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China Still Has a Long Way to Go

BY JOHN LEE

In the latest edition of *Foreign Policy* magazine, US Secretary of State Hillary Clinton reaffirmed America's intention to "pivot" from the Middle East to Asia through "increased investment—diplomatic, economic, strategic, and otherwise." Part of this is to signal to Americans, and reassure regional allies, that Washington will no longer stand by while China eats America's lunch in Asia. While it is true that Beijing is actively attempting to gradually dilute America's influence in what it sees as its own backyard, the perception of significant Chinese gains in strategic influence at America's expense does not actually accord with current reality.

John Lee, Michael Hintze Fellow for Energy Security at the Centre for International Security Studies, University of Sydney, explains why "Regional states are wary that China would like to emerge as Asia's preeminent power but are far from betting on Beijing being successful in doing so."

China is not only Asia's largest economy, but has emerged as the largest trading partner for major Indo-Pacific states including Japan, South Korea, India, many ASEAN states, and Australia. The concern is that China will use its presumed economic clout to seduce or otherwise compel regional capitals to shift course and move towards its strategic sphere of influence and away from the United States. However, despite China's emergence as an indispensable economic partner in the region, the exact opposite has happened.

Even as interregional trade with China deepens, the paradox is that every major country in the region has shifted closer to Washington as a hedge against China's rise—Japan, South Korea, Thailand, the Philippines, India, Australia, Vietnam, Indonesia, Singapore and Malaysia. This strongly suggests that China is having enormous difficulty translating economic size into proportionate strategic leverage in the region. Even as China rises, key Asian powers balance and bandwagon among themselves to ensure that America remains the preeminent strategic actor. Almost all Asian powers want America to remain the superior power in the region, rather than China or any other Asian power.

So why a preference for a country that Beijing believes is a recent interloper in the region?

First, there is the simple reason that China has land and maritime disputes with a number of Asian countries—including India, Japan, and several states in the South China Sea. In contrast, the United States does not.

Second, free and open trade—which is the lifeblood of growing prosperity—has depended on US naval power and the US-led hub-and-spokes defense structure for more than five decades. In contrast, China quite correctly sees this security architecture as a ready-made initiative to inhibit its strategic options. Therefore, even though it has greatly benefitted from it, most countries suspect that China wants to eventually revise and even dismantle this regional security interaction with the United States. Other states fear the revisionist tendencies of China in this context and the implications of a Chinese-led regional order.

Third, the fact that the United States is not geographically based in Asia works to its advantage. As a foreign leader, it requires greater levels of acquiescence from Asian partners to retain its presence in the region, such as basing rights. If asked to shift its bases—as occurred in the Philippines in 1992—America will do so peacefully. Even if there was resentment in Washington, the United States is in no position to punish Manila.

In contrast, a dominant Asian power would not need the same level of regional acquiescence to maintain its military footholds. Whereas America has to constantly negotiate the terms of its presence in Asia and is structurally bound to provide public security goods, there would be much less incentive for a dominant Asian power such as China in doing so.

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Regarding economic statecraft, there are a number of strategists putting forward the seemingly plausible argument that the importance of China as a trading partner will eventually compel key states to shift their strategic alignment. But these arguments are less convincing on closer inspection. The problem for Chinese leverage is that at least half, and perhaps as much as two-thirds, of its trade with East and Southeast Asia is "processing trade," with two-thirds of all finished products going to America and Europe. China's domestic consumer market is about US$1.5 trillion compared to the US market of about US$10.5 trillion and the EU's of US$11.5 trillion. For Asia's exporting countries, the Western consumer remains far more important than the Chinese one.

Even assuming the continuation of rapid growth in emerging markets and anemic growth in the industrialized economies over the next decade, one is still looking at a combined US and EU consumption market of around US$25 trillion versus a Chinese one of US$3 trillion.

Back to current reality, China could try to get its way by imposing selective trading bans on major firms or even individual countries. But if it did, production chains would be disrupted at great cost to all parties, including China. Asian firms would eventually find other manufacturing avenues, even if it were more costly and time-consuming to do so. Besides, China needs the technology transfer that comes with this trade, and politically cannot afford to do significant damage to its export manufacturing sector, which employs 150-200 million workers.

This is affirmed by the fact that while the Chinese economy currently constitutes a large component of global economic growth, it is not the central driver of global growth. This is due to the fact that 50-to-60 per cent of Chinese GDP growth is driven by domestically funded fixed investment. China's total domestically funded fixed investment amounts to about $2.5 trillion each year, as compared to $105 billion of foreign direct investment which is mainly destined for the export manufacturing sector. More than three-quarters of all bank loans go to state-owned enterprises (SOEs), and the most important and lucrative sectors are reserved for SOEs. This means that few foreign firms actually enjoy significant access to the most profitable Chinese markets. This is in contrast to America's open economy which offers foreign firms and governments deep access to its vast domestic consumer and financial markets, in addition to a fully convertible currency, transparent regulatory regimes and rule-of-law. The political consensus in Beijing is that policies protecting SOEs will likely remain since this is at the heart of how the Chinese Communist Party retains economic influence and relevance in the country. But it will further restrict Beijing's ability to use access to markets as a point of leverage.

None of this is to deny that China is already a formidable foreign policy and strategic actor. But its ability to shape strategic outcomes is determined by occasional bluster and intimidation, but most of all by size. Such an inefficient ability to exercise leverage means that the Chinese economy and military would need to reach an enormous size and capability to achieve the aim of "easing" America out of Asia.

Regional states are wary that China would like to emerge as Asia's preeminent power but are far from betting on Beijing being successful in doing so.

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