

ECONOMIC LIBERALISM AND REGIONAL SECURITY IN EAST ASIA: A CASE
STUDY ON THE IMPACT OF CHINA'S ACCESSION TO THE WTO

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Strategy

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The opinions and conclusions expressed herein are those of the student author and do not necessarily represent the views of the U.S. Army Command and General Staff College or any other governmental agency. (References to this study should include the foregoing statement.)

ABSTRACT

ECONOMIC LIBERALISM AND REGIONAL SECURITY IN EAST ASIA: A CASE STUDY ON THE IMPACT OF CHINA'S ACCESSION TO THE WTO, by Lieutenant Colonel Frederick Choo, 134 pages.

China gained formal accession to the WTO in December 2001 after fifteen years of negotiations and domestic economic reforms. Since then, China's economy has been on an upward trajectory, surpassing Germany and Japan to become the second largest economy in the world. Far from coming at the expense of the rest of East Asia, China's growth has helped propel East Asia as an engine of growth amidst the flailing economies in the West, as well as intensify regional economic integration. What has been the impact of China's accession to the WTO on the economies of China, and East Asia as a whole? Is there evidence, then, that this event has not only catalyzed economic growth, but also enhanced regional security in East Asia?

This research explores the relationship between economic liberalism and regional security in East Asia by using China's accession to the WTO as a case study. Building on previously conducted empirical studies predicting the impact of China's accession, this research conducts a comparative analysis on China's economic growth and interdependency with its East Asian neighbors prior to, and following, its accession to the WTO. Based on these findings, together with an assessment of the security climate in East Asia since 2001, this body of work attempts to prove the validity of the liberal theory concerning the pacifying effects of economic liberalism in the East Asian context.

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And finally, I save the last word for Mrs. Venita Krueger whom I believe has the entire Turabian manual stored in her memory, and whose meticulousness and patience I strongly admire and am thankful for.

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ACRONYMS

ACFTA	ASEAN-China Free Trade Area
ADB	Asian Development Bank
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
CCP	Chinese Communist Party
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
SOE	State-Owned Enterprise
UN	United Nations
US	United States
WTO	World Trade Organization

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CHAPTER 1

INTRODUCTION

On 11 December 2001, China was formally accepted as a member of the World Trade Organization (WTO). At that time, the event was hailed as “a defining moment in the history of the multilateral trading system” by then-Director General of the WTO, Mike Moore.¹ It capped almost 15 years of negotiations that resulted in over 900 pages of legal text agreed upon by the 142 member governments of the WTO. In order to gain accession, China had to agree to “undertake a series of important commitments to open and liberalize” its economic system in “order to better integrate into the world economy and offer a more predictable environment for trade and foreign investment in accordance with WTO rules.”²

Since then, China’s rise as a political and economic power has been nothing short of meteoric. China’s annual gross domestic product (GDP) growth averaged more than 15.5 percent³ from 2001 to 2008 and it has the distinction of owning the world’s largest foreign reserves holding of \$2.4 trillion.⁴ In the period since 2001, it has eclipsed Germany and Japan to become the world’s second largest economy. In the diplomatic

¹World Trade Organization, “WTO successfully concludes negotiations on China’s entry,” 17 September 2001, http://www.wto.org/english/news_e/pres01_e/pr243_e.htm (accessed 21 April 2010).

²Ibid.

³National Bureau of Statistics of China, “China Statistical Yearbook 2009,” <http://www.stats.gov.cn/tjsj/ndsj/2009/indexeh.htm> (accessed 7 November 2010).

⁴Central Intelligence Agency, “The World Factbook,” <https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html> (accessed 17 October 2010). All monetary figures in this thesis are denominated in US dollars unless otherwise indicated.

arena, China has become more assertive with her partners, including large developed countries and regions like the United States (US) and the European Union. Recent evidences include China's hawkish stance at the climate change negotiations at Copenhagen in December 2009, and strong diplomatic retaliations against the US following the latter's decisions to conclude an arms agreement with Taiwan as well as President Obama's meeting with the Dalai Lama in 2010. At the global stage, China has also carefully orchestrated its "arrival" through the 2008 Beijing Olympics and the 2010 Shanghai World Expo.

In contrast, the fate of the US seemed to have taken on a completely different trajectory. The 21st century began ominously for the US with the September 11 attacks in 2001, which precipitated a global war on terror and led to the US military's involvement in Iraq and Afghanistan. On both the external diplomatic and domestic political fronts, support for the US waned as the conflict became more protracted, casualties continued to mount, and victory seemed like an elusive outcome. Although the booming American economy served as an area of national pride and provided some respite from the disappointments of war, the period of irrational exuberance eventually reached its tipping point in 2008 with the emergence of the subprime crisis and the onset of a deep recession which threw the US economy into a state of paralysis.

Although the US is still undeniably the largest superpower in the world, it is similarly indisputable that its grip on the reins of global power is loosening. More than ever before, US soft power, a concept popularized by Professor Joseph Nye, seems to be eroding globally, especially when set relative to the concomitant rise of several other emerging powers such as China, India, Russia, and Brazil. In his book *The Post-American*

World, Fareed Zakaria describes this phenomenon not as the decline of the US, but rather the “rise of the rest.”⁵

What can one make out of this unprecedented confluence of geopolitical developments? Nowhere in the world are these developments more closely monitored and directly felt than in East Asia. From a geographical point of view, East Asia is broadly sandwiched between China and the US, giving rise to clear security and economic implications. In the decades following World War II, East Asian countries aligned themselves with the US to stave off Cold War communist influences and also to capitalize from a growing economic relationship unparalleled with other parts of the world. Along the entire East Asian region, American interests and influences are evident from its involvement in the Vietnam War, its unique “one China” policy, the handling of the North Korea nuclear crisis, and Japan’s recovery following World War II. As China continues to widen its sphere and depth of influence stemming from its economic prowess, the countries in the region would need to recalibrate its relationships with China vis-à-vis the US, especially when it involves longstanding security issues.

Against this geopolitical backdrop, the purpose of this study was to assess the impact of China’s accession to the WTO on its overall growth momentum as well as its economic interdependency with the respective East Asian states, and establish a link, if any, with the evolving security environment in the region. By extension, this study will help to inform the reader about the relevance of economic liberalism in the East Asian context and to what degree it enhances peace in the region.

⁵Fareed Zakaria, *The Post-American World* (New York: W. W. Norton, 2008), 2.

Research Questions and Approach

In order to properly frame the research process, the primary research question for this study was posed as, “How has China’s accession to the WTO contributed to regional security in East Asia?” Subsequently, two secondary research questions were defined as follows: (1) What has been the impact of China’s accession to the WTO on its economic relations with East Asia, both regionally and bilaterally; and (2) To what extent has regional security in East Asia since 2001 been defined by the level of economic interdependency in the region?

Before addressing these questions, a significant amount of literature had to be reviewed--firstly to identify the viewpoints of various authors who have been studying this subject intensely, but also to provide the necessary background information for the reader so as to better contextualize the analysis. Chapter 2 therefore covered topics such as international relations theory, the evolution of China’s grand strategy and how economic development features as a priority, the circumstances surrounding China’s endeavor to join the WTO, as well as the geopolitical underpinnings and the shape of the political economy in East Asia. Chapter 3 then set out the detailed methodology which was employed during the analysis. Following the methodology laid out in chapter 3, and using the literary background provided in chapter 2, chapter 4 attempted to answer the two secondary research questions in sequence. First, a comparative analysis of trade data and other indicators was conducted to ascertain the growing economic interdependency between China and the rest of East Asia. Second, based on selected regional security issues, the study explored whether the varying degree of economic interdependency has had any effect in reducing or eliminating the potential for conflict. Finally, chapter 5

concluded the findings gleaned from the analysis and provided an assertion on whether or not it could be said that China's accession to the WTO contributed to peace-building in East Asia.

Definitions and Limitations

Economic interdependency, in the international relations context, refers to a characteristic of economic relations either bilaterally or regionally, where the countries concerned depend on each other to varying degrees for their economic well-being. A common measure is the level of bilateral and intra-regional trade, while other measures such as capital flows and foreign direct investment (FDI)--which this study will revisit subsequently--are instructive too.

The next important definition is the geographical region which served as the locus of inquiry for this thesis. An accurate decomposition of all the states which make up East Asia is inherently a hazardous endeavor. Therefore, recognizing the constraints imposed by the duration of this study, the author has chosen to define East Asia as comprising China, Japan, South Korea, as well as the states in Southeast Asia which collectively make up the Association of Southeast Asian Nations (ASEAN). The author recognizes the limitations presented by the latter as ASEAN comprises a diverse group of countries with stark differences in their economic structures. This thesis did not explore China's economic relationship with Taiwan and North Korea, as well as China's Special Administrative Regions of Hong Kong and Macau. While other countries in the Asia and Pacific region, such as India, Australia and New Zealand, are doubtless a factor in assessing the overall security environment in the region, they were not covered in this thesis.

For expediency purposes, this study used “China” instead of the official designation “People’s Republic of China.” This applies to all government apparatus which were referred to in the study, for example “Ministry of Foreign Affairs, China.” As the thesis examined the consequences of China’s accession to the WTO in 2001, the period under analysis was limited to mostly from 2000 to 2009, with the exception of discussing China’s overall engagement strategy for which a historical study dating back to the Mao era would be necessary.

In the quantitative section of the analysis, a combination of primary and secondary sources was tapped on to identify trends that helped to address the research questions. However, the same data category is likely to have different values depending on the primary source and hence the method in which the data were derived. For example, the trade data from the Ministry of Commerce of China was different from those obtained from the WTO and the World Bank. Nevertheless, taking into account this limitation, this study focused on the general trend depicted by the data and not the accuracy of the absolute data itself.

Significance

There is an abundance of literature and ongoing debate about the role of economic liberalism in promoting peace. Based on the author’s review, a rigorous treatment of the subject in general is provided by Richard Ebeling and Dale Copeland in their respective studies⁶. Separately, James Dorn in his short commentary places economic liberalism

⁶Richard M. Ebeling, “A New World Order: Economic Liberalism or the New Mercantilism,” The Future of Freedom Foundation, July 1991, <http://www.fff.org/freedom/0791b.asp>; Dale C. Copeland, “Economic Interdependence and War: A Theory

under the context of China-US relations.⁷ However, China's accession to the WTO and its subsequent rise in Asia and the world represent a milestone of a scale not witnessed in a long while, and is likely to implicate East Asian security dynamics well into the 21st century. Therefore, this study is a timely and relevant undertaking to inform policy-makers and researchers alike with a vested interest in the East Asian region as they continue to navigate its multi-faceted geopolitics.

of Trade Expectations," *International Security* 20, no.4 (Spring 1996), <http://www.mtholyoke.edu/acad/intrel/copeland.htm> (accessed 25 March 2010).

⁷James A. Dorn, "The Case for Economic Liberalism," Cato Institute, http://www.cato.org/pub_display.php?pub_id=6636 (accessed 25 March 2010).

CHAPTER 2

LITERATURE REVIEW

There are four main tracks in this literature review. First, the review trawled the sea of international relations theories to identify a causal linkage between economic interdependency and peace-building, and established an objective framework that can apply to China's symbiotic economic relationship with East Asia and its contribution to regional security. Second, the review studied the grand psyche and strategy towards national security across the four generations of Chinese leaders, in order to determine the priority placed on the role of economic development and thereby identifying the roots of China's decision to join the WTO. Third, the review looked into the details surrounding China's accession to the WTO and the empirical research undertaken at that time to forecast the impact of the accession on China's economic relations with the East Asian countries. Finally, an overview of the geopolitical and security environment in East Asia, as well as the nature of East Asia's political economy, was provided to allow the reader an understanding of the historical legacies and strategic considerations when dissecting East Asian politics and economics. Collectively, these served as the literary foundation for the analysis of the significance of China's accession to WTO on regional security in East Asia.

Section I: Identifying the Link between Political Economy and Regional Security

It is not the purpose of this thesis to survey the entire spectrum of international relations theories postulated since the Peace of Westphalia⁸ in 1648, nor would doing so be beneficial. Nevertheless, it is important, in an attempt to answer the primary question, to possess a foundational understanding of such theories that explain the interaction between, and motivations of, states, and therefore the determinants of perpetual peace, or war. In so doing, the author will then be able to overlay the motivations and actions of the Chinese government, as well as its impact on the East Asian region, onto these theories and possibly prove the causality between economic liberalism and regional security in East Asia.

Realist and Liberal Schools of Thought

Broadly speaking, the two main theoretical traditions in international relations are realism and liberalism, both of which are sources of numerous theoretical variations. Realists believe that states have an innate motivation to seek power in order to survive, and that the moral or legal principles which circumscribe the relationship between the governed and the government cannot be applied to the international community. Therefore, without a similar set of principles nor an overall sovereign in the international system to arbitrate differences, disputes cannot be settled peacefully and will invariably lead to war. The origins of realist thoughts can be traced to the seminal work of classical

⁸The term denotes a series of peace treaties signed between May and October of 1648 in Osnabrück and Münster which ended the Thirty Years' War (1618-1648) in the Holy Roman Empire, and the Eighty Years' War (1568-1648) between Spain and the Dutch Republic. These treaties initiated a new political order in central Europe based upon the concept of a sovereign state governed by a sovereign.

writers, including Thucydides' *Peloponnesian War*, Niccolo Machiavelli's *The Prince*, and Thomas Hobbes' *Leviathan*.

In Thucydides' *Peloponnesian War*, the negotiations between the Melians and the Athenians revealed the realist fundamentals present even at that time. In response to the Melian commissioners' claim to the Melians' right to self-rule and not submit to the Athenians, the Athenian envoys retorted, "As far as right goes they think one has as much of it as the other, and that if any maintain their independence it is because they are strong, and that if we do not molest them it is because we are afraid; so that besides extending our empire we should gain in security by your subjection."⁹ Clearly, the Athenians saw the annexation of neighboring islands as a rational means of enhancing their security and the absence of an arbiter meant that Melian opposition to this concept only had one outcome--war.

In Machiavelli's *The Prince*, he posited that rulers and princes will only come to grief if they aim to make a profession of goodness in everything. In fact, in order to maintain the state, one must at times act against faith, charity, humanity, and even religion. In other words, the prince must "not deviate from what is good, if possible, but be able to do evil if constrained."¹⁰ Implicit in this is the notion that the end will somehow justify the means, and that the state could be lost if all actions that are necessary to ensure the security and integrity of the state are not undertaken.

⁹Robert B. Strassler, ed., *Thucydides, A Comprehensive Guide to the Peloponnesian War* (New York: Free Press, 1996), 351-356.

¹⁰Niccolo Machiavelli, *The Prince*, trans. George Bull (New York: Penguin, 1975), 90-101.

Hobbes, in setting out the doctrine for the foundation of states and legitimate governments, took a mechanistic view about the human being, and stated that men will resort to violence due to competition for material needs, the protection of their possessions, and reputation-building. He argues that “during the time men live without a common power to keep them all in awe, they are in that condition which is called war; and such a war, as is of every man, against every man.”¹¹

On the other hand, liberalism is based on values, progressivity, and mutual benefit. In this realm, war and conflict can be prevented, and peace can be sustained. Professor Richard K. Betts, in his work on the causes of conflict, outlined three general points that distinguish liberal views from realism.¹² First, regardless of the existing structure of international relations, the political and economic values of a society are likely to determine its orientation towards peace. Liberal societies view military capabilities as a form of self-defense, and not for hegemonic purposes, while economic interdependence promotes mutual exchange and a comparative advantage in production. Second, liberals believe that the world has learnt from the lessons of the past, evolving from a primitive, parochial, and destructive place to one which is modern, cosmopolitan, and efficient. Third, civility among nations can be possible even within an anarchic international system. Various forms of bilateral cooperation or multilateral mechanisms can work towards resolving disputes and therefore prevent an outbreak of war. Mutual interests, therefore, supersede mutual enmity.

¹¹Leo Strauss, *The Political Philosophy of Hobbes: Its Basis and Its Genesis*, trans. Elsa M. Sinclair (New York: Oxford University Press, 1936), 21-22.

¹²Richard K. Betts, ed., *Conflict after the Cold War: Arguments on Causes of War and Peace*, 2nd ed. (New York: Pearson Longman, 2005), 118.

There are three general variants of liberal theory which first surfaced in Emmanuel Kant's *Perpetual Peace* in 1795, hence their common reference by academics as the Kantian variables: (1) the economic variant is based on the assumed effects of self-interest and comparative advantage in international trade, (2) the domestic political variant is based on the effects of democratic constitutionalism, and (3) the third variant is based on neoliberal institutionalism that assumes the pacifying effects arising from the development of international norms and institutions.¹³ For the purposes of this study, the first variant will be looked at in further detail.

The Role of Political Economy

What about the role of political economy in catalyzing wars, or preserving the peace? In general, the liberal theory of political economy emphasizes that war should be obsolete not only because it is undesirable, but because it profits no one. It further holds that free trade in open markets yields the most efficient production and exchange of goods, thereby creating wealth for the nations involved. Since each nation holds a certain comparative advantage and area of specialization, the resultant dependence among nations therefore gives each a stake in each others' security and prosperity. The traditional clamor for territory is no longer relevant as the occupation of lands in itself does not create wealth. The argument then extends to the fact that since peace is the path to profit, greed should then discourage war and not promote it.

¹³John R. Oneal, Bruce Russett, and Michael L. Berbaum, "Causes of Peace: Democracy, Interdependence, and International Organizations, 1885-1992," *International Studies Quarterly* 47 (2003): 371-372.

Geoffrey Blainey, a prominent conservative political commentator with contrarian views about economic liberalism, referred to this school of thought as the Manchester creed¹⁴ due to the city's reputation as a symbol of free trade. Under this construct, disciples of the creed argued that nations grew richer through commerce and not conquest, and that overall welfare would be enhanced by rational discussion and not threats.¹⁵

If one traces back to the writings contained in Adam Smith's *The Wealth of Nations*, said to be one of the most influential books ever written, it theorized in the same vein that a nation gained most when its economic policy enriched rather than impoverished its neighbors, and that free trade had replaced war and mercantilism as a path to prosperity.¹⁶ On this issue, Kant was no less prescriptive as he writes, "The *spirit of trade* cannot coexist with war, and sooner or later this spirit dominates every people. For among all those powers (or means) that belong to a nation, financial power may be the most reliable in forcing nations to pursue the noble cause of peace (though not from moral motives); and wherever in the world war threatens to break out, they will try to head it off through mediation."¹⁷

¹⁴The Manchester creed originated in England during the period 1820 to 1850 when supporters of the Anti-Corn Law League championed for free trade and political freedom with minimal government intervention.

¹⁵Geoffrey Blainey, "Paradise is a Bazaar," in *Conflict after the Cold War: Arguments on Causes of War and Peace*, 2nd ed., ed. Richard K. Betts (New York: Pearson Longman, 2005), 228.

¹⁶Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan (New York: Random House, 1937), 635-636.

¹⁷Immanuel Kant, *Perpetual Peace and other Essays on Politics, History, and Morals*, trans. Ted Humphrey (Indianapolis: Hackett Publishing, 1983), 125.

Richard Rosecrance, in *The Rise of the Trading State*, delved deeper and specifically looked into the evolution of trade and its implications on international security. During the mercantilist era, nations pursued not only territory, but also a monopoly of markets. This allowed nations to achieve economic self-sufficiency, generate greater revenue for the building of larger militaries, and therefore wield more global or regional power. The great British empire was testament to this phenomenon, as was Genghis Khan and his military nomads, and the Turks under the Ottoman Empire. Even as trade began to flourish, it was more of a tactical endeavor used in between wars rather than a recipe for lasting peace.¹⁸

Nevertheless, Rosecrance suggested that the fundamentals changed after 1945. First, the number of nation states has greatly increased, and is likely to increase given the numerous nationalist and ethnic separatist movements. As a result of the vulnerabilities of these smaller and often weaker states, economic dependency has taken on a new meaning. These states could not depend on themselves alone and required economic linkages with other nations in order to survive. Therefore, “the method of international development sustained by trade and exchange will begin to take precedence over the traditional method of territorial expansion and war.”¹⁹ Second, due to the devastating nature and punitive costs of a potential nuclear conflict, a more tenable option is therefore a policy of economic development and progress sustained by the medium of international

¹⁸Richard Rosecrance, “Trade and Power,” in *Conflict after the Cold War: Arguments on Causes of War and Peace*, 2nd ed., ed. Richard K. Betts (New York: Pearson Longman, 2005), 274.

¹⁹*Ibid.*, 278.

trade. As Rosecrance aptly puts it, “to attack one’s best customer is to undermine the commercial faith and reciprocity in which exchange takes place.”²⁰

Third, the Industrial Revolution, and further industrialization after World War II, removed the link between territory and power and it became possible for nation states to gain economic strength without occupying new lands. This was achieved through the development and availability of transportation and communication means, which allowed manufactured goods to find markets in faraway countries. Fourth, besides the spurt in international trade, the growth in FDI globally since 1945 has been phenomenal. Whereas FDI accounted for only 10 percent of overall US foreign investments (the other component being portfolio investments in foreign stock exchanges) in 1913, this rose to nearly 30 percent in the 1980s.²¹ The main engine for this growth is the multinational corporation, which originates in one national jurisdiction, but operates in another by bringing along expertise, personnel, and capital. Such a form of investment represents “a much more permanent stake in the economic welfare of the host nation than exports to that market could ever be.”²²

Contrarian Views to Promoting Peace through Economic Liberalism

To the realists, however, the causality between economic interdependency and peace is far from convincing. Blainey pointed to the infrastructural features of economic interdependency, such as railways, canals, and steamships, and argues that instead of

²⁰Ibid., 279.

²¹Ibid., 285.

²²Ibid., 286.

preserving peace, they could have precipitated conflict. Referring to the Egyptian War in 1882 and the Russo-Japanese War in 1904, Blainey notes, “This is not to argue that these new arteries of commerce caused those two wars; but certainly they illustrated the hazards of assuming that whatever drew nations together was an instrument of peace.”²³ Therefore, more than being the cause of peace, economic interdependency could be better seen as an outcome of peace.

Professor Kenneth Waltz, one of the most prominent scholars of international relations and the founder of neorealism, kept in step with this thinking by stating that “close interdependence means closeness of contact and raises the prospect of occasional conflict.”²⁴ He viewed interdependence as a form of mutual vulnerability, and therefore susceptible to being forcibly overcome by one party so as to establish self-sustainability. Comparing the Cold War period with the pre-World War I period, when US-Soviet trade was 8 to 14 percent of gross national product and trade between the United Kingdom, France, Germany, and Italy was 33 to 52 percent of gross national product, Waltz argued that a lower degree of dependency was actually a healthy condition for maintaining peace. In sum, Waltz asserts that “the myth of interdependence both obscures the realities of international politics and asserts a false belief about the conditions that promote peace.”²⁵

²³Blainey, “Paradise is a Bazaar,” 231.

²⁴Kenneth N. Waltz, “Structural Causes and Economic Effects,” in *Conflict after the Cold War: Arguments on Causes of War and Peace*, 2nd ed., ed. Richard K. Betts (New York: Pearson Longman, 2005), 264.

²⁵*Ibid.*, 270.

Quantitative Evidence

As an extension of the theories laid out above, there have been attempts by social and political scientists to validate, or otherwise, the effects of economic liberalism on the security environment through quantitative studies. First, Hegre, Oneal, and Russett refuted previous studies that questioned whether economic interdependence promotes peace by incorporating the gravity model into the analysis of conflict. The results of their analysis of the period 1950 to 2000 show that “trade reduces the likelihood of a fatal militarized dispute.”²⁶ They further conclude that “whether paid prospectively or contemporaneously, the economic cost of conflict should reduce the likelihood of military conflict, *ceteris paribus*, if national leaders are rational.”²⁷ Second, Benjamin Goldsmith undertook research to assess the relevance of prominent Kantian hypotheses for understanding the international politics of Asia over the period 1950 to 2000. Specifically, Goldsmith wanted to demonstrate that the causality between the three Kantian variables of democracy, international organizations and law, and international economic interdependence and peaceful interstate relations can be applied to the Asian context.²⁸ Through the use of large-sample quantitative evidence pertaining to Asia to introduce a degree of theoretically based control of confounding factors, Goldsmith

²⁶Håvard Hegre, John R. Oneal, and Bruce Russett, “Trade Does Promote Peace: New Simultaneous Estimates of the Reciprocal Effects of Trade and Conflict,” Yale University Leitner Working Paper 2009-07, <http://www.yale.edu/leitner/resources/docs/HORJune09.pdf> (accessed 12 May 2010), 19.

²⁷*Ibid.*, 20.

²⁸Benjamin E. Goldsmith, “A Liberal Peace in Asia?” *Journal of Peace Research* 44, no. 1 (January 2007): 5.

conducted probit statistical analysis²⁹ to identify the effects of each of the liberal variables in Asia. While the results of the analysis were inconclusive with regards to the pacific effects of democracy or international institutions in Asia, the liberal expectations about the importance of economic interdependence for reducing conflict in Asia were robustly confirmed. In particular, it was found that trade dependence was robustly associated with lower conflict in Asia, thereby disproving realist expectations that trade may facilitate conflict by increasing the frequency and intensity of interactions.³⁰

Who is right then--the realists or the liberals? If the theories set out by these scholars are to be taken as a point of departure to analyze contemporary international relations, then the answer is probably somewhere in between. Indeed, as this thesis subsequently addressed China's interactions with the rest of East Asia, these theories will be revisited to determine their respective compatibility with the regional environment.

Section II: China's Grand Strategy

What is China's grand strategy? What constitutes a grand strategy in the first place? According to Professor Avery Goldstein, "Grand strategy, then, is *not* simply a label for a comprehensive description of a state's various foreign policies. Rather, it refers to the central logic that informs and links those policies, the regime's vision about how it can most sensibly serve the nation's interests (goals) in light of the country's capabilities (means) and the international constraints it faces (the context of

²⁹Probit analysis is a type of regression used to analyze binomial response variables in experiments across a variety of fields.

³⁰Goldsmith, "A Liberal Peace in Asia?" 18.

interdependent choice).”³¹ In other words, it refers to an overarching vision about how the political leadership of a country intends to combine a broad range of capabilities linked with military, economic, and diplomatic strategies to defend its national interests and pursue international goals.

China, of course, has never published a formal and detailed plan from the Chinese Communist Party (CCP) Central Committee outlining its grand strategy, unlike how the US government crafted the its Cold War strategy of containment in the document NSC-68. Nevertheless, through the statements made by China’s political leaders, as well as the consensus view among both the observers of Chinese foreign policy over a period of time, one is able to sketch out the distinctive combination of military, political, and economic means by which China seeks to pursue its goals.

At the same time, it is important to note that China did not have a singular grand strategy that stood unchanged with time. Instead, its strategy has evolved over the decades in accordance with the changes in China’s political landscape and the international environment. Looking back into China’s journey towards modernity, it could be said that China’s grand strategy underwent three key phases.

Three Phases of Strategy Evolution

Mao’s Strategy: Responding to a World of Threats

The first iteration of modern China’s grand strategy had its roots in the 1930s when Mao Zedong adopted a realpolitik approach that led to the revolutionary movement’s ultimate victory. Mao’s approach called for forming the broadest possible

³¹Avery Goldstein, *Rising to the Challenge: China’s Grand Strategy and International Security* (Stanford, CA: Stanford University Press, 2005), 19.

coalition of allies in order to cope with the most serious threat facing the CCP, regardless of their ideological orientations. Examples of these coalitions include the broad coalition of Chinese patriots during the anti-Japanese movement from 1935 to 1945, as well as the broad united front against the Kuomintang regime led by Chiang Kai-Shek from 1945 to 1949.³²

This approach continued, albeit with slight variations, even after Mao's CCP gained power in China. First, Mao decided to ally with the Soviet Union in the 1950s due to the perceived threat--ingrained during the course of the Korean War--posed by capitalist US. Then, faced with the prospect of collusion between the Soviet Union and the US, China turned to a coalition of third world nations as a hedge against the superpowers. Finally, the alliance musical chair came one full circle in the early 1970s when the Soviet Union was viewed as an increasingly hostile threat, hence resulting in China's alignment with the US to resist the "socialist-imperialist hegemon."³³ In sum, this approach was explicit and direct, in that the partners China chose to align itself with changed as soon as the threat evolved. During the bipolar era of the Cold War, this approach made sense for a China that was only beginning to find its footing in the world. As soon as this bipolar structure was dismantled, however, a new strategy was needed.

Deng and the Post-Cold War Era: Plugging into the World

The second strategic formulation began in the 1980s even before the end of the Cold War era, as the threat presented by the Soviet Union began to diminish. This made

³²Ibid., 20-21.

³³Ibid.

the counterhegemonic, realpolitik strategy formulated by Mao less relevant than before. On one hand, China did not feel quite as insecure as during the Cold War, when the military threat was direct and credible. The perceived absence of a principal adversary meant a less pressing need to forge explicit alliances. In addition, China recognized that the new world order would be dominated by a unipolar power--the US. Therefore, there were simply no peer competitors which China could turn to even if the previous approach were to be continued.³⁴

Unlike Mao's strategy, the second iteration of China's grand strategy was not as explicit and only became clearer during the middle of the 1990s. The main architect of this strategy was none other than Deng Xiaoping, who took over the reins of power from Mao in 1978. Deng observed a less threatening international environment where multipolarity could slowly begin to dominate international relations and conditions would be favorable for China's modernization through sustained economic development. In his analysis of China's new security diplomacy, Bates Gill opines that

China's new security diplomacy is rooted in the strategic verdict determined by the late Chinese leader Deng Xiaoping, who in 1982 concluded that the world was tending toward peace and development, the possibility of a World War was remote, and China could expect a stable international environment in which it could carry out its much-needed domestic development. This was in sharp contrast with Mao Zedong's line of war and revolution and preparation 'for an early war, a major war, and nuclear war,' which brought decades of economic hardship, ideological struggle, and international isolation in the first few decades of China's independence.³⁵

³⁴Ibid., 22.

³⁵Bates Gill, *Rising Star: China's New Security Diplomacy* (Washington, DC: Brookings Institution Press, 2007), 3.

By the 1990s, however, the circumstances had changed slightly, as it became clear that the path towards multipolarity is likely to be more long-drawn than Deng had earlier anticipated. Consequently, China's leaders sought to overcome three key challenges in crystallizing China's grand strategy. First, China needed to allay rising concerns from its neighbors about China's growing power. Second, continued growth in China's economy must be pursued so as to ensure domestic political stability. Third, the strategy must be able to deal with the potential dangers presented by the US as the world's unipolar power. The strategy that eventually took shape was characterized by two broad components as Goldstein articulates,

The first, great power diplomacy focused on establishing various types of partnerships, is designed to make China an indispensable, or at least very attractive, actor on whose interests the system's major powers are reluctant to trample. The other component of China's strategy embraces an activist agenda designed to establish Beijing's reputation as a responsible international actor, reducing the anxiety about China's rise that CCP leaders recognized might prompt others to oppose it, individually or jointly.³⁶

Goldstein aptly summed up by saying China's grand strategy "aims to increase the country's international clout without triggering a counterbalancing reaction."³⁷ These traits soon found its way into China's public documents, as well as formal speeches made by its leaders. For example, Gill highlighted that a white paper released by the Chinese government in November 1995 called for countries in the Asia and Pacific region to "establish a new mutual respect and friendly relationship between nations" based not just

³⁶Goldstein, *Rising to the Challenge*, 29-30.

³⁷*Ibid.*, 12.

upon the five principles of peaceful coexistence³⁸ but also “common economic development, peaceful settlement of disputes, and bilateral and multilateral dialogues and consultations.”³⁹ President Jiang Zemin also made a traditional-style, poetic statement “zengjia xinren, jianshao mafan, fazhan hezuo, bugao duikang,” which translates to “to enhance confidence, decrease troubles, promote cooperation, and avoid confrontation”⁴⁰-- thus building on the famous advice proffered by Deng “taoguang yanghui,” or “bide our time and build up our capabilities.”⁴¹

In their thesis interpreting China’s grand strategy, Michael Swaine and Ashley Tellis posited that China has shifted from a “weak-strong” state security approach to a “calculative” security strategy in the 1990s that contained three guiding elements. First, a highly pragmatic, non-ideological policy approach keyed to market-led economic growth and the maintenance of amicable international political relations with all states, particularly with the major powers. Second, a general restraint in the use of force

³⁸These principles were proposed by China in 1953 during the negotiations with India over Tibet. They are (1) mutual respect for sovereignty and territorial integrity, (2) mutual non-aggression, (3) non-interference in each other's internal affairs, (4) equality and mutual benefit, and (5) peaceful co-existence.

³⁹Gill, *Rising Star*, 5.

⁴⁰Zhongwei Lu, “On China-U.S.-Japan Trilateral Relations: Comments on Their Recent Exchanges of Top-level Visits,” *Contemporary International Relations* 7, no. 12 (December 1997): 9.

⁴¹Kishore Mahbubani, “Smart Power, Chinese Style,” *The American Interest*, March 2008, <http://www.the-american-interest.com/article-bd.cfm?piece=406> (accessed 3 March 2010). Deng crafted a total of seven guidelines: (1) lengjing guancha, observe and analyze developments calmly; (2) chenzhuo yingfu, deal with changes patiently and confidently; (3) wenzhu zhenjiao, secure our own position; (4) taoguang yanghui, bide our time and build up our capabilities; (5) shanyu shouzhuo, keep a low profile; (6) juebu dangtou, never become a leader; and (7) yousuo zuowei, strive for achievements.

combined with efforts to modernize and streamline the Chinese military. Third, an expanded involvement in regional and global interstate politics with an emphasis on attaining asymmetric gains.⁴² In terms of China's security strategy, Shiping Tan studied its social revolutionary nature and described the transition from Mao to Deng as a change in pitch from "offensive realism" towards "defensive realism."⁴³

Into the 21st Century: China's Peaceful Rise

In what appeared to be a public pronouncement of China's strategy than a radical revision, senior Chinese leaders and strategists associated with China's fourth-generation leadership began to speak of "zhongguo de heping jueqi," or "China's peaceful rise" in the early 2000s. This notion expressed both a confidence and an acknowledgement that China is a rising power but also asserts that China's emergence will not be disruptive.

Premier Wen Jiabao, in a speech in Washington DC in December 2003, pointed out that

the Chinese nation has always cherished peace and harmony. The rise of China is peaceful. It relies on itself for its progress. . . . China is still faced with such problems as unemployment, poverty, and uneven development, which we cannot afford to ignore. These problems are enough to keep us busy. It calls for arduous endeavors of generations for China to catch up with developed countries. China will never seek hegemony and expansion, even when it becomes fully developed and stronger.⁴⁴

⁴²Michael Swaine and Ashley Tellis, *Interpreting China's Grand Strategy* (Santa Monica, CA: RAND Corporation, 2000), 113.

⁴³Shiping Tan, "From Offensive to Defensive Realism: A Social Evolutionary Interpretation of China's Security Strategy," in *China's Ascent: Power, Security, and the Future of International Politics*, ed. Robert S. Ross and Zhu Feng (New York: Cornell University Press, 2008), 154.

⁴⁴Jiabao Wen, Speech by Chinese Premier Wen Jiabao in Washington, 12 December 2003, <http://www.china-embassy.org/eng/zmgx/zysj/major%20Events/t55995.htm> (accessed 4 July 2010).

This was further espoused by one of China's senior advisors, Zheng Bijian, in a major article in *Foreign Affairs* in 2005,⁴⁵ and again in the December 2005 white paper titled *China's Peaceful Development Road*.⁴⁶ In several regards, this was the clearest and most economical expression made by China with regards to its intentions since the turn of the century. Zheng also notes in 2006 that "as for those who take it for granted that as a communist party, China will inevitably follow the Soviet-style route of seeking international expansionism and practicing domestic autocracy, those views are groundless."⁴⁷

According to Gill, the notion of "peaceful rise" alluded to three issues. First, it addressed longstanding concerns about a rising China disrupting the global status quo like the way Weimar Germany and imperial Japan did. Second, China wanted to reassure its key neighbors in Asia of China's benign intentions to seek a win-win outcome through their bilateral and multilateral relations. Third, the concept was linked to China's mounting social and economic challenges brought about by China's policies of "gaige kaifang," or "reform and opening up." Although China's economy had been growing at a rapid pace, these challenges, if left unaddressed, will threaten the longevity of the CCP

⁴⁵Bijian Zheng, "China's Peaceful Rise to Great Power Status," *Foreign Affairs*, September 2005, <http://www.foreignaffairs.com/articles/61015/zheng-bijian/chinas-peaceful-rise-to-great-power-status> (accessed 30 July 2010).

⁴⁶China Internet Information Center, "White Paper on Peaceful Development Road Published," 22 December 2005, <http://www.china.org.cn/english/2005/Dec/152669.htm> (accessed 14 April 2010).

⁴⁷Xiangwei Wang, "Soviet-Style Rise 'Is Not on Agenda,'" *South China Morning Post*, 23 November 2005, 1, quoted in David C. Kang, *China Rising: Peace, Power, and Order in East Asia* (New York: Columbia University Press, 2007), 84.

and therefore affect China's overall security strategy.⁴⁸ Robert Sutter's assessment of China's peaceful approach, in his book *China's Rise in Asia*, also corroborated with the points above.⁴⁹

Understanding China's Identity

At this point, it is instructive to overlay the evolution of China's strategy over the past decades with a look at China's intrinsic identity--one that is built through the interaction between its two thousand years of history as well as current interactions and pragmatic goals. After all, geopolitical developments and leadership idiosyncrasies aside, it has been proven that much of a country's geopolitical orientation and behavior are informed by its experiences in the past, especially if it has an illustrious history like China.

David Kang, in his book *China Rising: Peace, Power, and Order in East Asia*, argued that the sources of stability, or potential instability, in East Asia, emanates primarily from China's identity; that is, studying China's identity, or its evolution over the centuries, will provide a clearer interpretation of China's national interests and ambitions. Kang opines that "China's foreign policy reveals more signs of stability and a status quo orientation than worrisome signs of nationalism and aggression."⁵⁰ He highlighted that contrary to contemporary belief, China's preoccupation with a "century

⁴⁸Gill, *Rising Star*, 7-8.

⁴⁹Robert G. Sutter, *China's Rise in Asia: Promises and Perils* (Landam, MA: Rowman and Littlefield, 2005), 265-267.

⁵⁰David C. Kang, *China Rising: Peace, Power, and Order in East Asia* (New York: Columbia University Press, 2007), 80.

of shame” and an obsession with state power to compete with the US, Japan, and Russia have been overhyped. For example, Michael Leifer reflected this common viewpoint by saying, “The rising power in Asia and Pacific as the twenty-first century approaches is China, whose leaders harbor a historical resentment of national humiliations inflicted on their weakened state by a rapacious West. China’s successful post-Cold War economic reforms have provided it with a historic opportunity to realize a sense of national identity, which many regional states view with apprehension.”⁵¹

Yet, beginning in the 1980s, China has been reducing its Marxist-Leninist revolutionary rhetoric and undertaking an active foreign policy designed to communicate its benign preferences and reassure the rest of Asia and the world--in effect moving beyond the previously-held “victim mentality” (*shouhaizhe xintai*) that emphasizes 150 years of humiliation to a “great power mentality” (*daguo xintai*).⁵² Nevertheless, the legacy of the “victim mentality” has served to guide China in developing its foreign policy which stresses largely on sovereignty and territorial integrity. In other words, the past century of humiliation, when outside powers intervened and interfered at will in China, has led to the lesson that national unity and sovereignty were key aspects of modern international relations.⁵³

Furthermore, Kang suggested that China has neither the desire nor the capacity to harbor any hegemonic intentions in East Asia. States of East Asia today are more

⁵¹Michael Leifer, “The ASEAN Regional Forum: The Merits of Multilateralism,” *Adelphi Paper* 36, no. 302 (1996): 54.

⁵²Kang, *China Rising*, 81.

⁵³*Ibid.*, 82.

powerful and domestically consolidated, and China is no longer the sole model for political and economic organization as it had been in past centuries.⁵⁴ With regards to territorial expansion, China's approach has been to address unresolved disputes over precise borders rather than to question or challenge the legitimacy or existence of other countries. China's resolution of territorial disputes in recent history shows that it tended to negotiate compromises about its frontiers, often in very unfavorable terms for itself. For example, China's settlement of its border dispute with Burma ended with China accepting only 18 percent of the disputed land, and only 6 and 29 percent in similar cases with Nepal and Mongolia respectively.⁵⁵

There is also a consensus view among scholars that China's approach is not confrontational, but rather more accommodative in nature. For example, Li Junru of the Central Party School writes that "China's rise will not damage the interests of other Asian countries. That is because as China rises, it provides a huge market for its neighbors."⁵⁶ According to Wu Baiyi from the Chinese Academy of Social Sciences, "the nature of China's security policy, therefore, is accommodative, rather than confrontational. Compared to past policies, the current concept signifies two major changes. . . . For the first time, economic security is treated as equally important with those of 'high politics'. Second, it focuses more on the interrelationship between external and internal security

⁵⁴Ibid., 83.

⁵⁵Taylor Fravel, "Regime Insecurity and International Cooperation: Explaining China's Compromises in Territorial Disputes," *International Security* 30, no. 2 (Fall 2005): 56.

⁵⁶Elizabeth Economy, "China's Rise in Southeast Asia: Implications for the United States," *Journal of Contemporary China* 14, no. 44 (August 2005): 413.

challenges.”⁵⁷ In summary, the two main aspects of China’s identity, according to Kang, are in fact an emphasis on sovereignty and the absence of territorial ambition.⁵⁸

The Pre-eminent Role of Economic Development

Although China’s grand strategy places a fair amount of importance on the Westphalian norm of sovereignty, perhaps the most significant driving factor resides domestically--the desire to create conditions that will sustain economic development. At its root, this factor is political as the CCP has recognized that continuous economic development is the only “drug” that can sustain the regime amidst a whole host of issues, including containing the spread of regional separatism, a tenuous balance of power between the central and local governments, and rising income inequality.⁵⁹ Sutter refers to this as “the importance of regime survival.”⁶⁰

According to the World Bank, the Chinese economy under the leadership of Deng Xiaoping began an unprecedented structural transformation in the late 1970s after nearly three decades of communist rule. This transformation produced “revolutionary improvements in China’s growth rates, patterns and volumes of manufacturing and trade, personal income levels, foreign exchange earnings, state revenues and levels of

⁵⁷Baiyi Wu, “The Chinese Security Concept and Its Historical Evolution,” *Journal of Contemporary China* 10 (2001): 281.

⁵⁸Kang, *China Rising*, 79.

⁵⁹Minxin Pei, “The Dark Side of China’s Rise,” *Foreign Policy*, 17 February 2006, http://www.foreignpolicy.com/articles/2006/02/17/the_dark_side_of_chinas_rise (accessed 30 May 2010).

⁶⁰Sutter, *China’s Rise in Asia*, 58.

technology.”⁶¹ In contrast, during the 27 years of post-1949 communist rule under Mao Zedong, China’s annual average per capita GDP growth was less than 3 percent, due in no small part to the devastating Great Leap Forward and Cultural Revolution.⁶² In 1977, on the eve of Deng’s reforms, China’s two-way trade as part of the world total dwindled down to only 0.6 percent, down from the peak of 2.3 percent achieved in 1928.⁶³

However, this rate of growth has not come without its costs. As Gill highlighted, once Deng’s policies of market reform took hold, political, social and economic problems began to set in. These included “pervasive official corruption, widening income gaps between the rich and poor, widespread layoffs and underemployment in the state sector, a fragile banking and financial sector and an ailing social welfare and public health system.”⁶⁴ Thus, “managing these growing sociopolitical and socioeconomic challenges at home, while also maintaining political leadership and expanding the domestic economy, became priority number one for Beijing.”⁶⁵ Sutter also concludes that “the pattern of post-Cold War Chinese strategy in Asia emphasizes conventional nation

⁶¹World Bank, *China 2020: Development Challenges in the New Century* (Washington, DC: The World Bank, 1997), 1-13.

⁶²*Ibid.*, 2.

⁶³The Economist, “The Real Leap Forward,” *The Economist*, 18 November 1999, http://www.economist.com/displaystory.cfm?story_id=259987 (accessed 16 June 2010). The 1928 peak was eventually surpassed in 1993.

⁶⁴Gill, *Rising Star*, 4.

⁶⁵*Ibid.*

building and gradually strengthening China's influence by a Chinese leadership more focused on domestic issues than expanding foreign power.”⁶⁶

Evidently, China's strategy emphasizes not only on amicable political relations with other countries, but also stable and open economic relations around the world. Former Singaporean diplomat and thinker Kishore Mahbubani pointed out in his book, *The New Asian Hemisphere* that China has kept to Deng Xiaoping's advice to “swallow bitter humiliation” and adopted a long view in conducting foreign policy. This carefully thought out strategy is premised on the belief that, as China becomes stronger and more powerful, its neighbors will have to adapt to its rise and acknowledge Chinese power.⁶⁷ Therefore, the idea is that other countries will eventually adjust to China if it succeeds in its single-minded goal of promoting economic development. This policy was spelled out by Yang Baibing, then-secretary of the CCP Central Committee's Secretariat, in a 1991 editorial, in which he writes, “We must make full use of the current favorable conditions both at home and abroad to push our economic construction onto a new stage and lay a foundation for rapid development in the next century . . . our country will completely shake off poverty and truly stride along toward becoming a developed and prosperous country as a giant in the East.”⁶⁸

⁶⁶Sutter, *China's Rise in Asia*, 15.

⁶⁷Kishore Mahbubani, *The New Asian Hemisphere* (New York: Public Affairs, 2008), 222-223.

⁶⁸Michael E. Marti, *China and the Legacy of Deng Xiaoping: From Communist Revolution to Capitalist Evolution* (Washington, DC: Brassey's, 2002), 154, quoted in Kishore Mahbubani, *The New Asian Hemisphere* (New York: Public Affairs, 2008), 223.

Several Chinese authors have also written about the role of economic development within China's overall grand strategy. According to Tianran Li, China's objective is to gain "comprehensive national strength" ⁶⁹ through economic reforms and sustained growth so as to reacquire the military capabilities and international political status it lost at the beginning of the modern era. ⁷⁰ Yimin Song further added that a period of sustained economic success will help bring about (1) domestic order and well-being; (2) the restoration of the geopolitical centrality and status China enjoyed prior to the modern era; (3) legitimacy and membership to the core structures regulating global order and governance; and (4) the discovery and delivery of civilian and military technologies necessary for sustaining China's security in the evolving regional order. ⁷¹

In a study on Deng Xiaoping's thoughts on the concept of comprehensive national power, Zhu Liangyin and Meng Renzhong contended that Deng's views that economic strength can be a force for peace and can counter military strength demonstrated that "economic power is the most important and most essential in comprehensive national

⁶⁹Comprehensive national power, or *zonghe guoli*, is a concept invented in the 1980s which stemmed originally from traditional Chinese military philosophy. It refers to the combined overall conditions and strengths of a country in numerous areas, including elements such as the military, economics, science and technology, and international influence.

⁷⁰Tianran Li, "On the Question of Comprehensive National Strength," *Journal of International Studies* 2 (April 1990), quoted in Michael Swaine and Ashley Tellis, *Interpreting China's Grand Strategy* (Santa Monica, CA: RAND Corporation, 2000), 99.

⁷¹Yimin Song, *On China's Concept of Security* (Geneva: UNDIR, 1986), quoted in Michael Swaine and Ashley Tellis, *Interpreting China's Grand Strategy* (Santa Monica, CA: RAND Corporation, 2000), 99.

power.”⁷² Finally, Tong Fuquan and Liu Yichang analyzed the concept of comprehensive national strength primarily from the economic perspective. According to them, “actual economic strength is, of course, the major component part of Comprehensive National Power, and to a certain extent, a country’s actual economic strength represents its Comprehensive National Power.”⁷³ Therefore, a country with strong economic power will be able to wield considerable political influence.

As another example of the emphasis which China placed on economic growth, former President Jiang Zemin, who was also the general secretary of the CCP, announced in a speech in 2001 a recommendation that private entrepreneurs be allowed to join the CCP. From the perspective of a party ideology which championed the interests of workers and peasants since 1921, this was a highly controversial move, but one which clearly demonstrated China’s resolve to adhere to its national strategy.⁷⁴

It is therefore clear that economic development represented a key pillar of China’s overall strategy to ensure its national security and to gain regional and global power. Under this context, this review took a closer look at what was ostensibly a key way in

⁷²Liangyin Zhu and Renzhong Meng, “A Study on Deng Xiaoping’s Comprehensive National Power Thought,” in *Studies of a New Period of Economic Theory*, ed. Li Lin and Zhao Qinxuan (Beijing: Junshi kexue chubanshe, 1995), 44-46, quoted in Michael Pillsbury, *China Debates the Future Security Environment* (Washington, DC: National Defense University Press, 2000), 211.

⁷³Fuquan Tong and Yichang Liu, *The World’s All-Directional Economic War* (Beijing: Junshi kexue chubanshe, 1991), 232, quoted in Michael Pillsbury, *China Debates the Future Security Environment* (Washington, DC: National Defense University Press, 2000), 215.

⁷⁴Bruce Dickson, “Economics as the Central Task: Do Entrepreneurs Matter?” in *China’s Leadership in the 21st Century: The Rise of the Fourth Generation*, ed. David M. Finkelstein and Maryanne Kivlehan (New York: M. E. Sharpe, 2003), 186.

which China sought to restructure the Chinese economy and achieve sustained economic growth: accession to the WTO.

Section III: Journey Towards Accession and the Impact Since

Following the end of World War II in 1949, 23 countries created the General Agreement on Tariffs and Trade (GATT), which was negotiated during the UN Conference on Trade and Employment and was the direct consequence of the failure to create the International Trade Organization. In 1986, after nearly 40 years and over 100 new members, plans were put in place for the formation of the WTO based on the goals consistent with the original GATT agreement. The WTO was finally established in 1995 during the Uruguay Round of trade negotiations to reform the global trading system in areas such as tariffs, intellectual property rights, and government subsidies. The formation of the WTO also saw the establishment of a Dispute Settlement Body, which arbitrates trade conflicts between member states that may violate WTO rules and regulations.

The primary objectives of the WTO are to “facilitate the flow of commerce, mediate trade-related disputes between members, and generally encourage freer markets through recurring rounds of talks. As the principal forum for the development and discussion of international trade law, the WTO establishes international protocols for each of its members that must be achieved in order for accession to the organization. These protocols dictate specific rules of trade engagement between members and the

WTO on virtually every industry and tradable good or service including production quotas, tariff rates, and general terms of trade.”⁷⁵

Interestingly, China was one of the 23 original contracting parties present at the inception of the GATT in 1949. However, following the split between the Kuomintang and the CCP, Taiwan decided to leave the GATT and several other international organizations. Although China did not follow suit in formally announcing its departure from the GATT, it likewise did not gain much visibility in the international trade arena until economic reforms were introduced in the late 1970s. In 1984, China was granted permanent observer status in the WTO, before it launched an official bid for accession in 1986 coinciding with the beginning of the Uruguay Rounds.⁷⁶ Thus began what would be the most dramatic, and keenly observed, process of reintegration into the global economy by the world’s most populous nation.

China’s Motivations for WTO Accession

Even before it joined the WTO, China had expanded its foreign trade by multiples of world trade growth. No country in the post-war period expanded its trade share as rapidly. By 2000, China had become the seventh largest trading nation in the world, and by the end of 2001, its cumulative FDI accounted for close to one-third of all FDI into

⁷⁵The World Trade Organization, “Trading into the Future: The Introduction to the WTO,” http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm (accessed 15 May 2010).

⁷⁶Jeffrey L. Gertler, “What China’s WTO Accession is All About,” in *China and the WTO: Accession, Policy Reform, and Poverty Reduction Strategies*, ed. Deepak Bhattachali, Shantong Li, and Will Martin (Washington, DC: World Bank and Oxford University Press, 2004), 21-22.

developing countries.⁷⁷ Why, then, did China want to be a member of the WTO? There were several driving factors, both economic and political. First, China sought to gain new markets and lower trade barriers for its exports with its WTO membership. In particular, industries with labor-intensive production processes, namely other consumer goods including the toys, footwear, handbags, and suitcases, were expected to experience a significant increase in exports as a result of China's accession to the WTO.

Second, China wanted to boost the value of FDI, which slowed in growth in the late 1990s when the Asian financial crisis crippled its regional trading partners even though FDI relative to the level of domestic investment remained exceptionally high even when compared with leading developed countries such as the United Kingdom and the Netherlands. In fact, even during the Asian financial crisis, FDI reached \$40 billion in 1997, making China the second-most highly invested country in the world.⁷⁸ Still, more could be done. China's accession to the WTO would result in more freedom and protection for investors under the international agreement as well as significant improvements in China's financial intermediaries, thereby encouraging foreign investors to increase their capital inflow into new businesses.

Third, the Chinese leadership saw WTO accession as a way to reform recalcitrant state-owned enterprises (SOEs). Despite repeated efforts by the Chinese government to move the economy towards privatization and other market initiatives, the SOEs were not

⁷⁷Nicholas R. Lardy, "Prime Numbers: Sweet and Sour Deal," *Foreign Policy*, 1 March 2002, http://www.foreignpolicy.com/articles/2002/03/01/prime_numbers_sweet_and_sour_deal (accessed 30 May 2010).

⁷⁸Supachai Panitchpakdi and Mark L. Clifford, *China and the WTO: Changing China, Changing World Trade* (New York: John Wiley and Sons, 2002), 17.

easy to reform because of their massive employment base and the strong inertia to move away from the heavy-industry and capital-intensive enterprises. Therefore, the Chinese government exploited the need for public sector reform as part of the WTO accession process so as to ensure that the SOEs were restructured in favor of more efficient private firms.

Fourth, and alluded to earlier, the Chinese leadership took WTO accession as an opportunity for China to elevate its geopolitical status. Foremost, this would reinforce China's political influence by reinstating China among the major global powers, or "at the high table of nations that most Chinese believe is theirs by right."⁷⁹ At the same time, the possibility of gaining membership before Taiwan was a major motivating factor, as China wanted to demonstrate to political observers that it could, with a socialist structure, do as well, if not better, than democratic Taiwan.

Fifth, China wanted to insulate its trade economy against other international disputes unrelated to trade. Membership in the WTO would allow China to "protect their interests and rights by participating in the creation of international trade laws, as well as provide an impartial mediator with its trade partners, particularly the US."⁸⁰ By granting China permanent normal trade relations status, formerly known as the most favored nation status, China would be freed of annual threats by the US to revoke trading privileges due to political motivations.

⁷⁹The Economist, "China Opens Up," *The Economist*, 18 November 1999, http://www.economist.com/displaystory.cfm?story_id=259927 (accessed 16 June 2010).

⁸⁰The Economist, "The Real Leap Forward," *The Economist*, 18 November 1999, http://www.economist.com/displaystory.cfm?story_id=259987 (accessed 16 June 2010).

World Bank researchers Bhattasali, Li, and Martin, in their work on the policy implications of China's WTO accession, saw the agreement as a means to fulfilling broader goals. One of them was to "facilitate the peaceful emergence of China as a great trading nation--and to avoid the trade tensions associated with the emergence of major new traders in the past."⁸¹ Another goal was to "accelerate the process of domestic reform--with the WTO acting as a "wrecking ball" for what remained of the earlier closed economy."⁸² However, Jeffrey Bader, who was the Assistant US Trade Representative for China during the final phases of the accession process, had an alternative assessment of China's motivations. He thought that "membership was not so much part of an economic strategy as it was a part of China's becoming a full-fledged member of the global community."⁸³

Key Obstacles to China's WTO Accession

Notwithstanding the above, the journey towards WTO accession was met with significant opposition. Domestically, the liberalization required to qualify for WTO accession led to significant changes in market access across most of China's previously heavily protected industries, including automobiles and telecommunications. With the likely increase in competition from foreign firms, many in China predicted that "the

⁸¹Deepak Bhattasali, Shantong Li, and Will Martin, "Impacts and Policy Implications of WTO Accession for China," in *China and the WTO: Accession, Policy Reform, and Poverty Reduction Strategies*, ed. Deepak Bhattasali, Shantong Li, and Will Martin (Washington, DC: World Bank and Oxford University Press, 2004), 1.

⁸²Ibid.

⁸³Kent Hughes, Gang Lin, and Jennifer L. Turner, *China and the WTO: Domestic Challenges and International Pressures* (Washington, DC: Woodrow Wilson Center, 2002), 6.

thundering herd of savvy, well-financed, technologically sophisticated foreign companies” would “invade” developing Chinese industries.⁸⁴ The SOE privatization efforts also meant that rising unemployment would need to be kept in check in order to maintain social order. In November 1999, SOEs were responsible for the employment of more than two-thirds of all urban workers in China. In the lead up to China’s accession to the WTO, at least 25 million workers from SOEs were laid off due to reforms.⁸⁵ In order to mitigate the negative social consequences due to the anticipated job losses, China negotiated for a gradual reform period of its SOEs as part of the multilateral agreement.

Externally, the main obstacle stood in the form of the US. According to WTO rules, a potential member needs to complete bilateral trade agreements with each of the current WTO member states before the multilateral WTO agreement can be negotiated. After China announced that it intended to join the WTO, many of China’s trade partners granted her permanent normal trade relations and the WTO working party of China was formed in 1988. Yet, there were still substantial reform and negotiation efforts, especially with the United States over the bilateral trade agreement; and the requirements for membership became increasingly tough as more trade rounds ensued still without China’s input and the GATT converted to the WTO in 1995.

One key concern of the US then was the growing trade deficit with China. By January 1999, the US’ trade deficit with China had surpassed that of Japan, making it the

⁸⁴Panitchpakdi, *China and the WTO: Changing China, Changing World Trade*, 139.

⁸⁵*Ibid.*

single largest contributor to the US deficit.⁸⁶ With China's accession to the WTO, the trade balance would favor China even more with the loosening of overseas trade barriers to Chinese products and the introduction of new export markets. Hence, the US argued that China's accession should be inextricably linked to reforms and market access in China that allowed the US to gain as well. In particular, the US highlighted the lack of transparency and accountability in China's non-tariff trade barriers as the primary factor for the limited penetration of US goods in China. The US Trade Representative office also demanded fewer restrictions and limitations in the telecommunications, financial services, agriculture, retail, and entertainment sectors. Other political issues that were thrown into the fray and slowed the negotiations included the Taiwan issue, the Tiananmen Square incident, demands for greater democratization in the Chinese political system, and the bombing of a Chinese embassy in Belgrade by an American pilot during the Kosovo conflict in Serbia.

After more than thirteen years of tough negotiations, the bilateral agreement between China and the US was finally reached in November 1999. Over the next two years, China completed negotiations with the European Union and Mexico and all the bilateral agreements were combined into the WTO multilateral accession protocol. On 11 December 2001, China joined the WTO as the one hundred and forty-third member, effectively concluding an arduous process that has brought China from the hermetic isolation of the Mao era to becoming a major global economic force to be reckoned with.

⁸⁶The Economist, "China and the WTO," *The Economist*. 1 April 1999, http://www.economist.com/displaystory.cfm?story_id=195194 (accessed 19 June 2010).

Assessed Regional Impact of China's WTO Accession

In his statement following the conclusion of accession negotiations, the Chinese head of delegation said that China's accession to the WTO would be a “win-win” and “all-win” for China as well as for the world, calling it “an important contribution made by China to the mankind.”⁸⁷ While there is little doubt concerning the “win” on China's part, how much does the East Asian region in general stand to gain through China's accession?

In their research on the regional impact of China's WTO accession, Ianchovichina, Suthiwart-Narueput and Zhao noted that countries in East Asia will feel the impact of China's accession to the WTO through four main channels: (1) expansion of markets in China for their exports; (2) increased imports from China into their domestic markets; (3) competition with China in third markets; and (4) expansion of FDI in China and, potentially, outward FDI from China.⁸⁸ In their subsequent analysis, the impact on three groups of East Asian countries--industrialized, middle-income developing, and low-income developing--was forecasted. For countries such as Japan, South Korea, and Singapore, they were expected to benefit from China's accession due to their status as important suppliers of intermediate inputs to China, such as petrochemicals, electronics, and machinery. In addition, these industrialized countries would benefit from China's higher demand for services in areas like communications,

⁸⁷Yongtu Long, “Statement by Head of the Chinese Delegation at the Eighteenth Session of the Working Party on China,” Geneva, 17 September 2001, http://www.wto.org/english/news_e/news01_e/wpchina_longstat_17sept01_e.htm (accessed 21 April 2010).

⁸⁸Elena Ianchovichina, Sethaput Suthiwart-Narueput, and Min Zhao, “Regional Impact of China's WTO Accession,” in *East Asia Integrates: A Trade Policy Agenda for Shared Growth*, ed. Kathie Krumm and Homi Kharas (Washington, DC: The World Bank, 2003), 58.

transport, and finance. In contrast, middle-income countries such as Indonesia, Malaysia, and Thailand were expected to receive a mixed impact due to their similarity in export structure (particularly in the garment and textile sectors) with China which would introduce certain competitive pressures. As for the lower-income countries who were less exposed to the Chinese market in comparison with the other groups, Cambodia was expected to be most negatively affected due to the predominance of their apparel exports. Nevertheless, these countries would benefit through the ASEAN-China FTA (ACFTA), under which they were granted most favored nation status despite not being a WTO member.⁸⁹

In another report, World Bank researchers Ianchovichina and Martin found that “among China’s trading partners, the largest absolute gains accrue to North America and Western Europe with close to half of the gains coming from elimination of the quotas they impose on China’s exports of textiles and clothing. North America, Western Europe, and Japan also gain from China’s cuts in protection, which increase China’s efficiency as an export supplier and its demand for their exports. The welfare gain by Taiwan from China’s accession to the WTO was estimated at \$3 billion per year--the second largest gain relative to the size of the economy after China’s. About half of the gain was realized as a result of the liberalization in China and Taiwan from 1997 to 2001, while remaining reforms were estimated to lead to an estimated real income gain of \$1.4 billion a year after 2001.”⁹⁰

⁸⁹Ibid., 63-77.

⁹⁰Elena Ianchovichina and Will Martin, “Economic Impacts of China’s Accession to the WTO,” in *China and the WTO: Accession, Policy Reform, and Poverty Reduction*

Again, the other newly industrialized economies were expected to benefit from China's accession, mainly as a result of trade liberalization and the removal of quotas on textile and apparel. It was also found that the largest losses would be incurred by Vietnam, who has a pattern of comparative advantage in labor-intensive products similar to China.⁹¹ However, not all researchers shared the same level of optimism about the impact of China's accession. For example, in his efforts to establish a causal relationship between the WTO and world trade, Andrew Rose found that there is no strong empirical evidence that the WTO has systematically played a strong role in encouraging trade.⁹²

Section IV: Understanding the East Asian Region

Having traced the evolution of China's strategic thinking and how it led to China's decision to join the WTO, this review turned to providing the reader with an overview of the region that was the subject of analysis, and the interactions China has had with it. The first part introduced China's political relationships with its East Asian neighbors--in particular, the way the East Asian countries have chosen to manage the rise of China. The second looked at the political economy of the region, and how China is increasingly the centerpiece of economic development in East Asia.

Strategies, ed. Deepak Bhattasali, Shantong Li, and Will Martin (Washington, DC: World Bank and Oxford University Press, 2004), 221.

⁹¹Ibid., 223.

⁹²Andrew Rose, "Do We Really Know That the WTO Increases Trade?" *The American Economic Review* 94, no. 1 (March 2004): 112.

China's Political Relations with East Asia

In order to understand China's contemporary political relations with its East Asian neighbors, it is instructive to start by looking back at history. Up until the intrusion of Western powers in the mid-nineteenth century, China was the undisputed regional hegemon and the most technologically advanced state in East Asia--to the extent that China's neighbors were willing to establish subordinate relations with China so as not to risk military hostilities and also receive security guarantees. For example, the Japanese Ashikaga shogunate sought investiture by the Ming emperor to eliminate the fear of a Chinese invasion, while Chosun Korea sought the support of Qing China to repulse Japanese attacks in 1592.⁹³ Such a hierarchical logic led to a regional order which was relatively stable and predictable, especially when compared with the state of affairs in the European theater over the same period. At the same time, East Asia already had an integrated and extensive economic system which centered on China since centuries ago. According to Kang, from the Song era of the tenth century to the end of the Qing dynasty in the nineteenth century, there existed a vibrant and cohesive trading system which included China, Japan, Korea, Siam, Vietnam, and the Philippines.⁹⁴

The arrival of the Western powers in the nineteenth century, followed by the invasion by and occupation of the Japanese during World War II, changed this order. China became weak for a long time as it became embroiled in a devastating civil war and subsequently was shackled by communist rule. In its place, post-war Japan stepped up to become the regional power. In Southeast Asia, several states were caught in guerilla wars

⁹³Kang, *China Rising*, 42.

⁹⁴*Ibid.*, 36.

either to fight for independence from the colonial masters or to resolve differences in political ideology. After the end of the Cold War, and the opening up of the Chinese economy, the transition began towards a familiar order whereby China is the regional power and that East Asia reverts to a standalone source of global growth powered and steered by East Asian states.

At the beginning of the 21st century, China had established good bilateral relations with all of its neighbors in East Asia, except for Taiwan. It concluded long-term cooperative agreements on political, economic and security cooperation with all ten of the ASEAN countries in 1999 and 2000. It also entered into a “Partnership of Friendship and Cooperation for Peace and Development” with Japan in 1998 and a “full-scale cooperative partnership” with South Korea in October 2000.⁹⁵ It has also been a constructive and cooperative participant in several regional fora which defines East Asia’s multilateral landscape, including Asia-Pacific Economic Cooperation (APEC), ASEAN Plus Three⁹⁶ and the ASEAN Regional Forum. These developments reflect in general the intent of the Chinese leadership to introduce itself as a rising power in a peaceful manner while expanding the webs of economic cooperation with its regional neighbors, as discussed earlier in this chapter.

⁹⁵Michael Chambers, “Rising China: A Threat to its Neighbors?” in *The Rise of China in Asia: Security Implications*, ed. Carolyn W. Pumphrey (Carlisle: Strategic Studies Institute, 2002), 71.

⁹⁶A regional platform comprising ASEAN member states, China, Japan, and South Korea.

Japan

China-Japan relations were generally positive during the Cold War, as they faced a common threat in the form of the Soviet Union which downplayed several other bilateral issues. The Japan-US alliance was tolerated and accepted by China, and Japan soft-pedaled reservations over China's missile developments and nuclear weapons programs. Following the collapse of the Soviet Union, strategic differences began to surface. First, North Korea's nuclear developments, especially its Taepodong missile overflight of Japan in 1998, presented a direct military threat to Japan and became a factor in relations with China who was the old-time ally of North Korea. Second, Japan's alliance with the US, and the US strategic relationship with Taiwan, meant that any conflict between China and Taiwan would inadvertently result in Japan's participation on the US' side.⁹⁷ At the same time, the historical baggage between China and Japan remained a significant factor in bilateral relations. This was due not only to Japan's sustained period of occupation and its brutal treatment of the Chinese, but also its inability to come to terms with the facts of history, either in public statements or in school history textbooks.

Nevertheless, China had sought to improve its relations with Japan from the late 1990s onwards, in tandem with its more flexible and cooperative approach in Asia. The visits by Prime Minister Hashimoto and Premier Li Peng to Beijing and Japan respectively between 1997 and 1998 led to formal agreements on issues such as environmental cooperation, fishery, and China's WTO membership bid.⁹⁸ This was

⁹⁷Sutter, *China's Rise in Asia*, 132-133.

⁹⁸*Ibid.*, 140-141.

followed by successive high-level visits to Japan by the Chinese leadership, including Defense Minister Chi Haotian, Vice-President Hu Jintao, and President Jiang Zemin. Despite these exchanges, however, issues such as Japan's position on Taiwan, the validity of Japan's exclusive economic zone, and Japan-US missile defense cooperation continued to color bilateral relations. In 2001, relations reached a new low with the controversy over Japanese textbooks glossing over Japan's wartime actions, as well as the visit of Japanese Prime Minister Junichiro Koizumi to the Yasukuni Shrine where Japan's World War II dead are buried.

South Korea

At the outset, South Korea's strategic considerations in managing relations with China appear to mirror those of Japan's. Like Japan, South Korea has had an alliance treaty with the US since 1953 which guarantees its security. Also, it has to contend with an economically, geographically, and demographically massive China's rise as a regional power. However, there are at least two distinctions that set China-South Korea relations apart. First, South Korea's suspicions about Japanese growing militarization, which is linked to its historical memories of Japanese colonization from 1910 to 1945, make Japan an unlikely candidate as a regional partner to balance China in the conventional realist sense. Besides, South Korea has had a long history of stable and peaceful relations with China--to the extent that the South Korea-China relationship has often been referred to as "sadae," or "serving the great."⁹⁹ Second, South Korea and China share a common strategic interest in North Korea. While their aims are different--South Korea's policy

⁹⁹Kang, *China Rising*, 106.

objective is Korean reunification, while China wishes to avoid domestic instability in North Korea and military intervention by the US--South Korea and China both agree on a peaceful resolution of the issue and are willing to work together to achieve that.

Consequently, conventional perspectives that predicted South Korea's closer ties with Japan and the US to balance China have not come to pass. Instead, South Korea appears to be adjusting positively to China's growing influence, at times to the frustration and anger of US officials.¹⁰⁰ Of course, the meteoric growth of bilateral economic relations made it difficult for South Korea to pursue a containment strategy against China. Bilateral trade grew from \$5 billion at the time of normalization of diplomatic relations in 1992 to \$41.2 billion in 2002, and China surpassed the US as South Korea's largest export target for the first time in 2002.¹⁰¹ A stronger relation with China has also provided more foreign policy options for South Korea, who previously had to contend with a purely US-centric strategy. However, considering that the US alliance remains of paramount importance to South Korea, striking a balance between these two powers will continue to be a challenge.

ASEAN

China's relations with ASEAN as a region perhaps best reflect its evolving grand strategy over the past decades. In the 1970s and 1980s, with the ASEAN institution still at its infancy stage, there were common concerns among countries in the region about China's military modernization and likely hegemonic intentions. China's invasion of

¹⁰⁰Ibid., 104.

¹⁰¹Sutter, *China's Rise in Asia*, 156.

Vietnam, its support of various communist insurgencies in Malaya and Indonesia, its assertive stance towards the South China Sea territorial dispute, as well as its widespread support for the repressive regimes in Cambodia and Burma, led to ASEAN's embracing of greater US military presence in the region.¹⁰² Nevertheless, absent of any significant historical grievances, China relations with ASEAN had the potential to improve in tandem with its foreign policy objectives--and improve it certainly did.

One of the key steps to alleviating the fear of China amongst the ASEAN countries was China's cooperation with ASEAN that led to a peace settlement in Cambodia. China also played a very constructive role during the Asian financial crisis in 1997 where China contributed to the International Monetary Fund-led bailout of Thailand and Indonesia--it provided \$1 billion each to Thailand and Indonesia and pledged \$4 billion overall--and refrained from devaluing the renminbi despite China's own slumping exports.¹⁰³ Mahbubani also alluded to two key events that cemented China's position in Asia: its contributions to the Asian financial crisis and its offer of a free trade agreement (FTA) with ASEAN in 2001 (which incidentally coincided with its accession to the WTO).¹⁰⁴

By the late 1990s, the Chinese approach towards ASEAN had become much more accommodative and attentive, particularly in the reduction of rhetoric remarks on the region's security cooperation with the US. During the same period, ASEAN-China economic partnership also grew significantly. For example, bilateral trade in 1992 was

¹⁰²Ibid., 178.

¹⁰³Chambers, "Rising China: A Threat to its Neighbors?" 77.

¹⁰⁴Mahbubani, *The New Asian Hemisphere*, 229-230.

fifteen times the volume in 1975 and ASEAN rose to become China's fifth largest trading partner by 1993. By 2001, China-ASEAN trade was worth over \$41 billion which was double the amount reached in 1995.¹⁰⁵ In fact, relations have turned so much for the better that, according to American analyst Joshua Kurlantzick, Chinese soft power in Southeast Asia is now so potent that the United States is facing a situation not since 1945 in which another country's appeal outstrips its own in an important region.¹⁰⁶

Finally, ASEAN-China relations need to be viewed in the context of the evolution of ASEAN-centric multilateralism in East Asia. Searching for an appropriate mechanism to conduct regional diplomacy, China gradually found ASEAN, a consensus-based grouping, a suitable platform from which to engage its regional partners on a regular basis without rousing suspicions and appearing to take center stage. Beginning with its attendance of the ASEAN Foreign Ministers Meeting in 1991, China went on to participate in the ASEAN Regional Forum in 1994 and the ASEAN Plus Three Summit in 1997.¹⁰⁷

In conclusion, China's dominance in East Asia is everything but a foregone conclusion. The post-Cold War order in East Asia has witnessed a tendency on the part of most governments to emphasize nationalistic ambitions and independence. Therefore, they are wary of coming under the dominant influence of a single country or power even if contributes significantly to economic development. In this regard, the United States

¹⁰⁵Sutter, *China's Rise in Asia*, 182.

¹⁰⁶Mahbubani, *The New Asian Hemisphere*, 230.

¹⁰⁷Kang, *China Rising*, 130.

looms large in the hedging calculus of East Asian states dealing with a rising China.¹⁰⁸

Reflecting the views of region, Singapore's Prime Minister Lee Hsien Loong said in an interview in April 2010 "... and in Asia, we particularly do not want to have to choose sides between China and the US. We want to be friends with both."¹⁰⁹

The Political Economy of East Asia

In tandem with China's meteoric rise as an economic power, the achievements made by East Asia as a region have been no less impressive. According to a study by the Asian Development Bank (ADB), East Asian living standards from 1956 to 1996 rose at a rate that was faster than any other region in the world, with East Asian countries accounting for eight of the ten economies worldwide that recorded an average rise in GDP of 4.5 percent or more. During the same period, the living standards in the East Asia grew at an average of 5.0 percent a year while the world as a whole averaged only 1.9 percent.¹¹⁰ Such statistical marvels may seem hard to believe initially, considering the heterogeneity that was, and continues to be, inherent in the region. East Asian economies not only differ largely in size, incomes, and endowments of human, natural, and capital resources; but also span a gamut of political structures, language, culture, and history.

¹⁰⁸Robert G. Sutter, "China's Rise and the Durability of U.S Leadership in Asia," in *China and the United States: Cooperation and Competition in Northeast Asia*, ed. Zhao Suisheng (New York: Palgrave Macmillan, 2008), 55.

¹⁰⁹Hsien Loong Lee, "Transcript of Interview with Charlie Rose," 14 April 2010, <http://www.charlieroose.com/download/transcript/10963> (accessed 20 May 2010).

¹¹⁰Asian Development Bank, *Emerging Asian Regionalism: A Partnership for Shared Prosperity* (Manila: Asian Development Bank, 2008), 27.

Humble Beginnings

Despite its demonstrable potential, economic integration in East Asia started with humble beginnings in the late 1940s, when the post-war settlement left East Asia devoid of multilateral institutions and mechanisms of cooperation. Unlike the situation in Europe, where the North Atlantic Treaty Organization and the Commission on Security and Cooperation in Europe were established and facilitated multilateral policies, a pattern of unilateralism soon prevailed in East Asia.¹¹¹ The geopolitics in East Asia after the war did not help matters either. A wave of anti-colonial nationalist movements swept and divided the region, while the Korean War in 1950 and the division between Taiwan and China in 1949 produced fault lines of mistrust and suspicion. Bruce Cumings describes it as “essentially a ‘hub-and-spokes’ system in which the capitalist countries of the region tended to communicate with each other *through the United States*.” This behavior was mirrored in the economic realm, as the East Asian political economy was primarily bilateral with the US. As a result, economic exchange with the communist countries in East Asia was virtually non-existent, and exports were mainly oriented towards the vast US consumer market.¹¹²

The problem was abated to a certain extent by foreign policy actions undertaken by the US in the 1960s and 1970s. First, the US lobbied for the normalization of Japan-South Korea relations in 1965 which led to a transfer of Japanese technology and kick-started South Korea’s industrialization journey. Second, the US established relations with

¹¹¹Bruce Cumings, “The History and Practice of Unilateralism in East Asia,” in *East Asian Multilateralism: Prospects for Regional Stability*, ed. Kent E. Calder and Francis Fukuyama (Baltimore: John Hopkins University Press, 2008), 43.

¹¹²*Ibid.*, 45-46.

China through President Nixon's visit in 1972, thereby paving the way for increasing dialogue between China and the other East Asian countries.¹¹³ Of course, the economic reforms instituted by Deng Xiaoping in 1978 (highlighted earlier in this chapter) also went a long way in correcting unilateralism in East Asia. Nevertheless, while the previously impervious security barriers have been eroded somewhat over the decades through policy actions, they continue to be an important factor when discussing East Asia's political economy and regional economic integration today.

The East Asian Model

In developing a model to describe East Asia's success, Kuznets identified competition in global markets as the key plank in East Asia's development.¹¹⁴ Leveraging on the region's abundance of relatively well-educated and low-wage labor, a labor-intensive and export-led economic strategy was initially employed. This was soon followed by a transition to a more capital-intensive approach as the economies developed internationally competitive technologies as well as attracted more foreign investments. This is not to say that all the economies within East Asia adopted this framework at the same time. In fact, Japan first started this model in the aftermath of the world war, when its access to the US market and its post-war low wages led it to develop labor-intensive exports to great success. Then, as Japan's exports shifted to more advanced products, a new wave of East Asia's industrializing economies, also known as the "Asian Tigers"--

¹¹³Ibid.

¹¹⁴P. W. Kuznets, "An East Asian Model of Economic Development: Japan, Taiwan, and South Korea," *Economic Development and Cultural Change* 36, no. 3 (1998): S11–S43.

Hong Kong, Taiwan, Singapore, and South Korea--began to fill the gap for the labor-intensive exports. This trend continued as the “Asian Tigers” likewise moved up the value chain, and handed over the reins to China.

China’s emergence as the preferred market for multinational companies in search of low-cost manufacturing bases proved unsettling for the other East Asian economies in the beginning. After all, China had accounted for 20 percent of Asian trade and 70 percent of the region’s FDI flows by the mid-1990s.¹¹⁵ Soon, however, the East Asian economies adapted and realized that China’s market provided plenty of opportunities in finished goods, raw materials, and intermediate inputs in particular. Consistent with the factor endowment theory,¹¹⁶ China amassed a significant comparative advantage in the assembly operations of machinery and electrical equipment courtesy of its endowment of low-cost labor,¹¹⁷ and consequently became the hub of production networks that involved components manufactured throughout East Asia.¹¹⁸

¹¹⁵Asian Development Bank, *Emerging Asian Regionalism*, 30.

¹¹⁶The theory, largely attributed to Eli Heckscher and Bertil Ohlin, states that international and inter-regional differences in production costs occur because of differences in the supply of production factors. In other words, commodities that require much of abundant factors of production and little of scarce factors are exported in exchange for goods that call for factors in the opposite proportions. Thus indirectly, factors in abundant supply are exported and factors in scanty supply are imported.

¹¹⁷Sarah Chan and Chun-Chien Kuo, “Trilateral Trade Relations among China, Japan and South Korea: Challenges and Prospects of Regional Economic Integration,” *East Asia* 22, no. 1 (Spring 2005): 40.

¹¹⁸Prema-Chandra Athukorala, “The Rise of China and East Asian Export Performance: Is the Crowding-out Fear Warranted?” Australia National University, Trade and Development Discussion Paper 2007/10, September 2007, <http://www.crawford.anu.edu.au/acde/publications/publish/papers/wp2007/wp-econ-2007-10.pdf> (accessed 15 July 2010), 20.

As an illustration of China's centrality in regional production networks, China sourced 43 percent of its imports of components from Japan and about 13 percent from South Korea in 2002.¹¹⁹ Therefore, it could be said that China has played an important catalytic role in driving regional economic growth as well as enhancing trade interdependency and economic integration in general in East Asia. By 2002, the amount of intra-regional trade in East Asia represented 26.5 percent of the region's GDP, more than that of any other developing region in the world.¹²⁰

The integration of East Asian economies was further aided by China's reduction of its tariff barriers. For example, China unilaterally reduced its tariff barriers with APEC members from 44.1 percent in 1991, when it joined APEC, to 15.3 percent in 2001. At the Vancouver APEC summit in 1997, China also promised to gradually reduce customs duties on industrial goods to 10 percent by 2005.¹²¹ At the global level, the global markets have been made more accessible and trade-friendly since the establishment of GATT in 1947. As a result of the substantial cuts in the barriers to manufactured imports since then, world trade has expanded 27-fold since 1950¹²²--a phenomenon which East Asia fully exploited.

¹¹⁹Francis Ng and Alexander Yeats, "Major Trends in East Asia: What Are Their Implications for Regional Cooperation and Growth," World Bank Policy Research Working Paper 3084, June 2003, http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=469372&piPK=64165421&menuPK=64166093&entityID=000094946_03071704242197 (accessed 18 September 2010), 56.

¹²⁰David Hale, "The Outlook for Economic Integration in East Asia," in *East Asian Multilateralism: Prospects for Regional Stability*, ed. Kent E. Calder and Francis Fukuyama (Baltimore: John Hopkins University Press, 2008), 59.

¹²¹*Ibid.*, 61.

¹²²Asian Development Bank, *Emerging Asian Regionalism*, 29.

The Case for Greater Regionalism

Notwithstanding the strides made since its humble beginnings, there remained potential for further economic integration through greater regional cooperation in East Asia. Whereas economic integration has up until the turn of the century been largely shaped by market forces, formal economic cooperation among Asian governments soon began to reinforce the markets as East Asia's evolving trade patterns were hard to ignore by politicians in the region.

In this regard, the East Asian Study Group was established in 2001 by the ASEAN Plus Three process to “deliver regional public goods, manage regional externalities, and help coordinate policies within the region.”¹²³ The study group's recommendations included “institutional developments--one of which, the establishment of the East Asian Summit, was implemented in 2004--as well as specific proposals on trade (specifically the formation of an East Asian FTA), investment, and financial cooperation.”¹²⁴ Separately, at the sub-regional level, China has called for “tripartite cooperation with Japan and South Korea, and has proposed the possible creation of a FTA involving the three economies at an ASEAN meeting in Phnom Penh in November 2002.”¹²⁵

¹²³ East Asia Business Council, “Final Report of the East Asian Study Group,” (Presentation at the ASEAN Plus Three Summit in Phnom Penh, Cambodia, 4 November 2002, <http://www.eastasiabc.org/userfiles/file/East%20Asia%20Study%20Group.pdf> (accessed 5 August 2010), 61-62

¹²⁴ Ibid.

¹²⁵ Chan, “Trilateral Trade Relations among China, Japan and South Korea,” 34.

David Hale offered several explanations for the concerted push towards greater regionalism in East Asia. First, the Asian financial crisis in 1997-1998 had exposed to political leaders in East Asia the perils of an overdependence on global markets. Hence, to insulate against future crises, new forms of economic cooperation within the region would be both prudent and economically beneficial. Second, the WTO Doha Round does not seem close to being concluded and the issues being contended or being held hostage, mainly in agricultural trade, are not under the control of East Asian countries. Therefore, an alternative strategy needs to be explored and pursued. Third, the use of trade diplomacy as a tool amongst the larger East Asian countries is giving rise to more trade agreements. On one hand, China is using the trade deals as a form of reassurance that their rise as an economic entity should not be seen as a threat to the others. On the other, Japan, out of concern that it is being squeezed out the play, is trying hard to enhance their economic relationships with the East Asian economies through trade deals.¹²⁶

Conclusion

This chapter has covered four main areas of literature which were deemed necessary to contextualize the subsequent analysis. First, the contending theories of realism and liberalism were reviewed, specifically in their respective treatment of the role of economic liberalism in considering regional security. Beginning with the writings of Adam Smith and Emmanuel Kant, who first espoused the pacifying effects of economic growth, and moving to those of contemporary liberal thinkers such as Richard

¹²⁶Hale, "The Outlook for Economic Integration in East Asia," 59.

Rosecrance, a theoretical foundation was laid on which the interplay between economic interdependency and regional security in East Asia can be better understood.

Second, China's grand strategy was traced to its origins using references from Avery Goldstein, Bates Gill, Michael Swaine and Ashley Tellis. In doing so, the author was able to appreciate the evolutionary nature of China's grand strategy in tandem with the changing geopolitical landscape over the past decades, and determine if contemporary circumstances warrant any shift in strategy. In particular, it was observed that much of China's behavior today can be attributed to the vision and thoughts of Deng Xiaoping, including the pursuit of economic growth as a tool to preserve domestic stability and ensure political longevity, and constructive participation in global and regional institutions. This way, China's effort to gain accession to the WTO was placed in a proper context. Third, the chapter provided an understanding of the history and mandate of the WTO as well as the journey which China took to gain accession, including the range of domestic economic reforms which were implemented as part of the accession process. Together with the quantitative projections made by World Bank researchers, these provided a point of reference when determining the consequent effect of WTO accession on trading patterns in East Asia.

Finally, a quick overview of the geopolitical landscape and the nature of the political economy in East Asia was conducted. The chapter leveraged on the work of prominent scholars of Chinese affairs, including David Kang and Robert Sutter, to encapsulate the nuances associated with China's bilateral relations with Japan, South Korea, and ASEAN. In particular, historical factors featured more prominently in relations with Japan and less so with South Korea and ASEAN; while US presence in the

region has consistently been a key factor in assessing China's relations with East Asia. As for East Asia's political economy, China has positioned itself as the hub of regional production networks and replaced Japan and the Asian Tigers as the region's main growth engine. Going forward, economic regionalism will become a key theme as governments seek to reduce its reliance on global markets and turn to regional agreements as an alternative to stalled WTO negotiations.

CHAPTER 3

RESEARCH METHODOLOGY

The central focus of this research, as highlighted in chapter 1, is to identify the pacifying effects of economic integration in the East Asian context using China's accession to the WTO as a case study. Therefore, the primary research question was framed as "How has China's accession to the WTO contributed to regional security in East Asia?" Following from this, two secondary research questions were proposed: (1) what has been the impact of China's accession to the WTO on its economic relations with East Asia, both regionally and bilaterally; and (2) to what extent has regional security in East Asia since 2001 been defined by the level of economic interdependency in the region?

To provide the necessary literary foundations, chapter 2 first delved into the theoretical underpinnings with regard to the liberal school of international relations--with specific emphasis on economic liberalism and the main criticisms levied on it. The chapter then collated the consensus view amongst experts in Chinese affairs concerning China's grand strategy, and how sustained economic development and domestic stability emerged as the cornerstone of China's policy objectives. Finally, the chapter took the reader through the journey leading up to China's accession to the WTO in 2001, as well as provided an overview of the geopolitical circumstances and political economy of East Asia.

This chapter rides on the literary foundations and sets out the methodology through which the author sought to answer the respective research questions. This methodology will then be put into action in the subsequent chapter, where the analysis

struck at the heart of whether there has been growing evidence of economic liberalism, to the extent catalyzed by China's accession to the WTO, contributing to regional security in East Asia. There are three main steps in the methodology adopted for this research: (1) analyzing the trade patterns in East Asia; (2) quantifying the other factors of economic interdependency in East Asia; and (3) evaluating the developments of the potential security flashpoints in East Asia. These steps are elaborated in turn below.

Step One: Analyze Trade Patterns

The author will first attempt to conduct an empirical analysis of the trade conducted between China and the East Asian countries since 2001, with the primary aim of establishing a causal relationship between China's accession to the WTO and the growing trade linkages within East Asia.

In the immediate period leading up to, and following, China's accession to the WTO, researchers have attempted to forecast the impact of China's accession on various factors such as domestic income, GDP growth, and global trade. The key conclusions arising from these research papers have been introduced in chapter 2. Nevertheless, there appears to be a dearth of research since then validating the forecasts made by these researchers. As it has been close to nine years since China's accession to the WTO, there is now sufficient empirical data that can be analyzed to determine the impact of China's accession on trade growth in East Asia.

A combination of primary and secondary sources will be used, including trade statistics from the International Monetary Fund, WTO, Ministry of Commerce of China, and other trade agencies in the respective East Asian countries, as well as recent studies undertaken by the ADB. Two aspects of trade developments in China and East Asia will

be compared between the ten-year period before China's accession and the period since then to 2009. First, the growth trends of China's total external trade; and second, the growth trends of bilateral trade between China and East Asian countries.

Step Two: Quantify other Factors of Economic Interdependency

While it is intuitive to assume that accession to the WTO would accrue direct trade benefits to a country, the second- and third-order effects of China's reform efforts in the lead-up to, and following, its accession to the WTO, outlined in chapter 2, should not be overlooked. For example, the enhanced freedom and protection for investors under WTO regulations as well as significant improvements in China's financial intermediaries had the effect of encouraging foreign investors to increase their capital inflow into new businesses. The liberalization of the financial markets in China has also led to greater financial integration in East Asia. In short, it is worthwhile to quantify these additional factors of economic interdependency, and compare them before and after China's accession to the WTO in 2001.

Again, a combination of primary and secondary sources will be used, including statistics from the Ministry of Commerce of China, and other investment agencies in the respective East Asian countries, as well as recent studies undertaken by regional institutions such as the ADB and ASEAN. First, the FDI inflows to China from the East Asian countries will be analyzed, together with the FDI outflows from China. Second, the analysis will cover the developments in East Asia's FTA structure to lend an additional perspective to economic interdependency in East Asia.

Step Three: Evaluate Developments of Security Flashpoints

The third step in this methodology is crucial in linking economic liberalism to regional security in East Asia. In particular, the findings from the previous two steps will be used to determine the degree of economic interdependency between China and the rest of East Asia, and whether it represents a significant factor in regional security dynamics. During the introduction to economic liberalism in chapter 2, several empirical studies were highlighted that modeled the effect of Kantian factors on promoting peace in Asia and the world in general. However, these works were generally based on an extended time period beginning in 1950 and did not take into account specific catalytic events such as China's accession to the WTO. Therefore, the approach in this research is to identify the key potential security flashpoints in East Asia, and analyze qualitatively how these flashpoints have evolved since 2001, in tandem with the economic transformation associated with China's accession to the WTO.

Three potential flashpoints will be discussed. First, this research will analyze the security situation in the Korean peninsula with particular emphasis on South Korea's growing economic relationship with China vis-à-vis the US. Second, the analysis looks at the Senkaku-Diaoyu Islands and the ongoing territorial dispute between China and Japan. Third, the unresolved dispute in the South China Sea will be analyzed, and used as a case in point for ASEAN's security relations with China.

Collectively, these three steps represent a systematic approach to address the identified research questions, by conducting a comparative quantitative analysis of the various factors of economic interdependence in East Asia followed by a qualitative analysis of three security flashpoints in East Asia since 2001.

CHAPTER 4

ANALYSIS

In order to address the two secondary research questions, this chapter begins by evaluating the economic impacts of China's accession to the WTO in 2001 on China and the East Asian region. First, China's external trade growth and bilateral trade with East Asian countries were analyzed using its accession to the WTO as a reference point. Next, other channels of economic interdependence were collated and analyzed, including the level of FDI and capital flows. Finally, the findings from the analysis of China's economic interdependence with East Asia were used to assess its concomitant impact on the security situation in East Asia--in particular, how it shaped the behavior of China's East Asian neighbors on issues pertaining to the Korean peninsula, the Senkaku-Diaoyu Islands, and the South China Sea.

Trade Implications of WTO Accession

The hypothesis that WTO membership accrues immediate trade benefits is beyond reasonable doubt. This runs along the core of the WTO's mandate, and is the key--although not the only--rationale for any country's decision to apply for membership. However, the rate of increase in China's external trade, or the degree by which WTO accession has cemented China's position as the regional economic power, is instructive for the purpose of this research. Three aspects of China's trade development were therefore analyzed across the time periods before and after China's accession to the WTO: (1) China's overall external trade; (2) China's bilateral trade with Japan and South Korea; and (3) China's trade with ASEAN as a regional bloc.

China's External Trade Skyrockets

It would be an understatement to say that China's external trade grew following its accession to the WTO in 2001. According to figure 1, it is clear that China's total external trade had skyrocketed since the turn of the century. From 1990 to 2001, China's total exports grew at an average rate of 15.3 percent, while total imports grew by 15.9 percent on average. On the other hand, total exports and imports expanded by 24.7 percent and 22.7 percent respectively on average from 2001 to 2008--astonishing figures by any measure. In less than twenty years, China's total external trade (both exports and imports) had risen from \$115.4 billion to \$2.56 trillion, which represented a more than 115-fold increase!

The anomaly shown for the year 2009, when exports and imports fell by 11.8 percent and 9.6 percent year-on-year respectively, was a direct consequence of the economic fallout due to the global financial crisis--when almost all trading nations were badly hit--and should not be attributed to the policy reforms undertaken by China to gain accession to the WTO. According to the National Bureau of Statistics of China, China's total external trade had already increased by 43.1 percent year-on-year to \$1.35 trillion in the first half of 2010--exports reached \$705 billion, up 35.2 percent and imports totaled \$650 billion, up 52.7 percent year-on-year.¹²⁷

¹²⁷National Bureau of Statistics of China, "National Economy Showed Good Momentum of Development," 15 July 2010, http://www.stats.gov.cn/was40/gjtjj_en_detail.jsp?channelid=1175&record=28 (accessed 18 August 2010).

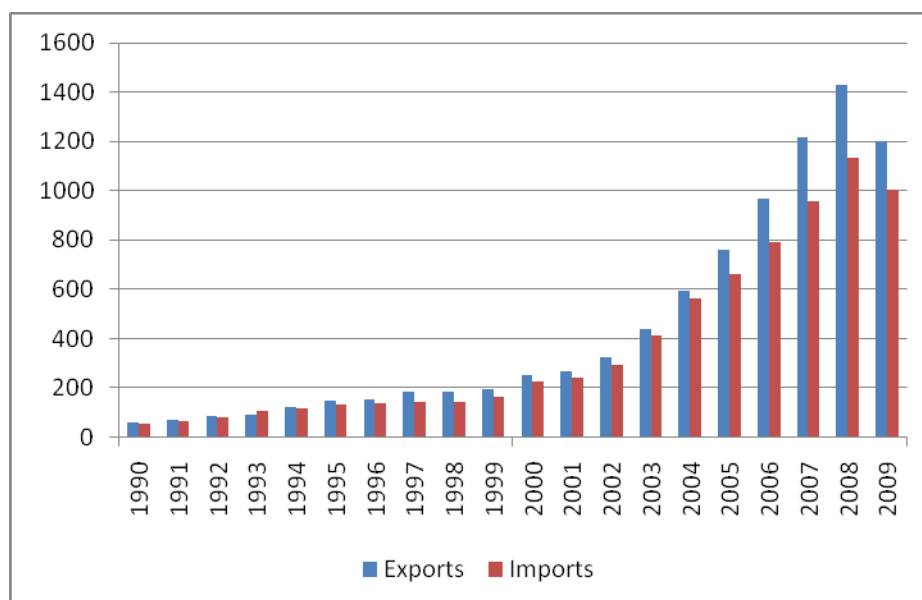


Figure 1. China's External Trade Growth, 1990 to 2009 (in \$ millions)

Source: Created by author, with data from Asian Development Bank, *Key Indicators for Asia and the Pacific 2010* (Manila: Asian Development Bank, 2010), Country Table for China.

China's Trade Dependency with East Asia Strengthens

Next, the impact of China's accession to the WTO on its trade dependency with East Asia was analyzed. Specifically, China's imports from, and exports to, Japan, Korea, and ASEAN were extracted and plotted over time to ascertain China's significance as a trading partner to these countries and region.

First, figure 2 illustrates the bilateral trade between China and South Korea from 1990 to 2008. Mirroring the overall trend of China's external trade during the same period, China's trade with South Korea increased significantly after 2001. From 1994 to 2001, South Korea's exports to China grew at an average of 21.3 percent, while its imports from China expanded by 21.8 percent on average. Contrast this with the period 2001 to 2008, when the exports and imports grew by 23.1 percent and 25.5 percent

respectively on average, and it is demonstrable how rapidly trade dependence between China and South Korea has grown since China's accession to the WTO. Since 2001, China's total trade with South Korea has multiplied by more than five times--from \$31.5 billion to \$168.3 billion. More importantly, China has catapulted past the US and Japan to become South Korea's top exports and imports partner, from being the second and third respectively in 2001. Exports to, and imports from, China now constitutes 21.4 percent and 17.7 percent of South Korea's total exports and imports respectively, compared to 10.9 percent and 8.9 percent for the US, and 6.6 percent and 14.0 percent for Japan. Translated to economic power, it can therefore be said that China now holds considerable leverage over South Korea compared to either the US or Japan.

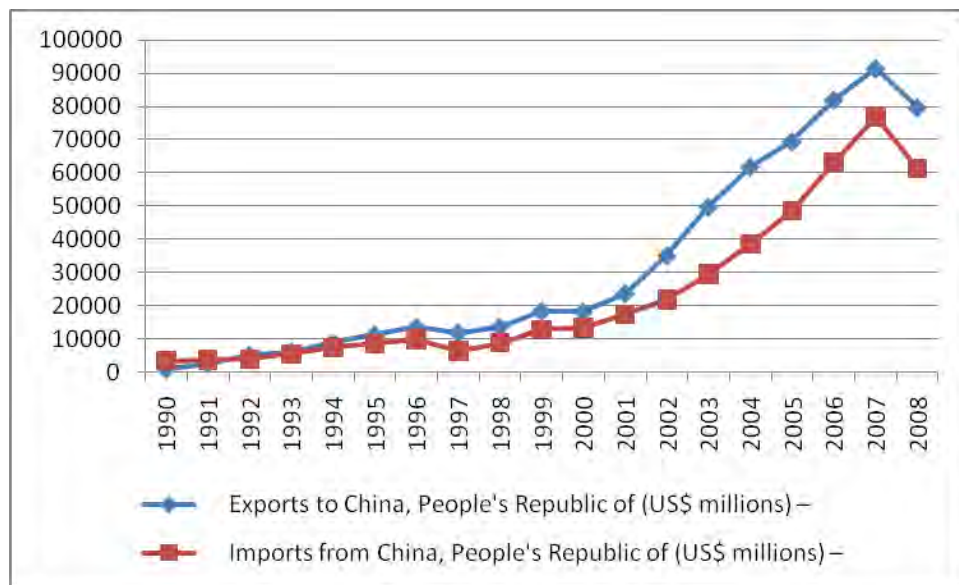


Figure 2. South Korea's External Trade with China, 1990 to 2008 (in \$ millions)
Source: Created by author, with data from Asian Development Bank, *Key Indicators for Asia and the Pacific 2010* (Manila: Asian Development Bank, 2010), Country Table for South Korea.

Second, it was found that bilateral trade between China and Japan likewise grew at an impressive rate since 2001, particularly in terms of Japan's exports to China. Figure 3 illustrates the bilateral trade between China and Japan from 1990 to 2008. Despite starting at a higher base compared to China's trade with South Korea, Japan's exports to China grew at an average of 9.0 percent from 1994 to 2001, and expanded at a considerably higher rate of 20.0 percent from 2001 to 2008. Japan's import figures from China were less conclusive, growing at an average rate of 16.1 percent from 1994 to 2001 and 12.9 percent from 2001 to 2008. This has helped to reduce Japan's trade deficit with China to 7.0 percent of total trade between China and Japan in 2008, compared to a deficit of 30.2 percent in 2001. China has also surpassed the US as Japan's top export destination, contributing to 18.9 percent of Japan's total exports in 2009 as compared to 7.7 percent in 2001.

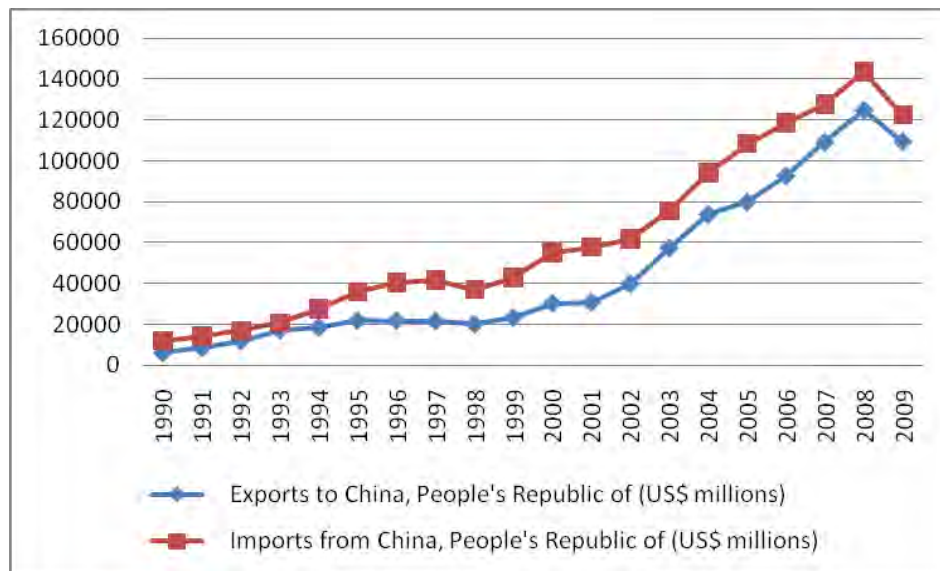


Figure 3. Japan's External Trade with China, 1990 to 2008 (in \$ millions)
Source: Created by author, with data from Asian Development Bank, *Key Indicators for Asia and the Pacific 2010* (Manila: Asian Development Bank, 2010), Country Table for Japan.

The phenomena aforementioned was alluded to by Kuroiwa and Ozeki, who, in their study of intra-regional trade between China, Japan, and Korea, observed that following its accession to the WTO, China became a leading assembly base and hence began to import large quantities of intermediate goods from Japan and Korea. According to their research, China's imports of intermediate goods from Korea increased from \$9.2 billion to \$63.1 billion while those from Japan increased from \$14.3 billion to \$73.4 billion.¹²⁸ In terms of consumption goods, the situation differed somewhat. With the exception of Japan's import of consumption goods from China, which stood at \$38.7 billion in 2007, intra-regional trade in such goods were low in comparison with intermediate goods.

Third, the analysis turned to China's external trade with ASEAN as a regional trading bloc. Figure 4 depicts ASEAN's external trade with China during the period 1995 to 2008. It was found that ASEAN's exports to China grew at an average annual rate of 16.3 percent from 1995 to 2001, and the growth rate almost doubled to 29.4 percent annually since China's accession to the WTO. The numbers for ASEAN's imports from China were equally startling, growing at an annual rate of 18.6 percent from 1995 to 2001, and then 30.2 percent from 2001 to 2008. Therefore, the impact of China's accession to the WTO appears to be significantly larger on China's trade dependency with ASEAN, as compared to Japan and South Korea. However, unlike the cases for

¹²⁸Ikuro Kuroiwa and Hiromichi Ozeki, "Intra-regional Trade between China, Japan, and Korea: Before and After the Financial Crisis," IDE Discussion Paper no. 237, May 2010, <http://www.ide.go.jp/English/Publish/Download/Dp/237.html> (accessed 1 August 2010), 4.

Japan and South Korea, ASEAN's trade deficit with China has been widening and reached \$21.4 billion in 2008.

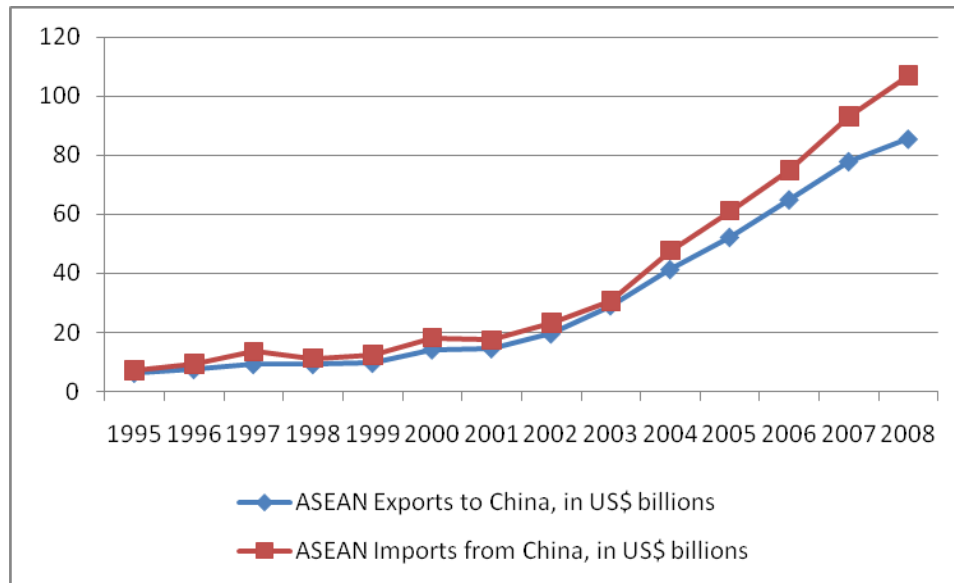


Figure 4. ASEAN's External Trade with China, 1995 to 2008 (in \$ billions)
Source: Created by author, with data from ASEAN Secretariat, *ASEAN Statistical Yearbook 2008* (Jakarta: ASEAN Secretariat, July 2009), 82-85.

China's position as ASEAN's key trading partner becomes more apparent when observed relative to the trade relations that ASEAN have with other important developed economies. Figure 5 illustrates how ASEAN's trade "pie" was split amongst its trading partners in the world, as well as how the "cutting pattern" has evolved from 1993 to 2008. Several trends are apparent. First, China's share of ASEAN trade increased substantially by 9.2 percent from 1993 to 2008. Second, US and Japan trade with ASEAN have been gradually reducing in relative terms since 1993. Specifically, US share of ASEAN trade went from 17.6 percent in 1993 to 10.6 percent in 2008, while

Japan's share also reduced from 20.2 percent to 12.4 percent. If this trend persists, China will soon become ASEAN's top trading partner in East Asia.

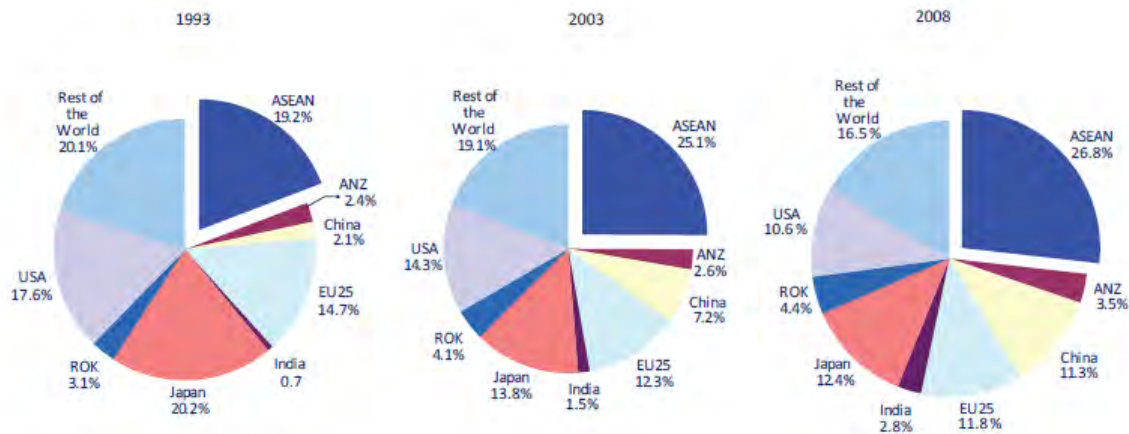


Figure 5. Share of ASEAN Trade with Selected Trade Partner Countries and Regions
Source: ASEAN Secretariat, *ASEAN Economic Community Chartbook 2009* (Jakarta: ASEAN Secretariat, September 2009), 22.

At the regional level, China's burgeoning trade growth has also contributed towards East Asia's growing regionalism. According to a recent ADB report, *Emerging Asian Regionalism*, the share of Asia's total trade conducted with it has risen from around a third in the 1980s to more than half in recent years. In fact, "Asia now trades more with itself than either the European Union or North America did at the outset of their integration efforts."¹²⁹ This is mainly due to the region's relatively high growth and its network-based production systems highlighted in chapter 2. Figure 6, which compares the percentage distribution of merchandise imports in the Asia and Pacific region in 1995 and 2009, depicts China as the top importer in the region, having overtaken Japan in

¹²⁹Asian Development Bank, *Emerging Asian Regionalism*, 40.

2003. China's command of overall merchandised imports in the Asia and Pacific rose from 7.1 percent in 1990, to 15.6 percent in 2001, and 27.2 percent in 2009. In a separate study by the International Monetary Fund, China's trade with the region accounted for half of trade within Asia, up from 29 percent in 1996.¹³⁰ China has therefore become a major driver of regional integration, contributing to both overall trade growth as well as growing intra-regional trade within the region.

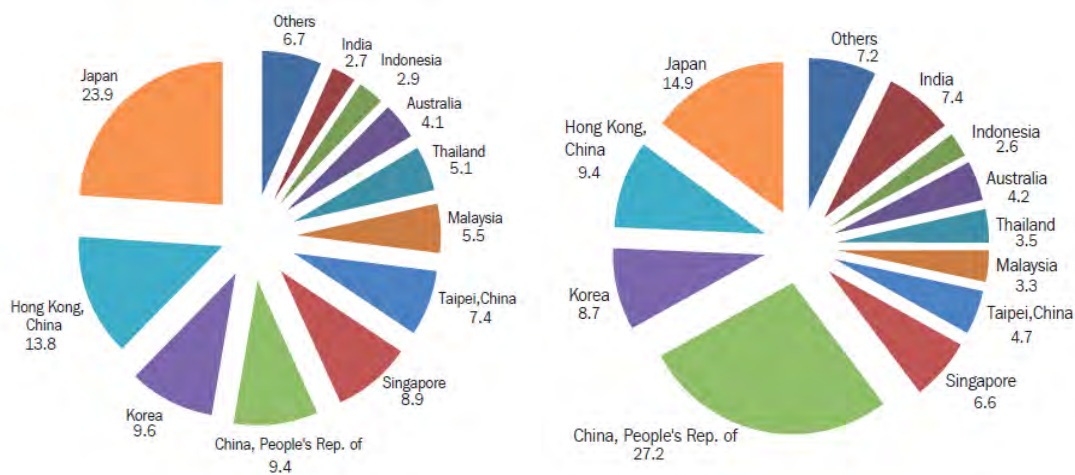


Figure 6. Percentage Distribution of Merchandise Imports in the Asia and Pacific Region, 1995 and 2009

Source: Asian Development Bank, *Key Indicators for Asia and Pacific 2010* (Manila: Asian Development Bank, 2010), 204.

The analysis of the impact of China's accession to the WTO on its trade developments throws up three observations. First, China has clearly reaped the intended economic benefits of joining the WTO through its impact on China's external trade. It

¹³⁰Ibid., 47.

followed its already impressive trade growth prior to WTO accession--which itself could be attributable to China's bid to join the WTO since significant market liberalization efforts needed to be completed prior to accession--with a phenomenal annual growth rate after 2001, thereby propelling China to become the world's largest exporter and second largest importer by 2009.¹³¹ While it is not accurate, nor is it the purpose of this research, to credit China's trade growth entirely to its accession to WTO, there is little doubt that the economic opportunities which opened up to China following its accession, together with the economic reforms made leading up to, and after, accession, have had a marked impact on China's external trade growth.

Second, China's trade linkages with its East Asian neighbors have strengthened, albeit in different ways. Beginning with modest trade relations in 1990, China is now South Korea's top export and import destination. In fact, South Korea is running a trade surplus with China--the only country to do so amongst the countries and region discussed in this research. Japan, on the other hand, has witnessed considerable export growth to China since 2001, resulting in the reduction of its trade deficit with China and the elevation of China as Japan's top export destination. The largest impact fell on trade relations with ASEAN--the annual growth rate of China's trade with ASEAN has almost doubled since China's accession to the WTO. However, ASEAN's trade deficit with China has also been steadily increasing.

Third, and based on the cumulative effects of the observations above, China has consolidated its position as East Asia's leading trading nation. China's comparative

¹³¹World Trade Organization, "Country Profile--China," <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN> (accessed 10 October 2010).

advantages in labor costs and availability of foreign investments have positioned it as an integral node of the regional production network and catalyzed intra-regional trade. This means that apart from extending its economic reach bilaterally, China is able to impact regional trade developments and therefore holds considerable influence in setting the pace and form of regionalism in East Asia.

Other Measures of Economic Interdependency

While intra-regional trade undoubtedly constitutes a key plank of economic interdependency between China and East Asia, it would be remiss not to consider other measures of interdependency. According to Chan, an analysis of economic interdependence needs to include other important channels such as direct investment, financial flows, macroeconomic links, and personal contacts.¹³² In an analysis conducted to assess the economic interdependency in Asia before and after the Asian financial crisis in 1998 (see figure 6), the ADB employed Chan's definition and found that there has been increased economic interdependency in all aspects analyzed since the crisis, with the largest impact on macroeconomic links and the smallest for tourism.

¹³²Beng Huat Chua, "Conceptualizing an East Asian Popular Culture," *Inter-Asia Cultural Studies* 5, no. 2 (August 2004): 5.

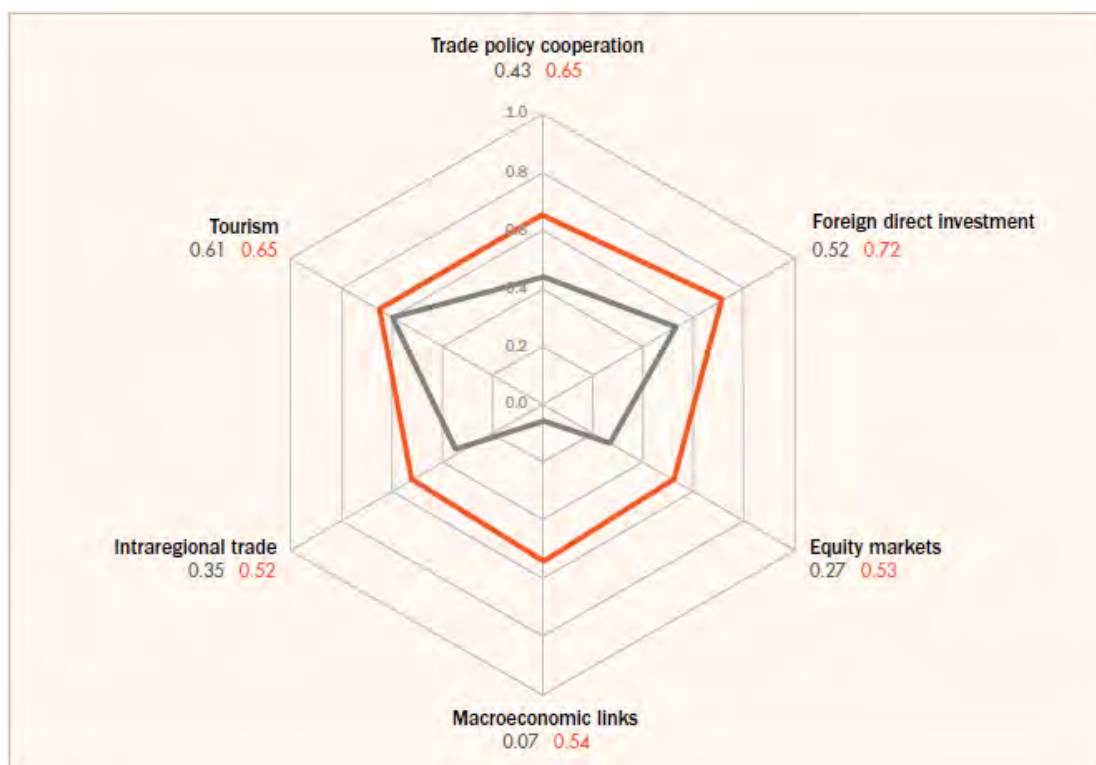


Figure 7. Indicators of Economic Interdependency in Asia (Pre- and Post-Crisis)
Source: Asian Development Bank, *Emerging Asian Regionalism: A Partnership for Shared Prosperity* (Manila: Asian Development Bank, 2008), 43. Note: Trade policy cooperation is measured by the density of free trade agreements among integrating Asian economies. FDI is measured by the intra-regional FDI share among integrating Asian economies. Equity markets are measured by the correlation of detrended quarterly equity price changes for integrating Asian economies. Macroeconomic links are measured by the correlation of detrended quarterly growth rates of gross domestic product for integrating Asian economies. Intra-regional trade is measured by intra-regional trade share. Tourism is measured by the share of intra-regional tourist inflows and outflows.

How much of this interdependence is dominated by China? Here, it is intuitive for the reader to question the impact of China's accession to the WTO on economic factors other than trade. After all, as the title of the institution, as well as its mandate, suggests, the WTO strives towards a world of barrier-free trade and arbitrates against members who flout the rules--but probably not much else. Yet, as China realized during its fifteen years-long journey towards accession, the domestic reforms imposed by the WTO were

not contained to merely trade tariffs, but actually spanned several other areas of the Chinese economy, including the uniformity of rules that allow the establishment of foreign companies in China and the liberalization of the financial system.

Foreign Direct Investment

The FDI inflows to China are a fairly recent phenomenon. In the 1980s, FDI inflows were limited to only joint venture partnerships with Chinese firms which were essentially export-oriented. After 1990, the investment climate changed gradually and steadily, as China allowed wholly foreign-owned enterprises to manufacture and sell a wide range of goods in the Chinese domestic market or export them to the international market. Despite China's pro-investment policies, FDI inflows to China leading up to the turn of the century were not particularly eye-catching, due in part to the Asian financial crisis which precipitated a general downturn in investment appetite in the region.

Again, China's accession to the WTO proved pivotal in fuelling foreign investments in China. This observation was put forward by Yu, who opined that "no sooner than China and its counterparts finally sealed the deals for China's entry into the WTO, the momentum of FDI inflows restored with a vengeance."¹³³ Figure 8 illustrates the growth of FDI inflows to China from 1990 to 2000--from 1990 to 2000, FDI inflows increased gradually and then plateaued following the Asian financial crisis; from 2001 onwards, China experienced a surge in FDI inflows which grew at an average annual rate of 13.4 percent.

¹³³Yongding Yu, "FDI in China," <http://www.joho-fukuoka.or.jp/kigyo/asif-fko/third/YongdingYu.pdf> (accessed 23 July 2010).

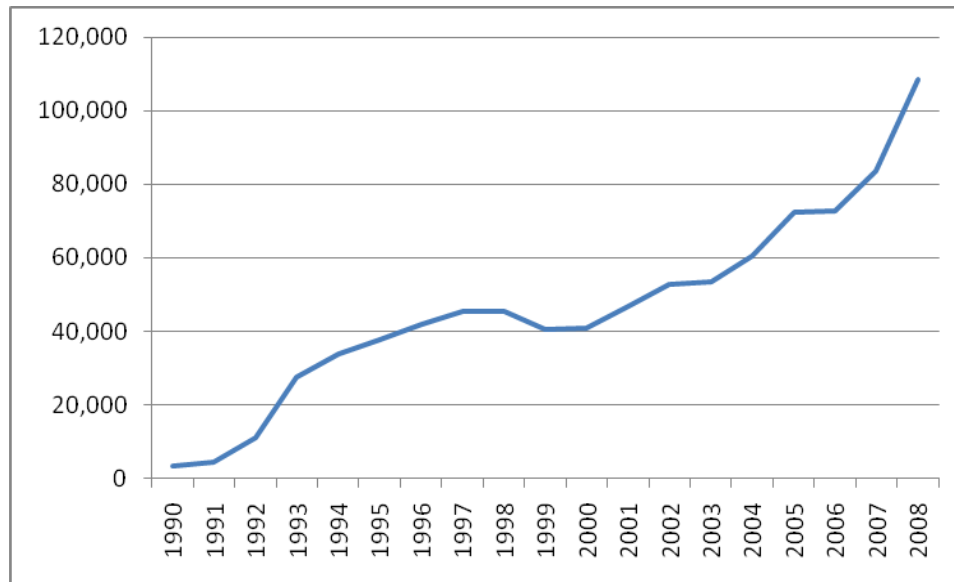


Figure 8. Annual Inward FDI Flows to China: 1990 to 2008 (in \$ millions)
Source: Created by author, with data from United Nations Conference on Trade and Development, UNCTADStats, <http://unctadstat.unctad.org/TableViewer/tableView.aspx> (accessed 20 November 2010).

An analysis of the sources of these FDI inflows revealed a regional bias in favor of East Asia. According to the US-China Business Council, all but one of the top six countries of origin of FDI inflows in 2009 were from the East Asian region: Hong Kong (1st), Taiwan (2nd), Japan (3rd), Singapore (4th), and South Korea (6th). Only the US (5th) was external to the region. In the case of Japan, FDI in China by Japanese manufacturers increased by 68 percent over five years to 3.74 trillion yen in 2009.¹³⁴ Evidently, the rise in FDI inflows to China from its East Asian neighbors has created further economic interdependence. From China's perspective, FDI inflows often equate to job creation, technology transfers, and a buildup of management expertise; while

¹³⁴Tony D'Altorio, "Japan and China Sitting in a Tree," Investment U Research, 26 August 2010, <http://www.investmentu.com/2010/August/japan-and-china-sitting-in-a-tree.html> (accessed 29 September 2010).

benefits accrued to the source countries in East Asia come in the form of corporate taxes (depending on the availability of an avoidance of double taxation agreement between China and the source country and the terms contained within) and profits for the shareholders, both public and private.

Notwithstanding the impact of the rise in FDI inflows to China, a growing and noteworthy trend is the investment flow coming from China to the rest of the world. China's outward investment in non-financial sectors in 2009 was \$43.3 billion, compared to an average of \$2.4 billion per year between 1990 and 2000.¹³⁵ Figure 9 illustrates the upward trajectory of China's outward FDI flow from 2002 onwards.

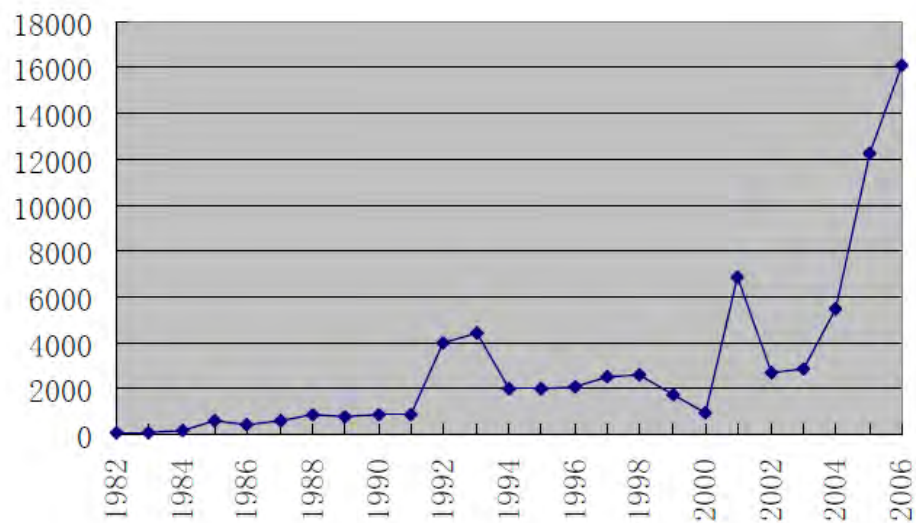


Figure 9. China's Outward FDI Flow: 1982 to 2006 (in \$ millions)

Source: Leonard K. Cheng and Zihui Ma, "China's Outward FDI: Past and Future," July 2007, 33, http://www.nber.org/books_in_progress/china07/cwt07/cheng.pdf (accessed 20 September 2010).

¹³⁵Michael J. Enright, W. John Hoffman, and Peter Wood, "Get Ready, Here China Inc. Comes," *Wall Street Journal*, 24 February 2010, <http://online.wsj.com/article/SB10001424052748704140104575056641551276982.html> (accessed 30 September 2010).

The linkage between China's FDI outflows and its accession to the WTO is less direct, but certainly it can be said to be a second order effect due to the successes of China's export-led economic strategy, which has been underpinned by its status as a WTO member. For one, the lowering poverty rates and the rising affluence of the Chinese middle class, together with the growth of industries led by the FDI inflows, have brought about a huge appetite for energy resources. Increasingly, Chinese companies have had to look abroad for supplies of raw materials such as oil and natural gas to augment its domestic energy sources. For example, China invested more than \$8 billion in gas, oil, and hydropower ventures in Myanmar from January to August 2010, which represents about two-thirds of the total of the previous two decades combined.¹³⁶

Another factor, also related to the increase in personal incomes, was the rise in labor costs, particularly in the coastal regions of China. While this has led to a trend whereby Chinese companies are exploring opportunities further inland, a significant number have been exploring alternatives to move their production operations to nearby countries so as to take advantage of lower costs and enhance their competitiveness. Lastly, China, through its export-led strategy, accumulated a vast amount of foreign reserves that could be channeled for overseas investment purposes. For these reasons, China began to encourage its national firms to "go global" in 2003, and the government

¹³⁶The Economist, "China's Relations with Myanmar: Welcome, Neighbor," *The Economist*, 9 September 2010, http://www.economist.com/node/16996935?story_id=16996935 (accessed 20 October 2010).

“not only relaxed the approval process of outward FDI, but also provided incentives for FDI in target industries.”¹³⁷

Coinciding with its accession to the WTO, China has witnessed an average annual growth in outbound investments of more than 50 percent for eight consecutive years since 2002. According to the Ministry of Commerce of China, “China is now the fifth largest investing nation worldwide, and the largest among the developing countries.”¹³⁸ Although much media attention has been devoted to China’s investments in Africa as part of its “charm offensive,” 74.1 percent of the outbound investments in 2009 were actually channeled to Asia.¹³⁹

Specifically, ASEAN has experienced a steady rise in Chinese investments since 1995, as shown in figure 9, even though China still lags far behind ASEAN’s main investors such as the European Union and Japan. Figure 10 shows that while FDI flows were almost unidirectional towards China in 2000, Chinese reciprocity since then has resulted in China’s FDI to ASEAN amounting to more than half of ASEAN’s FDI to China. This trend looks set to continue especially following the signing of the China-ASEAN Investment Agreement in August 2009 which, together with already-signed

¹³⁷Leonard K. Cheng and Zihui Ma, “China’s Outward FDI: Past and Future,” July 2007, 6, http://www.nber.org/books_in_progress/china07/cwt07/cheng.pdf (accessed 20 September 2010).

¹³⁸Besta Shankar, “China stands fifth in outbound investments globally,” *International Business Times*, 6 September 2010, <http://www.ibtimes.com/articles/59772/20100906/fdi-odi-protectionism-asean-emerging-markets.htm> (accessed 30 September 2010).

¹³⁹Reuters, “China inbound and outbound investment still on rise,” *Reuters*, 6 September 2010, <http://in.reuters.com/article/idINIndia-51302420100906> (accessed 30 September 2010).

agreements on trade in goods and services, completed the negotiation process of the ACFTA.¹⁴⁰

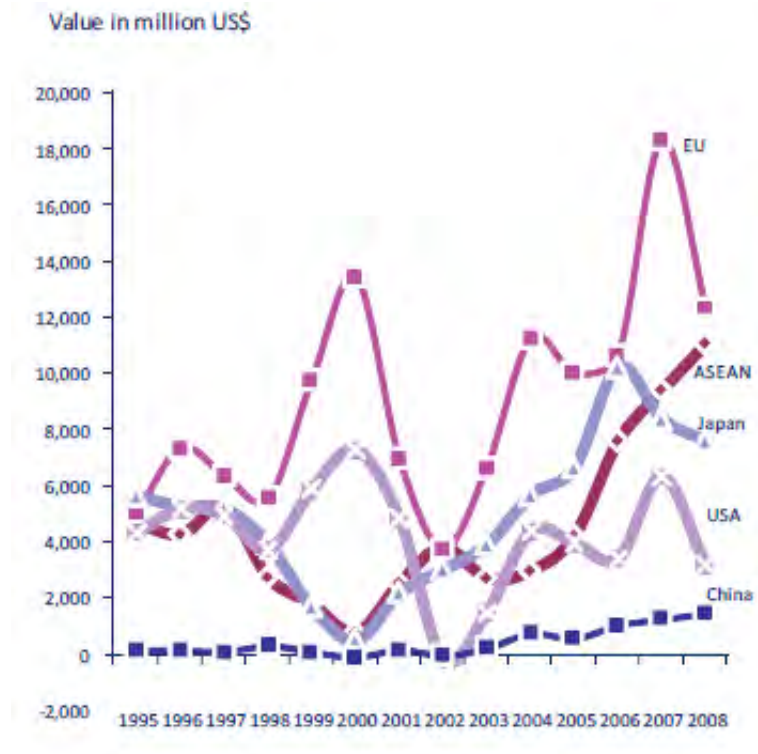


Figure 10. FDI Net Inflows to ASEAN by Source Country (in \$ millions)
Source: ASEAN Secretariat, *ASEAN Economic Community Chartbook 2009* (Jakarta: ASEAN Secretariat, September 2009), 43.

¹⁴⁰Chris, “China-ASEAN Investment Agreement Signed,” *Xinhua News*, 15 August 2009, http://news.xinhuanet.com/english/2009-08/15/content_11885891.htm (accessed 30 September 2010).

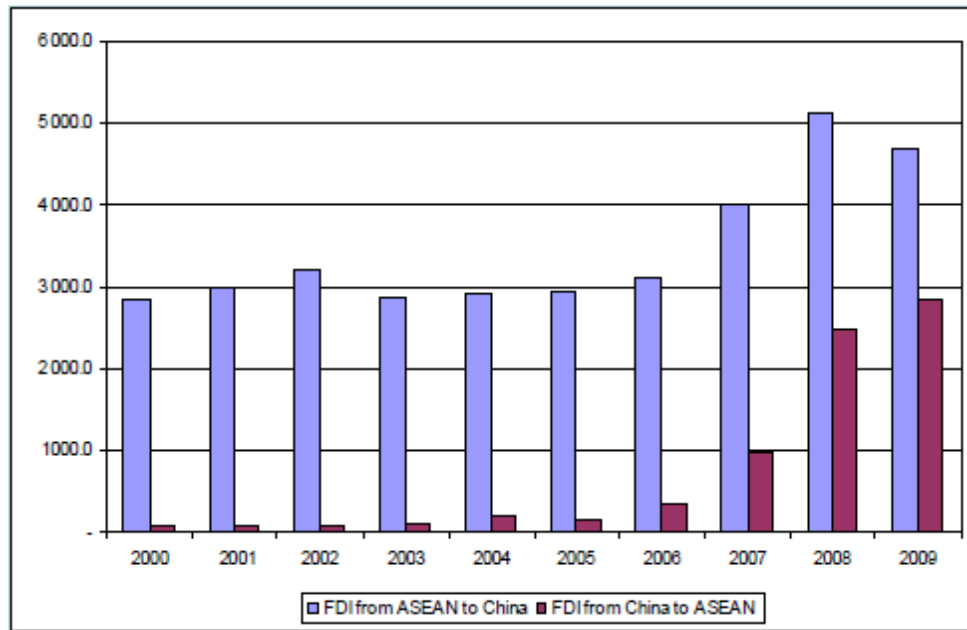


Figure 11. FDI Flows between ASEAN and China, 2000 to 2009 (in \$ millions)
Source: United Nations Conference on Trade and Development, *World Investment Report 2010: Investing in a Low-Carbon Economy* (New York: United Nations Publication, 2010), 42.

In relative terms, the FDI landscape has shifted--while the United States played a leading role in the 1960s and 1970s, followed by Japan in the 1980s, their share of investments in ASEAN has been declining since the early 1990s.¹⁴¹ Peering into the future, Fan Chunyong, executive vice president of China Industrial Overseas Development and Planning Association, said that China's outbound investments will go up to \$100 billion and the accumulative capital stock overseas will reach \$500 billion by 2013.¹⁴² Policy makers of the developing countries in ASEAN will no doubt pay serious

¹⁴¹United Nations Conference on Trade and Development, *World Investment Report 2010: Investing in a Low-Carbon Economy* (New York: United Nations Publication, 2010), 40-42.

¹⁴²Ministry of Commerce, China, "China's Direct Investment Abroad Expected to Breakthrough USD100b by 2013," 3 September 2010, <http://english.mofcom.gov.cn/>

attention to this prediction, as China increasingly represents a much needed source of capital investments.

Free Trade Agreements

In the area of trade policy cooperation, China's admission to the WTO in December 2001 provided an impetus to the negotiation and formalization of bilateral and regional FTAs. From China's perspective, the successful quest for WTO membership freed up valuable bureaucratic resources to begin its pursuit of regionalism with selected countries. China's WTO membership also meant that countries or regions embarking on FTA negotiations with China have a common understanding with regard to the credibility of the reform efforts undertaken by China and the adherence to WTO standards going forward. As a result, China has 10 FTAs in effect and another 12 proposed or under negotiation as of May 2010.¹⁴³

From the viewpoint of China's East Asian neighbors, establishing FTAs appears to be a competitive response to China's emergence as the region's economic powerhouse. Joining the WTO has forced China to enact many rules-based policies, open its markets, and create new opportunities for FDI and trade--thereby making China an even more effective exporter. Hence, the fear of increased competition from China has made some WTO members reluctant to over-liberalize and encouraged them to seek more limited

article/newsrelease/commonnews/201009/20100907117824.html (accessed 30 September 2010).

¹⁴³Masahiro Kawai and Ganeshan Wignaraja, "Free Trade Agreements in East Asia: A Way Toward Trade Liberalization?" ADB Briefs no. 1, June 2010, www.adb.org/documents/.../ADB-Briefs-2010-1-Free-Trade-Agreements.pdf (accessed 15 July 2010), 3.

agreements in the form of FTAs instead.¹⁴⁴ In 2000, only three FTAs were in effect in East Asia, including the ASEAN FTA, while several others were still under different stages of negotiation. Since then, in a study by the ADB, it was found that “East Asia had emerged at the forefront of global FTA activity, with 45 FTAs in effect and another 84 in various stages of preparation.”¹⁴⁵

Yet, despite the plethora of agreements, many of them were signed with partners outside East Asia, underlining the region’s commitment to open regionalism. In the case of China, only two of its agreements in effect were with countries or regions in East Asia—that with Singapore and ASEAN.¹⁴⁶ The ACFTA was proposed by then-Premier Zhu Rongji at the ASEAN-China Summit in November 2000 and afforded China a first-mover advantage in cementing political-economic ties with ASEAN. Taking many by surprise at that time, China’s maneuver was ostensibly for the reasons of reassuring ASEAN states nervous about the economic consequences of China’s accession to the WTO and the potential consequences for the regional balance of power due to China’s ascendance. Certainly, the opportunity to score political points against Japan cannot be ruled out as part of Beijing’s calculations.¹⁴⁷

¹⁴⁴Asian Development Bank, *Emerging Asian Regionalism*, 86.

¹⁴⁵Kawai, “Free Trade Agreements in East Asia,” 2-3.

¹⁴⁶Ministry of Commerce, China, “China FTA Network,” http://fta.mofcom.gov.cn/english/fta_qianshu.shtml (accessed 1 October 2010). China has agreements with Hong Kong and Macau, but these are discounted in this analysis as Hong Kong and Macau are sovereign to China. The other agreements in effect are those signed with Pakistan, Chile, New Zealand, Peru, and Costa Rica.

¹⁴⁷John Ravenhill, “The New Trade Bilateralism in East Asia,” in *East Asian Multilateralism: Prospects for Regional Stability*, ed. Kent E. Calder and Francis Fukuyama (Baltimore: John Hopkins University Press, 2008), 96.

The ACFTA has developed rapidly since then. Following the signing of the formal agreement in Phnom Penh in November 2002, where officials agreed to establish the FTA for trade in goods for the original six ASEAN countries¹⁴⁸ by 2010 and by 2015 for the newer ASEAN members, China made significant provisions such as the early reduction in tariffs on certain agricultural imports and food items as part of an “early harvest.” This ran in stark contrast with Japan’s reluctance to open its agricultural markets to ASEAN exporters around the same time.¹⁴⁹ The Agreement on Trade in Goods was signed in November 2004, while the Agreement on Trade in Services was signed in January 2007. After the Agreement on Investment was signed in August 2009, the ACFTA finally came into force on 1 January 2010.

Strategic considerations aside, an ASEAN group of experts concluded that the ACFTA when fully implemented would increase ASEAN exports to China by 48 percent and China’s exports to ASEAN by 55 percent; and it would increase ASEAN’s GDP by 0.9 percent and China’s by 0.3 percent.¹⁵⁰ This corroborates with the trend observed in the earlier section that analyzed ASEAN-China trade developments. Even without the introduction of the ACFTA, ASEAN’s trade with China had been growing at an annual rate of close to 30 percent since 2000. Already, the Chinese authorities have been heralding the positive effect of the ACFTA on trade relations with ASEAN. For example, it was reported that “under the background of the full launching of the ACFTA” the

¹⁴⁸Thailand, Singapore, Malaysia, Indonesia, Brunei, and Philippines.

¹⁴⁹Sutter, *China’s Rise in Asia*, 182-183.

¹⁵⁰John Wong and Sarah Chan, “China-ASEAN Free Trade Agreement–Shaping Future Economic Relations,” *Asian Survey* 43, no. 3 (May 2003): 508.

bilateral trade between Guangxi and ASEAN from January to April 2010 amounted to \$1.75 billion, up 55.2 percent from the same period in 2009 and exceeding the levels of the same period before the financial crisis.¹⁵¹

In contrast, trade agreements, bilateral or otherwise, with Japan and South Korea remain a remote possibility for China due to a confluence of political and historical factors. In a study on China's FTAs, Yang Jiang observed that China "is suspicious of the plausibility of a Northeast Asia FTA or East Asia FTA, even though it proposed the former to show goodwill to its neighbors," and that this stems from "Japan's problem on historical issues, as well as its protective stance in trade."¹⁵² The prospects of a China-Japan FTA are even more unlikely and remain almost a taboo subject, with the shadows of China's historical memories of World War II and unresolved territorial disputes over the maritime areas in the East China Sea still looming. This impasse is regrettable as the economic benefits of a union are clearly immense. China continues to impose high tariffs on important Japanese exports, such as automobiles, while there is scope for higher levels of investment by Japanese firms in China.¹⁵³ Notwithstanding these obstacles, South Korea has attempted to breathe life into a possible trilateral agreement between China, Japan, and South Korea. In February 2010, South Korea announced the launch of a joint

¹⁵¹Ministry of Commerce, China, "FTA Helps Trade between Guangxi and ASEAN in the First 4 Months Hit a New Record High over the Same Period," 19 May 2010, http://fta.mofcom.gov.cn/enarticle/enasean/chianaseannews/201006/2803_1.html (accessed 1 October 2010).

¹⁵²Jiang Yang, "China's Free Trade Agreements and Implications for the WTO," (Presentation at the ISA 49th Annual Convention: Bridging Multiple Divides, 26 March 2008), www.allacademic.com/meta/p250869_index.html (accessed 2 October 2010), 12.

¹⁵³Hale, "The Outlook for Economic Integration in East Asia," 65.

research group to study the feasibility of a FTA among China, Japan, and South Korea.¹⁵⁴ Although this is a notable development, and no doubt a diplomatic coup for South Korea, it remains doubtful if there will be a breakthrough in the near to medium term.

Under these circumstances, the only hope of trade policy cooperation in Northeast Asia lies in a possible agreement between China and South Korea. An “unofficial” feasibility study on a China-South Korea FTA was launched by Chinese President Hu Jintao and former South Korean President Roh Moo-Hyun in November 2004. The study, which was completed in 2006, was then “upgraded” in November 2006 to a study to be conducted jointly by the government, business and academia. After holding five joint research meetings, an announcement was made during Chinese Premier Wen Jiabao’s visit to South Korea in May 2010 to wrap up the study.¹⁵⁵ At the moment, the path appears to be clear for detailed bilateral negotiations to take place. Although not a foregone conclusion, China’s political commitment towards a FTA with South Korea will place it in good stead, politically and economically, especially when viewed alongside the stalling Korea-US FTA.

In addition to the levels of trade dependency covered earlier, this analysis has revealed that China has become more economically interdependent with its regional neighbors since 2001 via at least two proxies: the amount of FDI flows exchanged between China and East Asia, as well as the FTAs formalized and under negotiation in

¹⁵⁴Xianzhi Li, “China, S Korea, Japan to Launch Joint Study on Trilateral Free Trade Deal,” *Xinhua News*, 17 February 2010, http://news.xinhuanet.com/english2010/business/2010-02/17/c_13177870.htm (accessed 2 October 2010).

¹⁵⁵Ministry of Commerce, China, “China and ROK Wrapped Up Government-Industry-University Joint Study in FTA,” 4 June 2010, http://fta.mofcom.gov.cn/enarticle/enkorea/enkoreanews/201006/2805_1.html (accessed 3 October 2010).

the region. These phenomena are not independent of the China's dominant position as a regional trading power. The opening up of global markets afforded by WTO membership was a natural draw for multinational corporations searching for investment options, while China's strong trade relations with East Asia served as the impetus for regional authorities to address trade inefficiencies and reap mutual economic benefits through FTAs. Therefore, to the extent that China's WTO accession has directly contributed to the trading patterns in East Asia, it can likewise be said that the impulse it provided has transmitted into a more holistic form of economic interdependency in the region.

East Asia Since 2001: A Safer Place or Not?

This section of the analysis looks at the security developments in East Asia over the same period following China's accession to the WTO in 2001. Specifically, three potential security flashpoints along China's periphery were analyzed--the Korean peninsula, the Senkaku-Diaoyu Islands in the East Asia Sea, and the Spratly-Paracel Islands in the South China Sea. In each case, the analysis tracked the unfolding of key events which occurred and observed the actions taken by the Chinese authorities, either unilaterally or in concert with its regional neighbors and institutions. The intent is to investigate the relation between China's quest for uninterrupted economic growth, together with its strong economic linkages with Japan, South Korea, and ASEAN, and the overall security environment in East Asia.

Korean Peninsula: China as the Guarantor of Peace

At the turn of the century, North Korea appeared to have been contained through the actions taken by the Clinton administration. The direct dealings between Washington

and Pyongyang had led to an agreement where North Korea committed to building two nuclear reactors for energy purposes in return for oil and food aid to the regime. Even though Kim Jong Il's oppressive regime was still an eyesore to US authorities, the prevalent view was that regional stability had at least been attained. East Asia had one less thing to worry about, it seemed.

However, after the 11 September attacks and the Bush administration's focus on the global war on terror, North Korea sensed a strategic opening to achieve its unfulfilled objectives. In the summer of 2002, US intelligence uncovered evidence that North Korea was procuring equipment that demonstrated an intention to create a covert nuclear program based on uranium enrichment. This threatened to unravel the Agreed Framework which Washington and Pyongyang had agreed to in October 1994 to prevent North Korea from developing nuclear weapons. According to Glaser and Wang, the US judged that it had limited leverage to compel North Korea to abandon its nuclear programs, and therefore opted for a new multilateral strategy that "would enable regional actors with a stake in realizing a denuclearized Korean peninsula to pool their sticks and carrots."¹⁵⁶ However, China was not sold on this idea for fear of being seen as rallying behind the US against its longstanding ally. It would take further provocations by North Korea before China would change its position.

In early 2003, North Korea's reactivation of its nuclear reactor in Yongbyon and its withdrawal from the Non-Proliferation Treaty led China to the conclusion that it had

¹⁵⁶Bonnie S. Glaser and Liang Wang, "The North Korea Nuclear Crisis and U.S.-China Cooperation," in *China and the United States: Cooperation and Competition in Northeast Asia*, ed. Suisheng Zhao (New York: Palgrave Macmillan, 2008), 147.

to intervene.¹⁵⁷ There were two main considerations in China's strategic calculations. First, an attack by the US may trigger anarchy in North Korea and result in a flood of refugees flowing into northeast China, thus placing in jeopardy the social and economic stability in that region. Second, and probably more crucial, is the likelihood of being drawn into another Korean conflict, based on the 1961 Sino-North Korean Treaty of Friendship, Cooperation, and Mutual Assistance.¹⁵⁸ This would mean a direct affront with the US and can be ill afforded at a stage when China would much prefer to press on with its economic development.

There can be no doubt that China holds significant leverage over North Korea, especially since it is the supplier of approximately 90 percent of North Korea's oil supplies. In 2003, China shut down its pipeline from the Daqing oilfield in northeastern China to North Korea for three days in early March, citing "technical maintenance" as the reason, immediately after North Korea had test-fired a missile into waters between Japan and South Korea.¹⁵⁹ Soon after this, North Korea agreed to return to the diplomatic table and participate in a trilateral meeting with the US and China in Beijing in April 2003.

China continued to play a constructive role even as the talks expanded into Six-Party Talks in August 2003 with the addition of Russian, Japan, and South Korea. In fact, it was so heavily involved, which is contrary to the sage advice by Deng, that China found itself caught in an awkward position after three rounds of talks from September 2003 to July 2005 failed to yield any progress. To avoid being seen as incapable of

¹⁵⁷Ibid., 148.

¹⁵⁸Ibid., 157.

¹⁵⁹Ibid., 150.

negotiating an agreement, China had to “strong-arm” its way to a mutually agreed accord, albeit a vague one, in September 2005.¹⁶⁰

The second crisis, or an extension of the first, was created in October 2006 when North Korea tested a nuclear device. China responded uncharacteristically by issuing a demarche to Pyongyang, stating that North Korea had “defied the universal opposition of international society and flagrantly conducted the nuclear test.”¹⁶¹ China also, for the first time, supported the UN Security Council recommendations to impose limited trade and travel sanctions on North Korea. It continued to play a critical role leading up to the agreement reached in February 2007.

The Six-Party Talks were abruptly discontinued by North Korea in April 2009 after the UN Security Council threatened to expand sanctions against it in response to the test launch of the Taepodong-2 ballistic missile. In May 2009, North Korea conducted yet another nuclear test, presumably to demonstrate that its nuclear ambitions remain on track despite Kim Jong Il’s ailing health and the prospect of a leadership transition. Again the Chinese responded firmly, as evident from the statement released by the Ministry of Foreign Affairs, which said that “the DPRK (North Korea) ignored universal opposition of the international community and once more conducted the nuclear test. The Chinese government is resolutely opposed to it.”¹⁶²

¹⁶⁰Ibid., 153.

¹⁶¹Ministry of Foreign Affairs, China, “China Strongly Opposes North Korea Nuclear Test,” 9 October 2006, http://news.xinhuanet.com/world/2006-10/09/content_5180207.htm (accessed 17 October 2010).

¹⁶²Ministry of Foreign Affairs, China, “Chinese Government “Resolutely Opposes” DPRK’s Nuclear Test,” 25 May 2010, http://news.xinhuanet.com/english/2009-05/25/content_11433096.htm (accessed 20 October 2010).

From these developments, it is clear that China sees it in her best interests to adopt a proactive stance towards preserving peace in the Korean peninsula. An outbreak in hostilities would force China to take a stand--most probably on the side of North Korea--and derail its economic growth trajectory. In addition, its relations with the US would also be severely curtailed as a result of this showdown. Therefore, in the hope of maintaining the status quo in North Korea, China was willing to adapt its diplomatic strategy and involve its regional neighbors, Japan and South Korea, in the Six-Party Talks to manage the crisis. As Glaser and Wang described, the stakes of another Korean war are too high for China, so much so that its role evolved from “a passive onlooker, to a reticent host, and finally to a “chief mediator” and “honest broker.”¹⁶³

Tensions in the Korean peninsula reached a new peak in March 2010 when the South Korean naval vessel Cheonan sank off the country's west coast near Baengnyeong Island in the Yellow Sea. Following an investigation by a team led by South Korea and comprising experts from Sweden, Australia, United Kingdom, and the US, it was concluded that the sinking was a result of a North Korean torpedo attack. In a sharp contrast to its response to North Korea's nuclear tests, China did not publicly agree with the findings of the report and has been cautious in its treatment of the issue. In a meeting between Chinese Premier Wen Jiabao and South Korean President Lee Myung Bak in late May 2010, the former stressed that “China will make a judgment in an “objective and fair manner” and take its stance on the basis of facts concerning the incident.” Wen also “called on all parties concerned to remain calm and exercise restraint, so as to avert an

¹⁶³Glaser and Wang, “The North Korea Nuclear Crisis and U.S.-China Cooperation,” 144.

escalation of the situation.”¹⁶⁴ Separately, Wen was quoted as saying that “China will defend no one whatever the outcome,” according to a briefing by South Korean presidential adviser Lee Dong-Kwan after the meeting of the leaders.¹⁶⁵ China was neutral and non-committal in its position despite South Korea’s diplomatic efforts to gain China’s support in order to condemn or sanction North Korea through the UN Security Council. Evidently, China’s strong economic relationship with South Korea was not compelling enough a factor for China to throw its weight behind South Korea on this issue.

It is also interesting to note China’s unyielding efforts towards strengthening economic ties with its key partners, even during the midst of an uncertain security environment. In the same meeting where the Cheonan sinking was discussed, Wen pushed for the commencement of negotiations of the proposed FTA between China and South Korea in late 2010 or early 2011 upon the completion of a feasibility study. Wen also said that “China and South Korea should strive to make bilateral trade volume meet the target of 200 billion U.S. dollars by 2012 and 300 billion U.S. dollars by 2015.”¹⁶⁶ Therefore, it appears that China does not wish to entangle economic issues with security incidents such as the Cheonan sinking.

¹⁶⁴Xuequan Mu, “Chinese Premier Promotes Cooperation, Good Neighborliness in South Korea Tour,” *Xinhua News*, 29 May 2010, http://news.xinhuanet.com/english2010/china/2010-05/29/c_13321834_3.htm (accessed 20 October 2010).

¹⁶⁵Kelly Olsen, “China tells S. Korea it Will 'Defend No One',” *The China Post*, 29 May 2010, <http://www.chinapost.com.tw/asia/korea/2010/05/29/258613/China-tells.htm> (accessed 20 October 2010).

¹⁶⁶Mu, “Chinese Premier Promotes Cooperation, Good Neighborliness in South Korea Tour.”

On South Korea's part, it has assessed that the furtherance of economic relations with China is too important a gain to be sidelined for the sake of politicizing the Cheonan issue. Ultimately, South Korea understands that it needs the assistance of China to impose sanctions on South Korea at the UN Security Council, as well as employ its levers bilaterally on North Korea to bring the regime to the diplomatic table. Thus, using economic means to put pressure on China will not only damage its blossoming economic relations with China, but more importantly risk compromising China's "honest broker" attitude towards Korean peninsula security matters.

Senkaku-Diaoyu Islands: Pawns of a Power Struggle

In the case of Japan, the linkage between its economic interdependence and political ties with China appears more tenuous. The reasons are mainly historical. Professor Susan Shirk, in her book *Fragile Superpower*, considers Japan as the foreign policy relationship which is most difficult to handle for China's leaders.¹⁶⁷ Japan is considered an "emotional issue" and requires a skilful balancing act on the part of Chinese leadership to manage public opinion. On one hand, the fanning of nationalism at the expense of Japan is beneficial for the longevity of the Chinese regime; on the other, such nationalist movements run the risk of morphing into a push towards democracy--the case in point being South Korea in the 1960s.

Public opinion features significantly in Japan's calculations, too. As a consequence of the Japan-bashing that has been prevalent in China, the Japanese public began to view China as a threat and support political leaders like Koizumi who were

¹⁶⁷Susan L. Shirk, *China: Fragile Superpower* (New York: Oxford University Press, 2007), 144.

willing to adopt an assertive stance towards China. As of 2006, only 28 percent of the Japanese and 21 percent of the Chinese had positive views of each other.¹⁶⁸ Therefore, it can be said that China-Japan relations are often shaped by domestic politics more than any other factor, including economics.

The largest security flashpoint between China and Japan lies in a set of islands in the East China Sea referred to as the Diaoyu Islands by the Chinese and Senkakus by the Japanese.¹⁶⁹ Between July 2004 and June 2005, it was reported that China deployed naval surveillance aircraft 146 times and patrol boats 18 times to the disputed maritime area. At the same time, the Japanese air force has been scrambled approximately 30 times in the six months before February 2006 to intercept Chinese aircraft in the vicinity of the islands.¹⁷⁰

In September 2010, tensions were escalated after a Chinese fishing trawler apparently collided with two Japanese Coast Guard patrol boats near the islands. The Japanese then boarded the Chinese vessel and arrested the Chinese captain. While in New York for the UN General Assembly meetings, Wen told reporters that “it is totally illegal and irrational that Japan seized the Chinese fishermen and fishing boat in waters off the Diaoyu Islands and still detains the Chinese captain.” Wen went on to demand the

¹⁶⁸Ibid., 146.

¹⁶⁹Japan took control of the islands in 1895 following the first Sino-Japanese war, together with Taiwan and Korea. After the end of World War II, the US administered the islands until 1972 when it returned them to Japan. Since then, China has been disputing the ownership of the islands based on historical grounds.

¹⁷⁰Shirk, *Fragile Superpower*, 147.

immediate and unconditional release of the Chinese captain, failing to which “China will take further actions and Japan must bear all the consequences.”¹⁷¹

According to the New York Times, the Chinese customs authorities began halting the export of rare earth elements to Japan after Wen’s unequivocal demands.¹⁷² Although this action was denied by officials from the Chinese Ministry of Commerce, industry sources have revealed that the major export companies were told to withhold major exports of these elements, which are crucial for Japan’s automotive and electronics industry, to Japan with a clear indication that their export quotas would be affected otherwise.¹⁷³ On 24 September, the Chinese captain was released by Japanese authorities.

At around the time of Wen’s remarks in New York, Chinese authorities arrested four Japanese employees of Tokyo-based Fujita construction company for illegally videotaping a military installation.¹⁷⁴ After the Chinese captain was released on 24 September, China released three of the Japanese, but continued to detain the fourth--the sequence of events bearing a similarity with the Japanese detention of the Chinese

¹⁷¹Ministry of Foreign Affairs, China, “Wen Jiabao Urges Japan to Release Chinese Captain Immediately and Unconditionally,” 22 September 2010, <http://www.mfa.gov.cn/eng/wjb/zzjg/yzs/xwlb/t755599.htm> (accessed 21 October 2010).

¹⁷²Keith Bradshaw, “Amid Tension, China Blocks Crucial Exports to Japan,” *The New York Times*, 23 September 2010, <http://www.nytimes.com/2010/09/24/business/global/24rare.html?pagewanted=1&src=busln> (accessed 23 October 2010).

¹⁷³Theunis Bates, “Did China Ban Rare Mineral Exports to Japan?” *AolNews*, 23 September, <http://www.aolnews.com/world/article/did-china-ban-rare-mineral-exports-to-japan/19645461> (accessed 23 October 2010).

¹⁷⁴Ian Johnson, “China Arrests Four Japanese Amid Tensions,” *The New York Times*, 23 September 2010, <http://www.nytimes.com/2010/09/24/world/asia/24chinajapan.html> (accessed 22 October 2010).

captain for a week after the other crew members were released.¹⁷⁵ This bilateral spat continues unabated, as China remains steadfast in demanding an apology from Japan while Japan is asking China to pay for damages inflicted on the coast guard vessels.

Despite claims by Japanese Foreign Minister Seiji Maehara that the decision to release the captain was made independently by local prosecutors in Okinawa, this action was widely seen as a result of Japan buckling under the economic pressures exerted by China. Instead of exploiting the strong bilateral economic relations as an avenue to diffuse tensions with regards to the disputed islands, China has in fact employed its economic might, in this case its dominance in the production of rare earth elements, to “arm-twist” Japan. This is another clear example yet of how China can be unwavering in its position when the issue pertains to its territorial integrity, to the extent that economic considerations take second place.

Another perspective to adopt is the destabilizing effect on China-Japan relations, and therefore on regional stability, brought about by China’s rapid economic growth vis-à-vis that of Japan following its accession to the WTO. China’s overtaking of Japan as the world’s second largest economy in 2010 using absolute GDP represents the most significant power shift between regional neighbors in the 21st century. China new position as East Asia’s top economy has helped fuel a nationalistic wave in which the Chinese populace regards China as having regained its rightful position in the region. That the position was achieved at the expense of Japan is made more satisfying due to the

¹⁷⁵Chico Harlan, “China Releases Three Japanese Citizens,” *The Washington Post*, 30 September 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/09/30/AR2010093002350.html> (accessed 22 October 2010).

common conviction that Japan's expansionist policy and occupation of China from 1931 to 1945 was what set China back in the international order in the first place.

From Japan's viewpoint, the domestic forces are similar but act in a different direction. Although Japan recognizes that China's ascendancy is only a matter of time, its political leadership cannot afford to be perceived by the populace as the generation that has freely handed over the reign on the throne to China. After all, Japan has held on to this position since the 1960s. Therefore, the period of transition is likely to be one fraught with instability and uncertainty, as both countries continue to assert its position as the regional power. Shirk quotes a young Ph.D. in finance as saying "Right now there is close competition between China and Japan for leadership in Asia. When China is clearly number one then Japan will accept the situation and relations will be better."¹⁷⁶

Spratly-Paracel Islands: A Region in Need of Regionalism

The dispute over the ownership of the Spratly-Paracel Islands in the South China Sea is perhaps the only outstanding security issue that could lead to an armed conflict between China and members of the ASEAN bloc. Beginning in the 1970s, there have been competing claims by Vietnam, the Philippines, Malaysia, Brunei as well as Indonesia. In fact, there have been outbreaks in hostilities as a result of these claims in 1974 and 1988. In January 1974, China conducted an amphibious operation against South Vietnam and landed 600 assault troops on the Paracel (Xisha to the Chinese) Islands¹⁷⁷,

¹⁷⁶Shirk, *Fragile Superpower*, 180.

¹⁷⁷Larry M. Wortzel, "China's Foreign Conflicts since 1949," in *A Military History of China*, ed. David A. Graff and Robin Higram (Boulder, CO: Westview Press, 2002), 278.

while the Chinese Navy sank three Vietnamese supply vessels in March 1988 off the Spratly (Nansha) Islands in a bid to assert China's claim to the area.¹⁷⁸

China has been consistent in its efforts to gain territorial control over the islands--beginning with the publication of a white paper in January 1980 which claimed "indisputable sovereignty over the Xisha (Paracel) and Nansha (Spratly) Islands," and a statement issued by the Chinese embassy in Manila in 1994 that stressed Beijing's "indisputable sovereignty" over the Nansha Islands and the adjacent waters.¹⁷⁹ While some observers have pointed to these statements as evidence of China's hegemonic tendencies, David Kang opined that the ongoing dispute is "primarily one of "boundary setting" and the resolution of previously undemarcated borders among all the Southeast Asian states, rather than a case of Chinese expansionism."¹⁸⁰ Admittedly, however, the presence of oil and gas deposits in the disputed area, the airspace that it affords the claimant, as well as historical baggage form a compelling case for China's dogged stance.

Nevertheless, there was a discernable change in China's approach--in parallel with its economic spurt--heading into the turn of the century. A landmark development concerning the territorial dispute occurred in November 2002 when China signed the Declaration on the Conduct of Parties in the South China Sea, a memorandum that prohibits the use of force to settle rival claims over the islands. Since then, military overtures gave way to greater technical and scientific cooperation in the South China Sea. For example, in March 2005, China participated in a resource-sharing agreement

¹⁷⁸Ibid., 281.

¹⁷⁹Ibid.

¹⁸⁰Kang, *China Rising*, 136.

whereby it would join the Philippines and Vietnam to jointly explore oil exploration in the South China Sea.¹⁸¹ At the same time, China must have observed the rising economic exchanges with ASEAN, discussed earlier in this chapter, and assessed that taking unilateral actions on the islands are not worth disrupting the economic relations with ASEAN.

However, no progress has been made on the adoption of a code of conduct in the South China Sea, an objective which was agreed upon and stated within the 2002 declaration. Since 2007, tensions over competing sovereignty claims began to rise again as China undertook several initiatives which alarmed its ASEAN neighbors, including the increased frequency of naval exercises, the threatening of multinational oil companies operating in Vietnamese waters, the detention of Vietnamese fishermen and the construction of a new submarine base on Hainan Island.¹⁸² In 2009, China declared a unilateral moratorium on fishing in the South China Sea from May to August, coinciding with the Vietnamese fishing season; and enforced it when Chinese authorities seized the catches of Vietnamese fishing boats on more than one occasion. During a visit by US Deputy Secretary of State James Steinberg in March 2010, the Chinese authorities apparently claimed that the South China Sea ranks as a “core interest”--a status assigned previously only to Tibet and Taiwan.¹⁸³

¹⁸¹Ibid., 137.

¹⁸²Wendell Minnick, “China is Checkmated at ASEAN,” *DefenseNews*, 2 August 2010.

¹⁸³The Mainichi Daily News, “China Retracts Policy on S. China Sea, tells U.S.,” 23 October 2010, <http://mdn.mainichi.jp/mdnnews/international/archive/news/2010/10/23/20101023p2g00m0in007000c.html> (accessed 28 October 2010).

The issue came to a diplomatic boil at the ASEAN Regional Forum held in Hanoi in July 2010, when US Secretary of State Hillary Clinton made several remarks regarding the South China Sea dispute. The US had until then stayed on the sidelines of the dispute by emphasizing freedom of navigation, the non-use of force, and a peaceful resolution of the issue. According to Clinton,

The United States, like every nation, has a national interest in freedom of navigation, open access to Asia's maritime commons, and respect for international law in the South China Sea . . . the United States supports a collaborative diplomatic process by all claimants for resolving the various territorial disputes without coercion . . . the U.S. is prepared to facilitate initiatives and confidence building measures consistent with the declaration."¹⁸⁴

This was received negatively by the Chinese authorities, who had all along preferred a bilateral approach to addressing the dispute instead of a multilateral one as supported by the US. In response, Chinese Foreign Minister Yang Jiechi issued an uncharacteristically bellicose statement on 26 July 2010, stating that "The seemingly impartial remarks were in effect an attack on China . . . those disputes should not be viewed as ones between China and ASEAN as a whole just because the countries involved are ASEAN members . . . it (turning the issue into an international or multilateral one) will only make matters worse and the resolution more difficult."¹⁸⁵ Despite this retort, early indications suggest that the US has emerged from this diplomatic showdown as the victor. China recognizes that a refusal to demonstrate goodwill on this issue would only further incentivize the

¹⁸⁴U.S. Department of State, "Secretary of State's Remarks at Press Availability," (National Convention Center, Hanoi, Vietnam, 23 July 2010), <http://www.state.gov/secretary/rm/2010/07/145095.htm> (accessed 28 October 2010).

¹⁸⁵Ministry of Foreign Affairs, China, "Foreign Minister Yang Jiechi Refutes Fallacies in the South China Sea Issue," 26 July 2010, <http://www.mfa.gov.cn/eng/zxxx/t719460.htm> (accessed 1 August 2010).

ASEAN states to bandwagon with the US--an outcome which China clearly wishes to avoid. It has also acknowledged the signal sent out by the US--that the US is now fully vested in East Asian diplomacy and will not stand idle while China continues to demonstrate its military prowess to bully the respective claimants to the islands into submission.

During the ASEAN-China Summit in Hanoi in October 2010, Chinese Premier Wen Jiabao was reportedly open to the development of a legally-binding code of conduct on the South China Sea territorial dispute. According to Philippine Finance Secretary Cesar Purisima, “Wen made a comment that China is serious about the implementation of the declaration on the code of conduct in reaction to some of the comments of the ASEAN leaders.”¹⁸⁶ Earlier, Secretary-General of the ASEAN Secretariat Surin Pitsuwan had informed reporters after a working dinner of the ASEAN foreign ministers that a working group meeting between ASEAN and China would be launched in December 2010 to prepare for a code of conduct for resolving territorial disputes in the South China Sea.¹⁸⁷ It therefore appears that China is starting to make concessions on this matter to assuage the concerns of the ASEAN members who are claimants to the South China Sea and thereby limit the opportunity for the US to deepen its involvement in the region.

At the same time, this matter has a huge bearing on how regional diplomacy is conducted in East Asia. Although not all ASEAN members are claimants to the islands, it

¹⁸⁶Channel News Asia, “China Warms to Code of Conduct on South China Sea Dispute,” 30 October 2010, http://www.channelnewsasia.com/stories/afp_asiapacific/view/1090299/1/.html (accessed 30 October 2010).

¹⁸⁷The Mainichi Daily News, “ASEAN, China to Meet on S. China Sea Code of Conduct in December,” 28 October 2010, <http://mdn.mainichi.jp/mdnnews/news/20101028p2g00m0in006000c.html> (accessed 30 October 2010).

is nonetheless in the interests of the respective ASEAN claimants to adopt a multilateral approach to this issue, as ASEAN's collective weight and voice would surely be more effective in dealing with China. It is also at the ASEAN-centric summits and meetings where the US and other partner countries are represented and can provide further diplomatic muscles to counter a more assertive China. Despite its preference towards a bilateral approach, China has realized that it cannot maintain its international credibility by choosing to pursue further economic cooperation with ASEAN multilaterally when it meets China's interests, and yet preferring to go the bilateral route when it does not. Therein lies the dilemma of subscribing to regionalism--collective benefits can transform into collective pressure at any time.

At the moment, the benefits of cooperation with ASEAN seem to weigh more favorably than a stubborn insistence on the control of the South China Sea. In what is now a common trend in China's approach to regional diplomacy, China's focus on maintaining the momentum of growing economic relations in spite of the ongoing territorial disputes is paramount. In the official statement at the ASEAN-China Summit, the first proposal made by Premier Wen was to strive towards increasing ASEAN-China trade to \$500 billion by 2015 and to establish a FTA with each of the ASEAN member states within five years.¹⁸⁸

¹⁸⁸Ministry of Foreign Affairs, China, "Premier Wen Attends 13th ASEAN-China Leaders Summit and Delivers Address," 29 October 2010, <http://www.mfa.gov.cn/chn/gxh/tyb/zyxw/t765220.htm> (accessed 30 October 2010).

Conclusion

This chapter has addressed the following two secondary research questions: (1) what has been the impact of China's accession to the WTO on its economic relations with East Asia, both regionally and bilaterally; and (2) to what extent has regional security in East Asia since 2001 been defined by the level of economic interdependency in the region? In the first section of the chapter, the results of the comparative quantitative analysis of the trading patterns in East Asia before and after China's WTO accession in 2001 demonstrated unequivocally that WTO accession has played a pivotal role in catalyzing trade growth in China, and that between China and the rest of East Asia. China's total exports and imports expanded by an average of 24.7 percent and 22.7 percent respectively from 2001 to 2008 while its bilateral trade with Japan, South Korea, and ASEAN also exhibited similar growth trajectories, albeit with slight distinctions.

Beginning from a low base, China's total trade with South Korea has increased more than five-fold since 2001. South Korea continued to run a trade surplus with China, who became South Korea's top import and export partner in the process. As for Japan, its imports from China grew at a less impressive rate than exports, thereby helping to reduce its longstanding trade deficit with China. China's trade growth with ASEAN was most pronounced as both ASEAN exports to, and imports from, China grew annually by approximately 30 percent since 2001. Although China still lagged behind the US and the European Union as ASEAN's top trading partner in 2008, the gap is closing quickly.

In the analysis of two other factors of economic interdependency--FDI flows and FTAs--it was found that China's WTO accession likewise had a significant impact. FDI inflows grew at an annual rate of 21.5 percent since 2001, while FDI outflows, previously

non-existent, also increased noticeably. In particular, China's FDI outflows to ASEAN have been steadily rising and the trend is set to continue following the formalization of the ACFTA. In terms of FTAs, China has concluded agreements with Singapore and ASEAN, while negotiations are underway for a FTA with Korea. In sum, the political economy in East Asia has evolved to become more China-centric and integrated in nature as a result of China's accession to the WTO in 2001.

In the second section, the analysis of the three security flashpoints in East Asia showed that despite the unprecedented growth in economic relations between China and its neighbors since 2001, security fault lines still remain and appear to be intractable in the near term. There are a whole host of factors at play for the respective security issue which means that economic considerations alone, while certainly gaining in importance, will not be sufficient to produce an amicable outcome. In the case of North Korea, China's main preoccupation was to prevent a political implosion in Pyongyang as well as any outbreak in hostilities involving the US. Therefore, its strong economic ties with South Korea and Japan did not feature as an effective leverage in a "third party" issue such as North Korea. However, economic factors were found to play a larger role in terms of South Korea's determination of who to partner with to maintain peace in the Korean peninsula--China's economic proposition, and its leverage over North Korea, makes it an increasingly more compelling partner than the US.

Economic interdependency was found to be an even smaller factor when analyzing the Senkaku-Diaoyu Islands dispute. At its core, historical and nationalistic sentiments dominate the issue more than the actual value of sovereignty over the islands. Any attempt by China to yield on economic grounds would undermine domestic political

and social stability, the exact outcomes which economic development in China sought to avoid in the first place. Lastly, the recent conflagration in the South China Sea dispute between China and the respective ASEAN claimants has raised alarms in the region concerning China's growing militarism and possible expansionistic tendencies.

Nevertheless, the apparent willingness of China to resolve the matter multilaterally and jointly develop a code of conduct with ASEAN have validated the pacifying effects of economic regionalism--China's active participation in ASEAN-centric platforms and the conclusion of the ACFTA have lent much institutional credence to ASEAN, thus making it more difficult for China to deal with the issue outside of ASEAN.

CHAPTER 5

CONCLUSION

Summary of Findings

As China enters into its tenth year of WTO membership, there is a sense of vindication on the part of the Chinese leadership for undertaking the bold endeavor to seek WTO accession in 1986 and committing the country to drastic economic reforms at the behest of its SOEs. Since its formal accession in 2001, the resultant surge in China's external trade had catapulted China to become the second largest economy in the world and significantly enhanced the economic well-being of its population. At the same time, China's economic success had also led to its reemergence as a regional power and earned it a seat at the global high table of politics and diplomacy. While China's economic success and its ascendancy on the global stage are indisputable, less certain is its contribution to regional economic growth and the security environment.

Therefore, using China's WTO accession in 2001 as a point of departure, this study investigated the regional impact of China's entrance to the global trading system--both on the overall level of economic interdependency between China and East Asia, and the security landscape in the region. Based on the analysis conducted in chapter 4, there is overwhelming evidence to suggest that China's accession to the WTO had contributed directly to its export-led economic strategy as well as strengthened its economic interdependency with East Asia. Since 2001, trade as a proportion of China's GDP grew

from 43 percent to 70 percent¹⁸⁹ as its GDP expanded at an average annual rate of 10 percent. In addition, the increase in bilateral trade between China and its East Asian partners has been phenomenal to say the least--China has displaced the US as the top trading partner for Japan and South Korea, while it is quickly closing the gap on the US as ASEAN's top trading partner. In the other aspects of economic interdependency considered in this study, the results have also been conclusive. The domestic economic reforms have borne fruit as FDI inflows to China continue to increase, while reciprocal FDI outflows from China to East Asia is becoming a trend that bears watching. The regional trade architecture has likewise evolved since 2001, underpinned by the ACFTA alongside concurrent exploratory efforts by APEC and the East Asia Summit to promote regional economic integration. Evidently, China's accession to WTO, and the catalytic effects it created, has firmly cemented its position as the economic powerhouse in East Asia early in this century. Building on already substantive trade links with its economic partners, China's symbiotic economic interdependency with its regional neighbors today has become a key feature of the East Asian political economy.

Next, there are strong indications to support the thesis that the growing economic interdependency in East Asia has contributed to more stability and predictability in the region. Despite the fundamental causes of conflict present in the three outstanding security concerns in the region--North Korea, Senkaku-Diaoyu Islands, and the South China Sea--a cause for optimism is the fact that these differences have not yet led to a full-scale conflict over the last decade. Until 2009, multilateral dialogue has been the

¹⁸⁹Sarah Y. Tong, "Comparing Trade Performance of China and India," EAI Background Brief no. 398, 20 August 2008, <http://www.eai.nus.edu.sg/BB398.pdf> (accessed 30 October 2010), 7.

preferred method of diffusing the North Korea nuclear issue, while China's economic leverage over South Korea has meant that South Korea has been more willing to work in concert with China to identify and pursue peaceful outcomes to the issue. China also appears to be open to working towards a legally-binding code of conduct in the South China Sea based on its vested economic interests in ASEAN and in order to invalidate the US' offer to mediate such a development. While it is certainly a stretch to attribute the relative peace that has been maintained in East Asia solely to China's accession to the WTO, it is nonetheless accurate to state that the costs of entering a conflict in 2010 are much higher than in 2001 due to the economic benefits brought about by China's WTO accession. Although critics point to a similar juncture prior to the outbreak of World War I as evidence that economic costs alone are insufficient to deny the forces of realist interests, the difference today is the relative sophistication of active diplomacy and the maturity of multilateralism--both of which are to a large extent a result of enhanced regional economic cooperation.

In the case of China, costs can be measured in terms of how far a regional military conflict would set China back away from its strategic objectives. Despite all the attention on China's position as the world's second largest economy and predictions that China will overtake the US by 2025 or 2030, China is still a relatively poor country plagued by several social challenges. One of them is China's rapidly ageing population, a consequence of its "one child" policy, which will affect China's overall productivity in a few decades. Therefore, Chinese leaders rightly view this period as a "strategic opportunity" to maximize its economic gains and improve the living standards of its population before the onset of the ageing problem. From this angle, then, it is

understandable why China has been hesitant to overplay its hand and disturb the security equilibrium by too much. As chapter 2 had outlined, undermining the peaceful security environment in East Asia would disrupt China's quest for sustained economic growth which in turn is imperative for the sustained legitimacy of the CCP. In Premier Wen's words, "For China to continue its economic development and become a power to be reckoned with in Northeast Asia, it will need a secure, peaceful neighborhood and a peaceful world . . . Anything that threatens our prospects for development is worrisome."¹⁹⁰

Notwithstanding the above, maintaining its territorial integrity continues to be a strategic imperative for China--one which even economic development cannot override. This is in part a legacy of the "century of humiliation" where foreign powers violated China's territorial integrity at will, and also a shield against the "domino effect" as any signs of weaknesses where it pertains to territorial disputes may embolden dissidents in other parts like Tibet and Xinjiang to do likewise. Therefore, finding the right balance between these two conflicting imperatives will be the main challenge for China going forward. Quite clearly, the Chinese leadership has recognized the limit to which they could assert their claims, either diplomatically or militarily, without causing a backlash in global opinions.

This is evident in the analysis of the tussle over the South China Sea, when the US, having devoted much more attention to the region in recent years, entered the fray after observing China's bellicose behavior. An expansion of US presence in the region

¹⁹⁰Glaser and Wang, "The North Korea Nuclear Crisis and U.S.-China Cooperation," 158.

works against the interests of China, and China's insistence on its territorial claims will only create the outcome which it is trying to avoid. Worse still, a miscalculation may risk a military faceoff with the US and negate all the social and economic progress it has made thus far. As Professor Mahbubani alluded to, "China's decision to browbeat the Japanese into submission over the fishing trawler suggests that China may be throwing Deng's geopolitical caution out of the window . . . the geopolitical cards could turn out in Japan's favor if China overplays its hand."¹⁹¹

Implications for the United States

How can the findings of this study serve to inform US policy towards China and the East Asian region at large? First, China's relative success in its conduct of trade diplomacy, precipitated by its WTO accession, in East Asia is a clear reminder to the US regarding the important role which trade plays when cultivating strategic relations in East Asia. After all, the US had itself attained the status of a regional power in East Asia in the 1960s and 1970s largely due to its strong economic linkages with the region. At the moment, notwithstanding the important private investment role played by US multinational corporations in the region, a coherent trade policy in East Asia is sorely absent in the Obama administration at the same time when China is getting a firmer foothold by the day. Of immediate concern is the need to conclude the renegotiations of

¹⁹¹Kishore Mahbubani, "The Paradox of Blinking," *The Japan Times*, 20 October 2010, <http://search.japantimes.co.jp/cgi-bin/ea20101020a2.html> (accessed 1 November 2010).

the Korea-US FTA¹⁹² (originally agreed upon in 2007) so as to pave the way for ratification and implementation. Otherwise, the risk of being beaten to the post by China, who has begun negotiations with South Korea on a bilateral FTA, cannot be discounted.

To make matters worse, the global financial crisis had made East Asian leaders more wary of an over-reliance on US consumption habits. Therefore, despite the surge in diplomatic activity in the region--Secretary Clinton has made six visits to Asia since January 2010--the US needs to demonstrate its commitment to reengage East Asia in the economic realm to avoid being squeezed out of the region. Its recent announcement to join negotiations to join the Trans-Pacific Partnership¹⁹³ is a step in the right direction, but substantive political capital needs to be spent to navigate the US congress.

Second, it is in the interests of the US to strengthen regionalism in East Asia. This study has shown that an effective way to contain China in the various security issues is to employ a multilateral approach instead of portraying the US as the intervening “savior.” As discussed earlier, the introduction of the US in security matters in East Asia has often been met with much apprehension and suspicion on the part of China, and repeated threats by the US to intervene would only lead to the detriment of regional security. Rather, leveraging on the weight of regional institutions like ASEAN is likely to be less threatening and stands a higher chance of placating the concerns of China. Besides,

¹⁹²Despite widespread anticipation of a breakthrough at the Seoul G20 Summit in November 2010, the FTA remains in limbo due to issues relating to the automotive and beef industry.

¹⁹³Office of the US Trade Representative, “Trans-Pacific Announcement,” December 2009, <http://www.ustr.gov/about-us/press-office/press-releases/2009/december/trans-pacific-partnership-announcement> (accessed 17 November 2010). This multilateral FTA currently comprises Singapore, New Zealand, Chile, and Brunei; while the US, Peru, Australia, Malaysia, and Vietnam are negotiating to participate.

China's pursuit of economic regionalism has had the effect of building up diplomatic capital with its East Asian partners, and this capital would be best employed in a multilateral context. This is not to suggest that the US should then stay out of security issues in East Asia altogether, as they indirectly affect the national interests of the US. Instead, as far as diplomacy goes, form can be more important than substance at times, and therefore the style of US involvement needs to be calibrated according to the regional context.

Areas for Future Research

The constraints of a short foray into a substantive topic such as this meant that it was next to impossible to produce all the answers. Therefore, the author recommends the following three aspects which could serve as starting points for future research. First, it would be interesting to look into how China's economic relationships with East Asia would be affected, and its associated implications on regional security, once China alters its economic strategy, from one which is predominantly export-oriented to one which relies more on domestic demand. Already, there are indications from the Chinese authorities concerning a shift in this direction.

Second, subsequent research could focus on the impact of Chinese currency reforms on the regional economy and power dynamics. Specifically, China is in the midst of regionalizing its official currency (the renminbi) through various initiatives including the liberalization of the domestic bond market, allowing cross-border trade settlement in the renminbi, as well as arranging bilateral swap agreements denominated in renminbi. A growing regional reliance on the renminbi will make East Asian countries susceptible to any of its fluctuations, hence increasing Beijing's leverage on the region. Third, future

research could investigate the investment behavior of China's government investment arm, the China Investment Corporation, since its inception. As China's foreign exchange reserves continue to grow, the China Investment Corporation acts as a natural conduit to effectively utilize these funds. Consequently, China's economic reach in the region could be extended in this indirect manner despite official statements citing the corporation's investments as purely based on maximizing returns.

Final Thoughts

Within China's grand strategy, WTO accession represented a means towards the ultimate objective of sustained economic growth and political longevity for the CCP. A decade on, China's status as the regional trading giant has validated the benefits of WTO membership. At the same time, China has established symbiotic economic relations with its East Asian neighbors that loom large in regional security calculations. However, economic liberalism alone is insufficient to resolve existing security flashpoints, particularly where it infringes on China's territorial sovereignty. Nevertheless, there is scope to contain these flashpoints through regional diplomacy built on economic regionalism. The strengthening of multilateral institutions in East Asia, such as the expansion of the East Asia Summit to include the US, and the improvement in trade relations between the US and East Asia are steps in the right direction. Finally, the interaction between economic liberalism and regional security in China's context is perhaps best concluded by the following extract of Premier Wen's speech to the UN General Assembly in September 2010, "China will continue to focus on economic development. Development remains the top priority in China, (and) is the basis for solving all problems . . . China stresses friendship, but also principled and unswervingly

safeguard the country's core interests. In relation to sovereignty, unity and territorial integrity, the Chinese never give in, never compromise.”¹⁹⁴

¹⁹⁴Jiabao Wen, “Wen Jiabao spoke at the UN General Assembly: No Compromise on Sovereignty Issues,” <http://www.comhaha.com/blog/558652-wen-jiabao-spoke-at-the-un-general-assembly-no-compromise-on-sovereignty-issues> (accessed 30 October 2010).

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