

Promise or Threat? China's Commercial Diplomacy in Asia

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Two recent trends are redefining the balance of power in Asia, shifting its fulcrum from security only to a subtle mixture of security and economics. First, the drive toward closer regional integration has gained momentum, giving rise to a burst of preferential trade arrangements. Loosely known as free-trade agreements (FTAs), these arrangements symbolize closer political ties as well as commercial opportunity. Second, China has taken advantage of this new regionalism and has become a skilled practitioner of commercial diplomacy. This paper describes these trends and analyzes the strategic opportunities and risks that such a combination poses for the United States.

Commercial diplomacy is by no means the only mode of expression of the drive toward closer integration, but it has become its most visible glue. It has erected a structured, organized, cooperative political framework in a part of the world where governments cling fiercely to national sovereignty and resist both formal institutions and enforceable rule-making. Intra-Asian FTAs in particular have assumed a role akin to that of security alliances, serving as an expression of political and security ties as well as a harbinger of trade and investment. FTAs do not affect the military balance of power, but they alter and redefine the balance of influence, perceptions of security, and political alignments.

The Chinese government has adapted skillfully to this new environment. A key turning point was the Asian financial crisis of 1997-98. As the crisis gathered force, China took credit for not devaluing its currency and then announced a series of trade-related relief measures. The most visible symbol of Beijing's foray into commercial diplomacy occurred in 2000, when China

floated the idea of an FTA between China and the Association of South East Asian Nations (ASEAN). Two years later, Chinese and ASEAN leaders formally announced a decision to start negotiations aimed at establishing such an FTA within ten years. The initial phase of this agreement is in effect, but many details – governing exceptions for “sensitive” sectors, phrase-in periods, and other significant provisions – remain to be worked out.

This analysis describes and evaluates the combination of closer regional integration and China’s new role. It begins by sketching the Asian context of China’s commercial diplomacy, namely, the drive toward regional integration and the emergence of a small core of countries, including China, as its main locus. It traces the impact of this development on the political geography of the region. It then offers a brief sketch of China’s commercial profile in Asia and highlights China’s relatively rapid transformation, after a slow start, from suspicious and reactive outsider to active commercial diplomat. It argues that if present trends continue, Beijing’s new commercial-diplomatic “embedded-ness” bodes well for regional peace and prosperity and is broadly consistent with U.S. interests – provided, and it is a crucial proviso, that the United States stays engaged in the region.

But many things can go wrong. In addition to U.S. engagement in the region, a positive outcome from a U.S. perspective depends heavily on the constructive management of Sino-American relations. The chapter lists a number of possible crises of a political-economic nature that could sharply escalate Sino-American tensions, raise the likelihood of conflict, polarize governments in the region, and derail Asia’s potential prosperity -- at considerable cost to the United States. These setbacks are by no means inevitable. The chapter ends by suggesting several changes in American behavior, attitude, and style of decision-making to help ensure a peaceful and prosperous future.

I. Commercial Diplomacy and Asia's New Political Geography

Commercial diplomacy is a relatively new component of strategic analysis.¹ What distinguishes it from ordinary commercial ties is the direct involvement of governments. One definition refers to the process and conduct of negotiations designed to influence foreign government policy and regulatory decisions affecting trade and investment. The issue at hand may be tariffs, quotas, standards, services, subsidies, agricultural support, competition policy, privatization, a major procurement deal benefiting a particular firm, or anything else affecting international commerce. Since these practices are shaped by domestic politics, commercial diplomacy necessarily targets political decision-makers and those who exercise political influence.²

Another definition, more relevant to this analysis, encompasses the use of commercial power such as market access or technology transfer to influence non-commercial decisions in the political or even the security realm. In addition to trade agreements, it often targets large and visible infrastructure projects such as bridges, ports, and highways. Support for these large projects are popular with recipient governments because they come without the usual environmental and other “strings” attached to loans from the World Bank and other multilateral institutions. This version of commercial diplomacy illustrates with particular clarity the linkage between economics and security.

The exercise of commercial diplomacy relies on “positive-sum” economic incentives rather than “zero-sum” military buildups. It provides a fluid and flexible medium that both reinvigorates bilateral rivalries and channels them in peaceful and synergistic directions. It is

“softening” the politics of the region because it puts a premium on the balance of power in the form of *influence* rather than the balance of power defined as potential *force*.

Commercial diplomacy molds Asian security relationships in subtle but tangible ways. For China, it opens up new opportunities for influencing political and security developments in its most important neighborhood. The sheer size and dynamism of China’s economy may make explicit diplomatic intervention unnecessary. For non-Chinese Asians, it is a key tool in a conscious geopolitical and security strategy aimed at embedding a rising China in a web of peaceful relationships. For Japan, the various meetings associated with it constitute a safe, unpublicized neutral ground on which the government can hold bilateral discussions on sensitive topics behind the scenes. This is particularly important for Japan’s relations with China, which are currently prickly. From Tokyo’s perspective, the new prominence of commercial diplomacy also reminds Asians that while China’s domestic market is huge, Japan’s economy is enormous and its assets – including business, banking, technology, and a highly educated workforce -- are considerable. For India and Russia, commercial diplomacy provides a means of expanding their political presence in East Asia, broadcasting their peaceful intent, soliciting investment, and competing with China for influence. Moreover, India is a beneficiary of commercial diplomacy initiatives on the part of Japan and Singapore.

Commercial diplomacy is also altering the political geography of Asia. First, it is forging a north-south bridge linking two quite different sub-regions, Northeast Asia and Southeast Asia. China, currently assigned to “Northeast” Asia because of its Confucian heritage, actually overlaps substantially with parts of Southeast Asia (and Central Asia) as well. This overlap stems partly from geography; Hong Kong and Hainan Island are on roughly the same latitude as Indochina and Myanmar. It also arises from China-related commercial activities on the part of

both non-Han ethnic groups spanning China's borders and Chinese minorities in neighboring countries and elsewhere in Asia.³

Second, the expansion of trade and investment sparked by trade-liberalizing agreements is revitalizing maritime Asia. The slow but steady reduction of barriers to cross-border business is linking coastal cities and their surrounding regions and permitting communities long divided by colonial-era boundaries to trade freely again. At the same time, the concentration of trade and investment along or near this chain is widening the gap between coastal regions and ocean-accessible cities on the one hand and poorer interior regions on the other. This gap draws huge numbers of people to the cities in search of jobs and threatens to overwhelm the limited infrastructure of urban localities. These problems are particularly acute in China; cities are overcrowded and polluted and the rich-poor gap among and within certain provinces has risen sharply.

Third, commercial diplomacy in Asia is knitting together the "spokes" of the U.S.-centered hub-and-spoke security-alliance system and connecting them more closely with governments less friendly to Washington. This thickening is patchy and uneven, however. At China's insistence, Taiwan is left out and Hong Kong lacks a separate voice, even though both are members of the Asia Pacific Economic Cooperation forum (APEC). Three members of the web – Myanmar, Laos, and Cambodia – lag so far behind the rest of ASEAN politically and economically that their governments have little interest in economic integration. Mongolia is ignored. Australia sends a higher percentage of its exports to Asia than any of the so-called "ASEAN + 3" countries but is grouped, along with New Zealand, in a separate "+ 2" category.⁴ Canberra was not on the original invitee list for the December 2005 "East Asian Summit" but was eventually invited, along with New Zealand, after both governments agreed to sign

ASEAN's Treaty of Amity and Cooperation. Despite these anomalies, ASEAN + 3 provides the only ongoing, multi-level framework within which East Asians can consult regularly and freely. The ASEAN Regional Forum, for instance, includes the United States, Russia, and the European Union, among others.

Fourth, the web of new agreements has motivated India to enter the game of commercial diplomacy, thus expanding the geographic boundaries of Asian economic integration. Reinvigorating its "Look East" policy, New Delhi has greatly improved its relations with Beijing as well as other Asian governments. But Indian officials remain suspicious of China's intentions and hope to track and if possible match its initiatives. (A current example is Myanmar, where both governments are courting the military regime.) The Indian government has negotiated a framework agreement with ASEAN whose ambition and scope resemble the China-ASEAN agreement. It has also negotiated an economic cooperation agreement with Singapore, which could be a launching pad of sorts for an India-ASEAN FTA. An FTA with Thailand is also joining the list. Thanks to these and other diplomatic efforts, New Delhi now holds its own annual summit meeting with ASEAN in an "ASEAN + 1" arrangement and was included in the December 2005 "East Asian Summit."⁵

This logical and long overdue move is strategically significant. India already fields a powerful military force, including nuclear weapons and a blue-water navy. Anyone who has visited the great monuments and ruins of Southeast Asia sees carvings and inscriptions reflecting the vast historical sweep of India's cultural and religious influence. But decades of inward-looking and protectionist policies reduced India's economic role in the regional and global economy to a level lower than it was at the time of independence. Its infrastructure is decrepit, and its regulatory inertia calls to mind Dickens' Department of Circumlocution. Latching on to

East Asia's dynamic growth is one way for India to escape its poverty-ridden neighborhood, tap the Indian diaspora, and stimulate reform and domestic competition, especially in coastal cities and outward-looking southern states.

II. The Emergence of "ASEAN + 3"

Asia's new political geography and the driving role of ASEAN + 3 demonstrate that U.S. initiatives undertaken in one part of the world may unintended consequences in another. A major catalyst in the early 1990s was the domino effect of regional trade agreements in the Americas and the widening and deepening of the European single market. These moves stimulated Asians to launch their own regional initiative for fear of being left behind in the competition for trade and investment. It is doubtful that the Americans who negotiated the North American Free Trade Agreement (NAFTA) or the Europeans who hammered out a single European market gave much thought to the possibility of a collective and defensive Asian response. To the extent that they thought about Asia at all, the designers of NAFTA believed that Asians would be content to be members of APEC, which includes the United States and spans a much bigger market.⁶

There are many reasons to be skeptical about economic integration in Asia. Many Asian governments won their independence relatively recently and cling fast to national sovereignty. The societies, cultures, religions, and languages of Asia are extraordinarily diverse. And from an economic viewpoint, the use of FTAs to bolster the drive toward regional economic integration in Asia is distinctly "third-best." Every serious economic study shows that global free trade and investment would reap far more benefits for participants than narrowly regional or bilateral arrangements would. Second best would be liberalization within the vast Asia-Pacific market, including North America, Australia, New Zealand, and Taiwan.⁷

For a while it looked as if this second-best option would win out. In 1993, the newly elected Clinton administration announced that it was carrying forward a three-track trade strategy (global, regional, and bilateral) and placed trade high on its agenda. It concluded both the Uruguay Round of global trade talks and the North American Free Trade Agreement (NAFTA) and proposed the Free Trade Area of the Americas. Its Asia trade strategy found expression in the Asia Pacific Economic Community forum (APEC), which includes Taiwan, Hong Kong, Australia, and New Zealand as well as China. In a highly successful 1993 summit in Seattle, hosted by President Clinton, APEC's leaders committed themselves to "free and open trade and investment." In the following year, in Indonesia, they made this commitment meaningful by attaching a deadline of 2010 (2020 for developing countries).

By the mid-to-late 1990s, however, APEC had lost steam and the WTO process had stalled. Seeking to whittle down European protectionism and add structure to an important relationship, ASEAN began a series of dialogues with the European Union known as the Asia-Europe Meeting (ASEM).⁸ The European Union, which is excluded from APEC, saw a chance to expand its market share in Asia and add a layer of political visibility to the global reach of European companies and banks.⁹

The first ASEM meeting took place in Bangkok in February 1996. It was at that time that ASEAN + 3 began to crystallize from an informal grouping to a structured body. Championed by Malaysian prime minister Mahathir, it gained significant momentum as a result of the Asian financial crisis of 1997-98. The crisis began in Thailand, but the ensuing financial "contagion" convinced Asian leaders that Northeast Asia and Southeast Asia are linked and that Asians cannot count on outsiders to help with similar crises in the future. Ever since then, ASEAN + 3 has been the main vehicle of incipient East Asian integration. Its members have

proposed -- and in some cases negotiated – mostly bilateral trade agreements between themselves (as well as with others outside of the region).¹⁰

ASEAN + 3 has also taken on institutional characteristics. There is now an ASEAN + 3 unit within the ASEAN Secretariat in Jakarta. ASEAN + 3 governments and associated private-sector and academic groups hold regular meetings, establish working groups, and commission research and advice from outside experts. There is a flourishing “Track 2” (non-government) process, which some call “Track 1.5” because some of the participants have close ties to their governments.¹¹

Building on the ASEAN + 3 process, in December 2005 the Malaysian government hosted an “East Asian Summit” (EAS) to which India, Australia, and New Zealand were also invited. The most visible public results of the meeting were to establish the EAS as an annual forum for dialogue as an “integral part of the evolving regional architecture” and to proclaim an undefined “East Asian community” (with a small “c”) as a long-term goal.

The first effort to establish an East Asia grouping, spearheaded in the early 1990s by former Malaysian prime minister Mahathir, aroused fears of a closed, protectionist, and implicitly anti-American bloc. By contrast, Asian leaders are presenting the current drive to as a fluid, benign effort to address common challenges based on an emerging, outward-oriented, cosmopolitan East Asian identity.¹² Chinese officials have echoed these themes.¹³

III. Dimensions and Limitations of China’s Expanding Commercial Profile

Commercial diplomacy is an obvious tool for China. No other nation has ever expanded its role in international trade and investment on the scale that China has. The volume of its exports and imports has expanded at an average rate of 15 percent each year since 1979,

compared to a global expansion of 7 percent. Its share in world trade jumped from less than 1 percent in 1979 to about 7 percent in 2005.¹⁴ China is now the world's third largest merchandise exporter, accounting for more than 7 percent of world totals. It manufactures about 70 percent of the world's toys and about 10 percent of office telecommunications equipment. But an estimated 60-70 percent of China's exports stem from foreign companies (known as "foreign-invested enterprises") or joint ventures between Chinese and foreigners.

China is also the world's second-largest importer. Imports of energy and raw materials are contributing to an upsurge in world prices. China consumes about a third of the world's iron ore and two-fifths of the world's copper. Its burgeoning manufactured exports consist in large part of imported components, undercutting the accuracy of the label "Made in China."

In the area of foreign direct investment (FDI), China also breaks records. By the end of the 1990s, China's total stock of FDI was almost a third of cumulative foreign direct investment in *all* developing countries. As noted in the chapter by Brandt, Rawski, and Zhu, China surpassed the United States as the top FDI recipient in 2003.

The combination of China's large size and release of pent-up demand is creating a huge market for China's trading partners. China is already the world's largest market for cell phones (269 million in 2003).¹⁵ United Parcel Service, the world's largest package-delivery company, has announced plans to build 60 warehouses covering 200 Chinese cities.¹⁶ China's demand for energy is a bonanza for vast numbers of companies specializing in energy-related exploration, extraction, refining, infrastructure, and transportation. Similarly, outbound tourism is exploding. At a signing ceremony in February 2004, China granted 12 EU member countries the status of "approved destinations," heralding a growth rate in outbound tourism likely to be three times the rate in the rest of the world. By 2020, according to the World Tourism Organization, China will

be the fourth largest source of outbound tourism in the world, with travelers expected to spend a whopping \$1,200 (at today's prices) per person.¹⁷

The impact of all this activity on the rest of Asia is complex. On the one hand, it is a bonanza. As a percentage of China's total imports, imports from Asia have jumped from 15 percent in 1980 to over 50 percent.¹⁸ In some years imports from Asia in dollar terms have been increasing by as much as one-third, compared to roughly 20 percent from Europe and 10-15 percent or less from the United States.¹⁹ China is now the number-one customer for Japan and South Korea. Specific industries have benefited enormously. In 2003, for example, a 30 percent increase in China's oil imports helped feed a doubling of ship orders in South Korea.²⁰ Incoming travel has been a boon for the aviation, travel, and tourism industries. For example, there are now direct flights from Seoul to 24 Chinese cities. About 35,000 South Korean students are studying in China. More and more Asian students are learning Mandarin, studying in China, and watching Chinese films and cultural performances.

If fully implemented, the China-ASEAN FTA would create an economic area with a population of 1.7 billion, a combined GDP of over \$2 trillion, and a total trade volume of \$1.23 trillion.²¹ Despite the likely loopholes and shortcomings of the agreement, the very prospect of such a large market is already beaming a positive signal to traders and investors as businessmen in the region step up their activities in anticipation of more commercial opportunities.

On the other hand, as John Ravenhill's chapter in this volume demonstrates, China's explosive growth challenges other Asian governments, particularly those whose domestic policies fail to meet the demands of global competition. With respect to both the manufacturing sector and the ability to attract foreign investment, Indonesia's post-crisis record is particularly

weak, but no country can rest on its laurels. As illustrated in the Keller-Pauly chapter, the Chinese are moving rapidly up the technology ladder, forcing other Asian governments and private entities to undertake painful and difficult structural changes. Time is pressing; China's export base has diversified away from textiles and light manufacturing in a relatively short period. For example, the proportion of China's exports represented by machinery, transport, and electronics increased from 17 percent in 1993 to over 40 percent in 2003. China's dynamism is contributing to a high degree of specialization of production within an Asia-wide production network, particularly in the field of information technology.²²

Offsetting China's huge economic assets are various limitations on China's potential weight in the balance of influence. Known weaknesses in the banking system and widespread intellectual property violations have a dampening effect, and corruption is a serious problem. None of the world's "50 most admired companies" is Chinese, and China's biggest companies still lumber along under state control or state influence.²³ Japan, Asia's number-one aid donor, still wields great economic power; one economist has calculated that a Japan-South Korea FTA could match China's "hub-ness" (as in hub-and-spoke).²⁴ China may be the leader in low-cost manufacturing, but Japan is way ahead in technology; Singapore, Hong Kong, and Australia lead in high-end services; India has shown a flair for software design and English-language services; and Americans are geniuses at inventing popular new services and products that people didn't know they needed and delivering them rapidly and efficiently.

Moreover, Beijing will not be able to provide public security and economic welfare benefits comparable to those offered by the United States for decades to come. The Chinese are hoping to build a blue-water navy but have a long way to go. Nor has China acquired much "soft power" beyond its economic and commercial appeal. In previous centuries traditional Chinese

culture and governance were widely admired and emulated in the region, whereas today's China draws mixed reviews. Although forced modernization driven by an authoritarian government appeals to some, democratic governments and their supporters in Asia look askance at curbs on press freedom, the harsh treatment of dissidents, and the effort to contain democracy in Hong Kong. China's one-party political system is increasingly archaic. Chinese leaders themselves are seeking different models and talking openly of the need for more democracy.

Whether or not China can sustain its booming economic growth is a matter of debate. But for purposes of this analysis, it suffices to say that China's growth is a magnet for other Asians. And like other magnets, it changes the alignment of objects lying in its field.

IV. Beijing's New Activism

Along with China's galloping growth has come a new willingness to embrace commercial diplomacy. This shift was initially reactive in nature. In the early and mid-1990s China was a wary and reluctant novice in the field of commercial diplomacy. Its trade priorities were concentrated on gaining membership in the World Trade Organization (WTO). Although it took part in APEC meetings, it did so gingerly. Chinese leaders mistrusted global and regional institutions, believing that they were dominated by the United States or otherwise shaped to satisfy U.S. interests. Likewise, Beijing's security posture in Asia was unsettling; in 1995, China seized an unoccupied reef in the disputed Spratly Islands claimed by the Philippines. A year later, its military forces engaged in major saber-rattling vis-à-vis Taiwan, which caused President Clinton to send U.S. naval vessels toward the Taiwan Strait.

During these same years, however, China's policy in Asia was evidently undergoing a strategic shift.²⁵ There was a growing realization that economic modernization required peace

and prosperity in Asia, deeper economic engagement with Asia and other important regions, market-oriented economic policies, and better relations with the United States. As Joseph Fewsmith's chapter points out, those whose interests are harmed by international market forces ("reform losers") could threaten this consensus, but so far it appears to be holding.

The devastating Asian financial crisis of 1997-98 presented China with an unprecedented opportunity to carry out this shift toward engagement in Asia and reap good will at the same time. To some extent the financial crisis gave the Chinese the chance to just "walk in" to a situation created mainly by other Asians and downplayed or ignored by American policy-makers. Largely unaffected by the crisis because of controls on its capital market, China nevertheless took an active part in post-crisis agreements initiated by Japan. Known as the Chiang Mai Initiative, the heart of these agreements is a network of bilateral currency swap arrangements.²⁶ Beijing also lowered or eliminated tariffs on selected products from ASEAN countries and added ASEAN to the list of approved destinations for which Chinese tourists would no longer require an exit visa.

Nevertheless, Chinese officials stopped short of offering a full-blown FTA to the region and continued to express caution about the trend. What evidently tipped the balance in the minds of China's top leaders was the need to keep pace with Japan and South Korea, both of which had taken the lead in proposing bilateral trade initiatives. Chinese negotiators complained privately that Japan and Singapore were considering a bilateral FTA at a time when China was wholly preoccupied with WTO accession. Finally, in November 2000, Premier Zhu Rongji proposed to set up an expert group to study how economic cooperation and free-trade relations between ASEAN and China could be deepened. The proposal to establish a China-ASEAN FTA followed soon thereafter.²⁷

V. Asian Reactions to Chinese Engagement

Asian leaders have by no means shed their wariness about China's intentions in the region. Most of them are old enough to remember the Maoist era, when Chinese leaders whipped young people into a destructive frenzy and sought to manipulate overseas Chinese minorities to foment instability. But they encourage and applaud China's engagement in the region for at least five sound reasons.

First, China is a rising power with the potential to become a threat. But in Asian eyes, "containment" is not an option because it would be counterproductive. They do not wish to be forced to choose between Beijing and Washington. The integration initiative with its commercial-diplomacy arm is consciously designed to embed China in a web of interdependence. Most Asian leaders believe that integration promotes security by building trust, facilitating confidence-building measures, and raising the cost of war. It also provides a peaceful and constructive forum for political rivalry between China, Japan, and increasingly India in ways that benefit Asia as a whole.

Second, Asian governments believe that their countries are competing with China for investment, and China is winning. The drive to achieve a more integrated Asian market is a practical effort to ride China's economic coattails instead of being "hollowed out." ASEAN leaders in particular are convinced that they have no choice but to agree to a more integrated market with China in order to expand their own exports and especially to make their economies more appealing to foreign investors.²⁸ If investors can export freely to China, they will not be tempted to pull up stakes in other parts of Asia.

Third, affected Asian governments appreciated Beijing's nimble and seemingly generous response to the Asian financial crisis of 1997-98, which included loans to several Southeast Asian countries. Unwisely, the United States turned its back on Thailand when its currency collapsed, triggering the crisis, even though Washington had extended help to Mexico when the peso crashed in 1994. This contrasting behavior seriously undermined confidence in the United States and convinced Asians that no non-Asian power or institution can be counted on to help. Although ASEAN as a collective body was also on the sidelines, Malaysia, and Singapore, along with Japan and Australia, offered assistance to hardest-hit Indonesia, and Japan proposed an Asian Monetary Fund (subsequently vetoed by the United States). ASEAN + 3, which includes Japan as well as China, was a logical place to discuss measures to prevent or mitigate future crises.

Fourth, outward-looking governments with competitive economies, such as Singapore, are frustrated by the slow pace of global trade liberalization and the unwieldy nature of APEC. The WTO's Uruguay Round of trade negotiations took seven years to complete (1986-93). The WTO's current round, euphemistically called the "Doha Development Agenda," has been equally time-consuming, and its final results (if any) are likely to be disappointing. Regional and bilateral free trade agreements seem attractive because they can usually be negotiated much more quickly and because they stimulate competitive liberalization elsewhere. Asia's corporate leaders have become lobbyists for measures facilitating cross-border business, including FTAs. The big prize is access to the Chinese market.

Finally, Asian leaders need China's cooperation to address a wide range of non-military threats. In the criminal category are terrorism, piracy, drug smuggling, trafficking in human beings, money laundering, fraud, the illegal plundering of endangered species, and other crimes.

Many if not most of these have been around for a long time, but globalization and advanced technology have empowered their perpetrators. Other threats include depletion of water and other natural resources, treatment of contagious disease, and illegal cross-border pollution.

Japan, a member of ASEAN + 3, shares these perspectives but views both Asian regionalism and China with considerable concern. Loyal to the WTO and reliant on global trade rules, Tokyo was initially reluctant to go along with the ASEAN + 3 initiative and still prefers to involve the United States, Australia, and New Zealand. But trade officials, already stung by their exclusion from the NAFTA and seeking an offsetting economic stimulus, joined forces with foreign ministry officials and the business community. Along with South Korea, Japan was the first to initiate bilateral agreements with Asian neighbors and others.²⁹

Japan's residual protectionism, its resistance to large-scale immigration, and the clubby nature of its business culture act as a drag on Japanese influence in the region. Given the size of its economy, Japan punches below its weight. But rivalry with China is jarring entrenched habits. The announcement of a China-ASEAN FTA gave a particular jolt to Japan, loosening – at least to a small extent -- the grip of agricultural protectionists. Tokyo's FTA with Mexico was considered a breakthrough because when fully implemented it will permit the import into Japan of at least small volumes of orange juice and pork. This “camel's nose” breakthrough could eventually open the tent to similar concessions to ASEAN and South Korea, but only if the prime minister lends his personal support.³⁰ (Thus far the camel is still out in the cold.) The more Japan becomes a “normal” trading partner, able to sign full-blown FTAs, the more it will achieve its goal of being perceived as a “normal” country.

Japan has also shifted its aid priorities. Seeing a strategic opportunity and reluctant to feed a giant competitor, the Japanese government has channeled its aid loans away from China

and towards India. Tokyo has already slashed its soft yen loans to China by 50 percent since 2001, while India will become the prime recipient of such loans for the first time. Loans to India will be concentrated in infrastructure sector, particularly power generation and transport, where serious weaknesses hobble India's competitiveness.³¹

Although the Japanese proposal to establish an Asian Monetary Fund was defeated, Japan retains a competitive advantage in finance. Taking diplomatic advantage of the depth and sophistication of Japan's financial sector, Japan's Ministry of Finance and the Asian Development Bank have launched studies analyzing the feasibility of a regional bond market. Known as the Asian Bond Market Initiative, the idea is to mobilize Asia's considerable domestic savings and make them available for domestic investment without channeling them through foreign markets. Other goals include broadening the investor base, reducing foreign exchange risks, and strengthening the credit ratings of the issuers by enhancing the capability of local bond rating agencies. Bonds would be issued in local currencies (and eventually in a basket of Asian currencies) by multilateral development banks, foreign government agencies, and Asia-based multinational corporations.³² To assist other governments in financial matters, Tokyo has established the Japan Financial Technical Assistance program ("JAFTA").³³

To summarize what has been described thus far, China has taken advantage of the new regionalism to enhance its position in Asia through skillful use of commercial diplomacy. A workable and largely constructive balance of influence is evolving within Asia, with a prospering China, a lagging but still wealthy and resourceful Japan, a new "suitor" in the form of India, an active role for Australia despite its perceived "outsider" status, and a group of smaller ASEAN countries that actively invite the new jockeying while carefully hedging their bets. This mixture is dynamic but stable, fostering continued economic growth. The rest of this analysis describes

the advantages of these trends for the United States – and then lists some of the many things that could go wrong.

VI. Benefits and Risks for the United States

On balance, the United States has much to gain and little if anything to lose from the marriage of Asian regionalism and commercial diplomacy. All major members of ASEAN + 3, including China, insist that the effort to form a more integrated community in Asia is in no way directed against the United States. Japan, South Korea, and various ASEAN governments have told the Chinese and others that they have no intention of relinquishing their alliances with Washington. Smaller Asian nations have made plain that they see the United States as a stabilizing, constructive counterweight to China (as well as to India and Japan). A supra-national “Asian Union” comparable to the European Union has no place in Asian plans. Asia’s huge stake in global markets rules out a protectionist “Fortress Asia” -- even if one or two countries unfriendly to the United States might favor erecting one.

From an economic point of view, the evolving Asian landscape is dotted with encouraging trends. Competition in trade and services sprouting from cross-border trade and investment is raising standards of quality and customer satisfaction and allocating resources more efficiently. Competition for foreign investment is putting pressure on governments to slash excessive regulations and reduce corruption. Improvements in transparency and accountability are undermining entrenched elites and improving investor confidence. Weaker members of ASEAN + 3 are receiving at least limited amounts of aid and technical assistance from richer neighbors. All governments are under pressure to lower barriers to trade and investment, streamline customs, slash red tape, crack down on corruption, and improve education.

The combination of regional integration and commercial diplomacy also works in favor of good governance and social opportunity. The need for contract enforcement, banking supervision, stable and predictable taxation systems, bankruptcy laws, intellectual property protection, and other features of a business-friendly environment puts pressure on governments to strengthen the rule of law. In countries ruled by authoritarian or semi-authoritarian regimes, the expansion of commercial opportunities and the availability of Internet services are nudging the authorities to permit more open information and institute more transparency and accountability. Restless and unemployed young people are finding jobs, at least those with technical and language skills.

Two large and separate sets of risks threaten the future of this rosy picture, however. The first consists of disasters and cross-border threats that all sides have an interest in controlling or eliminating. These include disease, pollution, natural disasters, piracy, smuggling, human trafficking, money-laundering, financial crises, and additional spikes in the price of energy and raw materials. Many of these threats are already the focus of pan-Asian, Asia-Pacific, or global working groups. Lessons from the outbreak of Sudden Acute Respiratory Syndrome (SARS), improvements in the handling of avian flu, and the rapid response to the 2004 *tsunami* suggest that governments can make a difference if they work together, but in many areas there is a very long way to go.

The other set of risks lie more or less within the control of national governments. They include the dangers posed by the North Korean regime, China's desire to regain control of Taiwan, unresolved territorial disputes in the South China and East China seas, and local flare-ups in border regions (southern Thailand, for instance, from which Muslim insurgents and others fled to Malaysia and sought refugee status, triggering a sharp exchange of views). Handling them

successfully requires communication, cooperation, and willingness to compromise on the part of all the governments concerned. But the most crucial variable is the state of relations between Beijing and Washington. As one influential Chinese analyst puts it, “The emergence of Chinese power and influence in Asia is an almost indisputable reality....However, the most prominent factor in shaping geostrategic trends remains the China-U.S. relationship.”³⁴ Although the current US-China relationship is quite stable, high-level U.S. policy-makers and politicians have indulged in on-again-off-again diplomacy with China, alternatively excoriating and cultivating its leadership. The Chinese government, too, has been volatile and harbors a number of “hawks” who resent American “hegemony” and the U.S. presence in Asia. Thanks in part to years of indoctrination, a single episode can ignite strong anti-Americanism on the part of the Chinese public.

The major threat to cooperative US-China ties is the possible use of force to settle the status of Taiwan. An unexpected event such as the shooting down of another U.S. reconnaissance plane or the U.S. bombing of the Chinese Embassy in Belgrade could also roil the relationship. In addition, one can imagine a number of crisis scenarios that might embitter or inflame Sino-American relations and polarize or destabilize Asia. In line with the theme of this chapter, all of the following hypothetical illustrations are political-economic rather than military in their origin, but they quickly flag security concerns. They center on disputes over such issues as trade, investment, finance, technology transfer, economic reconstruction, economic sanctions, export controls, and energy. They are fictional, but they all have a basis in current facts.

Hypothetical Political-Economic Crisis Scenarios

1. North Korea

North Korea presses on with nuclear weapons and explodes a test weapon. The remaining 5 powers in the 6-power group split. The United States and Japan favor sanctions or other punitive action. China sides with South Korea in opposing them. Russia plays both sides. American anger at Beijing mounts.

Alternatively, North Korea implodes as the colonels surrounding Kim Jong-Il stage a palace coup. They try to govern in his name, but word spreads. Soldiers at the DMZ begin to lay down their arms, key officials seek to flee the country, and hungry refugees begin streaming north into China and south into South Korea. China's first priority is stability. Chinese border police treat North Korean refugees brutally. South Korea refuses to talk about outside assistance and blocks American C-130s from delivering rice; China backs Seoul. The 6-power group, once considered an incipient security framework, collapses, leaving the US-Japan alliance intact but strained as Tokyo is forced to choose sides. Sino-American and Sino-Japanese tensions increase sharply.

2. Iran

Iran has publicly renounced nuclear weapons and claims to be pursuing peaceful nuclear power only, but it has not given up its right to acquire the bomb. In a future scenario, Tehran announces that Iran has successfully tested its first bomb. Iranian crowds greet the announcement with pride and rejoicing. The United States proposes to tighten sanctions, but China's vast stake in Iranian energy leads Beijing to block U.S. moves in the UN Security Council. Russia, a long-standing provider of assistance to Iran, follows suit. Seeing that their efforts failed, the members of the European negotiating group (France, Germany, and the UK) begin to ignore existing sanctions,

urging the United States to adjust to Iran's nuclear capability as it has to Indian and Pakistani bombs. The United States, isolated, feels betrayed.

Meanwhile, the United States continues to advocate market-oriented solutions to energy shortages. But contrary to its own rhetoric, it continues to exert strong pressure to block oil and gas pipelines transiting Iran. China sides with Iran and helps finance these pipelines, providing credits and technology. Fortified by such support from China and others, Iran steps up its support for violent groups in Iraq and elsewhere in the Middle East.

3. Energy security

Fueling China's explosive growth requires huge amounts of energy. China's coal is dirty and its mines are unsafe, but shutting down the industry or refitting coal-fired power plants are not yet viable options. Oil is central to Beijing's energy strategy. China produces oil but became a net importer in 1993 and currently relies on imports for about a third of its supplies. It has become the world's second largest oil consumer after the United States and the fifth largest importer. In the last few years China has tripled its purchases of oil from the unstable Middle East, which now accounts for more than half of China's oil imports; by 2015 that share is expected to rise to 70 percent. Imports of liquefied natural gas are expected to begin in 2007.³⁵

Energy has not been a topic of commercial diplomacy because Beijing takes a somewhat mercantilist approach to world energy markets. Its energy policy is founded on a lingering distrust of markets and a preference to lock up supplies.

Four different examples of China's relentless quest for energy security prompt Congressional hearings and exacerbate US-China tensions:

- Distrusting the market, China's state-owned or state-influence oil companies forms strategic alliances with Middle Eastern and African governments to lock up supplies. Oil-for-arms deals are rumored.
- In Myanmar, China's plans to build a pipeline from the Bay of Bengal to Kunming prompt Beijing to shower aid and support on the country's repressive government. Beijing ignores the government's criminal activities and human rights violations and refuses to cooperate with U.S.-backed efforts to halt money laundering and narcotics trafficking.
- Sudan is on the point of splitting into two regions as the Sudanese government continues to refuse to take responsibility for the slaughter in Darfur. But Sudan is a major source of oil for China (and India). In the UN Security Council, China backs the government and vetoes a resolution that would have divided the country.
- In the South China Sea, China abandons its current restraint and presses its claim that a disputed Japanese-held island is merely a "rock" in order to deprive Japan of claims to oil in territorial waters. Seeking maximum stockpiles, Beijing rejects a proposal to establish a regional energy-sharing scheme similar to the one that covers Western countries and Japan.

4. Trade and Finance

U.S. "neo-realists" already worry that as Asians become dependent on the Chinese economy, China will become an exclusive hegemon, drawing investment away from U.S. allies and elbowing out the United States. The U.S.-China Security Review Commission, established by the Congress when normal trade relations were extended permanently to China, issued a

report that describes the shifting balance of power in traditional zero-sum terms. It warned that China's economic integration with its neighbors raises the prospects of an "Asia[n] economic area dominated or significantly influenced by China." China's gain, the Commission implied, would be America's loss.³⁶ According to another view, Asia may be reverting to a kind of China-centered hierarchy broadly comparable to the pre-modern tribute system.³⁷

Meanwhile, in language reminiscent of the Japan scare of the 1980s, some companies and labor unions are predicting the demise of American competitiveness and the collapse of American manufacturing. China's undervalued currency compounds this complaint.

It is not difficult to construct a dismal scenario. China continues to refuse to revalue the renminbi to any significant degree. The U.S. trade deficit with China continues to swell to unprecedented levels. Beijing reveals that it will henceforth peg its currency to a mixed basket of currencies. Currency traders speculate, not necessarily correctly, that China intends to diversify its foreign-currency holdings and reduce its dollar holdings. This move causes the dollar to tumble further and raises U.S. interest rates. The Treasury Department finally names China as a currency manipulator. Members of Congress vow retaliation for this "currency war" and pass legislation hiking tariffs on imports from China to 30 percent. The president vetoes the bill.

In a political drama reminiscent of events leading to the Plaza Accord of 1985, when Japan revalued the yen, the Executive Branch reverses itself and agrees to accept a petition charging that China's pegged currency is the equivalent of an illegal export subsidy. This move temporarily pacifies the Congress. But China wins the subsequent case in the World Trade Organization, reviving Congressional calls to withdraw from the organization. The conflict undermines supporters of free trade and encourages U.S. hard-liners and protectionists, who push

through a 15 percent tariff on Chinese imports by a veto-proof majority. Seeking to mobilize the U.S. business community, the Chinese government suspends further purchases of U.S. telecommunications and aerospace exports and invites European companies to resubmit their bids.

Another scenario centers on money laundering. Terrorists are known to acquire money both legitimately and criminally generated.³⁸ The Financial Action Task Force on Money Laundering (FATF), established by the Group of 7 (G-7) in 1989 and housed at the OECD, has listed China among the countries of “primary concern.” China supports the goals of FATF but is not yet a member.

In a widely publicized future episode, U.S. investigators trace a source of terrorist financing to a bank in Kunming, already known to harbor cross-border criminal operations. Fearing that greater transparency would invite U.S.-led sanctions and trigger a loss of confidence in the banking system, the Chinese government refuses to divulge the bank’s financial records. Invoking national sovereignty, it declines a World Bank/IMF request to submit a report on compliance with FATF standards.

5. Investment and Technology Transfer

The state-owned China National Offshore Oil Corporation (CNOOC) recently attempted to purchase the U.S. oil company Unocal but subsequently retracted the move in the face of Congressional opposition. While the bidding was underway, other potential buyers reportedly hesitated to enter the bidding process for fear of offending the Chinese government. The episode illustrated China’s new weight in the balance of influence.³⁹

In a future scenario, China tries again, targeting a high-technology company. Opponents of the sale, fearing China's acquisition of U.S. assets, demand a review by the interagency Committee on Foreign Investment in the United States. Several damaging leaks compound the controversy. It is revealed that a branch of this U.S. company illegally transferred state-of-the-art dual-use technology to China. As if on cue, newspapers reports that the FBI has cracked a major industrial espionage ring and traced it back to China. Chinese officials react badly to the accusations and suspend several large and visible deals in the aerospace, energy, and transportation sectors, singling out U.S. companies for punishment. Washington accuses Beijing of violating WTO commitments.

6. Military Discontent at Home

The insurgency in western China intensifies as rebels demand independence for "East Turkmenistan." China suppresses the rebellion harshly. Russia, seeing a "Chinese Chechnya," supports Beijing. Meanwhile, the Chinese government uses the rebellion as an excuse to clamp down on militant Islam and intensifies the repression of other threatening spiritual or religious movements, including evangelical Christianity. Conservative Christian groups in the United States take up the cause. Charging treason, the Chinese government executes a dissident known and supported in Western religious circles. Adopting an "I told you so" attitude, military hard-liners on each side see an opportunity to launch provocative or aggressive actions against the other. They gain support from corrupt senior Party members, who fear that privatization, investor-led demands for public accountability, and greater freedom of the press will expose their illegal assets and preclude further bribery.

Meanwhile, China accelerates the modernization of its navy, citing the need to protect commercial vessels and oil tankers. Hard-liners in Washington see this as a direct challenge to U.S. control of the sea lanes. An incident at sea brings this tension to the public eye when Chinese refusal to cooperate with a U.S. naval vessel in a search-and-rescue operation leads to unnecessary deaths. Beijing urges other Asians to withdraw from joint exercises with U.S. forces in the region, such as RIMPAC and Cobra Gold. The Pentagon orders ships to head toward the Taiwan Strait.

VII. Some Concluding Observations on U.S. Policy

As long as Asia remains peaceful, trust and communication among those who deal with these various problems should continue to improve, but the risks are substantial. As long as China is not fully democratic, the basic questions must remain unanswered. Is China's commercial diplomacy merely a tactical move, a mask concealing an attempt to dominate the rest of Asia and eject all but a token U.S. presence? This author thinks not, but no one can say for sure. Even if those are China's current goals, after ten or twenty years a new generation of Chinese leaders may see them as irrelevant and counterproductive.

The great question about China's future is, how and in what ways will the slow, wrenching, and enriching process of engagement in the global economy and polity temper and transform the coming generation of Chinese leadership, whether or not China becomes significantly more democratic?

Seen in that light, the combination of Asian regionalism and China's skilful use of commercial diplomacy poses a challenge for the United States – a constructive one, but a challenge all the same. American policy-makers often propose regional initiatives, or suggest

that others do so. In this case, Asians are marching ahead with a set of initiatives from which the United States is excluded. China is among those in the lead.

So far, there have been only two substantive but relatively narrow U.S. responses to the new commercial-diplomatic momentum in East Asia. In 2002, President Bush announced an “Enterprise for ASEAN Initiative,” offering bilateral FTAs to individual ASEAN nations subject to certain conditions.⁴⁰ This offer was eminently respectable as a matter of trade policy, fully consistent with WTO obligations, and more tangible and immediate in trade terms than a vague “U.S.-ASEAN” proposal. But the Initiative was not backed up by high-level strategic attention to the region and did not capture Asian imagination in the way that China’s more ambitious proposal did.

Until 2005, Washington’s response to East Asian regionalism and the strategic use of commercial diplomacy was “benign neglect.” In June 2004, for example, Assistant Secretary of State James Kelly expressed the benign view in less than a paragraph. In Congressional testimony, he declared that regional cooperation and integration in East Asia is part of an encouraging set of trends that includes democracy, the rejection of radical Islam, globalization, economic development, and peace. Then he moved on to anti-terrorism and non-proliferation.⁴¹ The few public pronouncements about Asia’s emerging regionalism have subtly warned against a protectionist economic bloc. The joint statement issued at the time of Indonesian president Yudhoyono’s visit to the White House in May 2005, for example, contains typical language: the two presidents “welcomed the development in the Asia-Pacific region of an *open and inclusive* institutional architecture that ...contributes to economic development and prosperity.” (Emphasis added.)⁴² Shortly thereafter Secretary of State Condoleezza Rice failed to attend the annual meeting of the ASEAN Regional Forum, a decision greeted with dismay in many capitals.

The second initiative, announced by the United States and ASEAN in November 2005, was the ASEAN-U.S. Enhanced Partnership. Described as “comprehensive, action-oriented, and forward-looking,” it encompasses cooperation in political and security affairs, economic and social affairs, and development.⁴³ A 19-page “Plan of Action” covered topics ranging from traditional and non-traditional security concerns to energy, agriculture, tourism, environment, education, and many other subjects.⁴⁴

To date there has been no U.S.-ASEAN summit. In the eyes of U.S. policy-makers, such a gathering would legitimize Myanmar’s repressive government.⁴⁵ Moreover, no U.S. president likes to travel without a clear purpose, and other issues seem far more pressing. Unfortunately, many Asian leaders and elites interpret this lack of interest as a sign that Washington only cares about anti-terrorism, Taiwan, and North Korea and not about the rest of Asia. The Plan of Action to implement the ASEAN-U.S. Enhanced Partnership contained commitments to “explore the possibility” of a U.S.-ASEAN summit and to convene a meeting of U.S. and ASEAN leaders on the sidelines of the 2006 APEC meeting, which conveniently excludes Myanmar.

The two recent U.S. initiatives are helpful, but they have not dispelled a widespread impression that America is indifferent to the changing balance of influence in Asia. The war in Iraq compounds that impression. This is unfortunate. All major governments in the region, including China’s, want the United States not only to retain a sizable military presence in Asia for the foreseeable future, but also to engage actively with the region. Non-Chinese Asians welcome China’s new role, but they have no desire to be dominated by China – or by Japan or India, for that matter. They see an actively engaged United States as a balancing and stabilizing presence that expands their room to maneuver and their freedom to choose.

The risk is not that the United States is in danger of being shut out from East Asian markets or forced to withdraw its military forces, but rather that its voice will be slowly drained of influence. If this happens, it will be not so much because of what Beijing is doing or hoping to do as what Washington is not doing. Preoccupied with anti-terrorism and non-proliferation and fixated on “homeland security,” the Bush Administration is taking only limited steps to avoid being left behind.

If current and future U.S. foreign policy-makers compound this risk by mismanaging the Sino-American relationship, prosperity and stability in the entire Asia-Pacific region will suffer. As Adam Segal’s chapter points out, Chinese objectives overlap with many U.S. security concerns and are not necessarily threats. Beijing and Washington have launched a low-key, ongoing strategic dialogue, but it is not yet clear whether its content will include anticipating and heading off potential crises of the sort sketched above. Nor is it settled whether the two sides will consciously strive to identify and reinforce common goals and interests, share information, and establish coordinated crisis-management measures.

It is a law of human nature that someone who is treated like an enemy is more likely to behave like an enemy. The same is true of governments. As the first chapter in this book makes clear, the United States has neither the political will nor the power to halt or even change substantially the expansion of China’s political-economic influence in Asia. Beijing’s commercial diplomacy is a tool of that influence. The U.S. government should recognize the harm caused by its on-again-off-again attention span and restore sustained, open-minded, high-level involvement with what is going on in Asia.

Finally, politicians and policy-makers should break their short-sighted habit of alternately demonizing and embracing China’s leaders. While not ignoring China’s poor human rights

record, they should get the U.S. economic house in order and work with the Chinese and others to stabilize the global economy. They will find their task easier if they approach China with the respect due to a great civilization that has emerged from war, domestic turmoil, and humiliation to become both a major commercial actor and a rapidly emerging regional power.

¹ I am grateful to Dr. Phillip C. Saunders of the Institute for National Strategic Studies, National Defense University, for his comments and insights.

² This definition is adapted from the Web page of the Institute for Trade & Commercial Diplomacy, Inc., <http://www.commercialdiplomacy.org>. The Institute was founded by trade expert Geza Feketekuty, long-time employee of the Office of the U.S. Trade Representative and former chairman of the OECD Trade Committee.

³ See Martin W. Lewis and Karen E. Wigen, *The Myth of Continents: A Critique of Metageography* (Berkeley: University of California Press, 1997); Wang Gungwu, *The Chinese Overseas: From Earthbound China to the Quest for Autonomy* (Cambridge: Harvard University Press, 2000); and Grant Evans, Christopher Hutton, and Kuah Khun Eng, *Where China Meets Southeast Asia: Social and Cultural Change in the Border Regions* (Bangkok: White Lotus and Singapore: Institute for Southeast Asian Studies, 2000).

⁴ “ASEAN + 3” refers to the ten members of the Association of South East Asian Nations (ASEAN) plus China, Japan, and South Korea.

⁵ For a schematic map detailing the multitude of actual and proposed agreements, see T. J. Pempel, "Introduction," in Pempel, ed., *Remapping East Asia: The Construction of a Region* (Ithaca, NY: Cornell University Press, 2005), Fig. 1.4, p. 17.

⁶ These impressions are based on the author's first-hand observations while working in the Office of the United States Trade Representative in 1993-95.

⁷ For some modeling results, see Robert Scollay and John P. Gilbert, *New Trading Arrangements in the Western Pacific?* (Washington, DC: Institute for International Economics, 2001), pp. 57-58 and 149; and Dean DeRosa, "Gravity Model Calculations of the Trade Impacts of U.S. Free Trade Agreements," a paper prepared for the Conference on free Trade Agreements and U.S. Policy, Institute for International Economics, Washington, DC, May 7-8, 2003, p. 35. For a critique of economic regionalism in Asia, see Edward J. Lincoln, *East Asian Economic Regionalism* (New York and Washington, DC: Council on Foreign Relations and the Brookings Institution, 2004).

⁸ It was in preparation for the first ASEM meeting that the selected Asian countries came to be known as "ASEAN + 3."

⁹ For more on ASEM and Asia-Europe relations, see Council for Asia-Europe Cooperation, *The Rationale and Common Agenda for Asia-Europe Cooperation* (Tokyo: Japan Center for International Exchange and London: International Institute of Strategic Studies, 1997); and Suthiphand Chirathivat, Franz Knipping, Poul Henrik Lassen and Chia Siow Yue, eds., *Asia-Europe on the Eve of the 21st Century* (Bangkok: Centre for European Studies at Chulalongkorn University and Singapore: Institute of Southeast Asian Studies, 2001).

¹⁰ The China-ASEAN FTA is under negotiation, but there are no concrete plans for an ASEAN + 3 FTA.

¹¹ For a thoughtful overview of the non-government process, see Paul Evans, “Between Regionalism and Regionalization: Policy Networks and the Nascent East Asian Institutional Identity,” in Pempel, ed., *Remapping Asia*, pp. 195-215.

¹² Mahathir proposed an “East Asian Economic Group” (subsequently re-named a “Caucus”) that included Japan but excluded Australia and New Zealand. On the quest for an Asian or East Asian “identity,” see the recent writings of Amitav Acharya. For visions of an East Asian community, see East Asia Vision Group Report, “Towards an East Asian Economic Community: Region of Peace, Prosperity, and Progress,” 2001; and “Charting East Asia’s Milestones,” Keynote Address by Prime Minister Abdullah Ahmad Badawi at the Second East Asia Forum, December 7, 2004, mimeograph.

¹³ See, for example, Yue Xiaoyong, “A Chinese Perspective on Strengthening Stability and Security in East Asia,” presentation at the Wilton Park Conference on Reducing Tension in North East Asia, October 6, 2004.. See also the articles by Zheng Bijian and Wang Jisi in the September-October 2005 issue of *Foreign Affairs*.

¹⁴ Eswar Prasad, ed., “China’s Growth and Integration into the World Economy: Prospects and Challenges,” *Occasional Paper 232*, International Monetary Fund, 2004, p. 1, available at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=17305.0>.

¹⁵ Robert J. Samuelson, “The China Riddle,” *Washington Post*, January 30, 2004, available at <http://www.washingtonpost.com>.

¹⁶ Jeffrey Ng, “UPS Says It Has Big Plans for China,” February 27, 2005, available at <http://www.washingtonpost.com>.

¹⁷ David Murphy, “Europe, Here We Come,” *Far Eastern Economic Review*, February 26, 2004, p. 42.

¹⁸ Prasad, ed., “China’s Growth and Integration,” *op.cit.*, Table 2.2, p. 6.

¹⁹ *Ibid.*, p. 8.

²⁰ “Koreans Look to China, Seeing a Market and a Monster,” *New York Times*, February 10, 2003, pp. W1 and W7.

²¹ Kevin G. Cai, “The ASEAN-China Free Trade Agreement and East Asian Regional Grouping,” *Contemporary Southeast Asia*, Vol. 25, No. 3, 2003, p. 401.

²² Kazuko Hamada, “The Impact of China’s Economic Integration: The Implications of China’s Role in the Asian Production Network for the Global Economic System,” unpublished MS, February 7, 2005.

²³ “FTWorld’s Most Respected Companies,” *Financial Times*, Special Report, January 20, 2004, p. 2; and David Murphy, “State Giants Still Dominate,” *Far Eastern Economic Review*, December 25, 2003, p. 56.

²⁴ Richard E. Baldwin, “The Spoke Trap: Hub and Spoke Bilateralism in East Asia,” unpublished paper written for the Korean Institute for International Economic Policy, 2003, unnumbered page.

²⁵ In “China Engages Asia: Reshaping the Regional Order,” David Shambaugh makes a well documented case that China’s altered behavior, sometimes labeled “charm diplomacy,” represents a strategic change in mindset rather than a tactical shift. See *International Security*, Vol. 29, No. 3, Winter 2004/2005, pp. 64-99.

²⁶ For China’s participation in post-crisis financial diplomacy, see C. Randall Henning, *East Asian Financial Cooperation*, Policy Analysis 68 (Washington, DC: Institute for International Economics, 2002).

²⁷ I am grateful to METI official Naoko Munakata for much of the information in this paragraph.

²⁸ The 1997-98 Asian financial crisis makes it difficult to determine to what extent investment in Southeast Asia was in fact diverted to China. From 1996 to 1999, the inflow of foreign direct investment in China increased from \$27 billion to \$45 billion, while that into ASEAN dropped from \$28 billion to \$11 billion. Without the crisis, both areas might have continued to attract substantial investment.

²⁹ Since Japanese agriculture is highly protected, Japan prefers to negotiate “economic partnership agreements” (EPAs) because they are more flexible and more sensitive to political realities. Makio Miyagawa, Director of the Japan Institute of International Affairs, makes the case for EPAs in “Integrating Asia Through Free Trade,” *Far Eastern Economic Review*, July-August 2005, 45-49.

³⁰ David Pilling and Bayan Rahman, “Japanese trade breakthrough with Mexico points way to Asia deals,” *Financial Times*, March 11, 2004, p. 4.

³¹ David Pilling, “Japanese soft loans pour into Indian projects,” *Financial Times*, March 12, 2004.

³² See, for example, the keynote address given by a Japanese Finance Ministry to a high-level ASEAN + 3 seminar on the Asian Bond Market Initiative, at <http://www.mof.go.jp/english/if/hls20030301b.htm>.

³³ Oral presentation by Shigeki Kimura, Director, Research Division, International Bureau, Ministry of Finance, to a Japan Chair Forum on the Asian Bond Markets Initiative, Center for Strategic and International Affairs, Washington, DC, September 14, 2005.

³⁴ Wang Jisi, “Geostrategic Trends in Asia: A Chinese View,” conference paper presented at the Regional Outlook Forum, Institute of Southeast Asian Studies, Singapore, January 6, 2005.

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³⁵ For an analysis of Asia's energy needs from a strategic perspectives, see Mikkal E. Herberg, "Asia's Energy Insecurity: Cooperation or Conflict?" in Ashley J. Tellis and Michael Wills, eds., *Strategic Asia 2004-05: Confronting Terrorism in the Pursuit of Power* (Seattle: National Bureau of Asian Research, 2004), pp. 338-377.

³⁶ *The National Security Implications of the Economic Relationship Between the United States and China*, Report to Congress of the U.S.-China Security Review Commission, Washington, DC, July 2002, p. 117. For a critique, see the dissenting comments by William A. Reinsch, pp. 206-207.

³⁷ David Kang, "Getting Asia Wrong: The Need for New Analytical Frameworks," *International Security*, Vol. 27, NO. 4 (Spring 2003), p. 71. For an argument against Kang's thesis, see Amitav Acharya, "Will Asia's Past Be Its Future?" *International Security*, Vol. 28, No. 3 (Winter 2003/04), pp. 149-164. Kang's rebuttal, entitled "Hierarchy, Balancing, and Empirical Puzzles in Asian International Relations," appears in the same issue

³⁸ Peter Reuter and Edwin M. Truman, *Chasing Dirty Money: The Fight Against Money Laundering* (Washington, DC: Institute for International Economics, 2004), p. 42 and Tables 3.1 and 3.3.

³⁹ James Politi and Doug Cameron, "Unocal suitors wary of Beijing," *Financial Times*, March 4, 2005, p. 15.

⁴⁰ The White House, "Fact Sheet: Enterprise for ASEAN Initiative," available at <http://www.whitehouse.gov/news/releases/2002/10/20021026-7.html>. Candidate countries must be WTO members and must have signed a "Trade and Investment Framework Agreement"

(TIFA), which sets up a non-binding consultative mechanism to discuss bilateral issues of interest. Singapore and Thailand signed on to this offer and subsequently negotiated free-trade agreements (FTAs) with the United States, while the Philippines and Indonesia hung back. Mahathir's Malaysia rejected the whole U.S. initiative, but after his departure Malaysia signed a TIFA and agreed to begin negotiations for a US-Malaysian FTA.

⁴¹ U.S. Department of State, "An Overview of U.S.-East Asia Policy," Testimony by James A. Kelly, Assistant Secretary of State for East Asian and Pacific Affairs, before the House International Relations Committee, Washington, DC, June 2, 2004, p. 2.

⁴² "Joint Statement between the United States of America and the Republic of Indonesia," White House press release, May 25, 2005.

⁴³ The White House, "Joint Vision Statement on the ASEAN-U.S. Enhanced Partnership," November 17, 2005, <http://www.whitehouse.gov/news/releases/2005/11/20051117-4.html>.

⁴⁴ Available from the ASEAN Secretariat Website at <http://aseansec.org/18589.pdf>.

⁴⁵ Sensitive to the Myanmar problem, ASEAN members persuaded Yangon to postpone assuming the chairmanship of ASEAN in 2006, even though it was its turn to do so.