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Trends in  
Southeast Asia

CHINA'S QUEST FOR ENERGY IN  
SOUTHEAST ASIA: IMPACT AND  
IMPLICATIONS

ZHAO HONG



ISEAS Publishing

INSTITUTE OF SOUTHEAST ASIAN STUDIES

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## FOREWORD

The economic, political, strategic and cultural dynamism in Southeast Asia has gained added relevance in recent years with the spectacular rise of giant economies in East and South Asia. This has drawn greater attention to the region and to the enhanced role it now plays in international relations and global economics.

The sustained effort made by Southeast Asian nations since 1967 towards a peaceful and gradual integration of their economies has had indubitable success, and perhaps as a consequence of this, most of these countries are undergoing deep political and social changes domestically and are constructing innovative solutions to meet new international challenges. Big Power tensions continue to be played out in the neighbourhood despite the tradition of neutrality exercised by the Association of Southeast Asian Nations (ASEAN).

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# China's Quest for Energy in Southeast Asia: Impact and Implications

By Zhao Hong

## EXECUTIVE SUMMARY

- Energy cooperation between China and ASEAN countries since its initiation in the late 1970s has been viewed as an important part of China-ASEAN relations. As China expanded its FDI to Southeast Asia after the global financial crisis in 2008, cooperation in this field developed to a new level, extending from energy trade to energy resource exploration and related infrastructure-building.
- However, while some momentum exists towards continued cooperation, several factors are pushing the region towards competition and conflicts. The expansion of China's outward FDI, the country's resilience during the global financial crisis and its continuing rapid growth have raised questions about the 'China model' of investment abroad. While seeking to maintain regional energy cooperation, China and ASEAN countries are nevertheless more concerned each with their national energy security than with regional energy security as such.
- This is exemplified in how China's half-hearted engagements at the local level in Myanmar, alongside poor crisis management, have nurtured the perception that China is solely concerned about the security of its own business operations and energy security, and has been ignoring the needs and interests of ethnic nationalities.
- Placing national interests and domestic energy security concerns well above regional ones is understandably a common practice. For example, Indonesia recently made several major domestic economic adjustments to benefit local firms and improve employment conditions. New regulations, such as the export ban it put on



unprocessed nickel in 2012 to encourage the development of domestic refining and processing of the metal, will certainly affect Sino-Indonesian energy resource cooperation.

- The extent to which China's energy resource cooperation with Southeast Asian countries can develop depends on whether or not constituencies in these countries, primarily labour unions, organized businesses and civil society groups, feel that their concerns about China's influence on their political economy are being taken into consideration.
- Beijing's willingness to comply with Indonesia's quest to correct the unbalanced trade profile between the two countries by reducing textile exports and urging Chinese firms to expand investment in the country's manufacturing sector; and the promise to make corporate social responsibility programmes an integral component of Chinese SOE operations in Myanmar are positive signs that Beijing is giving consideration to sensitivities in Southeast Asian countries.

# China's Quest for Energy in Southeast Asia: Impact and Implications

By Zhao Hong<sup>1</sup>

## 1. INTRODUCTION

Energy cooperation between China and ASEAN countries since its initiation in the late 1970s has been viewed as an important part of China-ASEAN relations. As China expanded its FDI to Southeast Asia after the global financial crisis in 2008, cooperation in this field developed to a new level, extending from energy trade to energy resource exploration and related infrastructure-building.

Based on this recent development, the Ministry of Foreign Affairs of China has argued that Beijing will push for even greater economic cooperation to strengthen energy security.<sup>2</sup> Many international scholars also contend that cooperation in energy issues can deepen regional integration and strengthen China-ASEAN relations. Saleem H. Ali claims for example that due to the permanence of their infrastructure, such as oil and gas pipelines, joint energy projects are likely to have a lasting impact and bring greater incentives for sustained cooperation.<sup>3</sup>

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<sup>1</sup> Zhao Hong is Visiting Senior Fellow at the Institute of Southeast Asian Studies (ISEAS), Singapore. He would like to thank the two reviewers of this paper for their insightful advice.

<sup>2</sup> Ministry of Foreign Affairs of the People's Republic of China, "Zhongguo guanyu xin anquan guan de lichang wenjian" (Document on China's position regarding its new security concept), 31 July 2002, <<http://www.fmprc.gov.cn/chn/gxh/zlb/zcwl/t4549.htm>>

<sup>3</sup> Saleem H. Ali, "The strategic logic of pipelines: toward 'rational regionalism'", The Brookings Institution paper, 2010.

However, these past few years have shown that while some momentum exists towards continued cooperation, and energy cooperation has largely broadened China-ASEAN bilateral relations, several factors are pushing the region towards competition and even conflict. Rising demand for energy resources has given rise to “energy protectionism” or “resource nationalism”, leading China and Southeast Asia into a full-fledged competition to secure energy supplies and protect national interests. As China continues its resource quest in Southeast Asia, many outside observers are concerned that China will also replicate the sort of ‘neo-mercantilist’ strategies that Japan adopted during its high-growth phase, a possibility that is reinforced by the prominence of “state capitalism” in a number of rising powers.<sup>4</sup> Chinese investments into Southeast Asia no doubt tie the partners closer together, but also remind politicians of “new colonialism”. An increase in resource nationalism makes friction more likely. Popular cries for governments to exercise sovereign power and control natural resources more effectively makes it harder for state officials to work toward a mutually acceptable compromise with Chinese companies. As Paul Stevens argues “cross-border pipelines and related projects can generate conflicts and local resentment, as parties with different interests and motivations are involved, and land use cannot be compensated properly”.<sup>5</sup>

Indeed, in recent years, China’s state-centred energy-security approach has drawn it towards securing energy supplies by gaining direct control of oil and gas fields and supply routes. Given the fact that Chinese OFDI into Southeast Asian countries has been growing phenomenally and has been largely welcome, this approach towards energy issues generates mixed feelings about China’s unavoidably increasing presence. On one hand, the new approach may offer an opportunity to enhance bilateral cooperation, but on the other, both developing and developed countries have expressed concerns that it may destroy market order,

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<sup>4</sup> Mark Beeson, Mills Soko and Wang Yong, “The new politics: can Australia and South Africa accommodate China?”, *International Affairs* 87, no. 6, 2011, 1365–84.

<sup>5</sup> Paul Stevens, “Oil and Gas Pipelines: Prospects and Problems”, *NBR Special Report #23*, September 2010.

erode confidence in fair access to future supplies, and aggravate strategic distrust.<sup>6</sup> They also argue that although China's loans to developing countries do not come with many political conditions, it remains to be seen whether they can be used in the future as leverage to sway the policies of recipient countries in China's favour, potentially disturbing the status quo in the region. In Southeast Asia, the past few years have witnessed how China's resource quest strategy has contributed to mounting distrust and concerns in local communities (such as in Myanmar and Indonesia), even though the level of direct state intervention has been quite varied. Zhu Feng of Peking University for example has recognized that Beijing was overly focused on building relations with Myanmar's government and had ignored the feelings and interests of the local people. Jia Qingguo of Peking University also argues that economic interdependence cannot ensure good relations between China and small states if the small states involved are uncertain about China's foreign policy intentions.<sup>7</sup> Hence, the questions that require examination are the following: What direction is China-ASEAN energy resource cooperation going in? What impacts has it had on the local communities in Southeast Asia? And how will the future of China-ASEAN relations be affected?

## **2. CHINA'S RESOURCE DIPLOMACY IN SOUTHEAST ASIA**

The energy issue did not become a factor in China's periphery policy until the mid-1990s when a growing energy deficit began interfering in the country's efforts to sustain economic growth. This newly relevant variable has since then helped Beijing through ODA (official development aid) or resource diplomacy to develop cooperative relations with some of its neighbours, notably some countries in Central and Southeast Asia. It is not an easy task determining the extent to which China's diplomacy

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<sup>6</sup> Gabe Collins, Andrew S. Erickson et al., "Asia's rising energy and resource nationalism: implications for the U.S., China, and the Asia-Pacific region", National Bureau of Asian Research, NBR Report, September 2014.

<sup>7</sup> A speech by Peking University's vice director of the School of International Relations professor Jia Qingguo, *Chahare xuehui*, 29 December 2011.

is shaped by its global search for oil and raw materials, but given the key function that uninterrupted energy supply fulfills in maintaining continued economic growth, and how that helps to secure the legitimacy of the Chinese Communist Party (CCP); the importance of oil and gas diplomacy cannot be underestimated,<sup>8</sup> especially where its closest neighbours are concerned. The increasing ODA, the low-interest loans offered for energy-related infrastructure, and the numerous visits made in recent years by top Chinese leaders to neighbouring countries and other parts of the world in search of raw materials and markets underscore this importance.

China's ODA programme dates back to the 1950s, but its early ODA was mainly concentrated in Africa and Latin America in support of new nations "fighting against colonialism and hegemony".<sup>9</sup> In the mid-1990s, with the economic situation greatly changing, China instituted a series of reforms in its aid programme, explicitly linking foreign aid with economic cooperation and trade. China was then facing a situation similar to that of Japan in the 1970s — a booming industrial economy that was flush with cash due to expanding exports, but increasingly dependent upon imported oil and other strategic resources.

China had become a net oil importer in 1996 and overtook Japan in 2003 as the second largest oil consumer after the U.S., becoming the third largest oil importer after the U.S. and Japan in 2004.<sup>10</sup> In 2010 China surpassed the U.S. to become the largest energy consumer in the world, accounting for 22 per cent of global energy consumption.<sup>11</sup> In the coming decades China will not only consolidate its position as the world's largest consumer of energy but also remain the largest oil importer.

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<sup>8</sup> Gerald Chan, "China joins global governance: the 10 conundrums", in *China and the New International Order*, edited by Wang Gungwu and Zheng Yongnian, Routledge, 2008, p. 176.

<sup>9</sup> Shang Changfeng, Wenge shiqi zhongguode duiwai yuanzhu [Chinese foreign aid in the era of the Cultural Revolution], *Dangshi wenhui* [Party History Digest] 2, 2010, p. 57.

<sup>10</sup> Zweig, David and Bi Jianhai, "China's global hunt for energy", *Foreign Affairs*, 84 (5), 2005.

<sup>11</sup> BP Statistical Review of World Energy, June 2013.

Like Japan in the 1970s, China soon began to leverage its burgeoning cash due to expanding exports to secure access to strategic energy resources. Similar to Japan's earlier aid programme, China's subsidized loans are often part of a larger investment package aimed at securing access to key strategic resources in developing countries. For example, China provided its first subsidized loan to Sudan in 1996 to finance oil exploration through a joint venture with China National Offshore Oil Corporation (CNOOC). From 2000 to 2005, China's outward FDI to Africa and Latin America rose by 37 per cent and 45 per cent respectively, with large increases in mining, particularly the oil sector.<sup>12</sup>

China launched its ASEAN resource diplomacy much later than Japan did as it did not normalize its political relations with ASEAN countries until the early 1990s. It was a milestone when ASEAN's perceptual shift from "China as a threat" to "China as an opportunity" took place during the Asian financial crisis in 1997. In the crisis, China firmly committed to not devaluing its currency and provided timely and generous financial assistance to ASEAN countries. It actively adjusted its ASEAN policies. Among major countries in the region, China was the first to sign the Treaty of Amity and Cooperation with ASEAN; the first to propose and sign an agreement to establish an FTA with ASEAN; the first to forge a Strategic Partnership for Peace and Prosperity with ASEAN; the first to pledge the accession to the protocol to the Treaty on Southeast Asia Nuclear Weapon Free Zone; and the first to sign a 'strategic partnership' with ASEAN at the October 2003 Bali Summit.

In 2008, China announced the establishment of the China-ASEAN Investment Cooperation Fund and committed loans for ASEAN countries amounting to US\$15 billion.<sup>13</sup> At the APEC meeting in Bali in October In 2013, Chinese President Xi Jinping proposed a Chinese-

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<sup>12</sup> Kobayashi, Takaaki, Evolution of China's aid policy, Japan Bank for International Cooperation, Working Paper No. 27, 2008.

<sup>13</sup> The China-ASEAN Investment Fund (CAF) is a private equity fund that commenced operation in 2010 to promote investment in ASEAN countries, with the China Exim-bank playing a central role. The International Finance Corporation, a member of the World Bank Group, became an investor in CAF in 2011 with the aim of improving the standards of Chinese funds.

led Asian Infrastructure Investment Bank (AIIB) to fund and spearhead regional infrastructure development and economic growth.<sup>14</sup> China has also utilized the framework of the Greater Mekong Subregion Economic Cooperation Program, facilitated by the Asian Development Bank, to improve the physical connectivity between the Mekong region and Yunnan Province and Guangxi Zhuang Autonomous Region. China's diplomacy towards ASEAN turned out to be the most successful story in Chinese foreign policy in the Post-Cold war era.<sup>15</sup>

It was against such a background that China was able to catch up with or even surpass Japan in its economic relations with ASEAN, and its aid to ASEAN countries increased continuously, with much of it going into resource-related infrastructure sectors. According to China's 2014 white paper on foreign aid, from 2010 to 2012, China provided US\$14.4 billion for three types of foreign assistance: grants, interest-free loans and concessional loans, with Africa and Asia being the main beneficiaries and accounting for 52 per cent and 31 per cent of China's foreign assistance respectively, while economic and energy resource-related infrastructure accounted for 45 per cent of China's total foreign aid.<sup>16</sup> Although the white paper does not provide data by country, it is obvious that the amount of trade, investment and ODA directed to Southeast Asia – in particular via infrastructure financing – has grown substantially in recent

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<sup>14</sup> On 24 October 2014, 20 countries signed a non-binding multilateral MoU in Beijing to set up the AIIB. The proposed initial authorized capital for AIIB is US\$50 billion, of which 20 per cent will be paid-up capital. AIIB will use commercial funding from financial markets to raise the necessary resources to provide competitive loans to the member countries. Its objectives will be to speed up infrastructure development in energy and power, transportation, telecommunication, rural infrastructure and agricultural development, urban development, logistics and other productive sectors as deemed appropriate. (*China Daily*, 25 October 2014).

<sup>15</sup> Wang Jianwei, "Great power relations and their impact on Japan-Southeast Asian relations", in *Japan's Relations with Southeast Asia – the Fukuda Doctrine and beyond*, edited by Lam Peng Er, 2013.

<sup>16</sup> China's Official Development White Paper 2014, <[http://news.xinhuanet.com/english/china/2014-07/10/c\\_133474011.htm](http://news.xinhuanet.com/english/china/2014-07/10/c_133474011.htm)> (accessed 26 July 2014).

years, and that China is one of the largest sources of economic assistance, defined broadly, to Southeast Asia.<sup>17</sup>

### **3. CHINESE FDI AND ENERGY RESOURCE COOPERATION WITH ASEAN**

In the early 1990s when China was beginning to expand its OFDI, ASEAN member countries were receiving only around 3 per cent of China's total OFDI. As developing countries' share rose over time, ASEAN's share also rose dramatically. According to the Ministry of Commerce of China, between 2003 and 2012, ASEAN saw an increase of China's inward investment from US\$0.12 billion to US\$6.1 billion, and ASEAN's share in China's total OFDI rose from 4 per cent to 8 per cent (see Figure 1). China's share in ASEAN's total FDI inflows had increased from 1.9% in 2004 to 5.3% in 2011, somewhat lower than that of Japan (13.2%), but higher than that of the U.S. (5.1%) and Australia (1.2%).<sup>18</sup> Although Chinese FDI in Southeast Asia is very diversified, its fast growth does reflect China's growing demand for energy resources (primary coal and Liquefied Natural Gas) and raw-materials. In fact, between 2008 and 2012, the share of China's OFDI in mining sectors in Southeast Asia increased from 9.7% to 28% of China's total OFDI in Southeast Asia.<sup>19</sup> This is almost equal to that in China's total investment in Africa. In 2012 the mining sectors accounted for 30.6% of China's total OFDI in Africa (US\$2.52 billion).<sup>20</sup> Considering that the total amount of China's FDI in

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<sup>17</sup> Thomas Lum, Hannah Fischer, Julissa Gomez-Granger and Anne Leland, "China's foreign aid activities in Africa, Latin America, and Southeast Asia", *Congressional Research Service*, 25 February 2009. <<http://www.fas.org/sgp/crs/row/R40361.pdf>> (accessed 21 September 2014).

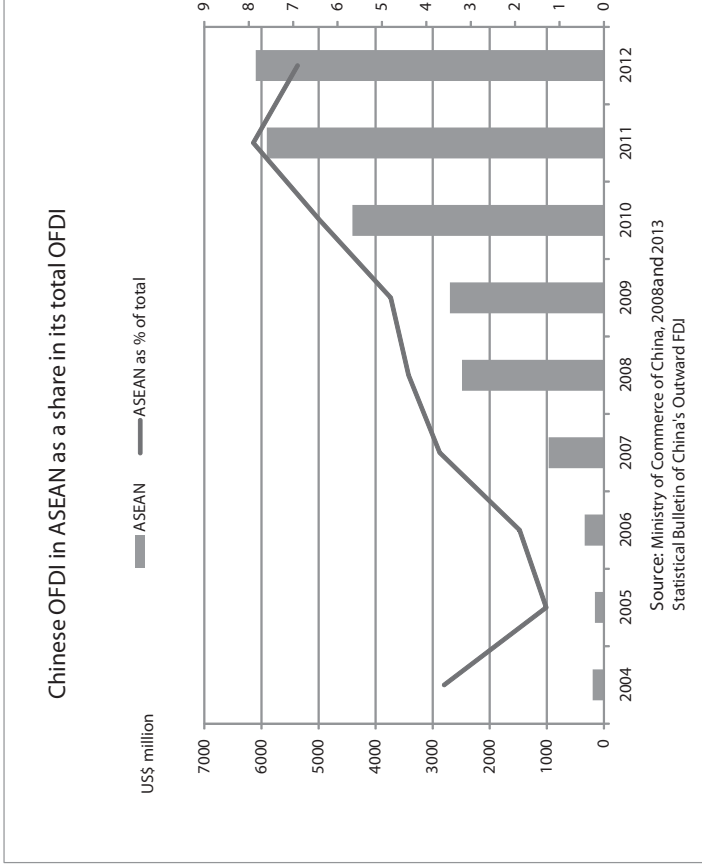
<sup>18</sup> ASEAN Secretary, *ASEAN Statistical Yearbook*, 2012, p. 131.

<sup>19</sup> Ministry of Commerce of China, 2008 and 2013 *Statistical Bulletin of China's Outward FDI*.

<sup>20</sup> "China-Africa Economic and Trade White Paper", State Council Information Office, August 2013, <[http://news.xinhuanet.com/english/china/2013-08/29/c\\_132673093\\_3.htm](http://news.xinhuanet.com/english/china/2013-08/29/c_132673093_3.htm)> (accessed on 18 November 2014)



**Figure 1. Chinese OFDI in ASEAN as a Share in Its Total OFDI**



Source: Ministry of Commerce of China, 2008 and 2013 Statistical Bulletin of China's Outward FDI.

ASEAN has so quickly grown to become larger than that in Africa, we can assume that the mining sectors are becoming increasingly attractive to China's investment.

In the 10 ASEAN countries, some resource-rich member countries have clearly witnessed a rapid expansion of China's OFDI inflows. For example, from 2003-2012, the amount of China's OFDI in Myanmar increased from US\$4.1 million (in 2004) to US\$749 million; in Indonesia this rose from US\$26 million to US\$592 million; in Laos it went from US\$0.8 million to US\$809 million; in Vietnam from US\$12.8 million to US\$349 million; and in Malaysia from US\$1.97 million to US\$199 million.<sup>21</sup> The private sector in these resource-rich countries has attracted much of China's investment. For example, in Malaysia, the number of iron ore mines in operation has increased more than sevenfold since 2007, mainly from Chinese investment.<sup>22</sup> In Myanmar, China's three largest state-owned oil companies – China National Petroleum Company (CNPC), Sinopec and China National Offshore Oil Corporation (CNOOC) — have all started oil exploration projects there. In November 2008, CNPC and Ministry of Energy Myanmar signed an agreement to build a US\$2.3 billion crude oil pipeline and US\$2 billion natural gas pipeline. Once the Myanmar-China oil and gas pipelines are in operation, it is expected that 22 million tonnes of crude oil will be transferred annually, accounting for approximately 10 per cent of China's total oil import in 2010.<sup>23</sup> And Myanmar is supposed to supply 10 billion cubic metres (bcm) of gas to China every year, accounting for around 6% of China's total gas consumption in 2013 (167.6 billion bcm).<sup>24</sup>

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<sup>21</sup> Ministry of Commerce of China, *2013 Statistical Bulletin of China's Outward FDI*.

<sup>22</sup> Keith Bradsher, "Chinese interests look to Malaysia for cheap iron ore, and profits", *The New York Times*, 19 November 2014.

<sup>23</sup> Arafinace, "Saudi Aramco to supply crude to new PetroChina refinery", 20 March 2011, <<https://www.arabfinance.com/news/newsdetail.aspx?Id=190465>>.

<sup>24</sup> "我国成为第三大天然气消费国" (China became the third largest gas consuming country), *中国石油报 (China Petroleum Daily)*, 20 May 2014.

Indonesia is also one of China's top suppliers of energy and raw materials such as LNG, coal, nickel ore, bauxite, and iron ore. It is the world's largest exporter of thermal coal — by 2010, it had proven reserves of 5,529 million tonnes of coal. Its coal production was 188.1 million tonnes of oil equivalent (toe), and its consumption was 39.4 million toe. Moreover, by 2010, Indonesia had proven gas reserves of 3.1 trillion cubic metres (tcm), with production reaching 82 billion cubic metres (bcm), and consumption at 40.3 bcm.<sup>25</sup> Indonesia is currently the world's third largest exporter of liquefied natural gas after Qatar and Malaysia, and supplies 12% of the world's LNG from two production centres — at Arun in Aceh and Bontang in East Kalimantan, and is the third largest LNG exporter to China. In 2012, 34% of China's total LNG import came from Qatar, 24% from Australia, 16% from Indonesia, and 13% from Malaysia.<sup>26</sup> As China plans to increase the share of gas in its total energy mix from 5.2% in 2012 to 12% by 2030, the China National Petroleum Corporation (CNPC) and the China Petrochemical Corporation (SINOPEC) project that Chinese gas demand will rise at an average growth rate of around 8 per cent per year between 2012 and 2030.<sup>27</sup>

Although China is making every effort to diversify its energy structure, over 70% of its total energy consumption still relies on coal. Hence, as soon as China became a net importer of coal in 2007, its main foreign supplier was Indonesia. Coal from Indonesia becomes increasingly attractive to the prosperous coastal regions of China, potentially displacing domestic Chinese production that must be railed and shipped long distances from Shanxi and Mongolia. In July 2010, Shenhua — China's largest coal producer — announced a US\$331 million coal project in Sumatra, and in October the same year, China's sovereign wealth fund injected US\$1.9 billion into Bumi Resources —

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<sup>25</sup> BP *Statistical Review of World Energy*, June 2011.

<sup>26</sup> US Energy Information Administration, <<http://www.eia.gov/countries/cab.cfm?fips=CH>>.

<sup>27</sup> Xu Yongfa, president of CNPC Economics and Technology Research Institute, as quoted in Interfax, *China Energy Weekly*, 27 February–2 March 2012, p. 8.

Indonesia's largest coal producer.<sup>28</sup> Indonesia is also China's top supplier of other raw materials, such as nickel ore, bauxite, and iron ore. By the end of 2012, more than 1,000 Chinese enterprises had invested in the country, with total Chinese accumulated investment totaling US\$31 billion, increasing from US\$122 million in 2004.<sup>29</sup>

## **4. FROM COOPERATION TO COMPETITION?**

Bilateral energy cooperation between China and ASEAN countries is not new. In July 1978, China and the Philippines signed a long-term Petroleum Trade Agreement which was the first energy trade agreement between China and an ASEAN country.<sup>30</sup> Since 2000, China has become Brunei's eighth largest consumer of crude oil, and in 2003 and 2006, China signed major contracts with Indonesia and Malaysia for the supply of liquefied natural gas (LNG).<sup>31</sup> On 30 August 2004 at the "Indonesia National Exhibition", Indonesian Minister of Trade and Industry stressed that Indonesia would further strengthen energy cooperation with China. As China expanded its FDI to Southeast Asia after the global financial crisis in 2008, China-ASEAN energy cooperation developed to a new level, extending from energy trade to energy resource exploration and related infrastructure-buildings.

However, while some momentum exists towards continued cooperation, several other factors are pushing the region towards unhealthy competition or even conflicts, adversely affecting bilateral relations. The rise of China's OFDI, its resilience during the global

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<sup>28</sup> Anthony Deusch, "Asia giants' scramble for coal reaches Indonesia", *Financial Times*, 9 September 2010.

<sup>29</sup> Ministry of Commerce of China, *2013 Statistical Bulletin of China's Outward FDI*.

<sup>30</sup> Li Tao & Liu Zhi. "shixi Zhongguo dongmeng nengyuan hezuo" (An Analysis to China-ASEAN Energy Cooperation), *Journal of Southeast Asian Studies*, No. 3, 2006.

<sup>31</sup> Storey IJ, "China a major player in S-E Asia pipeline politics", *Singapore Straits Times*, 23 October 2009.

financial crisis and its continuing rapid growth have raised questions about the “China model” of investment abroad. Although bilateral and regional energy cooperation is necessary, China and ASEAN countries clearly see energy cooperation as a means to secure their own individual energy supplies and national interests rather than as a sort of cooperation that leads to regional energy security. Chinese policymakers, for example, have primarily viewed energy security as a vehicle to rapidly modify China’s growing dependence on global markets and to diversify its energy sources and transportation routes. China sees Southeast Asia as contributing to its energy security in offering coal and gas, and sees Myanmar as an alternative port for oil and gas imports without having to traverse the region’s long and narrow straits. In the eyes of some western observers, “buying stakes in foreign oil fields, militarily protecting vulnerable shipping lanes, and all-out ‘energy scramble’ for resources are key features of China’s current approach to energy security.”<sup>32</sup> They argue that this has negative consequences for international politics in Asia – through threatening the resource security of other regional economies, weakening multilateral efforts to build open resource markets, and intensifying security competition in the region, particularly with Japan and the U.S.<sup>33</sup>

In Southeast Asia, the perspective is not very different. As John Lee has described it, “in the eagerness to deploy Chinese capital and expertise for rapid completion of resource extraction, transportation and power-generation projects, Chinese SOEs have been given wide leeway in disregarding environmental standards and the interests of local people affected by these projects”.<sup>34</sup> This is reflected in Myanmar’s

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<sup>32</sup> Benjamin K. Sovacool and Vu Minh Khuong, “Energy security and competition in Asia: challenges and prospects for China and Southeast Asia”, in *ASEAN Industries and the Challenge from China*, edited by Darryl S.L. Jarvis and Anthony Welch, Palgrave Macmillan, 2011.

<sup>33</sup> Cited in Jeffrey D. Wilson, “Northeast Asian resource security strategies and international resource politics in Asia”, *Asian Studies Review*, 2014, Vol.38, No.1, 15-35.

<sup>34</sup> John Lee, “Myanmar pivots awkwardly away from China”, *ISEAS Perspective*, 12 December 2013.

view that China's half-hearted engagements at the local level, along with poor crisis management, have added to the widespread perception that China is solely concerned with the security of its own business operations and energy security, and is ignoring the needs and interests of ethnic nationalities.<sup>35</sup> In the locals' view, Chinese investment projects, primarily in energy and natural resources, have failed to create sizeable employment opportunities for them. For Vietnam, bauxite exploitation projects in Tay Nguyen (Central Highlands) have triggered significant civil society movement and the situation has become a major turning point in the domestic politics of Vietnam<sup>36</sup> activating a movement of solidarity among scientists, intellectuals and civil society groups in Vietnam.<sup>37</sup> It would seem that China's presence in Southeast Asia has had more negative consequences than positive ones on local communities. It has not brought substantial benefits but instead strengthened local perceptions that economic relations with China are unequal and asymmetrical. In particular, locals believe that China is grabbing their natural resources and disregarding their interests.<sup>38</sup> Indeed, this is one of the dilemmas that makes balancing bilateral cooperation and the interest of local communities so difficult.

As one would expect, Southeast Asian countries seem equally preoccupied with placing national interests and domestic resource security concerns well above the need for bilateral cooperation. For example, Indonesia recently made several major domestic economic adjustments to benefit local firms and improve employment conditions. New regulations, such as the export ban it put on unprocessed nickel in 2012 to encourage the development of domestic refining and processing of the metal, will certainly affect Sino-Indonesian energy resource

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<sup>35</sup> Bernt Berger, "China's troubled Myanmar policy", *The Diplomat*, 23 August 2013.

<sup>36</sup> Huong Le Thu, "Vietnam: Straddling Southeast Asia's Divide", *Trends in Southeast Asia*, 2014 #5.

<sup>37</sup> Hunter Martson, "Bauxite Mining in Vietnam's Central Highlands: An Arena for Expanding Civil Society?," *Contemporary Southeast Asia* 34, no. 2, 2012.

<sup>38</sup> *Ibid.*

cooperation. The objective is to control natural resources and maximize rent appropriation to benefit national development. The Indonesian government is determined to transform its domestic economic structure from a resource-based one to a manufacturing-based one. As such Indonesia is increasingly described as a country where resource nationalism is on the rise.<sup>39</sup>

Further complicating the policies on natural resources in Indonesia is the fact that its major trading partner is also seen as a strategic threat in the region. Although bilateral relations with China has greatly improved in recent years, Indonesia's attitudes and policies are still shaped by uncertainty regarding the long-term implications of the rise of China for the larger East Asian region.<sup>40</sup> Beijing's growing military capability and how that will affect its role in Southeast Asia and in the South China Sea is an even bigger cause of worry for Indonesia.<sup>41</sup>

Indonesia implemented a new law to ban the export of raw ores starting from January 2014 (although it has been relaxed recently). The new regulations, aimed at reforming the mining and oil industries, are promoted in the name of "national interest", arousing a number of heated debates and concerns. Industry commentators, journalists and some scholars typically deploy it to criticize government attempts to assert greater control over resource sectors at the expense of foreign investors. At best, such analysts frame resource nationalism as short-sighted and poor policy-making. At worst they see it as the work of corrupt, rent-seeking government elites.<sup>42</sup> Left uncorrected, it will "inevitably lead to

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<sup>39</sup> Eve Warburton, "In whose interest? Debating resource nationalism in Indonesia", *Kyoto Review of Southeast Asia*, Issue 15, March 2014.

<sup>40</sup> Rizal Sukma, "Indonesia-China relations: The politics of re-engagement", *Asian Survey*, August 2009.

<sup>41</sup> *Ibid.*

<sup>42</sup> Eve Warburton, "In whose interest? Debating resource nationalism in Indonesia", *Kyoto Review of Southeast Asia*, March 2014, <<http://kyotoreview.org/yav/in-whose-interest-debating-resource-nationalism-in-indonesia/>> (accessed on 18 November 2014).

dramatic decline of output in Indonesia's extractive industries, damaging foreign investment and regional energy cooperation."<sup>43</sup>

In reality, Jakarta faces a dilemma regarding its resource export ban policy. On the one hand, it recognizes the importance of shifting from an economic model heavily reliant on raw material exports to one where Indonesia refines its own metals, minerals and ores, both for export and more importantly for domestic use in manufacturing industries. But on the other hand, without adequate urban and rural transport systems, Indonesia finds itself squeezed between slowing Chinese demand for raw materials and the inability to shift to greater domestic consumption of key minerals. As a result, "[the export ban] will inevitably lead to a dramatic decline of output in Indonesia's extractive industries, damaging foreign investment and economic growth, and disrupting global mineral markets".<sup>44</sup>

The new regulations, especially the export ban of raw materials, will certainly affect Sino-Indonesian energy resources cooperation. China is highly dependent on Indonesia for its nickel, bauxite, copper, and coal. In 2012, Indonesia produced 16 per cent of the world's nickel ore, and supplied 58 per cent of the world's demand for nickel and 48 per cent of global bauxite needs. Most of Indonesia's exports of these metals go to China and Japan. In 2013, China sourced 66% of its aluminum ore (bauxite is refined into alumina before being turned into aluminum) from Indonesia (up from 64% in 2012) and 57% of its bauxite ore (on par with 2012 level). In 2012, about 6% of China's copper ore imports came from Indonesia.<sup>45</sup>

The case of Myanmar also shows that national interests and local security concerns (social and environmental security) may well be

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<sup>43</sup> John Kurtz, "The myth of Indonesia's resource nationalism", *Strait Times*, 2 October 2013.

<sup>44</sup> John Kurtz and James Van Zorge, "The myth of Indonesia's resource nationalism", *Wall Street Journal*, 1 October 2013.

<sup>45</sup> "Indonesia struggles with an export ban", Stratfor Global Intelligence <<http://www.stratfor.com/search/site/Indonesia-struggles-with-an-export-ban>> (accessed on 21 November 2014).



above bilateral cooperation. In Myanmar, most dams were built either through exclusive concessions to Chinese firms or by China-Myanmar joint ventures where China provides the engineering technology and the loans without consultations with local stakeholders.<sup>46</sup> More importantly, China's investment projects in ethnic areas, and Kachin State in particular, increasingly touch upon fundamental questions of political self-determination and national conciliation. As Elliot Brennan and Stefan Doring argue, "with the country in the midst of a tentative national ceasefire process, land acquisition has become a key driver for protests, and dam sites have the potential to stir latent or resurrect suspended conflicts, as some of the construction sites are often within or nearby recent conflict zones."<sup>47</sup> The Burma River Network, an alliance of several local environmental activist groups, reported that up to 50 clashes between military forces and armed ethnic groups occurred in connection with ongoing hydropower projects in the last three years.<sup>48</sup> While this cannot be independently verified, it is nevertheless apparent that the ongoing peace process needs to address land rights, compensation, environmental protection and other issues that are directly associated with dam construction.

After suspending the Myitsone dam project in September 2011 in response to rising nationalism and domestic pressure, Nay Pyi Taw stopped the Kyaukpyu-Kunming railway project based on the reason that this project was popularly perceived as having "more disadvantages than advantages" and was cancelled in line with "people's desires".<sup>49</sup> But the real consideration seemed to have been the wish to reduce China's rising influence in Myanmar. As Sun Yun, a research fellow based at the Stimson

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<sup>46</sup> Lynn Thiesmeyer, "Mekong river transboundary management issues in the 21<sup>st</sup> century: Yunnan province and its southern neighbors", paper presented at the RSIS workshop on "China and Non-Traditional Security: global quest for resources and its international implications", 31 October 2014, Singapore.

<sup>47</sup> Elliot Brennan and Stefan Doring, "Myanmar's dam may be no show", *AsiaTimes online*, 4 March 2014.

<sup>48</sup> Aung Shinb, "Environmentalists calls on government to halt hydropower projects", *Myanmar Times*, 3 November 2013.

<sup>49</sup> Sun Yun, "China, Myanmar: stop the train", *AsiaTimes online*, 14 August 2014.

Center, wrote: “the Myanmar people perceive China’s efforts in building pipelines, dams and railways as a powerful neighbor’s overwhelming pressure to impose a deal that benefits China while harming Myanmar.”<sup>50</sup> Since the suspension of the project, China has not only postponed almost all its new major investment projects in Myanmar but also considered Myitsone a festering thorn in bilateral relations.<sup>51</sup> Thus, due to domestic rising resource nationalism, the special ties between China and Myanmar have the potential to deepen the projection of China as a threat.

From the Chinese perspective, while Chinese projects in Myanmar are consistently falling prey to public disapproval, several infrastructure projects that will connect Myanmar to India’s northeast states appear to be making progress, even in the face of similar local opposition. For example, the Kaladan Multi-Modal Transit Transport Project, which will connect India’s Mizoram State to the deep-sea port in Sittwe, is to be completed by 2015. The project will expand the capacity of the Sittwe port facility, giving India’s northeastern states access to the harbour in the Bay of Bengal and connecting Myanmar to Kolkata port. Another project, the India-Myanmar-Thailand trilateral highway corridor, is projected to be finished by 2016. In July 2014, the governments of India and Myanmar also pledged to proceed with the creation of a highway bus route that will connect Moreh in India’s Manipur state to Mandalay.<sup>52</sup> The Moreh-Mandalay highway will fill a crucial gap in the Asian Highway network as well as connect India’s northeastern states to the East-West Economic Corridor, which connects Mawlamyine in Myanmar to Da Nang port in Vietnam. On completion, India will achieve a level of connectivity into Southeast Asia similar to that which China has enjoyed for decades. The entry or resurgence of more global players like Japan and India will provide Nay Pyi Taw with more options, facilitating its attempts at loosening itself from China’s grip.

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<sup>50</sup> Ibid.

<sup>51</sup> Sun Yun, “China, Myanmar face Myitsone dam truths”, *AsiaTimes online*, 19 February 2014.

<sup>52</sup> Jacob Goldberg, “Myanmar’s great power balancing act”, *The Diplomat*, 29 August 2014.

## 5. RETHINKING CHINA'S RESOURCE QUEST APPROACHES

In a globalized economy, securing the supply of natural resources is a pressing issue for many states, including China. With its worsening gap between energy supply and demand, China is intensively engaged in efforts to acquire oil and gas resources from all over the world. China's political economy, where its heavily state-owned economy and regime legitimacy are largely reliant on high economic growth, relies heavily on SOEs (state-owned enterprises) to secure overseas supplies of oil and gas resources for domestic use.<sup>53</sup> The domestic thinking of not allowing free market mechanisms to dominate activities in "strategic sectors" is obviously reflected in Beijing's attitude toward its overseas energy security policy. In China's view, "strategic sectors are simply too important to be left to market forces alone".<sup>54</sup> Hence, the SOEs-led and politically-driven (rather than economic) approach to energy security policy prevails, while the role of market forces in determining supply, pricing, and distribution of energy resources throughout its economy is limited. Some analysts have thus argued that China's "going out strategy" is mercantilist in nature, as it mainly relies on government financial support and bilateral resource diplomacy to smooth the way for such investments.

Although China's evolving strategy has generated alarm and unfavorable comments about its resource investment in Southeast Asia, it is at the same time important to recognize that the Chinese do not

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<sup>53</sup> China's largest companies are almost all central SOEs and state-owned banks. For example, of the top 50 firms in 2011, central SOEs controlled 72 percent of the total revenue, with other central financial enterprises and the post office making up a further 17 percent. The senior executives of these companies are appointed by the CCP and are listed among the top officials in the country. [Peter Drysdale, "Chinese state-owned enterprise investment in Australia", East Asia Forum, 25 August 2014.]

<sup>54</sup> Heinrich Kreft, "China's quest for energy", *Policy Review*, no. 139, 1 October 2006.

view their policies as being very different from those of the U.S., Japan or South Korea. At the international level, energy resource nationalism leads to nationalist and mercantilist strategies for securing energy resources and commodity supplies, which employ tactics ranging from assertive diplomacy and financial support for acquiring oil and gas reserves, to military posturing and action to gain resource deposits and protect supply lines such as sea lanes.<sup>55</sup> In Asia, over the past decade, state-backed national oil companies (NOCs) have become increasingly more able at competing with international oil companies, with Chinese NOCs representing the largest winning group in the bid for Iraqi oil field development. Japan, South Korea, and India have also sought to reinvigorate their earlier NOC drive abroad.

In fact, resource security strategies are not without historical precedence in Northeast Asia. During the 1960s and 1970s, for example, the Japanese government offered financial and diplomatic assistance to its industrial corporations to sponsor the development of new mining firms in Latin America and Southeast Asia. These mining firms were connected to the Japanese economy through long-term contracts and investment ties, which guaranteed Japan's resource security by ensuring that their output was preferentially supplied to the Japanese market.<sup>56</sup> Korean heavy industrialization in the 1970s also saw its government launch a similar resource diplomacy programme to strengthen inter-government ties with its foreign energy suppliers.<sup>57</sup>

Moreover, these two countries have recently launched new resource security strategies and sped up their overseas investment in resource sectors. For example, from 2006 to 2010, the average annual growth rate

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<sup>55</sup> David R. Mares, "Resource nationalism and energy security in Latin America: implications for global oil supplies", James A. Baker III Institute for Public Policy, Rice University, *Working Paper*, 3 January 2011, <<http://weber.ucsd.edu/~dmars/MaresResourceNationalismWorkPaper.pdf>>.

<sup>56</sup> Ozawa Terutomo, *Multinationalism, Japanese Style: The Political Economy of Outward Dependency*, Princeton University Press, 1979.

<sup>57</sup> Lee Min Yong, Securing foreign resource supply: resource diplomacy of South Korea, *Pacific Focus*, 3(2), 1988, 79–102.

of Korean overseas resource investment was 50%, and the percentage of resource investment in its total OFDI increased from 2.5% in 2000 to 31.5% in 2010. By 2010, the SOEs accounted for 75.1% in Korean total overseas resource investment, 61.1% in its overseas oil and gas investment, and 13.7% of its total investment in other mineral resources.<sup>58</sup> From 2004 to 2010, the Korean government passed and implemented four Overseas Resource Development Master Plans, aiming to enhance the self-development rate of overseas mineral resources and increase its energy resource security. Similar to China's programme, Japan and Korean strategies have also called for national firms to make security-oriented investments in overseas resource projects, providing government assistance to national firms to acquire ownership, and ultimately control, of overseas resource projects.

In the case of China, the companies involved in China's "going out" strategy have, increasingly, a variety of owners, including central and provincial governments as well as a diverse range of private interests. The Chinese government extends a variety of incentives and means of support to its companies, and China's rapidly growing foreign exchange reserves allow state-owned financial institutions to underwrite overseas investment expansion. But if we compare with Japan and other developed countries, we find that China launched its ASEAN resource diplomacy much later and its foreign aid disbursements, with their potential role in securing resource contracts, are still quite limited in size.<sup>59</sup> While little attention has been paid to the strategies of other resource consumers in the region, or whether China's approach might share common causes and implications with those of Japan and Korea, it is the Chinese companies'

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<sup>58</sup> Quoted from Lin Chinxu and Shi Yinghong, "Hanguo haiwai ziyuang kaifa zhanglue" (South Korean overseas resource development strategy), *Journal of Contemporary Asia-Pacific Studies*, No. 2, 2014, pp. 54–65.

<sup>59</sup> For example, from 2010 to 2012, China appropriated in total \$14.4 billion for foreign assistance in three types: grant (aid gratis), interest-free loan and concessional loan (China's 2014 Foreign Aid White Paper, [http://news.xinhuanet.com/english/china/2014-07/10/c\\_133474011.htm](http://news.xinhuanet.com/english/china/2014-07/10/c_133474011.htm)). By contrast, in 2012 the Japanese government allocated total ODA of \$18.7 billion (Japan's ODA White Paper 2013, <<http://www.mofa.go.jp/policy/oda/white/2013/pdfs/all.pdf>>).

misbehaviour such as the lack of corporate social responsibility, and the disregard for the environment that have caused international and host countries' concerns.

So, what is it that may have caused such misbehaviour by Chinese OFDI companies? It is necessary to point out that most of these Chinese firms were newcomers, and are quite ignorant of local laws, regulations, and cultures. They still face a steep learning curve in their OFDI. A survey in 2010 shows that more than 80% of Chinese OFDI firms began investing abroad only after 2000, while only 4% of them had outward investments before 1990.<sup>60</sup> More importantly, most of these firms had only loosely abided by the law before they went out, and the Chinese legal system and requirements on business ethics, especially those with regard to environmental protection are immature compared to that of Japan, South Korea and other developed economies. Most of them therefore simply kept doing in foreign markets what they were used to doing back home.

So in addition to gaining a better understanding of local cultures and traditions, Chinese firms clearly need to strengthen their corporate transparency and compliance so as to win trust and to generate positive perception from local communities. Evidence shows that Beijing has recently been improving in this regard. For example, the State-owned Assets Supervision and Administration Commission of the State Council of China issued "Guideline on SOEs Fulfillment of Corporate Social Responsibility (CSR)" in late 2007 and asked SOEs, including big extractive companies like CNPC, Sinopec and CNOOC, to issue CSR reports to disclose information relating to their social responsibilities to stakeholders and the public in general, and to receive their supervision.

After the suspension of the Myitsone dam project in late 2011, Beijing has made corporate social responsibility programmes an integral component of Chinese SOEs' operations in Myanmar, and has initiated what it calls a "people to people" relationship with Myanmar. It has

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<sup>60</sup> Quoted from Bijun Wang and Rui Mao, "Overseas impacts of China's outward direct investment", *Asian Economic Policy Review*, Vol. 9, Issue 2, 2014, pp. 227-49.

arranged several friendship tours targeting various political parties in Myanmar, including the National League for Democracy (NLD), civil society organizations such as the 88 generation students' Peace and Open Society, as well as local media groups, to build better understanding between the societies of the two countries. All these steps are quite unprecedented where Chinese policy towards Myanmar is concerned. One could go further and see if Chinese firms investing in Southeast Asia and other regions will sign up to the Extractive Industries Transparency Initiative (EITI) which complements China's SOE's reporting requirements and which is aimed at improving transparency in NOC activities overseas.<sup>61</sup>

## **6. CONCLUSION: COOPERATION OR CONFLICT?**

While it is accepted that resource quests can trigger conflict, the fact that resource rivalry might also create opportunities for cooperation should not be ignored. As China follows its growth path, its concern about natural resource security has intensified and the Chinese government encourages FDI as a means of securing resources. Chinese capital will flow more intensively into the developing world, especially its neighbouring countries. This has in fact opened large-scale development opportunities in the resource sectors in Southeast Asia.

Concretely speaking, China's broader energy security strategy has been to pursue supply diversity and to find and develop offshore oil and

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<sup>61</sup> The Extractive Industries Transparency Initiative (EITI) was founded at a conference in London in 2003. It is an international organization and maintains a standard, assessing the levels of transparency around countries' oil, gas and mineral resources. This standard is developed and overseen by a multi-stakeholder Board, consisting of representatives from governments, extractives companies, civil society organisations, institutional investors and international organisations. EITI Standard is implemented in 48 countries. It consists of a set of requirements that governments and companies have to adhere to in order to become recognised as 'EITI Compliant'. The Chinese government has expressed interest in and support to EITI.

gas resources in Southeast Asia. According to the National Development and Reform Commission (NDRC), China plans to more than double its gas consumption from about 107.5 billion cubic metres (bcm) in 2010 to roughly 260 bcm in 2015.<sup>62</sup> To achieve this, China needs to import 50-60 bcm of natural gas in 2015, similar to the current import level of the European Union.<sup>63</sup> China has the intention of investing more in natural gas sectors in ASEAN countries such as Indonesia, Myanmar, and Malaysia.

Southeast Asia is richer in natural gas than in oil, and gas promises to play a central role in the domestic energy mix of countries in the region and to be a key export from Indonesia, Malaysia, Myanmar and Brunei. At the end of 2012, Southeast Asia had 7.5 trillion cubic metres (tcm) of proven gas reserves, representing 3.6% of the world total. However, gas development in Southeast Asia also faces some impediments. Many of Southeast Asia's gas production areas are located far from demand centres and will require either an expansion of transmission infrastructure or LNG liquefaction projects to ship the gas to regasification terminals at home or abroad. ASEAN needs significant investment to the related infrastructure to bring forward the projected amount of oil, gas and coal production. The Asian Development Bank (ADB) has estimated that developing countries in Asia need US\$800 billion every year in infrastructure funding. Without new investments or new exploration for gas fields, surplus supply over demand is expected to narrow and even diminish by 2030. According to IEA, the region requires a total of US\$700 billion of investment in fossil fuel-supply infrastructure (including pipelines, LNG terminals, and gas transmission and distribution infrastructure).<sup>64</sup> Financing investment in energy development and energy-supply infrastructure has always been a big challenge for ASEAN countries.

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<sup>62</sup> "Tianranqi fazhan shier wu guihua" [Twelfth Five-Year plan on natural gas], <<http://zfxgk.nea.gov.cn/auto86/201212/W020121203312244945303.pdf>>.

<sup>63</sup> "Commercial and strategic opportunities for LNG in China", <<http://www.norway.cn/Global/SiteFolders/webbeij/DNV%20-%20China%20LNG%20Final%20Report.pdf>> (accessed 15 November 2013).

<sup>64</sup> IEA, *Southeast Asia Energy Outlook 2013*, p. 66.



Given the importance of China's capital, technology and consumer market, China will remain ASEAN's major energy cooperation partner. More importantly, China has maintained close relations with ASEAN not only in the energy field but also in international politics, economic cooperation and business transactions. As ASEAN's importance for international markets increases with various energy challenges emerging in the region (such as increasing reliance on the Middle East for oil), China's deepening relations with ASEAN will be of growing strategic importance. The potential of energy cooperation between China and ASEAN countries is therefore great and important.

However, although the relationship between China and ASEAN has thus far generally proved to be mutually beneficial, the disquiet and uneasiness among Southeast Asians about the nature and impact of the bilateral relationship prevail. The extent to which China's energy resource cooperation with ASEAN countries such as Indonesia and Myanmar will develop depends on efforts from both sides. On the one hand, it depends on whether domestic constituencies in these countries, primarily labour unions, organized businesses and civil society formations, feel that their concerns about China's influence on their political economy are being addressed. Particular areas of concern are the continuing impact of Chinese FDI on local jobs and the environment, the erosion of the competitive advantage of domestic companies (in local and regional markets) by the growing presence of Chinese companies, skewed trade relations, and perceptions that expanding commercial relations have exerted a negative influence on these countries' foreign policy.

On the other hand, it also depends on whether host countries can depoliticize some high-profile Chinese deals and rationalize their public debates about the risks and benefits of Chinese investment. Nevertheless, Beijing's willingness to comply with Indonesia's quest to correct the unbalanced trade profile between the two countries by urging Chinese firms to expand investment in the country's manufacturing sectors; and Beijing's promise to make corporate social responsibility programmes an integral component of Chinese SOEs' operation in Myanmar suggest that Beijing is trying to deepen its understanding of the sensitivities and complexities of Southeast Asian countries' internal politics, and is adjusting its related policies accordingly.



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