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Globalisation and Regionalisation in East Asia – The China Factor

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GLOBALISATION AND REGIONALISATION IN EAST ASIA – THE CHINA FACTOR

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EXECUTIVE SUMMARY

GLOBALISATION AND REGIONALISATION are two dynamic transformative processes in the contemporary world. In the past few decades they have been major driving forces in the dramatic transformation of East Asia.

The rise of China in the 21st century as a regional, and potentially a global, economic power is the defining feature of regionalisation in East Asia. Rising China's integration into the regional and global economy in an orderly win-win manner presents challenges as well as opportunities for the ongoing transformation of the region.

The China factor that shapes the current character and the future trajectory of regional economic integration in East Asia can be seen first and foremost in the mutual endorsement between China and globalisation. The changing purpose of the global political economy after the end of the Cold War makes possible the deep integration of China into the new global economic order and for its transition to becoming the largest emerging market in a truly globalised economy.

In embracing globalisation, the purpose of the Chinese state has been redefined from serving the revolution to serving the needs of economic development under the conditions of globalisation. The logic of growth-based legitimacy relocates the main source of state legitimacy to external actors and institutions and dictates China's external policies in regard to globalisation and regionalisation.

The China factor refers secondly to the pivotal role of China, now the third largest global trader, in the rapid increase of intra-regional trade in East Asia. As the largest foreign direct investment (FDI) recipient of all developing countries, China is spearheading a new wave of trade and industrial transformation that deepens regional economic integration.

In recent years the new pattern of regionalisation has been strengthened by a plethora of bilateral and regional free trade agreements (FTAs), with China one of the principal drivers. Beijing's pursuit of an FTA strategy has, however, been motivated and sustained mostly by broader political and strategic considerations rather than economic calculation. One notable example is its pursuit of a China-ASEAN (Association of Southeast Asian Nations) Free Trade Area.

China's active diplomacy in promoting the new regionalism embodied in the processes of the ASEAN Plus Three (APT) constitutes the third facet of the China factor. For ASEAN, the APT serves the strategic objective of enmeshing China in a web of regional institutions. For China, participation in the APT is one pillar of its regional strategy to promote mutual trust with ASEAN and to institutionalise political and economic cooperation. China's active promotion of the APT is one stimulus for Japan's close involvement in this regional process.

China's rise has significantly transformed the regional geo-economic landscape and is generating new strategic dynamics in a region of ultimate policy concern for New Zealand.

The recent East Asia Summit (EAS) has initiated an ambitious political as well as economic project for constructing an East Asian Community (EAC). While the inclusion of New Zealand, Australia and India helps keep the EAS open and inclusive and defuses the United States' (US) concern about China's dominance, membership of the envisioned EAC remains contentious. With or without the US as a formal member, the construction of this new regional community will always be under the shadow of the American power and the strategic competition between the US and China. How the EAS positions itself vis-à-vis APEC (Asia Pacific Economic Cooperation) and the ASEAN Regional Forum remains a vital question yet to be answered.

China's rise has significantly transformed the regional geo-economic landscape and is generating new strategic dynamics in a region of ultimate policy concern for New Zealand. To capitalise on the opportunities presented by such transformation, policy makers and corporate leaders need to formulate creative policy responses and corporate strategies.

Three specific and immediate challenges confront New Zealand. First, as China's FTA strategy is driven largely by political and strategic considerations, a clear mismatch exists between the political logic and the economic rationale in the current New Zealand-China FTA negotiations. Overcoming such a mismatch needs wisdom and imagination to ensure that the outcome serves New Zealand's national interests and promotes global norms and principles of trade liberalisation and multilateralism.

Second, as a small liberal democracy and a developed economy with no stringent military alliance with the US, New Zealand has a unique contribution to make in playing a constructive role to bridge two potential divides in the inaugural EAS: that between East and West and that between developed and developing economies.

Finally, New Zealand's close involvement in the EAS raises tricky questions about its national identity. In what sense is New Zealand 'East Asian'? What role do values, belief systems, common interests and identity play in the conception and formation of a regional community? These questions challenge politics. They are not subject to any political solution.

Will the evolving regional architecture for free trade in East Asia disadvantage extra-regional players, particularly New Zealand and Australia?

INTRODUCTION

GLOBALISATION AND REGIONALISATION are widely acknowledged as the most dynamic transformative processes in the contemporary global political economy. Nowhere can this be more compellingly demonstrated than in the dramatic transformation of East Asia.¹ As early as 1993, the World Bank described the staggering development of East Asia, between 1965 and 1990, as an 'East Asian miracle' and noted four waves of high economic growth in the region in the increasingly globalised world economy.² However, the Asian financial crisis in the late 1990s brutally revealed the Janus face of globalisation, leading quickly to a spectacular meltdown of the 'miracle'.

The post-crisis record shows that while relentless globalisation continues to shape the policy processes and outcomes of individual states in the region, a diverse range of approaches has been adopted to redefine the relationship between states and markets. Today East Asia again enjoys high economic growth with great policy attention paid to regional and national economic governance. In so doing, East Asia reproduces globalisation in its own fashion.

East Asia has been a site of experimentation and exploration for a number of regional projects. Its market-driven and informal regional economic integration has been frequently contrasted with the European model of regional integration, driven by formal bureaucratic processes and emphasising legalistic decision-making procedures. Its successes in regionalisation are often measured by the production of sub-regional integration such as the ASEAN (Association of Southeast Asian Nations) Free Trade Area as well as East Asian regionalism writ large, namely the ASEAN Regional Forum (ARF). The 'open regionalism' attributed to the Asia Pacific Economic Cooperation (APEC)

is another regional project of considerable significance to note.

The recent regionalisation of East Asia has taken a decisive turn towards a so-called 'new regionalism', the ultimate expression of which is the political project to construct an East Asia Community (EAC).³ A bold attempt at this project was made with the initiation of the first East Asia Summit (EAS) in December 2005 in Kuala Lumpur.

For policy makers and corporate actors in New Zealand, the dynamic transformation of East Asia and the recent turn towards 'new regionalism' in seeking regional integration have complex implications and present a number of intellectual and strategic challenges. Will the 'spaghetti bowl' of bilateral free trade agreements (FTAs) concluded in East Asia lead to trade expansion or trade diversion? What is its impact on the multilateral trading system embodied in the World Trade Organisation (WTO)? Will the evolving regional architecture for free trade in East Asia disadvantage extra-regional players, particularly New Zealand and Australia? How can New Zealand benefit from closer political and economic links forged among East Asian economies? How will New Zealand position itself in response to the construction of an EAC that seems to be gathering momentum at the expense of a broader regional construct?

¹ 'East Asia' is used throughout this paper as a generic term to include Northeast Asia, particularly China, Japan and Korea and Southeast Asia comprising the members of ASEAN.

² See World Bank (1993), *The East Asian Miracle: Economic Growth and Public Policy*, Washington DC: World Bank.

³ Following conventional wisdom 'regionalisation' and 'regionalism' are used in two distinct senses. 'Regionalisation' refers to the increase in economic integration that takes place as the result of increased intra-regional trade, investment, technology and migration flows without any formal framework of cooperation. 'Regionalism', on the other hand, refers to formal economic cooperation and economic integration arrangements and agreements between two or more countries designed to institutionalise regional integration.

Simply put, China is at the centre of a fundamental geo-economic transformation in East Asia.

⁴ Lee, Hsien Loong (2005), 'The Future of East Asian Co-operation', at www.nni.nikkei.co.jp/FR/NIKKEI/inasia/future/2005/2005speech_lee.html [accessed 15 October 2005].

These challenges have been compounded by the rise of China as a significant regional and global economic power. The growing political influence and economic weight of China has already been felt in the recent drive of regionalisation in East Asia, particularly its active economic diplomacy. China has been noted for its unprecedented enthusiasm in pursuing bilateral and regional FTAs and for its active diplomacy in the ASEAN Plus Three (APT) processes. Simply put, China is at the centre of a fundamental geo-economic transformation in East Asia.

For East Asian regionalism as a whole, the need to accommodate China is undeniable. China's rise, the Singaporean Prime Minister Lee Hsien Loong stated recently, 'brings tremendous opportunities to all, but also causes major changes to the status quo.' It is critical 'to integrate China into the regional economy in an orderly, win-win manner.'⁴ In this light, the construction of an EAC becomes an economic, as well as a political, project.

This paper discusses the political logic and economic rationale behind the new trend of regionalisation and regionalism in East Asia and China's pivotal role as a principal driver for them. On the basis of this investigation, it outlines a number of implications for New Zealand. While acknowledging that a complex array of global, regional, national and local actors and forces are at work in shaping the political economy of East Asia, the paper argues that economic regionalisation in East Asia, and more broadly the trajectory of East Asian regionalism, will be increasingly determined by what is termed 'the China factor'.

CHINA, EAST ASIA AND THE NEW GLOBAL ECONOMIC ORDER

IN DISCUSSING the making of the 'East Asia miracle', the World Bank claimed that the high-performing economies achieved miraculous growth between 1965 and 1990 due to a combination of fundamentally sound development policies, tailored interventions and unusually rapid accumulation of physical and human capital. East Asia is noted as the only region that has significantly increased its proportionate share of world gross domestic product (GDP) since the 1960s, leading to considerable poverty reduction.⁵ The rapid growth of East Asian economies since the end of World War II is said to have fundamentally changed the distribution of global wealth and power.

The 'miracle' is even more astounding if we consider how politically, ideologically and economically divided the region was during this period. During the Cold War confrontations, East Asia was ideologically divided, with the American-dominated 'hub and spoke' bilateral security alliance arrangements in the Asia Pacific strategically fragmenting the region. The ideological divide was best demonstrated by the uncompromising hostility between the United States (US) and Communist China.

China as a revolutionary power was not recognised by the US and its allies and was excluded from the United Nations until 1971, as revolutionary China supported almost all insurgent communist movements in Southeast Asia. At home it ran a practically autarkic economy: in 1977, its share of world trade was a mere 0.6 percent. Even after its opening and reform started in 1978, China's disaffection with the dominant international economic order and international economic institutions was palpable, though it became member of both the World Bank and the International Monetary Fund (IMF) in 1980.

It was only logical that during the Cold War, any intra-regional and inter-regional cooperation in East Asia remained hostage to this security structure. The political purpose of the international economy, as defined by the US and its major allies, was 'primarily to strengthen the economies of the anti-Soviet alliance and solidify the political unity of the United States and its allies'.⁶ The end of the Cold War therefore liberated the global economy by removing the strategic rationale causing its fragmentation while also producing fundamentally different global conditions.

The globalising economic order that emerged at the end of the Cold War had two striking characteristics. It was truly global, as more and more developing economies and former communist countries became incorporated into the global market system. And it became increasingly market oriented, as neoliberal ideas revolutionised the orientation of the global economic system and became increasingly dominant in the policy agendas of transition economies.

By removing the constraining effect on globalisation in East Asia, the end of the Cold War opened up new possibilities for East Asia's full engagement with globalisation and for region-wide political and economic integration projects. It allowed ASEAN's expansion to include Cambodia, Laos, Myanmar and Vietnam and produced favourable conditions for pursuing regional projects such as the ARF and APT.

This is especially important for understanding China's particular place in the global economic order. By removing a formidable barrier, the end of the Cold War made possible China's full and deep integration into the global economy and also encouraged its full embrace of globalisation in its economic development strategy. Perhaps even

⁵ The so-called high-performance economies here refer to Hong Kong, Indonesia, Japan, Malaysia, Korea, Singapore, Taiwan and Thailand. For more detailed analysis, see World Bank, *The East Asian Miracle*.

⁶ Gilpin, Robert (2001), *Global Political Economy: Understanding the International Economic Order*, Princeton: Princeton University Press, p. 11.

In short, globalisation has redefined the purpose of the Chinese state.

⁷ Hu, Jintao (2005), 'Opening Address at the 2005 Fortune Global Forum', *People's Daily Online* at http://english.people.com.cn/200505/17/eng20050517_185302.html [accessed 10 December 2005].

⁸ It is worth noting that since its entry in 2001, one main thrust of Chinese economic diplomacy has been to negotiate bilateral recognition of its full market economy status.

⁹ Fan, Gang (2004), 'Lessons from China: custom-made globalisation', *The Straits Times*, 23 October 2004. S8.

more importantly, after the end of the Cold War the changing global strategy of the US enabled China and other dominant powers to reach a broad and tacit agreement on the changing purpose of the global economy: that is, towards promoting growth, development and prosperity, and perhaps also democratisation.

The convergence of Chinese economic reforms and the global transformation facilitated the arrival of China as the largest emerging market in the global economy in several ways. First, China was no longer perceived as a wilful disruptive force committed to a different economic order, instead it was seen as a market opportunity and engine of economic growth for the regional, and potentially global, economy. Second, it reinforced the market-oriented reforms in China and led to China's endorsement of globalisation and the unfolding global economic order, which in turn imposed a convergent policy agenda on Chinese economic governance. Third, and accordingly, it signalled a willingness on the part of China to pursue its developmental goals and national ambitions within the existing global economic and political system, despite its frequent rhetorical challenge to the power structure embedded in the global political economy.

China's embrace of the new global economic order changed its perspectives on globalisation. At the 2005 Fortune Global Forum, Chinese leader Hu Jintao claimed that it was 'with the surging economic globalisation' that China was 'becoming a new growth engine for the world.'⁷ Economic globalisation is now consistently represented in Chinese official documents as 'an irreversible trend' offering opportunities as well as challenges. It is the state's handling, i.e. through official policies and development strategies, which ultimately decides how globalisation works for the Chinese economy and society.

In short, globalisation has redefined the purpose of the Chinese state. Allowing capitalism to flourish and legitimising the capitalist mode of production is antithetical to the very purpose of the Chinese revolution. China's national ambitions in pursuit of wealth and power in the 21st century will no longer be served by making revolutions, but through seeking economic development under the conditions of globalisation. Its palpable desire to participate in the global capitalist economy and its willingness to accept stringent economic conditions for its participation are perhaps best reflected in its quest for full membership of the WTO even as a non-market economy.⁸

The reinvention of the Chinese state necessitates internal institutional changes, institutional building and institutional innovation to accommodate its transition to a full market economy. The purpose of state transformation is to make the reinvented state fit to play a strategic brokerage role in the mutual engagement between China and globalisation. China's approach to globalisation is 'custom made' precisely because the state has devised and implemented a series of policy instruments in navigating its eventual transition to a market economy while maintaining growth and economic and social stability.⁹

Globalisation in this fashion regulates the internal as well as the external political and economic behaviour of the Chinese state. It effectively relocates the main source of state legitimacy to external actors and institutions. When the Chinese Communist Party (CCP) officially embraced the market economy as the legitimate final goal for Chinese reforms in 1997, the political legitimacy of the regime became increasingly contingent on its successful engagement with global and regional institutions such as APEC and the WTO. While domestically the CCP relies on mobilising popular nationalism to address its 'legitimacy deficit', the political logic of growth-based legitimacy dictates its external policies in regard to economic globalisation and regionalisation.

CHINA AND THE NEW PATTERN OF REGIONAL ECONOMIC INTEGRATION

¹⁰ These economies include Hong Kong, Singapore, South Korea and Taiwan.

¹¹ See Breslin, Shaun (2005), 'Studying Regionalism(s): Comparativism and Eurocentrism', Paper for the joint conference by Fudan University and London School of Economics on China and Asian Regionalism, Shanghai, 7-8 January; and Harvie, Charles and Hyun-Hoon Lee (2002), 'New Regionalism in East Asia: How Does It Relate to the East Asian Economic Development Model?', *ASEAN Economic Bulletin*, 19 (2): 123-140.

¹² Drysdale, Peter (2005), 'Regional Cooperation in East Asia and FTA Strategies', Pacific Economic Paper No. 344, Canberra: Australia-Japan Research Centre and Asia Pacific School of Economics and Government.

¹³ In the same period, the share of emerging Asia in world exports more than doubled from eight percent in 1978 to 19 percent in 2002, whereas the share of industrial Asia, which consists of Australia, New Zealand and Japan, declined steadily. See Zebregs, Harm (2004), 'Intraregional Trade in Emerging Asia', IMF Policy Discussion Paper, PDP/04/01, Washington DC: International Monetary Fund. Zebregs uses 'emerging Asia' to include China, Hong Kong, India, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand.

¹⁴ Ministry of Commerce of the People's Republic of China (2005), *Trade Statistics*, at <http://english.mofcom.gov.cn/statistics/statistics.html> [accessed 10 December 2005].

¹⁵ World Bank (2005). *East Asia Update: East Asia's Dollar Influx – Signal for Change*, Washington DC: World Bank, pp. 17-19.

¹⁶ Kuroda, Haruhiko (2005), 'Asia and China: Growing Together?' Keynote speech at the Center for Global Development/Institute for International Economics, Washington DC, 23 June.

REGIONAL ECONOMIC integration in East Asia, it is well argued, is driven by the market and, more specifically, by transnational flows of trade and investment and global industrial restructuring. The story before the 1990s was often told in terms of the 'flying geese formation' of the East Asian development model, focusing on Japan and the newly industrialising economies.¹⁰ China's opening and economic reform in this period was at best secondary to this story. It is also often argued that the regionalisation in East Asia has taken place without regionalism because there were very few commercial agreements of any kind among East Asian states at least until the mid-1990s.¹¹

The story at the beginning of the 21st century is a different one. It is very much a China story. The China dynamic is shaping the new pattern of regional integration in East Asia in two important ways. It serves as a hub for the rapid increase of intra-regional trade; and it is the main driving force behind the proliferation of bilateral and sub-regional FTAs.

China's rise as the third largest global trader is regarded by some as spearheading a new phase in trade and industrial transformation that leads to deepening of economic integration in East Asia.¹² The rapid increase of intra-regional trade in East Asia centred on the phenomenal growth of China's trade is the defining feature of this new pattern of regional integration.

Between 1978 and 2002, exports between the economies of emerging Asia rose steadily from 20 percent to 40 percent of their total exports.¹³ Behind the rise in this trade is the foreign direct investment (FDI) into the region, particularly into China. In 2004 alone, China attracted more than \$60 billion, taking its total FDI to over \$600 billion; and now all but 20 of the Global

500 companies have a presence in China.

As global capital seeks to improve efficiency and productivity, particularly in the manufacturing sector, it continues to push for finer and greater specialisation and for ongoing dispersion of production processes across borders, relocating assembly operations to relatively low-cost economies. It is not surprising that China's processing trade grew sharply from \$122.5 billion in 2002 to \$162.9 billion in 2003, and to \$221.7 billion in 2004.¹⁴

In the same period, China's imports from the rest of East Asia grew on average 36 percent a year. According to the World Bank's most recent regional update on East Asia, China's contribution to East Asia's export growth was 40 percent in 2002, 41 percent in 2003 and 29 percent in 2004. 'For the third year in a row, import growth in China (and Hong Kong) was the largest single contributor to export growth in the rest of emerging East Asia.'¹⁵

In a recent speech in Washington, Haruhiko Kuroda, President of the Asian Development Bank, had the following to say:

Over the past few years, China has shifted from being an export competitor in the region to being a primary destination for regional exports. From 2001 to 2003, spurred by strong processing exports and domestic demand, China's imports from Asia in US dollar terms have risen by an average annual rate of over 31 percent. Thus, China is contributing significantly to both trade expansion and creation, and is presenting new and unprecedented opportunities for exporters in both developed and developing countries.¹⁶

If East Asia is emerging as a region of manufacturing and production in the global economy, there is a discernible hub-and-spoke

formation in its current economic integration, with China as the regional processing and assembly hub.

The traditional trade-driven regional integration in East Asia has been given a new momentum in the past few years by a plethora of bilateral and sub-regional FTAs; with China at the centre. Behind the rise of FTAs in East Asia, a region with a strong traditional aversion to bilateral preferential trade agreements, there are at least three regional and global factors.

First is the failure of the WTO at Seattle in 1999 to launch a new round of global trade negotiations. In 2004 '[t]he stalling of the Doha Round of WTO negotiations at Cancun' 'has given further impetus to the surge of preferential bilateralism in East Asia and international trade diplomacy.'¹⁷ Whether the most recent attempts at the WTO ministerial conference in Hong Kong in December 2005 can put the Doha Round 'back on track' remains to be seen. Second are concerns about the inability of APEC, the most important regional economic forum, to facilitate a broad regional trade liberalisation agenda and to act in support of global multilateralism at the WTO. APEC, some argue, is 'in trouble' with its future hanging in the balance.¹⁸ And thirdly, there are growing trends toward 'competitive regionalism' in both North America and Europe.¹⁹ Under these political and economic circumstances, bilateral FTAs are seen as the only way to make any appreciable forward progress.

Individual East Asian countries have, however, adopted their own FTA strategies under different political and economic circumstances. China's active economic diplomacy in promoting bilateral FTAs as a new strategy for regional integration begs more specific explanations. China made a surprise move during the 2000 ASEAN summit when its Premier

Zhu Rongji proposed a China-ASEAN Free Trade Agreement (CAFTA). In taking this unprecedented initiative, China was primarily prompted by political expediency and diplomatic considerations, rather than economic calculation. It was made shortly after it agreed on the terms of its entry into the WTO and was taken at a time when Sino-American relations were in serious disarray and the 'China threat' was widely propagated.

The ASEAN countries, in particular, were deeply concerned about China as an economic threat. There was fear that this '800 pound trading gorilla' would suck in trade and investment at their expense and that the competition from China would crowd out jobs and growth, impoverishing ASEAN economies and making them increasingly dependent on China.²⁰ The Chinese initiative aimed at allaying such fears by encouraging and allowing the ASEAN countries to participate in and to share its growth.

Chinese activism in driving closer economic integration through FTAs has since been sustained by broader strategic considerations. The evolving Chinese FTA strategy is regarded as a new thrust to promote its 'peaceful rise'. It has been incorporated as part of China's drive for recognition of its full market economy status and is closely linked to its overall strategy to promote regional stability in the Asia Pacific in order to ensure a peaceful international environment for its economic development. The Closer Economic Partnership Arrangements with both Hong Kong and Macau that came into effect in January 2004 are an indispensable part of this strategy.

China's FTA strategy has recently been widened with negotiations now comprising more extra-regional partners than intra-regional ones, including New Zealand, Australia, Pakistan and Chile as well as the Gulf Cooperation Council²¹ and the Southern

¹⁷ Drysdale, 'Regional Cooperation in East Asia and FTA Strategies', p. 13.

¹⁸ Gyngell, Allan and Malcolm Cook (2005), *How to Save APEC*, Sydney: Lowy Institute for International Policy.

¹⁹ See Munakata, Naoko (2003), 'The Impact of the Rise of China and Regional Integration in Asia – A Japanese Perspective', Statement before the US-China Economic and Security Review Committee Hearing on *China's Growth as a Regional Economic Power: Impacts and Implications*, at www.uscc.gov/hearings/2003hearings/written_testimonies/031204bios/naokmunakata.htm [accessed 6 August 2005]; and Desker, Barry (2004), 'In Defense of FTAs: from Purity to Pragmatism in East Asia', *Pacific Review*, 17 (1): 3-26.

²⁰ See McKibbin, Warwick and Wing Thye Woo (2003), 'The Consequences of China's WTO Accession on its Neighbours', Working Paper in International Economics, No. 6.03, Sydney: Lowy Institute for International Policy and Yuping, Zhou and Sanjaya Lall (2005), 'The Impact of China's FDI Surge on FDI in South-East Asia: Panel Data Analysis for 1986-2001', in *Transnational Corporations*, 14:1.

²¹ The Council consists of Saudi Arabia, United Arab Emirates, Kuwait, Oman, Qatar and Bahrain.

²² The members are South Africa, Botswana, Lesotho, Namibia and Swaziland.

²³ Munakata, 'The Impact of the Rise of China and Regional Integration in Asia' at www.uscc.gov/hearings/2003hearings/written_testimonies/031204bios/naokmunakata.htm.

²⁴ As Singaporean Trade Minister Yeo remarked in 2002: 'As an economic community, ASEAN must play the global game skilfully. As a region, we are of strategic importance to the US, Japan, China, Australia and Europe'. Quoted in Desker, 'In Defense of FTAs', p. 14.

²⁵ Under the Early Harvest Programme, China agrees to unilaterally reduce tariffs five years before the conclusion of CAFTA on a wide range of agricultural products including livestock, meat, fish, dairy products, live plants, vegetables, fruits and nuts. In 2006, all products covered by the Early Harvest Programme will have zero tariff rates. By the end of 2003, nine of the ASEAN countries, except the Philippines (which will join in 2006), had signed the Early Harvest Agreement with China.

²⁶ See Drysdale, 'Regional Cooperation in East Asia and FTA Strategies' and Garnaut, Ross (2005), 'Australia, U.S. and China: Open Regionalism in an Era of Bilateral FTAs', Paper presented at a Public Lecture, Asialink, Melbourne, 22 March.

²⁷ Zhang, Yunling (2003), 'Political Economy of Regional Economic Cooperation', *International Economic Review*, No. 5, pp.15-16.

African Customs Union.²² Early in 2005, China also started feasibility studies of FTAs with India and Iceland.

China's economic diplomacy is a major factor behind the proliferation of both intra-regional and extra-regional FTAs for obvious reasons. By reinforcing the argument that bilateral FTAs are building blocks for, not roadblocks to, the multilateral trade agreement to be hammered out at the WTO, it lends legitimacy to the move away from global multilateralism as the central focus of East Asian economic diplomacy. While debatable whether it has produced either an FTA race between China and Japan or a classic scenario of competitive liberalisation in East Asia,²³ it is clear that a complex picture of competing regional initiatives to institute FTA strategies for regional economic integration has emerged.

What stand China out are the vigour and enthusiasm with which it has pursued its FTA strategy since 2000 and the pace with which tangible results have been achieved. CAFTA provides a striking example.²⁴ It was China that moved quickly and decisively to reach an agreement with ASEAN in October 2001 to establish CAFTA within 10 years. This was followed by the signing of the Framework Agreement on Comprehensive Economic Cooperation between China and ASEAN in November 2002, incorporating a specific, and ambitious, schedule for establishing a free trade area for the original ASEAN six by 2010 and for its newer members by 2015.

When fully implemented, CAFTA is expected to constitute the largest free trade area of developing countries; covering an area of more than 1.7 billion consumers, with total GDP of US\$2 trillion, and trade volume of US\$1.2 trillion as of 2004. To accelerate CAFTA negotiations an 'Early Harvest'

programme, as a stepping stone, has been implemented since 2004, giving ASEAN countries preferential access to China's domestic market prior to the establishment of CAFTA.²⁵ China is able to move forward with this attractive schedule because of a more open approach [than that of Japan] to agricultural trade.

In November 2004, China and ASEAN signed the Agreement on Trade in Goods and the Agreement on Dispute Settlement Mechanism under the Framework Agreement. As part of the Agreement, ASEAN states agree to recognise China as a full market economy. In 2004, ASEAN-China trade exceeded US\$100 billion, a target set for bilateral trade in 2005; and now China has become ASEAN's second largest trading partner.

Two points need emphasising. One is that preferential trade agreements are controversial in theory and problematic in practice. The proliferation of bilateral FTAs in East Asia, according to a number of studies by Australian economists, is likely to be of limited value and can incur considerable economic costs in trade diversion and political costs of exclusion. Critics of the Australia-US FTA have already claimed that in that particular case, trade diversion has exceeded trade creation.²⁶ How much such bilateral FTAs contribute to regional economic integration continues to be debated. The second point is that it bears reiterating that China's attempt to conclude CAFTA as part of its regional FTA strategy is primarily motivated by political and strategic considerations rather than mere calculation of economic benefits. Indeed, as one Chinese scholar argues, the payoff of China's push for CAFTA is seen in CAFTA's facilitating role for the establishment of a strategic partnership between China and ASEAN.²⁷

The traumatic learning experience of engagement with globalisation instilled in East Asian states a strong sense of vulnerability.

ASEAN PLUS THREE AND NEW REGIONALISM IN EAST ASIA

THE ASIAN FINANCIAL crisis in the late 1990s is arguably the defining moment for the new thrust of regionalisation in East Asia. The pre-crisis regional economic integration was often regarded as 'regionalisation without regionalism'. After the crisis, regionalism became an economic as well as a political project pursued collectively by both Southeast Asian and Northeast Asian states. The traumatic learning experience of engagement with globalisation instilled in East Asian states a strong sense of vulnerability. It also led to the realisation that globalisation and regionalisation are two complementary, though sometimes contradictory, processes and that regionalism, properly constructed, can be an effective means both to engage and to resist globalisation. As is charmingly put by Peter Katzenstein:

Because they often mediate between national and global effects, regional effects, as in the story of Goldilocks, are neither too hot, nor too cold, but just right.²⁸

In this context, regionalism in East Asia assumes additional significance and is seen to serve different purposes. It is believed to provide a pathway for collective problem solving through closer policy coordination. And it is conceived as an effective means to mediate the undesirable effects of unfettered and unregulated globalisation and to construct regional institutional capacity and economic governance.

A complex set of catalysts lies behind the rise of 'new regionalism' in East Asia.²⁹ The Asian financial crisis was arguably the most important catalyst in several ways. First, it prompted East Asian nations to rethink and reassess the costs and benefits of economic globalisation and the vulnerability of their economies, particularly to the destabilising effects of unpredictable global

capital flows. Second, it exposed the institutional limits and flaws of the existing regional integration projects. Neither ASEAN nor APEC was conceived or constructed to deal with regional economic crises. Consequently, neither could provide any meaningful advice on and response to the biggest economic crisis to have struck the region since 1945. Third, it resulted in a deep sense of resentment among East Asian nations towards the US and the IMF. There developed a pervasive perception in the region that not only was the crisis triggered by the premature opening of capital accounts in Thailand and Indonesia induced by the so-called Washington Consensus, but that the US remained largely indifferent to the crisis. The policy prescriptions and rescue packages offered by the IMF only exacerbated the crisis, as they were directed to advance the IMF agenda and the financial interests of advanced industrial countries, not to rescue East Asia.³⁰ As Fred Bergsten put it, 'most East Asians feel that they were both let down and put upon by the West.'³¹

It follows that there was a sharp break with previous understandings of the purpose of regional projects. 'Region' was now perceived to be a crucial location for economic governance. A set of robust regional economic institutions and more comprehensive integration were seen as essential in averting any future economic crisis in the region. Policy makers in East Asia were quickly convinced that it was desirable to create an alternative to build up regional capacity to prevent and manage future financial and economic crises through close macroeconomic policy coordination. New regional projects aimed at playing a strategic brokerage role between globalisation and national economic development in order to mitigate the undesirable political, economic and social impacts of participating in the global economy. The key

²⁸ Quoted in Dieter, Herbert and Richard Higgot (2002), 'Exploring Alternative Theories of Economic Regionalism: From Trade to Finance in Asian Cooperation', CSGR Working Paper No. 89/02, Centre for the Study of Globalisation and Regionalisation, Warwick: University of Warwick.

²⁹ For example, Simon Tay suggests the following factors: 'first, attitudes about the U.S. during and after the 1997 financial crisis that swept through Asia; second, the failure of APEC; third, the need for a competent and competitive regionalism in Asia; fourth, the reception of U.S. security policies post Sept. 11; and fifth, the rise of China and the responses among different Asian neighbours, See Cossa, Ralph, Simon Tay and Chung-min Lee (2005), 'The Emerging East Asian Community: Should Washington Be Concerned?' *Pacific Forum*, Vol. 5, No. 9, p. 16.

³⁰ See Dieter and Higgot, 'Exploring Alternative Theories of Economic Regionalism'; Beeson, Mark (2003), 'ASEAN Plus Three and the Rise of Reactionary Regionalism', *Contemporary Southeast Asia*, 25 (2), pp. 251-268; and Kim, Samuel (2004), 'Regionalisation and Regionalism in East Asia', *Journal of East Asian Studies*, 4:39-67.

³¹ Bergsten, C. Fred (2000), 'East Asian Regionalism: Towards a Tripartite World', *The Economist*, 15 July, p. 24.

The recognition that economic security is indivisible in East Asia brings Southeast and Northeast Asia much closer and reshapes the understanding of East Asia as a region.

³² Kim, 'Regionalisation and Regionalism in East Asia', p. 61.

³³ For example, according to Asian Development Bank statistics, by the end of 2003, 16 bilateral swap agreements were signed with a total amount of only US\$36.5 billion under the CMI.

³⁴ *Financial Times*, 8 May 2000.

challenge lies in the new institutional designs of East Asian regionalism. The recognition that economic security is indivisible in East Asia brings Southeast and Northeast Asia much closer and reshapes the understanding of East Asia as a region.

China quickly came to embrace the new thinking behind the emerging regionalism in East Asia, principally from two perspectives. First, the most important foreign policy goal of Beijing was to foster a peaceful and stable strategic and international environment conducive to its economic development. China's policy behaviour during the crisis, standing firm on not devaluing the Renminbi and offering sizeable liquidity dollar for both Thailand and Indonesia, was consistent with the achievement of this goal. For China, the crisis highlighted two important and inter related aspects of regional stability: the danger of any contagion of regional economic crises to security and prosperity in East Asia as a region and the pivotal role that China can play in regional economic stability.

Second, although not significantly affected by the financial crisis, its painful lessons were not lost on Beijing. There was an enhanced understanding that globalisation, if mishandled by the state, can be a wanton force of economic destruction. In common with the crisis-hit countries, China shared the strong sense of economic vulnerability in the face of the relentless onslaught of globalisation. 'Economic security' has since been high on the agenda of Chinese foreign and strategic policies.

For Chinese policy makers, closer regional cooperation was not only desirable to head off potential crises at a regional level in the future but also served China's overall strategic interests in the region. There are therefore common interests in

promoting new regionalism in East Asia. The fact that China is perceived to have acted responsibly during the crisis encouraged its leadership role in regional projects. As observed, in the post-crisis environment, 'China's desire to act as a regional great power has both removed an obstacle and provides a catalyst to regionalism.'³²

It is perhaps no coincidence that the APT process started at the height of the Asian economic crisis has since evolved into the main vehicle in reinventing regionalism in East Asia. Most significantly, in May 2000, the new consensus on the need for financial cooperation led to the launch of the so-called Chiang Mai Initiative (CMI) by the APT finance ministers. The CMI aims to create a network of regional bilateral currency swap arrangements designed to protect regional currencies from speculative attacks. This is the first time that East Asian states have taken concrete collective action in reserve sharing to enhance regional monetary cooperation, though it has considerable limitations.³³

The involvement of Japan and China is of particular importance, since at the time they respectively held the world's largest and second largest foreign currency reserves. China's position on the CMI is interesting, as its finance minister emphasised that support for the CMI was not due to China's need for the swap scheme but because 'it would contribute to the economic and financial stability of the region.'³⁴ China, however, does not support the idea of an Asian Monetary Fund.

The APT as a regional project serves varying objectives and agendas for different participants. For ASEAN, engaging China and enmeshing the emerging power in a web of regional institutions remains its principal strategic objective. At the same time, the APT serves well ASEAN's economic

and political objectives of linking itself with the two largest markets in the region, China and Japan, and bridges the divide between Southeast and Northeast Asia.

For China, participation in the APT and the pursuit of CAFTA are two pillars in its regional strategy to promote mutual trust with ASEAN and to institutionalise political and economic cooperation. Since the formal inception of the APT process in 1999, China has pursued an agenda that has gradually expanded its cooperation with ASEAN from economic fields to political and strategic areas. In 2002 China signed the Declaration on the Conduct of Parties in the South China Sea with other concerned Southeast Asian nations; in October 2003 acceded to the Treaty of Amity and Cooperation in Southeast Asia; and in January 2004, formalised its cooperation with ASEAN in the field of non-traditional security issues by signing a Memorandum of Understanding.³⁵

Is China strategically using the APT to promote its vision of a multipolar world order? Or is it simply engaged in traditional rivalry with Japan for regional leadership? These are open questions. Three points of importance can be made, however. First, if the argument is valid that 'one of the main reasons for Japan's participation in the APT is to balance the influence of China in Southeast Asia',³⁶ then China's active diplomacy to promote regional political, economic and strategic cooperation through the APT provides a vital dynamic for its evolution into the pivot of East Asian regionalism. Second, as a result of China's active pursuit of regional cooperation, 'Within the wheel of emerging East Asian regionalism, China serves as the hub power and has managed to radiate a series of cooperative bilateral and mini-multilateral spokes.'³⁷ And third, China's engagement with

ASEAN in general and with the APT in particular has been an integral part of its 'peaceful rise' strategy.³⁸

The APT was prompted by a financial crisis, but from the beginning it was not merely conceived of as just a financial cooperation body. Against all odds, it has since developed a complex set of institutions to support and implement regional cooperation in political, security, economic and socio-cultural areas. In addition to the annual summit of the APT and the informal summit of the Plus Three, 14 ministerial-level APT meetings have so far been instituted. Clearly, the APT is going through a process of institutional consolidation in functional cooperation. Most importantly, the successful institutionalisation of the APT over time has induced a new vision and a more ambitious project of East Asian regionalism.

³⁵ Wang, Yi (2004), 'Globalisation and Regional Cooperation in Asia', *Journal of China Foreign Affairs University*, No. 76, pp. 191-193.

³⁶ Hund, Markus (2003), 'ASEAN Plus Three: Towards New Age of Pan-East Asian Regionalism?', p. 400.

³⁷ Kim, 'Regionalisation and Regionalism in East Asia', p. 52.

³⁸ Wang, 'Globalisation and Regional Cooperation in Asia', p. 192.

TOWARDS AN EAST ASIAN COMMUNITY?

³⁹ Munakata, 'The Impact of the Rise of China and Regional Integration in Asia', at www.uscc.gov/hearings/2003hearings/written_testimonies/031204bios/naokmunakata.htm [accessed 10 December 2005].

⁴⁰ The 2005 election manifesto of the ruling Liberal Democratic Party called for the creation of an EAC.

⁴¹ In addition to the APT countries, ASEAN was given the authority to invite countries that were full Dialogue Partners of ASEAN, had acceded or had an intention to accede to the Treaty of Amity and Cooperation and had substantive relations with ASEAN. Theoretically, this should include the US, though it is unlikely to consider accession to the Treaty.

⁴² Vaughn, Bruce (2005), *East Asian Summit: Issues for Congress*, CRS Report RS22346, Washington DC: Congressional Research Service, p. 3.

⁴³ China did make a last-minute attempt to create a two-tier membership with 'APT as the core' at the EAS in December 2005, but failed. See *People's Daily Online*: 'East Asia Summit: In the Shadow of Sharp Divisions', at http://english.people.com.cn/200512/07/eng20051207_226350.html [accessed 15 January 2006].

⁴⁴ *People's Daily*, 7 December 2005.

⁴⁵ *Kuala Lumpur Declaration on the East Asia Summit*, at www.aseansec.org/18098.htm [accessed 3 February 2006].

THE IDEA of an EAC had lain dormant since the proposal for an exclusive East Asian Grouping by the former Malaysian Prime Minister Mahathir met strong opposition from the US, but now, as Munakata observes, 'The surge of political interest in the vision of an East Asian community suggests that the region is in search of a new order to accommodate China's growing power and influence and to maintain regional peace and stability.'³⁹ Importantly, Japan has explicitly endorsed a revived idea of an EAC.⁴⁰ And at the 2004 ASEAN summit in Vientiane 13 leaders agreed on the long-term goal to establish an EAC, with the first decisive step taken at the inaugural EAS held in Kuala Lumpur in December 2005.

This is a significant turn in the new regionalism of East Asia. However, the construction of an EAC on the basis of the APT encounters immediate and uncompromising challenges as demonstrated by the controversy surrounding the first EAS. On the face of it, it is about membership and leadership of the envisioned EAC. But behind this features the spectre of China and the parameters of US strategic tolerance.

The APT's decision to make the inaugural EAS inclusive in terms of participation was a calculated strategic decision.⁴¹ It opened the door for Japan to lobby successfully for the inclusion of Australia and India to counter the dominance of China. The decision also lessened US concern, expressed in Singapore by visiting Secretary of State Condoleezza Rice in early 2005, that 'the East Asian Summit will be inward looking and exclusive.'⁴² For Washington in particular, Australia's participation in the EAS was a means to ensure that vital American strategic interests in the region would not be adversely affected by the emergence of this new regional forum. This inclusive pattern

of membership helped deflect any impression of Chinese dominance of the process and pre-empted any US opposition. The first EAS eventually settled on a 10+6 pattern, with the participation of the ASEAN 10 countries plus China, Japan, Korea, Australia, India and New Zealand.

Conceptually and politically, however, such inclusion creates a difficult problem of its own: namely, how to delineate 'East Asia' and how to define 'community'; two core concepts in this new regional construct. The inclusion of Australia, India and New Zealand defies any geographical logic.⁴³ In this case, the argument has been made that economic rationale overrides geography. The loosening of the geographical logic, however, encouraged Russia to knock at the EAS door in Kuala Lumpur.

There seem to be irrefutable political and strategic imperatives, though not sufficient economic rationale, to include Russia in the EAS, which some believe is 'only a matter of time.'⁴⁴ Theoretically, membership of the EAS is open to the US also. This 10+8 scenario for the EAS, then, quickly catches up with APEC in terms of the number of member states and in terms of their divergent political and economic systems and interests and of their cultural and national identities.

Not surprisingly, the Kuala Lumpur Declaration on the EAS is ambiguous about the future shape of an EAC, preferring to state that 'efforts of the East Asia Summit to promote community building in this region will be consistent with and reinforce the realisation of the ASEAN Community, and will form an integral part of the evolving regional architecture.'⁴⁵ The suggestion by the Malaysian Prime Minister Abdullah Badawi that Australia as well as India and New Zealand should be closely involved in the EAS out of strategic

The issue of leadership for the EAS also proves problematic. Its evolution has to tread a very thin line so as not to be seen to impair any American strategic interests.

considerations, but should not be members of the future community of East Asian states, is an uneasy compromise. It is not a solution, but a sign of the difficulties ahead in the construction of an EAC.⁴⁶

The issue of leadership for the EAS also proves problematic. Its evolution has to tread a very thin line so as not to be seen to impair any American strategic interests. Leadership from China becomes impossible for two main reasons. One is that China is perceived by Washington as a strategic competitor. Any China-led or China-dominated regional forum or institution would be perceived as part of China's regional ambition to replace the US. One purpose in instituting open membership of the EAS, as discussed above, is to reassure Washington that this new regional forum will not be China dominated. The other reason is the intense rivalry for regional leadership between China and Japan and the long-standing difficulties in Sino-Japanese relations, which often destabilise the region. The Japanese leadership can be quickly discounted, not only on this measure but also because of its close alliance with the US and historical memories in the region.

The uneasy consensus reached at the inaugural EAS is, therefore, that ASEAN should be 'the driving force working in partnership with other participants of the East Asia Summit' for the evolution of this regional forum.⁴⁷ This consensus defers, but does not resolve, the central issue of leadership for the EAS and for the construction of an EAC.

The questions concerning membership and leadership of the EAS make it clear that regional projects remain hostage to the broader strategic considerations of the US, the distant hegemon. The construction of an EAC has to be done under the shadow of the American power, the meaning of which has now been transformed by its assertive unilateralism in the context of the global war on terror.

The apparent apathy of the US towards the EAS at present hinges on two factors. One is its preoccupation with the global war on terror. The other is how the EAS positions itself vis-à-vis existing regional forums such as APEC and the ARF.⁴⁸ The US would be loath to see the centre of gravity for regionalism in East Asia shift away from the US-dominated APEC towards the EAS, of which it has yet to become a member, or towards any other form of regionalism dominated by China. As Ralph Cossa observes, US endorsement of and participation in regional multilateral institutions such as APEC and the ARF always has 'a caveat': 'No U.S. administration, be it Republican or Democrat, is likely to allow such institutions to be seen as substitutes for or threats to U.S. bilateral alliances and other security arrangements.'⁴⁹

⁴⁶ *Sydney Morning Herald*, 15 December 2005. Mr. Badawi was also reported to have said that 'I do not know how the Australians could regard themselves as East Asians. We are not talking about being a member of the community; we are talking about common interests. We want to see stability and prosperity and [if] our friends are willing to contribute through such forums as EAS, then certainly they will be welcome.'

⁴⁷ *Kuala Lumpur Declaration on the East Asia Summit*.

⁴⁸ Cossa, Ralph, Simon Tay and Chung-min Lee, 'The Emerging East Asian Community', pp. 15-16. Some believe that American suspicion and antagonism towards the APT has been largely avoided because it has not yet displaced the pre-existing APEC framework.

⁴⁹ *Ibid*, pp. 4-6.

IMPLICATIONS FOR NEW ZEALAND

⁵⁰ Hu, 'Opening Address at the 2005 Fortune Global Forum'.

⁵¹ According to Central Intelligence Agency's most recent estimate based on Purchasing Power Parity, China's GDP in 2004 was \$7.262 trillion, that of Japan \$3.745 trillion and that of the US \$11.75 trillion. See *The World Fact Book* at www.cia.gov/cia/publications/factbook.

⁵² See Lardy, Nicolas (2005), 'China: The Great New Economic Challenge?', in Bergsten, C. Fred (ed.), *The United States and the World Economy: Foreign Economic Policy for the Next Decade*, Washington DC: Institute for International Economics, pp. 121-141.

⁵³ Quoted in Munakata, 'The Impact of the Rise of China and Regional Integration in Asia', www.uscc.gov/hearings/2003hearings/written_testimonies/031204bios/naokmunakata.htm.

CHINA IS RISING in the age of globalisation.

The long-term implications of this for New Zealand and for the regionalisation of East Asia must first and foremost be appreciated from the perspective of China's unprecedented economic transformation, which has made it the fastest growing economy in the past 25 years and the largest emerging market globally.

Between 1978 and 2004, China's GDP increased more than 10 times from \$147.3 billion to \$1.6494 trillion with an annual growth rate of 9.4 percent.⁵⁰ China is projected to overtake both Great Britain and France in the next two years to become the fourth largest economy globally.⁵¹ It is now the world's largest consumer of copper, zinc, tin, platinum, steel and iron ores; and the second largest for petroleum, lead and aluminium. In 2004, China became the third largest trader in the world, just behind the US and Germany. All of this has profound implications for global growth and commodity prices.

The impact of Chinese economic development on the East Asian region comes not just from its growth, but more importantly from its increasing openness. China's already low barriers to imports and its openness to FDI are 'unprecedented for a large, low-income economy' and the ratio of China's imports to GDP doubled from 15 percent to 30 percent between 1990 and 2003. By a number of measures, the Chinese economy is now much more open than those of Japan and Korea.⁵²

China's growth is changing the economic dynamics of the East Asian region and its centrality in regional integration can hardly be overemphasised. As the largest FDI recipient of all developing economies, China is at the centre of a new industrial restructuring and transformation in the region, which drives the growth of

intra-regional trade. China's active economic diplomacy in promoting bilateral and sub-regional FTAs is changing the landscape of regional economic cooperation and integration. The newly instituted 'spaghetti bowl' of bilateral and sub-regional FTAs concluded in East Asia has facilitated intra-regional trade and seems to have led to trade expansion rather than trade diversion. There is no convincing evidence that this new trend of regionalism disadvantages the participation of Australia and New Zealand in the dynamic growth of the region.

The changing regional mood about the new economic dynamics is perhaps best reflected in the shift of perception of China as a threat to an opportunity. As the Japanese Prime Minister Koizumi stated at the Boao Forum on Asia held in April 2002 in Hailan:

Some see the economic development of China as a threat. I do not. I believe that its dynamic economic development presents a challenge as well as an opportunity for Japan. I believe a rising economic tide and expansion of the market in China will stimulate competition and will prove to be a tremendous opportunity for the world economy as a whole.⁵³

China's rising economic power seems to have been changing strategic dynamics in the Asia Pacific too, though in a subtle way. It is true that strategic tensions between China and the US and its allies persist, particularly over the Taiwan question, and history continues to trouble Sino-Japanese relations. There are nevertheless a number of significant transformations in the geo-economic landscape concerning these players in the region.

A number of crucial questions now confront policy makers and corporate leaders in New Zealand.

In 2004, China replaced the US as Australia's second largest export market. Owing largely to insatiable Chinese demand for raw materials and primary products, Australia suddenly sees its terms of trade as the best ever in its entire history.⁵⁴ Exports to China in the past three years have also been credited to have provided stimulus to lift Japan out of its prolonged recession and since 2003 China has been the largest trading partner of South Korea.

Even China and the US have forged an economic partnership in an intriguing way. Chinese purchases of US treasury bonds have been helping to finance the US budget deficit. As Chinese holdings of US treasury bonds continue to grow, they overshadow the investment of American companies in the manufacturing sector in China. The result, as is astutely observed:

is a historically unusual relationship in which the rising power, developing China, provides both exports (second-leading supplier) and loans (second-leading foreign holder of government debt) to the superpower, the industrialized United States.⁵⁵

Whether such geo-economic realignment will reduce, in any significant way, strategic tensions and competition between China and the US in the region is debatable. It is interesting that the US Deputy Secretary of State Robert Zoellick, in a recent speech to the National Committee on US-China Relations, called for China to take more responsibilities not just as a 'member' but as a 'stakeholder' in the existing international system.⁵⁶ It is also significant to note that John Howard, in a recent statement, claimed that Australia now has an opportunity to strengthen its relations with China 'further into a true partnership for prosperity' and that 'Australia does not believe that there is

anything inevitable about escalating strategic competition between China and the United States.'⁵⁷

China's rise has in many ways significantly transformed the regional economic landscape and is generating new strategic dynamics in a region of ultimate policy concern for New Zealand. A number of crucial questions now confront policy makers and corporate leaders in New Zealand. Do we have adequate understanding and knowledge of these changing regional economic and strategic dynamics? How should we respond and do we have the essential skills and expertise to formulate credible responses to these emerging challenges? On what basis and to what extent should we reorient our foreign policy and corporate strategies to capitalise on the opportunities presented by the transformation of East Asia?

The recent development of regional integration in East Asia poses two specific and immediate challenges to New Zealand. First is the new momentum behind the push for FTAs in the region, demonstrated through progress in the CAFTA and the prospect of the formation of a China-Japan-Korea Free Trade Area. The FTAs for which China is the prime mover are typically driven by a political agenda. This is also true of its approach to the New Zealand-China FTA. The expected gain for Chinese annual exports in goods and services to New Zealand between 2007 and 2027 is estimated by a joint study of the two governments at between \$40 million and \$70 million, which is negligible in Chinese trade statistics.

In contrast, New Zealand's FTA negotiations are primarily motivated by an economic agenda of trade expansion and reduction of transaction costs for business operations. There is a clear mismatch of the political logic and the economic rationale

⁵⁴ Thirlwell, Mark (ed.) (2005), *Growth 55: China in Australia's Future*, Melbourne: Committee for the Economic Development of Australia.

⁵⁵ Deng, Yong and Thomas Moore (2004), 'China Views Globalisation: Toward a New Great-Power Politics?', *Washington Quarterly*, 27:3, p. 132.

⁵⁶ Zoellick, Robert B. (2005), 'Whither China? From Membership to Responsibility: Remarks to the National Committee on U.S.-China Relations', *NBR Analysis*, 16:4, pp. 5-14.

⁵⁷ Howard, John (2005), *Australia in the World*, Address to the Lowy Institute for International Policy, 31 March, www.pm.gov.au/news/speeches/speech1290.html [accessed 15 December 2006].

As a small liberal democracy and a developed economy with no stringent military alliance with the US, New Zealand seems distinctively positioned to play a role in bridging these divides.

⁵⁸ *Kuala Lumpur Declaration on the East Asia Summit.*

⁵⁹ *Ibid.*

in the New Zealand-China FTA negotiations. How is it possible to reconcile the cost and benefit calculations behind the political rationale on the one hand and the economic logic on the other? How can New Zealand ensure that all its bilateral FTAs promote, not obstruct, the application and diffusion of the global norms and principles of trade liberalisation and multilateralism that it cherishes?

The second challenge relates to the construction of an EAC. It is certainly in New Zealand's national interest to be closely engaged in any regional constructs; the high stakes that it has in constructing a robust regional community can never be overemphasised. New Zealand's presence, together with that of Australia and India, at the inaugural EAS served the purpose of keeping this emerging regional forum 'open, inclusive, transparent and outward-looking.'⁵⁸

There are, however, two potential divides within the existing 10+6 that will test the construction of an EAC in the future. One is that between East and West and the other is between developed and developing economies. As a small liberal democracy and a developed economy with no stringent military alliance with the US, New Zealand seems distinctively positioned to play a role in bridging these divides. This should be first and foremost reflected in our long-term commitment to developing the EAS 'as a forum for dialogue on broad strategic, political and economic issues of common interest.'⁵⁹

Finally, New Zealand's active participation in the construction of an EAC raises tricky questions about identity and community. In what sense does New Zealand belong to 'East Asia'? How do we feel to be 'East Asian'? The rejection of Australasia from the Asia Europe Meeting process and the Malaysian Prime Minister's comments on Australian identity at the EAS mentioned earlier, both highlight the important question of how values, belief systems, common interests and identity play a role in the conception and formation of a community. This is a question that challenges politics, rather than a problem that is subject to any political solution.

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