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**CHINA AND ASIAN REGIONALISM\***

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## CHINA AND ASIAN REGIONALISM

This paper analyses China's role in the shift towards regionalism in Asia since 1997. In earlier waves of regional trading agreements (RTAs) Asia had been notably absent, with ASEAN the only significant grouping and its economic impact was small. The creation of APEC with its basis in open regionalism was almost anti-regionalism, essentially aimed to counter proposals for a more restricted RTA. China's role in the debates over APEC and participation in APEC during the 1990s were essentially passive.

The 1997 Crisis was a catalyst for regional arrangements in East Asia. Japan took the lead in advocating the creation of regional monetary institutions. The forum was a grouping of the ten ASEAN countries plus China, Japan and Korea, ASEAN+3, and the outcome was the 2000 Chiang Mai Initiative, creating formal swap arrangements among the grouping's central banks. Despite some advocacy of an Asian sequence of regional arrangements, the money-first approach made little further progress beyond the Chiang Mai Initiative.

China began to take a leadership role in the late 1990s as the emphasis shifted to trade agreements, which is where the recent action has been in East Asian regionalism. Chinese leadership was partly filling a vacuum as Japan faced a loss of confidence after a decade of slow growth and Korea was one of the countries seriously affected by the 1997/8 Crisis. The rapid growth of intra-Asian trade during the 1990s, temporarily reversed by the Crisis but quickly resumed, was a positive force for creating institutions to facilitate regional trade. Although Japan started the trend towards integrated production chains when it invested heavily in Southeast Asia after the yen's post-1985 appreciation, the networks became denser in the 1990s and China played an increasingly central role in the chains. Moving intermediate goods across borders required minimal delays and charges. Although China initially proposed trade liberalization among the ASEAN+3 group, foot-dragging by Japan and Korea led China to push ahead with its own RTA with ASEAN, which is the prime example of regionalism in Asia.

Whether China is leading the way towards an Asian bloc is debatable. Since WTO membership was secured, China has been pursuing global economic diplomacy. China has been active as an investor in Africa and Latin America. Closer to home China has strengthened ties with the main South Asian economies, and engaged with its western neighbours and Russia in the Shanghai Cooperation Organization. None of these initiatives involves discriminatory trade arrangements, and indeed the terms of the ASEAN+1 FTA pose little challenge to the multilateral trading system.

### 1. Asian Regionalism before 1997

A defining feature of the outward-oriented growth of East Asian economies in the second half of the twentieth century was multilateralism. Japan in the 1950s and 1960s, the new industrialized economies of the 1960s and 1970s (South Korea, Hong Kong and Taiwan) and China in the 1980s and 1990s all benefited from the openness of the multilateral trading system, even when they were not GATT/WTO members and even if they suffered from some special trade barriers. A corollary to this was avoidance of preferential trading arrangements which might appear to discriminate against their major trading partners in North America, in Europe or, increasingly, in Asia itself. The only significant regional trade organization in East Asia was the

Association of Southeast Asian Nations (ASEAN), whose initial driving force in 1967 was political (an association of the non-Communist countries of the region) and whose economic initiatives had minimal impact in the 1970s and 1980s (Pomfret, 2001, 146-7 and 302).

China's only attachment to a regional organization dealing with trade was its participation in Asia-Pacific Economic Cooperation (APEC).<sup>1</sup> The creation of APEC in 1989 was a specific reaction to the need for a regional framework in East Asia which would not conflict with specialization in the global economy. Japan, by far the largest Asian economy at the time, was wary of any discriminatory trading arrangement, and remained cool towards Malaysia's 1990/1 proposal for an East Asia Economic Group (later Caucus) which would include the ASEAN countries plus China, Japan and South Korea. The open regionalism concept was proposed by Australia and accepted by the USA and Japan as a preferable alternative to the discriminatory trade policies inherent in other regional trading arrangements such as the European Union, Closer Economic Relations between Australia and New Zealand or the Canada US Free Trade Area. APEC rapidly expanded its membership, and the participation of China, Hong Kong and Taiwan in 1991 increased APEC's importance.<sup>2</sup>

Various agreements in 1992 further institutionalized APEC, including establishment of a secretariat in Singapore. In 1993 the new US administration embraced APEC as the centrepiece of a more Asia-focused strategy, including promotion of trade liberalization in the Asia-Pacific region. APEC's function during the 1993-7 period was to provide a framework for concerted unilateral liberalization.<sup>3</sup> At the November 1994 Bogor summit APEC leaders adopted the goal of trade liberalization by APEC's developed country members by 2010 and by the developing economies by 2020. The Bogor Declaration was the high point of APEC's concerted liberalization. Differences over the comprehensiveness of liberalization and about the relationship between voluntarism and collective action were papered over in the 1995 Osaka Action Agenda. There was also fuzziness about the MFN implications of open regionalism; e.g. how did NAFTA, CER and ASEAN fit into non-discriminatory trade liberalization, and how could the EU be prevented from free-riding on intra-APEC trade liberalization?

The APEC phase of Asian integration was soon threatened by a widening split between the USA and East Asian countries who had conceived of APEC as a way of curbing US unilateralism and keeping Asia high on the US trade priority list (Barwick, 2007). The USA soon made it clear that its trade remedy actions (anti-dumping and countervailing duties) were non-negotiable, and the conclusion of NAFTA in 1994 and the 1995 Miami Declaration, pledging a Free Trade Area of the

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<sup>1</sup> Provinces of China did participate in some sub-regional agreements such as the Tumen River project, the Greater Mekong organization or Central Asian Regional Economic Cooperation (CAREC), but none of these involved discriminatory trade policies. Other regional arrangements such as the Shanghai Five (with Russia, Kazakhstan, the Kyrgyz Republic and Tajikistan – joined by Uzbekistan and renamed the Shanghai Cooperation Organization in 2001) focussed on security rather than economic relations (Pomfret, 2005b). The SCO and CAREC are discussed in the penultimate section of this paper.

<sup>2</sup> APEC now includes Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Taiwan, Thailand, the USA and Vietnam

<sup>3</sup> Concerted unilateral liberalization was not an empty slogan. Unilateral liberalization captures many actions in the 1980s and 1990s in Japan (e.g. the aluminium industry), China, Australia, New Zealand and southeast Asia, and there was an expectation that this could be more beneficial if concerted.

Americas by 2005, signalled an apparent return to a western-hemisphere-centred trade policy. In 1996 the USA pushed its market-opening strategy by launching the Early Voluntary Sectoral Liberalization (EVSL) Initiative for APEC liberalization in fifteen sectors, but by 1998 the EVSL had collapsed acrimoniously amid conflicting interpretations of voluntarism. Japan was particularly incensed by US assumptions that as a high-income country Japan had no opt-out rights, but there was a broader Asian disillusionment with APEC in reaction to perceived aggressive market-opening by the USA (Munakata, 2006, 91-2) and a growing sense among the East Asian countries that “it is more important to conceive of APEC as a trans-regional rather than a regional body” (Ravenhill, 2001, 214). China kept a low profile, but its chief negotiator was one of several participants to suggest that if sensitive items were to be liberalized on an MFN basis then the appropriate forum was the WTO.

China participated in APEC summits, which provided China’s leaders with an opportunity to meet other regional leaders and the US and Russian Presidents without the formality and pressures of a bilateral summit. The 2001 APEC summit in Shanghai illustrated the importance of this function, with the attendance of President Bush a month after 9/11. In the trade area, China mainly used APEC as a forum to announce liberalization measures which pushed along its WTO accession negotiations.

China’s trade policy priority during the 1990s was WTO accession. The application had been lodged in 1986 and frozen by leading WTO members after 4 June 1989. After the resumption of Chinese reforms in 1992, the WTO accession process moved slowly but steadily towards a successful conclusion. In 1997 China faced the added challenge of resuming sovereignty over Hong Kong. Until the late 1990s any evidence of regional leadership or activism was muted.

China’s accession to the World Trade Organization in 2001 signalled an important milestone for the multilateral trading system. China’s share of world trade had increased greatly since the country’s adoption of an “open-door policy” in 1978/9. Incorporating China into the WTO system was a major step forward for the rules-based multilateral trading system whose cornerstone is the unconditional most-favoured nation principle, ie. the commitment to treat all trading partners equally.

Surprisingly, WTO accession coincided with China’s embracing of regional trading arrangements. Although China had bilateral trade agreements with other planned economies during the Maoist era,<sup>4</sup> since the opening of the economy its trade had been based on multilateralism. China was typically identified, together with Japan and South Korea, among the few major economies that had not signed a regional trading agreement. In the late 1990s, however, this position began to be reversed and after the turn of the century China became one of the driving forces behind regional integration in East Asia.<sup>5</sup>

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<sup>4</sup> Following the establishment of the People’s Republic of China in 1949, trade relations were negotiated on a bilateral basis. During the 1950s these were primarily with the Soviet Union, but following the Sino-Soviet split the economy became more closed during the 1960s. During the 1970s as oil and mineral prices increased and relations with the West began to thaw following Nixon’s trip to China, foreign trade increased and trading partners diversified. Trade continued to be organized by sector-specific Foreign Trade Corporations until after the adoption of the open door policy in 1978/9, and even then the monopoly power of the Foreign Trade Corporations was only reduced gradually.

<sup>5</sup> Kawai and Wignaraja (2007, 1-13) review East Asian trade agreements negotiated between 2000 and 2007. Apart from notifications to the WTO reported on [www.wto.org](http://www.wto.org) the Asian situation is monitored on the ESCAP Asia-Pacific Trade and Investment Agreements Database ([www.unescap.org/tid/aptiad](http://www.unescap.org/tid/aptiad)) and by the ADB’s Asia Regional Integration Center database ([www.aric.adb.org](http://www.aric.adb.org)). Menon (2007)

## 2. Reactions to the 1997 Asian Crisis: Money and Politics

The Asian Crisis that erupted in July 1997 was an important stimulus to regionalism in East Asia. The multilateral institutions, notably the International Monetary Fund, were perceived to have let the region down, and there was a loss of confidence in the USA as guarantor of the system. In contrast to substantial financial support for bailouts of countries in other regions earlier in the decade (eg. Argentina, Mexico, Turkey, and Russia), the assistance given to the worst-hit Asian countries, notably Indonesia and Thailand, was seen as too little too late. Japan reacted to this situation by proposing regional monetary cooperation.<sup>6</sup>

Regional initiatives were initially in the monetary sphere (Pomfret, 2005a). China was cool to Japan's August 1997 proposal for an Asian Monetary Fund, but participated in the ASEAN+3 negotiations which led to the May 2000 Chiang Mai Initiative (CMI). The CMI, which became effective in November 2000, allows countries to swap their local currencies for major international currencies for up to six months and for up to twice their committed amount. By March 2002 six bilateral swaps, worth \$14 billion, had been concluded under the CMI (Manupipatpong, 2002, 118), and by the end of 2003 this had increased to sixteen bilateral swaps amounting to \$35.5 billion (Wang, 2004, 944).<sup>7</sup> After 2002, however, when the ASEAN+3 Shanghai meeting failed to move beyond the CMI, monetary integration appeared to be stalling.<sup>8</sup>

The first ASEAN+3 summit was held in December 1997 in Kuala Lumpur, after which these summits became annual. Although coinciding with the Asian Crisis, the 1997 meeting was in fact the culmination of a lengthy process to establish a regional forum after the USA had objected to a 1994 revival of Malaysia's proposal for an East Asia Economic Caucus (EAEC). Regional trading arrangements were on the agenda in 1998 and 1999, although without any immediate actions.

China's embracing of regionalism in the late 1990s was not just a reaction to Japan's moves in that direction. China had remained a steadfast supporter of the multilateral system until 1998 and followed the US lead, but considered that it received little acknowledgment or reward for its role. In particular, during the Asian Crisis China had maintained a stable exchange rate, resisting any temptation to join in competitive devaluations which could have set in motion a spiral leading to trade warfare. Feelings of lack of appreciation were heightened in spring 1999 when the

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analyses the global proliferation of bilateral trade agreements from an Asian perspective and Pomfret (2007b) analyses the threat of Asian regionalism to the global trading system.

<sup>6</sup> Although the Crisis provided a catalyst, Japanese disillusionment with the multilateral system had been growing during the 1990s as its economy stagnated and the need to assert some kind of regional leadership was stimulated by concerns about the rise of China. The desire for monetary cooperation in Asia may also have been kindled by signs that European countries were moving definitively towards adopting a common currency (Ravenhill, 2001).

<sup>7</sup> The CMI superseded the ASEAN swap arrangement, which had been in place since 1977 but at its maximum the facility only amounted to \$200 million.

<sup>8</sup> Attempts to create a more active regional bond market progressed slowly and involved a more diffuse country grouping. In 2003 the Executives' Meeting of East Asia and Pacific (EMEAP) central banks forum launched the Asian Bond Fund (ABF) Initiative. The EMEAP members (Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand) pooled \$1 billion in reserves for investment in US-dollar denominated bonds issued by sovereign or quasi-sovereign borrowers from eight EAMAP countries. In 2005 the eleven EMEAP central banks launched ABF2, which invested \$2 billion in sovereign or quasi-sovereign bonds from the same eight EAMAP countries, with the intention that ABF2 funds will be traded.

US bombed the Chinese embassy in Belgrade, and were not assuaged by half-hearted explanations in terms of a mistake based on obsolete maps. At the same time, China was becoming more aware of the interdependence between itself and the outside world (Shambaugh, 2005) and of its growing economic importance within East Asia, which was emphasised by Japan's long economic malaise during the 1990s and by the impact of the Asian Crisis on South Korea and most of southeast Asia, but with much less effect on China.<sup>9</sup>

In the trade sphere, open regionalism and APEC became passé,<sup>10</sup> and confidence in the WTO was damaged in 1999 by Seattle and the failure to launch a new round of multilateral trade negotiations. The endgame of China's WTO accession negotiations, which were concluded in 2001, could have been a countervailing force, but the moves towards regionalism were very much a political phenomenon, seen by China's own negotiators for WTO accession as economic madness.

### 3. Regionalism in the Twenty-first Century: Mainly about Trade

Towards the end of 2000 the leaders of the three major trading nations of the North Pacific announced steps to initiate bilateral trading agreements within the region, in a sharp break from their previous practice. On October 22 the prime ministers of Japan and Singapore agreed that on 1<sup>st</sup> January 2001 they would launch negotiations of a 'new age' preferential trade agreement to be known as the Japan-Singapore Economic Partnership Agreement (JSEPA).<sup>11</sup> On November 16 the US president and Singapore's prime minister announced that they would start negotiations on a bilateral free trade agreement.<sup>12</sup> On November 25, at the fourth ASEAN+China summit, China's premier Zhu Rongji called on the ASEAN members "to explore the establishment of a free trade relationship" with China (Munakata, 2006, 8-9).

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<sup>9</sup> Some commentators (e.g. Medeiros and Fravel, 2003) interpret China's more active diplomatic engagement since the mid-1990s, including greater willingness to play a leadership role in Asia, in a global rather than a regional context. Howe sees China's move towards regionalism in East Asia as the latest stage in China's embracing of globalization; China's need for "rapid, specific access to markets where Chinese goods are likely to be competitive" and need to "avoid its growing power causing serious conflict and disruption to the world system" (Howe, 2007, 97) can both be addressed by regional agreements.

<sup>10</sup> APEC's focus on the EVSL Initiative in the midst of the Asian Crisis raised questions about the forum's priorities and capacity to handle more than one issue at a time, and hiding behind the fig leaf of APEC's mandate not being concerned with financial issues was unconvincing. On the US side, disappointment with APEC and the EVSL led to a refocussing on the P5 likeminded countries (Australia, Chile, New Zealand, Singapore and the USA), which only strengthened Asian views that a regional body without the USA was needed.

<sup>11</sup> Japan intended initiating negotiations for bilateral trade agreements with South Korea (a move prompted by Korean President Kim Daejong's bold attempt at reconciliation between the two countries and reflected in agreement to co-host the 2002 football World Cup) and Singapore. The attempt to improve bilateral relations with South Korea made slow progress (Munakata, 2006, 109-10), but a Singapore free trade agreement was quickly concluded because there were no significant obstacles (eg. agriculture was irrelevant to Singapore).

<sup>12</sup> President Clinton's 1997 Trade Policy Agenda had included negotiation of bilateral trade agreements with individual Asian countries and the P5 proposal (for RTAs with Australia, Chile, New Zealand and Singapore) was on the table, but divisions within the administration had limited follow-up (Munakata, 2006, 188 n5). When President Bush took office in January 2001 the USA had one bilateral free trade agreement, with Israel, and one RTA, NAFTA. By 2007 the USA had seven bilateral FTAs in force (with Israel, Jordan, Chile, Singapore, Australia, Morocco and Bahrain), one pending (Oman), four awaiting Congressional approval (Peru, Colombia, Panama, and Korea) and three under negotiation (Malaysia, Thailand and United Arab Emirates), plus two RTAs (NAFTA and CAFTA-DR, with El Salvador, Nicaragua, Honduras, Guatemala and the Dominican Republic).

Thus, trade relations assumed centre stage in East Asian regionalism. This process was related to the rapid development of intraregional trade and investment during the 1990s.<sup>13</sup> The increased regionalization of the East Asian economy is often dated from the post-1985 appreciation of the yen and the subsequent surge of Japanese direct investment in southeast Asia. By 1996 intraregional trade was 50% of the East Asian countries' total trade, compared to about a third at the start of the 1980s. The share of intraregional trade in total exports dipped after the Asian Crisis, but it had climbed back to 52% in 2004, when the import share was 57% (Munakata, 2006, 47).<sup>14</sup> China's initial role was related to Japanese foreign investment, and these links are reflected in the increasing share of intra-industry trade in Sino-Japanese trade during the 1990s.<sup>15</sup> As China's economic weight increased dramatically over the decade of the 1990s, China's role in intraregional networks became more central (Gaulier, Lemoine and Ünal-Kesenci, 2006) and China changed from being a minor player in moves towards Asian regionalism before 2000 to become the major player after 2000.

East Asia's increasingly dense production networks provoked interest in, for example, streamlining customs procedures along a standard model, and created a sense that institutionalized approaches to reducing transactions costs within East Asia were needed. ASEAN had been considering in 2000 a proposal for integration among ASEAN+3, but rejected this in favour of individual trade agreements with Japan, Korea and China. While Japan and Korea were lukewarm, China moved swiftly in 2001 towards negotiating a trade agreement (Munakata, 2006, 117-8). China had an advantage over Japan or Korea because as a developing country it could reach a WTO-compatible agreement with ASEAN under the Enabling Clause, whose conditions are less restrictive than those of Article XXIV, and China was less concerned about protecting uncompetitive farmers. Nevertheless, the Chinese attitude in 2001/2 was notably more flexible and sympathetic to ASEAN members' concerns.

In November 2002 ASEAN and China signed the framework agreement on Comprehensive Economic Cooperation which foreshadowed establishment of an ASEAN-China Free Trade Area within ten years. China addressed ASEAN concerns by granting MFN treatment to the three ASEAN countries which were not yet WTO members (Cambodia, Laos, and Vietnam) and promising special and differential

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<sup>13</sup> The increased regionalization of the East Asian economy is described in Frankel and Kahler (1993), Hatch and Yamamura (1996), Aggarwal and Morrison (1998, 65-86), Lincoln (2004, 42-113), Munakata (2006, 37-61), and Rajan (2006). Gaulier, Lemoine and Ünal-Kesenci (2006) and Athukorala (2007) emphasise China's growing role in this process.

<sup>14</sup> These are higher than equivalent measures for NAFTA and similar to the shares for the EU in the mid-1980s. Other measures also show strong increases in intraregional trade in East Asia. Sohn (2002) used trade intensity indices to show that trade within the East Asia region was increasing during the 1990s. Ng and Yeats (2003) also calculated trade intensity indices in their study of trade relations involving China, Hong Kong, Japan, South Korea Taiwan and seven ASEAN countries. Ando and Kimura (2005) calculate very high shares of machinery (HS84-92) in East Asian countries' trade in 1996 and 2000, and conclude that this structure is especially suited to production fragmentation; they also use a large Japanese firm-level dataset from 2000 to analyse the nature of production networks, concluding that such networks are a feature not just of large Japanese firms but also of small and medium-sized Japanese enterprises.

<sup>15</sup> Xing (2007) calculates intra-industry trade (measured at the 3-digit SITC level) to have accounted for 6% of China's bilateral trade with Japan in 1980, 18% in 1992 and 34% in 2004 and finds that Japanese foreign direct investment performed a significant role in enhancing IIT (a result which was not replicated for US FDI in China). Zhang et al. (2005) have comparable estimates, although their study does not focus on East Asia. Kimura et al. (2007) argue that the IIT in Asia is fundamentally different than elsewhere, reflecting vertical IIT due to fragmentation of production rather than the horizontal IIT due to product differentiation observed in Europe.

treatment for the newer ASEAN members who feared competition from China, while proposing an ‘early harvest’ whereby both sides could move quickly to reduce tariff barriers on goods of particular interest. In June 2003 China and Thailand signed an early harvest agreement to eliminate tariffs on 108 edible vegetables and 80 edible fruits and nuts from 1 October 2003, and early harvest measures involving other ASEAN members were introduced on 1 January 2004.<sup>16</sup> In November 2004 the formal Agreement on Trade in Goods between ASEAN and China was signed; it envisaged establishment of a free trade area by 2010 for six ASEAN members and by 2015 for the four newest ASEAN members.<sup>17</sup> In addition, the framework agreement foresaw more comprehensive liberalization.<sup>18</sup>

As China proceeded with its ASEAN+1 strategy, it continued participating in the ASEAN+3 summits and also in trilateral cooperation talks with Japan and Korea.<sup>19</sup> The trilateral talks, however, revolved around setting up study groups rather than any immediate policy agenda. For China (as for Korea) there are deep-seated historical obstacles to cooperation with Japan, which were highlighted by the violent anti-Japanese demonstrations in several Chinese cities in spring 2005. In sum, the pattern for China, as for East Asia in general, in the first half-decade of the 2000s was one of talking regionally but acting bilaterally.

China’s ASEAN+1 agreement and the bilateral FTAs signed by some ASEAN members (notably Singapore and Thailand) with countries within and outside the region undermined the role of the ASEAN+3 grouping in regional trade liberalization.<sup>20</sup> The ASEAN+3 framework became used not for trade issues, but for various other functional areas such as finance, information technology, standards, the environment, health (after the SARS outbreak in 2003), and energy security (after the oil price hikes in 2004).

At the eighth ASEAN+3 summit in 2004, it was agreed to convene a regular East Asian Summit. In the early preparatory stages China had proposed holding the

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<sup>16</sup> The Thai-Chinese trade in agricultural products had been a problem due to non-tariff barriers such as food safety requirements and import licensing. Even though agricultural trade between northern Thailand and southern China surged after October 2003, disputes remained. A further bilateral agreement aimed to simplify inspection and quarantine procedures from May 2005, but it did so by restricting fruit exports to registered orchards and packing houses – a regulation whose market-friendliness is unclear.

<sup>17</sup> The free trade area in the ASEAN-China agreement envisages tariff rates of 0–5% on ‘normal’ goods. Because this is a south-south FTA, it can be negotiated under the Enabling Clause, which provides greater latitude than Article XXIV to exclude items. Thus, some 400 tariff lines at the HS 6-digit level (accounting for 10% of trade between China and the ASEAN-6 using 2001 trade data) and 500 tariff lines for Cambodia, Laos, Vietnam and Myanmar are to be exempted from inclusion in the ASEAN-China Free Trade Area (Hedi Bchir and Fouquin, 2006, 14-15).

<sup>18</sup> According to Sen (2004, 76) agriculture, human resource development, information and communication technology, investment, and development of the Mekong River Basin were identified as priority areas. Kwei (2006, 121) reports that collaboration on illegal immigration, drug smuggling, counterterrorism and other security concerns were also on the agenda.

<sup>19</sup> At the start of the decade China’s trade relations with Japan and Korea were not good. Trade wars were sparked in 2000 and 2001 by restrictions on China’s exports of leeks, reeds and shitake mushrooms to Japan and of garlic to Korea, followed by Chinese retaliatory tariffs on Japanese cars and air conditioners and on Korean mobile phones. The disputes were settled in 2001 and 2002. At the same time all three countries joined forces with the EU in a WTO complaint against US steel tariffs.

<sup>20</sup> Bilateral agreements signed by individual ASEAN members with non-ASEAN partners (e.g. Thailand with Australia, New Zealand and Bahrain, Malaysia with India, Pakistan and the USA, and Singapore with Australia, Japan, Jordan, New Zealand, Panama and the USA) also undermined preferential intra-ASEAN trade despite the existence of the ASEAN Free Trade Area and the 2003 decision to deepen integration by establishing an ASEAN Economic Community by 2020 – a deadline brought forward to 2015 in January 2007 and provided with a roadmap in November 2007.



first summit in Beijing, but Chinese policymakers quickly recognized that Chinese overpresence might stimulate concerns within the region about a Chinese threat. Hence, China was happy to let ASEAN play the leadership role, and the First East Asia Summit met on 14 December 2005 in Kuala Lumpur. The East Asia Summit was preceded by arguments about whom to invite, with China favouring a guest list limited to ASEAN+3.<sup>21</sup> Japan argued successfully for Australia, India and New Zealand to be included, so that the East Asian Summit configuration is sometimes referred to as ASEAN+6. At the summit China argued for Russia's inclusion, but no agreement was reached on this issue. The second East Asian Summit held in Cebu in January 2007 had the same participants as the first. There was also no clarification of the relative roles of the East Asian Summits and the ASEAN+3 summits in the evolving regional architecture.

One consequence of the East Asia Summit was to highlight the competition for regional leadership. Even though China gave way to Japan on the invitation list, the Summit was a Chinese initiative and Japan felt a need to respond. The Japanese proposal of a Comprehensive Economic Partnership in East Asia (CEPEA) among the sixteen East Asia Summit participants was a non-starter, especially because it seems even more than the EAEC to be an FTA which excludes the USA.<sup>22</sup> Japan's next response was to negotiate further bilateral trade agreements; when Australia had raised the prospect of an FTA in 2002, Japan (unlike the USA or China) declined to negotiate, but in 2006 Japan pushed for an FTA.<sup>23</sup> Meanwhile, China broadened its regional perspective in November 2006 by signing a free trade agreement with Pakistan, whose relations with China were described by President Hu Jintao on Pakistani TV as "higher than the Himalayas, deeper than the Indian Ocean, and sweeter than honey". China has also become more active in South Asian regional fora.<sup>24</sup>

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<sup>21</sup> In 2004 and early 2005 the USA lobbied Japan not to cooperate with proposals for an East Asian Summit, because the summit was designed to enhance the influence of China, while others suspected that the goal was to exclude the USA (Munakata, 2006, 15). In general, however, the USA showed less concern towards East Asian regionalism in the early 2000s than it had in the 1990s. This reflected other priorities, especially the war on terrorism after September 2001, but also the Bush administration appeared to have few principled opponents to discriminatory trade arrangements whether signed by the USA or by other countries. Fostering ASEAN integration had become US policy (see, for example, US Department of State *Fact Sheet* "ASEAN Cooperation Plan" 4 December 2002), influenced by the increased involvement of US transnational corporations in Asian production networks. Within APEC the USA shunned a 2003 Thai initiative to revive the Bogor Goals and a 2004 proposal for a Free Trade Area of the Asia-Pacific which was supported by Australia, New Zealand and Singapore (Barfield, 2007).

<sup>22</sup> Tumbarello (2007) takes a guardedly more positive view of a pan-Asian FTA among the 16 East Asian Summit countries, arguing that such consolidation might help to unravel the current "noodle bowl" of overlapping trade agreements. Proposals for a Free Trade Area of the Asia Pacific (FTAAP) among APEC members, which have been voiced in the Pacific Economic Cooperation Council (PECC) seem even more unlikely to be adopted.

<sup>23</sup> Some of Japan's motivation was directly related to perceived competition with China. Japan fears loss of Australian markets to China in areas such as auto components. More specifically, Japan aimed to secure the same exemptions from foreign investment review as those contained in the Australia-US FTA, in order to facilitate Japanese investment in Australia's energy and minerals sectors, where it sees itself in competition with China to secure resource supplies. Concerns about food supply have also helped to counter the Japanese Ministry of Agriculture's apparent veto of FTAs with Australia or other food suppliers. Kimura (2007) takes an optimistic view of the Australia-Japan FTA.

<sup>24</sup> In 2007 China was granted observer status at the South Asian Association for Regional Cooperation (SAARC), whose members are Afghanistan Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka. Along with the other observers (Japan, Korea, the EU and the USA) China attended the April 2007 SAARC summit, but China generally emphasizes areas other than trade as fields for

A feature of the various regional permutations described above is the absence of Taiwan. As a condition of China's WTO accession, negotiations with Taiwan proceeded more or less in tandem. Taiwan is also a member of APEC. In determining the composition of the various recent East Asian groupings, however, China has been able to exclude Taiwan. Thus a side-benefit for China of the shift in emphasis from the multilateralism of the WTO or the open regionalism of APEC to regional trading arrangements in a broader context of growing bilateralism has been the opportunity to exclude Taiwan from the main currents of Asian regionalism.<sup>25</sup>

#### **4. China's Regional Initiatives with Western Neighbours; Mainly about Security**

China has cultivated relations with its western neighbours, but consideration of Central Asia arises largely in the context of energy supplies or security, neither of which has much to do with trade policy. Trade with Central Asia is important for Xinjiang autonomous region, which borders three of the Central Asian countries, although physical barriers are substantial in the south. Overall, however, the Central Asian countries are minor trading partners of China.<sup>26</sup> To some extent this reflects official discouragement after an initial surge, from a very low base, following the Central Asian countries' independence in December 1991.<sup>27</sup> The evidence of the bazaars is that unofficial trade with China, in imported consumer goods, continues to flourish but is under-recorded. The potential for increased trade between Central Asia and China is substantial given their differing factor endowments and natural resources (Raballand and Andrésey, 2007), but realizing the potential depends upon a favourable trade environment and improved physical infrastructure.

In 1998 Chinese customs statistics report formal exports to Central Asia of \$456 million and imports of \$499 million.<sup>28</sup> Wiemer (2000) reports estimates of informal exports at \$300-600 million. Even with the highest estimates of informal trade, Central Asia accounted to less than one percent of China's total trade. For

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cooperation with SAARC. In 2001 China signed the Bangkok Agreement, which is open to all 62 members and associate members of UNESCAP, but currently has six members (Bangladesh, India, Republic of Korea, Lao PDR, Sri Lanka and China – Pakistan was invited to accede in January 2007). China and India offer each other tariff preferences but the coverage is minimal, eg. China's 2001 offer covered 2% of imports from India. In July 2006 the Bangkok Agreement was renamed the Asia-Pacific Trade Agreement (APTA) with some extension of the list of included items and increased depth of tariff preferences.

<sup>25</sup> This paper does not deal with Closer Economic Partnership Agreements with Hong Kong and Macao, which were negotiated in 2003 and whose implementation began in 2004, and which are seen by China as potentially including Taiwan under a 'one country - four regions' formula.

<sup>26</sup> In the thirty years preceding the dissolution of the Soviet Union, trade between Central Asia and China was severely restricted. Border crossings were closed in the early 1960s after the Sino-Soviet split, and only two – Horgos between Kazakhstan and China, and Torugart between the Kyrgyz republic and China – reopened when relations improved in the early 1980s. The first railway between China and Central Asia opened in 1990, and since then has carried the vast majority of freight by volume (mainly minerals from Kazakhstan to China).

<sup>27</sup> Cross-border trade between Central Asia and China grew rapidly in the early 1990s, although hard data are unavailable. The growth slowed in 1993-4, and in the mid-1990s some Central Asian governments expressed concern about their markets being flooded by Chinese consumer goods, while Chinese traders and potential investors worried about the insecurity of property rights in Central Asia. Some commodity trade was dominated by bulk state purchases and could fluctuate from year to year, eg. Uzbekistan's cotton sales to China fell from \$133 million in 1997 to \$29 million in 1998.

<sup>28</sup> See Pomfret (2006, Table 10.5); the main items were iron and steel (\$202m.), copper (\$87m.), aluminium (\$53m.) and fuel (\$40m.) imports from Kazakhstan and shoe exports (\$80m) to Kazakhstan and the Kyrgyz Republic.

Xinjiang Province, however, over half of international trade was with Central Asia. Trade was disrupted in 1999 following the Russian crisis and related crises in Kazakhstan and the Kyrgyz Republic. Kazakhstan closed border posts and devalued its currency substantially, cutting demand for imported Chinese goods. This is likely to have had a negative impact on the informal trade, although official trade data show continuous growth in Kazakhstan's exports to China, by far the largest single flow, over the period 1998-2000 (Pomfret, 2006, Table 10.5).<sup>29</sup> Trade between the Kyrgyz Republic and China stagnated after 1998 while the other three Central Asian countries' trade with China, especially their exports, remained tiny. In 2003-4 there appears to have been a surge in Chinese exports to the Kyrgyz Republic, a significant part of which went to bazaars for on-sale to Uzbekistan whose own bazaars are restricted.

A regional grouping, dubbed the Shanghai Five, emerged from a meeting in 1996 of China, Russia, Kazakhstan, the Kyrgyz Republic and Tajikistan intended to demilitarize borders (Chung, 2004). At subsequent meetings the focus was on security issues, until at a summit in Dushanbe in July 2000, the Five, with Uzbekistan as an observer, took up a number of themes related to trade facilitation as well as discussing issues such as countering Islamic terrorist groups. The extension into economic areas was a fresh departure, and the group changed its name to the Shanghai Forum and invited other countries to join. At the June 2001 summit Uzbekistan became the sixth member and the group was renamed the Shanghai Cooperation Organization (SCO).<sup>30</sup> Despite the intention to cover matters such as trade facilitation, the subsequent history of the organization has centred on political rather than economic matters.

China played a catalytic role in bringing the Central Asian countries together. In 1998-9 Central Asia was divided into two opposing camps, as Uzbekistan aligned with GUAM (Georgia, Ukraine, Azerbaijan and Moldova) and Kazakhstan, the Kyrgyz Republic and Tajikistan joined Russia and Belarus in the Union of Five and its successors (now the Eurasian Economic Community). This division eased in 2000 and 2001, in part because the incursion of Islamic fighters into the Ferghana Valley presented a common problem to the three countries whose territory was involved. China's promotion of the SCO as a more formal successor to the Shanghai Forum was also part of the wider shift in Chinese strategy after spring 1999, as China pursued a less pro-US course, which also included embracing Japanese proposals for Asian monetary cooperation (Pomfret, 2005a). Although Russia saw the SCO as a vehicle for its leadership in Central Asia, for the Central Asian leaders, especially Uzbekistan, the SCO was palatable because of China's counterweight.

The SCO is the only international group formed by China, and it receives extensive press coverage in China. Russia was also enthusiastic in the early years of the Shanghai Five, hoping the grouping would help Russia to retain leverage over Central Asia, but Kazakhstan, the Kyrgyz Republic and Tajikistan all reached border delimitation agreements with China in the late 1990s without consulting Russia. From 1998 to 2001 the organization evolved into a Sino-Russian vehicle for opposing

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<sup>29</sup> Even for this element, which is dominated by trade in minerals between official entities or large companies, there is a large discrepancy between the Chinese data and data collected by Kazakhstan. The substantially larger numbers reported by China most likely reflect the deficiencies of Kazakhstan's customs service which was widely believed to be one of the most corrupt parts of the administration.

<sup>30</sup> At subsequent SCO summits Mongolia, Iran, Pakistan and India have been admitted as observers. Iran, Mongolia and Pakistan have applied for SCO membership. Nepal is considering applying for observer status.

US hegemony and for mutual tolerance of anti-separatist measures in Chechnya and Xinjiang. The military side remains important and joint operations planning in 2001 represented the first cooperation between the Russian and Chinese military since the early 1960s.<sup>31</sup> Cooperation against terrorism has been a major theme at SCO summits, but in 2001 the SCO failed to respond to the September 9<sup>th</sup> assassination of Ahmad Shah Massoud or the September 11<sup>th</sup> terrorist acts in the USA.<sup>32</sup>

After the June 2004 SCO summit, Uzbekistan and Russia signed a strategic partnership agreement that could be a harbinger of greater coordination among SCO members. China announced plans to extend \$500 million in loans and credits to Central Asian countries, and its presence in the region building roads and other construction projects has grown. The Central Asian countries welcome infrastructure and other investment from both Russia and China, although Russia may not want to see China gaining economic influence in Central Asia. The rupture of US-Uzbekistan relations in 2005, when Uzbekistan reacted to reduction of US assistance due to its human rights record by embracing cooperation with Russia and China, provided a further boost to the SCO.

Fundamentally, however, the Central Asian governments do not share the Sino-Russian agenda of opposing US hegemony. Although there have been ebbs and flows in individual countries' warmth towards the USA, Central Asian governments have been willing to cooperate with the USA, providing bases since September 2001 and so forth, rather than coordinating anti-terrorist action under the aegis of the SCO.<sup>33</sup> Although relations with China are cordial, potential conflicts could surface if China proceeds with plans to divert water from rivers originating in Xinjiang and flowing into Russia and Kazakhstan.<sup>34</sup> Opinions on the future prospects of the SCO – or whether it has a future – are split. Chung (2004, 1007) concludes that “the SCO is likely to retain its organizational coherence . . . because it is in a way every member state's best fallback foreign policy position”, ie. its survival will be as a low-activity political institution with minimal economic impact.

In the economic sphere there are several potential sources of conflict or competition among SCO members that may outweigh the desire for cooperation. In many parts of Central Asia there are deep concerns about being swamped by Chinese goods or migrants, and these concerns are played upon when potential competition

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<sup>31</sup> Russia and China are united in their support for the 1972 Anti-Ballistic Missile Treaty and opposed to US plans to revise the ABM Treaty. The final statement at the 2001 SCO summit called the ABM Treaty “a cornerstone of stability, peace and nuclear deterrence”.

<sup>32</sup> The SCO decided to establish an anti-terrorist centre in Bishkek. However, in May 2001 the CIS Collective Security Treaty signatories had already created a rapid-reaction force with some 2,000 soldiers from Russia, Kazakhstan, the Kyrgyz Republic and Tajikistan committed to fighting potential insurgencies in Central Asia, and the CST would appear to be aimed at pre-empting Chinese participation in joint anti-terrorist action in the region. It took until December 2002 for SCO experts to meet in Bishkek to discuss the rules and activities, funding and staffing of the anti-terrorist centre, and then in September 2003 it was announced that the Bishkek centre had been cancelled and an anti-terrorist centre would be opened in Tashkent in 2004.

<sup>33</sup> Uzbekistan hosted the main US base for the invasion of Afghanistan, but closed the base after US criticism followed the 2005 Andijan massacre. Russia and China put pressure on the Kyrgyz Republic in 2006 to close the last remaining US base in Central Asia, but the Kyrgyz did not comply. As Uzbekistan distanced itself from the USA, Kazakhstan shifted its orientation in favour of the USA, highlighted by the Nazarbayev-Bush summit in Washington DC in September 2006.

<sup>34</sup> Horsman (2001, 79-81) concludes that “China is unwilling to engage in meaningful cooperation or compromise in the pursuit of its water demands”. If Kazakhstan were sufficiently aggravated, it might reinstate its agitation over Chinese nuclear testing at Lop Nor and treatment of Uighurs, two issues on which Kazakhstan (and the Kyrgyz Republic) have since the mid-1990s agreed to exercise restraint.

from Chinese goods undermines governments' import-substitution strategies, most notably in Uzbekistan. With the rapid increasing energy prices since 1999, China's search for greater energy security has led to deeper involvement in Central Asia through the construction of oil pipelines in Kazakhstan, which will eventually link the large Caspian oilfields with the Chinese domestic pipeline network, and long-term contracts with Turkmenistan for the supply of natural gas; both of these initiatives are a source of conflict with Russia, which seeks to retain an almost monopoly on Turkmen gas sales and a dominant role in Kazakhstan's choice of oil export routes.<sup>35</sup> In terms of regional organizations, there is potential competition for forum pre-eminence between the SCO and the Eurasian Economic Community (EurAsEc), and Russia's focus is currently on the latter.<sup>36</sup> Central Asian countries may resist Russian hegemony, but the recent trend is for this to be through bilateral agreements with China rather than by strengthening the SCO.

A looser organization involving Xinjiang autonomous region of China, Kazakhstan, the Kyrgyz Republic, Tajikistan, Uzbekistan, Afghanistan, Azerbaijan, and Mongolia is the Central Asia Regional Economic Cooperation (CAREC) program. CAREC is an initiative to encourage economic cooperation in transport, energy, trade policy, and trade facilitation supported by several multilateral institutions coordinated by the Asian Development Bank.<sup>37</sup> Despite slow progress since its launch in 1997, CAREC in 2004 established a Trade Policy Coordinating Committee which had its first meeting in September 2004. This may signal a willingness to take definite steps on trade facilitation among the CAREC members, although progress since 2004 has been slow.

## 5. Conclusions

China's regional leadership role in East Asia emerged as Japan's economy faltered and several ASEAN countries were weakened by the Asian Crisis. ASEAN remains important because the norms of behaviour which it espouses – equality, mutual respect, pragmatism and openness – remain central to progressing East Asian regionalism, perhaps similar to the role of Benelux in early steps towards European regional integration. Nevertheless key issues remain unresolved, including the role of Australia, New Zealand and India, who attend the East Asian Summits but not the ASEAN+3 summits, and also the role of Hong Kong and Taiwan which are major trading units but have no separate involvement in either process.

Since the late 1990s APEC appears to have terminally lost influence as a forum for "open regionalism". This was further emphasised by the September 11 acts in the USA, which distracted US attention from East Asia and highlighted that APEC

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<sup>35</sup> A 966-kilometer oil pipeline has already been constructed from Atasu in Kazakhstan to the Chinese border and this is scheduled to be extended 700kilometers further west by 2009. In July 2007 Turkmenistan and China signed a thirty-year gas contract which would be implemented through a trans-Kazakhstan gas pipeline, although many industry experts are sceptical of Turkmenistan's ability to meet all its contracted deliveries to Russia and China in the coming decades. China's initiatives in 2007 were in part a response to a Russian decision to terminate a pipeline on the Pacific coast aimed at the Japanese market, rather than linking it to the Chinese network.

<sup>36</sup> In 2005 Uzbekistan joined Russia, Belarus, Kazakhstan, the Kyrgyz Republic and Tajikistan in the Eurasian Economic Community. Thus, the membership of EurAsEc is that of the SCO minus China and plus Belarus.

<sup>37</sup> The other multilateral institutions participating in CAREC are the European Bank for Reconstruction and Development, the International Monetary Fund, the Islamic Development Bank, the United Nations Development Programme, and the World Bank.

was not well-equipped to deal with political issues such as security and their interconnection with economic decisions. APEC summits remain useful meeting places for leaders, and affiliates such as the APEC Business Advisory Council provide assistance in trade facilitation, but APEC is not the driving force for trade liberalization that its promoters anticipated in the early and mid-1990s. The Bogor targets for 2010 will clearly not be met, and this failure becomes more striking as the target date approaches.

Once China had secured WTO membership in 2000/1, a major vehicle for its regional leadership aspirations has been trade agreements. Regional trade agreements may be a stepping stone towards multilateralism; China's interest in regional cooperation along the Mekong River, for example, may be because some members of the Greater Mekong sub-regional grouping only recently became or are not yet WTO members.<sup>38</sup> Regionalism may also be an alternative to multilateralism, and that characterizes the broader shift in Chinese economic diplomacy in recent years. The shift was first apparent in the area of monetary cooperation after the 1997 Asian Crisis. It then became more apparent in the area of trade arrangements as China played a lead in the proliferation of bilateral agreements and proposals for Asian regional integration in the early 2000s.

Although regionalism may be viewed as an alternative to multilateralism, in the East Asian context there may be little conflict between the two. Duty payments on intra-Asian trade tend to be low as a result of trade liberalization and of the prevalence of duty-drawback systems in response to the production fragmentation and networks which emerged over the last two decades. The bilateral trade agreements tend to be narrow in scope and coverage, with trivial economic impact and problematic politics, corrosive of regional integration, wasteful of policymaking capacities, sucking oxygen from reform momentum, and causing negative reactions which lead to poor dynamics. Their saving grace is that most of the mooted trade agreements are not completed and even when implemented many traders continue to trade on an MFN basis rather than invoking bilateral agreements, e.g. less than 15% of Singapore's trade with preferred partners is conducted under the terms of bilateral agreements.<sup>39</sup>

In sum, although the content of China's East Asian regional agreements is economic, the driving motivation behind China's embracing of regionalism since the turn of the century is political. The various East Asian groupings have allowed China to assert its regional hegemony, and Japan has so far clearly come off second-best despite still having a larger economy than China's. Moreover, the flourishing of bilateral agreements as the highest profile trade policy agenda has left Taiwan totally sidelined. China's agreements with other neighbours, whether in Central Asia or South Asia, are less intense and with an even clearer dominance of political or security considerations over economic content.

Economists generally view regional trading arrangements with suspicion; they are in the realm of second-best, at best stepping stones to multilateral trade liberalization and at worst stumbling blocks and distractions. From a broader perspective, however, China's increasing engagement with its neighbours, and

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<sup>38</sup> Myanmar and Thailand were founder members of the WTO. Cambodia joined the WTO in 2004. and Vietnam in 2007. Laos lodged its membership application in 1997, but negotiations only got seriously under way in 2004.

<sup>39</sup> The litany of shortcomings draws on a public lecture by Peter Drysdale entitled *Where to Asian Regionalism?* at the Johns Hopkins University Bologna Center on 2<sup>nd</sup>. November 2006. On the trivial economic impact of many bilateral and other regional trading agreements, see Pomfret (2007a).

especially its good-neighbourliness over the last decade, is a positive development; in the 1980s almost all of China's borders were disputed and in the 1990s China threatened to settle ongoing disputes, such as in the South China Sea, by force, but today apart from the major exceptions of the sea-border with Japan and the land-border with India the disputes have been settled and China is no longer seen as a threat to its smaller neighbours. Although political struggles for hegemony continue in Asia, that is far preferable to the militaristic overtones of power struggles of the recent past.

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