European Institute
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Nomisma

The European Union's Strategic Interests in East Asia

Study on the economics and politics of East Asian Cooperation and in particular China's role in this process: Challenges and Opportunities for EU policy

Volume II: Expert Analyses of East Asian Cooperation, China's Role and EU Policy

Edited by Willem van der Geest

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Acknowledgments for Volume II

This study has been undertaken on the request of the European Commission, Directorate General External Relations. The main objective of this study is to identify the European Union's strategic interests in East Asia, and to provide information on the region's likely development in economic, political, security and socio-cultural terms, with a special focus on intra-regional co-operation and in particular China's role.

The specific objectives of the study are to: Analyse the current factual situation in the region, and in particular China, including relations with major global powers like the USA, Russia, India and the EU; Identify long-term shaping factors that affect/determine co-operation within East Asia and with the EU; Undertake a strategic analysis of role of the major world players in the region; Examine the existing EU policies and strategies towards the region and China; Analyse the challenges posed by the major powers in the region (Russia, China, USA, India); and Elaborate alternative scenarios, new options and recommendations for EU policies.

The EIAS-NOMISMA consortium, directed by Dr Willem van der Geest and Dr Roberta Benini, addressed these ambitious objectives in a brief six-month period through an intensive research and analysis effort, combining desk-research with a global round of expert interviews, a focus-group survey administered through a questionnaire, the preparation of a dozen of background papers by leading experts, a brainstorming workshop in Brussels presenting results and recommendations the writing of the 'Study Report' in two volumes. Whereas Volume I integrates the results of the above process, Volume II presents in full the twelve expert analyses of manifold aspects of East Asian cooperation, China's role in it and the challenges and opportunities which this process offers for the European Union.

The EIAS-NOMISMA Consortium gratefully acknowledges the financial support of the European Commission to invite twelve leading scholars to write issue and background papers: Prof Robert Ash (London), Dr Roberta Benini (Bologna), Dr Sebastian Bersick (Brussels), Dr Sophie Boisseau du Rocher (Paris), Prof Sean Golden (Barcelona), Mr Willem van Kemenade (Beijing), Dr Francoise Nicolas (Paris), Mr Frank Umbach (Berlin), Prof Wing Thye Woo (Davis, California), Prof Shujie Yao (London), Ms Roberta Zavoretti (London) and Prof Zhang Wei-Wei (Geneva).

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Long-term Outlook for China's Political Reform
(With special reference to the European interests in these reforms)

Prof. Wei-Wei Zhang

Long-term Outlook for China's Political Reform
(With special reference to the European interests in these reforms)

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1. Assessing China's Political Reform

China's post-1978 economic reform is generally acclaimed as success, for the Chinese economy has expanded nine-fold in a matter of 25 years and the country rose from the world's 34th largest trading nation in 1978 to the 3rd largest in 2004 ahead of Japan. Interestingly, the Chinese experiment is often described in the West as "economic reform without political reform". This begets the question: how could a politically un-reformed system be able to deliver such an economic miracle? In reality, China has conducted, by its own standards, major political reforms since 1978. Though far short of the Western expectations, the Chinese experience since 1978 should better be described as "great economic reforms with lesser political reforms", without which China's economic success would be inconceivable.1

Such "lesser political reforms" include:

First, mass ideological campaigns based on the Maoist doctrine of "class struggle" and creation of the "socialist new man" were repudiated, and virtually all political victims under Mao, numbering tens of millions, were rehabilitated. As a result, people could pursue their normal life and material interests;

Second, across China's vast countryside, the notorious people's commune system was abolished, following Deng Xiaoping's successful rural reform, thus liberating hundreds of millions of Chinese peasants from this rigid system of political, economic and administrative control that had impoverished them for over two decadesThird, the village-level election has been carried out in the Chinese countryside, which is a massive political experiment to introduce rudimentary democracy. The result of the experiment is mixed: in many villages, elections are genuinely free and competitive, while in others they are marred by rural cadres' abuses and clan-based voting patterns. The official assessment of the experiment claims that it is "not functioning properly in 40 percent of villages", a challenge for China's future democratisation;2

Fourth, driven by the logic of the market economy, the rule of law has made important headway, with 20-fold increase of trained professional lawyers in China since 1978. The People's Congress has promulgated more laws than anytime in China's history, and many deputies to the people's congresses at all levels have become more vocal than before on wide-ranging issues of public concerns;

Fifth, there has been a rapid growth of think tanks in China, as the country's economic reforms and opening up have exposed it to multiplying challenges unfamiliar to the Chinese leadership. Decisions are no longer made at the whim of individual leaders as had been the case with Mao. Think tanks are also engaged in relatively open policy debates;

Notes :
1 This part draws on the author's writings. See Wei-Wei Zhang (2000), pp.148-162, and Wei-Wei Zhang (2004).
2 Tony Saich and Xuedong Yang, p.187.

Sixth, the party's 'zone of indifference' has been drastically expanded with regard to popular behaviour and cultural expressions, and a process of "informal liberalisation" has set in.3 As a result, average person in China now has far more freedom of choice than any time since 1949. Individuals can make their own choices of jobs, housing, school, marriage and leisure, and can move freely within the country or go abroad given the means. A Chinese-style 'civil society' is emerging, and China's NGOs have grown like mushrooms mainly in those non-political domains ranging from helping the disabled to protecting the environment, from assisting the HIV/AIDS patients to providing legal services to the poor. However, the relationship between the emerging 'civil society' and the state is still confusing;

Seventh, the state apparatus have also undergone some reforms: a system of recruiting civil servants through exams has been introduced, a mandatory retirement has been adopted, and better-educated and relatively young technocrats have replaced veteran cadres. There is no massive purge any more since 1978, and "the victors co-opted most of the followers of the defeated leaders."4 This has partly explained why the fall of individual leaders since 1978 had relatively mild impact on the coherence of economic reform policies;

Eighth, many political reform experiments have been carried out, such as the cadre rotating system to break *guanxi* networks as well as the practice of "small government and big society", notably in the two newly established governments of Hainan Province and Shanghai Pudong District, which downsizes bureaucracy and forsakes its many functions that can be better performed by society, and

Ninth, with China's entry into the WTO, new emphasis has been placed on building a clean, efficient and transparent state based on the rule of law. The concepts of "political civilisation", "socialist democracy" and "harmonious society" have been put forward to guide the next stage of China's political reform.

Furthermore, perhaps more importantly, the country's successful economic reform and "lesser political reforms" have largely dismantled what can be called the economic and institutional basis of totalitarianism. Institutions underpinning omnipresent state control have crumbled or substantially weakened: with the rising prosperity, the rationing system for consumer goods disappeared; with growing social mobility, household registration (*hukou*) and personnel dossier system (*dang-an*) have significantly loosened up; and most people are no longer dependent for their livelihood on the state or their workplace (*danwei*), as most wealth and jobs in China today are generated outside the state sector.5

3 Wei-Wei Zhang (2000), pp.98-117.
4 Pei Minxin, p.70.
5 An important indication of the changing balance between state and society and how people can live outside the state sector is the drastic decline of state's share of savings and rapid increase of individuals' share in China's total bank deposits. While China's total GDP was quadrupled between 1978 and 1996, government's share of total savings decreased from 43.4 percent in 1978 to 3 percent in 1996, and individuals' increased from 3.4 percent to 83 percent for the same period. It would be more significant if one considers that in 1978, the state's share, including SOEs, accounted for 96.6 percent, but this figure dropped to about 10 percent in 1996, and this trend has continued since then.

Distribution of Savings in China:

	State	Enterprises	Individuals
1978	43.4%	53.2% (all from SOEs)	3.4%
1996	3%	14% (7% from SOEs)	83%

Source: Zhongguo Jingji Shibao (China Economic Times), 15-17 July 1997.

China's political reforms are essentially attempts for political rationalization aimed at facilitating rapid economic development, not democratisation as understood in the West, at improving the efficiency of the existing political system, not abandoning it. In contrast to the radical model of democratisation, which entails an uncompromising break with the past, Chinese reformers have carried out those "lesser political reforms" by working through the existing political institutions within the one-party framework, as Chinese leader Deng Xiaoping argued that China's political system has an overall efficiency which could and should be used to serve China's modernization drive.6

Driven by the market force, the Chinese state has undergone and is still undergoing, however haltingly, a process of self-transformation. The state has gradually turned itself from an anti-market totalitarian institution into a largely pro-business authoritarian institution. As market reforms entail a reinvention of state, the government has to move from doing many things badly to doing its fewer core tasks well.

The Chinese experience since 1978 is not a dichotomy of the party-state's clinging to power and a society bordering on rebellion. Chinese reformers themselves initiated a process of self-transformation: the state has been made to change many of its old functions and abandon much of its economic and social control. Yet the reformers still rely on the insufficiently reformed state to play a leading role in reforms. Without abandoning completely the old institutions, Chinese reformers have used frequently old mechanisms to promote reforms, because (1) these were things familiar to them and could be re-oriented in one way or another towards pursuing reform policies, and (2) there were few other realistic alternatives. The state institutions were the only effective institutions available for the party reformers, and the new institutions were still to be established. As a result, Communist legacies are partly used, partly abandoned, and partly re-built.

Such reforms have produced mixed results. On the one hand, China has ensured sustained political stability for its economic development, without confronting the risk of paralysing catastrophe as Russia had experienced, and on the other, the Chinese approach is also slow-moving and often confusing, with mixed social and political consequences.

Chinese reformers' priority to economic reform has sharply narrowed the scope of China's political reform and slowed the progress towards full enjoyment of people's political and civil rights. Yet emphasis on removing immediate political obstacles to economic progress has been indeed responsive to the pressing needs of the majority of the population for alleviating poverty after decades of neglect under Mao. Stressing economic reform over political liberalization has caused grave setbacks in China's democracy movements, yet it has provided ordinary people with unprecedented economic and other freedoms, thus contributing to an emerging Chinese-style civil society.

China's "lesser political reforms" have reduced country's opportunities for greater political change, thus alienating many reform-minded intellectuals. Nevertheless, it may also have helped China avert the possible economic and social upheavals which could have resulted from rushing too fast into a radically different economic and political system. Efforts to improve the efficiency of one-party rule is contrary to the principle of competitive democratic politics, yet each one of

6 Deng Xiaoping took pride in what he called "overall efficiency" of the Chinese political system, but aware of its major weakness. He observed, "under socialism the people of the whole country can work as one and concentrate their strength on key projects…", See Deng Xiaoping (1994) p.26. He also remarked that "when the central leadership makes a decision, it is promptly implemented without interference from any other quarters. When we decided to reform the economic structure, the whole country responded, ... from this point of view, our system is very efficient...". See Deng Xiaoping (1994), p.238.

the reformers' calls for political reform has offered opportunities for Chinese liberals to transcend the official discourse and promote the spread of liberal ideas and values.

During the process of reform, reformers have demonstrated their ability to ensure long-term policy coherence and macro-economic stability, through a combination of market and administrative methods. A significant portion of the party/state structure has developed its competence, expertise in shaping and implementing market reform policies. For instance, a dense web of local compliance mechanism has been established to facilitate the execution of reform policies. Policy enforcement for common goods has been relatively effective from a technocratic perspective, as shown in the state capacity to fight the century's worst floods in 1998, the outbreak of SARS in 2003 and in the high absorptive capacity for foreign direct investment. In fact, many international investors regard the Chinese state capacity as "probably the most impressive" as asserted in a recent *Newsweek* survey.7

Notwithstanding China's distrust of Western-style democratisation, the Chinese experience since 1978 have considerably increased elements which can be considered compatible with a more democratic process: rehabilitating former political enemies, greater social mobility, more diversified values, more elastic ideological standards, steps to curb the administrative power of the state over the economy, more laws and legal institutions, energizing people's congresses, and relaxing cultural restrictions. This has contributed to what has been called "partial pluralism" in China.8

However, these limited political and administrative reforms are far from sufficient to tackle China's growing social, economic and political problems, ranging from mounting corruption to "investment hunger" under the soft budget to the "bubble economy" in parts of China. For instance, Deng Xiaoping's decision in 1992 to open China further to the outside world immediately triggered Chinese bureaucrats to set up over 1800 special zones across the country, and Beijing had to order many of them to close, with a huge waste of financial resources. Half of state-owned enterprises are still in the red. Legal institutions are weak. Local protectionism remains strong. Paternalistic style of leadership is common, which breeds "crony capitalism". Furthermore, China is far short of an effective institutional framework to mediate social tensions. Harry Harding, a leading China expert, has suggested that while "dismantling many of the totalitarian institutions of the past", the Chinese state is not yet "prepared to move equally rapidly toward the creation of new institutions that could permit the articulation or aggregation of political demands".9 Thus, the party/state may still face the prospects of political instability in the future, especially if economic growth falters, and insufficient political reform, as to be discussed below, could be a major cause for social crises in the country.

2. Multiplying Challenges

China's unprecedented economic success since 1978 has been achieved at a high cost, and the dynamics of the reform process – its style, contradictions and convulsions – have generated far-reaching social and political consequences: society is more stratified and social-political issues are multiplying. Chinese social scientists often assert that developing societies tend to become more instable when their per-capita GDP reaches between $1000 and $3000 as is the case with China now.10 A survey of China's ranking cadres at the Central School of the Chinese

7 Fareed Zakaria (2005), p.23
8 Lieberthal and Oksenberg (1988), p.11
9 Harry Harding, "Political Reform" in Mark Borthwick (ed.), *Pacific Century – the Emergence of Modern Pacific Asia,* Westview Press, Boulder, 1992, p. 423.
10 Lan Xinzhen, p.20.

Communist Party conducted by the Chinese Academy of Social Sciences (CASS) in 2004 revealed that such challenges include (in the sequence of urgency as viewed by the respondents): rising corruption, income gaps, economic and social problems in the rural areas, regional gaps, reform of state-owned enterprises, rising crime rate and unemployment (See Table 1).

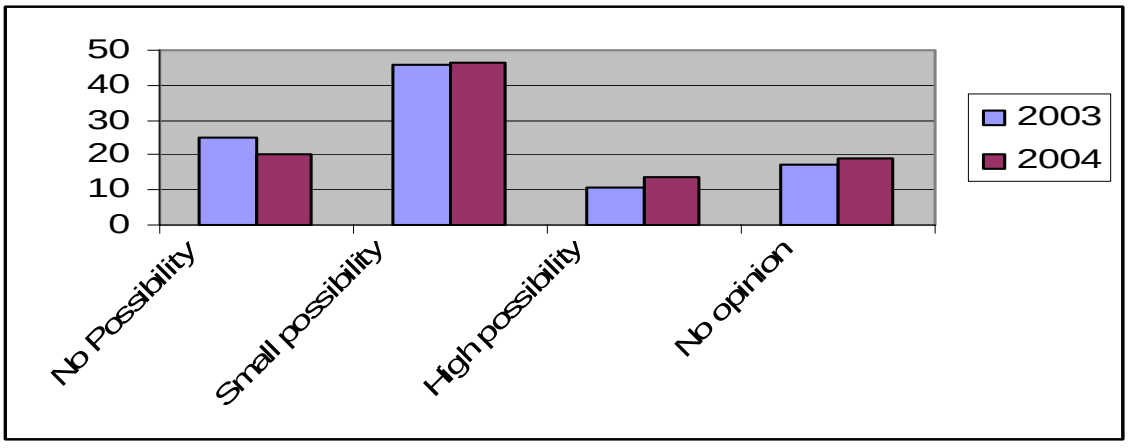
Table 1 *China's social and political issues (in the order of urgency for solution*

Issues:	Sequence of Urgency
Rising Corruption	55.1
Income gap	48.6
Rural issues	43.9
Regional gaps	42.0
Reform of state-owned enterprises	36.3
Rising crime rate	32.7
Unemployment	30.8

Source: Ru Xin, Lu Xueyi, Li Peilin (eds.), the Blue Book of China's Society 2005, p. 48

There is also fear in China that the above-mentioned challenges, if not probably handled, could cause major social crises. According to a survey of Chinese social scientists conducted by the CASS between October and November 2004, while 20.2 percent of the respondents believed that there is no possibility of such crises in the next 5 to 10 years, 46.2 percent held that there is a small chance for such crises, and 13.5 percent expected a high possiblity. A comparison of this survey with that of 2003, however, shows that the number of pessimists increased slightly within one year. (See Table 2):

Table 2 *Estimates on China's possibility for major social crises in the next 5 to 10 years*



Source: Ru Xin, Lu Xueyi, Li Peilin (eds.), the Blue Book of China's Society 2005, pp. 28-29

Furthermore, the same survey revealed that many in China now hold that China's lack of political reform could directly contribute to such social crises in the coming 5-10 years, and they are concerned with the growing gap between political and economic reforms: 39.4 percent of the respondents in 2004, as contrast to 33.9 percent in 2003, held that the gap between political and economic reforms in China had grown, which could cause major social crises (see Table 3).

Table 3 *Has the gap between political and economic reforms increased over the past year?*

	2003	2004
Increased	33.9	39.4
No change	53.2	46.2
Narrowed	6.4	11.5

Source: Ru Xin, Lu Xueyi, Li Peilin (eds.), the Blue Book of China's Society 2005, pp. 28-29

It is generally agreed now in China that with economic growth and rapid social change, social tensions in the country may in fact worsen, and political reforms, if well-designed and executed, could defuse such tensions. Since the year 2000, the Chinese leadership has put forward a number of concepts such as 'three represents' and 'building a harmonious society' in order to better adapt itself to the changed social conditions in China and handle more effectively the competing interests of different social groups while expanding its social basis to govern. The theme of 'three represents' essentially argues that the party should look beyond the interests of the working class, which the party was supposed to represent in the past, to represent the broadest possible range of social groups in China, especially the country's fast emerging new middle class, including entrepreneurs and capitalists, who are also supposedly "making contributions to China's cause of socialism".11 This re-orientation of the party may contribute to its expanded basis to govern, as it is to share, however grudgingly, its enormous political and administrative resources with more social groups.

However, like the early stage of China's economic reform, China's political reform remains a process of trial and error, and there is not yet a coherent grand plan or consensus on the ultimate shape of the Chinese polity. This may remain true in the foreseeable future, due to the confusion over how to redefine the role of the party in China. Yet, a lot of attempts have been made to explore the ways and means of political reforms, and emphasis has so far been placed on improving the party's capacity to govern the country and promoting the rule of law and greater social justice, as highlighted repeatedly by General Secretary Hu Jintao since 2003.12 In this connection, the CCP seems to have broadened its scope of learning from other political parties in the world. Wang Jiarui, Minister in charge of the International Department of the CCP Central Committee wrote in late 2004: China should learn from foreign political parties in terms of improving its capacity to govern the country. Wang identified six areas where the CCP can learn from foreign parties such as Britain's Labour Party, Singapore's People's Action Party and Sweden's Social Democratic Party: theoretic renovation, political mobilization, decision-making process, shaping the cause of social and economic development, crisis management, and international public relations.13 With this kind of effort to explore new ideas and practices, a more coherent shape of China's political reform may emerge in the coming decade.

3. Long-term Outlook for China's Political Reform

3.1 Scenario One: China's Inevitable Collapse?

There is a strongly held belief, especially among the more 'ideological' observers of Chinese affairs that unless there were a radical political reform, perhaps tantamount to a revolution, to rid China of its "oppressive" Communist Party, the Chinese system would inevitably collapse just like what had happened in the USSR and Eastern Europe.14 As the party has been in power,

11 'Three Represents' was put forward by ex-President Jiang Zemin and claims that the CCP should represet the most advanced productive forces, China's advanced culture and the fundamental interests of the Chinese people.
12 "President Hu Urges Political Reform, Expanding Democracy," *the People's Daily,* 3 October 2003.
13 Wang Jiarui, p.12.
14 The 1989 Tiananmen crisis had reinforced this argument. A comment by Avery Goldstein was typical in this regard: "Prior to the late 1980s, scholars documented trends and changes, but did not question the continued

China had been predicted to face collapse in the aftermath of the Tiananmen crisis of 1989, the Soviet Union's disintegration of 1990, the death of Deng Xiaoping in 1996, and the Asian financial crisis of 1997 and the 2003 outbreak of SARS. Yet all these forecasts turned out to be wrong and the track record of the China doomsayers over the past twenty years is indeed poor. But should we conclude that one should be optimistic, from now on, about China's evolution? Not necessarily. But a few tentative conclusions may be submitted here:

First, for most Chinese, it is not a problem of whether Communism is reformable or not, but reform represents the only sensible choice, as each revolution in China's modern history cost millions of lives, and the country is simply fed up, perhaps rightly so, with revolution, and the rapid marginalisation of the radical Chinese dissidents even among the overseas Chinese communities is an interesting example in this regard.

Second, the legitimacy of the Chinese state since 1978 has largely been based on impressive economic performance and continuous 'lesser political reforms'. China is thus not a case of the state on the verge of collapse and the ordinary people on the point of rebellion. Despite many reported protests in various localities of China in the Western media, there is no doubt that most Chinese have benefited from the reform programme over the past 25 years, and virtually all surveys carried out over the past 10 years suggest that the Chinese state enjoyed a reasonably broad support from the general public and most Chinese are optimistic about their future.15 It is therefore mostly likely that the state will continue its policies of gradual reform in the coming decades which proved relatively successful in defusing social tensions and adapting to societal changes.

Third, while China's rapid changes have made the Chinese society more vulnerable to tensions and crises, especially localised ones, China may, from a macro-historical perspective, have entered a stage of relatively medium-to-long term overall stability after more than one century of continuous instability. Indeed, for most Chinese, the past 25 years, however imperfect, is perhaps the best time in China's modern history in terms of sustained stability and growing prosperity. Over the past 140 years from the First Opium War of 1840-1842 up to the beginning of Deng Xiaoping's reform in 1978, China was more anarchic than stable. During these 140 years, the longest peace China had enjoyed lasted no more than 8 years: China's peace and modernization

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existence of the communist regime. The events of 1989 in China and elsewhere shattered this assumption and analysts embraced the task of diagnosing the condition of what most came to view as moribund system. This sea change raised questions about the fate of the country's communist political elite and institutions… Although scholars continue to disagree about the probable lifespan of the current regime, the disagreement now is usually about when, not whether, fundamental political change will occur and what it will look like." Another representative book in this connection is Gordon Chang's *the Coming Collapse of China*, Random House, New York, 2001.

15 In three consecutive surveys conducted in China from 1995 to 1999 by Jie Chen of Old Dominion University, USA, he concluded the Chinese regime still enjoys popular support. He asked his respondents to assess the following six statements as a way to measure the level of regime legitimacy in China:

I am proud to live under the current (socialist) political system;
I have an obligation to support the current political system;
I respect political institutions in China today;
I feel that the basic rights of citizens are protected;
I believe that the courts in China guarantee for fair trials;
I feel that my personal values are the same as those advocated by the government.

His conclusion was that "most respondents in all three surveys either agreed or strongly agreed with each of the six statements listed above, which were designed to collectively measure support for the political regime. See Asia Program Special Report (2002), pp.7-9 and 11-12.

This finding seems to be consistent with the findings from other two empirical studies of Chinese public opinions: one was based on a nationwide survey conducted in 1994 and the other was based on a six-city survey carried out in 1999. See Wenfang Tang (2001). Pp.890-909.

The survey conducted by Tony Saich of Harvard University in 2003 also showed that "people grumbled about local authorities, … but on the whole they were happy with the central government". See Simon Long (2005) p.14.

process had been repeatedly disrupted by foreign aggressions, peasant uprisings, civil wars and self-imposed ideological campaigns. The past 25 years, notwithstanding the Tiananmen crisis of 1989 which had been confined to some major cities, has marked China's longest continuous peace since 1840, in which China created an economic miracle and the living standards of most Chinese people were more than quadrupled, and their personal freedoms drastically expanded (though short of the European standards). This may have long-term implications for the next 10 to 20 years of China's political reform in the sense that most people are more likely to embrace gradual reform, and radicalism, whether Maoist or liberal, may continue to be marginalised.

Despite all kinds of problems that may prop up in the years to come, China apparently does not face a collapse scenario. The Chinese reformers seem to realize that absence of political reform will lead to social crises, but radical political reforms may lead to anarchy. China's cautious, perhaps excessively so, approach to political reform, however imperfect, serves to defuse major social tensions and avoid the type of systemic paralyse that Russia and Indonesia had experienced during their radical political changes.

Social injustice could be a major cause for China's future crises, since public concerns over this issue are growing, with the deepening of social stratification in the country. Yet so long as Beijing continues its steady economic, social and political reforms and present a genuine prospect of greater prosperity and justice, social injustice could be kept at a manageable level without undermining the overall political stability. A survey of Beijing residents about social justice conducted in 2000 by Martin King White of Harvard University and his Chinese collaborators serves to explain this. The survey revealed that 95 % of the respondents thought the current income gaps in China were too large, and 85 % felt that 'system failure' was at least somewhat responsible for families living in poverty, while 91 % said that having connections had at least some influence on determining who became rich. However, at the same time, most respondents still believed that they could prosper through honest work. The same survey showed that only a minority of respondents (24%) took exception to a statement that in China as a whole, ordinary people have a good chance to improve their standards of living, and most respondents also held that education and hard work were more important in China than having connections to high officials or personal *guanxi* networks, and 64 % of the respondents agreed that the free market is vital to China's economic development and about 69 % of the respondents claimed that their families were doing better economically than they were five years ago.16

The collapse of the Nationalist regime in 1949 may offer a useful comparison here. The Nationalist collapse had been caused by a number of factors: a war-torn economy, Mao's formidable armed opposition controlling much of the country and a totally corrupt regime which had lost all popular support. Beijing does not seem to face the challenge of this scale in the next decade or so: China's economy is in its best shape for centuries and may continue to enjoy high growth, and few economists now doubt that China may well achieve its objective of quadrupling its GDP by 2020 over that of 2000; no armed opposition is conceivable in the foreseeable future; corruption remains serious but anti-corruption measures are taking effect as indicated in the surveys by Transparency International: China's rank in the scores of corruption improved from 90th out of 146 countries in 1995 to 71st in 2004.17 Indeed, short of an economic collapse or colossus mistakes on the part of Chinese leaders, China has a reasonable chance to maintain the country's overall political stability so long as it continues its current policy of steady economic, social and political reforms.

16 *Asia Program Special Report*, Woodrow Wilson International Center for Scholars, Washington, No, 104, August 2002, pp. 7-9.
17 Simon Long, p. 8.

3.2 Scenario Two: China as a democracy?

Will China become a democracy through its political reform in 20 years? Indeed, a full democracy could be the best scenario for China, the region and beyond, but it is difficult to give a definitive answer, which will, to a great extent, depend on how to achieve democracy in China, i.e. the costs/risks involved, as well as what kind of ultimate shape such a democracy will take. For one thing, Western-style democracy has been clearly ruled out by China's leadership from Deng Xiaoping to Hu Jintao. In a speech in September 2004, Hu Jintao claimed that 'history indicates that indiscriminately copying Western political systems is a blind alley for China.' 18 Yet if the trend of Chinese-style political reform continues, China is likely to become more democratic. The past 25 years of reform have generated elements favouring this path: vastly improved living standards of most Chinese, the information and communication revolution, higher levels of education, the expanding middle class and non-state sector, the rise of autonomous organizations, the country's extensive contacts with the outside world, and recognition by the party that it cannot and shall not micro-manage the Chinese society.

Full-fledged democratisation, however, may still be a long way off for a number of reasons: First, there has emerged a widely-shared perception in China that, however imperfect, Chinese-style reform since 1978 is a success and the Russian model of radical change a failure. Chance of a Chinese Gorbachev is therefore extremely slim, not only because Gorbachev's deep unpopularity among the Russian people (despite his popularity in the West) but most Chinese also consider him a failure.

Second, there is an absence of credible models for a large developing country like China to move out of authoritarinism. The debilitating experiences of Indonesia and Russia are discouraging. The Indian model, however indispensable to India, is rarely attractive to the Chinese, given the huge gaps in economic and social performances between the two countries. Even on the issue of corruption, which is undercutting the regime's legitimacy, it is also noted that Russia has become more corrupt after its radical democratization. Transparency International's survey in 2004 revealed that both semi-democratic Russia and democratic India, two large and comparable countries, turned out to be more corrupt than China.19 There is no easy fix to corruption. The current consensus in China is that the rule of law, more open media and better institutionalized supervision may work more effectively than the U.S.-advocated model of mass democracy in checking corruption and advancing the cause of modernization.

Third, there is a widely shared concern among the Chinese population that adversarial politics may cause an economic downturn and political chaos, which had plagued China for too long in the past century. The prolonged crises in Russia suggest that it is by no means easy to create a viable administrative system in place of the one-party regime in a large country. Historical evidence also shows that mass democracy "typically followed rather than preceded or accomplished industrialization", and this was the case with all developed countries as well as major East Asian successful economies.20

As mentioned earlier, after more than a century of wars and revolutions, and after two decades of moderate reforms, the Chinese seem to be more willing to embrace gradual reform than radical revolution. Yet, as China further develops, new ideas and interests emerge, and a political structure to accommodate them must be found, and the next 20 years of political reform, even partial and gradual, will help pave the way for a new and more sophisticated political structure in

18 'Hu rejects China's political reform,' *BBC news*, 15 September 2004,news.bbc.co.uk/hi/asia-pacific.
19 Simon Long, p. 8.
20 Peter Nolan (2004), p.108.

China, and eventually China may even create its own model of building a more democratic and efficient political system, just as the process of China's economic reform has contributed to the Chinese economic model.

3.3 Scenario Three: Political Reform the Chinese Way

If full-fledged democratisation will take more time, the pressure for a more accountable government and more democratic society is growing, and this trend will continue with the rise of China's middle class and civil society. Therefore, the most likely scenario for China in the coming two decades is that China will continue its own approach to political reform, and the relative successful experience of China's economic reform may well set a pattern for China's political reform in the years to come:

a. It will adopt, like in the process of economic reform, a gradual, experimental and accumulative approach, moving from relative easy reforms to more difficult reforms, and the process could be confusing, with two steps forward, one step backward, with various pilots projects to test new ideas before they are extended elsewhere;

b. Political reform will be essentially a controlled process of change to ensure China's overall political and economic stability and the eventual success of China's modernization programme. In the elitist tradition of Chinese political culture, the party's "zone of indifference" will further expand, while tolerance for radical dissent may remain limited. At the same time, with the expansion of China's middle class, the process of political reform could become more interactive, and the voice of the people, especially the rising civil society, will expand via the media, the internet and other means;

c. China will try to use a syncretic method to assimilate whatever, from its perspective, is good from Chinese and non-Chinese ideas and experiences, and China may demonstrate once again its enormous capacity to learn from other cultures in the field of political and administrative reforms,21 just as in the process of its economic reforms;

d. China's political reform is likely to foucus on a few priority areas : the rule of law, intra-party democracy, good governance and grass-roots elections;

e. China is more likely to draw on, not copy, the models of Singapore (rule of law, good governance and controlled democracy) and Hong Kong (rule of law, transparent government, basic freedoms, and free economy) than American-advocated model of mass democracy. The various European models may also provide inspirations for the Chinese, especially in terms of building a more humane society and transparent government based on the rule of law.

Despite the intention of the Chinese reformers to carry out some more meaningful political reforms, the key issue will remain unclear in the coming years, i.e. how to redefine the role of the party in China's political life? More specifically, how to establish the rule of law when the party remains the most powerful? How to redefine the relations among the party, government, the economy and the society? And how to establish institutions to check corruption and mediate social tensions within the existing one-party political system? There are still no clear and easy answers to these vitally important questions.

These questions aside, political reforms, however limited, are supported by diverse social groups from left-leaning social critics to party reformers and liberal-leaning intellectuals. For the left, it

21 See Wang Jiarui.

is essential to ensure greater equality and a more humane society as China's market-driven economy has expanded the gap between rich and poor. For the liberals, emphasis is always placed on free press, protection of civil rights and extension of elections from village to the township and above; for party reformers, the chance of achieving a broad consensus on a controlled political reform is better now than ever, in the face of China's mounting socio-economic problems and the need to ensure party's legitimacy. Chinese reformers seem to be considering some more significant political reforms. If the failure of the Russian model has enhanced the appeal of neo-authoritarianism to many Chinese, the 1997 Asian financial crisis and China's growing social problems have highlighted the need for more meaningful political reforms. A new consensus seems to be emerging within the Chinese leadership that there should be a more substantial political reform to limit the power of bureaucrats, fighting corruption, promote the rule of law and make the state more transparent and accountable to the people, eventually with more intra-party democracy and increased legal protection of individual rights vis-à-vis the state. A strong state is, however, likely to be maintained to ensure overall political and macroeconomic stability.22

4. Assessing the Possible Impact and Costs of the Scenarios

The above three scenarios are also likely to generate vastly different impact on China's domestic developments and external relations. The following is a subjective assessment of the possible impact of the three scenarios on a number of key issues:

Table 4 *Assessment of the impact of the three scenarios on certain key issues :*

	Economic growth	Human rights	Ties with Taiwan	Ties with neighbours	Sino-US Relations	Sino-EU Relations	Overall scores
Scenario I : Regime collapse	1	2	2	1	2	2	10
Scenario II Full democracy	2	3	3	3	3	3	17
Scenario III Gradual change	3	2	2	2	2	2	13

Note: 1: negative; 2: mixed; 3: positive

Explanations:

A. Scenario I: regime collapse could cause sharp economic downturn; some rights may be improved (political and civil), and other rights (economic and social) may be undermined; ties with Taiwan could be complicated as Taiwan may face a less powerful adversary, but Taiwan's economy may suffer and Chinese nationalism against Taiwan may become a new rallying call; no China's neighbours want to see this scenario, given the possible implications for them (trade, refugees, spread of weapons of mass destruction, etc.); the US and the EU may feel content that another Communist regime collapses, but its negative implications could be enormous (trade, investment, spread of weapons of mass destruction, environment, etc.).

B. Scenario II: full democracy is an ideal scenario, and it is largely positive for all the issues involved, except that its impact on economic performance could be mixed (e.g. trend towards a welfare state).

22 Wei-Wei Zhang (2004).

C. Scenario III: gradual change may be good for China's economic performance as shown in the past 25 years. Its impact on other issues may be rather mixed: partly positive, partly negative. For instance, in Sino-EU relations, disputes over human rights issues will continue while the bilateral economic ties will further expand.

D. Overall scores: based on the above subjective assessment, Scenario I is the worst (10 points), and Scenario II is the best (17 points) and Scenario III falls in the middle range (13 points). While this assessment suggests full democracy may represent an ideal scenario, things become more complicated when we consider how to achieve this scenario, in particular considering the costs or risks involved in pursuing a radical or gradual approach to political reform.

The following is a subjective assessment of the possible costs involved in adopting the radical or gradual change:

Table 5 *Cost and Risk Assessment of Scenarios*

	Economic Cost	**Political Cost**	**Historical Experience measured as cost**	**Foreign experience measured as cost**	**Popular support measured as cost**	**Overall Scores**
Radical Change	2	3	3	3	3	14
Gradual Change	1	2	1	1	1	5

Note: 1: low cost ; 2. medium cost ; 3. high cost

Explanations:

A. Radical change may entail high costs in virtually all aspects: Economically, it may cause significant change of rules and government practices and there could be a prolonged period of confusion and even chaos, but it may boost private sector. Political costs could be high, as the radical approach may entail a regime change which could affect all aspects of China's political, social and economic life; China's only historical experience of Western-style democracy (the 1911 revolution) was more negative than positive, as the country soon degenerated into warlords fighting each other; foreign experience also points to the high costs of radical change: the debilitating experiences of Russia and Indonesia can serve as examples, and there is little support in China for radical change.

B. Gradual change seems to entail lower costs in virtually all aspects, except political costs which could be rather mixed, as slow change also means the prolonged continuation of many imperfect practices before they are possibly phased out. Economically, gradual approach is the least costly, and China's own experience also suggests that gradual reform may produce better results as shown in the past 25 years of reform, and foreign experience (the developed countries and major East Asian economies) also suggests that mass democracy typically follows, rather than precedes modernization; and there is popular support for gradual reform in China.

C. Overall scores: Gradual approach entails far lower costs (5 points) than radical one (14 points).

5. Five Crucial Areas

Based on the above analysis, China's political reform is most likely to unfold in a gradual way and it is likely to focus on the following crucial areas in the coming 10 to 20 years:

5.1 Rule of Law

Legal reform as a way of political reform is widely supported in China, thanks in part to China's market-driven economic reform, which has been the catalyst for moving the country towards the rule of law. With growing prosperity, there is also greater demand for legal protection of private property and human rights, which led to the revision of the Chinese Constitution in 2003 to include the protection of private property and human rights. It is conceivable that in the next 10 to 20 years, with China's growing middle class and more sophisticated economy and society, China may also move in the direction of gradually establishing an independent judicial system, first in the non-political domains and in more developed regions, and this step, though far short of the European standards, is important for China's own progress in building a society based on the rule of law. As for the complete judicial independence for the whole nation, it may well take more time, as it requires in particular the redefinition of the role of the party, more substantial political and legal reforms, more sophisticated legal institutions, more changes in cultural norms as well as better trained lawyers and civil servants. However, if a better and more independent legal system can be achieved in certain regions of China, this may well create internal competition between regions and eventually propel China to move decisively in the direction of establishing the rule of law across the whole nation.

5.2 Intra-Party democracy

Greater democracy within the party has become another consensus of the Chinese leadership, but its focus has been placed on cadre system reforms from the selection to promotion and supervision of cadres. If this is implemented in earnest, there will be closer supervision of the first party secretaries at all levels, and greater transparency of the party work, and party leaders of various levels will be made more accountable to the party rank and file and to the people in general. This may well generate a ripple effect throughout the Chinese society, given the dominance of the party in China's political life. With the rising level of education, cadres of the party are likely to become more vocal in demanding greater intra-party democracy, and as the society becomes more diversified, the party's 'zone of indifference' may further expand and it is likely to withdraw further from micro-managing the society as has been the case since 1978.

In the coming 10 to 20 years, there will be a new generation of party leaders at all levels of the Chinese society, who have grown up during the decades of China's rapid modernization with better education and good exposure to the outside world and they are likely to embrace greater intra-party democracy and eventually move the party further away from a Leninist one to that with a more open and modern outlook. An important indication of progress in intra-party democracy will be to see to what extent the party will be able to manage its internal differences in a more democratic way. In the long run, the party may move in the direction of "the dominant political party under a system of democratic elections",23and in due course, the party may wish to drop its present name "Communist Party of China" for a new name like "Socialist Party of China" or even "People's Party of China" to reflect more accurately the party's changed programmes and the will of its rank and file.

23 Peter Nolan (2004), p. 110.

5.3 Good Governance

Good governance in many ways is a continuation of China's 'lesser political reform' with focus on improving the transparency, accountability and efficiency of the government. Political reform through improving governance and public administration is now widely accepted in China and can serve as an effective way to promote China's political change in the coming two decades. Indeed, many political reforms in the Chinese context can be identified as reforms of public administration, partly to reduce the sensitivity of these reforms. This approach also allows for greater international comparability and justifies more "cultural borrowing" from other states.

China's entry into the WTO has undoubtedly provided a strong impetus to improving governance in China, and this drive will continue as the country further fulfils its WTO commitments and becomes more involved in East Asia economic integration. China is now faced with multiplying social challenges. Hence, crisis management has also become a new priority in China's effort for good governance, and the importance of crisis management has been highlighted in tackling the SARS epidemic in 2003.

In the coming 10 to 20 years, China is likely to go a long way in this regard, given the rising demand for good governance and expanded state capacity (increased revenues, better educated cadres, and new technologies, etc.) in pursuing such reforms. Like in other countries, the state will be made to become a better service provider to the society. The current effort to build e-government and "small state and big society" reflects this trend. The top leadership's commitment to achieving good governance in China is strong, and it may constitute China's main approach to political reform in the next 20 years, and it is also an area where China and Europe can find a lot of common ground for cooperation irrespective of their ideological differences.

5.4 Direct Elections

Chinese reformers have established a broad consensus on gradually raising the level of direct elections from the current village level to that of township, county, province, and eventually the whole nation, but they are unwilling to set a timetable on this.24 As the village-level election has been in practice for 20 years with mixed results, and the eventual success of the village-level election in promoting rural stability and economic prosperity could enhance Beijing's confidence in moving further down the road. Political disputes may continue in the coming 10 to 20 years between those in favour of quicker pace in promoting direct elections and those of slower pace. However, it is possible that by 2020, the quality of village-level election will be significantly improved than it is now, especially with the rising educational level of the people. One benchmark to indicate the progress in this direction will be to see if China can re-start its pilot-projects in township-level election and extend it across the country (So far only limited experiments at township level have been carried out, mainly due to the resistance from cadres with vested interests.25). Another more significant indicator will be to see if and how China will conduct direct election experiments at the county level in the coming two decades, as the political structure of a county in China is much more comprehensive and complex than that of the village or township, and it is in fact a microcosm of China's national political system, with the whole range of administrative, judicial and legislative organs.

5.5 Civil Society

24 "False Dawn," *Far Eastern Economic Review*, October 1, 1998. p.27.
25 Tony Saich and Xuedong Yang, P.187.

At the current pace of development, it is predicted that China's new middle class may well exceed the whole population of the United States by 2020,26 and the Chinese government also openly endorses the view that a society composed of a larger middle class tends to be more politically stable. The rise of the middle class also means growing demand for political transparency and accountability as has occurred in China's large cities like Shanghai, Beijing and Shenzhen, where citizens are more conscious of their rights and NGOs are also relatively more active.

In the coming 20 years, the Chinese civil society will grow further and undertake many causes that the state neither has the will nor means to pursue. Now the state seems to have decided to cultivate China's own NGOs that are partially dependent on the state and partially autonomous, capable of filling many gaps in public administration and ensuring greater social and political "harmony". But the state's relationship with the civil society is likely to remain confusing for many years to come, possibly experiencing ups and downs during this era of profound social transformation. China's civil society, however, will eventually become more autonomous, with the increase of NGOs in both numbers and quality, paving the way for a more sophisticated and democratic society in China.

In the coming 20 years, the leadership and membership of the so-called "democratic parties" in China27 will also be replaced by a new generation that has grown up during China's period of reform, and these "democratic parties" may evolve some new status in the Chinese society and play a greater role in China's political consultative process. There will be further growth of non-governmental think tanks that produce alternative policy options and the media will also become more diversified and more autonomous, in keeping with more diversified demands of the people and the increased financial independence of the media. The media's role in checking corruption and fighting abuse of power is likely to be much enhanced in the future. As a result, China's informal liberalisation may gradually become more formal, with increased institutionalised arrangements for liberalization.

6. European Interests in China's Political Reform

China is now a laboratory – the largest of its kind in human history – in economic, social and political change, and the success of the Chinese experiment will be greatly dependent on whether the country can carry out successful political reforms. Given the size of the country, the nature of the change and the stakes involved, Europe's interests in China's political reform will be enormous:

6.1 Europe's Political Interests

An open, prosperous and democratic China will be in the best interest of Europe, and China is in fact moving, however haltingly and slowly, in this direction since 1978. However, China is also a huge and complex country, and perceptions on how China should change politically diverge both within China and Europe, and China's political change may well take place in its own way against the backdrop of multiplying social, economic and political challenges as well as the country's unique political and cultural traditions. China's progress in this regard may also

26 CACC estimated that the middle class in China accounted for 15 percent of the Chinese population in 1999 and then it rose by 1 percent annually until it reached 19 percent in 2003. It is expected that by the year 2020, the middle class will account for 40 percent of the Chinese population. See "China's Middle-income Class in the Making", *the People's Daily*, 29 September 2004.

27 China's "democratic parties" are: China Revolutionary Committee of the Kuomintang, China Democratic League, China Democratic National Construction Association, China Association for Promoting Democracy, China Peasants' and Workers' Democratic Party, China Zhi Gong Dang, Jiu San Society and Taiwan Democratic Self-government League.

contribute to the rise of a unique Chinese model of political change. The democratic system taken for granted today in Europe in fact took centuries of effort and upheaval to take shape, how the Chinese process of political change will evolve in a relatively short time with less social upheavals will be a major challenge to the Beijing leadership, and any mismanagement of this process could be very costly for the Chinese as well as European interests. Indeed, Europe has a stake in the success of this change. Europe's political interests in China's political reform involve at least the following areas:

a. Europe's Soft Power

Being the cradle of liberal democracy, Europe has a lot of ideas, experience and expertise in building democracy that can be relevant or at least inspirational to China. To what extent, Europe and the European model can influence the goal and trajectory of China's political reform will demonstrate partly the extent of Europe's soft power in the world's most populous nation.

More and more Chinese now view, perhaps unfairly, the Chinese modernization experience since 1978 as too close to America's unbridled capitalism, and China should explore how to build an efficient yet more humane society. Chinese are looking around the world for inspirations to resolve their social, economic and political problems. At a time when Chins is increasingly looking beyond extreme liberalism of the right and state monopoly of the left and beyond savage capitalism and welfare socialism, Europe has a unique opportunity to use its soft power and display its ideas and expertise to China in building an efficient yet humanistic society.

The experience of China's economic reform shows that the country has tremendous capacity to learn selectively from other cultures and other countries. If "soft power" can be defined as the "ability to get what you want through attraction rather than coercion or payment"28, then it will be in Europe's political interest to use its soft power in influencing China, in a way acceptable to the Chinese, so that the country will draw on, even if selectively, the European experience and expertise, especially in the field of humanistic culture, good governance, rule of law, building social safety nets, fighting corruption, environmental protection, crisis management and better handling state-society relations. The more China is influenced by Europe, the greater Europe's soft power in China will be, and the more Europe's long-term political and other interests will be served. However, China's soft power is also likely to increase with the progress of its own style of economic and political reforms, which could even influence the future pattern of East Asian regional cooperation. To what extent the European and Chinese soft powers can accommodate each other will also be a political challenge to both Europe and China in the years to come (see also the following section on civilizational dialogues.).

b. Europe's Global Political Interests

China's political reform will to a great extent shape the trajectory of China's rise, and it is in Europe's political interest to influence China's political reform in such a way that the Chinese state will become not only more transparent and accountable to the Chinese people, but also more transparent and responsible to the international community, especially regarding such European concerns as maintaining long-term regional peace and stability through institutional arrangements, promoting non-proliferation of weapons of mass destruction, and implementing Beijing's commitments to Hong Kong and Macao. In this context, China could benefit in particular from Europe's experience in institutional building for national, regional and sub-regional cooperation. China's progress in this regard will also add more substance to Sino-European strategic partnership. Unlike Europe, East Asia, despite its economic dynamism, still

28 Joseph Nye (2002), p.X.

lacks institutional arrangement for regional political and security cooperation. China has demonstrated over the past few years its strong interest in promoting regional institutionalized cooperation. It is in Europe's political interest to assist China in this effort, which will be crucial for the long-term prosperity of the whole East Asia.

c. Protection of Human Rights

Europe can provide inspirations and assistance to China's political reform in the coming decades, especially in promotion and protection of human rights. It is important to promote, with emphasis on effective, concrete and feasible results rather than moralist rhetoric, all human rights, not simply civil and political ones, but also economic, social and cultural ones, in the immediate and long-term interests of the Chinese people. Progress in this regard will facilitate Sino-European cooperation in many other areas of mutual interest.

6.2 Europe's Economic Interests

Thanks to two decades of economic reform, China has emerged as a major economic powerhouse in East Asia and the world. By 2020, China's total GDP is expected to reach 35 trillion Yuan (or 4 trillion US dollars) at today's under-valued rate, and Europe's economic interests have been growing fast in China through increased investment and trade. But the Chinese economy is also faced with many challenges such as internal protectionism, corruption, weak financial system and non-performing public sectors, many of which call for political solutions. Europe's economic interests will also be better served with more significant political reforms particularly in the following areas:

a. A Unified Domestic Market

Despite China's impressive economic performance over the past 25 years, China's domestic market is still rather fragmented. Local protectionism, especially at the level of provinces, remains a hurdle to building China's unified domestic market. China's entry into the WTO has provided new impetus to building such a market. In the next 20 years, a number of initiatives may bear fruits, including the ASEAN and China Free Trade Area and regional cooperation between ASEAN, China, Japan and South Korea, and the Chinese Economic Area (China, Hong Kong, Macao and Taiwan). All this will serve as a new catalyst for China to establish a more unified domestic market and entail significant legal, regulatory and political reforms in China. It is in Europe's economic interest to assist these reforms aimed at building up this potentially world's largest consumer market.

b. *Rule of Law*

A major problem for European investors in China is the country's weak legal system. With European economic interests rapidly growing in China in the coming decades, disputes involving such issues as protection of intellectual property rights, labour-management relations and contract compliance are bound to increase. Europe's economic interests will be better served if China's political reform can lead to the further strengthening of the rule of law, especially in fighting corruption, resisting unwanted administrative interference, protecting intellectual property rights, promoting judicial independence and effective law enforcement. Europe should therefore assist, through concrete projects, those legal/political reforms that will improve the quality of China's legal system.

c. *Good Governance*

As part of China's political reform, China is in the process of reinventing the state from 'direct and micro-manage' the economy to 'indirect and macro-manage' the economy, and China's entry into the WTO has heightened this pressure for good governance. In the coming two decades, China and Europe are likely to maintain their status as each other's largest trading partners, and the Euro is to become a major currency in China's foreign exchange reserves, and the Chinese currency may become freely convertible. Europe's exposure to the Asian financial crisis in the late 1990s has compelled Europe to place greater emphasis on assuring domestic political institutions that are conductive to economic and financial stability. China is also faced with many governance issues: weak regulatory and supervisory framework, lack of trained human resources and officials' abuse of power. Europe's assistance to China in ensuring good governance will enhance China's capacity to implement its WTO commitments and help the country avert major economic and financial crises, which would impair the economic interests of both China and Europe.

6.3 Europe's Social and Cultural Interests

China's economic reform has reached such a stage that there has been an increasing demand for a greater balance between market forces and social justice. China's social inequality and differentiation have reached an unprecedented scale that is causing multiplying social problems and undermining China's political stability. As part of the reform of the Chinese state, China is engaged in re-building its social safety nets for its population and the Chinese civil society is also emerging fast as a response to these challenges.

A. Social Justice

In the coming 10 to 20 years, China will complete the reconstruction of its social safety nets to ensure greater social justice and better protection of the population, especially its vulnerable groups. The country will also pursue many other large-scale social reforms covering such issues as internal migration, household registration, building up urban and rural communities, and reform of educational and medical systems. In fact, many of these reforms are political in the Chinese context, as they entail inevitably readjustment of the relations between the state and society/individuals.

Such reforms, if executed in earnest, will contribute to the better realization of many economic, social and cultural rights of the Chinese people. Europe's experience in various social undertakings, past and present, positive and negative, can offer inspirations to China. Likewise, some of China's innovative initiatives in this regard may also be relevant for certain European countries as they are also engaged in reforming their welfare states. Europe's government and civil society should be encouraged to engage their Chinese counterparts and exchange ideas and experiences in their common effort to build a society with both efficiency and compassion.

b. Emerging Civil Society

As China's social stratification has deepened when the country is going through its own industrial and technological revolutions, China's NGOs have become a growing dynamic force in various social causes ranging from helping the poor and the sick to defending the interests of migrant workers to protecting the environment. In the Chinese context, the most likely trajectory of the evolution of the civil society is the further expansion of NGOs first in these non-political domains and then into other domains. The work of many Chinese NGOs itself is of great importance for the European interests, such as fighting environmental degradation in China. It is in Europe's interest to develop constructive long-term relations with China's emerging civil society and assist their various social endeavours, as their influence will further expand as China gradually becomes

a more sophisticate society. The rise of China's civil society will have long-term implications for China's future political change. It is therefore important for Europe to assist the emerging NGOs engaged in various social causes in China, as this is the most dynamic and promising part of the civil society in China. It is also a less controversial area for possible cooperation between China and the EU in promoting China's civil society, since Beijing itself is willing to draw on foreign experience and expertise in tackling its multiplying social problems and build what it calls 'harmonious society'.

c. Civilizational dialogue

The rise of China is to a great extent the rise of a non-Christian civilization, which Europe does not fully understand yet. In fact, both the European and Chinese civilizations have a long tradition of humanism, sophisticated cultures and different political traditions, and they could share with each other on many aspects of their fascinating cultures and civilizations. It is in Europe's interest to demonstrate an open mind and try to understand the Chinese way of economic and political development, however different it may be from the European model. The afore-mentioned poor record of forecasting China, much of which had been done by Europe's China watchers, highlights their little understanding of what can be called Chinese model or the country's soft power, which may well become more influential as China further grows and even challenge the Western orthodox view of development. China's soft power may help shape up the future pattern of East Asian regional cooperation in the coming decades. Drawing on the European experience in regional integration, East Asian regionalism may also evolve, not based on the community of democracies as in Europe, but on shared interests and some broadly defined "Chinese soft power" or "Asian soft power", strongly influenced by certain shared values in the region with emphasis on developmental state, industrial policies, unique cultural norms and respect for sovereignty. Indeed, the Sino-European political dialogue will be enhanced by more focussed discussions on China's way of development, as this may generate long-lasting implications, especially for the developing world. Furthermore, Sino-European dialogues on the divergences and similarities of their respective civilizations will not only enrich each other's culture, but also point to the international community, especially those who believe in the clash of civilizations, that understanding and mutual respect between different civilizations could offer a more sensible alternative.

7. Recommendations

Recommendation One:

As part of Europe's general approach towards China's political change, it is in Europe's interest to assist, in line with the view of most Chinese, gradual reform rather than revolution or 'regime change', which could produce hugely negative consequences for China itself, Sino-European relations and European interests in China and even East Asia.

Recommendation Two:

In order to achieve more practical and effective results, Europe is advised to present its perception of democracy and human rights to China, not always from a high moral ground, which the Chinese know well, but more from the angle of good governance and public administration, with focus on demonstrating how, in concrete terms, the European ideas and expertise may tackle, perhaps more effectively than the original Chinese approach, China's multiplying social, economic and political issues. This also requires Europeans to really study and better understand China's real economic, social and political environment.

Recommendation Three

There are potentially huge areas of cooperation between Europe and China in the field of political reform. Yet, given Beijing's suspicion of the West's intention to undermine China's political system, Europe should have a long-term vision in its support for China's political reform, and it may consider giving priority to projects in those areas that Beijing has identified as priority, such as the rule of law, good governance, fighting corruption and various social reforms. This demand-driven approach will not only facilitate China's political reform but also gradually create more mutual trust between the two sides for greater cooperation in the field of political reform.

Recommendation Four

Given the dominant position of the Chinese Communist Party in the Chinese society and its own objective to become a modern political party,29 Europe should strengthen its contact with the CCP by inviting CCP leaders, especially those of its younger generation at all levels, to visit or study in Europe or even take internships in European public services, and encourage party-to-party exchanges between Europe and China. This will help deepen CCP's knowledge of how modern political parties function in the market economy and pluralistic society, and this will eventually facilitate the modernization of the CCP and other Chinese political institutions.

Recommendation Five:

In the same context, it is necessary to encourage Europe's leading schools of public administration to develop joint programmes on public administration such as MPA with China's leading universities and various top party schools, and eventually, when conditions are ripe, establish a China-Europe School of Public Administration, along the line of the very successful China-Europe International Business School (CEIBS).

Recommendation Six:

It is necessary to encourage Europe's leading educational institutions to run various training programme for Chinese cadres not only from Beijing, but also from various provinces and major cities of China, as China's political power has become much more decentralized since 1978. One focus in this cooperation could be various training programmes for Chinese mayors, as much of China's day-to-day governance is now carried out at this level and the number of Chinese cities is expected to increase rapidly in the coming two decades with rapid progress in urbanization.

Recommendation Seven:

It is recommended that Europe and China should jointly explore, through concrete projects, ways and means to promote and protect all human rights, including encouraging best practices, giving due consideration to China's specific social and cultural conditions. This joint approach will help China to "own" human rights initiatives and also facilitate Europe's greater understanding of this complex nation.

Recommendation Eight:

29 Wang Jiarui (2004), p. 12.

It is advisable to encourage China to draw on Europe's rich experience in building regional economic and security institutions, as China is now engaged in various regional initiatives, including the Chinese Economic Area, the ASEAN + One and the ASEAN + Three. China should be encouraged to take the lead in building regional arrangements in the field of traditional security areas such as peace in the Korean peninsula and reconciliation between China and Japan as well as new security areas such as building an Asian energy community and fighting drug trafficking in East Asia.

Recommendation Nine:

The EU should encourage and support more policy-oriented studies on Chinese affairs and deepen Europe's knowledge and understanding of China and its way of economic and political change. The EU may also consider establishing an ad hoc China Advisory Group composed of leading China experts in Europe to provide regular consultancy service to the EU decision makers.

Recommendation Ten:

Hong Kong is a major European interest in its relations with China. The EU may try to persuade China, in due course, to take bolder steps in facilitating HK's political reform by encouraging China to view HK's political reform experiment as a pilot project for China's future political reform, which will serve China's long-term interest.

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Can ASEAN Support Northeast Asia's Pressure?
Stakes and Implications for the European Union-ASEAN Partnership

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Stakes and Implications for the European Union-ASEAN Partnership

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1. Introduction

After a thirty year period of consolidation and success (1967-1997), ASEAN is now facing with a series of strategic choices, choices that will ensure or put at risk its legitimacy as well as its longevity.

Three main events, from internal as well as external in nature, have deeply destabilized ASEAN these last ten years and have shaken what has made ASEAN successful, its mechanisms, its logic and its diplomatic code of conduct:

(1) ASEAN's enlargement, began in 1995 with the adhesion of Vietnam and finished in 1999 with the participation of Cambodia;
(2) The economic crisis of 1997 which has long-term implications on social, political as well as strategic issues and which has called a halt to the positive perception of the "ASEAN way". ASEAN has not been productive in initiating collective responses to the need for reform and the implementation of efficient regional mechanisms;
(3) China's new path of development and emerging diplomatic assertiveness which lead to bold initiatives concerning the regional architecture.

These events are currently having a transforming effect on Asia's regional dynamics and balances. As a progressive result, the structure of power and the nature of the regional system are altered and ASEAN is going through a decisive transition. In a region undergoing fundamental changes and in a quickly evolving context, with basic parameters and equilibriums moving rapidly, the strategic and fundamental question ASEAN has to answer to is the following one: **what would ASEAN gain and loose in the implementation of an East Asian Community?**

During the immediate aftermath of the crisis, instead of promoting pragmatic and coherent answers, in other words "deepening" its process, ASEAN has preferred enlarging its membership and has opened its meetings successfully to its Northeast Asian partners, Japan, China and South Korea. Simultaneously, the acceleration of trade and financial interdependencies among those actors have put on the table the necessary establishment of effective regional structures. This move, which will be formalised next November by the first East Asia Summit to be held in Kuala-Lumpur, could be interpreted as a dilatory way to postpone ASEAN's own decisions.

The strategic question of a costs/benefits ratio of an EAS is obviously a very complex one for ASEAN; part of the answer could and will be given with statistical facts and with functional prospects and benefits. But the other part of the answer, and the most decisive one, relates on a revisited political vision for the region, on its internal balance of power and on its potential autonomy towards external partners or, conversely, on their needed involvement. None of the answers on these issues is neutral and all will have diverging impact on world balances: the

European Union would better look cautiously to emerging long term trends in this part of the world.

For different reasons, ASEAN and the 10 ASEAN member-states are not in the right situation to bring constructive answers to these hot questions. Because internal situations and public involvement in ASEAN are highly differentiated among ASEAN member-States, and because regional partnerships are not ranked and appreciated in the same manner, and also because the debate on these highly sensitive issues, even among high senior officials or experts, is conducted with much caution, the answers might be short-sighted and rely more on immediate concerns than on a long-term vision for the future of ASEAN and East Asia.

In that context, and keeping in mind the decisive question ASEAN has to answer to, it is necessary to wonder

(i) to what extent can the European experience be useful to ASEAN?
(ii) how can the EU contribute to a peaceful emergence of East Asia as a coherent region?

Even if, obviously, the European Union and ASEAN are not constructed on the same mechanisms and logic, even if they experimented regionalisation in a different manner, degree and scale, they both have contributed to the emergence of politically constructed communities and therefore, have raised new expectations. They also have a lot to share on benefits and costs of a regional framework, going through normal turbulences of ups and downs. This fuelled partnership will be helpful now that ASEAN is, once again, confronted to sensitive options. As Europe's interest and position will be affected by the current changes in East Asia, and as its partnership with ASEAN is an old one (ASEAN set up a delegation in Brussels in 1972 and in 1980, the European Commission signed its first interregional arrangement with ASEAN) and one which certainly needs to be reactivated on new bases, and also because we now observe the emergence of an East Asia's new multilayered regional system, the European Union should participate, in its own manner, in the definition of new rules of the game. But until now, since the "New partnership with Southeast Asia" was presented in 2003, the European Union has not sent any strong strategic signal to ASEAN and remains at the "wishful thinking" level.

2. Does ASEAN have a choice?

2.1 ASEAN in 2005

ASEAN, the only regional organisation in East Asia, is in a confused situation: the recipe that has lead to its success from 1967 is no more efficient. After more than 30 years of cooperation and rapprochement, it has been pressured by internal changes, by the emergence of new trans-national parameters that do alter the political substance of the region and by the effects of globalisation. It is not to say that ASEAN has been inefficient or useless. Its utility has been proven throughout the years as its founders have reached a certain level of growth and stability that had direct repercussions on regional cooperation schemes. Indeed, its consensual and non-confrontational mechanisms, the prevalence of states' interests and sovereignty, the non-binding nature of institutional structures, have all been necessary when considering the basic aims and ambitions set up by ASEAN at its inception: to allow the political and economic development of each member and the stabilization of relations between those countries. But are such rules still appropriate today when Southeast Asian countries are increasingly interactive and enmeshed in a growing web of interdependence?

3.2 The ASEAN way

One cannot understand ASEAN without putting back its creation within its historical context: newly decolonized States that have been separated by artificial divisions imposed by their former foreign masters, fragile new States with no clear national identity (ethnicity, language, religion and culture might be distinctive from one national group to the other and feed contest to the basic political legitimacy of the States as insecurity within the national spaces)1, under-developed economies (in 1967, Singapore was still largely used as a regional entrepôt) marked by uncontrolled birth rates and a low level of education. Besides these local handicaps, the external context was not supportive of regional initiatives. The cold war polarised the region and exacerbated conflicts among regional players and even within national actors2; furthermore, the United States, heavily engaged in a security complex, discouraged autonomous initiatives towards such a trend.3

Therefore, ASEAN's creation has to be understood as an essential vector of incubation to assist the state-building process.4 The fragility of most countries' State structures5 and therefore of political regimes strongly incarnated in charismatic leadership, needed to be counter-balanced by regional reinsurance and the "goodwill" of ASEAN partners, eager to defend the non-interference principle for their own convenience: there was really, as Amitav Acharya described it, "a nationalist vision of regionalism".6

Born out of conflicts, ASEAN was keen to set up a security community, it is to say a community where the resort to war was only a remote possibility; this strategy was expressed as early as 1970 with the declaration of ZOPFAN (Zone of Peace, Freedom and Neutrality) and was completed in 1976 with the "Treaty of Amity and Cooperation" signed at Bali and outlining:

(i) mutual respect for the independence, sovereignty and territorial integrity of member-States,
(ii) non-interference in the internal affairs of one another,
(iii) peaceful settlement of differences and disputes,
(iv) renunciation of the threat of use of force.

These basic principles still live on and might be extended in the perspective of an East Asia Community.

Founded upon diversity, this security community worked on very pragmatic rules. First rule: to concentrate on what brings ASEAN members together and not on what keeps them apart. The persistence of intra-ASEAN disputes, and the diverging views on how to deal with external powers could have quickly lead to an exacerbation of intra-regional relations. Instead, this deliberately positive approach that some observers have qualified as "a tendency to deal with intra-ASEAN conflicts by sweeping them under the carpet rather than solving them" has allowed

1 Mutthiah Alagappa *Political Legitimacy in Southeast Asia,* Stanford, Stanford University Press, 1995
2 Michael Osborne *Region in Revolt: Focus on Southeast Asia*, Harmondsworth, 1971
3 Robert Tilman *Southeast Asia and the Enemy beyond: ASEAN Perception of external threats*, Londres, Westview Press, 1987, p: 125
4 Sophie Boisseau du Rocher, L'ASEAN et la construction régionale en Asie du Sud-Est, Paris, L'Harmattan, 1998
5 Ooi Giok Ling "Governance in plural societies and security: management of inter-ethnic relations in Southeast Asia" in Andrew Tan & Kenneth Boutin *Non traditional Security Issues in Southeast Asia*, Singapore, Select Publishing, 2001
6 Amitav Acharya *The quest for Identity: international Relations of Southeast Asia*, Singapore, Oxford University Press, 2000, p: 43

a positive apprehension and construction of its diplomacy.7 ASEAN is conflict-avoidant, not conflict-solving. Second rule: to promote the "ASEAN way" which emphasizes informality and organisational minimalism. The practices of "consultation and consensus" are used to allow any member "not to loose face". Consequently, there are no formal rules but a process of discussion and argumentation; even, the member States have expressed their deep aversion to any kind of institutionalisation or institutional over-centralisation. Because it was not constraining, it helped to build trust and confidence. Third rule: ASEAN member States still refuse to give the Association any power of a supranational character: ASEAN should not deal with integration but is still talking of inter-governmental cooperation. For most observers, this "ASEAN way" is as much part of a normative construct as part of "a common cultural heritage".8 All agree on the conclusion that ASEAN was conceived as a regional tool to maximize sovereignty and national interests: the overall political project for the region was absent.

ASEAN has provided a conducive climate for its member-states' economic development. In creating an environment of stability, confidence and peace, it invited external partners to take opportunity to support growth through FDI and trade. ASEAN member states benefited from the first wave of globalization. As a result, the average growth of ASEAN founders was 7.6 % in the 1970s and 5.8 % in the 1980s.This compares very favourably with the world average of 3.6 % and 2.8 % (International Financial Statistics, various years) and with the rest of Southeast Asian non-ASEAN countries. Consequently, resilience was strengthened with the support of societies, which directly benefited from the raising level of social and economic well-being. The cumulative effect of peace, prosperity and stability is the most direct benefit of ASEAN and one that critics easily neglect; but without the implementation of this positive dynamics, Southeast Asian countries won't have known the experience of modernization that they went through between 1967 and 1997. In this perspective, to evaluate the success or failure of ASEAN in considering the level of intra-regional trade (whose levels have hovered between 20 and 25 % of the regional global trade) is of no pertinence.

ASEAN has given its members not only a support for modernization but also a collective board for more autonomy and standing in the world community. ASEAN member States' growing self-confidence has had a direct impact on their international positioning. Be it with the United States, China, the European Union, ASEAN member States were able to negotiate better results with a collective front rather than with a national approach. ASEAN developed its own brand of diplomacy, convinced that having regular dialogue is itself an investment for peace. Such a method proved useful during the Vietnamese invasion of Kampuchea (from December 1978). Hanoi found it difficult to antagonize and sustain its policy on the long term with ASEAN insistently engaging it to negotiations and pursuing a very active diplomatic strategy within the United Nations.

The end of the cold war and the settlement of the Cambodian conflict in 1991-1992 was a period of euphoria for a courted ASEAN. It allowed the Association to launch new initiatives, the most determining being probably the ASEAN Regional Forum (25 July 1994), a multilateral dialogue on security issues, security being understood in its larger meaning and not only in military terms (which could be, according to Leifer, a way to limit its influence since "how to talk of security without using the word power?"9. This cooperative frame, comprising 18 founding members (including China), bears the ASEAN mark: inclusiveness, consensual decision-making process,

7 Jurgen Haacke "ASEAN's diplomatic and security Culture: origins, development, prospects", London, Routledge, 2003

8 Amitav Acharya *Constructing a security community in Southeast Asia*, London, Routledge, 2001, p: 28

9 Michael Leifer *The ASEAN Regional Forum*, Oxford, Adelphi Paper n° 302

equality among participants.10 The ARF has been conceived as a vector "to engage countries to meet in an informal and neutral atmosphere"; its aim is to achieve a cooperative path towards conflict prevention, preventive diplomacy and conflict solving. In essence as in practice, the ARF reveals both the strengths and the weaknesses of ASEAN-style multilateralism and critics have quickly emerged both from experts as from participants, namely the United States, uncomfortable with these loose practices for a strategic dialogue. 11 The same arguments are always on the front: ASEAN mechanisms and code of conduct should be adapted to new circumstances and adjust.

In its first form, and in a specific context, ASEAN was a much needed frame. But it should not be considered as lasting forever. A succession of turbulences, from the financial crisis to Hun Sen's coup before Cambodia's admission to ASEAN has illustrated the limits of its efficiency and tested the structures and even the rationale of the group: "since it has no capacity to produce solutions to regional problems, ASEAN cannot claim to be a manager of regional affairs"12. The 1997 crisis blew the whistle: Is ASEAN still necessary? Is ASEAN still relevant?

2.3 The 1997 watershed and the ASEAN crisis

Indeed, the 1997 financial crisis had devastating effects not only on local economies but on the regional atmosphere as well: it had largely exacerbated ASEAN inherent weaknesses. The contagion effect of the crisis which spread from Thailand to the other countries without rational distinction, illustrated the lack of adequate mechanisms and more deeply, the unnegotiable prevalence of domestic interests over regional cooperation. The Association of Southeast Asian Nations didn't find any collective solution to tackle the crisis because it was not equipped for such a rescue and more basically, because it was not created to do so. Even if the crisis, and the management of its aftermath, brought more discussions and meetings than before, concrete measures to come up with common solutions didn't spontaneously emerge. The 1997/98 financial crisis, with all its repercussions, demonstrated a lack of solidarity, the severe absence of joint mechanisms and worst, the lack of will to cooperate. More embarrassing indeed, the member countries have proposed different ways to manage the way out of the turbulences: Thailand and Indonesia adopted restrictive policies while Malaysia implemented expansionary policies and capital controls and Singapore relied on supply-side policies, measures like wage restraints and re-training programs. It only illustrated how ASEAN States did not constitute a strongly bound community.13

Furthermore, it took some time before collective answers were adopted as the speeding up of the implementation of a free trade zone. Established in 1993, the ASEAN Free Trade Area, AFTA, called for the reduction of tariffs on all intra-ASEAN trade; its first aim was not so much to increase intra-ASEAN exchanges, still very low (24 % of ASEAN members' external trade), but to increase ASEAN's competitive edge as a production base and to attract more investment to Southeast Asia to take advantage of the potential regional economies of scale. But the ASEAN economic elites continue to exhibit strong hesitations in following up their declared commitments to bring down tariffs to agricultural and industrial products (the famous "sensitive list"), leaving many observers sceptical about AFTA meeting the 2003 free trade deadline. The new members

10 Ralf Emmers *Comparative Security and the balance of power in ASEAN and ARF*, London, Routledge, 2003
11 Narine Shaun "ASEAN and the ARF: the limits of the ASEAN way", *Asian Survey*, 1997 -10, vol. 37 n° 10, p: 961
12 Jeannie Henderson *Reassessing ASEAN*, Adelphi Paper 328, Oxford, Oxford University Press, 1999, p: 12
13 Markus Hund "From Neighbourhood watch group to Community? The case of ASEAN institutions and pooling of sovereignty", *Australian Journal of international Affairs,* 2002, vol. 56, n° 1, p: 99

of ASEAN have had an extended timetable (Viet Nam 2006, Myanmar and Laos 2008 and Cambodia 2010).

What the 1997 crisis revealed, is the incompatibility between the "ASEAN way", based on inter-personal and consensual methods, and the management of raising technical issues, be they financial, ecological, logistical or even societal.14 Some issues having national causes but regional repercussions, should be treated at the regional level. The haze crisis stayed as the best illustration of this paradox.

The haze crisis of 1997 came at the worst time for ASEAN member States, already in an awkward situation with the financial turbulence. It was a result of forestry and land practices in Indonesia not conforming to state regulation regarding controls on the use of fire for land clearance. Fires over some Indonesia's islands (Sumatra, Kalimantan…) provoked a smoky haze over Malaysia, Brunei and Singapore up to the point that schools were closed because of the pollution. But nothing was really done by ASEAN, ASEAN Senior Officials on the Environment or ASEAN Haze Technical Task Force. As James Cotton noticed, "mutual solidarity and a preference for indirect diplomacy have collapsed in the face of the seriousness of the problem".15 ASEAN cooperative measures were ineffective because they didn't address the right causes of the fires which were Indonesia's patrimonial political economy. Everybody knew in ASEAN's circles that Suharto was only unwilling and / or unable to put the interest of his regional partners ahead of those of its closest associates. As for the economic crisis, there was a severe disappointment with ASEAN modalities that didn't have any influence on the situation on the ground. In fact, the ASEAN way was severely blamed for entertaining abusive political practices in the member States (such as collusion, nepotism…) by cautiously setting aside sensitive issues, thus letting them gain the potential to become regional destabilizing factors.

The East Timor debacle is another supplementary case in point. ASEAN's strict respect to non-interference in internal affairs was not well understood. First, ASEAN has not been able to curb the bloodshed; the killing of thousands in a wave of violence by pro-Jakarta militias after the 1999 vote in favour of independence from Indonesia has surprised public opinions in the region as well as in the world. Second and probably more prejudicial, ASEAN stayed silently, delaying any declaration on this sensitive issue "not to bother the President and his government in Jakarta". Even if there were calls for "regional intervention", ASEAN remained outside and the United Nations did send a peacekeeping force. Some ASEAN members even refuse to send troops to East Timor: ASEAN was powerless in weighing in the solution. The gap between ASEAN's ambitions and the reality on the ground was, without ambiguity, the major handicap for ASEAN's future.

That ASEAN pretends to deal with regional issues without having the capacity to handle them is nonsense since it precisely doesn't have the institutional power to propose regional solutions. It even doesn't have the financial, political, not to speak of military resources necessary to implement its policies in Southeast Asia. Its non-interference principle has allowed problems to escalate. Shaun Narine states that "even without the crisis, ASEAN's development would be seriously constrained by its inherent limitations".16 The different crises that happened in 1997 / 98 / 99, which reduced the overall capacities (be they political or financial) of the member-States, asked for a redistribution of the rules when no member was really ready for it.

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14 Tobias Ingo Nischalke "Insights from ASEAN's Foreign Policy Cooperation: the "ASEAN way", a real Spirit or a phantom?", *Contemporary Southeast Asia*, vol. 22, n° 1, April 2000

15 James Cotton *ASEAN and the Southeast Asian haze: challenging the prevailing modes of regional engagement*, Technical Report Working Papers, 1999/3, direction of International Relations, RSPAS, Australian National University, p: 21

16 Shaun Narine "ASEAN into the 21st Century", *The Pacific Review*, vol. 12, n°3, 1999, p: 358

To that extent, according to Shanmugam Jayakumar, former foreign minister of Singapore, ASEAN "has to counter the perception of the Association as ineffective and a sunset organisation". He pointed out the significant need to re-evaluate ASEAN's mode of operation. He was supported by Thailand and the Philippines, whose Foreign ministers proposed two concrete changes (the "flexible engagement" principle and the troika mechanism to respond to security crises). The crises have clearly showed that this ASEAN spirit was a relic of the past and that ASEAN needs to be better equipped to deal with the pressing problems of a new set of realities. The reality that the crises has revealed is the growing interdependence fostered through trade, investments, and human linkages… ASEAN has to redefine its goals, and therefore, its tools. "This reality of interdependence" has to be taken into account when it is too often under-estimated as if ASEAN, as a common frame, didn't produce any linkages. This "institutional gap" was unsustainable.

The loss of a common direction was not only due to this succession of crises. It was also the result of the enlargement process. The region, divided by the cold war and fuelled by the ASEAN / Vietnam conflict, began its reconciliation process in the early 1990s and achieved the vision of the founding fathers of "one Southeast Asia". It began with Vietnam's entry in 1995, followed by Laos and Myanmar in 1997 and finally Cambodia's delayed entry in April 1999. This enlargement, though very symbolic in its willingness to overcome the historical cold war divide in Southeast Asia, raised more issues than was expected. ASEAN, already weakened by its own challenges, had to confront new political, economic and strategic challenges as a result of additional members' expectations and visions. It didn't prepare itself to do it and limited this enlargement at its symbolic level! Thus, at a time when a common direction should have been put on the table and discussed, the Indochinese enlargement further extended the diversity of the Association, thus making its principle of consensus much more harder to reach decisions. It definitely widened the gap between members, not only on the economic front17, but also mostly on the political one.18 Certain members (especially Thailand and the Philippines) being ready to accept and promote adjustment to the sancrosant principle of non-interference when some others were reluctant (and even refused as the late comers) to move away from the non-interference principle in their behaviour and actions. In fearing the sovereignty-eroding potential of institutions, they logically (but not publicly) feared ASEAN and criticized the pressure for political reform. The ASEAN process was blocked.

In that context, ASEAN and its member States were not able, even willing, to deliver a new vision for the Association. They did it not to loose face (cf the Hanoï declaration or the Initiative for ASEAN Integration adopted at the ASEAN Informal Summit in Singapore in November 2000) but couldn't put any substance in it.

In 2000, the panorama was clear indeed. ASEAN didn't succeed to manage one crisis of the three that had been identified, its enlargement brought more obstacles than stimulation, and no member State was able to deal with the coming challenges. The 11th of September 2001 events re-introduced in the region the return of strategic uncertainty and polarized on the issue of Islam, its integration in national diverse societies (Thailand, Philippines) and its political representation (Malaysia, Indonesia). Once again, ASEAN had a relatively weak reaction, incapable of approaching terrorism (and even defining it) in a converging manner. Declarations were expressed (cf the "Declaration on joint Action to counter Terrorism" of November 5, 2001), programmes were set up (cf the "ASEAN work programme on counter-terrorism" May 17, 2002),

17 Helen Nesadurai *The Indo-chinese Enlargement of ASEAN: implications for regional economic integration*, Singapore, Institute for Defence and Strategic Studies, November 2003

18 Mya Than and Carolyn Gates, *ASEAN enlargement: impacts and implications*, Singapore, Institute of Southeast Asian Studies, 2001

the trans-national nature of terrorism was acknowledged, but governments didn't wish to go too far in the implementation of cooperative measures: even the level of informations exchanges remained difficult since, it was felt, those could be exploited for other purposes. Even when confronted with direct security threats, national solutions have taken precedence over collective policies. Some evolution came after the Bali bombings of October 12, 2002, but up to a certain extent, regional security cooperation would have not been conceivable without the implication of the United States. The ASEAN Security Community is a far ahead project.19

ASEAN is at best weakened by its internal division (on the way to manage the crises and on the rising gaps due to its enlargement), at worse, it is only surviving; some observe ASEAN as an organization marked by lethargy and ineffectiveness. Basically powerless, ASEAN, as an institution, had not many solutions. In order to prove its relevance, it decided not to deal with its own internal difficulties (an impossible task?) but to widen its scope and partnership with its regional partners and to try to benefit from their own dynamics. Deep changes were coming from Northeast Asia. China, in that context, was the best offer.

3. The Northeast Asian pressures

What happened between 1997 and 2004 is very interesting, and the period will be remembered as a period of "a great leap forward" in East Asia. On the regional field, proposals and initiatives are coming from Northeast Asia. Basically, four steps can be distinguished:

(i) the emergence of China as a "responsible power" in the region after 1997 ;
(ii) the relative infamous neglect of its partners by the United States after the economic crisis ;
(iii) the reorganization of economic (industrial, trade and financial) networks, fuelled by entrepreneurial energy, and their loose satellization around the Chinese activism and potential ;
(iv) the diplomatic exploitation of these interdependencies by Beijing.

As a result, eight years later, East Asia doesn't have the same appearance, the same balance of power, or the same network of alliances to impulse a new regional organization. South Korea, once a close ally of Washington, is now pondering the benefit of taking some distance to move closer to its regional partners. ASEAN, once in turbulences, is now courted by its neighbours. India, once considered as an external partner, has been propelled into the regional game as a counterbalance to China. And even if much of the East Asian regionalisation process has been driven by the demands of economic globalisation and the push for liberalisation of trade and investment, the rise of China, and its opportunities for Southeast Asia, may change the game into a more political one and call for a new pattern of cooperation and distribution of power in the region.

3.1 The rise of China

China's economic achievement continues to draw world's attention. In addition to its world's sixth largest GDP, China in 2004 has surpassed Japan to become the third largest trade nation in the world. Backed by the great trade surplus and continuing high economic growth rate, the size

19 Nicholas Khoo "Deconstructing the ASEAN Security Community: a review Essay" *International Relations of the Asia-Pacific*, 2004, vol. 4, n° 1

of its military spending is only second to the US. Even if its military capability still remains low compared to that of the United States or even Japan, China plays on its potential influence and on its capacity to decide peace or war in the region. Thus, through a combination of economic dynamism, skilful diplomacy and understated threat, China is shaping East Asia's future and is giving the rhythm of the proposed evolutions: others have to adjust.20

These developments in Chinese multilateral diplomacy were possible for a couple of reasons. One can be attributed to its rising influence over the surrounding region due to its economic success. Growing interdependence with regional partners, and the extension of its soft power, are paying dividends. On the ground, Asian economies are more dependent on Chinese dynamics and potential. After the crisis, China wanted to appear as a "responsible" economic player and did not devaluate its currency, which could have harmed Southeast Asia's exports. Even, in investing in ASEAN countries and in promoting trade, China capitalized on this perception; with an average growth rate of 20 % since 1990, ASEAN-China trade totalled US $ 105,8 billion in 2004, making ASEAN China's fourth largest trading partner (but Japan's trade with ASEAN is still three times that of China's and Japan's annual direct investment toward ASEAN countries is more than 10 fold China's in recent years). Because it didn't really have the choice, ASEAN has decided to cautiously exploit potential economic synergies. If China manages to maintain its present growth over the ten next years, it will become the economic hub of East Asia: if bandwagoning with its dynamics is not the only recourse for ASEAN member states, it looks like the most attractive opportunity and the easiest since Beijing is deploying a lot of efforts to attract these countries.

Indeed, China doesn't contain its policy to "economics only" but plays very softly on its "soft power" capacity. And more than one observer noticed the constant willingness of Beijing to push for a strong China-ASEAN axis. Despite the legacies of a difficult history with its Southeast Asian neighbours (mostly concerning China's past interventions in the region), China has tried to show the best intentions. As early as 1997 (and the coincidence of dates is not pure hazard), China unveiled the "New Security Concept" which emphasized the 5 Principles of peaceful Coexistence mutually beneficial to all its partners. It has managed to peacefully resolve its land border disputes (cf the agreement on Friendship, good Neighbourliness and long standing Stability signed with Viet Nam in February 1999); it also proposed a settlement to the South China Sea's disputes (signed in Phnom Penh, Cambodia, November 4, 2002), and proposed the idea of "shelving the dispute and developing together", a proposal that enables it to keep its sovereign claim while avoiding direct confrontation with the ASEAN States. Another factor can be explained by China's successful exploitation of US' preoccupation with war on terrorism and therefore, on a growing regional scepticism over its strategy to handle it in Southeast Asia. Ever since 9/11, the US has not been able to spare its attention and efforts to safeguard its national interests in East Asia as it did prior to 9/11. Although there are some claims that the US has successfully manipulated its war on terrorism to permeate its influence and presence in China's neighbouring region, thereby further advancing its encirclement policy, its unilateral way of handling terrorism, and thus in managing the muslim issue, has adversely undermined its position in these regions and put a strain in its relations with local societies.

The international community is beginning to witness growing Chinese influence and ascending cultural assertiveness due to the result of its burgeoning economy. The consequences of China's growing influence, whether with intent or not, are now mirrored in its active pursuit of regional diplomacy, or "good-neighbour policy" (*shanlin youhao zhengce*): ASEAN is the first target. Chinese emphasis on the importance of maintaining a friendly relationship with neighbouring

20 Kokubun Ryosei & Wang Jisi *The rise of China and a changing East Asian order*, Tokyo, Japan Center for international Exchanges, 2004; Byung-Joon Ahn "The rise of China and the future of East Asia integration" *Asia-Pacific Review (Tokyo)*, 2004 -11, vol. 11, n° 2 p: 18

states belies in its obligatory belief as preconditions for its economic modernization and socio-political stability. In such a transformation process, China could not afford instability at its frontiers; conversely, an economic crisis in China, possibly followed by a social chaos, is the n° 1 dramatic scenario for its regional partners. Accordingly so, China has been active in searching for peaceful solutions to fulfil its quest for development by continuously engaging itself in both bilateral and multilateral diplomacy. From 1997, after it unveiled the "new Security Concept", China has been trying to solidify its positions by putting aside differences and seeking common grounds with its regional partners. According to Robert Sutter, Beijing seeks "long-term gains" by

(i) securing its environment at a time when sustaining its economic development is the priority;
(ii) promoting partnerships that can assist its development;
(iii) boosting its regional and international power and influence.21

Ever since its participation as an observatory state at the first ASEAN Regional Forum (ARF) in 1994, however, its doubts on multilateralism began to dissolve. Thanks to the ARF and ASEAN's insistence to "invite" it, China has been "engaged" to join the first regional Asia-Pacific multilateral security institution and has become very active in either Track I or Track II.22 Instead, China has successfully transformed itself into a magnificent conductor of multilateralism and multilateral diplomacy. With the successful launch of Shanghai-Five in 1996 which would later become Shanghai Cooperation Organization (SCO) in 2001 (encompassing China, Kazakhstan, Kyrgystan, Russia, Tajikistan and Uzbekistan), China has been proactively pursuing multilateral diplomacy as a viable means in maintaining friendly relations with its neighbouring regions and States (from military confidence-building measures to multilateral military exercises). Beijing now perceives cooperative multilateralism as one of the most effective diplomatic tools in solving international conflicts and tensions. China's optimism and enthusiasm towards multilateralism, after a period when China's interactions with ASEAN were conducted solely on a bilateral basis, brought a major change in China / ASEAN relations; it complements its bilateral policy and thus, should be regarded as another tool to shape the "rules of the game" for regional cooperation at its own advantage.23

China progressively contributed to the thickening of regional networks by a positive and active participation. To consolidate its growth and fuel confidence in its economy, China needs a peaceful environment and will not try to go beyond implicit limits. Given the Chinese acknowledgement on the effectiveness of multilateralism on the integration process and because of the importance that ASEAN has gained through its thirty years of existence as the only regional institution in East Asia, China decided to employ a constructive diplomatic tactic in its approach to Southeast Asia by initiating different forums. The ASEAN-China SOC (Senior Officials Consultation), established in 1995, was the first of those. It was created to prepare for the ministerial meetings and to review the ASEAN/China relations in a "friendly and relaxed atmosphere". The so-called "ASEAN + 1 Free Trade Agreement (FTA)", proposed as early as November 2000, was launched with a good communication campaign and presented as a real

21 Robert Sutter *"China's recent approach to Asia: seeking long-term gains"*, Seattle, National Bureau of Asian Research, NBR Analysis, vol. 13, n°1, march 2002, p: 13
22 Alastair Iain Johnston and Paul Evans "China and multilateral security Institutions" in *Engaging China: the management of an emerging Power* ed. Alastair Iain Johnston and Robert S. Ross, London, Routledge, 1999, p: 256
23 Kuik Cheng Chwee "Multilateralism in China's ASEAN policy: its evolution, characteristics and aspiration", Contemporary Southeast Asia, 27, n° 1 (2005), p: 102

opportunity for ASEAN.24 This tactic had the immediate advantage to position ASEAN as a long-term partner for China: this proactive initiative was aimed to illustrate publicly China's goodwill towards ASEAN and its intention to convince its members that "a prosperous China is an opportunity rather than a challenge to ASEAN". As a "responsible power", China was taking into account the necessity to avoid another round of regional economic downturn, thus projecting its contribution as a positive parameter in Southeast Asia's recovery. The ASEAN-China relationship has been broaden as well as strengthened and several protocols have been concluded; the first China-ASEAN Exposition was launched in 2004, an expo to be held annually to bridge enterprises from China and ASEAN. China's accession to the ASEAN Treaty of Amity and Cooperation in October 2003 completed this strategy to highlight the peaceful nature of its rise. Last but not least, at the 2004 Summit, China and ASEAN signed the establishment of the China-ASEAN Free trade area. Chinese Prime Minister Wen Jiabao at the Summit reinforced confidence when he pledged greater cooperation with ASEAN, ranging from energy cooperation to financial matters, and, as previously said, to strategic issues. Even, at the 11th China-ASEAN Senior Officials Consultation, the implementation of a joint declaration for advancing a *China / ASEAN strategic Partnership* was discussed. China reiterated its willingness to join in the protocol of the *Southeast Asia nuclear weapons-free Zone Treaty*.

Certain observers are just dubious about such a rapprochement and assert that ASEAN will soon need other regional partners, such as Korea and Japan, to balance again Chinese precarious ascent. What clearly appears anyway, is that these developments have constrained China's neighbours (be it Japan which has to reinvent its model, South Korea which tries to exploit all the opportunities due to the Chinese dynamics or ASEAN which can't escape this multi-faceted pressure) to readjust their relations with Beijing. Either they like it or not, China has now entangled its regional partners in a very sophisticated web of interdependencies.

Last point, China tries to compensate its military modernization with a proportional involvement in multilateral networks and bilateral security dialogues.25 At the 2003 ARF inter-sessional group and ARF foreign ministers' meeting, China introduced a concept paper that included a set of proposals for increasing military exchanges and establishing annual security conferences. This initiative was consecutive to the frustration of China over the Shangri-la Dialogue where US participation was too dominant. ASEAN reacted promptly and adopted the initiative in July 2004 in Jakarta and the first meeting was held in November 2004 in Beijing. This initiative could announce a shift in the balance of power in East Asia.

In Northeast Asia, in the wake of the second North Korean nuclear crisis, China undertook the intermediate role between the US and North Korea, and succeeded in organizing the Six-party talks, a formula perceived by the international community as the best possible measure for peaceful solution of the crisis. It has now made its desire to institutionalize the talks to be known to the world on a few occasions while the talks went on. It also placed high expectations on the talks' potential for institutionalization based on its value on the fact that there was not a pre-existing occasion when all six regional states congregated for security reasons. For the talks to be a success, it posits that any form and type of resolution would have to be legally effective, implying commitment by the six parties be based on legal terms. Provided that all the six parties will persevere in their efforts to uphold the talks, China's insistence on institutionalization of the talks is not unrealistic, and may have to be realized. During that period, China was also very active on the economic front, proposing an eventual China-Japan-Korea free trade area.

24 Jose Tongzon "ASEAN-China Free Trade Area: a Bane or Boon for ASEAN countries ?", *World Economy* 2005 – 02, vol. 28 n° 2 p: 191

25 David Shambaugh *Modernizing China's Military: progress, problems and prospects,* Berkeley, University of California Press, 2003

China's economic and cultural resurgence, coupled with mitigated anti-American sentiments and the necessity to structure regional ties to avoid the "contagion effect" of the 1997 crisis partly explain the search for a new regional setting; but the preservation, even extension, of chinese national interests should not be under-estimated as China tries to position itself as the coming new world power. Anyway, in the current negotiations process, games, and bargains, are open. Old rules are challenged and previous modes of cooperation could not be maintained.

3.2 ASEAN and the East Asian regionalisation

This chinese push is currently generating a serious challenge to the fundamental ideology of regional integration in East Asia. Who, what country or group of countries is going to put its footprint on the East Asia Community? Once perceived and acknowledged as a formidable principle, the so-called "ASEAN way" could, to a certain extent, be on the verge of being substituted by what would be labelled as a "Chinese way"; indeed, as it has been suggested, China could hold clout and influence in the new grouping, asserting its rules and norms, thus putting at risk the benefits of ASEAN for Southeast Asia.26 This threat of dissolution for the Association of Southeast Asian Nations, the loss of its spirit and of its diplomatic way, have been recently stressed by President Yudhyono of Indonesia.

The 1997 economic crisis concretized the degree of interdependence in East Asia and the inherent risk of contagion; it also revealed a certain degree of exasperation with the Western attempt to manage the difficulties (through individual countries or international organisations such as the IMF). Therefore, it was not a surprise that multilateral summits between ASEAN member States, Japan, China and South Korea have been convened annually since December 1997 and that all these countries get entangled in a web of free trade agreements.

The ASEAN + 3 frame, a by-product of the East Asia Economic Caucus proposed by Mahathir, former Prime Minister of Malaysia, in 1991, represented the first formalised, summit based and exclusively East Asia economic grouping: it includes all the major economies of East Asia, except Taiwan. It definitely helped to build a sense of common purpose and identity.27 The East Asian Community concept, sealed in November 1999 with the establishment of the East Asia Vision Group, led by Korean former Foreign Minister Han Sun Joo, formalised the idea and submitted a blueprint for the East Asia community at the ASEAN + 3 Summit in Brunei in November 2001. More pragmatically, it contributed to launch new regional initiatives, mostly in the economic and financial sphere as the establishment of a currency swaps and financial monitoring (the "Chiang Mai initiative").28

Seven years after the launching of the ASEAN + 3 formula and without much fruition, negotiations are open to replace it by the so-called "East Asian Summit" (EAS) to be held in Kuala-Lumpur in November 2005. As EAS was initiated by China during the 10th ASEAN Summit meeting in Laos, the intention and purposes of EAS should be understood as a new "Asian approach" for the management of regional relations, most inspired by the Chinese way.29 The risk here is to engage countries in a new initiative without a solid basis, to produce more declaratory form than substance, without a vision in mind: China has the game in hand and do not want to loose its turn.

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26 Amitav Acharya "Culture, Security, Multilateralism: the "ASEAN way" and regional order", Contemporary Security Policy, 1999 -04, vol. 19 n° 1, p: 55-89

27 Richard Stubbs "ASEAN + 3: emerging East Asian regionalism ?", *Asian survey*, 42 (3), p: 453

28 United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) "Regional Financial Cooperation in East Asia: the Chiang Mai initiative and beyond", *Bulletin on Asia-Pacific Perspectives*, 2002 / 03, March 2002

29 Fu Ying "China and Asia in the new period", *Foreign Affairs Journal*, n ° 69, September 2003, p: 6

The idea of EAS was widely accepted by the member States in Vientiane, Laos, October 2004. The purpose is to achieve a greater integration of ASEAN + 3 with India and a hope to include Australia and New Zealand : this possibility would allow not to antagonize on "racial issues" while denying, for geographical reasons, a membership to the US. Thus, the geographical range of the East Asian regionalism will naturally expand to South Asia (India), Southeast Asia, Northeast Asia, and Oceania. Even if the intention is to strengthen the region's position against the deepening regionalization in other areas, such as America with its aspiration for Free Trade America Association (FTAA) taking root and EU with its enlargement at work (the EAC should be able "to hold its own agenda" following the declarations of Gloria Macapagal-Arroyo, President of Philippines), the scope of the agenda is not limited to economic issues. It intends to include those issues ranging from security to joint development in energy in particular. It is expected to forge a longer-term Asian economic, social, cultural and political community so as to "balance" the US, Europe and other groupings in the future. Simultaneously, the wide range of its scope is in itself, an object of perplexity as the foundations for this EAC still look fragile and shaky (cf sino-japanese dissensions).

According to analysts, optimism for the prospect of the EAS can be expected for the following developments in the region:

- First, Beijing and New Delhi's growing importance to ASEAN was officially acknowledged at summit level for the first time at the last Summit. While China's economic interdependence continue to grow, India's trade volume with the ASEAN states expects to reach $ 70 billion in 2007. ASEAN's recognition of China's importance has already been stressed and the stakes for ASEAN are high: to keep its marginal technological advance (Singapore, Malaysia and Thailand) and not become only a raw material producer for China. Its discussions for free trade agreements with Japan and Korea should begin in 2006. They will certainly reflect the growing tussle between China and Japan for Southeast Asia's partnership. To a certain extent, ASEAN has effectively gained a certain degree of influence in the process of deciding who is going to lead and manage the leadership in East Asia's regionalisation;

- Second, notable development underlies in ASEAN's decision to speed up its own economic linkages in setting up an ASEAN Economic Community (EAC). ASEAN member States know they have to sort projects out. ASEAN leaders signed pacts to push forward economic integration within the grouping, so that the "original" five ASEAN states (Indonesia, Malaysia, the Philippines, Singapore and Thailand) and Brunei would abolish trade tariffs in 11 sectors by 2007, three years ahead of schedule. These 11 sectors in fact constitute more than half of current intra-ASEAN trade. The other four economies (Vietnam, Cambodia, Laos and Myanmar) will join the trade pact by 2015, or five years earlier than scheduled. EAC will be further facilitated if and when ASEAN-China FTA partnership goes to fruition because it would provide ASEAN with an impetus to coalesce as investment shifts to China;

- Thirdly, although for the first time, India's participation was meant to be its official induction to the Asian economic integration process. It may seem a natural step considering the fact that India is currently negotiating an FTA with ASEAN. However, without China's normalization of relations with India, it would have not happened. China's improved relationship with India has helped paved the latter's integration with the region, although China's trade ties with the East Asian region clearly surpasses those with India;

- Fourthly, sub-regional or pre-summit meeting were held just before the main summit and those participated pledged to work together to narrow their wealth gap with other six "older" countries; they also pledged to move quickly towards integrating their four economies so as to

better attract foreign investment together. It is another example of growing influence of China in these four countries of Indochina because it provided this sub-regional impetus to integrate further, which in turn could also enhance Beijing's overall standing and influence within the "greater" ASEAN in the future;

- Fifthly, ASEAN invited for the first time Australia and New Zealand to the summit, as ASEAN prepares to begin negotiating FTAS with both Canberra and Wellington in 2006. This was significant because Australia, conscious of its alliance with US over Asia-Pacific affairs, refused to sign the ASEAN Treaty of Amity and Cooperation (TAC). Beijing also supported the inclusion of these two Pacific nations as mirrored in results of Hu Jintao's summit meeting with John Howard recently. On the occasion, Prime Minister Howard decided to confirm his nation's identity with Asia and China in particular during his recent visit to Beijing where he announced to lift arms embargo against it.

Based on these observations, China's leadership in playing out for the EAS is self-evident. Beijing for instance, has called for the end of the ASEAN + 3 framework to be replaced by the East Asian Summit; but in that format, the ASEAN members will be represented separately. China can only rise with other Asian partners, not alone, even less against them. There is a crucial decision that was taken to organize an EAS in Kuala Lumpur in 2005, when Malaysia takes over the chairmanship of ASEAN. It is already understood that the inaugural EAS in Malaysia will be followed by a second Summit to be held in China, thereby placing Beijing within the fundamental "core group" of the East Asian integration process. By hosting the second East Asian Summit in 2006, it could then affirm the group's agenda, scope, goals and even institutions in a more decisive way ; and here the basic question is the extent to which China will press for its national interest or will be ready to compromise with the constraints of region-building: to what extent will China pay attention to ASEAN's experience ?

However, games are not completely done. First, because of differences of opinion among ASEAN members in fleshing out details of the EAS, notably the issue of membership. The States of East Asia cannot agree on what form regional organisations should take and how effective they should be. Second, the modalities of organization are still not done. Japan has pressed for a system of co-chairmanship (with the chair rotating between an ASEAN and a non-ASEAN country); it also proposed a "tiered" system consisting of an inner core of ASEAN + 3, a second tier of relations and cooperation with extra-regional players like India, Australia and New-Zealand, and a third with the United States (Tokyo is suspected to do all it can to keep Washington in the regional game, thus widening the gap with its partners). On this special proposal, ASEAN is divided, some members refusing that non-regional members be allowed to join this club. And basically, some participants suggest that everybody put some order in its house, consolidating ASEAN in Southeast Asia, and slowing down the sino-japanese rivalry in Northeast Asia. Third, because participants do not agree on the scope of the agenda to be discussed; Japan and South Korea, supported by some countries like Thailand or the Philippines, would like to raise issues related to democracy, human rights, good governance and powers/duties of a regional institution while some others would prefer to focus on economic and trade issues which are, apparently less controversial.

Nonetheless, China's aspiration to be the leader of the EAS will not go unnoticed in the near future. It will continue to rely on all diplomatic means till it accomplishes this end. Its "global" pressure on ASEAN will continue. In other words, China intents to pursue a more active diplomacy around its southern periphery in Southeast Asia. Its $400 million soft loan, for instance, was promised as a result of Hu Jintao's summit meeting with Philippine President Gloria Macapagal Arroyo in Beijing in September 2004. It will be utilized to build a rail link between Manila and a former US air base, Clark, prompting Manila to conclude a defence

cooperation pact with China. In the following month when Hu Jintao paid a reciprocal visit to Manila, the two nations agreed to pursue joint energy cooperation around the Spratly island areas, which drew fervent opposition by the Vietnamese government for unsettled sovereignty rights over the areas reasons. However, Vietnam would eventually declare in November to join the project with China and the Philippines. Chinese investments in Indonesian oil, gas and power plants will certainly increase with the Yudhoyo administration. Thailand and China are in pursuit of an "early harvest" agreement that was offered by China the year before on fruits and vegetable, a step that is regarded as necessary and critical towards realizing FTA with ASEAN and China. And China's links with Burma are a secret for nobody: the emergence of China has already provoked important shifts in geo-political alignments.

4. ASEAN choices and the European Union

Changes are coming very fast with different forms and degrees; it means ASEAN has to react and make decisions quickly which is unusual and could put it under hard pressure. Two elements make it difficult for ASEAN. First, China is moving as one country, always faster than a group of countries linked by a consensual diplomatic mode. And second, East Asia is going through major developments but without a clear direction, and even less political will. There is even a discrepancy between the economic de facto integration and the diplomatic exploitation of political disagreement. In this confusion, to choose a direction looks like an impossible challenge.

If China seems to lead the way, rules and games are not yet done and could even prove reversible. If Beijing looks very active, its position is not yet consolidated. China's future is not without turbulences, and those will impact on the current negotiations and certainly put old and consistent players back on track. The reality is that China is making so much noise and waves, that it deliberately occupies all the public diplomatic space. It doesn't imply that the others are doing nothing. The commitment of Japan towards Southeast Asia has never been neglected and could offer a reliable alternative. The tsunami crisis of December 2004 has illustrated Chinese willingness to be present on the ground but without any real influence. Conversely Japan, which didn't talk a lot, brought a $ 500 million check on the table. Furthermore, China raises apprehensions over its economic long-term interests (since China is an almost perfectly integrated manufacturing economy from the lowest end to the highest technological chain of production) and its competitive edge in the agricultural field. In the perspective of a new regime of production networks in East Asia, will ASEAN become a subcontractor for the Chinese engine? What would be the new regional division of labour like with an emerging China? If Europe as ASEAN has much to gain from China's development achievement, they both have an interest not to pay the high price.

ASEAN has to regain some confidence to make decisions and embark on new proposals to be a full player in the coming Asian Century. The challenges are as much inward as outward in nature. External partnerships and regional alliances will be helpful to deal with their dual nature and avoid being drawn into a Chinese sphere of influence: they will give the necessary distance before a number of moves are able to impact on ASEAN's evolution. Even if the European reference is not the one model to follow, ASEAN has something to gain by studying the European experience. Europe is not here to give lessons, with arrogance and disdain (and the general perception in East Asia is very negative on this particular point) ; with a rather low perception and credibility of its position in world balances (only in Southeast Asia, Europe's position with ASEAN is on the decline: it is now the 4th trading partner after China), it better shares its experience with basic facts and methods. Indeed, its own situation, after some countries refused the constitutional Treaty, should make it cautious and low profile. If there is something to be shared between East Asia and Europe's experiences, it is precisely a questioning, a reflection

and a debate on how a group of countries deal with political sovereignty, economic competitiveness, social construction and ultimately, power; it is not "a teacher to pupil lesson".30 Even if Europe is the most advanced example in this construction process, it is not exempted from doubts, even failures.

The most valuable contribution the European Union can share is precisely the experience of this erratic process: how do you positively implement a global vision despite true and false obstacles and puzzling games? The European Union is perceived as too conceptual when people ask for pragmatic solutions. In the 5 challenges cited below, the European Union has an expertise to share. How to do it at best and help the Association to prepare for its future?31

First challenge: democracy. How to support and encourage it in a region still marked by its diversity in terms of political regimes (from Philippines constitutional democracy to Brunei's absolute monarchy and communist-led Laos or Vietnam)? What could ASEAN do to help at its implementation when the principle of non-interference is still the rule of the game? Of course, China, though not a member of ASEAN, is leaning on the lever as it proposes a model of partnership that does insist on exchanges and dynamics but not on the rule of the law or the participation of civil societies. Political issues are carefully put aside in the regionalisation scheme China proposes. If the European Union is to lift the embargo on arms sales to China, it should include more political criteria in its new "strategic partnership" with Beijing. Concerns over the EU's plan with China upset Asia's power of balance, and Southeast Asian countries do not welcome well the hypocrisy of the "double standard" policy. If Brussels is making democratic and human rights progresses the "essential elements" of any dialogue between the two regions, it should ask as much from Beijing as it asks from ASEAN. Obviously as the case of Myanmar has proved, Brussels's approach is not well interpreted and Beijing has thus also the political clout to ignore it and press ASEAN to ignore it too. To ease political restrictions and push forward for reforms is one thing, but to call for the release of all political prisoners (as the EU has asked to the junta) is another one, not well received in the ASEAN countries which consider these issues as domestic ones. The threat of a new boycott if Burma heads the Association of Southeast Asian Nations next year (on a rotating basis) might not be the right strategy to support ASEAN. Furthermore, European companies are leaving under pressure from a regime of sanctions while China attaches little or no importance to the issue of human rights abuses committed by the military regime. According to Stephen Frost, the basic question that now confronts the international community is not so much whether European investment outweighs Chinese, but what role China will play in a post-junta Burma?32 "Will Europe find itself marginalized in a rebuilding process?" It might be time for a common reflection.

Second challenge: development gap. How to maintain a unity when some countries rank among the poorest (Laos or Cambodia) and some (Singapore or Brunei) among the richest? How to bridge the development gap between the 4 new members and the rest? Here also, the EU has a special experience with its recent enlargement and the converging development process it justified. On this special issue, new comers, as European bureaucrats, have to show that the benefits of enlargement are substantial and largely outweigh the costs of accession and that development gaps can be managed if accompanied by policy measures and reforms. Here, the rationale for integration is to be put on the table since ASEAN member States do not seem completely convinced of its interest. But if ASEAN wants to weigh against Northeast Asian

30 Bertrand Fort and Sophie Boisseau du Rocher *Paths to regionalisation, comparing experiences in east Asia and Europe*, Singapore, Marshall Cavendish, 2005, p: xi
31 Simon Tay *The future of ASEAN: an Assessment of Democracy, Economies and Institution in Southeast Asia*, Singapore Institute of International Affairs, Singapore, September 2003, p: 49
32 Stephen Frost "Chinese outward direct investment in Southeast Asia", *the Pacific Review*, vol. 17, number 3, 2004, p: 335

economic dynamics, does it have the choice? A constructive debate on this theme could certainly strengthen convictions.

Third challenge: economic liberalisation. Despite successive revivals, AFTA is not yet a success and doesn't really matter. Administrative paperwork is still too complicated and too long to be filled up; on this concrete field, expertise and formation would be most welcome as ASEAN bureaucracy is not enough to support ASEAN to get its acts together. More basically, domestic economic resilience is still high and slows down the path towards a true regional market. China plays on the competitiveness of its neighbours, thus enlarging intra-ASEAN competition. There is no ASEAN firm yet and if joint ventures have to be pursued, it is between Northeast and Southeast Asian firms. In the perspective of an East Asian market, what is the best choice for ASEAN and ASEAN business communities? Instead of complaining about the rising competitiveness of East Asia, European firms should be more pro-active and involved in the current reorganisation to benefit from the implementation of China/ASEAN FTA; all the more that a free-trade agreement project between the EU and ASEAN is a far remote project !

Human security, with people afraid to lose their jobs under the pressure of Chinese competition, is the fourth challenge. The gap between the rich and the poor has become wider, be in Southeast Asia or in Europe. Thus Southeast Asia has the potential to become a less secure region with criminal activities (such as piracy, riots, robbery…) on the rise. Here too, Europe and ASEAN have a lot to share, both stressing the human dimension of security.

Fifth challenge: regional security community. ASEAN security initiatives are part of a security network that goes beyond Southeast Asia; ASEAN countries are in a "critical geopolitical situation", highlighted by important sea links. Even, the war against terrorism after September 11 has compelled ASEAN and Europe to be much more pro-active in dealing with regional security. The 2003 Indonesian initiative to establish an "ASEAN security community" should be interpreted as an opportunity to encourage ASEAN role in security and stability in a more realistic and practical way. In March 2005, the European Union declared its willingness to deepen its security links with ASEAN "to help strengthen the regional grouping and enable it to tackle terrorism more effectively". The fight against terrorism or organised crime is a common concern as "they are threats which are truly global in nature". To generate a more secure ASEAN could be one of Europe's ambitions and in so doing, a counterweight to the potential uncertainty that could weaken East Asia in the next years. But Europe has only limited involvement, and no direct military stakes, in Southeast Asia security. For the EU, the challenge is not only to anticipate the coming changes but to position itself as a reliable partner in order to stabilize the region.

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To handle such challenges, the support of the European Union will be most useful. But Europe suffers from a deficit of image. It is not perceived as a main partner in the Asian game, neither a staunch supporter of ASEAN; it is not considered as having any strong influence and credibility in the region.

Europe should not consider East Asia as only China, and therefore, Southeast Asia as a mere periphery. Some observations have been made, during interviews, that in the Asia/Europe Meetings (ASEM), European partners were just looking to their Chinese counterparts as if they were the spokespersons for East Asia! As has been previously said, games are still open; China is now on the rise but might be a factor of turbulences in the coming years. Anyway, the new trends and deep changes we observe in East Asia are not well prepared by the European Union.

The first point on which Europe should work is a reappraisal of its public image. Europe, viewed as too arrogant and elitist, doesn't appear any more as a vector of change and doesn't give rise to high expectation level.

Because of the gap between its political values, the weight of its bureaucracy and the weakness of its diplomatic visibility in Southeast Asia, the European Union is taking the risk to appear as the evanescent good conscience for the humanity ! A nice role, even a useful one, but a very productive one for itself?

The Political Economy of North-East Asian Integration

Willem van Kemenade

THE POLITICAL ECONOMY OF NORTHEAST ASIAN INTEGRATION

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1. INTRODUCTION:

This paper was commissioned before the outbreak of violent anti-Japanese demonstrations in major Chinese cities in April 2005. Since these incidents raised questions not only about the stability of one of the most important political and economic great power relationships in the world, but also about domestic political stability in China, it was considered to rename this paper: "The Political Obstacles against Northeast Asian Economic Integration". However, since the Chinese government, after some initial ambiguity, moved quickly to calm the situation, the status quo ante in the Sino-Japanese relationship of "hot economics – cold politics" was restored. Since the scope of this paper is to look beyond newspaper headlines towards long-term trends, the original title of the paper was maintained, but some extra chapters on the vicissitudes of Sino-Japanese relations were added.

The overarching question is how the dynamics of Sino-Japanese relations should be understood in the context of the emerging new 21st century world order. The classical paradigm of *neo-realist competition* for a shift in the balance-of-power is inadequate due to deeply-rooted nationalist sentiment and unique cultural factors. In contrast to historical analogies such as the rise of Germany and Japan in the early 20th century, one could characterize the current shift a *return to normalcy* rather than a cyclical rise of a new power or a *renversement des alliances.* As Japanese management-guru Kenichi Ohmae aptly put it in his book *China Impact,* a few years ago: "Over the last 4.000 years of history, Japan has been a peripheral country to China, with the exception of this one last century. In the future, Japan will be to China what Canada is to the United States, what Austria is to Germany, what Ireland is to Britain." The weight of history in the longer term will be more decisive than *realist* factors like military power and the *Hobbesian* 1 role of the United States in East Asia, which is unlikely to be permanent.

China and Japan have vast *complex interdependencies.* One prominent Japanese right-winger said: "Japan's high living standard depends on the US-Japan military alliance". 2 One could argue that it depends a lot more on economic integration, trade and investment with and in China, especially the relocation of Japanese industries to China where they can produce affordable consumer goods for the Japanese people to be reexported back to Japan. Japanese investment in China is not just bilateral, as most Taiwanese investment into the PRC is also linked to Japanese capital.3 The two countries also share environmental concerns. Japan is reconsidering its Official Development Assistance to China for sectors like infrastructure, but it will continue to finance environmental projects. Other "soft" interdependencies are cultural and educational exchange, pop-culture, tourism, motivated by cultural affinity, etc.

This paper looks first at the political obstacles against regional economic and trade-integration, first within Northeast-Asia (China, Japan, Korea) and then between Northeast and Southeast Asia. China's drive to integrate with ASEAN is motivated by its strategic design to marginalize Japan as a regional leader and to downsize the importance of Taiwanese trade and investment. (part 2.)

1 As described in Robert Kagan's article "Power and Weakness", Policy Review 113, 22 July 2002.
2 Interview with Ambassador Hisahiko Okazaki, Tokyo, April 2005.
3 Phil Deans, Japanese Economic and Political Involvement in the Taiwan Straits, EIAS Conference, Paris, 23 November 2004.

Part 3 deals with the historical first East Asia Summit, to be held in Kuala Lumpur, Malaysia in December 2005. Not only the ASEAN 10 and the Northeast Asian 3 will participate, but also India and New Zealand and perhaps Australia if it accepts a compromise on its security ties with the United States.

Part 4 focuses on the Northeast Asian Triangle, the bilateral economic relationships of China-Japan, China-Korea and Korea-Japan, the progress in negotiations for Free Trade Agreements and Japan's role in the region.

Part 5 is entirely devoted to the most important bilateral relationship in the region, that between China and Japan, which is also the most troubled one. It looks at World War II issues, including Taiwan, the role of the United States, the Sino-Japanese struggle for preeminence in East Asia, and the Japanese drive to become a "normal" country, i.e. without constitutional restrictions on the use of military power except for self-defense. The Sino-Japanese relationship is not expected to be friendly for a long time to come. Some leading Japanese speculate that a "Cold War" summits but no trust and also no fighting, might be the best that can be hoped for.

The final parts 6 and 7, offer Conclusions and Recommendations, whereas an appendix reports on East Asian views on a European role in East Asian security.

2. ECONOMIC INTEGRATION IN ITS INFANCY – POLITICAL INTEGRATION A DISTANT DREAM:

Regional integration in North- and Southeast Asia, both political and economic, is in its infancy, with many missing links, most spectacularly the direct Japan-China link. With a two way-trade volume in 2004 of $ 168 billion 4 it is one of the largest trade and investment relationships in the world. Yet the two great powers are unwilling to maintain friendly political relations with each other and engage in structured trade and investment agreements. The reasons are obviously competition for an impending shift in the regional status quo. China is not willing to accept the looming transformation of Japan into a so-called 'normal' country, i.e. a country without constitutional restrictions on the use of military power, that could reemerge as a regional military factor. Japan is not willing to accept the rise of China as a superpower. The two neighbors are increasingly interdependent, but Japan is moving further away from continental Asia, seemingly to become an ever closer military ally of the United States (see Section 5). China uses Japan's failure to atone for its criminal war past to keep it down and deny it membership in the most exclusive political club in the world, the permanent members of the Security Council of the United Nations. Prime minister Junichiro Koizumi's annual pilgrimages since 2001 to the Yasukuni Shrine, where Japan's war-dead, including executed class-A war criminals are enshrined, have become the prime symbol of the bad blood between China and Japan. Without termination of this ritual that is most offensive to both China and Korea, the prospects for a relaxation in political relations are dim.

Inflamed nationalism and mutually negative feelings on both sides obfuscate what the longer term objectives of the two countries are. A seminal article by People's Daily commentator Ma Licheng in 2002, advocating new thinking about relations with Japan, away from World War II issues and geared towards the future, triggered an extensive debate among academics from across

4 Chinese Customs Statistics.

the ideological spectrum, but it was counterproductive.5 Moderates were marginalized and an ensuing wave of ferocious Japan-bashing illustrated how deep hatred of Japan still runs in China. Nevertheless, some leading intellectuals remain optimistic. Wang Jisi, director of the Institute of American Studies at the Chinese Academy of Social Sciences wrote last year:
"As new generations of Chinese elites with no experience of the Second World War emerge, the historical imprint in China's policy toward Japan will hopefully fade. This process is likely to take more than a few years … 6

One Japanese author is more pessimistic about the younger generations in his country. According to former vice-minister of Foreign Affairs Yutaka Kawashima, "today to a younger generation that does not share the memory – of the war and of rebuilding Sino-Japanese friendship in the 1970s and 1980s - , arguments of the importance of the friendship between Japan and China are hardly convincing". 7

Two other legacies of World War II and the Cold War are bedeviling stability and security in the region: Taiwan's drive for formal independence and the North-Korean nuclear issue. China's rapid rise and these long term challenges are all unfolding in a region that lacks firmly established integrating institutions like those of the European Union, that help build trust.

Officials and academics are fully aware that integration in East-Asia will be far more difficult than in Europe since there is a mosaic of five distinct civilizations: Japanese, Sinic-Confucian, Islamic, Buddhist, Hindu and Christian, whereas in Europe there is historically only one: Judeo-Christian with three major branches – Catholic, Orthodox and Protestant. 8 Political and systemic differences are also much deeper due to the profound cultural-religious and linguistic diversity, different legacies of colonialism and communist revolutions. Gaps in economic development are deeper than anywhere else in the world. Per capita income in Japan is thirty times China's, and the Northeast Asian medium power South-Korea with a population of 47 million has a GDP not much less than the aggregate total of ASEAN with 522 million people.

On top of all these glaring disparities: Asia has no security community in the transatlantic sense, comparable to NATO and OSCE. ASEAN has a security dialogue process, the ASEAN Regional Forum (ARF), but it is only a consultative organ without any treaty- or military command structure. In Northeast Asia there is the halting "Six Party Dialogue on the North-Korean Nuclear Issue", which after a lull of more than a year will be resumed late July 2005. Military conflict in North- and Southeast Asia is still quite imaginable in at least three, perhaps four (potential) troublespots: the Korean Peninsula, the Taiwan Straits, the East-China Sea (around the Diaoyu/Senkaku Islands) and perhaps in the South-China Sea around the Spratly Islands.

3. THE COMING EAST ASIAN SUMMIT:

Up to now, the turmoil in Sino-Japanese relations – demonstrations, diplomatic snarling, and media-recrimination - has not affected the schedules of whatever regional integration efforts are

5 Ma Licheng, Dui Ri Xin Siwei (New Thinking on Relations with Japan), Strategy & Management, Beijing, Fall 2002. See also Peter Hays Gries, China's New Thinking on Japan, China Quarterly, 2005
6 Wang Jisi, China's Changing Role in Asia; In: The Rise of China and a Changing East Asian Order, Edited by Kokubun Ryosei and Wang Jisi, Tokyo, 2004, p. 15.
7 Yutaka Kawashima, Japanese Foreign Policy at the Crossroads, Challenges and Options for the Twenty-First Century, Tokyo 2003, p. 2.
8 Some consider Japan part of Confucian civilization, but Samuel Huntington in his famous 1993 Foreign Affairs essay "The Clash of Civilizations" lists Japanese as a separate civilization. besides Western, Confucian, Islamic, Hindu, Slavic-Orthodox, Latin American and possibly African civilization.

taking place. The first so-called East-Asia Summit (EAS) is scheduled to be hosted by Malaysia in December 2005.

Since bilateral dealings between China and Japan have been severely impaired for quite some time, ASEAN is in de drivers' seat and is now preparing the Summit with the ASEAN 10 + 3 – China, Japan, South Korea, plus India and New Zealand and possibly Australia if it agrees to sign on to the so-called Treaty of Amity and Cooperation in Southeast Asia (TAC).9 This pact for regional peace and stability was originally entered into by the five founding members of ASEAN, Indonesia, Singapore, Malaysia, Thailand and the Philippines in 1976 and its basic aim was to keep the region free from foreign – i.e. American – interference and domination. Besides promoting amity and cooperation, the treaty includes a "renunciation of the threat or use of force" and an agreement that all parties "shall not in any manner or form participate in any activity which shall constitute a threat to the political and economic stability, sovereignty, or territorial integrity of another High Contracting Party." Unlike New Zealand, whose military alliance with the United States is defunct since the Labour government of David Lange during the 1980s refused to allow nuclear-armed or nuclear-powered US navy-ships access to its ports, Australia faces a major dilemma in signing on to this treaty. On the one hand, it wants to benefit from the economic dynamism in the region through trade and investment and participate in the emerging network of "Free Trade Agreements", and on the other, it wants to maintain its military alliance with the United States and order military strikes, if necessary, in neighboring countries to pre-empt terrorist attacks being planned against Australians, like the one in Bali in 2002. Recent news reports have hinted that Canberra is preparing to do an about face and sign the treaty. Like Japan, it could insist that such an arrangement should not compromise its strategic obligations to the US military alliance. Such an outcome, however, would only pose new difficulties, e.g. the American demand that Australia support a US war against China over Taiwan.

China became the first major power to accede to the TAC when premier Wen Jiabao attended the 9th ASEAN Summit in Bali in October 2003. The accession can be seen as the political complement to China's breakthrough in economic relations at the 2002 summit in Phnom Penh, when the China-ASEAN Free Trade Area was adopted. This promises a virtually tariff-free trade zone with a population of 1.8 billion people by 2010 (less developed ASEAN countries have a 2015 timetable). India joined the treaty immediately after China, Japan and South-Korea signed on in 2004. 10
The Foreign Ministers of the East Asian countries, including those of China and Japan got together in Kyoto in May 2005 in the larger context of ASEM (Asia Europe Meeting) to discuss the framework for this EAS, including the membership. 11

4. THE NORTHEAST ASIAN TRIANGLE: CHINA-KOREA-JAPAN

4.1. New Low in Sino-Japanese Political Relations

As economic cooperation and some initial steps towards integration in Northeast- and Southeast Asia between the major players, China, Japan, South-Korea and ASEAN are advancing, the crisis

9 New Zealand prime minister Helen Clark announced her country's accession in principle on May 9, 2005 during the visit of Vietnamese prime minister Pham Van Khai. Beehive.govt.nz, the official website of the government of New Zealand.
10 The Treaty of Amity and Cooperation can be viewed at http://www.aseansec.org/1654.htm
11 Chairman's Statement of the Seventh ASEM Foreign Ministers' Meeting KYOTO, 6-7 MAY 2005. 8.
In connection with the strengthening of multilateralism, the Ministers exchanged views on the following:
The Ministers deepened their understanding through exchange of views on the development of regional integration in Asia and Europe: ASEAN+3 cooperation, the movement towards an East Asian community (EAc) and the East Asia Summit (EAS), as well as development in further EU integration and enlargement.

in political relations between the two regional great powers, China and Japan reached a new nadir in April 2005, with a wave of violent demonstrations against Japanese diplomatic and business establishments in major Chinese cities. The demonstrations coincided with an international petition drive to collect signatures on the internet opposing Japan's candidacy for permanent membership of the United Nations Security Council. There was a degree of tacit government support or at least tolerance for the demonstrations. Police allowed part of the angry crowds of mostly students to march to the Japanese embassy on Saturday April 9, watched passively while the crowds threw bottles and stones and then after a while, broadcasted messages from police-vans that: "You have vented your spleen enough. Now go back to your campus. The buses are waiting". 12

Two weeks later, on the sidelines of a conference in Jakarta, Japanese prime minister Junichiro Koizumi made an unusual high profile apology for Japan's wartime aggression expressing "deep remorse" over the pain Japan had inflicted on its neighbors in Asia.

After the apology, Koizumi had a chilly meeting with Chinese president Hu Jintao at the Jakarta conference venue. The Japanese leader confirmed that Mr Hu had raised the thorny issue of his repeated visits to the Yasukuni shrine — which venerates 2.5 million war dead, including seven World War II figures hanged for war crimes — but said they had agreed not to discuss the matter in detail. Koizumi added that there was no change in his policy on future visits to the shrine for the time being and that he would "make a judgment appropriately". The dispute reached a new climax in May when visiting Chinese vice-premier Wu Yi cancelled a meeting with Koizumi after the latter had just reiterated his determination to continue his Yasukuni visits.

Harsh criticism of Koizumi for his dogged persistence in continuing his Yasukuni "routine", even at the cost of further damage to relations with China and Korea, was escalating. On June 1, five former prime ministers Kiichi Miyazawa, Tomiichi Murayama, Ryutaro Hashimoto, Yoshiro Mori and Toshiki Kaifu and the speaker of the Diet, Yohei Kono urged Koizumi publicly to stop the Yasukuni visits and avoid further worsening relations with China. It seemed to be one of many moves in an elaborate scheme to break the deadlock. The Asahi Shimbun on June 5 published an editorial harshly critical of Koizumi: "We wonder if the victims of war enshrined there would really be pleased to see Koizumi engaged in practices that undermine the peaceful relations Japan has built up with China and South Korea." 13 A week later, the Japan War Bereaved Families Association, an organization whose support had brought Koizumi to power in 2001 issued a statement expressing appreciation for Koizumi's frequent visits to the shrine, but added that he should consider the feelings of neighboring countries: "We appreciate the visits very much, but at the same time it is most important that the spirits of the war dead rest in peace. It is necessary to give consideration to neighbouring countries and obtain their understanding." 14 The statement maybe a gambit by Koizumi's own entourage to create a smokescreen in which he can retreat without too much loss of face. However, according to commentators it has less to do with the China factor and more with domestic politics: the Yasukuni issue has become a decisive factor in determining who will succeed Koizumi as head of the LDP, and hence prime minister, in September 2006.

4.2. The China-Japan Economic Relationship

Japan did not establish official relations with the People's Republic of China until 1972, due to its inability to distance itself from the rigorous containment policy of the United States. The loss of

12 Willem van Kemenade, Witness Report on the Japanese Embassy Demonstration, China Digital Times, Los Angeles, April 9, 2005.
13 Asahi Shimbun, June 5, 2005.
14 David Pilling, Koizumi offered way to break shrine deadlock, Financial Times, June 12, 2005.

access to China, which had been a supplier of natural resources as well as a crucial market in the pre-war era was a serious handicap for the economic reconstruction of Japan. In an attempt to maintain economic ties with China, the Japanese government had adopted a policy of 'separation of politics and economics', which enabled businessmen to conduct limited operations in China prior to the Cultural Revolution. Normalization of relations was achieved under prime minister Kakuei Tanaka in 1972. In 1973, Japan initially eyed China as an alternative supplier of oil in the wake of the OPEC-engineered oil-crisis. Agreement on a peace treaty took another six years after normalization, owing to the difficulty of handling the anti-hegemony clause, i.e. an anti-Soviet clause that China insisted upon.

Toward the end of the 1970s, China expressed readiness to accept direct loans from the Japanese government on concessionary terms to finance various projects in key sectors of the economy. Friendly feelings among the Japanese toward China reached its highest point, 79 per cent in 1980. The bloody repression of the Tiananmen Square student rebellion wrecked this euphoric mood. Japan joined the other G-7 nations in imposing sanctions on China, but was the first country to lift them in 1990 and help China out of its international isolation. Japan's criticism of China's human rights record was adamantly rejected by the Chinese leadership and China retaliated by magnifying World War II issues. Thus the emotional link between the human rights issue and the legacy of World War II became a unique feature of the relations between Japan and China. 15

The China-Japan relationship further deteriorated in the mid-1990s. The top issue was Japan's willingness to allow visits by Taiwan president Lee Teng-hui, an alumnus of a Japanese university during Japan's colonial rule over the island and an "afficionado" of the Japanese empire. 16 As a result of historical and post-colonial cultural links, there was rising sympathy in Japan for the new democracy in Taiwan. In 1996 a real crisis erupted around Taiwan when China staged missile tests in waters near Taiwan to deter the electorate from voting for independence in the first direct presidential election. Japan was also increasingly concerned over China's nuclear tests over which it cancelled grant aid to China. 17

Despite chilling political relations, Sino-Japanese trade was soaring. In 2002, China became Japan's largest import partner. Japan's imports from China exceeded those from ASEAN in 1991, from the Newly Industrializing Economies (Hong Kong, Taiwan, South-Korea and Singapore) in 1997, from the European Union in 2000 and from the United States in 2002. 18

Most of Japan's imports from China are manufactured goods. The ratio of manufactured goods to Japan's total imports from China rose 84.1 per cent from 58.1 per cent during 1991-2001. The percentage of textiles and clothing remained relatively unchanged at 29.7 per cent in 1991 and 29.1 per cent in 2001. The ratio of machinery rose considerably to 28.5 per cent from 5.8 per cent. In 2001, import items recording the highest growth over the previous year were mostly IT products: telephone and facsimile-machines - 98.2 per cent; telecom equipment and t.v. parts and accessories - 81.4 per cent; computers - 67.1 per cent. In the near future, Chinese products are expected to dominate Japan's IT markets. Nearly two thirds of Sino-Japanese trade is apparently in the form of intra-industry and intra-company trade. 19

15 The above summary is excerpted from: Yutaka Kawashima, op.cit., Chapter 5: Relations between Japan and China, pp. 95-110.
16 A large percentage of the Taiwanese, i.e. the Chinese population who resided there before 1949, holds relatively favorable memories of Japanese colonial rule, and resented Kuomintang repressive rule after 1945 and the imagined prospect of an (armed) communist takeover more deeply.
17 Akio Takahara, Japan's Political Response to the Rise of China. In: Kokubun Ryosei and Wang Jisi, op.cit., chapter 10.
18 Hideo Ohashi, The Impact of China's Rise on Sino-Japanese Economic Relations. In: Ryosei/Wang, op.cit., chapter 11, pp. 175-193.
19 Ibid.

In 2002, Japan's exports to China expanded substantially and recorded 32.3 per cent growth over the previous year, mainly because of China's trade liberalization due to its WTO accession and its "positive fiscal policy" to stimulate domestic demand.

Input-Output tables, compiled by the Japan External Trade Organization (JETRO) show that 95.4 per cent of intermediate input goods were domestically sourced in China, because of its comprehensive industrial structure. Machinery and transport equipment however, were more dependent on imported intermediate input goods, about 9 per cent. Of this 9 per cent 5 per cent reflects dependence on Japan. Considering the massive Japanese manufacturing investments after 1995, one could say that China's dependence ratio on Japanese industries has in all likelihood only increased further.20 For an increasing number of Japanese companies, China is their main profit source. For example the profit of the Chinese subsidiary of construction equipment giant Komatsu increased 63 per cent in 2002-2003. Of the company's global profit, 40 per cent came from its operations in China. 21

Ohashi explains that the rise of China has brought about a new pattern of economic development in East Asia, different from the "flying geese" pattern. He attributes the rise of China to the FDI-trade nexus in the late 1990s. The traditional Ricardo and Hechscher-Ohlin foreign trade models do not assume an FDI-trade nexus. However, FDI has fundamentally altered production technology and factor endowment in China with new technology or production factors easily being transferred from Japan to China in the form of FDI. There seems to be little time lag now between the first goose – Japan – and the last one – China – developing and mass-producing a new product. For example, a new generation television with plasma or liquid crystal display panels was developed and commercialized in Japan early in 2000. Just a year later, major manufacturers of this new generation television started production at their Chinese plants. Due to FIE's bringing new technology and production facilities into China, a giant "goose" flies high, ahead, as it were of the NIE's and ASEAN countries. 22

4.3 The China-Korea Economic Relationship

Prior to the establishment of diplomatic relations between China and South-Korea in 1992, trade and investment flows between the two were limited. Korean exports to China were $ 2.65 billion and imports from China were 3.7 billion in 1992. In 2001, China overtook Japan as Korea's second largest trading partner. Korea was China's sixth largest trading partner in 2001, with total trade of around $ 40 billion. Broadly speaking, from 1992 to 2001, exports of Korean goods to China increased at an average annual rate of 24 per cent, while imports of Chinese goods increased at an average annual rate of 15 per cent. 23 Two way trade is expected to top $ 100 billion in 2005.

The nature of Korean exports has remained more or less the same in the past decade: intermediate industrial goods such as equipment and electrical machinery. But the commodity structure of Chinese exports to Korea has drastically changed from agricultural goods and fishery products, mineral fuels and consumer goods to equipment, electrical machinery and iron and steel. Korean foreign direct investment in China can be traced to 1988 and increased remarkably until 1997 when it stagnated as a result of the Asian Financial Crisis. During the early years, the bulk of

20 Since compiling an I-O table requires considerable time and effort, there is usually a time lag of several years, Ohashi, op.cit., pp. 178-179
21 Ibid., p. 180.
22 Ibid., p. 181.
23 Jwa Sung-Hee and Yoon Gong, The Riseof China's Economy: Opportunities and Threats to China-Korea Economic Relations. In: Ryosei/Wang, op.cit. chapter 13, pp. 205.

Korean FDI was made by small and medium enterprises (SME) but this fell dramatically with the onset of the crisis and since 2000, large firms have displaced SME's as the dominant Korean investors in China. In 2001 China surpassed the United States as Korea's number one destination for FDI. Telecom, consumer goods and electronics, and more recently automobiles are the three areas that South-Korean FDI has targeted. The impact of China's increasing competitiveness as a low cost producer in key Third World Country markets is of great concern to Korea. Korea's share of the US market appears to have peaked at 3.31 per cent in 2000, while China's market share in the United States continues to grow from 8.22 percent in 2000 to 10 per cent in 2002. A study by the Federation of Korean Industries and the Ministry of Commerce, Industry and Energy projected that China would surpass Korea in the competitiveness of its autoparts and semiconductor industries in 2010 while China had largely equaled Korea already in the production of many ordinary household appliances and electronic goods. A survey (2003) of major Korean conglomerates shows that 43 per cent of the businessmen believe that the technology gap between Korea and China has been reduced to approximately four to five years in key industrial fields. However, 27 per cent believe that the gap is only one to three years. Most of the polled firms were nevertheless planning to expand their operations in China, mostly through FDI. A number of private sector strategic business initiatives between Chinese and Korean firms have the potential to pave the way toward broader and institutionalized China-Korea economic integration, and this could help generate momentum toward regional integration initiatives. 24

4.4. The Japan-Korea Economic Relationship

Japan's guiding role in the South-Korean economy started in 1965 when president Park Chung Hee, a former volunteer officer in the Japanese occupation army in Manchukuo, took the controversial decision to normalize relations with Tokyo. In 1961, per-capita income in South Korea was less than $100 a year. North Korea, with mineral resources and an industrial base, was regarded as the stronger power in the peninsula. Normalization with Japan brought $800 million in economic aid with it, which was used to set up the Pohang Iron & Steel Co., build the expressway from Seoul to Pusan and an underground railway system for Seoul. Park agreed that year to send two Korean divisions to fight alongside U.S. forces in Vietnam, for which Korea was richly rewarded by Washington. [Of the 30.000 Korean soldiers in Vietnam more than 3.000 died].25 In the mid-'60s, revenues from the Vietnam War were the largest single source of foreign-exchange earnings for Korea. These funds helped launch the country's transformation over the next two decades from economic basket case to world leader in iron and steel production, shipbuilding, chemicals, consumer electronics and other commodities. Korea's per-capita income increased tenfold during Park's tenure. 26

Japanese companies became significant investors during the 1970s, especially in petrochemicals and consumer-electronics. A flood of Japanese low-end manufacturers moved to free-export zones which offered them low wages and protection from the attempts of labour unions to organize workers. Despite geographical proximity, total Japanese investment in South-Korea is surprisingly low. According to Tokyo figures from 1951-1989, it amounted to less than $ 3.9 billion, or 1.5 per cent of total Japanese overseas investment during that period. This placed

24 Ibid., pp. 214-219.

25 This section is compiled from: Japan in Asia, The Economic Impact on the Region, Far Eastern Economic Review, Hong Kong 1991, Chapter Two.

28 Donald Gregg, Park Chung Hee: Despite a dictatorial streak, South Korea's long-serving President converted an economic basket case into an industrial powerhouse, Time Magazine, August 23, 1999. (Mr. Gregg is a former US ambassador to South-Korea).

29 Japan in Asia, p. 32

South-Korea fourth among Asian recipients. The leader was Indonesia, followed by Hong Kong and Singapore. 27

By the early 1990s the trend in Japanese investment was already in decline due to the rising labor costs, union militancy and low productivity that have dogged South-Korea. Many of the Japanese firms pulled out of the free export zones completely. The long list of Japanese complaints about Korea includes: formal and rigid corporate bureaucracies even by Japanese standards; too little inclination to invest in product quality; too long holidays. Politics and economics are combined too closely, leading to the following comment of a bemused Japanese manager: "This country has been against communism, but in practice it has been the most centrally planned economy". 28

4.5 Free Trade Agreements and the Free Trade Area Project:

China embraced the idea of transnational economic integration already in the early 1980s when it first set up four Special Economic Zones in Southeastern coastal China that would be exempted from domestic socialist restrictions in attracting foreign investment and expand trade. Following the four Southern pioneering zones, 14 coastal cities stretching from Manchuria to Vietnam got similar status in 1984. Four of them were located relatively close to Korea and Japan: Dalian in Liaoning province, Yantai and Qingdao in Shandong province and Lianyungang in Jiangsu province. Political obstacles to proceed fast were China's ideological links with North-Korea, the absence of diplomatic relations with the South and South-Korea's residual "anti-communist" loyalty to Taiwan. These problems were partly resolved when China ignored North-Korean opposition to Chinese normalization of relations with the South in 1992 in exchange for which South-Korea broke with Taiwan. Another multilateral integration project was launched in Northeast Asia that would involve Russia, North-Korea and more distant Mongolia as well, i.e. the "Tumen River Area Development Project". Not much progress was made on the latter due to the first North-Korean nuclear crisis in 1994 and the Free Trade Area Project had to await China's ponderous accession to the World Trade Organization, which absorbed Beijing for most of the 1990s. The Asian Financial Crisis in 1997 stressed the need for financial and monetary cooperation, including the establishment of an Asian Monetary Fund and eventually a common currency.

On May 2, 2000 Southeast Asian economic ministers met for the first time in Yangon, Myanmar, with their Northeast-Asian neighbors China, Japan and South Korea, from now on known as ASEAN + 3, to explore wider economic and trade ties and pave the way towards a regionwide economic and trade bloc, comparable to the EU and NAFTA. Then there was the Chiang Mai Initiative, also in May 2000, establishing a system of pooled reserves that central banks could draw upon to buy time when their currencies come under attack by speculators. Another meeting in Chiang Mai concluded that a formalized system of mutual tariff concessions was needed to protect Southeast Asia from a flood of cheap exports, once China joins the WTO. The same meeting urged to press ahead with the creation of a free trade area, the "ASEAN Free Trade Area". The Eventual goal is an "East Asian Free Trade Area", comprising of ASEAN + 3.

China made an activist response to the ASEAN moves. After proposing a China-ASEAN FTA within ten years at the Brunei ASEAN + 3 Summit in 2001, premier Zhu Rongji unexpectedly proposed that China, Japan and South-Korea conclude an FTA during the ASEAN + 3 meeting in Pnompenh in November 2002. Japanese prime minister Koizumi was taken aback by Zhu's dynamism. Koizumi had launched his own lukewarm initiative to pursue a Japanese FTA with

28 Japan in Asia, p. 33.

ASEAN but he had no strategy and faced the impossible domestic political challenge of liberalizing Japan's highly protected agricultural market.
To the great annoyance of Japanese officials, China and ASEAN moved forward to sign a framework for the FTA negotiations at Pnompenh. The Japanese media described the Chinese moves as stepping stones towards Chinese leadership in East Asia and a "threat" to Japan. The momentum towards the creation of an East Asia Free Trade Area was now a reality and it was generated by China, not Japan.

4.6. A China-Korea-Japan Free Trade Agreement? Too premature!

Following Pnompenh, the leaders of Japan, China and Korea, agreed three years ago to initiate a study group of thinktanks to explore prospects for closer cooperation among the three countries. The three thinktanks are the *Development and Research Centre* of the State Council of China, the *National Institute for Research Advancement* (NIRA) of Japan and the *Korean Institute for International Economic Policy* (KIEP) of South-Korea.

> "We are in the third year of this study. China is arguing that this study should be elevated to a higher official governmental level, not just thinktank. When the three leaders met in Laos on November 29-30, 2004, China pushed for the participation of government officials as observers of the study group. Japan held off and pushed for negotiations on an investment treaty among the three countries. To this China responded it was not ready",

says Tatsuya Terazawa, director of the Northeast Asia Division of the Japanese Ministry of Economy, Trade and Industry 29. China pushed for upgrading of the study group, but the compromise was that the three countries agreed to explore a legal framework concerning the investment of the three countries or to have consultations among the three governments, not full negotiations yet.
Terazawa says an investment treaty has absolute priority. "So many companies are investing in China, we want more transparency. We hope foreign investment restrictions will be relaxed; we want to see stronger dispute resolution, etc. However, the Chinese are still cautious on initating negotiations on an investment treaty for the three countries. This is the way we proceeded with Korea. We agreed on an investment treaty in 2002 which was put into effect in 2003, and based on that result, we are negotiating an FTA with Korea. So we are arguing that that is the way we should proceed for the three countries as well. This is a difference of views and we hope this will be resolved at the time the three leaders meet in Malaysia in December (2005)". 30
Kyung Tae Lee, President of the *Korea Institute for International Economic Policy* (KIEP) and an insider on Northeast Asian integration says:

> "They (the Japanese) say that China is still far from having the economic infrastructure which will conform to the market-economy. They have a long way to go to reach market economy status. So it is premature for Japan to have an FTA with China. That's what Japan says, but is that the whole story ? There might be some other reason. Maybe political. Senkaku, energy exploration, the history issue. And also, in the region, China's presence is now becoming more prominent than Japan's. China is importing more from the region now than Japan. ASEAN-countries are now depending more on China than on Japan. Before, ASEAN was kind of the backyard of Japan. But Japanese investment in ASEAN has been slowing down these days and Chinese companies are becoming big investors there. Japan feels that its status is challenged by Chinas emergence. I guess the Japanese perception is, they think their predominance is threatened by China. They see China as their rival, not as a partner for cooperation." 31

29 Interview with Tatsuya Terazawa in Tokyo, April 19, 2005.
30 Ibid.
31 Interview with Kyung Tae Lee, president of the Korea Institute for International Economic Policy (KIEP), 29 April 2005.

4.7. A Japan-South-Korea FTA?

Negotiations on a bilateral South-Korean-Japanese FTA have not been proceeding smoothly. The two countries entered into negotiations more than one year ago (2004) and had six rounds of negotiations and by the end of 2004 they were suspended. South-Korea wants a comprehensive and a very meaningful high quality exchange, including agricultural issues and wants to complete the negotiations by the end of 2005. Kim Han Soo, the Director-General of the Free Trade Area Bureau in the South-Korean Ministry of Foreign Affairs and Trade laments:

> "During the negotiations, we found out that Japan has no intention to have high quality, serious negotiations. They are only serious in the case of the agriculture and fisheries sectors. They are very aggressive in those sectors in which they have much higher competitiveness than Korea. So, that is the current situation." 32

The South-Korean side is waiting for new proposals from the Japanese side. It is unknown whether and when negotiations will restart. The ball is in the Japanese court.
South-Korea also has initiated its negotiations with ASEAN. One bilateral FTA agreement, between South-Korea and Singapore has been completed and several other secondary rounds of bilateral FTA negotiations are under way.

> "With ASEAN we had very successful joint studies within one year and we had two rounds and so far the negotiations are going well" said director-general Kim. "We set the target of establishing a Free Trade Area between Korea and ASEAN by the end of 2009, with the view of eliminating at least 80 % of tariff rights. And for the remaining 20 % we would extend a further transitional period beyond 2009. And maybe for very highly sensitive products we could put in some exemption baskets. So it's currently ongoing. 33

4.8. A China-South-Korea FTA?

The joint study of the two public institutions, the Chinese Development & Research Centre (DRC) and the Korean Institute for International Economic Policy (KIEP) is expected to be finalized around the end of this year (2005). Between Japan and Korea, a major bilateral investment treaty has been concluded and the Japanese objective is to conclude this kind of agreement with China too. The major content of this deal between Japan and Korea is to guarantee the establishment of national treatment. "However at this moment, China is reluctant, is not willing to conclude this agreement with Japan while it is responding positively to the discussion of improving the investment environment. In a sense, Korea's position is in between Japan and China. As to the matter of concluding an FTA between Korea and China, China showed interest in initiating negotiations with Korea in the near future. But Korea is not prepared to initiate the consultations or negotiations in the near future. Producers of agricultural products showed strong opposition to the initiation of an FTA with China due to fear of increased import of agricultural products from China. Director-General Kim thinks the Chinese attitude behind the FTA's is very much politically driven.

> "I don't know what their real intentions are. ….. They reached such a rapid conclusion with ASEAN countries. They had the same approach to Korea ….. The feeling in Korea is – partially - that China is rebuilding its traditional sphere of influence. It makes sense. I don't know exactly what their real intention and their way of thinking is in driving so vigorously towards the ASEAN countries. Personally I think, they feel comfortable enough through their accession to WTO. They already opened their market; they paid a huge cost to enter WTO, now they think they can expand to other countries. Furthermore, they might be

32 Interview with Kim Han Soo, director-general of the FTA Bureau, Korean Ministry of Foreign Affairs and Trade, Seoul, 26 April 2005.
33 Ibid.

> concerned about some ASEAN countries' wariness against China. Because as you know most of the world's investment to Asia has been redirected towards China. So, China needs to soothe them and court further the ASEAN peoples by market-opening" 34

Hu Zhaoming, the director of the Division of Regional Cooperation in the Asia Department of China's Foreign Ministry gave an additional explanation, why China has moved so fast and flexibly into Southeast Asia:

> "Taiwan has close trade and investment relations with all the countries there. We just want to have better and closer economic relations with ASEAN countries, compared with Taiwan." Hu also considered this – China having a stronger trade and investment presence in Southeast Asia than Taiwan – a security interest.35

As for other regional integration efforts, China has already concluded its FTA with ASEAN at least partially. They have already agreed on the 'trade in goods' part between the ASEAN countries. The 'trade in services' part still needs to be worked out. Japan has started its negotiations with ASEAN countries in April 2005.
Provisions have been made already for the possible future integration of North-Korea in the emerging network of FTA's. In the FTA that South-Korea and Singapore initialed in March 2005, the products which have been produced in the *Kaesong Industrial Complex* in North-Korea by South-Korean investors, will be recognized as originating from S-Korea. This principle has been suggested and discussed in the process of negotiating with ASEAN. "In the future it is easily expected that North-Korea will consider allowing South-Korea to develop other industrial complexes in the territory of North-Korea", says Chun Bee-ho, deputy director-general of the Bilateral Trade Bureau in the Korean Ministry of Foreign Affairs and Trade. 36

4.9. Korea's Ambivalence about China's rise

Lee Jong Kook, the Deputy Director-General of Policy Planning in the South-Korean Foreign Ministry is well aware of the pitfalls that his relatively small country faces in its massive engagement with China.

> "China is an emerging country. They stress they want to rise peacefully. From a journalistic point of view, from the academic point of view, to a lesser extent even from the policy-makers point of view, such a rising power, is certainly a matter of concern. From the Koreans' point of view: we not only have to pay attention to China but to the positions of all sides, Japan, the US. All these interactions cause some instabilities in the region. We don't say a rising China is posing a threat to Korea. That is too simplistic. Economically, China is providing a huge market to us." 37

The bilateral trade volume this year, 2005, will reach $ 100 billion. South-Korea's overall trade volume is $ 500 billion. Considering the history of Imperial China's overlordship over Korea as a "tributary"state until the Japanese military takeover in 1910 and the tremendous economic opportunity that China now offers, South-Korea's view of China is obviously still mixed. DDG Lee stresses that China is very much interested in rising peacefully through economic development, domestic political stability as well as stability in the neighboring areas. "China is very much worried about North-Korean adventurism, with its nuclear weapons program. This causes more interference from the US in the region and a mood of imminent conflict. This is not what China wants." 38

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34 Ibid
35 Interview with Hu Zhaoming, Beijing, 3 June 2005.
36 Interview with Chun Bee-ho, Seoul, 28 April 2005.
37 Interview with Lee Jong Kook, Seoul, 27 April 2005.
38 Ibid.

China and South-Korea share the history of brutal Japanese military occupation and continuing anger and frustration over Japan's refusal to atone adequately for its criminal war-past, but the politics behind the way the two countries handle their relations with Japan are quite different and analysis requires a lot of nuance. Lee Jong Kook explains:

> "Korea is a middle-power in this region. China and Japan are big regional powers. Japan rose in the 19th century while China was declining. But now they both have a certain power-base. I think there are certain rivalries and from Japan's point of view they may have a certain suspicion that when China talks about textbooks, history, they may want to interpret this as Chinese intentions to restrain Japan in the face of present or future rivalries between the two regional powers. In our case, Korea does not have such ulterior intentions. When we talk about the textbooks, we want to have good relations with Japan. We are a victim and this has caused big hurt to our national pride and Japan inflicted this pain on us. Our complaints are very honest I think. We don't consider Japan our future rival in managing Northeast Asia. So that's different. We will not play a leading role, we want to play a balancer role, a facilitator role". 39

Facilitating the *Northeast Asian geographical triangle* – or with North-Korea a *quadrangle* - into functioning properly and becoming a reality, a "community of good-neighbors", may take generations. Lee Jong Kook accepts the challenge and he has no illusions about linking the immense geography, turbulent political diversity and economic disparity of North- and Southeast Asia.

> "In Northeast Asia the political weight of the three countries is much bigger than ASEAN. Even South-Korea's GDP is almost as big as the whole aggregate total of the ten ASEAN countries. There is a certain common ground to have an institutionalized cooperation not confined to Northeast Asia, but widen it to all of East-Asia, including Southeast Asia or Asia-Pacific. There are certain obstacles in Northeast Asia to promote regional cooperation. The last several months more and more negative signals are coming from North-Korea, but if this Six Party Talks Process is successful, we have a certain dream that this could be transformed into a regional security cooperation mechanism. 40

4.10. South-Korea: Disengaging from the United States – Moving towards Neutrality – Moving back into the Chinese Orbit ?

Anti-US sentiment has been on the rise in South-Korea well before George W. Bush took over the White House in 2001, but it has deepened ever since Bush threw South-Korea's détente with North-Korea, the so-called "Sunshine Policy" in disarray with his "Axis of Evil" rhetoric and his later threats of a pre-emptive strike against North-Korea's nuclear facilities. Towards the end of Kim Dae-jung's presidency, South-Korea was euphoric about its rapidly expanding relationship with China, in trade, culture and politics, but an unexpected dispute about ancient history erupted in 2004 and poured some cold water over the new warmth. It is still premature to view the US-Korean alliance as disintegrating, but there is definitely a deep lack of trust, that has hardly been restored during the June 2005 visit of president Roh Moo-hyun to Washington. 41
Lee Kyong-soo, Deputy Director-General for Asia-Pacific at the South-Korean Foreign Ministry doesn't agree that Korea is moving closer to China and that it is disassociating from the US.

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39 Ibid.
40 Ibid.

41 See Aidan Foster-Carter, The Sun is Setting on North-Korea, Financial Times, June 14, 2005: "Neither Mr Bush nor Roh Moo-hyun, South Korea's leader, who put a veneer of unity on an alliance in deep crisis at their Washington summit last week, is a match for Kim Jong-il. Four years in, a divided US government still has no Korea policy. Rude rhetoric undercuts Washington's belated, vague offers to North Korea - and alarms Seoul, where the conservative opposition favours engagement with Pyongyang. Mr Bush may go down in history as the president who lost South Korea, never mind the North."

> It is certain that solid relations with the US are crucial to the stability of the Korean peninsula and will be maintained, but at the same time we will have our own maneuvering vis-à-vis China, because it is a very important country to us in our efforts to stabilizing the Korean peninsula and eventually achieve reunification. We cannot disregard the China-factor. So, we have strategic relations with China at the same time. But we have our own interest in maintaining the alliance with the US and at the same time we are in search of a new role from China. Drops in ratings of China and the US among our people all depend on the issue. But traditionally they favor China." 42

The historical dispute that soured Sino-South Korean relations to some extent in 2004 was centred on the oldest and largest kingdom in Korean history, Koguryo (57 B.C. – 668 A.D.) that encompassed all of the present North-Korea and large chunks of Manchuria. Last year, Chinese historians suddenly came up with a spate of historical treatises, asserting that Koguryo had always been part of Chinese history. Koreans were at a loss, what the political implications of this campaign could possibly be. Was China going to reclaim parts or all of North-Korea at some point was the question that puzzled segments of the South-Korean media, public opinion and the diplomatic community.
Lee Kyong-soo doesn't think so.

> "China wants peaceful conditions at least for the time being, 50 years or so. They want to concentrate on economic development and for that they need the status quo. I don't think they want to take any risk to jeopardize that. The Chinese may consider nationalistic sentiment in North-Korea and in a future reunified Korea threatening. It may spill over across the border to the ethnic Koreans in Jilin. The Chinese Foreign Ministry used to have a website, describing Chinese history and it used to have the history of Koguryo. But last year they just deleted it. We noticed that there is a Northeast Asia project going on in academic circles in China. This has some very strong implications and it might not be good for relations between our two countries. Last August the two Foreign Ministers agreed to take necessary measures to rectify the situation. The issue is now just under the surface but we keep watching it closely."43

4.11 Japan's Role in the Asia-Pacific Region

The preface of the book already quoted above, *Japan in Asia, The Economic Impact on the Region,* published by the Far Eastern Economic Review in 1991 starts as follows: "Asia is entering an era in which the dominance of the US is being increasingly challenged by Japan, by virtue of its economic might. Governments and people in Asia are looking more and more to Tokyo for a lead, rather than to Washington. But it is a role that Japan is reluctant to play". If one interchanges Japan and Tokyo by China and Beijing, the quote except for the last sentence exactly depicts the situation in Asia in 2005 and illustrates how abruptly the brief historical cycle of Japan's rise was aborted. China is rising and challenging US dominance. During more than a decade of recession, Japan has been named a "Newly Declining Country" in commentaries around the world. "Will Japan Rise Again ?" was the boldface red title of a debate in *Foreign Affairs* five years ago. 44 After some years of some financial reform but more obstruction of reform by the LDP old guard, Japan is showing economic growth again, paradoxically thanks to its vastly expanded trade with China, the relocation of Japanese industries to China, the re-export of affordable Japanese goods for the Japanese consumer from China back to Japan, and the creation of jobs in Japan because of insatiable Chinese demand for steel, cement, paper and other old economy products. 45 It is not only the Japanese economy which is benefiting from China's rise, but other countries in the region are benefiting increasingly from the China factor and less so from Japan.

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42 Interview with Lee Kyong-soo, Seoul, 26 April 2005.
43 Ibid.
44 Will Japan Rise Again ? Diana Helweg on the Coming Economic Revolution; Aurelia Mulgan on the Roadblocks to Reform, Foreign Affairs, July/August 2000.
45 Interview with Tatsuya Terazawa, Director Northeast Asia Bureau, Ministry of Economy, Trade and Industry, Tokyo, April 2005.

Trade figures show how decidedly China is replacing Japan as the trade hub of the region. China's share of Asian imports rose from 10.5 per cent in 1995 to 23.7 per cent in 2003 and Japan's share declined from 26.7 per cent to 22 percent during the same period. 46
China also overtook Japan in 2003 as South-Korea's largest trading partner with the Sino-Korean trade volume reaching $ 57 billion against the Japanese-Korean $ 53.5 billion.
As the largest magnet of FDI in the world, China has sucked a lot of investment away from Southeast Asia, but in compensation it has spectacularly opened its market for huge imports of energy, raw materials, components and semi-manufactures from the region and the world at large, making everybody benefit. China has offered quick tariff reductions that will boost imports of agricultural products from ASEAN, whereas Japan is much less willing to engage in trade liberalization, especially in the highly protected agricultural sector. China has been leading in regional integration, which Japan did in the early 1990s while it has been holding off in recent years. China wanted to form an East Asian bloc in 2001-2002 which would include Japan, but since the cooling off of relations, the Chinese blueprint may no longer eye Japan but only continental plus archipelagic Southeast Asia as part of its grand strategic goal of a multipolar world, so as to counter American global domination. "Facts have proved that East Asian countries share the same stance with China on many issues, and China will wield more clout in the world arena when backed by East Asia", said Niu Jun, Research Fellow in the Institute of American Studies at the Chinese Academy of Social Sciences, .47 China's main concern is that economic development be shared and supported by the region. China together with India and Brazil – the so-called G-3 – is a champion of the interests of the developing world in the Doha Round. The phasing out of agricultural subsidies by the US and EU at the Geneva Talks in July 2004, were the result of energetic diplomacy of the G-3. With the support of the World Bank and Oxfam, the G-3 had turned the issue of American and French subsidies to their farmers into the main international "cause celebre". 48 Japan to the contrary is viewed as a "non-Asian" protectionist partner of the United States.

Japan has traditionally focused more on Southeast Asia than on China. ASEAN was a key region for Japanese corporate investment, long before China opened. ASEAN has received approximately $100 billion of Japanese investment since its founding in 1967. 49 Japanese-funded projects in China totaled 31,000 by the end of October 2004, with a combined investment of $46.1 billion, according to Chinese Commerce Minister Bo Xilai. 50 During the Asian Financial Crisis, Japan extended $ 80 billion in aid to victimized ASEAN countries and Korea. China has received a total of $ 30 billion in official development assistance from Japan since the late 1980s.

However, in the race for East Asian regional leadership since the Asian Financial Crisis in 1997, China has clearly outmanoeuvred Japan, despite the fact that the latter's current GDP of over $ 4 trillion is still two and a half times the size of China's. After a decade of on and off recession, Tokyo decided in 2001 to cut its overseas aid, most of it to Southeast Asia by 10 per cent, in order to cut its huge public debt. 51

46 *International Trade Statistics 2004*, World Trade Organization
47 Interview with professor Niu Jun, Beijing, June 2005.
48 Elizabeth Becker , WTO gains pact to cut farm aid in rich nations, International Herald Tribune, August 2, 2004
49 Yoriko Kawaguchi (Foreign Minister of Japan), A Summit to Build On Japan-Asean Partnership, Wall Street Journal, December 11, 2003.
50 Quoted in Asia Times Online: Phar Kim Beng, Japan eyes Greener Pastures in Southeast Asia, Asia Times Online, January 11, 2005.
51 Michael Richardson, Japan Loses Clout, International Herald Tribune, 19 December 2001.

In the political and security realm, Japan's attempts to lead Asia have been stymied for decades by its strategic dependence on and subservience to the U.S. and more recently by the rise of China. Japan has tried to break out of its "satellite-relationship" with the United States several time, but each time external events and American pressure frustrated this. Koizumi's announcement in 2002 that he would go to Pyongyang, just after George Bush had branded it part of the "axis of evil" was the latest example.
The first time was in the early 1990s. As a member of the the Western-dominated G-7, Japan had joined in imposing sanctions on China after the Tiananmen repression, but as an Oriental country, Japan refrained from criticizing China harshly and publicly and was the first one to lift sanctions and then tried to play the role of mediator between China and the West. Then Japan tried détente with Russia in getting the Southern Kurile islands back for a huge pay-out of $ 25 billion. Yeltsin wouldn't play ball. Then the first North-Korean nuclear crisis in 1993-1994 pulled Japan back into the American orbit and China's firing of missiles close to Taiwan in 1995-1995 further re-strengthened the US-Japan alliance. During the Asian Financial Crisis in 1997, the United States, followed by China, torpedoed a Japanese plan to set up an "Asian Monetary Fund" that would help Asian countries not according to the IMF criteria of the Washington Consensus, but according to "Asian Values" with Japan in the lead.

4.12. Japan and North-Korea

When Koizumi came to power in 2001, the public was dispirited over the stagnant economy, lack of progress with reform and the absence of any progress in foreign policy that would reduce Japan's dependence on the United States. Altogether, Japan appeared to be going nowhere in foreign relations except to support the United States under pressure, as after 9/11and again in 2003 in the war against Iraq. Below the surface there was constant worry that Bush's hardline approach towards North-Korea would lead to conflict and war and there was a strong urge to gain an independent voice on matters of East Asian security. When Koizumi made his surpise announcement in September 2002 that he would visit Pyongyang and meet with Kim Jong Il - in defiance of the Bush administration which had just declared the latter as a part of the axis of evil - it was after some initial confusion compared with Kim Dae Jung's Sunshine Summit in 2000 or even with Richard Nixon's meeting with Mao Zedong in 1972. 52 If Koizumi would succeed in persuading Pyongyang to bargain its missile and nuclear programme for a big pay-off in economic aid and participation in East Asia's emerging regional integration, he would prove that "the Asian Way" of discreet negotiations would be superior to Washington's public insults and threats and his place in history would be assured. Diplomatic progress with the North would have the extra benefit of facilitating further improvement of problematic relations with South-Korea. The issue of abductions of Japanese citizens by North-Korean agents had troubled relations for more than a decade, but it did not top the agenda for the Pyongyang Summit. However, while meeting Koizumi, Kim Jong Il made the stunning admission that 12 of 13 abductions on a previously published Japanese list had indeed taken place and that seven of them had died. Five of the surviving abductees would be allowed to return to Japan, but they had to leave their families behind. The drama inflamed public opinion in Japan to such an extent that no negotiations on security issues and economic aid could be held until Koizumi made a second visit to Pyongyang in May 2004. This second visit resulted in an agreement to allow the eight relatives of the abductees to go to Japan. 53 In the meantime, in August 2003 and February 2004 the first two rounds of the "Six Party Talks" on North-Korea's Nuclear Programme had been held

52 Tokyo University professor Akihiko Tanaka held this view. Quoted in: Gilbert Rozman, Japan's North Korea Initiative and U.S.-Japanese Relations, Orbis, Spring 2003.

53 Evaluating Koizumi's Second Trip to North-Korea, Izumi Hajime, interviewed by Watanabe Hirotaka, Japan Echo 8, August 2004.

in Beijing. The third took place in June 2004. No fourth session has been held so far. At issue is the North-Korean demand for an apology from United States Secretary of State Condoleezza Rice, who termed Pyongyang an "outpost of tyranny" during her confirmation hearing. The broader issues are however the American negotiating style and the veracity of United States intelligence. A revealing article in Foreign Affairs by seasoned North-Korea expert Selig Harrison shines a very different light on the American pattern of deception and manipulation in handling North-Korea in recent years. Referring to the Bush administration's misrepresentation and distortion of intelligence data to justify the war in Iraq, Harrison, wrote: "Relying on sketchy data, the Bush administration presented a worst-case scenario as an incontrovertible truth and distorted its intelligence on North Korea (much as it did in Iraq), seriously exaggerating the danger that Pyongyang is secretly making uranium-based nuclear weapons."54 What set the Six Party Talks in motion was the American announcement in October 2002 that North Korea was secretly developing a program to enrich uranium to weapons grade, in violation of the 1994 agreement that Pyongyang had signed with Washington to freeze its pursuit of nuclear weapons. The announcement came two weeks after Koizumi visited Pyongyang for the first time without asking Washington for permission. Washington had become alarmed by the progress of South-Korea's "Sunshine Policy" with the North – linking North and South by big infrastructure-projects, setting up investment-zones in the North and even de-mining the Demilitarized Zone, which the US refused to approve. On top of this came a conciliatory approach towards Pyongyang of America's most obedient ally, Japan. This had to be stopped. Not ready for a preemptive strike on North-Korea in the run-up of the Iraq War, Washington decided to cook intelligence and to mobilize a coalition against Pyongyang, the "Six Party Talks" not so much for negotiations as for a "diplomatic tribunal" to pressurize North-Korea and persuade the other participants to agree with America's hardline and join Washington in imposing sanctions.

In May (2005), China accused the Bush administration of undermining efforts to revive negotiations with the North Korean government and said there was "no solid evidence" that North Korea was preparing to test a nuclear weapon. Even as the White House presses China to find a solution to the nuclear issue, Chinese officials say, it has hurled insults at North Korea and given its leaders excuses to stay away from the bargaining table. Mr. Yang Xiyu, China top Foreign Ministry official in charge of the North-Korean nuclear problem said that when President Bush referred to the North Korea leader, Kim Jong Il, as a "tyrant" in late April, Mr. Bush "destroyed the atmosphere" for negotiations, undoing weeks of efforts – by China - to persuade North Korea that the United States would bargain in good faith. 55

Finally, on July 9, there was some relief. North-Korea had agreed after a lull of more than a year to resume the "Six Party Talks" before the end of July. An intricate tripartite game of face-saving had produced this result. The South-Koreans had persuaded the Americans to no longer publicly insult the North-Koreans, the Chinese had persuaded the North-Koreans to resume the talks and hosted a dinner for them with the American assistant-secretary of state for East-Asian Affairs Christopher Hill, which the North-Koreans had accepted as the direct contact that they had demanded. 56

54 Selig Harrison, Did North Korea cheat ? Foreign Affairs, January/February 2005
55 Joe Kahn, China says US impedes North Korea Arms Talks, The New York Times, 13 May 2005.
56 Joel Brinkley and David Sanger, North-Koreans agree to resume Nuclear Talks, The New York Times, July 10, 2005.

5. CHINA-JAPAN RELATIONS

5.1. The Historical Issues: World War II, Taiwan

Japan's brutal military conquests of its neighbors after its modern "revolution", the Meiji Restoration (1867-1868) goes beyond the scope of this paper. I will merely focus on the unique intersection of factors after World War II that resulted in Japan's failure, to atone for its criminal war past and its refusal to make genuine peace with its neighbors.

Professor Motofumi Asai, president of the Hiroshima Peace Institute at Hiroshima University, and a former director of the China Bureau in the Ministry of Foreign Affairs agrees that the majority of Japanese people are unable to be self-critical about their war-past, because they became obsessed with the idea that they were the victims in the Pacific War.

> "There is little, if any feeling that they were the aggressors and guilty about the past. There is an absence of shame, a moral obtuseness. On top of that, there has been the very sad history, surrounding the emperor. When the US occupied Japan, they forgave the emperor and accepted that he was not guilty. Since then, many Japanese faced this confusion, that the person most responsible for the war, the emperor was not guilty. So we lost conscience about blaming ourselves and blaming the past. If we blame the past, we must blame the emperor. But the emperor was sacrosanct. Still, Koizumi is so pious about the imperial system". 57

Renowned Japan expert Karel van Wolferen emphasizes what very few Japanese would not say or know, i.e. that keeping the incumbent emperor Hirohito was very much at the insistence of general Douglas MacArthur. "Whether he truly believed his reasons: that Japan would otherwise not be governable is an interesting question – he wanted to be seen as the most successful viceroy in history, and keeping the emperor certainly solved some problems. But it created the huge problem of depriving the Japanese of a reliable history". The mythology of a reluctant marine-biologist exploited by the militarists was enthusiastically continued by Harvard Japan scholar Edwin Reischauer, president John F. Kennedy's ambassador to Japan. "The damage goes much deeper than is generally appreciated. There was under the circumstances simply not a way to establish a common truthful Japanese wartime history." 58

Another complicating factor is that the Japanese are too much accustomed to viewing the world vertically, i.e. as a hierarchy of nations. There must be a division of strong and weak but there is no such way of thinking as viewing countries equally and horizontally.

> "For Japan it is very easy to look up at the US as the leading power, because it is strong and we are relatively weak. So it is OK that US-Japan relations are maintained in a hierarchical manner. China was historically superior to Japan, until the Meiji Era. After the Meiji era, we defeated China and we became the Number One in Asia. And after 1945, the US took the place of Japan as Number One in Asia and China and the US became enemies. Nowadays, we are facing a new situation, in which the US stands alone on top. China and Japan can meet each other on an equal footing, which for the Chinese is acceptable. But we, Japanese cannot get accustomed to that reality. Either they are weak or we are weak." 59

A Chinese academic, Shi Yinhong, professor of International Relations at Renmin University in Beijing and a frequent spokesman on Sino-Japanese relations had elaborated earlier on the same issues and his comments fit in perfectly with those of prof. Asai.

Prof. Shi says Japan didn't have to think seriously about its wartime aggression, because since China had become communist and since the West needed Japan for the war against communism in Korea, the defeated Japan became an ally of the most powerful country in the world, the United States. Korea was ruined and divided by the superpowers and China was blockaded and "excommunicated" by the United States under the crusading anti-communist secretary of state

57 Interview Motofumi Asai, Tokyo, 19 April 2004.
58 Interview with Karel van Wolferen, Amsterdam, 14 June 2005.
59 Ibid.

John Foster Dulles. Unlike Germany, that was held to account by the three Western occupying powers, there was no pressure on Japan to come clean at all. The militaristic component of traditional Japanese *"samurai"* culture became again a decisive part of the new American-imposed *"demokurashi"*. History became almost *tabu*. Japan was mainly concerned about its vertical relationship with its victor, the United States, and became arrogantly insensitive about the neighboring nations it had brutalized. 60

China has its own political anathema's. It has never thoroughly examined the excesses of the Mao-years and the Japanese manipulate that to dismiss any further Chinese lecturing about their serial aggression. They have gone through the motions of apologies several times, yet they have never payed reparations as part of political bargains with the Mao Zedong/Zhou Enlai leadership 61, but they have extended "Official Development Assistance" to the amount of some $ 30 billion, in recent years about 70 per cent of it for environmental projects. In the Japanese mind "Enough is enough!" But for the Chinese it clearly is not.

5.2 Struggle for East Asian Preeminence

Since the Asian Financial Crisis in 1997 an open contest has unfolded among the Chinese and Japanese for preeminence in East Asia in terms of politics, trade, investment and soft power. The Chinese are clearly gaining and the Japanese are losing ground. The Japanese answer is to align themselves more closely with the United States and as Japanese insiders outside of the government openly say, strengthen their unofficial, secret military ties with Taiwan. 62 Tense China-Japan relations are obviously in the interest of the United States as long as they don't get out of US control.

> "The US can relax as long as Sino-Japanese relations are bad. Every month there is a new dispute between China and Japan and the US never says anything. If Japan takes a more confrontational approach, China's strategic environment will deteriorate. The independence-hardliners in Taiwan have great hope for Japanese support. The Taiwan issue will become more difficult to solve. China's diplomacy in Asia will become more difficult". 63

China's main concern related to Taiwan is that Japan has in recent years overtly joined the United States in *diversifying* the US-Japan alliance to include Taiwan, create more ambiguity and come closer to what amounts to *containment* of China. The original purpose of the US-Japanese Alliance was to protect Japan against a monolithic communist bloc, headed by the Soviet Union. After president Richard Nixon's opening of China in 1972, China became a partner of the United States in the containment of the Soviet Union. At the end of the Cold War, the US-Japan Alliance had to redefine itself, which took some time because China was not identified as a threat yet. The first signs came in 1995-1996 when China conducted missile tests in Taiwan waters, to intimidate the electorate not to vote for the independence candidate, who at that time paradoxically was not the Kuomintang's Lee Teng-hui, but the aging Democratic Progressive Party militant Peng Ming-min. After the dispatch of a US carrier taskforce "to restore stability", a vague clause was added

60 Interview Shi Yinhong, Beijing, 31 March 2004.

61 In the Joint Communique on the establishment of diplomatic relations of September 29, 1972, the Government of the People's Republic of China declares (clause 5) ….. that in the interest of the friendship between the Chinese and the Japanese peoples, it renounces its demand for war reparation from Japan.

62 Masashi Nishihara, the president of the National Defense Academy said in an interview in April that Japan and Taiwan maintained unofficial military contacts through retired generals, such as the un-official representative (de facto ambassador). Last year in November when a Chinese submarine intruded in Japanese waters, somewhere halfway between Okinawa and Taiwan, president Chen Shui-bian claimed that he had informed Japan about this intrusion. Asked whether this was accurate, Nishihara said: "We are not supposed to talk about submarine surveillance. Nishihara said bluntly that Japan will get more involved in a possible future armed conflict between the US and China over Taiwan. "In the past we would say we have nothing to do with it, but now we have expressed our concern".

63 Interview Shi Yinhong, Beijing, 31 March 2004.

to the US-Japan Security Treaty, which opened the way for joint US-Japanese military action in Taiwan. 64 President Bill Clinton and Prime Minister Ryutaro Hashimoto agreed on bilateral cooperation in dealing with situations that may emerge in areas surrounding Japan. Beijing protested vehemently and demanded Tokyo's assurances that the wording *"areas surrounding Japan"* did not include Taiwan. The Japanese responded that they were unable to give such assurances because the definition of "areas surrounding Japan" was *situational, not geographical.* That was the public understanding of this issue, at least during the aftermath of the crisis in 1996. But now, nine years later, a prominent mainstream political analyst, Professor Akihiko Tanaka said that what Japan generally had in mind in 1996 was a contingency in North-Korea.

> "It was two years after the first nuclear crisis in North-Korea. If something happens on the Korean Peninsula, then America as an ally of South-Korea is automatically involved. Japan would not be automatically involved because we have no security treaty with South-Korea. But then America is automatically involved and the bases are in Japan. In the case of Taiwan, it is not very clear whether the US is automatically involved, despite the existence of the Taiwan Relations Act". 65

Prof. Tanaka agreed that the United States is deliberately obfuscating and that therefore Japan cannot be very clear either. "We may well, or may not join the US in defending Taiwan against a Chinese invasion. It will depend on the circumstances" 66.
American policy during the Clinton and previous administrations was one of *"strategic ambiguity"*, i.e. we are not going to say specifically when we will intervene or not because if we spell that out, either side will exploit this to its advantage. Bush (George W.) changed it orally in 2001, saying: "We will do whatever it takes to defend Taiwan ….. in case of *an unprovoked attack*". Again, there is no clear definition of what an unprovoked attack is. In the US there are indications every once in a while that the US will intervene in any military conflict between China and Taiwan, regardless of the prelude and the chain of causation.67 Prof. Tanaka concluded: "Japan would not say that it would automatically support the US if a military contingency arises from whatever reasons. We cannot make any judgment until that happens. This is not an official alliance, it is not a legal thing. If it were a legal thing, then we are quite sure, Japan would be involved. What Japan would do depends on the circumstances. It depends not just on who is the prime minister, but on the distribution of power in the Parliament. How strong is the ruling party, how strong are the opposition parties? So, it's a matter of politics." 68

5.3. Japan's Official Line on Taiwan

Under the *US-Japan Security Treaty* of 1952, revised in 1960, Japan has no obligation to fight on the side of the US under any circumstances. The treaty doesn't even mention Taiwan once. In the *Communiqué on the Establishment of Diplomatic Relations* (29 September 1972) the Government of Japan showed full understanding and respect for the stance of the Government of the People's Republic of China, that Taiwan is an inalienable part of the territory of the PRC and it firmly maintains its stand under Article 8 of the Postsdam Declaration (1945), in which Japan

64 Text: US-Japan Joint Declaration on Security: Paragraph 5 b: The two leaders (Clinton and Hashimoto) agreed on the necessity to promote bilateral policy coordination, including studies on bilateral cooperation in dealing with situations that may emerge in the areas surrounding Japan and which will have an important influence on the peace and security of Japan. FILE ID:96041704.EEA, 17-4-96.

65 Interview Akihiko Tanaka, Tokyo, 18 April 2005.
66 Ibid.
67 Michael E. O'Hanlon, Senior Fellow, Brookings Institution, The Risk of War over Taiwan is Real, The Financial Times, May 1, 2005. O'Hanlon plays down the positive momentum of the historical Lien/Soong visits to China and emphasizes that US principledness and credibility in support of Taiwan's vibrant democracy will be decisive.
68 Interview Akihiko Tanaka.

retroceded Taiwan – annexed in 1895 - to China.69 The third US-Japanese document, and the first official document making the Taiwan issue contentious again is the *"Joint Statement of the U.S.-Japan Security Consultative Committee"* of the foreign and defense ministers of the two nations of February 19, 2005, the so-called *"2 + 2 Statement"*. For the first time since Japan returned Taiwan to Chinese sovereignty in 1945, the reluctant Japanese were pressurized by the Americans to declare a peaceful solution of the Taiwan issue as a *common strategic objective*, on a par with issues relating to the Korean Peninsula and the Russian Far East. For China this represented another *gross interference in its domestic affairs,* as if Taiwan were another sovereign state in the Northeast Asian region, like Russia or Korea. Even after the end of the Cold War, China did not consider the US-Japan Alliance as opposed to its interests and viewed it as an instrument to prevent the remilitarization of Japan. However, since the Bush administration has been pushing the Koizumi administration openly and consistently towards amending its pacifist constitution and assuming a more assertive military role, not only regionally but also globally, in support of the overstretched United States, China has come to view the alliance as a direct threat to its security, particularly to what it considers its core interest, the resolution of the Taiwan issue 70.

5.4. The Koizumi Era: Remilitarization of Japan

When conservative populist Junichiro Koizumi became Japan's prime minister in April 2001, his first priorities were domestic economic and financial reform. He did not have a specific foreign policy agenda and belongs to the rather large and growing constituency who believe it is a good idea to revise Japan's pacifist constitution, i.e. abolish the war-renouncing article 9, which would have major foreign policy implications.71 Makiko Tanaka, the daughter of Kakuei Tanaka, the forceful prime minister who normalized relations with China in 1972 had helped Koizumi's victory over his rival Ryutaro Hashimoto and as a reward, she became the new foreign minister. However the *marriage of convenience* didn't last long. Ms. Tanaka, by her own description a "housewife-turned-politician" was highly popular with the public for her determination to eradicate corruption in the foreign ministry. As part of her father's legacy, ms. Tanaka had kept close ties with China and considered Japan's subordinate role in the US-Japan alliance as inimical to its national interests. Within weeks of her cabinet appointment, transcripts of discussions with European foreign ministers were leaked, revealing that she opposed the US National Missile Defense system because it antagonized China, and she was generally hostile towards the Bush administration. She later expressed sympathy with the calls for the removal of the US military bases on Okinawa and allegedly told Chinese leaders she supported Taiwan's reunification with China.

Koizumi and his chief cabinet secretary Yasuo Fukuda, son of former prime minister Takeo Fukuda, represent another tendency.72 The Fukuda Sr. faction had opposed Tanaka Sr.'s normalization of relations with China in 1972. Frustrated by Japan's failure to become the *leader of Asia* during the 1970s and 1980s, this time by economic means, they advocated a repeal of the country's constitutional constraints on the use of military power, which converged with the Bush

69 Interview with Shigeo Yamada, Principal Senior Foreign Policy Coordinator, Ministry of Foreign Affairs, Tokyo, 21 April 2005.

70 For a good analysis of the process of subordination of Japan to Bush's America, see: Gavan McCormack, (professor of Japan Studies at the Research Scool of Australian National University), *Koizumi's Japan in Bush's World*, ZNet, Nautilus Institute, KINU, Japan Focus, October 7, 2004.

71 The Constitution of Japan: Article 9: "Aspiring sincerely to an international peace based on order, the Japanese people forever renounce war as a sovereign right of the nation and the threat or use of force as means of settling international disputes. In order to accomplish the aim of the preceding paragraph, land, sea and air forces, as well as other war potential, will never be maintained. The right of belligerency of the state will not be recognized."

72 Koizumi, Fukuda and Tanaka are three paragons of Japan's hereditary politics: Koizumi's father and grandfather had been ministers; Fukuda's and Tanaka's fathers had been prime ministers.

administration's policy of encouraging Japan to remilitarize so that it could play an active role in any conflict on the Korean peninsula or with China and beyond. In order to build a broader base for this constitutional change, Koizumi has actively promoted Japanese nationalism. He supported the publication of school textbooks promoting rightwing patriotic views, resumed visits to the Yasukuni Shrine, this time annually, and simplistically dismissed Chinese and Korean official and popular anger over his insensitivity as ephemeral with the cliché: "Sooner or later they will understand". The only thing Koizumi considered was that China-bashing is a winning formula in Japanese domestic rightwing politics. Tanaka publicly criticised Koizumi's reckless actions for poisoning relations with China and the Koreas, which fear they could be targets of a resurgent Japanese militarism.
The unstable Koizumi-Tanaka alliance came to an end with "9-11" when Koizumi went out of his way to support the US "war on terror". To the alarm of China, as well as sections of the ruling elite in Tokyo, Koizumi pushed through legislative changes enabling the Japanese military to deploy the navy in support of the US campaign in Afghanistan. For the next step in Japan's remilitarization, American pressure was hardly needed. Koizumi volunteered to send 1.000 troops, ground-, air- and maritime units to Iraq for non-combat duties in the field of water-supply and medicare. Japan's bitter experience during the "legal" multilateral coalition Gulf War in 1991, when Tokyo paid $ 13 billion in cash, but did not send troops and did not get any recognition or respect in return, informed Koizumi's cooperativeness. However, according to some analysts, a.o. Gavan McCormack, professor of Japan Studies in the Research School of the Australian National University, the decisive reason was a deal Koizumi made personally with Bush: "I (Koizumi) help you in Iraq and you (Bush) help me in North-Korea". 73

Washington had become increasingly satisfied about the *"maturity"* of the alliance, but on top of billions of cash payments ($ 5 billion for the second Iraq War already), Japanese naval supply ships in the Indian Ocean and troops in Iraq, there was still one unfulfilled demand that the US had on Japan: it should also install a *"missile defense shield"* and co-finance the development of the project for the United States itself as well. The initial estimates called for $4.5 billion over five years but within a matter of months that had almost doubled. The Rand Corporation in 2001 estimated that a basic system, capable of intercepting "only a few North Korean missiles," would cost approximately $20 billion, and a full coverage system more than the national defense budget**.** Despite the astronomical cost, the Pentagon was absolutely determined to integrate Japan ever more firmly under its control. Whether missile defense would work is unknown, but the best scientific and military opinion seems to be that the present system is unproven, i.e. it might or might not work. 74 Japan invoked missile tests from North-Korea as justification for its growing partnership with the United States in developing a missile defense. This has allowed Japanese military planners to avoid referring directly to China. 75 In the *"National Defense Program Guideline FY 2005 - (for the next ten years)*, however, published December 10, 2004, the Japanese government identified China's modernization of its military and increasing defense spending (and North-Korea's nuclear weapons ambitions) as concerns. Defense Agency director-general Yoshinori Ono specifically cited "the recent case where a Chinese submarine intruded into Japanese waters". Ono agreed in separate talks with Rumsfeld on a US proposal for advancing joint research on a Theater Missile Defense (TMD) system to the development stage in fiscal 2006, potentially targeting North Korea's Nodong and Daepodong missiles as well as China's Dong Feng missiles. The missile defense system was assumed to become the actual core of the Japan-US security alliance of the future. The Japanese announcement was generally considered as paranoid over-reaction. Japan's emphasis that China now (2003) spent more on defense than Japan - $55.95 billion versus $ 42.84 billion - was misleading since Japan was the increasingly intimate junior partner of the United States, which spent $ 404.92 billion in 2003.

73 Gavan McCormack, Koizumi's Japan in Bush's World, Z/Net Japan, October 7, 2004
74 Ibid.
75 James Brooke, Japan to list China as a major threat, New York Times, 16 September 2004.

On the very same day, Japan also announced that it would exempt the export of missile defense components to the U.S. from its arms export ban, creating the impression that Japan was becoming an arms exporting nation again. 76 When the American and Japanese foreign and defense minister two months later declared the peaceful solution of the Taiwan issue as a common strategic objective, this was new evidence for the Chinese of US-Japanese collusion on Taiwan and further intensification of the US-Japan military alliance. At this point, the Chinese government gave up hope that worsening Sino-Japanese relations could be turned around any time soon. "Only a major crisis can make both sides realize the necessity of accommodation" said a concerned academic. 77 Perhaps the outburst of popular anti-Japanese violence in April was that crisis.

In June 2005, the US government asked Japan to pay $ 545 million, the same amount as it would spend itself to develop the high-tech defense project during 2006-2011. The Yomyuri Shimbun however, reported that Tokyo found the sum too high and wanted to negotiate a significant cut in the costs. "Japanese and US authorities are now in the work of determining cost sharing and other points as the project moves from joint research to the development phase, but nothing has been decided yet", the spokesman for the Japanese Self Defense Agency said. 78 By the end of June, the Pentagon notified Congress of a proposed sale to Tokyo of nine more sea-based missiles and related gear valued at up to $ 387 million built by Raytheon. They would be used on Japanese ships equipped with high tech AEGIS combat systems, built by Lockheed Martin. Japan has four AEGIS destroyers and two more are under construction. 79

5.5. Making the Unthinkable Happen: War in the Taiwan Straits

It would be rather inconceivable that the Japanese or U.S. governments or mainstream Japan or even mainstream Taiwan wish a war that would enable Taiwan to complete its secession from China. All of them probably prefer the status quo of *"no independence, no reunification, no war, joint economic development and some integration"*. Japan wants to be protected from emerging superpower China by the United States and wants to help maintain American control over a de facto independent Taiwan. The United States wants to maintain its strategic dominance over both Japan as a satellite ally and Taiwan as an unrecognized protectorate, being the twin pillars of its military supremacy in Northeast Asia. An officially independent Taiwan means war with China, which the U.S. cannot fight and doesn't want to fight, as long as the debilitating - and probably unwinnable - war in Iraq drags on.

Under what circumstances is war in the Taiwan Straits imaginable then ? On all sides there are vocal minorities and interest groups who think they will benefit from a war, which they reflexively assume, the US/Japan/Taiwan will win. The pro-Taiwan minority in the Diet and ultra-nationalist fringe groups in Japan, the hardliners in Taiwan's ruling DPP and the pro-Taiwan religious and neo-conservative groups in the US Congress, the arms industry etc. in the United States together form the "pro-war front".
One staunchly conservative Japanese commentator, Ambassador Hisahiko Okazaki, director of a small thinktank that carries his own name, the "Okazaki Institute", made some potentially alarming observations. He said war is likely, but it can be avoided. "In the coming several years, public opinion and the Congress of the United States will be the 'dictator' of the world, stronger than the President of the United States". The implication is that the US Congress could coerce the administration into wrongheaded decisions concerning Taiwan, just like when the Clinton

76 Kyodo News Service, Analysis: Japan naming China a concern may lead to a vicious cycle, December 10, 2004.
77 Interview prof. Shi Yinhong, Beijing, 31 March 2005.
78 Yomyuri Shimbun (English), June 20, 2005.
79 Reuters, Washington DC, June 29, 2005.

administration in 1995 first refused Taiwan president Lee Teng-hui to visit the U.S. but was then overwhelmed by near-unanimous resolutions of both houses of Congress. The visit did take place and was the prelude to the first military crisis around Taiwan since 1958. Okazaki doesn't know exactly how strong the pro-Taiwan constituency in Japan is. "We have to wait for an emergency to know" he says. Okazaki strongly advocates lifting of all constitutional and political barriers against Japan, displaying its full military potential. He says Japan has a formidable anti-submarine fleet, which the U.S. lacks, but it is not allowed to use it. "I am fighting to change this policy. And my goal will be achieved or maybe not." 80

Although there is growing support in the Diet now for a constitutional amendment that will broaden the scope of non-belligerent actions for the Japan Self-Defense Forces, the prospect that it will enable the SDF to take part in offensive operations in an American war against China is virtually nil. Kenjiro Monji, Director-General International Affairs of the Japan Defense Agency said a conflict arising from US ambiguity over intervention in a war or more limited military clash between China and Taiwan is a most troublesome scenario for Japan. (This is not mentioned in the NDPG at all). "If the US asks Japan to use American bases here, the official answer is: 'We don't know'. It will depend ! Public opinion in Japan is divided but people are becoming more anti-China, while at the same time economic interdependence is expanding. So, we think we will have to permit the US to use the bases. It will be a contingency situation. We will not get involved beyond rear area support, search and rescue of non-combatant refugees, provision of water, transportation, medical care etc." 81

Yasuhiro Matsuda, a senior research fellow at the National Institute for Defense Studies (NIDS) under the Defense Agency is very explicit that Japan will never get involved in
American offensive operations against China. "No, no, no ! There is no legal basis. Our Constitution doesn't recognize the right of collective defense. Only if Japan itself is attacked will we counterattack. In practice, if China conducts a very limited operation against Taiwan, we will not come into action. But in the case of a massive attack, we will give rear area support to the US." Matsuda elaborates that the SDF airforce may have to set up an airbridge, to evacuate Japanese citizens, approximately 15 to 20.000 from Taiwan. "Will Japan allow US forces to use their military bases in Japan for a war against China ? Theoretically yes and now, practically also yes ! If Japan would not allow the US to use their bases in Japan, it would be tantamount to: YANKEE GO HOME ! It would mean, we opt for China and end the US-Japan alliance. This is a very unthinkable situation". 82

5.6. An East Asian Cold War

Unshakeable belief in the durability of the US-Japan alliance and commensurate distrust and unwillingness to think in a nuanced, constructive or even pragmatic way about China is more the rule than the exception among Japanese. A figure as senior as Masashi Nishihara, President of the National Defense University expressed hope for China to disintegrate, considered "Taiwan not being integrated with China a great favor to Japan's defense", was sure that Japan would support US intervention to defend Taiwan. "If there is an armed conflict between US and Chinese forces and the US needs support, logistical support, Japan is likely to move. It will look that Japan is fighting China. That's a very serious development. But if we have to choose between the US and China, Japan will choose the US. That's the worst situation to arise". Nishihara had no hope for any rapprochement between China and Japan in the foreseeable future:

80 Interview with Hisahiko Okazaki, Tokyo, 22 April 2005.
81 Interview with Kenjiro Monji, Tokyo, 22 April 2005.
82 Interview with Yasuhiro Matsuda, Tokyo, 21 April 2005.

> "Tensions will continue for some time. I cannot see even ten, twenty years from now, we will become good friends. We will have huge trade, summit meetings etc. but tension will continue. Like during the Cold War, the Soviet Union and the United States, two very different powerful empires. They could never get really close. But there was détente, disarmament, reduction of tensions etc. They managed to be able to coexist, without fighting. Maybe something like that can develop between China and Japan. There will be disagreements, conflicts, but both sides will become more rational, less emotional." 83

The United States is still working assiduously to improve the command structures in Japan for perpetuating the Cold War in East Asia. The centerpiece of the US requests is the plan to transfer the command functions of the US Army I Corps (now based in Fort Lewis, Washington State) on the US Pacific coast, which is responsible for the whole Pacific Region, to Camp Zama, near Yokohama, south of Tokyo. The Army I Corps Command would then command US forces as far as the Middle East. The only problem this raises is that it goes way beyond the scope of the US-Japan Security treaty. The Japanese government is very reluctant to approve the transfer of the Army I Corps command functions, because it fears that this could become a major bone of contention in the domestic political arena. One specialist on the US-Japan alliance, Kazuya Sakamoto, a professor at Osaka University is advocating that Japan should willingly accept an expanded role in defending US interests in the Middle East. Sakamoto argues:

> "If the purpose of the Japan-US alliance is mutual cooperation to ensure the security of both parties, then surely it is only natural for Japan to cooperate in maintaining stability in the Middle East ….. Sakamoto recklessly concludes: Essentially, Japan must broaden the scope of Japan-US cooperation as far as possible and at the same time increase its own voice. ….. The Bush administration holds Japan in high regard, and during the next four years, it may make requests for Japanese cooperation based on its awareness of the limits of US power. Such requests will improve Japan's chances to get action on its own agenda." 84

6. CONCLUSIONS:

6.1. Asia-Scepticism, Hegemonic Struggle between China and US-supported Japan; Two or Three Times ASEAN + ONE:

As seen from the above, serious obstacles impede smooth progress in the emergence of regional integration in East Asia. Foremost negative factor is the longtime cold, and more recently hostile political relationship between the two major powers in the region, China and Japan. While China was a self-reliant, underdeveloped, mostly sleeping communist giant during the Mao-era, Japan emerged as the economic avant-garde during the 1970s and 1980s but it lost ground to China during the 1990s. Now, during the first decade of the 21st century, China is the regional and also global engine of economic growth and it imports more from the smaller regional economies than Japan does. Although Japan's economy is still three times larger than China's, Japan cannot assert itself as a leader due to the "deficit" of repentance over its war-past and more recently its role as the willing, subservient junior partner of an increasingly militaristic American hyperpower. China is the pre-19th century preeminent power in East-Asia and the weight of history is in its favor. However, it is also at a certain disadvantage to reassert its leadership role due to suspicion of its residual communist politics and lingering memories of its willingness to use force: India – 1962; Vietnam – 1979, and potentially the South-China Sea and the Taiwan Straits.

For that reason, ASEAN, a group of ten medium-sized and small relatively weak states, is in de drivers' seat, as if the Benelux would run Europe by default. In 2000 at the Rangoon Summit, ASEAN has built a bridge to Northeast-Asia, the so-called ASEAN + 3, but it only exists in

83 Interview with Masashi Nishihara, Tokyo, 19 April 2005.

84 Sakamoto Kazuya, A Bigger Japanese Voice Through Bilateral Cooperation, Japan Echo - Insight and Analysis from the Japanese Media, 4, April 2005. See also: Simon Tisdall, Japan emerges as America's deputy sheriff in the Pacific, The Guardian, April 19, 2005.

name. As a Chinese official put it: "In fact there are only "Three ASEAN's plus One". China has its FTA with ASEAN ready and has positive relations with South-Korea. South-Korea has its own negotiating relationship with ASEAN and Japan, and Japan is negotiating with ASEAN and Korea as well, but the big missing link is between China and Japan. 85

Scepticism, pessimism or a non-committal wait and see is expressed by officials from the Japanese and Korean sides. The Chinese are optimistic, because there is a general feeling that the future is theirs. Shigeo Yamada, principal senior foreign policy coordinator in the Japanese Ministry of Foreign Affair says: "The concept of an East Asian Community is often misunderstood. We are not talking about *European type communities*. We are far and far away from establishing that kind of community, because we don't have a common history and are in such different stages of economic development. All the differences are interlinked. When we ask about what steps have to be taken, it's probably not the time yet to really draw up a roadmap. Where we are at this moment is trying to strengthen the cooperation in various functional areas. If that results in more cohesive societies, and new ideas, then we might move to the stage that the European Union has achieved. Looking at it differently, we meet often, we cooperate in many functional areas. From that perspective, the EAC is already there". 86
Kim Han Soo, the Director-General of the Foreign Trade Bureau in the Korean Ministry of Foreign Affairs and Trade is much blunter: "I am not so optimistic about the East Asian Free Trade Area. EAC is a very newly discussed concept and it is a more politically oriented one. Regarding trade, FTA's, that's all straightforward. For politics, there is no framework. It is in a very, very initial stage. Even if they work hard, all the Pacific countries will have more than one FTA with other countries. You cannot make one single FTA. I don't know whether Japan is active or passive about this new concept of the EAC. But if they display very active intentions, that could be driven by a hegemonic struggle with China. They can not leave the region to China's hand. 87

6.2. European Interests in East Asian Regional Security and Integration

The Chinese are globalists, eclecticists, pluralists, multipolarists and multilateralists. With their 15 neighbors, their foreign relations are omnidirectional. They are deeply dissatisfied with the United States over its duplicity and regular incitement of Japan and Taiwan against China. But they know they are too weak to challenge the US now. China's overwhelming priority is economic development and growth and these would be severely affected without full access to the American market. The Chinese want to learn from the European experience with multilateral diplomacy, how to counter the US-Japanese scheme to freeze the Cold War status quo in East Asia and how to advance their *"core interest"*, the peaceful reunification with Taiwan on the basis of some vague, flexible long-term formula.

The Koreans describe themselves as a "medium power in between two great powers", China and Japan. They have a very rapidly expanding trade relationship with China and a more or less satisfactory political relationship. South-Korea and Japan have basically the same relationship with each other as China and Japan: *hot economics, cold politics* but no permafrost as the Sino-Japanese political relationship feels like. They are reluctant to admit that their relationship with the United States has gone downhill and don't elaborate too much about details. They need the US for preventing the North-Korea problem from getting out of control.
Japan under Koizumi has in security terms a uni-directional foreign policy. There is only one "abroad", the United States wants to keep it like that. An astonishing number of people in this

85 Interview with Hu Zhaoming, Director, Division of Regional Cooperation, Asia Department, Ministry of Foreign Affairs, 2 June 2005.
86 Interview with Shigeo Yamada, Tokyo, 21 April 2005.
87 Interview with Kim Han Soo, Seoul

conservative, inward-looking country behave as if their all-dominant China-obsession will go away if they ignore China, hope it will split, weaken and collapse again and/or that the United States will solve it for them.

7. RECOMMENDATIONS:

1. With the impending resumption of the "Six Party Talks" on the North-Korean nuclear issue, the European Union should explore ways to join the talks as a seventh party, so as to contribute to their greater effectiveness.
2. Individual EU members who have diplomatic channels with the DPRK should intensify their efforts to persuade Pyongyang to abandon its nuclear programme by a carrot and stick approach.
3. The European Union and OSCE should increase their efforts to help East-Asia to establish a permanent multilateral regional security cooperation mechanism.
4. The European Union should no longer delay the lifting of its arms embargo on China so as to contribute to more equilibrium in East-Asia which is dominated by an intensified US-Japan military alliance, which is in the process of expanding its geographical scope from a new US command Headquarters in Japan and envisages an expanded Japanese regional military role.
5. As tensions between Japan on one side and China and Korea on the other over World War II related issues flare up regularly, and apparently will not go away, and the United States – considering that Sino-Japanese tensions are beneficial to the 'divide and rule' power of the US - never expresses an opinion on this, the European Union should consider to add an independent voice to this historical debate and recommend the German experience as a model for solving outstanding issues.
6. Although tension in the Taiwan Straits has calmed considerably, despite the anti-Secession Law and thanks to China's deft diplomacy with the Taiwanese opposition, new problems are likely to arise. One major reason is the US determination to maintain Taiwan as one of the largest markets for its arms industries. The European Union should consider to end ambiguity on the status of Taiwan as still reflected in various communiqués and issue an explicit statement that "Taiwan is part of the People's Republic of China" period.

8. APPENDICES

8.1. East-Asian Views on a European Role in East Asian Security:

Li Yang, director of the Multilateral Cooperation Division, Asian Department, Ministry of Foreign Affairs:

> "The European side is always very positive, moderate and constructive in promoting the world's common security, peace and stability, unlike the United States. The problem is that the US is trying to use a very different way, that is unacceptable to a lot of countries in this world. The European side emphasizes dialogue, cooperation, economic assistance, based on international law, to help other countries to make their right strategic choice. For example the role that is being played by the European side in promoting a peaceful solution of the Iranian nuclear issue, is very constructive. Talking about the nuclear issue on the Korean peninsula, we also believe that if the European side could join the current six parties, that could have a very constructive effect. We also know the European side is not interested enough to join the current six party process now. But I must say, when your side decides to join this common effort and expand this to seven party talks, we would welcome that. ….. Your side is not interested in joining this process currently. ….. Some important members in the European Union, including Holland, France, Germany, and also Norway and Bulgaria enjoy good relations with North Korea and send delegations to Pyongyang to have

direct dialogues with Kim Jong Il to persuade, to convince the DPRK to give up its nuclear programme. This is very positive.
We also believe that in another regional issue, you can also have an important role, such as the regional security cooperation, how to establish, how to develop the regional security cooperation mechanism, a permanent mechanism. Frankly speaking, we are currently still in the process of exploring such kind of possibility. As you know, there are too many forums, too many proposals. Asian countries like to learn from the European experience. As I know, in the process of European integration, your countries have gained long experience. Of course Asian countries are much more different from each other than in Europe, different religions, different political systems, economies at different levels. Despite all these differences, we know cooperation is very, very important." 88

Zhu Feng, director of the International Security Program, School of International Studies, Peking University said that China's so-called "strategic partnership" with the European Union had some potential value in countering the US-Japan Alliance.

> "Europe and China consider world politics through a multi-polar prism. Both feel uncomfortable about America's unipolarity. So, our relations with the EU are an important balancing factor against US-Japan dominance of the East-Asian region. China however, will focus mainly on economic and domestic construction and we will not allow ourselves to get diverted by a conflict with the US and Japan, because we are very confident, China is benefiting a lot from globalization. China has no intention to compete with the United States for global influence. Our priority is economic development. The economy is improving but problems are accumulating. I don't think China is willing to take advantage of the good relations with France and Germany to combat the United States-Japan Alliance. I don't think that will happen although it dominates China's thought towards the European countries. Increasingly, China will keep a low profile. We consider that that serves our own interests best. On some of the issue-areas. We are strongly opposed to Japan entering the UN Security Council as a permanent member. We also follow our own line in the North-Korea "Six Party Talks" and refuse to yield to American pressure. ….. China is a big power."89

Prof. Zhu strongly believes that Europe has security interests in East-Asia.

> "In the first place, the EU has strategic interests in maintaining the stability and prosperity of East Asia. East Asia is the third largest and third most developed economic region in the world-economy. Regional security in East-Asia has also a lot to do with the EU's economic and commercial interests. Secondly: East Asia now increasingly involves EU-countries since the commercial issues spill over into the strategic field. For example, the EU attempts to lift the arms embargo on China, has provoked strong opposition from the US, Japan and Taiwan. But lifting the embargo emerged from commercial considerations, of course some of it strategic considerations".

Question by WvK: "For me the symbolic significance of lifting the embargo is supreme: it is tantamount to a European *'Declaration of Independence from the United States'*. A Europe that cannot say "NO" to the US is empty".

> ZF: That's why we welcome that Europe makes the right decision. But it is not easy. Trans-Atlantic relations are still very important. We hope you can independently decide what to do and demonstrate you're an independent entity in today's global power-system. It is really a handshake that you extend to China.
> The third European security interest in East-Asia is that the EU has to add its voice independently. We Chinese, naturally compare Japan with Germany. Germany's attitude towards historical WWII issues has been exemplary. Atonement, apologies, compensation etc. Japan has spectacularly failed to do anything comparable to Germany and the United States has always been quiet about this. Whenever we discuss this with American academics, they always blame China. One very prominent American East Asia scholar went even as far as putting the prime ministerial Yasukuni visits on a par with asking the American government

88 Interview with Li Yang,
89 Interview with Zhu Feng, Beijing, 18 May 2005.

> to stop paying homage to Arlington National Cemetary. Can you imagine that ? So it would be very important if Europe would add an independent voice, in this case, how to examine this dispute and how to conduct the current debate on this Sino-Japanese conflict. This could have a significant positive impact. 90

Shi Yinhong, professor of International Relations at Renmin University in Beijing
Thinks that the European Union can play a positive role in reducing the various tensions, China-Taiwan, North-Korea, China-Japan.

> "The European Union has its need for international prestige and influence. The EU has friendly relations with both China and Japan. It is in a unique position. It is kind of neutral. China doesn't consider Europe pro-Japan, like the United States, nor does Japan consider Europe too much pro-China. So Europe can advise and persuade both sides. Both China and Japan can learn a lot from the European processes of post-war reconciliation and integration."91

Japan:

Norio Maruyama, director for European Policy at the Japanese Foreign Ministry:

When asked about European security interests in East Asia, he only mentioned Japan's opposition to the European lifting of the arms embargo on China, because this would be a threat to stability in the region. Maruyama mentioned that prime minister Koizumi had conveyed this message to Jaap de Hoop Scheffer, NATO secretary-general, who was on avisit to Tokyo early April. De Hoop Scheffer told Koizumi that NATO had no position on this.

Motofumi Asai, former director of the China Bureau in the Japanese Foreign Ministry and now a professor at Hiroshima University, expressed the view that although it is never openly said: "Everybody understands that it is the common strategy of Japan and the US to prevent reunification of China and Taiwan, whether by peaceful or non-peaceful means." Asai thought that an explicit statement from the European Union that Taiwan is unambiguously "part of China" replacing the hedging and tinkering in many of the bilateral communique's that country XYZ "acknowledges, or agrees with the Chinese view that Taiwan is part of China". Asai thought such a statement would have a strong impact and advance peaceful reunification of Taiwan with China. 92

South-Korea:

Like the Chinese (see above), Seoul would also welcome a European role in the Six-Party Talks on North-Korea. Lee Jong Kook, the deputy director-general for Planning in the South-Korean Foreign Ministry referred to the helpful role Swedish prime minister Goran Persson had played as president of the EU Council when he met with Kim Jong Il in 2001 and got some commitment that N-Korea would respect the moratorium on missile tests.

> "This is certainly a good contribution. EU is also a member of the KEDO. Financially, you are participating and providing resources to this project. Of course the future is uncertain now because we have a second N-Korean nuclear crisis. The EU is also providing humanitarian aid to N-Korea, already five or six years. Various European countries have embassies there. N-Korea is a deeply isolated country and thanks to Europe the world knows a bit what is going on there. Recently when George Bush visited Europe the arms

90 Ibid.
91 Second Interview with Shi Yinhong, Beijing, 15 May, 2005.
92 Interview with Motofumi Asai, Tokyo, 19 April 2005.

embargo to China became a hot issue. The South-Korean position is somewhat vague in this matter, because we are not directly involved." 93

93 Interview with Lee Jong Kook, Seoul, 27 April 2005.

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Strategic Consideration in the US-China Relationship: A Role for European Soft Power?

Dr. Sebastian Bersick

Strategic Consideration in the US-China Relationship: A Role for European Soft Power?

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1. Introduction

Though China is an important trade partner of the USA, eijing is neither a political partner nor a military ally of Washington D.C.1 Former US Secretary of State Henry Kissinger characterizes the Sino-US relationship as "beset by ambiguity"2. This chapter analyses strategic considerations within the conceptual, the policy and the systemic dimension of US-Sino relations. Furthermore, the role of the EU's soft power in the context of US-China relations will be assessed. It will be argued that current US-China relations are mainly a function of the current US foreign policy towards China, which doesn't take into account that an engagement policy towards China needs to be paralleled by an engagement policy towards the East Asian region. A functional equivalent of the EU's soft power and its approach of bilateral and multilateral engagement of East Asian actors is a missing element in US-China relations.

Experts on East Asian affairs mainly agree that the bilateral relations between the People's Republic of China and the USA are the most important political shaping factors for the emergence of East Asia as a global actor by 2020-2025.3 However, multilateral institutions on the interregional level, like the ASEM or APEC process, are thought of as being less important. Since a majority of erts assesses EU-Asian relations as a defining element of international politics within the coming 20 years and – at the same time – attaches high importance to the ASEAN+3-process, the two processes need to be differentiated: The institutionalization of an East Asian Regionalism and the response to it by the rest of the world and in particular by the USA and the EU.4

Tian An Men and the end of the Cold War had strong influence on US China policy. With the end of the systemic bipolarity in international relations security positions were redefined and trade policy calculations and human rights aspects became more important.5 The second Clinton administration followed an engagement policy towards China of which the accession of the PR China to the WTO was an important result. The USA supported the membership of China in the WTO for four main reasons: 1. China would be the biggest (in terms of inhabitants) WTO country and would help the WTO to become a truly global organization. 2. China was to cut customs and tariffs which was seen as advantageous for US companies on the China market. 3. The USA could use a Dispute Settlement Mechanism in its trade relations with China. 4. It was expected that the necessary and irreversible economic reforms would result in political reforms of the Chinese political system in the mid to long term.

When President George W. Bush took over office in January 2001 he was determined that his administration's China policy was to follow the ABC policy – "Anything but Clinton". His staff

1 See: Bates Gill/Sue AnneTay, ‚Partners and Competitors. Coming to terms with the US-China Economic Relationship', April 2004, www.csis.org/china/0404_partners.pdf.

2 Henry Kissinger, ‚Conflict is not an option', IHT, 09.06.05, p.9.

3 See: Volume I of this Study, Annex I: Focus Group Questionnaire. A majority of the experts also holds the view that the Chinese-Japanese relationship is most important. For a discussion of the latter see Willem van Kemenade's chapter in this volume.

4 See: Sebastian Bersick, Auf dem Weg in eine neue Weltordnung? Zur Politik der interregionalen Beziehungen am Beispiel des ASEM-Prozesses [Towards a New World Order? On the Politics of Interregional Relations: The Example of the ASEM process] Baden-Baden 2004.

5 For the following see: Kolkmann op. 17 pp.

was convinced that the most important security problem in international relations would be the rise of states that could become a threat to the USA. Balance of power politics were conceptualized as a counter strategy to such a development. With reference to Asia the 2001 Quadrennial Defence Review Report of the Pentagon stated that it would be very difficult to keep a stable balance since China could become a military competitor with considerable resources. While President Clinton had called China a strategic partner, President Bush called China a strategic competitor. According to Eric Heginbotham from the Council on Foreign Relations in Washington D.C. "the pre 9/11 US administration's policy balanced China too aggressively"6.

Because of the so-called war on terrorism and the Chinese support of it, the status of China in US foreign policy changed again, turning from a strategic competitor to a potential partner in the war on terrorism. It was the then Secretary of State Colin Powell who described the bilateral relationship with China as being "candid, cooperative and constructive".7 The US National Security Strategy of September 2002 welcomes the rise of a strong, peaceful and prosperous China but mentions three areas in which US-Sino relations face basic disagreement: the status of Taiwan, Chinese weapons proliferation and human rights8.

2. The conceptual dimension

The thinking on China affairs in the USA can be broadly structured into two different schools of thought. On the one side there are those who favour an engagement policy vis-à-vis China. The engagement school argues that bilateral and multilateral cooperation with China needs to be intensified. Traditionally members of this school are found in the Department of State and the Bureau of the US Trade Representative. On the other side there are those who think of China as a threat that needs to be contained. The politicians and experts that belong to the threat school (e.g. in the Heritage Foundation and the American Enterprise Institute) emphasize their fears of China's future role on the regional and global level. Though China has supported the US's "war on terrorism" after the attacks of 9/11 Beijing's increasing military budget, its neglect of non-proliferation agreements (e.g. in its relations with Pakistan) and its behaviour within the Six-Party Talks are taken as examples of the China threat.

In that context a US expert on Southeast Asia that belongs to the threat school opines that since "ASEAN has no military capabilities China will keep Southeast Asia under her thumb".9 The expert reasons that the "Chinese vision of East Asia is the old tributary system. China wants the hegemony over East Asia." A US expert on East Asia warns that "China is playing a time game on the South China Sea issue and on the Taiwan issue, China is playing the confidence building game. Part of it is the FTA with ASEAN, all the talk-reassurance, the peaceful rising theory." Since "the US administration is distracted through the Iraq etc. from the rise of China" the US needs to develop new policies that allow further balance of power games, like the establishment of an ASEAN-US equivalent to the ASEAN+1 dialogues.

Those experts who favour an engagement policy explain the dynamics of US-China relations with the help of the paradigm of complex interdependence and point to the fact that "China can't play balance of power. The majority of China's exports goes to the EU and the USA. No East Asian regionalism will change that." Another US-China expert argues that "in the East Asian

6 Interview of the author, 11.03.05 in Washington D.C.

7 After the Hainan incident in spring 2001 the Department of Defence broke off all regular and informal contacts with the Chinese military.

8 See: The National Security Strategy of the United States of America, 17.09.2002, www.whitehouse.gov/nsc/nssintro.html.

9 The following interview information will be, for reasons of discretion, anonymized. They have been conducted by the author in March 2005 in Washington D.C.

context China's behavior is explained mostly by interdependence. Economics explains the region better" than balance of power considerations. The thinking of those two groups and their respective opting for either elements of an engagement or a containment policy of the US vis-à-vis China is brought together in conceptional terms by those experts who combine the two theoretical concepts. One US expert on China reasons that "economic interdependence needs to be developed in East Asia. At the same time a balance of power is needed to guarantee the security while interdependence is rising. Asia looks for a balance of power for reassuring its security." As Southeast Asian countries see "economic advantages of the rise of China but security problems the USA needs to balance China."

3. The policy dimension

In recent years the bilateral trade between the USA and China has grown rapidly. The USA is China's second largest trading partner. China is the US's third largest trading partner. US firms have invested much more FDI in China than in any other emerging market, about 45 Billion US$ in direct investments through the end of 2003.10 The USA runs its single largest bilateral trade deficit with China.

An indicator of the conflict-laden Sino-US trade relationship is the promise of Robert Portman, the US trade representative, to perform a "more aggressive approach" towards China's trade practices and the re-imposition of quotas on three categories of Chinese textile imports. In that context Nicholas Lardy of the Washington D.C. based Institute for International Economics reasons: "The Asian countries are gaining power as their trade increases. The EU and US are going down. There is a logical economic pattern. There is a potential for exclusive regional arrangements. A form of competitive liberalizations is taking place."

The Bic Mac-Index of The Economist11 provides a casual estimate of the value of a currency and it argues the Chinese currency Renminbi is estimated to be 59% undervalued against the American dollar. The fixed exchange rate, or peg, of the Chinese Yuan to the US dollar (roughly 8.3 Yuan) has for a long time been another issue that ranked on top of the Sino-US agenda. Though economists disagree whether there is "credible evidence that the renminbi is significantly undervalued"12 or not, US manufactures have complained that the peg offers unfair cost advantage to exports from China. There is a split in the US industry on the questions of the reintroduction of textile quotas. Retailers have launched legal action against the sanctions because these could limit their "access to cheap Chinese clothing"13. The US Senate had threatened to approve a measure that would have imposed a 27,5 % tariff on all Chinese imports if the Chinese government didn't change its currency policy. The Senators who had offered the legislation named it as their ultimate goal "to insure that China plays by the rules"14. The Senate intended to pass the bill this summer in order to allow the Yuan to float freely. Thereby, the argument goes, the Sino-US trade imbalance is supposed to be corrected by the market, as the trade deficit shall be reduced because the cost of exports and imports are no more distorted.15 The Senators complain about China's overall "mercantilist approach" that explains why Beijing is not reacting to the appropriation of American intellectual property and routinely hinders U.S

10 In 2003 China received, for the first time, more foreign direct investment than the USA. (USA received 40 Billion US $, China 53 Billion US$).

11 The Economist, June 9. 2005, http://www.economist.com/markets/bigmac/displayStory.cfm?story_id=4065603, download 10.06.05.

12 According to Goldstein and Lardy „China's real effective exchange rate has depreciated by 10% since February 2002, at the same time as it has run ever-larger current acount surpluses". See: FT, 27.04.05, p, 12.

13 FT, 11/12.06.05, p.1.

14 See: Charles E. Schumer / Lindsey Graham, ‚Free The yuan!', in: IHT, 09.06.05, p. 9.

15 The currency of a country with a trade deficit falls in value, causing imports to shrink (because they become more expensive) and its exports to rise (because they become cheaper).

companies from selling their products in China, "in defiance of the World Trade Organization"16.

Economists who argue against a free floating Yuan reason that the Chinese government has been a huge buyer of American securities and U.S. treasury bonds which (together with equivalent policies by other Asian central banks) financed more than two thirds of the U.S.'s trade deficit of 617 Billion US dollar in 2004. They point out that as a consequence of a free floating Yuan the US interest rates would rise – a process that could e.g. lead to the burst of the real estate bubble in the USA. Whilst the Renminbi has been recently delinked from its US dollar peg and devalued by 2% against the US currency the new regime of a currency basket will not solve the issue of the US-China deficit. This is because the reason for the increasing imbalance (124 Billion in 2003) is neither Chinese protectionist measures nor an undervalued Chinese currency but the consequence of foreign firms assembling manufactured goods in China.17 The components and parts of those goods are mainly imported from other Asian countries. As a consequence China's pattern of trade "surpluses with the USA and the EU but deficits with most of its Asian neighbours stems from China's rapidly increasing role in the global production chains of multinational corporations".18

The bilateral relationship between the USA and China becomes more complicated once security considerations are figured in.19 From the US perspective the main question is how Washington shall respond to and deal with an increasingly active role of China in economic, political and military affairs within the Asian region. According to Kenneth Lieberthal, Visiting Fellow at the Brookings Institution, "a Chinese-led East Asian grouping will challenge the USA. China intends to flatten the global hierarchy of power. That is what the Chinese call multipolarity. The USA is deeply engaged in East Asia. But the USA is only concerned about the war on terrorism. As a consequence of the single minded policy of the Bush administration, China is moving into the vacuum that the USA allowed to build up." Lieberthal goes on to explain that "within the last five years the perception of China in the region and especially in Southeast Asia has changed. The region is looking for China as a source for ideas. That is new (…) China doesn't want to kick the USA out of Asia."20

Yet, the US security interests in Asia are manifest in the overall goals of the new US Global Defense Posture Review (GDPR) in Asia, namely21: (a) to better prepare the US for regional contingencies in Korea, the Taiwan Strait, and to conduct counter-terrorism operations, (b) to renovate the US alliances in Asia through an increase of the interoperability, the reduction of frictions, stresses and unhealthy dependencies, (3) to increase US interactions with other regional security partners, (4) to overcome the lack of sufficient access to South Asia and Southeast Asia, since the current US military presence is mostly located in Northeast Asia.

According to a US expert on Asian security the Bush Jr. US administration, when coming into office, realized that the USA "had fallen behind the requirements of post-Cold War military

16 The Chinese government has been a huge buyer of American securities and esp. U.S. treasury bonds which (together with similar efforts by other Asian central banks) financed more than two thirds of the U.S.'s trade deficit 617 Billion US in 2004). Economists point out that as a consequence of a free floating yuan the US interest rates would rise – a process that could e.g. lead to the burst of the real estate bubble in the United States.

17 See: Nicolas Lardy, „China: The Great New Economic Challenge?", in: C. Fred Bergsten (ed.) The United States and the World Economy, Washington D.C. 2005; 125 pp.

18 Nicolas Lardy, op. cit., p. 126-127.

19 In the following I will concentrate on the example of the cross Taiwan strait relations.

20 Interview of the author in Washington D.C., 11.03.15.

21 See for the following: Non-published paper by Evian Medeiros, RAND Cooperation, presented at the 2004 meeting of the 'Waldbroel Group on the European and Euro-Atlantic Coordination of Security Policies vis-à-vis the Asia-Pacific', German Institute for International and Security Affairs (Stiftung fuer Wissenschaft und Politik SWP).

transformation which created a sense of urgency during the last years". "Strategic issues like China and North Korea and not the global war on terrorism are the reason for the US GDPR".22

As a result the overall changes in US force posture in Asia will be a consolidation and rationalization of troops, facilities and headquarters in Japan and South Korea, a massive increase of forward deployment of naval and air force capabilities in Guam and the establishment of nodes for Special Operation Forces and other contingency operations, especially in Southeast Asia. Furthermore the US will institutionalize bilateral security cooperation with Singapore (Strategic Framework Agreement) and perhaps with India and Mongolia and will generally expand military and security cooperation with Malaysia, India, Indonesia, Vietnam and Taiwan.

The regional security implications of the changing US force posture in Asia are manifold and reach from short term tensions within alliances to future tensions as US troops in host countries will be used for so-called expeditionary operations in Asia or other regions. Apart from that China's reactions to US GDPR will be a critical variable in the future since the Chinese government is aware of and concerned about those developments and may forge bilateral political relationships with Southeast Asian nations.

A rationale for the new US GDPR, its underlying assumption of the validity of balance of power games and for their operationalization through a policy of military containment, has been given by the US Secretary of Defence. During the meeting of the Shangri-La Dialogue in Singapore this June 2005, Donald Rumsfeld pointed to several areas of concern that exist in relation to China's role in Asia and underscored the increase in Chinese defence expenditure. The Secretary of Defence explained that "China appears to be expanding its missile forces, allowing them to reach targets in many areas of the world, not just the Pacific region, while also expanding its missile capabilities within this region. China also is improving its ability to project power, and developing advanced systems of military technology (…) Since no nation threatens China" – Donald Rumsfeld asked his audience in Singapore – "one must wonder: Why this growing investment? Why these continuing large and expanding arms purchases? Why these continuing robust deployments? He concluded: "China would appear more a welcome partner" if a "growth in political freedom" took place.23

In Singapore Donald Rumsfeld referred to the – at that time – unpublished annual report to the US Congress by the Office of the Secretary of Defence on 'The Military Power of the People's Republic of China'. The recently released report, which assumes that China will become in 2005 the third largest defence spender in the world after the USA and Russia, concludes that "[o]ver the long term, if current trends persist, PLA capabilities could pose a credible threat to other modern militaries operation in the region" though the report assesses at the same time that "China's ability to project conventional military power beyond its periphery remains limited"24. The report furthermore emphasizes that China has continued "to deploy its most advanced systems to the military regions directly opposite Taiwan"25.

22 Intervention of a US member of the 'Waldbroel Group on the European and Euro-Atlantic Coordination of Security Policies vis-à-vis the Asia-Pacific', German Institute for International and Security Affairs (Stiftung fuer Wissenschaft und Politik SWP), December 2004.

23 The IISS Asia Security Conference, First Plenary Session, The Hon Donald Rumsfeld, 04.06.05, www.iiss.org, download 05.06.05.

24 Annual Report to Congress. The Military Power of the People's Republic of China 2005. Office of the Secretary of Defence. http://www.defenselink.mil/, download: 20.07.05, Executive Summary.

25 Annual Report to Congress. The Military Power of the People's Republic of China 2005. Office of the Secretary of Defence, op. cit., p. 3.

The Taiwan issue is one of the potential hot spots in the Asian region and has been the "principle issue"26 in US-China relations for more than four decades. Since the normalization of US-China relations in 1979 the USA and particularly the current President has made it clear that he does not support Taiwan's independence and supports the One China principle. At the same time the Taiwan Relations Act from 1979 defines a threat to the security of Taiwan as a threat to the interests of the USA. On the basis of the Taiwan Relation Act the USA exports weapons to Taiwan. Those weapons are facing e.g. an increasing amount of missiles (around 700) that are stationed on the mainland side. While the US administration does not support any unilateral move of Taiwan towards independence,27 the US administration supported the recent visits of the two Taiwanese politicians Lien Chan and James Soong to mainland China. According to a Taiwanese expert on cross strait relations "both politicians would have never made their journey without the OK from Washington"28

As the tensions between China and Taiwan are the "biggest challenge for the Sino-US relationship"29 the lift of the European arms embargo against China would have a grave impact on Sino-US relations. In that context a European political observer in Washington D.C. opines that "the political cooperation between China-US-EU is in motion. The arms embargo issue is responsible for that. The Taiwanese do a good job on lobbying in Washington." Derek J. Mitchell of the Centre for Strategic & International Studies in Washington D.C. reasons: "We [the U.S.] do not feel that the EU should be involved in East Asia. We are more fearful that the EU could complicate our relations with Asia. If the EU wants to be more involved we want to be informed. The arms embargo is an example for the contrary. The arms embargo issue is a wake up call for the U.S. The State Department is realizing it. We need coordination as part of the transatlantic alliance. China continues to push. The lifting of the European arms embargo would send a wrong signal to China."30 In that context Kenneth Lieberthal argues: "Nobody in the EU is thinking of security issues in Asia. For the EU Asia is a threat in economic terms (e.g. textiles). But a major player should have responsibilities. The lifting of the European arms embargo against China is an example for Europe acting without responsibility. The sales of Airbus are the motivation for the lifting of the embargo. If the EU had a sensibility for security issues it would be beneficial to the policy making [of the US administration]. A future transatlantic forum on Asian and China affairs needs to deal with the Taiwan issue."31

A Chinese ambassador has recently argued32 that he understands that it is "not easy for the Europeans" to lift the embargo now because they are "under great pressure" from the US administration not to do so. Nevertheless he wants the EU "to show its independent personality in this issue". Yet, such a policy on the European side would run the risk that a wedge is being driven between the EU and the USA. In contrast to such a development transatlantic institution building with regard to Asian affairs is a more appropriate development33. Peter W. Rodman, Assistant Secretary of Defence, holds the view that "an institutionalized transatlantic forum on Chinese affairs is a good idea"34.

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26 David Shambaugh, ‚Patterns of Interaction in Sino-American Relations', in: Thomas W. Robinson/David Shambaugh (eds.), Chinese Foreign Policy. Theory and Practice, Oxford 1995, p. 222.

27 See alos Lee Hsien Loong, The IISS Asia Security Conference, 04.06.05, www.iiss.org, download: 05.06.05.

28 Interview of the author, 04.06.05, in Taibei.

29 Michael Kolkmann, ‚Die China-Politik der USA. Konzepte-Erfahrungen-Perspektiven', SWP-Studie, S 9, April 2005, p. 9.

30 Interview of the author, 08.03.05 in Washington D.C.

31 Interview of the author, 11.03.05 in Washington D.C.

32 Background interview of the author, 09.06.05.

33 See for that argument: Sebastian Bersick, EU-China relations and the EU's arms embargo, www.eias.org.

34 Interview in Washington D.C., 10.03.05.

In that context it has been an important recent development that the US Assistant Secretary of State for East Asia and the Pacific Affairs, Christopher Hill, visited Brussels in late May to further institutionalize a dialogue within the new framework of a "Transatlantic strategic dialogue on East Asia". Though – according to Denis Wilder who is the China Director of the National Security Council of the White House – "the dialogue has not been on the arms embargo but on East Asia" 35 – the establishing of a dialogue between the USA and the EU on Asian affairs is a hard indicator for a change in the institutional relationship between the USA, China and the EU.36

4. The systemic dimension

During the period of tight bipolarity in the 1950s and 60s the US-China relationship was in a state of armed confrontation. From the end of the 60s until the mid 1980s US-China relations were a function of the confrontations between the USSR and the USA and between the USSR and China. Because of the normalization of Sino-Soviet relations and the détente between the USSR and the USA from the mid 1980s onwards the relations between Washington D.C. and Beijing were less shaped by systemic forces than by factors at the societal and governmental level of analysis. After the end of the Cold War it was assessed that China would become the central actor in post-Cold War Asia. Furthermore, China's interests and actions would likely diverge increasingly from those of the United States (as well as its Asian neighbours) due to China's economic and military development. 37

Current developments in the international system show that an analysis of Sino-US relations needs to take into account the implications of regionalization processes in East Asia. According to Chinese experts on Asia a majority of Chinese policy advisors hold the view that few if any Asian powers would join a US lead coalition to contain China.38 Though China's regional concerns still focus strongly on the USA this is why a strategic encirclement of China is only feared by few Chinese strategists. Against this strategic setting and because China is dependent on a peaceful environment in order to sustain economic growth and social progress Beijing, has been developing a long-term strategy based on two fundamental assumptions:

1. "The global strategic structure is seriously unbalanced in favour of the USA." At least privately Chinese policy advisors admit that the quest for a multipolar world order 'will not prevent the USA to be the global hegemonic power in the decades to come.' But the Chinese "firmly believe that even without active Chinese resistance, hegemonic U.S. behaviour will not go unchecked in the international arena". This is why the "general trend in Asia is conductive for China's aspirations to integrate itself more extensively into the Asian region and the world" and why the "US would have difficulties in reversing the direction of this trend." Furthermore, Chinese experts on East Asia hold the view that the rise of China needs to be accompanied by the rise of Asia. A structural change in the global balance of power along these lines would – according to Beijing – better position China vis-à-vis the USA.

2. Different views and interests regarding China will continue to exist in the USA. At the same time the engagement between China and the USA has become so deep that the costs of a containment policy similar to that towards the Soviet Union during the cold war would be too

35 Observation of the author during the press conference, 23.05.05.

36 See also: David Shambaugh, The New Strategic Triangle: U.S. and European Reactions to China's Rise, in: The Washington Quarterly, 28:3, Summer 2005, pp. 7-25.

37 David Shambaugh, op. cit., p. 222.

38 See for the following: Wang Jisi, ‚China's Changing Role in Asia', in: Kokobun Ryosei/Wang Jisi (eds.), The Rise of China and a Changing East Asian Order, Tokyo 2004, p. 16 pp.

high. Therefore it is seen as unlikely that the USA will regard China as its principal strategic adversary in the coming years.

Members of the 'threat school' criticize that the US administration had put its geopolitical focus too strongly on the Middle East which enabled China to become the "power broker" in Asia Pacific. To them the increasing level of intraregional cooperation in East Asia and the proactive role that Beijing plays within it is part of a Chinese strategy to expand its influence within Asia.39 In that respect the Chinese support of the concept of an East Asian Community which shall develop out of the first East Asia Summit, that will be inaugurated in December this year in Malaysia's capital Kuala Lumpur, has raised suspicion on the US side. US politicians and experts question the direction of such a process and call it a "test of China's intentions (…) whether its growing capacity will be used to seek to exclude America from Asia or whether it will be part of a cooperative effort"40. Though US Deputy Secretary of State Robert Zoellick recently stated that "the United States is intent to deepening economic and political ties with Southeast Asia but not by trying to contain China's rising influence in the region"41 the statement of Secretary of Defence Donald Rumsfeld in Singapore indicates that the two rivaling schools of thought have not reached an agreement of how to operationalize the paradigm shift in international relations, that the rise of China and Asia constitutes.

On the diplomatic or operational level the US foreign policy vis-à-vis China needs to develop a policy that combines processes of bilateral and multilateral institution building in the East Asian region. According to David Lampton "the litmus test for the US will be whether the Chinese are proposing regional organizations in which the USA will participate." He goes on to explain that "the US doesn't like ASEAN+3 and FTAs because we are out. The core economic and security issues need to be dealt with in regional organizations of which the USA is a part of. The USA will not accept regional organizations which are exclusively designed to balance or contain American power."42 In this context Derek Mitchel argues: "China as the core of an East Asian regionalism raises the question whether this grouping will be exclusive or inclusive. If an East Asian regionalism is exclusive it will be bad for Europe. China will become a super power. China will have enormous influence on Europe. But if a Chinese-led East Asian grouping includes the US it will not challenge the current world order. The fundamental dynamics and architecture of security in Asia haven't changed. There is no alternative to the US security structure in Asia. China takes an indirect approach by quietly developing economic and political leverages. This is a long-term challenge."[43]

Yet, as long as the USA doesn't develop a regional Asia policy, that encompasses an approach to China and – at the same time – to East Asia the US policy towards China is destined to swing between engagement and containment or a mixture of both. Such a policy of hedged engagement, i.e. engagement that consists of political and economic enmeshment of China, hedged by political and military power balancing characterizes current US-China relations. This policy is mainly a function of the current US foreign policy towards China, which doesn't take into account that an engagement policy towards China needs to be paralleled by an engagement policy towards the East Asian region. Such a policy is practiced by the European Union, which engages China bilaterally (EU-China) and in a multilateral, interregional institution (ASEM process).

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39 See: Jane Perles, The New York Times, ‚Chinese Move to Eclipse U.S. Appeal in South Asia', 18.11.2004, p. 5.

40 Henry Kissinger, ‚Conflict is not an option', IHT, 09.06.05, p. 9.

41 Zoellick: Policy to contain China's influence ‚foolish', Agencies, updated 11.05.05, www.chinadaily.com.cn/english, download: 11.05.05.

42 Interview of the author, 11.03.2005 in Washington DC.

43 Interview of the author, 08.03.2005 in Washington D.C.

If, as Donald Rumsfeld has cheerfully indicated44, the reaction of the USA to community building processes in East Asia is not a cooperative and open one that proactively facilitates multilateral institution building on a regional level but an imbalanced one that puts too much emphasis on the build up of military capabilities and the inherent elements of a containment policy vis-à-vis China (as the new US Global Defense Posture Review indicates) the pattern of US-China security relations will be characterized by conflict and not cooperation.

5. A role for European soft power

Security policies do not solely determine the relationship between the USA and China. The US China policy is a function of both the US's economic and security interests. This explains why Washington follows a dual policy of simultaneous engagement and containment, i.e. a policy of hedged engagement. But the current state of affair of the Sino-US relationship does not reflect the rise of China as a de facto hegemon of an East Asian community. The current US China policy is confronted with an Asian region that "would like China's meteoric rise to be balanced by a sustained US commitment to defence of the region" but does not "want to be asked to choose between supporting one superpower over the other"45. The resulting dilemma for Washington D.C. lies in the consequentiality of its current policy of hedged engagement: The more institutionalized an East Asian regionalism becomes with an ever more assertive China driving the process the more political and military power balancing is needed – not only vis-à-vis China but also vis-à-vis East Asia. In the end US foreign policy could be forced to develop a hedged engagement policy for East Asia. That would raise the crucial question of how to develop a policy mix in order to be capable of engaging and containing a future East Asian regionalism. It is the inherent danger of the current US-China policy that the missing regional component in US-China relations could facilitate the formation of a fortress Asia.

Therefore, the decisive conceptual question within the future framework of Sino-US relations will be how US foreign policy will address the challenge of regionalization processes in East Asia and the increasing role that China plays within them. After having failed to conceptualize and operationalize the potential and strength of multilateral institution building on the regional level in Asia46 the US administration is challenged to adjust to two different but interrelated developments: the rise of China and the rise of an East Asian regionalism. Because of Europe's experience in the politics of interregional relations this issue area should become part of the EU-US Strategic Dialogue on East Asia. Whichever policy on East Asia the US chooses, China will hold the key to Asian regionalism.

Within this evolving new systemic context the EU's interregional relations with Asia and especially the ASEM process offer examples of how the EU and its member countries can take part in the molding of the international system. Thereby Europe develops the means to exert soft power47 in the Asian region by co-defining the norms and rules that facilitate the integration of the increasingly assertive Asian power China into a new world order in which regional communities and unions are seeking to become actors in their own rights.

With regard to China-US relations and the EU's interregional relations with the Asian region the EU should intensify its policy of exporting the European model of regional cooperation and

44 When asked in Singapore whether he believes „that the United States is threatened by the emergence of China" he cheerfully answered „no, and if China had only peaceful intentions, then why role out batteries of balistic missiles aimed at Taiwan"? Michael Vatikiotis, U.S. sights are back on China, IHT, 07.06.05, p. 6.

45 Vatikiotis, op. cit.

46 See: Francis Fukuyama, The Neoconservative Moment, The National Interest, Summer 2004.

47 Soft power being defined as the „ability to get what you want through attraction rather than coercion or payment". NYE Joseph, „*Soft Power: the Means to Succeed in World Politics*" (New York 2004), p. X.

integration. The European track record of supporting institution building in East Asia is vast. The EC has been the first dialogue partner of the ASEAN. Only after having started to engage China through the ASEM process in the middle of the 1990s did the three Northeast Asian countries China, Japan and the Republic of Korea and the then seven ASEAN members agree to cooperate in an institutional mechanism and started to formulate common "Asian" positions. This process has strengthened and supported the forces in East Asia that favor a deepening of intraregional cooperation and will lead to the inauguration of the East Asia Summit by the end of this year.

In order to further facilitate this paradigm shift within the international system it is imperative that the EU and its member countries continue to engage China bilaterally and multilaterally. Since Beijing holds the key to Asian regionalism, China should be the main target of European soft power in Asia by exporting the principles of regionalism and multilateralism to Asia. To what extend the EU and its model of intraregional cooperation and integration can influence the objective and trajectory of Asian regionalism will demonstrate partly the extent of Europe's soft power in the international system. Yet, the extent of Europe's soft power in the international system will be also a function of the future US foreign policy vis-à-vis East Asia and the related question to which extent the EU and its model of interregional cooperation can influence the US foreign policy on the conceptional and operational level.

6. Recommendations

- As the issue of the lifting of the EU embargo against China has made apparent the rising responsibility of the EU's actions in relation to China have repercussions on the Sino-US relationship. It is therefore necessary that the newly institutionalized strategic dialogue between the USA and the EU on East Asia is deepened and widened.

- The US and the EU need to start a dialogue on models and modes of regional integration. It is in the interest of both actors (and the EU member countries) to develop a common approach towards the challenge to support the development of an inclusive, i.e. open regionalism, in East Asia.

-From this follows the need for the European Union to promote its soft power and the concept of open regionalism as a normative and institutional basis of its interregional relations with East Asia.

- A transatlantic working group on the Comparative Studies of Regionalization should be set up that informs the official EU-US Strategic Dialogue on East Asia. It is in the interest of the EU and its member countries to exert its soft power within this working group.

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Family-Based Care for China's Ageing Population
- A Social Research Perspective -

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Family-Based Care for China's Ageing Population
A Social Research Perspective -

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1. Abstract

The occupation-based social security system in urban China came in need of reform as the market transition gathered pace, and a growing proportion of the population began to work outside the public sector. One of the greatest challenges for the reform is caring for an ageing workforce, and both the Chinese government and the World Bank see the revival of Confucian family values as being key to success. This paper seeks to conceptualise the Chinese intergenerational contract and contextualise it in order to verify the validity of this approach.

Despite the persistence of intergenerational support in reforming China, this paper maintains that due to the shrinking size of Chinese urban families and the increasing insecurity related to the market transition, these expectations are not realistic. The Chinese leadership needs to face this urgent issue not only to ensure a more balanced and sustainable economic development, but also in order to re-gain legitimacy among its 'people', thus securing the country's political stability. The European Union may provide China with valuable assistance in this process, as recommended at the end of this paper.

2. Urban insecurity

> "In France, 140 years elapsed before the proportion of the population over 60 doubled to 18% in 1976. It will take China just 43 years". (McCarthy and Zheng, 1996:8)

2.1 The Iron Rice Bowl

Before the reform, a comprehensive social security system provided Chinese urbanites with a considerable amount of services, administered by urban work units (*danwei*) of state-owned and collective enterprises. Although such a system allowed China to substantially improve life expectancy (Cook and White, 1998, Cook, 2000), it institutionalised the divide between urban and rural areas by cutting off the rural population from the provision of social welfare (Croll, 1999).

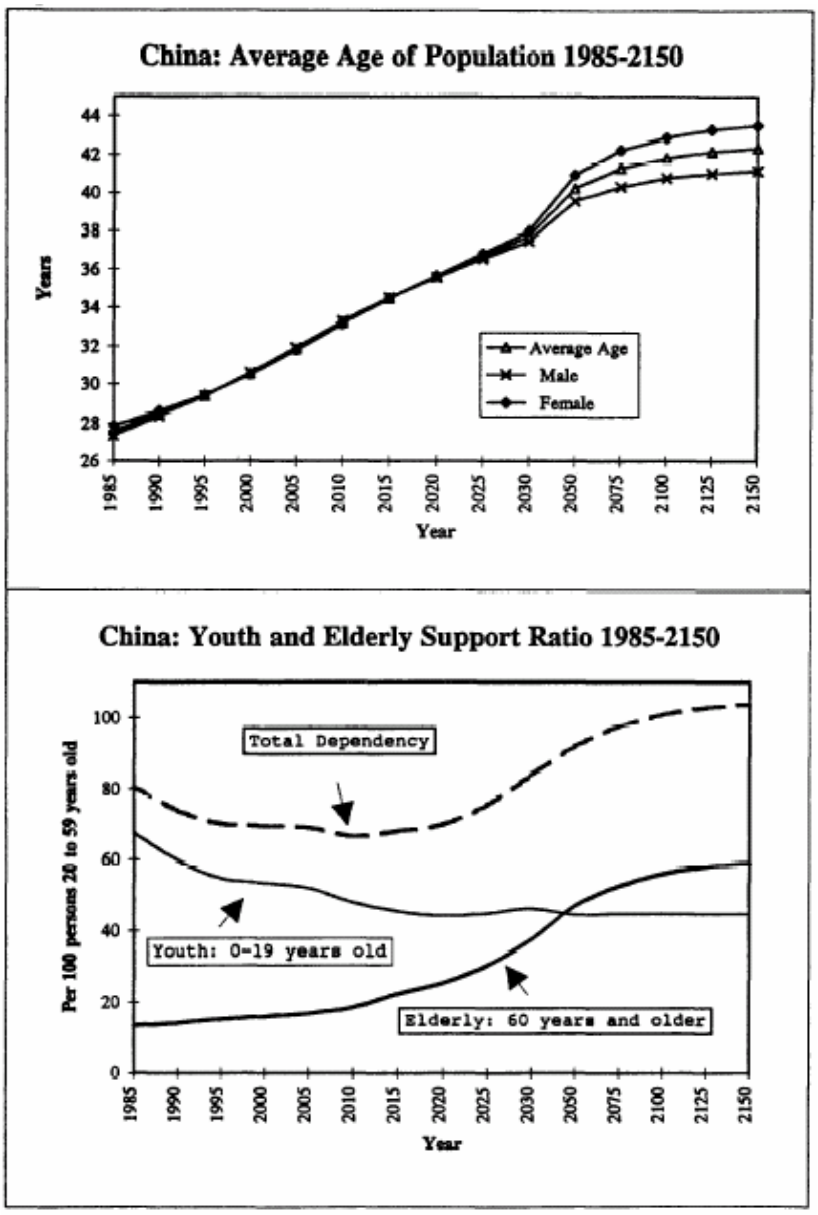
The occupation-based welfare system guaranteed permanent employment and financial security, retirement benefits, and a number of other services including housing and health care support, benefits for maternity, sickness and unemployment; this coverage ensured a generalised security, an 'iron rice-bowl' that the CCP could draw upon in order to win popular support (Cook, 2000). The broader term for 'social security' (*shehui baozhang*) includes: 1) social insurance (*shehui baoxian*): retirement pensions, medical treatment; unemployment, maternity, sickness, injury and disability benefits; 2) social provisioning of services (*shehui fuwu*): special benefits for the elderly, disabled and abandoned, as well as public services such as housing, healthcare and education; 3) social assistance or relief (*shehui jiuji*): assistance in cash and kind to the elderly and disabled without alternative source of income; 4) social preference (*shehui youfu*): services provided to those groups that have made a special contribution to the nation. In broad terms, the Ministries of Labour and Personnel were in charge of 1), while 2), 3) and 4) were administered

by the Ministry of Civil Affairs with the support of community organisations (White: 1996, Croll, 1999, Cook, 2000).

This system remained almost untouched for most of the 1970s and 1980s, when it became evident that, even under the assumption of sustained economic growth, it would not be financially sustainable (McCarthy and Zheng, 1996). In 1986 the State Council announced new regulations that would bring substantial change in the occupation-based social security system in response to the new trends emerging from market transition (Chen, 1996, Croll, 1999, Cook, 2000). Among such trends, a rising proportion of urban workers were finding employment outside the state-owned and collective sectors, thus losing their entitlements to state-provided pensions and social services: in 1999, 70% of the urban population were employed outside the public sector and were not covered by social insurance. This group included professionals and managers but also more vulnerable sectors such as migrants and the unemployed.

2.2 The challenges of market transition

Within the context of the reform of the social security system, pensions emerge as the most challenging issue for the Chinese leadership. In recent years, the rapid ageing of the workforce and the increasing costs of healthcare have led to a steep increase in the costs of retirement benefits (Chen, 1996, Croll, 1999). Population ageing in China may be linked to several causes, such as the successful implementation of the one-child policy in urban areas, and the extension of life expectancy, which is forecasted to reach 75 years at birth by 2030. The total number of pensioners increased from 3.14 million in 1978 to 30.94 million in 1995; and the old-age dependency ratio, which was 15 in 1995, is expected to rise to 38 in 2030 (McCarthy and Zheng, 1996:8). At the same time, social insurance and welfare costs went from 13.7% of the total wage bill in 1978 to 30% in the early 1990s (Croll, 1999).



Source: McCarthy and Zheng, 1996

Starting from the 1990s, and especially with the restructuring of state-owned enterprises in 1997, SOEs have been encouraged to avoid dependency on state subsidies and enter the profit-loss system. However, state-owned and collective enterprises can hardly compete on the market while fulfilling their responsibilities in terms of social welfare provision (Chen, 1996, Croll, 1999). The market reform brought a substantial decline in state benefit funds, with consequential erosion in job security and welfare services for those still working in the public sector. Unemployment is on the rise, even though it is often denied or disguised by retaining workers on a semi-employment or benefits-only basis, and hence difficult to estimate: in 2001, urban unemployed were reported to be 60 million, while in the same year *Social Sciences in China* reported that 30 million workers had lost their jobs; this may correspond to a proportion of the urban workforce between 14-29%204 (Solinger, 2003: 945).

Migrant workers, estimated to amount to 100 million, are a particularly vulnerable group. Urbanisation has grown sharply since the reform: the share of urban population rose from 17% in

204 These figures should be regarded as estimates due to the difficulties in measuring the actual size of the urban workforce.

1970 to 29% in 1993 (McCarthy and Zheng 1996:15). The loosening of the *hukou* registration system was gradually formalized since the late 1990s; in 2001-2002 a national wave of 'erasing' the rural-urban distinction took place, but only wealthier provinces such as Fujian, Guangdong, Jiangsu and Zhejiang abolished the distinction between agricultural and non-agricultural *hukou*. Inter-regional inequalities are not the only issue to be addressed: urban residence is often accessible to skilled labour, or in many cases it can be obtained through the purchase of housing. However, the large majority of the 'floating population' is not qualified to apply for urban *hukou* (Wang, 2004: 121). Although in some cases "the younger generation with better job opportunities may have enhanced financial capacities to support their parents" (McCarthy and Zheng, 1996:15), migrants are often unregistered and employed in the rapidly growing, but poorly regulated, informal sector; most of them struggle to find a stable occupation, and are not eligible for social security (Croll, 1999).

One of the groups targeted by the government with some kind of free service provision is represented by the 'Three Nos' (*san wu*): those with no family, no source of income and no ability to work. The elderly are passing from a condition of privilege to one of insecurity, having to cope with increasing costs of living and health care services, as well as with rapidly growing inflation; elderly women are especially vulnerable since they are most likely to lose their jobs, being put in early retirement or lacking their own income (McCarthy and Zheng, 1996:14, Cook and White, 1998, Croll, 1999, Whyte, 2003, Howell, 2003). Things are worsening even for those on state pensions, in many cases unpaid from mid 1990s (Whyte, 2003: 53); this condition leads many pensioners to seek re-employment, with the emergence of sharp inequalities between those with good educational qualifications and connections and the less qualified ones (Davis, 1988, Whyte, 2003). The erosion of the unit-based welfare state has allowed the emergence of 'new forms and risks of vulnerability' and of urban poverty, a phenomenon unthinkable before the reform (White: 1998, Cook: 2000).

The displacement of entitlements to state-provided social security has provoked a generalised sense of insecurity in urban areas, where the perceptions of those entitlements is deeply rooted. According to a survey carried out by CASS in 2001 in 72 cities, counties and districts, 23.8% of respondents declared that their standard of living had worsened since 1995, with 11.2% stating that it was much worse (Solinger, 2003: 946). Poverty and the widening gap between rich and poor, fast growing in the 'backward' regions is causing widespread social unrest: in 1998, the Hong Kong Centre for Human Rights and Democracy recorded 60,000 protests, including various social groups; in 1999 the number rose to 100,000 according to the *Far Eastern Economic Review*, and in 2002 the repression of escalating protests in the North East of China obtained coverage in the Western press (Solinger, 2003). Social unrest indicates the pivotal role that the provision of social security maintains in the social contract. The political leadership is thus in front of a political dilemma: on one hand, the government does not seem to have enough resources to tackle the escalating demand for social security services with a comprehensive, nation-wide system; on the other its insolvency puts at risk its very political legitimacy (Chen, 1996, Croll, 1999, Cook, 2000).

2.3 What solution?

Since the 1990s the Chinese government has attempted to transfer responsibilities from enterprises to social security agencies (Chen, 1996, Cook, 2000). There is also an awareness of the need for a society-wide, comprehensive social security system that would include:

> 'Provision for the aged, unemployment and medical insurance and form a multi-layered social security system combining social insurance ….and individual savings'205

Following the restructuring of Government Ministries that took place in 1998, the old Ministries of Labour, of Personnel and of Civil Affairs were merged into a new Ministry of Labour and Social Security. In the same year, the 'two guarantees' policy was introduced to secure basic support for retirees, and SOEs laid-off workers (Duckett, 2004). The emerging model, which has been designed with the support of the World Bank, implies a shift in administration and management of funds to specialised agencies and a commitment to include people working outside the public sector (Croll, 1999). The new multi-pillar system includes a fully funded 'social pooling' account, combined with a personal savings account built through the contributions of individuals and enterprises. In 2001, the government has piloted this model in Liaoning, using the revenue from the first pillar to pay present retirees; coverage has been expanded to non-state enterprises and first provisions have been made in the attempt to include migrant workers (Cai, 16-17).

The state also allows the development of commercial industries of welfare; however such organisations secure service access only for those who can pay, thus reinforcing existing inequalities. The government is encouraging the development of community services, welfare enterprises to employ disabled people and initiatives taken by NGOs as an aspect of a 'multi-level, multi-means and multi-channel approach to provisioning of social service' (Croll, 1999). Although community services and some welfare enterprises in prosperous areas have been fairly successful, they do not respond to the need for a long-term, coherent strategy in social security provision for the whole country (Chen, 1996, White, 1996), and state-sponsored collaborations with non-governmental organisations are hampered by a lack of specific rules and legislation (Croll, 1999).

The Government's commitment to the reform has been evident since the end of the 1990s: between 1998 and 2001, central fiscal spending on social security increased more than five-folds, and was expected to rise by a further 28% in 2002. In 2000, a National Social Security Fund was established and a White Paper on Social Security was published (Xinhua, 2002, Duckett, 2004). However, setting up a modern social security system in the present social and political context is proving difficult; after the transition to the market economy, many enterprises are unable to pay welfare insurance funds; another problem is the hand over of responsibilities for social pooling to urban local governments, as their deficit may encourage them to misuse pension funds (Zhang, 2000). While the reform proceeds in a piecemeal manner, home-based family care provides most of the necessary services to the elderly and disabled (Croll: 1999): a 1993 survey in Baoding reveals that the elderly in the sample rely overwhelmingly on their children or spouses for assistance (Whyte, 2003: 45).

Family responsibility for the elderly has been explicitly encouraged by the government, re-emphasized in the 1980 and 1990 legislation and incorporated in the Marriage contract (Palmer, 1995, Croll, 1999). The World Bank, in a Public Policy Research Paper published in 1996, suggests that "how to preserve and promote traditional family values shall be a key policy issue in designing old-age security systems in China" (1996:8). The paper, however, does not conceptualize this "key" issue, assuming that it would represent a 'natural' source of social security, at most in need of some 'encouragement'. On the other hand, it may be worth giving this issue some more serious attention, if the family is to play such a significant role in the sustenance of one of the fastest-growing populations in the world.

205 Long Range Goals in 2010 passed at the 4th session of the 8th National People's Congress (Croll, 1999: 692).

3. Tradition and transition

"This traditional natural harmony between generations within the family and among members of a community is now being disrupted as the economy modernizes and opens to external influences." (1996: 7)

3.1 The intergenerational contract in Chinese tradition

The Confucian ideal of family is based on the patrilineal structure of kinship and post-marital patrilocal residence (Kandiyoti, 1988, Kabeer, 2002). According to Confucian tradition, human society is founded on the unequal relation between father and son, where the father holds life-long authority over his children, who on the other hand must show deference and obedience to their parents. This condition is sanctioned and reinforced by the concept 'filial pity' (*xiao*), defined as the highest of virtues in Chinese classical texts (Croll 2000: 111). Filial children have to show their respect to their parents by following their wishes; in case their own desires do not coincide with their parents' ones, for example in the choice of their spouse, traditional morality suggests that children comply in order to maintain family harmony (Yan, 2003). Grown-up children have to repay their parents for the care they received in their childhood and hence are held responsible for their parent's subsistence and well-being during their old age (Croll, 2000:111): 'the young owed everything to the old, a debt that was never discharged' (Goode, 1963: 313).

Ideally, the traditional family was a multi-generational, extended one, in which sons brought in their wives and accepted their father's authority over them and their own family. The patriarch held authority on all junior members of the household. On the other hand, daughters 'married out', often far away from their own kin. Daughters could not perform ancestral rituals and had no place in their natal family, where they were regarded as a temporary presence and hence faced a strong disadvantage in terms of entitlements. According to Chinese proverb raising a daughter is like 'watering a shade-giving tree in someone else's garden'. Daughters were regarded in many cases as a double loss, since they also needed a dowry in order to marry (Davis, 1991, Milwertz, 1997, Croll, 2000: 122). Once in their husband's family, young women were cut off from their natal kin and passed under the authority of their in-laws. The young bride could earn some power only by giving birth to her own children, especially sons, as they ensured long-term financial security to the family and in particular to their mothers. Women who bore sons were entitled to a place in the family line, and in the long run would hold authority over their sons' wives. Childbearing was a strategy through which women could build their own pool of resources and allies within the household, also called 'uterine families' (Milwertz, 1997, Croll, 2002).

Both parents hence had reasons to strongly wish for the birth of sons and concentrate resources on their upbringing. For these reasons, the intergenerational contract in Chinese tradition is, in its continuity, a contract between father and son (Croll, 2000). The fact that the authority did not belong to the father, but flowed through him from the ancestors, could somehow counterbalance his power, since the "father was not free to act arbitrarily". However, the father was supposed to hold his family in control, and even when the latter was informally passed on to the eldest son, this did not imply an admission of lost authority from the father's part, nor a decrease in the deference due to him by his son (Goode, 1963: 313-314).

The upheavals of the twentieth century strongly challenged Confucian ideals of filial pity: with the emergence of the Nationalist Republic in 1911, young Chinese intellectuals, also influenced by Western ideals, started calling for a more equal relationship between parents and children. With the 1949 Communist Revolution, on the other hand, family obligations became the object of contradicting policies. The CCP condemned the Confucian deference to the elderly as feudal and incompatible with the communist project, and in a first moment adopted a radical agenda by

condemning concubinage and legalizing divorce. However, the Chinese leadership took a more cautious approach in terms of intergenerational obligations in order to maintain the family as the general base of production and reproduction (Whyte, 2003).

The Cultural Revolution forced many young Chinese to travel far from their families, while the socialist state also provided urban citizens with a considerable amount of social services. On the other hand, throughout those years children were legally bound to support their elderly parents by the Marriage Law of 1950. Besides, the chronic shortage of housing and the *hukou* system constrained relocation. Except for the limited number of youths who were sent to the countryside, the uncertainty of the Cultural Revolution may have played a part in strengthening familial bonds: in order to cope with unpopular policies and political uncertainty, individuals had to foster their most secure and readily available pool of *guanxi*: their family's. Despite the anti-Confucian rhetoric of the Maoist times, the constraints and uncertainty imposed by those same Maoist policies may have contributed to the persistence of intergenerational support (Davis and Harrel, 1993, Whyte, 2003).

3.2 The intergenerational contract in a context of transition

Recently, economic development, modernisation, urbanisation and demographic transition occurring in China are likely to have some impact on social relationships at large, hence also on the intergenerational contract and the value attached to children. Among the theories that look at such dynamics, a distinction can be drawn between those which maintain changing beliefs and values to be the pivotal element in transforming the role of the family and those that look at socio-economic trends as the determinant of those transformations (Mahotra and Kabeer, 2002). The work of Caldwell can be included in the former group, while the latter may be represented by William Goode's.

According to Caldwell, the transition from high-fertility to low-fertility societies is caused by a reversal in the intergenerational flow of resources: while traditional, high-fertility societies are characterised by a child-to-parent flow of wealth, goods and services, in modernised, low-fertility societies the flow of resources runs from parents to children. This reversal follows the 'westernisation' of beliefs and attitudes toward the family due to the spread of mass education and individualistic values. This 'emotional nucleation' includes a concentration of parental emotions and resources on children, and implies the decline of the authority and support accorded to the elderly (1976, Croll, 2000, Mahotra and Kabeer, 2002).

The theory of the sociologist Goode looks for elements of industrialism that impact on society and how they change family life. His theory, elaborated through the extensive study of a considerable number of societies including China, maintains that industrialisation implies a decline in the elderly's control over economic and political opportunities (1964: 105-6, 1963: 371):

> "Urban and industrial systems of agencies, facilities, procedures and organizations have undermined large corporate kin groupings since they now handle the problems that were solved within the kin network before industrialisation" (Goode, 1963: 368)

Young couples do not need to settle with the elderly anymore but can choose to live in their own independent household. The transition from the extended to the 'conjugal' family implies a decline in the traditional values linked to the role of the elderly and an emergence of strong 'conjugal ties', even though kin ties, devoid of function, may persist in a purely formal fashion (Goode, 1963).

Social researchers have challenged Goode's predictive statements, arguing that social relationships can be understood only within their specific historical context (Kabeer, 2002), since they represent unfolding and complex processes that cannot be divorced from the surrounding time and place.

4. Coping strategies

> "Three generations usually live under the same roof to pool resources and risks…the families themselves are getting smaller, especially in urban areas because of housing problems". (1996:7)

4.1 Fen er bu li

While the ideal of the multigenerational households still pursued in the countryside, in the city this preference cannot be assumed (Davis, 1991, Croll, 2000, Whyte, 2003). According to Davis, the choice to share accommodation is linked to the different conditions faced by individuals during their lifecycle, and to other external constraints (1991, Bian, Logan and Bian: 1998).

Multi-generational co-residence may not be a choice but a necessity due to housing shortage and costs. Under the employment-based welfare system, each *danwei* would allocate housing to its employees; during the socialist period, the shortage of housing held together 1/4 to 1/3 of stem families. The *dingti* system may have also played a role in keeping generations together (Whyte, 2003, Davis: 1993). Hence, urban parents never had to struggle to move in with their married children (Davis: 1993, Unger, 1993). According to a survey undertaken in 1985 Tianjin, 57% of interviewed parents and 63% of adult children did not want/plan to co-reside with the other generation (Unger, 1993: 39).

Whyte's surveys indicate a mildly increasing neo-local trend: in 1994 Baoding, 49% of the over 60 in Whyte's research sample were not co-residing with married children. The reasons for this arrangement were the need for more space, and proximity to job venues. Overall, decision not to co-reside had been mostly taken by parents or by parents and children jointly. The importance of parents' opinion may be linked to the fact that 87% of the elderly were living in premises allocated to or owned by them or their spouses, and hence did not have to depend on their children for accommodation (Whyte: 2003).

A more important finding of Whyte's study is that co-residence *does not* represent an essential pre-requisite for the maintenance of strong inter-generational ties, in both symbolic and functional terms. Whyte divided his respondents into three categories: children who co-resided with elderly parents, children who did not co-reside but had daily contact with their parents (likely to live nearby), and children who did not co-reside and nor had frequent contact with their parents. The last category emerged as less likely to offer support to elderly parents, due to physical distance.

The patrilocal tradition of co-residence was confirmed: in Baoding elderly parents were three times more likely to live with a married son than with a married daughter (2003). However, daughters seemed to be gradually integrated in intergenerational arrangements: all conditions being equal, daughters provided more assistance than sons, even though sometimes their contribution was under-reported by parents; such support was likely to remain unchanged after marriage (Whyte, 2003).

It seems legitimate to question the assumption that the decline of the multi-generational household should imply a weakening of children's support to ageing parents. Even when holding

separate residence, parents and married children do not live apart (*fen er bu li*). On the contrary, when living in proximity they maintain frequent mutual contact and support each other, building 'networked families' (*wangluo jiating*) (Bian, Logan and Bian, 1998, Whyte, 2003). Families change their living arrangements in order to cope with emerging problems, such as deteriorating health or widowhood (Davis, 1991, 1993, Ikels, 1993, Whyte 1997: 24).

4.2 Generation gap?

Social researchers have questioned the 'conservatism' of Chinese children by arguing that children may give the 'appropriate' response to sensitive questions on filial obligations. Since filial pity is regarded as the highest virtue and family harmony as an ultimate target, few people would jeopardize their reputation by openly admitting familiar contrasts (Davis, 1991). However, when asked their opinion about their children's behaviour, parents report high levels of satisfaction (about 90%), with 7% reporting that they receive even too much respect. This concern on maintaining a public image of family harmony clearly indicates that the values of 'familism' have not lost ground in Chinese society.

If in Chinese tradition "harmony in the family, or at least the appearance of harmony, was an indicator of how well family members conform to social ideas and served to enhance the relative standing of all its members", families in post-reform China are still keen to maintain such a reputation (Ikels 1990, 1993: 308) as a strategy to foster the wider circle of personal relations (*guanxi*). According to Croll, "since 1979 the importance of *guanxi* or networks of personal connections has spiralled to become essential, pervasive and even rampant in all aspects of social, political and economic life" (1997: 16); *guanxi* are, for example, the 'lifeblood' of employment dynamics and generally a preferential channel of social mobility (Bian, 972, Whyte, 1995). If "all China live in a web of social relations", then family relations represent the most secure and important one (Bian, 1994).

With the open door reform "families have entered a new relationship with the state" (Davis, 1993), that today encourages everybody to be competitive, to pursue economic prosperity and to consume anything from imported luxury goods to the products of Western cultural industries (Davis, 1993, Croll, 1997). Caldwell's theory maintains the 'westernisation' of values as one of the main factors that leads to a decline of inter-generational obligations. The increased commoditisation of society and the exposure to Western culture and individualistic values of both individuals and families are likely to affect the beliefs and perception of the younger generations, and may lead children to be less willing to comply with the expectations of their parents and pay their share in the intergenerational arrangement.

4.3 Commonality of interests

According to Chen, the existence of voluntary groups rests on the fact that the group represents a pool of resources or jointly produced goods that can satisfy the needs of the group members. If we consider the family as one such group, where children comply with family obligations by their own will, in order to keep members solidary the family has to become a place where members' material and emotional needs are satisfied. This implies in first place the devotion of parents to the welfare of the family, especially their children's. Their many years of dedication to their children's welfare aim at 'delivering a message' and are expected to instil in them strong feelings of obligation towards parents (Whyte, 2003).

Contrary to Goode's theory, parents still control resources badly needed by children, who continue to rely on the family both in early and adult age. Parents may secure their children's access to education and personal connections, two major assets for upward social mobility in

post-Mao China (Whyte, 1995, Cook, 2000). Besides, the most common kinds of assistance provided by parents to grown-up children include care for grandchildren, help with household chores, and provision of gifts in cash or kind (Whyte: 2003). 1980s ethnographies picture grown-up children as dependent on parents in terms of household chores and childcare, since young couples are generally employed full time and hardly have access to alternative childcare services (Unger, 1993, Davis, 1991). The benefits of co-residence for children may be as high as for parents, since 'the elderly, especially women, provide many services for the young and are generally viewed as earning their keep' (Ikels: 1993).

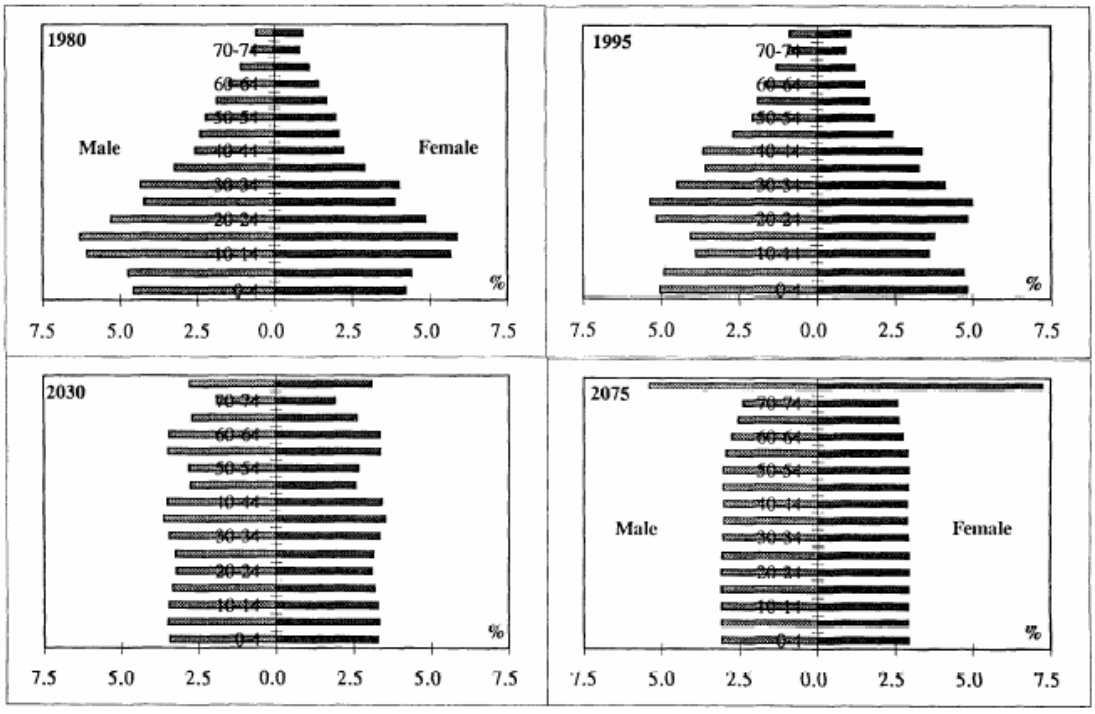
Family obligations are not fulfilled by the incidental assistance *per* se, but represent an enduring social process and are embodied and strengthened by the continued assistance that parents have given in the past. Parental investment in children is not provided out of some 'abstract' sense of duty nor even out of a purely emotional attachment: it is perceived as an inevitable part of the parental role and identity and as such it implies the expectation that 'good' children will provide continued assistance in the future. Extra efforts are made in order to maintain strong bonds and ensure that children will honour the open-ended obligations; by doing so, the younger generation may pay their share in the intergenerational contract and ultimately fulfill their role and identity as filial and deserving children (Davis, 1991, Whyte, 2003).

5. Can the family be a safety net?

5.1 The 4-2-1 Family

The care of a rapidly aging population is an unprecedented challenge for a society that has been marked for over 20 years by a strict policy birth control. The studies undertaken in the 1980s and by Whyte in the 1990s deal with families whose children were born before the strict enforcement of the one-child policy. During the second half of the twentieth century Chinese urban families underwent a shift in size and composition, shrinking significantly despite the serious housing shortage. While in 1947 the average household had 5.35 members, in 1982 it counted only 3.81 members, while according to Cook and White household size in the cities declined from 4.2 to 3.2 members between 1980 and 1996 (1998: 13).

China: Evolution of Age Structure



Source: McCarthy and Zheng, 1996

This shift is mainly due to the one-child policy, an impressive effort of the central government to interfere in the reproductive decisions of families by promoting a reproductive model that was in open contradiction with both Confucianism and Maoism. Since the end of 1970s, the policy was promoted by the Chinese leadership as an inevitable step to be taken in order to achieve the 'Four Modernisations', as well as a means to the advancement of women (Milwertz: 1997). As a result, urban Chinese families are entering into a 4-2-1 structure where the middle generation has to support four elderly and one child. Today's only-children are bound to face unprecedented pressure in the future: the over 60s are in fact expected to be 15.2% of the population by 2020, and to grow to 374 million, 24.3% of the population, at the peak of the ageing process (Cook and White, 1998: 14). In short, the ageing process poses similar challenges to both state and family provided social security.

5.2 Parenthood and the Gendered Division of Labour

Facing the impossibility of having a son, many urban families have to settle for an only daughter; this has recently led to an unprecedented inclusion of only daughters in the inter-generational contract. Some parents even report a preference for daughters, perceived as more attached especially to their mothers (*nuhai tiexin*); families are increasingly ready to invest in their daughters' education, as they would do for sons, and in general daughters are starting to share the expectations and entitlements traditionally attached to sons (Whyte, 1997: 30, Milwertz, 1997, Croll, 2000, Whyte, 2003). This preference can be interpreted as a "new expression of a tradition of securing care", where parents may feel that daughters, traditionally socialised as carers, may represent a more secure source of assistance than sons (1997: 147).

Parents are aware that children represent their most secure source of old-age security, especially with the new hardships that many urban families have had to face after the breaking of the 'iron rice bowl'. The resources still available to the elderly in the 1980s and 90s, such as income and housing, are today increasingly distributed according to the market; the lack of such entitlement may imply for many elderly parents a substantial erosion of their bargaining position within the

family. Hence, parents deliberately try to foster their child's sense of indebtedness by overtly speaking about children's life-long debt towards their parents (Milwertz, 1997, Croll, 2000).

Today's model of parenting is increasingly burdensome: even though urban couples have only one child, 'Today the energy and work that is required in order to raise a child is much more than in the past' (Milwertz, 1997). Childcare is largely considered to be women's duty. For men, the professional sphere is still considered to be the most important one, while they are expected to play only an auxiliary role within the household and in the education of children. In the official discourse, Maoist 'Iron Girls' are today replaced with 'softer' example of femininity, gentle home-makers who focus on their children while their husbands pursue professional careers (Croll, 1995, Milwertz, 1997, Roth, 1999).

Women's widespread involvement in paid employment, however, comes at odds with their role as depositary of household harmony. During the pre-reform era women were largely encouraged to enter paid employment, and safety nets were put in place in urban work units to protect women during pregnancy. As a result, in 1995 the participation of Chinese women in the labour force corresponded to 80.3%. However, in the near future urban Chinese women may have to cope with a disproportionate 'triple' burden (Whyte, 2003:189). This condition, together with the revival of the 'home-maker' model and the challenges posed to equal opportunities by the free labour market, is likely to represent a significant threat to women's economic independence (Howell, 2003).

6. In search for a model

"The Chile and Singapore systems are irrelevant. The Singapore system has a different background – they had no system before, so the government had no responsibilities to his citizens...But we have a forty year committment to our workers. As for Chile, their social and economic systems are different form ours. The burdern of SOEs is not so great there." (White and Goodman, 1998: 191)

6.1 Summing Up

During the reform, intergenerational obligations in urban China have changed in accordance with the broader context, interacting with political, economic and social transformations which are context-specific and whose complexity may be missed by universal theories of social change (Davis and Harrel, 1993, Whyte, 2003). According to Ikels, the care of the aged in China "is primarily a family responsibility, an unavoidable part of a contract between the generations". Research findings suggest that Confucian familism, held in check during the Maoist period, is re-emerging in the current age of market transitions (Davis and Harrel, 1993, Ikels, 1993).

Not only has this trend been formalized with the Marriage Law; with the 'Open Door' reform Confucianism has been re-habilitated by the CCP and even defined "a fine national tradition" by CCP Chairman Jiang Zemin (White and Goodman, 1998: 9). Following the attribution of the 'Dragons'' economic performance to a Confucian emphasis on harmony, obedience and discipline, the 'cultural specificity' of the 'Chinese family business firm' has ceased to be an obstacle to modernisation to become the lifeblood of a new kind of economic development. Greenhalgh (1994) and White and Goodman (1998) highlight how statements on the inherent 'goodness' of Chinese familism in relation to economic development retain strong political implications (Greenhalgh, 1994, White and Goodman, 1998, Whyte, 2003). The uncritical admiration that the 'East Asian welfare model' aroused in the West is challenged by White and Goodman on the basis that

> "The discourse on Confucian culture and economic development constitutes a form of orientalist economics that constructs Chinese culture

> as a set of 'Oriental' essences that exist in radical separation from and opposition to the West" (Greenhalgh, 1994: 747-8).

For Western economics, the risk is to fall into cultural essentialism while looking at socio-economic developments in East Asia; from the point of view of some Chinese policy makers, however, the 'Chinese' family-based approach to the provisioning of social security services may be the product of a 'unique' Chinese tradition "the centrepiece of which is invariably a looking back to Confucius". This trend cannot be easily dismissed since "a diffuse and living Confucianism" pervades with its precepts everyday social discourse and the very definition of person (*ren*) (Croll, 1997: 12-13). This acknowledgement allows us to understand the potential of the state's political discourse in the reconstruction of the "family as central economic, social and political institution in post-reform China" (Croll, 1991: 295), as well as in the re-making of family roles along the lines of age and gender.

Such a 'Confucianist' trend certainly comes at hand in a country where the social security system needs to provide for the fastest ageing population in the world, and therefore badly needs an increased role of families in the provision of care (Ikels, 1993, White and Goodman, 1998, Milwertz, 1997, Whyte, 2003). These expectations imply a concept of 'the family' as a 'black box', a household-based system where resources are invariably pooled and distributed according to each member's needs. Numerous scholars have questioned this model by describing household dynamics in terms of 'bargaining' and negotiation (Dwyer and Bruce, 1988, Kandiyoti, 1988).

In the case of China, the increased dependency of the elderly from their children may have the hardest consequences for those who cannot count upon high intra-family resource entitlement; and writes off categories such as the childless, especially childless widows (White and Goodman, 1998, Kabeer, 2002). The elderly's intra-family entitlements are in turn at risk due to the shift to a market regulated allocation of resources such as housing and jobs. An absolute reliance on family-provided care is likely to reinforce the unequal distribution of responsibilities within the family, putting at risk equal opportunities for women workers, and to reinforce inter-regional disparities and socio-economic inequalities, favouring the rich and educated over those who lack assets to invest in their children (Goode, 1963, Mahotra and Kabeer, 2002).

Access to care in China is still based on the privilege of few (White and Goodman, 1998, Croll, 1999, Duckett, 2004). According to Kabeer, "the family, however culturally vigorous, can no longer be self-sustaining" in the context of rapid socio-economic and demographic change such as the Chinese one. Social researchers can hardly anticipate how entire generations of only children will cope with the needs of a growing number of elderly people, in a context of declining state support and transition to a market economy. While the Chinese family has proved to be reliable in the provision of care, it needs to be combined with a comprehensive nation-wide welfare system. It is necessary to avoid a dichotomist perspective on 'state/family', 'formal/informal' provision of care, and "seek ways of combining the strength of different forms of social provisioning" (Mahotra and Kabeer, 2002: 27-28).

6.2 With a little help…

The attention recently given by the Chinese leadership and media to the reform of the social security system points at the scope of the problem and at the urgent need to tackle it. From the point of view of the Chinese leadership, the challenge is not only economic and social, but mostly a political one: after almost 30 years since the death of Mao, the political legitimacy of the government does not rest any more on socialist dogma, but on economic development (Croll, 1998, White and Goodman, 1998, Zhang, 2000). However, market transition has not only brought GDP growth and international recognition, but also growing inequalities and rapid social

differentiation, which in turn broke the links between the CCP and its original social base (Lewis and Xue, 2003).

Following the emergence of the theory of the "Three Represents" (*sange daibiao*) in 2000, social researchers and political commentators have highlighted that the categories of 'advanced productive forces', 'advanced culture' and the broad, undifferentiated 'people' fail to describe China's complex social and political landscape. It is not clear whether the need to address the "fundamental interests" of this third, category includes also those who are "still badly off". Research undertaken in 1999 in various cities and towns indicates that the second 'Represent' corresponded to just 18.3% of their sample; according to Sun Liping, a social scientist from Qinghua University, polarisation is going to become a solid reality for China, putting once more in question the validity of the 'Three Represents' and the legitimacy of the CCP (Solinger, 2003).

In his address to the 1998 ILO Annual Conference, the Vice Minister for Labour and Social Security Li Qiyan called for more technical cooperation and assistance "with a view to improve their [ILO Member States'] capacity of ratifying and implementing conventions" and "in accordance with the principles of mutual respect, seeking common ground while putting aside differences…and work for solutions on the basis of a broad consensus" (Li, 1998). This opens up a wide range of opportunities for the development of EU-China bilateral cooperation.

The myriad of local provisions and the prudent piloting of new systems in the richest provinces need to give way to a comprehensive and coherent restructuring of the social security system on a national scale. The 'European' model of social security may not be suited for the Chinese case, since the levels of contribution of EU employers and workers seem to be too high for China. Chinese policy makers may prefer an eclectic approach, building their own 'Chinese' model by combining different elements and adapting them to the Chinese context (White and Goodman, 1998).

Despite reassuring official messages about the reform's attention to 'fairness' (China Daily, 22 May 2003), the Chinese government will need to take initiatives to promote substantial redistribution of wealth across regions and social groups, such as the establishment a national pooling system. The World Bank has warned about the political challenges that this may imply, since some privileged groups will necessarily lose in the process. The Chinese leadership will need to undertake "a major public relations effort…to convince most groups that they will indeed be better off covered and should comply [with the requirements of the social security system]." (World Bank 1996)

If the family cannot be the only care provider, the Chinese leadership needs to fully exploit the potential represented by the persistence of the intergenerational contract. Family and community oriented labour policies need to be implemented in order to support the shrinking urban household in a creative and capillary way. Such policies should be designed in collaboration with the ACFTU and ACWF and promote the equal participation of men and women in the care of the elderly, sick and children. In addition, the elderly and disabled should not be seen as homogeneous categories of 'dependants', but should be supported in their efforts to be active as long as their health condition allows it; coordination between social policies and urbanisation projects should aim at keeping generations close in order to facilitate mutual support (Van Der Meulen-Rogers, 1999, Mahotra and Kabeer, 2002).

Conflict of interests among ministerial departments and agencies needs to be solved through a clear allocation of responsibilities. The unclear position of local authorities is a serious issue, especially in a context of spreading corruption and where such bodies face financial problems. Professionalism is needed in the agencies involved in the administration and delivery of social

security, both public and private ones. With reference to the latter, the development of a sound regulatory system is needed if they are to play a role in the reform of the social security system (White, 1996, White and Goodman, 1998).

Social consensus, representation and legitimacy will not be reached without engaging all social parties, including Trade Unions, ACWF, private sector employers as well as NGOs. Relations with such parties need to be expanded and improved through a more open dialogue. While civil society organisations may require concessions in terms of civil liberties, they are likely to be the most effective brokers for the new social security system. In an increasingly unstable and differentiated society, the Communist Party will need to engage in negotiation with different social groups, including not only the elites, but also those who so far have been the 'losers' of the market transition (White and Goodman, 1998, Solinger, 2003). What once was the privilege of few urban residents needs to become a tool for addressing the pressing issues of inequality that China is facing.

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The Long-Term Outlook for Economic Reform in China

Prof. Robert Ash

The Long-Term Outlook for Economic Reform in China: Resource Constraints, Inequalities and Sustainability

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1. Introduction

The erratic course of China's economic and social development before the late 1970s reflected Mao Zedong's unshakeable belief in the imperatives of class struggle and of making revolution. Deng Xiaoping's rejection of Mao's ideological orthodoxy and his explicit advocacy of economic construction as the core of China's policy agenda are at the heart of unparalleled growth that has taken place since the early 1980s. Deng's unqualified support for rapid growth was underlined by an intellectual flexibility that enabled him to proclaim "to get rich is glorious" and even to accept income inequalities as a temporary expedient until the benefits of growth trickled down to a wider constituency.

Such pragmatism, underlined by a willingness to experiment and innovate - even at the expense of violating previously hallowed ideological principles – has generally served China well. However, the inequalities generated by the reforms have turned out to be less than temporary. Indeed, during the last two decades they have widened sharply. As a result, the unequal regional and sectoral impact of development associated with the growth-maximisation strategy has given rise to increasingly severe social and economic tensions and contradictions. The threats to political stability posed by these developments remain, for the time being, potential more than real. But the damage which they have caused to the social, economic and environmental fabric of China is already evident. The profligate use of resources has generated serious shortages of water, arable and forested land, and has been accompanied by a severe deterioration in their quality. Imbalances in population growth have emerged, with high birth rates in rural,1 especially western, regions contrasting with an increasing recognition by urban couples of the advantages of one-child – even 'DINK' (double income, no kids) households.

The pace of China's economic growth has placed unsustainable pressure on basic natural and economic resources. The ethos of growth maximisation has been reflected in rapid industrial expansion. But it has also fostered a tendency towards excessively high rates of investment, which in turn has placed enormous strains on energy, raw materials and physical infrastructure. The lack of policy coherence and consistency inherent in a situation in which functions and responsibilities of the centre and 'locality' remain unclear has caused "blind' factory expansion, characterised by low-standard duplicate construction. The efficiency consequences of resource waste, stockpiling of excessive inventories and construction duplication are self-evident.

1 The impact of China's one child family policy is not in doubt, although it may have been exaggerated. In July 2004 a senior official of the National Population and Family Planning Commission revealed that China's birth rate was 18‰ – 45% higher than the official National Bureau of Statistics (NBS) figure and acknowledged that most families contained more than one child. The official said that single-child families were the norm in cities, but in rural areas families more often contained two children –in ethnic minority regions, three. Interestingly, he interpreted the difference between urban and rural child-bearing behaviour as a natural consequence of the "diversified mechanism" inherent in China's family planning policy since the early 1980s. It was even, he said, desirable, since strict implementation of the former 'one child' policy had threatened to increase rural families' hardship, given the lack of social insurance protection in the countryside.

Of greatest concern to Chinese policy-makers is the widespread social malaise - even social anomie - that has increasingly characterised urban and rural society in China. The immediate sources of dissatisfaction that is daily expressed by large numbers of Chinese citizens are readily identified. They lie in the rise in urban unemployment, both *de facto* and concealed, that has accompanied the halting restructuring programme among state-owned enterprises (SOEs); in the massive reservoir of underemployment that affects at least 130 million farmers;2 in the absence of even basic social security provision for the sick, the unemployed and the old; and in the highly differentiated access to education. In addition, the pervasiveness of corruption and its erosive and destructive impact on the normative framework that should regulate human economic and social relations have undermined the authority of the ruling party and government. All these factors threaten to break the social contract between state and individual in China.

One of the ironies of recent developments in China is that alongside massive poverty reduction and almost universal improvements in material consumption conferred by economic reform, there exists unprecedented social and economic dissatisfaction. The explanation has much to do with changing perceptions of economic status: from a preoccupation with absolute well-being to concerns about relative well-being. Concealed in this truism is the finding that the benefits of economic reform have accrued disproportionately to particular regions, sectors and social groups. There is, however, an important gloss of which we need to be reminded. It is, as post-Keynesian theories of consumption behaviour indicate, that an individual's perception of his/her consumption status is determined by subjective, but quite complex, accounting processes that have a time, as well as inter-personal dimension. The problem of poverty is at the heart of much of China's social malaise, especially in the agricultural sector. But problems associated with inequality relate to much more than just poverty.

Within the space constraints of this paper, what follows is necessarily quite narrow and selective. First, I examine a strategic initiative of the Chinese government that seeks to meet head-on the problem of *regional* inequality: namely, the 'Go West' strategy, designed to open up the impoverished, disadvantaged western regions of China. The second section briefly addresses the situation in the farm sector, with special reference to grain cultivation – still a key determinant of economic and social stability in the countryside. In the third section, I consider two factors impinging on inequalities between *sectors*: those of employment and migration. In the fourth I look briefly at some of the most serious resource constraints that have emerged in recent years. On the basis of the analysis of these three sections, in the conclusion I address the longer-term outlook for economic reform through the prism of the strategy of sustainability that has come to the forefront of China's social and economic development strategy during the last couple of years. To anticipate those remarks, I believe that the shift in policy formulation towards sustainability is an appropriate, indeed essential, response to some of the most profound problems that China faces today. Whether or not the new strategy will succeed is, however, much more difficult to predict. In this regard, China's past experience – and, in particular, the difficulties inherent in a system of government that has become increasingly fragmented and dislocative - cautions against exaggerated optimism. Too often in the past the impact of rational policies implemented in Beijing has been vitiated by mis-implementation or deliberate non-implementation at local government levels.

2. 'Opening up the West'

An important part of the reality of the last quarter of a century of China's economic experience is that western provinces have benefited far less from rapid national economic growth than have

2 Estimating the extent of surplus agricultural labour in China is notoriously difficult. The figure of 130m. is a minimum; the true figure is likely to be in excess of 150m.

other parts of the country. Since 1979 economic and social development in Western China3 has been slower and more halting than elsewhere, as a result of which it has lost much of the ground that it had previously gained vis-à-vis other regions. For those living there today, Horace Greeley's message to Americans in 1850 - "Go West, young man, and grow up with the country" - would have a decidedly hollow ring. For many millions of them, living precariously and in poverty, the more sensible option would surely be to "Go East" and join China's Oregon Trail in search of the El Dorado of the coastal regions.

The regional structure of the Chinese economy in 1949 was, for historical reasons, irrationally skewed towards the eastern seaboard. Although almost 70 percent of industrial projects under the First Five-Year Plan (1FYP, 1953-57) were sited inland, decisions on industrial location during the Mao Era were dictated by geo-strategic, not economic, factors. The most dramatic effect of military thinking on economic strategy happened between the mid-1960s and mid-1970s, when China sought to construct an inland 'Third Front': a self-sufficient, large-scale industrial-defence complex, deep in the western interior that would be safe from external attack from the US and/or the USSR. The scale of industrial and associated infrastructural undertakings was breathtaking, and Third Front activities accounted for half of China's total construction investment in 1966-70, and 41 percent during 1971-75.

Such gigantism was typical of the Maoist approach to development, as was the massive waste and inefficiency that followed in its wake. One result of the concentration on new, large-scale construction projects in the interior was that investment for upgrading and extending existing plants fell sharply. Non-productive spending – especially on education, public health and research – was also drastically reduced. Yet the looked-for economic transformation of the West to materialise, and no significant regional realignment of the economy took place. The cost of the adventure, in terms of economic growth foregone, was considerable.

The impact of Maoist development policies is captured in a few salient statistics. One is that the West's share in national GDP remained virtually unchanged throughout the Mao Era. Another is that although western provinces' share in capital construction investment rose from 15 to well over 23 percent (1953-78), their share in industrial GDP increased by less than three percentage points. Most telling of all is that alongside despite almost identical growth records, per capita consumption in Western China, expressed as a proportion of the national average, rose from 44 percent to 86 percent. Redistributive policies worked to the strong benefit of inhabitants of western regions. This is borne out in other welfare indicators, such as disproportionate improvements in access to health and education enjoyed by those living in western provinces.

The implementation of economic reform has had major implications for social and economic development in the West. In the 1980s, the growth maximisation strategy explicitly allowed regions with favourable conditions (in China's case, coastal provinces) to develop first, even at the expense of widening inter-regional differentials. Only when national living standards had reached a "moderate level of prosperity" [*xiaokang*] was the focus of development to turn to the West. The coastal bias of the early reforms was underlined in the introduction, during 1986-87, of the controversial 'coastal development strategy', which effectively sanctioned a further widening of inter-regional differentials. Although the 8FYP (1991-95) paid lip service to the need for a more rational distribution of resources (especially labour) between the eastern and western halves of the

3 12 provincial-level regions are embraced by the "open up the West" [xibu da kaifa] initiative: Tibet, Xinjiang, Ningxia, Inner Mongolia and Guangxi Zhuang Autonomous Regions; Chongqing; and Qinghai, Gansu, Shaanxi, Sichuan, Yunnan and Guizhou. Their massive physical scope underlines the variety of its natural and economic conditions. The identity of the region is best seen in terms of commonalities of economic backwardness and infrastructural weakness, and the concentration within it of China's minority nationalities.

country, not until mid-1999 did Jiang Zemin formally announce the large-scale development of the Chinese West as a strategic priority.

The outcome of the coastal bias is very apparent. Although nominal GDP growth in the West was only marginally slower than the national average, faster population growth caused the per capita GDP gap to widen sharply. Western regions were virtually unaffected by the open door policy: by 2000, the per capita value of trade had reached US$889 in Eastern China, compared with US$48 in the west. The corresponding figures for FDI were US$71 and a mere US$5. As for welfare indicators, it is noteworthy that in 2003, average per capita rural consumption in the 12 western provinces was almost 30 percent below the national average. Not only was this figure almost identical to that of 2000 (the year after the launch of *xibu da kaifa*) but it suggested a considerable widening of the gap since the end of the Mao Era. The share of household budgets allocated to food was well above the national average, while health and educational spending was much lower. Access to consumer goods showed a similar trend.4

Further, diversification of the rural and farm economies has progressed much more rapidly in eastern China than in the west. By 1995, rural industry already accounted for two-thirds of rural value-output in coastal areas, compared with one third in western China. Rural construction and service activities were similarly more advanced in the east. East-west differences have not only characterised the degree of rural diversification. Within agriculture 'proper' the contraction of crop cultivation in favour of fishing, husbandry, forestry and fruit farming has been less pronounced in many western regions. Such structural changes highlight two important findings: the first is that in the Chinese West, fewer rural workers are today engaged in industry and other high-return, non-farming jobs in the rural sector than in eastern China. The second is that among that larger share of the western workforce engaged in agriculture, more are dependent for a living on branches of farming that offer relatively low incomes.5

Western farmers have been subject to the exploitation that lies at the heart of the widespread discontent and 'rebelliousness' [zaofan xinli]6 that infect the countryside today. The source of their grievances are the taxes, fees, surcharges and levies – often illegal, arbitrary and wildly inflated – that have left many households destitute.7 This is the background against which protests and riots by farmers have become increasingly common and widespread. For many rural households in the region, survival in the face of lagging income growth, unsustainable exactions and even below-subsistence living conditions is only made possible by remittances from migrants. Such conditions are the source of a vicious circle of poverty, in which low farm incomes are reflected in low savings

4 In 2003, ownership of colour TV sets, washing machines, refrigerators, bicycles, motorcycles and land telephones per 100 rural households in western China was 56, 23, 7, 75, 21 and 28, compared with national averages of 68, 34, 16, 119, 32 and 49.

5 In the West over 55% of agricultural gross-value output derives from crop farming. This would be even higher, but for the disproportionate role of animal husbandry in Inner Mongolia, Qinghai and Tibet.

6 This emotive phrase has been openly used by senior Chinese government officials. The anxiety its use expresses is readily understandable. One of the historical parameters which frame Chinese attitudes towards agriculture is the recurrence of resistance and revolt by peasants who have been predominantly grain farmers. Another more recent shaping influence and an integral part of the same mind-set of is the catastrophic famine of the late 1950s and early 1960s. From these perspectives, the use of the phrase – and the continuing currency of a slogan coined in the early 1960s ("agriculture is the foundation of the economy") – seems to me to be a code, designed to convey the message that 'agriculture is the source of national catastrophe.' By the same token, that great lesson of Chinese history - "without farming, there is no stability; without grain, there is chaos" [wunong, bu wen; wuliang zeluan] - conveys a very specific moral: that it is through the activities of farmers (above all, grain farmers) crop that the most acute sources of economic and social dislocation are most likely to emerge.

7 The list of charges is bewildering: cash payments in lieu of labour corvée; fees for building permits, marriage registration, veterinary services; enforced contributions to funds for non-farm development and infrastructural construction, as well as to non-productive expenditure made by cadres; fines for violation of family planning regulations ….

that in turn give rise to low rates of investment. In this respect, it is telling that although western regions contain 38 percent of China's arable area, they account for under 30 percent of the total irrigated area, less than a quarter of all chemical fertiliser consumption, about one-fifth of total agricultural machine power, and barely 12 percent of total rural electricity consumption.

The strategy to 'Open up the West' was announced by Zhu Rongji at the NPC in March 2000. It focused on five key areas: infrastructural construction; human capital formation; environmental protection; improvements in regional investment conditions; and the development and restructuring of local industries (especially those reliant on natural resources). Noteworthy features of the campaign included a twin emphasis on large-scale construction projects and the designation of "fast-track belts" – that is, areas having superior economic conditions located along major transport routes.8

Improvements in physical infrastructure are at the heart of the 'Go West' strategy. These include the construction of eight highways, intended to better integrate the West into the national road network; the creation and extension of north-south and east-west railway systems; gas pipeline construction, which will facilitate the transmission of natural gas from Xinjiang to Shanghai and other coastal areas; and the creation of radial air networks, based on Xi'an, Urumqi and Chengdu. Environmental undertakings are also a major priority. The most important are reforestation efforts, designed to combat desertification in dry and arid regions (e.g., Inner Mongolia and Ningxia). The extension of forest cover is the central element in plans to improve the region's ecological balance, including a controversial proposal to return farmland to forest.

In the end, the success or failure of the 'Go West' strategy will depend on the ability to transform the investment environment of the region in order to attract domestic and overseas capital. The Chinese government has demonstrated its commitment through the allocation of large-scale investment funding. As of April 2003, more than 600 billion yuan (US$73 billion) had been invested in 36 key projects in the region, with a further 130 billion yuan promised in support of 14 new projects during the same year. Beijing has also put pressure on banks to extend credit to western ventures in, for example, Gansu, Qinghai and Ningxia. It is clear too that western regions stand to benefit from fiscal initiatives and bond issues, as well as from the receipt of more foreign government loans.9 A high level of international cooperation, both cross-border and with international agencies, will also be required if the strategy is to fulfil its goals.

The attractions of western China to foreign investors are plain enough: they lie in the region's enormous reserves of energy and mineral resources (hydropower, oil, natural gas, coal, potassium, phosphor, non-ferrous metals), as well as the existence of rich biological resources and great tourist potential. They also reflect the cheapness of labour in the Chinese West and the establishment of a significant high-tech capability (e.g., in Xi'an, Lanzhou, Chengdu and Chongqing), providing the basis for accelerated growth of research expertise. Of perennial interest remains the massive market potential of a region that contains almost 30 percent of China's total population.

I have shown elsewhere10 that after the early 1980s Chinese government policy initiatives facilitated a major expansion of cross-border trade by China's land-based border regions11 (most

8 Three such belts have been identified in the West: they embrace the Euro-Asia Railroad (the 'New Silk Road'), the upper reaches of the Yangzi River, and linkages between the principal urban centres of the southwest.

9 The World Bank and Asia Development Bank have both extended major loans in support of the 'Go West' strategy.

10 R. Ash, "China's regional economies and the Asian region: building interdependent linkages" in David Shambaugh (ed.), Power Shift: China and Asia's New Dynamics (forthcoming, University of California Press).

11 China's border regions embrace Liaoning, Jilin, Heilongjiang, Inner Mongolia, Gansu, Xinjiang, Tibet, Yunnan and Guangxi. Their immediate cross-border trading counterparts include North Korea, Russia, the Mongolian

notably, by 61 percent annually during 1988-92). Although such growth was interrupted by various economic factors,12 from the late 1990s recovery and renewed growth took place. In short, cross-border, trans-national trade has emerged as a significant force in China's external economic relations. The finding that the share of merchandise trade originating in, or destined for, countries and regions other than those constituting China's main trading partners13 was highest in the Northwest and Southwest highlights the growing importance of Russia, Central and South Asia as trading partners.14 It is, however, important to keep these findings in perspective. Such developments notwithstanding, China's Southwest and Northwest still account for less than 5 percent of the value of all Chinese exports, and under 3 percent of its imports. There is evidence too that the share of border trade in China's border regions' total exports and imports has been in decline in recent years.

Nevertheless, it seems likely that cross-border trade ties will continue to strengthen, especially as development accelerates in Russia, Central, South and Southeast Asia – a process to which the establishment of the Shanghai Cooperation Organisation (SCO) is likely to give further impetus. Chinese border regions in the North West will benefit from the Russia-China oil pipeline, as they will from the construction of China's first major land-based oil import route from Kazakhstan (the first phase of which, linking Atasu and Dashanzi (Xinjiang), got under way in 2004). Meanwhile, Tibet is already negotiating with Tajikistan for the supply of electricity. China has also committed itself to strengthen cooperation and promote regional development within the economic framework of the Greater Mekong Subregion.15

The achievements of China's 'Go West' strategy are not to be underestimated. Between 2000 and 2004, the GDP of West China rose by around 10 percent, and some 60 major transport, energy, hydraulic and ecological projects were launched. But from today's perspective, there is evidence too that the hoped-for returns from 'Going West' have not yet materialised. As a report published in April 2005 put it, development in western China continues to face "many difficulties, many problems and arduous tasks". 16 The litany of challenges which the report rehearsed highlights which faced.

Suggestions, made in some quarters in the first half of 2005, that the Chinese government had abandoned its 'Go West' strategy as a failure seem to be premature. But there remain formidable obstacles to the realisation of the West's potential. Natural, historical and institutional constraints – some of them the direct consequence of post-1978 reforms - have left western provinces lagging behind the levels of economic and social development attained elsewhere in China, especially along the eastern seaboard. Physical infrastructure – roads, telecommunications, power grids, water supplies – is inadequate. Widespread desertification and soil erosion underline the huge environmental challenge facing the region. The persistence of inefficient state-owned enterprises (about two-thirds of the region's industrial gross value-output comes from SOEs, compared with less than 40 percent nationally) underlines the structural problems faced by industry. The most extreme manifestations of rural poverty are also to be found in the West, especially – and significantly - among ethnic minority populations.

Republic, Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan, Pakistan, India, Nepal, Sikkim, Bhutan, Myanmar, Thailand and Vietnam.

12 See Ash (forthcoming), op.cit.

13 I.e., the USA, EU, Hong Kong, Japan, South Korea, Taiwan and ASEAN.

14 Interestingly too, an analysis of the composition of such trade reveals that the structure of Chinese cross-border exports has shifted markedly towards industrial manufactures.

15 In 1992 Cambodia, the Lao People's Democratic Republic, Myanmar, Thailand, Vietnam and Yunnan provinces formed the Greater Mekong Subregion (GMS) as a new growth area, based on enhanced regional economic integration.

16 See People's Daily (Renmin ribao) website, 18 Apr. 2005.

Such factors highlight the constraints that still face the West in its efforts to attract large-scale FDI, especially from major international players in the United States and Europe. The reality is that these regions are seriously disadvantaged in their attempt to attract private investment from domestic, as well as overseas sources. Even if plans for major improvements in education and vocational training in western provinces are successful, what is to prevent the beneficiaries from taking their skills to eastern China?17

China's development efforts since 1978 have been likened to the flight of an eagle propelled by just one of its wings. Even with the benefits of hindsight and catch-up, it is unlikely that China will match the speed with which the United States opened up its own western economy in the second half of the nineteenth century. It is a salutary reminder of the scale of the task that confronts it that the Chinese government has adopted such a conservative timetable in which to transform the economy of the West and raise the living standards of its residents to those currently enjoyed by in China's urban coastal economy. In the meantime – a "meantime" that may last several decades – the most intriguing aspect of the western development strategy may lie in the new opportunities it offers for new economic alignments and integration between the Chinese West and countries of Central, Southeast and South Asia.

3. The Agricultural Sector

In 2004, thanks to favourable climatic conditions and proactive policies towards the farm sector, four years of declining grain harvests were reversed and farmers enjoyed the biggest annual increase in income since 1997. However, this success reflected recovery, not net growth. It has not improved agriculture's weak foundation, nor prevented China from reverting to being a net grain importer. For the time being, agriculture remains a priority focus of government policy.

A cornerstone of this policy is the urgent need to improve economic and social conditions in the *grain* sector. To this end, major recent initiatives include efforts to improve land management, reduce agricultural taxes and extend direct subsidies to grain farmers. In 2004, such measures halted the downward spiral of grain output and incomes, although grain output was still 8 percent (43 million tons) below the 1998 peak, and per capita supplies were at about the level of 1989. The most important effect of rising grain production in 2004 was the income gain it brought to farmers. Average *rural* income rose by 12 percent to reach 2,936 *yuan*, with income from farming up by 13.3 percent to 1,746 *yuan*. Farm income from grain sales increased by over 60 billion *yuan*.

Grain demand has exceeded domestic output since the end of the 1990s, the 2004 partial recovery still left a shortfall of over 30 m. tons, or enough to meet the needs of 75 million people - and China remained a net grain exporter only by running down its reserves. But in 2004, cereal imports surged, and China's agricultural trade balance shifted from a surplus of US$2.5 billion (2003) to a deficit of US$5.5 billion. As grain prices stabilise, the fulfilment of the 2005 output target (480 million tons) will depend critically on the ability to maintain incentives for grain farmers. Even if this is achieved, the domestic shortfall is unlikely to be eliminated, and excess demand – probably around 14 million tons - will persist.

China's pursuit of grain self-sufficiency runs counter to economic logic, and moving from the current 95 percent self-sufficiency ratio to a 90 percent norm, or lower, would confer economic benefits and bring welfare gains to Chinese farmers. There are signs that the harsh economic and

17 Note too that recent months have seen considerable emphasis placed on the need to revitalise Northeast China (e.g., see RMRB website, 11 Apr. 2005).

social plight of many Chinese farmers may be pushing the government to revisit its self-sufficiency imperative.

4. Employment Issues and Migration

The importance which the Chinese government's attaches to employment maximisation reflects its new strategic emphasis on development sustainability. In Chinese parlance, 'sustainability' means more than the conservation and efficient use of natural and economic resources. It also embraces the need to generate a pattern of growth that can redress widening inter-regional and inter-sectoral economic and welfare gaps. A reduction in unemployment and underemployment, as well as the implementation of more effective social welfare support policies to accommodate those who still lack jobs, are both central to achieving sustainable development.

The reforms of the last twenty-five years have made China an increasingly urbanised society, and this process will accelerate in the coming years. But for the time being, China remains a predominantly *rural* society. Almost 760 million people, or 58 percent of the total population, are still officially registered as rural. Two-thirds of total employment takes place in the countryside, and agriculture alone still accounts for almost 45 percent of all jobs. These are formidable numbers. Any assessment of China's future economic and social development must take close account of the challenges posed by this 'rural bias', which has profound implications for the pursuit of full employment.18

China is still in a transitional phase of its development, and serious problems have yet to be overcome – not least, in the rural sector. In the 1980s, economic diversification in the countryside was so rapid that by 1990, the contribution of non-farming activities to rural value-output had already overtaken that of agriculture. Today, well over half of rural GDP comes from rural *industry* alone.

Employment trends mirror these changes. Between 1978 and 2002, TVEs generated almost 60 million jobs in industry, over 12 million in construction, and 37 million in services. The decline in the share of farm workers from 90 percent to 66 percent testifies to the remarkable diversification of rural employment that has occurred since 1978. But it is a salutary reminder of the employment challenge facing agriculture that although in decline since 1991, the number of workers still tied, however loosely, to farming 2003 was 42 million (15 percent) more than in 1978.

Indeed, the rural bias of Chinese society and the economy is still so pronounced that it is in the countryside that China faces the greatest employment challenge. The origins of this challenge lie in two structural features. First, reforms have transformed what before 1978 was large-scale concealed under-employment into a much more *visible* phenomenon. There are still at least 130-150 million surplus rural labourers – most of them, farmers. This suggests that about 47 percent of the entire agricultural labour force, or 31 percent of the rural labour force, are under-employed.

18 For reasons of space, this section does not address critical dimensions of China's employment problems. E.g., no consideration is given to the employment bias against women (the latest survey of women's social status indicates while women accounted for 38% of total employees, they constituted 56% of all laid-off and unemployed urban workers; about half of these claimed to have encountered gender discrimination in their efforts to seek new jobs). Nor do I address youth unemployment (the rate of unemployment among workers between 16 and 24 is more than twice as high as the national average, and almost one-third of all registered unemployed in cities are school leavers who have no previous work experience). Important questions of occupational safety and worker representation are also ignored.

The second structural feature is the occupational profile of farming. Chinese agriculture has traditionally been dominated by crop farming. Since 1978, rapid growth of animal husbandry and aquatic production has generated a much more diversified agricultural economy. But despite the contraction in the crop sector's share of agricultural gross value-output from 80 percent to 50 percent (1978-2003), in terms of employment crop farming has retained its dominance. Relevant data are hard to find, but an authoritative Chinese source indicates that well over 90 percent of the farm labour force remain tied – neither productively nor full-time – to crop cultivation. Since even today grain accounts for two-third of the total sown area, it is clear that farm under-employment is primarily reflected in the least rewarding of crop activities – viz., grain cultivation. To the extent that raising farm labour productivity depends on the provision of larger amounts of capital per agricultural labourer, the implications for labour productivity of such a high man-land ratio are profound. Higher labour productivity, if it can be achieved, promises to generate higher incomes, although for those – the great majority of farmers – still tied to crop farming, sustained income growth will demand not only a downsizing of the labour force, but also the diversification of farming in order to embrace processing activities. The development of agro-industry and agribusiness promises much in terms of poverty alleviation, and if agriculture's future economic trajectory cam embrace such structural traits, the potential for enhanced social stability in the countryside will be correspondingly strengthened.

The rural employment issue also has a geographical dimension, captured in the existence of a regional employment triptych, associated with the changing balance between rural farm and non-farm activities. The implications of this triptych can be summarized as follows. Since the mid-1980s, coastal regions have benefited from increases in rural income that have derived – increasingly so, as time series data would show – from higher-return, non-farming activities. At the same time, they have also benefited from rises in *agricultural* income that have relied on increasing pursuit of non crop-farming activities. By contrast, in interior regions incomes derive to a correspondingly greater extent from less remunerative farm activities. Self-evidently, such findings have important implications for employment policy in China.19

One final dimension of rural employment issues that must be addressed is that of migration. In the end, urban and rural employment issues in China are inseparable. It is no coincidence that alongside the persistence of a massive reservoir of surplus rural – above all, agricultural - labour, large-scale migration from the countryside into the cities has become a defining feature of recent changes in the disposition of labour supply. Such migration acts as a safety valve, which serves to alleviate widespread rural unrest. But it sometimes does so at the expense of generating new tensions in cities. Even if migrants do not directly compete with urban workers and take jobs that registered members of the urban labour force are not prepared to do, they place serious strains on urban infrastructure. If they fail to find employment, these strains can embrace the social dislocation occasioned by migrants' involvement in crime. Meanwhile, there is a good deal of evidence that migrants frequently have faced serious discrimination from both urban officials and residents. I return briefly to the question of migration below.

The recognition of widening differentials – inter and intra-regional, and inter and intra-sectoral – is central to any attempt to accommodate rural employment pressures. So is the recognition of the regional distribution of growth. Overall, post-1978 economic growth reflects an increasingly strong shift in the economic centre of gravity towards coastal provinces. This has worked to the detriment of employment opportunities in the interior, and especially in western China. From this

19 I have tried elsewhere to calculate regional labour surpluses. My calculations suggest that in 1996, 41% of all surplus labour in China was in western regions compared with only 27% in eastern coastal provinces. Inherent in this finding is the existence of a vicious circle facing western China. On the one hand, the burden it carries to find alternative employment for its surplus farm labour is significantly greater than in other parts of the country. On the other hand, the region's inherent poverty makes the fulfilment of this task more difficult than elsewhere.

perspective, it seems no coincidence that rates of rural trans-provincial migration are highest in central and western provinces. 'Opening up the West' is one strategic initiative that seeks to redress the balance (see above), but policies are also required that can offer shorter-term enhanced employment prospects. The provision of capital is crucial to this process. In 2003, ten eastern coastal provinces still absorbed 57 percent of total fixed investment, compared with 43 percent in the remaining 21 interior provinces.20 No less telling is the fact that in the same year, 84 percent of utilised foreign direct investment accrued to those same coastal provinces.

A necessary condition of maximising employment is the maintenance of buoyant growth, and it is therefore significant that official statistics show a declining trend in national GDP growth since the early 1990s. It is not a simple cause-and-effect relationship, but it is telling too that between 1980 and 1992 (the level of peak GDP growth since 1978), the rate of job creation increased annually by 3.8 percent p.a.; thereafter, until 2003, the corresponding figure was a mere 1.4 percent.

Aggregate GDP indicators offer only a proximate view of the relationship between economic growth and employment. The *structure* of economic growth is also critically important, since the employment response to output expansion depends on the values of employment elasticity associated with the relevant economic activities. In China, the average aggregate value of employment elasticity fell sharply between the 1980s, when it was 0.32, and the 1990s (0.11).21 Underlying this decline was, at least after 1984, low agricultural growth relative to that in both industry (manufacturing and construction) and services. The implications for employment of this structural shift deserve emphasis, for evidence suggests that between 1979 and 2000, sectoral average values of employment elasticity varied from 0.06 (primary sector) to 0.34 (secondary) to 0.57 (tertiary). The declining trend in China's aggregate employment elasticity highlights the increasing burden of growth that rests on an economy whose output structure has shifted from labour-intensive activities towards those that demand more capital, skill and knowledge, as well as one that has become more efficient.

Such observations are relevant to rural employment policies. They highlight the importance of maintaining the momentum of rural economic growth, but also underline the need for careful consideration of regional, as well as national employment elasticities, in order to maximise job opportunities through the implementation of an appropriate *structural* pattern of growth. Most obviously, they underline the importance of efforts to maximise employment within the rural sector, captured in the famous injunction to "leave the soil, but not the village; enter the factory, but not the city". The creation, since 1978, of more than 100 million jobs in TVEs is the most spectacular manifestation of the efficacy of rural industrialisation policies. But much of this effort has been concentrated in the eastern half of China. Where possible – and the challenge is huge - future rural industrialisation should focus more on regions where the rural, non-agricultural economy remains less developed (i.e., in central and western China). In addition, bearing in mind the employment elasticities cited earlier, they should not only embrace labour-intensive, rural industrial activities, but also extend to tertiary activities within the countryside. Extending rural industrialisation to areas where it remains under-developed also promises to achieve a better balance between demands for capital-deepening and capital-widening.

To what extent the widening geographical spread of rural enterprises can raise the rate of labour absorption is a critical policy issue. However, the simple policy recommendation that underdeveloped rural areas in China should follow is the pattern of enterprise expansion

20 The 12 western provinces accounted for only 19.5% of national fixed investment – and barely 17%, if Sichuan and Chongqing are excluded.

21 The underlying implication is that incremental job creation associated with a 1% increase in GDP growth fell by almost a third during this period. The estimates of employment elasticity cited here and below are from MOLSS.

experienced in more developed regions which is contingent on the existence of appropriate income levels, market conditions and labour supply conditions. None of these conditions is automatically guaranteed.

At the heart of China's rural problems is the issue of farmers' poverty. To look for solutions outside farming is a rational response to this problem. But employment creation possibilities *within* the farm sector should also be considered. In absolute and relative terms, farm employment will continue to contract in the coming years, but it will be many years before its share of total employment falls to the 10 percent that is thought desirable.22 Efforts are needed to encourage more productive and profitable agricultural employment – perhaps through greater intra-agricultural diversification, based on recognition that the prevailing imperative of maintaining a 95 percent degree of grain self-sufficiency is neither necessary nor desirable. Above all, much greater effort is needed to create a system of agriculture that embodies a higher degree of integration between farming, processing and other associated farm-related operations – in other words, the development of agro-industry and agribusiness.23

Meanwhile, government policies that treat migration in a creative, flexible and positive manner are crucial to accommodating rural employment pressures. Even allowing for the social and economic strains of large-scale movements of population, migration contains the potential to make a major contribution to rural economic development through skill enhancement, capital formation and employment promotion. The behaviour of rural migrants and Chinese attitudes to migration lend added significance to this contribution. Unlike their counterparts in some other Asian countries, migrants working in Chinese towns and cities remit significant funds to families left behind in the countryside. In recent years, the primary role of remittances has been consumption-orientated – that is, to lift living standards of many farm households to above-subsistence levels. But remittances also have the potential to facilitate agricultural investment. Given the high marginal propensity to save among migrants, many of whom aspire to return to the countryside, the role of *returnee* migrants is an important one. China's experience shows how the entrepreneurial and other skills they have acquired in an urban environment can enhance and transform backward rural economies to the benefit of economic development and community welfare.

It is beyond the scope of this paper to investigate in detail the scale of rural migration in China. Suffice it to say that even allowing for a significant margin of error, there is no doubt that the scale of rural out-migration has become huge. Sample survey data made available by the Ministry of Labour and Social Security in 2002 reveal, for example, that between 1997 and 2000 the rate of labour transfer to non-agricultural work rose from 18.1 percent (83.15 million) to 23.6 percent (113.4 million).24 A more recent report indicates that over 200 million people have shifted from farming to non-agricultural activities since 1978. Not all of these have been destined for urban destinations, let alone large cities. In 2001, slightly more than half of rural migrants moved outside their home township. Of these, slightly more than 20 percent remained in their home county; a further 30 percent moved beyond the confines of the home county, but stayed within the province; and almost half moved to another province. Over time, however, there has been a significant rise in the proportion of migrants seeking a new life beyond their home province.

Migration attracts those who are strong, innovative and relatively better-educated, and their return home promises to benefit both the rural economy and local community through the financial

22 According to official Chinese source, urbanisation proceeded at a rate of 2% p.a. in recent years.
23 For reasons of space, I have to ignore the likely impact of WTO membership on agricultural and rural employment. Suffice to say that this is an extremely important issue.
24 Two-thirds of labour transferees were male, and about the same proportion were 35 years of age or younger. Transferees also tended to be better educated than those who remained in their original jobs.

resources, skills and work experience that they bring back with them. Hence, the importance of the recent government initiative to provide and improve training in new skills and other techniques (managerial, organisational, etc.) in order to improve the quality of returnee migrants and maximise their modernising impact on local economies. It is unrealistic to suppose that returnee migrants will seek to use their resources – both financial capital and skills – in farming. More significant is their likely contribution towards the creation of small towns - a key focus of current rural policy - the modernisation and expansion of rural industry, and the development of rural tertiary activities. The wider horizon of returnees enables them to access resources, both within and outside the local community, that are unavailable to indigenous entrepreneurs. The fulfilment of these goals demands, however, the formulation and implementation of appropriate policies, such as temporary tax reduction and preferential access to resources (including credit, land, raw materials, water and electricity). Local governments should also provide practical help to facilitate reintegration of returnees into the local community, including the provision of schooling for their children. The scale of the challenge is not to be under-estimated. But the potential benefits to the rural economy of returnee migrants' financial and human capital are huge.

The Chinese government has affirmed the centrality of employment creation and improved working conditions in its pursuit of sustainable development. The simultaneous fulfilment of these economic and social goals presents a massive challenge. Employment maximisation makes heavy demands on both the rate, and structure, of GDP growth. The burden of creating a fair and decent working environment, without prejudice to any group on grounds of sex, age or background, is no less onerous. Meeting these objectives is a task for the long run, not the short term.

5. Resources: Land, Water and Energy

China's arable area contracted steadily since 1957, but the rate of decline has accelerated since 1978. Average per capita availability of farmland is now less than 40 percent of the world average and below the FAO's warning line (0.05 ha) The situation is especially severe in the fertile Lower Yangtze and the Pearl River Delta Regions, once major grain-surplus areas. In the countryside, the creation of new cities and towns has also resulted in reallocation of land from farming to non-farm uses (factory, house and road construction, even car ownership25). Shifts in land use from crop farming to animal husbandry, fisheries, fruit farming, etc. have taken a heavy toll, exacerbating arable land loss.

Transfer of farm land to non-agricultural use is supposedly governed by strict legislation. But overzealous industrialisation and urbanisation have led to widespread flouting of such laws (in some villages *half* of all farmland has been requisitioned), with dispossessed farmers receiving little or no financial compensation. In 2003, 160,000 cases of illegal and arbitrary land requisition were uncovered, and "blind" construction activities encroached on 35,000 km.^{2} – equivalent to Taiwan's entire surface area. Urbanisation causes 2-3 million farmers to lose their land each year, reducing their income by almost 50 percent. In autumn 2004, new legislation was enacted to prevent rent-seeking behaviour and offer proper compensation for officially requisitioned land.

An even more critical resource constraint is the shortage of water, which threatens to undermine the maintenance of China's growth momentum. Since the 1950s, the area of lakes has contracted

25 In his latest book, Lester Brown observes that a loss of 0.4 ha. of land is associated with the addition of every 20 cars to China's stock of cars. Thus, the 2 m. cars sold in 2003 implied the loss of over 40,000 ha., much of which was likely to be arable land (Outgrowing the Earth: The Food Security Challenge in an Age of Falling Water Tables and Rising Temperatures, 2005).

by 15 percent, while the wetland area has shrunk by just over a quarter. Gross water usage has, however, risen between four and five times (industry's share in total consumption rising from 2 percent to more than a quarter); per capita use has more than doubled. China ranks fifth in the world; but such is the pressure of population that on a per capita basis it ranks among the least well endowed on all countries (per capita availability is about 25 percent of the world average).

There is also a *qualitative* dimension to the problem. Well over half of major lakes are severely polluted, and only 38 percent of river water is drinkable; only 20 percent of the population has access to unpolluted drinking water, and almost a quarter regularly drink water that is heavily polluted. There is evidence that pollution is causing high rates of cancer along some rivers. In 2003, 68 billion tons of sewage - twice as much as in 1980 - were discharged into waterways. Industrial waste is the main source of polluted water in cities; agricultural pollution, caused by the leaching of fertiliser nitrates into groundwater supplies, is the major problem in the countryside.

Without major – and costly - improvements, existing water shortages will get much worse. Official sources indicate that national demand will exceed supply by almost 32 billion cubic metres by 2010, and by 50 billion cu. m. by 2030. Per capita water availability could fall to a mere 170 cu. m. by 2030 – a mere quarter of the current level.

China has accounted for a major share of the explosive rise in Asian demand for primary energy that has occurred in recent years. But there has been no matching increase in its energy production (especially of oil and gas). Despite high absolute levels of output and reserves, China is an energy-scarce economy, with per capita endowments that are far below the world average. Its unusually high dependence on coal will persist, as, for the time being, will related problems of transport, processing for industrial use and environmental impact. China has only succeeded in providing sufficient energy to drive growth through a rapid increase in net imports of crude oil – from 2 billion (1996) to 117 billion tons (2004). Its oil trade deficit (crude + refined) exceeded US$20 billion in 2003. A high degree of import reliance for oil will continue in the foreseeable future, and 50 percent import dependence by 2020 is entirely feasible.

China lies between the United States and Russia as the world's second-largest producer of greenhouse gases, accounting for about one-eighth of the global total. But in contrast to Russia, where emissions are falling, and the US, where they are rising very slowly, Chinese emissions are already increasing rapidly and will continue to do so in the foreseeable future. In particular, rapid economic growth, the continuing dependence on coal and the likely rapid rise in car use will probably more than double the current level of carbon dioxide emissions within less than 20 years. Given the Chinese government's view that the responsibility for rising greenhouse gas emissions rests mainly with developed countries, remedial policy measures that will significantly limit environmental damage from these sources-is unlikely to be forthcoming. In the meantime, emissions of other greenhouse gases will grow. The development of indigenous natural gas reserves will cause methane losses to increase, and as rice cultivation expands, methane emissions from paddies will also rise.

Overall, the situation is grim. Increasingly serious land and water shortages pose a potentially acute threat to China's future development. It is clear too that any exogenous shock that interrupted China's energy imports would take a heavy toll on its ability to sustain the momentum of recent growth. Doubtless, it is no coincidence that the Chinese government has recently embarked on a major initiative, intended to increase its strategic reserves of oil by a significant margin.

6. Conclusion: Sustainability – The Key to China's Long-Run Development

> "Sustainable development means promoting harmony between man and nature, achieving coordination between economic development and population, resources and environment, and persistently following the civilized development road of developed production, affluent living standards, and a benign ecology, to ensure sustained development down the generations" (Hu Jintao, 4 April 2004).
> "Much of China's GDP growth [has been] achieved by exploiting resources and interests that should have belonged to our children" (Niu Wenyuan, Chinese Academy of Sciences, 2004).
> "A gold or silver cup is not as good as the public praise of the common people" (XHNA, 22 March 2005)

Pressures on physical resources and on the environment are at the heart of many governments' preoccupation with and commitment to sustainability. In China's case, they are sufficiently serious on their own to justify the adoption by the central government of a more resource-friendly and environmentally-friendly policy thrust towards development than the 'growth at any cost' approach that has characterised China's development strategy under reform. But like so many notions, sustainability in the Chinese context has its own 'Chinese characteristics', reflected in the belief that future development must not only accommodate resource constraints and environmental pressures, but needs also to alleviate social tensions caused by widening inter/intra-regional and inter/intra-sectoral economic and welfare gaps generated by previous growth.

The urban-rural income gap – and, by implication, that between coast and interior - is now wider than it was at the end of the Mao period. Perceptions of declining relative economic status are at the heart of a social malaise that permeates cities and countryside throughout China. The unequal impact of reform-driven economic growth is reflected in feelings of envy and resentment among the increasing numbers of unemployed urban workers, underemployed crop farmers and other marginalised groups whose personal difficulties are reinforced by their lack of access to adequate social security provision. Such sentiments are reinforced by the vicarious experience of millions of rural migrants, as well as by the power of television (to which there is now universal access) to transmit pictures of coastal affluence to more deprived regions of the country. The rise of consumerism is another potent force. All these considerations help explain why some Chinese analysts have argued that economic, social and environmental imbalance could make development a zero-sum game.

In short, economic and social polarisation associated with China's growth-maximisation strategy has become the single most important domestic issue facing the Chinese government. Recent emphasis by senior officials on a new "people-centred" development strategy merely highlights the urgency of this problem. When added to the pressures of resource shortages and environmental degradation, the case in favour of shifting from growth-maximisation to sustainability appears to be unanswerable. These are the concerns that have prompted government leaders and officials to question China's existing development strategy and to formulate a "scientific" concept of sustainable development.

Perhaps the most authoritative explanation of the new strategy was articulated by Hu Jintao in a speech he made in May 2004. In it, Hu demanded a radical change in China's growth model from one characterised by "high input, high consumption, high pollution, and low efficiency" to a new

approach, based on "high science and technology contents, good economic benefit, low resource consumption, less environmental pollution, and full exploitation of human resource advantages." If this were to be achieved, "prominent contradictions" would have to be addressed, the single most serious of which was the excessive scale and speed of fixed-asset investment. The failure to address such problems would lead to the excessive expansion of credit, the worsening of existing resource shortages (e.g., of coal, electricity, oil, and transport), and an increase in inflationary pressure. In short,

> "we should both do a good job of protecting and exploiting enthusiasm of all sectors for accelerating development and guide such enthusiasm to deepening reforms, structural optimization, and efficiency improvement, so as to maintain steady, coordinated, and rather rapid economic development."

Hu insisted that intensification of reform was essential to the successful fulfillment of development sustainability. Future reforms were directed to realizing three main goals. The first was to enhance the diversified nature of the economy - "to improve the basic economic system based on the dominant position of public ownership and joint development of economies based on different ownership systems and to further work to create a new situation of joint development of economies based on different ownership systems". Secondly, in order to meet the requirements of a "fully-developed socialist market economic system" and to improve administrative efficiency, it was necessary to further reform the system of administrative management, including the transformation of government functions. The final goal was to accelerate the process of opening to the outside world.

Hu has been at pains to stress that sustainability means putting people's interests at the heart of China's development strategy.26 Hence, the priority emphasis on maximizing job opportunities, and putting in place effective social security provision system in order to provide universal access to the "five guarantees" (food, clothing, housing, medical care and burial expenses). Interestingly too, Hu's 2004 speech referred to the need for government at all levels to fulfil, in the broadest sense, its responsibilities in order to "overcome the phenomena of encroaching upon rights and interests of the masses of the people in real life".

Central to the new sustainability concept is a rejection not just of growth maximisation as an end in itself, but also of the notion – one that carries overtones of Soviet-style centralised planning - that the physical growth of GDP is the sole basis on which to assess the success of development strategy. Instead of "seeing only material and not people", the new concept proposes a "people-centred principle … that proceeds from the interests of the people and that brings benefit to the people". In short, it recognises that the ultimate, if not the sole purpose of growth is to meet people's material and 'spiritual' needs.27

The notion of sustainability also dictates a revision of China's GDP accounting system and a re-evaluation of official statistics relating to economic growth and changes in living standards. To this end, a 'green GDP' measure has apparently been introduced, in order to reflect the relationship between economic growth, welfare and environmental changes. By costing environmental damage and resource use, it seeks to give a new and more relevant meaning to the concept of efficiency, as well as to GDP growth. Even more interestingly, it promises also to offer a more

26 That is, "governing the country for the people, using power for the sake of the people, having sentiments tied to the people, and pursuing the interests of the people".

27 Such priorities were implicit in the economic goals laid down for 2004. One of the more interesting and novel of these was that future Treasury Bond issues should be used to promote rural development, social capital formation, environmental protection, ecological improvement, opening up the west and the rehabilitation of old industrial bases in northeastern China.

rational set of criteria – including the fulfilment of targets relating to education, medical care, recreation and environmental protection - on the basis of which to evaluate and promote local officials.28

The new approach has already been translated into policy. GDP growth targets for 2005 have been scaled down from 2004 in Guangdong (from 14.2 percent to 10 percent), Shenzhen (17.3 to 13 percent), Zhejiang, Shanghai (13.5 to 11 percent), Beijing (13.2 to 9 percent) and Tianjin (15.7 to 12 percent). Such adjustments are striking. They are not incompatible with the Chinese government's macro goal – reaffirmed by Hu Jintao in a speech to the 'Fortune Global Forum'29 in Beijing – of quadrupling China's 2000 GDP to reach US$4 trillion by 2020 and attaining a per capita income of $3,000. But the challenges posed by the issues raised in this paper are huge, not least against a background which offers plentiful evidence Beijing's ability to formulate rational policies, which local vested interests have prevented from subsequently being implemented.

Meeting the demands of 'sustainability with Chinese characteristics' requires nothing less than changing China's economic growth mode in order to maximise the benefits of industrialisation, urbanisation, greater market orientation and globalisation. Excessive resource consumption that has characterised past growth must give way to improved efficiency. Industrial rationalisation must seek to accommodate environmentally-friendly services and industries with a large high-tech content. Improvements in the pricing system will also be needed to improve resource allocation and eliminate waste. Accelerated urbanisation, more effective migration policies and the extension of social security provision are some of the key measures whereby the government will seek to mitigate social and economic polarisation. The formidable - and costly – nature of such priorities highlights the watershed at which China finds itself.

28 Shenzhen, Ningbo, Huzhou and Shaoxing have reported abolished "putting GDP in command" in judging the performance of their leading cadres. In other words, fulfilment of the GDP growth target will no longer be a major criterion by which they will judge the performance of their leading cadres.
29 17 May 2005.

The Return of the Dragon:
Scenarios of the International Impact from
China's Emergence as a Major Trading State

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The Return of the Dragon: Scenarios of the International Impact from China's Emergence as a Major Trading State

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1. China's Return to the Centre of the World Stage

Napoleon's parting shot comes true?
"Wake not the sleeping dragon because when it awakes, it will surely shake the world"
Quote on China attributed to Napoleon (probably, made before 1814)

A historical perspective on the passed two millenniums reveals the following:

- The distribution of economic power at the end of the first millennium was very different from that at the end of the second millennium. China and India were the richest economies in 1000, but had per capita incomes in 1998 that were below the average income of the world.

- See Table 1, where GDP is measured in 1990 international dollars.

- In the year1000, per capita GDP was $450 in China, $450 in India, $425 in Japan, $400 in Western Europe, $435 for the world. The respective figures in 1998 were $3,117 (China), $1,746 (India), $20,413 (Japan), $17,921 (Western Europe), and $5,709 (world). The US per capita income in 1998 was $27,331.

- China's share of world GDP was 22.7 percent in the year 1000, and 11.5 percent in 1998. The share of Western Europe-cum-USA went from 8.7 percent to 42.5 percent.

- China's share of world population was 22 percent in the year1000, and 21 percent in 1998. The share of Western Europe-cum-USA went from 10 percent to 11 percent.

The lagging performance of China since the year 1500, and the Rise of Japan since 1870 can be observed from the following, see tables 1 and 2:

- Compared to China's GDP per capita, Western Europe's went from 89 percent in 1000 to 129 percent in 1500, and then to 575 percent in 1998. In 1998, US GDP per capita was 877 percent that of China; and Japan's GDP per capita was 655 percent that of China.

- By 1500, China had practically isolated itself from international commerce. The isolation process had begun about 50 years before. The Ming Dynasty had sent large fleets of warships to as far as Kenya from the end of the 1300s to the first half of 1400s. The lead ship of the Chinese admiral, Zheng Ho, in 1411 was 400 foot long and 80 feet wide. Christopher Columbus's ship "Santa Maria" in 1492 was 150 feet long and 50 feet wide. China was technologically ahead of Europe in 1400; but might have even lost its technological edge by 1500.

- The income gap between China and Western Europe widened steadily from 1500 until 1973. The ratio of GDP per capita in Western Europe to GDP per capita in China widened from 149 percent in 1600 to 205 percent in 1820, 629 percent in 1913, and 1,375 percent in 1973.

- However, if compared to Japan's GDP per capita, Western Europe's went up from 94 percent in 1000 to 268 percent in 1870, and declined then to 88 percent in 1998.

- Japan had begun its catching-up process in 1868 with the termination of the Tokugawa Shogunate and the restoration of the Meiji Emperor. In 1868, Japan begun the convergence of its economic and education systems to those in the advanced western countries. The catching-up process was interrupted by World War 2. By 1973, Japan had definitely caught up with Western Europe – the respective GDP per capita were $11,439 and $11,534.

Counterfactual scenarios if GDP per capita in China (and possibly also in India) had caught up with Western Europe in 1998; and our prediction on China's steady-state share are shown in Table 3. Several key assumptions had to be made.

- Assumption I: China started the catching process at the same time as Japan, and achieved Western European GDP per capita in 1998, see Scenario I in Table 3. China's share of world GDP would have climbed to 43 percent (instead of the actual 11 percent); and the joint China-India share would be 46 percent (instead of 16 percent).

- We know that India had started deregulation reforms in 1991 after the sustained nature of China's high growth after 1978 had become obvious. Basically, if China had started Meiji-style reforms in 1868, a politically independent India was likely to have also done so within a decade.

- Assumption II: China and India started the catching process at same time as Japan, and achieved Western European GDP per capita in 1998, see Scenario II in Table 3. China's share of world GDP would have climbed to 33 percent; and the joint China-India share would be 59 percent.

- The joint China-India share of world population was 38 percent in 1998. If the other developing countries had also converged to Western European GDP per capita in 1998, the lower bound of the joint China-India share of world GDP would hence be about 38 percent, which is more than twice that of the actual share (16 percent).

Hence, the reasoned expectation is that the joint China-India share of world GDP in 2100 would be about 40 percent. The Memo Item in Table 3 points out that total world GDP:

- in 1998 was $33.9 trillion (in 1990 international $)
    - under Scenario I would be $52.4 trillion, i.e. one-and-half times larger than total output in 1998; and
    - under Scenario II would be $68.2 trillion, i.e. twice total output in 1998
- These large increases in global output under Scenario I and II reveals clearly an important implicit assumption behind Table 3: the assumption that the doubling of total global output would not bring the world economy beyond the ecological limits on production.

Recent developments and our growth forecasts are as follows:

- China has grown at an annual average of 9.5 percent during the 1978-2004 period. This high sustained growth is the result of, one, China allowing its economic institutions to converge to those of modern advanced capitalist economies, and, two, China opening itself steadily to free movement of goods and to free capital inflow.
- For the 2001-2025 period, the realistic range of growth forecast is given by:
  - our optimistic growth forecast of 9.8 percent
  - our highest probability growth forecast is an annual average of 8.6 percent
  - our pessimistic growth forecast is an annual average of 5.8.
- For the 2026-2050 period, the realistic range of growth forecast is given by:
  - our optimistic growth forecast of 8.0 percent
  - our highest probability growth forecast is an annual average of 6.5 percent
  - our pessimistic growth forecast is an annual average of 4.4 percent

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Scenarios behind these growth projections are taking into account the following perspectives on economic policy reforms:

- Privatisation and restructuring of SOEs:
  - *optimistic: mostly completed by 2010*
  - *highest probability: mostly completed by 2017*
  - *pessimistic: job half done by 2025*

- Private sector development
  - *optimistic: almost all official discrimination ended by 2010*
  - *highest probability: mostly completed by 2017*
  - *pessimistic: 2025 legal treatment of private sector is same as in 2005*

- Banking sector reform
  - *optimistic: a thriving financial system in 2010 that is characterized by equal treatment of state and domestic private banks, and by an effective prudential supervisory board. Private banks hold 35 percent of bank deposits.*
  - *highest probability: Private banks hold 20 percent of bank deposits in 2012, and prudential supervisory board is reasonably competent*
  - *pessimistic: Private banks hold 20 percent of bank deposits in 2025, and regulation is overly stringent.*

- FDI trends
  - *optimistic: 10 percent of total investment in 2025 is from FDI*
  - *highest probability: 7 percent of total investment in 2025 is from FDI*
  - *pessimistic: 2 percent of total investment in 2025 is from FDI*

- R&D capacity
  - *optimistic: significant collaboration in R&D research between universities and domestic private sector in 2015 <u>plus</u> existence of a dynamic domestic venture capital industry*
  - *highest probability: significant collaboration in R&D research between universities and domestic private sector in 2025 <u>plus</u> presence of some domestic venture capitalists*
  - *pessimistic: little change from present R&D activities and R&D financing*

2. The Global Economic Impact of China's Return

The key to understanding the international impact of China's emergence as a major economic power, as marked by its accession to the World Trade Organization (WTO), is that the global division of labor at the end of the last millennium was a highly unnatural one. It was unnatural because the self-imposed isolation of China in the 1949-1979 period and its slow integration into the international economy in the 1980-1991 period kept over one fifth of the human race from meaningful participation in the world trade and investment systems. This is why China's accelerated integration into the world economy beginning in the mid-1990s has led to significant relocation of labor-intensive industries to China. In mid-2003, the electronic and electrical firms in Penang, Malaysia, employed 17 percent fewer workers than in 2000. On the other side of the Pacific, 500 of Mexico's 3,700 *maquiladoras* (foreign owned export-oriented firms) have closed since 2001, and the surviving *maquiladoras* have reduced their employment by almost a third.

Foreign direct investment (FDI) into China increased from US$44.2 billion in 1997 to US$52.7 billion in 2002. This caused China's share of total FDI into the developing world during this period to rise from 22.9 percent to 32.5 percent, and its share of total FDI into Asia to soar from 40.6 percent to 55.5 percent.

Developments like the above are the reason why the then Prime Minister of Singapore, Mr. Goh Chok Tong, informed his fellow citizens during his National Day address in 2001 that:

> "... China poses a big economic challenge. Some economists describe China as an *800-pound trading gorilla.* A Hong Kong newspaper added that this gorilla was *very hungry* ...
>
> "Even India is being flooded with cheap but good quality Chinese goods. Some Indian manufacturers are finding it hard to compete. So they have done the next best thing. They stick 'Made in China' labels on their products to boost sales...
>
> "Our biggest challenge is therefore to secure a niche for ourselves as China swamps the world with her high quality but cheaper products. China's economy is potentially ten times the size of Japan's. Just ask yourself: how does Singapore compete against ten post-war Japans, all industrializing and exporting to the world at the same time?
>
> "I do not mean that China will overpower every other economy, and grow at the expense of everybody else. As China develops and exports more, its imports will grow too. There will be many opportunities to invest in China. We must grasp those opportunities."

Mr. Goh is certainly correct in pointing out that China cannot just be an exporter without also being an importer too. But the crucial issue is whether the composition of goods that China would import would require a complete overhaul of the production structures of East and Southeast Asia. Would China's emergence as a major exporter cause Indonesia, Malaysia, Philippines and Thailand (the ASEAN-4) to de-industrialize and return to their roles in the 1950s and 1960s as primary commodity exporters? Or would there be sufficient lucrative niches within the manufacturing production chains that the ASEAN-4 could specialize in?

Boom or doom? And for whom? In order to answer the above two questions about the international impact of China's rise as a major economic power, we have to first understand why China has been so arduous in its pursuit of WTO membership. Since WTO membership for China mainly requires it to implement drastic reductions in its trade barriers across-the-board in a relatively short period of time, it can therefore appear puzzling why WTO membership is necessary when China can achieve the same results by undertaking unilateral cuts in effective tariff rates by the amount that it chooses and within a time period that it determines. Why did China pursue protracted negotiations to get an arrangement where the lowering of trade barriers is

externally supervised, and leaves China open to international sanctions if the trade liberalisation does not meet the externally imposed criteria, when unilateral trade deregulation is an option?
The answer to this riddle is that the fundamental reason for China's enthusiasm for WTO membership is that WTO membership will greatly enhance China's economic security. The United States had enacted the Permanent Normal Trade Relations (PNTR) Act on 10 October 2000, and the PNTR ended the annual approval from the U.S. Congress for most-favored-nation (MFN) status in order for its exports to compete in the U.S. markets on equal terms against the exports from WTO countries. However, the important point to note is not the passage of PNTR, but the realistic situation that whatever laws passed by Congress, can also be repealed by Congress later without violating any international law. So, until China had become a WTO member, which gave China unconditional, ***permanent***, multilateral rights to trade with other WTO members, the threat of PNTR being repealed, rendered China's exports vulnerable to passing passions in the U.S. political arena. Examples of recent passing passions would include accidents like military airplane collisions in the South China Sea, and the Chinese burning of the US consulate in Chengdu following the unintended US bombing of the Chinese embassy in Belgrade. The importance to China of maintaining high export growth and of maintaining the competitiveness of its exports to the U.S. market is hard to overstate.

The United States is China's biggest export market. The United States, until the recent restrictions on steel imports, had been perceived as ideologically committed to free trade and consequently less prone to protectionism than Europe and Japan. Clearly, in order for exports to be a sustainable growth engine, China must secure assured access to its biggest market. It was, only WTO membership that could prevent the United States from the impulsive unilateral action of switching off one of China's most important growth engines by simply suspending the PNTR Act, and raising tariffs on China's exports.

2.1 China's Economic Linkages to the World

China's enhanced economy security has important implications for its neighbors because the international movement of goods is only one of China's two economic links to the world. The international movement of capital is the other. The important but often neglected point in analysing China's WTO membership is that the removal of the uncertainty about China's market access to the U.S. market increases China's reliability as a supplier. This means that producers of labor-intensive goods destined for sale in the high-income economies can now reduce management cost by reducing the geographical diversification of its production facilities. More of the production can now be carried out in China because its labor costs are lower than in the ASEAN-4.

Analytically, the removal of the MFN threat when China officially became a WTO member at the end of 2001 is equivalent to a reduction in the risk premium demanded by investors in China's export-oriented industries. The complete picture of China's WTO membership is more than a reduction in China's effective tariffs; it also includes a reduction in the risk premium for investment in export-oriented production inside China. The effect of the tariff reduction is to reallocate the composition of China's output from importables to exportables and non-tradeables; and the effect of the risk premium is to reconfigure the global distribution of FDI in China's favor.

There is indeed evidence of the FDI diversion effect created by China's WTO membership. The Japan Bank for International Cooperation (JBIC) conducts an annual survey of Japanese trans-national corporations (TNCs) to find out which are the top 10 locations for manufacturing FDI over the next three years. Table 4 contains the results from the surveys undertaken in 1996, 2000 and 2001. 68 percent of Japanese TNCs listed China as one of the top 10 locations in 1996, and

65 percent did so in 2000. These responses made China the most frequently identified promising location for FDI in both years, i.e. China was ranked first in the list of 10 locations.
The evidence in favor of our FDI diversion hypothesis is captured in the 2001 survey. It became clear to the international community at the end of 2000 that China's accession to WTO was imminent. The upshot was that the proportion of Japanese TNCs in 2001 that identified China as one of the 10 most promising locations for manufacturing FDI jumped to 82 percent from 65 percent in 2000. Most telling of all, the "identification gap" between China and the United States, which were ranked first and second respectively in 2000 and 2001, widened from 24 percentage points in 2000 to 50 percentage points in 2001.

The frequency that the ASEAN-4 economies were identified as top 10 locations for FDI dropped between 1996 and 2000, and the most important reason for this change in TNC's perception could be the Asian financial crisis. The frequency that Thailand was identified fell from 36 percent to 24 percent, Indonesia from 34 percent to 15 percent, Malaysia from 20 percent to 12 percent, and Philippines from 13 percent to 8 percent. In terms of ranking within the 10 most cited locations, Thailand slipped from 2 to 3, Indonesia from 3 to 4 and Philippines from 8 to 10, while Malaysia improved from 6 to 5.

As the Asian financial crisis was over by early 2000, the changes in the frequency of identification and ranking of the ASEAN-4 economies on the list of profitable FDI locations between 2000 and 2001 could therefore justifiably be attributed to the WTO-created improvement in China' reliability as an international supplier. The frequencies that Thailand and Indonesia were identified as desirable FDI locations are practically identical in 2000 and 2001, but the identification gaps between them and China increased significantly. The China-Thailand gap went up from 41 percentage points to 57 percentage points, and the China-Indonesia gap from 50 percentage points to 68 percentage points. The frequency that Malaysia was cited declined from 12 percent to 8 percent, and the Philippines dropped out of the top 10 list. Malaysia's rank moved from 5 to 9, and the China-Malaysian identification gap soared from 53 percentage points to 74 percentage points. These differences in the survey results of 2000 and 2001 are certainly consistent with our hypothesis of WTO-induced diversion of FDI to China.

The drop in inward FDI in Malaysia has been substantial in 2002, and that the Malaysia government has no doubt that much of the drop is due to FDI diversion to China:

> "Malaysia attracted approved manufacturing FDI of only RM 2.16 billion ... for the first six months of this year [2002]. This is a sharp drop from the RM 18.82 billion it pulled in for the whole of last year.
>
> ... 'Everybody is feeling the pinch because the amount of FDIs has shrunk and then, a lot of that is going to China,' Dr. Mahatir [Prime Minister Malaysia] told a news conference later." ("Malaysia turns inward for growth," The Straits Times, 21 September, 2002)

To fully appreciate the importance of this diversion of FDI, we should be cognizant of the possibility that FDI diversion could be more than just a simple relocation of the capital stock. FDI might also generate positive externalities. The East Asian experience suggests that FDI could facilitate technological transfers (i.e. generate technological spillovers) not only to domestic firms in the same industry but also to domestic firms in other industries. Furthermore, FDI could also help solve the difficulties of access to the international markets in these goods. In short, a country gaining FDI could experience not only a bigger capital stock but also possibly an (maybe temporary) increase in its total factor productivity (TFP) growth rate; while a country losing FDI could experience a (maybe temporary) slowdown in TFP growth as well as a (maybe temporary) lower capital stock.

Table 5 presents the evidence in support of the link between FDI and technological diffusion by presenting the index values of the Overall Technological Capacity, column (3), for a number of the 59 countries ranked in the World Competitiveness Report issued by the World Economic Forum (2000). Also shown in Table 5 are the two determinants of the Overall Technological Capacity: the Indigenous Ability to Innovate, column (1), and the Ability to Obtain Technology Transfer from Abroad, column (2). The overall technological capacity index is determined by averaging the other two indices, the "indigenous innovation index" and the "technology transfer index."

The rankings of the Overall Technology Index for Malaysia (18), Philippines (32), and Thailand (43) are above China (48), and Indonesia (50) is only slightly below China in ranking. However, it is important to realize that the higher average rank of the ASEAN-4 in overall technology (36) comes from the higher technology transfer from abroad – the rank of Malaysia is 7, Philippines is 19, Thailand is 36, China is 43, and Indonesia is 45. China's indigenous ability to innovate is ranked 34 which is substantially above the rank of the ASEAN-4 to innovate indigenously (46). The point is that the average ASEAN-4 economy depends critically on technological diffusion through FDI to raise its overall technological level to be above that of China. FDI diversion from China's WTO membership is therefore likely to cause the future rank of Indonesia, Malaysia, Philippines, and Thailand in the Overall Technology Index to fall, and of China to rise.

Since Hong Kong, Japan, Singapore, South Korea, and Taiwan rank above China in both the ability to innovate indigenously and to obtain foreign technology, the diversion of FDI into China is unlikely to affect their levels of technological capacity. The fact is that these five East Asian economies are some of the sources of FDI into China and into the ASEAN-4 means that they are amongst the sources of the technological diffusion that is being discussed.

In summary, there are three levels of answers in thinking about the consequences of China's WTO membership on the ASEAN-4. The first level is the standard analysis of a unilateral cut in China's effective tariff rates. The result is a redirection of labor and capital away from China's importable goods sector toward its exportable goods sector, causing China to import and export more. A more detailed examination might reveal that the additional Chinese imports will be capital-intensive goods from the developed economies, and the additional Chinese exports will be labor-intensive goods to developed and developing countries. We call the first level answer the '*naive analysis'*.

The second level answer recognizes that not only would there be tariff cuts as required by WTO membership but also that the removal of the market access threat to China would likely lower the risk premium required for investing in China. The expectation generated by the latter development is that there would be diversion of FDI to China, especially from its East and Southeast Asian neighbors. We call this second level answer the '*FDI Diversion analysis'*.

The third level answer enriches the second level answer by pointing out that FDI would not only increase the domestic capital stock, but some argue that it could also increase technological transfers to the whole economy and improve the access of more Chinese goods to foreign markets. We call this the *analysis of the diversion of FDI with technological spillovers*.

2.2 Quantifying the Impact – the G-Cubed (Asia-Pacific) Model

The G-Cubed Asia Pacific (AP-GCUBED) model is ideal for such analysis having both adetailed country coverage of the region and rich links between countries through goods and asset markets. The AP-GCUBED model encompasses the United States, Japan, Australia, New Zealand, South Korea, the Rest of OECD (ROECD), China, Indonesia, Malaysia, Philippines, Taiwan, Thailand,

Hong Kong, Singapore, India, OPEC, EEFSU (Eastern Europe and the former Soviet Union), and the Rest of the World (ROW). Each of the 18 countries in the AP-GCUBED model has 6 sectors: energy, mining, agriculture, durable manufacturing, non-durable manufacturing, and services.
Each core economy or region in the model consists of several economic agents: households, the government, the financial sector and the 6 production sectors. Intertemporal budget constraints on households, governments and nations (the latter through accumulations of foreign debt) are imposed. To accommodate these constraints, forward looking behavior is incorporated in consumption and investment decisions. The investment process is assumed to be subject to rising marginal costs of installation. Aggregate consumption is chosen to maximize an intertemporal utility function subject to the constraint that the present value of consumption be equal to human wealth plus initial financial assets. International trade imbalances are financed by flows of financial assets between countries (except where capital controls are in place).

As a result of this structure, the AP-GCUBED model contains rich dynamic behavior, driven on the one hand by asset accumulation and, on the other by wage adjustment to a neoclassical steady state. It embodies a wide range of assumptions about individual behavior and empirical regularities in a dynamic general equilibrium framework. The interdependencies are solved out using a computer algorithm that solves for the rational expectations equilibrium of the global economy. It is important to stress that the term 'general equilibrium' is used to signify that as many interactions as possible are captured, not that all economies are in a full market clearing equilibrium at each point in time. Although it is assumed that market forces eventually drive the world economy to a neoclassical steady state growth equilibrium, unemployment does emerge for long periods due to wage stickiness, to an extent that differs between countries due to differences in labor market institutions. The model has approximately 7,400 equations in its current form with 140 jumping or forward looking variables, and 263 state variables. More technical details of the model are given in Appendix 1 of this statement.

We will undertake four sets of simulations:

1. Baseline simulation;
2. Naïve simulation;
3. Reduction in risk premium simulation; and
4. Diversion of FDI with technological spillovers simulations.

The Baseline Simulation: This simulation generates the future values of all the endogenous variables based on the assumption that the existing policy regimes in the world will persist indefinitely into the future. The tariff rates we use are based on the GTAP 4 database which contains estimates of the levels of tariff and non-tariff barriers. The baseline simulation, in short, assumes that the trade regimes in 2000 are continued forever (which includes China's exclusion from WTO).

Counterfactual Simulation No. 1 -- The Naive Simulation: The only changes are the reduction in China's trade barriers (both tariff and non-tariff barriers). We assume that trade barriers are reduced gradually over time by an equal amount (measured in percentage points) over the ten-year period of 2003 to 2012.

Counterfactual Simulation No. 2 -- A Reduction in the Risk Premium Demanded by FDI -- TheFDI Diversion Simulation: This simulation supplements the naive simulation with a 1 percentage point reduction in the risk premium demanded by foreign investors in China.

Counterfactual Simulation No. 3 -- FDI creates technological spillovers in the host economy -- The FDI with Technological Spillovers Simulation: We supplement the simulation of the FDI diversion case with the 5 conditions of:

1. a temporary decrease in the total factor productivity (TFP) growth rate of the manufactured durable goods industries located in Indonesia, Malaysia, Philippines, and

Thailand. We assume an annual decline of 1 percentage point beginning in 2003 until TFP level is 10 percentage points below baseline TFP level in 2012;

2. a temporary decrease in the TFP growth rate of the manufactured nondurable goods industries located in Indonesia, Malaysia, Philippines, and Thailand. We assume an annual decline of 1 percentage point beginning in 2003 until TFP level is 10 percentage points below baseline TFP level in 2012;
3. a temporary increase in the TFP growth rate of the manufactured durable goods industries in China. We assume an annual increase of 1 percentage point beginning in 2003 until TFP level is 10 percentage points above baseline TFP level in 2012;
4. a temporary increase in the TFP growth rate of the manufactured nondurable goods industries in China. We assume an annual increase of 1 percentage point beginning in 2003 until TFP level is 10 percentage points above baseline TFP level in 2012; and
5. a temporary increase in the TFP growth rate of the service industries in China. We assume an annual increase of 1 percentage point beginning in 2003 until TFP level is 10 percentage points above baseline TFP level in 2012.

The above 5 conditions are assumptions about the stances of public policy and the steepness of the learning curves in the ASEAN-4 and China. We assume that it will take a decade for the ASEAN-4 to improve their scientific bases sufficiently to offset the slowdown in technological diffusion due to the lower FDI inflows. We also assume that it will also take a decade for the Chinese sectors to fully master the new technology contained in the diverted FDI. Again these are assumptions rather than predictions, but they give indicative estimates of the impacts of a range of plausible assumptions.

2.3 The Results of the Simulations

Naive Simulation: Figure 1 reports the deviations from baseline GDP of 11 economies: United States, Europe, Australia, New Zealand, Japan, South Korea, Taiwan, Indonesia, Malaysia, Philippines, and Thailand. None of their GDP deviations are more than two-tenths of one percent from the baseline, which are indistinguishable from measurement errors. Figure 2 shows the deviations of exports of 10 out of the 11 economies from the baseline to be less than three-tenths of one percent. The largest export deviation is that of the United States which is 0.8 percent above the baseline in 2020 -- possibly, the reduction in Chinese protection of its import-competing industries led China to import more capital goods from the United States. In practical terms, however, China's WTO membership has no impact on these 11 economies.

Simulation of the FDI Diversion Case: Figure 3 reveals that while the deviations in GDP are negative for these 11 economies, their magnitudes are trivial. In 2020, the deviations of 10 economies are below three-tenths of one percent, and Korea's deviation is almost half of one percent. The export deviations exhibited in Figure 4 are almost the same as in Figure 2 -- U.S. exports in 2002 is now 0.9 percent above the baseline. On the whole, it is hard to say that any of the eleven economies are hurt in a non-trivial way.

Simulation of the Case of FDI with Technological Spillovers: We consider this simulation to be the most realistic one. Figure 5 shows substantial long-run GDP losses by four Southeast Asian economies: 7 percent for Thailand, 5 percent for Malaysia and Philippines, and 3 percent for Indonesia. The GDP of the other seven countries show minor long-run deviations from the baseline. Figure 6 reports that only the ASEAN-4 face significant export displacements. The United States, being primarily an exporter of capital goods and high value added services, has the biggest positive deviation, which is about 0.9 percent in 2020.

The interested reader can find more details of the above simulations in McKibbin and Woo (2003a), and full details in McKibbin and Woo (2003b).

2.4 Economic Impact on the ASEAN-4

Table 6 examines the export composition for the *FDI diversion scenario* and the *Diversion of FDI with Technological Spillovers scenario* for China and the ASEAN-4. There are no substantial changes from the baseline for any ASEAN-4 country under FDI Diversion. In the export compositions from the Technological Spillover simulation, we observe significant deviations from baseline in the ASEAN-4 countries. Table 6 reports that:

1. China's manufactured exports accounted for 27 percentage points of the 33 percent increase in total exports above the baseline;
2. the manufacturing sectors in the ASEAN-4 show substantial long-run declines vis-a-vis their baselines. In Indonesia and Phillipines, the drop in manufactured exports exceed the drop in total exports; and in Malaysia and Thailand the decline in manufactured exports accounted for, respectively, 97 percent and 91 percent of the fall in total exports.

This transfer of manufacturing jobs to China will not stop in the medium-run because a vast amount of surplus agricultural labor remains to be tapped. Rightly, ASEAN is concerned about whether it would return to its previous role as a supplier of minerals and primary commodities. The likelihood of this development is greatly strengthened when one realizes that the other shoe is about to drop on ASEAN. India, which is still shallowly integrated into the world economy because of its strong economic nationalism and the home to another fifth of the world labor force, is now implementing significant economic deregulation in response to the sustained high growth in China, e.g. the cap on FDI has been raised from 51 percent to 76 percent. One sobering scenario for ASEAN is that whatever manufacturing jobs that did not move to China would now migrate to India!

This gloom-and-doom projection for ASEAN is not inevitable, however. The final outcome actually rests largely in the hands of ASEAN leaders. When the ASEAN-4 are able to implement policies to completely offset the reduction in technological diffusion from the reduction in FDI, then we are back in the FDI diversion case. In the FDI diversion case, China's insertion of one-third more workers into the international division of labor leads to further division of labor (i.e. to even finer specialisation in production activities) within the manufacturing sector worldwide rather than the displacement of the ASEAN-4 from manufacturing. The prerequisite for the lengthening of the production chains in manufacturing to create niches in manufacturing activities for the ASEAN-4 is that they are technologically versatile. For the ASEAN-4 to have such versatility, their governments must invest in strengthening the scientific and technological capability of their citizens.

China proposed the formation of a free trade area (FTA) with Southeast Asia. This action should be recognized as a natural consequence of a fast-growing China that is anxious to undertake investments in the production of primary commodities and minerals so that its vertically-integrated conglomerates could better absorb large price shocks of raw materials should they appear. (This is also why China also recently attempted, unsuccessfully, to buy oil fields in Russia.) China's enthusiasm for an FTA with ASEAN flows directly from the convergence of its economic interests to those of the major developed countries, i.e. the minimization of disruption from huge increases in the prices of raw commodities, the breakdown of the international communication system, and the collapse of the open multilateral trading system. This last concern is particularly important because, as elaborated above, China cannot get rich by exporting only to its neighbors, it needs access to all the markets of the world to get rich. This means that any Chinese regional economic strategy is likely to be subordinate to the concern of helping to maintain an open multilateral trading system, and that if, and when, China becomes the leader of an Asian economic bloc, China is unlikely to shape it into a protectionist trade bloc,

unless the European Union and the Free Trade Area of the Americas (FTAA) are already closed trade blocs.

Southeast Asia has welcomed the formation of an ASEAN-China FTA because this will increase, one, its access to the increasingly important Chinese market, two, the possibility of lengthening the production chain to permit ASEAN to occupy some niches in the manufacturing process, and, three, the inflow of FDI from China to offset the loss to China of FDI from other countries.

2.5 Economic Impact on the Developed Economies in East Asia, Western Europe, and North America

For the developed economies, the integration of China yields net positive benefits from the more refined global division of labor. This is most clearly seen in how the industries in Hong Kong, Japan, Singapore, South Korea, and Taiwan have preserved their competitiveness by shifting the labor-intensive manufacturing components of their production chains to China, and by expanding at home the higher value added components of research and development, and of marketing and distribution. The reason why the empirical work does not find much impact from China's emergence on the export and GDP levels of these five developed East Asian economies is because they were already in the stage of their product cycles where they were beginning to relocate their labor-intensive industries abroad. The emergence of low-wage China simply meant that more of these industries would be shifted to China instead of to the ASEAN-4.

It is highly possible that the China challenge might be more difficult for Taiwan than for the other developed economies. Because Taiwanese, unlike Japanese and Koreans, incur minimal adjustment costs in fitting into the social and cultural life in mainland China, this means that the entire production chain, not just the manufacturing component, might move from Taiwan to China in the medium run.

The fact that the total value of the international trade of Western Europe and North America are not affected significantly by the rise of China is not surprising. These developed economies are now exporting a larger proportion of their capital-intensive goods and high value added services to China and a lower proportion to the other Asian economies, and importing a bigger share of labor-intensive goods from China and a smaller share from the other Asian economies. This shift in the destination of Western European (North American) exports and in the sources of Western European (North American) imports is why there are noticeable changes in the composition of bilateral trade between Western Europe (North America) and individual Asian countries, but no noticeable change in the composition of overall trade between Western Europe (North America) and Asia.

3. Summing Up

Our analysis suggests that the full integration of China's huge labor force into the international division of labor could cause the ASEAN-4 to face the possibility of de-industrialisation. However, this dismal outcome is by no means inevitable. This will happen only if the ASEAN-4 economies allow the drop in FDI inflow to lower the rate of technological diffusion to their economies. If the ASEAN-4 can prevent themselves from falling behind technologically, then they can also find lucrative niches in the lengthened production chains in manufacturing activities. This finding suggests that the ASEAN-4 must give the highest priority in deepening and widening their pools of human capital by speeding up the diffusion of new knowledge to their scientists and managers, and providing appropriate retraining programs for the displaced workers.

The common challenge to the governments of the developed economies from the rise of China as a major manufacturer is how to upgrade the workers who had lost jobs in their manufacturing sectors. This challenge is no different from the structural adjustment that is needed to accommodate improvements in technological innovations. Just as one should not oppose technological progress in order to save obsolete industries, one should also not oppose free trade in order to save non-competitive industries. It is a failure of political will and of economic policy when governments in the developed economies impose protection instead of funding trade adjustment programs to assist the workers in the trade-impacted sectors.

The entry of China to take its place in the international economic system will permit further specialisation of tasks in the workplace, and this is a wealth-creating outcome. The country that can provide its workforce with the depth and range of scientific training required in the new workplace will be in line to receive some of the newly-created wealth. The country that is slow in building up its scientific and technological capability is one that does not understand the right remedy for the constant structural adjustment forced by globalisation. Herein is the *first* realistic major obstacle to the return of China: the rise of global protectionism.

What has been unmentioned so far is that the fulfillment of the projected scenarios of China's impact on the global economy will necessitate China to undertake even bigger economic structural adjustments than any of its trade partners. My estimate is that the wide-ranging economic deregulation package that China agreed to implement for its WTO accession will cause at least a fifth of its labor force to change jobs over the coming decade, and this could be a politically destabilizing process if not handled adeptly. Herein is the *second* realistic major obstacle to the return of China: a mistake by Chinese policymakers in the macroeconomic management of the required changes in the composition of China's output (and, hence, sectoral allocation of the workforce).

We should note that China's fast growth in the last two decades has done substantial damage to the environmental. Elizabeth Economy (*The Rivers Run Black: The Environmental Challenge to China's Future*, Cornell University Press, Ithaca, New York, 2004, pp. 18-19) summarized the economic toll as follows:

> "China has become home to six of the ten most polluted cities in the world.234 Acid rain now affects about one-third of China's territory, including approximately one-third of its farmland. More than 75 percent of the water in rivers flowing through China's urban areas is [unsuitable for human contact235] … deforestation and grassland degradation continue largely unabated236 ... The [annual] economic cost of environmental degradation and pollution … are the equivalent of 8-12 percent of China's annual gross domestic product."

The uncomfortable reality for China is that unless ecological balance is restored within the medium-term, environmental limits could choke off further economic growth.237 Herein is the *third* realistic major obstacle to the return of China: ecological barriers to growth.

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234 "300,000 people die prematurely from air pollution annually, which is twice the number for South Asia, which has a roughly comparable population" Economy, (op. cit., pp.85)

235 Economy (op. cit., pp.69)

236 " … degradation has reduced China's grassland by 30-50 percent since 1950; of the 400 million or so hectares of grassland remaining, more than 90 percent are degraded and more than 50 percent suffer moderate to severe degradation." Economy (op. cit., pp. 65)

237 And the uncomfortable reality for the rest of the world is that the negative consequences of large-scale environmental damage within a geographically large country are seldom confined within that country's borders. The continued march of China's desertification first brought more frequent sand storms to Beijing and then, beginning in April 2001, sent yellow dust clouds not only across the sea to

Developments external to China could also prevent the fulfillment of the scenarios projected by our analysis. External conflicts over North Korea, Taiwan, islands in the South China Sea, and Tibet could see a dramatic decline in FDI, and hence in the diffusion of technology, into China. Even a vastly less dramatic external event like the acceleration of economic deregulation in English-speaking India and its greater opening to inward FDI could reduce the FDI flow into China, and China's exports of labor-intensive industrial products. Herein is the *fourth* realistic major obstacle to the return of China: the simultaneous occurrence of several large negative external shocks.

Overall, our analysis suggests that the realization of the potential for greater common prosperity created by China's integration into the world economy will require more than good economic management by China and its trade partners, good sense by all as well as good luck for all are also required.

Japan and Korea but also across the ocean to the United States. China's environmental management is a concern not only for China's poverty level but also for poverty levels globally.

Appendix
A Technical Outline of Asia-Pacific G-Cubed Model

Full details of the model including a list of equations and parameters can be found online at: http://www.msgpl.com.au/msgpl/apgcubed46n/index.htm . The AP-GCUBED is based on the GCUBED model (described in McKibbin and Wilcoxen, 1998), which is in turn an expansion of the MSG2 model founded by McKibbin and Sachs (1991). There have been many studies of trade reform in China but most studies ignore the role of capital flows and dynamic adjustment, e.g. Wang (2002). There are three significant qualitative differences between the AP-GCUBED model and the standard general computable equilibrium (CGE) model:

1. The AP-GCUBED is based on explicit intertemporal optimization by the agents (consumers and firms) in each economy. In contrast to static CGE models, time and dynamics are of fundamental importance in the AP-GCUBED model.

2. There is an explicit treatment of the holding of a range of financial and real assets in the AP-GCUBED model (money, bonds, equity, household capital, physical capital etc). Money is introduced into the model through a restriction that households require money to purchase goods. The model distinguishes between the stickiness of physical capital within sectors and within countries and the flexibility of financial capital, which immediately flows to where expected returns are highest. This important distinction leads to a critical difference between the quantity of physical capital that is available at any time to produce goods and services, and the stock market valuation of that capital as a result of decisions about the allocation of financial capital. So the AP-GCUBED model has linkages between the financial markets and the real sectors, unlike the usual CGE models, which have real sectors only.

3. In AP-GCUBED, the behavior of agents is modified to allow for short run deviations from optimal behavior either due to myopia or to restrictions on the ability of households and firms to borrow at the risk free bond rate on government debt. The model also allows for short run nominal wage rigidity (by different degrees in different countries) and therefore allows for significant periods of unemployment depending on the labor market institutions in each country. The deviations from intertemporal optimizing behavior take the form of rules of thumb, which are chosen to generate the same steady state behavior as optimizing agents so that in the long run there is only a single intertemporal optimizing equilibrium of the model. The AP-GCUBED model's assumptions hence differ from the market clearing assumption in most CGE models.

Fig 1: Change in Real GDP in Other Countries -- Naive Case

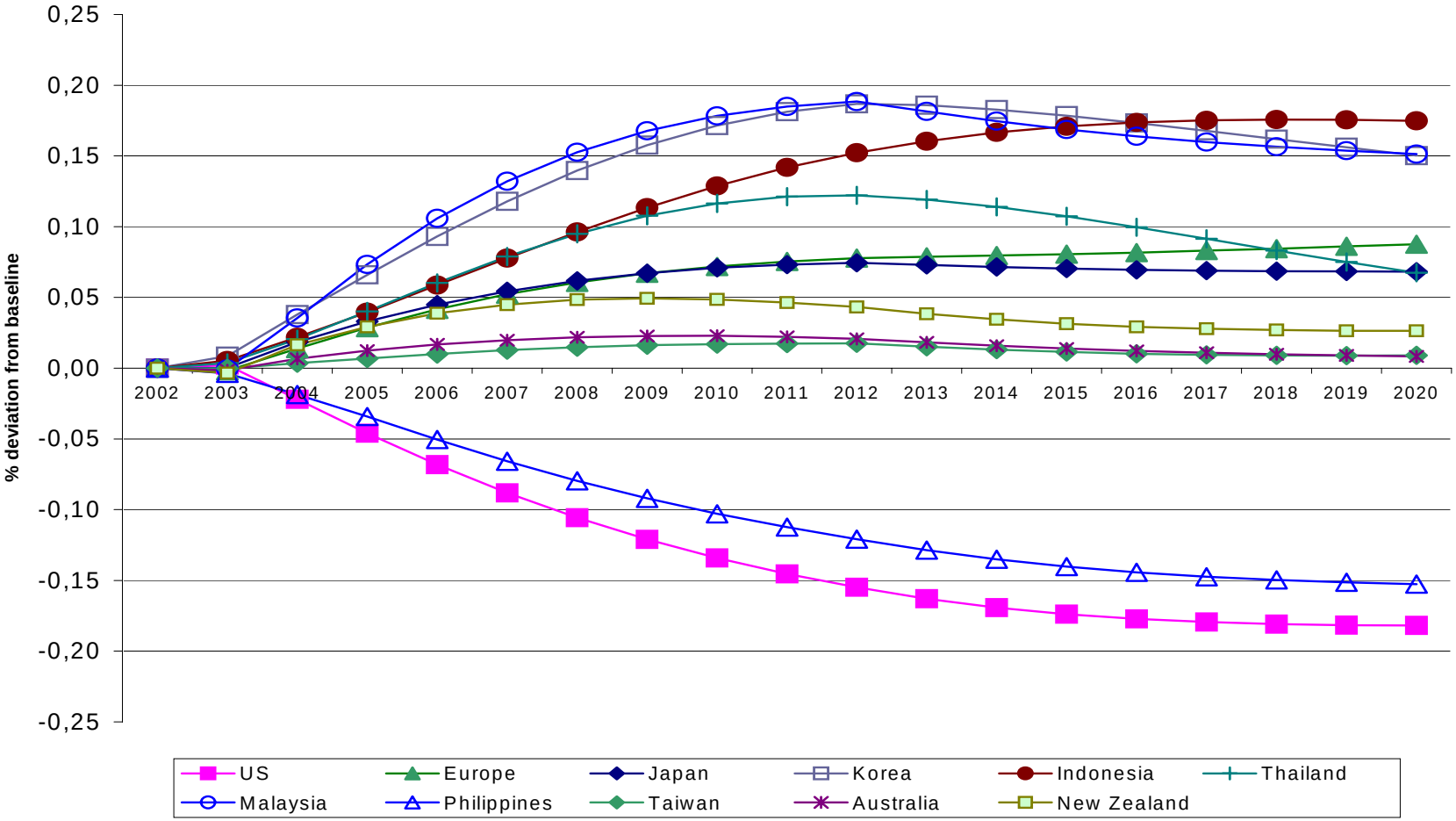


Figure 2: Change in Exports – Naive Case

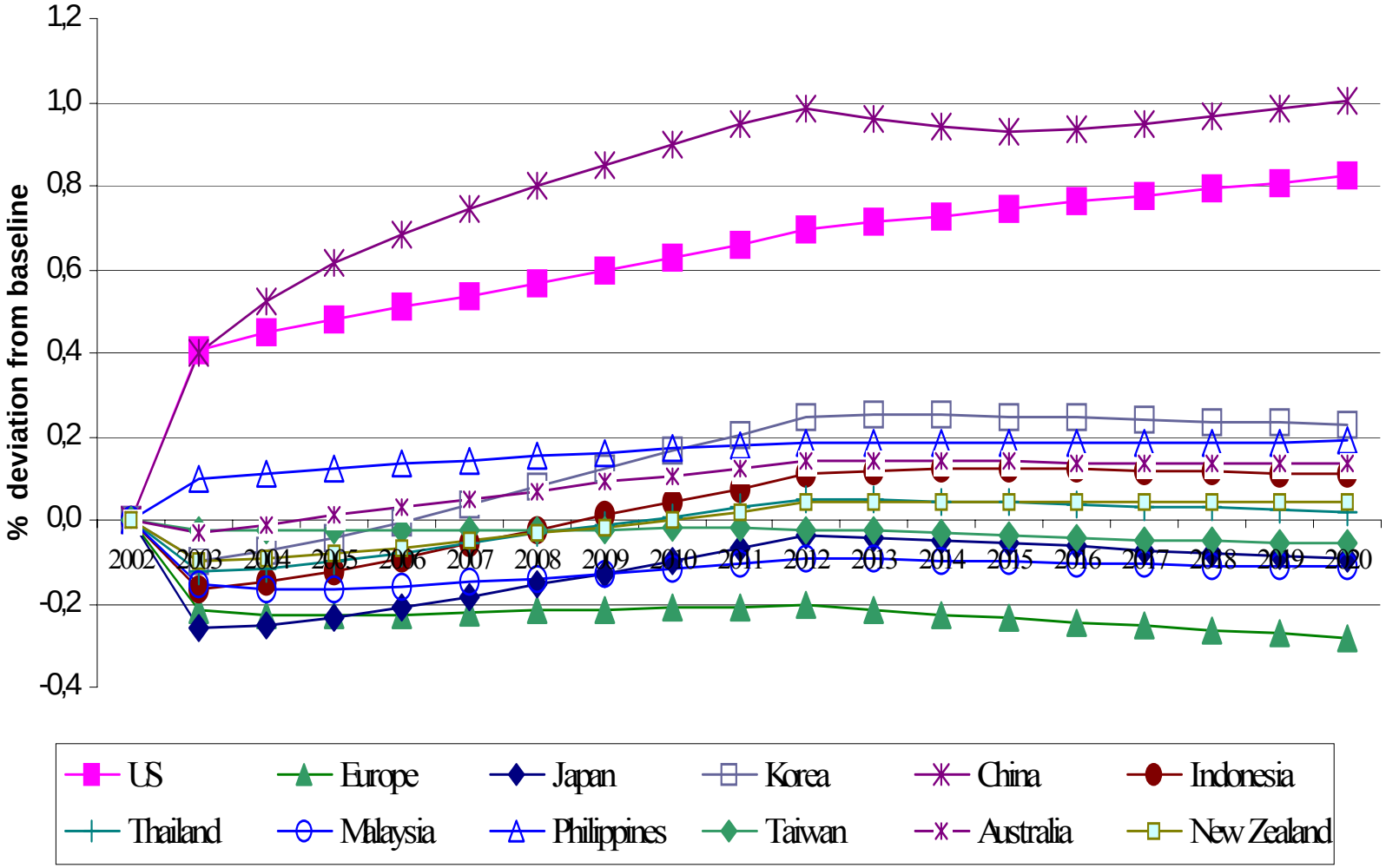


Figure 3 :Change in Real GDP in Other Countries - FDI Diversion Case

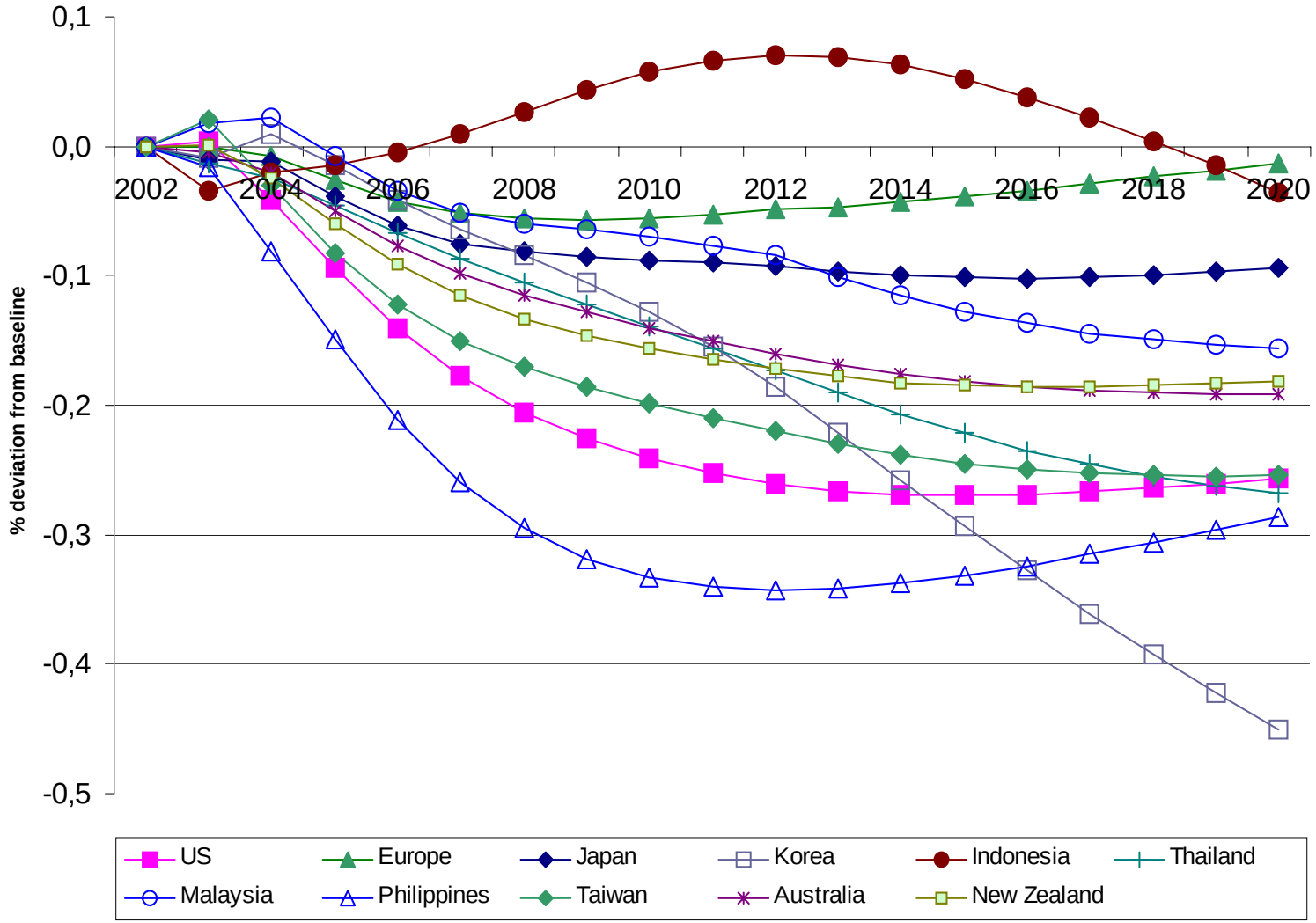


Figure 4: Change in Exports -- FDI Diversion Case

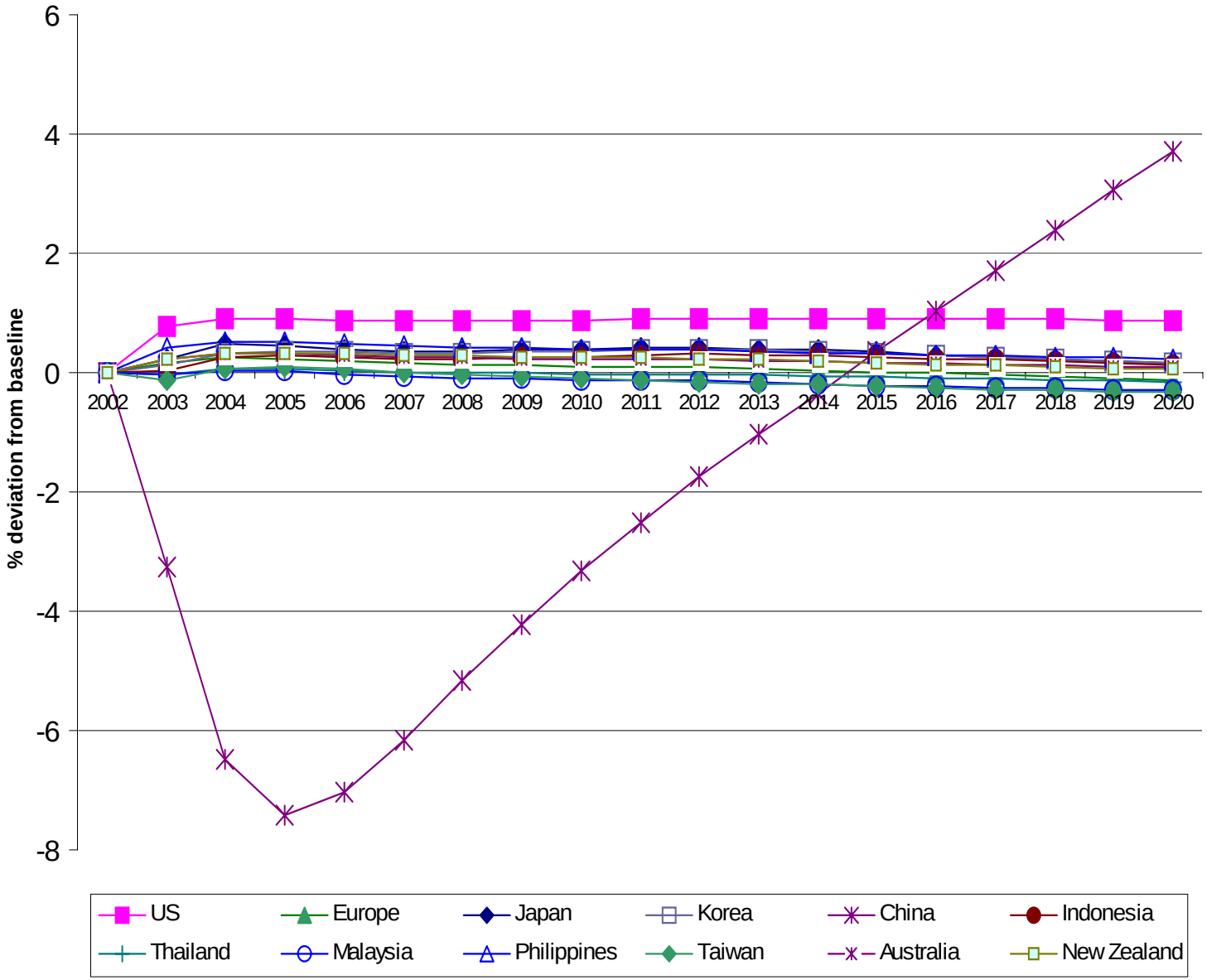


Figure 5: Change in Real GDP in Other Economies - Case of FDI with Technological Spillovers

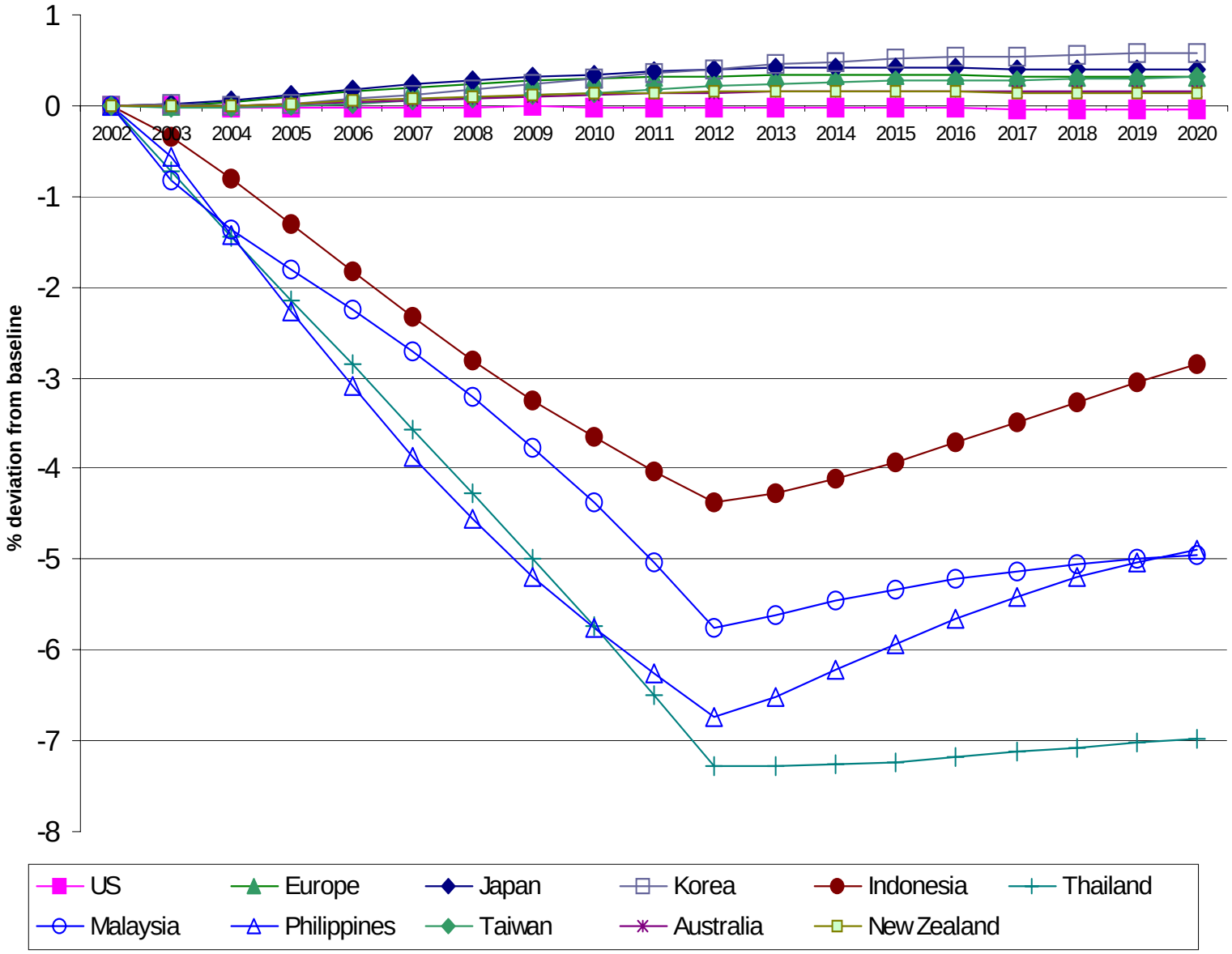


Figure 6: Change in Exports -- Case of FDI with Technological Spillovers

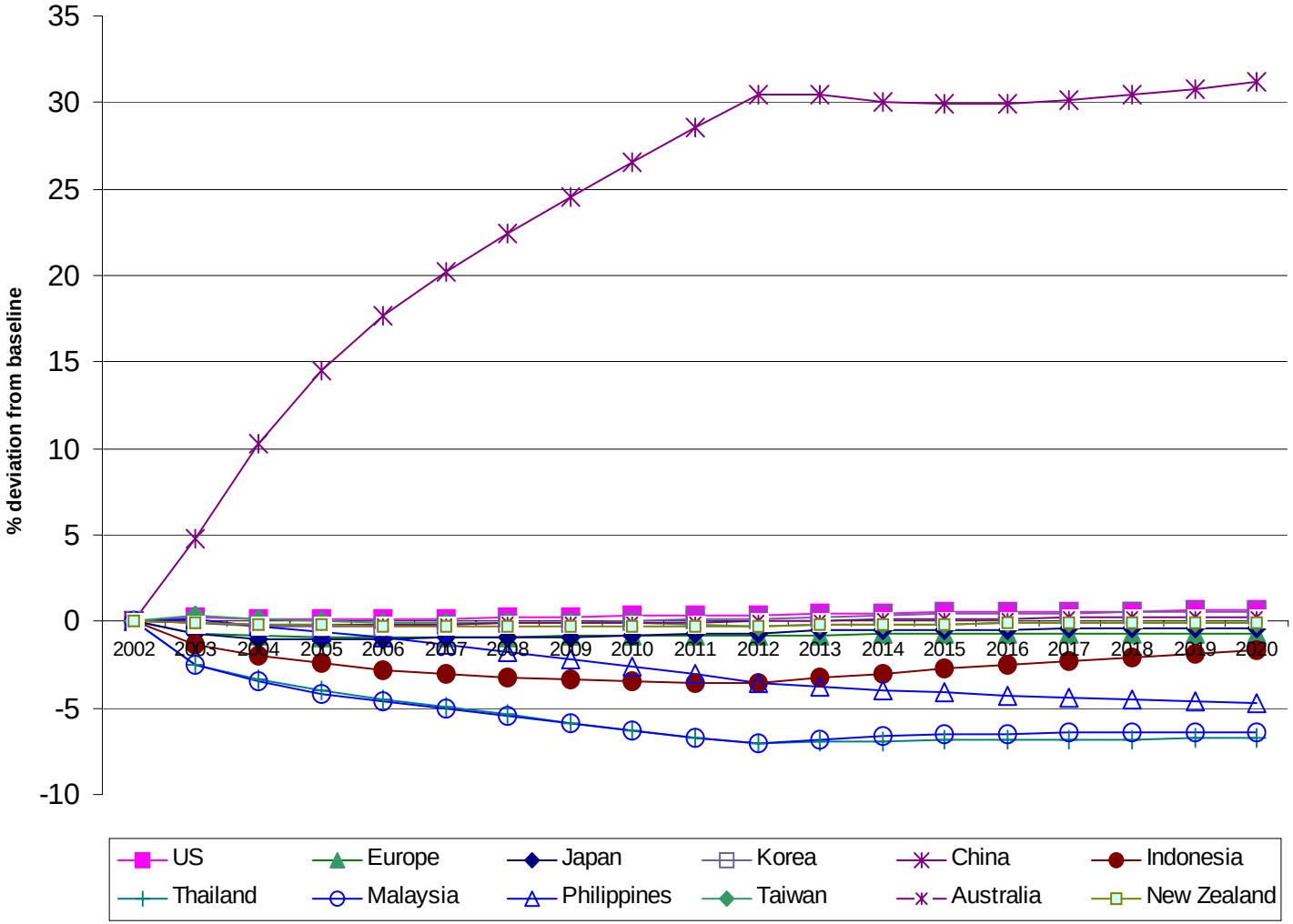


Table 1: Global Economic and Demographic Changes from 0 A.D. to 1998 A.D.

Year	0	1000	1500	1600	1700	1820	1870	1913	1950	1973	1998
Part A: GDP per capita (1990 international $)											
Western Europe	450	400	774	894	1.024	1.232	1.974	3.473	4.594	11.534	17.921
United States			400	400	527	1.257	2.445	5.301	9.561	16.689	27.331
Japan	400	425	500	520	570	669	737	1.387	1.926	11.439	20.413
China	450	450	600	600	600	600	530	552	439	839	3.117
India	450	450	550	550	550	533	533	673	619	853	1.746
World	444	435	565	593	615	667	867	1.510	2.114	4.104	5.709
Part B: Share of World GDP (percent of world total)											
Western Europe	10,8	8,7	17,9	19,9	22,5	23,6	33,6	33,5	26,3	25,7	20,6
United States			0,3	0,2	0,1	1,8	8,9	19,1	27,3	22,0	21,9
Japan	1,2	2,7	3,1	2,9	4,1	3,0	2,3	2,6	3,0	7,7	7,7
China	26,2	22,7	25,0	29,2	22,3	32,9	17,2	8,9	4,5	4,6	11,5
India	32,9	28,9	24,5	22,6	24,4	16,0	12,2	7,6	4,2	3,1	5,0
Part C: Share of World Population (percent of world total)											
Western Europe	10,7	9,5	13,1	13,3	13,5	12,8	14,8	14,6	12,1	9,2	6,6
United States	0,3	0,5	0,5	0,3	0,2	1,0	3,2	5,4	6,0	5,4	4,6
Japan	1,3	2,8	3,5	3,3	4,5	3,0	2,7	2,9	3,3	2,8	2,1
China	25,8	22,0	23,5	28,8	22,9	36,6	28,2	24,4	21,7	22,5	21,0
India	32,5	28,0	25,1	24,3	27,3	20,1	19,9	17,0	14,2	14,8	16,5

Part A: Maddison (2001) Table B-21 (pp 264)
Part B: Maddison (2001) Table B-20 (pp 263)
Part C: Maddison (2001) Table B-12 (pp 243)

Table 2: China Lagging Behind Since 1500, and Japan Catching Up Since 1950

Year	0	1000	1500	1600	1700	1820	1870	1913	1950	1973	1998
Part A: GDP per capita as a multiple of China											
Western Europe	1,00	0,89	1,29	1,49	1,71	2,05	3,72	6,29	10,46	13,75	5,75
United States			0,67	0,67	0,88	2,10	4,61	9,60	21,78	19,89	8,77
Japan	0,89	0,94	0,83	0,87	0,95	1,12	1,39	2,51	4,39	13,63	6,55
India	1,00	1,00	0,92	0,92	0,92	0,89	1,01	1,22	1,41	1,02	0,56
World	0,99	0,97	0,94	0,99	1,03	1,11	1,64	2,74	4,82	4,89	1,83
Part B: GDP per capita as a multiple of Japan											
Western Europe	1,13	0,94	1,55	1,72	1,80	1,84	2,68	2,50	2,39	1,01	0,88
United States			0,80	0,77	0,92	1,88	3,32	3,82	4,96	1,46	1,34
China	1,13	1,06	1,20	1,15	1,05	0,90	0,72	0,40	0,23	0,07	0,15
India	1,13	1,06	1,10	1,06	0,96	0,80	0,72	0,49	0,32	0,07	0,09
World	1,11	1,02	1,13	1,14	1,08	1,00	1,18	1,09	1,10	0,36	0,28

Table 3: Counterfactual Shares of World GDP Upon Catching-Up

Scenario I: China catches up with Western European income in 1998
Scenario II: China and India catch up with Western European income in 1998

	Actual 1998	**Counterfactual outcomes in 1998**	
		Scenario I	***Scenario II***
		China caught up with W. Europe	**India and China caught up with W. Europe**
Part A: Assumption of Share of World Population (percent of world total)			
Western Europe	6,6	6,6	6,6
United States	4,6	4,6	4,6
Japan	2,1	2,1	2,1
China	21	21	21
India	16,5	16,5	16,5
Part B: Assumption of GDP per capita (1990 international $)			
Western Europe	17.921	17.921	17.921
United States	27.331	27.331	27.331
Japan	20.413	20.413	20.413
China	3.117	17.921	17.921
India	1.746	1.746	17.921
World	5.709	8.818	11.487

Part C: CounterfactualShare of World GDP (percent of world total)			
Western Europe	20,60	13,41	10,30
United States	21,90	14,26	10,95
Japan	7,70	4,86	3,73
China	11,50	42,68	32,76
India	5,00	3,27	25,74

Table 4: The 10 most promising destinations for manufacturing FDI by Japanese TNCs over the next three years

(frequency, expressed in percent, that the country is identified by Japanese firms responding to annual surveys conducted by Japan Bank for International Cooperation, JBIC)

Rank	1996 survey	Ratio	2000 survey	Ratio	2001 survey	Ratio
1	China	68	China	65	China	82
2	Thailand	36	United States	41	United States	32
3	Indonesia	34	Thailand	24	Thailand	25
4	United States	32	Indonesia	15	Indonesia	14
5	Vietnam	27	Malaysia	12	India	13
6	Malaysia	20	Taiwan province of China	11	Vietnam	12
7	India	18	India	10	Taiwan province of China	11
8	Philippines	13	Vietnam	9	Rep. of Korea	8
9	Singapore	10	Rep. of Korea	9	Malaysia	8
10	United Kingdom and Taiwan province of China	7	Philippines	8	Singapore	6

footnotes:

a The share of firms that consider the country as promising in total respondent firms (multiple responses).

b Fiscal year.

Source: United Nations Conference on Trade and Development (2002)

Table 5: Indices of Indigenous Ability to Innovate, Technology Transfer from Abroad, and Overall Technological Capacity

Index of Indigenous Ability to Innovate	
USA	1
Finland	2
Germany	3
Switzerland	4
Japan	5
Singapore	14
Taiwan	16
South Korea	22
Hong Kong	27
Malaysia	30
China	34
India	38
Philippines	47
Thailand	50
Indonesia	55
ASEAN-4(average)	*46*

Index of Ability to Get Technology Transfer from Abroad	
Singapore	1
Ireland	2
Luxembourg	3
Malaysia	7
Taiwan	12
South Korea	13
Hong Kong	17
Philippines	19
India	26
Thailand	36
Japan	39
China	43
Indonesia	45
ASEAN-4(average)	*27*

Index of Overall Technological Capacity	
USA	1
Finland	2
Singapore	3
Ireland	4
Germany	5
Switzerland	6
Japan	7
Malaysia	18
Taiwan	24
Korea	25
Hong Kong	30
Philippines	32
India	37
Thailand	43
China	48
Indonesia	50
Ecuador	58
Bolivia	59
ASEAN-4(average)	*36*

The Indigenous Innovation Index and Technology Transfer Index are the two components of the Overall Technology Index.

The Overall Technology Index is combined with the Startup Index (relative ease in establishing a new firm) to produce the Economic Creativity Index.
The Growth Competitiveness Idex is constructed from the Economic Creativity Index, the Finance Index (relative efficiency of the financial system), and the International Index (degree of integration into the international economy).
These are the index values in 2000

Source: World Economic Forum (2000)

Table 6: Deviation of Exports from Baseline in 2020

	China	Indonesia	Malaysia	Philippines	Thailand
Simulation of FDI Diversion					
Deviation of total exports from baseline, in percent	*3,70*	*0,34*	*-0,04*	*0,12*	*-0,04*
Contribution to deviation from baseline, in percentage points					
Energy	0,11	0,64	0,01	0,04	0,00
Mining	0,01	-0,02	0,00	0,01	0,00
Agriculture	-0,10	-0,02	0,08	0,04	0,12
Durable Manufacturing	1,44	-0,01	-0,08	0,02	-0,01
Nondurable Manufacturing	0,87	-0,14	0,01	0,02	-0,02
Services	1,36	-0,10	-0,06	-0,01	-0,13
Simulation of Diverted FDI with Technological Spillovers					
Deviation of total exports from baseline, in percent	*32,64*	*-3,20*	*-6,95*	*-5,22*	*-8,09*
Contribution to deviation from baseline, in percentage points					

Energy	0,77	0,19	-0,02		0,02	0,00	
Mining	0,16	0,00	0,00		-0,01	0,00	
Agriculture	0,57	-0,20	-0,30		-0,11	-0,47	
Durable Manufacturing	14,34	-0,07	-4,59		-3,05	-3,94	
Nondurable Manufacturing	13,11	-3,28	-2,14	0,97	-2,36	-3,41	0,91
Services	3,69	0,15	0,10		0,28	-0,26	

East Asian Economic Integration –
Past Experience, Current State of Play and Future Prospects

Françoise Nicolas

East Asian Economic Integration – Past Experience, Current State of Play and Future Prospects

Françoise NICOLAS
(IFRI and University of Marne-la-Vallée)

Over the past decade, two major developments have affected the economic environment in East Asia, with major implications for the process of regional economic integration: the 1997-98 financial crisis and the economic rise of China. The purpose of the paper is twofold first to examine these various changes and the drivers behind them, and second to sketch the possible evolution of East Asia as a well-structured region, with an emphasis on the possible implications for the EU.

1. The 1980s: regionalization with limited regionalism

1.1 Limited regionalism

Prior to the 1997-98 financial crisis, integration efforts in East Asia were far more loosely institutionalized than in most other regions of the world, in particular Europe. There were no custom unions in the region and no common external tariff structure had been negotiated. The only formal body of integration was the Association of Southeast Asian Nations (ASEAN) which had been established in 1967, primarily for political reasons. ASEAN economic integration efforts started in the mid-70s, with preferential trading arrangements (PTAs) on a piecemeal and voluntary basis. Also several programs were initiated to promote industrial cooperation (ASEAN Industrial Projects, ASEAN Industrial Complementation Scheme, Brand-to-Brand

Complementation, and ASEAN Joint Ventures), with at best mixed results. Overall ASEAN has kept limited ambitions until recently and obtained even more limited achievements. ASEAN can be said to have been fairly successful in terms of political cooperation but not in terms of economic cooperation. A more daring project was launched in 1992, with the ASEAN Free Trade Area (AFTA) which aimed at realizing a free trade area within 15 years starting on January 1, 1993. The time frame was eventually (1994) shortened to 10 years with the aim of achieving the AFTA goals by the year 2003.

At the overall East Asian level by contrast, there was no formal cooperation arrangement. In particular the three major economies of the region - China, Japan and Korea - have not been part of any formal trading areas until recently. The first real attempt at institutionalized economic integration was not the result of an East Asian initiative but it came from the US in the late 1980s. This is what finally gave rise to the Asia Pacific Economic Cooperation (APEC). Malaysia's proposal of an "East Asian Economic Caucus" in 1991 was perceived by the US as likely to undermine APEC. As a result it met strong objections from Washington and was quickly torpedoed.

By contrast to what is generally believed, there is a long history to financial and monetary cooperation in Southeast and East Asia at large, yet with a low degree of commitment (Hamilton-Hart 2003). The first organization in charge of cooperation in the area of finance was Southeast Asia, New Zealand and Australia (SEANZA), a central bank group established in 1957. It was replaced by Southeast Asian Central Banks (SEACEN) in 1966. These groups were primarily involved in training and advisory activities. Cooperation among central banks was also conducted within ASEAN, with the Central Banks and Monetary Authorities Committee, later replaced by the Committee on Banking and Finance (1977), while the ASEAN Banking Council, established

in 1976, was in charge of private sector cooperation. More recently, a Japanese proposal for a new central bank forum led to the creation of the Executives' Meeting of East Asia Pacific central banks (EMEAP) in 1991. Its objectives include enhanced regional surveillance, exchange of views and information and financial market developments. Yet these various bodies and initiatives were merely instruments of consultation which did not prove to be significant in practical terms.

Similarly, currency cooperation in the region remained extremely modest: it was limited to a (never utilized) ASEAN swap arrangement established in 1977, by which member countries were allowed to tap in each other foreign currency reserves in case of financial difficulties. The agreement was initially set at $ 100 millions for five members, with a maximum of $ 40 million receivable per member, and was later raised to $ 200 million, or $ 80 million per member, in 1978. These arrangements proved however totally inadequate to help the affected countries during the financial crisis of 1997-98.

There is no shortage of explanations for this low degree of formal cooperation in East Asia. Munakata (2004), for instance, identifies three major obstacles on the road to institutionalization of regional economic cooperation, namely the lack of cohesiveness of the region (with wide development gaps in particular), the persistence of a strong extra-regional dependence (especially on the US, which showed systematic hostility to exclusively Asian frameworks1), and finally a deep-rooted skepticism towards a top-down approach to regional cooperation.

1.2 Dynamic regionalization

Despite the fragmentation of regional cooperation efforts highlighted above, and despite the quasi absence of institutionalized regionalism, economic interactions have kept deepening throughout East Asia ever since the emergence of the first-tier Newly Industrializing Economies. In this part of the world, economic integration has long been a "spontaneous" process fuelled by the private sector and by the quest for efficiency on the part of (mostly Japanese) multinationals, seeking to build up marketing and supply chain network to exploit economies of scale from division of labor and specialization (Barrell and Choy 2003). By contrast to what can be observed in Europe, the movements of firms to low cost locations are more common in East Asia than in Europe for instance (where firms move to the markets).

Interestingly enough, the progress in intra-regional trade has been extremely meager within ASEAN2 and is primarily due to a sharp increase in trade linkages between ASEAN countries and the rest of East Asia (Japan and the NIEs), as well as between Japan and the NIEs. Japan's

1 Japan's failure to act as a regional leader is obviously due to its fear of alienating the US. In particular, Japan initiated behind-the-scenes discussion on the formation of an East Asian economic bloc in the late 1980s out of concern about the moves by its US and European rivals to consolidate free trade blocs. Yet, Japanese governments were reluctant to openly campaign for an Asian grouping, fearing an adverse US reaction. To be fair, they were also probably conscious of painful memories throughout the region of Japan's wartime role and its "Greater Asian Co-prosperity Sphere". A good example of this external pressure is the US outright hostility in the early 1990s to Malaysia's proposal (backed by sections of Japanese big business) for the creation of an East Asian Economic Caucus, excluding not only the US but Australia and New Zealand as well. The plan was effectively shelved as a result of US opposition.

2 The bulk of ASEAN countries' trade is conducted with Asian countries, but usually outside ASEAN. The intraregional trade ratio for ASEAN increased from 16 per cent in 1980 to 16.9 per cent in 1990 and 21.2 per cent in 1995, while the ratio for the whole of East Asia rose from 30 per cent in 1980 to 34 in 1990 and 42 in 1995 (Agarwala and Prakash 2002). When adjusted for Singapore's entrepôt role, for trade in petroleum products, and for bilateral trade between Singapore and Malaysia, intra-ASEAN trade as a proportion of total trade of member countries becomes far less significant (below 5 per cent) than the commonly cited range of 16 to 20 per cent (Asher 1999).

exports to the rest of East Asia, which was 24 per cent of the total in 1980 increased to 44 per cent by 1996, and the share of imports from Asia rose from 22 per cent to 42 per cent over the same period of time. Similar developments can be observed for Korea, whose exports to the rest of Asia rose from 14 per cent in 1980 to 39 per cent in 1997.

The interactions between trade and direct investment flows account for the deepening of economic linkages in the region. In particular, growing outward direct investments from Japan (from the mid- 1980s) as well as from the East Asia NIEs (from the 1990s) to the rest of the region have increased the flow of raw materials and intermediate goods within the manufacturing networks of Asia, fuelling a rise in intra-regional trade (Barrell and Choy 2003).

In Southeast Asia (SEA) the spurt of growth started in the mid-1980s with the relocation of Japanese firms, followed by NIE firms, in the region. The sharp appreciation of the yen in the wake of the Plaza agreement in 1985 was clearly instrumental in fuelling the development of regionalization in East Asia. While Japanese firms had already relocated part of their production facilities in the first-tier NIEs (Taiwan, Singapore and Hong Kong), the rise in the yen in the late 1980s changed the direction of these shifts in favor of Thailand, Indonesia, Malaysia and Sri Lanka because the NIEs' currencies were realigned in the wake of the yen. As Japanese companies sought new cheaper manufacturing bases in a dollar zone, SEA countries were an obvious choice. In a secondary move, capital started flowing from the NIEs to the new low-cost sites (Pasuk and Baker 1995).3 Inflows of new production facilities enabled the receiving SEA economies to grow faster. In these countries trade liberalization ensued largely as a result of increased confidence in outward orientation made possible by FDI flows from Japan, and eventually Hong Kong, Taiwan and Korea.

As a result of these tight interconnections, East Asia was perceived (and rightly so) as a relatively coherent region prior to the crisis. This pattern of interdependence proved to be negative as financial difficulties spread from one country to another at the time of the financial crisis of 1997-98.

3 The loss of preferential access to major developed markets for the NIEs is an additional factor increasing the available supply of FDI (OECD, 1999).

Table 1 East Asia, Intra-regional Trade, 1986 - 2002

	Percent of GDP	Percent of Total trade
7.1.1.1 ASEAN5 +3 +2		
1986-92	***10***	***37***
1993-97	14	43
1998-2002	17	43
1993-2002	***16***	***43***
7.1.1.2 ASEAN5		
	14	***16***
7.1.1.3 1986-92		
	20	19
7.1.1.4 1993-97		
	27	20
7.1.1.5 1998-2002		
	23	***20***
7.1.1.6 1993-2002		

Source: European Central Bank
Note : ASEAN5 = Indonesia, Malaysia, Philippines, Singapore, Thailand ; +3 = Japan, South Korea, China ; +2 = Hong Kong, Taiwan.

***Table** 2 East Asia, FDI Inflows by country of origin, 1990-98 (in million dollars and in percentage of total)*

Destination **Investors**	**ASEAN[a]**	**China**	**South Korea**	**Taiwan**	**Total**
7.1.1.6.1.1.1 Japan	57 693 (19.2)	29 715 (5.5)	2 769 (10.5)	4 935 (22.7)	95 112 (10.7)
United States	35 082 (11.7)	42 658 (7.9)	9 331 (35.3)	3 885 (17.8)	90 956 (10.3)
Europe	40 375 (13.4)	27 311 (5.1)	8 935 (33.8)	2 484 (11.4)	79 105 (8.9)
ASEAN	27 943 (9.1)	33 421 (6.2)	3 271 (12.4)	1 108 (5.1)	65 293 (7.4)
Other East Asia[b]	46 731 (15.5)	336 132 (62.4)	551 (2.1)	1 571 (7.2)	384 985 (43.4)

a) 1991-98 for Brunei and Vietnam ; 1992-98 for the Philippines and 1994-98 for Cambodia
b) Hong Kong, South Korea and Taiwan
Source : Kawai and Takagi (2000)

2. The 1990s, a watershed

2.1 The 1997-98 financial crisis, a defining moment

The post-crisis rise of ASEAN+3

Among its many side-effects, the financial crisis of 1997-98 has proven to be a catalyst for deeper economic integration in East Asia. While it may be excessive to speak, as some authors do4, of a real revolution in integrationist thought and policy, there has definitely been a change of mindset in Asia with regard to economic integration, and a number of concrete economic steps have been taken in the direction of institutional frameworks to promote economic integration in the region. The emergence of the "ASEAN+3" framework (which includes the ten ASEAN countries as well as China, Japan and South Korea) is one such example.

Informal cooperation within the region and a non-optimal way of pegging the currencies explain the 1997-98 disaster in a context of insufficiently supervised banking. Also, the crisis exposed the limitations of traditional dollar tracking exchange rate policy (Barrell and Choy 2003) and prompted interest in exchange rate cooperation. The positive side of the *de facto* dollar peg in most countries of the region was the absence of beggar-thy-neighbor devaluations, while the negative side was contagion. The contagion mechanism and the spillovers underline the regional dimension of the crisis and the need for a collective approach. In the wake of the crisis it seemed to be in the interest of all the countries in the region to opt for a more active cooperation.

In practical terms, the crisis exposed the limits of so-called open regionalism and prompted a number of initiatives pointing to more formal economic integration within the region, with a shift from regionalization to regionalism as a result. It must be stressed at this stage that Government representatives of the ASEAN member states and the three Northeast Asian countries (Japan, China and Korea) had gradually got used to getting together every so often to coordinate their positions on a range of economic issues in the context of the ASEM process in particular. Hence the way had been gradually paved for the emergence of what has come to be known as the ASEAN+3 framework but the crisis proved to be a major catalyst in institutionalizing the new arrangement (Stubbs 2002).

In addition to the financial crisis, a number of factors converged to fuel the move towards more active regionalism. The successful launch of the euro in early 1999 clearly rekindled interest in exchange rate cooperation, while the fear of being marginalized in an increasingly uncertain global trading and financial environment certainly added to the momentum.5 Finally, discontent with surveillance and assistance programs by international financial organizations, such as the IMF, and a rising resentment towards the West and the way it addressed the Asian crisis, may account for the efforts at developing financial self-help mechanisms at the regional level6, and to place the emphasis on East Asia rather than on the wider Asia Pacific region.

Financial Cooperation

The initial rationale for deeper regional cooperation in East Asia was the need to avoid the recurrence of a crisis, hence its mainly financial orientation.

Financial and monetary cooperation rests on three major pillars: surveillance of macroeconomic performances, financial assistance and exchange rate policy coordination. While the first two components are certainly a prerequisite to the third one, they do not necessarily give rise to such coordination. Moreover, the first two components are complementary. On the one hand, effective surveillance mechanisms, while certainly extremely useful, are not sufficient to prevent financial

4 See Bergsten (2000).

5 While financial concerns were initially at the forefront, initiatives in favor of trade integration also emerged, as will be explained below. In the latter case, the link with the crisis is less straightforward. It is rather the continuation of a former tendency but was amplified in the wake of the crisis as East Asian countries increasingly feared exclusion from other FTAs (Lloyd 2002).

6 The latter factors reflect "defensive regionalism" as defined by Munakata (2004).

crises in the absence of financial assistance mechanisms. On the other hand, financial assistance mechanisms need to be associated with some form of surveillance so that they can be activated when necessary.

In the very early stages of the crisis, Japan suggested the creation of an Asian Monetary Fund7 which would provide a mechanism for the regional supply of funds. The mechanism was supposed to be a complement to existing international financial facilities. The concept was discussed internationally first on the occasion of the ASEM finance ministers' meeting in September 1997 and eventually among participants at the joint annual meetings of the IMF and the World Bank in Hong Kong later in the month. As the proposal met strong opposition from both the IMF, the US, the EU and, to some extent, China, it was quickly abandoned. The major criticism related to the possible lack of consistency with IMF conditionality.

Another attempt by the Japanese government took the form of the New Miyazawa initiative of October 1998. The purpose of the initiative was to help achieve greater stability in international capital markets but it focused on bilateral cooperation rather than on the creation of a regional institution. What matters is that it reflects persistent Japanese concerns with financial stability in the region.

Regional cooperation efforts were never fully dropped however. In the wake of the crisis, Asian countries' officials gradually met more and more systematically on an "ASEAN plus three" basis, in which Japan, China and Korea joined the 10 ASEAN countries. At the 1998 summit in Hanoi, the leaders of the ASEAN+3 countries agreed to hold such meetings regularly in the future and to extend their discussions beyond finance and currency matters. A major outcome of such meetings is the Chiang Mai Initiative (CMI), which was adopted at the May 2000 meeting of the ASEAN+3 finance ministers in Chiang Mai on the sidelines of the Asia Development Bank's annual meeting.8

The CMI aimed at creating a network out of the existing currency swap arrangements that had been set up within ASEAN (see above) and bilaterally between ASEAN members and the other three countries. The CMI rests on two pillars: an expanded ASEAN swap arrangement (ASA), and a network of bilateral swap and repurchase agreements among the 13 countries involved (BSA). The point of these mechanisms is to provide liquidity support to member countries facing short-run balance of payment difficulties, with the ultimate objective of avoiding serious currency/confidence crises and contagion effects, thus contributing to the financial stability of the region.

The ASA was first expanded to include the five new ASEAN member countries and the total amount of the facility was raised to $ 1 billion (up from 200 million in the previous scheme). The currencies available under the ASA are the dollar, the yen and the euro. Each member is allowed to borrow up to twice its committed amount for a period not exceeding six months (renewable once).

The BSA is a facility for short-term liquidity assistance in the form of swaps of dollars with the domestic currencies of participating countries. The maximum amount of drawing under each BSA is to be determined by bilateral negotiations. The disbursements are supposed to be made in

7 This proposal was in line with former moves, by the Japanese government, in favor of the creation of a regional institution to strengthen Asia's monetary stability (Kikuchi 2002).

8 It is worth noting that China gave full support to the CMI, which it probably viewed as a more balanced framework than the initial Japan-sponsored AMF proposal to which it had been opposed. This change in Beijing's attitude towards regional cooperation should not be taken lightly. It will probably be instrumental in maintaining the momentum for economic integration in East Asia.

a concerted manner through consultation among the swap providing countries. An important feature of the BSA is a kind of opt out clause by which the decision to activate the swap the decision to activate the swaps and credit lines is at the discretion of the lender. Another important feature is the link with IMF conditionality. By contrast to the previous AMF proposal, the CMI was clearly defined as a supplement to the IMF facilities: while up to 10 per cent of the maximum amount of drawing can be disbursed independently of the IMF, beyond this threshold countries are required to accept IMF conditions in the form of a program for macroeconomic and structural adjustments.9

As of end-2004, 16 BSA have been successfully negotiated, for a total amount of approximately $ 38.5 billions. Yet, as explained earlier, the maximum amount of money any individual country can draw varies a great deal. With 7 arrangements, Japan has clearly led the way, while the least enthusiastic among ASEAN countries are Singapore and Brunei, who obviously fear that the BSAs will be one way arrangements in which they will be asked to provide financial support to their ailing neighbors.

Table 3 *Chiang Mai Initiative, Status of the Bilateral Swap Arrangement Network (as of November 10, 2004)*

Bilateral Swap Agreements	7.1.1.7 Currencies	7.1.1.8 Date of conclusion	Amount (billion dollars)
Japan-Korea	US$/Won	4 July 2001 (extended on 4 July 2004)	2+5[a]
Japan-Thailand	US$/Baht	28 July 2001	3
Japan-Philippines	US$/Peso	30 Aug. 2001 (extended on 27 Aug. 2004)	3
Japan-Malaysia	US$/Ringgit	5 October 2001	1+2,5[a]
China-Thailand	US$/Baht	6 December 2001	2
Japan-China[b]	Yen/Renminbi	28 March 2002	3
Korea-Thailand[b]	US$/Baht	11 June 2002	1
China-Korea[b]	Renminbi/Won	24 June 2002	2
Korea-Malaysia[b]	US$/Ringgit	26 July 2002	1
Korea-Philippines[b]	US$/Peso	9 August 2002	1
China-Malaysia	US$/Ringgit	9 October 2002	1.5
Japan-Indonesia	US$/Rupiah	17 February 2003	3
China-Philippines	Peso/Renminbi	29 August 2003	1
Japan- Singapore	US$/SG$	10 November 2003	1
Korea-Indonesia[b]	US$/Rupiah	24 December 2003	1
China-Indonesia	US$/Rupiah	30 December 2003	1

Source : ASEAN Secretariat
Notes: a) the second figure corresponds to the amounts provided under the New Miyazawa Initiative.
b) two-way swap arrangement where each party can request the other to provide liquidity support in the specified currency up to the agreed amount. The overall availability is therefore counted as twice the face value of the BSA.

Although the CMI is tightly linked to the IMF it is also supported by a surveillance mechanism aimed at monitoring economic developments in the region, providing a forum for policy dialogues and coordination among member-countries, and imposing policy reforms on the countries making use of the BSAs.

In the wake of the crisis, ASEAN countries created a regional surveillance mechanism, the ASEAN Surveillance Process (ASP), which is consistent with the objectives defined in Manila in

9 This obligation does not mean that the negotiation with the IMF has to be finalized when the funds are disbursed but it must have started.

the very early stages of the crisis.10 The objective of the mechanism is to help member-countries identify a potential crisis and respond to it. The mechanism, which is based on peer pressure, was approved and supported by the ADB.

In November 1999, the ASP has been expanded to include China, Japan and Korea and turned into the ASEAN+3 Surveillance Process.

Next to this financial cooperation scheme, there is as of today no formal effort at exchange rate coordination. Not much has been done as yet in concrete terms beyond discussions and consultations about the feasibility, difficulties and challenges of going ahead with monetary integration. In particular the Kobe research project was launched in 2001 within the ASEM process with a view to derive lessons from the European experience with monetary integration.

For the time being, despite allegations to the contrary11, most East Asian countries continue to smooth their exchange rates against the dollar. As a result, there is an apparent return to the de facto dollar peg that prevailed prior to the crisis in a number of countries in the region, as well as a more formal peg in some others, in particular China and Malaysia, (McKinnon and Schnabl 2003). Of course, a major benefit of the *de facto* dollar peg is to help maintain a consistent exchange rate policy throughout the region and thus to avoid beggar-thy-neighbor phenomena. Yet this convergence prevails by chance rather than by design.

2.2 The Rise of China and its Implications

A major engine of informal integration

As a result of its open-door policy, China has been increasingly integrated with the global trading system. It is now the world's fourth largest trader. The country's exports and imports have surged since the early 1990s, with the US, Japan and the EU (in that order) as major export destinations, and with Japan, the EU and emerging East Asia as major suppliers of imports. While China does not export much to neighboring emerging Asian economies, it imports a lot from the rest of the region, from industrial and emerging economies alike.12

The emergence of China has thus **helped further fuel the dynamics of private sector-led regionalization** highlighted earlier. Following the normalization of its economic relations with a number of its Asian trading partners such as South Korea, **China's trade with neighboring emerging Asian economies has intensified dramatically**.13 Yet, the situation varies substantially across countries: the surge in China's imports from the rest of the region has not benefited all countries equally. As can be seen in figure 1, at the individual country level, Korea has undoubtedly benefited most from this development (and to a lesser extent Taiwan), and is nowadays the second source of imports for China, behind Japan but ahead of the US. The bilateral trade between China and Korea amounted to 45 billion US$ in 2002 (compared to 17 billion in 1995). Korean exports to China rose to close to 30 billion US$ in 2002, while Korean imports from China reached 15 US$ billions. From the Korean perspective, China now ranks first

10 The Manila framework was established in November 1997 in order to strengthen regional cooperation and to promote financial stability in the region.

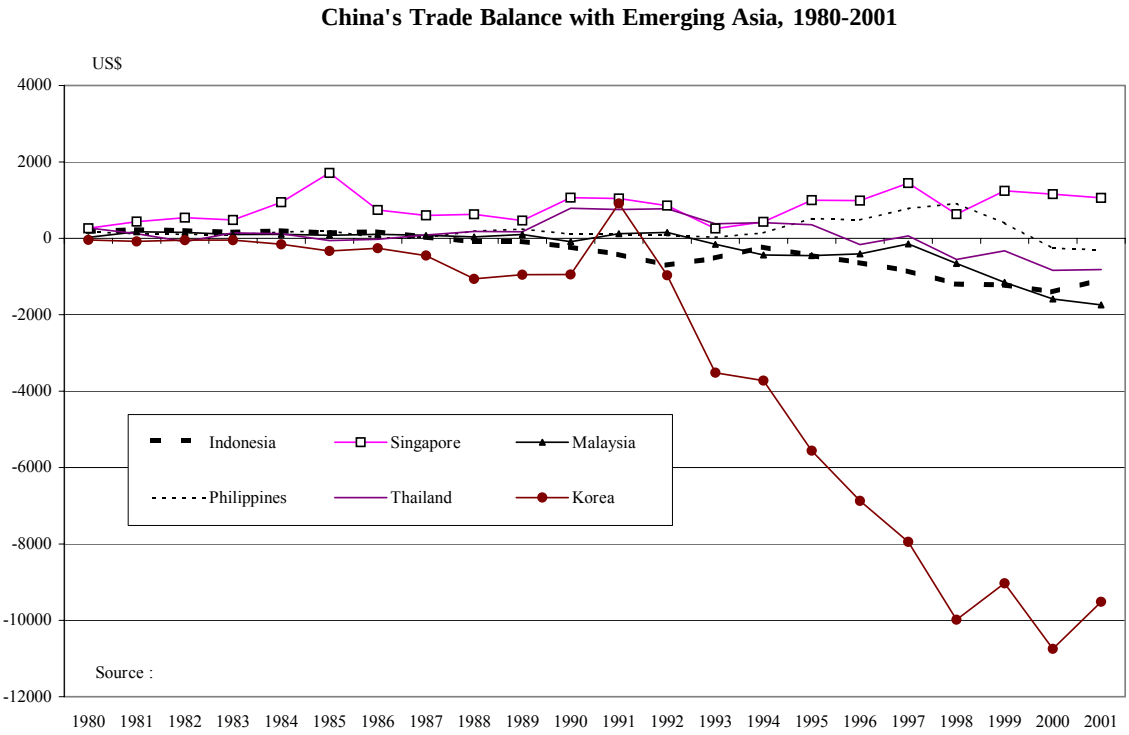
11 A number of countries in the region have officially adopted a flexible exchange rate since the financial crisis.

12 Over the period 1990-2000, the share of East Asia as a destination for Chinese exports has decreased (from 67 to 45.2 per cent) while its share as a source of imports has risen (from 55.4 to 62 per cent). In 2003, China surpassed Japan as the major export destination for East Asian countries: China imported $168 bn from this region and Japan only $152 bn.

13 This is also reflected in the upward trend of trade intensity indices among the East Asian economies (Ando and Kimura 2003).

among the country's export markets, ahead of the US. This has undoubtedly helped Korea maintain strong growth over the past few years14 but has also made it more dependent on the fate of the Chinese economy. Moreover, China's chronic trade deficit with Korea has fuelled complaints in the former country, leading to the imposition of anti-dumping measures and festering the relations between the two countries.

Figure 1 : *China's Trade Balance with Emergine East Asia, 1980-2001*



The pattern of China's imports from Asia differs substantially from the country's imports from the rest of the world.15 China's imports from the US and the EU are primarily concentrated in the aeronautics industry, in engines, auto-parts, telecommunication equipment and specialized machinery. Various electronic products (components in particular) weigh more heavily in China's imports from Japan. The pattern of China's imports varies across emerging East Asian countries and has varied over time. While China still tends to import non-edible agricultural products and crude oil from Indonesia, it primarily imports electronic goods (electronic components and computer equipment) from the rest of ASEAN. In the latter industry, there have been major changes in the structure of imports from ASEAN, with a rise in the share of machinery and electrical goods, mainly components and parts. The trade structure between ASEAN and China is characterized by intra-industry trade: computers, machinery and electrical equipment make up 38.2 per cent of ASEAN's exports to China and 46.6 per cent of ASEAN's imports from China (Hefeker and Nabor 2002). As far as Korea is concerned, its export pattern has substantially changed over time, with a radical shift away from textiles into electronic products, refined petroleum products and chemicals. Moreover Korean electronic exports to China have shifted

14 According to some estimations, exports to China accounted for about 40 per cent of Korea's export growth over the past few years.

15 Moreover, as stressed by Yang (2003) there seems to be a long-term shift in the sourcing of China's imports from industrial countries to developing countries.

from consumer electronics to electronic components, telecommunication equipment and more recently computer equipment.

More importantly, about half of China's imports are for processing and re-exporting16 (Rumbaugh and Blancher (2004) and this holds particularly true for imports from the rest of Asia. The bulk of China's imports from neighboring East Asia are made of parts, components, and raw materials. East Asian countries are the major providers of intermediate inputs for China's export-oriented industries: Japan accounts for 25 per cent of Chinese imports of intermediate products and the NIEs for 40 per cent (Lemoine and Ünal-Kesenci 2002). During the 1997-2002 period, parts and intermediate goods accounted for 69 to 76 per cent of Korea's exports of manufactured goods to China (Lee Chang-kyu 2003). The change in the pattern of ASEAN exports to China is also dramatic, with a drop in the share of resource-based commodities and a rise in the share of manufactured goods, in particular electrical machinery and computer equipment.

The rise in East Asia intra-regional trade since the early 1990s has thus been largely driven by rapidly growing trade in parts, components and intermediate products that is a reflection of greater vertical specialization and the dispersion of production processes across borders**.** China is being largely used as an outward processing region for goods developed elsewhere in Asia.17 This has been described as the "Asian integrated circuit".

The pattern of China's trade, with most exports directed to industrial economies outside Asia and imports originating to a large extent from emerging and industrial Asia, reflects the existence of a pattern of triangular trade. China imports large quantities of parts, components and intermediate goods from other Asian countries for assembling and processing and exports finished products to industrial countries. China's exports are thus heavily import-intensive, with a substantial share of these imports originating from neighboring Asian economies (Japan, Taiwan, Korea, Malaysia)18. As a result, China runs a trade deficit with Asia and a trade surplus with the industrial world, while overall its trade is basically balanced. All this suggests that East Asia is still heavily dependent on outside markets despite the rise in intra-regional trade (Athukorala and Yamashita 2005).

The gain in export market shares by China is almost exactly matched by a fall in export market shares for other East Asian economies. As emphasized by Weiss and Shanwen (2003), China's gains of market share in the US must be assessed in association with the rise in intra-regional intra-industry trade and with the rise in East Asian FDI in China. These gains should not be misinterpreted and are due to exports of some assembled parts and components originally produced in neighboring East Asian economies. This is particularly true in the electronics sector where China's production and exports of information technology hardware (primarily computer equipment) are based on imports of high value-added parts and components originating from emerging Asia (Korea, but also Taiwan, Singapore, Malaysia or even the Philippines).19

16 On the export side, so-called processing trade accounts for the bulk of China's trade. In the electronics and IT industry processing trade has accounted for approximately 90% of China's total exports since 1995.
17 As a result, China runs a trade surplus with East Asia in consumption goods and a deficit in intermediate goods.
18 According to Ng and Yeats (2003), ASEAN has played only a minor role in the expansion of intra-regional trade in East Asia.
19 Electronic components account for more than 40 percent of Malaysia's and the Philippine's total exports to China, while it accounts for 32 percent of Singapore's exports to China.

Table 4 *US Imports from East Asia, 1990-2002 (in percent)*

	1990	1995	2002
Japan	18	16,5	10,4
China	3,2	6,3	11,1
Hong-Kong	1,9	1,4	0,8
South Korea	3,7	3,2	3,1
Singapore	2,0	2,5	1,3
Indonesia	0,7	1,0	0,9
Malaysia	1,1	2,3	2,1
Philippines	0,7	1,0	1,0
Thailand	1,1	1,5	1,3
Vietnam	0,0	0,0	0,2
Total Asia	*31,7*	*35,7*	*32,2*

Source: Direction of Trade Statistics, IMF.

The parallel drop in East Asian economies' US market share and increase in exports of these economies to China is indicative of the fragmentation of production processes and of the new regional division of labor, with assembly activities migrating to low-wage China, while higher wage (and better-skilled) countries specialize in the production and export of components.20 The close correlation between the fluctuations in Chinese exports to the US and in East Asian exports to China further supports the hypothesis that China is being used as an export-processing zone (Zebregs 2004). Despite the increased overall Chinese dominance in East Asian exports to the US market, there is still room for other exporting economies to carve out their own niches in the trade, but this involves changes in specialization. Although the rise in China's exports of electronics and IT products may have initially threatened neighboring economies such as Korea, Taiwan, Malaysia, Singapore and Japan, most of these economies managed to enhance their competitiveness by diverting resources to production and exports of particular lines of production for which they command a competitive edge. As a result of China's participation in regional production networks, the structure of Asia's electronics and IT industry has become increasingly diversified and competitive. At the same time, the organization of these very networks is likely to become increasingly complex.

For the time being, economic integration in East Asia is based on intensive vertical intra-industry (even intra-product) trade. This type of integration is in contrast to what can be observed within EU15, where intra-industry trade primarily involves end-use products with varietal differences.21 By contrast East Asian intra-industry trade is comparable to intra-industry trade between the US and Mexico. The only difference is that the expansion of East Asian intra-industry trade has taken place in the absence of any regional FTA.

Another feature worth mentioning is that FDI inflows in China have come increasingly from the rest of Asia, especially the NIEs. As suggested in Table 5, the rest of Asia accounts for more than 60% of all FDI flows to China. Moreover, Chinese direct investments in ASEAN have surged recently, rising 40% in 2004. This is a further indication of the rising degree of interdependence

20 The fragmentation of the production process has led to a redistribution of industrial activities within the region: the high value-added stages of production (both upstream – development of prototypes, conception, etc. –and downstream – brand and services) remain in the most advanced economies, while low value-added stages (assembling) are relocated in China. In terms of profitability, this is referred as the "smiling curve", a term coined by Stan Shih from Acer in 1992.

21 With the enlargement to EU25, the pattern of intra-industry trade is likely to evolve, with a rise in the fragmentation of the production process. As Arndt (2001) aptly put it 'the major gains from entry will not come from freer trade along established patterns but from the reorganization of production and the consequent integration of those economies into the production networks of the EU."

in the region. A major result of China's participation in the regional production networks is that *de facto* economic integration in the region has substantially deepened.

Table 5 *FDI into China by source country, 1983-2002 (in percent)*

	1983-1991	1992-2002	1983-2002
Hong Kong	58.7	45.1	45.8
Taiwan	0.0	7.6	7.2
Singapore	1.2	5.0	4.8
Japan	13.4	7.8	8.1
Korea	0.0	3.6	3.4
Sub-total	**73.1**	**69.1**	**69.3**
United States	11.1	8.8	8.9
Virgin Islands	0.0	5.7	5.4

Source: China Statistical Yearbook, various issues.
Note: Data for realized FDI.

Of course, the degree of regionalization may vary across sectors: some products are more suitable (amenable) than others to fragmentation of the production process (electronics is a case in point). Moreover, different types of regional networks may emerge. While the electronics and IT industry is highly export-oriented, the automobile sector caters exclusively to the Chinese domestic market. In both cases, however, China's industries are strongly dominated by FDI and foreign technology. In the future, however, with the rise in purchasing power, China can be expected to become a major export market for the neighboring industrializing East Asian economies. There should thus be increased room for inter-and intra-industrial specialization and exchange between Northeast and Southeast Asian economies. At the same time increased regional specialization may be expected because China and ASEAN countries in particular are all export-oriented and highly dependent on the advanced economies for supply of the necessary technology. In the automobile industry by contrast, there is a risk that China will gradually shift towards exporting. If such is the case, the MNC-dependent Chinese car-makers will be competing with other MNC-dependent East Asian car-makers. The likely scenario is that various global auto giants will choose to specialize in different classes and models of vehicles and different categories of auto parts and accessories.

China's FTA activism …

In addition to being at the center of regional production networks (thus contributing to the growth of intra-regional trade and FDI links and to the overall economic growth of the region), China has also risen as an active promoter of regionalism, in particular since the Asian financial crisis. Thanks to its stellar economic performances, China has been seeking lately to play increasingly the role of a regional leader, thus leading to a shift in the balance of economic power in the region. This has a number of implications, first a potential rise in the Sino-Japanese rivalry, and secondly a new pattern of possible economic coalitions in the region. The more assertive stance taken by Chinese authorities in the region cannot be ignored by its neighbors, which now have to account with this new partner.

Various initiatives taken by China reflect the country's resolve to become a regional leader instead (or ahead) of Japan.22 The first initiatives date back to the 1997-98 financial crisis, when China actively publicized its refusal to devalue the renminbi, allegedly in order to protect its neighbors from a new round of contagious devaluations. At the same time, Beijing also provided

22 See Hale and Hale (2003).

some financial assistance to ailing economies such as Thailand and Indonesia, as a way of showing its rising sense of solidarity.23 China also contributed to initiate the ASEAN+3 mechanism and gave its support to the Chiang Mai initiative (CMI).24 More recently, Chinese officials kept trumpeting that their refusal to let the renminbi appreciate (vis-à-vis the dollar in particular) was motivated by their concern about the possible negative impact this may have on neighboring economies. This move was again meant to be interpreted as being not only in China's interest but also in its partners` interest, since a revaluation could be expected to lead to a drop in exports and thus to have a negative impact on the rest of the region as well, given the tight economic relations now in existence in the region. These moves all point in the same direction and are clearly aimed at proving China's amicable stance towards its neighbors.

The China-ASEAN FTA (CAFTA) is probably the latest and most dramatic example of China's new regional policy. Zhu Rongji first proposed the possibility of a CAFTA at the ASEAN+3 leaders meeting in Singapore in 2000, and official negotiations started in November 2001.25 The framework agreement on Comprehensive Economic Cooperation was signed a year later, formally launching the process of establishing a CAFTA by 2010 for the most advanced ASEAN member countries and by 2015 for the others (Cambodia, Myanmar, Laos, and Vietnam).

Under the agreement, the first phase of a free market comprising a quarter of the world's population - 1.7 billion people – and an overall nominal GDP of 2 trillion dollars will be completed within eight years. Yet, under the so-called "early harvest provisions" (EHP), tariff reductions on a broad range of goods26 are planned to begin sooner. The far-reaching commitments made by China to open domestic sectors (such as agriculture and financial services) that are important to neighboring trading partners should allow them to gain from China's sustained growth. Yet overall, China can be expected to gain most.

The official motivation of the agreement is to take advantage of complementarities and build on existing strengths in order to make the region collectively more efficient and competitive, and to attract investment. Yet, additional considerations certainly motivated the initiation of the scheme. 27 Through this agreement China is trying to quiet its weakest (and most vulnerable) neighbors` concerns that it is swooping up the lion's share of regional foreign investment by allowing them to export their goods to the expanding Chinese market. At the same time, it may also be seeking to defuse criticisms by industrial countries (and thus potential trade conflicts). The agreement may also be considered as a necessary strategy to preserve outlets for its production. Through this agreement China is also pushing its strategic and political interests in the region. Chinese officials have actually made quite clear their desire to extend cooperation with ASEAN into the security sphere. 28

Yet, the CAFTA is only one of a series of regional trade agreements recently concluded by China.29 So-called Closer Economic Partnership Agreements were signed with Hong Kong in

23 Although the amount may have been symbolic, the gesture was meant to be perceived as amicable. See Vatikiotis (2003) for more details on this point.

24 Interestingly enough, China did not support Japan's proposal for the creation of an Asian Monetary Fund in 1998. The shift in China's stance may be explained by its desire to act either as a leader or collectively, rather than simply as a follower behind Japan.

25 There is disagreement among researchers about the reason for this Chinese initiative. Some authors see it as a defensive move in response to Japan's proposed FTA with Singapore, while others consider that China acted on its own (See below footnote 31).

26 These include meat, fish, dairy products, fruits, and fresh vegetables.

27 China's entry into WTO clearly makes this strategy less costly.

28 Political (or strategic) motivations may actually dominate economic considerations (Sheng 2003).

29 These agreements have been concluded in parallel to China's accession to the WTO. As a result, China is behaving exactly like the US, with multilateral and regional strategies being followed at the same time.

June 2003 and with Macao in October of the same year. Since both Hong Kong and Macao are very open economies, the CEPAs actually boil down to a one-sided series of concessions by China. It is probably in the services area that the largest benefits are to be expected.

An important feature of the agreements involving China is their diversity both in form and coverage, which makes the emergence of an Asian trade bloc based on these agreements less likely or at least quite problematic (Antkiewicz and Whalley 2004).

The latest Chinese initiatives are aimed at partners outside the region, adding further confusion to the overall picture. In particular China has signed two broad initial framework agreements with Australia and New Zealand in late 2003 and early 2004 respectively, and it is also currently discussing a possible agreement with the Gulf Cooperation Council. As for the latter arrangement, the aim is obviously related to China's concern with energy security.

and its implications

China's active economic diplomacy over the past few years has given a new momentum to regional initiatives: beyond boosting and accelerating the completion of the ASEAN FTA, it has certainly contributed to give momentum to Japan-Korea, ASEAN-Japan and ASEAN-Korea negotiations.

To be fair, China was not the first country to go for a regional approach to trade liberalization. The first RTA involving a North East Asian country was the Japan-Singapore New Age Economic Partnership Agreement that was negotiated throughout 2000 and came into force in the summer of 2002. In an attempt to respond to a perceived shift in investor attention to Northeast Asia, Singapore also took the decision to strike bilateral FTAs with a wide range of partners in the broader East Asian region (New Zealand and Australia), as well as outside the region (US).30 According to some (primarily Japanese) analysts31, the China-ASEAN FTA was actually a response to this Japanese initiative.

Be it as it may, because of its magnitude, the China-ASEAN agreement apparently sent a shockwave throughout Asia, and in particular Japan. As a result, in a complete turnabout from its earlier approach to trade negotiations, Japan started actively considering other FTAs within the East Asian region.32

First, a Japan-ASEAN initiative was launched immediately after the signature of the China-ASEAN framework agreement in November 2002. The six founding ASEAN members and Japan made a schedule to establish a FTA by 2012 and the four newer members (CMLV) by 2017. Yet, the discussions have proven to be rather difficult, with Japan showing no real commitment. A major complaint from ASEAN is the absence of a single chief negotiator on the Japanese side. By contrast four negotiators are involved, each representing the different Ministries concerned (METI, Ministry of Finance, Ministry of Foreign Affairs, and Ministry of Agriculture). Another sign is Japan's refusal to use the term "agreement" and insistence on referring simply to a

30 These FTAs are "WTO plus" in that they cover strong commitments in goods, services, investment, public procurement and more, all underpinned by dispute settlement provisions.

31 See for instance Munakata (2004) or Tsugami (2003). There is disagreement on this point, however. See the debate between Tsugami and Lincoln, *RIETI policy debate*, 2003.

32 China's activism can be said to partly account for the shift in Japan's stance away from multilateralism and in favor of regional trade arrangements. Yet other factors also certainly played a role, in particular the surge of RTAs in other parts of the world (America and Europe), as well as persistent difficulties faced by the multilateral trading system as exemplified by the demonstrations and the ensuing failure of the negotiations in Seattle in late 1999. According to Ogita (2002), Japan gradually shifted toward regionalism as of 1999 but the first FTAs were not signed before 2002.

"framework for a comprehensive economic partnership" rather than to a "Framework Agreement on Comprehensive Economic Cooperation". Formal negotiations were due to start in April 2005.

Japan also resumed discussions with Korea. The initial steps were taken as early as September 1998 when, in a discussion with Korea business leaders, the Japanese Ambassador to Korea mentioned the future prospect of forming an FTA between the two countries. A joint study was initiated between the two countries at the end of the same year but it took another couple of years before formal negotiations could start.

It is often believed that unless Japan and Korea enhance their competitiveness through a bilateral FTA, they could easily be overwhelmed by China. For these two countries, the natural response to the rise of China is thus to team up against their big neighbor. Japan itself apparently considers *a Japan-Korea FTA* as a possible response to the rise of China (Cho 2004). It is worth stressing at this stage that for the Japan-Korea FTA (JKFTA) to be beneficial for both countries (but in particular for Korea) it has to encompass a broad spectrum of issues, otherwise the only result will be a deepening of Korea's trade deficit with Japan (Ahn 2004). The implementation of a comprehensive agreement would indeed involve other important benefits, in the form in particular of a rise in service trade and dynamic effects through a new division of labor and industrial cooperation. The JKFTA should thus not be only aimed at tariff reduction. Competition may indeed be increased but so will be intra-industry trade. Strategic alliances for a more sophisticated division of labor may also be possible, as well as restructuring of over-capacities. To some extent, this is what the European economies sought to do with the creation of the Single Market in 1992. At the time, the major objective was no longer to abolish tariff barriers but to create a genuine single market that would allow firms to reap the benefits from economies of scale, thus easing the necessary restructuring of a number of industrial sectors, which had lost competitiveness to foreign, in particular Japanese, rivals.33

A further reason for both countries to go ahead with a JKFTA is that it may provide an external pressure to push with reforms and impose long overdue adjustments. Both countries tend to be plagued with inertia in their economic systems, hampering the progress of deregulation. They thus need the type of external pressure that is brought about by the dynamic cross-border movement of management resources such as people, goods and money under an economic cooperation agreement (Fukagawa 2003). Yet, for the time being, the negotiations seem to be stalled primarily as a result of Korea's lack of commitment. The major difficulty facing the Korean Government is how to sell the agreement to the public (in particular to the industrial lobbies) and how to mitigate the short-term (primarily social) impacts.

One of the latest move is the *Korea-ASEAN FTA* negotiations. This is probably the most ambitious of all three negotiations with ASEAN. Despite the late start (February 2005), the deadline for the implementation is set for 2009, one year earlier than for the China-ASEAN agreement and two years earlier than the Japan-ASEAN agreement. Korea and ASEAN are mutually important economic partners, they are the 5th largest trading partner for one another, while ASEAN is the 3rd largest destination for Korean outward direct investment (Yul 2004). The complementary relationship has given rise to an increasing volume of intra-industry trade.

Finally, bilateral negotiations also proliferate between Japan and individual ASEAN member-states. A draft agreement was concluded with the Philippines on a bilateral free trade deal, which would allow Filipino nurses and careworkers to work in Japan. Negotiations with Malaysia and Thailand are already under way, while a Japan-Indonesia study group comprising government

33 In the late 1980s, Europe was going through a period of sluggish economic activity which has come to be known as « eurosclerosis ». The Single Market scheme, which came into existence in 1992 was a response.

officials, business people and academics recently adopted a report recommending the two nations launch talks to conclude a bilateral FTA. While there have been talks of a Northeast Asian FTA as well as of a possible East Asian FTA, encompassing all ASEAN+3 countries, concrete steps are still to be taken in this direction.

3. Whither East Asian Economic Integration?

3.1 The CMI: A Shaky Starting Point for Monetary Integration

The CMI reflects a primarily defensive approach to the extent that it complements the IMF assistance mechanisms by providing some degree of collective defense against speculative attacks. For the time being, the scheme can qualify as financial cooperation34 rather than monetary cooperation, which involves agreement to coordinate the external value of the concerned currencies (Hamilton-Hart 2003). Combined with strict exchange rate commitments, it could be a framework close to the EMS, but such is not yet the case. Moreover, it departs from the logic of the European endeavor, since the point is not to stabilize exchange rates within the region, but to provide the means to weather external attacks more easily and more effectively. As it stands, the CMI framework cannot be an instrument of intervention supporting intra-regional exchange rate stability comparable to the European Monetary Cooperation Fund, since it is based on the dollar.

Although the CMI is often perceived as the first step on the road to deeper financial and monetary cooperation (and ultimately monetary union), a number of weaknesses make it a relatively *shaky basis*. A first weakness has to do with the amount of funds which can be mobilized under the present scheme. Although the financial commitments exceed anything that has been attempted before in the region, the amount available to an individual country appears too limited to serve as a credible and effective system of defense. Yet, this argument should not be overestimated: the ERM also started with rather limited swap provisions that were only extended through the Basel-Nyborg agreement in 1987.

As is the case with any other financial assistance mechanism, the CMI also raises a classical moral hazard issue, although it is to some extent solved by the link with IMF conditionality.

The existence of an "opt out clause" is a more serious source of concern. As recalled earlier, the decision to activate the swaps and credit lines is at the discretion of the lender. While this is revealing of a weakness in the commitment of the participating countries, more importantly this raises a classical free riding problem: a country can refuse to participate in the financial stabilization of the region and yet benefit from it (Park and Wang 2002). The only way out would be the emergence of a strong and effective surveillance mechanism. In the absence of surveillance mechanisms capable of anticipating and heading off crises, and in the absence of a specific body capable of imposing strict conditionality on the crisis country, countries with strong currencies and deep pockets are unlikely to accept to offer support to their weak currency counterparts.

The snag is that the prospects for the emergence of a strong and effective surveillance mechanism are rather gloomy. Given the region's track record in the area of institutional economic cooperation, and the strong tradition of non interference, surveillance and peer pressure can be expected to be limited in East Asia (Eichengreen (2002b). The future of the CMI clearly hinges

34 Financial cooperation is based on the provision of financial support in case of trouble. Availability of a pool of funds together with the mechanisms and rules under which support can be made available. Financial cooperation also often involves monitoring of financial markets. Monetary cooperation is often supported by crisis management facilities (commitments to provide financial support to defend currencies at their agreed-on value).

on the capacity of the countries' in the region to develop comprehensive surveillance and monitoring mechanisms.

A further problem is that there is, as yet, no clear vision of where the CMI should be heading to. East Asian countries have not specified clear common policy objectives beyond the CMI. The initiative provides one instrument of financial cooperation, but nobody knows whether this is (or should be) a first step towards tighter economic integration or not. In the absence of any clear blueprint for the future, the chance that the various weaknesses highlighted above will be dealt with is rather slim.

A final source of concern lies with the apparent loss of momentum in the cooperation drive over the past year or so. Because the fear of a new round of financial crises has receded, the interest has clearly shifted away from financial and monetary issues towards the establishment of free trade areas. While this may turn out to be complementary to (and positive for) monetary cooperation, it may also reflect a definite drop in political commitment.

The lack of a real leader in the region is a clear weakness and a liability for any attempt at economic integration.

To conclude on a more positive note it must be emphasized that the CMI is important for a number of reasons. First it reflects a rising commitment to regional cooperation on the part of the two heavy weights in the region, namely China and Japan, and this is a real sea change. It is also important because it may help in the definition of common goals and, possibly, common best practices. Finally, thanks to this scheme East Asia will not start from scratch once it opts for a more resolute form of monetary cooperation because some instruments and mechanisms of cooperation are already in place (in the form of regular meetings of central bankers, mutual surveillance mechanism, financial assistance facilities) even if they might need to be revamped or strengthened.

Another positive sign is the emergence of the Asian Bond Market Initiative (ABMI) in the context of ASEAN+3. The point of the initiative is to enhance the development of a regional bond market which would help reduce the reliance on bank financing as well as contribute to the recycling of some of the region's huge savings into regional investment. As a result, the risks of double mismatches (currency and maturity mismatches) that were at the heart of the 1997-98 crisis, are likely to be greatly reduced.

3.2 Trade Integration: Weak Prospects in the absence of Political Will

Even if the possibility of an East Asian FTA has been actively discussed at various ASEAN+3 meetings, concrete steps are still to be taken in this direction. For the time being, the two most advanced projects are the China-ASEAN FTA (CAFTA) and, to a lesser extent, the Japan Korea FTA (JKFTA). A major issue is to determine how these two groupings may relate with one another and interact. In this respect, the European experience may hold interesting lessons in store. It suggests that the coexistence of different (and to some extent rival) regional groupings in the same region is unlikely to be long lasting. In Europe, two regional groupings were formed in the late 1950s, the European Communities on the one hand and the European Free Trade Association (EFTA) on the other. 35 Very soon the success of the former over the latter led a number of EFTA member countries to seek accession into the EC, while the remaining EFTA

35 In its initial form, the EC encompassed six member countries : the three Benelux countries, France, Germany and Italy, while EFTA was made up of seven countries : Austria, the UK, Denmark, Ireland, Norway, Sweden and Switzerland.

member countries eventually established a FTA with the EEC. After a decade and a half, the two groups had collapsed into one, with the most complete and well-structured group prevailing over the other looser grouping. This experience suggests that the modalities of regional arrangements matter.

In East Asia, the nature of the two competing FTAs differs widely. Because Japan and Korea are both members of the OECD, the JKFTA will have to be WTO consistent.36 By contrast, the CAFTA was negotiated under the enabling clause provision rather than GATT article 24. As a result, the JKFTA is more likely to provide an appropriate starting point for an East Asian FTA than the CAFTA. Yet, for this to be the case it is important for Japan and Korea to provide a benchmark framework for a Northeast Asian FTA (encompassing China, Japan and Korea) and eventually an East Asian FTA (including ASEAN+3 countries).

A preliminary assessment of the CAFTA suggests that this scheme may turn to be much ado about nothing. Tensions are quite large between some member countries, as a result of dissatisfaction with the implementation of the EHP provisions for instance.

As far as the other initiatives are concerned, a major issue is the still hesitant Japanese policy.

More generally, defensive regionalism is still the rule in East Asia. And this does not provide a strong basis for deeper economic integration. The driving forces behind the various regional and bilateral FTAs are loosely related to regional integration. The primary objective is to preserve competitiveness, to defuse potential conflicts or to avoid being left out of the worldwide FTA trend. As a result, the emergence of East Asia as a well-structured regional grouping is still a long way off. For the time being East Asia has fallen prey to the "spaghetti bowl syndrome" with substantial inconsistencies between the various initiatives and a clear lack of vision as to how to reconcile them.

The prospects for deeper trade-related integration are thus not very bright, given the hesitant path followed so far. While it may be argued that competition between Japan and China for the leading role in trade integration could accelerate the process, this interpretation is probably over-optimistic. Actually, as of now, the competition among the major economic powers in the region bodes ill for the future of economic integration.

A final remark is in order regarding the leadership issue in the region. China and India are now respectively considered as the world's factory for mass production and the global software house for business process outsourcing. As a result, these two economies may be expected to increasingly complement each other in the future. If that happens, the emergence of these two economic powers is likely to change the leadership equation in Asia and a new regime of production networks would occur accordingly.

3.3 A Note on the link between trade and monetary integration

In East Asia, there is an apparent ambivalence towards regional economic integration. Recently, as recalled earlier, attention has tended to some extent to shift away from financial and monetary issues to trade integration (FTAs). While this development may reduce the momentum for financial and monetary cooperation, the opposite may also be true.

36 In the context of WTO rules, FTAs must cover "substantially all trade", and zero duties should apply across the board to all sectors. In other words, there should be no a priori exclusion of any sector or sensitive product.

Theoretically, there are many reasons to believe that trade integration and monetary integration are closely related. First, the criteria used to gauge whether or not groups constitute an Optimum Currency Area (OCA) – symmetry of shocks, similarity in production structures, large share of intra-regional trade, etc. – tend to be the same as those used to consider a priori if a regional trade grouping can be expected to be efficient (Naya 2002, Plummer 2002). As a result, countries which qualify for one form of integration automatically also qualify for the other.

A major issue is that of sequencing. A first strand of the literature suggests that exchange rate coordination/stabilization is a prerequisite for trade integration. Because barriers to trade are mostly non-tariff barriers (among which the existence of different currencies loom large37), exchange rate stabilization should be favored if the goal is to deepen economic (trade) integration. Some authors go as far as saying that without exchange rate stability any attempts at real integration are endangered. This is because large swings in real exchange rates imply large shifts in relative competitiveness of national industries, thus triggering protectionist pressures. In other words, fixed rates might not only foster trade; they might be necessary to have free trade at all (Hefeker and Nabor 2002). Following this reasoning, monetary cooperation in the form of a more active intra-regional exchange rate stabilization is a prerequisite for advancing with trade integration.

Exchange rate misalignments between trading partners may be costly for further reasons: as they impact FDI flows in a FTA, competition for such flows becomes fiercer. Exchange rate fluctuations must thus be avoided in order to minimize predatory behaviors.

On the other hand, the conclusion of a FTA can work as an engine of monetary cooperation by imposing constraints on the conduct of exchange rate policy in the partner countries. According to Eichengreen and Taylor (2003), there are two channels through which trade integration can promote exchange rate stabilization (monetary integration): the first one is purely economic (more trade leads to less exchange rate variability) while the second is political (more trade raises the value of exchange rate stability and strengthens the pressure in this direction).

In the case of East Asia, since the emergence of a region-wide FTA is unlikely in the near future, the prospects for monetary integration appear rather bleak. Yet the deepening of economic interdependence in the absence of formal trade arrangements may still help raise the odds of monetary integration. In particular, as the scope of intra-industry rises, the benefits of exchange rate stabilization can be expected to be large. This is because the expansion of intra-industry trade is likely to lead to a better synchronization of business cycles and thus to raise the odds of exchange rate stabilization. FDI considerations are also particularly relevant in the case of East Asia, where the competition for FDI inflows is particularly fierce. As emphasized by Kawai and Takagi (2000), there is a strategic interdependence in the choice of exchange rate regimes for neighboring countries that compete for exports in third markets and also for FDI inflows (Korea and Malaysia in the former case, China, Thailand and Indonesia in the latter). Because of the similarities observed in the specialization pattern of some (if not all) of these countries, a sensible strategy is to defuse the possibility of beggar-thy-neighbour competitive devaluations by promoting monetary co-operation so that the competition for FDI can be based on structural factors of competitiveness.

As shown earlier, the increasing participation of China in regional production networks has created a complex web of economic linkages and given rise to tighter interdependence within the region. This new state of play provides a renewed incentive to push for exchange rate coordination, but also to push for the deepening of economic policy monitoring as envisaged in

37 Other obstacles may take the form of norms/standards.

the surveillance mechanisms of the CMI. This is particularly important since the risks of instability38 are far from negligible in China. This form of cooperation may actually be more urgent than any kind of FTA.

3.4 Implications for the EU

The developments highlighted in the paper have implications at two different levels for East Asia's European partners.

First, from the point of view of European business, East Asia appears to be economically more tightly integrated than ever and also more competitive. The rising competitiveness of this region and the increasingly complex interdependence associated with the emergence of regional production networks pose a real challenge to European firms. Another important feature of the East Asian region is that it is still more a production base than a market place.

Secondly, in contrast to what has just been said, progress has been much slower at the institutional level. As a result, East Asia is unlikely to emerge as a coherent and a well-structured institutional grouping in the near future. The previous observations even suggest that the pursuit of regional integration cannot be taken for granted in East Asia and that the exact shape that formal regional cooperation may take is still to be defined. A major issue facing East Asia is that of the appropriate scope for regional cooperation. While the tendency has been to opt for a very broad approach in the past, encompassing the whole of the Asia Pacific region, including the US, there has been recently a shift towards East Asia, defined as ASEAN+3 (and possibly+5). This has a number of implications for the EU. The major implication is that the EU should opt for a multi-layered or multi-pronged approach to East Asia. In concrete terms, this means that the dialogue with East Asian countries will have to take place both at the individual (bilateral) level and at the inter-regional level, in particular between the EU and ASEAN for instance. All this suggests that there is scope to further develop the EU-ASEAN traditional dialogue and cooperation initiatives, as well as the ASEM process.

As far as the latter is concerned, the unlikely emergence of a full East Asian FTA in the not too distant future implies that the project for a FTA between the EU and East Asia is doomed to be fraught with difficulties because in particular of the need to define rules of origin in an appropriate way.

To end on a positive note, the distinct "asianization" of the regional integration process39 over the past decade definitely suggests, however, that the EU is less at a disadvantage vis-à-vis the US than may have been the case in the past in East Asia.

38 There are indeed quite a few factors of risk such as the rise in unemployment, which may fuel social instability, the sorry state of the financial system, or the widening regional income disparities.

39 As argued by some analysts such as Jusuf Wanandi, the only reason why Asian countries keep the APEC process alive is to avoid antagonizing the US, yet the momentum for deeper regional cooperation has definitely shifted toward exclusively Asian groupings, be they ASEAN +3 or sub-groupings within this area.

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Global Energy Security and its Geopolitical Consequences to EU-Asian Relations

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Global Energy Security and its Geopolitical Consequences to EU-Asian Relations

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1. Introduction

> "Recent geopolitical developments and surging energy prices have brought that message dramatically home. Major oil- and gas-importers – including most OECD countries, China and India – will become ever more dependent on imports from distant, often politically-unstable parts of the world. Flexibility of oil demand and supply will diminish. Oil use will become ever more concentrated in transport uses in the absence of readily-available substitutes. Rising oil demand will have to be met by a small group of countries with large reserves, primarily Middle East members of OPEC and Russia. Booming trade will strengthen the mutual dependence among exporting and importing countries. But it will also exacerbate the risks that wells or pipelines could be closed or tankers blocked by piracy, terrorist attacks or accidents. Rapid worldwide growth in natural gas consumption and trade will foster similar concerns."40

On March 8, 2005, the German industry had organized its first conference on energy and raw material security since 20 years.41 Until last summer, the industry was confident that the "*markets solve everything*". Neither the German Ministry on Economics nor the industry itself was considering the necessity to discuss supply security of energy sources and raw materials with the German Foreign Ministry or regional experts of foreign and security policies. The reason can be in that it becomes increasingly difficult for Western companies to compete on the global markets. The emergence of PR China as the world's leading consumer (overtaking the U.S. in 2004) and one of the largest importer of oil and gas as well as many industrial raw materials had been overlooked in Germany and many other EU member states until 2004. Indeed, in 2004, global oil demand grew at the fastest rate in over 25 years.

The faith in market mechanisms as a cure-all appeared to be as boundless as ever. In the last 20 years the dependability of the energy supply has been left to the private utility companies, whose corporate strategy, however, is primarily profit-driven. Scarcely anyone has felt ultimately responsible for safeguarding the future supply of energy. Although the October 2001 energy report by Germany's Ministry of Economics, for instance, put as much importance on reliable energy supply as on the political objectives of environmental compatibility and efficiency, the vulnerability of the international energy supply received little attention. And what scant treatment the subject did get was not the kind the *EU-Commission* desired when it published its "*Green Paper*" in November 200042 for stimulating debates on the future energy security in its member states.

Despite the terrorist attacks of September 11, 2001 in the United States, whose aftermath has once again focused world interest on the future political stability of the Middle East, the geopolitical factors affecting the international security of the energy supply tend to be less of a concern in many of the old EU member states than in the rest of the world. Although Germany's

40 So the executive summary, called "Energy Security in a Dangerous World" in: International Energy Agency (IEA), World Energy Outlook 2004, Paris 2004, here p. 29 f.

41 "Energy Security" is commonly defined as "the availability of energy at all times in various forms, in sufficient quantities, and at a affordable prices."

42 See European Commission, 'Green Paper. Towards a European Strategy for the Security of Energy Supply (adopted by on November 29, 2000), Luxembourg 2001.

Foreign Minister *Joschka Fischer* has justifiably and repeatedly pointed out energy's centrality to world politics, his foreign ministry evidently still sees no need to involve itself long-term in the future energy policy of Germany and the EU by offering expertise in regional, foreign, and security policy. In contrast to Germany, however, the *EU-Commission for Transport and Energy* and the foreign and security experts of the EU have intensified their work and analyses on the EU's future energy and supply security. Energy security has also been mentioned in the EU's first global "*European Security Strategy*"43.

Meanwhile, China has already replaced the United States as the centre of the world's raw material's market and price setter for these industrial raw materials.44 Moreover, in 2003, it has displaced Japan as the world's second largest energy consumer and oil importer after the U.S and surpassed Tokyo as the third largest exporter after the U.S. and Germany. Alongside of its growing hunger for energy resources and industrial raw materials, China has become much more pro-active in its foreign and security policies at both the regional as well as the global level. Obviously, Beijing's import dependencies on energy and raw materials have numerous consequences for and impacts on its present and foreign, security and defence policies.45

Indeed, as the *International Energy Agency's (IEA's)* executive summary of its "*World Energy Outlook 2004*" (see the quotation above) has indicated, the question of energy security - which connects disparate issues such as economics, national security, and increasingly the environment - could become one of the major global challenges of the 21st century.
The objective of this paper is to analyse the global energy developments, the increasing importance of geopolitical factors for the EU's and Asia's future energy security, the energy demand of China as well as Asia, the resulting geopolitical and security challenges for the future energy security of the EU and the consequences for the future interregional EU-Asian relationship. Special attention will be given to China's energy strategies of its oil and gas imports from abroad and the implications for its foreign and security policies in a regional and global context. Finally, I will also discuss the importance of the potential energy resources in Central Asia and Russia for China's growing energy consumption and to which extent it may influence the future bilateral EU-China and interregional EU-Asian relationships (competition or cooperation)?

2. Market Strategy or Strategic Approach for Maintaining Global Energy Stability? – The Rising Importance of Geopolitical Factors

> "By and large, deregulation of energy markets has meant that the establishment of inventories and the determination of their size have been left by governments to the markets to decide, except in the case of government-held emergency stores. But markets do not always send fully accurate signals.

43 Moreover, in 2004 the British Foreign & Commonwealth Office has published an international "*Energy Strategy*" with its specific foreign policy view43, while the foreign ministry of the Netherlands plans to finish a similar paper during summer 2005. These differences between the EU member states also highlight their different energy policies and priorities which makes any coherent international energy security strategy of the EU difficult to implement, until it acquires a supranational authority to do it. Despite giving the EU more power and influence in the realm of energy policies in its constitution, it remains a field where member states and the *EU Commission* have to share their competence and authority.

44 See also David Hale, China's Growing Appetites, National Interest, Summer 2004, pp. 137-147.

45 See also F.Umbach, Global Energy Security: Strategic Challenges for the European and German Foreign and Security Policies, pp. 122 ff. and idem, Future Impacts of Chinese and Asian Dependency on Energy Imports from the Middle East and Central Asia, in: Erich Reiter/Peter Hazdra (Eds*.), The Impact of Asian Powers on Global Developments*, Heidelberg-New York 2004, pp. 143-163.

That is in part result of lack of market transparency and the realities that with imperfect information market participants tend to take the short view."46

Strategies to enhance energy security can be differentiated between a "*strategic approach*" (or "*geopolitical approach*") and a "*market strategy*" (see *Table 2*). The first strategy describes primarily state-sponsored economic measures with political initiatives, whereas the latter relies on the national and international energy markets that seek to reduce the risk of disruption by improving the efficiency of these markets and includes government interventions.47

Since the 1980s, the EU and Western energy companies have followed increasingly a market strategy to solve their pressing energy problems. Although it had helped to stabilize regional and global energy security, geopolitical factors have played anew an increasing role in international debates. For discussing these new strategic trend, the recent history also offers important lessons to learn anew in order to address the future challenges of energy security.

Basically, there are three sources of threats to secure energy supply: economic, physical and environmental. They can also be divided into global and local energy security challenges (see also *Table 1*). Any disruptions to energy supply, whether actual or threatened, can have dramatic effects on society and the economy as we have seen over the last two years in California, New York, France and most recently in Italy. Historically, we have witnessed three major disruptions during the last decades: during the 1973 Arab-Israeli war, the Iran-Iraq war between 1980-1988 (first Gulf war) and the international war against Iraq after Saddam Hussein invaded Kuwait in 1990/1991. They were all associated with an increase in consumer prices, a rise in unemployment rates and a decline in gross national product. But these supply disruptions had only short term negative effects.

Table 1 *A Working Classification of* ***"Energy Security"*** *Events*

Classification	Event
Global events	
a. Policy discontinuity	Reduction in output by producers, to raise prices
b. Fundamental discontinuity	Global shortage of production capacity
c. *Force majeure* disruption	Civil unrest, war, deliberate blockage of trade routes
d. Export disruption	Export cut-back by main exporters
e. Embargo disruption	Embargo by importers of a specific exporting state
Local events	
a. Embargo disruption	General embargo of specific importing state
b. Embargo disruption	Embargo of a specific importing state by a specific exporter or transit state
c. Logistical disruption	Accident, incident or terrorism, especially along transportation infrastructure
d. Local market disruption	By monopolist suppliers, by pressure groups, or through government mismanagement

Source: Philip Andrews-Speed/Xuanli Liao/Roland Dannreuther, 'The Strategic Implications of China´s Energy Needs', IISS-Adelphi Paper 346, Oxford University Press, 2002, p. 14.

The disruptions of oil supply in the 1970s, which were both economic and physical, led to international action to improve supply security through a package of new measures, including the newly created *International Energy Agency* (*IEA*) in Paris. The major Western energy importers have sought to ensure security of energy supplies in the following six ways since the mid-1970s:

46 Edward Morse/Amy Myers Jaffe, Strategic Energy Policy, here p. 26.

47 See Philip Andrews-Speed/Xuanli Liao/Roland Dannreuther, 'The Strategic Implications of China´s Energy Needs', IISS-Adelphi Paper 346, Oxford University Press, 2002, here p. 18 f. and Yuji Nakamura, 'The Historical Flow of Black Gold. Two Approaches to Energy Security', IIPS Policy Paper 282E, January 2002.

- by diversifying their energy mix, avoiding over-reliance on a single fuel;
- by diversifying their sources of imported energy;
- by pursuing the exploitation of domestic energy resources;
- by building up strategic reserves of oil on their own territories;
- by promoting energy efficiency and reducing the energy intensity/improving energy efficiency of their economies; and
- in the case of the US in particular, by actively taking a role in policing the Middle East.48

Emergency strategic reserves of oil and gas and traditional crisis measures, such as those set up by the *IEA* in 1974 at a level of 90 days of net imports and by Community legislation, have provided an important response to any external supply threats or supply interruptions of energy sources. But the history and experiences of negotiations within the EU have also indicated that effective co-ordination and co-operation are extremely difficult to achieve in practice. As the EU's *Green Paper* of November 2000 admits, for instance, during the Gulf War in 1991, it was the US *Strategic Petroleum Reserve* rather than the strategic stocks of the IEA that spearheaded proactive intervention in the oil markets.49 It is explained by the fact that the EU itself has no mandate and related centralized decision-making mechanisms through which oil could be released onto the market. Furthermore, the lack of a clear definition of a crisis that would trigger the oil distribution plan has forced member states in the 1990s to set up their own independent inventories or strategic reserves for certain energy products.

However, during the last decade the principles of subsidiary and liberalisation as well as deregulation have given the EU member states more responsibilities for governing their own energy stocks, reserve planning and crisis mechanisms in the event of a disruption to supplies. The political instability in the Middle East and Persian Gulf had persuaded many energy consuming nations to diversify their oil resources since the mid-1970s. Thanks to the more developed financial markets and more secure investment environment in Norway and the United Kingdom, investors have expanded their oil and gas production in the North Sea with attractive fiscal terms. Moreover, the increasingly widespread use of three-dimensional seismic imaging, horizontal drilling and subsea well completion technologies have all helped to expand domestic oil and gas production and to reduce development and reduction costs as like.

But this high level of oil production rates in the North Sea will also lead to a rapid depletion of oil fields by 2020. In 2001, the EU's total oil production was 3.2 mb/d. As much as 77percent came from the UK and 11 percent from Danish sectors of the North Sea. The EU's oil dependence on OPEC countries accounts for 42 percent. Meanwhile, Great Britain has already become a net importer of oil. The peak of its oil production was back in 1999. In 2-4 years, it will also become a net importer of gas. Norway - the eighth largest oil producer and fourth largest gas exporter in the world – also had to cut its natural gas reserves by 30percent just few years ago.50 Norwegian oil and gas companies are now focusing their future activities increasingly to the Barents Sea and

48 See Julian Lee, 'International Energy Security: Prospects and Problems', in: Krause, Joachim/ May, Bernhard/Niemann, Ulrich (Eds.), 'Asia, Europe and the Challenges of Globalization', Lectures. From the First ASEF-Summer School 1998, Singapore, June 1999, S. 165-186 (165 and 173).

49 See European Commission, 'Green Paper. Towards a European Strategy for the Security of Energy Supply', here p. 29.

50 See FAZ, 26 July 2003, p. 10.

the Arctic where around 25 of the world's undiscovered oil and gas reserves are expected (including areas of Russia and Alaska).51

The globalization of oil markets has made energy independence an anachronistic objective of energy policies on the consumers side whereas energy interdependence has become a reality that requires intensive international cooperation. In this respect, oil security can be understood less as an attempt by any consumer countries and more in terms of the integrated world oil market. But while the increasing reliance on market forces have indeed enhanced energy security, globalisation's market dynamics alone cannot guarantee full access to energy — particularly not in regions in which market forces have a mixed record and which are internally unstable, externally aggressive, and pursuing weapons of mass destruction such as the Greater Middle East. Although the world is not confronted with an overall shortage of energy resources (the end of the oil age will last for at least another 40 years), geopolitical factors nonetheless can constrain their availability. If political factors such as crisis and conflicts were to block the development of new promising oil fields in the Middle East, the ramifications for world oil markets could be quite severe unless measures are taken immediately to diversify to other energy fields. In this context, the following global security factors need to be taken into account for any future debates:

High Concentration of Energy Resources: The Middle East alone has 65percent of all globally proven oil reserves and 34 of all proven natural gas reserves. But given the fact that until 2020, the world energy demand will rise by almost 50percent, the Persian Gulf must expand its oil production by almost 80percent in this timeframe.52 But this is only achievable if sufficient foreign investment is possible, if Iran and Iraq are free of sanctions and the entire region remains politically stable!

Internal Conflicts and Domestic Stability of Export Countries: The violent unrest in the Niger Delta of Nigeria is showing the future risks of energy security in which corruption in the use of oil income and inequality in regional distribution of oil income have led to political protest and internal violence. Thus access to oil revenues enables authoritarian regimes to avoid public accountability, and has often hampered rather than fasten the transition to more pluralistic and democratic societies in the world.53

By 2020, 50percent of estimated total global oil demand will be produced by countries that pose a high risk of internal instability (and a crisis is seen as highly likely until then, particularly by at least 10 of the 14 top oil-exporting countries)54 and close to 40 percent of the world's oil supply is produced in countries that had in 1999 not signed or ratified the main UN human rights conventions or were subject to major criticism by the *U.S. State Department* and human rights organizations.55 Of the seven countries that the U.S. has designated as sponsors of terrorism and "*rogue states*", five (Libya, Iran, Iraq, Syria, and Sudan) are energy producers; three (Libya, Iran, and Iraq) are major producers that top the world oil market; and two (Iran and Iraq) together possess close to 20percent of the global proven oil reserves.

51 See Financial Times (FT), 29 December 2004, p. 7.
52 See 'The Geopolitics of Energy into the 21st Century. Volume 1: An Overview and Policy Considerations, Washington D.C., November 2000, here p. XVI.
53 See Michael L. Ross, 'Does Oil Hinder Democracy?', in: World Politics, April 2001, S. 325-361.
54 See 'The Geopolitics of Energy into the 21st Century. Volume 1', Washington D.C., November 2000, here p. XVII and XXI.
55 See 'The Geopolitics of Energy into the 21st Century. Volume 3: The Geopolitical Outlook, 2000-2020, Washington D.C., November 2000, here p. 13.

Furthermore, terrorist attacks on oil and gas pipelines or crude thefts of oil have increased world-wide, albeit they hitherto had only local impact.56 Nonetheless, the security of transporting energy sources will become another important challenge to cope with. Thus global LNG output is projected to rise 89percent from today up to 375 billion cubic meters in 2010. The U.S. gas consumption for instance will then grow from 3 to 10 percent.of global consumption. 57

Multiple Crisis and the Lack of Spare Capacity: In times of crisis and conflict, additional capacity to pump oil and deliver natural gas is more limited than ever. A particular challenge for the stability of global energy security are multiple crises as we have witnessed in 2002-2003 when Venezuela's oil production declined from almost 3mb/d to some 400,000b/d in early 2003 due to country-wide strikes to bring down President Hugo Chavez which were pushing oil prices above $30 per barrel. At the same time, the 3 November 2002 earthquake in Alaska and the unrest in oil-provinces in Nigeria, export disruptions in Colombia as the result of guerrilla attacks on oil facilities and pipelines, terrorist attacks on a French oil tanker, a failed *Al-Qaeda* plot to sabotage oil facilities in Saudi Arabia as well as continued instability in the Middle East (Iraq-war) and Indonesia all contributed to a growing sense of insecurity of sufficient oil supplies and the inherent risks of relying too heavily specifically on Middle Eastern oil supplies.58

In April 2003, the theoretically available spare oil production capacity of 7.3 mb/d had already dropped to between 0.7 and 1.2 mb/d. To reduce the international price of oil, Saudi Arabia raised its oil production by 2 mb/d, delivering up to 10.3 mb/d. The United Arab Emirates were likewise able to boost their production (by 400,000 mb/d), but Venezuela, Indonesia, Nigeria, and other leading oil-producers either no longer had any appreciable reserve capacities or had their own domestic political crises and production stoppages to deal with. At such levels, even Saudi Arabia's ability to raise production ("*the energy equivalent of nuclear weapons*"59) had its limits. In previous decades the world's surplus production capacity, including OPEC's, was never this low. The 10 OPEC members alone have lost more than 1 mb/d over the last two years by raising their oil production to compensate for production stoppages in Venezuela, Indonesia, Nigeria, Iraq, and other countries. International experts contend that Saudi Arabia (the "*central bank of oil*") could increase its production beyond 12 mb/d should further stoppages occur throughout the world. An additional 200,000 barrels per day could come from other members of OPEC and, theoretically, less than 1 mb/d from non-members. But the *International Monitory Fund (IMF)* has recently warned OPEC countries to increase their spare production capacity to 3-5 mb/d in order to ensure the future stability of world economy.60

"Cheap Oil" as a Source of Economic and Political Instability: Given the high dependence of many oil producing countries on its oil revenues, a dramatic decline in global energy consumption as the result of an economic recession and accompanied by a higher decline of international oil prices could trigger domestic or even regional instability in many of the world's major energy-exporting countries.61 In 1998 during the Asian financial crisis with its world-wide impacts, several oil exporting countries faced a decline of 50percent in their national incomes within a year that caused severe political and economic repercussions. At the end, governments

56 See also Ed Blanche, 'Terror Attacks Threaten Gulf's Oil Routes', Jane's Intelligence Review (JIR), December 2002, pp. 6-11 and Barry James, IHT, 7.3.2003, p. 2.

57 See Wall Street Journal Europe (WSJE), 13-15 May 2005, pp. M1 and M5 (M1).

58 See IISS, 'Strategic Survey 2002/3. An Evaluation and Forecast of World Affairs', Oxford-London 2003, pp. 41 ff.

59 See Edward L. Morse./James Richard, 'The Battle for Energy Dominance', Foreign Affairs, March-April 2002, S. 16-31.

60 See 'Oil in Troubled Waters. A Survey of Oil', the Economist, 30 April 2005, here p. 5.

61 See also Amy Myers Jaffe/Robert A. Manning, 'The Shocks of a World of Cheap Oil', in: Foreign Affairs, January-February 2000, pp. 16-29.

changed in Algeria, Brunei, Indonesia, Nigeria, and Venezuela as those losses exacerbated other national problems.

Development Costs: It is estimated that approximately $300 billion is required for the development of new oil and natural gas fields in the six member states of the Gulf Cooperation Council. The IEA has estimated that world-wide investment in the energy sector will come to $16 trillion by 2030. At the most recent meeting of the Asia-Pacific Economic Cooperation (APEC) even conservative estimates of the investment required to achieve average economic growth of only 3.5 percent in the region by 2020 went as high as $4.4 trillion for Asia's oil infrastructure alone—despite the decision by the ASEAN nations to follow China's example and recover about 10 percent of all the energy they consume.

U.S. Embargoes: The U.S. embargoes on Iraq, Iran and Libya, which together possess 22percent of the world's oil reserves, have constrained the development of the petroleum sectors in their countries which could be an important source for alternative supplies in any major supply interruptions.

*Impacts of the Revolution of Military Affairs (RMA) on Regional Stability and Energy Supply Security: A*dvances in weaponry and the *RMA* have led to an arms build up in the Middle East as well as in the Asia-Pacific (the two most important regions for the future energy security challenges), whereas defence expenditures have been reduced in the rest of the world during the last decade. These technology acquisitions have increased the military capabilities of many countries in these two regions and therewith the vulnerability of shipping routes around the world, but particularly in regard to *Sea-lane of Communications* (*SLOCs*) and sea-lane choke points in the Indian Ocean, Southeast Asia and East Asia as major routes for energy transport. The *Strait of Hormuz*, for instance, is a choke point through which some 30percent of world oil exports is being shipped and which may rise up to 38percent of world exports in 2020.62

Hence regional stability and security are pre-conditions to ensure access to, and the free flow of energy resources. Furthermore, the once sharp dividing line between foreign, domestic and economic policies is increasingly blurring in the age of globalisation. Against this background, new crisis management mechanisms need to be developed as the result of those liberalisation processes that give the companies and regulators more responsibilities which are still not clearly defined. It is also important to analyse the changing structures, patterns and relationships in the energy field such as the changing future geographic location of global refinery capacity which will also be based in the same highly unstable countries in the Middle East and the Asia-Pacific.

62 See 'The Geopolitics of Energy into the 21st Century. Volume 3, here p. 33.

Table 2 Summary and Classification of Possible Measures to Enhance Security of Oil Energy Supply

	`Strategic Approach`	**China´s `Strategic` Measures**	**`Market` Approach**	China´s **`Market`** Measures
Supply-side economic measures to reduce probability of disruption	Control through state companies Self reliance Investment in domestic and overseas production and transportation	***	*Liberalise energy markets:* Integrate with international markets Encourage domestic and international investment in production and transportation	*
Demand-side economic measures to reduce probability of disruption	*Use administrative measures to:* Increase energy efficiency Adjust transport policy Diversify transport fuels	*	*Use market measures to:* Increase energy efficiency Adjust transport policy Diversify transport fuels	*
Political measures to reduce probability of disruption	Enhance political links with energy exporters Outward investment and aid to energy exporters	**	Promote the efficient functioning on international energy markets	*
Measures to reduce impact of disruption	Strategic storage Oil sharing Emergency response procedures Fuel switching Surge capacity	*		

* Relatively low priority to date.; ** Substantial measures implemented.; *** Core component of current strategy.

Source: Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther, 'The Strategic Implications of China´s Energy Needs', IISS-*Adelphi Paper* 346, Oxford University Press, 2002.

3. The EU's Energy Security and its Rising Concerns about the Future Supply Security

> "As long as the EU fails to develop means to reduce the influence of the international markets, this situation will remain the Achilles heel of the European economy and its ability to influence dialogue at world level will remain limited. As a result, the Union will be unable to pull its weight in international political debate."1

Historically energy questions dominated the negotiations leading up to the treaties of Paris (1951) and Rome (1957), but the specific institutional provisions were made just for coal and nuclear industries (leading to the *EURATOM* treaty in 1957). With regard to oil, gas and renewable energy sources, each EU member has been free to decide for their own national energy policies. Since the first oil crisis, Europe's economy has grown faster than its energy consumption. EU members possess only about 0.6percent of the world's proven oil reserves, 2.0percent of the global gas reserves and, at least, 7.3percent of proven coal reserves. In 2001, the EU produced 4.1percent of the world's crude oil, 9percent of global natural gas, and 11percent of the world's coal. With the enlargement, the EU has only be able to increase its coal reserves substantially (by 41 percent), but not of its oil and gas reserves.

Since the first oil crisis, Europe's economy has grown faster than its energy consumption. While world energy consumption has risen since the first oil crisis, the EU was able to reduce its external energy dependence from 60percent in 1973 to 50 percent in 1999. Since 1986, its energy demand has been growing just at a rate of just between 1-2 percent annually. Only the demand for electricity has grown faster. In 1999, it was generated by nuclear energy (35percent), solid fuel (27percent), natural gas (16percent), hydro and other renewables (15percent) and oil (8percent). The future new capacity will be predominantly generated by gas while the number of oil and solid-fuel power stations will further decline. With the EU's enlargement policies by accepting new East European countries, Europe's energy dependence will reach even more worrying perspectives. Natural gas imports, for instance, may rise from 60 percent to 90 percent and oil from 90 percent to 94 percent of demand. In 2002, the EU accounted for 16 percent of world energy consumption with just 6percent of the world's population. In more detail, it represented in 1999 for 19 percent of world oil consumption, 16 percent of natural gas, 10 percent of coal and 35 percent of uranium.

In November 2000, the EU's "*Green Paper*" ("*Towards a European Strategy for the Security of Energy Supply*") is warning that in the next 20-30 years up to 70 percent of the Union's energy requirements (presently 50percent) will have to be imported. In regard to oil, EU's dependence could reach 90 percent for oil, 70 percent for gas, and 100 percent for coal.2

In 2020, 45 percent of oil imports may come from the Middle East and more than 60 percent of natural gas from Russia. Thus the EU's long-term strategy for energy supply security has to cope with uninterrupted physical availability of energy products on the market, at a price which is affordable for all private and industrial consumers. Moreover while respecting environmental concerns has become an even more important objective in the light of the *Kyoto-protocol*.

The *European Commission*'s "*Green Paper*" has defined "*energy supply security*" as follows:

> "Security of supply does not seek to maximise energy self-sufficiency or to minimise dependence, but aims to reduce the risks linked to such dependence. Among the objectives to be pursued are

1 European Commission, 'Green Paper. Towards a European Strategy for the Security of Energy Supply (adopted by on November 29, 2000), Luxembourg 2001, here p. 28.
2 See ibid and IEA, World Energy Outlook 2002, Paris 2002, pp. 177 ff.

those balancing between and diversifying the various sources of supply (by product and by geographical region."3

In the view of the EU Commission, security of supply is – together with environmental protection and economic efficiency – one of the three fundamental objectives of the Union's energy policy. The *Green Paper* has raised concerns in regard to increased external dependence over the next few decades. It has therefore criticized the five (Germany, Sweden, Spain, Netherlands and Belgium) out of eight EU member states (the other three are France, the United Kingdom and Finland) with nuclear power who have adopted or announced a moratorium for nuclear power or decided to give up nuclear energy production. Presently, nuclear energy does play a vital role — in 2002 it produced more than 35percent of electricity in Europe compared with just over 1percent from wind power — in the sustainable production of electricity. It is also the only industrially mature energy source with negligible greenhouse gas emissions, which can be expanded. The *Green Paper* concluded starkly that the EU would not meet its obligations under the *Kyoto-protocol* without nuclear energy. Annually, it avoids some 300m tonnes of carbon dioxide emissions – equivalent to half the amount produced by all the cars in the EU.

Table 3 *European Energy Demand 1999-2030*

Energy Sources	1999 (in percent)	2030 (in percent)
Oil	41	37-38
Gas	22	29-34
Coal	16	10-19
Fossil Fuels combined	79	86
Nuclear Energy	15	6-8
Renewable Energies	6	8-11

Source: European Commission, 'Green Paper. Towards a European Strategy for the Security of Energy Supply' (adopted by on November 29, 2000), Luxembourg 2001, here p. 3 and IEA, World Energy Outlook 2002, Paris 2002, here p. 184.

Against this background, some of the EU member states are presently re-thinking the nuclear option as the *EU Commission*, the *IEA*, the *World Energy Council* (*WEC*), and numerous international energy experts are urging precisely that. Even Germany's unilateral withdrawal from the use of nuclear power may not last the coming years when another coalition government were to win the next national elections (scheduled for autumn 2005). Finland, France, Russia, Italy, and many new Central European members of the EU have already indicated that they do not want to renounce the nuclear power option. In fact, the construction of new nuclear power plants is being declared or seriously considered. Meanwhile, even Sweden no longer precludes the possibility of rethinking its decision to close down its nuclear power plants. For economic, technological, and political reasons, the nuclear power option is also undergoing a renaissance in the United States and particularly in Asia.

If no significant changes are made in Europe's energy policy, the total energy picture in 2030 will still be dominated by fossil fuels (*Table 4*). Although the energy demand is projected to rise much slower than GDP between 1998 and 2030, gross energy demand is expected to be 11percent higher in 2030 than in 1998. Against this background, the EU calls for a mix of energy strategies that include maintaining nuclear energy, improving energy efficiency, changing consumer behaviour through taxation measures and others as well as doubling the share of renewable energies in the overall energy supply quota (from 6 to 12 percent)

3 European Commission, 'Green Paper', here p. 2. See also Ulrich Hartmann, 'Eine europäische Energiepolitik ist gefragt', Internationale Politik (IP) 1/2001, pp. 17-23.

Table 4 EU Natural Gas Usage Projections in 2020

EU Natural Gas Usage Projections in 2020 (assumes no enlargement)			
Scenario	No Replacement	If Nuclear replaced	If Nuclear and Coal Replaced
Zero Economic Growth	370 bcm	605 bcm	820 bcm
Slow Economic Growth	405 bcm	665 bcm	900 bcm
Fast Economic Growth	500 bcm	815 bcm	1100 bcm

Source: EIA, here following: 'Europe's Energy Needs', Stratfor.Com, 6.11.2000 , here p. 2 f.

Moreover, the expansion of natural gas as an environmental clean energy source will also play a very important factor in the next two decades for the EU member states. In this regard, the EU and Russia with its 48 trillion cubic meter reserves have declared an "*energy partnership*" in October 2000. Gas consumption is expected to increase from 370 billion cubic meter (bcm) to up to 820bcm. But these figures assume no increase in overall energy consumption. If the energy consumption is increasing by 0.4percent annually (as expected as in the U.S.) until 2020, then the EU gas consumption could rise to 900bcm. If new EU members are included then the overall projected gas consumption for the enlarged Europe is approximately 1250bcm (in current prices some $125 billion a year). Against this background, the *IEA also* projected a greater increase of natural gas imports to Europe (81percent) than the *European Commission* (70percent) until 2020.4 But whether the EU will expand its import dependence on Russia particularly in regard to natural gas by more than 50percent after 2010 is uncertain due to important political issues and Russia's energy policies themselves (liberalisation, privatisation and deregulation). But meanwhile the *IEA* as well as the British and French governments have warned Germany of not becoming too dependent on Russia.5 It would also have implications for other EU member states such as the new members who try to diversify their oil and gas imports in order to reduce their high dependence on Russia (up to 90 or even 100percent).

Table 5 Potential Natural Gas Exporters for Europe (mt)

Supplier	**Reserves**	**Production in 2000**	**Exports in 2000**
Kazakhstan	1500-2300	7	-0.8
Azerbaijan	310	5.6	0
Nigeria	3500	5.5	0
Saudi Arabia	5800	47	0
Libya	1300	6.5	1.1
Iran	23000	54	2.8
Qatar	8500	20	4.8
Uzbekistan	2100-2500	56	15
Turkmenistan	2900	25	21
Russia	48000	600	205

Source: EIA, here following: 'Europe's Energy Needs', Stratfor.com, 6.11.2000 , here p. 4.

Meanwhile, the *European Commission* has tried to get more control over Europe's oil stocks in an attempt to reduce price volatility and to deal with the increased risks of energy supplies after September 11, 2001. It has favoured a plan to increase the oil stocks from 90 to 120 days of net imports and to acquire powers – at present stocks are shared under rules of the *IEA*, but held within member states - to take decisions over them in times of urgency, in co-operation with producer countries. At the same time, it also wants to build up new strategic reserves of gas and a

4 The *IEA* figure is based on a GDP growth of 1,9% and an increase of the overall energy consumption of 0.7% in Europe – see IEA, World Energy Outlook 2002', Paris 2002, pp. 177 ff.

5 See FT, 12 January 2005, p. 2 and ibid., 3 December 2004, p. 1.

mechanism for sharing gas for 60 days in the event of supply disruption and a mechanism for sharing gas among member states.6 But whilst growing energy dependence on Russia becomes almost unavoidable, the EU also seeks to minimise that as well as manage it better than in the past. However, France, UK and others have objected to those proposals by the *European Commission* because they want oil and gas stocks to remain under the auspices of the *IEA* rather than passing more power to the EU. In September 2003, the EU Parliament rejected large parts of the EC's proposed measures by neglecting a global view and overlooking the increasing (and not decreasing) risks of its external dependencies from politically unstable regions and other geopolitical factors described above.7 There are at least six reasons for its increasing concerns:

Firstly, Given the high concentration of oil and gas resources in few regions and countries, the EU has only limited options to diversify its energy imports. The expected decline in oil production in places like the US and the North Sea will almost certainly be made up by increases in countries where internal politics will impose major risks of interrupted production.8 Although Russia has always fulfilled it supply obligations under its long-term contracts with the EU since the beginning of the 1980s, which reflects the economic-financial interdependencies between the EU and Russia, Moscow's pipeline plans and policies are not just determined by economic considerations but also by foreign and security factors. Despite their declared "*strategic energy partnership*", both sides are following very different philosophies and strategies.

Secondly, taking into account that the EU has for over 40 years failed to develop a consistent common energy policy within both the EU and the *International Energy Agency* (*IEA*), the EU – as its "*Green Paper*" has criticized - lacks the means and tools to negotiate and exert pressure vis-à-vis the OPEC members as well as other energy producer states - and therewith often any substantial bargaining power.

Thirdly, on the global level, the primary energy demand is projected to increase by 1.6percent per year on average from 77 million barrels per day (mb/d) in 2002 up to 121 mb/d in 2030. Although renewables and new technologies (such as the fuel cell) are becoming more important, they will reportedly be unable to contribute much to the global energy supply until after 2025 or 2030. Crude oil - accounting for 37 percent of the world's energy mix - will remain the world's most important global energy source, thanks to the expansion of the transport sector, whose share of total oil consumption will rise from 47 to about 55 percent. Thereby, almost all the increase in energy production will occur in non-OECD countries.9

True, the increase in global known reserves of oil and natural gas has accelerated again since 2000, making a global energy crisis unlikely in the short or medium term. But oil prices are likely to outpace that growth, because the global equilibrium between oil demand, oil production, and oil reserves will shift, because the costs of oil exploration in deep seas as well as in remote and relatively inaccessible regions like the Arctic will soar. OPEC countries alone will produce approximately 55 to 65 mb/d of that total, pushing OPEC's share of global oil production from its current level of 32-38 percent to more than 50 percent. Emerging countries will also be responsible for 29 mb/d of the forecast world-wide increase in oil consumption of up to 45 mb/d.

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6 See Daniel Dombey/David Buchan, Financial Times (FT), 10 June 2002, pp. 1 and 2.

7 See Daniel Dombey, FT, 22.2.2003, p. 4.

8 Although Russia has always fulfilled it supply obligations under its long-term contracts with the EU since the beginning of the 1980s, which reflects the economic-financial interdependencies between the EU and Russia, Moscow's pipeline plans and policies are not just determined by economic considerations but also by foreign and security factors. Despite their declared "*strategic energy partnership*", both sides are following very different philosophies and strategies.

9 See International Energy Agency (IEA), World Energy Outlook 2002, Paris 2002, here pp. 57 ff.

Table 6 _ *World Primary Energy Demand 1971-2030*

	1971	2002	2030	Average annual growth 2000-2030 (percent)
Coal	1,407	2,389	3,601	1.5
Oil	2,413	3,678	5,766	1.6
Gas	892	2,190	4,130	2.3
Nuclear	29	692	764	0.4
Hydro	104	222	365	1.8
Biomass and waste	687	1,119	1,605	1.3
Other renewables	4	55	256	5.7
Total Primary Energy Demand	*5,536*	*10,345*	*16,487*	*1.7*

Source: Energy Agency (IEA), World Energy Outlook 2002, Paris 2004, here p. 59.

Fourthly, geopolitical factors will determine energy policies and supply security around the globe increasingly. In general, beyond market trends, instability in energy prices or supply interruptions may result from a number of other disruptive factors: deliberate policies and actions by exporting countries, geopolitical disputes (both internal as well as regional conflicts) and the effects of exchange rates. With the privatisation of the gas sector, in which new companies emerge, there will be no single party which will assume overall responsibility for the security of gas supply.

Fifthly, the EU, China, India and other great powers may compete for the same energy resources in Central Asia and Russia. In this regard, whether they follow a "*market strategy*" or a "*strategic approach*" may ultimately answer the question whether they are able to cooperate for regional and global energy security or whether they will increasingly compete, leading to strategic rivalries, resource conflicts or even open and violent conflicts by using all means at their disposal of foreign, security and defence policies. Competition over resources, for instance, is already heating up in Asia, especially between China and Japan, the world's second- and third-largest oil consumers. Both states, for instance, are vying for a pipeline from Russia (to China or Nachodka on Russia's Pacific coast) and the exploitation of offshore oil in the East China Sea.

Sixthly, Western and EU energy companies, relying on market strategies, are increasingly being challenged by the growing power of oil and gas producing governments and/or state-owned companies which seems to confirm an important shift in the balance of power in the global oil and gas industry. At the same time, international oil and gas companies are confronted with the growing threat of national oil and gas companies moving beyond their borders to compete on energy deals. Ambitious national oil companies from countries such as Russia, India, Malaysia, Brazil and Algeria have expanded international operations. Chinese state-owned companies, in particular, are investing around the globe to secure energy supplies in order to maintain high GDP increases as the pre-condition of its economic-political stability. Together with India's national oil groups, for instance, they have recently signed huge oil and gas agreements in Iran and are exploring further collaboration with countries seen as "*states of concern*" in the U.S. and the EU. Their aggressive strategies indicate that they are willing and able to outspend their international rivals for licences and accepting lower returns on capital. Their investments are determined more by their government's intention to secure energy supply than by a need to guarantee shareholders' profits.

The new Energy Commissioner *Andris Piebalgs* has called for stronger action and strengthening the EU's energy efficiency efforts and intensified relations with major producer and consumer countries, notably with Russia and the countries of the Caspian Basin, the Mediterranean (in the framework of the *Rome Euro-Mediterranean Energy Platform/REMEP*), Norway and Ukraine (in the framework of the *EU-Ukraine Neighbourhood Action Plan*) in order to diversify the oil and gas supply networks. It also announced to enhance its energy discussions with the main consumer countries such as the U.S., China and Japan.10 However, the EU still lacks an important institutionalised dialogue forum with the OPEC countries and particularly the Persian Gulf States such as Saudi Arabia.

4. Asian Dependency upon Energy from the Middle East, Central Asia and Russia

The Regional Energy Policy Challenge in the Asia-Pacific Region

> "The new realities' of the world oil market suggest that the issue of security of oil supplies is no longer exclusively a strategic concern of the West. Asia's stake in securing reliable oil supplies is even greater because of the relative increase in its degree of dependence on oil from the Gulf."11

In contrast to the public views in the West, it is not only China's energy requirement that has increased. At present, Asia, led by its four economies Japan, China, South Korea and India, imports already more than 60 percent of its oil which can rise to almost 90 percent in 2020 — and linked with a corresponding increase in Asian vulnerability to any oil supply interruption as the result of regional conflicts and internal instabilities in the Persian Gulf. In comparison: In 2001, the United States consumed 19.6 million b/d of oil with an import of 54 percent (up from 42percent in 1990). Whilst 22-24 percent of the US imported oil comes from the Middle East, in terms of total oil consumption the Middle East accounts for just 14-15 percent in the United States. Due to dynamic economic growth in Asia and the fact that more than 55 percent of the world's total population live in the region, the dependency of the Asia-Pacific states on crude oil imports rose to 58 percent by 1998 and will probably rise to 68 percent by 2010. Already in 1998, 90 percent of the region's imports of crude oil came from the Middle East.

Asia's oil thirst is also having an impact at the international level. In 2010, Asia will probably account for a good 55 percent of the global increase in energy demand, while at the same time, the percentage of oil in the global energy mix will decline from around 40 percent at present. Against this background, Asia's dependence upon oil imports from the Middle East and the Persian Gulf region in terms of its total imports of crude oil will remain at 90 percent up to the year 2010.

In 1998 Asia's percentage of the world energy requirement had risen to around 26percent, up from around 18percent in 1984. Compared to this, regional production volume in Asia accounted for only eleven percent of global production of crude oil in 1998.12 No other region of the world has recorded an increase on this scale in the last 20 years. But like China, India that has the second largest population in the world, is also a driving force behind the rising demand for

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10 See 'IEA Ministerial Meeting in Paris: Andris Piebalgs Calls for Strengthening of Energy Efficiency & Intensified Energy Relations with Major Producer & and Consumer Countries'. EU Press Releases, IP/05/518, Brussels, 2 May 2005; 'Loyola de Palacio Welcomes in Rome the Practical Implementation of Energy Co-operation in the Mediterranean Region', ibid., IP/04/1238, 15 October 2004. For the background see also F. Umbach, 'Security Partnership and Strategic Energy Resources – Implications for CSFP and a Common EU Energy Strategy'. A Strategic Policy Paper on Behalf of the European Parliament, 18 pp., Berlin, January 2004 (via Web-Site of the European Parliament -http://www.europarl.eu.int/meetdocs/committees/afet/20040120/security.pdf).

11 Fadhil Chalabi, Gulf-Asia-Energy Interdependence, in: Calabrese, John (Ed.): Gulf-Asia Energy Security, Middle East Institute, Washington D.C. 1998, pp. 13-21 (p. 20).

12 See also Fereidun Fesharaki, 'Energy and Asian Security Nexus', p. 89.

energy. Its future oil consumption is expected to grow rapidly from 2.2 mb/d in 2003 (with net imports of over 1.4mb/d) to 2.8mb/d by 2010.13 By 2010 energy consumption will therefore probably rise by an average of 4.6 percent and demand for crude oil by as much as 10percent a year from 35 million tons per annum (in 1998). At the same time, it will not be possible to significantly alter the percentage of hydroelectric power (8.9 percent), natural gas (8.2 percent) and nuclear energy (two percent) in the national energy mix by this date.14

The situation is slightly more favourable with regard to natural gas. The Asia-Pacific region has over 6.4 percent of global gas reserves, but accounts for about ten percent of global gas consumption. Natural gas consumption in the Asia-Pacific region has not therefore kept pace with regional gas demand, so that in the 1990s, the Asia-Pacific region had to import increasing amounts of liquid gas from the Middle East and the Persian Gulf in addition to oil. Only in the case of coal, there is a balance between demand and production and regional reserves. Thus, the Asia-Pacific states possess over one third of the world's coal reserves, while production and coal consumption account for some 45 percent of global levels. For that reason, demand for oil and the security of oil imports pose the biggest challenges for regional energy security in Asia.

Even if forecasts for future regional oil requirements are based on assumptions of lower economic growth until 2010, Asian consumption of crude oil could still rise to a total of 15.6 to 21.5 million barrels a day. This would be a daily increase of eight to fourteen million barrels a day in the specified period.15 Only if the People's Republic of China were to suffer a large-scale economic collapse, leading to a significantly lower increase in energy demand, would the result be a major reduction in regional demand for energy in the Asia-Pacific region. Even if economic growth were to fall to one percent over the next three years, the daily demand in 2010 would still be nine million barrels a day higher than in 1996. In this case, the increase alone would be greater than the total current production of Saudi Arabia! The reason for scepticism about any major slowdown in the consumption of primary energy in the Asia-Pacific region is found in the still low level of per capita consumption, especially in China, of only 5 barrels (as opposed to 15 barrels in Taiwan, 32 barrels in Germany and 53 barrels in the U.S.A. – figures for 1994). Per capita consumption of electricity in China currently amounts to only eight percent (in India only 3 percent) of the OECD average.16

The gap between a rapidly rising demand for energy and limited own energy reserves will therefore become larger and can only be filled by a sharp increase in energy imports. No matter what form the solution to questions of energy security in East and South Asia takes, it cannot ignore the energy policy dimension of China. Current Chinese energy consumption already accounts for 64 percent of the total energy requirement of the Asia-Pacific region, and with the current GDP growth rate of seven to eight percent, this figure will continue to rise.

In Southeast Asia, by 2020, every country – with the exception of Brunei - will also be a net oil importer. While in Northeast Asia the prospects for an enhanced multilateral energy cooperation seems rather remote (with the notable exception of Sachalin), the ASEAN countries have agreed in June 2004 to a detailed 5-year "*Plan of Action for Energy Co-operation (2004-2009)*". The plan envisages the integration of regional energy infrastructure, promoting energy security, creating progressive policies for market reforms and liberalization and addressing environmental

13 See EIA, India. Country Analysis Briefs, Washington D.C., October 2004, p. 2.

14 See also Sujit Dutta, 'Indo-Gulf Relations: Dimensions of Security'. In: John Calabrese (Ed.), 'Gulf-Asia Energy Security', pp. 47-51 (47 f.).

15 Fadhil Chalabi, 'Gulf-Asia-Energy Interdependence'. In: John Calabrese (Ed.): Gulf-Asia Energy Security, p. 13-21 (16).

16 Private purchases of cars in Thailand for example rose by 18 % annually between 1985–1992. See also Robert A. Manning, 'The Asian Energy Predicament'. p. 77 f.

concerns. Although its projected energy demand is not so much in the news, its oil demand is expected to grow from 754 of today to 1,322 million in 2020. Furthermore, the countries of the Greater Mekong region agreed in 2002 to expand various cross-border power links.17 Besides the investment uncertainties to implement those subregional energy cooperations, political conflicts and mistrust as well as an outdated "*ASEAN way*" of cooperation may hinder the implementation or at least slow down those ambitions.

Forecasts of China's Increasing Oil and Gas Demands

> "While the Chinese government has focused most of its attention on strategic measures, such as raising domestic production and in investing in overseas sources of energy, far less effort has been directed to liberalising the internal energy markets and to initiating demand-side measures, such as coherent transport policies. Strategic measures need to be balanced by market-oriented policies which integrate China into international energy markets and ensure a more complete and less expensive energy security policy. It is this need for a more balanced policy which is the main challenge facing Chinese policy makers which, in turn, *requires a shift in strategic culture where energy security is seen as much in terms of market mechanisms as state-sponsored geostrategy* [highlighted by F.U.]."18

The energy demand of China as the world's most populous country, in particular, will have a long-term influence on regional and global energy supplies as well as manifold effects upon Beijing's foreign and security policy, regional stability in Northeast, South and Central Asia and Beijing's relations with the U.S.A. and Europe. Energy security has always been a very sensitive subject in China, where self sufficiency was a mantra during *Mao Zhedong's rule*. Even today, the Chinese government regards the rising energy imports as a "*strategically vulnerable resource*".19 As one of the world's largest economies without a strategic petroleum reserve, China seems still waiting and hoping during peace and war times, that armies, saboteurs and terrorists will not disrupt the rising oil and gas imports on which its booming economy increasingly depends.

During the last years, China has become the world's second-largest consumer of primary energy, accounting for more than 10 percent of the global primary energy demand. As an already existing key-player in world energy markets as one of the fastest growing economies in the world, the anticipated annual economic growth by around 4.8 percent will drive up China's energy demand, though on a lower scale (around 2.7percent). Mainly due to the vigorous demand of its transport sector, China's oil demand will rise to 40 percent until 2030. With a projected 3 percent annual increase in primary oil demand, China's oil consumption of 5mb/d in 2001 may more than double by 2025 to 12.8 mb/d, with net imports of 9.4 mb/d.*20* According to the *IEA's* projections, net oil imports will rise from 1.7 mb/d in 2001 to 4.2 mb/d in 2010, around 8 mb/d and 9.8 mb/d in 2030 — which is almost equivalent of those of the United States in 2000 and more than the present total crude oil production of Saudi Arabia as the largest oil producer in the world during the last years as well as more than the projected net imports of Japan, South Korea, Australia and New Zealand combined.

Since 1990, China has been a net importer of energy and in November 1993 it also became a net importer of oil products and in 1996 of crude oil. Those imports of oil and refined products are growing fast, whilst its crude oil reserves are limited (2.43percent globally; Asia-Pacific in total

17 See Andrew Symon, Energy and Economic Integration, in: ISEAS (Ed.), Southeast Asia 2005-2006. Regional Outlook, Singapore 2005, pp. 80-83.
18 So Philip Andrews-Speed, Xuanli Liao/Roland Dannreuther, 'The Strategic Implications of China´s Energy Needs', here p. 100.
19 So, for instance, China's foreign minister, Tang Jiaxuan, recently – see NAPSNet-Daily Report, 6 March 2003.
20 See also EIA, China. Country Analysis Briefs, Washington D.C., July 2004, here p. 2.

just 5percent of global oil deposits). China's current and future energy situation is defined by the following structural problems and challenges:

- A rapid increase in energy consumption in the next decades,

- Small oil and gas deposits in China and in the immediate geographic vicinity, resulting in a huge import requirement for these two fossil fuels, especially from the Persian Gulf;

- simultaneous increase of the energy demand of almost all other East, Southeast and South Asian states, which could lead to energy and political rivalry — in particular with Japan, India and the U.S.A. — over access to the few regional oil and gas resources in the South China Sea and those in the Persian Gulf and in Central Asia, but also Africa and Latin America;

- due to its disastrous environmental impact on the population, nature and the economy, China's strong dependency upon coal will have to be reduced in future;

- the need for a diversification of energy sources, transport routes and production sites (especially abroad) due to global economic trends (globalisation, cost efficiency etc.) and security policy factors; and

- a limited experience in participation in global economic processes characterised by mutual dependency and an international division of labour that contrast with China's historic "*strategic security culture"* and its traditional preference for economic autarky and bilateral relations. Yet at the same time, the institutional interdependence of geo-economic and geo-political interests plays a central role in China's foreign and security policy, as the state-owned energy companies are still part of the network of defence institutions in the Beijing power apparatus.

- China's rapidly increasing demand for energy is not due solely to population growth, but above all, to the accelerated pace of agricultural electrification, urbanisation and rapidly increasing consumption (refrigerators, washing machines, televisions, air-conditioning etc.) as well as the development of the transport and industrial sectors. This imbalance between demand caused by economic and population growth and domestic energy production is increasing slightly, so that in 2000 China was only able to cover 70 percent of its total energy requirement from its own reserves.

Oil demand

In 2004, China’s oil demand grew by nearly 16percent. Currently, it around 20 percent of total Asian and 6percent of global consumption. Although more than 90 percent of current Chinese oil is produced on the mainland, higher increases are recorded in the East and South China Sea. But even if offshore production in China rises to 73 million barrels over the next few years as China hopes, it was apparent early on that this would not be able to compensate for even faster growth in the demand for oil and other sources of primary energy. Earlier optimistic estimates of larger oil deposits in the South China Sea have not been fulfilled. Overall, China has only 2.43 percent of global crude oil reserves and 1.2 percent of the world's reserves of natural gas, as early hopes of large deposits of oil in the *Tarim Basin* (Sinkiang) have so far proved illusory. While domestic oil production has risen by only 1.67 percent during the last ten years, consumption of crude oil rose by 5.77 percent a year over the same period.21 Analysts expect a stagnation or even a

21 See also ‘China's Quest for Energy Independence’, Stratfor.Com, 24.5.2002, p. 1.

decline in crude oil production on the mainland, as most of the larger oil fields that are currently being exploited are likely to be exhausted within the next five years if current production quotas are maintained.22 In autumn 2001 Chinese experts are supposed to have found larger deposits of natural gas and oil in Tibet, officially put at four to 5.4 billion tons (or 28–37.8 billion barrels).23 However, more detailed geological studies of the true extent of the newly discovered fossil resources still have to be carried out, as Beijing has repeatedly exaggerated such discoveries in the past in order to persuade Western energy companies to make larger investments.24

China has already become the second largest energy user after the U.S.A. and has surpassed Japan as the world's second largest petroleum consumer in 2003. In order to reduce dependency and vulnerability to possible crisis scenarios in the oil producing states in the Middle East and Persian Gulf, China wants to stockpile around six million tons of crude oil as a strategic reserve by the year 2005.25 This reserve, however, would suffice China's oil refineries and petrochemicals industry for less than three days (compared to 90 days in the U.S.A. and 60 days in Japan).26

Natural Gas demand

Slightly larger deposits of natural gas have been found both in China and the entire Asia-Pacific region. However, the costs of constructing pipelines and liquefying plants are huge due to the long transport routes. Nevertheless, and also for environmental reasons, China has made increasing the use of natural gas a high priority, despite the massive investment costs and the fact that at present gas accounts for only slightly more than 3 percent of its total energy consumption.27 So far, however, despite annual growth rates of 18 percent, consumption of natural gas in the entire Asia-Pacific region remains far below the OECD average of 26 percent, at only ten percent.28 Nonetheless, China's gas consumption is believed to increase almost five-fold until 2030 (from 32 billion cubic meters in 2000 to 61 bcm in 2010 and 162 bcm). The Chinese government hopes that gas will cover 8-10 percent of the country's entire energy consumption by 2010, whereas the *IEA* has forecasted that it will remain small even in 2030 at7 percent.29

Coal and Alternative Sources of Energy

Although China possesses the third largest coal reserves in the world (after the U.S.A. and Russia) and is currently the largest consumer and producer of coal globally, it will have to import greater quantities of foreign coal in future, as the inadequate road network, particularly in the interior of the country, poses insurmountable transport problems. As a result, it is sometimes more expensive to transport domestic coal production than it is to import from abroad. Moreover, in Beijing's view, further increases in coal production have to be limited as the environment in China is already suffering from excessive pollution levels that increasingly threaten economic

22 See also Chien Chung: China's Energy Strategy in the 21st Century. Peace Forum Essays, Taipei 2001 www.dsis.org.tw/peaceforum/p_2e.htm#7.
23 For a comparison: the largest oil field in the world *Ghawar* in Saudi Arabia comprises 70–85 billion barrels of crude oil. The Kazakh oil field *Kashagan*, another mega oil field, contains around 10–30 billion barrels of crude oil.
24 Compare: Potentially Massive Oil and Gas Find in China. Stratfor.Com, 5.9.2001 and: China Finds Oil in Tibet. BBC-News, 21.8.2001 (Internet Version).
25 Compare the chapter. 'Energy'. In: FEER: Asia 2002 Yearbook. A Review of the Events of 2001. Hong Kong, December 2001, pp. 43–44 (44).
26 See also Chien Chung: China's Energy Strategy in the 21st Century, p. 1.
27 See also Amy Myers Jaffe/Steven W. Lewis: Beijing's Oil Diplomacy, p. 121 f.
28 See also Robert A. Manning: The Asian Energy Predicament. In: Survival, Spring 2000, pp. 73–88 (79).
29 See 'China – An In-Depth Study'. p. 255 f.

growth. At the same time, after the U.S.A, China is the largest producer of greenhouse gases and CO_2-emissions that are held responsible for global warming. Even in 1997 China was the largest producer of SO_2 emissions, surpassing both Europe and the U.S.A, with an output of 23.46 million tons.30 The main reason for this is the usually high sulphur content of the coal that is responsible for 75 percent of SO_2 emissions, 70 percent of smoke and smog and 85 percent of all CO_2 emissions in China.31 But in addition to this, 33 percent of all sulphur dioxide rainfall in South Korea and even 50 percent of the sulphur emissions that are said to be the cause of acid rain in Japan supposedly originate in China.32 If current trends continue, China and India are together expected to account for 75 percent of all global CO_2 emissions in 2020. It is projected to experience the largest absolute growth in carbon dioxide emissions within the next two decades.
China's coal reserves can therefore only play a greater role if clean and cost-efficient incineration technologies find widespread use. However, as financial resources are inadequate for this, the Chinese leadership is increasingly relying on other sources of energy. At the same time, however, environmental constraints are increasingly limiting the expansion of alternative sources of energy such as hydroelectric power, as demonstrated by resistance to gigantic construction projects (*Three Gorges Project*). Although demand for natural gas should rise by 8percent a year, in the medium term up to 2020 it will only account for a maximum eleven percent of China's total energy consumption. The share of civilian nuclear power as a percentage of China's total energy consumption will – despite the long-term increase in the number of nuclear reactors from 6 at present to 33 by 2020 – only rise from 1.5 percent in the mid-1990s to no more than 4-6percent in 2020.33

At the same time, the share of coal as a percentage of total energy consumption will decline (but not below 60 percent in 2020), although its production volume will continue to increase. Global coal consumption is expected to increase by around two billion tons from 1996 to 2020, 85 percent of which will be attributable to China and India. While China currently meets around 67 percent of its energy requirement with coal, the figure for India is 60 percent and for the entire Asia region 46 percent (oil: 38 percent; natural gas: 8 percent). This also explains why the entire Asia region – which according to these figures meets 84 percent of its energy requirement with coal and oil – is already the region with the highest CO_2 emissions, although per capita energy consumption in Asia has so far constituted only half the global average. However, China's per capita energy consumption of oil is now almost twice as high as India's (in the case of electricity, Chinese per capita consumption amounts to 8 percent of the OECD average, while in India it is only 3 percent). For environmental reasons and reasons of economic efficiency, larger quantities of cheaper coal with a far lower sulphur content than domestic production could be imported from Indonesia and Australia in future. China also plans to build several large coal liquefaction plants to convert Chinese coal into oil products in order to reduce crude oil imports. However, given the current price of crude oil, such plants are still relatively expensive.

In the long-term, the *State Development Planning Commission* plans to reduce the percentage of coal production for the national energy requirement to 35 percent, while oil and gas should account for 50 percent, with hydroelectric power, nuclear energy and other alternative sources of energy making up the remaining 20 percent.34 China also wants to increase the use of wind-

30 See also Gao Shixian: China. In: Paul B. Stares (Ed.): Rethinking Energy Security in East Asia. Tokyo-New York 2000, pp. 43–58 (52).
31 See also Yang Guang: China's Stabilizing Role. p. 40.
32 See also Shaun Breslin: The China Challenge? Development, Environment, and National Security. In: Security Dialogue 4/1997, pp. 497–508 (499). See also Gregory D. Foster: China's Environmental Threat: Crafting a Strategic Response. In: Comparative Strategy 2000, pp. 123–143.
33 So far China only operates two reactors — the nuclear power plant *Dayawan* in *Guandong* province and one in *Qinshan Zhejiang* —, while three others are under construction. The sixth nuclear power plant has been under construction since January 2002 – see: China Daily, 7.1.2002 (Internet Version).
34 See also the chapter: 'Energy'. In: FEER: Asia 2001 Yearbook, p. 49.

power, whereby the regions Sinkiang and Inner Mongolia offer the best perspectives. This is a long overdue development as wind-power has so far only met one percent of the national energy requirement and China lags far behind other newly industrialised countries – such as India – in this area.35 Moreover, wind and solar power as an integral component of a decentralised energy supply offer the most economic solution to energy problems in isolated regions of China, where large power plants and power grids are not economically feasible. For that reason, at least 10 million Chinese have to do without electricity. By 2010, 20 million inhabitants of isolated regions should be de-centrally supplied with wind and solar power, significantly improving their educational opportunities and chances of economic development.36

5. The Geo-Political Impact of Chinese and Asian Energy Demand on China's Foreign and Security Policy and Regional and Global Political Stability

Although many international energy experts fear significant price increases after 2010.The predicted increase in global oil production, the increasing market orientation of national energy policy including privatisation and the deregulation of national energy policy, more efficient use of energy and energy saving measures, could in principle, overcome the massive increase in oil consumption in China and East Asia. The issue of energy security, however, depends not least of all, on the policies of the states concerned and the choice of national strategies for energy security. This is especially true of the Asia-Pacific region, where 60 to 70 percent of all crude oil imports are still arranged by contracts with state-owned or semi-state controlled international Asian companies, that are not only determined by economic factors, but also by strategic aspects of the foreign and security policy of the individual country.37
Against the background above of a rapidly growing demand for energy and deteriorating prospects for major new energy discoveries in their own country, the Chinese political leadership and managerial elite has been keeping a greater look out for new energy resources abroad since 1996/97. As early as 1990, China purchased 81.5 percent of its crude oil from only three foreign states, although only Indonesia exported more than a million tons of crude oil to China. In 1997 the number of countries exporting more than two million tons of crude oil to China had doubled compared to the three in 1990: Indonesia, Oman, Yemen, Angola, Iran and Vietnam. Even in 1997, China imported oil from all Gulf States except Bahrain.38

Since early 1997 it has even been possible to observe a policy of demonstrative activity with regard to the securing of new sources of energy. In 1997 alone, *the Chinese National Petroleum Corporation* (*CNPC*) completed no less than eighteen international petroleum and petrochemical projects with a contract value of around USD 750 million. These included the purchase of foreign oil companies (or the acquisition of major stakes in the companies), pipeline projects (in Turkmenistan and Thailand) or the construction of refineries and depots abroad. In addition, the People's Republic is also participating in the development of oil fields in Russia, Pakistan, Kazakhstan, Indonesia, Egypt, Ecuador, Venezuela, Argentina, Iran and Sudan. In this way, China has paid around USD 8.2 billion since May 1997 for oil licences in Sudan, Venezuela, Iraq and in Kazakhstan. In that year, Beijing's total commitments amounted to USD 20.7 billion, if the costs of the pipeline in Central Asia are included. At the same time, negotiations were conducted for other oil licences in Iran, Indonesia, Russia and Turkmenistan, while Beijing signed joint venture agreements with Italy and India. Furthermore, China increased the number of its licences in Iraq and Sudan and also acquired interests in Venezuela.39 Until October 1997, China

35 See also "Changes in the Wind?", Stratfor.Com, 4.1.2001.
36 See also Klaus Sieg: Der Tagesspiegel, 12.6.2002, p. B. 2.
37 See also Katsuhiko Suetsugu, 'Energy Markets and Power Politics', p. 55.
38 See also Yang Guang, 'China's Stabilizing Role', p. 41 f.
39 See also Amy Myers Jaffe/Steven W. Lewis, 'Beijing's Oil Diplomacy', p. 122 ff.

concluded 126 contracts and agreements with a value of US$5.38 billion, signed with 67 companies from 18 countries.40

In the year 2002, China controlled more than 2.72 billion barrels of oil reserves outside its own territory by means of take-overs and international alliances.41 Although China's government plans to launch a new round of exploration projects inside China to reduce the country's growing dependence on foreign energy resources42, its main focus now is on gaining more overseas drilling rights for Chinese companies. These, steps, however, present new risks of China's future oil security. Nonetheless, Chinese companies have stepped up their investment abroad to acquire direct control or partial rights in some of the world's potential oil fields. Beijing has forged closer ties with almost all continents. It has become much more pro-active in Africa (Sudan, Chad, Angola), Middle East (Saudi Arabia, Iran, Algeria) and Latin America (Bolivia, Venezuela, Ecuador, Columbia, Peru and Brazil).43 Despite the fact that China has recently secured new supplies of oil and gas resources with Australia and Indonesia44, the Persian Gulf region has become steadily more important not only for the energy policies of China and the other Asian states, but also for their national foreign and security policies. At present Saudi Arabia is accounting for some 16percent of China's oil imports, while Iran is contributing 14-15percent of it.

The increasingly global orientation of Chinese foreign and security policy toward the Persian Gulf, Africa and even Latin America since the mid 1990s cannot be explained solely by China's increasing economic importance, prestige and its desire for great power status; to a considerable degree it is the result of the direct effects and consequences of China's energy requirements and rapidly increasing imports of oil and gas from countries outside the Asia-Pacific region. Europe in particular, has so far failed to heed and analyse these economic and political interdependencies and their geo-political implications for China's foreign and security policies, although they raise numerous challenges not only for the U.S.A. but also for the EU, that will influence economic and political stability around the globe.

6. Persian Gulf /Middle East: Political and Economic Interdependencies

China's pro-active energy strategies to build economic-political relationships and secure energy supplies around the world has increased the attention particularly in the U.S., Japan and India. Despite the recent rapprochement and declared interest at expanding their economic ties, the increasing strategic rivalry between the China and India, whose oil imports also rose dramatically during the last decade, could lead to a rapidly escalating arms race between these two countries, in particular between their naval and air forces, due to heightened competition for energy resources and strategic access to the Persian Gulf through the Indian Ocean as a consequence of

40 See Deng Shengliang/Xu Xiaojie, 'The Oil Dragon's Move', p. 83.

41 See also: China's Quest for Energy Independence, p. 2 f. and David Lague, 'The Quest for Energy to Grow', p. 4.

42 In August 2002, China awarded a $12 billion liquefied natural-gas contract to Australia for its Northwest Shelf gas fields over the next 25 years. At that time, Australia had beat out Indonesia because of its record of economic and political stability. A month later, however, China signed another pact worth $7.8 billion for Indonesia to supply liquefied natural gas from 2007

43 For an overview see Drew Thompson, China's Global Strrategy for Energy, Security, and Diplomacy, in: China Brief (ed. by the Jamestown Foundation), Vol. 5, Issue 7, 29 March 2005 and Ian Storey, China Seeks to Reduce its Dependence on Strait of Malacca, JIR, May 2005, pp. 36-39.

44 See Sadanand Dhume/Susan V. Lawrence, 'Buying Fast into Southeast Asia', FEER, 28.3.2002 (here Internet-Version); David Murphy/John McBeth, 'Having a Gas in China', ibid., 22.8.2002, pp. 16-17; Financial Times, 9.8.2002, p. 6; Keith Bradsher, IHT, 9.8.2002, p. 11 and Peter Wonacott/Bushan Bahree, Wall Street Journal, 9-11.8.2002, p. A 2.

unilateral strategies to ensure reliable energy supplies.45 These strategies tend to rely on strenuous efforts to achieve as much as energy autarky as possible and primarily military concepts of safeguarding energy supplies, instead of market economic concepts, globalisation requirements and an international division of labour and transnational energy co-operations organised by the private sector. Thereby, China often seeks energy relationships with countries which are well-known for their anti-Americanism such as Iran, Sudan, Libya and Angola. China's Iran policies have not only complicated the U.S. policy towards Teheran, but also of the EU that has a strategic interest at a nuclear weapons-free Iran. In addition, it has also frustrated many efforts of NGOs and donor nations as well as organizations in their efforts to instil good governance, accountability, transparency and improving human rights in these countries. All these Chinese diplomatic activities in the energy field have produced an economic-security nexus that is determined by China's most fundamental core interest of its political leadership: economic growth and domestic stability in order to ensure regime survival. However, these unilateral energy-security strategies are undermining multilateral and regional co-operations and may fuel already existing strategic rivalries such as with Japan, India and the U.S.

Like China, India also expanded its cooperation with the Gulf states in the 1990s both in terms of military policy and technology. The fact that 2.5 to three million Indian workers, technicians, engineers and managers work in the Gulf states explains India's strong interest in questions of regional security and stability in the Gulf region and the Middle East as well as Central Asia. At the same time, however, it strengthens India's anyway marked distrust of more extensive Chinese ambitions in the region and particularly in the Indian Ocean.46 India has also signed oil deals with Iran and is planning to build pipelines from Iran via Pakistan to India and from Central Asia to India via Afghanistan

The foreign and security policy impact of China's increasing dependency on steadily rising imports of oil and gas, made itself felt as early as the 1990s in Beijing's policies toward Iran or Iraq (such as arms exports, or Beijing's voting patterns in the UN Security Council). Both countries were regarded once officially by the U.S.A. as "*rogue states*," and are still suspected of developing long-range ballistic missiles and warheads that can be used with weapons of mass destruction. Beijing became a burgeoning arms exporter in the Middle East in 1980s. In March 1988, it became public that an unspecified number of *DF-3* ballistic missiles had been delivered by Beijing to Saudi Arabia. To date, China is believed to have sold 120 missiles of this type, which has a range of 3,500 km and is capable carrying nuclear, biological and chemical warheads. Reportedly, Iran has also received Chinese ballistic missiles, anti-ship cruise missiles and missile technology.

While Beijing's policies in the Gulf region have largely been characterised by pragmatism and caution since the mid-1990s47, China's policy of arms exports to this region48 and strong reservations about the U.S' policy of "*double containment*" and non-proliferation due to increasing crude oil and natural gas imports to China have had a negative impact both on the

45 U.S. energy expert Kent Calder, in particular, has drawn attention to these dangers. See his studies: 'Energy Forum', The Washington Quarterly, Autumn 1996, pp. 91–95 and: 'Asia's Deadly Triangle. How Arms, Energy and Growth Threaten to Destabilize Asia-Pacific'. London-Sonoma 1997. See also Frank Umbach, 'Konflikt oder Kooperation in Asien-Pazifik', Chapters 3 and 9.

46 Sujit Dutta, 'Indo-Gulf Relations: Dimensions of Security', p. 49.

47 See also Jonathan Rynhold, 'China's Cautious New Pragmatism in the Middle East', Survival, Autumn 1996. pp. 102–116.

48 See also Bates Gill, 'Two Steps Forward, One Step Back: The Dynamics of Chinese non-Proliferation and Arms Control Policy-Making in an Era of Reform', in: David Lampton (Ed.), 'The Making of Chinese Foreign and Security Policy in the Era of Reform'. Stanford 2001. pp. 257–288 and the data and discussion in Richard F. Grimmett, 'Conventional Arms Transfers to Developing Nations, 1993–2000'. Washington D.C. (Congressional Research Service), p. 58 <www.fas.org/asmp/resources/govern/crs.2000.pdf>.

regional stability of the Middle East and the Persian Gulf, and have also placed an additional strain upon bilateral relations between Beijing and Washington.49 Indeed, as Chinese energy and foreign policy experts admit, China had always played in the past a rather passive diplomatic role in the Middle East, declaring obvious platitudes about seeking peace and stability, but in reality not really caring too much about regional stability. Meanwhile, however, China has a lot at stake and pays much closer attention to the strategic developments in this region.

The Middle East and the Caspian Basin are confronted with countless internal and regional instabilities that could have a strong negative impact on the reliability of regional and global energy supplies in the future. Beside, China could find itself exposed to growing political pressure from the oil and gas exporting states in the Middle East. This political pressure could result in either greater Chinese arms exports, including sensitive dual use goods and technologies, or to concessions by Beijing on other political issues that run counter to Western and EU policies and long-term strategic interests such as in the case of Iran. Chinese support for the Russian and French positions on UN sanctions and objections to military action against Iraq, Western policy toward Iran and problematic arms exports to this and other Gulf states (including ballistic missiles) in the 1990s have already demonstrated this problem.50 And in the case of North Korea, barter and counter-trade deals such as "*oil for weapons*" are the rule rather than the exception, while during the Iran-Iraq war China was a major exporter to the Persian Gulf states. On the other hand, while Chinese transactions of this kind declined significantly in the 1990s, as Beijing also supported the UN sanctions,51 exports of Chinese ballistic missiles to the region continued. A solution to this problem is hardly likely to be found in the near future as, in practical terms, Chinese non-proliferation policy regarding ballistic missiles and other sensitive dual-use technologies, depends ultimately upon the quality and stability of its bilateral relationship with the U.S.A. and, simultaneously, is also increasingly influenced by domestic vested interests.

On the other hand, increasing political and economic interdependencies could have a number of positive effects on the basic structures of the international system and regional political stability in the Middle East. The long-term interest of the Chinese government in political stability in the region could therefore increase, in turn opening up greater possibilities of co-operation not only for bilateral U.S.-Chinese relations.52 Expansion of its political and economic, military and military-technology relations with the Middle Eastern states will also give China an increasing degree of influence over them and strengthen Beijing's position at a global level (in the UN for example). At the same time, however, these energy and foreign policy dependencies are also a risk for Beijing as it will increasingly run the risk of being unwillingly drawn into local or regional political conflicts, but without having a political influence comparable to that of the U.S.A. on the possible parties in the conflict.

7. Central Asia and the Caspian Basin

Given this background and the potential vulnerability of shipping routes through the Indian Ocean to the U.S. Navy, and, in the future perhaps to Indian and even Japanese naval forces as well, the Central Asian region with its eight successor states of the former Soviet Union has gained particular importance for Beijing as a strategic land bridge between the Middle East and the Persian Gulf and the PRC not only in general security policy terms, but in particular for energy policy reasons.53 This is in particular true for Kazakhstan and Azerbaijan, which together

49 See also John Calabrese, 'China and the Persian Gulf: Energy and Security', in: Middle East Journal, Summer 1998, pp. 351–366 and Amy Myers Jaffe/Steven W. Lewis, 'Beijing's Oil Diplomacy', p. 122 ff.
50 See also Amy Myers Jaffe/Steven W. Lewis, 'Beijing's Oil Diplomacy', p. 115 f.
51 See also Katsuhiko Suetsugu, 'Energy Markets and Power Politics', pp. 56–58.
52 See also Robert A. Manning, 'The Asian Energy Predicament', p. 82.
53 See also Amy Myers Jaffe/Steven W. Lewis, 'Beijing's Oil Diplomacy', p. 125 f.

account for 92 percent of the region's total oil reserves, Turkmenistan with 40 percent of the region's proven natural gas reserves (followed by Kazakhstan and Uzbekistan each at 27 percent) and Kyrgystan and Tajikistan as the two bordering Central Asian countries vis-à-vis China's western province of Xinjiang. In 2001, Central Asia produced only 1,4 million b/d (only 2percent of world oil production) with net exports accounting for about 57 percent. The region's dry gas production amounted to 11 billion cubic feet per day (bcf/d; 5percent of the world gas production). The projected oil exports are to reach 2.5 million b/d in 2010 and 3 million b/d in 2015, while gas exports can be expected at 7 bcf/d in 2010 and 9 bcf/d in 2015.**54**

However, in the medium-term perspective of the next ten to fifteen years, the options of land-locked Central Asia are limited and problematic for both economic and political reasons even after the Baku-Cyhan pipeline went into operation. Ambitious Chinese plans for oil pipelines with a length of up to 11,000 kilometres from Central Asia to China's east coast with its large and prosperous urban centres seem in particular hardly economically feasible for the time being. The planned 3,200 km oil pipeline between Kazakhstan and China, agreed in late 1997, for instance, has been blocked by a long diplomatic and economic dispute between both countries. As a Chinese feasibility study found out later, the project is not practical unless the pipeline could be filled with 20-25 millions tonnes of oil per year — far more than the acquired Aktobe oil fields in western Kazakhstan by China could produce.55

On the contrary, the economically more interesting option is the construction of pipelines from Central Asia to Iran or the Persian Gulf, where Central Asian oil and gas could be loaded onto tankers. Swap deals would be even more profitable. Central Asian energy would be transported to the north of Iran in pipelines and used by Iran itself, while in return, Teheran would export the same amount of Iranian oil and natural gas from its production sites on the Persian Gulf to Asia so that both states could net-off the quantities of crude oil with one another. However, due to Washington's "*double containment policy*" this option is currently unavailable to China, India and other Asian states. At best, crude oil and natural gas from Central Asia could be transported from Central Asia to Georgia or Russia or the Black Sea, or in future, through Turkey to the Mediterranean in pipelines and then loaded into tankers. However, this alternative costs two to three times as much as a swap deal with Iran.56

Furthermore, Beijing cannot overlook the fact that due to socio-economic, ethnic and political instability in Central Asia and the Caspian Basin, ambitious pipeline plans and other large-scale infrastructure investments carry great political risks that have so far deterred a large number of foreign investors. Nevertheless, despite the massive expansion of co-operation with Russia in the field of energy, Beijing does not wish to become excessively dependent upon its large northern neighbour, as Beijing remembers all too well how after the break with China in the late 1950s and 1960s, Moscow withdrew not only its nuclear weapons' engineers, but also its oil and energy experts and also ceased providing technical support, which at the time led to serious energy supply problems in China.

Furthermore, *Putin's* pro-Western policy has re-balanced Russia's foreign and security policy. Although the Russian arms exports to China have been maintained on high quantitative and qualitative level, Russia has at the same time initiated a strategic alliance with India which is expanding its traditional rivalry with China into Southeast Asia and the South China Sea. Moscow has also expanded its military exports to India (including leasing nuclear capable

54 See also Kang Wu/Fereidun Fesharaki, 'Managing Asia's Pacific's Energy Dependence on the Middle East: Is there a Role for Central Asia?' Analysis from the East-West Center, No. 60, June 2002. p. 3.

55 See Michael Lelyveld, 'Kazakhstan: Oil Pipeline to China a Victim of Diplomatic Dispute', RFE/RL-Analysis, 19 September 2001.

56 See also Fereidun Fesharaki, 'Energy and Asian Security Nexus', p. 94.

bombers and other high-tech weapons systems which have still not been delivered to China) and in particular military technology. The Russian government even went so far as to announce it would take its relationship with India into account before selling weapons to China. Given China's increasing energy and security ties in Central Asia, Russian politicians and experts see here another potential field for future conflicts between both sides because Moscow is now trying again to increase its long-term future by securing strategic control over Central Asia's oil and gas exports. Moscow is fearing that the region's small population, its underdeveloped economy, and the constantly declining strength of the Russian military since the mid-1990s have made Central Asia vulnerable to a rising Chinese hegemony in Russia's backward. On the other hand, both sides might still see some need to counteract U.S. hegemony in the region.

Moreover, even if China and the Asia-pacific region would absorb all of Central Asia's oil exports, the amount would satisfy only 10 percent of the region's total oil demand by 2015. In this respect, Central Asia cannot replace the Persian Golf for China's and Asia's total crude oil demand.57 In general, any major oil and gas export pipelines from Central Asia into China will be determined more by political and strategic concerns rather than by the need to secure low-cost supplies of oil and gas.58 However, even in the case that China's ambitions will not materialize to such as an extent, Beijing's political influence in Central Asia will be greatly enhanced in the future which can complicate its foreign and security policies in particular with the U.S., Russia, India, Japan and even with the EU.

Owing to this dilemma, the Chinese government is now willing to provide substantial financial support for the construction of long and economically dubious pipelines and, despite its traditional distrust of Western energy companies and previous focus on a policy of extensive autarky (designed to reduce economic and political dependencies and the vulnerability of shipping routes), to open up its own energy sector and at least isolated strategic energy projects, such as the construction of a 4,000 kilometre gas pipeline with a total cost volume of USD 18 billion, to foreign energy companies.59 At the same time, however, as part of its diversification efforts, China has extended and increased its energy investments to Africa, despite the greater distances and frequently higher transport costs. China's geo-economic and geo-political interests also overlap here, although a large number of oil exporting African states such as Sudan, Angola, Chad and Nigeria face high levels of internal instability, that could lead to supply difficulties or even long-term disruptions to oil exports.60

8. Russia-Chinese Energy Cooperation – Prospects and Dilemmas

Given China's Future energy needs and Russia's vast energy resources in Siberia and the Russian Far East as well as its desperate need to convert them into cash, energy cooperation between both countries have played an important stimulus for the growing economic and political ties since 1996. After Jiang Zemin's visit in Russia in the summer 2000, both sides and their oil companies signed a major agreement in 2001 providing for the building of an 2,400km oil pipeline with a capacity of 25-30 million tonnes a year. Once completed, the $2 billion pipeline will supply China with a total of 700 million tonnes of Russian oil over 25 years. At present, Moscow delivers only 1.4 million tonnes of oil annually to China by rail. This planned pipeline alone will boost their bilateral trade by almost 50 percent over the present level of $12 billion. Moreover,

57 See Kang Wu/Fereidun Fesharaki: Managing Asia's Pacific's Energy Dependence on the Middle East, here p. 4.
58 See Philip Andrews-Speed/Sergei Vinogradov: China's Involvement in Central Asian Petroleum. Convergent or Divergent Interests, Asian Survey, March-April 2000, pp. 377-397 (394).
59 See also South China Morning Post, 8.1.2002 (Internet Version).
60 See also Amy Myers Jaffe/Steven W. Lewis: Beijing's Oil Diplomacy, p. 127 f.

Moscow and Beijing have also advanced their cooperation in a joint project of nuclear power engineering.61

However, here again both sides have still a plenty of problems to resolve. The projected gas pipeline to China from the *Kovykta* field in the *Irkutsk* region, for instance, has yet to get off the ground. At the moment, China seems only willing to pay the same price for Russian gas as Russia sells its gas for at home. Other projects, such as to build the *Imin* and *Xinzhuang* heat and electric power stations being built with Russian assistance are re-running seriously behind schedule. There is also a large number of legal, tax, transport, and other problems to solve which the state solely cannot address single-handedly and without assistance from public organisations as well as oil and gas companies. Basically, huge investment in pipelines requires confidence not only that stability in relations has been reached but that it will last between Russian energy suppliers and Chinese end users. That is different to tankers and even more important to gas pipelines and imports which afford even more costly investments to the entire gas infrastructure. Importing oil by tankers gives you the ability to diversify supplies, in particular even during regional crises and violent conflicts. At present, China is only sixth among Russian export markets, while Russia ranks eighth for sales of Chinese goods.

Transneft, the Russian state-owned pipeline company, for instance, has been pushing for a rival route that would not dependent on China solely. It has argued that a 3,000 km pipeline from *Angarsk* to Russia's Far East port of *Nakhodka* would be a more attractive option because it would allow Russian energy resources to reach a range of export markets (South Korea, Japan and even the US). But the project would cost $4.6-6 billion. Moscow seems now to be backing both plans rather choosing between them. But influential Russian circles appear to have blocked the pipeline to China also on the basis of environmental reasons and have demanded a detour that raises the project's price by at least 50 percent. On the other side, China seems now willing not only to pay for the 700 million cost of building the planned pipeline on its territory, but also to finance half of the $1 billion section of the pipeline on the Russian side.

Furthermore, two multinational consortia are drilling and building rigs offshore of the Sakhalin island and plans are being laid for hundreds of km oil and gas pipelines. Western oil companies such as *Royal Dutch/Shell Group* and *Exxon Mobil Corp.* believe that as many 13 billion barrels of oil lie beneath the waters around Sakhalin (compared with about 22 billion barrels of reserves in the US). The *Sakhalin 1* project has already been praised by Russian President Vladimir Putin and US President Bush as a "*model for economic cooperation*". Therewith, Russia — holding 5 percent of the world's proved oil reserves and 32 percent of the global gas reserves — has become one of the major targets for both Chinese as well as Western oil and gas companies.

In general, despite China's interest to expand its economic and energy ties with Russia, it is concerned about the strategic risk of becoming to dependent on Russia (like in the field of military technology), a longstanding strategic rival for influence in East Asia. It also remembers the severe energy shortages after the 1960 Sino-Soviet split when Moscow withdrew its experts from China's oil industry.

On the side of Russia, similar distrust exists vis-á-vis China and its future strategic ambitions in Northeast Asia. Given Russia's catastrophic demographic trends overall and in particular in Siberia and the Russian Far East and the eroding military balance in this region, the expansion of economic ties with China has been severely hampered in this region itself and even in Moscow. While Russian President *Putin* has favoured a Chinese participation in auction of the Russian oil

61 See also F.Umbach, The Wounded Bear and the Rising Dragon - The Sino-Russian Relationship at the Beginning of the 21st Century: A View from Europe, *Asia-Europe Journal* 2/2004, pp. 43-62

company *Slavneft*, the anti-China faction in the *Duma* voted in December 2003 against the bidding of China's largest oil company, *China National Petroleum Corp.* (*CNPC*) for a 75 percent share in Russia's state-owned oil company, which is the largest privatisation sale in its history so far. It feared that the *CNPC* bid would result in Chinese control of a key Russian energy company and ultimately in large-scale Chinese immigration. According to Russian sources in this context, Beijing demanded "*the free flow of the Chinese workforce into Russia*" during the WTO negotiations — conditions *which "were an unpleasant surprise for Moscow*". Although each cause for distrust might be separate, it had unexpected consequences for the planned expansion of economic and energy ties. The anti-China faction included many pro-Western reformers (such as *Anatoly Chubais*, Economic Development and Trade Minister *German Gref* and Finance Minister *Alexei Kudrin*). In contrast to communist and nationalist circles, which exclude any foreign companies from acquiring stakes of Russian energy companies, these reformers prefer to see Western rather than Chinese businesses gaining a foothold in Russian markets. That may be one reason why Russia is also eager to expand its energy ties with Japan — China's major strategic rival in the region. Tokyo seems now for the first time really considering the import of major Russian oil and gas resources and willing to fund a proposed $5 billion Siberian oil pipeline which is much more costly than the shorter bilateral pipeline to China as the result of new efforts to diversify its energy needs. But here again, political and unresolved financial problems seem to postpone the project again.

9. Summary and Perspectives

"A surplus in energy supplies during the past two decades convinced policymakers that other objectives could take precedence over energy security and that the costs of neglect would remain low. That period has ended. In today's tighter energy markets, the costs of leaving energy security unattended could become extremely high. These costs, and the means of reducing them, need to be evaluated in a more purposeful, strategic fashion."62

The different approaches of energy security (geopolitical/strategic factors versus market forces) should not be considered as mutually exclusive but rather as complementary strategies in global energy security. The issue of ensuring international energy supply in the short- and medium-term therefore lies less in the finiteness of crude oil and natural gas reserves (41 and 60 years, respectively) than (1) in the accumulation of regional crises and domestic political stability of the countries producing crude oil and natural gas; (2) in surplus production capacity that has been steadily diminishing since the 1990s because of global competitive pressure; in an unexpected surge in global oil demand; and (3) in a huge need for investment in new exploration, refineries, pipelines, and other infrastructure elements.

In this light, the EU and its member states need to take the importance of geopolitical factors more into account for their future energy security. Therefore, the organisation of security for oil and gas supplies can no longer be entrusted solely to the industry. Whereas this separation of economics from politics has made sense for the internal EU market due to the existing common understanding of the overall importance of market forces, energy policies determined outside of Europe are still defined by strategic interests of national foreign and security policies (particularly in Russia, China, OPEC-countries, USA and others). The Europeans have neither built up sufficient strategic stocks to weather future crises, nor do they manage the stocks they have in a way that could ensure their energy security. They urgently need to do so before it's too late. Hence, traditional energy security concerns could conceivably become more acute in the near future, particularly in regard to the political stability in the Persian Gulf and the total Great

62 So the conclusions of an independent task force - Edward L. Morse Amy Myers Jaffe, Strategic Energy Policy, here p. 30.

Middle East as the "*Arab Human Development Report 2002*" by the *United Nations Development Programme* (*UNDP*) has impressively highlighted to the world.63

Therewith, traditional energy security concerns remain valid not just in East Asia with its weak multilateral organisations, historical mistrust, unresolved security challenges (such as territorial conflicts), a regional arms build-up and rather increasing strategic rivalries between China and India as well as China and Japan. Although China has not yet become a destabilizing force in East Asia's energy security, it remains unclear where it will lead in the next critical decades of China's economic and political transformation as well as concerning the impact on its foreign and security policies. Beijing neither trusts the U.S. nor has a blue-water navy to ensure safe passage of its oil and gas imports.

More multilateral cooperation and engagement is very much needed in regional energy co-operation such as by creating an *Asian Strategic Petroleum Reserve*. It would not only promote cooperation in time of crisis, but also help to stabilize volatile markets and reducing the financial burden of maintaining national stockpiles. Proposals and discussions of an Asian version of the *IEA* are underway to strengthen regional energy cooperation albeit it has not made much progress.

Although China as the world's second largest energy consumer (after the U.S.) and the world's third biggest oil consumer (behind the U.S. and Japan — the latter can be surpassed within the next decade) made gradual progress towards deregulating its energy policies and integrating itself into the global economy in the 1990s, although efforts to orient its energy industry to the needs of the market since 1998 have repeatedly faltered. Major energy policy decisions at the (state-run) energy corporations are still not made primarily, let alone solely, according to economic criteria, but by the Politburo in Beijing, where foreign and security policy factors frequently play a central role in energy policy decisions, sometimes to a rather unbalanced extent. Nonetheless, in the future, neither unilateral-national strategies nor increased armaments to secure energy import routes by land, and above all, by sea, will provide a real solution that will ensure reliable supplies of energy for China. At the same time, however, China is hardly likely to entrust the U.S. Navy with the task of securing its energy imports over sea routes. At present, this dilemma appears almost insoluble to Beijing for domestic reasons.

Given the manifold economic and political uncertainties in the Middle East, Central Asia and Russia as the three global energy bases that could potentially satisfy its long-term energy needs, China seems currently in many ways rather unable to define a coherent long-term energy policy and related strategic decisions such as the concrete level of Chinese dependency on the foreign energy market, the specific volume of investment in domestic oil and gas production, the concrete selection of long-term suppliers, and the feasibility of Central Asian and Russian pipelines.

Russia's, the US as well as the Japanese interest in China's energy and particularly oil strategy is in many ways rather ambivalent despite their economic and political interest of China's increasing integration of regional and global cooperation structures. If pragmatism prevails on both sides and the reform policies continue in China and Russia, the outlook for a more balanced and stable relationship between Moscow and Beijing has never been better politically and economically in their bilateral relations than today. However, mutual distrust is still an important and often overlooked factor in their planned expansion of energy ties.

63 See UNDP, 'Arab Human Development Report', New York 2002.

For the future interregional EU-China and EU-Asian relationship, the following recommendations can be made in addition to the Working Group of the *Council for Asia-Europe Cooperation (CAEC)* of 2004:

***CAEC*-Recommendations for a Multi-Pronged Approach to Interregional Cooperation on Energy Security (2004):**

- accommodating newly emerging Asian consumers and importers within existing cooperative schemes;
- providing assistance to countries lacking a complete energy policy;
- inferring lessons for Asia from European experience of regional cooperation (government-level dialogue);
- experience-sharing on national public policies (government-level dialogue);
- experience-sharing, information-exchange, and cooperation on scientific and technical issues (expert-level dialogue and public-private partnerships);
- joint initiatives in international fora dealing with energy issues;
- promotion of public campaigns on the issue of pacific nuclear use.

A long-term solution can only lie in the most international division of labour and multi-lateral policy (e.g. the creation of a regional strategic oil reserve), which promotes the opening up to outsiders, deregulation and privatisation of the Chinese energy sector.

The international community, including the EU, cannot only offer new technologies for renewable energy sources (wind energy) and for improving energy efficiency, but also support multi-lateral approaches to solving problems require a fundamentally co-operative foreign and security policy on the part of Beijing. The EU needs to widen and deepen its energy agenda with China by addressing not just technology transfers and EU support of the modernization of its energy infrastructure, but also its underlying strategies. A discussion of the *Treaty of the European Energy Charta* and the *Transit-protocol* could be a starting point albeit the prospects for a Chinese ratification are even worse than those of Russia's. Moreover, a more critical discussion of the global efforts of de-nuclearizing Iran in the context of China's energy and resource diplomacies is overdue on the EU side.

It is also in the interest of the rest of the world and the EU that a solution is found to the problem of how to guarantee China's energy supply and other questions concerning energy resources, if negative global impacts on environmental and security policies are to be avoided. The safer China feels regarding the solution to its energy problems, the safer its neighbours and the rest of the world will be. Hence China's concern about securing adequate oil and gas imports could encourage Beijing to become more assertive again over territorial claims in regions which adjoin large oil supplies. Hereby, the EU and the US need to take into account potential impacts of decisions in other areas not directly linked with energy questions such as the EU's trade policies. *David Hale*, for instance, has warned in 2004:

If the United States and Europe attempt to curb China's exports, Beijing will have no way to pay for its rapidly growing imports of oil and other raw materials. In such a scenario, China could

decide that the most attractive way of securing adequate energy supplies would be to reclaim lost territory in the Russian Far East with large oil reserves. Russia could thus become the casualty of protectionist trade policies in North America and Europe."64

In its own strategic interest and because of its dependency upon energy from the Middle East and Persian Gulf that will increase in the future (as well as the related risks to European energy supplies), the EU should strive towards a strategic co-operation with China in all areas of energy policy and thus also on exercise some influence over China's co-operative energy and thus also foreign and security policies. However, this requires a knowledge, which hitherto seems largely lacking in Europe, of the geo-economic and geo-political interdependencies of China's international energy policy, their impact on individual foreign and security policies as well as upon regional and global political stability.

In this context, a closer EU-Japanese co-operation on regional and global challenges of energy security would also be very helpful for both sides and counterbalance unilateral policies to enhance its national but not the regional and global energy security.

The EU itself — being in the midst of an ongoing liberalization of EU electricity and gas markets which makes it even more urgent to develop a coherent energy strategy at the European level — also need to bring back energy security discussions into the public by involving not just economic and energy experts, but also foreign and security specialists, as it is the case in the U.S. since the last few years, resulting in numerous new research projects and independent task groups that bring together both expert groups.

64 David Hale, China's Growing Appetites, here p. 143.

Building a Strong Nation, How Does China Perform in Science and Technology

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Building a Strong Nation, How Does China Perform in Science and Technology

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1. Introduction

After 28 years of economic reform and fast growth, China has emerged to become a real economic power in the world. With its abundant, cheap and skilled labour force, China has increasingly become an opportunity as well as a significant challenge to the developed world. One real question is whether China can become an economic and political superpower in the coming decades. The answer to this question partly depends on its ability to become a world leader of science and technology in order to compete directly with the leading economic powers such as the USA, Japan and the EU in the areas of innovation and technological progress.

A common perception is that China has relied on the expansion of labour-intensive industries and flooded the world market with cheap but low to medium level technology products. Although it has become the third largest exporting nation, China has failed to create a large number of big businesses that can compete with the world's leading multinational companies (Nolan, 2004). The expansion of the national economy has heavily relied on increasing use of raw materials such as steel, coal and cement. There are two negative consequences of this industrial policy. One is that the natural environment has deteriorated rapidly as the economy expands, rendering the long-term development of the economy unsustainable. The other is that China will have to become increasingly dependent on foreign technologies to maintain its high economic growth.

The Chinese government has long been aware of the weakness of its development strategy and has been trying to improve its own technological capacity through investments in basic research, innovations and the application of new technologies, utility models and designs. A number of national initiatives such as the Torch Programme, the 973 Programme and the latest 985 Programme have been launched over the last 15-20 years.65 Huge investments have been made to the Chinese Academy of Sciences, through the so-called 'Hundred, Thousand and Ten Thousands' Plan in order to attract as many top scientists as possible from home and abroad to concentrate their research in China.66 Similar investments have been made through the 211 Programme for 100 top universities and the latest 985 Plan on 38 key universities in order to make them as competitive as the world's leading research-oriented universities by 2020-2030.

Apart from making strategic investments in the national research institutes and research-oriented universities, the government has also encouraged research and innovative activities in large and medium size enterprises (LMEs). A Significant sum of funding has also been spent on buying patents and new technologies from all over the world, especially from the most advanced economies in North America, Japan and Europe. This paper will present an analysis of China's

65 The Torch Programme was launched in the 1980s to boost the technological progress in small and medium size enterprises, especially the rural township and village enterprises (TVEs). The 973 and 985 programmes were launched in the 1990s and recent years to boost the research capacities of universities through the establishment of national key laboratories and special support for key research scientists attracted from home and abroad.
66 The 'Hundred, Thousand and Ten Thousands' Plan was launched for the Chinese Academy of Sciences from the 1990s and has been lasting up to now. It aims to attract one hundred best scientists to lead the national key laboratories and institutes, one thousand top scientists to lead research programmes and ten thousand high level researchers to work within the research network covered by the Chinese Academy of Sciences.

development in science and technology and assesses how this has been related to economic reform and development.

2. An assessment of the development of science and technology in China

Science and technology was considered by the Chinese government as a key factor of production along with labour and capital. China's strategy on science and technology can be best described by the so-called 'walking with two legs' principle. The first leg is based on building up domestic research and innovative capacity. This is through investments in research institutes, universities and LMEs.

Table 1 Government expenditures in science and technology (billion yuan, current prices)

Year	Total government Expenditure	Expenditure in Science and tech	Share of total Expenditure (%)	Employment in S&T (000)	Scientists (000)
1980	122.88	6.46	5.26	----	----
1981	113.84	6.16	5.41	----	----
1982	123.00	6.53	5.31	----	----
1983	140.95	7.90	5.60	----	----
1984	170.10	9.47	5.57	----	----
1985	200.43	10.26	5.12	----	----
1986	220.49	11.26	5.11	----	----
1987	226.22	11.38	5.03	----	----
1988	249.12	12.11	4.86	----	----
1989	282.38	12.79	4.53	----	----
1990	308.36	13.91	4.51	----	----
1991	338.66	16.07	4.75	----	----
1992	374.22	18.93	5.06	1080	400
1993	464.23	22.56	4.86	1060	395
1994	579.26	26.83	4.63	1030	386
1995	682.37	30.24	4.43	1010	380
1996	793.76	34.86	4.39	990	385
1997	923.36	40.88	4.43	970	375
1998	1079.82	43.86	4.06	940	363
1999	1318.77	54.39	4.12	830	336
2000	1588.65	57.56	3.62	700	297
2001	1890.26	70.33	3.72	620	276
2002	2205.32	81.62	3.70	590	271
2003	2465.00	97.55	3.96	570	266

Source: NBS (2004), China Science and Technology Statistical Yearbook.

Table 1 provides some basic information on government expenditure and its expenditure on science and technology and the number of scientists and employees in research institutes in China. The total sum of expenditures in science and technology increased significantly over time, but as a share of total government expenditure, it actually declined from 5.27% to less than 4%. The total number of employees and scientists in research institutes also declined. However, this does not mean that China's research capacity has been reduced. China's reform on science and technology development was aimed to reduce the expenditure incurred by the central government and to increase the production efficiency of research institutes. Research expenses have been shifted away from the central budget to regional governments and LMEs.

Nonetheless, the declining share of central government expenditures in science and technology and the number of scientists in research institutes may reflect a certain degree of neglect in basic research, which has not kept up with the pace of economic growth.

Table 2 Science and technology in LMEs in China

Year	Number	Share of firms with S&T (%)	Total labour (mil)	Share of S&T in labour (%)	Total Sales Bil.yuan	New product as % of sales	R&D as% of sales	Import of technology as % of sales
1991	14935	53	31.95	2.59	1194	9.94	0.49	0.76
1992	16991	50	34.48	2.57	1524	10.47	0.50	0.80
1993	15000	63	35.71	2.57	1908	10.66	0.50	0.83
1994	20162	44	38.70	3.05	2390	10.22	0.51	0.90
1995	23026	40	38.93	3.17	3083	8.50	0.46	1.17
1996	24061	34	38.74	3.76	3355	10.08	0.48	0.96
1997	24024	30	37.80	3.90	3630	10.00	0.52	0.65
1998	23577	31	34.28	4.11	3746	11.66	0.53	0.57
1999	22276	32	31.37	4.64	4191	13.24	0.60	0.50
2000	21776	28	29.02	4.78	4985	15.33	0.71	0.49
2001	22904	26	28.04	4.88	5851	15.03	0.76	0.49
2002	23096	25	27.10	5.04	6745	16.07	0.83	0.55
2003	22276	25	31.03	4.55	9650	14.61	0.75	0.42

Source: NBS (2004), *China Science and Technology Statistical Yearbook*.

LMEs are an important force of innovations and technological creation. Over the period 1991-2003, the total number of LMEs rose by one-third, but the share of firms that have their own research institutes declined from 53% to only 25%, meaning that more and more LMEs opted out of basic research. For those which retained their research institutes, they had increased their research capacity in terms of the employment in science and technology activities and the ability to improve their product quality. The share of science and technology (S&T) employment in total employment rose from 2.59% to 4.55%. The sales of new products as a proportion of total sales rose from less than 10% to about 15%.

For LMEs, technology is either created within firms, or imported from overseas. There was a tendency to rely more on their research and development (R&D) than from abroad. The share of R&D in total sales rose from less than 0.5% to about 0.75%. The share of expenditure on imported technologies in total sales declined from 0.76% to 0.42%.

A logical interpretation of the figures presented in Table 2 is that LMEs had made a few important advances in the areas of science and technology. First, research and innovative activities have become more concentrated in a smaller number of firms. Second, there is a clear trend that firms have become more capable of improving their product quality, hence raising the proportion of new product sales in total sales. Third, importation of foreign technology is as important as the creation of technology at home. However, LMEs have become increasingly more capable to create new technologies themselves and less dependent on the import of foreign technology.

Table 3 Development of HEIs and their research

Year	Number HEI	Employment 1000	S&T employment 1000	R&D expenditure bil yuan, current price
1993	1065	1020	295.50	2.78
1994	1080	1040	301.32	3.87
1995	1054	1040	307.98	4.23
1996	1032	1040	316.35	4.78
1997	1020	1030	311.62	5.77
1998	1022	1030	311.42	5.73
1999	1071	1070	328.99	6.35
2000	1041	1110	315.11	7.67
2001	1225	1210	358.84	10.24
2002	1396	1300	376.14	13.05
2003	1552	1450	403.79	16.23

Source: NBS (2004), *China Science and Technology Statistical Yearbook*.

China's third major research and innovation base rests with the higher education institutions (HEIs). The development of higher education was the first area of reforms under Deng Xiaoping's leadership. After over 10 years of closure to public entry competition during the Cultural Revolution, China resumed the university entry examination in 1977, with a total enrolment of some 270,000 students in that year. The number of students and universities increased steadily during the 1980s and started to expand drastically in the 1990s. By 2003, the number of students enrolled to HEIs reached a record level of 3.83 million, rising from 0.61 million in 1990 and 0.28 million in 1980. The total number of postgraduate students rose from 10,934 in 1978 to 93,018 in 1990 and then 651,260 in 2003, or a rise of 65 folds in 25 years.

China has sent many students to study overseas. In 1978, 860 people were sent abroad. This number rose to 2,950 in 1990 and 117,307 in 2003. About 30% of the students sent abroad have gone back to China and many people have been employed by various institutions and organisations on a part time basis. As the majority of overseas Chinese students have studied in the world's most advanced countries, they have played a critical role in reducing the technology and know-how gap between China and the industrialised economies. The leaders of many national research institutes, key laboratories and research-led universities have studied and obtained their Ph.D degrees from the USA, Germany, the UK, France, Japan, Australia and Canada.

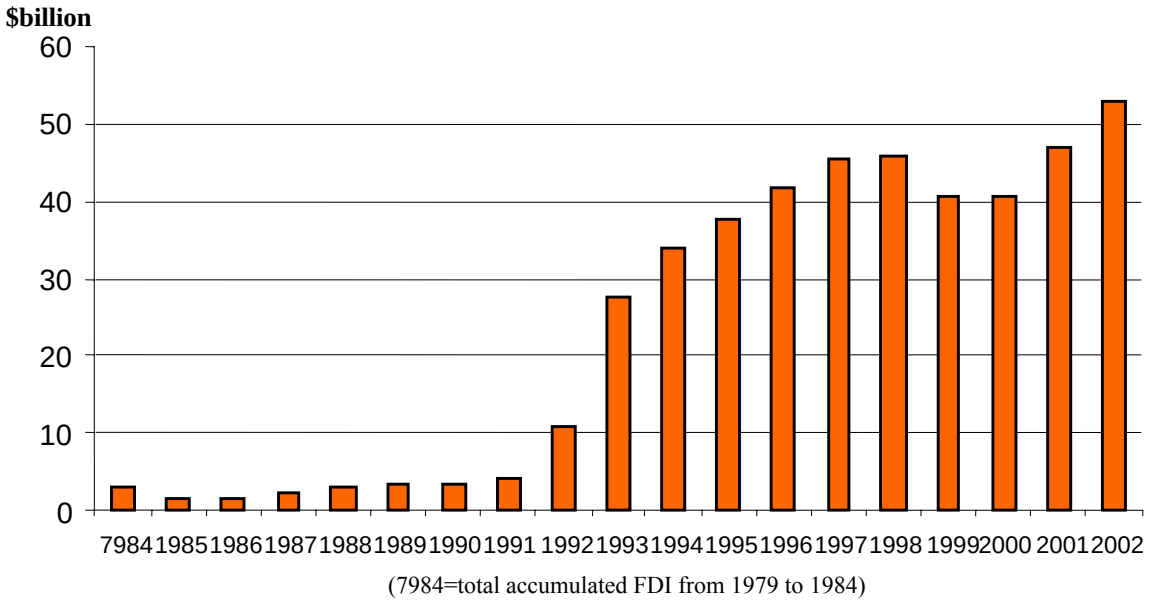
Table 4 gives some very basic information on the number of universities, the number of HEI employees and research scientists, and the expenditures on basic research over the period 1993-2003. It is obvious that the government has relied much more on HEIs to conduct research and other scientific activities. The total expenditure on research more than quadrupled in about 10 years in real terms and the number of research scientists increased by more than one-third.

China's second leg has been to build up its technology capacity through its open policy. Openness can be measured in different ways. In China, openness consists of three key elements. The most important element is its development strategy, which has gradually shifted away from import substitution to export-push. International trade has become an important factor in China's economic growth. In 1978, China ranked 23 in the world for its trade volumes, by 2002, China became the 6th largest exporter and the 7th largest in total exports and imports. In 2003, China became the 4th largest exporter in the world, with a trade volume of $851 billion (People's Daily, 12/1/04). In 2004, the volume of trade was more than $1.13 trillion, making China the third largest trading nation in the world. The composition of China's exports has changed from that

dominated by agricultural commodities and raw materials to that dominated by manufactured goods. The share of manufactured goods rose from less than 50% in 1980 to more than 90% in 2002. The contribution of foreign invested firms to China's exports increased from nothing to over 50% by 2002 (Yao and Zhang, 2003). In recent years, China, especially the Pearl River Delta and the Changjiang River Delta, has become the world's largest manufacturing base of many industrial goods, including colour television sets, computers, and other electronic appliances. In the early 1980s, over 90% of TV sets sold in China were Japanese brands. Nowadays, over 90% of TV sets sold are Chinese brands. In the first five months of 2003, China exported 770,000 colour TV sets for a value of more than $80 million (People's Daily, 4 July 2003).

Another key element of China's openness is the inflow of foreign direct investment (FDI). Figure 1 presents a picture of the evolution of FDI since economic reforms up to 2002. FDI was allowed right from the beginning of industrial reform in the early 1980s, but it was highly restricted until 1992 when Deng Xiaoping made his famous tour to south China. During his tour he told local party officials that 'we should move more quickly in domestic reforms, and be braver and more open to the outside world'. From 1993, inflow of foreign capital rocketed, and by 1996, China became the largest recipient of FDI in the developing world and the second largest recipient in the world, only second to the US. Despite the Asian Financial Crisis during 1997-98, China continued to attract large inflows of foreign capital, and by 2002, became the world largest recipient, surpassing the US. The accumulative stock of direct foreign investments was $501 billion in 2003 (People's Daily, 15/1/04).

Figure 1 FDI inflow in China, 1979-2002



Source: NBS, *China Statistical Yearbook,* 1987-2003

In the literature, FDI has been recognised as a major source of technology and know-how to developing countries. The knowledge created in developed countries, with their relatively high endowments of human capital, can be transferred to developing countries through FDI. Deng's policy of opening up China's door to FDI was not just to make up the shortfall of domestic investments, but more importantly to allow domestic firms to adopt new and advanced

technologies from the advanced economies, to learn from their organisation and managerial skills, and to improve their ability to compete in the international market (Yao, 2005).

The third element of openness in China is the reform of the foreign exchange market. At the beginning of economic reforms, the RMB was greatly overvalued, which was a significant constraint on China's attractiveness to foreign investors and its ability to export. With the gradual devaluation of RMB, China has created a conducive environment for both export and FDI. In recent years, as China has accumulated a large trade surplus and the world has been flooded with Chinese manufacturing goods, there is an increased pressure from Japan, USA and EU to ask China to appreciate the value of RMB. The Chinese government has been reluctant to respond to this pressure. One possible explanation is that China is not willing to damage its export-push development strategy. Another reason is that China has reached such a stage that it has built up its ability to compete directly with any international superpower. Even if China were to appreciate its currency, it would be unlikely that its export drive will be tarnished. It is interesting to note that Peter Mandelson, the EU trade commissioner, reached an agreement with his Chinese counterpart, Bo Xilai, the Chinese Minister of Commerce, on textile and garments exports to the EU in June 2005. From now to 2008, China will restrict its textile and garments exports to the EU, but from 2008, export restriction will be entirely removed.

3. How has China performed in science and technology?

Two main indicators of research performance include the number of patents granted to domestic researchers and the number of papers published and cited in key international indexes.

Table 4 shows the number of patents granted by the Chinese government. The patents are divided into three different categories: invention, utility model and design. Invention is innovative and should be treated as the most important type of patents. Foreigners are granted more invention patents than domestic researchers, implying that China has depended more on foreign technologies and innovations than domestic ones. However, the number of invention patents increased almost ten folds in nine years. For practical and applied technologies, which are reflected by the number of patents granted to utility model and design, China has mainly depended on domestic researchers, rather than foreigners. More than 99% of patents granted to utility models, and about 90% of patents granted to design were given to domestic researchers.

Table 4 Three kinds of patents granted from China and overseas

Year	Total	1. Invention patents		2. Utility models		3. Designs	
	1+2+3 (000)	Domestic (000)	Foreign (000)	Domestic (000)	Foreign (000)	Domestic (000)	Foreign (000)
1995	45.06	1.53	1.86	30.20	0.28	9.52	1.68
1996	43.78	1.38	1.59	26.96	0.21	11.38	2.25
1997	50.99	1.53	1.96	27.19	0.15	17.67	2.49
1998	67.89	1.66	3.08	33.72	0.19	26.00	3.25
1999	100.16	3.10	4.54	56.09	0.27	32.91	3.24
2000	105.35	6.18	6.51	54.41	0.34	34.65	3.27
2001	114.25	5.40	10.90	54.02	0.34	39.87	3.73
2002	132.40	5.87	15.61	57.09	0.39	49.14	4.30
2003	182.23	11.40	25.75	68.29	0.62	69.89	6.27

Source: NBS (2004), *China Science and Technology Statistical Yearbook*.

Key industrialised nations, including Japan, USA, Germany and other western European countries are the most important source of foreign invention patents granted in China. This implies that there has been an accelerating process of technological diffusion from the world's most advanced industrialised nations to China (Table 5). The three richest economies (USA, Japan and Germany) accounted for almost 80% of the total invention patents granted in China in 2003 (Table 5).

Table 5 Invention Patents granted by country of origin in 2003

Country	Number	%
Total	25750	100.00
Japan	9369	36.38
USA	5733	22.26
Germany	2615	10.16
Korea	2017	7.83
France	1038	4.03
Sweden	791	3.07
Stwitzerland	762	2.96
Netherlands	756	2.94
UK	572	2.22
All others	2097	8.14

Source: NBS (2004), *China Science and Technology Statistical Yearbook.*

China has paid serious attention to basic research and is ambitious to compete with the world's most innovative countries. This is reflected by the rising trend of papers published by Chinese scholars and cited in key international citation indexes. The number of papers cited in SCI, ISTP and EI rose almost three-fold during 1995-2002. China's ranking in the world improved from 15 to 6 for SCI citations, 10 to 5 for ISTP citations and 7 to 2 in EI citations over the same period.

Table 6 Chinese papers cited in key citation indexes

	1995	1996	1997	1998	1999	2000	2001	2002
Number of papers	26395	27569	35311	35003	46188	49678	64526	77395
Cited in SCI	13134	14459	16883	19838	24476	30499	35685	40758
Cited in ISTP	5152	3963	5790	5273	6905	6016	10263	13413
Cited in EI	8109	9147	12638	9892	14807	13163	18578	23224
China's position in world								
SCI	15	14	12	12	10	8	8	6
ISTP	10	11	9	10	8	8	6	5
EI	7	6	4	5	3	3	3	2

Source: NBS (2004), *China Science and Technology Statistical Yearbook.*

Although the number of citations does not fully reflect the true quality of publications, neither does it reflect the actual ability of technology creation, the rising trend of Chinese papers cited in the international indexes reflects the tremendous efforts of Chinese scientists to compete head on with scientists in the developed world.

4. Can China become a strong nation in the world?

After 28 years of reforms and fast economic growth, China is now the world's largest producer of many key industrial and agricultural products, including steel, coal, cement, cloth, fertilizers, TV sets, cereals, cotton and oilseed (Yao, 2002). It has also become increasingly more integrated with the global economy, through its fast growth in exports, imports and FDI inflows. China is now the third largest trading nation in the world with an annual growth of 8-9% in GDP and more

than 30% in international trade. China has become a real challenge to the world's most powerful economic blocks, USA, Japan and the EU. In the meantime, it has also become an important growth centre in the world economy. Fifteen years ago, no one would worry about China's economic growth rate, today, the growth prospects of many countries will depend on the health of the Chinese economy. One very simple example is the higher education sector in the UK. Fifteen years ago, many UK universities vice-chancellors would not pay any attention to the economic condition in China, today, up to 30% of their financial revenue come from fees of overseas students, of whom the Chinese are the largest group and their share has been growing year after year.

Although USA, Japan and EU fear that China (along with India and Russia) is posing a real threat to their future growth and prosperity, none of them cannot reverse or does not wish to reverse the strong growth of China. This is because a strong and growing China can create significant development opportunities for their industries, especially those in which they have clear comparative advantages.

The real issue is that what is considered to be a comparative advantage in the industrialised countries today may soon become a disadvantage tomorrow, depending on the ability of China (and other developing countries) to catch up with them in the technology and capital-intensive sectors. One simple example is the production of TV sets, which was dominated by Japan 20 years ago, but China has emerged to become the world's number one producer today. Another example is automobiles. At present, China looks like an assembling factory of all kinds of brand-named automobiles from all the key industrialised nations. It will not be surprising if China is to become a main exporter of motor vehicles in 10 years time. Some of the largest auto makers in China have accumulated huge financial assets thanks to the protection by the government over the past 20 years although they may not have any brand names of their own.

Empirical observations and data analysis presented in the previous sections suggest that China has its own characteristics in the areas of science and technology. These special attributes can be simplified as the 'walking with two legs' principle as discussed above. As a late comer of industrialisation, China is not able to create all the new technologies that are required to modernise its economy as many of the technologies have long existed in the advanced countries. What China needs to do is through 'learning by doing', 'learning by watching', imitation and adoption, and above all, importation of advanced technologies and know-how. This is typically the first stage of economic development when the country is specialised in the low to medium technology sectors. The necessary conditions in this stage of development are the gradual accumulation of human capital through education and training, applied research to digest and imitate what has been made available from the advanced economies, and the ability to buy foreign technology through an export-push strategy.

However, this pattern of growth may not be sustainable in the long term, especially if China is so ambitious that it wishes to become an economic superpower. As a result, China has paid significant attention to basic research and innovative activities. Large investments have been made in the Academy of Science and its national network of research institutes, in the research-oriented universities, and in LMEs. Although this investment strategy will certainly help China to reduce its gap with the world's most advanced countries, there is lack of evidence to prove that China has become one of the world's front runners in knowledge creation and innovations. Over the last decade, more than half of invention patents granted by the Chinese government still come from foreigners. Recently, the State Council has published the 'Medium and Long Term Science and Technology Development Plan' which details how China is going to develop its own research and innovation capacity and to use science and technology to support China's long-term economic growth.

The development of science and technology and economic growth are interrelated. Although China is large when its economy is measured in aggregate terms, it is a relatively poor nation when it is measured on a per capita basis. China is the 6th largest economy in the world when it is measured in nominal dollar and the 2nd largest economy when it is measured in PPP dollars. On a per capita basis, China's per capita GDP is only a small fraction of that of any of the industrialised economy whether it is measured in nominal or PPP dollar. Another basic fact is that China is still an agrarian economy with an agricultural labour force accounting for over half of the nation's total. In the foreseeable future, the biggest challenge on China is its ability to create enough non-agricultural jobs so that its economy can be fundamentally transformed from that dominated by agriculture to that dominated by industries and services. This industrialisation and modernisation process may take another 30 to 50 years, and over this period of rudimental industrialisation, China's development focus will still have to concentrate on the labour-intensive industrial sectors. The development of high-technology and capital-intensive industries is important but it cannot be the mainstream of the development process in the medium terms.

On the other hand, science and technology development is critical in the labour and low-technology industries. It is also important for China's gradual migration from the world's manufacturing plant to the world's leading economic superpower in the long term. Moreover, from the political and international relation point of view, China needs to create a good image to the outside world that it is not a country of 'low quality', but a country which can make significant progress in knowledge creation and innovation. Historically, China was one of the world's most advanced nations in science and technology. Zheng He's expedition ship around the globe was equipped with the world's most advanced technology six hundred years. China was also a nation with four basic inventions in ancient time. Only until 200 years ago did China start to lag behind Europe, the USA and then Japan. Mao Zhidong was ambitious that China should become a strong nation again in science and technology even when China was really poor during the Cultural Revolution. Following USA and Russia, China was the third country of the world being able to produce atomic and hydrogen bombs (1966 and 1973) and launch its first satellite in 1973. On 15 October 2003, China launched its manned-space craft (Shengzhou 5) to land on the Moon. The other only two countries which can send their men to the Moon are USA and Russia. In addition, China's Long March rocket launcher has become one of the most reliable launching systems in the world for satellites and other space crafts.

Nonetheless, the superiority of Chinese technologies in a specialised field may be just a showcase of China for its potential ability and determination to excel other countries. It is possible to concentrate heavy investments in some specialised areas but it will be difficult to make advances in all areas due to its limited resources and research capacity. In the long term, China has to use its resources more efficiently and focus on those areas that can lead to maximize production and economic efficiency. In the short and medium terms, these areas should be related to China's present comparative advantages in the world economy, including traditional manufacturing and labour-intensive industries.

5. Conclusions and recommendations

China has made significant advances in the following areas regarding science and technology.

- Research and innovative activities have been encouraged and supported by the central and regional governments.
- More research and innovative activities are encouraged in the LMEs.
- HEIs have become increasingly important for research and innovative activities.

- The export-push strategy and encouragement of FDI inflow are two important venues for importing advanced foreign technologies.

China also has a number of weaknesses in science and technology.

- Research expenditure has not kept up with economic development.
- There are not enough big businesses that are highly innovative and cannot compete effectively with the world's largest multinational enterprises.
- China is weak in the key industries that are intensive with advanced technologies, computer software, aircraft, automobile and electrical appliances, etc.
- Most of the LMEs are state-owned and are renounced for their inefficiency and loss-making.
- China has greatly depended on foreign technologies for its economic development.
- China's expenditures on science and technology have been low by international standards and low compared to its fast economic growth.
- China's economic growth has been heavily dependent on investments and labour and not so much on technological progress and efficiency improvement.

Policy recommendations:

- More research in research institutes and HEIs.
- More cooperation between LMEs and research institutes and HEIs.
- Strategic support for private enterprises to engage in R&D.
- More support to research and innovations in key industrial sectors.
- More collaboration with the most advanced economies such as USA, EU and Japan in every possible area of research.
- Continuation of export-push and openness development strategy.

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China-Russia economic and strategic relations: between rivalry and co-operation

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China-Russia economic and strategic relations: between rivalry and co-operation

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1. Introduction: the strategic role of Russia-China relations for Europe

The economic and strategic relations between Russia and China - beyond the long historical background of co-operation and competition since the 1950s, following fundamental changes in their respective political strategies during the different phases – are emerging at the present time. This is crucial for the stability of this large area, including Asia and Europe, but also fundamental for the European perspective, both for the enjeux vis-à-vis its close neighbouring country, like Russia and for the strategic interests of Europe toward China.

The broad and wide implications of Russia-China relations would need to be taken into consideration in the further elaboration of the European "neighbouring country policy", in order to better identify the Russian broader interests toward the Asian region and its attempt to redefine a lost role of economic power at the time of the USSR and also to better clarify the China's interests in the large Eastern European68 area, where Russia represents the most relevant neighbouring country, after the Accession of the Eastern and Central European countries to Europe.

The changing of the geo-political map, since 1990, following the breaking up of the USSR and the disruption of the COMECON area, has left uncertain the role of Russia between the Enlarged Europe, on the Russian Western border, and China, on the Russian Asian border, where historically the Russian territories, Siberia and Far-East, remain turned toward Asia. Furthermore, Russia's lost influence on the former Soviet Republics, like Central Asia and Kazakhstan69, has opened again a new road for China toward these culturally and geographically close neighbouring countries, rich in natural resources and especially in energy, where Russia hardly tried to keep close economic and political relations, pushed out also by the USA pressure.

EU through the recent Enlargement, has acquired new territorial dimension that might in fact facilitate the link towards the wide East-area, developing new economic ties: this turning of Europe toward East requires a far looking view and strategy towards Asia, where Russia might serve as a "bridge", in a dynamic and long term perspective, taking into consideration that Russia has always been territorially, economically but also politically, shared between Europe and Asia.

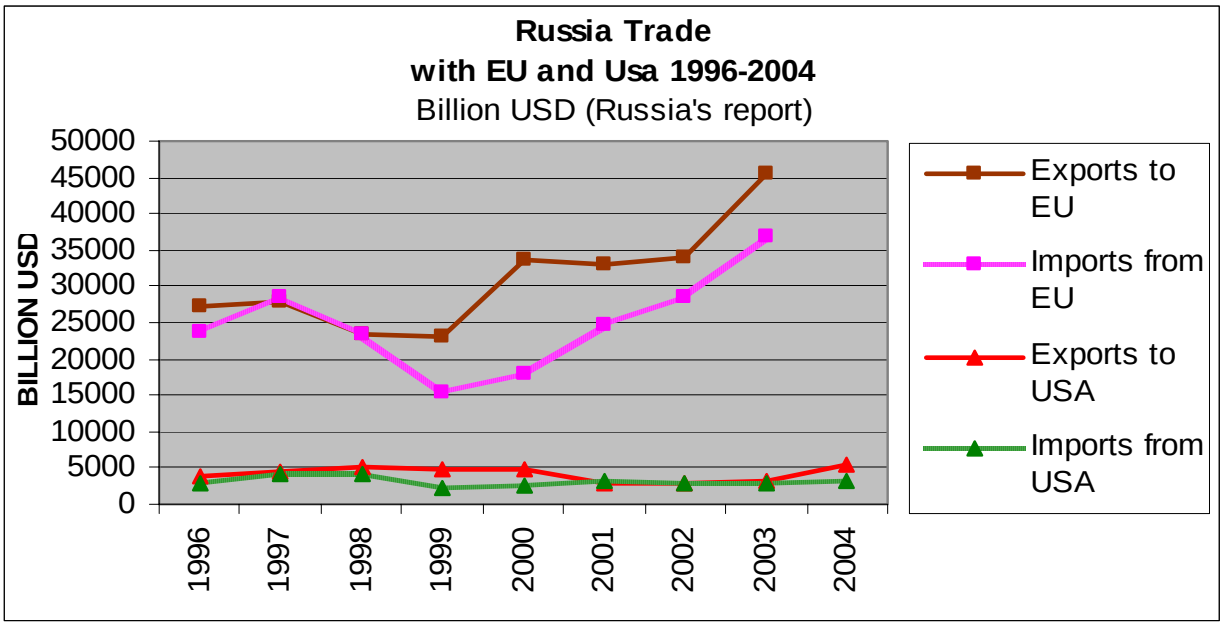
In this perspective, Russia - China relations are not only bilateral concerns, but have also wide implications on the European broad strategy toward Eastern and Asian regional area. It is there that Europe, for its peculiarity as "soft power", could contribute to re-compose so diverse interests and also possibly slow down some strong tensions.

67Alexander Nicolas Jett, intern at Nomisma has contributed to the collection of documentation and statistical data.
68 The results of the *Interview*s carried out in the framework of this project, by the author in the three Eastern European countries, namely Hungary, Czech Republic and Poland, outline the new strategic interests of China in the new EU Member countries from the economic points of view. Trade, migration flows and FDI from China have started to come to those countries at the beginning of the 1990ies, soon as the process of economic liberalisation and deregulation opened up and the Accession to the EU was clearly in the EU political agenda.
69 In particular Kirghizistan and Kazakhstan have been the closest allies of Russia that could have also represented an opportunity for strengthening the China-Russia relations in the area, before the recent changes in the political situations in both Central Asian republics.

2. Russia - China economic relations are strengthening: towards further integration?

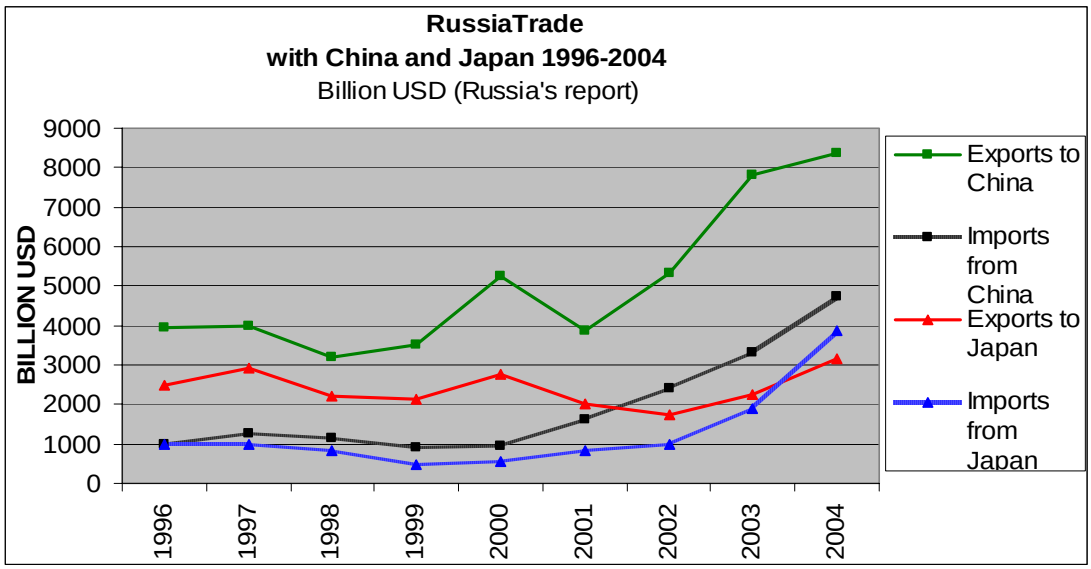
Once the long period of cool relations between Russia and China faded, the economic exchanges between them in the 1990s have resumed, in particular toward the end of the 1990s. The trade flows started to increase rapidly indicating the changing of the political agenda that did not exclusively turned toward Western side - in particular Europe and the USA, as president Yeltsin had focused on. Trade also went to the Asian side, looking back to re-establish good relations with its old neighbouring allies. The rapid increase in the trade volume between Russia and China if corroborate the reciprocal interests in reinforcing the economic ties, are however also the result of clear structural complementarities that have emerged and have been reinforced in the last decade and an half, depending on the different specialisation patterns that each country has consolidated, following a typical inter-industry trade pattern on the basis of their respective comparative advantages: Russia increasingly the energy resources provider and China the biggest consumer manufactures supplier.

Fig. 1 *Russian Trade with the EU and the USA*



Sources:UN Statistical Division, COMTRADE, 2005

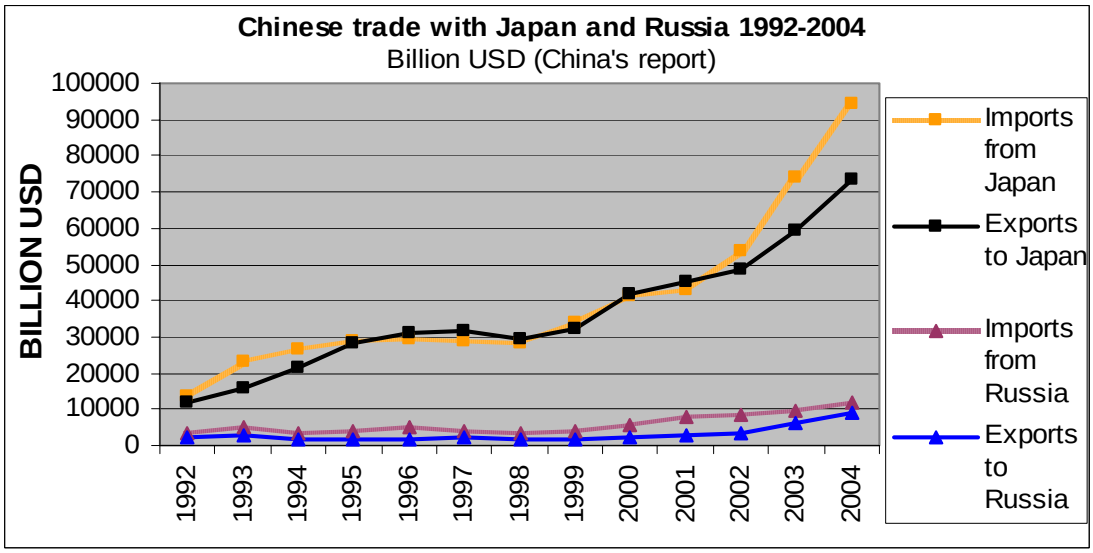
Fig. 2 *Russian trade with China and Japan*



Sources: UN Statistical Division, COMTRADE, 2005

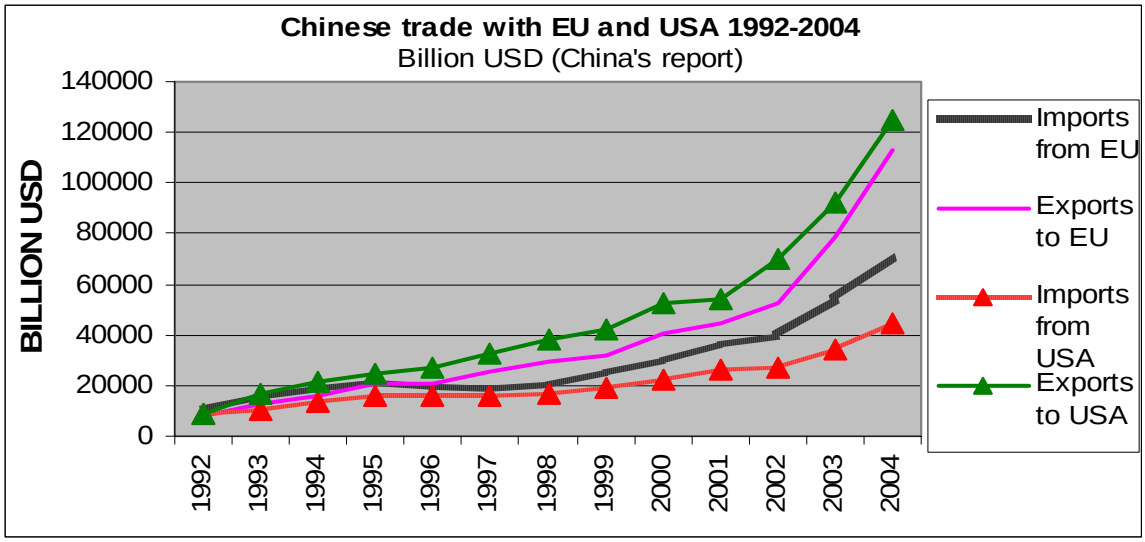
China has become the fourth largest trade partner for Russia after the EU, the CIS countries and the USA since 2000. Fig. 1 and Fig. 2 (Russia's report) show the diverse dynamics of the four major big world trade partners: China, Japan, USA and the EU. The volume of Russian import and export to China has markedly increased in the last few years, since 2000. By contrast, trade relations between Russia and Japan have slowed down and since 2001 remain globally much behind China's growing flows, showing a less dynamic trend and also confirming by contrast, China as the region's emerging demand driven by the large Asian-Pacific market. In fact the Russian export to Japan slowed down since 2001 and even if it resumed in 2003, remains far lower than the high increase of exports to China. This trend might indicate possible privileged economic relations between Russia and China at the expenses of Japan, even if on the political agenda the composition of the diverging interests might be different.

Fig. 3 *Chinese trade with Japan and Russia*



Sources: UN Statistical Division, COMTRADE, 2005

Fig. 4 *Chinese Trade with the EU and the USA*



Sources: Ibid.

Russia was the eighth largest partner for China in the last few years: even if Russian trade with China remains globally relatively low (see Fig. 3 and 4) compared with Japan, USA and the EU, their total volume of trade is increasing year by year, with an yearly growth rate of 20-35% in the last past five years, as reported by China's data. The figures reported by Russia and China on their reciprocal trade do not coincide, as discrepancy among the different country reporting happens: the Russian figures are lower then the Chinese figures. The illegal flows impact differently in each country depending on the import or export flows and border custom practices.

Comparing the larger trade partners with China, it is necessary to mention that the China's export capacity has been generated predominantly by the FDI flows that occurred in the last two decades and that have been the fundamental export-led engine of growth of the Chinese economy. The international de-localisation of part of the manufacture production cycles, through FDI, to China are therefore behind these export performances: accordingly the processing and assembling of labour-intensive goods still represent the largest share of its export achievements. Thus the trade relations between China and the major Western partners and Japan, are fundamentally dominated by intra-industry and intra- product trade patterns. The round-tripping FDI in fact is extremely relevant: there are different estimations varying from 25%, 23% to 50% of total FDI flows (Bajpai N, Dasgupta N. 2004; Harrold P. Lall R. 1993). Some estimates of Japanese and American subsidiaries in China indicate that between 50% and 53% of their production located in China is re-exported to third developed countries including Japanese or American markets (Fukao and alias, 2003), the remaining being for the local Chinese market.

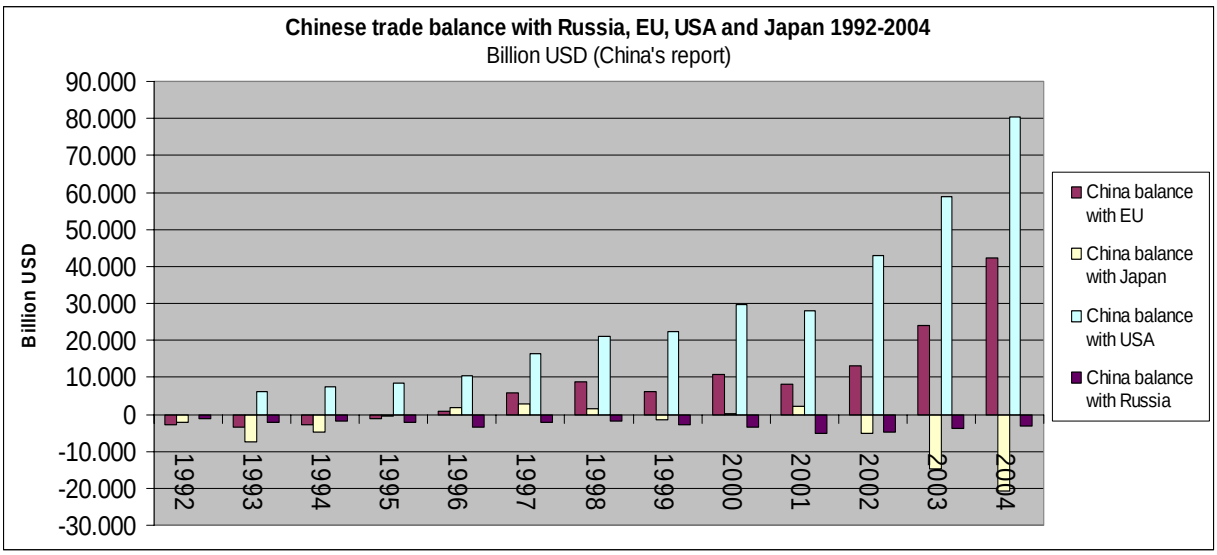
The Russia-China trade relations are instead characterised by final products exchanges or natural resources supply, on the basis of their relative comparative advantages and resources endowment.

The increasing Russia- China ties are expected to further strengthen in the near future, supported also by clear political statements from the Russian side70. There are some estimates that expect the total volume of trade between Russia and China to increase more than three times in five years, reaching 60 billion USD71, as long as the illegal trade is recorded and becomes legal. Since the last decade and half, Russia has had a positive trade surplus with China, but this has

70 Russian president Putin in June 2000 underpinned the new "*Foreign Policy Concept of the Russian Federation*" indicating the necessity for Russia to develop further economic and commercial ties with Asian countries, being the most dynamic growth countries in the world economy. (Chufrin, 2003)
71 Guan Xueling, at the Renmin University in Beijing mentioned this forecast, in Mc Gregor and Yen, *Financial Times*, 1 July 2005.

shrunk in the last two-three years, inspite of the growing oil price bill from Russia (see Fig. 5). However the Russian surplus is comparatively very small compared with the Japanese surplus that in fact between 2002 and 2004, has increased 3-5 times largely because of the intra-industry trade effects.

Fig. 5 Chinese Trade Balance with Russia, the EU, the USA, Japan



Sources: UN Statistical Division, COMTRADE, 2005

The highest Chinese trade surplus has been with the USA since 1993 and the EU since 1997 and it is impressive, the rapidity with which it is increasing: EU deficit vis-à-vis China in fact, even if smaller than the USA in relative terms, is growing faster than the latter. These trends confirm very clearly that China's trade performances have soared dramatically from the mid-1990s, as a result of the maturing of the multiplying effects generated by the FDI flows in the previous and ongoing decade. The improvement of the investments and production conditions in China have than engendered a virtuous cycle of the Chinese export capacity, that is amplifying in 2005 with the accession to the WTO and the lifting of the Multifiber arrangements for textile and clothing.

3. A strong trade specialisation pattern in the Russia-China exchanges

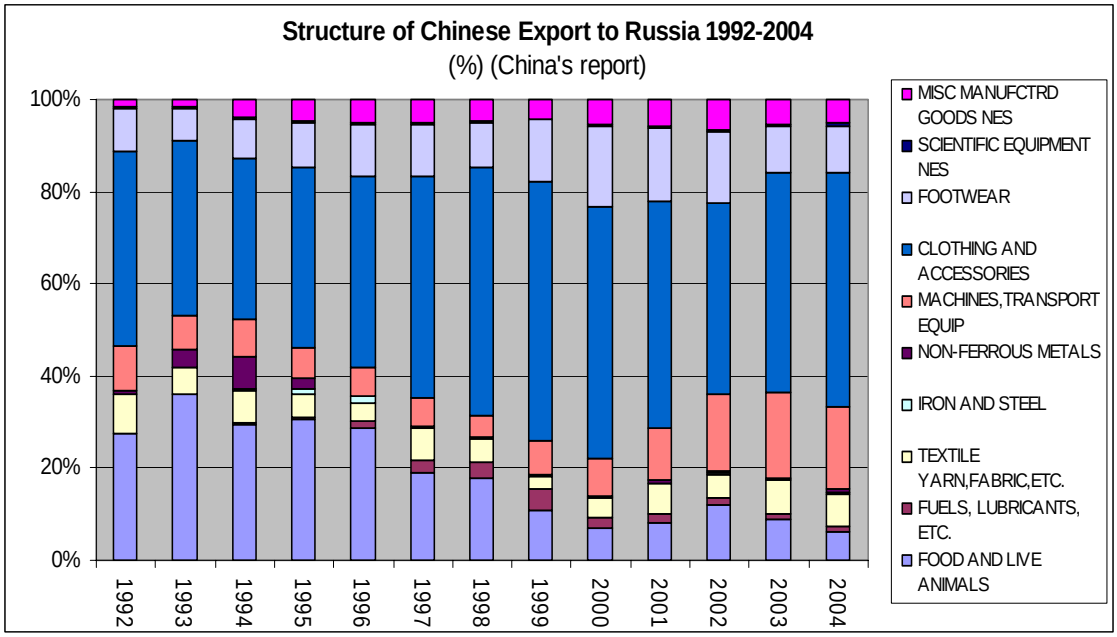
A strong sectoral trade pattern make the trade structure very focused on few items, responding to the different composition of the growth factors in the respective specialisations and factors (see Fig. 6 and 7, the Structure of the Export and Import) :

China is an increasing market for Russian industrial production like fertilisers, synthetic rubber, flat rolled steel products, but the main strategic items are three: energy (oil and gas), wood (mainly rough), arms and aircrafts. These three items are of strategic importance for China's growth and its strategic positioning in the world economy (see Fig. 6 below).

Russia's import is concentrated mainly on the cheap manufactured goods and agricultural products for its domestic demand, considering the disruption of Russia old obsolete industrial capacities, in particular in the consumer goods sectors, since the beginning of the transition in 1990 and also after the massive import of consumer goods and food from Western countries in the middle of the 1990s up to the 1998 Rouble crisis. The increasing domestic demand represents

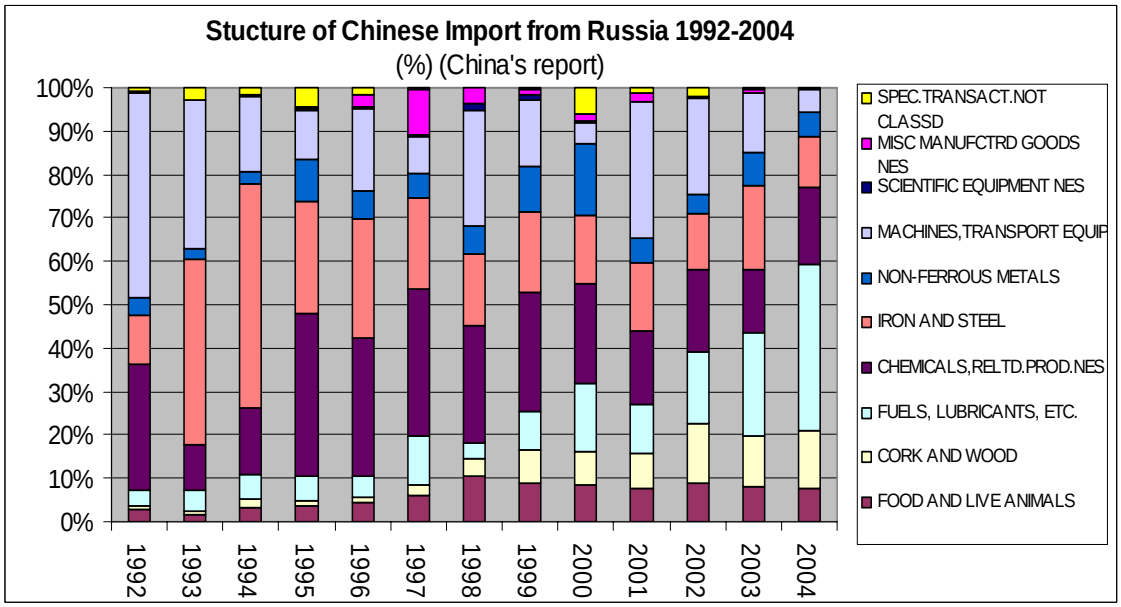
a large potential market for China goods and also with the increasing share of electronics devices, competing with Japan and South Korea's export to Russia. The structure of the Chinese export to Russia (see Fig.6 below), is if fact dominated by footwear, clothing and accessories that together with textile, making up more than 65-75% of total export in the last few years.

Fig. 6 *Structure of Chinese Export to Russia 1992-2004*



Sources: UN, Comtrade, 2005

Fig. 7 *Structure of Chinese Import from Russia, 1992-2004*



Sources: UN, Comtrade, 2005

Russia, on the other side, has amore diversified structure (see Fig.7), but for the above mentioned items - energy, wood, and arms - is a strategic supplier for China, making Russia a fundamental partner for China's growth strategy:

A. *Energy commodities (oil and gas):* Russia occupies a strategic position vis-à-vis China as an energy resource supplier, for satisfying its increasing energy needs. The energy import has in fact swelled since 1999 (see Fig.8). Related to this trend, the project concerning the construction of the pipeline from Russia to China is one of the most sensitive issues under controversial discussion, still in competition with the alternative construction of a Russia-Japan pipeline (see below chapter on Siberia and Far-East). The alternative choice are both extremely strategic for the relations in the whole of South-East Asia and also challenging for Russia, between the two major competitors, Japan and China, taking into consideration the Russian energy reserves constraints.

Fig. 8 *Chinese Export and Trade Balance with Russia 1992-2004*

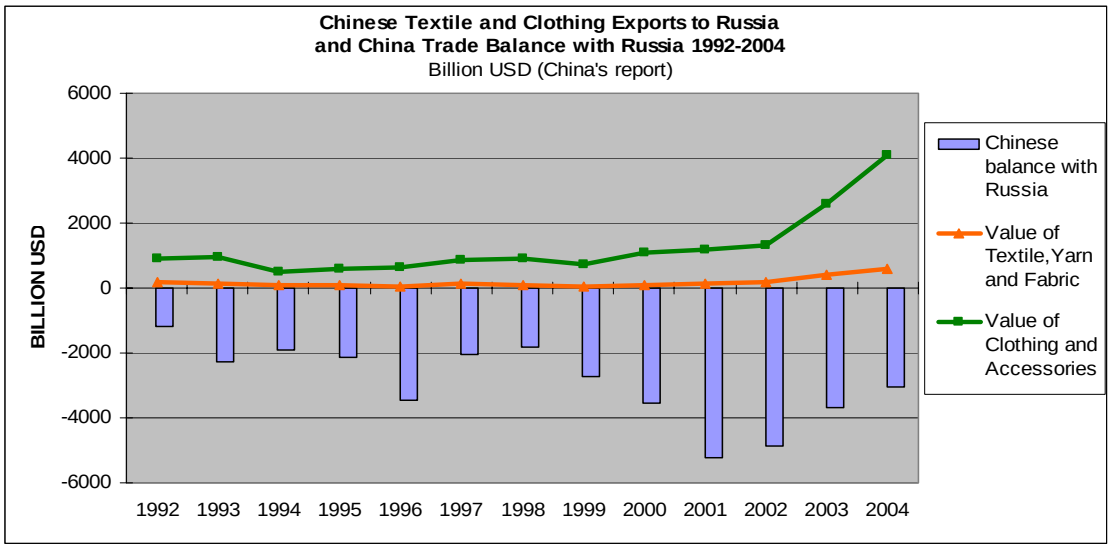
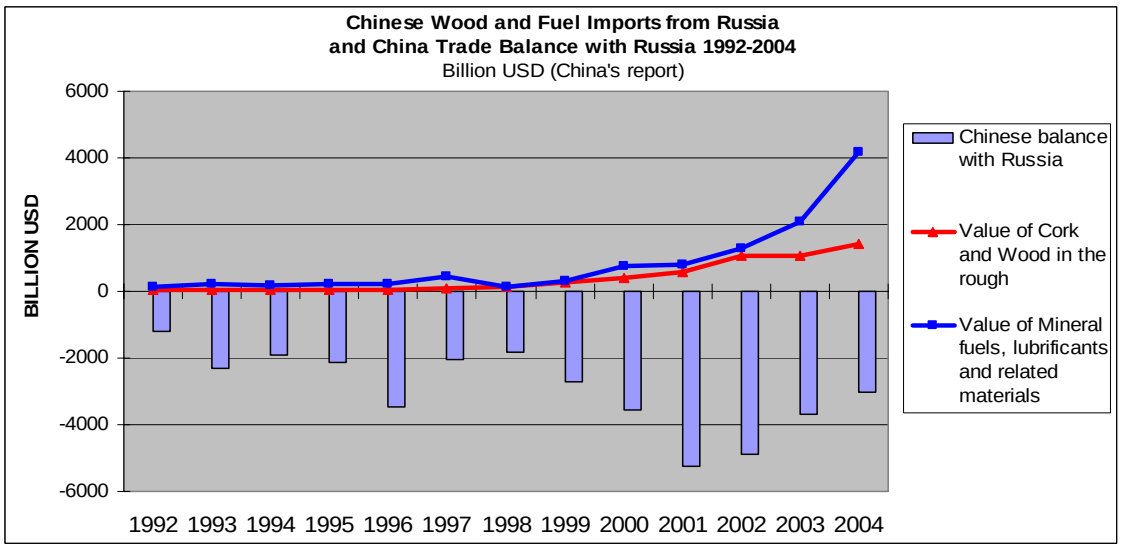


Fig. 9 *Chinese Import from Russia and Trade Balance with Russia 1992-2004*



Sources: UN, Comtrade, 2005

B. *Wood and timber*: Russia is the first supplier of China, that has became the second largest world importer of forest products in the last few years, after having pursued in the 1980s and beginning of the 1990s (Katsigris, E., Bull and al., 2004; Xiufang S., Katsigris E. and White A., 2004) a devastating de-forestation that has dangerously created ecological disasters in areas subject to raining. The increasing import of logs, that dominates the timber product

import, indicates also that China is developing its own wood processing industry, for satisfying the huge domestic demand for construction, infrastructures and housing. Russia is therefore increasingly an exporter of logs, primarily collected in Siberia, declining its timber and pulp and paper export (first processing items), confirming again Russia's natural resources profile. In the Fig.9 shows clearly the impact of the wood import and the general trend of the Chinese negative balance of payments in the last years.

C. *Military products*: the arms sale from Russia to China represents one of the most peculiar economic features that characterise their trade relations. As a consequence of the arm embargo on China, Russia has become the major supplier to China of military technology, Israel being the second one. China represents roughly 30% of the total Russian military export whilst India roughly 40%. Whereas Russian technology is far behind European and American technology standards, China has no alternative choice at this stage due to its isolation from the world defence market and from this perspective remains fundamentally dependent on Russian supplies, until the political arms embargo is partially or totally lifted. The scientific co-operation in the field of defence (including training) between Russia and China defence officials seems still very active. However China's payment to Russia have been until 2001 dominated by "barter" payment system: only 30% were paid in hard currency and the remaining in Chinese manufacture goods, which was not a strong incentive for therr Russian partners to provide their most sophisticated technology. Only in 2002, a new agreement lifted the barter trade.

4. China and Russia economic performance, rivalry and competition: success and failure of different growth strategies

The relative positioning of China and Russia in the world market and their capacity to play on the global arena represent factors that originate from clear tensions between the two countries, taking into consideration the very diverse economic performances: the process of reforms and restructuring since the 1980s for China and since the 1990s for Russia, have brought an increasing inverted relations between the two countries economic potential. In 1991 China's economy (total GDP) represented 90% of the Russian economy (with a population in China more than 7 times higher than Russia), but in 2001 Russia was merely 21-23% of that of the Chinese economy.

The growth rate of China in the last twenty-five years has rapidly pushed toward convergence with Russia, the latter characterised by slow growth rate: thus, the Russia-China ratio has changed between the 1979 -2001 period from 4:1 for Russia to 1:4 for China. Russia has clearly lost its past influence as a great world player, after the disruption of the Soviet Union, and its economic performances since the transition have been extremely poor.

These growth patterns might indicate an increasing worry of the emergence of China as a dominant economic power, in particular because Russia has become since 1990, increasingly a raw material export-led country, the energy export representing more than 50% of its total exports. The comparative advantages by sectors of the Russian economy, calculated on the Russian official figures by the Balassa's Index72 (UNSD- Comtrade, 2004), are extremely high for the minerals (5.67), followed by basic manufactures (1.93) and wood products (1.45), against other industrial processing industries and machineries with a very low index (from 0.33 to 0.07).

72 The Balassa's Index is composed by the share of the given sector over the national total export, divided by the world share of this sector over the world total export.

The weight of the energy production over the total domestic production in Russia has been recalculated by the World Bank (World Bank, 2004), as much higher than reported officially, for the practices of transfer prices from the extraction sector to the services sector, thus mushrooming artificially the service sector, for opportunistic fiscal reasons. Also an OECD Report (OECD, 2004) confirms such a hypothesis. If these assumptions are well funded, these results indicate an even dominant weight of the energy sector over the domestic economy, higher than before the transition started (1990s), and implicitly corroborate the conclusion that the reform policy in Russia has been fundamentally a failure for the target of creation of new competitiveness capacity.

The raw materials-endowed countries - typical of developing countries - are characterised by low growth rate and Russia confirms such a trend, even if the increasing oil world price in the last few years has contributed greatly to keep high its growth and to improve dramatically the State's reserves. Even if some industrial sectors have performed better, like food and chemicals, the overall Russian competitiveness has been fundamentally eroded.

On the other side, China is becoming increasingly a manufacture producer of the world market and with the accession to the WTO, is playing its full insertion into the globalisation of markets. The comparative advantages of China are predominantly in labour and resource intensive goods (Yue Ch, 2001), but a positive diversification towards higher value-added products, like electronics products and devices is already emerging, though for the time being these goods are predominantly the result of processing and assembling activities.

However China‘s ambitions are strategically focused on the technology and innovation policy, facilitated also by higher quality of FDI73, for creating better conditions for shifting from low value added (labour-intensive) products to higher value added, and all related policies are converging towards this medium-long term target (see Shujie Yao's paper in the Vol. 2 of the Report).

These opposite economic growth potentials and economic policy directions could bring an increasing marginalisation of the Russian economy, as far as Russia is failing to diversify its economy and to shift to more value-added sectors.

Siberia and Far East regions and their strategic role: Is China the only future chance for their development?

The strategic importance of the regional economic patterns in the relation between Russia and China, make the Eastern regions of Russia, Siberia and Far-East, the territorial enjeux that seems in fact to represent the core of the confrontation-cooperation between Russia and China.

Siberia and the Far East regions were historically territories occupied by Mongols, then by the Russian between the 16th to the 18th Century, but some regions in the Far East - like Khabarovsk, Primorye, Amur, Bizobidzhan – have been annexed by Russia only at the end of the 19th Century. Thus this long historical background has always foreseen the confrontation between Russian and

73 The recent regulation for the new FDI in the car sector - requiring to new foreign companies investing in China to transfer also the research and design activities, along with the production lines - confirms the wiliness of the Chinese government in imposing strict rules to foreign companies, in order to maximise the opportunities for the transfer of technology and consolidate innovation and management capacities of local firms and their Chinese managers, aware that often foreign companies maintain close control over own technology and only marginally let to disclose their know-how to the host country partners.

Chinese authorities. These regions, after the Soviet ruling, have opened up towards the Asian rims de facto only since 1990, following the breaking down of the USSR and the starting of transition (Trenin, 1999). Before this new recent historic turning point, these regions have been the legitimate frontiers - excluding the period of co-operation of the 1950s - of the Soviet system during the '60s to the '80s, that were closed up to commerce and exchanges with China, representing on the opposite side, the barriers to the "Chinese danger". The huge strategic infrastructure investments of the "Amour-Baikal magistral" along Eastern Siberia and Far East at the border with China, of the 1970s was in fact meant to defend the Russian territories from possible Chinese invasion, attempting to take back their ancient territories74 - considering the political breaks between Moscow and Beijing at that time.

The attempt of creating a stable population in Siberia and the Far East have been always the focus of attraction policy during the old and recent history and in particular, between the '50s to the '70s (Chufrin, 2003; Occhionero, 2005; Weede, 2003), with an active population migration policy with the employment of wage incentives and guarantees for basic facilities for households, in order to create stable urban settlements. The costs of such policies were politically justified within the Soviet planning system, together with the gigantic infrastructure projects and the creation of ex-novo Soviet urban centres - many of the Siberian cities have been created in the period between the 1930s to 1950s - based on military industrial complex and energy or natural resources exploitations.

This strategy was coherently pursued until the end of the 1980s, when the disruption of the Soviet Union and the very rapid de-regulation of the economy that has been pursued by the newly independent Russia, has left the infant market mechanism to start to play. The disappearing of the State support policy, the sudden abandonment of the Eastern regional incentive mechanisms and the withdraw of the huge infrastructure plans implementation, together with the closing down of most of the large military bases - in the "industrial towns"- have brought these uncomfortable and far away regions, to quickly decline. The increasing unemployment have led to the rise of out-flow migration (World Bank, 2004; Benini and Czyzewski, 2005), back to Western Russian regions, that coupled with the already deteriorated demographic situation of these towns, have caused a very dramatic drop of the urban population.

The de-population of these regions has thus opened up new challenges for the demographically declining Russia. China border-regions, are in fact very densely populated, and they might represent the potential reservoir for the consolidation of a Siberian and Far-East local population. Already the legal and illegal migration from border China's regions to Eastern Russian regions is increasing very rapidly since the 1990s, but in particular intensified in the last five-six years. The estimations vary greatly from few thousands to more than ten thousand.

At the same time, the overpopulated Chinese North-East regions found new markets and scopes for trading theirown cheap manufacture and agricultural products: the "shuttle trade" including the illegal one, with the Russian border regions75 has been estimated in 2001 to be around 12 Billion USD. Further bilateral trade agreements and the relaxation of the Visa requirement for the Chinese coming to Russia, have made very easy for the Chinese traders to increase the border trade. Russia on the other side, fears that this increasing new resident and commuting population will represent a threat to future development of these regions, in the hypothesis they would become economically influent in particular for the acquisition of key industrial assets in the energy sector.

74 In 1969 harsh confrontation happened at the border of Russia, in the Far-east, with local Chinese population, claiming back their ancient territories, now Russian.
75 The city of Suifenhe, in China at the border with the Russian Far East, has double its population in four years, becoming a central point for the shuttle trade between China and Russia. (McGregor and Yeh, 2005).

5. China's strategic interest in Russian energy delivery

Siberia provides the most relevant sources of oil and gas for Russia, the second largest oil exporter in the world: Western Siberia is in fact the region from where to day come the main oil extraction (Occhionero, 2005). Some estimations about the reserves indicate that Western Siberia represents in the short-medium term 75% of total Russian reserves, whilst Eastern Siberia 4%, and Far-East only 2% (Lambert and Wollen, 2004). Instead, the potential reserves, not yet identified might put Eastern Siberia, and relatively Far East, in a more prominent position: over the long term the shares might change to 61% for Western Siberia and increase to 14% for Eastern Siberia and 3% for the Far East76. These scenarios have therefore relevant impact on the long-term perspective of these regions that might add strength to Russia's capacity in providing energy supply to the world market and to the Asian countries, including China in the first place.

However there are two constraints to these scenarios:

i. First, the actual state of the technology for transporting oil and gas through pipelines is non adequate (Occhionero, 2005; Lambert and Wollen, 2004): the public company, Transneft is de facto a monopoly and manages 95% of total oil transport in the Russian territory and in consideration of the disparities between domestic and international energy prices (the former much lower than the latter), impose a system of quotas to the private companies, in order to ensure the provision of energy for the domestic market. This type of distortion have pushed the Russian oil companies to maximise their extraction for increasing their export capacity, forcing to the extreme levels the exploitation of the oil fields.

ii. Secondly, the inadequate state of the technology, that implies extremely high costs for oil extraction*77*compared with international standards, slow down the Russian competitiveness capacity: it is estimated that Russia would need to invest between 2001 and 2030, at least 328 Billion USD or 11 Billion USD/per year (IEA, 2003) for the up-grading of the energy sector, including technology and infrastructures, 95% of which would be dedicated to find new fields. Without a continuous investment policy in the energy sector Russia might fail in sustaining future perspective of oil extraction over the long term, seriously undermining its role in the world energy market.

The strong control by the State over the energy fields, that established the maximum of 15% of foreign participation to the extraction, and the quasi-oligopolistic situation with the main five giant78 oil companies, has generated strong conflicting situation among the different companies' international strategy and alliances including the confrontation between the State's (Putin) policy and the private companies' interests.

It is in this perspective that the agreement with China for the building of a pipeline from Siberia to Daquing, the oil port of China, sustained by Yukos has faced the opposite intention by Transneft, to support the pipeline to Nahokta, for serving Japan (see Umbach's paper in the Vol.2 of the Study). The confrontation between the State company, Transnneft, and the private company, Yukos is clearly also related to the China 's matters and contrasting interests within Russian establishments.

76 Estimations indicate that the reserves potential's might be of 30 billion of barrels, and reserves still to be discovered, might be about 90 Billion of barrels (Lambert and Wollen, 2004).
77 The costs of extraction of Russian oil is between 5-7 $ per barrel against 1-2 $ of South Arabia.
78 Lukoil, Yukos, SNG, TNK, Sibneft.

China's energy consumption are forecasted to increase from 5 Billion b/g in 2005 to more than 10 Billion b/g in 2020 (EIA, 2002), and of course China has strategic interests on the future of oil in Russia and the decision about the pipeline from Siberia either to China or Japan, is foremost sensitive but also strongly dependent on the political future scenarios.

The other Russian energy source, natural gas, is forecasted to have huge potential with 16% of total confirmed world gas reserves still to be exploited, with Gazprom monopolising the gas sector. However all Russian energy resources, including natural gas, are heavily undermined by the necessary economic liberalisation reform, a comprehensive restructuring plan for up-grading their technology and rationalise the whole system, in order to sustain the increasing world demand and more importantly, for confirming the Russian role in the Asia-Pacific region.

China is also trying to diversify its country's energy provisions, both in terms of countries as well as in term of alternative energy sources. Taking into consideration the territorial proximity with Russia, the Russian Eastern regions remain - strategically and inevitably - relevant and attracting for the Chinese long standing and "historical" interests in this area.

6. Final considerations in the Russia-China relations and the challenges for the EU

China and Russia relations are at present based on a complementary division of labour in the world economy that has however different implications for each of them, in a rapidly evolving world economic and political framework.

Russia's strategic position vis-à-vis China has structural weaknesses, since it is primarily based on raw material specialisation, as rent-seeking position, that by definition has no economic growth potential in term of growth dynamics. But even in the hypothesis that Russia will not be able to make major shifts toward high technology and high value added goods or services for the world trade, its capacity to keep its role as a simple raw material supplier to world markets, is also seriously undermined by its present technological constraints. Therefore, either Russia will be able to attract foreign investments in its strategic sectors, accompanied by more liberal economic reforms, bringing competition within the highly monopolised or olygopolistic internal markets, or will also slowly loose its advantages in this sector, over the long term.

China, on the contrary has its strongest advantages in the manufactured goods' field, gaining increasing world market shares at the expense of other middle and low income countries in the region (see Wing Thye Woo's paper in Vol.2 of this Report), in labour intensive goods. More importantly, China is rapidly increasing the share of higher value-added export goods, like electronics devices, indicating the new path that China is taking. Thus, according to the present conditions, Chinese potential growth is extremely high and this represents the major gap between the two countries, China and Russia, that might increase in a long-term perspective at the disadvantage of Russia.

At present, Russia can still play on the technology advantages in some specific sectors, like military, but in perspective these advantages might also disappear, in particular in light of the growing catching up of the Chinese technology and innovation capability, facilitated also by the technology transfers acquired through FDI investment in China, together with the increasing willingness of the Chinese government to pursue active innovation policy.

Which might be the challenges for the EU?

i. Europe in this framework can play at different levels in its foreign and trade policies, looking at the positive long-term perspective that might emerge from stable and non-conflicting relations between these two large countries.

ii. Europe could be a catalyst factor between the two countries, exploiting its privileged relations with Russia - also facilitated by the newly acquired Eastern Member States and by a more coherent and comprehensive "European neighbouring country policy" - and developing more accurate and deeper cooperation agreements with China.

iii. On the other side, Europe might also be more attentively interested in helping Russia in dealing with the economic and social decline of its Eastern regions, Siberia and the Far-East, because stability and improvement of the local conditions might also be an important factor that could help to stabilise the entire area, slowing down the possible excessive tensions that might emerge at the borders with China.

Europe therefore needs to elaborate a global strategy where both large countries – Russia and China - are foreseen and their peaceful and stable relations are also in a prime interest of Europe, beyond the European individual strategic interests with each of them, separately.

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Socio-Cultural Aspects of the Relationship Between the EU and East Asia, with Particular Reference to China

Dr. Seán Golden

Socio-Cultural Aspects of the Relationship Between the EU and East Asia, with Particular Reference to China

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言有宗，事有君 *yányǒuzōng, shìyǒujūn*
Words have an ancestor; affairs have a sovereign.
老子道德經 *Lǎozǐ Dàodéjīng*, 70, 17179

This will be a comparative study about words and about sovereignty; about the ancestry of the words that construct the discourse of sovereignty in the context of China; about the analysis and interpretation of the civic discourse and the rhetoric that construct Chinese sovereignty in the field of international relations and foreign policy, and about the consequences of this analysis and interpretation for the formulation of EU foreign policy with regard to East Asia, especially China, and the United States, as well as the feedback that notions of sovereignty have on the construction of Chinese civic discourse.

In the social sciences, as practised in Europe, there is an important tradition of discourse analysis and its relation to power: Antonio Gramsci's concept of "hegemony", or the control of information, as a counterpart to "institutional violence"; Michel Foucault's concepts of the "archaeology" and the "genealogy" of discourse; Louis Althusser's concept of "interpellation"; Gilles Deleuze's and Felix Guattari's concepts of dominant and subversive discourses, or Jürgen Habermas' concept of the public sphere and the rules of civic discourse that construct it, among many others. In East Asia, especially in China, there is a new, alternative and developing tradition whose hypotheses and conclusions are waiting to be integrated into the European academic framework of applied discourse analysis and comparative socio-cultural studies.

The Chinese term **君** *jūn* "sovereign" has an interesting etymology in this context: a hand holding a club, combined with a mouth that speaks. The hand and club are a metaphor for "authority", the authoritative role of the "father" in imposing order in the microcosm of the family in the socio-political in traditional Chinese political and social thought. With the addition of "mouth", authority becomes the authority of that person in Society whose words have the same force as the authority of "institutional violence", that is to say, the "sovereign". So there is a close relationship between words or discourse and sovereignty in traditional Chinese political thought. This idea is reinforced by the fact that such a significant term as dào, the "way", also means "discourse", "that which is said", "to dictate", "that which is dictated", "dictation", which is not so far from "dictator" or "dictatorship", which I would prefer to understand, in contemporary terms, as the discourse of power. When traditional Chinese political and social thinkers speak of "the Way" and its applications, they also try to identify the source of this civic discourse, and often attribute it to the "sovereign". In this sense, the "ancestry" of the words that construct discourse and rhetoric is bound up with "sovereignty".

The most famous definition of the relation between political power and social organisation in traditional Chinese political thought is the Confucian affirmation **君君臣臣父父子子** *jūnjūn chénchén fùfù zǐzǐ*, "that the sovereign [**君** *jūn*] act as a [competent] sovereign, the minister [**臣**

79 Cf. Lao Tzu [Laozi], *Tao Te Ching*, D.C. Lau (Ed. & Trans.), Penguin Books, 1963, p. 132.

chén] as a [competent] minister, the father/subject [父 *fù*] as a [competent] father/subject, and the son [子 *zǐ*] as a [competent] son", which is the illustration of the Confucian doctrine of 正名 *zhèngmíng*, "the rectification of names", or the need to establish a socio-cultural ideological consensus, at both the macrocosmic level of society in general and the microscosmic level of the individual family (to which we would need to add an extension to international relations and foreign policy).

In traditional Chinese political thought, 80 the establishment of an official discourse that could order society was a major concern of both thinkers and policy-makers alike, and the Chinese imperial examination system created a system that combined intellectual and literary competence with the administration of power, creating a situation of complicity between intellectuals and policy-makers that continues to be important today. The construction of the modern discourse of power at the national and international level is being carried out both in government and in academic circles. In the absence of a highly developed and independent civil society, which is still incipient in China today, modernisation and the translation —or recreation— of "Western" *modernism* in the Chinese context is to a large extent the result of debates among intellectuals who are also advisers, such as Yu Keping, on politics, or Hu Angang, on economics, or Wang Hui, who takes a more philosophical approach to the discourse of *modernism*, both "Western" and Chinese.

Over the last two centuries the discourse of *modernism* that had been developed in "the West" — and its concomitant concept of sovereignty— have confronted the Chinese tradition, with traumatic and unequal results that still play a major role in China's perception of the EU and of the United States (as well as Japan). As a result, an analysis of the genealogy of the discourse of *modernism* that came from the "West" is a necessary first step in the process of making a comparative analysis of contemporary Chinese civic and political discourse.

1. Shifting paradigms in the current debate on international relations

Modernism in the "Western" context is a product of the historical and cultural forces that produced the Enlightenment, forces of European histories and cultures that were different from those of China. This European *modernism* was introduced into China's history and culture by the force of arms, provoking a traumatic experience that has lasted for more than a century and half, and it would be impossible to understand the Chinese reaction to modernisation and *modernism* without bearing this fact in mind. Resistance to accepting the paradigms of European *modernism* as being "universal" is one of the consequences of Asia's colonialised past, and of Asia's postcolonial relationship with past imperial powers, that sparked off the debate about "Asian values". From the Asian point of view, the universality bestowed upon Enlightenment values by their authors became a justification of imperialism and its catastrophic consequences. As a result, a critical stance toward Enlightenment values has become a standard component of current Asian thinking.

Current geostrategy is being debated from the point of view of different paradigms in different contexts. Some situate the "new world order" in a post-Cold War framework, others in a postcolonialist or postmodern frameworks. Some "Western" voices speak of "a shock of civilisations" which threatens "the end of history" which they consider to have been achieved by

80 Cf. Guo Chengwu: *Ancient Chinese Political Theories*. The Commercial Press, Shanghai, 1975; Kung-chuan Hsiao,. *A History of Chinese Political Thought*, Princeton (NJ): Princeton University Press, 1979; He Zhaowu, Bu Jinzhi. *An Intellectual History of China*, Beijing: Foreign Languages Press, 1998; Mark Edward Lewis, *Writing and Authority in Early China*, Albany, NY: State University of New York Press, 1999.

the societies that had inherited the "universal" values of the Enlightenment. Even so, the transatlantic conflict provoked by the war in Iraq has revealed serious discrepancies between Europe and the United States about how to interpret this common heritage.81

Things are very different from the point of the view of the rest of the world. What appear to be profound differences between the EU and the US may not seem to be so profound from the point of view of postcolonial societies that see the EU and the US as one large block of shared interests, coordinated by NATO in accordance with the hegemonic interests of the US. A very large proportion of the world's population cannot view these values as "universal" because they have suffered the consequences of an imperialism which justified itself on the basis of these same values and principles, which have acquired semiotic connotations as a result: they have become symbols of a kind of discourse that attempts to justify a geopolitical strategy which defines itself as idealistic, but whose practical consequences contradict that idealism. What is important is not the content of what is being said, but rather the source of what is being said; and what is being judged and responded to are the actions that accompany the words, or their consequences, not the words themselves, or their contents.

It is in this postcolonial context that any analysis of Asian values and their geostrategic implications must be situated, and such an analysis must necessarily deconstruct some of the paradigms that justify the "realist" Cold War/post-Cold War framework, that had been based on the containment of communism —seen to have been a threat to the common heritage of the Enlightenment— at any price. Since the fall of the Berlin Wall and the disintegration of the USSR, and in view of the current modernisation of China and Vietnam, there is hardly any communism left to contain, and the phantom that stalked the "Western" world has been defeated. But the paradigm based on the containment of a clearly dangerous adversary, easily identified and therefore well-defined, still remains, so much so that some neoconservative strategists try to convert China into the future and inevitable rival/enemy of the US, thus provoking a standoff between the two that could convert the interpretations based on this paradigm into self-fulfilling prophecies; despite the fact that international terrorism, which is the actual enemy, is much less easy to identify or to respond to.82

The Cold War paradigm represents a vision based on a relatively short period of modern history; it is also a vision that prioritises the interests of the former imperial powers. Postcolonialism is a different paradigm, which forms part of a much longer period of history: the processes of imperialism, from colonisation through decolonisation and its consequences. From the point of view of this paradigm, the Cold War forms part of the colonialist/postcolonialist process. But there is another important distinction as well: postcolonialism prioritises the interests of the former colonies, not the former metropolises. One of the most fundamental consequences of this shift in paradigms is a critical analysis of the values and principles that imperialism used to justify itself in the past, an analysis that includes the deconstruction of the values of the former metropolises and the recuperation of native values.

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81 Oscar Wilde once said that the English and the Americans were two great peoples separated by a common language; in the current debate on transatlantic relations, it might be said that the EU and the US are two great peoples separated by a common Enlightenment. Cf. Seán Golden, "Valores asiáticos y multilateralismo", in S. Golden, (Ed.), *Multilateralismo versus unilateralismo en Asia: el peso internacional de los "valores asiáticos"*. Barcelona: Edicions CIDOB, 2004, 103-32.

82 EU-China relations are not exempt from this process, as the rhetoric of the titles of two recent articles by US authors demonstrates: David Shambaugh, "China and Europe: The Emerging Axis", *Current History*, Vol. 103, No. 674, September 2004, pp. 243-248; Frank Umbach, "EU's Links with China Pose New Threat to Transatlantic Relations", European Affairs, Washington, European Institute, Vol. 5, No. 2, 2004.

In the best of cases the nativist recuperation applies critical analysis and deconstruction to the former native values as well; in the worst, it represents a simple rejection of any "alien" value in favour of a simplistic non-critical glorification of any native value, an atavistic retrocreation of "native" values that never really existed.83 Inevitably, the mere fact of deconstructing the values of the former metropolises intrinsically and radically questions their "universality", and were this deconstruction to be admitted, it would open a relativist breach that would be incompatible with the Cold War paradigm, and therefore unacceptable to defenders of the "universality" of Enlightenment values. This incompatibility could provoke an intolerance of the diversity of values that would become an ethnocentrism inimical to the ethnodiversity defended by the postcolonialist paradigm, aggravating the risks of "a shock of civilisations". In addition to being incompatible, the postcolonialist deconstruction of supposedly universal and justifiable Enlightenment values converts them into the very cause of many of the ills the rest of the world has suffered at the hands of the inheritors of the Enlightenment.

A third paradigm that can be used to situate this debate is the concept of *modernism* as a process of consolidation of capitalist market economy and liberal parliamentary democracy as models for economic, social and political modernisation. In this sense, both *Les Droits de l'Homme* and *laissez-faire* are products of the Enlightenment. As Karl Polanyi said, "The origin of the [World War] catastrophe lay in the utopian endeavour of economic liberalism to set up a self-regulating market."84 John Gray has elaborated on this idea:

> The achievement of a similar transformation [to the rupture in England's economic life produced by the free markets that operated independently of social needs] is the overriding objective today of transnational organizations such as the World Trade Organisation, the International Monetary Fund and the Organisation for Economic Cooperation and Development. In advancing this revolutionary project they are following the lead of the world's last great Enlightenment regime, the United States. The thinkers of the Enlightenment, such as Thomas Jefferson, Thomas Paine, John Stuart Mill and Karl Marx never doubted that the future for every nation in the world was to accept some version of western institutions and values. A diversity of cultures was not a permanent condition of human life. It was a stage on the way to a universal civilization. All such thinkers advocated the creation of a single worldwide civilization, in which the varied traditions and cultures of the past were superseded by a new, universal community founded on reason….
>
> A single global market is the Enlightenment's project of a universal civilization in what is likely to be its final form. It is not the only variant of that project to have been attempted in a century that is littered with false Utopias. The former Soviet Union embodied a rival Enlightenment Utopia, that of a universal civilization in which markets were replaced by central planning….
>
> Even though a global market cannot be reconciled with any kind of planned economy, what these Utopias have in common is more fundamental than their differences. In their cult of reason and efficiency, their ignorance of history and their contempt for the ways of life they consign to poverty or extinction, they embody the same rationalist hubris and cultural imperialism that have marked the central traditions of Enlightenment thinking throughout its history.85

If the term *modernism* serves to describe this historical process that appeared to have been consolidated, and therefore terminated, when Francis Fukuyama wrote, "What we are witnessing is not just the end of the Cold War, or a passing of a particular period of postwar history, but the end of history as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government,"86 what processes would or should follow? If nothing were to change, the following period would be a

83 Cf. Benedict Anderson,. *Imagined communities: reflections on the origin and spread of nationalism*. London [etc.]: Verso, 1987.
84 Karl Polanyi, The Great Transformation: The Political and Economic Origins of our Time, Boston: Beacon Press, 1944, p. 140.
85 John Gray. *False Dawn. The Delusions of Global Capitalism*, New York: The New Press, 1998, pp. 1-3.
86 Francis Fukuyama, "The End of History?", *The National Interest*, Summer 1989.

simple continuation of *modernism*, but if the coming times were to represent a break with the values and practices of *modernism*, this *postmodernism* would have to represent a model that would be alternative to and different from *modernism*. What Fukuyama had proposed was that the consolidation of the model of *modernism* made it unnecessary to look for any alternative model; what remained to be done was to extend this model to the rest of the world, an idea that accompanied what came to be known as "the Washington consensus". As a result, for *postmodern* theoreticians, *modernism* could not serve as a model for the modernisation of the developing nations of the former colonies, nor should it be maintained in developed societies. *Postmodernism* represents a critical revision of *modernism* from the point of view of the classes that had been disadvantaged by the development of market capitalism in the former metropolises as well as from the point of view of the peoples who had been colonised as a result of the imperialism which was an intrinsic part of the same process.

For many contemporary Chinese thinkers, China should modernise without repeating the process of *modernism*, should leap over the system of values established by the Enlightenment that seemed to justify imperialism, and develop an economy and institutions that would serve to create wealth and to raise the standard of living of the population, without imposing values that are advantageous to a "West" that is already wealthy. They have identified a cultural dissidence within developed societies that advocates the values of *postmodernism* as a way of rejecting the values of *modernism*. In this context, they advocate the possibility of modernising their society without having to accept the imposition of values that originated in societies that have already begun to question them. In this way, China could reach *postmodernism* in a relatively short period of history without having to pass through the traumas that characterised the development of modernism in the "West" over a period of centuries (it would be difficult not to discern echoes of Mao Zedong's "Great Leap Forward" in this Chinese versions of the postmodernist paradigm).

Two new schools of thought have flourished in China since the '90's: **後現代主義** *hòuxiàndàizhǔyì* "postmodernism" and **後殖民主義** *hòuzhímínzhǔyì* "postcolonialism". Their popularity is such that a new term has been invented that combines both into a single tendency — **後學** *hòuxué* "post-studies"— described by Xu Jilin:

> To consider the factors internal to epistemology, [the "anti-Western" theorists of the 1992] all had begun by accepting the mainstream discourse of the Western intellectual genealogy. They believed that Western modernist thought should and could contribute to China's modernization adequate intellectual resources and patterns for action. As a consequence, the deeper their previous commitment, the more they were able to discover that the supposed universals of modernist theory were really nothing more than particular products of Western history/culture and were separated by a great gulf from the discourse of China's contemporary culture and historical tradition. This gap between western theory and Chinese discourse made it impossible for them not to shift their gaze from Western mainstream discourse and toward marginal discourses such as postcolonial cultural theory, analytical Marxism, and so forth. They hoped to find there inspiration for a pattern of modernization that would fit Chinese conditions.... Unlike previous cultural conservatives, these scholars' plan was not to "confront Western learning with native learning", but rather to "use aliens to control the aliens", to use Western marginal discourses to resist Western mainstream discourse.
>
> From the external, sociological perspective, the anti-Western trend is closely connected to a series of changes in the environment at home and aboard. Following the sudden takeoff of the Chinese economy, the national strength of China grew enormously; and the first reaction of a disfavored people that is emerging from its disfavored status is to say "no" to those privileged peoples it has long been attempting to overtake. In the 1980s, China's contacts with the west were limited, conflicts of interest were rare, and intellectuals had a flattering image of the West, so that Westernization had a suitable psychological support. But from the beginning of the 1990s China began to enter into the international political-economic system, and conflicts between China and the West became more and

> more direct: the opposition of the Western countries, particularly the United States, to China's joining the WTO and hosting the Olympic Games, trade frictions, the Yinhua incident, and a series of other events caused Chinese intellectuals to lose a great part of their faith in the West. Behind their beautiful Western discourse, they discovered ugly relationships of power, and an unequal power relationship that the Western countries were determined to force onto China. Thus the nationalistic feeling of Chinese intellectuals was greatly awakened, so that anti-Westernism had a deep psychological foundation.87

According to Zhang Yiwu, *hòuxué* thinkers insist on differentiating their approach from that of western postcolonial and postmodern thinkers:

> This exploration tries, first, to find a new position: "the Other of the Other". While seeking to transcend the old condition of "Otherness" and refusing to take either side of the oppositions of universal/particular, classic/modern, it reflects on both in the context of contemporary culture and offers new insights. Second, it implies participation in contemporary culture --it implies the Gramscian role of the "organic intellectual". It neither stands apart from culture, nor tries to transcend culture, but seeks theoretical advances from within the dialectical thought of transformations in society and culture. It maintains a critique of Western cultural hegemony, but this critique does not imply a decisively nativistic conservative perspective. This new perspective allows a new grasp on the "condition" of hybridity in contemporary China. This grasp was made possible by an appropriation of Western theories, but this appropriation does not imply the use of theory to advance interpretations of the Chinese context; rather, it recognizes that the transcendence of theoretical hegemony is dependent on reflection about and critique of theory. This requires the use of theory to critique theory, using contemporary Chinese conditions to reflect on theory, and using theory to match contemporary Chinese conditions, so as to produce a two-sided hermeneutic and gain a new cultural imagination and creativity.88

The discourse of political leaders often runs parallel to the intellectual debate on postmodernism in China. Many leaders and “official” intellectuals have co-opted the terminology of the “post” theories. Wang Yizhou, Deputy Director of the Institute of World Politics and Economics of the Chinese Academy of Social Sciences, made the following reply to an Internet debate on the NATO missile attack on the Chinese embassy in Belgrado:

> 'What is NATO's Strategy?'
>
> First, from a defensive military organization it is becoming a tool for expansion, first to all of Europe, then to the whole globe (...). Second, NATO's new concept demands that NATO no longer stay within its traditional geographical bounds: it will expand to wherever it is needed. For example, the first step was a peaceful eastward expansion with the entry of Poland, Hungary, and the Czech Republic; the next step is to press on toward the Mediterranean and North Africa; it may be that step three is to expand to the other nations of the world in order to realize NATO's goal of replacing the U.N.
>
> Third, in the past NATO was a strictly military alliance, and now it is moving in the direction of military government, so that, for example, it will no longer be concerned with security alone but will take on human rights issues, refugee issues, drug issues, criminal issues, etc. This is NATO's ambition of global expansion.
>
> The speed of China's modernization is sure to disturb the present international political and economic order and insensibly threatens U.S. and Western leadership. So we will certainly become the object of more and more attacks. The rest of the world will come forth with all kinds of excuses and pretexts for limiting or cornering China --human rights, the environment, non-proliferation, guided missile technology, trade deficits, etc. By setting impossible requirements, they hope to limit China's development, confine China to a frame set by themselves (...).

87 Xu Jilin. "Wenhua rentong de kunjin---90 niandai Zhongguo zhishijie de fanxihua sichaog" ["Las dificultades de la identidad cultural: la tendencia ant-Occidental en la vida intelectual china de los años 90"]. *Zhanlüe yu guanli* 18 (1996): 100-101; in Haun Saussy, "Postmodernism in China", *Great Walls of Discourse and Other Adventures in Cultural China*, Cambridge, MA: Harvard University Press, 2001: 122.
88 Zhang Yiwu. "Chanshi 'Zhongguo' de jiaolü", pp. 134-135. "On ‘the Other of the Other’f "; Saussy, op. cit., 135.

> About the "anatomy of U.S. hegemony" and the United States's use of theory to shore up their hegemony: (...) American hegemony, apart from its military and political aspects, is a cultural or conceptual hegemony. This is a much more complex, much craftier form of hegemony. Think of Hollywood movies or the global position of the English language, or American inventiveness in the field of ideas.
>
> We can point to any number of examples to show how U.S. hegemony gets various kinds of theoretical support. The first and most famous is the "clash of cultures" theory, which is a plan to give the United States the dominant role in determining the value of every people, every culture, every civilization (...). Another aspect is what is called "peace and democracy". Here the plan is to tell every country in the world: if you follow the pattern of the Western "democracies", you'll have peace and security, but if you refuse Western "democracy", you'll meet the same fate as Yugoslavia (...). Another means is the famous principle that "human rights take precedence over national sovereignty"". 89

This kind of deconstruction of "Western" geostrategy has also been extended to "Western" culture by authors such as Zhu Majie, Deputy Director of the Shanghai Institute of International Studies:

> Western civilizations rose from the same origin, though, their respective development differs, and the levels of development in different historic periods are not the same. However, they share the following common features:
>
> **Firstly, a salvationist spirit and sense of mission**. With self-arrogance this runs all through the history of the West, led by the United States. This spirit came from Christianity. …. As a paramount subject for worship, God dominates human being's thought, freedom, customs and ideas. This Christian doctrine engenders a universal spirit among its followers, so that saving the world becomes their mission. In the past, the soldiers of the West marched out to conquer the world "for God"… Today, Western leaders stress the importance of taking the leading role and feel an obligation to defend the free world and to promote and strengthen democratic values in the world as their "Holy Mission". …
>
> **Secondly, expansionism**. Western civilization constantly expanded outward in the process of modern social development and therefore is labelled the "blue civilization". The color of blue symbolizes the ocean which attracts to adventure, aggressiveness and conquest. In modern history, Netherlands, Spain, Britain and the U.S. successively have dominated the world. At the peak of Western capitalist development, many countries in Asia, Africa and Latin America were reduced to being their colonies or semi-colonies. The Western lifestyle, ideology and social system were also spread there. Westerners used gunboats to open up new frontiers, and the Bible to spread God's will. They took new markets with the force of goods and advanced science and technology. Therefore, the history of the Western civilization is also the history of expansion. …
>
> **Thirdly, individualism.** The most important value of Western civilization is individualism, which is one of its most prominent marks. Individualism was an ideological weapon used by the rising European capitalist class to oppose autocracy and the oppression of the feudal nobles. In the West, people advocated independent struggle and the pursuit the rights of individual emancipation, individual choice, and individual freedom and happiness.… Western individualism has now become a standard of morality. In the United States, individualism has become a highly evaluated moral virtue: the cowboy who can do whatever he wants is a heroic image. The mentality of self-importance, unrestricted behavior and an aspiration for outlaw conduct have become an important component of the nation's ideology.
>
> **Fourthly, liberalism.** Individualism and liberalism are the twins of the Western civilization. The concept of freedom is the main ideology and pillar in Western society. One of the flags used by the capitalist class to fight against the feudal nobles was to strive for freedom. They flaunted the freedoms of faith, speech and pursuit of property. … Francis Fukuyama said that the two world wars in the last century and the following revolution and the great turbulence "forced Europe and North America,

89 Wang Yizhou, People's Daily Online, (20 May 1999): "Wangyou de shengyin: Wang Yizhou boshi da wangyou wen, xia" ("Voices of our Internet community: Dr. Wang Yizhou responds to readers' questions"); http://www.peopledaily.com.cn/item/199905/14/wyz-wy.html); Saussy, op. cit., 140, 141.

which are at the forefront position of human civilization, more progressively to carry out their freedom."… In the economic area, the West also stresses the importance of such freedoms as free market, free trade and free competition. Fukuyama believes that the fundamental change that took place in the 20th century was the victory of "economic and political liberalism". From now on, liberalism dominates the material world, … and apparently is regarded as its most representative feature of Western civilization.

Fifthly, utilitarianism. The search for effectiveness and self-interest is the ethical concept of Western civilization. In the West, especially in the United States, utilitarianism is presented sometimes as "idealism" and sometimes as "pragmatism". To seek utility and to be bent solely on interests is a typical feature of the Western bourgeoisie. In the West what must be maintained is interest, rather than principle: there are no friends but only interests; these become the paramount object of worship.… Focusing on utility and interest is both a norm of conduct and value orientation in the West. The U.S.-led Western countries' handling of international affairs is a clear demonstration of the ethical concept of utilitarianism. Their "utility" lies in the desire to dominate the world, and their "interest" lies in the desire that their demand for self-interest be met. Whether the human rights issue is linked with the trade issue, or whether sanctions are imposed on other nations, or whether aid is given to other nations, the most fundamental criteria by which they make these judgments is their interest.90

Although "post" thinkers in China emphasise the differences between their version of postmodernism and the "Western" version, there are critical voices in the "West" that also deconstruct Enlightenment values by comparing them to Asian values:

The deeper differences between Asia's capitalisms and those in western countries will not diminish over time. They reflect differences not only in the family structures but also in the religious life of the cultures in which these diverse capitalisms are rooted. The greatest sociologist of capitalism, Max Weber, was right to link the development of capitalism in north-western Europe with Protestantism.

Western social thinkers and economists are mistaken in supposing that capitalism everywhere will come to resemble the highly individual economic culture of England, Scotland and parts of Germany and The Netherlands. It has not done so in France or Italy. In our time, capitalism in post-communist countries whose religious traditions are Orthodox will be unlike that in any 'western', Protestant or Catholic, country: neither the institutions of secular society, nor the limited state of such western countries has developed in any Orthodox culture. Russian capitalism, like capitalism elsewhere in the Orthodox world, will be *sui generis*.

The same goes for the capitalisms of Asia. Indian capitalism will never converge with that of countries whose principal religious inheritance is Confucian, Buddhist or Muslim. Its caste system may be the world's stablest system, having survived challenges from Buddhism, Islam and Fabian secularism, and it will surely condition profoundly the growth of an indigenous capitalism.

The new capitalisms in eastern Asia do not carry the western burden of doctrinal dispute over the merits of rival economic systems. This is partly because most of the religious traditions of east Asia make no claim to exclusivity. This freedom from sectarian claims to unique truths goes with a pragmatic approach to economic policies….

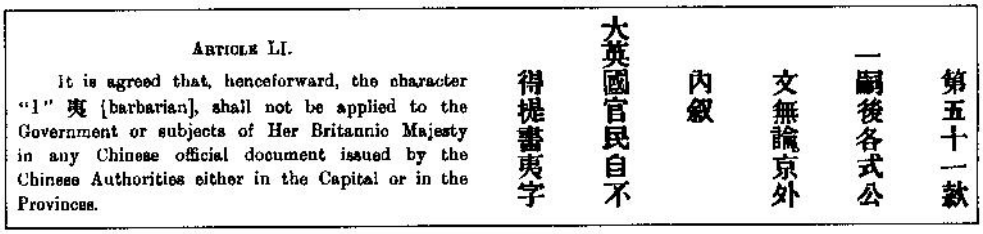
In Asian cultures market institutions are viewed instrumentally, as means to wealth-creation and social cohesion, not theologically, as ends in themselves. One of the appeals of 'Asian values' is that they avoid the western obsessions that make economic policy an arena of doctrinal conflict. That 'Asian' freedom from economic theology allows market institutions to be judged, and reformed, by reference to how their workings affect the values and stability of society….

90 Zhu Majie, "Western Civilization: Its Essence, Features, and Impact", *Cultural Impact on International Relations, Chinese Philosophical Studies*, XX, Yu Xintian (Ed.), Chap. 5; *Cultural Heritage and Contemporary Change*, Series III, Asia, Volume 20, http://www.crvp.org/book/Series03/III-20/contents.htm

> A monolithic 'Asia' is as much a chimera as 'western civilization'. The inexorable growth of a world market does not advance a universal civilization. It makes the interpenetration of cultures an irreversible global condition.91

One of the consequences of Chinese *postmodernism*, which is a kind of *antimodernism* with reference to the "West", is the growing role of Chinese nationalism. Chinese leaders perceive the unipolar geopolitics of the US to be a threat, and promote the reconstruction of a multipolar world, in which EU-China relations would have to play a major role. This consideration brings us back to the relationship between words and sovereignty that lies behind contemporary Chinese geopolitical discourse.

2. Sovereign language and sovereignty



ARTICLE LI.

It is agreed that, henceforward, the character "I" 夷 [barbarian], shall not be applied to the Government or subjects of Her Britannic Majesty in any Chinese official document issued by the Chinese Authorities either in the Capital or in the Provinces.

第五十一款 一嗣後各式公文無論京外內叙大英國官民自不得提書夷字

Article 51. It is agreed that, henceforward, the character "[yí]" **夷** [barbarian], shall not be applied to the government or subjects of Her Britannic Majesty in any Chinese official document issued by the Chinese authorities either in the Capital or in the Provinces. (Treaty of Tianjin, 1858)92

The imposition of European modernism on China in the 19th century by force of arms, unequal treaties and extraterritoriality, required Chinese thinkers to import new terms and new ideas by way of translation. The wholesale importation of new terminologies and new concepts occurred in a historical and cultural context that was quite different from the context that had produced the European Enlightenment. As a result there were very few precedents or cultural equivalents that could serve to foster mutual comprehension. The fact that an international treaty could censor the words that Chinese officials could use in official documents is a blatant example of an asymmetrical relationship between a Chinese society with a millenarian culture and the brave new world (or new world order) of European, American (and shortly thereafter, Japanese) expansionism, which would create difficulties both for translation and for understanding. The construction of modernism under duress in China is now one of the most important topics of research among Chinese scholars, both at home and overseas.93

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91 John Gray, *op. cit*., pp. 191-193.

92 Cited in Lydia H. Liu, *The Clash of Empires. The Invention of China in Modern World Making*, Cambridge, MA & London: Harvard University Press, 2004, p. 32.

93 Lydia H. Liu has coined the term "translingual practice" for this process and has dedicated two books to the subject thus far: *Translingual Practice. Literature, National Culture, and translated Modernity –China, 1900-1937*, Stanford, CA: Stanford University Press, 1995; and *The Clash of Empires*, op. cit. Some of Wang Hui's work on the subject has been published in English as *China's New Order. Society, Politics, and Economy in Transition*, Theodore Huters (Ed.), Cambridge, MA & London: Harvard University Press, 2003; and he is currently working on a four-volume study, *The Rise of Modern Chinese Thought* (in Chinese), that includes a long chapter on Yan Fu, one of the most important translators of the late 19th century, and his translations (personal communication). Cf. Rey Chow,. *Ethics After Idealism: Theory-Culture-Ethnicity-Reading*. Bloomington IN: Indiana University Press, 1998; Rey Chow, *The protestant ethnic and the spirit of capitalism*, Columbia University Press, New York, 2002; Rey Chow, *Writing Diaspora: Tactics of Intervention in Contemporary Chinese Cultural Studies*. Bloomington IN: Indiana University Press, 1993; Liu Kang & Tang Xiaobing. *Politics, Ideology and Literary Discourse in Modern China*. Durham, NC: Duke University Press, 1993; Kam Louie, *Theorising Chinese Masculinity: Society and Gender in*

The lack of cultural equivalents has been a difficulty in the dialogue between Europe and China since the late 16th century, when the first Jesuit missionaries, who were the first serious European Sinologists, began working in China,94 but their attempts to introduce Christian concepts and Catholic doctrine through a policy of accommodation to Chinese cultural values was substituted by gunboat diplomacy in the 19th century, accompanied by a much more aggressive and less tolerant version of Protestant missionary activity, both of which would provoke xenophobic reactions that were the precursors of current Chinese nationalism. When Yan Fu (1854-1921) translated the leading works on Darwinism, Social Darwinism and other branches of the social science into Chinese he had to use Chinese terms that did not have the same connotations as the "Western" terms he was translating. For lack of any native cultural equivalent, the term "Nation" became qún "herd", for instance, while "(political) Party" became dăng "faction", neither of which could convey an equivalent sense of what these terms meant in their European context.

Lydia H. Liu has provided many significant examples of the consequences of the imposition of sovereignty on words.

> One of the key concepts to emerge in the political discourse of modern China can be traced back to the neologisms invented by [W.A:P] Martin and the Chinese translators of *Elements of International Law*. The concept I have in mind is *quanli* [**權利**], or "right", which, like *zhuquan* [**主权**](sovereignty) and many other nineteenth-century coinages, no longer strikes us as strange or un-Chinese because it has been naturalized in the history of Chinese (and Japanese) political discourse and through repeated usage over nearly a century and a half. The situation was perceived differently, however, by those who lived in the mid-nineteenth century. This was duly documented by the translators themselves fourteen years after the fact, as they continued to feel a need to defend their "unwieldly" coinage. In a headnote to the 1878 translation of Woolsey's Introduction to the Study of International Law, known in Chinese as *Gongfa bianlun*, Martin and his Chinese collaborators describe how they had coined the neologism *quanli* to render the meaning of "right". Their tone was clearly apologetic:
>
> > International law is a separate field of knowledge and requires special terminology. There were times when we could not find a proper Chinese term to render the original expression, so our choice of words would seem less than satisfactory. Take the character *quan*, for example. In this book the word means not merely the kind of power one has over others, but something every ordinary person is entitled to. Occasionally, we would add the word *li* [to form a compound], as, for example, in the expression *quanli*, meaning the born "rights" of the plebeian, etc. At first encounter, these words and expressions may seem odd and unwieldy, but after seeing them repeatedly, you will come to realize that the translators have really made the best of necessity.
>
> …
>
> Indeed, as I have suggested, the noun *quan* commands a broad spectrum of meanings associated with "power," "privilege," and "domination" in the Chinese usage, much as the word *li* brings to mind "interest," "profit," and "calculation." Lurking behind the renderings of "rights" and "human rights," these banished meanings can always come

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China, Cambridge University Press, 2002; Kam Louie & Bob Hodge, *The Politics of Chinese Language and Culture*, London: Routledge, 1998; Kam Louie, *Inheriting Tradition: Interpretations of the Classical Philosophers in Communist China 1949-1966*, Oxford University Press, 1986.Another important study in this field is Haun Saussy's *Great Walls of Discourse*, *op. cit*. Cf. Joseph Fewsmith, *China since Tiananmen. The Politics of Transition*, Cambridge: Cambridge University Press, 2001.

94 Seán Golden, "From the Society of Jesus to the East India Company: A Case Study in the Social History of Translation", in Marilyn Gaddis Rose (Ed.), *Beyond the Western Tradiiton. Translation Perspectives XI*, Binghamton NY: State university of New York at Binghamton Press, 2000, 199-215. Cf. Saussy, *op. cit*.

back to haunt the super-sign and unwittingly open up the word "right" or "human rights" to its suppressed "other" meanings such as "privilege" and "entitlement." The subtext of "excess" signification thus glosses the self-evident meaning of the English word "right" with something more than it ostensibly says. This is not to say that the translators were incapable of comprehending the true meaning of "right." On the contrary, the "excess" signification seems to heed the historical message of "rights" discourse in the practice of international law only too well, because it registers the fact that the idea had been brought into China by the nineteenth-century representatives of European International law who had asserted their "trade rights" and the "right" to invade, plunder, and attack the country. Their language of "rights" cannot but convey a loud message of threat, violence, and military aggression to the Qing government at the negotiation table and to the Chinese population at large. 95

3. Euclidean and non-Euclidean geometries of values

> The importance of Euclidean geometry lies not so much in the actual mathematics that it contains as in the systematic method used by Euclid to present and develop that mathematics … the power of the axiomatic method, in which the truth of the derived theorems follows from the truth of the axioms and postulates. Because the latter were offered as self-evidently true, Euclid's contemporaries felt that the derived theorems constituted accurate descriptions of the world and valid tools for studying it. Euclid's parallel postulate attracted interest almost as soon as the *Elements* appeared, because it seemed less self-evident than the others. Its most popular equivalent is: Through a given point *P* not on a line *l,* there is only one line in the plane of *P* and *l* that does not meet *l.* Attempts to derive the parallel postulate from the others, thereby transforming it into a theorem, involved replacing it with its two alternatives--that there is no such line or that there are more than one--and then showing that contradictions ensue. Unexpectedly, no contradictions resulted from either substitution: the outcome was, instead, two new, non-Euclidean geometries that were found to be just as valid and consistent as Euclidean geometry. It soon became clear that it is impossible to tell which, if any, of the three geometries is the most accurate as a mathematical representation of the real world. Thus, mathematicians were forced to abandon the cherished concept of a single correct geometry and to replace it with the concept of equally consistent and valid alternative geometries. They were also forced to realize that mathematical systems are not merely natural phenomena waiting to be discovered; instead, mathematicians create such systems by selecting consistent axioms and postulates and studying the theorems that can be derived from them. (*Encyclopaedia Britannica*)

The Enlightenment notion of "self-evident truths" predates the discovery of non-Euclidean geometry, and bases itself on the assumed universality of Euclidean geometry. The role of Euclidean geometry in the development of Aristotelian logic, and therefore of Western rationalist thinking, is not in the least trivial. Aristotle's syllogism is derived from Euclid's axiomatic method. A.C. Graham, one of the 20th century's greatest Sinologists and a leading expert on ancient Chinese discourse, noted that there "is no evidence … that the [the earliest Chinese logicians] formulated geometrical proofs, the absence of which is one of the crucial gaps in Chinese as compared with Greek thought."96 The differing conceptual bases of societies with different histories and cultures can lead to alternative ways of constructing social reality. "Western philosophizing in languages with number termination starts from the adding up of particulars, leading at two of its limits to the reduction of cosmos and community to aggregates of atoms and individual persons, while the Chinese operating with generic nouns think in terms of

95 Liu, *The Clash of Empires*, *op. cit*., pp. 124-131.
96 A.C. Graham, *Disputers of the Tao: Philosophical Argument in Ancient China*, Chicago: Open Court, 1989, p. 160.

variously divisible Way, pattern, *ch'i*, and kind of thing."97 The introduction of foreign ideas and ideologies, such as Buddhism or Islam or Christianity, into Chinese thought and culture had to face

> what might be called a "cultural imperative": no marginal religion penetrating from the outside could expect to take root in China (at least at the social level) unless it conformed to that pattern that in late imperial times was more clearly defined than ever. Confucianism represented what was *zheng*…, "orthodox", in a religious, ritual, social and political sense; in order not to be branded as *xie*…, "heterodox" and to be treated as a subversive sect, a marginal religion had to prove that it was on the side of *zheng*. …Since [the Chinese converts] lacked the intellectual and theological heritage that their Jesuit teachers had carried with them from Europe, they had to accommodate the Jesuit input within their own traditional universe of discourse, just as more than a thousand years before, Kumarajiva's [fl. 385-409] Chinese disciples had eagerly absorbed the master's teachings, and yet created their own brands of Mahayana philosophy, simply because they lacked Kumarajiva's Indian scholastic frame of reference.98

What can be said of the introduction of new and foreign systems of religious thought into traditional Chinese culture would also be true of the introduction of new and foreign modern ideologies into Chinese culture in the 19th and 20th centuries, although it must also be pointed out that the balance of power had been inverted in the latter case. In the current situation, power has begun to swing back the other way, but the analysis of current Chinese geopolitical discourse must still respect the ancestry of the words involved and their implications for sovereignty.

4. A pregnant woman boarding a bus

> A developing country is like a pregnant woman, whose body is going through a delicate creative process that requires special attention and care. The transition toward a society that is predominantly urban implies veritable "hormonal transformations" of a traditional agrarian society. It is a shedding of skins, of values and of norms. For the population involved it is a journey into the unknown. For the policy-makers who try to govern the process, it constitutes endless risks and threats. … There are certain levels of performance, responsibilities or attitudes that you cannot demand of a pregnant woman or a developing country…. The idea is that, when we see a developing country on a bus, we get up and give it our seat…. Such a gesture should not be confused with paternalism, ingenuity or condescension. ... The attitude against yielding a seat to a developing country includes many things: amnesia about one's own history; a very European incapacity to see oneself in the shoes of someone who is different; archaic prejudices and stereotypes left over from the Cold War, now mixed together with new interests deriving from commercial rivalry; and, finally, echoes of an imperialist-colonialist attitude.…Giving up your seat to a pregnant woman does not mean abandoning a critical point of view. To the contrary, it means making it more serious and efficient, setting aside propaganda, and opting for a firm and respectful dialogue on all of these matters. …I am happy to see that EU policy papers have begun to move in this direction. And I am sure that our Chinese friends welcome and appreciate this dialogue. (Rafael Poch)99

Wang Minmin's analysis of the Chinese construction of and response to the discourse of world opinion is especially relevant to the discourse analysis of official Chinese discourse with regard to the EU.100 Six components have been proposed as a prototype of world opinion: moral force, pragmatic value, fear of isolation, power of world opinion, nation's image, and world as a unit.

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97 *Ibid*., p. 389. Another important study of ancient Chinese discourse is Xing Lu, *Rhetoric in Ancient China, Fifth to Third Century, B.C.E.: A Comparison with Classical Greek Rhetoric*. Columbia, S.C.: U of South Carolina P, 1998.

98 Eric Zürcher, "Jesuit Accommodation and the Chinese Cultural Imperative", in D.E. Mungello (Ed.), *The Chinese Rites Controversy. Its History and Meaning*, Nettetal: Steyler Verlag, 1994, pp. 40-41, 63.

99 Rafael Poch, *Cuando informamos sobre China* [When we report on China], a lecture delivered in the seminar AsiaMedia organised for Spanish journalists based in Asia by Casa Asia, Barcelona, Spain, December 2003.

100 This section of the study is based on Minmin Wang, "Comparison of Chinese and American Views on World Opinion: A Rhetorical Study of Media Reports," in Xing Lu, Wenshan Jia & D. Ray Heisey (eds.), *Chinese Communication Studies*, Westport, CT; London: Ablex Publishing, 2002, pp. 213-225.

> The moral component refers to shared value judgements of right and wrong or moral and immoral in nations' expressions of world opinion. The pragmatic component, which points to interests shared by nations in their use of world opinion, makes reference to attitudes, behavior, or policies that would be in all nations' interest. Isolation concerns explicit or implicit behaviour, e.g., boycotts, severing diplomatic ties, by national leaders or nations to distance themselves from or to condemn nations or national leaders who act counter to the dictates of world opinion. Power of world opinion is synonymous with the force of world opinion or influence world opinion is described as having in international affairs. Nations' image refers directly or indirectly to the perceptions that other countries have of a nation due to its past or present behaviour or to the reputation the nation wishes to project to the world. World as a unit includes the many ways in which nations of the world (e.g., "international community", "the civilized world") may be described as a unit conferring the judgement of world opinion.101

Coverage of US and Chinese press coverage of two events, the 4th International Women's conference in Beijing and the transfer of Hong Kong from British to Chinese sovereignty, revealed that the major difference between the United States and China is the U.S. emphasis on the first four components, which together strengthen a conception of world opinion as one of restraining power, and the Chinese emphasis on the last two components, which do not reflect to the same degree the binding power of world opinion. "The analysis reveals the rhetorical rules that the United States and China employ in their construction of world opinion. China seems to follow the rhetorical rules of (1) promoting its national image, and (2) maintaining a strong sense of the world as a unit. The United States seems to conform to the power of world opinion as a moral force."102

These differences have their origins in historical and cultural circumstances. "Literally meaning the Middle Kingdom, China's name reflects pride and a self-conception as the center of the world. Ancient history … confirmed this Sinocentric view. However the century after the Opium War in 1840 has provided more mockery than support for this definition. China's modern history is filled with invasions and defeats: a plethora of humiliations."103

The cultural influences on the construction of Chinese political discourse derive from the Five International Principles announced by Zhou Enlai at the Bandung Conference of African and Asian Nations (1955): mutual respect for sovereignty and territorial integrity; non-aggression; non-interference in each other's internal affairs; equality and mutual benefit; and peaceful coexistence. "From these principles one can clearly see the Chinese moral order in international relations and the basis for China's rhetoric on world opinion. Of primary importance is national sovereignty, which includes the concepts of mutual respect, equality, independence, non-interference in internal affairs, and nonaggression. In this moral order, world peace naturally flows from (and thus is contingent upon) the acceptance of each nation's sovereignty."104

> Arising from this moral order, the Five Principles inform China's rhetoric on world opinion. In addition to advocating self-reliance and independence, another profound historical and cultural influence reflected in China's international relationships is its suspicion of American imperialism … and it is important to see that China views world opinion to be in danger of being compromised by the U.S. political and economic hegemony. This wariness of U.S: dominance explains China's way of dismissing world opinion… negative world opinion toward China is labelled as the opinion of a small (usually American) anti-Sino faction. Since this opinion is seen as violating China's national sovereignty and independence, it is thus not at all world opinion, and thus does not deserve to be heeded.
>
> Since the Chinese concept of national sovereignty contains the concepts of justice, equality, and mutual respect, a violation of national sovereignty is also a violation of all these moral values. Thus, negative world opinion on China [was] seen as damaging China's sovereignty and thereby violating the standards of justice on which a world community could be based. Negative world opinion was presented as

101 *Ibid*.
102 *Ibid*.
103 *Ibid*.
104 *Ibid*.

> purposefully damaging the equality of nations and therefore deserved to be disregarded as the opinion of a small, biased faction. Such single-minded dismissal of negative opinion reflects the immense impact of the national sovereignty concept on China's international outlook, and its suspicion (and defensiveness towards) the (generally Western) countries which it sees as threatening.
>
> While China identifies the concepts of justice, mutual respect, and equality spontaneously with its concepts of national sovereignty, world peace (the fifth international principle) is no less removed from the security of national sovereignty. …the Chinese moral order in international affairs sees world peace as contingent on national sovereignty…. Since the concept of national sovereignty is of such importance in the international arena, besides securing its own independence and sovereignty China also sees as its responsibility to defend any nation whose sovereignty is threatened. The examples in [official] speeches usually regard creating equality: the responsibility of stronger nations towards those that are weaker, of wealthier nations to those that are poorer, and so on. ... It is aware of its proud and historical glory, and determined never to undergo the humiliations of modern history. This tripartite awareness –of the glory of its ancient past, of the humiliation of the modern past, and of the urgent responsibility it has to national pride and the ideals of justice and equality in the world arena—make China extremely sensitive to the issue of restricting power. Threats of isolation, of world moral disapproval, are taken more as a threat to China's national sovereignty (and thus disregarded or dismissed), and not as threats which have the power to regulate China…. Once China's (and any country's) identity and sovereignty are achieved, it is assumed that the rest –human rights, economic prosperity, world peace, etc., will follow…. World opinion is thus conceived mainly in terms of self-control and self-imposed responsibility: a strong nation's responsibility to a weaker nation, or a rich nation's responsibility to a poorer one…. Regulation can be conceived of in two ways, as self-regulation and as regulation imposed by an outside force. The Chinese emphasis on the primacy of national sovereignty leads it to favour a view of world opinion that further strengthens this sovereignty. This view of world opinion is in terms of self-regulation, and China conceptualizes world opinion as regulatory in the direction of promoting each country to fulfil its national sovereignty –which includes fulfilling its responsibility to the rest of the world. World opinion is conceived in terms of being as conducive to establishing national sovereignty as possible (self-regulation can be seen as a hallmark of strong national sovereignty). 105

The US is secure enough in its own sovereignty to regard world opinion in the sense of the term that is more consistent with all six components. "With the major issues concerning sovereignty resolved and in its position as a (if not *the*) superpower today, it is natural for the United States to conceive world opinion as a sort of imposed regulatory power…. As an established global power, the United States identifies with world opinion as an enforcer of global moral norms."106 Given the historical and cultural influences that have shaped China's rhetorical rules,

> is it ethical to ask China to adapt to an established conception of world opinion which includes all six components?... However, even if it is ethical to expect and even to require China (or any nation) to conform to a more universal code of ethics than it does now… Would it be possible for China to adapt to this more universal code? … [Were it possible to establish] a set of negotiable yet binding communicative rules and values, world opinion would both allow civic discourse *and* act as the binding power of an international norm. [Such] communicative rules [could] also be seen as what Xing Lu refers to as multicultural rhetoric, which is "a system capable of honouring both universal values and cultural insights in the practice and formulation of rhetorical perspectives"107 … Communicative rules and values would imply that we must first acknowledge the differences in moral orders on both sides, but then also move beyond this to realize the common ground on which both sides stand –which is the search for a more complete truth (in such a way that promises world peace).108

In this sense, multicultural rhetoric would require a critical capacity to analyse, demystify, reformulate or create new rhetorical and metaphorical structures without privileging received rhetorical and metaphorical structures. Some important work has been done on the analysis of the

105 *Ibid*.
106 *Ibid*.
107 Lu, *op. cit*., p. 308.
108 *Ibid*.

metaphors we rule (or are ruled by),109 but much more needs to be done on this aspect of comparative socio-cultural studies.

5. Mars and Venus, 武 *wǔ* and 文 *wén*, the Spirit and the Way

When Robert Kagan uses archetypes from Greek mythology to characterise the difference between what he perceives to be a Hobbesian US vision of the need to invest absolute power in the figure of a unipolar sovereign power that will ensure stability in the world order through the implicit or explicit use of force (Mars), versus what he perceives to be a Kantian EU vision of a multipolar worldwide confederation based on the seductive power of rational persuasion and the Enlightenment era categorical imperative (Venus),110 he is recurring, consciously of not, to a culturally-based metaphorical structure that is part and parcel of a "Western" anthropomorphic world view. Chinese political culture conceived of a different pair of concepts —**武** *wǔ* "military force" and **文** *wén* "culture"— whose dynamic relationship configured the political sphere since antiquity. The "institutional violence" (**武** *wǔ*) made it possible to mobilise society for war or for public works, but the "hegemony" (**文** *wén*) exercised by Mandarin technocrats was necessary for their design and administration. The continuity of this concept throughout the history of Chinese political culture is testified to by Mao's famous identification of political power with the barrel of a gun (**武** *wǔ*) while warning that it should be the Party (**文** *wén*) that aimed the gun and not the gun that aimed at the Party. While Mars and Venus serve as anthropomorphic personifications of alternative visions of the administration of power based on human narratives, **武** *wǔ* and **文** *wén* are processes and relationships, not personifications or narratives. In terms of the discourse of contemporary Chinese foreign policy, **武** *wǔ* would correspond to the "hegemonic" military power exercised by US unilateralism, while **文** *wén* would correspond to "soft power" as an asymmetrical Chinese response. In this paradigm, as opposed to the Mars-Venus paradigm, it remains to be seen how the EU should be characterised.

According to the *Encyclopaedia Britannica*, the substitution of chopsticks for knives at the table reflected the ascendancy of the scholar over the warrior as a cultural hero. This would be an early example of the subtle efficacy of soft power, as would the policy of the tributary state system that served over the millennia to regulate the Chinese empire's relations with its neighbours in terms of both foreign policy and foreign trade, and obviated any need for imperial expansionism (an interesting precedent for the current good neighbourliness policy China is practising in Asia, which gives the lie to the anti-China lobby's advocacy of the "China as threat" scenario).

The continuity of the role of **文** *wén* in Chinese and East Asian foreign policy can be illustrated by the "Spirit of Shanghai", associated with the Shanghai Cooperation Organisation (SCO), whose main purposes are "strengthening mutual trust and good-neighborliness and friendship

109 Cf. George Lakoff, *Moral Politics. How Liberals and Conservatives Think*, Chicago, London: The University of Chicago Press, 2002; George Lakoff & Mark Johnson, *Metaphors We Live By*, Chicago [etc.]: University of Chicago Press, 2003; George Lakoff & Mark Johnson, *Philosophy in the Flesh: The Embodied Mind and its Challenge to Western Thought*, New York: Basic Books, 1999.
110 Robert Kagan, Power and Weakness, *Policy Review online*, http://www.policyreview.org/JUN02/kagan.html

among member states; developing their effective cooperation in political affairs, the economy and trade, science and technology, culture, education, energy, transportation, environmental protection and other fields; working together to maintain regional peace, security and stability; and promoting the creation of a new international political and economic order featuring democracy, justice and rationality."111

The definition of the basic principles of the SCO correspond quite closely to Wang Minmin's abovementioned analysis of the bases of the Chinese rhetoric of world opinion (and are also well-reflected in China's EU Policy Paper): "adherence to the purposes and principles of the Charter of the United Nations; respect for each other's independence, sovereignty and territorial integrity, non-interference in each other's internal affairs, mutual non-use or threat of use of force; equality among all member states; settlement of all questions through consultations; non-alignment and no directing against any other country or organization; opening to the outside world and willingness to carry out all forms of dialogues, exchanges and cooperation with other countries and relevant international or regional organizations."112

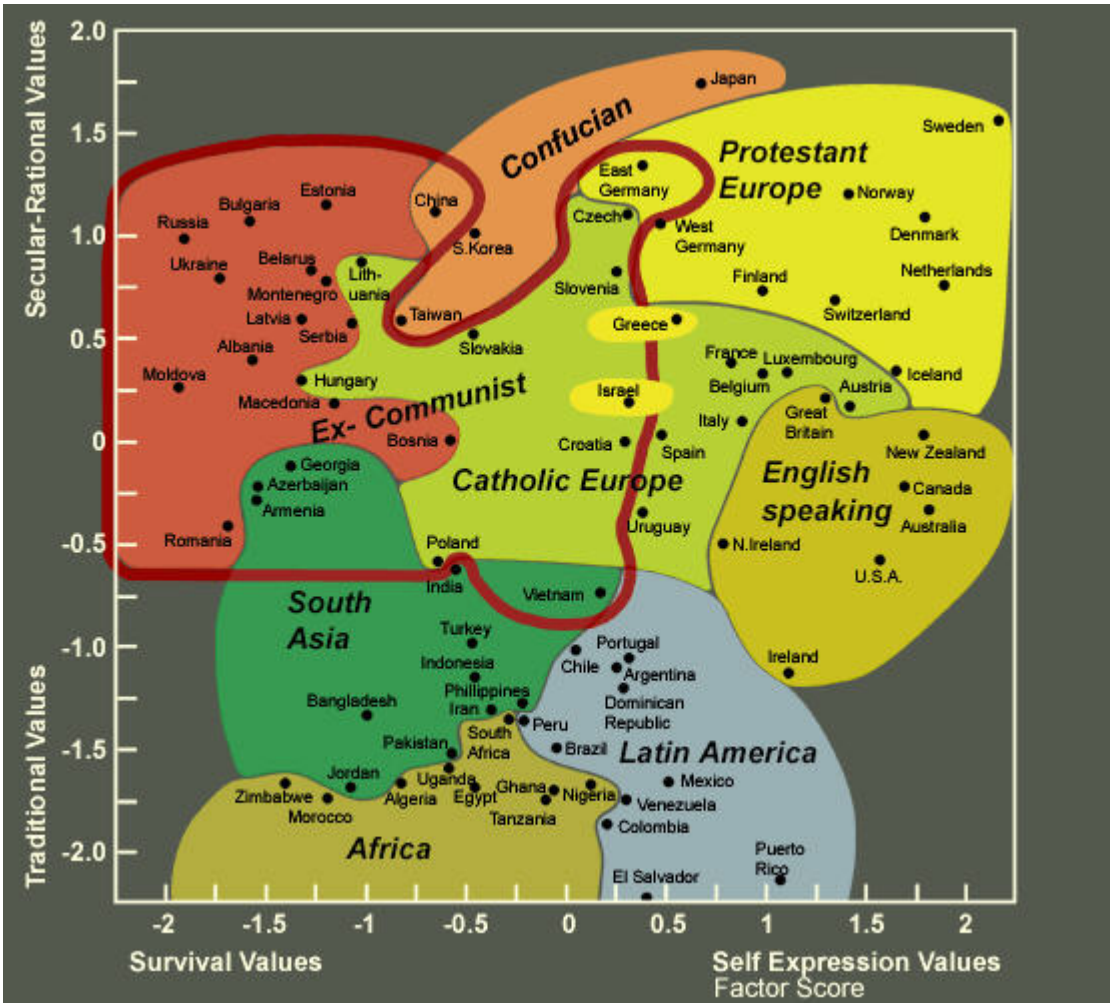
This formulation of the principles of the SCO or "the Spirit of Shanghai" have clear implications for comparing and contrasting the Chinese vision of partnership with that of the EU, as well as for understanding the Chinese stance on regionalism and regional cooperation.113 "The SCO stands for and acts on a new security concept anchored on mutual trust, disarmament and cooperative security; a new state-to-state relationship with partnership instead of alignment at its core, and a new model of regional cooperation featuring concerted efforts of countries of all sizes and mutually beneficial cooperation. In the course of development, a Shanghai spirit gradually took shape, a spirit characterized by mutual trust, mutual benefit, equality, cooperation, respect for diversified civilizations and common development."114

Another example of the continuity of the role of 文 *wén* in Chinese and East Asian foreign policy can be illustrated by *musyawarah dan mukafat* [consultation and consensus] "the ASEAN way", founded on indigenous village procedures: important questions should be decided through prolonged deliberations (*musyawarah*) in order to obtain consensus (*mukafat*). These attitudes have led to a diplomatic style of *musyawarah* and *mufakat*, or consultation and consensus, that is different from that of the EU or the US. ASEAN avoids taking stands on issues that exceed the comfort levels of all its members. "Achieving this requires a delicate balancing act, described in one official publication as not moving 'too fast for those who want to go slow, and not too slow for those who want to go fast.' The resulting consensus politics may be used to smooth over, obviate, and even occasionally resolve interstate disputes and conflicts among its members, but its two primary functions are to ensure the primacy of national governments and to prevent interference in their internal affairs, especially by governments external to the area."115

Before concluding with some specific references to the Chinese understanding of some of the key terms of the EU's China Policy papers, I think it is worth considering some additional socio-cultural aspects of contemporary China and East Asia, as revealed by the *World Values Map*, which Ronald Inglehart presented in the framework of the Dialogue on *Globalisation, identity and diversity* organised by the Universal Forum on Culture held in Barcelona in 2004.116

111 Cf. http://www.fmprc.gov.cn/eng/topics/sco/t57970.htm
112 *Ibid*.
113 Cf. Zainal Mantaha & Seán Golden, (Eds.), *Regionalism in Asia and Europe and Implications for Asia-Europe Relations. 10 – 24 November 2002, Barcelona, Spain*, Singapore: Asia-Europe Foundation, Universitat Autònoma de Barcelona, Fundació CIDOB, Casa Asia, 2004 (Forthcoming).
114 Ibid.
115 Cf. The ASEAN Regional Forum: A Concept Paper, http://www.state.gov/t/pm/rls/fs/2002/12052.htm
116 Cf. http://www.barcelona2004.org/eng/contenidos/

"The Inglehart Values Map visualizes the strong correlation of values in different cultures. Countries are clustered in a remarkably predictable way."



The World Values Surveys were designed to provide a comprehensive measurement of all major areas of human concern, from religion to politics to economic and social life and two dimensions dominate the picture: (1) Traditional/ Secular-rational and (2) Survival/Self-expression values….

The Traditional/Secular-rational values dimension reflects the contrast between societies in which religion is very important and those in which it is not. A wide range of other orientations are closely linked with this dimension. Societies near the traditional pole emphasize the importance of parent-child ties and deference to authority, along with absolute standards and traditional family values, and reject divorce, abortion, euthanasia, and suicide. These societies have high levels of national pride, and a nationalistic outlook. Societies with secular-rational values have the opposite preferences on all of these topics.

The second major dimension of cross-cultural variation is linked with the transition from industrial society to post-industrial societies-which brings a polarization between Survival and Self-expression values. The unprecedented wealth that has accumulated in advanced societies during the past generation means that an increasing share of the population has grown up taking survival for granted. Thus, priorities have shifted from an overwhelming emphasis on economic and physical security toward an increasing emphasis on subjective well-being, self-expression and quality of life. Inglehart and Baker (2000) find evidence that orientations have shifted from Traditional toward Secular-rational values, in almost all industrial societies. But modernization, is not linear --when a society has completed industrialization and starts becoming a knowledge society, it moves in a new direction, from Survival values toward increasing emphasis on Self-expression values.

A central component of this emerging dimension involves the polarization between Materialist and Postmaterialist values, reflecting a cultural shift that is emerging among generations who have grown up taking survival for granted. Self-expression values give high priority to environmental protection,

> tolerance of diversity and rising demands for participation in decision making in economic and political life. These values also reflect mass polarization over tolerance of outgroups, including foreigners, gays and lesbians and gender equality. The shift from survival values to self-expression values also includes a shift in child-rearing values, from emphasis on hard work toward emphasis on imagination and tolerance as important values to teach a child. And it goes with a rising sense of subjective well-being that is conducive to an atmosphere of tolerance, trust and political moderation. Finally, societies that rank high on self-expression values also tend to rank high on interpersonal trust. This produces a culture of trust and tolerance, in which people place a relatively high value on individual freedom and self-expression, and have activist political orientations. These are precisely the attributes that the political culture literature defines as crucial to democracy.117

The *World Values Survey* reveals that the cultural values of different countries in the world do not tend to converge, but economic development pushes all countries in a common direction: the reinforcement of values such as gender equality, tolerance, good governance and democracy (the latter two concepts as defined by the World Bank).118

East Asia, including China, ranks high on the Secular-rational values dimension (higher than the US and several EU member States), although China is closer to Survival values than to Self-expression values, if compared with Japan. On the other hand, if Inglehart's hypothesis is correct, increasing prosperity should move Chinese collective values further along on the Self-expression dimension, and thus closer to the combined dimensions of most developed EU States, thereby producing a culture still more conducive to good governance and democracy.

6. Implications for the EU

Any analysis or interpretation of the implications of the current situation in China and in China's international relations must be tentative because the accelerated rate of change in China forces us to apply a variant of "Moore's Law"119 to any analysis of current discourse or policy.

The stated aims of the EU China Policy are: "to engage China further, both bilaterally and on the world stage, through an upgraded political dialogue; to support China's transition to an open society based upon the rule of law and respect for human rights; to encourage the integration of China in the world economy through bringing it fully into the world trading system, and supporting the process of economic and social reform that is continuing in China; to raise the EU's profile in China."120

China's EU Policy Paper affirms that: China is committed to turning herself into a well-off society in an all-round way and aspires for a favourable international climate. China will continue to pursue its independent foreign policy of peace and work closely with other countries for the establishment of a new international political and economic order that is fair and equitable, and based on the Five Principles of Peaceful Co-existence. China will, as always, respect diversity in the world and promote democracy in international relations in the interest of world peace and common development.121

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117 Cf. http://www.worldvaluessurvey.org

118 Cf. http://www.barcelona2004.org/eng/banco_del_conocimiento/documentos/ficha.cfm?IdDoc=1676

119 Moore's law is the empirical observation that at our rate of technological development, the complexity of an integrated circuit, with respect to minimum component cost will double in about 24 months (http://en.wikipedia.org/wiki/Moore's_law)

120 General information and official policy documents about EU-China relations, including the document Stocktaking on China Strategy, can be consulted at http://europa.eu.int/comm/external_relations/china/intro/index.htm, where there is also a link to China's official EU Policy Paper (http://www.fmprc.gov.cn/eng/wjb/zzjg/xos/dqzzywt/t27708.htm).

121 Cf. China's EU Policy Paper, http://www.fmprc.gov.cn/eng/wjb/zzjg/xos/dqzzywt/t27708.htm

The Chinese affirmation conforms quite clearly to Wang Minmin's analysis of the Chinese moral order mentioned above. The Chinese side both recognises and accepts diversity: There is no fundamental conflict of interest between China and the EU and neither side poses a threat to the other. However, given their differences in historical background, cultural heritage, political system and economic development level, it is natural that the two sides have different views or even disagree on some issues. Nevertheless China-EU relations of mutual trust and mutual benefit cannot and will not be affected if the two sides address their disagreements in a spirit of equality and mutual respect.122

The Chinese emphasis on equality, mutual respect and mutual benefit, is a clear result of the felt need to redress the humiliations suffered throughout the 19th and 20th centuries and to make up for lost ground by following an independent path that is expected to receive the same degree of respect as The EU hopes to receive for its priorities. One notable difference in between the two discourses is the Chinese insistence on mutuality and reciprocity (ancient Confucian virtues), and mutual and equitable benefits, while the EU discourse speaks only of what China is expected to do. In this sense, the EU attitude is similar to the attitude that Wang Minmin attributes to the US in comparison with China: China seems to follow the rhetorical rules of (1) promoting its national image, and (2) maintaining a strong sense of the world as a unit. The United States seems to conform to the power of world opinion as a moral force.

This would imply a certain insensitivity to the linguistic and rhetorical registers that China expects to encounter in official EU-China policy and documents.123

One clear example is the treatment of "culture" in the Chinese document and the latest EU document.124 The Chinese document refers to culture four times. On two occasions the text pays homage to both cultural traditions, with special emphasis on quality and parity, on the other two occasions the reference is institutional or related to the production of cultural goods:

> ***Both*** ***China and the EU member states have a long history and splendid culture*** ***each*** and stand for more cultural exchanges and mutual emulation. The political, economic and cultural common understanding and interaction between China and the EU offer a solid foundation for the continued growth of China-EU relations….
>
> III. The Education, Science-Technology, *Culture*, Health and other Aspects…
>
> China will be more open in cementing and deepening its exchange and cooperation with EU members in the cultural field and work towards a multi-level and all-dimensional framework of cultural exchanges between China and the European Union, EU members and their respective local governments, and between their peoples and business communities so as to make it easier for the people of China and the EU to get to know ***each other's*** ***fine cultures.***
>
> China will establish Chinese cultural centres in capitals of EU members and the EU headquarters -- Brussels. ***On the basis of reciprocity and mutual benefit***, China welcomes the set-up of cultural centres in Beijing by the EU side. China will encourage high quality cultural exchange activities and explore new modalities of cooperation in ***culture***-related industries. Discussions will be held on the formation of a China-EU cultural cooperation consultation mechanism and the idea of jointly holding a China-EU cultural forum. (emphasis added)125

The EU policy paper refers to culture twice, once in a purely institutional framework, and once in a pejorative context, and makes no deference to "parity of esteem":

122 *Ibid*.
123 Cf. the concept of "parity of esteem" enshrined in the Northern Ireland Peace process.
124 A Maturing Partnership EU-China,
http://europa.eu.int/comm/external_relations/china/com_03_533/com_533_en.pdf
125 China's EU Policy Paper, *op. cit*.

> Promote a continued proactive stance by China in the ASEM (Asia-Europe Meeting) process, in consultations on international and regional security and other challenges within the ASEM political pillar, in building Asia-Europe understanding in the DDA negotiations under the economic pillar, and by fostering China's engagement in people-to-people contacts within the Dialogue on *Cultures* and Civilisations.

> the persistence of a ***protectionist culture*** favouring local industry

I think that this example is highly indicative of the value of Wang Minmin's analysis of the construction of China's rhetoric of world opinion and of the need for the EU to develop a communicative strategy more suited to Chinese rhetorical and cultural expectations.

EU policy-makers also have their own phetorical and cultural expectations, with a special anxiety to know how Chinese policy-makers understand key EU terms such as governance, political reform, democratisation, engagement, security, regionalism and regional cooperation, a maturing partnership, while having difficulty in understanding the Chinese use of terms such as political discrimination.

"Governance" or "good governance" is a concept that has acquired major importance in recent times, with reference both to government and to management (corporate government). There is no standard Chinese equivalent for this term. Sometimes it is translated as **統治** *tǒngzhì*, which combines the word for "govern" (**治** *zhì*) with the term for "system," "order" or "unity" (**統** *tǒng*), but which could imply "dominate" or doing things in an interconnected and unifying way. The term**治** *zhì* can mean "to govern" or "to cure", and appears as often in compound words that have to do with governing (not governance) or with medical treatments and remedies. This connection dates back to the ancient holistic vision of society and nature that is part of the China's "long history and splendid culture". Sometimes it is translated as**治理** [*zhìlǐ*], which could be understood to mean the theory or principle (**理**) of government (**治**). Yu Keping, perhaps China's leading expert on the subject, and Director of the Institute on Governance at Beijing University, has difficulty in finding an equivalent term in the Chinese texts of his work on the subject, and has to recur to the use of the English term in his Chinese text:

> "**治理**" [*zhìlǐ*] (governance)
>
> "**统治**" [*tǒngzhì*] (government)
>
> "**善治**" [*shànzhi*], [well known in English as] good governance [that could also be translated literally as] "**良好的治理**" *liánghǎo de zhìlǐ* 126

He uses the term **善治** *shànzhì* for "good governance", where shàn implies "good", "charitable," "kind,", but also "proper", while the alternative *liánghǎo* "good" or "desirable" is an adjective applied to the theory or principle of government, or political science (*liáng* implies "good," "fine", but is also associated with "[good] conscience"). Yu's analysis of the subject of governance as applied to the Chinese context, especially at the local or village level can also be found in English in an EIAS publication, *Toward an Incremental Democracy and*

126 Cf. http://www.gongfa.com/yukpzhili.htm

Governance: Chinese Theories and Assessment Criteria.127 (It is interesting to note that Yu describes the ongoing process of introducing principles of good governance at the local level in China as "incremental democracy" while a leading US expert on the Chinese system of government, Kenneth Lieberthal,128 describes it as "fragmented authoritarianism": two contrasting examples of the construction of civic discourse.)

Yu Keping distinguishes clearly between governance as related to government and governance as a system of administration or management independent of government, and concludes that Chinese civil society is not yet sufficiently strong to implement or consolidate all aspects of good governance. The implications for EU policy in this regard are similar to the implications of Rafael Poch's metaphor of a developing country being like a pregnant woman boarding a bus mentioned above, or like the implications of one of the conclusions of the *Barcelona Development Agenda*, authored by John Williamson and Joseph Stiglitz, among others in the framework of the Universal Forum on World Culture held in Barcelon in 2004:

> both basic economic reasoning and international experience suggest that institutional quality -such as respect for the rule of law and property rights- plus a market orientation with an appropriate balance between market and state, and attention to the distribution of income, are at the root of successful development strategies. Moreover, the institutions that put these abstract principles into reality matter, and developing countries should work hard to improve their institutional environments. But effective institutional innovations are highly dependent on a country´ s history, culture and other specific circumstances. Encouraging developing nations to copy mechanically the institutions of rich countries - as international financial institutions tend to do- is not guaranteed to yield results, and can do more harm than good.129

Williamson is considered to be the author of the "the Washington consensus", whose subsequent interpretation and application he has repudiated, so his involvement in the "the Barcelona Agenda" is especially interesting. Joshua Cooper Ramo has coined the term "the Beijing consensus" to describe China's evolving economic, political, foreign policy and security model as a viable, and increasingly more attractive development model for many countries in the world that reject the "Washington" model.130 Perhaps the Barcelona agenda is more appropriate for EU policy in the triangulation of EU-US-China relations. The definition of this triangle presents us with problems of orientation. Are both Brussels and Beijing looking toward Washington, from opposite sides of the world? Or should Brussels begin looking directly toward Beijing, without have to pass through Washington? The Eurasian landmass situates Brussels and Beijing as two extremes of the same territory, and instead of giving each other the back as they look to Washington, perhaps the EU and China should face each other, and begin developing what many voices now refer to as the "Eurasian arc". In any case, the development of an independent EU stance on governance and development, taking a different stance from the US or China, might be an important element of future EU policy.

It needs to be understood that the recent history of China has invested certain terms that are viewed positively in EU civic discourse with very pejorative connotations in the contemporary Chinese contexts, and one of these terms is "democracy", especially participative democracy, which in the context of China recalls the mass struggle campaigns of the Maoist period, and the excesses of the Cultural Revolution. "Power to the people" does not have the same connotations in China as in post May '68 Europe. Good governance in the Chinese context means institutional stability, above all else, as a means of avoiding social upheaval and sustaining economic growth.

127Cf. http://www.eias.org/publications/briefing/1999/incdemocracy.pdf.pdf

128 Kenneth Lieberthal, *Governing China. From Revolution through Reform*, New York, London: W.W. Norton & Company, 1995.

129 Cf. http://www.bcn.es/forum2004/english/desenvolupament.htm

130 Joshua Cooper Ramo, *The Beijing Consensus*, http://fpc.org.uk/fsblob/244.pdf

As Lydia H. Liu's aforementioned analysis of the term**權利** *quánlì* reveals, many of the key terms of "Western" political science are considered to be double-edged swords in China.

The contrasting points of view of the EU and the US on the subject of engagement (versus containment) are evident in any rhetorical analysis of the respective documents. The tone of *The National Strategic Policy of the United States* clearly reflects the distinction in point of view identified by Wang Minmin. "With the major issues concerning sovereignty resolved and in its position as a (if not *the*) superpower today, it is natural for the United States to conceive world opinion as a sort of imposed regulatory power…. As an established global power, the United States identifies with world opinion as an enforcer of global moral norms":

> The United States relationship with China is an important part of ***our*** strategy to promote a stable, peaceful, and prosperous Asia-Pacific region. … ***China's leaders have not yet made*** the next series of fundamental choices about the character of their state. In pursuing advanced military capabilities that can threaten its neighbors in the Asia-Pacific region, ***China is following an outdated path*** that, in the end, will hamper its own pursuit of national greatness. In time, ***China will find*** that social and political freedom is the only source of that greatness. We already cooperate well **where our interests overlap** … Addressing … transnational threats will challenge China to become more open with information, promote the development of civil society, and enhance individual human rights. China has begun to take the road to political openness, … yet remains strongly committed to national one-party rule by the Communist Party. To make that nation truly accountable to its citizen's needs and aspirations, however, ***much work remains to be done***. Only by allowing the Chinese people to think, assemble, and worship freely can China reach its full potential. ***We expect*** China to adhere to its nonproliferation commitments. … [emphasis added]131

There is no parity of esteem in this document, and its contrast with the rhetorical insistence on equality, mutual benefit and reciprocity of the Chinese official texts is noticeable. In many ways, relations with China must be based as much on form as on content. Respectful disagreement is acceptable, as long as China is given equal status in the dialogue. Form, ritual and protocol (**禮** *lǐ*) have been a basic element of Chinese social and political thought since antiquity. The contrast between EU and US policy toward China, and of the difference in China's response to both policies, has been illustrated quite clearly by the recent EU-China agreement on the voluntary limitation of the export of Chinese textiles. Both the government and the press in China insisted on praising the EU for not taking any unilateral actions and for sitting down to talk to China on the basis of mutual respect, and pointedly criticised the US for doing the opposite. Reciprocity (**恕** *shù*), not doing to another what one wouldn't want done to oneself, has always been the key to achieving the altruism preached by classical Confucianism, and still has value in the sphere of international relations, in accordance with the Shanghai spirit and the ASEAN way. When asked what was the key to his concept of ethics, Confucius replied that**忠恕** *zhōngshù*, acting in accordance with reciprocity, was the thread that ran through all his thinking.

When China does not receive what it perceives to be equal treatment, the term "political discrimination" comes to the fore. A recent article in China & World Economy analysed the EU's preliminary assessment of China's "Market Economy Status", one of China's most important foreign policy concerns, along with the lifting of the EU arms embargo, the maintenance of the One China policy, UN reform, and the consolidation of multilateralism in organisations such as the WTO (fomenting the G20 as a counterweight to the G7/8, cultivating the EU as a counterweight to the US) as well as regionalism and regional cooperation (China is promoting the creation of a free trade zone based on the ASEAN +3 framework, and hopes to advance this project at the summit to be held in Kuala Lumpur at the end of the year, with India, Australia and

131 Cf. http://www.state.gov/documents/organization/15538.pdf

New Zealand present as observers). The lack of EU recognition of Market Economy Status is described as "a utilitarian move". "People may easily come to the conclusion that the EU will only recognize China as a market economy if that recognition is beneficial to it. Politics is becoming more decisive than technical solutions in policy-making, which gives an impression that objective facts are no longer important and only might and power are useful."132 The perceived lack of reciprocity and mutual respect is singled out for special criticism. "The EU has not questioned the arguments and data provided by China, but only sorted out the shortcomings that China acknowledges in its materials, and those from other sources. Given such an approach, what is the meaning of repeatedly requiring China to provide relevant materials? Since the argument process concerns both China and EU, it is necessary that the EU respond to China's materials."133 At the same time, however, a generally positive attitude is expressed because the EU response was a postponement of, not a rejection of, any recognition of China's Market Economy Status. When the reasons for rejecting a Chinese petition cannot be seen to be based on objective criteria, "political discrimination" is alleged. This is also the case with the lifting, or not, EU arms embargo. The reasons alleged are not perceived as being objective; therefore they must be political, from the Chinese point of view.

7. Conclusion: hymn sheets or jam sessions?

The communicative strategy to be adopted by the EU in the rhetorical construction of its dialogue with China should be fully cognizant or and sensitive to the criteria of China's moral order as outlined in this study and specified in the Five Principles (mutual respect for sovereignty and territorial integrity; non-aggression; non-interference in each other's internal affairs; equality and mutual benefit; and peaceful coexistence), the Spirit of Shanghai and the ASEAN Way, with special emphasis on mutual recognition, parity of esteem, and mutual benefit. Any other discourse will be perceived semiotically as unilateralist and exploitative. respect for diversity is paramount, and the ability to harmonise diversity is a major function of Chinese political and cultural thought. "Harmony" and "peace" are the same word in classical Chinese: **和** *hé* (**和平** *hépíng* is the modern word for "peace" and **和聲** *héshēng* is the modern word for "harmony"). As a result, any practice that produced harmony, such as music or cooking, was a form of training for maintaining peace, social cohesion and solidarity in society (or among nations).

All singing from the same hymn sheet might permit some harmonising, but a better metaphor for the concert of the world's nations might be that of a jam session, which gives each musician a chance to make a creative and independent contribution to the overall harmony of the group. The ancient Chinese thinker Yanzi (m. 493 BCE) once made a distinction between harmony and uniformity or identity.

> Harmony … may be illustrated by cooking. Water, vinegar, pickles, salt and plums are used to cook fish. From these ingredients there results a new taste which is neither that of the vinegar nor of the pickles. Uniformity, on the other hand, may be likened to the attempt to flavour water with water, or to confine a piece of music to one note. In both cases there is nothing new. Herein lies the distinction between the Chinese words *t'ung* [**統** *tǒng*] and *ho* [**和** *hé*]. *T'ung* means uniformity or identity, which is incompatible with difference. *Ho* means harmony, which is not incompatible with difference; on the contrary, it results when differences are brought together to form a unity. But in order to achieve

132 Institute of Economic and Resources Management, Beijing Normal University, "Review of the EU's Preliminary Assessment of China's Market Economy Status," *China & World Economy*, Vol. 13, No. 2, March-April 2005, pp. 54-63.
133 *Ibid*.

harmony, the differences must each be present in precisely their proper proportion, which is *chung* [*zhōng*]. Thus the function of *chung* [**忠** *zhōng*] is to achieve harmony.134

That is the same**統** *tǒng* as **统治** *tǒngzhì*, government, the same**忠** *zhōng* as**忠恕** *zhōngshù*, acting according to reciprocity, and the same**和** *hé* as peace and harmony.

List of Abbreviations

ACFTU	*All China Federation of Trade Unions*
ACWF	*All China Women's Federation*
AFTA	*Asian Free Trade Area*
APEC	*Asia-Pacific Economic Cooperation*
ARF	*ASEAN Regional Forum*
ASEAN	*Association of South East Asian Nations*
ASEM	*Asia Europe Meeting*
CAEC	*Council for Asia-Europe Cooperation`*
CASS	*Centre for Applied Social Surveys*
CCP	*Chinese Communist Party*
CECC	*Congressional-Executive Commission on China*
CEIBS	*China Europe International Business School*
CFSP	*Common Foreign and Security Policy*
CNPC	*Chinese National Petroleum Corporation1*
COMECON	*Council for Mutual Economic Co-operation*
CPC	*Communist Party of China*
DINK	*Double Income, No Kids*
DPRK	*Democratic People's Republic of Korea*
DRC	*Development Research Center*
EAC	*East Asia Community*
EAS	*East Asia Summit*
EEFSU	*Eastern Europe and the Former Soviet/Union*
EI	*Engineering Index*
EIAS	*European Institute for Asian Studies*
ESIA	*Environment and Social Impact Association*
ESS	*European Security Strategy*
EU	*European Union*
FAO	*Food and Agriculture Organization*
FDI	*Foreign Direct Investment*
FIE	*Foreign Investment Enterprise*
FTA	*Free Trade Agreement*
FTAA	*Free Trade Area of the Americas*
FY	*Fiscal Year*
GDP	*Gross Domestic Product*
GDPR	*Global Defense Posture Review*
GNP	*Gross National Product*
GTAP	*Global Trade Analysis Project*
HEI	*Higher Education Institutions*
IEA	*International Energy Agency*
ILO	*International Labor Organization*

134 Fung Yu-lan, *A Short History of Chinese Philosophy*, Derek Bodde (Ed.), Macmillan, 1960, p. 174.

IMF	*International Monetary Fund*
IPR	*Intellectual Property Rights*
ISTP	*Index to Scientific and Technical Proceedings*
JETRO	*Japan External Trade Organization*
JBIC	*Japan Bank for International Cooperation*
KEDO	*Korean Peninsula Energy Development Organization*
KIEP	*Korean Institute For Economic Policy*
KMT	*Kuomintang (Nationalist Party of China)*
LDP	*Liberal Democratic Party of Japan*
LME	*Large and Medium size Enterprises*
LNG	*Liquefied Natural Gas*
MB/D	*Million Barrels Per Day*
MES	*Market Economy Status*
MFN	*Most Favored Nations*
NAFTA	*North American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
NDPG	*National Defense Program Guideline*
NGO	*Non Governmental Organization*
NIDS	*National Institute of Defense Studies*
NIE	*Newly Industrialized Economies*
NIRA	*National Institute for Research Advancement*
NPC	*National People's Congress*
NPT	*Non-Proliferation Treaty*
OPEC	*Organization of Petroleum Exporting Countries*
OSCE	*Organization for Security and Co-operation in Europe*
PLA	*People's Liberation Army*
PNTR	*Permanent Normal Trade Relations*
PRC	*People's Republic of China*
REMEP	*Rome Euro-Mediterranean Energy Platform*
RMA	*Revolution of Military Affairs*
RMB	*Renminbi*
ROW	*Rest of the World*
R&D	*Research and Development*
SCI	*Science Citation Index*
SCO	*Shanghai Cooperation Organization*
SDF	*Self-Defense Forces*
SLOC	*Sea-lane of Communications*
SME	*Small and Medium Enterprises*
SOC	*Senior Officers Consultation*
SOE	*State Owned Enterprises*
S&T	*Science and Technology*
TAC	*Treaty of Amity and Co-operation in South East Asia*
TFP	*Total Factory Productivity*
TMD	*Theatre Missile Defense*
TNC	*Trans-National Corporations*
TVE	*Town Village Enterprises*
UN	*United Nations*
UNDP	*United Nations Development Programme*
UNSD	*United Nations Statistics Division*
US	*United States*
USD	*United States Dollar*
USCC	*U.S.-China Economy and Security Review Commission*

USSR	*United Soviet Socialist Republic*
WEC	*World Energy Council*
WMD	*Weapons of Mass Destruction*
WTO	*World Trade Organization*