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China and its Neighbors: Trade Leverage, Interdependence and Conflict

Nabeel A MANCHERI

Abstract

Economically, China, ASEAN and other countries in the region are highly integrated. From an economic perspective, this is reflected in the rapid increase in trade and investment flows. As China grows fast and trade relations with its neighbours increase rapidly, the phenomenon may lead to a situation where China uses its trade strength against its partners as a political tool. Similarly, some of its trade partners may possess certain soft power against China by using trade as a potential leverage. This can be defined in terms of import strength or export strength of a particular country and its dependence on China. This paper tries to analyse how the import and export dependence among East Asian countries work as a potential leverage that is utilized for political gains and national power projections. It also tests whether trade dependence can avert military conflicts in East Asia or not.

Keywords

trade dependence, East Asian conflict, economic leverage

China, Association of Southeast Asian Nations (ASEAN) and other countries in the region hold a unique status among the comity of nations as the most dynamic economies of the world though their development paths have been different. These countries are highly integrated economically. From an economic perspective, this is reflected in the rapid increase in the degree of integration through international trade and investment flows. China is the largest economy in the region, also the largest exporter and largest trading nation, followed by Japan, South Korea and India. Trade constitutes almost 50 per cent of the Gross Domestic Product (GDP) of all countries in the region barring the least developed countries from South

Asia and ASEAN. This increased trade-GDP ratio has led to greater economic interdependence among East Asian countries while their political relations have been quite naïve in recent past.

The security dilemma and the emerging balance of power in the East Asian Region can be analyzed by comparing economic strength of each state. The main argument in this paper is developed to test whether trade dependence can prevent military conflicts from escalation in East Asia or not. The present study tries to analyse how the import and export dependence among East Asian countries work as a potential leverage that is utilised for political gains and national power projections. East Asia is stuck in a number of territorial disputes and there is possibility of miscalculations and military conflicts in the future.¹ The East China Sea disputes among China, Japan and Korea or the South China Sea disputes among China and ASEAN members or the long and unsettled border problems between India and China are the major concerns to the peace and stability in East Asia.

China's assertiveness in East Asia by various means including economic coercion represents a security threat to other nations, who have contested claims in the region. China's status can be interpreted as that of a regional power whose military and economic capabilities far outstrip those of other states. China's economic interests in the region are especially intermingled with China's grand strategy. According to Goodman P. M of Center for Strategic and International Studies (CSIS), economics and diplomacy are two sides of a same coin. One side represents diplomacy to promote exports, investment and other economic activities that contribute to a country's prosperity; and the other side represents it as an economic tool—from sanctions to trade negotiations—to shape the behaviour of other countries in support of a nation's security and other foreign policy goals.² Passive side of this proposition is that the economics or greater trade can deter the potential conflicts among countries.

The conflict in the region could also be theoretically understood through a neorealist paradigm. In spite of increasing economic cooperation between the parties involved, the region is in a state of suspicion, which breeds tension,

¹ China has unleashed a new wave of aggressive posture in the region started with the rare earth embargo to Japan in 2010 after a territorial incident in East China Sea and then the incidence such as de facto seizure of the Scarborough Shoal from the Philippines in 2012, declaration of an Air Defense Identification in 2013 over an area of the East China Sea, siege of the Second Thomas Shoal in the Spratlys in early 2014, construction of an airstrip on the Johnson South Reef, and the most recent naval skirmishes with Vietnam over Chinese deployment of Haiyang Shiyou 981 floating oil rig off the central coast of Vietnam, within Vietnam's lawful Exclusive Economic Zone (EEZ), just 120 nm from its maritime baseline.

² Goodman M P, "Economics as a Strategy", *Global Economics Monthly*, volume 3, issue 1 (January 2014), 1

conflict and war. Robert J argued that “when there are believed to be tight linkages between domestic and foreign policy, the quest for security may drive states to interfere preemptively in the domestic politics of others”. Relationships between and amongst states are always characterised by uncertainty and suspicion, necessitating a security dilemma. States look to ensure security and survival through building up sufficient military capacity to assert sovereignty.³ He also mentions that if use of forces is too costly to the states, there would be fewer restraints on the use of nonmilitary instruments such as economic tools described in this paper.⁴

Further, states are primarily concerned with relative gains that is either maintaining or improving their positions relative to other states. Within this context, states seek to maximise their security. States maximise their security by increasing their relative power status in the international system. Balance of power politics emerges as a tool to contain conflict and as a consequence of the structural dynamics of the international system and also if the distribution of power and capacities between and amongst states varies significantly. Neorealists mostly associate bipolar systems with greater degree of stability than multipolar systems. The balance of power is critical and maintaining the balance contributes significantly to reducing the likelihood of war.

There is also a collision between economics and security that pose a strategic challenge in Asia today. According to Feigenbaum, “the same countries that are trading, investing and growing together are beset by security tensions and dysfunctional diplomatic relationships”.⁵ Beijing’s long-term strategic intentions cast deep anxieties among other nations in the region despite China has become the top trade partner for many of Asia’s major economies. Yet, economic interdependence alone cannot serve as a conflict-mitigating mechanism.

1. Trade: A Conflict Mitigating Mechanism?

Looking at the total trade of these countries reveals that China is the top importer as well as exporter from the region followed by Japan, South Korea and India. China also maintains a robust trade surplus which was equal to 177.3 billion euros in 2011. Singapore and South Korea are the two other countries in the region who have the trade volume over 500 billion and also have positive trade balance. Japan

³ Robert J., “Cooperation under the Security Dilemma”, *World Politics*, (Cambridge: Cambridge University Press 1978), vol. 30, no. 2, 167-214

⁴ *Ibid.* 188

⁵ Feigenbaum A.E., “Ten Trends That Will Shape Asia in 2014”, Article, *Carnegie Endowment*, (December 30, 2013).

is the second largest exporter and importer in the region and has been maintaining a positive trade balance until recently. However, since last two years, the import has outperformed export with 42.7 billion trade deficit starting from 2011. India is the fourth largest trader from the region with huge trade deficit of 110 billion euros in 2011, making additional burden to India's current account deficit which is close to six per cent of Indian GDP. Indian exports are about 16 per cent of China's total exports, which is equal to 1.3 trillion.

China is an export giant and ranked number one in world's total exports since 2009, a huge climb from being number eight in 1997. Among the regional players, Vietnam, Malaysia and Singapore are more dependent on China for exports than others. The ratio of imports of these countries from China was 21 per cent, 10.1 per cent, and 14.8 per cent respectively in 2009. China's imports from the region rose more swiftly than its exports to the region, which resulted in its growing trade deficit with East Asian countries. In 1997, China enjoyed a trade surplus of US\$12.7 billion while in 2009, it had a deficit of US\$275 billion from the region.

As China grows fast and trade relations with its neighbours grow bigger, the phenomenon may lead to situation where China uses its trade strength against its partners as a political tool or some of its trade partners may invoke trade interdependence as a deterrence against China. This national strength will be dependent on the import volume or export volume of a particular country. If a country is a large importer, it might possess power as a buyer. Power will increase with the size of the market in the importing country, or with the size of exports from an exporting country.⁶ Such power can sometimes be coercive if a large buyer suddenly uses the refusal of purchases as a threat for political concession from a target country.⁷ So in this sense, China has accumulated lot of strength that it can leverage upon other states from the region. Or one can explain the assertiveness of China in the South China Sea and in the East China Sea with the economic significance of the Sea, both in terms of energy and as a sea route seems to emerge as a major factor driving Chinese perceptions in the region.

As explained by Matsuro, The idea that economic interdependence reduces the propensity for conflict is also deeply rooted in historical thought.⁸ In 1748, Baron de Montesquieu observed, "peace is the natural effect of trade. Two nations who differ with each other become reciprocally dependent; for if one has an interest in buying, the other has an interest in selling; and thus their union is founded on

⁶ Chen IT, "Balance of payments and power: assessing China's global and regional interdependence relationship" *International Relations of the Asia-Pacific*, (Oxford University Press, 2014) doi:10.1093/irap/lcu00

⁷ Lampton, D.M., *The Three faces of Chinese Power: Might, Money, and Minds*, (Berkeley: University of California Press, 2008).

⁸ Mastro Oriana. S., "The Problems with the Liberal Peace in Asia," *Survival*, Volume: 56, issue 6, (April /May 2014), 129-158.

their mutual necessities”.⁹ Kant E, posited in his 1795 essay *Perpetual Peace* that international commerce, international institutions and democratic governance were necessary for world peace.¹⁰ The case for free trade in nineteenth-century Britain was argued on moral terms, specifically that free trade not only created economic prosperity but also would ensure peace to the empire.¹¹

There are also parallels being drawn comparing the current situation in East Asia to early 20th century Europe. Britain and Germany went to war in 1914 even though they had close economic ties — much as China and Japan have now. Then, as now, there was a regional military buildup by Germany to become a naval power to compete with Britain, similarly what China is currently doing, competing with US and Asian countries. The argument is that economic interdependence may not prevent conflict under all conditions but may prevent from escalating to a full scale war. Understanding the complex connection between economic factors and conflict is not just an academic exercise; economic liberalism continues to shape critical military and security policies, especially that of countries like US and European countries. China is too moving in that direction.

Some International Relations (IR) scholars argue that in recent decades in particular, the international system has undergone a change in the degree of interdependence as a result of globalisation. This economic interdependence affects international behaviour. However, academics have not reached a consensus on whether and how trade prevents conflicts. There are other factors beyond economics that can too influence a country’s behaviour. For example, two countries may not fight because of factors such as their domestic political system like democracy, though they trade heavily or perhaps countries only trade heavily with countries they do not expect to go to war.¹²

2. Economic Dependence and State Leverage

This section looks at the Chinese trade dependence on the region and Chinese ability to leverage foreign policy and security decisions of other countries in the region by using trade as a tool. Gartzke E and Quan Li argue that interdependence

⁹ Montesquieu Baron de., “Of Commerce in Different Governments, of Laws in Relation to Commerce, Considered in its Nature and Distinctions”, *The Spirit of Laws*, book 20, Chapter four, (1748)

¹⁰ Kant E., *Perpetual Peace: A Philosophical Sketch*, (London: George Allen and Unwin LTD, 1795).

¹¹ Trentmann F., *Free Trade Nation: Commerce, Consumption and Civil Society in Modern Britain*, (New York: Oxford University Press, 2008)

¹² Mastro Oriana. S., “The Problems with the Liberal Peace in Asia,” *Survival*, Volume: 56, issue 6, (April /May 2014), 129-158.

is really complex. Economic linkages involve interactions at the systemic, dyadic, and national levels that are by themselves intricate. The political permutations of economic linkages further amplify complexity. By referring to Mansfield and Pollins, McMillan, Gartzke and Quan Li elaborate that how economics matters to political processes is ultimately an empirical question, but a question with significant analytical prerequisites.¹³

Therefore, to analyse the trade interdependence I, consider China's trade, imports and exports with select Asian countries as well as each of these countries' dependence on China for their exports and imports. I calculate the interdependence as the proportion of bilateral trade to each state's total trade (trade share).

$$\text{Tradeshare}_i = \frac{(\text{imports}_{ij} + \text{exports}_{ij})}{(\text{imports}_i + \text{exports}_i)} = \frac{\text{trade}_{ij}}{\text{trade}_i}$$

The concentration of trade share in a single partner is argued to represent vulnerability and might be indicative of political manipulation. Trade share seeks to measure the political importance of a given trading relationship; relative to trade with a state's other partners.¹⁴

China's trade relations particularly with East Asian countries are manifold higher compared to other trade regions such as EU or North America. The figures reveals that Japan tops as the biggest trade partner of China from the Asian region, though both countries have been at logger heads over various political and boundary issues. South Korea is the second biggest trade partner of China with a total trade of 184 billion euros, contributing seven per cent of China's total trade. India ranks fourth amongst the other Asian trade partners of China. While in case of India, China owns the top spot as the largest trading partner. China almost contributes to 1/10th of India's total trade. A huge negative trade balance however, indicates that China's exports to India are much greater than India's exports to China. Hence, China serves as a better import market rather than an export one for India.

¹³ Gartzke, E. and Quan Li, "Measure for Measure: Concept Operationalization and the Trade Interdependence-Conflict Debate" *Journal of Peace Research*, 40 (5, 2003), 553-571.

Mansfield, E. Pollins, B., "Interdependence and International Conflict: A Conceptual and Empirical Overview", in Edward Mansfield & Brian Pollins, eds, *New Perspectives on Economic Exchange and Armed Conflict*. (Ann Arbor: MI: University of Michigan Press, 2003): 1-28 ; McMillan, Susan M. "Interdependence and Conflict", *Mershon International Studies Review*, Volume 41-1 (1997), 33-58

¹⁴ Gartzke, E. and Quan Li, "Measure for Measure: Concept Operationalization and the Trade Interdependence-Conflict Debate" *Journal of Peace Research*, 40 (5, 2003), 553-571.

China’s all weather friend and ally, Pakistan, occupies the 10th position with the total trade of about seven billion euros, while India’s trade with Pakistan is just 1.5 billion. Comparing China with India, it is evident that China’s trade with Asian countries is much higher when compared to the trade of India or Japan. This is a crucial factor that will determine how events pan out in the Asian region with a growing economic clout of China. China’s dependence on the region for its trade is about 31.4 per cent of China’s global trade. Japan, Korea, India and all East Asian tigers including Vietnam are huge export markets for Chinese goods. As in the case of total trade, Japan, South Korea and India are the largest export market for Chinese commodities from the region. The combined market share of these three countries for Chinese commodity exports constitute about 15 per cent of China’s total exports.

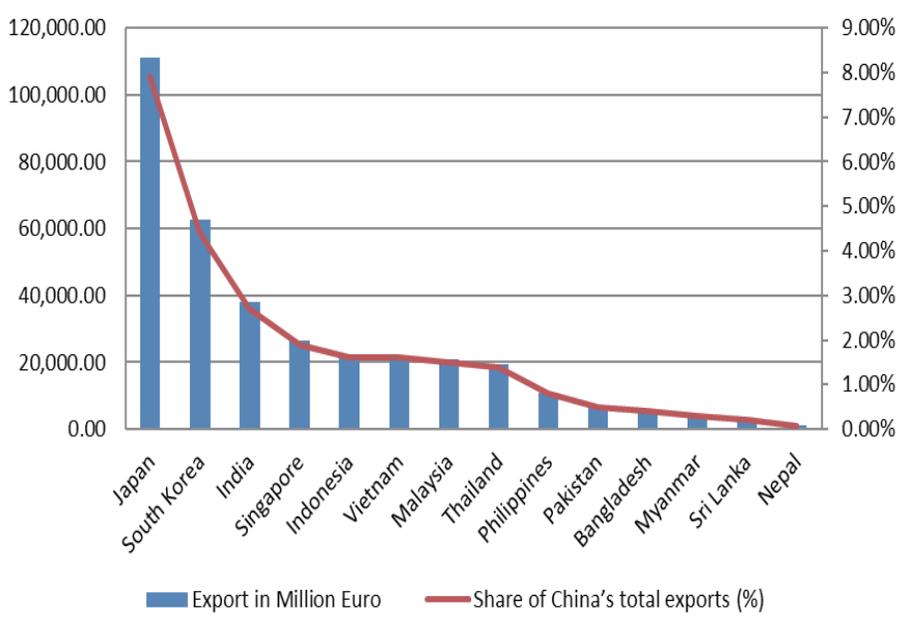


Figure 1: Chinese Exports to Asian Countries and Its Export Dependence in 2011
 Source: Euro Stat, 2012
 (<http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/statistics/>)

China’s exports of 304 billion euros worth of commodities to the region constituted about 23.6 per cent of its global exports in 2011 and India depends on the region for about 25.6 per cent of its global exports. Though, this part of Asia is a huge market for China, the trade data shows that China’s contribution is comparatively low in the domestic markets of each individual country in terms of their total imports. Also for exports, China is much more dependent on advanced economies in Europe and America. China’s export to small economies of South

and South East Asia is comparatively low. However, the recent trade facilitation measures by China show that it is working in the direction to improve its export market in smaller countries such as Nepal, Sri Lanka and Myanmar through various measures including financial assistance and investments in these countries.

One way to interpret the data is, China does not have much leverage in its export to Asian countries that can be used to settle the political disputes or to bring peace in China's favour. Particularly the individual countries in South East Asia cannot bargain with China as their imports from China are relatively weak. External export control is another way to flex muscles. The control can be powerful when the exports are strategic items or scarce natural resources. China used this tool as an informal embargo on rare-earth exports to Japan during the 2010 Diaoyu/Senkaku crisis. In this case, China used its dominant position in export to settle the political crisis. The confrontation between China and Japan in September 2010 over the detention of the captain and crew members of a Chinese fishing vessel by Japanese coastguard resulted in a number of retaliatory measures by China. The most controversial among them was the halting of shipment of rare earths and related material to Japan. This was a rare case of a country, taking an economic measure to solve a political dispute by using rare earth materials as a strategic weapon.

3. Case Study: Territorial Dispute in East China Sea and Rare Earth Embargo -2010

Even prior to this informal embargo on rare-earth exports to Japan during the 2010 Diaoyu/Senkaku crisis, Chinese experts and nationalist who are aware of the importance of REEs were anguishing over loss of China's national wealth at low rates to its rival countries such as Japan, South Korea and Western countries. Xu Guangxian, China's "Father of Rare Earths," has been vocal to build up strategic reserves of rare earths in China. On November 02, 2009 in an interview to China Economy Times, Xu, complained publicly that Japan and South Korea have built up stockpiles, which are enough for 20 years of consumption by taking advantage of low market prices of Chinese over supply. He was pushing the government on policy issues and suggesting the major rare earth producers such as Baogang, Minmetals, and Jiangxi Copper to implement the stockpiling. He also criticised the government's inability to prevent smuggling of Chinese natural resources to Japan, claiming that Japan gets approximately 20 per cent of its rare earths from China's black market.¹⁵

¹⁵ Rare Element Resources Ltd., "Chinese rare earth expert calls for immediate stockpiling", (November 3, 2009) <http://www.stockhouse.com/companies/bullboard/t.res/rare-element->

Rare earths were traded freely and at a discounted price on the global market before the mid-2000s. Since 2006, however, China-the world’s leading RE producer, gradually tightened export restrictions on Rare Earths. China has become the largest country of rare-earth deposits, producer, consumer and an exporter. There is a growing demand-supply gap because of dearth of any other major supplying nation. China’s imposition of export restrictions on several rare earth metals, on the grounds that it needs the higher quantities for its clean energy, and high-tech sectors, is squeezing an already starved market.

The data shows that starting from 2006 China has started to restrict the export of these minerals and along with pushing the average price per kgs upward reaching at its peak of US\$ 171.39 per kg in 2011. It was reported at that time, the average price of some heavy rare earths went up to 800 per cent. Though the price level has moderated currently, it would be difficult to reach at least the 2010 price level as China is strictly monitoring the production and consolidating the industry.

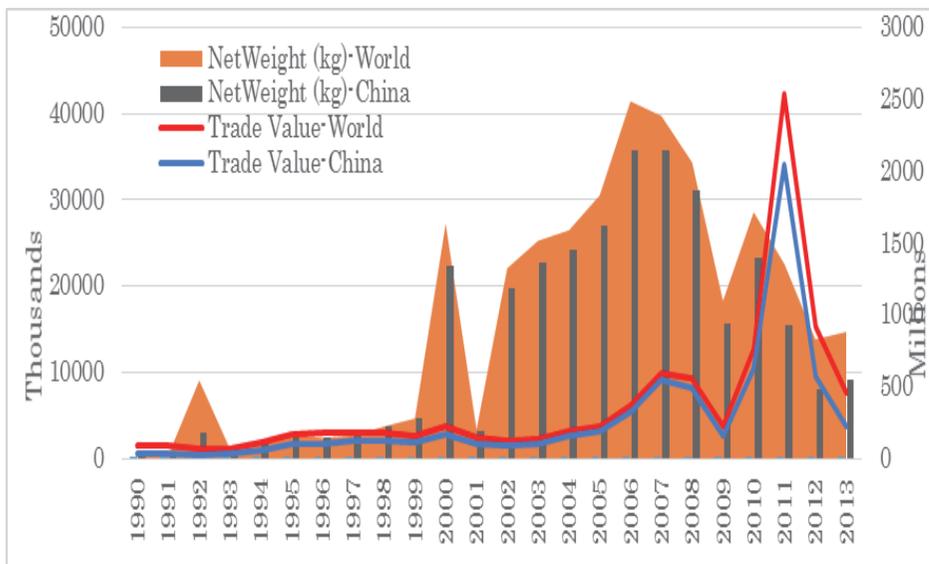


Figure 2: Japan’s import of REs from China and the world (1990-2013)
 Source: UNCOMTRADE database 2014

The diplomatic standoff with Japan started with the arrest of Chinese fishing crew and the captain by Japanese coastguard on September 07, 2010. Initially, China was cautious and had taken a restraint approach mainly through diplomatic

resources-ltd?postid=16449736 (searched date: August 18, 2013)

channels and were expecting the release of its citizens as early as possible. In Beijing, the Foreign Ministry's spokesperson Jiang Yu told the media that China was "seriously concerned over the Japanese action" and had "made solemn representations with Japan." Jiang reiterated China's historic claim to sovereignty over the area and demanded that Japan's Coast Guard refrain from taking so-called "law-enforcement activities" in Chinese waters.

It was reported that Chinese regulators urgently summoned the presidents of China's rare earth companies to a secret meeting in Beijing. It was informed to the mining executives that the Chinese Government was about to halt all shipments of rare earths to Japan and if any of their companies stepped up shipments to another country instead, allowing reshipment of rare earths from that country to Japan, then the company would lose its export license, which could mean financial ruin. The assembled executives were also warned against speaking to the news media about the coming embargo. Chinese Government trade statistics later showed that exports of rare earths to Japan dropped to almost zero during the embargo, which continued for two months. In addition to telling companies to halt exports, the Chinese Government had also instructed customs officials to stop any exports of rare earth minerals to Japan. China's customs agency had notified companies not allowing them to ship to Japan any rare earth oxides, rare earth salts or pure rare earth metals.¹⁶

However, a spokesman for the Chinese MOFCOM denied that any embargo had been imposed. Later, Chen Deming, China's commerce minister, also dismissed that any embargo was in place, suggesting that the country's rare earth exporters simultaneously developed feelings toward Japan that caused them to stop shipments. Mr Chen, the former governor of China's Shanxi province which also produces rare earth minerals might have been aware of the importance of these minerals and the dependence of Japanese companies to Chinese supply.

The action might have been taken by Chinese customs agents rather than as a formal trade embargo imposed by MOFCOM to give Beijing more negotiating room with Japan. Customs agency's halt of exports of rare earths without calling it an export ban carried political and legal advantages to China during the crisis. Imposing an unannounced embargo would have allowed China to ratchet up the pressure gradually on Japan to release the detained boat captain.¹⁷

Most important, the incident also shows the well-connected networks

¹⁶ Bradsher, Keith, "World can't restrain China on rare earth", *Deccan Herald*, (March 19, 2012).

¹⁷ Bradsher, Keith, "China Is Blocking Minerals, Executives Say", *New York Times* (September 23, 2010)

among the state and state agencies; state owned and backed companies and private players. China’s rare earths industry has the backing of the state and the communist party. The dramatic use of export restrictions to score a boundary dispute reveals the principal strategic benefit China owns by rare earths monopoly. Chinese dominance of REEs in the world market is a critical example of China’s rise to the world power status, which is clearly the result of a long term strategic industrial policy. For China, geo-economic and geo-strategic competition remains closely linked and ultimately, the role of the state is to defend the ruling regime and enhance China’s comprehensive national power.

The REE embargo episode had sent clear indication to the leaders around the world about growing doubt concerning Chinese real intentions and that a more powerful China might use its economic leverage or similar forms as a weapon. Given the critical reliance on rare earths for different military applications from missile to radars to satellites and promising new technologies, the exclusive reliance on China as a sole source of supply is a great risk. However, unlike in this case, Chinese capacity and willingness to use its economic strength to leverage political disputes may lead to countermeasures by other countries, which may not be in China’s long-term strategic interests.

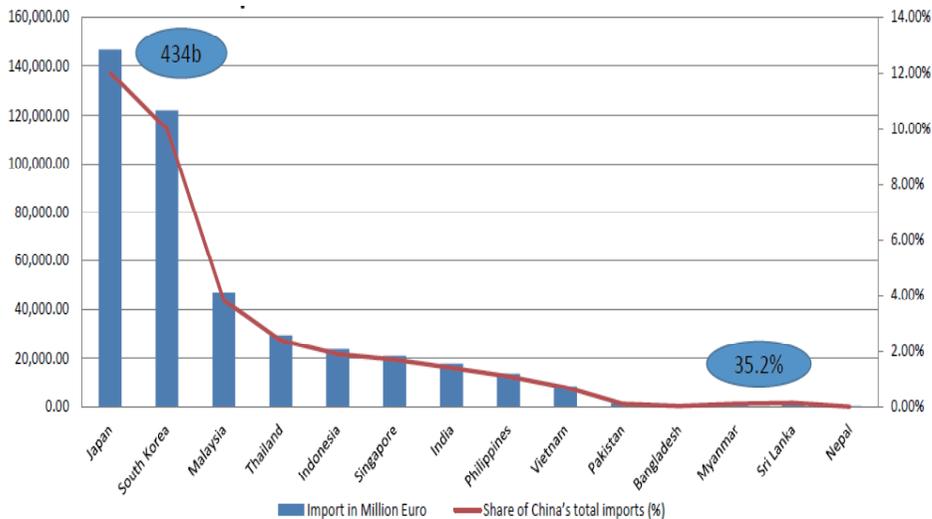


Figure 3: Chinese Imports from Selected Asian Countries and Dependence in 2011

Source: Euro Stat, 2012

(<http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/statistics/>)

The Chinese action, involving rare earth minerals have escalated to a trade

dispute involving the US, EU and Japan resulting a WTO ruling against China.¹⁸ Until recently, China typically sought quick and quiet accommodations on trade issues but the interruption in rare earth supplies is the latest sign from Beijing that Chinese leaders are willing to use their growing economic muscle.

Chinese import from the region was about 434 billion in 2011, constituting about 35.2 per cent of its total imports showing a clear difference with export share. Chinese import figures are more apparent and appealing if seen from other individual countries' perspective, which is exclusively dealt in next section. Japan ranks as the number one source of import for China from the region. China's imports from South Korea and Malaysia are also considerably high. China's import suggests that China is overly dependent on countries like Japan, Korea, Malaysia and Thailand. Chinese import from other countries in the region constitutes less than three per cent of its total imports. China's import from India stands at seventh position even below the smaller countries of the region such as Thailand, Singapore and Malaysia. The pure economic perspective suggests that China's role in the region is one of complete dominance. Moreover, it turns out that China is a valuable importer to the region and a big exporter to the Western world. In developing strong bilateral ties with almost all countries in the region, China has stamped its authority and will now look ahead and try to consolidate its position.

4. Trade Dependence of Selected Asian countries on China

Unlike the previous case of China's trade dependence, here I examine the trade dependence of select Asian economies on China. This is the most important matrix which gives a perspective of trade dependence of the Asian countries on China. The data reveals that any escalation of conflict in the region will be more damaging to these countries in relative trade terms than to China because of their trade dependence skewing towards China. China has become the number one export and import partner for many of these countries replacing either the US or Japan in recent years. As shown in Figure 4 ASEAN's trade share to the US and EU has continuously reduced since 2000 and on the contrary China's share has increased by leaps and bounds.

From the trade data, it can be inferred that in case of any conflict between China and Japan, most countries in the region would take a neutral position

¹⁸ Mancheri N, "Does the WTO ruling against China on rare earths really matter?", *East Asia Forum* (October 30, 2014), <http://www.eastasiaforum.org/2014/10/30/does-the-wto-ruling-against-china-on-rare-earths-really-matter/>

fearing the risk of loss of billions worth of trade. However escalation of any conflict between China-Japan or China-South Korea over territorial disputes is remote as China has become the leading trade partner for these countries and China would be in a position to leverage this trade strength to influence the behavior of its trade partners in favour of China. The export dependence of these countries on China is remarkable as around 26 per cent of Japan's total exports and 31 per cent of Korea's exports go to China. These two biggest economies in the region also depend on China for about 18 per cent and 17 per cent of their imports. The crucial question is will any of them bet on these huge trade volumes over these tiny islets in East or South China Sea? As the developed countries in the Western hemisphere are in economic doldrums with declining demands in their imports, importance of emerging countries like India, China and ASEAN will increase many folds, making the conflict escalation too costly affair to afford. It is also evident that many countries in the South East Asian region largely depend on China, close to a quarter of their total trade, either originate or flow towards China, even though political relations have been going southward.

Countries	Total trade with China	Share of exports to China	Share of imports from China
Japan	257,750.6	26.41	18.57
South Korea	184,504.6	31.58	17.07
Malaysia	67827.4	29.61	16.36
India	56129.7	6.3	12.1
Thailand	48,834.5	18.43	12.19
Indonesia	45,695.9	16.70	17.72
Singapore	47,565.2	7.36	10.76
Philippines	24,326.5	41.06	26.71
Vietnam	30,320.4	12.87	31.82
Pakistan	7966.3	8.83	17.52
Bangladesh	6,228.2	2.38	23.14
Myanmar	4,904.9	21.88	37.29
Sri Lanka	3,861.	1.12	15.40
Nepal	989.4	1.66	27.21

Table 1: Trade dependence of Select Asian countries on China (Million Euro)

Source: Euro Stat, 2012

(<http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/statistics>)

$$\text{Column-3} = \sum_{ij} \frac{X_{ij}}{X_{iw}} \times 100$$

(Country i's export to country j divided by country i's total exports to the world multiplied by 100)

$$\text{Column-3} = \sum_{ij} \frac{M_{ij}}{M_{iw}} \times 100$$

(Country i's import from country j divided by country i's total imports from the world multiplied by 100)

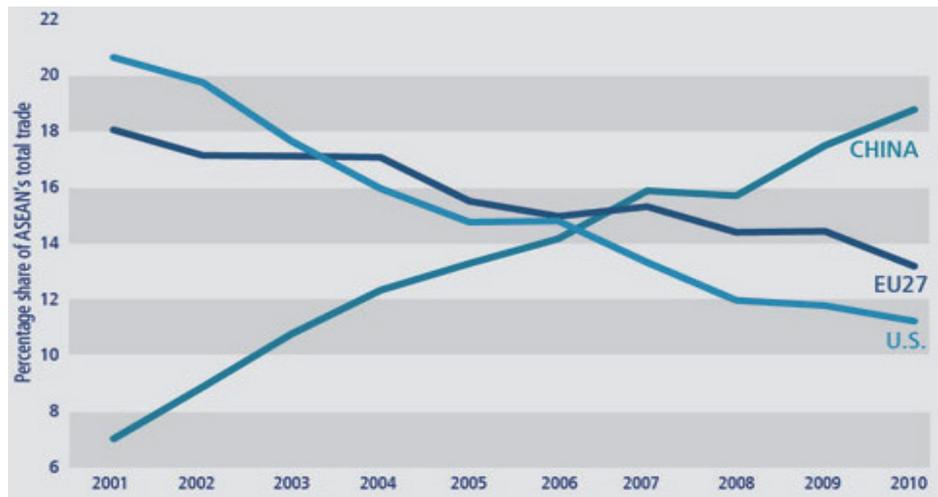


Figure 4: China becomes ASEAN's Largest Trading Partner

Source: Authors calculations on the basis of UNCOMTRDAE data base

Will this huge trade dependence between China and other countries in the region prevent conflicts from escalation? Some scholars argue so. For example, Richard Katz argued in *Foreign Affairs* that the conflict between China and Japan over the Senkaku did not escalate to a war because of 'mutual assured production,' or China needs to buy Japan's products as much as Japan needs to sell them.¹⁹ Japan's total trade with China has tripled since 2000 rising by 30 per cent year-on-year to more than \$300 billion; from 1995-2001, increased shipments accounted for 45 per cent of overall growth in Japanese exports. Both China and Japan share a mutual trade relation as 60-70 per cent of goods imported by China from Japan

¹⁹ Katz R., "Mutual Assured Production", *Foreign Affairs*, 92-4 (July/August 2013), 18-24.

comprises of machinery used to make China's own exports.²⁰

Trade dependence also means that if one country overly depends on another either for exports or imports, it may give the rival a wedge in strategic matters. For example, Philippines a staunch US ally in the region with an unresolved territorial dispute depends on China for 41 per cent of its total exports and 27 per cent of imports. In spite of heightened tensions over territorial disputes in South China, culminating in prolonged standoff in Scarborough Shoal, trade between the Philippines and China grew by 32 per cent in 2011, reaching 30 billion in 2012. Whereas Philippine's export to the US was about 10 per cent of its total exports and imports was just about 6.4 per cent of its total imports. This over dependence of Philippines for its exports on China particularly agricultural products has proved to be a disaster.

Since 2009, Chinese vessels have been involved in aggressive behaviour in the South China Sea. The activities such as Chinese patrol boats attempting to ram a Philippine vessel and the April 2012 standoff between the Philippine patrol vessels and Chinese surveillance ships have been seen as a deliberate campaign of coercive diplomacy in the South China Sea. Moreover, China also resorted to economic measures to punish the Philippines for perceived encroachment in the Scarborough Shoal standoff. Chinese authorities kept-off Philippine bananas from entering China, allegedly due to pests, and began slowing inspections of papayas, mangoes, coconuts, and pineapples from the Philippines. Chinese mainland tourist agencies stopped sending groups to the Philippines, which as the third largest source of tourists, was a great blow to Manila.²¹

5. The Relative Degree of Trade Intensity between China and Asian Countries

The Relative Degree of Trade Intensity (RDTI) Index represents the strength of the trade ties between the two countries. The RDTI is a measure of country *i*'s relative share in country *j*'s import market or vice versa. For example, in the case of China's trade with Asian countries, it implicitly benchmarks China's trade performance in Asia against those of China's trade competitors. The bilateral export/import intensity index is found by adjusting a country's export ratio by means of the relative importance of its exports to the total imports of another country. The index was used by Kojima K (1964) and Drysdale P and Garnaut R (1982). To investigate the bilateral trade intensity of select Asian countries with

²⁰ *Ibid.*, 22

²¹ Mastro Oriana. S., "The Problems with the Liberal Peace in Asia," *Survival*, Volume: 56, issue 6, (April /May 2014), 129-158.

China and vice-versa, the study uses three different proxies for bilateral trade intensity, following Frankel and Rose (1998):²²

$$I_{ij} = \frac{X_{ij}}{X_i} \div \frac{M_j}{M_w - M_i}$$

Where X_{ij} is country i 's exports to country j

X_i is i 's total exports

M_j is j 's total imports

M_i is i 's total imports, and

M_w is total world imports.

An RDTI of 1.0 indicates country i is doing relatively better than its trade competitors in country j 's market; an index number below 1.0 suggests country i 's trade competitors are out performing in country j 's market. An index number greater than 1 also indicates that the two nations have a comparatively strong trade relationship.

Countries	CHN	JPN	ROK	MAS	IND	THA	IDN	SGP	PHL	VNM	PAK	BGD	LKA	NPL
CHN	--	2.06	2.08	1.48	0.91	1.30	1.15	0.99	1.50	1.80	0.94	1.50	0.53	0.55
JPN	2.06	--	1.99	1.98	0.46	2.66	2.80	1.16	2.36	2.30	0.60	0.69	0.48	0.22
ROK	2.08	1.99	--	1.36	0.87	0.93	2.10	1.71	1.88	2.81	0.65	1.33	0.47	0.13
MAS	1.48	1.98	1.36	--	1.19	3.86	3.95	7.38	2.12	2.84	2.53	2.09	1.31	1.02
IND	0.91	0.46	0.87	1.19	--	0.77	2.26	1.48	0.46	1.08	1.39	4.35	6.24	7.94
THA	1.30	2.66	0.93	3.86	0.77	--	2.83	2.55	3.32	4.20	1.07	1.73	1.49	0.98
IDN	1.15	2.80	2.10	3.95	2.26	2.83	--	6.70	2.50	1.94	1.47	2.88	1.60	0.10
SGP	0.99	1.16	1.71	7.38	1.48	2.55	6.70	--	4.98	4.61	0.62	2.85	3.91	0.54
PHL	1.50	2.36	1.88	2.12	0.46	3.32	2.50	4.98	--	3.50	0.40	0.44	0.14	0.09
VNM	1.80	2.30	2.81	2.84	1.08	4.20	1.94	4.61	3.50	--	6.61	0.46	0.39	0.36
PAK	0.94	0.60	0.65	2.53	1.39	1.07	1.47	0.62	0.40	6.61	--	6.96	6.80	0.13
BGD	1.50	0.69	1.33	2.09	4.35	1.73	2.88	2.85	0.44	0.46	6.96	--	1.88	0.09
LKA	0.53	0.48	0.47	1.31	6.24	1.49	1.60	3.91	0.14	0.39	6.80	1.88	--	0.07
NPL	0.55	0.22	0.13	1.02	7.94	0.98	0.10	0.54	0.09	0.36	0.13	0.09	0.07	--

Table 2: The Matrix of Bilateral Trade Intensity Index of Select Asian Countries
Source: Authors calculations on the basis of UNCOMTRDAE data base

²² Kojima K, "The Pattern of International Trade among Many Countries," *Hitotsubashi Journal of Economics*, 5-1 (1964), 16- 36. Drysdale, P. and Garnaut, R, "Trade Intensities and the Analysis of Bilateral trade Flows in a Many Country World: A Survey," *Hitotsubashi Journal of Economics*, 22 (2, 1982), 62-84; Frankel J.A. and Andrew K. Rose, "The Endogeneity of the Optimum Currency Area Criteria," *The Economic Journal*, 108 (July 1998), 1009-1025.

The degree of trade intensity index is a clear indication of bilateral ties between countries in the region. From table-3, it is evident that for the stronger countries in the region like Japan, South Korea, Malaysia and a few others, the export to China is stronger (intensive) than the imports from China. Though, the region represents a considerable share in China's exports in terms of intensity, China's imports from the region is more intensive compared to China's total imports. As China becomes the huge market for these countries for selling their goods, China's relative power as buying nation also increases enabling China to dictate terms with most of these countries. The pure economic perspective suggests that China's role in the region is one of complete dominance. In developing strong bilateral ties with almost all the countries in the region, China has stamped its authority and will now look ahead and try to consolidate its position.

How this over dependence for trade on China can affect the behaviour of Asian countries? For example, China being Malaysia's largest trading partner, whereby its export to China amounts to 30 per cent of its total exports and about 17 per cent of its total imports. In 2012, the Chinese Embassy in Kuala Lumpur was the second-largest issuer of Chinese visas in the world. This huge dependence on China for its trade has compelled Malaysia to compromise its position on the South China Sea disputes.

It was reported that on March 26, 2013, that People's Liberation Army Navy (PLAN) conducted a major naval exercise in the South China Sea, close to what China calls Zhengmu Reef, which is known as Beting Serupai in Malay. It's some 80 kms away from Malaysia and 1,800 kms from the Chinese mainland. This was one of the biggest expeditions of PLAN with four vessels led by the PLAN's latest amphibious landing ship, the Jinggangshan. While serving as a sign of China's rising assertiveness, the exercise was also notable for the distinct lack of a visible public reaction from Malaysia. Neither the Malaysian Prime Minister nor the Foreign Ministry has made even the most perfunctory statement on the matter. In contrast to how such exercises are greeted in Hanoi and Manila, the Malaysian public response has been a deafening silence.²³ So what explains Malaysia's muted reaction to this overt demonstration of China's growing power? In August 2012, ASEAN failed to reach a consensus on a joint statement for the first time in 45 years of its history, because the chair, Cambodia was pressured by China to block any mention of the South China Sea disputes in the joint statement. Cambodia is largely dependent on China for economic aid; in 2011 alone the amount of foreign investment pledged to Phnom Penh by China was 10 times greater than that promised by the US.

²³ Shahrman, L., "Why Malaysia isn't afraid of China (for now)", *The Strategist* - The Australian Strategic Policy Institute Blog, (April 24, 2013)

This shows that other ASEAN nations will also eventually follow the Malaysian way as their economic ties with Beijing become more intensive. This soft stand of ASEAN members on China was evident in the ASEAN-Japan Commemorative Summit Meeting held in Tokyo in December, 2013. It was reported that despite a significant diplomatic effort, Prime Minister Abe failed to get a more coveted rebuke from ASEAN on China's recent imposition of a unilateral Air Defense Identification Zone (ADIZ) in the East China Sea. The lack of an ADIZ condemnation is not surprising as ASEAN remains divided on how much – if at all – it should prod China on its increasing assertiveness towards its regional neighbours.²⁴

Facing complex and evolving strategic circumstances—particularly China's ever-growing power and assertiveness, countries in the region are reinvigorating themselves with new partnerships with countries from the region as well as from outside like the US. Though, in the recent past relations of countries like Japan, Korea, Vietnam and Philippines have deteriorated with China yet most of the Southeast Asian states have maintained cordial links with Beijing despite their reservations about China's regional behaviour. Indonesia, Malaysia and Thailand are even tentatively developing defense and security links with China.

6. Implications at Large

The implications of this economic over dependence on China, an aspiring hegemonic power will be multi-faceted. Continued occurrence of Chinese assertiveness in the region such as declaration of ADIZ, naval maneuvering in East and South China Sea or the continued infiltrations in Indian border areas may become routine affairs. China may again use its trade power as a bargaining chip by selectively restricting exports or banning imports. No country from the region will be in a position to take a particular side if a bilateral confrontation or conflict occurs between China and an individual country from the region as the economic benefit for doing so will be higher than taking a side. Therefore, most of the countries would take a neutral stand. Some smaller countries like Cambodia or Laos even may align with China.²⁵ China remains an important player even in smaller countries like Bangladesh and Vietnam where India and Japan have a strong strategic hold. As a result these countries might choose to remain evenhanded as taking sides would be detrimental to their business. In effect, the

²⁴ Miller J. B., "Japan Doubles Down on ASEAN", *The Diplomat*, (December 23, 2013), at <http://thediplomat.com/2013/12/japan-doubles-down-on-asean/> (searched date: January 23, 2014)

²⁵ Cambodia and Laos are large recipients of China's aid.

trade relations of China neutralize all the soft power capabilities that India and Japan possess in the region.

For Japan, the increasing economic relations of China with Asian countries will have multifaceted implications. China has become the largest trade partner for many Asian countries replacing Japan. This is a crucial factor that will determine how events pan out in the Asian region with a growing economic clout of China. It can be inferred that with the declining trade relationship, the political importance of Japan to others from the region will also become less important. As shown in the article, if a conflict arise between China and Japan, most countries in the region would take a neutral position fearing the risk of loss of billions worth of trade and economic aid. However escalation of any conflict between China and Japan over territorial disputes is remote. The export dependence of Japan on China is around 26 per cent of Japan's total exports and about 18 per cent for imports. Also, 60-70 per cent of goods imported by China from Japan comprises of machinery used to make China's own exports. China needs to buy Japan's products as much as Japan needs to sell them.

This is remarkable and the crucial question is will any of them bet on these huge trade volumes over these tiny islets in East China Sea? However, as the economic strength of China increases, it would be in a position to leverage this economic strength to influence the behavior of its trade partners including Japan in its own favor. The economic dominance of China over region will give China the power to influence the domestic policies of other countries, what US has enjoyed for a long time and China will now look ahead and try to consolidate this position. The best strategy for Japan to counter this Chinese clout would be to increase the defense cooperation, economic aid and strategically important targeted investment in South and South East Asian countries. Instead of China+1 strategy, Japan should consider others as equal to China and should revise the policies in future as ASEAN+ China or India+ China.

Another argument is that trade dependence may prevent the bilateral conflicts form dangerous escalation. The cost of war is extremely high replacing the huge benefit from mutual trade that has actually helped the countries from the region to march towards prosperity. Given this, the more the two countries benefit from trade, the more they have to lose in the case of a war, and therefore both strive to avoid one. This argument assumes societies receive salient economic gains from trade, serious conflict among states disrupts trade, and decision makers take these two things into account.²⁶ Therefore, the People's Republic of China's (PRC's) emergence as a major trading power is not a zero sum concept from the

²⁶ Mastro Oriana. S., "The Problems with the Liberal Peace in Asia," *Survival*, Volume: 56, issue 6, (April /May 2014), 129-158.

perspective of the region.

However, the overall picture emerging from the trade matrices of the Asian region is that China's engagement in terms of trade in the region makes it a potent force where China's domination is very strikingly evident by mere numbers. This would allow China to dictate terms in the region as Beijing expands and enforces Chinese sovereignty claims in the region, rewarding those who fall in line and punishing those who do not. Consequently, this assertiveness would lead to a security threat to the ASEAN and other states in the region. China unequivocally aspires to become a regional superpower as the military and economic capabilities of China far outstrip those of other countries,

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