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**Not for Political Domination: China's Foreign Economic Policy
towards Vietnam, Singapore, and Malaysia in the Open Era**

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78,242 words

Submitted in fulfillment of the requirements for the Degree of PhD.

Abstract

This thesis is an exploration of China's bilateral foreign economic policy (FEP) towards Vietnam, Singapore, and Malaysia in the open era. It expects to answer the central question that what motivated China's bilateral economic cooperation with small partners? Is it for political domination, or is it for national prosperity?

Drawing upon the evidence from primary materials, this thesis challenges the hypothesis that China, as a rising economic power, intends to generate political gains from the creation of trade asymmetry of small partners. In contrast, this thesis argues that China's bilateral economic cooperation with individual ASEAN members is for the pursuit of prosperity; in this process, the shared concerns of Beijing's management of bilateral economic relations with individual ASEAN members are to raise the national income and to sharpen the national competitiveness in exports. In other words, Beijing's FEP at bilateral level has the very strong implication for national economic development in general. Contrary to the realist expectations about foreign trade, this thesis shows that China did not take initiatives in bilateral economic cooperation to ensure the advantageous political gains; in addition, this thesis also finds that different political relations did not seem to affect the implementation of China's bilateral FEP towards individual partners. By revealing China's preference order of foreign economic cooperation at different levels, this thesis also argues that the calculations of welfare effects, rather than the consideration of relative gains, is more likely to be the determinant of China's foreign economic behaviors.

Author's disclaimer

I declare that, except where explicit reference is made to the contribution of others, that this thesis is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature:

Printed name: Ariel Hui-min Ko

Acknowledgement

I find that the writer Haruki Murakami's self-reflection as a marathon runner is the particularly suitable metaphor of my PhD study. What is really important is to reach the goal I set myself, give it everything I have, endure what needs enduring, and hope that in the end, I will reach a place I am content with. In this process, I am greatly indebted to my excellent supervisors, Professor Jane Duckett and Professor Alasdair Young. Without their invaluable guidance, encouragement, and appropriate push, the completion of this thesis would be impossible. They also show me the role models as a scholar: be precise and critical, but always be aware of one's own limitations and possibilities of improvement. Carrying out this spirit, I assume all mistakes and omissions in this thesis are my sole responsibility, and I hope it can be turned into a better work in the future.

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During these years, I owe large gratitude to my family for their unwavering faith and generous support. And thank to Jack Gallagher, for his love, company, and great sense of humor.

Abbreviations

ADB	Asian Development Bank
AFC	Asian Financial Crisis
AoA	Agreement on Agriculture
AP	approved permit (Malaysia)
APEC	Asia-Pacific Economic Cooperation Forum
APMT	Asia Pacific Mobile Telecommunications Satellite
APO	ASEAN Plus One
APT	ASEAN Plus Three
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEAN-PMC	ASEAN-Post Ministerial Conferences
ASEM	Asia Europe Meeting
ATC	Agreement on Textiles and Clothing
BNM	Bank Negara Malaysia
BOP	balance of payment
CCP	Chinese Communist Party
CGDK	Coalition Government of Democratic Kampuchea
CIC	China Investment Corporation
CMI	Chiang-Mai Initiative
COMECON	Council for Mutual Economic Assistance
CPM	Malayan Communist Party
CPV	Communist Party of Vietnam
CSFTA	China-Singapore Free Trade Agreement
CSSD	China Singapore Suzhou Industrial Park Development Company
DPRK	Democratic People's Republic of Korea
DTA	double taxation agreement
DRV	Democratic Republic of Vietnam
EAEG/EAEC	East Asian Economic Grouping/ East Asian Economic Caucus

EAS	East Asian Summit
EDB	Economic Development Board (Singapore)
EEZ	exclusive economic zone
EHP	Early Harvest Program
EP	export promotion
EU	European Union
FDI	foreign direct investment
FECs	foreign exchange certificates
FEP	foreign economic policy
FIE	foreign-invested enterprise
FTA	free trade agreement
FTC	foreign trade corporation
G-2-G	government-to-government
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDP	gross domestic production
GIC	Government Investment Corporation (Singapore)
GLC	government-linked company (Singapore)
GMS	Great Mekong Sub-region
ICSID	International Center for Settlement of Investment Disputes
IDA	International Development Association
IFC	International Finance Cooperation
IMF	International Monetary Fund
IMSGT	Indonesia-Malaysia-Singapore Growth Triangle
ISR	Internal settlement rate
IT	information technology
JV	joint venture
LDC	least developed country
MAS	Monetary Authority of Singapore
MFN (then NTR)	most-favored nations (then normal trade relations)
MIGA	Multilateral Investment Guarantee Agency

MFA	Multifiber Agreement
MNE / TNC	multinational enterprise / transnational company
MOFCOM, 2003-	Ministry of Commerce, 2003-
(MOFTEC, 1993-2003;	(Ministry of Foreign Trade and Economic Cooperation, 1993-
MOFERT, 1982-1993)	2003; Ministry of Foreign Economic Relations and Trade, 1982-1993)
MOU	memorandum of understanding
NAFTA	North American Free Trade Agreement
NEP	New Economic Policy (Malaysia)
NDRC	National Development and Reform Commission
NIE	newly-industrialized economy
NGO	non-governmental organization
NPC	National People's Congress
NSC	New Security Concept
NTB	non-tariff barrier
ODI	outward direct investment
OEM	original equipment manufacturing
PBC	People's Bank of China
PLA	People's Liberation Army
PRC	People's Republic of China
PTA	preferential trade agreement
RMB	<i>Renminbi</i> , currency of PRC
ROC	Republic of China (Taiwan)
RoO	Rules of Origins
SACU	Southern African Customs Union
SAFE	State Administration of Foreign Exchange
SETC	State Economic and Trade Commission
SEZ	special economic zone
SGX	Singapore Stock Exchange
SIP	Suzhou Industrial Park
SIPAC	Suzhou Industrial Park Administrative Committee

SITC	Standard International Trade Classification
SND	Suzhou New District
SOE	state-owned enterprise
SME	small- and medium enterprise
SSBC	Singapore-Shangdong Business Council
S&T	science and technology
SWF	sovereign wealth fund
SZETC	Singapore-Zhejiang Economic and Trade Council
TPR	trade policy review
TRIPS	trade-related intellectual properties
TRM	transitional review mechanism
UMNO	United Malay National Organization
UN	United Nations
UNCLOS	UN Convention on the Law of the Sea
USSFTA	US-Singapore Free Trade Agreement
VAT	value-added tax
VMR	Voice of Malayan Revolution
WFOE	wholly foreign owned enterprise
WSIP	Wuxi Industrial Park
WTO	World Trade Organization
ZOPFAN	Zone of Peace, Freedom, and Neutrality

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Chapter 1: Introduction: motivation revisited

1. Introduction

From its open up to the world economy in 1979 onwards, People's Republic of China (PRC, hereafter, China) has acquired the impressively unabated economic growth. Along with the increased economic cooperation at global and regional levels, China's political influence is raised concomitantly. The economic strength and political influence therefore constitute the foundation of China's rise and has attracted heated debates on its implication to the international political economy, as well as the potential shifting of balance of influence in Asia; by the geographical proximity and historical linkage, China's emergence as an economic and political power is viewed to project the most on Southeast Asia. The fact that China has paid close and consistent attention to its economic relationship with the Association of Southeast Asian Nations (ASEAN), particularly since the early 1990s, has generated large amount of empirical studies about the motivation and objectives towards ASEAN as a whole; departing from this intellectual basis, this thesis intends to move further to explore the relatively ignored but equally important questions: whether or not China took the same initiatives to enhance the economic cooperation with individual ASEAN members? How did it come about and what form did China adopt? The answers are expected to lead to the closer examination of the bigger controversial topic in both academia and policy communities, namely, why did China seek to enhance economic cooperation with partners? Is it motivated by the ambition of power/influence expansion, or does it reflect China's pursuit of national prosperity?

This thesis is designed to fill the gap of existing literature regarding China's enthusiastic economic activities with Southeast Asia. Regardless of their various arguments, the underlying theme of existing literature has appeared to focus on to which extent China's rising power and its related foreign approaches towards ASEAN would challenge the US interests and predominance in the region. Although China's rise indeed implies large to world politics, the implicit presumption that China's policies towards ASEAN is

primarily determined by the US factor may lead to the over exaggeration of the need for China to prepare for future power competition against US, while the role of ASEAN as a whole in this game is downplayed as merely a pawn. It explains why China's approaches towards individual ASEAN members have been ignored: these member states are simply too weak to yield genuine influence to China's power competition against US, therefore the importance of bilateral interactions could be negligible in the game. Yet, the accentuation of security dimension as if it is the only one determinant of China's foreign economic policy (FEP) obviously compromises the equal significance of the other explanatory variable that as the representative institution, the state of China has the stake in national prosperity. To serve this goal, Beijing's FEP choices might not be dominated by the zero-sum rationale but the consideration of potential welfare effects.

The overall argument of this thesis is that China's bilateral economic cooperation with individual ASEAN members is not motivated by power ambition but the aspiration for national prosperity; in this process, the shared concerns of Beijing's management of bilateral economic relations with individual ASEAN members are to raise the national income and to sharpen the national competitiveness in exports. In other words, Beijing's FEP at bilateral level has the very strong implication for national economic development in general. As my analytical framework (see section 3.1) suggests, if China's FEP is primarily motivated by the ambition of power/influence expansion, China should place the utmost emphasis on the manipulation of bilateral trade relations, because this approach promises the most certain political gains through the creation of trade dependency in favor of the external ambition of the large partner. However, main findings from this thesis are not consistent with this realist expectation but point to the other direction. Since the open up in 1979, China has sought to acquire the broad foreign economic interests through trade and foreign direct investment (FDI); to this end, Beijing's FEP in the open era has been characterized by the carefully-controlled unilateral liberalization, and the simultaneous attempts of participation in multilateral trade cooperation. In addition, findings from the three case studies in this thesis demonstrates that China did not take initiatives in advancing bilateral cooperation with individual ASEAN members but the other way around, which is resulted from the

calculations of the potential welfare effects from both sides. Taken together, these findings suggest that China's FEP since the open up is more consistent with the liberal expectation; namely, although states may remain constrained by the international distribution of power, the quest of political ascendancy over trading partners may not always be the dominant motivation behind the national FEP. To meet the aggregate societal demands for economic growth, the primary criteria for states' cooperative choices would be the degree of utilities.

As the foundation of this thesis, this chapter is structured as follows. Section 2 will provide the review of existing literature as to the competing interpretations about China's 'economic first' approach towards ASEAN collectively, and the related debates on the implication of China's rise in the wider context. It will be followed with the quick examination of the three cases' distinctive perceptions about and political approaches towards China, because they might serve as the critical intervening variable to China's FEP at the bilateral level if the FEP is motivated by power. I will then proceed to the comparison of different assumptions of world politics and expectations about trade from both realism and liberalism, because they are the intellectual roots of existing literature, and will inform the establishment of my analytical framework. The methodology of this thesis will be drawn in section 3; I will explain the shapes and preference orders of two sets of 'ideal-types' of national FEP, which are derived from the theoretical expectations about trade from realist and liberal IR theories respectively for the study in the subsequent chapters. Section 3 will also cover the justification of my selection of cases, as well as the range and extent of primary research for this thesis. The overview of structure of this thesis will be demonstrated in section 4.

2. Literature Review

2.1 China's 'economic first' approach towards ASEAN as a whole

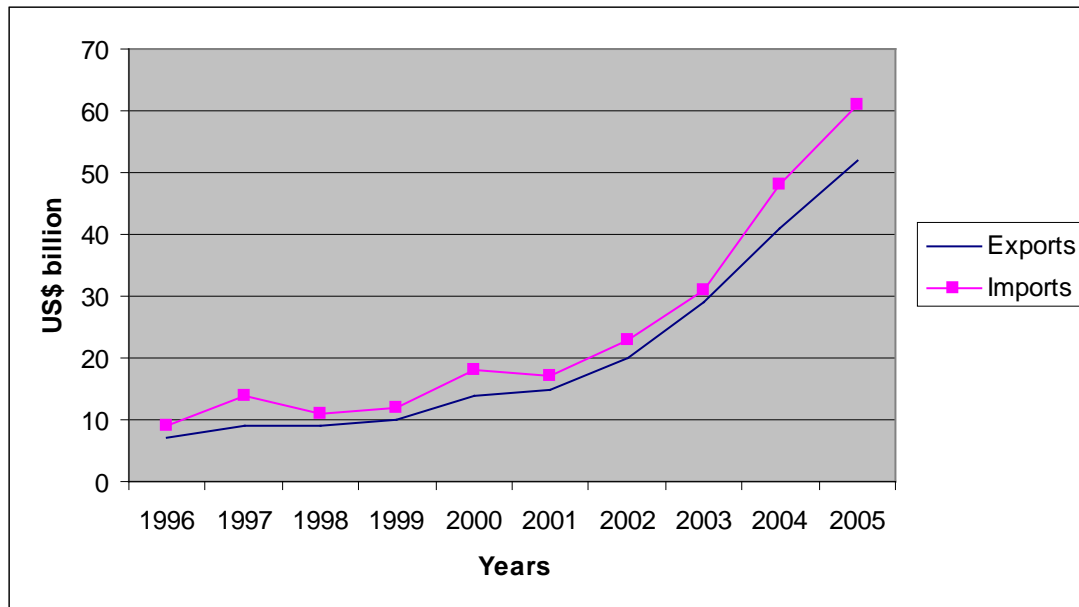
China's relations with ASEAN as a whole in the open era have gone through significant twists and turns that has invited exploration about why it happened. During the 1980s,

although worries about China's export of communist insurgencies and the claims of authority over ethnic Chinese remained prevailing in Southeast Asia, China's heightened involvement in Vietnam's intervention into Cambodia (and by extension, the Soviet influence) prompted ASEAN to seek the de facto alignment with China for collective security (Ba, 2003: 625-626). Hanoi's withdrawal in 1989 and the wane of Soviet influence with the end of the Cold War served as the important backdrop for ASEAN members to normalize the political relations with China and to invite external players to the ASEAN-led cooperative mechanisms, including the giant neighbor in the North. Yet, for the latter, China responded hesitantly because of its suspicion about the potentially detrimental effects on national sovereignty brought by the multilateral institutions (Kuik, 2005: 105-106); its behaviors even triggered ASEAN's misgiving that China was pursuing the 'talk and take' strategy (i.e. the so-called 'creeping assertiveness') towards South China Sea and was taking advantage of the perceived power vacuum left by the US in the first half of the 1990s (Leifer, 1995; Storey, 1999). However, since the mid-to-late 1990s, China has consistently taken actions to back up its emphasis on friendship and goodwill in the relations with ASEAN, in terms of proposing initiatives to enlarge the scope and degree of exchanges in multiple fields (Glosney, 2006: 24-25), which was argued to reflect Beijing's efforts of eliminating the fears of a 'China threat' (Cheng, 1999). Among them, cooperation in the economic realm appears the foremost approach that China has adopted; it leads to the stably growing bilateral trade (see Figure 1.1) and the signature of China-ASEAN Free Trade Agreement (China-ASEAN FTA) that was proposed by Beijing in 2000.¹ The Free Trade Area between China and ASEAN has taken effect since 1 January 2010.²

¹ Joint Statement of ASEAN-China Commemorative Summit, 'Towards an Enhanced ASEAN-China Strategic Partnership,' Nanning, China, 30 October 2006. Available at <http://www.aseansec.org/China-Com-Summit.Doc> (accessed 16 November 2009).

² 'China-ASEAN FTA to Boost Intra-regional Trade: Business Leader,' *Xinhua*, 31 December 2009. Available at http://news.xinhuanet.com/english/2009-12/31/content_12737265.htm (accessed 1 January 2010).

Figure 1.1 Trends of China's trade with ASEAN, 1996-2005³



Source: ASEAN Secretariat (2009: 82-83).

Although Beijing has reiterated that the ‘economic first’ choice is for smoothing the path to cooperative dealing with outstanding problems in the future,⁴ it did not stop the scholarly debates regarding China’s ‘real’ motivation behind this approach, namely for buying influence in order to compete against US and its alliance, or for national economic development (and the maintenance of regional stability); proponents on either side offer contradictory interpretations of the same events. For example, Robert Sutter (2005: 177) argues that Beijing’s recent attentive and accommodating diplomacy has been used along with the attraction of China’s growing economy to assuage ASEAN’s concerns in order to win greater influence at the expense of US in the area, while David Shambaugh (2004/05: 76) contends that Beijing’s new approach is not merely part of the larger ‘charm offensive’⁵ but represents the ‘fundamental compromises between limiting

³ The data is chosen to start from 1996 because it is the first year to include Vietnam, which joined ASEAN in 1995.

⁴ For example, the Chinese Foreign Minister Li Zhaoxing noted that ‘... [w]e are all flexible, pragmatic and innovative. Under the principles of addressing easier problems before moving on to thornier ones and gradual progress, we start with tangible economic and trade cooperation and then extend it to other areas.’ See ‘Speech by Foreign Minister Li Zhaoxing at the 10+3 Ministerial Meeting,’ Vientiane, Laos, 27 July 2005. Available at <http://www.mfa.gov.cn/eng/wjzb/zjzg/yzs/dqzzywt/t206079.htm> (accessed 16 November 2009).

⁵ See Limaye (2003) and Kurlantzick (2007).

its own sovereign interests for the sake of engagement in multilateral frameworks and pursuit of greater regional interdependence;’ in his view, China’s growing influence needs not result in a reciprocal decrease in the US power in Southeast Asia and could positively contribute to the reshaping of regional order. Both Sutter and Shambaugh have made it clear that their discussion is set against the background of China’s rise and how it affects the nature of the regional system as well as the international structure of power – in other words, to which extent China’s rising power and its related foreign approaches would influence the US interests and therefore challenge the US predominance in the region. This theme has appeared as the underlying concern running through most of the literature as to China’s behaviors towards Asia in general and towards ASEAN in particular. Meanwhile, the terms ‘power’ and ‘increased influence’ of China appear often to be used interchangeably; it reflects the general assessment of China’s ‘uneven growth’ of its various forms of power in both academic and policy communities.⁶

To facilitate this study, I attempt to separate the dominant debates regarding China’s motivation behind its ‘economic first’ approach towards ASEAN from the implication of China’s regional rise in the wider context in my literature review. This choice is out from the concern that since the central inquiry of this study is whether or not China seeks political dominance over individual ASEAN members through economic means, to focus on somehow conflicting reading about what are the principal drivers and considerations behind China’s approach towards ASEAN collectively would help pinpoint factors that determine the design and implementation of China’s foreign economic policy (FEP) in general and the bilateral FEP towards my case countries in the following chapters. Yet, because China’s rise is hugely significant that it could well be the direct cause to the shifting of economic and strategic landscapes in Asia, I will also offer a succinct overview of the competing interpretations of why China changes its regional posture in section 2.3. The focus will be the examination of scholarly explanations of what China stands for that leads to the changes of how it acts towards ASEAN, rather than on the

⁶ For example, David Lampton (2008) argues that the biggest challenges China is likely to present to the rest of the world will be in the domains of economics and ideas, not military power; also see the series of *Annual Report to Congress: Military Power of People’s Republic of China* prepared by the US Department of Defense since 2002.

assessment of how far China's growing influence in the region has come about because it is beyond the scope of this study. In other words, in the discussion of this part, examination on the 'predictions' of what China might do and become in the future will be deliberately avoided. Section 2.4 will offer the quick survey of the literature as to the bilateral relations between China and my three cases, namely Vietnam, Singapore, and Malaysia, with the specific focus on the three ASEAN members' approaches towards the rising China as the background information for the following case studies. The theoretical foundation of these debates on the interpretations of empirical evidence will be discussed in section 2.5, while it will help generating the analytical framework of this thesis.

2.2 Why did the dragon economically look south?

2.2.1 Aspiration for power through economic statecraft

For scholars who maintain that China's recent 'economic first' approach is for political ascendancy in Southeast Asia (Ba, 2003; Foot, 2005; Frost, 2007; Haacke, 2002; Kuik, 2005; Ravenhill, 2007; Sutter, 2005; Wang, 2007; Yoshimatsu, 2008; Zha, 2002), the trade activism, or, as coined by Frost (2007), the commercial diplomacy, is the reflection of China's exercise of subtle strategy that is contingent, tactical, and based on a cost-benefit analysis. Although opinions vary on how far China intends to achieve – that are ranged from ensuring its core interests to replacing the US as the hub of regional security-alliance system, consensus centers on that China has utilized its economic ascendancy as the tool to influence the political and security developments to its favor (at least in the long run) in the region. This strategy is argued to rely on the 'positive-sum' economic incentives, namely the benefits of access to the dynamic Chinese economy, and the use of this 'fluid and flexible' medium makes explicit diplomatic or coercive intervention unnecessary (Frost, 2007: 96-97; Wang, 2007: 19). Therefore, China's proposal for an FTA with ASEAN could be viewed as the concrete example of economic statecraft that is employed to facilitate China's 'peaceful' rise; this line of arguments could be summarized by Wang (2007: 3) that the FTA is used as 'a foreign policy instrument to advance [China's political] interests and power, and its increased power helps acquire more wealth.' In other words, China's increased national wealth, which is

the result of its open-door policy since 1979, serves as the critical foundation to expand China's power in the region and the reciprocal mechanism is consolidated between China's pursuit of wealth and power. Yet, although these scholars agree that China could 'acquire more wealth' through its 'economic first' approach that promises the access to natural resources and market in as well as the strengthened investment links with Southeast Asia, the realization of political goals that could serve the increase of China's influence is described to overshadow the economic gains in their analyses.

In this group of analyses, China's pursuit of increased influence in Southeast Asia through the utilization of economic rewards is argued to be driven by the anxieties of regime survival since the aftermath of Tiananmen; yet, with its phenomenal economic growth, the source of anxieties has gradually shifted to the worries about the potential containment and encirclement from other powers against China's rise in the mid-to-late 1990s (Ba, 2003; Haacke, 2002; Kuik, 2005; Wang, 2007; Yoshimatsu, 2008). The shift is argued to be in accordance with China's changing attitude towards the multilateral institutions led by ASEAN, and the breakout of Asian Financial Crisis (AFC) in 1997 is viewed to offer China an opportunity to effectively employ its economic statecraft (Foot, 2005; Haacke, 2002; Kuik, 2005; Sutter, 2005). In this process, the continued uncertainties in China's relations with US and the US predominance are argued to be the determining factors behind China's adoption of 'economic first' approach to consolidate the 'strategic partnership' with ASEAN (Ba, 2003; Foot, 2005; Frost, 2007; Haacke, 2002; Sutter, 2005; Wang, 2007; Yoshimatsu, 2008).⁷

In order to expand political influence in its involvement with ASEAN, the near-term political goals that China intends to achieve through intensified economic exchanges are argued to be set in the forging of political alliance with ASEAN, so that ASEAN could have similar stance on international issues with China. The process is said to start since the early 1990s. As the significant consequence of its open policy, Ba (2003: 631) argues that China's increased dependence on the world economy has made it more vulnerable to

⁷ Growing from the China-ASEAN dialogue in 1991, the comprehensive and deepening cooperation in many areas of mutual interests is claimed to enhance the 'strategic partnership' for peace and prosperity between China and ASEAN. See note 1.

external pressures; while the short-term economic sanctions and political isolation after Tiananmen heightened Chinese insecurities about its relationship with the world and how the relationship would affect regime survival. It is argued (Ba, 2003: 632) to be the driving force behind China's 'good neighbor' policy through which China began to make overtures to ASEAN, because ASEAN has shared China's concerns over the trade-linked political conditions as well as the push for political and economic liberalization from the US-led West. Since governments on both sides have relied on export-propelled economic growth to bolster their ruling legitimacy, in Ba's view (2003: 632), ASEAN offered China the '... attractive trading partners and political allies that shared many of China's developmental priorities and sensitiveness about external interference.'

The suspicion about the Western 'conspiracy' in ASEAN was further surfaced after the breakout of AFC, which is argued to be exploited by China to improve its image from a threat to a valuable and constructive partner (Ba, 2003; Frost, 2007; Haacke, 2002; Kuik, 2005); Foot (2005: 144) therefore asserts that 1997 is the 'turning point' of China's shift in strategy for expanding influence in the region. Since the faulty policy remedies from the US-backed IMF and the perceived apathetic Japan triggered the 'resentments' of the governments in ASEAN (Ba, 2003: 635-636),⁸ Frost (2007: 104) argues that to some extent, it gave China the chance to just 'walk in' to a situation created mainly by other Asians and downplayed or ignored by American policy makers. In assisting ASEAN going through the AFC, although China differentiated its approach relative to those of US and Japan to serve the demonstration of China's friendship and goodwill towards ASEAN, it is argued that China's actual actions were for its own domestic needs and outflanking Japan's traditional leadership in regional economics (Ba, 2003; Frost, 2007; Haacke, 2002; Sutter, 2005; Zha, 2002). The strategy is viewed to be based on Beijing's cost-benefit calculation as evidenced by their examination on China's deeds.⁹ Largely

⁸ For the analysis of governments of ASEAN members' responses to the intervention of international financial institutions in the context of debates over global liberalization, see Higgott (1998).

⁹ The most critical response China had to the AFC is the insistence of not to devalue its currency, Renminbi, which has been used by many as the 'evidence' to support their various arguments regarding China's possible regional intentions. Yet, by tracing the opinions of Chinese leaders on the exchange rate policy in different occasions in early 1998, Cheung (2007: 35-38) points that depreciation of Renminbi was not up for Beijing's consideration in dealing with the crisis. Cheung explains that it is because (domestic) administrative methods, instead of currency depreciation, are deemed to be more suitable to stabilize the

unaffected by the AFC due to controls on its capital market, Sutter (2005: 178) argues that China's decision not to devalue its currency and the support for IMF's policy prescription is because they could ensure China's export-led economic growth and cost Beijing little. In addition, China's extra funding and support for Thailand and Indonesia were actually slow in coming as Beijing became more concerned with its own financial health and was particularly wary of deep involvement in Indonesia without significant political and economic reform there. However, at the same time, China took an active part in post-crisis monetary agreements initiated by Japan that aimed to establish a network of bilateral currency swap arrangements with ASEAN, as known as the Chiang Mai Initiative under the ASEAN plus Three (APT) framework. Comparing with China's previous opposition to Japan's proposal for an Asian Monetary Fund (AMF) in 1997, the contrast is read as China's attempts to stifle Japan's economic and political influence by limiting the similar sorts of cooperation mechanisms within the APT framework, so that the credentials that China had gained in the AFC could be further capitalized to boost its own influence on ASEAN, as well as to advance China's emergent leadership in regional cooperation (Ba, 2003; Foot, 2005; Frost, 2007; Haacke, 2002).

The positive outcomes that China acquired in the AFC is argued to increase Beijing's confidence in the employment of 'economic first' approach towards ASEAN, particularly when ASEAN had been made weaker and were experiencing a great sense of vulnerability and loss of direction (Foot, 2005: 150); the establishment of the China-ASEAN FTA is viewed as the tangible reflection. This view is based on the evaluation of ASEAN's economic significance to China. For example, Wang (2007: 17-18) finds that although China's increasing trade and investment ties with ASEAN have made the two sides become more economically interdependent, these relationship are still trailing those China have with US and Japan, albeit the gap is narrowing. In addition, by examining the trends of FDI stocks and flows, as well as their changing positions in the markets of Japan and US for five major categories of exports of China and ASEAN, Ravenhill (2007)

financial system in China. This point is of particular importance to my examination of the relevant literature in this chapter. It highlights that the debates were often based on authors' selective reading of the coexisting causes to China's policy choices, while the implications, rather than what actually happened, were hence drawn to back up their claims of China's intentions in the first place.

concludes that regardless of the overall economic value of the China-ASEAN FTA, the actual benefits from the agreement may be limited. Therefore, both Wang (2007) and Ravenhill (2007) argue that the reasons for China to sell the FTA to its secondary partner should be better explained by political considerations. Review of this group of literature suggests that the identified political considerations could be linked back to China's intention of forging alliance with ASEAN as discussed above. With the FTA proposal, China's offer of preferential market access is interpreted to again highlight China's willingness and capability to be a valuable and constructive partner for ASEAN, since ASEAN's anxieties about member states' ability to economically compete against China was pushed to 'new levels' after the AFC and China's WTO accession (Ba, 2003: 638). By countering ASEAN's apprehension about China as a threat to trade, investment, and jobs, the proposal for the FTA is viewed as Beijing's attempt to convince ASEAN that an economically strong China would open the door to prosperity for regional neighbors; while the more intertwined economic interests resulted from the China-ASEAN FTA is argued to strengthen ASEAN's concerted stance with China on important global and regional issues such as human rights, multipolarity, developing countries' position in the global economic order, territorial disputes in South China Sea and Taiwan problem (Foot, 2005; Haacke, 2002; Kuik, 2005; Wang, 2007), as well as to give China greater negotiating leverage vis-à-vis other regional groupings in global regimes like the WTO and UN (Ba, 2003: 641). By extension, the swift conclusion of China-ASEAN FTA is viewed to be designed to shed negative lights to similar offers from US, Japan and South Korea, because the initiatives taken by these active proponents for regional FTAs could potentially reduce the political effects brought by China's promise of economic benefits in Southeast Asia (Ba, 2003; Foot, 2005; Frost, 2007; Haacke, 2002). This line of argument therefore could be summarized by Ravenhill (2007: 192) that ASEAN's concerns about the economic threat from China prior to its WTO accession underscore the tactical brilliance of Beijing in proposing the FTA to ASEAN, especially the 'early harvest' provisions that offer immediate gains for ASEAN; it was a 'diplomatic masterstroke' to serve China's political goals in assuaging ASEAN concerns about China's intentions and in putting other competitors of trade activism on the defensive.

China's employment of 'economic first' approach toward ASEAN as the means to expand its political influence is argued to play a catalyst role in its shifting attitude – from reserved to proactive – about the ASEAN-led multilateral institutions, while the need to counterbalance the perceived US unilateralism is contended to be the foremost factor motivating Beijing's ASEAN policy (Ba, 2003; Foot, 2005; Kuik, 2005; Sutter, 2005; Wang, 2007; Yoshimatsu, 2008). Through the application of economic rewards and cooperation within the APT framework in which China has gradually emerged as the *de facto* leader, China is expected to project it as a status quo power to ASEAN; yet, it is argued not just an end itself but a *sine qua non* for China to continue expanding its political influence (Kuik, 2005: 114; Wang, 2007: 23). In this group of analysis, authors argue that Beijing's changes in strategies for power reflect the same zero-sum worldview about national security (and implicitly but equally critical, the CCP regime survival). Since Beijing cannot be certain about Washington's responses to the rising Chinese power, the fear that China's continuing growth could be thwarted by US and its Asian 'spokes' is argued to be the root for China's attempts to forge political alliance with ASEAN as a way to forestall the potential containment and encirclement against China. It is argued to be the real reason behind China's cultivation of amicable relations with ASEAN and the pursuit to sell the image as a peacefully rising power, while the means that China has relied is the 'soft' forms of power (Foot, 2005; Kuik, 2005). Meanwhile, the timing is viewed favorable to Beijing. Both Sutter (2005) and Wang (2007) argue that the shift of American strategic attention away from Southeast Asia after the end of the Cold War, followed with the subsequent narrow agenda of counter global terrorism, and the declining Japanese economic stature have created the opportunity for China to enhance its position in geopolitics. Yet, Foot (2005: 151-152) argues that Beijing realizes that its champion of 'multipolarity' is not a goal that could be achieved anytime soon with the existence of American absolute military strength and relative power in other spheres, and the realization enhances the imperative for China to improve relations with ASEAN for leverage and hedge against an uncertain future, with the aim of reducing the level of threat that US could pose to China. Therefore, Wang (2007: 22) contends that Beijing's utilization of economic means and the support for multilateral cooperation within the exclusive APT are the coded opposition to the US unilateralism and the

expression of Chinese preference for the ‘multipolar’ world (in which China acts as a great power), while with the pragmatic calculation of avoiding the premature showdown or confrontation with the US so that China could continue advancing its economic power and political influence.

2.2.2 Striving for prosperity through intensified cooperation

For those who see China’s enthusiasm for intensifying economic cooperation with ASEAN is motivated by the pursuit of national wealth (Cai, 2003; Cheng, 2004; Park, 2007; Roland-Holst and Weiss, 2004; Srivastava and Rajan, 2004; Suthiphand, 2002; Tongzon, 2005; Vatikiotis, 2003; Wong and Chan, 2003; Xiao, 2009), substantial economic benefits through trade creation, as well as closer policy coordination as the active response to the challenges brought by economic globalization, are identified as China’s major goals. In their analyses, China’s seeking for deeper economic integration with ASEAN, as represented by the formation of China-ASEAN FTA, is enmeshed with China’s involvement in ASEAN-initiated institutionalized cooperation; and it is viewed likely to promote the longer term efficiency and sustained aggregate economic growth for both sides. Therefore, China’s recent moves are interpreted to reflect the pursuit for better regional governance, for which China intends to play a constructive role to ensure the achievement of collective interests (Cai, 2003; Stubbs, 2002; Thomas, 2009; Wang, 2005; Xiao, 2009). In this process, China’s political influence indeed has increased but it is viewed to be the ‘natural’ outcome of China’s endeavor to establish a less instrumental but more norm-based regional cooperative framework that serves China’s benign national interests – namely, a stable and prosperous periphery so that China’s economic modernization can proceed (Thomas, 2009; Wang, 2005; Xiao, 2009). In addition, the increase of Chinese influence is argued not come at expense of other powers; to the contrary, China’s recent activism is viewed to reflect the imperative of preventing itself from being marginalized by regional bodies that function as the joints of the increasingly dense web of ‘complex interdependence’¹⁰ among Asian states in the era of accelerating

¹⁰ The concept ‘complex interdependence’ is proposed by Keohane and Nye (1989 [2001]). They argue that the world politics under the situation of ‘complex interdependence’ would be very different from the realist

globalization (Shambaugh, 2004/05: 97; Thomas, 2009: 138; Wang, 2005: 172). This line of arguments serves as the foundation for those who hold 'cautious optimism' about the development in China's policy towards ASEAN; for example, both Glosney (2006) and Percival (2007) contend that China has proved itself to become a better neighbor at present, and its recent contribution to regional peace and prosperity makes ASEAN at least more hopeful that win-win might become a reality, albeit it is too early to declare whether a more powerful China will try to dominate the region in the future.

In this group of analyses, China's pursuit of prosperity through intensified economic cooperation is often placed in the wider context of the emergent East Asian regionalism; in other words, China's seeking for strengthening economic ties with ASEAN, which has moved towards a more institutionalized manners, is viewed as Beijing's countermeasure to external uncertainties and constraints on China's economic modernization. Although the opening up of Chinese economy since 1979 highlighted its economic potential, the potential gradually served to construct very different image of China to individual ASEAN members. The international isolation that China was forced into after Tiananmen as the fallout of the economic sanctions imposed by the West as well as the collapse of the Soviet and Eastern European Communist regimes is argued to be the trigger for Beijing's adjustment to a more Asia-oriented foreign policy, with Southeast Asia as a major focus; therefore, Beijing has started to make more active efforts to reduce ASEAN's fears that China's economic growth would come at their expense, which is the foundation of the 'China threat' thesis (Cheng, 2004; Glosney, 2006; Wang, 2005). Nevertheless, Cai (2003) argues that Beijing's policy orientation also mirrored the shared anxieties between China and ASEAN about the potentially detrimental effects brought by 'competitive regionalism' in global economy.¹¹ Since EU and NAFTA have not only formed themselves into increasingly closed markets but have also come to the multilateral trade negotiations as blocs, it raised the concerns of China and ASEAN over the diversion of trade and investment flows (given their heavy dependence on these tow

assumptions, in which multiple channels connect societies, a clear hierarchy of issues does not exist, and force is an ineffective instrument of policy (pp. 21-25).

¹¹ On the issue of how external forces affect the development of East Asian regionalism with particular focus on APT, see Stubbs (2002) and Webber (2001).

major markets and their outward-oriented developmental strategy) and left China and ASEAN frequently in a much weaker bargaining position in multilateral negotiations. Cheng (2004) attributes this important external variable to Beijing's attempts to raise the level of economic cooperation with ASEAN in the first half of the 1990s, as exemplified by its endorsement of ASEAN's initiatives of establishing the ASEAN Free Trade Area (AFTA) and working towards an ASEAN Investment Area (AIA).

Although Beijing has started to pay more attention to strengthen economic cooperation with ASEAN as a whole since Tiananmen, the breakout of AFC in 1997 is argued to be the real driver to China's pursuit of institutionalized economic multilateralism in Southeast Asia (Cai, 2003; Cheng, 2004; Glosney, 2006; Wang, 2005; Xiao, 2009). Indeed, China's short-term assistance to help ASEAN weather the storm of AFC demonstrated its constructive role to ASEAN, therefore served to assuage the regional economic fears about 'China threat;' but what is more important for Beijing is assessed to be the realization of China's place in economic interdependence and the need for the creation of a formal regional mechanism to prevent the recurrence of similar crisis in the future (Glosney, 2006; Stubbs, 2002; Thomas, 2009). Although China stood relatively unscathed, the problems disclosed by the AFC that include the imperative of closer policy coordination and the revealed ineffectiveness of existing regional bodies such as APEC and ASEAN itself, are argued to be the catalysts to Beijing's active involvement in the development of institutionalized links with ASEAN so as to better cooperate on economic issues (Cai, 2003; Stubbs, 2002). The rationale is explained that since China has increased the investment in and trade with ASEAN, the economic health of ASEAN members was very much in its own interests (Cheng, 2004; Stubbs, 2002; Vatikiotis, 2003); and the awareness is viewed to be reflected on China's active involvement in long-term financial monitoring and assistance programs, such as the Chiang Mai Initiative under the emergent APT framework (Glosney, 2006).

Against this background, Beijing's proposal of the FTA with ASEAN in the third ASEAN-plus-China summit in Manila in 1999 is argued to be just one of the few steps for China to establish a comprehensive and close relationship with ASEAN, which also

involves cooperation in finance, regional development, technological assistance, macroeconomic coordination, and other issues of common concern (Cai, 2003; Cheng, 2004; Wong and Chan, 2003). Among them, to address ASEAN's concerns over trade and FDI competition is contended to be China's foremost goal of the FTA; it is expected to serve the demonstration that China's growth is not necessarily threatening to ASEAN (Cheng, 2004; Glosney, 2006; Percival, 2007). With its emergence as the world's new manufacturing hub, ASEAN has worried about the possibility that competition with China would crown out their export-driven growth, particularly with the likely increase in efficiency after China's WTO accession; meanwhile, ASEAN is also concerned that as China develops it will attract most of the investment that used to go to the member states and thus severely damages ASEAN's future manufacturing capabilities. With the establishment of the China-ASEAN FTA, it is argued that Beijing intends to further subside these fears since ASEAN's trade with China accelerated, albeit trade with the rest of the world stagnated for many years after the AFC; the momentum of continuing growth in bilateral trade is expected to advance by granting ASEAN tariff reduction before other WTO members and preferential access to the Chinese market. As to investment, in addition to Beijing's promise of increasing the Chinese investment in ASEAN, the emergence of a clearer 'China plus Southeast Asia' investment strategy within the global production chains are argued to help shift the relative FDI flows from China to Southeast Asia (Glosney, 2006: 29-32; Percival, 2007: 92-93). In other words, the foundation of China's claim of the 'win-win' outcomes brought by the China-ASEAN FTA is viewed to be the anticipation that China's economic growth will drive ASEAN's growth; as contended by both Cheng (2004: 270) and Percival (2007: 92), the reality of increased benefits that ASEAN has gained from economic cooperation with China is now often conflated with anticipation of substantial potential in the future.

Literature that draws on both quantitative and qualitative examination on the extent of the impact for both sides brought by the China-ASEAN FTA appears to support the positive prospect of co-prosperity claimed by Beijing (Park, 2007; Roland-Holst and Weiss, 2004; Srivastava and Rajan, 2004; Suthiphand, 2002; Tongzon, 2005; Wong and Chan, 2003). Although scholars warn that at the present stage, ASEAN is expected to face particularly

intense competitive pressure from China in view of the overlap in relative factor endowments, export markets and heavy reliance on FDI inflows from similar sources and all of which are related systematically to particular product categories, economic gains are viewed resulting from static trade creation and dynamic complementary within the China-ASEAN FTA. Although there will be adjustment costs in industries where ASEAN has no competitive advantage against China, the sheer size and the growth of Chinese economy implies that China's demands for imports from ASEAN, especially intermediate and capital goods, agricultural products and raw materials, would increase. Park (2007: 500) therefore argues that China represents a potential engine of growth for ASEAN; in addition, from the Chinese viewpoint, the collective economic size of ASEAN means that the region offers a meaningful opportunity to diversify both of its export markets and import sources. Furthermore, Roland-Holst and Weiss (2004) argues that although the new competition in regional commodity trade is emerging, the *de facto* regional hierarchy of value-added in East Asia remains largely unchanged; it means that China and ASEAN, given their similar levels of development and income, could both gain in the value-added capture where economies not only increase both exports and imports but also strive to maximize the skill margin between the two in the long term. These economic analyses, therefore, suggest that the interlocked economic interests between China and ASEAN through the formation of FTA will provide a firmer foundation for prosperity and stability since trade and investment between the two sides are by no means zero-sum games, while the realization of mutual benefits, in terms of aggregate economic growth, is highly likely, albeit it requires further careful policy coordination between China and ASEAN (Roland-Holst and Weiss, 2004; Suthiphand, 2002; Wong and Chan, 2003).

The policy prescription offered by economists seems to be in consistent with China's active engagement with ASEAN through the APT framework; it is viewed to lead to the subregional economic integration in East Asia with strong implication of China's seeking for better regional governance (Cai, 2003; Cheng, 2004; Thomas, 2009; Wang, 2005). The issue is argued to be related back to the exposed impotence of APEC to regional economies during the AFC; because China did not play an active part in the competition

between the Anglo-American neo-liberal model and the East-Asian state-involved model within the APEC, the emergence of APT serves as the alternative cooperative institution for China to establish a smaller but more integrated framework to facilitate trade liberalization and economic capacity-building (Cai, 2003; Cheng, 2004; Wang, 2005). Thomas (2009: 126-127) contends that the concern is reflected on the signing of the Framework Agreement on Comprehensive Economic Cooperation between China and ASEAN in Vietnam in 2004, because it requires both sides to abide the dispute resolution made by supranational institution; in Thomas's view, it represents China's partial abdication of foreign policy principles of sovereignty and non-interference in order to gain greater economic benefits, and thus demonstrates its 'significant step' forward in the development of regional economic governance. This approach is viewed to enhance the trust building in Southeast Asia, and further economic integration is supposed to provide a cushion for China's political and security cooperation with ASEAN, thus contribute to regional stability (Cheng, 2004; Wang, 2005). Nevertheless, although the strengthened economic ties are attributed to ASEAN's growing willingness to take into account of China's preferences, it is assessed that China still does not possess the sufficient capacity both for internal development and for external aggrandizement (Glosney, 2006; Percival, 2007; Thomas, 2009). In addition to the fact that US and Japan remain well positioned in Southeast Asia, China's increasing cooperation with ASEAN that covers a wide range of issues is still peripheral to the core ASEAN meetings and processes. Percival (2007: 33-34) therefore claims that China's growing influence in Southeast Asia rests on its restraint in requesting adjustment in ASEAN's policies and ASEAN's anticipation of additional benefits to be derived from closer cooperation with China in the future; under this circumstance, Thomas (2009: 138) argues that China can be seen as less a 'hub' but more of a 'spoke' of the pre-existing ASEAN, and the choice is motivated by Beijing's belief that it needs a safe periphery if China is to continue to prosper.

2.3 The grand debates on China's rise

The contradictory interpretations of China's 'economic first' approach towards ASEAN, in fact, are the extensions of the grand debates on the implication of China's rise. The rise,

as summarized by Shambaugh (2004/05: 64), could be seen in China's growing economic and military power, expanding political influence, distinctive diplomatic voice, and increasing involvement in regional multilateral institutions; while the new proactive regional posture is assessed to reflect in virtually all policy spheres that would not only function as the primary driver of wide-ranging changes in East Asia's economic, political and security alignments but also a major variable to the shifts of strategic and economic landscape at the global level (Keller and Rawski, 2007: 3). Yet, although China is more integrated into, and more cooperative within, the regional and global political and economic systems than ever in its history, the growing uneasiness about China's ultimate intention within policy communities in both East Asia and US is reflected on the hot scholarly debates; as pointed in Johnston (2003a), since the early 1990s, practitioners and scholars alike have argued increasingly that whether or not a rising China would become the primary source of instability in the US-dominated international political and economic order. Nevertheless, in the large literature that aims to explore whether Beijing is pursuing revisionist or status quo foreign policies, I find that the disagreements have, sometimes implicitly, revolved around the puzzle as to whether Beijing's worldview – or, to be more precise, the perceptions about threats to national security and the related countermeasures – has ever changed in the open era. The different readings on this issue wield direct impacts on the competing interpretations of China's 'economic first' approach and increasing engagement with the ASEAN-initiated multilateral institutions that are viewed either as the subtle and less costly means to power or as the reflection of Beijing's awareness of the utilities of cooperation for advancing the national pursuit of prosperity in 'complex interdependence.' The following discussion will offer the succinct overview of key works on both sides.

2.3.1 Persistent realpolitik thought, but changing tactics

For those who claim that the rising China would challenge the extant institutions, norms and power distribution (Foot, 2005; Goldstein, 2003; Roy, 1996; Swaine and Tellis, 2000; Sutter, 2005), the constant preoccupation of security dilemma is argued to determine Beijing's employment of the combination of economic and diplomatic means to increase

national power for self preservation within the US-dominated international environment. It highlights the persistence of the hard realpolitik thought in Beijing's policy community;¹² because China has always faced the threat to national security (and the overlapped CCP regime survival) in the international system, it would need to prepare for the worst scenario, particularly along its far-flung and vulnerable geographical periphery (Roy, 1996; Swaine and Tellis, 2000); in this regard, ASEAN member states are argued of strategic importance to China's security concern because they either abut Chinese borders and claimed territorial seas, or are involved in regional politics with US and Japan that can challenge China's vital interests. For example, Nathan and Ross (1997: 100-101) draws the historical experience in the 20th century to demonstrate the necessity for China to pursue the power ascendancy in Southeast Asia in order to prevent the recurrence of foreign invasion or strategic encirclement from the same powers which have strong presence in Northeast Asia. Since the end of the Cold War, the US and its ally, Japan, are claimed to be considered as the main adversaries in the region with their strong military and economic presence by Beijing (Roy, 1996), particularly when ASEAN is assessed to consciously adopt the 'hedging' strategy by inviting competing powers to maintain the multi-dimensional regional balance of influence (e.g., Acharya, 2003/04; Ciorciari, 2009). In addition to this security externality, Beijing's awareness of its relative vulnerability to both the use of force and its consequences, as well as the geographically- and historically-determined reality that China is always surrounded by potential adversaries, is argued to be the main factors in settling China's new approach to ASEAN, which aims to 'reassure those who might otherwise collaborate against a putative China threat' as what Germany did in the late 19th century (Goldstein, 2003: 58).¹³ It implies that China has to look for opportunities to gain more influence in the region at the expense of US and Japan for its defensive consideration, and the breakout of AFC in 1997 therefore is viewed to serve this strategic imperative (Ba, 2003; Foot, 2005; Frost, 2007; Haacke, 2002; Kuik, 2005; Sutter, 2005; Wang, 2007; Yoshimatsu, 2008; Zha, 2002). It is claimed to be particularly the case when the US influence is said to be

¹² On the issue of Chinese realpolitik, see Christensen (1996). In Johnston's language, it could be called 'parabellum strategic culture' (1998).

¹³ Goldstein (2003) therefore labels this broad parallel in China's strategic choice as the 'neo-Bismarckian' turn.

declined after the withdrawal of American forces from the Philippines in 1992, as well as the episodic and inconsistent US attention to the region until the terrorist attacks in 2001 (Sutter, 2005: 179), and when the tensions between ASEAN and Japan heightened (Hughes, 2009; Zha, 2002).

In order to achieve the power ascendancy in Southeast Asia, it is argued that Beijing has deftly used the more flexible and norm-involved diplomacy as the supplement to its economic statecraft, which is reflected on China's active engagement with APT; this approach is viewed to be driven by Beijing's aspiration to shape the 'rules of the games' for regional cooperation through APT, so that the operation of these institutions could fulfill a range of China's foreign policy concerns (Foot, 2005; Kuik, 2005; Yoshimatsu, 2008). In doing so, it is argued that Beijing claims to support the 'ASEAN Way' that emphasizes consensus and consultation in regional cooperation to cement China's own insistence on national sovereignty and non-interference foreign policy principles endorsed by the 'New Security Concept' (Foot, 2005; Yoshimatsu, 2008). Kuik (2005: 115-119) explains that this approach is of particular importance to China because to shape the design, dynamic, and direction of the 'embryonic' ASEAN-led cooperative institutions is central to achieve China's foreign interests, such as to successfully 'shelve the dispute and develop together' with ASEAN in South China Sea and to further isolate Taiwan; thus, Kuik (2005) claims that China's participation in the institutional setting of APT is bound to have a far-reaching impact on the evolving regional order. The combined use of economic statecraft and diplomacy to expand political influence in Southeast Asia therefore is viewed to serve rising China's aspiration of challenging the US predominance in the region (Foot, 2005; Sutter, 2005), and it is argued to be the clear example of China's overall 'grand strategy' so that its pursuit of power maximization within the constraints posed by the international environment could continue (Goldstein, 2003; Swaine and Tellis, 2000).

2.3.2 Shifting worldview, and peaceful coexistence with other powers

For those who maintain that China's regional rise represents a gradual and peaceful adjustment to a constructive power in global economic and political affairs, this process involves the shift of Beijing's perceptions about the collective management of shared problems within the extant international system, and has reflected on China's support for the more rule-based and norm-driven cooperative mechanisms as a means to promote its national interests (Hempson-Jones, 2005; Lampton, 2008; Medeiros and Fravel, 2003; Shambaugh, 2004/05; Thomas, 2009; Wang, 2005; Yahuda, 2005). Although it is argued that China's domestic social and political upheavals as well as the spiraling China-US relations could be the most likely sources of a reversion of this current direction of China's foreign policy (Johnston, 2003a; Lampton, 2008), the consensus seems to confirm that China has turned to be willing to cultivate mutual dependence on more issues, and may not become another Soviet Union that translated the wish to be richer and more powerful into a concerted military effort to replace the US as the predominant state regionally and globally. In other words, China's promotion of its 'peaceful rise' (*heping jueqi*)¹⁴ that emphasizes 'opportunities, not threat; status quo, not change; (co-)prosperity and progress, not instability or regression' to the international community could be a genuine pursuit.

With China's open process, the separation between 'domestic' and 'international,' as well as 'political' and 'economic,' is argued to be increasingly blurred and thus plays a catalyst role for Beijing's departure from the prevailing realpolitik mindset if China is to continue to prosper (Deng and Moore, 2004; Kim, 2006; Moore, 2005). The awareness that China's economic growth is increasingly subject to exogenous constraints, as foremost surfaced after Tiananmen, is contended to shift Beijing's strategic attention upon survival away from the 'traditional' security dilemma against other powers to the

¹⁴ First floated by China's then Vice-President of the Central Party School, Mr Zheng Bijian, to a largely Asian audience during the Boao Forum for Asia in Hainan province in 2003, the concept of 'peaceful rise' provides the international audience with an introduction of China's new strategic thinking about its own developmental path. The essence is that in order to achieve the goal of having a modernized, medium-level developed country in the mid-21st century, China will – and has to – take the peaceful external means, including to 'embrace economic globalization' and to 'transcend ideological differences to strive for peace, development, and cooperation with all countries in the world'. See the Chinese transcript of Zheng's speech delivered in Boao at http://news.xinhuanet.com/newscenter/2003-11/24/content_1195240.htm, and his English work about this issue on *Foreign Affairs* (2005).

impacts brought by the existing international economic order on internal stability. As explained by Wang (2004), the aftermath of Tiananmen escalated the anxieties that the stagnant economic growth could exacerbate China's extant social problems and risk the effects of Beijing's countermeasures, thus threatens the ruling legitimacy of CCP. Yet, the assessment that China is a big winner of the current international economy – namely, the 'economic globalization' – and is expected to take further advantage of it is argued to create a strong incentive for China to explore how economic globalization could be properly managed through interstate cooperation in order to accelerate those aspects consistent with its policy preferences while slowing the changes inimical to China's pursuit of prosperity (Moore, 2005: 125; 133-134). From Deng and Moore's perspective (2004), it implies a significant change of Beijing's concerns from the US power per se to how the power is exercised. Thus, Beijing's promotion of normative appeals such as the 'democratization of international relations' and the 'establishment of a fair and rational new international political and economic order' since the 1990s is interpreted as different from its previous expectation of the imminent emergence of a dispersed power configuration, but the reflection of Beijing's concerns on collective decision-making with particular attention to disadvantages confronted developing countries (Deng and Moore, 2004; Kim, 2006); it is argued to be the drive of China's move towards the institutionalized cooperation with ASEAN, which provides mechanisms for both sides to work together and to mitigate incipient conflicts (Thomas, 2009; Wang, 2005; Xiao, 2009; Yahuda, 2005). Shambaugh (2004/05: 69) contends that Beijing's perceptual and behavioral changes are expected to serve the core purpose of its 'New Security Concept;' for Beijing, the peaceful coexistence with other powers is not only possible but also desirable through the means of 'dialogue, consultation, and negotiations on an equal footing ... to solve disputes and safeguard peace.'

China's peaceful rise as a constructive player within international system is explained as the outcome of Beijing's 'learning' through the increasing engagement with multilateral cooperative institutions (Dittmer, 2008); the engagement, in Johnston's words (2003b), implies the socialization process that requires China's voluntary participation in the first place. The learning is argued to make Beijing realize that participation in multilateral

institutions could enhance its bargaining power in the international decision-making (Dittmer, 2008), while both Johnston (2003b) and Yahuda (2005) attribute China's increasingly active involvement with regional cooperation in Southeast Asia to the 'ASEAN Way' that emphasizes consultation and consensus to uphold national sovereignty and non-interference. Although this approach is viewed to determine the non-binding, 'soft' form of regionalism in Southeast Asia (Johnston, 2003b), Yahuda (2005) argues that it helps to mask intramural political differences and significant divergences in strategic outlooks among resident states in the region; as embodied in the ASEAN-initiated cooperative institutions, it is contended to offer higher 'comfort level' and distribution of utility for China to participate in order to facilitate the collective management of particularly difficult issues while not to oppose the American security alliance in Southeast Asia,¹⁵ and therefore contribute to regional order (Johnston, 2003b; Yahuda, 2008).

The rising China's commitments to Southeast Asia, including economic engagement, security assurance, opposing superpower domination and championing a level trade playing field for developing countries, is viewed to accelerate regional interdependence and coincided with the broad US interests (Lampton, 2005; Shambaugh, 2004/05; Yahuda, 2008). In addition to the assessment that US is not deliberately excluded from China's regionalization process (Yahuda, 2008), Shambaugh (2004/05: 92-93) argues that because China and US share converged views and interests on many of the key regional issues, it may well enhance their opportunities for tangible cooperation. The consensus among those who hold optimistic prospect about the future development of China's rise therefore leads to the appeal for the US to adapt its China policies for constructive cooperation, instead of zero-sum competition, based on the strategic interdependence, so that China's rise could be profoundly positive to the US and the international system (Lampton, 2005; Medeiros and Fravel, 2003; Shambaugh, 2004/05; Yahuda, 2008).

¹⁵ For example, Foreign Minister Tang Jiaxuan told US Secretary of State Colin Powell that China 'welcomes the American presence in the Asia-Pacific region as a stabilizing factor' in July 2001; similar assurance was subsequently offered in private to US officials and scholars (Shambaugh, 2004/05: 91).

2.4 China's bilateral relations with ASEAN members: the cases of Vietnam, Singapore and Malaysia

Since one of the purposes of this study is to move the debates forward by broadening the range of cases, I attempt to extend the investigation of China's motivation behind its foreign economic policy (FEP) towards the individual ASEAN members at the bilateral level. Vietnam, Singapore and Malaysia are selected as the cases for this study because of not only their separate economic significance to China, but also their divergent perceptions of 'China threat' and the according approaches in dealing with the rising power, as summarized in Table 1.1. Findings from the literature suggests that the three ASEAN members have different strategies in dealing with China is expected to serve my trace of China's FEP and the motivation; if China is interested in political domination over individual partners through manipulation of economic relations, China should be seen to have different sets of deals with each of them as the response to the three cases' specific political concerns over the rising China.

Table 1.1 Three cases' divergent perceptions, issues, and approaches with relation to China.

	<i>Perception of China threat</i>	<i>Sources of tension</i>	<i>Approach</i>
<i>Vietnam</i>	Real	South China Sea; economic threat.	Politically hedge; economically bandwagon.
<i>Singapore</i>	Potential	China's growing military strength; South China Sea; Taiwan.	Hedge.
<i>Malaysia</i>	Fading away	Future friction.	Bandwagon.

2.4.1 Vietnam

Given the great disparities in power, wealth and population, as well as their historical links and geographical proximity, the development of bilateral relations between China and Vietnam constantly demonstrates the ‘politics of asymmetry;’ not surprisingly, China has always been a much more important presence for Vietnam than the other way around, and Vietnam has had a more acute sense of the risks and opportunities offered by the giant neighbor in the North (Ang, 1998; Wolmack, 2006). In Thayer’s words (1994a, 2004), Vietnam suffers from ‘the tyranny of geography.’ Although the development of bilateral relations is argued to be the two different games played by China and Vietnam in their own terms (Wolmack, 2006: 9), review of the literature shows that the games have represented the interplay of ideology and national interests within the larger geopolitical context (Ang, 1998; Amer, 1994, 2004; Roper, 2000; Shultz and Ardrey, 1995; Thayer, 1994a, 1994b, 2004; Vuving, 2006; Wolmack, 2006; Zhang, 2005). Albeit scholars seem to agree that the current ‘normalcy’ of bilateral relations is buttressed by the shared aspiration for economic development and regime stability, their works illustrate that Beijing and Hanoi have adopted divergent approaches towards each other.

In examining the development of bilateral relations from China’s side, a constant characteristic of Beijing’s approach towards Hanoi throughout the open era is shown to be the staunch insistence on its own perceived core interests in the literature; to this end, Beijing could appear very uncompromising, even it is alluded that China may not intend for political domination over Vietnam because of the high cost (Amer, 1994, 2004; Roper, 2000; Shultz and Ardrey, 1995; Thayer, 1994b; Zhang, 2005). China’s ‘punitive’ attack on Vietnam in 1979 started the mutual hostility for the following decade because of its uneasiness of the Soviet-Vietnamese alliance, which was viewed as the major threat to China’s national security; it leads to the opinion that albeit Beijing is deliberative and calculating on when and how military force was to be used, it is not hesitant from going to the war once the national interests are perceived at risk or at stake (Zhang, 2005). Although the gradual improvement of Sino-Soviet relations and the multilateral settlement of Cambodia problem that decided Vietnam’s lesser role in the affair made the full normalization of relationship possible between China and Vietnam in 1991, competing claims and settlement mechanisms regarding the territorial disputes in South

China Sea had been the major source of bilateral tension, notwithstanding the agreements on boundary delimitation were achieved. During the 1990s, China appeared saber-rattling over this issue and the aggression triggered the regional anxieties; discord remained sharp until China's signature of Code of Conduct in the South China Sea with ASEAN collectively in 2002 that emphasizes the self-restraint of concerned parties and peaceful settlement through negotiations (Amer, 1994, 2004; Shultz and Ardrey, 1995; Thayer, 1994b). At the same time, although China stressed the contribution of economic cooperation to the improvement of bilateral relations, Chinese exports are assessed to threaten the local production of Vietnam, not to mention the rampant smuggling and other cross-border crimes albeit Hanoi tried to ban the trade (Roper, 2000; Shultz and Ardrey, 1995). With the commitment to the 'all-round' cooperative relations in 1999, China started to import oil from Vietnam; it helped Vietnam's balance of payment (BOP) problem and further symbolized China's support for international openness as the shared policy priority with the other socialist economy. The action is argued to lay solid foundation for the normalcy of bilateral relations, and enhance the fundamental ideological resonance between the two leaderships since both have to resist the external pressure to political liberalization (Womack, 2006: 252-253).

On Vietnam's side, fear and distrust are argued to be the most important emotional foundation of its approach towards China although they might be veiled in official statements in order to avoid counterproductive effects (Thayer, 1994a; 2004); the ingrained perception of China threat, however, is viewed to lead Vietnam's move towards the tacit and soft balancing approach in dealing with China (Vuving, 2006). It is argued that the need to prepare for economic race against other regional states and the pressure from Kremlin motivated Hanoi to seek reconciliation with Beijing in the mid-1980s, yet the ideological competition among the ruling elites in Vietnam complicated the pursuit of normalization of relations and the subsequent approach towards Beijing (Ang, 1998; Thayer, 2004; Vuving, 2006). The shift of US policy away from support for the anti-Vietnamese coalition in Cambodia is argued to produce a more accommodating posture by Beijing, while Hanoi determined to seek ideological alliance with China through normalization of relations since the counterweight of Soviet Union was no longer

available in 1990; however, Hanoi's request to include security guarantees or a form of military alliance was rejected (Thayer, 2004; Vuving, 2006). In other words, the normalization was conducted on Chinese terms. The internal ideological debates is argued to continue playing a key role behind Hanoi's divergent responses to the growing Chinese power; for example, Hanoi is pushed to 'play the ASEAN card' and embarked on improving relations with US to balance China's assertiveness in South China Sea, but bandwagons with China for economic assistance to domestic reform, particularly after the breakout of AFC (Ang, 1998; Thayer, 2004; Womack, 2006; Vuving, 2006). Taking into account of China's increasing multilateral engagement with ASEAN as a means to demonstrate its 'peaceful rise,' although Vietnam remains wary of Chinese encroachment, the combined strategy is assessed to reflect its quest for economic development and contribute to the stability of bilateral relations with China (Womack, 2006; Vuving, 2006).

2.4.2 Singapore

The literature regarding the development of political relations between China and Singapore is limited, and appears to focus on Singapore's preference for active engagement with China and simultaneous pursuit of fallback position (Goh, 2005; Khong, 1999; Kuik, 2008; Latif, 2007; Lee, 2001; Story, 2004; Wong, 1998). Although China in the open era is depicted as keen to learn from developmental experience of Singapore, these authors make it explicit that to prevent China becoming a real threat from a potential one has motivated Singapore's three-faceted foreign strategy; in addition to advocate of integrating China into the extant economic and political games at both global and regional levels, Singapore has consciously adopted the hedging approach, namely to support the US preponderance in the region and maintain close relations with other powers, including Japan, Russia, and India. The logic is bluntly explained in Goh (2005: 311): since Singapore has acted from the realist assumption that small states might well be dispensable in the international system, the policymakers constantly try to make the country 'useful' to the major powers in their quest for security thus maximize Singapore's own chance of survival.

Although there had been frequent high-level exchanges since Deng Xiaoping's visit to Singapore on the eve of opening, official ties between the two countries were not forged until 1990s because of Singapore's concerns over geopolitics, its dominant ethnic Chinese population and the prevailing Cold War environment (Lee, 2001: 416). Yet, during this period Singapore appeared enthusiastic in responding to 'China's fascination with its development' (Wong, 1998); significant policymakers played the advisory role to help China improve efficiencies in different aspects under the macroeconomic control from the state. In addition to the real economic interests in China, the more important reason behind this strategic choice is argued to be Singapore's hope that the increase of economic rewards from international cooperation could suppress China's hegemonic ambition in challenging the regional status quo; therefore, Singapore argues that the West should refrain from pressurizing China over issues on human rights and political liberalization through trade (Goh, 2005; Khong, 1999; Story, 2004). To expand China's stakes in the regional status quo, Singapore started to politically engage with China via ASEAN-led institutions since the establishment of bilateral relations in 1990. This choice is argued to be motivated by Singapore's two basic needs, including to downplay the element of ethnic affinity in bilateral relations to both ASEAN members and other powers, as well as to ensure the continued US involvement in the region. This strategy is also viewed to highlight the importance of Singapore as a 'interlocutor' for China, particularly vis-à-vis the US, and as a useful bridge between the 'Asian way' and 'Western style' of diplomacy and politics (Goh, 2005; Khong, 1999).

Nevertheless, China's military modernization, and the tensions derived from its assertiveness in South China Sea as well as the relations with Taiwan are argued to be the major sources of Singapore's active seeking for powerful US presence in the region as the security guarantor (Storey, 2004). Because Singapore is realistic about the potential effects of China's growing power and is uncertain about China's intentions in the medium to long term, Singapore has openly strengthened military cooperation with US and has maintained defense relationship with Australia, New Zealand and Britain under the Five Power Defense Arrangements (FPDA), as well as declared the support for the

US war on terrorism (Goh, 2005; Khong, 1999). Despite political differences over domestic issues, Singapore's reliance on the US for regional security is explained that the US is perceived as a largely benign power as it makes no territorial claims in Asia and has a vested interest in maintaining freedom of navigation (Storey, 2004); therefore, while Singapore has been eager to 'socialize' China through soft institutionalism that is buttressed by the shared economic imperative, Singapore has cultivated its hedging policy by further emphasizing the need for the US presence in the region to check on the potentially revisionist ambition of China (Goh, 2005; Khong, 1999; Kuik, 2008; Lee, 2001; Storey, 2004).

2.4.3 Malaysia

The literature that looks at foreign policies of China and Malaysia towards each other is similarly dearth, and most of them are devoted to the examination of reasons behind the fading away of 'China threat' perception and Kuala Lumpur's pursuit of limited bandwagon with China (Acharya, 1999; Baginda, 2002; Balakrishnan, 2006; Kuik, 2008; Leong, 1987; Liow, 2000, 2005). The only one scholarly work that focuses on China's management of bilateral relations with Malaysia (Ku, 2006), however, argues that it is subsumed under China's three successive foreign initiatives since the early 1980s, namely the open-door policy, the good-neighboring policy, and the go-global policy; in addition, Ku (2006) emphasizes that China's improvement of relations with Malaysia is not a particular case but just part of China's overall strategy towards Southeast Asia that aim to serve China's pursuit of prosperity in a peaceful periphery. This argument seems to echo Acharya's inference (1999: 145) that with the international political reality, the stronger may not be seriously interested in engaging with the weaker; in order to discourage threatening policies and actions by the rising power, Malaysia's generally cooperative posture towards China must be backed up by a range of political and diplomatic instruments.

Among ASEAN members, Malaysia is the first to establish the diplomatic tie with China (in 1974) and to dismiss the notion of 'China threat' as nothing more than a self-fulfilling

prophecy;¹⁶ Kuala Lumpur's seeking to secure its own interests by navigating closer to Beijing, however, is argued to be forged through significant shifts in Malaysia's China policy (Baginda, 2002; Balakrishnan, 2006; Kuik, 2008; Liow, 2000, 2005). Although Malaysia's rapprochement towards China in the early 1970s, which was for assuring the regional peace and increasing potential harness on China's international behaviors through bringing China into the regional dialogue of neutrality and the support for China's UN seat, is argued to contribute to the normalization of bilateral relations (Baginda, 2002; Leong, 1987), China remained to pose a threat to Malaysia's national security until Beijing's cease to support the local communist insurgencies in the end of the Cold War (Acharya, 1999; Baginda, 2002; Balakrishnan, 2006; Kuik, 2008; Liow, 2000, 2005). However, since the mid-1980s, the need for external engine to domestic economic growth is viewed to drive Malaysia's seeking for closer relations with China, which determined Malaysia's champion of viewing the rise of China in a positive context. The champion is argued to be strengthened by China's support for Malaysia's international political initiatives such as the establishment of East Asian Economic Grouping (EAEG) and the collective proposal for the restructuring of the UN Security Council based on the shared concerns over democracy, human rights, and the position of developing countries in the US-dominated international order (Baginda, 2002; Balakrishnan, 2006; Liow, 2000, 2005); in Kuik's words (2008), Malaysia's moves have demonstrated its efforts to engage China through the normative binding in order to advance its own national interests. Malaysia's strategy in 'cashing in on the likely-minded views with China' is argued to be clearly rewarded by Beijing's mild reaction towards the territorial disputes in South China Sea (Kuik, 2008); given the fact that Malaysia's claimed territory lies furthest from China, it is argued to facilitate the shared defense of national sovereignty and the related preference for bilateral solution free from external interference, as well as the possibility of joint exploitation of maritime resources (Liow, 2000, 2005).

¹⁶ The former Malaysian Prime Minister Mahathir Mohamad offered a telling illustration: 'Why should we fear China? If you identify a country as your future enemy, it becomes your present enemy – because then they will identify you as an enemy and there will be tension.' Cited from 'I Am Still Here: Asiaweek's Complete Interview with Mahathir Mohamad,' *Asiaweek*, 9 May 1997.

Although Acharya (1999) suggests that the China's military modernization program intensified Malaysia's concerns, Malaysia's increasing belief that China is a valuable partner in pushing for joint goals in multilateral cooperation is argued to motivate Kuala Lumpur to downplay, if not overcome, the earlier apprehension about the potential security threat from China (Kuik, 2008: 174). It is argued that although Malaysia indeed has been wary of political domination from any powers in the region since it would hurt the national autonomy and interest, the concerns over the US unilateral tendency (as reflected on Washington's policies towards Afghanistan and Iraq) intensified Malaysia's search for bandwagon with China against the US or at least as leverage with Washington (Liow, 2005). Nevertheless, Kuik (2008) argues that Malaysia's bandwagon strategy may change in the future because frictions are likely to generate between Malaysia's sensitive about sovereignty and the growing Chinese power.

2.5 Theoretical foundation: competing expectations about trade from the main paradigms

This section is set to examine the theoretical foundation for the competing interpretations about China's motivation behind its intensified economic cooperation with ASEAN, and the extended debates on the implication of the rising China to the world politics. Although both paradigms of IR tradition, namely realism and liberalism, have treated states as the main units of analysis (e.g. Walt, 1998: 38), they distinctively diversify in identifying the nature of conflicts among states and utilities of institutions and cooperation. The arguments that China seeks power expansion in Southeast Asia, in terms of the increasing influence at the expense of US and its allies, through the employment of economic statecraft, echo the core assumptions of realist IR theories that for national survival in international anarchy, states may take offensive strategies to acquire advantageous distribution of political and economic gains from cooperation with partners. In this sense, trade and institutions are expected as instruments for states' external ambition. Yet, liberal theories provide the alternative explanation and expectations about state behaviors that are consistent with the arguments that China is motivated by the pursuit of prosperity; as the 'representative institution' of aggregate societal preferences, states are viewed to be primarily motivated by satisfying the

domestic needs of economic growth; since trade is a less costly and more potentially beneficial approach to achieve this goal, sensible states are expected to prefer transnational economic exchanges to wars. In order to ensure the absolute gains of each party and to solve collective action problems in the increasing economic interdependence, international institutions are argued as the reliable mechanisms to facilitate policy coordination. The contentious issues between realist and liberal IR theories that are relevant to this study are listed in Table 1.2.

Table 1.2. Contentious issues between realist and liberal IR theories.

	<i>Realism</i>	<i>Liberalism</i>
<i>Primary goal</i>	Power	Prosperity
<i>Constraints on the national pursuit of the goal</i>	International distribution of power.	Policy externalities.
<i>Expectations from trade</i>	Relative gains.	Absolute gains.
<i>Utilities of institutions</i>	Serving the unilateral political and economic benefits.	Solving the collective action problems.
<i>Predictions of world order</i>	Competition.	Cooperation.

2.5.1 Realism

Although contemporary neorealists may not take an extreme position like Hans J. Morgenthau ([1948] 2006: 4-16), the classical realist, that statesmen ‘think and act in terms of interest defined as power’ as the reflection of human nature (Baldwin, 1993: 7), Walt (2002) summarizes that variants derived from the realist tradition share certain common assumptions and premises. Realist theories generally assume that states, as the most prominent actors in world politics, seek to survive in the constant anarchy and that they pursue their ends in a more or less rational manner. Walt (2002: 200) recapitulates that the central conclusion of all realist theories is that ‘the existence of several states in anarchy renders the security of each one problematic and encourages them to compete with each other for power or security;’ since states are forced to provide security for

themselves in the self-help system (Waltz, 1979), the realist tradition sees the acquisition and management of power as the main issue that states face. Yet, disagreements on states' likely behaviors originate from whether or not they can be certain about others' intentions. Defensive realists (e.g. Jervis, 1978; Van Evera, 1999), as assessed by Walt (2002: 205-206), reinforce the status quo bias from Waltz by arguing that since expansion is usually difficult and rarely profitable, states tend to merely adopt defensive military posture and favor to balance aggressive powers based on their probabilistic judgments about others' purposes. This argument is challenged by offensive realists; for example, Mearsheimer (1994/95: 10-12) argues that states are driven to maximize their power to forestall others' likely aggression, because it is impossible to gauge on, or predict the changes of, one another's intentions with full confidence. To acquire more military power at the expense of others, in Mearsheimer's view, is the best way to ensure the state's defensive goal of survival.

Despite these clear differences, both variants share the assumption that states are primarily concerned about relative achievements of gains from cooperation with each other, no matter for defensive (survival) or offensive (power maximization) purposes. Since all states are viewed to be always motivated in some measure by fear and distrust (Gilpin, 1986: 304-305), states are acutely sensitive to any erosion of their relative capabilities; therefore, it is argued that the fundamental goal of states in cooperation is to prevent others from achieving greater gains, sometimes by cheating (Grieco, 1988). In other words, states have to care for not only expanding the pie so that they can get at least some portion of the increase but also how the pie is divided (Mearsheimer, 1994/95: 13). The concern of how the relative gains from cooperation will be distributed, which is viewed to be the capital of the constant positional competition among states in the anarchic environment, is argued to be the critical variable to the establishment and persistence of international institutions; defined as a set of negotiated rules that reflect state calculations of self-interests based primarily on the international distribution of power, international institutions is argued as the instruments of statecraft due to their attributes of being malleable and prone to manipulation by participating states (Mastanduno and Kapstein, 1999). In this view, institutions are essentially 'arenas for

acting out power relations' (Evans and Wilson, 1992: 330); as Krasner (1982, 1991) suggests, although institutionalized cooperation could facilitate participating states to acquire the Pareto suboptimal outcomes of prisoners' dilemma or market failure, such outcomes are always determined by the basic causal factors of national interests and power. The relative power of participating states that is reflected on the ability to determine who plays the game, or to define the rules, or to change the values within the payoff matrix, is indicated to condition whether the more favorable distribution of benefits could be secured.

Mearsheimer (2001: 55) argues that power is based on the particular material capabilities that a state possesses; since the increase of military strength requires socio-economic ingredients, realists have perceived an underlying long-run harmony between the national pursuit of wealth and power (Viner, 1948). As Gilpin (2001: 42-43) contends, the primacy of the national economic and political interests for the states' power competition has been illustrated since the mid-17th century, and the primary concern of states has been to acquire a favorable balance of trade/payments to finance their military and political ambitions; it implies that states would attempt to influence the market outcomes through the use of their power. Combined with the shared realist assumptions and premises noted above, the national foreign economic policy is expected to be used as a tool for states to obtain advantageous distribution of benefits from trade cooperation. If the ways in which the world economy functions are determined by both markets and the national foreign economic policy of states, Gilpin (2001: 23) argues that the interactions of the political ambitions and rivalries of states, including their cooperative efforts, create the framework of political relations within which markets and economic forces operate. Because the relationship of economics and politics is interactive, institutionalized trade cooperation is expected to be the outcome of bargaining and negotiating process in which states, as utility maximizers, seek to advance their relative gains of the mixed economic and political interests (Gowa, 1986). This line of thoughts constitutes the theoretical foundation for those who argue that China's economic cooperation with ASEAN is motivated by power (see section 2.2.1); as an increasingly powerful actor in the world economy, China is viewed to capitalize its newly-acquired capabilities to exploit the

game played with ASEAN for political ambition, namely, to compete for greater influence against the predominant US and its allies.

2.5.2 Liberalism

As presented in section 2.2.2, the arguments that China's intensified economic cooperation with ASEAN is motivated by the pursuit of (co-)prosperity under the circumstance of increasing interdependence, appear to echo the core assumptions of liberal IR theory. Although the possibility of wars is not rejected, the emphasis on human reason prompts contemporary liberals to hold out the prospect of ameliorative solutions to collective problems, thus facilitate cooperation which could lead to the 'perpetual peace' (Kant, 1991: 99-108). Despite justice or equity is not promised in the setting of world politics, in which the significant disparities of power and weak means of controlling the exercise of power have remained, the emergence of economic interdependence is argued to discourage rational states from using force against each other because warfare would threaten their separate pursuit of prosperity; in other words, the trade- and FDI-propelled economic growth is expected to reshape states in pacific directions and to provide strong incentives for peaceful economic expansion rather than military conquest (Keohane, 1990). Although empirical evidence seems to support the thesis that peace is more likely to be maintained among democratic states (e.g. Doyle, 1986; Fukuyama, 1992), the other emphasis of the liberal tradition – namely the prospect of cumulative progress based on the perceptual changes brought into policy-making process to promote cooperative outcomes, at least in certain specific issue-areas (e.g. Haas, 1992), implies the possibility that autocratic states could also 'learn' to adopt the more risk-averse and thus less belligerent foreign policy in order to serve the pursuit of economic benefits.¹⁷ This implication particularly coincides with the explanations of why China seeks the peaceful coexistence with other powers and regional stability in the first place (see section 2.3.2), which is argued to determine China's approach towards ASEAN for (co-)prosperity.

¹⁷ Derived from Moravcsik, 1997: 530-533.

The overview of liberal expectations about state behaviors is founded on the fundamental premises shared among different variants originated in liberal tradition. Moravcsik (1997: 516-521) summarizes that, from the liberal perspective, the state is a representative institution constantly subject to the aggregate societal preferences; it is expected to pursue particular interpretations and combinations of security, welfare and sovereignty based on the national support. The configuration of state preferences constitutes the perceived underlying stake to drive the national policy, while the link between unilateral preferences and the behaviors of other states, is argued to provide the policy interdependence in world politics. Defined as the set of costs and benefits created for foreign societies when the state seeks to realize its own aggregate preferences, the strategic pattern of policy externalities is contended to directly influence the form and substance of states' cooperative choice (e.g. Martin, 1992; Snidal, 1985; Stein, 1982). It therefore provides explanations about the sources of open economies; Ruggie (1982) argues that the pursuit of social welfare and economic stability requires modern states to adopt foreign economic policies that aim to maintain a congenial international environment for the realization of these goals. Although the cost-benefit calculations based on the structure of domestic and global economy determine both openness and closure of a state to transnational economic exchanges, free trade is argued to be a less costly means to achieve the national wealth through the exploitation of comparative advantages; consequentially, the greater the economic benefits for the domestic society, the greater its incentive to press the state to facilitate such interchange (Burchill, 2005: 63; Moravcsik, 1997: 528). Yet, because domestic distributional conflicts could be the source of pressure for protectionism, free trade is argued to be more likely where strong competitiveness, extensive intra-industry trade, large foreign investments, and low asset specificity internalize the net benefits of the society, thus reducing the influence of net losers from liberalization (Milner, 1988).

From the liberal perspective, since states are viewed to be the rational and self-interested actors in world politics, they are expected to seek economic growth through trade and foreign investment (although the degrees of openness could vary) as the more potentially beneficial strategy, rather than the military seizure of farmland (e.g. Keohane, 1990;

Rosecrance, 1986). Taking into account of the condition of policy externalities, it implies the ‘demands’ for reliable mechanisms – namely, the international institutions – to solve specific collective action problems through cooperation (Keohane, 1982). Institutions are argued (Keohane, 1984) to enhance cooperation by improving quality of information, reducing transaction costs, facilitating trade-offs among issue-areas, and assisting enforcement of accords; dedicated to economic openness, Deudney and Ikenberry (1999) contends that institutions serve the attempts of states to mitigate the effects of disparities in power among themselves so that to advance absolute gains, and to modulate preferences and features of other states that are politically and strategically congenial. The political complication entailed by increasing transnational economic exchanges therefore is expected to be managed by the complex network of formal and informal institutions, since it permits state preferences to vary while holding power and information constant and facilitates their policy coordination (Moravcsik, 1997: 536-538; Keohane and Nye, 2001). By and large, liberals have regarded the consequences of trade – the policy externalities and unilateral inclination-constrained cooperation – in positive terms, albeit empirical evidence suggests that the increasing economic interdependence and the more pervasive and stable peace could be limited to regions such as EU (Dunne, 2008; Zacher and Matthew, 1996), or the emerging economic integration between China and ASEAN. Nevertheless, the utilization of cooperation and institutional building, even within the fundamental constraints set by the international political and economic system, is stressed by the liberal expectation – if not the prescription – about the strategies that should be adopted by sensible states for their pursuit of national prosperity.

3. Methodology

3.1 Framework of analysis

Since this thesis is for examining whether China seeks to utilize its FEP as a tool to advance political dominance – or rather, to increase its political power – in Southeast Asia, it is necessary to set out a clearer definition and the usage of ‘power’. Although

‘power’ has been a ubiquitous theoretical concept with the rather elusive definition as seen in the literature, for the purpose of this study, I adopt David Lampton’s ‘policy process perspective on power’ (2008). By slightly modifying Joseph Nye’s definition of power,¹⁸ Lampton argues that power is the ability to *define and achieve* one’s purposes or goals in the international system. Because the exercise of power involves the purposeful use of resources to achieve a certain goal efficiently, power would be demonstrated throughout the entire cycle of the relevant policymaking (ibid: 8-10). Therefore, the important implication here is that there would be an observable congruence between intention and outcome of the policy. My analytical framework aims to contribute to trace the critical link between China’s employment of economic capabilities (which would be reflected on its FEP) and the intended outcomes, namely power expansion (as realists suggest) or welfare maximization (as liberals suggest). Yet, it is worth noting that although China’s power expansion in Southeast Asia, as one of the possible intended FEP outcomes, could result in China’s increased regional influence in terms of context-shaping ability (cf. Hay, 2002: Chapter 5), the exploration of this consequence per se is not the focus of this thesis. Since the argument of ‘power-as-influence’ has informed the heated debates about China’s ‘economic first’ approach towards ASEAN as presented in the previous sections, this thesis attempts to go beyond the predicament of simply interpreting what the economically rising China implies for the rest of the world. Instead, this thesis focuses on what China’s FEP intention really is in the first place. Therefore, the proposal of my analytical framework – to build up two separate sets of theoretically-informed FEP preferences for the subsequent comparison with empirical evidence – is designed to serve the ultimate concern of this thesis.

Building on the examination of logics and assumptions about state behaviors of both realist and liberal paradigms in section 2.5, it is possible to develop the ‘ideal-types’ of foreign economic policy (FEP) that could be adopted by states for their primary international goals of either power or prosperity. Defined as the ‘one-sided accentuation of viewpoints into a unified analytical construct’ (Weber, 1904 [2007]; Eliaeson, 2002:

¹⁸ In his article in 1990, Nye proposed a parsimonious and broader definition of power that ‘power is the ability to achieve one’s purposes or goals’ (p. 177).

46-51), the formation of various ‘ideal-types’ of FEP derived from realist and liberal IR theories separately is expected to distinguish the shapes of FEP that China ought to take at different levels to serve its ultimate motivation. Following Max Weber, the development of the ‘ideal-types’ of FEP is not expected to perfectly coincide with what China has been doing; instead, the synthesis of theoretical predictions will be used as the ‘benchmark’ for the subsequent comparison with China’s actual policies towards trade cooperation at global (see Chapter 2) and at bilateral (see chapter 3, 4, and 5) levels. In other words, rather than directly ‘testing’ the two competing hypotheses of China’s motivation, the task of this study is to examine whether China’s FEP at global and bilateral levels since open up is consistent with either theoretical predictions embodied in the ‘ideal-types’ of FEP. Seeking to contribute to the academic debates regarding China’s motivation behind its pursuit of intensified economic cooperation with neighboring countries, I attempt to avoid the ‘cherry-picking’ style of establishing causal relationship between a priori beliefs and selective reading of events, but to utilize my theoretical-informed instruments as the ‘guidance’ to help analyze China’s preferences for and concrete content of trade cooperation at different levels. The idea here is rather straightforward: if China’s trade cooperation is motivated by power, it should opt for the FEP that could yield asymmetrical political and (secondarily) economic interests; if China is motivated by prosperity, it should prefer the FEP that promises more potential gains in the economic realm.

From the realist perspective, the threat of war is the fundamental determinant of the patterns of economic activity. In order to increase the relative economic capabilities and technological advantages as the foundation of the long-term military strength, autarky may not be a particularly useful approach; it means opening to transnational economic exchanges should be the overall direction of the national FEP. Yet, the concern in relative gains should prevent states from adopting unilateral liberalization; they have no reason to simply allow the market to dictate the patterns and distribution of gains from the trade. For the purpose of maximizing political gains from economic activities, bilateral cooperation should be most favored by the large states. The insights from Albert Hirschman’s *National Power and the Structure of Foreign Trade* ([1945] 1980) point that,

large states should offer preferential deals to smaller partners in order to strengthen the latter's asymmetrical economic dependence since trade makes up a smaller portion of the former's total trade; by doing so, both implicit and explicit threats to break commercial ties affect the smaller partners disproportionately thus gives the large states coercive power. In addition, the offers should target at sectors which are politically powerful in the societies of smaller partners; these beneficiaries from trade offers are expected to pressurize their governments to continue to stay in the economic dependency, and the reshuffling of policy preferences of smaller partners thus gives the large states influence power. Both coercive and influence effects constitute the sources of the larger states' power ascendancy over smaller partners; therefore, if China was motivated by power expansion, it should place the utmost emphasis on bilateral trade relations with individual ASEAN members.

By extension, the disparities in economic size between China and ASEAN as a whole implies that China may seek to acquire similar coercive and influence power from regional trade cooperation through the employment of such economic statecraft,¹⁹ particularly with the condition that individual member states could well affect ASEAN's collective decision due to its institutional attributes of consensus and consultation; however, the political gains could be relatively limited vis-à-vis those originated from bilateral trade with individual ASEAN members, because not only the coercive and influence effects from trade could be relatively diffuse but the gap of economic sizes is narrowing. Finally, since multilateral institutions are viewed as essentially the platforms for power competition, a power-minded state's FEP at the global level tends to be associated with political conflicts. Because the relative gains from transnational economic exchanges will affect the underlying balance of power, it is expected to increase the national perception of vulnerability (Kirshner, 1999: 79-80). Particularly since the end of the Cold War, the international political economy has been characterized by the unipolar structure, within which the US is the only one that possesses a full range of great power attributes and is expected to seek the maintenance of its preponderance

¹⁹ In 2005, the total trade volume of China was \$1,422 billion while ASEAN's was \$1,246 billion. Data is available at http://www.wto.org/english/news_e/pres06_e/pr437_e.htm#table1_appendix; accessed on 15 December 2009.

(Mastanduno, 1998: 843-844). It implies that the political ambition of other potential great powers – such as China – is constrained in the current structure; therefore, one would expect China to adopt the ‘two-pronged’ FEP at the global level: on the one hand, China should insist on the preferential treatments so that it could continue to benefit from unprohibited export;²⁰ on the other hand, China should support, or even encourage, the bloc competition within multilateral institutions in order to increase its own bargaining power against US as the principal adversary. Although this strategy may help cultivate China’s political influence with its ‘allies’ (Kirshner, 2003), how easily it could be acquired appears questionable because China’s interests may not be compatible with those of the ‘allies’ (see Chapter 2); in addition, the political influence that China could gain over the ‘allies’ may not be as direct as that at bilateral and regional levels. Thus, if China’s FEP is motivated by power consideration, depending on the degrees of expected political gains, the preference order of economic cooperation at different levels could be clearly drawn as bilateral > regional > multilateral > unilateral liberalization.

From the liberal perspective, free trade is conceived as superior to trade protection (e.g. Kindleberger, 2000). Based on the principle of comparative advantages, classical economists such as Adam Smith and David Ricardo argued that free trade (with few exceptions) is the best way to achieve the overall national prosperity, because states would reap both static and dynamic benefits derived from specialization of production and the increased national efficiency in the long run (O’Brien and Williams, 2004: 139-142). Since the significant implication here is that even if other countries resort to trade protection, the economy that remains open would still gain more from cheaper imports than it would lose in denied export markets (Gilpin, 2001: 196), states that primarily aim at prosperity should adopt unilateral liberalization. However, free trade is pointed as the ‘historical exception’ while protectionism has been the rule (Bairoch, 1991: 16); if states have to constantly respond to the bottom-up pressure from competing groups for their economic interests, protectionism embodied in the national FEP seems to be politically

²⁰ Such requests from trading partners, including China, are argued to be perceived as the ‘unfair trade practices’ and to cause domestic pressure for protectionism in the US; as the response, the US has adopted controversial FEP tools such as 301, Super 301, and Special 301 to attack barriers to entry in foreign markets, while the US Trade Representative (USTR) has become the chief advocate for a more assertive defense of US economic interests in foreign policy (Mastanduno, 1998: 842-843).

reasonable. Although tariffs have been reduced to insignificant levels since the end of the Second World War, non-tariff barriers (NTBs) still make up an important policy tool for protectionism (Milner, 2002: 449). At the same time, the national emphasis on international trade is argued to shift from ‘comparative’ to ‘competitive’ advantages; international competitiveness and national trade patterns frequently result from arbitrary specialization based on increasing returns instead of efforts to take advantage of fundamental national differences in resources or factor endowment (Krugman, 1991: 7). Since the pursuit of national competitiveness in foreign trade is set within the post-war liberal economic order, states have begun the quest for international institutions to effectively manage the conflicts among each other (Keohane, 1990).

For this purpose, the multilateral cooperation should be favored the most by the states if their behaviors are motivated by the pursuit of prosperity through foreign trade. As O’Brien and Williams (2004: 150-156) explains, the multilateral approach is valued as the reflection of the commitment to the creation of the GATT/WTO to solve collective problems based on the rule, and it serves the periodic rounds of tariff-cutting. For trading states, to participate in multilateral cooperation implies that they would be benefited from the three key liberal trade principles, including non-discrimination (as enshrined in the Most Favored Nation, MFN) clause, reciprocity (applied through multilateral bargaining, one state’s concessions will in turn be granted equal trade concessions from others), and transparency (any discrimination must be clearly visible), as well as the reliable dispute settlement mechanisms. Yet, although the ideal international trade cooperation is often assessed as the multilateral one, states may simultaneously pursue the ‘minilateral’ agreements at regional and bilateral levels for the enhanced welfare effects (Kono, 2007; Viner, 1950).²¹ Assessed as the complement to multilateral approach, the regional trade agreements (RTAs) in Asia-Pacific are argued to be primarily driven by market force (Fishlow and Haggard, 1992; OECD, 2003); the increasing intra-regional trade in East Asia (from 37% in 1980 to 55% in 2006) that reflects the expansion of intra-regional production networks in machinery and electronics industries (Kawai and Wignaraja,

²¹ According to WTO, by July 2005 only one WTO member – Mongolia – was not party to any regional trade agreement (RTA), and a total of 330 such agreements had been notified (Best and Christiansen, 2008: 436).

2008), as well as the shift of ‘hub’ away from Japan to China (Lincoln, 2004), implies that China would seek the preferential agreements with regional partners in order to benefit from both trade diversion and trade creation brought by the common MFN tariff reduction.²² It means that states would pursue trade cooperation at the regional level through the establishment of RTAs, while the RTAs are expected to contain more far-reaching provisions than those found in the WTO to facilitate trade among members, although these provisions are rooted from, and must be compatible with the WTO rules and principles (OECD, 2003). Finally, trading states may also pursue bilateral preferential trade agreements (PTAs) with selective partners within and outside the region; in East Asia, this trend is argued to emerge and expand rapidly from the late 1990s onwards (Dent, 2003; Ravenhill, 2003; Solis and Katada, 2007). As the response to the weakness of existing regional arrangements in the AFC and slow progress in the WTO, the bilateral PTAs are expected to strengthen the ‘networking linkages’ by the FTA-plus nature, whereby additional cooperative measures carried within the agreements will bring economic agents and policymakers from both bilateral partners into closer and more extensive collaboration (Dent, 2003: 25). The bilateral PTAs in general are argued to offer potential wedge against domestic protectionist interests, and to help avoid painful domestic adjustment because of the substantially weaker pressure from only one party than that in multilateral trade talks (Ravenhill, 2003: 307); in the case of China, because Beijing does not face the tug and pull of conflicting interest groups like other states, the negotiations for bilateral PTAs is argued to particularly serve the negotiating capacity building and precedent setting (Solis and Katada, 2007). These empirical studies suggest that for China, it is more likely to establish the bilateral PTAs with insignificant trading partners so that the goals of demand for the recognition of China’s market economy status and protection of sensitive domestic sectors, as well as the exploitation of ambiguities in WTO rules, could be achieved. Since the likely welfare effects on participants of bilateral PTAs are smaller than trade cooperation at global and regional levels (Dent, 2003; Ravenhill, 2003; Solis and Katada, 2007), for the sake of national

²² Under the RTAs, participating states could reap the static gains from trade diverting from foreign suppliers to suppliers located within the common market, and the long-term dynamic gains from the creation of a larger combined market. Viner’s insight of the welfare effects of economic regionalization is assessed to remain valid today (Gilpin, 2001: 347).

prosperity, China's preference order could be drawn as unilateral liberalization > multilateral cooperation > RTAs > bilateral PTAs. The substance of my analytical framework is listed in Table 1.3.

Table 1.3 China's preference order of the 'ideal-types' of FEP.

	<i>Power-motivated</i>		<i>Prosperity-motivated</i>	
<i>Unilateral liberalization</i>	4	The least beneficial policy because of the concern in relative gains.	1	Free trade (with few exceptions).
<i>Bilateral cooperation</i>	1	Offering sweet deals to create individual partners' trade dependency on China.	4	Seeking bilateral PTAs with insignificant trading partners that demands for recognition of China's market economy status and protection of sensitive sectors.
<i>Regional cooperation</i>	2	Offering sweet deals to create ASEAN's collective trade dependency on China.	3	Seeking RTAs that contain the more far-reaching provisions than those in WTO.
<i>Multilateral cooperation</i>	3	Insisting on the advantageous preferential treatments and encouraging competition among trade blocs.	2	Participating in GATT/WTO to solve collective problems and to benefit from liberal trade principles.

3.2 Selection of cases

This thesis focuses on China's FEP towards and the related political relations with selective cases at the bilateral level, while the development of China's national FEP since open up will be reviewed in the next chapter. This choice is out from two considerations.

On the one hand, China's unilateral foreign behaviors and their likely implications, as well as ASEAN's collective external policies have been extensively discussed in the secondary literature, which reflect the significance of both China's rise and the shifting strategic and economic landscapes in East Asia. On the other hand, the development of my analytical framework in section 3.1 suggests that bilateral relations could be seen as the particularly telling case to examine the rival claims of power and prosperity. Seeking to help unravel the puzzle of China's motivation behind its commercial activities, I attempt to offer new empirical evidence from the field that has received the relatively less attention from academia, namely China's bilateral interactions with individual ASEAN members. Yet, once again, I am not directly 'testing' the two rival claims and aim at the arbitrary conclusion as if China's bilateral interactions are motivated by the static goal; instead, I intend to utilize my 'ideal-types' of FEP to assist the observation of China's policies towards the selective cases and to discern the particularities in such empirical reality that I am about to explain, so that the revealed shapes and meaning of China's behaviors could be compared with the 'pure' theoretical expectations and thus serves the inference of China's likely primary purpose.

I choose Vietnam, Singapore, and Malaysia as my three cases based on their separate economic significance to and political relations with China. Among ASEAN members, Vietnam's trade with China has enjoyed the highest growth rate albeit it started from a very low base, while Singapore has been China's most important economic partner in Southeast Asia. Relatively, Malaysia's significance to the Chinese economy is located in the middle. In the political realm, the three ASEAN members have had distinctive diplomatic approach towards China based on the various degrees of their 'China threat' perception, as summarized in Table 1.1. It implies that if China's FEP is motivated by power consideration, China should take initiatives in offering unusual deals to the three ASEAN members, while the content and the scope of deals should vary according to the specific bilateral economic and political relations. By choosing the three cases, I attempt to broaden the range of my examination on whether and how the different economic and political conditions influence China's bilateral FEP, and to avoid the imprecise generalization of China's likely motivation caused by the selection bias.

3.3 Sources

I draw on secondary sources in English literature for historical contexts of the development of bilateral political relations as the background of Beijing's management of bilateral FEP in each of my cases. Because most of them provide examinations from the side of individual ASEAN states, I also use the news stories from China's official mouthpiece, *Renmin Ribao* (*People's Daily*), to cross-check Beijing's stances on specific issues. Regarding China's FEP in general, although the process of China's open to the world economy is well documented in the English literature, the supplement strategies that Beijing has intended to use and the underlying reasons are somehow missing. To fill the gap, I rely on the policy documents compiled in the *Zhongguo duiwai jingji maoyi nianjian* (*Almanac of China's Foreign Economic Relations and Trade*); since 2004, the title has been changed to *Zhongguo shangwu nianjian* (*China Commerce Yearbook*). It is important to note that although Beijing has published the English counterparts of the Almanac/Yearbook, the policy documents are only available in the Chinese version. In addition, because China's bilateral FEP towards the three cases has, to some degrees, reflected the specific needs of the abutting provinces, I also consult a variety of *nianjian* that are published by the local governments. These primary materials were collected from my two trips to the Universities Service Center (USC) in the Chinese University of Hong Kong in September 2007 and August 2008, respectively. In addition, for the sake of accuracy and consistency, I use statistical data that are submitted to international institutions by Beijing and cross-check with those provided by the ASEAN Secretariat.

In my fieldwork trip to Beijing in August 2007, I was able to acquire the full texts of bilateral agreements between China and my three cases which are hardly available in the UK. I also conducted a limited number of interviews with scholars in the leading universities who are close to the policy community in Beijing. My original plan was to conduct interviews with the officials in charge of the foreign economic affairs with ASEAN, namely the Second Division of the Department of East Asia under China's Ministry of Commerce, but I got no replies to my requests. A lecturer in my host

university in Beijing and my interviewees explained that with Chinese bureaucratic ‘conventions,’ particularly in the central government, officials are suspicious of being interviewed; in addition, the preparation for the 17th National Congress of CCP two months later was claimed to strengthen the officials’ decisions of not to risk the ‘unnecessary potential problems’ generated from being interviewed by a PhD student from the foreign country. Nevertheless, I still got valuable opinions from my interviews as the supplement to my analysis in this thesis.

4. Structure of the thesis

This thesis will be structured as follows. Chapter 2 examines the evolution of China’s national FEP from the open up to world economy in 1979 to the realization of its WTO commitments (in general) in 2005 to set up the wider policy background for the subsequent case studies. By tracing the extents of reforms in the aspects of export promotion and import liberalization, this chapter argues that since the leadership of Deng Xiaoping, the opening to foreign trade and investment has been viewed as the best avenue to national economic growth. For this purpose, China has revealed to favor the unilateral liberalization to raise the national income, and the multilateral cooperation to protect and advance the broad foreign economic interests. Chapter 2 will also demonstrate the strategies China has utilized to support the national FEP, which are expected to be embodied in China’s bilateral FEP towards different partners.

Chapter 3, 4, and 5 are the case studies of this thesis. Chapter 3 will show that although China has opened to the world economy since 1979, the political hostility prevented bilateral economic cooperation with Vietnam until the 1980s. Albeit China is expected to seek the political ascendancy over Vietnam because of the difficult past thus to make Vietnam a ‘soft’ case, geographical proximity through taking advantage of Vietnam’s backward developmental level, Chapter 3 will show that China’s bilateral FEP practices are consistent with the general direction of its policy towards other partners. Instead of offering unusual deals, Chapter 3 argues that China’s emphasis have been to raise the national income through the opening of border provinces to Vietnam and the promotion

of the state-owned enterprises (SOEs), although the significance of bilateral trade to China's overall economic picture is negligible. Contradicting the theoretical expectation, findings from Chapter 3 suggest that to ensure Vietnam's trade dependency on China is not the main concern of China's bilateral FEP, but to stimulate the development of these selected domestic sectors.

Starting from the expectation that Singapore may represent a hard case for China's political ambition, examination of China's bilateral FEP towards Singapore in Chapter 4 will provide evidence for this speculation. Since the open up, China has been keen to respond to Singapore's 'engagement' strategy, and the good political relations have served as the foundation of closer economic cooperation. Chapter 4 will show how China utilized the initiatives proposed by Singapore to assist the economic catch-up at the national level, while the acceptance and swift signature of China-Singapore FTA in 2008 is expected to serve China's economic cooperation at multilateral level. Chapter 4 argues that China's FEP towards Singapore is aiming to advance China's broad foreign economic interests in terms of to improve the export composition and market diversification, as well as to stimulate the development of potentially competitive provinces.

Although Malaysia represents the 'intermediate' case of China's power ambition – the distance and good political relations imply that China's motive might be low, the cost of creating Malaysia's economic dependency on China could be low. Chapter 5 will show that China's FEP towards Malaysia actually has been similar to those to Vietnam and Singapore, while the bilateral trade imbalance is not resulted from China's manipulation but reflects China's increasing imports of raw materials and intermediate products to support the domestic manufacturing. By tracing the diplomatic interactions, Chapter 5 will also show that China did not seem to seek political gains through the 'alliance forming' with Malaysia. Therefore, Chapter 5 argues that China's FEP towards Malaysia is the telling reflection of its priority of advancing broad foreign economic interests, particularly when such interests have increasingly become the impetus to domestic economic growth.

Chapter 6 will summarize the main findings from the preceding chapters through the examination with my analytical framework. It will cover the three major ‘indicators’ drawn from the realist expectations about foreign trade to formulate the overall argument of this thesis. The findings that China’s preference for cooperation at different levels is based on the calculations of welfare effects, China did not take initiatives to ensure the advantageous relative gains from bilateral trade, and different political relations did not seem to affect the implementation of China’s economic cooperation with various partners, suggest that China’s bilateral FEP is for the pursuit of prosperity. In addition, Chapter 6 will also consider the limitations of this thesis, and the implication of China’s rising economic power in the wider context.

Chapter 2: China's Foreign Economic Policy, 1979-2005

1. Introduction

This chapter sets out to examine the evolution of China's national FEP from the inception of open up in 1979 to the implementation of its WTO commitments in the general term in 2005. This discussion has three purposes. First, it provides the broad background information about Beijing's choice on the 'alternative' avenue to economic growth and thus national development. Second, it identifies characteristics and practices of the policy that help to explain the strategies China has adopted to facilitate the pursuit of plenty. Third, it establishes the context against which China's bilateral FEP is situated and thus my subsequent case studies are set.

I start this chapter with the discussion of the consequences of autarky since they serve as the determinants of the shift of China's FEP in 1979. I then summarize significant policy measures – that are for export promotion and carefully-controlled liberalization of domestic sectors – to explain China's search for national wealth. China's emphasis on such 'dualistic' goals has remained constant throughout the opening up process and is reflected on China's WTO accession protocol, which leads to my exploration of Beijing's priority assigned to cooperation at different levels in order to advance China's foreign economic interests. Although China's regional approach appears high-profile recently, my survey of key events demonstrates that Beijing's primary concern has been multilateral economic cooperation through the global trade regimes. Nevertheless, unilateral liberalization has been Beijing's ultimate means to economic growth. China's keen pursuit of GATT/WTO membership since the mid-1980s therefore suggests that economic cooperation through regional institutions such as APEC and APT only functions as a complement to Beijing's global approach.

The evolution of China's FEP and Beijing's external approaches taken together establish the general context for my case studies. It suggests that Beijing's moves have been driven by the pursuit of prosperity; therefore, I proceed to briefly examine the 'outcomes' of

these policy choices, namely the features of China's overall trade and investment patterns. Corresponding to Beijing's priority assigned to cooperation at the global level, both ASEAN as a whole and its individual members are relatively insignificant to China in terms of their shares of China's trade and investment pictures; however, their trade intensity in relation to China appears greater than average and thus implies the possibility of trade dependence. It brings the story up to the core inquiry of this study that whether or not China seeks to achieve political dominance in its economic relations with individual ASEAN members. I conclude this chapter with the overview of China's national FEP and external approaches, which provides the backdrop to my case studies in the following chapters.

2. Alternative trade regime to serve national development

2.1. Trade policy before 1979

For nearly three decades after 1949, China's foreign trade policy had been part of a larger package of political strategies, which were shaped by China's assessment of international environment. Therefore, the volume of trade between China and trading partners had usually been a barometer of diplomatic relations, while Beijing had accepted the idea that trade is the engine of national development, as pointed out by the Minister of Foreign Trade Yeh Chi chung to the National People's Congress (NPC) in 1955 that 'export is for the sake of import, which, in turn, is for the socialist industrialization of our country' and Zhou Enlai's repeated indication that foreign technology was needed for the four modernization program (Tsao, 1987: 81).²³ In this sense, China's foreign trade policy before opening up in late 1978 was treated as an addendum to the overall political swings, which was shaped by various international events and domestic disputes (Naughton, 1995: 48-50).

²³ In 1971 Mao Zedong charged Premier Zhou Enlai with the responsibility for accelerating national economic development. After the signing of Shanghai Communique with the US in 1972, Zhou's Four Modernization Program was introduced to develop national economy through modernizing China's agriculture, industry, science and technology, as well as national defense through importing Western technology in March 1975; since then it constituted the top guideline of China's economic plans (Tsao, 1987: 31; 38).

During the 1950s, China showed the unprecedented degree of dependency on Soviet Union, the only other large communist country available as the developmental model. Although Beijing wanted to trade with as many countries as possible, China's participation in Korean War in 1950 not only strengthened its strategic alliance with Soviet Union but caused the isolation from the sources of Western assistance.²⁴ It left Beijing few choices but adopted the Soviet-style centrally-planned economy, which emphasized rapid capital-intensive industrialization centered on steel and machinery (Shirk, 1994: 8), accompanied with the 'lean-to-Communist-bloc' trade orientation (Howell, 1997: 174-175). However, the bitter Sino-Soviet estrangement led to the sudden withdrawal of Soviet aid in 1960; in response a series of attempts for the goal of 'self-reliance' (*zili gengsheng*) was put into force. After the Great Leap Forward (1958-60), a failed domestic developmental initiative, China started to seek for obtaining supplies of commodities and capital from multiple sources whenever possible (Lieberthal, 2004: 76); for example, in 1960 Zhou Enlai allowed to increase trade with Japan despite political differences over Taiwan, as well as with Western Europe to shift China's purchases of industrial plant and equipment (Ross, 1995: 441). Trade with Hong Kong was also expanded to \$5.39 billion during 1960-71, which made Hong Kong a significant source of China's foreign exchange attributed both to the huge surplus and to the remittances of overseas Chinese (*huaqiao*) through Hong Kong's economic networks with other parts in the world, especially Southeast Asia (Tsao, 1987: 88). Despite the fierce rhetoric against colonialism and capitalism of Cultural Revolution (1965-75), the volume of China's foreign trade held fairly steady until the tensions with the West eased in the early 1970s; it was resulted from Zhou Enlai and Deng Xiaoping's approach to the 'capitalist foes' as the deployment of new national security strategy and developmental plans.²⁵ The entry

²⁴ In October 1950 China sent troops to fight against the United Nations forces in Korea; two months later the US imposed a total embargo on American trade and payment transactions with China. In May 1951 the UN General Assembly adopted a resolution recommending every country impose an embargo on shipments of military weapons and strategic materials to areas under the control of China and Democratic People's Republic of Korea (DPRK, viz. North Korea) (Tsao, 1987: 83).

²⁵ China's security was endangered by the military threat from Soviet Union, which was erupted into overt conflicts at the border in 1969 and 1971 and by the war with the US in Indochina. Therefore Mao initiated to exploit the leverage inherent in its position between the Soviet Union and the US within the strategic triangle (Shirk, 1996: 192).

into the UN in 1971, the relaxation of the US embargo in 1972, and the normalization of relations with major industrialized countries including Canada, West Germany and Japan had allowed China to expand trade in order to facilitate domestic production and self-reliance, as Deng Xiaoping illustrated to the UN in 1974 that China wanted to increase sales of coal and oil to the West to pay for more technology (Howell, 1997: 176; Ross, 1995: 442-3). Nevertheless, although the volume of China's foreign trade expanded substantially during 1972-78, ideological debates over the new avenue to self-reliance within the CCP hampered the implementation of the open-door policy until Deng gained the majority support at the Third Plenum of the 11th CCP Central Committee in December 1978 (Tsao, 1987: 92).

Before 1979, the import-substitution regime was adopted to serve the needs of China's command economy; due to the shortage of foreign exchange, governmental intervention had dictated China's foreign trade (Lardy, 1992: 5). Exports were not viewed as directly contributing to economic growth but rather simply a mechanism for financing imports, while imports were set to increase the supplies of machinery and equipment, industrial raw materials, and intermediate goods that were in short supply and needed to meet physical production targets for high-priority final goods (Cerra and Dayal-Gulati, 1999: 5; Fukasaku and Lecomte, 1996: 13; Lardy, 2002: 29-30). In order to achieve the goal of a self-reliant industrial economy, domestic industry was protected from foreign competition by direct controls on imports as well as investment and administrative allocation of foreign exchange combined with an overvalued currency (Shirk, 1994: 8-9). Therefore, the trade policy during this period was characterized with the central planning and foreign trade monopoly conducted by twelve foreign trade corporations (FTCs); they had been designated as an institutional vehicle to implement the exports and imports plans of their specified product ranges (Panagariya, 1993: 53; World Bank, 1994: 24). Since the planning process was carried out in quantitative term, the exchange rate and relative prices were unimportant in determining the magnitude and the commodity composition of China's foreign trade (Lardy, 1992: 19-29). For the purpose of protecting domestic producers, most imports were priced similar to those of comparable domestic goods; for those imports which had no domestic equivalent such as machinery and

equipment for priority state investment projects, they were implicitly subsidized by the fixed exchange rate at an overvalued level. Thus, the overvalued exchange rate was, in fact, used as a trade policy instrument to promote rapid industrialization (Lardy, 2002: 30-31). Against this backdrop, the importance of conventional trade policy instruments such as tariffs, quotas and licensing was limited before 1979. Price-based measures such as tariffs were obviously insignificant since the planning system was based on quantity decisions rather than behavioral responses to prices; the imposition of tariffs was purely for revenue-raising. Similarly, there was little need for quotas or licensing because the quantities of imports could be controlled through the monopoly of FTCs (Fukasaku and Lecomte, 1996: 13; Ianchovichina and Martin, 2001: 3).

Yet the consequence of pre-reform trade regime was proved to be adverse to China's economic growth due to the inefficiency of domestic resource allocation. Exports did not reflect China's comparative advantages and domestic producers had no economic incentive to expand their international sales; they in turn impaired China's ability to finance a growing flow of imports that would have embodied technology more advanced than that available domestically, thus contributing to industrial productivity and economic growth. As a result, China simply failed to participate in the rapid growth of world trade after the World War II through exports expansion, and imports was fundamentally constrained, particularly in the 1960s and 1970s when China eschewed significant foreign borrowing and remained closed to foreign direct investment (FDI). In spite of increases in the trade volume since the 1970s brought about by the improved political relations with the West, the growth was at expense of distorted commodity composition; furthermore, China's share of world trade dropped markedly, from 1.5% in 1953 to 0.97% in 1978 (IMF, 1980; Lardy, 2002: 31).

2.2. Foreign economic policy until the mid-1990s: partial liberalization

2.2.1. Preferences for economic opening

The initiative of China's open-door policy, that is, to welcome foreign investment as well as to expand and decentralize foreign trade, signifies the transformation of national developmental strategies from autarky to participation in world economy. This significant change of policy was stimulated by the looming domestic economic crisis associated with international pressure, which happened to serve the needs for Deng Xiaoping's leadership competition within the CCP after the death of Mao Zedong in 1976. Under the import-substitution regime of the autarkic policy, the biggest beneficiaries were the capital-intensive heavy industry, inland provinces, military and central agencies of political and economic controls which had been protected from international competition and had remained as powerful coalition; at the same time, thorough social control to blockade information about world development and characteristics of Chinese institutions had precluded the overt demands for policy change from below by disenfranchising society as well as by political elites at lower tiers from forming competing coalitions. Therefore, when Deng challenged Mao's chosen successor Hua Guofeng and his core supporters, the leaders of China's energy and heavy industrial sectors (which are concentrated in inland regions), he took advantage of revelation of the downwards revised oil reserves that implied the unsustainable earning from exports thus endangered machinery imports for heavy industries, especially when the rapid growth of world trade and outwards investment from industrialized countries since the 1970s increased the opportunity costs for China. In response to the prevailing concerns among top leaders, Deng gained political support for his alternative foreign economic approach with special reference to the successful experiences of newly-industrialized countries (NIEs) in East Asia, namely, to accelerate economic growth through absorbing foreign investment and promoting exports of light industrial manufactured goods. This appeal allowed Deng to attract new set of supporters consisting of natural beneficiaries of open-door policy, including light industry and coastal provinces, and made an end run around the central planners and industrial bureaucrats who had perpetuated import-substitution self-reliance. Therefore, in the context of Chinese political institutions and pressure exerted by the world economy, Deng's open-door policy worked to consolidate his power and build a coalition behind the reform drive. The formal endorsement of open-door policy as the avenue to the overarching goals of rapid economic growth and national development was conducted in

the Third Plenum of the 11th CCP Central Committee in December 1978, which also confirmed Deng's position as the paramount leader (Frieden and Rogowski, 1996; Haggard, 1990; Naughton, 1993; Shirk, 1996).

This political reality explained important features of the subsequent implementation of open-door policy. Ultimate policy goals of promoting national development through rapid economic growth notwithstanding, the policy itself lacks a clear blueprint of the reform process and has proceeded gradually and experimentally; described with the Chinese saying, the process has been like 'crossing the river by groping for stepping stones', which means that each phase of reform has been directed at solving certain limited problems and moving the economy in the general direction of greater openness and market orientation (Naughton, 1993: 510). Instead of attacking the perquisites and powers of the central planning and trade agencies and industrial ministries head-on, Deng and other reformist leaders encircled the government bureaucracies by creating new forms of business from traditional state rules; at the same time, these old vested interests continued to receive priority in allocation of central state investment and promotion of oil exports, as well as the channels of foreign funding in offshore oil exploration and in coal (Shirk, 1996: 196-197). This political tactic leads to the creation of dualistic trade and investment system characterized by the parallel export promotion (EP) and import substitution regimes (Naughton, 1996), while the export promotion regime has been fueled by the administrative decentralization to local governments; the ending of central foreign trade monopoly and the offer of new financial incentives – devolution of fiscal revenues and foreign exchange retention rights – down to provinces and cities have spurred the development of local (light manufactured) industries and increase of exports. Since this experiment began in the coastal provinces, the material and political rewards they gained inspired heavy industries and inland regions to demand for the same 'particularistic contracting', which in turn helped to enlarge China's economic opening (Shirk, 1996: 197-199). Yet in contrast to consolidation of EP regime, the parallel import substitution regime started to lessen in terms of opening domestic market to foreign goods by lowering tariffs and other non-tariff barriers (NTBs) only since the mid-1990s as China's commitment as the WTO membership (Lardy, 2002). Therefore, the exact

content of China's open-door policy from 1979 to roughly mid-1990s was only partial trade liberalization aiming at increasing national income while protecting the less competitive domestic producers at the same time.

2.2.2. Significant measures of export promotion (EP) regime

2.2.2.1 Export restrictions

Beginning in the early 1980s, the pre-reform direct physical planning of exports had been replaced with the introduction of export licensing and quotas, which was abolished in the early 1950s when the state-controlled foreign trade monopoly was enforced. This policy instrument served three functions in the early stage of economic opening. Firstly, it prevented profit-maximizing traders from exploiting the differences of domestic and international prices of commodities which could have led to the shortage of domestic market. Secondly, the restrictions could prevent depressed world market prices of certain commodities, which China was the major source of supply, from excessive exports. Thirdly, it enabled China to comply with its bilateral agreements with developed market economies such as US and EU that placed quantitative restrictions on Chinese exports of textiles and apparel. Yet with the parallel price liberalization of non-agricultural products which eliminated the large differentials between domestic and world prices, the scope of such export restrictions was drastically cut down in the early 1990s, apart from textiles and apparel (Lardy, 2002: 24; 46-48). Along with the elimination of export restrictions, financial incentives have been also offered for export promotion, mainly through reform of foreign exchange regime and tax exemptions. The former had significant welfare implication by implicitly subsidizing domestic exporters until 1996, while the latter have been designed primarily in favor of foreign-invested enterprises (FIEs).

2.2.2.2. Foreign exchange reform

Reforms of foreign exchange system have been undertaken in order to facilitate the structural reform of trade sector since the beginning of open-door policy. In March 1979,

the State Administration of Foreign Exchange (SAFE) was established to assume the function of foreign exchange control, which introduced the foreign exchange retention system to provide incentives to exporters in the same year. Under the system, domestic exporters were allowed to retain a certain portion of their foreign exchange earnings in the form of quotas, and subsequently these quotas were permitted to transfer with other approved exporters. Furthermore, in order to adjust the cross-subsidies that the unprofitable export sector had been offset by the profits made by import sector through the overvalued official exchange rate, the RMB internal settlement rate (ISR) was enforced through 1981-84. The ISR was applied to trade-related foreign exchange transactions along with the more appreciated official rate, which had been determined in the value of a basket of currencies, was used to cover the service-related transactions such as overseas Chinese remittances, and foreigners were granted the foreign exchange certificates (FECs) at the official rate. However, the increased domestic price and the resulting ISR overvaluation necessitated additional subsidies to export sector; meanwhile, the external pressure from IMF and US on the adoption of dual exchange rate system, prompted China to adopt foreign exchange swap market as the alternative to the formally-abandoned dual exchange rate system in 1985 (Lin and Schramm, 2003: 250-253).

The foreign exchange swap markets, therefore, developed out of the foreign exchange retention system and the need to provide incentives to exporters without fiscal burden of fiscal subsidies. It not only provided a control measure of foreign exchange resources outside the central government but enabled the authorities to administratively control imports more with tariffs and NTBs especially when the retention ratios increased. As the integrated part of China's efforts of attracting foreign investment into special economic zones (SEZs) and coastal provinces since 1984, the State Council allowed the FIEs to swap actual foreign exchange among themselves in 1986, and even with domestic institutions within the SEZs. Since the swap price of foreign exchange determined by buyers and sellers through negotiations would be much higher than the official exchange rate, export earnings measured in domestic currency for each US dollar of sales abroad rose even though the official exchange rate was unchanged. As the state generally

allocated the surrendered foreign exchange to the favored domestic importers at the official rate, they derived net gains from such dual exchange rate arrangement, in addition to part of benefits received by domestic exporters, local governments, and FIEs generated by the system as the more depreciated swap market rate was applied to the transfer of their retained foreign exchange earning. In December 1989 the official exchange rate was devalued by 21.2%, resulted from the stronger macroeconomic control after the Tiananmen crackdown. In order to assist the phasing out of export subsidies as part of China's negotiation for the entry into GATT, the RMB official and swap market rates were unified in 1993; in addition, both the foreign exchange retention system and foreign exchange controls on exports were abolished, while the foreign exchange swap business for domestic enterprises terminated accordingly. The official rate was fixed in 1994 at the market-clearing rate, which suggested the necessity of cumulative change in the official exchange rate up to that time in eliminating the historically overvalued currency as an integrated part of extended economic opening (Lardy, 2002: 48-49; Lin and Schramm, 2003: 254-258).

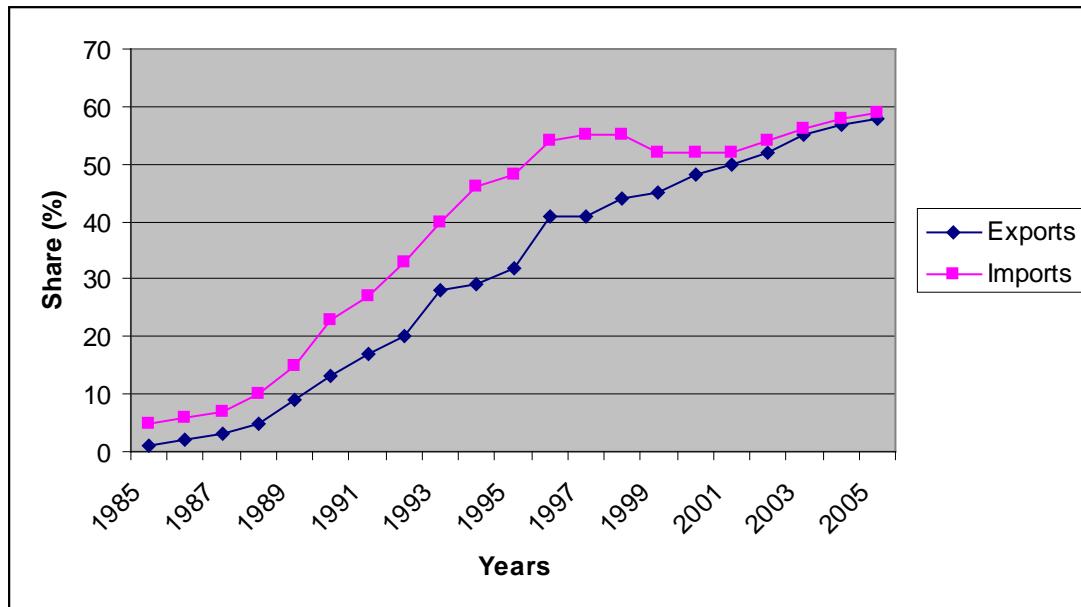
2.2.2.3. Promotion of export-processing associated with FIEs

Since 1984, two crucial policy measures have been introduced to encourage foreign investors to establish export-oriented enterprises in China: one is the development of an approval procedure, a legal framework,²⁶ and concessionary taxation administered mainly by the local government, while the other is the promotion of export-processing industry, for which the imported materials and components have been eligible to the duty drawback system, along with minimum of administrative interference (Naughton, 1996: 298-299; Lardy, 2002: 50). The export-processing has had two variants: in 'processing and assembly' (*lailiao jiagong*) trade, foreign firms outside China maintain ownership of materials and consign them to Chinese firms for processing, then manage the export of finished goods; in 'import-processing' (*jinkliao jiagong*) trade, FIEs inside China purchase imported inputs, process them, and export the finished goods by themselves (Naughton,

²⁶ *The Sino-Foreign Joint Venture Law of the PRC*, adopted at the Second Session of the Fifth National People's Congress on July 1, 1979.

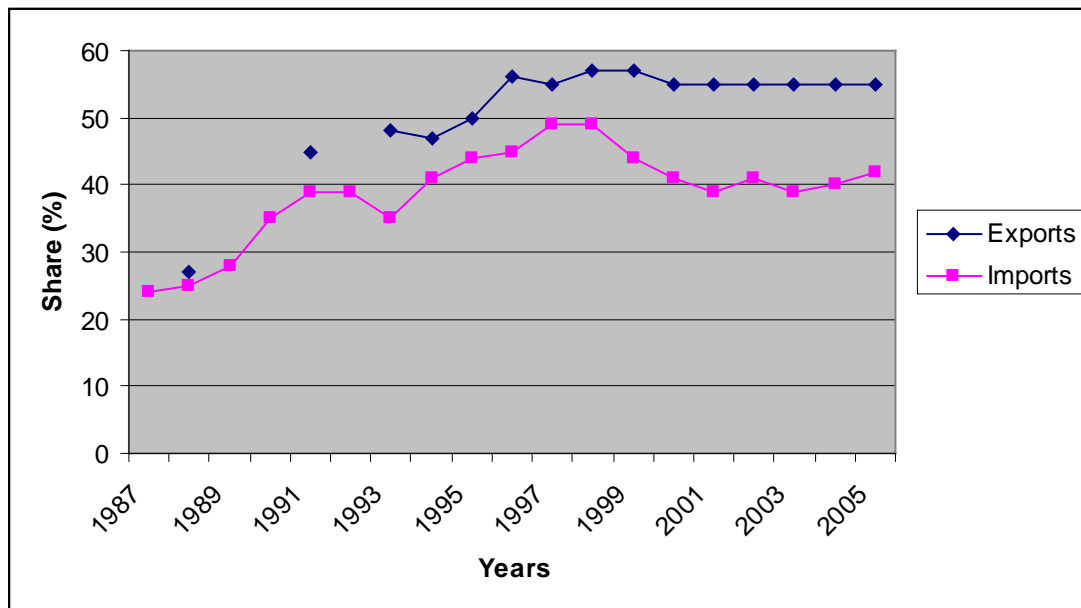
2000: 239). China initially supported the ‘import-processing’ trade by providing foreign exchange on favorable terms as discussed the previous section and preferred access to domestic raw materials, fuel, and electricity, which ten were in short supply; it was not until 1987 and 1988 that the State Council initiated programs to rebate import duties on raw materials, parts and components, and so forth used for export processing by FIEs and domestic enterprises, respectively (Lardy, 2002: 51). However, comparing with the domestic counterparts, FIEs have enjoyed other significant privileges which reflected the governmental efforts in attracting FDI. In addition to the ability to engage directly in foreign trade, other concessionary provisions are applicable to export-oriented FIEs. All FIEs have been eligible for duty-free import of investment goods until the phasing out in 1997; relative to the statutory corporate income tax rate of 33%, FIEs have been qualified for a variety of reduced on the basis of location (for example, 15% in the five SEZs and 15-18% in approved development zones in other regions; and 24% in large ‘open costal zones’ and the old urban districts in the 14 ‘open coastal cities’); those designated as ‘export-oriented’ have been eligible for an additional 50% reduction, irrespective of location; significant tax holidays in terms of the regular tax exemptions in the first two years of profit-making operation and levied at 50% of the full rate in year three to five, while losses incurred during startup can be credited against profits to delay the onset of the first profit-making year; and overt or implicit subsidies resulted from the competition between local jurisdictions to attract FDI, such as discounted prices for factors of production. Although these concessions are not unique, the scale on which these provisions are unusual (Naughton, 1996: 301-2); as the result, exports conducted by the FIEs had grown rapidly and accounted for more than half of China’s total exports in 1996 as illustrated in Figure 2.1; and the processing trade has also been an increasingly significant contribution to the growth of China’s trade (see Figure 2.2).

Figure 2.1 Trade conducted by FIEs, 1985-2005



Source: Lardy, 2002: 7; State Statistical Bureau of the PRC (2002-06).

Figure 2.2 Significance of China's processing trade, 1987-2005



Source: Lardy, 2002: 38; State Statistical Bureau of the PRC (2006: 735).

2.2.3. Extensive imports controls up to mid-1990s

In contrast to the promotion of exports, China's domestic market had been highly protected by the strict imports control with tariff and broad array of NTBs that aimed to insulate Chinese industries from international competition (Lardy, 1995: 1077); beginning since 1992, the relaxation of imports control was resulted from pressures imposed by the US, and the subsequent requirements for the GATT/WTO membership (Harrold, 1995: 141-144).

2.2.3.1 Tariff

When physical quantities of individual imports were determined in the planning system and most imports were sold at the same price as comparable domestic goods in the pre-reform era, the use of tariff was unimportant since it had little or no effects on changing domestic consumption behaviors, which would be responsive to final prices of available goods. Yet as the scope of import planning was reduced since the 1980s, the state introduced high tariff for many products and adjusted tariff upwards on others. In 1985, the NPC passed a new customs regulation and overhauled the entire tariff schedule; the relatively high rates and dispersed lines by international standards sustained with only extremely modest adjustments for the next seven years (Lardy, 1995: 1077; 2002: 33). This design had served twofold purposes. On the one hand, the desire to protect sectors in which domestic production was significant had meant that tariff on capital goods and intermediates was high (20-40%); in some cases such as road vehicles and textile yarns, the tariff was exceptionally high. In addition, where the tariff was used to penalize non-essential consumer goods, as in the case of tobacco, beverages and certain items of clothing, for example, rates were very high (could be up to 50%). This had kept import penetration in these sectors very low and had caused unintended effect of providing high margins of protection to local production. On the other hand, where applicable to 'essential goods' which were also subject to import planning, tariff had been very low (under 10%); it had created an inherent bias against certain raw materials and

intermediate inputs for which domestic prices had been kept artificially depressed (World Bank, 1994: 49-57).

However, relative to the value of imports, tariff revenue had been low due to the concomitant enforcement of tariff exemption on imported goods for export-oriented processing. Two major categories of imports have been eligible for tariff exemption since 1979, including raw materials and intermediates used in processing for exports, and capital goods used by the FIEs. Beginning in 1987, exemption has been expanded to all raw materials and intermediates, which meant that producers of these goods in China operated at international prices and were free from the distorted exchange rate system. When duty-free imports for processing trade quickly increased as shown in Figure 2.2, by 1994 the tariff collection rate had fallen to 3% of the value of imports (Lardy, 2002: 34, 37). It highlights the ‘protected export promotion (PEP)’ nature of China’s FEP as a whole up to the mid-1990s, since the system had been designed to simultaneously promote exports via incentives, while to offer significant domestic protection (Harrold, 1995: 138).

2.2.3.2. Use of NTBs

Other than tariff, China has used extensive NTB measures to control and regulate imports; it has been regarded as the more significant restriction on the inflows of foreign goods by the US. Two instruments have been at the core of NTBs for quantitative controls, including ‘canalization’, in terms of limits on imports right, and system of imports licensing and quotas.

Canalization emerged in the context of decentralization of China’s import planning. The system has been partially transformed from the extremely limited trading monopoly conducted by only twelve FTCs in 1979 to the increased number of companies authorized to trade as the introduction of ‘trading agency system’ (*daili zhi*) and, more importantly, by reducing the number of commodities for which trading rights were limited to one or a tiny number of these state trading companies. Although all FIEs have automatically had

the right to trade directly without using the services of the state trading companies from the outset of the reform, they were only allowed to import input needed for their own production (Lardy, 2002: 40). Canalization had been subsidiary to the implementation of China's import planning; goods subject to the import plan (most of them were the so-called category I imports) had been those regarded as essential either for people's livelihood or for national economic development. Typically, they had been also subject to state pricing at levels substantially out of the line with world prices, and therefore requiring an import subsidy (World Bank, 1994: 63). Although the scope of the import plan has been declining in the 1980s (Lardy, 1992: 40), in 1992 planned imports still applied to 11 broad product groups including commodities such as grain, fertilizers, iron ore, cotton, wool, plastic sheeting and wood pulp.²⁷ In addition to all commodities subject to the import plan, some other raw materials, such as certain imports for the textile and apparel sector, and some consumer goods such as tobacco (the so-called category II imports), were also canalized.²⁸ It was estimated that in 1992 it covered no less than 32% of imports, of which 18% were plan imports and 14% other canalized imports. This measure had three functions: for plan imports, it ensures adequate imports on the commodities lists with low domestic prices, such as grain and fertilizer; secondly, it limited such imports at times of balance-of-payment (BOP) shortage; and finally it protected domestic industries through the enforcement of import quotas handed out to designated trading companies (Harrold, 1995: 139; World Bank, 1994: 64).

Canalization has been complemented by import licensing and quotas. Re-introduced in the early 1980s, licensing has been used to balance the disequilibrium between rising demand for imports and limited sources of foreign exchange, to protect specific domestic industries such as consumer durables and automobiles, and in principle to contribute to the more rational choice and domestic distribution of imports (Lardy, 1992: 44-45). By the late 1980s, the number of commodity categories subject to licensing expanded to 53, and the share of all import subject to licensing requirements hit a peak of 46% (Lardy,

²⁷ The complete list of planned imports in 1992 is provided in World Bank (1994), Statistical Annex, Table A2.2, p. 273-276.

²⁸ The complete lists of imports subject to Category I and II in 1992 can be seen in World Bank (1994), Statistical Annex, Table A2.3, p. 277-286 and Table A2.4, p. 287.

2002: 39). Goods subject to licensing have considerably overlapped with, but do not correspond exactly to, the categorization of products under the import plan as the licensing has been concentrated in three broad groups. For agricultural raw materials subject to price controls and import planning (rubber, cork and timber, wood pulp and textile fibers such as wool and cotton), licensing has been used as an administrative device to allocate a fixed quantity of planned imports and state-controlled foreign exchange to different users. For critical manufacturing sectors such as iron and steel products, textile yarns, machinery and electronics where domestic production was significant, licensing has offered protection against international competition; and for non-essential consumer items such as beverages and tobacco, licensing has served mainly the purpose of BOP. In 1992, of imports subject to licensing, more than half were also subject to canalization (World Bank, 1994: 64-66).

The scope of NTBs was pushed to scale down when China signed the market access agreement with the US in 1992. Attempting to fix the souring political relations with the US by moderating the bilateral trade imbalance in the aftermath of Tiananmen crackdown, China agreed to remove 90% of its NTBs and to reduce tariff over time, which was expected to reduce the number of quantitative restrictions from 1,250 to 240 by the year 2000 (Harrold, 1995: 141-143).²⁹ This commitment was also regarded by Beijing as conducive to its striving for WTO membership, especially when the negotiations of pace and scope of market opening for ‘resuming’ the seat in GATT (*fuguan*) turned to be very difficult and eventually failed caused by the pressure from the GATT contracting parties. Yet the impediment was accrued from more political than pure economic reasons: the more demanding conditions set for China in the early 1990s not only partly reflected Western criticism on China’s human rights but was mainly for making China’s entry as a ‘template’ for future negotiations with other transitional economies, namely the former Soviet republics and allies; in addition, Beijing’s insistence on getting admitted into GATT ahead of Taipei further complicated the bargaining (Lanteigne, 2005: 38-39).

²⁹ *Memorandum of Understanding between the Governments of the United States of America and the People’s Republic of China concerning Market Access*, signed on 10 October 1992.

2.3. Accelerated trade liberalization: from mid-1990s to 2005

2.3.1. Achieving the GATT/ WTO deal: the two-level game

As discussed in the previous sections, relative to the export promotion, the liberalization of China's import regime appeared to be at the slow pace up to the early 1990s. The 'protected export promotion (PEP)' nature of open-door policy was rather a compromise of the key tenets of Deng's economic reforms that to expand exports to help pay for the modernization program, while to shield domestic industries from undue international competition and therefore avoid backlash from these interest groups. To keep moving toward this direction, China started to seek the GATT membership in 1986 with the anticipation that admission would provide it many economic benefits previously unavailable, such as attaining more market information shared among GATT members, constraining protectionist policies of China's key trading partners, particularly the US, within the GATT frameworks, and allowing China to address trade disputes more effectively with the GATT settlement mechanism (Lanteigne, 2005: 38). To this end China made tariff reductions the centerpiece of their entry protocol and expected it would reduce the more onerous foreign demands on increasing market access; it also argued for the 'developing country' status, under which state intervention was more tolerated and which allowed longer transition times for compliance with GATT rules. The offer was regarded as inadequate by the US, particularly on the grounds of trading rights, market access, and other national treatment issues; it directly caused the failure of China's GATT application in 1994. Even though, the basic policy decision of seeking GATT/WTO membership as a necessary means to China's economic transformation, initiated by Deng Xiaoping, was continued by his successor Jiang Zemin (Pearson, 2001), especially when the top leaders were concerned with the real output growth and the overall economic efficiency (Lardy, 2002: 11-15).

However, regarding critical issues, plural interests have become increasingly influential in the FEP decision-making process in the reform era. As the name 'fragmented authoritarianism' of the Chinese bureaucratic decision-making system suggests, multiple

affected parties, including the national economic commissions and cross-functional bureaus of the central government, nearly all industrial sectors, and provincial and local governments, were incorporated into the process along with the pro-accession (and pro-foreign) Ministry of Foreign Trade and Economic Relations (MOFTEC) as a way to consult with and gain the support from them. Yet the wide-ranged protectionist interests of industries and ministries dictated their positions in the WTO issue. Some of the strongest opposition was from ministries that were to benefit from the promulgation of industrial policies which aimed to protect 'pillar' industries largely through special funding and preferential tax policies, was considered vital to the development of not only a strong economy but a strong military; ministries represented the state-owned enterprises (SOEs) also strongly resisted WTO entry and the related bilateral agreements. In addition, opposition also existed among provincial governments, which for much of the period believed that they bore little of the cost of failing to join the WTO. Their opposition also seemed to gain more legitimacy from the heated ideological debates at home (Pearson, 2001), which was triggered by the considerably expanded WTO agenda. Formally concluded in the Uruguay Round in 1994, WTO membership requires liberalization of a much broader range of domestic economic activity such as many services, agriculture, intellectual property and certain aspects of FDI; some of them are traditionally regarded by most countries as among the most sensitive (Lardy, 2002: 10). Yet, in the WTO accession issue, elite preference of the top leaders finally outweighed the pluralization of policy inputs. By 1999 top leaders decided to insert themselves more decisively into the internal negotiation process, although for different reasons. Jiang Zemin had long voiced general support for WTO accession and seemed to have been influenced by a desire to build a legacy as the leader who brought China into the new world economy; while Zhu Rongji was driven more by the economic imperatives that the only way to break the hold of the 'old' economy and its champions was to force on it via the stringent requirements imposed by the WTO rules (Pearson, 2001: 363-364).

At the same time, export expansion has made China's foreign economic policy making more porous to the external pressure. In addition to the WTO requirements, the primary obstacle to China's WTO admission remained the US, the largest economy and thus the

major voice in deciding on new admissions. China was also anxious to ensure uninterrupted linkage with American economy by removing the annual congressional vote on Most-Favored-Nation status (MFN, now called Normal Trade Relations, or NTR) that was repeated buffeted by the overall cyclical nature of bilateral relations due to the bipartisan competition in the US. Reflected the massive domestic pressure, China had tried to negotiate terms that would be more favorable to its economic needs against the US concerns on ongoing price controls, high tariffs, and a lack of transparency in trade regulations; China also pushed very hard for its 'developing country' status since it would result in more lax conditions and deadlines in meeting WTO requirements, and would allow China to protect infant industries, restrict imports, and permit the state to issue development subsidies under the WTO rules (Lanteigne, 2005: 42; Pearson, 2001: 337-339). Difficulties for Beijing to make key concessions demanded by Washington not only out from domestic opposition but also the nationalistic sentiments at home, which claimed that Chinese policymakers were too willing to make concessions to American and Western demands in their pursuit of WTO membership, and that admission would result in considerable costs with uncertain benefits for China (Lanteigne, 2005: 45). With the decisive intervention of top leaders, China started another round of push in 1998. Politically, Beijing tried to exploit the better footing of bilateral relations after Clinton's successful visiting in June; in addition, Beijing realized a 1999 deal might avoid clouding the congressional vote on permanent normal trade relations (PNTR) with election politics in 2000. Economically, a deal closed by the end of 1999 could avoid the potentially higher conditions for WTO entry set in its next round of trade liberalization in the Seattle Summit; China also hoped to stem the slowdown of incoming FDI and exports from its WTO membership as a result of Asian Financial Crisis (AFC) (Pearson, 2001:344-345). In spite of the vehement anti-American protests triggered by the May 1999 bombing by US aircrafts of the Chinese embassy in Belgrade (Miles, 2000-1), the bilateral agreement was achieved on 15 November of the same year. In order to facilitate the deal, China had to make its own considerable concessions including the dropping of tariffs on imported industrial products from an average of 24.6% to 9.4%, removing quotas on textiles by 2005, permitting foreign banks to provide services using Chinese currency for Chinese enterprises, and for Chinese individuals at a later date, and the lowering of tariffs on

American farm goods (Lanteigne, 2005: 49). On 11 November 2001, China was formally admitted into the WTO with the even more sweeping commitments, including significant statutory tariff reduction, introduction of a tariff-rate quota system, phasing-out of all quotas and licenses, considerable curtailment of state control over trading system, and opening of key service sectors such as telecommunications, distribution, banking, insurance, asset management and securities to FDI. China has also agreed to abide by international standards in the protection of intellectual properties (the trade-related intellectual properties, TRIPS); additionally, its trade practices would be subject to an unprecedented annual review for the first eight years of membership, with a final review in the tenth year under the transitional review mechanism (TRM) which would be conducted by each of WTO's functional councils. By comparison, the normal Trade Policy Review (TPR) for WTO members is conducted by the staff in the TPR Division of the WTO Secretariat (Lardy, 2002: 22; 104).

The process for China to achieve its WTO deal therefore could be interpreted as a 'two-level game' (Putnam, 1988). The opposition against the concessions made for WTO membership is hardly surprising, since the benefits of market opening would be broadly dispersed whereas the costs would be concentrated (Pearson, 2001: 365). Along with the nationalistic voices, these domestic groups have pursued their interests by pressurizing the central government to affect negotiations with foreign players; the intertwined domestic demands and external pressure thus have complicated the achievement of China's WTO deal and related bilateral agreement with the US, notwithstanding the strong elite preference for WTO accession.

2.3.2 Export regime under the WTO protocol

Although the export barriers had been falling in the 1990s, restrictive measures of prohibitions, licensing and quotas have maintained on a number of items to avoid shortages in domestic supply, conserve exhaustive natural resources, or in accordance with international obligations (WTO, 2006: 102). At the same time, the 'passive quotas' had been placed on China's export of textiles and clothing in exchange for some specific

advantages with major trading partners after the end of the WTO Agreement on Textiles and Clothing (ATC) in 2005. For example, under the MOU with the EC, the growth rate of these exports would be limited to between 8% and 12.5% per year until the end of 2007; as a quid pro quo, EC agreed to end its ongoing safeguard investigation on these products and to refrain from adopting other measures permitted under WTO rules. In the similar agreement with the US, the agreed restraints on certain categories of textiles and clothing have expected to increase the overall export of these products at the rate from 8% to 17% until the end of 2008 (World Bank, 108-109).

In parallel to the bargaining with specific trading partners, another measure to promote exports is the continuing use of value-added tax (VAT) rebate. Since WTO allows the rebate of indirect taxes as a way to facilitate countries like China that relies heavily on indirect taxes to compete fairly with those – for example the US – that generate fiscal revenue primarily by direct taxes such as the corporate and personal income tax, this measure introduced by the State Council in 1984 have become increasingly important in assisting the structural upgrade of China's export-oriented industries. For example, by 1999, the 17% VAT on electronic and light machinery products was fully refundable; rebates were increased for some IT products in November 2004. The goal of meeting industrial development could be also achieved by discouraging some exports in certain instances, for example, the VAT rebates were withdrawn for exports of billet and other primary iron and steel products in April 2005, and lowered for some steel products one month later (Lardy, 2002: 50; WTO, 2006: 100). Increased VAT rebates have also served to stimulate export growth in the aftermath of AFC as well as for the border trade in Yunnan province and adjoining areas (WTO, 2006: 102). In addition, other tax incentives have also been applied to promote China's export-processing industries and the associated FIEs. Under China's accession protocol, imports of raw materials, spare parts, and assembly and packing materials for both 'processing and assembly' (*lailiao jiagong*) and 'import processing' (*jinliao jiagong*) are eligible for tariff exemptions. For FIEs, a reduction of 50% of the normal income tax rate of 33% could be obtained if 70% of their production volume is exported; those located in SEZs or other economic and technology

development zones continue to enjoy the income tax rate of 15% while could have a reduction of another 5% if the same export requirement is met (WTO, 2006: 100; 102).

2.3.3 Imports liberalization as the WTO commitments

2.3.3.1 Tariffs

Due to the demands from the US and GATT/WTO requirements, China has started to reduce the tariff levels since 1992; at the same time, the dispersion in the rates on individual tariff lines also declined significantly. The latter matters because for a given average tariff rate, greater dispersion in the individual rates generally increases the protection for domestic producers (Lardy, 2002: 34). After systematic tariff adjustments, China bound 100% of its tariff at *ad valorem* rate as a result of its WTO accession negotiations; in 2005, the average bound rate was 10% (15.3% for WTO-defined agriculture and 9.1% for non-agricultural products). The tariff of textile and clothing has also reached its final bound rate of 11.5% from 17.6% in 2002. Since the WTO accession, China also applies the MFN duty rates to all WTO members except El Salvador; the rates have closely followed its bound rates. In addition, the more preferential duty rates have been unilaterally applied under China's bilateral and regional trade agreement (World Bank, 2006: 64-69). For example, under the Early Harvest Program (EHP) of the China-ASEAN Free Trade Agreement (CAFTA), China has signed separate preferential agreements with each ASEAN member states (Lu, 2007). As the result of China's pledge of 'to accord MFN treatment consistent with WTO rules and disciplines to all non-WTO ASEAN member states',³⁰ the overall average agreement tariff rates for ASEAN members range from 8.8% to 9.2%, lower than China's overall applied MFN average. The breakdown of tariff summary is shown in Table 2.1. One important effect of the enforcement of EHP is that China provides better market access to all ASEAN states than to least developed countries (LDCs) included under its other unilateral special

³⁰ See the original text of *Agreement on Trade in Goods of the Framework Agreement on Comprehensive Economic Co-operation between the Association of Southeast Asian Nations and the People's Republic of China* at <http://www.aseansec.org/16646.htm>. The agreement has started to enter into force from 1 January 2005.

preferential tariff agreements;³¹ for example, when the overall special preferential tariff rate is reduced to 9.5%, the overall average tariff for Malaysia, Singapore and Vietnam stands at 8.9%, 8.8%, and 9.0%, respectively (World Bank, 2006: 72).

Table 2.1 Breakdown of tariff rates applied to Malaysia, Singapore and Vietnam in 2005 (%).

	MFN	Agreement tariff rates		
		Malaysia	Singapore	Vietnam
Number of preferential lines		535	536	484
Overall average	9.7	8.9	8.8	9.0
WTO agriculture	15.3	10.6	10.3	11.1
Animal & prod. thereof	13.7	3.9	3.9	5.2
Dairy products	12.1	4.0	4.0	4.0
Fruits & vegetables	16.0	6.9	5.7	7.0
WTO non-agriculture	8.8	8.6	8.6	8.6
Fish & fishery products	10.5	2.9	2.9	2.9
Textiles & clothing	11.5	11.5	11.5	11.5

Source: WTO, 2006: 71.

Tariff reductions have been also used to stimulate foreign trade and thus economic growth. For example, as the complement to VAT rebates, reduced or zero rates of customs duty are available for imports for export-processing companies established in the SEZs or other special zones (WTO, 2006: 73). In addition, this measure has been applied to border trade in order to boost local development as well as the promotion of trade and exchanges with neighboring countries,³² including Vietnam. Preferential treatment has involved two provisions. On the one hand, residents within a 15-20 kilometer area of the border may import products worth up to 3,000 RMB (equals to \$375 approximately in

³¹ China offers unilateral special preferential tariffs (zero rated) to some products (182 tariff lines) to LDCs; the number of countries receiving these preferences was increased to 39 in September 2005, including Cambodia, Laos and Myanmar (World Bank, 2006: 69, 72).

³² Stipulated in 'Circular of the State Council on Issues Concerning Border' in 1996.

2005) per person per day free from the normal MFN tariffs and VAT. On the other hand, enterprises registered in approved prefectures, counties, and cities along the border that are granted the right to conduct border trade, are subject to a 50% reduction in the tariff and VAT rates on their imports, except on cigarettes, alcohol, cosmetics, and products under import quotas, tariff-rate quotas and import licensing. Moreover, products subject to anti-dumping, countervailing or safeguard actions are also not eligible to such preferences (WTO, 2006: 72).

2.3.3.2 Declining NTBs

As China's implementation of its commitments under the Protocol of Accession, the non-tariff measures to restrict imports have also been falling progressively. The import quotas and licensing that applied to motor vehicles, petroleum products, natural rubber products, cameras and wrist watches at the time of China's WTO accession for protecting domestic industries have phased out gradually by 1 January 2005, while the remaining licensing system are largely for health and safety and under international conventions. Meanwhile, the canalization that was associated with trading rights over specific products has also phased out; FIEs were permitted to export and import products that are used in their own production and for export, although they were not entitled to distribute goods in China. Nevertheless, under the Protocol of Accession, products of grain (including wheat, maize, and rice), vegetable oil, sugar, tobacco, crude oil and processed oil, chemical fertilizer and cotton, are subject to state trading in order to ensure stable domestic supply, stabilize prices, safeguard food safety, and to protect the environment and exhaustible resources. Besides, the tariff-rate quotas system has been jointly administered by the National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) to restrict the import quantities of some agricultural products and chemical fertilizers (WTO, 2006: 76-82).

3. FEP strategies

3.1. FDI policy

3.1.1. Promotion of inwards FDI and its implications

Since the inception of China's reform era, measures designed to attract FDI inflows have been the key facilitator to Deng's open-door policy. Emerged in the early 1970s, the realization of China's apparent technological weakness attributed to the outdated machinery, equipment and techniques from the Soviet Union before the political split led to the shifting approach towards foreign capital advocated by Zhou and Deng, because it could be used as a vehicle to obtain advanced technology for the Four Modernization Program and therefore national development (Hayter and Han, 1998: 6). Yet, remaining misgivings about the potential adverse effect of the 'capitalist foes' on Chinese society and economy shared among powerful factions within the CCP have confined the initial opening to FDI to the four SEZs – Shenzhen, Zhuhai, Shantou (in Guangdong province) and Xiamen (in Fujian province) – at the experimental basis (Bachman, 1988). With the legal source for the existence of foreign investment provided by the Joint Venture Law in 1979, foreign firms were allowed to set up in these SEZs as 'windows on the world' for China and were encouraged to participate in China's fledgling export-oriented production (Pearson, 1991). For this purpose, the local authorities in the SEZs were not only granted independent power to administer the whole process of mobilizing foreign investors but authorized to offer preferential treatments – namely tax incentives and more management autonomy relative to domestic firms – unavailable elsewhere in China (Fu, 2000: 33-34), which has also contributed to the dualist feature of Chinese economy (Naughton, 1996). Since the local economic growth was stimulated in terms of accelerated exports, increased local employment and raised foreign exchange earning through successful attraction of a bulk of FDI from Hong Kong and Macau into the labor-intensive processing industry, other coastal regions started to lobby for the same 'particular contracting' with the central government (Shirk, 1994); it led to the opening of other 14 coastal cities to foreign investment with similar practices in 1984 (Ng and Tuan, 2001: 1055). However, in 1985 the exports and imports conducted by FIEs accounted only 1% and 5% of China's total trade, respectively (Lardy, 2002: 7).

The ‘twenty-two regulations’ promulgated in 1986 was a key action for China to create a more favorable environment for FDI. Preferential treatments were increased to lower fees for labor and rent, tax rebates for exporters, and made it possible for FIEs to convert Renminbi into foreign exchange and repatriate profits. It also extended the joint venture (JV) contracts beyond the original 50-year limit, and created a legal basis for wholly foreign owned enterprises (WFOEs) rather than investors must sign the JV contracts with Chinese partners (Breslin, 2004), which signified an important break from Marxist orthodoxy because China thus became the first socialist country to publish a national law that allowed foreign capitalist firms on its soil alongside the state enterprises notwithstanding the serious sectoral restrictions (Fang and Tang, 1988: 156). In addition, tax cuts and preferential access to foreign exchange before China unified its dual foreign exchange rates in 1994, as discussed in the previous sections, were granted to ‘export-oriented’ or ‘technology-advanced’ FIEs. It illustrated the motivation of utilizing inwards FDI to promote China’s export-led economic growth and thus national development by ‘directing’ investment into targeted sectors, such as textiles, other light industries, and machinery and electronics (Panagariya, 1993: 58). These measures were subsequently enforced in various types of opening regions, cities and zones which made an increasing spread of FDI and the associated export-oriented production to virtually all parts of costal China. In the hope of the same effect, border areas and many of the inland regions were also opened to FDI with various policy incentives comparable to, or even more favorable than, those in the costal areas (Zhang, 1998: 57).

The formal declaration of China as a ‘socialist market economy’³³ as a positive echo to Deng’s calling for rapid economic reform and further opening in his southern inspection tour (*nan xun*) in 1992 has started a new round of relaxation on FDI in services (Fu, 2000:

³³ The idea of creating a ‘socialist market economy’ was first proposed at CCP’s Fourteenth National Congress in October 1992, and was written into the Chinese constitution in 1993. It is critical to China’s economic reform and opening up because it involves changes of Chinese economic structure and the relevant policies. Although the leadership at the time deliberately downplayed the ideological differences between socialism and capitalism, the establishment of a ‘socialist market economy’ allowed Beijing to apply capitalist methods to further economic reform and opening up. With regard to this thesis, it has significant implications to creation of a proper legal system, separation of enterprise management from governmental administration, and decline of the planned sector of the economy. As a result, the Chinese economy has become progressively market-oriented that has led to China’s deepening involvement in the global economy. For the detailed discussion, see Wu (1994).

57). Although the detailed discussion of this part is out of the scope of this study, the opening of tertiary industries to FDI signalled an important shift of developmental strategy from a previously single focus on manufacturing to a now doubled-pronged emphasis on both industrial production and high value-added tertiary sector. The pursuit of higher-valued added activities and development then was also embodied in the clear ‘sectoral roadmap’ provided in the FDI guidelines promulgated in 1995 and was revised in 2002. They classify foreign investment projects into four categories: encouraged, permitted, restricted, and prohibited. In general, it appears that projects in the ‘encouraged’ category are those that use improved technology and are less polluting, while the ‘restricted’ and ‘prohibited’ projects are those use outdated technologies, over-exploit scarce natural sources, and tend to harm the environment. Foreign equity limits tend to vary by industry and are not necessarily related to the category. At the same time, foreign investors in the ‘encouraged’ category are permitted to import capital equipment duty free and may enlarge their scope of business with approval, if they are engaged in the construction and operation of infrastructure facilities related to energy, transportation, and urban utility sectors (coal, oil, natural gas, power, railways, ports, airports, highways and urban roads, sewage treatment, and garbage disposal, etc), which need a large amount of investment and a long payoff period. In addition, investors in the ‘permitted’ category that export all their products directly enjoy the same preferential treatment accorded to ‘encouraged’ projects, as do projects listed in the Catalogue of Advanced Industries for Foreign Investment in Central-Western China formulated jointly by NDRC and MOFCOM in order to facilitate the ‘Western Development’ (*xibu dakeifa*) program (Henley et al, 1999; WTO, 2006: 52-54).

To attract more inwards FDI to advance the industrial and developmental policies, tax incentives have been a long-lasting instrument. In addition to the different enterprises income rates applicable on the basis of location, FIEs involved in manufacturing with an operation period of longer than 10 years and hi-tech FIEs located in hi-tech industrial zones are eligible for significant tax holidays. Export-oriented FIEs enjoy the same two-year exemption and the 50% reduction of income tax as long as 70% of their annual production is exported. VAT rebates are applied to the imported capital goods for the

FIEs, while FIEs operating in designated manufacturing industries in the western and central regions of China are eligible to a complete tax holiday during the first two years after making profits and a 50% income tax reduction during the following six years (WTO, 2006: 56).

3.1.2. Emerging outward direct investment (ODI) policy

Before the economic reform, China's outward direct investment (ODI) was minimal and the only activities were largely trade-servicing in nature. With the beginning of open-door policy, although the ODI was viewed as a way to secure the supply of raw materials, enlarge export opportunities and strengthen economic relations with neighboring countries, the approval of all ODI projects was extremely centralized. It reflected Beijing's concerns regarding excessive capital outflows at the expense of domestic investment, a perception that ODI would not contribute as much as domestic investment to national development, foreign exchange constraints, and difficulties in monitoring overseas investment that could bring a loss of losing control over state property (Zhan, 1995: 67-69). Up to mid-1980s, when foreign trade was still under tight state control and the promotion of inward FDI was at the experimental basis, only state-owned FTCs as well as provincial and municipal international economic and technological cooperation enterprises (*guoji jingji jishu hezuo gongsi*) regulated by the State Economic and Trade Commission (SETC) were allowed to invest overseas (Wong and Chan, 2003: 279). It is hardly surprising that, during this period, the approved ODI projects were strongly linked to Beijing's political consideration. The key decisions on ODI projects, including choices of location and sector, were mainly determined by the motivations of expanding collaboration and enhancing trade relationships with foreign countries, rather than for profit maximization (Wu and Chen, 2001: 1238).

The gradual liberalization on ODI activities has started from the release of the 'Provisional regulation governing the control and the approval procedure for opening

non-trade enterprises overseas' in July 1985 by MOFERT.³⁴ With the other two documents regarding the administration of foreign exchange and approval procedure related to the ODI projects,³⁵ basic regulatory framework was formed; procedures and requirements are still applicable today, although the ceilings of approval were raised in 1992, 2002 and 2004 (Hong and Sun, 2006: 618). The state since then has allowed more enterprises, including non-state firms, to apply for permission to establish subsidiaries in other countries provided they had sufficient capital, technical and operational know-how, and a suitable foreign joint venture partner (Wong and Chan, 2003: 280). However, China's ODI regime also shares the 'particularistic' feature like other parts of FEP. Although the MOFERT has been authorized as the primary governmental organ responsible for the approval and administration of ODI, the process actually involves different levels of government and relevant ministries, depending upon the type, scale, and location of investment being processed (Cai, 1999: 872-873). This design clearly reflects the focus of regulating ODI has located on preventing illegal outflow of capital or unnecessary loss of state assets (Wong and Chan, 2003: 282). Yet, since the early 1990s, ODI has been viewed as a useful tool to help realize China's 'second-step' FEP strategies to sustain the foreign trade-propelled domestic economic growth, including 'score with quality' (*yizhiqusheng*) and diversification of markets (*shichang duoyuanhua*) as a response to the trading pressure from the West in the aftermath of Tiananmen crackdown. The 'score with quality' strategy comprised measures of structural upgrade of Chinese manufacture exports from labor-intensive textiles to more skill-intensive and higher value-added goods such as those under SITC category 7 (machinery and transport equipment) and category 5 (chemicals and related products); furthermore, policy initiatives aiming at speeding up technological improvement and efficiency enhancement were the parallel components. For the dimension of market diversification, Beijing announced to gradually reshape the position of Chinese export market. It meant to 'focus on Asia-Pacific and utilize the neighboring countries as the linchpin to support Chinese

³⁴ Non-trading activities refer to manufacturing (processing and assembling), resource development (such as mining and forestry) and contracting works such as turnkey engineering/construction. Trading activities are generally service-oriented activities (like financial intermediation, distribution, transport, and communications) which are trade-supporting in nature (Wong and Chan, 2003: 286).

³⁵ They are the 'Administration of foreign exchange for outward investment' in 1989 and the 'Approval procedures and administration of outward investment' adopted in 1993 (Zhan, 1995: 69).

exports' and aimed to 'create a reasonable and balanced market structure of developed and developing countries'.³⁶ As a whole, the employment of the two FEP strategies was expected to facilitate the domestic economic restructure in the name of 'grand trade' (*da jingmao*), i.e. the integration of trade and industry, agriculture, technology and finance as a cohesive system.³⁷

For this purpose, the government has specifically encouraged ODI in manufacturing (processing and assembling) industries in which Chinese companies have a competitive edge, resources exploration and extraction, hi-tech development, turnkey projects and tertiary sector (including trade-service, banking, insurance, hotel, tourism, medicine and real estate) by methods including tax incentives,³⁸ subsidies, national bank loans with preferential terms,³⁹ and better access to the domestic market for goods produced by the Chinese affiliates. Among them, electronics and machinery industry has even received particular promotion; prospective investors are exempted from paying a 'security deposit' (5% of the value of the proposed projects) to the government, and if proposed investments in this industry are less than \$0.3 million and are of after-sale service in nature, they can be invested freely with the company's own foreign exchange saving (Cai, 1999: 873). The perception of ODI as useful FEP instrument has also reflected on China's signing of bilateral investment treaties with foreign countries. Up to 2005, China had concluded such treaties with a total of 84 countries.⁴⁰ All of these earlier measures have contributed to the formation of China's 'going out' (*zouchuchi*) strategy;⁴¹ as the renewed version of the 'second-step' FEP strategies, in 1999, a directive was issued to

³⁶ See, for example, the Minister of MOFTEC Wu Yi, 'Opportunities and Prospects: the Basic Ideas of Developing Chinese Foreign Trade in the 1990s [*Jiyu yu qianjing: jiouling niandai zhongguo duiwai jingmao fazhan de jiben goxiang*]', 11 May 1994, documented in *Almanac of China's Foreign Economic Relations and Trade*, 1995/96, pp. 18-25.

³⁷ See, for example, the Deputy Minister of MOFTEC Shi Guangsheng, 'Promotion of Foreign Trade and Improvement of Open up [*Dali fazhan duiwai jingmao shiye, nuli tigao duiwai keifang shuiping*]', 20 November 1997, documented in *Almanac of China's Foreign Economic Relations and Trade*, 1998/99, pp. 20-26.

³⁸ In general, all foreign affiliates have been exempted from taxes for the first five years of their existence. After this period, foreign affiliates pay taxes on earnings of 20% (Cai, 1999: 873).

³⁹ These loans are especially provided to overseas projects if resources extraction and investment projects in the manufacturing/processing that require a large amount of initial capital (Cai, 1999: 873).

⁴⁰ Data is from UNCTAD online database, excluding those were signed by Hong Kong and Taiwan.

⁴¹ President Jiang Zemin, 'Seize Opportunity, Meet Challenge, and Participate in Economic Globalization', *People's Daily*, 19 December 2001.

encourage enterprises to engage in processing trade overseas. Enterprises producing light industrial goods like textiles, machinery and electrical equipment were specifically encouraged to establish overseas manufacturing bases that could process Chinese raw materials or assemble Chinese-made parts as a way to spur the exports. Export tax rebates, foreign exchange assistance, and financial support have been granted to these overseas Chinese enterprises that are 'integrated' in China's 'grand trade' system (Wong and Chan, 2003: 281).

3.2. Securing a profitable external environment through multilateralism

Before turning to the discussion of China's participation in multilateral economic institutions as one of the key tactics to serve the broad foreign economic interests, it is worth comparing China's opening up process with Bowie and Unger's explanation of why the four 'old' ASEAN members – Indonesia, Malaysia, the Philippines and Thailand – chose to increase their economic openness from the mid-1970s to the early-1990s (1997). Bowie and Unger argues that because economic success of the ASEAN Four in the postwar period was resulted from their integration into global division of labor with conditions of the relatively open US market and Japanese developmental assistance in production capacity, their FEP choices had become subject to the external structural changes. In order to sustain economic growth, national FEP of the ASEAN Four had shifted towards the more liberal direction as the response to the key external events, while the degrees of openness were influenced by various domestic factors. My examination of China's opening up process suggests the similar domestic determinants of national FEP changes. For example, to increase the access to foreign exchange and the sources of governmental revenue is seen to be the starting point of China's opening up in 1979, while the 'favorable' institutional and political arrangements – it involved the reshuffle of powerful coalitions – since then have been in play to ensure the national FEP moving towards the greater openness. However, the critical difference between the ASEAN Four's experience and China's story is the nature of the US factor.

As Bowie and Unger explains, economic growth of the ASEAN Four during the postwar years had been the US commitment to providing a market for their products, which was an important part for the US strategies of containing communism in East Asia. However, the access to the US market was not guaranteed for China in the first place. Since China has also relied on the export-oriented manufacturing as the main source of economic growth in the open era, the US – the dominant power in the global economic system – has represented a challenge, rather than the pure opportunities, to China's developmental prospect. It explains why China's major liberalization measures since 1979 have been closely related to the US pressure instead of the responses to the global economic structural changes. The imperative to strike a balance between addressing the US demands and protecting the national economic interests, therefore, has contributed to China's pursuit of economic multilateralism.

However, China's participation in multilateral economic institutions has reflected its developmental needs at different stages of opening up process. For example, China gained the membership in IMF and the World Bank as well as its affiliates of the International Development Association (IDA), the International Finance Cooperation (IFC), and the Multilateral Investment Guarantee Agency (MIGA) in 1980 for a broad range of economic benefits. They included professional advice on almost every aspect of China's economic reform, short-term balance-of-payments and budgetary deficit assistance, access to large pool of lending capital to finance infrastructure projects and finished goods for domestic consumption and exports, and personnel training and information about international economy. Politically, the institutional engagements have channeled strong external support and legitimation on a global scale for China's economic modernization program. In 1986, China also joined the Asian Development Bank (ADB). Other than utilizing ADB's commitment to economic development of its regional members by many of the same approaches as the IMF and World Bank, the major driver was to expel Taiwan from the earlier World Bank Group line (Feeney, 1998).

Participation in more multilateral institutions became more pressing when China faced the international uncertainties during the period of 1989-92.⁴² The Western economic sanctions after Tiananmen crackdown (1989-roughly 1992), the pass of China MFN trade status bill (H.R. 5318) with strict conditions principally on human rights, non-proliferation and trade practices in the US Congress (Suettinger, 2003: 93-134), and Europe's Maastricht Treaty (in 1991) as well as the 1992 North American Free Trade Agreement (NAFTA) were viewed detrimental to China's economic interests. The former two events were interpreted as the 'politicization of economic relations', in terms of the 'unilateral pressure on trading partners'; while the latter triggered China's worries about protectionism nourished by the establishment of trade blocs.⁴³ At the same time, the frustration of negotiation for GATT membership further strengthened the perceived necessity to collaborate with other countries in alternative institutions; in assisting the 'second-step' FEP strategies to place more attention in Asia for economic gains, Beijing enhanced its pursuit for membership in the Asia-Pacific Economic Cooperation (APEC). In contrast to the demanding requirements from large GATT contracting parties, APEC offered a forum to both China and Asian countries to promote trade liberalization and economic cooperation based on consultation and consensus, as well as at a pace that would accommodate the enormous disparities in wealth, technology, management experience, markets, and economic and political development in the Asia-Pacific economies.⁴⁴ Therefore, there should be neither 'bullying' by or the threat of sanctions from the more powerful and advanced economies such as the US and Australia – the strongest advocates for setting a clear trade liberalization deadline – nor domination of non-economic issues, particularly human rights and democracy, in the APEC (Klintworth, 1995). This appeal was welcomed by the ASEAN member states because they have also been uneasy about Western dominance of the agenda, which somehow justified Beijing's resistance to adopt the GATT/WTO rules on a faster timetable than China desired or than was previously accorded 'developing countries' (Pearson, 2001: 337-342). For example,

⁴² 'Premier Li Peng Made Report on His Visits to Three ASEAN Countries in the 15th Meeting of the Standing Committee of National People's Congress', *People's Daily*, 29 August 1990, p. 1.

⁴³ See, for example, the Minister of MOFTEC Li Lanqing, '*Guanyu duiwai jingji maoyi gongzuo luoshi shisida jingshen de jige wenti* [A Few Problems on Putting the Spirits of the 14th CCP Central Committee into the Foreign Trade Practice]', 24 December 1992, documented in *Almanac of China's Foreign Economic Relations and Trade*, 1993: 27-34.

⁴⁴ 'President Jiang Zemin's address to APEC leaders in Seattle', 22 November 1993, *People's Daily*, p. 1.

the Singapore Premier Goh Chok Tong warned that a break of Sino-US relations over human rights issue would have severe long-term consequences for the world and the APEC could provide the best forum to promote constructive engagement with China.⁴⁵ Comparing with the protracted negotiations over bilateral agreements with US, Japan and EU as parts of admission requirements to GATT/WTO (Pearson, 2001: 339), APEC was particularly important to China as a predictable trade institution, which helped to protect the Chinese interests in uninhibited export markets and to support joint working groups on trade-related topics such as industrial upgrade, human resources development, regional energy cooperation, marine resources conservation, telecommunication and transportation that are conducive to the long-term capacity building. The support from the majority of APEC members such as ASEAN and powerful American constituency – namely the multinational enterprises (MNEs), exemplified by Boeing – successfully confined APEC to economic issues and contributed to the US decision in May 1994 to de-link human rights in China from MFN status (Klintworth, 1995: 498-499; Suettinger, 2003: 183-190). APEC then has also become a platform for Beijing to cultivate bilateral diplomacy. A representative instance is President Jiang Zemin's meeting with the Malaysian Premier Mahathir Mohamad in the sideline of the 1998 APEC Summit in Kuala Lumpur when the latter was snubbed by the leaders of the US, Canada and Australia because of their criticism on the 'improper' handling of domestic political struggle in Malaysia (Felker, 1999).

In parallel to the participation in APEC, China's promotion of ASEAN Plus Three (APT) and the subsequent East Asia Summit (EAS) as feasible institutions has illustrated Beijing's tactics from the passive quest for tentative solutions to the proactive deployment about multilateralism, particularly at the regional level. Although China is not unscathed from the Asian Financial Crisis (AFC), it has contributed to shaping the image of China as a 'responsible power' and thus the emerging regional leadership through deepening cooperation in multilateral fora (Kim, 2006). Following the unilateral decision of not devalue the Renminbi that helped defuse fundamental threat to the economy of the AFC-sacked ASEAN members like Malaysia, China not only promoted

⁴⁵ *Financial Times* (London), 21 April 1994.

the Chiang Mai Initiative (CMI) with Japan and South Korea but took the lead to propose converting the CMI's separate bilateral swap agreements into a unified multilateral currency-swap agreement (Dent, 2005: 391-392). In addition to cooperation on such non-traditional security issues, during the fourth ASEAN-China summit (i.e. the ASEAN Plus One mechanism parallel to APT) in 2000, Premier Zhu Rongji proposed the China-ASEAN FTA (CAFTA) that would establish the free trade area by 2010 for the old ASEAN members and by 2015 for the new members with more preferential treatments than China's WTO commitments. Furthermore, the generous offer of the Early Harvest Program (EHP) under CAFTA by opening agricultural market is expected to bring more immediate benefits to ASEAN.⁴⁶ All of these practices have backed up China's reiteration of 'achieving common prosperity' with neighbors, while the concessions China offered to ASEAN could serve the demonstration of China's peaceful intention in particular. In other words, through the multilateral institutional engagement with special reference to ASEAN, China could not only gain the reputation as a peacefully rising power and the clear leadership but mollify fearful perceptions of its growing power and influence (Yoshimatsu, 2008: 131-135).

3.3 Pursuit of trade bilateralism

The increased emphasis on working for separate preferential trading arrangements (PTAs) with different countries and regions at a bilateral basis has juxtaposed with China's WTO accession in 2001 as part of China's solution to the difficulties in multilateral economic institutions. In spite of the sweeping commitments in order to gain the WTO membership, Beijing has somehow realized that it enjoys only limited influence in maximizing the sector-by-sector interests and faces difficult choices in coalition formation in the institution, at least in the early tenure. Although the creation of WTO in 1995 was supposed to transform a 'power-based' trading system into a 'rule-based' one and to protect the small and vulnerable from the predation of the big and powerful, the

⁴⁶ The interesting contrast is at the same time, China has been involved in disputes with Japan and South Korea over their agricultural exports that resulted in an exchange of retaliatory tariffs on Japanese cars and air conditioners and South Korean mobile phones (Kwei, 2006: 121).

institution has been increasingly politicized. In addition to the external pressure,⁴⁷ the feasibility of predecessor GATT reciprocity model has become questionable in WTO due to the deeper internal fissures. The vast expansion of membership since the late 1980s has added new sets of interests and preferences of developing countries, which has made decision-making more unwieldy because all members who have a significant interest in an issue will have a chance to be involved in consensus-building meetings; furthermore, conflicts among the ‘big beasts’ – particularly between US and EU – have become intense since the previous strategic bonds of shared security is dissolved after the Cold War (Sally, 2008: 99-105). For China, the game in Geneva therefore has been strenuous. Firstly, the leeway for Beijing to bargain within WTO has significantly reduced caused by the principle of ‘request and offer’ that without offering a concession, a member cannot seriously make a request as well as the agreement of ‘single undertaking’ that in essence members will have to sign onto the whole package rather than accept or veto portions of it. Secondly, although China has designated itself on behalf of the developing countries, its rhetoric of ‘Third World bridge’ is devoid of implication of true leadership due to the hugely diverse and often competing interests among developing countries.⁴⁸ Finally, China’s core economic interests increasingly lie in as much with specific developed countries on specific issues, especially as concerns exports (Pearson, 2006).⁴⁹

Similar problems for China also exist in APEC. The lack of hierarchy and formality in APEC as an institution means that no single member would be able to seek a leadership role within the institution; although it prevents China from taking the uncomfortable position to directly confront the rival powers such as US and Japan, the Chinese interests have risked being subjugated. The emphasis on consensus has challenged the creation of

⁴⁷ WTO has been challenged with the brunt of anti-globalization backlash as well as the combination of old-style protectionist interest groups and new-style NGOs (Sally, 2008: 103).

⁴⁸ For example, although rising Chinese textile exports made US launch safeguard actions against China in May 2005 (after the expiry of the Multifiber Agreement, MFA, in 2004), China is unlikely to form a strong coalition with other major textile-producing developing countries such as India, Pakistan, Mexico and Bangladesh because they worry about Chinese competition to their own textile exports (Pearson, 2006: 261-262).

⁴⁹ For example, in the negotiations of WTO Agreement on Agriculture (AoA), China quietly indicated some support for the US initiatives to against the coalition of EU, Japan, and South Korea because China sees agricultural exports as the future export strength (Pearson, 2006: 258-261).

a free trade region in the Pacific Rim by 2020,⁵⁰ which requires accelerating economic liberalization of the members. Those members favoring further liberalization at a more expedient pace include Australia, Canada, Hong Kong, New Zealand, Singapore and US; the so-called ‘Buick Group’ preferred APEC as a tool to further regional market opening and access. Yet it has been opposed by the so-called ‘capacity builders’ dominated by the Southeast Asian members, who favored initiatives which focus on improving regional business and economic development, such as advancing human resources and information technology (Lanteigne, 2005: 74). With the new guidelines – a strengthened version of the former ‘*mulin youhao*’ principles – of the periphery policy put forward in the 16th CCP Central Committee that ‘do thy neighbors good and keep thy neighbors company’ (*yulinweishan, yilinweiban*) targets at ASEAN as a whole,⁵¹ Beijing works out a rather ‘balanced’ strategy in arranging separate PTAs with members of either side; the benefits of such cautious leverage are obvious. To the side of ASEAN, China demonstrates its sincerity as a reliable regional partner who would take care of ASEAN’s needs in terms of not pushing a too quick move towards economic liberalization as well as offering unusually good deals in the CAFTA which China could afford (Lu, 2007).⁵² The proposal of CAFTA was viewed to ‘offer important opportunities and an additional motor for the growth of Southeast Asia, even at the same time that it presents an immense economic challenge’ (Leong and Ku, 2005: 192). For China, the expected economic

⁵⁰ The APEC summit in Bogor, Indonesia, in 1995 called upon all members to achieve free trade and investment among themselves by 2010 for developed economies and 2020 for the lesser-developed. In 1995 during the Osaka summit, a blueprint for achieving the ambitious ‘2020’ goals was introduced. They include policy harmonization in key sectors such as energy, telecommunications, small- and medium-enterprises (SMEs), and science and technology. Member economies were to present their individual plans to illustrate how they would contribute to regional free trade (Lanteigne, 2005: 68; Seki, 1996).

⁵¹ Deputy Director of Department of International Economic and Trade Relations of Ministry of Commerce (MOFCOM) Yin Zonghua, ‘Active Participation in Regional Economic Cooperation and Promotion of International Development [*Jiji canyu qiyu jingji hezou, buduan tuozhan guoji fazhan yewu*]’, in *China Commerce Yearbook*, 2004: 24-25.

⁵² The framework CAFTA came into force on 1 July 2003. The characteristics include 1) China made great concessions to the demand of ASEAN in opening its agricultural market, especially in the negotiation on the Early Harvest Program (EHP) against the backdrop that most ASEAN members (excluding Singapore and Brunei) have some advantages over China in the sector; 2) many articles of CAFTA were specially tailored for the new ASEAN members (‘CLMV’: Cambodia, Laos, Myanmar, and Vietnam); 3) many priority cooperative sectors were listed without a planned or proposed timetable; and 4) granting the MFN status, which is Chinese commitment to all WTO members, to Cambodia, Laos, and Vietnam (Lu, 2007: 91-93); also see the information available at <http://gjs.mofcom.gov.cn/aarticle/Nocategory/200212/20021200056452.html>. Last accessed in January 2009.

gains from the CAFTA go beyond the more closer cooperation on various trade-related issues, which are viewed conducive to the domestic Western Development Program (*xibu da keifa*); the more critical issue is by the signing of CAFTA, the Chinese influence could be secured since ASEAN has concluded a FTA with Korea, and has been negotiating with Australia-New Zealand, India and Japan for the same arrangements by June 2007 (Ravenhill, 2008: 131).

At the same time, China deftly utilizes the perceived favorable opportunities to negotiate PTAs with other individual countries mainly for defensive reason, in terms of avoiding barriers erected by proliferating PTAs in other regions (Hoadley and Yang, 2007). Comparing with other trading countries in East Asia, China is a relatively new comer to PTAs. For example, out of 36 Asian PTAs completed or contemplated by mid-2003, twelve involved Singapore, ten involved South Korea and five involved Japan; no bilateral PTA was on China's agenda at the time (Pangestu and Gooptu, 2003: 83). For China, the difficulties in WTO and attempts of not to displease competing trading groups, have been the major reason driving China to the PTAs especially after the stalemate of 2003 Cancun meeting. The fact that many of China's trading partners had started PTAs means that Chinese trade could be harmed by the subtle new barriers including tariff discrimination, technical barriers to trade and administrative protectionism such as anti-dumping cases; therefore, China could not afford to be marginalized in this trend (Kwei, 2005: 117).

Therefore, China has moved briskly in PTA negotiations since it could complement the multilateral negotiations. Other than to avoid exclusion from or discrimination in established markets, Beijing's economic considerations about RTAs also include to open new markets and leverage reforms in domestic enterprises by exposing them to competition, albeit in a controlled fashion. In addition, China has chosen its initial PTA partners deliberately, beginning with ASEAN as whole and moving on to smaller extra-regional countries such as New Zealand, Australia Singapore and Chile (talks were initiated by 2005) so that China could gain negotiation experience with minimum risk and setting more favorable precedents for future talks, such as the recognition of China as

a market economy (Green, 2004). At the same time, the preferential trading links with extra-regional partners could strengthen China's economic security, in terms of consolidating China's influence and ability to engage in strategic competition with other great powers, such as US and Japan (Hoadley and Yang, 2007: 341).

Table 2.2 China's bilateral PTAs (May 2009)

China	Signed	Negotiating	Study group
	ASEAN (2002); Hong Kong and Macau (2003); Chile (2005); Peru (2007); New Zealand (2008); Singapore (2008); Pakistan (2009).	Gulf Cooperation Council (GCC, comprising Persian Gulf states of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE); Australia; Iceland; Norway; Southern African Customs Union (SACU, comprising South Africa, Botswana, Lesotho, Swaziland and Namibia); Costa Rica.	India; South Korea.

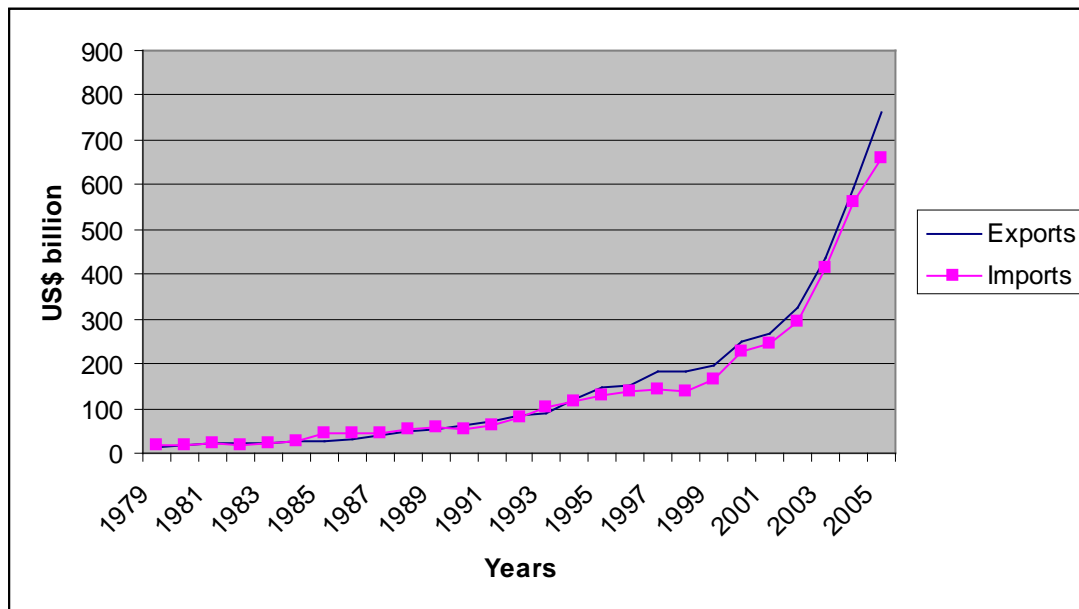
Source: <http://fta.mofcom.gov.cn/index.shtml>.

4. Patterns of China's foreign economic activities with special reference to the three cases

The result of the open-door policy, as a key part of China's overall economic reform, is the surge of foreign trade and FDI inflows. Foreign trade has grown from \$30 billion in 1978 to \$1,422 billion in 2005 (see Figure 2.3). Since the overarching policy goal is to promote the foreign trade-propelled economic growth, the GDP per capita has raised from \$148 in 1978 to \$1,721 in 2005 (WTO, 2008: 3). Rapid economic growth and increased integration into the world economy, especially since its WTO accession, has increased China's share of world trade to 6.7% in 2005. Thus, it overtook Japan (5.9%)

and has become the third largest trader, after EU (14.5%) and US (13.6%) since 2004. In 2005, total merchandise exports and imports amounted to 63.9% of GDP. Meanwhile, the effect of China's export-promotion trade regime has been obvious: much of the FDI has been channeled to manufacturing as a platform for exports. In 2005, almost 60% of China's exports and imports were conducted by FIEs as Figure 2.1 shows, and processing trade has taken significant share of China's trading profile (see Figure 2.2).

Figure 2.3 Growth of China's trade, 1979-2005



Source: IMF (various years).

Alongside with the trade expansion, other important features of China's trade pattern are the concentration in labor-intensive manufactured exports and the accompanied structural changes in recent years. The opening of SEZs to foreign-funded processing production for exports in the mid-1980s has allowed China to develop its exports of textiles and apparel; the source of foreign exchange earnings therefore has transformed from sales of primary goods to manufactures. Despite the import restrictions imposed in many significant foreign markets, China has become the largest exporter of textiles and apparel in the early 1990s and has steadily gained from this sector notwithstanding the gradually declining share of the total exports. Yet, with the juxtaposed goal of FDI absorption is the technological transferal as well as the upgrade of export capacity, since the early 1990s

China has used policy measures to ‘pull’ foreign investment to the more capital intensive and technological sophisticated processing production. This strategy has initiated China’s increasing participation in the global production networks of transnational enterprises (TNCs) from advanced economies, including the Asian NIEs, particularly when they started to outsource the assembly operations to countries where the labor costs are lower. It explains the distribution of China’s main FDI sources during the period of 1979-2005 that accumulatively Hong Kong takes the biggest share of 41.7%, followed with Japan (8.6%), US (8.2%), EU-25 (7.5%), Taiwan (6.7%), South Korea (5%) and Singapore (4.5%).⁵³ China’s position in the fragmented production process across countries along the value chain has been placed in the middle point between final consumers and suppliers of intermediates, which is reflected on the direction of China’s merchandise trade (Lardy, 2002; Tong and Zheng, 2008). For example, in 2005, the main destinations of China’s exports are the US (21.4%), followed by EU-25 (18.9%), Hong Kong (17%, presumably involving large entrepot trade), and Japan (12.4%), while the main sources of imports are Japan (15.2%), South Korea (11.6%), Taiwan (11.3%), EU-25 (11.1%), and the US (7.4%). In 2005, the three largest exports groups are office machines, telecommunication equipments and electrical machinery and together comprise 36.8% of China’s total exports; while electrical machinery and office machines account for 26.3% of the total imports.⁵⁴ At the same time, China runs large trade surpluses with the US (\$114 billion), Hong Kong (\$112 billion) and EU-25 (\$70 billion); by the contrast, the sources of trade deficits are Taiwan (\$58 billion), South Korea (\$42 billion), and Japan (\$16.5 billion). As the WTO Secretariat points out, these trade deficits significantly reflect outsourcing by the companies of the three countries which have also been important investors to China; as a matter of fact, the intra-industry trade between China and Taiwan accounts for more than 50% of China’s intra-industry trade with the world. To a large degree, the operation of these companies involve the import of parts and components from the home bases for processing and assembly in China, with the finished products subsequently being exported not just back home bases but to other parts of the world, notably US and EU (WTO, 2006: 24).

⁵³ *China Commerce Yearbook*, 2006: 306.

⁵⁴ UN Comtrade online database.

However, the growth of higher value-added merchandise trade does not necessarily translate to increase economic power of China. Since China's processing operations within the production networks have primarily involved the lower end of original equipment manufacturing (OEM) and foreign investors' subcontract through subsidiaries in Hong Kong to maintain cost efficiency,⁵⁵ China has had technological dependence on foreign producers and investors. As a manufacturing conduit, China runs deficits with 'supplier' countries in East Asia, and surpluses with 'demand' countries like US and EU-25; it implies that the growth of China's trade, and therefore economic development, is not only dependent on external demand but also largely on external supply. On the one hand, at the time of writing, Chinese industries are not major suppliers of foreign-funded export industries. On the other hand, external supply is essential for financing China's export boom (Breslin, 2005a). This constraint meshed with the power structure of global political economy therefore has cast serious challenge to China's capabilities and/or motivation of politically dominate Southeast Asian neighbors through economic means.

Although China has encouraged ODI to sharpen its competitive edge, the amount of Chinese ODI is still very small, as illustrated in Figure 2.4. Although the accumulative ODI in ASEAN-10 reached \$108 million in 2005,⁵⁶ China is by no means the major investor for ASEAN. Rather, major sources of FDI into ASEAN-10 during 1995-2003 are EU-15 (28.8%), US (16.5%), Japan (12.9%), and ASEAN itself (12.9%).⁵⁷ It means that China and ASEAN have been 'competing' for inward FDI, although this competition is not necessarily a zero-sum game. At the same time, the roughly similar developmental stages and comparative advantages have placed ASEAN member states into the same trade triangles of global production networks alongside with China. On the one hand, ASEAN competes against China for market shares of both traditional labor-intensive

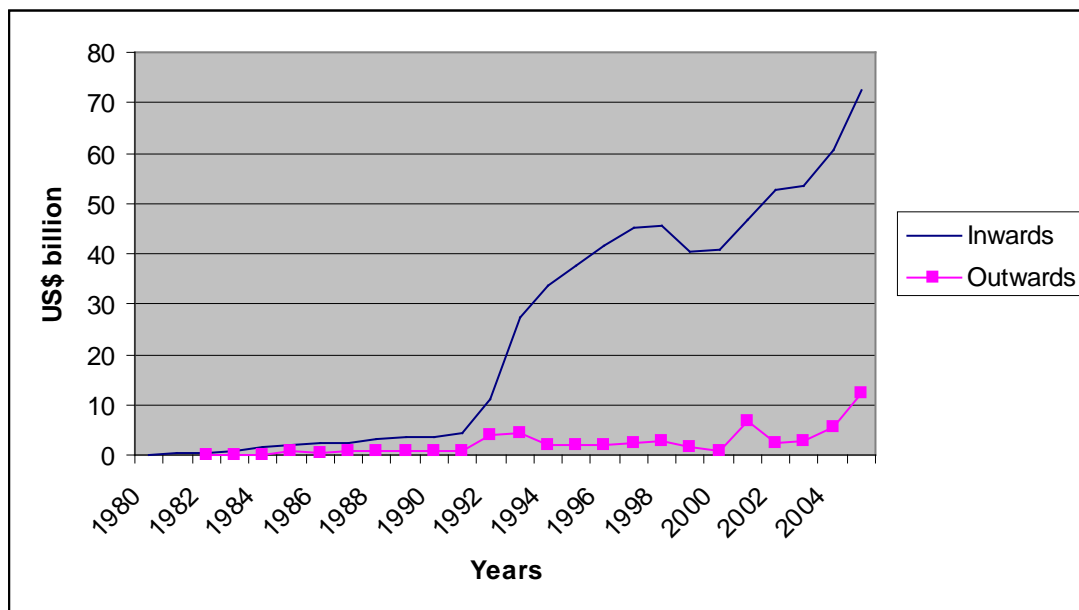
⁵⁵ The term OEM was first used to refer to companies that put their own brand name on components produced by another company under a special agreement with the original manufacturer; the situation has changed in some areas with the establishment of industrial standard leaders. The OEM production is particularly important in IT industries and in the production of hi-tech consumer goods. Many companies in Asian NIEs have located themselves as key links in the production chain: at a 'higher' level, they sign OEM agreements to produce goods using foreign technology and operating platforms, which almost entirely with Japanese and US companies; at the lower end, they outsource the low-tech and low value-added elements of production to other countries, such as China (Breslin, 2005a: 744-745).

⁵⁶ *China Commerce Yearbook*, 2006: 719.

⁵⁷ *ASEAN Statistical Yearbook*, 2004: 146.

exports of textiles and apparel (SITC 84) and footwear (SITC 85) and higher value-added manufacturers of office machine (SITC 75), electrical machinery (SITC 77) and telecommunication equipments (SITC 76) in EU, US and Japan. On the other hand, the increase of intra-industry trade of these sectors has created economic partnership for China and ASEAN (Ravenhill, 2006), which is evidenced by the fact that in 2003, office machine, electrical machinery and telecommunication equipments accounted for 40.6% of ASEAN exports to China, while the three groups took 54.4% of ASEAN's total imports from China.⁵⁸ Since both China and ASEAN are dependent on the same external driver to their foreign trade-propelled economic development, this structure leaves China limited space to enforce the classic mercantilist project, at least up to 2005.

Figure 2.4 Flows of China's direct investment, 1978-2005



Source: UNCTAD online database.

⁵⁸ ASEAN Statistical Yearbook, 2004: 97.

Table 2.3 Sources of FDI inflows, 1995-2003 (US\$ million).

Source countries	Malaysia	Singapore	Vietnam
ASEAN	7,009.0	6,574.6	2,695.8
Asian NIEs	1,972.6	3,554.8	4,468.2
Hong Kong	1,263.4	1,639.9	1,202.4
South Korea	98.5	53.4	1,427.5
Taiwan	610.7	1,861.6	1,838.3
<i>China</i>	<i>120.7</i>	<i>43.2</i>	<i>103.1</i>
India	-9.9	655.5	5.1
Japan	4,761.1	9,142.2	2,153.4
EU-15	8,232.6	36,760.5	2,277.1
Other EU	492.1	9,691.6	725.7
Canada	346.3	585.1	23.0
US	10,201.4	19,656.5	552.6
Australia	367.1	-417.4	85.7
New Zealand	45.4	139.5	2.1
All others	2,523.6	20,158.9	1,502.4
Total	36,062.2	106,545.0	14,594.1

Source: *ASEAN Statistical Yearbook*, 2004: 152-153.

5. Conclusion

In order to deal with the economic crisis as the consequence of autarky, China's FEP since 1979 has been directed towards greater opening of domestic sectors. External approaches, mainly the participation in multilateral cooperation at global and regional levels, have been adopted to advance China's foreign economic interests. For the pursuit of plenty, examination in this chapter reveals the 'hierarchy' of Beijing's preferences over available means. Unilateral liberalization (i.e. opening to the world economy) has been the primary approach to raise the national income, while the access to global trading regime has been deemed as the major auxiliary to ensure China's continuing export expansion. In this sense, the regional economic cooperation has appeared to take the third

place on China's agenda; while its influence on Beijing's striving after the more 'proper' treatments to developing countries in negotiations at the global level depends, Beijing's seeking to regional economic cooperation seems to aim at the long-term capacity-building for both China and the partners. The concern of enhancing potentially beneficial competitive effects on the domestic economy has arguably determined the least priority of trade bilateralism for Beijing; it is evidenced by the fact that the conclusion of bilateral preferential trade agreements (PTAs) is often resulted from China's acceptance of invitations for negotiations, which are initiated by the relatively insignificant partners, such as Singapore.

The evolution of China's FEP in general and Beijing's external approaches discussed in this chapter serve as the benchmark for the comparison with China's bilateral FEP towards each of my case ASEAN members in the next three chapters. If China aimed at political goals in its economic relations with the three case states, one would expect Beijing's practices towards them different from the characteristics and tendencies of China's FEP in general since which goals are to raise the national income through greater opening of domestic sectors and to enhance the competitiveness of domestic economy. One would expect Beijing to pay particular attention to my three case states in terms of offering economic concessions, while the scope and the contents should vary based on bilateral political relations. However, China's bilateral FEP has reflected the same characteristics and tendencies of China's FEP in general that run through each of my case studies, and they appear quite similar with each other, as illustrated in the subsequent chapters.

Chapter 3: China's FEP towards Vietnam: the late 1980s-2005

1. Introduction

China's FEP towards Vietnam is selected for this study because it should represent a 'soft' case of power domination. Against the background of bilateral hostility until the late 1980s and the continuing territorial disputes throughout the 1990s, it would not be surprising if China intended to achieve political goals in its economic relations with Vietnam, particularly when the conditions have appeared favorable to China. In addition to the adjoining geographical locations, the small size and the backward developmental level of the Vietnamese economy imply that the costs of manipulating economic asymmetry for political goals would be low to China. Therefore, Beijing is expected to initiate the bilateral economic cooperation, to seek to offer economic concessions, and to ensure Vietnam's trade dependence on China.

To investigate whether what happened is consistent with this expectation, section 2 will firstly outline the transition of bilateral relations from hostility to 'normalcy' since 1999 (e.g., Womack, 2006) as the critical context in which Beijing could implement the FEP towards Vietnam. Although Vietnam was excluded from China's opening process until the late 1980s, bilateral trade, investment, and double-taxation agreements were quickly signed after the normalization of bilateral diplomacy in 1991, followed with a series of cooperation pacts that are similar to China's general practices with other partners. In this course, Beijing did not seem to take initiatives but to apply its 'normal' procedure for bilateral economic cooperation as the demonstration of its sincerity in seeking common prosperity. Examination of the substance of China's FEP towards Vietnam in section 3 will show that instead of offering unilateral economic concessions, Beijing's emphasis has been to raise national income through greater opening of certain domestic sectors to Vietnam; it will lead to the discussion in section 4 that how the bilateral economic cooperation contributes to the growth in these identified sectors, albeit its significance to China's overall economic picture is negligible. This chapter will conclude that instead of ensuring Vietnam's trade dependence on China, the available evidence suggests that

Beijing's concerns have focused on stimulating the development of these identified domestic sectors in bilateral economic relations, and therefore contradict the expectation generated from the presumption that Beijing was motivated by power.

2. Development of political relationship

China's FEP towards Vietnam has been contingent upon the development of bilateral relations, which has reflected the shift of China's overall foreign policy orientation. Before 1976, China's overriding ideological concerns, including aspiration for socialist internationalization and fight against the Western imperialism, had underpinned the 'revolutionary brotherhood' of the two countries. China offered generous assistance to Vietnam for both military and economic uses. Subsequently, China's security consideration was of paramount concern of bilateral relations because Vietnam had been deemed as the proxy of China's perceived threat of Soviet Union in the region, which led to military conflicts and followed with long-term hostility until 1990. Although China had started to reintegrate into the world economy since 1979, Vietnam was excluded from this general FEP orientation at the time due to China's security interests, which were defined in narrow military terms, predominated its FEP towards Vietnam. Since maintaining a strong defense posture to safeguard the border was emphasized, bilateral trade was absent.

The thaw of bilateral enmity in 1990 could be interpreted as the by-product of China's foreign policy in the 1980s, which has centered on creating an international environment conducive to the successful implementation of China's economic reforms. Since the overall Chinese foreign policy has assumed not only a vigorous effort to embrace market principles and economic rationality but also an improvement of its political image in East Asia and the world, China's external policies towards the rest of Asia must be made compatible with these economic and political necessities. In the security dimension, these policies have focused on reducing existing or potential tensions with its neighbors (Wang, 1996). Such a shift of Chinese foreign policy orientation, embodied in China's taking specific diplomatic actions to deal with Cambodia conflict and downplaying its

assertiveness in territorial claims, has made the normalization of China-Vietnam relationship possible, which has served China's attempt in increasing economic opportunities. In addition to signing a series of national agreements as the legal framework for facilitating bilateral trade and investment like China has with other countries, the opening of border provinces has been particularly addressed in China's FEP toward Vietnam to improve the uneven distribution of economic growth caused by China's development strategy. However, since the normalization China's foreign policy and FEP towards Vietnam has been gradually subsumed into its political and economic interactions with the Association of Southeast Asian Nations (ASEAN) in the regional context. Because military security is basically assured, successful economic development requires Beijing to strengthen political ties and expand institutional linkages multilaterally. The following sections provide more details about the tortuous development of bilateral relationship.

2.1. Revolutionary brotherhood: 1949-1975

From 1949 to mid-1950s, the Sino-Vietnamese relationship was harmonious based on communist Vietnam⁵⁹'s necessary acceptance of China's tutelage. However, the subsequent political discord between them had been foreshadowed by the fact that the communist Vietnam had relied upon the Soviet Union for economic and military assistance and diplomatic support for the goal of national reunification at the same time (Buszynski, 1980: 830).

Throughout the period of the following twenty years, China shared the 'as close as lips and teeth' revolutionary brotherhood with the communist Vietnam. For the aspiration of socialist internationalization, China had been the biggest benefactor for the communist Vietnam—\$20 million of military and development aid to Hanoi—which contributed to the fall of Saigon in late April 1975. Nevertheless, the relations between China and

⁵⁹ The Party was founded by Ho Chi Minh in 1930. It had changed the name for twice during the first Indochina War (1946-1954) and the Vietnam War (1959-1975) and had fought against France and the US, while seeking for 'national liberation' from its controlled northern territory. After the end of the Vietnam War and the reunification of Vietnam, the Party's name was changed to the Communist Party of Vietnam (CPV) in 1976.

Vietnam had gone through dramatic change since then (Amer, 1994; Roper, 2000; Womack, 2006).

2.2. Discord to hostile stalemate: 1976-1990

The attempts of the newly-established Socialist Republic of Vietnam (in July 1976) of setting new courses in domestic and foreign policies for independence is the major cause to trigger China's irritation. For China, although it cut off all economic aids to Vietnam in 1978 due to domestic difficulties, Hanoi's decision to join the Soviet Union-sponsored Council for Mutual Economic Assistance (COMECON) was interpreted as the unwillingness to recognize China's leading role in the national liberation movement in the region and the world. It outraged many Chinese because Hanoi was perceived as ungrateful for China's aids and sacrifice during Vietnam's wars against the French and Americans (Duiker, 1990; Zhang, 2005). Other issues also intensified China's perceived threat to its critical national security interests. Direct challenge to Chinese survival arose from not only Vietnam's invasion into Cambodia with the backup of the Soviet Union⁶⁰, but also the worsen territorial disputes, including demarcation of borders on the land and in the Gulf of Tonkin and the overlapping sovereignty claims in the South China Sea (Ang, 1998: 1125-1134). Rising political tension gave Hanoi an excuse to deport and maltreat ethnic Chinese inhabitants in Vietnam, which was viewed as the even more acute provocation. The exacerbated relations culminated in China's military attacks on Vietnam in early 1979 (Amer, 2004; Duiker, 1986; Shultz and Ardrey, 1995; Thayer, 1994; Womack, 2006). Although China withdrew from Vietnam in March 1980, the bilateral relations remained hostile stalemate throughout much of the 1980s. Bilateral trade, therefore, had been very limited during this period due to the shut border for defense need, not to mention the investment, despite the fact that China has started to re-join the world economy since late 1978.

⁶⁰ The competition for influence in Cambodia between China and Vietnam during the post-1975 period has been attributed to the Soviet Union's ambition in Southeast Asia. For details, see Hood (1992).

2.3 Normalization of bilateral relationship: 1991-1998

China's softened attitude on the Cambodia conflict since 1990 ushered a turn of its relations with Vietnam (Acharya et al, 1991), and its acceptance of multilateral political settlement⁶¹ upon this issue made the normalization of bilateral relations possible (Amer, 2004). They have reflected the shift of China's overall foreign policy orientation since the 1980s, namely to improve the international environment by reducing the existing and potential tensions with its neighbors for economic development. The joint communiqué China and Vietnam signed in November 1991 demonstrates this point. It states that, based on the Five Principles of Peaceful Coexistence,⁶² the two countries were ready 'to restore exchange and cooperation in economics, trade, science and technology, transportation, and culture, with a view to gradually normalizing China-Vietnam relations'.⁶³ Regarding the territorial dispute, the communiqué committed the two countries to settle the boundary and other territorial issues peacefully through negotiations.⁶⁴ Since then, the mutual visits of high-level officials for expanding cooperation in various fields have been on a regular basis,⁶⁵ which illustrates the positive trend in improving bilateral relations.

2.4. Normalcy: 1999-

Since 1999 the bilateral relations have come to the 'normalcy' era (Womack, 2006). The 'Sixteen Word Guideline'—long-term, stable, future-oriented and all-round cooperative relations (*Changxi wending, mianxiang weilai, mulin youhao, quanmian hezuo*) – for improving future relations was announced when the CPV party secretary Le Kha Phieu visited Beijing in February 1999; in addition, China's vice Premier Li Lanqin said that

⁶¹ *Agreement on a Comprehensive Political Settlement of the Cambodian Conflict* (concluded at Paris in October 1991). Full text is at http://untreaty.un.org/unts/120001_144071/2/2/00000971.pdf. Last accessed in March 2008.

⁶² The Five Principles of Peaceful Coexistence are mutual respect for sovereignty and territorial integrity, mutual non-aggression, non-interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence (Chen, 1993: 242).

⁶³ *Zhongguo Waijiao Gailan* [Overview on Chinese Policy], Vol. 1992, p. 50.

⁶⁴ Xinhua News Agency, 10 November 1991.

⁶⁵ *Zhongguo Waijiao Gailan* [Overview on Chinese Policy], various years.

China would continue to promote the economic cooperation with Vietnam on the basis of 'equality and mutual benefit, emphasis on efficiency, multiple forms and joint development' in the same year.⁶⁶ The Sixteen Word Guideline was then fleshed out in a 'Joint Statement for Comprehensive Cooperation' adopted in December 2000,⁶⁷ and it was accompanied not only by a rapid increase in trade and investment, but also by treaties regarding maritime rights in the Gulf of Tonkin. In addition to the formal recognition of maritime borderline, it is stated in Article Seven of this treaty that when there is oil, gas or other natural source fields found traversing the borderline, the two countries shall agree on effective exploration and equally sharing the profits through peaceful negotiation. The two countries shall also cooperate in reasonable use of sources and sustainable development of the Gulf;⁶⁸ which could be viewed as an important symbolic step signifying the attempt by both sides to place the normalization of relations on a stable and permanent footing (Gu and Womack, 2000: 1042).

With the development of closer relationship with the ASEAN since the 1990s (Chang, 1997), China's placing its relations with Vietnam in the larger regional context has become more distinct in the normalcy era. As Chinese President Zhu Rongji put in 1994, that

'... both China and Vietnam [have been] concentrating on economic development⁶⁹ and raising people's living standard, therefore they need a peaceful international environment to pursue this fundamental national interest. In addition, the good relationship between China and Vietnam would also benefit regional peace and stability.'⁷⁰

In diplomacy, neither side opposed or interfered with the vital interests of the other side. For example, Vietnam has refused to coordinate with Taiwan's diplomatic attempts,

⁶⁶ *People's Daily*, 27 September 1999, p1.

⁶⁷ Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100667702>. Last accessed in March 2008.

⁶⁸ Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100667140>. Last accessed in September 2007.

⁶⁹ Vietnam has started its own economic reform program, *Doi Moi*, since 1986.

⁷⁰ *People's Daily*, 23 September 1994, p4.

which symbolized national sovereignty even Taiwan has been an important FDI source for Vietnam; likewise, China did not oppose Vietnam's admission to the ASEAN in July 1995. Other examples include that both countries have gradually adopted united postures in multilateral organizations such as the UN, ASEAN Region Forum (ARF), Asia-Pacific Economic Cooperation Organization (APEC) and the Asia Europe Meeting (ASEM);⁷¹ the peaceful resolution of territorial disputes in the South China Sea to provide multilateral assurance against provocations and hostilities (Womack, 2006: 28);⁷² and China's active participation of the Great Mekong Sub-region (GMS) project,⁷³ which has been expected to help Yunnan's developmental catch-up by enhancing the local infrastructure, such as transportation and power-generating.⁷⁴

3. China's bilateral FEP towards Vietnam

Since the normalization of political relations in 1991, the bilateral economic cooperation has increased accordingly. The detailed examination of China's bilateral FEP suggests that China has applied its normal treatments at the bilateral level to Vietnam. Three key aspects will be addressed to highlight this observation, including the bilateral treaties at the state level that aim to facilitate trade and investment activities through better legal frameworks; the opening of border regions, including Guangxi, Yunnan, and Hainan (to the smaller extent); and the state promotion of investment in Vietnam.

3.1. Major agreements on trade, investment, and economic cooperation

With the China-Vietnam joint communiqué on normalization of all-round bilateral relations, a bilateral trade pact was signed on 7 November 1991. This trade pact has

⁷¹ See Article 4 in Note 63.

⁷² *Declaration on the Conduct of Parties in the South China Sea* (concluded in 2002). Full text is at <http://www.aseansec.org/13165.htm>. Last accessed in March 2008.

⁷³ The GMS economic cooperation project was created by six countries sharing the Mekong River, namely the Yunnan province of China, Vietnam, Cambodia, Laos, Myanmar, and Thailand, with the help by the Asian Development Bank (ADB) in 1992 (Krongkaew, 2004: 977).

⁷⁴ *Transnational Agreement on electricity trade in GMS* (concluded in 2002). Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100667545>. Last accessed in March 2008.

granted each other the most-favored-nation (MFN)⁷⁵ status on goods, which prohibits discrimination between China and Vietnam with respect to tariffs and other border charges. It could be viewed as the first step for both countries to act cooperatively that are attentive to the mutual interests in improving their terms of trade (Schwartz and Sykes, 1996). Some other technical details are specified in addition to the general MFN status as well, such as the bilateral trade shall be carried out by foreign trade companies or other entities with foreign trading rights, while the commodities prices were controlled by the states through bilateral negotiation. Due to the fact that both countries had the currency control policy at the time, the trade settlement shall be made in hard currencies through national banks.⁷⁶

For the purpose to promote Chinese exports to the whole Southeast Asia through Vietnam, China signed an agreement on goods in transit with Vietnam in April 1994, while four land ports of Pingxiang, Youyiguan, Dongxing (in Guangxi) and Hekou (in Yunnan) were designated as the exclusive transit points. The other agreement signed later in the same year recognized the statutory rights of each others' different product examination standards.⁷⁷

In December 1992, China and Vietnam granted each other the MFN treatments for facilitating mutual investment.⁷⁸ The bilateral double-taxation agreement (DTA) was signed in May 1995; since then, China and Vietnam have enjoyed the non-discriminatory treatments in bilateral trade and investment. In 1994, the joint economic and trade cooperation committee was also established and is expected to supervise the implementation of these agreements.

⁷⁵ See Article I of the General Agreement on Tariffs and Trade (GATT) for the general MFN treatment clause at http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm#articleI_1. Last accessed in March 2008.

⁷⁶ Full text is at <http://vip.chinalawinfo.com/NewLaw2002/SLC/SLC.asp?Db=eag&Gid=100664427>. Last accessed in September 2007.

⁷⁷ Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100664796>. Last accessed in September 2007.

⁷⁸ Although it is not explicitly mentioned, the unconditional and multilateral features of MFN clause under GATT/WTO are clearly shown in the text of the China-Vietnam investment promotion and protection pact. For discussion on legal aspects of MFN and national treatment (NT), see, for example, Cebi and Ludema (2002), Ehrling (2002), and Horn and Mavroidis (2001). For political economy of the MFN issue, see Schwartz and Sykes (1996).

3.2 Opening of border areas

The border trade since spring 1989 has been representative of the overall trend in the resumption of economic and trading activities along the border between China and Vietnam that unfolded slowly at the end of 1988 (Gu and Womack, 2000: 1042).⁷⁹ Since then, the border trade with Vietnam has been particularly encouraged by local authorities; yet, it is worth noting that China has started to open its border areas to neighboring countries for trade since the early 1980s, for the reason that ‘border trade is the vanguard for enlarging the scope of opening and becoming rich in China’s hinterland provinces’.⁸⁰

3.2.1 Initial policy measures

The goal of making hinterland provinces rich is embodied in the *Interim Measures for the Administration of Small-scale Trade in the Border Areas*, which was promulgated by the State Council in 1984. It is for ‘to invigorate economy in the border areas, to satisfy the needs of the inhabitants in the border areas to a larger extent ..., to promote the contacts and communication between the border inhabitants of [China and neighboring countries], and to develop their good neighborly relations’. Instead of regular trade at state level, it allowed the departments or enterprises designated by provincial governments to carry out small-scale trade either in border townships of China’s side or at the mutual (barter) markets between the Chinese inhabitants in border areas and the neighboring countries. The designated departments or enterprises were allowed to do business only at mutually agreed ports or trading points, and were subject to the administration of provincial governments. Taxes (including tariffs, duties and VAT) shall be levied on this kind of small-scale trade, while trade in mutual markets was exempted if it did not exceed the quota.⁸¹

⁷⁹ *People’s Daily*, 9 November 1991, p2.

⁸⁰ *People’s Daily*, 26 April 1992, p2.

⁸¹ Full text is at <http://www.yfzs.gov.cn/gb/info/LawData/gif2001q/gwyfg/200306/25/0943407554.html>. Last accessed in December 2007. The quota of trade in mutual markets was not specified in the text, though.

This regulation has shown the central government's struggle in raising living standards of the impoverished border areas. These areas have suffered the disadvantage of being on the edge of a closed national economy; however, with border trade, the location has turned to be an advantage and the border region has become the most convenient place to buy and sell goods with the neighboring countries (Gu and Womack, 2000: 1047).

In April 1991, the State Council announced to half taxes levied on goods imported by designated enterprises through agreed ports for exclusive sale in border provinces, and the tax cut would last until the end of 1995.⁸² Goods valued less than 300 Chinese Yuan in the mutual markets were exempted from taxes. Nonetheless, normal tax rates were still applied to some goods, such as electrical machines subject to national restrictions, cosmetics, tobacco and alcohol. This general guideline is applied to all border provinces, except small-scale border trades towards Burma, Pakistan, Nepal and India.⁸³

3.2.2 *The opening measures in Yunnan and Guangxi*

Before the formal normalization of bilateral relations, the State Council had specifically authorized provincial governments in Guangxi and Yunnan to make regulations on preferential tax and administration for small-scale trade in the border areas towards Vietnam.⁸⁴ With the signing of the China-Vietnam trade pact in 1991, the two countries also signed a temporary pact over the border issues, while the border trade was emphasized. Although the demarcation problem remained unsettled at the time, both China and Vietnam agreed to open land border ports to each other for trade and civilian activities (including visiting friends/families, medical needs, and participation in ethnical festivals) to special border pass holders. It is a significant step since the border had been shut for ten years. Border pass was issued only to inhabitants in border areas and to people who either conducted border trade or held invitations to ethnical activities; they

⁸² 1991 to 1995 is China's Eighth Five Year Plan period.

⁸³ Full text of *Circular (No. 25, 1991) of Promoting Border Trade and Economic Cooperation for Prosperity and Stability in Border Provinces* is at <http://alpha.hwcc.gov.cn/cgibin/tripnet?base=fg1&rid=13409&usname=TRIPNET&passwd=iht6q2i&fmt=6&kw>. Last accessed in December 2007.

⁸⁴ See note 81.

must travel along designated paths. Of all land ports, only Pingxiang, Youyiguan, Dongxing (in Guangxi) and Hekou (in Yunnan) were opened to holders of either border pass or national passports.⁸⁵

Adhering to the *Interim Measures* in 1984, border trade towards Vietnam shall be conducted by entities with both border and provincial trading rights, except the small-scale border trade (which was allowed to be carried out by inhabitants at designated barter points in border areas). The pact granted provincial governments in Guangxi and Yunnan autonomy to regulate their trade with Vietnam, while the duties shall be imposed in accordance with Chinese laws.⁸⁶

To further utilize the trading with Vietnam, the State Council announced that the preferential treatment for promoting foreign trade and attracting inward investment of other coastal open cities were also applied to Nanning and Kunming, the capital cities of Guangxi and Yunnan, in June 1992.⁸⁷ In addition, five border townships, including Pingxiang, Dongxing (in Guangxi), Wanding, Reili and Hekou (in Yunnan),⁸⁸ were approved for further tax cut in order to develop the local agricultural processing industry and attract inward investment (from both abroad and other provinces at home). The key measures for opening the five border townships could be roughly put into three parallel but mutually-reinforcing groups. They included the expansion of local governments' autonomy in economic administration, tax reduction and the state-supported construction.

Following the Circular No. 25 in 1991, the five township governments were granted the autonomy in administering border trade and economic cooperation under supervision of Guangxi and Yunnan provincial governments, including affairs of border trade, processing industry, services and setting up of new border trade enterprises. In addition,

⁸⁵ Full text is at <http://vip.chinalawinfo.com/NewLaw2002/SLC/SLC.asp?Db=eag&Gid=100664426>. Last accessed in September 2007.

⁸⁶ See note 81.

⁸⁷ Article 1 of *Circular (No. 69, 1992) of Further Opening up Nanning, Kunming and Five Border Townships*. The full text is at <http://www.gzas-l-tax.gov.cn/taxlaw/show.asp?id=1436>. Last accessed in December 2007.

⁸⁸ The opening of Wanding and Reili is aiming at trade with Burma and is therefore not included in my discussion of this chapter.

the two provincial governments were authorized to approve the Chinese investment proposals under \$1 million in Vietnam.⁸⁹ The goal was to strengthen management of border trade (Gu and Womack, 2000: 1046).

The second policy measure to promote border trade with Vietnam is through the tax incentive, which covered both trade and investment aspects. On the trade aspect, taxes on inputs, technology and machines for local agricultural processing industry and export-oriented agriculture were completely exempted during the Eighth Five Year Plan period (1991-1995); in addition, foreign enterprises in the five townships would be taxed at 24% for their profits, which was lower than average at the national level. On the investment aspect, foreign investors from the adjacent countries (namely, Vietnam and Burma) were allowed to replace monetary capital with materials (including inputs and machines) in their investments in the five townships, while the taxes were halved on these materials.⁹⁰ It means that since then the cities and townships opened to Vietnam were subject to the same preferential policies as had been applied to the coastal areas, which granted local governments the rights to examine and approve investment projects, reduce or remit tariffs and taxes, and make loans for investment in fixed assets (Gu and Womack, 2000: 1046). In 1993, some townships in Hainan province were also approved to have 'border trade' with Vietnam and enjoyed some tax cut through the designated *Baimajing* harbor (Gu, 1996: 20).⁹¹ It is convenient to reach the middle part of Vietnam from Hainan province.

In order to further promote the economic cooperation between these regions and Vietnam, China has set up the 'economic cooperation districts' near the five border townships. Similar to the Special Economic Zones (SEZs), within the districts, Taxes on machines, facilities and other materials for infrastructures were completely exempted; and all newly-gained revenues were allowed to retain by local governments for further infrastructure development until 1995.⁹² The establishment of economic cooperation

⁸⁹ See Article 2.1 and 2.11 of note 83.

⁹⁰ See Article 2.2, 2.3 and 2.4 of note 83.

⁹¹ *People's Daily*, 19 December 1993, p1.

⁹² See Article 2.5 of note 83.

districts was expected to promote export-oriented industries and corresponding services by attracting both domestic and Vietnamese investors. For domestic export-oriented manufacturers located could be granted foreign trading rights (with Vietnam) by MOFERT if the business was big enough. These domestic manufacturers were eligible for 24% preferential tax rate of their profits, while another 9% may be levied when the profits were remitted back to their provinces of origin.⁹³ Moreover, these manufacturers were exempted from duties for domestic investment adjustment until 1995.⁹⁴ Goods from barter trade conducted by both foreign enterprises and domestic manufacturers located in the economic cooperation districts were allowed for re-sale and were eligible for half taxes, except those are subject to special national restrictions.⁹⁵

At the same time, Beijing also promised to fund infrastructure construction in these five townships; the township authorities were allowed to collect and retain customs clearance fees for further construction and township development. In addition, between 1991 and 1995, the central government would arrange loans on fixed assets of 20 million Chinese Yuan for Pingxiang, Dongxing, and Hekou, respectively, for development of these townships and economic cooperation districts.⁹⁶

3.2.3 Border trade policy since 1996

In January 1996, the State Council promulgated Circular No. 2 in regard to border trade. Different from the Circular No. 25 in 1991, the document in 1996 was applied to trade and economic cooperation with adjacent countries for all China's border areas. It also stated that following the principle of 'establishing a socialist market economy', the provincial governments are responsible for implementing related regulations made by the MOFERT and China Customs. The major purpose of Circular No. 2 was to clamp down

⁹³ See Article 2.6 of note 83.

⁹⁴ This duty has been levied on domestic enterprises from 1991 to 2002. It was for 'implementing national industrial policy, controlling investment scope, guiding investment direction, adjusting investment structure, developing key infrastructures, and ensuring the sustaining and stable national economic development'. Full text of this law is at <http://www.sdlw-l-tax.gov.cn/ShuiSFG/ssfgmx/td-2.htm>. Last accessed in December 2007.

⁹⁵ See Article 2.7 of note 83.

⁹⁶ See Article 2.8 and 2.9 of note 83.

on the abuse of preferential treatments, while at the same time the tax reduction – taxes on imports through small-scale trade in border areas were halved, except tobacco, alcohol, cosmetics and other goods subject to national restrictions – would be extended to 1998 (the first three years of the Ninth Five Year Plan).

Since trade and investment activities produced the transformative effect to both sides of the border region, the two countries revised the temporary pact on border affairs when the Vietnamese Premier Minister Phan Van Khai paid an official visit to China in 1998.⁹⁷ For the purposes of encouraging trade in border areas on the basis of reciprocity, the revised agreement emphasizes to clamp down on smuggling and counterfeit. All goods, except those are banned or subject to the licensing and quota restriction, are allowed for free trade after passing the national examination. The trade settlement can be made in convertible currencies, Chinese Yuan (CNY) or Vietnamese Dong (VND) while the detailed settlement process is left for negotiation by central banks of both countries. In addition to the central governments, the agreement also grants the local authorities in both countries power to coordinate for settling border trade disputes.⁹⁸

3.3 State promotion of investment in Vietnam

One of the features of China's bilateral FEP is the state support for the SOEs and domestic conglomerates to invest in Vietnam. As early as 1992, when meeting with his counterpart, Li Lanqing, the Minister of Foreign Economic Relations and Trade (MOFERT) at the time, had said that the two countries should encourage big companies of both sides to do business with each other and allow them to sign long-term cooperation contract.⁹⁹ This emphasis reflects the inheritance of the post-1978 state-guided national development project in China. First, the Chinese leadership emphasized the need for larger enterprises in the 'national team' to continue to be primarily publicly owned while the large Chinese enterprises are becoming too resistant to bureaucratic intervention.

⁹⁷ *People's Daily* (English version), 27 February 2002 at http://english.people.com.cn/200202/27/print20020227_91046.html. Last accessed in January 2008.

⁹⁸ Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100665005>. Last accessed in September 2007.

⁹⁹ *People's Daily*, 2 December 1992, p6.

Second, the state structures that the Chinese leadership was using to carry out an industrial policy centered on the creation of large globally competitive firms. Third, the efforts to initiate China's capitalist national development project and encourage the emergence of large corporations that would be globally competitive coincided with dramatic changes in the practices of the increasingly oligopolistic multinational enterprises (MNEs) with which the Chinese firms were expected to compete (Berger, 2005: 315). Therefore, the enhanced foreign economic relations with Vietnam have been treated as an excellent opportunity to realize the national industrial policy. Vietnam, due to not only its geographical, historical and cultural affinity with China but also the backward developmental stage, could offer a relatively easier environment for big Chinese SOEs to sharpen their edge for future business competition in other advanced markets. The promotion of big Chinese companies had been reiterated for many times during the exchange visiting of high-level officials from both sides, and the annually held (since 1993) China Import and Export Fair at Kunming (the capital city of Yunnan)¹⁰⁰ has been set up to help carry out this idea.

3.3.1. State-owned enterprises (SOEs)

With this policy promotion, Chinese SOEs have become the major players in doing business with Vietnam. For example, since Vietnam started to allow the import of Chinese produced insecticide¹⁰¹ in 1993 (it was imported into Vietnam through the third countries previously), the Sino-Agri Corporation has been the most important supplier for Vietnam through the national trade channel, while the amount was of 4 million Chinese Yuan.¹⁰²

State promotion for SOEs sometimes is reflected on the financial assistance from the state to help them win or realize contracts. For example, the China National Construction and Agricultural Machinery Import/Export Corporation (CAMC) carried out China's

¹⁰⁰ <http://www.kmfair.org/en/>.

¹⁰¹ Since about 60% of population is working in the primary sector, insecticide has become one of Vietnam's largest single imports (IMF, 2007: 14 and 28).

¹⁰² *People's Daily*, 5 May 1993, p7.

biggest export credit guaranteed project (more than \$5 million) with Vietnam by exporting a complete set of machines for producing cane sugar to Vietnam's Binh Dinh province in May 1997.¹⁰³ Financial assistance also covered other big SOEs such as China National Pharmaceutical Foreign Trade Corporation (SINOPHARM), China National Medical Equipment Industry Corporation (CMIC), and China National Light Industrial Products Import and Export Corporation (CHINALIGHT).

Some of the big SOEs are also able to provide multiple professional services. An important example is the China National Machinery & Equipment Import & Export Corporation (CMEC). Although it has been specialized in exporting the complete set of facilities for industrial production, it has enlarged its business to construction contract. In 1992, the CMEC cooperated with a Hong Kong company to sign a contract in building up a cement plant in Vietnam. This is the third complete facilities exported project in Southeast Asia for the CMEC (the other two are in Pakistan and Thailand); it is responsible for the overall design, facilities manufacturing and transport.¹⁰⁴ Other multiple services enterprises include China State Construction Engineering Corporation (CSCEC), China Civil Engineering Construction Corporation (CCECC) and China International Water & Electric Corporation (CWE).

These SOEs are benefited from state support in investing outwards, such as having better information sources, stable business opportunities, easier access to domestic loans, various assistance from the state and good reputations, which has enabled them to do business of a bigger scale in Vietnam (Pan, 2003: 46-47).

3.3.2. *Conglomerates*

China's domestic conglomerates are another group of key players in trading with Vietnam, which also receive the state promotion (to the smaller extent relative to big SOEs) because they are viewed as standing a better chance in succeeding abroad.

¹⁰³ *People's Daily*, 10 June 1997, p2.

¹⁰⁴ *People's Daily*, 21 June 1992, p2.

However, the entry of China's conglomerates into Vietnam is a rather recent phenomenon, which reflects the development of Chinese industry in the reform era. The important players include the TCL Group, which is a household appliances manufacturer, has held between 18 and 20 percent of the Vietnamese television market after entering the market in 1999; the New Hope Group, which is a national leading enterprise for agricultural industrialization; and the Jialing Industrial Co. Ltd and the Jincheng Corporation, both of them are major exporters of motorcycle parts and components to Vietnam.¹⁰⁵

Comparing with the big SOEs, these conglomerates are having different advantages, namely more advanced production skills and R&D abilities, which allows them to develop fast and promote 'China's valuable brands' with easier access to state finance or assistance in other forms (Pan, 2003: 46-47).¹⁰⁶

4. Trends of bilateral economic cooperation

4.1 Trade patterns

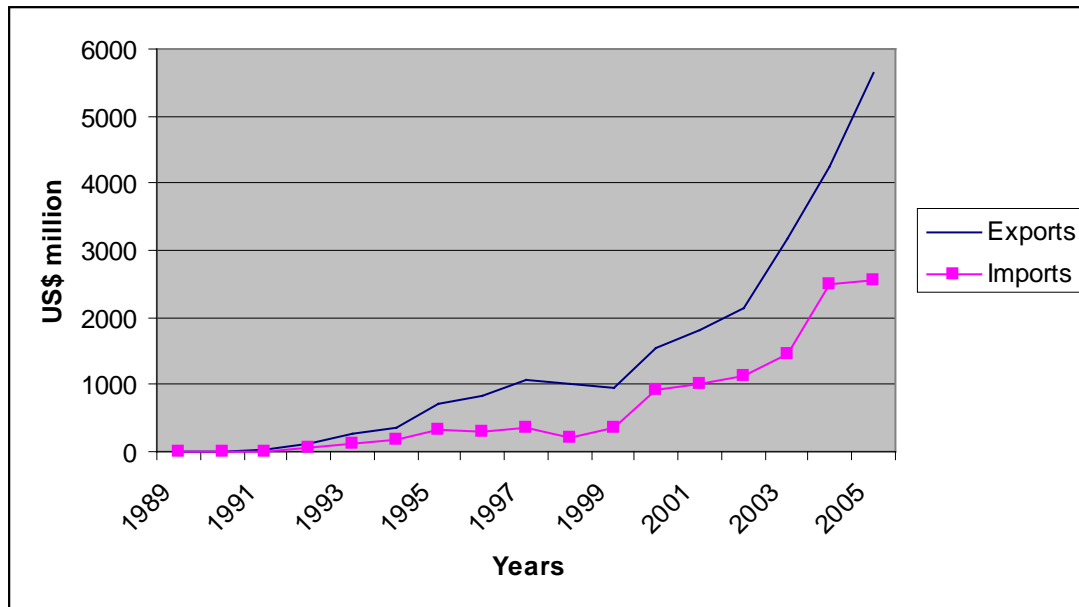
Although bilateral trade has been growing steadily since the normalization of relations in 1991 (see Figure 3.1), the volume has continued to be of insignificance to China. As less than 1% of China's overall trade (see Table 3.1), official trade with Vietnam in 2005 was at the same level as with Mexico (0.5%) and South Africa (0.5%).¹⁰⁷

¹⁰⁵ *People's Daily*, 27 January 2000, p1 and 14 March 2000, p10.

¹⁰⁶ *People's Daily*, 16 August 2000, p2.

¹⁰⁷ Although at the same level, the features of China-Mexico and China-South Africa trade are different from the China-Vietnam one. In 2005 China imported more than twice of its exports to Mexico; while China has had roughly trade balance with South Africa.

Figure 3.1 China's trade with Vietnam, 1989-2005



Source: IMF (various years).

Table 3.1 Significance of bilateral trade to each other.

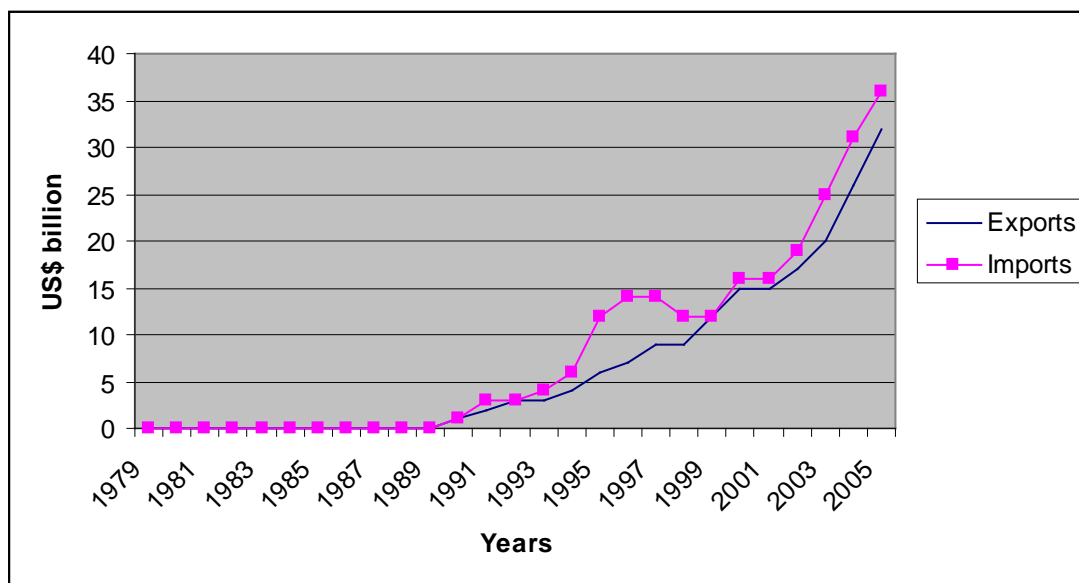
<i>Year</i>	<i>Exports (\$ million)</i>	<i>Imports (\$ million)</i>	<i>Share of China's total trade (%)</i>	<i>Share of Vietnam's total trade (%)</i>
1991	21	11	0.02	0.7
1994	342	191	0.2	5.4
1997	1,079	357	0.4	6.3
2000	1,537	929	0.5	8.2
2003	3,179	1,456	0.5	10.3
2005	5,639	2,549	0.6	12.0

Source: IMF (various years).

It is also clear that there has been serious trade imbalance in favor of China. Although this trend in fact is consistent with Vietnam's overall trade direction (see Figure 2), structural reasons have been largely responsible for China's persistent trade surplus with Vietnam. On the one hand, primary products have been Vietnam's main exports to China due to its own developmental stage, while China's most important exports groups to Vietnam are complete sets of facilities for industrial production, various machines and

vehicles and simple manufactures. On the other hand, although China granted Vietnam MFN status in 1991, in reality, the tariffs on Vietnamese agricultural product was high. For example, the tariff rate applied to shrimps was 50%, caviar was 40%, fresh water fish was 20% (Hu, 2000; Wang, 2001). It is consistent with China's policy of protecting the domestic primary sector, which had remained until the implementation of the Early Harvest Package in 2004 as a part of China-ASEAN free trade agreement (China-ASEAN FTA) negotiation.¹⁰⁸

Figure 3.2 Trends of Vietnam's overall trade, 1979-2005



Source: IMF (various years).

4.1.1 Crude oil imports from Vietnam

Among primary products imported from Vietnam, crude oil has been the most rapidly rising single product. By 2001 China was a major customer, buying over one-fifth of Vietnam's oil exports. The cause of this phenomenon, from Vietnam's viewpoint, is a convenient revenue source to help pay for its imports from China. In addition, the better

¹⁰⁸ See the *Joint Press Statement of the First Consultation between the ASEAN Economic Ministries and the Minister of Foreign Trade and Economic Cooperation of People's Republic of China* (released on 13 September 2002) at <http://www.aseansec.org/12275.htm>. Last accessed in May 2008.

relationship with China since the 1990s has helped make Vietnam feel more comfortable to start the oil sales (Womack, 2006).

From the Chinese perspective, the significance of crude oil imports from Vietnam is not for domestic use but for improving its gas industry. As early as 1994, the state has invested in Petroasia, a multinational joint venture, which was carried out by the state-owned China Petroleum and Chemical Corporation (SINOPEC). SINOPEC owns 30% of Petroasia, while Thailand's Charoen Pokphand Group (CP Group) owns 50% and Petroleum Authority of Thailand (PAT)—the Thai state oil company—owns 20%. Petroasia teamed up with Saigon Petro for 28 million US Dollars in Vietnamese downstream ventures, and the Petroasia (Saigon) ventures would include oil terminals and tank farms.¹⁰⁹

This investment projects might bear more economic considerations than security implication for China. Although China has been concerned of its energy supply, its major suppliers for domestic use are from Middle East, Central Asia and Russia (Jaffe and Lewis, 2002). However, the crude oil from Vietnam has granted China a good chance to develop its gas industry in the way that China buys crude oil from Vietnam, refines it domestically and sells refined petroleum products to various Southeast Asian countries, including Vietnam. The rationale has been explained as

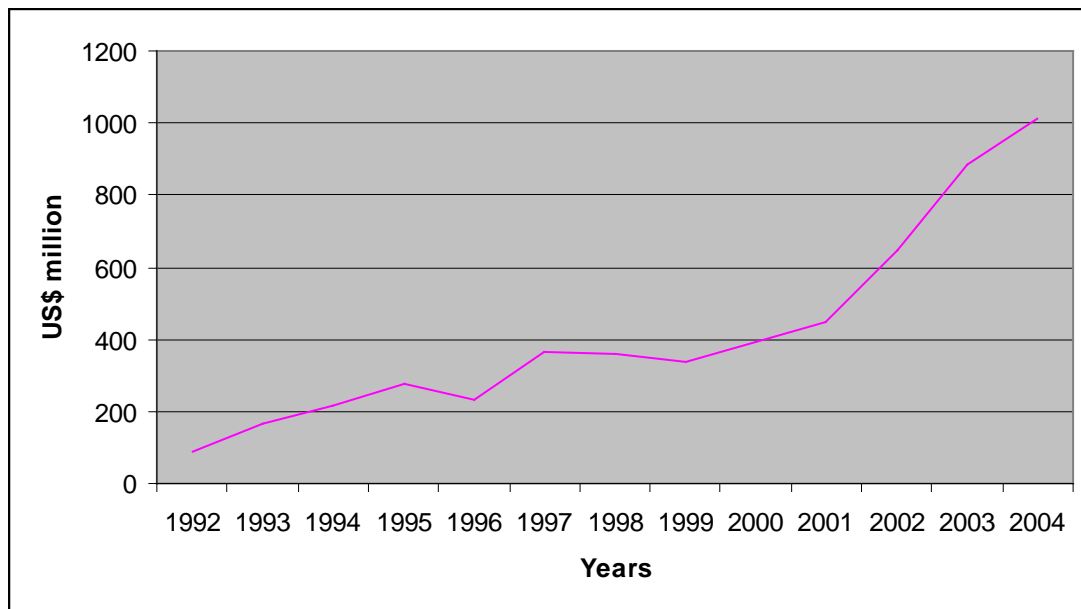
‘...The crude oil import from Vietnam helps China firstly realize its promise in reducing trade imbalance, secondly improve the refinery capability of China's gas industry, and thirdly earn foreign exchange by selling refined products abroad.’ (Interviewee 07T1, conducted in September 2007)

4.2 Border trade

¹⁰⁹ See *People's Daily*, 18 April 1994, p7; and ‘The Thais are making inroads into Asia's communist giants’ (Petroasia JV opens service stations in Maoming, China) in *The Oil and Gas Journal* (1994), 92: 23, p.2.

Although Vietnam has played a marginal role in China's national trade picture, it has been more important at local level in form of border trade, mainly in Guangxi and Yunnan (and Hainan since 1993). For example, Vietnam has been one of Guangxi's largest trading partners.¹¹⁰ The opening the border provinces has been one emphasis of China's FEP towards Vietnam, which has been expected to accelerate local economic development by exploiting locational endowments, such as convenience, familiarity and other localized factor advantages (Womack, 1994: 502). With the policy support, border trade has been stably growing, as Figure 3.3 illustrates.

Figure 3.3 China-Vietnam border trade in Guangxi and Yunnan, 1992-2004



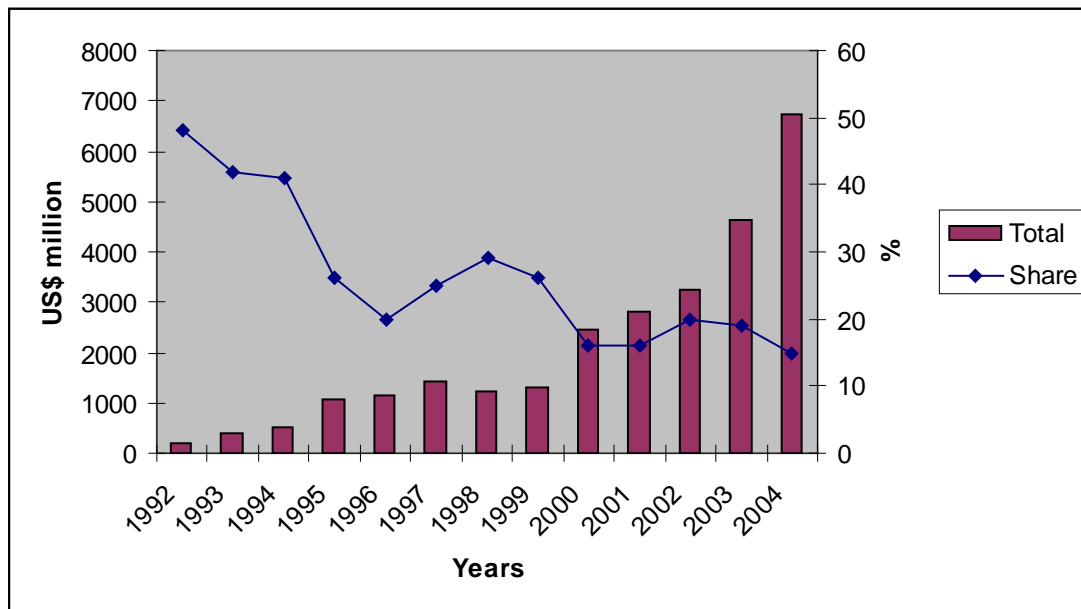
Source: Calculated from Li (2005: 14).

Most of the border trade has been conducted by small-scaled enterprises (both public-owned and private) or border inhabitants. The composition of border trade has been largely the 'export' of Chinese consumer and light industrial goods for quick financial returns. However, although border trade has been growing and has had a transformative effect at border townships in these provinces, mainly because these areas are poor by provincial standards and were especially disadvantaged during the 1980s (Womack, 1994: 504), it seems to gradually lose its significance of the total China-Vietnam trade, as

¹¹⁰ Original data has not been collected from *Guangxi Statistical Yearbook* yet.

Figure 3.4 shows, with the active participation of the big domestic companies. Such participation has been promoted by the central leadership and has become the other key aspect of China's FEP towards Vietnam. The support for domestic enterprises is aiming at winning international competition and making immediate profits, which have been viewed as conducive to national development in the long- and short-runs, separately.

Figure 3.4 Share of border trade in Yunnan and Guangxi relative to total trade, 1992-2004



Source: Li (2005: 14).

4.3 China's investment in Vietnam

Notwithstanding the state support, China's investment profile in Vietnam is comparatively weak relative to its trading might. It reflects the fact that even Chinese economy has been growing fast for almost 30 years since 1979, the national capital accumulation is still unable for China to proceeding outward investment. Exceptions emerge when there is state finance involved, as discussed in the previous section. Therefore, the general characteristics of Chinese investment in Vietnam are of smaller scope, taking longer than average (comparing with other foreign investors in Vietnam) to realize the projects, and concentrating on light manufactures. For all that, the increasing

number of exclusive Chinese ownership in investment projects in Vietnam does demonstrate the increasing Chinese economic strength.

From 1991 to 2001, China had 117 investment projects in Vietnam. Most of them are located in either three major cities (26 in Hanoi, 8 in Hai Phong, and 7 in Ho Chih Ming City), or provinces adjacent to China (13 in Quang Ninh, 8 in Lang Son, and 5 in Lao Cai). These investment projects normally are of rather small scope at \$2 million on average (the average scope of Vietnam's single foreign investment project is of \$16 million); in addition, most of these projects are only for 10-15 years, shorter than the average, while it normally takes longer than the average to realize these projects. Moreover, until the end of 1999 the two countries had not started direct banking service with each other; it resulted in all transactions have been forced to go through banks in the third country and are made of hard currency, which critically increases the costs of China-Vietnam trade (Dai and You, 2002: 40; Li, 1999).

Furthermore, in structure, China's investment projects have clearly concentrated in various light manufactures, which do not require advanced technology. Considering with the aforementioned general characteristics of China's investment in Vietnam, it might be explained by the inability of China's private enterprises to invest in capital-intensive and long-term projects. The large number of investment projects in primary sector and food processing industry might also proves China's efforts in exploiting the localized endowment of border provinces—since Guangxi has been the biggest investment source for Vietnam (Dai and You, 2002; Li, 1999). The industry distribution is shown in Table 3.2.

Table 3.2 Industry distribution of China's investment in Vietnam, 1991-2001 (\$ million)

<i>Industry</i>	<i>Number of project</i>	<i>Total investment amount</i>	<i>Agreed capital</i>	<i>Capital from Vietnam</i>	<i>Capital from China</i>
<i>Light industry</i>	37	38.69	23.06	4.31	18.62

<i>Heavy industry</i>	26	52.36	33.18	7.11	25.07
<i>Agricultural and forestry</i>	20	19.77	12.73	3.52	9.21
<i>Food processing</i>	12	21.59	12.99	3.76	9.23
<i>Construction</i>	8	15.23	8.60	3.15	5.45
<i>Hotels</i>	5	2.29	2.16	1.03	1.13
<i>Cultural and medical</i>	3	8.38	3.42	1.10	2.32
<i>Other Services</i>	3	1.46	1.11	0.26	8.52
<i>Commercial office</i>	1	5.00	1.50	0.45	1.05
<i>Telecommunication</i>	1	0.50	0.50	0.10	0.40
<i>Aquatic products</i>	1	0.40	0.30	0.18	0.12
Total	117	165.67	99.54	24.96	73.45

Source: Dai and You (2002: 41).

As Table 3.2 suggests, the major form of China's investment in Vietnam is joint-venture. However, the number of ventures of exclusive Chinese ownership has actually increased, and some previous joint-ventures have also shifted to this direction. The reason is in the early 1990s, due to lack of understanding about Vietnam, Chinese enterprises needed help from Vietnamese partners. Subsequently, with the improvement of Vietnam's overall investment environment and Vietnamese partners' inability of providing stable follow-up funds, the Chinese investors had the opportunity to acquire the single ownership of joint-ventures; and the new comers have seem to be affected when make choice in their business practice (Dai and You, 2002).

4.4 'Economic aid' as a form of state promotion for trade

Although bilateral aid normally denotes the help provided for the other to achieve socioeconomic objectives, such as economic growth (see, for example, Banerjee, 2007), aid has been used by China as a form to realize its political commitments to Vietnam and the state has financed the big domestic players since 1991. The statements that economic

aid is a form of economic cooperation for mutual benefits in a few national agreements reflects that, on the one hand, Vietnam needs external force for industrial catch-up at this stage, and on the other hand, China has made efforts in facilitating big domestic companies to succeed abroad. The obvious reason is ‘the large Chinese companies have been singled out as potential global competitors are painfully weak’ (Nolan, 2001), therefore the state assistance has become indispensable for this goal.

In the Vietnam case, up to 1978, China had aided 339 projects of establishing plants and other infrastructure in Vietnam for their shared ideology and interests. After the normalization of bilateral relations, in December 1992, China decided to offer interest-free aid of total 80 million Chinese Yuan within the period of 1992-2000 for refurbishment of some old Chinese-aided projects, such as Hebei nitrogenous fertilizer enterprise and Sanba textile enterprise, construction of small hydraulic power stations and water supply system in five northern Vietnamese provinces, where are adjacent to China (Dai and You, 2002).

Since then, some more aid of this manner has also been proposed. For example, in 1994, \$170 million of low-interest loans was offered for the extended plans of Hebei nitrogenous fertilizer enterprise and Taiyuan iron and steel enterprises, while China agreed to provide another \$10 million to subsidize Vietnam’s interests (the agreement was not signed until 1997, though). However, Vietnam proposed to change the use of these loans, which led to further negotiation. In June 2000 China and Vietnam signed an agreement of China providing aids of \$18 million and interest-free loans of \$36.8 million, while in November both sides agreed to have China’s two domestic enterprises as contractors (Dai and You, 2000). In 2002 China again signed two agreements in terms of ‘economic and technological cooperation’¹¹¹ and ‘preferential loans’¹¹² with Vietnam, of which it specified that the aid and loans could be used only on ‘mutually agreed’ projects. It implies the guarantee for Chinese companies to win the contract of projects.

¹¹¹ Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100667582>. Last accessed in March 2008.

¹¹² Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100667577>. Last accessed in March 2008.

The loans from China's national banks have played an important role for Chinese business to invest in Vietnam. For example, in 1993 Bank of China provided loans of 400 million Chinese Yuan to Harbin Power Equipment Corporation (HPEC)¹¹³ for its contract with Vietnam to construct a power plant. This is the first time for China to export large machine sets.¹¹⁴ Another example is in October 2000, the Export-Import Bank of China¹¹⁵ (China Eximbank) signed an agreement on preferential loans of more than 50 million Chinese Yuan with Vietnam's Ministry of Finance, for Vietnam to buy the Chinese produced machines for overpass construction.¹¹⁶ In other words, these SOEs are supported through massive subsidies, which often took the form of 'loans' from government or the banking system that might never be repaid (Breslin, 2005b: 351).

5. Conclusion

Although geopolitics and the economic disparities imply that Vietnam could be a soft case for China's political ambition, evidence presented in this chapter suggests the other direction. On the one hand, the development of bilateral economic relations does not meet the expectations about what Beijing should do to enhance its power ascendancy over Vietnam through the manipulation of economic cooperation; what I found in this chapter is that the bilateral FEP practices towards Vietnam seems to represent the usual

¹¹³ The HPEC is established upon the Russian-aided projects and has become the most important SOE in generating sets manufacture. It is one of the earliest Chinese SOEs to set up subsidiary outside the mainland and has been listed on Hong Kong stock exchange in 1994 (cited from the HPEC website).

¹¹⁴ *People's Daily*, 24 December 1993, p2.

¹¹⁵ The China Eximbank is established in 1994 and solely owned by the government. As a government policy bank, it is under the direct leadership of China's State Council and functions as an important force in the backup system of foreign trade. The China Eximbank has developed into a key channel of policy financing for export and imports of mechanic products, complete set of equipment, and high- and new-tech products, and for offshore construction contracts as well as overseas investment projects. Meanwhile, the Bank is also the major lending bank for foreign government loans and the sole lending bank for Chinese Government Concessional Loan entrusted by Chinese government. The main mandate of the Bank is 'to implement the state policies in industries, foreign trade, diplomacy, economy and finance to provide policy financial support so as to promote export of Chinese mechanical and electronic products and high- and new-tech products, to support Chinese companies with comparative advantages to conduct such cooperation with foreign partners such as offshore construction contracts and overseas investment projects, and to 'strengthen relations with foreign countries and to enhance Sino-foreign economic/technological cooperation and exchange' (cited from the China Eximbank website).

¹¹⁶ *People's Daily*, 30 October 2000, p2.

‘rituals’ Beijing goes through with trading partners in general. It therefore questions the presumption that the bilateral economic relations are motivated by Beijing’s power consideration. Since Vietnam has run a large trade deficit with China and seeks to have a trade relationship with the US that surpasses that with China as the countermeasure, it would be unreasonable for Beijing not to offer economic benefits to Vietnam so that the trade dependence could be maintained, particularly when the costs of doing so is low.

On the other hand, China’s FEP towards Vietnam has appeared to be directed to the same goals of China’s FEP in general, namely to increase the national income and to enhance the potential competitiveness of domestic sectors. The ‘target’ beneficiaries for the former are the regions adjacent to Vietnam, particularly Yunnan and Guangxi, while for the latter are largely the SOEs and, to some degree, the domestic conglomerates. The regional and the sectoral coverage is consistent with the direction of China’s FEP in general that to boost the overall national development through greater opening, while the story analyzed in this chapter suggests that to strengthen the weak domestic sectors through economic cooperation (whenever possible) as a means to address the inherent difficulties confronted these sectors may play a big role behind Beijing’s implementation of its FEP towards Vietnam.

Chapter 4: China's FEP towards Singapore, 1979-2008

1. Introduction

Among ASEAN members, Singapore represents a hard case for China's ambition of political domination. In addition to the distance (relative to countries in Indochina), the good bilateral political relations imply that China may have less motive of questing for dominance over Singapore. Furthermore, Singapore's developmental level implies that to seek for political goals in bilateral economic relations may accrue higher cost to China. Therefore, albeit the expectations of Beijing's bilateral economic behaviors that aim to achieve China's power ascendancy over Singapore remain the same – namely to take initiatives, to offer sweet deals in order to ensure the asymmetrical economic dependence, they should not be seen in this case.

The examination of China's FEP towards Singapore in this chapter appears to manifest the above anticipation. Although Beijing has welcomed Singapore's engagement with the opening process of Chinese economy since its outset, it is consistent with Beijing's attitude towards other partners in general. More importantly, Beijing has appeared rather responsive to Singapore's initiatives, as represented by the conclusion of China-Singapore Free Trade Agreement (CSFTA) in 2008. The passive behaviors thus suggest that for Beijing, the pursuit of political domination in its economic relations with Singapore may not be the primary concern in the span this study covers. Based on the findings in this chapter, I argue that China's bilateral FEP towards Singapore is for the aspiration after national development that has appeared on the same track of China's FEP in general. To this end, the main focus of the bilateral FEP has been capitalizing Singapore's competitive edges to facilitate the developmental goals of different aspects in China's opening process.

To illustrate my argument, section 2 will firstly trace the development of bilateral political relations to set the significant prerequisites regarding the 'degrees' of both China's motive and potential cost in seeking political dominance over Singapore. The

confirmation that Beijing has been keen to respond to Singapore's foreign strategy of 'engaging China' leads to the exploration of China's anticipated gains in bilateral economic relations in section 3; the examination of bilateral FEP will demonstrate how Beijing uses the initiatives proposed by Singapore to assist the economic catch-up at the national level, albeit the two countries' preferences in multilateral economic institutions have often appeared conflicting. The assessment of the 'outcome' of such bilateral FEP – namely the features of bilateral economic activities – will help our understanding about likely reasons for Beijing to consent to the proposal of CSFTA when the information inside the 'black box' remains opaque at the time of writing. This chapter will conclude that the bilateral FEP towards Singapore has been used as the complement to China's FEP in general and has been expected to assist China's overall developmental needs.

2. Development of bilateral political relations

2.1 Strategic context of bilateral relations before the open era

Although China did not recognize Singapore as an independent state until early 1975,¹¹⁷ China had sought to cultivate friendship with this island republic against the Soviet influence in the region (Lee, 2000: 575).¹¹⁸ This attempt reflected China's shifted perception of threat to national security in the changing strategic context. The 1968 Soviet invasion of Czechoslovakia,¹¹⁹ the Sino-Soviet border clashes in 1969 and the ebbing of the American presence in Vietnam drove China to make overtures to the US; while for the American calculation, it facilitated an important realignment in the

¹¹⁷ *Strait Times*, March 17 and 18, 1975; cited in Lee, 1975: 36. Singapore has withdrawn from the Federation of Malaysia on 9 August 1965 (Chia, 2007: 74).

¹¹⁸ Among other things, Soviet Union had concluded a trade agreement with Singapore in 1966 and established a trade mission in Singapore in 1967; it had also established diplomatic relationship with Singapore in 1968 and the Soviet ships began to use the port facilities of Singapore (Lee, 1975: 29). In addition, the Singaporean leaders were invited to Moscow in September 1970; recent record indicates that the Soviet interests were concentrating upon the potential Chinese influence and the US actions in Singapore (Lee, 2000: 441-443).

¹¹⁹ For China, this event marked the elevation of strategy over ideology in the seeking of foreign confederates. China condemned the invasion of Czechoslovakia as 'the most barefaced and typical specimen of fascist power politics...against its so-called allies' (documented in Jones and Kevill, 1985: 84). Chinese leaders believed that the Soviets were preparing for further armed interventions in other countries, including China. In this view, Soviet 'social imperialism' had come to be seen as a greater threat to socialist China than Soviet revisionism (Barnouin and Yu, 1998: 86; Yahuda, 1995: 278).

Northeast Asian power balance by creating a collaborative Washington-Tokyo-Beijing axis as a counterweight to rapidly expanding Soviet power in East Asia (Shambaugh, 1995: 198-199). The converged strategic interests culminated in the signing of Sino-American joint communiqué at Shanghai in 1972, which constructed the strategic partnership between China and US targeting at the Soviet Union (Chen, 2001: 238-276). For China's new foreign tactics of getting as many governments as possible to close ranks against Soviet Union and checking the expansion of Soviet influence into Southeast Asia (Lee, 2000: 575), to cultivate friendship with Singapore became imperative because Soviet Union had already made advances.

However, in the prevailing Cold War environment, from the perspective of Singapore, it is not a profitable move to establish the official ties with China too quickly due to its dominant Chinese population and geopolitics (Lee, 2001: 416). With the high ethnic Chinese composition of its population (about 75%), Singapore had been cautious to avoid being perceived as 'an agent of influence of China' by its two most important neighbors, Malaysia and Indonesia.¹²⁰ Singapore had also been worried about the subversive Communist activities in the region, which had received support from China (Storey, 2002: 207). To ease Singapore's anxiety, in the meeting with the Singaporean Foreign Minister Rajaratnam at Beijing in 1975, Zhou Enlai recapitulated China's respect for Singapore as an independent state and hinted the shift of China's overseas Chinese policy which, at the time being, had focused on the appeal to ethnic Chinese in Southeast Asia by underlining their kinship and calling upon their ethnic empathy. In addition, Zhou reiterated that China wished to have diplomatic relations with Singapore as soon as possible but was willing to wait for Singapore's convenience. Although no communiqué was signed during Rajaratnam's visit, Zhou summed up that China's overall foreign policy towards Singapore is based on the Five Principles of Peaceful Coexistence (Lee, 1975: 36-37). In

¹²⁰ Indonesia broke off relations with China following the mass killings of 1965-66 at home as the anti-Communist purge; the violent upheaval led to the downfall of Sukarno regime. The following president Suharto abandoned Sukarno's balancing act of nationalism, religion and Communism and marked his 'New Order' with freezing formal relations with China in October 1967 (Ricklefs, 2001: 346-352; Taylor, 2003: 356-359).

the next year Lee Kuan Yew¹²¹ was invited to visit China; despite the remaining different opinions about Singapore's pro-West attitude and regional Communist insurgencies, China promised its non-interference stance towards Singapore, which was announced as the base for developing bilateral relations (Lee, 2000: 578-586).

2.2 The setting of 'pragmatic' partnership

When Deng Xiaoping secured his political rehabilitation in 1977, he started to implement the strategy encompassing major foreign and domestic initiatives as the solution to China's crisis-ridden situation (Lieberthal, 2004: 125-127). In national security, military pressure on China's weak southern flank was heightened due to the united Vietnam's attempts of consolidating control over Laos and against China's client Pol Pot regime in Cambodia with the Soviet backing; the actions not only frustrated China's desire to maintain significant influence in Indochina but could have facilitated the claimed encirclement of China by providing basing rights for the Soviet force in the region (Levine, 1984: 113, 130). In economy, the accumulating problems of relative autarky policy such as wasted domestic investment, low industrial and agricultural productivity and, more importantly, the backward technological and administrative capabilities, were immensely severe (Naughton, 1995: 49-50). In this context the search for cooperation with ASEAN members became consequential because they could serve as the regional security alignment to resist the alleged Soviet expansionism, as well as the important trading partners and potential sources of ideas and capital for China (Levine, 1984: 115-116; Yahuda, 1993: 559).

For the twofold purposes Deng visited Thailand, Malaysia and Singapore in November 1978. Deng placed the Chinese concern over Soviet-Vietnamese military alliance in the framework of shared security threat from the Soviet hegemonism in terms of 'the Chinese support for the preservation of autonomy, the just struggle against foreign control and interference and the principles of peace, freedom and neutrality of the ASEAN' and

¹²¹ Lee served as Singaporean Prime Minister from 1965 to 1990; furthermore, he remains the prime architect and chief spokesperson of Singapore's China policy (Chia, 2007: 74; Khong, 1999: 112).

therefore advocated to strengthen regional cooperation to protect national resources and rights. In addition to this oratory, when met with Lee Kuan Yew, Deng particularly praised Singapore's non-alignment policy, which was attributed to the Singapore's solidarity and economic cooperation with developing countries, and the rapid economic growth under stable one-party rule.¹²² Lee, however, made no commitment to ally with China's anti-Soviet stance; instead, he hinted the possibility of more bilateral cooperation with the conditions that China entirely ceased the nationalistic mobilization of ethnic Chinese and the support for Communist insurgencies in Southeast Asia, which were crucial to both Singapore's geopolitical standing and the regional stability (Lee, 2000: 595-603). With the aspiration of making economic modernization as China's most primary issue, which was formalized at the third plenum of the 11th CCP Central Committee one month later (Goodman, 1994: 88-89), Deng seemed to implicitly accept the appeal that to avoid 'unnecessary problems' in Southeast Asia as a favorable condition for China's economic catch-up (Lee, 2000: 601). The reshuffle of strategic priorities was reflected on the description of Singapore as a garden city worth studying for its experiences in urbanization and public administration,¹²³ and on the subsequent actions which symbolized China's willingness to go part of the way towards meeting ASEAN demands of ethnic Chinese issue and of severing links with Communist parties (Levine, 1984: 131-138).

Deng's dealing with Singapore in 1978 ushered 'pragmatism' – it means to downplay the ideological or political factors to ensure future economic cooperation – as the keystone of bilateral relationship throughout the reform era. Yet, the mindset is not that different from his predecessor. With its non-alignment policy, the willingness to trade with all countries, and the place as the center for entrepot trade in Southeast Asia, Singapore had been one of China's few trading partners before the open up (Dent, 2002: 67; Storey, 2002: 207); after the suppression of Hong Kong riot in 1967, China began to bypass Hong Kong as a transshipment port and trade directly with Singapore (Lee, 1975: 17).¹²⁴ It explains

¹²² *People's Daily*, 21 November 1978, p. 1.

¹²³ *People's Daily*, 21 November 1978, p. 5.

¹²⁴ The Hong Kong riot (May to September 1967) was the large-scale pro-Communist demonstration inspired by radicals in the Cultural Revolution. It turned out to be violent movement against British

China's 'respect' paid to Singapore's foreign approach because China was benefited from the bilateral trade, which was only possible with Singapore's non-alignment policy. The management of bilateral political relations with Singapore since Deng Xiaoping therefore manifests the shift of China's strategic priorities; before Deng, Beijing had tried to woo Singapore into political alliance for its perceived struggle against the two super powers in the region; on the eve of reform era, the partnership with Singapore was still desired but mainly for economic objective.

2.3 Diplomacy serves domestic economic construction: the 1980s

Adhering to the principle of pragmatism, China's management of bilateral relations with Singapore throughout the period of 1979-2008 has been guided by its integrated regional policy, known as periphery policy (*zhoubian zhengce*) or good-neighboring policy (*mulin zhengce*).¹²⁵ This policy is deliberately devised by the reformist leaders in the hope to create a peaceful international environment conducive to China's economic modernization and national security; in particular, it has aimed at exploring the common ground with Asian countries in both economic and security arenas by conveying the image of a responsible power willing to contribute to stability and cooperation in the region (Zhao, 2004: 257-258). This stance proves to be welcomed by Singapore because its small size and dependence on external trade makes it extremely vulnerable to instability in the international system. Different from other ASEAN members, Singapore perceives the transforming China as a potential threat rather than an actual one (Storey, 2002: 221); to prevent it from upsetting existing international order, Singapore has advocated the engagement strategy, mainly economically but also politically, to reward China's cooperative international behaviors. It means to assist China's economic modernization and to incorporate China as a key player into the regional and global affairs (Khong, 1999). Obviously, this rationale well coincides with the goal of China's

colonial rule but was 'de-escalated' because China wanted to avoid more serious confrontation with the UK when domestic situation was chaotic enough (Barnouin and Yu, 1998: 69-71).

¹²⁵ See, for example, 'Congratulations on Premier Li Peng's successful visits to Malaysia and Singapore', *People's Daily*, 27 August 1997, p. 1.

periphery policy; the strategic convergence of interests on both sides therefore has underpinned the solid progress of partnership development until present.

Although Singapore did not ally with China's anti-Soviet appeal, China's high-profile involvement of Vietnam's invasion into Cambodia in the 1980s had eased Singapore's security concern (Storey, 2002: 208). In the due course, promotion of trade, investment and economic cooperation was the emphasis of bilateral interactions, which embodied Deng's policy guideline of 'forging foreign economic relations before formal diplomatic ties'.¹²⁶ Economic motivation was evidently influential in guiding the bilateral interactions as the attempt of China's periphery policy to make diplomacy a means of 'serving domestic economic construction' (*waijiao fuwu yu guonei jingji jianshe*) after the inception of the market-oriented economic reform.¹²⁷ In Deng's word, the economic power was both a means and an end of foreign policy.¹²⁸

China's behaviors seemed to strengthen Singapore's belief in its 'engagement' strategy. Singapore was muted to the Tiananmen crackdown in 1989; in fact, Singaporeans were among the first to return to Beijing.¹²⁹ When Beijing found itself more vulnerable to Western criticism and isolation after reorienting foreign relations to support economic modernization at home for a decade, Singapore's defense of Beijing based on the approval of not to allow the political system to be toppled and the understanding of Chinese leadership's historical self-perception as the society's guardian against chaos was highly appreciated. Furthermore, Lee Kuan Yew openly expressed his concern over the Western economic sanctions imposed on China because he believed that the efforts of integrating China into the global order should be continued (Latif, 2007: 102-115). This concern was shared by other ASEAN members although the unease of US efforts to link human rights to trade was the more pressing reason (Ba, 2003: 628). The need for ASEAN members to re-evaluate their strategic context also came from Washington's

¹²⁶ Deng Xiaoping, 'On Problems of China's Foreign Economic Relations' [*Guanyu woguo de duiwai jingji guanxi wenti*], 16 April 1982. Documented in *Almanac of China's Foreign Economic Relations and Trade*, 1984: 1-8.

¹²⁷ Liu Tsai-ming, 'A Special Interview of New Foreign Minister' [*Zhuanfang xin waijiao buzhang*], *Wenhui Bao*, 27 June 1998, p. A3.

¹²⁸ See Note 126.

¹²⁹ 'Singaporean Staff Return to Work', *People's Daily*, 18 June 1989, p. 1.

reluctance to support existing security arrangements without trade concessions from its Cold War allies after the Vietnamese withdrawal from Cambodia due to the difficulties of American economy (Crone, 1993: 510). This change coincided with Beijing's countermeasures when faced the Western pressure; thus Beijing started to make overtures to ASEAN. For example, Beijing cut ties with indigenous guerrilla groups in Southeast Asia, which no longer posed a substantial security problem to the governments there. Beijing also passed a nationality law in 1989 that appeared to terminate Chinese claims to authority over ethnic Chinese who had taken citizenship in foreign countries and advised Chinese citizens residing abroad to adhere to local laws (Sutter, 2005: 192). They significantly contributed to Indonesia's announcement of desire to begin normalizing relations with China (Sukma, 2002: 185-188), which opened the door for Singapore and Brunei to do the same.¹³⁰ Therefore, the aftermath of Tiananmen crackdown and the end of Cold War in 1989 provided Beijing the catalyst to give more weight to the periphery policy of its overall foreign practice as well as to the increasingly focused efforts to cultivate relations with ASEAN, which was critical for the normalization of Sino-Singaporean relationship.

2.4 Beijing's political 'concessions' for economic cooperation: the 1990s

2.4.1 Beijing's concessions over Taiwan issue

With the beginning of the 1990s many of the conditions and assumptions causing Singapore's delay of normalization with China were no longer applicable. Therefore, two months after Jakarta, Singapore proceeded with the establishment of formal ties with China in October 1990.¹³¹ Although the establishment of formal relations was described as the 'new chapter' of China's diplomacy,¹³² as the matter of fact, it was conducted as a very low-key event. An extremely short communiqué that simply stated the decision of

¹³⁰ Singapore had insisted to delay normalization with China until Indonesia did, so as not to be associated with China. Brunei, which often took Singapore's lead in foreign policy, also normalized relations with China once Indonesia did (Ba, 2003: 626).

¹³¹ 'Establishment of formal relations between China and Singapore based on the Five Principles of Peaceful Coexistence and UN Charter', *People's Daily*, 4 October 1990, p. 1.

¹³² 'The New Chapter of Sino-ASEAN Relations', *People's Daily*, 17 August 1990, p. 1.

the two countries to establish diplomatic ties and exchange ambassadors was signed by the Foreign Ministers of China and Singapore at the UN headquarters.¹³³ This unusual practice was designed for not to jeopardize Singapore's substantive interests in Taiwan after three rounds of difficult bargains (Lee, 2001: 418). Although Singapore has maintained one-China policy since 1972, it abstained on the UN Resolution (No. 2758) to expel Taiwan in 1971; in addition, since 1975 Singapore has started to send troops to Taiwan for extensive military training under the code name 'Exercise Starlight' because, on the one hand, both Singapore and Taiwan have purchased weapons mainly from the US; on the other hand, Singapore was anxious not to completely rely on Israel for military training (Lee, 2000: 559-561). Deng Xiaoping is said to have offered Singapore military training bases in Hainan province but the deal was turned down (Tkacik Jr. and Dillon, 2005). Singapore's refusal could have been based on its 'fallback position' strategy when engages with China that the strong Singaporean defense lies in concert with other US-backed Asian countries (Khong, 1999: 111), while the ostensible reason that Taiwan has proper hospitals, airports and communications to support military exercises was proposed (Lee, 2000: 559-561). Furthermore, Singapore disagreed to openly denounce Taiwan because the bilateral links were crucial; yet Singapore gave way to adjust the form of its relations with Taiwan in terms of allowing only low-profile Taiwan visits and renaming Taiwan's trade mission in Singapore from 'Trade Mission of the Republic of China' to 'Taipei Representative Office in Singapore'. For reaping pragmatic benefits, Beijing eventually gave in to Singapore and took the 'Exercise Starlight' as a *fait accompli* (Lee, 2001: 418). As a result, in his visit to Singapore in August 1990, Premier Li Peng announced that '... to set up the official ties based on the existing friendly and cooperative relationship is both the shared wish of the two countries' people and the historical inevitability...the Chinese government is willing to stand with the Singaporean government to achieve this meaningful task with the spirits of *mutual respect and understanding*...(emphasis added)',¹³⁴ while there were no public references to the Chinese sovereignty issue or other details on China-Taiwan relations released at the time.

¹³³ Original text is at <http://www.fmprc.gov.cn/chn/wjb/zzjg/yzs/gjlb/1323/1324/t6014.htm>. Last accessed in January 2009.

¹³⁴ See Note 126.

2.4.2. Territorial disputes in South China Sea

Although Singapore makes no territorial claims in the Spratlys,¹³⁵ it has been concerned over China's 'creeping assertiveness,' as reflected its declaration of the 'Law on the Territorial Sea and the Contiguous Zone' that unequivocally claimed the Chinese sovereignty over almost the entire area in 1992.¹³⁶ Since Singapore's survival and continued prosperity have relied on the maintenance of freedom of navigation in the area, through where are much of the world's trade passes linking the Indian and Pacific Oceans, the heightened regional tensions caused by the Chinese occupation of the Philippine-claimed Mischief Reef in 1995 extremely worried Singapore. From Singapore's perspective, the situation could lead to a vicious circle of events: China's military-backed expansion in South China Sea may curtail trade and investment from affected parties, which would inhibit economic growth in both China and ASEAN as a whole; the economic stagnation in China might further lead to domestic instability which would result in the more conservative or hard-line policy, thus caused greater regional instability. The rationale was raised by the Singaporean Premier Goh Chok Tong when he met with the Chinese Premier Li Peng in Beijing in 1995, as well as ASEAN's united stance of diplomatic confrontation. In addition, together with the Philippines, Singapore called for the American involvement. These actions sent an important signal to Beijing that Singapore's relations with ASEAN took precedence over its ties with China (Storey, 2002: 213-215). Also took into account of the concurrent possibility of military conflicts with US over Taiwan,¹³⁷ Beijing quickly decided to defuse the Spratlys crisis; at the

¹³⁵ The islands and/or maritime zones have been claimed by China, the Philippines, Malaysia, Brunei and Vietnam. Taiwan has also claimed sovereignty in the area but it has largely been ignored in the negotiation process (Cheng, 2001: 440).

¹³⁶ Full text is at

http://www.un.org/Depts/los/LEGISLATIONANDTREATIES/PDFFILES/CHN_1992_Law.pdf. Last accessed in January 2009.

¹³⁷ In opposition to the re-affirmation given by the American Secretary of State Warren Christopher to Chinese Foreign Minister Qian Qichen that the Clinton administration would continue to ban on visits of high-level Taiwan officials based on its one-China policy, the US Congress demanded President Clinton to grant the visa to the Taiwan President Lee Teng-hui with only one nay vote in 1995. It was interpreted by many political elites in Beijing as a clear indication of Washington's support for Taiwan's 'creeping independence' thus surfaced intense criticism on President Jiang Zemin and his moderate approach to Taiwan since 1993. Jiang was pressurized to go along with the hawks who advocated strong military

meeting of ASEAN Regional Forum (ARF) in August 1995 in Brunei,¹³⁸ Beijing had indicated for the first time that China would abide by the international law in sovereignty negotiations with the claimants to the Spratlys. It is pointed as a significant concession on the part of Beijing which had hitherto simply insisted that the Spratlys were Chinese territory. The fact that Beijing allowed the issue to be brought up in a multilateral forum, though only in an informal consultative session, was another notable concession because it had previously insisted on tackling the territorial disputes on a bilateral basis (Cheng, 2001: 424). The relatively reconciliatory gestures embodied Chinese principles of ‘shelving the disputes for joint development’ (*gezhi zhenyi, gongtong keifa*) regarding South China Sea;¹³⁹ to a larger extent, the compromise achieved in ARF was used as a leverage to counter the quest for US bilateral alliances in the region (Emmers, 2001: 287). Although doubts about China’s future actions to maintain its dominant position in the area for vital international shipping lanes and potentially valuable natural resources remained, ASEAN members seemed to buy China’s verbal commitments of preserving common interests in maintaining a peaceful and stable regional environment so that all could concentrate on economic development (Goldstein, 2007: 652-659).

3. China’s bilateral FEP towards Singapore

3.1. Singapore facilitate China’s opening: the 1980s

Under Deng Xiaoping’s policy guideline that ‘to forge foreign economic relations before formal diplomatic ties’ in order to serve the economic modernization program, China

response. After a few rounds of missile tests and extensive military exercises in the Taiwan Strait, the US signaled its resolve to defend Taiwan by deploying two aircraft carriers battle to the vicinity. Although China went ahead with huge exercise off the Fujian coast, no direct military engagement took place and the crisis came to a close (Shirk, 2007: 187-190; Swaine, 2001: 319-327).

¹³⁸ The ARF was launched in Bangkok in 1994. It is conceived as ASEAN’s attempts to maintain the US military engagement in Asia while tactically promote cooperative relations with China in the post-Cold War era (Leifer, 1996: 18-19).

¹³⁹ See, for example, Deputy Premier Li Lanqing, ‘The Chinese Development Is Indispensable to the World, and the World Development Is Indispensable to China [*Zhongguo de fazhan libukei shijie, shijie de fazhan libukei zhongguo*]’, address in ‘The future tide – ASEAN, Vietnam and China: the global business opportunities’ international conference in Singapore, 19 May 1994, documented in *Almanac of China’s Foreign Economic Relations and Trade*, 1995: 8-14.

appeared keen in accepting Singapore's wish to advance bilateral trade, and to utilize Singapore's developmental experience in the 1980s.

In responding to Singapore's request, China concluded significant agreements as the improved legal environment to facilitate bilateral trade and investment (the 'soft' environment, *jingmao ruan huanjing*). They included the trade agreement signed in December 1979,¹⁴⁰ in which China granted Singapore the most-favored-nation (MFN) status as reciprocal clause to the existing Singaporean treatment of Chinese goods.¹⁴¹ In addition, under the circumstance that there were no formal bilateral ties, China and Singapore agreed to mutually set up commercial missions in June 1980 for not only implementing the trade agreement but also working as the official representatives.¹⁴² The arrangement was made by the more flexible tactics of China's periphery policy; furthermore, although the Singaporean commercial mission was located in Beijing, its staff was allowed to travel freely to Shanghai and Guangzhou,¹⁴³ where were the key cities pinpointed by Beijing for opening to outside world at the outset of economic reform.

Similarly, two important agreements aiming at promotion of bilateral investment were signed in the mid-1980s. Placed in the framework of China's overall foreign policymaking, the 1985 *Agreement on Promotion and Protection of Investment* between China and Singapore in particular provides an interesting case to demonstrate China's strategy of yielding part of commanding power over business disputes to the weaker partner and to multilateral institutions in exchange for further cooperation with Singapore. In addition to the normal clauses such as the mutual commitments in protection of each other's enterprises and their assets from expropriation or nationalization and guaranty of bilateral free repatriation of capitals and returns of investments on a non-discriminatory

¹⁴⁰ 'Agreement on Bilateral Trade between China and Singapore' at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100666274>. Last accessed in September 2007.

¹⁴¹ 'The Singaporean Deputy Premier Goh Ken Swee Talked about His Chinese Trip', *People's Daily*, 18 April 1979, p. 5.

¹⁴² 'Agreement on Setting up Commercial Missions' at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100665717>. Last accessed in September 2007.

¹⁴³ See Note 142.

basis, the Agreement specifies that if the investment disputes fail to be settled through diplomatic negotiations within six months, either party shall go for the international arbitral tribunal. As far as possible, the arbitration shall be held in Singapore.¹⁴⁴ China also agreed with the proviso proposed by Singapore that once China signed the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*,¹⁴⁵ the two countries would promptly start negotiation about enlarging scope of cases which should be settled in the International Center for Settlement of Investment Disputes (ICSID).¹⁴⁶ Surely these arrangements are telling examples of Singapore's engagement strategy of 'making China subscribe to the rules and norms of existing international system' (Khong, 1999: 110); while Beijing's assent to the deals deserves some more attention.¹⁴⁷ Although in the agreements China maintained the traditionally preferable method of dispute settlement through bilateral negotiation at home (Kreisberg, 1995: 454-456), it agreed to abide by the verdict made by multilateral institutions as the final result. In other words, China was willing to enter into the self-binding bargains with Singapore by locking itself in the international economic order to some extent. Taking into account of the fact that Singaporean investment took only 0.2% of China's total inward FDI in 1985,¹⁴⁸ this behavioral adjustment to the preference of Singapore might be more important in serving other anticipated payoff. The perceived benefits include Singapore's continual participation in different fields of China's economic modernization

¹⁴⁴ Original text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100663707>. Last accessed in September 2007.

¹⁴⁵ It is a multilateral treaty formulated by the World Bank. It was opened for signature on March 18, 1965 and entered into force on October 14, 1966. It seeks to 'remove major impediments to the free international flows of private investment posed by non-commercial risks and the absence of specialized international methods for investment dispute settlement'. Singapore signed in February 1968 while China did on 9 February 1990. Information is from <http://icsid.worldbank.org/ICSID/FrontServlet>. Last accessed in July 2008.

¹⁴⁶ 'Exchange of Notes from Lee Hsien Loong (Minister of Trade and Industry of Singapore) to Wei Yuming (Representative of the PRC government)' at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100663709>. Last accessed in September 2007.

¹⁴⁷ In fact, the Director of Department of Treaty and Law of China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) pointed that the conditions of national treatment, issues of expropriation or nationalization and international arbitration of investment disputes had been major obstacles for China to conclude investment protection agreements with many foreign countries until the early 1990s when China started to keenly participate in multilateral trade institutions such as the Asia-Pacific Economic Cooperation (APEC) and General Agreement on Tariffs and Trade (GATT). See 'The New Progress of China's Foreign Economic Laws in 1993', *Almanac of China's Foreign Economic Relations and Trade*, 1994: 71.

¹⁴⁸ *Almanac of China's Foreign Economic Relations and Trade*, 1986: 1213.

which Singapore enjoys competitive edge;¹⁴⁹ for example, the tax sparing mechanism listed in the *China-Singapore Double Taxation Agreement (DTA)* in 1986 applied to not only business persons and enterprises but the professional services, teachers and researchers at invitation.¹⁵⁰ In addition, it could buttress Beijing's attempt of convincing weaker neighbors that the normative pledge of '... [in the international community] the big and the small are equal; we oppose misbehaviors that the stronger bullies the weaker and the bigger humiliates the small' and the respect of mutual interests were taken seriously,¹⁵¹ which are the essence of China's periphery policy.

The other significant aspect of using diplomacy to serve the economic modernization is 'to learn from the Singaporean experiences',¹⁵² which was reflected on the very frequent mutual visits of high-level officials. Singaporean leaders are granted access to the leadership in Beijing, which is available to few foreign counterparts (Khong, 1999: 110); in addition to Lee Kuan Yew himself, other important policymakers in Singapore have also played advisory roles at the early stage of China's economic reform. For example, Dr Goh Ken Swee, the former Deputy Premier of Singapore, was invited to be the advisor to China's special economic zones (SEZs) for a few years in 1985.¹⁵³ Suggestions from Singapore on economic development, such as to absorb advanced technology, to improve the managerial skills and human resources and to increase the familiarity of international economy, were incorporated into concrete projects of bilateral cooperation. Beijing attributed this collaboration to the shared language, culture and values, which were viewed as the special vantage for mutual understanding.¹⁵⁴

¹⁴⁹ See, for example, 'Premier Zhao Ziyang Holds the Meeting with Lee Kuan Yew on Development of Bilateral Friendship and Cooperation', *People's Daily*, 20 September 1985, p. 1.

¹⁵⁰ Original text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100663321>. Last accessed in September 2007. The revised China-Singapore DTA was signed on 11 July 2007 and started to take effect since 1 January 2008.

¹⁵¹ See, for example, 'Deputy Premier Deng Asseverates that China Will Never Seek Hegemony', *People's Daily*, 13 November 1978, p. 1.

¹⁵² See, for example, 'Foreign Minister Wu Xueqian Visits Singapore to Learn the Experiences in Economic Construction', *People's Daily*, 28 January 1985, p. 6.

¹⁵³ 'Dr Goh Ken Swee Accepted the Invitation as the Advisor on China's Economic Development in Coastal Areas', *People's Daily*, 11 July 1985, p. 2.

¹⁵⁴ See, for example, 'Zhao Ziyang Advocates to Enlarge the Sino-Singaporean Economic and Technological Cooperation', *People's Daily*, 1 June 1986, p. 1.

3.2 Realizing the 'second-step' FEP strategies for economic development: the 1990s

As shown in Chapter 2, China's overall FEP in the 1990s was devised to cope with the international uncertainties during the period of 1989-92.¹⁵⁵ In response, Beijing put forward the 'second-step' strategies to sustain the foreign trade-propelled domestic economic growth, including 'score with quality' (*yizhiqusheng*) and diversification of markets (*shichang duoyuanhua*). The 'score with quality' strategy comprised measures of structural upgrade of Chinese manufacture exports; furthermore, policy initiatives aiming at speeding up technological improvement and efficiency enhancement were the parallel components. As a whole, the employment of the two FEP strategies was expected to facilitate the domestic economic restructure in the name of 'grand trade' (*da jingmao*), i.e. the integration of trade and industry, agriculture, technology and finance as a cohesive system.¹⁵⁶ China's bilateral FEP towards Singapore in the 1990s had reflected these concerns.

3.2.1 Scientific and Technological (S&T) Cooperation

Since the normalization of bilateral relations Beijing had keenly pursued the collaboration with Singapore to realize its second-step FEP strategies, while the efforts of searching for joint development was the accentuated feature. In 1992, the State Councilor Song Jian (who was also in charge of the Ministry of State Science and Technology) led an official representative group to visit Singapore and signed the *Sino-Singaporean Agreement on Scientific and Technological (S&T) Cooperation*. It included exchange of personnel and intelligence, technological transfer, recruitment of S&T experts from the third countries, joint research projects, application of S&T findings to the production process, and marketing.¹⁵⁷ The cooperation coincided with Singapore's 1991-95 National

¹⁵⁵ 'Premier Li Peng Made Report on His Visits to Three ASEAN Countries in the 15th Meeting of the Standing Committee of National People's Congress', *People's Daily*, 29 August 1990, p. 1.

¹⁵⁶ See, for example, the Deputy Minister of MOFTEC Shi Guangsheng, 'Promotion of Foreign Trade and Improvement of Open up [*Dali fazhan duiwai jingmao shiye, nuli tigao duiwai keifang shuiping*]', 20 November 1997, documented in *Almanac of China's Foreign Economic Relations and Trade*, 1998/99, pp. 20-26.

¹⁵⁷ Original text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100664545>. Last accessed in September 2007.

Technology Plan aiming at economic restructure (Chia, 2007: 76) thus a Joint Committee on Science and Technological Cooperation was set up in the next year to further the competitiveness of each side.

Important cases of such S&T cooperation have concentrated in aviation and aerospace, telecommunications and automation which are among key industries of China's high-tech promotion programs (Cao, 2004: Qin, 1992). In aviation, for example, since 1990 Singapore has introduced France to participate in the China-Singapore joint project on helicopter manufacturing and an overall assembly line with an annual production capacity of 20 EC120 helicopters was built in Harbin, the capital city of Heilongjiang province in 2003.¹⁵⁸ In telecommunications, China and Singapore Technologies – a leading Singaporean government-linked company (GLC) – cooperatively initiated the Asia Pacific Mobile Telecommunications Satellite (APMT) project since December 1995, which provides mobile telecommunications services through national service providers in each country in the Asia Pacific region.¹⁵⁹

3.2.2 Suzhou Industrial Park (SIP)

For the parallel FEP strategic goal of enhancing the economic efficiency, Beijing enthusiastically accepted Lee Kuan Yew's proposal of setting up industrial townships in order to import the Singaporean style of economic management to China and to attract more FDI.¹⁶⁰ It was part of Singapore's 'Regionalization 2000' strategy; formally introduced in 1995, it aimed to add further momentum to develop Singapore's economic engagement in the regional locale beginning in the late 1980s with the project of Indonesia-Malaysia-Singapore 'Growth Triangle' (IMSGT) (Dent, 2002: 68). For

¹⁵⁸ *People's Daily*, 21 November 2003 at

http://english.peopledaily.com.cn/200311/20/eng20031120_128675.shtml. Last accessed in August 2008.

¹⁵⁹ Although the APMT project aims to provide telecommunication coverage from India to Japan and from China to Indonesia, it might have strategic and military implications. Since China initially held two third of the share of the consortium, major participants of this US\$640 million project are key state-owned enterprises (SOEs) of satellite launch and tracking control as well as aerospace. *People's Daily*, 14 April 1997, p2; also see information available at <http://www.fas.org/spp/guide/china/comm/apmt.htm>. Last accessed in August 2008.

¹⁶⁰ 'Lee Kuan Yew Talked about the Suzhou Industrial Park', *People's Daily*, 25 February 1994, p. 7.

Beijing's policy emphasis on opening up the lower Yangzi Delta and developing the Shanghai Pudong New District in the 1990s,¹⁶¹ the Singaporean-initiated industrial townships were decided to locate in Jiangsu province. Different from other coastal provinces, Jiangsu demonstrated a strong balance for both domestic and export-oriented production activities (Womack and Zhao, 1994). Its combination of agricultural and industrial output value consistently had been the highest in the 1980s (Jiang, 1994); in addition, Beijing had maintained special fiscal ties to Jiangsu and the bordering Shanghai municipality to serve as large and reliable sources for national revenue (Jacob and Hong, 1994; Shirk, 1993). Therefore, the choice of locating the Singaporean-styled industrial townships in Jiangsu was expected to contribute to China's strategic FEP goal of establishing the 'grand trade' system, while to have the Singaporean-developed and -managed industrial townships was viewed as the additional incentive to more potential foreign investors, especially those from Hong Kong, Macao, Taiwan and Southeast Asia since ethnic affinity had been an important component in Beijing's FDI strategy (Cheng, 1999; Pereira, 2004). Two projects were launched while the 'flagship' Suzhou Industrial Park (SIP), identified as the collaborative joint venture (JV) of the two central governments (government-to-government, G-2-G), provides a particularly interesting case to highlight China's attempt of achieving joint development with Singapore rather than competing against each other.¹⁶²

With the strong political support from Beijing, the SIP was formally launched by the signing of the *Agreement on Joint Development of the SIP* in 1994; it clearly stated that the SIP project aimed at the establishment of a high-tech oriented and modern-industrial centered industrial estate with the support of local tertiary industry.¹⁶³ The Singaporean consortium held a 65% stake against 35% stake held by the Chinese counterpart and the

¹⁶¹ Deputy Premier Tian Jiyun, 'China's Open up and Its Policy [*Zhongguo de geige kaifang xinshi han zhengce*]', 27 May 1992, documented in *Almanac of China's Foreign Economic Relations and Trade*, 1993: 21-24.

¹⁶² The other project is the smaller Wuxi Industrial Park (WSIP) located north-westward from Suzhou. Different from the SIP, the WSIP is not a top-level G-2-G project but a 'regular' Singaporean-developed industrial estate. It is a commercial JV between Sembawang Corporation (a GLC) and the Wuxi New Zone Development Company (formed by the Wuxi municipal government), while the role of the Singapore government in the WSIP was gradually reduced over time (Yeung, 2000).

¹⁶³ Original text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100664809>. Last accessed in September 2007.

SIP was described by the two countries as ‘...a new model for economic and technological cooperation’.¹⁶⁴ The political backing was shown by Beijing’s appointment of key leaders to sit on several of the project’s boards and committees and numerous public endorsements. For example, President Jiang Zemin was reported to have said that the project was ‘...priority of all priorities, and must not be allowed to fail’.¹⁶⁵ Also, Zhu Rongji, in his capacity as the acting Premier in 1995, was quoted as saying that what was learnt from the SIP, ‘...will make the five SEZs and the Pudong New District better’.¹⁶⁶ In addition, although the SIP had to comply with the laws and regulations under China’s SEZ program, Singaporeans were allowed to enforce these laws and regulations in a different manner. It was part of the ‘software transfer’ program, for which the Singaporean government would train the local Chinese administrative committee, the Suzhou Industrial Park Administrative Committee (SIPAC) for industrial development and administration. It helped the SIP to earn the reputation as ‘Mini-Singapore’ or ‘Singapore II’;¹⁶⁷ and the SIP became one of the fastest growing zones in China at the average annual growth rate of 20% for both the fixed committed investments and numbers of companies from abroad locating in the Park until 1997 (Pereira, 2004).¹⁶⁸

Notwithstanding the efforts of acquiring joint development on the basis of mutual interest from Beijing, the SIP project was viewed as a commercial disaster for Singapore. The SIP was the first transfer of Singaporean economic management ‘software’ beyond its sub-regional locale and thus carried significant political as well as financial risks, with the reputation and credibility of the ‘Singapore way’ at stake (Dent, 2002: 106). However, from the very beginning, the project had encountered with huge challenge from the dynamics of China’s internal ‘fiscal politics’ caused by the shifting central-local relationship of fiscal decentralization and the resultantly increasing local autonomy (cf., Guthrie, 1997; Huang, 1996; Walder, 1995; Zheng, 1999). On the one hand, the central government in Beijing mainly targeted at software transfer from Singapore through the

¹⁶⁴ *International Herald Tribune*, 21 May 1994.

¹⁶⁵ This quotation is from the SIPAC website (<http://www.sipac.gov.cn/english/>) and cited in Pereira, 2004: 186.

¹⁶⁶ *Singapore Business Time*, 5 October 1995.

¹⁶⁷ *International Herald Tribune*, 21 May 1994.

¹⁶⁸ Data could be collected from the China Singapore Suzhou Industrial Park Development Company (CSSD). Here I use Pereira’s compiled figures.

SIP project and expected to replicate the establishment of an integrated industrial estate composed of factories, commercial complexes, housing and social amenities in other places in China; on the other hand, as the major local partner, the Suzhou municipal government was more interested in the hardware and took immediate profit-making as the top priority of the whole SIP project. Therefore the Suzhou municipal government is said to apply the SIP operating system and competitive price of land use to the nearby pre-existing Suzhou New District (SND), which was blamed as the vicious competitor against the SIP from the Singaporean perspective (Pereira, 2004). In addition, the initial momentum of the project was hindered by the Asian Financial Crisis (AFC, 1997-99). These setbacks and the consequent hemorrhaging of investment funds led to Singapore's decision to cut the losses. In June 1999, Lee Kuan Yew announced that Singapore would complete just one sector of the project with the rest left for China to develop.¹⁶⁹ The Singaporean Premier Goh Chok Tong visited Beijing in April 2000 in part to smooth over the tensions arising from the SIP project, and on 1 January 2001 the Chinese authorities assumed majority ownership and management control of the SIP (Dent, 2002: 106-107).

Although the discussion above suggests that Chinas' complex internal politics may be a cause to Singapore's 'disengagement' of the SIP project, it is worth noting that the project has also highlighted the limitations of Singapore's 'transnational state entrepreneurship' attempt through the 'learning alliance' approach (Inkpen and Wang, 2006; Pereira, 2007). As explained in Pereira (2007), Singapore's proposal of establishing the SIP as a joint venture with China is a clear example of the state attempt on profit-seeking business activities overseas. Therefore, the generation of revenue from the SIP that could supplement Singapore's domestic economy was the 'single most important objective' of the city republic (ibid: 296), while the failure of achieving the goal directly led to Singapore's withdrawal from the project. Nevertheless, the questionable state efficiency (relative to that of business entities) in dealing with commercial activities, especially in international environment, is argued to attribute to Singapore's failed strategy. This point could be reinforced by the argument of Inkpen and Wang (2006). Since Singapore has expected to enhance its political and economic

¹⁶⁹ *Strait Times*, 10 June 1999; cited in Dent, 2002: 130.

engagement with China through the ‘knowledge transfer’ program embodied in the SIP project, it resulted in China’s strategic imitation and competitive behavior, as seen in the SND. In this situation, the frustration on the Singapore side and the decision to restructure the alliance ownership were viewed to be rather consequential. Put together, the SIP story illustrates the importance of mutual benefits – both profits and other intangible gains – to sustainability of inter-governmental collaboration as a new form of development strategy.

3.3 Bilateral cooperation as the complement to China’s multilateral approach: the 2000s

As shown in Chapter 2, China has confronted difficulties in the multilateral cooperative institutions, including WTO and APEC; thus, in the 2000s, China is seen to pay more attention to bilateral cooperation with selective partners, which is the major drive of China’s acceptance and swift conclusion of Singapore’s proposal for the bilateral FTA in 2008. Domestically, Beijing also put forward new FEP strategies to prepare China for the severe competition from multilateral and bilateral trade cooperation; from China’s perspective, it is the challenge of economic globalization (*jingji quanqiu hua*). To sharpen China’s competitiveness in the era of economic globalization, alongside with the second-step strategies of ‘score with quality’, market diversification and the establishment of grand trade system since the 1990s, the FEP strategies in the 2000s are ‘promoting trade with science and technology’ (*keji xingmao*) and ‘going out’ (*zouchuchi*). Both strategies were proposed firstly in the 1998-99 as ancillary measures to the FEP for dealing with the decreased trade volume and inwards FDI after the breaking out of AFC; while they have become the priorities of Chinese FEP since the WTO accession. The ‘promoting trade with science and technology’ strategy has embodied the emphasis on the causal link between advanced science and technology and national revitalization (*kejiao xingguo*) proposed in the 15th CCP Central Committee,¹⁷⁰ which aims to transform China from a merely ‘big’ trading country into a ‘strong’ one because ‘nowadays, the inter-state

¹⁷⁰ The ‘*kejiao xingguo*’ strategy was listed in the Scheme of China’s Tenth Five-year Plan. See Premier Zhu Rongji, ‘About National Economy and Social Development: the Report of the Tenth Five-year Plan Scheme [*Guanyu guomin jingji he shehui fazhan dishige wunian jihua gangyao de baogao*], report to the Ninth People’s Congress, 5 March 2001, documented in *Almanac of China’s Foreign Economic Relations and Trade*, 2001: 56-63.

economic competition is the competition of scientific and technological capabilities'. Comparing with the fact that high-tech products took 70% of Singapore's total exports, China's high-tech products took only 7% of the total national exports in 1998; it worried Beijing that China could lose out in the international trade.¹⁷¹ As the complementary, the 'going out' strategy aims to encourage competitive Chinese enterprises to invest abroad in the fields such as processing trade and joint development of natural resources to support the establishment of grand trade system.¹⁷² In other words, the FEP strategies of 'promoting trade with science and technology' and 'going out' are the renewed versions of China's second-step FEP strategies in the 1990s; all of them were implemented in order to sharpen China's competitiveness and to increase the exports. China's FEP towards Singapore in the 2000s therefore have been expected to help realize the two strategies; the comparative advantages Singapore has enjoyed, including the high techno-industrial capacities, extensive international business networks reinforced by the external expansion of GLCs and advanced as well as stable financial services (Chong, 2007; Dent, 2002: 82-83), has strengthened the attractiveness of Singapore as a partner to Beijing on the foundation of already close cooperation.

3.3.1 The realization of national FEP strategies

To serve the 'promoting trade with science and technology' and 'going out' FEP strategies, Beijing's practices have been designed to adapt to Singapore's FEP of building economic community as a hedge against a recurrence of financial crisis (Chong, 2007: 960). In 1998, the China-Singapore Joint Committee on Scientific and Technological Cooperation decided to initiate a joint research program to implement an integrated system of facilitating economic-related projects on a sustainable basis, so that both public and private research institutions of the two countries can undertake techno-industrial research and development (R&D) together; in addition, enterprises are also incorporated

¹⁷¹ Vice Minister of MOFTEC Zhang Xiang, 'Enforcing the Strategy of 'Promoting Trade with Science and Technology and Facilitate the Growth of Chinese Foreign Trade [*Dali Shishi 'kejixingmao' zhanlue, tuedong woguo waijingmao shiye chixu fazhan*]', documented in *Almanac of China's Foreign Economic Relations and Trade*, 1999/2000: 58-62.

¹⁷² President Jiang Zemin, 'Seize Opportunity, Meet Challenge, and Participate in Economic Globalization', *People's Daily*, 19 December 2001.

into the system for commercializing those R&D results. As the leading organization of the program, the China Torch Center – the executive body of the national Torch Program (*Huoju jihua*) aiming at industrial upgrade since 1988 – has been working closely with Singapore’s Economic Development Board (EDB), which led to the setting up of its Singapore office for hi-tech innovation in 2003.¹⁷³ This arrangement was also expected to utilize Singapore’s extensive trading networks to promote the Chinese high-tech exports; from Beijing’s perspective, Singapore could well serve as a launch pad for Chinese hi-tech enterprises to enter the international market. As a result, the number of Chinese hi-tech enterprises registered in Singapore had increased from 55 in 2002 to 105 in 2005.¹⁷⁴ Although the high-tech enterprises took only less than 7% of the total number of Chinese companies in Singapore,¹⁷⁵ Beijing’s FEP practices towards Singapore has facilitated the ideal combination of ‘promoting trade with science and technology’ and ‘going out’ strategies at the national level.

Furthermore, the local governments are also encouraged to implement the ‘going-out’ strategy by facilitating competitive enterprises in their own jurisdiction.¹⁷⁶ It has converged with Singapore’s ‘Regionalization 2000’ strategy; for generating a bigger pool of local entrepreneurs and building up the ‘external wing’ of the Singapore economy,¹⁷⁷ Singapore has been keen in coordinating with local governments in China. The intersection of interests has reflected on the establishment of closer cooperative ties between Singapore and the ‘second-tier’ provinces – it denotes their current level of economic growth and industrial potential relative to those opened earlier – in China,

¹⁷³ It is listed in the Memorandum of Understanding (MOU) on High-tech Cooperation in May 2002. Information is available at <http://www.fmprc.gov.cn/eng/wjb/zzjg/yzs/gjlb/2777/t16191.htm>. Last accessed in August 2008.

¹⁷⁴ Information is available at http://www.sedb.com/edb/sg/en_uk/index/news_room/news/2005/doubling_of_chinese.html and http://www.csc.mti-mofcom.gov.sg/csweb/scc/info/Article.jsp?a_no=12748&col_no=157. Last accessed in August 2008.

¹⁷⁵ The number of approved Chinese investment has been stably increasing since the mid-1990s; in 2004 the total number of Chinese enterprises was about 1,500. Information is available at http://www.sedb.com/edb/sg/en_uk/index/news_room/news/2005/doubling_of_chinese.html. Last accessed in August 2008.

¹⁷⁶ Deputy Director of Department of Foreign Economic Cooperation of MOFCOM Wu Xilin, ‘New Progress of Implementing ‘Going-out’ Strategy in 2002 [2002nian woguo shishi ‘zouchuchi’ zhanlue qude xinjinzhan]’, documented in *Almanac of China’s Foreign Economic Relations and Trade*, 2003: 89-90.

¹⁷⁷ Lee Kwan Yew’s talk, quoted in *Growing with Enterprise: A National Report 1993* (Singapore: EDB).

especially Liaoning, Zhejiang, Shandong and Sichuan.¹⁷⁸ They have been building up networks with Singapore, which are co-chaired by leading officials from both sides. For example, the Singapore-Zhejiang Economic and Trade Council (SZETC) formally inaugurated in November 2003, which was followed with the sending of an economic mission from Singapore in April 2004. To facilitate companies in Zhejiang to use Singapore as the first step before leapfrogging into the international marketplace, a Zhejiang commodities centre was set up in Singapore under the auspices of the SZETC. The centre is expected to assist Zhejiang companies to 'go out' with the promotion of Zhejiang-produced products, which could help the establishment of local grand trade system; at the same time, the centre aims to facilitate promising Zhejiang enterprises to list on the Singapore Stock Exchange (SGX). Catering for this need, the China Airlines has recently launched a direct service connecting Hangzhou, the capital city of Zhejiang, with Singapore; it is the second international air route of Hangzhou after linking Seoul in late 2003 (Kumar *et al*, 2006: 22-24). In the case of Shandong, major task of the Singapore-Shandong Business Council (SSBC) has been facilitating both capital absorption and exports of the high-tech industries in Qingdao, Yantai and Jinan (the three most important industrial cities in Shandong); for this purpose, a MOU was signed as the framework for Shandong enterprises to list on the SGX in January 2005.¹⁷⁹

3.3.2 China-Singapore Free Trade Agreement (CSFTA)

The bilateral FTA was proposed by Singapore. Since to build economic community with vital trading partners through FTAs has been Singapore's FEP strategy, China, with its position as Singapore's fifth export destination and third import source in 2005,¹⁸⁰ was also pursued in 2004.¹⁸¹ The first round of talks on issues of mechanism, range and timetable was initiated in August 2006; negotiations went rather expeditious and the

¹⁷⁸ Information is available at <http://www.iesingapore.gov.sg/>. Last accessed in August 2008.

¹⁷⁹ Information is available at http://www.csc.mti-mofcom.gov.sg/csweb/scc/info/Article.jsp?a_no=19388&col_no=154. Last accessed in August 2008.

¹⁸⁰ Data is from IMF online database.

¹⁸¹ 'China and Singapore to Negotiate FTA and Double Tax Avoidance Deals', 20 May 2004, Tax-News.com (Hong Kong) at http://www.tax-news.com/archive/story/China_And_Singapore_To_Negotiate_FTA_and_Double_Tax_Avoidance_Deals_xxxx16074.html. Last accessed in July 2008.

bilateral FTA was concluded on 23rd October 2008.¹⁸² After New Zealand,¹⁸³ Singapore is the second country in the Pacific Rim to sign the FTA with China. From 1 January 2009, all Chinese exports to Singapore would enjoy zero tariffs while China committed to the same treatment to 97.1% of imports from Singapore by 2010. Bilateral commitments also cover services in medicine, education and accounting, which are more preferential than those within WTO.¹⁸⁴

Although the details of negotiations are not made public at this moment, a few observations could be drawn to explain the swift conclusion of CSFTA. Firstly, China and Singapore has enjoyed close economic relations already. Singapore has been China's most important trading partner in Southeast Asia; bilateral trade has been growing steadily from \$402 million in 1979 to \$33.2 billion in 2005, while the expanding imports from Singapore has become conspicuous as demonstrated in Figure 4.2. Singapore has also been the biggest investor from Southeast Asia (as well as the eighth largest among the world) in China; until 2005 the accumulated utilized direct investment from Singapore reached \$27.7 billion.¹⁸⁵ In terms of China's outwards investment, Singapore has been the attractive destination; in 2005 the amount of Chinese investment in Singapore was \$20.3 million, which took 18.7% of the total Chinese investment in ASEAN-10.¹⁸⁶ Secondly, the two economies are complementary. Since 2000, commodities of bilateral trade have concentrated on electric machinery (SITC 77), office machines and automatic data processing equipment (SITC 75), telecommunications, sound recording and reproducing equipment (SITC 76) as well as petroleum and related products (SITC 33),¹⁸⁷ which reflects the result of China's FEP strategies since the 1990s and the increasing intra-industrial trade with Singapore; this trend is expected to continue

¹⁸² Information is available at <http://fta.mofcom.gov.cn/singapore/xiedinggaishu.shtml>. Last accessed in January 2009.

¹⁸³ The China-New Zealand FTA was concluded on 7th April 2008. Information is available at <http://fta.mofcom.gov.cn/newzealand/xiedinggaishu.shtml>. Last accessed in January 2009.

¹⁸⁴ See Note 182.

¹⁸⁵ 'FDI in China in 2005 (by region) [2005nian zhongguo xishou waishang zhijie touzi fen diqu qingkwang]', in *China Commerce Yearbook*, 2006: 424-425.

¹⁸⁶ *China Statistical Yearbook 2006*: page; 'China's Economic and Trade Relations with ASEAN in 2005 [2005nian zhongguo yu dongmeng guojia de jingji maoyi guanxi]', in *China Commerce Yearbook*, 2006: 718-722.

¹⁸⁷ Data is from UN Comtrade online database.

since Singapore has offered techno-industrial assistance to China. However, it is noteworthy that in spite of stable growth, Singapore took only tiny share (2.2% of exports, 2.5% of imports in 2005) of China's total trade volume (IMF, 2006); it leads to the third possible consideration for Beijing to conclude the CSFTA because it would not be threatening to China due to Singapore's small size. Fourth, as the unique 'developmental state', Singapore has favored foreign investor and local capital but has preferred cautious macroeconomic control, which was described as a 'greenhoused' version of capitalism (Chong, 2007: 954). Stable financial system closely monitored by the Monetary Authority of Singapore (MAS) enabled Singapore to avoid hurt by the AFC (Dent, 2002: 81-82), which could reinforce its appeal to Beijing since China was relatively unscathed from the crisis for similar reasons.¹⁸⁸ This consideration also reflects on Beijing's official statement that '... the CSFTA will help maintain economic stability and growth in current financial turmoil'.¹⁸⁹ Finally, as a new comer to FTAs, Beijing might expect to share Singapore's substantial experiences in setting up FTAs and the benefits of its FTA 'hub' position. The recognition of China's market economy status in CSFTA could also set the precedent for later negotiations with other countries (Green, 2004).

Although economic motive appears primary for Beijing's decision, the conclusion of CSFTA might also bear political implications. The challenge of economic globalization has driven China to make strategic economic moves in order to enhance the three dimensions of its 'comprehensive national power', namely military might, wealth, and influence (Lampton, 2008).¹⁹⁰ In the case of CSFTA, it might serve Beijing's attempt of counterweighing the US factor in the region. For Beijing, Singapore's 'fallback position' strategy when engaging with China could be again well highlighted as publicly pointed by Singapore's chief negotiator for US-Singapore FTA (USSFTA) Tommy Koh, that

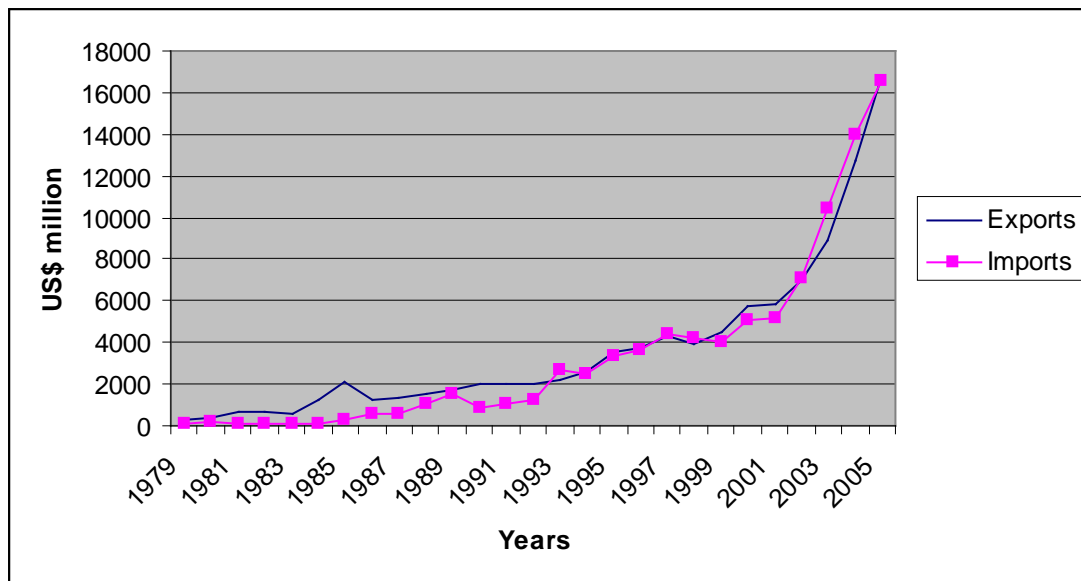
¹⁸⁸ China's relative immunity was due to the non-convertibility of its currency, substantial foreign exchange reserves to defend against speculative attacks on the Yuan, and a large inflow of FDI, only a small percentage of which is portfolio investment, which is more vulnerable than capital investment to quick withdrawal in a panic (Kim, 2006: 286).

¹⁸⁹ See Note 182.

¹⁹⁰ Although the definition of 'comprehensive national power' remains debatable, the representative Chinese scholarly work authored by Hu Angang and Men Honghua (updated 2007), has pointed eight indicators for measuring quantitative national power as well as less emphasis on the more intangible aspect of soft power.

‘...Singapore’s interest in the US, however, transcends business and economics. Singapore wishes to entrench the presence of the US in the region because it underpins the security of the whole Asia-Pacific. Singapore regards the USSFTA as a symbol of continued US commitment to the region; it is about enhancing the prospects of peace and stability in the region’ (cited in Hoadley, 2007: 305). The CSFTA therefore could endorse the Chinese rhetoric for supporting regional peace and prosperity as well as emphasize that an economically rising China will offer neighbors opportunities of joint growth rather than a threat.

Figure 4.1 China’s trade with Singapore, 1979-2005



Sources: IMF.

4. Conclusion

The examination of China’s bilateral FEP towards Singapore appears consistent with my anticipation listed in section 1 that to seek for political domination may not be Beijing’s primary concern in the bilateral economic relations. Followed the manifestation that Singapore is a hard case for China’s power ambition, I go on to argue that Beijing seems to pay more attention to capitalize Singapore’s unique competitive edges as a means to facilitate the domestic economic development since the inception of opening. Therefore,

the bilateral FEP has strong implication of reproducing the successful developmental experience (the ‘Singapore Way’) at home while the application has appeared to be adapted to the Chinese conditions, as exemplified by the SIP project. In addition, Beijing has particularly encouraged the hi-tech enterprises and the so-called ‘second-tier’ provinces to coordinate with Singapore’s ‘Regionalization 2000’ FEP strategy in order to take advantage of its extensive trading network. More recently, China also expected to adopt the Singaporean ‘model’ of managing the sovereign wealth fund (SWF) in order to diversify its investment of foreign reserves and to raise investment income (e.g. Shih, 2009; Zhang and He, 2009).¹⁹¹ Taken together, I find that these policy foci are expected to serve China’s foreign economic interests in terms of improving the composition and diversifying the direction of China’s exports, as well as stimulating the development of potentially competitive provinces; and these considerations are revealed to contribute to the swift conclusion of CSFTA in 2008. The findings in this chapter therefore back up my argument that instead of taking initiatives in the economic realm to serve the quest for political domination over Singapore, China’s bilateral FEP has largely reflected Beijing’s acceptance of Singapore’s engagement; and it has been directed to facilitate the overall economic development.

¹⁹¹ The sovereign wealth funds (SWFs) are the state-owned investment assets set up for investment of excess foreign exchange reserves or natural resource export surplus, which have risen as major investors in the global economy. It is pointed by Chinese experts that China is encouraged by the successful examples of the Government Investment Corporation (GIC) and Temasek Holding in Singapore to establish the China Investment Corporation (CIC) in September 2007 as the management authority of China’s SWF. Although the top managers of CIC are documented to repeatedly laud the Singaporean model and the associated motto of ‘making money’ as something that CIC can emulate, differences in corporate governance, institutional design, and the underlying domestic political dynamics have posted serious challenges to the profit-making efficiency of CIC. For the more detailed examination, see Eaton and Zhang (2010), Shih (2009) and Zhang and He (2009).

Chapter 5: China's FEP towards Malaysia, 1979-2005

1. Introduction

Comparing with Vietnam and Singapore, Malaysia could be viewed as the 'intermediate' case for China's ambition of political domination. Although the relative geographical distance and the good political relationship, which has been largely resulted from Kuala Lumpur's attempts to appease Beijing, imply that China might have low motive to achieve power ascendancy over Malaysia, the disparities of economic size and developmental levels suggest the cost for China to realize political goals in bilateral economic relations might be low. The fact that among ASEAN members, China has run its largest trade deficit with Malaysia further begs for exploration that whether or not it is the direct result of China's offer of economic benefits to strengthen Malaysia's trade dependence on China, therefore China could reap political gains. If it was the case, one would expect China to take initiatives to promote bilateral economic relations and to offer unusual deals. In other words, China's bilateral FEP towards Malaysia should be different from those towards Vietnam and Singapore as discussed in the previous chapters.

The examination of China's FEP towards Malaysia in this chapter, however, does not meet the above expectations; somehow surprisingly, the FEP and the related approach have appeared rather similar to those towards Vietnam and Singapore. This chapter finds that the bilateral trade deficit is not resulted from China's manipulation, while the increase of imports from Malaysia has been used to ensure the supply of raw materials as well as parts and components to support China's domestic production. Interestingly, this chapter also finds that China did not seem to seek political gains from such trade asymmetry, which is evidenced by Beijing's cautious support for Kuala Lumpur's international initiatives. Therefore, I argue that China's FEP towards Malaysia is the telling reflection of Beijing's priority of advancing broad foreign economic interests, particularly when the foreign economic interests have increasingly become the impetus to domestic economic growth.

To illustrate my argument, the next section will firstly discuss the development of bilateral political relations to explain Malaysia's 'intermediate' place for China's power ambition relative to Vietnam and Singapore. It will demonstrate that Kuala Lumpur's overtures made to Beijing has pushed the bilateral political relations forward, while Beijing's amicable response to Kuala Lumpur's requests are also translated to bilateral economic cooperation that is reflected on China's bilateral FEP towards Malaysia, as discussed in section 3. Yet, the examination of features of bilateral economic activities in section 4 will show that although Malaysia has enjoyed surplus with China, the bilateral trade has significantly contributed China's domestic production and increasingly the export-processing sector. This chapter will conclude that instead of expanding political influence through the manipulation of economic relations, China's primary concern in the bilateral FEP towards Malaysia is to serve the pursuit of national wealth at the global level.

2. Avenue to political coalition

Malaysia is the first ASEAN member to establish formal diplomacy with China, yet the development of bilateral relations is motivated by each other's political calculations with regard to other issues. For the long-term ruling party UNMO in Kuala Lumpur, the friendship with Beijing, notwithstanding suspicion harbored, provided an external assurance to domestic stability and could contribute in attracting votes from ethnic Chinese in general elections. For Beijing, Kuala Lumpur's resistance against influence from both great powers in the region was viewed conducive to the Chinese national security during the Cold War. Yet since the 1990s, the converged views in international affairs have characterized the bilateral relations; following the pursuit of foreign policies independent from the Western interference, the two countries have worked as the *de facto* alliance on various issues, particularly the advocacy for South-South cooperation and the confirmation of excluding external players in South China Sea. The political collaboration with Kuala Lumpur then serves to strengthen China's appeal of promoting multi-polarity as well as a fair and reasonable new international order, with implicit

challenge to the US predominance. In this sense, Beijing's management of bilateral relations with Malaysia is a very successful example of its good-neighboring policy; aiming at ensuring a stable and peaceful surrounding environment, the alliance with Malaysia in multilateral fora, rather than political dominance, proves to be a more effective approach to guarantee the Chinese interests.

2.1 Strategic motivation behind the diplomatic normalization

Among the five original ASEAN member states, Malaysia is the first to establish diplomatic relations with China in 1974. Internal vulnerabilities, mainly the fragile balance between Malays and Chinese,¹⁹² as well as the Beijing-backed Communist insurgency, were key factors for the Abdul Razak government to pursue formal diplomacy with China as the extra assistance to deal with such domestic concerns. Malaysia then began to make overtures to Beijing, exemplified by the proposal for neutralization of Southeast Asia, the opposition against the US resolution of dual representation of China as well as the support for the Albanian resolution to oust Taiwan from the UN (Wu, 1975: 49-55). These efforts were rewarded with the establishment of full diplomatic relations between Beijing and Kuala Lumpur in May 1974. Although Beijing made no mention of Chinese support for the Malayan Communist Party (CPM) and the clandestine radio 'Voice of Malayan Revolution (VMR)' in the joint communiqué of diplomatic normalization, it stated that the bilateral relations are established '... on the basis of the principles of mutual respect for sovereignty and territorial integrity, mutual non-aggression, non-interference in each other's internal affairs, equality and mutual benefit, and peaceful co-existence';¹⁹³ the passage was interpreted by Malaysia as the promise that the Chinese Communist Party (CCP) would not in anyway support an illegal organization in Malaysia aiming at overthrowing the established government. Equally significantly, the joint communiqué declared that

¹⁹² Malaysian citizens of Chinese origin (*huayi*) took 35% of the nation's population. Yet the intentions of developing racial harmony as well as unified national consciousness and identity were hindered by the expulsion of Singapore from the Federation of Malaysia in 1965, the May 1969 riot, and the preference given to Malays in employment and education (Milne and Mauzy, 1999: 12-25).

¹⁹³ *Joint Communiqué of the Government of the People's Republic of China and the Government of Malaysia*, 31 May 1974. It is at <http://my.china-embassy.org/eng/zt/BilateralDocuments/t317712.htm>. Last accessed in February 2009.

neither government recognized dual nationality and that ‘...the Chinese Government considers anyone of Chinese origin who has taken up of his own will or acquired Malaysian nationality as automatically forfeiting Chinese nationality’.¹⁹⁴ As one condition in setting up the formal diplomacy, this rather hand-off attitude towards Kuala Lumpur’s Malaynization policy could have been motivated by Beijing’s strategy of establishing a foothold on the land ridge dividing the Indian and Pacific Oceans as the countermeasure against the rise of Soviet power in the major shipping route; the consideration was also reflected in the joint communiqué that ‘...the two Governments consider all foreign aggression, interference, control and subversion to be impermissible’.¹⁹⁵ For Beijing, the diplomatic normalization with Kuala Lumpur obviously could benefit the national security since Malaysia pledged that it would not align with either power bloc. Such consensus was reconfirmed before Deng Xiaoping’s tour to Thailand, Malaysia and Singapore in November 1978; Chinese Foreign Minister Huang Hua highly praised Kuala Lumpur’s foreign policy of neutralization and non-alignment as well as the efforts to regional solidarity and cooperation in Southeast Asia when his counterparts visited Beijing.¹⁹⁶

2.2. Eliminating misgivings from Malaysia

Since the early 1980s, Beijing’s views on major international issues have been shared with Kuala Lumpur in spite of the lingering suspicion about China’s real intentions towards Southeast Asia. Although China has confirmed the national primacy of economic development after the third plenum of the 11th CCP Central Committee (Goodman, 1994: 88-89), the parallel foreign policy emphasis was to counterweigh the perceived threat from the Soviet Union. Therefore Kuala Lumpur’s condemnation of the Soviet invasion into Afghanistan and advocacy a neutral Cambodia, in terms of recognizing the Coalition Government of Democratic Kampuchea (CGDK) against the Vietnamese-supported regime in Phnom Penh, were valued by Beijing because Malaysia openly stood on the

¹⁹⁴ See note 193.

¹⁹⁵ See note 193.

¹⁹⁶ ‘Huang Hua waizhang huanyen Litaoding waizhang [Foreign Minister Huang Hua Meets with Malaysian Counterpart]’, *Renmin Ribao*, 21 September 1978, p. 4.

same front with China.¹⁹⁷ As the reciprocally friendly gesture, Beijing downplayed the ethnical appeal to overseas Chinese;¹⁹⁸ for example, when visited Kuala Lumpur in 1978, Deng Xiaoping himself not only reiterated the Chinese rejection of dual nationality but also demanded the Malaysian citizens of Chinese origin to abide by the local rules as well as to respect the local customs.¹⁹⁹ This shift was embodied in China's first nationality law promulgated in 1980.²⁰⁰ Furthermore, notwithstanding the enthusiasm of soliciting investment and expertise from overseas/ethnic Chinese to contribute to China's economic modernization, Beijing promised to increase the *bumiputera* (i.e. various indigenous ethnic groups in Malaysia) involvement in bilateral trade as the Chinese support for the Mahathir government (1981-2003), which strived to maintain political and social stability in multiethnic Malaysia through domestic economic policies aiming at wealth redistribution (Leong, 2006: 191-194; Liow, 2000: 676).²⁰¹ With the end of the Cold War, the alleged Chinese influence on the surrender of the CPM to the Malaysian government in 1989, the cessation of VMR broadcast from China, the promulgation of the second nationality law that appears to terminate Chinese claims to authority over ethnic Chinese who had taken citizenship in foreign countries and advised Chinese citizens residing abroad to adhere to local laws, as well as Beijing's rescission of backing for the Khmer Rouge in the early 1990s, had contributed to convince Kuala Lumpur of Beijing's honest intent of 'peacefully coexisting' with established governments in Southeast Asia, including Malaysia (Acharya, 1999: 135; Liow, 2000: 673; Sutter, 2005: 192). These events offered positive turns for Beijing to intensify the *de facto* alliance with Malaysia in international affairs in the post-Cold War era.

¹⁹⁷ 'Renda changweihui huanyen malaixiya yihui daibiaotuan [Standing Committee of National People's Congress (NPC) Meets with Representative of Malaysian Parliament]', *Renmin Ribao*, 7 October 1980, p. 1.

¹⁹⁸ For example, the restored Commission for Overseas Chinese Affairs (*Qiaowu Weiyuanhui*) was renamed to the Office for Overseas Chinese (*Qiaoban*) after Deng Xiaoping assumed power in 1978, which signified the downgrading of the organization and the according policy emphasis (Leong, 1987: 1113).

¹⁹⁹ 'Deng fuzhongli xiwang huaqiao tong dangdi renmin youhao xiangchu [Vice Premier Deng Expected Overseas Chinese to Be Friendly with Local People]', *Renmin Ribao*, 12 November 1978, p. 1.

²⁰⁰ Article 9 stipulated that 'Any Chinese national who has settled abroad and who has been naturalized as a foreign national or has acquired foreign nationality of his own free will shall automatically lose Chinese nationality'. Original text is at <http://www.fmprc.gov.cn/ce/ceindo/eng/lsqw/t87388.htm>. Last accessed in February 2009.

²⁰¹ By the 2000s, the ethnic Chinese in Malaysia were less economic dominant vis-à-vis the *bumiputera* than their counterparts in other parts of Southeast Asia, particularly Indonesia (Goodman, 1997).

2.3 International political collaboration

2.3.1. Alliance in the context of South-South Cooperation

The enhanced political cooperation between Beijing and Kuala Lumpur has offered a very interesting case to demonstrate how China has deftly utilized the conflicts between its ally and the US-led West to advance the call for creating a self-perceived just international order and solidarity in the Third World. The Chinese pursuit of the ‘emergence of multi-polarity’ and ‘South-South cooperation’ could be viewed as embodied in Beijing’s keen collaboration with the Mahathir government and his successor. In his capacity of Malaysian Prime Minister, the foreign policy has been the sole prerogative of Mahathir Mohamad, therefore the Malaysian relations with the world are a reflection of his predispositions (Liow, 2000: 678). It led to the fact that the Mahathir government was a regular critic of Washington’s crusade on norms; equally important, the Malaysian opinions on a range of regional issues are not always identical to those of other ASEAN members. At the same time, Mahathir’s foreign policy has had a strong economic bent, which motivated him to seek for closer ties with Beijing even when other political elites still harbored suspicion about the potential China threat (Acharya, 1999: 131; Liow, 2000: 676). For example, one of the key issues of Mahathir’s first visit to Beijing in November 1985 was how to take advantage of China’s opening up as a way to facilitate the Malaysian economic growth, which provided Beijing a good opportunity to voice the Chinese stance. When met with Mahathir, Chinese Premier Zhao Ziyang emphasized that notwithstanding the ideological and societal differences, countries in the Third World – particularly China and Malaysia – shared the same fundamental interests in peace and development as well as independent foreign policies free from external interference, which is the base for Beijing and Kuala Lumpur to strengthen friendship and cooperation.²⁰² In response, when gave a talk in Tsing Hua University in Beijing, Mahathir stated the importance of bilateral cooperation between China and Malaysia in achieving regional stability, peace and development. He

²⁰² ‘Zhao Ziyang tong Mahathir huitan [Zhao Ziyang Met with Mahathir]’, *Renmin ribao*, 22 November 1985, p. 1.

emphasized the need of Chinese support for the Malaysian-initiated concept of the Zone of Peace, Freedom, and Neutrality (ZOPFAN) because it can secure the regional autonomy and security self-reliance (Acharya, 1999: 144). In international affairs, Mahathir blamed Vietnam's invasion into Cambodia and confrontation between the two superpowers as the roots of regional unrest.²⁰³ Not surprisingly, these views were strongly endorsed by Beijing. As the architect of the Chinese foreign policy framework since the opening up, Deng Xiaoping reasserted that the increased mutual understanding with Malaysia would enhance the South-South cooperation when he met with Mahathir; in addition to opening to the developed world, the more stressing issue for China is to open to the Third World, including Malaysia, for common prosperity. Being fully aware of Malaysia's concern with the rising Chinese power, Deng reiterated that China will always belong to the Third World and never seek for hegemony, which is the fundamental principle; the Chinese economic modernization and the resultant welfare spillover to Southeast Asia would function as a stabilizer of the regional peace.²⁰⁴

The convergence of views on international affairs of Beijing and Kuala Lumpur has become remarkable since the 1990s. For example, when dealing with the Western criticism after the Tiananmen crackdown, China quickly identified Malaysia as its ally to oppose the US-dominated standards of human rights and democracy.²⁰⁵ The subsequent economic sanctions further enhanced the necessity to take the 'common ground' with Kuala Lumpur; it also justified Beijing's appeal of setting up a fair and reasonable international order through South-South cooperation to protect the shared interests of the Third World. In order to ensure Malaysia as its *de facto* political ally, Beijing adopted the strategy of mitigating the anti-Chinese sentiment by reaffirming that 'China would not

²⁰³ 'Mahathir zhingli zai qinghua daxue yenjiaing [Prime Minister Mahathir Gave a Talk in Tsing Hua University], *Renmin ribao*, 23 November 1985, p. 4.

²⁰⁴ 'Zhongguo zhongshi tong dongmong guojia fazhan youhao quangxi [China Emphasizes to Develop Friendship with ASEAN Member States], *Renmin ribao*, 23 November 1985, p. 1.

²⁰⁵ For example, Malaysia supported Beijing's insistence on 'we do not allow other people to impose their ways on China; different countries should choose their own ways based on their specific concerns'. 'Yang Zhuxi huijian malaixiya keren [President Yang Shangkun Meets Guests from Malaysia]', *Renmin ribao*, 8 May 1991, p. 1.

manipulate the Malaysian citizens of Chinese origin for unilateral interests’;²⁰⁶ the pledge that China would not interfere in Malaysia’s internal affairs was signified in the establishment of the Chinese-Malaysian Friendship Association in 1993 for the dual functions of ‘facilitating the friendship between China and Malaysia as well as the ethnic solidarity in Malaysia’,²⁰⁷ which is a positive response to the lifting of restrictions on Malaysian citizens to visit China in 1992 (Lee and Lee, 2006: 168). After Mahathir’s outspoken talk to the Clinton Administration regarding the link between human rights and MFN treatment to China,²⁰⁸ formal relations were also established between the ruling parties of China and Malaysia, namely CCP and the United Malay National Organization (UMNO) in 1994. It embodied the consensus that ‘the ideological and societal differences should not hinder the development of bilateral relationship since it conforms to the shared fundamental interests’.²⁰⁹ Through these amicable actions Beijing harvested the gain that Mahathir is the first leader in Southeast Asia to openly counter the warning of China threat.²¹⁰

The political collaboration attributed to converged perspectives has been reflected on the very frequent mutual visits of the highest leadership;²¹¹ in addition to the symbolic prominence of bilateral relations, they also provided important opportunities to refine the support for each other’s international political initiatives such as Malaysia’s proposal to establish the East Asian Economic Grouping (EAEG, detailed discussion in section 3.2.2),²¹² China’s resuming GATT membership and the WTO entry,²¹³ and collective

²⁰⁶ ‘Li Peng zai Jilongpo juxing jizhezhaodaihui tan zhongma guanxi he dui yixie zhongda guoji wenti de kanfa [Li Peng Talks about Sino-Malaysian Relations and Views on Some International Issues in Press Conference in Kuala Lumpur]’, *Renmin Ribao*, 14 December 1990, p. 1.

²⁰⁷ ‘Mazhongyouxie juxing shoujie huiyuan dahui [First Convention of Chinese-Malaysian Friendship Association Was Held in Kuala Lumpur]’, *Renmin Ribao*, 6 April 1993, p. 6.

²⁰⁸ ‘Jiang Zemin huijian Mahathir [Jiang Zemin Meets with Mahathir]’, *Renmin Ribao*, 13 May 1994, p. 1.

²⁰⁹ ‘Wen Jiabao huijian Malaixiya keren [Wen Jiabao Meets with Malaysian Guests]’, *Renmin Ribao*, 22 September 1994, p. 4.

²¹⁰ ‘Malaixiya zhongli zai Mangu qiangdiao Zhingguo dui bendiqu bu gocheng weixie [Malaysian Premier Emphasized that China Is Not a Threat in Bangkok]’, *Renmin Ribao*, 22 August 1993, p. 6.

²¹¹ ‘Malaixiya zuigao yuanshou hui jian Li Peng zhingli [Malaysian Supreme Head of State Meets with Premier Li Peng]’, *Renmin Ribao*, 23 August 1997, p. 1.

²¹² ‘Mahathir huijian Qien Qichen, shangfang qiangdiao geguo yingdui shijie fazhan gongtong fahui zouyong [Mahathir Meets with Qien Qichen; Both Parties Emphasized to Jointly Contribute to World Development]’, *Renmin Ribao*, 19 July 1991, p. 6.

proposals for restructuring the UN Security Council because China has the veto power as it holds the permanent seat (Liow, 2005: 290). At the regional level, the bilateral dealing with Kuala Lumpur has run parallel to China's engagement with ASEAN as a whole through the participation in multilateral fora such as the ASEAN-Post Ministerial Conferences (ASEAN-PMC), Asia Pacific Economic Forum (APEC) and ASEAN Regional Forum (ARF). Due to the characteristics of ASEAN that stresses consensus and voluntary partaking in collective initiatives, stances on various issues differ from member to member since they are shaped by separate national concerns, both domestically and internationally. The situation offers Beijing more flexibility to ensure the Chinese interests by working with individual ASEAN member states selected by the nature of issues; this consideration is particularly highlighted in security since China has been worried that the ARF may be used by its participating parties to gang up on China and oppose its strategic interests. For example, although Malaysia sees the American military presence as a necessary factor in securing the regional balance of power like other ASEAN members, it has had less elaborate defense ties with the US than those between Singapore and US or Thailand and US; furthermore, Malaysia has tried to moderate the potential tensions between Beijing and Washington (Acharya, 1999: 138-143). While dismissing the China threat and being a leading member in the doubt camp about the American deterrence, Mahathir 'foresees a lot of pressure' from a dominant US, suggesting that the rise of China is less of a security concern to Asia than the American tendency to 'impose things on others' in terms of attempts to seek extra-territorial rights and heavy-handed promotion of norms.²¹⁴

To a larger extent, the political collaboration with Malaysia is a successful case of China's good-neighboring policy (*mulin zhengce*) after opening up. Since the 1990s, the evolution of good-neighboring policy has revolved around the framework that 'relations with the neighboring countries are primary; those with the great powers are they key; those with the developing countries are foundation; and multilateral relations are the

²¹³ 'Li Peng huijian Malaixiya zuigao yuanshou [Li Peng Meets with Malaysian Supreme Head of State]', *Renmin ribao*, 8 September 1991, p. 1; 'Mahathir huijian Lou Gan [Mahathir Meets with Chinese State Councillor Lou Gan]', *Renmin Ribao*, 17 January 1995, p. 6.

²¹⁴ 'I am Still Here', Interview with Prime Minister Mahathir Mohammed, *Asiaweek*, 9 May 1997, p. 34.

arena' (*zhoubian shi shouyao, daguo shi guanjian, fazhanzhong guojiashi jichu, duobian shi wutai*).²¹⁵ Bilateral dealings with the neighboring Malaysia have served China's declaration of promoting solidarity in the Third World, while the coalition with Kuala Lumpur has been a useful supplement to Beijing's strategies when facing external challenges and has allowed Beijing more favorable conditions in the multilateral fora. This observation is best exemplified by the territorial disputes in the South China Sea.

2.3.2. *Malaysia's actions, China's responses: the South China Sea*

Although the South China Sea problem does not rank high on China's foreign policy agenda, the overlapping territorial claims and complex negotiations have made such disputes a source of conflicts between Beijing and other claimants, as well as potential tensions with extra-regional powers including US, Russia and India due to the strategic significance of the locale (Song, 2003). Beijing has resorted to historical discovery and ad hoc prior cooupatation to legitimize the Chinese ownership of all isles, undefined continental shelf and wide-ranging maritime zones which enables PRC to extend the boundary far south and engulf the territorial waters of Southeast Asian countries (Leong, 1987: 1115). With the naval expansion and dilatory diplomacy over the issue, ASEAN has been worried about Beijing's 'creeping assertiveness' (Tenesson, 2000); yet in order to ensure the immense economic value, Malaysia occupied three atolls of the Spratlys on the basis of the 1982 UN convention on the Law of the Sea (UNCLOS) following the military exercise by the Five Power Defense Agreement involving UK, Australia, New Zealand, Singapore and Malaysia in 1983 (Leong, 1987: 1115-1116).²¹⁶ Within Malaysia's exclusive economic zone (EEZ), the vicinity around Swallow Reef has been explored for oil and gas by Petronas, Malaysia's national oil corporation since the mid-

²¹⁵ 'Jiedu zhingguo xin waijiao zhanluetu: Quanfangwei heping waijiao chuxian jinzhan [Comprehension of China's New Diplomatic Strategic Chart: Progress in All-direction Diplomacy], *Xinhua*, 9 November 2005. Available at http://news3.xinhuanet.com/world/2005-11/09/content_3756767.htm/. Last accessed in February 2009.

²¹⁶ Based on map of its territorial waters and continental shelf boundaries in the end of 1979, Malaysia occupied Swallow Reef (*Terumbu Layang-Layang*) in August 1983, and Ardasier Bank (*Permatang Ubi*) and Mariveles Reefs (*Manatanani*) along with six smaller islets in November 1986. These reefs are more than 1,000 kilometers from Chinese coast and only 160 kilometers west of Sarawak (Acharya, 1999: 133; Leong, 1987: 1115; Liow, 2000: 685).

1980s, and was developed as a tourist resort in 1991; they made Malaysia the first country to use the disputed islands for economic activities. Comparing with harsh reaction to similar attempts of Vietnam over other parts of Spratlys at the same time, Beijing was rather moderate toward Malaysia (Chen, 1994: 901). Beijing remained silent over the Spratlys issue when the Malaysian Supreme Head of State Sultan Azlan Shah visited Beijing in 1991; while the emphasis of the meeting between Sultan Azlan Shah and Chinese Premier Li Peng was located on the mutual support for the Malaysian-initiated EAEG and China's resuming GATT membership.²¹⁷ Furthermore, in a leaked confidential speech to the general staff of People's Liberation Army (PLA), President Yang Shangkun stated that China was prepared to use military means to settle the Spratlys disputes with Vietnam, yet with no mention of Malaysia.²¹⁸ The legal base for Beijing to adopt military actions over South China Sea issue is the 'Law on the Territorial Sea and the Contiguous Zone' promulgated on 25 February 1992; it stipulates that any foreign bodies must first seek Beijing's consent before conducting activities in the contiguous zone (12 nautical miles from the baseline) of China's territorial sea; and China has the authority to exercise powers within the contiguous zone to 'prevent or punish' infringement.²¹⁹ Therefore it is interesting to note that Beijing did not choose to avenge on Malaysia's blatant contravention of the Chinese laws; to the contrary, Beijing has sought to achieve peaceful solutions with Malaysia by 'friendly discussion' through the consultation system between Foreign Ministers of the two countries launched since 1991;²²⁰ and Kuala Lumpur expressed the will to 'explore possibilities of shelving disputes and joint development with Beijing through bilateral channel'.²²¹ This strategy helped Beijing to gain the defense, at least in declaratory terms, from Malaysia when the regional tensions intensified caused by China's increasing moves in South China Sea in

²¹⁷ 'Li Peng huijian Malaixiya zuigao yuanshou [Li Peng Meets with Malaysian Supreme Head of State]', *Renmin Ribao*, 8 September 1991, p. 1.

²¹⁸ 'Report Show China to Develop Strong Navy', *Periscope Daily defense News*, 16 December 1992; cited in Liow, 2005: 292.

²¹⁹ Original text is at

http://www.un.org/Depts/los/LEGISLATIONANDTREATIES/PDFFILES/CHN_1992_Law.pdf. Last accessed in February 1992.

²²⁰ See the official description of development of Sino-Malaysian relations at <http://my-china-embassy.org/eng/sbgx/t174144.htm>. Last accessed in February 2009.

²²¹ 'Zhongma waijiaoguan juxing disanlun coushang [Foreign Ministers of the Two Countries Launched the Third Round Negotiation], *Renmin Ribao*, 9 April 1994, p. 6.

the first half of the 1990s (Odgaard, 2003). For example, in his speech in the 1994 China Summit Meeting, Mahathir argued that China 'has not exhibited any consistent policy of territorial acquisitiveness...full invasion and colonization has not been a feature of Chinese history'; he even appealed to the fellow ASEAN members that 'if Southeast Asia is not apprehensive of Japan, it should not be worried about China'.²²²

Beijing's strategy of forging alliance with Malaysia seemed to offer China a way out from being 'ganged up' by the subsequent aggregate actions over the Spratlys disputes in terms of going through multilateral dispute settlement mechanism, which, from the Chinese perspective, could have brought in influences of extra-regional powers, particularly the US. Instead, the alliance with Malaysia helped Beijing to advance the Chinese preferred bilateral negotiations and could contribute as a precedent in the future. When the collective concern for the Chinese expansionism reached the peak after China occupied the Philippines-claimed Mischief Reef in February 1995, ASEAN formed the unusually consensus of diplomatic confrontation; in order to prevent the looming armed conflicts in the region, Singapore and the Philippines called for the American involvement together. It is interesting to note that although Malaysia has been a strong supporter of the multilateral security cooperation in the region, Kuala Lumpur paid only lip service to ASEAN's collective initiative as said by the then-Foreign Minister Abdullah Badawi that 'it became necessary to refer the issue to the third party although China was reluctant and wanted to settle it among claimant countries';²²³ yet two weeks later, Malaysia opposed the Philippines' request of discussing the dispute in the ARF (Kuik, 2008: 173). Abdullah also noted that 'the ARF has endorsed the stand that third parties stay out of the Spratlys dispute, with the settlement process confined only to claimant countries' as Malaysia's gambit of reliance on private diplomacy rather than forming military coalition with US (Whiting, 1997).²²⁴ The converged approach was highlighted when Chinese Premier Li Peng chose his August 1997 visit to Kuala Lumpur to present the Chinese proposal to ASEAN that to 'shelve disputes and pursue joint

²²² Full text of this speech is at <http://www.pmo.gov.my/ucapan/?m=p&p=mahathir&id=1754>, delivered on 11 May 1994. Last accessed in February 2009.

²²³ 'Foreign Minister Comments on Spratlys Incidents', *Utusan Malaysia*, 15 July 1995; cited in Liow, 2000: 686-687.

²²⁴ 'Malaysia's Badawi Views Spratlys', *Star* (Kuala Lumpur), 2 August 1995; cited in Liow, 2000: 687.

development (*gezhi zhengyi, gongtong kaifa*) based on universally recognized principles of international law through peaceful and friendly negotiations'. Echoing to Mahathir's defense of China, Li Peng also emphasized that the South China Sea disputes are the problem inherited from the history; if it is difficult to achieve a satisfactory outcome immediately, China is willing to leave the problem to the next generation.²²⁵ The consensus between Beijing and Kuala Lumpur of Spratlys disputes settlement was formalized in the 1999 *Joint Declaration of Future Bilateral Cooperative Framework* that 'to secure the peace and stability in South China Sea, both sides agree to facilitate the dispute settlement through *bilateral* friendly consultations and negotiations based on international laws' (emphasis added).²²⁶ Such harmonious stance seemed to successfully ensure Beijing's position in South China Sea; for example, after opposing the Philippine's request to discuss the dispute in ARF in July 1997, the Malaysian Foreign Minister Syed Hamid Albar paid a visit to Beijing in the next month; while Beijing had only very low-key response when Manila protested vehemently over Malaysia's construction of structures on Investigator Shoal and Erica Reef in September of the same year. At the same time, Mahathir was in Beijing and held high-level talks with President Jiang Zemin and Premier Zhu Rongji. As Razak conjectured, Malaysia's actions could have acquired at least acquiescence from Beijing, while the two countries reiterated that the South China Sea disputes should be settled without the involvement of external parties (Razak, 2002: 244).²²⁷ This insistence was confirmed in the 2002 *Declaration on the Conduct of Parties of South China Sea* between China and ASEAN as a whole,²²⁸ while China and Malaysia agreed on 'actively exploring the subsequent implementation' of the Code in the 2004 bilateral joint communiqué.²²⁹ Beijing's advocacy of 'shelving disputes and pursuing joint development' was formally written into the 2005 bilateral joint communiqué, while China and Malaysia expressed the willing to treat the South China Sea as 'the sea of friendship and cooperation between China and ASEAN'.

²²⁵ 'Li Peng zhingli jiu guonei yu diqu wenti dawen [Premier Li Peng Answers Both the Domestic and Regional Questions]', *Renmin Ribao*, 23 August 1997, p. 3.

²²⁶ Full text is at <http://my.china-embassy.org/chn/zt/zmgxzywj/t299203.htm>, signed in Beijing on 31 May 1999. Last accessed in February 2009.

²²⁷ BBC Online Network, 19 August 1999.

²²⁸ Full text is at <http://www.aseansec.org/13163.htm>. Last accessed in February 2009.

²²⁹ Full text is at <http://my.china-embassy.org/chn/zt/zmgxzywj/t299204.htm>, signed in Beijing on 31 May 2004. Last accessed in February 2009.

Furthermore, Malaysia welcomed the Chinese participation in security cooperation in the Strait of Malacca and was willing to cooperate with Beijing in the fields such as intelligence exchange.²³⁰ All of these suggest that Beijing has gained strategic interests in the region through cordialities, rather than direct dominance, with Malaysia.

2.4. *Mature partnership in all aspects*

The Chinese Premier Li Peng's visit to Kuala Lumpur in 1997 ushered in the phase of mature partnership between China and Malaysia. Li Peng highly appraised 'Malaysia's active participation in international and regional affairs, rejection of hegemony, efforts to achieve justice, and promotion of joint development of Third World countries'; he also stressed that close contacts between Beijing and Kuala Lumpur has contributed to mutual understanding and trust as the foundation of improved bilateral relations. In international affairs, in addition to the general support for each other's stances, Li Peng particularly appreciated Mahathir's unwavering backing for China on human rights issue and his frequent public repudiation of 'China threat'.²³¹ To consolidate the mature partnership between Beijing and Kuala Lumpur, Li Peng proposed five principles to guide the development of amicable and friendly relationship (*mulin youhao*) in the 21st century, including mutual respect and equal treatment (*xianghu zunzhong, pingdeng xiangdai*), strengthening dialogues and consultations (*jiaqiang duihua, miqie cuoshang*), pursuing reciprocity and joint development (*hulihuhui, gongtong fazhan*), mutual support and enlarging cooperation (*xianghu zhichi, huxiang hezou*), as well as taking fundamental interests as the primacy and leaving different opinions aside (*zhouyuan daju, qiutong cunyi*); they are also applied to Beijing's management of enhancing cooperation with ASEAN as a whole.²³² According to the Chinese definition, the fundamental interests for Third World countries are peace and development, and to which the emergence of the multi-polarity is deemed as the most proper approach. Therefore Beijing is willing to

²³⁰ Full text of the 2005 Sino-Malaysian Joint Communique is at <http://my.china-embassy.org/chn/zt/zmgxzywj/t299205.htm>, signed in Kuala Lumpur on 15 December 2005. Last accessed in February 2009.

²³¹ See note 211.

²³² 'Fazhan mianxiang ershiyi shiji de mulin youhao guanxi [Developing the Amicable and Friendly Relationship towards the 21st Century]', *Renmin Ribao*, 23 August 1997, p. 3.

work with ASEAN to play the more significant roles in the process towards multi-polarity through amicable and friendly cooperation.²³³ With regard to Malaysia, Beijing expects to maintain the shared concerns that managing bilateral relations of the strategic angle for long-term interests; on this basis, China wants to advance to the higher level cooperation in all aspects with Malaysia.²³⁴

Beijing's pledge of valuing the state-to-state relations and pursuing all-dimensional cooperation with Malaysia was reconfirmed in the 1998 APEC Summit in Kuala Lumpur, in which the Chinese President Jiang Zemin met with Mahathir in the sidelines when the latter was snubbed by the leaders of the US, Canada and Australia (Liow, 2005: 290).²³⁵ This choice also contributed to convince the Malaysian government that China, unlike the West, would not interfere in its domestic affairs. On 31 May 1999, the two countries signed the *Joint Declaration of Future Bilateral Cooperative Framework* in Beijing, which substantiates Li Peng's five guiding principles in 1997. In politics, the two countries would strengthen the annual consultation system of Foreign Ministers and frequent high-level mutual visits would continue. Although both countries reiterated to adopt the UN Charter, the Chinese-proposed Five Principles of Peaceful Coexistence and the 1976 Declaration of ASEAN Concord in managing bilateral relations, they particularly emphasized non-interference as the parallel principle. The binding power also extends to other foreign countries because 'China and Malaysia reserve the right to choose their own societal, political and economic systems'. At the same time, in addition to strengthen the alliance in multilateral forums such as ASEAN, ARF, APEC, ASEM, WTO and UN, both countries will 'promote multi-polarity and a fair as well as reasonable new political and economic order'. All of these efforts were aiming to 'support developing countries to acquire their deserved position in such new international order'.²³⁶

²³³ 'Mahathir zhongli huanyen Li Peng zhongli [Premier Li Peng Meets with Chinese counterpart Li Peng]', *Renmin Ribao*, 22 August 1997, p. 6.

²³⁴ See note 211.

²³⁵ It reflects the Western criticism of imprisonment of the sacked Deputy Prime Minister Anwar Ibrahim caused by the internal political struggle within the UMNO (Felder, 1999).

²³⁶ See note 226.

The partnership was reinforced in the subsequent signing of two joint communiqués. At the thirtieth anniversary of establishing diplomatic relations, Malaysian Prime Minister Abdullah Badawi visited Beijing in 2004. Based on the spirits of the 1999 cooperative framework, the two countries called for the respect of world diversity and ‘democracy in international relations’ for the first time.²³⁷ Chinese Premier Wen Jiabao then paid a return visit to Kuala Lumpur in 2005 and both sides agreed to intensify the Sino-Malaysian strategic cooperation. In international affairs, the two countries will strengthen the mutual support to reform the UN; representatives of developing countries in the UN Security Council should be increased on the foundation of extensive consultation to ensure their interests.²³⁸

3. Foreign economic policy

By examining Beijing’s FEP measures towards Malaysia, the very interesting findings are Beijing has made efforts to shift the bilateral economic relations to Malaysia’s favor in terms of the national income from the trade, and has designed the FEP measures in line with Malaysia’s national economic developmental plan. Since these measures are against the mercantilist predictions that the bigger trading country would manipulate bilateral economic relations to create the asymmetric reliance of its partner, Beijing’s choices did partially meet the liberal hypothesis that instead of zero-sum game, China has been more interested in ensuring the absolute gain of itself and Malaysia. Yet, this section argues that for Beijing, the achievement of absolute gain can only be through the alternative international system. Although China has appeared cooperative in the existing rules of the games such as the participation in the APEC/WTO, it still cannot protect the Chinese interests from the Western predatism. Therefore, the strengthened economic relations with Malaysia have been more significant in Beijing’s attempts on the establishment of a more fair and reasonable economic order, at least in the region. In other words, comparing with the direct political dominance over smaller trading partner such as Malaysia, to intensify the support for each other’s appeals and to promote bilateral trade

²³⁷ See note 229.

²³⁸ See note 230.

as well as investment even at the slight expense of the overall income from such activities, appears to be more profitable for China's long-term pursuit.

3.1 Diplomacy serves domestic construction: the 1980s

Although China's overall FEP strategies at the inception stage were to increase exports and to absorb foreign capitals, they were not exerted on Malaysia as much as Beijing did in general until the mid-1980s. From the late 1960s to the early 1980s, Malaysia adopted the export-promotion strategy to develop an industrial-based economy; as a result, Malaysia had successfully shifted its dependency from primary to secondary exports and had maintained good economic performance, in terms of stable GDP growth and low inflation rates (Zubaidi, 2007). Since the booming Malaysian economy had been generated by integrated policies aiming to 'correct' economic imbalance among different ethnic groups, China had faced crucial obstacles in advancing the bilateral trade and investment with Malaysia.

3.1.1. Trade barriers against China

Firstly, stringent restrictions on people's visits to China had maintained in spite of the establishment of bilateral diplomacy in 1974. This measure was obviously motivated by security concerns that the communist elements could take advantage to infiltrate Malaysia; furthermore, it also reflected Malaysia's positive discrimination against the economically dominant Chinese group at home. In order to ensure the *bumiputera* gains from the trade with China, the government-owned Pernas Trading Company was set up in 1971 as both the supervisory body and the competitor with private firms in conducting trade with China. For the former role, Pernas was responsible for united national arrangements of leading delegations to trade fairs in China; yet for the latter, the Chinese counterparts had been reluctant to abandon their traditional ethnic Chinese trade channels through Hong Kong and Singapore to Malaysia. It was perceived by Kuala Lumpur as obstructing the attainment of Malaysia's New Economic Policy (NEP, since 1970) (Leong, 1987). The related second impediment was technical barriers. In line with the

NEP, imports from China had to go through Pernas, which imposed a 0.5 per cent commission on every consignment of goods. The importers were also required to apply for approved permits (APs) from the Malaysian government before doing business (Lee and Lee, 2006: 164). However, notwithstanding the policy discrimination against imports from China, bilateral trade had been in China's favor during the period of 1974-84 (IMF, 1982; 1985), mainly due to the heavy importation of Chinese foodstuffs, manufactured goods, and chemicals that outweighed exports to China of Malaysia's primary commodities of palm oil, rubber and timber (Fu, 1987: 158). In response to Kuala Lumpur's request, Deng Xiaoping promised to increase the imports of natural rubber from Malaysia with the consideration that quality materials were necessary for the Chinese industrial development; in addition, Beijing was also planning to import the skills of palm and rubber planting from Malaysia to increase the tropical economic crops in Yunnan and Hainan.²³⁹ However, China did not appear to actively promote bilateral trade with Malaysia in the first half of the 1980s. As discussed in section 2.2, during this period Beijing had made efforts to shape its benign image in terms of having no intentions of annexation as well as the representative of 'the oppressed Third World countries' against Soviet expansion and its Vietnam proxy. As complementary to China's foreign policy, the FEP towards Malaysia was rather drifting to avoid Kuala Lumpur's suspicion about the link between trading with China and Beijing's mobilization of ethnic Chinese, which was viewed threatening to the domestic stability of Malaysia.

3.1.2 Upturn of bilateral economic relations

The upturn of bilateral economic relations showed in the mid 1980s, yet it was initiated by Malaysia. Consistent with China's open-door policy, Beijing welcomed the nudge and had appeared cooperative as well as generous whenever possible. The improvement was ushered in the visit of the Malaysian Foreign Minister Ghazali Shafie, who led 33-member delegation that included top Malaysian businessmen, to Beijing in May 1984. The timing was significant because it marked the tenth anniversary of normalization of

²³⁹ 'Malaixiya zuigao yuanshou jiejian Deng fuzhongli [Malaysian Supreme Head of State Meets with Vice Premier Deng]', *Renmin Ribao*, 11 November 1978, p. 1.

bilateral diplomacy; being aware of the economic recession, Kuala Lumpur intended to investigate the possibilities of participating in China's open-door policy as a solution (Leong, 1987: 1117-1118). Ghazali introduced Malaysia's NEP to Beijing and emphasized the potential Malaysian contribution to China's economic modernization; since it would facilitate regional peace, to promote bilateral trade and economic cooperation meant mutual benefits.²⁴⁰ Beijing expressed the goodwill that whereas there were no direct interest conflicts between China and Malaysia, the two countries should pursue joint development;²⁴¹ in addition, to indicate China's sincerity in helping Malaysia's trade problem, Beijing signed a contract of importing \$0.7 million dried chillies through Pernas, which was 'regarded as something of a landmark in bilateral trade relations'. With similar symbolic importance, other major companies such as Promet, Malaysia Overseas Investment Corporation and the Kuok Brother's Group signed letters of intent for large investment projects in China (Leong, 1987: 1118). Among them, as the leading Chinese-owned consortium in Malaysia, the Kuok Brother's Group was consigned by the Ministry of Foreign Economic Relations and Trade (MOFERT) and the Beijing Municipal Government to build the China World Trade Center, which has been a landmark construction signifying China's opening up as well as one of the largest foreign invested JV (\$225 million) in the 1980s;²⁴² therefore this project bore important political implications. On China's side, it demonstrated the emphasis given in advancing bilateral economic cooperation with Malaysia; on Malaysia's side, it reflected the 'controlled balance' between strengthened economic ties with China, which had to follow the NEP guidelines, and the weakened suspicion about China threat since the government pledged that national security would not be compromised.²⁴³ China's strategic choices were 'rewarded' with Malaysia's formal

²⁴⁰ 'Jiazali wazhan biaooshi xiwang zenjia mazhong jingji guanxi [Malaysian Foreign Minister Ghazali Hoped to Increase the Bilateral Economic Relations], *Renmin Ribao*, 30 May 1984, p. 6; 'Wu Xueqian waizhan tong Jiazali waizhan juxing huitan [Foreign Minister Wu Xueqian Meets with Malaysian Counterpart Ghazali]', *Renmin Ribao*, 31 May 1984, p. 4.

²⁴¹ 'Wan Li daizhongli huijian Jiazali waizhang [Deputy Premier Wanli Meets with Malaysian Foreign Minister Ghazali]', *Renmin Ribao*, 31 May 1984, p. 1.

²⁴² 'Zhongguo guoji maoyi zhongxin yixiangshu zai Jing qianzi [Letter of Intent of China World Trade Center was Signed in Beijing], *Renmin Ribao*, 31 May 1984, p. 2; 'Li Peng huijian Guo Henien [Premier Li Peng Meets with the Tycoon of the Kuok Brother's Group]', *Renmin Ribao*, 30 March 1990, p. 2.

²⁴³ *Far Eastern Economic Review*, 4 July 1985, p. 12-13.

relaxation on visits to China on 25 June 1985 and some 250 Malaysian companies were trading with China (Leong, 1987: 1119-1120).

3.1.3. Improving legal environment to facilitate trade and investment

The attempt of boosting national economy by increasing exports to China or participating in JVs in China was again brought up by Malaysian's Prime Minister Mahathir when he led the largest trade delegation of 130 members visiting Beijing in November 1985. Mahathir suggested the two countries to share the results of each other's modernization and industrialization to achieve mutual benefits;²⁴⁴ for this purpose, during this visit Mahathir consciously downplayed thorny political issues, *i.e.* the relations between CCP and CPM as well as Beijing's overseas Chinese policy,²⁴⁵ but only alluded Malaysia's task of building national unity among various ethnic groups (Leong, 1987: 1122). Instead of addressing China as a big competitor in exports and inwards FDI against Malaysia, Mahathir emphasized that mutual benefits could accrue from closer economic cooperation with China; such cooperation would contribute to create a 'more equitable and fair economic order' to ensure national interests of the two countries, in terms of making joint request for preferential treatments, against trade barriers as well as the manipulation of raw materials from the West.²⁴⁶ Although Beijing made no direct comments on Mahathir's accusation of the Western protectionism, as a low-key endorsement, China took concrete measures to promote bilateral economic cooperation, including the signing of the Double Taxation Agreement (DTA) with Malaysia,²⁴⁷ and the cooperative agreement between China's Council for Promoting International Trade and Malaysia's Sino-Malay Joint Chamber of Commerce, which embodied Premier Zhao Ziyang's assurance that China did not follow 'blood or origins' in conducting business (Leong, 1987: 1122). In addition, the state-owned Sinosteel Trading Company also signed an MOU on importing of 200,000 tons of briquetted iron from Malaysia during

²⁴⁴ See note 203.

²⁴⁵ For example, in the press conference after his visit in Beijing, Mahathir said 'the two countries have achieved mutual understanding about the MCP problem...we decided to shelve the chasm and concentrate on trade issue, on which we share the same concerns.' See '*Mahathir zhongli lijing qu shanghai fangwen* [Mahathir Left for Shanghai]', *Renmin Ribao*, 24 November 1985, p. 4.

²⁴⁶ See note 203.

²⁴⁷ Full text is at <http://www.hasil.gov.my/DTA/China.pdf>. Last accessed in February 2009.

the following two years since the iron and steel industry was the key sector of Malaysia's NEP.²⁴⁸ An affiliated company of the Chinese Academy of Sciences also received 20 Malaysian-made Proton Sagas to explore the possibilities of importing Malaysian automobiles.²⁴⁹ This action not only strengthened Beijing's sincerity in promoting secondary imports from Malaysia but could serve the increasing domestic need for passenger cars as an outcome of economic growth.²⁵⁰ In terms of economic cooperation for 'spurring on positive change of trade structure',²⁵¹ joint projects of advancing production of raw materials, particularly palm oil and rubber, were initiated since 1986.²⁵²

Since then, an important component of China's FEP in general in the 1980s – to create a sounder legal environment for economic activities – was also placed in the relations with Malaysia. After Kuala Lumpur announced to abolish licensing on imports from China,²⁵³ the first trade agreement between the two countries was signed in April 1988; in which China and Malaysia granted the most-favored nations (MFN) status on tariffs to each other.²⁵⁴ Subsequently, the *Agreement of Reciprocal Encouragement and Protection of Investment* was signed in Kuala Lumpur; in which the two countries agreed to grant the MFN status to each other's investment (*i.e.* no less favorable than the treatment given to investment from any third countries), to protect each other's investment from unreasonable expropriation and to guarantee appropriate compensation once the expropriatory measures are taken, and to settle disputes in the International Arbitral

²⁴⁸ 'Malaixiya dali fazhan gangtie gongye [Malaysia Develops the Iron and Steel Industry]', *Renmin Ribao*, 29 August 1990, p. 7.

²⁴⁹ 'Zhongguo zhengfu he Malaixiya zhengfu guanyu dui suode bimian shuangchong zhengshui he fangzhi touloushui de xieding zaijing qianzi [China and Malaysia Signed the Double Taxation Agreement in Beijing]', *Renmin Ribao*, 24 November 1985, p. 4.

²⁵⁰ From the early 1980s to early 1990s Chinese imports of passenger cars rose steadily and many foreign manufacturers believed that the market for imported cars would explode as China's rapid economic growth began to create middle class of significant numbers. Yet Beijing announced an auto policy to develop domestic motor sector at the expense of imports in 1994; the protection remained until China's WTO entry in 2001 (Lardy, 2002).

²⁵¹ 'Tian Jiyun huanyan Malaixiya fuzhongli [Deputy Premier Tian Jiyun Meets Malaysian Counterpart]', *Renmin Ribao*, 8 September 1987, p. 4.

²⁵² 'Waishi jianxun [Briefing of Foreign Affairs]', *Renmin Ribao*, 3 December 1986, p. 4.

²⁵³ 'Malaixiya xuanbu duoxiang jihua cujin tong Zhongguo de shangbian maoyi [Malaysia Announced Multiple Plans to Promote Bilateral Trade with China]', *Renmin Ribao*, 17 March 1988, p. 7.

²⁵⁴ 'Zhongguo Malaixiya maoyi xieding zai Jing qianshu [China-Malaysia Trade Agreement Signed in Beijing]', *Renmin Ribao*, 2 April 1988, p. 4.

Tribunal if bilateral conciliation cannot be reached.²⁵⁵ To facilitate the implementation of the two agreements, the China-Malaysia Joint Committee of Economics and Trade were set up on the next day.²⁵⁶ All of these demonstrated Beijing's positive response to Kuala Lumpur's anxiety that comparing with other ASEAN countries such as Thailand and Singapore, Malaysia was behind in trade and investment with China (Leong, 1987: 1122). For example, by November 1988 there were only two JVs in Malaysia while the number in China was merely nine.²⁵⁷ In addition, these measures were expected to realize Beijing's promise of 'increasing direct trade rather than going through the third countries'.²⁵⁸

3.2. The 'second-step' FEP strategies for economic development: the 1990s

3.2.1. Scientific and technological (S&T) cooperation

Before visiting Singapore, the State Councilor Song Jian (who was also in charge of the Ministry of State Science and Technology) led an official delegation to visit Kuala Lumpur and signed the *Scientific and Technological Agreement* with Malaysia. The key cooperative fields are high-tech and environmental protection, on which the research would be jointly conducted by academic institutions of both sides.²⁵⁹ Beijing also expected to utilize Malaysia's resources and skills of developing primary industries, particularly palm oil, tin and forestry to facilitate its ultimate developmental goal of establishing the 'grand trade' (*da jingmao*), which is the integration of foreign trade and industry, agriculture, technology and finance as a cohesive system.²⁶⁰ In addition, the

²⁵⁵ Full text is at <http://www.colaw.cn/findlaw/invest/malaysia.htm>, signed on 21 November 1988. Last accessed in February 2009.

²⁵⁶ 'Zhongguo jingmao daibiaotuan fu Malaixiya fangwen [Chinese Economic and Trade Delegation Visits Malaysia], *Renmin Ribao*, 25 November 1988, p. 4.

²⁵⁷ 'Zhong ma qiending tozi baozheng xieyi [China and Malaysia Signed the Investment Protection Agreement]', *Renmin Ribao*, 23 November 1988, p. 4.

²⁵⁸ 'Yao Yilin huijian Malaixiya maogong buzhang [Vice Premier Yao Yilin Meets with Malaysian Minister of International Trade and Industry]', *Renmin Ribao*, 26 July 1989, p. 2.

²⁵⁹ [Zhongguo keji daibiaotuan fang Ma [Chinese Scientific and Technological Delegation Visits Malaysia], *Renmin Ribao*, 2 March 1992, p. 7.

²⁶⁰ See, for example, Vice Minister of MOFTEC Shi Guangsheng, 'Dali fazhan duiwai jingmao shiye, nuli tigao duiwai keifang shueping [Promotion of Foreign Trade and Improvement of Opening Up]', 20

other focal point of bilateral intra-industrial cooperation in electronics as well as iron and steel was expected to serve the structural upgrade of China's manufacture exports from labor-intensive to more skill-intensive and higher value-added goods such as those under SITC category 7 (machinery and transport equipment) and category 5 (chemicals and related products). Therefore, it is clear that the S&T cooperation with Malaysia was employed to help realize one of China's 'second-step' FEP strategies, namely the 'score with quality' (*yizhiqusheng*), which was put forward in the 1990s.²⁶¹ In political aspect, the S&T cooperation with Malaysia had played a big part in shifting the trade balance in Malaysia's favor.

At the same time, a joint committee of science and technology was also set up to promote the bilateral S&T cooperation by facilitating large JV projects. For example, in 1994 the two countries signed an MOU on setting up a joint auto parts manufacturer when the Malaysian Deputy Premier Anwar Ibrahim visited Beijing; in 1996, the Shangdong-based Jigang Iron and Steel Company started the manufacture in Malaysia through its holding subsidiary, which has been China's biggest JV with Malaysia; and in 1999, Beijing had planned a big investment project of wood and pulp processing in Sabah.²⁶² However, this project failed to materialize due to the local Malaysian concerns that it might develop the pattern for Chinese investment in big resource exploitation, while the ostensible reason regarding environmental protection was given (Lee and Lee, 2006: 173-174).

3.2.2. First attempt on alternative economic order: EAEC

In the 1990s, an important aspect of China's FEP towards Malaysia is Beijing's support for the Malaysian-initiated East Asian Economic Group (EAEG). This idea stemmed

November 1997, documented in *Zhongguo Duiwai Jingji Maoyi Nienjian* [Almanac of China's Foreign Economic Relations and Trade], 1998/99, pp. 20-26.

²⁶¹ It is interesting to note that unlike Singapore, Malaysia was not chosen as 'an avenue to international market for the commercialization of the results of China's S&T cooperation'. See 'Song Jian jieshu dui Ma Xin liangguo fangwen huiguo' [Song Jian Came Back from the Visits to Malaysia and Singapore], *Renmin Ribao*, 7 March 1992, p. 6.

²⁶² See the MOU between the State Planning Commission of China and Ministry of Primary Industries of Malaysia, signed on 26 August 1996. Full text is at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=eag&Gid=100668354>. Last accessed in February 2009.

from Mahathir's view that countries in East Asia (*i.e.* Southeast Asia plus China, Japan and South Korea) should be more proactive in helping lesser-developed economies in the region to overcome their difficulties, as well as in assisting their reform through consultation and cooperation (Chalermpanupap, 2002); yet strategically, the EAEG initiative is Malaysia's response to the Asia Pacific Economic Cooperation (APEC). In line with Mahathir's traditional 'Look East' foreign policy, he feared the APEC would be dominated by extra-regional powers, especially the US. Along with urging Japan to take on the leadership role in EAEG, Mahathir chose to firstly announce his proposal during the Chinese Premier Li Peng's visit to Kuala Lumpur in 1990 (Hund, 2003: 386; Liow, 2000: 676).

For China, the EAEG initiative seemed to be a promising solution to its predicament in the aftermath of Tiananmen crackdown in 1989. China found itself more vulnerable to the US-led Western criticism and the consequent economic sanctions as well as the linking between human rights and MFN status since its economic growth has increasingly relied on foreign trade after opening up to the world economy for a decade. In this context Beijing has given more weight to its good-neighboring policy (*mulin zhengce*) to ensure a profitable international environment for sustainable economic growth, while the fact that Malaysia shared similar misgivings about the American influence in the region makes it an ally to China's rejection of the 'politicization of economic relations'. The accusation of politicized economic cooperation in the region actually was, from the Chinese view, evidenced by the APEC initiating meeting in Canberra in November 1989. The Chinese representatives were not invited due to the diplomatic fallout by the Tiananmen crackdown; in addition, APEC was planning to include Hong Kong and Taiwan as members because both were important economic actors (Lanteigne, 2005: 65-66). Being aware of the fear of some ASEAN members that China would become the central focus of APEC if admitted early (Crone, 1993: 524), to consolidate the alliance with Malaysia and its EAEG initiative as a countervailing idea to protect the Chinese interests in foreign trade became a feasible strategy for Beijing.

Mahathir's speech delivered to welcome the visit of Li Peng in 1990 reflected the shared concerns about international affairs at the time with China. Firstly he emphasized that 'the Tiananmen event has no impact of our bilateral relations...China's non-interference principle has won the trust from its friends and by the same token, China has the legitimacy to deal with its own domestic affairs'. Mahathir then blamed the emerging trade blocs such as NAFTA and EU; he believed that the 'unhealthy trend' is the example of the Western conspiracy to prevent the rising East Asian countries from achieving development through trade manipulation. Therefore, in order to reach a balanced global economic growth, countries in Asia-Pacific should advance the connection of economic and markets with each other as the base of their own economic grouping to counterweigh the Western predominance. For this purpose, Malaysia invited China to play an important role in this process.²⁶³ Although Li Peng made no direct comments on this appeal, interestingly, full text of the talk was published on China's governmental mouthpiece, the People's Daily (*Renmin Ribao*). This action not only signified Beijing's endorsement of such advocacy but also revealed that Beijing's overall FEP maneuver has been guided by Deng Xiaoping's overarching principles in dealing with international affairs that 'not take the lead but increase the actual strength (*taoguangyanghui, yousuo zouwei*)' proposed in 1989. Following these principles, China should avoid both vocal and military rivalry but concentrate on economic growth with precise evaluation of its own influence.²⁶⁴ Hence, even faced the difficulties at the time, Beijing had tried to negotiate with the US instead of confrontations; yet Beijing obviously did not mind Malaysia taking the lead in retaliatory approach against this big bully and could be willing to offer support after circumspect calculations.

The term 'group' of EAEG was then replaced with 'caucus' (EAEC) to imply that this grouping would be informal and not acting as a challenge to the mandate of APEC. In

²⁶³ 'Mahathir zhingli zai huanying Li Peng zhongli yenhui shang fabiao tanhua, Ma Zhong guanxi yi jinru yige xinjiedian [Mahathir Delivered Welcome Speech to Premier Li Peng; China-Malaysia Relations Enters a New Phase]', *Renmin Ribao*, 11 December 1990, p. 6.

²⁶⁴ Yang Chengxu, 'Taohuanyanghui, yousuo zouwei: Deng Xiaoping sixiang qienyi [Not Take the Lead But Increase the Actual Strength: Brief Discussion about Deng Xiaoping's Thought], 9 August 2004, *Guangming Ribao*. Available at <http://www.southcn.com/NFLR/llzhuanti/jndxp/xuexixinde/200408100706.htm>. Last accessed in February 2009.

January 1992, the Chinese President Yang Shangkun confirmed China's support for the EAEC and highly praised it as 'of positive significance for the promotion of regional economic cooperation' in Kuala Lumpur.²⁶⁵ China's backing was mainly due to the shared aspiration of setting up an alternative economic order free from the American influence; while the large and diverse APEC membership since its inception has caused concerns that whether or not the organization could properly address China's specific economic issues such as the pace and scope of trade liberalization (Lanteigne, 2005: 79-80). Furthermore, the participation in EAEC helped Beijing to gain the recognition that both Taiwan and Hong Kong are subordinated to the Chinese sovereignty; the issue became pressing because the two economies were included in the APEC along with China in 1991 (Chalermpanupap, 2002).

Between 1993 and 1996 Malaysia had promoted EAEC as a loose consultative forum within APEC; it was endorsed by the ASEAN leaders as seen in the *Singapore Declaration* signed in the Fourth ASEAN Summit (Sopiee, 1996).²⁶⁶ However, the Clinton administration strongly opposed the EAEC caused by the worries that such grouping would eventually raise trade barriers and adopt other protectionist policies detrimental to American interests (Grieco, 1999: 329-330). Meanwhile, Japan and South Korea were reluctant to take a clear stand especially after the strong opposition of the US (Chalermpanupap, 2002). During this period, Beijing did not take serious actions to push the EAEC other than rhetoric support; the reason could be again the strategic calculations. While Beijing was trapped in the strenuous negotiations for GATT/WTO membership, it seemed unnecessary to provoke US for the realization of EAEC at the time.

²⁶⁵ 'Yang zhuxi huijien Mahathir zhongli, jiu shangbian guanxi guoji xingshu jiaohuan yijian qude gangfan yizhi [President Yang Meets with Malaysian Premier Mahathir and Achieves Consensus on Bilateral Relations and International Affairs], *Renmin Ribao*, 12 January 1992, p. 1.

²⁶⁶ The Heads of ASEAN members stated that 'ASEAN recognises the importance of strengthening and/or establishing cooperation with other countries, regional/multilateral economic organisations, as well as APEC and EAEC...With respect to an EAEC, ASEAN recognizes that consultations on issues of common concern among East Asian economies, as and when the need arises, could contribute to expanding cooperation among the region's economies, and the promotion of an open and free global trading system'. See the full text of *Singapore Declaration* at <http://www.aseansec.org/5120.htm>, signed on 28 January 1992. Last accessed in February 2009.

3.2.3 Better approach to alternative economic order: APT

For Beijing, the favorable turn of the rather problematic EAEC issue – which is actually only China’s first attempt to the alternative economic order – emerged when the Asian Financial Crisis (AFC) broke out in 1997. Mahathir openly displayed appreciation of China’s unilateral decision not to devalue the Chinese currency, which helped defuse the fundamental threat to the Malaysian economy while being highly critical to the lukewarm responses of US and EU (Liow, 2005: 290). The outbreak of AFC also intensified the imperative of establishing regional cooperative mechanisms; therefore the officially moribund EAEC concept was literally incorporated into the more far-reaching construction, namely the ASEAN Plus Three (APT). Mahathir hosted the inaugural meeting of the APT Summit in December 1997, followed with three successive ASEAN Plus One Summits (Chalermpananupap, 2002). China’s keen assistance to the AFC-sacked ASEAN members seemed to be the potent evidence of its good-neighborly policy and the commitments to the regional cooperation for shared prosperity to Southeast Asia, especially comparing with the reluctance of the traditional East Asian economic power, Japan. In contrast to the EAEC, Beijing seemed to reap more footing in advocating a fair and reasonable economic order free from Western influence in the region after the AFC through various mechanisms under APT; the participation in APT not only ensures the profitable surrounding environment (*zhoubian huanjing*) for China but also implied the leadership of regional cooperation. Therefore, together with Malaysia, Beijing’s keen promotion of an Asian Monetary Fund (AMF) as a regional answer to the failed policies of IMF, the APT currency swap mechanism (*i.e.* the Ching Mai Initiative), and the self-served ‘Asian Way’ to evade uncomfortable commitments all too soon (Hund, 2003: 387), have been useful strategies for China to balance the pressure from the West in foreign trade and investment. As affirmed in the *China-ASEAN Joint Statement* in 1997, China committed to ‘promote good-neighborly and friendly relations, increase high-level exchanges, strengthen the mechanism of dialogue and cooperation in all areas to enhance understanding and mutual benefit.’ In addition to expressing full confidence in the economies of the ASEAN region and their future prospects, China agreed to ‘consolidate [the China-ASEAN] close economic relations by promoting trade and investment,

facilitating market access, improving the flow of technology and enhancing the flow of and access to trade and investment related information.’²⁶⁷ It is important to note that in the opening mark of the Statement, all of these commitments are applied to both ASEAN as a whole and individual ASEAN members. With this newly-gained status, the Chinese President Jiang Zemin attended the sixth informal APEC leaders’ meeting in Kuala Lumpur in 1998, and appealed for the prompt WTO accession to applicants in accordance with WTO rules as well as a view towards achieving the universality of WTO membership in order to facilitate trade and investment liberalization for ‘achieving an overall balance of interests of all members’.²⁶⁸

*3.3. Increasing economic strength through concerted voice: 1999-2005*²⁶⁹

China’s FEP as a whole in the 2000s began to shape in the aftermath of the AFC and the preparation for its WTO accession; the FEP measures toward Malaysia from 1999 to 2005 therefore were placed in this grand design. In line with China’s support for capital and currency control policies introduced by Malaysia after the breaking out of AFC (Balakrishnan, 2006: 62), the accentuated feature of China’s FEP measures towards Malaysia is the cooperation in finance. In addition to work with Malaysia to reform the international financial management system, the People’s Bank of China (PBC) reopened its Malaysian branch in 2001 as significant and reliable financial channel in conducting bilateral trade and investment. In October 2002, the PBC signed the *US Dollar/Malaysian Ringgit Currency Swap Agreement* with the Bank Negara Malaysia (BNM). According to the agreement, the PBC will make available to BNM convertible currencies equivalent to US\$1.5 billion when necessary as a supplement to financial assistance provided by the international financial institutions in the event of balance of payments (BOP) difficulties

²⁶⁷ Full text of the *China-ASEAN Joint Statement* is at <http://www.aseansec.org/5476.htm>, signed in Kuala Lumpur on 16 December 1997. Last accessed in February 2009.

²⁶⁸ Full text of the APEC Economic Leaders Declaration: Strengthening the Foundations for Growth is at http://www.apec.org/apec/leaders_declarations/1998.html, signed in Kuala Lumpur on 18 November 1998. Last accessed in February 2009.

²⁶⁹ This section is based on the information revealed in three important policy documents regarding the future prospects of bilateral relations, namely the 1999 *Joint Declaration of Future Bilateral Cooperative Framework* (note 226) and the two Joint Communiqués signed in 2004 and 2005 (note 229 and 230), respectively.

in Malaysia to maintain financial stability. This generous offer in fact is the fourth of its kind under the Ching Mai Initiative adopted under the APT framework;²⁷⁰ as part of the implementation of Beijing's commitments in promoting sustained development of monetary and financial cooperation in East Asia, the stable financial system is viewed as the necessary condition for China's 'going out' (*zouchuchi*) FEP strategy. As a policy bank, the Malaysian branch of PBC has played a role in providing funds for the two countries to invest in each other's infrastructure; more importantly, it is also a foothold for the China-Malaysia JVs to invest in the third countries. In terms of China's the other important FEP strategy of 'promoting trade with science and technology' (*keji xingmao*), Beijing encouraged the joint research in agriculture and source exploitation, especially in oil and gas. In the high-tech field, Beijing particularly promotes Chinese investment in Malaysia's BioValley plan, which is designed to attract biotechnological and IT industries. In 2005, the state-owned China Ocean Shipping Company (COSCO) set up a holding subsidiary in Malaysia, which marked the transfer of China's headquarter of investment and management in ocean transportation in Southeast Asia from Singapore to Malaysia. With regard to bilateral preferential trade agreement (PTA), a study group has initiated in 2005 for the feasibility of the China-Malaysia Close Economic Partnership Agreement.

All of these FEP measures toward Malaysia in line with China's 'do thy neighbors good and keep thy neighbors company' (*yulinweishan, yilinweiban*) foreign policy principles in the 2000s reward Beijing a reliable alliance in multilateral trade institutions. Malaysia not only supported China's WTO entry by concluding the bilateral agreement in 2000, but also signed an MOU on cooperation of WTO/TBT rule in May 2004. Malaysia also recognized China's full market economy status in the same year, which is viewed beneficial to Beijing's fight for fair treatment in the WTO.

²⁷⁰ Information is available at <http://www.pbc.gov.cn/english/detail.asp?col=6400&ID=194>. Last access in March 2009.

4. FEP results: characteristics of bilateral trade and investment

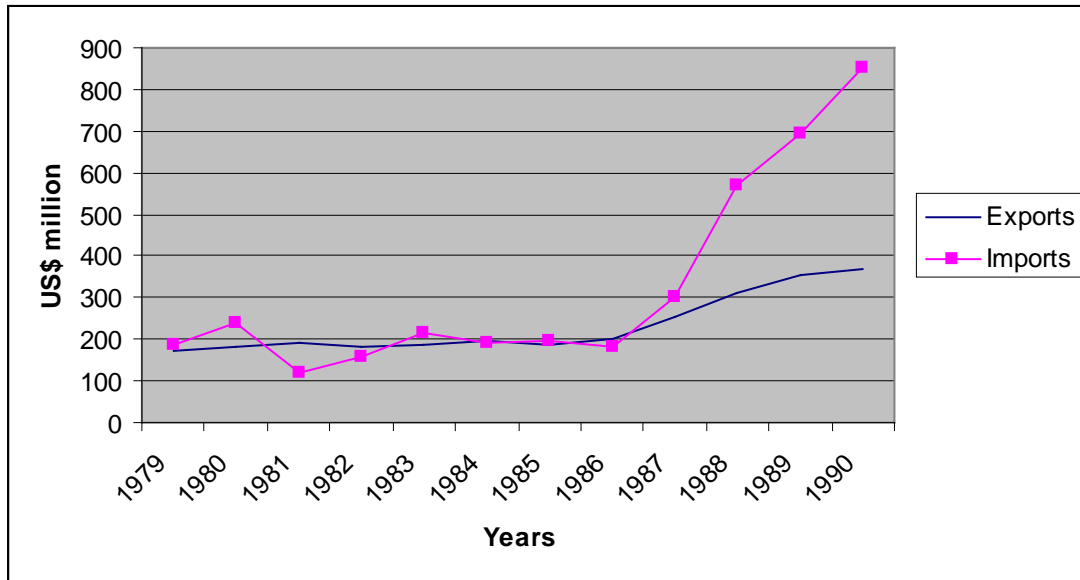
Beijing's deliberate avoidance of provoking the nationalistic sentiments of Malaysian government and the consequentially drifting FEP measures, as discussed in previous sections, reflected on the small volume and slow growth of bilateral trade until the mid-1980s. Yet notwithstanding the Malaysian trade discrimination against Chinese exports, bilateral trade appeared slightly in favor of China during the period of 1979-1984, as demonstrated in Figure 5.1. The figure also reveals the impressive increase of China's imports from Malaysia in the second half of the 1980s, which is the result of Beijing's promise of helping Malaysia going through economic recession by enlarging the imports from Malaysia as the concrete proof of China's sincere friendship. The imports expansion during this period concentrated on raw materials; for example, in 1990, the main imported commodities were palm oil (36.6%), cork and wood (23.7%), rubber (15.8%) as well as petroleum and related products (6.7%).²⁷¹ Although the share of raw materials to the overall imports from Malaysia has declined over time, they have remained major imported commodities. This fact implies that although Malaysia gained more from the bilateral trade in terms of increased national income, China secured the supply of quality raw materials to support its industrial needs; in fact, 70% of China's imports of palm oil were from Malaysia in 2005; China has been also the largest importer of Malaysia's rubber. This vantage is expected to maintain with the implementation of Early Harvest Package (EHP) under China-ASEAN FTA (CAFTA), which offered lower tariffs and elimination of trade barriers to agricultural products to ASEAN members, including Malaysia, from July 2005 (Li, 2006: 134).

Since 1989, the bilateral trade has steadily grown while the feature that the volume of imports surpassing in exports has remained (see Figure 5.2); it makes Malaysia the biggest source of trade deficits in ASEAN for China. Malaysia displaced Singapore as

²⁷¹ Information is from UN Comtrade online database. For data consistency, I use commodity category of SITC Rev.2 for the analysis of the study.

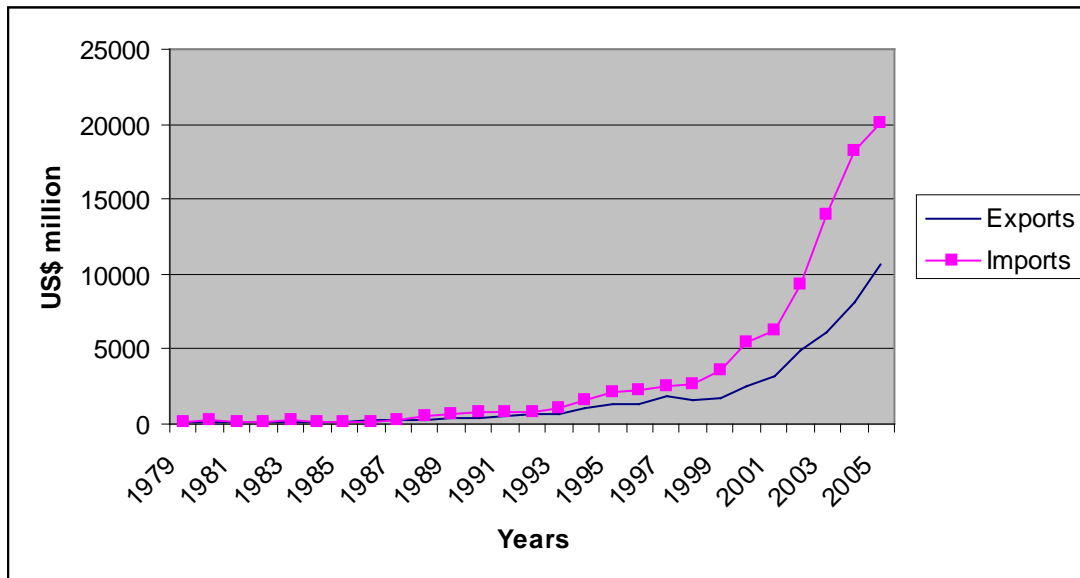
China's top trading partner in ASEAN in 2002 and 2003; it then became China's eighth largest trading partner in 2005.²⁷²

Figure 5.1 China's trade with Malaysia, 1979-1990



Source: IMF.

Figure 5.2 China's trade with Malaysia, 1979-2005



Source: IMF.

²⁷² *Zhongguo Shangwu Nianjian [China Commerce Yearbook]*, 2006: 719.

Along with the gross increase in imports from Malaysia, the other significant trait of bilateral trade since the mid-1990s is the emergence of trade overlap (two-way trade) in apparatuses and appliances of electric machinery (SITC 77), telecommunications, sound recording and reproducing equipment (SITC 76), as well as apparatuses and appliances of office machine and automatic data processing equipment (SITC 75). In 2005, the three commodity groups constituted 69.3% to China's total imports from Malaysia, while they took the combined share of 46.4% to China's exports to Malaysia.²⁷³ Indeed, the growing secondary exports fit China's overall FEP strategies of 'score with quality' (*yizhiqusheng*), namely to preserve its exports share in the world market through structural upgrade of exports composition, and market diversification (*shichang duoyuanhua*) since the 1990s; yet in terms of Sino-Malaysian trade, it reveals an important aspect that China has intensified its participation in global production networks through the two-way trade in parts and components with Malaysia.

Since China's opening up in 1979, it has achieved the striking trade performance through strong involvement in the international division of labor, as evidenced by the inceptive FEP measures of promoting export-processing industries. In other words, China has participated in the increased interconnectedness of production process in a sequential, vertical trading chain that stretches across countries, with each country specializing in a particular stage of a good's production (Devadason, 2009: 38). The production networks have deepened in East Asia throughout the 1990s with the outsourcing strategy of multinational enterprises (MNEs), while assembly and processing of imported inputs for re-export, not only have accounted for about half of China's overall foreign trade, but also have allowed China's rapid diversification from textiles to electronics (Gaulier *et al*, 2007: 210). With both the comparative advantages and the policy support, China has emerged as the production base in East Asia; it implies that intra-industry trade of the key sectors between China and its East Asian neighbors would be strengthened, while the real competition with neighbors in foreign trade would locate in China's industrial capabilities of moving up on the production ladder from simple assembly of imported inputs to higher value-added goods and services. Theoretically, this situation might

²⁷³ Information is from UN Comtrade online database.

suggest the phasing out of the mercantilist prediction of large trading countries' political strategy towards smaller partners because instead of simple manipulation of bilateral trade, intra-sectoral progression aiming at quality improvement of final goods exporting to the third markets would be more critical for trading countries to enhance their national power; yet the progression cannot be independent from the collaboration with trading partners, particularly when they are at similar stages of production chain and are somehow dominated by the global business arrangement of MNEs. In practice, it means China's political pledge of pursuing common prosperity shared with ASEAN is not baseless; in the case of bilateral trade with Malaysia, the intensification of intermediate trade within electrical machinery sector (SITC category 7), namely the mutual reliance on sending and receiving components and parts along the same production chain, would support each other's development of the electronics industry and therefore benefit the foreign exchange earning as well as foreign-trade propelled domestic economic growth, especially when the component trade has grown faster than trade in final manufactured goods (Athukorala and Yamashita, 2006). The circumstance that China's sustaining economic growth is to some extent subject to global production fragmentation might fundamentally weaken Beijing's incentive for political dominance over trading partners because the more useful means is either to squeeze out trading partners from the higher stage in the same production chain or to foster its own production system including raw material supply, production, marketing and design as the ultimate goal of building up a 'grand trade' (*da jingmao*) system of China's second-step FEP strategies. The initial fruit of such FEP strategies is the gradual decline of China's dependence on Malaysia for component supplies; China now seems to turn to developed countries for higher-quality inputs, which also reflects the rapid escalation of parts transactions among foreign affiliates (Lemoine and Unal-Kesenci, 2002), and has become capable in producing sophisticated final goods at competitive prices (Engardio, 2006).

Comparing with the booming bilateral trade, the direct investment from Malaysia to China has been very small. The accumulated utilized amounts of investment up to 2005 was only \$3.83 billion and took the tiny share of 0.62% to China's total accumulated

utilized FDI.²⁷⁴ China's direct investment in Malaysia is even smaller; up to 2005, the accumulated amount was slightly higher than \$1 billion (Balakrishnan, 2006: 65). The fact that no consistent data about bilateral investment flows available from China's major official publications implies the relative insignificance of bilateral investment in Sino-Malaysian economic relations; which means that the two countries are not each other's main investors. Along with the enhanced intra-industry cooperation with Malaysia, for China, to move up the international production ladder also means the opportunity to attract more capital and more advanced technology from MNEs that are the shared principal investors for both China and Malaysia. This again suggests that, to increase the national strength, it does not necessarily need to go through the creation of asymmetric reliance for Malaysia; as long as China could maintain the current cooperation with trading partners including Malaysia, it is highly likely for China to develop at a faster pace and outperform Malaysia as the warning that Malaysia has lost FDI inflows to China since the second half of 1990s (UNCTAD, 2002).

5. Conclusion

The argument presented in this chapter is structured by the detailed examination of the formation of political alliance between Beijing and Kuala Lumpur and China's FEP measures towards Malaysia, followed with the analysis on trends of bilateral economic relations as the evidence to help answer the central question of the study that what has motivated China to pursue closer relations with individual ASEAN members. The China-Malaysia case suggests that Beijing has tried to work together with Kuala Lumpur to fight for alternative international political and economic orders, which are viewed as the guaranty to the intact Chinese interests. Yet as the parallel strategy, China has been actively integrating into the existing games to minimize immediate threats and maximize gains; for example, Beijing has appeared to crowd out the influence from extra-regional powers politically but at the same time acquire better position in the international production chains managed by MNEs. Different from the classic mercantilist prediction, the increasing Chinese national power does not necessarily need to be at the expense of

²⁷⁴ *Zhongguo Shangwu Nianjian* [China Commerce Yearbook], 2006: 306.

Malaysia's dependence on China; rather, the consolidation of alliance with Malaysia not only brings about better footing for China in the current international games but ushers the possibility of alternative sets of rules in the future. Based on the examination of the three aspects of bilateral relations, I argue that to politically dominate Malaysia is not Beijing's motivation; somehow surprisingly, the pursuit of economic development through 'shared prosperity' with Malaysia and the competing international order, with the resistance against the current predominance, particularly from the US, appears to be Beijing's major concern.

Chapter 6: Conclusion - Path to Prosperity

1. Introduction

This thesis argues that China's FEP towards individual ASEAN members is more likely to be motivated by the pursuit of national prosperity. By tracing the evolution of China's national FEP from open up in 1979 to the realization of general commitments to the WTO accession in 2005, it clearly demonstrates that China has sought to acquire and maintain the gains from its broad foreign economic interests through the unilateral liberalization and the participation in global trading institutions. The examination of China's bilateral FEP towards Vietnam, Singapore, and Malaysia, directly challenges the realist assumption that to achieve power ascendancy through the creation and consolidation of trade asymmetry is the most likely intention of the large trading state's management of bilateral economic relations with the small partners. Instead, the concerns of raising the national income and sharpening the national competitiveness have appeared as the critical determinants of China's responses to the demands of enhancing bilateral economic cooperation from the three cases. The main findings from this thesis thus suggests that China's FEP behaviors in the open era are consistent with the liberal expectation; the perceived underlying stake in the unabated economic growth seems to determine China's cooperative actions at different levels, while the criteria are the calculations of welfare effects.

The summary of main findings will be conducted through the examinations with my analytical framework in section 2; it will cover the three major 'indicators' drawn from the realist expectations about foreign trade, including the state's preference order of trade cooperation, the rationale that China should take initiatives to ensure the advantageous relative gains from trade, and the critical intervening variables of political relations with the three partners to China's design and practice of bilateral FEP. The reflection upon the scope and validity of my conclusion, as well as the limitation of my primary research will be discussed in section 3. Finally, the implication of rising China's pursuit of plenty to the distribution of international power will be considered in section 4.

2. Summary of the main findings

2.1 China's revealed preference order of trade cooperation

Derived from the realist expectations about states' utmost concerns in relative gains from foreign trade, if China's FEP is motivated by power/influence expansion, China's preference order should be seen as bilateral cooperation > regional cooperation > multilateral cooperation > unilateral liberalization. Cooperation at both bilateral and regional levels should aim to create and consolidate partners' asymmetrical economic dependency on China, while the expected political gains originated from both coercive and influence effects are more certain in bilateral relations. As to the cooperation at multilateral level, because the 'mediator' of international trading institutions is viewed essentially as the platform of distributional conflicts over economic gains, China is expected to actively participate, or even encourage the competition among trade blocs in order to increase its own bargaining leverage against US as the principal adversary. With the same logic, China is not expected to adopt unilateral liberalization because the market power may dictate the patterns and distribution of gains from trade, thus adversely affects the accumulation of national wealth for military strength. However, the findings from this thesis show the completely different preference 'hierarchy' of China's FEP behaviors.

The examination of the evolution of China's national FEP since open up in Chapter 2 demonstrates that for Beijing, the unilateral liberalization has been the most important means to raising national income to support the economic modernization program as the reformist leaders' solution to the consequence of previous autarky. It explains the 'dualistic' feature of China's national FEP in the 1980s – to promote processing exports through the use of tax incentives for attracting the FDI, while to depress imports for balance of payment (BOP) and protecting the domestic sectors from international competition. The scope of protectionist measures had been progressively declining since 1992; although it had resulted from the US pressure, Chapter 2 finds that the gradual opening of domestic market had served China's strategy of ensuring the broad foreign

economic interests through the participation in multilateral institutionalized cooperation. The quest for gains that were otherwise unavailable, such as exclusive information, constraints on discriminatory treatments from China's key trading partners, particularly the US, and the efficient mechanism for dispute settlement, is the main driver of China's pursuit of GATT membership since 1986; when this attempt formally failed in 1994 caused by the political considerations of the GATT contracting parties, the lowering of tariff rates to the MFN level and the phasing out of extensive NTBs had become the centerpiece of China's negotiations for the WTO protocol. The findings from Chapter 2 suggests that the attempt on maintaining the unprohibited access to major export markets through the 'reciprocal' opening of domestic economy is the major reason behind Beijing's insistence upon the WTO accession, because the national economic growth has increasingly relied on the continuing export expansion as the significant consequence of China's open policy.

As the reflection of Beijing's calculations of potential welfare effects, this thesis finds that the regional trade cooperation has functioned as the complements to China's unilateral liberalization and the pursuit of multilateral cooperation. Although the economic growth has accrued from the promotion of export and FDI, China's domestic sectors still remain vulnerable to international competition; thus, China has sought to participate in the APEC and to strengthen the cooperation with ASEAN as a whole for the long-term economic capacity building. Chapter 2 finds that along with the strenuous negotiations for GATT/WTO membership, the APEC seems to promise China the alternative to the long-term national economic development, because it allows China more flexibility on the scope and pace of market opening, as well as the possibility to diversify China's exports from the reliance on the major markets of US, EU, and Japan. Instead of taking an active part in the competition between the Western neo-liberal and the East Asian state-involved models of development for its own bargaining power in the APEC, China is seen to enhance the various forms of economic cooperation with other developing countries, particularly the ASEAN collectively. Although such attempts have been facilitated by the mechanisms of APEC, the institution's inherent weaknesses of providing expeditious and appropriate assistance to the members were highlighted after

the breakout of Asian Financial Crisis (AFC); it played the catalyst role for China to seek the deepened cooperation with ASEAN proactively, as embodied in the various projects under the ASEAN plus Three (APT). Against this background, the proposal and establishment of China-ASEAN FTA could be viewed as the concrete reflection of China's pursuit of enlarged welfare effects through trade creation and closer policy coordination for economic facilitation with ASEAN. The important finding here is that, for China's overall calculations of actual and potential welfare effects from foreign economic activities, the bilateral cooperative approach might be the least beneficial one; it explains why the management of bilateral trade cooperation appears low on China's national FEP agenda but is often emphasized as the key component of China's 'good-neighboring' orientation of foreign policy. The examination so far clearly shows that China's preference order of transnational economic exchanges in the open era has been unilateral liberalization > multilateral cooperation > regional cooperation > bilateral cooperation, which is consistent with the liberal expectations about the states' behaviors in seeking national prosperity.

2.2 Did China initiate changes in bilateral economic cooperation?

Following the insights of Albert Hirschman ([1945] 1980), my analytical framework considers that if China intends for political domination through the employment of economic statecraft, it should meet two critical conditions: 1) the bilateral trade relationship is the foremost target of China's national FEP; and 2) the aim is to create and consolidate the partners' asymmetrical trade dependency on China. For the former, it is because the manipulation of bilateral trade promises the most certain political gains for China as the much larger partner, while to ensure the advantageous result, China is expected to take initiatives. For the latter, the partners' asymmetrical trade dependency on China is expected to grant China the 'coercive' and 'influence' power through the threat of disrupting the commercial ties and the reshuffling of state preferences of partners, thus constitutes the foundation of China's political domination. The preceding section has illustrated that bilateral cooperation for trade appears as the least beneficial option of China's national FEP, which is consistent with the liberal logic that to meet the

aggregate societal demands for economic growth, the calculations of welfare effects would be the more likely determinant of China's foreign economic behaviors; this section will present the evidence from Chapter 3, 4, and 5 to show that somehow contradicting the association between the realist expectations and China's emphasis on 'good-neighboring' orientation of foreign policy, the development of bilateral economic relations were initiated, and have been push forward, by the governments of Vietnam, Singapore and Malaysia.

Although only starting from the late 1980s, Chapter 3 finds that Vietnam's approach to China is out from the similar consideration of Malaysia. The perceptual shift that Vietnam's fate would be determined by economic race and the radical changes in Soviet foreign policy motivated Vietnam to set economic development as its top priority through the cooperation with other states, including China. Yet, although economic cooperation has been claimed as the key component of bilateral relations in numerous statements, the ongoing territorial disputes remained the top issue throughout the 1990s; this observation is further backed by the finding from Chapter 3 that when Vietnam put the bans on imports from China in order to protect domestic production, China did not respond with corresponding measures. Among ASEAN member states, Vietnam has the highest growth rates of bilateral trade with China, but the examination in Chapter 3 suggests that it should be attributed to the backward developmental level of Vietnam, rather than the manipulation of China's bilateral FEP.

Among the three cases, Singapore is the first to pursue the bilateral economic cooperation since the inception of China's open up. Chapter 4 finds that being aware of Beijing's search for appropriate developmental models, Singapore has been keen to make its own experiences useful for China; in addition to the economic gains from bilateral trade and investment, this policy choice is mainly motivated by Singapore's national security consideration. Reflecting the belief of significant policymakers of Singapore that the increasing stake in economic cooperation at various levels could effectively decrease the incentive of China's revisionist behaviors, the emphases of bilateral economic cooperation have been the transfer of the 'Singapore Way' – the improvement of public

administration for transnational economic exchanges, as exemplified by the Suzhou Industrial Park (SIP) project, and to incorporate China's foreign business into its own global trading networks. Therefore, Singapore's proposal of the China-Singapore FTA (CSFTA) in 2008 could be viewed as the extension of the same strategy, particularly when China becomes one of Singapore's top trade and investment partners. Chapter 4 finds that China's reasons to conclude the CSFTA swiftly are consistent with the liberal logic embodied in my 'ideal-type' of bilateral preferential trade agreements (PTAs). Comparing with the gains from closer policy coordination for trade and investment facilitation and the less costly domestic adjustment, the CSFTA is expected to particularly serve the precedent setting of the recognition of China's market economy status and the capacity building for future negotiations with others. In the situation that the direct welfare effects from the CSFTA could be small because Singapore's economic significance to China is not as important as other key partners, China's choice of the FTA with Singapore implies more for future cooperation at multilateral levels. This finding thus could be viewed as the additional evidence to back up my argument in the preceding section.

Chapter 5 finds that the advance of trade cooperation with China was also initiated by Malaysia in the mid-1980s. To consolidate the national building, Malaysia had adopted discriminatory measures against the imports from China to ensure the gains of *bumiputera* (i.e. various indigenous ethnic groups in Malaysia); however, the need for extra catalyst to domestic growth and the economic competition against other ASEAN members motivated Malaysia's pursuit of trade and investment cooperation with China, while China's attitude was shifted from drift to welcome accordingly. Different from the previous inaction in bilateral trade as the symbolic support for Malaysia's ethnic-based economic policy, China promised to increase the secondary imports from Malaysia to assist the latter's industrial development. Yet, although Malaysia becomes the most important regional source of imports for China in the early 2000s, Chapter 5 finds that it is not resulted from China's bilateral FEP but the increasing regional intra-industry trade within the electrical machinery sector (SITC 7), which is arranged by the MNEs for their global production chains. This circumstance thus does not meet the conditions of my

ideal-type of bilateral FEP. Albeit the trade imbalance does exist, it is difficult to claim that Malaysia is asymmetrically dependent on China; instead, it highlights the fact that both China and Malaysia have increasingly relied on the processing exports for domestic economic growth, while the foundation of political domination from bilateral trade – the coercive and influence power – may not be in China's hands.

All the findings from the three case studies suggest that China's approach towards individual regional partners tends to be passive. China did not seem to take concrete actions to advance bilateral trade relations with Vietnam, Singapore and Malaysia as what is expected if China intends for political domination through the use economic statecraft; instead, the general orientation appears that China 'welcomes' the neighboring states' pursuit of enhancing bilateral economic cooperation. This orientation thus conforms to China's 'good-neighboring' direction of foreign policy, while it is not costly and may bring gains to the Chinese economy.

2.3 Did China's bilateral FEP vary with the political relationship?

If China's bilateral FEP is motivated by the expansion of power/influence, political relations should be considered as the important intervening variable. On the one hand, my 'ideal type' of bilateral FEP for power expects that China should offer unusual deals so that it could reap the political gains of both coercive and influence power over partners from the economic concession; to ensure this effect, the scope and contents of bilateral FEP should vary with the political relations. On the other hand, bilateral relations may affect China's motive for political dominance in the first place. In this sense, the three case states respectively locate in different ranges of the spectrum. Vietnam may represent a 'soft' case of China's power domination through bilateral trade, because the long-term hostility and the disparities in development levels might strengthen China's motive while the cost could be relatively low. To the contrary, Singapore may represent a hard case, because the amicable relationship and Singapore's higher developmental level imply that China may have lower motive for domination over Singapore, while the cost of such attempts could be high. Comparing with Vietnam and Singapore, Malaysia could be

viewed as the ‘intermediate’ case. Although the relative distance and the good political relationship imply that China might have low motive to achieve power ascendancy over Malaysia, the disparities in economic size and developmental levels suggest that the cost for China to seek political gains from bilateral trade could be low. Surprisingly, findings from the three case studies point that the scope and contents of China’s bilateral FEP towards them are rather similar. In addition to the signature of bilateral agreements on issues of trade, double-taxation and protection of investment as the legal facilitation of economic cooperation, the examinations in Chapter 3, 4 and 5 finds that Beijing’s responses to these partners’ demands for advancing bilateral economic cooperation has reflected its effort to move the Chinese economy towards the general direction of greater openness and market orientation, while this approach has been utilized as the complement of China’s national FEP strategy, particularly since the 1990s. Taken together, the bilateral economic cooperation has strong implication for China’s overall economic development.

China’s management of bilateral economic cooperation with Vietnam, Singapore, and Malaysia is set within the larger national FEP context, while the Western sanctions after Tiananmen could be viewed as a turning point. Chapter 2 finds that this event played the catalyst role for Beijing to seek the upgrade of export commodities and the market diversification to sustain China’s economic growth. For this purpose, the scientific and technological (S&T) cooperation for trade has become the shared focus of China’s bilateral FEP with neighboring countries, while the ultimate goal is to facilitate the establishment of ‘grand trade’ (*da jingmao*) system that aims to integrate foreign trade and domestic production into a cohesive system. To implement this strategy, findings from the three case studies suggest that China seeks to utilize the overall economic advantages of partners to assist the development of specific domestic sectors. For example, Chapter 3 finds that the stress of economic cooperation with Vietnam has been the industrial renovation projects contracted by China’s state-owned enterprises (SOEs) to sharpen their international competitiveness. In the case of Singapore, Chapter 4 finds that the bilateral economic cooperation has centered on the joint research and development (R&D) programs in hi-tech industries and the improvement of domestic

techno-industrial capabilities; while for Malaysia, Chapter 5 finds that China's focus has been the intra-industry cooperation due to the similar roles of the two states in the global production chains in electronics as well as iron and steel.

In addition, examinations in the three chapters suggest that bilateral economic cooperation may serve the establishment of localized 'grand trade' system in the perceived suitable localities. Chapter 3 finds that China's promotion of border trade with Vietnam since the late 1980s, and the opening of the capital cities in Guangxi and Yunnan provinces to foreign trade and FDI since 1992, have aimed to help develop the local agricultural processing industry for export to Indochina through the attraction of inward investment from both neighboring countries and richer regions at home. Similarly, Chapter 5 finds that one of China's emphases of economic cooperation with Malaysia has been to utilize its resources and skills to develop the primary sector in Yunnan and Hainan. Since Guangxi, Yunnan, and Hainan have confronted inherent constraints such as their relatively remoteness and backward industrial foundation to attract FDI, China's bilateral economic cooperation with Vietnam and Malaysia seems to provide the alternative opportunities for local development. In the case of Singapore, Chapter 4 finds that Beijing has particularly encouraged the so-called 'second-tier' provinces – it denotes their current levels of economic growth and industrial potential relative to those opened earlier – such as Liaoning, Zhejiang, Shandong and Sichuan to coordinate with Singapore's 'Regionalization 2000' strategy, so that these provinces could accelerate the integration of local production and foreign trade through Singapore's trading networks. The findings demonstrated in this section thus manifests that China's bilateral economic cooperation with Vietnam, Singapore and Malaysia does not vary with political relations; instead, they have appeared on the same track in terms of supporting the implementation of China's national FEP strategy, which has strong implication for the overall national development.

3. Limitations of this study

3.1 *Validity of the argument*

The overall argument of this thesis is that China's bilateral FEP towards individual ASEAN members in the open era is motivated by the pursuit of prosperity based on my examination of China's economic cooperation with the selected cases of Vietnam, Singapore, and Malaysia. It thus generates the question that how valid this argument could be had I chosen other major ASEAN member states as the cases?

I doubt that my conclusion of this study would be reversed in the case of China's trade relations with Indonesia, the Philippines, and Thailand by considering their approaches towards China, followed with their separate locations in the spectrum of 'how likely China may intend for political domination over specific partners.' Although the shared driver of the three countries' relations with China has become trade, in the political realm, Indonesia has been 'persistently ambivalent' towards China (Sukma, 2002); the Philippines have adopted the hedge strategy; while Thailand traditionally has been bandwagening with China. In Indonesia, albeit the use of China factor for domestic political purposes finished with the fall of President Sukarno in 1998, sources of political frictions have remained. First, although Indonesia agreed to acknowledge the 'One China' policy in return for Beijing's affirmation of Chinese support for its national unity and territorial integrity in 1999, Indonesia appears to lag behind other ASEAN members in responding to Chinese pressure on Taiwan. Second, although trade and dreams of Chinese investment to reverse the 1997-2004 decline in FDI to help Indonesian economic growth is at the heart of the changing bilateral relations, worries about the Chinese competition against local manufacturing,²⁷⁵ as well as indigenous Indonesians' long history of resenting the economic role of the ethnic Chinese minority, could be easily conflated. Third, Indonesia's self-perception as the leader of ASEAN implies its

²⁷⁵ See, for example, 'China's Economic Power Unsettles the Neighbors,' *New York Times*, 10 December 2009. Available at http://www.nytimes.com/2009/12/10/world/asia/10jakarta.html?_r=2&hp; accessed on 12 December 2009.

uneasiness about China's emergent leadership in regional cooperation, which was reflected on Indonesia's push for an ASEAN community in 2003 and the opposition to the Chinese-Malaysian domination of early planning for the East Asian Summit (EAS) in 2005. Thus, although China has made overture to Indonesia as the signature of a 'strategic partnership' in 2005, it may not have too many immediate effects on these issues that will continue to influence Indonesia's China policy (Percival, 2007).

In the case of the Philippines, although the perception of a 'China threat' to security remains, the need for continuing gains from bilateral trade and Chinese investment for the stumbling domestic economy becomes the key of bilateral relations. From the establishment of diplomacy in 1975 to 1995, the bilateral relations were largely uneventful and stable; in addition, the exports of oil to China helped ease the Philippines' economic difficulties brought by the steep decrease of global oil price (Lim, 1999; Pablo-Baviera, 2002). Yet, China's occupation of Mischief Reef within the Philippines' claimed area in South China Sea in 1995 is the turning point of the Philippines' foreign policy; it thus sought to renew its traditional military alliance with the US. The suspicion about China's external ambition has persisted even after China's signature of the Code of Conduct of the Parties in South China Sea in 2002, which explains why the Philippines still relies on the US for external defense. Nevertheless, the rapid growth in bilateral trade (in which the Philippines enjoys a substantial surplus) and the beginning of Chinese investment have made the Philippines to improve the bilateral diplomacy; in addition to the open assessment that Manila considers China as a 'responsible power' in the international arena, and the acceptance of Chinese proposals for defense cooperation. Yet, being wary of the looming competition from the Chinese imports, the Philippines postponed its participation in the Early Harvest Program under the China-ASEAN FTA until 2005 (Percival, 2007).

Among ASEAN states, Thailand is assessed to 'eagerly snuggled up to China,' particularly since the Asian Financial Crisis (AFC). Percival (2007) argues that Thailand's management of bilateral relations with China is the reflection of its traditional diplomatic philosophy of adjusting to shifts in power and influence to protect Thailand's

room for maneuver. It explains Thailand's turning away from the US to China since the AFC with the expectation of Chinese patronage for the domestic economic growth. For China, Percival (2007: 47-49) argues that it sees the bilateral relations as a model for the region: strong personal ties and a growing network of cultural and security linkages complement booming trade relations. Strategically, Thailand could serve as China's potential counterweight to Hanoi should Vietnam's ambition in Indochina revive, and the bilateral cooperation on transportation route is essential to the development of China's landlocked Southwestern region. The amicable bilateral relations are reflected on the fact that Thailand is the first ASEAN member states that Hu Jintao visited in his presidency, and China has backed Thailand's initiative for a regional discussion forum entitled the 'Asia Cooperation Dialogue' by hosting one of its annual meeting in 2004. In the economic realm, Thailand has long run a trade deficit with China; and although the Early Harvest Program was aiming to grant the preferential market access to the agricultural products from ASEAN, the sector in Thailand has confronted severe competition from the cheaper agricultural imports from China.

The quick survey of the bilateral relations between the three major ASEAN member states and China shows that the advance of bilateral economic cooperation is pursued by the small partners, regardless of their various political approaches and the degrees of worry about the competition against Chinese products. In addition, the rapid growth of bilateral trade is not resulted from China's offer of unusual deals. The two significant indicators thus are consistent with the result of my case studies. The survey also suggests that the locations of Indonesia, the Philippines and Thailand in the spectrum of China's likely motive for political domination might be similar to the set of Vietnam, Singapore, and Malaysia. In the case of Indonesia and the Philippines, although disparities in economic development means that the cost to generate political ascendancy from trade could be low, their distance from China, the complicated domestic political dynamics in Indonesia and the Philippines' security alliance with the US implies that China may not intend for such attempts in the first place. In the case of Thailand, it presents a similarly 'intermediate' case; the amicable bilateral relations imply that China may have low motive in seeking political dominance over Thailand, but Thailand's pursuit of China for

the economic patronage implies the cost of such attempt could be low. The closer examination of China's bilateral FEP towards the three major ASEAN member states in the future may provide more solid evidence to back up this observation.

3.2 Scope and limitations of the argument

Although this thesis concludes that China's bilateral FEP towards Vietnam, Singapore and Malaysia is motivated by the aspiration for prosperity, this study does not cover the exploration of why China pursues national wealth. Although the fundamental assumption of liberal IR theories is that the state, as the representative institution, has to constantly respond to the aggregate societal demands and it determines the state's foreign behavior, the other equally important assumption is that the state's revealed policy preference is constituted by the configuration of different perceived interests in the society, including economics, security, and ideology. This assumption clearly points the competition among different concerns that could directly influence the national policy and the possibilities of the policy changes accordingly. A few possible domestic reasons for China to pursue the export-propelled economic growth are extensively discussed in the literature – such as to balance the developmental disparities in different regions at home, to raise the living standards so that the social stability could be ensured, and the increasing integration of business lobby into the policy process; yet, to examine and compare their actual effects on the making and implementation of China's bilateral FEP is beyond the scope of this study.

The other limitation of this thesis is that the research heavily relies on the printed Chinese materials, rather than the in-depth interviews with officials in charge of China's foreign economic affairs with Southeast Asia. Although my failed attempts are not unusual among others who are doing policy analysis of Chinese politics, it means that I had no opportunities to receive the different interpretations, or information that are unavailable from China's policy documents as the useful challenges from within the 'black box.' Under this circumstance, I cross-check the documented Chinese behaviors from secondary materials with the Chinese official newspapers to ascertain Beijing's stances

and whether these stances affect the development of China's bilateral FEP; this approach may risk the somehow over exaggeration of China's 'passive' attitude in the economic affairs with Vietnam, Singapore, and Malaysia. Although the confirmation of China's 'inaction' from its own domestic press seems to eco the usually missing parts in the secondary literature on China's FEP, the observation would gain the more solid backup if the affirmation and explanations from Chinese officials could be integrated.

4. Implication of China's pursuit of plenty

Although the major expectation from the liberal IR theories is that the pursuit of national prosperity could effectively increase the cooperative behaviors among states, the tradition did not deny the possibility of wars. For realists, the possibility of wars and zero-sum power/influence competition in the international society always loom large, particularly because no one can be perfectly certain about the others' intentions. This logic implies that even a state appears cooperative and prone to peace today, it could only be the tactics to increase the national military strength unabatedly for the state's aggression in the future. The reason for such tactics is for the accumulation of national wealth and in the current world, the most beneficial source of prosperity is international trade.

Informed by the realist logic, the interpretations that China intends to consolidate its political influence upon ASEAN through the use of its economic power to leverage, and ultimately compete against the US predominance in the region are not ungrounded. On the one hand, with the enforcement of the China-ASEAN FTA on 1 January 2010, the economic future of ASEAN will be inevitably tied together with China, and it is too early to predict that whether ASEAN will be able to adopt any effective countermeasures to the server competition against China, or to narrow the economic disparities. On the other hand, although the US has sought to deepen the cooperation in security and economics with ASEAN as a whole, the attempts so far have confronted a lot of difficulties. Thus, when the Chinese economy is expected to gain the new momentum to the continuing growth that would be the foundation of the Chinese military modernization, ASEAN may lose its bargaining power to the Chinese demands in the political realm. In this game, the

future role of the US is still uncertain. This consideration therefore leads to the last caveat of this thesis that my conclusion could be tentative. The span covered by this study is only from 1979 to 2005, and the argument that China's bilateral FEP during this period was motivated by prosperity may not be applicable to explain China's policy in the future.

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