

A Prospect toward Regional Integration from China's Point of View¹

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1. Introduction

East Asia is a crossroad between a realist world and a liberalist world. As Urata and Miura (2012) pointed out, a movement toward regional integration in Asia has become very active from the beginning of this century. Haba (2012) showed a current picture of this region with multilayered regional cooperation frameworks, which often include external partners. In May 2013, 16 Asian countries came to a bargaining table to start a negotiation for a new framework of the Regional Comprehensive Economic Partnership (RCEP). It is apparent that most Asian countries are now sharing common interests in promoting regional cooperation. In this sense, many differences and varieties in political systems, religions, languages, sizes, levels of economic development, culture, and so on, do not seem substantive obstacles to facilitating regionalism in East Asia. Many of the regional members are sharing the common values of capitalism and globalization.

However, recent bilateral disputes over territories, for example, Sino-Japanese disputes over the Senkaku Islands (Diaoyudao), Korean-Japanese disputes over Takeshima (Dokdo), Sino-Philippine disputes over the Scarborough Reef (Huangyan), and Sino-Vietnamese disputes over Spratly Islands, are casting dark clouds over East Asia. Repeated disputes over territorial issues within the region suggest that nationalism may easily destroy the germ of regional communication. The realistic aspects of this region have not damaged a major regional framework such as ASEAN plus three (Association of Southeast Asian Nations² plus China, Japan, and South

Korea). But a trilateral finance ministers' meeting among Japan, China, and South Korea, all of which were parties involved in recent disputes, was forced to stop in 2013.

From a perspective of realism, it can be said that China is involved in most of the territorial disputes in East Asia and is often criticized for recent attempts to resolve the disputes by force. China's hard-liner stance over Senkaku, Spratly, and Paracel will damage her accumulated diplomatic efforts for confidence building with neighbors. Needless to say, as the second economic power in the world, China's influence in East Asia is increasing not only economically but also militarily. Today, it is very controversial whether her increasing influence is positive or negative for the region. More importantly, we must ask whether China has a will to promote East Asian regional cooperation.

Based on China's responses to the international environment after the economic reform, this study clarifies how she intends to commit to East Asian regional cooperation. First, I will briefly mention recent studies of regional integration to clarify Asian characteristics compared to the EU. Second, based on studies about Chinese diplomacy published by Japanese and Chinese scholars, I will argue that there is a transition of Chinese diplomacy from bilateralism to multilateralism. I also discuss domestic factors behind the promotion of multilateralism. Third, I will explain major parts of China's free trade agreement (FTA) network with ASEAN, Hong Kong, and Taiwan. The arguments of this section indicate that China tends to give first priority to political interests in signing and implementing FTAs. Fourth, I will examine the current situation of currency internationalization by the Chinese government. The arguments of this section suggest that it is the nature of the Chinese Communist Party (CCP) to keep control over economic activities. In the fifth section, I will point out two possibilities that can put the Chinese government in a difficult position in the furthering of regional cooperation. Finally, I will summarize three characteristics of China's attitude toward the East Asian regional integration.

2. Arguments on regional integration and East Asia

There are two major trends in the study of regional integration. Scholars who pay attention to spatial expansion of regionalism argue that regional cooperation

networks are spreading across the world, from Europe and North America with highly institutionalized entities to other areas, such as South America, East Asia, South Asia, Africa, and the Pacific Rim. Despite different levels of institutionalization, regionalism is welcomed as an effective way to survive globalization. Haba (2012) also pointed out that an intraregional network between EU and ASEAN was concluded because economic dynamism of East Asia was very attractive to the European world.

Other scholars emphasize the quality of regional integration. They put EU at the highest level of regional integration because its members accepted a single currency. Tanaka (2010) explained the EU experiences and the long process that led to the birth of a single currency and indicated that the two major regional actors maintained strong political intentions toward monetary integration. European actors often faced conflicts over mutual interests and were pressured to make difficult decisions facing dilemmas between regionalism and nationalism. The adoption of a single currency meant that they prioritized regional cooperation against domestic resistance at the end in order to avoid an abortion of the integration initiative.

Things are different in Asia. Because the East Asian economic powers, Japan and China, do not have strong leadership to overcome domestic nationalism respectively, ASEAN has played the role of a pivot in East Asian regionalism. It is worth saying that ASEAN has made a great contribution toward drawing the regional economic powers to a negotiation table.

As many scholars have often indicated, the very features of East Asian regional cooperation lie in a lower level of institutionalization, a de facto integration, and a market-oriented regional integration (Urata & Miura 2012:7). These features are still positive in this region, but the members are gradually coming to orient more institutionalization in the 21st century. Four factors can be seen behind this trend. First, the European single currency and further development of North American regionalism prompted East Asian countries to take a new step toward institutionalization. They were unwilling to be left behind again. Second, facing a long stalemate of the Doha Round of the World Trade Organization (WTO), the East Asian countries tended to promote bilateral or regional-based FTAs as complementary. Third, the rapid increase of intra-regional trade in East Asia for two decades supported the liberalist idea of promoting regional integration (see Urata & Miura 2012). Fourth, a mechanism for

increasing FTAs was created in the Asia Pacific region. When a contracting party of a specific FTA and a non-contracting party have economic relations in trade and investment, the latter has to bear disadvantages caused from non-membership. In order to avoid disadvantages and costs, the latter side is motivated to conclude another FTA with the former (Nakagawa 2013: 203-204). The accumulation of this cycle rapidly increased FTAs in this region.

The above arguments were mainly made by liberal economists. Scholars from international relations and political sciences often pointed out that too much diversity hindered East Asia from regional integration, namely, heterogeneous economic development levels, different political systems, religious and linguistic diversities, geographical diversities, historical grudges, and still-divided nations as a heritage of the Cold War. Except for North Korea, however, East Asian countries overcame these impediments under a strong demand for economic development. The so-called "communists" such as China and Vietnam were not exceptions. After short-term ideological disputes at home, they finally jumped on the bandwagon of capitalism and allowed incomplete freedom in exchange for economic prosperity. Leaving issues on balances between economic prosperity and permanent values such as human rights and freedom open, we can expect for a dominance of liberalism in East Asia in the future. However, the realities around the East China Sea and the South China Sea remind us realist perspectives. In this situation, how can we evaluate Chinese presence in terms of regional integration?

3. China's transition to multilateral diplomacy

3.1 Changes in diplomatic approach

Many scholars studying Chinese foreign policy agreed that there was a transition from bilateral diplomacy to multilateral diplomacy in the 1990s. Zhao Hongwei (2011) insisted that the transition occurred before 1997. According to his argument, East Asian regionalism was initiated by the then prime minister of Malaysia, Mahathir, who first approached China in order to bring Japan into the East Asian Economic Group. At that time, China was pleased to accept the Mahathir's proposal because Malaysia was the first country that accommodated an official visit of the then prime minister, Li Peng, after the Tiananmen massacre of 1989. ASEAN states were less hostile to the

CCP's crackdown at the Tiananmen Square, since they also had authoritarian regimes. On the grounds of the responses of the ASEAN states, China placed importance on a good-neighbor policy to avoid intraregional isolation.

However, considering the situation then, it seemed that China could not afford to support the idea of regionalism in the early 1990s. After the Tiananmen massacre and the following events of democratization in East Europe and the end of the Cold War, China reconstructed its own foreign perception and defined the world as being under the control of globalization and unilateralism of the United States. Since then, concerns about the United States have become dominant in China's foreign policy. It was a period of "*tao guang yang hui* (to keep a low profile)." When the U.S.-led economic sanctions were lifted, the Chinese authority made great efforts to resume diplomatic relationships, mainly with developed countries³. The authority also had to handle the Taiwan issue⁴. Moreover, China was struggling to accelerate domestic economic reform and growth, both of which were hindered for a couple of years because of the economic sanctions. It can be said that the main purpose of China's good-neighbor policy toward ASEAN was to avoid regional isolation, no more and no less.

Not a few sinologists regard 1997 as a turning point for Chinese diplomacy. Takahara (2003: 60) argued that China shifted to multilateralism in 1997, when she faced political and economic crises. According to Takahara (2003: 63-64), China adopted multilateralism in order to balance keeping high economic growth and counteracting the "China threat" theory. In reality, that theory became widespread around the world as the Chinese economy grew rapidly. In the mid-1990s, China was facing two external concerns. One was the Sino-Philippine territorial issue, which raised "China threat" arguments in South East Asia. On the other hand, Beijing worried that the Japan-U.S. Joint Declaration on Security of 1996 might be an anti-Chinese coalition. In this context, China participated in regional cooperation frameworks and attempted to negate the "China threat" theory.

From an economic point of view, facing the Asian financial crisis in 1997, China understood that globalization was not avoidable in both a positive and a negative way. In a global world, the economic crisis, which severely hit economies and politics in South East Asia, easily contaminated neighboring countries. At that time,

Hong Kong was attacked by the crisis because its authority guaranteed free economic activities without regulations. Fortunately, the main land economy escaped from a direct attack of the crisis because the CCP government imposed strict regulations on capital flows. This experience made the Chinese government more conservative in promoting economic reforms after that. In dealing with the crisis and the rampant globalization, China became convinced of the importance of economic security. Meanwhile, during the crisis, China did not devalue the yuan and gained international reputation as a responsible country. The reputation developed her self-confidence to join multilateral frameworks.

Matsuda's approach (2007:97-103) focused on China's military diplomacy and clarified a strategy to classify the world nations into three categories (former foes, friends, and neutrals) and handle them in different ways. Needless to say, security assurance is essential for China's further economic development. Regional integration would be one of the tools used to assure surrounding security. According to his study, China uses a partnership strategy toward its former foes and makes it a confidence-building mechanism (CBM)⁵. To friends such as Pakistan and Myanmar, China offered generous support through arms trade and military assistance⁶. With the neutrals such as ASEAN states, China faces dilemmas. Given Deng Xiaoping's line of placing growth above anything else, neighboring states are important for China to maintain a peaceful environment for economic development. Therefore, China is willing to devote herself to develop a good-neighboring relationship with ASEAN. The same logic applies to central Asian states. On the other hand, most of the neighboring countries have disputes over territories, resource development, and history with China. Some ASEAN states have alliances with the United States. The military presence of the United States is expanding to central Asia as an anti-terrorism policy. The increase of American military presence near the borders brought Beijing concerns that the United States is attempting to organize an alliance against China. In this context, stabilization of surrounding areas remains a big agenda for the Chinese leaders to pursue. In fact, China took a multilateral approach in handling with neighboring states to avoid being isolated in East Asia. Starting from an argument about military aspects, Matsuda's conclusion suggests a lower possibility of China being an outlaw in the international society as long as she maintains the economic reform and opening-up

policy.

Then, what do the Chinese authorities see? Looking back on speeches of the former ministers of foreign affairs after the reform and opening-up policy, it is apparent that the major interest of the CCP administration lay in the Sino-American relationship and gave weight to bilateral approach until late 1990s. For example, in speeches for domestic audiences given by Qian Qichen (foreign minister from 1988 to 1998) in the early 21st century, he often talked about Sino-American relations and rarely said much about multilateral diplomacy in Asia (Qian 2004:348-349). Regarding the Asian financial crisis in 1997, he flattered China's bold decision not to devalue the yuan, which indirectly helped neighbors' economic recovery. Then, ASEAN states came to place a lot of confidence in China after the crisis. As for the disputes over sovereignty in the South China Sea, he said that China was proposing a principle of shelving the disputes, pursuing growth together, and facilitating a discussion to set rules for activities in this water. Judging from a mention about a successful experience of border demarcation with central Asian states, it can be said that Qian would bring a legal resolution into view.

One of the famous Chinese political scientists, Wang Yizhou of Beijing University, argues that Chinese multilateral diplomacy will lead to regional integration in the future. With the experiences of the EU in mind, Wang posits regional integration as a world trend. A lack of experience with regional cooperation does not matter. Since China has many disputes with almost half of the surrounding countries, she must develop multilateral diplomacy and avoid a rise of the "China threat" theory in East Asia (2007:108-113). As for China's contribution in the Asian financial crisis, Wang shares Qian Qichen's view and adds an explanation that this process of dealing with the crisis facilitated ASEAN's expansion of trade with China, resulting in a conclusion of FTA in 2010.

Looking back at history, Southeast Asia is a region where the military presence of the United States and the economic presence of Japan have been dominant. Wang (2011: 58-61) said that China should make inroads into ASEAN to hold a dominating position in this area. The problem is that China has not resolved issues on the maritime border in the South China Sea with Philippines, Vietnam, Malaysia, Brunei, and Indonesia. As for these concerns, Wang argued that China would refuse to be

pressured by collective action, and thus, she would desire to resolve the issues through a one-on-one negotiation if external countries support ASAEN's positions. His argument suggests that China will use both bilateralism and multilateralism, as the situation demands.

3.2 Behind the change: domestic explanation

China is not a monolithic state. Both the government and the party are divided and rich in diversity after the economic reform. The diversity often impinges on the society, economic reforms, and foreign policies. Since the era of Deng Xiaoping, not only economic policies but also foreign policies and ideologies have been subject to economic development. Diplomacy is considered a tool to achieve a peaceful environment in which China can pursue growth and power. Until achieving both, China should take a low-profile attitude in the international society.

A case of the WTO negotiation provides an explanation of a balance between domestic factors and multilateralism. Since the reform and opening-up policy started, China achieved high growth through an export-oriented strategy. China needed WTO access to obtain better trade conditions and avoid pressure from the United States in bilateral trade negotiations. In this context, the 15-year diplomatic negotiations to enter the WTO were justified along Deng Xiaoping's line. However, efforts made by the authority to overcome WTO standards needed a lowering of tariffs and improving industrial competitiveness. As a result, extensive economic reforms proceeded into areas of state-owned enterprises, banking, and government organizations. The cost was very visible, especially in cities, where many workers were laid off. In this situation, it was apparent that China had to impose more burdens on workers and farmers if she wanted to continue negotiating for a WTO membership. Despite domestic resistance, the then prime minister, Zhu Rongji (prime minister from 1998 to 2003), furthered both economic reform and the WTO negotiation. The reformers expected that the external pressures from WTO rules would facilitate domestic economic reforms and strengthen Chinese economy. The reformers of the CCP cadres believed that it was the only and best way for China to survive globalization. Overall, their strategy was right.

However, as mentioned above, China is not monolithic. As for the pace of economic

reform, some CCP cadres are relatively conservative. The Asian financial crisis proved the effectiveness of capital control. After the Tiananmen incident of 1989, China put more emphasis on national stability, both politically and economically. The conservative people recognized that globalization was rampant, disorderly, and devastating, as seen in South East Asian states during the 1997 crisis. Finally, the CCP cadres shared a common perception that the strict capital controls saved the Chinese economy. The conservative people insisted that China should be very cautious in releasing economic regulations. Today, the disputes over the level of financial regulation remain inconclusive and constrain the pace of the currency internationalization, as discussed in the fourth section.

Therefore, despite the establishment of an idea to justify economic liberalization and multilateralism, domestic arguments and a power struggle over vested interests often hamper China's motivation to increase regional cooperation. As a compromise, China prefers limited roles, such as bilateral FTAs and a regional framework of ASEAN plus three. Different from global economic frameworks led by developed countries such as the United States and Europe, the ASEAN-based economic frameworks are small in scale and do not require a high level of liberalization. In these frameworks, China can keep exercising a power and a presence to the full extent while avoiding diplomatic isolation.

4. China's commitment to East Asian regional cooperation

4.1 Sino-ASEAN relations

The first partner to conclude a free trade agreement with China was ASEAN. The initial proposal was raised by the Chinese side when Zhu Rongji visited Singapore to attend a summit with ASEAN states in November 2000. In 2001, ASEAN and China agreed a basic idea of a China-ASEAN (Thailand, Malaysia, Singapore, Philippine, Indonesia, and Brunei) Free Trade Agreement (CAFTA)⁷. CAFTA was in effect in 2010, representing a market of 1.8 billion populations and a GDP of 6000 billion U.S. dollars. The timing was just before China's joining the WTO. From the beginning of 2010, China avoided its tariff for 93% of imports from ASEAN. On the other hand, ASEAN avoided more than 90% of tariffs for imports from China.

From an economic point of view, CAFTA is advantageous for ASEAN so far. At the

end of 2010, when China became the largest trading partner for ASEAN, imports from ASEAN to China increased 44.8% to 154.56 billion U.S. dollars and exports from China to ASEAN increased 30.1% to 138.22 billion U.S. dollars. Overall trade increased 37.5% to 292.78 billion U.S. dollars. In 2015, Cambodia, Vietnam, Laos, and Myanmar will join this framework. The economic success of CAFTA stimulated Hong Kong, which is now negotiating an FTA with ASEAN.

Regarding the nature of CAFTA, Zhao Quansheng (2011) argued that CAFTA was not based on the principle of equality and mutual benefits because China's burden was set larger than that of ASEAN. The Chinese government was willing to bear the unequal treatment of the FTA in order to enhance economic relations with ASEAN states, which had kept strong economic ties with Japan for a long time⁸.

China's commitment to ASEAN is expanding by proceeding with infrastructure projects. Yunnan and Guangxi are the main gates to Southeast Asia. With fiscal support from the central government, the two provincial governments have become major regional players in regional cooperation. Beijing also offered generosity to build highways between Kunming of Yunnan, Laos, and Thailand as well as between Nanning of Guangxi and Vietnam. China also participates in a regional committee for the Greater Mekong Sub-region (GMS) development. These infrastructure projects definitely support smooth management of CAFTA. In addition, China has established the ASEAN China Center and held meetings with ASEAN states annually. As seen from the above, China is very positive in these projects because she can reflect her economic and geopolitical interests in them.

As Zhao Quansheng (2007:284) rightly pointed out, China is very positive in committing to regional frameworks under the names of "Asia" and "East Asia." He interpreted this tendency as representing China's intention to exclude the United States from Asian regionalism. If Zhao's interpretation is right, ASEAN plus three must be the most comfortable regional framework for China.

4.2 Economic relations with quasi-state regions

Since the establishment of People's Republic of China (PRC) in 1949, the CCP claimed the legitimacy to govern the whole China. As Hong Kong and Macau were smoothly restored from Britain and Portugal to the mainland in 1997 and 1999,

respectively, they were classified as special administrative regions that were allowed to keep the existing political and economic systems for 50 years. Now, Taiwan is the only annoyance for the CCP government in terms of national unification. The CCP government claims that there is one China and Taiwan is a part of China. It also insists that the Taiwan issue is a domestic problem. But the reality is different. In fact, special administrative regions and Taiwan are treated as domestic “foreign countries” in administrative procedures. For example, ordinary Chinese on the mainland cannot travel freely to these areas without passports and pass certificates. Some Chinese are laughing at the sign that says “*guonei chujing* (domestic embarkation)” at the Xiamen port when they take a ferry to Jinmen (Quemoy), an island under the control of Taiwan authority. China’s claim on national unification is built upon this complicated situation.

Politically speaking, there is no “another China” except for the PRC. However, in terms of economy, there are four Chinas, including the mainland, Taiwan, Hong Kong, and Macau. And now the CCP government is making great efforts to establish close economic ties among the four. In the following, I will introduce China’s attempts with Hong Kong and Taiwan.

China-Hong Kong economic relations

China restored Hong Kong on July 1, 1997. In the process of Sino-British negotiations for the restoration, China guaranteed the 50-year one-country, two-system principle to relieve Hong Kong people. In addition, Hong Kong obtained a privilege to maintain its memberships in international organizations and agreements. Through the path toward the restoration, as well as that of post-restoration, China basically kept a wait-and-see position toward Hong Kong in order to show a successful model of the one-country, two-system policy to the world, especially to Taiwan people. In other words, Hong Kong continued to enjoy economic prosperity, free trade, and a role of an international financial center.

Thus, Chinese government did not hesitate to support Hong Kong dollar when Hong Kong was contaminated by the Asian financial crisis. Since then, the recovery of the Hong Kong economy was important for the mainland. In June 2003, the both authorities concluded the Closer Economic Cooperation Partnership (CEPA)

to accommodate Hong Kong enterprises in trading with the mainland businesses. The content of CEPA is annually renewed to reflect business demands. Foreign enterprises in Hong Kong can also enjoy the same treatment with local enterprises in the framework of CEPA. CEPA addresses the fact that products made in Hong Kong that go through prescribed procedures by local manufacturers can be exported to the mainland with a customs-free treatment (see the JETRO report in 2012). It can be said that CEPA was another experiment for the mainland to prepare for the coming FTA with neighbors.

So far, both sides have managed CEPA smoothly, and Hong Kong's economic dependency on the mainland is increasing. However, the close economic relationship does not necessarily mean a harmonious relationship between the two. Outside of the CEPA framework, serious social and political frictions are occurring between the mainland and Hong Kong: political pressures from Beijing on local elections and freedom of speech in Hong Kong, the mainlanders' cornering of baby milk in Hong Kong, and an issue of an increasing number of pregnant females from the mainland who rush to hospitals to bear children in Hong Kong.

Building an economic relationship with Taiwan

The CCP government strongly opposes Taiwan's involvement with international organizations and multilateral agreements. Here, the CCP authority differentiates Taiwan from Hong Kong. According to the communists' logic, which originated in 1949, Taiwan was ruled by the Kuomintang for the most of the time after the end of the World War II. The Kuomintang, which lost the civil war, has no legitimacy as a state ruler nor the representative right as a state. The Taiwan authority is a local government of China ruled by the CCP and thus it is not qualified to gain membership in international organizations. Only with the CCP's generous permission, can Taiwan attend international societies under a name of "Chinese Taipei." The enforcement of this principle by the CCP government deeply disappointed most of the Taiwanese. As a result, the CCP's Taiwan policy came to a deadlock during the Jiang Zemin period.

Looking back at the past failures, Hu Jintao, the then Party Secretary, shifted the Taiwan policy from stressing "peaceful unification" to keeping the status quo (Matsuda 2008). Hu Jintao pointed out that the recent cross-strait relationship was relatively

stable and proposed that the mainland should be patient and wait for growing affinity among Taiwanese. Fortunately, the revived Kuomintang authority of Taiwan since 2008 has responded to Hu Jintao positively. The three direct links across the strait (direct communication, direct trading, and direct transportation), raised by the communists in 1979, were fully developed with a cooperation of Ma Yingjiu. In June 2010, both sides concluded the Economic Cooperation Framework Agreement (ECFA). Under an early-harvest framework of ECFA, the levies for 539 products of the mainland and 267 products of Taiwan were reduced to zero by January 1, 2013. Both parties are now negotiating to abolish levies for the remaining products in near future. Not only goods, but also services are subject to the early-harvest framework of ECFA, with conditions favorable to Taiwan.

As for cross-strait investments, Taiwanese businessmen have enjoyed preferable treatment for direct investments on the mainland since 1990s. On the contrary, the Taiwan authority treated them unkindly and strictly prohibited direct investment by the mainland in Taiwan for a long time. With the return of the Kuomintang to power, Taiwan removed a ban on investment from the mainland in June 2009. Now mainland businesses can make direct investment in more than 90 areas such as manufacturing, services, and public infrastructure, including airports and seaports. In August 2012, a cross-strait agreement to protect investments was concluded.

To facilitate the cross-strait economic activities, the two authorities concluded a memorandum of understanding for cross-strait cooperation of currency payment (MOU) to make direct payments between the Chinese yuan and the new Taiwan dollar at the end of August 2012. The MOU was effective in February 2013 and foreign exchange banks in Taiwan started dealing Chinese yuan ahead of the mainland (Ikegami 2012:40-41). A direct transaction without the intermediary of the U.S. dollar is a symbol of cross-strait financial cooperation on the both sides.

5. Internationalization of the Chinese yuan

In considering the increasing influence of the Chinese economy, we cannot avoid arguments on internationalization of the yuan. Many scholars and bureaucrats discuss China's currency internationalization, and most of the arguments assume appreciation of the yuan. So far, the yuan is continuing a gradual rise in relation to the U.S. dollar.

The Chinese authority is said to worry about the impact of currency appreciation on domestic industries and unfavorable consequences by inspections. However, it is more likely that the Chinese authority will allow the rising trend of the yuan as long as the appreciation pace is incremental. Then, how will the internationalization of the yuan cause changes in the East Asian region where the U.S. dollar is dominant in cross-border trading ?

A Chinese political scientist, Ren Xiao of Fudan University, argues that it is necessary for China to gain a strong international voice commensurate with her economic capability. He pointed out that at the end of June 2011, China occupied 11% of world trade but the yuan only occupied 0.9% in the world money supply. Ren recommended internationalization of the yuan to balance the trade volume of China. He also advocated that internationalization of the yuan would decrease excessive dependency on the U.S. dollar in managing foreign exchange assets of China. In this context, he insists that the existing economic order should be modified to reflect the Chinese economic power (Ren 2012).

In fact, the president of the central bank, Zhou Xiaochuan, proposed a reform of the international monetary system in March 2009 and surprised the developed countries who were the major members of the International Monetary Fund (IMF). Behind this situation, we can see a deep frustration of the Chinese government with repeated financial crises that have originated in the United States. Moreover, considering the nature of the China's central bank, which lacks political independency but is forced to be subject to the CCP, it can be said that China is serious about making a change to the existing financial order.

At present, China is taking relatively moderate methods to express its own interests by increasing quotas at the IMF and sending more Chinese human resources to international financial organizations. It is also necessary for China to increase the volume of the yuan in the world to obtain more financial influence. In reality, as the Chinese economy grew, transactions by the yuan for small-scale border trade are increasing spontaneously. In Southeast Asian developing countries, people living near a border with China prefer using the yuan in doing business with Chinese merchants. In addition, the Chinese government started financial experiments in Hong Kong to increase international volume of the yuan institutionally. After proceeding

experiments in Hong Kong, the government is now very positive in concluding bilateral agreements for direct transactions with foreign counterparts. Through these agreements, both China and the counterparts are mutually beneficial by saving transaction costs generated from using the intermediary of U.S. dollars.

However, it will take a long time for China to realize a substantial change in the international financial order. Before stepping into a reform of the international monetary order, China must tackle financial reform at home. From experiences, we can observe China's preference for keeping control over currency to comprehensive liberalization. For example, Murase (2011) pointed out that there are two different yuan markets: one in Shanghai and the other in Hong Kong. The Shanghai foreign exchange market is operated under the control of the Chinese government. The one in Hong Kong is basically operated with few financial regulations. As a corollary of different mechanisms for exchange settlements, there are two exchange rates for the yuan in reality. Murase critically advocates that the Shanghai foreign exchange market cannot be complementary to the Hong Kong market because of different levels of financial liberalization. He concludes that Shanghai will not be qualified to a world financial center without a floating rate system.

From the above arguments, it is apparent that China is not well prepared to internationalize the yuan because she is unwilling to abandon her control over the currency. Under a communist scheme, some economic activities are still subject to a disallowance-in-principle policy. For example, in May 2013, the central bank announced that the government would release a regulation on security investment by foreigners and avoided the upper limit of the investment. The new treatment is only available in a framework of qualified foreign institutional investors (QFII). Without obtaining a permit of QFII from the authority, foreign investors are excluded from the security market in China (*Nihon Keizai Shimbun*, May 3, 2013).

At the end of this section, I will introduce another initiative raised by Liu Guoshen, a chief of Taiwan Research Institute of Xiamen University. He proposed creation of a supra-sovereign currency to be circulated among the mainland, Taiwan, Hong Kong, and Macau. He said that the monetary unification of four Chinas would be a model of political unification (The Office of Taiwan Affairs People's Government of Fujian Province 2009). It is unlikely that both the Taiwan and the Hong Kong authorities

will hand over the monetary sovereignties to the mainland. In a similar fashion, the mainland will refuse to any attempt to damage credibility of yuan. However, Liu's unique proposal seems aware of EU experiences and a link between finance and politics. Internationalization of the yuan is a global-scale issue. But China can implement a monetary experiment with overseas Chinese across Asia to seek a possibility of being a financial power in the world.

6. Obstacles to East Asian regional integration

Two factors, both of which are deeply involved with China's core interests, may hinder the East Asian regional integration. One is the Taiwan issue and the other is the Sino-Japanese relationship. Some scholars leave the Taiwan issue and territorial disputes out of multilateral frameworks. For example, Akaha (2011:81) says that the Taiwan issue cannot be negotiable in a regional framework as long as China defines it as a domestic issue. He also says that other territorial disputes in East Asia, such as Takeshima, Senkaku, and northern territories, are bilateral issues with a sovereignty problem, and thus, multilateral regional frameworks cannot handle with these problems. He concludes that neo-liberal institutional theory cannot contribute to sovereignty issues and East Asia still lies in the neo-realist world (Akaha 2011: 94-95).

6.1 Taiwan issue

I argue that the Taiwan issue is highly international in reality. Despite the principle of the one-China policy claimed by the CCP government, Taiwan has its own political entity whose norms and mechanisms are quite open. China cannot hold a unilateral coercive action to Taiwan not only because of possible damages to the opening-up policy but also because of international monitoring. No matter how much the mainland authority hampers Taiwanese access to international or regional organizations, East Asian states cannot ignore the economic presence of Taiwan. Although the third party cannot directly intervene into the cross-strait political relations, it is necessary for East Asia to exercise wisdom to incorporate Taiwan into regional cooperation as much as possible.

From the Chinese side, concern is greatest for independent factions in Taiwan. Wang Yizhou (2007: 113-114) expressed a deep apprehension about unfavorable

linkages between the independent factions and external supporters. Given the increasing political and economic influence of China in the world, this concern is less likely to occur. However, China started a new policy to mitigate latent supporters of the independent factions with a physical method. Under a strong initiative of the central government, China's local delegations to Taiwan often execute volume purchase agreements for agricultural products of Taiwan. The mainland also accepts primary products of Taiwan through ECFA. Behind China's generosity, there is a strategy to divide independent factions and their potential supporters in the southern part of Taiwan where four features can be found: many native Taiwanese with little feeling of affinity to the mainland, a basement for independent factions, agriculture as a main industry, and relatively lower income at home. In other words, the targets of the communists' Taiwan policy now include not only Taiwanese businessmen on the mainland, but also farmers in Formosa. For that purpose, local governments in the southern parts of the mainland have to accept competitive relations between local agricultural products and imported ones from Taiwan. Everything is for national unification.

The change of Taiwan policy under the Hu Jintao administration contributed to bring stability across the Taiwan Strait. However, some concerns remain unresolved. First, there is no change in a fact that the unification issue is still on the agenda. Given the democratic nature of the Taiwanese politics, the CCP cannot get over the idea that the independent factions may regain strength in the future. In a similar fashion, there is no guarantee that the mainland leaders will maintain the status-quo policy in the future. Second, can the CCP government really gain Taiwanese hearts by volume purchasing? If there are business chances, Taiwanese are pleased to trade with the mainlanders. Currently, China's attempt to develop cross-strait economic ties does not necessarily mean a rapid increase in support for unification in Formosa. An experiment of Pingtan in Fujian Province, a national project to build a cross-strait comprehensive cooperation including economic activities and legal aspects, suggests a different level of interests between the mainland and Taiwan. In order to keep the ECFA framework politically effective, the CCP government makes South Korea a competitor for Taiwan in proceeding with bilateral economic cooperation to keep pressures on Taiwanese bureaucrats⁹.

For the East Asian states, the Taiwan issue is tricky. Reigniting the cross-strait disputes will definitely threaten the regional stability and development. On the contrary, in case that more obedient Taiwan to the mainland emerges, China may have more discretion in political and military activities in East Asia.

6.2 Sino-Japanese relations

China, the world's second-largest economy, and Japan, the world's third-largest economy, are the key powers in promoting the East Asian regionalism. Any regional framework will be ineffective with the absence of either party. Despite its relatively small economic powers, ASEAN has been a driver of the East Asian regionalism for a long time because both Japan and China could not gain trust in the region. As the weight of regional financial cooperation increases, a leadership with larger economic power is required. The ideal way for East Asia is a coordinated leadership of Japan and China. However, the region will have a long journey to achieve the goal.

As seen in the recent bilateral troubles, three factors often interrupt the Sino-Japanese relations. First, the history issue often hinders bilateral diplomacy. Despite the Japanese attempts for reconciliation with neighbors in the past, such as the Emperor's speech in 1992, the 1993 statement by the then Chief Cabinet Secretary, Yohei Kono, and the 1995 statement by the prime minister, Tomiichi Murayama, China, as well as South Korea, cannot remove grudges and resentments because of repeated thoughtless remarks by Japanese politicians. The situation occurred again in May 2013. By mid-April, China was positive to facilitating the trilateral FTA among China, South Korea, and Japan. The cooperative atmosphere was brown up when some Japanese ministerial colleagues visited Yasukuni shrine in Tokyo. China cancelled both a trilateral meeting by the finance ministers and the presidents of the central banks and a trilateral summit. A ministerial meeting on environmental issues among the three parties was held in Kitakyushu, Japan in May 2013. However, China sent a lower ranking official as a representative in an expression of displeasure. As long as China can get into line with South Korea on the history issue, Japan cannot expect a conciliatory attitude of China¹⁰.

Second, territorial disputes reemerge between the two states. As for the nationalization of Senkaku Islands by the Noda administration in 2012, both Japan

and China facilitated aggravation of the situation. The Japanese government took actions along domestic logics and revealed its disinterest in the modern history. The Chinese government was afraid of resentment from its own people and could not control mobs and hard-liners' opinions. As territorial disputes directly relate to sovereignty, domestic hard-liners often put pressures on the Chinese government to adopt a firm diplomatic attitude against Japan. The firm attitude often brings a sense of caution among the neighbors, which may result in regional isolation of China. Thus, the CCP leaders are required to handle domestic politics and diplomacy. As for this point, Wang (2011:132-133) indicated a tendency of China, in which a specific department attempts to protect their own interests under a name of "critical interests," "national interests," and "national core interests." If the Chinese government defines the small islands as national "core" interests, she will face another difficulty in the search for common ground with the Japanese side. To be fair, China was seeking a breakthrough to resume bilateral relations with Japan in spring of 2013. Unfortunately, she encountered the Japanese ministerial visits to Yasukuni, and faced with a dilemma again.

Third, as the Chinese economy grows, a rivalry between China and Japan, especially in East Asia, becomes intensive. For China, Southeast Asia is critical: first, the area is geopolitically close to China, and second, Japan has held a strong economic dominance there. Therefore, China is motivated to counterbalance the Japanese presence. In these years, China is rapidly increasing its presence in the region. Except for the ASEAN-related frameworks, bilateral and sub-regional cooperation frameworks such as the GMS initiative are established. In order to get rid of oppressive feeling, China acts very cautiously in dealing with the ASEAN states. In a case of the GMS initiative, the representative of China is not the central government, but the provincial government of Yunnan.

Meanwhile, the Sino-Japanese competition over regional leadership becomes more intensive by showing how much they can contribute to the East Asian financial cooperation. In 2009, China caught up to Japan in terms of quota and became one of the largest donors to the Chiang Mai Initiative¹¹. In May 2012, each of them offered 76.8 billion U.S. dollars. No other state in East Asia can bear such a financial burden for regional cooperation. In 2011, China competed with Japan for the top position of the

ASEAN plus three Macroeconomic Research Office. The Asian Development Bank is expected to be the next battlefield for the Sino-Japanese rivalry over the presidency.

7. Conclusion

The above arguments clarify three points regarding China's commitment to regional cooperation. First, with the development of highly institutionalized regionalism in the world, a weight of multilateralism in Chinese diplomacy increased in order not only to avoid isolation in the East Asia but also to assure national security. The concept of national security now includes an economic sphere, especially after the Asian financial crisis in 1997. Nevertheless, China prefers bilateral FTAs for regional economic cooperation to a global framework for economic liberalization because she considers the level of global liberalization is too high to overcome. Building closer relations with ASEAN brings China immediate benefits in various ways. Backed by the increasing trade volume and performance of positive commitment to South East Asia, China can enjoy a stable relationship with neighbors. The best environment for China is the ASEAN plus three framework, where she can exert influence in decision-making processes, perform as a benevolent regional partner, and keep low-profile talks with counterparts about bilateral disputes. In addition, the CPP government is trying another unique attempt to link the four Chinas. From the perspective of national unification, China cannot have failures in CEPA and ECFA. In sum, the world's second largest economy made these China-centering FTA networks available.

Second, the level of currency internationalization suggests a dilemma of China between her discontents with the existing financial order and a tendency to keep control over financial activities at home. At present, China attempts to achieve a better result by obtaining incremental powers in the global financial organizations. Meanwhile, it is seeking a future possibility of currency internationalization through experiments in Hong Kong and bilateral agreements for direct transactions by the yuan.

Third, the Taiwan issue and the Sino-Japanese relations are potential factors that might bring tensions into East Asia. These issues are difficult to cope with because they are also subject to domestic politics. Though it is less likely that these issues will destroy the accumulated regional cooperation, China's tendency to appeal bilateralism

may slow the pace. Uichiro Niwa, the former Japanese ambassador to China, exactly pointed out that one mistake will stop every communication in China (May 9, 2013, *Asahi Shimbun*). The East Asian states, especially China and Japan, will be required more consideration to break the ice and work together for coexistence and co-prosperity in a setting of more institutionalized regionalism.

Notes

- 1 The earlier version of this paper was presented at the 2013 ASPAC Annual Conference in Monterey, California, on June 9, 2013.
- 2 ASEAN consists of ten countries: Thailand, Indonesia, Singapore, Malaysia, Philippines, Brunei, Laos, Cambodia, Myanmar, and Vietnam.
- 3 For example, as an event to enhance Sino-Japanese relations, the first visit of the Japanese Emperor Akihito to China took place in October 1992. The emperor expressed a deep sorrow about the bilateral modern history.
- 4 The CCP government often had conflicts with the then Taiwan authority led by Lee Teng-hui. The peak of mutual hostilities came in 1995 and 1996 when the CCP took a policy of “*wengong-wube* (attack by pen and menace by force).”
- 5 For example, China rebuilt a relationship with Russia by decreasing its military force near the border and signing a border demarcation agreement. After that, the two powers facilitated military cooperation and arms trade.
- 6 Recently, China is making use of these friend states as de facto overseas strategic grounds of her own.
- 7 After concluding CAFTA, China’s FTA network is expanding. Here, I will explain only CAFTA because of its political and economic importance. Regarding other FTAs, I will list them briefly as follows: Chile (effective in 2006), Pakistan (effective in 2007), New Zealand (effective in 2008), Singapore (effective in 2009), Peru (effective in 2010), Costa Rica (signed in 2010), Australia (deadlock in 2013). Countries and regional organizations under negotiation are as follows: Gulf Cooperation Council, Southern African Customs Union, Iceland, Norway, Switzerland, Russia, Central Asia, South Korea, and India. A trilateral FTA between China, Japan, and South Korea is also under negotiation.
- 8 Japan had concluded FTAs with the ASEAN 6, namely, Singapore, Malaysia, Philippines, Indonesia, Brunei, and Thailand from 2002 to 2008. Zhao (2011) suggested that the process

of concluding an FTA between Japan and the ASEAN 6 stimulated China's inclination to multilateralism.

- 9 An interview held at Shanghai Institute for International Studies on March 16, 2013.
- 10 Facing the deteriorated Sino-Japanese relations, the Chinese government is very cautious to see leaders of Japanese political and economic world. Meanwhile, China is very positive in accepting a visit of the new South Korean president.
- 11 A total amount of quota by China and Hong Kong equaled to that of Japan.

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