



# Pursuing a More Comprehensive Approach toward Southeast Asia is Critical to Preserving U.S. Influence in Asia Pacific

*The Great Game between China and Japan, the Role of Infrastructure Development, and the American Wild Card*

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## INTRODUCTION

Despite the Obama administration’s “Asia pivot,” most of the American policymaking establishment gives little consideration to the countries of Southeast Asia or to the region as a whole,<sup>1</sup> continuing what some U.S. critics have called a foreign policy of “benign neglect.”<sup>2</sup> Though four Southeast Asian countries<sup>3</sup> are included in the Trans-Pacific Partnership (TPP) negotiations, the vast majority of U.S. engagement in the region is largely defined by U.S.-China bilateral relations and defense and military planning – a focus that has only grown more narrow with tensions in the South China Sea.

Viewing Southeast Asia mostly through a security policy lens is nothing new for the United States. In the latter half of the nineteenth century, Washington regarded the region’s geographical position as a stepping stone to the rich markets of East Asia, which provided motivation to seize the Philippines from Spain in 1898. However, with the rise of U.S. military power, American strategists quickly shifted their attention to the role Southeast Asia could play as a geopolitical bulwark and defensive line, first against Japanese expansion and later against Soviet Communism. Certainly, in the few decades leading up to the Pacific War,<sup>4</sup> the region was “the Middle East” of the day – rich in strategic resources (e.g., oil and rubber) and a key prize for colonial powers. The quest to control this mineral wealth was the primary impetus for Imperial Japan’s planned conquest of Southeast Asia and its preemptive strike against U.S. naval forces at Pearl Harbor.<sup>5</sup>

While the United States largely ignores the economic needs of Southeast Asia, including infrastructure development, China and Japan are jockeying for influence in the region, with each contending for multibillion dollar civil works contracts. While the vast majority of these investments clearly promote development in the region, strategic infrastructure projects also help integrate those economies with China and Japan. For Beijing, the objective is clear – resurrect a modern version of the centuries-old tributary system that would improve China’s national security and help fuel its economy. While Japan has largely viewed the region as providing low-cost labor and land for its industry over the past several decades, Tokyo increasingly appreciates the region’s potential tactical value in helping check the rise of China, particularly given tensions in the South China Sea and elsewhere. But for both powers, transportation and energy infrastructure development in Southeast Asia, carried out by their respective firms, generates both economic and political influence – a fact that will almost certainly cause even greater head-to-head competition in the years ahead.



Source: [Mapsof.net](http://Mapsof.net), *Southeast Asia*

1 The ten countries of Southeast Asia are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.  
2 Kerrey, Robert and Robert Manning. “The United States and Southeast Asia,” Council on Foreign Relations, July 2001.  
3 Brunei, Malaysia, Singapore, and Vietnam.  
4 The Pacific theatre in the Second World War.  
5 See, Goralski, Robert and Russell Freeburg, “War & Oil: How the Deadly Struggle for Fuel in WWII Meant Victory or Defeat,” William Morrow and Company, 1987.

Undeniably, the region wants and needs U.S. financial assistance and innovation to help spur growth and job creation and to alleviate substantial pockets of poverty that still exist across Southeast Asia. Roughly 120 million Southeast Asians, for example, remain without access to electricity. U.S. leadership is invaluable, in part because it is indispensable to maintaining a balance of power in the region that will enhance the political stability needed to meet economic growth and integration goals.

This report suggests the launch of a more comprehensive U.S. engagement as it pertains to regional integration efforts and briefly examines what that outcome could mean for U.S. national interests. In particular, much attention is paid to China and Japan, given their dominant roles and aspirations in the region, including objectives related to transportation and energy infrastructure. The level of interest displayed by both countries stands in stark contrast to what many would consider to be historical U.S. indifference; shining a light on Chinese and Japanese activity will hopefully call into question why the United States is not more engaged. Of course, the goals of Beijing and Tokyo go far beyond construction projects. Moreover, the politics and economics between foreign nations in Southeast Asia are much more complex with the European Union, South Korea, and Australia all playing important commercial and investment roles.

While there are many important elements in integration efforts (e.g., harmonization of standards and regulatory systems), focus is given to infrastructure, particularly energy systems because of the more immediate link between access to affordable and reliable energy and the means to eradicate poverty, improve health systems, and attract investment. The role of Southeast Asia in the global economy and ongoing efforts to create a single market are important topics that deserve their own paper.

## THE GROWING IMPORTANCE OF SOUTHEAST ASIA

Over the past several decades, Southeast Asia's geopolitical significance has increased with the economic rise of East Asia and the growing importance of its trade routes linking China, Japan, and South Korea to markets in the Middle East, Africa, and Europe. The United Nations Conference on Trade and Development (UNCTAD) estimates that nearly half of global annual seaborne trade tonnage transits the strategic Straits of Malacca, Sunda, and Lombok. In 1993 – the last year of Chinese self-sufficiency in oil, about 20 percent of global seaborne oil trade relied on the Strait of Malacca, according to the Center Naval Analysis; by the end of 2011, the U.S. Energy Information Administration (EIA) found that its share had grown to about one third.<sup>6</sup>

**Table 1: Selected Statistics for Southeast Asia, 2014<sup>7</sup>**

Country	Population (Thousands)	GDP (U.S. million \$)	GDP (per capita \$)	Electric Power Consumption (kWh per capita), 2012 <sup>8</sup>	% Pop. (Ethnic Chinese) <sup>9</sup>	% Pop. (Muslim) <sup>10</sup>
<b>Brunei</b>	413.0	17,108	41,424	9,092	11	52
<b>Cambodia</b>	15,184.1	16,771	1,105	207	1	2
<b>Indonesia</b>	252,164.8	983,571	3,901	730	-	88
<b>Laos</b>	6,809.0	11,777	1,730	-	-	-
<b>Malaysia</b>	30,261.7	326,346	10,784	4,345	24	61
<b>Myanmar</b>	51,486.0	65,785	1,278	153	3	4
<b>Philippines</b>	101,174.9	284,910	2,816	672	-	5
<b>Singapore</b>	5,469.7	307,872	56,287	8,690	77	15
<b>Thailand</b>	68,657.0	373,225	5,436	2,465	14	6
<b>Vietnam</b>	90,630.0	186,224	2,055	1,273	-	-
<b>Total</b>	622,250.2	2,573,589				

6 "The South China Sea is an Important World Energy Trade Route," April 4, 2013 at <http://www.eia.gov/todayinenergy/detail.cfm?id=10671>.

7 Unavailable data represented by "-". See <http://www.asean.org/news/item/selected-key-indicators>.

8 <http://data.worldbank.org/indicator/EG.USE.ELEC.KH.PC>

9 "Investing in ASEAN, 2013-2014" Association of Southeast Asian Nations at <http://www.asean.org/investing-in-asean-2012-2013-2/>.

10 See <http://www.pewforum.org/2011/01/27/table-muslim-population-by-country/>. Laos and Vietnam are negligible with less than one percent.

Moreover, the importance of Southeast Asia to the global economy has rapidly evolved from a poor backwater to an economic powerhouse. If the region were a true, single market, it would rank the seventh-largest in the world with a combined GDP of \$2.5 trillion.<sup>11</sup> By 2050, Southeast Asia could become the fourth-largest regional economy – only surpassed in size by North America, the European Union, and China, according to IHS Consulting.

The Association of Southeast Asian Nations (ASEAN)<sup>12</sup> Economic Community recently came into effect. While it holds immense potential, its full implementation is far from reality. While significant obstacles remain to the creation of a single market,<sup>13</sup> the International Energy Agency (IEA) argues that the region, which has been a “standout economic performer” for decades, is likely to remain resilient.<sup>14</sup> IEA estimates that its share of global GDP will grow from 5.9 percent to 7.7 percent between 2013 and 2040, while its per capita income will rise from about \$10,000 to \$27,000. In the same period, Southeast Asia’s population is expected to expand from 616 million to 706 million.

Vastly complicating efforts to create a single market is the fact that Southeast Asia is perhaps the world’s most diverse region – for centuries, a major crossroads for a number of different civilizations, religions, and customs. Chinese, Hindu, and Muslim traders and migrants, in particular, have played distinct, instrumental roles in shaping Southeast Asian society. Today, over 20 million Chinese live in a region that is also roughly 40 percent Muslim. Over one thousand different languages are spoken, which largely explains why ASEAN chose English as its working language.<sup>15</sup> Adding to the diversity is the type of national governance, varying from limited or hybrid democracy to authoritarianism. Moreover, the level of economic development swings widely with wealthy Singapore and Brunei on one end and poverty-stricken Cambodia, Myanmar, and Laos on the other.

### **SOUTHEAST ASIAN ECONOMIC INTEGRATION REQUIRES MASSIVE INVESTMENTS IN INFRASTRUCTURE**

In addition to its wide cultural diversity, Southeast Asia’s geography undeniably complicates economic integration. Indonesia, the largest archipelago in the world, stretches over 3,000 miles – a distance roughly equal from Ireland to Iran. Very few outside observers appreciate that Myanmar is closer to Syria than it is to the eastern most part of Indonesia, which is over 4,000 miles away via air travel. Consequently, to achieve a sense of Southeast Asian identity, the development of excellent physical infrastructure across the region, including bridges, highways, airports, and power grids, is indispensable.

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11 Stephen Groff, Vice President for Operation, Asian Development Bank. Remarks in Berlin, Germany, 23 June 2014 at <http://www.adb.org/news/speeches/keynote-speech-asean-integration-and-private-sector-stephen-p-groff>.

12 The Association of Southeast Asian Nations (ASEAN) was formed to promote political and economic development across Southeast Asia. The term “ASEAN” is often used interchangeably with “Southeast Asia.”

13 While the Association of Southeast Asian Nations (ASEAN) has chosen to delay a number of difficult economic integration milestones until 2020, its own scorecard indicates that the region had reached nearly 78 percent of its internal targets. Difficult “second generation” reforms – such as agreement on free trade in sensitive areas or tackling non-tariff barriers that are used as protectionist measures – remain major obstacles. For an interesting treatment of the role of the ASEAN organization, please see Ji Xianbai, “Why the ASEAN Economic Community will Struggle,” *The Diplomat*, September 24, 2014 at <http://thediplomat.com/2014/09/why-the-asean-economic-community-will-struggle/>.

14 “Southeast Asia Energy Outlook, 2015” International Energy Agency. See <https://www.iea.org/publications/freepublications/publication/world-energy-outlook-special-report-2015-southeast-asia-energy-outlook-2015.html>

15 Half of ASEAN countries were colonies held by the United Kingdom or the United States (Brunei, Malaysia, Myanmar, Philippines, and Singapore)

Unfortunately, the quality of infrastructure varies significantly across Southeast Asia. Bottlenecks in transport infrastructure, with “patchy,” “below standard sections and missing links,” compounded by differences in rail gauges, pose major hurdles to linking the region with India and Bangladesh, for example.<sup>16</sup> Addressing this type of challenge requires substantial investment – a sum that is far beyond Southeast Asia’s own financial resources – to better integrate the poorer countries or CLMV (Cambodia, Laos, Myanmar, and Vietnam) with the more prosperous economic centers, inside and outside the region.<sup>17</sup> The Asian Development Bank (ADB) estimates that infrastructure investment needs in Southeast Asia approach \$1 trillion over the next ten years.<sup>18</sup>

Undeniably, infrastructure investment in Southeast Asia would increase economic growth and intraregional trade and investment flows, resulting in related levels that are seen in more advanced free trade zones.<sup>19</sup> According to the ADB, the economic benefits of improving regional infrastructure, flowing from increased trade, would clearly outweigh the costs – with some studies suggesting that related investments could boost exports by roughly 5-30 percent.<sup>20</sup> Already, ASEAN countries trade more with each other than with outside economies; roughly one quarter of the region’s goods are exported to one another. However, this amount is less than half the share of intraregional trade in the European Union and the countries covered by the North American Free Trade Agreement (NAFTA).<sup>21</sup>

## **ACCESS TO AFFORDABLE, RELIABLE ELECTRICITY IS KEY**

While transport infrastructure is incredibly important to integration goals, energy systems, particularly investments in the power grid, pose a more immediate concern for poverty eradication efforts and job creation.<sup>22</sup> The Organization for Economic Cooperation and Development (OECD) argues that “access to affordable and reliable electricity [in Southeast Asia] is likely to be among the top criteria for investors in higher-value added industries where the electricity cost is a major component of the cost structure of the business.”<sup>23</sup> While significant progress has been made in providing electricity to the general population over recent decades, there is a high degree of energy poverty with roughly 120 million people still without access to power. Perhaps more alarming is the fact that 276 million (or 45 percent of Southeast Asia’s population) remain dependent on wood, charcoal, and other solid fuels for cooking, resulting in indoor pollution and major health problems.<sup>24</sup>

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16 Morgan, Peter, Mike Plummer, and Ganeshan Wignaraja. “Regional Transport Infrastructure: Mapping Projects to Bridge South Asia and Southeast Asia,” Asian Development Bank Brief, September 2015 at <http://www.adb.org/publications/regional-transport-infrastructure-mapping-projects>.

17 Stephen Groff, Vice President for Operation, Asian Development Bank. Remarks in Berlin, Germany, 23 June 2014.

18 The OECD estimates that 68 percent of required funding should be designated for new builds, while almost a third should be slotted for the maintenance of existing capacity. OECD, pp. 76. Also please see David Lipton, First Deputy Managing Director, International Monetary Fund. Remarks in Malaysia, 19 March 2015 at <https://www.imf.org/external/np/speeches/2015/031915.htm>.

19 Unfortunately, investment in infrastructure in Southeast Asia has been far below much-needed levels – roughly 1 to 4 percent of GDP. According to the World Bank, a 10 percent increase in infrastructure investment contributes to 1 percent GDP growth in developing countries. See <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTINFRA/o..contentMDK:23136173~menuPK:8497173~pagePK:64168445~piPK:64168309~theSitePK:8430730.00.html> and United Nations Conference on Trade and Development. “Supporting infrastructure development to promote economic integration: the role of the public and private sectors,” 11-12 April 2013.

20 “Southeast Asia Investment Policy Perspectives,” Organization for Economic Cooperation and Development (OECD), December 2014, pg. 69, 73. For example, “In Indonesia, inefficiencies of both hard and soft infrastructure make the cost of shipping goods from Jakarta to Hamburg lower than to Pandang, despite the significant difference in distances between cities.”

21 Vinayak HV, Fraser Thompson, and Oliver Tonby. “Understanding ASEAN: Seven Things You Need to Know,” McKinsey & Company, May 2014 at [http://www.mckinsey.com/insights/public\\_sector/understanding\\_asean\\_seven\\_things\\_you\\_need\\_to\\_know](http://www.mckinsey.com/insights/public_sector/understanding_asean_seven_things_you_need_to_know).

22 In Myanmar, for example, the OECD suggests that the country loses 21 percent of its output because of the poor state of its transmission and distribution systems. OECD, pp. 70.

23 OECD, pp. 73.

24 “Southeast Asia Energy Outlook, 2015” International Energy Agency, pp. 12.

**Table 2: Population without Adequate Access to Energy, 2013**

	Without Access to Electricity		Traditional Use of Biomass for Cooking <sup>25</sup>	
	Population (m)	% Pop.	Population (m)	% Pop.
<b>Brunei</b>	0	0%	0	0%
<b>Cambodia</b>	10	66%	13	88%
<b>Indonesia</b>	49	20%	98	39%
<b>Laos</b>	1	13%	4	65%
<b>Malaysia</b>	0	1%	0	0%
<b>Myanmar</b>	36	68%	49	93%
<b>Philippines</b>	21	21%	53	54%
<b>Singapore</b>	0	0%	0	0%
<b>Thailand</b>	1	1%	15	23%
<b>Vietnam</b>	3	3%	42	47%
<b>Total SEA</b>	<b>120</b>	<b>19%</b>	<b>276</b>	<b>45%</b>

According to IEA, Southeast Asia’s energy consumption will increase by 80 percent between now and 2040, largely resulting from increased access to energy services, a tripling of the size of the economy, and substantial population growth.<sup>26</sup> To meet this demand, the region will need \$2.5 trillion of cumulative investment in energy supply infrastructure during this period, which averages roughly \$100 billion per year. Over half of that investment is needed in the electricity sector, requiring the construction of 400 gigawatts (GW) of power generation capacity – currently roughly the size of the combined installed capacity of Japan and South Korea. Alarming from a climate mitigation perspective and distinct from other major economic regions, IEA estimates that the share of coal use in Southeast Asia will actually increase from about one third to 50 percent, playing a major role in a doubling of greenhouse gas emissions. By 2040, Southeast Asia is forecast to consume as much coal as India does today.<sup>27</sup>

**Table 3: Power Generation by Fuel in Southeast Asia (TWh)<sup>28</sup>**

	Shares					
	1990	2013	2040	1990	2013	2040
<b>Coal</b>	28	255	1,097	18%	32%	50%
<b>Natural Gas</b>	26	349	578	17%	44%	26%
<b>Oil</b>	66	45	24	43%	6%	1%
<b>Nuclear</b>			32			1%
<b>Hydro</b>	27	110	255	17%	14%	12%
<b>Other Renewables</b>	8	31	226	5%	4%	10%
<b>Total</b>	<b>154</b>	<b>789</b>	<b>2,212</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Worsening the environmental impact of coal-fired generation is the fact that the most efficient coal technologies have not been widely deployed at this point, given the lower capital costs and shorter construction periods for subcritical units. More than 90 percent of existing installed coal capacity in Southeast Asia is subcritical and less than 20 years old, locking in less efficient generation for at least another twenty to thirty years (operating lifetimes for coal plants are roughly 40 to 50 years). According to IEA, however, more efficient technologies (i.e., supercritical and ultra-supercritical) are likely to be built in the coming decades, resulting in a sharp decline of subcritical capacity to just over 50 percent of the region’s power supply by 2040.<sup>29</sup> Still, this assumption is largely based on a rational approach to the international financing policy of coal plants – one that aims to finance the most efficient coal generation whenever and wherever possible. Efforts in developed economies to block overseas coal plant financing in developing countries, including in Southeast Asia, would probably slow down the deployment of cleaner coal technologies as poorer countries would then be more likely to choose cheaper, less efficient units.<sup>30</sup>

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<sup>25</sup> Based on World Health Organization (WHO) and IEA databases. Table from IEA, pp. 119.

<sup>26</sup> Southeast Asian energy demand increased by more than 50 percent between 2000 and 2013.

<sup>27</sup> Ibid., pp. 9.

<sup>28</sup> Ibid., pp 39.

<sup>29</sup> Ibid., pp. 42.

<sup>30</sup> Banks, George David. “U.S. Coal Plant Financing Policy: A Threat to Long-Term U.S. Interests in the Developing World,” American Council for Capital Formation, February 2015 at <http://accf.org/special-report-u-s-coal-plant-financing-policy-a-threat-to-long-term-u-s-interests-in-the-developing-world/>.

**Table 4: Southeast Asia Net Trade by Fossil Fuel<sup>31</sup>**

	2013*	2020	2025	2030	2035	2040
<b>Oil (mb/d)</b>	-3.3	-4.1	-5.0	-5.8	-6.4	-6.7
<i>Import</i>	57%	61%	70%	75%	78%	79%
<i>Dependency</i>						
<b>Gas (bcm)</b>	54	41	32	22	5	-11
<i>Import</i>	25%	19%	14%	9%	2%	4%
<i>Dependency</i>						
<b>Coal (Mtce)</b>	319	253	236	243	241	234
<i>Import</i>	71%	54%	47%	43%	39%	35%
<i>Dependency</i>						

As oil fields mature and increased energy demand outstrips indigenous energy production, Southeast Asia will transition from a net exporter to a net importer of energy. This particularly holds true for oil and natural gas – a fact that carries with it trade flow concerns as spending increases for imports,<sup>32</sup> as well as geopolitical implications because the region is likely to grow more reliant on Middle East supplies. Thanks to Indonesia’s level of coal production, Southeast Asia is expected to remain a net exporter of coal.

According to IEA, the region’s oil import dependency will increase from 57 to roughly 80 percent by 2040 as imports more than double to 6.7 million barrels per day (mb/d) – similar to current Chinese oil imports.<sup>33</sup> Even Malaysia, which will overtake Indonesia as the largest oil producer in Southeast Asia, will grow more than 40 percent dependent on imports by 2040. The region will also become a net natural gas importer of approximately 11 billion cubic meters (bcm) by 2040 – a major change from 2013 when it exported 54 bcm and accounted for at least 30 percent and about 25 percent of Japanese and South Korean gas imports, respectively.<sup>34</sup>

While greater development of transportation infrastructure, in and of itself, increases economic growth and energy demand, infrastructure that is designed to integrate the region – and make effective use of resource diversity – would result in efficiency gains and improved reliability (i.e., energy security). Expanding regional energy infrastructure, particularly power grid connections that make effective use of hydropower, would further reduce the amount of oil and diesel used in electricity and the need for new gas-fired power generation. While this goal has been a long-held priority for ASEAN, a number of non-financial hurdles remain, especially technical and institutional barriers, such as the lack of harmonized standards and poorly developed regulatory systems.

### OVERVIEW OF CHINESE AND JAPANESE ENGAGEMENT IN SOUTHEAST ASIAN INFRASTRUCTURE

In contrast to the United States, Beijing and Tokyo have far more comprehensive approaches to their bilateral relations with the countries of Southeast Asia, as well as to the region. While China and Japan have different, complex histories with Southeast Asia, they share a common objective – the integration of those markets with their respective economies. Accordingly, both countries recognize the strategic importance of infrastructure development and how government-backed financial support and related contracts for their industry champions can translate into long-lasting political influence. Because energy access furthers more immediate, tangible national interests than the vast majority of transportation projects, energy projects maximize political influence and provide “more bang for the yuan or yen”.

31 Ibid., pp. 71. Exports are represented by positive values; related shares are a share of total production. Imports are represented by negative values; related shares are a share of total consumption. Oil data is from 2014.

32 Ibid., pp. 71. According to the International Energy Agency, Southeast Asia’s oil and gas import bill will triple in size to \$320 billion annually by 2040.

33 Ibid., pp. 51.

34 International Energy Agency, Energy Information Administration, and PFC Energy.

## CHINA

China's history with Southeast Asia goes back millennia in some cases. As discussed previously, over 20 million ethnic Chinese live in the region with the majority living in Thailand, Malaysia, and Singapore. Most Southeast Asian countries, entirely or partially, at some point during the past two thousand years, have belonged to the Middle Kingdom's<sup>35</sup> tributary system, which shaped Asia Pacific's foreign policy, trade, and culture for centuries.<sup>36</sup> China's tributary states were largely politically autonomous and independent – in stark contrast to the general European colonial practice of political subjugation. In the late nineteenth and early twentieth centuries, European intervention disrupted and broke much of the tributary construct; nearly the entire Southeast Asian region, with the notable exception of Thailand, fell under the control of Western powers.

Beijing's current views toward the region are shaped by this long history and the patriarchal idea that China – *as the elder brother* – has a certain responsibility vis-à-vis Southeast Asia, particularly the poorer countries of CLMV. And as China emerges as a global superpower, the geopolitical significance of Southeast Asia to the Middle Kingdom will unquestionably increase. Unlike the Soviet Union, which was surrounded mostly by weak powers during the Cold War, Beijing must consider the vulnerabilities of having strong power centers along its periphery – Russia in the north, India in the southwest, and Japan in the East. To avoid a potential encirclement in the form of a *containment policy* backed by the United States, China thus needs comfort that its southern flank is secure.

In this regard, Chinese “control or influence” over the trade routes through the Strait of Malacca and South China Sea is certainly a top priority, given the need to secure the supply of strategic minerals and energy resources from Africa and the Middle East.<sup>37</sup> The leadership in Beijing recognizes openly that the country faces a “Malacca dilemma” – a term actually coined in 2003 at a Communist Party Conference by President Hu Jintao, who also went so far to argue that “certain major powers” – no doubt referring to the United States and Japan – were determined to control the passage.<sup>38</sup> Consequently, integrating Southeast Asia as much as possible with China is an important component of Beijing's overall regional – and *global* – geopolitical strategy.

China, despite the relative late start compared to Japan and other major economies, has already achieved notable success in achieving this objective. ASEAN is China's third largest trading partner, behind the European Union and the United States, with expectations of becoming first soon.<sup>39</sup> In addition, China is the region's largest trading partner with nearly \$500 billion in commerce, roughly equal to the combined total of Japan and the United States.<sup>40</sup> This is a significant development with total trade nearly doubling in less than five years; forecasts suggest that this trend will only continue.<sup>41</sup>

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35 The Middle Kingdom is the Chinese name for “China,” dating from the Chou Empire around 1000 B.C. The Chou did not know of the existence of other civilizations, such as Egypt and Mesopotamia, and believed their empire, surrounded by barbarian tribes, was located in the center of the planet. Even today, the Chinese view themselves in much the same way.

36 See <http://www.globalsecurity.org/military/world/china/history-tributary-states.htm> for briefs on China's history with Southeast Asia and other former tributary states.

37 Currently, nearly 80 percent of Chinese crude imports transit the Strait. See “Sino-Myanmar pipeline boosts energy security,” China Daily, January 29, 2015 at <http://en.people.cn/business/n/2015/0129/c90778-8842625.html>. For more detail on the importance of the Straits to China, see Banks, George David. “Managing Pacific Rim Security Risks with U.S. Energy,” American Council for Capital Formation, November 2015 at <http://accf.org/managing-pacific-rim-security-risks-with-u-s-energy/>.

38 Marc Lanteigne, “China's Maritime Security and the ‘Malacca Dilemma’,” in *Asian Security*, 4:2, pp. 143-161, 2008.

39 “China-Southeast Asia Trade Links Expanding Rapidly,” Asia New Zealand Foundation at <http://103.253.194.15/bulletin/china-southeast-asia-trade-links-expanding-rapidly>.

40 China has a free trade agreement with all ASEAN countries, but it does not address sensitive issues, such as intellectual property, the environment, and labor rights. “Southeast Asia: Trends in U.S. and Chinese Economic Engagement,” United States Government Accountability Office (GAO), August 2015. Also see Asia New Zealand Foundation, “China – Southeast Asia Trade Links Expanding Rapidly” at <http://www.asianz.org.nz/bulletin/china-southeast-asia-trade-links-expanding-rapidly>.

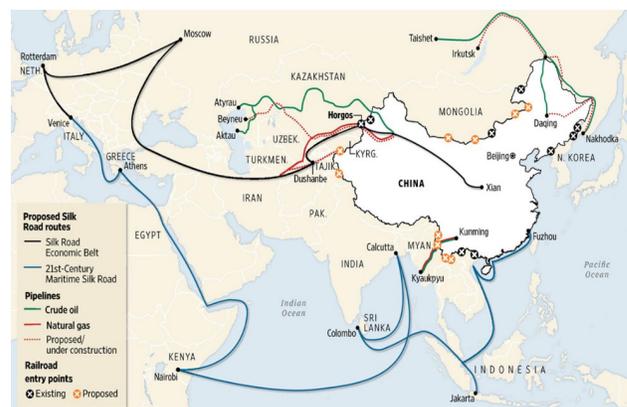
41 <http://www.businessinasean.com/en/doing-business-in-asean/looking-beyond-asean/asean-and-china/the-china-connection-for-asean.html>.

As part of its strategy, Beijing focuses on infrastructure development to accelerate integration. In this effort, Chinese firms have played an aggressive role. From 2000 to 2014, Chinese industries were awarded nearly \$800 million in World Bank contracts related to the region – a higher value than any other country’s firms.<sup>42</sup> According to the United States Government Accountability Office (GAO), civil works projects accounted for approximately 75 percent of the value of Chinese contracts during that period. In contrast, U.S. companies were almost totally involved in providing consulting services (almost 80 percent) with no awards for infrastructure development.<sup>43</sup> Results were roughly similar for contracts from the Asian Development Bank. In 2013 and 2014, construction projects represented over 80 percent of the total Chinese contract value with the largest share, by far, going to road transportation development in Cambodia, Laos, and Vietnam. Again, U.S. firms were nowhere to be found when contracts involved infrastructure development.<sup>44</sup>

To further its vision, China has created new multilateral financing mechanisms that give it greater control over decision making, in contrast with its limited influence in the World Bank and Asian Development Bank.<sup>45</sup> Beijing’s crown jewel in this endeavor is the Asian Infrastructure Investment Bank (AIIB), an institution with 57 members and an initial capital of \$100 billion. The AIIB, which the United States unsuccessfully tried to block, is anticipated to play a prominent role in Beijing’s plans to promote connectivity and integration with Southeast Asia. Importantly, all ASEAN countries are founding members of the AIIB. This high level of interest indicates that regional governments believe that a new bank is needed because existing multilateral banks have not been able to provide adequate low-cost financing for infrastructure creation.<sup>46</sup> Certainly, carbon conditions pushed aggressively by the United States have raised concerns that Western development banks have lost focus in helping provide developing countries the energy systems they actually want and need.

The AIIB was partly designed to complement and support China’s “Belt and Road Initiative” (BRI). The BRI, which was rolled out in multiple stages by Chinese President Xi Jinping in 2013, establishes a development strategy and framework for infrastructure development in Eurasia with a particular focus on Central, Northern, and Southeast Asia. According to the Center for Strategic and International Studies (CSIS), the BRI, which is widely viewed as a cornerstone of Xi’s foreign policy and domestic economic strategy, “will likely have an important effect on the region’s economic architecture – patterns of regional trade, investment, infrastructure development – and in turn have strategic implications for China, the United States, and other major powers.”<sup>47</sup>

## BELT AND ROAD INITIATIVE



Source: Wall Street Journal

Proposed projects in Southeast Asia are located mostly in the countries that border the Middle Kingdom to the south, particularly border crossings in Laos and Myanmar that help compose the land-based “Silk Road Economic Belt” (SREB). The “Maritime Silk Road” (MSR), which focuses on planned port and other coastal infrastructure developments, would better link Maritime Southeast Asia with the southern ports of China. We can assume that the AIIB will help finance many of the Belt and Road projects – again, given the fact that all ASEAN countries are members of the Bank.

42 Ibid., pp. 29.

43 Contracts for goods roughly made up the difference for both countries. Ibid., pp. 30.

44 Nearly all U.S. contracts with the ADB in this period were awarded to help manage emergency assistance to typhoon-affected areas of the Philippines. Ibid., pp. 30.

45 See Perlez, Jane, “U.S. Opposing China’s Answer to World Bank,” New York Times, October 9, 2014 at <http://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-opposition.html> and <http://www.reuters.com/article/2014/11/05/us-china-aiib-idUSKCN0ID08U20141105>.

46 “India Likely to Join Asian Infrastructure Bank,” Sidhartha, October 6, 2014 at <http://timesofindia.indiatimes.com/business/india-business/India-likely-to-join-Asian-infrastructure-bank/articleshow/44455632.cms>

47 Kennedy, Scott and David Parker. “Building China’s “One Belt, One Road.” April 3, 2015 at <http://csis.org/publication/building-chinas-one-belt-one-road>.

Taken together, Beijing’s activities conducted through the AIIB and BRI aim to improve broader relations with Southeast Asia – and to help reduce the region’s growing suspicions of Chinese intentions in the South China Sea. Unquestionably, effective use of the AIIB to implement successfully the Belt and Road Initiative would promote China-Southeast Asian integration and help resurrect a Sino-centric system of trade and investment that would translate into broader political and diplomatic cooperation at levels not seen since the zenith of China’s tributary system.

## JAPAN

Japan, in contrast to China, does not have a centuries-long, complex history with Southeast Asia. While the events of the Pacific War remain an important determinant in shaping Chinese and Korean attitudes toward Japan, Southeast Asians have largely moved past the wartime occupation and hold generally positive opinions of the country.<sup>48</sup> Few Southeast Asians believe that Tokyo harbors any territorial ambitions in the region, as opposed to the growing anxiety in some countries – especially in the Philippines and Vietnam – that China’s activities in the South China Sea may spark a conflict.<sup>49</sup> These views of Tokyo’s intentions owes itself largely to the success of Japan’s pacifist post-war foreign policy and the substantial, positive role played by Japanese investment, trade, and aid in the region’s economic development.<sup>50</sup>

**Table 5: How Southeast Asians Rate China, Japan, and the United States (Favorable Views Of...)<sup>51</sup>**

	China	Japan	United States
China	-	8%	50%
Indonesia	66%	77%	59%
Japan	7%	-	66%
Malaysia	74%	75%	51%
Philippines	38%	80%	92%
Thailand	72%	81%	73%
Vietnam	16%	77%	76%
United States	35%	70%	-

Japan-ASEAN economic relations are certainly deep. In 2011, the total volume of Japan-ASEAN trade was nearly \$250 billion, making Southeast Asia Japan’s second largest trading partner after China. At the same time, ASEAN was Japan’s second largest recipient of foreign direct investment at about \$19 billion.<sup>52</sup> Interestingly, Japanese and Chinese investments generally focus on different developing markets within ASEAN with China the primary investor in Cambodia, Laos, and Myanmar.

In comparison, Japanese interests are more active in Indonesia, Thailand, and Vietnam. In 2014, the United States only led foreign direct investment flows in one Southeast Asian country, the Philippines.<sup>53</sup>

48 “How Asians View Each Other,” Pew Research Center, July 14, 2014 at <http://www.pewglobal.org/2014/07/14/chapter-4-how-asians-view-each-other/>

49 Ibid.

50 Japan’s occupation of Southeast Asia also gave rise to nationalist movements that accelerated the end of Western colonialism in the region.

51 Taken from polling conducted by the Pew Research Center at <http://www.pewglobal.org/2014/07/14/chapter-4-how-asians-view-each-other/>.

52 “Factsheet on Japan-ASEAN Relations,” Ministry of Foreign Affairs of Japan, February 2013 at <http://www.mofa.go.jp/region/asia-paci/asean/factsheet.html>.

53 ASEANstats at [http://aseanstats.asean.org/Menu.aspx?rxid=4180e647-4986-4f20-ae94-69e727acda3c&px\\_language=en&px\\_db=4-Foreign+Direct+Investments&px\\_type=PX](http://aseanstats.asean.org/Menu.aspx?rxid=4180e647-4986-4f20-ae94-69e727acda3c&px_language=en&px_db=4-Foreign+Direct+Investments&px_type=PX).

**Table 6: Flows of Inward Foreign Direct Investment Flows, Selected Countries, 2014 (US \$ millions)**

Cambodia		Laos	
China	553.9	China	614.3
EU	138.8	EU	51.2
ROK	106.3	Australia	15.8
Japan	84.9	ROK	12.6
USA	50.3	Japan	2.1
Australia	33.3	USA	0.2
Myanmar		Vietnam	
China	70.5	ROK	3,248.2
Japan	37.7	Japan	969.2
EU	28.3	EU	552.1
ROK	11.1	China	209.6
Australia	0.2	USA	130.5
USA	0.0	Australia	62.1
Indonesia		Malaysia	
Japan	5,871.8	EU	2826.5
China	1,067.0	Japan	680.3
EU	996.1	China	230.9
ROK	826.0	Australia	-130.6
Australia	58.5	ROK	-425.2
USA	-1,375	USA	-633.6
Philippines		Thailand	
USA	1174.9	Japan	3,834.2
EU	176.9	USA	1,969.4
Japan	117.5	EU	1,222.1
Australia	70.9	China	1,060.6
China	41.4	ROK	378.4
ROK	4.7	Australia	87.1

Up until recently, Tokyo has observed the region largely through the lens of economic opportunity. Since the 1990s, Japanese economic planners have placed significant importance in Southeast Asia's lower labor and land costs and the need for Japanese industry to relocate or create parts of their supply chain there to exploit those advantages.<sup>54</sup> Accordingly, infrastructure investment that could further drive down the cost of production for Japanese industries in the region would increase their global competitive advantage. Specifically, Southeast Asia's need for a build-out of affordable and reliable power generation to attract energy-intensive industry has driven Tokyo to support the public financing of fossil fuel projects. This national interest has helped motivate Japan to openly oppose U.S. efforts to place unreasonable restrictions on overseas coal-plant funding from members of the Organization for Economic Cooperation and Development (OECD).<sup>55</sup> Such rare stiff opposition from Tokyo, in particular, forced a compromise by the Obama administration to abandon its insistence that coal plants be equipped with carbon capture and storage technology (which is not yet commercially available) before public funding could be approved, opting instead to use high efficient coal technology as a technology standard.<sup>56</sup>

Thus, like China, Japan views infrastructure development in Southeast Asia as crucial to its long term interests. With China's emergence as a major creditor and financier of civil works projects, Tokyo's commercial objectives are threatened as Chinese-backed infrastructure development is likely to benefit Chinese industry to the detriment of Japanese companies. The *Financial Times* reported last year that the two powers are increasingly "going head-to-head" to secure contracts for transportation and energy construction projects in the region.<sup>57</sup>

54 Limskul, Kitti. "Japan-ASEAN Comprehensive Economic Partnership." Presented at the Commemorative Symposium on Business Strategy and Economic Partnership in East Asia and APEC SME Business Network Promotion Forum, November 25-29, 2003.

55 Iwata, Mari. "Japan to Step Up Support for Overseas Use of Coal," *The Wall Street Journal*, July 23, 2014 at <http://www.wsj.com/articles/japan-to-step-up-support-for-overseas-use-of-coal-1406114037>.

56 "Japan to push coal technology despite OECD subsidy cut, Japan's environment minister says," Reuters/Bloomberg, November 26, 2016 at [http://www.japantimes.co.jp/news/2015/11/26/national/politics-diplomacy/japan-push-coal-technology-despite-oecd-subsidy-cut-japans-environment-minister-says/#.Vq5v2K\\_SnIV](http://www.japantimes.co.jp/news/2015/11/26/national/politics-diplomacy/japan-push-coal-technology-despite-oecd-subsidy-cut-japans-environment-minister-says/#.Vq5v2K_SnIV).

57 Bland, Ben. "Japan and China Step Up Fight for ASEAN Infrastructure Contracts," *The Financial Times*, November 22, 2015 at <http://www.ft.com/intl/cms/s/0/f20f9fec-90f4-11e5-bd82-c1fb87bef7af.html#axzz3ym99oRvw>

Although that is certainly the case, Beijing and Tokyo have different strategic priorities for their projects in a broader sense. While China focuses on accelerating its integration with the region by improving mostly north-to-south, direct road and rail transportation routes, Japan – and the Asian Development Bank, which it leads – has dedicated much of its effort to the East-West Economic Corridor (EWEC), linking Myanmar to Vietnam through Thailand and Laos and lowering transportation costs to ports on the South China and Andaman Seas.<sup>58</sup>

*Nonetheless, the integration of Southeast Asia, with the goal of creating a single market with a common foreign and defense policy, should be a priority for the United States.*

As tensions have escalated between China and Japan in recent years, Tokyo has begun to focus more and more attention on security and defense concerns, particularly as they pertain to the triangular relationship between China, Japan, and Southeast Asia. In some ways, China and Japan share similar geopolitical interests in the region, given the importance of the trade routes through the Straits and the South China Sea.<sup>59</sup> It is worth noting that the EWEC, for example, could help reduce dependence on the Strait of Malacca.<sup>60</sup> Nonetheless, we can expect greater jockeying between China and Japan to secure key infrastructure and civil works projects in the region as both powers fully appreciate that such contracts also translate into greater political influence.<sup>61</sup> This holds true even more for energy development if operation and maintenance of plants lasting for 40 to 50 years, for instance, are also included.

## THE NEED FOR A MORE COMPREHENSIVE U.S. APPROACH

Washington lacks a serious, cohesive approach toward Southeast Asia that promotes America's long-term political and economic interests. The level of diversity across Southeast Asia and lack of U.S. familiarity with much of Southeast Asia unquestionably complicates U.S. foreign policymaking, particularly as it pertains to defining a regional approach. After all, the concept of a "Southeast Asian" identity is in its embryo stage – an idea that is only supported by a small handful of scattered elites. Nonetheless, the integration of Southeast Asia, with the goal of creating a single market with a common foreign and defense policy, should be a priority for the United States.

In promoting this vision, Washington should prioritize initiatives that enhance economic integration with a particular focus on transportation projects that diversify Southeast Asia's access to the global market, as well as energy projects that improve the region's energy security. Furthermore, U.S. energy policy toward Southeast Asia should be grounded in reason. President Obama's remarks at the U.S.-ASEAN and East Asian Summits last November<sup>62</sup> that a U.S. commitment of \$100 billion by 2020 would allow Southeast Asia to "leapfrog" coal-fired generation and still achieve its development and poverty alleviation goals are far removed from reality<sup>63</sup> – given IEA's estimate that the region needs roughly \$100 billion per year between now and 2040 simply for energy infrastructure development.

58 Mazza, Michael. "China and Japan's Battle for Influence in Southeast Asia," American Enterprise Institute, October 6, 2015 at <https://www.aei.org/publication/china-and-japans-battle-for-influence-in-southeast-asia/>.

59 "A Cooperative Framework for Maintaining Safety in the Straits of Malacca and Singapore," the Nippon Foundation at [http://www.nippon-foundation.or.jp/en/what/spotlight/ocean\\_outlook/story4/](http://www.nippon-foundation.or.jp/en/what/spotlight/ocean_outlook/story4/).

60 Japan is poor in energy resources and strategic resources and its economy is extremely dependent on trade, more so than China. Tokyo, however, is provided some comfort by the U.S.-Japan Security Alliance and by the fact that the U.S. Navy remains the ultimate guarantor of the freedom of navigation – points that many strategists in Beijing wish to neutralize.

61 Einhorn, Bruce. "In its Fight for Allies, Japan Writes Big Checks," Bloomberg Businessweek, July 16, 2015 at <http://www.bloomberg.com/news/articles/2015-07-16/japan-china-expand-aid-to-asia-in-fight-for-influence>.

62 <https://www.whitehouse.gov/the-press-office/2015/11/22/remarks-president-obama-press-conference>.

63 Ibid. "There are going to be a number of countries who recognize the threat of climate change, want to do something about it, but they also have large populations suffering from extreme poverty, who don't have electricity, who don't have the ability to feed their families...And so the answer to that we've all agreed is a finance mechanism to help these countries...leapfrog old technologies so that instead of building old, dirty power plants, here are some smart, clean-energy plants. And we'll help you through technology transfer and financing so that you can achieve your development goals, but not add to the carbon problem. So far, with a target of \$100 billion, we've reached between private and public sources \$62 billion, and that target did not need to be met until 2020, based on our original commitments. So we're well on our way to meeting these commitments." President Barack Obama, Kuala Lumpur, Malaysia, November 22, 2015.

- From a public financing perspective, the United States should support the deployment of more efficient coal technologies if not doing so would increase the probability of the construction of subcritical coal plants. To improve energy efficiency, promote electricity exports, and reduce the need for new power investments, Washington should also work closely with international partners to lay the groundwork and then build an integrated power grid across Southeast Asia, allowing the region to make use of its diverse resources, particularly hydropower.
- While some fiscal conservatives in the United States might argue that Southeast Asia should use its own resources, it is important to note that the poorer countries in the region, especially Cambodia, Laos, and Myanmar, simply lack the domestic capital that would allow them to finance major civil works projects on their own. Moreover, private investment sources are highly hesitant to invest in countries where financial markets have limited depth and liquidity and regulatory systems are less developed.

Unquestionably, the United States lacks the financial resources and regional savoir faire to achieve these objectives alone. Consequently, Washington must expand existing partnerships with Asia Pacific countries that have greater ties to Southeast Asia, including Australia, Japan, and South Korea. Perhaps more politically challenging for Washington is the necessity to build with Beijing a constructive partnership amongst equals to achieve mutually-shared economic objectives in the region.

There are clearly ample opportunities for the United States to expand its influence in Southeast Asia. Countries in the region want and need the United States to strengthen its bilateral and regional engagements, particularly trade and investment ties to further economic integration. Given the multi-cultural composition of the many countries of Southeast Asia, it is important to the independence and sovereignty of each that not one country dominates. Thus, the United States is viewed by many regional observers as vital to preserving any balance of power.

- Tensions in the South China Sea and recent controversies of Chinese domestic interference in the region<sup>64</sup> provide the United States an opportunity to increase U.S. influence in Southeast Asia, but Washington should not overplay its hand.

Current U.S. policy, focused on defense and security concerns, risks undermining regional integration by creating armed camps (i.e., China and the United States). By strengthening the concept of a Southeast Asian identity, the United States could bolster the independence of the region, free from entanglements that increase the probability of confrontation. Many Southeast Asians want to avoid a redux of the Cold War, preferring instead constructive U.S. engagement that views Beijing as an equal partner in promoting economic development and security across the South China Sea rim.<sup>65</sup>

- While Southeast Asia should be free to choose its own destiny, Washington – in close cooperation with other powers outside the region, especially China and Japan – should seek a neutral, prosperous partner that helps build political consensus and promotes economic security across the Asia Pacific.
- It would be a mistake for the United States to pursue unconstructive competition with China in Southeast Asia, given the Middle Kingdom’s proximity to the region, its strong cultural and historical ties, and overwhelming economic influence. Forced to choose between the two powers, it is more likely than not that most – if not all – of Southeast Asia would eventually side with Beijing, resurrecting a 21<sup>st</sup> century version of the tributary system and ending the likelihood of the emergence of a neutral, integrated Southeast Asia.

64 Kurlantzick, Joshua. “Is China ‘Losing’ Southeast Asia,” National Interest, October 13, 2015 at <http://nationalinterest.org/blog/the-buzz/china-losing-southeast-asia-14064>.

65 Parameswaran, Prashanth. “Playing it Safe: Malaysia’s Approach to the South China Sea and Implications for the United States,” Center for a New American Security, February 2015 at [http://www.cnas.org/playing-it-safe-malaysia-approach-to-south-china-sea#.Vp1OIq\\_SnIU](http://www.cnas.org/playing-it-safe-malaysia-approach-to-south-china-sea#.Vp1OIq_SnIU).

Achieving the goal of an integrated Southeast Asia would require a long-term cohesive approach that cuts across multiple U.S. presidential administrations. Measures taken by President Obama to increase U.S. understanding of the region, such as the opening of a dedicated U.S. Mission to ASEAN, U.S. accession to ASEAN's Treaty of Amity and Cooperation, and the elevation of the U.S.-ASEAN relationship to a strategic partnership, are clearly important first steps.<sup>66</sup> The next U.S. President, however, must build on this foundation and conduct a more balanced approach that focuses U.S. engagement more on regional economic integration and less on military and security operations, particularly those vis-à-vis China.

Within the next decade, Southeast Asia is poised to grow in importance to the United States – from both an economic and strategic perspective. It would be a shame if U.S. policymakers squander current opportunities to gain goodwill and political capital by supporting regional economic growth, job creation, and poverty eradication. Given increasing levels of uncertainty in the Asia Pacific as we head toward the century's third decade, the United States needs a strong, neutral Southeast Asia as a partner in its quest for global peace and prosperity.

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66 The February 2016 Sunnyland's Declaration provides an excellent framework to develop a more comprehensive U.S. approach to Southeast Asia. See "Joint Statement of the U.S. – ASEAN Special Leaders' Summit: Sunnyland's Declaration" at <https://www.whitehouse.gov/the-press-office/2016/02/16/joint-statement-us-asean-special-leaders-summit-sunnylands-declaration>.