**China's Economic Statecraft in Southeast Asia: Exploring the Determinants of China’s Official Financing**

(Working Paper)

Abstract

While existing literature has primarily examined China's economic statecraft in other parts of the world, it is equally essential to study Southeast Asia as a crucial region for understanding Beijing's deployment of economic instruments abroad. This study focuses on China’s Official Financing (COF) as the primary form of China's economic statecraft in Southeast Asia, aiming to find the factors that influence the amount of COF received by a Southeast Asian country in a given year. By employing mixed effects models, we analyze data spanning 2000 to 2021 and find that the amount of COF to Southeast Asian countries is associated with their volumes of imported goods from China, resolutions pertaining to the South China Sea territorial disputes, and their embeddedness in China’s institutional networks, the Belt and Road Initiative (BRI). The findings are further examined through detailed case studies of three key Southeast Asian countries: Indonesia, Cambodia, and the Philippines.

1. Introduction

Southeast Asia holds a special role in Chinese foreign policy due to its unique geographical location relative to China, historical social ties, and growing economic and military capabilities. Economically, it plays a significant role in the world economy as it hosts several highly relevant state actors in shipping, manufacturing, and processing. China has also been the biggest trading partner of the regional bloc since 2009, with its total trading volume reaching US$544.9 billion in 2022 (ASEAN 2022). In November 2021, Chinese leader Xi Jinping commented on an ASEAN – China special summit that China would always be a “good neighbor, good friend and good partner” to ASEAN, a regional organization consisting of Southeast Asian countries (Xi 2021). Xi’s statement reflects China’s “neighborhood diplomacy,” in which China proactively seeks to gain influence and advance its strategic interests in the region. To this end, it employs a series of policy instruments that resemble economic statecraft.

In the foreign policy context, economic statecraft can be broadly conceptualized as the strategic use of economics to pursue national objectives as part of a nation’s broader foreign policy and grand strategy (Baldwin 1985). Recent observations yield that China tends to see the major task of its economic statecraft as translating its national wealth into instituting new, pro-China international rules and norms (Xiaotong and Keith 2017; Gunn 2021). Although existing scholarship has already examined China’s economic statecraft for strategic interests in Europe, Africa, Asia, and Latin America, they have not explored the underlying mechanism or a theory-based argument.

In this article, we employ a mixed-method approach to conduct a systematic analysis grounded in the economic statecraft analytical framework. We use China’s Official Financing (COF) as a standardized proxy to examine China’s efforts of economic statecraft. A prominent example of COF would be Official Developmental Assistance, which primarily aims to promote economic development and welfare in recipient nations (Dreher et al. 2018). They often manifest in loans with discounted interest rates, infrastructure development deals, or initiatives with official endorsements. How do we explain China’s decisions to increase or thwart the amount of official financing through political and economic lenses? What nuanced logic can we learn about China’s intentions from its pattern of economic statecraft?

Bearing in mind principles of economic statecraft policies, we hypothesize that three factors determine the amount and frequency of COF in Southeast Asia. First, Chinese employment of official financing in Southeast Asia can be understood as a function of its economic linkages with the countries in the region. The amount of COF is determined by the bilateral trade relations between China and individual countries in Southeast Asia. Second, we theorize that Chinese economic statecraft is used to complement Beijing’s territorial disputes in the Southeast Asian neighborhood. As literature has shown, territorial conflicts affect bilateral economic activities (Simmons 2005; Brutger and Wright 2014), and policy-related concessions would also be associated with territorial tensions in the region. Third, COF would also be used to reinforce an institutional network dominated by China. A government’s embeddedness in China’s international institutional network can determine its status as a recipient of COF.

In the sections that follow, after a brief overview of the existing scholarly contributions on economic statecraft, we test the above hypotheses to identify their significance. We find that the amount of COF sent to Southeast Asia from 2000 to 2021 is associated with the volume of Chinese exports to Southeast Asian countries in the previous year. We further examine our results through in-depth case studies focusing on China’s relations with three Southeast Asian players – Cambodia, Indonesia, and the Philippines – and we find that the resolution of South China Sea territorial disputes and institutional networks such as the Belt and Road Initiative (BRI) would also influence China’s decisions to increase and decrease the usage of its official financing capabilities. A mixed-method approach utilizing statistical analysis and qualitative case studies helps us better explore the underlying mechanisms between the proposed factors and COF activities.

1. Research Design

The overarching goal of our research design is to comprehensively evaluate the factors influencing China’s COF allocations to Southeast Asian countries. We adopt a mixed-method strategy: we first employ statistical analysis to explore the relationships between potential factors and China’s COF provisions, then conduct an in-depth case study analysis to identify the causal mechanism, examine the validity of the relationships, and explain the factors that are not in line with our hypotheses.

*Hypotheses*

China's economic statecraft in Southeast Asia is multifaceted, involving strategic engagements underpinned by economic interdependence, the intricacies of territorial disputes, and the depth of institutional embeddedness. Each area offers insights into the mechanisms and strategies employed by China, reflecting broader geopolitical and economic objectives.

1. ***Economic Interdependence***

The concept of economic interdependence, as articulated by Keohane and Nye (2011, 7), highlights the mutual benefits and vulnerabilities stemming from cross-border exchanges. China's engagement with Southeast Asia exemplifies this, with its extensive economic linkages fostering a complex web of interdependencies. Asymmetry in these relationships allows China to leverage its position, influencing the economic and political landscape of less economically powerful nations. This dynamic is further nuanced by the structural characteristics of trade , where a country's reliance on imports or exports shapes its vulnerability and strategies (Hirschman 1980). Given China's growth trajectory and its reform policies since the late 1970s, its strategies towards Southeast Asia are likely calibrated to maximize economic gains while managing potential vulnerabilities. This leads to the formulation of two hypotheses:

Hypothesis 1 (a): The proportion of a country's imports from China is linked to an increase in COF allocations.

Hypothesis 1 (b): The proportion of a country's exports to China correlates with increased COF allocations.

1. *Territorial Disputes and Resolution*

Territorial disputes pose significant challenges to bilateral economic activities, as evidenced by the research of Simmons (2005), Brutger and Wright (2014), and Camba and Magat (2021). These disputes introduce uncertainty and elevate costs, impacting trade and investment. In the context of the South China Sea (SCS), such disputes not only affect Chinese FDI but also raise questions about the relationship between territorial disputes and official financing. This study posits that territorial disputes are a critical factor in determining COF allocations, with increased dispute intensity expected to result in decreased financing. Furthermore, the preference for dispute resolution methods, particularly China's inclination towards bilateral, non-binding approaches, is anticipated to influence its financing policies (Wiegand et al. 2020). This understanding generates two additional hypotheses:

Hypothesis 2 (a): SCS dispute severity is negatively associated with increased COF allocations from China.

Hypothesis 2 (b): SCS dispute formal resolution is negatively associated with increased COF allocations from China.

1. *Institutional Embeddedness*

China's rapid economic ascent has been accompanied by the development of institutions aimed at facilitating its financial statecraft. Empirical studies of institutionalized COF have shown that it is rarely provided without economic, political, and strategic considerations (Carothers and De Gramont 2013; Mattlin and Gaens 2018; Kalyanpur and Newman 2019). In Southeast Asia, China has adopted an emerging network of financial infrastructures that support its foreign policy objectives. Since its initiation, the Belt and Road Initiative (BRI) has resulted in many cooperation agreements or joint investment deals across Southeast Asia (Gong 2019; Petry 2022). China also launched the multilateral Asian Infrastructure Investment Bank (AIIB) in Beijing in 2016. Since its founding, the AIIB has served not only as a loan agency for China’s Southeast Asian partners but also as a means to enhance China’s regional influence and international status (Haga 2021). A government’s embeddedness in China’s institutional network would determine its status as a recipient of Chinese COF. This leads to the development of two hypotheses:

Hypothesis 3 (a): Membership in the BRI is positively associated with increased COF allocations from China.

Hypothesis 3 (b): Having AIIB membership is positively associated with increased COF allocations from China.

*Variables*

Our study constructs a country-year panel dataset that spans from 2000 to 2021, encompassing eight formal ASEAN member states. These countries include Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Thailand, and Vietnam.[[1]](#footnote-1) The dataset contains approximately 200 observations. While this may seem like a modest sample size, it is adequate for our statistical analyses.

We use **China's Official Financing (COF)** as the Dependent Variable, aggregating annual Official Development Assistance (ODA), Other Official Flows (OOF), and VOF data for eight ASEAN countries from AidData.[[2]](#footnote-2) ODA is government aid intended to promote the social and economic development and welfare of developing countries (OECD 2022). It can be channeled directly from a donor country to a recipient country or indirectly via multilateral development institutions like the United Nations (UN), the World Bank (WB), or various multilateral lending institutions. China primarily adopts a state-to-state foreign aid approach, focusing on physical infrastructural projects for continuous access to natural resources and overseas markets (Zhang 2016).  Other Official Flows (OOF) represents official sector transactions that do not meet the criteria for ODA. VOF accounts for projects with official backing but indeterminate categorization due to inadequate data. These categories collectively provide a comprehensive view of China's statecraft.

For Independent Variables, we measure **Trade Dependency** through Southeast Asian countries’ import and export percentages with China.[[3]](#footnote-3) A higher ratio in these measures indicates a stronger trade dependency on China. **Dispute Intensity** isquantified using three binary indicators: (1) the existence of public statements or formal diplomatic protests against China's activities in the SCS; (2) the duration of a country engages in international arbitration against China over sovereignty claims in the SCS; (3) the existence of standoff and confrontational incidents between Chinese and Southeast Asian parties, whether civilian or military, including events leading to arrests or casualties. A higher Dispute score denotes intensified territorial disagreements between China and a claimant country. **Dispute Resolution** is the propensity for peaceful dispute resolution. It is calculated through four indicators: negotiations, non-binding third party methods (NBTP), arbitration, and adjudication from Territorial Peaceful Resolution of Dispute (TPRD) Dataset (Wiegand et al.). A higher score suggests a greater inclination towards peaceful resolutions. Last, **Engagement in China's Institutions** is examined through a country’s memberships in the Belt and Road Initiative (BRI) [[4]](#footnote-4) and the Asian Infrastructure Investment Bank (AIIB).[[5]](#footnote-5) But these two binary indicators may not appropriately represent the depth of a nation's involvement in these China-led financial networks because their little variability likely fail to capture the nuanced and evolving dynamics between Southeast Asian countries and China.

Control Variables include a country's non-permanent **UNSC Membership**,[[6]](#footnote-6) **GDP per Capita**,[[7]](#footnote-7) **Population Size**,[[8]](#footnote-8) **Political Stability**, and **Democracy**.[[9]](#footnote-9) We also consider the influence of aid from other international institutions, so we include **OECD Development Assistance Committee (DAC)**[[10]](#footnote-10) and **Asian Development Bank (ADB) Loans**.[[11]](#footnote-11) We note that China, being an ADB member since 1986, may have overlapping financial contributions with the ADB. However, given that China's ADB financing isn't as significant as countries like Japan, the US, and Australia,[[12]](#footnote-12) we can confidently include ADB loan data in our models. SCS-related variables are included to assess geographical proximity's impact on COF allocations, as with **SCS Border** [[13]](#footnote-13) and **SCS Features** [[14]](#footnote-14) reflecting strategic interests in the disputed territories.

1. Data Analysis

*Model Selection*

Our analysis employs multilevel modeling, which mitigates the limitations of fixed-effects models and accommodates time-invariant predictors: SCS border and features ​(Wooldridge 2010), allowing exploration of various group-level intercepts and slopes. This approach, however, requires validating assumptions for each model level, such as additivity and homoskedasticity ​(Snijders and Berkhof 2008)​. We also run a null model without any predictors to confirms the necessity of multilevel modeling, as indicated by the Intraclass Coefficient (ICC).[[15]](#footnote-15) Then we build three multilevel models alongside baseline OLS. Model 1, a random-intercept model with only level 1 predictors, proved superior in diagnostic tests and parsimony compared to Models 2 and 3, which include additional predictors and random intercepts for year. Nonetheless, we present all models to ensure the robustness of our findings.

We also transformed seven variables—COF, exports, imports, GDP per capita, population, OECD DAC funding, and ADB loans—using natural logarithms to stabilize variance and reduce skewness ​(Durbin et al. 2002; Wang et al. 2012; Changyong et al. 2014)​. Acknowledging China's funding decisions' delayed effects necessitates analyzing lagged economic and political variables including Import percentage, export percentage, non-permanent UNSC status, GDP per capita, population, political stability, OECD DAC funding, and ADB loans.

*COF patterns*

COF variations in eight Southeast Asian countries from 2000 to 2021 indicate China’s strategic positioning. According to Figure 1, Notably, from 2015 onwards, Indonesia, Laos, Malaysia, Myanmar, and the Philippines saw a significant rise in COF, diverging from others like Thailand, which received far less. These observations, particularly Indonesia's peak in 2015, align with the South China Sea tensions and suggest that economic flows from China could be a tactical move to extend its regional influence.

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Figure 1. COF distributions across countries 2000-2021

The Influence of Imports and Exports on China’s COF Allocations

Table 1 illustrates the differential impacts of trade on China’s COF allocations. The percentage of goods imported from China exerts a significant positive influence on COF allocations across all models. Specifically, for every one-unit increase in the percent of imports from China from the prior year, the expected log COF from China increases by 0.11 (Model 1), with other variables constant. Conversely, the percentage of goods exported to China does not have statistical significance. In a word, the significant influence of imports aligns with our hypothesis H1(a), whereas the insignificant impact of exports doesn't provide empirical support for H1(b). These contrasting results suggest that China places greater emphasis on its exports to Southeast Asian countries (the imported goods from China) when considering economic assistance to countries. And economic interdependency does not automatically translate into increased aid from China; instead, we discern distinct roles played by imports and exports in shaping economic and political decisions.

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Table 1. The Regression Results of Imports and Exports [[16]](#footnote-16)

*The Influence of Disputes and Resolutions on COF Allocations*

Table 2 reveals that disputes and dispute resolutions have no statistically significant impact on China’s COF allocations. The results deny the second set of hypotheses. However, the negative signs of these variables still indicate potential negative relations between dispute intensity/formal resolution and China’s COF allocations. It might imply that as the SCS dispute intensifies, China would decrease official financing to a country, and as disputing countries choose to deal with SCS disputes by more legally formal resolution methods, China would not use official financing to pacify other countries. However, these vague implications require a more detailed exploration through case studies.

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Table 2. The Regression Results of Disputes and Resolution [[17]](#footnote-17)

*Influence of Institutional Participation on COF Allocations*

Institutional affiliations like BRI and AIIB memberships do not exhibit a statistically significant impact on COF allocations, implying that China would not consider a country’s participation in its institutional networks to allocate COF funding. The results refute the third set of hypotheses. But this statistical finding does not properly relate to theoretical and real-world implications. So, it could be the case that these binary membership indicators are not precise and efficient enough to measure a country’s embeddedness in China’s institutions. We need to find other indicators, regardless of qualitative and quantitative evidence, in our case study to examine the underlying institutional influence.

Although the coefficients are insignificant, their directions still offer an interesting insight. As shown in Table 6, BRI membership shows a positive directional trend across models, whereas AIIB coefficients are negative, suggesting a potential inverse relationship with COF from China. This implies that China-led institutions do not uniformly impact COF allocations. China may deploy these institutions towards different goals, and financing through them may not adhere to consistent logic. Thus, it is still worthy of further investigation into the nuances of institutional influence on COF allocations.

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Table 3. The Regression Results of BRI and AIIB Membership

1. We exclude Singapore because there is no data about China’s ODA to Singapore and exclude Brunei because of no V-dem democracy data. [↑](#footnote-ref-1)
2. AidData, https://www.aiddata.org/china. [↑](#footnote-ref-2)
3. World Bank Group’s World Integrated Trade Solution (WITS) data library, https://wits.worldbank.org/ [↑](#footnote-ref-3)
4. Green Finance & Development Center has a detailed list of participatory countries, https://greenfdc.org/countries-of-the-belt-and-road-initiative-bri/. [↑](#footnote-ref-4)
5. AIIB records different types of member states, https://www.aiib.org/en/about-aiib/governance/members-of-bank/index.html. [↑](#footnote-ref-5)
6. A country's non-permanent status in the UN Security Council (UNSC) might impact China's aid decisions. UNSC lists all countries which have been elected as members at least once since 1946, https://www.un.org/securitycouncil/content/countries-elected-members. [↑](#footnote-ref-6)
7. It measures a country's level of development. It is drawn from The World Bank 2022, GDP per capita (current US$), https://data.worldbank.org/indicator/NY.GDP.PCAP.CD. [↑](#footnote-ref-7)
8. Populous nations represent larger potential markets. It is sourced from World Development Indicators, https://databank.worldbank.org/source/world-development-indicators. [↑](#footnote-ref-8)
9. We use Electoral Democracy Index from the V-Dem (Varieties of Democracy) dataset, see electoral democracy index V-Dem codebook, page 44, <https://v-dem.net/data/the-v-dem-dataset/>. [↑](#footnote-ref-9)
10. See 32 member countries, only Japan and South Korea are Asian countries, <https://www.oecd.org/dac/development-assistance-committee/>. [↑](#footnote-ref-10)
11. See 68 member countries. China joined ADB in 1986. https://www.worlddata.info/alliances/adb-asian-development-bank.php. [↑](#footnote-ref-11)
12. See contributions of donor countries to ADB's Asian Development Fund, https://data.adb.org/dataset/donor-contributions-asian-development-fund. [↑](#footnote-ref-12)
13. It is a binary variable, marked as 1 if a country has a shared border with the contested SCS region. [↑](#footnote-ref-13)
14. It counts the number of reefs and islets that a claimant occupies. See this map produced by the Asian Maritime Transparency Initiative (AMTI), https://amti.csis.org/maritime-claims-map/. AMTI also has island trackers for each country, https://amti.csis.org/island-tracker/. [↑](#footnote-ref-14)
15. The ICC value is 0.13, greater than 0.1, meaning the responses are more similar within a cluster (Schumacker and Lomax 2004, 196). [↑](#footnote-ref-15)
16. Delving into the random effects, we find evident variability in COF allocations across countries and over time. For instance, in Model 1, the logged COF’s residual variance (σ²) is 4.43, indicating remaining variability after accounting for predictors and the random intercept. An ICC of 0.23 in Model 1 reveals that country differences account for 23% of the variability in COF allocations. [↑](#footnote-ref-16)
17. [1] Regarding model fit, random-intercept models, especially the simplistic Model 1, outperform OLS based on AIC values. The variance in the country random effect decreases from Model 1 to Model 2, pointing to the influence of the additional predictors (SCS border and features) in accounting for between-country variations. [↑](#footnote-ref-17)