

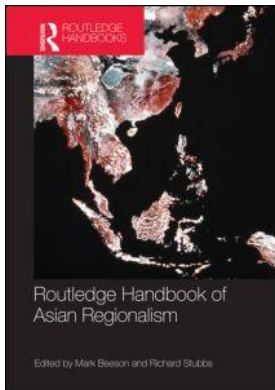
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China–ASEAN relations

The core of Asian regionalism

Nicholas Thomas

Introduction

The China–ASEAN relationship is the key nexus for wider moves towards Asian integration. At the heart of that relationship are the economic and trade ties between China and the ten economies of Southeast Asia. Although often described in modern terms, these ties stretch back to antiquity. Later, the Tang, Song and Yuan dynasties all encouraged trade with surrounding nations and tributary states. The Ming and Qing also relied on foreign trade, of which the fifteenth-century travels of Ming admiral Zheng He are the most famous. In more recent times, while the exigencies of the Cold War and the later Sino-Soviet split restricted China's ability to engage in international trade relations with its traditional regional partners, the 1970s heralded a return to a pragmatic – rather than ideological – foreign economic policy. Throughout this decade China (re)established diplomatic relations with most of Southeast Asia. These political acts had a positive impact on economic relations, with a sustained renewal of Chinese–Southeast Asian trade relations. Importantly, these relations were not restricted to central-level engagements but also drew upon the geographic trade benefits afforded by China's southern provinces, especially Guangxi and Yunnan. Both provinces established land-ports with their Southeast Asian neighbours, ensuring that China–ASEAN economic relations would not only be multilevel but would also draw upon local-level business and their overseas counterparts.¹

Since ASEAN's formation in 1967, China–ASEAN economic relations have expanded and deepened. In January 2010 the long-awaited China–ASEAN Free Trade Agreement (CAFTA) was launched. In the year since, trade ties between the 11 economies have only intensified. But to what end? The initiation of CAFTA provides an appropriate moment to review China–ASEAN economic and trade linkages. In doing so, this chapter will first review the broader China–ASEAN relationship. This review provides a context for then understanding the expansion of economic and trade linkages – both in policy and practice. This chapter will then consider two case studies, both of which have an important place in China's regional economic ties: (1) the formation of the Chiang Mai Initiative (CMI) and the subsequent Chiang Mai Initiative Multilateralization; and (2) the creation and impact of CAFTA. Some of the implications arising from the case studies for both the present and future state of economic relations will also be explored. In particular, it will be argued that although these relations are (in the near-term) weighted in favour of China-centric

regional economic order, they also hold the (longer-term) potential to transform the region away from its Westphalian preoccupation towards a more integrated region with supranational characteristics.

China's relations with Southeast Asia

The opening up of China throughout the 1980s highlighted its economic potential. This potential gradually served to construct a very different image of China, one of economic promise rather than strategic threat. By the end of the Cold War, both images coexisted uneasily in regional perceptions of China. In some countries (the Philippines or Indonesia, for example), the threat perception was stronger. In other countries (such as Malaysia or Singapore), there was a greater willingness to see China's promise. However, despite these differences, with the ending of the Cold War, there was a perceived need to address the 'China question', so that the threat aspect could be diminished and the promise could be realized.

At the same time, China was also interested in reviving ties with Southeast Asia. During a visit to Thailand in 1988, the then Chinese Premier Li Peng announced that China saw no impediment to the establishment of diplomatic ties with all ASEAN states (*Xinhua 1988*). At that time, the ASEAN states – which had been working with China to settle the problem of Vietnam's intervention in Cambodia – were generally positive to upgrading formal relations. As a consequence, over the next two years, China established diplomatic relations with all ASEAN states. This was the basis for an invitation to the Chinese foreign minister Qian Qichen to attend the opening session of the twenty-fourth ASEAN Ministerial Meeting (AMM), as a guest of Malaysia, in 1991. Over the next five years the relationship gradually developed across a range of functional areas, including economic and trade cooperation and collaboration in scientific and technological projects (ASEAN 1993). China also continued to attend the AMM and became a consultative partner of the ASEAN Regional Forum (ARF) in 1994. The political and security relationship reached a high point in 1996, when China's status within the AMM was upgraded to that of a full 'dialogue partner', with a similar status being acquired within the ARF. While the involvement of China in the ARF could be seen as an example of its commitment to multilateralism with peripheral states, at least in the beginning, Mack suggests, the ARF was rather 'an ASEAN initiative whose creation the Chinese were powerless to prevent. China joined the ARF not least so it could put a brake on initiatives that the Chinese saw as inimical to their interests and to try to keep other issues off the agenda' (Mack 1996: 56–57). Hence, although China's involvement in the ARF did represent the involvement of the People's Republic of China (PRC) in an emerging regional institution, its commitment to the associated institutional norms is questionable (Johnston 2007).

In 1996, China further expanded the basis for its Southeast Asian – and regional – ties when it joined with the then seven members of ASEAN as well as Japan and South Korea in representing Asia for the Asia-Europe Meeting (ASEM) talks. This was the first time that all the countries had been grouped together in a regional bloc. While the focus since the first meeting mainly has been on socio-economic and trade issues between Europe and Asia, it has also provided a useful meeting for the heads of government from the Asian region as well as their respective senior representatives (*Deutsche Presse-Agentur 1996*). In particular, it gave China an opportunity to build on its Southeast Asian relations while also beginning to identify its place in wider regional processes.

A watershed for China–ASEAN relations came in 1997, with significant improvements in the economic as well as political fields. The 1997 Asian Financial Crisis, while devastating for Southeast Asian economies, significantly advanced China's position in regional politics. China's decision not to revalue the yuan was welcomed by Southeast Asian states, not only for the

economic benefits that the decision was perceived to provide but also because it was interpreted as a significant statement of affinity with the regional states. This affinity was in stark contrast to perceptions of Western countries and international organizations (such as the IMF) during the crisis. It also stood despite China aligning itself with the United States to oppose the Japanese proposal for an Asian Monetary Fund, which had the support of several Southeast Asian states. Indeed, from this point onwards, China has steadily cemented its place as ASEAN's key partner in East Asia, much to the dismay of Japan.

Towards the end of 1997 China also joined in the first informal meeting of ASEAN Plus Three.² This new grouping linked the ASEAN states with the three key Northeast Asian states of China, Japan and South Korea. The formation of this group was due to ASEAN's recognition that Southeast Asia's future was irrevocably tied to that of Northeast Asia – a point reinforced by the financial crisis. Of the three sets of bilateral talks ASEAN held with its northern neighbours, the China–ASEAN meeting was the only one that based itself on both ASEAN and Chinese norms. Neither the Japanese nor Korean bilateral discussions made any reference to such issues.³ Paragraph two of the *Joint Statement of the Meeting of Heads of State/Government of the Member States of ASEAN and the President of the People's Republic of China* (1997) mentioned, in part, that both sides:

affirmed that the Charter of the United Nations, the Treaty of Amity and Cooperation in Southeast Asia, the Five principles of Peaceful Coexistence and universally recognized international law should serve as basic norms governing their relations. They reaffirmed in particular their respect for each other's independence, sovereignty and territorial integrity and the principle of non-interference in the internal affairs of other states.

(ASEAN 1997a)

This norm agreement served as a far stronger basis for the development of China–ASEAN relations than was the case with either the Japan–ASEAN or Korean–ASEAN relationship.

In 1999 the ASEAN Plus Three group was further solidified with the first ever meeting of all 13 states: the 3 Northeast Asian states as well as all 10 Southeast Asian states. Although this meeting is noteworthy for the decision to create the East Asian Vision Group, it is equally important to note that the *Joint Statement on East Asia Cooperation* (issued at the end of the meeting) included the 'Five Principles of Peaceful Coexistence' as one of the key norms guiding the development of mutual relations (ASEAN 1999).⁴

However, even as the ASEAN Plus Three group has expanded cooperation into a wide range of areas (see Table 11.1), it has been the China–ASEAN relationship that has remained the key axis for regional development. In the past five years this bilateral relationship has developed faster and further than either the Japan–ASEAN or Korean–ASEAN relationship. This rapid development of ties has also meant that the structures and norms developed in the China–ASEAN meetings have often become the basis for Japan and South Korea's institutional ties.⁵

As China has steadily taken the lead over Japan and South Korea, it has expanded cooperation with ASEAN in the political and strategic, economic and financial as well as social and cultural areas. In terms of political and strategic cooperation, the two sides have signed a joint declaration on cooperation in non-traditional security issues as well as a code of conduct on matters relating to the disputed areas in the South China Sea. In 2002 China became the first non-Southeast Asian state to reach an agreement with ASEAN on a framework agreement to further bilateral economic cooperation towards the realization of a phased free trade agreement, which became a reality in July 2005 (see below). This agreement is in addition to accords on transport, agricultural and ICT cooperation that have also been signed since the turn of the century. At the Bali Summit in 2003,

Table 11.1 Indicative scope of ASEAN Plus Three cooperation

Area	Year of Establishment
Political and Security	2000
Economic, Trade and Investment	2000
Finance and Monetary	2000
Agriculture, Fishery and Forestry	2001
Labour	2001
Environment	2002
Tourism	2002
Culture and Arts	2003
Energy	2004
Health	2004
Information Technology and Communications	2004
Social Welfare and Development	2004
Transnational Crime and Counter terrorism	2004
Science and Technology (SOM only)	2001
Youth (SOM only)	2004

Source: Tanaka (2009): 66.

China became the first non–Southeast Asian state to sign ASEAN’s *Treaty of Amity and Cooperation*. In social and cultural areas in mid-2005 the two sides agreed on an *ASEAN–China Memorandum of Understanding on Cultural Cooperation*, which will ‘promote culture cooperation through artistic collaboration and exchange, joint research and study, exchange of information and people-to-people exchange and interaction’ (ASEAN 2005a). China and ASEAN senior officials and ministers for youth affairs have also been meeting since mid-2004 (ASEAN 2001).

While these agreements could be dismissed as simply political statements with relatively little impact on practical integration, it is necessary to consider the nature of some of the more recent agreements. During 2005 China and ASEAN sought to upgrade their relationship with the convening of a bilateral Eminent Persons Group (EPG) to develop a blueprint for advancing the relationship over the following 15 years. Beyond the usual commitments to political, economic and security concerns, the EPG report placed significant emphasis on developing multilevel institutional ties between sub-national, municipal, civil society organizations, especially in the sociocultural and functional-cooperation fields. In terms of guiding norms, the EPG clearly placed the relationship within the ‘purposes and principles of the UN Charter, the Treaty of Amity and Cooperation in Southeast Asia, the Five Principles of Peaceful Coexistence, and the Ten Principles of the Bandung Asian-African Conference’ (ASEAN 2005b).

The work of the EPG was further developed in 2006 during the ASEAN-China Commemorative Summit, when ten priority areas were identified for deeper and broader functional cooperation. These areas encompassed: ‘agriculture, information and communication technology (ICT), human resource development (HRD), two-way investment, Mekong River Basin development, transportation, energy, culture, tourism and public health, as well as the signing of several Memoranda of Understanding (MOUs)’ (ASEAN 2006b). Cooperation on the environment was added to the list of priority areas the following year (ASEAN 2007a). The outcomes from the 2006 summit can be seen throughout 2007 when the number of meetings in the priority areas increased along with a concomitant rise in the number of agreements signed. Meetings on ports development, agreements on food safety and consumer rights, a Memoranda of Understanding (MOU) on inspection and quarantine cooperation, as well as a new Centre for

Promoting Trade, Investment and Tourism all signified the acceleration of the relationship.⁶ At the bilateral summit in November 2007, both sides identified a further 14 projects for formulation or implementation (ASEAN 2007a).

This acceleration of policy initiatives reached a new peak in October 2010 with the signing of the 'Plan of Action to Implement the Joint Declaration on ASEAN-China Strategic Partnership for Peace and Prosperity (2011–15). The scope of this plan showed the extent to which the bilateral relationship had developed and the plans for future growth. In political and strategic areas, issues of human rights, legal and judicial training and cooperation, and expanded non-traditional security ties were all covered. Economically, the five-year plan supported national and sub-national economic, trade and business fora as well as deeper forms of financial and sectoral cooperation; while socially and culturally issues ranging from gender equality, media exchanges, environmental cooperation and education were all identified for future growth. Although many of the items included in the plan were already under development and many were issues of which the parameters for discussion were already limited (such as the South China Sea), the scope of the activities listed reflects both the expansion of China–ASEAN ties as well as the confidence – which both sides find in the relationship – to list so many areas previously considered contentious or difficult.

The economic heart

While Sino–ASEAN economic and trade ties had been gradually developing since the late 1970s, the 1997 financial crisis provided a window of opportunity for realizing their potential. In the two decades since, two-way trade has increased from US\$22.6 billion in 1997 to in excess of \$223 billion by 2008 (Tang and Wang 2006; Tong and Chong 2010). Although the impact of the global financial crisis had a negative impact on bilateral trade volumes, by 2010 it had again resumed its upward growth trajectory (see below) (*Vietnamese Business News* 2010), suggesting that China–ASEAN trade continued to grow even as the developed economies struggled with the financial crisis. This expansion of ties reflects the economically complementary nature of the relationship, in which Southeast Asia generally takes the role of supplying primary resources and machinery parts and China provides these as well as more developed products in return (HKTDC 2010). This is, of course, not always the case. Singapore, for example, is a supplier of high-technology goods to China, and the Philippines is increasingly supplying labour in the form of foreign domestic workers to a China keen to develop English-language skills in the home.

Although the 1997 crisis provided an opportunity for the development of Sino–ASEAN economic ties, the complementary nature of the economies as well as the fact that this was the least contentious aspect of the bilateral relationship meant that it was always a logical area for joint policy development. An earlier initiative – the Greater Mekong Subregion (GMS) – that was started in 1995 was, in part, in recognition of the complementarity between the Chinese and Southeast Asian economies, in this instance Yunnan province and the five states of mainland Southeast Asia. Working with the Asian Development Bank (ADB) and the United Nations Development Programme (UNDP), the countries in the project identify areas of cooperation across seven areas – transport, energy, telecommunications, environmental, human resource development, trade and investment, and tourism.⁷ Although there is no GMS secretariat, the number of ministerial summits, senior official meetings and related fora encourages a high degree of policy cooperation between participating states. Hence, the integration between the GMS members represents a compressed form of what is occurring in the wider China–ASEAN relationship.

As Harayati (2001) has noted, subregional cooperative efforts form strong bases for wider regional integration, as they encourage small-scale transnational development to take place that would not otherwise occur. In many respects, the challenges faced by these projects mirror

broader bilateral issues. First, given wide social, economic and political disparities the benefits may be unequally distributed between participating countries. Second, states have to provide long-term commitment to the project's objectives (Tan, *et al.* 1995: 238). This means that participating states have to willingly accept constraints on their ability to allocate resources – a key aspect of state sovereignty. In addition, the activities in the GMS are heavily dependent on private sector investment. This raises issues of government transparency and accountability in providing accurate information to investors. In some cases regional governments are not accustomed to providing timely economic and financial data, and may even regard such information as secret. Although this data is usually considered sensitive by host governments – and its provision an encroachment on state sovereignty – the added value of the GMS initiatives encourages governments to change management practices and adopt new governance policies; for example, in the case of the harmonization and standardization of customs procedures to facilitate subregional trade and investment.⁸

Since 1997 China and ASEAN have been actively developing multilateral and bilateral initiatives. As the immediate crisis began to recede, both sides started to consider ways to both enhance their economic relationship as well as to protect themselves from future financial shocks. In 2000, two new endeavours commenced: the multilateral Chiang Mai Initiative (CMI) and the bilateral China–ASEAN Free Trade Agreement (CAFTA) negotiations. Taken together, these two efforts helped to shape the regional post-crisis economic landscape and placed China–ASEAN relations at the heart of the emerging economic order.

The Chiang Mai initiative and beyond

The CMI had its genesis in the 1997 crisis discussions concerning the need to protect and prevent regional economies from future financial shocks. Although it was initially linked to the idea of an Asian Monetary Fund (AMF), the contentious nature of the latter proposal meant that its development was stalled while the CMI continued to attract interest. It is worth noting that the original proposal for an AMF was, in part, supported by such a currency-swap arrangement. Taken together these were seen as building blocks for an Asian economic order, although what shape that order would take remained unstated. As the (then) Malaysian Finance Minister Mustapa Mohamed said, '[i]t can evolve into something. But there was not discussion of what it was going to be' (Cheeseman 2000: 14). However, despite the pre-existing ASEAN agreement there remained opposition from China in these initial efforts – concerned about issues of financial sovereignty – as well as from other Southeast Asian countries wary of the expansion of Japanese economic power. As Chey noted, 'China did not support the proposal, out of worries about an increase in Japanese regional influence. China perceived the AMF proposal as an attempt by Japan to assume regional leadership and to establish hegemony of the yen in the region, and Beijing did not wish to see that happen' (Chey 2009: 459).

Despite its contentious precursors, in May 2000 the ASEAN Plus Three finance ministers agreed to extend an existing currency-swap arrangement between the 5 more economically advanced ASEAN states to all 13 countries in ASEAN Plus Three.⁹ The CMI envisaged a 'network of bilateral swap and currency repurchase agreement facilities among the ASEAN countries, China, Japan, and the Republic of Korea' (ASEAN 2000). In this respect the CMI built upon the 1977 ASEAN Swap Arrangement (ASA) and the currency-swap agreements that Japan had already undertaken as part of the New Miyazawa Initiative (Ngiam 2003). The importance of the CMI, especially in terms of broader Sino–ASEAN confidence-building efforts, should not be underestimated. As Hiwatari observed, '[m]ost notably, the initiative was the only proposed post-crisis regional financial arrangement actually realized' (Hiwatari 2003: 350).

Philippines, Indonesia and Singapore. As an initial proposal, this concept represents a midway point between the CMI and the AMF; one that is more acceptable to China as well as to external actors such as the United States. While this new proposal deepened the region's financial architecture, it was limited at the time by how preoccupied regional states were with 'sovereignty, state building, and security', which affects the ability of regional economic systems to prevent future financial shocks (Narine 2002a:187).

Nonetheless, the ASEAN Plus Three financial ministers were committed to explore options for evolving the CMI into something more institutionalized. As their 2006 meeting observed, the ministers wanted 'to set up a "new task force" to further study various possible options towards an advanced framework of the regional liquidity support arrangement (CMI multilateralization [CMIM] or Post-CMI)' (ASEAN 2006a). Over the next three years, the CMIM framework took shape. At the 2009 ASEAN Plus Three financial ministers' meeting – against the backdrop of the global financial crisis – ministers announced the CMIM, which was operationalized in March 2010 to a value of US\$120 billion (Bank of Japan 2010).

One important outcome of the CMIM process can be seen in the levels of contributions made by China and Japan. Whereas Japan had been the main source of support for the first two stages of the CMI, by 2009 Chinese economic capacity had grown sufficiently to allow it to occupy a co-equal place with Japan in regional economic affairs. For the CMIM both states pledged to each contribute 38.4 per cent of the total fund pool (see Table 11.2 below). As Rathus observed:

[t]his agreement is a symbol of how far China has come since the beginning of its charm offensive a decade ago. The phenomenon of China's rise, and the consequent eclipsing of Japanese power, is also on display. Compared to the other regional institutions it had joined earlier such as the Asian Development Bank, China's presence (and potentially its formal voting weight) as a ratio of that of Japan's has increased from under a half to near parity.

(Rathus 2009)

Table 11.2 CMIM contributions and borrowing multiplier

Country	Contribution (USD Billion)	Borrowing Multiplier
Brunei	0.03	5
Cambodia	0.12	5
China	38.4 China (exclude Hong Kong, China) 34.2 Hong Kong, China 4.2	0.5 2.5*
Indonesia	4.77	2.5
Japan	38.4	0.5
Korea	19.2	1
Lao PDR	0.03	5
Malaysia	4.77	2.5
Myanmar	0.06	5
Philippines	3.68	2.5
Singapore	4.77	2.5
Thailand	4.77	2.5
Vietnam	1.00	5

Source: ASEAN (2009b).

A second important outcome is the decision to create a formal secretariat for the CMIM to provide independent surveillance. The bilateral nature of the CMI meant that individual states could monitor and decide to release funds as needed. Indeed an earlier proposal by Japan for a surveillance mechanism for the CMI was opposed by China as being too intrusive into its sovereign affairs. For the CMIM, however, China has shifted its position and now supports the creation of such a unit, signalling not only a confidence with regional economic processes but also a willingness to engage more deeply in areas earlier considered intrusive to its sovereignty. Unlike other regional-coordination bodies, this unit – to be known as the ASEAN Plus Three Macroeconomic Research Office (AMRO) – will be based in Singapore not Jakarta. It will commence operations in mid-2011 (Chalongphob 2010).

As Chey concludes, '[t]his rising Chinese support for East Asian financial cooperation appears to stem partly from its foreign policy objective of taking leadership in the region... it now puts higher priority on reducing U.S. influence than on limiting Japan's role in East Asia' (Chey 2009: 459), which can be seen as a reflection of China's belief that it is superseding Japan in regional affairs and, consequently, needs to focus on global rather than regional competitors. 'This change in China's view of regional financial cooperation is [also] partly attributable to the positive outcomes its earlier participation in regional multilateral arrangements such as the ASEAN Regional Forum have produced' (Chey 2009: 462).

Beyond multilateral fora such as the CMI and CMIM, China has also identified parallel benefits to participating in other bilateral groupings such as the China-ASEAN Closer Economic Cooperation Agreement and, later, the China-ASEAN Free Trade Agreement. These two agreements build on the knowledge and capacities acquired during the CMI and CMIM developments (as well as China's (re)joining of the WTO and its other ASEAN Plus One and ASEAN Plus Three activities) to form the centrepiece of China's economic relationship with Southeast Asia.

Sino-ASEAN economic cooperation

While the economic ties between China and Southeast Asia are long-standing, they have always lacked a singular focus: an aspect of the relationship that could act as a foundation for maximizing immediate benefits whilst providing a basis for future bilateral economic activities. As both sides began to develop close ties in the early 1990s, the China-ASEAN Joint Committee on Economic and Trade Cooperation (CAJCTEC) was established in 1994 (Ministry of Foreign Affairs 2002). Although CAJCTEC was tasked with discussing regional and international economic issues as well as matters pertaining to the bilateral trading relationship, its infrequent meetings meant that it was unable to provide the necessary basis for the economic relationship to advance. In 2000, during the ASEAN Plus One meeting, then Chinese Premier Zhu Rongji suggested that China and the ten ASEAN states should formalize and deepen their relationship by developing closer economic cooperation through the setting up of 'an expert group for China-ASEAN economic integration under the framework of the China-ASEAN Joint Committee of Economic and Trade Cooperation to discuss how to strengthen economic relations, facilitate trade and investment and other issue of mutual interest' (Zhu 2000).¹⁰ Although the suggestion took ASEAN (as well as Japan and South Korea) by surprise, both sides agreed to set up an expert study group to identify ways to advance the economic partnership.

The expert group's report was tabled at the following ASEAN Plus One summit in Brunei. Not surprisingly the group advocated the establishment of a Closer Economic Cooperation Agreement (CECA) as a first stage towards developing a bilateral free trade agreement. The report noted that the 'strong dependence of the ASEAN as well as China on the U.S. market is a source of instability for the region. Promoting the ASEAN-China intraregional market through

the free trade arrangement is a means toward the promotion of regional self-reliance and stability' (ASEAN–China Expert Group on Economic Cooperation 2001). Following the expert group's report, China also announced that it would unilaterally remove tariffs on products from the ASEAN economies as part of an early harvest programme (EHP) (ASEAN 2001). This decision was of particular benefit to the four lesser-developed Southeast Asian economies of Cambodia, Laos, Myanmar and Vietnam as well as to their developed counterparts. However, Indonesia and the Philippines resisted joining the EHP as they were worried about the eventual economic impact of Chinese goods in their domestic markets. Although the Philippines was the last regional state to sign on to the EHP, Indonesia has since indicated that it would like to renegotiate tariff reductions with China in order to give it more time to mitigate against the impact of cheaper Chinese goods in the local market.

The findings of the expert group led to the signing of the *Framework Agreement on Closer Economic Cooperation between ASEAN and the People's Republic of China* at the Phnom Penh summit in 2002. The Framework Agreement also began the process of developing economic cooperation in a range of other priority sectors: agriculture, information and communications technology, human resource development, investment and the Mekong River basin development. Beyond these five sectors, the Framework Agreement also contained a list of other areas for economic development, including 'banking, finance, tourism, industrial co-operation, transport, telecommunications, intellectual property rights, small and medium enterprises (SMEs), environment, bio-technology, fishery, forestry and forestry products, mining, energy and sub-regional development' (ASEAN 2002a). In other words, with the basic economic cooperation agreement established, most other key areas of economic, trade or investment activity were to be brought under the Framework Agreement's principles.

The signing of the Framework Agreement for the CECA was followed by the decision in 2004 on the Dispute Settlement Mechanism. In contrast to earlier agreements, where interpretation was dependent upon a mutual understanding, the Framework Agreement has a later associated agreement for the establishment of a dispute resolution mechanism. When a dispute arises between any of the states covered under this agreement, an arbitration tribunal can be appointed to decide the issue. In two key departures from the mode of earlier agreements, not only is the decision of the tribunal binding but, in the event of a dispute over the composition of the tribunal, the director-general of the WTO or their deputy acts as referee. This represents a significant step forward in the development of regional economic governance, as both sides will have to abide by the decision of a supranational institution. To do so will require the partial abdication of sovereignty in order to gain greater economic benefits. Although the significance of the dispute resolution mechanism will only be known fully when it is tested (successfully or otherwise), its presence with the Framework Agreement does suggest that even as both sides publicly uphold the norms of state sovereignty and non-interference they are prepared to modify these norms to fit in with the objectives of new regional institutions.

Using the CECA as a foundation, in 2007 China and ASEAN also signed a bilateral Agreement on the Trade in Services (ASEAN 2007b). This was designed to complement the agreements covering the trade in goods and opened up more developed sectors for economic cooperation. Two years later, the two sides signed the ASEAN–China Investment Agreement. In addition to this agreement, China also announced that it would establish a 'US\$10 billion China–ASEAN Investment Cooperation Fund to finance major ASEAN–China investment cooperation projects in infrastructure, energy and resources, information and communication technology and other fields' (ASEAN 2009a).

In January 2010 the China–ASEAN Free Trade Agreement was formally launched. Covering 1.9 billion people and with a combined GDP of US\$6 trillion, CAFTA is the largest market under

such an agreement. The timing of this agreement was auspicious, coming at the same time as the world's major economies were still recovering from the global financial crisis. For the first nine months of 2010, trade between China and Southeast Asia rose 44 per cent from the previous year, to US\$211 billion. This trend was supported by investment figures that showed 'aggregate bilateral investment reached 69.4 billion U.S. dollars' by the first half of 2010 (*Xinhua* 2010a, b). Although ASEAN still lagged behind the European Union, the United States and Japan as China's fourth largest trading partner, the impact on the ASEAN economies was significant with China cementing its position as ASEAN's largest trading partner. As Qiu *et al.* (2007) noted, in the period between Zhu Rongji's proposal and the start of CAFTA 'the economic welfare of ASEAN countries [increased] by approximately US\$1,624m, and China's economic welfare [increased] by approximately US\$517m' (Qiu *et al.* 2007: 89).¹¹

With all the major pieces now in place, the China–ASEAN economic relationship has the infrastructure to continue to support and deepen economic, trade and investment ties between the two sides. The increase in bilateral flows in these three areas over the last decade is testimony to the value of the relationship, and the importance both sides attribute to it. At the 2010 Hanoi summit, China announced a number of key intentions for economic relationship with ASEAN, in particular its plan to increase bilateral trade to US\$500 billion and new direct investment from China to reach US\$10 billion (ASEAN 2010a). If, as former ASEAN secretary-generals' have stated, the China–ASEAN relationship is the key nexus around which other regional integration initiatives take place, then these flows hold the potential to act as a foundation for the wider economic integration of East Asia.

Beyond the economic benefits from such closer cooperation, however, is the strategic reality that the flag follows – or is, at least, heavily influenced by – trade. As Vatikiotis and Hiebert observed, 'China's approach has been subtle, using economic diplomacy to build a benign multilateral framework in the shape of a free trade agreement with ASEAN' but which (quoting Wang Yi) "will serve as a helpful trial and practice of China's new security concept featuring comprehensive, cooperative and common security" (Vatikiotis and Hiebert 2003: 31). This would suggest that China is using its economic relations in an attempt to forge 'a close knit economic and security community with Beijing at its centre' (Vatikiotis and Hiebert 2003: 33). Given the centrality of ASEAN to regional integration, this community would also pull Japan and South Korea into a normative orbit dominated by China. If, as the National Intelligence Council (2004) suggests, Asia is the global future, then China's economic ties with Southeast Asia develop a broader strategic weight beyond raw trade and investment figures and beyond the East Asian region.

Issues arising

Who leads?

One of the key areas where China's economic interests with Southeast Asia meet its security agenda is over the issue of regional leadership. In every other region, the impetus towards integration is generated by the largest economies. It is an interesting quirk of the East Asian process that it is the smaller economies that have driven the policy processes. However, a key challenge for the region will be whether or not to maintain this tension with small-states in the driver seats or to relinquish control to one of the bigger economies. According to Mattli (1999: 73–77), the existence of 'leader states' usually assumes a single state able to develop the regionalist cause; however, it has also been postulated that 'a coalition of leading states may provide the requisite leadership for successful integration' (Webber 2001: 345). The problem with the 'leader

state' concept in the East Asian case is twofold. First, within the core ASEAN group, there is no such leader state. Indonesia is the largest state in terms of population and geographical spread. However, Indonesia lacks the resources to drive the regional processes forward. Singapore has the resources but lacks the size and has a troubled relationship with other neighbouring countries. Of all the ASEAN states, only Thailand has the potential to assume such a leadership role but its capacity is currently only that of a middle-sized ASEAN country and, in any case, is beset by ongoing political turmoil that looks set to continue unresolved for many more years to come.

Second, all the ASEAN states are underqualified for a leadership role when compared with the Plus Three Northeast Asian countries. As ASEAN expands its cooperation and integration with these three countries, their scope to exert a leadership function will increase. The problem then becomes one of which of these countries should lead. Even though it is still going through a prolonged economic downturn, Japan still has the largest economy in the region and is well placed to contribute to regional growth. However, any overt leadership bid would trigger a response born of lingering resentment over Japanese actions during the Second World War; something that still detracts from Japan's regional relations. Compared to its two neighbours, South Korea has neither the size nor the resources to drive regional processes. Instead, it is contributing to regional developments in certain niche areas, for example the East Asian Vision Group.

China, however, is the biggest regional state in terms of economy and population. It is also now the largest trading partner with all East Asian states. With these ties have come additional economic and social prosperity for China's Asian partners, which only encourages deeper ties to be formed in other areas. If the flag follows trade, then China is well positioned to assume the mantle of regional leader and, indeed, may well have already done so in a *de facto* manner. As former ASEAN Secretary-General Ong noted, the rapidity with which China has engaged with the ten ASEAN states in economic and finance matters as well as in a host of other areas (from agriculture to youth affairs)¹² has required the Southeast Asian states to develop common positions on many areas where there was previously uncertainty or disagreement. In practical terms this meant that when Japan and South Korea later began to negotiate their economic and finance agreements with ASEAN a fixed position – one relevant to China's needs – had already been formed. It was not possible to alter that position without first seeking the agreement of all ten states as well as China. Hence, it can be concluded that the regional order that is emerging is doing so along the China–ASEAN axis with Japan–ASEAN and South Korea–ASEAN fixed into subsidiary roles.

A related issue, however, is the way in which China might assert its leadership, particularly when challenges emerge to its core interests. If CAFTA was an explicitly security-focused agreement then it would be possible to conceive of strategic responses to threats, yet as it is an economic agreement then issues of trade or investment-based responses by China to perceived threats need to be explored. One such issue occurred in September 2010 when China restricted the sale of rare earths to Japan. While it is debatable as to whether the minerals trade was suspended or simply placed under enhanced review, the outcome – the absence of rare earth shipments to Japan – was the same. This action was seen as linked to the arrest of a Chinese fishing captain who rammed a Japanese coastguard vessel off the Senkaku/Diaoyu islands. This was the first time that China had used an economic sanction to respond to a territorial challenge. As China holds the largest supply of rare earth minerals, its actions sparked international concern and calls for 'an end to government "interference with commercial sale of rare earth elements, domestically or internationally, to advance industrial policy or political objectives"' (Richardson 2010). Given that China has become the largest trade partner with almost all other Asian economies, its ability to dictate terms has increased proportionately. Although China has long denied any ambition to become a regional (or global) hegemon, its actions in this instance suggest that as its economy

grows and its external trade ties expand its ability to influence the outcomes of regional issues will deepen. Given the economic disparity between China and Southeast Asia, and the presence of similarly contentious territorial/security issues (such as the South China Sea), the question of ‘who leads?’ and ‘who follows?’ becomes more significant for the ten states of ASEAN.

Given these issues, it is not currently feasible that Mattli’s leadership model can be applied in East Asia. Webber takes a broader approach, suggesting that ‘a coalition of leading states may provide the requisite leadership for successful integration’ (Webber 2001: 345). As the region still lacks a single state able to drive forward regional integration, it is more likely that Webber’s concept of a group of states will be the most likely scenario for East Asia. Here we see the importance of the ASEAN Plus One (China) relationship. However, a future key challenge will be for ASEAN to continue to maintain its central policy relevance as a trusted actor in regional economic (and other) affairs. If China’s economic strength begins to translate into political and strategic force – which ASEAN is unable to oppose because of its economic reliance on access to China’s markets – then it may well emerge as the leader state but, given tensions between China and Japan as well as South Korea, plus external states such as the United States, it is unclear whether or not this would be a positive outcome for the region.

Towards a new regional (Economic) architecture

One development that may reduce possible political and strategic concerns to a stronger China is the creation of binding supranational rules of behaviour. Here, the agreement for an independent surveillance unit as part of the CMIM, as well as the dispute settlement mechanism (DSM) as an addition to the 2002 Framework Agreement, are important steps towards developing both a China–ASEAN economic order as well as a regional order that mitigates risk and provides transparency for all parties. In the case of AMRO, this is the first time that participating states have been willing to have their policies and actions scrutinized by an independent regional body. The 2004 decision to establish a dispute settlement mechanism is the only time that China has been willing to have its decisions policed by an external process. With both of these initiatives there is a clear modification away from the soft law environment characterized (in this context) by the ASEAN Way and China’s adherence to its non-interference doctrine towards the utilization of hard law able to enforce an outcome. As such, the limitations for regional integration imposed by sovereign concerns of member states have started to be eroded and a more flexible definition of non-interference enplaced. As noted above, even though the regional DSM has not yet been tested, its presence as part of the regional policy landscape encourages states (in a contrary way) to work more closely and to negotiate compromise solutions, so that the uncertainty of the legal process does not have to be faced. At present, this erosion is still limited to the economic sector. However, this was also the sector to lead bilateral and regional integration. If the logic of that process (starting with the least contentious area, building confidence and moving to other areas of cooperation) still holds, then this shift to hard law may – in future – be replicated in other sectors as well.

Conclusion

Deng Xiaoping once wrote that China should ‘not raise its head’ and become a leader nor ‘should it allow its true abilities to become known’. Yet, when it comes to economics, China is increasingly lifting up its head and showing its strength. The foundation for this change has been China’s economic ties with Southeast Asia. Although this is not a recent development, in the past two decades it has become an important relationship for China, for ASEAN and for the wider region.

The successful conclusion of the Chiang Mai Initiative and the subsequent CMIM highlighted the change in the regional economic order. Where Japan had once been the unchallenged economic leader, China was now its peer. Taken as part of a longer trend, there is no evidence to suggest that this situation will reverse. Indeed, with China having overtaken Japan as the world's second largest economy in 2010, it can be concluded that China now leads Japan in the region. The reason for this change in economic leadership partly lies in the successful realization of the China–ASEAN Free Trade Agreement. This has brought measurable economic, trade and investment benefits to both parties. As a template, CAFTA also requires Japan and South Korea to modify their engagement with ASEAN – a development that has implications for the creation of a regional order in East Asia.

Despite these benefits, questions remain as to where this shift in leadership will lead the region: towards a China-dominated regional order – where political or strategic challenges can be responded to with economic force – or to a more unified region where there are clear and binding rules on all actors. At present there are few incentives for China to encourage the spread of hard law principles in regional initiatives, which leaves it in ASEAN's interest to attempt to balance China in conjunction with other regional and extra-regional actors. In the end, however, there are also no indications to suggest that the China–ASEAN economic relationship will be downgraded. If anything, its role as a successful example of China's economic engagement with the regions on its periphery means that China has a strong incentive to continue to develop its ties with the Southeast Asian economies – seeking new opportunities for trade and investment, deepening other aspects of its ASEAN partnership, and forging a new economic order in East Asia.

Notes

- 1 Guangxi actually established a land-port with Vietnam in 1978, but tensions over Cambodia and the subsequent Sino-Vietnamese War soon shut it down.
- 2 This was actually the second informal meeting, albeit the first informal meeting of the ASEAN Plus Three group. The first informal meeting was held in 1996 between the (then) six member-states of ASEAN and the four non-ASEAN Southeast Asian states. For more information see: ASEAN 1996.
- 3 See, respectively, ASEAN 1997b and c.
- 4 For more information see paragraph 4 of the *Joint Statement on East Asia Cooperation*, Manila, 28 November 1999, (ASEAN 1999).
- 5 Comment made by a senior ASEAN official during a visit to Hong Kong, 1 November 2005.
- 6 See, respectively, ASEAN 2007c, d, e.
- 7 For a detailed overview on the GMS see www.adb.org/gms.
- 8 On this point, with reference to the GMS, see the proceedings of Ministerial, Forums and Working Groups meetings held at <http://www.adb.org/GMS/gmsproc.asp>
- 9 A currency-swap arrangement is where a number of countries agree to purchase each other's currencies in order to reduce the impact of speculators as well as abrupt shortfalls in the value of a particular currency in the arrangement.
- 10 It was suggested by Zheng that 'The central government's decision to propose CAFTA in 2000 was strongly driven by the provincial government leaders in the southwest, mainly Guangxi, Yunnan, Chongqing and Sichuan'. If accurate, this links the origin of China–ASEAN economic ties back to the sub-national strategy of opening up of land ports between the 1970s and early 1990s, as discussed in the opening paragraph of this chapter. See *Knowledge@Wharton* 2010.
- 11 Text amended to reflect past tense.
- 12 For a good summary of the relationship see: ASEAN 2005b.