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Li, Xing; Shengjun, Zhang

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**Center for Comparative Integration Studies**  
at Department of History, International and Social Studies



**CCIS**

Center for Comparative  
Integration Studies  
Aalborg University  
Fibigerstraede 2-99  
DK-9220 Aalborg East

Phone: +45 9940 8310  
Fax: +45 9635 0044

E-mail: [ccis@lists.ihis.aau.dk](mailto:ccis@lists.ihis.aau.dk)

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**Li Xing & Zhang Shengjun**

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*The Secretariat*  
Center for Comparative Integration Studies  
Fibigerstraede 2, room 99  
Aalborg University  
DK-9220 Aalborg East  
Denmark

Tel. + 45 9940 8310  
Fax. + 45 9635 0044

E-mail: [ccis@lists.ihis.aau.dk](mailto:ccis@lists.ihis.aau.dk)  
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# China and Regional Integration in East Asia: Opportunities, Constraints and Challenges

Li Xing<sup>1</sup> & Zhang Shengjun<sup>2</sup>

## Introduction

### *Regional integration in East Asia*

Over the past decades, topics of regional integration have become part of the focus and interest of development studies. Among them, the regional integration of East Asia<sup>3</sup> has appeared prominently in these researches. Within the various domains of development studies, East Asia has been applied as valuable comparative parameters due to a number of its significant characteristics (see table 1):

- East Asia has the world's largest regional market of almost 2 billion populations, and it is many times bigger than the 27-EU 495 million and NAFTA 405 million populations.
- East Asia has been since the 1960s the fastest growing region in the world. Over the last two decades the region has an average annual economic growth rates of around 7%, which is much higher than the average 5% growth in the rest of the world.
- East Asia has historically had a high domestic savings rate of about 20-45% (it is different from country to country). It is much higher than the EU's average of about 20%.
- East Asia holds over half the world's foreign exchange reserves. China alone has the world largest foreign exchange reserve which passed \$1.4 trillion in 2007.
- Along with the NAFTA and the EU, East Asia is one of the world's three largest economically integrated regions.

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<sup>1</sup> Ph.D., Associate Professor, Department of History, International and Social Studies, Aalborg University, Denmark.

<sup>2</sup> Ph.D., Professor, Institute of Political Science and International Relations, Beijing Normal University, China.

<sup>3</sup> The geographical notion of East Asia is defined in various ways. Some refer it to the Far East, others refer it to Northeast Asia excluding Southeast Asia. Here, the notion of East Asia means the "eastern part of Asia" including Northeast and Southeast Asia.

**Table 1. Selected indicators of the three largest regional economic blocs**

<b>Indicators</b> (2002 unless otherwise specified)	<b>East Asia</b>	<b>European Union</b>	<b>NAFTA</b>
Population (million)	2,014.5	453.3	420.6
GDP (\$ trillion), 2003	7.5	11.0	12.3
Average GDP Growth (%), 1980-2003	7.0	5.0	6.0
Domestic Savings (% of GDP)	28.8	20.2	15.0
Investment (% of GDP)	26.5	18.7	37.5
FDI Flows (\$ billion), 2003			
Inflows	105.5	295.5	36.4
Outflows	57.7	337.0	173.4
Foreign Exchange Reserves (\$ billion)	1,177.0	304.4	116.4
Current Account Balance (% of GDP)	3.20	0.29	(4.10)

(Source: Akhtar, 2004:2)

Largely inspired by the intense curiosity on this first successful case of rapid industrialization outside the Western cultural sphere, the East Asian newly industrialized economies became the object of various academic studies and interpretations. The World Bank had invested on a special study report on *The East Asian Miracle* (1993), which generated a global debate on the various factors behind the East Asian success.

The regional integration process in East Asia can be historically traced back to the Japanese project of “Greater East Asia Co-Prosperity Sphere”<sup>4</sup> during the Second World War and the flying-geese<sup>5</sup> phenomenon in the 1950s-1980s. In both cases Japan played a leading role, for good and bad, in regional economic integration, and economies in the region were moving ahead together in layers with Japan at the front layer. The flying-geese pattern of regional economic

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<sup>4</sup> Japan made the first attempt to lead Asian countries before the Second World War. At that time, the Japanese Government embarked on a brutally expansionist policy the result of which was creation of the first gaggle of “flying geese” under the name of the “Greater East Asia Co-Prosperity Sphere.” During the “flight” Japan militarily invaded and brutally ruled most of the countries in the region, and forcefully imposed its own worldviews and values on the rest of the region. At the same time, the Japanese Government assumed hostile attitude toward Western countries. Japan’s defeat in the Second World War signified the end of flight of the first “flying-geese” gaggle.

<sup>5</sup> The hypothesis of the flying-geese and ladder-patterned of intra-regional economic relations suggests that a group of nations in this region are flying together in layers with Japan at the front layer. The layers/ladders signify the different stages of economic development achieved in various countries. In the flying-geese model of regional economic development, Japan as the leading goose leads the second-tier geese (second generation of newly industrializing economies) which, in their turn, are followed by the third-tier geese (third generation of newly industrializing economies).

development and industrial relations led to sustained economic growth and spatial expansion in this region.

Despite the fact that since the 1990s economies in East Asia have gradually increased their economic interdependence through internal structural reforms and external liberalization and have further expanded intra-regional economic relations, thus creating a de-facto economic “common market”, the region still lacks a strong institutional framework to handle crucial issues which are indispensable to economic regionalism, such as political trust, economic unbalance, security challenges, trade and financial issues, etc. A solid regional institutional structure is becoming more and more important especially through the lesson of the Asian financial crisis in 1997.

The European regional integration was historically originated and driven by the desire to foster political and social cohesion. Interdependence in political and economic ties within the EU is seen as an effective way to resolve security conflicts in the region. In retrospect, the institutional evolution of the European Union has a history of about 50 years. It is a matter of fact that the engine driving the EU project was economic cooperation, beginning with the Bank for International Settlements, and then moving to the European Coal and Steel Community. Later on the European Common Market was upgraded to the European Economic Community and finally to the European Union and the Euro Zone.

Seen from the comparative perspectives, East Asia is a region with intensified economic interactions and interdependence but without a *common* political mandate and without any institutionalized arrangement of regional integration. Even the sub-regional organization, ASEAN, cannot be compared with the European Union because it lacks infrastructure and institution to lead the process. The three big economies in North East Asia - Japan, China and Korea - do not even have a free trade agreement (FTA) among themselves. Although a grand vision of regional integration has been presented and there are growing sentiments among member countries of East Asia to move towards the direction, there are still many difficulties to be resolved.

### **China's reemergence in East Asia**

In historical retrospect China had been the hegemonic power in the East Asian region with tributary relationships with other neighboring countries in the Qing dynasty and before. And culturally East Asian region was also heavily influenced by Chinese traditional culture including language and philosophies. Similar historical and cultural ties hold true for other countries in Southeast Asia and for Vietnam in particular. Even in the mid of 19<sup>th</sup> century China was still the

largest economy in the world. But since the mid 19th and early 20th centuries, China was overwhelmed by static decay, civil instability, famines, military defeats and foreign occupation. During the Cold War period, China's social experiments achieved some progresses but suffered serious setbacks due to the internal and external constraints. Since China started the economic reform in late 1970s, the world witnesses the return of China's emergence as a regional and global political and economic power. According to the report of the IMF, the balance of power in the world economy is undertaking changes with China replacing a faltering United States as the biggest contributor to global growth in an "uncertain and potentially difficult period" (Elliott, 2007).

The failure of Japan's militant implementation of the "flying-geese" industrialization in East Asia was connected to its defeat in the Second World War and the victory of the Chinese Revolution in 1949. It is an irony of history that a contributing factor to the deformation of Japan's second leadership of the "flying-geese" pattern of regional development is again connected to the rise of China as one of the key regional and global economic actor. Throughout the 1980s and 1990s China's continuous economic dynamism and its constructive role in releasing the heavy pressure of the regional financial crisis in 1997 made China the engine of regional economic growth. Since then, Japan was gradually no longer the central "locomotive" of the regional economic growth.

China's open-door policy has attracted a large amount of foreign investment and many labour-intensive and capital- and technology-intensive industries have been moved to China. For instance, Hong Kong has almost moved its entire manufacturing industries to Mainland China while continuing to act as a financial and service centre. Taiwan and Mainland China have developed similar highly dependent economic relations in recent years. As a result of these shifts, the regional growth pattern and convergence structure was also beginning to change.

In terms of intra-regional economic relations in East Asia, since the 1990s there has been a shift away from the previous Japan-led "flying geese" model of vertical economic integration structured on the basis of the Japanese investment, technological transfer and supply of manufacturing parts in line with a hierarchical market exchange and regional division of labour and production networks to a new horizontal intra-regional economic integration. According to a World Bank study, the economic integration of China in East Asia has a positive effect in contributing to economic and trade growth in the region:

The economic integration of China has deepened production fragmentation in East Asia to an unprecedented level. The rapid integration of China into regional production networks has countered fears that China's global

integration would crowd out the opportunities of other countries for international specialization. International production fragmentation has intensified the dynamism of East Asian economies and increased economic interdependence within the region.

(Easper, 2007)

### *The role of overseas Chinese diaspora*

There is a consensus that overseas Chinese diasporas, whose economic power is greater than that of any other diasporas of any other states, are one of the main economic and financial resources for sustaining China's economic growth and connecting China with the rest of the region since China started its economic reform at the end of 1970s. The overseas remittances and investments contributed by Chinese diasporas accounted for a substantial proportion of China's growth. It is not an exaggeration to claim that Chinese Diasporas are a vital key to China's economic success as well as to its further integration with regional and global economy.

The first wave of foreign direct investment to China was primarily from the overseas Chinese who took a pioneering step into China's premature market in face of regulatory uncertainty and political sensitivity and who were willing to take the risks of the lack of property law and unclear political systems. After the late 1990s and since the 2000s there was a rise of flow of FDI from North American and European corporations. Following its membership of the WTO, China has to reduce the preferential treatment to the overseas Chinese capitals.

One distinctive feature about the diaspora capitals can be seen from the crucial synergy they bring about between overseas investors and markets and China's local development, one not found to the same extent or in the same form with non-Chinese FDI (Smart and Hsu, 2004). The diaspora capitals paved the most dynamic linkages between diaspora capitalism and entrepreneurship and the booming economies of the towns and villages of the coastal regions (Lever-Tracy, et al, 1996).

The new engine of regional economic growth is driven by FDI-directed supply chain which has created a pattern of parallel development for the region in many ways. It has not only generated diverse and vibrant networks of local enterprises and industries around the whole region, but also further decomposed and extended the supply chains geographically. This kind of network-based exchange of trade and capital has profound impact to East Asian economic convergence because the new situation necessitates governmental cooperation and institutional building. One of the key actors in generating dynamic intra-

regional industrial and economic integrations is the overseas Chinese business communities.

Although it has been a consensus that the historical rapid economic growth in East Asia was achieved through a regional production networks with close production ties with Japan as the key actor of central importance, the role of ethnic Chinese business networks (Chinese Diaspora) has increasingly become an important integrative driving force in promoting regional economic integration not only in terms of being the major source of FDI contributing to China's economic growth but also in terms of being the network connector linking the Chinese market with the rest of the region (Peng, 2000). A typical phenomenon is that many firms from the developed economies in the region use China as low-cost manufacturing based as well as an export base instead of directly exporting finished goods to the Western markets. By doing so they have moved their productions to China, further enhancing China's integration in the regional economy and leading to the reorganization of industrial relations in East Asia. The key actors behind those firms in this process of economic regionalization are those ethnic Chinese firms and their business networks which act as sources of capital, technology and expertise and bring in business synergy between Mainland China and the rest of the region (Crawford, 2000).

The spill-over effect of the regional network-based Chinese capitalism can be illustrated by the role of the hundreds of successful ethnic Chinese family business and networks connecting and interlocking medium-sized businesses in many countries in the region. Overseas Chinese entrepreneurs, business executives, traders and financiers are the major players linking local economies with that of the region. Among the major actors, the Chinese-dominated regions such as Hong Kong and Taiwan have been playing a decisive role. Their capital, technology, entrepreneurial capability, marketing skills and international trading experience matched very well with the advantages of cheap land and abundant supply of low-priced disciplined labour in the mainland. Not only in China, ethnic Chinese are also major and sometimes prime sources of capital and entrepreneurship of most of the Southeast Asian countries.

### **The “China factors” in regional integration**

The rise of China has met different responses from different corners of the world. The immediate feelings of China's impact are nowhere more manifest than in Asia where China's emergence has been felt most strongly due to obvious geopolitical and economic factors and cultural and historical ties. China's rapid economic growth and active regional diplomacy have already transformed Asia in many ways. Economically, China's commercial and energy ties with all major regions of the world are expanding. China is one of the main

driving forces proliferating regional and bilateral trade agreements. Politically, it is often interpreted that China seeks to shape the region's emerging political-institutional contours and to encourage movement toward an "East Asian community" in order to balance the declining influence of the United States.

#### *Dissolution of the flying-geese relations*

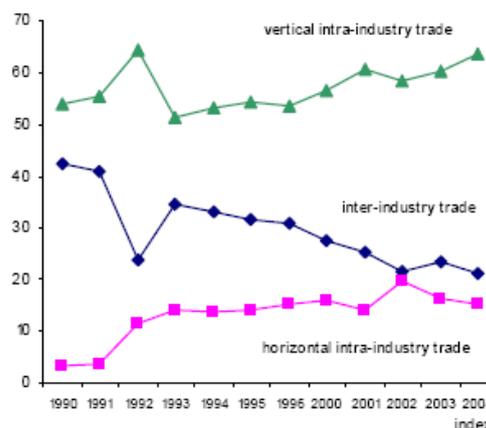
China's "core" position can be explained in this way that the country's vast size and unbalanced development levels between its internal regions with their respective levels of industrial stages and comparative advantages enables China to cooperate with the rest countries of the region and even the whole world, rich and poor, advanced and underdeveloped both vertically and horizontally. This is to say that on the one hand, this signifies the unbalanced development of China's domestic economy in different regions, on the other hand, the advantages of China's multi-level economy enable it to cooperate with countries of different stages at the same time; and different Chinese provinces can give full play to their comparative advantages with all countries in the East Asian region.

When global FDI began to horizontally spread to China and other East Asian countries, the early Japan-based flying-geese and ladder-patterned intra-regional industrial, trade and the linkages with global FDI was transformed into a relationship of competition in which countries in this region are competing with one another for capital and financial resources as well as for export market. It is often the fact that many enterprises and industries in the region are facing direct competition with Chinese products. To some scholars, the emergence of China's economic strength was among the factors leading to the shift of financial and economic balance of power in the region, which partially contributed to the financial crisis in 1997 (Li, et al, 2002).

The rise of China as a global manufacturing centre has a great impact on the traditional intra-regional economic relations and division of labour, leading to further specialization within various industries and to new divisions of labour both vertically and horizontally. Until the 1980s of the 20<sup>th</sup> century, trade in East Asia was patterned on the basis of "north-south trade" in line with comparative advantages - namely trade between industries. Since the 1990s, dramatic transformations took place in East Asian trade relations. Inter-industrial trade was gradually replaced by intra-industrial one which was based on vertical division of labour.

The figure shows that vertically-based intra-industrial trade in the region expanded substantially in East Asia, which was partly driven by the global trade of spare parts. This also indicates the position of East Asia as part of global manufacturing networks. Transnational companies from developed countries such as Japan, the United States and the EU took advantage from the manufacturing networks in East Asia and outsourced their labour-intensive products to China and ASEAN countries for processing and assembling. It needs to indicate the fact that “this growth dynamism based on vertical specialization has depended heavily on extraregional trade in final goods, and this dependence has increased over the years.” (Easper, 2007:3)

**Figure 1. inter-industrial and intra-industrial trade ratio in East Asia**



Source: UNCOMTRADE and Urata 2006

Note: The indices are aggregated at the 6-digit HS level and computed using the method proposed by Fukao, Ishido, and Ito (2003).

China’s integration with the global and regional economies made it an ideal base for product processing and assembling and a centre of global manufacturing networks in East Asia, which further intensified intra-product divisions of labour in the region. China’s export-oriented and processing-based trade reveals the intensification of its integration in the global vertical division of labour as well as its role as an important promoter in the development of intra-regional trade.

However, from a long-term development perspective and despite its further advance in manufacturing capacities, China will eventually face many challenges following the gradual maturation of manufacturing at a global level. The value-added rate of manufacturing will slowly but surely decline, so will the role of manufacturing in economic growth. Over dependency on manufacturing without other alternative sectors to further promote economic growth would slowdown or even stagnate China’s economic development. Therefore, it is important for China to initiate policies which help to assist sectoral structural adjustment, for example, developing service industries as future growth-driven sectors.

### *China as a new engine for growth*

Since 2000, China’s contribution to global GDP growth almost doubled the contribution from the other three newly industrializing economies (India, Brazil and Russia). According to the World Bank calculation, China’s contribution to

world economic growth between 1980-2000 period was 14 percent, lower than the US 20.7%, but was 7% higher than that of Japan (Japan's economic growth in the 1950s had a great impact on the world economy). China's figure further jumped to 17.5 percent in 2002. The UN "World Economic Situation and Prospects for 2003" acknowledged that China has become the "locomotive" for Asian economic growth.

China's contribution to global trade growth shows another indispensable aspect of its global and regional dynamism. Ravenous China's oil imports rose by 30% in 2003, largest oil import second only to the US. In addition China accounted for half of the world's consumption of cement, 30% of its coal, and 36% of its steel. Today China is the third largest contributor to the world trade growth after the US and the EU. China trade has a decisive effort on the economic and trade growth of developing countries. For example, China's overall trade with Africa rose from \$10.6 billion in 2000 to \$40 billion in 2005, and in 2006 the trade between China and Sub-Saharan Africa amounted to US\$25 billion, which accounted for about 85 percent of all African exports to China (Wang, 2007:5). However, China's global trade has also a side-effort, namely a tendency towards overdependence on foreign market for oil, raw and energy resources, which bears far-reaching implications for its national security and sustainable economic growth. China has to look for other alternatives in terms of renewable energy, innovation and sustainable development.

There is indeed a consensus that China's economic power especial its growing domestic market has become an important force promoting regional economic cooperation and trade growth and spurring East Asian economic recovery. In Northeast Asia, Japan has acknowledged that its recent economic recovery has been due in a large part to its massive exports to the Chinese market shifting its traditional trade deficit to surplus. Japan has remained China's largest trading partner and import source as well as third largest export market for 10 consecutive years. First time in history China (excluding Hong Kong and Macao) surpassed the US and became Japan's largest trading partner in 2007. For South Korea, China (excluding Hong Kong and Macao) already became its top export market in 2003.

The financial crisis in 1997 had substantially deteriorated the regional economy, and the region recognized the fact that it was China, not the United States or Japan, that played the most important role in the region's economic recovery. During the crisis China refused to devalue its currency, instead, it drew on its extensive foreign exchange reserves to assist distressed nations. In addition, China refused to withhold its committed aid to Asian nations that tried to put their vulnerable economies in shape.

In Southeast Asia, bilateral trade volume between China and nations in this region has reached 40 billion US dollars a year and the region's exports to China are bigger than those to any other place in the world. Chinese statistics show that from 1990 to 2005, China-ASEAN trade volume surged at an average of 22% on year-on-year basis, four percentage points higher than the growth rate of China's overall foreign trade volume in the corresponding period. In 2006 China-ASEAN trade reached \$160.8 billion, a 23.4% increase comparing with the 2005 figures (Xu, 2006). Currently China and ASEAN are each other's fourth largest trading partners and trade experts estimate that China-ASEAN trade may reach the \$200 billion target by 2008 (*People Daily* online, October 30, 2006). China and ASEAN countries have been committed to the goal of establishing a free trade area by 2010 as scheduled - ASEAN-China Free Trade Area (ACFTA). The rise of China changed the East and Southeast regional landscape in two ways. On the one hand, China's new role as a link in the production network contributed to the growth of intra-regional trade. On the other hand, China became an active player in developing institutional frameworks to promote regional integration.

**Table 2: The changes of trade flows among countries and regions in East Asia (the ratio of export to the trading partners vis-a-vis their total trade volume)**

Exporting Country/regional	East Asia		China		Japan	
	1990-94	2000-04	1990-94	2000-04	1999-94	2000-04
East Asia	44.1	49.0	6.4	11.1	8.6	8.2
Indonesia	62.0	56.9	3.6	5.4	32.9	21.0
Malaysia	54.7	45.2	2.5	5.3	13.6	11.35
Philippine	36.1	53.7	1.2	4.2	17.4	16.4
Singapore	48.2	56.4	2.0	6.1	7.8	7.0
Tailand	41.7	48.3	1.5	5.3	17.3	14.7
Vietnam	—	49.0	—	9.6	—	15.7
China	60.5	45.3	—	—	15.8	14.3
China-Hong Kong	47.0	55.5	29.9	39.3	5.4	5.4
China-Taiwan	42.7	55.2	0.0	10.3	11.3	9.2
Korea	40.8	46.6	4.2	15.6	15.7	9.8
Japan	34.6	43.1	3.7	10.0	—	—

Source: Direction of Trade Statistics Database, International Monetary Fund. ESDS International <http://www.esds.ac.uk/international/access/access.asp>.

The above table indicates that China has become the centre for trade expansion in East Asia. Comparing trade flow figures between 1990-1994 and 2000-2004, it shows that 1) intra-regional trade had substantially increased; 2) China became the destination of export increase for the region; 3) trade ratio with Japan for almost all countries declined. These demonstrate that East Asian trade flow in the global manufacturing networks had considerable changes under the

impact of the rise of China. Some trade flows previously destined to Japan turned to China. The intra-regional trade expansion also intensified intra-regional trade dependency.

There is no dispute today that China is increasingly looked as the locomotive of the region's economic growth and development. While having a large surplus in its trade with the United States and the EU, China actually has trade deficits with most Asian countries. China's import is helping to fuel the economic recovery and growth of its smaller neighbours. Even Japan has acknowledged that its economic recovery last year has been due in a large part to its massive exports to the Chinese market. China displaced the United States as the largest source of Japan's imports for the first time ever in August 2001. Due to its internal regional differences in economic development, China's economic growth is expected to last for a long period due to the "catching-up" process from within.

A positive integration trend led by China-driven regional economic growth is confirmed by a research on the spill-over effect on the economic growth in the home country generated by openness, market size, and level of development of neighbouring countries in the same region. The conclusion of the study verifies such an effect described by a scholar that "the economies of countries near large and open economies grow faster. Also, the level of development of neighbouring economies, especially when they are open, has significant positive spill-over effects" (Vamvakidis, 1998:265). For example, according to the study by Gaulier (et al, 2005), the China-centered economic regionalism can be seen from the reorganization of production in East Asia in which a triangular trade pattern emerges in such a way that companies of advanced economies use China as "an export base" (exporting intermediate goods to their affiliates in different regions in China rather than directly exporting finished products to the US and Europe markets), increasing the US and European trade deficits with China whereas decreasing their deficits with Japan and the newly industrializing economies.

#### *China's soft power and the need for further improvement*

To play a hegemonic leadership role in shaping policies in the region, political and economic power is indispensable, but soft power is imperative. "Soft power" is a concept theorized by Joseph Nye (2004) which depicts the role of a country (the United States) as a benign hegemon in safeguarding a designated projection or objective not through military means but through the influence of its culture, political values, foreign policies, and economic attraction as essential components of national strength, providing the capacity to persuade other nations to willingly to follow the same suit. Nevertheless, the traditional image of China as a revolutionary communist country with a communist party still in

power is still a psychological and ideological obstacle in accepting China as a regional benign hegemon.

It is partially true that China's achievement is seen by the West as being attractive to authoritarian leaders around the world who seek to defend their sovereignty and remain in power. However, many democratic regimes in the developing world, like India, Brazil and South Africa, also positively assess China's development model in order to meet their own objective of establishing a more multilateral world order. Currently the impact of China's soft power development is felt differently in different part of the world, for example, China is becoming an appealing partner for Africa, Latin Africa and Middle East; and the "Beijing Consensus"<sup>6</sup> has become a counter-hegemonic discourse against the "Washington Consensus" (Li, 2007).

To speak of China's role in East Asian regional integration, it is unavoidable to talk about China's soft power. This is because soft power in terms of cultural and political influence, human capital and diplomatic relations are indispensable elements for the region to accept China's leadership role in building and influencing policy in the region. However, the picture of China's soft power in East Asia is somehow more complicated than it seems to be.

According to the results of a survey of public opinion, *Soft Power in Asia Survey 2008*, by The Chicago Council on Global Affairs in 2008, "China's growing economic and military might have not yet been fully translated into the elements of soft power that help a nation wield indirect influence in its region and the world" (Survey 2008: 4).

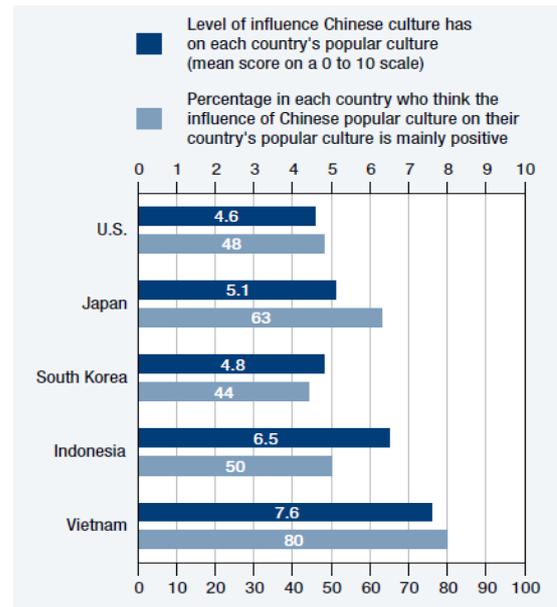
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<sup>6</sup> This notion by Ramo (2004) is referred to the "Chinese developmental model". This model is coined with distinct attitudes to politics, development and the global balance of power. It is driven by China's success in economic development with a strong belief in state role and sovereignty and global multilateralism. The concept is often applied in contrast to the Washington Consensus.

**Fig. 2: Importance of economic relations**



**Fig. 3: Influence of Chinese culture**



The Chicago Council, *Asia Soft Power Survey 2008*, p.4, 7

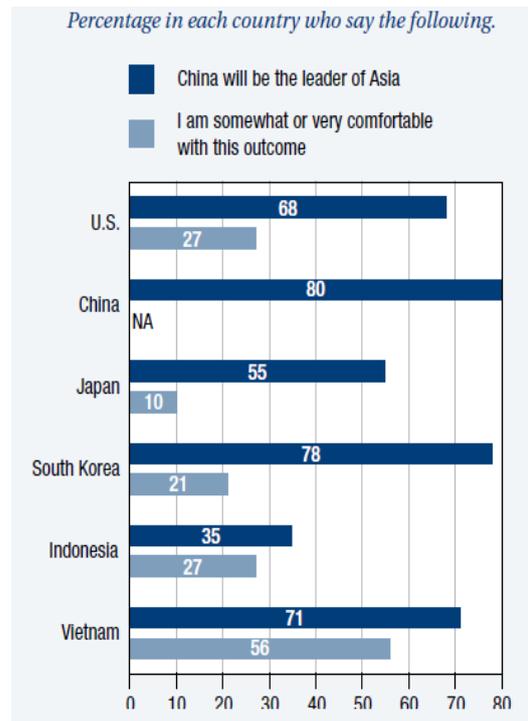
The above figures indicate that most countries surveyed attach a high importance to their economic relations with China, no less important than the traditional link with the US (fig.1). However, China's perceived economic power has not been fully matched its cultural influence in terms of popular culture, political culture, human rights and the rule of law.

**Fig. 4: viewing Chinese soft power**

Average level of influence on a 0 to 1 scale when soft power questions are combined for five key areas (see Appendix A for questions included).

Survey Countries	Economic	Human Capital	Cultural	Diplomatic	Political
United States	0.52	0.55	0.56	0.40	0.34
Japan	0.57	0.58	0.57	0.44	0.41
South Korea	0.57	0.64	0.54	0.51	0.48
Indonesia	0.73	0.74	0.62	0.69	0.71
Vietnam	0.70	0.80	0.77	0.67	—

**Fig. 5: China as the leader of Asia**



The Chicago Council, *Asia Soft Power Survey 2008*, p. 5

The above figures indicate that the influence of China's soft power is weaker than its economic influence (in Southeast Asia China's soft power is perceived stronger). On the question of China becoming the leader of the region, a majority of surveyed believe that China will eventually become the leader of this region; however, they also express a high extent of uncertainties regarding the idea of China one day becoming the leader of Asia. In order for China to play a larger role as a new hegemonic driving force in regional integration in East Asia, China still needs to further accumulate soft power.

### **Regional integration without regional security system and institutionalized polity**

#### *The lack of regional security system*

One of the important differences between East Asia and Europe is that as a holistic entity, Europe has developed into such a stage that it begins to show a collective willingness and capacity of transcending the Westphalian system of nation-state. This was realized partly due to the successful construction of a regional security framework – NATO – under the US hegemonic leadership. On the contrary, since the mid-19th century colonialization and the mid-20th century national liberation as well as rapid economic development since the late-20th century, many East Asian countries have just entered the historical stage of forming a core consciousness of nation-state. Furthermore, since the Asian financial crisis in 1997 and especially since the new century, nationalism or nationalistic tendency in East Asia has become more serious. In other words, in comparison with the EU the integrative cooperation in East Asia lacks the promotion of a transcendent “regional spirit” driven by cultural and ideological convictions.

This is to indicate the fact that due to the legacy of the Cold War and the two-pole confrontational order, the suppressed national consciousness and many conflicts related to “sovereignty”, “rights” and “interests” are emerging. Up to now, the East Asian region still has shadows of the Cold War in such a way that although the ending of the Cold War in East Asia was relatively earlier than that in Europe, the region has many unresolved issues left over by the Cold War leading to the fact that a higher level of integration is difficult to realize. The regional security dilemma is manifested by a number of bilateral contradictions between China-US, China-Japan, Japan-Russia, and between middle powers such as the two Koreas as well as between big powers and small states such as between China and ASEAN countries as well as between small states within the ASEAN. Some key powers in the region have bilateral security alliance NOT among themselves but WITH the United States. The dilemma facing many countries in the region is that while nationhood is still closely connected with

the identity of nation-state in which “sovereignty” is severely attached to “national identity”, or “national interest”, economic and political affairs are becoming more and more transnationalized.

The above security dilemma can also be seen from the fact that each country in the region has different security policies in terms of containment, prevention or alliance leading to many interrelated complications in regional security matters. Until now there is no commonly accepted and recognized security system or mechanism in controlling and balancing the multiple regional actors, which lead to unstable bilateral and multilateral security relations. Hence, security issues are unfortunately becoming the key major obstacles in enhancing mutual trust – indispensable cement for regional integration. However, following the gradual implementation of security dialogue mechanism, the security issues can become an impetus to the promotion of regional integration.

Scholars have different opinions about the objectives and motives of regional integration in East Asia. An overwhelming consensus tends to regard economical calculations as the most important motivation. Yes, for many years the economic rationality looks imperative. But, with the profound transformations taking place in the region in the last decade, security is emerging to become one of the key prominent motives driving towards regional integration.

#### *The lack of institutionalized polity*

As the paper demonstrates, the region’s economic integration was market-driven linking with the rise of major economic powers and with the division of labour and production relations led by these powers. Regional integration was slowly built up without institutionalized coordination even between the monetary and trade initiatives.

There are currently two processes driving further towards to Asian regionalism at sub-regional levels: top-down regional and governmental cooperation fostered by organizations like the Association of Southeast Asian Nations (ASEAN), and other bottom-up economic integration through cross-border investment and the establishment of regional production networks. The Asian Financial Crisis of 1997-98 played also a role in pushing the region into forming trade and financial agreement in one way or another including the establishment of a regional surveillance mechanism, the introduction of a regional liquidity support system (CMI) and Asian bond market development.

An important step to further economic regionalism is the formation of several bilateral Free Trade Agreements (FTAs) including the negotiations for sub-regional FTAs. Since then, the ten ASEAN countries have initiated a regular

series of meetings at the cabinet and head-of-government levels with their counterparts from Japan, China, and Korea. The development is also followed by some parallel structures: ASEAN10+1 (ASEAN 10 countries + China), ASEAN10+3 (ASEAN 10 countries + China, South Korea and Japan) and ASEAN10+6 (ASEAN 10 countries + China, South Korea, Japan, Australia, New Zealand, and India)

However, despite the fact that the organization of ASEAN has been playing an active role in sub-regional integration in the past decades, and in recent years the organization demonstrates a dynamic facilitating function in East Asia regionalization process, the “ASEAN+” model still has many structural problems. One of the central problems is the leadership issue, because most ASEAN countries are small countries and it is beyond their political and economic capacity to lead the big countries in the process of regional integration and to construct an effective regional security order. Accordingly, the ASEAN’s inadequate leadership authority is unsurprisingly reflected by the limited role it can play in diplomatic balance among big powers.

*The United States as an avoidable “remote control”*

The restoration and prosperity of the key economic powers of East Asia (Japan, South Korea, Taiwan) in the post-war period were realized as a result of the impact of restoring global stability alleviated by reconstruction funds provided by the United States whose post-war foreign and economic policies were aimed at fostering developmentalist, authoritarian and anti-Communist states in different parts of the world.

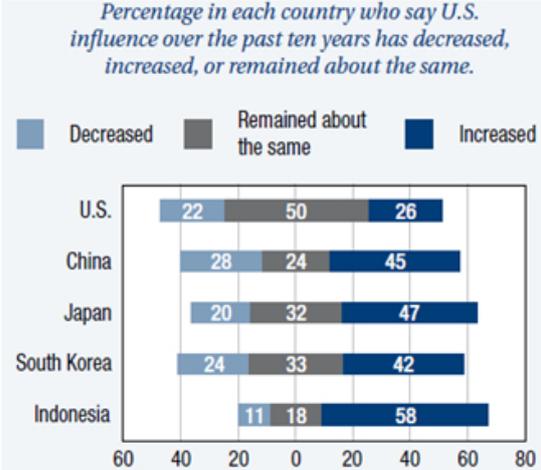
In Europe American “Marshall Aid” was used to revive the Western European industries within the possibly shortest time so as to eventually block Communist expansion. In East Asia the pivotal object of American post-war policy was basically the same as its policy in Europe: that is to revive the Japan-centred capitalist regional economies including South Korea and Taiwan. Under American protection, external military threats and the internal danger of communist expansion were substantially reduced in these two regions. The burden of the allied countries’ military expenses was also greatly reduced by the American military presence. American military bases have been documented to have not only protected these countries but also provided them with economic benefits such as employment. Even now, the withdrawal of American military forces would be considered as a substantial economic loss.

The end of the Cold War also marks the end of American geopolitical rationality for the region’s take-off and prosperity. America’s current global strategic policy is based on deregulation (Haass,1997), i.e. no longer regulated by superpower rivalry and *transnational liberalism* (Agnew and Corbridge, 1995)

in which nations interact in compliance with the rules and standards endorsed by the Washington Consensus. Thus, it is argued that the shift of the power base of the new US hegemony from hegemonic order/stability (*balance of power* under nation-state structure in a bipolar world) to hegemonic liberalism and market economies (*imbalance of power* under transnational structure in a multipolar global economy) is one of the important factors contributing to the East Asian financial crisis in 1997.

Nevertheless, despite the acknowledged weakening of the US global influence, the Chicago Survey in 2008 indicates that people in this regional still perceive the United States as either the first or second most influential economic power in Asia and rank it as their most important trading partner. A vast majorities surveyed believe that it is somewhat important for the young generations to learn English for the sake of their future career. Many Asians would still identify the United States as either their first or second choice foreign destination for higher education for their children since U.S. universities score the highest for their perceived quality (Survey 2008: 6-7). Albeit the rise of China’s economic influence in the region, the US still remains to be most influential in perceptions of its diplomatic, political, and human capital soft power. Fig. 6 indicates that very few people view the US influence in the region has decreased over the last decade, and most of them even regard the US influence as being either remained the same or even increased.

**Fig. 6. The influence of the United States**



The Chicago Council, *Asia Sofot Power Survey 2008*, p. 6

Therefore, it is even legitimate to ask the question: Can East Asian regionalism be realized without the United States? Even today, the US is still the largest export market for the key countries in the region. In addition, the US has much more closer political and military alliance with South Korea and Japan. Apart from the economic rationalities, the United States will have to both involve in and regulate East Asian affairs in order to make sure, for the sake of its own global interest, that China is becoming a responsible regional player in East Asia and a rational stakeholder in the international system. Therefore, the US strategic position in East Asian regional integration is still an unknown factor.

### *Political, territorial and historical obstacles*

As an extension to the previously mentioned security issues as unresolved problems in the regional integration process, other diversified political and security factors deserve equal scrutiny. Will common regional economic interests pressure governments to look beyond territorial disputes, historical memories and nationalism? As long as Japan's historical crime is still not clearly and sincerely acknowledged by the Japanese government, the fundamental political distrust among major powers of the regional will not easily disappear. Otherwise, regional integration in East Asia can only remain at the level of market interaction without political and cultural foundation.

Globalization and the post-Cold War power relations in East Asia with the disappearing of the balance of power necessity among world powers are paving the way for traditional international conflicts over territories and natural resources. Furthermore, severe economic competition and rapid economic growth in this region have intensified rising competition for fish, petroleum, gas and other resources and at the same time are spurring emotional nationalism in the region especially among China, Japan and South Korea, leading to the aggravation of long-standing disputes over territorial claims and history interpretations. Countries in this region, weak or powerful, rich or poor, are seeking ways to extend their power beyond their territorial waters. The South China Sea, the East China Sea Shore and the Spratly Islands are at present the hot spots for possible confrontations among a number of countries.

Historically China was the dominant regional power both politically, economically and culturally, whereas Japan began to emerge as a military and economic power since the *Meiji Restoration*<sup>7</sup> in the later 19<sup>th</sup> century. Right now, it is first time in the history of East Asia that Japan and China are becoming “two tigers in the same mountain”<sup>8</sup> – a rivalry competition. The growing economic interdependence among China, Japan and South Korea since the end of the Cold War has not been matched by a corresponding improvement in relations in socio-political and socio-cultural spheres. Without substantial foundations and levels of social, intellectual and political trust these three great countries will not be able to overcome the historical problems making a true

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<sup>7</sup> It refers to the period of the enlightened reign of Emperor Meiji (1868-1912) during which Japan started a series of modernization processes and rose to become a great regional power.

<sup>8</sup> It echoes the Chinese proverb “a mountain cannot be occupied by two tigers.” Here, it questions the possibility of two equally powerful countries engaging in cooperation rather than in a zero-sum competition.

full-fledged regionalism in East Asia unreachable. Other countries in the region do not have sufficient confidence, nor do they have the economic power to play the leadership role.

*Contradictions in economic levels, divisions of labour and other diversified factors*

Unlike the EU and NAFTA, economies of East Asia are too diversified in terms of economic size and development level as well as living standard. On the one hand, the region has two of the global economic giants – Japan and China, more advanced economy – South Korea, Singapore, etc; on the other hand, it also has world's poorest countries – Cambodia, Laos and Burma, etc. Many countries are still struggling with political stability and with serious poverty concerns.

Although intra-regional economic interdependence in East Asia has the appearance of a well-organized structure, further studies and examinations can disclose some embedded contradictions. The fact that the final products of different stages go through production processes in many countries in the region - indicates that this new division of labour is both horizontal in the sense that the entire industry or production line is passed on, and vertical in another sense that the sub-processes may be passed on to other countries. It must be seen that the region's economies are not in well-balanced harmony but are more in competition with one another in terms of labour cost, labour talent, seeking markets for export, technological upgrading, etc.

Other obvious factors blocking a full regional integration are vast differences in many key areas, such as political systems, social structure and cultural values, which make it impossible to reach basic consensus in order to form a region-based foreign, economic and financial policies. Most underdevelopment countries in the region are diversified in ecosystem, population, ethnicity, religion. Rather than integration obstacles they are facing more serious internal development problems such as emerging income gaps, environmental degradation, urbanization and congestion, and various social problems.

**Conclusion remarks: political integration in East Asia desirable or possible?**

This paper analyzes China's role in regional integration in East Asia as a new engine in promoting economic and trade growth. On the one hand, China's closer integration with economies in the region, along with a trend toward more assertive political and diplomatic manner, has contributed to great optimism for the economic and political regionalization in East Asia. On the other hand, China's rise has raised a leadership problem that may constitute an unknown factor on the process of increased regional integration in East Asia. Regional

integration has reached such a historical stage in East Asia where more structure and leadership is needed. China's future role is vital but hard to define. However, one thing is sure that China will continue to act as a facilitator and enforcer of regional cooperation.

As the neo-functional theories point out, the development of regional supra-national institutions was not historically an initial goal of regional integration but was out of functional imperatives (political or economic necessity). However, a crucial question to bear in mind is whether political integration in East Asia has ever been an objective of the regional integration project? In the case of the EU, supra-national sovereignty was historically already part of the initial ideals behind the integration project.

Nevertheless, many fundamental differences with deep-seated difficulties and obstacles between countries in the region are too wide to be bridged, such as vast diversities of economic level, political system, cultural value, security concern, etc. Currently, some sub-regional integration movements of free trade are developing. It is interesting to observe whether these sub-regional movements can generate the positive spill-over effect to eventually reach the regional integration at a higher institutionalized level.

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