course Chair of the Southeast Asia Area Studies Program in the State Department's Foreign Service Institute.

She previously taught at Hull University in England, the National University of Malaysia, and Temple University Japan. She has also been a Visiting Professor at Peking University and a Visiting Fellow at the Institute of Southeast Asian Studies in Singapore and at the Institute of Security and International Studies at a university, which I'm not going to pronounce, in Bangkok.

Finally, we have Murray Hiebert, Senior Fellow and Deputy Director of the Sumitro Chair for Southeast Asia Studies at the Center for Strategic and International Studies. Prior to joining CSIS, Mr. Hiebert was senior director for Southeast Asia at the U.S. Chamber of Commerce, where he worked to promote trade and investment opportunities between the U.S. and Asia.

Prior to that, he worked as a journalist in the Wall Street Journal's China Bureau where he covered trade and China's accession to the WTO. He has also worked for the Wall Street Journal Asia and the Far Eastern Economic Review, reporting on U.S.-Asia relations. For the Far Eastern Economic Review, he was based in Hanoi, reporting on Vietnam's economic reforms, and in Bangkok, covering political and economic developments in Vietnam, Cambodia and Laos.

Mr. Hiebert is the author of two books on Vietnam, including Chasing the Tigers.

We ask of you, as we ask of all our witnesses, that you keep your opening remarks to seven minutes. Ms. Clapp, we'll go ahead and start with you.

**OPENING STATEMENT OF PRISCILLA CLAPP
SENIOR ADVISOR, U.S. INSTITUTE OF PEACE AND THE ASIA SOCIETY**

MS. CLAPP: Thank you very much.

I'm delighted to have the opportunity today to speak with you about Burma's relations with China. But before I do so, let me just say that I've been asked to reiterate that the views I express today are my own and not those of either the U.S. Institute of Peace or the Asia Society with whom I have advisory relationships.

So with that out of the way, Burma, or Myanmar, as it's now officially known, is the largest mainland Southeast Asian country. It's about the size of Texas with a population larger than 50 million, somewhere between 50 and 60 million, depending upon how you count the people.

As I watched the earlier proceedings of this hearing today, I was struck by the strategic implications of the transition that's underway in Burma. We tend to look at it strictly in human rights terms, democratization terms, and not in its entirety as the large mainland Southeast Asian country.

Burma during the years of military government, particularly the last ten years, was more or less a dependency of China. It depended on China to protect it politically in the U.N. Security Council and other international organizations, to protect it from further sanctions or from internationalizing the unilateral sanctions that already existed. It depended upon China economically to offset the effect of the sanctions and also became economically dependent because the generals who ran the country at the time were kleptocrats. They were lining their pockets with Chinese money.

And the Chinese were very interested in the resources in Burma. It is very resource rich, and it probably has the highest biodiversity of any country in the world because it's been cut off for so long, and it has the big rivers running through it. They're all biodiversity hotspots. And the new government that has taken over in the country, that has been installed in the country, is very environmentally conscious. So this has rather stopped a lot of these projects in their tracks.

At any rate, the change that's taken place in Burma has strategic implications for both China and the United States, and I don't think we've given this proper assessment in our own calculations about our relationship with Burma. Burma is not part of the maritime equation in Southeast Asia. It's really quite removed from the situation in the South China Sea. But its relations with China are conditioned by its long land border, which is more than 1,300 miles, and it has been throughout history.

So it looks at China as a big neighbor, not as any maritime assets that it needs to protect. And it has tried very hard in the past to keep China at a distance. They did not succeed in this the last ten years of the military regime because they needed China.

As soon as the new government came in, within the first six months, or about six months after he was seated, the new president suddenly suspended construction on a huge dam the Chinese were building up in the north. That dam was going to feed energy to Yunnan Province; more than 90 percent of the output, the energy output, or the electrical energy output, of that dam was going to be shipped to China, and the generals would be paid for it.

When the president suspended it, Beijing was shocked. They didn't see this coming. And at first, they were very upset and started beating up on the new leadership. It didn't work. So they backed off and began to revise their whole business approach to Burma, and today they realize that they have to build in environmental and social standards in any project that they

undertake there.

In the first year of the new government, Chinese investment took a big hit. It went from 13 billion to one in one year. It's climbing back up again, but most of the foreign direct investment now is coming from other places, from western countries, from Japan, particularly Japan, from Southeast Asia, from ASEAN countries. China is really now not one of the major, not one of the top five major investors. It may climb back up again, but on completely different standards, and they will have to compete with the rest of the world now.

And it's been a bit of a shock to them. I think they've had to rethink how they do business, not only in Burma, in other Southeast Asian countries and in Africa.

On the security side, China looks at the border as a way of leveraging Burma, in a way, because all along the China-Burma border are a series of tribes that extend over into Burma. It's a very porous border, and they go back and forth. In the north, it's the Kachin, and then it's Kokang, and then it's the Wa, and then it's the Mong La. They're all basically Chinese minority ethnic tribes, and the border was set by the British colonial powers. So like all borders from colonial era, it's arbitrary.

And those tribes move back and forth. Many of them have been at war; all of them actually have been at war with the Burmese Army since independence. The new government is making peace with them now or trying to make peace. Some fighting has broken out again, and there's a question in Naypyitaw about Chinese complicity in this fighting.

So China has sort of used this instability on the border to pressure the central government, but it also works against China because they also, they have an interest, a trade interest, in establishing a southern Silk Road through Burma to the ocean, and they started building the pipeline and they were planning to do a high-speed rail line and a road, a major highway, and a deep water port in Kyaukpyu, which is on the Bay of Bengal.

And all of these projects--the pipeline is finished finally, but the other projects are either disappearing or not taking off, and I think a lot of that is because of inaction on the Burmese side. They're not sure that they really want to commit to opening the country to China that way. They already have large enough Chinese migration into the country, and they're concerned about being overtaken by their neighbors, either on the east side or the west side, because they're bordered by the two most heavily populated countries in the world, well, three if you count Bangladesh--Bangladesh, China, and India.

And so they feel population pressures because it's much less densely populated than the other, than their neighbors, and so they are worried about the future implications of this population density.

At any rate, their security concerns with China are quite different from the maritime Southeast Asian countries. And they're only remotely interested in the South China Sea. They managed to support ASEAN strongly during their presidency last year of ASEAN in promoting the idea of the Code of Conduct in the South China Sea. They did not cave the way that Cambodia did before, and they're perfectly willing to stand up to China. They've been doing it for centuries.

Let me just say a few things about U.S. policy. I think it's time for us to take a more strategic look at this country and not let our policy simply be governed by human rights, democracy, and so forth concerns because that leads only to punishment, punishing policies like sanctions and other forms of punishment that we have placed on them.

The sanctions have been eased, but they're all still mostly in place, and they act as a great inhibition on our economic and political relations with the country. Right now, the government

is very interested in becoming a Western style democracy. A lot of it is rhetorical at this point because they don't understand what it takes to be that kind of a democracy, but they really are looking for help and advice, not necessarily money, but advice.

They would particularly like more advice from the Congress because they're trying to put together a parliament, and their system is sort of a hybrid between ours and the British Westminster parliamentary system. So they're trying to figure out how to manage executive-legislative relations, and it's been pretty rocky the last four years.

So there's a lot that we can do for them if we could sort of bring our minds around and start working directly with them. Our sanctions don't allow us to work with the government--very closely, let's put it that way. They don't allow us to have a good dialogue with the military. We should be thinking about that.

I understand that we should not be, in fact, I support that we should not be helping a military that has been so deeply involved in human rights abuse, but we should be looking at the young, the young officers coming along. They are going to be very malleable. We should be trying to reach out to them.

One of the suggestions I make in my written testimony is that we should think about offering a few positions at some of our military academies to incoming military officers on their side who don't have a record in human rights abuse at this point. At any rate, I think we need to start thinking more broadly about our own policies.

Thank you very much.

PREPARED STATEMENT OF PRISCILLA CLAPP
SENIOR ADVISOR, U.S. INSTITUTE OF PEACE AND THE ASIA SOCIETY
China's Relations with Burma

Testimony before the U.S.-China Economic and Security Review Commission
China's Relations with Southeast Asia
May 13, 2015

Priscilla A. Clapp
U.S. Charge d'Affaires in Burma 1999-2002
Senior Advisor to the US Institute of Peace and the Asia Society¹⁰⁵

Burma and China are inextricably linked by geography, history, ethnicity, culture, and economy. The original Myanmar tribe came down from Tibet and spawned the kings who united the kingdom of Bama or Myanmar in the 12th century and became the dominant ethnic group of modern Burma, now formally known as Myanmar. The two countries share a land border of more than 1,300 miles, populated largely by tribes living on both sides of the border in Burma's eastern Shan and Kachin States and in China's southwestern Yunnan Province. The very long history of coexistence and interaction between the two countries makes their bilateral relations highly complex and often inscrutable to Western eyes.

On the whole, Burma and China have enjoyed cordial relations since the time their modern border was drawn during the British colonial years. Perhaps the major exception might be the period during China's cultural revolution when the Peoples' Liberation Army joined and supported a communist insurgency inside Burma. However, even as he was pitting his army against the communist insurgency in the country's northeast, General Ne Win, the head of Burma's military government at the time, was careful to maintain correct relations with Beijing. He also formed a close working relationship with China's then enemy, the Soviet Union, and received military and other forms of assistance from the United States. The period of conflict with the PLA, nonetheless, left an important imprint on Ne Win's military successors, all of whom earned their battle scars fighting the Chinese intruders. These former military leaders now occupy the leadership positions in both the executive and legislative branches of the government in Naypyitaw formed in 2011.

After Deng Xiao Ping came to power, Chinese support for the communist insurgency in Burma was withdrawn and Beijing encouraged the Kokang, Kachin, Wa, and Mong La insurgent border groups to negotiate cease-fire agreements with the Burmese military government. As part of the ceasefire arrangements with the military regime, these tribes were assigned relative autonomy over areas of the Shan and Kachin States, which later became enshrined in the 2008 constitution.

These ceasefire agreements and the improving relations with China coincided roughly with the 1988 popular uprising against the Ne Win government, which resulted in the formation of a new military regime in Rangoon after Ne Win stepped down. When Western governments began imposing sanctions on the military government in response to the harsh military repressions of 1988 and the regime's failure to follow through on the results of their 1990 elections, China

¹⁰⁵ The views expressed in this testimony are those of the author alone and not the Asia Society or the U.S. Institute of Peace.

became the prime source of support and protection for Burma in the international community.

Economic Relations

Since the late 1980's, China has been Burma's major source of military equipment and training, a major investor in the Burmese economy, and a major export market for Burma's wealth of natural resources. Because much of the bilateral trade has consisted of illegal cross-border activity between Burma's Kachin and Shan States and China's Yunnan Province, the totality of the bilateral economic relationship can only be roughly calculated. Furthermore, most of the Chinese mega-projects in Burma were concluded in the final years of Burma's previous military government, the State Peace and Development Council (SPDC), and the first year of the new government, creating a somewhat distorted three-year jump in Chinese investment from roughly \$1 billion to nearly \$13 billion between 2008 and 2011.¹⁰⁶ After the first year of the new government in Burma, however, Chinese investment in major projects in the country began to experience serious difficulty and total Chinese investment dropped precipitously to less than \$1 billion in fiscal year 2012/2013. In the past year, Chinese investment has tended to trend upward once again.

Chief among the troubled mega-projects have been the giant Myitsone Dam at the headwaters of the Irrawaddy River in the Kachin State, the oil and gas pipelines extending across Burma from the Burmese port of Kyaukphyu on the Bay of Bengal to China's Yunnan Province, and the expansion of the Letpadaung copper and gold mine just north of Mandalay. All three of these projects were designed to pump energy and resources into the rapidly expanding Chinese economy, particularly in Yunnan Province, and, with the advent of the new government in Burma, all three ran into serious political roadblocks in the form of public protest.

In September 2011, just six months after he took office, President Thein Sein abruptly suspended construction of the Myitsone Dam in response to mounting public opinion against it and concern for the serious downstream impact it could have on the Irrawaddy River, which is considered the country's major lifeline. A joint venture between the large Chinese state-owned enterprise CPI and the Burmese crony company Asia World, which probably had the backing of some of the country's top generals, the Myitsone Dam was designed to transmit more than 90 percent of its electricity output to China and create a lake the size of Singapore in the middle of the Kachin State, sitting on an earthquake fault line. The base of the dam appears to have been rushed into construction before the end of the SPDC and environmental groups inside and outside Burma had already begun to protest the project before the transition to the new government. President Thein Sein's sudden suspension of the construction in 2011 nonetheless came as a major shock to Beijing and created a period of tension between the two governments.

Subsequently in 2012, a long-running low-level protest by local villagers against the expansion of the Letpadaung mine mushroomed into a national movement, drawing activists from urban centers and from across the border in Thailand, demanding cancellation of the project. A joint venture between Burma's large military company the Union of Myanmar Economic Holdings

¹⁰⁶ Yun Sun, "Chinese Investment in Myanmar: What Lies Ahead?" Stimson Center Issue Brief No. 1, September 2013 in the series Great Powers and the Changing Myanmar is one of the best sources on the state of Chinese investment in Burma today. This part of my testimony draws heavily on this source.

Ltd and a Chinese state-owned arms producer Wanbao, the contract, like Myitsone, had been concluded in the final years of the SPDC with no concern for its environmental and social impact on the surrounding population. When police action against the protesters resulted in serious injury in 2012, the new government formed a parliamentary commission under the chairmanship of NLD leader Aung San Suu Kyi to produce a thorough study of the project in all its aspects and recommend solutions. Both partners to the project agreed to comply with the commission's recommendations and came up with fundamental revisions to the original agreement that essentially corrected its environmental, social, and financial imbalances. Although the core of protesters who would settle for nothing less than cancellation of the project continued their activities against it, the majority of the local inhabitants eventually came to see enough benefits from the project that it was finally allowed to proceed in 2014.

Meanwhile, the long dual oil and gas pipelines, stretching from the Bay of Bengal in Burma to Kunming in Yunnan Province, had also drawn major protests both inside and outside Burma from the time the original agreement was concluded in 2009. Once the new government was in place in Naypyitaw, the Chinese contractor was able to meet the concerns of towns and villages affected by construction of the pipeline and forged a variety of programs along the length of the pipeline that brought roads, bridges, schools, clinics, and power sources to local inhabitants. Eventually local opposition to the pipeline subsided, construction was completed, and they began operating in late 2013.

Responding to popular opposition to these large infrastructure projects, the new government ordered the renegotiation of all the large infrastructure agreements that had been concluded at the end of the previous government to ensure that they met environmental and social standards. Furthermore, it is probably fair to say that the environmental and social corrections made to the pipeline and Letpadaung mine projects by the Chinese companies had a substantial impact on China's approach to other large infrastructure projects not only in Burma, but in other countries, as well.

While the original Chinese anger over President Thein Sein's suspension of the Myitsone Dam has subsided, CPI is still pressing to move forward with the dam when the next government comes to power in Naypyitaw. Undue Chinese pressure to proceed with this project, however, runs the risk of igniting serious anti-Chinese sentiment in Burma, because the dam is not only highly unpopular with the people, but also within the leadership itself. No elected Burmese leader is likely to risk this degree of unpopularity and Beijing probably understands this.

Aside from these large projects undertaken by China's state-owned enterprises, private Chinese entrepreneurs have historically comprised a significant portion of Burma's business sector. Many migrants from China have settled in the northern part of the country, especially the urban centers of Mandalay, Lashio, Muse, and Taunggyi, purchasing Burmese identity papers from corrupt immigration officials. Much of the illicit border trade is probably associated with their businesses, as well as businesses in Yunnan Province. Yangon also has a very successful Chinese business class, but it is not necessarily connected directly with China. Rather these are people who have lived in the country for more than a generation and identify as Burmese today.

Security Relations

Burma's security and stability are significantly linked to China. Although Burma often purchases military equipment from a variety of sources, China remains the single largest source of equipment and training for Burma's military forces. Beijing has an interest in maintaining stability on its long border with Burma and generally cooperates with Burmese security organizations, both military and police, in attempting to control drug trafficking and other illegal cross-border activities, although not with great success in recent years.

Narcotics production and use in Burma have grown at alarming rates in the past ten years and Chinese traffickers are deeply involved in providing precursors, running meth and heroine labs, paying farmers to grow opium, and purchasing and trafficking the products. Unfortunately, unlike narcotics trafficking patterns a decade or more ago, when the bulk of the narcotics produced in Burma was moved to markets outside the country, today much of it goes to markets inside the country. Drug addiction has spread across the country, particularly among younger people, and the country's political leadership is becoming alarmed about its consequences.

Chinese in Yunnan Province have very close connections with the ethnic groups living along its border with Burma. The Wa, Mong La, and Kokang regions are probably better connected to Yunnan with roads and economic activity than they are to Burma itself. The principal language of these regions is Chinese and trade is conducted in Chinese currency.

The recent outbreak of fighting in the Kokang region is a good example of Naypyitaw's dilemma in managing its border with China. When the former leader of the Kokang ceasefire group was forced into exile by the Burma army in 2009, he disappeared somewhere along the border, perhaps in Yunnan, perhaps inside Burma. Late last year, he managed to regroup with a new fighting force raised and equipped in Yunnan, and he attacked the Kokang capital of Laukkai, seeking to retake his former domain and become part of the negotiation then underway with Naypyitaw for a national ceasefire agreement. The Burma Army responded forcefully to this attack and the political leadership in Naypyitaw became quite confused about Beijing's motivation in allowing such a serious battle to erupt on its border. Beijing, after all, had been closely monitoring and encouraging the national ceasefire negotiation between the Burmese government and the armed ethnic minority groups who had been battling government forces since the end of the colonial period. In his meetings with Burmese leaders, Chinese premier Xi Jin Ping had been promoting the idea of developing a major trade corridor from China through Burma to South Asia, the Middle East, and Africa.

After a period of tense interaction between Beijing and Naypyitaw during February and March this year, Naypyitaw appears to have accepted the notion that Beijing does not have assured control over the activities of border groups in Yunnan Province and was not complicit in the outbreak of fighting in Kokang. The preliminary agreement reached on a draft national ceasefire agreement at the end of March, at which the official Chinese observer was present, probably served to alleviate Naypyitaw's concern about Beijing's intentions on the border, at least for the time being.

There has also been frustration in Naypyitaw with Yunnan's support for the Kachin

Independence Organization in its continuing conflict with the Burma Army. While this support is not readily visible, there is no question that illegal cross-border trade and Chinese mining in the Kachin State provide a great deal of the wealth that supports the continuing conflict. In recent months, the Naypyitaw government has arrested two groups of Chinese truckers moving logs illegally across Kachin State to the Yunnan market, and operations have been interrupted at some of the lucrative jade mines in Hpakant.

On the whole, there is wide opportunity for much greater cooperation and coordination between Burma and China in regulating and controlling cross border activity, including drug trafficking, illegal trade, and disease control. However, until a stable ceasefire agreement and political settlement can be reached between the Burmese government and the armed ethnic groups, the border areas will remain somewhat unstable and very difficult to police.

Political and Diplomatic Relations

China and Burma enjoy what they call brotherly relations, with China often looking down on Burma as the little brother. For some twenty years, China protected the previous military regime from harmful action by the UN Security Council and helped to offset the economic effects of western sanctions on Burma. In fact, Chinese business was quite comfortable dealing with the corrupt practices of the generals who controlled the economy and the country's natural resources. Burma's military leaders, however, were not comfortable becoming so dependent on and indebted to a single great power, because Burma's post-colonial foreign policy had traditionally practiced a studied equi-distance from the world's major powers. As a founding member of the Non-Aligned Movement, for example, Burma had withdrawn from the group when it sensed that the NAM had become too aligned with one side during the Cold War.

In the final years of Burma's military regime, Beijing joined ASEAN in gently urging the generals to proceed with their plans for political transition, undoubtedly expecting that the transition would bring badly needed economic reform and improve the business climate for Chinese investments in the country, while leaving the government essentially in the hands of its military leaders. Beijing therefore appears to have observed the first year of the transition in 2011 with some alarm when it realized that the generals seemed to be using a form of western liberal democracy as the political objective of the reforms. This alarm was only intensified by the unexpected decision by President Thein Sein in September 2011 to suspend construction of China's major investment, the Myitsone Dam. It quickly became clear that the favorable investment climate China had expected might not be so hospitable after all and that Burma's new politics could risk posing a challenge to China's internal political stability.

When NLD leader Aung San Suu Kyi decided to join the new parliament in 2012, Beijing had to adjust its approach to the new government in Burma, as it began to take on true multi-party dimensions. Beijing could no longer base its bilateral relations strictly on party-to-party ties between the large Union Solidarity and Development Party (USDP) and China's Communist Party. China increasingly hosted visits by members of parliament from various parties and Chinese organizations formed a variety of new bilateral relations with the growing civil society in Burma. Realizing that China suffered from a serious deficit of analytic knowledge of Burma and its emerging political diversity, Beijing encouraged its various universities and policy research institutes to develop new study programs for Burma. Consequently, China's policy

community gradually began to grasp a more nuanced and sophisticated attitude toward its changing relations with the new Burma, particularly as it became apparent that the military no longer dominated the country's economic and political life, as it had under the SPDC.

Beijing has been especially concerned about the implications of the budding friendship between Burma and the United States, as the new government began responding to U.S. concerns about human rights and civil liberties, eventually gaining a relaxation of the harsh U.S. economic sanctions and hosting visits by top U.S. officials. Chinese political analysts began to warn that U.S. interest in Burma was actually part of a strategy to encircle and contain China around its perimeters. Travel by U.S. officials in parts of northern Burma receives special attention in the Chinese press and Beijing has remained adamant that the U.S. should not participate as an observer in the ceasefire negotiations with Burma's ethnic armed groups.

Naypyitaw has carefully cultivated its relations with Beijing, making the obligatory leadership visits to Beijing before venturing out to the United States or other western countries. The necessary apologies have been offered for accidental military incursions across Chinese borders in battles with the Kachin and Kokang, but the battles have continued. Naypyitaw has also continued to rebalance its economic ties with China by courting robust Japanese, Korean, ASEAN, and western investment. While giving rhetorically positive responses to Beijing's proposals for building an economic corridor through Burma, somehow the pieces of this corridor, such as a high speed railway and highway along the route of the pipeline and a special economic zone (SEZ) for China on the Bay of Bengal, have so far failed to come together for one reason or another. Meanwhile the Japanese SEZ at Thilawa port near Rangoon is building its first factories.

Political instability in Burma is not in China's interest and Beijing keeps a close watch on the political transition, undoubtedly preferring to see continued authoritarian characteristics in the new government. A strong NLD victory in the coming elections will test China's flexibility, because while the new head of state may not be a member of the NLD, the democracy party may well be the kingmaker in the parliament and thus a force to be reckoned with. Recognizing her rising political strength in the government, Beijing has developed channels of communication to NLD leader Aung San Suu Kyi and senior members of her party and has praised her for leading the solution to the Letpadaung mine protest. And finally, Beijing is very sensitive to any signs of rising anti-Chinese sentiment in Burma, for fear that it could quickly turn violent against Chinese residents, as it has in the past.

Senior members of the new government in Naypyitaw have from time to time expressed concern about the prospect of Burma becoming a battleground for U.S.-Chinese competition and suggested that both governments should make efforts to cooperate in the country's economic development. At the same time, if cooperative U.S.-Chinese efforts in Burma were to materialize, this could raise another set of concerns about great power collusion. Therefore such efforts have so far been limited to trilateral conferences and academic conversations about comparative perspectives on Burma's transition. Furthermore, there is little convergence between U.S. and Chinese interests in Burma upon which to build cooperative efforts.

As if to disprove Chinese conspiracy theories that the U.S. sees Burma as part of a containment

strategy, for more than 25 years, U.S. policy in Burma has focused consistently on the promotion of democratic political development and respect for human rights. U.S. economic and political sanctions against Burma in pursuit of these policy objectives have effectively inhibited the development of political, diplomatic, and economic relations with the country until the past two or three years. In fact, U.S. bilateral relations with Burma are still at a formative stage, with only tentative efforts at building political and economic ties, until the country's reforms have become more clearly sustainable. U.S. objectives in Burma, therefore, have had little bearing on its proximity to China or to larger U.S. objectives in its own massive bilateral relationship with China. For these reasons, Burma is unlikely to be an area of U.S. competition with China. China will remain an essential neighbor and economic partner to Burma and the United States will continue to promote Burma's democratic development from half way around the world.

Relations with the Neighborhood

Burma is a committed member of ASEAN and views the organization as a form of protection against exploitation by any of the world's major powers, particularly those in its neighborhood. ASEAN provides all of its members, not least of all Burma, with an organizing principle for managing Southeast Asia's relations with the rest of the world. The East West Center calculates, for example, that ASEAN is now the third largest trading partner for the United States, after Japan and China, and it provides the largest destination for U.S. exports.¹⁰⁷

During the final years of Burma's military government, the U.S. government even sacrificed its political relationship with ASEAN on the altar of sanctions, refusing to send senior officials to high-level ASEAN meetings as a means of punishing the organization for having accepted Burma as a member in 1996. In the final analysis, however, ASEAN was a major motivator behind Burma's transition, when it began to move forward in 2010. Most tellingly, the organization convinced Burma's military leaders to step aside from its turn to chair the organization in 2006 until it had completed its so-called "seven step" move to democracy, effectively speeding up the transition and providing a stable regional environment for undertaking serious political change.

When the new government in Burma finally got its turn to chair ASEAN in 2014, it was determined not to repeat Cambodia's experience in the chair, when it caved to Chinese pressure and prevented an ASEAN statement on the South China Sea. As chair of ASEAN, Naypyitaw successfully maneuvered ASEAN support for a code of conduct in the South China Sea and managed to avert Chinese pressure against it. Burma can be expected to remain a loyal, if not particularly dynamic, member of ASEAN, although it will strain to meet the structural and other requirements of ASEAN economic integration.

Geographically, Burma sits between India and China. In the past, India tended to view Burma as an arena of military and economic competition with China, often sounding the alarm about Chinese military installations in Burma. With time it has become clear that Burma opposes the stationing of any foreign military on its territory and that India's democratic economic system is not geared to competing directly with China's centrally driven investment machine. India remains a key economic partner for Burma, especially as a major market for beans and pulses,

¹⁰⁷ <http://www.asiamattersforamerica.org/asean/data/trade/importexport>

but its investments in Burma are dwarfed by those of the other large Asian economies of China, Japan, and Korea.

With the change of government in 2011, Japan reached out with major new investment and aid packages that have created a dramatic spike in Japan's stake in Burma's economy. Among other things, Japan provided the necessary loan guarantees to remove Burma's debt to international financial institutions, making it possible for them to resume assistance to Burma. Japanese investment and ODA has been the driving force behind development of Burma's first Special Economic Zone at Thilawa port near Rangoon and it has contributed significantly to infrastructure projects for transportation and electricity. In fact, the steep drop in Chinese investment in 2012 and 2013 was more than offset by Japanese and other foreign investment. Burma's FDI rose from \$329.6 million in 2009-2010 to more than \$8.1 billion in fiscal year 2014-2015, thanks largely to investment in telecoms, energy, and manufacturing.¹⁰⁸

Thoughts on U.S. Policy toward Burma

The coming elections in Burma this year will be a key turning point in the political transition. Although the 2008 constitution poses a number of undemocratic structural impediments to truly free and fair elections,¹⁰⁹ if the existing rules governing competition for the elected parliamentary seats are applied fairly, Aung San Suu Kyi's National League for Democracy (NLD) is likely to become the single largest party in the parliament and have a major impact on the country's political future in the next five-year parliamentary term. Although the current government deserves credit for creating the conditions for the NLD to rise to a prime political position after nearly 25 years of severe repression, this will nonetheless be a serious test of whether the country's former and current military leaders genuinely intend to develop democratic governance in Burma. One way or the other, the results of the elections will also have continuing consequences for Burma's relations with China.

In my estimation, it is time for the United States to strengthen its commitment to Burma's democratic future by expanding U.S. engagement in all respects. Over the past four years, U.S. assistance to Burmese civil society has made a critical contribution to the rise of civilian power in the country's political and social life. U.S. institutions are helping with election preparations and will be participating in the elections as observers. The easing of economic sanctions has allowed U.S. business to invest significantly within the rules of responsible engagement laid out by the U.S. State and Treasury Departments. As such, it is helping to create a modern business environment in the country that will improve the prospects for future investment.

However, the remaining U.S. sanctions still present serious impediments to full U.S. engagement in building the country's democratic future. We should be prepared to assist also in strengthening government institutions to implement reforms effectively; in developing the badly needed structures to support rule of law; and in forging effective channels of communication with the military. If it is still too soon to engage directly with senior military, we should at least

¹⁰⁸ <http://www.reuters.com/article/2015/03/25/myanmar-investment-idUSL3N0WR25Q20150325>

¹⁰⁹ For example, eligibility rules for the presidency are restrictive, 25 percent of parliamentary seats are occupied by appointed military personnel, and sparsely populated constituencies have greater weight in the national parliament than more densely populated urban areas.

be offering the new generation of military officers an opportunity to be educated in our prestigious military academies, where an appreciation of the role of the military in a democracy can be instilled. We should develop a fair and transparent exit strategy for those individuals and businesses that remain on the U.S. list of Specially Designated Nationals with whom U.S. entities are enjoined from engaging. Instead of continuing to sanction the country for its weak banking institutions that are susceptible to money laundering and for its narcotics and human trafficking problems that are driven in large part by neighboring countries, we should be sending the expertise to help them tackle these problems more robustly.

The experience of the past four years has produced enough evidence that, unlike many countries in other parts of the world where the U.S. is fully engaged, Burma has a good chance of building a democratic future. However, it is not realistic to expect that full-fledged democracy will spring to life overnight in a country that has been held in a state of arrested development for more than 50 years. The rapid pace of change during the past four years has created serious social strains that will take time to resolve. Our response to these problems should not be further punishment, but rather more active efforts to help develop the political, economic, and social institutions required for stable democratic governance. The United States is uniquely positioned to help with this critical task.

**OPENING STATEMENT OF PEK KOON HENG
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DR. HENG: Good afternoon. Thank you for inviting me to appear before the Commission.

My answers to the questions posed to me are drawn from analysis of Malaysia-China relations within the wider context of Malaysia-ASEAN and Malaysia-U.S. relations.

A medium-sized nation, covering an area slightly larger than New Mexico, inhabited by a multi-ethnic population of 30 million, the organizing principles of Malaysia's external relations with both China and the U.S. are: first, to maintain an "equidistant" policy towards both; to foster vibrant economic and otherwise productive relations with each other; and minimize the potential for interference in its domestic racially and religiously charged politics.

Although Malaysia has today close and essentially irritant-free relations with both China and the U.S., China's recent strident assertiveness in the South China Sea has been deeply troubling, causing Malaysia to seek closer security ties with the U.S. Furthermore, as the current ASEAN chair, Malaysia is well positioned to support near-term U.S. security interests in the region.

In response to the Commission's questions, let me begin by noting that Malaysia became the first country in Southeast Asia to establish diplomatic ties with Beijing. After the CCP ended party-to-party ties with the Malaysian Communist Party in 1978, political relations became warm and productive. In 2013, both countries upgraded their relationship to a "Comprehensive Strategic Partnership."

As a founding member of ASEAN, Malaysia has actively promoted China's participation in all ASEAN-led institutions and was instrumental in facilitating full dialogue partnership for Beijing in 1996.

Until the recent incursions of a Chinese naval flotilla in waters also claimed by Malaysia, Kuala Lumpur has had no cause to view China as a direct security threat. Over more than 40 years, Beijing has displayed a hands-off policy by not attempting to exploit Malaysian-Chinese grievances, particularly those arising from the government's preferential treatment of Malay Muslim majority population.

The robustness of that relationship was much in evidence during the last year's MH370 tragedy, which resulted in the loss of 154 Chinese lives. Beijing's criticisms of Malaysia's handling of the missing airplane was notably tempered. Unlike the outraged protests outside the U.S. Embassy following the 1999 U.S. bombing of the Chinese Embassy in Belgrade, Beijing only permitted peaceful demonstrations outside the Malaysian Embassy in Beijing.

Economic cooperation is very strong. In 2008, Malaysia became China's largest trade partner in ASEAN, and the third largest in Asia after Japan and South Korea. And China became Malaysia's top trade partner in 2010.

Malaysian Chinese entrepreneurs, facilitated by cultural, linguistic, and familial bonds, were among the first generation of foreign investors to invest in China. They have also expedited the second wave of Malaysian FDI, which comprises an increasing component of Malaysian government-linked companies.

The stock of Malaysian FDI in China reached \$7 billion in 2013, an amount that dwarfed Chinese investments in Malaysia that stands at \$1 billion. However, China is set dramatically to increase its Malaysia-bound investments when Malaysia and China state-controlled companies

will jointly develop industrial parks and other infrastructural projects.

By becoming a founder member of the AIIB, Malaysia has signaled its intent to play a leading role in China's economic regional integration strategy and has proposed to Beijing to set up an AIIB ASEAN office in Kuala Lumpur.

There have been no security, no major security disputes, between the two countries since the end of the Emergency in Malaysia. But security cooperation is quite limited compared to the strong defense ties that Malaysia has with the U.S.

Malaysia and China signed their first defense MOU in 2005, held their first formal security consultation in 2012, and waited until last year to conduct their first bilateral military exercise.

With regard to disputes in the South China Sea, China has not publicly criticized Malaysia's extensive oil and gas activities and reclamation projects in waters that fall within its Nine-Dash Line. Beijing's soft treatment of Malaysia, in sharp contrast to its aggressive handling of Vietnam and Philippines, might be due to the fact that, one, Beijing currently has its hands full dealing with Vietnam and the Philippines; two, unlike Vietnam and the Philippines, Malaysia and China have deep energy ties. Malaysia is China's third-largest LNG supplier, and China participates in Petronas-led projects outside the region. And, thirdly, China does not want to push Malaysia closer toward the U.S., which security ties with Malaysia have become tighter since President Obama's rebalance to Asia.

However, recent incursions of PLA naval vessels some 50 miles off Malaysia's coast and the Chinese building of a military strip, air strip, in the southern Spratlys have been a serious cause of concern to Malaysian security strategists.

On transitional and non-traditional security challenges, Malaysia's cooperation with China is limited, compared to the robust partnership it has with the U.S. on a wide spectrum of issues covering illegal migrant workers, refugees, trafficking in persons, drugs and terrorism, combating maritime security and money laundering, and responding to natural disasters.

In the area of Malaysia-ASEAN-China relations, Malaysia has actively sought to integrate China in the ASEAN-led economic regional architecture, and in turn seeks to benefit from China's AIIB and Maritime Silk Road initiative.

At the same time, it should be noted that Prime Minister Najib sees the TPP as a framework for Malaysia to achieve advanced economic status by 2020, not to China but to the U.S. that it turns to for high-tech, high quality investments.

While there doesn't appear to be a downside in Malaysia-China-ASEAN economic ties, the security dimension is more complex. Malaysia sees ASEAN as the preferred platform to conclude a binding ASEAN-China Code of Conduct to manage its bilateral territorial disputes with China. At the same time, it doesn't want to endanger its ties to Beijing.

However, unlike Cambodia in 2012, Malaysia as ASEAN chair acknowledges the concerns of Hanoi and Manila, as evident in the statement that was released in the recently concluded ASEAN Summit.

To conclude, I have five recommendations for congressional action and four for executive branch action. My five recommendations for action by Congress is:

One, pass the TPA. It is necessary that the TPP is concluded. Otherwise, America's reputation and political standing in Southeast Asia will suffer, and China's AIIB will be advanced.

Two, maintain a high level of bipartisan congressional support for America's Asia rebalance policy and ensure that the winner of the 2016 presidential race continues to make

engagement with ASEAN a centerpiece of U.S. policy in Asia.

Three, obtain funding to support and sustain the rebalance policy that has won new friends and staunch partners, including Malaysia.

Four, join UNCLOS to provide a solid legal bedrock to support ASEAN's efforts to conclude a binding Code of Conduct in the South China Sea with China.

Five, join the AIIB so Washington can exert influence from inside, together with its European allies, to set up high standards of diligence and transparency in the bank's decision-making processes.

And my four recommendations for action by Congress and the executive branch are:

One, set up, immediately set up working committees to implement the Malaysia-U.S. Comprehensive Partnerships signed by President Obama and Najib, Prime Minister Najib, in April 2014.

Two, promote U.S. private sector investments, especially in infrastructural projects, in Malaysia through AmCHAM.

Three, support "ASEAN centrality" in order to prevent it from being divided and marginalized by China's coercive diplomacy in the South China Sea.

And finally, give support, give full support to Malaysia as ASEAN chair and work with Malaysia and other claimant ASEAN states in establishing an ASEAN-based conflict prevention and rapid response mechanism to deal with localized incidents in the South China Sea before they break out into open conflict.

ASEAN may be viewed by some in Washington as nothing more than a "talk shop," but it remains America's best multilateral instrumentality for helping advance its maritime and other geostrategic and political objectives in the region.

Thank you.

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Testimony before the U.S.-China Economic and Security Review Commission

HEARING ON CHINA'S RELATIONS WITH SOUTHEAST ASIA

May 13, 2015

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Written Statement

My answers to the specific questions asked by the Commission regarding Malaysia's relations with China, and the impact of that relationship on Malaysia's interactions with the Association of Southeast Asian Nations (ASEAN) and the United States are drawn from the paper's analysis of the development of Malaysia-China relations within the wider context of Malaysia-China-ASEAN and Malaysia-United States relations covering the period from Malaysia's attainment of independence in 1957 until the present. The paper concludes with policy recommendations addressed to Malaysia-China, Malaysia-U.S., and Malaysia-ASEAN relations.

Driving Principles of Malaysia's Foreign Policy

A medium-sized nation, covering an area slightly larger than New Mexico and inhabited by a multi-ethnic population estimated at 30 million in 2010,¹¹⁰ Malaysia's foreign policy has consistently manifested roughly the same mix of objectives focused on promoting domestic stability, fostering economic growth, maintaining regime legitimacy, safeguarding national sovereignty, and taking steps aimed at ensuring an external environment conducive to regional stability and economic prosperity. Over the years since its independence in 1957 the leaders of first Malaya and then (since 1963) Malaysia have closely associated themselves with the political and economic values espoused by Western democracies, while at the same time keeping a wary eye on developments in the People's Republic of China, the nation they have long expected they would one day have to reckon with as the region's dominant player. During this same period these leaders have also given priority to maintaining strong relations with the United States, partly because of direct bilateral benefits to be gained and partly because they recognize that U.S. power makes it the only viable counterweight to Chinese assertive expansionism. With such considerations in mind, Malaysia has since the end of the Vietnam War essentially pursued a hedging posture, one that seeks to safeguard national security while deriving maximum economic benefits from expanding trade and investment ties with both the United States and

¹¹⁰ The population is broken down into: Malay 50.1%, Chinese 22.6%, indigenous 11.8%, Indian 6.7%, other 0.7%, non-citizens 8.2%. *CIA World Factbook: Malaysia*, 2010.

China. This foreign policy stance has been variously described by scholars as one that seeks to maintain “equidistance” between U.S. and China,¹¹¹ as one that strives to avoid dominance by either power while embracing engagement with both,¹¹² and as one that relies on a strategy of “middlepowermanship” to enable the country to “balance, hedge, and countervail the foreign policies of major powers.”¹¹³

Six Malaysian Prime Ministers have steered the course of Malaysia-China ties since 1957: Tunku Abdul Rahman Putra Al Haj (1957-1970), Tun Abdul Razak Hussein (1970-1976), Tun Hussein Onn (1976-1981), Tun Dr. Mahathir Mohamad (1981-2003), Tun Abdullah Ahmad Badawi (2003-2009) and Datuk Najib Abdul Razak (2009-present). In the political and economic realms, Malaysian foreign policy goals have consistently revolved around forging racial harmony among the country’s majority Malay Muslim and minority non-Muslim Chinese and Indian communities; promoting economic development while redistributing national wealth in an equitable manner between Malays and non-Malays through Malay (*bumiputera*) affirmative action; and enhancing the legitimacy of the United Malays National Organization (UMNO)-dominated National Front (*Barisan Nasional*) government coalition that has held power since 1957.

Malaysia-China Relations, 1957-present

When Malaysia attained independence from Britain in 1957, it was still traumatized by the Chinese Communist Party’s (CCP) backing of the Malayan Communist Party (MCP) insurrection in 1948 that sought to establish a People’s Republic of Malaya. The UMNO leadership continued to view China as one of Malaysia’s greatest security threat, even when China was undergoing massive economic, social and political upheavals under Mao Zedong’s Great Leap Forward and Cultural Revolution campaigns from 1960 to the mid 1970s. Such a perception stemmed from the support the MCP received from the Chinese-educated working class, who formed the majority of the immigrant Chinese community (which constituted 38% of the population in 1957), and whose loyalty was considered by the Malay leadership to be primarily China-centric.¹¹⁴ Although the insurrection was effectively quelled by the late 1950’s, Beijing patronage of the MCP accounted for Malaysia’s firmly pro-West foreign policy during the major part of the Cold War. Strong relations with London were viewed as paramount to the new nation’s security and political development, while Washington was considered an important potential partner for expanding and diversifying economic ties.

It was not until 1974 that Malaysia, under Prime Minister Abdul Razak, established diplomatic ties with China. It was the first country in Southeast Asia to do so. Malaysia’s overture to China was a carefully calibrated response to the changing regional security and economic landscape that emerged after 1970 in the wake of President Richard Nixon’s “One China” policy, the U.S.

¹¹¹ Kuik Cheng Chwee, “Malaysia-China Relations: Three Enduring Themes,” Meredith Weiss, ed., *Routledge Handbook of Contemporary Malaysia*, 2014: 417-427.

¹¹² Helen Nesadurai, “Malaysia and the United States: Rejecting Dominance, Embracing Engagement,” RSIS Working Paper no.72/04, RSIS, Singapore, 2004.

¹¹³ Johan Saravanmuttu, *Malaysia’s Foreign Policy: The First Fifty Years: Alignment, Neutralism, Islamism*, Institute of Southeast Asian Studies, 2010: 330.

¹¹⁴ Heng Pek Koon, *Chinese Politics in Malaysia: A History of the Malaysian Chinese Association*. Oxford University Press, 1988.

military disengagement and withdrawal from Vietnam, and China's transition to a state-guided, market-driven economy under Deng Xiaoping's "Opening and Reform" policy.

The transformation in Malaysia's China policy from hostility to rapprochement and strong friendship resulted from five key developments: (1) severance of party-to-party ties in 1978 between the CCP and the MCP; (2) promulgation of China's new citizenship laws in 1989, which ceased to recognize "Overseas Chinese" as nationals of China; (3) introduction of Prime Minister Mahathir's "Look East" policy in 1981 which sought to increase trade and economic ties first with Japan and subsequently with a rapidly modernizing China that had become more receptive than Japan to foreign investments; (4) China's support of Mahathir's proposal in 1991 of an East Asia Economic Grouping (EAEG), an Asia-only economic integration framework; and (5) China's decision not to devalue its currency in the wake of the Asian Financial Crisis, a decision that positively benefited Malaysia by allowing its exports to remain competitive in the U.S. and European markets.¹¹⁵ Malaysia's diplomatic breakthrough with Beijing paved the way for the normalization of ties by other Southeast Asia countries that had also been unhappy with Beijing's support of their domestic communist movements. Thailand and the Philippines established ties in 1975, though Indonesia and Singapore did not do so until 1990.

The Economic Dimension of Malaysia- China Relations and Enhanced Cooperation under the Comprehensive Strategic Partnership

In October 2013 Prime Minister Najib Razak and President Xi Jinping upgraded the "special relationship" of their two countries to a "Comprehensive Strategic Partnership." While the new partnership envisaged enhancing ties across a broad spectrum of cooperative activities, the major focus is economic cooperation, the strongest pillar of the bilateral relationship. Since 2008, Malaysia has been China's largest trading partner in ASEAN as well as its third-largest in Asia after Japan and South Korea, a notable achievement given Malaysia's modest-sized 30 million population. China surpassed Singapore in 2010 to become Malaysia's top trading partner. Bilateral trade reached \$106 billion in 2014 and both sides pledged to increase trade volume to \$160 billion by 2017.¹¹⁶

¹¹⁵ See, e.g., Kuik, "Malaysia-China Relations: Three Enduring Themes."

¹¹⁶ Ernest Bower & Phuong Nguyen, "Will China-Malaysia Relations Remain a Model for Asia?" CSIS. February 18, 2014. <http://cogitasia.com/will-china-malaysia-relations-remain-a-model-for-asia/>.

(In comparison to Malaysia-China trade that amounted to MR203.2 billion in 2013, the figure for Malaysia-US trade was MR109.0)¹¹⁷

Malaysian Chinese entrepreneurs were among the first generation of foreign investors to finance the initial low-capital, labor-intensive phase of China's capitalist opening under Deng Xiaoping. Led by businessmen such as Robert Kuok (whose investments in China include high profile real estate holdings such as the Shangri-La Hotel chain and a 87.5% stake of Coca-Cola's bottling venture as of 2012)¹¹⁸ and William Cheng (whose Lion Group owns real estate, department stores and breweries in China), the entry of these Malaysian Chinese business pioneers into the new China market was facilitated by cultural, linguistic and familial bonds that ethnic Chinese in Malaysia drew from their ancestral home country. The business know-how, Chinese language and cross-cultural skills of Malaysian Chinese entrepreneurs have enabled and leveraged the second wave of Malaysian foreign direct investment (FDI) in China that went in after the 1997 Asian Financial Crisis. This latter wave comprises an increasing component of Malaysian government-linked companies (GLCs), in which Khazanah Nasional, the country's sovereign wealth fund, holds substantial stakes. With access to seemingly unlimited public sector funding and political patronage, the investments made by Khazanah and other GLCs, such as Sime Darby, the world's largest palm oil plantations owner, are significantly larger, and are more capital and technology intensive than the pioneer wave of private sector Malaysian Chinese FDI.¹¹⁹

The stock of Malaysian FDI in China reached \$7 billion in 2013, an amount that dwarfed Chinese FDI in Malaysia, which amounted to \$1 billion.¹²⁰ However, China is set to dramatically increase its Malaysia-bound investments under the Comprehensive Strategic Partnership. It will co-fund the China-Malaysia Qinzhou Industrial Park in Guangxi Province, the Malaysia-China Kuantan Industrial Park in Prime Minister Najib's home state of Pahang, and a significant upgrading of the Malaysian port of Kuantan. To maximize the synergies in their economies, the industrial park in China will specialize in food processing, biotechnology, and information technology, and the Kuantan site will host businesses in steel manufacturing, aluminum processing, and palm oil refinery. The two countries also pledged to undertake cooperation in telecommunication, remote sensing satellite and biological technology.¹²¹ Economic cooperation recently expanded into the financial sector, with the two countries' central banks agreeing to establish a yuan clearing bank in Kuala Lumpur as part of China's quest to internationalize the renminbi. Malaysia was the first country outside China to use the renminbi for trade settlement and has grown to become one of the world's top 10 offshore yuan centers and the second country in Southeast Asia, after Singapore, to host a yuan clearing bank.¹²²

¹¹⁷ Malaysian Ministry of International Trade and Industry 2013 Report. The exchange rate is roughly MR3 to \$1.

¹¹⁸ "The world's shrewdest businessman – Founder of Shangri-La Mr. Kuok." April 1, 2012.

<https://stulanglaut.wordpress.com/2012/01/04/the-worlds-shrewdest-businessman-founder-of-shangri-la-mr-kuok/>.

¹¹⁹ See, e.g., <http://www.thestar.com.my/Business/Business-News/2013/10/04/Khazanah-Nasional-invests-RM486m-in-exposure-to-China-enviro-sector/?style=biz>; and

http://www.khazanah.com.my/docs/Media%20Statement_Khazanah%20and%20Beijing%20Enterprises%20Group%20forge%20partnerships%20in%20environmental%20related%20sectors_4Oct2013.pdf.

¹²⁰ "MCCC: Malaysia to see influx of China FDI." *The Edge*, December 16, 2014.

<http://www.msn.com/en-my/money/topstories/mccc-malaysia-to-see-influx-of-china-fdi/ar-BBGRMI>.

Expanding Economic Cooperation under China's Maritime Silk Road Initiative and Asian Infrastructure Investment Bank

President Xi Jinping's announcement of the 21st Century Maritime Silk Road (MRI) initiative in October 2013 and establishment of the Asian Infrastructure Investment Bank (AIIB) in April 2015 to fund MRI-related projects will further deepen Malaysia-China economic cooperation. Buttressed by the proposed overland Silk Road Economic Belt (SREB), the Maritime Silk Road (MSR) will build up port and maritime connectivity to broaden China's trade channels with the maritime regions of Southeast Asia, South Asia, the Middle East and East Africa. That geographic footprint harks back to Imperial China's historic maritime tribute trade routes, which reached their apogee during the Ming Dynasty (1368-1644). Together with the overland routes for land transportation corridors that connect China to Europe as well as all other major Asian sub-regions, including Indochina, Southwest and Central Asia, the Silk Road Economic Belt and Maritime Silk Road (termed "One Belt one Road," or OBOR) are intended to lay the foundations of a Sino-centric new world economic order. Through muscular trade diplomacy and infrastructure diplomacy, Xi Jinping envisages a resurgent Chinese Middle Kingdom superpower at the apex of a new order spanning Asia, Africa and Europe.

Apart from providing \$50 billion toward the \$100 billion initial capital for the AIIB, China has set aside another \$40 billion for MRI projects. Responding positively to the opportunity to fund its "infrastructure investment gap" (an Asian Development Bank study in 2009 predicted that Malaysia will need \$188 billion to finance planned infrastructure projects between 2010 and 2010), Malaysia was one of AIIB's 35 Prospective Founding Members (PFMs), and another 23 countries have applied for this status.¹²³ Malaysia's priority projects include a high-speed rail connection between Kuala Lumpur and Singapore, the first of its kind in Southeast Asia, which has drawn interest from the China Railway Construction Corporation as well as companies from Japan, Germany and France.¹²⁴ Due to Malaysia's support for the AIIB, the chief economist of the country's leading bank, Maybank, has proposed that Beijing set up an AIIB ASEAN Office in Kuala Lumpur to coordinate its ASEAN activities.¹²⁵

The robust economic foundations of the bilateral relationship served Kuala Lumpur well during the MH370 tragedy that resulted in the loss of 154 Chinese lives in March 2014, when the ill-fated Malaysian Airlines carrier disappeared without a trace in the Indian Ocean.¹²⁶ That tragedy occurred soon after the two countries launched the "Malaysia-China Friendship Year" to celebrate the 40th anniversary of diplomatic ties. Beijing criticism of Malaysia's handling of the missing airplane was notably tempered and has not cost damage to the relationship. Unlike the outraged protests outside the U.S. Embassy following the U.S. bombing of the Chinese Embassy

¹²¹"Malaysia, China Agrees to Lift Ties To Comprehensive Strategic Partnership." October 4, 2013. http://news.xinhuanet.com/english/china/2013-10/04/c_132772213.htm.

¹²²"Malaysia, China to take ASEAN-China FTA to next level," *The Sun Daily*, May 31, 2014. <http://www.thesundaily.my/news/1064215>.

¹²³ Larkin, Stuart, *The Conflicted Role of the AIIB in Southeast Asia*, ISEAS Perspective #23, May 8, 2015: 3.

¹²⁴"Chinese firms have leg up in deal for Kuala Lumpur-Singapore rail line." March 11, 2015. <http://english.caixin.com/2015-03-11/100790345.html>.

¹²⁵"AIIB to provide new infrastructure funding avenue, promote China-ASEAN connectivity: Malaysian economist." April 27, 2015. http://www.asean-china-center.org/english/2015-04/27/c_134187284.htm.

¹²⁶"MH370 search area will be expanded if no discovery made by May: Liow," *New Straits Times*, April 16, 2015. <http://www.nst.com.my/node/80716>.

in Belgrade in 1999, Beijing only permitted peaceful rallies outside the Malaysian Embassy in Beijing.¹²⁷ Not seeing Malaysia as having any ulterior motive behind the loss of its nationals, Beijing's measured reaction has allowed the two countries to maintain strong ties, and the two countries continue to cooperate in joint search operations in the Indian Ocean, aided by Australia.

The Political-Security Dimension of Malaysia-China Relations

While the political relationship between Malaysia and China was not affected by the MH370 tragedy, the resurgence of Chinese assertiveness in the South China Sea may prove much more difficult to handle. Although to date China has not directed any of its coercive maritime tactics toward Malaysia, unlike its hostile treatment of territories claimed by Vietnam and the Philippines, recent Chinese naval incursions into territorial waters claimed by Malaysia have caused serious concern among Malaysia's strategic thinkers.

Unlike Malaysia-U.S. security relations that have broadened and strengthened over the past four decades (discussed further on), Malaysia's security cooperation with China is recent and quite limited. After signing their initial defense MOU in 2005, the first formal security consultation between Malaysian and Chinese senior defense officials to increase exchanges between the two militaries, deepen law enforcement, and strengthen counter-terrorism and transnational crime cooperation was held only in 2012. It was not until 2014 that the two countries conducted their first bilateral military exercise.¹²⁸

Renewed Tensions in the South China Sea

China's charm offensive and good neighbor policy in South East Asia, exemplified by its accession to the ASEAN-sponsored Declaration of the Code of Conduct in the South China Sea in 2002 effectively ended in April 2010, when Beijing reasserted its "indisputable claim" by declaring that the South China Sea was a "core interest" of China's on a par with its claims to Taiwan, Tibet and Xinjiang.¹²⁹ Chinese reassertion of its maritime claims has been viewed by some observers as a proactive response to the moves of other claimant states to solidify their claims vis-à-vis Beijing.¹³⁰ Malaysia and Vietnam's joint submission to the UN Commission on the Limits of the Continental Shelf in May 2009, requesting information pertaining to their respective extended continental shelf claims, triggered off the current round of renewed tensions. Chinese analysts argue that the US pivot to Asia had emboldened ASEAN claimants to advance their claims at a time when political succession in China made it "impossible for the leadership to continue its passivity toward sovereignty issues."¹³¹ President Xi Jinping established and personally headed a central "crisis response leadership group" to coordinate the policies and actions of all government agencies, including the People's Liberation Army Navy, to implement China's new coercive diplomacy in the East and South China Sea. Beijing's recent spate of

¹²⁷ "Why MH370 will not change Chinese/Malaysia Relations," Huffington Post, May 20, 2014.

¹²⁸ Prashanth Parameswaran, "Malaysia, China Begin First Joint Military Exercise," *The Diplomat*, December 24, 2014.

¹²⁹ M. Landler, "Offering to Aid Talks, U.S. Challenges China on Disputed Islands," *New York Times*, 24 July, 2010.

¹³⁰ You Ji, "Deciphering Beijing's Maritime Security policy and Strategy in Managing Sovereignty Disputes in the South China Seas," *RSIS Policy Brief*, Singapore, October 2010.

¹³¹ *ibid*: 4.

reclamation operations in disputed waters in the South China Sea, including the building of an airstrip suitable for military use in the Spratly Islands in waters that are also claimed by the Philippines, has made the South China Sea Southeast Asia's biggest potential military flashpoint.

Although China acceded to the United Nations Convention on the Law of the Sea (UNCLOS) in 1996, it continues to use the “nine-dash line” delimitation to assert its claim over its “historical” maritime domain, with the apparent aim to control the fisheries, minerals and other maritime resources as well as the potentially vast oil and gas deposits to be found there. Articulating the official line, a Chinese analyst at a state-sponsored think tank stated: “UNCLOS, which came into force in 1994, cannot deny China’s ‘U-shape line’ published almost half a century ago”¹³² China’s claims are challenged by Malaysia and other three ASEAN states: Brunei, Philippines and Vietnam, which are also signatories of UNCLOS. Claimant states seek jurisdiction over land features and exploitation rights over marine and seabed resources in their Exclusive Economic Zones (EEZ), which extend up to 370 kilometers (220 nautical miles) from their respective coastlines.

While China occupied the Paracel Islands and Mischief Reef in the Spratly Islands after winning naval skirmishes against Vietnam in 1974 and 1988, and the Philippines in 1995 and 1998, it has not acted against Malaysia’s occupation of disputed features that fall within the nine-dash line in the southern-most part of the South China Sea. That demarcation appears to go as close to 55 kilometers (34.2 miles) off the coast of Malaysia’s Sarawak state. Malaysia currently occupies eight features in the Spratlys, compared to 22 by Vietnam, nine by the Philippines, one by Taiwan and seven by China following its latest round of reclamation, which includes the military airstrip and other defense installations.¹³³ Malaysia occupied Swallow Reef (Layang Layang) in 1983, and subsequently built up the reef into an artificial island covering six hectares to support naval personnel, a 500-meter airstrip, and a 90-room dive resort.¹³⁴

In sharp contrast to its belligerent confrontation of Vietnamese and Philippine activities inside its claimed waters – when Chinese coast guard and fishing vessels faced off Vietnamese and Philippines vessels over the deployment of a Chinese oil rig in the first instance, and over access to Scarborough Shoal in the second – Beijing has not publicly objected to Malaysia’s extensive oil and gas explorations, nor has it complained about Malaysia’s recent announcement of a discovery of oil and gas deposits 90 miles off Sarawak. At least nine gas and oil blocks are currently under development and are expected to go online in 2016. Investors include U.S.-based Murphy Oil Corp and Conoco Phillips, in a joint venture with Malaysia’s state-run Petronas.¹³⁵

Underlining China’s tolerance of Malaysia’s reclamation and exploration activities in its claimed waters, a Chinese Foreign Ministry statement issued in June 2014 acknowledged that while China and Malaysia have disputes, “the two sides share broad consensus on appropriately handling the disputed areas.”¹³⁶ A Malaysian strategic analyst stated that both Malaysia and

¹³² Q. Cao, “A Sea of False Accusations: The Philippines’ legal challenge over South China Sea disputes is untenable,” China Institute of International Studies, 22 April, 2014.

¹³³ Mary Fides Quintos, “Artificial Islands in the South China Sea and Their Impact on Regional (In)Security,” *FSI Insight*, vol. II, no. 2, March 2015.

¹³⁴ *ibid.*

¹³⁵ “Malaysia, China Keep Low Profile on Conflicting Sea Claims,” *Wall Street Journal*, June 24, 2014.

¹³⁶ *ibid.*

China have implicitly agreed to pay heed to each other's legitimate interests and "to go to extra lengths to avoid playing out their disputes through the media."¹³⁷

China's soft approach toward Malaysia might be due to the fact that Beijing currently has its hands full dealing with both Vietnam and Philippines, whose claims lie in waters closer to the Chinese mainland than Malaysia's more distant activities. In addition, unlike Vietnam and the Philippines, Malaysia and China have deep energy ties: Malaysia is China's third largest supplier of liquefied natural gas (LNG), and the state-owned China Petroleum & Chemical Corporation (Sinopec) is a minority partner in a Petronas-led project in Canada's Pacific Northwest LNG.¹³⁸ Finally, China needs good relations with Malaysia in light of America's rebalance which it perceives as a neo-containment policy despite Washington's assurances to the contrary. Thus, Beijing is likely to refrain from taking actions that could alienate Malaysia, particularly given Washington's warm ties with Prime Minister Najib, that would benefit U.S. strategic interests.

However, recent unprecedented appearances of Chinese naval vessels close to Malaysia's coast have unnerved Kuala Lumpur. In March 2013, four Chinese vessels conducted exercises just 50.3 miles away from Sarawak. They were followed by a second exercise in early 2014 when another flotilla carrying PLA-Navy personnel pledged to defend Chinese sovereignty in an oath-taking ceremony.¹³⁹ While Malaysia made no public protest, choosing instead to convey its concern quietly through standard diplomatic channels, those incidents have caused some Malaysian political strategists to warn that Malaysia needs to heed what they describe as a "wake-up call that it could happen to us and it is happening to us."¹⁴⁰ At the same time, a retired senior Foreign Minister official counseled prudence, observing that, as Malaysia's neighbor, "China is here to stay for ever, and it will assume superpower status sooner or later...[so] the correct approach towards China is not to isolate China but to engage China. This is the best way for Malaysia to maintain its non-aligned posture and sustain its independence in the international arena."¹⁴¹

Malaysia-China Cooperation on Transnational and Nontraditional Security Issues

Malaysia's cooperation with China on transitional and non-traditional security (NTS) challenges is limited and insignificant compared to the robust partnership it has with the U.S. on this range of issues. Due to stronger shared mutual concerns across a wide spectrum, Malaysia has chosen to work with Washington instead of Beijing in addressing major transnational challenges posed by illegal migrant workers, refugees, trafficking in people, drugs and arms trafficking, terrorism, maritime piracy, money laundering and natural disasters. Unlike the U.S., which has provided valuable assistance to Malaysia and other ASEAN countries through programs such as the USAID and State Department co-funded ASEAN Development Vision to Advance National Cooperation and Economic Integration (ADVANCE), China has lagged behind the U.S. in proffering such "public goods" in countries other than those of particular strategic interests to it, notably Laos and Cambodia.

¹³⁷ Shahrman Lockman, "Why Isn't Malaysia Afraid of China (For Now)," *The Strategist*, April 24, 2013.

¹³⁸ "Malaysia, China keeps low profile on conflicting sea claims," *Wall Street Journal*, June 24, 2014.

¹³⁹ Kuik Cheng Chwee, "Malaysia-China Relations After MH370: Policy Change or Business as Usual," *The Asan Forum*, October 15, 2014.

¹⁴⁰ Tang Siew Mun, "China's assertiveness hardens Malaysian stance in sea dispute," *Insight*, February 26, 2014.

¹⁴¹ Cited in Kuik, "Malaysia-China Relations: Three Enduring Themes," 2014.

The NTS threats for which Malaysia has cooperated with China, both bilaterally and as a member of ASEAN, have included actions to contain the SARS (severe acute respiratory syndrome) outbreak in 2003, prevent Avian Flu pandemics, build law enforcement capacity to counter cross-border human and drug trafficking between China and its bordering countries (particularly, Laos and Burma/Myanmar), combat piracy, and undertake humanitarian assistance and disaster relief (HADR) joint exercises.¹⁴²

On a bilateral basis, Malaysia cooperates with China in promoting people-to-people education and cultural exchanges, especially in expediting flows of students and tourists between the two countries. After signing an agreement in 2011 to promote educational exchanges, some 4,000 (predominantly Malaysian Chinese) Malaysians were enrolled in 820 Malaysia-recognized Chinese institutions, and some 10,000 Chinese students studied in 71 China-recognized Malaysian private and public English-medium colleges as of January 2013. In 2015, Xiamen University (originally endowed by a rags-to-riches Chinese Fujian migrant to Malaysia, Tan Kah Kee) will be the first China university to open an overseas campus in Malaysia, with all courses taught in English.¹⁴³ By comparison, 6,822 Malaysian students were enrolled in the U.S. during the 2013/2014 academic year.¹⁴⁴ With regard to tourism, some 1,558,785 Chinese tourists visited Malaysia in 2013,¹⁴⁵ a figure that dwarfs the flows of American tourists to Malaysia.

Leveraging Malaysia-China Relations in ASEAN

China's special relationship with Malaysia also stems from Beijing's appreciation of the benefits gained from Kuala Lumpur's successful efforts to integrate China into the ASEAN-led regional economic order. As a founding member of ASEAN in 1967 that normalized ties with China in 1974, Malaysia effectively opened the door for Chinese participation as a full dialogue partner of ASEAN in 1995, after Indonesian and Singapore established ties with Beijing. It was Prime Minister Mahathir who proposed Chinese membership, together with Japan and South Korea, in the East Asia Economic Grouping, an Asia-only organization that was opposed by Washington. However, that concept subsequently evolved to become the ASEAN plus Three (APT) grouping after the Asian Finance Crisis, when the U.S. no longer objected to Japan and South Korea joining it. Malaysia and China subsequently worked together in 2005, when Malaysia was ASEAN chair, to upgrade the APT into a Leaders Summit. The establishment of the East Asia Summit, comprising the ten ASEAN countries, China, Japan and South Korea, would have given material shape to Mahathir's initial vision of an "Asia for Asians" regional institution. However, a notable difference between the EAEG concept of 1991 and its EAS avatar in 2005 was that China had by then emerged as the grouping's strongest political and economic force instead of Japan, which had been weakened by long-term economic stagnation and domestic political travails. However, concerns raised primarily by Indonesia and Singapore about China's prominent role in an organization of asymmetrical power relations between Beijing and its 10 weaker ASEAN neighbors scuttled the EAS' original Asia-only composition. When finally established in December 2005, India, Australia and New Zealand were added to

¹⁴² David Arase, "Non-traditional Security in China-ASEAN Cooperation," *Asian Survey*, Vol. 50, No. 4, July/August 2010.

¹⁴³ "China-Malaysia Recognition Increases Mobility," *The PIE News*, January 21, 2013. <http://thepienews.com/news/china-malaysia-mutual-recognition-increases-mobility/>.

¹⁴⁴ "Open Door Factsheet: Malaysia 2013," www.iie.org.

¹⁴⁵ "Malaysia to meet target of 1.7mil Chinese tourists arrivals in 2013," *The Star*, July 19, 2013. <http://www.thestar.com.my/news/nation/2013/07/19/malaysia-to-meet-target-chinese-tourists-arrivals-in-2013/>.

balance China by expanding the EAS' democratic make-up.¹⁴⁶ The U.S. and Russia became members in 2011.

While the opportunity offered by Malaysia for China to play a leading role in the EAS did not materialize, participation in ASEAN-led institutions worked to China's advantage in several ways. Positioning itself to benefit from the eventual integration of a 600- million strong ASEAN market and production base, China was the first country to establish a free trade agreement with ASEAN, the China-ASEAN Free Trade Agreement (CAFTA) in 2002. Although limited in scope and low quality in standards compared to free trade agreements negotiated between the U.S. and its trading partners, the lowering of tariff barriers under CAFTA enabled China to more closely integrate Southeast Asia's supply chain and production networks that feed intermediate goods from the region to China's "Factory Asia" hub, which turned these intermediate goods into finished exports for the U.S. and European market.¹⁴⁷ The establishment of the ASEAN Economic Community and realization of the ASEAN-led Regional Comprehensive Economic Partnership (RCEP), comprising ASEAN and its free trade partners of China, Japan, South Korea, Australia, New Zealand and India, will further fuel China's economic growth at a time when its fast-paced growth rates are finally slowing down. Malaysia, for its part, hopes to serve as a clearing house for Chinese yuan flows, and as a gateway for goods produced in sites such as the China-Malaysia Qinzhou Industrial Park, to the larger ASEAN Economic Community.¹⁴⁸

Malaysia's China Hedging Policy – Strengthening the Malaysia-US Relationship

While trade and investments between Malaysia and China, and Chinese initiatives such as the AIIB and Maritime Silk Road will inevitably draw both Malaysia and ASEAN closer into China's economic orbit to form what Xi Jinping calls a "community of shared destiny," that process has geostrategic and security connotations that could work against the national interests of Malaysia.¹⁴⁹ Due to its unhappy experience with China's support of the Malaysian Communist Party-led insurrection, the Malay leadership is understandably wary that a politically dominant and military powerful China could once again threaten its national interests domestically and externally. Although Malaysia's Chinese have long since divested themselves of China-centered political sentiments, they have also largely abandoned the UMNO-led governing coalition in the general election of 2008 and 2013. Their opposition to the government stem from grievances over Malay affirmative action policies, lack of transparency and accountability in governance, and rising racial and religious polarization between Malay Muslims on the one hand, and non-Malays and non-Muslims on the other. At the same time, Chinese claims over energy resources and fisheries in the South China Sea, construction of defense installations in the southern Spratlys, and intrusion into waters claimed by Malaysia pose a serious existential threat to Malaysia's national security and strategic interests.

China's rise to be the dominant Asian power would also challenge Malaysia's and other member countries' concept of ASEAN centrality. Beijing's vision of an asymmetrical, core-periphery

¹⁴⁶ Michael Green & Gill Bates, eds., *Cooperation, Competition, and the Search for Community: Asia's New Multilateralism*, Columbia University Press, 2009.

¹⁴⁷ Claudia Canals, "China, at the heart of 'Factory Asia,'" June 5, 2014. http://www.lacaixaresearch.com/en/web/guest/detail-news?lastnewsportal_articleData=413233,10180,1.9.

¹⁴⁸ "Malaysia-China Relations Blossoming Beyond Expectations," *Bernama*, November 15, 2014.

¹⁴⁹ Larkin, 2015: 10.

power structure under a new Sino-centric regional order would be quite different from ASEAN's current promotion of an ASEAN-based multilateral regional integration. In 2012 China effectively carried out a "divide and rule" strategy when it put pressure on Cambodia, the then ASEAN chair, to prevent the release of a joint ASEAN Ministers Meeting statement, against the desire of Vietnam and the Philippines to have that document refer to China's behavior in the South China Sea.¹⁵⁰ ASEAN was momentarily and publicly in disarray before it finally joined ranks again under Indonesia's leadership.¹⁵¹ Fear of China's ability to marginalize and divide ASEAN led Malaysian Deputy Foreign Minister Hamzah Zainuddin in March 2015 to describe China "as an aggressive nation in the South China Sea," and he called for ASEAN to be united against that source of aggression.¹⁵² When Malaysia chaired the 26th ASEAN Summit in April, 2015, Prime Minister Najib's Chairman Statement declared that ASEAN leaders shared serious concerns that land reclamation being undertaken in the South China Sea has eroded "trust and confidence and may undermine peace, security and stability in the South China Sea." The statement also affirmed freedom of navigation in and over the South China Sea, emphasized the need for all parties to ensure full and effective implementation of the Declaration of the Code of Conduct to exercise self-restraint and not resort to threat or use of force and resolve all differences and disputes through peaceful means in accordance with international law, including the 1982 UNCLOS, and to work to ensure the expeditious establishment of an effective and binding Code of Conduct for the South China Sea.¹⁵³

In order to deter China from exerting unwanted pressure on Malaysia, the UMNO leadership has adopted a policy of "soft balancing," primarily through strengthening bilateral ties with the U.S. on all fronts: economic, political, defense, and social. Malaysia-U.S cooperation has never been stronger than under the current Najib and Obama Administration.¹⁵⁴ Warmly embracing Obama's pivot or rebalance to Asia, which has actively courted Malaysia, together with Indonesia and Vietnam, as Washington's new partners in the region, Najib has ramped up military cooperation, including increasing the numbers of U.S. naval ship visits to Malaysian ports, upgrading Malaysia's status in the US-led Cobra Gold military exercises from observer to participant status, drawing on the U.S. to build up Malaysia's Marine Corps, and holding the first exercise with the U.S. Marine Corps in August 2014. While that exercise was conducted in Sabah, close to waters visited by the PLA-Navy flotilla, Malaysia was careful publicly to reassure China that its recent defense capacity-building measures in East Malaysia were aimed at the threat posed by Sulu insurgents of the self-styled "Royal Army of the Sultanate of Sulu," who invaded Lahad Datu in 2013 in an abortive attempt to reclaim the territory for the defunct Sulu Sultanate.¹⁵⁵

On the economic front, Malaysia is one of the four negotiating partners from ASEAN in the

¹⁵⁰ Carl Thayer, "ASEAN'S Code of Conduct in the South China Sea: A Litmus Test for Community-Building?" *The Asia-Pacific Journal*, 10 (34), 4, 20 August 2012.

¹⁵¹ Carl Thayer, "South China Sea in Regional Politics: Indonesia's Efforts to Forge ASEAN Unity on a Code of Conduct," Paper presented to 3rd Annual Conference on managing Tensions in the South China Sea, Center for Strategic and International Studies, Washington DC, June 5-6.

¹⁵² "Malaysia to push drafting Code of Conduct to settle dispute with China," *The Star*, March 12, 2015.

<http://www.thestar.com.my/News/Nation/2015/03/12/Parliament-CoC-Malaysia-China/>

¹⁵³ "China maritime tensions dominate Southeast Asia summit," *Reuters*, April 27, 2015.

¹⁵⁴ Heng Pek Koon, "Malaysia and the United States: A Maturing Partnership," Meredith Weiss, ed., *Routledge Handbook of Contemporary Malaysia* 2014.

¹⁵⁵ Zachary Keck, "Malaysia to Establish Marine Corps and South China Sea Naval Base," *The Diplomat*, October 19, 2013.

U.S.-led Trans-Pacific Partnership talks. The U.S. is Malaysia's fourth-largest trading partner, and the largest holder of cumulative FDI (totaling \$15 billion in 2012, an increase of 21.1% from 2011),¹⁵⁶ while Malaysia is the U.S. second largest trading partner in ASEAN. Najib remains committed to bringing the TPP talks to a successful conclusion in the face of stiff domestic opposition, led by former Prime Minister Mahathir.¹⁵⁷ Thus, while Malaysia's economic engagement with China is set to expand bilaterally and multilaterally through participation in the AIIB, and trade liberalization in the ASEAN Economic Community and the Regional Comprehensive Economic Partnership, Najib looks steadfastly to technology-rich America and the 12-TPP member markets to fulfill his long-held desire for Malaysia to become an advanced economy by 2020.

When Malaysia-U.S. bilateral relations were upgraded to a Comprehensive Partnership in 2014, the bilateral cooperation became significantly more vibrant than that with China. With Washington's renewed focus on militant Islam in Iraq and Syria, Malaysia has pledged to work pro-actively with the U.S. to prevent the Islamic State (ISIS/ISIL) from recruiting jihadists from within its borders. In April 2014, Malaysia passed the Prevention of Terror Act, which allows for imprisonment of terror suspects for two years, with multiple extensions, or restriction of their movements for five years.¹⁵⁸

Apart from security and economic cooperation, other areas of cooperative activity focus on education, exchanges, and cultural heritage preservation. The U.S. Fulbright English Teaching Assistant program in Malaysia is among the largest in the world, helping improve the English language skills of thousands of Malaysian secondary school students. In 2014 during his state visit to Kuala Lumpur (the second by a U.S. president since President Johnson in 1966), President Obama launched the Young Southeast Asian Young Leaders Initiative (YSEALI) that provided additional exchange programs, grant opportunities and fellowships for Malaysian and other ASEAN youth between the ages of 18 and 35.¹⁵⁹

Policy Recommendations: Malaysia-U.S., Malaysia-China, and Malaysia-ASEAN Relations

The following policy recommendations address the organizing principles that determine Malaysia's relations with both China and U.S. These are: that Malaysia desires to maintain an "equidistant" foreign policy with both major powers; that it seeks productive and positive relations with each; that it continues to be "non-partisan" and "even-handed" in not having to "take side" with either power; and that it wishes to minimize the potential for interference by either power in its domestic handling of Malay affirmative action policies amidst rising racial and religious tensions between Malay Muslims and non-Malay Muslims in the country. After the occasionally scratchy bilateral relationship under Mahathir, Malaysia has become a reliable and steadfast partner under Najib. Fuelled by growing unease over China's strident assertiveness and

¹⁵⁶ Office of the United States Trade Representative: Malaysia, April 30, 2014. <https://ustr.gov/countries-regions/southeast-asia-pacific/malaysia>.

¹⁵⁷ Heng Pek Koon, "The Trans-Pacific Partnership Negotiations: Challenges and Prospects for Malaysia," *International Law Journal*, Shanghai University of International Business and Economics, 2014 (12): 82-98.

¹⁵⁸ "Lurch to illiberalism," *The Economist*, April 11, 2015.

¹⁵⁹ U.S. Department of State: Fact sheet, Malaysia. Jan 23, 2015. <http://www.state.gov/r/pa/ei/bgn/2777.htm>.

reclamation activities in the South China Sea, Kuala Lumpur is likely to forge even closer security ties with Washington. As the chair of ASEAN in 2015, and a non-permanent member of the United Nations Security Council in 2015-2016, Malaysia is, in turn, well positioned to support U.S. interests both regionally in ASEAN and globally in the UN.

Policy recommendations to the USCC:

1. Implement the Malaysia-U.S. Comprehensive Partnership by establishing Working Committees to strengthen bilateral cooperation in trade and investment, defense and security, education and people-to-people exchanges, science and technology, energy, environment and climate change, health and pandemics, and democracy and civil society promotion.
2. Sustain the Obama Administration's Asia rebalance policy and continue to engage Malaysia as a key partner and stakeholder of the pivot. Give full support to Malaysia as the ASEAN chair. Ensure President Obama's attendance at the US-ASEAN Leaders Summit and the EAS Leaders Meetings in Kuala Lumpur in November later this year.
3. Maintain a high level of bi-partisan Congressional support that includes sufficient funding for the diplomatic, defense and economic resources needed to sustain effective U.S. engagement in the region. Obama's successor in the 2016 presidential race should be encouraged to pursue the key actions and policies of the pivot, as well as to manage expectations and perceptions regarding mutually shared U.S.-Malaysia-ASEAN objectives and concerns in the region.
4. Pass the Trade Promotion Authority (TPA) and bring the Trans-Pacific Partnership (TPP) negotiations to a timely conclusion. Failure to do so would harm U.S. reputational, political and economic standing in the region, while allowing the China-led AIIB, Silk Road Economic Belt and Maritime Silk Road initiatives to gain momentum toward the establishment of a 21st Century Sino-centric regional order.
5. Promote U.S. private sector investment in Malaysia through the American Chamber of Commerce (AMCHAM) and work with the US-ASEAN Business Council to deepen economic cooperation and trade liberalization in ASEAN in the U.S.-ASEAN Expanded Economic Engagement (E3). Encourage U.S. public-private funding to help Malaysia and ASEAN member countries address their "infrastructure investment gap."
6. Join the AIIB. Rather than opposing this lavishly-funded Chinese initiative that has been heartily welcomed by all the countries of South East Asia, it would be much more preferable for the U.S. to join its European allies in order exert influence from the inside to set high standards of diligence, transparency and accountability in the new bank's decision-making processes.
7. Support "ASEAN centrality" by participating in and building institutional capacity of ASEAN and ASEAN-led groupings such as the East Asia Summit (EAS), ASEAN Defense Ministers Meeting Plus (ADMM+) and the ASEAN Regional Forum (ARF). Continued U.S. backing for ASEAN would prevent it from being divided and marginalized by China's coercive diplomacy in the South China Sea.

8. Join UNCLOS as a means of supporting Malaysia's and ASEAN's commitment to upholding international laws governing freedom and right of passage in and over waters such as the South China Sea and thus provide the legal bedrock for a binding ASEAN-China Code of Conduct in the South China Sea. This issue has been one of considerable urgency, because by building up land features to support military installations in the Spratly Islands, Beijing is rapidly creating a de facto "Air Defense Identification Zone" (ADIZ) in the South China Sea, like the one it formally established in the East China Sea.

9. Work with Malaysia and other claimant ASEAN states in establishing an ASEAN-based conflict prevention and rapid response mechanism to deal with localized incidents in the South China Sea before they break out into open conflict. ASEAN may be viewed by some in Washington as nothing more than a talk shop, but absent a U.S. willingness to directly confront China in the South China Sea, ASEAN remains America's best multilateral instrumentality for helping advance its maritime and other geo-political and strategic interests in the region.

**OPENING STATEMENT OF MURRAY HIEBERT
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MR. HIEBERT: Thank you.

So I'm talking about China-Vietnam relations. I think it's not an exaggeration to say Vietnam, like the Philippines, is a front-line state in the dispute in the South China Sea with China.

The two countries have a 2,000 year history and maybe even longer of dealing with each other. That period includes a thousand years when Vietnam was a colony. They obviously have a long border, and Vietnam is very heavily dependent economically on China. So that these complex relationships do really affect how Vietnam can respond in the South China Sea.

The Vietnamese--it's somewhat unusual, but actually the Vietnamese Communist Party has to be fairly responsive to its population on China. When the oil rig showed last year, in May last year, off the coast of Vietnam, there was a huge domestic pressure on the government to respond more strongly, and during a Pew poll survey of Vietnam last year, it was found that only 16 percent of Vietnamese have a favorable view of China. Only Japan has a less favorable view in Asia.

The government tried initially to keep the lid on the anti-China sentiment. It did for the most part, but we did eventually see them countenancing protests and including some protests that turned violent.

The response to China in the South China Sea has prompted a debate within Vietnam's leadership. There's not so much a debate about what they should do immediately with China, but there's a huge debate about how it can balance its relations with China, meaning how far can it go with the United States, Japan, and India and others in the region?

I guess the other--so I mentioned the U.S. role with Vietnam. The Vietnamese, one of their key determinants on how far they go with the United States, is determined by how China might react. So constantly when they are making moves to move closer to the United States, they look over their shoulder to see how the country that's 90 kilometers from Hanoi is going to respond.

The Vietnamese, on the oil rig last year, which was such a determinant event, basically had three or four different ways of responding. First, they tried to internationalize the South China Sea dispute, taking it to regional multilateral forums, such as ASEAN that Professor Heng alluded to, and stepping up ties with the United States and Japan.

They've also really taken steps to modernize their navy, their air force, their coast guard. So they have really stepped up high-level defense and security ties with Washington. Last year, the United States--yeah, in October, six months or so after the oil rig incident, Washington partially lifted its ban on arms sales to Vietnam. That's mainly for maritime domain awareness equipment rather than more kinetic stuff.

The two navies have also started to upgrade joint search and rescue exercises and those kinds of things.

ASEAN, as Professor Heng alluded, is also very important in Vietnam's thinking about how to respond to China. So it really is very active in trying to build support within ASEAN, and then in terms of military modernization, they have planned in the two years to have six advanced Kilo-class submarines. They're also buying new fighter jets from the Russians. Their

goal really is--they know they can never stand up to China. Their goal is just to make it more costly for China to do things like the oil rig and to increase the costs on China.

The other issue that is creating some tensions is what's happening on the Mekong River. China is damming in the upper part of the river. It and Thailand are also helping build dams in Laos and Cambodia, and if you travel now through those countries, you can quickly hear people, analysts, security analysts, saying the Mekong may be the next South China Sea in that Vietnam, and as you go up the Mekong, fishing and rice production will be very dramatically affected. The lower Mekong is the rice basket of the region. And if you start having saline water intruding into the delta, it's going to have a huge impact. And so the Vietnamese are really busy trying to figure out what to do.

Despite the conflicts, Vietnam and China have taken quite a few steps to demarcate the Gulf of Tonkin in the north. They have demarcated their land border. They are working on things like human trafficking, bride selling across the border, those kinds of issues that are very tough, but they are working to address those.

China is by far Vietnam's largest trading partner--huge economic impact. The electricity in the north comes from China. The inputs for textiles, rice, a lot of the electronics that Vietnam is producing and exporting come from China. So Vietnam has to temper how it responds in the South China Sea, lest it have huge economic impact.

And that's part of the reason why Vietnam decided to join the TPP, the Trans-Pacific Partnership. It does see economic advantages, knocking down tariffs and forcing domestic reform, but it's also looking for to hedge, to find alternative markets, to find alternative sources for its economy.

Finally, I'll just end with a few recommendations. I think engaging Vietnam, which is 20 years ahead of where Myanmar, Burma, are at in reforms, but it is working on issues like in providing greater transparency and a greater, quote-unquote, "democracy" in the election process, in the National Assembly process, and for Congress to keep engaging as they have been doing does have an impact. It is also a barometer. It provides a barometer on human rights. So there are a lot of advantages to staying very engaged with Vietnam, particularly, from both Congress and the administration probably.

The other thing that's happening is Party Chief Trong is going to visit here probably in July, maybe August, visit the United States. It's kind of unusual to host a party chief who doesn't have a government job. I think there are advantages also to hosting him because you expose the Party apparatus, which largely isn't exposed to the United States and democracy, to this alternative, and it does help overcome some of the America syndrome that still exists in Vietnam, like we have a Vietnam syndrome.

The big issue that's out there is what does Congress say to the administration if they want to totally lift the ban on arms? It's very controversial because of human rights problems in Vietnam which exist. Human rights has really improved a great deal, but it's not paradise. They're still arresting bloggers and people in the freedom of expression space do face some restrictions. So that's really an issue that has to be worked out between the two countries.

And then I think in terms of helping Vietnam expand its maritime domain awareness, it is very useful to keep having naval, increased naval and coast guard cooperation between the two countries. Vietnam doesn't have a clue what the Chinese are doing in the South China Sea for the most part.

Thank you.

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May 13, 2015

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**Testimony before the U.S.-China Economic and Security Review Commission
China's Relations with Southeast Asia**

China-Vietnam Relations

Political and diplomatic ties

Background and current state of relations

China and Vietnam this year celebrate 65 years of bilateral diplomatic relations. However, the two countries only normalized ties in 1991 following a period of hostility from 1978 to 1991. Following the reunification of Vietnam under communist rule in 1975, the government oppressed and drove out many ethnic Chinese from southern Vietnam, fortified its alliance with the then Soviet Union, and launched an offensive in late 1978 to overthrow the Khmer Rouge regime in Cambodia, an ally of China. These actions prompted Beijing to consider Hanoi a threat to its regional influence and, in 1979, Chinese forces launched a punitive attack into northern Vietnam, prompting a brief but deadly border war.

Communist parties rule both countries today and the two cultures share a common Confucian heritage. But the dynamics of their bilateral relations are extremely complex. Geographical proximity and economic dependence requires that Vietnam maintain amicable relations with China. At the same time, Vietnam's opening to the world since the late 1980s, coupled with a changing regional strategic environment, have caused an evolution of Vietnam's policy toward China.

Under a new foreign policy framework agreed on by Vietnam's Communist Party Central Committee in 2013, Vietnam will treat China as an economic and ideological partner, but as its adversary with regard to disputes in the South China Sea. Conflict in the South China Sea remains the single largest obstacle in China-Vietnam relations. Vietnam claims sovereignty over the Paracel Islands, which China seized from the U.S.-backed South Vietnamese regime in 1974, and all the Spratly Islands, which China also claims.

Chinese and Vietnamese leaders upgraded ties to a strategic partnership in 2008, and elevated their relations to a comprehensive strategic cooperative partnership a year later.

Domestic political issues in Vietnam affecting China-Vietnam relations

Two major domestic factors influence Vietnam's policy toward China: rising nationalism in the population with regard to maritime disputes with China and a debate among elites about China's position in Vietnam's future foreign policy.

Vietnamese leaders have been under mounting pressure from the population to show resolve in dealing with China in the South China Sea. According to a Pew Research Center survey on global attitudes in 2014, only 16 percent of Vietnamese surveyed said they have a favorable view of China, the second lowest level in Asia following Japan.¹⁶⁰ The government for the most part has kept a lid on anti-China sentiment and demonstrations out of fear that protests could be hijacked by anti-government forces.

However, in the wake of China's deployment of an oil drilling rig to waters off the Paracel Islands in May 2014, authorities gave implicit support to rallies by thousands of anti-Chinese demonstrators across Vietnam. Following an initial round of impromptu protests, mobs went on a rampage against foreign businesses believed to be Chinese-owned in two industrial zones in southern Vietnam. Several Chinese workers reportedly died during protests against a Taiwanese project in central Vietnam.

Amid the oil rig crisis, some protesters and activists seized the opportunity to advocate for domestic political reforms as a way to garner Vietnam greater international support and leverage vis-à-vis China in the long run. These calls have been made in the past, but last year they were renewed in a slightly different context. A number of Vietnamese analysts have attributed what they see as the government's reluctance to stand up more forcefully to China to the shared ideology between Hanoi and Beijing.¹⁶¹

Meanwhile, Vietnamese officials believe that they have defended the country's national interests and navigated the South China Sea issue to the best of their abilities. Hanoi recognizes that China will always be at its doorstep and prefers to avoid antagonizing China if possible. It has sought to find a balance between appeasing and hedging against Beijing, depending on the circumstances.

A serious debate has taken place within Vietnam's top leadership in recent years about how to deal with China's ambitions in the South China Sea more effectively. The focus of the debate is not about whether Vietnam should submit to or distance itself from China, but rather how and to what extent it can use its growing partnerships with countries such as the United States, Japan, and India to keep Chinese assertiveness in check.

Traditionally, senior party officials and military leaders, many of whom fought against the United States during the war, tend to be more skeptical about the prospects or utility of expanding Vietnam's ties with the West and the United States in particular. Hanoi also has

¹⁶⁰ Pew Research Center, "Global Attitudes & Trends: Global Indicators Database – Opinion of China," <http://www.pewglobal.org/database/indicator/24/>.

¹⁶¹ Phuong Nguyen, "South China Sea Standoff Turns into Domestic Challenges for Hanoi," CogitAsia, May 15, 2014, <http://cogitasia.com/south-china-sea-standoff-turns-into-domestic-challenges-for-hanoi/>.

concerns about how Beijing may respond if the U.S.–Vietnam military rapprochement proceeds too quickly.

Nonetheless, the trend line in recent years shows that Vietnamese leaders continue to advance defense and economic cooperation with the United States as a way to improve Hanoi’s strategic autonomy vis-à-vis Beijing.

In early 2016, Vietnam will hold a Communist Party congress to select a new leadership team. Against this backdrop, different political factions are becoming increasingly divided over how Vietnam should position itself – politically, economically, and geopolitically. China lies at the center of all these divides.

The importance of party-to-party ties

The longstanding ties between the communist parties in China and Vietnam continue to inform the relationship between the two countries and serve as the first and foremost channel through which bilateral disagreements are communicated and resolved. Party-to-party ties have acted as a key stabilizer in China-Vietnam relations in recent years, as Hanoi alternates between accommodating and standing up to Chinese maritime aggression.¹⁶²

However, the oil-rig crisis in 2014 was a real turning point in this relationship. After China moved to station the rig off Vietnam’s coast and amid the dangerous standoff between Chinese and Vietnamese forces at sea, senior Vietnamese party officials made multiple overtures to their counterparts in Beijing but to little avail. The crisis resulted in the sharpest deterioration of ties in decades between China and Vietnam. It is believed that Chinese president Xi Jinping even refused to meet with his Vietnamese counterpart, Communist Party secretary-general Nguyen Phu Trong. China also reportedly issued preconditions for sitting down with Vietnam, which included demands for Vietnam to stop harassing the rig with patrol boats and fishing vessels, drop its sovereignty claims over the Paracel Islands, renounce any plans to pursue legal action against China, and promise not to involve any third parties in the conflict. Hanoi did not budge, and China eventually withdrew the rig a month ahead of schedule.

As a result of the oil-rig crisis, even party stalwarts in Hanoi have become disillusioned with China’s treatment of Vietnam. Strategic trust has been weakened. Yet following a weeks-long standoff, Hanoi and Beijing began patching up ties. Beijing resorted to calling on Hanoi not to use “megaphone diplomacy” and urged Vietnam to keep bilateral ties on the correct path – interpreted to mean a path preferred by China. But that did not stop Hanoi from filing a statement in late 2014 asking the Permanent Court of Arbitration in The Hague to consider Vietnam’s rights when evaluating the legal case brought by the Philippines against China.¹⁶³

Vietnam’s Communist Party chief paid a high-level visit to China in early April, ahead of his much anticipated visit to the United States later this year. It has been reported that Beijing only

¹⁶² Murray Hiebert, Phuong Nguyen, and Gregory B. Poling, *A New Era in U.S.-Vietnam Relations: Deepening Ties Two Decades after Normalization* (Center for Strategic and International Studies, June 2014), http://csis.org/files/publication/140609_Hiebert_USVietnamRelations_Web.pdf.

¹⁶³ Phuong Nguyen, “Vietnam’s Careful Dance with the Superpowers,” East Asia Forum, January 21, 2015, <http://www.eastasiaforum.org/2015/01/21/vietnams-careful-dance-with-the-superpowers/>.

extended an official invitation to Trong when it became clear that he would visit Washington.¹⁶⁴ During Trong's visit, Chinese state media raised concerns about so-called outsiders who sought to exploit recent developments to sow discord between China and Vietnam and those in Vietnam's leading political circles who it believed have become accomplices in this effort.¹⁶⁵

The South China Sea dispute in China-Vietnam relations

The South China Sea remains the biggest area of tension in bilateral ties. While Vietnam and China stress the importance of ties between the two communist parties, each country has its own approach to the disputes.

Vietnam's approach in the South China Sea

Vietnam has sought to internationalize the South China Sea issue through regional and multilateral forums and increase cooperation with partners such as the United States, Japan, and India. It has also stepped up modernization of the Vietnamese Navy, Air Force, and Coast Guard, and developed a maritime strategy that will guide Vietnam's maritime policy until 2020. One critical element in Vietnam's South China Sea strategy is an emphasis on self-restraint in the case of a crisis or conflict.

In addition, Vietnam regards high-level defense and security engagement with the United States and garnering U.S. support for Vietnam and U.S. regional leadership over the South China Sea as extremely important. Toward this end, Hanoi for years called on Washington to lift its ban on the sale of lethal arms to Vietnam in order to normalize defense relations between the two countries. The United States partially lifted this ban in October 2014, but Vietnam continues to call for the full lifting of the ban.

In 2014, U.S. and Vietnamese navies for the first time conducted a joint search and rescue exercise off the coast of Danang in central Vietnam. Earlier this year, the two navies conducted a joint exercise to practice the Code for Unplanned Encounters at Sea off Danang, and the two air forces conducted a joint search and rescue operation. (The Code for Unplanned Encounters at Sea was signed by 21 Pacific nations at the Western Pacific Naval Symposium in Qingdao, China, in April 2014).

However, there are perceived red lines that Vietnam will not cross in its relations with the United States out of fear of provoking China. There is also a perception among some Vietnamese elites that Hanoi is only a pawn in the U.S. rebalance to Asia and that Washington's great power calculus with regard to Beijing is real and Vietnam could easily get jettisoned if it became an obstacle in U.S.-China relations.

For instance, many in Vietnam see China's seizure of the western half of the Paracel Islands in 1974 from then South Vietnam as a byproduct of the U.S. withdrawal of troops from Vietnam

¹⁶⁴ Phuong Nguyen, "Vietnam Party Chief's Visit to China Raises the Bar for U.S.-Vietnam Relations," CogitAsia, April 6, 2015, <http://cogitasia.com/vietnam-party-chiefs-visit-to-china-raises-the-bar-for-u-s-vietnam-relations/>.

¹⁶⁵ Deng Yushan, "Commentary: No Room for Wedge in China-Vietnam Relations," *Xinhua*, April 7, 2015, http://news.xinhuanet.com/english/2015-04/07/c_134129188.htm.

and moves toward rapprochement with China two years earlier. Similarly, these sources believe the skirmish between China and Vietnam on Johnson South Reef in the Spratlys in 1988 was a byproduct of Soviet hints of withdrawal from Cam Ranh Bay, a deep-water harbor in central Vietnam overlooking the South China Sea developed by the United States during the war. Many in Hanoi believe the United States once again acquiesced to China's actions. This sentiment will likely linger for some time to come.¹⁶⁶

The 10-nation Association of Southeast Asian Nations (ASEAN) also serves as a platform for Vietnam to internationalize and voice its concerns about Chinese actions in the South China Sea. Vietnam has quietly worked to persuade its ASEAN neighbors that they should take China's growing assertiveness in the maritime realm more seriously. While Hanoi does not regard ASEAN forums and meetings as a means to resolve the conflict, it has worked hard on cultivating members of the grouping to ensure that it sees that a threat to Vietnam could eventually be a threat to the region. ASEAN's support is especially important since Vietnam is a claimant state on the frontlines of the South China Sea dispute and yet it does not have any close or credible ally that will come to its defense in case of a conflict with China. Vietnam has emerged as one of the most proactive strategic voices in ASEAN in recent years.

Within ASEAN, Vietnam has cemented closer ties with member states that also share its concerns about maintaining stability in the South China Sea. Vietnam signed a strategic partnership with Indonesia in 2013, becoming the only country in the grouping to do so. It has been in talks with the Philippines, one of the six disputing countries in the South China Sea, to finalize a bilateral strategic partnership this year.

As of last year, Vietnam left open the possibility of pursuing legal action against China under the UN Convention on the Law of the Sea, as the Philippines has done. But it is unlikely Vietnam will decide to take China to court over the South China Sea disputes in the foreseeable future.

China's approach to the South China Sea disputes

As for China, it has urged bilateral talks and diplomacy among the disputing countries as a way to handle territorial disputes. China has been adept at exploiting Vietnam's strategic vulnerability in the South China Sea. This was demonstrated through China's deployment of the oil rig last year: Beijing was confident that Hanoi would have no credible means to respond to such action and that no foreign country would come to Vietnam's aid.¹⁶⁷ China's military calculus in the South China Sea, in addition to seeking to establish control of this maritime space, has aimed at keeping Vietnam's maritime posture in the contested Spratly Islands in check. This is because Vietnam controls the most islands in the Spratlys and, among Southeast Asian claimants, Hanoi currently possesses the most credible deterrence against China's military forces, therefore raising the costs for China's military actions against Vietnam.

The Vietnamese Navy and Air Force, which until the early 2000s had little capacity to protect

¹⁶⁶ Nguyen, "Vietnam's Careful Dance with the Superpowers."

¹⁶⁷ See "Sino-Vietnamese Conflicts Can Be Contained Till Solution Found," *Global Times*, April 13, 2015, <http://www.globaltimes.cn/content/916658.shtml>.

Vietnam's maritime interests, have over the past decade undergone rapid modernization.¹⁶⁸ The Navy will operate a fleet of six advanced Kilo-class submarines by 2017, and will be equipped with land attack missiles that analysts believe are designed to target China's submarine base on Hainan Island and disputed islands in the South China Sea. Vietnam's Air Force will operate 36 Su-30 MK2 fighter jets, which are anti-ship missile-capable, by the end of 2015, in addition to an older fleet of roughly 190 other Soviet-made aircraft.¹⁶⁹ Vietnam's military modernization is geared toward making any Chinese actions against Vietnamese claims more costly. Hanoi fully recognizes it will never be able to compete militarily with Beijing.

In 2011, China and Vietnam reached an Agreement on Basic Principles Guiding Settlement of Maritime Issues, which calls for, among other things, confidence building between the two countries' navies and coast guards.¹⁷⁰ In 2008, China's Navy was invited back to Vietnam for a port visit after a 17-year hiatus. Yet despite talks and confidence-building measures, both sides still forge ahead with advancing their own strategic interests in the South China Sea.

Other areas of tension in China-Vietnam relations

The second major area of tension between China and Vietnam has to do with China's growing footprint in Cambodia and Laos, both of which share land borders with Vietnam. Because of their shared histories, Vietnam has long maintained close links at many levels with government and party organizations in Cambodia and Laos. Yet Vietnam finds itself increasingly unable to match China's growing political and economic footprint in these two countries. Hanoi worries that Chinese influence in its next-door neighbors, especially Laos, if left unchecked, could have geopolitical ramifications down the road. As a result, Vietnam has encouraged Laos to explore its options by cooperating with external partners such as Japan, South Korea, and the United States.¹⁷¹

Another major area of tension concerns dam construction along the Mekong River, which originates in Yunnan province in China and flows through Laos, Thailand, and Cambodia, before ending in Vietnam. Hanoi believes that China's construction of a series of upstream dams in Yunnan province paved the way for downstream countries to follow suit, and that China's role in supporting and financing the construction of dams in Cambodia and Laos is adverse to Vietnam's economic and environmental interests.

The lower Mekong region is home to approximately 240 million people, with some 70 million depending on the Mekong River for their livelihoods. China reportedly plans to build a total of 19 large dams on the Mekong.¹⁷² The environmental effects of these planned dams, including damage to rice and fish production and increased risk of natural calamities, will be felt most

¹⁶⁸ Murray Hiebert and Phuong Nguyen, "Vietnam Ramps Up Defense Spending, But Its Challenges Remain," Asia Maritime Transparency Initiative, Center for Strategic and International Studies, March 18, 2015, <http://amti.csis.org/vietnam-ramps-up-defense-spending-but-its-challenges-remain/>.

¹⁶⁹ Ibid.

¹⁷⁰ "China, Vietnam Pledge to Properly Settle Maritime Issues," *China Daily*, October 15, 2011, http://usa.chinadaily.com.cn/china/2011-10/15/content_13906285.htm.

¹⁷¹ Phuong Nguyen, "in Laos, A Strategic Opening the United States Cannot Miss," Center for Strategic and International Studies, April 2, 2015, <http://csis.org/publication/laos-strategic-opening-united-states-cannot-miss/>.

¹⁷² Anchalee Kongrut, "China Should Set Good Example on the Mekong River," International Rivers, January 25, 2013, <http://www.internationalrivers.org/resources/china-should-set-good-example-on-the-mekong-river-7806>.

strongly in the lower Mekong and the Mekong delta, which is Vietnam's rice basket.

Areas of security cooperation

Despite their differences, China and Vietnam have in recent years carried out talks on demarcating the mouth of the Gulf of Tonkin and have conducted joint fisheries patrols in this area. By mid-2014, the two countries' coast guards had conducted a total of 16 joint fisheries patrols. China and Vietnam agreed on the final demarcation of their land border in 2009.

The two governments continue to hold working group meetings on demarcating the Tonkin Gulf based on a principle known as "easy-first, difficult-later." Hanoi and Beijing last year agreed to launch joint surveys in this area and carry out cooperation on marine scientific research and environmental protection, search and rescue, and disaster prevention.¹⁷³

China and Vietnam also have established mechanisms to cooperate on border security. These include management of border gates, monitoring the entrance and exit of people in each country, combating crime, and holding joint border patrols. The flow of Uighur Muslims from China to neighboring countries has not caused serious problems for China-Vietnam relations so far, but this could potentially emerge as an area that requires more bilateral coordination. In April 2014, Vietnamese authorities arrested a group of at least 15 individuals believed to be Uighurs who crossed into Vietnam and Chinese authorities asked Hanoi to repatriate them to China. This request led to a deadly gun fight in which a Uighur man reportedly shot dead at least seven people, including several Vietnamese border guards.¹⁷⁴ In January, another group of Uighurs were reportedly shot dead by Chinese police near the Vietnamese border.¹⁷⁵

Human trafficking and bride buying present another challenge in China-Vietnam border relations. Thousands of Vietnamese women and children have been lured into China by fraudulent labor opportunities and later sold to brothels. In addition, many Vietnamese women who migrated to China as part of internationally brokered marriages have been subject to forced labor, forced prostitution, or both.¹⁷⁶ The practice of buying Vietnamese brides is common in many rural areas in China, where a wide gender gap and shifting socio-economic conditions have made it difficult for Chinese men to marry. There have been reported cases in which Vietnamese brides who were sold as wives to men in northern China have gone missing in what authorities believe may have been organized human trafficking operations.¹⁷⁷

The Vietnamese government has begun sending officials on short-term assignments to China to take part in joint trafficking investigations. These efforts have led to rescue operations of trafficking victims and the arrest of hundreds of traffickers.¹⁷⁸

¹⁷³ "Chinese Premier Li Keqiang Visits Vietnam," *VietnamNet*, October 14, 2013, <http://english.vietnamnet.vn/fms/government/86738/chinese-premier-li-keqiang-visits-vietnam.html>

¹⁷⁴ Nga Pham, "Vietnam Border Shoot-Out Raises Uighur Questions," *BBC News*, April 29, 2014, <http://www.bbc.com/news/world-asia-27200562>.

¹⁷⁵ "China police 'Shoot Two Uighurs Trying to Enter Vietnam'," *BBC News*, January 19, 2015, <http://www.bbc.com/news/world-asia-china-30875969>.

¹⁷⁶ U.S. Department of State, *Trafficking in Persons Report 2013*, <http://www.state.gov/j/tip/rls/tiprpt/2013/>.

¹⁷⁷ "China Police Search for Missing Vietnamese Brides: Paper," *Reuters*, December 11, 2014, <http://www.reuters.com/article/2014/12/11/us-china-vietnam-brides-idUSKBN0JP0R420141211>.

¹⁷⁸ State, *Trafficking in Persons Report 2013*.

The two governments have worked together to devise a joint action plan to combat drug trafficking and drug-related crimes on their shared border. Police, customs, and law enforcement officials from Vietnam's seven border provinces and China's Yunnan Province and Guangxi Zhuang Autonomous Region hold regular exchanges.¹⁷⁹ Vietnamese and Chinese organized crime groups have reportedly been responsible for the forced labor of Vietnamese children on cannabis farms in the United Kingdom.¹⁸⁰

The ministries of public security of the two countries also maintain close ties. However, the extent of bilateral cooperation on matters of domestic security is opaque and much less understood.

Trade and investment relations

In 2013, total two-way trade reached \$50 billion, an increase of 22 percent year-on-year, making China Vietnam's largest trade partner. Of this amount, nearly \$37 billion was Vietnamese imports from China. In particular, Vietnam's thriving export-led manufacturing sector, from garments to electronics and rice, depends heavily on imports of raw materials and inputs from China. Northern Vietnam also gets a considerable amount of its electricity needs from China. Bilateral trade is expected to reach \$60 billion in 2015.

However, China's investment in Vietnam has lagged far behind bilateral trade. While statistics vary widely, it is estimated that accumulated Chinese investments in Vietnam ranged somewhere between \$2.3 and \$4.8 billion in over 900 projects by the end of 2013. A surge in Chinese investment between 2012 and 2013 – Chinese foreign direct investment in 2012 was estimated to be only \$371 million – resulted from the signing of a project for the construction of a thermal power plant in southern Vietnam between Chinese and Vietnamese state-owned companies.¹⁸¹

Other major Chinese investments in Vietnam include two large-scale Chinese-Vietnamese joint ventures in bauxite mining and processing in the remote central highlands that prompted a backlash in Vietnam. A number of Vietnamese, including prominent intellectuals and former party officials, have expressed concern about the environmental impact caused by these projects and have questioned their commercial viability. They also complained about the use of thousands of Chinese workers brought to Vietnam to implement this project as economic exploitation and invasion of Vietnam's sovereignty.

During Chinese prime minister Li Keqiang's visit to Vietnam in late 2013 as part of China's new economic charm offensive toward its neighbors,¹⁸² the two countries agreed to boost bilateral economic relations in light of China's planned Maritime Silk Road initiative. Chinese state

¹⁷⁹ "Vietnam, China Hold Meetings on Cooperation in Drug Prevention," *China Daily*, October 1, 2014, http://www.chinadaily.com.cn/world/2014-10/15/content_18740895.htm

¹⁸⁰ State, *Trafficking in Persons Report 2013*.

¹⁸¹ Nguyen Thi Hang Ngan and Zhang Jianhua, "Interview: More Chinese Investment Boosts China-Vietnam Trade Ties," *Xinhua*, January 16, 2014, http://news.xinhuanet.com/english/indepth/2014-01/16/c_133050466.htm.

¹⁸² See Phuong Nguyen, "China's Charm Offensive Signals a New Strategic Era in Southeast Asia," Center for Strategic and International Studies, October 17, 2013, <http://csis.org/publication/chinas-charm-offensive-signals-new-strategic-era-southeast-asia>.

media hailed Vietnam as “a sparkling new state in the new ASEAN,” and urged the Chinese government not to overlook a market of soon-to-be 100 million people in Vietnam.¹⁸³

During Li’s visit, Vietnam agreed to plans for the construction of a Chinese-invested industrial zone in southern Vietnam and implementation of the Shenzhen-Haiphong trade corridor, which, once realized, will link the northeastern port city of Haiphong to the major trading hub in southern China. It was announced after the April summit between Vietnam’s party chief and his Chinese counterpart that China will help upgrade the port facility in Haiphong to accommodate large container ships, which could be completed as early as the end of 2017. Cargo bound for inland areas in southern and southwestern China could then be unloaded in Haiphong instead of Shanghai or Hong Kong, reducing the shipping time.¹⁸⁴

China and Vietnam have recently set up working groups on infrastructure and monetary cooperation as part of China’s new strategy of boosting cross-border connectivity with its neighbors. The two countries plan to begin construction of highways linking Vietnam’s border province of Lang Son with Hanoi and the border city of Mong Cai with the popular tourist destination at Ha Long Bay. They also agreed to conduct a feasibility study for a proposed high-speed railway between Vietnam’s border province of Lao Cai and the port city of Haiphong.¹⁸⁵ This building spree is in part a response to Japan’s increase in assistance for infrastructure projects in Vietnam in recent years. Vietnam has emerged as the largest recipient of Japanese overseas development assistance.¹⁸⁶

A less talked about aspect of China’s Maritime Silk Road initiative is its efforts to boost people-to-people exchanges with youth in neighboring countries, including Vietnam, as a way to lay the foundation for China’s future engagement with the region. There are currently over 13,500 Vietnamese students studying in China (compared to more than 16,000 Vietnamese students studying in the United States). Hanoi and Beijing in 2013 reaffirmed their commitment to boost educational exchanges in coming years.¹⁸⁷

Vietnam has joined the 12-nation Trans-Pacific Partnership (TPP) currently under negotiation to help the country diversify its economic ties so it is less dependent on China. A number of Chinese companies, recognizing that Vietnam will benefit from increased access to the United States, Japan, and other markets, have begun investing in garment and textile mills in Vietnam so that they can potentially benefit from the preferential terms of the TPP.¹⁸⁸

¹⁸³ Gu Yuanyang, “Vietnam Offers China Shared Ideology and Deeper Trade,” *Global Times*, November 25, 2013, <http://www.globaltimes.cn/content/827512.shtml#.UpNansRebTo>.

¹⁸⁴ Tetsuya Abe and Atsushi Tomiyama, “China, Vietnam to Cooperate on New Trade Corridor,” *Nikkei Asian Review*, April 8, 2015, <http://asia.nikkei.com/Politics-Economy/International-Relations/China-Vietnam-to-cooperate-on-new-trade-corridor>.

¹⁸⁵ “Chinese Premier Li Keqiang Visits Vietnam,” *VietnamNet*.

¹⁸⁶ See Tom Wright and Mitsuru Obe, “Vietnam Plays Key Role in China-Japan Aid Battle,” *Wall Street Journal*, March 27, 2015, <http://www.wsj.com/articles/vietnam-plays-key-role-in-china-japan-aid-battle-1427431451>

¹⁸⁷ “Chinese Premier Li Keqiang Visits Vietnam,” *VietnamNet*.

¹⁸⁸ Nigel Cory, “Impact of TPP Agreement on Vietnam’s Garment Industry: Weak Spot Could Become Its Major Gain,” *CogitAsia*, April 17, 2015, <http://cogitasia.com/impact-of-tpp-agreement-on-vietnams-garment-industry-weak-spot-could-become-its-major-gain/>.

Recommendations for the U.S. Congress

Vietnam has emerged in recent years as one of the most promising partners for the United States in Southeast Asia. Yet, there is still much untapped potential in U.S.-Vietnam relations, both bilaterally and multilaterally. Fears of antagonizing China remain a major factor that has prevented Vietnam from moving closer to the United States.

Congress should continue its already robust and high-level engagement with Vietnam's National Assembly and government, and engage the rising crop of Vietnamese leaders and lawmakers. Ten of 16 members in Vietnam's Politburo will reach retirement age in 2016, and most of them will step down as a result. The leadership transition next year will be generational, allowing the United States an opportunity to cultivate relationships with future Vietnamese leaders. Although Vietnamese leaders will not abandon their longstanding party-to-party ties with China anytime soon, there may be opportunities to boost cooperation in many areas, including defense, with the United States if mutual trust can be established. The United States and Vietnam have held extensive defense talks since 2008, but the two sides have yet to develop a self-sustaining level of mutual trust.

Toward this end, veteran members of Congress can invest in raising awareness among newer U.S. legislators about the importance of U.S.-Vietnam relations. A so-called "America syndrome" still exists among an older generation of senior Vietnamese officials who fought against the United States during the war, which sometimes serves as a deterrent against deeper bilateral cooperation.¹⁸⁹ When the Chief of General Staff of the Vietnamese armed forces visited the United States for the first time in 2013, he was warmly greeted by Congress, as well as many U.S. government agencies and military leaders. Visits like these provide an excellent opportunity for Congress to help senior Vietnamese leaders feel more comfortable with the U.S. system and contribute to trust building between the two countries.

Vietnam's communist party chief Trong is slated to come to the United States later this year in a historic visit as the two countries celebrate the 20th anniversary of normalization of diplomatic ties. Those in Hanoi who advocate closer U.S.-Vietnam ties believe that this visit will be of paramount importance to the relationship going forward.¹⁹⁰ It will send a message to China that Vietnam will continue to deepen defense and economic ties with the United States to protect its strategic autonomy, in contrast to China's belief that Vietnam will not dare to stray far from its orbit. Congress should consider meeting the secretary-general and his delegation, and express U.S. support for resolution of disputes according to international law, the freedom of navigation, and non-use of force in the South China Sea.

Congress could also support efforts by the administration to explore the full lifting of the lethal arms ban against Vietnam. It remains to be seen whether Vietnam will decide to acquire any U.S. weapons platforms following the partial lifting of the ban. A full removal of the ban could go a long way in forging trust with the senior Vietnamese military leadership. This move, of course,

¹⁸⁹ Murray Hiebert and Phuong Nguyen, "The Time is Right for President Obama to Visit Vietnam in 2015," Center for Strategic and International Studies, February 19, 2015, <http://csis.org/publication/southeast-asia-scott-circle-time-right-president-obama-visit-vietnam-2015>.

¹⁹⁰ Hiebert and Nguyen, "The Time is Right for President Obama to Visit Vietnam in 2015."

will require that Vietnam makes concrete progress on human rights and the treatment of prisoners of conscience.

Congress can support efforts by the United States and Vietnam to expand both naval and Coast Guard cooperation, which would help Hanoi gain increased maritime domain awareness in the South China Sea. Similarly, the two countries could step up cooperation in intelligence, surveillance, and reconnaissance that would give Vietnam increased awareness about China's activities in the disputed sea. While Hanoi is open to some military cooperation with the United States, it still holding back due to concern about China's reaction.

Congress can make a significant impact on consolidating U.S.-Vietnam relations by boosting funding for the clearance of unexploded ordnance left over from the Vietnam War. A fifth of Vietnam's land is contaminated with undetonated bombs, and in the central provinces, unexploded ordnance kills more than 1,500 people every year and injures thousands of others.¹⁹¹ Stepping up efforts to assist Vietnam with war legacy problems such as unexploded ordnance and the effects of Agent Orange (dioxin), will go a long way in sustaining the goodwill of ordinary people and future generations of Vietnamese toward the United States.

¹⁹¹ "US to Provide \$8mn for UXO Removal in Central Vietnam," *Tuoi Tre News*, March 3, 2015, <http://tuoitrenews.vn/society/26416/us-to-provide-8mn-for-tackling-uxo-removal-in-central-vietnam>.

PANEL III QUESTION AND ANSWER

HEARING CO-CHAIR BARTHOLOMEW: Thank you very much. It's interesting testimony, and we've set up kind of a difficult dynamic because each of you have one country that you've been focused on. So we might ask you to move a little bit beyond that country as we go through our questions and answers.

Commissioner Shea.

VICE CHAIRMAN SHEA: Very, very interesting. Thank you so much for joining us.

I'm glad you gave, well, Ms. Clapp and Dr. Heng gave population numbers. I happen to sort of know the population of Vietnam. It's about 90 million or so. You look at 50 million plus 30 million plus 90 million, that's 170 million people. That's a lot of people.

And we've been hearing the reports of manufacturing, particularly lower value manufacturing, traveling to Southeast Asia from China. And I was wondering if you could, in each of the--it seems probably most prominent in Vietnam, but I'd like to hear about it in Malaysia, and what is the potential in Burma, and how are the Chinese reacting to that?

MR. HIEBERT: Should I start because of Vietnam? I mean a lot of U.S. companies, others, Koreans, Japanese, view Vietnam as the China plus one. As costs go up, as there are other disputes, Vietnam they find to be a pretty good place to do business. Samsung now manufactures the lion's share of its mobile phones in Vietnam, and it's really interesting, as Vietnam gets into the TPP, the Chinese notice that Vietnam is going to have tariff reductions in areas like garments, that there's going to be something called Yarn Forward in the TPP, which is going to require Vietnam to get its inputs for garments where it's now getting cloth, thread, zippers, buttons, et cetera, from China. So you're now starting to see Chinese companies investing in textile mills, garment factories in Vietnam so that they can take advantage of the TPP.

Generally, though, for Vietnam, China is more of a trading country rather than an investor. It's just starting--

VICE CHAIRMAN SHEA: Is the trade deficit with Vietnam a serious concern in Vietnam? My understanding is that Vietnam has a significant trade deficit with China.

MR. HIEBERT: Yes.

VICE CHAIRMAN SHEA: Is that recognized among the Vietnam people as a problem?

MR. HIEBERT: You hear some officials talking about it. I think the average guy on the street doesn't focus on that too much, but they also know that they have a huge trade surplus with the United States for selling products that we just talked about.

I think they recognize that the deficit is due to the fact that they get so many inputs for their exports, and so they make it up in their trade with Europe and with the United States. They, however, they're not so worried about the deficit; they're worried about being so beholden, and that's why they would like more options.

VICE CHAIRMAN SHEA: Dr. Heng.

DR. HENG: There are not very many Chinese low-tech, you know, labor-intensive manufacturing in Malaysia because the Malaysians themselves are very robust in developing their own, and whereas the Chinese investments coming in are for the infrastructural projects and the development of, in the recent development of industrial sites, upgrading of ports. The Chinese railway companies bid for the first high-speed rail link in Southeast Asia between Kuala Lumpur and Singapore.

And so Malaysian investments--Chinese investment--Malaysian Chinese investments in

China is much, much more than Chinese investments in Malaysia. But the Chinese state-owned enterprises investment will increase dramatically. This is what I expect to see.

VICE CHAIRMAN SHEA: I've read that Malaysia is becoming a center of solar panel production. Is that correct?

DR. HENG: Well, Malaysia is--yeah, First Solar is actually U.S. It's Solar First is a U.S. company, not the Chinese. The Chinese are not there because it's cheaper for them to produce in China. So the U.S. First Solar went over to Malaysia I think maybe six or seven years ago and has really more than doubled its production there.

But China has very little of that kind of investment in Malaysia. It's concentrated in real estate, you know, some real estate, but I don't see much in the retail section. It's not noticeable compared to South Korean or Japanese or American investments.

China's investments are very low, but the big wave is to come. I expect the big wave will come in port, railway, industrial park development that Malaysia is looking for.

VICE CHAIRMAN SHEA: Thank you.

Ms. Clapp.

MS. CLAPP: Burma is primarily an agrarian economy, and manufacturing in that country is in very, very early stages. But the garment industry is growing fast, and the last four years, it has grown very fast. When we removed our sanctions on trade, we became a market for them again, and that's very important.

So Chinese are actually building factories there, but many other countries are, too--Japan, South Korea, Singapore, other ASEAN countries.

VICE CHAIRMAN SHEA: India?

MS. CLAPP: India has built some factories there, yeah. India has problems, I think, making decisions about these projects and carrying through on them. They talk about concluding agreements, but then somehow it doesn't get followed through on.

They've also had some bad experiences back in the days of the military government where they set up factories sort of on a turnkey basis, and the minute they turned them over, the Burmese didn't know how to run them, and they just were abandoned. There are a lot of abandoned projects in the country.

Now that they have much better relations with the big investors, I think they're going to have better luck with the manufacturing that they're undertaking now, and with the garment industry, it seems to be moving forward very fast. And they also export a lot of food products, seafood, rice, beans and pulses, to India. India is a big market for them. China is a big market for them.

But they tend to export unfinished products. They just tend to export the raw products. So they need to--what they would like to do is establish food processing factories and some value-added before they export these things, including timber and natural resources. They'd rather have some manufacturing in Burma before it leaves the country, but they still have a long way to go.

VICE CHAIRMAN SHEA: Uh-huh. Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Tobin.

COMMISSIONER TOBIN: Thank you, Madam Chair.

This morning we were talking among our other panelists about the arbitration with the Philippines call to the U.N., and, in 2016, we're apt to get the first of the decision made public.

I'd like to know what each of you think might be the case for Burma, for Malaysia, for Vietnam, if the decision goes in support of the Philippines or if it goes largely in support of the

Philippines, what will those countries do; what are their thoughts apt to be?

And I suppose if it doesn't go positively, the question is moot, but assuming that there's some legitimacy to that claim, I'd like to hear what you think each of these countries can do but also collectively whether you think ASEAN countries might be able to--what's the word for it--set the tone that this behavior will not be tolerated in terms of the disputes in the sea?

DR. HENG: It is clear that all the four claimant states, the three other claimant states, will support Philippines, you know, adjudication, whatever, and they are probably confident it will be ruled in the Philippines' favor because that principle that the disputes in South China Sea should be settled according to UNCLOS law is already in the Declaration of Code of Conduct. It is really something ASEAN has asked, you know, has set down and will want that principle to be recognized in a binding Code of Conduct.

However, unlike the Philippines, Malaysia doesn't want to endanger its relationship by asking to submit its own claim to UNCLOS. It's happy to see the Philippines do it. Initially there wasn't much big support because Philippines apparently did not consult very properly with the other ASEAN countries when they went ahead to submit their claim.

But I think Malaysia has come around to it. Vietnam, I'll leave Murray to answer to that. And so Malaysia has made it very clear that it will be a moral victory in the court of public opinion if it's ruled in Philippines favor, but it also knows that really it has no teeth at all, and that China can ignore it and will continue to ignore it.

In fact, what's happening is that China through all its recent reclamation in the South China Sea has already, is really putting in place a de facto ADIZ. It exists. It's a de facto ADIZ. It doesn't need to announce it like it did for the Senkakus. It's there, you know, with its military airstrip and garrisons of soldiers.

So really there's very little that the ASEAN countries can do so it's an extremely difficult position, but they will also support this ruling, and they expect it to be ruled in the Philippines' favor.

COMMISSIONER TOBIN: And I'll hear from the others, but let me just say that we know that China will not be responding, and I see it truly as an opportunity, even for Malaysia, to collectively--it is a moment in time.

Mr. Hiebert.

MR. HIEBERT: The Vietnamese are watching this case very carefully. They have been quite supportive. In last December, the Vietnamese put in their own submission to the arbitral tribunal in which they asked the tribunal to consider Vietnam's case as well when they adjudicate. They didn't put in their own submission but made, put in a document which suggested that they're very supportive.

I think, like Professor Heng, they aren't confident that China will change in light of what happened. In fact, I think probably almost nobody thinks the tribunal will rule totally against China. In fact, I think if it did, it would be a mistake. I think we're going to have to--maybe if they rule on the Nine-Dash Line being illegal, but I'm not sure they're going to be able to rule on all the features, which is the other issue.

But Vietnam and the U.S. and others are already going around talking to people trying to build support. We might recall that back in the day, the U.S. also ignored a Nicaragua claim against the U.S. and ignored it for eight or nine years, and then the political situation changed, and the U.S. decided to go along with it.

I'm hoping that the moral pressure on China even though they can't tell you up front that they're going to do it, that they'll eventually come to that point.

COMMISSIONER TOBIN: And it is a moment for ASEAN.

Ms. Clapp.

MS. CLAPP: We shouldn't expect Burma to be taking any initiatives with the South China Sea. They will stand behind an ASEAN consensus if one emerges, but they're not going to get out in front on that issue.

COMMISSIONER TOBIN: Thank you.

HEARING CO-CHAIR BARTHOLOMEW: All right. I'm going to take the prerogative of the chair and ask a few questions.

Mr. Hiebert, did I hear, I want to make sure I understand what you just said, that you think that ultimately, presuming that the bulk of the tribunal's ruling goes against China, that you think that there's a chance that ultimately they might comply with part of it?

MR. HIEBERT: I guess that was a face statement.

[Laughter.]

MR. HIEBERT: I was hoping that they would follow the example of another big power and do that. Although I have to say you start to, when talking to foreign ministry officials, talking to academics that come through here, you do sense the recognition that they need to clarify what the Nine-Dash Line means and clarify what is being claimed inside the Nine-Dash Line.

So I think you're already starting to see at least a little debate in China to prepare for what might happen early next year.

HEARING CO-CHAIR BARTHOLOMEW: That's very interesting and quite different from--I don't know. I look at it and I just think how are the affected countries going to deal with what certainly seems like a fait accompli that the Chinese have essentially taken over the South China Sea?

And what I was going to ask all of you--though, Dr. Heng and Mr. Hiebert, this is probably more relevant to the countries that you're talking about--was do you think that the leaders and the strategists in these countries have been surprised by what the Chinese have done, the assertiveness or the aggressiveness?

And then are people concerned about what next? I mean does it stop here? Or where are people thinking what next if China--people talked earlier today, we've heard other people talk about the sort of the salami slice, or the two steps forward, one step back. Of course you go two steps forward, one step back, you never go back to where you were. So are people worried about Chinese expansionism? Or do they think that it would end here within the Nine-Dash Line?

I'm just wondering what the strategists in these countries are thinking about and preparing for?

DR. HENG: I think Malaysian strategists, they're still trying to figure out how to deal with this very, very complex issue. First of all, I'd like to say that China's recent, the last phase, this is the reason is, you know, China fought two naval skirmishes with Vietnam and two with Philippines to get Paracels and then Mischief Reef. And it was very, very good. It had a charm offensive. They signed onto the Declaration of Code of Conduct.

And the latest round is actually, it was actually due to an action taken by Malaysia and Vietnam in 2009 when they submitted their claims based on continental shelf, which gives them a larger area of water than the EEZ. They submitted it to UNCLOS to have some ruling on its continental shelf, and this is when China then said, okay, you know, we had the status quo, but you are now upsetting the status quo. We had this Nine-Dash Line. We didn't have to fight. We didn't do anything about this. We have not been--been behaving very, very well. But you have

set, you have upset us by doing this. So China's response is really, you know, and it has spread, that reaction from China.

So what I think is going to happen is that the only way that these countries or the claimant states can prepare themselves is actually look to the U.S. They cannot by themselves stand up to China. They all know this.

But more importantly, what I think also, as Murray says, about the UNCLOS arbitration, all these features can only be resolved through bilateral, bilateral talks and bilateral consultation and agreement between the countries involved.

So ASEAN has bilateral, has got claims and disputes with other ASEAN countries. It's not between China and Vietnam, but also--and Malaysia. It's also Vietnam-Malaysia, Vietnam-Philippines, and the ASEAN countries have got to, first of all, resolve their bilateral differences before presenting that to the Chinese.

I don't think a Code of Conduct can be drawn without the ASEAN countries working on their bilateral claims first, and they have begun to work on it. They've begun to do it, and we're going to see more of this, and the U.S. should encourage ASEAN to settle the outstanding bilateral claims, and then they can work with the Chinese on this.

MR. HIEBERT: China started putting more pressure on the other disputants in the South China Sea in 2009 by initially cutting some seismic and arresting fishermen, but for the Vietnamese, that was all sort of one thing. Oh, they actually also let CNOOC, their oil and gas company, offer some of Vietnam's blocks that had already been given to companies, including some from the United States.

HEARING CO-CHAIR BARTHOLOMEW: Right.

MR. HIEBERT: But the real shocker was the oil rig in mid-May last year. The Vietnamese were shocked by the fact that it happened, and then they had these Party-to-Party ties that went way back, and when the Party guys tried--in Hanoi tried to call the Party guys in Beijing, they got no answer, and it went on for over a month. They were shocked.

And I think they realized then this Party-to-Party stuff was only going to get them so far. And I think you're going to--and that really was a serious development that forced Vietnam to start thinking about how it was going to deal with its foreign relations. It had already been moving to step up ties with the U.S., Japan, et cetera. But in the wake of that, it has been moving much faster.

And so I think they don't know where this will end. They do talk of Air Defense Identification Zone maybe being next, which Professor Heng already alluded to. But they expect again in the summer to be--China divides the oceans, says you can't fish above this area during these months. It's a moratorium on fishing. Their fishermen--both the Philippines and Vietnam have been sending their fishermen around the Spratlys and the Paracels for centuries; they're going to keep going. They need it to survive economically, and they'll keep getting arrested.

So there's going--but the danger is that in through some of these moves, you have a mistake, and somebody overcalculates and runs into a problem that results in some guys shooting at each other.

HEARING CO-CHAIR BARTHOLOMEW: Ms. Clapp, anything to add?

MS. CLAPP: Again, Burma doesn't have a direct problem in the South China Sea, but it does have a security problem with China on its border. It has an active war right now on the border with China in which China may or may not be implicated. So that's where they focus their concerns right now.

But as I said, they will stand by an ASEAN consensus. They would stand by ASEAN

over China in some of these issues because ASEAN is their protection against China.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Fiedler.

COMMISSIONER FIEDLER: A couple things. Just a comment on your report of the Pew poll in Vietnam, about 16 percent favorable rating for the Chinese; right? And less for the Japanese. Do you understand why that was? I'm not sure most people do--they have historic--

HEARING CO-CHAIR BARTHOLOMEW: Wait, wait. That was the Vietnamese perception of Japan or Japanese perception of China?

COMMISSIONER FIEDLER: No. No. It was Vietnamese perception of Japan was less favorable than their perception of China.

HEARING CO-CHAIR BARTHOLOMEW: No, wasn't it Japanese perception of China?

MR. HIEBERT: It's Vietnamese perception of China and Japanese perceptions of China.

COMMISSIONER FIEDLER: Oh.

MR. HIEBERT: And Vietnamese have a little more favorable view of China than the Japanese do.

COMMISSIONER FIEDLER: And did they poll the Vietnamese view of the Japanese?

MR. HIEBERT: I don't think that poll did it.

COMMISSIONER FIEDLER: Because the historical memory there is millions of people were starved by the Japanese in 1944 when they took all the rice to feed the Japanese army, which is a more recent memory--

MR. HIEBERT: Yeah.

COMMISSIONER FIEDLER: --than the thousand year domination that was overthrown by the Trung sisters in the historical revolution.

There are no client states in Southeast Asia of the Chinese, and there are no client states. Burmese were the closest, I believe, to a client state at one point, and then I suspect that the growing superpower of China experienced their first major intelligence failure, which they should probably get used to as a superpower.

So you'd have a different world problem. Southeast Asia countries have a long history of sort of independence, which is somewhat geographical-based but not entirely; right? The Thais were never controlled by a colonial power.

The difference, the difference here is, in my view, and you tell me what you think, the hedging strategy doesn't work for very long. I've heard a couple of you say--I think it was you, Ms. Heng--that the Malaysians are looking to the United States. The Vietnamese may be looking to the United States. The Indonesians might be looking in the mirror at the moment instead of at anyone else. The Burmese may be actually looking a little more to the United States than before, and we haven't perceived that yet.

What point does security cooperation with the United States, which seems to be growing, belie hedging in the Chinese view of them?

MR. HIEBERT: Now, that's a really--

COMMISSIONER FIEDLER: I mean this is, this is different. I mean add one thing, this is their backyard, I mean, so you take the United States, Latin America, what would we do when somebody is starting all kinds--Chinese security relationships start to increase in the Caribbean or in Latin America, what are we going to do? So hedging--hedging only works if the Chinese allow it to work unless it's no longer a hedge but an alliance.

The Chinese have picked two alliance partners of the United States to test: Japan and the Philippines. They didn't choose Malaysia and Vietnam. That seems willful. That seems strategically smart in terms of testing the will of the United States. This hedging I'm deeply

concerned about because it doesn't--hedging doesn't help U.S. interests or, in fact, freedom of the seas navigational interests of all the states in Southeast Asia for very long.

Do you--am I somehow wrong in thinking that hedging is not a viable option for Southeast Asian states?

DR. HENG: Thank you for that very, very challenging question.

[Laughter.]

DR. HENG: Let me just begin by saying actually the closest client state that China has in Southeast Asia is Laos.

COMMISSIONER FIEDLER: Yeah.

DR. HENG: Laos is really, I mean it's insignificant, but that is--and Cambodia, you know--

COMMISSIONER FIEDLER: Meaningless state in the Southeast--

DR. HENG: --but, you know, well, and we don't know what Laos is going to do as ASEAN chair next year. That is a concern. For Malaysia, we'll know that there will be consensus. Malaysia will uphold the consensus and will articulate or communicate Vietnam's and Philippines' concerns, but Laos is a different story. And that's where we're going to see problems in ASEAN.

In terms of hedging, this is, what else can these countries do apart from making it more difficult for China to--I mean China maybe, you know, when it gets stronger, when its naval forces are sufficient, have capacity, they probably will be a lot more aggressive, and Malaysia probably expects that to happen at some point.

But they want to make sure that in swallowing these countries, China will get a bad stomachache. It will be hard for China to do because what Malaysia has done to make sure that China thinks twice before it does anything else, it has now allowed ships, U.S. aircraft carrier visits to the Malaysian coast of Sabah.

It's getting the Americans to train the Malaysian Marine Corps. It started the first marine exercise with Malaysia and the U.S. So if all ten countries--well, not the--the maritime states, if the maritime states were to do this, it's harder for China to pick one of--you know, to pick them out one by one. So ASEAN sees its strength, this is the symbol of ASEAN, ten stalks of rice, and ten stalks of rice are harder to break than a single stalk, and that's how they see their policy in staying China's hand.

And so it's so crucial that ASEAN remains united in dealing with China, but there is a difference between the maritime and the mainland ASEAN states. Maritime, America has a lot more interest in maritime Southeast Asia than it has in mainland Southeast Asia because of the commerce, you know, because of the investments. There are more American investments in Singapore alone than in China.

So American investments in the maritime Southeast Asia is big; it's huge. And so I think it's in America's interests, you know, really to also support the ASEAN position as well.

COMMISSIONER FIEDLER: The unspoken other part of a so-called hedging strategy is actually it's not hedging, it's letting the U.S. do it--okay--which is perhaps an even more dangerous game than hedging; right?

And what, as I--if you were here for the earlier panels, when I raised the question of what is going on in the South China Sea right now is a direct test of American will, and therefore perhaps has more importance than the apparent issues from an overall security point of view. I actually think security trumps all economics at some point anyway.

So the description of Southeast Asia economic interests vis-a-vis China is significant but

not dominant yet. The security interest may dominate more quickly than the economic, and I'm still worried. Nobody today has given me any comfort that we're on a miscalculated path here. I'm sorry, Mr. Hiebert, I don't buy moral suasion with China. Okay. I think we've done a lot of moral suasion that I wouldn't bother ever again.

So I think it's a very dangerous situation here that with Xi's consolidation of power and his domestic imperatives make the mix more dangerous. I think it's a very dangerous situation. The only more dangerous situation is if he miscalculated and thought he could get Taiwan before we could get there.

I don't think there's any other--these two situations are the most dangerous we're facing, and I'm not particularly comforted today in legal solutions and the Chinese honoring them in partial face-saving solutions. I haven't been convinced this isn't more dangerous than I thought it was six months ago.

DR. HENG: Absent America's political will to confront China directly in the South China Sea, it has to work with ASEAN because I mean in the way that you have not been able to give the Philippines a guarantee that you will support Philippines the same way you've given Japan a guarantee for the Senkaku.

COMMISSIONER FIEDLER: But the sort of political imperative why the United States in my view doesn't give the Philippines a guarantee is the alliance doesn't call for it, and the strategic ambiguity of that acts as somewhat of a restraint on Philippine behavior.

DR. HENG: Yes, precisely, yeah. So you want to restrain--that's why we need to have a mechanism to deal with the low-class incidents. That is the first thing we've got to do is to set up an ASEAN-based rapid response conflict management mechanism, you know, to then deal with whatever local issues that might break out in the region. And this is the only thing we can--

COMMISSIONER FIEDLER: Why wouldn't ASEAN countries participate in joint freedom of navigation operations in the South China Sea that the U.S. apparently launched unilaterally, which is its normal--I mean it is the guarantor of freedom of the seas generally speaking?

MR. HIEBERT: As you probably read in the Wall Street Journal, there was--

COMMISSIONER FIEDLER: Yes.

MR. HIEBERT: --the Wall Street Journal reported that was actually the U.S. policy. However, that the U.S. was going to do a freedom of navigation exercise--

COMMISSIONER FIEDLER: Yes.

MR. HIEBERT: --either by air or sea. And China responded very sharply overnight.

COMMISSIONER FIEDLER: Yes.

MR. HIEBERT: But the administration says they aren't nearly that far in deciding yet what to do. Those are suggestions that have been debated, but that they haven't actually gone to Secretary Carter yet, and so the U.S. itself isn't clear that it's ready to do a freedom of navigation because if China responds, that does have implications; right? You got to know how far you're ready to go. If China stands up or demands why are you within our 12-mile Exclusive Economic Zone, then what?

COMMISSIONER FIEDLER: I'm sorry to be cynical. I mean that is like saying that the Chinese ASAT test was a rogue test that the Central Military Commission or Hu Jintao at the time didn't know it was going on. The U.S. coastal littoral combat ship, you're telling me I'm supposed to believe that the Defense Department didn't know what it was doing?

MR. HIEBERT: What I was saying is that to do a freedom of navigation exercise, you can get challenged.

COMMISSIONER FIEDLER: Right.

MR. HIEBERT: There was, the Wall Street Journal reported that the administration had decided to do it.

COMMISSIONER FIEDLER: I read the report.

MR. HIEBERT: The administration, if you talk to them, say they have not made any decisions. No recommendation has gone up to Secretary Carter. That's all I'm saying. So they do have ships that can do this.

COMMISSIONER FIEDLER: And did it.

MR. HIEBERT: Have done it? They've done it, but not necessarily in the reclaimed. That's all I'm saying--the reclaimed reefs, they have not done it as far as I know.

COMMISSIONER FIEDLER: So what would inhibit the ASEAN states from joining in a freedom of navigation exercise in the South China Sea prior to adjudication?

DR. HENG: You could bring this up in the next, in the next ASEAN Defense Ministerial Meeting-Plus, ADMM-Plus. That's the place to talk about working with ASEAN, and I think ASEAN would be--if it can be couched in a way, and China is also an ADMM, I think the ADMM-Plus is the platform to begin to discuss how you do deal with this, whether U.S. to float this idea and then to hear the other reactions.

MR. HIEBERT: But I would bet you pretty much money that the ASEANs will never agree to do that. They're two divided. You're going to have the Vietnam and the Philippines maybe agree, but beyond that, nobody--Malaysia would not go along with--

COMMISSIONER FIEDLER: Do you all agree that the South China Sea issue is a freedom of navigation issue? Not just a sovereignty issue?

MR. HIEBERT: It's that for sure. It's probably that--you know--now I just wanted to add two other things. You asked which countries are client states? Pek Koon talked about Laos. I think Cambodia is pretty much in that state also, and watching Thailand, it's not quite sure, clear where it is going. They had a coup last May. The U.S. did some--reduced its engagement, and as a result, China has really launched a charm offensive trying to do joint military exercises, invite Prayuth, the commander, and other senior leaders to China.

There's a massive charm offensive. I think the Thais probably are playing this for all it's worth right now to see if that lures the United States back. But I think the United States has to think about if Thailand is going to go through this fairly frequent cycle of coups, how the U.S. wants to respond to that because Thailand, the level of engagement between the two countries, the Cobra Gold, which is so critical, which did go ahead last year, the cooperative--it's the biggest embassy in the region because there's so much regional stuff happening there. That is now sort of not on ice, but sort of at a reduced level. So who knows what's going to happen there.

With the Vietnamese on hedging, you know, Secretary Panetta three years ago goes to Cam Ranh Bay, deep water port that you know a lot about, and that was built by taxpayers you know well. And the Vietnamese--he basically said can we figure out something here, and the Vietnamese have said maybe not because of the implications for its relations with China.

I think you're going to see a lot of countries really wanting the U.S. but not too close and certainly no conflict with China. So they really are paranoid about what's going to happen economically if there's a conflict.

COMMISSIONER FIEDLER: They can't have it all ways.

MR. HIEBERT: That's the problem; right?

HEARING CO-CHAIR BARTHOLOMEW: Okay. Commissioner Shea.

VICE CHAIRMAN SHEA: I want to talk about Burma. Get Ms. Clapp involved here. You mentioned a couple times--we've read the reports about the Burmese Central Military having fights with the Kokang rebels, if you want to call it that, and bombs dropping into fields in Yunnan Province, and the Chinese expressing regret and anger. But you said the Chinese may or may not be implicated in these wars. You said that a couple of times. Could you flesh that out?

And to what extent is this being followed by the Chinese domestic population? I mean I'm thinking this sounds like a Crimea situation where it might provide a pretext to protect Chinese nationals who happen to be living across the border, to enter and maybe get a little extra territory. I don't know. I'm just--tell us what you know.

MS. CLAPP: It's funny you should mention Crimea because the last time I heard that was from one of the senior ministers in the Burmese government.

VICE CHAIRMAN SHEA: Well, we've been talking to--

MS. CLAPP: They are looking at Crimea, yes.

[Laughter.]

MS. CLAPP: And that was just two weeks ago.

VICE CHAIRMAN SHEA: Interesting.

MS. CLAPP: When I say may or may not be implicated, I guess I probably should have qualified that as Beijing. Yunnan is definitely implicated.

VICE CHAIRMAN SHEA: Yunnan provincial government?

MS. CLAPP: Well, not, what--everything is government in China.

VICE CHAIRMAN SHEA: Okay.

MS. CLAPP: Yunnan people. And probably people that are related to the Kokang tribe. The former leader of the Kokang armed group who was overcome by the Burma Army in 2009 and fled Kokang, he probably was in China. He could have been in another part of Burma. He could have been in Thailand. Anyway, he was somewhere around in the region and at least part of the time in Yunnan.

That's where his family and his money and so forth are. He definitely raised his new forces in Yunnan, probably gets a lot of military and financial support from sources in Yunnan. And came back into Kokang from Yunnan. So, yes, Yunnan is implicated.

But whether Beijing has control over this activity out of Yunnan is another question, and I think at first, Naypyitaw, the government in Burma, was thinking that Beijing was implicated, but they're not saying that now. They may still believe it, but they're not saying it. They're saying that we'll give Beijing the benefit of the doubt.

They have apologized for the bombs that landed on the Yunnan side. But whether it was a heartfelt apology or not, we don't know.

The same thing happened in the Kachin state a couple of years ago when they were fighting right on the border of the Kachin state; the bombs went over into China. So it wasn't the first time, and those bombs may go into China on purpose just to remind them that this is a war on their border.

The Chinese population inside China is not happy about this, and it takes it as a great insult that Burma should be fighting against them and hurting their Chinese nationals in Burma. They get all worked up about it, and Beijing in the context of this Kokang fight actually started closing down some of the blogosphere because it was getting a little too nationalistic. This happens fairly often with Burma.

VICE CHAIRMAN SHEA: Sure. Is the source of the tension on the border just about

resources and power? What is the source of the--

MS. CLAPP: It's control over territory. Kokang is a little piece. It's an autonomous piece that sort of juts like an arrow into China, and it was part of China. I think the British hived it off during the colonial period, and the Kokang who live there are basically Yunnan Chinese.

They speak Chinese. They trade with Yunnan. They're not really connected by roads, by good roads, to Burma. And it's existed fairly autonomously from the rest of Burma. So this guy that came back in, he's in his 80s now--he's not a young, young guy--with his army was really just trying to reclaim the territory that he lost in 2009, and probably get in on the peace talks that the Burmese government is conducting now with all these old ceasefire groups.

I think he wanted to get on it and be part of the settlement in the end. Rehabilitate himself inside Burma.

VICE CHAIRMAN SHEA: So this notion, I mean the fact that this was territory once considered part of China, not too long ago--

MS. CLAPP: Well, yeah--

VICE CHAIRMAN SHEA: --is there a concern that this could provide a pretext for--

MS. CLAPP: There may be.

VICE CHAIRMAN SHEA: --assuming that territory?

MS. CLAPP: There may be, but it's latent at this point.

VICE CHAIRMAN SHEA: And it's not real?

MS. CLAPP: The army is fighting hard there. The army has really deployed significant forces in this, and they're not doing very well because this Kokang group that came back in is conducting a sort of a guerrilla warfare against them, and a lot of--they've lost a lot of people. The army has lost a lot of soldiers. So they don't--they don't want to advertise that. But right now they're refusing to let the Kokang into the ceasefire talks. Other groups are saying let them in, let them in. We'll see what happens.

I think that border is going to be unstable for awhile. Whether China wants to have it that way or not is not clear. All of those tribes are more economically and culturally connected to China than they are to Burma.

VICE CHAIRMAN SHEA: Uh-huh.

MS. CLAPP: The Burmese even withdrew the teachers from the schools several years ago so they're not even learning the Burmese language anymore. They all speak Chinese. They need to build some roads into Burma.

VICE CHAIRMAN SHEA: Uh-huh.

MS. CLAPP: Right now all the roads go into China, and there's a huge amount of illegal trade across the border.

VICE CHAIRMAN SHEA: Okay. Thank you.

HEARING CO-CHAIR BARTHOLOMEW: Commissioner Tobin, did you have one more question?

COMMISSIONER TOBIN: Yes. Thank you, all.

You've all in your testimony been very clear with a roster of recommendations for Congress or the executive branch, but I'd like you to distill if you had to pick one action item for the United States to take vis-a-vis ASEAN or the country that you're speaking about here today, what would it be? Over the next few months, our team puts forth its report, and then we speak to Congress through that report on what we think needs to be done. If you had to say one thing that would have the greatest impact, what would be?

Yes, Ms. Clapp.

MS. CLAPP: I think I would say that we need to get over sanctions.

COMMISSIONER TOBIN: Uh-huh. You mentioned that before that we need to look at that--

MS. CLAPP: But you said just one, one thing.

COMMISSIONER TOBIN: Yes.

MS. CLAPP: I think--

COMMISSIONER TOBIN: Good.

MS. CLAPP: --I think we really need to get beyond the sanctions.

COMMISSIONER TOBIN: Yeah. That's fair. Great. Thank you.
Doctor.

DR. HENG: I would say that sustain the pivot is very important because some countries in the region are now questioning whether America is serious about focusing on the region with its problems in the Middle East, and this is the most concern that most countries have in the region.

So sustain the pivot, make sure there's funding to maintain it, and support ASEAN centrality as a way of safeguarding American interests in the region.

COMMISSIONER TOBIN: Thank you.

Mr. Hiebert.

MR. HIEBERT: Yeah. I think I would go back to one that I suggested earlier, and that is to sustain very high level engagement with Vietnam. There's a lot of opportunities. That's one country that really wants to engage. And you can engage at so many different levels, and I think we do have opportunities through having advisors in the National Assembly and doing the human rights dialogues, like just happened last week, to have an impact on nudging that country into a different space while at the same time helping it protect itself against China.

COMMISSIONER TOBIN: It is an opportune time, and I think we--those are three excellent responses. Thank you.

HEARING CO-CHAIR BARTHOLOMEW: All right. I want to thank all of our witnesses. I'm just going to note that while we were sitting here, Reuters came out with a story that senior State Department official has said that Secretary Kerry will leave China, quote, "in absolutely no doubt," unquote, about Washington's commitment to freedom of navigation and flight in the South China Seas when he is Beijing this weekend. So we'll see how things all unfold.

I want to thank our staff for putting this hearing together, particularly Matt Southerland, Kevin Rosier and Michael Pilger. You guys did a great job. I know we had a lot of witness scrambling.

Thank you very much to our witnesses. We may well come back to you with other questions as we move forward with the process, but thank you, it's been a very informative hearing. So with that, we will close our hearing down. Thank you.

[Whereupon, at 2:50 p.m., the hearing was adjourned.]