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RESOLVING THE NORTH KOREAN NUCLEAR ISSUE THROUGH THE SIX-PARTY PROCESS: A CREATIVE FORMULA

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ABSTRACT

North Korea's alleged admission of a highly enriched uranium program in October 2002 sparked the second nuclear crisis on the Korean peninsula, openly accelerating North Korea's nuclear weapons development program. It is estimated that the DPRK already has six or seven nuclear devices. Furthermore, Pyongyang officially announced on February 10, 2005 that it had nuclear weapons. The North Korean nuclear issue—a serious international issue as it is undoubtedly the most important obstacle to the Korean peace process—needs to be resolved as soon as possible peacefully through diplomatic negotiations at the six-party talks: a resolution that the Bush administration insists can only be arrived at through the six-party process. This article analyzes and evaluates the six-party talks in detail, viewing them as a mechanism providing a multilateral framework for resolving the North Korean nuclear issue. The author argues that the six-party process is the best means to resolve the North Korean nuclear dispute, and further maintains that bilateral talks between the U.S. and North Korea are essential to a resolution of North Korea's nuclear standoff peacefully and diplomatically. Both need to engage in direct negotiations without preconditions through the six-party talks however, while at the same time avoiding the risk of adopting hard-line policies that cannot resolve the nuclear issue peacefully. Therefore, both sides need to be flexible about their respective positions and demonstrate
the political will to compromise. This article has three specific goals: (1) to evaluate the fourth and fifth rounds of the six-party talks in terms of a multilateral framework for resolving the nuclear issue; (2) to take a closer look at U.S. financial sanctions against North Korea and the positions of concerned parties; and (3) to make policy recommendations for implementing the 9.19 joint statement to realize a denuclearized Korean peninsula.

Key Words: Six-party talks, Sept. 19 joint statement of principles, denuclearization, counterfeiting, money laundering

INTRODUCTION

The United States alleged in October 2002 that the former Assistant Secretary of State James Kelly had confirmed from North Korean officials in Pyongyang that the Democratic People’s Republic of Korea (DPRK or North Korea) had a covert nuclear weapons program using highly enriched uranium. North Korea’s alleged admission of a highly enriched uranium program sparked the second nuclear crisis on the Korean peninsula, openly accelerating North Korea’s nuclear weapons development program. It is estimated that the DPRK already has six or seven nuclear devices. Furthermore, Pyongyang officially announced on February 10, 2005 that it had nuclear weapons.

The North Korean nuclear issue—a serious international issue as the most important obstacle to the Korean peace process—needs to be resolved as soon as possible peacefully through diplomatic negotiations at the six-party talks. The Bush administration has also insisted that the North Korean nuclear crisis must be resolved through the six-party process. Thus, the author analyzed the origin and development of the second nuclear crisis on the Korean peninsula and evaluated the six-party talks as a mechanism that provides a multilateral framework for resolving the nuclear issue from the first round of the six-party nuclear talks to the third round elsewhere in
detail.¹

The author has argued that the six-party process is the best means to resolve the North Korean nuclear dispute. The author maintains that bilateral talks between the U.S. and North Korea are essential to a resolution of North Korea’s nuclear standoff peacefully and diplomatically. Both need to engage in direct negotiations without preconditions through the six-party talks. Both must avoid adopting hard-line policies that cannot resolve the nuclear issue peacefully. Therefore, both sides need to be flexible about their respective positions and demonstrate the political will to compromise.

This article has three specific goals: (1) to evaluate the fourth and fifth rounds of the six-party talks in terms of a multilateral framework for resolving the nuclear issue; (2) to take a closer look at U.S. financial sanctions against North Korea and the positions of concerned parties; and (3) to make policy recommendations for implementing the 9.19 joint statement to realize a denuclearized Korean peninsula.

Let us first evaluate the 4th round of the six-party talks to resolve the North Korean nuclear issue. The peaceful resolution of the nuclear issue is a sine qua non for building a peace regime on the Korean peninsula.² Thus, it is significant to understand the key issues discussed and the joint statement of principles signed by the six nations at the 4th round of the six-party talks.

THE FIRST PHASE OF THE FOURTH ROUND OF SIX-PARTY TALKS

The first phase of the 4th six party nuclear talks held in Beijing on July 26-August 7 went into recess on August 7 after the six

² For the Korean peninsula peace regime building initiative, see Tae-Hwan Kwak, “In Search of the Korean Peninsula Peace Regime Building,” Pacific Focus, Vol.XX, No.2(Fall 2005), pp.147-192.
nations had engaged in intensive negotiations. The U.S. and the 
DPRK actively engaged in direct bilateral negotiations for thirteen 
days, but could not reach an agreement on the core issue of 
Pyongyang’s right to peaceful nuclear activities. This issue became 
a stumbling block to the consensus on a joint statement of principles 
by the six participants involving the U.S., China, Russia, Japan, the 
DPRK and the Republic of Korea (ROK or South Korea).

**DPRK Position: Right to Peaceful Use of Nuclear Energy**

Chief DPRK negotiator and Vice Foreign Minister Kim Kye Gwan 
demanded that the DPRK be allowed to retain its right to pursue 
peaceful nuclear activities. The DPRK expressed resentment towards 
the U.S. opposition to its peaceful use of nuclear power. Despite 
concerted diplomatic pressures, the DPRK consistently insisted on 
its right to a nuclear program for peaceful purposes. Pyongyang 
demanded the right to the peaceful use of nuclear energy under the 
conditions that it would abandon all nuclear weapons development 
programs, including the existing nuclear reprocessing and enriched 
uranium facilities in the future. Furthermore, North Korea wanted 
to restore the suspended KEDO light-water nuclear reactor project. 
Both Seoul and Washington opposed this demand.

The DPRK’s demands created problems for the Seoul government. 
Seoul’s offer to supply two million kilowatts of electricity to Pyongyang 
was based on the premise that the KEDO project be scrapped and 
Seoul’s financial contributions to the KEDO would be redirected to 
the electricity supply project.

**U.S. Position: No Nuclear Energy**

The U.S. argued North Korea should not even be allowed to 
maintain nuclear reactors for civilian use because North Korea had 
turned a research facility at Yongbyon into a production center for

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3 For details, see Tae-Hwan Kwak, “North Korea’s Right to Peaceful Nuclear Activities, *Vantage Point*, Vol.28, No.9(September 2005), pp.15–19
weapons-grade plutonium after the collapse of the 1994 Geneva Agreed Framework. Light-water nuclear reactors (LWRs) are considered less likely to produce weapons grade plutonium than graphite-type nuclear reactors do, but the U.S. still has nuclear proliferation concerns with such installations. Further, President Bush supported South Korea’s offer of electricity to the North as another reason why Pyongyang doesn’t need any kind of nuclear program even for power generation.

**ROK Position: Conditional Support**

Unification Minister Chung Dong-young said in an interview on August 11, 2005, “North Korea has a general right to the peaceful use of nuclear energy for agricultural, medical and power-generating purposes.” He also said, “In this, our position differs from that of Washington.” Chung’s initial statement did not attach conditional support, but later President Roh attached conditional support for the DPRK’s right to use nuclear energy peacefully. ROK Foreign Minister Ban Ki-moon also said that the North should be allowed to explore peaceful uses of nuclear energy if it rejoins the NPT (Nuclear Non-Proliferation Treaty) and allows inspections by the IAEA (International Atomic Energy Agency). Ban reiterated there was no major difference in principle between U.S. and South Korean views on the DPRK’s possible future use of nuclear energy.

Unification Minister Chung made it clear that the ROK would not supply two million kilowatts of electricity to North Korea and fund the KEDO project to construct two LWRs at the same time. He said the ROK electricity aid plan for North Korea was based on the premise that the DPRK would abandon its nuclear weapons programs and the KEDO project. His remarks were intended to make it clear that the ROK would not endorse the DPRK demand for restoring the suspended KEDO project if the North would accept Seoul’s offer of electricity. Chung reaffirmed ROK conditional support for the DPRK’s right to the peaceful use of nuclear energy.

No compromise over this issue would mean the failure of the 4th round of the six-party talks. Even if the second phase of the
4th round talks resumed it would be difficult to bridge the wide gap between Pyongyang and Washington. If both sides insist on their respective positions on this issue, they cannot find a solution.

THE SECOND PHASE OF THE FOURTH ROUND OF SIX-PARTY TALKS

The second phase was held in Beijing on September 13~19, 2005, when the six nations finally signed a joint agreement of principles to guide a detailed roadmap for achieving the denuclearization of the Korean peninsula. The North Korean position remained unchanged. The key issue at the 4th six-party talks was North Korea’s demand for a LWR to produce electricity as part of any deal to give up its nuclear weapons programs. In the meantime, the Bush administration remained adamant that the DPRK must abandon its nuclear weapons programs and forgo nuclear energy production. The U.S. refused to consider a light-water nuclear reactor for North Korea.

The ROK has proposed supplying electricity to North Korea as part of the nuclear disarmament agreement, which chief U.S. negotiator Christopher Hill suggested was a more practical way to meet North Korea’s energy needs if that was the issue.⁴ North Korea again demanded on September 14, 2005, that the U.S. and other nations give it money to build a new light-water nuclear reactor before it would end its nuclear weapons programs. “Neither the United States nor any other participant is prepared to fund a light-water reactor,” said Hill. A light-water reactor would cost $2 billion to $3 billion and take about a decade to build. The five participants in the talk agreed that North Korea’s condition that it received a light-water nuclear reactor (LWR) before ending its arms programs was unacceptable. However, the U.S. signaled softening of that line, saying they would

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be willing to leave aside the issue of civilian uses of nuclear technology for now to clear the way for a general agreement on ending North Korea’s nuclear weapons programs.\(^5\)

**Key Contents of the 9.19 Agreement Signed by the Six Participants**

The six–party joint statement was signed on the seventh day of the second phase of the 4th six–party talks, which had been deadlocked and appeared headed towards another standoff. Although the accord included only general terms, it marked the first specific agreement among the six parties since the six–party talks first began in August 2003. It was designed to serve as the basis for further talks on the timing of North Korea’s dismantlement of its nuclear weapons programs and the corresponding provision of economic aid and diplomatic relations and other incentives for the DPRK.\(^6\)

The joint statement was a diplomatic victory for China as a host country and mediator. The agreement was based on a compromise proposal by China to bridge differences between Washington and Pyongyang over the issue of a LWR. The compromise was achieved: the DPRK would be accorded the right to peaceful nuclear energy in principle, but only after dismantling its nuclear weapons programs and rejoining the U.N. nuclear inspection regime and the nuclear Non–Proliferation Treaty(NPT). The Chinese compromise proposal was introduced after it became apparent that North Korea would not accept an earlier draft agreement with no mention of its demand for a LWR as part of any accord on abandoning its nuclear weapons programs. The agreement said, “The DPRK stated that it has the right to peaceful uses of nuclear energy. The other parties expressed their respect and agreed to discuss at an appropriate time the subject of the provision of a light–water reactor to the DPRK.” Those terms of the agreement represented a concession by the United States and the DPRK.

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The DPRK Concessions

The agreement stated, “The DPRK committed abandoning all nuclear weapons and existing nuclear programs and returning at an early date to the treaty on the non-proliferation of nuclear weapons (NPT) and to IAEA safeguards.” However, the agreement was vague at best, and did not specify anything about when or under what conditions the DPRK would dismantle all of its nuclear programs, re-enter the NPT and allow IAEA inspections.

There was no mention about the highly enriched uranium (HEU). The agreement does not explicitly address the issue of North Korea’s uranium program. North Korea still denies having one, despite growing evidence that it at least tried to develop bomb fuel that way with Pakistan’s assistance. However, the enriched uranium program was covered by the pledge to dismantle “all nuclear weapons and existing nuclear programs” and by a separate reference to a 1992 inter-Korean joint declaration on the Korean peninsula denuclearization, which prohibited uranium enrichment. But the accord did not require North Korea to confess to the existence of the program, meaning that unless the North admits to the program in a declaration of all nuclear facilities, inspectors would have to work to uncover the uranium program in an adversarial way down the road. This issue will remain a key issue at the six-party talks.

Moreover, the agreement makes no mention of a verification process. Regarding the timing of the provision of LWR to North Korea, U.S. Secretary of State Rice argued that the wording of the agreement implied that North Korea would disarm first. “At an appropriate time we are prepared to discuss — discuss the idea of building a nuclear reactor,” she said. She said several times that the discussion would not even begin until North Korea dismantled its weapons program.7

U.S. Concessions

After four years of bitter arguments over whether to negotiate with the DPRK or try to engineer its collapse, the 9.19 joint agreement President Bush finally approved provided the bare minimum – an agreement in principle that the DPRK would abandon a five-decade pursuit of nuclear weapons programs. Part of the reason Bush signed the agreement was that he had to close the breach among his negotiating partners: China, Russia, Japan and the ROK. Hard-liners in the Bush administration blocked negotiations for the first few years of Bush’s presidency, but in the end, both President Bush and Secretary Rice were persuaded that if a confrontation ever occurred with North Korea, they had to be prepared to show that they had made every effort to reach a diplomatic solution. The Bush administration finally dropped its opposition to the DPRK receiving aLWR in the future, showing a softening of its hard-line position. President Bush cautiously welcomed the agreement, but warned, “We expect a verifiable process.” So verification will be a major issue at the upcoming fifth round of the six party talks.

Chief U.S. negotiator Hill said that the administration didn’t want to see any mention of providing North Korea with aLWR in the joint statement, but the Chinese included it. The United States also balked at the use of the vague term “appropriate” to describe the timing. South Korea, Russia and China were happy to accept that language, because it left open the question of when the DPRK would receive the nuclear reactor. To break the impasse, Secretary Rice suggested that each country would issue separate statements describing their understanding of the deal with a qualifier that provision of a LWR is not in the agreement itself. The ROK and Japan went along with the idea, though Seoul complained that it would “sour the atmosphere.” Russia and China issued vague statements that left the sequence of events unclear.8

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Overall, both President Bush and Chairman Kim Jong Il benefited by finally approving the joint agreement. The DPRK took a major step toward securing international acceptance. It will allow Chairman Kim to hang on to power for the foreseeable future and will gradually open North Korea to foreign investment and avoid its sudden collapse. One long-term incentive in the joint statement was the call for the United States and Japan to take steps to normalize relations with North Korea if the DPRK dismantles its weapons programs. Such a historic rapprochement could mean billions of dollars worth of economic assistance from Japan alone in belated World War II-era reparations. For President Bush, the agreement was welcome at a time when the war in Iraq has lost considerable support at home and negotiations with Iran over its nuclear programs have gone astray. In addition, the president’s approval ratings were low in the wake of his administration’s slow response to Hurricane Katrina.

Several controversial issues would need to be resolved at the forthcoming six-party talks. First, the United States urged North Korea to issue a declaration of its nuclear weapons, materials, and facilities so that proper verification procedures can be devised. This request could be controversial because the United States wanted the declaration to include Pyongyang’s uranium-enrichment program. Second, the U.S. and the DPRK will likely disagree with the proper sequencing for issues in the joint statement. The United States wanted North Korea to fulfill its denuclearization commitments before providing any benefits. By contrast, the DPRK maintained that all issues “should be resolved on the basis of simultaneous actions.” Third, the six nations need to agree on verification procedures and the timing of LWR provision.

**THE FIRST PHASE OF THE FIFTH ROUND OF SIX-PARTY TALKS**

The first phase of the fifth round of six party talks was held on November 9-11, 2005, to implement a plan for the verifiable denuclearization of the Korean peninsula in the 9.19 joint agreement
among the six parties. The question is how to implement the agreement. Article 5 of the agreement states the six—parties will take coordinated steps to implement the agreement in a phased manner in line with the principle of "commitment for commitment, action for action." The negotiation process may be long and occasionally frustrating, and will require enduring patience.

During the three—day discussions in Beijing, the parties presented their positions on implementation plans at the general session. A three—point plan to resolve the North Korean nuclear dispute was put forward on the opening day of the fifth round of six party talks; the three categories comprised: the dismantling of North Korea’s nuclear program, economic cooperation and energy aid for North Korea, and the normalization of relations between North Korea and the U.S. and Japan. The United States and Japan issued similar road maps and said the talks should be broken down into working—level groups to discuss the three categories. It was unclear if North Korea would accept the proposals.

Chief ROK negotiator Song Min—soon told reporters in Beijing that North Korea did not single out the issues one—by—one but came up with a rudimentary opinion about the issue of a light—water nuclear reactor and the process of dismantling the nuclear program.

President George W. Bush during his trip to Brazil called the North Korean leader a “tyrant” again. North Korea’s human rights issue, which was omitted in the joint statement, may become a hot topic. Washington’s hardliners have been openly disapproving of U.S. chief negotiator Christopher Hill’s flexible approach to the North, which led to the fallout of his initial plan to visit Pyongyang before the fifth round of the talks.

The DPRK will face many difficulties in the future, chief among these is likely to be the human rights issue, one of the key agendas of the Bush administration, and which may well become one of the largest stumbling blocks for the future negotiations, along with Japan’s call for North Korea to modify the kidnapping case prior to normalizing diplomatic relations between the two. The Japanese government claimed that the North kidnapped in the 1980s 15 Japanese to train
them as spies, while the North insisted that it kidnapped 13 Japanese, of which eight of them have died. North Korea sent five of them back to Japan. Japan demanded the North provide more specific data of the eight deceased claiming that the remains sent by the North could be bogus.

THE U.S. FINANCIAL SANCTIONS AS MAJOR OBSTACLE TO RESUMING THE SECOND PHASE OF THE FIFTH ROUND OF SIX-PARTY TALKS

The six-party nuclear talks have come to a deadlock since North Korea demanded that the U.S. lift its financial sanctions during the first phase of the 5th round of the six-party talks in November 2005. This section will present a brief analysis of: (1) U.S. financial measures influencing the negative impact on the six-party talks; (2) both U.S. and North Korean positions; and (3) a possible resolution of this issue.

Banco Delta Asia(BDA) as a “pawn” for Pyongyang

The U.S. Treasury Department in September 2005 designated Banco Delta Asia(BDA) in Macau as a financial institution of “primary money-laundering concern” under Section 311 of the Patriot Act. The U.S. claimed that BDA was a “pawn for the North Korean government to engage in corrupt financial activities through Macau.” BDA allegedly provided financial services for more than 20 years to the Democratic People’s Republic of Korea(DPRK or North Korea) and has facilitated many of its criminal activities, including circulating counterfeit U.S. currency. The U.S. has launched a large-scale operation aimed at cracking down on North Korea’s criminal activities, and claimed that nearly all counterfeit $100 bills, known as “super notes,” were believed to be produced by North Korea. The U.S. alleged that senior officials at BDA handled large cash deposits, including counterfeit US currency, supplied by North Korean officials and agreed to put the fake currency into circulation. The DPRK has allegedly produced
more than $45 million in high-quality fake $100 bills since 1989.9

In October 2005, the U.S. blacklisted eight other North Korean firms for allegedly participating in the spread of weapons of mass destruction. In mid-December, the U.S. issued a formal advisory concerning North Korea’s illegal activities and cautioned U.S. financial institutions to take steps to guard against the abuses of their financial services by North Korea. President Bush vowed to uphold U.S. law and protect the U.S. currency, and continue a crackdown on North Korea for counterfeiting U.S. dollar bills on January 26, 2005. He said, “There is no compromise.”10 Thus, the U.S. position on this issue is firm and it would seem that it is unwilling to make any compromise with North Korea.

Banco Delta Asia has frozen North Korea’s accounts. Other financial institutions have also reportedly curtailed their dealings both with the bank and North Korea. Korea Exchange Bank, controlled by U.S. equity fund Lone Star, terminated all transactions, including remittance and foreign exchange dealings with BDA and the bank was the first South Korean financial institution to join U.S.-imposed sanctions against BDA. The two Japanese banks - The Bank of Tokyo- Mitsubishi UFJ, the world’s largest bank and Mizuho Bank, Ltd. also terminated all transactions with BDA.11

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11 KEB joins sanctions against N.K. at http://www.koreaherald.co.kr/site/data/html_dir/2006/02/04/200602040008.
Changing North Korean Position after Kim’s Secret Visit to China

The DPRK has vehemently denied U.S. allegations of counterfeiting and money laundering. The DPRK has repeated that it would not return to the six-party talks unless the U.S. lifted its financial sanctions against it. The DPRK demanded an end to the U.S. crackdown on its financing activities before it would return to the six-party talks. Chairman Kim Jong Il reaffirmed his commitment to the six-party talks and again to denuclearization during his secret visit to China on January 10~18, 2006. Kim and Chinese President Hu Jintao agreed to maintain the “stand of seeking a negotiated peaceful solution” to the nuclear issue by pledging to work together to “overcome the present difficulties” at the six-party talks.\(^\text{12}\)

The long-stalled six-party nuclear talks will not serve the interests of the parties concerned, particularly the U.S. and the DPRK. For Pyongyang it would impede North Korea’s effort to revive its moribund economy with foreign investment. And for Washington, it would obstruct the U.S. effort to stop the spread of North Korean nuclear weapons. According to Kyodo News, on February 11, 2006, Chairman Kim Jong Il said his government could collapse if the United States continued to impose financial sanctions against North Korea. Kim made the remarks when Chinese President Hu Jintao asked him in Beijing in January 2006 to drop the lifting of the sanctions as a condition for North Korea to return to the stalled six-party talks.\(^\text{13}\) It appears clear that this indicated Chairman Kim’s fear of financial sanctions against North Korea by the United States.

Different Approaches to a Resolution of the Issue

DPRK position: The DPRK is willing to make a compromise with the United States. Chief U.S. delegate Christopher Hill met with


the Chinese and North Korean delegates to the six-party talks in Beijing on January 18, 2006. According to Hill, the DPRK “indicated they would be prepared to subscribe to international norms with respect to money laundering and would want to cooperate intentionally on these issues.”

A DPRK Foreign Ministry spokesman on February 9, 2006 insisted that his government did not sanction crimes enumerated by the U.S. and even suggested that individuals responsible for them would be punished. Pyongyang again denied U.S. accusations of financial crimes, calling them fabrications aimed at defaming the North Korean regime. He stressed, “North Korea opposes all sorts of illegal acts in the financial field... We will, as ever, actively join the international actions against money laundering.” This important message indicated that the DPRK is ready to make a compromise with the U.S. on the issue of counterfeiting and money laundering.

Li Gun, Director of American affairs in North Korea’s Foreign Ministry, made four requests at the March 7, 2006 meeting in New York. They included demanding that the United States lift its ‘financial sanctions,’ establish a joint U.S.–North Korean task force to examine the counterfeiting concerns, give North Korea access to the U.S. banking system, and provide North Korea with technical assistance on identifying counterfeit bills. He was reported as saying that Pyongyang would not link the U.S. financial measures with the six-party talks according to Kyodo News. He, however, said lifting of the U.S. sanctions against BDA was ‘the least condition’ for Pyongyang’s return to the six party nuclear talks. North Korea’s change in its position had raised hopes that it may be poised to return to the six-party talks.

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15 KCNA, February 9, 2006; “North Korea vows to join international anti–money laundering drive,” February 9, 2006, at http://mnin.mainichimsn.co.jp/international/asia/news/p20060209p2g00m00m0299000c.html
party talks if the U.S. would be flexible.

U.S. position: The U.S. State Department on February 10, 2006 dismissed North Korea’s denunciation of illicit financial activities as “rhetoric” and demanded Pyongyang should show action by ceasing illegal activities immediately. State Department spokesman Sean McCormack said at a daily briefing, “Well, it’s a fine rhetorical commitment, but what we would call upon is the North Korean government to cease all such activities,” and “It’s very simple. It is within the power of the North Korean government to do so.” He said on February 15, 2006, that the DPRK must show some “convincing evidence” that it had stopped counterfeiting US currency to satisfy U.S. concerns. Specifically, he said that Pyongyang must “provide evidence that the equipment and plates for the so-called supernotes had been destroyed so that concerns about further ability [to print more notes] will be reduced.” Washington is therefore waiting to see if Pyongyang will take concrete action to prove it will stop its illicit financial activities.

U.S. and DPRK officials met on March 7 in New York to discuss a U.S. financial crackdown on Pyongyang. Assistant U.S. Treasury Secretary Daniel Glaser briefed U.S. actions on Pyongyang’s illicit financial activities for Ri Gun. The U.S. quickly rejected a DPRK proposal for establishing a separate negotiation framework bilaterally with Washington to discuss its punitive measures against BDA and the allegations against North Korea. The U.S. again urged North Korea to return to the six-party talks on its nuclear weapons program. It was also reported that the U.S. urged North Korea to join the Asia-Pacific Group on Money Laundering (APG), a regional anti-money laundering organization, in order to demonstrate its commitment to prevent illicit financial activities in the future. The U.S. had clearly stated its position: the issue of North Korea’s money laundering and

20 Yonhap News, March 11, 2006
counterfeiting activities was not subject to negotiation.

The Bush administration believed that U.S. financial sanctions against North Korea had proved to be far more effective in causing a ripple effect around the world than anyone had imagined. Banks around the world have limited their dealings with North Korea. The White House gave the Treasury and Justice Departments “full authority to take additional legal and financial actions against North Korea.”

U.S. effective action against North Korea has once again energized hard-liners in the Bush administration. The U.S. appears to have adopted a new policy, “squeeze them(North Koreans), but keep the negotiations going.” The new U.S. policy is likely to invite North Korea to take similar actions, and moderates in the State Department feared that the new policy would not persuade North Korea to disarm, while also alienating Beijing and Seoul.

PROSPECTS FOR RESUMING THE SIX-PARTY TALKS

ROK National Intelligence Service(NIS) Director Kim Seung-gyu said in early February 2006 that it had no conclusive evidence that the DPRK has been counterfeiting U.S. dollars since 1998. A widening gap in U.S. and ROK strategies for dealing with the DPRK has caused disagreement between Washington and Seoul. While Washington favors a harder line, Seoul desires a “pragmatic” approach to North Korea. The ROK seems to fear that pushing the counterfeiting issue may derail the six-party process.

China said that U.S. financial sanctions against the DPRK have had a negative impact on the six party talks, stressing the need for active contacts between all parties concerned in order to promote the six-party process. In my view, China’s role in resolving this

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issue is, indeed, crucial. China has investigated the North Korean counterfeiting and money laundering issue since the issue is directly related to its interest. But it has not made any public statement regarding its findings while investigating the issue. It appears that the U.S. believes that China has accumulated clear evidence proving North Korea has been involved in counterfeiting operations. Nevertheless, China is reluctant to provide it to the U.S. government because it does not want to push North Korea to the point where there is a real danger of its system collapse. Thus, the U.S. should not expect that China would readily hand over any such evidence that it may have discovered.

THE AUTHOR’S THREE-PHASE ROADMAP FOR IMPLEMENTING THE 9.19 JOINT STATEMENT

The six parties will discuss how to implement the Sept. 19 joint statement by deciding who will be responsible for taking what measures and exactly when they will be taken. There are two methods—line-up and subject-based—that will be discussed at the next six party talks. The line-up method would be to put the issues surrounding nuclear dismantlement and all the compensations in one frame and then proceed to collate them based on the time frame. This would mean that the first step in the dismantlement process would be North Korea’s full report on all of its nuclear programs, and the last step being actual “dismantlement and verification.” In between these two ends, the parties would negotiate which of the compensations like energy aid and normalization of relations would go in where.

The subject-based method could be to divide up the contents of the 9.19 joint statement into different subjects, for instance, forming working-level talks based on each separate field like nuclear dismantlement, energy compensation, normalization of relations between North Korea and the United States and Japan, and establishing a peaceful regime on the Korean peninsula.

It is most likely that both methods would be considered at the six party talks in order to draw up a roadmap for implementing the
9.19 joint statement. The ROK unofficially prefers approaching the negotiations on the basis of the line-up method, as it is steadfast in its goal of reaching nuclear dismantlement. But it is also open to other methods as long as all six participants agree to them. The United States has been reportedly leaning towards the line-up method recently, in contrast to its previous hints that it may want to discuss the implementation of the dismantlement process by categories. The United States may be aware that negotiating based on categories may work to the advantage of North Korea, the sources said. North Korea has not specifically shown its preference, but China reportedly favors dealing with the issue through a subject-based method.

Policy Recommendations

Whichever of the two methods is adopted at the second round of the 5th six party talks, it is clear that the six parties need to draw up a roadmap for implementing the goals and principles contained in the 9.19 joint statement. Thus, the author would like to propose a three-phase roadmap for achieving verifiable denuclearization on the Korean peninsula.

Phase 1: Preparation for dismantlement of North Korea’s nuclear programs

The DPRK should make a complete declaration of all its nuclear programs and freeze all nuclear activities in order to make preparations for dismantling all nuclear weapons and existing nuclear programs. It is reasonable for the DPRK to first renounce its enriched uranium program since it has denied the existence of it in the first place. Thus, North Korea can declare that it will not continue with its enriched uranium program in the future. If North Korea simply renounces its enriched uranium in a verifiable manner, the other five nations would in return supply heavy fuel oil to North Korea. With the supply of the fuel oil, the DPRK would again join the NPT and invite IAEA’s special inspections of its nuclear programs. The other five nations should discuss providing North Korea with economic
assistance in the future and also address the LWR issue. The ROK should play its part by discussing the supply of electricity to the North. The six parties should also discuss and agree to verification procedures. These measures should be simultaneously taken.

Phase 2: Actual Dismantlement of Nuclear Weapons and Facilities

The DPRK should implement the agreement on dismantlement of nuclear weapons and nuclear facilities in a phased manner. The IAEA should inspect and verify nuclear dismantlement and North Korea’s past nuclear activities.

The five nations and the DPRK must agree on a new construction of a LWR or the resumption of the suspended KEDO project at Sinpo under a new arrangement. Furthermore, the five parties should provide written security guarantees to the DPRK. At the same time, US–DPRK normalization and DPRK–Japan normalization talks should proceed.

Phase 3: The End of Nuclear Dismantlement /Conclusion of the “Six-Party’s Korean Peninsula Denuclearization Guarantee Agreement”

During the third phase, there will be the end of nuclear dismantlement in North Korea, and the six parties should conclude a six-party non-nuclear guarantee agreement that should contain institutional and legal arrangements for enforcement measures to ensure the denuclearization of the Korean peninsula. The six participants must draw up a multilateral nuclear agreement in which North Korea would completely dismantle its nuclear programs in exchange for multilateral security guarantees and economic cooperation. This agreement should be registered with the United Nations Secretariat. The construction of LWR should be under way, and massive economic assistance to North Korea will also be under way at this time, while US–DPRK and Japan–DPRK normalization agreements will be signed during this phase. (See Table 1)
\textit{Table 1}  Three-phase roadmap for denuclearization of Korean peninsula

<table>
<thead>
<tr>
<th>Concerned Parties</th>
<th>North Korea (NK)</th>
<th>International Community (5 Parties + )</th>
</tr>
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</table>
| **1st Phase:** preparation phase | • Abandoning of all nuclear weapons/existing nuclear programs  
• Discontinuance of and Freeze on all nuclear facilities  
• Return to NPT/ IAEA inspections  
• Renunciation of HEU | • Fuel oil supply to NK(5 parties)  
• Economic aid to NK discussed  
• South Korea’s supply of electricity to NK discussed  
• LWR provision discussed  
• Verification procedures agreed |
| **2nd Phase:** NK dismantlement of nuclear weapons and facilities | • Implementation of nuclear dismantlement  
• IAEA inspections of nuclear facilities  
• NK’s agreement on IAEA inspections on its past nuclear activities | • Resumption of suspended LWR or new construction of LWR  
• Written security guarantees by 5 Parties  
• NK—US, NK—Japan normalization talks began |
| **3rd Phase:** End of NK dismantlement/ Conclusion of Six-Party’s Guarantee Agreement on Korean peninsula denuclearization | • End of nuclear dismantlement  
• Conclusion of a non-nuclear guarantee agreement among the six parties  
• 2nd Inter-Korean Summit meeting prepared | • LWR nuclear reactor construction began  
• Promise of grand economic assistance program to NK  
• U.S.—NK, Japan—NK normalization agreement signed  
• Joint Korean peninsula denuclearization agreement registered with UN Secretariat |
In the final analysis, there will be a long and rough road ahead to a peaceful resolution of the North Korean nuclear issue. The U.S. and the DPRK should continue to cooperate through compromise and concessions in order to achieve the verifiable denuclearization of the Korean peninsula.

The Bush administration now plans to ask North Korea to begin disclosing the extent and locations of its secret nuclear development programs to test the sincerity of DPRK’s commitment to abandon its nuclear ambitions.24 The U.S. wants the DPRK to make a complete declaration about its nuclear programs, including HEU and nuclear weapons. The 9.19 Beijing agreement seemed a major breakthrough after two years of deadlock, but it left too much open to different interpretation. The DPRK reiterated that it would not rejoin the NPT or allow international nuclear inspections until it received a light water nuclear reactor from the United States, while Washington equally insisted that all nuclear weapons and related programs should be dismantled first. This disagreement may once again be a key obstacle to the second round of the 5th round of six-party talks.

CONCLUDING REMARKS

Chairman Kim Jong Il must make a bold decision to return to the six-party talks. He committed himself again to the denuclearization of the Korean peninsula during his secret visit to China in January 2006. Kim and Chinese President Hu Jintao agreed to maintain the “stand of seeking a negotiated peaceful solution” to the nuclear issue. Nevertheless, the long delay in resuming the six-party nuclear talks is not serving the interests of the six parties concerned, particularly the U.S. and the DPRK. Chinese Foreign Ministry representative Liu Jianchao said that U.S. financial sanctions against the DPRK have had a negative impact on the six party talks, stressing the need for active contacts between all parties concerned in order to promote

the six–party process. The major obstacle to restarting the six–
party talks would therefore seem to be U.S. financial sanctions against
North Korea.

What can and should be done to resolve the counterfeiting issue?
The U.S. and the DPRK need to reach a “political” compromise
through which both can save face. Hard–line policies from either
side are only likely to make matters worse; without making mutual
concessions there is unlikely to be a resolution of the issue. Thus,
the DPRK should take the initiative in seeking a solution to the
impasse, just as it admitted that it had previously abducted Japanese
citizens. The DPRK should simply admit to engaging in money
laundering and provide assurances that it will cease these illicit
activities forthwith, in return for Washington’s lifting of the financial
sanctions imposed against it. Should Pyongyang decide to atone for
its past wrongdoing and take remedial measures, Washington should
reciprocate by lifting its financial sanctions. These actions would
need to be simultaneously taken by both sides. Given such a positive
scenario, then there is every likelihood that the deadlocked six–
party talks could be resumed and a roadmap for implementing the
denuclearization of the Korean Peninsula successfully drawn up.

February 14, 2006.
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SEARCH FOR A PEACE COMMUNITY: REGIONAL COOPERATION IN NORTHEAST ASIA

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ABSTRACT

A peace community is the ultimate goal of regional cooperation in Northeast Asia. However, a peace community cannot be accomplished in one move and will only be achieved step by step over the long-term. At present, Northeast Asia is only at the stage of regional cooperation, which it is hoped will lay the foundation for an eventual peace community. This paper examines the current situation and the elements affecting regional cooperation in Northeast Asia, points out that APEC can play an exemplary role in Northeast Asian cooperation, and analyzes China’s perspective and attitude towards this region’s cooperation.

Key Words: peace community, regional cooperation, APEC’s role, China’s perspective

INTRODUCTION

There are two views on the precise expanse of Northeast Asia: one is a broad perspective in that it includes China, Japan, the Republic of Korea(ROK), the Democratic People’s Republic of Korea(DPRK), Mongolia, and Russia; and the other is a much narrower perspective in that it only includes Northeast China and North China,

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Japan, the ROK, the DPRK, Mongolia, and the Eastern area of Russia. Comparing the two views, it would seem that the former is more widely accepted nowadays.

The location of Northeast Asia is strategically important. It wedges westward into the heartland of the Eurasia Continent, borders northward on the Arctic Ocean, and occupies eastward the island chains of the western Pacific Ocean. It not only occupies the main part of the Asian continent, but it also has a lot of marginal seas, peninsulas, islands, and straits. Northeast Asia is the key to Asia’s security and economic development.

Northeast Asian countries were in a divided situation between either the Western or Communist spheres of influence caused by the pattern of bipolarity during the period of the Cold War. With the interior changes that transpired in the two blocs, the conditions in this region became even more complicated from the mid-1960s, which made Northeast Asia one of the regions in the world where there were many contradictions and conflicting interests. There was little in the way of cooperation, still less a peace community in this situation.

Regional cooperation in Northeast Asia began to take hold after the end of the Cold War due to a number of factors. Firstly, the improvement of international relations in Northeast Asia has laid the foundation for cooperation in this region. Peace and development are not only the topics of the era, but are also of key importance to relations among countries. Secondly, economic interests have become the interior motives of regional cooperation in Northeast Asia. Driven by economic interests, Northeast Asian countries have enhanced regional cooperation to develop their economies.

Regional cooperation is different from regional order that is compulsorily established with military strength; in contrast to regional order, regional cooperation is built on the basis of common participation, common development and common security. Regional cooperation in Northeast Asia should be pluralistic and multi-leveled; the pressing matter of the moment is how to establish cooperation and consultation mechanisms in the region.

The ultimate goal of regional cooperation in Northeast Asia is the
establishment of a peace community. A peace community, as the term suggests, is a group of people living in one place who have shared interests in peace. So a peace community in Northeast Asia means that this group of countries all have a common interest in ensuring peace and security in the region. There are, however two issues that need to be resolved concerning the founding of a Northeast Asian peace community: one is exactly who should be the participants. This paper considers that all of the Northeast Asian countries: China, Japan, the ROK, the DPRK, Mongolia, and Russia should be the participants of a future peace community in the region; the other issue is precisely to what extent would any such peace community have shared interests in peace. This involves the goal of the community, which undoubtedly would be lasting peace and stability in Northeast Asia. However, such a peace community cannot be accomplished in one move, and will only be achieved step by step over the long-term. This paper considers that the goal of Northeast Asia’s peace community in the short-term should be the establishment of regional cooperation and consultation mechanisms, while the goal in the medium-term should be the transition toward regional integration. At present, Northeast Asia is only at the stage of regional cooperation, which it is hoped will eventually lay the foundation for a peace community.

**CURRENT SITUATION OF REGIONAL COOPERATION IN NORTHEAST ASIA**

Northeast Asia’s security situation has been relatively stable in recent years, which has deepened economic interdependence, and increased the possibility of peacefully settling the current disputes between Northeast Asian countries. There are already several cooperation dialogues in place in the region.

The first one is the Six-Party Talks, which were convened for the purpose of resolving the nuclear crisis involving North Korea. The Korean Peninsula is the last place in the world where the Cold War still has not ended. The relations between the DPRK and the United States have always been tense, though the relations between
the DPRK and the ROK have improved considerably in recent years. In terms of the recent past, there was a second nuclear crisis involving North Korea in October 2002. To resolve this crisis, there were Four-Party Talks in April 2003 and two rounds of Six-Party Talks in October 2003 and March 2004 respectively; all of the talks up to now have been held in Beijing. These talks have started the process of resolving the North Korea nuclear issue through dialogue.

The second one is the summit conference of Chinese, Japanese, and South Korean leaders within the framework of the ASEAN plus Three. China, Japan, and South Korea are important countries in not only Northeast Asia, but also in terms of East Asia. Dialogue and consultation among the three countries within the framework of ASEAN plus Three have helped to promote both mutually beneficial cooperation among the three countries and contributed towards the development of regional cooperation in Northeast Asia. Encouraged by the first summit conference of the leaders of China, Japan, and South Korea, held in 1997, trilateral cooperation has gradually extended since then. The three countries' leaders expressed jointly in the summit conference held in 2002 that they would further deepen their cooperation in order to facilitate prosperity and stability based upon mutual trust, and push trilateral cooperation forward on a wide range of issues. The leaders of three countries exchanged their views on the situation on the Korean Peninsula in this summit conference, too. Following a proposal by Chinese Premier Wen Jiabao, China, Japan, and South Korea signed a joint declaration for trilateral cooperation during the summit conference held in 2003, which was the first formal document outlining trilateral cooperation issued by the leaders of their respective countries, and sets the basic framework and future direction for trilateral cooperation. China, Japan, and South Korea agreed in December 2003 to establish a trilateral committee led by the three countries' Ministers of Foreign Affairs, whose task is the researching, planning, and surveying of the prospects for trilateral cooperation in various fields as well as substantiating trilateral cooperation content. What is significant here is that regular meetings between the three countries' leaders have led to trilateral cooperation being carried out at the highest level. Annual summit
conferences of the three countries’ leaders and their ongoing trilateral cooperation will act as a driving force for regional cooperation in Northeast Asia.

The third one is the Northeast Asia Cooperation Dialogue (NEACD), which is an unofficial security dialogue, aimed at ensuring lasting regional stability. Both the Institute of Global Conflict and Cooperation, University of California, San Diego and the Institute of International Affairs, Japan are co-sponsors of the NEACD. NEACD’s participants come from America, China, South Korea, Japan, and Russia, while North Korea’s participants have been present since 2002.¹ The agenda of NEACD includes regional security policy, anti-terrorist measures, the situation on the Korean Peninsula, and the U.S.–Japan alliance, etc. All participants have freely exchanged their views, and emphasized how to establish the relations of mutual cooperation in Northeast Asia. Hopefully, multilateral mechanisms like the NEACD can contribute to promote mutual trust and confidence building in Northeast Asia, which over the long-term would become the foundation of peace and stability in this region.

However, there are still some outstanding and somewhat controversial issues that need resolving between countries in the region, such as disputes over territories, boundaries, and coastlines in Northeast Asia, as well as a lack of mutual understanding and trust on the part of some; all factors which hamper the further development of regional cooperation.

The Elements Affecting Regional Cooperation in Northeast Asia

It is undoubtedly true that regional cooperation in Northeast Asia has developed in recent years, nevertheless, there are many elements affecting further development since regional cooperation in Northeast Asia started later than it did in other regions in the world.

The first of these elements is the impact of geopolitics upon Northeast Asia. Northeast Asia is still one of the regions in the world that is blighted with the legacy of the Cold War, which can be seen

by the way in which its aftermath has impacted on the development of international relations in Northeast Asia. A Cold War mentality still persists in this region to this day, even though the Cold War officially ended more than a decade and a half ago. There are a number of issues left over from the Cold War hindering regional cooperation including: differences in state systems, disputes over territory, problems of national unification, and the United States–Japan military alliance to cite just a few.

The second is that there are differences in social systems and ideologies among Northeast Asian countries as mentioned above, which have brought about mutual suspicion and mistrust, and which contribute to creating barriers preventing full regional cooperation in Northeast Asia.

The third is that the region lacks a multilateral consultation mechanism to help further an integrated approach to cooperation. Northeast Asian countries have been aware of the importance of regional cooperation; however, they have differed both in their attitudes on how to achieve it and on the extent of their participation. This situation has resulted in the lack of a multilateral consultation mechanism which can provide an overall framework for regional cooperation, a factor which has prevented multilateral cooperation from moving forward.

The fourth is that there remain huge military forces in Northeast Asia today. The United States’ troops stationed in the Asia–Pacific area are mainly quartered in Northeast Asia. The two sides on the Korean Peninsula maintain powerful military forces and a state of military standoff, albeit a peaceful one for the past 50 years or so, exists between them. The Japan Self–Defense Force has already gone beyond the limits of its own country by being deployed in Iraq on nation–rebuilding activities, while the U.S.–Japan military alliance has been further developed in recent years.

The fifth is that there are several disputes over territory and the division of ocean rights and interests in Northeast Asia, which have given rise to bitter controversies between countries and adversely influenced the region’s peace and stability.

The sixth is America’s influence on Northeast Asia, which is
currently. Northeast Asia is a region where the interests of the major powers are not only intricate but also inextricably linked; probably many would argue that American influence in the region is the most widespread. While not being a Northeast Asian country by geography, the United States has played and plays a significant role in this region, and is deeply involved in the affairs of Northeast Asia. One cannot ignore the American element when discussing regional cooperation in Northeast Asia. The U.S. has military alliances with Japan and the ROK respectively, stations its troops in these countries, and is also a main participant in the Six-Party Talks. The relations between every country in the region and the United States are closer than even the relations among neighboring Northeast Asian countries, which makes some Northeast Asian countries prefer bilateral arrangements to multilateral ones. As currently the only remaining superpower in the world, The United States' strategic goal is to establish and maintain its regional dominance and it doesn't allow any situation to arise that would challenge its strategic interests and strategic position in Northeast Asia. America may well be afraid that the development of a multilateral cooperation mechanism in Northeast Asia would undermine the bilateral military alliances that it has established in the region, thereby thwarting its strategic aim of establishing a security cooperation mechanism centered around those key alliances.

The seventh is Japan's relations with its neighboring countries, especially with China and South Korea. Recent tensions between China and Japan and between South Korea and Japan respectively have threatened to undermine regional cooperation, since territorial disputes have been inflamed and friction over Japanese history textbooks has been renewed. Especially, there are two important obstacles to improving Sino-Japan relations: one is an issue of security, while the other is one of history. China's main concerns regarding the security issue is not that Japan would return to militarism and directly threaten China, but that augmentation of Japanese military strength would possibly destabilize regional relations. Therefore, this issue is not one that can be resolved by China and Japan alone, but more importantly by improving regional relations in Northeast
Asia. As for the history issue, China thinks that Japan cannot deny the war crimes that it committed during the Second World War, and consequently it should sincerely apologize to all victimized countries and peoples for its war crimes; otherwise, failure to do so would lead to deteriorating relations between Japan and its neighbors.

APEC’S EXEMPLARY ROLE IN REGIONAL COOPERATION IN NORTHEAST ASIA

APEC has been focusing on the promotion of trade and investment liberalization, together with economic and technological cooperation since it was founded, and has not covered issues pertaining to regional security, even though there were several suggestions to discuss security issues before the financial crisis broke out in 1997. Since the terrorist attacks of September 11, however, APEC has signaled its intention of keeping up with the times by openly discussing security issues, looking at ways of combating terrorism through international cooperation, and so on.

APEC has established a cooperative approach that has been accepted by all members, which is called the APEC Way. It conforms well politically, economically, and culturally to the diversity in the Asia-Pacific region. The main characteristics of the APEC Way are as follows: acknowledging diversity; emphasizing flexibility and gradualness; observing the principles of respect, equality and mutual benefit for each other; reaching unanimity through consultation; respecting rights of self-determination and autonomy, and so forth. To avoid the restraints of autocratic institutionalization and compulsion, APEC has emphasized consultation instead of negotiation, promise instead of agreement, and promoted common development and prosperity.

The APEC Way is well coordinated with the interests and requirements of both developed and developing members, accommodating the different capabilities of APEC members, and encouraging each member to make a contribution towards furthering regional cooperation. It is felt that the APEC Way can play an exemplary role in developing regional cooperation in Northeast Asia.

All of APEC’s members, big or small, are considered equal, and
respect each other in the process of discussion and consultation. Since there are different views, capabilities, and requirements for each APEC member, this approach helps to nurture a climate of mutual understanding helping to promote cooperation and constructive dialogue. APEC’s success can be attributed to the fact that decision-making is by member consensus, and it is not something which is carried out unilaterally by a big member. Northeast Asian countries should follow this principle in regional cooperation, because there are significant economic, political and cultural differences between them. Otherwise, little in the way of real progress can be made in the arena of Northeast Asian cooperation.

The principles of both respecting diversity and flexibility are also significant factors that have helped to ensure APEC’s success to date. There are different political systems, different levels of economic development, different ideologies, and so on prevalent throughout Northeast Asia. To acknowledge diversity means to allow all Northeast Asian countries to coexist peacefully regardless of their differences, which is helpful in fostering an atmosphere of mutual trust in the region; the principle of flexibility can encourage them to fully respect diversity, mobilize their enthusiasm for regional cooperation, help lay the foundation for stability and solidarity and avoid unnecessary complaints and disputes among them.

APEC’s principle of gradualness can allow Northeast Asian countries more time to adapt their policies to an environment of regional cooperation, while at the same time guaranteeing each member’s domestic stability throughout this process of adjustment.

Naturally, every APEC member has its own interests to consider first, which of course at times might clash with some of the other members’ requirements or propositions and work against the overall objective of regional cooperation. This is equally true for each individual Northeast Asian country. By reaching unanimity through consultation however, APEC can seek common ground while still acknowledging and accepting the unique differences existing among Northeast Asian countries, enabling its members to solely focus on the issues that have a decisive impact on regional cooperation.

Another reason why APEC has proven to be such a vigorous
multilateral mechanism is that it has made rights and responsibilities evenly shared among its members by ensuring a mutually beneficial framework of cooperation. Therefore it can maintain a basic balance by looking after each member’s interests as there are potentially both gains and losses among Northeast Asian countries in regional cooperation.

Last but not least, is the fact that APEC has adhered to open regionalism. The same approach should also be taken by the Northeast Asian countries in any attempt to establish a peace community. In particular, the region’s members need to pay attention to the American element and should consider America’s interests in this region appropriately in view of its important role in and its close relations with Northeast Asia.

APEC has been very successful in developing a regional cooperative mechanism in harmony with the diversities and differences existing among members of the Asia-Pacific region through a series of policy decisions and initiatives. The greatest value of APEC has been its gradual evolution into the region’s foremost security forum. The long-range goal of APEC is to establish a stable, secure and prosperous community. Regional cooperation in Northeast Asia can learn much from APEC.

**CHINA’S PERSPECTIVE ON REGIONAL COOPERATION IN NORTHEAST ASIA**

China has consistently thought that the prime goal of regional cooperation in Northeast Asia should be the creation of a peaceful environment in order to benefit the region’s members and enable them to develop their economies and raise people’s living standards.

This goal is closely related to China’s policy toward Asia, which has been taking shape in recent years. The core of this policy is that China hopes to establish a new pattern of relations with Asian

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countries, which will promote dialogue and cooperation and ensure peaceful coexistence, development and cooperation among Asian countries. China is well aware that her development and security rely on regional cooperation and integration.

For this reason, it is a policy objective of China’s to vigorously promote Asia’s development, rejuvenation, peace and stability. In line with this objective, China’s policy guiding its relations with its neighbors is as follows: to become a good neighbor and a good partner; to strengthen good neighborly ties; to intensify regional cooperation; and to elevate China’s exchanges and cooperation with its neighbors to a new high. Building an amicable, tranquil and prosperous neighborhood in the region is an essential component of China’s own development strategy. Premier Wen Jiabao explained this policy clearly when he made a speech at the ASEAN Business & Investment Summit on the subject of “China’s Development and Asia’s Rejuvenation” on 7 October 2003:

- To build an amicable neighborhood means adherence to the Chinese philosophy, which emphasizes benevolence, good neighborliness and harmony. Guided by the principles that all countries, big or small, are equal and that one should live amicably with its neighbors, China is ready to work together with its neighbors to foster stable and harmonious state-to-state relations in the region.

- To build a tranquil neighborhood is to actively maintain peace and stability in the region, to consistently enhance mutual trust through dialogue and cooperation, and to settle disputes through peaceful negotiations, thus creating a peaceful, tranquil and stable regional environment for Asia’s development.

- To build a prosperous neighborhood is to step up mutually beneficial cooperation with the neighboring countries, deepen regional and sub-regional cooperation, and vigorously facilitate economic integration in the region, thus achieving common development with other Asian countries.º

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Besides the general policy mentioned above of building an amicable, tranquil and prosperous neighborhood in the region, China’s particular policy toward Northeast Asia is composed of three parts: maintaining peace and stability in the region, promoting dialogue and cooperation with the countries concerned in this region, and maintaining her own stability and development. From this perspective, the Chinese government has attached importance to the following four aspects:

The first of these is to maintain peace and stability in Northeast Asia.

China has put forward the New Security Concept to achieve this goal. Former Vice Premier Qian Qichen gave a clear explanation of this New Security Concept on the occasion of the 30th anniversary meeting of the founding of ASEAN held by private sector members of ASEAN: “We should have a new security concept and a new way of maintaining peace when we summarize experiences and lessons of the past and face challenges and opportunities in the future.” Qian pointed out that it has already been proved that peace could not be maintained by the security concept held in the period of the Cold War, which was based on both military alliance and military build-up. Expanding military blocs and strengthening military alliances are also contrary to the trend of the times given the new world order. Instead, a new security concept needs to be fostered and a new way for maintaining peace needs to be sought in order to build a lasting peace.4 There are three aspects included in China’s New Security Concept as follows: Firstly, relations among countries should be established on the basis of the Five Principles of Peaceful Coexistence: mutual respect for territorial integrity and sovereignty, mutual non-aggression, non-interference in each other’s internal affairs, equality and mutual benefit, and peaceful coexistence. These provide the foundation for the political basis and premise of global and regional security. Each country has the right to choose its own social system, development strategy, and way of life, and no other

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country should interfere in the internal affairs of any other country in any way or under any pretext, much less resort to military threats or aggression. Secondly, in the economic field, all countries should strengthen mutually beneficial cooperation, open up to each other, eliminate inequalities and discriminatory policies in economic and trade relations, gradually reduce the development gaps between countries, and seek common prosperity. Such steps can form the economic basis of global and regional security. Maintaining a normal and sound economic, trade, and financial order calls for not only a perfect macro-economic management system as well as a sound system of economic operations, it also calls for strengthening regional and international economic contacts and cooperation, so as to jointly create a stable and secure external economic environment. Thirdly, all countries should promote mutual understanding and trust through dialogue and cooperation, and seek the settlement of divergences and disputes among nations through peaceful means. These are the realistic ways to guarantee peace and security. Security is mutual, and security dialogues and cooperation should be aimed at promoting trust, not at creating confrontation, still less at directing the spearhead against a third country or infringing upon the security interests of any other nation.5

The core of China’s new security concept is cooperative security, which has the following characteristics: Firstly, the form of security is one where all countries cooperate in security affairs at both regional and global levels, so that every country’s security can be safeguarded. Secondly, the content of security is one of all-round security, which means not only political and military security, but also the elements of economic development, environmental protection, and nation building, etc. are to be included. Thirdly, the method of security is one which establishes a multilateral security cooperation mechanism step by step, and places emphasis upon the non-military methods of maintaining security. Fourthly, relations among the partners participating in this security cooperative mechanism are equal, and

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each partner's internal affairs cannot be interfered with by others. In short, the concept of cooperative security conforms to the trend of the times.

China has been more and more active in regional cooperation in Northeast Asia by promoting this New Security Concept, and has advocated establishing a regional multilateral mechanism and organization in Northeast Asia. Northeast Asia's security structure, unlike other regions in the world, has unique characteristics that are a legacy of the various international treaties signed and the mechanism of bi-lateral relations formed during the period of the Cold War, which, unfortunately, has continued to exist on the Korean peninsula to this day. So China will participate actively in establishing a security cooperation mechanism and consultation mechanism in Northeast Asia, which will conform to the new world order of the Post-Cold War era.

The second is to maintain peace and stability on the Korean Peninsula.

Peace and stability on the Korean Peninsula is an issue of concern to all countries in Northeast Asia. The Korean Peninsula is located in the center of Northeast Asia, and its peace and stability is to some extent integrated with the peace and stability of Northeast Asia as a whole. Therefore, it is a common aspiration of not only the people of Korea, but also of all people in the region. It is a task of the utmost priority that Northeast Asia cooperates in security in order to maintain lasting peace and stability on the Korean Peninsula, and therefore, it needs to establish a security dialogue mechanism for handling the Korean issue. Presently, the Six-Party Talks constitute this security dialogue mechanism, the final goal of which is the establishment of a mechanism for lasting peace on the Korean Peninsula. There are, however, many difficulties with the process of Six-Party Talks. Nevertheless, as long as every party participating in the Six-Party Talks pursues the principles of treating each other as equals; seeking common ground while reserving differences; resolving easier issues first by reaching a consensus while dealing with more difficult issues afterwards; and the parties proceed in an orderly way through a step by step process, then the Six-Party Talks
have the potential to make great progress, and contribute to the peaceful unification of the Korean Peninsula and to peace and stability generally in Northeast Asia. China will, as always, play a positive and active role in the Six-Party Talks.

For China, the Korean Peninsula issue is directly related to her national interests. China’s national strategy, which is centered around economic development, needs a lasting peaceful and stable international environment, just as a peaceful, stable, unified Korean Peninsula conforms to China’s fundamental interests. This is one of the reasons why China devotes herself to resolving the Korean Peninsula issue. China has consistently held that the Korean Peninsula should be denuclearized; both the north and the south are the main parties concerned in the Korean Peninsula issue, and so the final resolution of this issue should be left to the two sides. China firmly supports any dialogue and cooperation that benefits peace and stability on the Korean Peninsula. The orientation of China’s policy in this regard is: to realize the denuclearization of the Korean Peninsula, and to peacefully resolve the DPRK’s nuclear issue; to promote the normalization of the DPRK’s relations with the United States and Japan, and to support the DPRK in joining a regional cooperation mechanism; to support the institution of a permanent peace on the Korean Peninsula.

The third is to increase economic cooperation in Northeast Asia.

Both geopolitics and geoeconomics are interconnected. Geoeconomic cooperation can be helpful in improving geopolitical relations. Northeast Asia is vast in area, and generally rich in minerals and resources, and has strong economic complementarity. There are three levels of economic development in the region: Japan is the first level; South Korea and China are the second level; and North Korea, Mongolia, and the Eastern area of Russia are the third level. Northeast Asia has great competitive advantage and huge development potential. The volume of Northeast Asia trade now makes up 15% of the total volume of world trade, while the total GNP of Japan, China, and South Korea combined accounts for 22.4% of world GNP. Closer economic cooperation in the region would deepen
interdependent relations among Northeast Asian countries and by having common economic interests would engender the sense of being in the same boat, thereby helping to reduce conflicts and disputes in the region. China supports any efforts to intensify economic cooperation in Northeast Asia, and currently is interested in the creation of a China–Japan–South Korea Free Trade Area.

The fourth is to develop friendly relations with every Northeast Asian country based upon the Five Principles of Peaceful Coexistence. China hopes to become a good neighbor and a good partner with other Northeast Asian countries, too, and will therefore continue to develop traditionally friendly relations with the Democratic People’s Republic of Korea and Mongolia; to further develop its cooperative partnership with the Republic of Korea, to develop friendly relations with Japan, and to develop a strategic coordinative partnership with Russia.

In addition, the United States has a traditional influence and interests in East Asia, which have evolved over time and remain objective realities today.⁶ China hopes to develop constructive and cooperative relations with America and jointly to focus on security cooperation in Northeast Asia.

**TOWRD A PEACE COMMUNITY: PROSPECTS FOR THE FUTURE**

The foundation of a peace community in Northeast Asia must be accompanied with comprehensive cooperation in the region, which is not only pluralistic and multi-leveled, but also political, economic, and cultural.

For political cooperation to take hold in Northeast Asia, some

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of the major controversial historical issues first need to be resolved, together with the establishment of a regional security mechanism in the region. The Six-Party Talks could ultimately evolve into a future Northeast Asia security forum, which would be permanent and institutionalized, and focus on the creation and maintenance of a peace community in the region.

In other possible developments, the DPRK and the ROK could increase cooperation between them over the issue of the Korean Peninsula’s peace and unification, and finally reach a framework agreement of peaceful unification, which would take the Korean Peninsula’s unification movement forward into a new stage. China and Russia could also play a constructive role in the settlement of the Korean Peninsula issue. If the two countries wish their relations to develop further, then Japan and Russia need to sign a peaceful agreement to resolve their territorial dispute over the Four Northern Islands(also known as The Northern Territories). There would probably have to be bilateral and multilateral political consultations to resolve disputes such as the dispute over Diaoyu Island between China and Japan, the dispute over Du(Zhu) Island between South Korea and Japan, and various other disputes over coastlines, etc. To maintain peace in Northeast Asia, while at the same time settling the problems left over by history, Northeast Asian countries need to make joint efforts to explore ways to establish a balanced and stabilized regional security mechanism.

For wider economic cooperation in Northeast Asia, the scope and extent of regional cooperation would need to be wider. The content of regional cooperation in Northeast Asia includes productive cooperation, technical cooperation, financial cooperation, and environmental conservation cooperation, etc. The goal of regional cooperation in Northeast Asia is regional economic integration through trade and investment liberalization.

Cultural exchange in Northeast Asia has already taken hold to a certain extent, as can be witnessed by the ongoing cultural exchange between South Korea and Japan in terms of music, movies and television dramas. Further cultural exchange would not only enhance understanding and trust among countries, but also promote the
development of political and economic cooperation.

It is a common responsibility for all countries in Northeast Asia to explore ways to establish a regional cooperation mechanism and framework. The Five Principles of Peaceful Coexistence should be the basic principles of regional cooperation in Northeast Asia, the final goal of which is the foundation of a peace community in Northeast Asia.

While every country in Northeast Asia should make efforts to accomplish the goal of a peace community, both China and the ROK should shoulder more responsibilities since Sino-ROK relations are a crucial link in the chain of multilateral relations in Northeast Asia, and therefore are vital to promoting and strengthening peace and security in the region. The development of relations between China and the Republic of Korea will therefore play a positive role in the foundation of an eventual peace community in Northeast Asia.
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ENHANCING AMERICA’S ALLIANCES IN A CHANGING ASIA-PACIFIC: THE CASE OF JAPAN AND AUSTRALIA

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ABSTRACT

It has long been thought that the US alliance system provides the security guarantee which has stabilised the Asia-Pacific. In recent years the two anchors of the system, the alliances with Japan and Australia, have been enhanced. This article examines this process and considers the extent to which these moves have increased security and stability in one of the most important regions in the international system. The first and second parts of the article assess the contemporary state of each alliance and overview the ways in which they have been enhanced in recent years. The third considers the impact of these changes on regional order in the Asia-Pacific. The article concludes that it is the way in which the alliances are being enhanced which casts serious doubt on their ability to provide assurances to the region. The article argues that it is far from clear that the current trajectory of US policy in the region, and that of its allies, is going to be appropriate to the circumstances of the Asia-Pacific in the 21st century.

Key Words: Asia-Pacific, regional order, security, US alliance system

AMERICA’S ASIA-PACIFIC

For many in the region and beyond, it has long been an article of faith that the forward projection of American military force, and
its political framework—the series of bilateral alliances and security agreements the US has with a range of key states—has been vital to the strategic stability of the Asia-Pacific. In spite of being home to two of the world’s most volatile geopolitical disputes (Korea and Taiwan), the Asia-Pacific has avoided major inter-state conflict for more than 25 years. There is a clear consensus, both within the region and beyond, that this is primarily because of the American presence (Sutter, 2002; Tow and Stuart 1995). Among a diverse political, economic, social and geographic landscape, in which there is more distrust than amity, America has been the most important stabilising force. Erstwhile Singaporean PM Lee Kuan Yew pithily described the US as ‘the least distrusted power’ in the region (Buckley 2002). It was precisely this, along with its massive preponderance of military power which kept the PRC, the DPRK and the Soviet Union in check through the latter phases of the Cold War and beyond.

While not utterly unproblematic (we can never really know why something did not happen), the orthodox account is reasonably compelling and was undoubtedly accepted as such by many key powers in the region. Certainly, ASEAN states, as well as Japan and South Korea, were deeply concerned when the US appeared to flirt with isolationism in the early 1990s. To assuage these fears the US released the 1995 and 1998 Nye Reports setting out the strategic rationale for continuing to project force in a Cold War fashion in a post—Cold War Asia—Pacific (Department of Defence 1998).

In the past seven years or so the strategic environment in the region, and in the international system, has changed considerably. Elements such as the economic and military rise of the PRC, the continuing predominance of the US fuelled by its explosive economic growth between 1996 and 2001, the coming to power in the US of a more assertive and militarily minded administration, the attacks of September 11, the intervention in Iraq and the proliferation of nuclear weapons are only some of the more significant aspects of these changes. In response to these changing circumstances, and particularly in reaction to the challenges made evident by September 11, as well as to technological developments and the preferences of key policy-makers, the US is beginning to reorganise its global strategic posture
and doctrine. While we have yet to see how this will be fully operationalised, a number of things are clear already. First, the US is to move away from its ‘twowar’ policy whereby its military deployments and acquisitions were intended to be able to fight two conventional wars at the same time. Second, it is going to adopt a lighter and more agile strategic posture. Although we do not have the precise details, it is reasonably clear that the global deployment of high numbers of troops in foreign lands is unlikely to last. Under these conditions it is hard to envisage an indefinite continuation of a Cold War style deployment in the Asia-Pacific. In military terms, the US intends to continue to be able to wield a similar level of force globally (and in the Asia-Pacific) but do so with a ‘smaller footprint’.

Any significant restructuring or reorganisation of America’s strategic posture will involve a commensurate amendment to the political framework within which these policies operate, for they reflect a change in US political aims. In the Asia-Pacific, the political dimension of American grand strategy has been, and continues to be, its series of bilateral alliances and security agreements. The Japan-US alliance is without doubt the most important, but the alliances with Korea and Australia are of considerable weight as well. The curious fact of American power in the region is that, in spite of the reconfiguration of the geopolitical and geoeconomic map that has occurred since the early 1980s, and which has accelerated since 1991, the bilateral alliance framework is still deemed to be the most appropriate policy approach by US planners. Although the broad approach—the self-styled ‘hub and spokes’—is being maintained there have been some subtle yet significant developments. Although not the focus of this article, the US-ROK relationship is faring poorly; it is not beyond repair, but relations are at a low ebb and show no meaningful sign of improvement in the short term. On the other hand, both the alliance with Australia and with Japan have been strengthened in recent years. In Koizumi’s Japan and Howard’s Australia, George Bush has two enthusiastic partners and two popular

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1 For an overview see: http://www.defense.gov/transformation/about_transformation.html.
political leaders who share the American view both of their own respective roles and of the broader American strategic presence in the Asia–Pacific and beyond.

During the Cold War, Australia and Japan were seen as strategic anchors of America’s bilateral alliance system whose purpose was to contain and ultimately defeat the perceived communist menace. Clearly, Japan was the more important relationship, although Australia’s proximity to the troublesome region of Southeast Asia, its loyalty plus the advantages for satellite communications of its location gave it added heft. The alliance system has survived beyond its Cold War origins and, in Japan and Australia, is undergoing considerable enhancement. Given this, can one say that these alliances still anchor an American Asia–Pacific? More importantly, do they enhance the broader stability and security of the Asia–Pacific?

The purpose of this article is to consider these developments in the context of Asia–Pacific regional order. The buttressing of these two relationships, occurring as it does at a time of ever–rising Chinese confidence and military spending, and given that it involves a decisively more muscular approach to defence and security policy in Japan, is a significant development in the international relations of the Asia–Pacific and in world politics more generally. The statement made following the ministerial level US–Japan Security Consultative Committee meeting in Washington in February 2005 makes clear how this is viewed on both sides of the Pacific: ‘the US–Japan Alliance, with the US–Japan security arrangements at its core, continues to play a vital role in ensuring the security and prosperity of both the United States and Japan, as well as in enhancing regional and global peace and stability’ (Department of State 2005). In essence this article critically examines this proposition and asks whether the strengthening of America’s alliances with Japan and Australia increase regional stability and security. The article is in three parts. The first and second provide an assessment of the contemporary state of each alliance and an overview of the ways in which they have been enhanced in recent years. The third considers

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2 Italics added.
the impact of these changes on regional order in the Asia-Pacific. The conclusion reached is that the underlying proposition is not unreasonable, but it is the way in which the alliances are being enhanced which casts serious doubt on their ability to provide assurances to the region. In short, it is far from clear that the current trajectory of US policy in the region, and that of its allies, is going to be appropriate to the circumstances of the Asia-Pacific in the 21st century.

THE CONTEMPORARY CHARACTER OF THE US-JAPAN ALLIANCE

The US–Japan alliance has recently been described as: “the bedrock of Japan’s security and the anchor of regional stability” (Department of State 2005). During the Cold War, US–Japan security arrangements were intended both to act as the foundation for the application of containment to the region and to keep Japanese geopolitical aspirations in check. In return for defence guarantees and the extension of the American nuclear umbrella, Japan would act as the unsinkable aircraft carrier, would keep itself out of international security affairs and focus on domestic economic development.

Through the 1980s and 1990s, concerns about the future of the alliance emerged. With the cooling of super power rivalry coming as it did at the highpoint of Japan’s economic success there were perceptions in the US that Japan was an economic threat to American interests. This alongside trade frictions, concerns about technology transfers, host nation support payments, American troop behaviour and a broader lack of strategic clarity and priorities appeared to put the relationship at risk. In the closing years of the 20th century the alliance appeared, in the title of an authoritative study, adrift (Funabashi 1999).

In the four years since Koizumi Junichiro’s accession to the prime ministership uncertainty about the foundations and future direction of the alliance have been laid to rest. Strengthening the
alliance is the central plank of a broader transformation of Japanese security and defence policy. Koizumi appears intent on moving Japan away from its past attitude to security and defence matters and toward a more assertive foreign policy stance. This ultimately involves a Japan that is much more at ease with the use of military force as a means of advancing its security aims, than it has been since 1945. Of course, ever since the formation of the SDF (Self—Defence Forces) in 1954, Japan has been incrementally moving away from the pacifist principles enshrined in the post—war constitution. From the ramping up of spending under Nakasone through to the despatch of SDF forces to the UN mission in Cambodia, for a long time there has been a gentle growth in a more militarily minded approach to foreign policy. The past four years or so have marked a considerable break with this incrementalist past.

In recent years, Japan’s security and defence policy has taken a distinctly more militarised dimension (Tanter 2005; Hughes 2004). Given its centrality to the alliance enhancement, it is worth sketching key dimensions out briefly. The highest profile has, of course, been the deployment of SDF forces to Iraq and Afghanistan as part of the US—led ‘war on terror’ and Japan’s increasing willingness to deploy its military forces as part of UN PKOs. As a further part of the anti—terror efforts Japan has signed on to the Proliferation Security Initiative. In December 2004 the National Defence Programme Outline was revised along more assertive lines, including a focus on the deployment of military forces abroad (Fouse 2005a), and following this, Japan is acquiring enhanced defence capabilities and is considering changes to its security doctrine and possibly the constitution. Japan has also signed on to the American Ballistic Missile Defence programme to the consternation of many. Senior policy makers have also begun talking openly about adopting a pre—emption doctrine with regards to North Korea and debate about nuclear acquisition (although far from likely even in the medium to long term) is no longer taboo. Many point to the Coast Guard’s sinking of a North Korean ship in December 2001 and the chasing of a Chinese submarine as evidence of this new assertiveness being put into practice.

This more assertive policy has a number of aims, the most basic
of which is the enhancement of Japan’s security in the face of what is perceived to be a more complex world. The contemporary environment poses a quite different set of challenges than that which faced Japan in the Cold War and hence a shift in posture is warranted. Some argue that this shift is little more than a quiescent response to the demands of an imperial America. For example, McCormack argues that Koizumi’s policy derives from a toadyng approach to the US in which the PM is little more than a dupe desperate to please American demands (McCormack 2004). This view sees Koizumi’s nationalist gestures—such as visits to Yasukuni Shrine—as sops to a domestic constituency which might not be pleased with such fealty: they ‘are probably best seen not as a sign of a reviving nationalism but as an empty gesture to compensate for an abandoned one’ (McCormack 2005, 43). Such a view overlooks two important points. First, the political and bureaucratic elite genuinely feel that militarisation, of a limited kind, is an appropriate response to the current circumstances. Second, it overlooks the way in which enhancing Japan’s military capability within an alliance dominated by the US is the only means through which a mature Japanese nationalism can be articulated in a politically palatable fashion.

The most significant development in Japanese security policy has been the enhancement of the US–Japan alliance. From a period of wavering, when voices on both sides had competing views about purpose, strategy and funding, the alliance now has a clear purpose and a policy consensus at the political and bureaucratic levels as to its function and mutual obligations.

Japanese and American views have converged on the strategic purpose and scope of the alliance. Elites on both sides believe that the strategic environment of contemporary world politics—especially the spectre of international terrorism, the proliferation of WMD and the nasty scenario of the two combined—requires a particular response on the character of which they agree. For Japan, the alliance’s traditional aim, to provide for the security and defence of Japan, is

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supplemented by a now overtly expressed second purpose: to stabilise the Asia-Pacific. Perhaps most significantly is the recognition that to service the alliance and to secure its aims will require military action that is global in scale. The alliance is key to Japan’s security, much as it always has been, but the sources of insecurity have changed in such a way as to warrant action, in concert with the US and others, well beyond Japan’s borders. In short, the situation that Japan finds itself in means that, in the eyes of contemporary policy-makers, it needs to be more willing to use the SDF in support of its foreign and defence policy aims, to tighten the alliance and operate at a global level. From the American perspective, it finds in Koizumi’s Japan a steadfast supporter of both the aims and methods of the Bush Doctrine.

How has this shared vision led to a practical strengthening of the alliance? The rebuilding and enhancement of the alliance began with the Nye reports where the US made clear its long term commitment to the region and to continuing to structure its presence through its bilateral relationships. Following the Nye Report, the passage of the new Defence Guidelines in 1996 marked the beginning of the transformation of both the alliance and Japan’s security policy. This involved moving the focus of threat away from geography and toward a situational understanding, as well as advancing the scope of cooperation. In this Japan made an important political step which at once showed the diminution of concerns about ‘normalization’ (however minor) and its support for a more active role within the alliance (Hughes 2004, 98–105).

The recent strengthening of things involves a range of moves which are at once military and political. Perhaps the highest profile has been the Japanese involvement in the ‘war on terror’ and its consequent deployment of SDF forces to Afghanistan and, more controversially, to Iraq. The military deployment was more important as a political statement than it was an operational contribution. Beyond helping to present a multinational face to American actions (especially in the unpopular war in Iraq), in these two actions Japan made clear that it was (i) no longer going to practice chequebook diplomacy in American led operations; (ii) that it saw its security
policy requiring it to send its forces—even in a clearly circumscribed fashion—well beyond its traditional limits; and (iii) that it would take controversial military actions to enhance the alliance. In many respects, as with the UK and Australia, Japanese participation in the ‘war on terror’ is an exercise in alliance politics. Particularly with the current administration, the failure to participate in a concrete fashion would have had negative consequences for the alliance. This was not the only reason for deployment, but it was an important element. In participating in these actions Japan has nailed its colours firmly to the mast of the US global strategic posture. It is reasonable to conclude that this will not be the last time such a deployment occurs.

In the face of domestic concern about basing and the political consequences of America enhancing the operational significance of forces and command facilities on Japanese soil, the government continues to provide significant Host Nation Support for US forces. To try to ease Japanese concerns about the conduct of American troops, the two parties have recently signed a new Status of Forces agreement intended to smooth American responses to concerns about the behaviour of local troops.

The adoption of the National Defence Program Outline (NDPO) in late 2004 is a further demonstration of an enhancement to emerge from the Japanese side. While the NDPO lacks the clarity some may have wished for, nevertheless it has an unmistakable intent: it reaffirms the centrality of the alliance to Japan and to its vision of the region (an important departure from previous Outlines). More importantly, it places Japan’s security policy firmly in the hawkish camp regarding its position on both China and the DPRK and sets out Peace Keeping Operations (PKOs) and counter-terrorism as core elements of Japan’s defence posture. In more detailed terms, the Outline enhances the alliance by prioritising intelligence sharing, technology exchange and enhanced inter-operability between US and Japanese forces.4

Finally, the most contentious aspect has been Japan’s commitment to America’s Ballistic Missile Defence (BMD) programme. Japan has long shown an interest in missile defence programmes as they have

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evolved in the minds of American policy-makers and researchers, but this interest has always been highly constrained by concerns about the constitutional implications and the strategic consequences. Moreover, the technical and political dimensions have hitherto never really pressed the issue to any great significance. Through the 1990s Japan participated in joint research for a defence programme but made clear that its involvement was strictly limited to research. Under the Bush administration’s guidance, the programme has emerged as a political and strategic priority. Largely in line with the increased emphasis placed on the programme, Japanese policy-makers have warmed to the idea of deployment. On 19 December 2003 the government announced that it would acquire an ‘off-the-shelf’ system as well as continue to participate in collaborative research on BMD technology.\(^5\)

For many, this is the most important element of the alliance enhancement. Not only does it have operational elements which tie Japan ever more closely into the American military command and control system, it has significant political consequences. The decision to acquire such a BMD system increases Japan’s dependence on the US (Hughes 2004, 110–4), but it also escalates tensions with China and poses serious questions for the existing interpretation of the defensive character of Japan’s alliance role. Although the wording of the announcement sought to underline the purely defensive character of BMD technology and involvement, and specifically stressed that it did not compromise Japan’s refusal to play any role in collective self-defence, there can be no doubt that the technological aspects of the system make this stance very hard to sustain.\(^6\)

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\(^6\) Paragraphs 4 and 5 spell this out; the announcement notes, that the ‘BMD system is only and purely a defensive measure ...and meets the principle of exclusively defense-oriented national defense policy. Therefore, it is considered that this presents no threat to neighbouring countries, and does not affect regional stability...It will be operated based on Japan’s independent judgment and will not be used for the purpose of defending third countries, therefore it does not raise any problems with regard to the issue of the right of collective self-defense.’ See [www.kantei.go.jp/foreign/tyokan/2003/1219danwa_e.html](http://www.kantei.go.jp/foreign/tyokan/2003/1219danwa_e.html).
Japan is still some way from becoming a ‘normal’ alliance partner with the obligations that one expects in traditional military alliances such as NATO. Yet the past four to five years have seen a clear emboldening of Japanese policy and a decisive strengthening of the alliance relationship. The purpose of the alliance, the role and use of Japan’s military forces as part of the alliance and operational aspects have all been upgraded. That said, alliance politics have not been without their problems. A range of issues continue to dog relations and especially make the domestic politics of the alliance a more complex affair for both parties.

Trade concerns continue to niggle with recent problems involving beef, apples and automobiles.\(^7\) The SOFA issues and specifically US handling of problems deriving from force deployments are a perennial problem. In spite of the formulation of a new SOFA which was intended to be more sensitive to Japanese demands, the August 2004 helicopter crash in Ginowan and US refusal to allow Japanese police to investigate brought the issue up again. Also, there are concerns that the reorganization of US forces is going to compromise the limits of security cooperation. The other recent source of tension derives from Japan’s bid for a permanent seat at the UN Security Council (UNSC). Japan has long harboured these ambitions and the political momentum for UN reform that recently emerged has provided an opportunity to advance them. It appears that the US is opposed to any substantive change to the UNSC and looks to be acting in concert with the PRC to stymie the efforts of the G4 (India, Brazil, Germany and Japan) as well as the African Union’s proposal for admission.

These niggles aside, the alliance is in better shape than in many years and now formally embraces the idea that collective action is central not only to Japan’s defence but to the security and stability of the region. To put things in more general terms, Japan has clearly opted for an active band—wagoning strategy in the face of the security environment of the early years of the 21st century. It sees that the risks, both political and strategic, of this enhanced role and increased

\(^7\) On recent tensions generally see Glosserman (2005) and Fouse (2005b).
use of military assets are worth taking to secure its place in the region and the international system.

**THE CONTEMPORARY CHARACTER OF THE US-AUSTRALIA ALLIANCE**

Through the Cold War and beyond, the relationship between the United States and Australia has been remarkably robust. The formal military alliance cemented a relationship forged in the Pacific theatre of World War II and was founded on a common cultural heritage, values, norms and ideals as well as a shared commitment to the strategic priorities of the Cold War. In less grandiloquent terms, the alliance met Australia’s needs to ensure its security as a sparsely populated trade dependent state, located in an insecure part of the world whose previous colonial protector had lost both its will and its capacity to underwrite Australian security. In return Australia would provide geopolitical advantages and steadfast political support of American grand strategy. It is notable that of America’s many allies, few can boast the level of Australian military commitment. Whenever the US has called on its allies to send troops, Australia has answered. From Korea to Vietnam, Kuwait to Iraq, Australia has committed troops whenever the US has asked. The strength and consistency of this support for the alliance has many sources including a convergence of values and interests, but draws much of its longevity from the support it has garnered from the two major political parties (Gyngell 2005). While the governing conservative Liberal party has recently tried to paint Labor as anti-American, both sides of Australian politics have excellent credentials in Washington.

Viewed from the longer perspective, the Australia–America alliance has been, and continues to be, the cornerstone of Australia’s security and defence policy. Indeed Australia’s broader foreign policy posture is built upon this solid foundation. Yet through the 1980s and the 1990s the alliance did become slightly strained. By no means was it about to collapse, but it had become a little worn by a number of factors. The first was the on-going economic bickering driven
largely by trade disputes (Ravenhill 2001). Second, the alliance suffered from a lack of strategic clarity about precisely what purpose it served. The ANZUS treaty was a Cold War product intended to cope with the communist challenge, local insurgencies and a Sino–Soviet block which appeared intent on regional hegemony. In the early 1990s there was no clear sense of either a broader strategic vision or of a specific set of threats against which the alliance should focus its efforts. Third, political relations between the two were tested in 1999 over the upheaval in East Timor following the referendum. While one must not overstate this—the place of the alliance as the foundation of Australian policy was never seriously challenged, nor did the US seek to reassess its value—it is certainly fair to say that the 1990s was a period in which the alliance lacked the focus it had had in the Cold War and, for many, the political foundation stone of Australia’s geopolitics was possibly at risk.

Upon coming to office, John Howard’s conservative coalition government made clear its intention of moving away from the previous Labor government’s emphasis on its engagement policy with East Asia. Central to this aim was the desire to tighten relations with the United States, both economically and politically. On the whole, the government was not able to advance this ambition due to its inability to make any real headway with the Clinton administration and a lack of concrete plans on how to effect any change. The key to recent deep enhancement of the relationship was the election of the conservative Bush administration in 2000 and, most importantly, the transformation in American foreign policy that resulted from the terrorist attacks of 11 September 2001.

Since 2001 the broader Australian–US relationship has flourished and the basis of this has been Australia’s commitment to America’s foreign policy aims and the enhancement of the alliance (Tow 2004). Beyond the steadfast political support and broader array of activities that have burnished relations, Australia has undertaken a number of important actions, both military and political, that have strengthened the political, strategic and operational aspects of the relationship. Following the attacks in 2001 John Howard, who serendipitously happened to be in Washington DC at the time, made a broad ranging
commitment to assist the US. At the time, the language was thought to be heavy on the rhetoric, yet the fulsome nature of Australia’s commitment to the US has since been matched through a significant transformation of the relationship (Lyon 2005).

The most obvious aspect of all this has been Australia’s commitment to the ‘war on terror’. Australia invoked ANZUS for the first time in its history in 2001 (mirroring NATO’s invocation of Article 5) and sent SAS troops to fight in Afghanistan as well as ADF ships and logistics support for the campaign. More contentiously, Australia has made very public its support for the American–led intervention in Iraq. This involved not only a high–profile diplomatic support role (adding much needed multinational credence to a pretty thin coalition) but also committed 2000 troops to the invasion. Australia, however, did seek to minimise the risk to its troops, mindful that the electorate was not enthusiastic about the commitment, and rapidly reduced its troop level to a token force. More recently, it was forced to deploy further troops to serve in the al–Muthanah region protecting Japan’s SDF troops.

The open–ended commitment to the war on terror has been matched with a series of other decisions to further strengthen the alliance. First, Australia, somewhat surprisingly, has signed on to America’s BMD programme. While it does not appear that Australia is going to acquire and deploy a system, it is committed to participating in the proposed programme under development. This is significant both technologically and politically and has caused some disquiet in the region. Second, Australia is moving to enhance its operational inter–operability with American military forces. Australia has made a clear decision that its military future lies in American hands. This refers not only to the broader strategic realities of American predominance, but also to the decision to structure future hardware acquisitions and training on the assumption of joint operation. From the purchase of M1 tanks to participation in the F35 JSF, Australia has put its lot firmly in line with American military systems.

The Howard government has dramatically reinvigorated the alliance with the United States. This has been part of a broader policy aimed to enhance the full range of the relationship. From the
recently enacted Free Trade Agreement to the excellent personal relationships that Bush and Howard as well as other key elites have (notably Australia’s former Ambassador in Washington, Michael Thawley), virtually all aspects of the relationship have become more firmly entrenched. One must recognise that many in Australia are uneasy about this enhancement. Concerns that Australia has reduced its policy flexibility, that it has undermined its relations with its East Asian neighbours, that it will become dragged into conflicts that it could otherwise have avoided and that it has increased its prospects of becoming a terrorist target are just some of the more prominent concerns voiced (e.g. Beeson 2003; Harries 2004). The past five years has seen a considerable transformation of Australia’s defence and security policy. Australia is now more willing than it has been since Vietnam to use force to advance its policy ends, to deploy combat troops a long way from home, and to participate in risky actions with the US to advance America’s global aims which may not necessarily be compatible with traditional understandings of Australia’s national interests.

This transformation is the product of three important developments. First, it derives from a shift in the perceptions of Australian policy makers about the character of security threats which Australia faces. Second, it is a product of alliance requirements: due to the alliance Australia is expected to assist the US in advancing its global aims. Third, it is a policy which suits the preferences and values of key decisions-makers. Some present Howard et al as fawning courtiers desperate to make a good impression at Washington’s imperial palaces. Amusing as this may be, it misses the point. The decision-makers in Canberra today see the requirements of the alliance as vital to advancing Australia’s security. In stark contrast to Canada, a power equally dependent on American security guarantees, Australia believes that actively participating in the war on terror and hunkering down ever closer to the US is vital to its own security. Not to go to Iraq, not to participate in BMD, not to integrate itself into the military programme of the world’s most powerful democracy, and to displease and distance oneself from Washington, for this group of policy makers, would be a folly of the first order.
Similarities Between Japan and Australia

Before considering an analysis of the regional consequences of these developments, it is worth making a few brief remarks about the similarities between Japan and Australia’s respective positions. The most striking similarity between their moves to tighten their alliances is the way in which they have both used their participation in controversial overseas deployments as the means to advance a broader strategic shift. Howard had for some years wanted to shift Australia’s strategic policy to a closer fit with America’s and joining the US in its campaigns against terrorism has helped achieve this aim. This is not to say that there is not a genuine sense within the leadership that these actions enhance Australia’s security in their own right, nor that this was a purely instrumental decision, rather it is to recognise the multiple motives of these decisions. For Japan, the move had added controversy due to the constitutional issues, but equally represented a mechanism through which strategic transformation could be advanced.

A second commonality is to be found in the political leadership. Both are led by popular conservative politicians who appear to be skilled at manoeuvring between the complex demands of the competing requirements of the domestic and international aspects of alliance management. Both also share electorates that are sceptical of the foreign policy priorities of the leadership (which are closely identified with the person of the prime minister) and yet those same electorates continue to provide sustained support for the leaders themselves, a curious example of electoral compartmentalization.

Third, both groups appear to welcome the impending transformation of America’s military and its implications for their roles. Both parties have signed on to BMD, are moving down a path of greater military inter-operability and are thought to be locking themselves into an American alliance system and its strategic priorities. This means not only an operational tightening of relations, but also that both parties are prepared to participate in global actions to secure American interests. These interests are seen to be commensurate with, if not equivalent to, local interest. Finally, it is important to remember that
both are ultimately dependant on the US for their security and
defence. While Japan has both political and constitutional constraints
on its defence force, Australia simply has too small an economy and
population base to be able to undertake the kind of defence policy
which it feels is appropriate. Consequently, for very different reasons,
and albeit to different degrees, both Japan and Australia are reliant
upon the US for their security. From this perspective it is hardly
surprising that both have sought to enhance their alliances in the
face of the changed circumstances in world politics.

DO STRONGER ALLIANCES MAKE
FOR A MORE SECURE REGION?

At first glance, this question would appear to be a non-starter.
These two alliances have been the foundations of a stable American-
brokered regional order. In the fluid and quite combustible circumstances
of the Asia-Pacific it would appear self-evident that efforts to
strengthen these relationships would result in a more stable and
secure regional setting. While intuitive it is not clear that such faith
is warranted. It is distinctly possible that stronger alliances may
stabilise the region, but it is contingent upon the way in which the
alliances are enhanced and through this, contingent upon the kind
of role that they play. As noted above, the alliances have changed
significantly, moreover the character of the Asia-Pacific has been
transformed and it is not clear that the fit between the newly
strengthened alliances and the security setting of the Asia-Pacific
is as appropriate as it could be. The purpose of this section of the
article is to explore this proposition. The reinforcement of the two
alliances, and clear steps to a more assertive policy for Japan and
for more risky commitments for Australia, have not directly undermined
or reconfigured regional relations. Yet there are good reasons to

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8 There is an argument to be made that the geographic defences of Australia are
sufficient as not to require the kind of defence guarantees which successive Australian
governments have felt are necessary.
doubt that this is an optimal security strategy, either for each state or for the region as a whole.

**New Region-Old System**

The character of the international system has fundamentally changed since these alliances were first established and the Asia-Pacific is now a very different place. If one looks at the political, economic and institutional character of the region it is almost entirely different. Where in the past the region was dominated by authoritarian states, today it is inhabited by a growing number of democracies many of whom appear to be well consolidated. Perhaps more importantly, where once the region was divided between those that were part of the capitalist economy and those that were not, virtually all have now embraced global capitalism. Equally, in the early phase of the Cold War even those states that were a part of the system tended to favour a mercantilist approach to economic development, today virtually all are now relatively open and outward looking. Finally, the region is now criss-crossed with a series of embryonic multilateral efforts to cooperate in the economic and security spheres.

The alliance system was created as a means to project America’s containment policy to the Asia-Pacific. The bilateral relationships were thought to be the best means for the US to contain the perceived threat posed by the Sino-Soviet presence. For the allies, the security guarantees of the system were the primary benefits. As the region evolved through tri-polarity and beyond, the bilateral system was maintained as the respective members preferred the benefits which it extended, and the broader uncertainty and mistrust in the region generated a preference for the status quo. Today, the security environment of the region has some clear lines of continuity but also some significant differences from that which existed even ten years ago.

The two most obvious lines of continuity are the continued division of Korea and the dispute across the Taiwan Strait. Here there have been some important developments in recent years which have transformed the security environment: the Korean peninsula
now has a nuclear dimension and Taiwan is a consolidated democracy. Even among the unfinished business of the Cold War in the Asia-Pacific circumstances have changed in ways which will have important ramifications for the eventual resolution of these problematic lines of continuity such as the Korean and Taiwan issues. But it is the changes to the region which have had a much more important impact on the security setting and strategic balance. Of the many shifts the following are of particular importance: the success of Chinese modernisation and its economic and diplomatic consequences; the incorporation of Vietnam, Laos and Cambodia into ASEAN; the proliferation of WMD; the increased perception of vulnerability to terrorism; the growth of ‘new’ security challenges, especially infectious diseases, piracy and environmental problems; and resource security. In short, the security of the Asia-Pacific is challenged by distinctly different forces now and thus one has good reason to question whether bilateral means are the best way to enhance regional security and stability.

As Tow and Stuart pointed out a decade ago, the alliance system that was born in the early years of the Cold War cannot continue on as it has in the past (Stuart and Tow 1995). Beyond the basic point that the strategic setting which it was intended to stabilise has fundamentally changed, one can no longer be certain that the states of the region prefer the predominance of the US to all other scenarios. Of the many factors that have made the system obsolete, it is China that is most important. China’s economic growth, and its foreign policy transformation (Medeiros and Fravel, 2003) has substantially changed regional attitudes toward China. As the PRC has made good its normalization programme few in the region actively distrust it. More importantly, many in the region feel that China should be treated as a status quo power and not contained. The alliance system is one still based primarily on a containment footing and its target is the PRC. Whatever American conservatives may say about China and its military modernisation programme, their words resonate with few in the region.

To a certain extent, the enhancement of the alliances is a response to new circumstances, but it is not clear that they are
an appropriate response. In part this is because these changes, while continuing to provide a deterrence element, also appear to be creeping toward the territory of collective security. This should not be over-stated, but the nature of the alliances now are such that partners are expected to contribute to security actions in ways that would never have occurred in the past. More importantly, the alliances are now central elements of America’s global security strategy. This means that alliance partners are expected to contribute to and participate in wide-ranging activities with a global scope and with ramifications well beyond the region whose security they ostensibly serve. Given that the character of the region’s sources of insecurity has changed, that the focus of the alliances are now global as well as regional, and closely allied to this point is the fact that there has been a noticeable shift in regional preferences, it is not clear that the logic of alliance enhancement is compelling.

**Being Bound to Follow**

In his now famous work on soft power, Joseph Nye declared that the US was ‘bound to lead’ due to its predominance in both hard and soft power (Nye 1990). Not examined in the book, however, was the other way in which the US was bound to continue its dominant position in the international system because it had little option. The configuration of military, economic and political interests which had produced predominance tied America into its leadership position. In just such a fashion both Australia and Japan are bound to follow the US. They are both bound in the sense that they are surely going to continue to ally with the US given their history and preferences, but they are also bound in the sense of being tied to the US. This ‘bound to follow’ syndrome is the function of both political necessity and recent operational linkages. In both perceived and real terms, especially both sides’ commitment to BMD and the focus on interoperability of military force, both Japan and Australia appear to have locked themselves into their alliance relationships in the longer run.
While the operational aspects are ties that bind, they induce a political posture in which autonomy can be more difficult to negotiate. ‘Bound to follow’ syndrome means that policy choices for both have become increasingly limited. More importantly, it reduces the flexibility of decision-makers to respond to regional developments. If one considers the policy response that Australia and Japan would have to develop to a crisis in the Taiwan Straits or an American pre-emption somewhere in East Asia, one can gain some sense of the problems which binding poses. The extent to which this acts as a constraint will depend on Washington’s attitude toward policy deviation. Given the current climate, it is very hard to imagine Japan or Australia having much latitude for regional difference. Indeed, Australia’s attempts to carve out policy space in regard to Taiwan and the EU embargo on arms sales to China have earned it rebukes.

Being bound to follow means that a state’s flexibility to deal with crises in the short term and to changes in the structure of its interests in the medium to long term can be seriously curtailed. Perhaps more importantly, given the global character of American strategy—and the way in which the Asia-Pacific appears to be seen to be part of the globe rather than a region in its own right—this brings with it two distinct challenges for alliance partners. First, states can considerably increase the risks of being ensnared in conflicts and crises of little or no immediate interest. The dilemma of entrapment is ramped up given the double movement of tightening cooperation by the partner and the global focus of the US. Second, there is the distinct risk of a reduction in attention to regional problems. There can be no doubt that the Asia-Pacific is a part of a larger international system and its fortunes shaped by global forces, yet the region has specific and pressing security challenges which require close and careful attention. Being bound to follow to a partner who requires global responses runs the very real risk of failing to spot or respond appropriately to local challenges or worse, spotting them and not being able to take appropriate action due to alliance commitments.
The China Factor

China’s rise has transformed the political and economic landscape of the Asia-Pacific and through this has caused most in the region to shift, if only subtly, their foreign policy preferences. Some feel that the military modernization programme will radically shift the strategic balance. It may also be true that China will actively seek to challenge American strategic predominance. This is a prospect that no one in the region relishes, but nor is it one in which others in the region’s interests are unambiguously on America’s side. Whatever gloss one wishes to put on it, the projection of American power is intended, under the current administration, to prevent any other power coming to a position of dominance. This has potentially damaging long term consequences for the region. America is clearly focussing on containing China and doing what it can to prevent the PRC from becoming the pre- eminent military power in the region. The US continues to make the military, structured through the alliance, the central platform of its strategic response to the transformation of China. The means through which this is to be structured is via the alliances. Yet it is far from clear that a military response to China’s rise is the most effective means of stabilising the region. At the most basic level this runs the risk of creating a self fulfilling prophecy whereby concerns about China enhance PRC insecurity which then fuels a more militarised approach to defence and security policy which in turn prompts a classic security dilemma response from the US.

For Japan and Australia this is an especially worrying development. Both have extensive economic interests in China which will be placed at risk in any confrontation (whether overt or indirect) whereby they appear to be on the American side. While most in the region, and this is particularly so of Japan and Australia, would prefer not to have to choose between the US and China, it is very hard to see how, given their alliance commitments, they could do otherwise.

More broadly, the shift in regional perception on the treatment of China is clear. There is certainly not a consensus in the region
which concurs with the hawkish interpretation of Chinese intentions and a preference to avoid treating China in a way which encourages a more assertive policy. China has managed a remarkable economic transformation and its future success (and that of the CCP) is predicated on continuing this challenging process. America and its allies appear committed to the belief that this will produce a military power that, by dint of its existence, will challenge American interests. The rest of the region has adopted a hedging strategy and both Japan and Australia have denied themselves this option. Other regional powers recognise that China is not necessarily atavistic, that it has sufficient interests at risk to constrain the more nationalist elements and that China has a recent foreign policy record that gives some comfort to those who take a status quo view of China’s intentions. In solidifying themselves in what looks to be an alliance system with an anti-China bias, the US, Australia and Japan may be contributing to the instability they seek to diminish and may be locking themselves out of regional multilateral security efforts which take a US-exclusionary posture.

New Security Dilemmas

The alliance system is still focused on traditional security problems, particularly the territorial disputes of Taiwan and Korea and the perpetuation of US military predominance. Important though these may be, the system has little scope for, or interest in, coping with the very pressing security problems posed by ‘new’ problems such as infectious diseases, organised crime and resource security. For many in the region, these are far more significant and immediate sources of insecurity than traditional territorial disputes. As a traditional security alliance system it is unlikely if it would ever address these matters, nor for that matter whether it would offer much even if it were to be so reconfigured.

While in the Asia-Pacific one can find reasons for its continued relevance in the context of traditional security problems, there are a raft of new security problems (alluded to above) which do not fit easily into this traditional thinking. The security setting of the Asia—
Pacific is a perplexing combination of the new and the old. Ultimately, states in the region have to face two elements of the security problem: these are external (traditional) and internal (new). The problem is that they require almost contradictory efforts to resolve. While there is some scope for dual movement, the limited character of defence spending in Japan and Australia means that money spent on military programmes with the US is money not spent on other means to secure themselves and the region from these pressing problems. The actions of Japan and Australia illustrate how states respond to this environment given their geographic, political and economic constraints. Bandwagoning with the major power represents what they believe to be the optimal strategy, yet it provides cold comfort for many of the more pressing and acute crises that exist or lie just over the horizon.

Perhaps the most pointed aspect of the new security dilemma relates to terrorism and is, in many respects, a new version of an old problem. Traditionally, alliance partners have had to cope with the security problems that alliances engender, specifically, the challenges of entrapment or abandonment. When a state enters an alliance there is the possibility that it will be dragged into conflicts that could otherwise have been avoided or worse, that in spite of alliance guarantees it will be abandoned. For alliance partners managing these possibilities is a perennial challenge. For Japan, these fears have long existed, equally, for Australia there has always been some doubt in some people's minds about the genuine character of the security guarantee. If Australia were really attacked, would America really risk itself to defend this far-off land?

As Hughes correctly points out, historically, Japanese security policy makers have negotiated this dilemma relatively well (Hughes 2004, 21-9). Japan's Cold War policy made excellent use of the fact that the US needed Japan more than Japan needed the US. The enthusiasm with which both Japan and Australia have embraced the Bush doctrine and participated in the War on Terrorism (WOT) has manifestly increased the entrapment problem. Equally, as noted above, it does so also with regard to North Korea and Taiwan. Both sides may be willing to wear this risk, but its knock-on
effects for the region should not be underestimated.

**Stability and Security in an Uncertain Region**

While the belief that stability in the region depended on US troop presence was well founded in the Cold War period, there are good reasons to question whether a substantial reduction or removal of troops would necessarily lead to wholesale regional instability. The region is marked by a considerable degree of uncertainty and lingering mistrust between key players, most notably Japan and China. This instability derives, in part, from the American troop presence and American policy more generally. There can be no doubt that the PRC and the DPRK share a considerable portion of the blame for destabilising the region over, respectively, the Taiwan Straits and the nuclear issue, but the American presence and the policy of the Bush administration have contributed to a growing sense of insecurity. It is not unreasonable to conclude that American force projection is not providing the level of comfort that some argue that it does.

In entrenching a military and political system which retains a focus on the containment of China and the perpetuation of American military dominance of the region, the alliance strengthening of Japan and Australia cannot be said to have enhanced the stability of the Asia-Pacific. This is not say that they have destabilised it, but the assumption that the bilateral alliance system is the optimal means to improve regional stability and security can no longer go unchallenged. The region has witnessed a distinct shift in which the growth in power and influence of China, coupled with its normalised policy to its regional neighbours, has encouraged many to move slightly away from their previous position favouring an American brokered status quo. Given that the US approach is predicated on a confrontational approach to China, this slight movement becomes more distinct. The region does not want to see a growing rivalry between China and the US (this was one of the primary motives behind the formation of the ASEAN Regional Forum), but if pressed most will not side with the US over the PRC. Moreover, the PRC’s actions have promoted rather than undermined regional trust. For most, this move
has been slight but the signs thus far are promising. One indicator for region watchers is the Spratlys. If China is genuine about its normalised footing in the region then it has little choice but to adopt a peaceful resolution to the Spratlys dispute. For regional stability the most important element is not perpetuating US military predominance but increased trust and amity between the major powers, and particularly between China and Japan and the US and China. Under the current system this is virtually impossible.

Australia and Japan have positioned themselves in such a way that they have little option but to be with the US. Their regional security interests therefore will be more heavily influenced by preferences in Washington than within the region. If Washington adopts accommodative policies, this will not prove too problematic; if assertive, then their futures will be more complex. However viewed, for Tokyo and Canberra their flexibility to respond to crises has been constrained, while their capacity to contribute to regional multilateral groupings is limited as they are perceived to lack autonomy and may find themselves increasingly isolated if moves to squeeze the US out of regional matters increases. Equally, pressure will come from the US to stay out of such developments. In short, it is hard to concur that enhancing these alliances enhances regional security. They do improve each party’s specific short-term interests, but the regional consequences are at best ambivalent.

The strengthened alliances do continue to provide key structural support elements to American military hegemony in the region. However, the tightening of the alliances combined with a more assertive US, which is undertaking a distinctively global strategic posture, makes many in the region uneasy. This is particularly the case with regard to its approach to China, which is changing, as are the means through which the US perpetuates its military presence. These factors, along with the problems of rigidity, provide good reasons to doubt that the alliance system will continue to have the stabilising effect that it has had for the past thirty years. The specific problems of the transformation of the regional international system and the requirements of the alliances, the limits imposed by being bound to follow, concerns about provoking China, the possibility of
regional conflict, and the lack of fit with the pressing problems of new security challenges, build up a persuasive case to be sceptical of the stabilising prospects of a bilaterally structured security system in the early years of the twenty first century.
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NUCLEAR THREAT REDUCTION AND THE DYNAMICS OF SINO-U. S. RELATIONS

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ABSTRACT

In recent years Beijing and Washington have maintained close cooperation on issues ranging from the war on terrorism to dealing with the North Korean nuclear crisis. However, major differences remain over the U.S.—Japan alliance, controversies over missile defenses, the role of nuclear weapons in the bilateral relationship and, until recently, cross—Strait relations. The paper argues that the possibility of nuclear threat reduction between the two countries will depend on two sets of variables. The first is whether the issues in question are merely perceptual or fundamentally irreconcilable structural ones. Better communication and strategic dialogue could help address perceptual misunderstanding. The second refers to the relative importance the two major powers ascribe to the role of nuclear weapons in national security and the use of force (and even nuclear force). Beijing and Washington need to expend greater efforts in arms control, crisis management, and confidence building to address perceptual misunderstanding and most important, to prevent open military conflicts between the two.

Key Words: Sino—U.S. relations, U.S.—Japan alliance, cross—Strait relations, nuclear threat reduction
INTRODUCTION

Sino–U.S. relations are currently at their best since President Nixon’s historical 1972 visit to China. Not only are the two countries in regular and close consultation on issues ranging from anti-terrorism to North Korea’s nuclear weapons programs, Beijing and Washington are even in agreement on the controversial Taiwan referendum, with the U.S. side explicitly discouraging the Chen Shui-bian government from undertaking such a provocative act. This is a far cry from the (in)famous “whatever it takes” statement by President George W. Bush in early 2001 when he began his first term in office.

China and the United States have also sought to manage, with various degrees of success, disputes that used to irritate bilateral relations. These include trade, human rights, and the proliferation of weapons of mass destruction. Chinese President Hu Jintao’s April 2006 visit to the U.S., for example, had been preceded by major Chinese purchases and Beijing’s commitment to address trade imbalance, market access, and currency exchanges.1 Bilateral security, arms control, and defense consultations are being institutionalized, enabling the two sides to discuss their differences through dialogue. Beijing for its part since 2002 has issued a series of nonproliferation export control regulations, joined the Nuclear Suppliers Group (NSG) in 2004, and has been in consultation with the other multilateral export control regimes—the Missile Technology Control Regime (MTCR), the Australia Group (AG), and the Wassenaar Arrangement (WA).2

The amicable atmosphere is due in no small part to Washington’s post—9–11 efforts to seek major power cooperation in its campaign against international terrorism and to Beijing’s desire to maintain a stable relationship with the U.S. However, fundamental differences between the two countries over military alliances, the role of nuclear deterrence, missile defenses, use of force, and the resolution of the

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Taiwan issue remain. Indeed, both continue to view each other’s objectives and policies with caution and even suspicion, and neither has let down their guard against future contingencies.

This paper examines the current dynamics in Sino-U.S. relations, from cooperation on resolving the North Korean nuclear issue, to issues that could drag the two into conflict—Chinese misgivings about the U.S.—Japan alliance, the controversies over missile defenses, and cross-Strait relations—and discusses the role of nuclear weapons in the bilateral relationship. It argues that the possibility of nuclear threat reduction between the two countries—which in itself should be a worthy goal to pursue—will depend on two sets of variables. The first is whether the issues in question are merely perceptual or fundamentally irreconcilable ones. Better communication and strategic dialogue could help resolve perceptual misunderstanding. Otherwise, arms control and conflict management would be the more appropriate mechanisms. The second refers to the relative importance that the two countries ascribe to these issues and the degree of determination in protecting their interests, including the use of force (and even nuclear force). Prevention of such occurrence would be of utmost interests to policymakers in both Washington and Beijing.

COOPERATION AND CONFLICT

Sino-U.S. relations did not begin well with the incoming Bush administration. During the 2000 presidential campaigns, candidate Bush described China as a potential strategic competitor for the U.S. The new administration vowed to strengthen its alliance relationships and downplayed the importance of China in its Asia policy. Then came the April 2001 EP-3 incident and the largest U.S. arms sales to Taiwan in a decade. The bilateral relationship dropped to its lowest point. The September-11 terrorist attacks on the United States, however, provided a “strategic window of opportunity” for re-building the tattered Sino-U.S. relationship. The Bush administration’s international focus is now on the war against terrorism, not on the possibility of a future challenge from
China. Chinese analysts recognize that, given the current situation, the challenge for Beijing is to maximize the benefits and minimize other negative factors such as the growing U.S. global military presence and its declared policy of the preemptive use of force. For the time being at least, common interests in fighting global terrorism and defusing the North Korean nuclear crisis have seen Beijing and Washington enjoying a period of stable relations.

At the same time, China and the U.S. have different objectives and priorities for the post–Cold War Asia. For Beijing, the end of the Cold War has removed a major threat (from the Soviet Union) to its territorial security and a peaceful environment is conducive to its goals of economic development and building the country into a stable, prosperous regional power. Economic security, political stability, and national unity have become major Chinese foreign policy objectives. The United States, on the other hand, seeks to maintain its primacy in the region through its alliance systems and by strengthening its military presence. Washington is determined to prevent any power from rising to challenge its interests and looks to emerging democratization and continued marketization as the pillars to ensure regional stability.

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7 Zalmay Khalilzad et al., *The United States and a Rising China: Strategic and Military Implications.* MR–1082–AF (Santa Monica: RAND, 1999); Zalmay Khalilzad
Three contentious issues have emerged to dominate the Sino–U.S. strategic discourse: the U.S.–Japan alliance, missile defenses, and Taiwan.

The North Korean Nuclear Crisis

The crisis over North Korea’s nuclear weapons program has provided the opportunity for Sino–U.S. cooperation, even though Beijing’s initial reactions were rather passive. When the crisis first broke out, China stated its position on the issue as follows: (1) peace and stability on the Korean Peninsula should be preserved; (2) the peninsula should remain nuclear–free; and (3) the dispute should be resolved through diplomatic and political methods between the United States and the Democratic People’s Republic of Korea (DPRK). These criteria form the core of Chinese approaches to the resolution of the nuclear issue. Chinese officials and analysts have maintained that the key to resolving the crisis would be direct dialogue between North Korea and the United States. Instead of blaming North Korea for the collapse of the 1994 Agreed Framework, Beijing was calling for both Pyongyang and Washington to resolve their dispute through dialogue. The Chinese hoped that face–saving ways could be found for Pyongyang and Washington to return to the negotiating table.\(^8\)

Indeed, Beijing worried that hard–line positions in Pyongyang and Washington and continued stalemate could push North Korea to take even riskier steps. A military confrontation on the Korean Peninsula would not only cause much destruction it would also bring down the North Korean regime, costing China a strategically important buffer. The environmental devastation would be severe and there

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would also be a massive refugee flight into China, where there are already an estimated 100,000 to 300,000 illegal North Koreans residents. A hastily unified Korea following the collapse of the North Korean regime would present Beijing with tremendous uncertainty. China, for example, could face the daunting prospect of a U.S. military presence right up to the Chinese–Korean border. A united Korea might inherit the North’s nuclear and missile capabilities and rising Korean nationalism could also pose a challenge to Beijing’s ability to manage its Korean ethnic minority in Jilin Province. Finally, there is also the specter of a nuclear chain reaction, with concerns over Japan’s possible rearmament and nuclearization, using the North Korean nuclear issue as a pretext.

These considerations led China to adopt more active diplomacy in order to forestall these potentially negative consequences from an escalation of the North Korean nuclear crisis. Indeed, one could argue that Beijing’s efforts—including twisting Pyongyang’s arm—played no small part in getting Pyongyang to the April 2003 trilateral meeting in Beijing and to accepting the subsequent two rounds of six-party talks in August 2003 and February 2004, respectively. However, while the process for engaging North Korea has been kept alive and both China and the U.S. have found common grounds for continued cooperation and consultation, significant differences remain between the two countries over specific approaches and

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long-term objectives, which could in future strain bilateral relations. The U.S. and North Korea’s positions remain poles apart, as demonstrated by the five rounds of the Six-Party Talks held in Beijing between 2003 and 2005. China’s patience may wear thin as it increasingly finds itself frustrated in its role as a facilitator and an honest broker.

The Chinese are suspicious of the real U.S. intentions regarding the resolution of the Korean nuclear crisis. They point out that the U.S. is using the crisis to advance its own strategic interests in the region, including bringing Japan and South Korea in a strong bind under its alliance systems, justifying enhanced military presence and force deployments in the region, forcing China to make the difficult choices, and creating unstable regional security environments to disrupt and delay China’s economic process. Indeed, the U.S. is sometimes viewed as an obstacle to the solution to the problem, such as its hostile policy toward North Korea.

Chinese analysts suspect that the Bush administration is never sincere about resolving the North Korean nuclear issue. It wavers between a “Libyan” solution, to regime change, to possible military operations. Never has the administration considered the return to the Clinton administration’s “negotiation to buy time” strategy. The administration’s basis assessment is that real nuclear dismantlement is never achievable, nor is any credible verification. The U.S. in now more interested in a comprehensive settlement of all the issues ranging from human rights, missile proliferation, to counterfeit

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currencies. This high-handed pressure tactic has become essentially obstacles to the Six-Party Talks, since Pyongyang, always paranoid on being isolated, is constantly looking for excuse not to participate in the process unless it is absolutely certain that its security concerns can be addressed. 15 Indeed, the second Bush administration will stick to its “three no changes”—there will no change on its position on completely dismantling North Korea’s nuclear programs, no change in its views on North Korean leadership, and no change on its principle and strategy of no concessions to Pyongyang. 16

Beijing believes that it has done its share, and in its own ways, in seeking to defuse the North Korean nuclear crisis. In general, it shares the ultimate goals of a nuclear-free Korean Peninsula with all the other powers. It rejects U.S. assertion that it is not doing enough to rein North Korea’s nuclear programs and the misperception and mischaracterizing that China cares more about peninsular stability than the nuclear development. Indeed, the Chinese would suggest that Beijing, while acknowledging that it understands Pyongyang’s security dilemma, nonetheless makes it very clear to its northern neighbor that it is strongly opposed to a nuclear peninsular; that the North should engage in negotiation, especially the Six-Party Talks, rather than seeking unilateral actions to escalate tension; that Pyongyang should expect unqualified support from China, the 1961 treaty notwithstanding; and that North Korea should undertake reforms to improve its economic situations. 17

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The U.S.–Japan Alliance

Chinese attitudes toward the U.S.–Japan alliance have over the years shifted from outright condemnation and opposition in the 1960s, to tacit acquiescence in the 1970s and 1980s, to growing criticisms since the end of the Cold War. Beijing has reacted negatively to the April 1996 U.S.–Japan Joint Declaration on Security and the September 1997 U.S.–Japanese Defense Cooperation Guidelines. While in the past the alliance in Beijing’s eyes served a useful purpose of keeping Tokyo from seeking re–militarization, it is now increasingly viewed as a security threat.18

Three issues stand out. First, Beijing considers the revitalized U.S.–Japan military alliance as part of Washington’s containment strategy against China. After all, the alliance was established during the Cold War years with the defense of Japanese territories as its primary mission. Now the Cold War has ended, the very raison d’être—protecting Japan from Soviet aggression—no longer exists. The alliance therefore reflects Cold War mentality and actually justifies and facilitates continued U.S. military presence in the region with unmistakably clear objectives: to maintain American primacy against China as a potential future adversary.

Second, the new defense guidelines extend the alliance’s defense perimeter to include the Taiwan Strait; China is understandably concerned with the possible intervention of the U.S.–Japan alliance in what it regards as its internal affairs and re–unification plans. Tokyo’s ambiguity regarding its defense perimeter, an ambiguity seemingly based not on geography but on events, only heightens Beijing’s suspicions.19

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Third, the revitalized alliance allows the Japanese Self Defense Force (JSDF) to take on additional responsibilities. Beijing is increasingly worried that a more assertive Japan actively involved in the region’s security affairs and seeking to be a “normal” power will emerge as a result.\(^{20}\) The new defense guidelines in effect give Japan the green light to go beyond the originally intended exclusive right to self-defense to a collective defense function, therefore providing justification for Japan to intervene in regional security affairs.\(^{21}\) Japan already has one of the largest defense budgets in the world and has a reasonably sized (given its peace constitution) and the best-equipped military in the region. In addition, Japan’s industrial and technological wherewithal will provide it with ready resources should it decide to become a military great power at short notice, including the acquisition of nuclear weapons.\(^{22}\)

Indeed, Beijing is particularly attentive to Japan’s growing military capabilities. The December 2001 National Defense Program Outline (NDPO) earmarked ¥25.16 trillion for the next five years, making Japan second to the United States in terms of overall defense spending and first on a per-soldier basis. Large allocations have been devoted to procuring major sea and air weapons systems and platforms. When the Japan Defense Agency (JDA) announced its participation in the 2000 Rim of the Pacific (RIMPAC) military exercises, the Liberation Army Daily commented that Japan “is casting off its peace constitution” and “the ghost of Japanese militarism is stirring on the Japanese archipelago.”\(^{23}\) The dispatch of JSDF ships and personnel to the Gulf and Iraq since the Afghan War and U.S. invasion of Iraq is a worrisome sign that Japan may have started on this path.\(^{24}\) It is no coincidence

\(^{20}\) Lu Zhongwei, “Riben de guoji zuoxiang yu zhidong guanxi [Japan’s Course of Direction and Its Relationship With China],” *Xiandai guoji guanxi [Contemporary International Relations]*, (July 2001), pp.2–7.


\(^{24}\) Beijing Xinhua, “Riben anbao tixi yanbian [Japan’s Evolving Security System],”
that Beijing is also critical of Japan’s intention to upgrade the Japan Defense Agency (JDA) to the ministerial level.\textsuperscript{25}

\textit{U.S. Missile Defenses}

Another potential point of conflict between Beijing and Washington concerns the contentious U.S. missile defenses and their deployment in Asia.\textsuperscript{26} Beijing has a number of specific concerns over the development and deployment of missile defenses.\textsuperscript{27} First, U.S. missile defenses can negatively affect China’s core national security interests, in particular their ability to undermine the credibility and effectiveness of China’s small-size nuclear retaliatory capabilities. By contrast, given Russia’s large nuclear arsenals, proposed U.S. missile defenses would not be able to neutralize Russian retaliatory capabilities. The apparent U.S. targets\textsuperscript{34}the so-called rogue states\textsuperscript{34}do not yet possess long-range missiles to threaten continental America, nor would they risk massive retaliation by attacking the United States first. The only explanation for U.S. missile defense systems, Beijing strongly suspects, is that

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\textsuperscript{26}General discussions include the Atlantic Council of the United States, \textit{Missile Defense in Asia} (June 2003); Michael D. Swaine, with Loren H. Runyon, “Ballistic Missiles and Missile Defense in Asia,” \textit{NBR Analysis} 13:3 (June 2002), pp.1–84.

they are aimed at China’s limited nuclear deterrent capability. This is particularly so in the context of the continued Sino–U.S. conflict over Taiwan and the declared U.S. commitment to Taiwan’s defense. Indeed, one prominent Chinese missile defense analyst suggests that “China fears that if the USA believes that a first nuclear strike plus an NMD system could render impotent China’s nuclear retaliatory capability, the USA might become less cautious during any crisis involving China.”28 Any such crisis, in most instances, would likely be over Taiwan.

Second, the Chinese dismiss U.S. justification that missile defenses are a reaction to increasing ballistic missile threats from the so-called rogue states. Rather, Beijing sees it as yet another deliberate step that the United States has taken to further enhance its offensive as well as defensive capabilities. Beijing is aware that U.S. development of missile defense systems, as a way to pursue absolute security, comes at a time when major shifts are emerging in new U.S. defense policy, including the heightened role of nuclear weapons in the strategy of pre-emption. In this context, missile defenses could elevate the importance of military elements in international relations, resulting in greater U.S. unilaterality and the threat and use of force. The deployment of such missile defenses is therefore seen by China as part of an overall U.S. global strategy of sustaining American post–Cold War primacy and absolute security through increased military interventions in regional affairs. U.S. abrogation of the ABM Treaty and its planned missile defense deployment could erode international arms control and invite regional arms races, further undermining international and regional security.29

While China tacitly acknowledges the role of Theater Missile Defense (TMD) in protecting U.S. forward-deployed troops from missile attacks, it objects to an advanced TMD system that could extend to Taiwan and may also serve as a forward component of

NMD.\textsuperscript{30} In an interview with Defense News in February 1999, Sha Zhukang said that China was not concerned about “what we call genuine TMD.” Instead, “what China is opposed to is the development, deployment and proliferation of antimissile systems with potential strategic defense capabilities in the name of TMD that violate the letter and spirit of [the Anti–Ballistic Missile Treaty] and go beyond the legitimate self-defense needs of relevant countries.”\textsuperscript{31}

Third, Japan’s participation in theater missile defense is also drawing increasing attention from China and elsewhere in Asia.\textsuperscript{32} Since the North Korean Taepo–dong missile launch in August 1998 and recent nuclear developments, Japan has speeded up steps to acquire and deploy missile defense systems in addition to its ongoing research and development collaboration with the U.S.\textsuperscript{33} China contends that regional (theater) missile defense (TMD) research and development encourages and provides a pretext for Japanese re–militarization.\textsuperscript{34} Beijing’s suspicion of a post–Cold War assertive Japan is reinforced by Tokyo’s reluctance to be forthcoming on its historical records, its ambiguity regarding its defense perimeter, its potent and potential military capabilities, and its potential involvement in a future Taiwan


\textsuperscript{32} Quote from Diamond, “China Warns U.S. on East Asian Missile Defense Cooperation,” p.27.


\textsuperscript{34} “Japan Adopts Missile Defense System,” \textit{Mainichi Daily News}, December 19, 2003 \texttt{<http://mdn.mainichi.co.jp/news/archive/20031219/20031219p2a00m0dm007000c.html>.

\textsuperscript{34} Hong Yuan, “The Implications of a TMD System in Japan to China’s Security,” Nuclear Policy Project Special Report, August 1999; Sun Cheng, \textit{Riben yu yatai–shiji zhijiao de fenxi yu zhanwang [Japan and Asia Pacific–Analysis and Prospect at the Turn of the Century]} (Beijing: Shijie zhishi chubanshe, 1997).
Given Japan’s current naval capability (it already possesses four Aegis destroyers and has the strongest naval fleet among Asian countries), TMD systems would equip Japan with both offensive and defensive capabilities.

Finally, China is strongly opposed to missile defense coverage of Taiwan for three reasons: (1) It encourages Taiwan independence; (2) It leads to a de facto Taiwan–U.S. security alliance; and (3) It interferes with China’s unification objectives. To quote Ambassador Sha Zukang, former director-general of the Department of Arms Control and Disarmament in the Chinese Ministry of Foreign Affairs, “China’s opposition to U.S. transfers of TMD to Taiwan is also based on … its adverse impact on China’s reunification. TMD in Taiwan will give the pro-independence forces in Taiwan a false sense of security, which may incite them to reckless moves. This can only lead to instability across the Taiwan Strait or even in the entire North-East Asian region.”

Taiwan

Despite the apparent common view on the Taiwan referendum issue expressed by both Beijing and Washington in December 2003 when President Bush publicly rebuked Chen Shuibian at a joint conference with the visiting Chinese Premier Wen Jiabao, the stability of long-term Sino-U.S. will likely remain affected by their handling of cross-Strait relations. The U.S., while annoyed by Taipei’s reckless and provocative postures that could disrupt the status quo and create unnecessary tension at a time when American capabilities are tied elsewhere, is nonetheless sympathetic to Taiwan’s democratization

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35 Hong Yuan, “The Implications of a TMD System in Japan to China’s Security,” Nuclear Policy Project Special Report, August 1999; Sun Cheng, Riben yu yatai shijii zhijiao de fenxi yu zhanwang [Japan and Asia Pacific Analysis and Prospect at the Turn of the Century] (Beijing: Shijie zhishi chubanshe, 1997).

36 Amb. Sha, “Some Thoughts on Non-Proliferation.”

and bound by the Taiwan Relations Act regarding the latter’s defense. Within the United States, there are forces that are strongly pro-Taiwan and call for American support of the independence course. Indeed, even as Washington was admonishing Taipei’s referendum plan, officials in the Bush administration were also sending signals of reassurance to Chen’s government. The controversial re-election of Chen Shui-bian for a second term and a recent U.S. announcement of the planned sale of long-range early-warning radar worth up to $1.78 billion to Taiwan reinforce this concern.

Indeed, long-term US-Taiwan policy remains the most serious security concern for Beijing. Since the mid-1990s, three trends have been particularly worrisome for the Chinese leadership. The first has been U.S. deviation in recent years from the “One China” principle set forth in the three Sino-U.S. joint communiques. Since the Bush administration came into office in 2001, the U.S. has steadily upgraded its supposedly unofficial ties with Taiwan. Transit stops granted to Chen Shui-bian, Taiwan’s president and Annette Lu (vice-president) are also happening more frequently during the current Bush administration than during the Clinton administration. The U.S. has also openly supported Taiwan’s bid to join the World Health Organization.

The second is the continuing U.S. military sales to Taiwan, which are seen by China as contravening the spirit of the August 17, 1982 Sino-U.S. Communique. Over the last two decades since the communique was issued, the U.S. has provided Taiwan with a full spectrum of military equipment, including: F-16 air superiority

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39 See, for instance, statements by Richard Lawless, Deputy Assistant Secretary of Defense and Randy Schriver, Deputy Assistant Secretary of State at the U.S.-China Economic and Security Review Commission hearing on Military Modernization and Cross-Strait Balance, February 6, 2004.
fighters, Knox-class frigates, Kidd-class destroyers, anti-submarine S-2T, E-2T Hawkeye airborne early-warning aircraft, long-range early-warning radars, attack helicopters, Patriot-derived Modified Air Defense Systems and Hawk and Chaparral ground-based air defense systems, among others. The U.S. Department of Defense also runs exchange programs with Taiwan on C4I, air defense, and anti-submarine warfare (ASW). In April, 2001, President Bush caused quite a stir when he gave the controversial “whatever it takes” to help defend Taiwan statement. Washington is becoming increasingly frustrated as Taipei fails to push through a special defense procurement budget to purchase U.S. arms approved by the Bush administration more than five years ago.

Third and finally, there have been incessant congressional efforts at not only enhancing the U.S.-Taiwan relationship, but also expanding it to include closer security cooperation. The 1999 Taiwan Security Enhancement Act, which was passed in the House by a landslide, would require even closer defense cooperation between the U.S. and Taiwan in the areas of defense planning, threat analysis, training programs, and missile defense systems, all of which have been strongly opposed by Beijing. The establishment of the Taiwan Caucuses in the U.S. Senate and the House of Representatives are another major

43 East Asia Nonproliferation Program, Center for Nonproliferation Studies, “Arms Sales to Taiwan: Statements and Developments 1979–2003 <http://www.nti.org/db/china/twnchr.htm>. Additional information regarding US arms sales to Taiwan can also be found at: <http://taiwansecurity.org/TSR-Arms.htm>
development. The U.S. position on its Taiwan policy over the next five years will be a critical element in both the stability of the Taiwan Strait and Sino–U.S. relations.

THE NUCLEAR FACTOR

China developed its nuclear weapons program in response to U.S. nuclear blackmail. After detonating its first nuclear bomb in October 1964, China achieved hydrogen bomb capability in 1967 and by 1981 had deployed its first–generation intercontinental ballistic missiles (ICBM) capable of reaching the United States. Over the next two decades, progress in Chinese nuclear modernization was continually slowed down by technological issues. The Chinese leadership’s priority in economic development, coupled with an improved international security environment since the mid–1980s also contributed to the slow progress. Today, China has the third largest nuclear arsenal among the P–5 countries (the United States, Russia, China, Britain and France) with over 400 weapons. However, most of the systems currently in deployment are of 1970s and 1980s vintage and their vulnerability to disarming first strikes remains an issue for Chinese strategic planners. Anticipating U.S. missile defense deployment and a new nuclear posture, China has renewed its efforts to develop and deploy new generations of nuclear missiles.

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U.S. Nuclear Posture Review

In January 2002, the Bush administration released a declassified summary of its Nuclear Posture Review (NPR). According to Chinese analysts, a number of fundamental trends in post–Cold War U.S. defense posture can be detected. These include Washington’s reassessment of the new international security environment and major threats facing the United States and its allies: new strategic guidance for the U.S. nuclear force structure, size, and missions; and the move away from massive retaliation–based threats to the development of credible nuclear capabilities that could be put to use. Within this broad context, the Cold War nuclear triad of land–based ICBMs, airborne strategic bombers, and submarine-launched ballistic missiles (SLBMs) are to be replaced with a new strategic triad of offensive systems (nuclear and non–nuclear), active and passive defenses, and a defense–industrial infrastructure. This new U.S. defense posture would thus enable Washington to retain massive retaliatory capabilities (even after the significant reduction of its strategic nuclear force) against the other major nuclear powers, to confront and neutralize threats from the so-called “rogue” states through its missile defense systems, and to deal with any potential opponents effectively by applying precision–guided munitions.50

U.S. nuclear policy is of considerable concern to China. The

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NPR reveals that it contains contingency plans to use nuclear weapons against China and six other countries.\textsuperscript{51} Chinese strategic analysts focus particularly on what they consider as fundamental shifts in post–Cold War U.S. strategic posture. One is the nuclear threshold. The elevation of the role of nuclear weapons is particularly worrisome to Chinese analysts. In the past, nuclear weapons were always the weapon of last resort, of deterrence against the use of nuclear weapons. However, the new posture suggests the use of nuclear weapons against hardened, difficult—to—penetrate targets, and as retaliation against WMD use. Perhaps the most serious concern to Beijing is the potential nuclear use “in the event of surprising military developments,” including a war between China and Taiwan.\textsuperscript{52}

Current Chinese discussions of the NPR remain confined to academic analysis. One of the most clearly articulated views is that China needs to maintain and enhance its deterrence proficiency in terms of capability, credibility, and survivability. The Chinese government has yet to articulate its position beyond mere initial reactions. Indeed, one could wonder about the heretofore relatively low—key responses from the official channel, given the fact that China probably would be the most negatively affected by a change in U.S. policy. This ambivalence may reflect the dilemma Beijing faces in developing viable counterstrategies, particularly in the international diplomatic arena. China would be all alone in opposing the U.S., well aware that it won’t have any real impact. At the same time, there is the need to assess the overall effect of the new U.S. strategy on China’s security interests. In this regard, Chinese reactions cannot be seen as merely responding to the NPR but also reflecting the general trends in U.S. nuclear strategy in the coming years.\textsuperscript{53}


\textsuperscript{53} Jing—dong Yuan, “Chinese Media Discusses U.S. Nuclear Superiority,” WMD
Chinese Nuclear Modernization

As mentioned above, China's nuclear modernization over the years since the early 1980s has been slow and sporadic. The pace and scope of Chinese nuclear modernization in the past have been affected by technological and economic constraints. While China demonstrated a remarkable feat in achieving a nuclear detonation, an MRBM flight, and a hydrogen bomb explosion within a short span of three years (1964–1967)—generating great expectations of its future nuclear weapons developments—events that unfolded since then suggest that such optimism was not well founded. Economic constraints and political turmoil such as the Cultural Revolution of 1966–1976 may have contributed to slow progress, and a technological bottleneck may have been a key impediment to the development of new—generation ICBMs and miniature nuclear warheads, prompting the Cox Report charges of Chinese nuclear espionage. While finding the necessary resources presents few obstacles given China's growing economic capabilities, technological deficiencies will remain a serious impediment to what China can achieve in its strategic nuclear force modernization and at how fast a pace it can achieve this.

However, new U.S. nuclear policy and its planned missile defense deployment could prompt Beijing to re-energize its efforts. Of the various responses China could adopt, one of the most feasible would be to expand its number of current missile forces to avoid a potential decapitating first strike. A greater number will also give China psychological reassurance as well as sustain the level of uncertainty that the United States must cope with. This short-term makeshift measure could be paralleled by accelerated development, testing, and deployment of the road-mobile DF-31s and DF-31As to enhance survivability of China's retaliatory capability. A three-stage,


54 The following discussion draws on Phillips C. Saunders and Jing-dong Yuan, "Strategic Force Modernization," in Bolt and Willner, eds., China's Nuclear Future, pp.79–118.

solid-fuel, mobile ICBM mounted on a transporter-erector-launcher (TEL), the 8,000-kilometer DF–31 has been flight-tested several times since 1999.\textsuperscript{56} The extended range version of the DF–31, the DF–31A, would have a range of at least 12,000 km. An SLBM derivative, JL–2, with a range of about 8,000 km, is also under development and will be deployed on the next-generation fleet ballistic missile submarine (SSBN), the Type 094.\textsuperscript{57}

The exact number of additional missiles that China would need will likely depend on the types of missile defenses that the United States is going to deploy, the estimated number of ICBMs surviving a first strike, and the ability of the remaining missiles to penetrate missile defenses with or without penetration aids, such as decoys and other countermeasures. The July 2003 DoD report put the number at 60 ICBMs, while the December 2001 NIE report projected 75–100 by 2015.\textsuperscript{58} China might also retain older missiles in its inventory for longer periods instead of retiring them. The same DoD report on Chinese military power suggests that the DF–5A, Mod–2 will likely be deployed over the next few years. Chinese responses likely will remain proportionate to the size and types of missile defenses the U.S. will deploy.

The ways in which China’s responses take place will also be determined by whether it will seek to enhance the survivability of its limited nuclear forces, thus maintaining the uncertainty principle, or reformulate its nuclear doctrine to adopt a limited deterrence posture or launch on warning. The latter would also have significant impact on China’s no-first-use (NFU) principle and its ability to develop smaller nuclear warheads, raising questions about its commitment to a nuclear test moratorium. It also raises the issue of


\textsuperscript{57} Gill \textit{et al.}, “The Chinese Second Artillery Corps.”

its nuclear transparency.\(^5^9\) Missile defenses would make submarines more attractive as a means of increasing missile survivability and for launching from locations and flying on depressed trajectories to avoid detection and minimize counteraction time.

The new-generation ICBMs could be armed with countermeasures, such as decoys. Once deployed, these new capabilities will enable China to achieve real credible minimum deterrence, even under a U.S. missile defense environment. It could deploy Multiple Reentry Vehicles (MRVs) or Multiple Independent Re-entry Vehicles (MIRVs) to increase the number of warheads that could penetrate U.S. missile defenses. U.S. missile defenses would also make the deployment of penetration aids essential. However, MIRVing requires smaller nuclear warheads. Without nuclear tests, the technical hurdles involved in MIRVing could prevent its introduction in the near term. China has tested MRVs, decoys, and penetration aids, but has not deployed these capabilities on operational missiles.\(^6^0\) While Beijing may still face significant technological hurdles in adopting these measures, it could also turn to Russia for technical assistance in developing countermeasures and even develop its own missile defense systems. China and Russia may also pool their resources together to develop means to overcome U.S. missile defenses.\(^6^1\)

Indeed, technical assistance from Russia could significantly speed up China’s modernization. There have been unconfirmed reports of Ukrainian missile experts working in China, and Russia may have shared technical data on its own 4th-generation ICBM (SS–18 and

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SS–25).\textsuperscript{62} While such information is difficult to verify, recent developments in Sino–Russian and Sino–Ukrainian military cooperation are openly reported. From the Russian/Ukrainian perspective, there is much to gain through such assistance. It could further strengthen the so-called strategic partnership, and it serves to alleviate concerns about what it views as a recent tilt toward the United States. Economic factors are also important as Russia and Ukraine seek to maintain the viability of their defense industrial complexes. R&D on future weapons development could also be funded through greater cooperation with and assistance to China.

**AVOIDING NUCLEAR MISUNDERSTANDING**

U.S. decisions on ballistic missile defenses and the changing role of nuclear weapons in its nuclear strategy will directly shape Chinese decisions about force structure. While chances for nuclear confrontation between the major powers in the post–Cold War are remote, uncertainties and concerns remain and miscalculations cannot be completely ruled out in the Sino–U.S. context, especially given the contentious issues between them. For one thing, a vastly expanded and much modernized Chinese nuclear force can raise questions about the credibility of a U.S. nuclear umbrella to its allies in the region; it can also confirm allegations within the U.S. that China is driving for regional hegemony. The possibility of military conflict over the Taiwan Strait, however unwelcome, also exists and a China with inferior conventional forces has greater incentive to rely on nuclear deterrence. These factors must be addressed.\textsuperscript{63}

U.S. strategic interests in Asia call for strengthened alliance relationships, a forward military presence, and concerted efforts to prevent WMD proliferation.\textsuperscript{64} In this regard, Washington seeks to be

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\textsuperscript{62} Private correspondence with former Soviet/Russian officials.


\textsuperscript{64} U.S. Department of Defense, *The United States Security Strategy for the East*
a force of stability in the region, and it is here where Beijing may share some of the more immediate goals of its counterpart, such as the de-nuclearization of the Korean Peninsula. Resolution of the crisis could forestall a potential Northeast Asian nuclear chain reaction, with Japan going nuclear as the most serious threat to Chinese security interests. While China is concerned with Japan’s growing military role, it also recognizes the values of continued U.S. engagement in the region as a check on unbounded Japanese re-militarization. It is here that greater consultation, not only between Washington and Beijing but also a trilateral process that involves Tokyo, would be very helpful in addressing issues and concerns ranging from the missions of the U.S.–Japan security alliance, the exact role for the Japanese SDF, and the perimeter and limitation of its new responsibilities. Such efforts are already underway, albeit at lower governmental level and mostly involving Track–II activities.\(^{65}\)

Although technology and resource constraints have shaped and often limited China’s strategic modernization efforts, political and strategic factors have played an equally important role. Perceived nuclear threats from the United States prompted China’s initial decision to develop nuclear weapons.\(^{66}\) During the Korean War and the 1954/1958 Taiwan Strait crises, the Truman and Eisenhower administrations had threatened the use of nuclear weapons against China.\(^{67}\) In the

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1960s, the Kennedy administration even contemplated preventive strikes to destroy China’s nascent nuclear programs. Concerns in the early 1980s about the potential impact of the Strategic Defense Initiative prompted Chinese efforts to develop the new strategic weapons systems that will be deployed in this decade. Although the United States cannot as such dictate the size of China’s nuclear forces, Washington’s decisions about its own nuclear forces, nuclear doctrine, and political relationship with China will have a large influence on the decisions Chinese leaders make about the size and composition of China’s future strategic forces. U.S. nuclear decisions and international actions will also influence the overall health of the global arms control and nonproliferation regime, another factor in Chinese strategic decision-making. The United States needs to recognize this strategic interaction, and take China’s likely reactions into account when deciding the role that nuclear weapons should play in U.S. security.

The United States could address China’s concerns over its missile defenses by clarifying the technical parameters of its planned BMD architecture and discussing China’s responses. Strategic dialogue is important because differing assessments of BMD effectiveness mean that many Americans will view China’s response as excessive, even if China feels it is being restrained. The goal should be to minimize damage to bilateral relations through mutual strategic reassurance. The United States might offer assurances about the ultimate scope of its BMD system; China might offer greater transparency about its modernization plans (possibly including force structure levels keyed to specific missile defense architectures). Open-ended U.S. plans for BMD expansion or an explicit effort to nullify China’s nuclear deterrent would have a devastating impact on bilateral relations that would foreclose prospects for future security and arms

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69 Roberts, China–U.S. Nuclear Relations.

control cooperation. Addressing Chinese concerns without allowing Beijing to dictate U.S. policy could help avert misperceptions (and potentially moderate the size of China’s nuclear build-up). However, any serious strategic dialogue requires a minimum degree of reciprocity. Greater transparency on China’s part about its views on nuclear deterrence without revealing details in its planned nuclear force structure could go a long way toward dispelling U.S. and regional concerns.

The two countries must address the issue of nuclear misunderstanding and their long-term nuclear relationship. Here the determining factors will be whether the two view each other firstly as strategic foes with irreconcilable differences over fundamental issues, or secondly as competitors with potential conflicts of interests, but with each ascribing differing degrees of importance and commitment to some rather than others, or finally as potential partners on general international and regional security issues, with each willing to search for comprises where interests diverge. The history of the bilateral relationship suggests that all three scenarios are possible and indeed each has manifested itself at one time or another. Obviously, the reality today is a combination of the latter two descriptions, but the first scenario can not be completely ruled out and one that both countries should try hard to avert and avoid. The successful management of this critical bilateral relationship would also say a great deal and perhaps contribute to the existing debates in international relations theories.

Over the past few years, the process of bilateral security dialogue has been established between Beijing and Washington. However, that process needs to move beyond being a forum where the U.S. presents its Chinese interlocutors with long lists of the latter’s WMD proliferation violations to mutually beneficial and frank exchanges. This “new” dialogue has been apparently taking place since 9/11 and the two countries’ shared interest in defusing the North Korean nuclear crisis provides a basis to put nuclear threat reduction on the bilateral agenda. In summer 2005, the two countries established a Senior Level Dialogue between the U.S. Deputy Secretary of State and Executive Vice Foreign Minister of China on a twice—annual
basis.\textsuperscript{71} A model that could be followed may be the kind of strategic dialogue that developed over the years between the former Soviet Union/Russia and the United States. A key element of superpower arms control negotiations during the Cold War years was the development of communication channels that could address potential misperceptions and miscalculations that might trigger a nuclear exchange. A corollary of that process was the formation of what analysts later called an epistemic community that shared a culture of hard-nosed but professional exchanges on substantive life-and-death issues in the nuclear age.\textsuperscript{72} This kind of strategic dialogue is currently lacking between the United States and China.\textsuperscript{73} For instance, Chinese officials have repeatedly expressed the view that strategic political relationships will have a major impact on how China perceives U.S. BMD deployments.

Nuclear threat reduction can take a number of forms ranging from confidence building to de-targeting, to reduction of weapons. One form of confidence building can start with a mutually agreed pledge for "no-first use" between the two countries. For instance, the two countries have also signed the Military Maritime Consultative Agreement (MMCA); a confidence building measure modeled on U.S.–Soviet Incidents at Sea Agreement.\textsuperscript{74} De-targeting is another method. In the late 1990s, Beijing and Washington did negotiate an agreement on nuclear de-targeting but later events such as the Cox Report on Chinese nuclear espionage, the bombing of the Chinese embassy in Belgrade, and the generally deteriorating atmosphere diminished if not completely nullified the largely symbolic agreement.\textsuperscript{75}


Arms control is yet a third, and one would argue, very critical mechanism in managing the U.S.–China nuclear dynamic.

Thomas Schelling and Morton Halperin defined arms control as to “include all the forms of military cooperation between potential enemies in the interest of reducing the likelihood of war, its scope and violence if it occurs, and the political and economic costs of being prepared for it.”76 According to Jeffrey Larsen,

“Arms control can be defined as any agreement among states to regulate some aspects of their military capability or potential. The agreement may apply to the location, amount, readiness, and types of military forces, weapons, and facilities. Whatever their scope and terms, however, all plans for arms control have one common factor: they presuppose some form of cooperation or joint action among the participants regarding their military programs.”77

Contemporary arms control practices evolved from the U.S.–Soviet negotiations during the Cold War in their efforts to manage arms competition.78 In the broader European context, arms control mechanisms initially could be more accurately described as confidence building measures. Indeed, some even suggest that conflict avoidance measures (CAMs) may be the more appropriate term. Initial steps can be modest in that they meet “the minimal requirements of not worsening any state’s security and not increasing existing levels of hostility.” The objectives are to prevent crises from occurring, to facilitate disengagement, and based on a building block approach,

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to begin with modest aims first. Both China and the United States could benefit from starting such a process.

CONCLUSION

Chinese analysts point out that the new Chinese leadership faces serious challenges in the coming years. These include unprecedented U.S. global dominance and its impact on China's security interests re Taiwan; economic adjustments and dislocation after WTO entry; China's security concerns in Northeast Asia, including the Korean nuclear issue and the rise of a normal Japan; and Taiwan independence. Handling these challenges requires that China maintain a stable working relationship with the U.S. to advance China's interests. Certainly Beijing should not seek confrontation with Washington. Challenging U.S. unipolarity only reinforces "China threats" advocates in the U.S. government. China's responses to U.S. dominance remain low-key, and focus on key areas of fundamental security interests such as Taiwan. At the same time, Beijing is seeking opportunity to expand the cooperative aspects in its relations with the U.S. to advance its short- to medium-term interests - continued economic development and strengthening of comprehensive national power.

Hence the primary goals of Chinese foreign policy should continue to be sustaining a benign international environment for the development and strengthening of China's power; unipolarity will consequently remain a fact of life in international politics for some time to come. China should of course attempt to oppose hegemony, but at the same time avoid direct confrontation with the U.S.; unilateralism and
preemption, while deplorable, are not directly targeted at China and therefore confronting unipolar hegemonism should not be China’s strategic priority. China’s security interests are better served by seeking and developing strategic dialogue with the U.S. to reduce mistrust and better address China’s security concerns.82 Beijing’s efforts in cooperating with Washington on the North Korean nuclear and anti-terrorism issues and its participation in the U.S. Container Security Initiative are guided by such recognition.83

At the same time, the U.S. is focused on global terrorism and WMD proliferation. The new U.S. national security strategy emphasizes the importance of major power cooperation. However, as much as both countries seek to maintain a stable bilateral relationship, there remain issues that could drag them into conflicts. Due to the asymmetry in both nuclear and conventional capabilities, miscalculations and incentives for nuclear use exist. Beijing and Washington need not repeat the Cold War U.S.—Soviet nuclear arms race that resulted in huge nuclear arsenals on both sides that threatened the whole human race. Indeed, their efforts to avoid future nuclear confrontation would make a significant contribution to global and regional peace and stability. Managing their differences over the U.S.—Japan alliance, missile defenses, and the cross—Strait relations would be significant issues to start with in testing their respective resolve to do so.

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INDUSTRIAL POLICIES, CHAEBOLS, AND MARKET REFORM AGENDA IN KOREA

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ABSTRACT

This paper provides a bird’s-eye view on the evolution of Korean industrial policies. Special attention, however, is paid on how the chaebols have grown out of the Korean industrial policies under the Centralized Management Economic System (CMES). After reviewing both the major contributions made and the harms caused by this unique feature of the Korean industrial structure, an in-depth analysis of recent government chaebol policies following the economic crisis of 1997/98 is undertaken. A number of suggestions are presented for future industrial policies on the basis of this analysis. In so doing, this paper tries to emphasize that the chaebol problems can not be solved without government sector reform. In other words, without modification of the CME system, no feasible reform of the chaebols can be expected.

Key Words: Industrial policy, Korean economy, Chaebol, CMES

INTRODUCTION

On December 30 2003, the Korea Fair Trade Commission (KFTC) announced its new vision for the Korean economy under “The Three-year Market Reform Roadmap,” which could be summarized as follows.

First of all, the reform was to be carried out in terms of free market competition by strengthening the market’s self-monitoring
mechanism, while the government’s direct regulation of the market would be eased and reduced on a gradual basis.

Secondly, in order to increase efficiency in resource allocation and enhance the status of the Korea economy, the reform was aimed at establishing a fair and transparent economic system through the introduction of class action lawsuits, amendment of audit related laws, disclosure of information on activities related to terms of corporate restructuring, and maintenance of a firewall between industrial capital and financial capital.

Thirdly, in order to improve corporate ownership and governance structure of large business conglomerates, disclosure of information relating to these two areas was requested to be expanded. In addition, regulations pertaining to total equity investment, which were first introduced in 1987 to prevent major shareholders from expanding their control and forming inflated capital via complicated equity investment among affiliates, were targeted for improvement by setting the graduation standard of the regulations¹. Further, companies were encouraged to have advanced holding company structures.

Judging from the vision and goals of the market reform and policy measures for each goal, we could witness quite a turnaround by the government from the traditional development—oriented industrial policy principles of the last century.

In any case, capital development was understood to be an essential process of institutional modernization and industrialization by Local Development Corporations (LDCs) during the period of early economic development that occurred generally throughout East Asia during the 1950s and 1960s. Establishment of an industrial society was thus a major concern for economic development. When it came to economic development strategies, however, the emphasis was put mostly on quantitative accomplishments in terms of major macroeconomic indicators. Microeconomic or institutional approaches to industrial policy were often neglected as a result. Korea was no exception in this respect.

It is customary for a study on industrial issues of a nation to

consider industrial organization, structure and related policies as a whole. This paper will, however, concentrate on the evolution of industrial policies of Korea, the economic effects of those policies and the so-called chaebol problems associated with them, in particular considering their relative importance.

In order for economic development to be achieved through industrial development or industrialization, it is essential that private property rights are legally acknowledged, that the pursuit of economic self-interest based on them are guaranteed, and that the free market mechanism is promoted. It is not easy for developing countries to establish such a system or to provide an environment conducive for one in a comparatively short period; it usually takes a lot of time for the free market mechanism to properly function through autonomous operation. Korea, in particular, which underwent a debilitating colonization and a brutal civil war, could not achieve industrialization through the free market mechanism and thus needed a positive and leading developmental role of government, and its intervention at the same time. In a nutshell, Korean industrial policy can be characterized by the term, "aggressive industrial policy," in which the government aggressively intervened in the market whenever it was thought needed or desirable, and by doing so led the industrialization process. A policy principle of this kind surely contributed to upgrading the industrial structure, increasing exports, and expediting economic growth. Nevertheless, at the same time it has also engendered serious adverse effects in recent decades. As a new international order emerged with the opening era of WTO, traditional industrial policies could not be carried out any longer. The time has come for Korea to reconsider its long-cherished policy principles. Fundamental reform of industrial policies is now an urgent matter for the new century.

In order to establish new policy principles to meet such needs, this paper will review Korean industrial policies and their characteristics as well as the background which led to the formation of the chaebol, their economic impact on the Korean economy, and recent government reform policies on the chaebols following the 1997/98 economic crisis. Finally, it will derive some suggestions for future policy principles based on such a review.
EVOLUTION OF KOREAN INDUSTRIAL POLICIES

Korean industrial policies can be properly analyzed when they are studied in conjunction with Korea's basic economic development strategy, i.e., rapid economic growth through export-oriented industrialization. Korean industrial policies thus share common characteristics with a so-called government-led CMES (centrally managed economic system), and have evolved along with the development stages of such a system. In the following section the evolution of Korean industrial policies will be reviewed based on the development phases of a CMES.

Foundation period of Market Economic System and Industrial Base: 1945~1960

Following liberation from Japanese rule in 1945, the Korean government tried to pave the way for a free market economic system with the cooperation of the US military government by establishing a modern ownership system, i.e. a free market system based on private property rights. Coupled with the political objective of democratization of ownership, two major economic reforms were carried out. One of them was farmland reform and the other was the privatization of confiscated enemy properties (factories and enterprises). Through the former, modern ownership of land was established in the form of democratic redistribution based on the "farmers only" principle. All the enemy farmland and tenant farmland over 3 chongbo in size were to be sold to farmers. It ended semi-feudalistic ownership and the tenant farming system, and created many small modern farm owners. The latter reform, on the other hand, contributed to creating modern capitalists and was a first step in the primitive accumulation of capital. The principle of so-called pre-emptive rights was adopted in this reform in the process of selling confiscated enemy properties. This principle was condoned both by the Korean government and the US military government.

There were, however, conflicts at the outset of the reform over how to privatize enemy properties. The government insisted that a
privatization method based on the principle of pre-emptive rights, one which favored experienced management staff, be adopted, while congress, the majority of whom were landlords, suggested that when purchasing enemy properties, priority should be given to former landlords who had been forced to sell their farmland to the Japanese colonial government and new independent farmers. The government remained firm in its position on having its principle adopted as the official privatization method. Priority was given to directors and executives, stockholders, former management and employees, and former landlords who had sold their farmland to the government in that order. Such a pre-emptive rights oriented privatization method gave an advantage to those experienced managers under the Japanese rule or the US military rule and helped them to regain their control over industrial ownership. This policy was initiated by the government in part to expedite social stability through the expeditious restoration of productive activities. The government also needed to build a supportive right-wing industrial group to cope with a developing ideological confrontation with North Korea and the left-wing activities in support of the North that were currently underway in South Korea.

It was a second best decision in a sense. It was unpopular, but efficient. It could not avoid criticism, since it was obviously against the general principle of democratic privatization. The land and property sales prices were real bargains. Properties were sold based on government-set 1945 book prices which were a lot lower than their-prevailing market prices. In addition, payment was allowed to be made by installments for as long as fifteen years, which was almost as good as purchasing the properties for free when we consider the ferocious inflation rates in the 1950s. Further, ownership was allowed to be exercised from the very first installment payment, providing a very attractive deal to those who had pre-emptive rights. This was not the case, however, from the government’s perspective, which was unable to add any significant funds to government revenue from these sales. Despite this, new industrialists were created and a base for primitive capital accumulation was formed during this process.

Sales of confiscated enemy properties for privatization started with small and medium-sized businesses, and later moved to big
enterprises. Almost all the big national enterprises were privatized until the end of 1954. Even commercial banks were sold in the latter half of the 1950s. The privatization principle was a strong policy recommendation from the US. Then-president Seungman Rhee was, however, believed to implement the privatization policy on a wider scale than was actually needed at the time, since some of the later privatization that was carried out was more politically motivated than economically motivated, and thus was mixed up with corruptive influences and transactions. Particularly of note was the fact that small and medium-sized businesses were active and led national production, but this was true only until big firms were privatized, receiving at the same time diverse benefits and government support such as lower loan rates, tax benefits, and so on. In spite of the establishment of the modern ownership of enterprises, the artificially created advantages that the big enterprises enjoyed helped them to begin exercising unduly monopolistic power from the 1950s.\(^2\)

Although the government put the promotion and management of international trade and foreign exchange rate determination under government control, in view of the underdeveloped industrial production capacity, the overall government industrial policy was in general to promote the establishment of a free market economic system, and to minimize government intervention. The excessive pursuit of privatization at all costs did, however, bring problems: in particular the sale of commercial banks was carried out without adequate forethought or proper preparation and before the market environment was mature enough to handle it. It established a private retail and personal banking sector, but this ended up being re-nationalized when a military coup broke out in 1961. It aptly illustrated the fact that the pursuit of pure market economic principles cannot be successful or desirable in times of extreme social instability or war, or in an immature society.

In any case, the big business oriented industrial structure, which resulted from a privatization policy based on the principle of preemptive rights, was further consolidated in the process of economic

\(^2\) Lee and Yoo (1995)
reconstruction after the Korean War for the following reasons.

First of all, what were desperately needed following the Korean War were food, medicine, and other daily necessities, together with the restoration of production facilities. Relief goods were supplied mostly through foreign aid, while major consumer goods had to be supplied through the expeditious restoration of domestic production facilities. Thus, this situation gave rise to the "real-demands principle," which allowed distribution of aid material (including industrial equipment) only to those who already had operational facilities.

Secondly, a serious consequence of the "real-demands principle" was that it gave a windfall gain to those who could acquire aid materials, since the Wholesale Price Index (WPI) rose four times during the 1953-61 period. On the other hand, even when the official exchange rate approached the market rate in 1955, the discrepancy between the sales price of aid materials and their prevailing market price ranged from 7 to 73% at any one time. Thus, the government was actually responsible for fostering a consumer goods industry and later on paving the way for the rise of the big-business oriented Chaebol structure.

Thirdly, in addition to the advantages given to those who had operational production facilities, especially in relation to the "three-white" industries (the cotton, wheat and sugar industries), the government provided them with special benefits such as the application of much lower interest rates for their loans, mostly 10% or lower, which was lower than the general bank loan rate of 18.25%, and much lower than the informal curb market rate of 48% (4% per-month) prevailing among private lenders. Even the inflation rate was higher than the nominal bank loan rate at that time. Further, various tax credits and benefits were added. Also, loans were allocated in favor of big firms. This in turn made the equity capital ratio of big firms lower than that of small and medium firms. The former was 28%, and the latter, 46% in 1960. Such a practice was instrumental in contributing to the establishment of a special government-business nexus and inevitably led to wide-scale corruption. The usual kickback rate for bank loans was reported to be about 20% (Shin, 2000, 277).

Fourthly, such a procedure helped those big businesses to form
cartels such as the Korea Textile Association, through which they could monopolize raw material aid such as cotton (100%), molasses (100%), wheat (81%), and sugar (27%). These associations also practiced sales cartelization. For example, 19% of the textile industry took 89% of the market, while only 2% of the sugar industry accounted for 92% of the market. The Che-il Woolen Textile Co. controlled 60% of the market, and three leading flour milling companies took up 50% of the market in the 1950s.

Since such monopoly positions were not built up based on economic productivity, but rather on special benefits from the government, the firms involved could establish neither optimum levels of production scale, nor competitiveness in international markets. In addition, labor productivity was estimated to be as low as one third or one half of the level of their Japanese counterparts in the textile industry (cotton).

What made those industries either flourish or survive was the preferential treatment they received in terms of aid material allocation, special benefits in tax and financing, monopolistic business operation, and most of all, the utilization of labor for long working hours for very low wages. People worked 11–12 hours a day for a monthly salary of 13–26 thousand hwan, when the minimum living expenses of laborers of 8 hours working was set at 23 thousand hwan. This was possible because there was an abundant supply of unemployed labor. The unemployment rate was estimated to be 45%, if a 20% level of hidden employment was included.

All these facts helped big businesses grow with high profits. The gains only from the difference between fluctuating exchange rates were estimated to be as big as US$1.3 billion during the period 1953–1960. Nine of the biggest ten Korean Chaebols established their core sectors during this period. Unfortunately, their products were centered around aid raw material related products such as cotton, wool, sugar and food. Consumer goods industries such as fertilizer, cement, and flat glass, which could generate bigger forward and backward linkage effects, had not yet been established.

In short, the big-business oriented industrial structure was not the outcome of natural market competition, but rather was a
consequence of government policies such as the “real demand” principle. Attention was neither paid to the long-term planning for an industrial structure, nor to the efficient allocation of resources when considering industrial policies. Although the government intervened in the market to some extent through the application of the real-demand principle, the fluctuating dual exchange rate system, import restrictions, and so on, this period could be classified as the defensive industrial policy period. Although an artificial allocation of resources was carried out by the government, the degree of government intervention remained relatively low at this stage.

**General Export Oriented Industrialization Policy Period: 1960s -early 1970s**

Seungman Rhee was dethroned by the April 19 Democratization Movement in 1960, and was succeeded by Myon Chang, who was himself ousted by the 1961 military coup leader Chung Hee Park. Both the Chang and Park governments condemned big business groups as illicit fortune makers, and penalized them for their illegal profiteering in the process of confiscated enemy property privatization and aid material allocations. Some of them, including all the major commercial banks were nationalized at this time. Special consideration was bestowed upon small and medium businesses and the agricultural sector, which had been given a cold shoulder in the past. For example, curb loans and usurious loans of farming and fishing families were consolidated, new bank loans were offered to help finance farm expenses, and agricultural commodity prices were stabilized and maintained. An industrial structure oriented towards an import-substituting light-industry was, however, retained together with the catch phrase “the establishment of a self-sustainable economy.”

Faced with difficulties of economic development, coup leaders came to induce big business groups to participate in national projects by allowing them to concede a proportion of their company stocks to the government, instead of punishing them as originally intended. It was quite ironical that the reform government which proclaimed that the eradication of past corruption practices and the punishment
of illegal profiteering were among its goals, finally accepted big
business groups as partners due to the significant role that their
businesses played in the national economy.

The military government never failed to exercise its control over
big businesses by extending its policy of nationalization to some of
the leading enterprises including major commercial banks. Nationalization
of the banks enabled the government to seize the power of financing
and to control the supply route of money. Consequently, an aggressive
industrial policy principle was established in the process. Not only
the mobilization of capital, but also its allocation came under the
government’s full control, by which it was able to take the lead in
economic development planning through the establishment of a CME
system.

On the other hand, the government came to the conclusion that
economic development could not successfully be achieved with an
import—substituting industrial policy alone. An EOI (export—oriented
industrialization) strategy was thus soon adopted instead. Korea could
not raise any foreign exchange with the development of import—
substituting industries alone, so the government simply necessitated
an increased demand for foreign exchange. Korea tried to finance

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3 CMES (Centrally Managed Economic System): The terminology is employed in
this article to describe the characteristics of the Korean economic development
process. With this term, I try to emphasize the role of the government (or political
power group) and its bureaucrats who played a leading role in establishing economic
development plans and executing policy. With this term, I try to refute other popular
approaches including the dependency model approach at the same time. Marxists
emphasized the role of ownership of the means of production, with which they tried
to explain productivity, the production relationship and consequent inequality.
However, I try to emphasize the fact that managerial control and the power of the
government and bureaucrats played a bigger role in the Korean economy than
artificial or legal ownership.

On the other hand, I also introduce this terminology in order to put emphasis on
the fact that the feudalistic bureaucrat system stemmed from the Kwa—keo—j, which
still exists in the minds of the Korean people, even though the formal ownership of
the factors and means of production were transferred to the private sector. The
monopolistic power of an absolute monarchy and nationalization of all the means
of production are gone. However, the practice of centralized management has, in
Korea, long been part of government.
export industries with all possible means, while it did its best to supply needed capital through foreign loans, domestic currency reform, and even reparation payment from Japan. As a result, a new industrial policy principle was established to pursue rapid economic growth through an EOI policy under strong government leadership. This in effect was how the CME system was created.

A salient feature of the industrial policy in the 1960s was that it favored exports in general, without specific sectoral preferences or biases. It could thus be differentiated from 1970s industrial policy that gave priorities to some specific strategic sectors, and so it might be described as a general EOI policy. It simply favored credit allocation for exporters in general, with the notion that export-oriented investments could bring about higher social returns than import-substituting investments. What was particular about this policy principle was that it induced competition among exporters, whether intended or not.4

On the other hand, the Park government maintained its policy of favoring a big-business oriented industrial structure by rewarding firms exhibiting size and growth with access to scarce capital and further set the stage for the formation of family-owned firms and the concentration of industry in the hands of a few.

To recapitulate, the aggressive EOI strategy, which was in accordance with the CME system of maximum government intervention, originated from the industrial policy of the 1960s, and contributed to the growth of Korea's unique chaebol oriented industrial structure. Government-owned financial intermediaries controlled interest rates, foreign exchange rates, and rationed credit, based on a centrally managed credit allocation policy. Such a system was supported by the holding of monthly export promotion meetings where even the president, together with cabinet members and business leaders would attend.

Strategic Sectoral EOI Policy Period: mid- and late 1970s

The Park regime extended its reign through a national referendum, but eventually had to face the dissatisfaction of the US government.

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4 See Westphal (1990) and Krueger (1997) for details.
President Park had to cope with a rising incidence of bankruptcy among many businesses that had been reliant on foreign loans to finance their operations, and which had begun to experience serious setbacks due to their weakened state of international competitiveness since the late 1960s. The balance-of-payment deficit had also grown incessantly due to the increasing dependency of export industries on foreign raw materials and intermediate goods. In order to solve all these problems, President Park executed a far-reaching financial policy, called the August 3rd Measure, in an effort to rescue the troubled industries. At the same time, he set out the HCI (heavy and chemical industry) drive. By so doing, he intended to build a more self-sufficient economy by lowering its dependency on foreign intermediate goods. President Park also thought that Korea and his regime could be freer from US political intervention by building its own munitions industry. This determination was encouraged by the unexpected turnaround from the 1973 oil shock to the so-called Middle East Boom in the mid-1970s. During this period, Korea experienced a balance-of-payments surplus for the first time in its history, thanks to the high earnings of construction companies stationed in the Middle East. The HCI drive received support as it was seen as a means of upgrading Korea's industrial structure by establishing high value-added industries, reducing foreign dependency by creating domestic intermediate-goods industries, and regaining the country's competitive edge over the newly emerging LDCs.

The HCI drive policy could be differentiated from the 1960s' general EOI policy in that it was a strategic-sector oriented policy in nature. The government adopted an extremely favorable and selective interventionist approach favoring the HCIs. This typical sector-oriented HCI promotion policy thus boosted the upsurge of large-scale, capital-intensive industries through strategic supports such as tax exemptions, custom rebates, low strategic loan rates, and easy access to foreign exchange. Indeed, this was the very measure that contributed the most to the consolidation of the chaebol-oriented industrial structure so prevalent in Korea today. The

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5 See Hee (2004, ch.6)
government even selected which particular HClS to build and support, and coercively invited or rather forced private business groups to participate in the project with extremely differentiated benefits. The government even initiated the building of entry barriers in favor of the selected HCIs.

With the HCI drive, Korea could substantially raise its level of industrialization, develop some potentially world-class firms, and enter the lucrative, Japanese-dominated markets (Leipziger, 1988; Leipziger and Petri, 1994). Criticisms were, however, voiced against this policy at the same time in that it created inappropriate industry choices, excessively capital-intensive and overlapping investments in an otherwise capital-starved economy, and retarded trade and financial liberalization. In fact, the HCI drive indirectly forced the use of domestically produced intermediate goods and parts, and led to the restriction on imports of raw materials and intermediate goods until Korean HClS could build up their international competitiveness. In the early stage of HCI development, Korea exercised an import-substituting industrial policy. The final and primary objective of the HCI drive, however, was aimed at strengthening the EOI policy first introduced in the 1960s. The fact that the major export items of Korea from the 1980s were HCI products was hard evidence of this.

The HCI policy, which was implemented through directed, subsidized credit, selective protection, regulations affecting industrial entry, and direct government intervention in industrial decision-making was considered a fiasco by most Korean scholars. It received other evaluations in recent years from outside the country. The World Bank’s assessment was neutral, while even favorable light was shed on it by some scholars like Amsden (1989) and Wade (1990). Major criticisms stemmed from the following negative aspects of the HCI policy.

First, most of the leading Korean chaebols established their core business sectors during the process of the pre-emptive right oriented privatization of confiscated enemy properties, and real-demand oriented allocation of aid materials in the 1950s. They increased their size through benefits from the government’s EOI policy in the 1960s, and finally grew into world-class business groups in the 1970s.
by participating in the HCI drive, for which the government provided them with generous financial support and special treatment. Their monopolistic power was not built based on their efficiency or competitiveness, but was artificially created through government favors. What was the worst part of this process was that the chaebols could take over ownership of bankrupted firms with preferential treatment through collusion with government or bureaucrats, could earn special financial benefits simply by participating in government-directed projects, and even could earn windfall gains by participating in the construction of special industry complexes. The chaebols even extended their businesses to every possible sector where they did not have any professional know-how through a policy of business diversification. By so doing, they became conglomerate business groups spanning manufactures, logistics, construction, and financing in addition to international trade. For the extension of their businesses, they often used funds for other purposes than directed by the government, such as for land speculation.

Second, it was true that subsidiaries of the same business group could improve their efficiency by lowering costs or dispersing risks through vertical or horizontal integration, exercise expeditious business decisions, and mobilize needed capital to a maximum level. They were, however, concentrating on increasing their group size, through cross-investments and cross-liability guaranty, and increasing their monopolistic power. Realizing the crucial role of the government, which was essential for their growth and safety, the chaebols took collusive action with the government whenever big deals were at stake. In consequence, the government-led HCI drive brought about a business-government nexus, monopolistic industrial structure, and large family-owned and family-operated chaebol groups. Discretion rather than rules worked in any important economic and business decisions taken in the late 1970s.

Foundation Period of Market-Oriented System: 1980s

The HCI drive was reconsidered following the October 26 Incident in 1979, when the initiator of the drive, then-President Park was
assassinated. Discussions were made on how to minimize its aftermath. The final decision was to abandon the policy of HCI preferences and to terminate strategic credit allocation in order to spur competition. Through the 1985 formalization of the Industrial Development Law, selective industrial promotion laws were simultaneously repelled. Preferences were shifted away from intensive interventions in HCI in favor of small and medium industries, while support for research and technology replaced directed credits as the mainstay of policy. In addition, financial section liberalization was begun, starting from the sales of commercial banks to shareholders, although much less progress was made than expected in the 1980s. Further, a long-term trade liberalization schedule was released and embarked upon. Import liberalization policy was begun in May, 1978, followed by the liberalization of foreign technology imports in April, 1979, an expansion policy of direct foreign investment (DFI) in Korea (Sep., 1980), and the adoption of more liberal DFI regulations, and so on. This liberalization policy was escalated in the late 1980s in the face of strong pressure from the US to open up its markets, three-year long balance-of-payments surpluses, and consequent inflationary pressure.

On the other hand, Korea enacted the fair trade law in 1980, and began to implement it from April 1981. It was aimed at establishing a law to regulate unfair trade and to restrain economic concentration by the chaebols at the same time. Such ambitious government policy objectives could not be fulfilled easily in a short time due to the long-prevailed environment of government regulation, protection and support. The government itself still had not abandoned its ad hoc industry interventions. For example, it restricted entry into industries where size was thought to be necessary for export success. To be specific, Samsung Group’s intention to buy the ill-fated KIA co. was denied. The government also helped to rationalize various sunset industries with government-mandated mergers, divestitures, and closings. It kept the badly damaged financial sector solvent, while eight industries were rationalized under the Industrial Development Law.

The Korean government also remained closely involved in credit policy. Sanctions against the chaebol’s excess land holdings, and prevention of bank credit abuse were good examples. Besides, the
chaebols were told to select three core operations for specialization, which would be exempted from credit limits. This implied that access to credit still remained rationed and could be politically determined. Consequently, the potential for the abuse of such systems controlled in this way continued to grow. Finally, the government even allowed financial institutions to borrow short-term loans from abroad and in turn provide them to domestic businesses on a long-term basis, without proper consideration of its possible consequences. In fact, this policy mishap contributed to the 1997 financial crisis.

In sum, the 1980s were a period where Korea began to realize the importance and necessity of a market-competition oriented economic policy instead of a government-led regulatory one. Thus the basic policy principles were set with the intention of: shifting from government-led to private sector-led economic development; promoting market competition through deregulation and termination of strategic credit allocation; expanding trade liberalization in order to cope with the monopolistic concentration of the domestic market together with inflation; and finally to enhance international competitiveness.

Industrial Policy Reform Period and Dilemma: 1990s

Entering the 1990s, the Y. S. Kim government extended the deregulation, decentralization, and liberalization drive still further, while at the same time trying to remain at arm’s length from traditional, aggressive industrial intervention. It simply tried to provide a favorable environment for efficiency-oriented market competition. It even discontinued the practice of setting up major macroeconomic targets and policy measures to accomplish them based on the traditional economic development planning mechanism. Despite such substantial adjustment efforts, however, Korean industrial policy continued to be dominated by the goals and instruments of the past, although these turned out to be much less effective in the 1990s.

Korean industrial policy was in fact in confusion. One of the key problem areas was the chaebol. Government was ambivalent toward it. Korea continued to need strong big companies to pursue global technologies and markets, while at the same time it was concerned about the power
of the chaebol. The government thought that it still needed some instruments to control the chaebol’s behavior, and thus had to maintain some power through financial leverage. Such an ambivalent attitude on the part of the government resulted in ad hoc interventions and inconsistent policies and damaged the government’s credibility regarding economic policy. The close relationship between business and government, once referred to as “Korea Inc.,” was over, while the prospects of reestablishing a healthier and more transparent cooperative business—government relationship in the near future were not bright. This dilemma retarded industrial policy reform, and failure to carry out the necessary reforms contributed to the outbreak of the 1997 financial and economic crisis. Nevertheless, reform policies were more rigorously carried out following the crisis and some noticeable progress was made in this endeavor. The cooperative spirit between business and government was, however, difficult to revive. It was apparent that it would take quite some time to establish a new paradigm of industrial policy to replace the old one.

SEARCH FOR A NEW PARADIGM OF INDUSTRIAL POLICY

Korean industrial policy had been at the center of the CME system, coupled with the government’s directed credit policy. This rapid economic growth policy based on the EOI strategy under the CME system gave birth to an aggressive and selective industrial policy. It is true that this contributed to rapid economic growth, the creation of world—class business firms and to upgrading the industrial structure. Nevertheless, it also brought about some adverse effects at the same time, such as inefficiency resulting from excessive government intervention, an unbalanced industrial structure stemming from strategic credit rationing and over—diversification, and excessive

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6 In addition, the Korean chaebols were too diversified and needed to become nimble in order to be internationally competitive. Further, the weakness of the Korean industrial structure that stemmed from preferential treatment for large companies was evident in the underdeveloped infrastructure of small—component and parts suppliers, compared with its competitors.
and overlapping investments originating from flag-ship type business operation by the chaebol. This environment resulted in an economic structure afflicted by high-cost and low efficiency for the government and the business and financial sectors and contributed to the financial crisis in the end. To remedy this situation, a much more rigorous transformation program of industrial adjustment has been implemented since the crisis. Faced with recent difficulties in industrial reform, however, some even argue that Korea simply has lost its competitive edge by abandoning policies of selective and strategic support of industry without establishing suitable alternatives. Others maintain that Korea has been reluctant to abandon an intervention strategy that is no longer suited to Korea’s modern, complex economy.

It is obvious that the same government instrument may produce different results in different environments, i.e. the effectiveness of policy instruments are constantly changing. Instruments appropriate in one economic environment can be ineffective or illegal in others. Especially, in the case of developing economies, early development bottleneck problems vanish with economic growth, while others take their place at more advanced stages of economic development. The time has come for Korea to reconsider its long-cherished industrial policy instruments. A new policy paradigm must be one that is neither based on Korea’s past policy principle nor on the elusive “lassaiz-fair” principle. Whatever the form that the new one takes, it should be able to create a conciliatory environment capable of resolving the type of conflicts between business and government that have arisen from recent industrial reform policies. It should also be one which can help Korea’s existing large corporations become world-ranked competitors, and develop a strong infrastructure for small and medium industries at the same time. Government intervention if needed, however, should remain functional rather than be directly selective. The time has come for the bureaucracy to confine itself to statutory powers, rather than being swayed by political motives, instead it should concentrate on the coordination and sharing of information and regulatory activities. Simple disentanglement of the government from direct intervention wouldn’t be enough, however. Although authority over resource allocation would be shifted to the private sector, we would also need to expose private firms to greater competition and firmer
regulatory oversight. More importantly, the government would need to maintain a firm but consistent and predictable regulatory environment.

Chaebol Policy

What is the Chaebol?

The Chaebol is a business group of large companies which are owned and managed by family members or relatives in many business areas. It is unique in Korea and differs from the US conglomerates, the Japanese Kairetsu or the German financial clique in that it consists of varied corporate enterprises engaged in diverse businesses that are owned and controlled by typically one or two family groups.7

What is interesting about the chaebols is that their distinctive features are a private sector replica of the central government in Korea. They are characterized by an ambitious and aggressive entrepreneurial orientation, paternalistic leadership and centralized planning and coordination. Family controlled and managed chaebols can be very efficient in making quick decisions, since power is centralized in the hands of CEOs, who are seldom changed, and whose decisions are absolute. In fact, the majority of top managers are family members, although they are not professionals. The Korean chaebols formed a close relationship with the government, but as subordinates, since their financing came mostly from government.

Chaebol Habitat

The chaebols are a natural outcome of the Korean economic development policies. They are not an object to protect or to sublate or ostracize. They are a part of the Korean economy. Accordingly, they cannot be considered independently from Korean economic

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7 Japan had the Zaibatsu before WWII that were held by family members, although they still differed from the Korean chaebol. The Zaibatsu were dissolved by General MacArthur following WWII, through the redistribution of stocks and the prohibition of management or previous managers or owner groups to be involved in their future operation. They eventually evolved into the current form of Kairetsu.
policies and structure. They are an offspring of the economic development strategies under the CME system. Before drawing any conclusions about the types of problems arising from the chaebol, we need to examine the major arguments related to criticisms of the chaebols.

First of all, as noted earlier, the formation of the chaebols started as early as the 1950s. The core businesses of the chaebols were established through the cheap acquisition of enemy properties (based on preemptive right oriented privatization), the exclusive allocation of foreign aid materials (based on the real-demand principle), the acquisition of import licenses and quotas, lower interest rates, and participation in government contracts. Such a big-business oriented industrial policy principle was strengthened through government-directed support systems such as tax exemptions, customs rebates, and subsidized credits in the 1960s, and more rigorous selective and strategic credit rationing in the 1970s; these were all measures which were adopted in pursuit of rapid economic growth on the basis of an EOI strategy.

As the chaebols became more powerful, they began to exercise their influence on important economic and political policy decisions. They used the significance of their businesses to the national economy as a useful weapon in trying to extend their operations further, perhaps with the notion that they were simply “too big to fail.” They did not mind making excessive or overlapping investments as long as they helped their growth strategy. Any capital shortage problems were solved through cross-investment or cross-liability guarantees. This strategy definitely weakened their competitiveness, increased their debt service ratio, and lowered their equity capital ratio. In addition, whenever they were in danger of going bankrupt, they simply asked for the government’s financial support. They knew that the government could not refuse their requests due to the importance of their businesses to the Korean economy. Eventually this government bailout approach was to lead to insolvency problems at many financial institutions.

Secondly, economic concentration by the chaebols reached its peak when the HCI policy was driven intensively in the 1970s. The concentration ratio of the largest 50 or 100 firms in the mining & manufacturing sectors rose from 17.8% and 28.7% respectively in 1970 to 34.7% and 45% respectively in 1977. This trend eventually
stabilized, however, as investments in HClS were reduced during the late 1970s. Consequently, oligopolies became more prevalent in industries than either monopolies or duopolies.

Thirdly, industrial concentration was reduced during the first half of the 1980s, as the government shifted its policy principle toward a private-sector oriented economic system together with the liberalization of financial transactions and international trade. For example, the sum of CR3 (market share of the biggest three firms) has been downwardly stabilized since the 1980s. In addition, the concentration ratio of the largest 30 chaebols in the mining and manufacturing sectors began to slide following its peak during the 1981–5 period, and the general concentration ratio of the largest 100 firms has also exhibited a declining trend since 1981.

<Table 1> Market Concentration

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Industries Whose CR3 ≥ 75</td>
<td>146 (35.0)</td>
<td>182 (34.1)</td>
<td>145 (24.3)</td>
<td>113 (18.9)</td>
<td>113 (18.9)</td>
<td>136 (23.0)</td>
</tr>
<tr>
<td>Number of Industries Whose CR3 ≥ 95</td>
<td>61 (14.6)</td>
<td>71 (13.3)</td>
<td>62 (10.4)</td>
<td>41 (6.9)</td>
<td>45 (7.5)</td>
<td>62 (10.5)</td>
</tr>
<tr>
<td>Average CR3 for All Industries</td>
<td>62.3</td>
<td>58.3</td>
<td>52.5</td>
<td>46.3</td>
<td>46.9</td>
<td>50.6</td>
</tr>
</tbody>
</table>

Source: The Korea Fair Trade Commission
Note: CR3 represents the sum of market share of the biggest three firms, and figures in parenthesis represents the ratio to the industry.

<Table 2> Weight of the 100 Biggest Firms in Mining and Manufacturing

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Production Base</td>
<td>46.2</td>
<td>37.2</td>
<td>39.2</td>
<td>39.6</td>
<td>47.8</td>
<td>45.1</td>
<td>44.8</td>
<td>43.7</td>
</tr>
<tr>
<td>Employment Base</td>
<td>22.2</td>
<td>18.6</td>
<td>18.3</td>
<td>17.5</td>
<td>21.0</td>
<td>18.1</td>
<td>17.0</td>
<td>16.0</td>
</tr>
</tbody>
</table>

Source: The Korea Fair Trade Commission
The number of subsidiaries of the chaebols did not decrease, however, until the mid-1990s. The largest 10 chaebols owned a total of 272 subsidiaries in 1987, a figure that had risen to 356 by 1999⁸. Furthermore, each one of the largest five chaebols controlled approximately 40 subsidiaries up to the mid-1990s, spanning about 30 different business areas: the fact also that a similar level of production was achieved, yet with a greater number of subsidiaries than the chaebols had had in the 1980s, signaled their weakened competitiveness and efficiency. It was a consequence of the over-diversification of their businesses instead of specializing in specific core sectors.

<Table 3> Number of Affiliates of the 10 Biggest Chaebols

<table>
<thead>
<tr>
<th>Year</th>
<th>1987</th>
<th>1990</th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2005*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rank</td>
<td>Chaebol</td>
<td>Number of Affiliates</td>
<td>Chaebol</td>
<td>Number of Affiliates</td>
<td>Chaebol</td>
<td>Number of Affiliates</td>
</tr>
<tr>
<td>1</td>
<td>Hyundai</td>
<td>32</td>
<td>Hyundai</td>
<td>39</td>
<td>Hyundai</td>
<td>48</td>
</tr>
<tr>
<td>2</td>
<td>Daewoo</td>
<td>29</td>
<td>Daewoo</td>
<td>27</td>
<td>Samsung</td>
<td>55</td>
</tr>
<tr>
<td>3</td>
<td>Samsung</td>
<td>36</td>
<td>LG</td>
<td>58</td>
<td>Daewoo</td>
<td>22</td>
</tr>
<tr>
<td>4</td>
<td>LG</td>
<td>57</td>
<td>Samsung</td>
<td>45</td>
<td>LG</td>
<td>50</td>
</tr>
<tr>
<td>5</td>
<td>Ssangyong</td>
<td>22</td>
<td>Hanjin</td>
<td>17</td>
<td>SK</td>
<td>32</td>
</tr>
<tr>
<td>6</td>
<td>Hanjin</td>
<td>13</td>
<td>SK</td>
<td>24</td>
<td>Ssangyong</td>
<td>22</td>
</tr>
<tr>
<td>7</td>
<td>SK</td>
<td>16</td>
<td>Ssangyong</td>
<td>21</td>
<td>Hanjin</td>
<td>23</td>
</tr>
<tr>
<td>8</td>
<td>Hanwha</td>
<td>22</td>
<td>Lotte</td>
<td>31</td>
<td>Kia</td>
<td>14</td>
</tr>
<tr>
<td>9</td>
<td>Daewin</td>
<td>14</td>
<td>Kia</td>
<td>10</td>
<td>Hanwha</td>
<td>29</td>
</tr>
<tr>
<td>10</td>
<td>Lotte</td>
<td>31</td>
<td>Hanwha</td>
<td>27</td>
<td>Lotte</td>
<td>29</td>
</tr>
<tr>
<td>Average</td>
<td>27.2</td>
<td>29.9</td>
<td>32.4</td>
<td>40.0</td>
<td>35.6</td>
<td>35.1</td>
</tr>
</tbody>
</table>

Note: *Hyundai Motors and POSCO were treated as independent groups since 2001
Source: The Korea Fair Trade commission

⁸ The number of subsidiaries seemed to show a decreasing trend following the foreign currency crisis, but soon bounced back to the 1999 level.
Fourthly, the ratio of family owned stocks of the largest 30 chaebols was only 10.5% as of April 1995; it has even decreased further since then. They controlled, however, 43.3% of equity ownership through the creation of a 32.8% ownership ratio of subsidiaries. The Hyundai group maintained the highest family—controlled ownership ratio of 60.4%. This amazing statistic was also one that had been downwardly adjusted, according to the law of limiting excess cross investments, which was enacted in 1987 and implemented in stages up to April 1992. The ownership ratio of subsidiaries decreased from 40.4% in 1987 to 33.5% in 1992. At first glance it seemed that the total equity ownership ratio had decreased from 57.2% in 1983 (family ownership ratio, 17.2%; subsidiary ownership 40.0%) to 43.3% in 1995. It revealed the fact, however, that the chaebol owners continued to exercise unduly high ownership rights with a smaller number of family shares and a larger number of artificially swollen subsidiary shares.9

Fifthly, chaebols have been reluctant to make public offerings of their stocks. While it is true that the ratio of public shares has increased, it has done so very slowly. The average public holdings ratio of the largest 30 chaebols remained at 56.9% as of the end of 1992, declining slightly to 56.8% at the end of 1997 and declining further to 53.05% by the end of 1999. As four major reform policies were put into effect following the currency crisis, the public holdings ratio increased to 61.25% in 2001.

Importance of Chaebols in the Korean Economy

The chaebol habitat described above has created some adverse effects in the Korean economy, and thus needs to be changed. It had not been changed much though until the country was hit by the currency crisis in 1997. The problems related to the chaebol cannot be thought of as capable of being solved in a relatively short time, although some improvements have been made since the chaebol reform policies were carried out.

9 See Lee (2004, 488-489) for details.
For instance, the weight of the 30 largest chaebol groups in the Korean economy had fallen during the period 1999~2000 compared to the period 1995~1998, thanks to the chaebol reform policy of the Korean government. Conversely, the weight of their profits in the Korean economy increased from 37.56% to 78.34% during the same periods. This reflected the fact that the reforms had also contributed to their profitability. Their weight in terms of created value added were, however, only slightly over 10%, while their weights in terms of total assets, liabilities or sales recorded above 40%. This implies that the chaebols have created inefficiencies, while growing with high debt ratios. It is also important to point out that their contribution ratio of job creation has remained at a very low level. (see Table 4).

<Table 4> Weight of the 30 Biggest Chaebols

(Unit: %)

<table>
<thead>
<tr>
<th>Base</th>
<th>Ratio to the Economy</th>
<th>Ratio to Manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value-added</td>
<td>13.12</td>
<td>11.54</td>
</tr>
<tr>
<td>Total Asset</td>
<td>46.38</td>
<td>40.37</td>
</tr>
<tr>
<td>Total Liability</td>
<td>47.72</td>
<td>38.15</td>
</tr>
<tr>
<td>Total Sales</td>
<td>46.59</td>
<td>43.05</td>
</tr>
<tr>
<td>Net Current Profits</td>
<td>37.56</td>
<td>78.34</td>
</tr>
<tr>
<td>Number of Employees</td>
<td>4.19</td>
<td>2.94</td>
</tr>
</tbody>
</table>

Source: Seung-no Choi, Korea’s Conglomerates in 2001, Table 2-1, and 2-3, 18-24

Their weights when compared to the total manufacturing sector revealed a similar result. Net profits of the largest 30 chaebols had grown 74 times larger than those of the overall manufacturing sector in 1999. In 2000, the largest 30 chaebols recorded a substantially higher profit rate than in 1999, while the manufacturing sector as a whole recorded a negative rate.
Such a discrepancy was a natural consequence of the chaebol reform policy, which forced the chaebols to improve their financial status from the 500% level of debt/asset ratio to the 200% level according to the BIS standard. Table 10–5 shows that the ratio of debt guarantees to equity capital decreased from 90% in 1998 to 22.3%, 4.7% and 1.03% in 1999, 2000 and 2005 respectively.

**Table 5**  Debt Guarantee Standing of the 30 Biggest Conglomerates

(Unit : trill. won, %)

<table>
<thead>
<tr>
<th></th>
<th>Equity Capital (A)</th>
<th>Debt Guarantee</th>
<th>Debt Guarantee Ratio to Equity Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total (B)</td>
<td>Limiting Target of Cross Debt Guarantee (C)</td>
<td>Non-limiting Subject of Cross Debt Guarantee (D)</td>
</tr>
<tr>
<td>April 1, 1993</td>
<td>35.2</td>
<td>165.5</td>
<td>120.6</td>
</tr>
<tr>
<td>April 1, 1997</td>
<td>70.4</td>
<td>64.9</td>
<td>33.6</td>
</tr>
<tr>
<td>April 1, 1998</td>
<td>68.1</td>
<td>63.5</td>
<td>26.9</td>
</tr>
<tr>
<td>April 1, 1999</td>
<td>100.4</td>
<td>22.4</td>
<td>9.8</td>
</tr>
<tr>
<td>April 1, 2000</td>
<td>132.2</td>
<td>7.3</td>
<td>1.5</td>
</tr>
<tr>
<td>April 1, 2001</td>
<td>154.8</td>
<td>4.9</td>
<td>0.4</td>
</tr>
<tr>
<td>April 1, 2002</td>
<td>265.6</td>
<td>4.6</td>
<td>0.6</td>
</tr>
<tr>
<td>April 1, 2003</td>
<td>309.0</td>
<td>4.5</td>
<td>0.6</td>
</tr>
<tr>
<td>April 1, 2004</td>
<td>322.5</td>
<td>4.5</td>
<td>0.5</td>
</tr>
<tr>
<td>April 1, 2005</td>
<td>383.0</td>
<td>4.0</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Note: Conglomerates whose total assets are greater than or equal to 2 billion won were considered for the period 2002 and onward.

Source: The Korea Fair Trade commission
Suggestions for Future Chaebol Policy

The above analyses indicate that the chaebol oriented economic structure and habitat have caused adverse effects on the national economy, and thus need to be reformed in one way or another. The enactment of fair trade laws and the establishment of the principle of free market competition have contributed somewhat to alleviating such problems. The attitude of the chaebols, however, had not changed in any way until the economic crisis hit the country in 1997. For example, the often-suggested separation principle between ownership and management can hardly be enforced successfully. The chaebol problems cannot be resolved by adopting this principle alone. Let's review some of the leading policy proposals that have been revealed so far.

First, on the basis of fair trade laws and a policy of market competition, strict standards of oversight should be formulated and applied to equity stakes and equity dealing related to family ownership (including subsidiary ownership). Additionally, various unfair trading and cross liability guarantees among subsidiaries should be regulated or banned. The inter-company trade ratio of the largest four chaebols (Samsung, Hyun-dai, LG, and SK) shown on their Balance Sheets recorded a level of approximately 40.2%, which is a lot higher than that of the next ten largest chaebol groups(5th–15th), at only 11.3%. This clearly illustrates the engagement in unfair trading or anti-competition by the leading chaebols.

Secondly, the modernization of corporate governance structure can be a more efficient approach than a simple separation of management from ownership in order to alleviate the problem of a heavily family-dominant management. For example, such measures as the creation of many small shareholders, the invitation of foreign investment, the adoption of an employee-shareholding system, and the activation of a company investment system can all be conducive to this end.

Thirdly, transparency should be enhanced through the adoption of combined and consolidated financial statements, and so on.

Fourthly, management should be subject to strict oversight through
the adoption of proper checks—and—balances in accordance with 
international practice such as outside executive members and auditors.

In spite of these and other very worthy proposals, any significant 
chaebol reform was not carried out until the 1997 financial crisis. 
The D. J. Kim government finally embarked on a chaebol restructuring 
policy, which was one of its four major reform policies. In October 
1998, five principles for chaebol restructuring were established. They 
were:

① the prohibition of cross debt guarantees, ② core—sector 
oriented restructuring (a big—business deal between the five largest 
chaebols), ③ improvement of financial status based on BIS standards 
(200% or lower debt ratio), ④ the adoption of consolidated statements, 
and ⑤ the adoption of outside executive members and auditors. The 
government added three additional principles later. They were: ① 
the prohibition of circular investment financing among chaebol group 
subsidiaries, ② the restructuring of the chaebols’ ownership of non— 
banking financial institutions and ③ taxation on inheritance and 
donations of the chaebols’ leading families.

Although the government did not necessarily intend to dissolve 
any of the chaebol groups, one of the big five chaebols, the Daewoo 
group finally ran into bankruptcy. Many other smaller business firms 
were also dissolved, leaving their employees unemployed. The over— 
demanding restructuring objectives and schedules were enforced, 
coupled with the IMF’s policy suggestions. Improving the financial 
status of the chaebols by lowering their respective debt/asset ratios, 
from an average level of 500% to a maximum individual debt/asset 
ratio of 200%, in accordance with the BIS (Bank for International 
Settlement) standard was also a target. That could not, however, be 
accomplished easily in a year or two, especially as the ongoing 
financial crisis at the time had led to liquidity problems causing a 
serious credit crunch. In consequence, policy goals could not be 
accomplished fully, while antagonism between government and 
business flared up. It should be remembered that the chaebol problem 
is not one that can be solved in a short time period with the simple 
execution of sudden reform policies. The chaebols should not be 
considered as targets either to condemn or to destroy. They are a
part of the Korean economic structure. We need to build up some positive future perspectives of the Korean industrial structure where the chaebols can play a vital role in revitalizing the Korean economy.

Search for a New Business-Government

Government and business established a close cooperative relationship while working towards their common end, namely economic growth, and thereby helped Korea's economic rise to become a world-ranked competitor. Industrial structure was also upgraded in this endeavor, reshaping its trade profile from light-industry products such as textile & garments, plywood and wigs of human hair in the 1970s, to heavy & chemical products such as ships, steel, automobiles, agricultural and industrial chemicals, and electronic products during the 1980s and onward.

Due to the various adverse effects of the CME system and the consequent chaebol oriented industrial structure, the government's policy principle has shifted toward private sector oriented market competition, and liberalization of trade and financial transactions since the 1980s. The CME system began to be relaxed, although the process was slower than needed, by abandoning strategic and selective credit rationing. Deregulation and decentralization were also brought in as new policy principles, while industrial restructuring was also carried out as a part of this transition process. As noted earlier, conflicts between the government and businesses flared up as the restructuring process fell into frequent disruptions. Inconsistency of industrial policies increased due to conflicts between actual goals and employing the means to achieve them, which undermined the credibility of government policies. Even expert opinion was split into those taking the pro-side and those taking the con-side regarding the industrial restructuring plan, making it a stalemate.

Policy principles that could be agreed so far by those on either side of the issue are as follows. First of all, the government was urged to refrain from direct intervention in industry and to hand over its allocative authority to the private sector, while at the same time it was also asked to assume stricter oversight of the private
sector and bring stronger pressure to bear to encourage more competition.

Secondly, the government was recommended to provide a firm but consistent supervision mechanism.

In spite of all this advice and effort, industrial restructuring has been sluggish at best, especially due to reluctance on the part of the bureaucracy to relinquish its authority that it has long enjoyed. This has been one of the major impediments to industrial restructuring. It has created inconsistency in policy implementation, and led to public distrust regarding the government’s resolve to carry out the necessary reforms, and worst of all given rise to antagonism between government and business.

Before arriving at any conclusions on the future of Korean industrial policy, it is perhaps useful to conduct a final review of the government intervention principle. The rationale behind aggressive government intervention in industry can be summarized as follows.

Firstly, according to this viewpoint, it is the government that can solve market failure problems, which the private sector cannot solve by itself. For example, in the early stages of economic development of the LDCs, it is the government that can break the vicious circle of poverty through finding a way out of supply bottleneck problems. It can bring a deadlock situation to an end through intensive investments in SOCs and key industries for instance.

Secondly, government can efficiently lead a national economy into upgrading its industrial structure by shifting resources and giving priority to developing fast-growing and high value-added industries.

Thirdly, globally competitive large enterprises, which become essential for advanced economics, can be established much more easily with strategic support from government.

The second and third objectives can be generated, however, by market forces, while selective government support has the danger of creating overly-ambitious industries or those requiring capital-intensive production in labor-intensive economies. The first objective can be the most justifiable one. This should end soon, though. All these logical criticisms of an industrial policy of intervention notwithstanding, there are few who believe that Korea could have
established its HCI-oriented industrial society without concentrated government support.

It is useful at this point to review the usual means of government intervention in industry. Basically they are established either to increase sales revenue for the protected industry through import restrictions or to decrease input costs through direct subsidies, tax exemption, financial benefits, and so on. Having said that, these interventions are not ones that can be effective anytime and anywhere. Many of them are now prohibited due to a new international order represented by the WTO system. On top of that, there is always the danger of pursuing inadequate or overly-ambitious industrial projects because of political interests. On the other hand, sunset sectors can oftentimes be more effective with government support when facing international competition, although this could be to the detriment of emerging sunrise sectors. The more obvious costs of government intervention are that it will increase people’s financial burden due to tax increases to cover subsidy financing, it will distort resource allocation, it will provide an environment conducive to monopolistic economic concentration, and it will foster economic rent-seeking behavior or corruption due to the exclusive power of the government that can render monopolistic benefits to certain sectors.

Considering all these factors together, we may derive the following policy suggestions in order to gain future perspectives on Korean industrial policy. First, Korea should move towards handing over decision making authority to the private sector, business firms and financial institutions that are better able to judge market conditions. It is good enough for the government to assume responsibility for providing an environment conducive to appropriate financial market operation; although in addition it needs to establish strong and independent supervisory institutions. The government is also responsible for providing its long-term industrial development visions and indicating its preferences through non-coercive methods and indirect support instead of direct intervention. Most of all, the government should do its best to minimize the unhealthy influences of the bureaucrats through government sector reform or restructuring. Furthermore, it should ensure stable and consistent policy principles,
foster predictable policy environments, promote cooperative dialogue between business and labor, expand SOC investments, take steps to prevent industrial disasters, preserve and protect the environment, extend the social safety net, and encourage investments in education and technology.

Second, the government should try to avoid disputes and antagonistic confrontation with the chaebols, and instead initiate a cooperative spirit that can foster a new and intimate business–government relationship. The government should avoid direct credit controls, but instead promote economic efficiency by enforcing greater competition through the separation of management from ownership, the elevation of government and corporate transparency, and the prohibition of cross investments, etc., while at the same time ensuring transparent and stricter supervision in the marketplace. Competition policy should be implemented to promote an efficiency–oriented industrial restructuring in an orderly market system. An open door policy for international trade will expedite this transition, opening up even the non–trading sectors to international competition. Focusing on competition rather than focusing on regulation should be the general rule for future industrial policy.

Third, ensuring market competition and adequate supervision cannot be successfully pursued by the government alone. These are tasks that should be fulfilled by the autonomous screening functions of financial institutions in the first place, and then enforced by the secondary involvement of independent regulatory institutions such as the Bank of Korea, and the Korean Office of Financial Supervision. Strengthening the independence of these institutions and separating them from the political process are essential for successful transparent supervision. It should be emphasized here that the status of the Bank of Korea has been rather downgraded in the recent financial restructuring process. It also needs to be noted that Korea still has a long way to go to accomplish full–fledged privatization of its commercial banks, which is essential for independent financial operation. The oft–quoted catch phrase regarding reform of the financial industry is that it is nothing more than empty talk, inasmuch as the banks are owned and directed by the government, and their top executive
members are appointed by the government.

All these facts lead us to believe that the day when Korean industry is free from direct government influences is still somewhat far off. It is in part understandable that the insolvency problem of financial institutions has been a major impediment to industrial restructuring and full privatization of banks since the 1997 financial crisis. It is also true that financial sector reform has been complicated by an inadequate handling of the losses caused by government-directed lending. The government, however, if it has the will to follow through with appropriate financial reform measures, can tackle the legacy of the past financial mismanagement once and for all, by carrying out a bold and transparent disposal of non-performing loans through the issuance of new government bonds to replace delinquent assets. If this measure can successfully ensure the restoration of normal financial operations, then the government can recover its investments without difficulty. The bottom line, however, is that the government is still reluctant to give up its discretionary power over the financial sector.

Fifth, in relation to the debate on the full privatization of the banks, Nam (1990) argues that probable control of the banks by the chaebols would not cause a problem if strict and transparent supervision can be carried out by independent regulatory agencies. He also maintains the position that a ban on chaebol bank ownership is not feasible in reality, and prefers the prudential regulation of the behavior of the banks and the chaebol to bank ownership rules that have questionable merit, and are difficult to enforce. It is true that the majority of non-banking financial institutions are already owned by the chaebols. At the time of writing, ten of the largest chaebol own more than thirty of them, which are not subject to credit controls by the central bank. Leipziger and Petri (1994) even suggest using Korea’s traditional corporate strength to create (non-family) banking chaebol to develop Korea’s banks into respectable world-class financial institutions. It could be a plausible suggestion, provided the family-ownership oriented management tradition of the chaebols can be relinquished, and provided Korea’s strong and aggressive business entrepreneurship and know-how can be channeled into
creating a modern financial industry.

The government once considered looking to appoint new bank owners and executives with professional knowledge who specialized only in financial businesses. In order to prevent ownership by the big chaebols, the government also considered excluding the biggest 10 or 30 chaebols from the list of new bank owners. Instead, the government began to limit bank accounts to a single customer and bank ownership was limited to a maximum of 8% of equity capital being owned by any single shareholder. Corporate ownership, however, is hard to trace in nature. Thus the government began to consider lifting restrictions on maximum share ownership at an appropriate time, because the 8% rule, if it worked, would distribute responsibility so widely across different owners that effective shareholder oversight could hardly be exercised. This argument raised the possibility of adopting the Japanese-type financial holding company system. Ideas to support a move to approximate the Japanese financial setup are as follows. Once each chaebol is allowed to acquire and develop a group bank through cross-ownership ties, each chaebol will do its best to ensure the financial soundness and profitability of its bank, while the bank can serve in an oversight capacity by imposing strict financial discipline on subsidiaries of the chaebol in return.

This seemingly plausible idea neglects an important point, however, in that it overrides the checks and balances function between industry and the financial sector. It is highly improbable to assume that a group bank can effectively oversee and control any one particular chaebol group; something which even the government has not been able to supervise effectively under the CME system. The recent mismanagement of the Hyun-dai Securities Company and Hyundai Investment Trust Company provides a good example of how the chaebols can make the best use of their group financial institutions in order to protect and maintain family ownership. Independence and privatization of the financial sector cannot be realized without establishing proper institutions to ensure a system of checks and balances operates effectively within the financial sector.

Based on the three-year market reform roadmap which was announced in December 2003, the Korea Fair Trade Commission
has striven to revise the regulatory system and practices that affect the activities of market participants. It is hoped that the reform is carried out successfully so that large business conglomerates can evolve into various forms, whether that involves transforming their ownership structures into a simplified and transparent holding company structure, dividing themselves into smaller business groups, or separating themselves into independent businesses in the long run.
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CHINA-AUSTRALIA TRADE:
HOW IMPORTANT AND COMPLEMENTARY IS IT?

HOU MINYUE
East China Normal University

ABSTRACT

In China's post-modernisation years, Sino-Australian trade in goods, a chief component of their economic relations, has displayed some mutually acknowledged important characteristics, of which two major ones are a steady growth in value and a complementarity in commodity trade. Viewed largely from a Chinese perspective, this article aims to undertake an in-depth study in order to reveal the genuine trade relationship between the two countries. While elaborating on the ebb and flow and the complementarity of trade, the article will focus on investigating the fundamental factors in shaping their trade relationship.

Key Words: China–Australia Trade, Trade Complementarity, Sino–Australian Relations

This article examines the relationship in merchandise trade between China and Australia since the implementation of China's modernisation strategy in 1978. It is the economy that has been at the heart of the post-1978 Chinese modernisation program. One of Beijing's principal initiatives in this direction was the decision to open up its economy to the outside world, particularly the developed capitalist countries, including Australia. The question immediately arises: How important has the Australian contribution been to China's rapid economic growth generally, and more specifically to the modernisation priorities set by the Chinese leadership? This is the key question this study addresses.
It should be said at the outset that one of the principal contentions of this study is that economic linkages have become central to the overall relationship. They have helped to cement bilateral links in good and bad times. However, overestimation or exaggeration of this role has been commonplace in both countries. While arguing for the critical importance of the trade relationship, and the key role played by China’s modernisation, this study will carry out an analysis of the characteristics in Sino–Australian trade in goods with a view to highlighting both the scope and limitations of the economic partnership, including both achievements and unresolved difficulties, so as to deepen our understanding not only of the trade relationship itself but also of its function in China’s industrialisation on the one hand and its effect on the wider, bilateral relationship on the other.

THE INCREASING RELATIVE IMPORTANCE OF TRADE

Over the past two decades, a great many scholarly and official commentaries in both China and Australia have stressed the amazing speed of trade expansion between the two countries, commentaries which are accurate if the point of the comparison is simply to emphasise the growth in the volume of bilateral trade. As is widely known, after the founding of the People’s Republic of China (PRC), Sino–Australian trade was slight in value and restricted to the non–official level. Because of food shortages in China, especially after China’s Great Leap Forward in the late 1950s, large Chinese wheat purchases took off in 1961, strongly boosting Chinese imports from Australia. Prior to diplomatic normalisation in December 1972, two–way trade peaked at $267.3 million1 in 1967, accounting for 6.5 per cent of China’s total overseas trade that year. Chinese imports from Australia amounted to $243.0 million, nearly 12 per cent of total Chinese imports, whereas its exports to Australia amounted to only $24.3 million, a little more than 1.1 per cent of total Chinese exports.2

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1 In the text $ stands for US dollars and A$ is used to represent Australian dollars.
Two years before normalisation, bilateral trade dropped dramatically to $58.8 million and $86.4 million in 1971 and 1972 respectively.² It was therefore not too difficult focus efforts on the post-diplomatic normalisation of trade, with the result that trade rose sharply in 1978 to $832.8 million, of which $715.1 million was accounted for by Australia's exports to China. This was the very year when China's reform and opening up of the economy were formally launched. Two-way trade in 1978 was more than nine times larger than in 1972 when the PRC obtained Australia's formal recognition.

Progress in China's industrialisation during the modernisation years has undoubtedly created a powerful stimulus to China's external trade. Merchandise trade between China and Australia since the announcement of the modernisation policy may be divided into three phases if the pace of growth is used as the main criterion: the gradual step-by-step growth of the first decade (1979–1989), the rapid expansion of the second decade (1990–1999), and the unprecedented acceleration of the early 2000s.

Bilateral trade in the first phase showed steady but moderate growth, with the total value fluctuating between $1.14 billion in 1979 and $1.55 billion in 1989.³ If, however, the devaluation of the Australian dollar is taken into account, the annual value of China–Australia trade for these two years measured in dollars was A$1.03 billion to A$2.40 billion respectively. In the second phase, bilateral merchandise trade grew even faster. In US dollars bilateral trade grew from $1.61 billion in 1990 to $6.31 billion in 1999,⁴ up by nearly 300 per cent. In Australian dollars the corresponding amounts were A$2.63 billion and A$10.70 billion, that is, a 400 per cent increase.⁵ In other words, it took two decades for the value of bilateral annual trade to surpass

³ ACFERT 1984, p.83.
⁴ ACFERT 1990, p.284.
⁵ ACFERT 1991, p.314; 2000, p.470
⁶ Statistics and trade increases in Australian dollars in the first two phases are compiled and calculated from trade data supplied by the Australian Bureau of Statistics (ABS), Year Book Australia, for various years.
A$10 billion. However, as the following table reveals it would take only three years (2000 to 2002) for this value to exceed A$20 billion, and another three years (2003 to 2005) to go beyond A$30 billion in the third phase:

**<Table 1> China-Australia merchandise trade, 1995~2005**  
(AS$ billion)

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>1995</td>
<td>6.99</td>
<td>8.00</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>8.72</td>
<td>10.70</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>1997</td>
<td>9.61</td>
<td>15.08</td>
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<tr>
<td>1998</td>
<td>17.90</td>
<td>21.21</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>23.33</td>
<td>25.67</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>2000</td>
<td>34.06</td>
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</tbody>
</table>


**<Table 2> Share of China’s trade with Australia as a percentage of total Chinese trade, 1980~2004**  
($ million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Chinese Exports</th>
<th>% share in total Chinese exports</th>
<th>Chinese Imports</th>
<th>% share in total Chinese imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>223.6</td>
<td>1.2</td>
<td>1,063.0</td>
<td>5.48</td>
</tr>
<tr>
<td>1982</td>
<td>206.5</td>
<td>0.99</td>
<td>915.5</td>
<td>5.25</td>
</tr>
<tr>
<td>1984</td>
<td>229.8</td>
<td>0.88</td>
<td>950.0</td>
<td>3.47</td>
</tr>
<tr>
<td>1986</td>
<td>210.0</td>
<td>0.68</td>
<td>1,400.0</td>
<td>3.26</td>
</tr>
<tr>
<td>1988</td>
<td>360.0</td>
<td>0.75</td>
<td>1,110.0</td>
<td>2.01</td>
</tr>
<tr>
<td>1990</td>
<td>530.0</td>
<td>0.86</td>
<td>1,350.5</td>
<td>2.53</td>
</tr>
<tr>
<td>1992</td>
<td>660.0</td>
<td>0.78</td>
<td>1,670.0</td>
<td>2.07</td>
</tr>
<tr>
<td>1994</td>
<td>1,487.9</td>
<td>1.23</td>
<td>2,451.8</td>
<td>2.12</td>
</tr>
<tr>
<td>1996</td>
<td>1,673.0</td>
<td>1.11</td>
<td>3,434.0</td>
<td>2.49</td>
</tr>
<tr>
<td>1998</td>
<td>2,340.0</td>
<td>1.32</td>
<td>2,690.0</td>
<td>1.92</td>
</tr>
<tr>
<td>2000</td>
<td>3,428.9</td>
<td>1.38</td>
<td>5,024.0</td>
<td>2.23</td>
</tr>
<tr>
<td>2002</td>
<td>4,585.6</td>
<td>1.41</td>
<td>5,850.2</td>
<td>2.0</td>
</tr>
<tr>
<td>2004</td>
<td>8,838.3</td>
<td>1.48</td>
<td>11,552.5</td>
<td>2.06</td>
</tr>
</tbody>
</table>

One phenomenon worth noting is the striking change in the relative importance of bilateral trade for each partner. As Table 2 indicates, the Australian share of China’s total foreign trade remained low and often declined.

On the other hand, the share of trade with China as a proportion of total Australian trade rose gradually from a low base and grew steadily over time. Australian annual exports to China, which averaged 2.86 per cent of total Australian exports between 1988 and 1993, jumped to 5.4 per cent in 2000 and 10.2 per cent in 2005. Similarly, annual imports from China, as a proportion of total imports, rose from 3.26 per cent between 1988 and 1993 to 7.8 per cent in 2000 and 13.3 per cent in 2005.7

Changes in the relative importance of bilateral trade also reflected changes in their relative positions in trade rankings. China has been one of Australia’s top ten trading partners over a long period of time. In the late 1990s, it was ranked among the top five. Then it rose even more spectacularly, becoming Australia’s second largest trading partner in 2005, next only to Japan. By contrast, in the early 2000s, the Australian rankings oscillated around eleventh among China’s trading partners, a generally lower position than that registered at different times in the 1990s. Several factors contributed to these changes, among which the most important was the extraordinary growth of Chinese foreign trade, particularly after the late 1990s.

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Table 3 indicates that since 1991, the year when China–Australia relations returned to normality, Chinese merchandise trade has been growing much more strongly, which helps to explain the sharp jump in their bilateral trade. Total Chinese foreign trade increased annually by more than $100 billion in 2000 and 2002 respectively and over
$200 billion each year from 2003 to 2005. Placed in this context the massive increase in China–Australia two-way trade is hardly surprising. Rapid growth in bilateral trade after 1991 closely paralleled the intensification of China’s modernisation efforts guided by Deng Xiaoping’s strategic exhortations of the post–1989 period.

While China became the world’s sixth largest trading nation in 2001 in terms of exports and imports, Australia’s worldwide exports ranking dropped to twenty-fifth and its imports ranking to twentieth. With its total trade valued at $127.3 billion, Australia had fallen behind South Korea, Hong Kong, Taiwan, and such ASEAN nations as Singapore and Malaysia. This is all the more striking given that in economic terms Australia had for many years occupied third place in the West Pacific region after Japan and China. It is this overall decline which helps explain why Australian trade with China did not keep pace with China’s trade with other regional economies, and hence the decline of Australia’s ranking in China’s overall trade.

The export destinations and import sources for both China and Australia also help to explain the differential impact of trade expansion. In the early 2000s, for instance, East Asia, the United States and the European Union were the most important export destinations and import sources for both of them. This similarity in trading partners meant that while China figured prominently in Australia’s trade relations, the reverse was not true. If one then adds to the equation the much larger size of China’s economy and foreign trade compared to Australia’s, it becomes much easier to understand China’s increasing importance to Australia and Australia’s diminishing importance to China, at least so far as trade is concerned.

The net effect of the trends we have been discussing has been to increase the weight of economic considerations in Australia’s China policy, and to provide China with greater diplomatic leverage vis-à-vis Australia. A recurring feature of Chinese pronouncements since the late 1990s has been the need to base the development of economic and trade relations on a sound and stable political environment.

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footing. Chinese rhetoric implied that there were destabilising factors in the political relationship and that China could not be expected to pursue closer economic links without also endeavouring to improve political relations. This would become the key political demand that Chinese leaders would subtly but firmly put to the Howard government. While concluding a new gas deal with Australia, the China–Australia Trade and Economic Framework, and launching the China–Australia Free Trade Agreement feasibility study in Canberra in October 2003, the visiting Chinese President Hu Jintao linked a rich bilateral trading relationship to Taiwan by stating that “the Chinese government and people look to Australia for a constructive role in China’s peaceful reunification”. During the 10+3 summit in Laos in November 2004, in parallel with a promise to double the trade with Canberra within the next five years, Chinese Premier Wen Jiabao, in meeting his Australian counterpart, explicitly expressed the hope for Canberra to offer Beijing the full recognition of a free market economy. In mid–April 2005, Beijing and Canberra entered into negotiations over a free trade agreement following Australia’s official recognition of China’s market economy status, which the United States, Japan and the EU countries had not yet agreed to give China at this present time of writing.

COMPLEMENTARITY IN SELECTED GOODS

During the 1980s and 1990s governments and scholars in both countries often referred to the strong complementarities between the

two economies. It is true that for many years a pattern of export specialisation had become a distinctive feature of their bilateral trade. Agricultural and mineral commodities dominated Australian exports to China, while Chinese exports to Australia were predominantly labour intensive manufactures. According to DFAT estimates in 2001, “rural and resource commodities accounted for just over 80 per cent of the value of Australian goods and services exports to China”, while “manufactured goods dominated Chinese exports to Australia, totaling A$9.7 billion or 86 per cent of exports”.14 It became therefore fashionable to describe Australia–China economic relations in terms of complementarity, often, however, without an appropriate definition. In similar vein, DFAT’s Economic Analytical Unit claimed that China’s trade relationship with Australia was, in terms of complementarity, second only to that with Japan.15

This claim must be subjected to closer scrutiny. First, in what sense can it be argued that China’s complementarity with Australia was second only to the relationship with Japan when its trade with Hong Kong, Taiwan, South Korea, Singapore and Malaysia well exceeded its trade with Australia? Given that Australia remained China’s eleventh or twelfth largest trading partner for many years, is it not reasonable to assume that China’s economic relations with its top ten trading partners were more complementary? The point of raising these questions is not to produce definitive answers but rather to shed greater light on the alleged complementarity of the Chinese and Australian economies, and to ask whether this complementarity was in any way unique to this particular bilateral relationship. In many ways, this was a normal trade relationship, as normal as their trade relations with other economies. It was a case of one selling to the other what it lacked and vice versa. In this study, therefore, the term “complementarity” is used in this neutral sense. An analysis of the commodities traded between the two countries indicates that the scope of their complementarity was

15 Ibid., p.61.
limited, and based primarily on the importance to each other of some selected exports.

<Table 4> Shares of major Australian exports to China in selected years

<table>
<thead>
<tr>
<th>Year</th>
<th>Cereals</th>
<th>Textile fibres</th>
<th>Metalliferous ores</th>
<th>Sugar</th>
<th>Non-ferrous metals</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>33.9</td>
<td>23.3</td>
<td>14.0</td>
<td>5.0</td>
<td>4.4</td>
</tr>
<tr>
<td>1993</td>
<td>Metalliferous ores 27.3</td>
<td>Textile fibres 23.0</td>
<td>Cereals 8.8</td>
<td>Chemicals &amp; related products 6.5</td>
<td>Non-ferrous metals 5.3</td>
</tr>
<tr>
<td>1999</td>
<td>Metalliferous ores 20.0</td>
<td>Textile fibres 15</td>
<td>Non-ferrous metals 13</td>
<td>Coal &amp; petroleum 8.8</td>
<td>Electrical machinery 6.1</td>
</tr>
</tbody>
</table>

Source: Compiled and calculated from data supplied by *Almanac of China’s Foreign Economic Relations and Trade* and DFAT sources on Australia-China trade on its website.

<Table 5> Shares of major Chinese exports to Australia in selected years

<table>
<thead>
<tr>
<th>Year</th>
<th>Textiles</th>
<th>Clothing</th>
<th>Chemicals &amp; related products</th>
<th>Footwear</th>
<th>Miscellaneous manufactures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>28.9</td>
<td>27.5</td>
<td>6.5</td>
<td>5.4</td>
<td>3.3</td>
</tr>
<tr>
<td>1993</td>
<td>Clothing 31.9</td>
<td>Textiles 12.3</td>
<td>Electrical machinery 9.7</td>
<td>Miscellaneous manufactures 9.2</td>
<td>Footwear 5.5</td>
</tr>
<tr>
<td>1999</td>
<td>Electrical machinery 31.0</td>
<td>Clothing 28.2</td>
<td>Textiles 8.3</td>
<td>Footwear 8.3</td>
<td>Miscellaneous manufactures 6.2</td>
</tr>
</tbody>
</table>

Source: Compiled and calculated from data supplied by *Almanac of China’s Foreign Economic Relations and Trade* and DFAT sources on Australia-China trade on its website.
Tables 4 and 5 report that metalliferous ores (mainly iron ore), textile fibres (mainly wool), cereals (mainly wheat and barley) and machinery and transport equipment were Australia’s major exports to China. The bulk of Chinese exports to Australia covered light and textile industrial products (mainly TCF: textiles, clothing and footwear), miscellaneous products (toys, furniture, sporting and travel goods) and machinery and transport equipment (computers, electrical appliances, telecommunications equipment).

While the trade pattern itself did not fundamentally change over the years, change was reflected primarily in the ups and downs of the rankings of different commodities at different times. As a generalisation, the export of metalliferous ores, in particular iron ore rose dramatically in line with the sustained pace of China’s industrialisation. At the same time wool continued to be one of Australia’s top three exports, closely reflecting the growth of China’s textile and clothing industries. In 2004–2005, iron ore and wool remained the principal commodities sold to China, reaching A$3.818 billion (29.4 per cent) and A$1.276 billion (10 per cent) respectively.\(^{16}\)

Among cereals exports, which had been declining sharply as a proportion of total exports, barley sales grew strongly in the 1990s following the rapid expansion of China’s beer production and expanding foreign investment in this industry in China. By the late 1990s, China had imported about half of Australia’s total exports of malting barley,\(^{17}\) making China Australia’s major barley market.

If bracketed together, textile, clothing and footwear exports were the largest item on China’s export list to Australia, followed by electrical machinery and miscellaneous products. Chinese sources indicate that in 1997, electrical machinery exports had for the first time surpassed clothing sales to Australia.\(^{18}\) In recent years, computers

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and telecommunications equipment exports have grown most strongly within this category, reaching A$3.19 billion, which comprised 15.7 per cent of total Chinese exports to Australia in 2004–2005.\textsuperscript{19} Toys, games, sporting and travel goods, furniture and articles of plastics were the main items featuring in the rapid export growth of miscellaneous products.

The evolving pattern of China–Australia trade supports the argument that a limited degree of complementarity had developed, whereby Australia sold raw materials to China in return for low-cost, labour-intensive manufactured goods. Chinese exports consisted primarily of consumer goods whereas Australian exports served primarily the needs of China’s rapidly expanding industrialisation and rising domestic consumption.

Limited as it was, complementarity had far-reaching implications for both countries. Taking resource complementarities as an example, by 2001 China had become Australia’s second largest customer for iron ore after Japan, accounting for more than 26 per cent of Australian exports; Australia supplied 75 per cent of Chinese alumina imports, that is about one quarter of total Australian alumina exports; and China purchased 36 per cent of Australia’s copper ore exports, making Australia the second largest supplier of copper ores to China after Chile.\textsuperscript{20} China’s steel output surged from 31.78 million tonnes in 1978 to 297 million tonnes in 2004.\textsuperscript{21} Imports of Australian iron ore, normally accounting for around half of China’s total imports, contributed greatly to this upsurge, which in turn strongly supported the growth in such sectors as the vehicle industry, building and infrastructure industries where steel requirements were considerable and rising.

Australia’s proximity to the Chinese market reduced transport costs, estimated at between 20 and 45 per cent of the landed cost

\textsuperscript{19} DFAT information on trade with China (accessed at www.dfat.gov.au/geo/china/index.html on 9 April 2006).

\textsuperscript{20} EAU, China Embraces the World Market, 2002, pp.64–65.

\textsuperscript{21} Source from National Bureau of Statistics of China (accessed at http://www.stats.gov.cn/was40/detail?record=14&channelid=9951&presearchword=%B8%D6 on 11 April 2006).
of iron ore. This consistently made Australia a lower cost supplier than Brazil, Australia’s major competitor of iron ore exports. Moreover, the fact that China’s limited port facilities could not accommodate the larger iron ore carriers tended to benefit closer suppliers, like Australia and India and disadvantage more distant suppliers, like Brazil. It is also worth remembering that China’s iron ore reserves are of low ore content (approximately 31 per cent, compared to 60~65 per cent for Australian iron ore).

It has been estimated that, in the process of China’s modernisation, the cost of environmental pollution is equivalent to several percentage points of gross domestic product. Much of the pollution has resulted from the consumption of coal, the largest source of energy in China. This necessitates a quick growth of clean energy production, including nuclear energy production. As part of a long-term objective, China will build 19 nuclear power stations by 2020, aiming to increase its nuclear energy production sixfold by then. China’s uranium supplies, however, are insufficient to meet its energy demands, thus furnishing great opportunities to Australia, a country enjoying 40 per cent of the world’s uranium reserves. The signing of two agreements between Beijing and Canberra on nuclear energy cooperation during Premier Wen Jiabao’s tour to Australia in April 2006 secured more than A$30 billion in long-term uranium sales to China, which will account for a third of China’s total uranium imports in the years to come. Evidently, for Australia, in addition to the handsome profit it has reaped from becoming a reliable supplier of energy and other resource inputs into China’s amazing industrialisation, it is also profiting from buying low-cost manufactured products from China, the new “workshop of the world.”

22 EAAU (East Asia Analytical Unit, DFAT), Iron & Steel in China & Australia, EAAU, 1995, p.65.
23 David Humphries, Hamish McDonald, "PM trusts China to do right thing with uranium," Sydney Morning Herald, 3 April 2006.
There is another consideration. Australia is an important US ally; therefore, expanding Australian resource imports might add to Beijing's leverage vis-à-vis Canberra. To illustrate this point, consider John Howard's third visit as prime minister to China in May 2002: the bidding competition between Australia, Indonesia and Qatar for China's liquefied natural gas (LNG) project was close to conclusion and the Dalai Lama was on his way to Australia. Much speculation ensued in Australia on the linkage between Australia's bid for the project and the fact that no senior officials met the Dalai Lama on this occasion. The Chinese decision in August to award the gas contract to Australia was no doubt based primarily on an assessment of the most effective way of safeguarding China's economic modernisation. On the other hand, China's Ambassador Wu Tao explained that "this project will have a favourable and continuous impact on bilateral economic links and their overall relationship." Furthermore, the LNG contract provided in the Ambassador's opinion, "full evidence regarding the Chinese stress on, and trust in, China-Australia long-term stable cooperation." While signing a uranium deal in his April visit to Canberra, Chinese Premier Wen Jiabao observed: "We believe that countries which are allies of the US can also be China's friends, and Australia is one of them." Wen further elaborated that by being friends with each other it meant that "China and Australia should become a model of peaceful co-existence for countries with different social systems, historical and cultural backgrounds." These words carried an implicit message. The economic projects were connected, however indirectly, with the Chinese wish to strengthen political relations with Australia, yet without placing explicit emphasis on political objectives as both governments had taken the view that a cautious approach to political issues was the best way to facilitate the development of economic linkages.

It is therefore arguable that Canberra’s strategic significance to China’s resource requirements was shaped by three factors: price, quality and Beijing’s political calculus. Complementarity in the resource sector was helpful to their respective economies and conducive to expanding employment opportunities. But the question remained: Where was this bilateral trade heading? A study of the major commodities traded between the two economies and the requirements of China’s ambitious plan for its economy may offer useful clues in answer to this question.

<Table 6> Australia’s major exports and imports – by value and percentage of total Australian trade, 1991 and 2000

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude materials, inedible, except fuels</td>
<td>13.7 (25.5%)</td>
<td>21.3 (19.3%)</td>
</tr>
<tr>
<td>Mineral fuels, lubricants and related materials</td>
<td>10.9 (20.3%)</td>
<td>23.1 (20.9%)</td>
</tr>
<tr>
<td>Food and live animals</td>
<td>9.3 (17.3%)</td>
<td>18.6 (16.9%)</td>
</tr>
<tr>
<td>Manufactured goods classified chiefly by material</td>
<td>6.5 (12.1%)</td>
<td>13.6 (12.3%)</td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td>4.9 (9.1%)</td>
<td>12.5 (11.3%)</td>
</tr>
</tbody>
</table>

Though China was one of Australia’s principal customers in these five categories of imports and exports (see Tables 7 and 8), a comparison of China’s ranking in Australia’s list of trade partners should clarify the implications for the future of complementarity.

**Table 7** Australian merchandise exports to top eight economies and China’s ranking, 2001-02

<table>
<thead>
<tr>
<th>Commodities</th>
<th>China (A$ million)</th>
<th>Japan</th>
<th>Korea, Republic of</th>
<th>New Zealand</th>
<th>Singapore</th>
<th>Taiwan</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food and live animals</td>
<td>470 (7)</td>
<td>3,903</td>
<td>654</td>
<td>696</td>
<td>619</td>
<td>624</td>
<td>214</td>
<td>2,502</td>
</tr>
<tr>
<td>Crude materials, inedible, except fuels</td>
<td>3,267 (2)</td>
<td>4,160</td>
<td>1,838</td>
<td>121</td>
<td>38</td>
<td>674</td>
<td>235</td>
<td>296</td>
</tr>
<tr>
<td>Mineral fuels, lubricants and related materials</td>
<td>561 (7)</td>
<td>7,331</td>
<td>2,819</td>
<td>855</td>
<td>1,706</td>
<td>1,371</td>
<td>419</td>
<td>795</td>
</tr>
<tr>
<td>Manufactured goods classified chiefly by material</td>
<td>683 (6)</td>
<td>1,821</td>
<td>1,007</td>
<td>1,096</td>
<td>256</td>
<td>1,804</td>
<td>379</td>
<td>1,122</td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td>271 (7)</td>
<td>307</td>
<td>524</td>
<td>2,101</td>
<td>576</td>
<td>106</td>
<td>514</td>
<td>3,072</td>
</tr>
<tr>
<td>Total of the five exports</td>
<td>5,252 (4)</td>
<td>17,522</td>
<td>6,833</td>
<td>4,869</td>
<td>3,195</td>
<td>3,859</td>
<td>1,761</td>
<td>7,787</td>
</tr>
</tbody>
</table>

Source: ABS, Year Book Australia 2003, p.919.
<Table 8> Australian merchandise exports form top eight economies and China’s ranking, 2001-02

<table>
<thead>
<tr>
<th>Commodities</th>
<th>China (A$ million)</th>
<th>Germany</th>
<th>Indonesia</th>
<th>Japan</th>
<th>Korea, Republic of</th>
<th>New Zealand</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mineral fuels, lubricants and related materials</td>
<td>127 (4)</td>
<td>5</td>
<td>1,866</td>
<td>37</td>
<td>97</td>
<td>323</td>
<td>6</td>
<td>285</td>
</tr>
<tr>
<td>Chemical and related products</td>
<td>470 (5)</td>
<td>1,151</td>
<td>127</td>
<td>542</td>
<td>219</td>
<td>391</td>
<td>1,609</td>
<td>3,367</td>
</tr>
<tr>
<td>Manufactured goods classified chiefly by material</td>
<td>1,830 (1)</td>
<td>717</td>
<td>554</td>
<td>1,399</td>
<td>649</td>
<td>1,031</td>
<td>508</td>
<td>1,592</td>
</tr>
<tr>
<td>Machinery and transport equipment</td>
<td>3,249 (4)</td>
<td>3,914</td>
<td>318</td>
<td>12,086</td>
<td>2,535</td>
<td>795</td>
<td>2,704</td>
<td>11,792</td>
</tr>
<tr>
<td>Miscellaneous manufactured articles</td>
<td>5,144 (1)</td>
<td>658</td>
<td>260</td>
<td>867</td>
<td>167</td>
<td>516</td>
<td>1,018</td>
<td>3,223</td>
</tr>
<tr>
<td>Total of the five imports</td>
<td>10,820 (3)</td>
<td>6,445</td>
<td>3,125</td>
<td>14,931</td>
<td>3,712</td>
<td>3,056</td>
<td>5,845</td>
<td>20,259</td>
</tr>
</tbody>
</table>

Source: ABS, Year Book Australia 2003, p.919.

Table 7 shows that in relation to five major Australian exports, China ranked seventh among the top eight economies in three categories (food and live animals, mineral fuels, lubricants and related materials, machinery and transport equipment), sixth in one category (manufactured goods classified chiefly by material), and second in crude materials. Considering the growth of China’s economy and
of its domestic market and China’s on-going implementation of WTO commitments, there exists enormous potential for continued growth in Chinese imports of Australian raw materials.

China’s rapid industrialisation in the preceding two decades, together with its expanding population, was widening the gap between resource demand and supply. In the mid-1990s, China’s per capita arable land was one-third of the world average, and grassland per person was half of the world average. It is estimated that by 2030 when China’s population is expected to reach a peak of 1.53 billion, the likely result of industrialisation and urbanisation would be a net decrease of farming land of some 5.3 million hectares.\(^{29}\) In all probability China would have to increase imports of food and food related products, thereby presenting immense opportunities to Australian exporters.

\(<\text{Table 9}>\) Estimates on China’s shortage of selected minerals by 2010

<table>
<thead>
<tr>
<th>Mineral</th>
<th>Estimated production</th>
<th>Estimated demand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude petroleum (million tonnes)</td>
<td>180</td>
<td>280</td>
</tr>
<tr>
<td>Natural gas (million cubic meters)</td>
<td>80,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Iron ore (million tonnes)</td>
<td>329</td>
<td>399</td>
</tr>
<tr>
<td>Manganese ore (10,000 tonnes)</td>
<td>472</td>
<td>750</td>
</tr>
<tr>
<td>Aluminium ore (10,000 tonnes)</td>
<td>805</td>
<td>1,120</td>
</tr>
<tr>
<td>Copper ore (10,000 tonnes)</td>
<td>90</td>
<td>170</td>
</tr>
<tr>
<td>Lead (10,000 tonnes)</td>
<td>Not available</td>
<td>45</td>
</tr>
<tr>
<td>Zinc (10,000 tonnes)</td>
<td>Not available</td>
<td>120</td>
</tr>
</tbody>
</table>


Two nationwide Chinese surveys and assessments of the demand and supply of mineral resources are worth noting. Completed in the mid-1990s the second survey concluded that of the 45 major minerals needed for national economic development, 15 were already or would soon be in short supply, and would therefore need to be imported. Such minerals as natural gas, crude petroleum, iron ore, alumina, copper ore, nickel, manganese, lead, zinc, all Australian export items, were included in this category. The estimated shortage of some of these products by 2010 was as follows:

By the early years of the present decade it was clear that these were conservative estimates. Available data show that in 2004 China’s crude oil consumption had already exceeded 290 million tonnes, of which 117.32 million tonnes were imported. With China’s steel production rising by 100 million tonnes over just nine years (1994–2002) and jumping to 297 million tonnes in 2004, its iron ore imports rocketed to 208 million tonnes, causing the dependence of domestic iron ore consumption on imports to step up from 22 per cent in 2001 to 51 per cent that year. The dramatic boom in mineral purchases by China gave a strong boost to Australia’s mineral exports, with a large number of contracts following soon after:

- December 2001: Australian Rio Tinto’s Hamersley Iron concluded an agreement with China’s Shanghai Baosteel Group Corporation, to supply 200 million tonnes of iron ore over a period of twenty years or approximately 10 million tonnes of ore per year.
- October 2002: The contract formalising the LNG deal between China and Australia was signed. This was hailed in Australia

30 Ibid., p.39.
as the largest ever single-value export contract valued at up to A$1 billion per year for 25 years. The commitment to supply 3.3 million tonnes of LNG per annum to China would boost Australia’s LNG export earnings to A$3.5 billion per year, and add around 15 per cent to the value of Australia’s total exports to China.  

- August 2003: A A$1 billion nickel supply agreement between Australian company WMC Resources Ltd and China’s largest nickel producer, Jinchuan Group was reached, providing for the export of 120,000 tonnes of nickel from WMC to Jinchuan between 2005 and 2010. Nickel was now expected to become one of Australia’s largest exports to China in the years ahead.

- October 2003: During Chinese President Hu Jintao’s visit to Australia, a preliminary agreement between Australia’s Gorgon Joint Venture and the China National Offshore Oil Corporation was concluded, which could see Australia supplying another A$30 billion worth of LNG exports to China over a period of 25 years.

- March 2004: Mining giant BHP Billiton succeeded in concluding Australia’s biggest single iron ore supply deal, worth A$11.6 billion, with four leading Chinese steel mills. The contract was for a supply of 12 million tonnes of iron ore a year over 25 years.

- June 2004: Rio Tinto announced long-term, high value resources deals which would see it supply an additional 40

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million tonnes a year of iron ore under long term contracts over the next 10 years to major Chinese steel mills, worth around A$15 billion.38

- April 2006: The agreements on long-term nuclear energy cooperation were to provide a fresh and powerful stimulus to China’s resource imports from Australia.

These large and long-term deals may be said to have reinforced trade complementarity in the resource sector. As for Chinese exports to Australia, China was already the largest supplier in two of the top three categories of Australian imports: manufactured goods classified chiefly by material and miscellaneous manufactured articles (see Tables 6 and 8). China’s market share in these two categories of Australia’s imports was relatively high: 9.6 per cent and over 26 per cent respectively. Several commodities in the category of miscellaneous manufactures had enjoyed a dominant market share for many years. In the twelve months to September 2000, China supplied 62 per cent of the total of Australia’s clothing imports and more than 53 per cent of its imported footwear. During the same period, however, China supplied only 3.8 per cent of Australia’s imported machinery and transport equipment,39 placing China far behind Japan and the United States.

Given China’s high market share of Australia’s imports of miscellaneous manufactures, and Australian attempts to diversify import sources, it was unlikely that China would substantially expand its exports to Australia in this category. Opportunities for Chinese exporters were more likely to be found in manufactured goods classified by material, especially in machinery and transport equipment, as this category accounted for more than 45 per cent of Australia’s total annual imports. In 2000, in a report filed back to China, the


39 Figures calculated from data supplied by ABS, International Merchandise Trade, Australia, September Quarter 2000, pp.32–35.
business office of the Chinese Consulate-General in Sydney urged Chinese exporters to restructure their exports to Australia by increasing machinery and transport equipment sales, and called on "the Chinese government and enterprises to work hand in hand to fully exploit the potential of exports to Australia." 40 But any attempt to achieve this expansion was definitely to be met by fierce competition. To be more precise, China would need to compete with Japan and the United States, the world's two largest economies which also happened to be Australia's largest suppliers of machinery and transport equipment.

CONCLUDING OBSERVATIONS

What, then, may we conclude from this survey of Sino-Australian trade over the last two decades? First, though trade complementarity between them was modest in the beginning, it was gathering in intensity and developing a degree of interdependence in such goods as iron ore, LNG, alumina, wool, barley, uranium, and textile, clothing and footwear products, electrical machinery and miscellaneous manufactures. Complementarity had thus become a double-edged sword. On the one hand, it had brought substantial economic returns to both parties. On the other hand, any future downturn in China's industrial development in areas linked to these commodities will seriously affect Australia. China's attempt in 2004 to apply a break on its steel and real estate industries in the interests of achieving an economic soft landing aroused anxieties in the relevant Australian business sectors. 41 The trade relationship had already by then acquired such depth that, both for now and the foreseeable future, it can be expected to have a substantial impact on the overall bilateral relationship and in Australia's case at least, on the overall health of Australia's economy.

41 ABC News Radio, Australia, 7.30 pm Australian eastern time, 8 June 2004.
Secondly, given the different sizes of their respective markets and China’s undiluted ambition to modernise, there is every possibility that complementary trade links will be broadened and deepened and that Australia will increase its exports, particularly in the agricultural and resource sectors.

Thirdly, the development of complementary ties will continue to be driven by China’s economic growth. In the 1980s, at a time when China and Australia were politically closer and the idea of complementarity received its first official expressions of enthusiastic support, progress was relatively slow because of the limitations of China’s domestic production, market size and foreign exchange reserves. In the 1990s, when the political relationship was periodically disrupted, whether by events such as Tiananmen Square, or other differences, trade complementarity greatly accelerated, principally because of China’s strong economic performance. Though the expanding economic ties were now the principal drivers of the overall relationship, they could not but have a beneficial effect on other facets of the relationship.
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REGIMES AND ECONOMIC DEVELOPMENT: CHINA, INDIA AND SOME OTHERS

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ABSTRACT

A question frequently addressed in the literature of ‘development’ – primarily economic, but also social and cultural as well as political – is the impact of regime types on relevant capabilities. Some Western literature takes what may be termed an “ideological” view. It ascribes universalistic capabilities, good and bad, to particular regime types with political democracy frequently favored in Western sources. This essay presents evidence for an “empirical” position suggesting that the interplay of regime, particular socio-cultural-physical settings, and the nature of specific policies pursued, is likely to offer significant variations from the “ideological” model. The cases in point are China and India, both continental-size nations, beginning an independent existence under unified, although very different regimes (one a form of dictatorship, the other a democracy) at about the same time. Using indicators assembled by the UN in the last fifty–odd years, it appears that, by a substantial margin, China has outperformed India, although the latter was actually ahead of China in virtually all the relevant categories at the approximate “starting point.” The performances of some Communist, post-Communist, and conservative-authoritarian political systems are also compared with presumed relevance to the democratic-authoritarian dichotomy. It is suggested, however, that stability and popular acceptability of regimes cannot be inferred solely from performance indicators.

Key Words: regimes, development, democracy, dictatorship, indicators
ASIAN EXAMPLES:

One of the more important tests of the relationship between “politics” and “economics” in the modern world has been taking place in Asia over the past half century. It revolves around the experience of two continental-size nations, China and India, which, over virtually the same period of time, have nurtured their respective economies under the auspices of two very different, even opposite in a sense, political systems. Since independence and partition in 1947, India has followed the pattern of a parliamentary, constitutional democracy, one in which power is exercised through competitive and widely inclusive popular elections. Individual rights, freedom of speech, assembly and association as well as private property are all constitutionally protected in India. Courts operate with substantial independence and governments are accountable to the representatives of the people assembled in the legislature, and, in turn, to the electorate which may grant or deny them the power to rule through its choices at the ballot box.

China, throughout its existence under a unified Communist regime since 1949, has been a dictatorship in the name of its ruling Marxist-Leninist Communist Party. It has followed all sorts of policies in the last 50–odd years, but it has maintained continuity in denying power to the spontaneous preferences of a national electorate and in restricting the rights of individuals and autonomous social entities so characteristic of India and various other Western-style political democracies. The governments of China since the 1940’s have operated with the typical tools of dictatorship, among them coercion, surveillance, censorship, secrecy and propaganda. (Groth 1988, 134–5; Groth 2003, 355)

Although the governments of India, like virtually all world governments, have not entirely eschewed the resort to coercion and the use of force, the “tools” here have been more often persuasion, bargaining, negotiation, and the manipulation of incentives and disincentives of a more moderate nature than in the case of China—as probably most clearly contrasted in the history of agricultural management under these two regimes. (Lupher 1996,
In a perspective often articulated in the West, especially in the United States in recent years, the Indian political system might be seen as a gateway to human achievement and material advance. To be sure, there have been somewhat different interpretations of the dictatorship–democracy differences in political science literature. But even analytical studies have often succumbed to overly favorable stereotypes. What may be termed the predominant Western view of the contrast between dictatorship and democracy was put forward by the highly influential scholar in the field of political development, Gabriel Almond in 1966 in these terms:

“The dominant and legitimate culture of totalitarian [dictatorships] is ideological in its intellectual characteristics. There are limits on rational calculation and analysis. …Decision making, thus, tends to be relatively rigid in comparison with the more open process of balancing and combining ends and means characteristic of the political process in fully differentiated and secularized democracies. …The profile of capability of the most developed democracies is more versatile and adaptive. What this means is that all types of capability are developed in both the input and output phases of the political process. The political system can respond to or adapt to the demands that are being made upon it from its own social environment or from the international environment, and at the same time it can cope with and manipulate its social and international environments.” (Almond and Powel 1966, 307–308)

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1 As Lupher says: “Even though estimates of the dead range from 1 million to ‘no less than five million’ by 1953 the landlord class had been completely expropriated, and nearly 40 percent of the cultivated land had changed ownership.” …“in the cities [likewise] hundreds of thousands of counterrevolutionaries were …executed.” Among works which examine the dark underside of the regime’s methods in conducting its policies and achieving “results,” Steven W. Mosher estimates the loss of life in one year—1960—as a consequence of the so-called Great Leap Forward “somewhere between 11 million and 30 million. Nearly all of those who lost their lives were peasants.” (Mosher 1983, 264)
On the other hand, there have also been skeptics and critics. John Plamenatz, for example, argued that democracy was valuable for the private rights which it conferred upon individuals but also that:

"Democracy can neither be explained nor justified as a political system that maximizes the satisfaction of wants better than other systems do. There is no utilitarian argument for democracy…" (Plamenatz 1973, 181–82)

Since both China and India, however large and diverse, are clearly particular socio–political and cultural entities, any comparisons between them do not necessarily have universal implications. They do, nevertheless, have a bearing on propositions advanced about the relationship between politics and economics, and, in this case, they suggest caution with respect to some of the frequently advanced broad generalizations.

If “democracy” is identified with robust economic, social, and cultural development, while “dictatorship” is identified with the negation of such development, the China–India contrast is oddly anomalous. In the last half century, all fluctuations of policy on either side notwithstanding, China has very substantially outperformed India in a very large number of developmental categories, especially economic ones. And it has done so despite the fact that, starting at about the same time, China needed to overcome a considerable, initial Indian advantage in order merely to draw even.

Parenthetically, China also needed to overcome subsequent catastrophic economic lapses of its own. Among these were clearly the Great Leap Forward and the Great Cultural Revolution. Both of these phenomena were strikingly less incremental than anything officially sanctioned in India during the whole period of its independence.

**INDIAN ADVANTAGES:**

For many years prior to Mao’s consolidation of national power in 1949, China experienced intense warfare and destruction on its
Beginning with the Japanese invasion of the 1930’s, the infrastructure of China, its agriculture and industry, its transportation system, its educational system, its great urban centers and its countryside, were all simultaneously subjected to the ravages of foreign invasion and civil war. During those same years, however, India managed to avoid the calamities of both invasion and civil war. India’s great urban centers were not seriously bombed or shelled during the Second World War. Her transportation and power facilities were not ravaged. Her libraries and hospitals were not burned. The bulk of India’s territory remained unaffected by warfare and, British presence excepted, it was free of military occupiers.

At the beginning of what may be termed as the economic competition between India and China in the aftermath of the Second World War, the initial advantage lay clearly with India. India enjoyed the benefits of a higher per capita income, higher aggregate energy output, more substantial food supply, a much better, more developed transportation system, and a higher level of literacy and skills among its population— all among some of the more important elements of its start–up advantage.

To be sure, India, too, experienced large scale violence in 1947 with the partition of the subcontinent into the states of Pakistan and India. Perhaps as many as two hundred thousand persons died in the communal clashes. But both in duration of violence and in the number of casualties, as well as in geographic comprehensiveness, these events were not nearly on the scale of China’s monumental devastation beginning with Japanese aggression in 1931 and 1937 and ending with the conclusion of the Civil War in 1949. John Ellis gives the following casualty figures for the period 1939–1945: Military, China 1.4 million killed; 1.8 million wounded; India 36,100 killed; 64,300 wounded. Ellis offers no estimate for India’s civilian losses during this period; his total Chinese civilian casualties are given at 8 million.

With respect to the Civil War, Jan Palmowski offers a figure of 1 million casualties just for the Nationalist armies in the 1947–8 period, and no figures on Communist losses. (Ellis 1993, 121) Patrick Brogan says, “China’s losses in the war against Japan were enormous, perhaps as high as 20 million” (Brogan 1990, 161)
Even taking into account the great Bengal famine of 1943 which may have led to the deaths of perhaps more than two million people, the extent of destruction and the number of deaths in China from the early 30’s to the late 40’s was far greater.

Indeed, in India war-related activities enhanced some important economic capabilities.

“In the longer term, India’s economy was left with increased industrial potential...mainly in the sectors which produced strategic goods...

...200 airfields were constructed, 130 new hospitals were built, railways and ports were expanded, new depots and camps were set up, and new roads constructed in the difficult north-eastern border lands.” (Brogan 1990, 161)

With the level of 1937 set at 100, India’s industrial output was 120 in 1945, a statement which could not be made for most states whose territory was substantially occupied, invaded, and/or physically traumatized during the war. (Woytinsky and Woytinsky 1953, 1001, 1002) In 1949 the per capita income of India exceeded that of China: 54 dollars per capita for India and 35 dollars per capita for China—a disparity of 54 percent in India’s favor.

As early as 1938 there were 9,743 factories in India registered under the Indian Factories Act, employing 1.7 million workers, while in China in March of 1947, i.e., after the conclusion of World War II but still during the Civil War, there were only 7,851 factories “most of which were engaged in the preparation of food and drink...textiles...and...chemical products” with the number of workers “estimated at [only] between 400,000–500,000.” (Woytinsky and Woytinsky 1953, 995–96)

In 1936, India produced 14 percent more coal than China and used three times as much coal as China for the operation of its railroads and fifty percent more than China in its manufacturing, notwithstanding the fact that China’s coal reserves (“actual, probable and possible”) were much larger than those of India. (Woytinsky and Woytinsky 1953, 853)
During the whole decade of the 1940’s, until the assumption of power by the Communists in 1949, Chinese coal output averaged less than 10 million tons a year (from 1940 to 1945 it averaged only 6 million tons) while during the same period India averaged nearly 30 million tons. In 1937, India’s energy consumption in per capita terms was 190 pounds of coal equivalents to just 170 for China. Even in 1950, the ratio of installed electric power was 2 to 1 in favor of India and actual output 2.25 to 1 in favor of the latter.

With obvious importance, India had had a very long “head start” on China with respect to the development of its transportation system. While still part of the British empire, in 1880, India accounted for 93 percent of all of Asia’s railroads, and still for one third as late as 1947. In 1948, the length of highways of all types was 126.3 thousand miles in China but 239.1 thousand in India. Given the disparity in size between the two countries, this was an almost six-fold difference in highway diffusion per square mile in favor of India. As late as 1949, the distances traveled by India’s aviation exceeded those of China by 15.095 million kilometers against 14.396 million for the latter. (Woytinsky and Woytinsky 1953, 354, 531) Coincidentally, going as far back as the eve of the First World War, the value of the foreign trade of China was 710 million dollars while the value of Indian trade—then British India—was 1.383 trillion, i.e., almost twice as much.

There were also some important contextual factors which have continued to favor the development of India but whose impact has turned out to be less important than one might have expected some fifty years ago. The proportion of land which has been considered “arable” in China by prevailing modern standards is only 10 percent, while the equivalent proportion of land in India is 56 percent. This translates to roughly 370,000 square miles of land capable of cultivation in China vs. some 710,000 square miles in India, a virtually two to one ratio in favor of India. (McGeveran 2004, 755, 854)

Both countries have been relatively rich in mineral deposits with coal, iron ore, natural gas, mercury, tin, tungsten, aluminum, and zinc significantly represented in China, and coal, iron ore, natural gas, oil, titanium, manganese, bauxite, and chromite represented in
India. Certainly both countries have far more mineral wealth than, for example, highly developed Japan, and rapidly developing South Korea. (Churchill 2000, 590) But extraction and exploitation of resources, has proved to be a very different matter.

**CHINA’ S PREEMINENCE:**

By the turn of the century, despite some initial disadvantages, China’s economy exceeded the Indian in most categories of quantifiable performance. The estimated GDP per capita in India c. 2000 at $2,540 was only 58 percent that of China at $4,400. China’s per capita energy consumption was more than twice as large as India’s. In 2004, China produced almost three times as much electrical power per capita as did India (1,420.35 billion KWH vs. 533.34 billion KWH.)

According to data reflecting the situation around the new millennium, China was among the top ten manufacturers in 14 out of 15 basic mineral–based products. India was a leader in five of the fifteen. China was in first place in the world in the production of coal; fifth in the production of crude oil; fourth in the manufacture of aluminum; fifth in bauxite; first in cement; eighth in copper; first in iron ore; second in raw steel; first in lead; third in phosphate; second in salt; third in sulfur and first in zinc.

These formidable accomplishments were not the simple result of mineral resource availability. Illustrative of this aspect of economic development, India ranked fourth in the world in the output of iron ore but was absent from the list of top ten produces of raw steel, while Japan and South Korea—although they did not figure on the iron ore list—were both among the top ten steel producers.

Contemporaneously, the value of Chinese foreign trade—exports and imports—was 581.4 billion dollars. The corresponding figure for India was only 98.3 billion, a nearly six–fold difference. In 1999, China drew a total of 8,432,296 foreign tourists as compared with only 2,481,928 by India—a 3.4 fold difference in favor of China.
Table 1 below summarizes the more general differences in agricultural production between China and India c. 2000 with respect to several major output categories monitored by the UN. The differences are presented in both aggregate numbers and also in percentages of Indian output as compared with the Chinese.

<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>CHINA</th>
<th>INDIA</th>
<th>INDIA as % of CHINA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cereals (metric ton)</td>
<td>408,431.0</td>
<td>239,814.0</td>
<td>58.7</td>
</tr>
<tr>
<td>Oil Crops (metric ton)</td>
<td>15,334.0</td>
<td>8,606.0</td>
<td>56.1</td>
</tr>
<tr>
<td>Livestock (head)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cattle &amp; Buffalo</td>
<td>127,181.0</td>
<td>312,572.0</td>
<td>245.8</td>
</tr>
<tr>
<td>Sheep &amp; Goats</td>
<td>279,496.0</td>
<td>180,900.0</td>
<td>64.7</td>
</tr>
<tr>
<td>Pigs</td>
<td>437,551.0</td>
<td>16,500.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Horses</td>
<td>8,916.0</td>
<td>990.0</td>
<td>11.0</td>
</tr>
<tr>
<td>Asses</td>
<td>9,348.0</td>
<td>1,000.0</td>
<td>11.0</td>
</tr>
<tr>
<td>Mules</td>
<td>4,673.0</td>
<td>200.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Round Wood (million cubic meters)</td>
<td>287.5</td>
<td>319.5</td>
<td>111.0</td>
</tr>
<tr>
<td>Fish(ton)</td>
<td>22,789,887.0</td>
<td>2,035,488.0</td>
<td>9.0</td>
</tr>
<tr>
<td>Nitrogenous Fertilizers (metric ton)</td>
<td>24,391.3</td>
<td>11,886.0</td>
<td>48.7</td>
</tr>
<tr>
<td>Phosphate Fertilizers (metric ton)</td>
<td>8,893.1</td>
<td>4,753.0</td>
<td>53.4</td>
</tr>
<tr>
<td>Potash Fertilizers (metric ton)</td>
<td>3,391.0</td>
<td>1,733.0</td>
<td>51.1</td>
</tr>
<tr>
<td>Sugar (metric ton)</td>
<td>7,616.0</td>
<td>20,247.0</td>
<td>264.5</td>
</tr>
<tr>
<td>Meat</td>
<td>51,096.0</td>
<td>4,120.0</td>
<td>8.1</td>
</tr>
<tr>
<td>Beer</td>
<td>126,693.0</td>
<td>3,632.0</td>
<td>2.2</td>
</tr>
</tbody>
</table>
Table 2 below summarizes major differences in industrial production between China and India c. 2000. The differences here are also presented in both aggregate numbers and percentages of Indian output as compared with China’s.

**Table 2**  INDUSTRY

<table>
<thead>
<tr>
<th>PRODUCT</th>
<th>CHINA</th>
<th>INDIA</th>
<th>INDIA as % of CHINA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leather Footwear (millions of pairs)</td>
<td>1,613,647.0</td>
<td>134,524.0</td>
<td>8.2</td>
</tr>
<tr>
<td>Sawn Wood (cubic meters)</td>
<td>7,202</td>
<td>7,900</td>
<td>110</td>
</tr>
<tr>
<td>Paper (metric tons)</td>
<td>35,529.0</td>
<td>3,850.0</td>
<td>10.8</td>
</tr>
<tr>
<td>Cement (metric tons)</td>
<td>573,000.0</td>
<td>100,230.0</td>
<td>17.5</td>
</tr>
<tr>
<td>Pig Iron &amp; Crude Steel (metric tons)</td>
<td>124,260.0</td>
<td>24,704.0</td>
<td>19.9</td>
</tr>
<tr>
<td>Aluminum (metric tons)</td>
<td>2,809.0</td>
<td>550.0</td>
<td>19.6</td>
</tr>
<tr>
<td>Radio &amp; TV Receivers (thousands)</td>
<td>49,113.0</td>
<td>2,561.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Passenger Cars (thousands)</td>
<td>40.0</td>
<td>577.0</td>
<td>14.4</td>
</tr>
<tr>
<td>Refrigerators (thousands)</td>
<td>12,100.0</td>
<td>2,012.0</td>
<td>16.6</td>
</tr>
<tr>
<td>Washing Machines (thousands)</td>
<td>13,422.0</td>
<td>N.A.</td>
<td>0.0</td>
</tr>
<tr>
<td>Trucks</td>
<td>573,600.0</td>
<td>163,200.0</td>
<td>28.5</td>
</tr>
</tbody>
</table>

**SOME SOCIAL CONSEQUENCES:**

In 2004 median life expectancy in the “world” (189 states) was 68.9 years—averaged for both men and women. China’s average was above this figure with 72.3 but India’s was below it with 63.65. The average life expectancy for the 189 world states was 64.34 years— with India just below this figure and China well above it. (According to data published by the UN in 1990, China had 9.3
physicians for 10,000 inhabitants; India had 3.9. There were also 759,485 nurses in China to only 170,870 in India.)

China at 25.3 deaths per 1,000 live births was in the upper half of world states in child mortality, while India at 59.6 deaths was substantially mired in the less successful half. In 2004, out of 189 nations featured in UN statistical compendia, India was ahead of only 58 in infant mortality per 1,000 live births; China was ahead of 103. India’s death rate put it ahead of 95 nations; China was ahead of 127. India was ahead of 92 nations in controlling its annual population increase; China was ahead of 141. India’s literacy rate placed it ahead of only 33 other states. China was ahead of 82.

Notwithstanding land resource constraints, China, now for a considerable period of time, has provided a more substantial diet to its population than has India. Illustratively, in the period 1985–87, the average number of calories consumed in China was 2,617.9 while it was 2,224.0 in India, i.e., only 85 percent that of China. During the 1997–99 period, at 3,037.2 calories for China and 2,434.0 calories for India, Indian consumption actually fell to 80 percent that of China.

While both countries have increased their average consumption over time, the Chinese food basket grew faster than the Indian. In 1985–87, Indian consumption of proteins was 88 percent as high as China’s but in 1997–99 it fell to only 71 percent; Indian consumption of fats compared with the Chinese declined during the analogous period from 85.5 percent in 1985 to only 60 percent in 1999. (U.N. 2002, 86)

Although India has provided considerably more exposure to higher education for its population than has China, China has outperformed India in per capita access to primary education. And it is certainly of great relevance to the development of the two societies that the number of people classified as “researchers, technicians and other supporting staff engaged in research and development” was 787,000 in China in 1996; but it was only 357,172 in India, i.e., only 45.4 percent of the Chinese figure. (U.N. 2002, 678)

If UN statistics may be believed, unemployment has been a problem in China affecting 3.1 percent of the work force. Taking
into account the size of the respective populations, however, it was actually a seven times more severe problem in India than it was in China. (U.N. 2002, 275–292)

Reflecting on the regulatory power of the state, Colin Rosser, in a report to the Ford Foundation, made these critical observations about life in Indian cities twenty-five years after independence:

“The advent of freedom far from improving municipal administration, witnessed a remarkable deterioration—If this stagnation is not broken, it is difficult to visualize how we can keep conflict and violence out of the cities.”

“If Calcutta has the worst urban situation in the world, all the other major cities of India (except perhaps Delhi, though even there the prospects look bleak) seem to be heading rapidly in Calcutta’s direction. (Rosser 1972, 43; Yeung 1998, 145–46, 409)

Communication and Culture:

China has developed a far more extensive modem communication system than has India. In media diffusion, the ratio of TV sets to population c. 2000 was almost 4 to 1 in favor of China, i.e., 291 sets per 1,000 persons vs. 75 sets. The ratio in radio diffusion was almost 3 to 1 in favor of China (342 to 120 per 1,000 persons). Only in the circulation of daily newspapers did India have a substantial advantage over China—78.1 copies per 1,000 persons vs. only 23 in China. But in the diffusion of telephones China had a commanding lead over India—at a ratio of approximately five to one (214,420,000 vs. 41,420,000). And, according to data available in 2004, the number of persons classified as “internet users” was 29.1 million in China but only 16.58 million in India. In the mid-1990’s, China’s publishing houses turned out 100,951 different book titles while India published only 11,903—a ratio of 8.48 to 1. Analogously, in the early 1990’s, cinema attendance per capita was 12.3 in China and 5.0 in India,
a ratio of 2.46 to 1 in favor of the former.

Transport:

In the area of transportation, India maintained a significant advantage over China in railroad passenger travel c. 2000—about 20 percent in per capita terms. However, in the transportation of goods, China recorded a figure of 1,283,840,000,000 ton kilometers as compared with only 305,201,000,000 ton kilometers for India, a ratio of 4.2 to 1 in favor in China. Contemporaneously, the size of China’s shipping fleet for oil and bulk transport was 2.5 times that of India’s.

India maintained a moderate edge in motor vehicle transportation with 84.56 inhabitants per vehicle to China’s ratio of 101.65 inhabitants per vehicle. Interestingly, in view of the comparison between China and India in passenger traffic by railroad and motor vehicle—where a modestly significant per capita advantage still rested with India—in air transportation China now held a decisive advantage. In 1999, the air distances flown in the latter were 19.877 billion passenger kilometers as against only 13.1 billion kilometers in India.

CHINA AND POST-COMMUNIST STATES:

To the extent that comparable information could be assembled, unemployment has been a much more serious problem in most of the post-Communist, democratized, formerly Marxist states than it has been in China. In data published by the UN in 2002, Bulgaria reported 1999 unemployment of 326 thousand, a rate which was apparently close to 10 percent of its work force; Croatia was at 13.5 percent; Slovenia at 7.4; Macedonia at 38.8; Serbian and Bosnian figures were not reported. The Czech Republic was at 9 percent and Slovakia at 16.2 percent. Russia’s unemployment stood at 13.4 percent in 1999; Ukraine was at 11.9. The three Baltic republics—Estonia, Latvia and Lithuania—averaged 13.4 percent; Moldova was at 32 percent; Hungary 9.6, Poland 13, Romania at 11.5 percent.
There were 7 constituent republics of the former USSR whose unemployment figures were relatively low: The Kyrgyzstan figure appeared to be under 3 percent; Azerbaijan was at 1.2 percent; Belarus at 2.0; Kazakhstan at 3.9 and Mongolia at 5.7 percent; Tajikistan at 2.7 and Uzbekistan at only 0.4 percent.

In summary, among the 23 post-Communist states whose unemployment figures were made available to the United Nations, all but 5 appear to have had substantially higher unemployment rates than China. Interestingly also, those that had relatively the lowest unemployment levels—Azerbaijan, Belarus, Kyrgyzstan, Tajikistan, and Uzbekistan—were all, by general consent, it would appear, among the least “democratized” systems in the former communist orbit.

To be sure, employment statistics are always somewhat imprecise and often disputed—dependent on what is being counted and on how it is counted. A somewhat more reliable and objective index of economic activity among the nations, however, is energy consumption. (e.g., Darmstadter 1971, Cottzell 1953, Levy 1966) And here, so far as it is possible to make comparisons, it appears that, between the “fall of Communism” in the 1980’s and the beginning of the twenty-first century, virtually all the so-called post-Communist states—unlike China—declined both in absolute numbers and in their relative position vis a vis the rest of the world.

<table>
<thead>
<tr>
<th>Table 3</th>
<th>ENERGY CONSUMPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1987/1988</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>World Rank Order of States by Highest Level of Energy* Consumption Per Capita (Top 30)</th>
<th>World Rank Order of States by Highest Level of Energy** Consumption Per Capita (Top 30)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rank</td>
<td>Country</td>
</tr>
<tr>
<td>------</td>
<td>----------</td>
</tr>
<tr>
<td>1</td>
<td>Qatar</td>
</tr>
<tr>
<td>2</td>
<td>UAE</td>
</tr>
<tr>
<td>3</td>
<td>Bahrain</td>
</tr>
<tr>
<td>4</td>
<td>Luxembourg</td>
</tr>
<tr>
<td>Rank</td>
<td>Country</td>
</tr>
<tr>
<td>------</td>
<td>---------------</td>
</tr>
<tr>
<td>5</td>
<td>Canada</td>
</tr>
<tr>
<td>6</td>
<td>USA</td>
</tr>
<tr>
<td>7</td>
<td>Brunei</td>
</tr>
<tr>
<td>8</td>
<td>Kuwait</td>
</tr>
<tr>
<td>9</td>
<td>GDR</td>
</tr>
<tr>
<td>10</td>
<td>Norway</td>
</tr>
<tr>
<td>11</td>
<td>Netherlands</td>
</tr>
<tr>
<td>12</td>
<td>Australia</td>
</tr>
<tr>
<td>13</td>
<td>USSR</td>
</tr>
<tr>
<td>14</td>
<td>Saudi Arabia</td>
</tr>
<tr>
<td>15</td>
<td>Czechoslovakia</td>
</tr>
<tr>
<td>16</td>
<td>Bulgaria</td>
</tr>
<tr>
<td>17</td>
<td>Trin. &amp; Tobago</td>
</tr>
<tr>
<td>18</td>
<td>Finland</td>
</tr>
<tr>
<td>19</td>
<td>Belgium</td>
</tr>
<tr>
<td>20</td>
<td>Germany</td>
</tr>
<tr>
<td>21</td>
<td>Iceland</td>
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<tr>
<td>22</td>
<td>Denmark</td>
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<td>U.K.</td>
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<td>Poland</td>
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<td>25</td>
<td>Singapore</td>
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<td>26</td>
<td>Romania</td>
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<tr>
<td>27</td>
<td>New Zealand</td>
</tr>
<tr>
<td>28</td>
<td>Austria</td>
</tr>
<tr>
<td>29</td>
<td>Hungary</td>
</tr>
<tr>
<td>30</td>
<td>France</td>
</tr>
</tbody>
</table>

* Communist States Highlighted.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Coal Kg Equivalents</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Canada</td>
<td>7,782</td>
</tr>
<tr>
<td>6</td>
<td>USA</td>
<td>7,633</td>
</tr>
<tr>
<td>7</td>
<td>Brunei</td>
<td>7,582</td>
</tr>
<tr>
<td>8</td>
<td>Luxembourg</td>
<td>7,540</td>
</tr>
<tr>
<td>9</td>
<td>Singapore</td>
<td>7,301</td>
</tr>
<tr>
<td>10</td>
<td>Trin. &amp; Tobago</td>
<td>7,108</td>
</tr>
<tr>
<td>11</td>
<td>Iceland</td>
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<tr>
<td>12</td>
<td>Norway</td>
<td>6,017</td>
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<tr>
<td>13</td>
<td>Australia</td>
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<td>14</td>
<td>Netherlands</td>
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<td>16</td>
<td>Finland</td>
<td>5,043</td>
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<td>17</td>
<td>Saudi Arabia</td>
<td>4,887</td>
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<td>18</td>
<td>Sweden</td>
<td>4,641</td>
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<tr>
<td>19</td>
<td>Palau</td>
<td>4,402</td>
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<tr>
<td>20</td>
<td>Nauru</td>
<td>4,093</td>
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<td>21</td>
<td>New Zealand</td>
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<td>22</td>
<td>U.K.</td>
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<td>23</td>
<td>Russia</td>
<td>3,942</td>
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<td>24</td>
<td>Germany</td>
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<tr>
<td>26</td>
<td>Japan</td>
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<td>Switzerland</td>
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<td>29</td>
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</tr>
<tr>
<td>30</td>
<td>Italy</td>
<td>2,915</td>
</tr>
</tbody>
</table>

** Post-Communist States Highlighted.
It is certainly a noteworthy aspect of the dynamism of China’s economy that between 1988 (i.e., the eve of the so-called Fall of Communism) and 2004, the nominal dollar value of China’s foreign trade rose by a virtually astonishing factor of 11.529—from 73.67 billion in 1988 to 849.4 billion in 2004. Among the rest of the world’s top ten trading nations (U.S., Germany, Japan, U.K., France, Italy, Canada, Netherlands and Belgium) the value increase was by a more modest factor of 2.842. In still greater contrast, however, among the post-Communist states (accounting for all of the successor states of Yugoslavia, USSR and Czechoslovakia) the increase in the value of foreign trade was only by a factor of 1.76. This figure was well below the world average of approximately 3.4 in nominal dollar terms and testified to the inability of the democratized post-Communist states to keep up with the rest of the world in one clearly very important aspect of economic development.

UNRESOLVED ISSUES:

If China had persisted in the policies of the Great Leap Forward, or those of the Great Cultural Revolution of a decade later, it is most unlikely that the present India–China comparison would be nearly as favorable to the latter as it has become in the first decade of the twenty-first century.

It is this history itself which suggests the contingent and potentially widely differing effects of political pluralism— or monism— in economic (as well as other) policy making. Pluralism implies a dispersal of power and therefore a need for various actors to accommodate each other’s preferences in order to be able to reach and successfully implement policy decisions. Under pluralism, the alternative to accommodation is, in effect, a veto, or at least serious dissonance within the policy-making system. This feature of pluralism may be useful in various circumstances as a barrier to “bad,” “extreme,” or “reckless” policy decisions. But, depending on circumstances, and the particular dispositions of various participants in the policy process, pluralism may also be a vehicle for stagnation or stalemate or for
possibly very timidly incremental and disjointed actions where bolder measures, politically untenable, might be more "effective."

High growth rates, and other indices of rapid development, have been shown in some past studies to occur in authoritarian states of quite different political–ideological orientations. In the 1960’s and 1970’s, certain then–authoritarian, conservative systems, including South Korea, Taiwan, Portugal, Greece, and Brazil manifested exceptionally high growth rates. In these cases, it was thought that "regime authority, stability and reliability, growing administrative competence and persistent regime supports to producers, exporters, traders and other economic actors made manifest in a broad range of policy decisions and rhetorical expressions, [gave] them a common cast." (Wade and Groth 1979, 781–787) Other factors, which transcended Left–Right differences, included continuity of political leadership at the highest levels of government with moderate to low personnel turnover in cabinet and presidential posts; low levels of factionalism manifested in the dearth of public disputes over policy or leadership; possession of substantial, well coordinated bureaucratic and military infrastructures; absence of large–scale physically disruptive oppositions "as evidenced by insurgent guerilla movements [and or] state inability to control significant portions of national territory"; and evidence of frequent, substantial, and significant policy initiatives "regulating, stimulating, or otherwise shaping and channeling the economic, cultural and social order." Especially significant were counter–mobilizational measures used by these regimes to minimize the impact of any officially unsanctioned parties, factions, interest groups, trade unions and economic associations as well as individuals, trying to exert spontaneous "pressures upon the system." (Wade and Groth 1979, 784–85)

Whatever may be said of the now cumulative economic performance of China’s dictatorship, it has clearly entailed social costs of great magnitude – costs in lives and costs in freedoms, and, with somewhat greater uncertainty, costs in legitimacy. To what extent, for example, have the mass executions, incarcerations, banishments, and sundry deprivations historically administered by China’s regime translated into bitter individual and collective memories of people— that may
yet haunt the regime on the occasion of some future crisis? Are there any analogies in the experience of India with respect to frustrated aspirations and burdens borne, attributable perhaps less to cruelty than to ineffectiveness, indifference, neglect, and perhaps divisions among decision-makers?

Is it possible that the regime of India is actually less fragile, less prone to overthrow, than that of China because its economic shortcomings are more acceptable to its citizens? Given the great, world-wide, influence of the ideal of popular sovereignty in our time, this may well be the case. There may also be fewer hidden resentments, terrible memories, and explosive grievances among the Indian population than among the Chinese, or, in colloquial terms, fewer scores awaiting the opportunity to settle. These are important although speculative issues.

Modern literature concerned with the subject of revolution casts an oblique light on the relationship between economic efficacy and political stability. It leaves the implications of our India—China comparison unresolved and uncertain because it relates stability and instability not to any particular, fixed level of material attainments, but rather to a sense of relative deprivation based on expectations that differ from place to place and from time to time. (Gurr 1970, 6) But if rapid economic progress in China succeeds in fueling massive social and cultural change, is that not likely to create expectations, norms and attitudes among the populace that will severely challenge its inherited authoritarian regime?

Although violence has been a clearly significant feature of dictatorial control in China—especially in the formative years of the regime—it has also been a significant aspect of Indian political life since independence, although in a generally different way. In the words of the comparativist, John D. Nagle:

"India has been beset by secessionist movements in Kashmir, Assam, Punjab, and Gurkaland; by continued communal violence between Hindus and Moslems and Hindus and Sikhs; and by violence among castes and between language, ethnic, and social class groups. [Illustratively], between 1948 and 1967, there
were 558 large-scale riots in India and over seventeen hundred armed attacks by political groups on either the government or other organized groups..." (Nagle 1992, 359–60)

The late Chinese leader, Deng Xiaoping, suggested in one of his famous aphorisms that if one was interested in catching mice, it was not important whether one’s cat was black or white. What really mattered was how good the cat was at hunting its natural quarry. Insofar as issues of social and economic development are examined in their concrete manifestations—what, where, how much, etc.—ideologically-driven perspectives are highly suspect. The nature of the policies adopted, the effectiveness of their implementation; the character of the environment in which the policy is applied; and the qualities of the decision-makers and implementors, are all issues which are not resolvable with stereotypical ideological postulates. The view that every possible multitude or collectivity—ranging from a national electorate to a city council—is always a better and sounder policy maker than any possible one person or small group of persons, as much as the categorically obverse proposition, is, at best, only a perennial challenge to empirical inquiry.

Although much of people’s “quality-of-life” derives from economic development, various aspects of it are associated with more general regulatory powers of the state. These aspects tend to be qualitative and ultimately subjective with recipients or beneficiaries. For example, how important is it to have a right to unrestricted procreation? Or the right to come and go as one pleases? Or the right to express opinions in the public forum? Or the right to a largely unrestricted practice of religion?

On the other hand, what about the “right” to be protected from the spread of dangerous diseases? From criminal violence, theft, burglary, or, for that matter, public turmoil? From terrorism? Some state-sponsored or supervised protections, which recipients may view as “rights,” actually involve a mix of economic development as well as state regulatory power— for example the right to “freedom from hunger” or the “right to literacy” and, indeed in many different ways, “access to opportunity.”
One can only say that the popular response to such values or "rights"—and whatever may be seen as an appropriate "balance" or "mix" of them—varies among different constituencies and, very importantly, varies with respect to place, time, and circumstances.
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