

China's Economic Diplomacy

Focusing on the Asia-Pacific
Region

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Abstract: Of all the major activities and initiatives by the fifth-generation Chinese leadership, formally inaugurated in 2012, those relating to the Asia-Pacific region are the most noteworthy. The past two years witnessed the Chinese leadership enunciating a “Chinese Dream” vision for the nation and offering to share the prospects of prosperity and stability with the entire Asia-Pacific region and beyond. The leadership also adopted a “new normal” mode, aimed at stabilizing domestic economic growth and improving its quality. By way of establishing and expanding free trade zones, China demonstrates its commitment to liberalization. The spate of free trade agreements concluded with U.S. security allies, in addition to a commitment to expedite conclusion of a bilateral investment treaty with the U.S., points to China’s separation of rules-based trade/investment management from concerns about geostrategic denial. Chinese initiation of the Asian Infrastructure Investment Bank and integration with economies along a “Silk Road Economic Belt” and a “Twenty-first-Century Maritime Silk Road” are bold yet challenging. At the same time, other Chinese economic diplomacy initiatives

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have yet to win broad-based support. Nevertheless, in its totality, China is not seeking to rewrite established rules of world economic governance.

Keywords: China; economic diplomacy; Asia-Pacific; geoeconomic competition.

Formal inauguration of the fifth generation of the Chinese leadership took place against the background of major uncertainties in the domestic and global economies. Toward the end of 2012, the massive stimulus investment injected in the wake of the 2008 world financial crisis had run its course. New momentum of growth had to be based on new policy designs. The aggregate size of the Chinese economy had grown to be the second largest in the world. This change leads to, in some quarters, calls for China to do more in energizing global recovery/growth and efforts to guard against the spread of Chinese influence in other contexts. Yet, as acknowledged by serious observers both in and outside the country, China is and will remain for some years, possibly decades, low in the value chains in the Asia-Pacific region and beyond. In a geostrategic sense, the rise of China will continue to produce mixed reactions by the established powers.

Fully two years into its ten-year mandate, the Chinese leadership has articulated its visions and adopted a sufficiently large number of measures to allow for a preliminary synthesis of its economic diplomacy. In line with recognition that, today, how the Chinese leadership tackles its domestic economic challenges has a direct impact on the evolution of the entire world economy, a meaningful stocktaking should include linking the government's domestic and foreign economic policy choices. Furthermore, the economic geography of the Asia-Pacific region offers bright prospects for Chinese approaches to managing cross-border economic affairs and will also eventually serve as the testing ground for Chinese strategies. As such, in the rest of the paper, I shall mainly focus on how China relates to the Asia-Pacific. Hopefully this treatment can be helpful in addressing the larger question of how China relates to the rest of the world as well.

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Let me begin with a sketch of the vision the new Chinese leadership projects for the country.

The Chinese Dream: A Vision of Inclusion

In December 2012, the 18th Congress of the Chinese Communist Party formalized the entry of the fifth generation of Chinese leaders. Amidst expectations of a core strategy for governance, Xi Jinping, the new Party Secretary and President of the country, popularized the term “Chinese Dream” during a speech at “The Road to Revival” exhibition at the National Museum of History in Beijing, only days after he took office. Since then, the “Chinese Dream” has become a standard reference in major policy discussions.

In one sense, the notion of a dream is a promise to the general populace of continual improvement in prosperity. Ever since Deng Xiaoping in 1982 articulated the goal of “a relatively well-off society” (doubling of the country’s GDP by the end of the twentieth century, among other key markers), successive Chinese leaderships have built on the very notion of wealth augmentation. A decade into the twenty-first century, however, there was a growing awareness that it was not in China’s interest to make numerical growth targets the driving rationale for governance. As such, the fifth-generation leadership sought to define its mission by reminding itself of sound performance in anticipation of the “two centennials”: the 100th anniversary of the birth of the Chinese Communist Party in 2021 and the 100th anniversary of the founding of People’s Republic of China in 2049.

Still, the term “Chinese Dream” is rather loosely defined. The leadership may well be seeking to unify the people behind the party and government, as this catch-all phrase allows different groups within Chinese society to project their own ideas onto the new slogan.

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The notion of “Chinese dream” can also be understood as a new principle guiding China’s own development and how China relates to the rest of the world. It builds on the twin concepts of “harmonious society” and “harmonious world,” which emerged at the 16th Party Congress in 2002 and marked the formal transition of an earlier generation of

leadership. The concept of “harmony” was officially presented as a guiding principle for global politics at the summit held to mark the sixtieth anniversary of the founding of the United Nations in September 2005.¹ It thus replaced China’s earlier concept of a “better world” as had been articulated by the then Chinese head of state’s speech at the fiftieth anniversary meeting of the United Nations in 1995.²

Entry of the fifth generation of Chinese leadership came against the international context of uneven worldwide recoveries from the global financial crisis of 2008. What has not changed is China’s need for a stable international environment to develop its economy. As its economy is heavily dependent on the security of its supply chains, it must win trust and support of the international community. What has changed is the size of the Chinese economy. It overtook Japan in nominal GDP to be the world’s second largest in 2010. China must address the question of how to exercise its wealth, power, and status. Cornerstones of the “Chinese Dream” are harmony, peace, stability as well as wealth creation. The phrase represents an open invitation for all nations to work together as each has a right to achieving its own dream of stability and prosperity.

At the Asia Pacific Economic Cooperation (APEC) forum held in Beijing in November 2014, President Xi observed that leaders of the region “are duty-bound to create and fulfill an Asia-Pacific dream for our people.” He further elaborated that the Asia-Pacific dream is about staying ahead of global development and making greater contribution to the well-being of mankind. Through having higher levels of economic vibrancy, free trade and investment facilitation, better roads, and closer people-to-people exchanges, countries and peoples of the region can develop a better sense of shared destiny.³

Meanwhile, the idea of China offering to share its “dream” of wealth and power has yet to win endorsement by those Western powers already in dominant positions of decision-making in global economic governance. A

¹Hu Jintao, “Nuli Jianshe Chijiu Heping Gongtong Fanrong de Hexie Shijie [Strive to Construct a Harmonious World of Long-lasting Peace and Common Prosperity],” China.com.cn, September 15, 2005, <http://www.china.com.cn/chinese/news/971778.htm>.

²Jiang Zemin, “Rang Women Gongtong di Zao Yi Ge Geng Meihao de Shijie [Let Us Work Together for a Better World],” *Xinhua News*, October 24, 1995, http://news.xinhuanet.com/ziliao/2005_03/15/content_2700416.htm.

³Xi Jinping, “Seek Sustained Development and Fulfill the Asia-Pacific Dream,” APEC-China, November 13, 2014, <http://www.apec-china.org.cn/41/2014/11/13/3@2580.htm>.

case in point is that by the end of 2014, the U.S. Congress had declined to pass legislation to enable voting reform of the International Monetary Fund (IMF). The IMF reform package, on which the U.S. administration signed in 2010, would double the fund's resources and hand more IMF voting power to China, in addition to Brazil, Russia, India, and South Africa. It would also revamp the IMF's board to reduce dominance of Western Europe. Part of the reason is that the U.S. administration "[hasn't] really put [its] shoulder into it at all, in the last nine months."⁴ Without Washington's seal of approval, reform of the IMF and other Bretton Woods institutions is virtually impossible.

As can be seen, China has not made many inroads in having itself included in the existent mechanisms of world economic governance. At the same time, the new leadership does not seem to be interested in acting out script of responsibility from those states with more decision-making power either. In the second half of 2012, the Chinese economy began to decelerate. Instead of making China an engine of growth lifting the rest of the global economy, the new leadership worked to shape external expectations.

A "New Normal" Economy: Shaping Expectations

At the Beijing APEC summit, President Xi also sketched out a full image of the Chinese economy's "new normal." What is new? For one thing, the economy has shifted gears from the previous high speed to a medium-to-high speed growth. Given China's record of growth, an annual rate of eight percent (or above) for GDP growth is the benchmark of high growth. For another, the economic structure is constantly being improved and upgraded. Tertiary industry and consumption demand are replacing investment as the main driver. Urban-rural and regional disparities are narrowing. Household income is going up as a percentage of national income. The benefits of development are reaching more people.

Technically, "new normal" is not an official Chinese creation. As a matter of fact, when growth of Chinese GDP decelerated to 7.8 percent in the first half of 2012 from 9.6 percent a year earlier, it was a manifestation of

⁴Anna Yukhananov, "U.S. Congress Closes Out Year without Passing IMF Reforms," Reuters, December 11, 2014, <http://www.reuters.com/article/2014/12/11/usa-congress-imf-idUSL1N0TU2QC20141211>.

the underlying view among officials that the slowing growth rate was as much structural in nature as cyclical. In November 2008, China implemented a 4-trillion Renminbi stimulus package. In the years thereafter, the government's massive investment programs were criticized for increasing financial and fiscal risks. Chinese economists were increasingly vocal about the need to tolerate slow growth in order to improve growth sustainability. They emphasized the policy objective of stabilizing, rather than boosting growth in the face of increasing downside risks to the economy. For China, the more "fundamental question" is whether it "can overcome the 'middle-income trap' and become a rich country. It is natural that an economy's growth rate declines as it moves closer to the world's technological frontier."⁵

The term gained ground in China during President Xi's inspection tour in Henan Province in May 2014. He described the need to adapt to a "new normal" and remain cool-headed. According to a year-end chronicle in the *People's Daily*, Xi spoke of the "new normal" as a mode of economic governance on nine other occasions throughout the year.⁶

President Xi's repeated reference to the phrase indicates a recognition that three decades of almost uninterrupted double-digit growth came at a high price, most visibly in the choking air pollution country-wide. In addition, China's past growth relied on exhaustive exploitation of natural resources, both domestically and abroad. The essence of the "new normal" is not just about speed. It is more about fostering an improved economic structure which relies more on tertiary industry, consumption demand, and innovation.

Most importantly, the leadership seems to be shaping domestic and international expectations. Growth of the Chinese economy decelerated to 7.7 percent in 2012 and 2013, and in the first three quarters of 2014, the figure was 7.4 percent. The society is told to remain placid about the overall health of the country's economy.

Very much like the "Chinese Dream," implementing the idea of a "new normal" in the country's economy is open for interpretation and debate. It is easier to muster consensus over abstention from broad stimulus measures despite slowing growth, deepening the rule of law to bolster the fight

⁵Huang Yiping, "The 'New Normal' of Chinese Growth," East Asia Forum, October 14, 2012, <http://www.eastasiaforum.org/2012/10/14/the-new-normal-of-chinese-growth/>.

⁶Tian Junrong and Wu Qiuyu, "Xinchangtai Dianliang Zhongguo Jingji [New Normal Lights the Path of China's Economy]" *The People's Daily*, December 25, 2014.

against graft and excesses, to bring about more balanced economic growth requires careful calibration of risks and opportunities. But it is more difficult for the leadership when it comes to dealing with lobbying — in the name of preventing serious disruptions of growth — by the country's vested interests. The process is open-ended, with signposts of success constantly changing as well.

To be fair, this is not the first time China has had to adjust its familiar trajectory of development. Arguably, the most profound trigger in recent decades came when China joined the World Trade Organization (WTO) in 2002. The country's performance has proved skeptics wrong, at least in terms of wealth creation for the country, because China has become an engine of global economic growth. Back then, the Chinese leadership used the argument of China linking to the international track in an effort to dissuade domestic resistance against reforms and reassure the rest of the world of China's benign geo economic intent.⁷ But today, a "new normal" does necessitate that China become more proactive in managing international economic governance.

a "new normal" a means of managing expectations from the society and market

In relation to the rest of the world economy, if the idea of a "Chinese Dream" is a promise of domestic and international inclusion in pursuit of wealth and power, and a "new normal" a means of managing expectations from the society and market, then China must still demonstrate through action

that it is staying on top of new challenges, domestic and external. Indeed, rather than waiting for a new set of international rules to be agreed upon, the central government initiated a trial of trade and investment liberalization, as shall be highlighted below.

Free Trade Zones: Proactive, Albeit Limited Liberalization

In August 2013, China's State Council set up a pilot free trade zone (FTZ) in Shanghai.⁸ Though limited in geographical span (29 square kilometers), the

⁷Wang Hongying, "Linking up with the International Track: What's in a Slogan," *The China Quarterly*, No. 189 (March 2007), pp. 1–23.

⁸See the official website of the Shanghai FTZ at <http://www.ftz-shanghai.com/>.

creation of the zone is an effort on the part of China to unilaterally liberalize its trade and investment regime, against persistent absence of progress in the WTO's Doha Round negotiations. The Shanghai FTZ is a bid to reduce administrative interventions, ease restrictions on investments, further open up China's financial system, and internationalize its currency to boost shipping, logistics, and commerce.⁹

The word "pilot" in the Shanghai FTZ gives away the scale of challenge in bringing about structural economic policy changes in China. Different from a decade ago, when China began to implement WTO rules, economic governance in today's China is too complex to make a unitary mandate by the central government a viable option. This explains why the municipal government of Shanghai was tasked to develop policy details from the start.

Among other major policy changes, the FTZ operates itself using the "negative list" model in managing investments established therein. For governing investments in the zone, the government publishes a list of business fields that are closed or conditionally open for investment, while leaving the rest for businesses to decide on their own. This is a departure from the usual practice of subjecting a business to seek prior government approval. The most significant change in the zone is that foreign investors automatically receive equal treatment with Chinese ones. These changes bring Chinese treatment of investment closer in line with norms in developed economies. Domestic and foreign businesses registered in the zone have more freedom in conducting their operations.

But difficult reforms, such as setting Renminbi exchange rate and interest rates in banking, require joint effort of different ministries. The municipal government of Shanghai approached rule-making in the zone by staying within its own power, without upsetting the preferences by central government ministries. Without intervention by the highest authorities of the central government, the Shanghai FTZ made a few gains while fighting against resistance from vested interests within the Chinese system.¹⁰

Toward the end of 2014, the central leadership decided to expand the Shanghai FTZ's geographical scope to include the city's commercial center

⁹Wan Zheng, Zhang Yang, Wang Xuefeng, and Chen Jihong, "Policy and Politics Behind Shanghai's Free Trade Zone Program," *Journal of Transport Geography*, Vol. 34 (2014), pp. 1-6.

¹⁰Yang Li, "Assessing FTZ after the First Year," *China Daily*, November 28, 2014.

where major multinational companies and Chinese banks have their headquarters. It also approved the creation of similar FTZs in three other provinces (Guangdong, Fujian, and Tianjin). The rationale behind the expansions is that some policy changes had passed the test of time. Provincial governments hosting the new zones are likewise allowed to propose more specific policies that suit local conditions.

It needs to be noted that enthusiasm in hosting FTZs from other provincial governments, including the three that eventually got the nod from the central government, may have arisen more from calculations of new opportunities in promoting trade. The provinces tend to downplay the FTZ's reform role in finance and government. After all, Tianjin may wish to boost trade with South Korea and Japan, Guangdong is closer to Hong Kong and Macao, while Fujian is eager to increase trade with Taiwan and Southeast Asia. Even in Shanghai itself, local resistance against designs for the pilot project is formidable. As a matter of fact, twice in 2014 alone, the central government found it necessary to reshuffle the top administration of the Shanghai FTZ. This was widely recognized as an indication of impatience with the level of devotion to structural reforms.¹¹

Assessment by international observers of the Shanghai FTZ experiment is also mixed. Some foreign observers see "a significant milestone for the country's economic reforms and its strategy of opening up its domestic markets for foreign investors."¹² Others are less satisfied with progress in policy change. For example, the Obama administration's Treasury Secretary Jack Lew is quoted as saying that as of July 2014, the reform "doesn't appear to be [targeting] areas of major interest for U.S. market access."¹³ Sentiments on the part of the American business community and U.S. government do constitute an important form (or lack) of endorsement, although they are only of reference value to investors from around the world.

It is useful to bear in mind that cross-national investment policy-making, on both the domestic and international fronts, now involves ideology-loaded issues such as national/economic security, national

¹¹Ibid.

¹²Gladie Lui, "Shanghai Pilot Free Trade Zone: Shaping of China's Future Foreign Investment Environment," *International Tax Journal*, Vol. 40, No. 4 (July/August 2014), pp. 31–43.

¹³Anonymous, "Lew Says China Update of Shanghai FTZ List Contains No Major U.S. Benefits," *Inside US-China Trade*, Vol. 24, No. 27 (July 2, 2014). Archived in ProQuest database.

treatment, dispute resolution, restrictions on technology transfer, and protection of intellectual property rights. There can be no easy consensus, as all governments struggle to strike a balance between a multitude of ideals and interests.

For China, the true significance in policy innovation is that the fifth generation of leadership has broken some of the old norms in handling foreign investment, such as adoption of a “negative list” to replace the traditional investment guidelines. The process of implementing investment guidelines does give a milieu of government agencies broadly (and even willfully) defined scopes of authority. Indeed, China’s National Development and Reform Commission (NDRC) has been hit the hardest in the government’s anti-corruption campaigns.¹⁴ A structural factor behind the malaise is that the NDRC — as well as its equivalent in lower tiers of the governing body — has the authority to set broad economic policies, approve major investments, mergers and acquisitions, and to influence commodity prices.

Viewed internationally, the FTZ experiment, limited and incremental as it is, does mark a significant departure from the habitual insistence on China being a developing country thereby justifying continued broad restrictions on the inflow of foreign direct investment. In the wake of the 2008 financial crisis, China’s guarantee of a market share for Chinese corporations regardless of market performance (especially to state-owned entities) fostered waste and corruption, and also deterred technology and management innovation. A lesson was learned, albeit quietly so.

A short conclusion about China’s FTZ experiment is that the leadership has found the wisdom and political capital to approach the rest of the world through proactive liberalization. There has to be a critical mass of evidence for China to be able to claim leadership by example. Yet it is noteworthy that China is putting forward deeds of liberalization, which could potentially become a source of motivation for other nations.

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¹⁴Anonymous, “Anti-corruption Campaign Shows Broad Power of NDRC Officials,” *China Daily*, October 9, 2014, http://www.chinadaily.com.cn/china//2014-10/09/content_18710223.htm.

Free Trade Agreements: Signing Up New Partners

For the past two decades, free trade agreements (FTA) have been a popular instrument used by governments around the world to hedge against the slow (or even stalled) multilateral trade liberalization process under the WTO. As of this writing, China has 12 FTAs in operation with 20 FTAs under negotiation.¹⁵

A noticeable feature in China's FTAs is that they are done with small economies, which do not have either large trade volumes or materials critical for the Chinese economy (for example, energy, industrial minerals, and food).¹⁶ This gives credibility to academic conclusion that China is exceptional to international norms when it comes to FTA activity. Seemingly, China demonstrates a "big country morality" by offering agreements to help smaller countries. This reflects the country's relative weakening liberalizing forces vis-a-vis protectionist ones after its WTO accession.

A case in point is the FTA China has in place with economies of the Association of Southeast Asian Nations (ASEAN). By one measure, the China-ASEAN Free Trade Agreement (CAFTA) covers the world's largest free trade territory in terms of population and is the third largest in terms of nominal GDP after the European Union and the North American Free Trade Area. Yet, CAFTA, signed off in 2002, came into effect only in 2010. Furthermore, the scheme aims to reduce tariffs on nearly 8,000 product categories, or 90 percent of imported goods, to zero, between China and the original ASEAN members (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand). Cambodia, Laos, Myanmar, and Vietnam are scheduled to implement these terms in 2015.¹⁷ Whereas CAFTA endorses the customary Southeast Asian (and Chinese) preference for handling trade

¹⁵For official information about China's FTAs, see "China's FTA Network" site of the Chinese Ministry of Commerce official website at <http://fta.mofcom.gov.cn/english/index.shtml>.

¹⁶The 12 FTAs China has in operation are with the Association of Southeast Asian Nations (ASEAN), Pakistan, Chile, New Zealand, Singapore, Peru, Costa Rica, Iceland, and Switzerland, in addition to closer economic and partnership arrangements with Hong Kong and Macau (each with its separate status as an economic area under the WTO).

¹⁷Gregory Chin and Richard Stubbs, "China, Regional Institution-building and the China — ASEAN Free Trade Area," *Review of International Political Economy*, Vol. 18, No. 3 (August 2011), pp. 277–298.

liberalization on a voluntary basis, its efficacy as a legal instrument for trade promotion and market reform remains weak.

As a matter of fact, ASEAN as a group has designated 2015 as the year to launch an economic community of its own. Some of the ASEAN members, most notably Singapore, have been active in negotiating high quality FTAs, both bilateral and multilateral. In 2005, together with Brunei, Chile, and New Zealand, Singapore signed a Trans-Pacific Strategic Economic Partnership (P4), which became a template for the United States to push for its version of a Trans Pacific Partnership (TPP) agreement.¹⁸ The TPP has generated heated discussions about China's foreign economic policy, especially with the United States, which will be addressed in a separate section later in the paper.

In November 2014, the Chinese government did surprise a good many skeptics by signing a declaration of intent on a bilateral FTA with Australia. This means the two have practically concluded bilateral negotiations, with only technical details to be worked out. The China-Australia FTA deal came after more than 20 rounds of negotiations over the past nine years.

China's FTA with Australia, in comparison with the majority of those already in operation, is more comprehensive and of a higher level of trade and investment liberalization. The agreement with Australia is unique for it covers more than ten areas including trade in goods and services, investment and trade rules, e-commerce and government procurement.¹⁹ Also in November, Beijing and Seoul announced the conclusion of their substantive FTA talks.

Together with the China-Canada foreign investment promotion and protection agreement, which went into force in October 2014, China has demonstrated that it is moving fast in upgrading its economic ties with major economies in the Asia-Pacific region. In a geostrategic sense, each of the three FTA partners is strategic allies of the United States, which is usually viewed to be locked in competition with China in the region. It is

¹⁸Deborah Elms, "From the P4 Agreement to the Trans-Pacific Partnership: Explaining Expansion Interests in the Asia-Pacific Region," in Simon Evenett, Mia Mikic, Ravi Ratnayake, eds., *Trade-Led Growth: A Sound Strategy for Asia*, United Nations/ESCAP, 2011, <http://www.unescap.org/sites/default/files/11-PAR~1.PDF>.

¹⁹See a description of the China-Australia FTA at <http://dfat.gov.au/fta/chafta/>.

thus interesting to note that China does not seem to see the U.S.-led security alliance as an obstacle to trade liberation and investment protection.

A significant FTA under negotiation for China is that with the Gulf Cooperation Council (GCC).²⁰ Formal launching of the China-GCC FTA dates back to 2004. The two parties have held five rounds of talks and have reached agreements on the majority of issues concerning goods trade. Negotiations on service trade are also ongoing. By the end of 2014, Chinese trade officials were quoted as committed to bringing those negotiations to an early conclusion.²¹

For China, FTAs with Australia and the GCC economies can be understood as a major shift in resource security governance. Resources — oil, gas, iron ore and other industrial minerals (from Australia), grain, dairy and other agricultural products — have long been viewed as strategic by corporate and government sectors in China. Translated into trade policy preference, the notion of a commodity being “strategic” usually implies resistance against instruments like FTA. This means that China’s own corporations, especially the state-owned ones, must learn to adjust to increasing competition from corporations of supplier countries. In a sense, for Chinese FTAs with Australia and the GCC economies to materialize implies a greater level of acceptance of the notions of “virtual water” and “virtual land”: China can address its stresses in water supply and loss of arable land (together with land degradation) through increasing imports of water- and land-intensive products from abroad.²²

Still, for China, a Bilateral Investment Treaty (BIT) is arguably the most far-reaching in terms of challenging itself in moving toward a rules-based management of inflows and outflows of foreign direct investment. In July 2013, Beijing and Washington agreed to expedite their BIT negotiations, which had by then gone through a dozen rounds. By the end of 2014, Chinese and American negotiators were reported to be finalizing text

²⁰Member economies of the GCC are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

²¹Zhong Nan, “FTA Talks Reach across the Gulf,” *China Daily*, December 30, 2014, http://www.chinadaily.com.cn/business/2014-12/30/content_19198206.htm.

²²Literature on Chinese management of resource security in international trade is voluminous. For a recent study on food, see, for example, Zha Daojiong and Zhang Hongzhou, “Food in China’s International Relations,” *The Pacific Review*, Vol. 26, No. 5 (December 2013), pp. 455–479.

checks on the BIT, with a pending formal exchange of negative lists in 2015. The reported aim is to complete negotiation within the term of the Obama presidency.²³

Over China's pursuit of rule-making for trade and investment, there is a visible increase in the pace of liberalization. Still, significant differences remain, as shall be discussed below.

The TPP and FTAAP: Gaps to Narrow

The most representative of the geostrategic nature among various multilateral FTA schemes in the Asia-Pacific region is the Trans-Pacific Partnership (TPP). More pointedly, after 2008, the U.S. administration expressed interest in joining the above-mentioned P4, which was until then little noticed but open to new participants. The same year saw Australia, Vietnam, and Peru join the P4 negotiations as well. By March 2013, with Japan becoming the twelfth negotiating party, TPP was fast becoming the most powerful trade bloc of the entire Asia-Pacific region. Many observers point to the TPP membership as a manifestation of post-Cold War U.S. grand strategy in East Asia. China is the most notable exclusion from the negotiation process.²⁴ To be fair, exclusion of membership in TPP negotiations was mutual, from the start.

A change of diplomatic atmosphere came at the end of May 2013. The spokesman of China's Ministry of Commerce remarked that China was going to "analyze the advantages, disadvantages, and the possibility of joining the TPP, based on careful research and principles of equality and mutual benefit."²⁵ This change in position may as well be a response to

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²³"Sino-US Investment Treaty Sees Major Progress," *China Daily Online*, December 17, 2014, http://usa.chinadaily.com.cn/business/2014-12/17/content_19104951.htm.

²⁴Benedict E. DeDominics, "US Post Cold War Grand Strategy and Multilateral National Integration in Europe and East Asia," *Review of Business and Finance Studies*, Vol. 6, No. 1 (2015), pp. 57–80.

²⁵"China to study possibility of joining TPP: MOC," *Xinhua News*, May 30, 2013, http://news.xinhuanet.com/english/china/2013-05/30/c_132420541.htm.

earlier comments by U.S. trade negotiators that so long as China is “capable of meeting the high standards that we’re negotiating,” the United States leaves its options about the eventual TPP membership open.²⁶

Over the TPP, little else since then has materialized between Beijing and Washington. But the two sides are not that far apart in terms of the texts of treaties under negotiation. The China-U.S. BIT is envisioned to include all stages of investment and all sectors. Contents in the BIT are the same as those in the investment chapter of the TPP. Then, what is holding Beijing and Washington apart in the TPP process? The short answer is that neither Beijing nor Washington was ever for sharing the negotiation room with the rest of the TPP negotiators. Geopolitical considerations certainly play a role. As American analysts argue, the TPP is as much about leadership competition as it is about trade and investment.²⁷

Inclusion of Japan in the TPP reinforces suspicion in China about a return of a U.S.-led containment or a roll-back of China’s rise. Political relations between Beijing and Tokyo went on a definite downward spiral, most notably after 2012, when Tokyo moved to “nationalize” the disputed Diaoyu/Senkaku islands in the East China Sea. Commentators in China have also argued that Japan has dragged its feet in the China-South Korea-Japan FTA negotiations to curtail China’s increasing economic role in the region. Japan and the U.S. are seen as supporters of the “status quo” in the region and blocking China’s economic interests. Last but not least, since assuming his position as prime minister for the second time in 2012, Shinzo Abe made a point of strengthening economic and security ties with ASEAN countries, in an effort to reinforce regional temptation to deal with an alleged China threat.²⁸

On the part of Beijing, both President Xi and Premier Li visited Southeast Asia in 2013. These trips underscore the importance of the region in Beijing’s current approach to international affairs. Beijing’s approach

²⁶Joseph Boris and Li Jiabao, “Door to TPP is open for China, says US,” *China Daily Online*, March 22, 2013, http://www.chinadaily.com.cn/bizchina/2013-03/22/content_16332085.htm.

²⁷Mireya Solis, “The Trans-Pacific Partnership: Can the United States lead the way in Asia-Pacific integration?” *Pacific Focus*, Vol. 27, No. 2 (December 2012), pp. 319–341.

²⁸Maya Kaneko, “Abe bolsters Southeast Asia Ties in Bid to Counter China’s Rising Threat,” *Japan Times*, January 20, 2013, <http://www.japantimes.co.jp/news/2013/01/20/national/abe-bolsters-southeast-asia-ties-in-bid-to-counter-chinas-rising-threat/>.

entails an “upgrading” of the China-ASEAN FTA, the promotion of a new “diamond decade,” and a broader diplomatic offensive in which the Confucian philosophy of “seeking harmony but not uniformity” has been invoked as a guiding principle in China-ASEAN relations. The U.S. approach, on the contrary, is rules-based.

Taking advantage of hosting the 2014 APEC economic leaders’ meeting in Beijing, China chose the Free Trade Area of the Asia Pacific (FTAAP) as its landmark initiative for the annual gathering. This builds on President Xi’s call at the 2013 APEC summit in Bali, Indonesia, for “open and inclusive” trade agreements with APEC playing a “leading role.” The U.S. description of TPP being “non-exclusionary” refers to the fact that all sectors are included in the negotiations; China’s charge of “exclusion” is based on the fact that not all countries in the region are included in the TPP.

China’s endorsement of FTAAP can be seen as a geostrategic statement. No lines will be drawn in the middle of the Pacific, in contrast with the U.S. insistence on prioritizing association with its “like-minded” countries. But also in Beijing, the U.S. effectively eliminated any reference to a specific timeline for FTAAP conclusion, but China managed to secure the launch of a collective strategic study on issues pertaining to FTAAP’s realization. It remains to be seen whether this compromise will hold in the long run.

AIIB, Road, and Belt: Bold but Challenging

Arguably, the boldest Chinese attempt at playing a leadership role in international investment and trade came in two proposals unveiled in 2014. One was China’s offer to create the Asian Infrastructure Development Bank (AIIB). The other is a focused promotion of trade and investment along a “Silk Road Economic Belt” and a “Twenty-first-Century Maritime Silk Road.” The Belt scheme envisions closer economic ties between China and economies spanning from Central Asia, the Middle East and on to Europe. The Road scheme is more about relating to Southeast Asia.

On October 21, 2014, China secured twenty other countries as founding members of the AIIB.²⁹ By the time of the second chief negotiators’

²⁹The initial round of founding members are, in addition to China, Bangladesh, Brunei, Cambodia, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Myanmar, Nepal, Oman, Pakistan, Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan, and Vietnam.

meeting to establish the bank, in mid-January 2015, five other states have joined as prospective founding members.³⁰ Initiated by China and to be headquartered in Beijing, the AIIB has an authorized capital of US\$100 billion and is scheduled to start functioning in late 2015.

According to studies by the Asian Development Bank (ADB), investments required in the Asian developing countries during 2010–2020 for national infrastructure alone amounts to US\$8 trillion per year. The ADB lends only about 1.5 percent of this amount.³¹ The need for an additional investment-pooling mechanism is only too obvious.

For China, the idea of the bank is, in reality, taking a page from how the World Bank and ADB supported infrastructure development as a key element of poverty reduction, especially before the Chinese economy began to take off in the mid-2000s.³² The extent of faith in exporting a purportedly “Chinese model” of poverty reduction and economic growth is a topic of interpretation and beyond the scope of this paper.

What are the possible motives behind China's initiation of the AIIB? Fair-minded observation should acknowledge existence of geoeconomic and geostrategic motives, as is true of all such endeavors by any country. But dissatisfaction with the U.S.-led institutions alone cannot be a sufficient explanation. First, today China can choose to invest part of its foreign reserves of US\$3.9 trillion on commercial terms rather than putting them in U.S. treasuries where the real value is shrinking. Second, the AIIB will contribute to the internationalization of the Chinese currency. Third, the bank will help secure contracts for Chinese firms to boost employment opportunities at home. Fourth, in recent years, China has funded numerous infrastructure projects all over the world through the China Development Bank and the Export-Import Bank despite local disfavor. Through a multilateral institution, China stands a better chance of reducing malpractices by its own corporations and

³⁰These are Indonesia, Maldives, New Zealand, Saudi Arabia, and Tajikistan.

³¹ADB Institute, *Infrastructure for a Seamless Asia*, 2009, <http://www.adbi.org/book/2009/09/15/3322.infrastructure.seamless.asia/>.

³²See, for example, Gene Marvin Tidrick, *China: An Evaluation of World Bank Assistance* (Washington D.C.: World Bank, 2005). The Asian Development Bank, *Effectiveness of ADB Approaches and Assistance to Poverty Reduction* (Manila: ADB, 2000).

shouldering less of the communal acrimony against perceived Chinese economic intrusion.³³

As for the Road and Belt conceptualizations, indeed, on the sidelines of the 2014 APEC, President Xi pledged US\$40 billion to a new Silk Road fund for investing in infrastructure, resources, and industrial and financial cooperation across Asia. This is without doubt a demonstration of leadership resolve both domestically and internationally. But the real test down the road is whether the initiative will turn out to be a spending spree without due considerations of project feasibility in terms of either business or social feasibility.

Details in the Chinese blueprint for the Road and Belt schemes are just beginning to emerge.³⁴ It is nevertheless useful to bear in mind that availability of investment capital alone is far from being sufficient in making China the lender of choice. The fact that the United States and its key security allies in Asia (namely, Australia, Japan, and South Korea) have not joined the AIIB ought not to be viewed as a loss. Rather, their absence ought to serve as a reminder that it is incumbent for China to take the lead to prove the critics and skeptics wrong.

Substantive assessment of the bank and investment/trade schemes dubbed as Road and Belt will take years to be meaningful. It suffices now to say that the true challenge is how Chinese entities (governmental, corporate and societal) work with those in fellow members of the AIIB and the host governments in designing and executing future infrastructure projects, whether or not they fall under the Road or Belt scheme.

Conclusion

This paper offers a justifiably partial accounting of Chinese economic diplomacy, focusing on large initiatives by the fifth generation of Chinese leadership in relation to the Asia-Pacific region. As mentioned before, the Asia-Pacific is and shall remain the testing ground for geoeconomic and geostrategic competition between China and other major powers.

³³See Zha Daojong's contribution to a discussion of the "Will Asia Bank on China" question at <http://www.chinafile.com/conversation/will-asia-bank-china>.

³⁴"China Sketches out Priorities of 'Belt and Road' Initiatives," *China Daily Online*, February 1, 2015, http://www.chinadaily.com.cn/china/2015-02/01/content_19461058.htm.

A number of broad observations can be made from the previous stocktaking of China's initiatives in economic diplomacy since 2012. First, the thrust in the new leadership's economic diplomacy can be generalized as an attempt to proactively shape the external environment. Under this approach, the Chinese leadership made an ideational offer of sharing dreams of prosperity and stability across the Asia-Pacific region, in addition to acknowledging a "new normal" of more sustainable mode of economic growth. As a matter of fact, with China's wish for greater levels of attraction in the region and beyond, it must demonstrate that it can put its own economic house in order, as a foundational step.

Second, the purported geostrategic competition between China on the one hand and the U.S. and its security allies on the other hand needs to be put in proper context. Too often, that competition is said to be mutually exclusive. But in the past several years, Beijing and Washington have kept alive the pursuit of rule-based governance of investment flows through negotiating a high-standard bilateral investment treaty. China and the U.S. do differ over the TPP and FTAAP. Yet, the recent spate of China's conclusion of FTAs with Australia, Canada and South Korea (all U.S. security allies) can be seen as manifestation of the limits of their difference. The lesson for other countries in the region and even beyond is that they do not have to choose between China and the United States as the party to collaborate with. All parties, in the end, cooperate on those issue areas where they can share the lowest common denominator of interests.

Third, the fifth generation of Chinese leadership is clearly demonstrating that China, too, can be innovative in handling multilateral trade and investment initiatives and further liberalizing its own trade and investment regimes. Though limited in scope and depth, the country's new FTZs are based on innovation in investment and trade policies, rather than a repetition of conventional methods of project-based concession for

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attracting investment and tariff reduction for trade promotion. The AIIB and offers of deeper integration with economies along the Road and Belt are bold. The true challenge for China is to prevail in the regional competition for attraction as a source of foreign direct investment.

Last but not least, China is still in a process of domestic reform and opening to the rest of the world. Changes in the past two years, both in domestic economic governance and in economic diplomacy, should be seen as a continuation of the same orientation that has guided the country for the past three decades. References to “the Chinese Dream” and a “new normal” for the Chinese economy are in reality recognition of limits to willful action. It is true that China is beginning to take some bolder steps — including some institutional changes — to pursue new opportunities in the world. Nevertheless, China is not in a position to alter the landscape of the world economy. Nor does it seek to rewrite established rules of world economic governance. As repeatedly indicated throughout this paper, what the Chinese leadership has sought to achieve is to try to enlarge its space for autonomy in international economic decision-making.