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What Economic Slowdown? Asia Looks at China

From the point of view of China's neighbors in Asia, it is inconceivable that even a China severely weakened by economic slowdown, howsoever one might define "weakened" or "slowdown," will cease to be a significant political and military actor in the region.

If the slowdown in China started about 2011, then the assumption of leadership by Xi Jinping and his cohort at the 18th Party Congress of the Communist Party of China (CPC) in 2012 set in motion several significant changes in direction, both domestically and externally, in terms of the country's political, economic and security policies.

For one, there seemed to be greater drive on display to achieve domestic reforms following the apparently "wasted decade," as many Chinese now see it, of the Hu Jintao-Wen Jiabao tenure. For another, the Chinese leadership has also been willing to give up

Deng Xiaoping's advice in foreign affairs about "biding time," "hiding capabilities" and "never claiming leadership." The former dimension is evident in the ongoing anti-corruption campaign, the call at the CPC Central Committee's Third Plenum in 2013 to let the markets play a "decisive role," and the announcement of the restructuring of the People's Liberation Army (PLA). The latter aspect is seen in the greater assertiveness on territorial disputes in the East and South China Seas; Beijing's willingness both to take an active role in existing multilateral organizations and create new ones, such as the BRICS New Development Bank and the Asian Infrastructure Investment Bank; and in such new initiatives as the 'One Belt, One Road' (OBOR) project.

China's Asian neighbors are at the receiving end of this second set of developments. Whether these have come in spite of the slowdown or because of it – OBOR,

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for example, is designed to shift or better employ China's industrial and infrastructure overcapacity abroad – is largely immaterial to them, for they see both its positive and negative sides. As difficult as it is for China to achieve the fine balance between achieving its regional and global interests and not being seen as a hegemon in the making, so it is also for its neighbors to partake of China's economic capacity and bounty while simultaneously countering its political and security challenges. This policy brief will look at the interactions of some key Asian nations with China in the context of both the centrality of China's economy to Asian growth and its military-backed assertiveness in the region.

China's continuing economic might

To start with, opinion is divided on whether or not the economic downturn in China affects India, China's biggest rival in Asia in terms of size and potential competition for leadership. In November 2015, Reserve Bank of India Governor Raghuram Rajan stated that while the Chinese slowdown had helped India some because of cheaper commodity prices, it had also resulted in lower demand for some Indian exports to China. He also contradicted Indian Finance Minister Arun Jaitley's declaration a month earlier that India had not been affected by the slowdown since it was "not a part of the Chinese supply chain," saying that in fact India "had been adversely affected by the Chinese slowdown" given its close integration with the global economy. Earlier, Prime Minister Narendra Modi himself had called on Indian industry to seek opportunities both in China's market and in light of its problems.

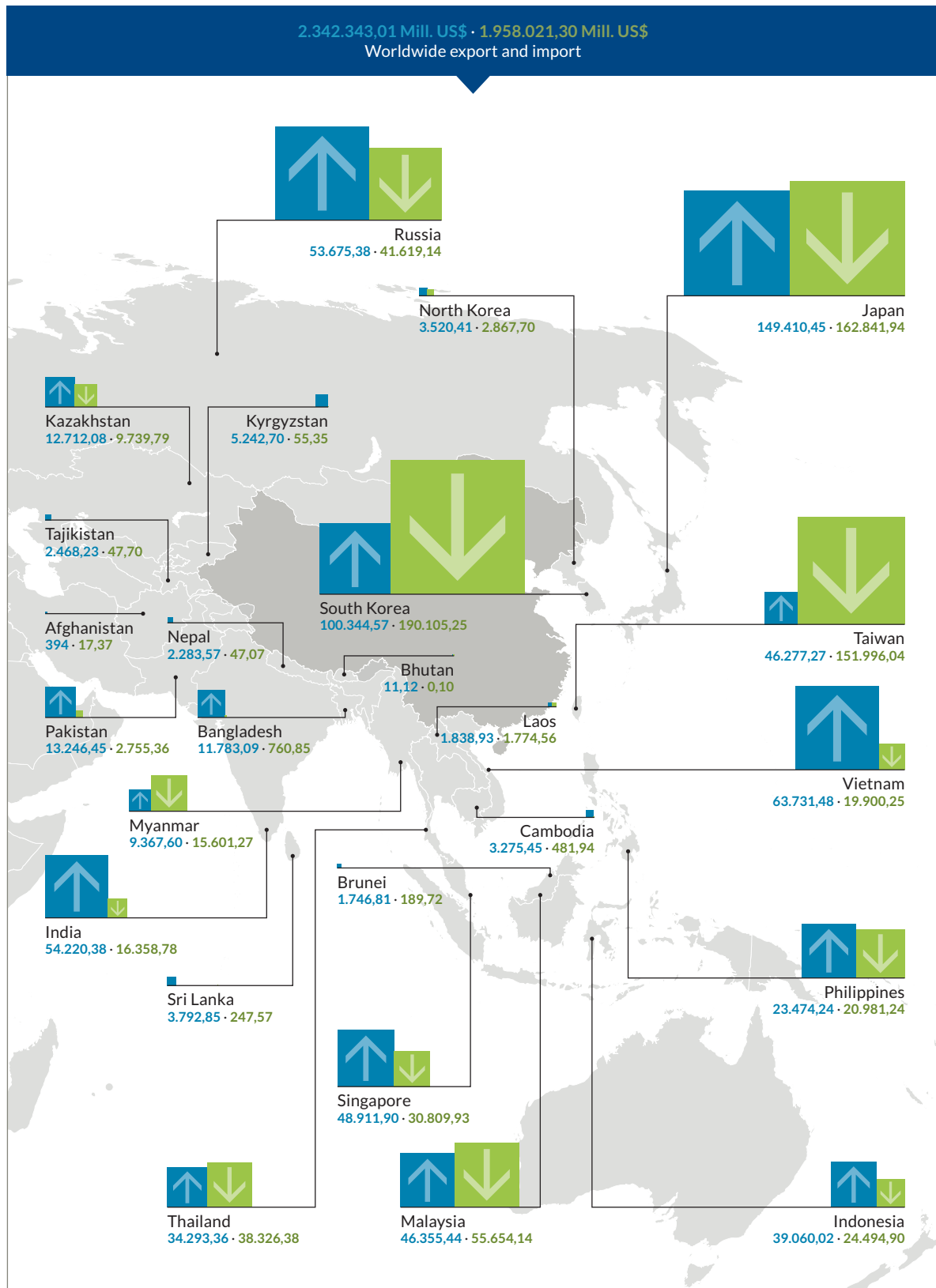
However, the Indian manufacturing sector remains far from capable at the moment of exploiting the gap created by Chinese economic woes and in the wake of China's renminbi devaluation in August. Furthermore, industry has called on Indian authorities to ensure lower interest rates and to implement dumping duties against Chinese products. These demands mirror China's own fitful commitment to letting the market "play the decisive role in the allocation of resources," as announced at the Third Plenum. A case in point here is China's continuing intervention in the foreign exchange markets to prop up the value of the renminbi. While both economies are in need of great structural reforms, these protectionist tendencies meanwhile aggravate political tensions as well.

In fact, a big plank of the Indian prime minister's outreach to China since coming to office in mid-2014 has been about increasing Chinese investments in India in critical sectors, such as road and rail infrastructure, and in the form of support for his government's flagship Make-in-India manufacturing campaign. Indeed, with Modi's arrival it seemed for a while that the initial bonhomie of the Sino-Indian economic relationship of the early 2000s was set to return. In those early years of takeoff in economic ties, India enjoyed trade surpluses, but these soon turned into persistent trade deficits due to a skewed trade basket, since India mostly exports raw material and commodities and imports finished products from China. While Chinese investments in India have grown from US\$16 million in 2007 to US\$243 million in non-financial investments and realized contract projects worth US\$41.06 billion in 2014, Indian investments in China have grown from US\$52 million in 2006 to US\$564 million in 2014. Indian companies, however, find it difficult to win contracts in China because of various kinds of non-tariff barriers including the opaque legal structure there. This affects Indian pharmaceutical and IT companies in particular. Chinese private players have, on the other hand, become major investors in Indian tech startups such as Alibaba in Paytm and Snapdeal, and Didi Kuaidi in Ola.

This, then, has added fuel to widely prevalent mistrust of China in New Delhi's political and security establishments. And even Modi, with his successes soliciting Chinese investments as Gujarat Chief Minister, has failed to move the needle much so far, whether on the suspicion or on the deficit. There were great expectations for Xi Jinping's September 2014 visit to India, especially on the economic front. The Chinese consul-general in Mumbai had even touted a figure of US\$100 billion in potential investments in India, but the visit ended up delivering only some US\$20 billion worth of commitments. By contrast, the figure for Pakistan promised during Xi's visit there in April the following year was more than twice the investments promised to India. Meanwhile, while three industrial parks specifically dedicated to Chinese investors are on the anvil in India, there has been little to no movement yet.

Elsewhere in South Asia, in Sri Lanka, despite an initial hiccup following the 2015 exit of Mahinda Rajapaksa, the country's China-leaning president, the Colombo Port City project, a major Chinese initiative – and the largest foreign investment in the

Chinese exports to and imports from Asia 2014



↑ Export in Million US\$ ↓ Import in Million US\$

Figure 1 | Source: UNCTAD Stat International Trade 2016

| BertelsmannStiftung

country – appears to be back on track under the new president, Maithripala Sirisena. The importance of China to the Sri Lankan economy can be gauged from the fact that during the election campaign, even the opposition United National Party stated that its promised review of all major infrastructure projects to check for irregularities did not mean that there were “any misgivings or bad blood with China,” but that it considered China “a good friend.” This feeling extends to the economic elite as well. The Ceylon Chamber of Commerce, for instance, in a statement after the elections declared that enhancing competitiveness and productivity in the Sri Lankan economy required deepening economic ties not just with India, but also with China and through a Free Trade Agreement (FTA). Indian industry by contrast is strongly opposed to Chinese requests for an FTA with India.

Moving to Southeast Asia, the region’s close integration with China in terms of the production and value chains is already quite well known. But China’s prowess is truly evident when one considers the case of its ties with Vietnam. Even as the two countries contend strongly over the Paracel and Spratly Islands in the South China Sea, China is now Vietnam’s largest trading partner and ninth-largest investor. At US\$83.63 billion as of February 2016, bilateral trade was up substantially from US\$58.5 billion in 2014. About 10 percent of Vietnam’s exports – mainly food and natural resources – go to China. China is also Vietnam’s fifth-largest source of overseas development assistance with the total, including preferential loans, coming to over US\$395 million as of June 2015, even if most of this is for the construction of a single urban rail project in Hanoi.

As in the case of India, Vietnam’s trade deficit with China has risen substantially from US\$190 million in 2011 to US\$ 32.3 billion in 2015 and to US\$43.83 billion as of February 2016 with no reversal in sight. Vietnam depends heavily on China for basic raw materials for many of its manufactured products, and also faces pressure from its dependence on China as a significant consumer of its agricultural exports. China is the largest buyer of Vietnamese rice, and in April 2015 a general tightening of Chinese inspections along the border meant that rice exports from Vietnam fell until September when Chinese buying picked up again. It is not surprising, then, that Vietnam has sought to widen its options by signing the US-led Trans-Pacific Partnership (TPP) in February 2016.

Japan, too, has a robust economic relationship with China even as attacks on Japanese products and establishments have always occurred over the decades during China’s periods of foreign policy dissatisfaction. The bilateral trade relationship, worth roughly US\$340 billion in 2014, is the third-largest in the world and China’s shift to higher-end manufacturing and to a more environment-friendly growth model will have to rely on Japanese high-technology transfers. This, however, will also be a matter of political trust between the two countries – and of that there seems to be very little on display.

In the meantime, the Chinese economy’s overtaking of the Japanese as the second-largest in the world – achieved during this period of slowdown – has sparked some Japanese angst as well as rethinking of the country’s political and economic direction. As in the case of Vietnam, some Chinese commentators have suggested that Japan is in a relationship of some dependency on China in view of the “crucial role” China plays in the prospects of Japanese enterprises and in light of the Chinese tourists helping lift Japan’s sagging economy.

That said, the changes in China – whether by design or as a result of the economic downturn – have also forced Japanese manufacturers to consider shifting production out of China to countries with lower wage and production costs. And after several decades of foreign policy drift in the region, Japan under Prime Minister Shinzo Abe is also using this economic imperative to recover its importance in the Asian order by focusing attention and investments on Southeast Asia and emerging powers such as India.

One Belt, One Road (OBOR)

One of the major manifestations of China’s self-confidence and creativity in the face of the economic downturn is its launch of the OBOR infrastructure development and investment initiative. This Chinese plan has actually helped to divide opposition to China in many countries and/or provided additional incentive for other countries to deepen engagement with China. In India, for instance, policymakers view OBOR with great suspicion as some sort of Trojan horse, with potential security implications vis-à-vis India’s ties with its neighbors, while many analysts, pointing to India’s participation in the Asian Infrastructure Investment Bank (AIIB), have called on the government to adopt a more creative and flexible ap-

proach. India’s neighbors, however, are by and large buying into the Chinese portrayal of the “new Silk Roads” as “a new form of global cooperation” and innovation, and as a source of “inclusive growth.”

Pakistan is possibly the biggest beneficiary of China’s economic largesse. The China–Pakistan Economic Corridor signed during Xi Jinping’s visit to Islamabad in April 2015 is worth an estimated US\$46 billion, of which some US\$28 billion worth of agreements are intended for building roads, ports and power plants. The Pakistanis have largely been so enthusiastic about the promised Chinese largesse that they have fallen to bickering among themselves, arguing about the exact alignment of the Economic Corridor with some complaining of being denied a chance to partake of the benefits. Balochistan rebels meanwhile view the Corridor as an extension of Pakistani colonialism and have threatened to disrupt it.

In Bangladesh, China has committed to various physical infrastructure projects ranging from bridges and railways to water and sewage treatment plants. This includes a bridge over the Padma in Bangladesh’s southwest that is expected to add up to 1.2 percent to Bangladeshi GDP. In Sri Lanka, in addition to the Colombo Port City, other big-ticket investments include a US\$1.3 billion coal power plant and a US\$1 billion highway.

While many of these plans are older than the announcement of OBOR, they are all now viewed under the rubric of the new Chinese initiative, just as the Bangladesh, China, India, Myanmar (BCIM) Economic Corridor announced during Chinese Premier Li Keqiang’s visit to India in May 2013 has now been subsumed under OBOR. OBOR, it must be remembered, saw its first official iteration by Xi Jinping only in September of that year. It is possible to say

One Belt, One Road

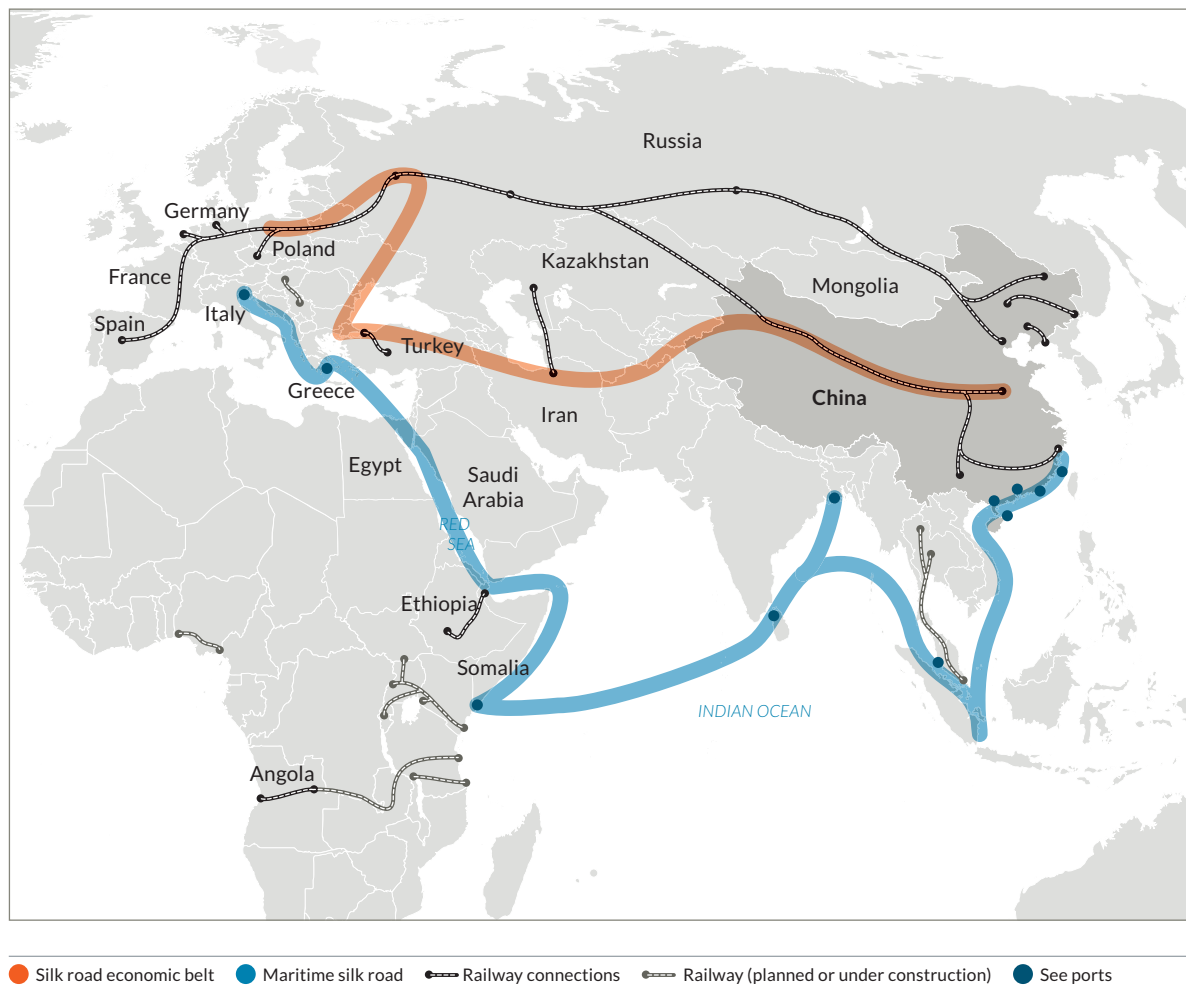


Figure 2 | Source: Own compilation

that the enthusiasm of Indian authorities for the Economic Corridor has considerably cooled since then.

Southeast Asia is another region that has mixed feelings about OBOR, in particular about the Maritime Silk Road. It is a sign of China's remarkable confidence that it should promote such ideas even as the South China Sea disputes involving several ASEAN members continue to fester. It cannot have escaped ASEAN's notice that Beijing's initiative is designed to draw it into a still tighter economic and strategic embrace with China, replicating, in fact, ASEAN's own 2011 Master Plan on Connectivity in many ways.

While Vietnamese suspicions are natural, it is also notable that Indonesian President Joko Widodo has put forward his own plan to make his country what he termed a "global maritime fulcrum." As much a strategic economic initiative as OBOR, it has largely been ignored by Chinese analysts even if officials have tried to highlight the complementarity of the Indonesian initiative with the Chinese Maritime Silk Road. In terms of regional or global recall value, however, the Chinese plan wins hands down. This is not surprising. China's initiative comes on the back of a strong economy and promises tangible benefits to other countries, while Indonesia's idea is still based only on the aspiration of a stronger economic and political role and faces issues stemming from lack of domestic capacity.

Territorial disputes and a widening military footprint

More than anything else, it is China's assertiveness in the East and South China Seas that has convinced many of its neighbors that, slowdown or not, China remains a strong power, even threat, to be reckoned with. In the case of many countries such as India and Japan, this only confirms existing fears about China, while ASEAN has turned into a divided house under pressure from the twin Chinese approaches.

The Chairman's Statement at ASEAN Summits in recent years has invariably expressed concern on the South China Sea disputes and indirectly criticized China, but the strength of the criticism has varied. While Vietnam continues to arm itself, it has not gone as far as the Philippines, which initiated international arbitration even though the Chinese have not been willing to participate.

Despite Chinese provocations, many Southeast Asian countries will, however, also be reluctant to see the revival of the Japanese military or to ally too closely with the United States, if that alliance is going to be backed by the same lack of congruence between words and actions as marks the Chinese case. Despite the recent American freedom-of-navigation operations in the South China Sea, the US is not taking sides in the disputes nor does it seem likely that it or anybody else will be able to stop China's ongoing reclamation activities. Nor are the Southeast Asians interested in precipitating conflicts that will affect not just their economies, but also the stability of ruling regimes in many countries.

In Japan itself, China's rapid military modernization – fed by double-digit budget increases for several decades now – has caused consternation and inspired several moves to get around the constitutional strictures on a more "normal" role for the Japanese Self-Defense Forces. The creation of a National Security Council in 2013 and several subsequent legislative initiatives have all implicitly had the Chinese threat as a driving force.

While Chinese weaponry is a minor part of Southeast Asia's overall arms trade, the licensing and buying of Chinese weapons is a substantial part of the budgets of several countries in South Asia, notably Pakistan, as well as a major policy instrument. This is the result of two factors: one, the history of Indian dominance and sometimes obnoxious behavior vis-à-vis many of its smaller neighbors and, two, the history of Sino-Indian suspicion and competition starting with the countries' brief border conflict in 1962. Thus, as India's antagonist, China is seen as a possible friend or ally by many sections within several South Asian countries in their efforts to counter Indian pressures. India has responded to both this and Chinese incursions along their still disputed boundary with the decision to raise a new mountain strike corps in its army that is focused on China, and to deepen military engagement, especially in the maritime domain, with Japan and the US. India also did not take too kindly to the unannounced visit of Chinese submarines to Sri Lanka in 2014, which probably also solidified its opposition to the Rajapaksa government.

China's economic slowdown does not appear to have affected China's external military ambitions or its desire to put on a good parade. It organized the lat-

ter in August 2015 to mark the victory that ended World War II, an event that, in a pointed signal, was showcased as a victory over Japan and fascism and to which several Asian countries sent leaders and military contingents. Cambodia and Laos sent both military units as well as their heads of state to participate, as did Russia, Mongolia, Kazakhstan, Kyrgyzstan and Tajikistan, from China's Eurasian neighborhood, and Pakistan, from South Asia. Even Vietnam sent its president. For these and other countries, this was no doubt a way of thanking China for – and keeping it interested in – continuing to disburse its economic largesse.

Conclusion

As an analyst from a Chinese think tank speaking about China-Sri Lanka relations put it, no one would want to “miss the chance to catch the express train of China's development.” Further, in cases such as Pakistan, the Chinese might even deserve credit for being willing to take on the onerous task of bringing development to one of the world's most unsafe places. Nevertheless, China's hard line on sovereignty disputes including the blatant disregard for international law has raised suspicions of whether its economic development programs in the form of OBOR are a disguise for political and security objectives. Nor does it appear that China's economic slowdown has in any way moderated either China's interest in building economic links with the outside world or its willingness to brandish its military might in territorial disputes around the region. If anything, if the downturn gets worse, China's leaders might rely still more on military threats to stoke nationalism and to deflect attention from domestic problems.

China's neighbors in Asia would not be surprised.

Further reading

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