Contemporary Chinese Political Economy and Strategic Relations: An International Journal

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(continued inside back cover)
Contemporary Chinese Political Economy and Strategic Relations: An International Journal

Vol. 4, No. 3, December 2018
Contemporary Chinese Political Economy and Strategic Relations:
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Contents

Foreword
State-Society Relations, Domestic-Foreign Policy Nexus: Recalibration for the “China Dream”?  
*Emile Kok-Kheng Yeoh*

*Belt and Road Initiative, Trade and Finance*

The Sino-US Trade War: Survival, Domestic Reforms and the Belt and Road Initiative  
*Guorui Sun and Alex Payette*

The Asian Infrastructure Investment Bank, the New Development Bank and the Internationalisation of the Renminbi (RMB) – The New International Financial Institutions as Part of the Chinese Strategy to Build Up an International Reserve Currency  
*Rafael Ramos Codeço*

*Taiwan, New Southbound Policy and Cross-Strait Relations*

Ending Taiwan’s Economic Stagnation: The Implications of the Elections of Presidents Tsai and Trump  
*Cal Clark, Alexander C. Tan and Karl Ho*

Chinese-Taiwanese-Southeast Asian Triangular Relations: On Building and Rebuilding Political and Economic Assertiveness in South China Sea  
*Reymund B. Flores and Rachel Mary Anne A. Basas*
The Elephant and the Dragon

Chinese and Indian Public Pension Systems and Universal Old-age Security in Times of Rapid Demographic Changes
Silvan Siefert

To Cooperate, or Not to Cooperate: Assessing Pay-offs of the Belt and Road Initiative for India
Obja Borah Hazarika

China in Africa

The Engagement of China in Nigeria’s Oil Sector: Is the Transformation Positive?
Gold Kafilah Lola and Evelyn S. Devadason

Promoting Production Capacity Cooperation and Industrialization through Energy Infrastructure Development: The Case of China-Ghana Partnership
Lucy Anning and Clayton Hazvinei Vhumbunu

ADIZ and the Chinese Military

Geo-Strategic Significance of East China Sea Air Defense Identification Zone (ECS-ADIZ): A Threat-Import Analysis
Al Chukwuma Okoli and Uchenna Simeon

The Chinese Military in National Security Policy-making
Ching Chang

CCPS Vol. 4 No. 3 (December 2018)
Culture, Sustenance and Development

Food Consumption and Economic Development in Contemporary China
Tian Guang, Camilla Hong Wang, Kathy Tian and Liu Yu

Does Religious Obligation of Muslims in Western China Influence Their Intention to Adopt Islamic Banking?
Zhonghua Han, Emile Kok-Kheng Yeoh and Wan Marhaini Binti Wan Ahmad

Book Review
reviewed by Amadea Bata-Balog
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CCPS Vol. 4 No. 3 (December 2018)
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FOREWORD

State-Society Relations, Domestic-Foreign Policy Nexus: Recalibration for the “China Dream”?

This third and final issue of Volume 4 of Contemporary Chinese Political Economy and Strategic Relations: An International Journal (2018) represents a collection of research articles covering some of the most pertinent aspects of the state of and changes in the political economy and strategic relations of today’s China.

This Volume 4, Issue 3, of CCPS consists of six segments each carrying two articles. The first segment, Belt and Road Initiative, Trade and Finance, takes up where our April issue (Vol. 4, Issue 1, Special Issue: Geopolitics of Belt and Road Initiative and China’s international strategic relations) has left off, with Guorui Sun and Alex Payette’s article “The Sino-US Trade War: Survival, Domestic Reforms and the Belt and Road Initiative” moves further to explore the possible way China could push forward its now BRI-driven global geopolitical ambitions in a jittery world newly shaken by the US-China trade war and the inward-turning Trump Administration, after examining how the trade war could turn out to be favourable in aiding the Xi Administration in quickening the pace of domestic financial and economic reforms. Such linkage between the global and the domestic will again be picked up later in subsequent articles. Meanwhile, in this same segment,
Rafael Ramos Codeço picks up on the pertinent issue of China’s increasingly assertive foreign policy and criticism of the current international financial system, with its attempt to change the latter reflected unabashedly in its launching of the Asian Infrastructure Investment Bank and the New Development Bank through which the internationalisation of its currency might also be facilitated, in his article “The Asian Infrastructure Investment Bank, the New Development Bank and the Internationalisation of the Renminbi (RMB) – The New International Financial Institutions as Part of the Chinese Strategy to Build Up an International Reserve Currency”.

Eventually, as Guo and Payette caution, as China is now counting so much on the success of the Belt and Road Initiative for the success of its economic transition, its increasingly aggressive posture and actions in its local neighborhood have made the global community adopt a very skeptical and guarded stance towards its declaration of a “peaceful rise”, and as Codeço also points out, its efforts in internationalising the renminbi also faces constraints from pace of the flexibilisation of its own monetary system and domestic reservations over the risk tied to such flexibilisation. While Sun and Payette has ruminated on how the trade war could have impact on China’s domestic financial and economic reforms, both international and domestic motivations are also emphasized by Codeço.

As Amadea Bata-Balog highlights in her review of Elizabeth C. Economy’s latest book on China published this year, The Third Revolution: Xi Jinping and the New Chinese State, paradoxes abound in the Xi government’s dealings with the outside world, not least being policies like BRI taking advantage of the political and economic openness of other countries without comparable opportunities for other countries to engage within China’s borders, as well as the doubtful reconcilability between a “secure confidence” externally and an
“obvious insecurity” internally, the latter being manifest in the tightly
lidded powder keg of social grievances, the iron-wrist approach of the Xi
government towards the country’s volatile ethnic frontier regions, and
the temperamental, and potentially explosive, relations with Taiwan now
under the sovereignty independence-leaning Democratic Progressive
Party presidency. The last of this list leads us across the Taiwan Strait to
the first vibrant liberal democracy in Chinese history since political
democratisation began in mid-1980s, whose recent domestic
development and foreign policy form the subject of study in the two
article under the second segment of this journal issue, Taiwan, New
Southbound Policy and Cross-Strait Relations.

Cal Clark, Alexander C. Tan and Karl Ho in the first paper under
this segment, “Ending Taiwan’s Economic Stagnation: The Implications
of the Elections of Presidents Tsai and Trump”, discuss the implications
for Taiwanese economy of the 2016 presidential victories of DPP’s Tsai
Ing-wen and maverick tycoon and political novice Donald Trump who
have brought about major shifts in foreign relations and economic
strategies for their respective countries that have arguably in a
significant way destabilised the long-existing Taiwan-China-US triangle.

Another strategic triangle that is critical for Taiwan’s resilience and
survival as a de facto independent nation-state that has gone through
a “best-case” democratisation process (Rigger, 2004) to emerge as
a superior model of political rights- and civil liberties-respecting
democracy in facing the rapacious leviathan across the Strait is that
between herself and China and Southeast Asian countries, which in turn
forms the subject of investigation in the second article under this
segment, Reymund B. Flores and Rachel Mary Anne A. Basas’s
“Chinese-Taiwanese-Southeast Asian Triangular Relations: On Building
and Rebuilding Political and Economic Assertiveness in South China
Sea”. Whether the Taiwan-China-US three-way relationship today still

CCPS Vol. 4 No. 3 (December 2018)
resembles Lowell Dittmer’s earlier depiction as a “romantic triangle”\(^1\) or Yaegi Hong’s later proposed modification as a “dual-romantic triangle”\(^2\) and whether Taiwan-China-Southeast Asian three-way relationship can fit well into Dittmer’s “romantic triangle” formulation with Southeast Asia, though internally diverse as it is, replacing the US (as in most works employing this framework that involve cross-Strait relations) as the pivot (the pivot position in which being the optimal choice, which the two wings compete to court) would be a very interesting issue to ponder in today’s changing environments of trade war, BRI and NSP.

Complicating the scene is the forever thorny cross-Strait relations imbued with unresolvable distrust and contradictions, wherein on the Xi government’s side on the mainland its newly promoted “China Dream” – which Xi declared early six years ago as “the greatest dream of the Chinese nation in modern history”, as Amadea Bata-Balog directs our attention to Elizabeth Economy’s reminder to us in her review article here – represents a call for the “great revival or rejuvenation of the Chinese nation” in which “Taiwan’s reunification with the Motherland” features as a major component, whereas across the Strait to the majority of the citizens of the vigorously liberal democratic island state, *de facto* independent from the mainland since seven decades ago and just managed to free herself from the terror and shackles of an own dictatorial regime hardly three decades ago, Xi’s so-called “China Dream” symbolises nothing but an undying dream of territorial revanchism or worse, of predatory irredentism, and a despotic regime’s sinister intention to bring into political and cultural subjugation the island state’s freedom-loving people.

Not all relations are three-way, of course. The next segment of this journal issue, *The Elephant and the Dragon*, turns to a one-on-one rivalry between two aspiring regional powers: India and China, with an article on welfare system performance between these two most populous

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*Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) ♦ 2018*
nations on earth, followed by another on the implications of China’s BRI for India. While Silvan Siefert’s paper “Chinese and Indian Public Pension Systems and Universal Old-age Security in Times of Rapid Demographic Changes” provides a good comparative analysis of China’s and India’s pension systems to illustrate that the learning capacity of the institutional actors matters in the policy process of implementing political decisions including universal old-age security, Obja Borah Hazarika, in her paper “To Cooperate, or Not to Cooperate: Assessing Pay-offs of the Belt and Road Initiative for India” ponders as to how India should best react to China’s BRI overture to her.

Interestingly, Siefert’s article concludes that China’s institutional features encourage learning to a larger extent than India’s in the specific policy process of pension provisions and the main reason lies in the Chinese government’s legitimacy deficit that forces Chinese decision-makers, who are dying for output performance and lacking feedback channels, to decentralise more authority in the implementation process to the lower administrative tiers through pilot projects before going national after gradual adjustment and reviewing that provide the central government an internal learning procedure for upcoming pension reforms, while in India ironically the democratic features of her multi-party electoral system, strong federalism and changing government coalitions have served to limit administrative room for learning capacity. It is indeed such uncertainty in democratic efficacy (here exemplified by the world’s largest multi-party electoral democracy of India) that has increasingly led to legitimacy based on performance (here exemplified by the biggest single-party dictatorship on earth, that is China) trumping legitimacy based on political process, the distinction between which as highlighted by Richard Bush (2016), or Pippa Norris (2012)’s bureaucratic autocracies (where state capacity is high but democracy is low) trumping her three other regime varieties – bureaucratic democracy
(the best-case scenario where both variables are high), patronage democracy (where state capacity is low but democracy is high) and patronage autocracies (where both variables are low).

Such phenomenon is also seen in the works of various researchers who found higher external efficacy for authoritarian countries like the one-party state of China than for multiparty liberal democratic countries like India or Taiwan. While internal efficacy refers to a citizen’s belief that s/he can understand and thus participate in politics, another type of political efficacy – external efficacy – refers to citizens’ belief that the government will respond to their demands. Yingnan Joseph Zhou and Ray Ou-Yang in their article last year, “Explaining high external efficacy in authoritarian countries: A comparison of China and Taiwan” (2017), explain this phenomenon in terms of institutional differences between these two types of regimes – voters in democracies with real competitive multiparty elections who did not see their preferred candidates elected are predisposed to critical assessment of government responsiveness; elections incentivise democratic leaders to over-respond to certain groups vis-à-vis others; authoritarian leaders in countries without genuine democratic elections that confer them political legitimacy are compelled to cement performance-based legitimacy by increasing responsiveness while democratic leaders with solid and clear electoral legitimacy may not deem it necessary to entertain particularistic demands made through unconventional channels like street protests. Or as Francis Fukuyama explains: “[T]he quality of Chinese government is higher than in Russia, Iran, or the other authoritarian regimes with which it is often lumped – precisely because Chinese rulers feel some degree of accountability towards their population. That accountability is not, of course, procedural; the authority of the Chinese Communist party is limited neither by a rule of law nor by democratic elections. But while its leaders limit public criticism, they do try to stay on top of popular
discontents, and shift policy in response.”3 This is manifest, according to Fukuyama, in that “[t]he most important strength of the Chinese political system is its ability to make large, complex decisions quickly, and to make them relatively well, at least in economic policy. This is most evident in the area of infrastructure, where China has put into place airports, dams, high-speed rail, water and electricity systems to feed its growing industrial base. Contrast this with [democratic] India, where every new investment is subject to blockage by trade unions, lobby groups, peasant associations and courts.”4

Such perspective, typical of a “convert from neoliberalism to the Chinese model”, as the late Arif Dirlik (2012: 283) explained, sees authoritarianism as making possible “the rapid and efficient mobilization of resources not possible in a democratic society, exemplified by India, another so-called ‘developing economy’. The party-state may be repressive in other ways, but it is a force for innovation and efficiency economically.” Dirlik found this to be in line with Arundhati Roy’s argument (2011) on India: “Roy’s passionate condemnation of the government–corporate alliance against the interests of the rural population, especially the indigenous people, should give pause to facile contrasts between democratic India and dictatorial China. Equally important is the fact that Maoist activity has been the most effective among the indigenous people, the adivasis.”5 Such considerations also underline Hazarika’s concluding remarks and policy advice for India. Ultimately, alluding to Hazarika’s game theory section, in the one-on-one game of strategic relations, as described by our segment heading, between the down-to-earth behemoth traditionally symbolising composedness, strength, intellect, wisdom and pragmatism and the high-flying mythical beast – traditionally bringer of either great power and fortune or calamitous floods and typhoons – across the Himalayas, the policy directions taken by either side will inevitably carry great
consequences for the future of humanity. Eventually, as Siefert’s and Hazarika’s articles respectively inform, whether and how the imbalanced economic performance between the South Asian multi-party electoral democracy that accounts for almost one fifth of the world population and the East Asian unelected one-party autocracy that rules over another one fifth will impact the relationship between them and their rivalry for regional leadership will ineluctably carry great consequences for the livelihood, welfare and freedom, economic and political, of citizens of other nations in the region and beyond.

After looking at issues related to BRI, cross-Strait relations and India-China comparisons and relations, this journal issue moves on to a segment on *China in Africa* where Gold Kafilah Lola and Evelyn S. Devadason analyse China-Nigeria trade and China’s foreign direct investment in and aid to Nigeria, in particular China’s commercial presence in Nigeria’s oil sector, and Lucy Anning and Clayton Hazvinei Vhumbunu explore the role of the China-Ghana energy infrastructure development partnership in promoting production capacity and industrialization cooperation between the two countries. While finding China-Nigeria engagement to be complementary taking together into consideration investments, trade and aid, Gold and Devadason’s paper “The Engagement of China in Nigeria’s Oil Sector: Is the Transformation Positive?” is commendable for not ignoring the doubt over whether China’s vertical-type investment pattern in Nigeria’s oil sector highly concentrating in just a few large State-owned enterprises does benefit the local communities, and its recognition that the effects on the local economy and local communities in terms of domestic linkages, skills and technology spillovers, job creation, labour standards, human rights and environmental concerns remain key to ascertaining whether there really are sustainable benefits from China’s engagement in the extractive sector of Nigeria. On the other hand, Anning and Vhumbunu’s

*Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) ♦ 2018*
paper “Promoting Production Capacity Cooperation and Industrialization through Energy Infrastructure Development: The Case of China-Ghana Partnership” has served to contribute to this segment another country case study of the East Asian giant’s footprint on the African continent.

If China’s quest for energy, including infrastructure-for-oil, on the African continent has raised much alarm, if not trepidation, among a large portion of the local people as well as the Western powers as regards China’s true agenda behind what her critics have accused as her “debt-trap diplomacy” riding on her BRI drive through Southeast Asia, the Indo-Pacific island nations, South and Central Asia all the way to Africa has mainly remained within the economic and financial domains, her increasingly assertive foreign postures in the East and South China Seas have raised much concern and unease among her regional neighbours on the military dimension. The next segment of this journal issue, ADIZ and the Chinese Military, carries two articles that evaluate respectively the strategic implications of China’s unilaterally declared East China Sea Air Defence Identification Zone (ECS-ADIZ) for regional security and the involvement of the Chinese military in the country’s national security policy-making. While Al Chukwuma Okoli and Uchenna Simeon’s paper “Geo-Strategic Significance of East China Sea Air Defense Identification Zone (ECS-ADIZ): A Threat-Import Analysis” analyses China’s self-declaration of the ECS-ADIZ as a turning point in China’s determination to assert control over the disputed maritime territories and her first significant move against US interest in the Pacific, Ching Chang’s article, “The Chinese Military in National Security Policy-making”, attempts to answer from several different dimensions the often raised question as regards the possible degree of political influence the Chinese People’s Liberation Army (PLA) have on the country’s national security policy-making.

CCPS Vol. 4 No. 3 (December 2018)
This journal issue’s collection of research articles on various pertinent topics related to contemporary China’s political economy and strategic relations ends with a final segment on *Culture, Sustenance and Development*. While Tian Guang, Camilla Hong Wang, Kathy Tian and Liu Yu’s article, “Food Consumption and Economic Development in Contemporary China”, explores food consumption as a cultural behaviour in contemporary China and the importance of the development of food industry to the country’s overall economic development and job creation, Zhonghua Han, Emile Kok-Kheng Yeoh and Wan Marhaini Wan Ahmad in the second paper of this segment, “Does Religious Obligation of Muslims in Western China Influence Their Intention to Adopt Islamic Banking?”, move beyond the corporeal and physio-cultural domains into the socio-psychological to investigate by employing the theory of planned behavior (TPB) the effects of the factors of attitude, subjective norms, perceived behavioral control and religious obligation on the intention to adopt Islamic banking services amongst Muslims in China.


This present issue of *Contemporary Chinese Political Economy and Strategic Relations: An International Journal*, the third and final issue (December) of this year, thus significantly completes the 2018 volume beginning with the special issue of Vol. 4, No. 1 (April), *Geopolitics of Belt and Road Initiative and China’s international strategic relations*, and followed by Vol. 4, No. 2 (July/August)’s *Focus – Dissent, political freedom, civil liberties and the struggle for democracy: Essays in honour of Liu Xiaobo*, a commemorative issue published on the first anniversary of the passing of China’s emblematic prisoner of conscience, the Nobel Peace Prize laureate Liu Xiaobo. The present issue, Vol. 4, No. 3, thus
brings the 2018 volume to a close by revisiting some of the most critical areas of the state of and changes in the political economy and strategic relations of contemporary China which the journal has explored through the two issues of April and July/August, in particular the pertinent dimensions of State-society relations and domestic-foreign policy nexus that are again highlighted in several of the present journal issue’s articles, dimensions that have gained increased criticality and urgency under the Xi Jinping presidency that through its “China Dream” slogan have projected an assertive vision, as Amadea Bata-Balog brings to the fore of our attention here in her review of Elizabeth C. Economy’s book The third revolution: Xi Jinping and the new Chinese state (2018), that requires recalibrating the Chinese Communist Party-State’s relationship with the civil society as well as its relationship with the outside world.

Before ending this foreword, we would like to thank all the contributing authors and the anonymous reviewers for their invaluable efforts in making the publication of the three issues of this 2018 volume possible. We are also grateful to Mr Yemo Zhang for his crucial assistance in proof-reading, and to Miss Wu Chien-yi for the journal’s website construction and maintenance. The responsibility for any errors and inadequacies that remain is of course fully mine.

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CCPS Vol. 4 No. 3 (December 2018)
Notes

1. Dittmer (1981). Assuming that relations between actors may be classified as either “positive” or “negative”, Lowell Dittmer depicts four possible configurations of the triangle: (a) Unit veto – enmity among all three actors; (b) Marriage – a positive relationship between two partners against a third “pariah”; (c) Romantic triangle – positive relationships between one “pivot” and two “wing” actors, who have better relations with the pivot than they have with each other; (d) Ménage à trois – positive relationships among all three actors.

2. Hong’s paper (2016) proposes a “dual-romantic triangle” in which both amity and enmity are present between the pivot and each wing by taking into consideration the ambiguity in American foreign policy that depends on Administration-Congress convergence or divergence. In a sense, this is akin to a combination of Lowell Dittmer’s “romantic triangle” and “unit veto” formulations.

3. Francis Fukuyama, quoted in “The end of the end of history” (by M.S.), The Economist, 18th January 2011.

4. Ibid.

5. See Dirlik (2012: 296), Note 15.

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Hong Kong, 25-27 June 2016.)
Belt and Road Initiative, Trade and Finance
The Sino-US Trade War: Survival, Domestic Reforms and the Belt and Road Initiative

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Abstract
In July 2018, President Donald Trump stated in an interview with CNBC that he is willing to impose tariffs on all USD 505 billion worth of Chinese exports to the US. At the time of this writing, this has not become a reality. While it is strikingly clear that China cannot match the US in a tit-for-tat tariffs fight due to an imbalance in import volumes in favor of the latter, China can and has made some tactical decisions in its imposition of tariffs. For example, many of the tariffs levied on US goods target products which originate from states that have voted for Trump. At the same time, many of these products – such as soybeans – China can procure in other markets. This paper does not explore how China can mobilize the extent of its geoeconomic tools to gain an advantage in this developing trade war, as this has already been widely
covered in the media. Instead, comprising two parts, this paper examines how China can use the pressures created by this trade war to better advance its grand strategy. In the first, against the backdrop of the regime’s survival, the trade war can be used to leverage and increase the pace of its domestic reforms, which will be critical to the long-term sustainability of its financial sector and economy. In the second part, this paper explores how China can push forward its geopolitical ambitions – notably, the Belt and Road Initiative – in the vacuum left behind by the trade war and the Trump Administration at large.

**Keywords:** Belt and Road, grand strategy, reforms, trade war, Chinese economy

1. **Introduction: Structure of Opportunity for More Ample Reforms?**

On September 24, 2018, the US imposed a 10% tariff on USD 200 billion worth of annual Chinese imports, with the tariff rate rising to 25% beginning January 1, 2019. In addition, the US has threatened further duties on USD 267 billion worth of goods should China retaliate – which it did. Coming into effect on September 24 as well, China enacted 10% tariffs on USD 60 billion worth of US goods (Associated Press, 2018). This, at the time of writing, has been the latest scrimmage in the ongoing 2018 Sino-US trade war, and the largest round of tariffs imposed on Chinese imports by the US.

Since the first shot of the trade war – on March 9, 2018, the US enacted 25% tariffs on steel and 10% on aluminum from all nations – mainstream media like that of CNBC and Bloomberg have duly pointed out that the ratio of US goods imported by China versus Chinese goods imported by the US is simply too low for China to win in any tit-for-tat tariff battle (Li, Zhang, and Hart, 2018). According to the Office of
the United States Trade Representative, in 2017, the US imported USD 505.5 billion worth of goods from China and exported only USD 129.9 billion – more than a three-fold difference. This economic reality effectively renders a tariff-focused strategy for China impossible. This paper does not explore how China can gain an advantage against the US in this trade war using various geoeconomic means – such as currency devaluation or targeting imports produced by President Donald Trump’s voter base, with soy possibly being the best case (Taheripour and Tyner, 2018), as this topic has already been duly covered in mainstream media, industry press, and recent academia (Li, He and Lin, 2018; Zheng, Wood, Wang and Jones, 2018). The paper does, however, explore China’s opportunities for domestic reform amidst this economic battle.

From the beginning of 2018, China has launched an economy-wide continuous series of reforms aimed at further liberalization and stabilization, as well as the strengthening of its financial sector – such as the tightening of insurance regulations aimed at tackling local governments’ debt exposure announced on January 18 by the country’s insurance regulator, which later merged with the banking regulator in order to create the “super ministry” that is the China Banking and Insurance Regulatory Commission (中国银行保险监督管理委员会 – CBIROC).

These reforms come against the backdrop of China’s ongoing economic transition and China’s new economic head, Liu He (刘鹤), who appears to be mainly following in his predecessor’s footsteps – for now. Since the 1980s, China has pursued an export-led economic development model (EOI) with incremental reforms (gradualist approach) allowing the once closed country to slowly integrate with the global economy (Naughton, 2007, 2018; Yang, 2004). While this path has worked wonders for the Chinese economy and consolidated the rule of the Chinese Communist Party (CCP) – by way of performance-based
legitimacy, it has also produced a substantial amount of negative economic externalities, such as high levels of non-performing loans (NPL)\textsuperscript{3} and skyrocketing real estate prices\textsuperscript{4}. As a result, the CCP has vowed to shift from this economic model to one more balanced with an emphasis placed on domestic consumption and innovation, which necessitates a wide range of economic reforms\textsuperscript{5}.

While these ongoing reforms since the beginning of 2018 were likely to be rolled out regardless of the trade war, it is unquestionable that the latter has imbued the reforms with a new sense of urgency and legitimacy\textsuperscript{6}. Furthermore, the trade war pressures give President Xi Jinping additional clout within the CCP to strong-arm and push forward reforms\textsuperscript{7} which, given a different set of circumstances, may not have been politically viable. As such, this paper examines how China can exploit the pressures emanating from the Sino-US trade war to pursue domestic and international objectives that fit within the overall Chinese grand strategy. The first section identifies the objectives of Chinese grand strategy within the country’s domestic and international environments. From this, the subsequent two sections examine how the trade war can aid in China’s pursuit of these objectives. In terms of limits and scope, this article, insofar as it deals with recent events related to the ongoing trade war between the US and China, aims at articulating current political risks and opportunities in a very unsettled international environment. As such, listed ideas and positions are posited as possible outcomes.

2. China’s Grand Strategy: Political Survival Masked as Economics

While the CCP has not published any authoritative white papers outlining or defining a national strategy for the country (as it is “crossing the river by feeling the stones”), the latter’s objectives can be distilled by
examining the nature of the Chinese regime and large policy objectives already mandated by the CCP. Viewed within the scopes of China’s domestic and international environments and examined in further detail below, we emphasize that all of its strategic objectives are of an economic nature, and are vital for the survival of the Chinese regime.

2.1. Domestic Objectives

We begin with an assessment of China’s present domestic environment. The backbone of China’s grand strategy is the survival of the CCP (Logic of Political Survival [LPS]) (Gallagher and Hanson, 2013). Drawing on a general view of authoritarian resilience (Nathan, 2003; Dickson, 1997, 2016), the legitimacy of the CCP is grounded in the continuous provision of socio-economic goods to the Chinese populace, on its ability to build institutions – that can serve and address public grievances – and to vouch for them, and on its capacity to co-opt large segments of the population (e.g. the “party class”, new middle class, etc.). This is, in turn, achieved through economic growth which, in the past four decades or so, has brought an unprecedented number of people out of poverty. However, as the coastal regions of China developed rapidly under the export-led economic model, leaving behind central China and mainly the resource-rich west, growth – while still impressive – has slowed down in the past few years, forcing the CCP to lower its GDP growth targets. The important point to note is that a substantial economic slowdown, let alone a recession, produces wide-ranging socio-political problems for the CCP, which are further aggravated by the sheer size of the population. For example, under the current export-led economic model, a significant slowdown of growth could mean massive layoffs, especially in the richer coastal regions (such as Shenzhen back in 2008), leading to social resentment, unrest, and dissent on a massive scale that are further exacerbated by dysfunctional (or simply absent)
social security and welfare programs. As such, this type of situation is not tenable, in the long run, for the “Organizational Emperor”.

Should the CCP fail to provide the populace with a continuous stream of socio-economic goods, the Party-State might face a regime crisis, directly impacting its resilience let alone its survival. And while the CCP could use heavy-handed repression tactics against a dissenting populace (yet unlikely scenario), the root of the problem remains that the Party-State draws legitimacy mainly from its ability to steer and provide economic development. As a result, continuous economic growth, which would be achieved through the ongoing economic transition, is a crucial strategic objective for China as it is inextricably linked to the resilience and survival of the regime. This is the central focus point of China’s grand strategy, and subsequent strategic objectives are derived from this.

The second objective in China’s grand strategy is the implementation of reforms, specifically economic reforms, which chiefly aid the economic transition via two channels. Firstly, one set of these reforms are aimed at liberalizing various aspects of the Chinese economy, especially in the area of foreign direct investment and ownership. These types of reforms will not only help China transition into a more balanced economic model, but they will also aid in the regime’s pursuit of international strategic objectives, which are further discussed below. Secondly, another set of these reforms aid the economic transition by soothing externalities accumulated from decades of relying on the export-led model. As previously noted, this economic transition has not been an easy task. The aforementioned path allowed China to achieve nothing short of an economic miracle, enjoying decades of double-digit GDP growth, and most importantly, gave the CCP political consolidation and legitimacy that other authoritarian regimes could only dream of. However, over-reliance on EOI has

*Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) ♦ 2018*
allowed socio-economic and socio-political problems to metastasize. Notably, state-owned banks dominated and continue to dominate the domestic financial landscape, providing morphine-like injections of capital to prop up failing or, at best, inefficient and bloated state-owned enterprises (SOEs) in the export sector, rendering domestic competition lethargic and further increasing the sector’s barriers to entry for private companies, all of which to keep some of the 1990s ideals alive (e.g. the state as the main employer, high rates of employment versus efficiency\textsuperscript{13}). At the same time, the shadow banking industry (Allen, Qian, Tu and Yu, 2018; Shen, 2017)\textsuperscript{14}, which had been booming until industry regulations clamped down on its development very recently, reveals the difficulty of securing loans from mainstream financiers for private companies that do not have the upfront collateral required by state-owned banks. Having rapid economic growth outpacing regulations creates ample room for economic and financial risks to build up – in October 2017, China’s outgoing central bank governor Zhou Xiaochuan (周小川) warned that the country faced a possible “Minsky Moment”\textsuperscript{15} – a sudden collapse of asset values due to an abrupt drop in investor confidence.

More concerning is that state-owned firms and their many subsidiaries and affiliated entities along the massive supply chains in the Chinese export sector have become a substantial political force in the country, if not downright sub-factions themselves. They exercise considerable economic and political leverage (especially on provincial and local governments\textsuperscript{16}) and are, in general, opposed to the reforms aimed at economic transition. Furthermore, as wealth spread and accumulated at a rapid pace, corruption and rent-seeking activities spread like wildfire in China’s politically intertwined economic system (Ngo and Wu (eds), 2008). It comes as no surprise that since taking office in 2013, two hallmarks of the Xi Administration have been to
stamp out corruption and roll out reforms aimed at strengthening industry regulations. As such, the second objective in China’s grand strategy can be summarized as implementing reforms which aid in the country’s economic transition.

2.2. International Objectives

We now move onto China’s role on the global stage, and the objectives of its grand strategy as laid out within the international environment. It is important to remember that these objectives, while seemingly global at face value, remain inextricably attached to the country’s economic interests, and by extension, the CCP’s political survival. China’s primary global objective is the Belt and Road Initiative (BRI) – essentially a massive infrastructure project aimed at connecting China by rail, road, and ports, to the rest of Eurasia and parts of Africa. Under the guise of international cooperation and the “Peaceful Rise” (和平崛起) slogan, the BRI – if it comes to fruition – can alleviate a multitude of pressures bearing down on the Chinese economy (e.g. new markets for Chinese goods, primary resources, heavy chemical industries and other forms of “dirty” manufacturing).

Firstly, the BRI will allow many underdeveloped regions of the world, such as central Asia and parts of Africa, to become better connected to the global economy at large. As these parts of the world develop at a faster rate, rising GDP per capita levels in these countries will demand more consumer goods, thereby creating new markets for Chinese exports. The mismatch between manufacturing growth in China and GDP growth in developed economies has been a critical problem for China’s export-led model for a number of years now. Effectively, the developed economies of the world cannot absorb Chinese exports, especially consumer goods, at a pace which matches the output of the latter. The BRI can alleviate some of this pressure and allow a more
smooth transition away from exports. At the same time, China will gain access to these resource-rich emerging economies. As many large parts of China remain underdeveloped – notably, the central and western regions – the country’s future development will require a constant flow of raw materials. The BRI in this case provides China with many new and cheap channels to import these resources. On the other hand, since much of the immense infrastructure demands will be shouldered by China, the BRI will also act as a channel for the Chinese economy to unload much of its excess production of industrial materials, such as cement and steel\(^\text{17}\).

Secondly, the BRI acts as a conduit for China to export its currency, allowing a faster route to RMB internationalization (Sun and Payette, 2016; 2017). In tandem with China’s growing economic clout, this topic has gained much traction in the past few years, especially with the inclusion of the RMB in the International Monetary Fund’s special drawing rights currency basket in 2016. Academic literature on international currencies widely points to a number of economic benefits for the issuing country: the exchange of fiat currency for goods; the ability to borrow from global markets in the country’s own currency; ease of trade settlement between countries holding that currency; and most importantly, decrease reliance on the dominant USD (Cheng, 2015). The latter point is of special interest to Chinese policymakers as the country’s vast USD reserves accumulated over the course of decades has become equal parts hedge and risk\(^\text{18}\). Following the 2008 financial crisis, China has echoed the concerns of other major economies on the world’s reliance on the USD, especially with regard to whether or not the US implements “responsible” monetary policy\(^\text{19}\). In the case of RMB internationalization, the BRI will connect China to developing countries with low liquidity, unstable currencies, and which are oftentimes deep in debt. This provides China with a prime opportunity to offer the RMB as
a reserve currency for these countries. On the other hand, in the relatively more developed east and southeast regions of Asia, China has an opportunity to pitch the RMB as a regional currency, which would mark a significant milestone for the currency’s internationalization. However, this last point is very dependent on the diplomatic acumen of the CCP.

Finally, the BRI can provide some additional benefits for China – technology transfers and the opportunity to enshrine the Chinese stock market as a new center for price settlements of various commodities. Upon examining the routes of the BRI, China and Western Europe are placed on the opposite extremities of this project. Connecting these two large markets by rail, road, and sea will further increase the interdependency between these two markets by improving the flow of goods, capital, and people. As a result, the two regions will be better placed to find areas of multilateral cooperation, be it economic, political, or in the realm of science. In any case, warmer relations between China and Western Europe increase the chances of economic windfalls for the former in shape of technology transfers. Already, China has moved to reform some of its strict policies governing foreign investment in a number of its protected sectors; this, coupled with further interconnectedness with Western Europe, presents China with a crucial opportunity to attract and absorb foreign know-how. And briefly, the East Asia region has long suffered from price shocks in many of the world’s key commodities – notably, crude oil – especially since these countries are generally oil poor. Since this region is geographically distant from the settlement centers of the world’s two largest crude oil benchmarks – the West Texas Intermediate (WTI) crude and the Brent crude – its crude oil demands are different from those regions primarily serviced by WTI and Brent. Reliance on WTI and Brent has rendered countries in this region vulnerable to sudden expansions or contractions.
in global oil supplies\textsuperscript{21}. With China’s growing appetite for petroleum, which will continue to grow as the country shifts away from coal, coupled with China’s position along the BRI as a major import destination for natural resources, and the rising status of Shanghai and Shenzhen as major regional stock markets, China can consolidate market pressures to establish a new regional crude benchmark price opposite Tokyo\textsuperscript{22}. Evidence of China’s attempt at establishing a crude oil benchmark can be traced back to March 2018 (right after State Council’s reshuffling), when the Shanghai International Energy Exchange, an energy derivatives-focused subsidiary of the Shanghai Futures Exchange, launched RMB-denominated crude oil futures (Xinhua, 2018b). While this is also further evidence of China’s recent financial sector reforms, the Shanghai-traded futures are still in their infancy. However, looking beyond crude oil, China is also a major producer and importer of widely traded metals, such as gold, silver, aluminum, copper, iron, and platinum. The sheer volumes of Chinese imports and exports of said metals will only increase as the BRI develops, and this again provides momentum for China’s stock markets to establish benchmark prices, which would in turn be beneficial for resource-rich developing nations to bring their commodities to an accessible market.

\textbf{2.3. Political Survival}

How, then, do these strategic objectives help the CCP and, by extension, China thrive as a one-party state? China is and will remain an export giant. As such, a major component of the BRI is to connect the relatively isolated markets of central Asia and parts of Africa, thereby opening up and developing these economies so as to allow Chinese exports to be absorbed – both in terms of goods and capital. However, as previously explained, the many failings of this export-dominant model have allowed a plethora of cancerous issues to grow – at times uncontrolled –
throughout the Chinese economy. Naturally, an economic transition to a more balanced model by increasing imports and consumption, along with timely reforms, is critical for the regime’s survival. On this front, too, the BRI provides many opportunities for China to capitalize on. As much as the BRI is about opening up new markets for Chinese exports, it is equally focused on attracting imports – raw materials from the developing economies, and technology and expertise from the developed markets\textsuperscript{23}. At the same time, the BRI provides an impetus to China’s ongoing reforms; that is, in order for the BRI to be realized, the Chinese economy must open up. The pace, however, will depend on ever-changing domestic and global conditions.

3. The Sino-US Trade War: Domestic Pressure and Global Realignments

3.1. The Xi Administration’s Domestic Opportunities

The Sino-US trade war has already inflicted damage on both sides. Farmers and workers in metal industries in the US have felt the effects of tariffs put in place by their own government, while the Chinese and Hong Kong stock markets have seemingly entered into a bear market (i.e. a market in which asset prices are falling) (\textit{Bloomberg}, 2018b) alongside a depreciating RMB. From the beginning of this trade war, the US rhetoric has remained on the offensive criticizing unequal trade policies on China’s part, and the Xi Administration appears to be on the defensive, constantly playing catch-up with tariffs. Yet at the same time, up until recently, China was seen as playing the “strong nation” card (厉害啦，我的国). In turn, this slogan, upheld by Wang Huning (王沪宁), exacerbated tensions with the US. Wang’s “mistake” created a rift in the CCP between those who have practical political experience, such as Wang Qishan (王岐山) and Hu Chunhua (胡春华), and those,
like Wang, who do not, fueling unrest among the population. Wang Huning underestimated Trump’s reaction and attitude towards China, which could be considered as a major shortcoming for the head of China’s top think-tank (Payette, 2018). Since then, Wang has been somewhat “isolated” and retrenched to party work and to his new position (as of August 2018) on the “rule the country by law” committee (中央全面依法治国委员会)²⁴.

As we have already mentioned in the introduction, China simply cannot match the US in this tit-for-tat battle of tariffs due to the difference in bilateral trade volumes. At the time of this writing, the impact of the US tariffs on Chinese goods has yet to be fully realized in the latter’s economy. However, there is undoubtedly substantial domestic pressure on the Xi Administration to bring a conclusion to this trade spat before the Chinese economy takes on any serious damage – which many market analysts are predicting to be in 2019 (CNBC, 2018a). In as much as the Sino-US trade war is weighing down on the Xi Administration, especially if we consider the possibility that much of the reason for its escalation could be due to internal mistakes (Payette, 2018), it also gives the administration ample firepower to push forwards many reforms and regulations that help China’s economic transition, but would otherwise face opposition from the manufacturing and the export industry. The reforms and regulations can largely be separated into two camps defined by their objective: aiding economic transition or economic stability and resilience. Naturally, many of these reforms and regulations have elements of both, but let us not get lost in the weeds, it is the major direction of these policies that matter most.

On the side of helping China’s economic transition, the government, since the beginning of 2018, has made progress on further opening up its domestic market to foreign capital on a number of occasions. For example, in July, tariffs on nearly 1,500 consumer goods, automobiles
and automobile parts were cut – in some cases, by more than half of their original rate (Xinhua, 2018a). And again, in November, China released another round of cuts in consumer goods tariffs, this time on products ranging from machinery, electrical equipment and textiles (Reuters, 2018d). The effects of these cuts were almost immediate: in August, China’s automobile imports rose 70% with Japanese and European vehicles leading the charge (Nikkei, 2018). Likewise, as this paper explores further down, insofar as these reforms help open up China’s domestic market, they also play an indirect geopolitical role as well. For example, in June, Sino-French relations hit a high note when China announced it would import more farm produce and civilian aircrafts from the European country (Reuters, 2018b).

As we have noted earlier, a major component to China’s economic transition is the expansion of its import volumes. At least on this front, these reforms have been relatively successful thus far in helping China attract foreign capital and products, as well as consolidating its trade networks while a trade war goes on with the US – thereby making good on its pledge to defend international trade and globalization. However, it is important to keep in mind that the trade pressure exerted by the US has helped the Chinese government tremendously in being able to reduce its import tariffs. Under the export-led economic model, protecting its domestic industries from foreign competition was absolutely paramount for China (and for previous states which followed the productivist model), as the absence of world-class technology and quality meant that Chinese industry could hardly compete against foreign firms if the latter moved into China unfettered. If domestic industries failed to develop, China’s economy would fail to develop by extension25, thereby creating a regime crisis for the Party-State. Consequently, Chinese firms have enjoyed the protection of the government against foreign competition since the beginning of the Opening Up and Reform period26 – thereby
creating informal groups and allowing certain political factions to deepen their roots in some sectors\textsuperscript{27}, ultimately hampering efforts at reform. Of course, as these domestic firms became lucrative and profitable from exports, rent-seeking behavior (corruption) spread. At the time, the latter took a backseat to economic development. However, the Xi Administration has, since 2013, been hard at work cleaning up the rust left behind by decades of unfettered economic development. The anti-corruption campaign, led in first instance by Wang Qishan, has cleared many of Xi’s enemies\textsuperscript{28} and provided his administration with plenty of firepower to push forth reforms that otherwise would have faced strong opposition in the past, as seen during the Hu-Wen decade.

Now, the Sino-US trade war gives this current government even more clout to push reforms – that is, reform or suffer massive economic damage. As such, with a rising middle class\textsuperscript{29}, China needs to attract imports, and while cutting tariffs may seem like a superficial fix to an urgent problem, it does fall in line with China’s approach to economic reform; that is, as Deng Xiaoping famously said, “crossing the river by feeling the stones” – incremental changes with a reactive approach\textsuperscript{30}. In a sense, these tariff cuts are the Chinese government’s way of testing the waters of this new round of reforms, and are a good way to hedge against the risks of this Sino-US trade war. That being said, once this trade spat calms, more deep-reaching reforms targeting the structure of the Chinese economy will likely be implemented. However, these structural reforms can only come after a more stable economy has been consolidated.

China’s reforms aimed at economic stability and resilience are arguably more important than those aimed at aiding economic transition. Just as decades of unfettered economic growth allowed corruption to spread through the ranks of politicians, military officials and businesses, it has also built up substantial structural risks within the Chinese
economy, drastically increasing the system’s exposure to internal and external shocks. There is effectively one encompassing structural risk – debt. The massive amounts of corporate and sub-national debt accumulated within the Chinese economy are an urgent matter, directly threatening the success of the country’s ongoing economic transition. However, debt is symptomatic of deeper issues at work: economic inefficiency, misguided policy, and shadow economic activity – chiefly, shadow finance\textsuperscript{31}. The latter has become a threat to the viability of the current financial and economic system (e.g. high levels of insolvency, bankruptcy, assets shortage risks) (Li, Hsu and Qin, 2014) and yet remains of crucial importance for some parts of the formal economy (e.g. SME [small and medium enterprise] capitalization) (Lu et al., 2015).

The Xi Administration’s other great campaign is that of nationwide deleveraging\textsuperscript{32}. Since 2009, all of the major state-owned banks have slowly but surely cleaned up their balance sheets thanks in no small part to Zhou Xiaochuan (CEIC, n.d.). However, in recent years (mainly since 2013), their NPL ratios have rebounded slightly, possibly due to massive investments earmarked for the BRI, but these levels have remained well below their pre-2009 peak (above 5-6\%). Regardless, insofar as the deleveraging campaign has been a practical operation in financial prudence, it has also allowed the government to implement many reforms that will yield a long-term benefit for the health of the Chinese economy, and 2018 has so far been a great year for financial regulation in the country.

One major structural change was the merging of the country’s insurance and banking regulators into one superagency in April (CBNE, 2018). The CBIRC now has oversight over both sectors, allowing for more effective regulation as financial products are oftentimes intertwined in both businesses. Of course, this merger is also aimed at
tackling much of the shadow finance activity that occurs in China’s banking and insurance sectors. The creation of this superagency follows a concentrated crackdown effort on the country’s fast-expanding shadow finance sector, which previously found a niche in China’s then poorly regulated banking, insurance, mobile payments, peer-to-peer (P2P) lending\textsuperscript{33}, and the recent cryptocurrency industries – all of which have now been hit with new regulations (\textit{Business Insider}, 2018). While this crackdown has inevitably driven large numbers of companies to bankruptcy and spooked investors, the long-term advantages for the economy as a whole are clear, with regard to financial stability. Further, in April, China’s central bank, now under the direction of Yi Gang (易纲)\textsuperscript{34}, announced new regulations on the massive asset management industry, which has also grown at a rapid pace in recent years due to the country’s tough capital controls (\textit{Reuters}, 2018a). These comprehensive rules ultimately change the industry at a structural level, covering regulations such as leverage limits, banning implicit guarantees, and closing loopholes on arbitrage. The end goal, clearly, is to further improve the financial sector’s stability and resiliency. And in another move to rein in corporate debt, the National Development and Reform Commission (NDRC)\textsuperscript{35} – also known as the “small State Council” (小国务院) – announced in June that real estate and infrastructure companies, as well as local governments, will have their funds raised from offshore bonds limited to repaying existing debt, banning them from using such proceeds to invest in domestic property projects and replenish working capital (\textit{South China Morning Post}, 2018). This appears to be a very timely regulation as the US Federal Reserve’s aggressive interest rate hikes have left many firms in developing economies that borrow in USD insolvent, bankrupt, or on the verge of one or the other (Inman, 2018). Finally, China’s sub-national government debt – which as of October could be much higher than what
is publicly disclosed with Standard & Poors’ analysts estimating at about USD 6 trillion (CNBC, 2018b) – has long been a major structural risk for the Chinese economy. Insofar as Xi’s de-leveraging campaign has been about state-owned banks cleaning up their balance sheets, the other major target of the campaign consists of local governments (Bloomberg, 2018a). In order to tackle this issue, the government has implemented a number of reforms. For example, in September, the Chinese cabinet released new guidelines on de-leveraging for 30 state-owned firms (Reuters, 2018c). However, these guidelines also address local government debt indirectly by prohibiting authorities from hiding financial liabilities through issuing corporate bonds. These guidelines follow an earlier set published in August which ordered local governments to find exactly how much debt has been accumulated over the past three years that has not been listed on their balance sheets, and accordingly create risk control plans (China Daily, 2018). Despite these efforts, there is still much concern over local government debt, especially since the pressure created by both the trade war and the BRI has created a need to simultaneously maintain economic growth while further consolidate financial stability. And in a rather contradictory move, in August, the banking and insurance regulator proposed to lower the risk weighting of Chinese banks’ holdings of local government debt from 20% to 0, thereby signaling encouragement to stockpile on these bonds (Caixin, 2018). As reforms and regulations targeting local government borrowing are still developing, the situation remains both problematic and delicate as the central government must balance financial risks with the overall growth of the country. Needless to say, the Sino-US trade war is a major test for the CCP, and while it has created pressure for domestic changes in China, it has also created changes in the international landscape opening up new channels of opportunity for the Middle Kingdom to capitalize on.
3.2. Global Shifts

Global politics has shifted greatly since the 2016 US election. The Trump Administration has since shown the rest of the world that, ally or opponent, no one can predict what the president will do next and how he will respond to changing conditions. Consequently, we have seen a realignment of global geopolitics. An aggressive Trump and, by extension, US, has pushed various states into awkward positions.

Firstly, Sino-Russian relations have gained a new momentum as both states have become increasingly suspicious of the Trump Administration, given how hostile the latter has been to global economic interests (Bin, 2018) – not to mention the debacle that is Russian meddling in the 2016 election, and now, the unraveling of a highly sophisticated Chinese corporate espionage scheme stretching back years and possibly jeopardizing both US companies and the government. Sino-Russian relations have ebbed and flowed since the Sino-Russian split, but have seemingly reached a new high as emphasized by their recent large-scale joint military exercises.

However, the two states still have ample reason to remain cautious when dealing with one another, and it remains to be seen whether the forces of cooperation are stronger than those of competition in the Sino-Russian context. On one hand, China needs Russian oil and gas, just as Russia needs Chinese capital. Further, in a neighborhood full of states worried about China’s rise, Russia remains a relatively more reliable ally as its concerns seem to mostly be preoccupied by NATO and its European borders. Just as much, the BRI’s success is also heavily dependent on a friendly Russia. On the other hand, Russia already faces geopolitical pressure along its European borders, and its Middle East ventures have seemingly disappointing returns. Given the recent unpredictability of the US, especially if Robert Mueller’s investigations draw damning evidence of Russian interference in the 2016 elections,
and further threats from Islamic terrorism which could flood in from Central Asia, Russia’s geopolitical position may be threatened. As such, Russia must remain vigilant of China’s rise and intentions, especially if the BRI does prove to be a success and a rekindling of Sino-US relations sets the groundwork for a 21st century containment strategy against Russia. The same is true for China: poor relations with Russia could severely hamper efforts at an economic transition as the BRI would be stalled and oil and gas flows could be cut. However, despite these concerns on both sides, China ought to maximize this opportunity made in large part by Trump’s election to pursue Sino-Russian relations to the highest possible extent and particularly focus on expanding the part of the BRI that runs through Russia. Any success, in terms of economic gains, that can be derived from the Russia route will help dispel some suspicion over China’s intentions with the BRI, which will be critical to the overall success of the project.

The second global realignment is that of Sino-European relations. The two regions have had a similar experience dealing with the Trump Administration: both are long time trading partners of the US who have been the target of Trump’s allegations regarding unfair trade practices. Regardless of whether or not those allegations have any truth to them, the Trump Administration did indeed put its money where its mouth is and slapped tariffs on various goods coming from the European Union and China. While the EU has long remained suspicious and fearful of Chinese capital and has been lukewarm towards the BRI, the region has now warmed up slightly to the Middle Kingdom. Of course, this may be due to a variety of domestic factors, such as the financial ticking time bomb that is Italy (CNN, 2018), the political attrition as fallout from the lack of any real progress on Brexit, and the recent wave of populism sweeping over the region. However, it is well within reason to include the Trump Administration’s stance on trade as part of the reason for the
EU’s recent change of attitude towards China. At least on a rhetorical level, the EU and China share a united front on the issue of global trade and globalization; that is, they have brought unprecedented wealth to many parts of the world and are a net benefit to all states involved, and that global cooperation and a rules-based international system ought to remain the status quo. This, of course, stands in stark contrast to Trump’s rhetoric of “America First” and his blasting of globalization, as well as the frequent mentions of how the US has been ripped off by its trading partners.

The EU, however, remains in a rather awkward position. On one hand, its suspicions towards China are not unfounded at the least – as previously mentioned, the recent unraveling of China’s corporate espionage scheme feeds into this suspicion; and the fear of Chinese capital buying up assets across the EU remains a common sentiment. At the same time, the EU – and China, too – has learned that the US, once the champion of a rules-based global system, can fall to domestic populism and lash out at its long-time allies and partners. In short, no individual or state is safe from Trump’s ire, and what is more troublesome is that no one can seemingly predict what this administration will pull out next. The EU’s worries are further amplified by the fact that China has not, outside of its rhetoric, made any strong gestures of how it will act as a superpower, and as such, China’s intentions remain shrouded in mystery to outside observers and states. However, the global economic system must go on, and the EU must choose between sticking by its Atlantic ally or taking a chance at potentially forging a new alliance with a rising superpower that seemingly acts different from the US and Russia. In this case of Sino-European relations, China has much room to maneuver, and the potential gains are massive with little downside. For one, China can pursue new trade deals or renegotiate existing ones with the EU, now that the US has
shown itself to be unreliable. In exchange, China can offer up more of its domestic market access to the EU, given that China will need to do so anyway for its economic transition. Further, China ought to leverage this period of uncertainty between the US and the EU, as well as the friction between the UK and the EU over Brexit, to pitch the BRI in a better light and be forthcoming about its role as superpower. If China is indeed for a rules-based global system as its rhetoric has time and time again broadcasted, then it must play a more active role in upholding this system. Whereas Russia needs reassurance from China on a geopolitical level, the EU needs reassurance on a leadership level – that is, it needs to know, or at least be satisfied, that an influx of Chinese capital or the interconnectedness that would be brought forth by the BRI between China and the EU will not be for some nefarious political objective and that China will not abuse its influence to meddle in the EU’s domestic functions.

A final global shift is that of the smaller states in China’s local cluster. Neighboring states, such as Vietnam, Malaysia, Thailand, and Cambodia have watched China’s rise with suspicion and have been very reluctant to participate in Chinese-led initiatives. However, as with Russia and the EU, these neighboring states – especially South Korea and Japan – are also now placed in a position on the fence. On one side stands an unreliable US with a failed attempt at a pivot to Asia that has also turned inwards; and on the other a continuously rising China with an ambitious infrastructure project, but fielding an ever-growing military. These states could swing either way, and must watch carefully how the undercurrents of global politics shift. A key issue, for example, would be whether or not the US will return to a normal state of affairs – that is, whether the Trump Administration survives for another four years in 2020. However, this is further complicated by the possibility of an impeachment stemming from the Mueller investigations which will
salt the wounds of an already divided American society. These states will of course reach their own conclusions on such issues; China can nonetheless play an active role in shaping how neighboring states perceive it. On this front, China needs to be extremely careful in how it deals with territorial disputes in the South China Sea. On one hand, territories are a matter of pride and nationalism for China. On the other, outright aggression and disregard for other states involved will do little to further the BRI. In recent years, we have seen how these smaller states have responded negatively to the BRI\textsuperscript{36}. For example, in early 2017, the Sri Lankan government’s leasing of the Hambantota port drew ire from locals as protests erupted in the region. In a similar vein, both Pakistan and Malaysia have moved to curtail Chinese investment in their respective countries following leadership changes in 2018 – Mahathir bin Mohamad in Malaysia and Imran Khan in Pakistan (Schwemlein, 2018)\textsuperscript{37}.

That being said, China’s unchallenged economic clout – both in terms of export and import volumes – in the region offers it a unique opportunity to act as an organizing force for the Asia-Pacific. Just as these local states have become uneasy at the BRI, they also require economic windfalls to further develop their economies and hedge against rising US interest rates. For example, even as Pakistan has moved to curtail Chinese investments, it has simultaneously moved to conduct bilateral trade in RMB in October this year out of necessity to ease mounting financial pressures on its economy (\textit{VOA}, 2018). However, while the project’s ambitions are grandiose, they need to be grounded in reality; that is, as we have seen with regard to the growing negative sentiments to the BRI, China will need to spend much more effort courting the states in its local cluster to realize this project – insofar as these neighboring states are all united in their pursuit of economic interests, they are also united in their mutual distrust of China,
and a divide and conquer strategy may not work to the Middle Kingdom’s advantage in this case. Dealing with its neighborhood, China must realize that as much as everyone is worried about their own economy, they also worry about how China acts as a regional power.

4. Conclusion

At the time of this writing, China and the US are still locked in this trade war, with no clear ending in sight. Fortunately, we remain at the stage of tariffs, which means that the more devastating geo-economic tools have not been deployed by either side, despite Trump’s repeated accusation of Chinese currency manipulation – which the US Treasury has recently refuted (U.S Department of the Treasury, 2018). Insofar as this trade war has the potential to inflict incredible damage to a fragile global economy and further erode trust between the world’s two largest economies, it has also provided China multiple avenues of opportunity.

While China’s one-party state must survive through a continuous provision of socio-economic goods to its populace, it can use the trade war’s economic pressure to push forward unappetizing reforms to reorient its decades-long export-led development model towards a more balanced economy with an emphasis on imports and consumption. Years of reliance on exports has infected China with a plethora of challenging issues which threaten to derail its economic success and ultimately, the hard-earned political consolidation of the CCP. Of course, the ruling party is undoubtedly aware of these issues and would have rolled out these reforms despite the trade war. However, the latter imbues these reforms with a sense of legitimacy and urgency.

On China’s geopolitical chessboard, the trade war – and the Trump Administration’s general hostile attitude towards the rest of the world – has created a rather awkward situation for many states. On one side is an
essentially rogue US that has fallen to the flames of populism, rebuked its traditional allies, praised dictators, and become hostile to an international system it once built and chaired. On the other, a nominally communist China that has made repeated remarks on the global stage about how it will uphold a rules-based international system and champion free trade. Now that the US has more or less fallen as the once reliable pillar for many small states, China’s BRI seems like a positive-sum project with no strings attached. However, while China’s rhetoric seems welcoming at face value, its increasingly aggressive posture and actions in its local neighborhood have made the global community adopt a very skeptical and guarded stance. Whether or not China can use the trade war as a gateway to winning diplomatic and thereby, economic, gains will depend entirely on the astuteness of the CCP. However, China has thus far placed much of its chips on the success of the BRI, which is intrinsically tied to the success of its economic transition. China will need to understand that mutually beneficial economic gains between itself and other states is not sufficient for bilateral and multilateral cooperation. Its image on the global stage – which is ultimately a way for states to assess how China will operate as the new superpower – is just as, if not more, important.

Notes

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1. Currently under the direction of Guo Shuqing (郭树清), an ally of former premier Zhu Rongji (朱镕基) and an associate of the central bank’s ex-governor Zhou Xiaochuan.

2. Liu He, Xi’s main “economist”, is currently part of the Politburo, vice-premier and director of the small leadership group on finance and on the economy. Liu, who has long experience inside the Planning Commission and the subsequent Development and Reform commission, is said to “imitate” the style of Zhu Rongji even if he was not necessarily one of Zhu’s top picks for leadership positions in the 1990s.

3. Mainly the result of the early reform era (1978-1983) policies of blind lending to newly formed state-owned enterprises (SOEs) and town-village enterprises (TVE) – or simply lending to keep them afloat in order to maintain high levels of employment – NPLs have “pushed” the privatization of former SOEs back in the mid-1990s but have also been a key problem for China’s entry into the WTO in 2001. NPLs, sometimes
“forgotten”, are making a comeback as Chinese companies enter the international market and pursue listings on stock exchanges (i.e. pressure to declare bad debt to prospective investors). According to the CBIRC, the current NPL ratio sits at 1.8% (more than USD 220 billion).

4. In some parts of Hebei, according to our local source, local cadres are helping locals to secure loans to buy real-estate even if they cannot afford it only to supply housing market production (i.e. sustaining the bubble) (Zhao et al., 2017). Furthermore, NPL were found to have a negative impact on real estate prices (Wan, 2018).

5. Far from being a new idea at this point, a domestic-focused economy has been discussed since the 11th five-year plan (2006-2010) and again in the outline of the 12th (2011-2015). At the time, when energy production and consumption was the main issue, the plans suggested a strong turn towards domestic production in contrast to external dependency.

6. On September 30, 2018, China’s finance ministry announced that, effective November 1, tariffs on a wide range of textiles and metal products, including steel, will be cut down to 8.4% from 11% (Reuters, 2018c).

7. To this effect, this point of view runs contrary to the prevailing opinion that “Xi is under pressure” or that “Xi is facing discontent inside the Party”. Factionally speaking, none of these two statements can be deemed true simply because of the sheer number of allies Xi has placed on the provincial political scene (i.e. governors and party secretaries alike), inside the party structure (e.g. organization department, united front department, party schools, etc.) and in the overall state administration (e.g. State Council, leading ministries and bureaus) since 2013 (thus tossing aside or simply jailing – by way of the anti-graft campaign – “old” political opponents such as Jiang Zemin’s (江泽民) men and Hu Jintao’s (胡锦涛) “tuanpai” (团派). As such, Xi is by far the most powerful figure inside the CCP at the moment, and dissent or pressure from other factional groups is improbable at best.

9. It is believed that under current circumstances, this will be one of the first generations (the one that entered the job market in the 2000s) who will fare worse than their parents.

10. During one instance, more than 60,000 workers in the IT sector were laid off in Shenzhen during the 2008 crisis (Lüthje, Hürtgen, Pawlicki and Sproll, 2013).

11. In contrast to a simple “political crisis” or a “party crisis” which does occur in some Western democracies, thus leading to elections.

12. As the logic was that the party was best suited to control and distribute economic development in China.

13. Similar in many fashions to the Japanese model back in the late 1980s (Sakikawa, 2012).

14. For some, like Karry Lai, shadow banking could represent as much as RMB 65 trillion (Lai, 2018).

15. On September 7, 2018, in an interview with Bloomberg, Zhou echoed his earlier warning and stated that while the Sino-US trade war has a limited impact on the Chinese economy considering the latter’s size, market sentiments could change suddenly and wipe out investor confidence (Bloomberg, 2018c).

16. Local governments as in prefecture-level cities, counties or even township-level entities. This is more likely to happen in resource-rich regions as an SOE or TVE may be one of the sole employment providers (as proven by the case of coal in some parts of Shanxi, or of both ferrous and non-ferrous metals in Inner Mongolia) and tax payers. Considering the dire situation of many of these localities (i.e. drastic budget cuts affecting payroll and all forms of local investments), not pandering to these SOEs or TVEs is simply not an option. Lastly, up until recently, many of these sectors (mining, oil, and even grain in Anhui, for example) were tied to Jiang’s
ancien régime, wherein individuals allowing for corruption and rent-seeking spaces were, in most cases (but not all), first-, second- or even third-degree allies of Jiang’s lieutenants, such as Su Rong (苏荣), Ni Fake (倪发科), and Chu Bo (储波).

17. This is especially important for SOEs, which are the preferred contractors for BRI infrastructure projects. Chinese SOEs employ vast portions of the population and are considered crucial for national security, but are generally inefficient – to say the least – and have in recent years faced mounting economic pressure from both the market and the state to trim down and deleverage. However, the BRI has breathed new life into many Chinese SOEs allowing them to extend their corporate lifespans a little longer to work on infrastructure projects (Watts, 2018).

18. While China’s currency basket – of which the RMB is pegged to – comprises most of the world’s major currencies, the overwhelming role the USD plays in the RMB’s exchange rate is undeniable. The relatively low liquidity of the EUR, CAD, or the SGD, versus the USD means that changes in those currencies affect the RMB much less.

19. We are referring to the Triffin Dilemma. Formulated by Robert Triffin in the 1960s. The dilemma posits that the issuer of an international currency runs into a conflict of economic interests between its short-term domestic policy objectives and the long-term demands of those countries that hold the currency in its foreign exchange reserves, and by extension, the interests of the global economy (McKinnon, 1996).

20. With the possible exception of China, which has a number of large oil fields. However, they are not sufficient for the country’s needs (Payette and Mascotto, 2011), and at the end of 2013, China became the world’s largest net importer of petroleum. Furthermore, while the South China Sea has large deposits of petroleum, the region remains hotly contested among the bordering countries (US Energy Information Administration, 2015).
21. While crude oil is indeed traded on the Tokyo Commodity Exchange, the volume of contracts pales in comparison to those of WTI and Brent (TOCOM, n.d.).

22. Tokyo’s crude oil futures have so far failed to establish themselves as the regional benchmark. This may be due to a variety of reasons, including Japan’s low domestic demand for crude, and the relatively low liquidity of these contracts versus WTI or Brent.

23. Most studies on the BRI focus on the regional/international impact the later will have on the new leadership role that China will have to assume or on how the BRI is actually a new grand strategy aiming at becoming the new superpower (Beeson, 2018; Schortgen, 2018; Clarke, 2017). We are leaving out the literature dedicated to political risk (in terms of foreign investment, local investment, special insurance, etc.) as it is not relevant to our discussion.

24. However, some observers noted that perhaps the policy research center of the Central Committee, still headed by Wang at the moment, should be led by one of Xi’s men instead of someone who still represents the Jiang era.

25. Thus being in clear reference to what can more or less be expected of a state following some theoretical tenets of the “developmental state”.

26. Mirroring the experience of Japanese zaibatsu (财阀) shielded by the MITI (Ministry of International Trade and Industry) back in the early 1980s.

27. In this case, we mainly refer to sectorial factions like the Oil Faction, led by (during the 1980s onwards) Zhou Yongkang (周永康) – which still has roots in the oil sector today; the Inner Mongolia Faction, previously led by Chu Bo and its local mining industry; and many other regional subgroups led by party members in Qinghai (oil), or in Guizhou (mining). In turn, natural resource extraction and transformation had become the turf (rent space) of several individuals tied to Jiang’s ancien régime.
28. Most of the high-profile targets who were put under investigation and sentenced had ties to the systematic corruption set by the gradual approach to domestic reforms back in the 1980s. As such, clearing the slate might have prevented, and we generalize here, further pressure on an already fragile economic system.

29. As Chen Jie pointed out, this class, despite not being necessarily “pro-democracy” (in part because it owes its place and wealth to the party), are rather “pro-law” and “pro-procedural formalization”. They might be agents of the status quo, but at the same, the party needs to provide more social and economic goods to the latter to ensure co-optation (Chen, 2010).

30. Which has been the way in which reforms have been implemented since 1978: enacting tentative reforms and projects followed by unintended consequences and adjusted by subsequent new reforms and adjustments. The creation of the Shenzhen Economic Zone back in the 1980s and even the incremental privatization of land communes in central China followed this pattern.

31. Some of these issues have been previously tackled in the academic literature (Taylor-Armstrong, 2016).

32. As Chan argues, deleveraging will need to be accompanied by more in-depth structural supply-side reform in order to actually be impactful (Chan, 2018).

33. Lots of issues have already been assessed in the academic literature when it comes to P2P lending (Lin, Li and Zheng, 2016).

34. Yi Gang, part of the “reformers”, was also one of Zhu Rongji’s protégés and an ally to both Zhou Xiaochuan and Guo Shuqing, current CBIRC chief (Payette, 2017).

35. The NDRC is currently directed by He Lifeng (何立峰), one of Xi’s Fujian-based allies.
36. On the other hand, when it comes to larger states like India, some have argued that the BRI could benefit the latter and could even promote cooperation between the two states (Baruah and Mohan, 2017).

37. Other recent works have underlined the tensions between the BRI’s objectives (in terms of regional infrastructure and investment) and smaller states (Deepak (ed.), 2018), while others, like Chen Shaofeng (2018), have argued that changes in local elites’ perspectives highly depend on the degree of trust (towards China), local leaders’ ideology (pro- or against China) and local social responses (social unrest vs. acceptance).

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The Asian Infrastructure Investment Bank, the New Development Bank and the Internationalisation of the Renminbi (RMB) – The New International Financial Institutions as Part of the Chinese Strategy to Build Up an International Reserve Currency

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Abstract

China’s economic rise is being followed by an increasingly assertive foreign policy, which is marked by criticism of the current international financial system and attempts to change it. Beijing’s leading role in the launch of two international financial institutions (IFI) – the Asian Infrastructure Investment Bank and the New Development Bank – is a good example of these attempts. Chinese leaders are wary that international financial leadership necessarily requires the internationalisation of its currency, and their leading position within the new IFIs provides a good opportunity to internationalise the renminbi.
Keywords: China, Asian Infrastructure Investment Bank, New Development Bank, RMB internationalisation, international reserve currency

1. Introduction

China’s impressive economic development in recent decades has elevated the country’s global standing to the extent that it is increasingly capable of shaping the international economic order. More recently, China has been adopting a more assertive approach aimed at reshaping the current US-led system through the expansion of its leadership in trade and investment, the creation of new international financial institutions (IFIs), and the internationalisation of its currency, the renminbi\(^1\) (RMB) (Sun, 2015: 28). The launch of the New Development Bank (NDB) and the China-led Asian Infrastructure Investment Bank (AIIB) has raised debates about China’s ability to take advantage of the IFIs to enhance its economic power, for example, by advancing the internationalisation of the RMB (Kynge, 2014).

This paper attempts to assess China’s involvement in the launch of the AIIB and NDB as part of its broader strategy to internationalise the RMB. As the IFIs in question are not exclusively subject to China’s will, it is worth checking the political positioning of other shareholders. The likelihood of their complying with China’s self-interests within the banks will be appraised here. It is also illuminative to analyse the IFIs’ legal framework to explore the extent to which they are able to accommodate China’s interests. A crucial issue addressed by this article, for example, is an investigation of the IFIs’ ability to make loans denominated in RMB. It will also examine whether the AIIB and NDB’s loans will increase China’s foreign trade and investment, enhancing RMB’s international role.
The examination of these issues helps clarify the relationship between the AIIB, the NDB, and the internationalisation of the RMB. The connection entails subtle causalities. As Prasad (2017: 248) claims, the creation of the new IFIs, the expansion of China’s leadership in trade and investment, and the internationalisation of the RMB are intrinsically correlated and complementary. The AIIB and the NDB will pave the way for the enlargement of Chinese overseas trade and investment, which in turn will open new fronts for the global use of the RMB.

This paper will demonstrate that the new Banks are a part of China’s broader strategy to upgrade the status of the yuan as an international reserve currency. Section One will provide an introduction to the IFIs, a review of what is being said about the internationalisation of the RMB and a brief description of the materials and methods used to conduct the research. Section Two provides the necessary background regarding international reserve currencies, including their pre-requisites, benefits, and the motivations that drive Beijing’s interests. Section Three presents the argument that the new IFIs are going to promote three issues that are critical to the internationalisation of the RMB. Firstly and most importantly, the IFIs will enhance China’s capacity to deploy RMB through loans. This fact, together with the increase in China’s trade and investment flows, will result in two secondary effects: the increase of RMB offshore centres among China’s trade partners, and the deepening of the RMB bond market. Section Four will analyse the tendencies counter to the advancement of the RMB internationalisation agenda within the banks, in particular the United States (US) opposition and the resistance of Chinese economic groups to the shifts in monetary policy. Finally, this paper concludes that the banks will serve as tools to promote RMB status, but they will have only a limited impact as the RMB internationalisation agenda will be constrained by the pace of China’s financial markets reform.
The intention to launch the AIIB was announced by Chinese officials in 2013 as a means of meeting the increasing demand for infrastructure in Asia. Other countries in Asia, except Japan, reacted positively to the initiative and the Bank promptly gained massive support (Bob, 2015). By April 2015, AIIB had attracted 57 prospective members, including close allies of the US such as Great Britain, South Korea and Australia. By June 2018, the number of members had increased to 64. The US and Japan, however, have taken a wary approach, indicating that they perceive the initiative to be an attempt to challenge the current international monetary system (IMS) (ibid.).

The NDB was created in 2014 by BRICS (Brazil, Russia, India, China and South Africa) with the objective of meeting shortfalls in infrastructure finance in the member countries. The NDB also has a Contingency Reserve Agreement (CRA), which is a fund of US$100 billion aimed at providing financial rescue to members experiencing difficulties with their balance of payments (Ministry of External Relations, Brazil – BRICS, 2014). The genesis of BRICS was already marked by a declared desire to reshape international power relations in a manner reflecting the economic rise of emerging countries (Peruffo and Prates, 2016), which includes a reduced over-reliance on a limited number of reserve currencies (Danese, 2017). By engaging in such initiatives, China not only aims to reduce the influence of the dollar but also to establish a political and financial foothold in the member countries that can be used to advance the use of the RMB in trade and finance (Prasad, 2017: 234).

China, as the main shareholder of the two IFIs and as the member state supporting them most enthusiastically, is in a strategic position to make better use of both IFIs to amplify its international economic power (Subacchi, 2017: 190). Although Chinese officials have been claiming
that those financial institutions will complement rather than challenge the current US-led system, such claims should be taken cautiously. After all, in the initial phase of its rise as an economic powerhouse, where it still lacks political reputation and prestige, China tends to be over-respectful rather than defiant to the extent of triggering open political confrontation.

The phenomenon of currency internationalisation is commonly explained through two approaches in literature. The first explanation draws on the fact that currencies of major economies fully integrated in the global market are highly coveted for foreign trade and foreign direct investment (FDI) (Eichengreen and Kawai, 2015: 1). China, as the biggest merchandise exporter (International Trade Centre, 2017) and the third largest recipient and second largest source of FDI (OECD, 2017) already fulfils that condition.

The second approach highlights the functions played by national governments to seek an international role for their currencies. Although economic size matters, convenience, low costs and confidence are more important for currency internationalisation – predicates that are achieved as monetary authorities build up the adequate facilities and trust in the financial system (Cruz, Gao, and Song, 2015: 275; Nugée, 2010: 13).

The literature highlights transactional liquidity, credibility and international usefulness as prerequisites for a given currency to become an international reserve asset (Cohen, 2000: 5; Wheatley, 2013: 18). This paper analyses how the agenda of the AIIB and the NDB support the achievement of these three prerequisites. This analysis proceeds through an assessment of the IFIs’ legal framework, their official statements, and the academic debates over this issue.

This paper also assesses the benefits of internationalisation of the RMB in light of China’s international and domestic motivations. To this end, it analyses the work of Cohen (2012) who exposes a broad class of
gains arising from the currency internationalisation process. Prasad’s (2017) book and Sun’s (2015) chapter are used to evaluate how China’s international ambitions are coupled with the new IFIs and RMB internationalisation. The chapter by Nugée (2010) appraises the debates about the IMS with special emphasis on Chinese dissatisfaction with the outdated, dollar-centred IMS. The chapter by Volz (2014), in turn, sheds some light on the domestic motivations of the internationalisation of the RMB in China, and names the impetus it will give to China’s financial market reforms. This paper also gathered a number of statements made by Chinese high-ranked officials as well as opinions conveyed in documents of Chinese monetary authorities and think tanks that demonstrate the intention to internationalise the RMB.

The main features of the NDB and the AIIB that can increase RMB’s international role are also investigated here. In order to appraise the capacity of the Banks to make loans denominated in RMB, I have done an extensive search of the official documents of both IFIs, such as the Articles of Agreement (AOA) and Policy on Financing Operations. These documents were evaluated together with the decision-making process and the shareholder composition of both institutions to illustrate how China has to persuade other shareholders, some closely allied to the US, to put forward the RMB internationalisation agenda within the AIIB and NDB. Moreover, the works of Subacchi (2017) and Griffith-Jones (2015) provide a comparison between the lending capacities of the NDB and the Chinese policy banks, which enables an assessment of the relative impact of the new IFIs.

Understanding the drivers behind the creation of currency clearance arrangements and their importance for the currency internationalisation process is essential to appraise how the new IFIs will enhance the RMB’s international role. To this end, this paper utilised the chapter by Cheung (2015), the 2016 report of the People’s Bank of China (PBC)
and a report from the Renmin University of China on the RMB internationalisation together with data analysis on the trade flow between China and some of its main commercial partners, to explain how the large-scale deployment of RMB and the increase of trade and investment flows between China and other members of the IFIs will create the necessary conditions for the proliferation of RMB offshore centres.

Another crucial issue to this paper is linking the AIIB and the NDB with the expansion of RMB bond markets. According to Cohen (2015), a well-developed bond market gives extra incentives to financial agents to hold a given currency, since it will represent an attractive alternative to park their assets. This paper analyses the NDB’s bond issuance strategy vis-à-vis the current stage of development of the RMB bond markets in order to estimate the impact of the new IFIs on the expansion of the RMB bond market.

2. Background

2.1. Pre-requisites of a Reserve Currency

Reserve currencies need to fulfil some pre-requisites. The most commented on literature are credibility, usefulness and transaction liquidity (Cohen, 2000). The attainment of such pre-requisites would require much effort and reform from the Chinese monetary authorities. This section briefly mentions the pre-requisites of international reserve currencies with the aim of assessing, in Section 3, how the NDB and the AIIB will enhance the prospects of the RMB achieving such pre-requisites.

Credibility signifies the trust that the currency holders will put in a currency’s long-term value, which is reliant on credible monetary and fiscal systems of the issuing country and political stability (ibid.).
Government creditworthiness, built upon the development of rules and institutions that ensure the market functioning with no manipulation and the enforcement of contracts by impartial courts, is of fundamental importance to a currency’s reputation (Cohen, 2015: 234). The extraordinary acceptance of the dollar, for example, was forged by a solid credit record in which the treasury has honoured debts owed to private citizens for centuries (Wheatley, 2013: 18).

A not less important characteristic of a reserve currency is its usefulness. The currency’s utility can be compared with that of a language: the incentives to use a given language depend on the number of people with whom one can communicate. In the same manner, a currency’s international usefulness increases with the number of global players using it (Dowd and Greenway, 1993: 1189). Nugée (2010: 11) explains that “since one of the main qualities that those financial operators are seeking is general acceptance of the currency by other operators, the choice tends to be made on the basis of consensus and critical mass rather than anything more scientific or precise”. Consequently, the establishment of the most widely used currency is not enforced by law or any other hard power, but is established by the natural choices made by financial operators on a rational basis.

The transactional liquidity comprises the existence of a well-developed and broad domestic financial market that offers a wide range of short- and long-term investment opportunities in that currency as well as free convertibility (Cruz, Gao and Song, 2015: 272). In this sense, the easier the access to a given currency, the higher the incentive of the financial operators to acquire it, since they “need to be assured that the availability of the medium of international exchange is not in doubt; and they need to be able to acquire it easily and at reasonable expense” (Nugée, 2010: 11). US markets’ unrivalled depth and liquidity, for instance, are very important to the dollar’s status of main international
reserve currency, since the US dollar holders have no reason to distrust that they can sell billions in treasury bonds without risk of price collapse (Wheatley, 2013: 24).

Although it is not within the scope of this paper to detail the efforts that the Chinese government is making to enhance RMB’s liquidity, it is important to emphasise that the monetary authorities have already started a series of reforms that are gradually liberalising the financial market and making the currency more liquid (Eichengreen and Kawai, 2015: 4).

2.2. Benefits and Motivation: RMB Leveraging the Chinese International Clout

The status of international reserve currency can entail enormous political and economic advantages to the issuer country. The classical literature drawing from political science and economics identifies five types of gain: the reduction of transaction costs, seigniorage, macroeconomic flexibility, leverage of influence and reputation (Cohen, 2012). The reduction of transaction costs occurs as individuals benefit from trading overseas in local currency, thus minimising exchange rate risk and increasing profits (ibid.). Seigniorage is the monetary gain that happens whenever foreigners acquire any amount of domestic money to buy goods, services or liabilities (ibid.). It represents an implicit economic gain, since the issuing central bank receives money in exchange for banknotes that cost almost nothing to print (Wheatley, 2013: 9). The gains of seigniorage are very important for the US, allowing it to finance its current account deficit easily and cheaply² (Benigno, 2010: 23). It can also enhance the macroeconomic flexibility on monetary and fiscal policies by loosening constraints of the balance of payments. Since the ability to finance external deficits with the domestic currency increases, the government’s capacity to pursue policy objectives also increases as
the issuer has more latitude to manage domestic employment levels and price behaviour (Cohen, 2012).

More direct benefits that China can obtain with RMB internationalisation are international leverage and reputation. This means, in this context, the influence that the issuer of a reserve currency enjoys from the dependence created when other countries rely on the domestic currency for any purpose (ibid.). A reserve currency issuer is able, for example, to exert pressure on uncooperative governments by threatening to exclude them from the national banking system, thus blocking a critical channel for trade payments (Wheatley, 2013: 9). Moreover, the issuer of a major reserve currency, having lower borrowing costs and high capacity to mobilise financial resources from creditors, can print out a vast amount of money without the constraint of running up fiscal deficits (ibid.: 17). This is in fact the main explanation of the US’s extraordinary capacity to maintain its military supremacy for such long periods.

To contextualise the AIIB and the NDB in the strategy of RMB internationalisation, it is important to highlight the motivations driving China towards that end. Chinese commentators have been demonstrating an increasing concern regarding the depreciating trends of the dollar as the American fiscal deficit worsens (Hong, 2018). This concern relates to the quantitative easing policies carried out by the US administration to remedy the financial and economic crisis. As the US Treasury keeps issuing large amounts of dollars, China, as the biggest international holder of dollar assets, is naturally concerned that its assets are depreciating (Nugée, 2010: 10). Beijing is convinced that American quantitative easing is only possible because of the dollar-centred IMS, and sees RMB internationalisation as a means of reducing its dependence on the dollar: the more Chinese companies can clear their foreign trade transactions in RMB, the fewer dollar assets the PBOC
needs to purchase (Cintra and Pinto, 2016: 393; Cheung, 2015: 207). Chinese financial agents are already reflecting this scenario on the price of American Treasury Bonds. In early 2018 China’s most prominent rating agency, Dagong Global, downgraded federal treasuries to BBB+ with a negative outlook, on the grounds of the growing fiscal deficit and the weakening repayment ability of US government (Poenisch, 2018)

The internationalisation of the RMB is also likely to match the reform of the domestic financial sector (Volz, 2014). The currency internationalisation process requires broader opening-up of capital accounts, as well as the relaxation of some financial constraints that will ultimately give market forces greater sway over interest rates and the exchange rate (Di, 2013). The natural outcome of this process would be an upward pressure in the price of the RMB that, in turn, would contribute “to rebalance Chinese growth away from an export-led to a domestic consumption-led dynamic” (Minikin and Lau, 2013: 7).

Elevating the RMB to one of the world’s dominant currencies is among the international objectives of the Chinese government, which sees the existing IMS as a source of undue privileges (Prasad, 2017). According to Chinese commentators, the role of the RMB would also involve challenging or even breaking the dollar dominance that inhibits the multivariate competition in global trade (International Monetary Institute, Renmin University of China, 2017). The internationalisation of the RMB also resonates well with the ambitious foreign policy of the new Chinese leadership and its view of the “great rejuvenation of the Chinese Nation”, as it would enhance Chinese international influence (Volz, 2014). With this in mind, granting a leading role to the RMB is fundamental for establishing a new, “proper” world order that reflects China’s elevated economic strength and political status (Sun, 2015: 28). Indeed, during the occasion of the first RMB bond issuance outside China (at London Stock Exchange), high-ranked Chinese officials
praised the initiative as a milestone of a greater international role of the RMB and an important step towards the stability of the Chinese economy (Bank of China, 2016).

The 2016 PBC report enumerates various actions carried out in 2016 to further facilitate cross-border business in RMB, which indicates a steady commitment of Chinese authorities with the internationalisation of the RMB (The People’s Bank of China, 2016: 60). The same report also highlights the efforts taken by the Chinese monetary authority to incentivize the orderly development of overseas RMB lending (The People’s Bank of China, 2016). There are thus many reasons to believe that China will take advantage of all the possibilities to upgrade the RMB as an international reserve currency. Some of these possibilities will be bestowed by the AIIB and the NDB, which will be demonstrated in the next section.

3. AIIB and NDB: New Arms of the Chinese Financial Statecraft

This section explores the main features of the AIIB and NDB that make them likely to enforce the trend of RMB internationalisation towards the status of a major international reserve currency. It is divided into three core cases. The first is increasing the capacity of loans denominated in RMB. The second core case – the increasing number of RMB offshore centres – is a consequence of the first. As the member countries receive loans in RMB, they will naturally create offshore centres to exchange RMBs for local currency. The third core case addresses the deepening of the RMB bond markets, which derives from the fundraising process of both banks.
Table 1 A Comparison of AIIB, NDB and World Bank

<table>
<thead>
<tr>
<th></th>
<th>AIIB</th>
<th>NDB</th>
<th>World Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total capital</td>
<td>US$100 billion</td>
<td>US$100 billion</td>
<td>US$268.9 billion</td>
</tr>
<tr>
<td>Subscribed capital</td>
<td>US$100 billion</td>
<td>US$50 billion</td>
<td>US$268.9 billion</td>
</tr>
<tr>
<td>Paid-in shares</td>
<td>US$20 billion</td>
<td>US$10 billion</td>
<td>US$16.1 billion</td>
</tr>
<tr>
<td>Headquarter</td>
<td>Beijing</td>
<td>Shanghai</td>
<td>Washington DC</td>
</tr>
<tr>
<td>Number of employees</td>
<td>Around 50</td>
<td>Around 50</td>
<td>More than 10,000</td>
</tr>
</tbody>
</table>

Sources: Caixin (2016); World Bank (2017).

3.1. Loans in RMB

The AIIB and NDB have a considerable financial capacity. Despite the short period of their existence, their total capital is worth US$100 billion each, making their size almost half that of the World Bank (see Table 1). This core case, however, is more applicable to the AIIB than to the NDB. A stated policy goal of the NDB is to increase the amount of loans denominated in local currency (New Development Bank, 2017c), which means the banks will promote loans in the currency of the country where the projects are being financed. By doing so, the NDB will be acting to reduce US dollar dependence within its members; therefore, if not strengthening the use of the RMB, it will weaken the position of the dominant global reserve currency.

By early 2017 NDB signed its first loan agreement to be funded in RMB in China (New Development Bank, 2017c). Despite its principle of lending in local currency, it is important to highlight that NDB’s “General Strategy 2017 – 2021” allows funding in any other hard currency. The document states that the funding currency will be chosen
“according to market conditions, investor demand and the cost of funding” (New Development Bank, 2017d: 25). Some commentators, however, cast doubt about the ability of the NDB to fund in RMB or any local currency. The strict regulations of the Chinese financial markets as well as the advantages of borrowing in dollar, they argue, can discourage borrowers to accept loans in RMB or any other currency (Shelepov, 2016). Although this may be true, it is important to recapitulate the recent reforms aiming to liberalise the Chinese financial markets. As the RMB becomes increasingly convertible and liquid, it is likely that lending in RMB in the near future will match the requirements of “investor demand and cost of funding” as stated in the NDB’s General Strategy.

The AIIB’s framework is even more susceptible to accommodate the Chinese will of lending in RMB. Its statutory regulations, such as the Operational Policy on Financing (AIIB’s OPF) and Article of Agreement (AIIB’s AOA), contain some rules regarding lending in RMB. The general rule, stated in Article 4.2.1 of the AIIB’s OPF, is that loans are committed and repayable in US dollars. The same article, however, states that “at such time as the Bank determines that it is in a position to offer loans in other currencies, loans may be committed and repaid in such other currency or currencies as the Bank is able to hedge itself efficiently from time to time” (AIIB, 2017b). Article 3.1.5 of the same statute also allows AIIB to “provide financing in its operations in the currency of the country concerned, in accordance with policies that minimize currency risk” (AIIB, 2017b). Moreover, the AIIB Asset Liability Management Policy states that “the Bank may offer loans denominated in currencies other than US Dollars whenever it has the means to adequately operate in other currencies and manage risks unique to the products” (AIIB, 2017c).
If the AIIB is to make loans denominated in RMB, it therefore has to follow a specific procedure to determine that it “is in a position to offer **loans in other currencies**” and “it has the means to adequately operate in other currencies and manage risks unique to the products”. Article 28.2.1 of the AIIB’s AOA states that “except as otherwise expressly provided in this Agreement, all matters before the Board of Governors shall be decided by a majority of the votes cast” (AIIB, 2015). In other words, the AIIB would be allowed to make loans denominated in RMB if more than 50 per cent of the Board of Governors decides so.

Given the geopolitical implications of this, it is important to analyse the likelihood of such a decision coming to be approved by the shareholders. Due to lack of space of this paper, it is impossible to assess the likelihood of every AIIB member complying with China’s aspirations. However, only the voting shares of member countries that are already engaged in monetary initiatives aimed at changing the current IMS (which is the case of the BRICS countries) already account for 41.69 per cent of all AIIB’s voting shares. We can add the voting shares of countries that are under US sanctions, and thus tend to be uncooperative with the dollar-centred IMS, which is the case of Iran and other prospective members (see Table 2).

The possibility of disbursing loans denominated in RMB will give China a valuable opportunity of deploying the RMB on a large scale, increasing the prospects of its internationalisation in the long run (Sun, 2015: 33). Indeed, the International Monetary Institute, a Chinese think tank affiliated to the Renmin University of China, encourage the use of RMB along the Belt and Road “to compensate the shortage of the US dollar liquidity and enhance the RMB internationalisation while meeting the demands of those countries’ national economic development”.

CCPS Vol. 4 No. 3 (December 2018)
Table 2 Voting Shares of BRICS and Iran in the AIIB

<table>
<thead>
<tr>
<th>Member</th>
<th>Capital subscription</th>
<th>Voting power</th>
</tr>
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<tbody>
<tr>
<td>China</td>
<td>US$29.78 billion</td>
<td>27.5186%</td>
</tr>
<tr>
<td>India</td>
<td>US$8.37 billion</td>
<td>7.9254%</td>
</tr>
<tr>
<td>Russia</td>
<td>US$6.54 billion</td>
<td>6.2499%</td>
</tr>
<tr>
<td>Iran</td>
<td>US$1.58 billion</td>
<td>1.7156%</td>
</tr>
<tr>
<td>Total</td>
<td>US$46.27 billion</td>
<td>43.4095%</td>
</tr>
</tbody>
</table>

Source: AIIB (2017a).

Although the AIIB only has a regional reach, it would be important as a first move of a broader internationalisation of the currency (Lim and Kim, 2017).

It is worth revisiting the rise of the dollar as the main global reserve currency at this point. The huge loans provided by the US under the Marshall Plan greatly expanded the volume of the American currency in Europe, which contributed to its reputation and expedited its internationalisation (Cheng, 2015: 368). The Belt and Road Initiative (BRI), which uses the AIIB and NDB as the means by which it will deploy huge loans throughout Asia, arguably plays the same role for China as the Marshal Plan did for the US (Power, 2015). Chinese specialists argue that the RMB, as the strongest currency among the Belt and Road regions, should be used to finance the related projects (Shen, 2016).

Jin Liqun, President of the AIIB, has however announced on January 2016 that all of AIIB’s loans will be in dollars (Coats and Di, 2016), which is consistent with the AIIB’s OPF general rule. Mr. Jin’s announcement indicates that Beijing will not use the AIIB as a platform to promote RMB internationalisation. However, this declaration of
intention cannot be taken so adamantly. China as a potential challenger of the US hegemony is not supposed to demonstrate its rivalry so clearly before becoming strong enough for open confrontation. As China strengthens its position as a responsible stakeholder of the AIIB and a major player in the global economy, it is likely to adopt a more assertive attitude towards the agenda of internationalisation of the RMB within the AIIB.

To better assess the impact of AIIB and NDB lending on RMB internationalisation, it is nevertheless important to compare their potential with those of the so-called Chinese policy banks, especially the Chinese Development Bank (CDB) and the China Exim Bank. Between 2009 and 2010, the aforementioned banks lent nearly US$110 billion overseas (Subacchi, 2017: 46). The CDB’s outstanding loans abroad rose from US$16.2 billion in 2005 to US$276 billion in 2015, including 69 billion denominated in RMB (China Development Bank, 2017). The figures are murky and there are divergences in the sources, but given their huge amount, there can be few doubt about their importance to the internationalisation of the RMB.

Due to the short existence of the AIIB and NDB, with both banks still in their initial phases of capitalisation, it is wiser to assess their lending estimates instead of the amount they have lent so far. According to Griffith-Jones (2015: 3), the NDB’s lending capacity after 20 years may reach US$34 billion yearly, which is comparable to the level of European Investment Bank and larger than the World Bank’s lending for infrastructure. The AIIB, on the other hand, is already authorised to lend the equivalent of 2.5 times its capital, what would totalise the outstanding amount of US$250 billion (Kynge, 2017). Figure 1 compares the historical and current level of the outstanding loans of CDB with the expected future loans of the AIIB and NDB to elucidate the relative potential of the new IFIs.
Figure 1 CDB Outstanding Loans v. AIIB and NDB Expected Outstanding Loans (US$ billion)

*potential to be achieved in the period of 20 years as estimated by Griffith-Jones (2015:3).


The long-term lending potential of the new IFIs is by no means negligible. However, considering the long period that AIIB and the NDB will take to achieve their full potential, it is reasonable to assume that China’s policy banks’ lending abroad are considerably more impacting. The intense disbursement of capital by the Chinese policy banks is nevertheless not the best approach if China wants to increase its financial influence abroad. Many countries that have been receiving Chinese loans have been expressing preoccupation about the potential risks of building such an imbalanced relationship in terms of economic power and financial resources (Subacchi, 2017: 46). For this reason, with the AIIB and the NDB, China will gain more authority for its financial assistance, as the IFIs will provide a kind of legitimacy stamp for its loans (Sun, 2013; Cintra and Pinto, 2016: 397; Prasad, 2017).
3.2. The Proliferation of RMB Offshore Centres and Swap Arrangements

An offshore currency centre is defined as a financial centre that provides services of currency clearing, trade settlement and investment products denominated in currencies not issued by that offshore market (Minikin and Lau, 2013: 140). The increasing number of RMB offshore centres would improve RMB liquidity overseas (ibid.) and separate the currency risk from the country risk, since the former becomes combined with the risk of the country where the offshore market is located (Cheung, 2015: 209). Provided that China neither enjoys financial regulations assuring liquidity nor good reputation in the rule of the law, the intermediation of an offshore centre might constitute an important incentive for a non-resident to use RMB.

Cheung (2015: 232) praises the importance of the offshore markets in the rise of the dollar as the main international reserve currency in the 1950s and 1960s, when the proliferation of offshore centres such as the Eurodollar was of fundamental importance to its emergence as a global currency. In the case of the RMB, the offshore arrangements will elevate its liquidity to the level of the major developed currencies, since it will remain out of the reach of the PBOC’s tight monetary controls, hence making it readily used for payments or switched for other currencies (Prasad, 2017: 111). In light of this, the offshore RMB approach is a clever solution to circumvent the underdeveloped domestic financial market and to avoid the strong monetary controls in mainland China (Cheung, 2015: 208). China’s trade partners, consequently, will be more willing to hold RMB to pay for the import of Chinese goods, which will further promote the RMB as an international reserve currency (Fung, Ko and Yau, 2014: 10).

The motives for the establishment of a RMB offshore centre in a given country are directly related to the volume of money that flows
from China abroad and vice versa. China’s extensive trade and investment networks are the main drivers of the proliferation of RMB offshore centres around the globe (Minikin and Lau, 2013: 131; Cheung, 2015: 218). Trade settlement in RMB entails advantages to importers of Chinese goods, since it contributes to the reduction of exchange risk against the dollar and protects them from a shortage of trade funding during financial crises (Fung, Ko and Yau, 2014: 10). As China’s commercial partners begin envisaging the advantages of trading in RMB, there will be demand for currency offshore services (Minikin and Lau, 2013: 58). The main driver of the creation of currency offshore centres is therefore the high volume and consistent flow of money across the border. Particularly in the case of China, the creation of RMB offshore markets represents an extra advantage, since it enhances the currency’s liquidity and trust and reduces transaction costs, which in turn reinforces the use of RMB for trade settlements in a virtuous cycle.

The AIIB and NDB expedite the creation of RMB offshore centres in two ways. The first is through the likely disbursement of loans denominated in RMB. As the member countries start to receive large quantities of RMB to fund infrastructure projects, they will require the development of offshore centres to swap RMB for local currency (Week in China, 2016). It is not hard to presume that the loans denominated in RMB will make its internationalisation similar to that of the dollar after the Marshall Plan. In that case, the provision of loans in dollars to European countries created a cross-border need for currency circulation that in turn stimulated the emergence of the offshore dollar market (Cheung, 2015).

The second way by which the AIIB and the NDB will advance the creation of RMB offshore centres is by reinforcing the economic ties, via trade and investment, between China and the Banks’ members. Both IFIs are meant to finance infrastructure projects, a sector where Chinese
companies accumulate a large expertise and are extremely competitive (Lim and Kim, 2017: 3). The chance that Chinese companies will succeed on the procurement process for funding the infrastructure projects of AIIB and NDB are therefore high (Harris, 2015: 39; Jin, 2015; Koike, 2015).

China’s involvement in AIIB and NDB not only boosts infrastructure-related sectors but also increases bilateral trade through the enhanced interconnectivity. It may also promote RMB use in the projects financed by the multilateral banks as well as new trade deals between China and the Banks’ other partners (Huang and Xia, 2018). Expansion of FDI will also enhance the international use of RMB by providing an impetus for domestically funded financial institutions to go global and develop offshore RMB business (International Monetary Institute, Renmin University of China, 2017). The recent data show that the share of Chinese foreign investment to the countries of BRI increased to 12 per cent of total outbound investment from 8 per cent in 2016 (Huang and Xia, 2018) and more than half of RMB trade settlement occurs in the areas along the BRI (International Monetary Institute, Renmin University of China, 2017). Given the massive scale of the projects the new Banks are going to fund, the trade and investment flows between China and the Banks’ members are likely to increase considerably, thus promoting the creation of new RMB offshore centres and new swap arrangements.

The PBC official data show RMB trade settlement reached 9.85 trillion yuan and about 240,000 domestic companies were using RMB to conduct cross-border trade settlement by the end of 2016. Moreover, in the same period, banks from 129 foreign jurisdictions and enterprises from 146 countries opened about 29,400 RMB accounts in China (The People’s Bank of China, 2016). It is important to emphasize that the pace of RMB internationalisation slowed down since 2016. From the side of
the external environment, the uncertainties created by the US election as well as the expectation of a rise of the interest rate by the Federal Reserve (Fed) caused a large quantity of capital flow back to the United States. There were also domestic factors such as Chinese economic slowdown and tighter capital policy that affected the international use of RMB (International Monetary Institute, Renmin University of China, 2017). Nevertheless, analysts are optimistic that a variety of initiatives will turn the decline around and lead to the greater international use of RMB. One of the biggest drivers will be the Belt and Road Initiative, which has as main financier the AIIB and the NDB (SWIFT Business Intelligence, 2018).

Several RMB clearing arrangements have emerged in virtue of a steady flow of trade and investment involving China and its partners. According to data from PBC, by the end of 2015, there were 36 bilateral swap arrangements signed by China with the total size exceeding RMB 3.3 trillion (The People’s Bank of China, 2016: 61) and, by the end of 2017, over 60 countries and regions have adopted the RMB as reserve currency (Mo, 2017). Moreover, the International Monetary Fund database reports that RMB-denominated assets grew from the equivalent of US$91 billion at the end of 2016 to US$107 billion in the third quarter of 2017. Accordingly, the share of RMB-denominated assets grew from 0.78 percent to 0.96 percent of the global total of foreign reserves (Xia, 2018). The figures show a renovated trend of the RMB internationalisation after a period of stagnation. Much of this new impetus was made possible by a greater presence of Chinese companies abroad. It is not unreasonable to expect, therefore, that the new trade and investment channels that AIIB and NDB will open for China will create the same stimulus for the establishment of new RMB offshore centres.
3.3. The Emergence of a Deep Bond Market

The RMB bond market can be defined as the bulk of financial assets and derivatives denominated in the Chinese currency available for investment (Fung, Ko and Yau, 2014: 103). It serves also as an alternative to borrowing in RMB since governments, enterprises, and financial institutions can issue RMB-denominated bonds to raise funds (Subacchi, 2017: 127). The RMB bonds commercialised onshore for non-Chinese residents are known as Panda Bonds, whereas their offshore counterparts are designated as Dim Sum Bonds. It is important to highlight that the Panda Bonds correspond only to a small fraction of the total RMB onshore market, but is still more important for measuring internationalisation as it can be issued by non-residents (Minikin and Lau, 2013: 12).

A deep and broad bond market is important for the international use of RMB because it offers additional opportunities for investors to hold RMB-denominated funds for investment, thus reinforcing it as investment medium and reserve currency (Cohen, 2015: 232). The existence of a varied range of RMB-denominated assets further encourages trade settlement in RMB. Having attractive options to park RMB receipts, foreign companies would be more willing to accept the currency in payment (Minikin and Lau, 2013: 12). As Subacchi (2017: 127) puts it, “the more RMB denominated instruments, the less onerous and constraining it is to hold it.” Consequently, the more the investment options in RMB, the more convenient for overseas investors to increase their holdings in RMB (E, 2018). According to Prasad (2017: 252), the unrivalled depth of the dollar bond market gives the American currency an enormous advantage as a medium of investment. For the RMB to emerge as a global reserve currency, therefore, China has to develop the RMB bond markets by expanding the bulk of assets available to invest in. By doing so, investors and national governments will be prone to
hold RMB assets, and companies trading with China more willing to accept payments in RMB.

There are two means by which the AIIB and the NDB will further the development of the RMB bond market. The first is by issuing RMB-denominated bonds to support their fundraising process. As discussed above, this enhances the prospects of internationalisation of the RMB by diversifying the currency’s investment portfolio and encouraging companies, governments, and investors to hold financial assets denominated in RMB. The fundraising process, in turn, is likely to give member countries the opportunity to become offshore centres, since they will be eligible to take up the role of selling the bonds issued by the IFIs (Hong, 2015).

The second front that the IFIs will help to develop the RMB bond markets, which is more attainable in the case of the AIIB than the NDB, is through the growth of the trade settlement in RMB. Since AIIB members are likely to increase their commercial and investment transactions with China, their central banks and companies will have extra incentives to hold RMB for future transactions (Sun, 2015: 33). Member countries are thus likely to consider allocating part of their foreign currency reserves in RMB, which will expedite the currency internationalisation process.

So far, save for one single bond issuance carried out by the NDB, every other capitalisation of both Banks has been conducted in US dollars, which would suggest that they do not intend to use RMB. According to the AIIB treasurer, however, the initial capitalisation was expected to be in US dollars as that is the Bank’s official currency, but the IFI is likely to use RMB at a stage when it makes sense for the AIIB to do so (Tani, 2017). Wang (2017) also believes that both IFIs will likely use RMB in the next capitalisations. Indeed, the NDB Annual Report 2016 states that the Bank “will continue to explore further local
currency bond issuances in China” (New Development Bank, 2017a: 32). Moreover, the NDB Budget Summary for 2018 projects “to raise between USD 1 billion to 1.5 billion through a mixture of issuances in USD and local currencies” (New Development Bank, 2017b). Accordingly, the PBC 2016 report highlights the deep support of Chinese authorities for the issuance of RMB-denominated bonds by the NDB (The People’s Bank of China, 2016), which indicates that Beijing will seize the opportunity provided by the new IFIs to further develop the RMB bond market.

The AOA of both IFIs contain the permission to issue financial assets for fundraising purposes. Article 16 of the AIIB’s AOA states that “the Bank may raise funds, through borrowing or other means, in member countries or elsewhere, in accordance with the relevant legal provisions” (AIIB, 2015). The NDB’s legal framework not only allows the issuance of financial assets, but also encourages it to “utilize external investment – mainly via bond issues on capital markets” (New Development Bank, 2017c). In July 2016, the bank issued RMB 3 billion (equivalent to US$445 million) in China’s interbank green bond market (New Development Bank, 2017a).

The Chinese state-owned banks have been the largest issuers of RMB bonds in offshore markets. According to Fung, Ko and Yau (2014: 70), it is a part of China’s strategy to internationalise RMB. To support their argument, they cite a part of the mandate of an issued bond, which makes explicit the aim of “promoting the development of the offshore renminbi business in Hong Kong, and promoting the settlement for and circulation of RMB in the surrounding countries and regions” (ibid.). Given the Chinese influence on the AIIB and NDB, it is reasonable to imagine that Beijing will push for the issuance of RMB-denominated bonds in the next capitalisations.
Figure 2 Dim Sum and Panda Outstanding Bonds vs. NDB’s Expected Bond Issuance (US$ billion)

Sources: Bloomberg (2017); New Development Bank (2017c).

To best evaluate the impact that the AIIB and NDB can have on the development of the RMB bond market, it is worth checking the bond market’s current size vis-à-vis the Bank’s potential for issuing bonds. The NDB has publicised its Funding Strategy, stating that it intends to raise funds “mainly via bond issues” worth up to US$1,950 billion in 2017, reaching the outstanding amount of US$21 billion by 2021 (New Development Bank, 2017d: 24). Although the AIIB has not disclosed any information about bond issuances, it is reasonable to presume that it will keep to the same level of the NDB, if not higher (Wang, 2017: 115).

The most recent data shows that the outstanding volume of RMB bonds in the Panda and Dim Sum Bond Markets amounted, in August 2017, to US$26 billion and US$62 billion respectively (Bloomberg, 2017). The amount of bonds that NDB itself intends to issue in 2017, therefore, is equivalent to 2 per cent of the outstanding value of the Dim Sum and Panda Bond markets combined (see Figure 2). Taking into
account the short existence of the Bank and the expected increase of bond issuances until 2021, the contribution that NDB can make to the RMB bond market will be considerable. Considering the future bond issuances of the AIIB, the impact is even more substantial.

Despite the fact that the new IFIs can contribute considerably to the development of the RMB offshore markets, it is important to emphasise that the main limitation to their development is the low liquidity of Chinese financial markets. E (2018) cites that offshore investors fear the restricted freedom of movement of funds as well as the insufficient market liquidity when entering China’s bond market. Operators of Dim Sum Bonds highlight that, no matter how diversified the portfolio of financial assets, the lack of liquidity has been making it difficult to find buyers for the securities (Bloomberg, 2017). The same applies to the Panda Bond Market, where restrictions to repatriate the capital from China has been discouraging foreign investors (Reuters, 2017). The AIIB and the NDB, therefore, are likely to make an important contribution by issuing RMB-denominated bonds, thus diversifying and deepening the RMB Bond Market. Its further development, however, will depend on the approach that Chinese monetary authorities will adopt on the regulation of the financial markets, which will be further discussed in Section 4.2.

4. Counter-tendencies

4.1. US Opposition: A Dispute over an Exorbitant Privilege

Section 2.2 demonstrated the benefits China will enjoy from the internationalisation of the RMB. Some of those benefits, notably “Leverage” and “Reputation”, will occur at the expense of the US’s financial clout and the dollar’s prestige (Prasad, 2017: 252). The US, indeed, is wary that the rise of China coupled with some financial
consequences, such as the internationalisation of the RMB, might eventually undermine its supremacy (Callaghan and Hubbard, 2016). Since such a development can erode the benefits enjoyed by the dominant reserve currency, such as seigniorage and financial influence over other countries, it is reasonable to expect some reaction by the US to block initiatives aimed at internationalising the RMB within the new IFIs.

There are, however, competing views regarding this issue. The necessary steps that China has to take in order to increase the convertibility and liquidity of the RMB will imply looser monetary control over its currency (Volz, 2014). If the PBOC is thus to enhance the RMB’s convertibility and liquidity, it will necessarily have to release control over the capital account that, ultimately, will make the exchange rate more similar to the market rate. Consequently, Chinese exports would lose competitiveness, which would alleviate the huge trade deficit that the US bears with China.

According to Subacchi and Drifill (2010: 122), the perception that RMB internationalisation is benefiting the US, which remains concerned with its trade deficit, neglects the potential consequences of the deterioration of the dollar’s “exorbitant privilege”. The idea of a smaller trade deficit thus undoubtedly pleases American authorities, but the counterpart of the trade-off certainly horrifies them to the extent that they might try to block it at any cost. The US’s ability to hamper the RMB internationalisation agenda within the AIIB and the NDB could be realised by influencing IFI members to prevent the Bank from either lending or issuing bonds denominated in RMB. As demonstrated in Section 3.1, the composition of the voting shares of the IFIs are favourable to China, but Beijing’s ability to control all decisions is an open question.
In the case of the AIIB, for example, the accession of so many shareholders is on the one hand a victory for Chinese diplomacy. On the other, it makes it hard for China to turn the Bank into an instrument of its foreign policy (*The Economist*, 2015). The extent to which Beijing will use the Bank to advance its national interests will be subject to the scrutiny of the other members. Harris (2015: 39) highlights some motivations that led China to set up the IFI, such as export promotion for Chinese goods and services, support for China’s One Belt, One Road strategy, and an attempt to boost its international influence. According to him, the international community’s awareness of the intentions regarding the Bank already caused criticism and this is likely to increase as China lets its own commercial and political considerations take priority (*ibid.*).

To figure out how China’s behaviour has been shaped by the other members of the AIIB, it is worth recovering some facts that happened since the negotiations of its constituency. Sun (2015: 28) praises the negotiation of the AIIB’s AOA as a process where Beijing became aware of the incompatibility of some of its initial objectives, in turn leading the negotiators to adapt its intentions. She argues that the AOA today is considerably different from what Chinese authorities expected before 2015, and that the evolution of the AIIB may indicate a trend for a future conflict of interest within the Bank, where China’s intentions can be accommodated without overturning the current global financial order (*ibid.*).

Harris (2015: 41) highlights that the criticism and opposition from Japan and the US also played a decisive role in dissuading Beijing’s ambitions for pushing its own agenda. Whereas some commentators might still perceive AIIB as a case of China threatening the current international order, the events so far indicate that the global establishment still possesses the ability to contain that threat, check Beijing’s ambitions and persuade it to play according to the rules (*ibid.*).
Despite this evidence, it is worth reviewing Beijing’s behaviour from a broader perspective. China’s leaders could opt to intensify its involvement in the US-led World Bank or the Japan-led Asian Development Bank. Instead, China has preferred to lead the creation of alternative IFIs at the same time that it elevated criticism against the current global financial architecture. As Prasad (2017) argues, China is turning into a prominent player in the global community not as the West would like, by being co-opted into current structures under the existing rules, but on its own terms and by attracting other countries into the framework it wants to conduct. The broader picture thus suggests that China’s agreement with other countries’ demands within the AIIB only reflects the current balance of power, against which China sees itself as a potential challenger that is building up its capacity rather than a player ready for open confrontation.

It is expected, therefore, that Beijing will adopt a more assertive posture in the long term as China consolidates its position of leadership. As discussed in Section 3.1, China and its allies might not find it difficult to reach the 50 per cent vote shares necessary to approve the disbursement of loans in RMB. For a restricted number of issues, however, the AOA establishes a supermajority quorum of 75 per cent. While it is hard for Beijing to take for granted to achieve this quorum, it still has the 25 per cent necessary for the power of veto (AIIB, 2017a), granting it significant control over the AIIB’s decisions.

Even in the NDB (a financial institution that emerged from a group of countries intending to change the global financial order), there is space for some kind of interference by the Bretton Woods Institutions. The Treaty for the Establishment of the CRA puts some conditions on the access to financial resources aimed at supporting member countries facing pressure on their balance of payments. In Article 5.d.II, the Treaty states that access to an amount superior to 30 per cent of what a country
is able to borrow is subject to the existence of an on-track arrangement
between the requesting member and the IMF involving “a commitment
of the IMF to provide financing to the Requesting Party based on
conditionality, and the compliance of the Requesting Party with the
terms and conditions of the arrangement” (Ministry of External
Relations, Brazil – BRICS, 2014). These requirements have raised
concerns that the NDB might enforce the current financial architecture
rather than change it, particularly in what concerns the centrality of the
dollar (Peruffo and Prates, 2016).

The requirement itself, however, is restricted to the hypothesis of
financial support to face difficulties in the balance of payments rather
than acting as a constraint on the disbursement of loans denominated in
RMB. As mentioned in Section 3.1, NDB has already completed its first
loan denominated in RMB. Therefore, if the US is to use its influence to
block the RMB internationalisation agenda within the new IFIs, it would
be more attainable in the AIIB. However, considering the high voting
shares of the “would-be” challengers of the US dollar, this is not likely
to happen.

4.2. Opposition from Chinese Economic and Political Groups
Apart from the presumable US opposition to RMB internationalisation,
there are also internal debates in China that might push against it. The
monetary reforms to pursue the macroeconomic conditions to a deeper
currency internationalisation would undermine the Chinese Communist
Party’s (CCP) political power (Eichengreen and Kawai, 2015: 10;
Wheatley, 2013: 14) and cause side effects that might ultimately harm
export sectors (Lim and Kim, 2017). On the other hand, RMB
internationalisation is seen as a means to modernise the country’s rigid
and ineffective financial sector and promote the efficiency of its
monetary policy (Volz, 2014: 2).
As discussed above, Chinese authorities recognise that the internationalisation of the RMB requires wide and deep financial reforms, especially those that will liberalise the exchange rate, promote the openness of the capital account and free convertibility. The PBC has been affirming its commitment with exchange rate reform towards greater reliance on market forces, but still under a ‘‘managed floating exchange rate regime based on market supply and demand’’ (People’s Bank of China, 2010). The abovementioned monetary policy has been implemented since July 2005 and it is deepened whenever the macroeconomic conditions are favourable to a further liberalisation without compromising China’s external trade and balance of payments (ibid.). As highlighted by the PBC 2016 report, Chinese monetary authority promoted the RMB internationalisation in a steady and well-sequenced manner, following the principle of better serving the real economy (The People’s Bank of China, 2016).

According to Eichengreen and Kawai (2015: 12), such mere basic capital account convertibility would be enough to enhance RMB’s international use for foreign trade and for financial transactions, but not for institutional investors and central banks to use it as a reserve asset. For the reforms to turn the Chinese currency liquid and make it trusted enough to attract the asset managers’ attention, monetary authorities would have to loosen some control over the financial markets and capital accounts (Wheatley, 2013: 14). These controls have, however, largely been used as tools to enhance China’s economic performance. The control of the exchange rate guarantees the Chinese industry extra protection against imports, as well as making it more competitive in its exports (World Bank, 2013). Artificially repressed interest rates have been used as an instrument to incentivise strategic sectors of the economy, keeping levels of economic activity and employment high, which is essential for the legitimacy of the CCP (Cohen, 2015: 235). By
loosening the monetary controls, therefore, the ruling party would curtail its own means of macroeconomic management, which it has used to keep political power.

There are nevertheless risks of financial disruption followed by capital account liberalisation. Such risks proved particularly high in countries with weak financial markets and less well-developed regulatory institutions (Eichengreen and Kawai, 2015: 10). Although one of the long-term effects of currency internationalisation is the strengthening of macroeconomic flexibility (Cohen, 2012), the opening-up of China’s capital account in the prevailing architecture, before improving financial markets efficiency, heightens the possibility of volatility and economic instability (Yu, 2014: 19; Eichengreen and Kawai, 2015: 2). Chinese commentators, indeed, recommend that Beijing keep close control on the exchange rate and capital flows in order to curb macro-financial risks while ensuring the smooth realization of RMB internationalisation (International Monetary Institute, Renmin University of China, 2017). Chinese authorities thus face a trade-off between financial market efficiency and control over the economy. Yet, taking the necessary steps towards a deeper currency internationalisation before adopting a market-oriented approach in the financial sector implies a problem of sequencing that can bring financial instability and increase the prospects of financial crisis.

As discussed above, one of the side effects of the mandatory reforms is to make the currency exchange rate more similar to the market rate. This shift will reduce Chinese exports competitiveness as the opening of domestic financial markets to global investors with increasing appetite for RMB-denominated assets could introduce excessive appreciating expectations on Chinese currency (Xia, 2018). It would be a re-orientation of government priorities that, for a long period, have been stimulating export expansion and economic growth through
currency depreciation (Lim and Kim, 2017; Cohen, 2015: 217). The powerful Chinese export sectors are likely to react to this shift and press for the maintenance of a controlled exchange rate that is more favourable to their exports. Although it does not influence the RMB internationalisation agenda within the AIIB and the NDB directly, it can result in additional pressure on the IFIs’ leadership to not to take the measures aimed at increase RMB’s international role.

The counterpoint to this is the fact that the necessary shifts to internationalise the RMB match with the desire of Chinese reformers to restructure the country’s financial sector (Eichengreen and Kawai, 2015: 2; Cohen, 2015: 217). To keep the exchange rate undervalued, PBOC must keep interest rates low to avoid attracting foreign capital and intervene in the foreign exchange market through open market operations (Volz, 2014: 12). The fact that interest rates are artificially low makes deposit rates unattractive to households, which prefer investing in real estate, thus increasing the Chinese real estate bubble (ibid.). Besides that, PBOC’s intervention through open market operations reinforces the accumulation of US dollars at a large cost to the Chinese treasury (ibid.). Moreover, Chinese authorities maintain that the RMB internationalisation is a long-term strategy aimed at resolving the systematic drawbacks under the existing global monetary system led by the US dollar and offering a Chinese solution in order to promote a more robust and fair global monetary system (E, 2018).

Therefore, as is frequently the case with reforms, the shifts on China’s monetary system will put powerful stakeholders on opposite sides. Although the continuity of the prevailing system is more consistent with the CCP’s pursuit of political stability, the recent movements indicate that Beijing will gradually relax monetary controls in favour of RMB internationalisation (Cohen, 2015: 217). In January 2018, for example, the PBC optimized policies for cross-border RMB
business by simplifying cross-border RMB settlement by enterprises, facilitating foreign institutional investors to use the RMB for direct investment and promoting RMB business for individuals (E, 2018). Steps already taken towards currency internationalisation and the measures of the Chinese leadership aiming to enhance its international clout demonstrate that China is in firm pursuit of RMB internationalisation.

Given the central importance of political stability, however, it is reasonable to expect that this shift will occur slowly, without prejudice to economic growth. As argued by E Zhiguan (2018), “increasing RMB’s proportion in global exchange reserves and foreign exchange market cannot be realized in a short period of time. Instead, it is necessary to explore from multiple perspectives, such as cross-border trade and investment, encouraging third-party usage, etc.”

Time is in Beijing’s favour in this case. Chinese industry is quickly moving from low-added value to being high technology-based (World Bank, 2013). As this shift consolidates, Chinese industry will reduce its dependence on the overvalued exchange rate, leaving room for further flexibility in its monetary policy and for advancing RMB internationalisation.

5. Conclusion

This paper has assessed the extent to which the AIIB and the NDB are part of China’s strategy to turn the RMB into a major global reserve currency. The extraordinary economic performance of the last decades has elevated China to the status of second largest economy in the world. Recent movements in China’s diplomacy indicates that the country is keen to transform its economic power into political influence. Beijing is aware that the internationalisation of the RMB is a crucial step towards
global leadership, as it will increase its revenue via seigniorage and boost its influence over the international community. China’s leading role in the AIIB and the NDB provides it with the opportunity to use the IFIs to support its own interests, including the internationalisation of the RMB.

The statutes of both Banks are suitable for promoting the internationalisation of the RMB through the disbursement of loans and the issuance of bonds denominated in yuan. The deployment of large-scale RMB-denominated loans overseas will popularise the currency internationally and, consequently, will create the necessary structure (such as RMB offshore centres and swap arrangements) to use it internationally. Even if the Banks do not manage to lend in RMB they will contribute to increasing the trade and investment flows between China and other members, which will eventually create new beachheads to internationalise the yuan. The provision of finance overseas has long been part of the Chinese foreign policy and RMB internationalisation strategy. However, the participation of the IFIs in this process provides legitimacy as recipient countries will not fear an excessive dependence on Chinese money. The issuance of RMB-denominated bonds, on the other hand, will diversify the financial asset portfolio in yuan, incentivising investors and central banks to hold it.

China’s strategy, however, is likely to face resistance from the US and domestic industrial and political groups. The US, as the issuer of the main international reserve currency and fearing to lose the privileges granted by this status, might try to detain all China’s initiatives aimed at the RMB internationalisation. Due to the composition of the voting shares in both Banks, however, there is little room for any American manoeuvre to succeed. Within China, some political groups and economic sectors might also resist the internationalisation of the RMB, motivated by the lack of political prestige and economic losses that
might result from the flexible monetary policy that is necessary for RMB internationalisation.

The AIIB and the NDB are clearly part of China’s strategy to internationalise the RMB. Given their capacity to deploy RMB on a large scale throughout the world, they are meant to play an important role in the process. Nonetheless, the main driver of the RMB internationalisation is the Chinese monetary policy. While it remains tightly controlled, the IFIs will only partially enhance the international role of the yuan. Therefore, the AIIB and the NDB will help promote RMB internationalisation, but their effectiveness will be limited by the pace of the flexibilisation of the Chinese monetary system.

Notes

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The views, thoughts, and opinions expressed in the text belong solely to the author, and not necessarily to the author’s employer, organization, committee or other group or individual.

1. The terms RMB and yuan are used interchangeably as a designation of the Chinese currency.

2. Estimates indicate that seigniorage gains accounted for up to 3% of annual tax collection in the US (Jefferson, 1998).

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Taiwan, New Southbound Policy and Cross-Strait Relations
Ending Taiwan’s Economic Stagnation:  
The Implications of the Elections of Presidents Tsai and Trump

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**Abstract**
Taiwan’s economy has slowed down significantly since the late 1990s. Not surprisingly, growing economic stagnation has become a salient political issue in the early 2000s. In addition, Taiwan’s position in the Taipei-Beijing-Washington triangle has been destabilized by the 2016 presidential victories of Tsai Ing-wen and Donald Trump, who among other things advocated major shifts in economic strategies for their nations. This paper, then, examines the implications of these two new presidencies for Taiwan’s economic evolution. The first section describes the increasing economic stress on Taiwan; and the second discusses the impact of President Tsai and President Trump on the country’s economic future.
Keywords: Taiwan, economic stagnation, New Southbound Policy, economic transformation, DPP administration, Tsai Ing-wen presidency

1. Economic Stagnation in 21st-Century Taiwan

The evolution of Taiwan’s economy appears rather paradoxical. From the 1950s through the 1980s, the country went through a series of economic transformations that have been called an “economic miracle”. In particular, Taiwan advanced quite rapidly from domestic light industry in the 1950s, to an export boom based on these manufactured goods in the 1960s and early 1970s, to substantial industrial upgrading into the heavy and high-tech industries from the late 1970s through the early 1990s. Moreover, the fruits of economic development were widely shared as poverty and income inequality were reduced substantially, creating a record of “growth with equity” (Chan and Clark, 1992; Fei, Ranis and Kuo, 1979; Galenson (ed.), 1979; Gold, 1986; Wade, 1990). In the early 1990s, therefore, Taiwan could be considered an economic success story and model for developing nations.

Over the last quarter-century, in sharp contrast, the country’s economic performance declined, especially after the Global Financial Crisis struck in 2008 (Clark and Tan, 2012; Copper, 2016; Lin, 2016). For example, during the 1990s Taiwan averaged 6.6% annual growth compared to 9.3% during the industrial upgrading of the 1970s and 1980s; and the first decade of the 21st century was marked by somewhat lower growth (4.8%) between the recessions at its beginning and end. Beyond these raw numbers, furthermore, the people of Taiwan were clearly far from satisfied with their country’s economic performance as first the Chen Shui-bian (陳水扁) administration (2000-2008) and then the Ma Ying-jeou (馬英九) one (2008-2016) received widespread harsh criticism for their economic policies (Clark and Tan, 2012).

Contemporary Chinese Political Economy and Strategic Relations:
An International Journal 4(3) • 2018
Table 1 Economic Dynamism and Structure (all data are percentages)

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<td>0.7</td>
<td>-1.6</td>
<td>10.6</td>
<td>3.8</td>
<td>2.1</td>
<td>2.2</td>
<td>3.8</td>
<td>0.8</td>
<td>1.4</td>
<td>2.9</td>
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<td>Exports</td>
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<td>1.4</td>
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<td>Manufacturing</td>
<td>2.6</td>
<td>0.2</td>
<td>-1.0</td>
<td>6.1</td>
<td>2.0</td>
<td>1.1</td>
<td>0.4</td>
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<td>-0.2</td>
<td>0.6</td>
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<tr>
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<td>-2.2</td>
<td>-4.2</td>
<td>9.6</td>
<td>0.5</td>
<td>0.6</td>
<td>1.9</td>
<td>3.1</td>
<td>1.4</td>
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<tr>
<td>Percentage of GDP</td>
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<td></td>
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<tr>
<td>Exports</td>
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<td>61.9</td>
<td>52.5</td>
<td>62.3</td>
<td>64.5</td>
<td>62.7</td>
<td>60.9</td>
<td>60.4</td>
<td>54.6</td>
<td>80.5</td>
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<tr>
<td>Services</td>
<td>64.5</td>
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<td>66.3</td>
<td>64.4</td>
<td>65.3</td>
<td>65.6</td>
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<td>62.8</td>
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<tr>
<td>Manufacturing</td>
<td>29.6</td>
<td>28.3</td>
<td>27.2</td>
<td>29.3</td>
<td>28.7</td>
<td>28.4</td>
<td>28.4</td>
<td>29.1</td>
<td>30.3</td>
<td></td>
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<tr>
<td>Savings</td>
<td>31.5</td>
<td>29.6</td>
<td>29.3</td>
<td>33.1</td>
<td>31.5</td>
<td>30.5</td>
<td>32.0</td>
<td>33.0</td>
<td>34.7</td>
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<tr>
<td>Investment</td>
<td>23.5</td>
<td>23.9</td>
<td>19.3</td>
<td>24.2</td>
<td>23.0</td>
<td>21.8</td>
<td>21.5</td>
<td>21.2</td>
<td>20.1</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: *Estimated, October 2017.
Sources: Clark and Tan (2012: 26 & 82); NDC (2016: 4, 6, 19, 20 & 216); NDC (2018: 4); Bloomberg (2018).

Table 1 presents data on the dynamism and structure of Taiwan’s economy from 2007, the last year before the Global Financial Crisis hit, to 2018 for growth rate and 2015 for the other seven economic indicators. The country’s real growth rate is in the first row. Following a robust 6.5% in 2007, the Global Financial Crisis hit the island hard for the next two years which averaged a slight decrease of -0.5% per year in 2008-2009. The economy then jumped 10.6% in 2010, but the dream of a dynamic recovery was quickly quashed. Growth averaged a respectable 3.0% for 2011-2014 but then dropped precipitously to a minuscule 0.8% in 2015 and 0.5% in 2016, before recovering a little to a projected 2.2% in 2017 and 2.3% in 2018. The next three rows contain the independent contribution to growth of exports, manufacturing, and domestic demand. Note that this is how much they contributed to the overall growth rate, not their own growth. For example, in 2007, overall growth was 6.5%; and exports accounted for 6.9%. In other words, without exports, the country would have been in a recession. These data
indicate the highly export-dependent nature of Taiwan’s economy as exports’ contribution tracks the ups and downs of overall growth almost perfectly. In addition, Taiwan’s recovery in 2017 has been linked to its increased export of components for high-tech products (Bloomberg, 2017). Manufacturing’s contribution was generally about half the amount attributed to exports. In contrast, domestic demand exhibits a different pattern of changing contributions over time. From 2007 through 2012, it only made a significant contribution to Taiwan’s growth in the spurt of 2010 (9.6% out of 10.6%). For 2013 to 2015, however, its contribution tracked the overall growth rate closely. If this turns into a long-term trend, it would provide a welcome supplement to the country’s export-dependent economy. These low growth rates are also reflected in the deceleration of GDP per capita, as shown in Table 2. Taiwan reached middle-income status by 1995 when its GDP per capita reached US$13,129. However, its increases became much lower after that to US$17,814 in 2005 and US$22,294 in 2015.

Table 2 GDP per capita (in current U.S. dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>229</td>
</tr>
<tr>
<td>1975</td>
<td>985</td>
</tr>
<tr>
<td>1985</td>
<td>3,315</td>
</tr>
<tr>
<td>1995</td>
<td>13,129</td>
</tr>
<tr>
<td>2000</td>
<td>14,941</td>
</tr>
<tr>
<td>2005</td>
<td>16,532</td>
</tr>
<tr>
<td>2010</td>
<td>19,278</td>
</tr>
<tr>
<td>2015</td>
<td>22,294</td>
</tr>
</tbody>
</table>

Sources: NDC (2016: 19).

The last five rows in Table 1 describe the structure of Taiwan’s economy as measured by various economic indicators in terms of their
share of GDP. Exports generally accounted for a little over 60% of GDP but fell quite significantly in the bad years of 2009 (52.5%) and 2015 (54.6%), again demonstrating the key role of exports in the nation’s economic performance. Throughout this period, Taiwan’s structure of production was quite stable with services providing a little less than two thirds of GDP and manufacturing a little under 30%. Finally, the data on savings and investment clearly show that Taiwan was a substantial exporter of capital during this period. For example, in 2007 the savings rate was 31.5% while the investment rate was 23.5%, creating a gap of 8.5 percentage points. This gap remained quite stable through 2011. In 2012, however it began to rise steadily to a gap of 14.6 percentage points between the 34.7% savings rate and the 20.1% investment rate. Overall, these data indicate that Taiwanese save at a fairly high rate even in economic downturns but that good investment opportunities remain limited.

The economic stagnation reflected in the preceding data should not be taken to mean that all of Taiwan’s economic miracle has faded. As shown in Table 3, for instance, the country’s businesses are the leading producers in the world for an impressive array of goods, many of them in the high-tech sphere. When offshore production is included in the analysis, Taiwan is the world leader in 19 goods. For example, Taiwan corporations account for 80% to 90% of the world production of motherboards, Cable CPE, notebook PCs, and golf heads and for 60% to 75% for PND, Foundry, DSL CPN, WLAN, and glass fiber. For six of these items, Taiwan leads the world with just its domestic production. These data, therefore, imply two broader conclusions. First, Taiwan is a world leader in important high-tech industries, especially in the computer and electronics field. Second, its corporate leaders are embedded in complex global commodity chains in which the production process involves several stages in different countries (Gereffi, 1998).
Table 3 Products in which Taiwan is World Leader, 2015 (global market share, percentage)

<table>
<thead>
<tr>
<th>Item</th>
<th>(Including Offshore Production)</th>
<th>(Domestic Production Only)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motherboards*</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>Cable CPE**</td>
<td>85</td>
<td></td>
</tr>
<tr>
<td>Notebook PCs**</td>
<td>84</td>
<td></td>
</tr>
<tr>
<td>Golf heads**</td>
<td>81</td>
<td></td>
</tr>
<tr>
<td>PND*</td>
<td>73</td>
<td>55</td>
</tr>
<tr>
<td>Foundry*</td>
<td>71</td>
<td>67</td>
</tr>
<tr>
<td>DSL CPE**</td>
<td>66</td>
<td></td>
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<tr>
<td>WLAN*</td>
<td>62</td>
<td></td>
</tr>
<tr>
<td>Glass fiber*</td>
<td>61</td>
<td>27</td>
</tr>
<tr>
<td>IC packaging &amp; testing*</td>
<td>54</td>
<td>48</td>
</tr>
<tr>
<td>Functional fabric*</td>
<td>51</td>
<td>32</td>
</tr>
<tr>
<td>High level bicycles**</td>
<td>50</td>
<td>47</td>
</tr>
<tr>
<td>Desktop PCs**</td>
<td>48</td>
<td></td>
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<tr>
<td>Servers**</td>
<td>37</td>
<td></td>
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<tr>
<td>Copper foil*</td>
<td>31</td>
<td></td>
</tr>
<tr>
<td>PCBs*</td>
<td>29</td>
<td></td>
</tr>
<tr>
<td>ABS**</td>
<td>28</td>
<td></td>
</tr>
<tr>
<td>Instant noodles**</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Tea drinks**</td>
<td>18</td>
<td></td>
</tr>
</tbody>
</table>

Notes: *Value; **Volume.
Source: NDC (2016: 12 & 13).

Strong arguments have been advanced that economic development should be evaluated in terms of the consequences that it has for the general population of a nation (Clark and Roy, 1997; Sen, 1999). Table 4, then, presents a variety of indicators concerning human resource development. The first two rows consider unemployment and labor force participation. Both were surprisingly unaffected by the country’s economic ups and downs. The unemployment rate stayed at the fairly
low level of about 4% except when it jumped to 5.9% in the recession of 2009 and lingered at 5.2% in the following year. The labor participation rate was almost constant at 58% for 2007-2015. Thus, even the Global Financial Crisis did not create much dislocation in Taiwan’s labor markets; and the unemployment rate remained quite good by international comparisons. This optimistic picture changes dramatically, however, when we turn to the comparisons of changes in productivity and compensation in rows three and four. Normally, productivity and compensation should move in tandem. In Taiwan, this was certainly not the case for 2007 to 2010 when productivity change greatly outstripped compensation growth in three of those four years: 7.1% to 1.8% in 2007, 0.6% to -9.2% in 2009, and 17.2% to 8.4% in 2010, indicating that most of the gains from growth were accruing to owners, not workers. Over the next five years in contrast, productivity and compensation moved pretty much in tandem in the stagnating economy.

**Table 4** Human Resource Development (all data, except household inequality, are percentages)

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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment Rate</td>
<td>3.9</td>
<td>4.1</td>
<td>5.9</td>
<td>5.2</td>
<td>4.4</td>
<td>4.2</td>
<td>4.2</td>
<td>4.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Labor Participation Rate</td>
<td>58.3</td>
<td>58.3</td>
<td>57.9</td>
<td>58.1</td>
<td>58.2</td>
<td>58.4</td>
<td>58.4</td>
<td>58.5</td>
<td>58.7</td>
</tr>
<tr>
<td>Growth in Productivity</td>
<td>7.1</td>
<td>-1.0</td>
<td>0.6</td>
<td>17.2</td>
<td>3.4</td>
<td>-0.8</td>
<td>0.1</td>
<td>3.8</td>
<td>-1.3</td>
</tr>
<tr>
<td>Growth in Compensation</td>
<td>1.8</td>
<td>-0.2</td>
<td>-9.2</td>
<td>8.4</td>
<td>2.6</td>
<td>1.1</td>
<td>0.2</td>
<td>3.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Education Spending % GDP</td>
<td>5.5</td>
<td>5.8</td>
<td>6.3</td>
<td>5.7</td>
<td>5.9</td>
<td>6.1</td>
<td>5.8</td>
<td>5.2</td>
<td></td>
</tr>
<tr>
<td>R&amp;D % GDP</td>
<td>2.6</td>
<td>2.8</td>
<td>2.9</td>
<td>2.9</td>
<td>3.0</td>
<td>3.1</td>
<td>3.0</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td>Govt Spending*/GDP</td>
<td>17.1</td>
<td>17.8</td>
<td>20.6</td>
<td>18.2</td>
<td>18.3</td>
<td>18.2</td>
<td>17.5</td>
<td>16.4</td>
<td>15.9</td>
</tr>
</tbody>
</table>

Note: *All levels of government.

The last three lines in Table 4 examine several indicators of investment in Taiwan’s future. During the period covered by the table,
R&D spending grew slowly but steadily from 2.6% to 3.0% of GDP. This growth of R&D spending is much more substantial, if not spectacular, when it is compared to its levels of 1% in 1985 and 1.7% in 1995 (NDC, 2016: 23). Clearly, the increasingly sophisticated nature of Taiwanese products has stimulated a growing commitment to research and development, despite its economic stagnation in the early 21st century. Economic change has, however, constrained the government’s ability to develop policy responses to the increasingly bleak economic situation. Unlike R&D spending, education spending’s share of GDP has been fairly stable (NDC, 2016: 15). It did rise significantly from 5.5% to 5.8% between 2007 and 2009, but then fell from 6.1% to 5.2% between 2012 and 2014. Given Taiwan’s increasingly advanced economy, education should be given a higher, not lower, priority. Finally, government spending’s share of GDP has been cut almost in half from 29% of GDP in 1992-1993 to 16% in 2015 (NDC, 2016: 181), which almost certainly imposes sharp limits to what it can do to stimulate growth.

One important problem for Taiwan, as noted above, is that its vaunted earlier record of “growth with equity” has been tarnished by growing inequality since the mid-1980s. Table 5 charts this by reporting the inequality ratio which compares the total income of the richest fifth of the population to that of the poorest fifth. In 1985, this ratio was 4.5 which was low even by the standards of developed nations. The late 1980s and 1990s, however, were marked by the massive movement of Taiwan’s low-wage industries offshore as the country’s rapid development priced it out of this niche in the global economy. With the loss of these jobs, inequality jumped considerably as the inequality ratio rose to 5.5 in 1995 and 6.1 in 2003. For the 2007-2014 period, the inequality ratio stayed fairly stable at 6.0-6.3. Thus, there does appear to be a “silver lining” to Taiwan’s inequality problems in that neither the
Great Recession nor the economic stagnation in the second decade of the 21st century have appeared, somewhat surprisingly, to have exacerbated the issue.

**Table 5** Household Income Inequality Ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>4.5</td>
</tr>
<tr>
<td>2000</td>
<td>5.5</td>
</tr>
<tr>
<td>2003</td>
<td>6.1</td>
</tr>
<tr>
<td>2007</td>
<td>6.0</td>
</tr>
<tr>
<td>2008</td>
<td>6.0</td>
</tr>
<tr>
<td>2009</td>
<td>6.3</td>
</tr>
<tr>
<td>2010</td>
<td>6.2</td>
</tr>
<tr>
<td>2011</td>
<td>6.2</td>
</tr>
<tr>
<td>2012</td>
<td>6.1</td>
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<tr>
<td>2013</td>
<td>6.1</td>
</tr>
<tr>
<td>2014</td>
<td>6.1</td>
</tr>
</tbody>
</table>

Note: *Ratio of the incomes of the richest fifth of households to those of the poorest fifth.

Inflation represents another key factor in a nation’s economic performance. Here, Taiwan has had a stellar performance. Raging inflation in the late 1940s presented the government with an extreme challenge that had to be overcome before real growth could occur. The regime, hence, implemented a stringent stabilization program in the late 1940s and early 1950s. This package included currency reform and high interest rates, as well as the imposition of tight state regulation over the financial system which aimed at controlling the money supply and credit availability (Tan, 2001). Additionally, the government implemented a conservative fiscal policy of maintaining a balanced budget. This stabilization program proved to be highly successful as inflation has never been a major problem since the early 1950s (Kuo, 1983; Li, 1988;
Scitovsky, 1986; Tan, 2009). Table 6 demonstrates that Taiwan’s inflation record was excellent during 2007-2015. Except for a 3.5% increase in consumer prices in 2008, inflation never exceeded 2%; and the bank lending rate declined from 4.5% for 2007-2008 to 2.8% for 2009-2015. Taiwan, therefore, scores quite highly on the “economic fundamentals” of small government (Table 3 above) and low inflation.

Table 6 Annual Change in Inflation Indicators (all data are percentages)

<table>
<thead>
<tr>
<th>Year</th>
<th>Change in Consumer Prices</th>
<th>Bank Lending Rate (December)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>1.8</td>
<td>4.4</td>
</tr>
<tr>
<td>2008</td>
<td>3.5</td>
<td>4.5</td>
</tr>
<tr>
<td>2009</td>
<td>-0.9</td>
<td>2.5</td>
</tr>
<tr>
<td>2010</td>
<td>1.0</td>
<td>2.6</td>
</tr>
<tr>
<td>2011</td>
<td>1.4</td>
<td>2.8</td>
</tr>
<tr>
<td>2012</td>
<td>1.9</td>
<td>2.8</td>
</tr>
<tr>
<td>2013</td>
<td>0.8</td>
<td>2.8</td>
</tr>
<tr>
<td>2014</td>
<td>1.2</td>
<td>2.8</td>
</tr>
<tr>
<td>2015</td>
<td>-0.3</td>
<td>2.8</td>
</tr>
</tbody>
</table>

Source: NDC (2016: 8 & 174).

One vital question about Taiwan’s economic stagnation is how it has affected the nation’s politics. Thus, we used data from a major study of public opinion at the time of the 2016 presidential election (TEDS, 2016) to explore this question. The data in Tables 7 and 8 certainly demonstrate that Taiwanese citizens viewed their economic situation as dismal at the time of the January 2016 elections. For example, respondents to the TEDS (2016) survey felt Taiwan’s economy had become worse rather than better during 2015 by a margin of 55% to 4% (see Table 7). The views about how serious a problem inequality
represented were even more alarmist as 94% viewed inequality as either serious (34%) or very serious (60%), while only 4% did not think that it was a serious problem (see Table 8).

Table 7 Beliefs about Taiwan Economy over 2015 (percentages)

<table>
<thead>
<tr>
<th>Perception</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Much Better</td>
<td>0.4</td>
</tr>
<tr>
<td>Better</td>
<td>3.9</td>
</tr>
<tr>
<td>Stayed the Same</td>
<td>40.3</td>
</tr>
<tr>
<td>Worse</td>
<td>41.8</td>
</tr>
<tr>
<td>Much Worse</td>
<td>13.6</td>
</tr>
</tbody>
</table>

Source: TEDS (2016).

Table 8 Beliefs about Inequality as a Problem (percentages)

<table>
<thead>
<tr>
<th>Perception</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very Serious</td>
<td>59.6</td>
</tr>
<tr>
<td>Serious</td>
<td>33.9</td>
</tr>
<tr>
<td>No Opinion</td>
<td>2.8</td>
</tr>
<tr>
<td>Not Very Serious</td>
<td>3.5</td>
</tr>
<tr>
<td>Not Serious</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Source: TEDS (2016).

The next question, of course, is whether these extremely negative views on the economy benefitted Tsai Ing-wen (蔡英文) as the challenger to the incumbent Kuomintang (國民黨, KMT) administration. For most of the country’s democratic history national identity has been the dominant issue in its politics (Clark and Tan, 2012; Fell, 2005, 2012; Hsieh, 2002, 2016), but growing economic problems and alienation from the political elites strongly suggested that these issues are becoming important in Taiwan too (Clark, Ho, and Tan, 2017; Copper, 2016; Wu, 2013). To test this hypothesis, we used indicators of national identity, economic concerns (with failing growth and inequality being treated separately) and cynicism about government officials, along
with eight demographic factors to explain who voted for Tsai in a logistic regression. Table 9 describes the variables in this analysis.

**Table 9 Variables in Logistic Regression**

**Variables**

*Presidential Vote*

0 = Eric Chu Li-lun (朱立倫) or James Soong Chu-yu (宋楚瑜);
1 = Tsai Ing-wen (蔡英文)

*Issues*

Taiwan’s Ultimate Status

Independence: 0=No; 1=Yes

Unification: 0=No; 1=Yes

Government Helps Social Welfare: 0=No; 1=Yes

Inequality Very Bad: 0=No; 1=Yes

Taiwan Economy Worse: 0=No; 1=Yes

*Demographic Characteristics*

Income: 0=Under NT$59,000 a month; 1=Over $59,000

Occupation: 0=Not White Collar; 1=White Collar

Education: 0=Jr. High or Lower; 1=High School or Higher

Gender: 0=Male; 1=Female

Age: 0=Under 40; 1=Over 40

Area: 0=North & East; 1=South

Minnan Father: 0=No; 1=Yes

Mainlander Father: 0=No; 1=Yes

The logistic regression results in Table 10 show that in combination the independent variables have a moderate impact on supporting Tsai Ing-wen with a Pseudo R2 of .39. National identity clearly exerts the
strongest influence with support for Independence being more important than support for Unification. Even after these effects are controlled, the other three issue indicators have a statistically significant impact. A belief that the economy was getting worse made a person more likely to vote for Tsai (Sig = .0004), as did one that inequality was bad (Sig = .035). Somewhat surprisingly, perhaps, only three of the demographic factors (Mainlander Father, White-Collar Occupation, and Age) exhibit independent relationships with Tsai Vote. Clearly, hence, economic stagnation has become politically relevant in Taiwan.

Table 10 Binomial Logistic Regression for the Impact of Issues and Demographics on Tsai Vote

**Dependent Variable:** Voted for Tsai

**Overall Equation**

-2 Log Likelihood 988
Chi Square 336
Sig. .0004
Nagelkerke Pseudo R² .39

<table>
<thead>
<tr>
<th>Separate Effects of Independent Variables</th>
<th>b</th>
<th>St. Er.</th>
<th>Sig</th>
<th>Adjusted Odds Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence</td>
<td>1.79</td>
<td>.21</td>
<td>.0004</td>
<td>6.01</td>
</tr>
<tr>
<td>Unification</td>
<td>-.74</td>
<td>.22</td>
<td>.001</td>
<td>.48</td>
</tr>
<tr>
<td>Economy Bad</td>
<td>.83</td>
<td>.17</td>
<td>.0004</td>
<td>2.30</td>
</tr>
<tr>
<td>Inequality Bad</td>
<td>.35</td>
<td>.17</td>
<td>.035</td>
<td>1.42</td>
</tr>
<tr>
<td>Govt Helps Public Welf</td>
<td>-.70</td>
<td>.16</td>
<td>.0004</td>
<td>.50</td>
</tr>
<tr>
<td>South</td>
<td>.26</td>
<td>.17</td>
<td>.129</td>
<td>1.29</td>
</tr>
<tr>
<td>Min-nan Father</td>
<td>.28</td>
<td>.22</td>
<td>.189</td>
<td>1.33</td>
</tr>
<tr>
<td>Mainlander Father</td>
<td>-1.20</td>
<td>.32</td>
<td>.0004</td>
<td>.30</td>
</tr>
<tr>
<td>Income</td>
<td>.20</td>
<td>.17</td>
<td>.25</td>
<td>1.22</td>
</tr>
<tr>
<td>White Collar Occupation</td>
<td>.10</td>
<td>.18</td>
<td>.57</td>
<td>1.11</td>
</tr>
<tr>
<td>Education</td>
<td>-.73</td>
<td>.23</td>
<td>.001</td>
<td>.48</td>
</tr>
<tr>
<td>Age</td>
<td>-.59</td>
<td>.19</td>
<td>.001</td>
<td>.56</td>
</tr>
<tr>
<td>Female</td>
<td>-.24</td>
<td>.16</td>
<td>.133</td>
<td>.79</td>
</tr>
</tbody>
</table>
Historically, debate over economic policy in Taiwan was muted before the early 21st century, even after the country’s democratization, presumably because of its success (Clark and Tan, 2012; Fell, 2005, 2012). The current debate over development policy emerged during the 2008 presidential campaign when the KMT’s Ma Ying-jeou centered his campaign on a promise to reinvigorate the country’s economy by deepening its economic links to and integration with People’s Republic of China (PRC). This has been the standard KMT argument since then, which the Democratic Progressive Party (DPP) has strongly challenged as undermining Taiwan’s sovereignty and creating conditions for the nation’s economic decline. In terms of citizen support, the free trade program, the Economic Cooperation Framework Agreement (ECFA) of 2010, appears to have been fairly popular, while the Cross-Strait Service Trade Agreement of 2013 was not implemented because of popular opposition and massive student demonstrations (Lin, 2016).

Initially when Taiwan’s basic industries began migrating offshore, President Lee Teng-hui (李登輝) tried to steer them toward Southeast Asia rather than China. However, cultural similarity and geographic proximity resulted in a growing economic integration between Taiwan and China, in which labor-intensive production was moved to China, while design and the manufacturing of advanced components stayed in Taiwan; and over time the nature of Taiwanese investments and exports became more advanced and diversified (Clark and Tan, 2012; Lin, 2016; Wu, 1995). Early in this process, most of Taiwan’s exports to China were transshipped through Hong Kong, although this had become marginal by the middle of the first decade of the 21st century. Thus, we included two overlapping data series in Table 11 on the percentage of Taiwan’s exports going to China: (1) the first column (1991 to 2010) includes transshipments through Hong Kong; and (2) the data in
column 2 (2001 to 2016) excludes them. In addition, we also report the combined exports to China and Hong Kong for 2007 to 2016.

Table 11 Taiwan’s Exports to China

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports to China as % of All Exports (including HK transshipment)</th>
<th>Exports to China as % of All Exports (excluding HK transshipment)</th>
<th>Exports to China and Hong Kong as % of All Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>17</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>16</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>20</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>23</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>25</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>27</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>28</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>28</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>30</td>
<td>25</td>
<td>40</td>
</tr>
<tr>
<td>2008</td>
<td>29</td>
<td>26</td>
<td>39</td>
</tr>
<tr>
<td>2009</td>
<td>30</td>
<td>27</td>
<td>42</td>
</tr>
<tr>
<td>2010</td>
<td>31</td>
<td>28</td>
<td>42</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td>27</td>
<td>40</td>
</tr>
<tr>
<td>2012</td>
<td></td>
<td>27</td>
<td>40</td>
</tr>
<tr>
<td>2013</td>
<td></td>
<td>27</td>
<td>40</td>
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<tr>
<td>2014</td>
<td></td>
<td>27</td>
<td>40</td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td>26</td>
<td>40</td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td>26</td>
<td>39</td>
</tr>
</tbody>
</table>

Sources: Clark and Tan (2012: 97); MAC (2017); NDC (2016: 228).

The general stereotype is that the KMT has promoted and the DPP has resisted the huge increase in cross-Strait economic interactions. Yet, the data in Table 11 are inconsistent with this political explanation.
There were two growth spurts indicated by the data in column 1 of Table 11. The first occurred between 1991 and 1995, despite President Lee’s less than enthusiastic attitude, when China’s share of Taiwan’s total exports rose sharply from 10% to 17%. The second occurred during the presidency of the pro-Independence DPP’s Chen Shui-bian between 2000 and 2005 when it jumped from 16% to 28%, associated with President Chen’s “Active Opening” Reforms in 2001. During the administration of Ma Ying-jeou, in contrast, columns 2 and 3 show that there was little change in the proportion of Taiwan’s exports going to China (about 27%) and to China and Kong Kong combined (40%), despite such major cross-Strait trade agreements as the Three Links and the Economic Cooperation Framework Agreement (ECFA). Thus, cross-Strait trade appears to have been determined by economic, not political factors.

2. The Implication of the Tsai and Trump Presidencies for Taiwan’s Stagnant Economy

The victories of Tsai Ing-wen and Donald Trump shook up domestic politics in their nations and the triangular relations among Beijing, Taipei, and Washington. This section, hence, assesses what their new presidencies may portend for Taiwan’s economic future. Table 12 summarizes the economy that Tsai inherited when she was inaugurated as President in May 2016. The overall picture was a stagnant economy that was perceived by huge majorities of Taiwanese as being even more dismal than the economic data implied; and whatever benefits that may have accrued from the country’s growing economic integration with China in the early 21st century appear to have maxed out by the end of the Ma administration. On the other hand, Taiwan’s businesses appear to be strongly embedded at the high end of global commodity chains; and
advanced manufacturing and services play a very significant part in the
domestic economy.

Table 12 Taiwan’s Economic Situation at Start of Tsai Administration

| OVERAL ECONOMIC SITUATION | Stagnating Economy
|                          | Popular perceptions of poor economic performance |
| CENTRAL CHARACTERISTICS   | Export-led
|                          | Advanced manufacturing & services important
|                          | Part of global commodity chains
|                          | Little recent growth in economic ties to China |
| NEGATIVE FEATURES         | Major gap between increases in productivity and wages
|                          | Government with limited capabilities
|                          | Declining priority of education |
| POSITIVE FEATURES         | Low unemployment
|                          | Low inflation
|                          | Gradually increasing priority for R&D
|                          | Low taxes |
| POLICY CONTRADICTION      | Low taxes to promote business vs. the sharp limitations on government capabilities that they create |
| POSSIBLE POLICY GOALS     | Develop new partners for trade & investment
|                          | Upgrade qualifications of workforce
|                          | Help those marginalized by economic change |

It is possible to discern positive, as well as negative, features of Taiwan’s current economy; and these are described in the third and fourth rows of the table. Clearly, the significant gap between productivity growth and wage growth, the limited capabilities of a financially strapped government, and the slowly eroding priority of education all point toward continuing problems for Taiwan. Yet, low unemployment, low inflation, a gradually increasing priority for research
and development, and low taxes to stimulate business activities and consumption indicate some hopeful trends as well. These positive features, however, raise a fundamental policy contradiction that Taiwan now faces. The low taxes that promote entrepreneurship and consumption deny the government the resources to do very much about the country’s economic challenges. Finally, the new DPP administration could follow one or more of three possible policy goals to improve the economic situations of Taiwanese citizens. First, it could develop new partners for its trade and investment; second, it could upgrade the qualifications of its citizens; and, third, it could develop new programs to help those who have been marginalized by the forces of economic change.

Tsai Ing-wen had every incentive to find alternative economic partners to China, whose economic influence was seen as malign by her Democratic Progressive Party. Once she assumed the presidency in March 2016, her administration moved quickly in this area. In mid-September, the government announced its New Southbound Policy or NSP (Chiou, 2016; Ho, Clark, and Tan, 2016; Taipei Times, 2016). It was focused on the 18 countries south of Taiwan (10 from ASEAN, 6 from South Asia, and 2 from Oceania). This initiative makes sense geographically and economically. The region is generally one of the more dynamic ones in the global economy; and the NSP countries were the second largest recipient of Taiwan’s exports in 2015 at 15.6%, compared to 25.7% going to the PRC (Ho, Clark, and Tan, 2016).

While a central goal of the NSP is to build a new regional economic alliance with these countries, it visualizes the development of a regional community encompassing a growing array of business, people-to-people, and direct or indirect governmental contacts. The program is designed to “forge a new and mutually beneficial model of cooperation and ultimately create a sense of economic community” (MOFA, 2017).
Table 13 Percentage of Taiwan’s Exports Going to Major NSP Trading Partners and to China and Hong Kong

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>2010</th>
<th>2015</th>
<th>CHANGE 2010-15</th>
<th>2017</th>
<th>CHANGE 2015-17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NSP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>4.4</td>
<td>6.1</td>
<td>2.7</td>
<td>5.6</td>
<td>-0.5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.0</td>
<td>2.5</td>
<td>0.5</td>
<td>3.3</td>
<td>0.8</td>
</tr>
<tr>
<td>Philippines</td>
<td>2.2</td>
<td>2.6</td>
<td>0.4</td>
<td>3.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Thailand</td>
<td>1.9</td>
<td>2.0</td>
<td>0.1</td>
<td>2.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Australia</td>
<td>1.2</td>
<td>1.2</td>
<td>0.0</td>
<td>1.0</td>
<td>-0.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.9</td>
<td>1.1</td>
<td>-0.8</td>
<td>1.0</td>
<td>-0.1</td>
</tr>
<tr>
<td>TOTAL</td>
<td>13.6</td>
<td>15.5</td>
<td>2.9</td>
<td>15.9</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>PRC &amp; HK</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>28.0</td>
<td>26.7</td>
<td>-1.3</td>
<td>28.0</td>
<td>1.3</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>13.8</td>
<td>13.7</td>
<td>-0.1</td>
<td>13.0</td>
<td>-0.7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>41.8</td>
<td>40.4</td>
<td>-1.4</td>
<td>41.0</td>
<td>0.6</td>
</tr>
</tbody>
</table>


According to the official statement of the Executive Yuan (行政院, executive branch of Taiwan’s government), the NSP is comprised of four central tasks or areas of policy initiatives (MOFA, 2017):
1. Promote economic collaboration
2. Conduct talent exchange
3. Share resources
4. Forge regional links

Promoting economic collaboration, which is of particular interest here, involves three major activities. First, the NSP will help Taiwanese firms integrate with local supply chains with special emphasis on Taiwan’s advanced technological capabilities. Second, sophisticated analyses of NSP domestic demand should help Taiwanese exporters enter and expand in local markets, as well as promoting bilateral trade. Finally, Taiwan should help the economic development of their partners by participating in large-scale infrastructure projects in such areas as energy, petrochemicals, and the environment.

It is obviously far too soon to evaluate the success or even the potential of the NSP. Still, there are some hopeful signs even in the economic area. For example, in January 2017, the number of tourists from NSP countries had jumped 43% and the value of exports had increased 20% compared to the previous January (Taipei Times, 2017; Focus Taiwan, 2017). Still, the data in Table 13 on the share of Taiwan’s exports going to the six NSP nations considered to be among Taiwan’s major trade partners and to China and Hong Kong would definitely be considered disappointing from the DPP’s perspective. First, only 6 of the 18 NSP nations received 1% or more of Taiwan’s exports in 2017, indicating that most were still marginal in their economic interactions. Second, Singapore is clearly the leading importer of Taiwanese goods among these countries. The major impetus for this, however, was the free-trade pact that was negotiated by the Ma administration in 2013 (Taipei Times, 2013). Moreover, Singapore’s share of Taiwan’s exports fell significantly from 6.1% to 5.6% between 2015 and 2017. Malaysia
and the Philippines have had steady increases over both periods from about 2% to 3%. There are two somewhat contradictory interpretations of this. On the one hand, there seems to be a basis for long-term growth; on the other, the Tsai period does not really stand out from the Ma era. Otherwise, there was little change in the export shares of Thailand and Australia, while Indonesia actually suffered a significant decline between 2010 and 2015. Overall, therefore, this table strongly implies that a major change in the economic relations between Taiwan and the NSP nations has yet to occur. The Tsai government has also failed to reduce its economic ties with China as would have been expected. Between 2015 and 2017, China’s share of Taiwan’s exports actually went up from 26.7% to 28.0%, although this was somewhat counterbalanced by a 0.6 decline in Hong Kong’s share. The Tsai administration, in contrast, has shown little interest in the other two possible goals for improving Taiwan’s economic situation: upgrading the nation’s human resources and improving the conditions of those who have been marginalized by economic change in Taiwan. Most fundamentally, the new government has indicated no intention of challenging the low-tax policy which constrains the government’s ability to pursue either of these strategies, in essence continuing the unpopular policies of the Ma administration. For example, the administration’s controversial efforts at pension reform presuppose a “zero sum” situation in government finances. In addition, Tsai and the DPP were widely viewed as favoring business over labor in the debate on the “five-day work week” (Hickey and Niou, 2017).

Donald Trump’s victory in the 2016 presidential elections led to massive changes in America’s domestic and foreign policy. Trump’s economic nationalism has been the major factor impacting Taiwan’s economic prospects. Trump’s withdrawal of the United States from the Trans-Pacific Partnership or TPP (Granville, 2017) has the potential to
give Taiwan’s attempts to broaden its trading partners a sharp setback. With the other TPP partners forging on to establish the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) despite the US’s withdrawal, Taiwan would gain preferred access to many important Pacific markets if it can become a member (Yeh and Chen, 2017) but without the US’s support the likelihood of Taiwan being able to join the CPTPP is low (CNBC, 2017). President Trump has also threatened the liberal global trading order by openly criticizing the World Trade Organization (WTO) and starting a trade war with China. This could be disastrous for Taiwan because of its linkages with global supply chains going through the PRC. It is still unclear, however, whether the Trump administration is trying to increase American access to the Chinese market, which the PRC would probably negotiate, or setting the stage to impose “significant unilateral protectionist measures”, which Beijing would almost certainly find unacceptable (Bader, Dollar and Haas, 2017; CNN, 2017; The Washington Post, 2017). As it stands, in 2018 the U.S. has imposed tariffs on Chinese exports to the U.S. and China has retaliated with its own tariffs on U.S. exports to China. The impasse between the U.S. and China on trade has led the International Monetary Fund (IMF) to forecast that global trade and growth is likely to decline in 2019 (The Washington Post, 2018).

As the United States turns aggressive in its bilateral trade relations, Taiwan could also be at risk, as indicated by the data in Table 14. Trade with America is still important for Taiwan. It sends 12% of its total exports to America; and trade with the U.S. constitutes 11% of its total positive trade balance. Furthermore, 48% of its exports to the U.S. in 2015 were machinery and electrical equipment which demonstrates that America is an important market for Taiwan’s advanced manufacturing sector. The danger for Taiwan that might make it a target for retaliation by the Trump administration is that it runs a substantial positive trade
balance with the U.S. that is equivalent to 15% of its exports and Taiwan has been identified as a foreign exchange currency rate manipulator.

**Table 14** Taiwan’s Exports to U.S., 2015 (All data are percentages)

<table>
<thead>
<tr>
<th>Exports to U.S. / Total Exports</th>
<th>12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade Balance with U.S / Total Trade Balance</td>
<td>11</td>
</tr>
<tr>
<td>Machinery &amp; Electrical Machinery / Total Exports to U.S</td>
<td>48</td>
</tr>
<tr>
<td>Trade Balance with U.S / Exports to U.S.</td>
<td>15</td>
</tr>
</tbody>
</table>


**3. Concluding Remarks**

In this article, we have highlighted the challenges and headwinds that Taiwan’s economy faces from a changed domestic and international environment. Taiwan’s economy has clearly been stagnating in the early 21st century with widespread citizen perceptions of too low growth and bad inequality. Two broad strategies for improving this situation would be to develop new partners for trade and investment and to increase state support for human resource development and for reducing the problems associated with inequality. President Tsai’s New Southbound Policy has the potential to expand Taiwan’s economic partners significantly but has yet to have a major impact. However, President Trump’s withdrawal of the U.S. from the Trans-Pacific Partnership may well have derailed a more potent possibility for Taiwan to expand its trade and investment ties. In the area of domestic politics, the Tsai administration has
continued the conservative policies of its KMT predecessor by, in particular, making no effort to change Taiwan’s low tax, small government status. In a heightened level of global political and economic volatility, the ability of Taiwan to snap out of its economic conundrum and end its economic stagnation will require its careful management of these many headwinds.

Notes

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Chinese-Taiwanese-Southeast Asian
Triangular Relations: On Building and Rebuilding
Political and Economic Assertiveness
in South China Sea

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Abstract
China’s extraordinary economic growth and active diplomacy continue to transform greater East Asia with its sphere of influence extending to the other side of the globe through its robust development aid provisions. Taiwan, despite its political isolation with the admission of China into the United Nations as well as due to the “One China” principle managed to grow its economy as one of Asia’s tigers – a driver that led Taiwan to establish economic and cultural relations with Southeast Asian states in the absence of formal diplomatic relations. Meanwhile, Southeast Asia has seen robust and continued economic growth in the past few decades. Notwithstanding these economic gains, the present geopolitical sphere in this part of the world is becoming
tenser than ever. China has been increasingly assertive in its actions in the South China Sea for years now, while Taiwan has also done a fair share of mobilisation in the contested islands. Protests from some ASEAN-member states have escalated, as manifested in their foreign policies. Within this trajectory, this paper looks into the underlying aspects of the triangular relations between China, Taiwan, and Southeast Asia.

**Keywords:** China-Taiwan-Southeast Asian relations, China-Taiwan-ASEAN trilateral relations, China-Taiwan-ASEAN political economy, sharp power projection, regional hegemony

1. Introduction

The People’s Republic of China (PRC) has come a long way from being touted as a “sleeping giant” to becoming the world’s second largest economy (The World Bank, 2018). China’s extraordinary economic growth and active diplomacy continue to transform greater East Asia (Flores, 2017), with its sphere of influence extending to the other side of the globe through its active foreign policy and robust development aid provisions. Taiwan, despite its political isolation that began with the admission of China into the United Nations (Ku, 2017) due to the “One China” principle managed to grow its economy such that it has become one of Asia’s tigers – a driver that led Taiwan to establish political, economic, military and cultural relations with Southeast Asian countries in the absence of formal diplomatic relations (Yang, 2017). Thus, it is no wonder that the contemporary political and economic behaviour of these “Two Chinas” in regional and global realms continue to interest scholars of global politics and policymakers. One of the issues that is often observed and studied by scholars and policymakers are China’s
various territorial and maritime disputes with neighbouring states, specifically the maritime Southeast Asia (SEA).

Since the end of the Second World War, the ocean has become a source of instability in the international system (Yee, 2011). Despite the existence of the United Nations Convention on the Law of the Sea (UNCLOS) to properly set boundaries and resolve disputes arising from overlapping claims, states still disagree on the basis of the legality of claims\(^1\); thus, the disputes. The South China Sea (SCS) is one of the areas where several countries have overlapping claims, leading scholars call it the “mother of all territorial disputes” (Baviera, 2004). Comprising hundreds of islands, reefs, cays, and banks, the CSC is considered the “maritime heart of Southeast Asia” (Boonpriwan, 2012) and a “key economic lifeline” (Blazevic, 2012) that links East Asia to the rest of the world. SCS is a major transport hub through which the goods to and from Northeast Asia are shipped, and an essential Sea Lane of Communication (SLOC) as the number of ships that passes through this region is double that of the number which passes through the Suez and Panama Canals (ibid.), which leads Burgess (2003) to contend that it is “the second busiest international sea lane with more than half of the world’s petroleum-bearing traffic” (Burgess, 2003; Hutchison, 2003; Salil, 2012). While 90 percent of intercontinental world trade is carried out by water, the data show that in 2012 alone, over half of international commercial shipping tonnage and 5.3 trillion USD of trade passed through the SCS (Blazevic, 2012). This makes it probably the most strained shipping lane in the world (Cronin (ed.), 2012: 7).

In particular the energy resources make the lane vitally important for the East Asian economies. Moreover, it is not only known for being a transit route for energy resources, as it is likewise considered as a gold mine of resource deposits – estimated billions of barrels of oil, minerals, hydrocarbons, and natural gas are said to be contained within the SCS
region. Another commodity which the South China Sea offers is an abundant stock of fish. It is one of the richest marine life areas in the world, representing about 10 percent of the world’s fish catch (Turcsányi, 2018). However, the strategic importance of the SCS goes beyond the transport routes and the resources it offers. The SCS also constitutes a natural barrier for the ships of the mainland countries before they reach the open oceans. From the perspective of China, the so-called “first island chain” is being formed by the eastern and southern banks of the SCS, preventing the Chinese Navy from reaching the Pacific or Indian Oceans without passing through the vicinity of the littoral states, and hence they are easily tracked (Yoshihara and Holmes, 2011). Moreover, from China’s perspective, the SCS is the only easily accessible sea with relatively deep water and is thus suitable for extensive underwater military operations through the use of submarines via the route to Japan, with the rest of it going to South Korea, China, Taiwan, and other economies (Turcsányi, 2018). Also, the demand for liquefied natural gas (LNG) is expected to grow in the coming years. Finally, large quantities of coal from Australia and Indonesia – two of the world’s largest coal exporters, pass through the SCS to their markets in China, Japan, India, and elsewhere (U.S. Energy Information Administration, 2013).

Due to this backdrop, the SCS is a site of perennial “escalating military tensions” (Baviera, 2011). The disputes among these states involve territorial sovereignty and jurisdiction over maritime zones; economic exploitation of the areas through the setting of Exclusive Economic Zones (EEZs) and continental shelves; and lastly, the conduct allowed within the EEZ of coastal states (Baviera, 2011; Dutton, 2011) all within the context of ensuring the freedom of navigation and security in this maritime region. As Baviera (2011) has stated, the territorial disputes “are very much intertwined with the maritime boundaries and
jurisdiction conflicts as they determine the basis from which a state’s maritime zones are to be projected as stipulated in the UNCLOS.”

China has been increasingly assertive in its actions in the South China Sea for years now, building formal structures in most of the disputed islands which has been protested – time and again – by some ASEAN-member states. These countries, in turn, have articulated clearly in their national policies and international engagements their own stance regarding China’s claims. In the recent years, Taiwan has also done a fair share of mobilisation in the South China Sea. While China is part of ASEAN plus 3 (Association of Southeast Asian Nations plus China, Japan and Republic of Korea), Taiwan is not. However, in these meetings, economic issues dominate political ones.

This paper analyses how China, Taiwan and the ASEAN-member states are building and rebuilding their political and economic policies and presence given this picture. As such, through process tracing and by utilising the general inductive approach, this paper: (1) Explores how these states reconcile an increasing economic interdependence and removal of borders for trade between them while at the same time, challenge and assert their political sovereignty over their own territories and in the disputed islands; (2) Probes into the interconnectedness of political and economic ties between Southeast Asia and China; (3) Analyses the role and behaviour of Taiwan over the disputed territories and waters in the SCS; (4) Traces the SEA-China historical ties to modern state relationships and explores how the “political” is embedded in the “economic”, and how the “economic” is likewise embedded in the “political” aspects of their relationships; (5) Reviews the PRC’s position in the South China Sea, focusing on its motivations and actions, specifically the extent of China’s regional power and influence in the SEA region to contextualise its actions and the responses of the SEA states to the said actions; (6) Elucidates how China utilises
its *sharp power* which it gains from – and reflects through – trade, language, and cultural exchanges and SEA perceptions over China; and (7) Ends with a discussion on how the region sees the possibility of a regional hegemon, and how the SEA states see China as a “leader”.

2. Mainland China-Taiwan-Southeast Asian Economic Interdependence

The more than fifty years of rivalry and the drastically growing economic ties between China and Taiwan over the past decade are two important starting points to be examined, where both have sustained rapid economic growth for more than three decades. This growth has become even more symbiotic over the years despite ups and downs in China-Taiwan political relations (Rosen and Wang, 2011); and since Taiwan’s own history is deeply intertwined and often runs in parallel with that of Southeast Asia, one should never exclude Taiwan-Southeast Asian ties in these discussions. Its strategic location off the Asian mainland and astride sea lanes between Northeast and Southeast Asia means that Taiwan has long been part of the networks of migration, commerce, cultural interaction, and conflict traversing in the SEA region. More so, the social exchanges characterised by linkages between Southeast Asia and Taiwan and connections that are evident in business, popular culture, religious practices, family ties, and even the languages spoken in Taiwan and Southeast Asia, the outreach efforts between Taiwan and Southeast Asia, such as Taipei’s New Southbound Policy, are natural extensions of these long-standing relationships, and can serve to further consolidate existing societal and other bonds that reach across the South China Sea. Henceforth, even if official ties are subjected to the usual political constraints, due to either direct pressure from Beijing or preemptive efforts to avoid provoking China, substantive possibilities
for fostering Taiwan’s relations with Southeast Asia remain.

From the early 1990s until 2008, a corrosive political dynamic came to dominate political relations between Taiwan and China, dashing the faint hopes in the early 1990s of a political reconciliation after decades of hostility. All this happened in spite of their complementary economic relations.

Back during the Cold War era, China was not influential in Southeast Asia, even though by 1991 it had formalised diplomatic relations with all the countries in the region\(^2\). However, through the implementation of its Good Neighbour Policy\(^3\) in 1990, China began to make changes regarding its regional diplomatic relations. This has led to then Chinese premier Li Peng’s visits to Indonesia, Singapore, and Thailand in August 1990, and to Malaysia and the Philippines in December of the same year. This was the first time that a Chinese leader had, within four months, visited five major countries in Southeast Asia. The acceptance of China as full dialogue partner of the Association of Southeast Asian Nations (ASEAN) in July 1996 has laid a sound foundation for the further development of this previously isolated Asian giant’s diplomatic relations throughout Southeast Asia.

Additionally, 1990 marked the lifting of bans by Taiwan’s Ministry of Economic Affairs (MOEA) on indirect investment in China\(^4\) that soon made the latter the most important host country of the former’s outward investment. The trade figures from the Bureau of Foreign Trade, MOEA, Taiwan, from 2001 to 2011 indicated its growing dependence on China in its overall trade while the share of Taiwan in China’s external trade is decreasing. Chiang and Gerbier (2013) examined the economic dependency of Taiwan on China and they found out that the percentage of Taiwan’s exports to China and Hong Kong in its total exports jumped from 27 percent in 2001 to 40 percent in 2011. Additionally, while Taiwan’s exports to China continued to take a great share of its total

CCPS Vol. 4 No. 3 (December 2018)
exports, its total shares of exports to the US, Europe and Japan have likewise declined significantly, except for the Southeast Asian countries. Additionally, Taiwan’s import figures show, although Japan remains to be its largest import source, Japan’s share in Taiwan’s total imports has been significantly decreasing, from 24 percent in 2001 to 19 percent in 2011 (ibid.). Imports from the US, Europe and ASEAN also decreased noticeably over the last decade. Meanwhile, the share of Taiwan’s imports from China increased from 7 percent to 16 percent in the same period.

At the regional level, Taiwan’s signing of Economic Cooperation Framework Agreement (ECFA) with China implied that it is now following the wave of “China-centred” regionalisation. The conventional “market-driven” and “China-centred” regionalisation would be further supported by the different sorts of Free Trade Agreements (FTA) already implemented between China and other major economies in the region, that include Taiwan, Hong Kong, Macao and ASEAN.

Therefore, some analysts assume that the harm from the loss of China’s market for Taiwan would be greater than the loss of source of imports from Taiwan for China. Although many Asian economies have also turned their trade dependence from the US to China in recent years, the difference with Taiwan is that their dependence on China will not damage their political sovereignties. The establishment of institutionalised economic relations seems the unavoidable way to secure Taiwan’s benefits in the Cross-Strait economic exchanges. But that institutionalised economic relations will in turn tie the economies between Taiwan and China more deeply. Although the political reconciliation is still a long-term issue, Taiwan’s rising economic and trade dependence on China will put the island in a disadvantageous position in the future negotiations.
China strongly supported the agreement and will strive to make it work. China’s more aggressive pursuit of claims in the South China Sea, which has caused some blowback, and thorny issues with the United States, makes amicable relations with Taiwan even more important. Though Chinese leaders view ECFA as a stepping stone to political agreements with Taiwan and see it as a means to pursuing its policy of reunification, it is still a distant goal. For now, it is hard to connect the two in a meaningful way. Copper (2010) argued that it seems accurate to say that, currently China does not want to make Taiwan part of China. He believed that owning Taiwan, today, would not be advantageous to China in some important respects: (1) Economic relations are nearly as good as they can be; (2) Taiwan would be troublesome if incorporated by China as many people would flee ahead before it happens and ruling Taiwan might prove difficult; and (3) Sino-American relations would be irretrievably damaged. What is clear at present is that China wants to prevent a declaration of independence.

3. The Role of Taiwan in Southeast Asia and Its Behaviour in SCS

In recent years, as China’s economic ascent facilitates growing military capabilities and assertiveness on the South China Sea (SCS), there have been some alarming views that China’s great power potential, combined with its latent expansionist ambitions and increasingly assertive foreign policy stance, could be a threat to regional and global security as it might trigger major power realignments in the East. The maritime and territorial disputes in this highly contested region have become one of the biggest potential flashpoints for Beijing’s rapid military modernisation along with Washington’s “pivot” or “rebalancing” to Asia⁵.

CCPS Vol. 4 No. 3 (December 2018)
The fight over the overlapping exclusive economic zones in the SCS carries with it a complex chronology of events steeped in the turmoil of Southeast Asian history. Being an important international sea lane, China is bolstering its military equipment installed on islands and reefs within the South China Sea region, and has even installed surface-to-air and anti-ship missiles on some reefs and shoals. Moreover, the Chinese People’s Liberation Army (PLA) is slowly, but surely building a tactical military advantage in the region, which will have inevitable consequences for East and Southeast Asian regions’ stability.

The dispute involves not only several bilateral conflicts (China vs. Vietnam in 1974 and 1988; China vs. the Philippines in 1995) but also a possible conflict between two groupings: the ASEAN states (Brunei, the Philippines, Malaysia, Vietnam) versus the non-ASEAN countries (China and Taiwan). There is a continuous debate in Taiwan over what should be the official position on the Spratlys, that is, whether Taipei should join the People’s Republic of China (PRC) in refuting other claimants. Taiwan’s diplomatic isolation and its inadequate power projection further complicate Taipei’s South China Sea policy dilemma.

Southeast Asian states likewise have important interests at stake in developments within Taiwan Strait. Though only about 30 small islands are above the water at high tide along Spratlys, claimants in this island group have already established structures on more than 40 islets and reefs (Chang, 1990: 20).

It is important to note, however, that Taiwan was the earliest nation to establish a foothold in the South China Sea. For this reason, Taiwan’s geopolitical status in the region is likely to become even more vital and, as it is located within the so-called “first island chain”, Chang (2018) argued that its strategic value will undoubtedly be elevated as well. Presently, it holds possession of an important territory – Pratas Islands (Dongsha Islands) – as well as the largest natural island within the
Spratly Islands (Nansha Islands), the Itu Aba Island (Taiping Island). Henceforth, it has been viewed that Taiwan has an opportunity to also make use of its advantageous position to fight for increased representation and a louder voice on the international stage.

Though ASEAN-member states recognise the “One China” principle, the potential impact of conflicts in the Taiwan Strait on the political and economic development of the region remains a major concern for them. They certainly want to avoid taking a strategic stand should military conflicts occur within Taiwan Strait. What remains to be the rational choice for Southeast Asian states is to maintain substantial informal relations with Taiwan, and keep persuading the United States to continuously engage in the Asia-Pacific region.

When the Permanent Court of Arbitration, in The Hague, ruled in July 2016 in favour of the Philippines against China’s claims, China responded by saying it would not abide by the ruling. The office of Taiwan’s president likewise rejected the verdict in terms similar to Beijing. If there is anything China and Taiwan can agree on, it is that the contested scattered islands in the South China Sea are Chinese territory (Linthner, 2018). The People’s Republic of China (PRC) inherited its claims from the Republic of China (ROC) after the Chinese civil war. Thus, the ROC’s interpretation of its claims is relevant to the PRC’s claims.

Contrary to the conventional wisdom, the Democratic Progressive Party (DPP) administration chose to emphasise this main Chinese legacy when the PCA ruling came. In addition to rejecting the ruling and highlighting the ROC’s territorial claim over the South China Sea, including the eleven-dash line, Taipei even sent a naval frigate to the site. Those moves are similar to or even more assertive than Beijing’s. Taiwan’s strong responses to the ruling of the Permanent Court of Arbitration (PCA) on South China Sea may not be wise from a foreign

CCPS Vol. 4 No. 3 (December 2018)
policy standpoint, but the reaction highlights the undeniable linkage across the Taiwan Strait, a potential breakthrough in the cross-strait relations (Wu, 2016).

This decision of the Tsai administration is a form of political populism. Public opinion in Taiwan usually demands governmental action to defend territories. The Taiwanese mainly accepted their Chinese legacies, especially when it comes to accessible territories. As the PRC has generally replaced the ROC in the international community, Taiwan is unable to take legal moves due to a lack of international recognition. Therefore, making a “show” of sending vessels to disputed areas is a tool for political leaders to comfort people.

Taiwan, in the past years, has taken small but significant steps toward clarifying that its claims are from land and in accord with UNCLOS and international law. It adopted a more conciliatory position by advocating that the East China Sea Peace Initiative, which calls on parties to shelve disputes and promote joint exploration and development in the East China Sea, be applied in the South China Sea (Kuok, 2015). A subtle shift in position is likewise evident in the Policy Guidelines set by the Tsai government after the arbitration. It contains “Four Principles and Five Actions” to guide Taiwan’s South China Sea policy⁹. Taipei stipulates that it would increase the quotas for international scientists to conduct scientific research on Taiwan-occupied Itu Aba, or Taiping island, in the Spratlys. Taipei would cooperate with different organisations to make Itu Aba a centre of humanitarian assistance.

When Minister of the Interior Yeh Jiunn-rong paid a visit to Itu Aba in August 2016, he declared that Taipei would install more scientific devices on the island to monitor the impact of climate change in the South China Sea. Also, in August 2016, Taiwan adopted the New Southbound Policy¹⁰ in order to identify a new direction and a new

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⁹ Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) • 2018
driving force for a new stage of Taiwan’s economic development, redefine its important role in Asia’s development, and create future value. At the same time, through this policy, the Tsai administration hopes to start up wide-ranging negotiation and dialogue with the nations of ASEAN and South Asia as well as New Zealand and Australia, with an eye to establishing close cooperation and together achieving regional development and prosperity.

President Tsai Ing-wen has since consistently vocal about the southbound initiative in many of her high-level engagements\(^\text{11}\) in keeping her commitments to forging stronger economic and people-to-people ties with the island’s neighbours in the South and Southeast Asia, Australia, and New Zealand thereafter. Though under an increasing pressure to present progress on her southbound pivot, these strong commitments were manifested by the significant growth of trade, tourism, and educational linkages between Taiwan and these countries, and the ASEAN as President Tsai highlighted.

These investments and position shift by Taipei clearly sent a credible message to other South China Sea claimants that even if Taiwan is not able to be a formal party to UNCLOS, it is willing to provide public goods in the South China Sea and cooperate with other claimants to peacefully manage the disputes through marine conservation programs, humanitarian assistance, and joint development with which, arguably, Taipei has come to regard the South China Sea as a shared resource, at least to a certain extent.

4. Southeast Asia’s Political Relations and Economic Ties with China

Abb and Strüver (2015) points out that SEA is deeply interconnected with China economically even before the era of colonisation. The region’s interactions with China are also already deeply-institutionalised.
Tai and Soong (2014) traces this relationship to being tributary in nature. Early trade networks were formed through establishing vassal states. Even the creation of several Chinese chambers of commerce in SEA states was an effort to develop political alliances under the branding of trade expansion overseas *(ibid.)*. However, the economic aspects of this relationship were more marked and lasting than the political aspects that characterised the surface.

While the establishment of the People’s Republic of China (PRC) in 1949 and the ensuing formation of the Association of Southeast Asian Nations (ASEAN) in 1967 led the two entities to two opposing ideological poles as the latter was established “partly motivated by anti-Communist sentiment” *(ibid.: 23)*. The trade relationships then began to be blemished by political stances, despite Zhou Enlai’s promulgation of China’s “Five Principles of Peaceful Coexistence” as its guide in doing diplomatic relations with SEA states. The thawing of relations between the United States and China in 1972 with the visit of President Richard Nixon to China paved the way for the establishment of diplomatic relations between China and Southeast Asian states.

On the political realm, the Cold War brought back reluctance on the part of SEA states regarding China’s intentions, given the worries on the “China threat” *(ibid.: 23)*. However, despite this, trade between China and the individual SEA states remained strong and stable, partly due to China’s “Open Door Policy” and the subsequent “Good Neighbour Policy” in the 1990s which entailed its leaders to have frequent visits to SEA states to rekindle and bolster relationships, as well as increase the volume of bilateral trade between China and individual SEA states. Hence, from US$200 million in trade by the end of the 1990s, the amount now reaches more than US$100 billion, with China being ASEAN’s highest trading volume partner in the Asia-Pacific *(ibid.: 26).*
What cemented China’s presence in SEA was its actions during the Asian Financial Crisis of 1997 where its strong economic and trade position allowed it to not depreciate its currency (Ba, 2014; Singh, 2015), thereby being the beacon of stability in the region. Aside from this, China also extended financial support to SEA states to weather the crisis – most notably in infrastructure, trade, and economy (Tai and Soong, 2014; Shekhar, 2012). This enabled China’s re-establishment of ties with SEA states, and its status known as a “good, stable, and wealthy neighbour” (Ba, 2003: 646). Moreover, China’s acquiescence to the Bangkok Agreement in 2001 opened the doors for it to have close economic partnerships with SEA.

Moving forward, China continued its efforts to reduce tensions through state visits initiated by its presidents, which thwarted fears of “China threat” and transformed it into “peaceful rise”. This shift in the way PRC engages in the world is important for academics and policymakers to assess and anticipate its effect on the global balance of power. China’s use of “soft power”\(^{12}\) began circulating in the US headlines as early as 2004, where papers such as the *Chicago Tribune* wrote that China “counterbalances US power” (Schmidt, 2008).

Tai and Soong (2014) posits that at the beginning of the 20th century, China was in a position to establish “economic and trade rules for East Asia” (p. 24). In fact, the last decade saw China replacing Japan in leading East Asian economic development. The “China threat” during the Cold War was replaced with “China opportunity” (*ibid.*: 24), due to China’s proactive role in establishing friendly relationships with SEA states through three main strategies: (1) the formation of the China-ASEAN free trade area; (2) increased border trade; and (3) expansion of trade networks through Chinese businesses, Chinese immigrants who are now based in SEA states, as well as Chinese tourists. The year 2006
marked the first time that Chinese tourists in SEA registered the highest number of tourists from a single country. The development of trade networks also includes the increase in the number of Confucius Institutes to promote the learning and teaching of the Chinese language, which becomes a method of exporting China’s cultural values into ASEAN.

Tai and Soong (2014) asserts that the fact that China was able to implement profit-sharing measures with SEA states through the FTA makes it a provider of public goods. These measures are in the form of the “economic cooperation framework agreement, the early harvest program, the goods trade agreement, and the service trade agreement” (p. 29), among others. These provisions resulted in SEA states’ increased willingness to cooperate with China, as well as their acceptance of the emerging power.

Christopher Walker and Jessica Ludwig of the National Endowment for Democracy, in 2017, coined the term “sharp power” to describe these Chinese political and economic activities. However, others continue to identify them as a form of soft power. Some experts argue China’s sharp power is nothing more than an element of hard power. While it is true that sharp power shares some characteristics with both hard and soft power, it is uniquely different because its targets are more likely not having the ability to consciously participate in the decision-making process. Beijing employs a diverse tool kit that includes thousands of people-to-people exchanges, wide-ranging business and cultural activities, education programs and the development of media enterprises and information initiatives with a global reach (Walker and Ludwig, 2017). Moreover, because many are unable to identify a number of Beijing’s activities, and believe them as elements of soft power, their intent and effect are often underestimated.

Beijing has become increasingly assertive and controlling in its efforts to outmanoeuvre rivals and critics since the 2008 financial crisis.
and Xi Jinping’s ascent to power by means of offering the following landmark examples of public goods:

• **China-ASEAN Free Trade Agreement (FTA)**

The framework for China-ASEAN FTA was signed in 2002 (Schmidt, 2008). This initiative was led by China under its “Good Neighbour Policy”, with informal talks between China and ASEAN leaders prior to its establishment as early as 1997 (Tai and Soong, 2014). It came to fruition finally in January 2010, when the agreement entered into force.

The FTA saw the increase in bilateral trade volume between China and ASEAN, which, when translated to individual countries, volume of trade is directly proportional with their respective economic scales. Hence, SEA states with relatively higher GDPs as compared to other SEA states “had greater potential for import demand” (*ibid.*: 28).

With reduced – and subsequently, eliminated – tariffs between China and ASEAN, the volume of trade between the entities is seen to increase exponentially. Schmidt (2008) claims that the two-way trade between China and ASEAN is growing faster than that of Japan and ASEAN. ASEAN-China trade amounted to US$39.5 billion and US$41.6 billion in 2000 and 2001, respectively. Tongzon (2005), as cited in Schmidt (2008), writes that China is the 6th biggest trading partner of ASEAN – and with the ASEAN-China FTA, will highly likely to be the first.

• **Belt and Road Initiative**

SEA sees itself benefitting from China’s “Belt and Road Initiative” (BRI, previously known as One-Belt-One-Road initiative), which is increasingly seen as a public good. This development which commenced in 2013 entails building roads and ports connecting China to the rest of the world – both in Southeast Asia and in Europe.
In terms of positioning of individual SEA countries with regard to economic ties with China, those countries sharing borders with China are the ones who have very little trade with the emerging power. Tai and Soong (2014) attributes this to being “technologically-backward” of these countries, thereby limiting them from exploiting the geographic proximity and trade potential between them and China. To this, China developed strategies to increase trade within its borders, such as the Western China Development Program aimed at expanding the economic capacities of Western China, as well as the Greater Mekong Subregional Cooperation Program targeting the development of the Mekong River Basin in China’s southwestern border. Likewise, the Kunming-Bangkok expressway which passes via Laos and links China and Thailand is also funded by China. It was completed in 2008.

● Development banks and funds

Another public good that China offers is the Asian Infrastructure Investment Bank (AIIB), an investment lending platform for infrastructural construction in SEA, as well as the China Development Bank (CBD) and the Silk Road Fund. These are China’s counterparts to the World Bank and the Asian Development Bank, whom China sees as unable to capitalise and maximise on the unmet demand in infrastructure development – it saw the resources offered by the two multilateral platforms as “grossly deficient” (Zhang, Li and Cheong, 2017: 130). Aside from these, China also forged bank alliances with SEA state-owned banks, which then facilitates building a plethora of infrastructure projects simultaneously due to its interest-free and concessional loans and grants. Schmidt (2008) states that this trend that China treads – FDIs combined with overseas development aid (ODAs) – is similar to Japan’s, Taiwan’s, and South Korea’s pattern.
5. China’s Regional Power and Policy Influence over SCS: Persuasion, Inducement, and Argumentation

From the discussion in the preceding section, it is clear that China’s economy is increasingly tied with the rest of the world, especially with SEA states, and any effect — be it adverse or beneficial — to China’s economy redounds to SEA economies as well. These economies are now interwoven in an intricate web such that one small movement in one part has repercussions on the rest of the parts.

For thirty years (1982-2012), China’s GDP is at 7 percent per annum on average (Zhang, Li, and Cheong, 2017), most of it built on trade. This unprecedented, continued high economic growth has enabled it to pursue strategic interests not only in the contiguous region, but also in areas as far as Africa, the Americas, and Australia. In fact, in 2009-2010, China outperformed Germany as the world’s largest exporter (Zhang, Li and Cheong, 2017; Ba, 2014).

However, the year 2012 saw a general deceleration in China’s economic growth rate, which the Chinese leadership recognised and acknowledged as the “new normal” (Zhang, Li, and Cheong, 2017: 126). This phenomenon where China’s economic growth is driven by technological innovation and rests on slower economic development, as opposed to one driven by cheap labour and characterised by consistent double-digit growth rate, is spilling-over on a global scale.

Despite this slowdown, China still maintains a stable economic growth rate. This wherewithal allows China to provide several public goods, thereby making it indispensable and essential in discussions about shaping and reshaping the current world order. In continuing to do so, China has also faced worries and resistance from several SEA states, especially on the matter of territorial and maritime disputes. Shekhar (2012) aptly puts it in this way: that while China is ASEAN’s
largest trading partner, it is also the only great power that has territorial
and maritime disputes with some SEA states (p. 228).

5.1. China’s Motivations in SCS

Schmidt (2008) asserts that China’s interest in the region is underpinned
by the following: (1) increase in ODA and trade; (2) increase in inward
and outward FDI; (3) China’s need for natural resources such as oil, gas,
and energy; and (4) China’s defence and diplomatic priorities.

Majority of China’s overseas investments are marked by resource-
based extraction activities such as the ones in Australia, Indonesia and
Thailand. Chinese state-owned enterprises (SOEs) and several private
companies are “investing heavily in mining, natural gas, and logging”
(Schmidt, 2008: 28) in the region. Aside from this, Chinese companies
also settled to ASEAN and established new production platforms.
Besides from Myanmar’s natural resources to Indonesia’s natural gas,
China has also invested in several infrastructure projects in the
Philippines, Laos, Thailand, Cambodia, and Singapore.

As China is the world’s second-largest oil consumer, and since
1993, a net-importer of crude oil (Schmidt, 2008) of which 80 percent of
those imports pass through the Malacca Strait, it is vital and imperative
for China to secure passage of its imports. To this, Schmidt (2008) sees
that China desires to secure supplies and resources in the form of oil, gas
and other natural resources by land and sea. Its actions in the South
China Sea, along with its infrastructure agreements with ASEAN
countries reflect this desire. The infrastructure it funds and builds, from
the roads, ports and dams, to the railroads and airfields in ASEAN
countries all support this overall strategy (ibid.).
5.2. China’s Strategies in SCS

China invests heavily in ODA in SEA, while consolidating control over the contested islands in the South China Sea. One of the most notable ways that it employs to consolidate control is modernising its military and building structures in the contested islands in the SCS.

Today, China has the largest military in the world. After 20 years of stagnation\(^\text{15}\), China has pursued a comprehensive military modernisation programme since the late 1990s which aimed to improve its armed forces’ capacity to fight and win short-duration and high-intensity regional military conflict (U.S. Office of the Secretary of Defense, 2013), and address a wide range of PRC objectives including advancing territorial claims. This modernisation has greatly increased its capabilities relative to its neighbours. While the US still spends more on defence than any other country (43 percent of global military spending)\(^\text{16}\), China’s spending continues to increase. Accounting for 6.2 percent of global military spending, China increased its budget by 17.8 percent in 2007, and 17.6 percent in 2008\(^\text{17}\), the latter being the eleventh successive time the PRC approved a double-digit increase in defence spending (Herrington, 2011; Fenby, 2012) and the time when China was hailed for the first time as the world’s second highest military spender.

In this modernisation, China aims to reach critical military benchmarks by 2020, which include, among others, the attainment of the capability to fight and win potential regional conflicts and the defence of territorial claims in the South China Sea and East China Sea. As such, its main thrust of modernisation and expansion is at the sea following Hu Jintao’s call for the navy to “make extended preparations for military combat” (Fenby, 2012; U.S. Office of the Secretary of Defense, 2013). Through modernising its military, China believes that it can deter actions by outside powers that could damage Chinese interests or defend itself
against such actions should deterrence fail (U.S. Office of the Secretary of Defense, 2013).

5.3. Stance of SEA States on the China’s Actions
Shekhar (2012) argues that SEA states have divergent opinions on China’s actions, as reflected in their foreign policy stances and responses. While Thailand and Malaysia have strong economic relations with China, the Philippines and Vietnam hardened their stances against China amidst the South China Sea disputes. The increasing apprehension of these latter states is exacerbated by China’s statements, such as the statement by then-Foreign Minister Yang Jiechi that “China is a big country and other countries are small” (Abb and Strüver, 2015: 35). Meanwhile, Zhang, Li and Cheong (2017) states that that Vietnam has already agreed to do bilateral negotiations with China.

ASEAN as a regional bloc remains to be divided on how the “dispute is to be settled” (ibid.: 131), as its member countries do not all have claims in the disputed territories and have not experienced clashes with China (Abb and Strüver, 2015). Abb and Strüver (2015) propose that as a group, ASEAN takes a middle position, gravitating towards contestation and accommodation of China’s policies, depending on the current – and changing - domestic and international circumstances.

Shekhar (2012) notes that ASEAN efforts at regional integration is threatened by instability and insecurity, of which one of the major causes is China’s actions in the South China Sea. While ASEAN wishes to engage China in multilateral forums with the hopes of precluding it from engaging bilaterally with each ASEAN member state, China uses the same avenue to “extend its regional influence” (Schmidt, 2008: 40) through engaging SEA states bilaterally. China’s preference for bilateral agreements is observable as early as 1999, when it has successfully concluded agreements with each ASEAN country. Multilateral forums
have become China’s avenue to engage with each of the ASEAN member states individually, with the aim of concluding more bilateral agreements.

6. China’s Exercise of Sharp Power: Political, Economic and Regional Security Implications

Chinese influence is attracting increasing attention from around the world. There is a general consensus that PRC is boosting its attempts to make friends and influence people, particularly its neighbour. From the elucidation of how China utilises its *sharp power*, this section focuses on how SEA perceives China. Essential to this is a discussion on China’s relationship with Cambodia, Laos, Myanmar and Vietnam (CLMV), as well as how China’s *sharp power* poses several implications for the sustainability of regional trade.

6.1. China’s Relationship with CLMV

Ba (2014) notes that while China has more volume of trade with the original ASEAN-5 countries, it is more active in Cambodia, Laos, Myanmar and Vietnam (CLMV) in terms of infrastructure development and investments in capacity building and human resource development. The CLMV is also where most loans and grants are accorded.

Myanmar and Cambodia are seen as very close to China in terms of economic, political and military agreements. Several military agreements are signed which is marked by China providing arms to the two countries, as well as funding for training and procurement of equipment. While China sees its actions as a “win-win situation for all” (Schmidt, 2008: 28), some trade agreements have produced fears of “economic dependence and political domination” (*ibid.*), especially on the part of Myanmar, Cambodia and Thailand.
6.2. **Regional Trade Implications**

At present, the international division of labour is still leaning towards the newly emerging economies, with services and manufacturing comprising most of the movement from the west to the east.

The decline of SEA exports in the Western markets due to increasing protectionism has led SEA to look inward, especially to China, for trading (Shekhar, 2012). As to the volume of goods traded, the surplus of goods from China poses a threat to the competitiveness of SEA’s domestic products. Schmidt (2008) argues that China has a “comparative wage advantage” (p. 29) because it has the “lowest labour unit cost” in East and Southeast Asia.

Schmidt (2008) claims that China’s want of FDI and export structure is similar to that of ASEAN countries – that the products are labour-intensive and technologically complex, with destinations to EU, US and Japan. Wong and Chan (2003), as cited in Schmidt (2008), traced that Chinese firms are even driving away local firms for market shares. The example of TCL driving away Sony and Samsung in Vietnam and gaining 15 percent market share within three years of entering the Vietnamese market is a tangible illustration.

6.3. **“New Voices” on BRI: China’s Neighbours Say “No!”**

China’s flagship Belt and Road Initiative (BRI) is dealing with ever-greater resistance, slowing a momentum that once seemed unstoppable – Sharma (2018) even argues that the BRI is stalled. This is clearly evident from the “new voices” coming from Southeast Asia and the rest of China’s neighbours – Malaysia halted Chinese projects worth US$22 billion; Pakistan, Nepal and Myanmar have cancelled or sidelined three major hydroelectricity projects worth nearly US$20 billion planned by
Chinese companies. These declarations come as a serious jolt to BRI and its image.

China is not used to recipients of its largesse challenging the terms on which it is offered. However, Malaysia’s 93-year-old new prime minister Dr Mahathir was plain-speaking and deft, showing to China that his country is now “the Malaysia that can say no”. He said that Malaysia is cancelling the US$20 billion East Coast Rail Link, a massive Belt-and-Road project, as well as two oil pipelines in the state of Sabah. His message, in essence, was: very sorry – lovely projects, but since coming to office we’ve discovered we can’t afford them. Implicit was another point: we can’t afford them because we now know how inflated the costs are, and how skewed the deals are in China’s favour – or plain fishy (The Economist, 2018).

Pakistan’s new prime minister Imran Khan18 in cancelling the US$14 billion Diamer-Bhasha Dam project, cited tough financing terms imposed by China as the reason. Pakistan is by far the biggest debtor to China. Also, Nepal’s deputy prime minister19 recently announced a decision to scrap a US$2.5 billion contract for a hydroelectricity project, accusing the Chinese company of financial irregularities. In the case of Myanmar, which halted a US$3.6 billion Chinese-backed dam three years ago, it declared that it no longer is interested in big hydro-electric power projects.

These “new voices” from China’s neighbours could mean a serious loss of image for BRI (The Economist, 2018), which involves plans to build infrastructure across the globe, including in developed countries like the United States and those in Europe.

Though China has the tendency to launch tirades against countries that confront it (ibid.), in this case the response from Beijing has been muted. That may be partly because Malaysia is an influential country in SEA, a region that China wants to draw closer into its orbit, and China
does not want to make enemies among Belt-and-Road countries. Moreover, officials in Beijing see Pakistan as a counterweight to India, China’s geostrategic rival. China needs Pakistan’s help in keeping Islamist extremism at bay, and regards its neighbour as a vital route to the Arabian Sea.

6.4. China’s Bid for Regional Hegemony?

Ba (2014) states that in International Relations theory, the term “leadership” is always associated with the term “hegemonic” or “major power”, and always goes with the supposition that these “major powers” gain following because of their capacity to provide public goods and distribute benefits, and/or the followers being out of fear of missing out or “retribution” (ibid.: 144) from the major power. However, what is not always captured in the literature and theories is the “acceptability” and “recognition” dimension of “leadership”: that is, how the would-be followers view or perceive the would-be leader. Hence, Ba (2014) asserts that aside from material power and what the emerging power can provide, acceptance of would-be followers also matters in assessing the potential of an emerging power. This acceptance or perception is constantly changing, and is a “socially-negotiated one” (ibid.: 146).

Vu (2017) notes that China’s rise since 1997 was towards being a regional leader. Ushering in a “China century”, China was instrumental in the maintenance of a stable regional order following the Asian Financial Crisis. However, the reaction and acceptance of Southeast Asian countries were varied. Vu (2017), from his research with data spanning from 1997 to 2013, found out that there were cases where China was successful in steering an initiative, such as the creation of the China-ASEAN Free Trade Agreement signed in 2002. Nevertheless, mirroring this are cases where China was not successful in leading an endeavour, such as the East Asia Summit of 2005 where China would
have wanted the Summit to be based only on ASEAN Plus Three countries and not to include other countries outside it. China actively “lobbied for the exclusion of not only the United States but also India, Australia, and New Zealand” (Singh, 2015: 90). However, this was rejected by the majority. Ultimately, the Summit included emerging powers outside the East Asian Region such as India, as well as great powers outside it like the United States.

China is seen time and again as declaring that it does not intend to replace the United States as a regional power (Tai and Soong, 2014). It sends its leaders to SEA states regularly to abate fears and worries about China’s actions. However, its expressed lobbying on the exclusion of several powers from the East Asia Summit is the opposite of that. Manifestations of the success of the emerging power’s leadership projects is the establishment of a political-military alliance in both the multilateral and bilateral levels. What is noteworthy in these alliances is that the organisation or the alliance itself only has the emerging power and the lesser states – it excludes other “powers” (Vu, 2017).

On the side of ASEAN, Vu (2017) points out that SEA considers China as a regional leader but only in some cases. Regional dynamics is still at play, especially with ASEAN member states who prefer to engage multilaterally, as opposed to China that prefers bilateral negotiations. In addition, the lower power capabilities of SEA relative to China’s lead the bloc to “bandwagon” instead of “balance”, which is seen in how ASEAN values consensus in decision-making (Abb and Strüver, 2015).

Vu (2017) states that China’s position within the SEA is improving; however, having a China-led region is still far from reality. There is as yet no organisation in the region where China has the monopoly of involvement with the SEA states – it has always been with other powers, such as Japan, India, and/or the United States. China is also not yet accorded veto powers in institutions of which it is a member. Despite
this, given the dynamic nature of global politics today, the era of a Southeast Asian region marked by Chinese leadership may come sooner rather than later since it is undeniable that China, because of its nuclear capability, permanent status in the United Nations Security Council (UNSC), large-size armed forces, and the PLA, has a special place in Asian security and strategic order (Flores, 2017).

7. Conclusions

In employing process tracing, this paper established the link between economic and political wherewithal and its translation into “sharp power” characterised by “assertiveness”, with the South China Sea theatre as the case in point and the triangular relations between China, Taiwan, and Southeast Asia as the subjects. In doing so, this paper demonstrated how the subjects share intertwined, interconnected and interdependent political, economic, trade and cultural histories, and how these histories traverse and transcend into the current geopolitical space – specifically, that of the rival claims in the South China Sea. Through this elucidation, it is clear that the proactive and reactive stances, as well as responses, are in constant flux – always undergoing construction and reconstruction, depending on the respective circumstances of these states in the domestic and international sphere.

Zeroing in on specific cases and instances, this paper also traced and dissected how these stances and responses root from projections of power. It is interesting to note that sharp power projection is already deeply entrenched and interwoven into the political, economic and social realities of China, Taiwan, and Southeast Asia. Conversely – and ultimately – these realities feed into, and continue to shape and reshape, the states’ foreign policies. What happens next in this amphitheatre is a compelling and intriguing development to see.

Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) • 2018
Notes

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1. China, Taiwan, Vietnam, Malaysia, the Philippines and Brunei all have claims in the South China Sea founded on a variety of historical, territorial and legal issues.
2. By the mid-1970s, most of Southeast Asia had switched formal diplomatic recognition to China. In August 1990, Indonesia was the first major country in the region to do so, followed by Singapore in October 1990 and Negara Brunei Darussalam in October 1991. Vietnam suspended its relations with China in the late 1970s, but in October 1991 it too restored formal relations.

3. Four of the seven elements of the Good Neighbour Policy have to do with Southeast Asia. See S.D. Muni, *China’s strategic engagement with the new ASEAN*, IDSS Monograph No. 2 (Singapore: Institute of Defense and Strategic Studies, 2002), p. 16.

4. In the 1990s, Taiwan government allowed only the indirect investment to China. The indirect investment channels included (1) a branch of a Taiwan company established in a third country; (2) another company located in a third country; (3) a company in a territory outside mainland China; (4) indirect remittance of their investment from a third country to China (Lin, 1997, p. 29).

5. Washington has repeatedly asserted that the goal of its pivot, designed to shift some 60 percent of American overseas-based forces to the Asia-Pacific by 2020, is not aimed at containing China. Nonetheless, the policy has triggered “Chinese anxiety about U.S. containment” (Glaser, 2012).

6. The Spratlys region consists of 230 islands, reefs, cays, and banks.


8. In 1947, Republic of China internally circulated an atlas, drawing an eleven-dash line to indicate the geographical scope of its authority over South China Sea. Two dashes were removed from the eleven-dash line in 1953, when the territorial title for the Bach Long Vi island (Gulf of Tonkin) was transferred from China to Vietnam. The first two lines lay within the Beibu Gulf or Gulf of Tonkin, bordered by Vietnam and China. When the
nine-dash line emerged in the 1950s, the two states were politically close, with each having a three-mile territorial sea. Also see the eleven dash-line map of South China Sea claim at: <http://isdp.se/publication/understanding-chinas-position-south-china-sea-disputes/eleven-dash-line-map-of-south-china-sea-claim/>.


11. One of President Tsai’s high-level engagements was during the Asian Dialogue for Innovation and Progress that gathered a few high-level current and former government officials, scholars, entrepreneurs, and NGO leaders from target countries for the New Southbound Policy, as well as from the United States, Japan, and South Korea, to discuss economic and social connectivity issues in the region.

12. Joseph Nye defines “soft power” as “the ability of great powers to obtain cooperation and alliance of other states within the world international order” (Aljunied, 2011: 655) through persuasion, cultural exchanges, and common values, among others.


15. For further information, see Lee (2011).

16. For further information, see Fenby (2012).

17. Stockholm International Peace Research Institute (SIPRI) estimates China’s military expenditure to have been US$84.9 billion during this year.


**References**


Economics.
The Elephant and the Dragon
Chinese and Indian Public Pension Systems and Universal Old-age Security in Times of Rapid Demographic Changes

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Abstract
India and China have become countries of rapid economic growth and at the same time of socio-economic contrast. The classical old-age security arrangement has focused mainly on the formal sector and excluded a majority of the population working in the informal sector. Consequently, along the road of economic growth, increasing living standards and higher wages, a good proportion of the population are threatened by old-age poverty. Elderly people in rural areas, people in precarious employment situations, such as migrant workers, disabled and sick people belong to the high risk-group of people at risk of old-age poverty due to the lack of old age security arrangements for these groups in the informal sector. In times of rapidly aging societies and growing socio-economic disparity, New Delhi and Beijing have realized the increasing importance and urgency of extending pension coverage to all parts of society. In recent years decision-makers in both countries have made huge efforts to reform their pension systems and to alleviate poverty
among the elderly today and in coming years. The political commitment is closely linked to the demand for output legitimacy to gain public support from these groups. Contrary to the theoretical imperative of the superiority of democracies, China seems to be doing much better than India in the provision of universal coverage for the informal sector. To answer the puzzle, this article examines the impact of institutional features and socio-economic characteristics on the pension policy process. It is argued that country-specific institutional settings and political commitments affect the learning ability in the policy making process, which determines the output performance of pension politics and the realization of universal coverage for old age security in the informal sector.

**Keywords:** old-age security, informal sector, demographic growth, pension system, social security, China, India, learning capacity

1. Introduction

The official announcement that India is planning to enter into Social Security Agreements with China in 2017 is not surprising at all. Despite political and economic competition for control of the Himalaya region, the maritime trade roads through the Indian Ocean and dominance of the Asian market, India and China are two of the most populated countries in the world. Both are facing similar challenges of rapidly aging societies and the threat of widespread old-age poverty. These target groups for old-age poverty are not marginal. These are people who could not benefit from the economic boom of the last decade, such as elderly people in rural areas and people in precarious employment situations, including migrant workers, disabled people, and the mentally and physically ill. They “do not have access to pension plans organized or run by employers, may lack official registration papers or other
documents which could help the relevant authorities target them for other schemes, may change jobs frequently and often live and work in rural areas in which financial infrastructure is poor or non-existent” (Hu and Stewart, 2009).¹

The good news is that decision-makers in Beijing and New Delhi have begun to address the issue of missing old-age security for the majority of their society. In a rapidly aging society of growing income disparity and a traditionally strong informal sector (Esping-Andersen, Gallie, Hemerijck and Myles (eds), 2002), both governments have been preoccupied with the process of overhauling the design of pension schemes and reforming the limited coverage for the formal sector.

2. Defining the Puzzle

It is noteworthy that India and China have attempted to expand their old-age safety nets in the 1990s and early 2000, but the schemes were still neither strong nor popular enough to protect most of the risk-groups of the elderly population from falling into old-age poverty. Another issue has been the focus on the formal pension system to close the gap but these public schemes have traditionally been a very strong link between pension entitlements and pre-retirement earnings. Therefore it is unfit to cover the informal sector. As a consequence, large sections of the population are employed in precarious employment situations in the informal sector and do not have either access to or the money for the classical formal pension schemes.

Recently the socio-economic and public reform pressure and increasing political commitment for universal old-age security have initiated deep reforms of the existing pension system in both countries. Still, barely 34 million (or less than 12 percent) of the estimated 58 million-strong working population in India are eligible to participate in
formal provisions meant to provide old-age income security (OECD, 2015). However, the Indian National Surveys from 2014\(^2\) stated that less than 11 percent of the elderly population has a pension of any sort. Contrary to India, in China nearly 860 million Chinese residents have been covered by one of the three public pension schemes introduced, which account for 86 per cent of the total adult population in the last few years.

3. Core Question

The literature on welfare states and the democratic system tends to generalize the advantage of democracies for providing old age security. Despite the argument found in the welfare literature (Esping-Andersen, 1990), China seems to have been more effective in expanding its universal non-contributory old-age security net, with universal coverage for the majority of its population.

China has achieved unprecedented improvements in its pension coverage in the last five years. Between 2009 and 2015 the coverage ratio of the rural residents jumped from 33.26 million to 463 million (Liu and Sun, 2014). Roughly 80 percent of the total population is entitled to an old-age security scheme in China. In India the progress and policy outcomes of pension reforms and opening of the pension system for the informal sector fell short of any expectations. It is assumed that only 35 per cent of senior citizens are entitled to some kind of pension. As a consequence it is assumed that 20 million or 61.7 per cent of India’s elderly population will be without any income security by 2050 (OECD, 2015).

Accordingly, the question arises: Why is China doing better in the implementation process of setting up universal non-contributory old-age security for its citizens?
4. A Different Argument: Relevance of Institutional Learning

In this article, it is argued that the current pension systems in India and China are products of complex and dynamic processes. Although both governments have aimed to set up universal old-age pension schemes, the policy outcomes vary across both countries. Accordingly, the argument is two-folded. Departing from a new institutional approach, the political is seen as a main driving-force for expanding the safety net. But it is argued that besides the political commitment and socio-economic factors, the institutional performance is determined (1) by the implementation process and in particular (2) by the institutional learning capacity of the institutional actors. It should be noted that this article does not attempt to compare the two country-specific pension systems with each other but focuses on the relevance of the policy implementation process and the learning capacity of institutions and actors in both contexts.

Public policies are formed, implemented and evaluated. The precise nature varies from country to country according to the political, historical, and socio-economic features. Following Esping-Andersen et al. (eds) (2002: 25), “the single greatest challenge we face today is how to re-think social policy”. Accordingly, for any reforms or pension policy process a political commitment is needed which explains the driving force behind the policy process. Implementation forms a phase within the policy cycle which can be broke down to five components: the problem definition, agenda setting, decision making, implementation, evaluation and re-definition or termination proposed (Blum and Schubert, 2009: 102). Specific policy choices and goals are set by decision-makers and handed down to institutions and institutional actors for implementation and evaluation. The higher the room to manoeuvre for institutions and actors to evaluate and adapt, the higher
the learning capacity and therefore the possibility of higher policy output performance.

In the following discussion the political decision-making are considered as independent variables and the pension policy results are considered as dependent variables.

5. Solving the Puzzle: Socio-economic Pressure on Policy Choices

In recent decades, India and China have been mired in deep structural pension reforms to expand universal coverage. As Whitford (2002) argues, political interest is triggered when environmental pressures alter the effectiveness and legitimacy of prevailing policy. Or as Radaelli (2009) points out, reforms or policy transfers are driven by legitimacy deficits. Hence, it is argued that adequate pension politics is not only about preventing poverty; it is about gaining public support or output legitimacy.

All political systems seek legitimacy and support. Although governments in democracies and autocracies have different instruments for establishing political stability and legitimacy, what both systems have in common is the demand for measurable policy outputs and outcomes. One main instrument to achieve support and socio-economic outcomes is social policy making – or to be specific, the provision of old-age security, especially for those segments of society which do not participate in the economic process. In countries with high poverty rates among the elderly and low safety-net benefits, the disparity or gap in living standards and old-age security mechanisms between specific socio-economic groups and/or regions tends to reduce the legitimacy of governments (ibid.). One major environmental pressure or legitimacy deficit for modern Asian states such as China and India (Sadhak, 2013; Liu and Sun, 2014) is the missing coverage in the existing pension funds
of the majority of the rural population and in the pension funds of workers in precarious employment situations.

To elaborate this argument, a brief historical account of early modern welfare states and their pension systems is needed. The early modern roots of welfare states can be traced to at least the late nineteenth century in the Danubian Monarchy and Weimar Republic, which illustrate the relevance of pensions as instruments to gain the support and loyalty of specific segments of society. Following the rise of modern welfare states in the West and Eastern Europe, old-age security has become the main instrument of the state for building up a safety net for pensioners and the elderly which provides financial benefits to guarantee old-age security. Hence, it is assumed that universal old-age security provision by the government aims to satisfy the demands of stakeholders/pensioners. Eastern European countries provide evidence of the desire of governments to build up self-sustainable pension systems by balancing funding and benefits. Since the rise of the modern welfare state, one main instrument to gain support from citizens or specific groups has been the provision of old-age security for these target groups. In the early day of the Bismark system the target group was state employees and later on the welfare states paid attention to the working class and low-income segments of society.

6. Output Legitimacy and Pension Coverage for the Informal Sector

How to explain the shifting policy attention toward the informal sector? In both Asian countries the workforce in the informal sector represents a major part of the population as well as an engine of domestic trade and service sector. Accordingly, the interests of this group should not be underestimated as stakeholders and for socio-economic development and political support. In India’s democratic system of fair and free elections
the political support of the majority of the Indian population is essential for any political party. The policy-seeking model assumes that any party would want to have as much impact on public policy as possible. Parties are focused on their ideological commitments and how to change the current system in regard to their political goals and electoral promises. It is assumed that citizens of democracies support a certain political party exactly because it makes a difference and is in line with what they want the country to achieve (Størm et al., 2008).

In most autocracies the lack of elections and feedback channels reduces governments’ legitimacy options. Various instruments can be used to overcome these limitations. One main instrument is output legitimacy. In short, the government legitimates itself by referring to its measurable outcomes and the benefits of its reign for all segments of society. Accordingly, the socio-economic situation of the population is relevant policy field for internal and external legitimacy. Providing old-age security means output legitimacy and social legitimation through public support of the system by the pressure group/stakeholders.

The close link between legitimacy and stakeholder interests is pointed out by Freeman (1984: 45): “Stakeholder connotes ‘legitimacy’ ... Hence legitimacy can be understood in a managerial sense implying that it is ‘legitimate to spend time and resources’ on stakeholders, regardless of the appropriateness of their demands.” Or as Nicolodi (2007: 75) notes, the legitimacy of a sustainable pension fund requires coherent answers with regard to the legitimacy of multiple stakeholder interests. Furthermore, he argues that “stakeholder relationships are influenced by and formed according to the economic and/or societal interests involved.” To sum up, in modern Asian states a majority of the population still works in the informal sector and is threatened by old-age poverty due to a missing old-age security system.
7. The Demand for Institutional or Policy Learning Ability

Coming back to the core question on the higher performance of the Chinese policy-making process, the article highlights the relevance of institutional learning capacity to adjust and reconfigure policy choices to conform to social realities. The notion of “policy learning” is essential to the policy-making process; however, learning ability is seen by most analysts as a by-product of the institutional structure (Kohler-Koch, 1996). A common consensus in comparative literature is that the country-specific and system-specific institutional structure matters in determining the “room to maneuver” for decision makers and the learning capacity of institutional actors (Streeck and Thelen (eds), 2005). The complexity of the interaction between the formal and informal factors and the resulting “rules of the game” are highly relevant for understanding contemporary policy choices. Public goods and public policy making are instruments for the government to steer the development process and gain desired outcomes. Stein Ringen (1987 / 2006: xlvi) reminds us that the “welfare state is reform on a grand scale”. It is an attempt to change the circumstances in which individuals and families live. Gøsta Esping-Andersen (1990) and Anthony Giddens (1998) advocate the use of a theoretical institutional approach to determine the departure from the institutional and ideological foundations of the modern welfare state and its social security provisions. Following an institutional approach, institutional learning capacity is seen as the function of adaptable systems of “governance under uncertainty” (Richardson, 1996: 30). The interaction between institutional actors, regional and local systems of governance and the capacity of the central government is essential for institutional learning capacity, particularly in the process of policy making and the pushing through of unpopular but necessary social reforms with the consent of opposition parties, trade unions and employer organizations (Palier (ed.),
2010). Public administration literature has given evidence of the stronger attributes of local institutional actors, such as local administration, expert committees or bureaucrats, and their key role as “idea brokers” and “bridge builders” to facilitate the deliberation and dissemination of policy-relevant ideas (Lindblom, 1978; Verdun, 1999). In pursuit of “learning by doing” or “learning by past successes and failures”, institutions can adapt to long-term rather than specific conditions, which heavily improves the outcomes (Garmise, 1995). But as Hall (1993) remarks, learning capacity requires institutions flexible enough to implement necessary changes but at the same time capable of coming to the right conclusions. Rhodes and Meny (eds) (1998) conclude that dialogue among actors is mostly relevant to allowing the learning capacity of local institutions as well as the ability of local governments to actively learn from their counterparts. Hence, the degree of decentralization of the administration is highly relevant for such an interaction to offer the local governments sufficient financial and administrative leeway to realize structural reforms (ibid.). Paraskevopoulos (2001) concludes that the crucial prerequisite for institutional learning and adaption is “certain capacity for collective action at regional and local levels which facilitates the shaping of the system for interaction and coalition-building among key social and economic actors.”

The pragmatist governance approach stresses that effective problem-solving capacity demands learning capacity. Cohen and Sabel (2002: 313) emphasize that “collective decisions are made through public deliberation in arenas open to citizens who use public services, or who are otherwise regulated by public decisions. But in deciding, those citizens must examine their own choices in the light of relevant deliberations and experiences of others facing similar problems in comparable jurisdictions or subdivisions of government. Ideally, then,
directly deliberative polyarchy combines the advantage of learning and self-government with the advantages (or discipline) of wider social learning and heightened political accountability that results when the outcomes of many concurrent experiments are pooled to permit public scrutiny of the effectiveness of strategies and leaders.” In particular, the empowerment of involved actors (Cohen and Sabel, 2002) produces “iterated co-design”, “benchmarking” and mechanisms of “error-detecting”, which demand effective learning capacity. For these authors learning capacity is synonymous with democratic institutional design and participation but autocracies tend to be innovative as well. Despite theoretical assumptions, various studies have produced evidence that consultative and deliberative practices are utilized by authoritarian systems to gain policy legitimacy, information and output performance (He and Warren, 2011). Various authors have argued that autocracies tend to counterbalance missing feedback or input dimension to gain a decent degree of “public feedback” and information (Evans, 2011).

What follows is an investigation into the current socio-economic and institutional features that determine to a decent degree the policy choices and outcomes of modern pension systems and their development in India and China.

8. Demographic Pressures and the Legitimacy Deficit in China and India

The most pressing concern for both countries with growing elderly population is to provide old-age security schemes (Sadhak, 2013). To begin with, what is required is an adequate understanding of the development of contemporary pension reforms and the demand for constant adjustment of these reforms in light of changing socio-economic realities.
Figure 1 Decline in the Support Ratio, 1960-2060


Demographic development is a key impetus for public policy and pension politics. In rapidly aging societies, and in most Western democratic countries, the ratio between retirees and the workforce has rapidly altered, threatening the long-term financial funding of the pension system for future generations. Over the medium term the demographic situation and available workforce in both countries are still
favorable until 2050. However, the population pyramid in both countries is narrowing due to the increase in life expectancy and a decline in the birth rate. Demographic tendencies in the two Asian countries are flanked by higher life expectancy – what is called aging. A shrinking working-age population comes with a decline in the pension support ratio, which in turn burdens the sustainability of the pension system.

The predictions show that the Indian population is rapidly growing and indicate that the Chinese population is aging faster. Among the major economies in Asia, India’s birth rate is well above the replacement level of 2.1 at the moment but with a constant decline similar to the trend in the OECD countries (OECD, 2015). The overall age structure of the Chinese population is different from that in India, but both countries face similar issues as rapidly aging societies. The current UN projection is that India, with its current population of 1.2 billion people, will overtake China as the most populous country in 2022; other projections say that will happen earlier, in 2028. By 2050, life expectancy at birth is projected to reach 74 years. While the population of working-age people in India will increase to 1,143 million by 2050, the absolute number of elderly people will also rapidly rise from 90 million to 332 million or from 16 percent today to 34 percent in 2050 (Bloom, 2011; United Nations Population Division, 2011).

As indicated by all available figures, the need to adjust the pension system to reflect demographic changes is higher in China than in India. However, both governments are facing a rapidly aging population and the accompanying challenges for the sustainability of their pension systems.
9. Today’s Challenge: Low Benefits and Missing Coverage of At-risk Groups

The second major challenge for adequate pensions for current and future retirees in the informal sector relates to the level of benefits. In particular, as will be discussed, the old-age security schemes for the informal sector are neither sustainable nor do they provide adequate old-age security given a shrinking workforce and declining individual pension contributions.

Figure 2 Full Minimum Pensions as Percentage of Average Earnings

Note: Among countries with minimum pension arrangements in place, the full benefit is equivalent to 25% of average earnings on average compared to 20% in the basic pension scheme (OECD 2015).

The data from China’s 2010 population census indicate that as far as the main sources of support for people aged 65 and over are concerned, 49 percent comes from the support of other family members, 20 percent comes from their labor income and 25 percent from pensions for elderly
and retired veterans. As they get older, the elderly gradually lose labor capacity and rely more and more on the support of other family members. For people aged 65, 40 percent have labor income as the main source of support; for 70 year olds, the percentage drops to 23 percent; for people aged 80, it is five percent. At the same time, 31 percent of people aged 65 have family members as the main source of support; for people aged 70, it is 44 percent, and for people aged 80, the number rises to 63 percent (Population Census Office, China, 2012). One important point is that a small proportion of the elderly population receives pensions for the elderly and retired veterans as their main income source, and most of these people live in urban areas. The social security systems for the elderly who live in rural areas are at a low level. On the other hand, the percentage of elderly people in poor health who name pensions for the elderly and retired veterans as their main income source is less than 20 percent, while the proportion of older people who primarily depend on the support of other family members is around 70 percent. In 2013, the monthly per capita pension provided by the basic endowment insurance for urban and rural residents was only 82 yuan; in 2014, it was 90 yuan (14 USD per month) (Caijing Net, 2015), which is far from enough to cover someone’s daily needs. In 2014, the average monthly pension for the elderly and retired veterans (according to the basic endowment insurance for workers) was 2,061 yuan (318 USD per month). To supplement this shortfall, the government has been promoting a basic pension for urban and rural residents who are not necessarily formally employed. This scheme requires residents to pay contributions into an individual account for at least 15 years before becoming eligible for a pension upon retirement. The fund is subsidized by the government but monthly pay-outs, especially in rural areas, are generally very low. Indeed, official figures show that the average pay-out for the 148 million people receiving benefits in 2015 was just 1,432
yuan for the whole year. By contrast, the average annual pay-out from the basic urban pension fund was 28,363 yuan.

In India the replacement rate of the formal pension system is extremely good. Unfortunately, only a marginal portion (around 9.1 percent) of the workforce is entitled to these pension schemes. In 2010, about two thirds of the elderly lived in villages and nearly half were of poor socio-economic status (Lela et al., 2009). Half of the elderly are dependents mainly due to widowhood, divorce or separation, and a large number of these are female (Rajan, 2001). About 60 percent of the elderly depend on others for their day-to-day maintenance while less than 20 percent of elderly women and a majority of elderly males were economically independent. Among the economically dependent, 85 percent of men and 70 percent of women were supported by their children. Of the economically independent elderly, more than 90 percent supported one or more dependents. Nearly 40 percent of elderly, 60 percent of whom are males, were working; the proportion was higher in rural areas as 66 percent of rural men were working compared to 39 percent of urban men (Population Census, India, 2001). Another issue is that the existing monthly pension benefit is lower than 10 USD PPP, representing less than 5 USD a month (ILO, 2015). With little old-age income support and few savings, labor force participation remains high among Indians aged 60 and older (39 percent), and particularly high among older rural Indians (45 percent) (Uppal and Sarma, 2007). In the future, Bloom (2011) argues that India’s system of family-based support will not be able to withstand the increased numbers of older Indians. The 2005-2006 National Family Health Survey in India examined living arrangements by household. The survey found that more than four out of five (78 percent) Indians aged 60 and older lived in the same household with their children, while about 14 percent lived with only a spouse and five percent lived alone (Kumar, Sathyanarayana and Omer, 2011).
During the same period, the share of older Indians living with their children declined by about seven percentage points.

Old-age poverty is present and will be an issue in India as well as China. For the target group of informal workers and rural citizens, the provided pension benefits cannot meet the daily costs of living. Despite the fact that the replacement ratio of the public pension schemes for government employees is high in both countries at 97 percent for average earners in India and 94 percent for average earners in China, the minimum pension scheme benefits are extremely low at two percent in China and three percent in India. Surveying the data makes it clear that India is even more pressured by a majority of elderly people with no or low pension arrangements.

10. A Political Commitment to Expanding the Pension System

In light of the issue of old-age poverty, pension politics have become a significant policy concern (Sadhak, 2013; Liu and Sun, 2014). As argued earlier, the socio-economic situation of elderly people without access to public pension schemes has worsened. One main reason is the socio-economic processes that have increased income disparity and living costs. Another relevant factor is the eruption of traditional family systems that functioned as old-age security schemes.

As the economic growth rate slows in pace, both governments have paid more attention to the provision of old-age security nets for the informal sector (OECD, 2015). These target groups are becoming more vulnerable to old-age poverty and still represent a large segment of the population (Sadhak, 2013). Accordingly, the coverage gap in old-age security has become a national and international legitimacy gap for both countries. In recent decades both governments have been devoted to addressing the coverage gap.
Given such challenges and the resulting legitimacy deficit, decision-makers in New Delhi and Beijing have been under pressure to reduce old-age poverty and improve the coverage of old-age security for all segments of society. Having learned that mandatory or quasi-mandatory pension systems for the formal sector are not well prepared to provide universal coverage, both governments have sought to introduce new benefits schemes for the informal sector.

While the goal has been the same, the output policy performance in the policy field differs significantly which cannot only be explained by the variations of socio-economic factors. Policy output performance is heavily linked to the institutional performance and the underlying learning ability of the institutional actors.

11. The Case of India and Its Missing Coverage: A Learning Deficit?

As indicated by the national surveys (OECD, 2015), roughly 12 percent of the population are covered by the formal pension system and the majority of elderly people depend on traditional but fading family support, community services and/or charity. Unlike the unified Chinese pension system, India’s pension system is characterized by fragmentation, which challenges the social safety program, (mandatory and voluntary) occupation-related schemes, and individual voluntary arrangements (Steward and Yermo, 2008). One reason for the fragmentation is the policy behavior and strong path-dependency in pension politics. Reforms of the formal and overgenerous pension schemes for civil servants and public administration are less likely realized due to the political system and the strong pressure group of stakeholders.
The focus on the formal sector is grounded in the historical development of the pension system in India. Since the early beginning which dates back to the colonial period of British India decision-makers mainly focused on the experiences in Europe and old-age security for civil servants, public administration and the working force in the formal sector. The Royal Commission on Civil Establishments introduced in 1881 provides pension benefits to government employees. The Government of India Acts of 1919 and 1935 made further provisions which paved the way for the Central Civil Service Pension Scheme and the Civil Service Provident Fund established in 1972 and 1981. The dominant political leaders of the independent Indian Republic followed a Soviet-orientated development approach in pursuit of industrialization. The introduction of a License-Permit-Quota Raj, central planning and a closed economy model did not help to realize the transformation. In the 1990s the decision-makers had to face the harsh reality. The ongoing economic transformation and urbanization promoted a decline of the traditional family system, immense migration of rural residents and an ongoing increase in the life expectancy. In the political arena, the ongoing decline of the dominant Indian National Congress accelerated the political fragmentation and the need of office-seeking parties to include the public demands of the poor majority.

Accordingly, a major political concern has been old-age protection for the informal sector and in particular for the rural population. In 1995 a basic pension has been introduced (will be discussed later). But the government relied on the experience of the formal public pension system. In 1999 a commission has been installed to expand the formal security net to the informal sector which was the birthdate of the new National Pension Scheme or New Pension Scheme (NPS).
**Figure 3** Progress to Universal Old-age Coverage in India

Source: Author’s illustration.

Civil employees of the central government who have joined service on or after January 2004 are covered under the Defined Contribution based on the New Pension System (NPS). The scheme was later consolidated and expanded to provide retirement benefits to the entire public sector. The year 2003 brought about a paradigm shift in the focus of policy making which however did not result in fundamental deep reforms but more or less ad hoc action by introducing a new administrative body, the Pension Fund Regulatory and Development Authority (PFRDA), to oversee the NPS. The NPS was mandatory for all new employees in the formal sector but for the first time was opened for all citizens in 2009. However, the program could not meet the expectation for universal coverage. It is worth noting that although the legislation momentum closed the legal coverage gap, only 12.9 million registered in the NPS in 2016 and 33.6 percent belonged to the formal sector. In 2015 still less than 11 percent of the elderly have any kind of old-age security (HelpAge India, 2015).
The schemes for the informal sector lack behind in their continuity, coverage and legal anchorage. Similar to Beijing, New Delhi attempted to address the low coverage of rural citizens. The flagship in expanding pension coverage is the National Old Age Pension System (NOAPS) that provides a fitting example for the ad hoc politics in changing the range, scope and the program itself. The National Old Age Pension scheme was introduced in 1995 and is part of the National Social Assistance Program. The tax-financed program is a perfect example for the ad hoc policy making following political agendas and not policy learning experiences. It was routinely revamped over the years in its focus and range by the changing coalition governments. In 2000 the decision-makers attempted to close the coverage gap of the NOAPS by introducing the Annapurna Yojana scheme. In 2007 the NOAPS has been merged with other schemes, renamed Indira Gandhi National Old Age Pension Scheme and extended to cover all individuals living below the poverty line. In 2009 the age limit has been reduced and in 2012 the benefits raised. NOAPS covers 7.3 million people but only roughly 30 percent of the poorest elderly with a monthly pension of Rs 75 (1.17 USD) which is extremely low due to the low budget. In 2013 the Task Force on Comprehensive Social Assistance Programme criticized the low benefits. A consequence has been that various state governments have set up their own pension schemes which compete against the national program with higher benefits ranging from USD 2.2 to USD 4.4 per month (Steward and Yermo, 2008). In 2015 the new prime minister, Mr. Narendra Modi, followed the typical attitude of pension politics and revamped the old Swavalan Yojana into a new Atal Pension Yojana to improve the attractiveness and therefore the coverage of the NPS for informal workers. Currently the impact is modest. To sum it up, the NPS characterizes the strong focus on existing and formal pension system to address the issue. Other characteristics are the constant revamping of the
program and its typical top-to-bottom policy scheme, and its being victim to the rapid changing political agendas.

Both schemes, the NPS and the NOAPS, have been implemented without much consultation with lower tiers, and with on-the-go adjustments and a one-size-fits-all approach without considering local schemes or the variations in the living costs across India. Furthermore, not much enthusiasm for addressing the commonly known administrative drawbacks has been shown. The performance of the ad hoc pension initiatives on national level for the informal sector is limited. In the informal sector very few are enrolled in the mandatory pension system and more have to participate in voluntary pension arrangements offered by insurance companies (ADB, 2006; Park, Lee and Mason (eds), 2012).

12. The Case of China and Its Struggle to Achieve Universal Coverage

China undertook deep reforms to improve pension coverage and benefits as well as the output performance of anti-poverty policies. Contrary to India, Chinese policy making aimed to reconstruct the entire pension system (Liu and Sun, 2014). The experiences with the financial drawbacks of the overgenerous pension system in China have produced pressure for structural reforms. The goal has been the financial sustainability and the continuing expansion of the coverage for all segments of society. A consequence has been the step-by-step fundamental reforms since the 1999 until the 2007 of the entire pension system. China has step by step set up a two-tier pension system that includes a basic pension and a mandatory employee contribution to a second-tier plan for urban workers (OECD, 2015).
Figure 4 Progress to Universal Old-age Coverage in India


In the urban areas a mandatory funded pension program has been set into motion. Public sector employees were covered by separate, generous pension arrangements. For the rural population which lacked old-age security the government initiated various pilot projects in 1999. The funded and defined contribution scheme was voluntary. The scheme was based on one pillar. The benefits varied according to the individual contribution over the years until retirement. Only 80 million or 11 per cent of the rural population participated in 1999 and the number dropped to 53.89 million in 2004. In 2009 the OECD survey concludes that still over 60 percent have no access to the formal pension system in rural areas. To close the rural coverage gap the Chinese government redesigned the rural pensions by taking the experiences seriously. A first step was the traditional opening of the entrance to the compulsory public pension system; however the participation rate has been extremely low.
Furthermore, voluntary, occupational pension arrangements have built up but a precondition for these schemes is participation in the mandatory public pension schemes. In addition to these options, similar to India, private life insurance has become more popular due to the flexibility of participation. A key component to providing old-age security and the flagship in fighting old-age poverty in rural regions has been the introduction in 1999 of the minimum income guarantee for poor citizens. The benefits provide an amount equivalent to around 20 percent of the local average salary (Hu and Stewart, 2009). In contrast to India, China addressed this limitation by making the voluntary affiliation of the working-age population a condition for parental receipt of a non-contributory pension (ILO, 2015). A key sign of progress was the launch of the rural residents’ pension system in 2009. The new basic pension scheme for rural residents has been another step in the direction of universal coverage. The central government also took another major step in that direction in 2011 in closing the coverage gap of people not covered by the basic pension scheme. In 2011 a pilot project was started for pension schemes for urban residents not eligible for the basic pension scheme. In 2012 the urban residents’ pension was approved and went national. In 2012 participation in old-age security tripled and in 2017 the majority of the rural population (roughly 80 percent) enrolled in voluntary schemes (ILO, 2015; OECD, 2015). The peak of institutional transition was the merging of rural and urban residents’ pensions in 2014. Undeniably the process aims to improve overall coverage as well as one system for all citizens regardless of their residence. In 2015 the State Council in its Decision on the Reform of the State Employee Pension System introduced a new pension plan designed to equalize the private- and public-sector systems. Under the new scheme, public sector employees will also have to make their own contributions to the pension fund. However, the authorities have stated that the basic salaries and
pension benefits of civil servants and employees of public institutions will be augmented to offset any financial losses for employees under the new system. For urban and rural residents the newly introduced pension scheme could achieve coverage of roughly 80 percent in 2015 (OECD, 2015).

The figures in terms of coverage speak to Chinese policy performance. Contrary to India, China has unified its pension system, decreased fragmentation and improved coverage. In the policy process the State Council used pilot projects and the gained lessons to define and adjust the new pension schemes for achieving universal coverage. In India the bottom-up approach, the missing self-sustainability and the fragmentation of pension system decreased the overall output performance.

13. Legislation and the Issue of Legal Coverage Gap

To understand the higher policy performance of China, the institutional features have to be investigated, which allows, as argued, more room for learning, adjustment and evaluation. One main institutional determinant is the social security law. Constitutions and laws determine the formal rules and legislative boundaries. These boundaries dictate the available room to maneuver for decision-makers, institutional actors and even the rights of citizens. Therefore legislation heavily affects institutional learning capacity and trial-and-error adjustment on lower tiers. Social law is “a system of rules and guidelines which are enforced through social institutions to govern behavior”.10 Without any legislative coverage for social protection, there is no legal certainty of the right for compensation.11

Social laws and legislative regulations determine the actual shape of the pension system and social protection contingencies. Hence the right
for old-age benefits or compensation is ensured by legislative coverage of social protection and the specific access modalities; the compensation and target groups of social security schemes are defined by legislative measures and regulations. One main obstacle is the limitation of the right for compensation or the so-called legislative coverage gap (Barrientos, 2009). Since the 1990s China and India have been active in changing their social legislation to close the traditional legislative coverage gap by introducing new pension schemes, merging old one and adjusting the regulations for entrance.

Chinese social security law is characterized by the absence of binding constitutional or institutional design. The constitution of the CPR is dominating but less detailed on actual social rights of the citizens. A milestone has been the approval of the long-awaited social insurance law. In October 2010 the Standing Committee of China’s National People’s Congress (NPC) passed a new law. Before the new law the social insurance system was based upon specific regulations and provisions in the 1994 Labour Law and 2008 Labour Contract Law. The 98 pages of law faced four sessions in the NPC in the three years before the legislation was passed. The resulting Chinese law on social insurance shapes the legal framework and regulates basic endowment insurance (a mandatory pension system), basic medical care insurance, workers’ compensation, unemployment insurance, and maternity insurance. It should be taken into consideration that the operational interpretation of the law is up to the issued regulation of the State Council. Looking at the law makes it obvious that the legislation sets the boundaries in which institutional actors, such as the State Council, can make necessary adjustments through the regulations without the demand for acceptance by superior institutions.

In India the legislation has a fundamental role in the republic and democratic system. The Constitution of India has affirmed social and
economic justice to all its citizens and clearly specifies the social rights of the citizens. On the next level the acts and rules, such as the milestone The Pensions Act, 1871, are passed by the government to set the legal framework for the pension systems and their administration\textsuperscript{12}. The adherence of the Rules and Acts are enforced by the Department of Pension and Pensioners’ Welfare and by the judicative. Contrary to China, Indian government is in demand for political majority in the two chambers to pass permanent acts. Although, as discussed earlier, the government introduced the New Pension System in 2004, only in 2009 the parliament issued the opening of the NPS to all Indian citizens aged 18-55 on a voluntary basis and since 2009 to all non-residential ones (Park, Lee and Mason (eds), 2012). The Pension Fund Regulatory & Development Authority Act, 2013 took another 3 years to be passed and was mainly steamrolled through legislation due to the public protests in 2013. In 2009 also the NOAPs was merge and extended to all people below the poverty line. The closure of the legal coverage gap did not improve the overall coverage due to the missing popularity of the schemes. Furthermore, another relevant factor is that the ministerial and administrative body is more restricted by specific social rights, acts and regulation in their ability to ably structural reforms.

Expanding the legislative coverage gap in old-age pensions in India and China had priority for both governments but was only a formal act. Concerning the main argument, the legislative framework and the provided leeway for administration adjustment and the learning policy process seem to be even more relevant in both contexts. In China the less strict legislation gives decision-makers more room to maneuver for reforms, adjustments and adaption without much consolidation. Chinese legislation provides recommendations rather than strict requirements, which give the executive bodies, i.e. the State Council, the authority and leeway to modify the pension reforms more easily. In India the
democratic pluralistic setting and stronger legislation regulations limit the room to maneuver in the policy process. Furthermore, legislative acts and rules take their time to be negotiated and passed by both houses in India. Structural changes and feedbacks are less easily being implemented due to the various legal and institutional boundaries in India compared to China.


Comparative political literature has given evidence of the advantages of non-democratic systems compared to democracies in terms of long-term planning capacity. In democracies free and fair elections promote political competition and a higher number of veto players restricts the continuity of policy-making. Between the 1990s and 2010 India and China undertook serious reforms to expand the coverage and benefits of old-age security. One crucial element of better performance in the provision of old-age security to address old-age poverty in China has been long-term planning capacity. Interestingly, India’s democracy relies even today on 5-year plans for determining national policy goals. But the national plans are more or less guidelines and actual policy-making is done by the government which is in demand for a majority in the supreme legislative body – the parliament or Lok Sabha – and in most cases concerning finances and pensions a majority in the upper house – the council of states or Rajya Sabha. As a consequence of India’s fragmented multi-party system the coalition governments and seats in the two houses are heavily fragmented without major parties. The number of veto players is reducing the ability of governments to push through deep and often unpopular reforms. Since the decay of the one-party rule by the Indian National Congress in the 1970s composition of the coalition governments change rapidly, as do political goals, reducing
the overall coherency of politics and long-term planning capacity. In India, under the pressure of coalition bargaining and electoral demands, the changing multi-party governments constantly merged the existing programs and changed the range, focus and target groups of the schemes (Mitra, 2006). In contrast to India’s changing coalition governments, the Chinese administration has gradually built up a unified pension system since 1995 with the backing of the central government. The higher long-term learning capacity is an advantage of the authoritarian one-party system and political stability in China. The Five-Year Plans are more or less initiatives for development but offer the executive body enough leeway for policy-making. Hence, the administration has been able to gradually realize deep reforms over long period (Sadhak, 2013). From 1995 to 1999 the Central Government reformed the pension system for the formal sector. In the 2000s the authorities began to adjust the existing system and expand coverage for the private and informal sector. In the process the State Council passed various regulations for the implementation of the new pension insurance system, universal pension scheme for employees in cities/township enterprises, the rural pension system and the National Social Security Fund (MOHRSS, 2014).

The institutional feature of central planning is present in both countries but in India the instrument for development is less effective in providing long-term planning capacity and reliability for pension reforms due to the less predictable policy choices of the involved political actors and veto players.

15. The Capacity of the Administration

Institutional learning ability is in need of “open space for new and innovative solutions” (Kohler-Koch, 1996: 372-373). As Scharpf (1999) pointed out, centralized authority can be seen as a “shadow” hanging
over the local government instead of acting as resolution mechanisms. The degree of the administrational infrastructure’s decentralization is essential in the learning capacity of the local governments (Mitra, 2006). All autonomous pension funds have a governing body or board that is the starting point for understanding differences in the quality of pension fund governance across countries. The International Organisation of Pension Supervisors survey (IOPS, 2007) identified general governance problems that affect the performance of the pension system. The survey highlighted administrative problems in transparency, competency and expertise of the governing body, rising complexity of the pension administration, and information on pension benefactors (Verdun, 1999). In its conclusion, IOPS (2007) found that governance practices were improving but that there were still many lingering problems. In a study of a sample of large pension funds from six different countries dispersed across North America, Europe and Asia-Pacific, Clark and Urwin (2007) conclude that their superior regulative performance is linked to strong governance and coherency in the systems.

Country-specific surveys for India include a report by Ranadev Goswami et al. (2000) highlighting the “shadow issue” and the administrative problems in governance practices. Furthermore in the pluralistic system, policy processes are increasingly complex and governed by divergent interests (Verdun, 1999). Accordingly, the policy lessons of the central state are drawn from experiences all over India and pension reforms are hard-bargained topics in the political arena in the two houses and mostly result in marginal reforms due to the high number of veto points. Despite this fact, social security administration for the national public schemes is administered by only one body for the whole country which leads to a strict one-size-for-all implementation process. As far as administrative learning ability is concerned, the strict central planning and separation of national and local administrative
bodies are limiting the institutional performance, interaction and communication between involved actors. Indian state governments in the federal structure have more leeway in the implementation of additional pension programs than in the implementation and reform process of national pension schemes. Despite the fact that their resources are limited, the electoral pressure for the local and district government has positive effect on the local social politics. Due to the majority of poor people, India’s political parties are eagerly trying to catch voters by electoral promises for more target group benefits (Mitra, 2006). Therefore, the local politicians and governments set up their own pension schemes which are in most cases directly overlapping with the national pension programs.

In the case of China, He and Warren (2011) introduced the concept of “authoritarian deliberation” which could overcome the “shadow issue”. As argued by the authors, deliberation is possible in autocracies that promote learning capacity by enhancing consultative and deliberative practices. Chinese central government has learned its lesson that policy output performance is in demand for feedback. Due to the missing input or feedback channels by citizens and non-governmental actors, Beijing mainly relies on the administrative feedback of the local governments and party organizations. Pension politics give the best example of the governmental practice. The central government introduced its own initiative to overcome the traditional input deficit of an authoritarian system through information gathering and enhancing legitimacy (Kornreich, 2017). The initiation phase of pension system implementation is being handed down to the local authorities at the provincial and municipal levels. In the classical trial-and-error test phase the local government implements new pension schemes and adapts them to specific demands. Effective, innovative initiatives are often taken up as national policy and implemented across the country. Due to
competition pressures the main priority is guaranteeing policy output performance, self-sustainability and decent administrative effectiveness. As Fewsmith (2012) argues, under the “shadow” of the central government the local authorities fight over resources and privileges. In the process local governments are discouraged to set up their own programs; however, the local authorities are more interested in affecting the pilot projects to ensure second-best outcomes for themselves.

The Worldwide Governance Indicators provide evidence of the slightly higher governance performance of the Chinese administration. In terms of government effectiveness China scores 68 and India only 56. It should be noted that regulatory quality is limited in both countries; still China achieves a slightly higher score of 44 to 40 in the benchmark.13 The outcomes underline the illustrated common drawbacks and similar low administrational capacity of both systems which highlights the demand for learning capacity.

China demonstrates the need for including local governments in active development through consultative and deliberative practices (MOHRSS, 2014). In particular, the adjustment of new pension schemes and programs to cover the complexity of informal and migrant work all over the country illustrates the Chinese advantage in including local authorities in the policy process. In contrast to India, the local authorities in China participate in the policy development process for new pension schemes and initiatives (ibid.). The pilot projects and trial-and-error method grant the policy process a higher learning capacity and information gathering. India has a disadvantage here: the national pension schemes are handled by the national administrative body (Sadhak, 2013). India’s state governments have the authority to set up additional programs but, similar to their Chinese counterparts, financial and administrative resources are restricted.
16. Improving the Flexibility for the Target Groups

Flexibility of the system is essential for adjusting the pension schemes on-the-go to the local demands of target groups. Furthermore, flexible regulations offer the administration the ability to learn and adopt on the spot without consulting higher authorities. As the OECD Report (Hu and Stewart, 2009) shows, “[o]ne of the main reasons why informal sector workers do not want to participate in voluntary pension systems (and in some cases even comply with mandatory schemes) is that they find the strict criteria involved too onerous, e.g. in terms of contribution requirements, vesting policies and requirements on governance structure of pension fund itself etc.”

China’s informal sector employees are required to join the mandatory public pension scheme but the relatively high contribution rates and lack of enforcement of the requirements by the Ministry of Labour have resulted in low participation. Instead of enforcing the mandatory contribution, Chinese authorities have taken the socio-economic issues into consideration and reduced the contribution rate by eight percent. Another example is the additional voluntary pension schemes among small- and medium-sized enterprises. By introducing collective pension funds (CPF) that directly target small- and medium-sized enterprises in China, these smaller units benefit from easier application procedures and faster assessment processes (Hu and Stewart, 2009).

In India the flexibility is provided by the additional pension system offered by the state governments. Unfortunately, the quality and availability of these schemes are restricted by the state governments and their resources (Sadakh, 2013). Moreover, these additional schemes in most cases overlap with the national pension schemes. The resulting program concurrency is one common drawback of India’s fragmented political system on various levels.
Another issue is raising public knowledge and awareness, thereby potentially leading to increased pension coverage, including for the informal sector (Stewart, 2006). For example, around 80 percent of the informal sector employees in India surveyed by the Asian Development Bank did not know what a pension was, and so even though they meet the criteria, very few informal sector workers join the Public Provident Fund (ADB, 2006).

17. Social Support: Including Non-governmental Agencies’ Learning Capacity

Policy learning demands information or feedback. Institutional feedback functions are, as illustrated earlier, not restricted to democratic systems. Authoritarian regimes tend to utilize social organization to improve policy process and output performance (Evans, 2010). Authoritarian systems with limited input and/or feedback mechanisms ensure that decision-makers benefit from cooperation to gain information and feedback. The ILO survey of 2011 (cited in the ILO survey (2015)) has given evidence of the central role of the All-China Federation of Trade Unions in the policy and implementation processes of pension reforms. In India the fragmentation of the trade unions along political fault lines has excluded them from the policy and implementation processes (Mitra, 2006).

18. Finances

One of the biggest problems with the current pension system is long-term financing. The conflict between rapidly aging societies, increasing life expediency, and an increasing percentage of pensioners on the one hand and a low statutory retirement age, weak financial sustainability and generous benefits on the other hand seems inevitable.¹⁴
Most countries have reviewed the incentives of their tax/benefit systems in order to make them more “employment friendly”. This development has been motivated by competitiveness concerns, but also by the wish to neutralize the vicious spiral of “welfare without work” generated by “contribution-heavy” social insurance systems (Palier ed.), 2010). India publicly managed the first pillar of the pension scheme, and the expenditure patterns of the non-contributory, unfunded public pension programs are putting increasing pressure on the government’s budgetary allocations. Generous pension benefits together with health benefits provided to retirees are threatening the financial sustainability of these schemes. As in the other major economies, long-term public pension spending is expected to increase significantly with the exception of India. India currently spends only 1.3 percent and it is estimated that in 2050 the percentage will drop to 0.7 (OECD, 2015). Assets in pension funds and public pension reserve funds in India are low, at 6,819 million USD or 0.4 percent of the GDP in 2013 (OECD, 2015). Even today, with a low participation ratio, the publicly subsidized schemes are heavily tax-financed by the central government.

In China policies have sought to relieve public finances and to shift some of the responsibility for welfare provision to individual workers or social partners. Still all three main schemes benefit from public subsidies. But the public pension reserve fund is only around 3.4 percent of the GDP or 98,896 million USD. In 2014, in 22 out of 30 mainland provinces, income failed to cover the expense of pensions, and financial subsidies from all levels of government have been used to finance the gap (OECD, 2015 and 2017). The problem of weak financial sustainability is not new for the Chinese pension system. Since 2002 subsidies have rapidly increased from 40.92 billion to 227.2 billion yuan in 2011 and to 301.9 billion yuan in 2013. In 2015 the subsidy was 367
billion yuan (Guo, 2015). Eight more provinces, including Liaoning, Jilin, Shaanxi and Hubei, have only enough money to pay pensioners for fewer than 10 months. On a national basis, China’s pension funds could cover 17.7 months of payouts for retirees in 2015, down from 19.7 months three years ago, the report shows (MOHRSS, China, 2015). The OECD pension report predicts that public pension expenditures are expected to increase in 2050 to 9.3 percent of the GDP, which will heavily burden state finances.

In international terms, India and China currently have low public pension expenditures compared to other major economies with similar systems (OECD, 2015). In China the financial pressure has been handed down to local governments, which, however, struggle to fill the gap in financing and providing the pension benefits for an aging society. India’s heavily tax-financed pension schemes for the informal sector have weak financial sustainability and their deficit is rapidly growing with increasing numbers of benefactors. Considering the low share of the gross domestic product and the estimated number of unregistered potential beneficiaries the integrity of the schemes will become a political issue (Sadhak, 2013).

19. Conclusion

This paper has attempted to illustrate that learning capacity of the institutional actors matters in the policy process of implementing political decisions, such as universal old-age security. Particularly, the learning ability in the policy process seems to be an important factor for adapting national political decisions on old-age security schemes for the informal sector more effectively to the socio-economic realities and demands of the target groups. Despite the assumed higher learning and long-term planning capacity in China, both pension systems are still
troubled by common drawbacks and rapid aging society. But Chinese institutional features encourage the learning to a larger extent than India in the specific policy process of pension provisions. Here the legitimacy deficit plays a central role. As argued, Chinese decision-makers are in demand of output performance and their feedback channels are limited, so they hand down more authority in the implementation process to the lower administrative tiers through pilot projects before going national. The gradual adjustment and review process on lower tiers, long-term planning ability, and less regulative laws have granted the central government an internal learning procedure for upcoming pension reforms. In the Indian case, the democratic features of a multi-party system, strong federalism and changing government coalitions have limitations for administrative room for learning capacity.

Old-age poverty should not be underestimated by current policy-makers, and in times of rapidly aging societies, inflation, and slowing down of economic growth the financial situations of most pensioners will worsen. Even growth as strong as that observed in China and India cannot absorb the changing ratio of pensioners into the workforce. As the OECD Report comments, “historical experiences from Western welfare states and global pension reform suggest that a universal pension arrangement does not necessarily mean more redistribution and better old age protection; for example, an extremely low level of universalism can also result in the shifting of state responsibility to the private savings of individual households.” (OECD, 2015)

Notes
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1. “Though the definition of this sector varies by country, informal sector workers are generally those with low incomes or self-employed, working in very small (unregistered) companies or the household sector, often on a part-time basis (and migrant workers) in industries such as agriculture, construction and services.” (Hu and Stewart, 2009).

2. See the report by HelpAge India (2015).

3. He points out that legitimacy deficit encourages decision-makers to act and reform their own system. In the process even foreign experiences and policy choices are often adapted.

4. Under the presumption that pension systems consist of and are affected by multidimensional policy choices and are made up of interdependent social and economic policy repertoires with different dimensions. Pensions or old-age security are designed for the orderly transitions out of employment by offering predictable financial transitions between work and retirement. In short, pensions could be described as transaction to compensate workers for their employment by providing financial old-age security after retirement. (Stewart and Yermo, 2008).

5. Pension support ratio describes the ratio of the number of people of working age to the number of people over pension age.

6. In China life expectancy climbed from 67.77 years old in 1981 to 74.83 in 2010, with a sharp drop in birth rates from 2.63 in 1982 to 1.18 in 2010. By 2050 approximately 25 percent of the Chinese population will be above the age of 65 years old. In 2010, 118.93 million people (8.92% of the population) were 65 or older.

7. Also in India life expectancy increased from 48 years in 1980 to 65 years in 2011 due to the decline in infant mortality rate accompanied by better
immunization rates and better nutrition, and at the same time the birth rate declined from 5.8 in the 1950s to 2.6 in 2010 (Haub and Gribble, 2011).

8. As indicated by the OECD (2017) report, the employees in the formal sector are covered by earnings related to the employee pension scheme and the defined contribution to employee provident fund administered by the Employees Provident Fund Organization (EPFO) and other employer-managed funds.


10. Law is “a binding custom or practice of a community; a rule or mode of conduct or action that is prescribed or formally recognized as binding by a supreme controlling authority or is made obligatory by a sanction (as an edict, decree, rescript, order, ordinance, statute, resolution, rule, judicial decision, or usage) made, recognized, or enforced by the controlling authority. See: Merriam-Webster (1981). Webster’s third new international dictionary of the English language. Springfield, MA: G. & C. Merriam Company.

11. In 2013 only one third of the countries world-wide had set up social protection system based on laws which covered the all ILO social protection contingencies.


14. Government officials have announced that detailed plans for increasing China’s statutory retirement age will be unveiled in 2017 (*The Wall Street Journal*, 2015).


16. Third Plenary Session of the 18th Central Committee of the Communist Party of China held in November 2013; and Lou Jiwei, the minister responsible for the Ministry of Human Resources and Social Security of the People’s Republic of China, interpreted the proposal for the Thirteenth Five-Year Plan, and stated that the next step for extending social security, especially the social insurance system reform, should be to uphold the principle of balance based on actuarial mathematics, to promote a social insurance fund to strike a self-regulating balance, and organize a long-term, stable operation (Guo, 2015).

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To Cooperate, or Not to Cooperate:
Assessing Pay-offs of the Belt and Road Initiative
for India

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Abstract

This paper seeks to examine the implications of China’s One Belt One Road project on India. While the OBOR has generated trepidation in India with regard to the project being a cover for China’s intentions to smother India’s strategic space, embolden its neighbours with projects like the China-Pakistan Economic Corridor and increase China’s presence in India’s neighbourhood, it is argued in this paper that participation in this project could outweigh possible deleterious outcomes and would be better than sitting it out altogether. It is argued that overtures by China to India to join the OBOR should not be eschewed and instead should be consummately debated as participation in this multimodal project would make available for India an avenue to mold it in a way which is not inimical to its visions of regional balance as well as afford it with economic prospects in tune with its ambitions under the Act East Policy, while at the same time enable it to equipoise any strategic space which would be accrued by China.

Keywords: India, China, OBOR, BRI, CPEC, strategy, economy
1. The Belt and Road Initiative: An Introduction

Scripting a successful rise to hegemony in international affairs in the 21st century is even more formidable than it was in previous centuries given the fact that basing such a rise solely on hard power has been made undesirable with the evolution of rules and norms regarding the manner in which states ought to behave in the international domain. While China has been keen to dispel arguments that it seeks hegemonic status, its policies are in step with those of a rising power seeking to emerge as a dominant player in international politics whether in deciding the global agenda, framing of international norms or in ensuring that international decisions which are agreed upon ensure benefits for China. China has also undertaken some policies which reflect its desire to rise as a crucial and indisputable player both in economic and strategic matters, and one of the latest among these is the One Belt One Road (OBOR) project which is gargantuan in imagination and will be in its implementation as well. The massiveness of the project is perhaps a manifestation of China’s vision of its influence given its rising economic and military profile and can thus be viewed as a reflection of the grand and perhaps hegemonic role it envisages for itself in world affairs.

Since China’s economic reforms began in 1978, the country has been economically gaining strength and is currently positioned as the second largest economy in the world. The OBOR Project, also known as the Belt and Road Initiative (BRI) has been launched with a view to ensure the continuation of such economic growth by overcoming challenges to it. The BRI consists of a “Silk Road Economic Belt” (SREB) and the “21st Century Maritime Silk Road” (MSR) and will link Asia, Africa, Europe and South Pacific. The ancient Silk Routes which bore the happy burden of ideas, people and goods in the ancient times and connected Asia, Africa and Europe has been harnessed by China as
examples of mutually beneficial historical antecedents of the BRI. The “Vision and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road” released by China states that the BRI aims to bring benefits to all member countries by creating a regional economic grouping based on openness, balance, inclusiveness, mutual benefit and common ideology. The document mentions the need to enhance China’s development and security, improve connectivity and build infrastructure along the countries involved in the BRI (National Development and Reform Commission, MFA and MOFCOM, 2015). In order to achieve these objectives the proposed SREB will link China to Europe through Central Asia and the MSR will connect the coastal regions of China with those in Africa, and then through the Suez Canal into the Mediterranean Sea. The MSR will extend from China to the Strait of Malacca from where it will extend to ports in South Asia and then on to African ports by crossing the Indian Ocean. On the finance front, China has spearheaded several institutions and funds to facilitate the connectivity infrastructure under the BRI including the China Investment Corporation, China Development Bank, Asian Infrastructure Investment Bank (AIIB), BRICS New Development Bank and a US$40 billion Silk Road Fund. The scheme also includes “large industrial parks and special economic zones (SEZs) coupled with manufacturing plants” and “investments in shipping, construction, energy, commerce, tourism, information technology, biotechnology and alternative energy. Beyond this, the MSRI [i.e. 21st Century Maritime Silk Road Initiative] will encompass trade fairs, exhibition halls and other structures that facilitate and support economic activity” along the BRI (Blanchard and Flint, 2017: 227).

The BRI would thus enable commerce between commodity-rich countries and nations with large markets. The BRI in essence is a “spatial fix” as it can be comprehended as an attempt to restructure
geography in order to ensure the continued economic growth of China as it envisages the creation of “economic corridors” which “are essential for building connections across the geography of countries” at different levels of capitalist development (Palit, 2017: 2).

Manuel Castells’s metaphor of a “network society” is also useful in analyzing the BRI. According to Castells, flow of capital information, technology and elites between global networks of metropolitan regions have become the dominant spatial configuration instead of national spaces. The BRI can thus be seen as an attempt to increase free flow of capital, products and technology and although the BRI covers entire continents, the “configuration of these flows are to be predominantly across a network of major urban nodes” or “major urban clusters such as port cities, international airport hubs and inland cities, linked together by a network of major transport arteries” (Summers, 2016: 1636).

There are several perceptions with regard to the BRI. Chinese officials stress that the BRI is intended to build a community based on trust, economic integration, inclusiveness, commonality of interests, responsibilities and a shared future (China Daily, 1st February 2015). Others view the BRI as a plan to address China’s economic interests and as a method to create China’s economic dominance as it may allow “massive asymmetries that China can leverage to flood foreign markets with goods, lock participant countries into supplier dependencies, ensnare borrowers in debt bondage, control higher value-added production, and dominate countries hosting its MNCs” (Blanchard, 2017: 250). Further, the BRI has been perceived as reflecting both hard and soft power of China. Its soft power is reflected in the economic, cultural and institutional objectives of the project while its hard power objectives are reflected in the construction of “dual-use ports that berth its cargo ships and military vessels, as China constructs overseas basing arrangements and maintenance facilities in Indian Ocean region (IOR)
places such as Djibouti and Gwadar (Pakistan) that allow it to send forces to protect its nationals, ships, and investments, and as China dispatches its amphibious vessels, warships, and submarines to ensure sea lines of communication remain open and to deter or defeat threats (e.g., piracy)” (Blanchard, 2017: 251).

While falling well short of China’s soft as well as hard power, India too harbours a desire to ensure that its rise continues in an unmitigated manner. There are several issues pertaining to the OBOR which can prove detrimental to India’s economy, security, and more worryingly, its sovereignty. These issues will be examined in this paper with an emphasis on analysing the manner in which India seeks to address concerns arising out of the OBOR. It is argued that given India’s unequal position compared to that of China and since the latter holds the key to unlocking several opportunities for India in the international and regional realms, it would be imprudent to shun overtures by China to be part of some aspects of the OBOR. It is also contended in the paper that India should delink the CPEC from the rest of the envisioned infrastructural links as India, if on board the OBOR, can reap benefits and perhaps even mold the manner in which the intricate lattice of communication and infrastructural networks are realized which would enable India to strengthen her own economy and security and create a complex interdependence with China, thereby segueing relations between the two from friction to cooperation.

2. Contextualizing the BRI

Domestic, economic and strategic concerns of China underlie the BRI. Geopolitics as well as the infrastructure building capacities of China drives the conceptualization of the BRI. The multifaceted and mutable initiative seeks to ascertain China’s economic growth and geopolitical
prominence in the region as well as the globe. One of the major reasons which underlie the BRI is its role in bringing a balance to the lopsided development of the different parts of China. Eastern and coastal regions of China were favoured by the opening-up strategy followed since Deng Xiaoping’s rule which led its western and southern regions to lag behind in terms of development. The lopsided development in China was further buttressed by the landlocked nature of its western and southern regions and their proximity to volatile neighbouring countries. Prior to the BRI, China had attempted to close the gap between its east and west by emphasizing on the development of its western regions in the form of promoting greater investment as well as sub-national diplomacy of these landlocked regions. The BRI thus can be seen as partly reflecting the extension of previous policies of China such as ‘Develop the West’ and 12th five-year plan whereby the development of the west and south of China was being promoted (Summers, 2016: 1632). The BRI is an upgradation of these frameworks whereby the opening-up of areas such as Yunnan and Xinjiang would be pursued by creating “institutional and infrastructural linkages with neighbouring provinces in China” and linking them with markets of West Asia, South Asia and beyond with a view to achieve development (ibid.: 1633).

China’s economy is also facing certain challenges which are sought to be met by the opportunities which are expected to be opened up by the implementation of the BRI. The challenges to China’s economy include slower economic growth due to excess capacity in industry, burden of debt, and property market challenges. The projects to be implemented under the BRI, it is assumed, would alleviate some of these economic roadblocks faced by China and accelerate employment and the production of goods and services in the country as well as provide markets for China’s firms. The BRI would also enhance China’s resource security by enabling China to gain access to resources as well
as ensure that “there is sufficient production of the resources China needs” (Blanchard, 2017: 256). Further, the BRI would provide opportunities for China to invest its US$4 trillion worth of foreign exchange reserves. The initiative will also promote the internationalisation of the Yuan which will enable the issue of Yuan bonds by China’s firms to fund the project. China’s clout in the international bodies such as the International Monetary Fund is expected to grow as the demand for the Yuan increases with a rise in trade carried out through the routes envisaged under the BRI. The involvement of China Investment Corporation, China Development Bank, AIIB and BRICS New Development Bank in financing the BRI will also promote the internationalization of the Yuan.

Strategic concerns form yet another significant motive behind the BRI. China is interested in maintaining a large presence in the Strait of Malacca through which much of its trade passes. The BRI will enable China to diversify its trade routes over and above the Strait of Malacca. China is also interested in ensuring that its influence is maintained in its surrounding regions as well as its extended neighbourhood such as the Indian Ocean, which is straddled by important trade routes as well as the energy-rich region of West Asia. Since the new administration in the United States of America under Donald J. Trump has all but made redundant the US-led Trans-Pacific Partnership and the rebalance to Asia, the BRI can no longer be viewed as a counter to these projects which were seen to be aimed at isolating China. Nonetheless, a successfully implemented BRI which excludes the US but includes several of its allies may elevate China’s status as a regional as well as a global power while ensuring the relative decline of the US.

Regional integration though the BRI intends to further boost economic cooperation between member countries and China. China stands to benefit from the BRI amidst demands for greater exploration of
minerals and diversification of China’s exports and imports due to the identification of new drivers of trade. The BRI is intended to increase the reach of China’s technology and investment which is expected to yield greater exploration of resources which in turn would cater to increasing energy demands of China. China’s BRI would allow it to increase its economic as well as political influence in the countries along the project.

Through the BRI, China intends to posit itself as a bridge between resource-rich developing economies and the capital, advanced technology, and know-how from the developed world (Zhao, 2015: 103-104). The BRI will also enable China to cultivate better relations with its western neighbours which it intends to do by way of “creating jobs, bettering infrastructure, upgrading transportation, diversifying exports, enhancing economic competitiveness, and financing local innovations” in these countries (Zhao, 2015, p. 104).

3. Implications of the BRI

The prime implication for those countries involved in the BRI is expected to be an improved trade relationship between them and China. For most of the member countries, China is already the dominant market and investment and trade partner. The BRI would further entrench China’s economic as well as political presence in these countries. The BRI was initially met with trepidation by many countries. Although China has been able to allay concerns of most countries, there have been some hurdles to its projects. For instance, Sri Lanka which was unable to pay its debts to China had to enter into a debt equity swap which allowed China to gain a 70 percent stake in the Hambantota Port by paying US$1.12 billion for a lease agreement of 99 years. This swap has been interpreted as effectively ceding the country’s sovereignty to China.
Moreover, Pakistan terminated the plan to build the Diamer-Bhasha dam which was a part of the CPEC due to concerns over financing terms laid down by China. In another instance, a BRI-related project – the 1200 MW Budhi Gandaki hydropower plant which was estimated to cost US$2.5 billion – was scrapped by Nepal over bidding irregularities.

Despite such disconcerting events, none of these countries have avowedly dismissed their involvement in the BRI possibly due to the benefits they would receive by participating in such a multimodal network. First, it is contended that the BRI would also provide opportunities for the member countries to access better markets, investments and enhance trade with the rest of the countries in the initiative and beyond as the project would ensure improved connectivity and infrastructure in these countries. Further, countries along the BRI due to a greater convergence in their policies of trade may also promote closer political ties between them. Moreover, a shared platform will be provided by the BRI and its institutions to a heterogeneous group of countries thereby promoting closer cooperation and understanding between them. In addition, the BRI will provide a milieu for resource-rich but infrastructure-deficient countries to bridge this gap. Countries with large markets but lacking in industrial development will also be provided opportunities through the BRI to address such challenges. Countries along the BRI would also benefit from multimodal connectivity. Landlocked countries along the BRI would also be provided with connectivity which offers them outlets into sea routes as envisaged under the project. Such investments are plausible as they will benefit China’s industries as well. Countries with relatively poor development such as Cambodia and Laos and others in Africa could achieve economic benefit from the BRI as they could become preferred locations for China’s investments for constructing steel and cement plants and they could also reap the benefits from possible resource
exploration technology provided by China. New industries, greater technology, multimodal connectivity and new markets are but some of the benefits awaiting those countries along the BRI scheme.

4. Divergent Views in India on Joining the BRI

India and China have had a tumultuous history, which continues to cast its shadow on present ties as well. Garver (2001) points out that India and China’s search for accommodation has been ruptured by “one limited but intense war, a half a dozen militarized confrontations, dozens of instances of hard political-diplomatic struggle, chronic conflict over national policy, and layer upon layer of mutual suspicion”. Frankel and Harding (2004: 40) succinctly sum up four broad perceptions harbored by circles in India with regard to China: one view perceives China as a threat as it could emerge in a much more assertive manner; a second view opines that while some convergence between India and China exists yet certain calculations of strategic interest differ from India’s which amounts to security problems for India; thirdly, it is viewed that China may not be prone to accepting India’s rise as a regional and world power; and fourthly, it is perceived in India that there is ground for India and China to avert future problems through diplomacy and other action.

There are also divergent views with regard to BRI’s implications for India. Some are of the view that it would be prudent not to be a part of the BRI as it is nothing but a Chinese veneer to increasing its influence in the Indian Ocean and South Asia at the cost of India’s (Chellaney, 2015). It has been contended that China is a revisionist power seeking to establish its hegemonic status by restructuring the existing maritime status quo (Chellaney, 2016). It has also been pointed out that India’s sovereignty would be adversely impacted if it accepts parts of the BRI such as the China-Pakistan Economic Corridor which has been planned.
in Pakistan Occupied Kashmir (PoK). There are others, however, who argue that it would be economically as well as strategically prudent to be a part of the BRI in order to reap the benefits of infrastructure and communication links envisaged under the scheme. Infrastructure cooperation with China is deemed essential for India (Saran, 2015). As India cannot block other countries from joining the BRI, India should also seek to positively influence it (Mohan, 2015). They contend that as part of the BRI India could shape the eventual trade, financial and transportation architecture, which emerges under the BRI. As a part of the BRI, India would be able to influence its evolution in terms favourable to it, which will not be possible if it decides to shun China’s overtures to join it. Nonetheless, officially India has refused to cooperate or be a part of the BRI, despite welcoming overtures from China.

On 25 May 2017, in what has been construed by many as a response to the BRI, India and Japan launched a vision document for Asia-Africa Growth Corridor or AAGC at the African Development Bank meeting in Gujarat which outlined four aims of the project including development and cooperation projects, quality infrastructure and institutional connectivity, capacity and skill enhancement and people-to-people partnerships. It was enunciated in the vision document (2017) that the AAGC intends to create “new production channels, expanding and deepening the existing value chains, ensure economic and technical cooperation for enhancing capacities, facilitate a greater flow of peoples between the two continents, and achieve sustainable growth over the longer term. The AAGC will be developed through quality infrastructure and complemented by digital and regulatory connectivity.” Digital connectivity will also support the growth of innovative technology and services between Asia and Africa.

The AAGC has certain differences in comparison to the BRI. It has been pointed out by Panda (2017) that the BRI is a unilateral initiative
whereas the AAGC is a bilateral one and that the latter is founded on a consultative basis while the BRI does not have a similar multi-party-based decision-making basis. The funding structure of the BRI and the AAGC are also not similar as the former is based primarily on funds from China’s banks while the AAGC will be based on funds from private, government, and also international banks. The BRI is also much more extensive compared to the AAGC. Nonetheless, there are conceivable overlaps between the two schemes as both are connectivity schemes to accelerate economic development. It has been contended that the AAGC “currently neither poses a challenge to China’s BRI, nor is its mandate as comprehensive” (Panda 2017: 9). China, in the state-run Global Times, has enunciated that India and Japan are free to embark on any new connectivity issue but it should not be designed in a way that seeks to counterbalance the BRI as the routes of the two projects have a considerable overlap (Xiao, 2017).

5. Should India Cooperate or Not Cooperate?
- A Prisoner’s Dilemma

Currently, according to India’s official position it has sought not to cooperate with China on the BRI. In May 2017, India articulated its position on the BRI in a response to a query on the participation of India in the BRI Forum, which China had invited India to attend. India’s Ministry of External Affairs (2017) outlined that India was keen to ensure that connectivity projects were based on “international norms, good governance, rule of law, openness, transparency and equality”, and India’s Ministry of External Affairs also outlined that “Connectivity initiatives must follow principles of financial responsibility to avoid projects that would create unsustainable debt burden for communities; balanced ecological and environmental protection and preservation
standards; transparent assessment of project costs; and skill and technology transfer to help long term running and maintenance of the assets created by local communities. Connectivity projects must be pursued in a manner that respects sovereignty and territorial integrity”. Such rationalizations have been provided as justifications of India’s stance not to cooperate on the BRI with China.

This section alludes to game theory, or more specifically the “prisoner’s dilemma” model, to show what underlies India’s move not to cooperate. It is also contended here that changing a strategy from not cooperating to cooperating would render India with greater pay-offs. The “prisoner’s dilemma” model is one kind of game under the game theory, which implies a formal structure used to comprehend interaction between humans or states. Game theory helps make prediction of human behavior and outcomes of their behavior and is supposed to help in strategizing by helping a player make best decisions by anticipating others’ decisions. A game consists of a set of players and a set of strategies for each player, such as “to cooperate” (C) or “not to cooperate” (NC). Game theory assumes that the players are rational actors who understand that their actions affect the actions of other actors and that they tend to maximize utility and make decisions in pursuit of their own interests. Each strategy a player chooses would give them certain pay-offs and in the “prisoner’s dilemma” model it is contended that rational actors would choose that option which provides them with maximum pay-offs or benefits. In the “prisoner’s dilemma” model it is contended that the behavior of others influences the choices of a player. A Nash equilibrium (NE) is said to have been reached if the strategy of the other is kept fixed and the player changes his/her own strategy to see if they have any incentive to change their strategy; if they do not have any incentive to change their strategy then a Nash equilibrium is said to have formed.1
While a pay-off matrix for the BRI is difficult to design given that India and China are unequal actors, yet the overall schema of the “prisoner’s dilemma” model can be used to assess which option would lead to better pay-offs. Out of the two options available to India of cooperating and not cooperating, according to the official positions of India, it calculates maximum pay-offs in not cooperating while China, which had invited India to join the BRI, sees maximum pay-offs in cooperating. Such a stand leads to two NE. One when India and China do not cooperate (NC,NC) and the other when they cooperate (C,C). However, despite the emergence of two Nash equilibriums, as India has decided to not cooperate, it implies that it views that NC,NC would lead to greater pay-offs than C,C.

While India and China are unequal actors, given the economic, military and other differentials, these two players and their responses is represented in a prisoner’s dilemma in this article to provide a model of their behavior. The next section uses theories of cooperation in an attempt to show that keeping China’s strategy of cooperation fixed if India changes its strategy to C it is benefitted with much better payoffs than NC. Thereby, I contend that the NE of C,C outweighs the NE of NC,NC for India.

6. Factors Underlying India’s Refusal to Join the BRI

It has been pointed out that although the BRI would bring much needed investments into India, India’s general wariness of China leads it to be sceptical of the initiative (Sakhuja, 2014). There are several security concerns of India arising from the BRI. India is concerned about China’s intense network of connectivity corridors planned around India. Such connectivity is of concern for India as it is felt that China will use such connectivity lines to increase not only its trade with these countries but
also its strategic influence in these countries thereby possibly undermining India’s economic and security relationships with them. Of particular concern to India are China’s claims over certain regions in Northeast India such as Arunachal Pradesh as well as overall increase in China’s influence in India’s turbulent North Eastern Region (NER). The series of multimodal connectivity planned around the countries neighbouring the North Eastern Region of India provides a basis for India’s concern pertaining to China’s intentions with regard to the region as they would enhance China’s access to this region.

Another security concern of India pertains to China’s growing presence in Pakistan. China’s intention to increase its strategic presence in Pakistan is manifested in the form of the plan to construct the China-Pakistan Economic Corridor (CPEC) which passes through Pakistan Occupied Kashmir. Such a corridor would impinge on India’s sovereignty, embolden Pakistan’s claims on the territory and increase China’s influence in the region. China’s presence in Pakistan would also be bolstered if it goes ahead with its plan to supply eight type 039 A submarines to Pakistan (Nataraj and Shekhani, 2015: 69). Such weaponry being delivered to Pakistan would further militarize the region and could result in the spread of an arms rivalry in South Asia and beyond. China’s maritime facilities which have been planned in Pakistan would obligate Pakistan to serve the security interests of China, which would be adversative to India as such presence could be leveraged by China to increase its presence in the Indian Ocean as well. Greater Chinese presence in Pakistan would enable China to use Pakistan as a conduit for channeling its weaponry into the region in case of a conflict in the region which would be detrimental to India and would prohibit India from being able to ward off possible incursions along Indian regions which are claimed by China (ibid.).
India is also concerned with regard to the fact that “the ‘Southern Corridor’ through Myanmar would involve several new connections to the Indian Ocean, including the Kunming-Yangon road and river route, new links to the Myanmar port of Kyaukpyu, and potentially, the ‘BCIM Corridor’” (Brewster, 2017: 282). India’s concerns pertain to the issue that the “trans-Myanmar and trans-Pakistan projects, if completed, will have major economic and strategic implications for the region” as these “connections could stimulate considerable economic development in the land-locked provinces of Xinjiang, Tibet and Yunnan, and lead to an expansion of China’s economic and political influence in Pakistan and Myanmar and other neighbouring states” (ibid.: 284). Development of Xinjiang, Tibet and Yunnan could also be detrimental for Northeast India if simultaneous development of this region is not achieved as it would not have the economic clout to mold decision-making or influence agenda-setting in regional organizations such as the Bangladesh, China, India and Myanmar Economic Corridor (BCIM-EC) which has the sub-regions of Yunnan and Northeast India as stakeholders.

7. Why India Feels Cooperating Will Lead to Fewer Pay-offs

This section seeks to explain the rationalizations of India as mentioned above which prevent it from cooperating with China on the BRI. Cooperation between states in international politics has been theorized as having occurred if states change their behavior to the preference of other states by coordinating their policies (Keohane, 1986). This implies that state behavior is altered to ensure the negative consequences for other states is mitigated and is geared towards certain goals; and amounts to the actors involved getting some gains. Cooperation is understood as opposed to conflict or unilateral behavior, which does not taken into consideration impact on other states. Cooperation, thus, is
considered achieved in international politics if there is mutual policy coordination to realize joint gains. Given that India has continued to shun China’s overtures to join the BRI it can be assumed that cooperation, which includes mutual policy coordination to realize joint gains, does not yet exist.

Cooperation between states has been theorized to occur between states in different ways. Axelrod (1984) posits that states cooperate to realize absolute gains as they seek to maximize their utility. However given the prevalence of anarchy in the world, Axelrod (1984) asserts that reciprocity cannot be maintained due to cheating and lack of sanctions. Thus the tit-for-tat approach, which means changing a player’s strategy to one which is an optimum response to the strategy of the other player is the best approach to ensure cooperation of parties involved. Furthermore, Axelrod (1984) posits that the assumption that states exist in an anarchic world signifies a non-cooperative “prisoner’s dilemma” approach. Following Axelrod’s theorization, given the domination of a realist understanding of the world where anarchy predominates the worldview of those in power, where sanctions and cheating cannot be prevented, may underlie India’s refusal to cooperate in the BRI.

Keohane (1986) asserts that cooperation is achieved by reciprocity as states are rewarded for cooperating while punished for defecting. In the “prisoner’s dilemma” model, cooperation is achieved when the game is repeated and expectations of actors converge. In realistic social situations, Keohane (1986) opines that reciprocity contains elements of contingency and equivalence, which means that it involves the exchange of approximately equivalent values of benefits and costs and the lack of such equivalence would amount to misunderstanding, which would prevent cooperation and instead lead to alternate arrangements, which are seen as counter-measures. Following Keohane’s (1986) understanding of equivalence, India’s disinclination to join the BRI can
be explained to be based on its perception of a lack of equivalence with regard to gains and losses, which are to be accrued by China and India. For instance, the fear of the CPEC running roughshod on India’s sovereignty is not matched with similar costs on China’s part. The gains for China in terms of being the preeminent transport node, the possibility of converting its economic presence into strategic advantages as well as being the principle architect of the BRI cannot compare with any equivalent gains which India can accrue out of the initiative.

Grieco’s (1990) theorizes that states do not always pursue absolute gains but also relative gains, in which they compare their absolute gains with those of others and cooperation thus becomes difficult as no state wants to realize absolute gains which are fewer than others. India’s refusal to join the BRI, perceived from Grieco’s conclusions, can be viewed to be an outcome of India’s assessment of pay-off from the BRI from a purely relative gains lens instead of opting for a perspective which is more germane to its relative size, power projection, economic and infrastructural wherewithal compared to China.

8. Why India Should Join the BRI: Cooperation Leads to Better Pay-offs

This section seeks to argue the ways in which cooperation with China on the BRI would yield better pay-offs for India with the help of theories on cooperation, as well as enumerating several benefits which India would avail by participating in the initiative.

According to Grieco (1990) only a distribution of gains between two or more cooperating states, which is balanced, can lead to cooperation. Balanced exchange can mean benefits which are equally distributed to all states or proportionally to some value, such as investment amounts, power projection ability, size of economy etc.
While Axelrod (1984) posits that payoffs are balanced only if they are symmetric towards each player, Grieco (1990) however states that any agreement producing benefits can be said to be balanced if side benefits are possible. India’s stand not to cooperate according to such a formulation based on balanced payments can be seen to be a reflection of its apprehensions that its participation will not lead to symmetric payoffs; however, given that India and China are not equal players, payoffs seen to be proportional to their relative size and investment are more practical in a world where states are only legally equal. In addition, side benefits of infrastructural overhaul and complementariness with projects such as Act East Policy and Project Mausam can render the pay-offs roughly balanced.

It is also argued by realists that states believe in self-help as other states cannot be relied upon for tomorrow a friend may turn into a foe and such reasoning underlies lack of cooperation between states. India’s refusal to partake in the BRI can thus also be explained as stemming from such a calculation based on self-help. However, it has been contended that when several states are in a system, cooperation may be far more effective than going it alone. Snidal (1991) contends that the inclusion of more players increases the likelihood that groups will cooperate to enhance their security. In the BRI case, if “security” is broadened to include “economic” as well as other benefits, then cooperation on India’s part will increase its economic benefits given that 65 or so nations have committed to the BRI. It has also been contended that relative gains of others will enhance one’s own security, thereby benefits from the BRI to nations surrounding India would consequently lead to benefits for India.

India’s official position, which is antithetical to joining the BRI, seems to be based on the calculation that minimizing relative gains of others maximizes its security. However, power should be seen as
fungible and the positive-sum nature of power should also be kept in mind. Baldwin (1980) stresses that power in an interdependent relationship flows from asymmetry which means that the one who gains more from the relationship is more dependent. Following from Baldwin’s argument, since the BRI is primarily China’s brainchild, its dependence on it and on the partners in the BRI will be much more than that of any other country participating in the BRI. India therefore should not shun overtures to join the BRI on the basis of becoming dependent on the BRI as it is China, which will end up having more at stake and thereby providing more leverage to India and other participating countries.

Apart from these, there is a gamut of benefits which India will accrue if it joins the BRI. These provide rough equivalence for India in terms of benefits compared to those that will be gained by China. Despite security concerns there are other implications of the BRI for India which pertain to possible gains which could be accrued by joining the initiative. The BRI would enable India to reap economic benefits of greater market access, investments, technical expertise, connectivity and trade as envisaged under the scheme. Endeavours such as the Bangladesh, China, India and Myanmar Economic Corridor of which India is a part would be enhanced by its link with the BRI. It would allow India to leverage its own soft power in the countries along the scheme. Although the CPEC is seen as riding roughshod on India’s sovereignty, India’s involvement in the rest of the BRI could enhance her influence in the decision-making to construct the CPEC along lines which are suited for both India and Pakistan. It could perhaps bypass the disputed territory so as to countermand the sovereignty issue of both nations or two corridors could be fathomed, one each in Pakistan and India. A flourishing trade link in this region could also have positive bearings for the ongoing turmoil in this region and could also possibly
address some of the economic reasons behind the chasms thus alleviating the conflict to some extent. The CPEC could bring India some other benefits as well as it could act as a conduit to increase the efficiency of the Indian market and will enable India and Pakistan to trade directly through it rather than through third countries. Thus, a shift from a purely national security framework to one in which human security of the people suffering from the precarious situation in Pakistan Occupied Kashmir and adjacent regions could be a more fruitful basis for comprehending and implementing an economic corridor around the region, rather than using the concept of “sovereignty” and refusing to engage with possible ideas which could bring greater prosperity to the region.

Being a part of the CPEC as well as the rest of the routes envisaged under the BRI would also enable India to direct trade in the oceans to a larger degree which it has not been able to do with the existing infrastructure. It is also important to note that China is keen on bringing India on board the BRI and in this regard Kolkata has been identified as a key port in the MSR of the BRI. India could leverage its involvement in the BRI by acquiescing to China’s overtures in order to mould the CPEC on its own terms and at the same time India could use its presence in the financial institutions as well as the BRI to influence China to be more favourably disposed to India’s bid for entry into the Nuclear Supplier’s Group as well as seek a revision on China’s stand on Masood Azhar. India could also use its influence if it joins the BRI to include more Indian ports to act as central nodes in the initiative. Further, India could use its influence to bring other regional architectures like South Asian Association for Regional Cooperation (SAARC) as well as the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) into the ambit of the BRI thereby decentering the China focus of the BRI into a more shared and regional
project. Further, as China is keen to have India on board the BRI, it could use its influence to push “Pakistan to pursue a more dedicated focus on economic objectives and regional trade linkages rather than a security-centric agenda”, which may lead to India potentially becoming “the greatest beneficiary other than Pakistan itself” (Small, 2016: 17).

India is also an important trade partner of most of the countries under the BRI and thus being a part of the BRI will enable India to enhance such partnerships given the trade benefits which the BRI is supposed to initiate. By not being a part of the BRI, India would run the risk of dwindling trade with its neighbouring countries, most of which are part of the BRI. China on the other hand would then be free to shape its relations with India’s neighbourhood thereby improving its bilateral ties with these countries as well as improve its regional presence in South Asia which would be detrimental to India’s economic as well as security calculations. If the BRI is built, China will become a preferred destination for countries seeking investment and trade as opposed to India as the former would be better connected to them than the latter and also because of increased Chinese presence in the countries which would act as an added motivation for countries to divert trade away from India. Thus, by not being a part of the BRI, India endangers its trade with countries with which it currently has trade ties greater than or similar to China’s.

Other adversarial fallouts of India eschewing its chance to participate in the BRI pertain to the even greater use of the China card by its neighbours which would further isolate India which would be pernicious to its already complex presence in the neighbourhood. It has been noted by Garver (2001: 17) that “links with China are often attractive to India’s South Asian neighbours precisely because of perceived Indian efforts at domination.” A greater Chinese involvement in port-building activities in India’s neighbourhood would embolden
China by increasing its sphere of influence in the region thereby undermining India in her own backyard. China’s investments would give it “... control over the new infrastructure assets enabling their potential utilization for military and strategic purposes” (Palit, 2017: 2). By being a part of the BRI, India could increase its own presence in the member countries so as to offset such a rise in China’s influence.

By eschewing the BRI, India would also run the risk of neglecting its dire need for infrastructural changes which can be achieved by accessing the financial help from the gamut of institutions being created for the implementation of the BRI. Scepticism of Indian businesses towards their abilities to exploit the new external infrastructure of the BRI “given the inadequate and inefficient infrastructure” of India and the rest of South Asia has been an impediment to India’s acceptance of the BRI (ibid.: 7). However, by shunning the BRI altogether would not be pragmatic as the initiative intends to create infrastructural lifelines across the South Asian region, which if on board the BRI, would benefit India. Being a part of the BRI could also help India in attracting greater investments from China which could enable it to correct the trade imbalance between the two countries as well as help India meet its deficits in infrastructure (Chhibber, 2017: 36-37). As with China, the BRI will enable India to access greater markets, satiate its demands, and attract investments at a faster rate and in a more efficient manner, making it prudent for it to consider its options of joining the initiative rather than dismissing it outright.

By being a part of the BRI, India would also be able to increase its own presence in port cities along the route which will also allow it to bolster its presence in these regions. India’s presence in key locations such as the Chabahar port in Iran would provide India with a springboard into West and Central Asia while the BRI would provide other connecting routes and gateways for increased flows to and from
India. India would also benefit from greater contact between citizens of
different nationals and a uniform transnational financial system. Most
significantly, the BRI can become yet another significant and more
tangible platform, after BRIC (Brazil, Russia, India and China) and
BASIC (Brazil, South Africa, India and China), for India and China to
increase convergences and build trust and stability in their ties. The
growth of such a shared framework between the two countries could
then segue into alleviating other bilateral issues such as border and river-
water sharing. India’s participation in the BRI could also help bring
financial and security coordination with the other member countries and
in so doing become a harbinger of greater regional cooperation. Other
factors which should impel India to join the BRI include the fact that it
“is an open mechanism for regional economic cooperation” which “does
not set an access threshold, nor has it established multilateral
international organizations” (Li, 2016: 25).

Being a part of the BRI would also enhance India’s engagement of
its neighbours as envisaged under its extended neighbourhood vision as
well as its Act East Policy. It would signify the commingling of policies
of India and China with regard to their regional ambitions. Since ties
between China and India have been held ransom by numerous obdurate
bilateral issues on which common ground has been unattainable, India’s
participation in the OBOR could help generate common visions and
combined participation in actions with regard to the regional dynamics
which could form an indomitable framework to be harnessed by the two
countries to find solutions to intractable bilateral issues.

It has also been argued by Garlick (2017: 7) that China has a good
record of realizing improbable goals, for instance, apart from building
high-speed rail networks across difficult terrain, entire villages under
special economic zones in China have been transformed into financial
hubs. Such transformations make for solid evidence of China’s ability to
realize the gargantuan goals envisaged under the BRI. Another reason pointed out by Garlick (2017) in support of India backing the BRI relates to the fact that despite global slowdown, China’s GDP growth continues to be higher than any of the developed countries.

Garlick (2017: 9) offers an interesting way to circumvent the overt fear in some circles in India with regard to the String of Pearls strategy of China by suggesting that India “start with a single major port development using Chinese capital and know-how, just as other countries have done, hoping to kick-start their economies with a mega-port and surrounding developments. This can easily be encompassed within the Sagarmala project. Port facilities, factories and road and rail infrastructure go naturally together, and Chinese companies are expert in financing and constructing all of these. By virtue of an Indian port becoming part of the ‘string of pearls’, the feeling of possible threat and encirclement which negatively influences Indian thinking about China and prevents cooperation could be defused.”

One way in which India and China has come to agreement with regard to the issue of CPEC is to follow the framework set in the China-led Asian Infrastructure Investment Bank (AIIB) regarding disputed areas. India is one of the members of the AIIB. Funding for 24 projects related to infrastructure has been funded by the AIIB, out of which five of them are in India. Total loans for these projects in India amount to US$1.074 billion which accounts for nearly 28% of money lent by the AIIB. India became the first country where the AIIB committed financially more than US$1 billion. India’s participation has continued in the AIIB despite several contentious border issues with China. Such participation of India despite contentious issues with China can be explained by referring to the clauses in the charter of the AIIB which clearly state that in case of funding in disputed areas it will be granted only if the parties concerned are in agreement: “Financing for a Project in a territorial area that is
claimed by two or more countries only if it is satisfied that each of the
governments concerned agrees that, pending the settlement of the
dispute, the Financing proposed may proceed without prejudice to its
claims to the disputed area”, which prevents the AIIB from funding
projects in areas which are claimed by more than one state (AIIB, 2017).
As India has already agreed to such a clause in a China-led initiative, a
similar framework can be provided for the BRI as well.

Not to board the BRI would thus mean that India’s neighbourhood
would become more militarised; India would be encircled by China; it
would lose access to greater trade, markets and infrastructure and would
be faced with an increasingly emboldened and less acquiescent
neighbours, while losing an opportunity to collaborate on regional issues
which could help in generating a framework which could alleviate
bilateral issues. These developments make it pertinent for India to join
the BRI and influence the way in which it is realized. India would also
be aided by the BRI as it could complement India’s own transnational
visions including the projects envisaged under the Act East Policy, the
Spice Route and the Mausam Project. Member countries could enjoy
fruits of institutional engagement such as greater cooperation and
convergence of interests which in turn would enhance stability in the ties
between the nations.

When Deng Xiaoping took over from Chairman Mao in 1978, he
aimed to quadruple China’s standard of living by the end of the century.
In order to do this China attempted to normalize relations with India,
held down expenditures on defense, extended economic contacts of
China internationally, and reduced chances of conflict which would
impede China’s development (Garver, 2001: 216). Picking a leaf from
Xioaping’s strategy, given the Narendra Modi government’s intention of
developing for all, India would do well to cooperate with China on the
BRI, while at the same time continue with other plans such as AAGC so
as to diversify aid avenues while ensuring that China also assists India in its *Vikas* agenda. India-China relations should not be held ransom by an assessment of ties based only on *realpolitik* and “[w]hile the border issue and regional security rivalry may not find an easy way out, it should not impede the leaders of the two countries from expanding the areas of cooperation and building up strategic trust between the two peoples” (Hu, 2017).

9. Conclusions

The above-mentioned explanations highlight the possible ways in which India’s official position, which is heavily based on relative gains, may be counterproductive to its own absolute gains. While keeping China’s strategy to “cooperate”, if India changes its strategy to “cooperate”, both countries would have the outcomes or pay-offs which bring more benefits to them, as seen from the arguments presented in the earlier sections, than if they do not cooperate. While the major issue of India has been the CPEC, in practice India has little control over what happens in that region. Harping on national sentiment that the region through which the CPEC is to run, which India terms Pakistan Occupied Kashmir, is an integral part of India and thus India should not enter into negotiations on the BRI, misses the plethora of economic, infrastructural and other benefits, which its involvement in the BRI would bring to India.

Thereby in order for India to realize that cooperation is a better strategy than not cooperating, it is required to envision international politics not simply from a relative gains or a zero-sum position which is solely based on power calculations but from an absolute gains position or non-zero-sum position which ensures comparative advantages to all involved in cooperation. Morgenthalau’s (1973) definition of power as
control of man over man (state over state) or as domination should be replaced by power as defined by Arendt (1969) as the ability of humans to act in concert with others, in order to enable countries to switch from expecting greater pay-offs from not cooperation to cooperating.

Despite the above-mentioned merits of the BRI, it cannot be a panacea for all ills which plague the 65 and counting countries which are a part of this initiative. Other challenges to the BRI pertain to the feasibility of China’s plan to invest and build infrastructure lines and then protect them in regions along the BRI, some of which are volatile, unstable and at varying levels of development. The BRI would need to reconcile the vast differences “in infrastructure capacity and trade performance ... between Europe and most other parts of the MSRI, particularly Africa and South Asia” (Palit, 2017: 6). The amount of time and money which will be needed for the implementation of the BRI which is still mutable is also a cause for concern for the partner countries. The immense investment which China is seeking to undertake in the BRI may not yield favourable results if the member countries are unable to provide the stable circumstances required for the completion of the BRI. The initiative also needs to accommodate existing bilateral institutional frameworks and existing rules of origin between countries seeking to join the BRI. Existing trade agreements and rules of origin which give preferential treatment to trade in goods will make it difficult for countries seeking to join the BRI to choose between preferential tariffs of existing agreements and more efficient new routes and incentives of institutions planned under the BRI (ibid.). Civil wars, border disputes, terrorism, piracy, corruption, change of political parties in member countries, local opposition to foreign investment and resentment over possible loss of jobs, and uneven development of countries along the BRI may also cripple China’s efforts at implementing the BRI which may lead to financial losses for China. The
framework with which the BRI intends to bring cooperation between sixty-five or so countries, through coordination of trade, communication, policies, infrastructure, finance and people of the member countries, can help in alleviating some of the abovementioned problems which plague the member countries. Given the mutable nature of the BRI, it is possible for all countries to coordinate their ideas and visions regarding the initiative which would provide a foundation built by all member countries making it less probable for bilateral or regional tensions to hold it ransom. India’s involvement in the OBOR/BRI would help in resolving some of the issues regarding local resistance to projects in countries like Myanmar and Vietnam, as Indian projects have not been met with similar protests in the past unlike China’s projects which are seen as detrimental for local communities as they are not benefitted in the form of basic income or employment.

In a nutshell, the BRI is a project aimed to ensure the continuation of China’s economic growth; it is an exercise in soft power undertaken by China by harnessing the concept of the ancient Silk Routes which straddled much of the same areas as will the BRI and it is a project with security ramifications for China as its presence in key economic and strategic regions will increase once the BRI is implemented.

If India decides to stay out of the BRI it may hamper India’s economic growth as China will be leading the emerging architecture and framework for trade between the BRI countries on terms which may not be favourable to India. While India’s current infrastructure needs a boost, if India remains a non-member to the BRI, it may end up having infrastructure as well as financial wherewithal and rules which will be at odds with the rest of the BRI nations. In addition, by staying out of the BRI India would also lose strategic space to China whose influence in the BRI nations would increase with a rise in its economic cooperation with them. By being a part of the BRI, India could act as a mediator
between China and the West; it could mould the BRI on lines which are more favourable to it; it could counter China’s increased economic and strategic presence in India’s neighbourhood and extended neighbourhood while at the same time increase its own economic and strategic footing along the BRI. This article has therefore not contended that cooperating may lead to a simplistic win-win for both India and China but it asserts that cooperating may lead to better or more favorable terms for India – in terms of accruing benefits for economic growth and connectivity, providing a space for India’s involvement in decision-making, influencing other members involved in the region, increasing presence in the region, preventing China from further encircling India in its own neighbourhood, possible positive implications on bilateral issues between India and China – than if it decides not to cooperate on the BRI.

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Notes

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National Development and Reform Commission (NDRC), Ministry of Foreign Affairs (MFA), and Ministry of Commerce (MOFCOM) of the People’s


China in Africa
The Engagement of China in Nigeria’s Oil Sector: Is the Transformation Positive?

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Abstract

Many a time, the relationship between China and Africa is stereotyped as an energy quest to sustain China’s economic growth, leading to anti-Chinese resistance narratives in Africa. Against this background, the observed presence of China in Nigeria, more specifically, warrants attention, as the strategic relationship has expanded significantly to emerge as a powerful, yet questionable, South-South alliance. We document the economic activities of China in Nigeria, through the channels of trade, foreign direct investment (FDI), and aid, to frame our understanding of the content of those ties. As the engagement of China in Nigeria is skewed towards the extractive industry, this paper mainly focuses on Nigeria’s oil sector, by tracing the transforming developments and addressing the challenges of Nigeria that relates with economic, environmental and social life, with China’s commercial presence in the oil sector. With the economic dimensions of this
contextual engagement, we set out a research agenda that focuses on the effectiveness of commercial activities of China in the Nigerian oil sector.

**Keywords:** China-Nigeria relations, foreign investment, trade, aid, oil

1. **Introduction**

The expansion of China’s economic strength to the African continent has gained prominence in the literature of contemporary African development (Wang, 2007; Hanusch, 2012; Carmody, 2009; Jenkins and Edwards, 2006; Edwards and Jenkins, 2014). The Chinese engagement with Africa became entrenched in “powerful market dynamics” (Eisenman, 2012) since 1995, making China the third importer of manufacturing in 2007 after the United States of America (USA) and Germany (Giovannetti and Sanfilippo, 2009). This fast-growing economic cooperation between China and Africa has led to the proliferation of Chinese companies and other multinational enclaves in the African continent (Mohan, 2013).

Consequently, China’s relation is “stereotyped” (*ibid.*) as energy quest to sustain its economic growth (Alden, 2005; Bing and Ceccoli, 2013; Cheru and Obi, 2011; Eisenman, 2012; Oyejide *et al*., 2009; Taylor, 2006; Tull, 2006), leading to “anti-Chinese resistance narratives in Africa” (Eisenman, 2012). On the other hand, the China-Africa protagonist (Gu, 2009; Aguilar and Goldstein, 2009; Ajakaiye, 2006; Broich and Szirmai, 2014; De Grauwe *et al*., 2012; Kaplinsky and Morris, 2009; Kaplinsky, 2013; Kragelund, 2009; Renard, 2011; Shen, 2015; Wu and Cheng, 2010; Yin and Vaschetto, 2011) argue that the presence of China has been beneficial to Africa through poverty reduction, improvement in GDP and prices of commodity exports in the global market. While the realities of the potential benefits of China’s engagement with Africa remain contestable, bilateral cooperation is
continuous with African countries who perceive China as a model for development and an alternative to their traditional partners (Kragelund, 2009; Renard, 2011; Giovannetti and Sanfilippo, 2009), among which Nigeria’s engagement with China is one of such bilateral relations.

As in the case of China’s engagement in Africa, the relationship between the Western countries and Nigeria is tagged as being exploitative, based on the structure and patterns of investment in the crude oil sector of the economy (Oyeranti et al., 2011; Taylor, 2015). Despite the negative perturbations of external influence on the domestic economy, Nigeria continues to court the presence of these foreign actors, more precisely, in the Nigerian oil sector, that is an essential driver of the local economy\(^2\). For China, its pursuit of “going global strategy” (Alden, 2005; Biggeri and Sanfilippo, 2009) led to the rising demand for oil inputs\(^3\) that are outstripping the country’s domestic resources. Hence, there is a need to source the natural resources from other countries, which includes Nigeria (Ogunkola et al., 2008; Kolstad and Wiig, 2011). However, as essential as the oil sector is to Nigeria’s economy, it is plagued with incessant issues of environmental degradation, pipeline vandalization, oil theft/production loss and job loss in the Niger Delta and other regions where exploration and production take place. Previous studies focused on the impact of foreign investment, and the challenges faced by Nigeria’s textile industry with the presence of the Chinese as the key player (Oyeranti et al., 2011; Atomre et al., 2009; Murtala Muhammad et al., 2017; Murtala Muhammad et al., 2018). Also, China-Nigeria oil-for-infrastructure plan has been studied (Gold et al., 2017; Quigley, 2014): whether their relationship is win-win or win-lose and the likely political undertones on an aggregate basis (Oyejide et al., 2009; Egbulu and Zheng, 2011; Taylor, 2007; Ogunkola et al., 2008). Therefore, to fill this research gap, this paper carries out a detailed assessment of the economic engagement between China and Nigeria in
the oil sector, to establish an adequate understanding of the sector-specific impact. The critical inquiry of China’s involvement in the Nigerian oil sector is based on the patterns of trade, FDI and aid.

Delineated in this paper are the related opportunities and challenges for the development prospect of Nigeria. The introduction section of this paper is followed by Section 2 that traces the historical and diplomatic ties between China and Nigeria. In section 3, China’s entry and environmental blueprint in Nigeria’s oil sector shall be discussed, while Section 4 reviews China’s engagement in Nigeria’s extractive sector, through the channels of trade, FDI, and aid. Section 5 discusses the government’s policies towards the sustainability of China-Nigeria relations. Section 6 provides some implications for change and transformation, following engagement of China in the Nigerian extractive industry. Section 7 concludes with some recommendations for further research.

2. The Historical Relationship between China and Nigeria

2.1. General Observations

China-Nigeria relationship is different from that of other African countries, the reason being that Nigeria is the second largest Chinese export market (Haugen, 2011; Egbula and Zheng, 2011) behind South Africa (Quigley, 2014). On the other hand, about 80 per cent of Nigeria’s exports to China are crude oil and other minerals (UNCTAD, 2014). The peculiarity of Nigeria is because Nigeria is a member of OPEC, and the 11th largest oil producer in the world with 38 billion barrels of production capacities (as depicted in Table 1). In addition to crude oil, the Geological Survey Agency of Nigeria records 44 exploitable minerals in commercial quantities (Nigeria Investment Promotion Commission, 2015).
Table 1 Volume of Nigeria’s Total Proved Oil Reserves in Africa (1994-2014)

<table>
<thead>
<tr>
<th>Region/country</th>
<th>Thousand million barrels</th>
<th>Thousand million tonnes</th>
<th>Share of total</th>
<th>R/P ratio</th>
</tr>
</thead>
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<tr>
<td></td>
<td>1994</td>
<td>2004</td>
<td>2013</td>
<td>2014</td>
</tr>
<tr>
<td>Algeria</td>
<td>10.0</td>
<td>11.8</td>
<td>12.2</td>
<td>12.2</td>
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<tr>
<td>Angola</td>
<td>3.0</td>
<td>9.0</td>
<td>12.7</td>
<td>12.7</td>
</tr>
<tr>
<td>Chad</td>
<td>-</td>
<td>0.9</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Rep. of Congo (Brazzaville)</td>
<td>1.4</td>
<td>1.5</td>
<td>1.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Egypt</td>
<td>3.9</td>
<td>3.6</td>
<td>3.9</td>
<td>3.6</td>
</tr>
<tr>
<td>Equatorial Guinea</td>
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<td>1.8</td>
<td>1.7</td>
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<td>2.2</td>
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<td>South Sudan</td>
<td>-</td>
<td>-</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Sudan</td>
<td>0.3</td>
<td>0.6</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Tunisia</td>
<td>0.3</td>
<td>0.7</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Other Africa</td>
<td>0.6</td>
<td>0.6</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Total Africa</td>
<td>65.0</td>
<td>107.6</td>
<td>130.1</td>
<td>129.2</td>
</tr>
<tr>
<td>Total World</td>
<td>1118.0</td>
<td>1366.2</td>
<td>1701.0</td>
<td>1700.1</td>
</tr>
</tbody>
</table>

Notes: * More than 100 years; # Less than 0.05 per cent.

As a result of Nigeria’s enormous oil reserves and mineral deposits, the nature of China’s imports from Nigeria is more of energy (Pegg, 2012; Murtala Muhammad et al., 2018). Besides, Nigeria needs fund for its development agenda, while China holds approximately US$3 trillion in foreign exchange reserves (Renard, 2011). Therefore, Chinese officials frequently refer to China and Nigeria’s relationship as complementary (China Daily, 2015; Alabi et al., 2011).

Specifically, the channels through which China has been able to impact on Nigeria are on FDI, trade and aid. In addition, the technical cooperation and financial aid that Nigeria gets from China indicate a long-time engagement between Nigeria and China (Oyeranti et al., 2011; Ogunkola et al., 2008; Oyejide et al., 2009; Gold et al., 2017). It is worth mentioning here that technical cooperation and financial assistance were the oldest forms of engagement between China and Nigeria before trade and investment were added as the basis for engagement. For a developing country like Nigeria, there is a need to go
beyond trade and investment in her engagement with China. As such, the relationship, according to China, has been described more of a strategic partnership. These channels are said to complement each other considering China’s goal of relating to Nigeria (Renard, 2011). Another interesting fact is that the movement of citizenries between China and Nigeria is trade-investment-related, with a diverse relationship. This engagement between China and Nigeria is accompanied by a wave of economic migration to Nigeria of state-influenced construction teams, oil and mining workers, as well as private traders of goods and services (Broadman, 2008; Mohan, 2013). Similarly, other challenges and benefit such as environmental spillovers and governance have also surfaced through this cooperation.

2.2. Historical and Diplomatic Links

Similar to most other African countries, the diplomatic relationship that Nigeria established with China is part of the benefits of the eight measures proposed at the 2006 Beijing Summit of Forum on China-Africa Co-operation (FOCAC, 2015)⁴. Furthermore, the 2006 Africa Policy made by China’s Ministry of Foreign Affairs reaffirmed its old principles of cooperation with the African continent on trade and investment. In addition to that, the intergovernmental Nigeria-China Investment Forum was founded in 2006 to promote the two countries’ investment cooperation among other things. Other agreements include the establishment of China’s Development and Trade Promotion Centre in Nigeria, and the establishment of a Nigeria Trade Office in China. The late 1990s to 2000s marked a watershed in the China-Nigeria relations. Part of the strengthened relationship was the bilateral engagement of China and Nigeria that was developed and strengthened with the signing of various agreements and memorandums of understanding (MOUs) as reported in Table 2.
Table 2 Selected Forms of Cooperation between China and Nigeria, from 2001 to 2015

<table>
<thead>
<tr>
<th>Year</th>
<th>Agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>Trade, Investment Promotion and Protection</td>
</tr>
<tr>
<td>2002</td>
<td>The Avoidance of Double Taxation and Prevention of Fiscal Evasion of Tax and Income</td>
</tr>
<tr>
<td>2002</td>
<td>Consular Affairs</td>
</tr>
<tr>
<td>2002</td>
<td>Cooperation on Strengthening Management of Narcotic Drugs, Psychotropic Substances and Diversion of Precursor Chemical</td>
</tr>
<tr>
<td>2002</td>
<td>Tourist Cooperation</td>
</tr>
<tr>
<td>2003</td>
<td>South-South Co-operation between China, Nigeria, and FAO</td>
</tr>
<tr>
<td>2005</td>
<td>MOU on a Strategic Partnership</td>
</tr>
<tr>
<td>2006</td>
<td>Economic Cooperation Agreement between Nigeria and Xinguang International Group of China</td>
</tr>
<tr>
<td>2009</td>
<td>Agreement against fake products exported to Nigeria from China</td>
</tr>
<tr>
<td>2009</td>
<td>MOU on promotion between the Ogun State government of Nigeria and Zhejiang Province of China</td>
</tr>
<tr>
<td>2010</td>
<td>MOU on peaceful cooperation</td>
</tr>
<tr>
<td>2013</td>
<td>China’s State Council Information Office (SCIO) agreement on showing free documentaries of China’s economic, political and other accomplishments in the Nigerian Television Authority (NTA) Abuja</td>
</tr>
<tr>
<td>2013</td>
<td>Economic and Technical Cooperation on:</td>
</tr>
<tr>
<td></td>
<td>i. Provision of finance for the Zungeru power plant and four airport terminal expansion projects;</td>
</tr>
<tr>
<td></td>
<td>ii. Mutual visa exemption for holders of diplomatic and official passports;</td>
</tr>
<tr>
<td></td>
<td>iii. Prevention of theft, illegal imports and exports of cultural property; and</td>
</tr>
<tr>
<td></td>
<td>iv. Maintaining the initial agreements on oil and gas</td>
</tr>
</tbody>
</table>

Sources: Ministry of Commerce China (MOFCOM, 2015); Nigeria Trade Hub (Nigeria Trade Hub, 2015) and Egbula and Zheng (2011).

The official forms of cooperation are complemented by the exchange of visits between the two countries at the highest political level (see Table 3). China-Nigeria engagement blossomed under the leadership of President Olusegun Obasanjo (1999-2007), because of the “oil for infrastructure” as a development strategy and Obasanjo’s frequent visits to China during his tenure. Under this strategy, China was awarded oil contracts in exchange for infrastructure development, due to her expertise in civil work, coupled with her ability to provide the necessary financial assistance (Oyeranti et al.; 2011, Gold et al., 2017). However, this “oil for infrastructure” development arrangement with the Chinese government was cut short in 2007 by a new government led by Umaru Musa Yar’Adua. The late Umaru Yar’Adua revoked most of the
“oil-for-infrastructure” contracts awarded by the previous government led by Olusegun Obasanjo, based on lack of transparency (Gold et al., 2017).

Table 3 Official Visits (1974-2014)

<table>
<thead>
<tr>
<th>Year</th>
<th>Name and Status of Leader(s)</th>
<th>Year</th>
<th>Name and Status of Leader(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov 1981</td>
<td>Huang Hua: Vice-Premier</td>
<td>Apr 2002</td>
<td>Jiang Zemin: President</td>
</tr>
<tr>
<td>Nov 1984</td>
<td>Tian Jiyan: Vice-Premier</td>
<td>Apr 2004</td>
<td>Hu Jintao: President</td>
</tr>
<tr>
<td>Mar 1990</td>
<td>Wu Xueqian: Vice-Premier</td>
<td>Nov 2004</td>
<td>Wu Bangguo: Chairman of the Standing Committee of the National People’s Congress (NPC)</td>
</tr>
<tr>
<td>Jan 1995</td>
<td>Qian Qichen: Vice-Premier and Foreign Minister</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sept 1996</td>
<td>Luo Gan: State Councillor and Secretary-General of the State Council</td>
<td>Jan 2006</td>
<td>Li Zhaoxiong: Chinese Foreign Minister</td>
</tr>
<tr>
<td>May 1997</td>
<td>Li Peng: Premier</td>
<td>Jan 2010</td>
<td>Yang Jiechi: Chinese Foreign</td>
</tr>
<tr>
<td>May 1999</td>
<td>State Councillor Ismail Amat: Special Envoy of President Jiang Zemin</td>
<td>May 2011</td>
<td>Minister</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Sheng Guangzu: Minister of Railways</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sept 2013</td>
<td>Zang Dejiang: Chairman of the standing committee of the NPC</td>
</tr>
<tr>
<td></td>
<td></td>
<td>May 2014</td>
<td>Li Keqiang: Chinese Premier</td>
</tr>
</tbody>
</table>

Sources: Egbula and Zheng (2011); This Day (2014); Ministry of Commerce China (MOFCOM, 2015) and Oyeranti et al. (2011).

The trend continued until the Umaru Yar’Adua-led government was succeeded by President Goodluck Jonathan in 2010, when China-Nigeria relations was rekindled, leading to a sharp upsurge in trade, investment and aid to Nigeria. Similarly, President Jonathan also involved China in infrastructural maintenance and solicited China’s assistance in the implementation of industrialisation program, coupled with other areas of economic development (Egbula and Zheng, 2011; Gold et al., 2017).
3. China in Nigerian Oil Sector

3.1. Emergence of China in Nigeria Oil Sector

Due to technology deficiency, high required capital and other associated risks, Nigeria, like other resource-endowed African countries, invites multinational corporations (MNCs) to invest in the oil & gas and other minerals sectors of the country (Obi, 2008; Taylor, 2007). The invitation is done under the Concession Agreement (CA), or Production Sharing Agreement (PSA) method as mentioned in Feng and Mu (2010). In the case of Nigeria, the latter is adopted in the oil sector. The oil sector is dominated by the Western investors that have been in a long-standing relationship with Nigeria (Nigeria is a former colony of the United Kingdom). China’s interest in Nigerian oil became more prominent when Nigeria began to experience a stable polity in 1999 (Egbula and Zheng, 2011), when President Obasanjo (1999-2003) sought China’s “oil-for-infrastructure” development model used to help develop the civil war-torn Angola (Bing and Ceccoli, 2013; Gold et al., 2017). On the basis of the bilateral relationship, three major Chinese state-owned enterprises (SOEs) listed in Table 4 were granted a refinery permit in Nigeria’s oil fields from late 2004 to 2006. Apart from these three, the interest of China in Nigeria has expanded beyond oil production and extraction. The China National Machinery (Sinomach), an engineering Chinese SOE, has more recently sought investment opportunities through construction contracts in Nigeria. Not only that, other firms that are seeking investment opportunities in Nigeria are China Power Investment, China Energy Engineering and Shenzhen Energy and Power Construction Corp.

More specifically, China came into Nigerian oil sector through powerful diplomacy and a deal of launching the Nigerian satellite in 2006 (Taylor, 2007; Taylor, 2015). The successive government revoked
Table 4 Major Chinese Oil and Gas Companies in Nigeria

<table>
<thead>
<tr>
<th>Company</th>
<th>Sector</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>China Petroleum &amp; Chemical Corporation (SINOPEC)</td>
<td>Oil and Gas</td>
<td>Bloc of 64, 66, 29 and operating right to bloc 2 Nigeria-São Tomé Joint Development Zone</td>
</tr>
<tr>
<td>China National Petroleum Corporation (CNPC)</td>
<td>Oil and Gas</td>
<td>Oil Prospecting License (OPLs) for 471,721,732,298</td>
</tr>
<tr>
<td>China National Offshore Oil Corporation (CNOOC)</td>
<td>Offshore oil and gas</td>
<td>45 per cent interest in Offshore exploitation (Oil Mining License OML) 130</td>
</tr>
</tbody>
</table>


the diplomatic oil-for-infrastructure agreement. However, before the oil blocs and licenses were revoked in 2007, China’s SINOPEC and Nigerian National Petroleum Corporation (NNPC) signed two agreements in December 2004 to develop Oil Mining Lease (OML) 64 and 66 (Taylor, 2007). The OML 64 has five exploration wells, with one well-encountering hydrocarbon resources, while OML 66 has drilled 18 exploration wells with 12 encountering hydrocarbon resources (Hurst, 2006; Taylor, 2006). Correspondingly, SINOPEC has a contract with the Nigerian Petroleum Development Corporation (NPDC) and the Nigerian Agip Oil Company (NAOC-Eni-Italian Oil) to develop the Okono and Okpoho oil fields, and both have 500 million barrels of reserves (Taylor, 2007; Taylor, 2015). CNOOC and NNPC in 2005 signed a US$800 million agreement to purchase thirty thousand barrels of crude oil daily for five years (Anyu and Ifedi, 2008; Hurst, 2006; Taylor, 2015; Taylor, 2007). Also, CNOOC purchased with US$2.27 billion a 45 per cent acquisition of OML 130 (China’s most significant acquisition in the world) in a controversial opaque ownership history for a working interest in an offshore bloc with Total-Petrobras (Alden and Davies, 2006; Downs, 2007).

In April 2006, a further 35 per cent oil exploration license was purchased for US$60 million (Obi, 2008). Subsequently, CNOOC paid
US$2.3 billion plus an adjustment of US$424 million for other expenses for NNPC 50 per cent equity stake in the OPL 246 bloc-Akpo oil and gas field. Also, China acquired OPL 246 oil field with guaranteed 70 per cent profits, while the NNPC would take 30 per cent of the profits as well as in the 80 per cent oil cost. As part of the deal, CNOOC is to refund US$600 million to the Total company being the money spent in developing the oil field. The OPL 246 bloc was equally controversial as it was initially allocated to South Atlantic Petroleum owned by the former Nigerian Defense Minister Theophilus Danjuma who believed that OPL 246 bloc was relinquished for political reasons. Hence, South Atlantic Petroleum sued the Nigerian government and lost the case (Taylor, 2007; Taylor, 2015).

Following the visit of China’s President Hu Jintao to Nigeria, CNPC benefited from Nigeria’s sale of four oil blocs (2 in the Chad Basin and 2 in the Niger-Delta region) in April 2006 (Obi, 2008). While SINOPEC paid US$2.5 billion to finalise a deal of 20 per cent share in bloc OML 138 with Total oil in 2009. Also, the purchase of Total oil comes on top of the 90,000 barrels per day that are currently being produced for SINOPEC by their client company Addax (Quigley, 2014). Therefore, Chinese companies invest in purchasing equity shares in oil blocs (Alden and Davies, 2006), not sole control, minimising their risk and enhance technological transfer from established industries. Thus, they rely on their major international oil companies (IOC) partners in carrying out actual production and releasing them from the technological demands that come with offshore drilling (Anyu and Ifedi, 2008; Quigley, 2014).

3.2. China’s Environmental Footprint in Nigeria

Despite the challenges facing China in the Nigeria oil sector, China is working hard to make headway and leverage in areas where they have a more competitive advantage (Carmody and Owusu, 2007; Downs, 2007;
Alden and Davies, 2006), through offering something different from their Western rivals (Pegg, 2012). Even though Chinese engagement in the extractive industry is late, its *modus operandi* is similar in many respects when compared to the other established MNCs operating in Africa (Kelley, 2012; Downs, 2007; Alden and Davies, 2006). Along with this line, the Chinese MNCs in Nigeria is willing to take more risk and pay higher to secure oil than their Western counterparts. For instance, in 2006, CNOOC offers a quarter of a billion dollars for the acquisition of Nigeria’s Akpo offshore oil and gas field over and above that of the Indian oil company (Kelley, 2012, Downs, 2007). While this is regarded as a success in China, the international competitors and non-governmental organizations (NGOs) view China’s oil companies’ business approach as unfair practices due to bribes and under-the-table bonuses it offers to secure oil fields (Anyu and Ifedi, 2008). Nevertheless, the emergence of China in the Nigeria oil sector is applauded at a time when the Niger-Delta region is becoming vulnerable due to the activities of the militias, oil theft, high production costs, insecurity and corruption concern which has led to the decrease in the number of Western MNCs operating in the region (Obi, 2008; Quigley, 2014).

As China’s engagement with Nigeria deepens in the extractive industry, hitherto, its pattern of trade and investment is criticised (Alabi *et al*., 2011; Oyeranti *et al*., 2010), as it skewed towards the extractive industry. In support of China, Pegg (2012) argues that China’s SOE MNCs’ negative impact in Africa is greatly exaggerated and are not significantly different in their actions from the traditional partners who have been exploiting the continent since the colonial period. The Nigerian traditional MNCs partners’ activities and their connivance with political elites has led to severe environmental, security and socioeconomic problems in the Niger-Delta oil-producing region (Anyu
and Ifedi, 2008). Besides, the resource-endowed Sub-Saharan African countries have challenges in managing their oil wealth successfully (Obi, 2008; Carmody and Owusu, 2007), a situation which predates the emergence of China’s engagements in the region (Pegg, 2012). These issues have led to the up-rise of militia and abduction of foreign oil companies’ nationals working in the region. The Chinese oil workers like their Western counterparts are not immune from the militia that are agitating and demanding for resource re-distribution and a cleaner environment (Alabi et al., 2011; Pegg, 2012; Hilsum, 2008). Nevertheless, while Chinese workers in the oil region were abducted too, there is no direct hostility towards them when compared with the Western MNCs abductees.

However, China is criticised for its role in selling arms to the Nigerian government to combat the Niger-Delta militias and ignoring human rights concerns amid the time when the region was volatile and traditional allies were reluctant to send any weapons to the reckless Nigerian military (Hilsum, 2008; Obi, 2008; Taylor, 2007). We admit that there are a lot of risks associated with crude oil mining in Nigeria. For instance, the communities where resources are being explored have high expectations of the impact of the oil company’s corporate social responsibility (CSR) on them (Pegg, 2012), whereas the term CRS and Extractive Industry Transparency Initiative against corruption in the Nigerian oil sector were relatively new to Chinese investors (Hilsum, 2008). In terms of specific CSR activities, China’s CNOOC in 2009 contributed the sum of US$1.03 million out of the US$2.28 million (in line with its own share), provided in educational scholarships by the consortium operating bloc OML 130 in Nigeria (Pegg, 2012).

As compared to the Western oil investors who are not meeting up to expectations and are contributing to environmental degradation in the oil-producing region (Kragelund, 2009; Anyu and Ifedi, 2008; Pegg,
2012), the overall size of China’s MNCs’ mergers and acquisitions in the region are modest (Downs, 2007), reason being that many of the Chinese oil companies invest in onshore fields and not so much in the oil-rich offshore fields. Hence, they are less vulnerable to the population of the areas hurting their production (Quigley, 2014). Therefore, evaluating the long-term consequence of the increased Chinese presence in the Nigerian extractive sectors may be too soon, as such relevance must be demonstrated empirically (Pegg, 2012).

4. China-Nigeria: Role of Trade, FDI, and Aid

4.1. Trade Patterns

As a reflection of the increase in demand for resources (Kolstad and Wiig, 2011), trade between China and Nigeria recorded considerable growth since the 1990s. In 2006, China began to build its first ever free trade zone (FTZ) abroad in Lagos, Nigeria. The Sino-Nigerian joint venture is to provide about 300,000 jobs and serve as a point of exit for locally produced Nigerian goods to markets in Europe and North America (Taylor, 2007). The China-Nigeria trade volume as shown in Figure 1 indicates that from 1992-1999, the disparity in their trade volume is minimal as compared to 2000-2015. The period of their renewed engagement of the year 2000 upward witnesses an astonishing increase in China’s exports to Nigeria, though Nigeria’s exports increase too. Gauging the exponential rise in Sino-Nigerian trade relations since 1992 when trade volume was US$96 million to US$18.57 billion in 2014 shows that the trade balance is in China’s favour, as imports from Nigeria is lower than the number of China’s exports (Figure 1). By 2013, Nigeria had a total of 6 per cent of China’s trade with the continent, while China recorded a total of US$10,486 million surpluses in trade with Nigeria (UN Comtrade, 2016).
Figure 1 China-Nigeria Trade Flows, 1992-2016

Source: UN Comtrade (2016).

In the composition of trade, China’s exports to Nigeria are comprised of diversified manufacturing goods, while China imports mainly minerals from the latter, as shown in Figure 2. In the three categories of trade, agriculture had a small share of 13.4 per cent and 2 per cent as exports from China to Nigeria and imports from Nigeria to China respectively. Due to the non-competitive nature of Nigerian manufacturing industries, its exports to China during the period under study was 23.5 per cent. On the other hand, China exported 77.8 per cent of its manufacturing in return to Nigeria. The third category, oil mining imports of China from Nigeria was about 75 per cent, while Nigeria’s exports of mining stood at about 8.8 per cent, which is the focus of this research, and the engine of the Nigerian economy shows surpluses in different years. The structure of trade between China and Nigeria remained the same for the past two decades and is unlikely to change.
**Figure 2** Composition of China-Nigeria Trade Partnership

**China's Exports to Nigeria (1992-2016)**

- Agriculture: 77.78%
- Mining: 13.40%
- Manufacturing: 8.81%

**China's Imports from Nigeria (1992-2016)**

- Agriculture: 74.51%
- Mining: 23.51%
- Manufacturing: 1.98%

Note: Based on the Harmonized System (HS) at the 2-digit level. HS01-HS24 – agriculture; HS25-HS27 – oil (mining); HS28-HS99 – manufacturing.
Source: Calculated from UN Comtrade (2016).
4.2. FDI Channel

In the entire region, Nigeria accounted for about 6 per cent of China’s total FDI outflows. It was ranked as the third largest investment destination behind Mozambique and South Africa in terms of FDI flows in 2013, as against Nigeria’s first position in 2012. In addition, at the end of 2012, China’s stocks in Nigeria were estimated at 9 per cent, and the share of the oil and gas sector was about 75 per cent (UNCTAD, 2014). As shown in Figures 3a and 3b, until the year 2002, Chinese FDI flows and stocks in Nigeria from 1992-2002 was zero. The period of increase in FDI coincides with when China officially launches in 2003 its “go global policy” (Alden, 2012). The developments in the Chinese FDI flows were US$68 million in 2006, US$390 million in 2007 and US$1631.14 billion in 2008, while FDI stocks totalled US$7446 billion at the end of 2012. However, the level of FDI attracted by Nigeria is still considered relatively minimal vis-à-vis other recipients of Chinese FDI in Africa when compared with her resource base, large market size and potential needs (Alabi et al., 2011).

More so, the actual benefits of Chinese investment that accrue to the Nigerian side have been debatable, as the human capital development in most of the agreements with China has not been given due attention (Atomre et al., 2009). In addition, there is growing concern about Chinese work practices, and people are sceptical about the benefits of Chinese firms. According to Taylor (2007; 2015), China “has fewer regards for local content, and proper safety standards are not upheld in most of their factories in Lagos. For instance, a fire incident occurred in a Chinese factory in Ikorodu-Lagos, an investigation revealed that the workers were locked up in the factory, which prevented the rescue of the affected persons”. To date, the Chinese firm has not been held accountable for the loss of workers. Nonetheless, Nigeria has continued to embrace Chinese investments (Ogunkola et al., 2008).
**Figure 3 (a)** Percentage of Nigeria in China’s Total FDI Flows to Africa, 1992-2015

![Graph showing percentage of Nigeria in China's Total FDI Flows to Africa](image)

**Figure 3 (b)** Percentage of Nigeria in China’s Total FDI Stocks in Africa, 1992-2015

![Graph showing percentage of Nigeria in China's Total FDI Stocks](image)

Source: Computed with data from UNCTAD and Johns Hopkins University (SAIS China-Africa Research Initiative, 2016).
4.3. Aid and Other Forms of Economic Cooperation

In 1982, Chinese Premier Zhao Ziyang visited Africa and declared the “South-South Cooperation” and added a new principle to its foreign aid: “diversity in the form”. The African continent is now the largest recipient (52 per cent) of China’s external development assistance, which is influenced by economic reasons, strategic diplomacy, domestic politics, ideologies, and values. China’s aid to Africa is highly criticised based on its divergence from the traditional official development assistance’s (ODA) norm. The concern is that it would be counterproductive to natural resources for cheap loans and other forms of assistance. However, Chinese finances are no longer automatically linked to access mineral equity, as China is moving towards direct acquisitions as a form of market entry into Africa (Bräutigam, 2011b; Bräutigam, 2011a).

At the bilateral level, China joined the league of donors in Nigeria through formal economic and technical cooperation agreements. For the period 2000-2009, China’s aid to Nigeria was about US$589 million (Figure 4). China’s official assistance to Nigeria is characterised by aligning debt financing with commercial projects, using aid to leverage funding from non-government sources, and focusing on capital expenditure and development of productive sectors (Bräutigam, 2010; Gold et al., 2017).

As depicted in Figure 4, Nigeria received less than 4 per cent of China’s total loan from 2000 to 2014. It is noted that the Export-Import (Ex-Im) Bank actively supports the finance of China’s engagement in Nigeria, and while SOEs pioneered China’s involvement in Nigeria, private players were not left out. These private entities include companies such as the China Civil Engineering Construction Corporation (CCECC), China Railway Construction Corporation
(CRCC) and Sinohydro, among others. Approximately, 20 per cent of the total construction in Nigeria is carried out by Chinese firms (International Monetary Fund, 2015). The numerous dealings mentioned above make Nigeria to be China-expertise-dependent. Thus, China’s approach to financing has also been identified as unique, especially in business development projects, in attracting trade credit and commercial loans, and in most cases, in that repayment is linked to the output of the projects (particularly crude petroleum).

**Figure 4** Volume of China’s Loans to Nigerian and African Governments, 1998-2016

![Graph showing volumes of China's loans to Nigeria and Africa (1998-2016)](image)

Source: Computed with data from Bräutigam and Hwang (2016) and SAIS China-Africa Research Initiative (2016).

However, Broadman (2008) and Kelley (2012) argue that the Chinese model of business development is somehow counterproductive, as many of the foreign-funded infrastructure projects do not meet the local needs and are pricy, while most are not supported with
maintenance. Few technical investments are channelled into the maintenance of the infrastructure constructed by the Chinese workers due to issues associated with transparency and governance. In a nutshell, the economic cooperation through investments and aid from the Chinese government has the potential to worsen the problem of mismanagement that already prevails in the extractive sector. For instance, China-financed infrastructural development projects under the Belt and Road Initiative (BRI) or the One Belt One Road (OBOR) carried out in Ethiopia and Sierra Leone are generating argument in the media (Kuo and Kommenda, 2018). The China’s Ex-Im Bank-financed Mamamah airport project in Sierra Leone was cancelled due to bombardment of disapproval from Sierra Leoneans, International Monetary Fund (IMF) and World Bank who perceived it as uneconomical when the existing one is grossly underutilised (The British Broadcasting Corporation, 2018; Construction Kenya, 2018). Also there are problems with the inaugurated Addis Ababa-Djibouti freight railway amid Djibouti’s concerns over non-proximity to users, maintenance, completion, and the quality of material used among others (Bekele, 2016; Anberbir, 2017; Berhane, 2017).

Nevertheless, there are no concerns on the potential implications of these African countries’ problems with China for the future of Sino-Nigeria relations. This is because the empirical evidence in the foregoing indicates the nature and the direction of the impacts of Sino-Africa relations vary from one African country to another, depending on the economic, social and political structures of the country in question (Kaplinsky and Morris, 2009; Broich and Szirmai, 2014). For these reasons, Yin and Vaschetto (2011) cautions on the issue of over-generalizing the findings and conclusions of specific case studies or selected countries in Sino-Africa relations as it may not be too relevant.
or applicable. Rather, African governments must strengthen their bargaining power and institutional structures to enact rules and regulations to be adhered to for the sustainability of their relationship.

5. Government Policies

There is no bilateral trade agreement between China and Nigeria. Instead, several policy reforms and agreements such as bilateral investment treaties that is meant to protect and promote investments partly explained much of the developments in China’s engagements with Nigeria (Oyeranti et al., 2010). Therefore, the China-Nigeria trade can also be explained through the analysis of changes in “at-the-border” trade policies, “behind the border” domestic market constraints, “between-the-border” factors and mutual relationship between investment and trade (Ogunkola et al., 2008).

More so, the Nigerian government has formulated various attractive policies through its agencies to attract FDI, promote trade relations and development assistance to maximise China’s engagement in all facets of its relations. The Bureau of Public Enterprises (BPE) – the agency responsible for the privatisation of state-owned enterprises in Nigeria – is an example. The agency emphasised and appealed to the Chinese government to invest in petroleum, mining, telecommunications, power and manufacturing sectors as these represent the main targets for investment (ibid.). In addition, the Nigerian Export Promotion Council (NEPC) is vested with the responsibility to administer export incentives in Nigeria. The Nigeria Investment Promotion Commission (NIPC) was as well created to support government policies gearing towards promotion, mobilization and reformation of the investment climate into key resources sectors. NIPC is conferred with the power to promote economic linkage and technology transfer between major projects, and
smaller adjacent businesses, to improve productivity, competitiveness, employment and growth in the economy (NIPC, 2015). In agreement with China-Nigeria development policies, the Chinese government did not hesitate to lay out to the Nigerian officials its terms of relations, which is energy security, to sustain its rapidly expanding economy. This happened during the process of renewal of bilateral engagement with China in the year 2002 (Egbula and Zheng, 2011).

More importantly, due to the sensitivity of Niger-Delta and other mining communities, the Nigerian government established the Federal Environmental Protection Agency (FEPA) with Public Act (1988). FEPA is to change the legal status quo of environmental regulation in the Nigeria petroleum industry, and to control or minimize the associated environmental impacts (Ite et al., 2013). Under the FEPA Act of 1988, penalties and enforcement mechanisms were imposed on MNCs to be liable for the costs of cleanup, restoration and payment of compensations to parties injured during their practices. According to Ebeku (2008), the Nigerian Petroleum Act 1969, Regulation 26, requires that one year upon a lease of license, the MNCs through its agents and contractors should submit to the Minister of Petroleum Resources the detailed program for the recruitment and training of Nigerians in all phases of petroleum operations, while Paragraph 37 demands that the oil MNCs upon ten years of oil mining lease should employ 60 per cent of all categories of skilled, semi-skilled and unskilled Nigerian citizens (Ebuk, 2008). Other policies include the Extractive Industry Transparency Initiative against corrupt practices in oil sector, CSR, labour law, and a local content requirement that will enable human capital development, environmental protection and technology transfer (Hilsum, 2008; Alabi et al., 2011).

However, in despite of the government policies put in place to checkmate and sanction excesses from MNCs investing in Nigeria,
China has been alleged for near total disregard for labour unions demand, labour law and work-related safety. Beijing disputably import workforce from home, thus depriving the host economy of the benefits of job creation. Yet, there are no “known voices” in Nigeria be it among economists, politicians or civil societies against China’s current disposition in this area. Neither has it raised any critical concerns about the implications of continuing China-Nigerian relations (Oyeranti et al., 2011; Taylor 2007). Although survey results show that Chinese private enterprises in Nigeria, Madagascar and Ghana uses over 90 per cent local workers for production except for managerial positions (Gu, 2009), we are of the opinion that the Nigerian government should not only put in place good governance and better macroeconomic environment, but should also ensure that Chinese investors comply with laws and regulations as this will translate to sustainable relationship.

6. Implications for Nigeria

The China-Nigeria engagement is considered complementary, when investments, trade and aid are taken together. This is evident through an increase in trade alongside with an increase in FDI and aid from China. The increase in trade, FDI and aid from China is reflected in the upward movement of Nigeria’s oil sector. Chinese vertical-type investment pattern in Nigeria’s oil is highly concentrated in just 2-3 large SOEs and it is significantly questionable whether the benefits get to the beneficiaries, i.e. the local community. While the macro implications of China’s engagement in the extractive sector of Nigeria indicate positive and negative transformations for the latter, the micro-level effects remain unclear as surveys are restricted towards that area. More importantly, “beneficiation” or “resource nationalism” must be accounted for to provide a clear understanding of whether China’s involvement in Nigeria
has been meaningful and transformative for the latter. The effects on the local economy and local communities, regarding domestic linkages, spill-overs (technology and skills), job creation, labour standards/human rights and environmental concerns, are key to understanding sustainable benefits from China’s engagement in the extractive sector of Nigeria.

For example, the local content development in the Nigerian energy sector has to some extent led to high-end value-chain activities, with many local companies licensed to operate upstream oil and gas assets and provide high-end engineering and drilling services to MNCs (Akinkugbe, 2013). Despite that, Broadman (2008) argues that the Chinese engagement in Africa only produces limited spillovers, as their business strategies entail the enclave type of corporate profiles. Regarding employment in the extractive sector, which is relatively less labour-intensive, recent statistics indicate that between 2007 and 2014 more than 8,000 jobs were created in Nigeria through cooperation with China (China Daily, 2015). Notwithstanding, the labour union has complained about the poor working conditions and the low wage payable to Nigerian workers in Chinese companies (Egbula and Zheng, 2011; Atomre et al., 2009). In the context of the oil mining sector in Nigeria, employment generation following China’s growing involvement and adherence to labour laws by Chinese companies is unknown (Ayodele and Sotola, 2014). Broadman (2008) is sceptical of employment creation in large numbers in this sector, because of the large capital involved and the sizable growth in imported Chinese labourers (Mohan, 2013). The outlook on employment generation appears even more unfit with the recent news of unregistered Chinese companies engaged in illegal mining in Nigeria, denying the local citizens gainful employment as these companies recruit mostly Chinese workers (Daily Times Nigeria, 2015).
Furthermore, the poor track record of China’s environmental issues at home is alarming; hence environmental concerns in the extractive sector in Nigeria (Rocha, 2008) will not be prioritized by Chinese companies, and this may lead to further degradation. Nigeria is being considered an infamous nation because of its oil-companies-related challenges. The above arguments have yielded no consensus on the impacts of Chinese engagement in Nigerian’s extractive sector of the local and community economy. It is empirically evident that the domestic outcomes of Nigeria through the growing involvement of China in her extractive sector is worthwhile. Existing surveys are relatively restricted (Hanusch, 2012) and even if they have examined the attitudes towards the Chinese in Africa, they have done so at the country-level basis. Examination at the country-level may provide some implications for the local economy (for example, the displacing effects of cheap imported manufactured goods from China, and the exacerbation of the resource curse), but often do not detail the implications for the local community. As discussed above, there are several socioeconomic dimensions through which the local community can be directly affected by larger activities in the extractive sector.

7. Conclusion and Recommendations for Further Research

This paper has conducted an analysis of China’s three effective strategies: trade, FDI and aid in Nigeria’s oil sector. Although China-Nigeria relations may be too early to measure considering the period of engagement, especially when comparing the benefits and the time frame of Nigeria’s traditional partners, it puts some assertion to rest on the magnitude of Chinese engagement with Nigeria, which is often exaggerated by the media. Furthermore, it also qualifies as some arguments and anecdotal evidence on the implications of China’s
participation in Nigeria’s extractive sector of the local economy and community. It is noted that there are no clear answers to the extent of beneficiation to the local community in Nigeria with the opening of the oil sector for China’s participation. Further research is therefore required to study the detailed impact on the local economy and host communities, following China’s involvement and engagement in the oil sector. For this purpose, this paper recommends a detailed survey of businesses in the extractive industry of Nigeria that has varying degrees of involvement with Chinese investors (large SOEs, small SOEs and private players).

Notes

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1. At present, 30 per cent of China’s energy is derived from Africa (Ayodele and Sotola, 2014), of which 70 per cent comprises crude oil (Kelley, 2012).
2. The extractive sector accounts for about 98 per cent of Nigeria’s exports, and about 40 per cent of its investments (Ogunkola et al., 2008).
3. China became the world’s second largest importer of oil after the US (Hanson, 2008; Alden, 2005). It is estimated that by 2030, China’s demand for oil will increase to 13.1 million barrels per day. This request will amount to the entire oil production in Africa and twice the production of Saudi Arabia (Kelley, 2012).
4. FOCAC was inaugurated in 2000, and there has been follow-up every three years in Beijing to foster the strategic China-Africa relations.
5. A term used to describe the proportion of the value derived from mineral exploitation which stays in the country and benefits the local community.
6. The Nigerian Oil and Gas Industry Local Content Bill was signed into law in April 2010. It places obligations on international and local oil companies relating to capacity-building and use of Nigerian services and personnel.
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Promoting Production Capacity Cooperation and Industrialization through Energy Infrastructure Development: The Case of China-Ghana Partnership

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Abstract
Although a number of studies have analyzed China-Ghana economic relations, an in-depth exploration of the role of the China-Ghana energy infrastructure development partnership in promoting production capacity and industrialization cooperation between the two countries is still lacking. In light of the Forum on China-Africa Cooperation (FOCAC) Action Plan (2016)’s commitment between China and African countries towards production capacity and industrialization cooperation, this paper examines the extent to which production capacity and industrialization cooperation between China and Ghana can be facilitated and promoted through energy infrastructure development in Ghana. Methodologically, secondary data sources are utilized. The paper argues that whilst China
and Ghana already have a number of projects under implementation in the energy sector, there is scope for China and Ghana to increase and intensify the current levels of investment cooperation in energy infrastructure development to spur industrialization and economic development in Ghana. The paper therefore recommends strategic prioritization of investments in the energy sector, a shift towards more emphasis on renewable energy, improvement of investment climate through policy and regulatory framework review, and complementing Chinese investments through exploring alternative sources of local and international funds for energy infrastructure development.

**Keywords:** energy infrastructure development, industrialization, production capacity, China, Ghana

1. Introduction

The economic relations between China and Africa span back to the 14th century during China’s Ming Dynasty with the voyages of Admiral Zheng He in East Africa (Vhumbunu, 2016: 272). Whilst the economic relations intensified over time with increasing trade, aid and investments which has seen China becoming the largest trading partner and investor in Africa, it is the formalization of the production capacity and industrial capacity cooperation between China and Africa through the Forum on China-Africa Cooperation (FOCAC) Summit of 2018 which presented an opportunity to transform Africa’s industrialization agenda. To facilitate the production capacity and industrial capacity cooperation, China and Africa committed to cross-sector infrastructure development, which included, among others, the development of energy infrastructure. Just as other countries, Ghana was presented with an opportunity for energy production which is key in industrialization. Whilst a number of
studies have been conducted on China-Ghana economic relations, there has not been any exploration of the role of the China-Ghana energy infrastructure development partnership in promoting production capacity and industrialization cooperation between the two countries. This paper therefore sought to examine the extent to which production capacity and industrialization cooperation between China and Ghana can be facilitated and promoted through energy infrastructure development in Ghana. In terms of organization, the paper will present a background and context of the China-Africa production capacity and industrialization cooperation. A review of literature on energy infrastructure and industrialization will then be presented, followed by an overview of energy production trends and patterns in Ghana. The impact and implications of China-Ghana cooperation in energy infrastructure development on Ghana’s industrialization will be discussed, before outlining the recommendations of the study in the form of policy review and strategies.

2. China-Africa Production Capacity and Industrialization Cooperation: Background and Context

One of the key outcomes of the FOCAC Summit of 2018 was the joint commitment made by China and African countries to promote production capacity and industrial capacity cooperation between the continent and China. Africa has had a long history of industrialization attempts, dating back to the colonial era, and the economic Structural Adjustment Programmes (SAPs). The understanding has been that accelerated industrialization will modernize the continent, facilitate job creation and poverty reduction, and promote inclusive growth (African Development Bank, 2018).
However, all the attempts appear to be failing to industrialize the continent at the desired pace and expected quality as evidenced by the state of industrialization in almost all of the African countries. The manufacturing trends on the continent depict de-industrialization in some countries whilst reflecting very minimum growth in manufacturing value added (MVA) component. For instance, the United Nations Industrial Development Organization (UNIDO)’s *Industrial Development Report* of 2018 states that whilst global MVA has more than doubled between 1990 and 2016, Africa’s MVA remains very low by global comparison. Even in all manufacturing and industrialization indexes, African countries continue to rank low. The UNIDO (2017)’s *Competitive Industrial Index Report* of 2017 which benchmarks the ability of countries to produce and export manufactured goods competitively ranks the majority of African countries low in terms of the MVA per capita and in Gross Domestic Product (GDP) Index, Industrialization Intensity Index, Manufacturing Export per Capita Index, Share of Manufacturing Exports in Total Exports, Manufacturing Export Indexes, Share in World Manufacturing Export Index, Share of Medium and High-Tech Activities in Total Manufacturing Export, and Index Industrial Export Quality Index (*see* UNIDO’s *Competitive Industrial Performance Report*, 2016: 6-295).

Table 1 presents a comparison of Africa’s MVA to other regions for the period between 1990 and 2016. As depicted in the table, it can be noted that industrialization in Africa has generally been low as compared to other regions. On the other hand, China has fast industrialized, having joined the Asian Tigers (Hong Kong, Singapore, South Korea and Taiwan) in Asia and Pacific region. China remains the world’s largest manufacturing producer and exporter with manufactured exports representing almost 97 percent of its total exports (UNIDO, 2018).
The country accounts for 18.4 percent of world’s trade in manufactured goods and 23.5 percent of global MVA, thereby accounting for the world’s largest share of MVA (UNIDO, 2018: 86).

**Table 1** Manufacturing Value Added (MVA) in Developing and Emerging Industrial Economies (1990, 2000 and 2016)

<table>
<thead>
<tr>
<th>REGION</th>
<th>MVA PERCENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1990</td>
</tr>
<tr>
<td>Africa</td>
<td>9,2</td>
</tr>
<tr>
<td>Asia and Pacific</td>
<td>38,6</td>
</tr>
<tr>
<td>Europe</td>
<td>16,0</td>
</tr>
<tr>
<td>Latin America</td>
<td>36,2</td>
</tr>
</tbody>
</table>


With such a manufacturing and industrialization base and performance, China is well-positioned to partner with African countries for industrial capacity cooperation and production capacity promotion. Therefore a smart partnership is essential and indispensable if industrialization is to be realized in its full potential. The joint commitment made by China and Africa to promote production capacity and industrial capacity cooperation thus presents a pivotal and fundamental opportunity to facilitate accelerated industrialization.

Under *Industry Partnering and Industrial Capacity Cooperation* in the FOCAC Action Plan (2016-2018:8), China and African countries expressed their readiness to “combine China’s competitive industries and high quality industrial capacity with Africa’s industrialization and economy diversification” for industrialization. The Action Plan stated:
“The Chinese side is willing to give priority to Africa in industrial partnering and industrial capacity cooperation. The African side welcomes the transfer of labour-intensive competitive industrial capacities of China to Africa in an orderly way, assisting Africa to increase employment, taxation and foreign exchange, and achieving technology transfer and common development.”

Further, there was a commitment to develop infrastructure through Public-Private Partnership (PPP) and Build-Operate-Transfer (BOT) across all sectors given its role in facilitating industrialization. Among other sectors targeted is the energy infrastructure development.

Ghana, like most Africa countries, is faced with the energy deficiency challenge which is impeding industrial growth and other economic activities. Access to electricity and other forms of energy remains a key component in achieving sound economic development and economic production since all these depend on a reliable and sustainable energy supply as aspired in the 2015 United Nations Sustainable Development Goal (SDG) Number 7 which seeks to achieve affordable and clean energy so as to ensure access to affordable, reliable, sustainable and modern energy for all people. The African Union (UN) Agenda 2063 also commits to “harness all African energy resources to ensure modern, efficient, reliable, cost-effective, renewable and environmentally friendly energy to all African households, businesses, industries and institutions” (African Union, 2015: 16).

However, adequate, efficient and sustainable energy production has been sluggish in Ghana for many years despite the existence of vast potential energy in hydro-electric energy, solar energy, marine power, geo-thermal energy, wind energy, and bio-energy, as well as crude oil and natural gas deposits (see for instance Andrews and Nwapi, 2018;
Asumadu-Sarkodie and Owusu, 2016; Rupp, 2013; Odoom, 2017; Prasad, 2008). It will be prudent, therefore, for Ghana to fully utilize the China-Ghana partnership with a view to promote production capacity and industrialization cooperation through energy infrastructure development.

3. A Review of Literature on Energy Infrastructure and Industrialization

Energy infrastructure development has for long been acknowledged as salient in any society given its socio-economic utility in economic production, economic growth, industrialization, modernization and sustaining improved living standards of citizens. Several empirical studies have confirmed that the expansion, upgrading and maintenance of a country’s energy infrastructure immensely contributes towards economic growth and development (see for instance Alper and Oguz, 2016; Bhattacharya et al., 2016; Alshehry and Belloumi, 2015; Bilgili and Ozturk, 2015; Bloch et al., 2015; Inglesi-Lotz, 2016; Iyke, 2015; Shahbaz et al., 2015). The authors stress the importance of energy access to health service delivery, education, reducing the cost of doing business, and job creation. As the African Development Bank (2018) notes, energy access is a key driver of inclusive growth as it opens up opportunities for all citizens including traditionally marginalized groups in the society such as women, youths and children in both rural and urban areas.

Countries that have emerged and succeeded in industrialization have largely invested heavily in energy production infrastructure. Jiang and Lin (2012) argued that energy demand has characterized industrialization and urbanization in China. As established by the authors based on a comparison of China to developed countries, higher economic growth fuels high energy demand, which then underscores the
need for a sufficient energy infrastructure base as a sine qua non for accelerated industrialization and economic development. This is critical if one considers the losses that are incurred by industries due to lack of reliable access to energy. The African Development Bank (2018: 2) hinted that firms in Ghana and Tanzania are losing 15 percent of the value of their sales due to incessant power cuts. The same debilitating effects on African industries and industrialization which are affected by load shedding, power faults, power cuts, and power technical constraints such as overbilling was confirmed by several other studies (see for instance Mandina and Kurwiravamwe, 2016; Mensah, 2018).

Of importance to note, however, is that debate on energy consumption-economic growth and energy production-industrialization nexus has lost much traction. Instead, the discourse has now shifted to energy renewability, energy production and distribution methodologies, as well as energy consumption formulas. Such has characterized global and regional trends in energy infrastructure development. Being the second largest consumer in the world after the United States (US), China has also shifted towards renewable energy production.

Alper and Oguz (2016) examined the role of renewable energy in economic growth using the asymmetric causality test approach and auto-regressive distributed lag (ARDL) model based on Eurostat data. The study focused on selected European Union (EU) countries for the period between 1990 and 2009. The authors’ overall finding was that there is a causal relationship between economic growth and renewable energy consumption. Similarly, Bhattacharya et al. (2016)’s study on the effect of renewable energy consumption on economic growth established that renewable energy sources are a significant driver of economic growth. The authors’ study focused on 38 top renewable energy consuming countries and applied heterogeneous panel estimation techniques. What has to be noted, however, is that the full potential of energy production,
upgrading and distribution may be hamstrung by barriers such as financial inadequacy, politics, climate change, human technical limitations, geographical factors, tariff regimes, as well as limited investment flows.

A study by Chang et al. (2003) reviewed the production and consumption of traditional and renewable energy in China since the 1970s. The findings were that China had committed a lot of investments towards research, development and exploitation of renewable energy. It is not surprising that today, studies are confirming that China has made strides in the development of renewable energy supplies. Csefalvay and Horvath (2018)’s assessment of the sustainability of renewable energy in the US, Canada, EU, China and Russia revealed that China, among other countries under review, was making significant progress in replacing non-renewable energy such as natural gas, crude oil and coal with a wide array of renewable energy sources like bioethanol, solar energy, et cetera for the purposes of sustainability. As Jiang (2008: 257) recommended, China should now focus on “energy-saving, high efficiency, diversified development, environment protection, technology guidance and international co-operation”.

It is the international cooperation dimension in energy production infrastructure that stands to be a fundamental feature in promoting production capacity and industrialization cooperation through energy infrastructure development in Africa in general, and in Ghana particularly. This is because Africa generally, and Ghana particularly suffers from energy deficit as well as constrained energy production, maintenance and upgrading capacity. The African Development Bank (2018) has stated that over 640 million people in Africa have no access to energy, with most African countries having an electricity access rate of just over 40 percent which is the lowest in the world. Per capita energy consumption in Sub-Saharan Africa (excluding South Africa) is
180kWh which is far below the 13,000 kWh per capita in the US, and 6,500 kWh in Europe (African Development Bank, 2018). This is despite having vast energy potential; for instance, studies have revealed that Africa is currently utilizing less than a tenth of its hydropower potential whilst failing to harness the immeasurable and boundless solar and wind energy potential on the continent (Cuesta-Fernandez, 2015; Tshombe et al., 2017; Mukasa et al., 2017; African Development Bank, 2018).

With specific reference to Ghana, Asumadu-Sarkodie and Owusu (2016)’s study on the potential and economic viability of solar photovoltaic (PV) power in Ghana established that at least 5 MW can be harnessed in 20 regional areas at a cost of US$17,752,179. To facilitate investments into the sector, the authors submitted that incentivization from the Government of Ghana via subsidies and creation of a conducive environment for investments was essential. As of 2015, Ghana was ranked 18 out of 45 African countries in terms of electricity consumption per capita, recording just over 400 kWh, with Libya, South Africa, and Seychelles constituting the top three with over 4,000 kWh of electricity consumption per capita (African Development Bank, 2017: 20).

Whilst the energy sector is vital for Ghana’s industrialization and socio-economic development, the energy infrastructure that facilitates the generation, transmission and distribution of electricity for both industrial and commercial purposes as well as domestic use remains inadequate. All in all, indications are that the electricity sector in Ghana is confronted with multifarious and multitudinous challenges. In “Energy demand in Ghana: A disaggregated analysis”, Mensah et al. (2016) avers that the existing power plants in Ghana are operating below full capacity due to constraints in power supply, climate challenges, limited water inflows in hydropower plants resulting in peak power
shortages. In the study, which sought to estimate the energy demands in Ghana through disaggregated analysis, the author recommended subsidization policies, encouragement of independent power producers as well as energy conservation programmes to enhance energy service delivery. Likewise, Appiah (2018) also recommended massive investments into the energy sector with more emphasis on renewable energy with the objective of boosting energy efficiency.

Whilst the recommendations are plausible and prudent, the need for high capital investments would require cooperation with international investors given the limits of domestic capital. This has been acknowledged by the various public institutions that administer the power system in Ghana, namely the Ministry of Power, the Energy Commission (EC), the Ghana Grid Company (GridCo), Volta River Authority (VRA), Public Utility Regulatory Commission (PURC), as well as the Electricity Company of Ghana Limited (ECG) (see Ghana Investment Promotion Centre, 2018). Therein lies the importance of promoting production capacity and industrialization cooperation with China through energy infrastructure development. This would also assist the country to achieve its renewable energy targets as set out by the Government to achieve 10 percent contribution of modern renewables in the electricity generation mix by the year 2020, and reduce wood fuels demand from 72 percent to 50 percent by the year 2020 (see Ghana Investment Promotion Centre, 2018: n.p.). Moreover, by 2030, Ghana will have a projected population of 40 million, which would translate to an energy demand of 18,000 to 25,000 MW, and per capita output of about 3,000 kWh. A smart partnership with China in energy infrastructure development will be necessary and needful.

Indeed, China has been involved in several energy infrastructure development projects in Africa through what has been widely termed “hydro-diplomacy” or “energy diplomacy” (see for instance Vhumbunu,
2016; Du Plessis, 2016; Arewa, 2016; International Energy Agency, 2017; Sy and Copley, 2017; Shen and Power, 2017). The projects mainly funded by Chinese State-owned banks though concessional loans and grants, mainly been implemented by Chinese State-Owned Enterprises (SOEs), may be a giant step towards the realization of Africa’s energy dream. A study by Castellano et al. (2015), Brighter Africa: The growth potential of the sub-Saharan electricity sector, states that Africa’s power sector alone requires US$450 billion up to the year 2030 to close the energy deficit whilst the oil and gas industry requires an estimated excess of US$2 trillion in investment between the years 2013 and 2035.

Several energy generation projects have been implemented by African countries in partnership with China. For instance, hydro-power projects alone include projects such as the Merowe Hydro-Electric Dam in Sudan, Song’oro Hydro-Electric Plant in Kenya, Zongo II Hydro-Electric Power Plant Project in the Democratic Republic of Congo (DRC), Kariba South Power Station Expansion Project in Zimbabwe, Dikgatlhong Hydro-Electric Dam Project in Botswana, Tekeze Dam in Ethiopia, Caculo Cabaca Hydro-Electric Power Project in Angola, Batoka Gorge Hydro-Electric Power Station Project in Zambia, Mamve’ele Hydro-Electric Dam Project in Cameroon, Soubre Hydro-Electric Power Station Project in Côte d’Ivoire, Imboulou Hydro-Electric Power Station Project in Congo Brazaville, Poubara Hydro-Electric Dam Project in Gabon, Mambila Hydro-Electric Dam Project in Nigeria, Isimba Power Plant Project in Uganda, and Grand Renaissance Dam in Ethiopia, among other several projects across Africa. Whilst studies by various scholars such as the International Energy Agency (2017), Vhumbunu (2016), Du Plessis (2016), Arewa (2016), Sy and Copley (2017) and Shen and Power (2017) have all stressed the fundamental role played by Chinese-partnered projects in terms of contributing to energy access, impacting on economic development, and
transferring of modern technologies in the energy sector via cheap loans or grants from China, there has been criticism of the funding mechanism that involves a conditionality for contracting Chinese companies in project implementation (Davies et al., 2008; Jansson, 2009) whilst other studies have identified long-term debt over-hang as a possible challenge in the long run (International Energy Agency, 2017; Jansson, 2009; Davies et al., 2008). Perhaps as Davis et al. (2008) recommended, African countries need to have an adequate understanding of Chinese aid architecture as well as improve the reporting capacity of government agencies for accountability purposes whilst debt reporting will also enhance transparency in debt accumulation.

Sustainability also remains vital in the China-Africa partnership in energy infrastructure development. Tan-Mullins et al. (2017) study “Evaluating the behavior of Chinese stakeholders engaged in hydropower projects in Asia and Africa” explores the interests of different Chinese stakeholders and accompanying implications in the Chinese hydropower projects using fieldwork data from four hydropower projects in Cambodia, Ghana, Nigeria and Malaysia. To the authors, the implementation of energy infrastructure projects in general, and hydropower projects in particular, requires sustainable planning, building and mitigation strategies that consider the national development priorities, local communities and the environment (Tan-Mullins et al., 2017: 464). Certainly, such an approach allows for sustainability even in industrialization and economic development.

The China-Africa partnership in energy infrastructure development can also be viewed within the context of the Belt and Road Initiative (BRI). The BRI is a long-term strategic development initiative of the Silk Road Economic Belt (SREB) and 21st Century Maritime Silk Road meant to foster trans-continental economic cooperation and connectivity through logistical and transport networks in the form of roads, pipelines,
airports, seaports, railways, energy and ICT infrastructure between China and over 65 countries of Europe, Middle East, Asia, and Africa. Although the BRI initially mentioned Egypt and Kenya as the main African players, other African countries may link the Africa BRI route and derive economic benefits of investments and trade. As Mathews and Huang (2018) argue, the BRI presents another dimension as a “conduit for clean power project”. Thus the BRI opens an opportunity for African countries to benefit from Chinese energy infrastructure development investments.

4. Energy Production Trends and Patterns in Ghana
The need for Ghana to embark on the massive industrialization and building of social amenities such as roads, schools, hospitals, and factories called for a reliable supply of power after attaining independence in 1957. This heightened need for infrastructural development initiated the building of a dam to provide the country with hydropower. The government therefore sourced for funding in terms of loans from the World Bank and the USA (VALCO specifically) to execute the project. Due to this factor, the Volta River Authority (VRA) was established in 1961 and charged with the duties of electricity generation via the hydropower of the Volta River, the construction of the Akosombo Dam and a power station near Akosombo, and the resettlement of residents. Formal construction of the dam begun in 1962 and was completed in 1965 at an estimated cost of US$200 million (Eshun and Amoako-Tuffour, 2016).

Rapid import substitution industrialization followed the construction of the dam in Ghana’s major cities, thus increasing the demand for power. By 1980, electricity demand matched electricity produced. Total generating capacity of the Akosombo Dam by 1972 had reached
3,321.23 GWh with the installation of two additional generating units. Domestic power consumption increased nearly sixfold from 540 GWh in 1968 to 3,917 GWh by 1976 with about a 10 percent annual growth rate. Domestic power consumption, however, fell from 3,917 GWh in 1976 to 3,429 GWh in 1978 and declined further to about 1,151 GWh in 1984 (VRA Annual report 2016) as a result of the deteriorating economy in the late 1970s and early 1980s especially in 1983.

**Figure 1** Trend of Energy Supply and Demand in Ghana, 2007-2016

![Trend of Energy Supply and Demand in Ghana, 2007-2016](image)


By the end of the year 2016, the total primary energy supply was 9,660 (KTOE). This was mainly generations from oil, natural gas, biomass, hydro and solar plants. Total energy demand on the other hand by the year 2016 was 7,085.5 (KTOE), also comprising mainly demand for electricity, petroleum products and biomass consumptions. Up until 1991, Ghana solely depended on hydropower for energy. Thereafter, other power generating alternatives were enacted to expand electricity
networks in Ghana especially in the northwest areas of Accra. This brought about the introduction of other sources of power such as thermal energy, solar energy, wind energy, bioenergy and renewable energy. In 1994 the construction of the first thermal energy plant was anticipated, enacted and it was completed by the year 1997. Upon completion, the plant contributed about 300 MW of electricity to the Ghana national grid.

Over the last decade, Ghana has experienced an increase of 49.8 percent in peak load from 1,274 MW in 2007, 1,506 in 2010 and 2,087 MW in 2016 respectively (Energy Commission, Ghana, 2018). Energy supply or generation capacity has also more than doubled over the period between 2007 and 2016, from 6,406 KTOE to 9,660 KTOE, recording an average annual increase of 8.60 percent. In spite of this, the country is still struck with energy instability, which has been the case over the last decade. This major challenge has affected many industries in their various operations and hence attracted huge losses to several others. With Ghana yet to be an industrialized economy, this power instability is going to greatly impact the economy becoming an industrialized nation since potential investors are becoming more rational with their business venture choices.

Figure 2 shows the share of distribution regarding access to electricity. This captures the total population’s access to electricity, access to electricity in the urban sectors of Ghana as well as access to electricity in the rural sectors. The trend indicates an annual increase in electricity access rate in both the rural and urban sectors of the economy. Given Ghana’s commitment to achieving universal access to electricity in a bid to become an energy economy by the year 2020, the National Electrification Scheme was established (Ministry of Energy, 2010). The National Electrification Scheme (NES), which is one of Ghana’s flagship projects, serves as the principal instrument leading the efforts to extend
electricity to all parts of the country within a period of thirty years from 1990 to 2020. As confirmed by the Ministry of Energy (2010), as at the time the scheme set off to assume service only about 15-20 percent of Ghana’s population had access to electricity (Energy Commission, Ghana, 2018). However, access to electricity reviews indicate a high access rates of 66.7 percent in 2009, 80.51 percent in 2015 and 82.5 percent in 2016 (Ministry of Power, 2016). The trend shows an annual increase in electricity access rate of 2.60 percent. However, Ghana’s situation is not that hopeless. There is hope for a sky-high revival if the right measures and policies are enacted.

**Figure 2** Access to Electricity – Urban and Rural Sectors, 1994-2016

Table 2 Installed Grid Energy Generation Capacity Operational as of May 2018

<table>
<thead>
<tr>
<th>GENERATION PLANT</th>
<th>Installed Capacity (MW)</th>
<th>Dependable Capacity (MW)</th>
<th>Fuel Type</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Hydro Generation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Akosombo</td>
<td>1,020</td>
<td>900</td>
<td>Water</td>
</tr>
<tr>
<td>Kpong</td>
<td>160</td>
<td>140</td>
<td>Water</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td><strong>1,180</strong></td>
<td><strong>1,040</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Thermal Generation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TAPCO- T1</td>
<td>330</td>
<td>300</td>
<td>LCO/Gas</td>
</tr>
<tr>
<td>Takoradi International Company(TICO 2)</td>
<td>80</td>
<td>320</td>
<td>LCO/Gas</td>
</tr>
<tr>
<td>Mines Reserve Plant (MRP)</td>
<td>110</td>
<td>70</td>
<td>Gas</td>
</tr>
<tr>
<td>Tema Thermal 1 Plant</td>
<td>49.5</td>
<td>100</td>
<td>LCO/Gas</td>
</tr>
<tr>
<td>Tema Thermal 2 Plant</td>
<td>38</td>
<td>45</td>
<td>Gas</td>
</tr>
<tr>
<td>Tema Thermal 2 Plant (Expansion TT2PP-X)</td>
<td>38</td>
<td>32</td>
<td>Gas/DFO</td>
</tr>
<tr>
<td>Kpone Thermal Power Plant (KTPP)</td>
<td>220</td>
<td>200</td>
<td>Gas/DFO</td>
</tr>
<tr>
<td>VRA Navrongo Solar Plant</td>
<td>2.5</td>
<td>-</td>
<td>Sunlight</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td><strong>2,340</strong></td>
<td><strong>2,107</strong></td>
<td></td>
</tr>
<tr>
<td><strong>IPP</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sunon Asogli Phase 1</td>
<td>200</td>
<td>180</td>
<td>Gas</td>
</tr>
<tr>
<td>Sunon Asogli Phase 2 Stage 1</td>
<td>180</td>
<td>160</td>
<td>LCO/Gas</td>
</tr>
<tr>
<td>Sunon Asogli Phase 2 Stage 2</td>
<td>180</td>
<td>160</td>
<td>Gas/LCO</td>
</tr>
<tr>
<td>CENIT Power Plant</td>
<td>110</td>
<td>100</td>
<td>LCO</td>
</tr>
<tr>
<td>Kar Power Barge 1</td>
<td>235</td>
<td>225</td>
<td>HFO</td>
</tr>
<tr>
<td>Ameri Power Plant</td>
<td>250</td>
<td>230</td>
<td>Gas</td>
</tr>
<tr>
<td>BXC Solar</td>
<td>20</td>
<td>-</td>
<td>Sunlight</td>
</tr>
<tr>
<td>AKSA</td>
<td>360</td>
<td>340</td>
<td>HFO</td>
</tr>
<tr>
<td>Kar Power Barge 1</td>
<td>235</td>
<td>225</td>
<td>HFO</td>
</tr>
<tr>
<td>Ameri Power Plant</td>
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<td>BXC Solar</td>
<td>20</td>
<td>-</td>
<td>Sunlight</td>
</tr>
<tr>
<td>AKSA</td>
<td>360</td>
<td>340</td>
<td>HFO</td>
</tr>
<tr>
<td><strong>Sub-Total</strong></td>
<td><strong>1,935</strong></td>
<td><strong>1,735</strong></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>4,275</strong></td>
<td><strong>4,882</strong></td>
<td></td>
</tr>
</tbody>
</table>

Table 2 shows Ghana’s installed electricity generation capacity. Ghana’s power supply sources are mainly from hydroelectricity, thermal fueled by crude oil, natural gas and diesel, solar and some imports and exports to and from Côte d’Ivoire, Togo, Benin and Burkina Faso respectively. With the current activities on grid expansions, there is high anticipation that Ghana will be unable to export energy to other neighboring countries in the sub-region (Energy Commission, Ghana, 2018). Ghana has a vibrant power generation terrain with players from both the public and private sectors. Reforms in the power sector in the 1980s gradually removed barriers and created a level playing field for the participation of independent power producers in an area which hitherto had only public sector participants.

As of May 2018, Ghana’s total installed capacity for existing energy plants was 4,132 MW consisting of hydro 38 percent, thermal 61 percent and solar less than 1 percent respectively. By the year 2020, Ghana aims to become an energy economy with reliable supply of high-quality energy services for the Ghanaian economy, with a budget of power distribution amounting 70,421,555 Ghana cedis. Prior to making Ghana an energy economy by the year 2020, a number of projects and activities (some completed with others yet to be completed) at various levels have been affected within the recent past years. For instance in 2017 a total of 445 MW of power capacity was added to the country’s installed generation capacity to bring the installed capacity from 4,132 MW in 2016 to 4,577MW in 2017. Significant among these projects are Kpando-Kadjebi 161 kV Transmission Line which was completed, the Aboadze-Prestea 330 kV Transmission Line which is about 70 percent complete, the Prestea-Kumasi 330 kV Transmission Line which is about 70 percent complete, and the Kumasi-Bolgatanga 330 kV Transmission Line which is about 50 percent complete. The current 225 MW
Karpowership was replaced by a 450 MW Karpowership resulting in an addition of 225 MW capacity. Counting on, the Unit 2 of Kpong Generation Station Retrofit Project and Phase 1 of the 220 MW out of the 370 MW AKSA Power Project were also completed. As of May 2018, the 340 MW CenPower Power Project is 85 percent complete. Works has also commenced on the 400 MW Early Power project and 240 MW Amandi Power Project (Energy Commission, Ghana, 2018).

Until the late 1990s, Ghana’s power sector had the Volta River Authority playing a monopolistic role in terms of generating and transmitting electricity to all regional sectors of the economy amidst balanced distribution to the Northern Sector through its subsidiary the Northern Electricity Department (NED). After the enacting of the power sector reform in the late 1990s, it came to light the need for Volta River Authority (VRA) to split into a separate generation and transmission system operations. This came as an opportunity for the private sector domain which also made it possible for other Independent Power Producers (IPP) to penetrate the market. According to Edjekumhene, Amadu and Brew-Hammond (2001), power supply constraints amidst growing energy demand coupled with the challenge associated with securing financial aid from the traditional financiers of the sector, including the World Bank, propelled the initiation of the power sector reform in Ghana. Overall, the inclusion of generating activities of the energy sector has in one way or the other increased access to energy.

5. China-Ghana Cooperation in Developing Ghana’s Energy Sector

The Republic of Ghana, with a population of just over 24 million, is one of the best performing economies of West Africa. Ghana is classified as a low-middle income country with a per capita GDP (PPP) of US$2,500. China’s relationship with Ghana dates back to the Pharaonic times in the
early 1960s even though modern Africa-China relations only began to blossom upon the continent’s decolonization in the 1950s and 1960s (Zeleza, 2014). Since 2000, after the first FOCAC, China has substantially scaled up its financial assistance to Ghana focusing largely on infrastructural projects (including water supply projects), making up for approximately two thirds of investments since 2007. The intention has been to support Ghana’s effort towards addressing the huge infrastructural deficits that impedes the country’s economic development.

According to the Ghana Investment Promotion Center, China continues to remain on top of foreign direct investment in Ghana, with a cumulative total of 23 new projects registered in just the first quarter of 2011 (Sarpong, 2015). With the aim of rising to a middle-income status nation, Ghana sets to implement all efforts needed to stimulate productivity in agriculture, expand the industrial base and encourage learning and innovation in information and communications technology (ICT) to place the country in good stead to benefit from the global information technology (IT) industry (Keith, 2014). Given the fact that Ghana depends mostly on hydropower plants, it has become necessary to investigate China’s engagement with Ghana in the energy sector. In the project analysis of China-Ghana South-South Cooperation on Renewable Energy Technology Transfer (Energy Commission, Ghana (n.d.)), in order to sustain its current economic performance, Ghana’s energy sector vision is to develop an “Energy Economy” to secure a reliable supply of high-quality energy services for all sectors of the Ghanaian economy and also to become a major exporter of oil and power.
6. Highlight on China-Africa Partnership on Energy Development Projects

The Bui Dam stands as one of the hydropower projects developed in recent years in Africa financed by China Exim Bank (CEB) and constructed by Sinohydro. Built on the Black Volta River in western Ghana, the Bui Dam is a multi-purpose dam with the key aims of electricity generation and water supply. Bui Dam’s history began in 1925 when its location was first deemed to be promising for a dam. In 1978, negotiations on the construction of the dam had evolved to the planning stage, with the involvement of the World Bank and Australia. Nevertheless, as elaborated by Hensengerth (2011: 9) a couple of coups d’état made accomplishment of this initiative an impossible one.

As highlighted by International Rivers (2015), there is no doubt that “China’s low-interest loans got the [Bui Dam] project into becoming a reality”. This is evident in Anane’s (2015) report indicating that the World Bank refrained from the decision to fund the project in the early 2000s particularly due to “the amount of campaign against the dam” on the environmental impacts of the project. The World Bank also generally abstained from hydropower projects at that time (The Guardian, 2013). Apparently, the Ghanaian government had to fall back on the Chinese counterpart for needed support again. After this period, Sinohydro finally submitted a proposition for the dam in the year 2005. The Bui Dam’s initial total project costs amounted to stand at US$622 million. Of this amount, US$562 million was provided by CEB, while the remaining US$60 million was accessed via an investment of the Ghanaian government (Hensengerth, 2011; International Rivers, 2015). Further funding of US$168 million accounting for about 27 per cent was needed to ensure the project was successfully completed. The CEB provided this additional funding (The Ghanaian Chronicle, 2011).
The Bui Dam with an envisaged capacity of 400 MW is currently ranked the second largest hydroelectric plant in Ghana next to the Akosombo Dam with a capacity of 1,020 MW (Volta River Authority, 2015). Together with the Kpong Dam with a capacity of 160 MW, the Bui Dam and the Akosombo Dam are Ghana’s only hydroelectric power stations. According to Water Technology (2015) and Stocks (2014), the Bui Dam also comprises an irrigation scheme that is likely to supply water for approximately 30,000 hectares of land, 32 km north-east of the dam (Kirchherr et al., 2016). This area would be comparable to 7.3 percent of Ghana’s Tain District where the project is located (Ghana Districts, 2015).

Aside from the construction of the Bui Dam, several other engagements and partnerships have also evolved. Significant among these include the signing of a US$3 billion deal with China Development Bank (CDB) in 2010 to develop Ghana’s oil and gas infrastructure as well as a US$10 billion deal with CEB to develop the country’s roads, railways, schools, and hospitals (Verma, 2011).

In the context of deepening Africa-China and Ghana-China ties, Shaanxi Regional Electric Power Group (SPG) has also partnered with BXC Ghana as a strategic partner. This partnership has seen the Electricity Company of Ghana (ECG) receiving over US$200 million in investment to boost its infrastructure to ultimately revive the local power distributor and make it more efficient. SPG is a large-scale electric power company which supplies power to more than 1,000 townships in 70 counties and districts in 9 municipalities of China’s Shaanxi province. With 6.38 million power customers, SPG proudly covers 76 percent of the provincial territory, or an area of 142,500 square kilometers, and provides electric power service to more than 20 million people in its catchment area. According to Business & Financial Times (2018), SPG
stands ready to forge ahead with IPP partners such as BXC Ghana to
make investments and contributions to the development of power
distribution network in Ghana by jointly building a new type of modern
power distribution network in West Africa.

Again, as of June 2018, construction plans are underway to birth
another huge energy project prior to the signing of a partnership
agreement between the two countries in March 2015. Armech Africa
Limited, a subsidiary of the Armech Group, in a partnership agreement
with Electricity Company of Ghana will construct a US$300 million
waste-to-energy (W2E) power plant in Tema to generate 60 megawatts
of clean energy (Construction Review, 2018). The project will be pre-
financed by the Armech Group via Industrial and Commercial Bank of
China, a Chinese multinational bank, without any sovereign guarantee
from the government and is intended to create over 1,500 direct and
indirect jobs and will also increase access to green and renewable
electricity and lower environmental hazards as well as exposure to
harmful pollution. Here again, the construction will be done by Energy
China, one of the largest comprehensive solutions providers for the
power sector and infrastructural project in China and the world. This
project is intended to significantly enhance environmental sustainability,
 improve public health and limit the need for landfill sites, whilst
producing the scarce base load renewable energy and will represent the
first waste-to-energy project in the Economic Community of West
African States (ibid.).

With a project budget of US$2,720,000, Denmark financed the
China-Ghana South-South Cooperation on Renewable Energy
Technology Transfer Project (RETT). RETT is a four-year (2015-2018)
tripartite initiative designed to facilitate the transfer of knowledge and
technology between China and Ghana, by building on China’s unique
experience in renewable energy development via south-south
cooperation with funding support from Government of Denmark. The project forms an integral part of the Government of Denmark’s commitment to enabling coherent cooperation between China and countries in Africa, in the promotion of the UN’s Sustainable Energy for All (SE4ALL) initiative (United Nations Development Programme, 2018). This is in relation to the reality that even though the national-level electricity access in Ghana has increased to 76 percent, rural areas lag with only 40 percent access, which has a negative impact on rural development in Ghana.

This project is a partnership of the Energy Commission in Ghana, the Ministry of Science and Technology in China together with the UNDP Country Offices in Accra and in Beijing. The project operates both at the upstream level (supporting the creation of an enabling environment for technology transfer) and downstream level (actual transfer and demonstration of technologies with potential upscaling by the private sector). By June 2017, pre-feasibility studies have been conducted and potential sites identified. Match-making between Chinese and Ghanaian companies is ongoing with the hope that this project will be completed and finally see the light of the day. If this becomes a shining reality, Ghana can have a sigh of eventual relief from severe energy technology deficiency (United Nations Development Programme, 2018).

The above projects indicate that there is firm foundation for greater cooperation in terms of energy production which is vital in ensuring productive capacity cooperation between China and Ghana whilst triggering Ghana’s industrialization. The two countries have greater scope to partner in energy production across the various energy sources, especially relating to renewable energy production.
7. Possible Challenges and Threats to the China-Ghana Partnership in Energy Infrastructure Development

Whilst the China-Ghana partnership in energy infrastructure presents very valuable opportunities to facilitate the promotion of production capacity and industrialization cooperation, one cannot ignore the potential challenges that may threaten the process. The main challenges affecting the effective implementation of China-Africa partnership projects may also perturb the China-Ghana energy infrastructure development projects. In the report *Dance of the lions and dragons: How are Africa and China engaging, and how will the partnership evolve?*, Sun *et al.* (2017) state that while job creation and skills development, knowledge and technology transfer, and access to infrastructure financing are accrued as benefits from Chinese investments, there are challenges that local outsourcing is limited, local managers in China-Africa investment projects are few, and challenges such as corruption, labour law violations and insufficient adherence to environmental regulations are still common. A very prominent case is the massive deportation of Chinese nationals from Ghana in 2013 after they were accused of being involved in illegal gold mining activities ("galamsey") which was also causing extensive damage on the environment (see Aidoo *et al.*, 2017).

With respect to skills transfer, Tang (2018: 940)’s study on the impact of Chinese investments on Africa’s manufacturing sector focusing on Ghana observed that Chinese investors were unwilling to teach local workers and companies skills because of communication problems, prejudice against Ghanaians or competition concerns, whilst also revealing that most of the machinery/technology brought to Ghana were out-of-date or already “mature” which obviously retards industrialization and modernization. The China-Ghana partnership in
energy infrastructure development may fail to promote production capacity and industrialization cooperation due to these factors.

The real benefits of production capacity cooperation and industrialization has a possibility of being affected by corruption amongst political leadership and within the bureaucracy. Idun-Arkhurst (2008) also observed that despite Ghana’s impressive policy performance on investment governance issues compared to most African countries, there is prevalent corruption in political circles which is often worsened by bureaucratic delays in handling and approving investment deals. If checks and balances are not instituted, perhaps through enhancing the oversight role of parliament as well as promoting the watchdog role of civil society organizations and media, corruption will affect the end objectives of the China-Ghana partnership in energy infrastructure development.

With the heightened fear of debt accumulation, the China-Ghana partnership in energy infrastructure development faces a possible threat. Through what has now been termed the “debt-trap diplomacy” (see The Australian, 2018), there are legitimate fears that some African countries may mortgage their strategic assets and resources. More prudent financing mechanisms are encouraged which will also preserve the international reputation and image of China as a viable investor on the continent. The real threat may be shortcomings with respect to negotiation abilities and skills amongst the political elite and bureaucrats within African governments. Coupled with this, limited capacity of African governments to undertake comprehensive investment project planning, project design, project risk management and analysis may also threaten the optimum delivery and socio-economic impact of the energy infrastructure development projects in Ghana since this is also a challenge. This has been the case with other Chinese projects elsewhere on the continent; for example, the US$4 billion Addis Ababa-Djibouti
freight railway officially inaugurated in 2018 was reportedly costing China almost US$1 billion in losses due to debt restructuring whilst Sierra Leone scrapped the US$318 million Mamamah International Airport Project which had been commissioned by the previous president of the country in March 2018 and was scheduled to be completed by 2022, on the basis that the project was economically unviable and had been embarked on without due diligence (The Straits Times, 2018). Proper and detailed project feasibility analysis as well as wide consultations and stakeholder engagements are critical as Ghana engages China on energy infrastructure development projects.

8. Recommendations and Conclusion

From the discussions, it can be noted the China-Ghana partnership in energy infrastructure development has significant potential to facilitate more effective production capacity and industrialization cooperation between the two countries. This is because as discussed, energy infrastructure development ensure more reliable distribution and access to energy which propels industrialization and economic production in Ghana.

It is therefore recommended that Ghana fully utilizes the opportunities presented by Chinese production capacity and industrialization cooperation through identifying priority energy infrastructure development projects for investments from China. These may cut across different sources such as hydro-electric energy, solar energy, marine power, geo-thermal energy, wind energy, and bio-energy, as well as crude oil and natural gas deposits. Developing an energy sector investment catalogue will facilitate strategic engagement with China and allow for Ghana to be able to pursue its interests in the sector when negotiating with investors from China.
It is also recommended that Ghana focuses more on prioritizing renewable energy infrastructure development. Such an approach will require the key public institutions in Ghana, namely the Ministry of Power, the Energy Commission (EC), the Ghana Grid Company (GridCo), Public Utility Regulatory Commission (PURC), and Electricity Company of Ghana Limited (ECG) to prioritize renewable energy projects in light of the threats posed by climate change on the country’s heavy reliance on hydropower energy. Given China’s advanced and sophisticated technology in the energy sector as well as its drive for renewable energy, Ghana may take advantage to negotiate more investments into harnessing abundant solar energy, wind power, geothermal energy, biofuel, biomass, tidal power, and biogas. For instance, China is one of the leading producers and developers of photovoltaic power stations across Africa (see for instance Wang, 2010; Zhang and Yang, 2006; Zhao et al., 2013; Zhao et al., 2011). It will be strategic to incentivize Chinese investments in solar energy production given Ghana’s advantageous geographical location along the equatorial region.

With the establishment of the US$10 billion China-Africa Industrial Capacity Cooperation Fund, jointly established by the China Foreign Exchange Reserves and Export-Import (Exim) Bank of China, engaging China to secure infrastructure financing is critical. However, developing bankable and sustainable projects remains a pre-requisite. Thus the Government of Ghana should invest in diligent project preparation capacity building, effective project planning and management, as well as sound practices in monitoring and evaluation especially in the private and public sector. This will also reduce the possibility of lopsided and asymmetric investment deals on the part of Ghana.

It is also prudent for Ghana to complement its partnership with China in energy infrastructure development through Private-Public
Partnerships (PPPs) as well as other local sources of funds for infrastructure development such as further capacitating its already existing Sovereign Wealth Fund (SWF), tapping into pension funds, incentivizing local investment initiatives, and cooperating with other international economic partners or investors. This will assist to avoid a debt trap and accumulation of unsustainable debts through China’s lending.

Lastly, the development of conducive policy, legislative and regulatory frameworks within the energy sector in Ghana will assist to promote production capacity and industrialization cooperation between the country and China. Crucial to this is the reduction of cost of doing business as well as other barriers to investment. Currently, Ghana is ranked 111 out of 137 countries on the *Global Competitiveness Report* of 2017-2018 (World Economic Forum, 2018). However, with specific reference to the performance of public institutions, which encompasses, among other indicators, the burden of government regulation and efficiency of legal frameworks, the country is ranked 46 out of 137 (*ibid.*). This is not so bad by African standards and peer comparison although there is scope to improve on all the indicators. Investment governance has to be strengthened to prevent corruption and facilitate quicker turnaround time with regard to investment approvals.

Similarly, the World Bank’s *Doing Business Report* for 2018 ranks Ghana on position 120 out of 190 countries (World Bank, 2018). The World Bank rankings are a product of consideration of 10 indicators, namely revolving around procedures, time and cost of starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency (World Bank, 2018: 2). Therefore, as committed in the study of Jonker and Robinson (2018: 8) on the FOCAC Action Plan (2016-
2018), Ghana must continue to “improve laws, regulations [in terms of improving the functioning of market-regulating institutions] and introduce preferential policies [in a bid to pursue macroeconomic stability, and strengthen procedures for contract enforcement and dispute settlement. To this effect the Ghanaian government can also improve the coherence of policies in areas such as trade, tax, competition and investment promotion which will in turn affect the volume of investment and its development impact] to create an enabling conditions and environment to attract investments by Chinese companies and support industries and industrial capacity from China.”

On the basis of the study’s findings, it can be concluded that the China-Ghana partnership presents massive opportunities for the two countries to promote production capacity and industrialization cooperation through energy infrastructure development. There is scope for China and Ghana to increase and intensify the current levels of investment cooperation in energy infrastructure development to spur industrialization and economic development in Ghana. Strategic prioritization on the part of Ghana as well as further improving the investment climate in the country will bear desirable fruits in energy infrastructure development.

Notes
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ADIZ and the Chinese Military
Geo-Strategic Significance of East China Sea Air Defense Identification Zone (ECS-ADIZ): A Threat-Import Analysis

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Abstract
This study aims at evaluating the strategic implications of the East China Sea Air Defense Identification Zone for regional security. On November 23, 2013, China announced the establishment of an Air Defense Identification Zone on her East Sea axis. This was in its determination to assert control over disputed maritime territories, and to respond to the United States’ Asia Pivot role geared towards containing and encircling China on one hand, and support for Japan’s remilitarization on the other hand. In its declaration, China demanded that all aircraft transiting the zone must comply with the identification rules, threatening that non-compliance will attract emergency defensive action. This move was necessitated by the imperative for safeguarding Chinese sovereignty, territorial and airspace security, as well as to maintain flight order in pursuit of self-defense. The manner in which the Chinese ADIZ was declared, particularly its coverage that goes beyond Chinese airspace, stretching into the disputed maritime territory, has generated
considerable anxiety among regional and international stakeholders. Relying on qualitative analysis of secondary data, and guided by a threat-import approach to securitization, the study posits that the creation of the East China Sea ADIZ portends a geo-strategic threat capable of engendering tension in the wider Asia-Pacific. The paper recommends that, rather than resorting to armed build-up and possible confrontation, the parties involved should seek a pacifist resolution to the maritime question based on regionally mediated diplomatic tradeoffs.

**Keywords:** aircraft, Air Defense Identification Zone, disputed maritime territories, East China Sea, identification rules

1. Introduction

Every state in contemporary international system exists and functions within a strategic environment comprising allies and adversaries. Arising from this, the pattern of a state’s interaction within its strategic milieu is predicated upon its perception and interpretation of stimuli emanating from its surroundings. Historical and empirical evidence clearly reveals that actors have at various times responded both negatively and positively to overt and covert stimuli from their strategic locality. In 1907, for instance, Britain widened its alliance with France to include Russia under the umbrella of Triple entente fearing that Germany’s rising power could make it become isolated and affect its capacity to defend its distant empire. Germany, in return, seeing it encircled, tightened her partnership with Austria and Hungary under the Triple alliance (Nye, 2003).

Recently in Eastern Europe, as the boundaries of the North Atlantic Treaty Organization advance ever closer to the territory of the Russian Federation, Russia responded to what it perceived as an attempt by the United States and its allies in the European Union to militarily encircle
Russia and perhaps render inoperable Sevastopol (Black Sea docking facilities) which has been an essential nucleus to advance Russia’s naval capability on a global platform, by superintending over the organization of a referendum in Crimea that paved the way for the former’s annexation of the later in the aftermath of the Western-backed Colour Revolution that ousted pro-Russian Ukrainian Prime Minister Viktor Yanukovich in February 2014 (The Guardian, 2014; Owen, 2014; Walberg, 2014).

The foregoing illustrations are a pointer to the significance of a country’s strategic milieu and the need for states to react to stimuli emanating from the same. As Owen (2014, para. 3) rightly noted: “spheres of influence exist in the minds of many nations even if not formally acknowledged in international law”. The People’s Republic of China is not left out in this statecraft. In reaction to the escalation of military apprehensions in the Asia-Pacific region precipitated by the Obama administration’s “Pivot to Asia” foreign policy (anti-China strategy) which is fundamentally targeted at isolating and encircling China both diplomatically and militarily and checking China’s challenge to United States’ dominance in East and South Asia by supporting Japan’s remilitarization (Chan, 2013, November 25), the Chinese government, in the exercise of its right to self-defense as enshrined in Article 51 of the United Nations Charter and in accordance with international practice, on November 23, 2013, announced the establishment of an Air Defense Identification Zone in the East China Sea with the aim of safeguarding state sovereignty, territorial land and air security and preserving flight order (Erickson, 2013, November 23).

Before the recent Chinese declaration of an ADIZ over the East China Sea, the US military, in acknowledging different countries’ de facto valid control over their territories, had after the World War II and during the Korean War, demarcated the existing ADIZs in the Northeast
Asia in such a manner as to disallow overlap between the existing ADIZs; consequently, in order to avert an accidental clash, South Korea, Japan and Taiwan took over these lines (Osawa, 2013).

In spite of its multilateral implications for two thirds of the East China Sea, the Chinese ADIZ was announced suddenly and apparently without consultation with countries, in this case US and Japan, and other neighbours like South Korea and Taiwan, whose civilian and military aircrafts will be affected by the declaration (Metcalf, 2013; Osawa, 2013). The Chinese ADIZ overlaps with other ADIZs in the region: it overlaps with Taiwanese ADIZ by comparatively diminutive 23,000 square kilometres (Taipei Times, 2013) as well as the Japanese and South Korean ADIZs. Also, the East China Sea ADIZ covers an area of ocean where South Korea has a marine research station built on a submerged rock (South Korean-claimed Socotra Rock) (Gale, 2013); it encompasses the disputed maritime territories known as Senkaku (尖閣) in Japan and Diaoyu (釣魚) in China but currently under Japanese control. At the same time, the East China Sea ADIZ includes some joint training airspace of the US Air Force and the Japan Air Self-Defense Force, as well as US military firing and bombing ranges in the East China Sea (Osawa, 2013).

Another problem with the East China Sea ADIZ is that unlike most countries’ ADIZs which only require identification for aircrafts intending to enter their national airspace, China in its declaration has demanded that aircraft flying in the zone identify themselves even when their destination is not the Chinese mainland (Laird and Timperlake, 2013) thereby contradicting with the basic early warning and traffic control purposes of an ADIZ (Metcalf, 2013,¹ as cited in Erickson, 2013). Moreover, though there is no internationally legally binding rules governing the declaration and operation of an ADIZ, the US and Japan, in their submission during the International Civil Aviation Organization
(ICAO) Council meeting held in Montreal in March averred that by contemplating the adoption of defensive emergency measures to respond to aircraft that do not cooperate in the identification, China’s ADIZ contravenes the principle of “freedom of over flight” in high seas as codified in Article 87 of the 1982 United Nations Convention on the Law of the Sea (UNCLOS) (Lee, 2014).

The Chinese ADIZ has also been adjudged as an anomaly or an irrational act challenging multiple players in the Pacific, having fallen within the strategic quadrangle in the Pacific, that is, a central area where the US and several core allies such as Japan, South Korea, Australia, India, Singapore et cetera are reaching out to shape collaborative defense capabilities to ensure defense in depth (Laird and Timperlake, 2013, as cited in Keck, 2013). Noting that the freedom to operate in the quadrangle is a baseline retirement for allies, Laird and Timperlake (2013, as cited in Keck, 2013) have warned that with the East China Sea ADIZ, the People’s Republic of China is putting down its marker unto the quadrangle and if not properly addressed, will definitely expand its definition of air and maritime defense outward.

In the light of the foregoing, the following questions have become imperative: Does the ECS-ADIZ escalate tensions in the Pacific and even beyond? Does the ECS-ADIZ pose a threat to global peace? In responding to these vital analytical posers, the study maintains a threat-import analytical approach, which emphasizes the strategic implications of ECS-ADIZ as a veritable security threat in the geo-strategic context of the East China Sea. This investigation is justified on two reasons: the first is that it helps to bridge the knowledge gap occasioned by over-reactions trailing the East China Sea ADIZ declaration; the second justification derives from the fact that given deep-seated hostilities between China and its neighbours, especially Japan where territorial dispute over pockets of islets in the East China Sea has assumed a
disturbing dimension as well as hegemonic struggle between China and US over the control of resources in the Pacific, these new air traffic restrictions and the first of its kind by China has the propensity of escalating these tensions into a full-blown war in the event that China decides to embark on military enforcement of its ADIZ rules.

This paper is divided into seven segments: part one deals with introduction; part two addresses on the historical and contextual issues concerning ADIZ; part three explores the background of ECS-ADIZ declaration and the reactions it generated; part four focuses on the rules and procedures for aircraft identification; part five assesses the implications of the ECS-ADIZ declaration for security in the Asia-Pacific region; part six examines the repercussions of the ECS-ADIZ on global peace while part seven is the conclusion.

2. Historicizing and Contextualising ADIZ

Though the origin of the concept of an ADIZ is not a recent development in international politics as it dates back to the 1950s, as a result of the controversy generated by China’s declaration of an ADIZ in the East China Sea, it has become imperative that we attempt a resolution of contending issues surrounding the ADIZ phenomenon.

Page (2013) asserts that an ADIZ has no foundation in international law and is not administered by any international organization. As such, definitions and rules differ among diverse countries. Characteristically, such zones extend well beyond a country’s airspace to provide its military time to respond to potentially hostile inward bound aircraft. According to him, ADIZ declaration requires foreign military aircraft to identify themselves and their flight plans on entering the ADIZ or else such aircraft will often be intercepted and escorted inside the ADIZ but will not be repelled or forced to land unless it is regarded as a threat.
From the American initiative, the Air Defense Identification Zone (ADIZ) means an area of airspace over land or water in which the ready identification, location and control of all aircraft (except for Department of Defense and law enforcement aircrafts) is required in the interest of national security (Air Defense Identification Zone – Code of Federal Regulations 2015, para 1). An aircraft entering the ADIZ is mandated to radio its intended course, destination and any supplementary information about its trip through the ADIZ to a higher authority, typically an Air Traffic Controller, and any aircraft flying in the ADIZ without approval may be branded as a threat and treated as an enemy aircraft, potentially leading to interception by fighter aircraft. From this perspective, ADIZ applies only to commercial aircraft aspiring to enter US airspace; ADIZ procedures do not apply to foreign aircraft not intending to enter the United States airspace and do not recognize the right of a coastal state to apply its ADIZ guidelines to foreign aircraft not intending to enter their national airspace (The Commander’s Handbook on the Law of Naval Operations, 2007, as cited in Abeyratne, 2011).

Ma (2013) defines Air Defense Identification Zone as an area of airspace demarcated by a state to guard against potential air threats with the aim of securing enough time for the Air force to discover and identify aircraft in the interest of national security. According to him, following rapid scientific development since World War 1 which has persistently challenged the conventional air defense system as the latest model of hostile aircraft equipped with advanced technology and tactics give too little time for it to correspond to unexpected activities, several states embarked on the creation of ADIZs beyond their territorial airspace over high seas and the extension of early warning spaces has become a common practice to guarantee enough interception time so as to prevent some unidentified aircraft from intruding into the territorial airspace by accident.
For Sevastopulo (2013), ADIZ is a zone that provides an early warning system to help a country detect possible incursions into its sovereign airspace. He argues that the zone stretches beyond the boundary of a country’s national airspace. If an aircraft enters an ADIZ without warning, the country in question may scramble fighter jets to visually identify the aircraft and determine whether it poses a threat or not.

Abeyranie (2011, para, 1) in his own contribution conceptualizes the Air Defense Identification Zone as an area in airspace over land or water which may not be over the sovereign territory of a state in which the ready identification, location, and control of all aircraft are required in the interest of national security. According to him ADIZ must not be confused with Flight Information Regions (FIRs) which are areas established for the facilitation of airspace and air traffic management, generally involving a subjacent state that has undertaken responsibility for providing air traffic control services.

Answering question on the meaning of an Air Defense Identification Zone, Yomiuri Shimbun (2013) averts that there are no international treaties or agreements that set legal conditions for Air Defense Identification zone (ADIZ); hence, each country has to set its ADIZ through domestic laws or ordinances. Arising from this, he posits that countries cannot legally force others to comply with their ADIZ regulations such as imposing duties to report aircraft flights, stressing that in contrast, countries’ exclusive rights are recognized in their territorial airspace.

It can be deduced from the preceding analysis that ADIZ does not derive its doctrinal foundation from any international legal framework. The zone is not identical with prohibited airspace or no-flight zone within which flights are prevented from operating; rather the ADIZ aims
at creating sufficient time for early warning to enable the country discover potential incursions into its sovereign airspace for national security reasons. Its content, terms and composition can best be comprehended within the context of its establishment as its practice cannot in anyway be standardized because it varies from country to country and is subject to modifications as circumstances permit. However, while setting the rules care must be taken in order not to infringe on the over flight right of legitimate users.

3. Background to the East China Sea ADIZ Declaration and Reactions Trailing It

In an effort to promote and bolster affirmative and fruitful association with China after the World War II in addition to securing Chinese assistance in checkmating British, Russian and Japanese expansion in Asia, then United States President Franklin Roosevelt proposed the Cairo Conference in 1943 as a means of conveying public confidence in the Republic of China. At the series of meetings in Cairo, Egypt, between November and December of 1943, President Roosevelt met with British Prime Minister Winston Churchill and Chinese President Chiang Kai-shek to consider the progress of the war against Japan and the prospect of post-war Asia (“The Cairo Conference, 1943” – see: U.S. Department of State, 2001-2009 Archive).

Delineating his vision for post-war Asia, Roosevelt told the assembly that he needed a cooperative world order in which a dominant power in each major region would be responsible for maintaining the peace. Based on this mental picture, the need to institute China as one of his “Four Policemen” became exceedingly imperative to help prevent Japanese expansionism and supervise decolonization under a trustee system. The outcome of this Conference was the Cairo Declaration
jointly released by the United States, the Republic of China and Great Britain on December 1, 1943, where the allies pledged to continue the war against Japan and expel Japanese forces from all territories it had occupied including the Chinese territories, Korea and The Pacific Islands (“The Cairo Conference, 1943” – see: U.S. Department of State, 2001-2009 Archive).

The main points of the Cairo Declaration which was broadcast through radio on December 1, 1943, were (Cairo and Potsdam Declarations, 1943 – see: Chen and Reisman, 1972):

- The Allies are not fighting Japan for their own territorial expansion.
- The Allies are resolved to bring unrelenting military pressure against Japan until it agrees to unconditional surrender.
- Japan shall be stripped of all islands she has seized or occupied in the Pacific since the beginning of World War I in 1914.
- All the territories Japan has taken from China such as Manchuria (Dongbei), Formosa (Taiwan), and the Pescadores (Penghu), shall be restored to the Republic of China.
- The Allies are determined that Korea shall become free and independent.
- Japan will also be expelled from all other territories which she has taken by violence and greed.

A confirmation of the Cairo Declaration was contained in Section eight (8) of the Potsdam Declaration of July 26, 1945, which is referred to by the Japanese Instrument of Surrender and it stated that the terms of the Cairo Declaration shall be executed and Japanese sovereignty shall be restricted to the islands of Honshu, Hokkaido, Kyushu, Shikoku and such minor islands as we determine (Cairo and Potsdam Declarations, 1943 – see: Chen and Reisman, 1972). On September 2, 1945, Japan
inked the Instrument of Surrender popularly and distinctively acknowledged the terms of the Potsdam declaration, which incorporated by reference the terms of the Cairo Declaration:

We, acting by command of and in behalf of the Emperor of Japan, the Japanese Government and the Japanese Imperial General Headquarters, hereby accept the provisions set forth in the declaration issued by the heads of the Governments of the United States, China, and Great Britain on 26 July 1945, at Potsdam, and subsequently adhered to by the Union of Soviet Socialist Republics, which four powers are hereafter referred to as the Allied Powers.

(Instrument of Surrender, 1945, para 1 – see: Ministry of Foreign Affairs, Japan, 1949)

The United States, having used China to secure victory over Japan, realized that the tossing of those islands in the Pacific to China was an error of strategic judgment that needed to be checked. As George Kennan rightly observed:

... this thoughtless tossing to China of a heavily inhabited and strategically important island which had not belonged to it in recent decades, and particularly the taking of this step before we had any idea of what the future China was going to be like, and without any consultation of the wishes of the inhabitants of the island, produced a situation which today represents a major embarrassment to United States policy, and constitutes one of the great danger spots of the post-war world.

(Kennan, 1960: 376-377,² as cited in Chen and Reisman, 1972)
The time became ripe for double standard and high-level conspiracy between the United States and its foremost ally, the United Kingdom. The duo started with self-serving interpretations of the Cairo Declaration. On December 27, 1950, the United States in its aide memoire interpreted the Cairo Declaration in these words:

The Cairo Declaration of 1943 stated the purpose to restore “Manchuria, Formosa and the Pescadores to the Republic of China.” That Declaration, like other wartime declarations such as those of Yalta and Potsdam, was in the opinion of the United States Government subject to any final peace settlement where all relevant factors should be considered. The United States cannot accept the view, apparently put forward by the Soviet government, that the views of other Allies not represented at Cairo must be wholly ignored. Also, the United States believes that declarations such as that issued at Cairo must necessarily be considered in the light of the United Nations Charter, the obligations of which prevail over any other international agreement.

(Carlyle (ed.), 1953: 622-623, as cited in Chen and Reisman, 1972)

For the British, its Prime Minister Winston Churchill stated that the Cairo Declaration “contained merely a statement of common purpose” (Parl. Deb., 1955 – see: Chen and Reisman, 1972).

Not yet satisfied with this, to further expedite action in its desire to control and oversee affairs in the far east, on September 8, 1951, at the city of San Francisco, the United States and Japan signed the Mutual Security Treaty that paved the way for the stationing of United States troops on Japanese soil for the defense of Japan. On March 8, 1954, the two countries signed the Mutual Defense Assistance Agreement which
allowed for the presence of United States armed forces in Japan for the purpose of peace and security while simultaneously encouraging Japan to take on more responsibility for its own defense, rearming in a manner suited for defensive rather than offensive purposes (US and Japan Mutual Defense Assistance Agreement, 1954). These two agreements (Cairo Declaration and Mutual Security Treaty) involving US and China on one hand and US and Japan on the other no doubt have serious implications for Asians. The two deals were aimed at entrenching rivalry between the two dominant powers (China and Japan) thereby hindering any form of cooperation that would foster regional solidarity, a scenario the US would leverage on to achieve its foreign policy goal of controlling and superintending over the affairs in the region.

During the Cold War, there was a change of attitude towards China as the United States treated China as an ally against Russia after President Nixon’s popular engagement with China in the early 1970s. With the demise of the Cold War, United States-China association recommenced with the later serving as an export processing platform for the former’s multinational corporations (Smith, 2013). This sudden romance with China was however deep-rooted in fundamental contradictions. The United States having being economically incorporated with its key international contender depended on Chinese credit to maintain the deficit and cheap labour to boost the bottom lines of United States corporations and facilitated the off-shoring of production to China by United States corporations. As this was going on, the United States and its corporations became increasingly clashing with the Chinese state and capital (NBC News, 2007).

To manage this contradiction, the United States combined the policy of engagement with a subordinate policy of containment (Friedberg, 2011: 88,5 cited in Smith, 2013). At the peak of United States’ engagement with China during the Clinton administration, the American
Department of State portrayed China as a “strategic partner” while at the same time nourished its military capability all through Asia as a deterrent to China to the level of staging the single largest military operation ever since the Vietnam war in 1996 to obstruct China’s threat against Taiwan (Smith, 2013).

During the Bush administration, after the United States found itself engaged in a ruthless confrontation with China over a collision between a Chinese fighter jet and an American spy plane over China, Washington re-named China a “strategic competitor” (ibid.). President George W. Bush, however, backed off his antagonistic approach toward China to search for the latter’s support in the war against terror after the September 11, 2001, terrorist attack in the United States. This is in addition to campaigning for China’s admission into the World Trade Organization as a means of integrating China into the global capitalist system controlled by the United States (ibid.).

In a bid to reinforce its majestic affirmation of world’s only surviving superpower and simultaneously deflect manifest threats from core imperial rivals such as China, Russia, India, Brazil among others, after the forceful invasion of Iraq and Afghanistan and botched endeavours at regime dethronement in Syria and Iran with the objective of controlling the greater part of Middle East, its energy reserves, shipping and pipeline routes triggered both strategic and economic catastrophe, the Obama administration, just as committed as his predecessor George Bush, in January 2012 issued a new Defense Strategic Guidance targeted at altering United States’ global overlordship to the Asia-Pacific, which analysts envisage will be the centre of twenty first century capitalism (ibid.).

This momentous swing in United States’ foreign policy from a Middle Eastern/European preoccupation to an East/South Asia one “Pivot to East Asia” regional strategy has as its major concerns:
strengthening bilateral security alliances; deepening of United States’ working relationships with emerging powers, including China; engaging with regional multilateral institutions; expanding trade and investment; forging a broad-based military presence; and advancing democracy and human rights (Clinton, 2011).

According to Clinton (2011), with almost half of the world’s population residing in the Asia-Pacific, the region’s significance in furthering United States’ economic and strategic interests cannot be over-emphasized as open markets in Asia present the United States with unparalleled prospects for investment, trade and access to cutting-edge technology. Moreover, United States’ economic recovery at home will depend on exports and the capacity of American firms to take advantage of the enormous and growing consumer base of Asia. Finally, she noted that strategically maintaining peace and security across the Asia-Pacific is increasingly central to global advancement, whether through protecting freedom of navigation in the South China Sea, countering the nuclear proliferation efforts of North Korea, or guaranteeing transparency in the military activities of the region’s key actors.

As anticipated, President Barack Obama’s “Pivot to Asia” strategy elicited mixed reactions from countries within the region with different states responding in various ways depending on their perception of this policy modification. For the People’s Republic of China, this turning point in the United States’ foreign policy strategy that aimed at maximizing its interest in the Pacific to the detriment of China needs to be checkmated; hence, the declaration of an Air Defense Identification Zone covering much of the East China Sea, including the disputed maritime territory of Senkaku/Diaoyu Islands which are under Japanese control at the moment. The zone includes the airspace within the area enclosed by China’s outer limit of the territorial sea and the following six points: 33°11’N (North Latitude) and 121°47’E (East Longitude),

_CCP Vol. 4 No. 3 (December 2018)_
33°11’N and 125°00’E, 31°00’N and 128°20’E, 25°38’N and 125°00’E, 24°45’N and 123°00’E, 26°44’N and 120°58’E (Statement by the government of PRC, 2013 – see: Erickson, 2013, para. 5).

**Figure 1** Diagrammatic illustration of the East China Sea Air Defense Identification Zone Overlapping Those of Japan and South Korea


Justifying the establishment of the Zone, the Chinese Ministry of National Defense in a statement issued on November 23, 2013, in Beijing stressed that the government of the People’s Republic of China pronounced the creation of the East China Sea Air Defense Identification Zone in accordance with the Law of the People’s Republic of China on

*Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) ♦ 2018*

Despite clarifications by the spokesman of the Chinese Ministry of National Defense that the East China Sea ADIZ is not a no-fly zone and as such will not affect freedom of over flight of other countries’ aircraft in compliance with international laws and that the zone does not aim at any specific country or target, rather that its purpose is to set aside adequate time for early warning to defend China’s airspace, several countries have expressed reservations over the manner the ADIZ was proclaimed including the coverage (Erickson, 2013, November 23).

Australia, through its Minister for Foreign Affairs, Julie Bishop, has voiced its disapproval to any coercive or unilateral actions to alter the status quo in the East China Sea stressing that the timing and mode of China’s proclamation are disturbing in view of existing regional apprehensions, adding that it will not contribute to regional stability (ABC News, 2013, November 28a). Tensions between China and Japan over the disputed maritime territories in the ECS are of great concern to Australia. Economically, three (China, Japan and South Korea) of Australia’s four leading trading partners are located in Northeast Asia while sea lanes vital to Australian trade run through the waters of the East China Sea; strategically and politically, two US allies are based in this region and America maintains a strong forward military presence there (Bisley and Taylor, 2014).

For the European Union, its worry about the ADIZ declaration stems mainly from the statement by China’s Ministry of National Defense that it will take emergency defensive measures in case of non-compliance, stressing that the East China Sea ADIZ proclamation amplifies the threat of escalation and contributes to increasing anxiety in
the region (European Union, 2013). It noted that under international law, rights to the legitimate use of sea and airspace are essential for security, stability and prosperity, and hence, the need for all sides to exercise caution and restraint (ibid.).

Even though Chinese ADIZ overlaps with Taiwanese ADIZ by a comparatively diminutive 23,000 square kilometers, official response from Taiwan was primarily muffled giving rise to remonstrations from the opposition Democratic Progressive Party (DPP) and some academics that the government was falling short of affirming Taiwan’s sovereignty (for instance, according to Chris Huang, an associate professor at the Institute of Law for Science and Technology at Taiwan’s National Tsing Hua University – see: Taipei Times, 2013). Reacting to the development, the Taiwanese government declared that the East China Sea ADIZ demarcation is not an issue about territorial airspace or territorial sovereignty, and hence it directed that flight plans for planes flying through the zone should be submitted to Beijing as requested (ibid.). On the other hand, Laird and Timperlake (2013, as cited in Keck, 2013), employing the concept of “strategic quadrangle”, highlighted how Taiwan fits into the East China Sea ADIZ controversy and declared thus:

We have placed the ADIZ down upon the strategic geography we have identified and a key reality quickly emerges. Just by chance, the zone covers reinforcements to Taiwan. That is, the ADIZ happens to cover the exact areas that the US or Japan would have to traverse in order to promptly respond to a PLA invasion of Taiwan.

On the basis of this, they averred that the US would be unable to use its immense military resources in South Korea and Japan to defend Taiwan, since China can deny it (US) and allied forces to operate in the waters and airspace covered by the ADIZ.
Responding to ADIZ declaration by China, an announcement by the US State Department described China’s creation of the ADIZ as a unilateral action that constitutes an attempt to alter the existing order in the East China Sea, adding that freedom of over flight and other globally lawful uses of sea and airspace are essential to prosperity, stability and security in the Pacific. The statement further adds that the United States does not support efforts by any state to apply its ADIZ rules to foreign aircraft not intending to enter its national airspace, stressing that the United States does not apply its ADIZ guidelines to foreign aircraft not intending to enter United States national airspace (US statement on the East China Sea air defense identification zone – see: Chan, 2013). While urging China not to execute its threat to take action against aircraft that do not identify themselves or adhere to instructions from China, it (United States) however, declared that the Chinese proclamation will not in any way alter how the United States conducts military operations in the region, asserting that the United States remains steadfast in its commitment to its allies by reiterating its established policy that Article V of the United States-Japan Mutual Defense Treaty applies to the disputed Senkaku Islands (US Secretary of Defense Chuck Hagel, cited in Erickson, 2013).

Like the US, the presence of China as the central power in the Asia-Pacific and its relationship with its neighbours has equally drawn the attention of Russia to the events in that region, territorial disputes in East China Sea inclusive; hence, tension between China and Japan as a result of territorial disputes continues to increase concern in the region and beyond (Topychkanov, 2014). Though Russian interests in the Asia-Pacific region dwell mainly on the economic aspects with little or no emphasis on political issues, its interest in developing relationships with China and its neighbours cannot be under-estimated: escalation of conflicts in the region and disruption of trade and economic relations
between regional countries are all of serious concern to Russia (ibid.). The Philippines blamed China for striving to convert the area into its domestic airspace with Filipino Aviation official John Andrews cautioning that Beijing might undertake to set up an additional ADIZ in the South China Sea, where the two countries (the Philippines and China) have rival claims (ABC News, 2013, November 28b).

In its reaction, the South Korean Transport Ministry averred that the East China Sea ADIZ did not comply with international regulations; hence, its airlines would not recognize the Chinese ADIZ. As reported by Yonhap (연합 / 聯合) News Agency, South Korean Foreign Minister Yun Byung-se argued that the East China Sea ADIZ dispute had made “tricky regional situations even more difficult to deal with” (Gale, 2013). One key issue of contention for South Korea is that the East China Sea ADIZ covers an area of ocean where South Korea has a marine research station built on a submerged rock, the South Korean-claimed Socotra Rock (Gale, 2013; VOA, 2013).

Though Japan maintains an ADIZ in the region, its Foreign Ministry stated that the Chinese ADIZ is completely undesirable and exceedingly deplorable as it incorporates the Japanese territorial airspace over the Senkaku Islands (maritime territory under Japanese control). Signaling its disapproval over the creation of the East China Sea ADIZ, Japan declared that unilaterally establishing such airspace and restricting flights in the area is very risky as it may lead to miscalculation in the area (Chan, 2013, November 25).

4. Rules and Procedures of Identification for Foreign Aircraft

In concurrence with the proclamation by the Government of the People’s Republic of China on setting up of the East China Sea ADIZ, the Chinese Ministry of National Defense issued a pronouncement on the
aircraft identification rules for the East China Sea ADIZ. According to
the report, foreign aircraft in the zone will be expected to conform to the
following (Announcement of aircraft identification rules, 2013 – see:
Erickson, 2013):

1) Aircraft flying in the East China Sea Air Defense Identification Zone
must abide by these rules.
2) Aircraft flying in the East China Sea ADIZ must provide the
following means of identification:
   • Identification of flight plan. Any aircraft in the East China Sea ADIZ
     must report its flight plans to the Ministry of Foreign Affairs of the
     People’s Republic of China or China’s Civil Aviation Administration.
   • Radio identification. Aircraft in the zone must maintain two-way-
     radio communication and respond in a timely and accurate manner
     to identification inquiries from the administrative organ of the East
     China Sea ADIZ or the unit authorized by the organ.
   • Responder/Transponder identification. Aircraft flying in the East
     China Sea ADIZ, if equipped with an Air Traffic Control Radar
     Beacon System transponder must keep it on throughout the entire
     course.
   • Logo/Sign identification. Any aircraft flying in the East China Sea
     ADIZ must display insignia indicating its nationality and registration
     identification in accordance with related international treaties.
3) Aircraft flying in the East China Sea ADIZ should follow the
instructions of the administrative organ of the East China Sea ADIZ
or the unit authorized by it as the Chinese Military will adopt
“emergency defensive measures” in response to aircraft that refuses to
follow the instructions or fails to cooperate in the identification.
4) Chinese Ministry of National Defense is the administrative organ of the East China Sea ADIZ.
5) The Ministry of National Defense of the People’s Republic of China is responsible for the explanation of these rules.
6) These aircraft identification rules will come into force at 10 a.m. November 23, 2013.

These rules and procedures for aircraft identification no doubt have serious geo-strategic implications. Metcalf (2013, as cited in Erickson, 2013) has argued that an ADIZ is not a provocative or negative step in itself as it can be in the interests of stability and security of the country enforcing it, stressing that many countries including Japan, South Korea and the United State (which started it decades ago) have such zones. He however, criticized the East China Sea ADIZ on the following grounds (Metcalf, 2013, as cited in Erickson, 2013, para. 3):

• It is a unilateral step, announced suddenly and apparently without consultation with two countries whose civilian and military aircraft will be affected, the United States and Japan.
• It includes a contested maritime area, notably the Senkaku/Diaoyu Islands, and thus can be seen as a deliberate effort to change the status quo, even a provocation.
• Its rules demanding that aircraft identify themselves and obey Chinese direction on flights paths seem to apply to all aircraft in the zone and not only aircraft enroute to China. This contradicts with the basic early warning and air traffic control purposes of an ADIZ, and with long-standing Pentagon regulations advising United States military aircraft to comply with a foreign ADIZ only when they are flying on a course into that country’s airspace, not when they are simply on transit or patrol.
• It looks like a pretext for one of two undesirable security outcomes. If foreign aircraft now regularly obeys the new Chinese rules, we will see precedents set for the unilateral expansion of Chinese authority over contested maritime territory. Alternatively, if foreign aircraft contests or ignores the Chinese zone and a dangerous or deadly incident occurs (such as a collision or forceful encounter), then China will have prepared the way to absolve itself of legal or moral blame, making it easier to use the incident as a justification to escalate the crisis if China so chooses.

He wrapped it up by arguing that if China’s new zone did not include disputed maritime territory, if its requirements for compliance applied only to aircraft heading into Chinese airspace, and if neighbours like Japan and South Korea had been consulted ahead of the announcement, then, there would be little or nothing for others to object to adding that it could have been part of a wider strategy of cooperation to reduce maritime security risks in North Asia (Metcalf, 2013, cited in Erickson, 2013, para.2).

Jen Psaki, the chief spokesperson for the US State Department, has pointed out that China had made the pronouncement in an uncoordinated approach which is incompatible with standard practice. According to him, the fact that China’s declaration has caused uncertainty and amplified the threat of accident simply further underlines the validity of concerns and the need for China to repeal the procedures (The Guardian, 2013).

For O’Hanlon and Steinberg (2013, cited in White, 2013), the problem with China’s ADIZ is that it encompasses Islands whose sovereignty is contested between China, Japan and Taiwan, noting that in contrast with the conventional defense zone which helps build
stability by plummeting the likelihood of mishaps based on flawed identity, the unilateral and forceful character of the new Chinese efforts raises the risk of conflict. On the basis of this, Wang (2013,10 cited in White, 2013) opines that China’s move seems to have shot itself in the foot, and will be used as an illustration of China’s status as a revisionist state which will additionally reinforce the threat narrative.

In contrast, some observers are of the opinion that the barrel of criticisms levelled against the East China Sea Air Defense Identification Zone amount to over-reaction. According to Chen Weihua, columnist and chief Washington correspondent for China Daily (cited in ChinaFile, 2013), the declaration of such ADIZ should by no means be seen as a signal that China is prepared to shoot down any foreign aircraft entering the zone without prior reporting since China has as large a stake in the peace, stability and prosperity in the region as anyone else. While noting that the Air Defense Identification Zone is not a Chinese innovation as the United States, Japan and some 20 other countries declared such zones in their airspace long time ago, he further stressed that China’s pronouncement of its first ADIZ in the East China Sea echoes its dissatisfaction with Japan’s refusal to acknowledge that there is a row over the sovereignty of Diaoyu Islands, or, as the Japanese call them, the Senkaku, pointing out that a number of times, Japan has used its own declared ADIZ as a ploy to disparage China for interfering in its airspace, which, in China’s observation, is disputed.

In a related development, Ma (2013) has argued that the East China Sea Air Defense Identification Zone is not directed against any specific country; rather, it satisfies the pragmatic requirements of national security. He however declared that it is a modest reaction to the incessant frustrations from certain countries against China as can be attested to by the recent Japanese claim that it would shoot down China’s drones and fire warning shots at Chinese aircraft entering its own ADIZ.

Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) ♦ 2018
According to him, Japanese ships and aircraft have carried out stalking, surveillance, monitoring, and even precarious deeds of incursion on Chinese normal military instruction activities for relatively a long time and taking note of Japan’s provocations, many people are predisposed to construe China’s establishment of the ADIZ as a response to Japan’s impudence. Also justifying the Chinese act, Chinese Defence Ministry spokesman Geng Yansheng (Reuters, 2013, December 3) opines that “the East China Sea Air Defense Identification zone is a safe, not risky zone, a zone of cooperation not confrontation”.

All the reactions trailing the East China Sea ADIZ are triggered by individual actor’s perception and interpretation of the Chinese move. For those who understand the ADIZ as directed at territorial claim on the disputed maritime territories, the East China Sea ADIZ is a destabilizing factor that has altered the status quo in the area. On the other hand, actors that view the Chinese ADIZ as a mechanism for ensuring stability and security through the maintenance of flight order will cooperate to avoid possible miscalculation and accident.

5. Asia-Pacific in the aftermath of East China Sea ADIZ Declaration

The swing of the centre of gravity of global politics and economy from the Atlantic to Pacific occasioned by the alteration in balance of power has simultaneously created opportunity for security cooperation and triggered regional concerns and tensions. As a home to a host of actors with varying political, economic and social systems coupled with divergent security perspectives, the Asia-Pacific region has become more prone to the so-called “gray situations”, that is, situations that are neither pure peacetime nor contingencies over territorial sovereignty and interests (Cabinet Secretariat, Japan, 2013). Therefore, in response to the unilateral and assertive manner of the new Chinese ADIZ declaration,
Japan, South Korea and the United States have all defied China’s new directive by carrying out a series of daring and provocative moves in response.

In what is regarded as disapproval of China’s ADIZ declaration, the US flew two unarmed nuclear-capable B-52 bombers through the zone without notifying Chinese authorities, stressing that US military aircraft would not adhere to the new Chinese protocols (Symonds, 2014). Following far-reaching apprehension about China’s regional capability, South Korea is constructing a new naval base for 20 warships, including submarines, and planning to purchase the F-35, stressing that it has to guard critical shipping lanes in the East China Sea for its exports, as well as loads of electronics headed to China (Sanger, 2013). In addition to carrying out a flight operation unannounced through the newly declared Chinese ADIZ few days after the pronouncement, South Korean navy has not only conducted sea and air military drills in an area within the East China Sea ADIZ but also expanded its own ADIZ more than 300 kilometres to the South which partially overlaps Chinese ADIZ with both countries’ zones presently enveloping the airspace above a rock called Ieodo (이어도 / 離於島) by South Korea (i.e. the Socotra Rock) and Suyan (蘇岩礁) by China, which though claimed by both countries but is administered by South Korea (BBC News, 2013, December 8).

The new zone which was expanded by about 66,480 square kilometres (25,670 square miles) or about two thirds of the size of the country in waters off its south coast (Business Insider, 2013), according to Jang Hyuk, Head of Policy of South Korea’s Ministry of National Defense, will also result in an overlap with Japan’s air defense zone (Reuters, 2013, December 8). As reported by Yonhap News Agency of South Korea (as cited in BBC News, 2013, December 8), this will be the first time that South Korea has adjusted its ADIZ since it was first set up by the US military in 1951 during the Korean War. On its part, few days
after the Chinese declaration, Japan defied the Chinese ADIZ by engaging in routine surveillance operation without informing China. Besides, December 17, 2013, marked a momentous inflection point in Japan’s history in responding to its security environment. Citing China’s activities around Japan, the Senkaku Islands and the ADIZ, Japan unveiled its first ever National Security Strategy aimed at maintaining the peace and security of Japan as well as ensuring its survival (Cabinet Secretariat, Japan, 2013).

Partly due to doubts about US commitment in the Pacific region on one hand and as part of a basic alteration in the national orientation toward a Japan that is more fervent and capable to defend itself than any time since the World War II, Japan, besides planning to construct a new army base by 2016 on a small inhabited island near the disputed Senkaku or Diaoyu Islands (as they are known in Japan and China respectively), is also preparing to deploy more F-15s and radar planes to Okinawa (沖縄), a new helicopter carrier and for the first time has mulled over buying unarmed American drones to patrol the area, as part of a three-year-long shift in military strategy to focus on their Southern Islands and China (Sanger, 2013). Moreover, in a move believed by Chinese analysts as aimed at further strengthening Japan’s maritime capability, the Japanese government on January 7, 2014, affirmed that it would register 280 isolated islands as state property in order to boost their management despite the fact that its earlier resolution of September 2012 to nationalize three of the Senkaku / Diaoyu islets sparked strong objections from China and considerably escalated tension between the two countries (Symonds, 2014). Also on the same day, Japan proclaimed that it scrambled fighter jets to head off a Chinese civilian aircraft (Y-12 propeller plane) that entered Japan’s ADIZ near the disputed islands in the East China Sea (ibid.).
For China, determined to make real its threat and also prepare for any eventuality in its resolve to increasingly assert control over islands though uninhabited but that would confer on its owner exclusive oil, mineral and fishing rights in surrounding waters, has not only continued to increase its defense budget at double-digit rates but might also decide to put in place another ADIZ in the South China Sea (White, 2013). Furthermore, on May 24, 2014, during joint maritime exercises with Russia, China scrambled two pairs of fighter jets and flew them unprecedentedly close to a Japanese OP-3C surveillance plane and a YS-11EB electronic intelligence aircraft, having declared the area a no-fly zone ahead of the Sino-Russia joint naval drill (CNN, 2014). According to a statement from Japanese Minister of Defense, Itsunori Onodera (小野寺五典), the incident was the closest that Chinese planes had flown to Japanese aircraft, passing about 30 meters from one plane and 50 meters from another (ibid.).

Reminiscent of the arms race that characterized the Cold War era between the West represented by the United States and East represented by the Union Of Soviet Socialist Republic, the foregoing has shown how China’s increasingly aggressive posture towards territorial claims through the unilateral proclamation of an air defense identification zone has pitted it against the United States on one hand and its neighbours, South Korea and Japan, on the other. As Sanger (2013) succinctly noted, as the Chinese grow more determined to assert their territorial claims over a string of islands once vital mostly to fishermen, America’s allies are also pouring military assets into the region thereby potentially escalating the once obscure dispute into a broader test of power in the Pacific.

One of the greatest concerns raised over the military enforcement of the ECS-ADIZ is the possibility of an accident or mid-air clash between Chinese military aircraft and other countries’ aircraft operating within the zone. As the US and China seek to assert their military capability in the East China and South China Seas, there have been series of near misses between Chinese and American ships and aircraft (*The Washington Post*, 2014). Shortly after the ECS-ADIZ declaration, US reported of a near-collision in the South China Sea as Chinese warships encountered a US guided missile cruiser (*BBC News*, 2014).

Also, in August 2014, a Chinese fighter jet conducted a dangerous intercept of a US Navy surveillance and reconnaissance aircraft off the coast of China in international airspace. According to Pentagon Press Secretary, Rear Admiral John Kirby, the Chinese J-11 fighter jet brought one of its wingtips within 20 feet of the US Navy Poseidon P-8 patrol aircraft, 135 miles east of Hainan island, performed a “barrel roll” at close range and flashed past the nose of the US aircraft at a 90-degree angle with its underside exposed, apparently to make a point of showing its weapons (*The Washington Post*, 2014). Considered as the fourth such incident since March 2014, the act in Kirby’s assertion posed a risk to the safety and the well-being of the air crew and was inconsistent with customary international law (*BBC News*, 2014).

It should be recalled that in 2001, what is today regarded as a most serious incident occurred when a Chinese fighter jet (the Peoples Liberation Army F-8) collided with a US Navy EP-3 spy plane killing the Chinese pilot, causing the American aircraft to make an emergency landing in China (*BBC News*, 2014). Another country that could be affected and probably drawn into the conflict as a result of tension between China and Japan is Australia. Bisley and Taylor (2014) have
analysed the circumstances under which conflict in the East China Sea could occur and the implications thereof for Australia by exploring three hypothetical East China Sea conflict scenarios thus:

First is where there is an exchange of fire involving Chinese and Japanese air patrols occasioned by Chinese decisions to enforce militarily the ADIZ; second scenario involves an accidental clash between a Chinese submarine and a US destroyer that takes place during a trilateral military exercise among America, Japan and Australia; third scenario involves non-state actors and stems from an incident at sea between a commercial cruise ship carrying a large proportion of retired Chinese military officers and the Japanese Coast Guard in waters near the disputed Senkaku/Diaoyu islands. Arising from these three scenarios, Bisley and Taylor (2014) went further to identify five facets of escalation that will shape if and how Australia would become drawn into a potential conflict:

1) When a conflict is clearly instigated by one side, Australia will face a much more bleak set of choices. An incident where aggressive Chinese behaviour has ignited a clash is, for instance, more likely to elicit Australian involvement than one where the circumstances around the eruption of conflict are murkier

2) How does the US respond? Regarded as the greatest determinant of Australian involvement, an ECS conflict is very unlikely to lead to an automatic invocation of Australia, New Zealand, United States (ANZUS) Security Treaty. On the other hand, because of the strong links established between Washington and Canberra in recent years as well as the expanded strategic purpose of the alliance, if US expects Australian involvement, then it will be very difficult to remain on the sidelines.
3) Does Japan request assistance? Next to the US in forging strategic relationship with Japan is Australia; hence, Australia would be among the first to whom Japan would turn to for support in the event of conflict in the East China Sea. This has certainly increased the prospects of Australia being caught up in a possible conflict.

4) What costs can China impose? As Chinese wealth and power grows, China will have more ways in which it can impose costs on Australia. As a result, Australia’s approach to conflict in the East China Sea will also be shaped by how China responds and what leverage it can exert.

5) How much freedom of manoeuvre will Australia have? The involvement of Australian nationals in any contingency, the impact of social media, US alliance expectations, as well as statements and positions that Australian policy makers adopt in the lead up to any crisis will condition how much freedom of manoeuvre Australia has if and when crisis strikes.

China’s declaration of an ADIZ over the East China Sea which is considered by Japan as an attempt to change the status quo by coercion against the provisions of international law within the maritime and aerial domains has made the later intensify action towards re-militarization. According to Topychakov (2014), there have been discussions among experts in Japan to the effect that in reaction to the increasing Chinese threat, Japan will use appropriate means if all the usual conventional means cannot stop the aggression of China, then a decision will have to be made as to the development of nuclear weapons.

If Japan re-militarizes, North Korea which has already embarked on nuclear weapons programme would intensify efforts at increasing its stockpile. South Korea will not be left out. South Korea and Japan have been at loggerheads over a couple of maritime territories in the East China Sea known as Dokdo (독도 / 獨島) by Koreans (i.e. the
Liancourt Rocks) and Takeshima (竹島) by Japanese (International Business Times, 2015). Already, South Korea has conducted its own missile test and successfully launched a newly developed ballistic missile capable of striking most of North Korea (Choe, 2014). For North Korea, nuclear weapons have become a core element of its national security strategy, having launched live-fire drills near the disputed border with South Korea, test-fired ballistic missiles capable of hitting Japan, flown rudimentary drones into the South and threatened to carry out a “new” type of nuclear test such that the dangers of a nuclear-armed North Korea will place added importance on a stable security environment in Northeast Asia along with a stable and secure North Korean posture (Roehrig, 2013).

Russia on its part is not left out in the East China Sea ADIZ saga. Far from being enthusiastic about securing greater transparency in China’s nuclear arsenal as well as concerned over the situation on the Korean peninsula occasioned by North Korea’s desire to develop nuclear weapons, Moscow will not take lightly any attempt by forces in Japan and South Korea to acquire nuclear weapons (Topychaknov, 2014). Of important reference here is the 60-year old disagreement between Russia and Japan over four Islands of Kunashir known in Japan as Kunashiri, Iturup (Eturofu), Shikotan, and the rocky Habomai islets which are known in Russia as the Southern Kurils and in Japan as Northern territories which has prevented both countries from signing a peace treaty to end the World War II (BBC News, 2013, April 29). With this dispute in place, Japan’s desire to re-militarize will definitely not be taken for granted by Russia and this might lead to the escalation of the conflict. A more dangerous dimension might be added to this in the event that the US decides to take part in the crisis by invoking Article V of the US-Japan mutual Defense Treaty which obligates the US to defend Japan against attack.
From the foregoing revelations, if the ECS-ADIZ controversy is not properly managed, it is capable of triggering another World War, the third of its kind in human history. The actors involved in the ECS-ADIZ are numerous, most of them (US, China and Russia especially) acknowledged as possessing nuclear weapons and other weapons of mass destruction. If China decides to embark on military enforcement of the ECS-ADIZ by adopting emergency defensive measures against aircraft (belonging to perceived adversaries especially US and its ally Japan) that do not comply with the rules of identification, it has the propensity of further dampening the already frosty relationship between US and China occasioned by the former’s commitment at containing the latter’s rising both regionally and globally. If this happens, the world might be heading for another catastrophe. Historical evidence attests to the fact that one of the major causes of World War I was Britain’s response to the rising German power, whose heavy industry surpassed that of Great Britain in the 1890s and its gross national product twice that of Britain at the beginning of twentieth century (Nye, 2003). It will be disastrous if history is allowed to repeat itself in this twenty-first century of high level of interdependence and de-fragmentation.

7. Conclusion

The East China Sea Air Defense Identification Zone declaration of November 26, 2013, is seen as a turning point in China’s determination to assert control over uninhabited but disputed maritime territories and by extension, in response to US Pivot role in Asia. What is considered today as China’s first significant move against US interest in the Pacific has no doubt escalated tensions capable of sparking fratricide and cataclysm of even genocidal proportion in a fragile region. Worthy of note here is that China’s dilly-dally approach at perfecting its interest in
the disputed maritime territories of Senkaku/Diaoyu following the Cairo and
Potsdam Declarations (over 70 years ago) is at the epicentre of this
renewed rivalry.

Nonetheless, there are many of such zones around the world today
as can be attested to by the case of United States which not only started
this practice but maintains about four to five of such zones. Japan
established its ADIZ in 1969 (forty four years earlier than China) which
not only includes China’s Diaoyu Islands but also overlaps Chinese
Exclusive Economic Zone, and on June 25, 2010, Japan unilaterally
extended its ADIZ 22 kilometres westwards thereby overlapping with
China’s ADIZ. The duo of South Korea and Taiwan also maintains
ADIZs. In all these cases, there has not been any case of accident or
downing of an aircraft traced to refusal to observe ADIZ rules and as
such, the East China Sea ADIZ should not be allowed to degenerate into
“Armageddon”. In the absence of any international legal framework or a
universally accepted standard practice guiding the declaration and
enforcement of an Air Defense Identification Zone, like the Berlin
Conference of 1885 convened by European Imperialists to partition
Africa, diplomatic solution should be explored to resolve the territorial
disputes that have paved the way for the air traffic restriction.

Notes

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Contemporary Chinese Political Economy and Strategic Relations:
An International Journal 4(3) ♦ 2018
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The Chinese Military in
National Security Policy-making

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Abstract

The political influence of the People’s Liberation Army within the decision-making process of the People’s Republic of China politics is persistently a focus of all sinologists. Nonetheless, the role actually played by the Chinese military in national policy-making is frequently overstated. The author of this paper would like to offer a perspective of this issue with certain aspects generally ignored by many China studies researchers. The author would like to scrutinize the involvement of the Chinese military in the national security policy-making from several different dimensions. What is the legitimate institution or mechanism for the People’s Liberation Army leadership to participate in the overall national security policy-making? Whether a collective Chinese military perspective does exist in the process of the national security policy-making? Whether the military professional viewpoint may have the position against party leadership? How the service rivalry exposed out of the military may shape the national security policy? The actual influences owned by the Chinese military professionals on the national security policy can be identified through the efforts of observations from
angles listed above. The core issue of surveying the People’s Liberation Army’s authority on the national security policy may be the need to examine how the party leadership may effectively control the military professionals and its leadership. Whether the military professionals may only contribute their professionalism but never exercise their political aspirations during the security policy-making process is the key question that needs to be answered. The article would like to provide certain assessment on this aspect as its conclusion.

**Keywords:** China, People’s Liberation Army, national security policy, Chinese Communist Party

1. Factors of the Chinese National Security Policy-making

National security policy-making is a very popular topic for those who may have concern about politics, international relations or other related fields. Nonetheless, there are many factors that are contained within the process of national security policy-making.

National security was a concept originated by the United States after World War Two. It started from the military aspect and subsequently expanded to further cover other dimensions. Moreover, threats on the national security may not only come from origins other than nation-states, the traditional and major actors in the international community, but also other non-state actors such as terrorist organizations, criminal groups, domestic ethnic clans, religion branches or even establishments of the private sectors like the multinational corporations or other commercial communities as long as their objectives are against national policies and possess imminent threats to the nation. The range of national security threats may expand even to cover those natural disasters or other non-human factors affecting national security interests.
Different nations would have definitions for their own versions of national security concepts. Their coverage may include various dimensions: “There is no single universally accepted definition of national security.” As we attempt to discuss the Chinese military in security policy-making for the moment, it is inevitably necessary to examine the “overall national security outlook” persistently addressed by the present Chinese political leadership. The overall national security outlook is a concept initially put forward by Xi Jinping (习近平) on April 15, 2014 at the first meeting of the PRC National Security Commission.

It is necessary to note that the overall national security outlook was defined in a very broad scope by Xi as he personally chaired the first meeting of the PRC Central National Security Commission. Xi has specified a national security system covering eleven fields such as politics, territory, military, economy, culture, society, science and technology, information, ecology, nuclear and natural resources. Frankly speaking, the scope of the national security matters can be very flexible. The coverage of issues may also be varied from state to state since different nations are facing their own specific strategic environment and their perceptions toward the national security challenges may also be altered accordingly.

The military may not be necessarily only involved in traditional security challenges. Employing armed forces to cope with non-traditional security challenges had already become more popular in recent years. Specific terms and military doctrines are also developed for tackling tasks originated from this non-traditional security threats. We therefore should not be surprised that the Chinese military may also participate in many security tasks defined by their political leadership. Many aspects regarding the national security that the People’s Liberation Army forces are involved in can be very different from its Western
counterparts. We should also expect that the level of influences on the security policy decision-making that the Chinese military acts on can be varied from aspect to aspect and even from case to case. In other words, the PLA’s policy influence on the national security matters should be fundamentally dynamic.

We also need to remind that the initial decision in the dimension of the national security for any specific event might not necessarily be the final conclusion. It may vary according to the substantial situations. The policy adaptation and adjustment is a frequent phenomenon in the actual national security practices. Again, this phenomenon may also prove the dynamic nature of the national security policy or decision-making process. All the policy-making processes are the reflections of political wrestling among various national security agencies or even all the public and private institutions involved in the specific cases. Regardless of the political institutions and the political cultures, the eventual national security decision-making is nothing but a realization of the interactions between these two elements.

Many previous efforts are already made for surveying the practices of the PRC’s national security policies and decision-making. Among them, “Chinese national security decision-making: Processes and challenges” written by Yun Sun is an outstanding work published by the Brookings Institution in May 2013. A study of the national security leadership system (国家安全領導體制研究) written by Wang Xiaodong (王曉東) and published by the Current Affairs Publishing (時事出版社) in 2009 is a standard must-read text in Chinese for those who are interested in this dimension of contemporary China studies. Far earlier than these two publications, a journal article titled “The PLA and Chinese national security policy: Leaderships, structures, processes” has already been contributed by Michael D. Swaine and published by The China Quarterly. Swaine’s efforts are popularly recognized by other
researchers working towards similar dimensions. In 2016, a research report with relatively minor scope on the Chinese national security and the People’s Liberation Army was published by Rand Corporation after the overall national security outlook was eagerly advocated by Xi. The authors of this report titled “The PLA and China’s rejuvenation: National security and military strategies, deterrence concepts, and combat capabilities” put focus on the purely military dimension. The same report also recommended readers to a reference published by Rand Corporation a year before known as “China, inside and out: A collection of essays on foreign and domestic policy in the Xi Jinping era” for understanding the domestic and foreign policy decision-making in the People’s Republic of China. It proves that a linkage among the PRC’s national strategy, security strategy, military strategy and the subsequent war fighting concepts was well perceived by the authors, and elements from domestic and foreign strategic environment naturally turn out to be the basis for the security calculus.

From all the texts already noted till now, we may clear identify that the Chinese national security policy and associated decision-making schemes are never a terra incognita for policy researchers. Indeed, much valuable information regarding the institutions, mechanisms, processes and particular individuals involved in the national security policy decision-making has been well recorded and analyzed by previous researchers. On the other hand, Beijing has also become much more willing to publicize its national security policies and concepts. Particularly, after Xi took over the leadership, it is obvious that the state and party mouthpieces are very eager to deliver his policy directives regarding the overall national security outlook concept. Many conclusions and directives regarding the national security policies are openly addressed after the meetings of the National Security Commission.
The transparency of the national security is theoretically improved significantly. Nonetheless, all these efforts seem fail to clarify the role of the Chinese military actually played in the PRC’s national security policy decision-making process. What should be the basic logic behind the military involvement in the process? This is exactly what the author of this paper intends to examine and to argue in the following paragraphs. Instead of providing answers to this matter, the author would like to point out those issues beyond our apprehension at the moment. Perhaps, asking the right questions is much more valuable than giving answers in a reckless way.

2. The Identity of PLA in Policy Decision-making

The most significant missing link of assessing the policy decision-making process regarding the military in the People’s Republic of China is “Who is the People’s Liberation Army”? Many researchers are frequently viewing the People’s Liberation Army as one single identity. It is generally assumed that the Chinese military is a mechanism that may forge its own consensus since the general image of the military is a highly homogeneous professional group. All the pre-assumption of the Chinese military involved in the policy- or decision-making process is that the People’s Liberation Army may exercise its influences to safeguard its individual organizational interests. Is this assumption totally true? Is there a possibility that the Chinese military may not necessarily have a consensus or even a firm stance towards certain issues but may only be following the will of its political masters? The perspectives shown by the Chinese military in the national security policy-making process that are a reflection of professionalism, or organizational interests or even political aspiration till now can only be a good question but with no answer yet. All the unsolved mysteries are
originated from a fundamental question: “Who is the People’s Liberation Army in the national security policy-making process of the People’s Republic of China?”

It is generally misperceived that there is only one voice in the military. In many cases, the military professionals are portrayed to be more faithful to their organizational interests than their commitment to the superior political directives or national goals. Nonetheless, are there always consensuses towards the national security issues at all time? How can the military personnel establish those consensuses on these matters? Will it be necessary to establish such consensuses or general perspectives around the low-rank military personnel before submitting the policy perspectives in the national level of security policy decision-making? There are many factors that are totally ignored as we simply label the military as basically homogeneous.

We also need to remind that compliance will also eliminate presence. If a certain institution always agrees with their peers or superiors in all cases, their perspectives will soon be totally ignored. The reason why we do need to be concerned with specific opinions from a particular institution is simply because this agency may express its disagreement on certain policy proposal and have the responsibilities of charging those assets and resources necessary to support the fulfillment of these policies. If an institution always unconditionally follow others’ perspectives but with no viewpoints of its own, we may conclude that this organization can be treated as totally insignificant since it has almost no influence at all.

Based on this hypothesis, we need to go back to the strategic culture or the military culture of “party commands the gun” (党指挥枪) persistently emphasized by the Chinese Communist Party almost since its birth in 1920s. According to this principle, the Chinese Communist Party exercises the absolute leadership on the armed forces in various
periods of Chinese communist history. After establishing the People’s Republic of China in 1949, the same code is retained till now. Most importantly, the possibility for professional differences with other peer administrative organizations does exist; yet, any perspective to reveal political aspiration of the military professional in the national security affairs should be well leashed and tightly gripped by the party apparatus within the People’s Liberation Army, i.e., the political commissar system of the Chinese military.

We also need to remind that the utmost policy- and decision-making mechanism of the Chinese military, the Central Military Commission, is essentially a double-hatted committee under the one-party-dominated government and the party itself. It is very hard to identify the final conclusions regarding the national security policies as the reflection of the collective perspectives from the leadership of the military professionals, or, on the contrary, the professional advises granted by a party organization manned by certain party members with military professionalism. The ambiguity of the Central Military Commission identity may also further blur the true identity of the overall Chinese military involved in the national security policy decision-making of the People’s Republic of China.

Another factor that may further confuse whether the Central Military Commission could have the capacity to represent the collective perspectives of the Chinese military professionals is that this highest-level policy- and decision-making mechanism is chaired by the civilian leadership. Different nations may have their own arrangement of political control or civilian supervision of the military. The Central Military Commission chaired by the civilian leadership is the Chinese style of superior oversight on the armed forces. Most of the time, the political figure who chairs the Central Military Commission in the mainland politics is the one who owns the fundamental power and the

Contemporary Chinese Political Economy and Strategic Relations:
An International Journal 4(3) ♦ 2018
final say of the policies in many cases. This arrangement may also reveal a simple fact that the military professionals may not have the chance to establish a final policy proposal without civilian leadership involvement but that is only achieved by the top brass. Again, this feature may return to the matter of the identity of the Chinese military. If there is no way to exclude civilian involvement in or even direction on all those seemingly People’s Liberation Army’s perspectives delivered to the supreme national security policy decision-making mechanism together with perspectives from other branches of the Chinese government for assessment or arbitration, then it is essentially very hard for us to judge the exact influence of the Chinese military on these aspects.

The possibility for the military professionals to challenge their political masters within the policy decision-making mechanism within the Central Military Commission is almost hard to assess since we may only get to know the final conclusions after the exact decisions were already made. Nonetheless, indication of openly criticizing the decisions already made by the Central Military Commission chaired by the civilian leadership seems never appear. Given the reality that the civilian leadership chairing the Central Military Commission may not have the appropriate military professionalism to dominate details in decision-making, we therefore may expect that the opinions of the military professionals should be well respected and considered.

One point that we should address here is that military professionalism is impossible to be the sufficient political capital for rebuking the directives of the political master, i.e. the civilian leadership of the Central Military Commission, in any dimension of decisions associated with the military affairs. Of course, it is hard to believe that the civilian leadership of the Central Military Commission may exercise micromanagement-style practices in trivial issues since the political master may not be necessarily needed to be concerned about such details.
in policy decision-making. However, the civilian leadership may inevitably have the final say of the Central Military Commission’s eventual policy proposals before delivering them to the higher level of the overall national security policy decision-making mechanism in the People’s Republic of China.

It is necessary to note here that the military professionals may have a better chance to exercise their political influences only when they can secure personal loyalty from certain factions within the military community. Given the rigid internal control and supervision system generally conducted by the political commissar system, such an attempt to organize a personal connection network for influencing policies can be a suicidal act in the Chinese politics. Given the several cases of the People’s Liberation Army’s high-ranking officers facing disciplinary actions or even judiciary trials and punishments, regardless how influential these top brass were, no indication can prove that the authority of the civilian leadership within the Chinese military had ever been challenged in any circumstance.

Last but not the least, there is a very distinctive decision-making feature to indicate the tight policy control by the civilian leadership within the military. As for certain important issues, it is quite often to establish specific working group as the task force within the regular decision-making mechanism. Such a provisional arrangement can be viewed as a supplementary function or organization to support the existing institutions. Nonetheless, these ad hoc working groups or leading small groups, either provisional or institutional, associated with key policies are in general presided by the civilian leadership of the Central Military Commission. By such an institutional design, it is indeed to identify who is “the military” and separate the military perspectives from its civilian leadership in the overall policy decision-making process.
For the case like the national defense and military reform of the People’s Republic of China, Xi Jinping personally chaired the Leading Group for the National Defence and Military Reform of the Central Military Commission (中央军委深化国防与军队改革领导小组). This leading group drafted the Proposal of Deepening National Defense and Military Reform Overall Plan (深化国防与军队改革总体方案建议) as the mainframe roadmap for the Chinese defense reform task and submitted it to the Central Military Commission Standing Committee, which is again another institutionalized mechanism chaired by Xi himself. Finally, after this national security policy proposal was approved by the Central Military Commission Standing Committee, it was eventually reviewed and approved by the Political Standing Committee of the Chinese Communist Party, once more another decision-making chaired by Xi Jinping. The subsequent result after the decision of the national policy was made is a practical plan for actual execution of the policy conclusions. The Implementation Plan for Administration and Command Structure Reform (领导指挥体制改革实施方案) submitted by the Leading Group for National Defence and Military Reform of the Central Military Commission was inspected and approved by the Central Military Commission Standing Committee in its routine meeting, which was still chaired by Xi, according to the party-approved proposal (Chang, 2016).

This is indeed a very unique decision-making process in national security affairs associated with the military organization. Nevertheless, it also revealed the fundamental fact that the “party commands the gun” principle is still firmly practiced by the politics of the People’s Republic of China and Chinese Communist Party. The party and civilian leadership within the Central Military Commission almost totally eliminated the possibility to establish any pure military perspective.
The identity of the Chinese military becomes hard to be defined since there is no policy decision or policy proposal that may exclude the party direction or political leadership’s direct influences. As long as the identity of the Chinese military could not be well defined and its distinctive separation from the party supervision and the civilian leadership involvement cannot be established, it is really very hard to assess the actual influence of the Chinese military towards the security policy-making in the People’s Republic of China.

3. Possible Military Influences on Other National Security Aspects

Apart from the traditional security dimensions such as territory, military and politics that the military would unavoidably get involved in, there are other dimensions also noted by Xi Jinping in his overall national security outlook such as economy, culture, society, science and technology, information, ecology, nuclear and natural resources that may also be associated with the Chinese military since the People’s Liberation Army may either have the assets to cope with the potential challenge or is already being assigned tasks to help secure the national security of these dimensions.

As already noted above, it is very hard for the People’s Liberation Army to form any collective consensus on national security policy by excluding the civilian leadership involvement or party supervision. Nonetheless, the Chinese military can still be very influential on security dimensions other than those traditional missions assigned to the People’s Liberation Army through various approaches. These approaches are mainly established by personnel exchange, practical participation and institutional arrangements. It is very important to note that no matter how seriously the military had ever been committed to these aspects of the broadly defined national security, it is hard to believe that the

Contemporary Chinese Political Economy and Strategic Relations: An International Journal 4(3) ♦ 2018
Chinese military may have the possibility to acquire the position of exercising the final say on any policy since the principle of “party commands the gun” already assured the party leadership and political control over the military.

There is much professionalism that exists in the Chinese military which may have the potential as the capital to construct the second career in public services or even private sectors. For instance, medical, judiciary, aviation, finance and engineering professionals would have the possibility to be transferred from their original military career to other professional fields associated with the national security matters. Especially, while these public or private institutions had accommodated discharged or retired military professionals to engage with the Chinese military for tackling the national security issues, whether the professionalism and practical military service experiences will become a factor to influence the policies and decisions though the level of their influences is really hard to reasonably assess. Although these former military professionals would not be directed by the military anymore, yet, their expertise is still a positive factor to implicitly represent military influences.

We also need to note that those paramilitary forces committed to social stability, a vital aspect of the overall national security outlook, are tightly associated with the Chinese military. Personnel exchange after leaving the regular military service is a well-known reemployment mechanism. Cadres of the People’s Armed Forces Department in various levels of local governments, state-owned enterprises and higher education institutions are manned by the retired People’s Liberation Army personnel. The Chinese paramilitary forces may include Armed Police, Militia, Reserve Service Forces and the Xinjiang Production and Construction Corps. Given the activities those paramilitary forces have been involved in and the significance of the national security contained
in those activities, we may well identify the extension of the influences from the Chinese military towards these dimensions. These paramilitary units have also contributed to defense education that is actively shaping the cultural aspect of national security. Coordinating the relationship between the military and local government may also positively harmonize the civil-military interactions, which is a vital factor of the national security calculus.

The space program of the People’s Republic of China is closely associated with the People’s Liberation Army though it is nominally directed by the China National Space Administration. Many key decisions regarding the space program such as the selection of astronauts as well as exploitation of Earth-Moon space for industrial development are openly directed and issued by the Central Military Commission. The Chinese military has played a vital role in supporting all the activities of the space program, thus proving its significance in the dimensions of the national security on science and technology. Also, the People’s Liberation Army is also retaining the partnership relationship with the defense industry community of the People’s Republic of China. Features like military expenditures, research and development, weapons production and arms sales to foreign states all need the expertise provided by the Chinese military. Many military personnel may have the possibility to be transferred to the defense industries to further contribute their expertise but are meanwhile extending the military influences towards this aspect implicitly. This connection makes the Chinese military have the opportunities to exercise its influences on the dimensions of economy, nuclear, science, and even technology aspects of the national security policies addressed by the overall national security outlook concept.

There is a section in the Foreign Ministry of the People’s Republic of China known as the Department of Arms Control that is in charge
of issues such as international arms control, disarmament, non-proliferation, export control and global or regional security. This department is also tightly associated with the Chinese military though its leadership is fundamentally professional diplomat. The professionalism generally held by the Chinese military personnel is the essential elements for the diplomats to conduct their assigned duties. The military strategy insisted by the People’s Liberation Army is also the core factor for the Foreign Ministry officials to fulfill the international obligations noted by the arms control mechanism that the People’s Republic of China had promised. The Chinese military obviously has significant influences on this aspect of national security policies basically out of its area of responsibility. The possibility for the military personnel to support the diplomatic function of this dimension is also expectable.

Many members of the Chinese military who had been involved in the intelligence operations may have the chance to join other public service department to engage with foreign states or any situations possibly undermining the national security. The typical cases are those who have joined the organizations for dealing with Taiwan affairs or issues related to the Hong Kong or Macao Special Administrative Regions. This again justifies that the military professionalism may have the possibility to continue its influences on the national security affairs through personnel exchange.

The second approach for the Chinese military to exercise its influences on national security either from the policy formulation or on the practical execution is based on its substantial involvements in national security operations. The Chinese military has adopted its assets to support many missions other than the traditional defense operations. Those non-traditional military functions may facilitate the People’s Liberation Army authority to acquire a better position in the central government’s national security policy formulation process. It is well-
known that the Chinese military and the paramilitary forces, particularly, the Armed Police Forces, shouldering the protection of key infrastructures such as transportation, communication, energy and water supply facilities is already a routine mission. Many forces with the expertise in engineering, territorial survey and communication that are committed to these function have acquired significant achievements. These forces are not only important in the dimension of social stability and national security but are also successfully shaping a positive social image for the military professionals.

Sometimes, those military forces stationed in the remote locations will contribute to the infrastructure construction tasks. The Chinese military plays a key role in supporting the effort of forestation, wetland protection and ecological preservation, which is the essential dimension also addressed by the overall national security outlook. To support these construction tasks and infrastructure facilitations is a vital task for the military to secure its relationship with local community. It is very important for the Chinese military to retain a harmonic interaction with the general public since traditionally, according to Mao’s directive, the military is the fish and the people is the water. The mutually supportive relationship does help many communities in the remote areas to improve their living standard and leave the status of poverty. By so doing, the Chinese military enhances social stability and support the overall national security via an indirect approach. The fact that it is necessary for the Chinese military leadership to participate in the annual Central Economic Work Conference since it was held for the first time in 1994 may indicate the importance of the People’s Liberation Army in the economy aspect of the national security policy.9

The Medical Corps and military hospital service system is another asset owned by the military to support broadly defined national security. These medical assets and facilities are not only serving the practical
medical services in rural areas and poor remote countryside but also coordinating with national medical system to eliminate epidemic diseases in order to guarantee social stability and contribute to national security. Apart from practicing its medical professionalism to support social stability and welfare, the Chinese military medical service system also works with those military higher education institutions, research establishments and forces with advanced technology expertise to take charge or to share tasks assigned in the national science and technology research projects. By so doing, the Chinese military has also substantially contributed to the science and technology aspects of the overall national security outlook. In addition, all the efforts of supporting national economic and social development as noted by the government white paper titled *The diversified employment of China's armed forces* may have significant implication for the broadly defined national security policy as well.¹⁰

Another popularly recognized aspect to which the Chinese military is actively committed is emergency rescue, disaster relief and humanitarian assistance.¹¹ Unquestionably, all these endeavors contributed by the People’s Liberation Army and other Chinese paramilitary forces may support the security dimension of the social aspect. As the Chinese military is engaging with these missions in overseas territories, it may also support national security in the dimension of politics and diplomacy though such an apprehension may not be necessarily well identified and accommodated into the overall national security outlook yet.

Actually, maintaining social stability in order to assure national security in the social dimension is another vital application of the Chinese military forces openly addressed by the People’s Republic of China government. All the substantial achievements are well listed in the government white paper to indicate this function.¹² Chinese paramilitary
forces such as the militia also participate in the collective efforts together with the constable units to safeguard important transportation infrastructures like bridges, tunnels and railroads as already noted before; yet, all these tasks are supported by the Chinese regular military forces as part of their national defense missions contained in the national security functions.

In recent years, the People’s Liberation Army Navy is very enthusiastically committed to overseas deployment that is basically supporting the diplomatic and political functions by fulfilling the United Nations Security Council resolutions. For instance, assisting the United States vessels to destroy the Syrian chemical weapons is a typical case (Perlez, 2013). Other than that, the Chinese communist navy vessels and air force aircrafts also attended as the platforms for retracting overseas Chinese during contingencies. These civilian evacuation operations may also be defined as an extension of the national security coverage.

Of course, the People’s Liberation Army Navy has also coordinated with other Chinese maritime law enforcement forces in various functions to safeguard national maritime interests. It is necessary to note that the People’s Liberation Army Navy also owns certain utmost authority on oceanographic issues, as it is noted by the China Navy Hydrographic Office website:

According to the relevant rules and regulations of Surveying and Mapping of the People’s Republic of China (PRC), the Navy is in charge of the management of PRC basic hydrographic surveying and mapping. CHINA NAVY HYDROGRAPHIC OFFICE is the PRC’s official hydrographic surveying and mapping organization and the only publishing house for nautical publications authorized by the government. The Navy has the specialized academy to train professionals in hydrographic, institute of hydrographic technology,
hydrographic surveying and research fleet, navigation publications
press, and has the offices and agencies to sell nautical publications
along the coastal cities of the mainland, Hongkong, and Tokyo of
Japan. Currently, the Navy has officially published all kinds of Charts,
Thematic Charts and Atlas including Navigational Chart, Harbor
Chart, General Sea Area Chart, Fishery Chart and so on, regularly
publishes Notice to Mariners and all kinds of nautical publications
including Nautical Almanac, List of Lights, Sailing Directions,
produces hundreds of paper charts and digital charts yearly and
hundreds volumes of nautical publications which have been sold to
many countries around the world.¹⁴

Hence, the influence of the Chinese military on this part of national
security issues in many aspects can be undeniably identified.

Given all the activities associated with the national security aspects
noted by the overall national security outlook persistently addressed by
the Chinese political leadership directly involved by the People’s
Liberation Army or indirectly supported by the Chinese military, we may
clearly recognize that the Chinese military would have certain level of
influence on the policy decision-making regarding all these issues.
However, the actual influences of the People’s Liberation Army are hard
to measure since we could not specifically identify the identity of the
Chinese military by excluding effects caused by the party supervision
and civilian leadership within the Central Military Commission.

Besides by way of the personnel exchange and substantial
participation of the national security matters, we also need to remind that
the Chinese military always have its traditional position in political
participation process of the Chinese communist regime since the military
has played a vital role in the nation-building process and subsequently
acted as the essential element of sustaining internal stability in the
People’s Republic of China. Members from the People’s Liberation Army attending the National Congress of the Communist Party of China, the National People’s Congress and the National Committee of the Chinese People’s Political Consultative Conference is guaranteed by the actual practices of the People’s Republic of China politics.

Although the military personnel presence in these meetings may signify that the political sphere of influence is firmly held, yet, as already mentioned before, it does not justify that the Chinese military may have its own policy position free from the party direction and civilian political leadership.

By the same token, the number of seats in the Central Committee of the Chinese Communist Party can be another indication of Chinese military political influences. Likewise, there are two seats of the Chinese communist politburo that are reserved for the Deputy Chairman of the Central Military Commission. Nevertheless, these two members are appointed simply to contribute their professionalism in the political decision-making process within the politburo, not to reflect their political preferences collectively decided by all the military personnel. Other party apparatuses such as the Secretariat of the Communist Party of China and the Central Commission for Discipline Inspection may sometimes recruit party members with military background. Some military members are frequently selected into the Central and Political and Legal Affairs Commission. However, such appointments are never regular and routine. It may more or less indicate that the influence from the military professionals is virtually limited within the party organization.

As for the military influence on the national security decision-making, we should point out that the Foreign Affairs Leading Small Group, the National Security Affairs Leading Small Group and the National Security Commission of the Communist Party of China are the
major mechanisms for formulating the national security policy and exercising those associated decision-making processes. Members of the Chinese military leadership are directed to participate in these mechanisms; yet, the staff organization of these leading small groups and national security commission is mainly under the influences of professional diplomats and party bureaucracy.

Obviously, the Chinese military would have less influence to set the agenda for issues discussed within these mechanisms. It may reflect that the Chinese military is actually in a less favorable position in national security policy decision-making through these party apparatuses. Regardless of these mechanisms specifically addressing the national security matters, the final decision would still be achieved through the party decision-making system, i.e. the Politburo of the Chinese Communist Party. The Outline of the National Security Strategy is a directing document adopted by the Politburo of the Communist Party of China on January 23, 2015, indicating that the party leadership held a tight grip on the fundamental directives of the national security matters (Tiezzi, 2015). In such a process, the Chinese military influence and perspective have no chance to prevail in front of party leadership.

4. Conclusion

This paper has analyzed the identity of the Chinese military and the features of the People’s Liberation Army in the national security matters of the People’s Republic of China. The author would like to argue that the role played by the People’s Liberation Army leadership within the PRC national security policy decision-making and the influences of the Chinese military are generally overstated. The politics of the People’s Republic of China is mainly a one-party system that retains a traditional principle known as “party commands the gun”; the military therefore has
a very slim possibility to acquire policy choice and political maneuver spaces of its own.

Whether the Chinese military may play a vital role in executing the PRC national security policies is a question that does not need to be asked since the People’s Liberation Army is openly participating in many activities with national security significance. What is the exact level of influence possessed by the Chinese military in the processes of PRC national security policy decision-making is a matter of perception and also a matter of judgment. Perhaps we could never have a consensus on this issue.

Notes

* Dr Ching Chang (張競) is a researcher with long distinguished experiences in national security affairs. He served in the Republic of China Navy as a line officer for over a quarter of a century. Numerous lessons were acquired from various posts in his naval career. Particularly, a decade of sea duty service in which he has committed to different types of surface combatants allows him to grasp much valuable first-hand information and lessons that could never be gained from any academic arena. Further, as a graduate from the Republic of China Naval Academy ( 中華民國海軍軍官學校 , 高雄 / Kaohsiung City, Taiwan, ROC), Naval Staff College of the US Naval War College and Naval Command College of the US Naval War College, Dr Chang received orthodox professional military education which serves to support his advancement in research on national security. Dr Chang has a diversified academic background comprised of a Bachelor’s degree in navigation and maritime engineering granted by the Republic of China Naval Academy, a Master’s degree in electrical engineering gained from the University of Colorado at Boulder in the United States, and a Doctorate in politics and international studies.
confessed by the University of Hull in the United Kingdom. Apart from the posts in the naval fleet, Dr Chang also attained the position of staff officer at various levels in the defense hierarchy. With nobility granted by the defense authority of the Republic of China, Dr Chang has been selected as the teaching staff in the Chinese Naval Command and Staff College as well as the War College of the ROC National Defense University (國防大學, 桃園 / Taoyuan City, Taiwan, ROC). Dr Chang also owns a honor to be the speech writer for the Defense Ministers of the Republic of China and in charge of the Office of Policy Coordination for the Defense Ministers for two years. Dr Chang has concluded his military career with the rank of navy captain several years ago, thus acquired a privilege called the “Honorable Citizen of the Republic of China”, and was invited by the ROC Society for Strategic Studies (中華戰略學會, 台北 / Taipei, Taiwan, ROC) to be a research fellow. Further, Dr Chang is also an active columnist and TV commentator on political issues. <Email: chingchang@hotmail.com>

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References


Culture, Sustenance and Development
Food Consumption and Economic Development in Contemporary China

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Abstract
Food consumption is closely related to, and contributes to, economic production. It undertakes social functions, participates in economic activities and forms industries. Additionally, food culture reflects nature, history, politics, philosophy, religion, as well as the status of social life. Food consumption is mutable, encompassing both material and spiritual elements of any given society. All-round development of food consumption will, in turn, accelerate economic growth. It is found that food consumption has extensive social attributes, in addition to the
natural attributes of economic development. Fashion-oriented, original simplicity-oriented and health-oriented food supplies are required in the global catering market. Standardization, diversification and internationalization are necessary in the field of food consumption servicing for economic development.

**Keywords:** food culture, dietary behavior, service industry, economic development

1. Introduction

Food, as the primary material resource for humanity’s survival and development, functions as one of the fundamental social lifestyles of people. Chinese food culture has a long-standing history, and through its historical changes, a better comprehension of China’s economic and social development can be unveiled (Chen and Wang, 2017). As such, it is suggested that Chinese food culture can strongly reflect China’s nature, history, politics, philosophy, and religion, as well as the colorful social life of Chinese people (Tian *et al.*, 2018). In addition to its natural attributes, food has extensive social attributes. Food is endowed with and reflects human consciousness, thinking and psychological status, integrates with the spiritual wealth from history, geography, literature, art, and education (Zhang, 2017).

Food functions to not only satiate people’s hunger; it has also become an integral aspect of life enjoyment, which represents an essential component of food anthropology (Li and Tian, 2014). Food anthropologists stress that changes in people’s eating habits not only depend on the local food culture, which may be specific to a given region, but also varies with economic development in different regions. In general, as people gradually become wealthier in emerging market
economies, their requirements for sustenance become increasingly higher after overcoming poverty. Today, these consumers not only pay attention to the quality and nutrition of food but also require that food should be appealing in color, aroma and taste. Therefore, rapid development of a country’s economy and society spurs significant changes in food culture (Liu, 2016).

Meanwhile, all-round development of food will in turn promote the growth of economies. The food industry, as a labor-intensive industry, except for providing food commodities and services, encompasses a high degree of industry relevance in the economies. Hence, the development of the food industry can further drive the economic development of relevant industries, thus creating numerous employment opportunities. The food industry in China, following the rapid and steady growth of the national economy, as well as consistent rising of urban and rural residents’ income level, has demonstrated a strong momentum of robust development. As such the number of enterprises and the food industry revenues have been consistently increasing. The food industry has become a vital aspect of China’s national economic development; thus, it is evident that the food industry is one of the important forces driving China’s economic development (Baker and Friel, 2016).

2. Economic, Social Development and Changes of Food Culture

Currently, the extant academic scholarship has yet to cultivate a unified definition of food culture. Some scholars suggest that food culture refers to food, cooking, food processing techniques, diet nutrition and health care as well as food-based culture and art and that it is the summary of ideology and philosophy. Per historical geography, economic structures, food resources, religious consciousness, cultural traditions, customs and other factors, they divide the world’s food culture into three
self-contained class groups based on flavors, namely oriental food culture class group, Western food culture class group and Islamic food culture class group (Hua, Wu and Yu, 1998). However, other scholars advocate that food culture refers to the development and utilization of food resources, the technologies and arts in food-making and food-consumption processes, as well as the customs, tradition, ideology and philosophy based on food and that it is the summary of all food matters formed in people’s production and lifestyles, processes, functions etc. (Zhao and Xie, 2006).

Food culture covers all material culture and spiritual culture related to food. As a social category, food culture has objectively existed since human society appeared, while as a subject concept, it appeared not long before. Considering mankind’s food activities as a form of culture originates from sociology and anthropology (Ji, 2010a), transitioning from devouring raw meat and drinking blood in ancient times to food civilization in modern times reflects the results of mankind’s constant acquisition and evolution in the process of transforming nature. In addition, eating habits are determined by geographical factors, climatic conditions, and productivity development levels, amongst other factors. Climatic conditions mainly determine the flavors of food. For instance, in cold regions, people tend to consume greasy foods to meet their need for storing fat to keep insulated from the cold; in warmer regions, people lean toward plain foods because their digestive functions relatively decline due to more body water loss in hot weather and plain food is more easily digested. Therefore, food civilization has produced different food cultures in the development process because of the changes addressed above.

Productivity development level determines the degree of improvement and evolution in such aspects as food material growing, feeding and processing technology, cooking methods and food
consumption methods. Geographical factors, climatic conditions and productivity developments do not exist in isolation but affect certain regional scope, which is termed “cultural circle” by some scholars. As such a cultural circle is influenced by the unbalanced geography, climate, productivity and other factors, cultures of different circles present distinctive styles (Ji, 2010b). In a certain extended period, geographical conditions and climatic conditions will not have substantial changes in a certain region, while productivity development level, i.e. economic and social development, may have momentous changes. Hence, changes of food culture are closely related to the economic and social development level of different regions.

Taking Wanzhou City in China as an example. It is under the jurisdiction of Chongqing Municipality and located in the east of Sichuan Basin, Southwestern China. Adjacent to the Three Gorges, it is in the vital part of Three Gorges Reservoir Region. Before the Three Gorges tourist industry flourished, that is, before the economy flourished, the food culture in Wanzhou was facing some negative issues, such as small production and operation scale, few high-quality well-known products, narrow market, and failure to develop and make use of the cultural connotation of various local snacks and delicacies (Jiang, 2014).

However, after the Three Gorges tourist industry became prosperous, Wanzhou’s economy had experienced a highly qualitative leap forward. Subsequently, Wanzhou’s tea culture, poetry and liquor culture along with the food culture have developed in a positive direction with the characteristics of branding and internationalization. Presently, China is one of the countries with successful development of culture and civilization in the history of human civilization development, and “food” has been regarded a priority for the Chinese to take care of, whether in terms of livelihood or in national policies. Compared with
other nations, the historical culture of the Chinese nation presents more distinctive and typical “features of food”.

Catering products are the material carrier of food culture. China’s long history of food and booming modern culture provide unlimited room for the continuous development of, and innovations in, food culture. It can be seen from the perspective of cooking, cuisine culture or people’s concepts of food that current catering products should, on the premise of fully satisfying people’s needs of pursuing hygiene and safety, pursue anesthetization of food with their flavor, quality, aroma, color, shape, utensil and other basic attributes as the material presentation (Yang, 2012). In reviewing the development history of anthropology, it is not difficult to discover that cultural anthropology has a tradition of analyzing food culture.

Lewis Henry Morgan, one of the inaugurators of anthropology, had divided human society into seven stages in his book Ancient society (1877, London: MacMillan & Company). Morgan regards production, technology and invention of means of production as the symbols for dividing social stages. Per Morgan, intermediate unenlightened society started when people acquired fish as food and knowledge of how to control fire; advanced unenlightened society began with the invention of bows and arrows; and low-level unenlightened society started from the invention of ceramics (Tan, 2004). Therefore, food culture and social phenomena are closely interrelated, with economic and social development of various levels corresponding to developments in food culture.

In an economically low-level society, adequate food and clothing should be stressed, while in a higher-level society, relatively comfortable lifestyle should be highlighted. One of the main advancements of evolving from a society where people have enough to eat and wear to a moderately prosperous society is the change from physiological need of
satisfying hunger to the spiritual need of pursuing exquisite food (Li and Tian, 2014).

3. Food Consumption Facilitates Economic Development

Economic behaviors refer to the economic activities which the economic subject conducts to achieve a certain fiscal goal and fulfill its rights and obligations in the process of participating in economic and legal relations, including economic management behaviors, service-rendering behaviors and task-accomplishing behaviors. Economic anthropology is a young subject established and developed in 1940s-1950s. Starting from a generalized perspective, it explores the foundation and motivation of human society’s economic behaviors. As the global economy has always related to various public activities and social systems, such as religion, rituals, customs and legends, only when human society can be observed and going into the deep structure of various societies and cultures can the nature of economic activities accurately representing the relationship between human, society and economy be uncovered. Food is the primary need of mankind for livelihood and development as well as one of the fundamental forms of social life. Dietary behaviors are one of the main contents of human economic activities, which become the major research subjects for food and economic anthropologists (Tian and Luo, 2013).

3.1. Dietary Behaviors Have a Close Relationship with Human Life

The famous American psychologist Abraham Harold Maslow proposed the well-known “Maslow’s hierarchy of needs” (Maslow, 1943). He divided human needs into physiological needs, safety needs, esteem needs, needs for love and belonging, and needs for self-actualization, among which physiological needs are essential for human being’s
external conditions to maintain and develop life. Food, however, is the most basic need in physiological needs (Sun, 2015).

People pay more attention to their health issues when economic development trends move toward prosperity. There are many factors affecting human health, including living environment, inadequate exercise, eating habits, psychological temper etc. Among these factors, eating habits, as the foundation of health, are closely related to human health. Previous studies show that eating habits have an important influence on elderly people’s health and lifetime. Healthy eating habits help promote health, maintain normal operation of body functions, strengthen disease resistance, reduce the chances of suffering from obesity and diabetes, and even aid in curing diseases (Jahan, 2010).

Elliott et al. (2008) examined the correlation between reasonable exercise and healthy dietary behaviors and epilepsy based on the data from a survey on Californian health conducted in 2005. The study results indicate that people who exercise less and smoke more are more likely to suffer from epilepsy. These people tend to enjoy the consumption of alcohol while failing to consume enough vitamins, which can be found in fruit and vegetable salads. Further, their results also suggest that unbalanced diets undermine physical balance and trigger diseases (Nyarugwe et al., 2016).

Dr. Sun Yat-sen mentioned in his People’s livelihood doctrine, Strategy of nation-building (民生主義，建國方略 (1917-1920)) that in the evolution of modern civilization, China lags behind other countries in every aspect except for diets. The food which China has discovered is certainly superior to that of Europe and America. China’s exquisite cooking methods are unparalleled (Hu, 2002). Knowing how to use fire symbolizes human beings’ development from animals towards human civilization. In the Stone Age, Chinese people were already using fire to barbecue food. After years of human civilization development,
Chinese in the Xia (夏), Shang (商) and Zhou (周) dynasties had already had the consciousness and concept of cooking.

Going through prosperity and development of Qin (秦), Han (汉), Tang (唐) and Song (宋) dynasties, Chinese people’s cooking consciousness and concept passed down from generation to generation and became more mature. They utilized unique and advanced cooking utensils, food containers, food material selection and cooking techniques. A diversified food culture system was developed centering on eight major cuisines, supplemented by local cuisines. Concerning Western food development, due to relatively frequent occurrence of historical and regional conflicts as well as division and migration of economic civilization, various kinds of unbalanced development patterns had existed for extensive periods, and the Western food pattern, Italian cuisine-oriented, appeared only by the 16th century (Yang, 2014).

It can be observed from the above that Chinese cooking methods and its profound culture have a high position and are highly praised worldwide, such that European and American countries may have to struggle to catch up. Chinese dietary behaviors have a rich connotation, which can be divided into three levels: (a) material level, including dietary structure and food utensils; (b) behavior level, containing cooking techniques, utensil-making technology, food storage, transportation methods etc.; (c) spiritual level, covering cultural connotations such as the concept of diet, diet customs, humanity and psychology, national characteristics etc.

Regional dietary behaviors are an integral part of culture. There is an old saying that “food is the paramount necessity of people”, and every country in the world possesses its own culture and boasts rich and diverse food culture as well. In China, for instance, as depicted in an ancient book of Qimín yáoshù (齊民要術, i.e. Essential techniques for the welfare of the people, completed between AD 533 and 544),
there are more than 10 methods for making sauce and 21 for making vinegar, involving nearly 10 kinds of raw materials. Records in the book *Compendium of materia medica* (*Bencao gangmu* / 本草綱目, AD 1578) are more somniferous, covering 48 kinds of congee, such as camellia project congee, tea congee, ilium brownie congee etc. (Liu, 2012).

Regional differences and type of region influence people’s selection of food materials and their tastes and habits through natural produce (Maguire, 2016). For example, seaside areas are predominately famous for seafood dishes, riverside areas are primarily known for freshwater food dishes; in gorge-torrent areas, as fish and shrimps have to fight with the torrents to survive, they taste bouncy and delicious and have a special mouth feel; mountainous areas are known for game and mountain products; beef and lamb in arid areas lack rich flavors and the quality of fruits and vegetables are the best; and rice produced in the north is better than that produced in the south (Chen, 1994).

Different climates and cultural customs lead to various catering systems. Considering China as an example, China has gradually formed a catering system centering on “eight major cuisines”, including Guangdong cuisine, Sichuan cuisine, Shandong cuisine, Huaiyang cuisine, Zhejiang cuisine, Fujian cuisine, Hunan cuisine and Anhui cuisine based on the specific climate and cultural customs. Chinese food is well-known worldwide. For instance, Sichuan cuisine is renowned for it features of “pungent” and “spicy”, and it has formed its unique food culture characteristics and become an emerging tourism product (Xu et al., 2002). Internationally speaking, a great number of regions in different countries have formed their own unique food culture and style going along with the booming food industry. In addition, restaurants across the country are influenced by the eight major cuisines, so it can be observed that food industry has broken through the regional limits and
that the food customs of different regions have been integrated and are jointly influencing people’s daily life (Xie and He, 2006).

3.2. Needs of Dietary Behaviors to Economic Production

Undoubtedly, food is the primary need of human beings for survival and development and one of the basic forms of social life. Through years of development, each country has formed its own food system, covering aspects such as dietary structure, food making, food utensil, nutrition and health care, food aesthetics etc. With the development of social production and the rising of people’s living standards, people’s needs for food do not stagnate at the stage of having enough to eat (Park, 2017). Instead, people start to pursue a higher-level enjoyment of food. People not only pay attention to the edibility of food but also start to care about whether food can bring them spiritual satisfaction and sensorial enjoyment. Higher demands for food and the expansion of the food industry have facilitated the flourishment of the food industry.

Along with the economic development and the change of enterprise models, the food industry also undertakes social functions. As modern enterprises seldom have an independent canteen, employees must have breakfast, lunch and dinner at nearby restaurants. With the work rhythm speeding up and office environment getting increasingly intensive, socialization of work meals brings a new business opportunity to the development of food industry. Moreover, with the continuous improvements in gender equality, more and more women have become employed, so they spend less time on traditional household duties, such as cooking. Continuous improvement of living standards makes modern professional men and women tend to order take-out or eat out to satiate their families.

Per international trends, when per capita GDP reaches about 1,000 US dollars, people’s consumption structure will rapidly upgrade and the
frequency of eating-out and level of consumption will rise. In 2005, the per capita food and drink consumption of the United States reached 1,600 US dollars and that of France reached 1,050 US dollars, while that of China’s urban residents was less than 100 US dollars (Xiong, 2005). It indicates that there is a huge gap between the per capita food and drink consumption of China’s urban residents and that of advanced countries, and this also indicates that China’s food industry has a large development space and enormous potential.

Chinese food industry system, with continuous high-speed development, is getting increasingly sound, the operation is getting more distinctive and brand awareness is getting even stronger. So far, China’s food industry has formed three levels of consumption, respectively high-, medium- and low-grade consumption, with Chinese food and Western food coexisting and traditional national flavor and modern food matching appropriately. With continuous growth of China’s GDP and acceleration of China’s industrialization, urbanization and modernization processes, steady development of society and continuous improvement of people’s life provide wider space for the development of China’s food industry, thus bringing it great market demands. Relevant data indicates that China’s catering income reached 2,786 billion yuan (renminbi) in 2014, a year-on-year growth of 9.7%, with the mass catering accounting for 80%. Food industry has entered a new stage of mass transformation, structure optimization and power conversion. By analyzing the current situation of China’s food industry, it is clearly shown that the proportion of food industry in the total retail sales of consumer goods has exceeded 10% and thus has become an important pillar in the tertiary industry and made great contributions to boosting consumption, expanding domestic demands, ensuring employment and benefiting people’s livelihood (Lu, 2015).
The 9th China Food Industry Development Conference 2015, sponsored by China Cuisine Association, was grandly held at the Shanghai Exhibition Center. It was noted at the conference that the national catering income was 745.8 billion yuan in the first quarter of 2015, a year-on-year growth of 11.3%, and China’s food industry has entered a period of important strategic opportunities. The *Analysis report on China’s top 100 catering enterprises and top 500 shops 2014* released at the conference shows that the operation revenue of China’s top 100 enterprises in 2014 was 191.62 billion yuan, a year-on-year growth of 9% and 3.3% faster than 2013. Among them, group meal’s development was most notable, with the fastest year-on-year growth of the operation revenue up to 33.2% (Mo, 2015), and large-scale catering enterprises were getting more and more; the operation revenue of the top 100 groups had exceeded 100 billion yuan, accounting for 3.6% of China’s total food industry, which was mainly in three major direct-controlled municipalities – Shanghai, Beijing and Chongqing.

Per the data shown above, it can be estimated that China’s food industry has been maintaining a strong momentum of growth, more and more catering tycoons have formed, and the economic benefits brought by this cannot be underestimated. In recent years, as China’s food industry has been rapidly developing and prospering, more and more catering enterprises have participated in the market competition. Per the report of China’s Ministry of Commerce, in the Spring Festival golden week in 2015 (from the Chinese New Year’s Eve to the sixth day of the first month of lunar year), the sales of China’s key retail and catering enterprises reached 678 billion yuan, a growth of 11% compared with the same period in 2014, and “New Year’s Eve dinner” was a main event in the Spring Festival catering market. During the golden week, sales of the commercial and trade enterprises mainly supervised in Gansu, Hunan, Liaoning and Hubei increased by 14.2%, 14%, 13.2% and 12.9%
respectively, and sales of the enterprises mainly supervised in Qinghai, Shanghai, Guangxi and Chongqing increased by 12.8%, 12.6%, 12.4% and 12.4% respectively (Li and Leng, 2016). China’s food industry carried out splitting boom in such a brief time; the reasons should mainly be attributed to the following three aspects.

First, the policy of macro-control provided great support to develop food industry. Relevant national policies mentioned many times that food consumption should be promoted, proportional relation between investment and consumption should be adjusted, the policy of expanding domestic demands should be adhered to and consumer demands should be expanded by priority.

Second, steady economic growth created a good macro-economic environment for the sustainable development of food industry. With the reform and opening-up as well as rapid development of China’s economy, employment channels become diverse, labor reward increases, people are devoted to working at great tension, and thus the labor value and time value are enhanced. Pushed for time, fewer and fewer people are willing to spend time cooking but choose to eat out at a restaurant, and eating-out has become an important way for modern people to make friends, discuss business and entertain themselves, thus increasing the needs for catering services.

Third, the structural adjustment of catering enterprises and the improvement of the overall service level provided sufficient internal motivation for the sustainable development of food industry. In the case of China, after China received full membership from the World Trade Organization (WTO), numerous overseas-funded and foreign enterprises entered China’s market, and China’s national economy started to take off. Meanwhile, increase in number of foreigners with different eating habits and culture in China has opened new development space for China’s food industry. The entering of famous foreign catering
enterprises has brought China new operation philosophy and advanced operation modes and increased competition in the domestic catering market, thus urging domestic catering enterprises to keep learning advanced knowledge, updating products and enhancing management efficiency (Zhang and Zhang, 2009).

3.3. Ways of Food Industry’s Participation in Economy

Food industry can create considerable job opportunities and thus is good for the stability of the country and the society. The Chinese leadership proposed that the government should attribute great importance to the most direct and realistic benefit issue people are concerned with – employment, which is the capital of people’s livelihood, and continuously increase remuneration of labor, especially the frontline labor; the Party and the State should implement active employment policies, create more job opportunities, improve employment environment and strengthen employment quality (General Secretary Xi Jinping’s series of important speeches, 2014).

As testified above, the issue of employment is still the priority among priorities of the future government work. The fundamental measure to solve the employment issue is to create job opportunities, which are closely related to the degree of economic prosperity. Although food industry’s technical content is relatively low, it is a labor-intensive industry. Compared with other industries, as it has relatively low requirements on professional skills and on the employed, it can absorb numerous low-level social laborers and thus make great contributions to the solving of employment conflict that is getting increasingly prominent.

The third national economic census data showed that there were a total of 200,000 accommodation and catering enterprise legal entities with 10,694,000 employed persons across the country, showing an
increase of 37.9% and 82.7% respectively compared with that in 2008 (National Bureau of Statistics of the People’s Republic of China, 2014a). In addition, many rural surplus laborers are pouring into big cities at present to seek job opportunities, and food industry is an important choice. Therefore, the development of food industry plays a certain role in solving the “three agriculture-related issues in China”. Food industry plays an active role in driving China’s economic and social development in three-fold reasons.

First, food industry makes positive contributions to economic growth. Food industry, as a traditional service industry in China’s tertiary industry, has been maintaining robust growth momentum, making rapid progress and presenting flourishing new situations since the founding of new China, especially after the reform and opening-up. Food industry has apparently become a noticeable consumption hotspot. It has successfully realized leaps of the total sales of 10 billion, 100 billion and 1 trillion in a brief period of 60 years, creating amazing miracles in the history, and it has become important force driving China’s economic growth (Yang, 2013).

Second, the food industry facilitates the development of China’s tourism industry. With the rise in people’s economic levels, holiday travels have become one of the main ways for people to spend their leisure time. As the tourism industry is vibrantly developing, traditional sightseeing-based travel cannot meet people’s needs, and experience-based tourism with leisure as the main purpose is becoming increasingly favorable to consumers. In the development of leisure tourism and experience-based tourism, food tourism has gradually become new fashion pursued by people (Niu, 2012).

Third, food industry promotes the development of relevant industries. Food industry has close relevance with planting industry, breeding industry, handicraft industry and many other industries, its
development can thus promote the development of relevant industries, increase local peasants’ income and facilitate local economic development.

3.4. Food Industry Is an Important Modern Industry

Food industry can provide product service and consumption service, it is highly relevant to agriculture, animal husbandry and aquaculture industry. Meanwhile, changes of food culture have also facilitated the development of culture industry and leisure entertainment industry. Food industry requires low investment cost and less technical content, so its entry threshold is relatively low; its market potential is considerable and thus it can absorb numerous employed persons. In recent years, global economy has maintained a rapid growth, but lots of countries, especially underdeveloped and developing countries, are still facing problem of high unemployment pressure and employment difficulties.

Therefore, food industry’s development is closely tied to social and economic stability, and it has certain comprehensive social effect. Following the development of economy further reinforcement of opening-up and improvement of people’s living standard and consumption ability, people’s demands for catering products and services have further increased, which provides a significant opportunity for the optimization and development of global food industry.

Considering China’s food industry, data show that during January-May 2015, the total consumption in food industry was 1,238 billion yuan, a year-on-year growth of 11.7%, accounting for 10.55% of the total consumption of social consumer goods (Hua, 2015). So, it is well-founded to say that food industry plays a decisive role in the total retail sales of consumer goods. Healthy and rapid development of food industry is an important booster facilitating China’s social and economic development (Liang, 2012). The developing tendency of food industry in
China in the past decade had the features of diversified competition, adjustment of catering structure, and chain-oriented catering operation.

First, diversified competition: It has developed from pure price competition and product quality competition to product and enterprise brand competition and cultural taste competition, and from single-shop and single-business type competition to multi-business type, chain-oriented, collectivized and large-scale competition.

Second, adjustment of catering structure: Continuous upgrade of competition has resulted in changes in catering structure. With changes of food culture and consumers’ eating habits, food industry has to adjust its strategies to attract consumers. For example, as consumers pay more attention to food safety and health problems at present, it is necessary for food industry to launch healthy green food to meet consumers’ needs. In addition, the fast pace of modern life certainly requires people to reduce cooking time, and fast food’s popularization and development are the specific responses of catering enterprises to satisfy consumers’ needs.

Third, chain-oriented catering operation: The chain-oriented business model has scale advantages, which would reduce operation cost. In China, the contemporary food industry represented by chain operation, brand cultivation and technical innovation has been fully replacing traditional food industry’s business model that features go-as-you-please manual operation, single workshop-type operation and experience-based management, moving towards the industrialized, chain-oriented, collectivized and professional business management model (Wang, 2007).

Rapid development of China’s economy and upgrading of people’s consumption level have boosted the development of food industry. In recent years, China’s economic growth rate has been maintaining at above 7%. The recent Statistic Bureau’s data show that the urban per capita disposable income was 28,844 yuan, an actual growth of 6.8%
regardless of price factor; the rural per capita disposable income was 10,489 yuan, an actual growth of 9.2% regardless of price factor. Additionally, the classification of income sources suggests that the people’s income from wage and salary, net income from operations, net income from property and net income from transfer nationwide were 11,421 yuan, 3,732 yuan, 1,588 yuan and 3,427 yuan respectively, an increase of 9.7%, 8.7%, 11.6% and 12.6% respectively over the previous year. The growth rates of net income from property and net income from transfer were higher than those of income from wage and salary and net income from operations, indicating that diversification of people’s sources of income has further improved (National Bureau of Statistics of the People’s Republic of China, 2014b).

The improvement of consumer’s consumption ability has paved the way for the rapid development of various industries. Economic development has also strengthened social and economic activities, and the increase of enterprises’ business exhibitions, international academic conferences and exchange activities has undoubtedly accelerated the development of local food industry. With the gradual progress of global integration process, economic development has enabled China to see a higher international position and reputation, and its international social communication activities have increased greatly. Therefore, consumers of China’s food industry are not limited to domestic residents, and foreigners from all over the world are the potential customers of China’s food industry. Chinese-Western cultural exchange has also facilitated integration of food cultures, and some Chinese-Western dishes launched in some areas have received high praise. Moreover, with people’s consumption concepts changing gradually, the urban resident’s consumption expenditure on eating-out has been rising accordingly (Liang, 2007).
4. Conclusion

Food has extensive social attributes in addition to its natural attributes. As a cultural behavior, food consumption is endowed with, and reflects, human consciousness, thinking and psychological states in the process wherein raw food evolved to cooked food when human beings learned how to cook food, i.e. the process in which naturalness transformed to culture, and it has integrated various kinds of spiritual wealth of human beings (Montanari, 2017). In addition, social and economic development has facilitated changes in food culture. With continuous social development, global catering market circumstances are developing towards standardization, diversification and internationalization, and more and more international catering brands are springing up. Meanwhile, all-round development of the food industry has in return promoted economic growth. The food industry, as a labor-intensive industry, has high industry relevance in addition to the food commodities and services it provides. Development of the food industry can boost the development of relevant industries and thus create numerous job opportunities. Under the influence of foreign food culture, food industries in each country should adhere to the following three developing directions:

(a) Fashion-oriented. It entails the uniqueness and freedom of food. As modern social environment is over general, modern people tend to appreciate food aesthetics. Consequently, distinctive foods will become more popular with consumers. In addition, food freedom is the expression of modern people’s pursuing personality and freedom of life, and the flourishing of buffets reflects modern people’s desire for food freedom.

(b) Original simplicity-oriented. As the pace of modern urban life is fast-paced, people are longing for a tranquil idyllic life, and such kind of
returning to the nature will naturally result in increased needs for countryside diets. Hence, original simplicity of food materials, food-making technology and dining atmosphere form one part of the major trends of catering product innovation.

(c) Health-oriented. Food safety problems have been occurring frequently, and this has drawn significant consumer concern for healthy diets. Thus, consumers’ concern will certainly transfer to safe and healthy nutritional diet, and this new tendency undoubtedly provides new ideas for the future development of food industry.

The leadership in China has stressed that realizing the Chinese nation’s great rejuvenation is the greatest dream of the Chinese nation in contemporary times, and the construction of integrating politics, economy, culture, society and ecological civilization are the specific strategic measures to realize China’s dream. This strategy, feasibly, also fits for international development. Food is an important aspect of social culture and has a close relationship with economic development. In other words, food and economic development supplement each other. Therefore, vigorously developing food industry to enrich the food culture that belongs to people is one of the specific measures to expedite economy development.

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Does Religious Obligation of Muslims in Western China Influence Their Intention to Adopt Islamic Banking?

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Abstract
With a total number of 23 million Chinese Muslims, the Islamic banking service in China is still at its early stage of development. This study seeks to examine the factors that influence the Chinese Muslims’ intentions to adopt Islamic banking. Employing the theory of planned behaviour (TPB), the present study investigates the effects of attitude, subjective norms, perceived behavioural control and religious obligation on the intention to adopt Islamic banking services amongst the Chinese Muslims. The survey data used in the process of research was collected from 669 Muslim respondents across four major cities in the western
regions of China. The hypothesized relationships are examined by using the Structural Equation Modeling (SEM). The results show that attitude, subjective norms, perceived behaviour control, and religious obligation significantly influence the intention to adopt Islamic banking among the Chinese Muslims.

**Keywords:** Islamic banking, theory of planned behaviour, intention, Chinese Muslims

1. Introduction

Islamic banking was not a widespread commodity limited to only the Islamic countries, but was also present in Western countries. The earliest Islamic banking product started out as a small, rural banking in a countryside of Egypt, but has since gained its momentum as many international banks now provide Islamic banking services (Iqbal and Molyneux, 2005). Presently, Islamic finance is growing rapidly worldwide – from Asia to Europe, and even the Americas. Malaysia is one of the earliest countries of Asia to introduce Islamic banking. The country’s first Islamic bank was set up in 1983. Malaysia had provided excellent infrastructures to promote the establishment of an Islamic banking centre among Muslim countries; and the central bank of Malaysia, Bank Negara Malaysia, was one of the first to adopt a systematic planning approach to facilitate the Islamic finance system (Nasser and Muhammed, 2013). The first establishment in Europe was the “Duchy of Luxembourg International Holdings Group”, established in 1978. Luxembourg was not only the earliest Western country to have a seat amidst the International Islamic Liquidity Management, but had also built the Central Bank of Luxembourg – the establishment being one of the first members in the Islamic Financial Services Board (IFSB)
as well. Being one the first countries in Europe that has issued sovereign Sukuk, the Grand-Duchy of Luxembourg became the world’s third largest Islamic financial centre (Ernst and Young, 2016). Subsequently, the United Kingdom had started to set up the Islamic Bank of Britain in 2004, and had allowed London to become a centre for Islamic finance. Furthermore, it is one the leading Western countries that functions as a premier centre for Islamic finance in Europe (UK Trade & Investment, 2014).

On the other hand, as a country with the largest population in the world and possessing the third largest population of Muslim minority, China has also shown great interest in promoting and participating in the industry of Islamic finance. This is evident as Islamic banking was offered in year 2009, when the Ningxia Bank (宁夏銀行) set up three Islamic bank windows at Shizuishan (石嘴山) city, which was located in the Ningxia Hui Autonomous Region (宁夏回族自治区, NHAR). For Hong Kong, the country had launched two Islamic bonds (Sukuk) in the year 2014 and 2015.

According to China’s 2010 Population Census, there are more than 23 million Muslims residing in China. The populace is observed to be mainly concentrated in the Western regions of China, where the Xinjiang Uyghur Autonomous Region (新疆維吾爾自治區, XUAR), Gansu (甘肅) province, Ningxia Hui Autonomous Region, and Qinghai (青海) province are located. The number of Chinese Muslims had accounted for 1.7% of the total of 1.3 billion inhabitants in China. And in that 1.7 percent finds ten minority ethnic groups of China; they are the Hui, the Uygur, the Kazak, the Uzbek, the Tajik, the Tatar, the Kirgiz, the Salar, the Dongxiang, and the Baoan. To further demonstrate the previous statement, Table 1 shows the Chinese Muslims’ area of distribution and population.
Table 1 Chinese Muslims’ Distribution Area (Province) and Population

<table>
<thead>
<tr>
<th>Ethnic group</th>
<th>The main distribution area (province)</th>
<th>2000</th>
<th>2010</th>
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<td>Population</td>
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<td>(People)</td>
<td>(%)</td>
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<td>Hui</td>
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<td></td>
<td>Ningxia</td>
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<td>9,816,805</td>
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<td>10,586,087</td>
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<td>Inner Mongolia</td>
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<td>Guizhou</td>
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<tr>
<td>Uighur</td>
<td>Xinjiang</td>
<td>8,399,393</td>
<td>41.34</td>
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<tr>
<td>Kazak</td>
<td>Xinjiang</td>
<td>1,250,458</td>
<td>6.15</td>
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<tr>
<td>Dongxiang</td>
<td>Gansu</td>
<td>5,130,805</td>
<td>2.53</td>
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<tr>
<td>Kirghiz</td>
<td>Xinjiang</td>
<td>160,823</td>
<td>0.79</td>
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<tr>
<td>Salar</td>
<td>Qinghai</td>
<td>104,503</td>
<td>0.52</td>
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<tr>
<td>Tajik</td>
<td>Xinjiang</td>
<td>41,028</td>
<td>0.2</td>
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<tr>
<td>Baoan</td>
<td>Gansu</td>
<td>16,505</td>
<td>0.08</td>
</tr>
<tr>
<td>Uzbek</td>
<td>Xinjiang</td>
<td>12,370</td>
<td>0.06</td>
</tr>
<tr>
<td>Tatar</td>
<td>Xinjiang</td>
<td>4,890</td>
<td>0.02</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td>20,320,580</td>
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</tbody>
</table>


In recent years, a number of studies on Islamic banking have been conducted by Chinese researchers in western China (An, 2012; Ma, 2012a; Zhang, 2009; Zhang and Zhao, 1987; Ba et al., 2009; Feng, 2017). China has a population of more than thirty million Muslims, and more than 75% of Muslims are living in the western parts of China, hence having a tremendous potential to operate Islamic banking in their country (Ma, 2012a; Feng and Chen, 2011). Moreover, the Chinese central government has introduced the “One Belt One Road” (OBOR) / “Belt and Road Initiative” (BRI) to the world, and further highlighted the importance of Islamic finance to China (Ding et al., 2016). With the BRI initiative, Islamic banking will gain new opportunities due to the support from the countries along the BRI route, as well as the demand for the establishment of diversified financial systems (Feng, 2017). The BRI involves the development of the economic areas along the
Silk Road as well as its linkages with the Islamic world due to the number of Muslim countries along the route. Hence, China should give priority to developing Islamic finance (Xie and Liang, 2016).

Due to the high demand for Islamic finance in western China and the fact that researchers studying the behavioural intentions of Chinese Muslims were a rarity; this study has chosen to examine the intention to adopt Islamic banking among the Chinese Muslims from the western regions of China. Additionally, this study also adopts the theory of planned behaviour (TPB) and postulates that attitude, subjective norm, perceived behaviour control and religious obligation are key determinants of intention to adopt Islamic banking amongst the Chinese Muslims.

As such, the main objectives of this study are as follows. First, the paper examines the influences of attitude, subjective norm, and perceived behaviour control on the adoption of Islamic banking. Secondly, it examines the effects of religious obligation on the intentions to adopt Islamic banking. Lastly, this paper evaluates the applicability of the TPB on Chinese Muslims and the intention to adopt Islamic banking.

2. Literature Review

The objectives of the “Belt and Road Initiative” (BRI) are to develop the infrastructure and various trades of Central Asia, Southeast Asia, as well as the Middle East, whilst promoting the development of the western regions of China. The route of BRI covers a huge Muslim population area, especially the Silk Road which links western China, Central Asia, and the Middle East. Islamic finance plays a significant part in the implementation of the BRI. On a separate note, there are 65 countries along the BRI route with a total population of an estimated 4.4 billion, including China – which accounts for 63% of the global population; and
with 29 Muslim countries that have a total population of 1.2 billion, it accounts for 75% of Muslims populating in various parts of the globe. The countries which are located along the BRI route are considering developing Islamic finance as their own development strategy; among them are countries such as Malaysia, the United Arab Emirates, and Bahrain – all nations that were committed to promoting the construction of international Islamic financial centres in the region. Presently, those countries have already started their development in Islamic financial services in certain cities that serve as financial centres and have formed sufficient liquidity in Islamic financial markets. The BRI brought opportunities for the development of Islamic finance, whilst Islamic finance provided financial support for the construction of the BRI correspondingly (Feng, 2017).

In recent years, a number of studies on Islamic finance had emerged in China, especially in the areas of Islamic banking products and services as well as their operation in China (Adilijiang, 2010; Bao, 2016; Feng, 2017; Ba et al., 2009; Ma, 2012a). One of the earlier studies made in China was conducted by Adilijiang (2010), who explained that the theoretical basis of Islamic finance are the Quran, Hadith, and the Islamic law, and the core principle of Islamic finance is that it prohibits the practice of interest and profit-sharing. Ma and Qi (2009) explained the ideology of Islamic finance, and concluded that the Islamic financial system needed to expand the types of businesses, and to introduce advanced business management methods due to its necessitated requirement for participating in the process of globalization. Islamic finance is attracting vast amounts of attention, and relevant, related researches conducted on the subject have great significance for China’s financial market as well as the economic development in the western minority areas of China (Zhang, 2009).
There are more than 3 million Muslims residing in the Ningxia Hui Muslim Autonomous Region (NHAR), giving the area a unique advantage in developing Islamic finance. The NHAR has been building close trading relationship with Arab countries in recent years (Bao, 2016). Hence, as Ningxia formally took its first steps to set up an Islamic bank, the region has strengthened its cooperation and exchanges with international financial organizations, and has subsequently started a pilot project that launched Islamic banking in Yinchuan (银川) city in December 2009. The Ningxia Bank has selected the Wuzhong branch, the Plaza branch, the Guangming branch, the Xinhuaixin Street branch and the Xincheng branch as windows of Islamic financial services, actively pushing forward the progress of Islamic banking. On the other hand, Hong Kong had actively expanded Islamic finance in recent years due to the growing proportions of the Chinese Muslim population in Ningxia province, as it is as high as being one third of China. Both Hong Kong and Ningxia play a complementary and cooperative partnership in the field of Islamic finance, jointly creating a platform for business opportunities – resulting in a “win-win” situation for the future of China-Arab trade and their economy (Ho, 2011).

Zhang (2016) has introduced the basic idea of Islamic finance and the main characteristics of the Islamic banking system, and has analysed the establishment of Islamic finance in the Gansu province of China. She concluded that Gansu had its advantages of developing Islamic banking – ones that involve the geographical, the Islamic cultural demand and the experiences of operating Islamic banking. The Gansu province is located in the western part of China, and was an important section of the ancient Silk Road just as it is the core area of the BRI. A large number of Chinese Muslims populate the area and the Islamic culture in Gansu is so strong that the province has been ranked the third most Islam-centric area in China, right after Xinjiang Uyghur Autonomous Region and
Ningxia Hui Autonomous Region. The financial industry amongst the Gansu Muslims has made great development in recent years, and has promoted trade as well as the cultural exchanges between the Chinese Muslims and the other Muslim countries. Therefore, Gansu has both internal and external advantages of establishing Islamic finance (Zhang, 2016). On the other hand, Fang and Ma (2017) had analysed the factors that influence civil financial development in Linxia City (臨夏市) of Gansu province. They found that the civil financial activities in Linxia was heavily influenced by the Islamic financial ideas due to the Chinese Muslims’ beliefs in the religion of Islam. The high proportion of financial activities between Muslims includes the adoption of zero interest rate loans and profit-and-loss sharing, therefore indicating that there is a real need for Islamic banking in the market. An (2012) has studied and compared modern Islamic finance and the common business practices among Chinese Muslims, and has found that the two practices had high similarities due to the reasoning that there was something in common between Islamic religion and cultural basis.

Presently, there are a group of scholars who are familiar with the Islamic law and the Islamic economic thought in the northwestern regions of China, where a large number of Chinese people who believe in Islam form a suitable market for the development of Islamic finance. Therefore, the first trial of Islamic finance in China will obtain a very broad market (Ma, 2012a). Introducing Islamic finance is meaningful for the economic construction of Kashi – a special economic zone in Xinjiang, and it is also feasible in the aforementioned region because of the large Chinese Muslim population in Xinjiang. The Kashi (喀什, Kashgar) area has an estimated number of 90% Uyghurs, who believe in Islam. Thus, introducing Islamic finance has the foundation of Islamic religion and Chinese Muslim minorities (Sui, 2011). Several Chinese scholars have introduced Islamic banking systems and the basic Islamic
banking products, such as works by Sui (2010), Xu and Ouyang (2011). They described Islamic banking products, which are those of the Murabahah, Musharakah, Mudarabah, Ijara, Istisna’a, and Salam. In addition to that, they had summarized the differences between Islamic finance and conventional finance and discussed the combination of Islamic finance and banking, stocks, bonds and insurance in the Chinese financial market.

However, there were some challenges to establishing the Islamic finance in the world (Ma, 2012b). According to Xie and Liang (2016), the main problem is that market participants are unfamiliar with the Islamic finance practice in China. And because the Halal industry is the foundation of Islamic finance and is in its growing phase, the Chinese financial institutions do not have comprehensive programs to deal with Islamic financial risks. To meet and abolish the challenges, the Chinese government should consider setting up a special task team to study and promote Islamic finance, strengthen the media’s transmission and create good environments for the development of Islamic finance, as well as systematically cultivating Islamic financial professionals to carry out prospective researches (Xie and Liang, 2016).

Quantitative studies of the demand for Islamic banking in China are particularly rare. To fill this gap, this study adopts the theory of planned behaviour (TPB) and has added a new independent variable, which is religious obligation. Given that the subjects under study are Chinese Muslims who live in the northwestern regions of China, who were known to observe and live according to their religion’s beliefs even in their daily financial and economic transactions, the objective of this study is to empirically explore the effects of the determinants such as attitude, subjective norm, perceived behaviour control and religious obligation on their intention to adopt Islamic banking in China.
The theory of reasoned action (TRA) was popularized by Fishbein and Ajzen in 1975, and has since then been extensively used to study the intention to act or behave in a certain way, particularly in adopting a product or service. Due to the fundamental disadvantages of the TRA, however, Ajzen (1985) introduced perceived behaviour control (PBC) as a variable to the TRA model – resulting in an extended version of the TRA, also known as the theory of planned behaviour (TPB). According to the TPB, the behaviour intention of an individual is jointly influenced by his or her attitude, subjective norm and perceived behaviour control (Ajzen, 1985). The main reason for this study to adopt the TPB is the fact that this theory has successfully predicted and interpreted human behaviour across a variety of studies (Ajzen, 1991, Ajzen, 2002). The TPB has been employed to study the intention of individuals to exercise (Rhodes and Courneya, 2003; Rivis and Sheeran, 2003), to patron insurance (Innan and Moustaghir, 2012), to purchase halal products (Hanzae and Ramezani, 2011; Shah Alam and Mohamed Sayuti, 2011), to deal in online trading (Gopi and Ramayah, 2007; Ramayah et al., 2009), to choose online grocery shopping (Hansen et al., 2004), and to adopt Internet banking (Al-Ajam, 2013). Furthermore, the TPB model has been widely tested to predict the intention to adopt Islamic banking services by many researchers who have found that this model was applicable in the context of Islamic banking. These include studies about Islamic banking services (Echchabi and Aziz, 2012), Islamic unit trust (Ali et al., 2014), Islamic credit cards (Amin, 2013; Amin, 2012; Ali et al., 2017a), and Islamic home financing (Alam et al., 2012; Amin et al., 2009). Due to the reasons previously stated, this study opts to adopt the TPB to explore the influencing factors which affect Chinese Muslims’ intention in using Islamic banking. This is done to hopefully help the stakeholders to comprehend and forecast the behaviour of Chinese Muslims, in regard to the adoption of Islamic banking in China.
Noting that the TPB alone does not completely interpret the relationship between intention and behaviour (Conner and Armitage, 1998), studies have recommended the addition of new variables (Ajzen, 2011) – which for this study is religious obligation. The reason to add and examine religious obligation is the fact that this study is conducted on Chinese Muslims, who are strongly influenced by their Islamic religion. Therefore, the present study includes religious obligation when it examines the factors, namely attitude, subjective norm, perceived behaviour control, whilst explaining the rationality of Chinese Muslims in choosing Islamic banking.

### Table 2 Review of Literature on Islamic Finance

<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Country</th>
<th>Models</th>
<th>Analysis</th>
<th>Key Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Echchabi and Abd. Aziz (2012)</td>
<td>Morocco</td>
<td>TPB</td>
<td>Multiple Regression</td>
<td>Findings illustrate that the TPB provides a comparable fit; on the other hand, attitude, subjective norm, and perceived behaviour control significantly influence the intention to use Islamic banking among Moroccan banking clients.</td>
</tr>
<tr>
<td>Amin, Abdul-Rahman and Abdul-Razak (2013)</td>
<td>Malaysia</td>
<td>TPB, IDT</td>
<td>SEM</td>
<td>The study shows that the integrated model is valid in the context of Islamic home financing, and attitude, subjective norm, perceived behaviour control, simplicity and compatibility are significant predictors of the intention to adopt Islamic home finance.</td>
</tr>
<tr>
<td>Fauziah, Ramayiah and Abdul-Razak (2008)</td>
<td>Malaysia</td>
<td>TRA</td>
<td>Multiple Regression</td>
<td>Findings of this study verify that the TRA is applicable in the context of Islamic diminishing partnership financing, and that attitude, subjective norm, and religion jointly affect the intention to adopt Islamic home finance.</td>
</tr>
<tr>
<td>Alum, Janor, Zanariah and Ahsan (2012)</td>
<td>Malaysia</td>
<td>TPB</td>
<td>SEM</td>
<td>The study indicates that the attitude, perceived behaviour control, and religiosity significantly influence the intention to use Islamic home financing among Malaysians in the Klang valley; on the other hand, subjective norm does not influence the intention to use Islamic home financing.</td>
</tr>
<tr>
<td>Ali, Raza and Puah (2017)</td>
<td>Pakistan</td>
<td>TRA</td>
<td>Factor, Regression Analysis</td>
<td>Findings show that attitude and subjective norm significantly impact the intention to use Islamic credit cards in Pakistan while the perceived financial cost has a negative effect on the intention to use Islamic credit card.</td>
</tr>
<tr>
<td>Ali, Raza, Puah and Karim (2017)</td>
<td>Pakistan</td>
<td>Modified TPB</td>
<td>SEM</td>
<td>Findings indicate that the TPB is applicable in the context of Islamic home financing in Pakistan, where attitude, subjective norm, perceived behaviour control and religious belief significantly influence the customers’ intention to choose Islamic home financing.</td>
</tr>
<tr>
<td>Amin, Abdul-Rahman and Abdul-Razak (2013)</td>
<td>Malaysia</td>
<td>TPB</td>
<td>SEM</td>
<td>The study confirms the applicability of the TPB in the context of Musharakah, Mutanaqishah home financing in Malaysia, and that attitude, subjective norm, and perceived behaviour control are found to have significant impact on the intention to be partner in Islamic home financing.</td>
</tr>
</tbody>
</table>

CCPS Vol. 4 No. 3 (December 2018)
3. Hypotheses Development

3.1. Attitude

Attitude is a significant element of a person’s predisposition to respond and has been shown to be have significant relation to behaviours (Allport, 1935). Fishbein and Ajzen (1975) defined attitude as the evaluative effect of a positive or negative perception about an individual conducting certain behaviours. A great number of studies have been conducted on attitude and behaviour intention, and have found that there was a significant and positive relationship between the two. For instance, on the subject of Internet banking, Shih and Fang (2004) examined the factors that influenced the intention to adopt Internet banking in Taiwan. The study found that attitude had a significant relationship with the intention to adopt Internet banking. Similar results were reported by Gopi and Ramayah (2007) and Ramayah et al. (2009) in their studies on the factors that influence intention to use online trading in Malaysia; where a positive relationship between attitude and intention was also found among the customers of Islamic banking services in Morocco (Echchabi and Aziz, 2012) and Indonesia (Wahyuni, 2012). In this empirical study, attitude is suggested to have a positive relationship with the intention to adopt Islamic banking. The greater the positive attitude towards Islamic banking, the greater the intention to adopt Islamic banking will be among the Chinese Muslims in western China. Thus, the study proposes the following hypothesis:

HI: Attitude has a positive effect on the intention to adopt Islamic banking
3.2. Subjective Norm

Subjective norm has been defined as an individual’s perception that people who are important to them should or should not carry out the target behaviour (Fishbein and Ajzen, 1975). The subjective norm reflects the influence of significant people, which relates to an individual’s behavioural decisions. In short, when people for whom the individual hold high regard, such as parents, spouses and friends, encourage a certain behavioural decision, the person is more likely to have the intention to take that particular action.

Taylor and Todd (1995) found that the subjective norm significantly affected the consumers’ intention to adopt innovative products. Similarly, Gopi and Ramayah (2007) and Ramayah et al. (2009) discovered that the subjective norm has significant, positive effects on the intention to adopt Internet stock trading in Malaysia. Subjective norm was also found to be a significant predictor in different areas of study. Lada et al. (2009) examined the factors that influence the intention to use halal goods, and amongst the 485 responses in Malaysia has revealed that the subjective norm is the most important factor in the Malaysian’s context of intention. Amin (2007) found a similar trend in the adaptation of Internet banking among the Malaysian Islamic banking consumers. The relationship was reiterated again as Echchabi and Aziz (2012) found that the subjective norm significantly affected the customer’s intention to use Islamic banking in Morocco.

This study examines the role of subjective norm on the intention to adopt Islamic banking among the Chinese Muslims in China. Subjective norm is proposed to have a positive relationship with the intention to adopt Islamic banking. The greater the subjective norm on Islamic banking, the greater the intention to adopt Islamic banking will be among the Chinese Muslims in western China. As such, the study surmises the following hypothesis:
H2: Subjective norm has a positive effect on the intention to adopt Islamic banking

3.3. Perceived Behaviour Control

In the theory of planned behaviour (TPB), besides the factors of attitude and subjective norm, perceived behaviour control is assumed to have an effect on intention. For Ajzen (1991), perceived behavioural control embodies the self-perceived level of difficulty to take certain actions, including the individual’s feeling of internal factors, such as knowledge, determination and skills, whilst external factors are resources, time, conditions, etc. Thus, Ajzen (1991) had concluded that the role of perceived behavioural control in determining an individual’s intention should not be neglected. In the empirical study of Islamic banking, perceived behavioural control was found to be significant by Echchabi and Aziz (2012), Alam et al. (2012) and Ali et al. (2017b). The later study had then adopted the structural equation modelling in examining the Islamic home financing in the Pakistan context.

This study proposes that perceived behaviour control is to have a positive relationship with the intention to adopt Islamic banking. The greater the perceived behaviour control on Islamic banking, the greater the intention to adopt Islamic banking among Chinese Muslims in western China will be. Based on the extant research, the hypothesis is postulated as follows:

H3: Perceived behaviour control has a positive effect on the intention to adopt Islamic banking
3.4. Religious Obligation

Religious obligation has a role in influencing an individual’s choices and activities (Amin et al., 2011). Omer (1992), who examined Muslims in the United Kingdom, found that the fundamental motivations for them to engage with Islamic banking was their religious belief. Metawa and Almossawi (1998) also revealed that religion was the most important influencing factor in adopting Islamic banks in Bahrain. Other studies that have arrived at the same conclusions include Lee and Ullah (2011) and M. Ali et al. (2017a) who studied bank consumers’ attitudes towards Islamic banks and financing respectively in Pakistan, while Souiden and Rani (2015) assessed a sample size of 217 Islamic banking customers in Tunisia. Studies by Haron et al. (1994) and Amin et al. (2011) on Malaysian respondents, however, concluded differently as they have found that religion was not an influencing factor for customers to engage with Islamic banks. On the basis of the previous studies, the following hypothesis is proposed in this study:

\[ H4: \text{Religious obligation has a positive effect on the intention to adopt Islamic banking} \]

4. Methodology

4.1. Sample

The target population of this study is the Chinese Muslim population living in the four cities west of China, namely Lanzhou (蘭州), Ürümqi (Wulumuqi, 烏魯木齊), Xining (西寧) and Yinchuan. The purposive sampling technique was applied since it was impossible to list all samples of study as it was difficult to attain the exact population of study (Neuman, 2005). A total of 1000 questionnaires were sent out
### Table 3 Demographics of Respondents (n=669)

<table>
<thead>
<tr>
<th>Measure</th>
<th>Value</th>
<th>%</th>
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</thead>
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<tr>
<td><strong>Gender</strong></td>
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<tr>
<td>Female</td>
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<tr>
<td>Married</td>
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<tr>
<td><strong>Age</strong></td>
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<tr>
<td>21 to 30</td>
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<tr>
<td>31 to 40</td>
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<td>41 to 50</td>
<td>135</td>
<td>20.2</td>
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</tr>
<tr>
<td>61 above</td>
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<td>2.4</td>
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<td><strong>Education Level</strong></td>
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<td>Below high school</td>
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<td>Government employee</td>
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<td><strong>Income per month</strong></td>
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<tr>
<td>Below 2000</td>
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<td>4001 to 5000</td>
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<tr>
<td>5001 above</td>
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<td><strong>City of Residence</strong></td>
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<tr>
<td>Lanzhou</td>
<td>168</td>
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</tr>
<tr>
<td>Urumqi</td>
<td>171</td>
<td>25.6</td>
</tr>
<tr>
<td>Xining</td>
<td>179</td>
<td>26.8</td>
</tr>
<tr>
<td>Yinchuan</td>
<td>151</td>
<td>22.6</td>
</tr>
</tbody>
</table>
and 669 questionnaires were usable, attaining a net response rate of 66.9 percent. The study was carried out from June to December 2015.

The demographic profile of the respondents is as shown in Table 3. The distribution of the respondents was 25.1% for Lanzhou, 25.6% for Urumqi, 26.8% for Xining, and 22.6% for Yinchuan, which was a distribution consistent across the four provinces. Even though 39.6 % of the respondents had education levels that were below high school level, the age and income of the respondents were of those who were able to access to banking products and services.

4.2. Development of Questionnaire

All questionnaire items were adopted from previous studies and had been modified accordingly to reflect the context of this study. The constructs of attitude and subjective norm were adopted from Amin et al. (2009) and Amin (2013), while the constructs of perceived behavioural control were scales from Gopi and Ramayah (2007) and Amin et al. (2009). The questionnaire items for intention and religious obligation were adapted from Amin et al. (2011). All constructs were measured using seven-point scales, ranging from “strongly disagree (1)” to “strongly agree (7)” from left to right. This is consistent with the ideal seven-point Likert-scale proposed by Bollen (1989) for structural equation modelling. The survey questionnaire was developed in English at first and then translated into Chinese to accommodate the non-English speakers. This study applied the back-translation technique, as suggested by researchers, which has been widely adopted in cross-cultural studies (Brislin et al., 1973; Chapman and Carter, 1979). Because this study was conducted in China and the sample of population were non-English speakers, the questionnaire had passed through translation works. Brislin et al. (1973) had suggested several translation approaches, for example: bilingual techniques, back-translation, pre-test, and committee approach.
Back-translation is a method in which the language is translated back to its language of origin, and it needs to be checked and proven that the translation finished could be used as a study instrument. This technique is remarkably accepted and recommended by scholars, as it is widely used in cross-cultural studies (Brislin et al., 1973; Chapman and Carter, 1979). Thus, this study employs the back-translation technique to enhance the translation quality of the questionnaire from the origin language (English) to the Chinese language.

5. Results of the Study

5.1. Data Analysis

In this study data analyses are distributed in two steps: the first step is the preliminary analysis and the second is the SEM analysis. In the first procedure, the data screening process has been conducted to make sure that the data are entered properly and fulfill the assumption of normality.

According to Hair et al. (1998), normality is one of the assumptions to apply in the SEM, and the data of the study should be analysed to examine the normality of data. Due to this study applying the SEM, its fundamental procedure is to examine the univariate and multivariate normality. Therefore, this study introduces the AMOS software to test the normality of both the univariate and the multivariate. Through running the measurement model with AMOS, it had shown some outliers in the data set. After deleting the outliers, the data had reached univariate and multivariate normality. According to Anderson and Gerbing (1988), the absolute value of skewness being equal to or less than 1 indicates that the data is normally distributed, and if the sample size is more than 200, the value of the absolute skewness reaches 1.5. Meanwhile, the value of critical region (CR) for the kurtosis should not be greater than 3.0 (Awang, 2015).
Table 4 Confirmatory Factor Analysis

<table>
<thead>
<tr>
<th>Construct</th>
<th>Items</th>
<th>Factor Loading</th>
<th>AVE</th>
<th>CR</th>
<th>Cronbach Alpha</th>
</tr>
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<td>Attitude</td>
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<td>0.773</td>
<td>0.601</td>
<td>0.883</td>
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<tr>
<td></td>
<td>3</td>
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<tr>
<td>PBC</td>
<td>1</td>
<td>0.812</td>
<td>0.562</td>
<td>0.864</td>
<td>0.860</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>0.802</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>0.627</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>0.794</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>5</td>
<td>0.696</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RO</td>
<td>1</td>
<td>0.724</td>
<td>0.584</td>
<td>0.875</td>
<td>0.875</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>0.745</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>0.770</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>0.799</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>0.780</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intention</td>
<td>1</td>
<td>0.759</td>
<td>0.582</td>
<td>0.848</td>
<td>0.846</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>0.766</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>0.755</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>0.772</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: SN, subjective; PBC, perceived behaviour control; RO, religious obligation.
In the second procedure, the structural equational modelling (SEM) process has been executed, and that the analysis involves two steps (Anderson and Gerbing, 1988). In the first step, it comprises examining the SEM measurement model, which deals with the assessment of the unidimensionality of all contracts and engages the modification as well as the specification of the model. It also needs to examine the reliability and validity of measurement models.

The objective of reliability is to reduce biases and error. According to Nunnally and Bernstein (1978), this can be achieved when the Cronbach alpha value is more than 0.70. To evaluate the reliability of the study, the Cronbach’s alpha value of all variables should be greater than 0.80 (Nunnally and Bernstein, 1978). In Table 4, the Cronbach’s alpha for attitude, subjective norm, perceived behaviour control, religious obligation and intention are 0.882, 0.867, 0.860, 0.875 and 0.846 respectively. Since the values for the variables are higher than 0.8, the model is deemed to have adequate internal reliability. Meanwhile, the average variance extracted (AVE) and CR were assessed to check reliability. A confirmatory factory analysis (CFA) was adopted to calculate the AVE and the CR values, which is introduced by Fornell and Larcker (1981). The scores are illustrated in Table 4, where all results for the AVE is greater than 0.5, and results of the CR have exceeded 0.7, which is recommended by Bagozzi and Yi (1988).

Validity refers to whether the sample data gathered could effectively embody the issues to be examined and appraise the quality of the study. Thus, this study has also gone through the validity assessment, which is measured by content validity and construct validity. By reading previous literature, the questionnaire items were developed in English. Due to this study being conducted in China, the questionnaire should be translated into Chinese. Bilingual students interpreted the questionnaire items into Chinese, which is in line with the habit of thought of the Chinese locals.
After being reviewed by relevant experts who have helped to correct the inconsistencies, the items were translated back into the English version. Brislin (1986) proposed that the back-translation is a required method in cross-cultural studies.

To assess the convergent validity and the discriminant validity of the measurement models, Fornell and Larcker (1981) suggested that the three criteria should be reached at first, and that all measured variables of factor loading (FL) ought to be significant, whilst value should be greater than 0.5. Secondly, all construct reliability (C.R.) values should exceed 0.8. And finally, the average variance extracted (AVE) should surpass 0.5. However, this study used the FL, C.R., and AVE for convergent validity, as shown in Table 4, where the value of FL ranged from the lowest of 0.627 to the highest of 0.812. This exceeded the recommended factor loading by Chin et al. (1997), which was supposed to be above 0.60. The value of the AVE ranged from 0.562 to the highest of 0.601, which was found to be consistent with the suggestion made by Bagozzi and Yi (1988). The values of the CR in this study are all above 0.8, indicating convergence reliability among the variables (Gesen et al., 2000). Therefore, the values of the factor loading, AVE and CR indicated the achievement of convergent validity. Therefore, all three requirements for convergent validity were fulfilled.

In order to assess discriminant validity, the Fornell-Larcker (1981) criterion has been adopted. Table 5 illustrates that the values of the square root of AVE are higher than that of the correlations between the latent variable and the other variables. Thus, the requirement of discriminant validity was achieved. In summary, the measurement model has illustrated adequate internal reliability, convergent validity, and discriminant validity. This study was conducted using the common method bias test, and as Table 5 shows – the correlation value between constructs does not reach 0.8, which means that there is no single
variable that influences all constructs. Therefore, it can be concluded that there is no issue of common method bias in the data.

**Table 5 Latent Variable Correlation Matrix**

<table>
<thead>
<tr>
<th></th>
<th>Att</th>
<th>SN</th>
<th>PNC</th>
<th>RO</th>
<th>Intention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Att</td>
<td>0.775</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SN</td>
<td>0.429**</td>
<td>0.754</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PBC</td>
<td>0.390**</td>
<td>0.408**</td>
<td>0.750</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RO</td>
<td>0.405**</td>
<td>0.400**</td>
<td>0.323**</td>
<td>0.764</td>
<td></td>
</tr>
<tr>
<td>Intention</td>
<td>0.639**</td>
<td>0.600**</td>
<td>0.511**</td>
<td>0.530**</td>
<td>0.763</td>
</tr>
</tbody>
</table>

Notes: Att, Attitude; SN, subjective norm; RO, religious obligation. Diagonal items are the square root of average variance extracted.

5.2. Results of the Study

According to Anderson and Gerbing (1988), the two-step approach is recommended for structural equation modelling (SEM), which is both the measurement model and the structural model. This study has started with the measurement model by executing the confirmatory factor analysis (CFA), followed by the structural model, which was employed for hypotheses testing. The AMOS 22.0 version was used to analyse both of the models.

5.3. Measurement Model

The AMOS applies the maximum likelihood estimation for which Kline (2005) recommended to use, and the use of a larger sample size more than 200 was adequate. Due to the sensitivity of Chi-square to sample size, especially when the sample size is bigger than 200, it was expected that a larger sample size would result in a larger Chi-square value.
Therefore, this study has adopted the most commonly used model-fitting indicators to review the results. These indicators are: ChiSq/df, GFI, CFI, and RMSEA. The results of the measurement model for all constructs are as shown in Table 6. The values of the ChiSq/df ratio are all below 5.0, which are within the value recommended by Bagozzi et al. (1991). The values of GFI are above 0.90, which show the acceptable model fit (Baumgartner and Homburg, 1996). And the values of CFI are all higher than 0.90, which reach the recommended value (Hu and Bentler, 1999). All values of RMSEA are below 0.08, which indicate that there is an absolute fit (Browne et al., 1993). Therefore, there is a reasonable, overall fit between the measurement model and the measured data.

**Table 6 Results for Measurement Model**

<table>
<thead>
<tr>
<th></th>
<th>GFI</th>
<th>CFI</th>
<th>RMSEA</th>
<th>ChiSq/df</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attitude</td>
<td>0.993</td>
<td>0.996</td>
<td>0.044</td>
<td>2.307</td>
</tr>
<tr>
<td>SN</td>
<td>0.996</td>
<td>0.999</td>
<td>0.021</td>
<td>1.306</td>
</tr>
<tr>
<td>PBC</td>
<td>0.997</td>
<td>1.000</td>
<td>0.007</td>
<td>1.028</td>
</tr>
<tr>
<td>RO</td>
<td>0.990</td>
<td>0.992</td>
<td>0.062</td>
<td>3.549</td>
</tr>
<tr>
<td>Intention</td>
<td>0.997</td>
<td>0.998</td>
<td>0.041</td>
<td>2.114</td>
</tr>
</tbody>
</table>

Notes: SN, subjective; PBC, perceived behaviour control; RO, religious obligation.

**5.4. Structure Model**

After satisfying the validity and reliability of the measurement model, the study proceeded with the testing of the structural model. The structural equation model is as shown in Figure 1. The ChiSq/df ratio is equal to 1.394 and is within the recommendation of Bagozzi et al.
The GFI is 0.960, which shows an acceptable model fit (Baumgartner and Homburg, 1996), while the CFI is 0.989 and reaches the recommended value (Hu and Bentler, 1999). The value of RMSEA is 0.024 and below the recommended 0.08. This again shows that there is an absolute fit (Browne et al., 1993). Therefore, the proposed structural model is revealed to be a good model fit.

In the vein of the TPB, attitude, subjective norm and perceived behaviour control are the independent variables, while intention is the dependent variable. This study has introduced a new independent variable, namely religious obligation. The values of correlation between the four independent variables are all below 0.8, indicating that all exogenous variables have achieved discriminant validity while the exogenous variables are not redundant, as shown in Figure 1.

**Figure 1** AMOS Structural Model Results

![AMOS Structural Model](image)

Note: * p < 0.01.
### Table 7 Results of Regression

<table>
<thead>
<tr>
<th>Construct</th>
<th>Construct</th>
<th>Estimate</th>
<th>S.E.</th>
<th>C.R.</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intention</td>
<td>Attitude</td>
<td>.377</td>
<td>.038</td>
<td>10.052</td>
<td>***</td>
</tr>
<tr>
<td>Intention</td>
<td>SN</td>
<td>.280</td>
<td>.036</td>
<td>7.850</td>
<td>***</td>
</tr>
<tr>
<td>Intention</td>
<td>PBC</td>
<td>.225</td>
<td>.042</td>
<td>5.323</td>
<td>***</td>
</tr>
<tr>
<td>Intention</td>
<td>RO</td>
<td>.198</td>
<td>.033</td>
<td>6.078</td>
<td>***</td>
</tr>
</tbody>
</table>

Notes: Significance level: ** p < 0.01, *** p < 0.001.
SN, subjective; PBC, perceived behaviour control; RO, religious obligation.

### Table 8 Results of Structural Model

<table>
<thead>
<tr>
<th>Construct</th>
<th>Construct</th>
<th>Hypothesis</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intention</td>
<td>Attitude</td>
<td>H1</td>
<td>Supported</td>
</tr>
<tr>
<td>Intention</td>
<td>SN</td>
<td>H2</td>
<td>Supported</td>
</tr>
<tr>
<td>Intention</td>
<td>PBC</td>
<td>H3</td>
<td>Supported</td>
</tr>
<tr>
<td>Intention</td>
<td>RO</td>
<td>H4</td>
<td>Supported</td>
</tr>
</tbody>
</table>

Notes: SN, subjective; PBC, perceived behaviour control; RO, religious obligation.

The proposed model is as shown in the AMOS graphic in Figure 1. The AMOS yielded the regression path coefficients for the structural model, as shown in Table 7. The rule of thumb is that if the critical ratio (C.R.) value is \( \geq 1.96 \), then the estimate is fitting (Chau, 1997). The model produced \( \beta = 0.40 \), \( P < 0.001 \) for attitude, \( \beta = 0.31 \), \( P < 0.001 \) for subjective norm, and \( \beta = 0.19 \), \( P < 0.001 \) for perceived behaviour control. This indicates that all independent variables significantly affect the intention of adopting Islamic banking. Therefore, the hypotheses of H1, H2 and H3 are supported, as shown in Table 8. Similarly, the assessment
of religious obligation on intention has resulted in $\beta=0.22$, $P<0.001$ and the C.R value of 6.078. Thus, H4 is also supported.

6. Conclusion, Implication and Limitations

6.1. Conclusion

This study has empirically assessed the factors that influence the intention to adopt Islamic banking among the Chinese Muslims in western China. To the best of our knowledge, this is one of the earliest researches in adopting the TPB, and has composed religious obligation as a factor into the model to observe the Chinese Muslim consumer behaviour in Islamic banking settings. And the study contributes to the Chinese Muslim consumers’ behaviour adoption by studying attitude, subjective norm, perceived behaviour control and religious obligation in Islamic banking services.

The outcome acknowledges the original TPB, which poses that attitude, subjective norm and perceived behaviour control directly influence intention. The results of the study have demonstrated that attitude is a significant predictor of intention to adopt Islamic banking, and it is consistent with the studies by Echchabi and Aziz (2012) and Ali et al. (2017a). Therefore, for Chinese Muslims, attitude is the most important factor in influencing them to adopt Islamic banking services, which is proven by the highest beta value ($\beta=0.40$). It can be interpreted that once Chinese Muslims have a positive attitude towards Islamic banking services, they will intend to use it. Chinese Muslims feel that adopting Islamic baking is good, useful, beneficial, and a good idea for them. The findings of this research display that the subjective norm has a positive relationship with the intention to adopt Islamic banking. The finding is in line with the studies conducted by Echchabi and Aziz (2012), and Amin et al. (2013). The explanation on this is that Chinese
Muslims make decision based on others’ opinion such as that of parents, friends or people who are much more important to them. The results also indicate that perceived behaviour control has a significant effect on the intention to adopt Islamic banking. This is consistent with the findings of Echchabi and Aziz (2012), Ali et al. (2014) and Gopi and Ramayah (2007). It can be interpreted that Chinese Muslims feel confident to be able to adopt Islamic banking, and they are capable of choosing Islamic banking services. In addition to the above, the present study has found that religious obligation does have positive influence on the intention to adopt Islamic banking among Chinese Muslims. This indicates that the Chinese Muslims consider religious obligation to be a very important factor in deciding their choice of banking. The finding of this study is consistent with Ali et al. (2017b). On the other hand, Lu (2014) concluded that the behaviour of Chinese Muslims was different from other Chinese people due to the fact that they were much influenced by the Islamic religion and Islamic law, including their attitude towards adopting financial services. Being Muslim, they should follow the principles of the Quran, which prohibits interest (Fang and Ma, 2017). Thus, bankers should be made aware that religious obligation will influence the intention to adopt Islamic banking among the Chinese Muslims while they are setting up Islamic banking services in western China. The principles of Islamic banking are based on the Quran, the Hadith and the Islamic law (Shariah), which are the foundations of the Islamic banking system. Bankers should abide by the most important ideological principles of Islamic finance, which is consistent with Islamic law, prohibiting interest, as well as profit and loss sharing. By developing the Islamic banking, Chinese Muslims will be made aware of the alternative and will gradually adopt Islamic banking in western China.
6.2. Policy Implications

The findings of this study provide a number of managerial implications for the policymakers and bank managers. Since attitude, subjective norm, perceived behaviour control and religious obligation are the most influential factors for the intention of using Islamic banking among the Chinese Muslims in western China, it is paramount for bankers to engage in certain actions and processes in the future. More importantly, as bankers establish Islamic banking brand in the western regions of China, the principles of Islamic banking should be based on the Quran, the Hadith and the Islamic law, which represent a critical base of establishing the Islamic banking system. Bankers should abide by the most essential ideologies of Islamic finance, comply with the Islamic law, prohibiting interest, and sharing profit and loss.

6.3. Limitations and Recommendations of the Study

The empirical findings of the study are favourable for both theoretical and practical objectives. However, there are some limitations that ought to be discussed as follows. First, the sample of this study includes four specific cities (Lanzhou, Urumqi, Xining and Yinchuan) in China, as these cities are geographically situated in the western regions of China. It is to be noted that samples of the Chinese Muslims who reside in other parts of China were not studied, such as Xi’an (西安), which is located in the central part of China, and Kunming (昆明), situated in the southwest of China. These findings may generalize the western regions of China but has not considered Chinese Muslims in China as a whole.

Secondly, the research model embodies the independent variables, such as attitude, subjective norm, perceived behaviour control, and religious obligation, which influence the intention to adopt Islamic banking among Chinese Muslims. It does not involve other independent
variables which would affect the intention to adopt Islamic banking, such as the Chinese cultural factors of face and group conformity. Thus, future studies should incorporate other potential influential factors into them.

Thirdly, this study has employed a cross-sectional study, which has several limitations when compared to longitudinal study. The data of a cross-sectional study arise at a certain point of time (Johnson and Onwuegbuzie, 2004). According to Veleva et al. (2012), the data gathered in a cross-sectional study are only present for the sample at a specific time, and as a result, are not possible for researchers to distinguish the respondents’ accurate, steady perceptions, feelings, and opinions, and hence could be deemed temporary.

Notes

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References


Religious Obligation of Muslims in Western China and Islamic Banking


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Book Review
Book Review


Elizabeth C. Economy’s book published by Oxford University Press on 3rd of May 2018 is without any doubt an essential reading for anyone interested in China, and it is a masterful synthesis of the Xi era, covering both China’s domestic and international affairs in depth. The acclaimed author, Elizabeth Economy is the C.V. Starr senior fellow and director for Asia studies at the Council on Foreign Relations and a distinguished visiting fellow at Stanford University’s Hoover Institution. She is an expert on Chinese domestic and foreign policy, writing on topics ranging from China’s environmental challenges to its role in global governance. She is a prominent scholar, who does not only study the wide-ranging literature on China, but in her rewarding analysis of *The Third Revolution* she adduces conversations with Chinese officials, interviews of think-tank analysts and civil-society activists, and discussions with Chinese scholars in Beijing, Shanghai, Dubai, and Washington, D.C., which all frame the analysis more credibly. Economy’s deep knowledge, insightful analysis, and engaging style of writing make *The Third Revolution* a highly valuable read for those who wish to understand the paradoxes and contradictions in the political, economic and social trajectories of Xi’s China.
The Third Revolution is far more than a summary or a brief of China seeing that its core value is the intention to “sift through all of the fast-changing, contradictory, and occasionally misleading information that is available on China to understand the country’s underlying trends” (p. xiv). It provides us with adequate quantitative variables, diverse data, information, as well as far-reaching explanations. The work is properly propped up by a dozen of footnotes and references at the end of the book, which help the reader to follow the thread and relate them to further sources.

The structure of the book is clear and coherent, organized in eight chapters with lively subheadings that help guide readers through the text. Beginning with President Xi Jinping himself and his vision for the future of China, then driving into six areas identified by the Xi government as top reform priorities: politics, the Internet, innovation, the economy, the environment, and foreign policy. Chapters from 2 to 7 provide a captivating account of the transformation of China’s political institutions and processes that led to the dramatic centralization of authority.

The book examines Xi’s focus on a number of bottom-line areas, from the “reform” – the reassertion of the party in the decision-making – of state-owned enterprises (SOEs) to the creation of the tightly controlled “Chinanet” and the free flow of ideas and information, attempts to clean up air pollution, the aggressive anticorruption campaign as a pillar issue of regime legitimacy, the government’s drive to reinvent China as an innovative nation, and China’s ambition under Xi to reassert itself as a great power in world politics through the exercise of its growing hard and soft power.

When it comes to the title of the book, The Third Revolution, it incites the reader to reckon its meaning and the term “revolution”. In Economy’s understanding, Xi Jinping as Chinese Communist Party general secretary (2012) and president (2013) is embarking on a “third
revolution”, with its totalitarianism due to its strategy of intensified penetration of the party-state in domestic political and economic life combined with an ambitious and expansive role for China abroad. She calls it the third revolution after China’s first two “revolutions” – the literal one, spearheaded by Mao Zedong (1966-76), and the figurative revolution of “reform and opening” under Deng Xiaoping (1978) – when each changed China almost beyond recognition in a generation. This brings us to one of the central elements and arguments of the book: whether it does mean that drastic changes have been going on and presumably will be ahead in China. Economy has laid out in the book – as well as in an intriguing interview by the Council on Foreign Relations\(^1\) – that Xi’s third revolution has already been transformative in several aspects, and she describes and underlines her argument in a highly informative way.

Notwithstanding, interpreting the tensions and contradictions inherent in such transformation in terms of revolution is fraught with conceptual difficulties and analytical risks; hence not all China experts agree with the term “revolution”, finding it not apt to describe China under Xi. David Shambaugh\(^2\) and Yongjin Zhang\(^3\) claim that if revolutions are meant as progressive and truly transformative in nature often associated with human emancipation, then what Xi has been doing internally is “profoundly retrogressive, not progressive”, likewise “reactionary rather revolutionary”. The regressive consequences of the new China that we are facing is expressed by Liselotte Odgaard\(^4\) too. She argues that Xi’s dismantlement of liberal elements of the past three decades – including growing freedom of speech, market economic mechanisms, and enhanced international exchanges – may weaken the legitimacy of the Chinese leadership and harm the country’s social and economic development. Nevertheless, in The Third Revolution, Economy also agrees with the fact – bringing us to an essential
ascertainment of the book – that though the “party first” perspective and initiatives outlined by Xi resulting in institutional changes to restore the central role of the Chinese Communist Party (CCP) have certainly succeeded in the short term in forging the party stronger and more disciplined today than it was five years ago, Xi’s actions in the longer term may be weakening the party. She aptly notes: “By enhancing the role of the state and diminishing the role of the market in the political and economic system, as well as by seeking to limit the influence of foreign ideas and economic competition, the leadership has deprived itself of important feedback mechanisms from the market, civil society, and international actors” (p. 15). To the extent that China’s third revolution is in progress, we can undoubtedly predict a China utterly different from five years ago.

The essence of President Xi Jinping’s vision – being the first leader since Deng with a clear view and ambition on where he wants to take his country already from the very beginning of his presidency – is the call for the “great revival or rejuvenation of the Chinese nation” (p. 5). What may come into our minds is that such must be a powerful message from a leader of the modern world’s global powers, as later similarly echoed by Donald Trump’s “Make America Great Again” campaign. Xi also addresses “the greatest dream of the Chinese nation in modern history”5 – later referred to as “Chinese Dream” – which not to confuse with the American-kind-of-dream, Xi was careful to distinguish the individualistic American form from the Chinese one rooted in collective values, a dream of the whole nation. However, this particular understanding of Xi has not been shared by all Chinese, many expecting different changes in the future of China. As the author puts it: “To accomplish Xi’s vision requires recalibrating the state’s relationship with society, as well as its relationship with the outside world” (p. 58). The question is through what means is it proponed to “recalibrate” these
relationships and what consequences will it have for China and the rest of the world? In one way or another, taken together the separate reform efforts among the top priorities of the government of China presented in the book of Economy, a more comprehensive picture of the arc of Chinese reform is provided for the reader with reference to the past five years, and the implications of this revolution for the rest of the world.

Elizabeth Economy points out one of the greatest paradoxes of China today, a phenomenon which is conspicuous, often controversial and raises manifold questions in everyone’s mind when dealing with China. From the very beginning, Xi Jinping has been making a great effort to position himself as a champion of globalization and as a partner of fundamental institutions of the liberal world order, while at the same time China has become an increasingly illiberal state fighting Western liberal values and it restricts the free flow of capital, information, and goods between China and the rest of the world.

This determination of China and the contradictory development have been facilitated by China’s ability to take advantage of the political and economic openness of other countries through policies such as the Belt and Road Initiative (BRI), while providing considerable overseas political and financial commitments. At the same time, China does not provide foreign countries with similar opportunities to engage within its borders.

What the author wisely forecasts with her analysis is the currently ongoing trade war – she speaks of a “friction” (p. 238), likewise the Chinese refer to it – between the United States and China declared on 6th of July 2018 due to the longtime abuse of the broken international system and unfair practices by China. Experts suggest that the concern between China and the US is rather political than economic; be that as it may, it has its consequences. Although China has been aiming for win-win outcomes during its history, yet in a so called “war”, there will be no

CCPS Vol. 4 No. 3 (December 2018)
winners considering the fact that on neither sides it is ever pleasing to be a soldier. The actuality of the trade war between the world’s biggest economies would definitely demand a whole new analysis with its up-to-date proceedings, a topic that would be interesting to include and/or add in a future edition of the book – especially with reference to the set of recommendations that the author provides for the US and China in the last section of the book. Anyhow, even if the Trump administration does not succeed in changing China’s unfair investment and trade practices, the situation – already noticed in Economy’s book – has rightly pointed to the need to redress the imbalance between the country’s easy access to overseas markets and its restrictive domestic policies.

One question that kept recurring to me as I read the book was whether the Xi regime is sustainable with its paradoxes. I am inclined to believe that the sustainability of the regime depends on the legitimacy of the CCP both domestically and internationally. However, an additional question arises here considering the relationship between domestic policy and China’s role in the global stage. Is it reconcilable to have an “obvious insecurity” internally while having a “secure confidence” externally in the case of China? The answer for the question according to the findings of *The Third Revolution* is that there is a robust linkage between greater domestic repression and a more ambitious and expansive foreign policy. Economy explains it by the fact that “domestic repression is needed to secure the Chinese people from subversive – Western – ideas and influences, while nationalism helps make the population quiescent at home and ambitious abroad. In this way, repression and nationalism easily reinforce both regime legitimacy and international ambition”6.

Public discontent concerning the “reforms” and ways of transformation of China has appeared in the country, as well as restlessness among the international participants. These assumptions are
very well supplemented with examples in the book, such as precedents of public tensions and demonstrations. Even despite censorship, people by now are giving voice to their disagreements and often confirm the widespread sense of uncertainty and anxiety in Chinese society resulted from Xi’s hardline policies. There is an open debate on how Xi’s rhetoric about China’s rise as a global power has raised the suspicions of countless other countries, and ultimately encouraged the US to challenge China economically. Consequently, a long-run societal insecurity and fear may undermine the legitimacy of the CCP if combined with slow economic growth and lacking preferential opportunities for social and economic advancement in the population at large. This valuable point of sustainability of the regime is emerging throughout the book, however Economy has deliberately refused to forecast a future scenario for the Xi regime in order to focus greater attention on understanding the actual changes underway in China and what this transformation proposes for both Chinese political life and the country’s interactions with the rest of the world. Her study attempts “to assess the relative success or shortcomings of the Chinese leadership’s initiatives on their own merits” (p. xi).

Considering the comparative methodology, the book could have offered more comparative examples with reference to politics of Japan or Russia for instance. On the other hand, the book very much adopts a comparative approach by considering Xi’s policies within the context of Chinese history, such as referring to Mao Zedong and Deng Xiaoping, and the coherence of Xi Jinping’s reforms with their revolutions. Respective chapters explore how Chinese leaders throughout China’s history have approached the issue under discussion. Therefore, indeed large-scale comparison with other countries would have likely distracted from a more profound understanding of Xi’s China, which rather relates to disparate lines of historical traditions.
After all, it is President Xi Jinping who is responsible for the overall coordination of economic and political reforms of China – though “many observers suggest that there is significant disagreement with China’s political system over SOE and broader economic reforms” (p. 151) – together with the country’s ambitious international affairs. To such a degree “the challenge of making sense of China has been compounded by the emergence of Xi Jinping” (p. xiii). Avoiding surprise in dealing with China is an essential strategy for the global world – probably the most important goal of the US policy – which is why Economy’s message of caution in her book is so valuable. The fact of the matter is that we are approaching a world order in which the conditions of security have fairly changed for the reason that it has become difficult to determine who is a friend and who is an enemy, and thus is often difficult to determine the real intentions, the hazy interests and the targets of threat in terms of international relations. As Economy highlights: “China is using its newfound status to shape regional and global institutions in ways that better suits its interest ...” (p. 238). With such a complex environment, it may not be easy to navigate if China continues to prioritize party interests.

The prevailing conclusion of the book regarding the Chinese model is that “the lion of China has awoken”.7 China by the 21st century has become ready not only to show off the capability to be a global power – and a “superpower”8 – but it is “ready to claim all the rights that such status confers” (p. 237) in order to shape the global stage. President Xi Jinping seeks greatness for China. “The trappings are there: a world-class military, a game-changing economy with world-class technology, and a global footprint that matches – and perhaps even exceeds – that of any other country. Yet, Xi’s quest remains largely unrealized ... their value and import have yet to be realized.” (p. 285) The book seems to suggest that the party is a robust and fundamental element of the China
we are facing for the foreseeable future, along with the fact that its polity makes it highly unlikely that the country will continue its support for liberal international institutions in the years to come, and contrary to the very essence of globalization, it moves to reverse the trend of greater flows of information between China and the outside world.

The substance of Economy’s book leaves the reader not only briefed in a one-sided way of the era of Chinese dominance to be upon us, but aware of China’s strengths and most importantly weaknesses in a balanced view at a point when this rising dragon is gaining a new, powerful position – striking a much more confident and assertive presence on the world stage under the presidency of Xi Jinping.

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Notes

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Dissent, Political Freedom, Civil Liberties and the Struggle for Democracy: Essays in Honour of Liu Xiaobo
Focus Issue Editors: Joseph Y.S. Cheng and Emile K.K. Yeoh

Foreword

Dissent Is the Highest Form of Patriotism: Chinese Dissidents 283
and the Legacy of Liu Xiaobo
Emile Kok-Kheng Yeoh

Introductory Commentary

Liu Xiaobo as the Spiritual Rival of Xi Jinping 305
Albert Ho Chun-yen

Party-State, Dissent and Human Rights

The Policy Programme and Human Rights Position of the 319
Xi Jinping Administration
Joseph Yu-shek Cheng

Liu Xiaobo and “Charter 08” – Freedom of Expression and 349
Cultural Relativism
Patrick Kar-wai Poon

Xi Jinping’s Religious Freedom Policy vs Human Rights 369
Beatrice K.F. Leung

(Continued on next page)
### Regional Reach of Authoritarianism

**Hong Kong No More: From Semi-democracy to Semi-authoritarianism**  
*Benny Yiu-ting Tai*

Human rights in Hong Kong: One Country looms as Two Systems Fade  
*Chris Yeung*

**Hong Kong Youth Radicalization from the Perspective of Relative Deprivation**  
*Łukasz Zamęcki*

**The Radicalization of Xinjiang: Its Roots and Impact on Human Rights**  
*Roy Anthony Rogers*

**Parliamentary Representation in the Macau Special Administrative Region: A Quantitative Analysis of Roll Call Voting Behavior in the 5th Legislative Assembly, 2013-2017**  
*Jinhyeok Jang*

### East Asia’s Despotic Other: DPRK in Comparison

**Post-Communist Transition Revisited: The North Korean Regime in a Comparative Authoritarian Perspective**  
*Soyoung Kwon*

### Postscript

**Brave New World Meets Nineteen Eighty-four in a New Golden Age: On the Passing of Liu Xiaobo, Advent of Big Data, and Resurgence of China as World Power**  
*Emile Kok-Kheng Yeoh*
<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guest Editor’s Introduction</td>
<td>1</td>
</tr>
<tr>
<td>István Csaba Moldicz</td>
<td></td>
</tr>
<tr>
<td>The Belt and Road Initiative – a Way Forward to China’s Expansion</td>
<td>9</td>
</tr>
<tr>
<td>Judit Sági and István Engelberth</td>
<td></td>
</tr>
<tr>
<td>Geopolitical Implications of the Belt and Road Initiative:</td>
<td>39</td>
</tr>
<tr>
<td>The Backbone for a New World Order?</td>
<td></td>
</tr>
<tr>
<td>Enrico Cau</td>
<td></td>
</tr>
<tr>
<td>Geopolitical Consequences of the 21st Century New Maritime Silk Road</td>
<td>107</td>
</tr>
<tr>
<td>for the Southeast Asian Countries</td>
<td></td>
</tr>
<tr>
<td>Péter Klemensits</td>
<td></td>
</tr>
<tr>
<td>Hungarian Economic Development Prospects – in the Light of the One</td>
<td>139</td>
</tr>
<tr>
<td>Belt and One Road Initiative</td>
<td></td>
</tr>
<tr>
<td>Tamás Novák</td>
<td></td>
</tr>
<tr>
<td>Differing Interpretations of the One Belt and One Road Initiative:</td>
<td>155</td>
</tr>
<tr>
<td>The Case of Hungary</td>
<td></td>
</tr>
<tr>
<td>István Csaba Moldicz</td>
<td></td>
</tr>
</tbody>
</table>

(Continued on next page)
East European “Big-Bang” Revisiting East Asia?  179
Why Chinese “Gradual Transition” Can End Up with “Shock Therapy”
Mikhail Karpov

Emergency Management Governance: Examining Leadership Styles across Cultures  203
Dean Karalekas

Changing Role of China in the International Politics of the Last 15 Years in Reflection to the US  221
Szilárd Boros

Two Major Powers in Captivating Regional Influence and Dynamics: Comparing Foreign Policies of China and United States in Southeast Asia  247
Affabile Rifawan and Novi Amelia

Book Review – Michael Burleigh (2017), *The Best of Times, the Worst of Times: A History of Now* reviewed by István Csaba Moldicz  273